Click for Table of Contents

1988 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL HOSPITAL INSURANCE TRUST FUND

COMMUNICATION

From

THE BOARD OF TRUSTEES, FEDERAL HOSPITAL INSURANCE TRUST FUND

Transmitting

THE 1988 ANNUAL REPORT OF THE BOARD, PURSUANT TO SECTION 1817(b) OF THE SOCIAL SECURITY ACT AS AMENDED

LETTER OF TRANSMITTAL

Board of Trustees of the
Federal Hospital Insurance Trust Fund
Washington, D.C., MAY 5, 1988

HONORABLE JAMES C. WRIGHT, JR.
Speaker of the House of Representatives
Washington, D.C.

HONORABLE GEORGE BUSH
President of the Senate
Washington, D.C.

GENTLEMEN:

We have the honor of transmitting to you the 1988 Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund (the 23rd such report), in compliance with the provisions of section 1817(b) of the Social Security Act.

Respectfully,

James A. Baker III

JAMES A. BAKER, III,
Secretary of the Treasury, and
Managing Trustee of the Trust Fund

Ann McLaughlin

ANN McLAUGHLIN,
Secretary of Labor,
and Trustee

Otis R. Bowen M.D.

OTIS R. BOWEN, M.D.,
Secretary of Health and
Human Services, and Trustee

Mary Falvey Fuller

MARY FALVEY FULLER,
Trustee

Suzanne Denbo Jaffe

SUZANNE DENBO JAFFE,
Trustee

William L. Roper MD

WILLIAM L. ROPER, M.D.,
Administrator of the Health Care Financing
Administration, and Secretary,
Board of Trustees

Click on a Topic Below

CONTENTS

1988 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 has five members. Three serve in an ex officio capacity. These members are the Secretary of the Treasury, the Secretary of Labor, and the Secretary of Health and Human Services. Two public members, Mary Falvey Fuller and Suzanne Denbo Jaffe, are provided for by the Social Security Amendments of 1983 (Public Law 98-21, enacted into law on April 20, 1983). The two public members were nominated by the President for a term of four years, and were confirmed by the Senate.

By law, the Secretary of the Treasury is designated as the Managing Trustee and the Administrator of the Health Care Financing Administration is designated as Secretary of the Board. The Board of Trustees reports to the Congress each year on the operation and status of the trust fund, in compliance with section 1817(b)(2) of the Social Security Act. This is the 1988 annual report, the twenty-third such report.

EXECUTIVE SUMMARY

The hospital insurance (HI) program pays for inpatient hospital care and other related care of those aged 65 and over and of the long-term disabled. In calendar year 1987, about 28 million people over age 65 and about 3 million disabled people under age 65 were covered under HI, financed primarily by the contributions of 131 million workers through payroll taxes. Payroll taxes during 1987 amounted to $58.6 billion, accounting for 91.5 percent of all HI income. Interest payments to the HI fund amounted to 7.0 percent of all HI income for 1987. The remaining 1.5 percent of calendar year 1987 income consisted primarily of transfers from the Railroad Retirement Account and the general fund of the Treasury (in accordance with provisions for the collection of taxes from railroad workers, the collection of taxes on deemed military service wage credits, and reimbursement to the fund for benefits for certain uninsured persons), and premiums paid by voluntary enrollees. Of the $50.3 billion in HI disbursements, $49.5 billion was for benefit payments while the remaining $0.8 billion was spent for administrative expenses. HI administrative expenses were 1.6 percent of total disbursements.

As mentioned above, the HI program is financed primarily by payroll taxes, with the taxes paid by current workers used primarily to pay benefits to current beneficiaries. Income not currently needed to pay benefits and related expenses is held in the HI trust fund. The assets of the fund may not be used for any other purpose. While in the fund, the assets are invested in certain interest-bearing obligations of the U.S. Government.

The HI contribution rates applicable to taxable earnings in each of the calendar years 1984 and later are shown in Table I. The maximum taxable amounts of annual earnings are shown for 1984 through 1988. After 1988, the automatic increase provisions in section 230 of the Social Security Act determine the maximum taxable amount.

TABLE I.--CONTRIBUTION RATES AND MAXIMUM TAXABLE AMOUNT OF ANNUAL EARNINGS

Calendar year	Maximum taxable amount of annual earnings	Contribution rate (Percent of taxable earnings) Employees and employers, each	Self-employed
1984	$37,800	1.30	2.60
1985	39,600	1.35	2.70
1986	42,000	1.45	2.90
1987	43,800	1.45	2.90
1988	45,000	1.45	2.90
Changes scheduled in present law:			
1989 & later	Subject to automatic increase	1.45	2.90

