



## A SUMMARY OF THE 2011 ANNUAL REPORTS

Social Security and Medicare Boards of Trustees

### 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 2011 Annual Reports.

The financial conditions of the Social Security and Medicare programs remain challenging. Projected long-run program costs for both Medicare and Social Security are not sustainable under currently scheduled financing, and will require legislative modifications if disruptive consequences for beneficiaries and taxpayers are to be avoided.

The long-run financial challenges facing Social Security and Medicare should be addressed soon. If action is taken sooner rather than later, more options and more time will be available to phase in changes so that those affected have adequate time to prepare. Earlier action will also afford elected officials with a greater opportunity to minimize adverse impacts on vulnerable populations, including lower-income workers and those who are already substantially dependent on program benefits.

Both Social Security and Medicare, the two largest federal programs, face substantial cost growth in the upcoming decades due to factors that include population aging as well as the growth in expenditures per beneficiary. Through the mid-2030s, due to the large baby-boom generation entering retirement and lower-birth-rate generations entering employment, population aging is the largest single factor contributing to cost growth in the two programs. Thereafter, the continued rapid growth in health care cost per beneficiary becomes the larger factor.

### Social Security

Social Security expenditures exceeded the program's non-interest income in 2010 for the first time since 1983. The \$49 billion deficit last year (excluding interest income) and \$46 billion projected deficit in 2011 are in large part due to the weakened economy and to downward income adjustments that correct for excess payroll tax revenue credited to the trust funds in earlier years. This deficit is expected to shrink to about \$20 billion for years 2012-2014 as the economy strengthens. After 2014, cash deficits are expected to grow rapidly as the number of beneficiaries continues to grow at a substantially faster rate than the number of covered workers. Through 2022, the annual cash deficits will be made up by redeeming trust fund assets from the General Fund of the Treasury. Because these redemptions will be less than interest earnings, trust fund balances will continue to grow. After 2022, trust fund assets will be redeemed in amounts that exceed interest earnings until trust fund reserves are exhausted in 2036, one year earlier than was projected last year. Thereafter, tax income would be sufficient to pay only about three-quarters of scheduled benefits through 2085.

Under current projections, the annual cost of Social Security benefits expressed as a share of workers' taxable wages will grow rapidly from 11-1/2 percent in 2007, the last pre-recession year, to roughly 17 percent in 2035, and will then dip slightly before commencing a slow upward march after 2050. Costs display a slightly different pattern when expressed as a share of GDP. Program costs equaled roughly 4.2 percent of GDP in 2007, and are projected to increase gradually to 6.2 percent of GDP in 2035 and then decline to about 6.0 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 (OASDI) Trust Funds is 2.22 percent of taxable payroll, up from 1.92 percent projected in last year's report. This deficit amounts to 17 percent of tax receipts, and 14 percent of program outlays.

The 0.30 percentage point increase in the OASDI actuarial deficit and the one-year advance in the exhaustion date for the combined trust funds primarily reflects lower estimates for death rates at advanced ages, a slower economic recovery than was assumed last year, and the one-year advance of the valuation period from 2010-2084 to 2011-2085.

While the combined OASDI program continues to fail the long-range test of close actuarial balance, it does satisfy the conditions for short-range financial adequacy. Combined trust fund assets are projected to exceed one year's projected benefit payments for more than ten years, through to 2035. However, the Disability Insurance (DI) program satisfies neither the long-range nor short-range tests for financial adequacy. DI costs have exceeded non-interest income since 2005 and trust fund exhaustion is projected for 2018; thus changes to improve the financial status of the DI program are needed soon.

### Medicare

Relative to the combined Social Security Trust Funds, the Medicare HI Trust Fund faces a more immediate funding shortfall, though its longer term financial outlook is better under the assumptions employed in this report.

Medicare costs (including both HI and SMI expenditures) are projected to grow substantially from approximately 3.6 percent of GDP in 2010 to 5.5 percent of GDP by 2035, and to increase gradually thereafter to about 6.2 percent of GDP by 2085.

