

1970 ANNUAL REPORT OF THE BOARD OF
TRUSTEES OF THE FEDERAL HOSPITAL
INSURANCE TRUST FUND

LETTER

FROM

BOARD OF TRUSTEES
FEDERAL HOSPITAL INSURANCE
TRUST FUND

TRANSMITTING

THE 1970 ANNUAL REPORT OF THE BOARD (5TH REPORT),
PURSUANT TO THE PROVISIONS OF SECTION 1817(b) OF THE
SOCIAL SECURITY ACT, AS AMENDED



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LETTER OF TRANSMITTAL

BOARD OF TRUSTEES OF THE
FEDERAL HOSPITAL INSURANCE TRUST FUND,
Washington, D.C., April 1, 1970.

THE SPEAKER OF THE HOUSE OF REPRESENTATIVES,
Washington, D.C.

SIR: We have the honor to transmit to you the 1970 Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund (the fifth such report), in compliance with the provisions of section 1817(b) of the Social Security Act, as amended.

Respectfully,

DAVID M. KENNEDY,
Secretary of the Treasury,
and Managing Trustee of the Trust Funds.

GEORGE P. SHULTZ,
Secretary of Labor.

ROBERT H. FINCH,
Secretary of Health, Education, and Welfare.

ROBERT M. BALL,
Commissioner of Social Security
and Secretary, Board of Trustees.

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1970 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL HOSPITAL INSURANCE TRUST FUND

THE BOARD OF TRUSTEES

The Federal hospital insurance trust fund, established on July 30, 1965, is held by the Board of Trustees under the authority of section 1817(b) of the Social Security Act, as amended. The Board is comprised of three members who serve in an ex officio capacity. The members of the Board are the Secretary of the Treasury, the Secretary of Labor, and the Secretary of Health, Education, and Welfare. The Secretary of the Treasury is designated by law as the managing trustee. The Commissioner of Social Security is secretary of the Board.

FISCAL YEAR HIGHLIGHTS

The fiscal year 1969 was the third full year of operation of the hospital insurance program insofar as benefit payments are concerned (since benefits were first available on July 1, 1966). Contributions had been collected during the latter half of the preceding fiscal year (i.e., on and after January 1, 1966).

Contributions in fiscal year 1969 amounted to \$4,423 million from persons directly covered by the hospital insurance program, plus an additional \$54 million with respect to railroad workers that was transferred from the railroad retirement account under the financial interchange provisions.

Total receipts of the trust fund amounted to \$5,344 million in fiscal year 1969. In addition to contributions, receipts consisted of \$96 million in interest on investments, and \$771 million reimbursed from the general fund of the Treasury (\$22 million for the long-range costs of benefits based on noncontributory credits for military service before 1957 and \$749 million for the costs of benefits and the related administrative expenses for uninsured persons).

Total disbursements from the trust fund in fiscal year 1969 amounted to \$4,758 million. Of this amount, \$4,654 million was paid out for benefits (this amount is based on Treasury statements). The remaining \$104 million was for administrative expenses, which represented 2.2 percent of benefit disbursements. The actual outgo for benefits in the third year of operation was 11 percent higher than the cost estimate made in the 1969 annual report.

The excess of total income over total outgo, amounting to \$586 million, increased the total assets of the trust fund from \$1,431 million on June 30, 1968, to \$2,017 million on June 30, 1969.

Estimates for the 3 fiscal years 1970-72 show that both contribution receipts and disbursements will increase steadily. However, the disbursements will rise more rapidly, and by 1970, the receipts will be approximately equal to disbursements. After 1970, the disbursements

will exceed the receipts, and the trust fund would be exhausted in fiscal year 1973, unless additional financing is provided. It should be kept in mind, however, that under the conditions of the assumptions underlying the actuarial cost estimates, a significant amount of additional financing is almost certain to occur in the future as a matter of course, without action being taken solely for the sake of the hospital insurance program.

The assumptions are made in the cost estimates for the hospital insurance system that earnings levels (and hospital costs similarly) will rise steadily in the future, and that the maximum taxable earnings base for both this program and for old-age, survivors, and disability insurance will be increased in the future proportionately with rises in the general wage level. It seems most likely that, if earnings do rise in the future (as they have in the past), then such earnings base will be increased (as it has in the past), and this will provide additional financing, without creating additional benefit liability. Alternative estimates are presented under the assumption that the earnings base will remain unchanged at the present \$7,800 per year.

Long-range cost estimates for the hospital insurance program under the present financing provisions indicate that the program has an actuarial balance of -0.48 percent of taxable payroll (under the assumption that the earnings base is kept up to date). The level-cost of benefit payments and administrative expenses combined, estimated over a future period of 25 years on an intermediate-cost basis, is 2.04 percent of taxable payroll. The level-equivalent of the graded schedule of contributions is estimated to be 1.56 percent of taxable payroll. If it is assumed that the maximum taxable earnings base remains fixed in the future at the present \$7,800, then the actuarial balance is -1.24 percent of taxable payroll (level-cost of benefit payments and administrative expenses of 2.76 percent and level-equivalent of contributions of 1.52 percent).

As will be discussed subsequently, several alternative methods of providing additional financing so as to restore the actuarial balance of the program are possible. This can be done by increasing the maximum taxable earnings base and contribution rates or by increasing the contribution schedule only. Again, it should be recognized that, with the rising future earnings levels assumed in the hospital insurance cost estimates, it is virtually inevitable (and even almost automatic in nature) that the taxable earnings base will rise, and thus a certain amount of additional financing will be available for the hospital insurance system. This would provide part of the financing needed to restore the actuarial balance of the program. The earnings base would likely be raised under such circumstances, as it has in the past, because of the necessity of keeping the cash-benefits program up to date (which also would have its financial status improved by such action of increasing the earnings base).

