

---

Revised April 2, 2008

## TRUSTEES REPORTS SHOW SOCIAL SECURITY SHORTFALL MANAGEABLE, MEDICARE'S PROBLEMS MORE DAUNTING

by Paul N. Van de Water

The annual reports of the Social Security and Medicare trustees project the financial status of these two programs for the next 75 years. The new reports confirm that policymakers will need to take action to keep Social Security and Medicare on a sound financial footing. In evaluating the new reports, the reader should keep several points mind.

**The projections in this year's trustees reports are similar to those of last year.** The projected dates of exhaustion of the combined Social Security trust funds and of Medicare's Hospital Insurance trust fund have remained the same. Social Security's projected 75-year deficit has declined from 1.95 percent to 1.70 percent of taxable payroll as a result of changes in methods used to project immigration.

**Social Security's funding shortfall is relatively small and manageable.** The trustees report reaffirms that Social Security is in excellent financial shape over the near term. The program will be able to pay 100 percent of promised benefits for more than three decades — until 2041. At that point, income will be sufficient to pay only 78 percent of benefits. Measured over the next 75 years, the amount by which income will fall short of what is needed to pay benefits amounts to 0.6 percent of gross domestic product (GDP). Many combinations of modest revenue increases and benefit reductions would remedy the projected shortfall for 75 years and beyond.<sup>1</sup> Social Security is structurally sound and does not require drastic changes.

**Medicare's financial problems are much more challenging.** The Medicare Hospital Insurance (HI) Trust Fund is projected to start running deficits in 2010. Current income and trust fund reserves will be sufficient to pay all hospital insurance benefits until 2019, when reserves are projected to be depleted. At that point, if policymakers do not make changes, scheduled HI income will cover 78 percent of estimated expenditures. The HI deficit will average 1.6 percent of GDP over the next 75 years.

---

<sup>1</sup>See Virginia P. Reno and Joni Lavery, "Options to Balance Social Security Funds Over the Next 75 Years," National Academy of Social Insurance, Social Security Brief No. 18, February 2005.

The Supplementary Medical Insurance (SMI) Trust Fund is always adequately financed because beneficiary premiums and general revenue contributions are set annually to cover expected costs. However, the rapid growth of program costs will place increasing pressures on both beneficiaries (to pay the premiums) and taxpayers (to provide the general revenues).

**Medicare’s long-term financing problems stem primarily from the continuing sharp rise in both public and private health care costs, not from structural problems with the program.**

Medicare spending is growing rapidly for the same reasons that private health spending is growing rapidly — increases in the cost and use of medical services. For several decades, increases in Medicare costs per beneficiary have mirrored the increases in costs in the health system as a whole. Between 1970 and 2006, Medicare spending for each enrollee rose by 8.7 percent annually, and private health insurance spending rose by 9.7 percent per person per year.<sup>2</sup>

The similarity in growth rates between Medicare and private insurance is not surprising, because Medicare aims to provide its beneficiaries with access to the same doctors, hospitals, and services as the rest of the population. As David Walker, former Comptroller General, has emphasized, “[F]ederal health spending trends should not be viewed in isolation from the health care system as a whole. For example, Medicare and Medicaid cannot grow over the long term at a slower rate than cost in the rest of the health care system without resulting in a two-tier health care system.”<sup>3</sup>

**Although not the primary cause of Medicare’s financing problems, Medicare’s payment policies offer opportunities for restraining program costs.** The Medicare Payment Advisory Commission (MedPAC) has recommended that Congress end the massive overpayments that Medicare is making to insurance companies that participate in Medicare Advantage (the privatized part of Medicare). Medicare is paying private insurance plans *13 percent more* on average than it would cost to treat the same patients under traditional Medicare, MedPAC reports. The Congressional Budget Office estimated last year that equalizing payment rates for Medicare Advantage plans would save Medicare about \$150 billion over ten years. Medicare’s actuaries project that this one step alone would extend Medicare’s solvency by 18 months.

MedPAC’s March 2008 report contains additional recommendations to slow the growth in Medicare expenditures by creating incentives for greater efficiency, rewarding quality, and modifying payment rates to providers and private plans. In its June 2008 report, MedPAC promises to offer ideas for altering Medicare’s payment systems to reward better coordination of care and improved efficiency and for investing in information about comparative effectiveness.<sup>4</sup>

**Many Medicare beneficiaries are financially or medically vulnerable.** Most Medicare beneficiaries live in families with modest incomes. In 2004, 57 percent of Medicare’s non-institutionalized beneficiaries had annual family incomes of less than \$25,000. Only 14 percent had

---

<sup>2</sup> Centers for Medicare and Medicaid Services, “NHE [National Health Expenditure] Web Tables,” January 2008, table 13, available at <http://www.cms.hhs.gov/NationalHealthExpendData/downloads/tables.pdf>. The cited figures refer to benefits commonly covered by Medicare and private health insurance.

