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1973 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 1973 ANNUAL REPORT OF THE BOARD (8TH REPORT), PURSUANT TO SECTION 1817(b) OF THE SOCIAL SECURITY ACT, AS AMENDED

JULY 16, 1973.—Referred to the Committee on Ways and Means and ordered to be printed

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LETTER OF TRANSMITTAL

BOARD OF TRUSTEES OF THE
FEDERAL HOSPITAL INSURANCE TRUST FUND,
Washington, D.C., July 13, 1973.

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

SIR: We have the honor to transmit to you the 1973 Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund (the eighth such report), in compliance with the provisions of section 1817(b) of the Social Security Act, as amended.

Respectfully,

GEORGE P. SHULTZ,
Secretary of the Treasury,
and Managing Trustee of the Trust Funds.

PETER J. BRENNAN,
Secretary of Labor.

CASPAR W. WEINBERGER,
Secretary of Health, Education, and Welfare.

ARTHUR E. HESS,
Acting Commissioner of Social Security.

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1973 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. The Board of Trustees reports to the Congress once each year in compliance with section 1817(b)(2) of the Social Security Act. This Report is the annual report for 1973, the eighth such report.

HIGHLIGHTS

The more important developments during fiscal year 1972, discussed in more detail in later sections, are indicated below:

(*a*) The hospital insurance trust fund decreased during fiscal year 1972, by an amount somewhat less than that predicted in the 1972 Report. Income for fiscal 1972 amounted to just over $6.0 billion, up very little over fiscal 1971. Benefit payments and administrative expenses totalled nearly $6.3 billion, 12 percent more than in fiscal 1971. The fund decreased by $244 million in fiscal 1972 to $2.9 billion on June 30, 1972.

(*b*) Approximately 20.8 million persons were protected by the hospital insurance program in June 1972. About 4.6 million persons actually received benefits during fiscal year 1972. An estimated 95 million workers had earnings in calendar year 1971 that were taxable and creditable toward eligibility under the program.

(*c*) The trust fund earned $188 million in interest during the year, equivalent to an annual rate of 6.7 percent.

(*d*) The Secretary of HEW promulgated a $72 inpatient deductible for 1973 after a ruling by the Price Commission that the deductible was a price paid for hospital services and could not increase by more than 6 percent.

SOCIAL SECURITY AMENDMENTS SINCE 1972 REPORT

Since the close of fiscal year 1972 there have been important amendments to the Social Security Act (and the Internal Revenue Code) substantially affecting the hospital insurance system. Unlike last year's report, which could not consider the changed situation when and if legislation then partway through the legislative process might be enacted, this Report fully recognizes the new legislation.

Social security amendments of 1972 provided for an increase in the employer-employee contribution rate, effective as of January 1, 1973, from 0.65 percent (on a $9,000 base) to 1.0 percent (on a $10,800 base). This increase is expected to strengthen the financing of the hospital insurance program, and to reverse the downward trend in the trust fund, even though the 1972 Amendments also extended coverage to disabled workers entitled to disability insurance benefits for at least 24 consecutive months, and to persons requiring dialysis or transplants as a result of chronic kidney disease. Details of the 1972 Amendments and their financial effect can be found in documents prepared by and for the Congress.

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 includes workers covered under the old-age, survivors, and disability insurance program and those covered under the railroad retirement 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 wages (cash tips, covered as wages beginning in 1966 under the 1965 Amendments, are an execption 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 contribution rate and the maximum amount of annual earnings taxable in each of the calendar years 1966 and later is shown below. The table, for 1972 and earlier, is an historical record based on continually changing law. For 1973 and later the table indicates the provisions of present law, as last amended in 1972.

Calendar years	Maximum taxable amount	Contribution rates (as a percent of taxable earnings)	
		Employees and employers, each	Self-employed
1966	$6,600	0.35%	0.35%
1967	6,600	.50	.50
1968–71	7,800	.60	.60
1972	9,000	.60	.60
1973	10,800	1.00	1.00
1974	12,000	1.00	1.00
1975–77	(1)	1.00	1.00
1978–80	(1)	1.25	1.25
1981–85	(1)	1.35	1.35
1986 and after	(1)	1.45	1.45

[1] In accordance with automatic adjustment provisions.

