SOCIAL SECURITY AND MEDICARE TRUSTEES' 2001 ANNUAL REPORTS

JOINT HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

AND

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

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COMMITTEE ON WAYS AND MEANS

BILL THOMAS, California, *Chairman*

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TUESDAY, MARCH 20, 2001

U.S. House of Representatives,
Committee on Ways and Means,
U.S. Senate, Committee on Finance,
Washington, DC.

The Committee met, pursuant to notice, at 10:11 a.m., in room 1100 Longworth House Office Building, Hon. Bill Thomas and Hon. Charles E. Grassley (Chairmen of the Committees) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE HOUSE COMMITTEE ON WAYS AND MEANS AND THE SENATE COMMITTEE ON FINANCE

FOR IMMEDIATE RELEASE
March 13, 2001
FC–4

CONTACT: (202) 225–1721

Thomas and Grassley Announce Joint Hearing on the Social Security and Medicare Trustees' 2001 Annual Reports

Congressman Bill Thomas (R–CA), Chairman of the Committee on Ways and Means, and Senator Chuck Grassley (R–IA), Chairman of the Senate Committee on Finance, today announced that their committees will hold a joint hearing to examine the findings and recommendations made by the Board of Trustees of the Social Security and Medicare Hospital Insurance trust funds in its 2001 Annual Reports on the financial status of the trust funds. **The hearing will take place on Tuesday, March 20, 2001, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

In view of the limited time available to hear witnesses, oral testimony will be heard from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The Board of Trustees was established under the Social Security Act to oversee the financial operations of the Old-Age and Survivors Insurance and Disability Insurance (OASDI) and the Medicare Hospital Insurance (HI) trust funds. The Board is composed of six members: the Secretary of the Treasury (who is the Managing Trustee), the Secretary of Labor, the Secretary of Health and Human Services, the Commissioner of Social Security, and two members who are appointed by the President and confirmed by the Senate to serve as public trustees for four-year terms. The Social Security Act requires that the Board of Trustees report annually to the Congress on the financial and actuarial status of the OASDI and HI trust funds. The *2001 Annual Reports* are scheduled to be released shortly.

Ensuring the financial viability of Medicare and Social Security is one of Congress' most important responsibilities. The annual release of the Trustees' Report provides a valuable update on the programs' fiscal well-being.

Over the past few years, the Trustees' annual reports have shown an improvement in the financial status of the OASDI trust funds, mainly due to increased economic growth. The *2000 Annual Report* projected that the combined OASDI trust funds would begin running cash flow deficits in 2015 and would become insolvent in 2037. In that year, annual payroll taxes would be sufficient to pay 72 percent of promised benefits. President Bush has expressed his commitment to reforming Social Security and has announced his intention to strengthen Social Security and modernize the program for young and future workers, beginning with a Presidential Commission on Social Security reform. The findings of the Trustees will provide invaluable support to the Commission and the responsible committees in the House and Senate as proposals to save Social Security are considered.

The release of the *2001 Annual Report* on the Medicare HI trust fund report will be particularly timely, because its findings will establish the financial parameters against which Medicare modernization plans will be evaluated. Over the next several months, Congress will be developing a comprehensive Medicare improvement package that will include a universally available outpatient prescription drug benefit. The Trustees' Report will help members evaluate new Medicare spending proposals and begin discussion on whether new solvency measures are needed to ascertain the program's overall financial standing.

In announcing the hearing, Chairman Thomas stated: "This historic joint hearing reflects our desire to work in a bipartisan and bicameral fashion to understand the fundamental challenges facing the long-term health of both Social Security and Medicare. I look forward to this hearing and to the report of the non-partisan Social Security and Medicare Trustees."

Chairman Grassley said, "This joint committee hearing underscores the importance the Committees place on ensuring the financial viability of these programs. The trustees' findings will provide critical guidance as we work to improve and strengthen Medicare and Social Security for the baby boomers and beyond."

FOCUS OF THE HEARING:

The hearing will examine the findings and recommendations of *The 2001 Annual Reports of the Board of Trustees of the Federal OASDI and HI Trust Funds.* The hearing will focus on the long-run financial status of the Social Security and Medicare HI programs.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should *submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect or MS Word format, with their name, address, and hearing date noted on a label,* by the close of business, Tuesday, April 3, 2001, to Allison Giles, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Committee office, room 1102 Longworth House Office Building, by close of business the day before the hearing.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect or MS Word format, typed in single space and may not exceed a total of 10 pages including attachments. **Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.**

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman THOMAS. If our guests could find seats, please. It was more than 75 years ago that the chairman of the Senate Finance Committee sent a note back to the chairman of the Ways and Means Committee with this quote, "Thank you for the invitation to sit with the Ways and Means Committee in the consideration of this very important question." The question that was considered at that time in December 1933 was reducing taxes on intoxicating liquors, thereafter the one and only time that the two full Committees, the Ways and Means Committee of the House and the Finance Committee of the Senate, had held a joint hearing until today. With the urging of my colleague and chairman of the Senate Finance Committee, we are meeting today in joint session to hear testimony on the two great trust funds which form the safety net for a growing number of Americans, the Social Security trust funds and the Medicare trust funds. And today we will hear a mixed review of Medicare's long-term viability, the pleas that the Trustees will project from the Hospital Insurance Trust Fund, that it has been extended by another 4 years with the projected exhaustion date of 2025.

Just 6 years ago the HI Trust Fund was projected to be insolvent by 2002. However, at the same time the trustees clearly indicate that the long-term challenges remain formidable. Most of us are familiar with the statistics quoted about the number of workers per retiree and that declining ratio. But in fact the long-term projections are even more pessimistic than last year's report because of the adoption of a health growth percentage greater than had been used in the past. But probably the most important factor that we really need to focus on is that the Trustees' report does not evaluate the fiscal health of the entire Medicare Program.

When you look at the entire Medicare Program, growing from less than 2 percent of the budget today to more than 8.5 percent of the budget just a few decades from now, that overall spending for Medicare, not just the HI so-called trust funds on Part A Medicare but the Part B supplemental medical insurance funds, will be growing from 40 percent of the total Medicare costs to almost 50 percent, yet none of those Part B funds are accounted for in the current measure of Medicare solvency. Indeed, the current test of the solvency leaves it open to gaming. Moving those services offered under Part A to Part B would greatly enhance the solvency of the Medicare Trust Fund. In fact, that was done in 1997. In fact, one of reasons we moved dramatically from a 4-year solvency to more than a 20-year solvency was in large part due to the shifting of services under Part A to Part B.

Social Security's financial outlook has improved slightly relative to last year's projections as well. One of the concerns I hope we focus on at the beginning of the argument is that given the recent increase in productivity gains of the American worker, impressive as they are, they cannot grow us out of our current Social Security deficit concern. Indeed, if we elevate it from the Trustees' 1.5 productivity percentage to the current 2.3 percent, that would only cover about 40 percent of our shortfall.

One of the things I hope we take away from this Committee is a realistic assessment of where we are and, more importantly, where we need to go. As the elected leaders of this country we have a choice. We can legislate for the next election and leave a lasting legacy of reducing benefits or increasing payroll taxes, or together we can legislate for the next generations by taking advantage of this historic joint meeting to begin to work in a bipartisan, bicameral way more so than ever before.

Today is the first day of spring, and I think it is a good day to start.

[The opening statement of Chairman Thomas follows:]

Opening Statement of the Hon. Bill Thomas, M.C., California, and Chairman, Committee on Ways and Means

It was more than 77 years ago, on December 11, 1933, when the Chairman of the Senate Finance Committee expressed his appreciation to the Chairman of the Ways and Means Committee for "the invitation to sit in with the Ways and Means Committee in the consideration of this very important question." The question considered that day was reducing taxes and excises on intoxicating liquors.

That was the one and only time the two Committees held a joint hearing— until today.

In 1933, our Committees were faced with the urgent need to repeal the eighteenth amendment—prohibition. Today, our Committees are faced with a different type of urgency—the need to strengthen and modernize Medicare and Social Security for our children and future generations.

Today, we will hear a mixed review of Medicare's long-term viability. I am pleased that the Trustees will project that the Hospital Insurance trust fund has been extended by another four years from last year's projection of 2025. This is due in no small part to the efforts of this Committee. Just six years ago, the HI trust fund was projected to be insolvent by 2002.

However, the Trustees also make the case that our long-term challenges remain formidable. The number of workers per retiree will decline from about 3.9 today to about 2.3 in 2030, and HI expenditures as a fraction of workers earnings will more than triple from 2.7% in 2000 to 10.7% in 2075. These longer-term projections are more pessimistic than last year's report.

More importantly, the Trustees' report does not evaluate the fiscal health of the entire Medicare program. The Trustees project that *all* Medicare expenditures will rise dramatically as a share of the economy, from 2.2% in 2000 to 5.0% in 2035 and then to 8.5% in 2075. And more of the spending will occur in the out-patient area not accounted for in the HI trust fund. Over the next decade, while Medicare expenditures will more than double, the Part B outpatient portion of Medicare will grow from 40% to 47%. Yet none of these Part B expenditures are accounted for in our current measure of Medicare solvency.

Indeed, the current measure of solvency is open to gaming. The Balanced Budget Act transferred home health care, the fastest growing part of Medicare at the time, from Part A to Part B to result in about 6 more years of solvency, notwithstanding that transfer had absolutely no impact on spending. If we only cared about HI solvency we could transfer inpatient hospitalization out of Part A, and save the fund *$2 trillion* over 10 years or transfer out skilled nursing facilities and save $300 billion over 10 years. I hope this hearing will help us begin to develop a more accurate measure of taxpayer obligations to other people's health care.

We can and must modernize Medicare's benefits and delivery structure. Prescription drugs are integral to seniors' health care and must be integrated into Medicare. But we need to be circumspect about the challenges we confront and the constraints we are under.

Social Security's financial outlook has improved slightly relative to last year's projections. Despite this slight improvement, the Trustees note that Social Security still faces a long-term financing crisis. The Social Security Trust Funds continue to face a financing "cliff" whereby cash deficits increase with each passing year. Even if productivity growth remains at the extraordinary level of the last 5 years, the Trustees note that Social Security will still face a significant long-term deficit. We must adhere to the advice from the bipartisan public trustees who emphasize we must initiate change sooner rather than later to address rapidly growing annual deficits that will occur soon after the baby boomers begin to retire.

As the elected leaders of this country, we have a choice. We can legislate for the next election and leave a lasting legacy of crippling benefit cuts or stifling payroll tax increases to our children and to future generations.

Or, together, we can legislate for the next generation by taking advantage of this historic joint hearing to work in a bipartisan and bicameral fashion to understand and remedy the fundamental challenges facing the long-term health of both Social Security and Medicare. I pray we make the right choice.

