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THE 1993 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 1993 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL HOSPITAL INSURANCE TRUST FUND, PURSUANT TO 42 U.S.C. 401(c)(2)

APRIL 7, 1993.—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., April 6, 1993

HONORABLE THOMAS S. FOLEY
Speaker of the House of Representatives
Washington, D.C.

HONORABLE ALBERT GORE, JR.
President of the Senate
Washington, D.C.

GENTLEMEN: We have the honor of transmitting to you the 1993 Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund (the 28th such report), in compliance with the provisions of section 1817(b) of the Social Security Act.

Respectfully,

LLOYD M. BENTSEN,
Secretary of the Treasury, and
Managing Trustee of the Trust Fund

ROBERT B. REICH,
Secretary of Labor, and Trustee

DONNA E. SHALALA,
Secretary of Health and Human Services,
and Trustee

STANFORD G. ROSS,
Trustee

DAVID M. WALKER,
Trustee

WILLIAM TOBY,
Acting Deputy Administrator of the Health Care
Financing Administration, and
Secretary, Board of Trustees

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A. SUMMARY

1. Operations of the Hospital Insurance Program

The hospital insurance (HI) program pays for inpatient hospital care and other related care for those age 65 and over, and for the long-term disabled. In calendar year 1992, HI covered about 31 million aged and about 4 million disabled enrollees at a cost of $85.0 billion. Of this amount, $83.9 billion was for benefit payments and $1.1 billion, 1.3 percent of total disbursements, was for administrative expenses.

The HI program is financed primarily by payroll taxes, with the taxes paid by current workers and their employers used mainly to pay benefits for 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 United States Government. These obligations are backed by the full faith and credit of the U.S. Government.

The payroll taxes of 137 million workers and their employers amounting to $81.7 billion, or 87.1 percent of total income to the fund, were collected during calendar year 1992. Interest income to the HI trust fund amounted to 11.0 percent of total income. The remaining 1.8 percent of calendar year 1992 income consisted mostly of a transfer from the railroad retirement program, transfers to and from the general fund of the Treasury, and premiums paid by voluntary enrollees.

The HI contribution rates applicable to taxable earnings are 1.45 percent for employees and employer each and 2.90 percent for self-employed. The maximum taxable amount of annual earnings for 1992 was $130,200. After 1992, the automatic-adjustment provisions in section 230 of the Social Security Act determine the maximum taxable amount.

The adequacy of the HI program's scheduled financing to support program costs in the future is examined under three alternative sets of assumptions: optimistic, intermediate, and pessimistic. The intermediate set of assumptions, alternative II, represents the Trustees' best estimate of the expected future economic and demographic trends that will affect the financial status of the program. Alternative I is a more optimistic set of assumptions from the standpoint of HI financing and alternative III is a more pessimistic set of

assumptions. Under the intermediate set of assumptions, the trust fund ratio, defined as the ratio of assets at the beginning of the year to disbursements during the year, reached a level of 136 percent in 1992 and then is projected to decline steadily until the fund is completely exhausted in 1999. Under the more optimistic set of assumptions, the trust fund ratio is projected to decline until the fund is completely exhausted in 2000. Under the more pessimistic set of assumptions, the trust fund ratio is projected to decrease rapidly until the fund is exhausted in 1998. These projections clearly demonstrate that the HI program is severely out of financial balance using a range of plausible economic and demographic assumptions.

Table I.C.4 in this report summarizes the estimated operations of the HI trust fund that have just been described under the three alternative sets of assumptions. As can be seen from Table I.C.4, the Trustees' short-range test of financial adequacy, which is described in the "Expected Operations and Status of the Trust Fund" (section I.C.), is not met. In addition, the trust fund is projected to become insolvent within the next 5 to 7 years under all three sets of assumptions.

The adequacy of the current law financing schedule for the HI program on a long-range basis is measured by comparing on a year-by-year basis the tax rates specified by law with the corresponding incurred costs of the program, expressed as percentages of taxable payroll. However, the financial status of the program is often summarized, over a specific projection period, by a single measure known as the actuarial balance. The actuarial balance using the present value method is defined to be the difference in the sum of the present values of the tax rates for the valuation period over the sum of the present value of the cost rates (insured, incurred costs expressed as a percentage of taxable payroll) of the program for the same period, divided by the sum of the present values of the effective taxable payroll for the valuation period. The "Actuarial Status of the Trust Fund" (section I.D.) describes the method used to calculate summarized cost rates, tax rates, and actuarial balances. The HI trust fund does not meet the Trustees' long-range test of financial adequacy, as discussed in section I.D., under any of the three sets of assumptions.

Table I.A.1 presents a comparison of the projected experience contained in the 1992 and 1993 reports. As Table I.A.1 indicates, the projections in the 1993 report show that the fund will be depleted earlier than projected in the 1992 report under all three sets of assumptions. The major reasons for this change are the continued rapid growth in skilled nursing facility (SNF) and

home health agency (HHA) benefit payments, the larger estimated disabled population, and the lower estimated payroll taxes. Section I.D. discusses in more detail the reasons for the change in the actuarial balance. Compared to last years report, by the Trustees' intermediate set of assumptions, the date of exhaustion will be three years earlier and the 75-year actuarial balance will worsen by .91 percent of taxable payroll.

Table I.A.1. – STATUS OF THE HI TRUST FUND

	Year in which the trust fund is exhausted as published in the		75-year actuarial balance of the HI program as published in the	
Sets of assumptions	1992 report	1993 report	1992 report	1993 report
I (optimistic)	2009	2000	-1.34%	-2.04%
II (intermediate)	2002	1999	-4.20	-5.11
III (pessimistic)	2000	1998	-9.45	-10.61

2. Conclusion of the Board of Trustees

Under the Trustees' alternative II assumptions, the present financing schedule for the HI program is sufficient to ensure the payment of benefits only over the next 6 years. Also, the HI trust fund does not meet the Trustees' short-term test of financial solvency. Under the more pessimistic alternative III, the fund is projected to be exhausted in 1998, approximately 5 years from the present. Under the more optimistic alternative I, the trust fund is projected to be exhausted in 2000.

