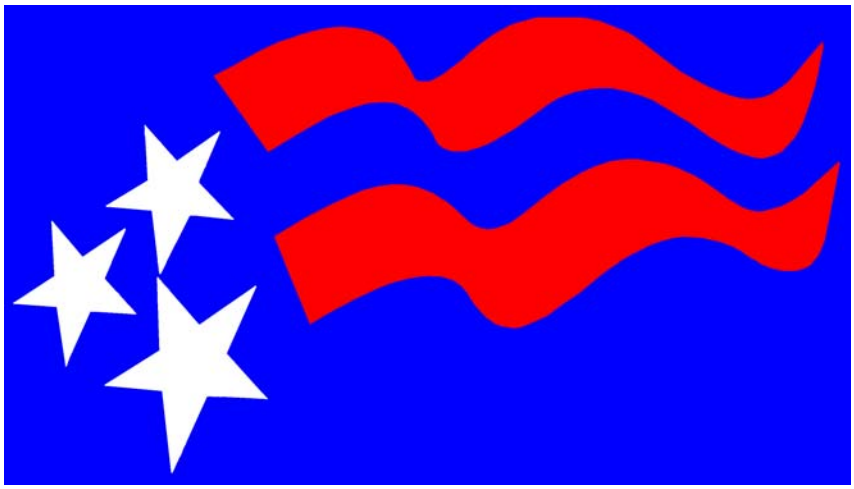
2012



Status of the Social Security and Medicare Programs

A SUMMARY OF THE 2012 ANNUAL REPORTS

Social Security and Medicare Boards of Trustees

The Social Security and Medicare Trustees Reports as well as this document, are available at the following addresses:

Social Security (OASDI):	**www.socialsecurity.gov/oact/tr/2012/index.html**
Medicare (HI and SMI):	**www.cms.gov/reportstrustfunds/**
Summary:	**www.socialsecurity.gov/oact/trsum/index.html**

Other information about Social Security benefits and services is available at **www.socialsecurity.gov** or by calling toll-free **1-800-772-1213**.

Other information about Medicare benefits and services is available at **www.cms.gov** or by calling toll-free **1-800-633-4227**.

A MESSAGE TO THE PUBLIC:

Each year the Trustees of the Social Security and Medicare trust funds report on the current and projected financial status of the two programs. This message summarizes our 2012 Annual Reports.

The long-run actuarial deficits of the Social Security and Medicare programs worsened in 2012, though in each case for different reasons. The actuarial deficit in the Medicare Hospital Insurance program increased primarily because the Trustees incorporated recommendations of the 2010-11 Medicare Technical Panel that long-run Medicare cost growth rate assumptions be somewhat increased. The actuarial deficit in Social Security increased largely because of the incorporation of updated economic data and assumptions. Both Medicare and Social Security cannot sustain projected long-run program costs under currently scheduled financing, and legislative modifications are necessary to avoid disruptive consequences for beneficiaries and taxpayers.

Lawmakers should not delay addressing the long-run financial challenges facing Social Security and Medicare. If they take action sooner rather than later, more options and more time will be available to phase in changes so that the public has adequate time to prepare. Earlier action will also help elected officials minimize adverse impacts on vulnerable populations, including lower-income workers and people already dependent on program benefits.

Social Security and Medicare are the two largest federal programs, accounting for 36 percent of federal expenditures in fiscal year 2011. Both programs will experience cost growth substantially in excess of GDP growth in the coming decades due to aging of the population and, in the case of Medicare, growth in expenditures per beneficiary exceeding growth in per capita GDP. Through the mid-2030s, population aging caused by the large baby-boom generation entering retirement and lower-birth-rate generations entering employment will be the largest single factor causing costs to grow more rapidly than GDP. Thereafter, the primary factors will be population aging caused by increasing longevity and health care cost growth somewhat more rapid than GDP growth.

Social Security

Social Security's expenditures exceeded non-interest income in 2010 and 2011, the first such occurrences since 1983, and the Trustees estimate that these expenditures will remain greater than non-interest income throughout the 75-year projection period. The deficit of non-interest income relative to expenditures was about $49 billion in 2010 and $45 billion in 2011, and the Trustees project that it will average about $66 billion between 2012 and 2018 before rising steeply as the economy slows after the recovery is complete and the number of beneficiaries continues to grow at a substantially faster rate than the number of covered workers. Redemption of trust fund assets from the General Fund of the Treasury will provide the resources needed to offset the annual cash-flow deficits. Since these redemptions will be less than interest earnings through 2020, nominal trust fund balances will continue to grow. The trust fund ratio, which indicates the number of years of program cost that could be financed solely with current trust fund reserves, peaked in 2008, declined through 2011, and is expected to decline further in future years. After 2020, Treasury will redeem trust fund assets in amounts that exceed interest earnings until exhaustion of trust fund reserves in 2033, three years earlier than projected last year. Thereafter, tax income would be sufficient to pay only about three-quarters of scheduled benefits through 2086.

A temporary reduction in the Social Security payroll tax rate reduced payroll tax revenues by $103 billion in 2011 and by a projected $112 billion in 2012. The legislation establishing the payroll tax reduction also provided for transfers of revenues from the general fund to the trust funds in order to "replicate to the extent possible" payments that would have occurred if the payroll tax reduction had not been enacted. Those general fund reimbursements comprise about 15 percent of the program's non-interest income in 2011 and 2012.

Under current projections, the annual cost of Social Security benefits expressed as a share of workers' taxable earnings will grow rapidly from 11.3 percent in 2007, the last pre-recession year, to roughly 17.4 percent in 2035, and will then decline slightly before slowly increasing after 2050. Costs display a slightly different pattern when expressed as a share of GDP. Program costs equaled 4.2 percent of GDP in 2007, and the Trustees project these costs will increase gradually to 6.4 percent of GDP in

2035 before declining to about 6.1 percent of GDP by 2050 and then remaining at about that level.

