

### ***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 2010 Annual Reports.*

*The outlook for Medicare has improved substantially because of program changes made 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). Despite lower near-term revenues resulting from the economic recession, the Hospital Insurance (HI) Trust Fund is now expected to remain solvent until 2029, 12 years longer than was projected last year; and the 75-year HI financial shortfall has been reduced to 0.66 percent of taxable payroll from 3.88 percent in last year’s report. Nearly all of this improvement in HI finances is due to the ACA. The ACA is also expected to substantially reduce costs for the Medicare Supplementary Medical Insurance (SMI) program; projected program costs as a share of GDP over the next 75 years are down 23 percent relative to the costs projected for the 2009 report.*

*Much of the projected improvement in Medicare finances is due to a provision of the ACA that reduces payment updates for most Medicare goods and services other than physicians’ services and drugs by measured total economy multifactor productivity growth, which is projected to increase at a 1.1 percent annual rate on average. This provision is premised on the assumption that productivity growth in the health care sector can match that in the economy overall, rather than lag behind as has been the case in the past. This report notes that achieving this objective for long periods of time may prove difficult, and will probably require that payment and health care delivery systems be made more efficient than they are currently. To facilitate this outcome, the ACA establishes a broad program of research on innovative new delivery and payment models to improve the quality and cost-effectiveness of health care for Medicare—and, by extension, for the nation as a whole. The improvement in Medicare’s finances projected in this report highlights the importance of making every effort to make sure that ACA is successfully implemented. If health care efficiency cannot be substantially improved through productivity gains or other measures, then over time the statutory Medicare payment rates would become inadequate. In that situation, the payment update reduc-*

*tions might be suspended, in which case actual long-range costs would be larger than those projected under current law.*

*While the financial outlook for Medicare in this year's report is substantially improved relative to last year, further reforms will be needed. It is expected that the HI Trust Fund balance will fall below one year's projected expenditure beginning in 2012, which means the test for short-range financial adequacy is not met. And it is projected that SMI will continue to put increasing pressure on the federal budget and beneficiaries in the years ahead, though to a much lesser extent than was projected last year prior to the ACA. Over the next 75 years, SMI costs are expected to average 3.3 percent of GDP, which is 1.4 percentage points higher than the SMI cost share of GDP in 2009.*

*The financial outlook for Social Security is little changed from last year. The short term outlook is worsened by a deeper recession than was projected last year, but the overall 75-year outlook is nevertheless somewhat improved primarily because a provision of the ACA is expected to cause a higher share of labor compensation to be paid in the form of wages that are subject to the Social Security payroll tax than would occur in the absence of the legislation. The Disability Insurance (DI) Trust Fund, however, is now projected to become exhausted in 2018, two years earlier than in last year's report. Thus, changes to improve the financial status of the DI program are needed soon.*

*Social Security expenditures are expected to exceed tax receipts this year for the first time since 1983. The projected deficit of \$41 billion this year (excluding interest income) is attributable to the recession and to an expected \$25 billion downward adjustment to 2010 income that corrects for excess payroll tax revenue credited to the trust funds in earlier years. This deficit is expected to shrink substantially for 2011 and to return to small surpluses for years 2012-2014 due to the improving economy. After 2014 deficits are expected to grow rapidly as the baby boom generation's retirement causes the number of beneficiaries to grow substantially more rapidly than the number of covered workers. The annual deficits will be made up by redeeming trust fund assets in amounts less than interest earnings through 2024, and then by redeeming trust fund assets until reserves are exhausted in 2037, at which point tax income would be sufficient to pay about 75 percent of scheduled benefits through 2084. The*

*projected exhaustion date for the combined OASI and DI Trust Funds is unchanged from last year's report.*

*The long-run financial challenges facing Social Security and those that remain for Medicare should be addressed soon. If action is taken sooner rather than later, more options will be available, and more time will be available to phase in changes so that those affected have adequate time to prepare.*

### **Medicare**

*The projected 75-year actuarial deficit in the Hospital Insurance (HI) Trust Fund is 0.66 percent of taxable payroll, down substantially from 3.88 percent projected in last year's report. The HI fund still fails the test of short-range financial adequacy, as projected annual assets drop below projected annual expenditures within 10 years—by 2012. The fund also continues to fail the long range test of close actuarial balance. The projected date of HI Trust Fund exhaustion is 2029, 12 years later than in last year's report, at which time dedicated revenues would be sufficient to pay 85 percent of HI costs. The share of HI expenditures that can be financed with HI dedicated revenues is projected to decline slowly to 76 percent in 2045 and then to rise slowly, reaching 89 percent in 2084. Over 75 years, HI's estimated actuarial imbalance is 23 percent as large as payroll taxes, and 16 percent as large as program outlays.*