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 contributions, 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 contributions he paid on such excess wages. The amount of contributions 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.

The Social Security Act provides that the trust funds shall be reimbursed from general revenues for expenditures resulting from those provisions that granted non-contributory wage credits for military service. The Secretary of Health, Education, and Welfare made a determination in 1970 of the level annual appropriations to the trust fund necessary to amortize over a 44-year period, beginning in fiscal year 1972, the estimated total additional costs arising from payments that had been made since July 1966 and that will be made in future

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years, after taking into account the amounts of annual appropriations in fiscal years 1966–70 that had been deposied into the trust funds.

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.

Hospital insurance benefits are provided to certain uninsured persons aged 65 and over. Such payments are made initially from the hospital insurance trust fund, with reimbursement 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.

Certain persons not eligible for hospital insurance coverage either on an insured basis or on the uninsured basis described in the previous paragraph may enroll in the program after July 1, 1973. Such enrollees pay a monthly premium of $33 in fiscal year 1974. The premium amount is adjusted annually thereafter in proportion to changes in the inpatient deductible.

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 pertaining to the hospital insurance program 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.

The Social Security Amendments of 1967 and 1972, respectively, authorize the Secretary of Health, Education, and Welfare to develop and conduct a broad range of experiments and demonstration projects designed to determine various methods of increasing efficiency and economy in providing health care services, while maintaining the quality of such services, under the hospital insurance and supplementary medical insurance programs. The costs of such experiments and demonstration projects are paid out of the hospital insurance and supplementary medical insurance trust funds. The costs paid out of the hospital insurance trust fund are included as part of benefit payments in the financial statements of operations of the trust fund as set forth in subsequent sections of this Report.

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—like the net worth of all other non-financial 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 guaranteed 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.

Summary of the Operations of the Trust Fund, Fiscal Year 1972

A statement of the income and disbursements of the Federal hospital insurance trust fund during fiscal year 1972 and of the assets of the fund at the beginning and the end of the fiscal year is presented in table 1. Also appearing in the table are comparable amounts for fiscal year 1971.

The total assets of the trust fund amounted to $3,103 million on June 30, 1971. By the end of fiscal year 1972, the assets amounted to $2,859 million, a decrease of $244 million.

Net receipts of the trust fund amounted to $6,031 million. Of this total, $4,743 million represented tax collections appropriated to the trust fund and $534 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, $51 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.

Net contributions amounted to $5,226 million, representing an increase of 6.7 percent over the amount for the preceding fiscal year. This growth in contribution income resulted primarily from (1) the higher level of employment and taxable earnings and (2) the increase in the maximum annual amount of earnings taxable from $7,800 to $9,000 that became effective on January 1, 1972.

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 interchange 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 $63,782,000 from the railroad retirement account to the hospital insurance trust fund would place this fund in the same position, as of June 30, 1971, 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 1971, together with interest to the date of transfer amounting to $2,324,000.

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. In accordance with these provisions, the Secretary of Health, Education, and Welfare made a determination in 1970 of the level annual appropriations to the trust fund necessary to amortize over a 44-year period, beginning in fiscal year 1972, the estimated total additional costs, for military service performed before 1957, arising from payments that have been made since July 1966 and that will be made in future years, taking into account the amounts of annual appropriations in fiscal years 1966–71 that have been deposited into the trust funds. The annual amount resulting from this determination was $48 million. Thus, a reimbursement amounting to $48 million was received by the trust fund in December 1971.

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 1972 amounted to $503 million, consisting of $496 million for benefit payments, $19 million for administrative expenses, and, as an offset, $12 million due the general fund for interest on negative adjustments to cost in prior fiscal years.

The remaining $188 million of receipts consisted almost entirely of interest on the investments of the trust fund.

