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THE 1966 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL HOSPITAL INSURANCE TRUST FUND

LETTER

FROM

THE BOARD OF TRUSTEES, FEDERAL HOSPITAL INSURANCE TRUST FUND

TRANSMITTING

THE 1966 ANNUAL REPORT OF THE BOARD OF TRUSTEES, PURSUANT TO THE PROVISIONS OF SECTION 1817(b) OF THE SOCIAL SECURITY ACT, AS AMENDED

FEBRUARY 28, 1966.—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., February 28, 1966.

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

SIR: We have the honor to transmit to you the 1966 Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund, in compliance with the provisions of section 1817(b) of the Social Security Act, as amended, which is the first such report.

Respectfully,

HENRY H. FOWLER
Secretary of the Treasury,
and Managing Trustee of the Trust Fund.

W. WILLARD WIRTZ,
Secretary of Labor.

JOHN W. GARDNER,
Secretary of Health, Education, and Welfare.

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

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THE 1966 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL HOSPITAL INSURANCE TRUST FUND

THE BOARD OF TRUSTEES

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

FISCAL YEAR HIGHLIGHTS

The hospital insurance program was not enacted until after the close of the fiscal year covered by this report so that there are no activities about it to report on for fiscal year 1965.

SOCIAL SECURITY AMENDMENTS IN 1965

Public Law 89–97, approved July 30, 1965, amended the Social Security Act and related provisions of the Internal Revenue Code by establishing the hospital insurance program. A summary of its provisions is as follows:

I. COVERAGE PROVISIONS (FOR CONTRIBUTION PURPOSES)

(a) All workers covered by old-age, survivors, and disability insurance system.

(b) All railroad workers (covered directly by system, and not through financial interchange provisions, if railroad retirement taxable wage base is not the same as the hospital insurance base; if bases are the same, railroad retirement system collects contributions and transfers them to hospital insurance trust fund through financial interchange provisions;[1] hospital insurance trust fund pays benefits to suppliers of services in either case).

II. PERSONS PROTECTED (FOR BENEFIT PURPOSES)

(a) Insured persons: All individuals aged 65 or over who are eligible for any type of old-age, survivors, and disability insurance or railroad retirement monthly benefit (i.e., as insured workers, dependents, or survivors), without regard to whether retired (i.e., no earnings test).

[1] Public Law 89-212, approved Sept. 29, 1965, provided that the railroad retirement wage base will, in the future, be automatically adjusted so as to be the same as the earnings base under the hospital insurance system.

(b) Uninsured persons: Individuals who attain age 65 before 1968 who are not eligible for any type of monthly benefit under the old-age, survivors, and disability insurance or railroad retirement programs, who are citizens or aliens lawfully admitted for permanent residence with at least 5 consecutive years of residence, and who are not covered under the Federal Employees Health Benefits Act of 1959 (including certain individuals who could have been covered if they had so elected), are not members of any organization referred to in section 210(a)(17) of the Social Security Act, and have not been convicted of any offense listed in section 202(u) of the Social Security Act. Those in this category attaining age 65 after 1967 must have certain amounts of old-age, survivors, and disability insurance or railroad retirement coverage to be eligible for hospital insurance benefits—namely, three quarters of coverage for each year after 1965 and before age 65, so that the provision becomes ineffective for men attaining age 65 after 1973 (for women, 1971), since then the "regular" insured status conditions for cash benefits are easier to meet.

III. BENEFITS PROVIDED

(a) Hospital benefits: Full cost of all hospital services (i.e., including room and board, operating room, laboratory tests and X-rays, drugs, dressings, general nursing services, and services of interns and residents in training) for semiprivate accommodations for up to 90 days in a "spell of illness" (a period beginning with the first day of hospitalization and ending after the person has been out of a hospital and an extended care facility for 60 consecutive days), after a deductible of $40 and coinsurance of $10 per day for all days after the 60th one and also a deductible of the cost of the first 3 pints of blood; after 1968, the $40 deductible and the $10 coinsurance will be automatically adjusted to reflect changes in hospital costs after 1966; lifetime maximum of 190 days for psychiatric hospital care.

(b) Extended-care facility (skilled nursing home or convalescent wing of hospital) benefits following at least 3 days of hospitalization, beginning within 14 days of leaving hospital, and for continued care of a condition for which a person was hospitalized, up to 100 days of such care in a spell of illness, with coinsurance of $5 per day for all days after the 20th one; after 1968, the $5 coinsurance will be automatically adjusted to reflect changes in hospital costs after 1966.

