

A MESSAGE TO THE PUBLIC.

The Boards of Trustees are pleased to present this Summary of the 1993 Annual Reports of the Social Security and Medicare trust funds. The reports include extensive information about and careful analysis of these important social programs and, we believe, fully and fairly present their financial condition.

We encourage current and future beneficiaries to understand what the reports say. Based on the Trustees' best estimates, the reports show:

- *The Federal Old-Age and Survivors Insurance (OASI) Trust Fund, which pays retirement benefits, will be able to pay benefits for about 50 years. Congress will eventually need to take action to assure the long-range financial soundness of the program.*

- *The Federal Disability Insurance (DI) Trust Fund, which pays disability benefits, is projected to be exhausted in about 2 years. As a result, the Board urges that prompt legislative action be taken to improve the financial integrity of this trust fund by reallocating to the DI fund a larger share of the overall OASDI tax rate.*

- *The Federal Hospital Insurance (HI) Trust Fund, which pays inpatient hospital expenses, will be able to pay benefits for only about 6 years and is severely out of financial balance in the long-range. The Trustees urge the Congress to take additional actions designed to control HI program costs through specific program legislation and as a part of enacting comprehensive health care reform.*

- *The Federal Supplementary Medical Insurance (SMI) Trust Fund, which pays doctor bills and other outpatient expenses, is financed on a year-by-year basis and, on this limited basis, is adequately financed. The Trustees urge the Congress to take additional actions designed to control SMI*

costs through specific program legislation and as a part of enacting comprehensive health care reform.

By the Trustees:

*Lloyd M. Bentsen,
Secretary of the Treasury,
and Managing Trustee*

*Robert B. Reich,
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*Donna E. Shalala,
Secretary of Health
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*Stanford G. Ross,
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*David M. Walker,
Trustee*

STATUS OF THE SOCIAL SECURITY

AND MEDICARE PROGRAMS

A SUMMARY OF THE 1993 ANNUAL REPORTS

What Are the Trust Funds? Four trust funds have been established by law to finance the Social Security and Medicare programs. For Social Security, the Federal Old-Age and Survivors Insurance (OASI) Trust Fund pays retirement and survivors benefits; and the Federal Disability Insurance (DI) Trust Fund pays benefits after a worker becomes disabled. When both OASI and DI are considered together, they are called the OASDI program.

For Medicare, the Federal Hospital Insurance (HI) Trust Fund pays for hospital and related care (often called "Part A") for people over 65 and workers who are disabled. The Federal Supplementary Medical Insurance (SMI) Trust Fund pays for physician and outpatient services (often called "Part B") for people over 65 and workers who are disabled. Unlike Social Security, these two trust funds are not usually considered together, because they are funded differently.

Who Are the Boards of Trustees? Five people serve on the Social Security and Medicare Boards of Trustees: the Secretary of the Treasury, the Secretary of Labor, the Secretary of Health and Human Services, and two members appointed by the President and confirmed by the Senate to represent the public.

What Do the Boards Issue Annual Reports? One of the major responsibilities of the Boards is to report to the Congress each year on the operation of the trust funds during the preceding year and the projected financial status for future years.

How Are the Trust Funds Financed? Most OASDI and HI revenue consists of taxes on earnings that are paid by employees, their employers, and the self-employed. The tax rates are set by law and apply to earnings that do not exceed a certain annual amount. This amount, called the earnings base, rises as average wages increase. In 1993, the earnings base for OASDI is \$57,600 and for HI it is \$135,000. The rates employees and employers each are scheduled to pay under current law are:

Year	<u>OASI</u>	DI	<u>OASDI</u>	HI	<u>Total</u>
1990-99	5.60	0.60	6.20	1.45	7.65
2000 and later	5.49	0.71	6.20	1.45	7.65

People who are self-employed are charged the equivalent of the combined employer and employee shares, but only on 92.35 percent of net earnings, and may deduct one-half of the combined tax from income subject to federal income tax.

All the trust funds receive income from interest earnings on trust fund assets and from miscellaneous sources. The OASI and DI Trust Funds also receive revenue from the partial taxation of Social Security benefits.

The SMI or Part B program is financed similarly to yearly renewable, term insurance. Participants pay premiums each year that cover about one-fourth of the cost; the rest is paid for by the Federal government from general revenues. The 1993 monthly premium is \$36.60.

In all trust funds, assets that are not needed to pay current benefits or administrative expenses (the only purposes for which trust funds may be used) are invested in special issue U.S. Government securities guaranteed as to both principal and interest and backed by the full faith and credit of the U.S. Government.