*Part B of Supplementary Medical Insurance (SMI), which pays for doctors' bills and other outpatient expenses, and Part D, which pays for access to prescription drug coverage, are both projected to 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 will result in SMI costs growing rapidly from 1.9 percent of GDP in 2009 to 3.5 percent of GDP in 2040; about three-quarters of these costs will be financed from general revenues and about one-quarter from premiums paid by beneficiaries. Relatively small amounts of SMI financing are received from special payments by States and from fees on manufacturers and importers of brand-name prescription drugs.*

*As occurred in 2010, it is expected that about one quarter of Part B enrollees will be subject to unusually large premium increases next year.*

*This occurs because premium rates are set so that total premiums finance a specific share of Part B costs, and it is projected that the other three-quarters of Part B enrollees will not be subject to a premium increase in 2011 due to an expected zero Social Security benefit COLA in December 2010. A “hold-harmless” provision of current law limits those individuals’ premium increases to the increase in their Social Security benefits.*

### **Social Security**

*The annual cost of Social Security benefits represented 4.8 percent of GDP in 2009 and is projected to increase gradually to 6.1 percent of GDP in 2035 and then decline to about 5.9 percent of GDP by 2050 and remain at about that level. The projected 75-year actuarial deficit for the combined Old-Age and Survivors Insurance and Disability Insurance (OASI and DI) Trust Funds is 1.92 percent of taxable payroll, down from 2.00 percent projected in last year’s report.*

*The 0.08 percentage point reduction in the actuarial deficit reflects a 0.06 percentage point increase due to the change in the valuation date to 2010 and the inclusion of an additional year, 2084, in the projections, a 0.14 percentage point reduction due the ACA’s effect on the share of labor compensation that is subject to OASDI taxes, and other changes that net to zero. Although the combined OASDI program passes the short-range test of financial adequacy, the DI program does not; DI costs have exceeded tax revenue since 2005, and trust fund exhaustion is projected for 2018, two years earlier than was projected last year. In addition, OASDI continues to fail the long-range test of close actuarial balance. Projected OASDI tax income will be sufficient to finance about 75 percent of scheduled annual benefits in 2037 through 2084 after the combined OASI and DI Trust Funds are projected to be exhausted. Over 75 years, Social Security’s actuarial imbalance is 15 percent as large as payroll taxes, and 12 percent as large as program outlays.*

### **Conclusion**

*The ACA makes significant progress toward making Medicare financially viable. But while it is projected that the Medicare HI Trust Fund is adequately financed until 2029, and the Social Security OASI and DI Trust Funds are adequately financed until 2040 and 2018, respectively, the significant longer term financial imbalances of the programs still need to be*

*addressed. The sooner action is taken to address the long-run financial imbalances, the more reform options will be available, and the more time there will be to phase in changes so that those affected will have adequate time to prepare.*

*By the Trustees:*

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*Michael J. Astrue,  
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and Trustee*



## A SUMMARY OF THE 2010 ANNUAL SOCIAL SECURITY AND MEDICARE TRUST FUND REPORTS

**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, subject to confirmation by the Senate. The two Public Trustee positions are currently vacant.

**What Are the Trust Funds?** Congress established the trust funds in the U.S. Treasury to account for all program income and disbursements. Social Security and Medicare taxes, premiums, and other income are credited to the funds. Disbursements from the funds can be made only to pay benefits and program administrative costs. All excess funds must 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 on which a market rate of interest is credited. The trust funds represent the accumulated value, including interest, of all prior program annual surpluses and deficits, and provide automatic authority to pay benefits.

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. (The two trust funds are often considered on a combined basis designated OASDI.) 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.

**What Were the Trust Fund Results in 2009?** In December 2009, 42.8 million people received OASI benefits, 9.7 million received DI benefits, and 46.3 million were covered under Medicare. Trust fund operations, in billions of dollars, are shown below (totals may not add due to rounding). The OASI and SMI Trust Funds showed net increases in assets in 2009; DI and HI Trust Fund assets declined.