The projected 75-year actuarial deficit for the combined Old-Age and Survivors Insurance and Disability Insurance (OASDI) Trust Funds is 2.67 percent of taxable payroll, up from 2.22 percent projected in last year's report. This is the largest actuarial deficit reported since prior to the 1983 Social Security amendments, and the largest single-year deterioration in the actuarial deficit since the 1994 Trustees Report. This deficit amounts to 20 percent of program non-interest income or 16 percent of program cost. The 0.44 percentage point increase in the OASDI actuarial deficit and the three-year advance in the exhaustion date for the combined trust funds reflect many factors. The most significant factor is lower average real earnings levels over the next 75 years than were projected last year, principally due to: 1) a surge in energy prices in 2011 that lowered real earnings in 2011 and is expected to be sustained, and 2) slower assumed growth in average hours worked per week after the economy has recovered. An additional significant factor is the one-year advance of the valuation period from 2011-85 to 2012-86.

While the combined OASDI program continues to fail the long-range test of close actuarial balance, it does satisfy the test for short-range financial adequacy. The Trustees project that the combined trust fund assets will exceed one year's projected cost for more than ten years, through 2027.

However, the Disability Insurance (DI) program satisfies neither the long-range test nor the short-range test. DI costs have exceeded non-interest income since 2005, and the Trustees project trust fund exhaustion in 2016, two years earlier than projected last year. The DI program faces the most immediate financing shortfall of any of the separate trust funds; thus lawmakers need to act soon to avoid reduced payments to DI beneficiaries four years from now.

Medicare

The Medicare HI Trust Fund faces depletion earlier than the combined Social Security Trust Funds, though not as soon as the Disability Insurance Trust Fund when separately considered. The projected HI Trust Fund's long-term actuarial imbalance is smaller than that of the com-

bined Social Security Trust Funds under the assumptions employed in this report.

The Trustees project that Medicare costs (including both HI and SMI expenditures) will grow substantially from approximately 3.7 percent of GDP in 2011 to 5.7 percent of GDP by 2035, and will increase gradually thereafter to about 6.7 percent of GDP by 2086.

The projected 75-year actuarial deficit in the HI Trust Fund is 1.35 percent of taxable payroll, up from 0.79 percent projected in last year's report. The HI fund again fails the test of short-range financial adequacy, as projected assets are already below one year's projected expenditures and are expected to continue declining. The fund also continues to fail the long-range test of close actuarial balance. The Trustees project that the HI Trust Fund will pay out more in hospital benefits and other expenditures than it receives in income in all future years, as it has since 2008. The projected date of HI Trust Fund exhaustion is 2024, the same date projected in last year's report, at which time dedicated revenues would be sufficient to pay 87 percent of HI costs. The Trustees project that the share of HI expenditures that can be financed with HI dedicated revenues will decline slowly to 67 percent in 2045, and then rise slowly until it reaches 69 percent in 2086. The HI 75-year actuarial imbalance amounts to 36 percent of tax receipts or 26 percent of program cost.

The worsening of HI long-term finances is principally due to the adoption of short-range assumptions and long-range cost projection methods recommended by the 2010-11 Medicare Technical Review Panel. Use of those methods increases the projected long-range annual growth rate for Medicare's costs by 0.3 percentage points. The new assumptions increased projected short-range costs, but those increases are about offset, temporarily, by a roughly 2 percent reduction in 2013-21 Medicare outlays required by the Budget Control Act of 2011.

The Trustees project that Part B of Supplementary Medical Insurance (SMI), which pays doctors' bills and other outpatient expenses, and Part D, which provides access to prescription drug coverage, will remain adequately financed into the indefinite future because current law automatically provides financing each year to meet the next year's expected costs. However, the aging population and rising health care costs cause SMI projected costs to grow rapidly from 2.0 percent of GDP in 2011 to

approximately 3.4 percent of GDP in 2035, and then more slowly to 4.0 percent of GDP by 2086. General revenues will finance roughly three-quarters of these costs, and premiums paid by beneficiaries almost all of the remaining quarter. SMI also receives a small amount of financing from special payments by States and from fees on manufacturers and importers of brand-name prescription drugs.

Projected Medicare costs over 75 years are substantially lower than they otherwise would be because of provisions in the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (the "Affordable Care Act" or ACA). Most of the ACA-related cost saving is attributable to a reduction in the annual payment updates for most Medicare services (other than physicians' services and drugs) by total economy multifactor productivity growth, which the Trustees project will average 1.1 percent per year. The report notes that sustaining these payment reductions indefinitely will require unprecedented efficiency-enhancing innovations in health care payment and delivery systems that are by no means certain. In addition, the Trustees assume an almost 31-percent reduction in Medicare payment rates for physician services will be implemented in 2013 as required by current law, which is also highly uncertain.

The drawdown of Social Security and HI trust fund reserves and the general revenue transfers into SMI will result in mounting pressure on the Federal budget. In fact, pressure is already evident. For the sixth consecutive year, the Social Security Act requires that the Trustees issue a "Medicare funding warning" because projected non-dedicated sources of revenues—primarily general revenues—are expected to continue to account for more than 45 percent of Medicare's outlays, a threshold breached for the first time in fiscal year 2010.

Conclusion

Lawmakers should address the financial challenges facing Social Security and Medicare as soon as possible. Taking action sooner rather than later will leave more options and more time available to phase in changes so that the public has adequate time to prepare.

By the Trustees:

Timothy F. Geithner,
Secretary of the Treasury,
and Managing Trustee

Hilda L. Solis,
Secretary of Labor,
and Trustee

Kathleen Sebelius,
Secretary of Health
and Human Services,
and Trustee

Michael J. Astrue,
Commissioner of
Social Security,
and Trustee

Charles P. Blahous III,
Trustee

Robert D. Reischauer,
Trustee

A SUMMARY OF THE 2012 ANNUAL SOCIAL SECURITY AND MEDICARE TRUST FUND REPORTS

Projected long-range costs for both Medicare and Social Security are not sustainable under currently scheduled financing and will require legislative action to avoid disruptive consequences for beneficiaries and taxpayers. If lawmakers act sooner rather than later, they can consider more options and more time will be available to phase in the changes, giving the public adequate time to prepare. Earlier action would also help avoid adverse impacts on vulnerable populations, including lower-income workers and people dependent on program benefits.

