

**TESTIMONY**  
**SENATE FINANCE COMMITTEE**  
**Bob Kerrey, March 7, 2002**

You have my sympathy. As elected representatives of the people, you have been given two irreconcilable and at times unconditional demands: lower taxes and higher spending. Polls show that Americans believe their taxes and government spending are too high, but those majorities also want more spending on almost everything that affects them directly. They don't want their military base closed, they don't want their highway project unfunded, they want smaller class sizes for their schools, and they want help paying for the cost of their prescription drugs. Which is what brings us together this morning.

You have invited me to testify on the question of adding a prescription drug benefit to Medicare. My simple advice is don't do it. Not unless you are prepared to make fundamental reforms in the way Americans finance the cost of their health care. Adding a prescription benefit to Medicare without fundamental reform will partially solve one problem while increasing the size of several others.

It will partially solve the problem of helping current Medicare beneficiaries pay for their prescriptions, but it will increase the size of the problem of declining shares of our federal budget available for spending on such things as education, child care, transportation, and technology. At best it does nothing to solve and at worse it increases the problem faced by non-Medicare eligible and uninsured working Americans. With budget caps gone, income taxes already cut, and bipartisan enthusiasm to spend considerably more on defense, it is safe to say that the era of surpluses was like passing through a village in Nebraska: we passed through it before we realized we were there.

Last year's Congressional Budget Resolution set aside \$300 billion over 10 years for a Medicare prescription drug benefit. All things seemed possible at this time last year when both CBO and OMB were projecting a 10-year unified surplus of \$5.6 trillion (\$3.1 trillion on-budget and \$2.5 trillion off-budget). This year any such initiative would have to be financed by borrowing from the public or from the Social Security surplus.

And the assumption there will be future surpluses even counting Social Security is dubious if the following is true:

1. That most of last year's tax cut (along with several other popular tax provisions) will be extended rather than repealed at the end of 2010;
2. That Congress will reduce the individual Alternative Minimum Tax as the number of people covered by this provision grows from 2 to 40 million — far more than was ever intended;
3. That defense and non-defense discretionary spending will grow faster than inflation.

Indeed, the Concord Coalition has prepared an alternative baseline using CBO numbers showing what would happen if just two of these three occur: all expiring tax cuts are

extended and discretionary spending keeps pace with GDP growth. This is far from a “Doomsday “ scenario. In fact it seems more plausible than the official baseline. Under these circumstances the entire unified surplus is virtually eliminated. Payroll taxes in excess of costs for Social Security and Medicare will be needed to pay for defense and non-defense spending.

The bottom line is that there is no room to add a major entitlement expansion such as a Medicare prescription drug benefit. Such an addition – as worthy as it may seem in isolation – would significantly impair the financial future of working men and women, the people who pay the bills. And their financial future has already deteriorated significantly in just one year.

Consider this: Last year Americans were looking at a future in which we were projected to eliminate the debt held by the public by 2008. Total debt limits would not be exceeded until 2009. Net interest payments over the period from 2002 through 2011 were estimated to be \$622 billion. Today we no longer forecast that public debt will be eliminated. The debt limit will be reached this year — maybe this month — and net interest payments over the next ten year period will be \$1 trillion more than expected last year. That is \$10,000 per American household or \$1,000 per household per year.

What makes this gloomy picture of our financial future worse is that we still have not changed Federal laws to accommodate for the baby boom generation. From 2006 to 2026 the number of workers whose taxes support retirement benefits will increase from 160 million to 174 million while the number of Social Security and Medicare beneficiaries will increase from 49 to 78 million. Instead of being able to tax three to support one we will be taxing two to support one.

The details of what will happen were presented to Congress by the General Accounting Office in February. I regret to inform you that few of us outside Congress were paying much attention to what GAO said and were still suffering the illusion that Medicare’s future still was bright. We had been focused on the improvement in the HI Trust fund’s shorter-range solvency status and missed that Medicare’s long-term outlook has worsened significantly during the past year. Three conclusions should alarm anyone concerned about the financial future of our country:

1. Social Security, Medicare and Medicaid will nearly double as a percent of GDP by 2030.
2. Social Security outlays will exceed earmarked tax revenues by a widening margin beginning in 2016. In this year Treasury will have to redeem the trust fund IOUs with cash that can only be obtained from cutting spending, raising taxes, or borrowing more money;
3. Even without a prescription benefit these programs along with net interest payments, would require roughly three-quarters of total federal revenue in 30 years leaving the Federal government in a position of doing little more than mailing checks to the elderly and their health care providers.

All of this said I know there is pressure on you from 35 million elderly Medicare beneficiaries and 5 million disabled who are telling you they need help to lessen the burden of paying for their pharmaceuticals. I know you have been moved by stories of individuals who simply do not know where they are going to get the money to pay for a life saving prescription ordered by their doctor. I know that few things affect us more directly than health care.