The projected 75-year actuarial deficit in the HI Trust Fund is 0.79 percent of taxable payroll, up from 0.66 percent projected in last year's report. The HI fund fails the test of short-range financial adequacy, as projected assets drop below one year's projected expenditures early in 2011. The fund also continues to fail the long-range test of close actuarial balance. Medicare's HI Trust Fund is expected to pay out more

in hospital benefits and other expenditures than it receives in income in all future years. The projected date of HI Trust Fund exhaustion is 2024, five years earlier than estimated in last year's report, at which time dedicated revenues would be sufficient to pay 90 percent of HI costs. The share of HI expenditures that can be financed with HI dedicated revenues is projected to decline slowly to 75 percent in 2045, and then to rise slowly, reaching 88 percent in 2085. Over 75 years, HI's actuarial imbalance is estimated to be equivalent to 21 percent of tax receipts or 17 percent of program outlays.

The worsening of HI's projected finances is primarily due to lower HI real (inflation-adjusted) non-interest income caused by a slower assumed economic recovery, and by higher HI real costs caused by higher assumed near-term growth in real economy-wide average labor compensation. The resulting increases in HI real deficits are concentrated in the near term, which is why trust fund exhaustion occurs five years earlier than was projected last year despite a relatively modest increase in the 75-year actuarial deficit.

Part B of Supplementary Medical Insurance (SMI), which pays doctors' bills and other outpatient expenses, and Part D, which provides access to prescription drug coverage, 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 and rising health care costs will cause SMI costs to grow rapidly from 1.9 percent of GDP in 2010 to approximately 3.4 percent of GDP in 2035 and approximately 4.1 percent of GDP by 2085. Roughly three-quarters of these costs will be financed from general revenues and about one-quarter from premiums paid by beneficiaries. Small amounts of SMI financing are received from special payments by States and from fees on manufacturers and importers of brand-name prescription drugs.

Projected Medicare costs over 75 years are about 25 percent lower because of provisions in the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (the "Affordable Care Act" or ACA). Most of the ACA-related cost saving is attributable to a reduction in the annual payment updates for most Medicare services (other than physicians' services and drugs) by total economy multifactor productivity growth, which is projected to average 1.1 percent per year. The report notes that the long-term viability of this provision is debatable. In addition, an almost 30-percent reduction in Medicare payment rates for physician services is assumed to be implemented in 2012, notwithstanding experience to the contrary.

The drawdown of Social Security and HI trust fund reserves and the general revenue transfers into SMI will result in mounting pressure on the Federal budget. In fact, pressure is already evident. For the sixth consecutive year, a "Medicare funding warning" is being triggered, signaling that projected non-dedicated sources of revenues -- primarily general revenues -- will soon account for more than 45 percent of Medicare's outlays. That threshold was in fact breached for the first time in fiscal 2010. A Presidential proposal is required by law in response to the latest warning..

### **Conclusion**

Projected long-run program costs for both Medicare and Social Security are not sustainable under currently scheduled financing, and will require legislative corrections if disruptive consequences for beneficiaries and taxpayers are to be avoided.

The financial challenges facing Social Security and Medicare should be addressed soon. If action is taken sooner rather than later, more options and more time will be available to phase in changes so that those affected can adequately prepare.

By the Trustees:

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## A SUMMARY OF THE 2011 ANNUAL SOCIAL SECURITY AND MEDICARE TRUST FUND REPORTS

Projected long-range costs for both Medicare and Social Security are not sustainable under currently scheduled financing and will require legislative corrections if disruptive consequences for beneficiaries and taxpayers are to be avoided. If action is taken sooner rather than later, more options and time will be available to phase in changes, giving those affected adequate time to prepare. Earlier action will also afford policymakers greater opportunity to minimize adverse impacts on vulnerable populations, including lower-income workers and those who are substantially dependent on program benefits.

