The Impact of Medicare Premiums on Social Security Beneficiaries

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Summary

Most Social Security beneficiaries pay Medicare premiums. Beneficiaries who participate in Medicare Part B (Supplementary Medical Insurance) or Part D (prescription drugs) must pay monthly premiums, unless they qualify for low-income assistance. Part B participants who also receive Social Security must have the Part B premiums automatically deducted from their Social Security checks. Part D participants may choose to have their premiums deducted from their Social Security checks.

Medicare premiums are absorbing a growing share of Social Security benefits. To see the effect of growing premiums, consider a Social Security beneficiary who earned the average wage throughout his or her career. If this retiree chose to participate in Part B—as the vast majority of Social Security beneficiaries do—the standard Part B premium would have absorbed almost 5% of benefits upon retirement in 2000 and about 8.5% in 2010 after over a decade of retirement. For a new retiree in 2010, the Part B premium absorbs about 9% of the Social Security benefit, and combined premiums for both Part B and Part D absorb about 12% of the average initial Social Security benefit check. Medicare's trustees project that premiums for Parts B and D will grow at a faster rate than average Social Security benefits in the future, thus consuming a greater proportion of benefits over time. In 2078, a retired worker receiving the average initial Social Security benefit amount is projected to need 22% of benefits to pay the Part B premium and 31% of initial benefits to pay combined Parts B and D premiums.

The deduction of Medicare premiums affects beneficiaries differently, depending on their Social Security benefit amounts and total incomes. Medicare premiums absorb a greater fraction of lower earners' Social Security benefits than of higher earners' benefits, because although benefit amounts are progressive, low earners tend to have lower dollar amounts of benefits. However, some low-income beneficiaries are eligible for subsidies that cover their Medicare premiums and other out-of-pocket costs. Other beneficiaries may be protected by a hold harmless provision that prevents a beneficiary's Social Security check from declining due to Part B premium increases.

The Social Security Administration (SSA) has announced that there will be no Social Security cost-of-living adjustment (COLA) in 2010, and both SSA and the Congressional Budget Office predict that there will be no COLA in 2011. Over the same period, total Medicare Part B program costs and premiums are expected to increase. In a typical year, the hold harmless provision affects a small fraction of beneficiaries. However, in a scenario where there is no Social Security COLA, the effects of the hold harmless provision are larger and more complex. For more information on this issue, please see CRS Report R40561, *The Effect of No Social Security COLA on Medicare Part B Premiums*, by (name redacted) and Alison Shelton.

Finally, it is important to note that although Social Security beneficiaries are affected by rising health care costs, the benefits of participating in Medicare are substantially greater than the costs.

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Introduction

Social Security and Medicare are large and important parts of America's safety net. About 45 million older and disabled individuals—1 in 7 Americans—are beneficiaries of both Social Security and Medicare.[1] Social Security and Medicare account for a large amount of federal spending. For 2010, spending on the two programs is projected at about $1.2 trillion, about 35% of outlays and about 8.4% of gross domestic product (GDP), one measure of the size of the U.S. economy.[2] Although Social Security and Medicare both play important roles in the well-being of older and disabled Americans, the interactions between the two programs are rarely examined.

This report focuses on how Medicare premiums affect Social Security beneficiaries. Medicare premiums are rising faster than Social Security benefits and are consequently consuming an increasing share of benefits over time.

Rising Medicare premiums could have a large effect on Social Security beneficiaries, particularly on those with low incomes and those who rely on Social Security as their primary source of income. Some beneficiaries may have more difficulty paying for rising health care costs than others. For example, among Americans aged 65 and older, 50% of married couples and 72% of unmarried persons receive more than half of their income from Social Security, and 20% of married couples and about 41% of unmarried persons receive more than 90% of their income from Social Security. [3] Some of these beneficiaries may see a decline in their standard of living as their Medicare premiums rise.

This report shows how the deduction of Medicare Part B and Part D premiums affects Social Security beneficiaries.[4] It describes how increases in Social Security benefits and Medicare premiums are calculated under current law and explains the circumstances under which many Social Security beneficiaries are held harmless for increases in the standard Part B premium, as well as the premium assistance available to low-income beneficiaries. It shows the growth in Social Security benefits and Part B premiums in recent years and describes how rising Part B premiums have affected Social Security beneficiaries with different levels of earnings, including both current beneficiaries and new enrollees. It also provides estimates of Social Security benefits and Medicare Parts B and D premiums to 2078, using the Social Security and Medicare trustees' intermediate projections, and describes how beneficiaries would be affected by projected Medicare premium increases.

[1] Social Security Administration, 2009 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, May 12, 2009, at http://www.ssa.gov/OACT/TR/2009/tr09.pdf. (Hereafter cited as 2009 Social Security Trustees Report.) Centers for Medicare and Medicaid Services, 2009 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, May 12, 2009, available at http://www.cms.hhs.gov/ReportsTrustFunds/downloads/tr2009.pdf. (Hereafter cited as 2009 Medicare Trustees Report.)

[2] Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020*, January 2010, Table 3-1, at http://www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf.

[3] http://www.ssa.gov/pressoffice/basicfact.htm

[4] Medicare Part B, Supplementary Medical Insurance (SMI), covers physician services and other outpatient expenses. Medicare Part D covers prescription drugs through private plans.

Background

Social Security Benefits

Social Security provides retirement, disability, and survivors benefits to workers and their families. People become insured for benefits by working in Social Security-covered employment (i.e., by paying Social Security payroll taxes).[5] Generally, people who qualify for retirement benefits may receive reduced Social Security benefits as early as age 62 or full benefits at the full retirement age.[6] Those who qualify for disability or certain survivors benefits may receive them at any age.[7] The amount of a worker's Social Security benefit is calculated by applying a progressive benefit formula to his or her lifetime earnings, adjusted for wage growth. Historically, the average Social Security benefit paid to new beneficiaries has increased at about the same rate as average earnings.

