

## The 2015 Social Security And Medicare Trustees' Reports

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In this article, Warshawsky discusses the projected outlook for Social Security and Medicare for 2016, including the forecast insolvency of the disability program and the (un)likelihood of a benefit increase for Social Security recipients.

The 2015 annual report released on July 22 from the trustees of the Social Security and Medicare trust funds projects a slight improvement in Social Security's future finances as compared to last year's projections. This is primarily a result of methodological changes in earnings, tax, and benefit projections, as well as projected slower growth in employer contributions to health insurance premiums, which would lead to an increase in taxable payroll. The disability segment of the program, which has its own trust fund, is still expected to be insolvent in 2016, as benefit payments and enrollment have grown rapidly, even after adjusting for the anticipated aging of the workforce. Hence, unless there is reform of the program or new financing, the law will require a 19 percent cut in disability benefits.

The 2015 report for Medicare also shows an improvement in the outlook as compared to last year because of a significant change in the methodology, leading to a somewhat slower rate of projected growth in healthcare spending in the out years, even as actual Medicare spending grew noticeably in 2014, particularly for drugs and physicians. Because there was no consumer price inflation in the past year, mainly because of the drop in fuel prices, the trustees forecast that there will be no benefit increase for Social Security recipients in 2016, which means, by law, there will be no increase in either the Social Security taxable wage base (that is, contribution and benefits) or in Medicare Part B premiums for most, but not all, beneficiaries.

### Social Security

Under current law and absent reform, the Social Security trustees project that the program will suffer cash-flow shortfalls — gaps between payroll and benefit taxes and expenditures — forever. The shortfall was \$74 billion in 2014 and is projected to be \$84 billion in 2015. Shortfalls will increase rapidly after 2018 as the pace of baby-boom generation retirements picks up. Note that as recently as 2009, Social Security once represented a positive cash flow to the federal budget, as tax revenue exceeded expenditures. The negative turnaround in program finances hit sooner and deeper than expected.

The “theoretical combined” trust funds for the old age and survivors insurance (OASI) and the disability insurance (DI) programs (collectively OASDI) are projected to be exhausted of reserves in 2034, one year later than projected last year. At that point, continuing tax revenue would be sufficient to pay 79 percent of scheduled benefits, declining to 73 percent in 2089. The DI trust fund, however, is expected to run out much sooner, by the fourth quarter of 2016. When that occurs, the government must by law reduce disability payouts to 81 percent of scheduled benefits.

Because the primary source of revenue for Social Security and, to a lesser extent, Medicare, is the payroll tax, the programs' revenues and costs are traditionally expressed as percentages of taxable payroll — that is, the amount of worker earnings taxed to support the programs. (Note that taxable payroll is almost 25 percent larger for Medicare than for Social Security because the Medicare payroll tax is imposed on all earnings, while Social Security taxes apply only to earnings up to an annual maximum — \$118,500 in 2015.) The Social Security annual cost rates are projected to increase from 13.99 percent of taxable payroll in 2014 to 16.71 percent in 2040, decline to 16.54 percent in 2050, and then rise gradually to 18.01 percent in 2090. The Social Security revenue rate — which includes payroll taxes at 12.4 percent level and income taxes on benefits — was 12.8 percent in 2014 and is expected to increase slowly over time, to 13.32 percent in 2090, because the amount of Social Security benefits excluded from income taxation is not indexed for inflation and benefit growth.

The 75-year actuarial balance measure includes the trust fund reserve at the beginning of the period, an ending balance equal to the 76th year's costs, and projected costs and revenue over the

period, all expressed as a percentage of taxable payroll for the 75 years. The balance (actually a deficit) represents the average amount of program changes needed (benefit cuts or tax increases) throughout the valuation period to achieve a zero balance. For OASI, the 75-year actuarial deficit is now 2.37 percent of taxable payroll; for DI, it is 0.31 percent; and for the entire program, OASDI, it is 2.68 percent, which is 0.2 percent smaller than last year's measure. Most of this improvement comes from new economic data and assumptions (mainly a lower assumed rate of growth in employer contributions for health insurance premiums) and new methods and programmatic data (higher future earnings, higher benefits taxes, and lower benefit payments). While individually small, these changes add up to a slightly improved outlook.