What Were the Administrative Expenses in 1992? In fiscal year 1992, the cost of administrative expenses, shown as a percentage of benefit payments from each trust fund, was:

	OASI	DI	<u>OASDI</u>	HI	SMI
<u>Administrative Expenses (1992):</u>	0.7	2.8	0.9	1.5	3.4

What Were the Trust Fund Results in 1992? All trust funds except DI showed an increase in assets during calendar year 1992. At the end of the year, 41.5 million people were receiving OASDI benefits and about 35 million people were covered under Medicare. Trust fund operations, in billions, were:

	<u>OASDI</u>	<u>HI</u>	<u>SMI</u>
Assets (end of 1991)	\$280.7	\$115.2	\$17.8
Income during 1992	342.6	93.8	57.2
Outgo during 1992	291.9	85.0	50.8
Net Increase	50.7	8.8	6.4
Assets (end of 1992)	331.5	124.0	24.2

How Are Estimates of Trust Fund Balances Made? Short-range (10-year) estimates are reported for all funds, and, for the OASI, DI, and HI Trust Funds, long-range (75-year) estimates are reported. Because the future cannot be predicted with certainty, three alternative sets of economic and demographic assumptions are used to show a range of possibilities. Assumptions are made about economic growth, wage growth, inflation, unemployment, fertility, immigration, and mortality, as well as specific factors relating to disability, hospital, and medical services costs.

Alternative II, the intermediate assumptions, reflects the Trustees' best estimate of what the future experience will be. Alternative I is more optimistic; alternative III is more

pessimistic; they show how the trust funds would operate if economic and demographic conditions are better or worse than anticipated.

What Concepts Are Used to Describe the Trust Funds? The measures used to evaluate the financial status of the trust funds are based on several concepts. Some of the important concepts are:

- Taxable payroll is that portion of total wages and self-employment income that is covered and taxed under the OASDI and HI programs.
- The annual income rate is the income to the trust fund from taxes, expressed as a percentage of taxable payroll.
- The annual cost rate is the outgo from the trust fund, also expressed as a percentage of taxable payroll.
- The percentage of taxable payroll is used to measure income rates and cost rates for the OASDI and HI programs. Measuring the funds' income and outgo over long periods of time by describing what portion of taxable earnings they represent is more meaningful than using dollar amounts, because the value of a dollar changes over time.
- The annual balance is the difference between the income rate and the cost rate. If the balance is negative, the trust fund has a deficit for that year.
- Annual balances are summarized for periods of up to 75 years and adjusted to include the beginning fund balance and the cost of ending the projection period with a trust fund ratio of 100 percent; the resulting figure is then called the actuarial balance; if the balance is negative, the fund has an actuarial deficit.

- The trust fund ratio is the amount in the trust fund at the beginning of a year divided by the projected outgo for the year. It shows what percentage of the year's expenditures the trust fund has on hand. For example, a trust fund ratio of 50 percent would be six months' worth of expenditures.
- The year of exhaustion is the first year a trust fund is projected to run out of funds and to be unable to pay benefits on time and in full.

How Is the Financial Status of the Trust Funds Tested?

Several tests, based on the intermediate assumptions, are used to review the financial status of the trust funds.

- The short-range test is met if, throughout the next 10 years, the trust fund ratio is at least 100 percent. Or, if the trust fund ratio is initially less, but reaches 100 percent within the first five years and stays at or above 100 percent, and there is enough income to pay benefits on time every month during the 10 years, the short-range test is met.
- The long-range test is met if a fund has an actuarial deficit of no more than five percent of the cost rate over the 75 years, and the actuarial deficit for any period of the first 10 years or longer is less than a graduated amount of five percent. If the long-range test is met, the trust fund is in close actuarial balance.
- The test for SMI actuarial soundness is met for any time period if the trust fund assets and projected income are enough to cover the projected outgo and there are enough assets to cover costs incurred but not yet paid. The adequacy of the SMI Trust Fund is measured only for years for which both the beneficiary premiums and the general revenue contributions have been set.