Currently about four covered workers support each HI enrollee. This ratio will begin to decline rapidly early in the next century. By the middle of that century, only about two covered workers will support each enrollee. Not only are the anticipated reserves and financing of the HI program inadequate to offset this demographic change, but under all the assumptions, the trust fund is projected to become exhausted even before the major demographic shift

begins to occur. As noted above, exhaustion of the fund is projected to occur by the turn of the century under all three sets of assumptions.

The Trustees note that some steps have been taken to reduce the rate of growth in payments to hospitals, including the implementation of prospective payment and diagnosis-related groups. Initial experience under the prospective payment system for hospitals suggests that this payment mechanism may be an effective means of constraining the growth in hospital payments and improving the efficiency of the hospital industry. Nonetheless, projected costs for the HI program far exceed projected revenues over the 75-year long-range period. As a result, the HI program is severely out of financial balance and is unsustainable in its present form.

The long-range status of the HI program has deteriorated over the years as measured by the actuarial balances reported in this report and prior years reports. In addition, this year the HI trust fund fails to meet the short-range test of financial adequacy. In view of the worsening condition of the HI trust fund and the failure of the fund to meet the short-range test of financial adequacy, the Board of Trustees is making a seperate report to alert the Congress of the unfavorable financial status of the HI trust fund as required under section 709 of the Social Security Act.

The HI program is projected to increase from 1.4 percent of Gross Domestic Product (GDP) in CY 1992 to 5.1 percent of GDP in CY 2065. This rapid growth is attributable primarily to (1) increases in hospital admissions, and (2) increases in reported case mix. With the magnitude of the projected actuarial deficit in the HI program and the high probability that the HI trust fund will be exhausted by the turn of the century, the Trustees urge the Congress to take additional actions designed to control HI program costs through specific program legislation and as a part of enacting comprehensive health care reform. The Trustees believe that prompt, effective, and decisive action is necessary.

B. 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 composed of five members, three of whom serve in an ex officio capacity: the Secretary of the Treasury,

the Secretary of Labor, and the Secretary of Health and Human Services. The President nominated and the Senate confirmed Stanford G. Ross and David M. Walker to be the other two members, who serve as representatives of the public. Mr. Ross and Mr. Walker are serving 4-year terms that began on October 2, 1990.

By law, the Secretary of the Treasury is designated as the Board Chairperson and 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 annual report, for 1993, is the 28th such report.

C. EXPECTED OPERATIONS AND STATUS OF THE TRUST FUND

Table I.C.1 shows the expected operations of the trust fund during fiscal years 1993 to 1995, together with the past experience of the program. The estimate shown in Table I.C.1 is based on an intermediate set of assumptions labeled "Alternative II." This set of assumptions represents the Trustees' best estimate of the expected future economic and demographic trends that will affect the financial status of the program. The assumptions underlying the alternative II projections are presented in the technical section.

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 HI contributions. Estimates of the corresponding outgo are included in the disbursement items.

Estimated income to the trust fund which is appropriated from general revenue to reimburse the program for the cost of coverage of noninsured persons is the same as the estimates of disbursements incurred for such persons, net of corrections for differences between costs and amounts transferred for previous years. Premium income for other noninsured persons who may enroll in the HI program on a voluntary basis is estimated based on projected premium rates calculated according to statute and estimated average enrollment.

The transfers from general revenue for military wage credits are based on provisions of the Social Security Amendments of 1983 (Public Law 98-21), as described in the technical section.

The investment of new assets received during fiscal years 1993-95 is assumed to be in the form of special public-debt obligations bearing interest rates ranging from 5.875 percent to 6.375 percent, payable semiannually. The average effective annual rate of interest on the assets held by the HI trust fund on September 30, 1992, was 8.9 percent.

Disbursements for benefits are projected to increase in fiscal years 1993-95, primarily as a result of the increase in hospital payment rates and hospital admissions under the program. The expenditures for benefit payments shown in Table I.C.1 will differ from those shown in the President's proposed 1994 Federal Budget. These estimates are based on more recent demographic and economic projections, and they do not reflect the implementation of proposed changes in regulations which were included in the budget. The expenditures for benefit payments shown in this section are based on the assumption that for fiscal years 1994 and later, the prospective payment rates will be increased in accordance with Public Law 101-508, the Omnibus Budget Reconciliation Act of 1990; for fiscal year 1993, the prospective payment rates have already been determined in accordance with the same statute.

The actual operations of the HI program are organized, in general, on a calendar year basis. Earnings subject to taxation and the applicable tax rates are established by calendar year, as are the inpatient hospital deductible and other cost-sharing amounts. The projected operations of the trust fund on a calendar year basis are shown in Table I.C.2, according to the same assumptions as used in Table I.C.1. The ratios of assets in the trust fund at the beginning of each calendar year to total disbursements during that year are shown in Table I.C.3 for past years and as projected, under the same assumptions, through 1995.

TABLE I.C.1.--OPERATIONS OF THE HI TRUST FUND DURING FISCAL YEARS 1970-95

(In millions)

	Income							Disbursements				Trust fund	
Fiscal year[1]	Payroll taxes	Transfers from railroad retirement account	Reimbursement for uninsured persons	Premiums from voluntary enrollees	Payments for military wage credits	Interest and other income[2]	Total income	Benefits Payments[3]	Administrative expenses[4]	Total disbursements	Interfund borrowing transfers[5]	Net increase in fund	Fund at end of year
Historical Data:													
1970	$4,785	$64	$617	--	$11	$137	$5,614	$4,804	$149	$4,953	--	$661	$2,677
1975	11,291	132	481	$6	48	609	12,568	10,353	259	10,612	--	1,956	9,870
1980	23,244	244	697	17	141	1,072	25,415	23,790	497	24,288	--	1,127	14,490
1981	30,425	276	659	21	141	1,341	32,863	28,907	353	29,260	--	3,603	18,093
1982	34,390	351	808	25	207	1,829	37,611	34,343	521	34,864	--	2,747	20,840
1983	36,387	358	878	26	3,663[6]	2,629	43,940	38,102	522	38,624	-$12,437	-7,121	13,719
1984	41,364	351	752	35	250	2,812	45,563	41,476	633	42,108	--	3,455	17,174
1985	46,490	371	766	38	86	3,182	50,933	47,841	813	48,654	1,824	4,103	21,277
1986	53,020	364	566	40	-714[7]	3,167	56,442	49,018	667	49,685	10,613	17,370	38,648
1987	57,820	368	447	40	94	3,982	62,751	49,967	836	50,803	--	11,949	50,596
1988	61,901	364	475	42	80	5,148	68,010	52,022	707	52,730	--	15,281	65,877
1989	67,527	379	515	42	86	6,567	75,116	57,433	805	58,238	--	16,878	82,755
1990	70,655	367	413	113	107	7,908	79,563	65,912	774	66,687	--	12,876	95,631
1991	74,655	352	605	367	-1,011[8]	8,969	83,938	68,705	934	69,638	--	14,299	109,930
1992	80,978	374	621	484	86	10,133	92,677	80,784	1,191	81,974	--	10,703	120,633
Estimates[9]:													
1993	82,657	395	367	575	79	12,415[10]	96,488	90,118	1,122	91,240	--	5,248	125,881
1994	89,921	376	506	669	74	10,720	102,266	101,571	1,188	102,759	--	-493	125,388
1995	94,657	374	323	755	70	10,284	106,463	113,466	1,271	114,737	--	-8,274	117,114