(c) Home health services benefits following at least 3 days of hospitalization, beginning within 14 days of leaving hospital or extended-care facility, up to 100 visits in the next 365 days and before the beginning of the next spell of illness; such services are essentially for homebound persons and include visiting nurse services and various types of therapy treatment, including outpatient hospital services when equipment cannot be brought to the home.

(d) Outpatient hospital diagnostic services benefits, 80 percent of the cost of such services, after a deductible of $20 with respect to services furnished by a particular hospital in a 20-day period; the amount of the deductible would be adjusted after 1968 in the same manner as the hospital deductible; any deductible paid for these services is used as an incurred expense under the voluntary supplementary plan.

(e) Services not covered, services obtained outside the United States (except for emergency services for an illness occurring in the United States and the foreign hospital involved was closer, or substantially more accessible, than the nearest adequate U.S. hospital), elective "luxury" services (such as private room or television), custodial care, hospitalization for services not necessary for the treatment of illness or injury (such as elective cosmetic surgery), services performed in a Federal institution (such as a Veterans' Administration hospital), and cases eligible under workmen's compensation.

(f) Administration by Department of Health, Education, and Welfare. Each provider of services can nominate a fiscal intermediary (such as Blue Cross, other health insurance organizations, or State agencies) or can deal directly with the Department. The providers of services are reimbursed on a "reasonable cost" basis, and the fiscal intermediaries are reimbursed for their reasonable costs of administration. The providers of services must meet certain standards, including establishment of utilization review committees for hospitals and extended care facilities and development of transfer agreements between hospitals and extended care facilities.

(g) Effective date July 1, 1966, for all benefits except extended care facility benefits (January 1, 1967).

IV. FINANCING

(a) Insured persons on a long-range self-supporting basis (just as under the old-age, survivors, and disability insurance system), through separate schedule of increasing tax rates on covered workers (see table A), with same maximum taxable earnings base as scheduled for the old-age, survivors, and disability insurance system, $6,600; same rate applies to employees, employers, and self-employed (unlike under the old-age, survivors, and disability insurance system).

(b) Hospital insurance trust fund, separate trust fund, with separate board of trustees (same membership as for old-age and survivors insurance and disability insurance trust funds) and with same investment procedures.

(c) Noninsured persons from general revenues, through the hospital insurance trust fund.

TABLE A.—*Hospital insurance contribution rates*

[In percent]

Calendar year	*Rate* [1]
1965	----
1966	0.35
1967–72	.50
1973–75	.55
1976–79	.60
1980–86	.70
1987 and after	.80

[1] Rate for employee; same for both employer and self-employed.

NATURE OF THE TRUST FUND

The Federal hospital insurance trust fund was established on July 30, 1965, as a separate account in the U.S. Treasury to hold the amounts accumulated under the hospital insurance program.

The major sources of receipts of the trust fund are (1) amounts appropriated to it under permanent appropriation on the basis of contributions paid by workers and their employers, and by individuals with self-employment income, in work covered by the hospital insurance program and (2) amounts deposited in it representing contributions paid by workers employed by State and local governments and by such employers with respect to work covered by the program. All employees and their employers in employment covered by the program are required to pay contributions with respect to the wages of individual workers. All covered self-employed persons are required to pay contributions with respect to their self-employment income. In general, beginning with calendar year 1966, an individual's contributions are computed on annual wages or self-employment income, or both wages and self-employment income combined, up to a maximum of $6,600, with the contributions being determined first on the wages and then on any self-employment income necessary to make up the $6,600.

Under the Internal Revenue Code, as amended, the contribution rates in effect for calendar year 1966 are 0.35 percent each for employees, for their employers, and for the self-employed. Table A shows the scheduled increases in tax rates in the present law.

Except for amounts received by the Secretary of the Treasury under State agreements (to effect coverage under the program for State and local government employees) and deposited directly in the trust fund, all contributions for both hospital insurance and old-age, survivors, and disability insurance are collected by the Internal Revenue Service and are paid into the Treasury as internal revenue collections. However, sums equivalent to 100 percent of these taxes, after proper allocation, are transferred to the hospital insurance, old-age and survivors insurance, and disability insurance trust funds from time to time. Such transfers are first made on the basis of estimated tax receipts. The exact amount is not known since hospital insurance contributions, old-age, survivors, and disability insurance contributions, and income taxes withheld are not separately identified in tax-collection reports received by the Treasury Department from the district offices of the Internal Revenue Service. Periodic adjustments are subsequently made to the extent that the estimates are found to differ from the amounts of contributions actually payable on the basis of reported earnings.

