THE HENRY J. KAISER FAMILY FOUNDATION

MEDICARE

ISSUE BRIEF

May 2009

The Social Security COLA and Medicare Part B Premium: Questions, Answers, and Issues

For the first time, Social Security recipients are expected to receive a zero percent cost-of-living adjustment (COLA) in 2010, with projections of no or low COLAs through 2012.[1] The absence of a COLA will have direct financial implications for more than 50 million Social Security recipients, many of whom live on fixed incomes and rely on Social Security as their primary source of income.[2] The absence of a COLA in the coming years will also affect the amount of the Medicare Part B premium paid by roughly a quarter of all Medicare beneficiaries, with a particularly steep increase anticipated between 2010 and 2011. These premiums are paid by, or on behalf of, beneficiaries who are enrolled in the Supplementary Medical Insurance part of the Medicare program (Part B), which covers outpatient services, including physician visits. This policy brief explains the relationship between the Social Security COLA and the Medicare Part B premium, and the implications for those who are covered by both programs, based on the most recent projections of the Medicare and Social Security Trustees.

1. Why will Social Security recipients not receive a cost-of-living benefit increase in 2010?

Social Security recipients generally receive an annual cost-of-living increase that reflects higher costs associated with inflation. For 2009, Social Security recipients received a 5.8 percent COLA, the largest increase in more than 25 years (see Appendix). The COLA is based on the change in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) between the third quarter (July-September) of the previous year and the third quarter of the current year.[3] The COLA for 2010 will be based on the change in the CPI-W between the third quarters of 2008 and 2009 – a period marked by a dramatic drop in prices at the end of 2008. The Social Security and Medicare Trustees project a zero percent COLA for 2010 and 2011, and a 1.4 percent COLA for 2012, resulting in no increase in monthly Social Security benefit payments until 2012.

2. How does the Social Security COLA affect Medicare Part B premiums, and what is the "hold-harmless" provision?

Typically, the Social Security COLA has no bearing on the amount of the Medicare Part B premium that most beneficiaries pay – but 2010 is not shaping up to be a typical year. Historically, Social Security payments have increased annually by a COLA, just as Medicare Part B premiums have increased almost every year to keep pace with the growth in Medicare Part B expenditures, with beneficiary premiums covering 25 percent of program expenditures.[4] For most beneficiaries, the dollar amount of the monthly Social Security COLA increase each year has been more than enough to offset the dollar amount of the increase in the monthly Part B premium, resulting in net increases in Social Security benefits from year to year **(see Example #1)**.

Example #1: The Interaction Between COLAs and Medicare Part B Premiums in a Typical Year

John received a $1,053.70 Social Security payment in 2007. After a 2.3 percent COLA, his Social Security payment increased by $24.24 per month in 2008. Meanwhile, the monthly Medicare Part B premium increased from $93.50 in 2007 to $96.40 in 2008. Because the Medicare Part B premium increase of $2.90 was more than offset by the $24.24 increase in John's monthly Social Security payment, his net Social Security benefit increased by $21.30 per month in 2008.

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[1] The 2009 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Trust Funds.

[2] The COLA also determines the percentage increases in Supplemental Security Income (SSI), veterans' pensions, and railroad retirement benefits.

[3] The CPI-W is produced by the U.S. Department of Labor, Bureau of Labor Statistics.

[4] Most Social Security recipients opt to have the Medicare Part B premium deducted from their monthly benefit payment.

Under current law, a so-called "hold-harmless" provision prevents Social Security payments from decreasing from one year to the next as a result of Part B premium increases.[5] This provision, originally intended to help those with relatively modest incomes, prevents a reduction in Social Security payments that would otherwise occur for an individual if the monthly Part B premium increase is larger than their monthly Social Security cost-of-living increase **(see Example #2)**.

> **Example #2: How The Hold-Harmless Provision Works**
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> Helen, age 70, received a monthly Social Security benefit payment of $349 in 2004. Between 2004 and 2005, her Social Security payment increased by 2.7 percent ($9.42 per month). That year, however, Medicare Part B monthly premiums increased by $11.60 – more than the amount of her monthly COLA increase. The hold-harmless provision protected Helen from a reduction in her monthly Social Security payment that would otherwise have occurred in 2005 due to an increase in the monthly Medicare Part B premium.