[1]Fiscal years 1970 and 1975 consist of the 12 months ending on June 30 of each year; fiscal years 1980 and later consist of the 12 months ending on September 30 of each year.

[2]Other income includes recoveries of amounts reimbursed from the trust fund which are not obligations of the trust fund and a small amount of miscellaneous income.

[3]Includes costs of Peer Review Organizations (beginning with the implementation of the Prospective Payment System on October 1, 1983).

[4]Includes costs of experiments and demonstration projects.

[5]A negative amount is a loan to the OASI trust fund; a positive amount is a repayment of loan principal to the HI trust fund.

[6]Includes the lump sum general revenue transfer of $3,456 million, as provided for by section 151 of P.L. 98-21.

[7]Includes the lump sum general revenue adjustment of -$805 million, as provided for by section 151 of P.L. 98-21.

[8]Includes the lump sum general revenue adjustment of -$1,100 million, as provided for by section 151 of P.L. 98-21.

[9]Under alternative II.

[10]Includes $1,805 million transfer from the SMI catastrophic coverage reserve fund, as provided for by P.L. 102-394.

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

TABLE I.C.2.--OPERATIONS OF THE HOSPITAL INSURANCE TRUST FUND DURING CALENDAR YEARS 1970-95

(In millions)

	Income							Disbursements				Trust fund	
Calendar year	Payroll taxes	Transfers from railroad retirement account	Reimbursement for uninsured persons	Premiums from voluntary enrollees	Payments for military wage credits	Interest and other income[1]	Total Income	Benefits Payments[2]	Administrative expenses[3]	Total disbursements	Interfund borrowing transfers[4]	Net increase in fund	Fund at end of year
Historical Data:													
1970	$4,881	$66	$863	--	$11	$158	$5,979	$5,124	$157	$5,281	--	$698	$3,202
1975	11,502	138	621	$7	48	664	12,980	11,315	266	11,581	--	1,399	10,517
1980	23,848	244	697	18	141	1,149	26,097	25,064	512	25,577	--	521	13,749
1981	32,959	276	659	22	207	1,603	35,725	30,342	384	30,726	--	4,999	18,748
1982	34,586	351	808	24	207	2,022	37,998	35,631	513	36,144	-$12,437	-10,583	8,164
1983	37,259	358	878	27	3,456[5]	2,593	44,570	39,337	540	39,877	--	4,693	12,858
1984	42,288	351	752	33	250	3,046	46,720	43,257	629	43,887	--	2,834	15,691
1985	47,576	371	766	41	-719[6]	3,362	51,397	47,580	834	48,414	1,824	4,808	20,499
1986	54,583	364	566	43	91	3,619	59,267	49,758	664	50,422	10,613	19,458	39,957
1987	58,648	368	447	38	94	4,469	64,064	49,496	793	50,289	--	13,775	53,732
1988	62,449	364	475	41	80	5,830	69,239	52,517	815	53,331	--	15,908	69,640
1989	68,369	379	515	55	86	7,317	76,721	60,011	792	60,803	--	15,918	85,558
1990	72,013	367	413	122	-993[7]	8,451	80,372	66,239	758	66,997	--	13,375	98,933
1991	77,851	352	605	432	89	9,510	88,839	71,549	1,021	72,570	--	16,269	115,202
1992	81,745	374	621	522	86	10,487	93,836	83,895	1,121	85,015	--	8,821	124,022
Estimates[8]:													
1993	83,521	395	367	597	79	12,620[9]	97,579	92,969	1,129	94,098	--	3,481	127,503
1994	90,950	376	506	693	74	10,647	103,246	104,631	1,208	105,839	--	-2,593	124,910
1995	95,877	374	323	776	70	9,950	107,370	116,612	1,293	117,905	--	-10,535	114,375

[1]Other income includes recoveries of amounts reimbursed from the trust fund which are not obligations of the trust fund and a small amount of miscellaneous income.

[2]Includes costs of Peer Review Organizations (beginning with the implementation of the Prospective Payment System on October 1, 1983).

[3]Includes costs of experiments and demonstration projects.

[4]A negative amount is a loan to the OASI trust fund; a positive amount is a repayment of loan principal to the HI trust fund.

[5]The lump sum general revenue transfer, as provided for by section 151 of P.L. 98-21.

[6]Includes the lump sum general revenue adjustment of -$805 million, as provided for by section 151 of P.L. 98-21.

[7]Includes the lump sum general revenue adjustment of -$1,100 million, as provided for by section 151 of P.L. 98-21.

[8]Under alternative II.

[9]Includes $1,805 million transfer from the SMI catastrophic coverage reserve fund, as provided for by P.L. 102-394.

