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1972 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 1972 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE TRUST FUND, PURSUANT TO SECTION 201(C) OF THE SOCIAL SECURITY ACT, AS AMENDED

JUNE 6, 1972.—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., June 6, 1972.

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

SIR: We have the honor to transmit to you the 1972 Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund (the seventh such report), in compliance with the provisions of section 1817(b) of the Social Security Act, as amended.

Respectfully,

JOHN B. CONNALLY,
Secretary of the Treasury,
and Managing Trustee of the Trust Funds.

J. D. HODGSON,
Secretary of Labor.

ELLIOT L. RICHARDSON,
Secretary of Health, Education, and Welfare.

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

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1972 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 1972, the seventh such report.

Highlights

The more important developments since the 1971 Report, discussed in more detail in later sections, are indicated below.

(*a*) The growth of the hospital insurance trust fund during fiscal year 1971 was close to that predicted in the 1971 Report. Income for fiscal 1971 amounted to $6.0 billion, up by 7 percent over fiscal 1970. Benefit payments and administrative expenses totalled $5.6 billion, 13 percent more than in fiscal 1970. The fund increased by $0.4 billion in fiscal 1971 to the level of $3.1 billion on June 30, 1971.

(*b*) Approximately 20.4 million persons were protected by the hospital insurance program by the end of June 1971. About 4.5 million persons actually received benefits as a result of covered institutional care during the year. An estimated 93 million workers had earnings in calendar year 1970 that were taxable and creditable toward benefits under the program.

(*c*) The trust fund earned $181 million in interest during the year, equivalent to an annual rate of 6.5 percent.

(*d*) The report of the 1971 Advisory Council on Social Security was received, and its recommendations concerning the financing of the hospital insurance program were carefully evaluated.

(*e*) A wage-price freeze became effective in August 1971 and the Phase II Economic Stabilization Program in November 1971. The Price Commission guidelines were issued in December 1971. The Economic Stabilization program is expected to have a pronounced effect on the level of benefit payments under the hospital insurance program.

Social Security Amendments Since 1971 Report

There have been no amendments affecting the Federal hospital Insurance Trust Fund since the passage of Public Law 92–5, approved on March 17, 1971. The changes brought about by the passage of the 1971 legislation were only with respect to the maximum taxable earnings base, raised to $9,000 beginning in 1972.

Legislation which would substantially modify the current law was introduced into the House of Representatives as H.R. 1, was favorably reported by the Ways and Means Committee on May 26, 1971, and was passed by the House of Representatives on June 22, 1971. As of the submission of this report, H.R. 1 is a matter of pending business before the Senate, but it has not become law. This report necessarily assumes current law, and does not consider the changed situation when and if H.R. 1 (or any modification thereof) is enacted.

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 taxable in each of the calendar years 1966 and later is shown in the table below. The contribution rate applicable to taxable earnings in each year is also shown. The table, for 1971 and earlier, is a historical record based on continually changing law. For 1972 and later the table indicates the provisions of present law, as last amended in 1971.

CONTRIBUTION RATES AND MAXIMUM TAXABLE AMOUNT OF ANNUAL EARNINGS

Calendar years	Maximum taxable amount of annual earnings	Contribution rates (percent of taxable earnings): Employees and employers, each	Contribution rates (percent of taxable earnings): 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
1973–75	9,000	.65	.65
1976–79	9,000	.70	.70
1980–86	9,000	.80	.80
1987 and after	9,000	.90	.90

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.

Sections 217(g) and 229(b) of the Social Security Act authorized 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.

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.

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 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 1971

A statement of the income and disbursements of the Federal hospital insurance trust fund during fiscal year 1971 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 1970.

The total assets of the trust fund amounted to $2,677 million on June 30, 1970. By the end of fiscal year 1971, the assets amounted to $3,103 million, an increase of $426 million.

Net receipts of the trust fund amounted to $6,018 million. Of this total, $4,477 million represented tax collections appropriated to the trust fund and $486 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, $65 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 $4,898 million, representing an increase of 2.4 percent over the amount for the preceding fiscal year. This growth in contribution income resulted primarily from the somewhat higher level of taxable earnings.