**What Are the Trust Funds?** Congress established trust funds in the U.S. Treasury to account for Social Security and Medicare income and disbursements. Social Security and Medicare taxes, premiums, and other income are credited to the funds. There are four separate trust funds. For Social Security, the Old-Age and Survivors Insurance (OASI) Trust Fund pays retirement and survivors benefits and the Disability Insurance (DI) Trust Fund pays disability benefits. (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.

Disbursements from the funds can be made only to pay program benefits and 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.

**What Were the Trust Fund Results in 2010?** In December 2010, 43.8 million people received OASI benefits, 10.2 million received DI benefits, and 47.5 million were covered under Medicare. Trust fund operations, in billions of dollars, are shown below (totals may not add due to rounding). The OASI Trust Fund showed a net increase in assets in 2010; DI, HI, and SMI Trust Fund assets declined.

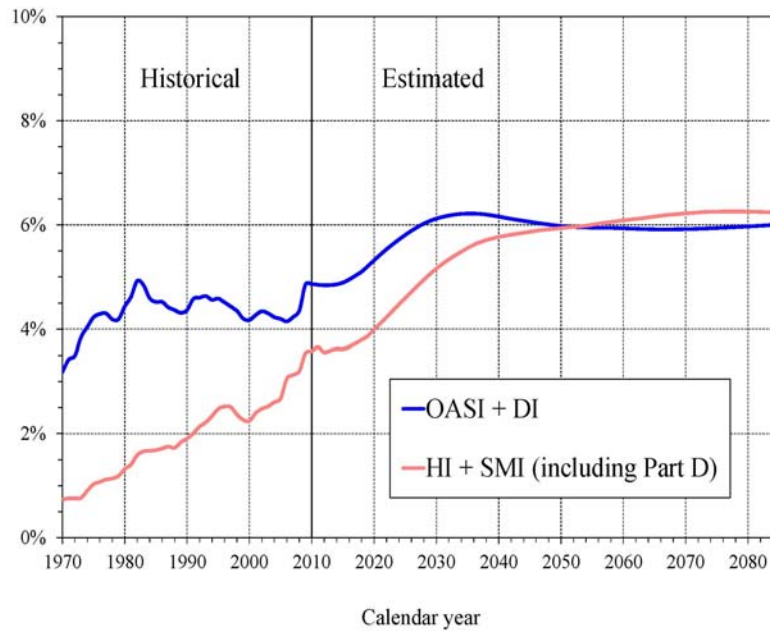
	OASI	DI	HI	SMI
Assets (end of 2009)	\$2,336.8	\$203.5	\$304.2	\$76.6
Income during 2010	677.1	104.0	215.6	270.4
Outgo during 2010	584.9	127.7	247.9	274.9
Net increase in assets	92.2	-23.6	-32.3	-4.5
Assets (end of 2010)	2,429.0	179.9	271.9	72.1

**What Were the Sources of Income to the Trust Funds in 2010?** The following table shows income, by source, to each trust fund in 2010 (totals may not add due to rounding)

Source ( <i>in billions</i> )	OASI	DI	HI	SMI
Payroll taxes	\$544.8	\$92.5	\$182.0	—
General revenues	—	—	0.1	\$204.6
General Fund reimbursements	2.0	0.4	—	—
Interest earnings	108.2	9.3	13.8	3.1
Beneficiary premiums	—	—	3.3	58.4
Taxes on benefits	22.1	1.9	13.8	—
Transfers from States	—	—	—	4.0
Other	<sup>a</sup>	—	2.7	.2
Total	677.1	104.0	215.6	270.4

<sup>a</sup> Less than \$50 million.