Annual Cost-of-Living Adjustment

After a person becomes eligible to receive Social Security benefits, his or her monthly benefit amount is increased annually to maintain purchasing power over time. Near the end of each year, the Social Security Administration (SSA) announces the cost-of-living adjustment (COLA) payable in January of the following year. The amount of the COLA is based on inflation as measured by the Consumer Price Index-Urban Wage Earners and Clerical Workers (CPI-W).[8] If the CPI-W decreases, Social Security benefits stay the same—benefits are not reduced during periods of deflation.

COLAs for 2010 and 2011

SSA has announced that there will be no Social Security COLA in 2010, and both SSA and the Congressional Budget Office predict that there will be no COLA in 2011.[9] For more on this subject and how this could affect Medicare Part B premiums, see CRS Report R40561, *The Effect of No Social Security COLA on Medicare Part B Premiums*, by (name redacted) and (name redacted).

[5] The amount of time a person must work in Social Security-covered employment to be insured for benefits depends on the type of benefit, among other factors. For more details, see CRS Report 94-27, *Social Security: Brief Facts and Statistics*, by (name redacted).

[6] The age at which workers may receive full retirement benefits is rising from 65 (for those born before 1938) to 67 (for those born after 1959).

[7] Social Security also provides benefits to a worker's family, such as spouse benefits and survivor benefits, that are based on the lifetime earnings of the worker. For more information, see CRS Report 94-27, *Social Security: Brief Facts and Statistics*, by (name redacted).

[8] The CPI-W tracks the prices of a fixed market basket of goods and services over time. Social Security's COLA is calculated as the change in the CPI-W from the third quarter of the prior calendar year to the third quarter of the current calendar year. If the CPI-W increases during this period, Social Security benefits for the next year increase proportionately. See CRS Report 94-803, *Social Security: Cost-of-Living Adjustments*, by (name redacted) and CRS Report RL30074, *The Consumer Price Index: A Brief Overview*, by (name redacted).

[9] http://www.socialsecurity.gov/pressoffice/factsheets/colafacts2010.htm.

Medicare Premiums

Medicare is the federal health insurance program for people aged 65 and older and for certain disabled people. Medicare is composed of four parts:

- Part A: Hospital Insurance (HI);
- Part B: Supplementary Medical Insurance (SMI), which covers physician services and other outpatient expenses;
- Part C: Medicare Advantage (MA), which covers the same services as Parts A and B through private health insurance plans; and
- Part D: prescription drugs, which are covered through private plans.

Participation in Part A is required for Social Security beneficiaries aged 65 and older and for those who have received disability benefits for more than 24 months.[10] Part A beneficiaries may choose to participate in Parts B, C, and D.[11]

Medicare is funded through a combination of payroll taxes, general revenues, and beneficiary premiums. Medicare Part A is funded primarily through the payroll taxes of current workers and their employers, which are credited to the HI trust fund.[12] Parts B and D are financed through a combination of beneficiary premiums and federal general revenues, which are credited to the SMI trust fund. Part C is financed through the HI and SMI trust funds; Part C participants must pay the Part B premium.[13] Because this report focuses on the payment of Medicare premiums, the analysis herein primarily relates to Parts B and D.

Part B Premiums

At the end of each year, the Centers for Medicare and Medicaid Services (CMS) announce Part B premiums for the next year. The Balanced Budget Act of 1997 permanently set standard Part B premiums to cover 25% of projected per capita Part B program costs for beneficiaries aged 65 and older.[14] If projected Part B costs increase or decrease, the premium rises or falls

[10] People who receive Social Security benefits that confer eligibility for Part A (i.e., retirement benefits for those aged 65 and older and disability benefits after 24 months) may not waive Part A entitlement. (Social Security Administration, Program Operations Manual System, HI 00801.002, at https://s044a90.ssa.gov/apps10/poms.nsf/lnx/0600801002!opendocument.)

[11] Of Part A beneficiaries, roughly 94% are enrolled in Part B, and about 22% are enrolled in Part C. In 2008, about 90% of Medicare beneficiaries had prescription drug coverage of some kind. About 25 million were enrolled in stand-alone Part D plans or had prescription drug coverage through their Part C plans, and an additional 14 million were enrolled in other health insurance plans that were subsidized by Part D. (CRS Report RL34280, *Medicare Part D Prescription Drug Benefit: A Primer*, by (name redacted).)

[12] About 99% of Medicare beneficiaries qualify for premium-free Part A coverage, which they earn if they (or their spouses) have worked at least 10 years in Medicare-covered employment. Individuals without sufficient work history who are otherwise eligible for Medicare may participate in the program if they pay monthly Part A premiums.

[13] The law requires that Part C participants pay the Part B premium. Some Part C plans subsidize the premium for their enrollees; others require that enrollees pay the full Part B premium plus an additional premium directly to the plan sponsor.

[14] Disabled Medicare beneficiaries under age 65 pay the same premium amount as those aged 65 or older, though their per capita Part B costs are higher.

proportionately. Unless they qualify for low-income assistance, Part B participants must pay monthly premiums; they must also pay other out-of-pocket costs when they use Part B services.

Starting in 2007, higher-income beneficiaries have paid higher Part B premiums.[15] Less than 5% of Part B beneficiaries will pay income-related premiums in 2010.[16]

Part B Premiums for 2010

In 2010, the standard Part B premium is $110.50 per month, up from $96.40 per month in 2009. In 2010, individuals whose modified adjusted gross income (AGI) exceeds $85,000, and couples whose modified AGI exceeds $170,000, are subject to higher premium amounts, as shown in **Table 1** below.[17] The analysis in this report focuses on the standard Part B premium of $110.50, which is paid by most beneficiaries. In addition to premiums, Part B beneficiaries must also pay other out-of-pocket costs when they use services. The annual deductible for Part B services is $155 in 2010. After the annual deductible is met, beneficiaries are responsible for coinsurance costs, which are generally 20% of Medicare-approved Part B expenses.

Table 1. Part B Premiums, 2010

Modified Adjusted Gross Income (AGI)		Premium
Single	Couple	
$85,000 or less	$170,000 or less	$110.50
$85,001-$107,000	$170,001-$214,000	$154.70
$107,001-$160,000	$214,001-$320,000	$221.00
$160,001-$213,000	$320,001-$426,000	$287.30
More than $213,000	More than $426,000	$353.60

Source: Social Security Administration, Medicare Part B Premiums: Important Information For People Newly Eligible For Medicare 2010, January 2010, at http://www.ssa.gov/pubs/10162.pdf

Note: For more information, see CRS Report R40082, *Medicare: Part B Premiums*, by (name redacted).