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

TABLE I.C.3. – RATIO OF ASSETS IN THE FUND AT THE BEGINNING OF THE YEAR TO DISBURSEMENTS DURING THE YEAR FOR THE HI TRUST FUND
(In percent)

Calendar Year	Ratio
Historical Data:	
1967	28%
1968	25
1969	43
1970	47
1971	54
1972	47
1973	40
1974	69
1975	79
1976	77
1977	66
1978	57
1979	54
1980	52
1981	45
1982	52
1983	20
1984	29
1985	32
1986	41
1987	79
1988	101
1989	115
1990	128
1991	136
1992	136
Estimates[1] :	
1993	132
1994	120
1995	106

[1]Under alternative II.

Since future economic, demographic, and health care usage and cost experience may differ considerably from the intermediate assumptions on which the cost estimates were based, projections have also been prepared on the basis of two different sets of assumptions labeled "Alternative I" and "Alternative III." The assumptions used in preparing projections under alternatives I and III, as well as under alternative II, are discussed in the technical section.

The three alternative sets of assumptions were selected in order to indicate the general range in which the cost of the program reasonably might be expected to fall. The alternative I assumptions are more optimistic than the alternative II assumptions, resulting in a lower average cost over the projection period and enhanced trust fund finances. The alternative III assumptions are more pessimistic than the alternative II assumptions, resulting in a higher average cost over the projection period and weaker trust fund finances. Alternatives I and III provide for a fairly wide range of possible experience. Actual experience reasonably may be expected to fall within the range, but no assurance can be made that this will be the case, particularly in light of the wide variations in experience that have occurred since the beginning of the program.

The estimated operations of the HI trust fund during calendar years 1992-2000, on a cash basis for all program income and disbursements, are summarized in Table I.C.4 for all three alternatives. Under alternative II, the trust fund as a percent of a year's disbursements (trust fund ratio) reached a level of 136 percent in 1992 and then is projected to decline steadily until it is completely exhausted in 1999. Under alternative I, the trust fund ratio is projected to decline until the fund is exhausted in 2000. Under alternative III, the trust fund ratio is projected to decrease rapidly until the fund is exhausted in 1998. There is a significant narrowing of the band due to the severity and short term nature of the financial deterioration of the HI program. These projections do not reflect any reduction in disbursements due to proposed changes in legislation or regulation which were included in the 1994 Federal Budget but which have not been enacted or implemented.

TABLE I.C.4. -- ESTIMATED OPERATIONS OF THE HI TRUST FUND DURING CALENDAR YEARS 1992-2000, UNDER ALTERNATIVE SETS OF ASSUMPTIONS
(Dollar amounts in billions)

Calendar Year	Total income	Total disbursements	Net increase in fund	Fund at end of year	Ratio of assets to disbursements[1] (percent)
ALTERNATIVE I:					
1992[2]	$93.8	$85.0	$8.8	$124.0	136
1993	98.4	94.1	4.3	128.3	132
1994	104.9	104.9	0.0	128.3	122
1995	110.4	116.1	-5.7	122.7	111
1996	116.1	128.4	-12.2	110.4	96
1997	120.9	139.3	-18.5	92.0	79
1998	126.0	150.5	-24.4	67.5	61
1999	130.9	162.2	-31.3	36.2	42
2000	135.6	174.6	-39.0	(3)	21
ALTERNATIVE II:					
1992[2]	$93.8	$85.0	$8.8	$124.0	136
1993	97.6	94.1	3.5	127.5	132
1994	103.2	105.8	-2.6	124.9	120
1995	107.4	117.9	-10.5	114.4	106
1996	111.4	131.3	-19.8	94.5	87
1997	114.4	143.6	-29.2	65.3	66
1998	117.5	156.6	-39.1	26.2	42
1999	120.5	170.9	-50.4	(4)	15
ALTERNATIVE III:					
1992[2]	$93.8	$85.0	$8.8	$124.0	136
1993	97.3	94.1	3.1	127.1	132
1994	101.7	106.5	-4.8	122.3	119
1995	104.8	120.0	-15.1	107.2	102
1996	110.4	137.3	-26.9	80.3	78
1997	111.9	152.3	-40.4	39.9	53
1998	112.7	167.5	-54.8	(5)	24

[1]Ratio of assets in the fund at the beginning of the year to disbursements during the year.
[2]Figures for 1992 represent actual experience.
[3]Trust fund depleted in calendar year 2000.
[4]Trust fund depleted in calendar year 1999.
[5]Trust fund depleted in calendar year 1998.

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

In order to meet the test of financial adequacy in the short-range projection period, the ratio of estimated assets in the trust fund at the beginning of the year to estimated disbursements during that year must either (a) be at least

100 percent throughout the 10-year projection period, or (b) reach a level of 100 percent within 5 years and remain at or above 100 percent throughout the remainder of the 10-year period. In addition, the fund's estimated assets at the beginning of each month of the 10-year period must be sufficient to cover that month's estimated disbursements. This test is applied to the estimates under alternative II for the period 1993-2002. Failure of the trust fund to meet this test is an indication that the solvency of the program over the next 10 years is in question and that action is needed to improve the short-range financial adequacy of the program. As can be seen from Table I.C.4, this short-range test is not even close to being met. Under the alternative II assumptions, the trust fund ratio falls below the 100 percent level in 3 years and is exhausted in 6 years.

Figure 1 shows historical trust fund ratios for recent years and projected ratios under the three sets of assumptions. Figure 2 shows end-of-year trust fund balances for recent historical years and for projected years under the three sets of assumptions.