**What is the Long-Range (2011-85) 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 A)

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

Costs for both programs increase substantially through 2035 because (1) the number of beneficiaries rises rapidly as the baby-boom generation retires and (2) the lower birth rates that have persisted since the baby boom cause slower growth of both the labor force and GDP. Social Security's projected annual cost increases to about 6.2 percent of GDP in 2035, declines to 6.0 percent by 2050, and remains at about that level through 2085. Under current law, projected Medicare cost increases to 5.6 percent of GDP by 2035, reaching 6.2 percent in 2085, driven in the latter period largely by the rising cost of health care services per beneficiary. These projected costs may well be exceeded because they are based on the assumptions that the deep reductions in physician fees required by the sustainable growth rate system are not waived by legislation and the Affordable Care Act's reduced provider payment updates are sustainable over the long run.

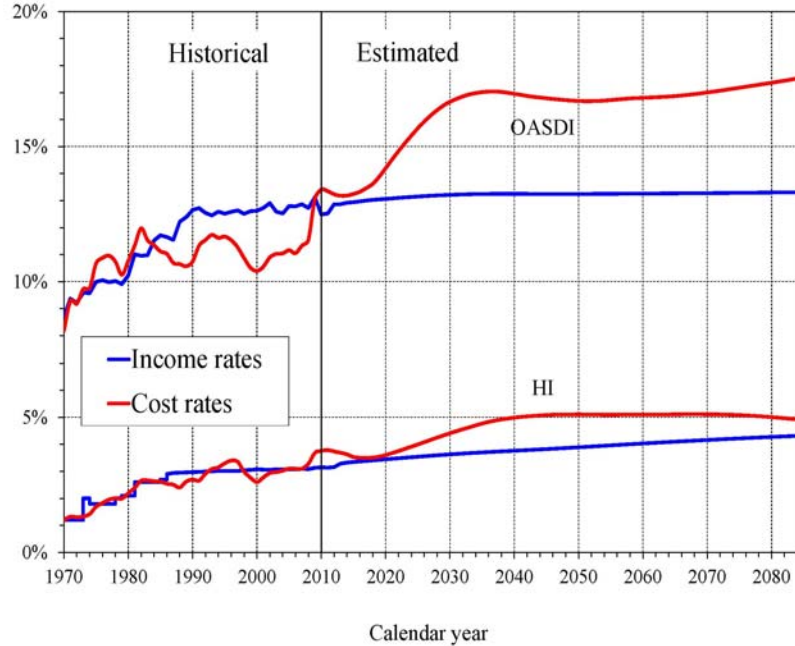
In 2010, the combined cost of the Social Security and Medicare programs equaled 8.4 percent of GDP, and is projected to increase to 11.8 percent of GDP by 2035, reaching 12.2 percent of GDP by 2085. Although Medicare cost (3.6 percent of GDP) was smaller than Social Security cost (4.9 percent of GDP) in 2010, the gap is expected to close gradually, with the costs being very similar after 2050.

The projected costs for OASDI and HI depicted in Chart A and elsewhere in this document reflect the full cost of scheduled current-law benefits without regard to whether the 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 could be payable in years after trust fund exhaustion is lower than shown, as described later in this summary.

**How Will Social Security and Medicare HI Costs Grow in Future Years in Relation to Taxable Earnings?** Because the primary source of income for OASDI and HI is the payroll tax, it is customary to compare the programs' non-interest income and costs expressed as percentages of taxable payroll, the "income rate" and "cost rate" shown in Chart B. Both the OASDI and HI annual cost rates increase over the long run from their 2010 levels (13.40 and 3.76 percent). Projected Social Security costs grow to 17.01 percent of taxable payroll by 2035, decline to 16.69 percent in 2050, and then rise gradually thereafter, reaching 17.56 percent in 2085. Medicare HI costs rise to 5.11 percent of taxable payroll in 2049 and level off thereafter under the intermediate assumptions employed in this report, with an ultimate cost rate of 4.90 in 2085.