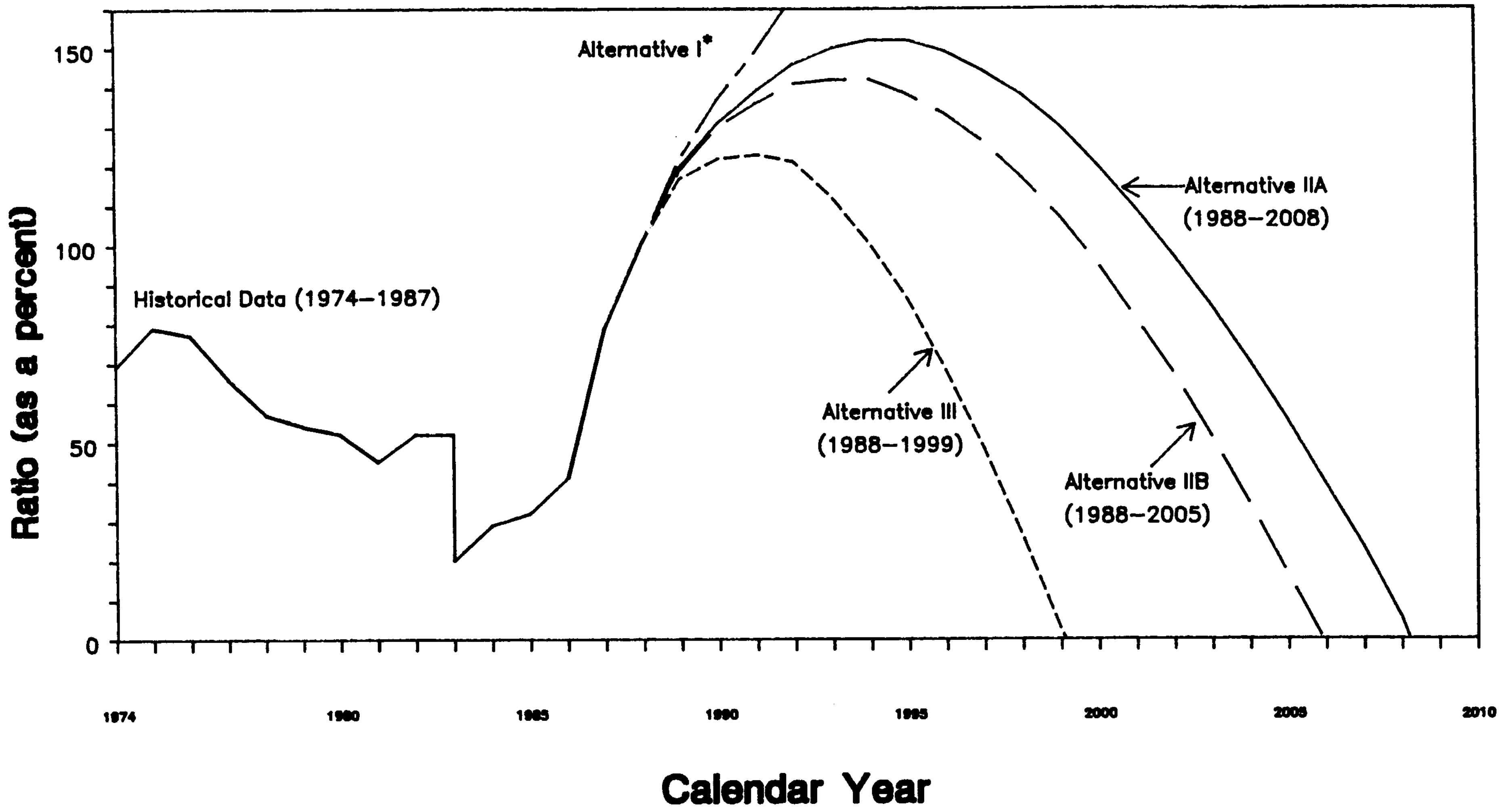
Actuarial Status of the Trust Fund

The Board of Trustees recommends that it is advisable to maintain a balance in the trust fund equal to a minimum of one-half year's disbursements, as a reserve against fluctuations in program experience and to provide time for any needed legislation to remedy unexpected imbalances. At the beginning of 1988, the trust fund was above the minimum desired level.

Projections were made under four alternative sets of assumptions: optimistic, two intermediate sets (alternatives II-A and II-B), and pessimistic. Under both sets of intermediate assumptions, the trust fund ratio, defined as the ratio of assets at the beginning of the year to disbursements during the year, is projected to increase until about 1994 and then decline steadily until the fund is completely exhausted shortly after the turn of the century. Under the more optimistic set of assumptions (alternative I), the trust fund is projected to remain solvent throughout the first two 25-year projection periods, with trust fund exhaustion occurring in 2044. Under the more pessimistic set of assumptions (alternative III), the trust fund ratio is projected to increase to a level of about 123 percent in 1991 and then decrease rapidly until the fund is exhausted in 1999.

Table 11 in this report summarizes the estimated operations of the HI trust fund under the four alternative sets of assumptions. Figure 1 shows historical trust fund ratios for recent years and projected ratios under the four sets of assumptions.

Figure 1
Short Term HI Trust Fund Ratios



*The trust fund is depleted in 2044 under alternative I.

Note: The trust fund ratio is defined as the ratio of assets at the beginning of the year to disbursements during the year.

The adequacy of the financing of the HI program on a long-range basis is measured by comparing on a year-by-year basis the actual tax rates specified by law with the corresponding costs of the program, expressed as percentages of taxable payroll. The actuarial balance is defined to be the excess of the average tax rate for the valuation period over the average cost of the program expressed as a percentage of taxable payroll 1/. Table II compares the actuarial balance under each of the four sets of assumptions for the 75-year projection period 1988-2062 2/. Figure 2 shows the year-by-year costs as a percent of taxable payroll for each of the four sets of assumptions, as well as the scheduled tax rates. The cost figures in Figure 2 do not include amounts for maintaining the trust fund at the level of at least a half-year's disbursements.

Figure 2 emphasizes the inadequacy of the financing of the HI program by illustrating the divergence of the program costs and scheduled tax rates under each set of assumptions.