What Are the Trust Funds? Congress established trust funds managed by the Department of the Treasury to account for Social Security and Medicare income and disbursements. The Treasury credits Social Security and Medicare taxes, premiums, and other income to the funds. There are four separate trust funds. For Social Security, the Old-Age and Survivors Insurance (OASI) Trust Fund pays retirement and survivors benefits and the Disability Insurance (DI) Trust Fund pays disability benefits. (OASDI is the designation for the two trust funds when they are considered on a combined basis.) For Medicare, the Hospital Insurance (HI) Trust Fund pays for inpatient hospital and related care. The Supplementary Medical Insurance (SMI) Trust Fund comprises two separate accounts: Part B, which pays for physician and outpatient services, and Part D, which covers the prescription drug benefit. In 2011, 44.8 million people received OASI benefits, 10.6 million received DI benefits, and 48.7 million were covered under Medicare.

The only disbursements permitted from the funds are administrative costs and benefit payments. Federal law requires that all excess funds be invested in interest-bearing securities backed by the full faith and credit of the United States. The Department of the Treasury currently invests all program revenues in special non-marketable securities of the U.S. Government which earn a market rate of interest. The balances in the trust funds represent the accumulated value, including interest, of all prior program annual surpluses and deficits, and provide automatic authority to pay benefits.

What Were the Trust Fund Results in 2011? Trust fund operations, in billions of dollars, are shown below. (Totals may not add due to rounding.) The OASI and SMI Trust Funds each showed a net increase in assets in 2011; DI and HI Trust Fund assets declined.

	OASI	DI	HI	SMI
Assets (end of 2010)	$2,429.0	$179.9	$271.9	$72.1
Income during 2011	698.8	106.3	228.9	301.0
Outgo during 2011	603.8	132.3	256.7	292.5
Net change in assets	95.0	-26.1	-27.7	8.6
Assets (end of 2011)	2,524.1	153.9	244.2	80.7

What Were the Components of Trust Fund Outlays in 2011? The following table shows payments, by category, from each trust fund in 2011. (Totals may not add due to rounding.)

Category *(in billions)*	OASI	DI	HI	SMI
Benefit payments	$596.2	$128.9	$252.9	$288.5
Railroad Retirement financial interchange	4.1	0.5	—	—
Administrative expenses	3.5	2.9	3.8	4.0
Total	603.8	132.3	256.7	292.5

What Were the Sources of Income to the Trust Funds in 2011? The following table shows income, by source, to each trust fund in 2011. (Totals may not add due to rounding.)

Source *(in billions)*	OASI	DI	HI	SMI
Payroll taxes	$482.4	$81.9	$195.6	—
Taxes on benefits	22.2	1.6	15.1	—
Beneficiary premiums	—	—	3.5	$65.4
Transfers from States	—	—	—	7.1
General Fund reimbursements	87.8	14.9	0.5	—
General revenues	—	—	—	222.8
Interest earnings	106.5	7.9	12.0	3.2
Other	[a]	—	2.2	2.5
Total	698.8	106.3	228.9	301.0

[a] Less than $50 million.

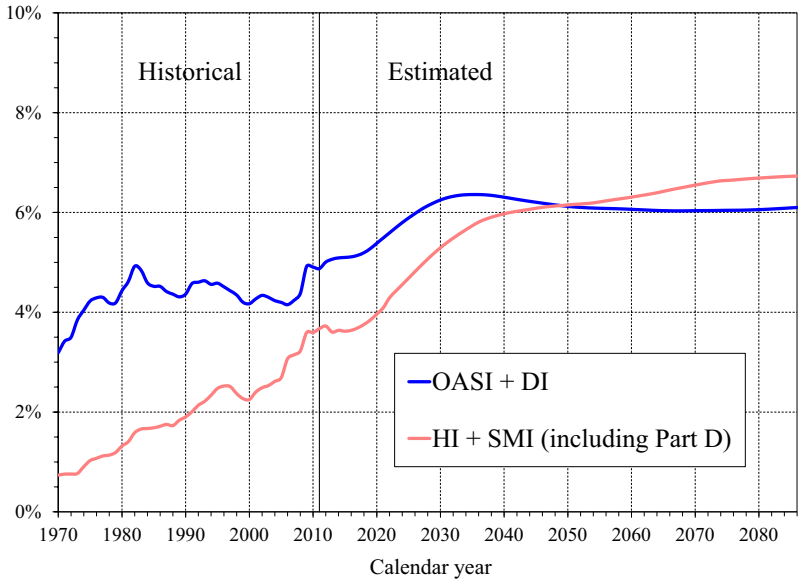
What is the Outlook for Future Social Security and Medicare Costs in Relation to GDP? One instructive way to view the projected cost of Social Security and Medicare is to compare the cost of scheduled benefits for the two programs with the gross domestic product (GDP), the most frequently used measure of the total output of the U.S. economy (Chart A). Measured this way, costs for both programs increase substantially through 2035 because: (1) the number of beneficiaries rises rapidly as the baby-boom generation retires; and (2) the lower birth rates that have persisted since the baby boom cause slower growth of the labor force and GDP. Social Security's projected annual cost increases to about 6.4 percent of GDP in 2035, declines to 6.1 percent by 2055, and remains at about that level through 2086. Under current law, projected Medicare cost rises to 5.7 percent of GDP by 2035, largely due to the growth in the number of beneficiaries, and then to 6.7 percent in 2086, with growth in health care cost per beneficiary becoming the larger factor later in the valuation period.

In 2011, the combined cost of the Social Security and Medicare programs equaled 8.5 percent of GDP. The Trustees project an increase to 12.1 percent of GDP in 2035, which then reaches 12.8 percent of GDP in 2086. Although Medicare cost (3.7 percent of GDP) was smaller than Social

Security cost (4.9 percent of GDP) in 2011, the projected gap closes gradually until 2049, when Medicare becomes the more costly program. During the final 10 years of the long-range projection period, Medicare cost is about 10 percent larger than Social Security cost.