Still, I urge caution. Medicare is social insurance with an asterisk. The asterisk informs us that the program is, for several reasons, not insurance. First of all it is not fully funded. The current unfunded liability for future beneficiaries is \$10 trillion before a prescription drug benefit is added. Second, it is not true insurance because the insurer is underwriting a risk that is almost certain to be used continually. This is especially true with most of the prescription drug proposals where the usage will be expected and annual.

I also urge caution because money is money. By that I mean that the distinction between government money and private sector money is an ideological distinction not a real one. While it is true that some government spending can grow the private sector (look at the impact of government spending on rural counties, for example), the sale of goods and services in the private sector generates the revenue taxed by the government for its services.

This is not an academic argument. Too many citizens answer the question where are we going to get the money for a prescription benefit with: The government will pay for it. Current beneficiaries need to understand that most of the money for this benefit will not come from them. Most of the money will come from a tax on the wages and salaries of Americans who are in the work force. And a growing number of these workers, who are seeing an increasing share of their income going to insure someone else, do not have health insurance themselves. These workers are also the ones who suffer the negative consequences of having too little to spend on education, childcare, transportation and technology.

Current beneficiaries also need to understand that there is a limit to Federal spending. Since the Second World War the Federal government has rarely removed more than 20 percent of the U.S. economy for taxes. Federal spending since the Second World War has never gotten above the 23.5 percent of GDP it reached in 1983 and for the most part has hovered around 20 percent. This 20 percent number has remained relatively constant and was trending downward during the 1990's economic expansion. What has not remained constant is the mix of Federal spending within that 20 percent. While spending on health and other entitlements has risen, spending on defense and non-defense appropriations has taken up a declining share of the budget and the economy. This trend is forecast to continue.

When the baby-boom generation begins to retire in 6 years Medicare spending will increase rapidly as a percentage of our Federal budget. As a consequence, something has

to give. With history as our guide the likely loser will be spending on the programs that will benefit the working families who are being taxed more and more to pay for someone else's health care.

The first question that should be asked and answered is not do we need a prescription drug benefit but can we afford it? Those of us who thought we might be able to afford it were given a wake-up call to what beneficiaries will eventually demand when the American Association of Retired Persons submitted a proposal that would cost \$750 billion. This is twice the cost of the previous high.

Members of the Finance Committee, I do not think that doing nothing is an option. Americans can afford a prescription drug benefit but I do not believe we can afford to add it to Medicare as it is currently structured. More challenging I do not believe we can solve this problem by focusing on benefit changes or reductions in reimbursements to providers. Instead I believe we need to focus our attention on fundamental reform of the way Americans become eligible under Federal law for health insurance.

Though intuition is often a good guide when making decisions sometimes it fails us. In this case intuition signals that we should narrow the scope of our Federal health care entitlement programs in order to save money. However, I believe the counter-intuitive choice, namely to expand the entitlement, is the least costly choice.

By expand the entitlement I mean we should change the language of Federal law so that Americans and legal residents become eligible for health care as a consequence of their having proved they are Americans or legal residents. Under current law there are six main ways a resident of the United States can become eligible for insurance:

1. Work forty quarters and wait until they are 65;
2. Demonstrate they are disabled;
3. Get blown up in a war;
4. Prove they are poor and promise to remain poor;
5. Join a military service or work for the Federal government;
6. Find a job with an employer who uses the tax code to reduce the cost of purchasing insurance.

Under current law the only people who are not eligible are 40 million uninsured Americans who aren't old enough, disabled enough, poor enough or lucky enough to qualify. On the other hand all 40 million are eligible to have taxes collected from them to pay the subsidies for all the rest of us who have met a statutory test.

I urge you to consider that for budgetary, economic and moral reasons we cannot get from where we are now to where we want to go by adding a new and expensive benefit to an entitlement program. Nor can we get there by just reforming existing programs. We can only get there by fundamentally altering the way we become eligible for insurance in the first place.

Beginning with a universal entitlement does not mean higher spending or more governmental interference with the choices made by patients or providers. In truth it could mean a lot less of both. It would mean that we would start thinking about ourselves as a single group of 280 million Americans who are all part of the same health system and who all need to face the challenge of matching our appetite for quality with our capacity to pay.

No doubt this proposal seems a little out of place in a hearing on a prescription drug benefit. But those of you who know me – and who invited me to testify anyway – are familiar with my tendency to say things that are out of place. In this case I do not believe a fundamental change in the way we become eligible for health insurance is out of place. I strongly believe it is the only way we can enact a prescription drug benefit we can afford that does not make matters worse for all those working families who will be paying for it.

Finally, while technology and the trend towards longer life expectancies have increased the cost of Medicare and Social Security we should not let the actuaries persuade us that this is bad news. In my case I will need that extra longevity in order to attend my second son, Henry's, college graduation in 2022. In many other cases Americans are entering the last phase of their lives with more optimism and health than ever before in part thanks to Medicare and Social Security. I trust that you have the wisdom and the desire to make certain both will be there for many generations to come.