	<u>OASI</u>	<u>DI</u>	<u>HI</u>	<u>SMI</u>
Assets (end of 2008) .....	\$2,202.9	\$215.8	\$321.3	\$60.3
Income during 2009 .....	698.2	109.3	225.4	282.8
Outgo during 2009 .....	564.3	121.5	242.5	266.5
Net increase in assets .....	133.9	-12.2	-17.1	16.3
Assets (end of 2009) .....	2,336.8	203.5	304.2	76.6

**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 1.92 percent of taxable payroll, 0.08 percentage point smaller than last year's estimate. The main reason for the smaller deficit is the anticipated effect on the rate of growth in the average wage level of the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010. This legislation, referred to more briefly in this summary as the Affordable Care Act (ACA), slows the rate of decline in the share of employee compensation paid in wages covered by Social Security after 2018 when an excise tax on high-cost, employer-sponsored, health insurance plans begins, thereby increasing projected growth in the average real wage. The OASI Trust Fund and the combined OASI and DI Trust Funds are adequately financed over the next 10 years. Evaluated on its own, the DI Trust Fund does not meet the short-range test for financial adequacy because its assets are projected to fall below 100 percent of annual expenditures by the beginning of 2013, and to become exhausted in 2018.

Medicare's HI Trust Fund has a projected 75-year actuarial deficit equal to 0.66 percent of taxable payroll under the intermediate assumptions, a large improvement from the 3.88 percent figure reported last year. That change is largely attributable to the ACA, which mandates a reduction in the growth in Medicare payment rates for most health service providers, reduces payments to Medicare Advantage plans, and imposes higher HI payroll taxes for high earners. Those factors slow the depletion of HI Trust Fund assets and delay the anticipated fund exhaustion date to 2029, 12 years later than reported last year. Even so, the HI Trust Fund fails the short-range test of financial adequacy because its assets are projected to fall to 94 percent of annual expenditures by the beginning of 2012. It is important to note that the substantially improved results for HI (and for SMI Part B, below) depend in part on the long-range feasibility of the lower increases in Medicare payment rates. Moreover, in the context of today's health care system, these adjustments would probably not be viable indefinitely into the future. As a result, the actual future costs for Medicare are likely to exceed those shown by the current-law projections in this year's report.

The SMI Trust Fund is adequately financed under current law because of the automatic financing established for Medicare Parts B and D. The ACA's reductions in the Medicare payment rates to most service providers result in substantially lower projected costs for Part B than reported last year. Note, however, that Part B costs are almost certainly understated as a result of incorporating substantial reductions in physician fees during the next several years that would be required under current law, but are very unlikely to occur. The ACA is expected to have a much smaller net effect on projected Part D costs. Lower-than-anticipated drug spending in

2008 and 2009, and a lower projected rate of growth in Part D costs during the next decade, are partially offset by the ACA's phasing out of the benefit formula coverage gap (or "donut hole") during 2011-20. Part D costs are projected to grow at an average rate of 9.4 percent annually over the next decade. Despite the reductions in cost growth described in this year's report, the SMI Trust Fund will require large increases in enrollee premiums and general revenue funding over the long-range projection period.

**How Are Social Security and Medicare Financed?** For OASDI and HI, the major source of financing is payroll taxes on earnings that are paid by employees and their employers. The self-employed are charged the equivalent of the combined employer and employee tax rates. During 2009, an estimated 156 million people had earnings covered by Social Security and paid payroll taxes; for Medicare the corresponding figure was 160 million. The payroll tax rates are set by law and for OASDI apply to earnings up to an annual maximum (\$106,800 in 2010) that ordinarily increases with the growth in the nationwide average wage. When the cost-of-living adjustment (COLA) for December of any year is zero, which occurred in December 2009 and is projected for December 2010, the maximum taxable amount of earnings is not increased for the following year. This constraint will lower OASDI tax income in 2010 and 2011. In contrast, HI taxes are paid on total earnings. The payroll tax rates (in percent) for 2010 are:

	OASI	DI	OASDI	HI	Total
Employees . . . . .	5.30	0.90	6.20	1.45	7.65
Employers . . . . .	5.30	0.90	6.20	1.45	7.65
Combined total . . .	10.60	1.80	12.40	2.90	15.30

Starting in 2013, the ACA 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.

About 75 percent of SMI Part B and Part D expenditures are paid from Federal general fund revenues, with most of the remaining costs covered by monthly premiums charged to enrollees. Part B and Part D premium amounts are based on methods defined in law and increase as the estimated costs of those programs rise.

In 2010, the Part B standard monthly premium paid by about one-quarter of enrollees is \$110.50. There is also an income-related premium surcharge for Part B beneficiaries whose modified adjusted gross income exceeds a specified threshold. In 2010, the initial threshold is \$85,000 for individual tax return filers and \$170,000 for joint return filers. Under the ACA, the thresholds are not indexed to inflation during 2011-19; thereafter, the thresholds will be inflation-adjusted each year. Income-related premiums range from \$154.70 to \$353.60 per month in 2010. Under a

“hold-harmless” provision, about three quarters of enrollees continue to pay the 2009 premium rate of \$96.40 due to the zero Social Security COLA.