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

The hospital insurance trust fund also has receipts from appropriations from the general fund of the Treasury with respect to the benefit payments to presently uninsured persons (and the accompanying administrative expenses).

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

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

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

Under section 1106(b) of the Social Security Act, the Secretary of Health, Education, and Welfare is authorized to charge for providing certain services not directly related to the hospital insurance program. The Social Security Administration will accumulate a unique body of information in the course of the administration of the program. Situations arise when it is in the public interest to use this information to perform certain services, such as the preparation of statistical tabulations for research purposes, when such services can be performed without interfering unduly with the administration of the program. Such services could not properly be provided at the expense of the trust fund. Receipts derived from performance of these services are credited to and form a part of the trust fund.

Public Law 881, approved August 1, 1956, granted noncontributory $160 monthly wage credits to persons who served in the Armed Forces from September 16, 1940, through December 31, 1956. Public Law 85-840 broadened the provisions of prior law dealing with noncontributory wage credits of $160 for each month of active military service for the United States to provide such credits for certain American citizens who served in the armed forces of our allies during World War II. Public Law 89-97 provided that the hospital insurance trust fund will be reimbursed for the additional costs arising from these provisions for noncontributory credit for military service. A summary of the method for the financing of credit for military service appears in appendix II.

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

The managing trustee invests that portion of the trust fund which, in his judgment, is not required to meet current expenditures for benefits and administration. The Social Security Act restricts permissible investments of the trust fund to interest-bearing obligations of the U.S. Government or to obligations guaranteed as to both principal and interest by the United States. Obligations of these types may be acquired on original issue at the issue price or by purchase of outstanding obligations at their market price. In addition, the Social Security Act authorizes the issuance of special public-debt obligations

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

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

Public issues acquired by the fund may be sold at any time by the managing trustee at their market price. Special public-debt obligations issued for purchase by the trust fund may be redeemed at par plus accrued interest. Interest receipts and proceeds from the sale or redemption of obligations held in the trust fund are available for investment in the same manner as other receipts of the fund. Interest earned by the invested assets of the trust fund will provide income to meet a portion of future benefit disbursements. The role of interest in meeting future benefit payments is indicated in tables 1 and 2.

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

Expected Operations and Status of the Trust Fund During the Period July 1, 1965, to June 30, 1968

In the following statement of the expected operations and status of the hospital insurance trust fund during the period July 1, 1965, to June 30, 1968, it is assumed that present statutory provisions affecting the hospital insurance program remain unchanged throughout the period. The income and disbursements of the program, however, are affected by general economic conditions, hospital utilization rates under this new program, and hospitalization costs, as well as by legislative provisions. Because it is difficult to forecast these factors, the assumptions and the resulting cost estimates presented here are subject to some uncertainty. This statement of the expected operations of the trust fund should therefore be read with full recognition of the difficulties involved in making the estimates.

Estimates are presented in table 1 to show the expected operations of the trust fund in fiscal years 1966–68. They are based on the assumption that economic activity will expand throughout the period, with employment and earnings increasing steadily. Under this assumption the estimated number of persons with taxable earnings under the hospital insurance program is expected to increase from 81 million during calendar year 1966 to 85 million during calendar year 1968; their taxable earnings are estimated to increase from $298 billion in 1966 to $321 billion in 1968. The increase in estimated income from contributions in fiscal years 1966–68 reflects the assumed

upward trend in the levels of employment and earnings as well as the effect of the scheduled increase in contribution rates, effective on January 1, 1967. Benefit disbursements increase from fiscal year 1967 to 1968 because of the long-range upward trend in the number of beneficiaries under the program and the assumed increase in hospitalization costs per unit of service.

Income of the trust fund is expected to exceed outgo in each of the 3 fiscal years 1966–68. During this period, there is an estimated net increase in the trust fund of $1.9 billion. Benefit disbursements from the trust fund will increase over the period as the program goes into operation.

Reference has been made earlier to the financial interchanges between the railroad retirement account and the trust fund under the provisions of the Railroad Retirement Act. The estimates shown in table 1 reflect the effect of future financial interchanges.

