BUDGET BULLETIN
A WEEKLY BULLETIN PRODUCED WHEN THE SENATE IS IN SESSION.
COMMITTEE ON THE BUDGET Republican Staff
Judd Gregg, Ranking Member
202/224-0642 http://budget.senate.gov/republican

111th Congress, 1st Session: No. 3 May 5, 2009

INFORMED BUDGETEER: IMPACT OF THE RECESSION ON SOCIAL SECURITY AND MEDICARE FINANCES

While the annual reports of the actuaries for the Social Security (SS) and Medicare programs are expected to be released later this month, budgeteers don't have to wait for those reports to figure out that the recession has had a major impact on the trust funds associated with those programs and on the calculation of Social Security taxes and benefits.

Catalogue of Trust Fund Metrics

There are three different snapshots of a trust fund using different pieces of information that tell you different things.

The simplest is what is the **cash surplus/deficit** each year? In other words, how much money is coming in from workers, employers, or beneficiaries in the form of tax or premium income, and how does that compare to the total outlays expended by the trust fund that year? If income exceeds the spending on benefits, then there is a cash surplus. To the extent there is a surplus, it is invested in special Treasury bonds (the generic term is "securities," but we'll say "bonds" for simplicity) held by the trust fund. In addition, the amount of the surplus recorded that year represents the amount the Treasury does not have to go out and borrow from the private sector to finance deficit spending by the rest of the federal government.

If a trust fund runs a cash deficit instead of a surplus, then the trust fund has to redeem its Treasury bonds (if it has any) to provide additional resources necessary to pay benefits. In this situation, unless the rest of the government is running a surplus, the Treasury has to borrow from the private sector to get the cash to make good on the bonds redeemed by the trust fund.

Another metric is what is the ***change* in the trust fund balance** each year? The **balance** of a trust fund at the end of each year is the **sum** of the balance at the end of the previous year, **plus** the cash income, **plus** interest income on Treasury bonds held by the trust fund, **minus** outlays from the trust fund for benefits. While interest income to the trust fund is just an intragovernmental payment from one part of the federal government to another and therefore does not affect the bottom-line federal deficit, it does represent resources available to the trust fund to pay benefits.

If the balance of a trust fund increases every year (that is, if the change in the balance is positive), then the trust fund is still accumulating additional resources beyond what is necessary to pay its annual bills and will hold those resources until needed to pay future bills. If the year to year change in the balance is negative, then that means the trust fund has started to redeem its Treasury bonds to pay benefits.

Finally, one can look at the trust fund balance projected for each year (not the *change* in the balance, but the **absolute level** of the balance). If the balance is positive, then that means the trust fund still has resources to pay all benefits that year. But if the trust fund balance is negative, then that means that not only is the cash income that year insufficient to cover expected benefits, but that there are no longer any Treasury bonds to redeem to pay benefits. As a result, not all benefits can be honored under this situation. The trust fund would be insolvent.

Effects on Trust Funds

The primary method of assessing the health of those programs is to look at their trust funds. A trust fund surplus for a year is defined as the amount by which revenue into the trust funds exceeds spending (outlays) out of the trust fund. Lower tax revenue reduces the size of a trust fund's annual surplus, if any (Medicare has already been running a deficit; Social Security's surplus, which must be invested in Treasury securities, has been falling; when the trust fund holds fewer Treasury securities, interest income into the fund falls, reducing the surplus even more).

In CBO's revised baseline issued in March, its 10-year projection of annual cash surpluses in the Social Security trust fund is $561 billion lower (compared to projections from March 2008) over the 2009-2018 period due to projections of tax revenue and interest income that are 11 percent lower than a year ago. For Medicare, cumulative annual cash deficits over the same period are $196 billion worse than estimated a year ago.