In 2010, the Part D “base monthly premium” is \$31.94. (Actual premium amounts charged to Part D beneficiaries depend on the specific plan in which they are enrolled and are expected to average around \$30 for standard coverage.) 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 2010, State payments are estimated to cover 7 percent of Part D costs.

Income, by source, to each trust fund in 2009 is shown in the table below (totals may not add due to rounding).

Source ( <i>in billions</i> )	OASI	DI	HI	SMI
Payroll taxes . . . . .	\$570.4	\$96.9	\$190.9	—
General fund revenue . . . .	—	—	1.9	\$209.8
Interest earnings . . . . .	107.9	10.5	15.3	3.0
Beneficiary premiums . . . .	—	—	2.9	62.3
Taxes on benefits . . . . .	19.9	2.0	12.4	—
Other . . . . .	*	—	2.1	7.7
Total . . . . .	698.2	109.3	225.4	282.8

\* Less than \$50 million.

**What Were the Administrative Expenses in 2009?** Administrative expenses charged to the trust funds, expressed as a percentage of total expenditures, were:

	OASI	DI	HI	SMI
Administrative expenses 2009. . .	0.6	2.3	1.3	1.3

**How Are Estimates of the Trust Funds’ Future Status Made?**

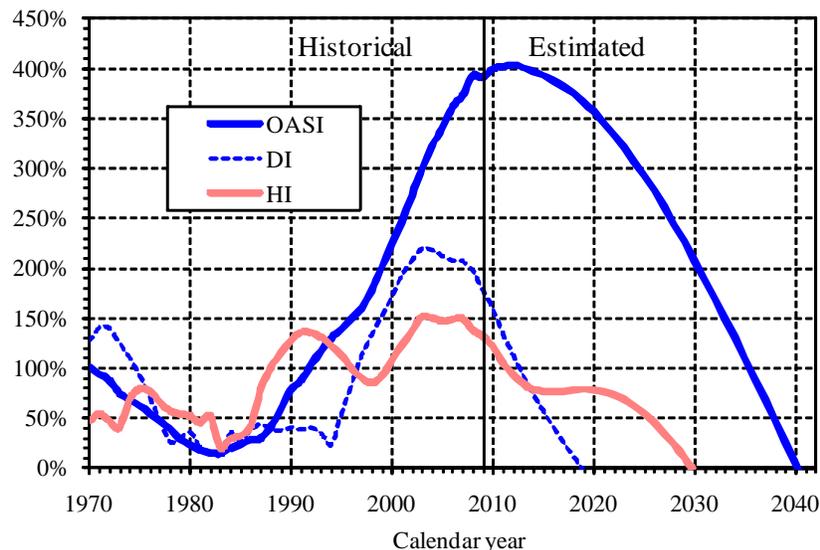
Short-range (10-year) and long-range (75-year) projections are reported for all funds. Estimates are based on current law and assumptions about factors that affect the income and outgo of each trust fund. Assumptions include economic growth, wage growth, inflation, unemployment, fertility, immigration, mortality, disability incidence and termination, as well as factors that affect the cost of hospital, medical, and prescription drug services.

Because the future is inherently uncertain, three alternative sets of economic, demographic, and programmatic assumptions are used to show a range of possibilities. The intermediate assumptions (alternative II) reflect the Trustees’ best estimate of future experience. The low-cost alternative I

is more optimistic for trust fund financing, and the high-cost alternative III is more pessimistic; they show trust fund projections for more and less favorable conditions for trust fund financing than the best estimate. The assumptions are reexamined each year in light of recent experience and new information about future trends, and are revised as warranted. In general, greater confidence can be placed in the assumptions and estimates for earlier projection years than for later years. The statistics presented in this Summary are based on the intermediate assumptions.

**What is the Short-Range (2010-19) Outlook for the Trust Funds?** For the short range, the adequacy of the OASI, DI, and HI Trust Funds is measured by comparing their assets at the beginning of a year to projected costs for that 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 considered a good indicator of a fund’s short-term adequacy. That level of projected assets for any year means that even if expenditures exceed income, the trust fund reserves, combined with annual tax revenues, would be sufficient to pay full benefits for several years, allowing time for legislative action to restore financial adequacy.

