Legislation Needed to Protect the Social Security COLA:
Republican Prescription Drug Plan Erodes Cost of Living Protection, Cuts Social Security Benefits

Background

Social Security has a valuable feature for retirees, disabled workers and survivors: an annual cost of living adjustment (COLA). This benefit is all the more important because it is missing from many private pensions. However, rising health care costs in the past three years of Republican control have forced up the premiums for Medicare Part B so much that a large part of the COLA is now absorbed by the annual increase in those premiums. Under current law, individuals for whom the increase in the Part B premium would exceed their COLA do not have to pay the excess premium. But even that protection is missing for the new Part D prescription drug premium. Without a legislative change, millions of Social Security beneficiaries will see a substantial erosion in the purchasing power of their benefit check and some will even see their check shrink.

The Problem

The Social Security COLA is based on the previous year's change in the consumer price index (CPI), a measure of overall inflation in the economy. The goal of the COLA is to maintain the purchasing power of the benefit check in the face of rising prices. But that objective is undermined if the Medicare premium, which is typically deducted from a retiree's Social Security check, is growing very rapidly.

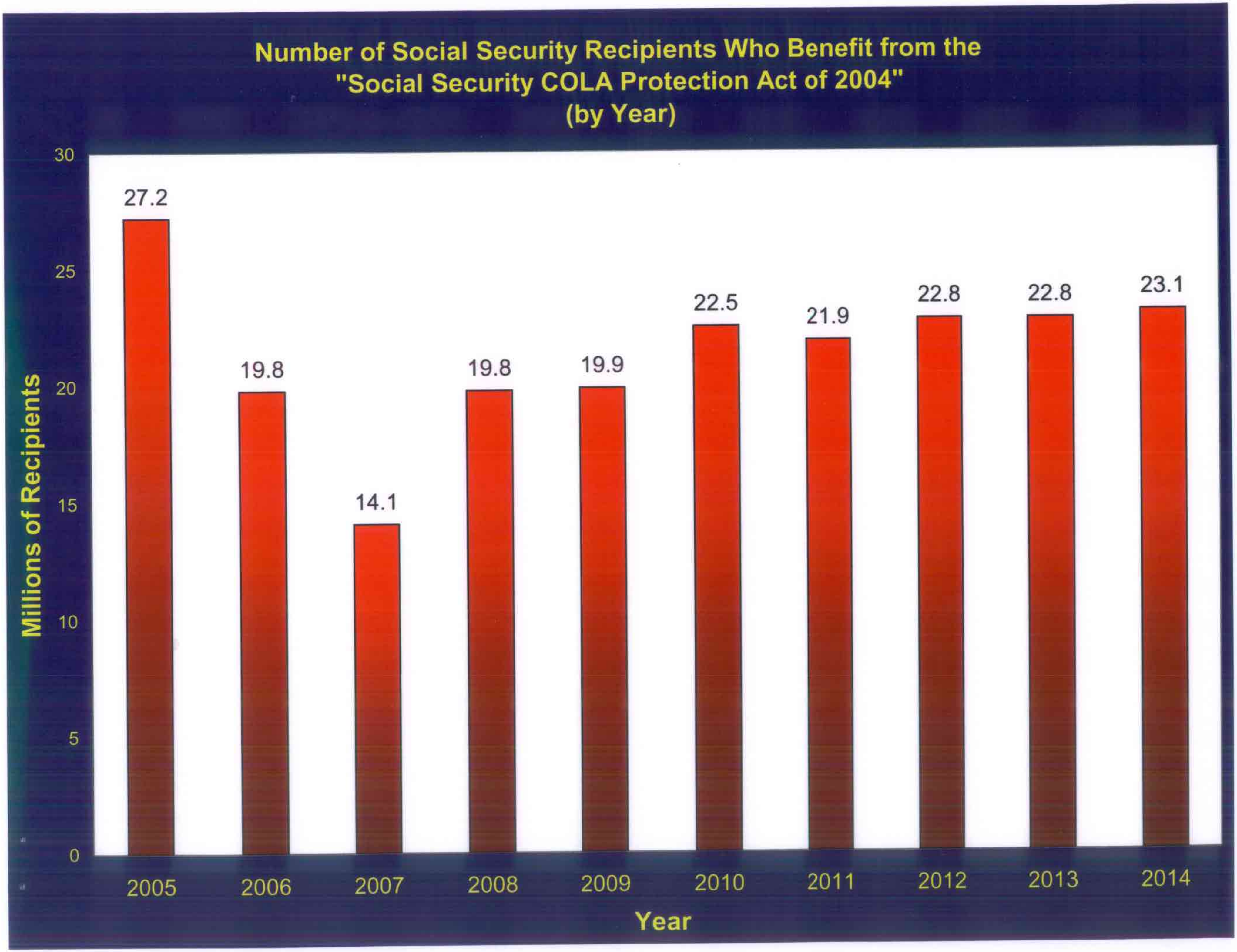
The current Medicare premium rises with spending in the program. In the past three years, when health care costs have risen much more rapidly than prices generally, the increases in Medicare Part B premiums have been substantial. As a result, for many beneficiaries, the additional deduction in their monthly benefit check to cover the higher Medicare premium has offset much of their COLA increase, leaving an inadequate amount to cover increases in the costs of all other goods and services.