Medicare Advantage (Part C)

Beneficiaries who are entitled to Medicare Part A and enrolled in Part B may choose to enroll in a private health insurance plan through Part C, also known as Medicare Advantage (MA), which provides health care coverage in lieu of traditional Medicare. In 2009, about 23% of Medicare beneficiaries were enrolled in Part C, mostly in managed care plans.[18] Medicare Advantage plans are generally required to offer the same services as Medicare Parts A and B. MA managed care

[15] The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173) increased the Part B premium percentage for high-income enrollees; the Deficit Reduction Act of 2005 (P.L. 109-171) accelerated the phase-in period for such premiums.

[16] SSA, Medicare Part B Premiums: Important Information For People Newly Eligible For Medicare 2010, January 2010, at http://www.ssa.gov/pubs/10162.pdf.

[17] For more information, see CRS Report R40082, *Medicare: Part B Premiums*, by (name redacted).

[18] Kaiser Family Foundation, *Fact Sheet: Medicare Advantage*, November 2009, at http://www.kff.org/medicare/upload/2052-13.pdf.

organizations must also offer at least one Medicare Advantage-prescription drug plan (MA-PD) that includes drug coverage at least equivalent to standard coverage in Part D plans. (Beneficiaries enrolled in MA managed care plans may not enroll in a stand-alone Part D plan.)[19]

Part C Premiums

Medicare Advantage participants' total premium amounts may be higher or lower than the Part B premium. Although the law requires that MA participants pay the Part B premium, some plans subsidize the premium for their enrollees. Other plans require that enrollees pay the full Part B premium plus an additional premium directly to the plan sponsor.[20]

Part D Premiums

Medicare Part D was established in the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA, P.L. 108-173) and began covering beneficiaries' prescription drugs through private plans in January 2006.[21] To participate in Part D, qualified individuals must enroll in a participating prescription drug plan. Unless they qualify for low-income assistance, Part D participants must pay monthly premiums; they must also pay other out-of-pocket costs when they use Part D services.

MMA established guidelines for *standard* Part D coverage, including specific deductible and coinsurance amounts and a formula for calculating average premiums. Individual prescription drug plans are also allowed to offer *alternative* coverage that has at least actuarially equivalent benefits. In other words, alternative coverage plans must pay, on average, equal or greater benefits per person than standard coverage plans. Alternative coverage plans may charge higher or lower premiums, deductibles, and coinsurance than standard coverage plans.[22] This report focuses on beneficiaries' premiums for *standard* Part D coverage, which vary by plan. On average, a beneficiary's premium covers about one-fourth of the value of a standard coverage plan and the federal government pays for the remaining three-fourths.

[19] MA providers of nonmanaged care plans (i.e., private fee-for-service [PFFS] plans and medical savings accounts [MSAs]) are *not* required to offer prescription drug coverage. Drug coverage is optional for PFFS providers; PFFS plan enrollees without drug coverage are permitted to enroll in a stand-alone Part D plan. MSAs may not offer drug coverage.

[20] As of early 2009, about half (49%) of MA participants' total premiums were equal to the Part B premium amount, and about half (49%) paid higher premiums. About 2% paid lower premiums. (AARP Public Policy Institute, *A First Look at How Medicare Advantage Benefits and Premiums in Individual Enrollment Plans Are Changing from 2008 to 2009*, by Marsha Gold and Maria Cupples Hudson, March 2009, at http://assets.aarp.org/rgcenter/health/i25_medicare.pdf.)

[21] See CRS Report RL31966, *Overview of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003*, by (name redacted) et al. and CRS Report RL31525, *Beneficiary Cost-Sharing Under the Medicare Prescription Drug Benefit*, by (name redacted).

[22] For example, in 2010 premiums for all stand-alone Part D plans ranged from $8.80 to $120.20 per month (Kaiser Family Foundation, *Fact Sheet: The Medicare Prescription Drug Benefit*, November 2009, http://www.kff.org/medicare/upload/7044-10.pdf hereafter cited as Kaiser, *Part D Fact Sheet*).

Part D Premiums for 2009

The average premium for standard Part D coverage is $30 in 2010, up from $28 in 2009. The annual deductible for standard coverage is $310 in 2010. After meeting the deductible, beneficiaries pay 25% coinsurance costs for drug costs up to $2,830, all of their drug costs between $2,830 and $6,440, and about 5% of drug costs above $6,440.[23]

Medicare Premium Subsidies for Low-Income Beneficiaries

The analysis in this report focuses on Social Security beneficiaries who pay Medicare premiums. However, low-income individuals (including MA participants) may qualify for low-income subsidies, that cover all or part of their Part B and Part D premiums.[24] As of early 2009, about 8.8 million low-income Medicare beneficiaries received full Part B premium subsidies, and 9.6 million receive Part D subsidies.[25] Some beneficiaries who qualified for premium subsidies did not apply for them.

To qualify for subsidies, beneficiaries must have limited income and assets. Beneficiaries may qualify for full Part B premium subsidies if they have incomes of less than 135% of poverty and assets of less than $4,000 for an individual or $6,000 for a couple. Beneficiaries may qualify for full or partial Part D premium subsidies if they have incomes of less than 150% of poverty and assets of less than $12,510 for an individual and $25,010 for a couple in 2010.[26]

Hold Harmless Provision for Medicare Part B Premiums

A *hold harmless* provision reduces the Part B premium for most beneficiaries whose Social Security COLAs are not sufficient to cover the standard Part B premium increase.[27] If, in a given year, the increase in the standard Part B premium would cause a beneficiary's Social Security

[23] The majority of plans offered to beneficiaries in 2009 were alternative coverage plans. Many of these plans include tiered cost-sharing, under which costs are lower for generic drugs and higher for brand-name drugs (Kaiser, *Part D Fact Sheet* and CMS, *Announcement of Calendar Year (CY) 2010 Medicare Advantage Capitation Rates and Medicare Advantage and Part D Payment Policies*, April 6, 2009, Attachment IV, available at http://www.cms.hhs.gov/MedicareAdvtgSpecRateStats/Downloads/Announcement2010.pdf).