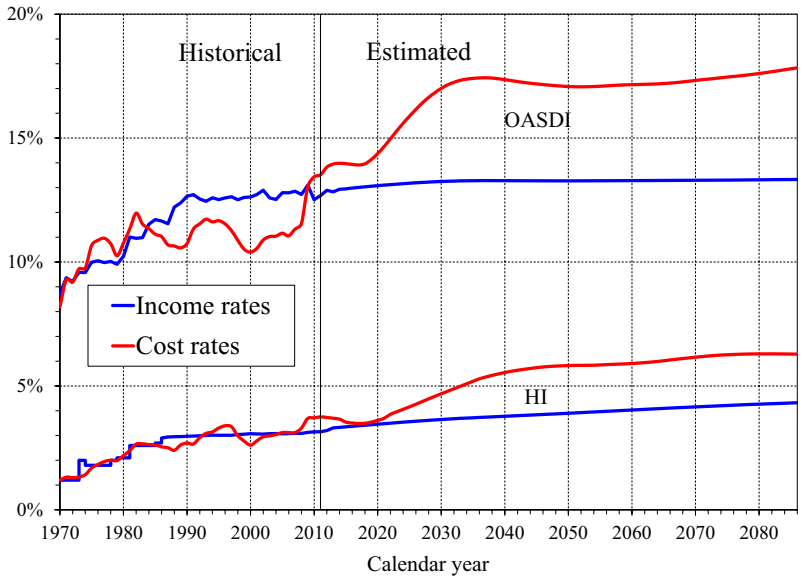
The projected costs for OASDI and HI depicted in Chart A and elsewhere in this document reflect the full cost of scheduled current-law benefits without regard to whether the trust funds will have sufficient resources to meet these obligations. Current law precludes payment of any benefits beyond the amount that can be financed by the trust funds, so the amount of benefits that would be payable in years after trust fund exhaustion is lower than shown, as described later in this summary. In addition, the projected costs assume realization of the full estimated savings of the Affordable Care Act as well as adherence to Medicare's sustainable growth rate limits. In practice, lawmakers are likely to prevent a large reduction in payment rates for physician services that will otherwise take effect for 2013. Also, as described in the Medicare Trustees Report, the projections for HI and SMI Part B depend significantly on the long-range feasibility of the various cost-saving measures in the Affordable Care Act—in particular, the lower increases in Medicare payment rates to most categories of health care providers. For such efforts to be successful in the long range, providers will have to generate and sustain unprecedented levels of productivity gains or other improvements in efficiency.

Chart A–Social Security and Medicare Cost as a Percentage of GDP



What is the Outlook for Future Social Security and Medicare HI Costs and Income in Relation to Taxable Earnings? Since the primary source of income for OASDI and HI is the payroll tax, it is informative to express the programs' income and costs as percentages of taxable payroll—that is, of the base of worker earnings taxed to support each program (Chart B).[1] Both the OASDI and HI annual cost rates rise over the long run from their 2011 levels (13.52 and 3.75 percent). Projected Social Security cost grows to 17.41 percent of taxable payroll by 2035, declines to 17.07 percent in 2052, and then rises gradually to 17.83 percent in 2086. The projected Medicare HI cost rate rises to 5.82 percent of taxable payroll in 2050 under the intermediate assumptions employed in this report, and thereafter gradually increases to 6.28 percent in 2086.

Chart B–OASDI and HI Income and Cost as a Percentage of Taxable Payroll



The OASDI income rate—which includes payroll taxes, taxes on benefits, and any other transfers of revenues to the trust funds excepting payments of interest—is 12.89 percent in 2012 and increases little over time, until it reaches 13.33 percent in 2086. Scheduled payroll tax rates remain unchanged from their 1990 levels with the exception of temporary reductions in the tax rates for 2010, 2011, and 2012 that are offset by reimbursements from the General Fund of the Treasury. Annual income from the other tax source, the taxation of OASDI benefits, will increase gradually relative to taxable payroll as a greater proportion of Social Security

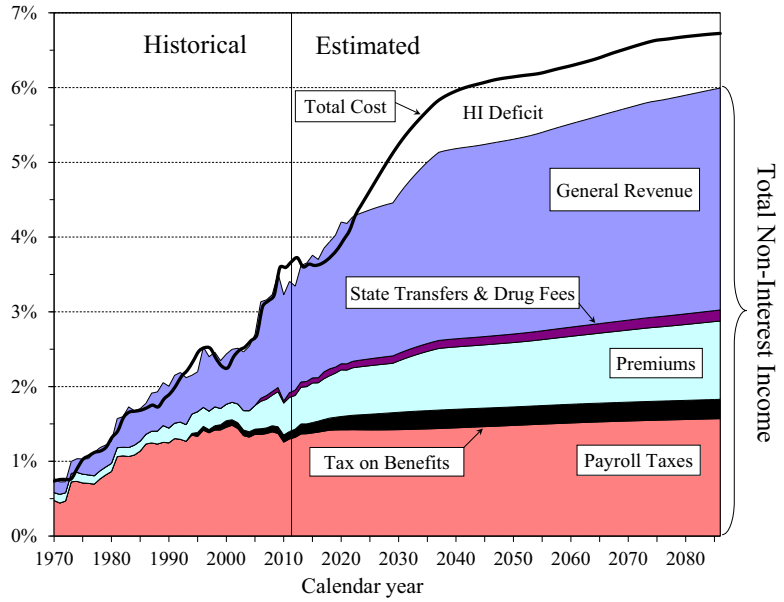
[1] Taxable payroll is larger for HI than for OASDI. See page 12 for further details.

benefits is subject to taxation in future years, but will continue to be a relatively small component of program income.

The projected HI income rate rises gradually from 3.20 in 2012 to 4.32 in 2086 due to the Affordable Care Act's scheduled increase in payroll tax rates for high earners starting in 2013. Individual tax return filers with earnings above $200,000, and joint return filers with earnings above $250,000, will pay an additional 0.9 percent tax on earnings above these earnings thresholds. An increasing fraction of all earnings will be subject to the higher tax rate over time because the new law does not index the thresholds.

How Will Cost Growth in the Different Parts of Medicare Change the Sources of Program Financing? As Medicare costs grow over time, general revenue and beneficiary premiums will play an increasing role in financing the program. Chart C shows scheduled cost and non-interest revenue sources under current law for HI and SMI combined as a percentage of GDP. The total cost line is the same as displayed in Chart A and shows Medicare cost rising to 6.7 percent of GDP by 2086.

