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INSIGHTS

DECLINING SOCIAL SECURITY & MEDICARE BENEFITS

Each year the Trustees of the Social Security and Medicare trust funds report on the current and projected financial status of the two programs.
A quick refresher on the funds:

Congress established trust funds managed by the Secretary of the Treasury to account for Social Security and Medicare income and disbursements. There are four separate trust funds:

- For Social Security, the Old-Age and Survivors Insurance (OASI) Trust Fund pays retirement and survivors benefits.
- The Disability Insurance (DI) Trust Fund pays disability benefits.
- For Medicare, the Hospital Insurance (HI) Trust Fund pays for Part A inpatient hospital and related care.
- The Supplemental Medical Insurance (SMI) Trust Fund comprises two separate accounts: Part B, which pays for physician and outpatient services, and Part D, which covers prescription drug benefits.

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

How Are Social Security and Medicare Financed?

- For OASDI and HI, the major source of financing is payroll taxes on earnings paid by employees and their employers. Self-employed workers pay the equivalent of the combined employer and employee tax rates. During 2020, an estimated 174.8 million people had earnings covered by Social Security and paid payroll taxes. For Medicare the corresponding figure was 178.9 million.
- Current law establishes payroll tax rates for OASDI, which apply to earnings up to an annual maximum ($142,800 in 2021) that ordinarily increases with the growth in the nationwide average wage. In contrast to OASDI, covered workers pay HI taxes on total earnings.
    - o There is 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.
- Taxation of Social Security benefits is another source of income for the Social Security and Med care trust funds. Beneficiaries with incomes above $25,000 for individuals (or $32,000 for married couples filing jointly) pay income taxes on up to 50 percent of their benefits, with the revenues going to the OASDI trust funds.
- The trust funds also receive income from interest on their accumulated reserves, which are invested in U.S. Government securities.

The key findings of the report are summarized as:

- The OASI Trust Fund, which pays retirement and survivors benefits, will be able to pay scheduled benefits on a timely basis ***until 2033***, one year earlier than reported last year. ***At that time, the fund's***

continued on page 2

reserves will become depleted and continuing tax income will be sufficient to pay 76 percent of scheduled benefits.

- The DI Trust Fund, which pays disability benefits, will be able to pay scheduled benefits ***until 2057***, 8 years earlier than in last year's report. ***At that time, the fund's reserves will become depleted and*** c***ontinuing tax income will be sufficient to pay 91 percent of scheduled benefits.***
- The HI Trust Fund, or Medicare Part A, which helps pay for services such as inpatient hospital care, will be able to pay scheduled benefits ***until 2026***, the same year as reported last year. ***At that time, the fund's reserves will become depleted and continuing total program income will be sufficient to pay 91 percent of total scheduled benefits.***
- The SMI Trust Fund has two accounts: Part B, which helps pay for services such as physician and outpatient hospital care, and Part D, which covers prescription drug benefits. SMI is adequately financed into the indefinite future because current law provides financing from general revenues and beneficiary premiums each year to meet the next year's expected costs. ***Due to these funding provisions and the rapid growth of its costs, SMI will place steadily increasing demands on both taxpayers and beneficiaries.***

The system's expenditures have been above its income for some time – with the difference being taken out of the asset fund and the interest it creates - but the gap has been widening over the years. While in the early 1980s, summarized OASHI costs only exceeded incomes by around 15 percent, that gap grew to almost 26 percent in 2021.

As Baby Boomers retire and Americans are having fewer children, the balance between those who are working and funding social security and those who are receiving old age, survivor or disability benefits continues to tip. In fact, 2021 marked the first year when interest earned on the fund could no longer bridge social security's spending gap, sending the asset reserve into a downward spiral.

Because Social Security services are funded by the payroll tax on a pay-as-you-go basis, the income-cost gap equals the amount the administration would no longer be able to pay out if the fund would in fact be depleted. In order to stop funds from running low, Congress would have to act to provide additional revenue to Social Security, for example by raising the dedicated payroll tax, to lower its cost by cutting benefits or attempt a combination of both.

Congress has until 2026 (for Medicare – 2034 for Social Security) to figure out how to pay for the four programs without adding more to the already eye-watering $28.3 trillion debt burden. As mentioned above, it seems the most likely option will be hiking payroll taxes, reducing benefits, or a combination of both.
It has become more important than ever that Americans save and invest in order to make up the ever-declining shortfall in future Social Security and Medicare benefits.

Matt Jones, JD, CFP
President

LEGACY CAPITAL

David Trent
Managing Principal