1/ In last year's report, the actuarial balance was defined to be the excess of the average tax rate for the valuation period over the average cost of the program, expressed as a percentage of taxable payroll, for the same period, where cost included (1) program expenditures and (2) a small amount to maintain the trust fund at the level of at least a half-year's outgo after accounting for the offsetting effect of interest earnings. In this report, the actuarial balance is defined to be the excess of the average tax rate for the valuation period over the average cost of the program, expressed as a percentage of taxable payroll, for the same period, where cost represents program expenditures only. This approach is more in line with the reporting methods of the OASDI report.

2/ Multi-year actuarial balances in this report are computed on the average cost basis, as described on page 45 of this report.

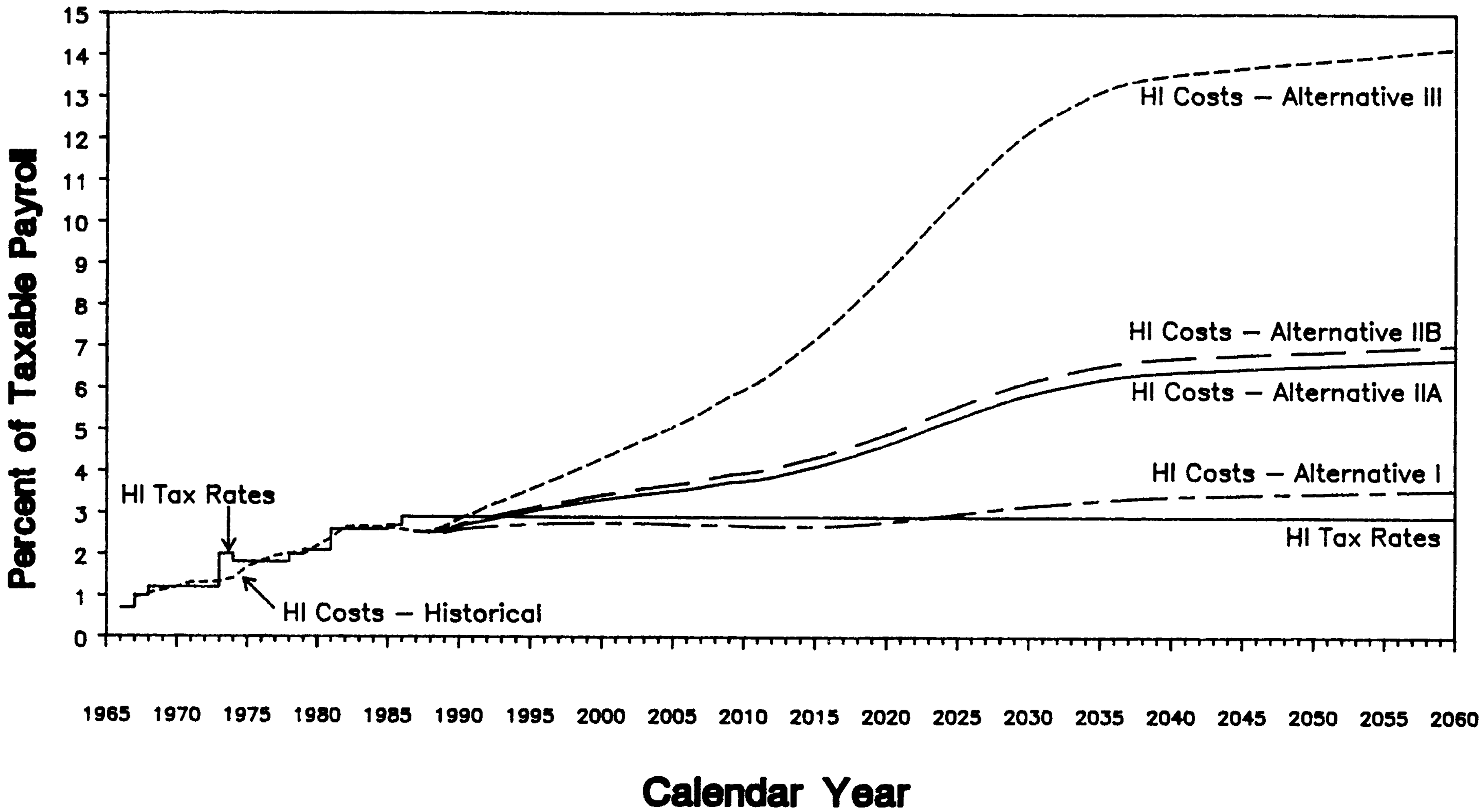
TABLE II.--SEVENTY-FIVE YEAR ACTUARIAL BALANCE OF THE HOSPITAL INSURANCE PROGRAM, UNDER ALTERNATIVE SETS OF ASSUMPTIONS 1/

	Alternative			
	I	II-A	II-B	III
Average contribution rate 2/	2.90%	2.90%	2.90%	2.90%
Average program expenditures 3/ 4/	3.05	5.01	5.25	9.53
Actuarial balance 5/	-0.15	-2.11	-2.35	-6.63
Trust fund building and maintenance 3/ 6/	+0.00	+0.01	+0.02	+0.12
Program cost including trust fund building and maintenance 3/ 7/	3.05	5.02	5.27	9.65
Augmented balance 8/	-0.15	-2.12	-2.37	-6.75

1/ For the 75-year period 1988-2062.
2/ As scheduled under present law.
3/ Expressed as a percentage of taxable payroll.
4/ Expenditures for benefit payments and administrative costs for insured beneficiaries, on an incurred basis.
5/ Difference between the average contribution rate (tax rate scheduled in the law) and program expenditures.
6/ Allowance for building and maintaining the trust fund balance at the level of at least a half-year's outgo after accounting for the offsetting effect of interest earnings.
7/ Sum of program expenditures and trust fund building and maintenance.
8/ The augmented balance is the difference between the average contribution rate and the average cost of the program, including trust fund building and maintenance.