TABLE 1.—STATEMENT OF OPERATIONS OF THE HOSPITAL INSURANCE TRUST FUND DURING FISCAL YEARS 1970 AND 1971

[In thousands]

	Fiscal year— 1970	1971
Total assets of the trust fund, beginning of year	$2,016,521	$2,677,401
Receipts:		
Contributions:		
Appropriations	4,389,125	4,477,040
Deposits arising from State agreements	444,864	485,873
Gross contributions	4,833,989	4,962,913
Less payment into the Treasury for contributions subject to refund	49,200	64,934
Net contributions	4,784,789	4,897,979
Percentage increase in net contributions, 1970 to 1971		2.4
Transfers from railroad retirement account	63,537	65,945
Reimbursements from general fund of the Treasury for costs of—		
Noncontributory credits for military service	11,000	11,000
Benefits for uninsured persons:		
Benefit payments	596,211	819,201
Administrative expenses	12,974	26,925
Interest	8,077	16,723
Total reimbursement for costs of benefits for uninsured persons	617,262	862,849
Interest:		
Interest on investments	133,441	181,366
Interest on adjustments in provisional transfers from supplementary medical insurance trust fund for reimbursement of benefits paid initially from hospital insurance trust fund [1]	4,511	−800
Interest on amounts of interfund transfers due to adjustment in allocation of administrative expenses and construction costs [1]	−759	−229
Total interest	137,193	180,337
Total receipts	5,613,782	6,018,110

TABLE 1.—STATEMENT OF OPERATIONS OF THE HOSPITAL INSURANCE TRUST FUND DURING FISCAL YEARS 1970 and 1971—Continued

[In thousands]

	Fiscal year— 1970	Fiscal year— 1971
Disbursements:		
Gross benefit payments	4,966,942	5,480,271
Less transfers from supplementary medical insurance trust fund for reimbursement of benefits paid initially from hospital insurance trust fund [2]	162,700	37,300
Net benefit payments	4,804,242	5,442,971
Percentage increase in benefit payments, 1970 to 1971	13.3%	
Administrative expenses:		
Department of Health, Education, and Welfare [3]	125,729	142,633
Treasury Department	6,220	6,379
Construction of facilities for Social Security Administration	616	171
Interfund transfers due to adjustment in allocation of—		
Administrative expenses	15,251	280
Construction costs	853	22
Gross administrative expenses	148,669	149,485
Less receipts from sale of surplus supplies, materials, etc	9	51
Net administrative expenses	148,660	149,434
Total disbursements	4,952,902	5,592,405
Net addition to the trust fund	660,879	425,705
Total assets of the trust fund, end of year	2,677,401	3,103,106

[1] Positive interest transfers represent transfers of interest to the hospital insurance trust fund from the other social security trust funds. Negative interest transfers represent transfers of interest from the hospital insurance trust fund to the other social security trust funds.

[2] For explanation, see text.

[3] Includes administrative expenses of the intermediaries.

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 $65,364,000 from the railroad retirement account to the hospital insurance trust fund would place this fund in the same position, as of June 30, 1970, 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 1970, together with interest to the date of transfer amounting to $581,000.

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. In accordance with these provisions, the Secretary of Health, Education, and Welfare determined, in September 1965, that the annual amount due this trust fund was $14.2 million. An annual reimbursement amounting to $11 million was received in December 1970.

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 1971 amounted to $863 million, of which $819 million was for benefit payments, $27 million was for administrative expenses, and $17 million was for interest.

The remaining $180 million of receipts consisted of interest on the investments of the trust fund, adjusted for interest on amounts of interfund transfers among the four trust funds, old-age and survivors insurance, disability insurance, hospital insurance, and supplementary medical insurance.

Disbursements from the trust fund during fiscal year 1971 totaled \$5,592 million. Of this total, \$5,480 million represented gross benefit payments from the trust fund. As an offset, \$37 million was transferred from the supplementary medical insurance trust fund with respect to certain costs for radiology and pathology services that were paid from the hospital insurance trust fund but that are liabilities of the supplementary medical insurance trust fund. (Reimbursements for such costs are made on a provisional basis and are subject to adjustment, with appropriate interest allowances, as the actual experience develops and is analyzed.) Net benefit payments from the trust fund in fiscal year 1971, therefore, amounted to \$5,443 million, an increase of 13.3 percent over the corresponding amount paid in fiscal year 1970. The remaining \$149 million of disbursements was for 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, and costs of construction, for prior periods are effected by interfund transfers, with appropriate interest allowances.