Figure 1. SHORT-TERM HI TRUST FUND RATIOS

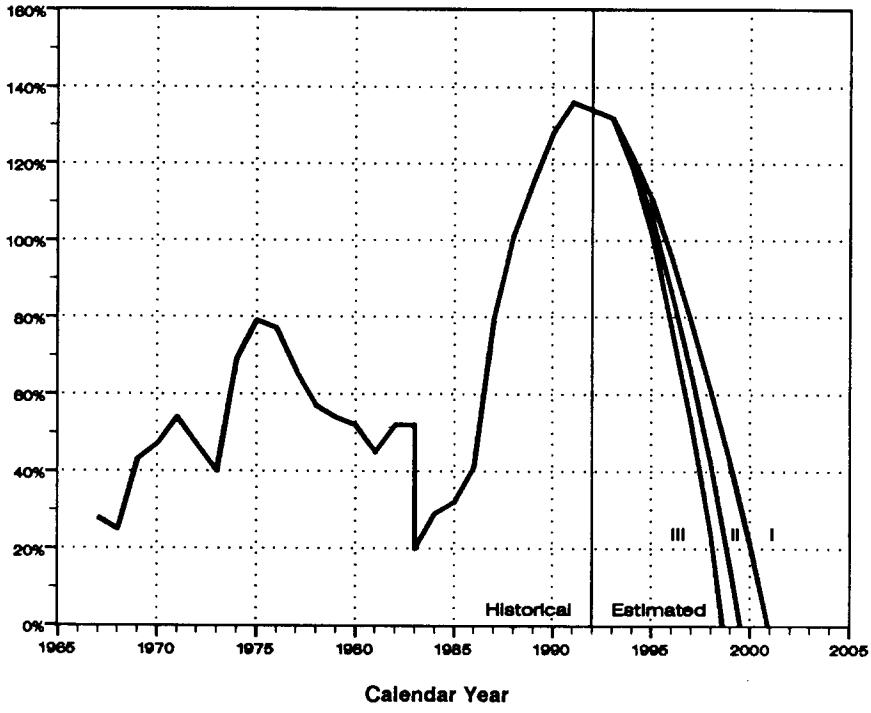
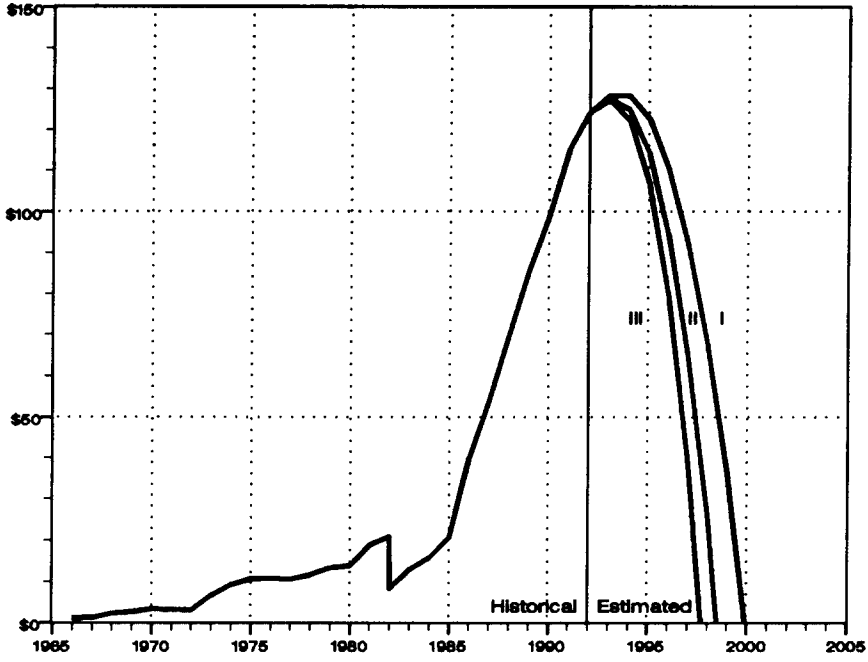


Figure 2. HI TRUST FUND BALANCE, END-OF-YEAR (in $ Billions)



D. ACTUARIAL STATUS OF THE TRUST FUND

In the previous section, entitled "Expected Operations and Status of the Trust Fund" (I.C.), the expected operations of the HI program over the short-term period were presented. In this section, the actuarial status of the trust fund, or the adequacy of the scheduled financing to support program costs well into the future, is examined, under all three alternative assumptions. The assumptions used in preparing projections under all three alternative sets of assumptions are summarized in the technical section.

The adequacy of the current law financing schedule for the HI program on a long-range basis is measured by comparing on a year-by-year basis the tax rates specified by law with the corresponding incurred costs of the program, expressed as percentages of taxable payroll. If these two items are exactly

equal in each year of the projection period and all projection assumptions are realized, tax revenues will be sufficient to provide for program costs. In practice, however, tax rate schedules generally are designed with rate changes occurring only at intervals of several years, rather than with continual yearly increases to match exactly with projected cost increases. To the extent that small differences between the yearly costs of the program and the corresponding tax rates occur for short periods of time and are offset by subsequent differences in the reverse direction, the financing objectives can be met by maintaining an appropriate contingency reserve. In projecting costs under the program, only incurred expenditures (benefits and administrative costs) attributable to insured beneficiaries are considered, since benefits and administrative costs for noninsured persons are expected to be financed through general revenue transfers and premium payments rather than through payroll taxes.

The historical costs of the HI program, expressed as percentages of taxable payroll, are shown in Table I.D.1. The ratio of expenditures to taxable payroll has increased from 0.94 percent in 1967 to 3.01 percent in 1992, reflecting both the higher rate of increase in program costs than in earnings subject to HI taxes and the extension of HI benefits to disabled and end-stage renal disease beneficiaries. The projected costs of the program under alternative II, expressed as percentages of taxable payroll, and the tax rates scheduled under current law for selected years over the 75-year period 1993-2067, are shown in Table I.D.2. Further increases in the ratio of expenditures to taxable payroll under alternative II result from the projection that the cost of the HI program will continue to increase at a higher rate than taxable earnings, as discussed later in this section. It can be seen from the selected years shown in Table I.D.2 that, on a year-by-year basis, the tax rates specified by current law are insufficient by a large margin to support the projected costs of the current program. As a result, the program is severely out of financial balance and prompt actions will need to be taken to increase revenues and/or reduce expenditures.

TABLE I.D.1. – COST OF THE HI PROGRAM, EXPRESSED AS A PERCENT OF TAXABLE PAYROLL

Calendar year	Expenditures under the program[1]
1967	0.94%

TABLE I.D.1. -- COST OF THE HI PROGRAM, EXPRESSED AS A PERCENT OF TAXABLE PAYROLL

Calendar year	Expenditures under the program[1]
1968	1.04
1969	1.12
1970	1.20
1971	1.32
1972	1.30
1973	1.33
1974	1.42
1975	1.69
1976	1.83
1977	1.95
1978	2.01
1979	1.99
1980	2.20
1981	2.39
1982	2.65
1983	2.67[2]
1984	2.64
1985	2.63
1986	2.55
1987	2.45
1988	2.43
1989	2.60
1990	2.71
1991	2.74
1992	3.01

[1]Estimated costs attributable to insured beneficiaries only, on an incurred basis. Benefits and administrative costs for noninsured persons are expected to be financed through general revenue transfers and premium payments, rather than through payroll taxes. Gratuitous credits for military service after 1956 are included in taxable payroll.