<sup>3</sup> David M. Walker, “Long-Term Fiscal Issues: The Need for Social Security Reform,” Statement before the Committee on the Budget, U.S. House of Representatives, February 9, 2005, p. 18.

<sup>4</sup> Glenn M. Hackbarth, “Report to the Congress: Medicare Payment Policy,” Statement before the Subcommittee on Health, Committee on Ways and Means, U.S. House of Representatives, March 11, 2008.

income of \$50,000 or more.<sup>5</sup> To assist the neediest, MedPAC has recommended that Congress expand eligibility for the “Medicare Savings Programs,” which help low-income beneficiaries pay their Medicare premiums and cost sharing.

Medicare spending is highly concentrated in a small group of people with large medical needs. In 2003, just six percent of beneficiaries incurred \$25,000 or more in program costs and accounted for 55 percent of program expenditures. At the same time, 52 percent of beneficiaries incurred less than \$1,000 each in Medicare costs and accounted for only 2 percent of program expenditures.<sup>6</sup>

**Although the Medicare trustees again project that 45 percent of Medicare funding will come from general revenues within six years, this standard is fundamentally misguided.**

The Medicare Modernization Act of 2003 (Public Law 108-173) establishes a process for issuing a “Medicare funding warning” when the share of Medicare financing from general revenues is projected to exceed 45 percent. The 45-percent level, however, is not a measure of solvency but an arbitrary benchmark that is unrelated to the financial health of the program. By its very design, Medicare is supposed to be financed in significant part with general revenues. That at least 45 percent of Medicare will be financed with general revenue is no more a problem than that 100 percent of defense, education, or most other federal programs is financed with general revenues.<sup>7</sup> Medicare’s financing problems stem from the rate at which its costs are rising — not from an increase in the share of its funding that will come from general taxes rather than payroll taxes and beneficiary premiums.

**Social Security funds are always used for Social Security purposes.** When Social Security or Medicare collects more in payroll taxes and other income than it pays in benefits and other expenses, the Treasury invests the surplus in interest-bearing Treasury securities backed by the full faith and credit of the U.S. government. Social Security and Medicare can redeem these securities whenever needed to pay future benefits. Congress fully anticipated this outcome when it enacted the recommendations of the Greenspan Commission in 1983, and Social Security has run a surplus in every year since 1984. Under current projections, Social Security will continue to run surpluses until 2027, and its redemption of the trust fund’s assets will allow it to pay full benefits until 2041.

The Social Security surplus helps lower the debt owed to the public. When the rest of the budget is in deficit, a Social Security annual cash surplus reduces the amount that the government has to borrow from the public and thereby makes it easier to afford Social Security in the future.

**Measures of “unfunded obligations” should be used with care.** A program’s unfunded obligation is a way of summarizing its funding shortfall in a single dollar number. Technically speaking, it is the difference between the present value of the projected cost of a program over a specified time period and the present value of projected income (including the initial value of the trust fund). Put another way, the unfunded obligation is the additional money that the trust fund would need today to make the program financially sound for the specified time period. Because present values expressed in dollar terms can be easily confused with annual expenditures or deficits

---

<sup>5</sup> Data from the 2004 Medicare Current Beneficiary Survey, provided by Westat, March 21, 2008.

<sup>6</sup> Kaiser Family Foundation, “Medicare: A Primer,” March 2007, p. 23.

<sup>7</sup> James Horney and Richard Kogan, “The President’s Budget and the Medicare “Trigger,”” Center on Budget and Policy Priorities, February 15, 2008.

even though the figures are not comparable, unfunded obligations are better displayed as percentages of projected GDP.

The trustees estimate that the unfunded obligation of Social Security for past, current, and future participants is \$4.3 trillion over the next 75 years, or the equivalent of 0.6 percent of GDP over that period. The unfunded obligation of the Medicare's Hospital Insurance Trust Fund over the next 75 years is \$12.4 trillion, or 1.6 percent of GDP. The Supplementary Medical Insurance Trust Fund has no unfunded obligation; general revenues cover all spending that is not financed by other dedicated funding sources. However, the trustees report also provides an estimate of the present value of the required general revenue contributions to Parts B and D of Medicare, equal to \$23.6 trillion (3.0 percent of GDP) over 75 years.

Since 2004, the trustees reports have included a measure of unfunded obligations that extends indefinitely. The American Academy of Actuaries has warned, however, that calculations over an infinite period are unreliable and of little value to policy makers.<sup>8</sup>

---

<sup>8</sup> American Academy of Actuaries, Social Insurance Committee, "Letter to the Board of Trustees of the Social Security System," December 19, 2003.