NOTE: The balances shown in this table do not use the new level-financing methodology used in the OASDI report.

Figure 2
Estimated HI Costs and Tax Rates



Note: HI projected costs shown are expenditures attributable to insured beneficiaries only, on an incurred basis, without an allowance for building and maintaining the trust fund balance at the level of at least a half-year's outgo.

Table III presents a comparison of the projected experience in the 1987 and 1988 reports. As Table III indicates, the projections in the 1988 report show that the fund will be depleted a few years later than in the 1987 report under all alternative projections. This change is primarily due to legislation passed since the 1987 report was issued. Table IV shows the major reasons for the change in the 75-year actuarial balance of the HI program from the 1987 report. The section of the report entitled "Actuarial Status of the Trust Fund" discusses more completely the reasons for the change in the actuarial balance.

TABLE III.--STATUS OF THE HOSPITAL INSURANCE TRUST FUND

Alternative assumptions	Year in which the trust fund is exhausted as published in the		75-year actuarial balance 1/ 2/ of the HI program as published in the	
	1987 report	1988 report	1987 report	1988 report
I (optimistic)	2043	2044	-0.11%	-0.15%
II-A (intermediate)	2005	2008	-2.02	-2.11
II-B (intermediate)	2002	2005	-2.30	-2.35
III (pessimistic)	1996	1999	-6.55	-6.63

1/ The actuarial balance of the hospital insurance program was defined in the 1987 report to be the excess of the average tax rate for the valuation period over the average cost of the program, including an amount for trust fund building and maintenance and expressed as a percentage of taxable payroll, for the same period. Trust fund building and maintenance is not included in the definition of the actuarial balance in this report. For purposes of comparison, the figures from the 1987 report have been restated according to this report's definition of the actuarial balance. This approach is more in line with the reporting methods of the OASDI report.

2/ Multi-year actuarial balances in this report are computed on the average cost basis, as described on page 45 of this report.

Table IV.--CHANGE IN THE 75-YEAR ACTUARIAL BALANCE SINCE THE 1987 REPORT

1. Actuarial balance, alternative II-B, 1987 report 1/ 2/	-2.30%
2. Changes:	
a Valuation period	-0.06
b. Base estimate	+0.09
c. Legislation since the 1987 report	+0.40
d. Economic and demographic assumptions	-0.24
e. Hospital assumptions	-0.24
f. Net effect, all changes	-0.05
3. Actuarial balance, alternative II-B, 1988 report 1/ 2/	-2.35

1/ The actuarial balance of the hospital insurance program was defined in the 1987 report to be the excess of the average tax rate for the valuation period over the average cost of the program, including an amount for trust fund building and maintenance and expressed as a percentage of taxable payroll, for the same period. Trust fund building and maintenance is not included in the definition of the actuarial balance in this report. For purposes of comparison, the figures from the 1987 report have been restated according to this report's definition of the actuarial balance. This approach is more in line with the reporting methods of the OASDI report.

2/ Multi-year actuarial balances in this report are computed on the average cost basis, as described on page 45 of this report.

Conclusion of the Board of Trustees

The present financing schedule for the hospital insurance program is sufficient to ensure the payment of benefits over the next 17 to 20 years if the intermediate assumptions underlying the estimates are realized, with trust fund exhaustion occuring in 2008 and 2005 under alternatives II-A and II-B, respectively. Under the more pessimistic alternative III, the fund is exhausted in 1999. Under the more optimistic alternative I, the trust fund is exhausted in 2044.

There are currently over four covered workers supporting each HI enrollee. This ratio will begin to decline rapidly early in the next century. By the middle of that century, there will be only about two covered workers supporting each enrollee. Not only are the anticipated reserves and financing of the HI program inadequate to offset this demographic change, but under all but the most optimistic assumptions, the trust fund is projected to become exhausted even before the major demographic shift begins to occur. Exhaustion is projected to occur shortly after the turn of the century under the intermediate assumptions, and could occur as early as 1999 if the pessimistic assumptions are realized.

The Board notes that promising steps to begin reducing the rate of growth in payments to hospitals have already been taken, including the implementation of prospective payment and diagnosis-related groups and the legislation described on pages 14 through 16 of this report. Initial experience under the prospective payment system for hospitals suggests that this payment mechanism is an effective means of constraining the growth in hospital payments and improving the efficiency of the hospital industry. Efforts focused on improving the efficiency and reducing the costs of the health care delivery system need to be continued, in close combination with mechanisms that will assure that the quality of health care is not adversely affected.

Because of the magnitude of the projected actuarial deficit in the HI program and the probability that the HI trust fund will be exhausted shortly after the end of this century, the Board believes that early corrective action is essential in order to avoid the need for later, potentially precipitous changes. The Board, therefore, urges that the Congress take early remedial measures to bring future HI program costs and financing into balance, and to maintain an adequate trust fund against contingencies.

SOCIAL SECURITY AMENDMENTS SINCE THE 1987 REPORT

Since the 1987 Annual Report was transmitted to Congress, several laws affecting the HI program have been enacted. The more important legislative changes are described below.

The Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987 (Public Law 100-119) was enacted on September 29, 1987, and contained the following changes:

(1) The prospective payment update factor was zero percent for discharges occurring during the extension period beginning on October 1, 1987, and ending on November 20, 1987.

(2) The transition from a blended payment based upon regional and national rates to a wholly national rate in the Federal portion of a hospital's payment was delayed until November 21, 1987.

(3) The blend of a 25 percent hospital-specific rate and a 75 percent Federal rate was extended to include the first 51 days of each hospital's cost reporting period which began during fiscal year 1988.

(4) The 3.5 percent reduction in payments for capital was extended through November 20, 1987.

(5) The percentage increase in payment per admission for hospitals exempt from the prospective payment system (PPS) was zero percent for the first 51 days of the hospital's cost reporting period which began during fiscal year 1988.

The Omnibius Budget Reconciliation Act of 1987 (Public Law 100-203) was enacted on December 22, 1987, and contained the following changes:

(1) Payment reductions of 2.324 percent, required by the November 20, 1987 sequester order, are continued until December 31, 1987, for all services, and until March 31, 1988, for all inpatient hospital services.

(2) Effective April 1, 1988, the hospital prospective payment rates are increased (over prior year) as follows: Hospitals in urban areas with populations exceeding one million will receive updates of 1.5 percent in fiscal year 1988, and 2 percent less than the hospital input price index (IPI) in fiscal year 1989. Hospitals in other urban areas will receive updates of 1 percent in fiscal year 1988, and 2.5 percent less than the IPI in fiscal year 1989. Hospitals in rural areas will receive updates of 3 percent in fiscal year 1988, and 1.5 percent less than the IPI in fiscal year 1989. Hospitals exempt from PPS will receive an update of 2.7 percent in fiscal year 1988, and an update equal to the IPI in fiscal year 1989. All hospitals will receive an update equal to the IPI in fiscal year 1990 and later.

(3) A regional minimum payment amount (regional floor) is established for PPS hospitals and is effective from April 1, 1988, to September 30, 1990. A hospital will be paid the greater amount of either the national rate or the sum of 85 percent of the national rate plus 15 percent of the regional rate.

(4) In fiscal years 1989 and 1990, the indirect medical education adjustment is reduced to approximately 7.6 percent. In fiscal year 1991, the adjustment will increase to approximately 8.3 percent.

(5) The disproportionate share adjustment is extended one year to include discharges occurring before October 1, 1990. For urban hospitals with 100 or more beds, the cap of 15 percent on the disproportionate share adjustment has been removed. For qualifying hospitals who receive 30 percent of their revenues from state and local sources, the disproportionate share adjustment is increased to 25 percent.

(6) By October 1, 1990, the Secretary of Health and Human Services is required to recompute the wage indices used in computing the prospective payment system payments. These indices will be recomputed every three years thereafter.

(7) Payment for capital costs is reduced by 7 percent between November 21 and December 31, 1987, and by 12 percent from January 1 through September 30, 1988. For fiscal year 1989, the reduction is 15 percent.

(8) No Medicare payment may be issued, mailed, or transmitted before a certain number of days have elapsed since receipt. This time period is 10 days effective July 1, 1988, and 14 days for fiscal year 1989.

(9) Individuals who reestablish entitlement to disability benefits, irrespective of their time off the rolls, may be covered by Medicare without a waiting period if their current impairment is the same as, or directly related to, that in their previous period of disability.

(10) Employers are required to pay HI taxes on the full amount of covered tips, effective January 1, 1988.

Detailed information regarding these changes 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 United States Treasury. All the financial operations of the hospital insurance program are handled through this fund.

The primary source of income to the trust fund is amounts appropriated to it under permanent authority on the basis of contributions paid by workers, their employers, and individuals with self-employment income, in work covered by the hospital insurance program. Beginning January 1, 1987, these appropriated amounts include contributions paid by, or on behalf of, workers employed by State and local governments and their employers, with respect to work covered by the program through State agreements. (Prior to 1987, such contributions were deposited directly into the trust fund.) The coverage of the hospital insurance program includes workers covered under the old-age, survivors, and disability insurance (OASDI) program, those covered under the railroad retirement program, and Federal employees.

All employees, and their employers, in employment covered by the program are required to pay contributions with respect to the wages of individual workers, including cash tips. (Prior to 1978, employees paid contributions with respect to cash tips but employers did not. From 1978 to 1987, employers paid contributions on that part of the tip income deemed to be wages under the Federal minimum wage law.) 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 up to the maximum annual amount.

The hospital insurance contribution rates applicable to taxable earnings in each of the calendar years 1966 and later are shown in table 1. For 1989 and later, the contribution rates shown are the rates scheduled in the provisions of present law. The maximum amount of annual earnings taxable in each year 1966-88 are also shown. For 1975-78, the contribution and benefit bases were determined under the automatic increase provisions in section 230 of the Social Security Act. In 1979, 1980, and 1981, the bases increased to the specified amounts as provided under the 1977 amendments. After 1981, the automatic increase provisions are again applicable.

All contributions are collected by the Internal Revenue Service and deposited in the general fund of the Treasury as internal revenue collections. The contributions received are automatically appropriated to the trust fund, on an estimated basis. The exact amount of contributions received is not known initially since HI contributions, OASDI contributions, and individual income taxes are not separately identified in collection reports received by the Treasury Department. 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.