[2]Deemed credits for military service before 1984 were attributed to the year in which such service had occurred. If all such credits had been attributed in 1983, expenditures under the program in 1983 would have been lower by 0.18 percent of taxable payroll.

TABLE I.D.2. -- COST AND TAX RATES OF THE HI PROGRAM, EXPRESSED AS A PERCENT OF TAXABLE PAYROLL [1]

Calendar Year	Expenditures under the program[2]	Tax rates scheduled in the law[3]	Difference[4]
1993	3.21%	2.90%	-0.31%
1994	3.41	2.90	-0.51
1995	3.60	2.90	-0.70
2000	4.32	2.90	-1.42

TABLE I.D.2. -- COST AND TAX RATES OF THE HI PROGRAM, EXPRESSED AS A PERCENT OF TAXABLE PAYROLL [1]

Calendar Year	Expenditures under the program[2]	Tax rates scheduled in the law[3]	Difference[4]
2005	4.99	2.90	-2.09
2010	5.57	2.90	-2.67
2015	6.44	2.90	-3.54
2020	7.31	2.90	-4.41
2025	8.30	2.90	-5.40
2030	9.31	2.90	-6.41
2035	10.10	2.90	-7.20
2040	10.61	2.90	-7.71
2045	10.93	2.90	-8.03
2050	11.17	2.90	-8.27
2055	11.45	2.90	-8.55
2060	11.81	2.90	-8.91
2065	12.24	2.90	-9.34
2067	12.43	2.90	-9.53

[1]Under alternative II.

[2]Estimated costs attributable to insured beneficiaries only, on an incurred basis, under alternative II. Benefits and administrative costs for noninsured persons are expected to be financed through general revenue transfers and premium payments, rather than through payroll taxes. Gratuitous credits for military service after 1956 are included in taxable payroll.

[3]Rates for employees and employers combined.

[4]Difference between the tax rate scheduled in the law and program expenditures.

While the year-by-year comparisons discussed are necessary to measure the adequacy of the financing of the HI program, the financial status of the program is often summarized, over a specific projection period, by a single measure known as the actuarial balance. The actuarial balance of the HI program is defined to be the difference between the summarized tax rate for the valuation period and the summarized cost rate (insured, incurred costs expressed as a percentage of taxable payroll) of the program for the same period. The present-value method is used to calculate summarized cost rates, tax rates, and actuarial balances in this report, unless otherwise indicated. This approach is the same as that used in the OASDI report. Under the present-value method, the summarized tax rates, cost rates, and actuarial balance are based upon the present values of future income attributable to taxes on an incurred basis, future insured costs on an incurred basis, and future taxable payroll. The present values are calculated by discounting the future annual amounts, at the assumed rates of interest credited to the HI

trust fund, to the beginning of the valuation period. The summarized tax and cost rates over the projection period are then obtained by dividing the present value of the taxable payroll into the present values of tax income and cost, respectively. The difference between the summarized tax rate and cost rate over the long-range projection period, after an adjustment to take into account the fund balance at the valuation date and any target trust fund at the end of the valuation period, is computed to obtain the actuarial balance. In keeping with a decision by the Board of Trustees that it is advisable to maintain a balance in the trust fund equal to a minimum of one year's expenditures, the target trust fund balance is equal to the following year's estimated costs at the end of the 75-year projection period. It should be noted that projecting an end-of-period target trust fund balance does not necessarily insure that the trust fund will maintain such a balance on a year-by-year basis.

Calculating the fund balance under the present-value method is a convenient, generally accepted way of summarizing actuarial status. The actuarial balance computed under the present-value method can be interpreted as the immediate, level, and permanent percentage that must be added to the current law tax rates and/or subtracted from the current law cost rates throughout the entire valuation period in order for the financing to support program costs and provide for the targeted trust fund balance at the end of the projection period. The tax rate increase according to this method is 5.11 percent of taxable payroll. However, if tax rates or cost rates were not changed until the year the trust fund falls below the 100 percent level recommended by the Board of Trustees, the level of the increase would have to be 5.29 percent of taxable payroll under alternative II. If no changes were made until the year the trust fund will be exhausted, the actuarial deficit would be 5.51 percent of taxable payroll. The OASDI report also employs the present-value method of summarizing the long-term financial status of the Social Security program. An alternative way of calculating actuarial status, the modified average-cost method, is presented in section III.A.

The actuarial balances under all three alternative sets of assumptions, for the first 25-year period, the first 50-year period, the entire 75-year period 1993-2067, and for each 25-year subperiod, are shown in Table I.D.3. The summarized tax rate for the entire 75-year period is 2.90 percent. The summarized cost of the program under alternative II, for the entire 75-year period, is 8.01 percent of taxable payroll. As a result, the HI program fails to meet the Trustees' long-range test of financial adequacy, which is described

in the OASDI report and the Glossary of this report, under any of the three assumption sets.

TABLE I.D.3. -- ACTUARIAL BALANCES OF THE HI PROGRAM, UNDER ALTERNATIVE SETS OF ASSUMPTIONS

	Alternative		
	I	II	III
Projection periods:			
1993-2017:			
Summarized tax rate[1]	2.90%	2.90%	2.90%
Summarized cost rate[2]	3.99	5.01	6.36
Actuarial balance[3]	-1.09	-2.11	-3.46
1993-2042:			
Summarized tax rate[1]	2.90	2.90	2.90
Summarized cost rate[2]	4.52	6.84	10.81
Actuarial balance[3]	-1.62	-3.94	-7.91
1993-2067:			
Summarized tax rate[1]	2.90	2.90	2.90
Summarized cost rate[2]	4.94	8.01	13.51
Actuarial balance[3]	-2.04	-5.11	-10.61
25-year subperiods:			
1993-2017:			
Summarized tax rate[1]	2.90%	2.90%	2.90%
Summarized cost rate[4]	3.99	4.94	6.18
Actuarial balance[3]	-1.09	-2.04	-3.28
2018-2042:			
Summarized tax rate[1]	2.90	2.90	2.90
Summarized cost rate[4]	5.15	9.04	16.08
Actuarial balance[3]	-2.25	-6.14	-13.18

TABLE I.D.3. – ACTUARIAL BALANCES OF THE HI PROGRAM, UNDER ALTERNATIVE SETS OF ASSUMPTIONS

	Alternative		
	I	II	III
2043-2067:			
Summarized tax rate[1]	2.90	2.90	2.90
Summarized cost rate[4]	6.08	11.48	21.96
Actuarial balance[3]	-3.18	-8.58	-19.06

[1]As scheduled under present law.

