



# JOINT ECONOMIC COMMITTEE DEMOCRATS



REPRESENTATIVE PETE STARK (D-CA) – SENIOR DEMOCRAT

ECONOMIC POLICY BRIEF

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## RISING MEDICARE PREMIUMS UNDERMINE THE SOCIAL SECURITY COLA *NEW MEDICARE LAW COULD CUT BENEFITS FOR SOME*

Unlike most private pensions and other forms of retirement annuity income, Social Security benefits include an annual cost-of-living adjustment (COLA) that is designed to prevent an erosion of benefits due to inflation. Unfortunately, rising health care costs and last year's Medicare law threaten this valuable cost-of-living protection.

### Background

In 1975 Congress replaced ad hoc increases in Social Security benefits with an automatic COLA based on the previous year's change in the consumer price index (CPI). The CPI is an index of prices paid by the typical consumer for a representative bundle of goods and services. The goal of the COLA is to ensure that Social Security benefits keep pace with increases in the price of food, clothing, and other necessities—including medical care—so that seniors and other beneficiaries can maintain a stable quality-of-life.

Participants in Medicare Part B, which covers doctors' services, pay a monthly premium that is deducted from their Social Security check. So too will most participants in Medicare Part D, the new prescription drug program. The size of the premiums is based on projected costs for those respective programs. During periods of rapidly rising health care costs, increases in Medicare premiums can represent a significant fraction of the overall Social Security COLA for many Social Security beneficiaries. With the latest Medicare

changes, some may even see their benefits cut as their premium increases outpace their COLAs.

Current law puts a limit on the extent to which growth in Medicare Part B premiums can erode the purchasing power of an individual's Social Security benefit. The "hold harmless" provision guarantees that the increase in a person's Part B premium will not be larger than that person's COLA. This ensures that the dollar amount of the benefit received after deducting the Part B premium will never be reduced, but it does not guarantee that the purchasing power of that benefit will not fall. In fact, the entire COLA could be consumed. The latest Medicare legislation does not apply even this "hold harmless" protection to the Part D prescription drug premium. Thus, seniors are exposed to the possibility that large increases in medical costs, especially unchecked prescription drug costs, could eat up a large piece of their Social Security COLA and even cut their Social Security benefit.

### Recent Experience with COLAs and Medicare Part B Premium Increases

During the past three years, rapidly rising health expenditures have been accompanied by large increases in Medicare premiums. Based on current projections, the cumulative increase in the monthly Part B Medicare premium during the four years of the Bush Administration will be at least \$26, nearly twice as much as the total increase of \$13.40 over the entire eight years of the Clinton Administration. At the same

time that Medicare premiums have been rising rapidly, inflation has been very low. As a result, Social Security COLAs have been relatively modest, and many beneficiaries have seen a substantial portion of their COLA consumed by the increases in Medicare premiums.

In 2004, for example, Social Security beneficiaries received a COLA of 2.1 percent (\$2.10 for each \$100 of monthly benefit). At the same time, the monthly premium for Medicare Part B increased from \$58.70 to \$66.60, an increase of \$7.90 or 13.5 percent. **Table 1** shows what part of the COLA was consumed by the increase in the Part B premium for individuals receiving different levels of monthly benefit.

Table 1

**Impact of Medicare Premium Increases on Social Security COLAs, 2004**

Monthly Social Security benefit in 2004 (dollars)	2004 Social Security COLA (dollars)	COLA after deducting increase in medicare premiums (dollars)	Fraction of COLA absorbed by Medicare premium increases (percent)
384	7.90	0.00	100
500	10.28	2.38	77
750	15.43	7.53	51
1,000	20.57	12.67	38
1,250	25.71	17.81	31
1,500	30.85	22.95	26

Source: JEC Democratic staff, based on Congressional Budget Office projections.

Individuals with 2004 monthly Social Security benefits of less than \$384 received a COLA in 2004 that was less than the increase in Medicare premiums. Because of the “hold harmless” provision, their premium increase was limited to the amount of their COLA. Still, for these individuals (an estimated 1.4 million people), their entire Social Security COLA was wiped out, leaving them nothing to pay for increases in all other goods and services they consume.

Individuals with a monthly benefit of \$1,000 (roughly the average benefit of retired men) had to devote nearly 40 percent of their COLA to the increase in their Medicare premium. Those with a monthly benefit of \$750 (roughly the average benefit of retired women) needed half their COLA to cover the increase in Medicare premiums. And those with a monthly benefit of \$500 (roughly the average benefit of wives of retired workers) needed more than three-quarters of their COLA to pay for the increase in their Medicare premium.

**The Impact of Part D Prescription Drug Premiums**

Current forecasts indicate that the Medicare Part B premium increase in 2005 will be the largest dollar amount ever.<sup>1</sup> As a result, seniors can expect another year like 2004, when increases in Medicare premiums will absorb a large percentage of their COLA. CBO’s current projections call for the rate of increase in Medicare premiums to abate after 2005, but those projections do not reflect possible legislative changes that would increase physician payments, resulting in higher premiums. Furthermore, beginning in 2006, seniors participating in the Part D prescription drug program will have an additional Medicare premium for that program deducted from their Social Security check.