The OASDI income rate, estimated at 12.52 percent in 2011, increases little over time, reaching 13.31 in 2085. Payroll tax rates are scheduled to remain unchanged from their 1990 levels (with the exception of temporary reductions in the tax rates for 2010 and 2011 that are offset by reimbursements from the General Fund of the Treasury). Annual income from the other tax source, the taxation of OASDI benefits, will increase gradually relative to taxable payroll as a greater proportion of Social Security benefits is subject to taxation in future years, but will continue to be a relatively small component of program income.

**Chart B—Income and Cost Rates**  
(Percentage of taxable payroll)

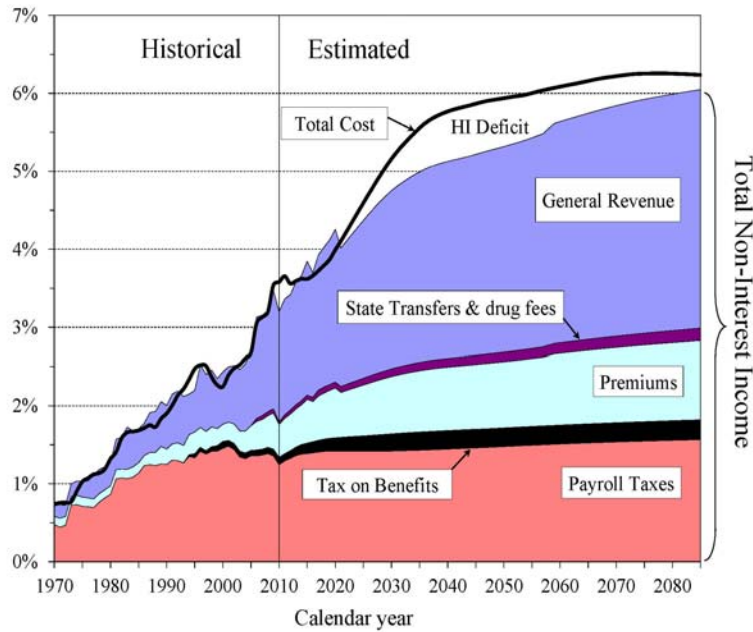


The projected HI income rate rises gradually from 3.14 in 2011 to 4.32 in 2085 due to the Affordable Care Act's increase in payroll tax rates for high earners starting in 2013. Individual tax return filers with earnings above \$200,000, and joint return filers with earnings above \$250,000, will pay an additional 0.9 percent tax on earnings above these earnings thresholds. An increasing fraction of earnings will be subject to the higher tax rate over time because the thresholds are not indexed.

**How Do the Sources of Medicare Financing Change as Costs Grow?** As Medicare costs grow over time, general revenue and beneficiary premiums will play an increasing role in financing the program. Chart C shows current-law 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 A and shows Medicare cost rising to 6.2 percent of GDP by 2085.

Projected revenue from payroll taxes and taxes on OASDI benefits credited to the HI Trust Fund increases from 1.4 percent of GDP in 2011 to 1.8 percent in 2085 under current law, while projected general revenue transfers to the SMI Trust Fund increase from 1.5 percent of GDP in 2011 to 3.1 percent in 2085, and beneficiary premiums increase from 0.5 to 1.0 percent of GDP. The share of total non-interest Medicare income from taxes would fall substantially (from 41 percent to 30 percent) while general revenue transfers would rise (from 44 to 51 percent), as would premiums (from 13 percent to 17 percent). The distribution of financing changes because Part B and D costs increase at a faster rate than Part A cost, while Part B and D financing keeps pace with cost growth and Part A financing does not. By 2085, the Medicare SMI program will require general revenue transfers equal to 3.1 percent of GDP. Moreover, the HI deficit represents a further 0.2 percent of GDP in 2085 and there is no current-law provision to finance this deficit through general revenue transfers or any other revenue source.