**Chart A—OASI, DI, and HI Trust Fund Ratios**  
*[Assets as a percentage of annual expenditures]*



By this measure, the OASI Trust Fund is financially adequate throughout the 2010-19 period, but the DI Trust Fund fails the short-range test because its projected trust fund ratio falls to 93 percent by the beginning of 2013, followed by exhaustion of assets in 2018. The HI Trust Fund also does not meet the short-range test of financial adequacy; its projected trust fund ratio falls to 94 percent by the beginning of 2012. In contrast

with the 2017 fund exhaustion date reported last year, the ACA is expected to result in much smaller HI deficits for the next several years, followed by small annual surpluses through the remainder of the short-range period, which postpones trust fund exhaustion to 2029. Chart A shows the trust fund ratios through 2040, the expected year of OASI Trust Fund exhaustion, under the intermediate assumptions.

For SMI Part B, a less stringent annual “contingency reserve” asset test applies because the major portion of the financing for that account is provided by beneficiary premiums and Federal general fund revenue payments automatically adjusted each year to meet expected costs. Part D is similarly financed 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 unrealistically low for 2011 and beyond because the projections assume that current law will substantially reduce physician payments per service beginning in December 2010. Multiple years of substantial physician fee reductions are very unlikely to occur before legislative intervention, as evidenced by Congress overriding scheduled reductions for 2003 through November 2010. These understated physician payments affect projected costs for Part B, total SMI, and total Medicare.

In addition, a “hold-harmless” provision prevented premiums for most Part B enrollees from increasing in 2010 and is projected to do so again in 2011. This provision limits the premium increase to the dollar amount of a beneficiary’s cost-of-living adjustment (COLA). This year’s report projects a zero COLA for December 2010 and a small COLA increase (1.2 percent) for December 2011. The hold-harmless provision would limit the premium increases that could be charged to about three-quarters of Part B enrollees. To prevent asset exhaustion and maintain an adequate contingency reserve requires unusually large premium increases for Part B enrollees who are not subject to the hold-harmless provision (new enrollees each year and those who pay the income-related premium adjustment) and for State Medicaid programs that pay the full premium for dual Medicare-Medicaid beneficiaries. Monthly premiums are estimated to be \$120.10 and \$113.80 for 2011 and 2012, compared with \$96.40 in 2009. This method of addressing a revenue shortfall caused by the hold-harmless provision is the only one available under current law.

The following table shows the projected income and outgo, and the change in the balance of each trust fund (except for SMI) over the next 10 years. SMI income and expenditures are shown in separate columns for Parts B and D. Changes in the SMI Trust Fund are not shown because of the automatic annual adjustments in program income to meet the following year’s projected expenditures.

### ESTIMATED OPERATIONS OF TRUST FUNDS

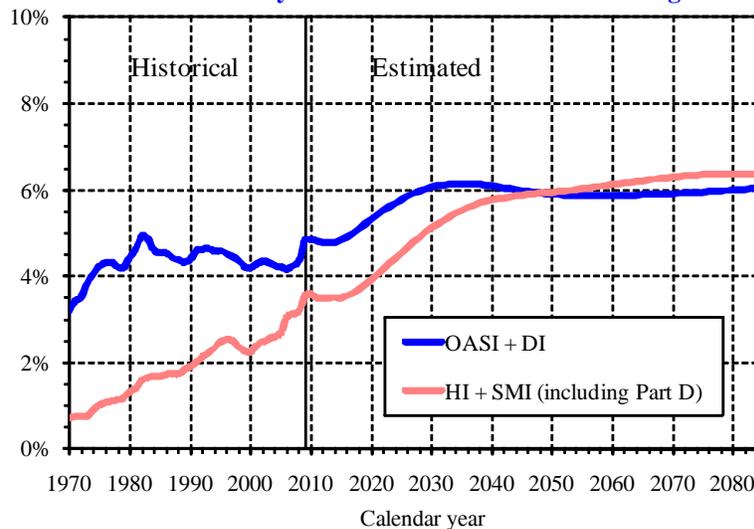
*[In billions—totals may not add due to rounding]*

Year	Income					Expenditures					Change in fund		
	OASI	DI	HI	SMI		OASI	DI	HI	SMI		OASI	DI	HI
				B	D				B	D			
2010	\$686	\$105	\$218	\$204	\$61	\$586	\$128	\$249	\$220	\$62	\$100	-\$23	-\$32
2011	742	113	241	235	71	608	134	259	215	71	134	-21	-18
2012	790	118	254	264	78	638	141	271	226	78	151	-23	-17
2013	845	124	277	287	86	680	147	283	242	86	165	-23	-6
2014	902	131	297	312	93	728	153	296	260	93	174	-23	1
2015	959	137	316	364	103	780	160	305	276	102	179	-23	11
2016	1,019	144	337	333	113	836	167	321	293	112	183	-23	15
2017	1,078	150	357	395	124	897	174	338	314	123	181	-24	19
2018	1,137	<sup>a</sup>	378	436	136	962	182	358	338	136	175	<sup>a</sup>	20
2019	1,193	<sup>a</sup>	398	477	150	1,032	190	380	365	150	161	<sup>a</sup>	18

<sup>a</sup> The DI Trust Fund is projected to be exhausted in 2018 under the intermediate assumptions. Certain trust fund operation values from 2018 forward are not meaningful under current law and are not shown in this table.