Table 2 compares the actual experience in fiscal year 1971 with the estimates presented in the 1970 and 1971 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 1971 reflects the aforementioned type of adjustments to contributions for prior fiscal years. On the other hand, the "actual" amount of contributions in fiscal year 1971 does not reflect adjustments to contributions for fiscal year 1971 that were to be made after June 30, 1971. The estimated contributions in both the 1970 and 1971 reports were quite close to the actual experience. Actual benefit payments were 13 percent lower than estimated in the 1970 report, while the corresponding figure with respect to the 1971 report is only 3 percent.

The assets of the trust fund at the end of fiscal year 1971 totaled \$3,103 million, consisting of \$2,980 million in the form of obligations of the U.S. Government, \$50 million in securities of federally sponsored agencies, and \$73 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 1970 and 1971.

The net increase in the par value of the investments held by the fund during fiscal year 1971 amounted to \$377 million. New securities at a total par value of \$7,116 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 \$6,739 million.

The effective annual rate of interest earned by the assets of the hospital insurance trust fund during fiscal year 1971 was 6.5 percent. The interest rate on public-debt obligations issued for purchase by the trust fund in June 1971 was 6⅛ percent, compounded semiannually.

TABLE 2.—COMPARISON OF ACTUAL AND ESTIMATED OPERATIONS OF THE HOSPITAL INSURANCE TRUST FUND, FISCAL YEAR 1971

[Amounts in millions]

Item	Actual amount	Comparison of actual experience with estimates for fiscal year 1971 published in— 1971 report: Estimated amount	1971 report: Actual as percentage of estimate	1970 report: Estimated amount	1970 report: Actual as percentage of estimate
Net contributions	$4,898	$4,954	99	$5,005	98
Benefit payments	5,443	5,600	97	6,250	87

TABLE 3.—ASSETS OF THE HOSPITAL INSURANCE TRUST FUND, BY TYPE, AT END OF FISCAL YEARS 1970 AND 1971

	June 30, 1970		June 30, 1971	
	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, 1973	$24,056,000	$24,056,000.00		
4¾-percent, 1974	415,179,000	415,179,000.00		
5⅝-percent, 1975	495,529,000	495,529,000.00	$400,116,000	$400,116,000.00
6⅛-percent, 1978			931,182,000	931,182,000.00
6½-percent, 1976	729,200,000	729,200,000.00	729,200,000	729,200,000.00
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)	2,583,322,000	2,583,322,000.00	2,979,856,000	2,979,856,000.00
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
Federal Assets Financing Trust—Government National Mortgage Association: 6.30-percent, 1971	20,000,000	20,000,000.00		
Total investments in federally-sponsored agency obligations	70,000,000	70,000,000.00	50,000,000	50,000,000.00
Total investments	2,653,322,000	2,653,322,000.00	3,029,856,000	3,029,856,000.00
Undisbursed balances		24,078,515.94		73,249,599.39
Total assets		2,677,400,515.94		3,103,105,599.39

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

TABLE 4.—ACTUAL AND ESTIMATED OPERATIONS OF THE HOSPITAL INSURANCE TRUST FUND, ON CASH BASIS FISCAL YEARS 1969–74

[In millions]

Item	Actual 1969	Actual 1970	Actual 1971	Estimated 1972	Estimated 1973	Estimated 1974
Income:						
Contributions	$4,423	$4,785	$4,897	$5,213	$6,110	$6,822
Interest on Investments	96	137	181	171	147	120
Transfers from railroad retirement account	54	64	66	66	65	73
Reimbursement for uninsured persons	749	617	863	503	468	548
Reimbursement for military service wage credits	22	11	11	48	48	48
Total income	5,344	5,614	6,018	6,001	6,838	7,611
Disbursements:						
Benefit payments	4,654	4,804	5,443	6,265	6,950	7,965
Administrative expenses	104	149	149	169	179	209
Total disbursements	4,758	4,953	5,592	6,434	7,129	8,174
Net increase in fund	586	661	426	—433	—291	—563
Fund at end of year	2,017	2,677	3,103	2,670	2,379	1,816

Expected Operations and Status of the Trust Fund During the Period July 1, 1971 to June 30, 1974

The income and disbursements of the hospital insurance program are affected by general economic conditions, hospital costs, and the expansion and rate of use of hospital services. Because it is difficult to forecast these factors, particularly the last, the resulting cost estimates presented here are subject to some uncertainty, which should be considered in interpreting the result.

Table 4 presents data on the actual operations of the hospital insurance trust fund on a cash basis for fiscal years 1969–71. It also presents estimates of the expected operations of the trust fund for fiscal years 1972–74.