Disbursements from the trust fund during fiscal year 1972 totalled $6,276 million. Of this total, $6,114 million represented benefits paid directly from the trust fund for health services covered under title XVIII of the Social Security Act and $905,000 represented amounts paid under incentive reimbursements. As offsets to benefit payments, transfers were made from the supplementary medical insurance trust fund consisting of $6 million for certain costs of radiology and pathology services, and $81,000 for costs of incentive reimbursement arrangements, that were paid initially from the hospital insurance trust fund but that were liabilities of the supplementary medical insurance trust fund. Net benefit payments from the trust fund in fiscal year 1972, therefore, amounted to $6,109 million, an increase of 12.2 percent over the corresponding amount paid in fiscal year 1971.

The remaining $166 million of disbursements was for net administrative expenses. Administrative expenses are allocated and charged directly to each of the four trust funds—old-age insurance, disability insurance, hospital insurance, and supplementary medical insurance—on the basis of provisional estimates. Periodically, as actual experience develops and is analyzed, adjustments to the allocations of administrative expenses, and costs of construction, for prior periods are effected by transfers among the four trust funds, with appropriate interest allowances.

Table 2 compares the actual experience in fiscal year 1972 with the estimates presented in the 1971 and 1972 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 1972 reflects the aforementioned type of adjustments to contributions for prior fiscal years. On the other hand, the "actual" amount of contributions in fiscal year 1972 does not reflect adjustments to contributions for fiscal year 1972 that were to be made after June 30, 1972. The estimated contributions in both the 1971 and 1972 Reports were quite close to the actual experience. Actual benefit payments were 9 percent lower than estimated in the 1971 Report, while the corresponding figure with respect to the 1972 Report is only 2 percent.

The assets of the trust fund at the end of fiscal year 1972 totaled $2,859 million, consisting of $2,834 million in the form of obligations of the U.S. Government, $50 million in securities of federally-sponsored agencies, and, as an offset, an overdraft of $25 million which was covered by the redemption of securities on July 3, 1972. Table 3 shows a comparison of the total assets of the fund and their distribution at the end of fiscal years 1971 and 1972.

The net decrease in the par value of the investments held by the fund during fiscal year 1972 amounted to $146 million. New securities at a total par value of $6,464 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 $6,610 million. Included in these amounts is $5,926 million in certificates of indebtedness that were acquired and redeemed within the fiscal year.

The effective annual rate of interest earned by the assets of the hospital insurance trust fund during fiscal year 1972 was 6.7 percent. The interest rate on public-debt obligations issued for purchase by the trust fund in June 1972 was 5¾ percent, compounded semiannually.

TABLE 1.—STATEMENT OF OPERATIONS OF THE HOSPITAL INSURANCE TRUST FUND DURING FISCAL YEARS 1971 AND 1972

[In thousands]

	Fiscal year— 1971	1972
Total assets of the trust fund, beginning of year	$2,677,401	$3,103,106
Receipts:		
Contributions:		
Appropriations	4,477,040	4,743,453
Deposits arising from State agreements	485,873	533,753
Gross contributions	4,962,913	5,277,206
Less payment into the Treasury for contributions subject to refund	64,934	51,315
Net contributions	4,897,979	5,225,891
Transfers from railroad retirement account	65,945	66,106
Reimbursements from general fund of the Treasury for costs of—		
Noncontributory credits for military service	11,000	48,000

TABLE 1.—STATEMENT OF OPERATIONS OF THE HOSPITAL INSURANCE TRUST FUND DURING FISCAL YEARS 1971 AND 1972—Continued

[In thousands]