Prior to May 1983 and after June 1984, the estimated internal revenue collections were transferred to the trust funds immediately upon receipt. For May 1983 through June 1984, estimated total collections for each month were credited to the trust funds on the first day of the month. As the actual collections were received during the month, they were deposited in the general fund of the Treasury and remained there. The trust funds paid interest to the general fund to reimburse it for the interest lost because of this provision.

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 substantial source of trust fund income is interest received on investments held by the fund. The investment procedures of the fund are described later in this section, on pages 22 and 23.

The income and expenditures of the trust fund are also affected by the provisions of the Railroad Retirement Act 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, prior to modification by the Social Security Amendments of 1983, authorized annual reimbursement from the general fund of the Treasury to the hospital insurance trust fund for costs arising from the granting of deemed wage credits for military service prior to 1957, according to quinquennial determinations made by the Secretary of Health and Human Services. These sections, as modified by the Social Security Amendments of 1983, provided for a lump sum transfer in 1983 for costs arising from such wage credits. In addition, the lump sum transfer included combined employer-employee HI taxes on the noncontributory wage credits for military service after 1965 and before 1984. After 1983, HI taxes on military wage credits are credited to the fund on July 1 of each year. The Social Security Amendments of 1983 also provided for (1) quinquennial adjustments to the lump sum amount transferred in 1983 for costs arising from pre-1957 deemed wage credits and (2) adjustments as deemed necessary to any previously transferred amounts representing HI taxes on noncontributory wage credits.

Section 231 of the Social Security Act authorizes reimbursement from the general fund of the Treasury to the hospital insurance trust fund for any costs arising from the granting of deemed wage credits to individuals who were interned during World War II at a place within the United States operated by the Federal Government for the internment of persons of Japanese ancestry.

Under section 103 of the Social Security Amendments of 1965, 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.

Section 1818 of the Social Security Act provides that certain persons not eligible for hospital insurance protection either on an insured basis or on the uninsured basis described in the previous paragraph may obtain protection by enrolling in the program and paying a monthly premium.

Section 201(i) of the Social Security Act authorizes the Managing Trustee to accept and deposit in the trust fund unconditional money gifts or bequests made for the benefit of the fund or any activity financed through the fund.

Expenditures for benefit payments and administrative expenses under the hospital insurance program are paid from the trust fund. All expenses incurred by the Department of Health and Human Services 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 and Human Services certifies benefit payments to the Managing Trustee, who makes the payments from the trust fund in accordance therewith.

Prior to fiscal year 1984, hospitals, at their option, were permitted to combine their billing for both hospital and physician components of radiology and pathology services rendered to hospital inpatients by hospital-based physicians. Where hospitals elected this billing procedure, payments were made initially from the hospital insurance trust fund. The reimbursements so made were on a provisional basis and are subject to adjustment, with appropriate interest allowance.

The Social Security Amendments of 1967 and 1972 authorize the Secretary of Health and Human Services 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. A sizable portion of the costs of such experiments and demonstration projects is paid from the hospital insurance and supplementary medical insurance trust funds.

Congress has authorized expenditures from the trust funds for construction, rental and lease, or purchase contracts of office buildings and related facilities for use in connection with the administration of the hospital insurance program. Both the capital costs of construction financed directly through the trust funds and the rental and lease, or purchase contract costs of acquiring facilities are included in trust fund expenditures. In 1972-75, construction of several large facilities was authorized under purchase contract authority, wherein initial capital costs were borne by the private sector. Under this method of facilities acquisition, trust fund expenditures for use and ultimate Government ownership of a facility are made over periods of from 10 to 30 years. Whatever the manner of acquisition, the net worth of facilities and other fixed capital assets is not carried in the statement of the assets of the trust fund presented in this report. This is because the value of fixed capital assets does not represent funds available for benefit or administrative expenditures and, therefore, is not viewed as being a consideration in assessing the actuarial status of the funds.

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 (including special public-debt obligations described below), 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. These obligations may be acquired on original issue at the issue price or by purchase of outstanding obligations at their market price.

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 bear interest at a rate based on the average market yield (computed 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 month. These special issue securities are always redeemable at par value, and so are not subject to the uncertainty of price fluctuations as interest rates change.

From December 29, 1981, until January 1, 1988, the Social Security Act authorized borrowing among the OASI, DI, and HI trust funds when necessary "to best meet the need for financing the benefit payments" from the three funds. Interfund loans under the borrowing authority were made to the OASI trust fund from the DI and HI trust funds in 1982, and were fully repaid by May 1986. In this report, the assets of the HI trust fund at the end of 1982 through 1985, inclusive, do not include the amounts owed to the trust fund. This procedure is followed because the borrowed amounts were available to the borrowing fund for the payment of benefits or other obligations, while such amounts were not readily available to the lending fund.