The increase in the Medicare Part B premium in 2005 will be the largest ever, according to current projections. That means that in the four years of the Bush Administration, the cumulative increase in the monthly premium will be about $26, nearly twice as much as the cumulative increase of $13.40 over the entire eight-years of the Clinton Administration. Next year, for example, a widow with a $600 monthly Social Security check will have 59 percent of her COLA used up by the increase in the Medicare premium for current services.

Republican insensitivity to the problem of Medicare premiums undermining the Social Security COLA is reflected in their design of the new prescription drug benefit. An average senior is expected to spend five to six percent of his or her income on combined Medicare Part B and D premiums in 2006. But far more than six percent of the COLA will be used up by increases in the premiums. Next year, as a result of the large Part B premium increases, 30 percent of beneficiaries will have more than half of their COLA absorbed by the premium increase. The Congressional Budget Office estimates that in 2007, almost one in every four beneficiaries (23 percent) will have more than 25 percent of their COLA used up by Medicare premium increases. This rises to 64 percent—22 million beneficiaries—by 2014.

The Proposal

The "Social Security COLA Protection Act of 2004" would ensure that no more than 25 percent of a retiree's annual COLA could be absorbed by increases in Part B and Part D Medicare premiums. Doing so would reserve 75 percent of the COLA for price increases in other goods and services, such as food, clothing, shelter, energy, and other health expenditures.


Number of Social Security Recipients Who Benefit from the
"Social Security COLA Protection Act of 2004"
(by Year)
Millions of Recipients
30
25
20
15
10
5
0
27.2
19.8
14.1
19.8
19.9
22.5
21.9
22.8
22.8
23.1
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
Year

Number of Beneficiaries Affected and Costs Under the "Social Security COLA Protection Act of 2004"

	Calendar Year									
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
SMI Enrollees (in millions)	39.2	39.8	40.4	41.2	42.0	42.8	43.7	44.9	46.2	47.5
Beneficiaries for Whom the Part B Premium is Withheld from Social Security Benefits and Who Paid Premiums in the Prior Year (in millions) /1/	29.7	29.8	30.1	30.6	31.2	31.6	32.2	32.8	33.7	34.7
Beneficiaries Who Pay Part D Premiums (in millions) /2/		21.3	21.0	21.1	21.5	21.9	22.3	22.8	23.4	24.0
Number of Beneficiaries Affected By the Proposal (in millions)	27.2	19.8	14.1	19.8	19.9	22.5	21.9	22.8	22.8	23.1
Percent of Beneficiaries Affected /3/	91%	66%	47%	65%	64%	71%	68%	70%	68%	67%

/1/ This is the total number of Medicare beneficiaries that are potentially eligible for COLA protection under the legislation. It excludes beneficiaries whose Part B premiums are paid by
/2/ Excludes beneficiaries whose premiums are paid by the Low-Income Subsidy or through the alternate subsidy program.
/3/ A reduction in 2006 and beyond (relative to 2005) is based on current law, which allows for physician payments to drop significantly starting in 2006; if legislation is enacted to increase

Committee on Ways and Means Democratic Staff, based on CBO analysis
July 21, 2004

How the COLA Protection Bill Works

Example 1. Widow with $500 in monthly Social Security benefits in 2004

Her annual Social Security benefit is $6,000, and the COLA will increase her income by $162 in 2005 (a 2.7 percent increase).

However, Medicare Part B premiums are projected to rise by at least $114 that year. *Without* the bill's protection, a premium increase of $114 will eat up 70 percent of her COLA.

With the bill's protection, only 25 percent of her COLA will be absorbed by Medicare premium increases, leaving 75 percent ($122 per year) to cover other increases in her cost of living. The bill preserves an additional $74 of COLA to be used for other expenses.

By 2009, the bill will save $197 of her COLA. In 2014, $545 of her COLA will be protected. Over 10 years, the projected total savings for this beneficiary will reach $2,615.

Example 2. Retired couple with $1,100 in combined monthly Social Security benefits in 2004.

Their annual benefits are $13,200: $8,400 for the husband and $4,800 for the wife. A 2.7 percent COLA would increase their income by $356 in 2005.

However, the Medicare Part B premiums paid by this couple are projected to rise by at least $228 in 2005. *Without* the bill's protection, a premium increase of $228 will eat up 64 percent of their combined COLA.

With the bill's protection, only 25 percent of their COLAs will be absorbed by Medicare premium increases, leaving 75 percent ($267 per year) to cover other increases in their cost of living. The bill preserves an additional $139 of COLA to be used for other expenses.

By 2009, the bill will protect $358 of their COLA. In 2014, $1,016 of their COLA will be protected. Over 10 years, the projected total savings for this couple will reach $4,829.

How much would others save?

Annual Benefit Amount	Savings Over 10 years	Average Annual Savings*
$7,200 ($600 per month)	$2,213	$221
$9,000 ($750 per month)	$1,611	$161
$9,600 ($800 per month)	$1,410	$140

** The particular amount in each year could differ from this average because each year, the amount of protection provided by the bill would depend on the interaction between the Medicare premium increase and that individual's COLA increase. If the premium increase is large while the COLA is small, savings would be larger. If the premium increase is modest while the COLA is large, then savings would be smaller.*

What fraction of the those who pay Medicare premiums would benefit from the bill?

2005: 90 % (This is a year when many beneficiaries will need protection to prevent their COLA from being swallowed by Medicare premium increases, because the premium increase is projected to be the largest ever.)

2007: 47 percent

2009: 64 percent

2011: 68 percent

2014: 67 percent