TABLE 1.—*Estimated future operations of the hospital insurance trust fund, fiscal years 1966–68*

[In millions]

Item	1966	1967	1968
Income:			
Tax contributions [1]	$816	$2,385	$3,055
Interest on investments [2]	8	40	63
Transfers from railroad retirement account		16	41
Reimbursement for noninsured persons [3]	26	283	275
Disbursements:			
Benefit payments for insured persons		2,068	2,306
Benefit payments for noninsured persons		270	262
Administrative expense for insured persons [4]	27	75	77
Administrative expense for noninsured persons [4]	26	13	13
Net increase in fund	797	298	776
Fund at end of year	797	1,095	1,871

[1] Includes reimbursement from general fund of the Treasury for additional cost of noncontributory credits for military service. Adjusted to exclude refunds of employee taxes paid on wages in excess of maximum taxable earnings base.
[2] Includes net profits on marketable investments.
[3] Reimbursement for benefit costs and additional administrative expense for noninsured persons is made currently from general fund of the Treasury.
[4] Receipts from sales of surplus materials, services, etc., are deducted from gross administrative expenses.

NOTE.—In interpreting the estimates, reference should be made to the accompanying text which describes the underlying assumptions. Estimates were prepared in January 1966.

Section 217(g) of the Social Security Act, as amended by the 1965 amendments, provides that the trust fund shall be reimbursed from general revenues for expenditures resulting from the provisions that granted noncontributory $160 monthly wage credits to persons who served in the Armed Forces at some time during the period September 16, 1940, through December 31, 1956, and from the provisions enacted in 1946 that granted survivor protection to certain World War II veterans for a period of 3 years after leaving service. A description of the legislative history of provisions relating to credit for military service is contained in appendix II. The estimated total additional costs arising from payments that will be made in future years are intended to be amortized by level annual appropriations to the trust fund over a 50-year period beginning in fiscal year 1966 according to a determination made by the Secretary of Health, Education, and Welfare in September 1965 (the amount so determined was $14.2 million). Periodically, the estimated amount of annual

payment will be refigured to reflect actual costs incurred and revision in the future estimates.

The Budget of the United States Government for the fiscal year 1967 makes provision for appropriations initiating these reimbursements (for both fiscal years 1966 and 1967 at $11 million each year). The estimates shown in table 1 reflect the effect of the annual reimbursements on this basis.

Actuarial Status of the Trust Fund

Hospital insurance benefit payments will increase for many years—not only in terms of dollars, but also as a percentage of taxable payroll. Long-range estimates are needed, therefore, to show how much the cost is likely to increase and to indicate whether the scheduled tax rates are adequate.

The benefit cost will rise for somewhat the same reasons that are applicable to the cash benefits under the old-age, survivors, and disability insurance program and, in addition, because of the likely increase in hospitalization costs per unit of service. The cost for cash benefits increases primarily because the U.S. population will, in the long run, almost certainly become relatively much older, on the average. Hospitalization costs have increased in the past significantly more rapidly than general earnings levels, and it is likely that this trend will continue for some years. Even in the long run, it is likely that hospitalization costs will continue to rise since the general earnings level has a similar trend—although the current differential between the rates of increase of these two factors will very probably be eliminated or may even be reversed.

The long-range actuarial cost estimates for the hospital insurance program are made over a future period of 25 years, whereas the long-range actuarial cost estimates for the old-age, survivors, and disability insurance program are made over a 75-year future period. It is believed that a 25-year projection period for the hospital insurance program is as far ahead as should be considered because of the uncertainties as to future hospital practices. Even so, it is necessary to look ahead for a period such as this so as to have some idea of the rising cost that can possibly ensue.

Another difference between the cost estimates for the two programs is that for old-age, survivors, and disability insurance, the cost estimates assume level earnings trends in the future, whereas under the hospital insurance program, rising earnings are assumed; this different approach is used so as to provide a margin of safety in each case. Under the former program, the level-earnings assumption is a conservative one and provides a margin of safety, since increases in earnings, with no changes in the program, result in lower costs relative to taxable payroll; or, to put it another way, this assumption provides a margin that can be used, when earnings rise, to increase benefits without changing the contribution rates, so as to attempt to keep the system up to date with price and earnings changes. On the other hand, under the hospital insurance program, increases in the general earnings level, when accompanied by parallel increases in hospitalization costs, result in higher costs relative to taxable payroll unless the maximum taxable earnings base is kept up to date, since under these conditions hospitalization costs rise more rapidly than

the covered earnings, whose increase is "dampened" by the effect of the earnings base. Thus, the use of the rising-earnings assumption for the hospital insurance program is of a conservative nature and provides a margin of safety.