**What is the Long-Range (2010-84) Outlook for Social Security and Medicare Costs?** An instructive way to view the projected cost of Social Security and Medicare is to compare the cost of all 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 B).

**Chart B—Social Security and Medicare Cost as a Percentage of GDP**



Costs for both programs rise steeply between 2015 and 2030 because the number of people receiving benefits will increase rapidly as the large baby-boom generation retires. During those years, cost growth for Medi-

care is higher than for Social Security because of the rising cost of health services, increasing utilization rates, and anticipated increases in the complexity of services. Social Security's projected annual cost increases to about 6.1 percent of GDP in 2035, then declines to 5.9 percent by 2050, and remains between 5.9 and 6.0 percent through 2084. Under current law, Medicare costs increase to 5.5 percent of GDP in 2035, and to 6.4 percent in 2084.

It is important to understand that the projected costs for OASDI and HI depicted in Chart B and elsewhere in this document reflect the full cost of scheduled current-law benefits without regard to whether the benefits would be fully payable. Current law precludes payment of any benefits beyond the amount that can be financed by the trust funds. Therefore, the amount of benefits that are payable in years after trust fund exhaustion is lower than shown, as described later in this summary.

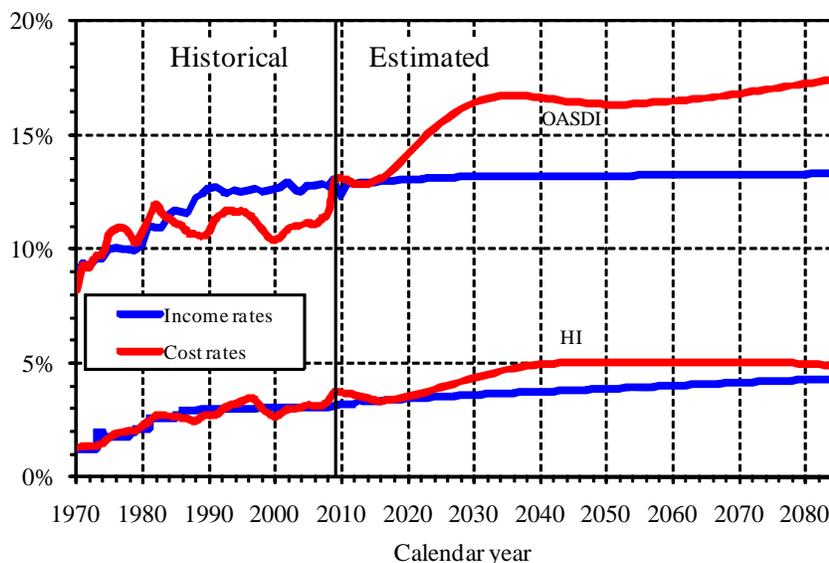
The long-range cost outlook for Medicare is much improved from last year's report due mainly to the ACA legislation. The 2009 report projected Medicare costs to increase to 7.2 percent of GDP by 2035, reaching 11.4 percent by the end of the 75-year projection period (2083). The new long-range projections assume that the ACA's mandated reductions in health care cost growth are implemented over the full 75-year projection period. To illustrate the potential understatement of Medicare cost projections under current law, if such implementation were not possible and payment rate adjustments were gradually phased out during 2020-34, and if Medicare payment rates to physicians were updated using the Medicare Economic Index rather than declining by 30 percent under the current-law formula, then projected Medicare costs would represent about 11.0 percent of GDP in 2084.

In 2009, the combined cost of the Social Security and Medicare programs equaled 8.4 percent of GDP. Social Security's cost amounted to 4.8 percent of GDP in 2009 and is projected to increase to 6.0 percent of GDP in 2084. Medicare's cost was smaller in 2009—3.5 percent of GDP—but is projected to surpass the cost of Social Security in 2049. In 2084, the combined cost of the programs would represent 12.4 percent of GDP, assuming that all provisions of current law remain unchanged throughout this period.