LEGISLATION IN 1969

The Tax Reform Act of 1969 (Public Law 91-72, approved December 30, 1969) amended both the Internal Revenue Code and the Social Security Act. It revised the benefits and financing of old-age, survivors, and disability insurance program. However, it made no change in the hospital insurance program.

Section 1813 of the Social Security Act, as amended, established that the Secretary of Health, Education, and Welfare shall determine and promulgate each year the inpatient hospital deductible amount. Such promulgations for 1969 and 1970 are shown in appendices V and VI.

NATURE OF THE TRUST FUND

The Federal hospital insurance trust fund was established on July 30, 1965, as a separate account in the U.S. Treasury to hold the amounts accumulated under the hospital insurance program. All the financial operations which relate to the system of hospital insurance are handled through this fund.

The major sources of receipts of this fund are (1) amounts appropriated to it under permanent appropriation on the basis of contributions paid by workers and their employers, and by individuals with self-employment income, in work covered by the hospital insurance program, and (2) amounts deposited in it representing contributions paid by workers employed by State and local governments and by such employers with respect to work covered by the program. The coverage of the hospital insurance program is identical with that of the old-age, survivors, and disability insurance program.

All employees in covered employment are required to pay contributions with respect to their wages, and their employers are also required to pay contributions with respect to their wages (cash tips, covered as wages beginning in 1966 under the 1965 amendments, are an exception to this; employees pay contributions with respect to cash tips, but employers do not). All covered self-employed persons are required to pay contributions with respect to their self-employment income. In general, an individual's contributions are computed on annual wages or self-employment income, or both wages and self-employment income combined, up to a specified maximum annual amount with the contributions being determined first on the wages and then on any self-employment income necessary to make up the annual maximum amount. The maximum amount of annual earnings to which the contribution rates are applied was \$6,600 in calendar years 1966 and 1967. Beginning with calendar year 1968, the maximum amount is \$7,800.

Under the Internal Revenue Code, the contribution rate for hospital insurance for employees and their employers of 0.50 percent each that was in effect in calendar year 1967 increased to 0.60 percent each on January 1, 1968; the contribution rate for the self-employed also rose from 0.50 to 0.60 percent. The following table shows the scheduled tax rates in the present law:

Calendar years	Percent of taxable earnings	
	Employees and employers, each ¹	Self-employed
1969-72.....	0.60	0.60
1973-75.....	.65	.65
1976-79.....	.70	.70
1980-86.....	.80	.80
1987 and after.....	.90	.90

¹ Only the employee tax is paid on tips that are taxable as wages.

Except for amounts received by the Secretary of the Treasury under State agreements (to effectuate coverage under the program for State and local government employees) and deposited directly in the trust fund, all contributions are collected by the Internal Revenue Service and deposited in the general fund of the Treasury as internal revenue collections; then, on an estimated basis, the contributions received are immediately and automatically appropriated to the trust fund. The exact amount of contributions received is not known initially since (1) hospital insurance taxes, (2) old-age, survivors, and disability insurance taxes, and (3) individual income taxes are not separately identified in tax-collection reports received by the Treasury Department from the district offices of the Internal Revenue Service. Periodic adjustments are subsequently made to the extent that the estimates are found to differ from the amounts of contributions actually payable on the basis of reported earnings.

An employee who worked for more than one employer during the course of a year and paid contributions on wages in excess of the statutory maximum can receive a refund of the taxes he paid on such excess wages. The amount of taxes subject to refund for any period is a charge against the trust fund.

Another source from which receipts of the trust fund are derived is interest received on investments held by the fund. The investment procedures of the fund are described later in this section.

The income and expenditures of the trust fund are also affected by the provisions of the Railroad Retirement Act of 1937, which provide for a system of coordination and financial interchange between the railroad retirement program and the hospital insurance program. A description of the legislative provisions governing the allocation of costs between the two programs appears in appendix II.

Sections 217(g) and 229(b) of the Social Security Act authorize annual reimbursements from the general fund of the Treasury to the hospital insurance trust fund for any costs arising from the granting of noncontributory credits for military service, according to periodic determinations made by the Secretary of Health, Education, and Welfare. A summary of the legislative history of the financing of noncontributory credits for military service appears in appendix II.

Section 1833 of the Social Security Act provides that pathology and radiology services rendered by physicians after March 1968 to hospital inpatients are not subject to the deductible and coinsurance provisions of the supplementary medical insurance program. Hospitals, at their option, are permitted to combine their billing for both hospital and physician components of radiology and pathology services rendered hospital inpatients by hospital-based physicians. Where hospitals elect this billing procedure, payments are made initially from the hospital insurance trust fund, with reimbursement from the supplementary medical insurance trust fund. The reimbursements so made are on a provisional basis and are subject to adjustment, with appropriate interest allowances, as the actual experience develops and is analyzed.

Section 103 of the Social Security Amendments of 1965 provides hospital insurance benefits to certain uninsured persons aged 65 and over. Such payments are made initially from the hospital insurance trust fund, with later reimbursement, with interest, from the general fund of the Treasury for the costs, including administrative expenses,

of the payments. The reimbursements so made are on a provisional basis and are subject to adjustment, with appropriate interest allowances, as the actual experience develops and is analyzed. A description of the legislative provisions governing the allocation of costs between the trust fund and the general fund of the Treasury appears in appendix II.

Under a decision of the Comptroller General of the United States (B-4906) dated October 11, 1951, receipts derived from the sale of surplus supplies and materials are credited to and form a part of the trust fund, where the initial outlays therefor were paid from the trust fund.