With no cost-of-living increase projected for Social Security recipients for 2010 and 2011, the hold-harmless provision will prevent the majority of Medicare beneficiaries from paying the increase in Part B premiums, despite projected increases in Part B expenditures.[6]

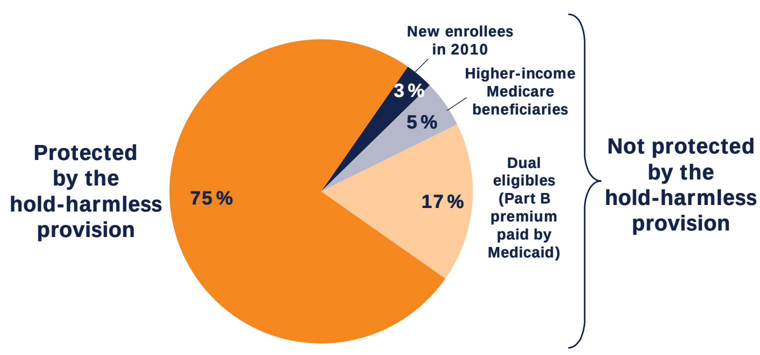
3. Which Medicare beneficiaries are not protected by the hold-harmless provision?

The majority of Medicare beneficiaries – roughly 75 percent – are protected by the hold-harmless provision, but about 25 percent are not **(Exhibit 1)**. Under current law, Part B premium increases will be paid by or on behalf of the following:

- Low-income individuals who are eligible for both Medicare and Medicaid (the "dual eligibles"), whose Social Security payments will not be directly affected by the Part B premium increase because Medicaid (funded jointly by States and the Federal government) pays the monthly Part B premium rather than the individuals themselves (about 17 percent of all Medicare beneficiaries); thus, Medicaid will pay the higher Part B premium on behalf of dual eligibles.
- Higher-income Medicare beneficiaries, with a modified adjusted gross income greater than $85,000 for individuals and $170,000 for couples in 2009, who are required to pay an income-related surcharge in addition to the monthly Part B premium amount (about 5 percent of all Medicare beneficiaries).
- New enrollees whose Social Security payments could not decline from one year to the next because they did not receive Social Security payments and/or were not covered under Part B in the previous year. More than 2 million people are new Medicare Part B enrollees[7], most but not all of whom would be expected to pay the higher premiums because they are neither protected by the hold-harmless provision, nor covered by Medicaid.

EXHIBIT 1

Distribution of Medicare Beneficiaries Who Are/Are Not Protected by the Hold-Harmless Provision in 2010



Source: 2009 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds.

[5] See Section 1839 (f) of the Social Security Act.
[6] Part B expenditures are projected to increase from $202.6 billion in 2009 to $217.7 in 2010, assuming that Congress acts as it has in previous years to prevent a scheduled reduction in physician payment rates from taking effect in 2010.
[7] Estimate provided by the Centers for Medicare & Medicaid Services, personal communication. May 20, 2009.

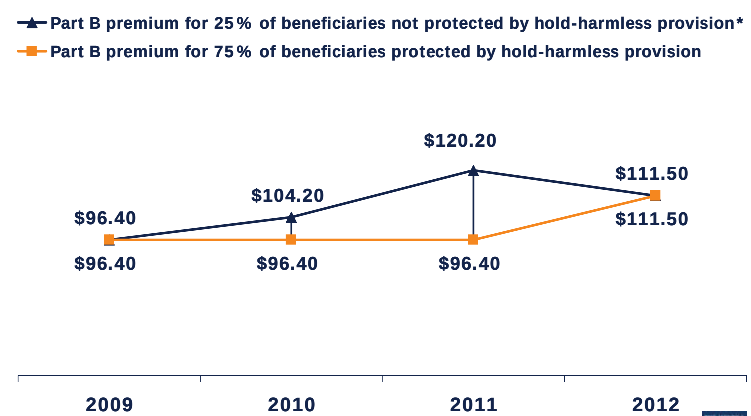
4. How much will the Medicare Part B premium increase for those who are not protected by the hold-harmless provision?