Chairman GRASSLEY. I thank very much the chairman of the Ways and Means Committee for organizing this joint hearing. I think that there are several things that we can do in the Congress to make our efforts more efficient and to save the time of a lot of cabinet people appearing on the Hill and expedite the business of Congress, and I hope this is a successful effort and will be followed.

I welcome our Secretary of Treasury Paul O'Neill here for the financial release of the trustees' report. This is a Washington tradition that often goes unnoticed with the American public. Turning a discussion of things involving trust funds solvency and actuarial balance into quite exciting events is a very difficult task. Quite exciting or not, though, these reports do provide valuable information about the financial health of Social Security and Medicare and the security of our seniors in America not only for this decade but for decades well into the future.

Today's hearing will help the public understand the problems facing these programs. As this year's report reveals, Social Security and Medicare are simply unsustainable in their current form. The trustees project that promised benefits will exceed scheduled payroll taxes and premiums by $465 trillion over the next 75 years, an astounding and probably not understandable figure.

Some may try to tell us, well, that is not so bad. These people do not know what they are talking about. For example, in theory a portion of this shortfall will be covered by government bonds and Social Security and Medicare Trust Funds. But these bonds are merely a claim on future general revenue. So the government can only redeem them if it raises taxes or more revenues from the public. So the hope of these trust fund surpluses is somewhat of a fool's hope.

Some claim that using the Social Security surplus to pay down the Federal debt will alleviate the funding shortfall by reducing interest payments to the public. But these interest savings will cover less than 5 percent of the shortfall. If the government borrows more from the public to cover the rest, it will only take 14 years to run the debt back up again. So that is no real solution.

Even more troubling, the near term surpluses projected to accumulate in the Social Security and Medicare Trust Funds will soon exceed the amount of debt available for repayment. At that point the government will be forced to invest trust funds in nongovernmental assets. Such investment will disrupt the financial markets. We shouldn't do that.

With respect to Medicare in particular, for the first time ever the trustees in this report have established a new section that looks at Medicare's financial health in toto. This is important considering only 22 percent of the beneficiaries utilized part A while 87 percent of the beneficiaries relied on Part B in the year 2000, and part A represents only 55 percent of the total spending, while part B represents 45 percent and is growing in double digits. When you look at Medicare as a whole it will grow at a much faster rate than projected 1 year ago. So we need to examine with caution and not worsen this looming financial crisis.

Finally, there are those who suggest the magnitude of the problem facing Social Security and Medicare preclude any meaningful reduction of any Federal income tax. But tax relief for working men and women will promote economic growth, thereby making it easier to fund promised benefits. So we should harness the power of our economy to help us save these programs for tomorrow's retirees. I believe we can provide tax relief for hard working Americans while at the same time protecting and improving Social Security and Medicare, and let's meet this challenge.

Once again I thank the chairman for the joint hearing, as historical as I now realize it is.

[The opening statement of Chairman Grassley follows:]

Opening Statement of the Hon. Chuck Grassley, U.S.S., Iowa, and Chairman, Senate Committee on Finance

I would like to welcome our distinguished witness, Treasury Secretary Paul O'Neill. The purpose of today's hearing is to review the 2001 Social Security and Medicare trustees reports.

The annual release of the trustees reports is a Washington tradition that often goes unnoticed by the American public. Turning a discussion of "trust fund solvency" and "actuarial balance" into exciting prose is no easy task. Exciting or not, these reports do provide valuable information about the financial health of Social Security and Medicare.

I hope that today's hearing will help the public understand the problems facing these programs. As this year's reports reveal, Social Security and Medicare are simply unsustainable in their current form. Let me repeat: simply unsustainable. In fact, the trustees project that promised benefits will exceed scheduled payroll taxes and premiums by $465 trillion over the next 75 years. That's an astounding number—$465 trillion.

Some may try to tell us that it's not as bad as it sounds. Well, believe me they don't know what they're talking about. For example, in theory, a portion of this shortfall will be covered by government bonds in the Social Security and Medicare Part A trust funds. But these bonds are merely a claim on future general revenue, so the government can only redeem them if it raises income taxes, or borrows from the public. So the hope that these trust fund surpluses will save us is a fool's hope.

Some claim that using the Social Security surplus to pay down the Federal debt will alleviate the funding shortfall by reducing interest payments to the public. But these interest savings will cover less than 5 percent of the shortfall. If the government borrows from the public to cover the rest, it will only take 14 years to run the debt back up again. So that's no real solution.

Even more troubling, the near-term surpluses projected to accumulate in the Social Security and Medicare trust funds will soon exceed the amount of debt available for repayment. At that point, the government would be forced to invest Social Security and Medicare funds in non-governmental assets. Such investment could disrupt the financial markets and reduce the efficiency of our economy. We shouldn't go there.

With respect to Medicare in particular, for the *first time ever* the trustees have established a new section of the report that looks at Medicare's financial health *in total*. This is important considering only 22% of beneficiaries utilized Part A, while 87% of beneficiaries relied on Part B in the year 2000. And Part A represents only 55% of total spending, while Part B represents 45% and is growing in double digits. When you look at Medicare as a whole, it will grow at a much faster rate than projected even one year ago! So we need to exercise caution in taking steps that might worsen this looming financial crisis.

Finally, there are those who suggest the magnitude of the problem facing Social Security and Medicare precludes any meaningful reduction in Federal income taxes. But tax cuts will promote economic growth, thereby making it *easier* to fund promised benefits. Let's harness the power of our economy to help us save these programs for tomorrow's retirees.

I believe we can provide tax relief to hard-working Americans while at the same time protecting and improving Social Security and Medicare. Let's meet this challenge.

Once again, thank you for being with us today, we look forward to your testimony.

Chairman THOMAS. I thank the chairman and now I would recognize the gentleman from New York, the Ranking Member of the Ways and Means Committee, Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman. I indeed feel privileged to be involved in this historic joint session and, Mr. Secretary, you have to be very tolerant and patient of the Democrats in the House because we are not used to the compassionate bipartisanship that has been expressed by the President of the United States. Some of us would believe that some of our House Republican leadership would wish that Social Security just never came into existence. Some of us would believe that others in the Republican leadership would hope that maybe Medicare would twist slowly on the vine and just disappear. There may even be a smaller number of Republicans that believe that maybe we can just reduce guaranteed Social Security and Medicare benefits and that those benefits will be provided by the private sector.

Now we know that we are overly suspicious and skeptical and that the President will prevail, but we need the President's help now. That is why I am a little surprised that Secretary Thompson is not here because, when he was before this Committee recently, he made it abundantly clear to us that not only would every nickel of the Medicare trust funds be spent for Medicare, but he acknowledged that, in his opinion it would violate the law of the United States if something was done otherwise.

Yet, last night I saw a television program and I heard the Secretary say, "Why think about Medicare as part A and part B." "Health care is health care and we have a crisis and we will have to reform the system and reform it now."

Well, it just seemed to me that it is hard to have a crisis when you have a surplus in part A that everyone agrees to, and I don't see how you have a crisis in part B when 75 percent of it is funded by general revenues, unless we are saying that anything that goes through appropriations and that any program in which you intend to have increased spending is a crisis. If so, we have a crisis in funding education, a crisis in funding defense. And while my Chairman is right as always, in at lease part of what he said, that what we did in the past—shift part of part A obligation to part B—it was only that part of home care for the aged that was not held in the hospital. So it should be in part B even though it did relieve some of the burdens of Part A.

What I am saying is that we know that this administration does not intend to merge the obligations that come out of general revenue with those precious trust funds that we know it is against the law to think about merging into one. So you will be able to help us in this because if we send our old folks out to the private sector, God bless them, it is hard for me to think that private insurers will be reaching out to old sick folks, as people that they would want to see enrolled in their for-profit health delivery system. And of course the Social Security system that some of my colleagues think is a socialist experiment that should never have been created, we are anxious to see how we can get more of the people's money invested in the private sector to get a higher yield. Of course, not this quarter but maybe the type of quarters we experienced during the Clinton-Gore years will come back so we can get those higher yields, so we can get more benefits at less expense. We don't see how you can reduce the revenue that is paid into the trust fund in any way without reducing the benefits, and we really don't see where you would get the money if you are going to compensate for the benefits.

So we know you have the answers and we know the President is going to be there to help us get over these suspicions that we have. But I am asking that just one Member from the Medicare Subcommittee and one from the Social Security Subcommittee may ask one question, not for an immediate answer but so that you might include that in your testimony and we could expedite the hearings. So I yield to Mr. Stark for his question and as soon as he completes it I would yield to Mr. Doggett for his question. And ahead of time I want to thank you for the great, great contribution we expect you to be making to bring not only the House and Senate closer together but the House Republicans and Democrats closer together because we are very, very far apart.

Mr. STARK. Mr. Secretary, I thank the distinguished gentlemen for yielding to me. My question is to just reconfirm in the Bush budget outline, which is all we have seen, Medicare's trust fund of 526 billion has been put into a contingency fund that is used for defense or anything else outside of the Medicare field and I want to reconfirm that it is the administration's intention with respect to the Medicare surplus that it only be used for part A, not for the part B, not for pharmaceutical drugs or defense or anything else. But as Secretary Thompson said to us when he testified here last week, he understands it would be against the law.

[The following was subsequently received:]

The Budget of the United States Government, Fiscal Year 2002 showed, in table S. 1, that the President's budget policy proposed a $1.4 trillion reserve for "additional needs, debt service and contingencies." That reserve accounted for about one-fourth of the total projected surpluses over the 10-year budget window.

All monies being paid into the various trust funds—including Social Security and Medicare—are being properly accounted for. A legal obligation exists to use trust fund income only for the designated purposes. That obligation exists and will be met as provided for by law. That obligation can be thought of as a liability on the government's balance sheet. Additions to the HI Trust Fund due to a positive cash flow into the fund, should be viewed as an increase in HI trust fund assets which represent a partial offset to projected future Medicare payments. The special-issue bonds held by the trust fund are the government's formal commitment to pay those future benefits upon redemption. The cash flow generated by the excess of income over outlays is incorporated in the projected on-budget surpluses.

The President outlined uses of the projected on-budget surpluses in Table S. 1 of the budget. Aside from specific proposals to raise spending, including Medicare, and for debt service, the table showed a remainder of $841 billion as a contingency reserve. There is no formal accounting for the components of this reserve. Rather, this "contingencies" fund represented a portion of the projected on-budget surpluses that will be available over the 10-year budget window to pay down debt to cover unforeseen events. "Contingencies" are by their nature unforeseen events or emergencies, and no specific accounting can be made in advance. Its ultimate use—such as to pay down debt—is independent of the existing legal obligations reflected in the various trust funds, including Medicare.