[24] For more information on subsidies for low-income Medicare beneficiaries, see CRS Report R40082, *Medicare: Part B Premiums*, by (name redacted) and CRS Report RL32402, *Medicare Prescription Drug Benefit: Low-Income Provisions*, by (name redacted).

[25] Kaiser Family Foundation, *Dual Eligibles: Medicaid's Role for Low-Income Medicare Beneficiaries*, February 2009, at http://www.kff.org/medicaid/4091.cfm; Kaiser, *Part D Fact Sheet*.

[26] Centers for Medicare and Medicaid Services, *Medicare and You, 2010*, available at http://www.medicare.gov/Publications/Pubs/pdf/10050.pdf#78.

[27] 42 U.S.C. § 1839(f). The hold harmless provision was first implemented in January 1987.

check to be less, in dollar terms, than it was the year before, then the Part B premium is reduced to ensure that the nominal amount of the individual's Social Security check stays the same.[28]

Several groups are *not* covered by the hold harmless provision. New enrollees to either Medicare or Social Security, as well as Part B enrollees who do not receive Social Security benefits, will pay higher Part B premiums without protection from the hold harmless provision.[29] High-income individuals, who pay income-related Part B premiums instead of the standard premium, are not protected by the hold harmless provision and may see reduced Social Security checks from one year to the next as a result of an increase in the Part B premium. Low-income beneficiaries are not held harmless, but because they also do not pay the Part B premium—Medicaid pays the premiums for them—the costs of low-income beneficiaries' rising Part B premiums will generally be borne by state governments instead of by the beneficiaries themselves.[30]

Whether a beneficiary is held harmless depends on the amount of the standard Part B premium increase relative to the amount of his or her Social Security COLA in a given year; this determination is made by SSA. As described earlier, an individual's Social Security COLA is determined by multiplying his or her benefit amount by the inflation rate (i.e., the CPI-W). Part B premiums are determined by projected Part B program costs. Thus, the number of people held harmless can vary widely from year to year, depending on annual inflation rates and projected Part B costs.[31]

In some cases, a beneficiary may be held harmless one year but not the next. In other cases, a beneficiary will be held harmless in a current year because his or her Part B premium was reduced in an earlier year. The cumulative effect of the hold harmless provision can produce substantial savings for individuals with low benefits.

A beneficiary is *not* held harmless if the increase in his or her Part D premium (or the combined increase in Part B and Part D premiums) causes his or her Social Security check to decline. In other words, a person's Social Security check may decrease from one year to the next as a result of Part D premium increases.

No Social Security COLA Scenario

SSA announced on October 15, 2009, that there will be no Social Security COLA in 2010. Furthermore, both SSA and the Congressional Budget Office predict that there will be no COLA in 2011. Over the same period, total Medicare Part B program costs and premiums are expected to increase.[32] In a typical year, the hold harmless provision affects a small fraction of beneficiaries

[28] If a beneficiary's benefit amount changes during a year in which he or she is held harmless (e.g., a beneficiary begins to be affected by the government pension offset), the Part B premium amount does *not* change. For more information on the hold harmless provision, see CRS Report R40561, *The Effect of No Social Security COLA on Medicare Part B Premiums*, by (name redacted) and Alison Shelton.

[29] To be held harmless in a given year, a beneficiary must have had Part B premiums deducted from both the December check of the prior year and the January check of the current year.

[30] For more information on the hold harmless provision and the impact on Part B premiums if there is no Social Security COLA during 2010 and 2011, see CRS Report R40561, *The Effect of No Social Security COLA on Medicare Part B Premiums*, by (name redacted) and Alison Shelton.

[31] For example, about 1.8 million Part B participants (6% of those paying premiums) were held harmless in 2005, and roughly 1 million participants (3% of those paying premiums) in 2006 (SSA Actuarial Note No. 147).

[32] By law, Medicare Part B premiums cover 25% of annual program costs.

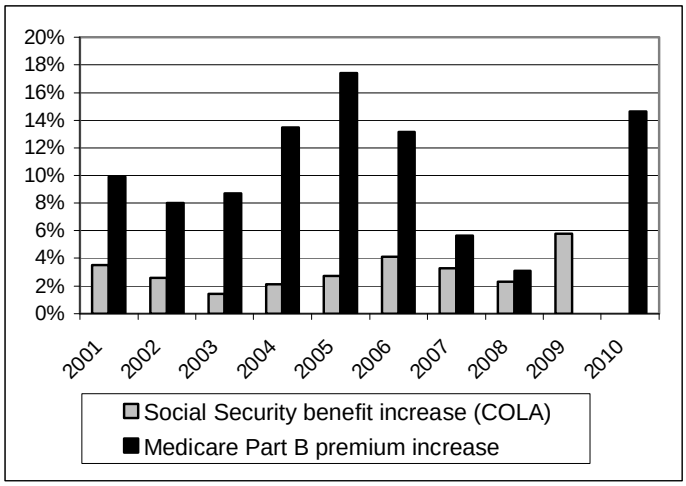
and has a limited impact on program finances. However, in a scenario where Medicare Part B premiums increase but Social Security benefits do not, the effects of the hold harmless provision are larger and more complex. For more information on this issue, please see CRS Report R40561, *The Effect of No Social Security COLA on Medicare Part B Premiums*, by (name redacted) and (name r edacted).

Growth in Social Security Benefits and Medicare Part B Premiums from 2001 to 2010

Figure 1 shows the annual rates of increase in Medicare premiums and Social Security retiree benefits (reflecting COLA increases) from 2001 to 2010. The cumulative growth in standard Part B premiums has been dramatic, but annual changes have been somewhat erratic. During the past 10 years, annual Part B premium increases have ranged from 0% to more than 17%. Social Security COLAs, meanwhile, have ranged from 0% to 5.8%. In 2009, there was no Part B premium increase and in 2010, there was no COLA

For a worker who retired in 2001, the percentage increase in the Part B premium exceeded the Social Security COLA in each year through 2008. In dollar terms, which increase is greater would vary from individual to individual, depending on how the dollar amount of the Part B premium increase compares to the dollar amount of a given individual's COLA (which in turn depends on the dollar amount of his or her benefit before the COLA increase).