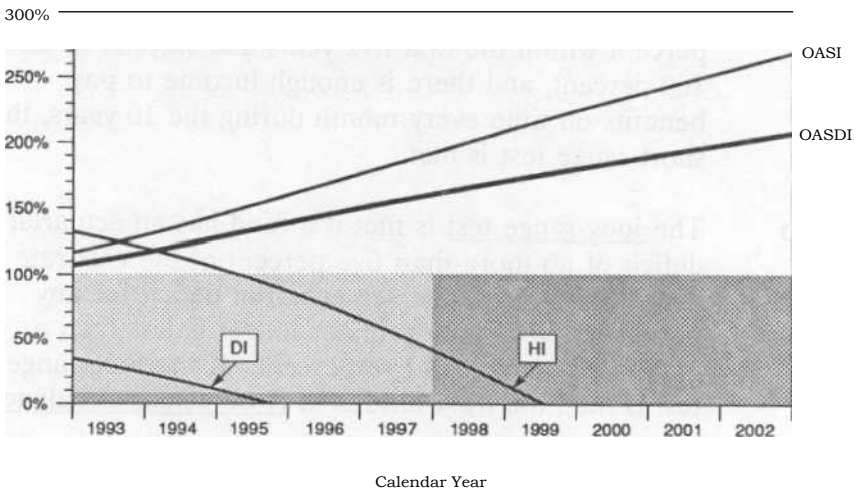
What Is the Future Outlook for the Trust Funds?

The status of the OASI, DI, and HI Trust Funds is shown together on charts because they are financed the same way. SMI is financed differently, so its status is described separately.

o THE SHORT-RANGE OUTLOOK (1993-2002)

Chart A shows the projected trust fund ratio under the alternative II assumptions for OASI, DI, and HI separately. It also shows what the ratio is for the combined OASI and DI trust funds.

Chart A.-Trust Fund Ratio and Short-Range Test of Financial Adequacy



The OASI trust fund ratio line is over the 100 percent level at the beginning of the 10-year period and stays over that

level through the year 2002. Therefore, the OASI Trust Fund meets the short-range test of financial adequacy.

However, the trust fund ratio line for DI starts at 35 percent and does not reach the 100 percent level at any time in this period; it does not meet the short-range test. Moreover, the DI Trust Fund is expected to be exhausted in late 1995 under the intermediate, alternative II assumptions, and in early 1995 if economic and other conditions in the future turn out to be more pessimistic, as under alternative III.

The trust fund ratio line for the combined OASI and DI trust funds begins above the 100 percent level and stays over that level throughout the 10-year period; thus, the OASDI program, as a whole, meets the short-range test of financial adequacy.

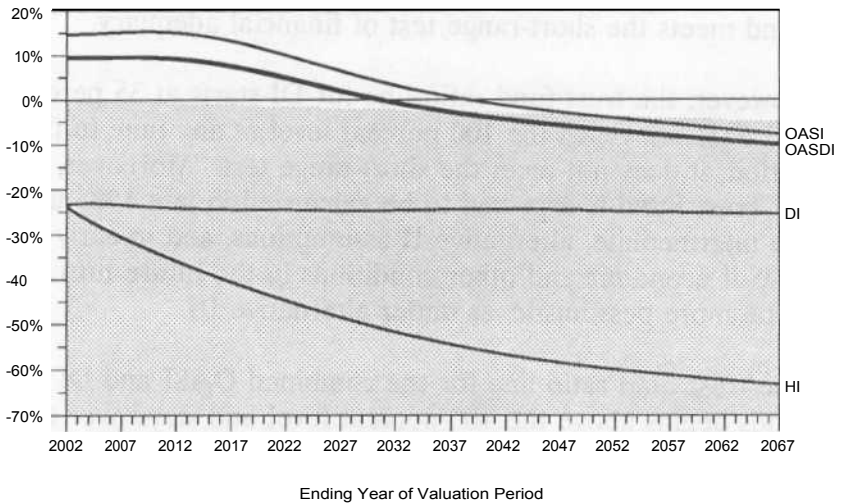
Although the trust fund ratio line for HI is over the 100 percent level at the beginning of the 10-year period, it falls below that level in 1995. As a result, it does not meet the short-range test. Under alternative II assumptions, the projected year of exhaustion for the HI Trust Fund is 1999; under more adverse conditions, as in alternative III, it could be as soon as 1998.

The financing for the SMI Trust Fund has been set through 1993, and the projected operations of the trust fund meet the test of SMI actuarial soundness.

o THE LONG-RANGE OUTLOOK (1993-2067)

Chart B shows the actuarial balance, as a percentage of the cost rate, for OASI, DI, and HI separately under the alternative II assumptions. It also shows the actuarial balance for the combined OASI and DI trust funds.

Chart B.-Actuarial Balance as a Percentage of Summarized Cost Rate and Long-Range Test of Close Actuarial Balance



For a trust fund to meet the long-range test of close actuarial balance, the actuarial balance line for that trust fund must stay above the shaded area throughout the 75-year period. The triangle above the shaded area but below the zero percent level shows the range of allowable deficits a fund can have and still be in close actuarial balance.