Chairman THOMAS. The gentleman from New York's time has expired and I believe another Member was supposed to fit inside the Ranking Member's time.

Mr. RANGEL. Yes, Mr. Doggett.

Mr. DOGGETT. Thank you. My question will concern the administration's intention to address the anticipated shortfall in the Social Security trust funds by shortening it further, and by removing money dedicated for guaranteed Social Security benefits for privatization purposes. Surely you will be able to tell us, regarding the approximately $600 billion that you propose to take from guaranteed Social Security benefits, how much sooner I believe it is about a decade you will be reducing the ability of the funds to pay off benefits, and how much Social Security benefits will be cut in order to implement a Social Security privatization plan.

[The following was subsequently received:]

As you are aware, on May 2 President Bush announced the formation of a Commission to Strengthen Social Security. He directed the Commission "to submit bipartisan recommendations to modernize and restore fiscal soundness to the Social Security system." And this must be done in a way that does not change Social Security benefits for retirees or near-retirees.

Clearly, the President's intention is to strengthen the system in a way that will enhance retirement security for future retirees. This objective can be achieved by allowing individuals to invest some of their payroll taxes in higher-yielding private accounts. Future beneficiaries will benefit directly from their own accounts and the American economy will benefit from increased private investments.

Though President has laid out a set of principles for reform, a specific plan will be developed after the Commission has made its recommendations. We look forward to the Commission's report next fall.

Chairman GRASSLEY. It is my privilege to call on Senator Baucus, the Democratic leader of the Senate Committee.

Senator BAUCUS. Thank you very much, Mr. Chairman. My concerns are similar to those that have just immediately been expressed. Let me just say them a little bit differently. In my mind the Medicare Trustees' report offers both encouragement as well as admonition. The solvency projection to 2029 is of course encouraging. Nobody can have any other view. After all I am sure most of us in this room today can remember back to 1997, the chairman has referred to it, when the part A trust fund was projected to be solvent to 2001. So we have made tremendous improvements now that the solvency projection is up to 2029.

The report also gives us pause, pause to reflect, to think carefully about the impending financial burden that will be upon us beginning in 2010 when the baby boom generation begins to retire. To me that means we should proceed with caution. We should protect the resources that we now have, a point made by some of the previous speakers, and think about how best to put more money, not less, I repeat that, more money, not less into Medicare. We should use the part A surplus for part A benefits and we should not put that money into a contingency fund as the President has proposed.

Turning to Social Security, we did have good news. The status of the trust funds has improved since last year's report. As expected, the trust funds are adequately funded in the short term but significant long-range problems do exist. The lesson I take from the Social Security report is not much different than the lesson I take from the Medicare report. The Social Security System by most accounts has been very successful for more than 65 years. It plays a unique role in retirement planning in that benefits are guaranteed—let me repeat that—a unique role in retirement planning in that benefits are guaranteed and they not subject to the ups and downs of the market. After the week we have just experienced on Wall Street, the worst for the Dow Jones since 1989, that guaranteed feature of Social Security seems comforting. I understand the desire of many to explore options for modernizing Social Security in the current environment of retirement planning, and I am open to considering a range of options. But like Medicare, we should proceed with caution, and we should look for ways to dedicate more, not less, but more resources to the program. The 40 million beneficiaries on Social Security—soon to be almost 80 million—deserve no less. Thank you, Mr. Chairman.

[The opening statements of Mr. Crane and Mr. Ramstad follow:]

Opening Statement of the Hon. Philip M. Crane, M.C., Illinois

Today's historic joint hearing is timely, allowing the key Congressional Committees to examine the findings and recommendations made by the Board of Trustees of the Social Security and Medicare Hospital Insurance trust funds in their 2001 Annual Reports on the financial status of the trust funds released yesterday.

In 1995, when Republicans took control of Congress, the Medicare Trust Fund was projected to go bankrupt by 2002. Through our hard work the Medicare Trust Fund is now solvent until 2029.

The Medicare Trustees' projections show a mixed picture of the Hospital Insurance (HI) trust fund (Part A). Due to last year's strong economy, and low Medicare payment expenditures, the HI solvency has been extended by four years over last year's projections, from 2025 to 2029. However, over the long-term, the use of improved assumptions of the long-range growth rate on Medicare and overall health care spending growing faster than Gross Domestic Product indicates a greater deficit than projected last year.

It is important to point out that Medicare Part A only includes a portion of Medicare's benefits. The Supplementary Medical Insurance (SMI) Trust Fund (Part B) expenditures are expected to continue to grow faster than the economy as a whole. The eventual cost is much higher than projected last year due to the use of improved assumptions reflecting an expected continuing impact of advances in medical technology on health care costs both in Medicare and the entire health sector. The Medicare trustees state "it is important to recognize the financial challenges facing the Medicare program as a whole." We should consider Medicare's finances in their entirety—the expenses and committed revenues in Medicare as a whole (Part A and Part B combined) show that the program is running a deficit. Given these projections on the HI and SMI trust funds, the current definition of Medicare solvency as it relates to HI is not useful.

While some lawmakers may take the improved short-term outlook of the Medicare program as an indication that the Congress should not be so swift to act on solutions to improve the financial picture of Medicare, the Medicare trustees state that "Medicare's financial condition has improved in recent years, but this should not lead to complacency. Medicare still faces financial difficulties that come sooner—and in many ways are more severe—than those confronting Social Security." We should be looking at solutions that allow us to continue to strengthen and improve the

Medicare program but ensure that these improvements are contingent on the outlines of a Medicare reform proposal.

Regarding Social Security, last year's economic growth, along with some minor methodological changes, have extended the date on which Social Security will begin to run an excess of costs over payroll tax revenues from last year's reported 2015 to 2016. This is the critical date in the debate because thereafter Social Security becomes a net borrower.

Other dates you will hear include 2025, which is the first year that Social Security runs an absolute deficit when you include in income both payroll tax receipts and the "income" earned on the "assets" held in the Social Security Trust Fund. This date is less important than the 2016 date because, as you know, the assets in the Trust Fund are meaningless, and so the interest earned on those assets is also meaningless.

The other date you will hear is the "exhaustion" date for OASI (Old Age Survivors Insurance) and DI (Disability Insurance), which is when the Trust Funds will be fully depleted. The reported exhaustion date was 2037 last year and it has moved to 2038 in the most recent report. This change tells us the situation has gotten marginally better, but it is not a terribly meaningful figure otherwise since it presumes current law will be maintained, which is absurd. While the short-term financial outlook for Social Security has improved slightly, the program still faces a long-term financing crisis. We must act sooner rather than later to address the rapidly growing annual deficits that will occur soon after the baby boomers begin to retire.

Most importantly, the current environment relates to the effects of strong economic growth on the solvency of the Social Security and Medicare Trust Funds. I believe the Bush economic program will cause the economy to be stronger than it would otherwise be and that this will further strengthen both Medicare and Social Security, which does not eliminate the need for reform, but it certainly gives us more options.

Opening Statement of the Hon. Jim Ramstad, M.C., Minnesota

Mr. Chairman, thank you for scheduling this historic joint hearing today to discuss the most recent findings on the future of Social Security and Medicare—programs of vital importance to seniors and individuals with disabilities across our nation.

While I am certainly pleased that the Trustees have reported that the insolvency date of these two programs has been extended to 2038 for Social Security and 2029 for Medicare, I believe the true impact of this Report is elsewhere.

More importantly than the date when the programs become insolvent is when the programs begin to see reductions in revenue and especially when expenditures begin to exceed revenues. Mr. Chairman, that date is 2016, which is why I believe we must act now to modernize and strengthen these two programs. In addition, the long term deficit in the Part A program has increased dramatically since last year.

The Trustees have also acknowledged that the current measure of insolvency for Medicare seriously underestimates the magnitude of the problem. The current solvency measure fails to take into account the Supplementary Medical Insurance, or Part B, spending. I agree with the Trustees call for a *comprehensive* look at the entire Medicare program.

The insolvency measure also falls short because programs can be shifted to Part B, extending the solvency of Part A. This happened in the Balanced Budget Act in 1997 when Home Health spending was shifted to Part B.

Mr. Chairman, the long term financial difficulties of Medicare mean that comprehensive Medicare reform can't wait.

Many on the other side believe that Medicare is fine and that we can simply add a prescription drug benefit to the program.

I strongly disagree. Congress should only add a prescription drug benefit as part of a comprehensive Medicare reform package . . . a package that solves the long-term challenges faced by this vital program. A package that improves the benefits utilized by seniors. A package that secures Medicare for the future. Thank you again, Mr. Chairman for calling this hearing.

Chairman THOMAS. Thank you on behalf of Chairman Grassley and myself. Mr. Secretary, thank you very much. I do understand you have a tight schedule and we are to conclude the presentation of the trustees' report by noon, and therefore I would say that if any Member has a statement they want to put into the report they can do so under the usual and customary procedures in writing, and if the Secretary has a statement in writing, without objection, it will be submitted for the record. And, Mr. Secretary, you can address us in any way you see fit, understanding that the mike is very unidirectional in terms of the sound.

Thank you very much, Mr. Secretary, and welcome to the joint hearing.

STATEMENT OF HON. PAUL O'NEILL, SECRETARY, U.S. DEPARTMENT OF THE TREASURY, AND MANAGING TRUSTEE, SOCIAL SECURITY AND MEDICARE BOARD OF TRUSTEES

Secretary O'NEILL. Well, thank you, Mr. Chairman and Mr. Chairman and ranking members. This is really quite a wonderful group to come before this morning, and I appreciate your invitation for me to be here. I do have a prepared statement and, as the Chairman has indicated, I would be happy to submit it for the record and maybe with just a few summary comments provide an opportunity for you to ask me questions about the report which we signed and transmitted to the Congress yesterday.

I think, first of all, it is worth saying that if you look at the transmittal sheets which you will see there, what you will see there are the names of the signatories to this transmission and it lists myself as Managing trustee, and I point that out to you because I consider this an important characterization and distinction in the way that I am presenting myself to you today, not in a partisan way, but with the same sense of fiduciary responsibility I would have if I were your banker in giving up advice about the condition of funds that you had entrusted to my keeping.

And with that premise and understanding of what I am here to accomplish this morning, I want to say to you that this report shows a link to the reports of the last several years, that if we follow the current law, including both the revenue raising components and the expenditure components or obligations that you have legislated for the American people, that there is a prospect down the road of our not being able to honor the obligation that you have made by law to the American people. That is a simple sum of what is here.