Since the cost estimates assume that the earnings base will not be changed in the 25-year period under consideration, but do assume that earnings and hospitalization costs will rise steadily, the cost estimates are on a conservative basis, because it seems unlikely that, in the face of rising earnings, the taxable earnings base would not be changed for 25 years. It is for this reason that steadily increasing contribution rates over the 25-year period were adopted to finance the hospital insurance program. Correspondingly, if the earnings base is kept up to date, and if the experience follows the various assumptions, then the several increases in contribution rates scheduled for 1973 and after will probably not be necessary.

TABLE 2.—*Estimated progress of hospital insurance trust fund, intermediate-cost estimate at 3.50 percent interest* [1]

[In millions]

Calendar year	Contributions [2]	Benefit payments	Administrative expenses	Interest on fund	Balance in fund at end of year
1966	$1,637	$987	[3] $50	$18	$618
1967	2,756	2,210	66	25	1,123
1968	3,018	2,406	72	46	1,709
1969	3,123	2,623	79	66	2,196
1970	3,229	2,860	86	82	2,561
1971	3,329	3,077	92	91	2,812
1972	3,433	3,303	99	95	2,938
1973	3,891	3,540	106	100	3,283
1974	4,096	3,788	114	108	3,585
1975	4,260	4,047	121	112	3,789
1980	6,113	5,307	159	166	5,790
1985	7,026	6,860	206	259	8,341
1990	9,015	8,797	264	323	10,426

[1] An interest rate of 3.50 percent is used in determining the level-costs, but in developing the progress of the trust fund, a higher rate is used in the 1st 10 years (4.0 percent for 1966–70, and then a gradually decreasing rate).

[2] Includes financial interchange payments from the railroad retirement system.

[3] Includes administrative expenses incurred in 1965.

NOTE.—The transactions relating to the uninsured persons who would be covered for the benefits of this program, the cost for whom is borne out of the general funds of the Treasury, are not shown in the above figures.

Table 2 shows the estimated progress of the hospital insurance trust fund according to the intermediate-cost estimate. This estimate is that which was derived at the time the 1965 amendments were enacted. It should be noted that the progress of the trust fund shown in table 2 does not include the transactions relating to the uninsured persons who would be covered for the benefits of this program, the cost for whom is borne out of the general fund of the Treasury. The early year figures for the progress of the trust fund on a long-range, calendar-year basis are not completely consistent with the short-range estimates on a fiscal-year basis, shown in the preceding section, which were prepared in January 1966, but the differences are relatively small. The benefit payment figures are fully consistent between the two sets of estimates, while the contribution income figures are slightly lower in the long-range cost estimates.

The estimated level-cost of the benefits under the hospital insurance program is 1.23 percent of taxable payroll. The level-equivalent of

the contribution schedule is also 1.23 percent of taxable payroll. Accordingly, this estimate indicates that the program is in exact actuarial balance under the assumptions made.

The benefits for the uninsured group and the accompanying administrative expenses will be paid from the hospital insurance trust fund, with current reimbursement therefor from the general fund of the Treasury. The estimated cost will decrease slowly because the effect of mortality on this closed group more than offsets the increasing hospital utilization per capita for this group, as the average age becomes higher, and the rising trend of hospitalization costs. The estimated cost for the first 5 calendar years of operation is as follows:

[In millions]

Calendar year	*Cost*
1966	$140
1967	278
1968	272
1969	264
1970	256

These figures on a calendar-year basis are completely consistent with the short-range fiscal-year figures presented in the preceding section.

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

Conclusion

The current long-range actuarial cost estimates for the hospital insurance program indicate that it is in exact actuarial balance. It is recognized that, in a new program such as this, the actuarial cost estimates are subject to a range of variation. Nonetheless, the intermediate-cost estimates indicate that a sizable fund will be accumulated, which, after several years, will reach a magnitude of 1 year's benefit payments. In the initial years of operation, the balance in this fund, according to these estimates, should be sufficient to meet any adverse fluctuations of benefit payments as compared with contribution income.