None of the three trust funds is in close actuarial balance over the next 75 years. However, the chart shows that the actuarial balance line for OASI, as well as for the OASDI program, as a whole, stays above the shaded area for many years to come.

The actuarial balance line for DI alone starts well into the shaded area and declines slightly over the 75-year period. The actuarial balance line for HI also starts well into the shaded area but then declines sharply over the long-range period.

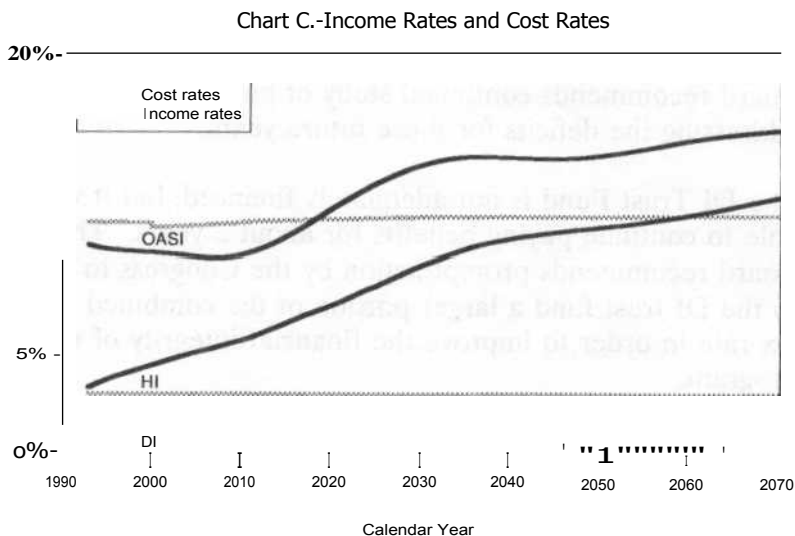
The year of exhaustion for the OASI Trust Fund under intermediate assumptions does not occur until 2044--51 years from now. For the combined OASI and DI trust funds, the year of exhaustion would be 2036--in 43 years.

Another useful way to view the outlook of the trust funds is to compare the income rate for each fund with its estimated cost rate. The income rates for the OASI, DI and HI remain relatively constant over the 75-year period, while the cost rates increase by widely differing amounts.

For OASI, the income rate is projected to remain significantly above the cost rate for a number of years. Starting in about 2010, however, the OASI cost rate will begin increasing rapidly as the baby boom generation begins to reach retirement age. In 2017 and later, the cost rate for OASI will exceed the income rate.

The cost rate for DI is slightly higher than the income rate initially, and the shortfall is projected to increase slowly over the 75-year period.

The cost rate for HI also is higher than the income rate throughout the next 75 years but by rapidly growing amounts -- by the end of the period, the HI cost rate is projected to be roughly 4 times greater than the HI income rate. Chart C shows the virtually level income rates and rising cost rates for OASI, DI and HI.



CONCLUSIONS

The status of the Social Security and Medicare programs can be summarized by looking at the results of the tests used to evaluate the financial status of the trust funds and at the number of years before each trust fund is expected to be exhausted under the intermediate assumptions:

FINANCIAL STATUS OF THE OASI, DI, HI, AND SMI PROGRAMS

<u>Trust Fund</u>	<u>Is the Test Met:</u>		<u>Years Until Exhaustion</u>
	<u>Short-Range 10 Years</u>	<u>Long-Range 75 Years</u>	
OASI	Yes	No	51
DI	No	No	2
OASDI (combined)	Yes	No	43
HI	No	No	6

The SMI Trust Fund meets its test of actuarial soundness.

Based on the Trustees best estimates (alternative II):

The OASI Trust Fund is expected to be able to pay benefits for about the next 50 years. Because the fund is not in close actuarial balance for the 75-year long-range period, the Board recommends continued study of possible ways of addressing the deficits for those future years.

The DI Trust Fund is not adequately financed, but it will be able to continue paying benefits for about 2 years. The Board recommends prompt action by the Congress to allocate to the DI trust fund a larger portion of the combined OASDI tax rate in order to improve the financial integrity of the DI program.

A reallocation of the OASDI tax rate is possible because the combined OASI and DI Trust Funds are estimated to

continue growing for more than 30 years into the future and would not be exhausted until 2036. Although the need is not immediate, the Board recommends that action be taken in due course to strengthen the long-range financing of the combined OASDI program.

The HI Trust Fund will be able to pay benefits for only about 6 years and is severely out of actuarial balance over the next 75 years. Because of the magnitude of the projected actuarial deficit in the HI program and the high probability that the HI Trust Fund will be exhausted before the turn of the century, the Trustees urge the Congress to take additional actions to control HI program costs through specific program legislation and as a part of enacting comprehensive health care reform.