You can find, you can find something positive here, if you like, with the actuaries' projection that says, well, maybe we have an extra 4 years to go for Medicare part A, maybe we have 1 more year to go for OASDI. I would advise you not to take great comfort in the fact that we are going to be bankrupt 1 year later than we thought last year. I think it is quite important, as we have indicated in the report, that we take account of the demographics that are going to happen no matter what else we may do. The composition of the population and that part that is dependent on the benefits that you have legislated for them will be there, and the relationship between the retired beneficiary population and the working population will change no matter what else we may do, and so my only advice to you would be that we take these data seriously and hopefully together, maybe not in a bipartisan way but in a nonpartisan way, we can together discharge our ongoing obligations to the American people.

Thank you, Mr. Chairman.

[The prepared statement of Secretary O'Neill follows:]

Statement of Hon. Paul O'Neill, Secretary, U.S. Department of the Treasury, and Managing Trustee, Social Security and Medicare Board of Trustees

It is a pleasure to be here today before this unique joint hearing of the House Committee on Ways and Means and Senate Committee on Finance. I applaud Chairman Grassley and Chairman Thomas for focusing more than the usual attention on the Social Security and Medicare Trustees' reports on the financial status of these two vital programs.

Yesterday, the Trustees met to complete our annual review of the trust funds and to forward the reports to Congress. While the short-term financial status of both Social Security and Medicare has improved somewhat since last year's report, our long-term analysis highlights a real threat to the retirement security of future generations and has led us to conclude that both programs need to be reformed and strengthened at the earliest opportunity. Focusing only on the short-term ignores the long-term impact of a rapidly aging population on both trust funds which results in both funds being widely out of long-term actuarial balance.

Medicare

Let me first talk about Medicare. The Medicare program as a whole presents financial challenges that will require integrated and comprehensive solutions. Costs for the two Medicare program components—HI and SMI combined—will grow from 2.2 percent of GDP today to 8.5 percent in 2075. By comparison, HI tax income and SMI premium revenues will only grow from 1.8 percent of GDP today to 2.5 percent in 2075, leaving a gap of 6 percentage points in 2075. Counting current law general revenues dedicated to SMI, the shortfall will still be 3 percentage points at the end of the projection period. Medicare spending is ultimately projected to exceed even the costs of Social Security. The financing gap for HI alone is larger than the gap for Social Security, and the HI Trust Fund will become insolvent 9 years sooner than the OASDI Trust Funds. HI tax income will fall short of outlays beginning in 2016.

It might be tempting to ignore Medicare's problems by pointing to the improved short-term solvency of the HI fund and the fact that on an actuarial basis the Supplementary Medical Insurance (SMI) Trust Fund is projected to remain adequately financed into the future. Neither of these factors should be used as an excuse for complacency. First, because a panel of experts recommended changes in health cost assumptions to improve the accuracy of the Trustees' projections, the long-term cost estimates for both HI and SMI are raised substantially, thus worsening the long-term actuarial deficit in the Medicare HI Trust fund. Second, the SMI trust fund automatically relies on general revenues to make up the difference between its premium revenues and costs. This method hides the fact that the SMI trust fund will consume a rapidly growing share of general revenues over time and beneficiary premiums will be increased substantially.

With the accounting complexities of two trust funds, it might be easy to lose sight of the basic fact: we need to focus on Medicare in its entirety. It is clear that steps should be taken now to develop a more accurate overall measure of Medicare's financial health, and to work together to improve it.

Because I think it is so important to this discussion, I also want to elaborate on what I see as the tremendous potential for improvements in the health care sector. I raise this issue out of concern for the health of the American public, and particularly for the elderly and disabled who depend on Medicare. The recent reports of the prestigious Institute of Medicine on medical errors and quality of care are quite sobering. In 1999, the IOM reported uncovering a stunningly high rate of medical error—errors that resulted in death, premature disability, and unnecessary suffering. Earlier this month, the Institute released a follow-up report on the overall quality of health care in America, concluding that reforms could close the enormous chasm between the current level of health care quality and the potential we know exists.

Social Security

Turning to the combined OASDI Trust Fund, the Trustees report a financial outlook that has improved a little since last year—a projected exhaustion date of 2038, one year later than last year. Still, the fund continues to be in long-term deficit—with a financing gap equal to 1.86 percent of payroll. Moreover, once the baby boom generation starts to retire, financial pressure will build and continue to be a factor beyond the 75-year projection period.

The primary cause of the long-term deficit is the aging of the population that will occur as the baby boom generation retires and expected increases in longevity become reality. Annual OASDI outlays will exceed OASDI tax revenue beginning in 2016. Deficits are expected to persist and are projected to rise to more than 6 percent of taxable payroll by 2075. These large deficits at the end of the projection period are an indication that costs will almost certainly continue to exceed tax revenue after 2075. As a result, ensuring the sustainability of the system after 2075 will require larger changes than needed to restore the system to 75-year balance. The Trustees believe that action should be taken to address the financial shortfall now, as the sooner adjustments are made, the smaller and less abrupt they will have to be.

This spring President Bush will form a Presidential commission to study how to reform Social Security. The commission could make its recommendations by next fall. Reform should be based on these principles: it should preserve the benefits of all current retirees and those nearing retirement and preserve the disability and survivors components: it should return Social Security to sound financial footing without increasing payroll taxes or allowing the Government itself to invest Social Security funds in the private economy; and it should offer personal retirement accounts to younger workers who want them.

The President's goal is clear: Social Security must be safe and secure for this generation and for future generations. We must work now to preserve and protect Social Security by putting it on a firm financial footing so we can keep our commitment to current seniors and also meet the needs of our children and grandchildren.

Finally, this is the first opportunity I have had as a Trustee to comment on the status of the Medicare and Social Security trust funds. In recent years, bipartisan reform efforts have not succeeded, and the Trustees have reported that minor reforms and "improved economic projections" have allowed us to add a few additional years of life to the trust funds— though serious long-term structural imbalances have remained. This report, sadly, is similar to previous recent reports. However, it is my hope that this Administration and Congress can work together in a bipartisan way to find the necessary confluence of opinion, wisdom and courage to restore long-term health to these programs.

Thank you for inviting me to testify today. I look forward to answering your questions.

Chairman THOMAS. Thank you, Mr. Secretary. And in cognizance of the shortness of the time, the Chair will forego any questioning and recognize the ranking Republican, the gentleman from Illinois, Mr. Crane.

Mr. CRANE. Thank you, Mr. Chairman. Mr. Secretary, the Bush tax program will strengthen the economy. If it were to permanently increase the economy's real rate of growth by two-tenths of a percentage point a year, which is a very conservative estimate, would you not expect such a change to extend the solvency of the Social Security?

Secretary O'NEILL. Prospectively it could, sure.

Mr. CRANE. And starting from your intermediate assumptions and building in the effect of the Bush tax cuts, do you have any sense of how many additional years we would gain before the trust funds were exhausted?

Secretary O'NEILL. I guess without actuarial equations I wouldn't hazard a guess, but there would be some addition.

Mr. CRANE. The Medicare Trustees' report shows by 2016 total Medicare expenditures will begin to exceed general revenues. In terms of dollars how big do you expect the gap for financing revenues to grow?

Secretary O'NEILL. If you look at the projections through this whole 75-year period, we are talking from the Medicare side moving to 2.5 percentage points to 8 percentage points. So we are talking about a monumental change, and I don't know whether you have had a chance to work your way through the details of the report, but if you look at the details there are in this report with the Medicare assumptions, projection from the outside panel that was convened last year, an extension of the logic says in the year 2075 one-third or about one-third of our total gross national product would be consumed by health and medical care. So the prospects that are embedded in this report are really quite a huge change from where we have been.

Mr. CRANE. Some lawmakers might take the Trustees' projection of 4 more years of Medicare solvency as a sign that we should not address the fundamental reforms to the Medicare program, but rather focus on adding additional benefits to the program like a prescription drug benefit. In your opinion, if the Congress were to simply add on a prescription drug benefit to the existing program, how would that change the outlook of the program?

Secretary O'NEILL. Well, I think it would falsely assume that we have room to provide an expansion of benefits without accepting the fiscal responsibility to pay for it. There is nothing in this report that suggests that we have that money to spend. Quite the contrary, it says we need, I believe, fundamental changes in order to secure the long-term financial certainty of the benefits that have been voted by the Congress.

Mr. CRANE. Thank you, Mr. Secretary. Mr. Chairman, I yield back the balance of my time.

Chairman THOMAS. Thank you very much, Mr. Crane. Mr. Chairman.

Chairman GRASSLEY. Mr. Secretary, during my time I will only have two issues to discuss with you. I am going to start with the fact that a number of people have suggested that we should lock away every penny of Social Security and Medicare surplus to pay down the debt. Now, according to data that we have, however, from the actuaries, Social Security and Medicare benefits will exceed payroll taxes and premiums by $465 trillion over the next 57 years. It is my understanding that locking away all the Medicare and Social Security surplus to pay down the debt does not solve the massive shortfalls that I have just mentioned in both of these programs, as some would argue. So I would like to have your thoughts on that from your position not only as economic advisor to the President but also as from the standpoint of your trusteeship.

Secretary O'NEILL. Well, you have mentioned that we have a concept of a lockbox and I think without exception so far as I can tell every Member of Congress has indicated together that we should not use—funds that come to the Federal Government through the application of the Social Security tax or through the Medicare tax should not be used for other purposes, and I don't find anyone that disagrees with that. Now, I think at the same time most people understand that when the money comes in for those programs and it is in excess of the amounts that are required to discharge the responsibility for a particular period of time, for a particular year for example, that the books of the Federal Government, that is to say, the financial statements of the Federal Government show an obligation on the part of the Federal Government to hold and protect that money and to use it for the purpose that it was collected. And so there is a, for certain accounting, recognition of an ongoing obligation as to how those funds will be used. At the same time when the funds are collected by the Federal Government, they flow into the Treasury and they do not have names on them that are associated with the source that produced them. And so as we have bills that come due because of legislation passed by the Congress, we send checks from the Federal Government to those who have an obligation against the Federal Government; and to the degree that we have cash in excess of the need to service the direct financial obligation of the Federal Government, we reduce the outstanding debt held by the public. And so there is no doubt that we are going to use these funds for the stated purpose because we have a clear recording of the obligation to do so.

At the same time, Mr. Chairman, to your question, there is no way, at least in the opinion of the Trustees, that there is no way when one looks at the projected obligations of the Federal Government and the expected revenues associated with Social Security and Medicare, that we are going to be able to discharge the benefits that have been legislated by the Congress when one gets to 2016, the year for Social Security, and at 2029 for Medicare, and so, no, it is not possible to hold that. We are going to be OK if only we do not spend the money for something else, because we are going to spend the money only for these purposes.

Chairman GRASSLEY. Now, I want your thoughts on a couple of quotes from the Trustees' report. Quote, We highlight the most significant implications of these findings, which is that both Social Security and Medicare needs to be reformed and strengthened at the earliest opportunity. End of quote. Second quote about Medicare, quote, The need for further long-term reform has not substantially abated despite improvements brought about in recent years, end of quote.