[2]Expenditures for benefit payments and administrative costs for insured beneficiaries, on an incurred basis, expressed as a percentage of taxable payroll, computed on the present-value basis, including the cost of attaining a trust fund balance at the end of the period equal to 100% of the following year's estimated expenditures, and including an offset to cost due to the beginning trust fund balance.

[3]Difference between the summarized tax rate (as scheduled under present law) and the summarized cost rate.

[4]Expenditures for benefit payments and administrative costs for insured beneficiaries, on an incurred basis, expressed as a percentage of taxable payroll, computed on the present-value basis. Includes neither the trust fund balance at the beginning of the period nor the cost of attaining a non-zero trust fund balance at the end of the period.

The divergence in outcomes among the three alternatives is reflected both in the estimated operations of the trust fund on a cash basis (as discussed in section I.C.) and in the 75-year summarized costs. The variations in the underlying assumptions, as shown in the technical section, can be characterized as (1) moderate in terms of magnitude of the differences on a year-by-year basis, and (2) persistent over the duration of the projection period. During the first 25-year projection period, under the intermediate assumptions, program expenditures are projected to increase faster than taxable payroll, at a rate which gradually declines to about 2 percent more per year than taxable payroll by 2010. However, program expenditures are expected to grow at a rate over 3 percent more than taxable payroll for alternative II in 2017, the last year of the first 25-year projection period. This is just after the major demographic shift, as described below, begins. Under alternative I, program expenditures are also projected to increase faster than taxable payroll, but at a somewhat lower rate, which gradually declines to about 0.5 percent more per year than taxable payroll by 2010; the rate then increases, reaching about 1.5 percent more per year than taxable payroll in 2017. Similarly, alternative III follows a pattern whereby program expenditures initially increase faster than taxable payroll and at a somewhat

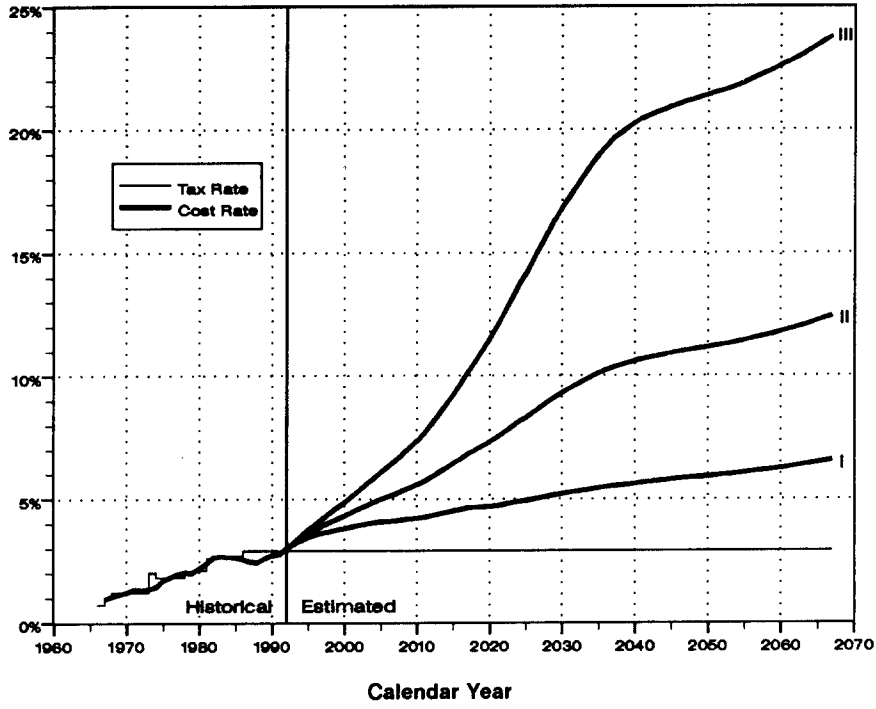
higher rate than the intermediate assumptions, gradually declining to about 4 percent more than taxable payroll by 2010, and then increasing to about 5 percent more than taxable payroll in 2017. Past experience has indicated that conditions producing results as adverse as those under alternative III can occur. In view of this and because of the wide range of possible experience, it is important that a balance be maintained in the HI trust fund as a reserve for contingencies.

A valuation period of 75 years is needed to present fully the future contingencies that reasonably may be expected to occur, such as the impact of the large shift in the demographic composition of the population which occurs after the turn of the century. As Table I.D.2 indicates, estimated expenditures under the program, expressed as percentages of taxable payroll, increase rapidly during the second 25 years of the projection period. This rapid increase in costs occurs because the relatively large number of persons born during the period between the end of World War II and the early 1960's (known as the "baby boom") will reach retirement age and begin to receive benefits, while the relatively small number of persons born during later years will comprise the labor force. During the last 25 years of the projection period, the projected increases in expenditures under the program stabilize.

Costs beyond the initial 25-year projection period for alternative II are based upon the assumption that costs per unit of service will increase at the same rate as that of average hourly earnings. Thus, changes in the last fifty years of the projection period primarily reflect the impact of the changing demographic composition of the population. Costs beyond the initial 25-year projection period for alternatives I and III begin by assuming that program cost increases, relative to taxable payroll increases, are approximately 2 percent less rapid and 2 percent more rapid, respectively, than the results under the intermediate assumptions. The 2 percent differentials gradually decrease until the year 2042 when program cost increases, relative to taxable payroll, are approximately the same as under the intermediate assumptions.