Using CBO’s projections of the Social Security COLA and Medicare premium costs, the Joint Economic Committee Democratic staff has estimated the portion of the COLA that will be absorbed by increases in Medicare premiums in coming years. For a person with a monthly benefit of \$500 (in 2004 dollars), the annual increase in combined Part B and Part D premiums will absorb almost three-fifths of the annual COLA, on average, during the 2007-2010 period. Medicare premiums will absorb over two-thirds of the COLA in the 2011-2014 period. Increases in Medicare premiums will absorb a lesser but still significant fraction of the COLA for individuals with larger monthly benefits (**Table 2**). Because there is no “hold harmless” protection, up to 2 percent of beneficiaries could experience benefit cuts.

Table 2

**Average Impact of Medicare Premium Increases on Social Security COLAs, 2007-2010 and 2011-2014**

Monthly Social Security benefit (2004 dollars)	Average fraction of COLA absorbed by Medicare Part B and Part D premium increases (percent)	
	2007-2010	2011-2014
500	59	69
1,000	24	34
1,500	16	23

Source: JEC Democratic staff, based on Congressional Budget Office projections.

Although the rising cost of Medicare Part B and Part D premiums can absorb a very large fraction of the annual Social Security COLA for those with modest benefit checks, the problem is not confined to them. CBO estimates that in 2007, the first year that increases in Part D premiums will have an impact, 6.9 million people, or nearly 25 percent of those who have Medicare premiums withheld from their Social Security benefit will see at least one-quarter of their COLA

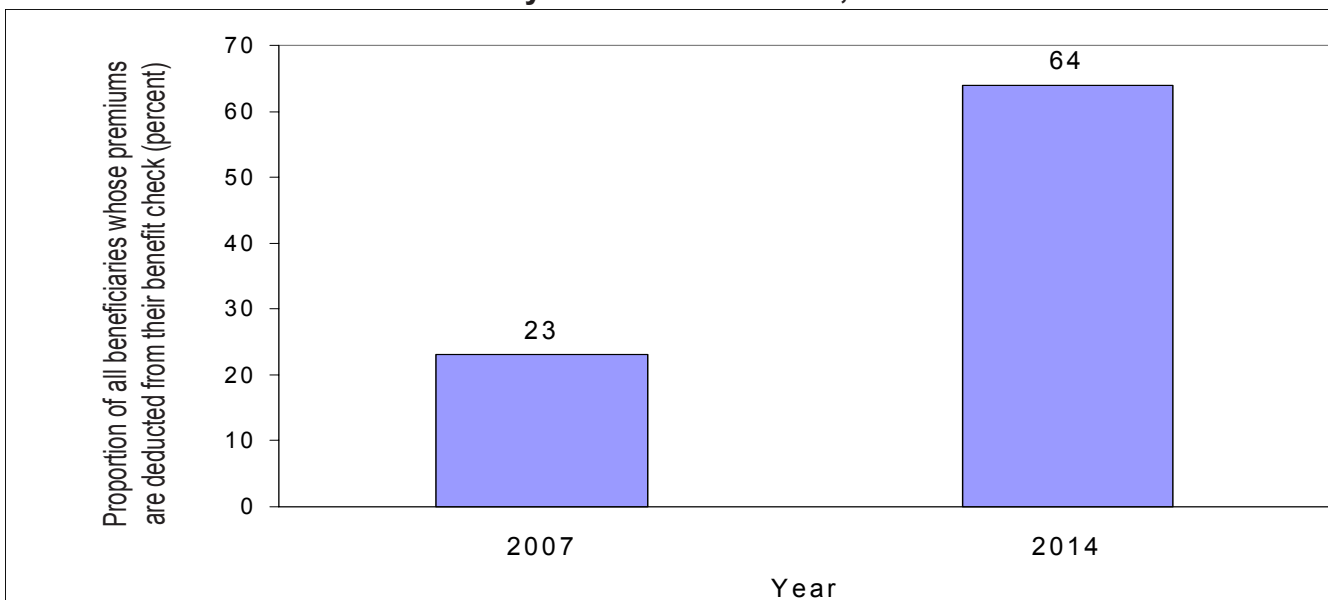
absorbed by increases in combined Part B and Part D premiums. By 2014, 64 percent of beneficiaries, or 22.2 million people, will lose at least 25 percent of their COLA to increases in their Medicare premium (Chart 1).

**Conclusion**

For Social Security beneficiaries, the annual COLA is an important protection against rising prices eroding the real purchasing power of their benefit. In the past three years, however, rapidly rising health care costs have undermined this protection by driving up Medicare Part B premiums, which are automatically deducted from participants' monthly Social Security check. For many participants, the increase in Medicare premiums has absorbed a large fraction of their annual COLA, leaving little to deal with the rising costs of all the other goods and services the COLA is meant to cover. That problem will be aggravated when the new premiums for Part D prescription drug coverage take effect, unless policymakers take action to address this gutting of Social Security COLA protection.

Chart 1

**Fraction of Social Security Beneficiaries Whose Medicare Premium Increases Will Reduce Their COLA by at Least 25 Percent, 2007 and 2014**



Source: Congressional Budget Office.

## Endnote

1. If past practice is followed, the Social Security COLA percentage increase and the increase for Medicare premiums will be announced in mid-October. The calculations used in this paper assume an increase in the 2005 monthly Part B premium of \$9.50. That is higher than the current CBO baseline estimate of \$8.70, but the JEC Democratic staff believes that CBO's estimate will increase when it updates its baseline in August. The Medicare actuaries are currently predicting an even higher increase of \$11.50 in the monthly premium.