Do you agree with the statements and what are the implications of these findings for Congress as we consider whether to pursue both prescription drug coverage and Medicare reform this year?

Secretary O'NEILL. Certainly I agree with both of those observations. The implication of not acting early is really important and it is different from many other things we in the United States face. I think it is probably correct to characterize us as a people who respond well to crises but find it difficult to make anticipatory changes, and for lots of things that is all right, it is okay not to be prepared. And I would argue in the case of a national defense we would not want to wait and decide whether we should support a military until we are confronted with the military situation. Then by our actions we collectively indicated that we agree with that concept.

It seems harder for us to deal with the reality that is confronting us in Social Security and Medicare because it is out there a ways.

The difficulty with waiting until we have a crisis condition; that is to say that we were effectively in bankruptcy, is that there is no way to climb back up on the cliff after you have gone over it when it comes to Social Security and Medicare. If we don't take preventative measures, we are going to create a real crisis, and the depth of the crisis will become more and more extreme as we have approached the precipice of nonsolvency. Because of the magic of compounding, if you will, the earlier we can take action, the easier and simpler and less painful it is going to be to sustain good benefit levels for the aged and the disabled and those who are entitled to medical benefits.

Chairman GRASSLEY. Thank you very much.

Chairman THOMAS. The gentleman from New York, Mr. Rangel, wish to inquire?

Mr. RANGEL. Mr. Chairman, because there has been some concern that I have deliberately——

Chairman THOMAS. I will tell the gentleman there is no concern.

Mr. RANGEL. Violated the privilege of the opening statement, in order to shatter that idea, I yield back the balance of my time.

Chairman THOMAS. I will tell the gentleman there was no concern and the chairman himself yielded his time to another member. Does the gentleman from California, Mr. Stark, have more than the one question that he had proffered?

Mr. STARK. Thank you, Mr. Chairman. Mr. Secretary, as I indicated earlier, if you take the $526 billion out of the Medicare surplus and put it in a contingency fund where it is suggested it could be spent on other than Medicare, you would exasperate any problem that Medicare has. But there is also the question that Medicare in the abstract is inadequate now because it does not provide a drug benefit to the seniors. So I think that is generally agreed upon. The Bush budget had set aside $153 billion. I might add that is less than about one-tenth of the amount earmarked for tax cuts. It is not even as much as giving back the inheritance tax, which would be $50 billion a year. But if you take $48 billion away from this projected $153 billion in the immediate helping hands block grant, which is neither immediate, I might add, or much help, you only leave $100 billion for a drug benefit. That is a little over $10 billion a year and by all standards that we know a decent drug benefit might cost $40 billion a year. Interestingly enough, that is just what getting rid of the inheritance tax costs.

If we have got enough money to give back the estate tax or give back $40 billion a year, why cannot we hold that and use that $40 billion for a drug benefit which would benefit every senior, 30 or 40 million seniors, as opposed to just a couple of thousand extremely rich Americans? Why isn't that a better use of our money?

Secretary O'NEILL. Well, I think the President has indicated that he believes we should have a drug benefit. And he said more broadly to all the Members of Congress that he thinks we should do and work together on substantial Medicare reform, and so I don't see an inconsistency in what he said we should do. And I don't—I guess I am still not able to articulate the difference between cash flow and how we account for the sources of funds in describing what happens to Medicare and Social Security funds when they come into the government and they are not required for immediate discharge of Federal obligations. I am struggling with how I can help to make that clearer because I keep hearing these questions about contingency funds, and it is a misunderstanding and I suppose a weakness on my part in not being able to clarify the difference between balance sheets——

Mr. STARK. If you yield. Secretary Thompson didn't have any trouble distinguishing. He said before this Committee that, yes, they had added the $526 billion in Medicare trust. They were counting that in the line on page 17, I believe it is, for this contingency. They did not do that with Social Security. That is up there as a separate item. That trust fund was protected. But the Medicare part A trust fund is buried in that $820 billion contingency fund. We call that three-card monte where I come from, Mr. Secretary, but you might call it a shell game or however you might want to define it. I know where the President hid that and in his understanding the suggestion is that that money for Medicare could be spent on other things, and that is not preserving a trust fund in my book.

Secretary O'NEILL. The funds that were sourced from a Medicare tax will be recorded on the books of the United States as an obligation of the Federal Government to be discharged as beneficiaries present themselves for Medicare entitlement programs, without a doubt.

Mr. STARK. Then how does it get in the contingency fund? Then there is no contingency funds. That is all right with me. We just misnamed the contingency fund. That should have been named the Medicare part A reserve fund.

Secretary O'NEILL. I don't know if we really want to go to this question, but I think most of the American people understand that we have a growing obligation account for Medicare and for Social Security and that that obligation is reflected by entries in bookkeeping statements. It is not reflected by a physical asset that someone can go and draw out. Those obligations represent representation by Members of Congress that when the bills come due they will be paid, and there should be no doubt that that is the case. But the conventions that we use from an accounting point of view to talk about trust funds are frankly I think not well understood because they will suggest something quite different from what they are in fact.

Chairman THOMAS. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman. Mr. Secretary, with all respect, I don't think that the average American listening to Mr. Stark's questions and your answers would think that you answered the question, because if the basic question is where is the $526 billion, is it still in Part A or is it in the contingency fund. I will not delve into that any more because quite frankly I don't think your answer will be different, but I don't think you answered the question.

I want to ask a different question; namely, the merging, the administration's not the trustees, but the administration's merging Part A with Part B surpluses I think is a kind of bait and switch tactic that is trying to show that there is a much greater problem than there actually is in order to justify, quote, reform. And reform means different things in the eyes of the beholder. To some people reform means one thing, to some people reform means something else. I think to most people reform means solvency. How do we better assure that the dollars are there? To some people reform means competition models, and those are very important discussions.

But my question is, where in the administration do you, how do you propose to close the gap between excessive expenditures and revenues, even given your, I think, incorrect merging of the two funds? Your chart page 21 shows this gap. How do you propose to close that gap? What ideas do you have for providing more dollars to Medicare? I don't see them and I would like to learn about them.

Secretary O'NEILL. Well, again the President has indicated that he is prepared to work with the Congress on a total Medicare reform that I think we in the administration stand ready to do that. I guess I would argue that conceptually at least merging the ideas of health insurance and the supplemental medical insurance is a sensible thing to do because out there in the real world where many of us have parents and family Members who are drawing on these benefits, I think it is awfully hard for them to understand why we make a distinction between what is in SMI and what is in HI, and I think frankly probably most of them don't care and wish they did not have to take the trouble to understand why do I have these different things that I have got to deal with. And from a medical care concept, actual point of view, it is hard to imagine that medical care is really practiced in the artificial way we have designed it from an accounting point of view.

So putting these things together in the way the real world works, at least conceptually if we can't do it artificially, seems to be a perfectly logical thing to do.

And then to your question about how do we solve it.

Senator BAUCUS. Where is the money? That is the question. Where is the money?

Secretary O'NEILL. Well, you know, again, I think there are a number of things that we can do and maybe I will go back to my previous incarnation and talk a little bit about what I have been doing the last 5 years to demonstrate what I believe to be the case, which is that we can, we in this country can substantially improve the value equation of health and medical care. But it will take systemic reform in the way care is practiced. It will take attention to the last two reports that have been issued by the Institutes of Medicine. I don't know how many Members have seen the two reports from the Institutes of Medicine. The one last year called attention to the fact that 100,000 people a year are being killed by medical mistakes and attest to the level of mistake-making that takes place in the delivery of care. If we could capture the potential that exists to do it right the first time we would probably reduce health and medical care costs 30 to 50 percent. And if you would like witnesses on that, I would suggest Dr. Donald Berwick from Harvard, who is the Director of the Institute of Health Care Improvement, and Lucy Ann Leap, who is the first who identified the huge gap between where we are and where we could be.

Part of what I am saying is as much as we may try here to sort out and deal with these complex issues in health and medical care, if we are really going to receive substantial improvement it is going to take place in places like the Intermountain Health Care System in Salt Lake City, where they are working on these important ideas. They will take place at Deaconness Glover in Boston, where they are working on these ideas.

Senator BAUCUS. Mr. Secretary, I appreciate that but as I hear you, you are not really answering the question. The question is where is the money and where is the administration's proposal to close the gap. With all due respect, there is none. The talk of reform and the competition models and everybody who has analyzed the competition models has concluded they don't yield much money, they don't address the solvency part of the problem that we are attempting to address and I just suggest frankly that the administration be more forthcoming; so far it has not been. Then the administration can perhaps be able to have a dialogue with this Congress. Otherwise until it has a proposal detailing where the money is coming from I don't know why this exercise really makes much difference.

Chairman THOMAS. Does the gentleman from Florida, Mr. Shaw, the chairman of the Social Security Subcommittee, wish to inquire?

Mr. SHAW. Yes, I do, Mr. Chairman, and I thank you for yielding the time to me. I am sitting here drowning in frustration. I think from some of the comments that have been thrown out without being answered here at this hearing and all over Washington, sometimes I think for the new symbol of Congress, we should remove the eagle and put in the ostrich with his head under the ground. It is absolutely incredible when I think of so many people thinking that we have until 2038 until we solve this problem.

Mr. O'Neill, you were absolutely correct in what you said, the closer we get to the cliff the more likelihood we will drop off and the more likelihood we will not sustain the benefits. But we have an opportunity now to do something. The word "solvency" has been I think dramatically misused during this entire debate because as far as I am concerned the solvency ends in 2016, when we no longer have enough money to come in in order to take care of our obligations.

Mr. Secretary, you show the assets of the Social Security trust funds in your report. Those assets I assume include the government obligations, which are nothing more than an IOU from the government to the government, is that correct?

Secretary O'NEILL. That is exactly right.

Mr. SHAW. Now you are doing this under existing law, and I wanted to make that very, very clear. But if a private company, if Alcoa, when you were CEO if you were to show those obligations of yourself in the balance sheets to the stockholders or to the bankers, what would happen?

Secretary O'NEILL. Well, it depends on how serious the problem was. If the problem was as serious as the one we have here, they would probably withdraw support for us. One distinction between the private sector and the public sector that gives momentum and sustenance to where we are is you all have the ability to raise taxes in the financial systems of the world and the people who believe they are going to be able to collect benefits assume you will raise taxes to pay for your obligations.

Mr. SHAW. Precisely, so the assumption is we are going to raise taxes and tax the people who have already paid into the system in order to pay them their obligations; is that correct?

Secretary O'NEILL. That is correct.