Figure 3 shows the year-by-year costs as a percent of taxable payroll for each of the three sets of assumptions, as well as the scheduled tax rates. Figure 3 illustrates the magnitude of the projected financial imbalance in the HI program by displaying the divergence of the program costs and scheduled tax rates under each set of assumptions.

Figure 3. ESTIMATED HI COSTS AND TAX RATES AS PERCENT OF TAXABLE PAYROLL



The 75-year actuarial balance of the HI program, under alternative II, is estimated to be -5.11, as shown in Table I.D.3. The actuarial balance under alternative II as reported in the 1992 Annual Report was -4.20. The major reasons for the change in the 75-year actuarial balance are summarized in Table I.D.4. In more detail, these changes are:

(1) Changes in valuation period: Deletion of 1992 and the addition of 2067 to the 75-year projection period substitutes a very large deficit year for a much smaller deficit year with respect to the operations of the HI trust fund. The net effect on the actuarial balance is -0.12.

(2) Home Health Assumptions: Changes in the home health assumptions described in the technical section result in a -0.46 change in the actuarial

balance. The primary factor contributing to the change is significantly higher recent trends in utilization which are projected to continue.

(3) Economic and demographic assumptions: Changes in the economic and demographic assumptions described in the technical section result in a +0.09 change in the actuarial balance. Most economic assumptions are more favorable in the short range.

(4) Updating the projection base: The cost as a percent of payroll for 1992 was more than estimated in the 1992 report. The net effect of this change on the actuarial balance is -0.52.

(5) Hospital assumptions: Changes in the hospital assumptions described in the technical section result in a +0.10 change in the actuarial balance. The primary factor contributing to the change is the lower labor and non labor differentials.

TABLE I.D.4. – CHANGE IN THE 75-YEAR ACTUARIAL BALANCE SINCE THE 1992 REPORT

1. Actuarial balance, alternative II, 1992 report	-4.20%
2. Changes:	
a. Valuation period	-0.12
b. Base estimate	-0.52
c. Home health assumptions	-0.46
d. Economic and demographic assumptions	+0.09
e. Hospital assumptions	+0.10
f. Net effect, above changes	-0.91
3. Actuarial balance, alternative II, 1993 report	-5.11

E. CONCLUSION

The balance in the Federal Hospital Insurance Trust Fund at the beginning of 1993 was 132 percent of estimated outgo for calendar year 1993, above the minimum 100 percent level recommended by the Board of Trustees. However, the tax rates specified in the law are only sufficient, along with interest earnings and assets in the fund, to support program expenditures only over the next 6 years, under the Trustees' intermediate assumptions. Also, the trust fund does not meet the short-range test of financial adequacy, which was described in a previous section of this report. Under all of the three sets of assumptions, the HI trust fund is projected to become exhausted within the next 5 to 7 years. Any significant adverse deviation from these projections

could result in the inability of the fund to meet its obligations even sooner than projected.

Over the 75-year projection period, the tax rate necessary to provide for benefits and administrative expenses far exceeds the tax rate scheduled in the law in most years. The actuarial balance, as defined in the previous section (that is, including the cost of attaining a trust fund balance at the end of the period equal to 100% of the following year's estimated expenditures, and including an offset to cost due to the beginning trust fund balance), is -2.11 for the first 25-year projection period, -3.94 for the first 50-year projection period, and -5.11 over the entire 75-year projection period, under the alternative II assumptions. The actuarial balances for the 25-year subperiods, as defined in the previous section (that is, including neither the trust fund balance at the beginning of the period nor the cost of attaining a non-zero trust fund balance at the end of the subperiod), are -2.04, -6.14, and -8.58 for the first, second, and third 25-year subperiods, respectively, under the alternative II assumptions. The trust fund does not meet the Trustees' long-range test of financial adequacy, which is defined in the OASDI report and the Glossary of this report, under any of the three assumption sets. In order to bring the HI program into actuarial balance even for the first 25-year projection period under the alternative II assumptions, either outlays will have to be reduced by 42 percent or income increased by 73 percent (or some combination thereof).

Currently about four covered workers support each HI enrollee. This ratio will begin to decline rapidly early in the next century. By the middle of that century, only about two covered workers will support each enrollee. As the post-World War II "baby boomers" becomes eligible for benefits, the annual rate of increase in program costs as a percentage of taxable payroll rises substantially, from about 2 percent in 2010 to 3 percent in 2015 under alternative II. Not only are the anticipated reserves and financing of the HI program inadequate to offset this demographic change, but under all the assumptions the HI trust fund is projected to become exhausted even before the major demographic shift begins to occur. Exhaustion is projected to occur before the turn of the century, in 1999 under the alternative II assumptions, and could occur as early as 1998 if the pessimistic assumptions were realized.

The Trustees note that some steps have been taken to reduce the rate of growth in payments to hospitals, including the implementation of prospective payment and diagnosis-related groups. Initial experience under the

prospective payment system for hospitals suggests that this payment mechanism may be an effective means of constraining the growth in hospital payments and improving the efficiency of the hospital industry. Nonetheless, projected costs for the HI program far exceed projected revenues over the 75-year long-range period. As a result, the HI program is severely out of financial balance and the Trustees believe that Congress must take timely action to fundamentally reform the HI program and control related program costs.

The long-range status of the HI program has deteriorated over the years as measured by the actuarial balances reported in this report and prior years reports. In addition, this year the HI trust fund fails to meet the short-range test of financial adequacy. In view of the worsening condition of the HI trust fund and the failure of the fund to meet the short-range test of financial adequacy, the Board of Trustees is making a seperate report to alert the Congress of the unfavorable financial status of the HI trust fund as required under section 709 of the Social Security Act.

The HI program is projected to increase from 1.4 percent of GDP in CY 1992 to 5.1 percent of GDP in CY 2065. This rapid growth is attributable primarily to (1) increases in hospital admissions, and (2) increases in reported case mix. With the magnitude of the projected actuarial deficit in the HI program and the high probability that the HI trust fund will be exhausted before the turn of the century, the Trustees urge the Congress to take additional actions designed to control HI program costs through specific program legislation and as a part of enacting comprehensive health care reform. The Trustees believe that prompt, effective, and decisive action is necessary.