Both Social Security and Medicare costs are projected to grow considerably faster than the economy over the next three decades, but tax income to the OASDI and HI Trust Funds will not. Tax income for Social Security will increase from 4.6 percent of GDP in 2010 to 4.8 percent in 2040, and then decrease to 4.6 percent by 2084. For the Medicare HI program, projected tax income equal to 1.3 percent of GDP in 2010 is expected to increase to 1.7 percent by 2040, and then to increase further to 1.8 percent by 2084.

**What is the Outlook for OASDI and HI Costs Relative to Taxable Earnings?** Because the primary source of income for OASDI and HI is the payroll tax, it is customary to compare the programs' income and costs expressed as percentages of taxable payroll (Chart C).

**Chart C—Income and Cost Rates**  
*[Percentage of taxable payroll]*



Both the OASDI and HI annual cost rates are projected to increase over the long run from their 2009 levels (13.00 and 3.69 percent). For OASDI, the income rate will increase little (from 13.07 percent in 2009 to 13.31 percent in 2084) because payroll tax rates are not scheduled to change. Income from the other tax source, taxation of OASDI benefits, will increase only gradually relative to taxable payroll as a greater proportion of Social Security benefits is subject to taxation in future years. The HI income rate is projected to increase gradually from 3.13 in 2009 to 4.30 in 2084 due to the ACA's 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 the threshold. Because the thresholds are not indexed, an increasing fraction of earnings will be subject to the higher tax rate over time.

**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 in terms of 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. (Because SMI is

brought into balance annually through premium increases and general revenue transfers, actuarial balance is not an informative concept for that program.)

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

**LONG-RANGE ACTUARIAL DEFICIT OF THE  
OASI, DI, AND HI TRUST FUNDS**  
*[As a percentage of taxable payroll]*

	OASI	DI	OASDI	HI
Actuarial Deficit . . . . .	1.62	0.30	1.92	0.66

The actuarial deficit can be interpreted as the percentage points that could 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. Actuarial balance is achieved if trust fund assets at the end of the period are equal to the following year’s expenditures. Note, however, that Social Security’s generally increasing annual deficits projected for 2016 through 2084 indicate that a single tax rate increase for all years sufficient to achieve actuarial balance would result in large annual surpluses early in the period, followed by increasing deficits later in the period. If the ACA’s mandated cost savings are realized, HI annual deficits begin to decrease after 2045 and the trust fund is projected to have a long-range actuarial deficit that is only one-sixth of the magnitude projected in last year’s Medicare Trustees Report. For illustration, if the lower payment updates for HI were gradually phased out in 2020-34, the actuarial deficit would be 1.91 percent of taxable payroll, substantially larger than projected under current law, but still only half of the level shown in the 2009 report.

**What Are Key Dates in Long-Range OASI, DI, and HI Financing?**

When cost exceeds income excluding interest (Chart C), use of trust fund assets occurs in stages. For HI, non-interest income fell short of expenditures in 2008 and again in 2009, when the HI fund used interest income (\$15 billion) and assets (\$17 billion) to meet expenditures. This year’s report anticipates a large deficit for 2010, due mainly to the recession’s negative effect on payroll tax revenues, followed by periods of declining deficits (2011-14) and small surpluses (2015-19) as tax revenues increase with the economic recovery from the recession and the ACA’s deficit-reduction provisions take effect. In 2020, demographic change causes projected annual deficits to re-emerge and increase until 2045, after which the cost rate exceeds the income rate by decreasing amounts through 2084. In 2020, under current law, interest income will again be required to meet projected HI expenditures and beginning in 2022, drawdown of assets will again be required each year until the trust fund is exhausted in 2029, after which tax income is estimated to be sufficient to pay 85 per-

cent of HI costs, declining to 77 percent in 2050, and then increasing to 89 percent by 2084.

For OASDI, annual cost will exceed tax income in 2010 by an estimated \$41 billion, although the combined trust funds will continue to grow because projected interest earnings of \$118 billion will substantially exceed \$41 billion. This large cash-flow shortfall is mainly the result of revenue adjustments in 2010 of \$25 billion for prior years for which estimated payroll tax allocations were too large. Annual cost is projected to exceed tax income by \$7 billion in 2011, followed by three years of small surpluses before increasing annual shortfalls of tax income return permanently in 2015. The report indicates that annual OASDI income, including interest on trust fund assets, will exceed annual cost and trust fund assets will increase every year until 2025. At that time it will be necessary to begin drawing down trust fund assets to cover part of expenditures until assets are exhausted in 2037. After trust fund exhaustion, continuing tax income would be sufficient to pay 78 percent of scheduled benefits in 2037 and 75 percent in 2084. Although the projected exhaustion date for the DI Trust Fund is 2018, the value of the OASI Trust Fund would be sufficient at that point to make assets available to pay full DI benefits, but only with authorizing legislation.