TABLE 1: CBO's BASELINE PROJECTIONS OF TRUST FUND FINANCES OVER 10 YEARS

($ billions)	Total 2009-2018		
	Mar-08	**Mar-09**	**Change**
Social Security			
Income	9,128	8,336	-792
Outlays	8,485	8,254	-231
Surplus	643	82	**-561**
Medicare			
Income	2,929	2,651	-278
Outlays	3,279	3,197	-82
Deficit	-350	-546	**-196**

Source: CBO Note: Details may not add due to rounding

Social Security. In the Social Security program, **outlays are now projected to begin to exceed payroll tax revenue beginning in 2017**. For 2009-2016, the annual Social Security cash surplus will provide a much smaller cushion to overall federal finances (compared to estimates a year ago). In 2017, SS will begin to be a drag on federal finances as the program starts to redeem Treasury bonds held by the trust fund and Treasury has to go finance those redemptions by borrowing from the private sector.

But we don't have to wait for 2017 for signs that the health of the Social Security trust fund is deteriorating. In four of the last nine months (August, October, November, and February), the Social Security trust fund has run a cash-flow deficit – the first time since November 1997. This marks a directional change in the program's ability to reduce the amount Treasury has to borrow to finance the unified federal deficit. Table 2 (on the next page) illustrates how 87 percent of the projected annual surpluses over the 2009-2018 period has disappeared since the projections a year ago.

Fortunately, the SS trust fund has about $2.4 trillion in Treasury bonds that it can redeem when its cash income each year is insufficient to cover annual outlays. Last year, the actuaries reported that SS would be able to pay full benefits until 2041. Because of the deteriorating cash flow projections over the past year, one would expect that the upcoming report would estimate an earlier date when the SS trust fund balance goes negative.

Medicare Trust Fund goes broke. Medicare's situation is far worse. While only part of all Medicare costs are provided through a trust fund (see previous *Bulletin*), for the part of Medicare that is covered by dedicated trust fund revenues, the Hospital Insurance (HI, aka Medicare Part A) trust fund is already running an annual cash deficit.

Table 3 (on next page) shows that the large decline in projected revenue has increased the trust fund's annual cash deficits by more than half over 2009-2018, which translates into consuming remaining trust fund balances much faster. Under CBO's latest baseline projections, after 2016 there will be no more balances in the HI trust fund. Because the Medicare HI trust fund is already running an annual deficit, it is already redeeming its Treasury bonds (purchased with previous annual trust fund surpluses) to cover the part of annual HI expenses not funded by annual HI revenue. The HI trust fund runs out of assets in 2017. It will then be insolvent and will no longer be able to pay all of its obligations.

Treasury's General Fund Provides @ 50% of Medicare Financing. The Medicare Modernization Act (2003) requires the Medicare Actuary to measure annually the amount of general fund revenue spent on Medicare benefits. Under this measure, a warning is tripped if more than 45% of Medicare spending comes from the general fund (rather than payroll taxes, premiums) within seven years of the projection window.

TABLE 2: CBO's BASELINE PROJECTIONS OF ANNUAL SOCIAL SECURITY CASH-FLOW SURPLUS(+)/DEFICIT(-)											
($ billions)	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
2008 (March)	80	86	35	95	88	80	68	54	38	19	643
2009 (March)	16	3	9	16	26	27	20	6	**-11**	**-29**	82
Reduction in Annual Surplus	64	84	26	79	62	53	48	49	49	49	561

Source: CBO Note: Details may not add due to rounding

TABLE 3. MEDICARE HI TRUST FUND ($ billions)												
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
March 2008 Projection												
Annual Cash Deficit	-9	-13	-13	-21	-13	-25	-33	-41	-60	-62	-69	-350
Cumulative Balance	311	314	318	313	317	307	290	264	218	167	106	
March 2009 Projection												
Annual Cash Deficit	-8	-31	-34	-44	-39	-48	-58	-60	-74	-77	-81	-546
Cumulative Balance	319	305	286	257	231	195	147	94	24	-52	-137	

Source: CBO Note: Details may not add due to rounding

This warning was tripped in both 2007 and 2008 when the Actuary determined that the limit had been exceeded in the projected seventh year (2013 and 2014, respectively). This year, CBO is projecting that the warning will be tripped in every year of the relevant seven-year projection window (2009-2015, as well as the years thereafter). While CBO's projections are just a preview to the Actuary's evaluation, it provides one more example of the deterioration in Medicare's finances.