The income estimates are based on the assumption that earnings will increase each year through 1974 in accordance with earnings increase assumptions derived for the federal budget. The increases in income from contributions also assume an increase in the maximum amount of earnings taxable and creditable under the program, effective January 1, 1972, and the scheduled increase in contribution rate effective on January 1, 1973.

Similarly, the disbursements shown for 1972–74 are consistent with those included in the federal budget and used to test the adequacy of the financing of the program. A more detailed analysis of these estimates appears in Appendix I.

It is anticipated that disbursements will exceed income in fiscal year 1972 and thereafter, under the provisions in present law. As a result, the fund will decrease beginning in fiscal year 1972, until it is exhausted during fiscal year 1976, unless improvements are made in program financing.

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 interchange.

Section 217(g) of the Social Security Act 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. In accordance with section 217(g), 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 have been made since July 1966 and that will be made in future years, after taking into account the amounts of annual appropriations in fiscal years 1966–71 that have been deposited into the trust funds. The annual amount of this determination for the hospital insurance trust fund was $48 million. The estimates shown in table 4 reflect the effect of past and expected future reimbursements under section 217(g).

As described in an earlier section, hospital insurance benefits for certain uninsured persons are provided from the hospital insurance trust fund with later reimbursement from the general fund of the

Treasury. These reimbursements, net of corrections for previous years, are also shown in table 4.

The ratios of assets at the beginning of each calendar year to total expenditures during the year are shown in table 5. Actual historical values are shown for 1967–71. Estimated values, consistent with the fiscal year estimates shown in table 4, are presented for calendar years 1972–74.

The ratio of assets to expenditures built up gradually until it reached the level of approximately one-half year's expenditures as of the beginning of 1971. However, this ratio has fallen slightly since then, and can be expected to decline rather rapidly under the contribution schedules in present law.

Table 6 shows administrative expenses paid in fiscal years 1967–71 as a percent of benefit payments. Administrative expenses paid since the beginning of the program amount to 2.7 percent of benefits paid.

TABLE 5.—*Assets at the beginning of the year, related to expenditures during the year for the hospital insurance trust fund, calendar years 1967–74*

[Ratio of assets, at beginning of year, to expenditures during the year]

Calendar year	Ratio
Past experience:	
1967	0.28
1968	.25
1969	.43
1970	.47
1971	.54
Estimated future experience:	
1972	0.45
1973	.36
1974	.27

TABLE 6.—*Relationship of net administrative expenses of the hospital insurance program to benefit payments, fiscal years 1966–71*

[Administrative expenses as a percentage of benefit payments]

Fiscal year	Percent
1966–67	3.5
1968	2.1
1969	2.2
1970	3.1
1971	2.7
1966–71	2.7

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 by the Secretary of Health, Education, and Welfare in May 1969. The Council submitted its report on April 5, 1971. Among its findings and recommendations are those concerning changes in the benefit provisions and coverage of the hospital insurance program. These do not directly affect the financing or the operation of the trust fund and are not referred to further. The Council has made certain other recommendations which do affect the financing of the trust fund. As to these, the Trustees have the responsibility of a careful evaluation, and the transmittal of the Trustee's views as a part of this, or subsequent, reports.

The Council has organized its findings in the financing area under twelve headings. Eleven of these (numbers 1–6 and 8–12) concern the financing of the hospital insurance trust fund and are discussed below.

C. FINANCING

Actuarial Soundness of the Program

1. *Current Status.—Unless income is increased, the hospital insurance trust fund will be exhausted in 1973.*

The Board of Trustees agrees that the hospital insurance program is not adequately financed. Current projections, which take into account the Price Commission guidelines, indicate that the fund will last until fiscal year 1976 without an improvement in financing provisions.

Management and Investment of the Trust Funds

2. *Investment Policy.—The Managing Trustee of the social security trust funds should adopt a policy of investing in special obligations with maturity dates equal to the maximum maturity date of Treasury notes (at present 7 years) rather than maturity dates of 15 years from date of purchase.*

The Board of Trustees concurs in this recommendation of the Advisory Council, and the Managing Trustee will adopt such a policy.

3. *Interest Rate Formula.—The interest rate on special obligations issued to the trust funds should be equal to the average market yield on all marketable Treasury notes that are not due or callable until 4 or more years from the time the special obligations are issued.*

The Board of Trustees has no position as to this recommendation at the present time, pending further study as to whether the interest-rate on special obligations will be higher or lower under the Advisory Council's recommendation than under current law.

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 is still investigating the implications of this recommendation, and has no position at the present time.