Mr. SHAW. So beginning in 2016 in the existing system we will not have sufficient assets coming in in the form of 12.4 percent payroll tax in order to pay the benefits. I would like to submit for the record the definition of bankruptcy as it appears in Black's Law Dictionary: The state or condition of one who is unable to pay his debts as they become due.

[The information follows:]

Bankrupt. The state or condition of one who is unable to pay his debts as they are, or become, due. Amenability to the bankruptcy laws. The condition of one who (under the Bankruptcy Act of 1898) has committed an "act of bankruptcy" (q.v.), and is liable to be proceeded against by his creditors therefor, or of one whose circumstances are such that he is entitled, on his voluntary application, to take the benefit of the bankruptcy laws. The term includes a person against whom an involuntary petition has been filed, or who has filed a voluntary petition, or who has been adjudged a bankrupt. Person or municipality referred to as a "debtor" under Bankruptcy Act, § 101(12). See Act of bankruptcy; Arrangement with creditors; Bankruptcy Act; Bankruptcy proceedings; Composition in bankruptcy; Composition with creditors: Contemplation of bankruptcy; Insolvency; Wage earner's plan.

Chairman THOMAS. Without objection.

Mr. SHAW. We will not be able to do it unless we raise taxes and tax people again or cut benefits. So by doing nothing we are simply putting ourselves in that position where we are going to have to totally depend on, or in good part at least, a third of the taxpayers in order to get the necessary funds to hold the benefits to where we are today. Is that close to being correct?

Secretary O'NEILL. That is exactly right.

Mr. SHAW. It is tremendously frustrating, particularly when I see that Social Security is becoming a worse deal over time and it will continue to get worse without change. Young and future workers will get a very bad deal. People disagree about exactly how the Social Security rate of return is calculated, but according to the administration, young people entering the work force today can expect a return of less than 1.8 percent of the contributions that they and their employers have paid into the system. That is illustrated on the chart that is to your right, Mr. Secretary.

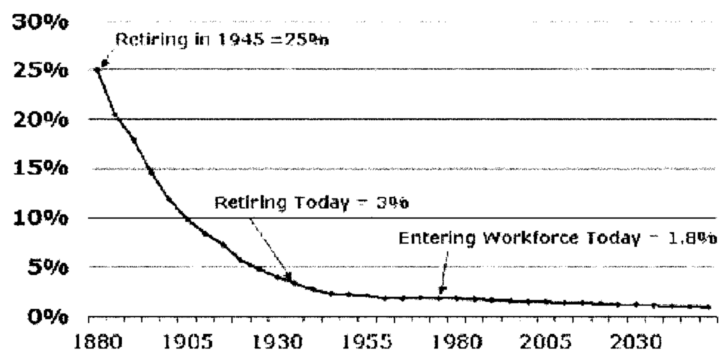
Do you disagree with that? What we show is the date of birth of the population, which is along the bottom of the chart, and it shows a percentage where people born in 1880, for instance, and were retiring in 1945, they were getting 25 percent return and now it is down to 1.8 percent. That is absolutely disgraceful. As a matter of fact, I think probably what we should do is to adopt this as a symbol for Social Security for the young people of this country. It is absolutely unconscionable that we are allowing this to continue and allowing this charade and the corrupt type of the accounting, which is required by law and which you are dutifully following as you have to, and I understand your frustration that you must feel by inheriting this system.

President Roosevelt said when he signed this thing to the effect that more was being put out of the reach of the politicians. It has never been out of reach of the politicians, and it is disgraceful the way we are handling this thing, and I would hope that the Members of Congress would join some of the leadership on both sides of the aisle, and I include Senator Breaux in there, who has been very forthcoming in trying to put together solutions, which I don't totally agree with but I agree in principle, and it is time we move forward and solve this system for the next generation. It is tremendously important, and I think it is tremendously important to this country. Social Security will be going into the red in 2015, and it is time we quit talking about 2038.

Thank you, Mr. Secretary. Thank you, Mr. Chairman.

[The chart follows:]

Social Security's Real Rate of Return by Birth Year



Source: Social Security Administration, Office of Research and Statistics Working Paper Series Number 59, February 1994

Chairman THOMAS. Thank you. The gentlewoman from Connecticut, Mrs. Johnson, the chairman of the Health Subcommittee, wish to inquire?

Mrs. JOHNSON of Connecticut. Yes, I do. Thank you, Mr. Chairman.

Secretary O'Neill, I am very pleased that you are focusing today on the long-term solvency of Social Security and Medicare. There are no two programs that are more important to every senior in America and every person under 65 in America. They are not only important to our parents, but they are important to ourselves and our children, and if we do not start taking the long view we will destroy these programs and the very fabric of our society, in our estimation.

I notice that you do mention in your report that to bring just the HI Program into solvency over 75 years we would have to increase the payroll tax 60 percent or reduce the benefits 37 percent. Now that is serious business, and I regret the focus on this short-term budget controversy. We all know the politics of that. When the urgency of the long-term view is so great, and anyone sitting on this Committee or Member of the Congress, House or Senate, could read last year's GAO report, which says that by 2030, this was a year ago and so it is a different figure and I understand that, but even then they were talking by 2030 that Social Security, Medicare, and Medicaid would absorb all together 75 percent, three-quarters, of all available revenues, 75 percent. So it is urgent that we not only look at the problems in Social Security and Medicare, but that we adopt more modern management techniques so that the growth in these programs will be sustainable.

We talk about sustainable development in urban areas. A lot of my Democratic colleagues are interested in that. I am interested in sustainable growth in Medicare and Medicaid, and in order to get there, in Social Security at least, we do have a pretty good idea of what it would cost. So we have a number of proposals developed in the Congress about how to deal with it, and we hope now with leadership from the executive branch we will be able to do it. But in the area of Medicare we have made it harder to understand what our total program obligations are rather than easier.

Two years ago, when the administration proposed moving home health from A to B, of course A looked better. Great. What an accomplishment. B looked worse. We didn't notice that. There is no report required about B. So we can't just shift costs from one fund to another. We could do that forever. We could get $2 trillion if we shifted some big things out of part A and it would look great, but our problem would be exactly the same.

So have you given much thought as to how we develop a solvency standard that would give us an understanding of the total program costs in Medicare, their growth rate, and what we could expect in terms of solvency as a whole so we can better focus on how do we manage this growth so it can be sustainable and we can deliver not only today's Medicare benefits but prescription drugs, terribly important, turn the program into preventive health? It is absurd that you can't get a physical exam under Medicare.

We have big work to do, but we can't do it unless we have some help with understanding when the program is solvent and when it is going to be insolvent and those kinds of very basic issues, what are we spending and how much money do we have coming in. And to say it will come in more and more from general revenues is absolutely absurd, and I hope we won't talk about that because, sure, if we do that, by 2030 three-quarters of all revenues would go to these programs. What a disservice to our children and grandchildren. It is outrageous to imagine that we could so rob them of the resources to have a good education system, good roads and bridges, adequate national defense.

So on this issue of a solvency measure, so we can know where we are going and what we are doing, have you given, have the Trustees given any thought to how we go about this?

Secretary O'NEILL. Well, we are a new group of Trustees save for the two public Trustees. We had our first formal opportunity to meet yesterday and to review these figures, and I think we were unanimous in our view of being struck by the enormity of what these projections for Medicare suggest for both the composition of our economy in broader sense, the notion that more than 30 percent of our gross national product would be consumed by health and medical care, and the consequence of the composition, as you suggest, for Federal tax and Federal benefits is really quite awe-inspiring, to say the least.

We have resolved we will meet together as Trustees to think about and talk about these subjects going forward, but I would say again I think the Trustees have by statute a very clear demarcation of their role in being the financial, fiduciary area that you all can rely on to tell you in a nonpartisan way what the financial condition is and what it will be if the laws are not changed, either with regard to taxes or benefits. And so I think it is fair to expect the initiative for suggesting changes and working with a Congress, with the administration rather, so we don't muddy the role of the Trustees in discharging their very clear financial responsibility.

Secretary O'NEILL. In that regard, the President has already indicated to you that he intends to appoint a commission on Social Security; and he is ready to begin working with the Congress on the fundamental reform of Medicare. And I think that is where the impetus will come from, those thrusts, rather than from the Trustees themselves.

Chairman GRASSLEY. The Chair recognizes Senator Rockefeller, the Senator from West Virginia.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Mr. Secretary, I want to go back to what our ranking member on the Senate side indicated in his questioning because I didn't really hear an answer. He didn't, I didn't, and I think it is a very important question.

First I want to say, though, that when you—every time you talk about a prescription drug benefit, like the President, you also talk about reforming Medicare, those two things. Are you saying that unless there is reform of Medicare—and I would posit to you that there is no consensus within the Congress to make that happen, general reform of Medicare; are you saying that unless there is a general reform of Medicare, that you would oppose a prescription drug benefit?

Secretary O'NEILL. Quite the contrary, Senator. I think the President has said he would be very happy to have his prescription drug proposal active on a stand-alone basis. But what he has heard, and I thought it was a bipartisan hearing, is a preference on the part of the Members to undertake a broader reform of Medicare and not settle just for prescription drugs.

Senator ROCKEFELLER. That is—the point I am making is that you are making the assumption if we are going to have one we are going to have the other. And what I am just positing to you for the sake of this discussion is that I don't think that the consensus is anywhere near to the point in Congress where we can, on a broad basis, reform Medicare as most people would interpret that to be. Therefore, we are left with the question of can there be a prescription drug benefit if there is not broad Medicare reform in the eyes of the President and the Secretary of the Treasury?

Secretary O'NEILL. I guess I would defer to the judgment of the Senator as to whether or not the Senate is interested in doing a stand-alone change. My sense is, that is not where the will of the Senate is.

Senator ROCKEFELLER. And Senator Baucus asked you to try and talk about where the money came from, how the administration proposed closing the gap on Medicare A and B. And he made the point, as I would, that none of the reform proposals really addresses the long-term solvency question. And I again would ask, what are your proposals with respect to closing that gap?

Secretary O'NEILL. All right. I guess I am not prepared to give you a full-fledged range of proposals for how we close the gap in Medicare. And the President has said we are going to, or he is going to appoint the commission to work on how we close the gap in OASDI, and I think you will see that happening in the next few weeks.

I frankly don't know anyone who has, until yesterday maybe, except for insiders, seen the size of the Medicare projections that we are facing if we don't do anything, because this work was completed in December under the previous administration, asked for the formation of a special panel to evaluate the assumptions about the growth of medical care obligations going forward. And it was in December when Secretary Summers was still here that they got a report with the panel members agreeing that for the Trustees' purposes we should use an assumption that medical care expenses in the United States would grow not at the rate of gross domestic product, but at the rate of gross domestic product plus one. And the consequence of that, as I have said before, is to suggest that if we don't do anything different, that more than 30 percent of the gross national product of the United States is going to be consumed by health and medical care in the year 2075.