Figure 1. Annual Percent Increase in Social Security Benefits and Standard Medicare Part B Premiums, 2001-2010



Source: *2009 Medicare Trustees Report* and the *2009 Social Security Trustees Report, updated for 2010 Part B premium and announcement of no 2010 Social Security COLA.*

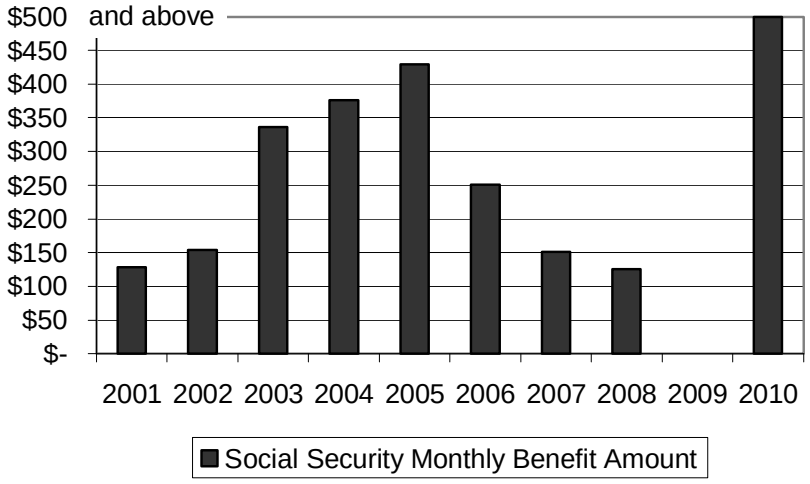
Note: There were no increases in the Part B premium in 2009 and the Social Security COLA was zero in 2010.

Historical Benefit Thresholds for the Hold Harmless Provision

As discussed above, a *hold harmless* provision reduces the Part B premium for most beneficiaries whose Social Security COLAs are not sufficient to cover the standard Part B premium increase.

Figure 2 shows approximate Social Security hold harmless threshold amounts from 2001 to 2009. The majority of Social Security participants with monthly benefit amounts below the thresholds were held harmless, whereas participants with monthly benefit amounts above this threshold were not held harmless. In particular, for monthly Social Security benefit amounts below these thresholds, the dollar amount of the Part B premium increase was greater than the dollar amount of the Social Security benefit increase (which in turn is the previous year's Social Security benefit times the COLA), so that the net Social Security benefit would have fallen relative to the previous year's benefit in the absence of the hold harmless provision. To prevent a decline in the Social Security benefit from one year to the next, the Part B premium increase is reduced for most beneficiaries with monthly Social Security benefits below the threshold.[33] If a beneficiary had benefits above the threshold in a given year, he or she would pay the full Part B premium increase in that year. In 2010, there is no Social Security COLA, therefore the hold harmless provision applies to all beneficiaries except for the previously noted groups.

Figure 2. Approximate Social Security Benefit Thresholds for Hold Harmless Provision, 2001-2010



Source: Congressional Research Service calculations, based on figures from the *2009 Medicare Trustees Report* and the *2009 Social Security Trustees Report, updated for reported 2010 Part B premium and announcement of no 2010 Social Security COLA*.

Notes: There was no increases in the Medicare Part B premium in 2009 so the hold harmless provision did not apply. In 2010, there was no Social Security COLA so the hold harmless provision applied to all Social Security benefit amounts except for excluded categories of beneficiaries, as described above.

[33] Some beneficiaries with benefits below these thresholds would *not* have had their Part B premiums reduced because their benefit checks would not have declined as a result of the Part B premium increase, due to the fact the Social Security benefits are rounded down to the nearest dollar. These thresholds apply only to beneficiaries who were not held harmless in the previous year. For more information, see SSA Actuarial Note No. 147.

Impact of Medicare Premiums on Social Security Beneficiaries

Ultimately, almost everyone who is eligible for Social Security retirement or disability benefits qualifies for Medicare.[34] Most people who elect to participate in the Part B or Part D programs pay premiums.[35] By law, the Medicare Part B premium is automatically deducted from the Social Security benefits of those enrolled in Part B (including MA and MA-PD participants).[36] Medicare Part D participants may choose to have their Part D premiums deducted from their benefits or to pay them directly to their prescription drug plan sponsors.

For new enrollees, the full amount of the Part B premium, including any annual increase, is subtracted from the Social Security benefit. New enrollees are not held harmless from Part B premiums increases, as described above. Initial Social Security benefits generally increase in line with national wage growth; in other words, as successive cohorts of workers retire each year, each cohort's initial benefits is somewhat higher as a reflection of the wage growth it experienced while working. Over the past decade, initial benefits have increased by about 37%. During the same period, standard Part B premiums have more than doubled, from $50.00 in 2001 to $110.50 in 2010, an increase of 121%.

Once a person has retired, his or her Social Security benefit is indexed to inflation and thereafter grows with annual Social Security COLAs. A "hold harmless" provision, described below, caps the Part B premium increase (but not the Part D increase) at the dollar amount of a beneficiary's COLA. Over the past decade, Social Security's annual COLA resulted in a cumulative benefit increase of about 31%, less than the Part B premium growth of 121%.[37]

Impact on the Cohort that Retired in 2000

The following section illustrates how the deduction of Medicare Part B premiums would have affected the Social Security benefits of three hypothetical workers who retired in 2000 and received Social Security benefits, increased for the annual COLA, through 2010.[38] The three workers are a low earner, a medium earner, and a high earner.[39] The *low earner* is assumed to

[34] Generally, people aged 65 and older who qualify for Social Security benefits and people of any age who receive disability benefits (after a two-year waiting period) are entitled to Part A, with some exceptions. Part A beneficiaries are also eligible to enroll in Part B, in a private health insurance plan through Part C, and/or in a private prescription drug plan through Part D.

[35] Some beneficiaries do not pay Medicare premiums, either because they receive low-income assistance or because they choose not to enroll in Medicare Part B or Part D.