Under projections of zero COLAs for 2010 and 2011 that protect three-fourths of beneficiaries from paying higher Part B premiums than they paid in 2009, premiums will be higher than they would be otherwise for the one-fourth of beneficiaries who are not protected by the hold-harmless provision.[8] According to the Medicare Trustees, Medicare Part B premiums for those not protected by the hold-harmless provision will increase from $96.40 per month in 2009 to $104.20 per month in 2010 and $120.20 per month in 2011, under current law **(Exhibit 2)**.[9] The Part B premium increase is higher than it would otherwise be because the costs are spread across a smaller share of beneficiaries, rather than across the entire Medicare population. If the beneficiaries' 25 percent share of Part B costs were spread across all beneficiaries, rather than just one-fourth of Part B enrollees, the premium would not rise as rapidly between 2009 and 2011.

The majority of beneficiaries who *are* protected by the hold-harmless provision will continue to pay Part B premiums of $96.40 per month until 2012, the year in which Social Security recipients are again projected to receive a cost-of-living increase in their monthly benefit payments. At that point, the increase in Part B expenditures can be spread across most, if not all, Part B enrollees, which is projected to result in a monthly Part B premium of $111.50 in 2012.

EXHIBIT 2

Monthly Medicare Part B Premiums for Beneficiaries Who Are/Are Not Protected by the Hold-Harmless Provision



Note: Although current law requires a 21.5 percent cut in physician payments under Part B, the Trustees' Part B premium projections under current law assume a margin that takes into account the likelihood that physician payments will not be reduced for 2010-2012.
Source: 2009 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds.

By establishing different levels of Part B premium payments, the interaction between the COLA, the Part B premium and the hold-harmless provision has the potential to cause confusion among Medicare beneficiaries during the next few years **(see Example #3)**.

Example #3: Inequities for "Notch" Boomers

Bob turned 66 in 2009. He retired, started to collect Social Security payments, and enrolled in Medicare Part B. Bob elected to have his Part B premium deducted from his Social Security payment. Bob receives a monthly benefit payment of $1,200, after having $96.40 deducted for the Medicare Part B premium. Although the Medicare Part B premium is scheduled to increase in 2010 and 2011, Bob will not pay a higher premium if he does not receive a COLA in either year, due to the hold-harmless provision. Bob will continue to pay $96.40 per month for Part B in 2010 and 2011.

Mary, Bob's younger wife, will turn 66 in January 2011 and will retire that year. Mary will begin to collect Social Security, enroll in Part B, and pay the projected current law Medicare Part B premium of $120.20 per month in 2011. She will pay $23.80 more per month in Medicare Part B premiums than her husband for the same set of benefits because she is not protected by the hold-harmless provision.

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[8] Individuals enrolled in Medicare Advantage plans are generally subject to the same Part B premiums as all other beneficiaries. Higher-income beneficiaries who enroll in Medicare Advantage plans are still required to pay the income-related premium, and lower-income dual eligibles in Medicare Advantage plans are entitled to have their Part B premiums paid by Medicaid. Medicare Advantage plans are permitted to use rebate dollars to buy down the amount of enrollees' Part B premium, but most do not do so.
[9] 2009 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds.

5. Even with the hold-harmless provision, is it possible that some Medicare beneficiaries will see a reduction in their Social Security payments in 2010?

The hold-harmless provision does not apply to *Part D* premiums for the voluntary Medicare prescription drug benefit. Medicare beneficiaries receiving a zero percent cost-of-living increase who are enrolled in Part D plans could see a reduction in their Social Security payments in 2010 as a result of an increase in their monthly Part D plan premiums. The actual amount of the reduction would depend on the increase in the monthly premium for a given beneficiary in a specific Part D plan. In a year with no Social Security COLA, any increase in a beneficiary's Part D plan premium would result in a dollar-for-dollar decrease in an individual beneficiary's monthly Social Security payment.

Some Medicare beneficiaries would be protected from facing a reduction in their Social Security payment as a result of increases in Part D plan premiums. Medicare beneficiaries who receive low-income subsidies (LIS) under Part D and are enrolled in a plan designated for LIS recipients, known as "benchmark" plans, do not pay Part D premiums, and thus would not experience a reduction in their Social Security benefit payment if their plan premium increases.[10] However, more than two million low-income beneficiaries are eligible for low-income subsidies for Part D coverage but are not currently receiving them; these low-income beneficiaries may see a reduction in their Social Security payments if they are enrolled in a Part D plan – unless they sign up for the LIS benefits to which they are entitled or switch to a lower-premium plan.