Under section 1106(b) of the Social Security Act, the Secretary of Health, Education, and Welfare is authorized to charge outside persons, agencies, and organizations for providing certain services not directly related to the hospital insurance program. The Social Security Administration has accumulated a unique body of information in the course of the administration of the program. Situations arise when it is in the public interest to use this information to perform certain services for outside parties, such as the preparation of statistical tabulations for research purposes, when such services can be performed without violating the confidentiality of the records or interfering unduly with the administration of the program. Such services could not properly be provided at the expense of the trust fund. Receipts derived from performance of these services are equal to the cost of providing them; in some instances, the receipts are credited to the trust fund to counterbalance administrative expenses already paid from the trust fund (in which case such amount is netted out of the figures on administrative expenses in the financial statements of the trust fund), while in other instances such receipts are not credited to the trust fund, and the applicable administrative expenses are met directly from them. Accordingly, such administrative expenses, and the offsetting receipts, do not have any effect on the financial statements of the trust fund.

Expenditures for benefit payments and administrative expenses under the hospital insurance program are paid out of the trust fund. All expenses incurred by the Department of Health, Education, and Welfare and by the Treasury Department in carrying out the provisions of title XVIII of the Social Security Act and of the Internal Revenue Code relating to the collection of contributions, are charged to the trust fund. The Secretary of Health, Education, and Welfare certifies benefit payments to the managing trustee, who makes the payment from the trust funds in accordance therewith.

Congress has authorized expenditures from the trust fund for construction of office buildings and related facilities for the Social Security Administration. The costs of such construction are included as part of the administrative expenses in the financial statements of operations of the trust fund as set forth in subsequent sections of this report. The net worth of the resulting facilities—just as the net worth of all other capital assets—is not carried as an asset in such statements.

That portion of the trust fund which, in the judgment of the managing trustee, is not required to meet current expenditures for benefits and administration is invested, on a daily basis, in interest-bearing obligations of the U.S. Government, in obligations guaran-

teed as to both principal and interest by the United States, or in certain federally-sponsored agency obligations that are designated in the laws authorizing their issuance as lawful investments for fiduciary and trust funds under the control and authority of the United States or any officer of the United States. Obligations of these types may be acquired on original issue at the issue price or by purchase of outstanding obligations at their market price.

In addition, the Social Security Act authorizes the issuance of special public-debt obligations for purchase exclusively by the trust fund. The law requires that such special public-debt obligations shall have maturities fixed with due regard for the needs of the trust fund and shall bear interest at a rate based on the average market yield (computed by the managing trustee on the basis of market quotations as of the end of the calendar month next preceding the date of such issue) on all marketable interest-bearing obligations of the United States forming a part of the public debt which are not due or callable until after the expiration of 4 years from the end of such calendar month. Where such average market yield is a multiple of one-eighth of 1 percent, this is taken as the rate of interest on such special obligations; otherwise such rate is the multiple of one-eighth of 1 percent nearest such market yield.

Interest on public issues held by the trust fund is received by the fund at the time the interest is paid on the particular issues held. Interest on special public-debt obligations issued specifically for purchase by the trust fund is payable semiannually or at redemption, if earlier.

Marketable public issues acquired by the fund may be sold at any time by the managing trustee at their market price. Special public-debt obligations issued for purchase by the trust fund may be redeemed at par plus accrued interest. Interest receipts and proceeds from the sale or redemption of obligations held in the trust fund are available for investment in the same manner as other receipts of the fund. Interest earned by the invested assets of the trust fund will provide income to meet a portion of future benefit disbursements. The role of interest in meeting future benefit payments is indicated in tables 4 and 5.

In addition to serving as a source of income, the assets of the trust fund assure the continued payment of benefits without sharp changes in contribution rates during periods of short-run adverse fluctuations in total income and expenditures.

SUMMARY OF THE OPERATIONS OF THE TRUST FUND, FISCAL YEAR 1969

A statement of the income and disbursements of the Federal hospital insurance trust fund during fiscal year 1969 and of the assets of the fund at the beginning and the end of the fiscal year is presented in table 1.

TABLE 1.—STATEMENT OF OPERATIONS OF THE HOSPITAL INSURANCE TRUST FUND DURING THE FISCAL YEAR 1969

Total assets of the trust fund, June 30, 1968.....		\$1,430,636,435.86
Receipts, fiscal year 1969:		
Contributions:		
Appropriations.....	\$4,072,833,997.28	
Deposits arising from State agreements.....	425,901,886.96	
Gross contributions.....	4,498,735,884.24	
Less payment into the Treasury for contributions subject to refund.....	75,500,000.00	
Net contributions.....	\$4,423,235,884.24	
Transfers from railroad retirement account.....	54,168,000.00	
Reimbursements from general fund of the Treasury for costs of—		
Noncontributory credits for military service.....	22,000,000.00	
Benefits for uninsured persons:		
Benefit payments.....	707,067,593.00	
Administrative expenses.....	23,145,854.42	
Interest.....	18,754,877.00	
Total reimbursement for benefits for uninsured persons.....	748,968,324.42	
Interest:		
Interest on investments.....	95,843,005.13	
Less interest on amounts of interfund transfers for reimbursement of administrative expenses and construction costs.....	172,290.00	
Net interest.....	95,670,715.13	
Total receipts.....	5,344,042,923.79	
Disbursements, fiscal year 1969:		
Benefit payments.....	4,653,976,096.46	
Administrative expenses:		
Department of Health, Education, and Welfare.....	95,234,386.00	
Treasury Department.....	5,875,779.09	
Reimbursement to old-age and survivors insurance trust fund due to adjustment in allocation of administrative expenses for fiscal year 1968.....	2,508,484.00	
Reimbursement to old-age and survivors insurance and disability insurance trust funds for costs of construction for fiscal year 1968.....	577,000.00	
Gross administrative expenses.....	104,195,649.09	
Less receipts from sale of surplus supplies, materials, etc.....	13,768.43	
Net administrative expenses.....	104,181,880.66	
Total disbursements.....	4,758,157,977.12	
Net addition to the trust fund.....	585,884,946.67	
Total assets of the trust fund, June 30, 1969.....		2,016,521,382.53

The total assets of the trust fund amounted to \$1,431 million on June 30, 1968. By the end of fiscal year 1969, the assets amounted to \$2,017 million, an increase of \$586 million.