5. *Boards of Trustees.—The Council recommends that two non-government members, to be appointed by the President subject to confirmation by the Senate, be added to the Boards of Trustees of the social security trust funds.*

The Board of Trustees supports this recommendation of the Advisory Council, and recommends to Congress that the law be changed to add two non-government members.

6. *The Trust Funds and the Unified Budget.—Even though the operations of the social security trust funds and other Federal trust fund programs are combined with the general operations of the Federal Government in the unified Federal budget, policy decisions affecting the social security program should be based on the objectives of the program rather than on any effect that such decisions might have on the Federal budget. The operations of the social security and other Federal trust funds should continue to be identified as such and separated from the general operations of the Government.*

The Board of Trustees agrees that the Social Security System should be financed in accordance with the financial principles of the program, and that the contribution rate should not be set out of considerations of broad fiscal policy or because of the impact of the financing provisions on the unified budget balance.

8. *Single Best Estimate.—Contribution rates should be based on a single, best estimate derived from a single set of assumptions that reflect likely future trends in the factors that affect income and outgo of the program, rather than on an average of a low-cost and a high-cost estimate, as has been the case in the past; and there should be a series of estimates which show the extent to which the best estimate might vary if experience with respect to any of the major factors were to differ from the assumptions.*

The Board of Trustees concurs in this recommendation of the Advisory Council, and the estimates contained in this Report are based on a single set of assumptions. The principle of sensitivity testing is developed in Appendix 1, and will be further developed in future Reports.

9. *Valuation Period for Health Insurance.—The Council recommends that the valuation period for estimating health insurance program costs be reduced from 25 years to 10 years.*

The Board has presented a 25-year evaluation in the present report in order to show the long-range implication, just as the Board has in the past. The Board will study further the proposal to limit the valuation period to 10 years.

10. *Current Cost Financing.—The financing of the program should be on a current-cost basis, with the trust funds maintained at a level approximately equal to one year's expenditures.*

The Board of Trustees concurs with this recommendation of the Advisory Council. It notes that the Council specifically recommends *that the law be changed to require the Board of Trustees to report immediately to the Congress whenever it is expected that the size of any of the trust funds will fall below three-quarters of the amount of the following year's estimated expenditures, or will reach more than one and one-quarter times such expenditures.* The Board of Trustees supports the Council's specific proposal. The Board recognizes that the hospital insurance trust fund is currently only about one-half of one year's expenditures and recommends that the contribution rates be so set that the fund is projected to increase to the level of a full year's expenditures.

General Revenue Financing of Medicare

11. *Gradual increase in General Revenue Financing of Medicare.—The combined Medicare program should be financed with a general-revenue contribution equal to one-third of total program costs, with such share being lower than one-third at first and gradually increasing over a period of years to the one-third level.*

The Board of Trustees agrees with the Council's recommendation to combine the supplementary medical insurance trust fund and the hospital insurance trust fund for financing purposes. The Board of Trustees, however, does not accept the Council's recommendation for a general revenue contribution equal to one-third of total program costs.

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 larger period.

The Board of Trustees concurs with the first sentence of this recommendation, while recognizing that several different contribution rate schedules would fit the recommendation depending on the time over which the fund is built to the recommended level. The Board will study further the proposal to restrict future contribution rates established in the law to 10 years.

Actuarial Status of the Fund

This section provides a history of the financing of the hospital insurance program, and a 25-year projection of the anticipated financial requirements. The latter is then compared with the financing provisions of the present law.

The tables in this section are presented on an incurred basis. They reflect contribution income earned and services provided, rather than income collected and disbursements made, in the calendar year indicated. In this sense they are different from results presented earlier, but the differences are only with respect to timing.

Table 7 shows for past years the incurred cost of benefits and administrative expense, for persons insured under the hospital insurance program, as a percent of taxable payroll. Incurred expenditures have increased from less than 1.0 percent of taxable payroll in 1967, to approximately 1.3 percent in 1971. It is clear from table 7 that benefits have increased at a more rapid rate than taxable payroll.

The projection of the future costs of the program as a percent of taxable payroll is shown as table 8. The results shown are comparable with table 7, with the exception that table 8 includes a provision for building the trust fund from its present level of about one-half year's expenditure to a full year by 1985, and to maintain it at that level thereafter.

The projected taxable payroll used in table 8 assumes that earnings in covered employment will rise in the future at a rate of 5 percent annually, and that the taxable earnings base will increase at the same rate.