	Fiscal year— 1971	1972
Benefits for uninsured persons:		
Benefit payments	819,201	496,000
Administrative expenses	26,925	19,033
Interest[1]	16,723	−11,682
Total reimbursement for costs of benefits for uninsured persons	862,849	503,351
Interest:		
Interest on investments	181,366	187,427
Interest on transfers from the supplementary medical insurance trust fund for reimbursement of benefits paid initially from the hospital insurance trust fund[1]	−796	5
Interest on amounts of interfund transfers due to adjustment in allocation of administrative expenses and construction costs[1]	−233	348
Total interest	180,337	187,781
Total receipts	6,018,110	6,031,128
Disbursements:		
Benefit payments:		
Paid directly from the trust fund for costs of—		
Health services	5,479,709	6,114,314
Incentive reimbursement arrangements[2]	622	905
Gross benefit payments	5,480,331	6,115,220
Less transfers from the supplementary medical insurance trust fund for reinbursement of payments made initially from the hospital insurance trust fund for costs of—		
Radiology and pathology services[2]	37,300	6,000
Incentive reimbursement arrangements[2]	59	81
Net benefit payments	5,442,971	6,109,139
Administrative expenses:		
Department of Health, Education, and Welfare[3]	142,633	159,606
Treasury Department	6,379	6,607
Construction of facilities for Social Security Administration	171	1,144
Interfund transfers due to adjustment in allocation of—		
Administrative expenses[4]	280	−1,101
Construction costs[4]	22	118
Gross administrative expenses	149,485	166,375
Less receipts from sale of surplus supplies, materials, etc	51	5
Net administrative expenses	149,434	166,370
Total disbursements	5,592,405	6,275,509
Not addition to the trust fund	425,705	−244,381
Total assets of the trust fund, end of year	3,103,106	2,858,725

[1] A positive figure represents a transfer of interest to the hospital insurance trust fund from the general fund of the Treasury or from the other social security trust funds. A negative figure represents a transfer of interest from the hospital insurance trust fund to the general fund of the Treasury or to the other social security trust funds.
[2] For explanation, see text.
[3] Includes administrative expenses of the intermediaries.
[4] A positive figure represents a transfer from the hospital insurance trust fund to the other social security trust funds. A negative figure represents a transfer to the hospital insurance trust fund from the other social security trust funds.

TABLE 2.—COMPARISON OF ACTUAL AND ESTIMATED OPERATIONS OF THE HOSPITAL INSURANCE TRUST FUND, FISCAL YEAR 1972

[Amounts in millions]

Item	Actual amount	1972 report: Estimated amount	1972 report: Actual as percentage of estimate	1971 report: Estimated amount	1971 report: Actual as percentage of estimate
Net contributions	$5,226	$5,213	100	$5,368	97
Benefit payments	6,109	6,265	98	6,690	91

Comparison of actual experience with estimates for fiscal year 1972 published in—

TABLE 3.—ASSETS OF THE HOSPITAL INSURANCE TRUST FUND, BY TYPE, AT THE END OF FISCAL YEARS 1971 AND 1972

	June 30, 1971		June 30, 1972	
	Par value	Book value [1]	Par value	Book value [1]
Investments in public-debt obligations sold only to this fund (special issues):				
Notes:				
5⅝ percent, 1975	$400,116,000	$400,116,000.00		
5¾ percent, 1979			$537,999,000	$537,999,000.00
6⅛ percent, 1978	931,182,000	931,182,000.00	931,182,000	931,182,000.00
6½ percent, 1976	729,200,000	729,200,000.00	445,419,000	445,419,000.00
7⅝ percent, 1977	919,358,000	919,358,000.00	919,358,000	919,358,000.00
Total public-debt obligations sold only to this fund (special issues)	2,979,856,000	2,979,856,000.00	2,833,958,000	2,833,958,000.00
Investments in federally-sponsored agency obligations:				
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
Total investments in federally-sponsored agency obligations	50,000,000	50,000,000.00	50,000,000	50,000,000.00
Total investments	3,029,856,000	3,029,856,000.00	2,883,958,000	2,883,958,000.00
Undisbursed balances		73,249,599.39		[2] −25,233,199.85
Total assets		3,103,105,599.39		2,858,724,800.15

[1] Par value, plus unamortized premium, less discount outstanding.
[2] A minus figure represents an overdraft which is covered by the redemption of securities on the first working day of the following month.

Report of the 1971 Advisory Council on Social Security

Pursuant to Section 706 of the Social Security Act, an Advisory Council on Social Security was appointed in May 1969 and submitted its report on April 5, 1971. The Council made certain recommendations which directly affect the financing methods, the actuarial methodology, and the adequacy of the trust funds. As to these, the Trustees have the responsibility of a careful evaluation, and a transmittal of the Trustees' views, as a part of the Trustees' Reports.