TABLE 1.--CONTRIBUTION RATES AND MAXIMUM TAXABLE AMOUNT OF ANNUAL EARNINGS

Calendar years	Maximum taxable amount of annual earnings	Contribution rate (Percent of taxable earnings): Employees and employers, each	Contribution rate (Percent of taxable earnings): Self-employed
Past experience:			
1966	$6,600	0.35	0.35
1967	6,600	0.50	0.50
1968-71	7,800	0.60	0.60
1972	9,000	0.60	0.60
1973	10,800	1.00	1.00
1974	13,200	0.90	0.90
1975	14,100	0.90	0.90
1976	15,300	0.90	0.90
1977	16,500	0.90	0.90
1978	17,700	1.00	1.00
1979	22,900	1.05	1.05
1980	25,900	1.05	1.05
1981	29,700	1.30	1.30
1982	32,400	1.30	1.30
1983	35,700	1.30	1.30
1984	37,800	1.30	2.60
1985	39,600	1.35	2.70
1986	42,000	1.45	2.90
1987	43,800	1.45	2.90
1988	45,000	1.45	2.90
Changes scheduled in present law:			
1989 & later	Subject to automatic increase	1.45	2.90

SUMMARY OF THE OPERATIONS OF THE TRUST FUND, FISCAL YEAR 1987

A statement of the income and disbursements of the Federal Hospital Insurance Trust Fund in fiscal year 1987, and of the assets of the fund at the beginning and end of the fiscal year, is presented in table 2.

The total assets of the trust fund amounted to $38.648 billion on September 30, 1986. During fiscal year 1987, total receipts amounted to $62.751 billion, and total disbursements were $50.803 billion. The assets of the trust fund thus increased $11.949 billion during the year to a total of $50.596 billion on September 30, 1987.

Included in total receipts during fiscal year 1987 were $55.944 billion representing contributions appropriated to the trust fund and $1.989 billion representing amounts received in accordance with State agreements for coverage of State and local Government employees and deposited in the trust fund. As an offset, $113 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 $57.820 billion, representing an increase of 9.0 percent over the amount of $53.020 billion for the preceding 12-month period. This growth in contribution income resulted primarily from (1) the higher level of earnings in covered employment; (2) the two increases in the maximum annual amount of earnings taxable from $39,600 to $42,000 and from $42,000 to $43,800 that became effective January 1, 1986, and January 1, 1987, respectively; and (3) the increase in the combined tax rate from 2.7 percent to 2.9 percent effective January 1, 1986.

The section entitled "Nature of the Trust Fund" referred 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 on behalf of certain uninsured persons. The reimbursement in fiscal year 1987 amounted to $447 million, consisting of $454 million for benefit payments, $8 million for administrative expenses, and -$15 million for interest on adjustments to costs in prior fiscal years.

The section entitled "Nature of the Trust Fund" referred to provisions of the Social Security Act under which certain persons aged 65 and over but not otherwise eligible for hospital insurance protection may obtain such protection by enrolling in the program and paying a monthly premium. Premiums collected from such voluntary participants in fiscal year 1987 amounted to about $40 million.

In accordance with the 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, the Railroad Retirement Board and the Secretary of Health and Human Services determined that a transfer of about $330 million from the railroad retirement account to the hospital insurance trust fund would place this fund in the same position, as of September 30, 1986, in which it would have been if railroad employment had always been covered under the Social Security Act. This amount, together with interest to the date of transfer amounting to about $38 million, was transferred to the trust fund in June 1987.

In accordance with provisions for the appropriation to the trust fund of HI taxes on noncontributory military wage credits as discussed in the section entitled "Nature of the Trust Fund," the trust fund was credited on July 1, 1987 with $94 million for calendar year 1987 taxes on wage credits.

On January 1, 1987, the Northern Mariana Islands (NMI) Social Security System became part of the U.S. Social Security and Medicare programs. At this time, a portion of the NMI Social Security Retirement Fund, amounting to about $8 million, was transferred to the trust fund.

The remaining $3.973 billion of receipts consisted almost entirely of interest on the investments of the trust fund.

Of the $50.803 billion in total disbursements, $49.967 billion represented benefits paid directly from the trust fund for health services covered under title XVIII of the Social Security Act. Benefit payments increased 1.9 percent in fiscal year 1987 over the corresponding amount of $49.018 billion paid during the preceding 12 months.

The remaining $836 million of disbursements was for net administrative expenses. Administrative expenses are allocated and charged directly to each of the four trust funds -- old-age and survivors insurance, disability insurance, hospital insurance, and supplementary medical insurance -- on the basis of provisional estimates. Similarly, the expenses of administering other programs of the Health Care Financing Administration are also allocated and charged directly to the general fund of the Treasury on a provisional basis. 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, including transfers between the hospital insurance and supplementary medical insurance trust funds and the program management general fund account, with appropriate interest allowances.

Table 3 compares the actual experience in fiscal year 1987 with the estimates presented in the 1986 and 1987 annual reports. The section entitled "Nature of the Trust Fund" referred 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 3, it should be noted that the "actual" amount of contributions in fiscal year 1987 reflects the aforementioned type of adjustments to contributions for prior fiscal years. On the other hand, the "actual" amount of contributions for fiscal year 1987 does not reflect adjustments to contributions for fiscal year 1987 that were to be made after September 30, 1987.

The assets of the hospital insurance trust fund at the end of fiscal year 1986 totaled $38.648 billion, consisting of $38.314 billion in the form of obligations of the U.S. Government or of federally-sponsored agency obligations and an undisbursed balance of $334 million. The assets of the hospital insurance trust fund at the end of fiscal year 1987 totaled $50.596 billion, consisting of $50.770 billion in the form of obligations and, as an offset, an extension of credit of $173 million against securities to be redeemed. Table 4 shows the total assets of the fund and their distribution at the end of fiscal years 1986 and 1987.

New securities at a total par value of $73.456 billion were acquired during the fiscal year through the investment of receipts and the reinvestment of funds made available from the redemption of securities. The par value of securities redeemed during the fiscal year was $61.016 billion. Thus, the net increase in the par value of the investments held by the fund during fiscal year 1987 amounted to $12.439 billion.