Table 8 indicates that hospital insurance outlays are expected to continue to increase faster than taxable payroll. Part of this increase arises from growth in the insured population and to increases in the days per capita spent in medical institutions. However, the greatest portion of the increase is due to an increase in cost per hospital day.

TABLE 7.—*Incurred cost [1] of hospital insurance system for the insured only as a percent of taxable payroll*

Calendar year:	*Incurred cost in percent*	Calendar year—Continued	*Incurred cost in percent*
1967 [2]	0.95	1970	1.17
1968	1.03	1971	[3] 1.30
1969	1.09		

[1] Benefit payments and administrative expenses.
[2] 1967 was the first full calendar year of the hospital insurance program.
[3] Preliminary estimate.

TABLE 8.—*Incurred cost [1] of hospital insurance system for the insured only as a percent of taxable payroll [2]*

Calendar year:	Incurred cost in percent	Calendar year—Continued	Incurred cost in percent
1972	1. 50	1985	2. 27
1973	1. 60	1990	2. 46
1974	1. 70	1995	2. 58
1975	1. 80	25-year average	2. 21
1980	2. 20		

[1] Benefit payments and administrative expenses, plus a provision for trust fund growth equal to 1 year's expenditures for 1985 and thereafter.
[2] Earnings in covered employment and taxable earnings base assumed to rise 5 percent annually.

It is assumed in these projections that the Economic Stabilization Program will have an immediate and continuing influence, holding down the rate of inflation in hospital costs. As long as the present wage-price control strategy is maintained, the Social Security Administration will not recognize, for reimbursement purposes, increases in hospital costs beyond those permitted by the Price Commission guidelines, so that in the short run at least, hospital cost increases will be close to those assumed. The cost estimates assume also that effective controls will be maintained indefinitely and in the long run become increasingly more restrictive. It is assumed that after 1980 increases in hospital costs will drop below the level experienced in the decade preceding the enactment of Medicare. It seems realistic to anticipate these results only if wage and price controls prove to be effective, and if long-range costs are contained by both restraint on the part of providers and by the force of public influence. The specific assumptions as to the future rates of increase in the cost of hospital care that underlie table 8, appear in table D in Appendix I, together with the assumptions concerning extended care facility and home health agency services. This appendix also illustrates future costs of the hospital insurance program if hospital costs increase relative to average earnings at a rate comparable to that which occurred in the decade before the hospital insurance program began.

Table 9 compares the average of table 8 results for the twenty-five year period 1972 to 1996 with the average combined contribution rate provided under present law for the same period. The negative actuarial balance (−0.61% of taxable payroll) indicates that the system under present law is seriously underfinanced. The contribution schedule in present law should be increased by nearly 40 percent to bring the financing into balance with the projected expenditure.

TABLE 9.—*Estimated actuarial balance [1] of hospital insurance program as a percent of taxable payroll*

	Percent
Average rate [2] in present contribution schedule	1. 60
Average cost of system	2. 21
Actuarial balance	−0. 61

[1] Over 25-year period 1972-1996.
[2] Combined employer-employee rate, adjusted for self-employed.

Conclusion

The hospital insurance trust fund at the beginning of 1972 is 48 percent of the projected expenditures for that year, and is therefore below the level of one year's expenditures recommended by the Advisory Council. Under the financing schedule in current law, the ratio of the fund to expenditures will decline, with the fund now projected to be exhausted during 1976. Clearly, higher contribution rates for the hospital insurance portion of the Social Security system are required. The Trustees support increased rates for the hospital insurance program, such as those provided in H.R. 1, although the Board recognizes that the goal of an actuarially sound hospital insurance program could be reached with a variety of contribution schedules.

For 1972 the financing for both the old-age, survivors, and disability insurance and the hospital insurance systems can be improved by a reallocation of the contribution rate to provide a larger portion for hospital insurance.

As the Trustees look beyond the current calendar year, they recognize that legislation is likely to be enacted which would change both the benefits and the financing of the hospital insurance system. The trustees recommend that the financing schedules be designed in accordance with the current-cost financing principles recommended by the Advisory Council, with the hospital insurance trust fund projected to reach the level of one year's expenditures sometime within the next 15 years.

The Trustees recognize that the hospital insurance cost estimates presented in this report for years beyond the immediate future are dependent on a continuation of controls on hospital cost increases and on future public influence toward reducing the rate of increase in hospital expenditure. The cost estimates will prove to be low should the rate of inflation in the cost of hospital services that has been experienced in the past continue.