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



The Medicare Modernization Act (2003) requires that the Board of Trustees determine each year whether the annual difference between program outlays and dedicated revenues (the bottom four layers of Chart C) exceeds 45 percent of total Medicare outlays in any of the first seven fiscal years of the 75-year projection period. In effect, the law sets a threshold condition that signals that 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 submit proposed legislation within 15 days of the next budget submission to respond to the warning and requires Congress to consider the proposal on an expedited basis.

This year's report projects the difference between outlays and dedicated financing revenues to exceed 45 percent of total Medicare outlays during fiscal year 2011, prompting a determination of "excess general revenue Medicare funding" for the sixth consecutive report, triggering another "Medicare funding warning."

**What Are Key Dates in Long-Range OASI, DI, and HI Financing?** For HI, non-interest income fell short of expenditures in 2010, as it has since 2008, and the HI fund used interest income (\$14 billion) and assets (\$32 billion) to help finance expenditures. This report anticipates a \$34 billion deficit for 2011 due to lower estimated HI tax revenues and continued HI expenditure growth, followed by a period of declining deficits (2012-18) as the growth in taxable earnings accelerates. Because the annual HI deficits in this year's report are higher than estimated in 2010, the projected drawdown of HI Trust Fund assets is accelerated until the trust fund is exhausted in 2024 (five years earlier compared to last year's report), after which tax income would be sufficient to pay 90 percent of HI costs, declining to 76 percent in 2050, and then increasing to 88 percent by 2085.

In 2011, OASDI annual cost will exceed the sum of tax income plus General Fund reimbursements (for payroll tax revenue forgone under Public Laws 111-147 and 111-312) by an estimated \$46 billion, the second consecutive year in which non-interest income has fallen short of cost. Nevertheless, the combined trust funds will continue to grow because projected interest earnings of \$115 billion substantially exceed the non-interest income deficit. The report indicates that annual OASDI income, including payments of interest to the trust funds from the General Fund, will exceed annual cost every year until 2023, increasing the nominal value of combined OASDI trust fund assets. Beginning in 2023, net redemptions of trust fund assets with General Fund payments will be required until assets are exhausted in 2036. After trust fund exhaustion, continuing tax income would be sufficient to pay 77 percent of scheduled benefits in 2036 and 74 percent in 2085. When the programs are considered separately, the projected exhaustion date for the OASI Trust Fund is 2038, while that for the DI Trust Fund is 2018. Payment of full DI benefits beyond 2018 will require legislation to address the financial imbalance, such as a reallocation of the OASDI payroll tax rate between OASI and DI.

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>	2017	2005	2010	2008
First year outgo exceeds income including interest <sup>a</sup>	2025	2009	2023	2008
Year trust funds are exhausted	2038	2018	2036	2024

<sup>a</sup> Dates indicate the first year that a condition is projected to occur and to persist annually thereafter through 2085.

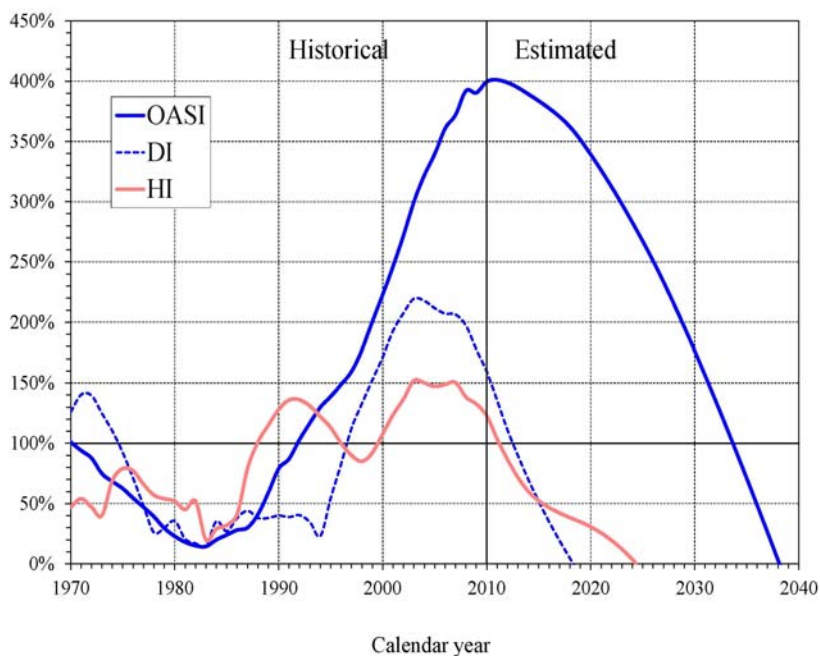
**What is the Outlook for Short-Term Trust Fund Adequacy?** The reports measure the short-range adequacy of the OASI, DI, and HI Trust Funds by comparing fund assets to projected costs for the ensuing year (the "trust fund ratio"). A trust fund ratio of 100 percent or more -- that is, assets at least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