I think in 1965 or 1970, we were at 6 percent, and we have doubled since then. And this suggests another doubling. And I don't know anyone who has contemplated that prospect and created a set of proposals to either change that outcome or figure out how we are going to pay for it.

[The following was subsequently received:]

President Bush is committed to protecting Social Security for current and future retirees through bipartisan reform. Social Security is much more than a retirement program. It also provides critical benefits to survivors and disabled workers. One of the basic principles of the President's approach is that Social Security modernization must preserve the disability and survivors components of the program. I would expect the President's Commission on Social Security reform would carefully evaluate the effect on the Disability Insurance program of all reform proposals they consider, and make certain that the President's commitment is fulfilled.

Senator ROCKEFELLER. My time is about to run out. I have a final quick question.

About 10 years ago we started—or more, we started in Senate Finance debating managed care, managed cost, whatever you want to call it, plans. And there was at that time a rather broad agreement by a surprising array of people that managed care, managed cost plans, however you want to—what they do is they save money for the first couple of years except for those that have very long histories, but after that they stop saving money. Do you disagree with that?

Secretary O'NEILL. No, I think that is the correct reading of the evidence. And I guess I would like to make clear, in my earlier remarks, that is not what I had in mind. What I had in mind and what I think I could demonstrate to you, maybe with a field trip to southwestern Pennsylvania, is that it is possible to achieve a level of health outcome performance that is so wonderfully better than what we have accomplished that there is a way that we can both pay for obligations that we would like to undertake on behalf of the American people and, if you wish to, expand the scope of care by a very substantial amount and reduce the price at the same time. Because if one examines the range of non-value-added work, if you can characterize it that way, that occurs in the delivery of health and medical care, it is truly amazing how much room there is for improvement to the benefit of patients and to human beings. But it is going to take very systemic reform.

I will give you one indication of a kind of reform, because I know you all have your own connections to your health and medical care system out there; and next time you have an opportunity, I would urge you to go to your local doctors or your local hospital and talk to them about what it feels like to be a provider these days. Many of them—at least the ones that I know, and I know hundreds, if not thousands of them—feel that they are the enemy because the signal they get from here is that they are people who are out there only to make money.

Most of these people are so altruistic, they have dedicated their lives to helping others; and the signals they get from the way we reimburse and the way we talk about medical service delivery personnel is that they are the enemy. And we have so structured the process so that it is very difficult for medical professionals to tell each other when they have made a mistake and therefore to learn from it, because if they do so, they risk the danger of losing their right to provide medical care.

And this is a tip of an iceberg of the systemic problems that we have created out there, with the very best of intentions, since we began moving further and further into reimbursement systems and ways of characterizing those service providers as the bad people in our society.

With a change in that attitude, we can make a fundamental change in the value of delivery that we capture out there in health and medical care.

Senator ROCKEFELLER. Thank you, Mr. Secretary. Thank you, Mr. Chairman.

Chairman THOMAS. Does the gentleman from New York, Mr. Houghton, wish to inquire?

Mr. HOUGHTON. Thank you, Mr. Chairman.

Mr. Secretary, good to have you here. Thanks very much for your honest answers. You know, I can understand why the Joint Committee, the Finance Committee and Ways and Means only meet every 75 years. If I were Secretary of the Treasury, I wouldn't want to be facing this panel.

People asked, where does the money come from? This is not a complicated question. It doesn't come from the sky. It comes from us. And we here will decide where that money and in what proportions it is directed.

We have got a great system; we have got to keep funding it. There are huge numbers involved. It will require changes. We have got to get at it soon, and it is our problem. But as General Marshall used to say, Let's not fight the problem.

And so maybe you could describe a little bit about this commission and what you hope it will accomplish.

Secretary O'NEILL. Thank you.

The charter hasn't been written yet, but there are some drafts working in the present thinking about the compositional structure and the timing to be provided, but always true to the idea that beneficiaries, both current and near-term prospective, can count on the Federal Government to discharge the obligation that all of you have said they should expect to see.

I guess aside from that very important baseline idea is an idea that this undertaking may be the most important thing this administration can do in domestic and social policy to finally provide leadership and create some nonpartisan agreement to solve this problem while there is still time to do it in a reasonably graceful way, but with a real determination on the part of the President that he may and will deliver on the commitment that he made in the course of his campaign for the office, that he will help to produce a solution that the American people can count on and believe in, and that he will deliver the benefits that are promised and, at the same time, hopefully, move us into an era where we have more—we have more wealth creation and asset accumulation on the part of individuals to help with their own retirement and medical care needs than they would under traditional concepts.

Mr. HOUGHTON. Thank you very much.

Chairman THOMAS. Does the gentleman from California, Mr. Herger, wish to inquire?

Mr. HERGER. Thank you, Mr. Chairman.

And I join in welcoming you to our Committee this historic time, Mr. O'Neill.

The trustees' report tells us that, absent reform, general revenue transfers will ultimately constitute the largest single source of income to the Medicare program as a whole and would place a large burden on the Federal budget. What does this increasing dependence on general revenues mean for the program, and how useful is a solvency definition that only uses payroll taxes and which will ultimately constitute minority program revenues.

Secretary O'NEILL. Well, if we—as we move; I should not say "if"—as we move to a greater degree of general revenue financing, we are really saying that these program entitlements are a general draw on the tax revenues of the American people, independent of anything else; and that whatever obligations may be voted and entitlements may be written into law, that there is no connection between the source of the revenues and the people that use them. So, in effect, we are destroying any linkage of those who pay and those who receive the benefits.

And I suppose one could say, as we do, that we are becoming in this area an income transfer program; or I guess—not to use a pejorative term, but to say it in the way most would say it—becoming a welfare program rather than a self-supporting contributory program.

Mr. HERGER. I thank you, Mr. Secretary. No further questions, Mr. Chairman.

Chairman THOMAS. Does the Senator from Louisiana, Mr. Breaux, wish to inquire.

Senator BREAUX. Thank you, Mr. Chairman. And thank you for helping to convene a historic joint hearing with the House and the Senate. I take it that a joint markup session on the tax bill is probably not likely?

Chairman THOMAS. I will tell the gentleman if we could pull this off, we will try.

Senator BREAUX. Thank you, Mr. Secretary, for being with us. I think tomorrow—and, in fact, today and probably tomorrow as well—many of headlines in the newspaper will basically say something along the lines that Medicare is in pretty good shape. And I think that those headlines would be terribly misleading.

I sort of compared it to a person going to his doctor for his physical and having the doctor tell him he is in pretty good shape after only taking his blood pressure. Because what we have done is to—in the Trustees' report is essentially focus in on Part A, which covers only about 55 percent of the Medicare costs. So of course it is going to look good. Had it not been for what we did in 1997 in transferring a portion of home health care to Part B, plus other changes that we made, we would be insolvent today.

So, I mean, the report, while it is valuable and people are here to get the results of it, I think it can tend to be incredibly misleading because it basically looks at Part A and says, Pretty good shape, folks; it is a little bit better than last year; in fact, for 3 years, it has run a surplus.

So the question is, how do we get serious about talking about the condition of Medicare by looking not only at one part of it, but both parts of it? I mean, you have to do more than just take the blood pressure of Medicare. You have to look at everything, including home health care and doctors and everything that we shifted over to Part B. Obviously, if we put hospitals into Part B, Medicare would be in good shape for eternity; it would be fine because everything is in Part B and nothing is left in Part A.

In the Breaux-Frist bill that we have pending over on the Senate side, we said there should be a point when you look at the general revenues being spent on this program in determining whether it is in good shape or not. Now it is about 34 percent of all of Medicare costs to pay for out of the general Treasury; and we suggested that when it gets to be 40 percent—pick a number, we said 40 percent—that you ought to have a relook at what we are doing with this program and recalculate whether we want to continue just to shift more of it into general revenues.

Does this administration have an idea about that concept? Because I think this is—while it is valuable, it is like not reading the rest of the story. We are only looking at part of it. We look at Part A when Part B becomes larger and larger.

Do you have any comments on that?

Secretary O'NEILL. Senator, I welcome your question. As I indicated, yesterday is the first time that the Trustees have met together since this administration was formed. And we agreed that we will have another meeting fairly soon, but partly at the request of myself, the Chair, to provide an opportunity for us to talk about exactly the kinds of things you are suggesting that we could bring to our work in the next year.

But I am very mindful of wanting to stay within a strict interpretation of what the law tells the Trustees they are supposed to do.

Senator BREAUX. I understand that. What do you think about the proposed change, though?

Secretary O'NEILL. I think it would be helpful to ask the Trustees to think about helping medical care, without regard to A and B, in the context of what it is we have obligated ourselves to do for that population; and to give some advice to the Members of this Committee, more broadly to the Congress and the American people. Because I think the context is clearly more appropriate and doing it that way could reduce the misunderstanding that people have that we have already seen in today's headlines, celebrating that things are better, which suggests a pretty superficial reading.

Senator BREAUX. Let me ask a second question on Social Security.

You saw a chart up there. It talked about the recent rate of return on Social Security being invested in Treasuries; it was 1.8. I think it is probably closer to 3 percent or slightly under 3 percent.

Some of us have suggested the concept of allowing Social Security folks to be—that is a 1994 chart? Don't you all have anything more modern than that? Whose chart was that? That is 7 years old; I think it is probably different.

Anyway, the concept of doing what we all can do up here and putting a portion of our payroll into a retirement account that we own; and we suggested 2 percent. And some said, Look, the market is going down the last couple of days, it is a terrible idea, although over a 20-year period, which is a normal period that people invest in retirement, we have never had a negative rate of return in the market.

How would you comment as to the concept of allowing potential retirees to put a portion of their payroll tax into a private retirement account?

Secretary O'NEILL. It is a very good question, and I think you provided exactly the right indication of how to think about this thing.

If you look at the rate of return on equity investments in the United States back to, I guess I would say recorded history, let's say back to 1875—I don't care when you choose a start period or end period, unless it is yesterday—you can find any reasonable period of time, 20 years or 30 years or 40 years, where the rate of return on equity investments was not greater than 4 percent. Again, the long run rate of return on risk-free investments—which, let's say, are Treasury securities—is something on the order of 2.5.

And so there is not a question about the difference in the rate of return between risk-free investments and long-term investments and the equities of the U.S. Economy as a general matter. And it is true, if you look at the last 6 months, you couldn't make that claim.

But even if you extend yourself back 3 years or so, or 4 years, you will find that equity investments always win. And when one is planning a retirement account, especially as we put people into their first employment engagement in the United States, say at age 20 or 21, and look forward for 40 or 45 years, there is no question, at least not in recorded history, that one would be better off invested in the general equities of the United States than in risk-free returns.

Senator BREAUX. Thank you.