[36] 42 U.S.C. § 1840(a)(1). Part B premiums are also deducted from Railroad Retirement benefits (42 U.S.C. § 1840(b)(1)).

[37] The COLA increases the benefits paid to *current* beneficiaries. In contrast, average Social Security benefits (those paid to new and current beneficiaries) have risen at a faster rate than the annual COLA, because the formula for calculating initial Social Security benefits is linked to *wage* growth, whereas the COLA is based on *price* growth. Generally, wages rise faster than prices.

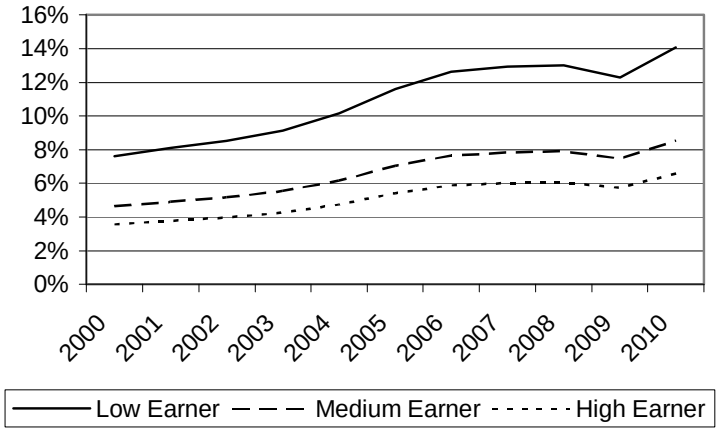
[38] Part D premiums are not included in this example because Medicare Part D did not exist in 2000.

[39] The hypothetical workers were developed by SSA's actuaries. See Social Security Administration, Office of the Chief Actuary, Actuarial Note Number 144, *Internal Rates of Return Under the OASDI Program for Hypothetical Workers*, by Orlo R. Nichols et al., June 2001, at http://www.ssa.gov/OACT/NOTES/note2000s/note144.html.

have earned 45% of the average wage during each year of his or her career (about $19,553 in 2010) and to receive a monthly Social Security benefit of about $800 in 2010.[40] The *medium earner* is assumed to have earned the average wage during each year of his or her career (about $43,451 in 2010) and to receive a monthly Social Security benefit of about $1,300 in 2010. The *high earner* is assumed to have earned 160% of the average wage during each year of his or her career (about $69,522 in 2010) and to receive a monthly Social Security benefit of $1,700 in 2010. All of the hypothetical workers are assumed to have been born in 1935, to have worked full-time each year from the ages of 22 to 65 with no interruptions, to have retired in 2000 at the age of 65, and to pay the standard Part B premium without low-income assistance or protection under the hold harmless provision.[41]

Figure 3 shows the percentage of each hypothetical retired worker's Social Security benefits that was deducted to pay the standard Part B premium, for a single cohort of workers who retired in 2000 and continued to receive Social Security benefits, increased for the COLA, through 2010.

Figure 3. Percentage of Total Social Security Benefits Deducted for Standard Part B Premiums, 2000-2010



Source: Congressional Research Service calculations, based on figures from the *2009 Medicare Trustees Report* and the *2009 Social Security Trustees Report, updated for reported 2010 Part B premium and announcement of no 2010 Social Security COLA*..

Note: The calculations in this figure are based on individuals who retired in 2000. Estimates for other cohorts would vary.

As shown in **Figure 3**, a growing proportion of Social Security benefits have been deducted to pay Part B premiums over the 11-year period. In 2000, the medium earner needed approximately 4.6% of his or her Social Security benefits to pay the Part B premium each year. By 2010, after 11

[40] The *average wage* is defined by SSA's Average Wage Index (AWI), found in Table VI.F6 in the 2009 Trustees Report. The AWI tends to overestimate workers' lifetime earnings. See University of Michigan Retirement Research Center, Working Paper WP 2004-074, *Modeling Lifetime Earnings Paths: Hypothetical versus Actual Workers*, by Andrew Au, Olivia Mitchell, and John W.R. Phillips, March 2004, at http://www.mrrc.isr.umich.edu/publications/Papers/pdf/wp074.pdf.

[41] The low earner could potentially qualify for assistance in paying Part B premiums if he or she had little or no income besides Social Security benefits, had assets below the statutory limit ($4,000 for an individual and $6,000 for a couple), and applied for assistance.

years of retirement, the Part B premium absorbed about 8.5% of the medium earner's benefits. In other words, the proportion of benefits needed to pay the standard Part B premium nearly doubled over the past decade.

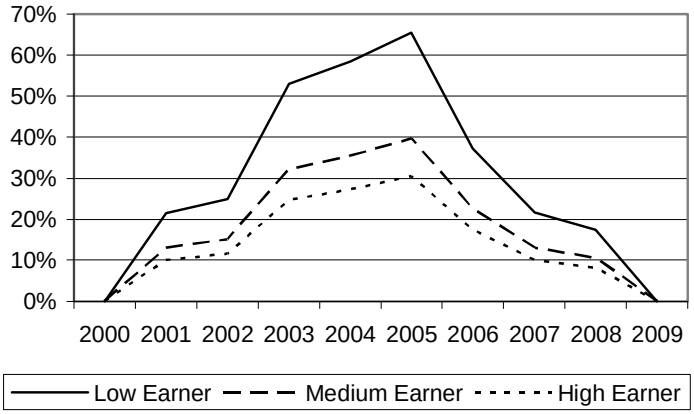
Lower earners need a greater fraction of their Social Security benefits to pay the Part B premium than do higher earners. For example, in 2010 the low earner in this illustration needs about 14% of his or her Social Security benefit check to pay the Part B premium. In contrast, the high earner needs about 7% of his or her benefit check to pay the Part B premium. Although Social Security benefits are progressive, they are also based on a workers' lifetime earnings; consequently, low earners are disproportionately affected by the deduction of Medicare premiums. Some low earners may be protected by Medicaid's Part B premium subsidies for low-income beneficiaries.