Net receipts of the trust fund amounted to \$5,344 million. Of this total, \$4,073 million represented tax collections appropriated to the trust fund and \$426 million represented amounts received by the Secretary of the Treasury in accordance with State coverage agreements and deposited in the trust fund. As an offset, \$75.5 million was transferred from the trust fund into the Treasury as repayment for the estimated amount of contributions subject to refund to employees who worked for more than one employer during the course of a year and paid contributions on wages in excess of the statutory maximum earnings base. This amount consisted of two transfers—one, made in January 1969 and amounting to \$33.5 million, represented refunds on earnings in calendar year 1967; the other, made in June 1969 and

amounting to \$42.0 million, represented refunds on earnings in calendar year 1968. The latter transfer resulted from an acceleration in the schedule of refund transfers into the Treasury.

Net contributions amounted to \$4,423 million, representing an increase of 26 percent over the amount for the preceding fiscal year. Growth in contribution income resulted from (1) the increase in the maximum annual amount of earnings taxable from \$6,600 to \$7,800 that became effective on January 1, 1968, (2) the increase, from 1.0 percent to 1.2 percent, in the combined employer-employee contribution rate (and the corresponding increase in the self-employed contribution rate) designated to finance benefits from the hospital insurance trust fund that also went into effect on January 1, 1968, and (3) the high level of employment and taxable earnings. The increase in net contributions would have been larger had it not been for the acceleration in the schedule of refund transfers into the Treasury. Although the increases in the earnings base and in the contribution rate became effective in 1968, fiscal year 1969 was the first full year during which they were operative.

Reference has been made in an earlier section to provisions of the Railroad Retirement Act which coordinate the railroad retirement and the hospital insurance programs and which govern the financial interchanges arising from the allocation of costs between the two systems. In accordance with these provisions, the Railroad Retirement Board and the Secretary of Health, Education, and Welfare determined that a transfer of \$53,776,000 from the railroad retirement account to the hospital insurance trust fund would place this fund in the same position, as of June 30, 1968, as it would have been if railroad employment had always been covered under the Social Security Act. This amount was transferred to the trust fund in August 1968, together with interest to the date of transfer amounting to \$392,000.

Reference has also been made earlier to provisions under which the hospital insurance trust fund is to be reimbursed annually from the general fund of the Treasury for the costs of granting noncontributory credits for military service performed before 1957, according to a determination made by the Secretary of Health, Education, and Welfare in September 1965. The annual amount of this determination for this trust fund was \$14.2 million. The trust fund received two annual reimbursements during fiscal year 1969; each amounting to \$11 million. The first of these reimbursements was received in July 1968, and the second was received in December 1968. The latter reimbursement represents an acceleration in the schedule of annual reimbursements.

Again, reference has been made earlier to provisions under which the hospital insurance trust fund is to be reimbursed from the general fund of the Treasury for costs of paying benefits under this program to certain uninsured persons. The reimbursement in fiscal year 1969 amounted to \$749 million, of which \$707 million was for benefit payments, \$23 million was for administrative expenses, and \$19 million was for interest.

The remaining \$96 million of receipts consisted of interest on the investments of the trust fund less interest on amounts of interfund transfers between this trust fund and the other three trust funds, old-age and survivors insurance, disability insurance, and supplementary medical insurance.

Disbursements from the trust fund during fiscal year 1969 amounted to \$4,758 million, representing \$4,654 million in benefit payments and \$104 million in net administrative expenses. Administrative expenses are allocated and charged directly to each of the four trust funds on the basis of provisional estimates. Periodically, as actual experience develops and is analyzed, adjustments to the allocations of administrative expenses for prior periods are effected by interfund transfers, with appropriate interest allowances.

Table 2 compares the actual experience in fiscal year 1969 with the estimates presented in the 1968 and 1969 annual reports of the Board of Trustees. Reference was made in an earlier section to the appropriation of contributions to the trust funds on an estimated basis, with subsequent periodic adjustments to account for differences from the amounts of contributions actually payable on the basis of reported earnings. In interpreting the figures in table 2, it should be noted that the "actual" amount of contributions in fiscal year 1969 reflects the aforementioned type of adjustments to contributions for prior fiscal years. On the other hand, the "actual" amount of contributions in fiscal year 1969 does not reflect adjustments to contributions for fiscal year 1969 that were to be made after June 30, 1969. The estimated contributions in both the 1968 and 1969 reports were very close to the actual experience. The estimated benefit payments in the 1968 report were 16 percent lower than the actual experience, while the corresponding figure with respect to the 1969 report is 5 percent. The estimated assets at the end of the fiscal year in the 1968 report were 52 percent higher than the actual assets, while the corresponding figure with respect to the 1969 report was 9 percent—largely because of the difference between estimated and actual benefit payments.

TABLE 2.—COMPARISON OF ACTUAL AND ESTIMATED OPERATIONS OF THE HOSPITAL INSURANCE TRUST FUND
FISCAL YEAR 1969

[Amounts in millions]

	Comparison of actual experience with estimates for fiscal year 1969 published in—				
	Actual amount	1969 report		1968 report	
		Estimated amount	Estimated as percentage of actual	Estimated amount	Estimated as percentage of actual
Net contributions ¹	\$4,465	\$4,450	100	\$4,356	98
Benefit payments ²	4,585	4,367	95	3,865	84
Assets, end of year ¹	2,128	2,328	109	3,225	152

¹ The actual amounts have been adjusted to exclude the effect of the 2d transfer into the Treasury for refund of contributions, resulting from the accelerated schedule, in order that the actual experience be presented on a basis consistent with the basis on which the estimates shown in the 1968 and 1969 annual reports were prepared.