Effects on SS Benefits and Taxes and on Medicare Premiums

NO Social Security COLA in January 2010. Enacted in 1983, the methodology for calculating the annual cost-of-living (COLA) adjustment (to protect SS benefits from inflation) compares the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) from the 3rd quarter of the current year to the 3rd quarter of the preceding year. In 2008, this comparison yielded the 5.8% COLA that beneficiaries began receiving in January 2009 – the largest COLA since 1982. This resulted from the spike in the price of oil that occurred just at the benchmark time required for the calculation (July, August, and September of 2008).

Since then, the price of oil has declined sharply. While inflation as more widely measured (CPI-U) was essentially zero from December 2007 to December 2008, the CPI-W index actually decreased (the change in the index was negative). For 2009 and 2010, CBO is projecting continued very low inflation. As a result, CBO projects that the CPI-W index will not exceed the level for the 3rd quarter of 2008 **until after the 3rd quarter of 2012**. ***This means that the next Social Security COLA might not be until January of 2013***.

While this may seem unfair, seniors are actually protected from what would have been a decrease in their Social Security benefits next year. As stated above, the COLA received in January 2009 overstates the actual price increases experienced in the U.S. over the past year, where consumers have seen more deflation than inflation. However, the law protects seniors from having their Security benefits reduced even though the CPI-W will decline this year (3rd quarter 2009 over 3rd quarter 2008). So even though the index will decrease, Social Security checks in 2010, 2011, and 2012 will not decline; rather, they will stay at their current levels until inflation "catches up" to the artificially high level of benefits being received during 2009 as a result of a temporary, but coincidental, spike in oil and gas prices a year ago.

NO Increase in the Social Security Tax Base. The interaction of the law with the effects of the economy also limits the extent to which Social Security revenue is likely to increase over this same period. The cap on income subject to the payroll tax – the Contribution and Benefit Base (sometimes called the TAXMAX) – is also limited during periods when there is no COLA.

For 2009, the maximum contribution base is $106,800, meaning the most Social Security payroll tax an employee has to pay is $6,621 (with the employer having to match up to that amount). This TAXMAX amount will remain the same until a Social Security COLA is again awarded (CBO projects January 2013). This, along with higher unemployment, is a contributing factor to the decline in projected Social Security payroll tax revenues.

Some Medicare Beneficiaries Will Pay Higher Premiums. In addition, most Social Security beneficiaries are also protected from higher Medicare Part B premiums. In a complicated turn of events, the changes in Social Security will affect who pays how much premiums under Medicare Part B (a part of Medicare not covered by the Medicare HI trust fund). Part B is the doctor-visits component of Medicare that is partly (about 25%) funded by insurance premiums paid by beneficiaries (the remaining 75% of funding for Part B expenses comes from the general fund). The premiums are usually deducted directly from the beneficiaries' SS checks. Premiums usually increase every year, but so do SS checks, so every year most beneficiaries still see a net increase in their Social Security check.

Current law prevents an annual increase in Medicare insurance premiums from reducing the monthly Social Security benefit of some Social Security beneficiaries. For 2010, this hold-harmless provision will apply to about 75% of seniors in Part B. That means the remaining 25% of Medicare beneficiaries will pay ALL of the amount necessary to keep the required 3:1 ratio of general fund contributions to Part B premiums. Who are the beneficiaries not held harmless?

- new enrollees;
- a small number of beneficiaries who pay premiums on their own, typically because their Social Security check is smaller each month than the Part B premium;
- seniors who are also eligible for Medicaid (Medicaid pays the premiums); and
- wealthier seniors who pay a larger portion of premium costs as part of the Part B means-testing program enacted in the Medicare Modernization Act.