The key dates regarding cash flows are shown in the following table.

**KEY DATES FOR THE TRUST FUNDS**

	OASI	DI	OASDI	HI
First year outgo exceeds income excluding interest <sup>a</sup> . . . . .	2018	2005	2015	2020
First year outgo exceeds income including interest <sup>a</sup> . . . . .	2026	2009	2025	2022
Year trust fund assets are exhausted . . . . .	2040	2018	2037	2029

<sup>a</sup>Dates indicate the first year that a condition is projected to occur and to persist annually thereafter through 2084.

**How Do the Sources of Medicare Financing Change?** As Medicare costs grow over time, general revenues and beneficiary premiums will play a larger role in financing the program. Chart D shows scheduled cost and current law non-interest revenue sources for HI and SMI combined as a percentage of GDP. The total cost line is the same as displayed in Chart B and shows Medicare cost rising to 6.4 percent of GDP by 2084. Revenue from taxes would increase from 1.3 percent of GDP in 2010 to 1.8 percent in 2084 under current law, while general fund revenue contributions are projected to increase from 1.4 percent of GDP in 2010 to 3.1 percent in 2084, and beneficiary premiums from 0.4 to 1.0 percent of GDP. Thus, the share of total non-interest Medicare income from payroll taxes and the taxation of benefits would fall substantially (from 43 percent to 30 percent) while general fund revenue would rise (from 43 to 51 percent), as would premiums (from 13 percent to 17 percent). These

current-law funding relationships could change as a result of the need to address the projected annual HI Trust Fund deficits. By 2084 the Medicare program is projected to require general revenue transfers equal to 3.1 percent of GDP. Moreover, the HI deficit represents a further 0.2 percent of GDP in 2084, and there is no provision to finance this deficit under current law through general fund transfers or any other revenue source.

**Chart D—Medicare Cost and Non-Interest Income by Source as a Percent of GDP**

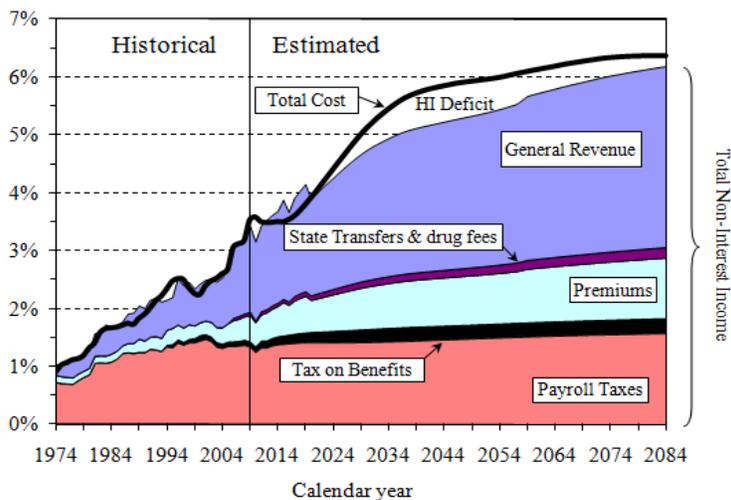


Chart D summarizes a much improved financial outlook for Medicare from the one described in last year’s report, largely due to the ACA’s mandated reduction in the rate of growth in health care costs. The transformation of the U.S. health care system that will be required to achieve those efficiency gains adds a new element of uncertainty to the Trustees’ projections. Even if the envisioned cost reductions are fully realized, additional steps will be required to address Medicare’s escalating cost.

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 D) exceeds 45 percent of total Medicare outlays within the first seven years of the 75-year projection period. In effect, the law sets a threshold condition that signals that a trust fund’s general revenue financing of Medicare is becoming excessive. In that case, the annual Trustees Report includes a determination of “excess general revenue Medicare funding.” When that determination is made in two consecutive reports, a “Medicare funding warning” is triggered. The warning directs the President to respond by submitting proposed legislation within 15 days of the next budget submis-

sion to address the problem, and for Congress to consider the proposal on an expedited basis.

This year's report projects the difference between outlays and dedicated financing revenues to exceed 45 percent in 2010, prompting a determination of "excess general revenue Medicare funding" for the fifth consecutive report. Another "Medicare funding warning" is triggered.

The 2010 Trustees Reports describe large long-term financial imbalances for Social Security and Medicare, and demonstrate the need for timely and effective action. The sooner that solutions are adopted, the more varied and gradual they can be.

*Because the two Public Trustee positions are currently vacant, there is no Message from the Public Trustees for inclusion in the Summary of the 2010 Annual Reports.*