Chart C–Medicare Cost and Non-Interest Income by Source as a Percentage of GDP



Projected revenue from payroll taxes and taxes on OASDI benefits credited to the HI Trust Fund increases from 1.4 percent of GDP in 2012 to 1.8 percent in 2086 under current law, while projected general revenue transfers to the SMI Trust Fund increase from 1.4 percent of GDP in 2012 to 3.0 percent in 2086, and beneficiary premiums increase from 0.5 to

1.0 percent of GDP. The share of total non-interest Medicare income from taxes would fall substantially (from 43 percent to 31 percent) while general revenue transfers would rise (from 42 to 50 percent), as would premiums (from 14 percent to 17 percent). The distribution of financing changes in part because Part B and D costs increase at a faster rate than Part A cost under the Trustees' projections. By 2086, the Medicare SMI program will require general revenue transfers equal to 3.0 percent of GDP. Moreover, the HI deficit represents a further 0.8 percent of GDP in 2086. There is no provision under current law to finance this deficit through general revenue transfers or any other revenue source.

The Medicare Modernization Act (2003) requires that the Board of Trustees determine each year whether the annual difference between program outlays and dedicated revenues (the bottom four layers of Chart C) exceeds 45 percent of total Medicare outlays in any of the first seven fiscal years of the 75-year projection period. In effect, the law sets a threshold condition that signals that general revenue financing of Medicare is becoming excessive. In that case, the annual Trustees Report must include a determination of "excess general revenue Medicare funding." Two consecutive reports with such a determination triggers a "Medicare funding warning." The warning directs the President to submit proposed legislation within 15 days of the next budget submission to respond to the warning and requires Congress to consider the proposal on an expedited basis. To date, elected officials have not enacted legislation responding to these funding warnings which have been included in the five previous reports.

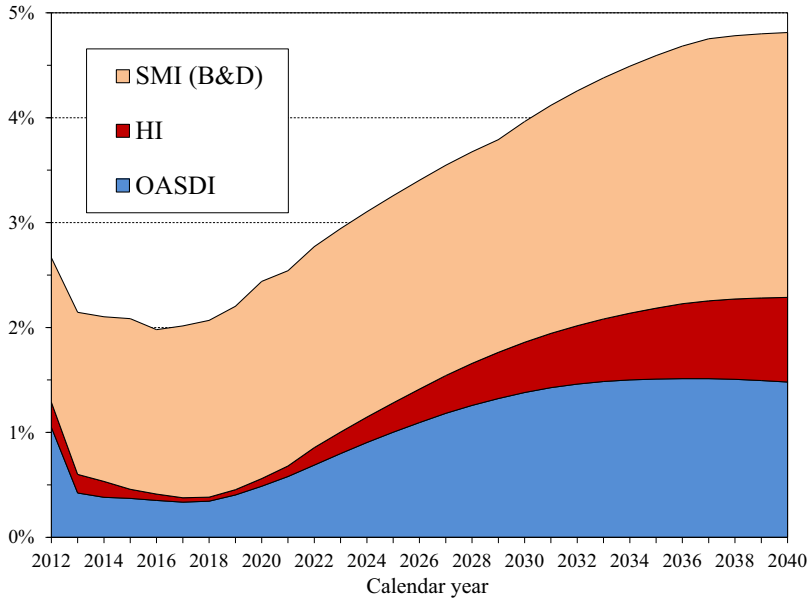
This year's report projects the difference between outlays and dedicated financing revenues to exceed 45 percent of total Medicare outlays during fiscal year 2012, prompting a determination of "excess general revenue Medicare funding" for the seventh consecutive report, triggering another "Medicare funding warning."

What are the Budgetary Implications of Rising Social Security and Medicare Costs? Concern about the long-range financial outlook for Medicare and Social Security often focuses on the exhaustion dates for the HI and OASDI trust funds—the time when projected trust fund balances under current law would be insufficient to pay the full amounts of scheduled benefits. A more immediate issue is the growing burden that the programs will place on the Federal budget well before exhaustion of the trust funds.

Chart D shows the excess of scheduled outgo over dedicated tax and premium income for the OASDI, HI, and SMI trust funds expressed as percentages of GDP. Each of these trust funds' operations will exert rapidly rising pressure on the Federal budget in future years. General revenues pay for roughly 75 percent of all SMI costs. From now through 2024, interest earnings and asset redemptions, financed from general revenues, will cover the shortfall of HI tax and premium revenues relative to expen-

ditures. In addition, general revenues must cover similar payments as a result of growing OASDI deficits through 2033.[2]

Chart D–Projected SMI General Revenue Funding plus OASDI and HI Tax Shortfalls
[Percentage of GDP]



In 2012, the projected difference between Social Security's dedicated tax income and expenditures is $165 billion. For HI, the projected difference between dedicated tax and premium income and expenditures is $38 billion.The projected general revenue demands of SMI are $217 billion. Thus, the total general funds for Social Security and Medicare in 2012 are $420 billion, or 2.7 percent of GDP. Redemption of trust fund bonds, interest paid on those bonds, and transfers from the general funds provide no new net income to the Treasury, which must finance these payments through some combination of increased taxation, reductions in other government spending, or additional borrowing from the public.

Chart D shows that the difference between cost and revenue from dedicated payroll taxes, income taxation of benefits, and premiums will grow rapidly through the 2030s as the baby-boom generation reaches retirement age. This imbalance would result in vastly increased pressure on the

[2] As noted earlier in this summary, if trust fund exhaustion actually occurred as projected for HI in 2024 and for OASDI in 2033, each program could pay benefits thereafter only up to the amount of continuing dedicated revenues. Chart D, by contrast, compares dedicated sources of tax and premium income with the full cost of paying scheduled benefits under each program. In practice, lawmakers have never allowed the assets of a Social Security or Medicare trust fund to become exhausted.

Federal budget if the law were changed to maintain scheduled benefits in the absence of an increase in dedicated tax revenues, with such financing requirements equaling 4.8 percent of GDP by 2040.

What Is the Outlook for Short-Term Trust Fund Adequacy? The reports measure the short-range adequacy of the OASI, DI, and HI Trust Funds by comparing fund assets to projected costs for the ensuing year (the "trust fund ratio"). A trust fund ratio of 100 percent or more—that is, assets at least equal to projected costs for a year—is a good indicator of a fund's short-range adequacy. That level of projected assets for any year suggests that even if cost exceeds income, the trust fund reserves, combined with annual tax revenues, would be sufficient to pay full benefits for several years.

