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New Reports Highlight Continuing Challenges for Social Security and Medicare

Based on the "intermediate" assumptions in this year's report, the Social Security Administration is projecting that the cost-of-living adjustment, (COLA) announced in the fall of 2018, will be 2.4%. This COLA would apply to benefits starting in January 2019.

Most Americans will receive Social Security and Medicare benefits at some point in their lives. For this reason, workers and retirees are concerned about potential program shortfalls that could affect future benefits. Each year, the Trustees of the Social Security and Medicare Trust Funds release lengthy annual reports to Congress that assess the health of these important programs. The newest reports, released on June 5, 2018, discuss the current financial condition and ongoing financial challenges that both programs face, and project a Social Security cost-of-living adjustment (COLA) for 2019.

What are the Social Security and Medicare Trust Funds?

Social Security: The Social Security program consists of two parts. Retired workers, their families, and survivors of workers receive monthly benefits under the Old-Age and Survivors Insurance (OASI) program; disabled workers and their families receive monthly benefits under the Disability Insurance (DI) program. The combined programs are referred to as OASDI. Each program has a financial account (a trust fund) that holds the Social Security payroll taxes that are collected to pay Social Security benefits. Other income (reimbursements from the General Fund of the U.S. Treasury and income tax revenue from benefit taxation) is also deposited in these accounts. Money that is not needed in the current year to pay benefits and administrative costs is invested (by law) in special Treasury bonds that are guaranteed by the U.S. government and earn interest. As a result, the Social Security Trust Funds have built up reserves that can be used to cover benefit obligations if payroll tax income is insufficient to pay full benefits.

Note that the Trustees provide certain projections based on the combined OASI and DI (OASDI) Trust Funds. However, these projections are theoretical, because the trusts are separate, and generally one program's taxes and reserves cannot be used to fund the other program.

Medicare: There are two Medicare trust funds. The Hospital Insurance (HI) Trust Fund helps pay for hospital care (Medicare Part A costs). The Supplementary Medical Insurance (SMI) Trust Fund comprises two separate accounts, one covering Medicare Part B (which helps pay for physician and outpatient costs) and one covering Medicare Part D (which helps cover the prescription drug benefit).

Highlights of Social Security Trustees Report

- This year, for the first time since 1982, Social Security's total cost is projected to exceed its total income (including interest), and remain higher for the next 75 years. Consequently, the U.S. Treasury will start withdrawing from trust fund reserves to help pay benefits in 2018. The Trustees project that the combined trust fund reserves (OASDI) will be depleted in 2034, the same year projected in last year's report, unless Congress acts.
- Once the combined trust fund reserves are depleted, payroll tax revenue alone should still be sufficient to pay about 79% of scheduled benefits for 2034, with the percentage falling gradually to 74% by 2092.
- The OASI Trust Fund, when considered separately, is projected to be depleted in 2034. Payroll tax revenue alone would then be sufficient to pay 77% of scheduled benefits.
- The DI Trust Fund is expected to be depleted in 2032, four years later than projected in last year's report. Both benefit applications and the total number of disabled workers currently receiving benefits have been declining. Once the DI Trust Fund is depleted, payroll tax revenue alone would be sufficient to pay 96% of scheduled benefits.
- Based on the "intermediate" assumptions in this year's report, the Social Security Administration is

projecting that the cost-of-living adjustment (COLA), announced in the fall of 2018, will be 2.4%. This COLA would apply to benefits starting in January 2019.

Highlights of Medicare Trustees Report

- Annual costs for the Medicare program exceeded tax income each year from 2008 to 2015. Although last year's report projected surpluses in 2016 through 2022, this year's report projects that costs will exceed income (excluding interest income) in 2018.
- The HI Trust Fund is projected to be depleted in 2026, three years earlier than projected last year. Once the HI Trust Fund is depleted, tax and premium income would still cover 91% of estimated program costs, declining to 78% by 2042 and then gradually increasing to 85% by 2092. The Trustees note that long-range projections of Medicare costs are highly uncertain.

Why are Social Security and Medicare facing financial challenges?

Social Security and Medicare are funded primarily through the collection of payroll taxes. Because of demographic and economic factors including higher retirement rates and lower birth rates, there will be fewer workers per beneficiary over the long term, worsening the strain on the trust funds.

What is being done to address these challenges?

Both reports urge Congress to address the financial challenges facing these programs soon, so that solutions will be less drastic and may be implemented gradually, lessening the impact on the public. Combining some of these solutions may also lessen the impact of any one solution.

Some long-term Social Security reform proposals on the table are:

- Raising the current Social Security payroll tax rate. According to this year's report, an immediate and permanent payroll tax increase of 2.78 percentage points would be necessary to address the long-range revenue shortfall (3.87 percentage points if the increase started in 2034).
- Raising the ceiling on wages currently subject to Social Security payroll taxes ($128,400 in 2018).
- Raising the full retirement age beyond the currently scheduled age of 67 (for anyone born in 1960 or later).
- Reducing future benefits. According to this year's report, scheduled benefits would have to be reduced by about 17% for all current and future beneficiaries, or by about 21% if reductions were applied only to those who initially become eligible for benefits in 2018 or later.
- Changing the benefit formula that is used to calculate benefits.
- Calculating the annual cost-of-living adjustment for benefits differently.

According to the Medicare Trustees Report, to keep the HI Trust Fund solvent for the long term (75 years), the current 2.90% payroll tax would need to be increased immediately to 3.72% or expenditures reduced immediately by 17%. Alternatively, other tax or benefit changes could be implemented gradually and might be even more drastic.

You can view a combined summary of the 2018 Social Security and Medicare Trustees Reports and a full copy of the Social Security report at ssa.gov. You can find the full Medicare report at cms.gov.