Note that the share of the Social Security benefit absorbed by the Part B premium from 2000 to 2010 in **Figure 3** increased despite the hold harmless provision. Effectively, the Part B premium increase absorbed part of the COLA each year, as described in **Figure 4** below, but the dollar amount of the premium increase did not exceed the dollar amount of COLA in any of the years (except 2010), so the hold harmless provision was not triggered for any of the example workers until 2010 (when it was triggered for most workers).[42]

Figure 4 shows, for the same hypothetical workers shown in **Figure 3**, how much of the Social Security COLA was absorbed by the Part B premium increase in each year. The premium clearly absorbed more of the COLA in some years than in others. For example, in 2005 the Part B premium increase absorbed about 40% of the medium earner's COLA. In 2000 and 2009, there was no Part B premium increase, so beneficiaries kept their entire Social Security COLAs. In years with premium increases, those with lower benefits need a greater fraction of their Social Security COLAs to cover the Part B premium increase than those with higher benefits. In 2010 (not shown in **Figure 4**), the absence of a Social Security COLA means that for the typical worker the Medicare Part B premium will not be allowed to increase.

[42] Consistent with this, the benefit levels of the three model workers, as described at the beginning of this section, are all higher than the hold harmless thresholds described in the figures.

Figure 4. Percentage of Social Security COLAs Absorbed by Standard Part B Increase, 2000-2009



Source: Congressional Research Service calculations, based on figures from the *2009 Medicare Trustees Report* and the *2009 Social Security Trustees Report, updated for reported 2010 Part B premium and announcement of no 2010 Social Security COLA*.

Notes: The calculations in this figure are based on individuals who retired in 2000. Estimates for other cohorts would vary. There were no increases in the Medicare Part B premium in 2000 or 2009, and no Social Security COLA in 2010 (not shown because the ratio of Part B premiums to the COLA for 2010 would involve dividing by zero).

Impact on Initial Benefits of Cohorts Retiring in Each Year from 2010 to 2078

Looking forward, most experts agree that Medicare cost growth will continue to outstrip growth in prices (and thus Social Security COLAs for existing beneficiaries) and wages (and thus initial Social Security benefits for new beneficiaries). The trustees of Social Security and Medicare project that over the long term, annual inflation will average 2.8%, annual wage growth will average 3.9%, and annual increases in Parts B and D costs per beneficiary will average 5% or more. Long-range projections are inherently imprecise; the further into the future one looks, the wider the range of possible outcomes. Projections of Medicare cost growth are particularly uncertain. Sources of uncertainty range from the difficulty of predicting medical breakthroughs to the ongoing implementation of Part D. In fact, many experts believe that Part B costs will grow faster than the trustees have projected.

Why the Trustees' Projections of Medicare Part B Premiums May Be Too Low

Trustees Assume Cuts to Physician Payments. The Medicare trustees make their projections of future program costs and premiums based on the provisions of the law that authorizes Medicare. The law requires a sustainable growth rate (SGR) formula to be used to calculate Medicare physician payments, which account for about 50% of Part B costs. Application of this formula would result in cuts to physician fees of about 21% in 2010 and by additional amounts in subsequent years. The Medicare trustees assume that these cuts will be made.

However, congressional action has prevented cuts to physician fees for 2003 to 2009. Many Members of Congress were concerned about the impact of potential payment reductions on beneficiaries' access to services. The trustees acknowledge that "multiple years of significant reductions in physician payments per service are very unlikely to occur before legislative changes intervene." If the trustees had *not* assumed that physician payments would be cut, projected Part B costs would be significantly higher. Consequently, projected Part B premiums would be higher, because they are proportionate to projected program costs.

Trustees Assume Medicare Cost Growth Will Slow. The Medicare trustees assume that the growth in Medicare costs (and thus premiums) will slow in the future. The Congressional Budget Office (CBO) explains that "in their long range forecasts, the Medicare trustees assume that the development and increasing use of new medical technologies will cause spending per enrollee to continue to grow faster than [inflation and wages] but that significant pressures will be brought to bear on the entire health-care system to reduce [costs]." Consequently, the trustees project that the growth in Medicare premiums will also slow. The trustees' intermediate projection is that Part B premiums will increase by an average annual rate of at least 5% over the long term.

Many experts believe this projected growth rate is too low. One reason is that the trustees' projections are significantly lower than past growth rates for Part B premiums. If Part B premiums continue to rise at the same rate as they have in the past, they will increase much more rapidly than the Medicare trustees project.

Sources: *2009 Medicare Trustees Report*; CBO, *The Long-Term Budget Outlook*, December 2007; and CBO, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020*.

It is also difficult to project how Medicare Part D premiums, implemented in 2006, might change over time. (See the **text box**.) Early estimates of Part D costs varied widely. The nature of Part D makes it difficult to project premiums, because individual plans set premiums for their beneficiaries. In general, prescription drug spending has been rising at least as much as overall health spending; this trend is expected to continue.

Uncertainties in Projecting Part D Premiums

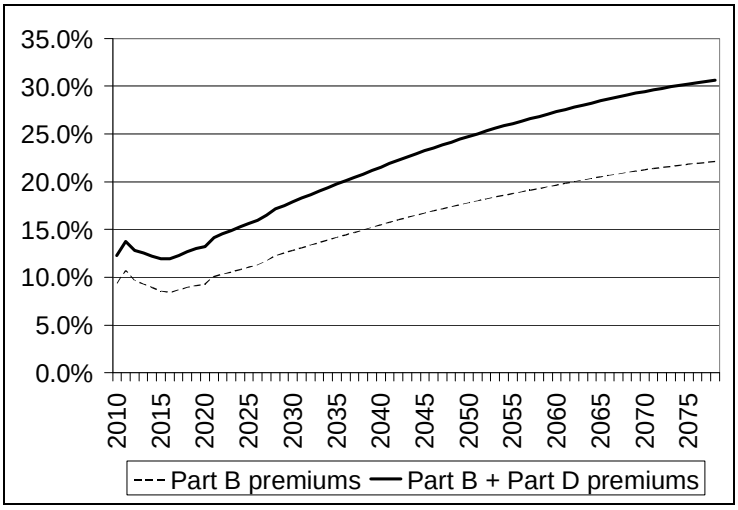
How will drug prices and utilization change? Changes in drug prices and utilization could have a significant impact on Part D premiums. If generic drugs become increasingly available or more widely used, premiums could be lower than expected. Alternatively, pharmaceutical breakthroughs or increased use of expensive prescriptions could lead to higher premiums.