The Trustees discharged this responsibility to a large extent in the 1972 Reports. Two of the Council's financing recommendations, which were not discussed then, have now been evaluated, as follows:

4. *Securities Issued by Federally-Sponsored Agencies.—The Council believes that there is adequate statutory authority for investment of trust fund money in securities issued by federally-sponsored agencies. The Council recommends that the Managing Trustee establish a policy of purchasing a portion of new obligations issued by such agencies as investments for the trust funds.*

The Board of Trustees recognizes that statutory authority exists for trust fund investment in securities of federally-sponsored agencies; and that the trust funds might earn a small amount of additional interest if the Council recommendation were followed. The Board is nonetheless opposed to this recommendation under present procedures for federal agency financing. The Secretary of Treasury's dual roles as Managing Trustee and as chief financial officer of the Government would create conflicts of interest that do not now exist. Purchase of securities of agencies privately owned but federally-sponsored would become an expenditure in the Federal accounts, would add to the Federal deficit, and would deprive the President and the Congress of their full range of choice in determining priorities. It is possible that these difficulties may be resolved if plans for a federal-financing bank materialize, in which case the Board of Trustees will reconsider their position.

12. *Contribution Rates.—The Council believes that the contribution rate schedule for the next 10 years should be designed to follow closely the principle of current-cost financing. Contribution rates for the Medicare program would not extend beyond a 10-year period since the Council does not believe that it is feasible to make realistic estimates for this program for a longer period.*

The Board of Trustees concurs with the first sentence of this recommendation, but not with the final sentence. The Board feels that the advantages claimed in shortening the period for which hospital insurance contribution rates are established are not sufficient to warrant the risk of disturbing public acceptance. The traditional 25-year period over which hospital insurance financing is measured has proven to be satisfactory.

Expected Operation and Status of the Trust Fund During the Period July 1, 1972 to June 30, 1975

The expected operation of the trust fund during the next three fiscal years is shown in table 4, together with the past experience of the program.[1]

[1] The actuarial methodology followed in preparing the estimates of future experience of the hospital insurance system is described in Appendix A.

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TABLE 4.—OPERATIONS OF THE HOSPITAL INSURANCE TRUST FUND, CASH BASIS, FISCAL YEARS 1967–75

[In millions of dollars]

Fiscal year	Income							Disbursements			Trust fund	
	Payroll taxes	Transfers from Railroad Retirement Account	Reimbursement for uninsured persons	Premiums for voluntary enrollees	Reimbursement for military wage credits	Interest on investments	Total income	Benefit payments	Administrative expenses	Total disbursements	Net increase in fund	Fund at end of year
Historical data:												
1967	2,689	16	327		11	46	3,089	2,508	89	2,597	492	1,343
1968	3,514	44	273		11	61	3,902	3,736	79	3,815	88	1,431
1969	4,423	54	749		22	96	5,344	4,654	104	4,758	586	2,017
1970	4,785	64	617		11	137	5,614	4,804	149	4,953	661	2,677
1971	4,898	66	863		11	180	6,018	5,443	149	5,592	426	3,103
1972	5,226	66	503		48	188	6,031	6,109	166	6,276	−245	2,859
Projection:												
1973	7,710	63	381		48	211	8,413	6,710	210	6,920	1,493	4,352
1974	11,359	105	537	82	48	354	12,485	8,790	296	9,086	3,399	7,751
1975	12,429	125	530	104	48	541	13,777	10,440	353	10,793	2,984	10,735

The estimates of income from hospital insurance contributions increase raidly during the period projected, primarily as a result of the increase in the hospital insurance tax rate to 1 percent on January 1, 1973, from 0.6 percent the previous year. Income during fiscal years 1973 and 1974 is increased by the change in the earnings base to $10,800 that took place on January 1, 1973. Income during fiscal years 1974 and 1975 is increased by the increase in the earnings base to $12,000 scheduled to occur on January 1, 1974.

Income received through the financial interchange between the railroad retirement account and the trust fund under the provisions of the Railroad Retirement Act is estimated on the same basis as income from hospital insurance contributions. Estimates of the corresponding outgo are included in the disbursement items.

Income to the trust fund appropriated from general revenues to reimburse the program for the cost of non-insured persons for coverage paid for by the Federal Government is estimated to be the same as the estimates of disbursements for such persons, net of corrections for differences between costs and reimbursements for previous years. Premium income and disbursements for other non-insured persons over age 65 who are permitted to enroll in the hospital insurance program beginning in July 1973 are based on a projected enrollment of 200,000.