Annual deficits are 1.31 percent of taxable payroll in 2015 and will increase steadily to 3.5 percent in 2040 and to 4.69 percent in 2090. Hence, an immediate increase in the payroll tax rate of 2.62 percentage points (the equivalent of an immediate benefit cut of 16.4 percent) would be insufficient to achieve sustainable or permanent solvency for the program. In particular, if payroll taxes were increased 2.62 percentage points now, in just a year or two, measured under a 75-year valuation period, the program would again show an actuarial deficit, thereby undermining public confidence. These smaller changes would create only a temporary veneer of well-being and generational equity for the program. Every year that passes increases the deficit, demonstrating the need for an even longer valuation horizon for assessing and developing sustainable, permanent reforms.

According to the trustees, a more comprehensive "infinite horizon" measure would suggest either raising the payroll tax rate by 3.9 percentage points, cutting benefits by 23.4 percent, or doing some combination of the two — presumably phased in gradually — to achieve permanent solvency and to apportion the burden of reform fairly between current and future generations.

As mentioned above, the DI program will soon go bankrupt. Some have proposed reallocating payroll taxes from the retirement program, as was done in 1995, to avoid this outcome. Yet that ignores the dire and worsening finances of the retirement program, the soaring disability rolls of workers removed from productive labor and paying taxes (even as the general health of the population has improved), several scandals in the adjudicative process, and the unchanging criteria for disability determination, even as formidable assistive technologies and more accommodative work conditions have arisen to help disabled workers. Some have claimed that the deficit in the disability program is

the inevitable and predictable product of demographic trends — that is, as the workforce ages, there will be an increase in the payout for disability benefits. However, that explanation is inconsistent with the significant increase in the age- and gender-adjusted incidence rate of disability in the program over a relatively short period.

The trustees project that the cost of the DI program will decline noticeably in coming years. In 2014, the cost rate was 2.36 percent of taxable payroll. The trustees project that the cost rate will be 2.1 percent by 2020 and 2.05 percent by 2030. These projected declines are largely contrary to the recommendations of technical review panels and the assumptions of the Congressional Budget Office. They are also surprising, given that the actual cost rate increased from 1.42 percent in 2002 to 2.47 percent in 2012, an increase that clearly cannot be explained by any demographic impact of the aging workforce. The small decline to 2.36 percent in 2014 is likely related to the recent tightening of adjudication practices, which may or may not continue in the future. Indeed, based on past experience, a reasonable projection of the program's politics is that as the disability claims backlog builds up (as is occurring now), adjudication practices will be loosened to speed up the process.

### Medicare

The gap between Medicare's expenditures and revenue from payroll taxes and premiums was \$258.8 billion in 2014, up from \$249.4 billion in 2013. The shortfall represents just less than half of total program spending and is a significant drain on the federal budget. The Hospital Insurance (HI) Trust Fund — a major component of Medicare (also called Part A) and mainly financed by the payroll tax — is projected to be exhausted by 2030, the same year as projected in last year's report. At that time, dedicated revenue will be sufficient to pay 86 percent of HI costs. Thereafter, the share of HI cost financed by dedicated revenue is projected to decline slowly to 79 percent in 2039 and then increase to 84 percent by 2089, as an increasing portion of earnings are subjected to the additional 0.9 percent payroll tax (because the earnings thresholds are not indexed for this tax introduced by the Affordable Care Act).

The projected 75-year actuarial deficit for Medicare Part A is 0.68 percent of taxable payroll, down from 0.87 percent in last year's report. The improvement in the HI financial outlook was not a result of lower-than-expected spending in 2014, which was actually close to the projected amount. Rather, the improvement came from lower long-range growth in Medicare cost, the result of (1) changed assumptions about the effect of increases in income, technology, and healthcare prices on healthcare costs;

and (2) recent legislation that reduced provider payments. Partially offsetting the favorable changes is the assumption that a higher proportion of Medicare beneficiaries will enroll in Medicare Advantage plans, which the trustees believe are more expensive than traditional Medicare.