6. If Congress passes legislation to prevent a scheduled reduction in Medicare payments to physicians in 2010, what would be the effect on Medicare Part B premiums?

Under current law, Medicare payments to physicians are expected to decline by 21.5 percent in 2010, 5.5 percent in each year from 2011-2014, and 0.2 percent in 2015.[11] The 2009 Medicare Trustees projections for the Part B premium, based on current law, do assume a margin that is sufficient to take into account the likelihood that Congress will change current law to prevent a reduction in physician payments, as they have in the past.

Over time, however, the Trustees project that increases in Medicare payments to physicians (or freezing payments at current levels) would accelerate the increase in Part B premiums. According to the Medicare Trustees, if lawmakers freeze physician payments over the next decade rather than allow scheduled reductions to occur, beneficiaries' monthly premiums would be 16 percent higher in 2018 than they would be under current law projections ($151.80 per month vs. $131.40 per month). These calculations take into account the likelihood that Social Security recipients will receive a cost-of-living adjustment beginning in 2012.

CONCLUSION

According to the most recent projections issued by the Medicare and Social Security Trustees, Social Security recipients are projected to receive no cost-of-living adjustment in 2010 and 2011 and only a modest COLA in 2012. At a time of great economic uncertainty, with many seniors experiencing a significant decline in their retirement savings and with nearly two-thirds relying on Social Security for at least half of their income[12], the projected absence of a COLA in the coming years could represent an added hardship for many recipients.

The absence of a COLA will also affect Medicare Part B premiums. Most beneficiaries will not pay higher premiums in the next few years because they are protected by the hold-harmless provision. However,

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[10] LIS recipients could potentially face higher Part D premiums and lower Social Security payments in the following year if their Part D plan no longer qualified as a "benchmark" plan.
[11] Centers for Medicare & Medicaid Services, Office of the Actuary, "Projected Medicare Part B Expenditures under Two Illustrative Scenarios with Alternative Physician Payment Updates," May 12, 2009.
[12] Social Security Administration, "Income of the Population 55 or Older, 2006," February 2009.

without a change in law, a small share of beneficiaries will compensate for those protected by the hold-harmless rule, and pay higher monthly Part B premiums – creating a temporary cohort of “notch” beneficiaries who will pay more for Part B than other beneficiaries. The relatively steep increase in Medicare Part B premiums between 2010 and 2011 will also increase costs for states because Medicaid pays premiums on behalf of beneficiaries dually eligible for Medicare and Medicaid.

Whether or how policymakers will respond is not yet clear, and the design of a legislative response will depend on how the “problem” is defined. If policymakers are concerned that seniors and people with disabilities will receive no COLAs in 2010 or 2011, Congress could consider overriding the CPI-based formula that is used to determine the cost-of-living adjustment for Social Security recipients. The increase in monthly payments would need to be sufficient to more than offset any increase in Medicare Part B and Part D premiums to ensure that Social Security recipients actually receive an increase in their benefit payments. An increase in Social Security payments, however, would result in higher expenditures. Unless the increase is offset by new revenue, it would also increase the federal deficit and contribute to the long-term fiscal shortfall facing Social Security, potentially accelerating the looming debate over the future of entitlement programs.[13]

Alternatively, to address potential concerns about some Medicare beneficiaries (e.g., new enrollees) paying higher Medicare Part B premiums than others (aside from those with higher incomes who currently pay a higher income-related premium), Congress could modify current law so that new enrollees and states (on behalf of dual eligibles) are not required to pay higher premiums than beneficiaries who are protected by the hold-harmless provision. To do so, Congress could override the statutory requirement that beneficiary premiums fund 25 percent of Part B expenditures so that beneficiaries who are not protected by the hold-harmless provision pay the same premiums as others. This approach is not without precedent. The American Recovery and Reinvestment Act of 2009, for example, exempted Part B premiums from rising in response to increases in Part B expenditures provided under the Act. This approach would increase the share of Part B expenditures funded by general revenues, and, unless the increase was offset by new revenue, would increase the federal deficit. Total Medicare spending would not be affected.