² The actual amounts have been adjusted to take into account the effect of the transfer (in October 1969) made to this trust fund from the supplementary medical insurance trust fund to reimburse for the cost of certain physician radiology and pathology services which were paid at first from the hospital insurance trust fund, but were an obligation of the supplementary medical insurance trust fund. The amount of such transfer that related to services rendered in fiscal year 1969 was \$69 million. This adjustment was made so that the actual experience would be presented on a basis consistent with the basis on which the estimates shown in the 1968 and 1969 annual reports were prepared.

Note: In interpreting the figures in the above table, reference should be made to the accompanying text.

The assets of the trust fund at the end of fiscal year 1969 totaled \$2,017 million, consisting of \$1,890 million in the form of obligations of the U.S. Government, \$112 million in securities of federally-sponsored agencies, and \$15 million in undisbursed balances. Table 3

shows a comparison of the total assets of the fund and their distribution at the end of fiscal years 1968 and 1969.

The net increase in the par value of the investments held by the fund during fiscal year 1969 amounted to \$631 million. New securities at a total par value of \$6,157 million were acquired during the fiscal year, through the investment of receipts and the reinvestment of funds made available from the maturity of securities. The par value of securities redeemed during the fiscal year was \$5,526 million. A summary of transactions for the fiscal year, by type of security, is presented in table 3a.

TABLE 3.—ASSETS OF THE HOSPITAL INSURANCE TRUST FUND, BY TYPE, AT END OF FISCAL YEARS 1968 AND 1969

	June 30, 1968		June 30, 1969	
	Par value	Book value ¹	Par value	Book value ¹
Investments in public-debt obligations sold only to this fund (special issues):				
Notes:				
4¾ percent, 1972	\$46,131,000	\$46,131,000.00	\$46,131,000	\$46,131,000.00
4¾ percent, 1973	46,131,000	46,131,000.00	46,131,000	46,131,000.00
4¾ percent, 1974	415,179,000	415,179,000.00	415,179,000	415,179,000.00
4¾ percent, 1971	255,794,000	255,794,000.00	157,770,000	157,770,000.00
5¾ percent, 1975	495,529,000	495,529,000.00	495,529,000	495,529,000.00
6½ percent, 1976			729,200,000	729,200,000.00
Total public-debt obligations sold only to this fund (special issues)	1,258,764,000	1,258,764,000.00	1,889,940,000	1,889,940,000.00
Investments in federally-sponsored agency obligations:				
Agency securities:				
Federal National Mortgage Association debentures:				
6 percent, 1969	41,500,000	41,512,248.19	41,500,000	41,503,602.31
Participation certificates:				
Federal Assets Liquidation Trust-Government National Mortgage Association: 5.20 percent, 1982	50,000,000	50,000,000.00	50,000,000	50,000,000.00
Federal Assets Financing Trust-Government National Mortgage Association: 6.30 percent, 1971	20,000,000	20,000,000.00	20,000,000	20,000,000.00
Total investments in federally-sponsored agency obligations	111,500,000	111,512,248.19	111,500,000	111,503,602.31
Total investments	1,370,264,000	1,370,276,248.19	2,001,440,000	2,001,443,602.31
Undisbursed balances		60,360,187.67		15,077,780.22
Total assets		1,430,636,435.86		2,016,521,382.53

¹ Par value, plus unamortized premium, less discount outstanding.

TABLE 3a.—STATEMENT OF TRANSACTIONS IN PUBLIC-DEBT AND IN FEDERALLY-SPONSORED AGENCY OBLIGATIONS FOR THE HOSPITAL INSURANCE TRUST FUND DURING THE FISCAL YEAR 1969

[All amounts represent par values]

	Acquisitions	Dispositions
Public-debt obligations sold only to this fund (special issues):		
Certificates of indebtedness:		
5¼-percent, 1969	\$448,508,000	\$448,508,000
5¾-percent, 1969	704,297,000	704,297,000
5½-percent, 1969	942,842,000	942,842,000
5¾-percent, 1969	278,378,000	278,378,000
6-percent, 1969	891,781,000	891,781,000
6½-percent, 1969	950,189,000	950,189,000
6¼-percent, 1969	859,058,000	859,058,000
6½-percent, 1969	352,474,000	352,474,000
Notes:		
4¾-percent, 1971		98,024,000
6½-percent, 1976	729,200,000	
Total transactions	6,156,727,000	5,525,551,000

On June 30, 1969, the special issues held by the hospital insurance trust fund, totaling \$1,890 million, were distributed by year of maturity, 1971-76, in varying amounts ranging from \$46,131,000 to \$729,200,000 (table 3).

The public-debt obligations issued for purchase by the hospital insurance trust fund are to have maturities fixed with due regard for the needs of the trust fund. In implementing the similar provision for the old-age and survivors insurance and disability insurance trust funds, the maturity dates for the holdings of special issues are spread as nearly as practicable in equal amounts over a 15-year period. It has not been possible to implement this policy with respect to such investments of the hospital insurance trust fund. The circumstances that have influenced the setting of maturity dates for investments in special issues of this fund are illustrated by the acquisition in June 1969 of the 7-year notes maturing June 30, 1976. (A similar situation existed in June 1968 when 7-year notes maturing in 1975 were acquired.) Briefly, the interest rate on special issues acquired in June 1969, as determined under section 1817(c) of the Social Security Act, was 6½ percent, while the interest rate on long-term issues is limited to 4¼ percent. Therefore, the intended policy to spread the maturities equally over a 15-year period could not be followed, and the entire available amount was invested in 6½ percent 7-year notes, the longest term issue possible at the prescribed interest rate.