By this measure, the OASI Trust Fund is financially adequate throughout the 2012-21 period, but the DI Trust Fund fails the short-range test because its projected trust fund ratio falls to 83 percent by the beginning of 2013, followed by exhaustion of assets in 2016.

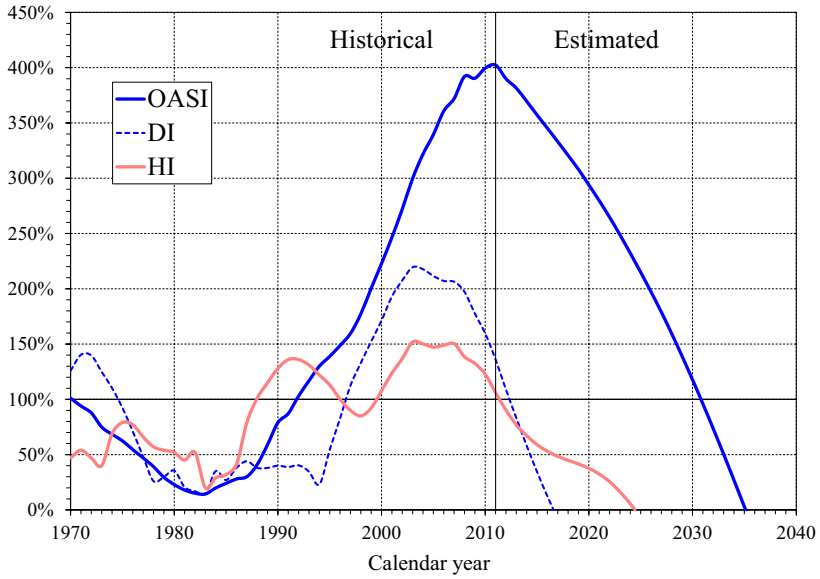
The HI Trust Fund also does not meet the short-range test of financial adequacy; its trust fund ratio was 90 percent at the beginning of 2012 based on the year's anticipated expenditures, and the projected ratio does not rise to 100 percent within five years. Projected HI Trust Fund assets are fully depleted in 2024. Chart E shows the trust fund ratios through 2040 under the intermediate assumptions.

The Trustees apply a less stringent annual "contingency reserve" test to SMI Part B assets since the overwhelming portion of the financing for that account consists of beneficiary premiums and general revenue contributions that are set each year to meet expected costs. Part D financing is also set on an annual basis. Moreover, the operation of Part D through private insurance plans, together with a flexible appropriation for Federal costs, eliminates the need for a contingency reserve in that account. Note, however, that estimated Part B costs are improbably low for 2013 and beyond because the projections assume that current law, which substantially reduces physician payments per service under the sustainable growth rate system, will not change. The estimated physician fee reduction for 2013 is 30.9 percent. A reduction in fees of this magnitude is highly unlikely; lawmakers have acted to prevent smaller reductions in every year since 2003. Underestimated payments to physicians would affect projected costs for Part B, total SMI, and total Medicare.

What Are Key Dates in OASI, DI, and HI Financing? In 2011, the HI fund used interest income ($12 billion) and assets ($28 billion) to help finance expenditures. This report anticipates a $38 billion deficit in non-interest income for 2012, followed by a period of declining deficits (2013-18) as the growth in taxable earnings accelerates. The projected

Chart E–OASI, DI, and HI Trust Fund Ratios

[Assets as a percentage of annual cost]



trust fund exhaustion date is 2024 (unchanged from last year). Under current law, scheduled HI tax and premium income would be sufficient to pay 87 percent of estimated HI costs in 2024 and 69 percent by 2086.

In 2011, Social Security's cost continued to exceed both the program's tax income and its non-interest income, a trend that the Trustees project to continue throughout the short-range period and beyond. The 2011 deficit of tax income relative to cost was $148 billion and the projected 2012 deficit is $165 billion. The sizes of these deficits are largely due to a temporary reduction in the Social Security payroll tax for 2011 and 2012. The legislation establishing the payroll tax reduction also provided for transfers of revenues from the General Fund of the Treasury to the trust funds to "replicate to the extent possible" revenues that would have occurred in the absence of the payroll tax reduction. Including these general revenue reimbursements, the 2011 deficit of non-interest income relative to cost was $45 billion and the projected 2012 deficit is $53 billion.

The combined Social Security trust funds continue to grow because projected interest earnings ($110 billion in 2012) still substantially exceed the non-interest income deficit. The report indicates that annual OASDI income, including payments of interest to the trust funds from the General Fund, will exceed annual cost every year until 2021, increasing the nominal value of combined OASDI trust fund assets. As noted earlier, how-

ever, the trust fund ratio (the ratio of projected assets to costs) will gradually decline despite this nominal balance increase, as it has since 2008.

Beginning in 2021, net redemptions of trust fund assets with General Fund payments will be required until exhaustion of these assets in 2033. After OASDI trust fund exhaustion, continuing tax income would be sufficient to pay 75 percent of scheduled benefits in 2033 and 73 percent in 2086. When the programs are considered separately, the projected exhaustion dates are 2035 for the OASI Trust Fund and 2016 for the DI Trust Fund. Payment of full DI benefits beyond 2016, when tax income would cover only 79 percent of scheduled benefits, will require legislation to address the financial imbalance, possibly including a reallocation of the OASDI payroll tax rate between OASI and DI.

The following table shows key dates for the respective trust funds.

KEY DATES FOR THE TRUST FUNDS

	OASI	DI	OASDI	HI
Year of peak trust fund ratio[a]	2011	2003	2008	2003
First year outgo exceeds income excluding interest[b]	2010	2005	2010	2008
First year outgo exceeds income including interest[b]	2023	2009	2021	2008
Year trust fund assets are exhausted	2035	2016	2033	2024

[a] Dates pertain to the post-2000 period.

[b] Dates indicate the first year that a condition is projected to occur and to persist annually thereafter through 2086.

What is the Long-Range Actuarial Balance of the OASI, DI, and HI Trust Funds? Another way to view the outlook for payroll tax-financed trust funds is to consider their actuarial balances for the 75-year valuation period. The actuarial balance of a fund is essentially the difference between annual income and costs, expressed as a percentage of taxable payroll, summarized over the 75-year projection period. Premium increases and general revenue transfers necessary to bring SMI into annual balance occur as a requirement of Federal law so actuarial balance is not an informative concept for that program.