Reimbursement from general revenues for military wage credits are projected at $48 million in each year, based on the determination made by the Secretary of Health, Education, and Welfare in 1970 of the level annual appropriations necessary to amortize the additional costs arising from these wage credits. The estimates assume that the amount of appropriation due for such military service wage credits are paid in the appropriate period.

Estimated disbursements for benefits and administrative expenses increase sharply in fiscal years 1974 and 1975, primarily as a result of the coverage of some disabled beneficiaries and persons suffering from chronic kidney disease beginning in July 1973. Due to the delay between the date on which services are performed and reimbursement for the cost of such services is paid from the trust fund, the full effect of the coverage of these new beneficiaries is not until fiscal year 1975.

The expenditures for benefit payments shown in table 4 are different from those shown in the current Federal Budget. The budget document incorporates some legislative recommendations which have not yet been enacted into law and hence are not reflected in any of the cost estimates in this Report, and some administrative actions and expenditure controls for which plans for implementation have been altered somewhat from those planned at the time the budget was published. The administrative actions are:

(*i*) Elimination during fiscal year 1973 of "current-financing" payments to providers, which compensated institutions for any delay between the date on which services were performed and payment for them was made on the basis of bills submitted.

(*ii*) A program of pre-admission certification and intensified utilization review.

(*iii*) New regulations by the Cost-of-Living Council which would substantially reduce the rate of increase in hospital costs recognized by the program for reimbursement purposes.

Current plans are to recover current-financing payments during fiscal year 1974 rather than during fiscal year 1973 as originally planned. A program of intensified utilization review will be instituted in conjunction with the implementation of the 1972 Amendments, and in a manner consistent with plans for subsequent implementation of peer review under professional standards review organizations. The estimated impact of these changes are reflected in the estimates underlying table 4. The final form of new price control regulations for medical institutions has not yet been determined by the Cost-of-Living Council and no date for implementation has yet been set. Consequently, no specific allowance could be made in the cost estimates in this Report for the new program. Estimates of the impact of prompt implementation of one of the options under consideration are discussed in Appendix A.

The actual operation of the hospital insurance program is in general organized on a calendar year basis. Earnings subject to taxation are determined by calendar year and the applicable tax rates are set by calendar year. The amount of the inpatient deductible and other cost sharing are also set for each calendar year.

Projections of the operations of the trust fund on a calendar year basis are shown in table 5, according to the same basis as used in table 4. The effect of increasing the hospital insurance tax rate in 1973 is more fully apparent in the income figures on a calendar year basis, as are the effects of increasing the maximum annual earnings subject to taxes. Further discussion of the financing of the hospital insurance program is also by calendar year, since the tax rates used to finance the program pertain to particular calendar years.

TABLE 5.—OPERATIONS OF THE HOSPITAL INSURANCE TRUST FUND, CASH BASIS, CALENDAR YEARS 1966–75

[In millions of dollars]

Calendar year	Income							Disbursements			Trust fund	
	Payroll taxes	Transfers from Railroad Retirement Account	Reimbursement for uninsured persons	Premiums for voluntary enrollees	Reimbursement for military wage credits	Interest on investments	Total income	Benefit payments	Administrative expenses	Total disbursements	Net increase in fund	Fund at end of year
Historical data:												
1966	940	16	26	------------	11	25	1,027	891	43	934	------------	944
1967	3,152	44	301	------------	11	51	3,559	3,353	77	3,430	129	1,073
1968	4,116	54	1,022	------------	22	74	5,287	4,179	99	4,277	1,010	2,083
1969	4,473	64	617	------------	11	113	5,279	4,739	118	4,857	422	2,505
1970	4,881	66	863	------------	11	158	5,979	5,124	157	5,281	698	3,202
1971	4,921	66	503	------------	48	193	5,732	5,751	149	5,900	−168	3,034
1972	5,731	63	381	------------	48	180	6,403	6,319	184	6,503	−99	2,935
Projection:												
1973	10,458	105	537	40	48	251	11,439	7,820	252	8,072	3,367	6,302
1974	11,851	125	530	93	48	445	13,092	9,490	324	9,814	3,278	9,580
1975	12,915	132	533	111	48	622	14,361	11,150	383	11,533	2,828	12,408