How many prescription drug plans will compete for beneficiaries? In the first several years of implementation, a greater-than-expected number of plans offered Part D benefits. If a large number of plans continue to offer Part D benefits, competition to attract beneficiaries could drive down premiums. Alternatively, some analysts believe that the fierce competition for beneficiaries will force some plans out of Part D in future years, reducing competition and leading to higher premiums.

Figure 5 shows the proportion of the average Social Security benefit that would be needed to pay standard Part B premiums from 2010 to 2078, for new enrollees to Social Security and Medicare in each of these years. It also shows the proportion of the average Social Security benefit that would be needed to pay the combined standard Part B and average premium for standard Part D coverage. The graph is based on the trustees' intermediate projections. Each year in the graph shows the projected percentage of average Social Security benefits that would be needed to pay Medicare premiums *for a person who turned 65 and retired in January of that year*. In interpreting **Figure 5**, it is important to note that Part D premiums vary widely by plan, and that Part D premiums may be deducted from beneficiaries' Social Security checks or be paid directly to the plan.

The estimates in **Figure 5** show the proportion of *initial* Social Security benefits needed to pay Medicare premiums for a series of different cohorts retiring in each year from 2010 to 2078. As noted above, the initial Social Security benefits received by new enrollees generally rise in line with wage growth, so that cohorts retiring in successive years will each receive somewhat higher initial benefits than the previous cohorts. After the initial year of benefits, a retiree's Social Security benefits are indexed to inflation using the COLA, so that for a single cohort retiring in a given year, all future benefits rise with inflation. Thus, **Figure 5** below represents the initial benefits of different cohorts retiring in successive years, whereas **Figure 3** represented a single cohort for whom the Part B premium was deducted each year from the COLA-indexed benefit. On average, Medicare premiums have grown faster than both wages and prices and are projected to do so in the future.

Figure 5. Percentage of Average Initial Social Security Benefits Deducted for Standard Medicare Part B and Part D Premiums, 2010-2078



Source: *2009 Medicare Trustees Report*, Figure III.C1.

Note: Part B premiums are *not* expected to decrease as a proportion of Social Security benefits, as they are shown to do in the early years of **Figure 5**. **Figure 5** is based on the trustees' projections; the trustees acknowledge that their short-run projections of Part B costs are "unrealistically reduced" due to the assumption that physician payments will be cut (*2009 Medicare Trustees Report*, p. 31). **Figure 5** shows different cohorts of hypothetical workers *each year* in the first year of their retirements.

Beneficiaries are projected to need a much larger fraction of their Social Security benefits to pay Part B premiums in the future. For example, in 2011 it is projected that the Part B premium will absorb 11% of the average initial Social Security benefit in the first year of retirement, and the combined Parts B and D premiums will absorb 14% of the average initial benefit. In 2078 premiums are projected to absorb more than twice that share, with 22% going to pay the Part B premium in the first year of retirement, and 31% of the average initial benefit in the first year of retirement going to pay combined Parts B and D premiums. In the future, as in the past, low earners will need a greater fraction of their benefits to pay the Part B premium than will high earners.

Legislation in the 111th Congress

As a result of SSA's announcement that no COLA will be paid in 2010, and if, as projected, there is no Social Security COLA in 2011, then a range of issues may potentially be addressed through legislation. These issues may include the impact of the hold harmless provision on the Part B premiums paid by beneficiaries who are not held harmless, the impact on seniors who will pay higher Part D premiums and higher out-of-pocket medical costs, and other issues. Several bills before the 111th Congress would address one or more of these issues. For more information, please see CRS Report R40561, *The Effect of No Social Security COLA on Medicare Part B Premiums*, by (name redacted) and (name redacted).

Conclusion

Rising Medicare premiums are consuming a growing share of beneficiaries' Social Security benefits. An increasing number of Americans will be affected by this interaction as the number of Social Security and Medicare beneficiaries grows over time. The Social Security trustees project that by 2040, the proportion of Americans aged 65 and older—most of whom are eligible for both Social Security and Medicare—will almost double.[43]

Low-income beneficiaries and those who rely primarily on Social Security may see a decline in their standard of living as their Medicare expenses rise. Premiums for Parts B and D are projected to increase significantly faster than Social Security benefits. As a result, the Part B and Part D premiums are projected to consume a growing share of the annual Social Security COLA, which was designed to maintain beneficiaries' living standards.

Some beneficiaries will be protected from rising Medicare premiums: Medicaid covers premiums for some persons who meet income and asset tests, and the hold harmless provision protects most Social Security beneficiaries against Part B increases (although not Part D increases) that exceed the annual Social Security COLA. Many beneficiaries could struggle to cover their health care expenses, however, including new enrollees who are not covered by the hold harmless provision.[44]

Out-of-pocket costs for Parts B and D are projected to grow at the same rates as premiums, contributing to the growing health care expenses of beneficiaries. Most beneficiaries are likely to have some income apart from their Social Security benefits. However, many of tomorrow's beneficiaries, like today's, are likely to rely mostly on Social Security, especially as traditional pension coverage declines and many Americans save little or nothing for retirement.[45]

Finally, it is important to remember that Social Security beneficiaries gain from their participation in the Medicare program. Medicare provides health care coverage to the vast majority of

[43] *2009 Social Security Trustees Report*, Table V.A2.

[44] For more information on the hold harmless provision and the impact on Part B premiums if there is no Social Security COLA for 2010 and 2011, see CRS Report R40561, *The Effect of No Social Security COLA on Medicare Part B Premiums*, by (name redacted) and Alison Shelton.

[45] CRS Report RL30122, *Pension Sponsorship and Participation: Summary of Recent Trends* and CRS Report RL30922, *Retirement Savings and Household Wealth in 2007*, both by (name redacted).

Americans aged 65 and older and to most disability beneficiaries. Together, Medicare and Medicaid cover a majority of participating Social Security beneficiaries' health care expenses. Although Social Security beneficiaries are affected by rising health care costs, the benefits of participating in Medicare are substantially greater than the costs.

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