The OASI, DI, and HI Trust Funds all have long-range actuarial deficits under the intermediate assumptions, as shown in the following table.

LONG-RANGE ACTUARIAL DEFICIT OF THE OASI, DI, AND HI TRUST FUNDS

[Percent of taxable payroll]

	OASI	DI	OASDI	HI
Actuarial Deficit	2.30	0.37	2.67	1.35

A useful interpretation of the actuarial deficit is that it represents the percentage points that would have to be either added to the current-law income rate or subtracted from the cost rate for each of the next 75 years to bring the funds into actuarial balance. The actuarial balance equals zero if trust fund assets at the end of the period are equal to the following year's cost. Note that the Trustees project that Social Security's annual deficits, expressed as the difference between the cost rate and income rate, will increase gradually from 2017 to 2037, decline slightly during 2038-52, and then resume increasing through 2086 (Chart B). Increasing annual deficits during the final three decades of the projection indicate that a single tax rate increase for all years starting in 2012 sufficient to achieve actuarial balance would result in large annual surpluses early in the period followed by increasing deficits in later years. The relatively large deficits at the end of the 75-year projection period—equal to 4.50 percent of taxable payroll in 2086 (see Chart B discussion)—indicate that sustained solvency would require payroll tax rate increases or benefit reductions (or a combination thereof) by the end of the period that are substantially larger than those needed on average for this report's long-range period (2012-86).

Projected HI Trust Fund annual deficits gradually decline to 0.08 percent of taxable payroll in 2018, then increase to 1.93 percent in 2050 and remain at about that level through 2086.

The financial outlooks for both OASDI and HI depend critically on a number of demographic and economic assumptions. Nevertheless, the projected actuarial deficit in each of these programs is large enough that continued solvency under current-law financing is extremely unlikely. An analysis that allows plausible random variations around the intermediate assumptions employed in the report indicates that OASDI trust fund exhaustion is highly probable by mid-century.

How Has the Financial Outlook for Social Security and Medicare Changed Since Last Year? Under the intermediate assumptions, the combined OASDI Trust Funds have a projected 75-year actuarial deficit equal to 2.67 percent of taxable payroll, 0.44 percentage point larger than last year's estimate. The anticipated asset exhaustion date moves closer by three years to 2033. The increased OASDI shortfall is due chiefly to changes in economic projections which incorporate new starting values and revised assumptions. Had assumptions, methods, and starting values remained unchanged from last year's report, the projected change in the actuarial deficit would have been 0.05 percent of taxable payroll, caused by the inclusion of 2086 (a year with a large negative balance) in the 75-year projection period.

Medicare's HI Trust Fund has a long-range actuarial deficit equal to 1.35 percent of taxable payroll under the intermediate assumptions, larger than the 0.79 percent figure reported last year. Medicare cost projections

are higher principally because the Trustees adopted the 2010-11 Medicare Technical Review Panel's recommended changes in projection assumptions that raised near-term costs and the long-range rate of increase in average HI and SMI Part B costs per beneficiary. Nevertheless, the projected date of exhaustion for the HI Trust Fund remains 2024 because the higher costs were offset during 2013-21 by a 2-percent reduction in expenditures expected under the Budget Control Act of 2011.

Who Are the Trustees? There are six Trustees, four of whom serve by virtue of their positions in the Federal Government: the Secretary of the Treasury, the Secretary of Labor, the Secretary of Health and Human Services, and the Commissioner of Social Security. The other two Trustees are public representatives appointed by the President and confirmed by the Senate: Charles P. Blahous III, Research Fellow at the Hoover Institution, and Robert D. Reischauer, President Emeritus of the Urban Institute.

How Are Social Security and Medicare Financed? For OASDI and HI, the major source of financing is payroll taxes on earnings paid by employees and their employers. Self-employed workers pay the equivalent of the combined employer and employee tax rates. During 2011, an estimated 158 million people had earnings covered by Social Security and paid payroll taxes; for Medicare the corresponding figure was 162 million. Current law establishes payroll tax rates for OASDI and apply to earnings up to an annual maximum ($110,100 in 2012) that ordinarily increases with the growth in the nationwide average wage. In contrast to OASDI, covered workers pay HI taxes on total earnings. The scheduled payroll tax rates (in percent) for 2012 are:

	OASI	DI	OASDI	HI	Total
Employees	3.59	0.61	4.20	1.45	5.65
Employers	5.30	0.90	6.20	1.45	7.65
Combined total . . .	8.89	1.51	10.40	2.90	13.30

Note two caveats concerning these rates. The Temporary Payroll Tax Cut Continuation Act of 2011 (Public Law 112-78) and the Middle Class Tax Relief and Job Creation Act of 2012 (Public Law 112-96) reduced the OASDI tax rate for 2012 by 2 percentage points for employees and for self-employed workers. Under current law, the employee tax rate reverts to the employer rate in 2013. Transfers from the General Fund of the Treasury to the OASI and DI Trust Funds compensate for the loss of payroll tax revenue due to the temporary reduction and have no financial impact on either trust fund. Furthermore, starting in 2013, the Affordable Care Act imposes an additional HI tax equal to 0.9 percent of earnings over $200,000 for individual tax return filers, and on earnings over $250,000 for joint return filers.

Payments from the General Fund finance about 76 percent of SMI Part B and Part D costs, with most of the remaining costs covered by monthly

premiums charged to enrollees or in the case of low-income beneficiaries, paid on their behalf by the Medicare or Medicaid. Part B and Part D premium amounts rely on methods defined in law and increase as the estimated costs of those programs rise.

In 2012, the Part B standard monthly premium is $99.90. There are also income-related premium surcharges for Part B beneficiaries whose modified adjusted gross income exceeds a specified threshold. In 2012 through 2019, the threshold is $85,000 for individual tax return filers and $170,000 for joint return filers. Income-related premiums range from $139.90 to $319.70 per month in 2012.

In 2012, the Part D "base monthly premium" is $31.08. Actual premium amounts charged to Part D beneficiaries depend on the specific plan they have selected and should average around $30 for standard coverage. Beginning in 2012, Part D enrollees with incomes exceeding the thresholds listed above must pay income-related monthly adjustment amounts in addition to their normal plan premium. For 2012, the adjustments range from $11.60 to $66.40 per month. Part D also receives payments from States that partially compensate for the Federal assumption of Medicaid responsibilities for prescription drug costs for individuals eligible for both Medicare and Medicaid. In 2012, State payments should cover about 12 percent of Part D costs.