The ratios of the balance in the trust fund at the beginning of each calendar year to the total disbursements during that year are shown in table 6 for past years and as projected through 1975. The ratio of the fund to such disbursements grew gradually until it reached approximately the level of one-half of a year's expenditures as of the beginning of 1971. The ratio has fallen slightly since then, but is expected to increase to 83 percent of 1975 expenditures at the beginning of that year and to 100 percent of 1979 expenditures at the beginning of that year—as a result of the increase in the tax rates and earning bases beginning in January 1973.

TABLE 6.—*Assets at the beginning of the year, related to expenditures during the year for the hospital insurance trust fund*

Calendar year	*Ratio of assets, at beginning of year, to expenditures during the year*
Historical data:	
1967	0.28
1968	.25
1969	.43
1970	.47
1971	.54
1972	.47
Projection:	
1973	.36
1974	.64
1975	.83

ACTUARIAL STATUS OF THE TRUST FUND

The hospital insurance program, as a mature long-range social insurance program, is financed on a current-cost basis. The proportion of persons over age 65 who are currently eligible for benefits is nearly as high as can be expected in future years. Although the proportion of the population who have been disabled more than 2 years is gradually increasing, the impact of the increase on the expenditures of the program is relatively small. Similarly, the number of persons covered as a result of chronic kidney disease is projected to grow rapidly, but accounts for only a small proportion of total expenditures. It is appropriate to finance such a system on a pay-as-you-go basis, if modified to avoid abrupt changes in the tax rates and to maintain a suitable fund for adverse contingencies. The Board of Trustees, acting on the recommendation of the 1971 Advisory Council, has adopted these general financing principles.

The adequacy of the contribution rates specified by the current law to support the hospital insurance system is measured by comparison with "current costs" for the program over the 25-year valuation period. The current cost for the program in any year is essentially the combined employer-employee contribution rate that would be just sufficient to (1) provide the benefit payments and administrative expenses for the year, and (2) maintain the trust fund at the level of the following year's disbursements.

To finance the program over future years using these concepts, two further considerations must be taken into account. If the trust fund is not currently equal to the desired level of expected disbursements during the next year, the "current-costs" must be modified to adjust the growth (or decline) of the trust fund to a path that will lead to the desired level in some future year. Further, in recommending a schedule of tax rates, it is desirable that the rates recommended be rounded to avoid frequent changes in rates charged.

The current-costs of the hospital insurance program over the next 25 years are summarized in table 7, along with that part of the current-cost required to actually pay disbursements in each year. For purposes of comparison, the latter are also shown for past years.

TABLE 7.—EXPENDITURES OF HOSPITAL INSURANCE PROGRAM, 1967–95, AND CURRENT COSTS OF HOSPITAL INSURANCE PROGRAM, 1973–95 (AS PERCENT OF TAXABLE PAYROLL)[1]

Calendar year	Expenditures[2]	Current costs[3]
Historical data:		
1967	0.95	
1968	1.03	
1969	1.09	
1970	1.17	
1971	1.30	
1972	1.26	
Projection:		
1973	1.44	1.71
1974	1.64	1.77
1975	1.74	1.86
1980	2.28	2.37
1985	2.58	2.66
1990	2.92	2.99
1995	3.21	3.27
Average cost[4]		2.67

[1] Taxable payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple employer "excess wages."

[2] Benefit payments and administrative expenses for insured beneficiaries.

[3] Includes provision for maintenance of fund equal to next year's expenditures.

[4] The average cost is the average of the "current costs" for the 25-year period 1973–97, adjusted to build the trust fund to 100 percent of the following year's expenditures.

Since the projected level of the hospital insurance trust fund at the begining of calendar year 1973 is only 36 percent of the projected disbursements during 1973, provision must be made for increasing the trust fund to the desired level. The average allowance required for this purpose over the 25-year projection period is added to the average of the current costs over this period to obtain the average cost of 2.67 percent of taxable payroll.