Medicare also includes Part B, which covers physician and other services, and Part D, which covers prescription drugs. Together, parts B and D are called supplementary medical insurance (SMI). Both parts are financed to some extent by enrollee premiums but mostly by general revenue transfers from the federal budget. The aggregate cost of Part B benefits increased notably, by 7.4 percent in 2014, compared to an increase of only 3.1 percent in 2013, the smallest increase in decades. On a per capita basis, the increase was relatively large, from \$5,085 to \$5,308. In aggregate, there was also an increase as a share of GDP from 1.45 percent in 2013 to 1.5 percent in 2014. The trustees project Part B expenditures as a share of GDP will increase to 1.92 percent by 2024, increase to 2.48 percent by 2035, and remain flat thereafter. These projections are initially higher over the horizon than those in last year's report, but they then drop much lower, reflecting recent legislative changes to physician Medicare reimbursements that tightly constrain payments (perhaps unrealistically) in the out years. The trustees continue to assume that the ACA-required significant cuts in provider payments for general productivity improvements will go into effect, despite widespread doubts that the health-care sector and politicians will tolerate such large and continuing cuts.

Aggregate Part D benefit costs increased noticeably, at 12.1 percent in 2014, after a brief period of modest increases. Per capita benefits also increased rapidly, from \$1,772 to \$1,920, and the share of Part D benefits as a share of GDP rose from 0.41 percent to 0.45 percent. The trustees attribute this inflation to the rising cost of specialty drugs used to treat hepatitis C. The Part D spending share in GDP is projected to increase to 0.69 percent in 2024, 1.02 percent in 2050, and 1.35 percent in 2085. This represents initially higher, and then slightly lower, growth compared to last year's trustees' report.

Considering all three parts of the program together, average Medicare costs per beneficiary increased \$282 in 2014 to \$12,432. The trustees project that total Medicare costs will grow from 3.54 percent of GDP in 2014 to 5.42 percent of GDP by 2035 and will increase gradually thereafter to 5.98 percent by 2085. Regarding the financing of Medicare, the share of total non-interest Medicare tax revenue will fall substantially through 2080 (from 42 percent in 2014 to 32 percent), while

general revenue transfers rise (from 42 percent to 48 percent), as does the share of premiums (from 14 percent to 17 percent).