EXPECTED OPERATIONS AND STATUS OF THE TRUST FUND DURING THE PERIOD JULY 1, 1969, TO JUNE 30, 1972

In the following statement of the expected operations and status of the hospital insurance trust fund during the period July 1, 1969, to June 30, 1972, it is assumed that present statutory provisions affecting the hospital insurance program remain unchanged throughout the period. The income and disbursements of the program, however, are affected by general economic conditions, hospital utilization rates, and hospitalization costs. Because it is difficult to forecast these factors, the assumptions and the resulting cost estimates presented here are subject to some uncertainty. This statement of the

expected operations of the trust fund should, therefore, be read with full recognition of the difficulties involved in making the estimates.

Estimates are presented in table 4 to show the expected operations of the trust fund in fiscal years 1970-72. They are based on the assumption that economic activity will expand throughout the period, with employment and earnings increasing through 1972. Under this assumption, the estimated number of persons with taxable earnings under the hospital insurance program is expected to increase from 92 million during calendar year 1969 to 98 million during calendar year 1972; their taxable earnings are estimated to be \$402 billion (\$374 billion of taxable wages and \$28 billion of taxable self-employment income). The increase in estimated income from contributions in fiscal years 1970-72 reflects the assumed upward trend in the levels of employment and earnings. Benefit disbursements increase from fiscal year 1970 to 1972 because of the long-range upward trend in the number of beneficiaries under the program and the assumed increase in hospitalization costs per unit of service, as well as the assumed long-term trend in hospital utilization rates.

TABLE 4.—ACTUAL AND ESTIMATED OPERATIONS OF THE HOSPITAL INSURANCE TRUST FUND,
FISCAL YEARS 1966-72

[In millions]

Item	Actual				Estimated		
	1966	1967	1968	1969	1970	1971	1972
Income:							
Contributions ¹	\$909	\$2,689	\$3,514	\$4,423	\$4,758	\$5,005	\$5,227
Interest on investments ²	6	46	61	96	131	129	74
Transfers from railroad retirement account.....		16	44	54	63	63	62
Reimbursement for uninsured persons ³		327	273	749	617	879	673
Reimbursement for military service wage credits.....		11	11	22	11	11	11
Total income.....	915	3,089	3,902	5,344	5,580	6,087	6,047
Disbursements:							
Benefit payments.....		2,508	3,736	4,654	5,175	6,250	7,360
Administrative expenses ⁴	64	89	79	104	147	136	156
Total, disbursements.....	64	2,597	3,815	4,758	5,322	6,386	7,516
Net increase in fund.....	851	492	88	586	258	-299	-1,469
Fund at end of year.....	851	1,343	1,431	2,017	2,275	1,976	507

¹ Adjusted to exclude refunds of employee taxes paid on wages in excess of maximum taxable earnings base.

² Includes net profits on marketable investments, adjustment for interest on administrative expenses reimbursed to the old-age and survivors insurance trust fund, and for interest on reimbursement for uninsured persons.

³ Reimbursement for benefit costs and additional administrative expenses for uninsured persons is made currently from general fund of the Treasury.

⁴ Receipts from sales of surplus materials, services, etc., are deducted from gross administrative expenses.

Income of the trust fund is expected to exceed outgo in fiscal year 1970; then, the outgo will exceed the income. During fiscal years 1970-72, there is an estimated net decrease in the trust fund of \$1.5 billion.

Reference has been made earlier to the financial interchanges between the railroad retirement account and the trust fund under the provisions of the Railroad Retirement Act. The estimates shown in table 4 reflect the effect of future financial interchanges.

Section 217(g) of the Social Security Act, as amended by the 1965 amendments, provides that the trust fund shall be reimbursed from general revenues for expenditures resulting from the provisions that granted noncontributory \$160 monthly wage credits to persons who served in the Armed Forces at some time during the period September 16, 1940, through December 31, 1956, and from the provisions enacted

in 1946 that granted survivor protection to certain World War II veterans for a period of 3 years after leaving service.

A description of the legislative history of provisions relating to credit for military service is contained in appendix II. The estimated total additional costs arising from payments that will be made in future years are intended to be amortized by level annual appropriations to the trust fund over a 50-year period beginning in fiscal year 1966 according to a determination made by the Secretary of Health, Education, and Welfare in September 1965 (the amount so determined was \$14.2 million). Periodically, the estimated amount of annual payment will be refigured to reflect actual costs incurred and revision in the future estimates.

The reimbursement in fiscal year 1969, amounting to \$22.0 million represents payment for 2 fiscal years, 1968 and 1969; \$11.0 million has been appropriated for fiscal year 1970, and it is assumed that the reimbursement will be received by the trust fund before July 1970. Moreover, the budget of the United States for the fiscal year 1971 makes similar provision for another reimbursement to the trust fund. The estimates shown in table 4 reflect the effect of past reimbursements and assume that future reimbursements will be made in similar fashion.

ACTUARIAL STATUS OF THE TRUST FUND

When the hospital insurance program was being enacted in 1965, a certain procedure for developing the cost estimates and determining the actuarial balance of the program was established by the Congress after considering possible approaches recommended by actuaries. This procedure has continued to be followed and used to prepare the actuarial cost estimates for the various annual reports of the Board of Trustees.

The long-term actuarial cost estimates for the HI program are made over a future period of 25 years. It is believed that a 25-year projection period for this program is as far ahead as should be considered, because of the uncertainty as to future institutional care practices and possible changes in the costs of these institutional services. On the other hand, the program is a long-term social insurance program; thus, it is necessary to look ahead for a period in the future to have some idea as to the rising costs that are possible, even with the uncertainties stated above.