As can be seen from table 7, the ratio of expenditures to taxable payroll has increased from .95 percent in 1967 to an estimated 1.26 percent in 1972, reflecting the higher rate of increase in hospital costs per capita than in earnings subject to hospital insurance taxes. This ratio is projected to increase to 1.44 percent in 1973 and 1.64 percent in 1974, reflecting both a continuation of this trend and the extension of hospital benefits to disabled beneficiaries and persons suffering from chronic kidney disease. A further increase in this ratio in the long run to 3.21 percent in 1995 results from the assumed continued increases in the cost per capita of institutional health care at a higher rate than in average taxable earnings.

The additional allowance necessary to maintain the trust fund at the level of 100 percent of the next year's disbursements (provided the trust fund is already at the level of the current year's disbursements at the beginning of the year) is projected to be at a relatively high level in the short run as a result of increases in disbursements related to disabled beneficiaries and persons with chronic kidney disease. In the long run, this factor is relatively less important, declining to 0.06 percent of taxable payroll in 1995.

The current cost is estimated at 1.71 percent for 1973, rises to 1.86 percent in 1975 when the coverage of new beneficiaries has full effect, and is projected to increase to 3.27 percent by 1995.

The assumptions used in projecting these current cost rates (as adjusted to build the trust fund to the required levels) are described in the Actuarial Appendix. The long run cost of the hospital insurance program depends primarily on the relationship between the aggregate cost of hospital services furnished to beneficiaries and the aggregate taxable payroll. In the long run, the average increase in the average earnings of hospital workers cannot differ substantially from that for other workers. Consequently, the rate of increase assumed for all workers will affect hospital costs and average earnings in approximately the same way over the long run and is thus a relatively unimportant parameter. Ultimately, it is the increase in quality, complexity, and extent of health services furnished in an institutional setting that determines the major portion of the increase in the current cost of the hospital insurance program. Demographic aspects play a relatively minor role over the 25-year period covered in the projections.

These projections assume that public pressure will keep hospital costs from increasing substantially faster than average earnings, in contrast to what has happened in the recent past. It is specifically assumed that in the long run such pressure will reduce this differential (between the rate of increase in hospital costs and the rate of increase in average earnings) to only 2 percent per year. The cost estimates will prove to be too low should there be a continuation of the rate of increase in the cost of hospital services that has been experienced in the recent past. Restraints on cost increases which are more effective than those existing at the present time will be required to keep the cost of the program within the estimates, especially in the long run. The 1972 Amendments included a number of provisions permitting administrative actions which when implemented could reduce the cost of the program. Projections of the cost of the program, assuming higher rates of increase in hospital costs are discussed in the Actuarial Appendix, along with a more detailed discussion of the assumptions used.

Table 8 compares the average current cost from table 7 with the average combined contribution rate under current law for the same 25-year period. The slightly negative actuarial balance (−0.04 percent of taxable payroll) indicates that the system is approximately in balance, according to the assumptions used.

TABLE 8.—*Estimated actuarial balance*[1] *of hospital insurance program* (*as a percent of taxable payroll*)

Average contribution rate in present schedule	2.63
Average current cost	2.67
Actuarial balance	−.04

[1] Over 25-year period 1973–97.

CONCLUSION

The hospital insurance trust fund at the beginning of 1973 is 36 percent of the projected expenditures for that year, and is therefore well below the Level of one year's expenditures recommended by the Advisory Council. Under the new financing schedule effective January 1, 1973, the ratio of fund to expenditures will increase, with the fund now projected to reach 83 percent of the year's expenditures at the beginning of 1975 and 100 percent of the year's expenditures at the beginning of 1979.

The new financing schedule is actuarially adequate over a 25-year period to provide the expenditures anticipated, including the benefits for newly eligible classes of beneficiaries, provided that the assumptions underlying the estimates prove to be realistic. Among these are the assumption of future public influence toward reducing the rate of increase in hospital expenditure. The cost estimates will prove to be low, and the contribution rates inadequate, should inflation and the rate of increase in the cost of hospital services continue at as high a rate as has been experienced in the recent past.