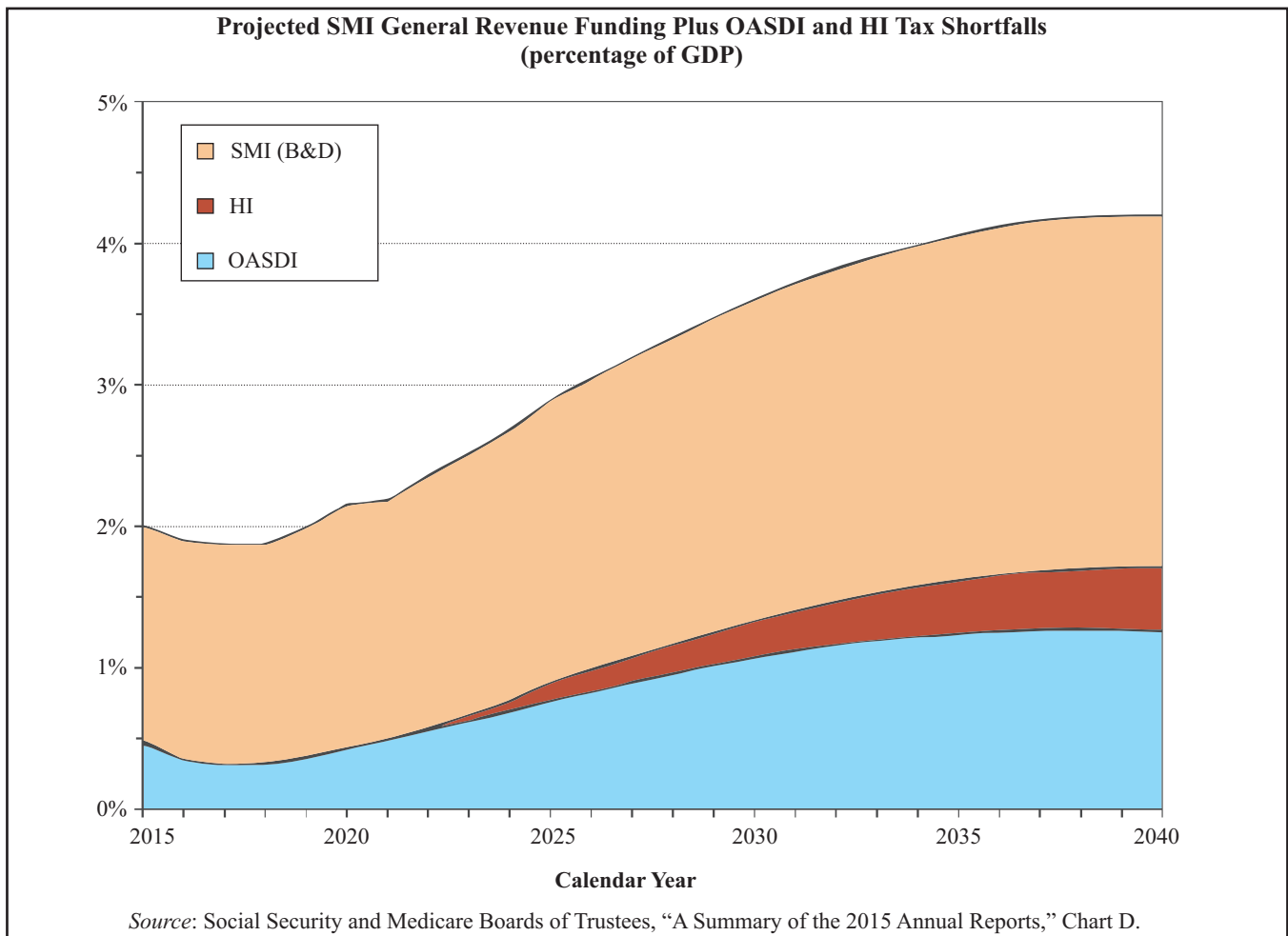
### Impact on the Federal Budget

The trustees somewhat direct attention away from the trust fund exhaustion dates to the more immediate issue of how all the programs (Social Security and Medicare) affect the unified federal budget.<sup>1</sup> Their chart, reproduced below, shows the excess of projected scheduled costs over dedicated tax and premium income of these programs as percentages of GDP. In 2015 the total general fund requirements for Social Security (\$84 billion) and Medicare (\$4 billion for HI and \$276 billion for SMI) are \$364 billion, or 2 percent of GDP. This shortfall will grow rapidly through the 2030s as the baby boom generation retires, to 4.2 percent of GDP by 2040. Clearly, serial reforms will be needed before then, and it is unlikely that payroll tax increases will play the major role in these changes, given the size of the shortfalls and the growing needs arising from other parts of the budget. The pressure on the budget will only intensify, as it will include increasing interest payments from years of deficit financing of government spending, along with the prospective rise in interest rates.

### No COLA

Because of falling oil prices in 2015, the overall rate of general price inflation has been flat, as shown by the consumer price index. Therefore, under the law, it is unlikely that there will be a cost of living adjustment for Social Security beneficiaries for 2016. Following hold-harmless provisions in the law, this implies that the Medicare Part B premium for most beneficiaries will remain at the current level — \$104.90 monthly. (Without the hold-harmless provision, the Part B premium would be \$120.70, a large increase reflecting rising costs.) For other beneficiaries (mainly new entrants to the program and those whose premiums are paid by the government), however, premium levels must be raised substantially to offset premiums forgone under the hold-harmless provision, both to prevent

<sup>1</sup>This emphasis was strongly criticized by the Social Security actuary in his statement of actuarial opinion on the trustees' report. In a discussion that seems more political in nature than actuarial or economic, the actuary invokes a concept that it is not familiar to this author from law or practice: "Redemptions of trust fund reserves represent a deferred use of revenues earmarked for the trust fund program alone, which have been collected in prior years and saved for later use." Unlike employer pensions in the private and public sectors, Social Security benefits are not accrued or guaranteed, and Congress may change them at any moment for any reason, including budget pressures. This is true regardless of the amount stated to be in the trust fund.



exhaustion of the Medicare Part B Trust Fund and to maintain a contingency reserve. The new standard premium will be \$159.30 for 2016. Also, by law, when there is no Social Security cost of living adjustment there is no increase in the Social Security

contribution and benefit (wage) base for OASDI payroll taxes. This indexing freeze also applies to the retirement earnings test exempt amounts (currently \$15,720 under the normal retirement age and \$41,880 at the normal retirement age).