The SMI program, though actuarially sound, has experienced rapid growth: program outlays have increased 60 percent in the last five years and grew 22 percent faster than the economy as a whole. Because this growth shows little sign of abating, the Trustees urge the Congress to take additional actions to control SMI costs through specific program legislation and as a part of enacting comprehensive health care reform.

A MESSAGE FROM THE PUBLIC TRUSTEES:

We are pleased to join with the new ex officio trustees in issuing this third Summary of the Annual Reports of the Boards of Trustees of the Social Security and Medicare trust funds. We strongly believe in the importance of this Summary which is designed to provide timely, useful and accurate information about these vital programs in a concise and coordinated manner.

Since one of our most important responsibilities as public trustees is communicating as effectively as possible to beneficiaries and taxpayers affected by these programs, we offer the following observations about the 1993 Annual Reports to highlight their most critical points.

Based on the best estimates of the Trustees, the short-range (10 year) projections show that:

- The Federal Disability Insurance (DI) Trust Fund, which pays disability benefits, is projected to be exhausted in 1995. As a result, the Trustees urge prompt legislative action to address the near-term financial needs of the DI Trust Fund. We also recommend that additional research be undertaken on a priority basis to better understand the reasons for the recent adverse financial experience of the DI program and likely longer range demands in our society for disability insurance benefits.*

- The Federal Hospital Insurance (HI) Trust Fund, which pays inpatient hospital expenses, is projected to experience a rapidly deteriorating financial condition and to be exhausted in 1999. As required by section 709 of the Social Security Act, the Board of Trustees is notifying the Congress of this urgent condition. We believe that prompt, effective and decisive action is necessary to reform the HI program through specific program legislation and as part of comprehensive health care reform.*

- The Federal Supplementary Medical Insurance (SMI) Trust Fund, which pays doctor bills and other outpatient*

expenses, is financed on a year-by-year basis and is currently actuarially sound on that limited basis. However, the cost of SMI is projected to continue to rise sharply. As a result, prompt, effective and decisive congressional action also should be taken to reform this program.

- *The Federal Old-Age and Survivors Insurance (OASI) Trust Fund, which pays retirement benefits, is well financed over the next 10 years and presents no immediate concern. Indeed, the OASI fund is able to provide resources for reallocation to the DI fund to meet that program's near-term financing needs.*

In addition, the long-range (75-year) projections show that:

- *None of the trust funds that are measured over a 75-year period--OASI, DI, or HI--meets the Trustees' long-range tests of financial solvency. However, the financial imbalances of the programs differ greatly in both timing and magnitude, and it is important to understand these differences.*

- *The OASI Trust Fund is projected to have adequate funds to meet benefit payments for about 50 years, but it is not adequately financed over the entire 75-year projection period. Although the financing needs of the OASI program are manageable--with a deficit of less than 1 percent of taxable payroll--this program is so important to the retirement security of the American people that its long-range financing needs should be considered whenever legislative proposals are presented regarding financing resources which might be used for OASI.*

- *The DI Trust Fund is projected to have a shortfall over the 75-year period that is relatively small in the overall OASDI context--less than 0.5 percent of taxable payroll. However, additional financing beyond that needed in the short term should be provided only after a full review of the DI program is completed.*

Lastly, we want to make the following points about the Medicare program:

- The HI and SMI programs have both experienced rapid growth in costs. Under present law the cost of these programs is projected to increase significantly in the future. As a result, the programs are projected to represent an increasing percentage of the Federal budget and the overall economy.*
- Based on our understanding of the reasons for the rapid growth in the cost of these programs and the projected insolvency of the HI Trust Fund in about 6 years, we believe that the HI and SMI programs are unsustainable in their present form. As a result, the Congress should address the need for fundamental reform of the HI and SMI programs as an integral part of comprehensive health care reform legislation. Otherwise, there is a great danger that the resources available for health care may be allocated without sufficient consideration of the dramatic future increases in HI and SMI costs that are currently projected.*

We are privileged to take part in the very thorough and careful process by which the Annual Reports are prepared to provide this vital public accounting. We believe they fully and fairly represent the financial condition of the Social Security and Medicare programs. We also believe they demonstrate clearly and conclusively the need for congressional action to ensure the continued viability and fiscal integrity of these important national programs.

We hope this Summary will encourage present and future beneficiaries to understand what the Annual Reports say about the financial condition of the Social Security and Medicare programs.

*Stanford G. Ross
Trustee*

*David M. Walker
Trustee*