A MESSAGE FROM THE PUBLIC TRUSTEES

The 1983 Social Security amendments established the public trustee position pursuant to the recommendation of the National Commission on Social Security Reform (also known as the "Greenspan Commission"), which concluded that the "presence of such public members" would, among other things, "help to assure that the demographic and economic assumptions for the cost estimates" are developed "in an objective manner." While the production of the Trustees reports inevitably involves the blending of diverse analytical viewpoints, we have found that the differing perspectives are consistently offered in ways that fulfill the Commission's stated goal. Once again we have been impressed, in this our second year as Public Trustees, by the professionalism and objectivity of the ex officio Trustees, the Social Security and CMS actuaries, and the supporting staffs.

The formal Social Security and Medicare Trustees Reports have always been long and complex. This year the Trustees, led by the Commissioner of Social Security, together with their dedicated staffs put a great deal of effort into making them more understandable. We believe the language of this year's reports is much clearer than that of previous years; nevertheless we recognize that there remains room for further future improvement.

This year the Trustees benefited from the analysis and recommendations of the Medicare Technical Panel convened by the Department of Health and Human Services and the Social Security Technical Panel convened by the Social Security Advisory Board. These panels, whose members are expert economists, actuaries, and demographers, reviewed the assumptions and methods used by the Trustees. We thank them for their diligent and useful work. Our current reports incorporate some, but not all, of their recommendations. We intend to continue to draw from their insights to inform refinements of our methods for future reports.

In our joint message last year, we warned that both Social Security and Medicare face substantial challenges, and opined that elected officials will best serve the interests of the public if changes are enacted at the earliest possible time. This year we sound the same warning but with greater urgency. The reasons for the increased urgency are somewhat different, however, for each program.

The Medicare program's near-term finances remain qualitatively similar to those described in last year's report, while the reported long-term financial outlook has grown worse. For example, the Trustees' new pro-

jection for the date of Hospital Insurance (HI) Trust Fund depletion remains 2024 as was projected last year, while the HI program's long-term actuarial deficit has grown significantly—from 0.79 percent of taxable payroll to 1.35 percent (an increase of over 70 percent). Similarly, this year's projection for overall Medicare costs in 2035—5.7 percent of GDP—is very close to last year's projection of 5.6 percent of GDP, while our projection for 2085 has grown from 6.2 percent of GDP to 6.7 percent. The reason for the deterioration in the long-term is primarily methodological, reflecting the incorporation of the recommendation by the Medicare Technical Panel that we increase our estimate of long-term Medicare cost growth rates.

We do not regard the updated projection as a qualitatively significant further deterioration in the long-term outlook for Medicare, as much as it is a methodological refinement that better reflects Medicare cost growth factors relative to those for health care generally. We expect to incorporate further methodological improvements to the projections next year, in particular a method for basing future health care cost growth projections on a new model of factors contributing to growth. We do not currently have reason to believe this will cause a qualitative change in our projections.

Although Medicare's near-term outlook has not qualitatively changed over the last year, pressure on HI financing is nevertheless increasing. The passage of time has brought us one year closer to the program's projected date of trust fund exhaustion, even with the program cost reductions recently enacted in the 2011 Budget Control Act which were not part of last year's projections.

This year's report, like previous reports, contains warnings that future Medicare costs are likely to be underestimated in the report's intermediate projections. The primary reason for this is not methodological but rather is due to likely changes to current law. The most immediate among these is the near-certainty that lawmakers will override the nearly 31 percent cut in physician fee-schedule payments that the current-law Sustainable Growth Rate (SGR) formula requires in January 2013.

The Social Security outlook has worsened significantly relative to last year's report. The actuarial deficit in its combined trust funds is now 2.67 percent of taxable payroll, the highest recorded since the last major Social Security financing reforms roughly three decades ago. The single-year deterioration in the 2012 report is the largest recorded since the

1994 report. While the projected depletion date (2033) for the combined trust funds is not the earliest recorded since the 1983 reforms, we are nevertheless now closer to the point of projected depletion than we have been since enactment of those reforms. The combined Social Security trust funds' balance continues to grow in nominal terms, but has been declining generally relative to the total cost of paying benefits since 2008, and will be shrinking after 2012 in real (inflation adjusted) terms. Thus by almost any objective measure, the financial health of the Social Security system has entered a concerning decline.

While there is no way for us to know what mixture of additional tax revenues and restraints on benefit growth will prove to be the most palatable means of strengthening Social Security's financial position, lawmakers should be aware that it will become increasingly difficult to avoid adverse effects on current beneficiaries, those close to retirement, and low-income beneficiaries in all birth cohorts if legislative changes are delayed much further.

The weak economy of recent years has placed both direct and indirect pressure on Social Security. It has placed direct pressure on program finances by depressing payroll tax income. Much of the financial deterioration in this year's Social Security report reflects updated economic data and assumptions, including weaker-than-expected economic performance and unexpectedly high inflation in 2011. But the weak economy has placed indirect pressure on the program as well, in that lawmakers have relieved workers of part of the tax burden of financing Social Security benefits so as to bolster near-term economic growth. Under this policy, over $200 billion will be transferred from the General Fund of the Treasury to replace foregone Social Security tax collections. In 2011, due in large part to this change in program financing, payroll tax revenue represented only 70 percent of total Social Security income. Lawmakers should carefully consider whether continued significant General Fund financing for Social Security could threaten to undermine long-standing public perceptions of the program as an earned benefit financed by workers according to contributory social insurance principles.

The legislative achievement in creating the Social Security and Medicare programs remains a remarkable one, in that the two programs have provided critical social insurance protections for hundreds of millions of Americans, at exceptionally low administrative cost, with financing methods that have been accepted historically as generally equitable. We believe that with responsible bipartisan action, Social Security and Medicare can continue to fulfill these vital roles—but we stress that such action

must be prompt and sufficiently decisive if these programs are to serve future generations as well as they have served earlier ones.

Charles P. Blahous III,
Trustee

Robert D. Reischauer,
Trustee

2012