Hospital insurance benefit payments will increase for many years—not only in terms of dollars, but also as a percentage of taxable payroll. Estimates covering a 25-year future period are needed, therefore, to indicate the extent to which the cost will increase and to indicate whether the financing provisions of existing law are adequate to maintain the system on an actuarially sound basis over this period (after also taking into account, interest earnings on the trust fund).

The benefit cost will rise in future years because there will be greater numbers of people over age 65. During recent years, hospitalization costs have increased more rapidly than general earnings levels, and it is likely that this trend will continue for some years. In the long run, it is expected that hospitalization costs will increase at the same rate as general wages.

The cost estimate for the hospital insurance program assumes that earnings in covered employment will rise in the future. This is a differ-

ent approach from the assumptions used in the cost estimates for the old-age, survivors, and disability insurance system. Under the latter program, a level-earnings assumption is used (for reasons described in detail in the trustees report for that program). Such procedure provides a margin of safety, because increases in earnings, with no changes in the program, result in lower cost expressed as a percentage of taxable payroll. In other words, the result of this assumption is that, when earnings rise, a margin will be provided that can be used to increase benefits without changing the contribution rates.

On the other hand, the actuarial cost estimate for the hospital insurance program assumes that hospitalization costs will have a rising trend. The major cause is that wages are increasing and about 60 percent of the hospital costs are due to wages. Since the trend of increasing wages is reflected in the benefit cost, then it is only realistic to take into account the additional income from the increase in earnings in covered employment.

Two alternative assumptions have been made as to the maximum taxable earnings base. The first alternative assumes that the earnings base will be increased in the future proportionately with changes in the level of general earnings (as has been the actual experience during the last two decades). If the Congress continues to increase the earnings base in the future when earnings levels rise (as it has done in the past), then such increase in the maximum taxable earnings base would generate additional contribution income, but no additional benefit liability (unlike the situation for the cash benefits program). Because it is assumed in the cost estimates for the hospital insurance program that earnings will rise in the future, then it is reasonable to assume that the earnings base will similarly rise. This is so, not necessarily for reasons relating to this program, but rather because, if the base were to remain level under conditions of rising earnings, then there would over the long run be a serious deterioration of the benefit protection provided by the cash benefits program (as more and more people had earnings above the base, and thus did not have their full earnings utilized for benefit computation purposes).

The second alternative assumes that the earnings base will remain fixed at the present \$7,800 per year for the entire 25-year period, even though it is assumed that earnings levels will increase throughout the 25-year period. Although this assumption is not as reasonable as the foregoing assumption of the earnings base keeping up to date with changes in earnings, it is included here in part because this has been the basis for the long-range cost estimates that have been made since the program was enacted.

Table 5a shows the estimated progress of the hospital insurance trust fund on an incurred basis, according to the intermediate cost estimate, for various future calendar years up through 1994 under present law (including the assumption that the earnings base remains fixed at the present \$7,800 for the 25-year period). Table 5b shows similar data under the assumption that the earnings base is kept up to date with changes in the general earnings level in the future. This estimate was prepared at the end of 1969, using the latest actual experience from the hospital insurance program. The cash figures on a fiscal year basis as shown in table 4 are prepared on the same basis as the figures in table 5, except that the latter is on an incurred basis.

TABLE 5a.—PROGRESS OF HOSPITAL INSURANCE TRUST FUND, UNDER ASSUMPTION THAT EARNINGS BASE REMAINS FIXED AT \$7,800, INCURRED BASIS, INTERMEDIATE-COST ESTIMATE ¹

[In millions]

Calendar year	Contributions ²	Payments from General Fund ¹	Benefit payments	Administrative expenses	Interest on fund	Fund balance at end of year
1966.....	\$2, 115	\$232	\$1, 397	³ \$107	\$45	\$888
1967.....	3, 330	495	3, 367	77	56	1, 325
1968.....	4, 315	553	4, 102	99	80	2, 072
1969.....	4, 618	593	4, 873	117	120	2, 413
1970.....	4, 973	618	5, 820	140	139	2, 183
1971.....	5, 231	656	6, 894	150	101	1, 127
1972.....	5, 482	685	8, 031	161	8	(⁴)
1973.....	6, 202	701	9, 204	172	(⁴)	(⁴)
1974.....	6, 461	701	10, 383	183	(⁴)	(⁴)
1975.....	6, 718	688	11, 477	195	(⁴)	(⁴)
1980.....	9, 855	490	16, 138	260	(⁴)	(⁴)
1985.....	11, 405	282	21, 462	345	(⁴)	(⁴)
1990.....	14, 765	116	28, 586	457	(⁴)	(⁴)
1994.....	16, 700	45	35, 500	560	(⁴)	(⁴)

¹ Including transactions with respect to uninsured persons. The payments shown as being from the General Fund of the Treasury do not include any interest-adjustment items (which are included in the interest column). The benefit payments and administrative expenses with respect to uninsured persons are included in their respective columns.

² Including transfers from the railroad retirement account under financial interchange provisions and reimbursement from the General Fund of the Treasury for the cost of additional benefits arising from noncontributory military service wage credits.

³ Including administrative expenses incurred in 1965.

⁴ Fund exhausted in 1972.

