

# ACTUARIAL NOTE

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## COMPARISON OF MEDICARE EXPENDITURES WITH ESTIMATES, FIRST THREE YEARS OF OPERATION

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This Actuarial Note will make a comparison of the actual disbursements for benefit payments and administrative expenses under the Hospital Insurance program for the first 3 years of operation (July 1966 through June 1969) with the cost estimates therefor that were made in 1965 when the legislation was initially enacted. Also given will be an analysis, on an accrual basis, of the disbursements for benefit payments and administrative expenses under the Supplementary Medical Insurance program for these first 3 years of operation as compared with the income from premiums and matching government contributions, so as to indicate the relative sufficiency of the standard premium rates. Such premium rate was, according to legislation, \$3 per month through March 1968; it was \$4 per month from April 1968 through June 1969, by promulgation of the Secretary of Health, Education, and Welfare.

In summary, the actual 3-year benefit experience for the HI program was about 18% higher than originally estimated in 1965 (after taking into account the counteracting effect of higher contribution income). Similarly, the disbursements for benefit payments and administrative expenses of the SMI program (on an accrual basis) for the first 3 years of operation were about 7% higher than could be financed on a continuing basis by the premium rates actually charged and the matching government contributions.

The original estimate of disbursements for HI benefit payments and administrative expenses for insured persons for the period

July 1966 through June 1969 was \$7,142 million, while the corresponding figure for non-insured persons was \$822 million.

These figures are shown on a calendar-year basis in the Actuarial Cost Report issued by the House Ways and Means Committee on July 30, 1965. The actual disbursements for HI benefit payments and administrative expenses for this period (on a "cash" basis, representing actual payments from the trust fund) were \$11,236 million, or 41.1% higher than the original estimate. Considering only insured persons, it is estimated that the actual disbursements for HI benefit payments and administrative expenses were \$9,764 million, or 36.7% higher than the original estimate.

It should be mentioned that the original estimate of HI benefit payments was on both a "cash" basis and an "accrual" basis. In other words, it was assumed that hospitals would be reimbursed currently as the covered expenses are incurred. Although this is largely the case, it is not completely so, and as of June 30, 1969, about \$300 million of accrued obligations under HI were present. On this "accrual" basis the ratio of actual to estimated, considering only insured persons, would be 40.9% (instead of 36.7%).

Comparisons of actual disbursements with the original estimates do not validly tell the entire story because it is necessary to consider not only variations in disbursements as compared with estimates, but also offsetting variations in contribution income. It is assumed that the increases in cost of hospitalization are directly related to increases

in wages and thus to taxable payroll. The original estimate of contribution income on a cash basis for the period January 1966 through June 1969 was \$9,030 million. The actual contribution income during this period was \$11,649 million, but this should be adjusted to allow for the fact that the financing provisions were changed from those initially enacted, on which the original cost estimate was based (specifically, effective January 1, 1968, the maximum taxable earnings base was increased from the initial \$6,600 to \$7,800 and the contribution rate for employers, employees, and the self-employed was increased from 0.5% each to 0.6%). Such properly adjusted actual contribution income is then \$10,452 million, or 15.7% higher than the original estimate. Accordingly, the relative excess of the actual HI disbursements for benefit payments and administrative expenses over the original estimate (considered as being on a "cash" basis) for the first 3 years of operation, after considering the corresponding excess for contribution income, is 18.2% (1.367 divided by 1.157).

As to the SMI program, it is estimated that the total accrued disbursements for

benefit payments and administrative expenses for the first three years of operation, July 1966 through June 1969, amounted to \$4,883 million. By "accrued" is meant the total payments made both in this period and subsequently with respect to all medical services furnished in this period. As evidence of the lag involved between the accrual basis and the cash basis, the total disbursements for benefit payments and administrative expenses actually made from the SMI Trust Fund in the 3-year period under consideration was \$4,171 million, or some \$700 million lower than the estimated accruals. The income from premiums and matching government contributions for the 3-year period amounted to \$4,492 million, while the interest receipts were \$58 million. Accordingly, the estimated accrued disbursements for benefit payments and administrative expenses, after reduction for the effect of the interest receipts, for the first three years of operation of the program, amounted to \$4,825 million, or 7.4% higher than the corresponding income from premiums and government contributions.