The effective annual rate of interest earned by the assets of the hospital insurance trust fund during the 12 months ending on June 30, 1987, was 10.1 percent. (This period is used because interest on special issues is paid semiannually on June 30 and December 31.) The interest rate on public-debt obligations issued for purchase by the trust fund in June 1987 was 8.625 percent, payable semiannually.

TABLE 2.--STATEMENT OF OPERATIONS OF THE HOSPITAL INSURANCE TRUST FUND
DURING FISCAL YEAR 1987
(In thousands of dollars)

Total assets of the trust fund, beginning of period	$38,647,727
Receipts:	
Appropriation of employment taxes	$55,943,629
Refunds of employment taxes	-112,650
Deposits arising from State agreements	1,989,450
Interest on investments	3,956,464
Amortization of premium and discount (Net)	17,024
Premiums collected from voluntary participants	40,334
Transfer from railroad retirement account	329,900
Transitional uninsured coverage	447,000
Military service credits of 1987	94,000
Interest on reimbursements, SSA 1/	-147
Interest on reimbursements, HCFA	0
Interest on reimbursements, Railroad	38,105
Income from the Merger of the Northern Mariana Islands Retirement Fund with the U.S. Social Security and Medicare programs	8,219
Other (Gifts)	26
Total receipts	$62,751,353
Disbursements:	
Benefit payments	$49,967,012
Administrative expenses:	
Treasury administrative expenses	27,294
Salaries and expenses, SSA	245,559
Salaries and expenses, HCFA 2/	526,107
Salaries and expenses, Office of Secretary	19,374
Construction	14,563
Professional Standard Review Organization	219
Reimbursement of SSA expenses	0
Reimbursement of HCFA expenses	0
Payment Assessment Committee	2,908
Public Health Service	0
Other	-310
Total disbursements	50,802,726
Total assets of the trust fund, end of period	$50,596,354

1/ A positive figure represents a transfer to the hospital insurance trust fund from the other trust funds. A negative figure represents a transfer from the hospital insurance trust fund to the other trust funds.

2/ Includes administrative expenses of the intermediaries.

NOTE: Totals do not necessarily equal the sums of rounded components.

TABLE 3.--COMPARISON OF ACTUAL AND ESTIMATED OPERATIONS OF THE HOSPITAL INSURANCE TRUST FUND, FISCAL YEAR 1987
(Dollar amounts in millions)

		Comparison of actual experience with estimates for fiscal year 1987 published in--			
		1987 report 1/		1986 report 1/	
Item	Actual amount	Estimated amount	Actual as percentage of estimate	Estimated amount	Actual as percentage of estimate
Net contributions	$57,820	$57,112	101	$56,916	102
Benefit payments	$49,967	$48,164	104	$52,513	95

1/ Alternative II-B.

TABLE 4.—ASSETS OF THE HOSPITAL INSURANCE TRUST FUND, BY TYPE, AT THE END OF FISCAL YEARS 1986 AND 1987 1/

	September 30, 1986	September 30, 1987
Investments in public-debt obligations sold only to the trust funds (special issues):		
Certificates of indebtedness:		
7 1/4-percent, 1987	$837,712,000.00	------
7 3/4-percent, 1987	80,040,000.00	------
9 -percent, 1988	------	$4,367,948,000.00
Bonds:		
8 1/4-percent, 1993	622,286,000.00	622,286,000.00
8 3/8-percent, 1987-88	2,137,108,000.00	------
8 3/8-percent, 1989-2001	16,529,250,000.00	16,529,250,000.00
8 3/4-percent, 1993-94	972,757,000.00	972,757,000.00
8 5/8-percent, 1989-2002	------	12,116,654,000.00
9 3/4-percent, 1993-95	1,240,090,000.00	1,240,090,000.00
10 3/8-percent, 1987	83,104,000.00	------
10 3/8-percent, 1988-2000	4,266,722,000.00	4,259,732,000.00
10 3/4-percent, 1987	588,410,000.00	------
10 3/4-percnet, 1988-98	3,530,460,000.00	3,530,460,000.00
13 -percent, 1993-96	1,770,094,000.00	1,770,094,000.00
13 1/4-percent, 1993-97	2,541,541,000.00	2,541,541,000.00
13 3/4-percent, 1987	262,135,000.00	------
13 3/4-percent, 1988-99	2,423,351,000.00	2,423,351,000.00
Total public-debt obligations sold only to the trust funds (special issues)	$37,885,060,000.00	$50,374,163,000.00
Investments in federally-sponsored agency obligations:		
Participation certificates:		
Federal Assets Liquidation Trust-Government National Mortgage Association:		
5.10-percent, 1987	50,000,000.00	------
6.40-percent, 1987	75,000,000.00	75,000,000.00
6.05-percent, 1988	65,000,000.00	65,000,000.00
6.45-percent, 1988	35,000,000.00	35,000,000.00
6.20-percent, 1988	230,000,000.00	230,000,000.00
Unamortized Premium & Discount (Net)	-26,479,157.10	-9,455,552.40
Total investments	$38,313,580,842.90	$50,769,707,447.60
Undisbursed balance	334,145,911.98	-173,353,560.84
Total assets	$38,647,726,754.88	$50,596,353,886.76

1/ Certificates of indebtedness and bonds are carried at par value, which is the same as book value. Book value for participation certificates is par value plus net unamortized premium and discount.