TABLE 5b.—PROGRESS OF HOSPITAL INSURANCE TRUST FUND, UNDER ASSUMPTION THAT EARNINGS BASE IS KEPT UP TO DATE WITH INCREASES IN EARNINGS, INCURRED BASIS, INTERMEDIATE-COST ESTIMATE ¹

[In millions]

Calendar year	Contributions ²	Payments from General Fund ¹	Benefit payments	Administrative expenses	Interest on fund	Fund balance at end of year
1966.....	\$2, 115	\$232	\$1, 397	³ \$107	\$45	\$888
1967.....	3, 330	495	3, 367	77	56	1, 325
1968.....	4, 315	553	4, 102	99	80	2, 072
1969.....	4, 618	593	4, 873	117	120	2, 413
1970.....	4, 973	618	5, 820	140	139	2, 183
1971.....	5, 556	656	6, 894	150	110	1, 461
1972.....	5, 841	685	8, 031	161	38	(⁴)
1973.....	6, 972	701	9, 204	172	(⁴)	(⁴)
1974.....	7, 300	701	10, 383	183	(⁴)	(⁴)
1975.....	7, 802	688	11, 477	195	(⁴)	(⁴)
1980.....	12, 785	490	16, 138	260	(⁴)	(⁴)
1985.....	16, 690	282	21, 462	345	(⁴)	(⁴)
1990.....	24, 132	116	28, 586	457	(⁴)	(⁴)
1994.....	29, 926	45	35, 500	560	(⁴)	(⁴)

¹ Including transactions with respect to uninsured persons. The payments shown as being from the General Fund of the Treasury do not include any interest-adjustment items (which are included in the interest column). The benefit payments and administrative expenses with respect to uninsured persons are included in their respective columns.

² Including transfers from the railroad retirement account under financial interchange provisions and reimbursement from the General Fund of the Treasury for the cost of additional benefits arising from noncontributory military service wage credits.

³ Including administrative expenses incurred in 1965.

⁴ Fund exhausted in 1972.

The benefits with respect to the uninsured group, and the accompanying administrative expenses, are paid from the hospital insurance trust fund, with the intention being that there will be current reimbursement therefor from the general fund of the Treasury. These benefit payments will decrease slowly in the future because the effect of mortality on this closed group more than offsets the rising trend of hospitalization costs and the increasing hospital utilization per capita for this group, as the average age becomes higher. The estimated

benefit payments and administrative expenses for this category for 1970 and the following 5 calendar years are as follows (in millions):

Calendar year:	
1970	\$618
1971	656
1972	685
1973	701
1974	701
1975	688

The estimated level cost of the benefits and administrative expenses under the hospital insurance program is 2.04 percent of taxable payroll under the assumption that the earnings base will be kept up to date in the future with rises in earnings. The level equivalent of the contribution schedule is estimated at 1.56 percent of taxable payroll. Therefore, the new actuarial cost estimate indicates that the program has an actuarial deficit of 0.48 percent of taxable payroll on a level cost basis. Under the assumption that the earnings base remains fixed at \$7,800 over the 25-year period, the corresponding figures are: benefits and administrative expenses, 2.76 percent of taxable payroll; contributions, 1.52 percent of taxable payroll; and actuarial deficit, 1.24 percent of taxable payroll.

As shown in table 5, in 1970, the disbursements will exceed the income, and the trust fund would decrease thereafter and would be exhausted in 1972.

The long-range actuarial cost estimates presented here were developed in late 1969. Using the estimate based on the assumption that the earnings base remains unchanged at \$7,800 for the entire 25-year period—for purposes of comparability—these new estimates show a much more unfavorable actuarial balance than the previous one as shown in the 1968 report of the Board of Trustees—namely, a negative balance of 1.24 percent of taxable payroll as compared with the previous negative balance of 0.29 percent. The worsening of the actuarial balance according to the new cost estimates arises largely from the assumptions that unit costs of services will continue to increase substantially over the next few years (whereas in the estimates made in 1968 and before, it had been assumed that these rates of increase would drop off sharply in the near future). The actual experience has indicated that there has been no slackening of these rates of increase, and so it is only prudent that any future assumptions in regard thereto should involve much slower declines than had previously been assumed. Such declines will certainly occur, because otherwise the indefinite maintenance of the current high rates of increase would produce such anomalous results as hospital employees having much higher wages than other workers and as the cost of a day in a hospital being in excess of the annual earnings of most workers.

Another factor which should be recognized, based on recent experience and likely future developments, is some increase in the utilization of services, especially those involving other than inpatient care. Current indications are that there will be extensive increases in utilization of extended care facility services and home health services in the future, as more and more of these services become widely available. Although some people believe that extension of these out-of-hospital services will result in a reduction of in-hospital services, there

is no evidence to substantiate that there will be an absolute reduction of in-hospital utilization—although perhaps otherwise there might be more of an increase therein than will actually eventuate.

A discussion of the assumptions under which these new cost estimates have been made appears in appendix I.

CONCLUSION

New long-range actuarial cost estimates for the hospital insurance system were completed in February 1970. These indicate that the system has an unfavorable actuarial balance—0.48 percent of taxable payroll according to the intermediate-cost estimate on a level-cost basis computed over the next 25 years, under the assumption that the earnings base will be kept up to date in the future, by increasing it proportionately with increases in the general earnings level (as has been the case in actual past experience since 1950). If the assumption is made that the maximum taxable earnings base will remain unchanged at \$7,800 per year in all future years (as in present law), despite the assumption in the cost estimates that the earnings level will increase significantly in future years, then the hospital insurance program would have an unfavorable actuarial balance of 1.24 percent of taxable payroll.

Under either assumption about the earnings base, new legislation would have to be sought to finance the system on an actuarially sound basis. Under the assumption that the earnings base will be kept up to date in the future, this situation could be achieved through several different alternative approaches—for example, (1) by having a level contribution rate on workers and employers of 1 percent each in all years after 1970, or (2) by increasing all rates in the present contribution schedule by 0.25 percent each (so that the rate for 1971–72 would be 0.85 percent each, and the ultimate rate, for 1987 and after, would be 1.15 percent each).