By this measure, the OASI Trust Fund is financially adequate throughout the 2011-20 period, but the DI Trust Fund fails the short-range test because its projected trust fund ratio falls to 90 percent by the beginning of 2013, followed by exhaustion of assets in 2018. Furthermore, despite the increasing nominal value of the OASI and combined OASDI trust funds throughout the short-range period, both the OASI and DI trust fund ratios -- indicators of the duration of continuing benefit payments that the trust funds could finance out of current assets -- will continue to decline from 2011 forward.

The HI Trust Fund also does not meet the short-range test of financial adequacy; its projected trust fund ratio falls to 86 percent by the beginning of 2012. Projected HI Trust Fund assets are fully depleted in 2024. Chart D shows the trust fund ratios through 2040 under the intermediate assumptions.

A less stringent annual "contingency reserve" test is applied to SMI Part B assets since the overwhelming portion of the financing for that account consists of beneficiary premiums and general revenue contributions that are set each year to meet expected costs. Part D 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 improbably low for 2012 and beyond because the projections assume that current law, which substantially reduces physician payments per service under the sustainable growth rate system, will not be changed. The estimated physician fee reduction for 2012 is 29 percent. A reduction in fees of this magnitude is highly unlikely; Congress has acted to prevent smaller reductions in every year since 2003. Underestimated payments to physicians would affect projected costs for Part B, total SMI, and total Medicare.

**Chart D—OASI, DI, and HI Trust Fund Ratios**  
(Assets as a percentage of annual cost)



A "hold-harmless" provision in the law, applicable to most Part B enrollees, limits the premium increase to the dollar amount of the beneficiary's Social Security COLA increase. Thus, zero COLAs for December 2009 and December 2010 prevented premiums for most Part B enrollees from increasing in 2010 and 2011 beyond the 2009 premium amount of \$96.40, while a higher standard premium was paid by or paid on behalf of some beneficiaries for whom the "hold harmless" did not apply. This year's report projects a small COLA for December 2011, which will again result in some enrollees paying less than the standard premium in 2012.

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 since program income is set each year to meet the following year's projected cost.

**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
2011	\$701	\$107	\$229	\$234	\$67	\$606	\$133	\$263	\$228	\$67	\$95	(\$26)	(\$34)
2012	753	114	244	242	76	633	139	275	221	76	120	-25	-32
2013	796	119	262	272	85	670	144	288	234	85	126	-25	-25
2014	846	124	281	295	91	712	149	301	252	91	134	-25	-20
2015	894	130	297	338	100	757	154	308	268	100	136	-24	-11
2016	943	136	314	319	110	806	159	322	284	110	138	-24	-8
2017	994	141	331	370	120	858	165	337	303	120	136	-24	-6
2018	1,049	a	350	403	131	915	172	355	324	131	133	a	-6
2019	1,102	a	367	440	142	981	179	375	347	142	121	a	-8
2020	1,155	a	385	486	157	1,053	188	399	376	157	102	a	-14