Policymakers could also consider a change in law that would prevent increases in Part D premiums from reducing Social Security payments, as it does for Part B premiums. This would essentially extend the hold-harmless provision to include the effects of increases in both Part B premiums and Part D premiums. This option could be difficult to administer given wide variation in Part D premiums across plans and regions, and would increase general revenue contributions to Part D, increasing federal spending.

With attention increasingly focused on Medicare and Social Security entitlement spending, this issue underscores some of the difficult tradeoffs involved in trying to protect seniors' incomes, particularly during a recession, without compounding the fiscal challenges facing Medicare, Social Security, and the federal budget.

This issue brief was prepared by Tricia Neuman and Juliette Cubanski of the Kaiser Family Foundation. Lisa Potetz of Health Policy Alternatives provided helpful comments.

[13] Another approach might be to provide a lump sum payment to Social Security recipients to compensate for the absence of a COLA, funded by general revenues, similar to the $250 payment for individuals who receive Social Security, Supplemental Security Income (SSI), Railroad Retirement Benefits, and/or Veterans, Disability Compensation or Pension benefits provided under the American Recovery and Reinvestment Act of 2009. This would increase federal spending but have no direct impact on Social Security.

APPENDIX

Social Security Cost-of-Living Adjustment, Average Monthly Social Security Payment, Monthly Medicare Part B Premium, and Average Monthly Medicare Part D Premium, 1975-2009

Year	Social Security Cost-of-Living Adjustment[a]	Average Monthly Social Security Payment[b]	Monthly Part B Premium	Monthly Part D Premium[c]
1975	8.0%	$212.07	$6.70	--[d]
1976	6.4%	$232.75	$6.70	--
1977	5.9%	$254.33	$7.20	--
1978	6.5%	$277.89	$7.70	--
1979	9.9%	$314.47	$8.20	--
1980	14.3%	$359.25	$8.70	--
1981	11.2%	$396.28	$9.60	--
1982	7.4%	$410.95	$11.00	--
1983	3.5%	$410.23	$12.20	--
1984	3.5%	$429.46	$14.60	--
1985	3.1%	$443.09	$15.50	--
1986	1.3%	$456.93	$15.50	--
1987	4.2%	$484.01	$17.90	--
1988	4.0%	$504.88	$24.80	--
1989	4.7%	$538.70	$31.90	--
1990	5.4%	$559.32	$28.60	--
1991	3.7%	$592.77	$29.90	--
1992	3.0%	$620.66	$31.80	--
1993	2.6%	$645.91	$36.60	--
1994	2.8%	$665.67	$41.10	--
1995	2.6%	$688.37	$46.10	--
1996	2.9%	$708.70	$42.50	--
1997	2.1%	$734.53	$43.80	--
1998	1.3%	$754.23	$43.80	--
1999	2.5%	$791.18	$45.50	--
2000	3.5%	$842.84	$45.50	--
2001	2.6%	$881.12	$50.00	--
2002	1.4%	$927.23	$54.00	--
2003	2.1%	$963.80	$58.70	--
2004	2.7%	$961.12	$66.60	--
2005	4.1%	$1,011.60	$78.20	--
2006	3.3%	$1,045.85	$88.50	$32.20
2007	2.3%	$1,077.55	$93.50	$27.35
2008	5.8%	$1,083.34	$96.40	$27.93
2009	0%[e]	$1,155.28	$96.40	$30.36

[a] COLA increase applies to Social Security payments in the following year.

[b] Average monthly benefit for retired worker, by year of entitlement, December of each year, except for 2009 which is as of April.

[c] Actual amounts (and increases) vary by plan. Monthly premiums based on national average monthly premium amount.

[d] Part D took effect in 2006.

[e] Projected.

The Henry J. Kaiser Family Foundation

Headquarters
2400 Sand Hill Road
Menlo Park, CA 94025
(650) 854-9400   Fax: (650) 854-4800

Washington Offices and
Barbara Jordan Conference Center
1330 G Street, NW
Washington, DC 20005
(202) 347-5270 Fax: (202) 347-5274

www.kff.org

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