Mr. SHAW. If I could say to the Senator, this is the latest data that is available to the Social Security Administration.

Senator BREAUX. Does that show a rate of return in risk-free of 1.8?

Mr. SHAW. That is as to what is put into the system and what is getting out of the system as far as retirement benefits.

Chairman THOMAS. Tell the gentlemen, as you go out in outyears, rather than look at actual wages and conditions of the market, they run a percentage in the outyears. And we are comparing obviously significantly different periods, but return on it is a percentage. And as you can see, it went from 25 percent in the early years to 1.8. And that line continues to narrow to just slightly above 1 percent out around 2030, 2037.

Does the gentleman from Louisiana wish to inquire?

Mr. MCCRERY. Yes, Mr. Chairman.

Mr. Secretary, the discussion from today has been somewhat revealing, I think. There has been a lot of talk about Part A and Part B and the trust fund and the solvency; and the bottom line is, Part A and Part B represent an anachronistic structure that was created 35 years ago and has little relevance to today's health care system, and we ought to junk it. That ought to be our goal, to junk Part A, Part B, and come up with an overarching reform of the system which will change some of these horrendous figures that we have been hearing.

And I want to follow up on Ms. Johnson's line, looking at Social Security Medicare and Medicaid costs vis-a-vis the budget of the United States. She used the year 2030. If you go out to 2075, and look at these costs, they will consume about 100 percent of the budget if we keep spending at the Federal level about 18 percent of GDP, which is what it has been historically—100 percent of the budget. That means we don't get to pay any interest on the debt. We don't get to pay anything for defense, for highways, for environmental protection, nothing.

So clearly we have a problem that is bigger than Part A or Part B or who gets what. We have got to figure out a way to stop these programs from growing so rapidly. Never mind Social Security; I think we can take care of that fairly easily. Medicare and Medicaid are much bigger problems and much more difficult to solve. But if we don't, I believe—look at the entire health care system and get away from this notion of trying to solve Medicare. I am not sure we can solve it, Mr. Secretary.

I hope the administration will look beyond just Medicare and Medicaid and show a little more vision, frankly, than has been shown in this town for the last few years when it comes to health care. Because if we don't, I don't think we can change these numbers significantly, and the result will be a tremendous increase in taxes to cover the costs.

And probably part of that answer will be to simply expand Medicare for everybody so that we have one health care system controlled by the government and paid for through the tax system. That is where we are headed, and these numbers are undeniable in that regard. This is exactly where we are headed if we don't show some vision and come up with a different path to follow that will avert this kind of situation.

So, I urge you, Mr. Secretary, to use some of the thinking that I heard you say here today about some different ways to deliver health care and pay for health care. We have got to start thinking outside the box on this question or we are going to be in a box, big time, and there is no way out except for the government taking over health care and establishing a budget and rationing health care. That will be the answer that we come up with, and I certainly want to avoid that if at all possible.

Would you comment?

Secretary O'NEILL. Well, thank you. I certainly agree with you.

To maybe deepen the notion with a few facts that you are talking about, I suppose most of you know about the concept call Six Sigma. What it means, in a million events, a million repetitive events, that there will be 3.4 mistakes in a million events. And to put it in context where we are in medical care, if you look at medications in the United States, one in every 2,000 medications is wrong. Think about that in the context of Six Sigma.

And, again, it is not to be accusatory nor to find fault in the consequence of lots of practices, many of which are now being replaced. But if you think about the scribble on a little white pad and the error potential that exists with that scribble not turning into the right medication; or maybe in a broader sense, that scribble not being integrated in an information system with other medications a patient is taking so that the formulary and the computer can tell you when there is a contraindication about combining drugs.

Then you begin to see the potential of the number of people who wouldn't have to be in the hospital except for the fact that they have a medication error, or those who are there for an extended stay because once they got to the hospital, they got what is called—the so-called nosocomial infection, more commonly known as a staph infection; and you begin to put number values on how much money we could save by doing things right the first time.

In my mind there is no doubt that we can simultaneously improve outcomes for Americans, but make the medical profession more rewarding for those who are in it and simultaneously deal with the financial considerations which have been the focus of most of a national involvement in health and medical care over the last 35 years.

Chairman THOMAS. The gentleman's time has expired. Does the gentleman from Michigan wish to inquire?

Mr. CAMP. Thank you, Mr. Chairman.

Just to follow up a little bit on what my colleague, Mr. McCrery, said, in the Balanced Budget Act 1997, home health coverage was shifted from Part A to Part B and that extended the life of the trust fund by 6 years. And if we took some other items, for example—and no one is seriously proposing that we do that, but for example, if skilled nursing were shifted from Part A to Part B, that would impact the trust fund by almost $300 billion.

I guess my point is that these mere bookkeeping changes have significant ramifications for the solvency of the fund. And I think—a comprehensive look at the viability of Medicare as a whole, I think is needed, and I think that his point is well taken. I guess I would be interested in your comment on that, and then I have one other question.

Secretary O'NEILL. I agree completely with what you have said.

Mr. CAMP. All right. The trustees' report tells us that without reform general revenue transfers will really be the largest single source of income to Medicare, and obviously that would have significant effect on the Federal budget. What do you think this means for the program and how useful is a solvency definition that only uses payroll taxes which will—actually will not be a majority of the program revenues?

Secretary O'NEILL. My own view, as you can probably tell from the things that I have said this morning, is that we need to look at the substance of what it is we are paying for. Because I am convinced that no matter how hard we may try, making even well-intentioned modifications to reimbursement formulas doesn't get at the need to, or even the system toward, creating value instead of responding to signals from Washington that are an economic model that assumes—that we can devise signals to health care providers, to hospitals and doctors, that somehow will keep the costs down and simultaneously produce good results.

I think all the evidence we have for 35 years now is to the contrary. In fact, if I have time, I would give you an example of the perversion that occurs because of our reimbursement systems. If you are a bypass patient and you go into a hospital, and one looks at the reimbursement performance or you look at the discharge performance, what you find is that the average discharge date after surgery is 5.9 days. And so the reimbursement formulas reward institutions that discharge people before 5.9 days and they penalize institutions that keep people longer than that. And so the reimbursement formula is economically designed to get people to do what the data say the average should be.

The thing that data don't show you, unless you look at individual patient experience, is this: that 20 percent of the people who are discharged in a way that rewards people for getting out early are readmitted to another hospital within the next week, many of them with complications, and many of them die. But because of the way the reimbursement system is designed, that is OK.

Our signal to the system is, get out early and if it causes to you have complications or death, it is a new event. And so, from a financial point of view, this is what we reward. It is not what we intended, but it is because we are not designing our systems to be human-being, patient oriented. We are designing them to make sure that somebody doesn't stay too long or some doctor doesn't charge us too much.

It is only an illustration of the problems that we have created with the very best of intentions as we have become less oriented toward health, medical care, and more oriented toward accounting as we are being eaten up by program costs that come here that have to be paid for somehow.

Mr. CAMP. Thank you very much. I yield back.

Chairman THOMAS. Does the gentleman from Michigan, Mr. Levin, wish to inquire?

Mr. LEVIN. Thank you.

You get Michigan twice in row, Mr. Secretary. Welcome. I just wanted to be clear, so we are all talking from the same figures; I want to go back to discussions about the surplus and the contingency fund.

On page 185 of this blue budget book, it has a figure of 842 across from Contingencies. Now, is it your understanding that the 842 includes the projected Part A surplus of 526 billion?

Secretary O'NEILL. I am sorry, I don't have that book with me. Here we are. The way that this table is constructed, it is in that number. Yes, it is in that.

Mr. LEVIN. So the 842 includes the 526?

Secretary O'NEILL. And one could argue it is partly in the 417. Because, again, Mr. Levin, it is——

Mr. LEVIN. I mean, does the 842 include essentially the 526? The part A——

Secretary O'NEILL. I would say it is arguably all in the debt service. This is a table that shows distribution of funds. It doesn't deal at all with the ongoing obligation to use funds that are collected by Medicare and Social Security taxes for the purposes that they were collected.

This is a question of funds flow. There is not a question of what the obligation of the United States is to the people who sent in funds for Medicare and Social Security. And so it is——

Mr. LEVIN. So you are saying, you don't think that the Part A surplus of 526, which is more than 417, is debt service that relates to the increased amount of debt service because of the use of funds other than for debt service.

Secretary O'NEILL. It is arguably—you know, because of the way the table is constructed, you have Social Security surplus, and that is a number and that number is generated by how much money is going to be paid in for Social Security. And as everyone has said, we should subtract that from the 5.6 and then the proposed number for tax relief.

Mr. LEVIN. I understand that. But, please, because Secretary Thompson was here and we went through this, your position is that the 526, which is the projected Part A surplus, is or is not part of the 842?

Secretary O'NEILL. It is arguably a debt service and indeed because debt service of 417 is arguably part of the contingencies. But again it is a mixing of concepts between what are the obligations of the Federal Government and what is the available flow of cash that we have available.

Mr. LEVIN. The Social Security surplus is listed separately. That is a cash flow thing too, so why don't you list the Part A?

Secretary O'NEILL. You could put—if you would like, you could put the 526 in additional needs debt service and contingencies. I think it is——

Mr. LEVIN. Let me ask you then, is it your position or not that the projected Part A surplus should be used only for Part A purposes?

Secretary O'NEILL. Absolutely. There is no doubt, by law, money that is collected from the people for Social Security and Medicare benefits can only be used for those purposes.

Mr. LEVIN. Could I ask you, as a key Member of the administration, within the next few days, to submit a revised table S–1 that lists separately the Part A surplus, like you do the Social Security surplus. Will you do that?

Secretary O'NEILL. Indeed. I will give you a table that differentiates in the clearest way I know how from a cash flow—the thing to me, this continuing discussion is a misunderstanding of the difference between cash flows and the balance sheet of the Federal Government, which includes accruing liabilities. And I would be very happy to give you those statements so that you will have them.

Mr. LEVIN. OK.

Chairman THOMAS. I am sure there were not that many people who followed that discussion. I just want to make——

Mr. LEVIN. It is an important discussion.

Chairman THOMAS. It is, and that is why I wanted to make the point because it was not as clear as it needed to be. Because we are discussing trust funds and surplus and a Contingency Fund. The problem of course is Trust Fund is misnomered and the Contingency Fund is a misnomer. But I believe the impression has been left thus far that the only Trust Fund in surplus in the Contingency Fund is the Part A Trust Fund. It is my understanding that there may be as many as three dozen or more other trust funds that are in surplus that are also covered in that Contingency Fund.

Is that correct, Mr. Secretary?

Secretary O'NEILL. Yeah, that is right.

Chairman THOMAS. So we have between 30 and 40 trust funds that are in surplus that are included, not just the Part A. And the assumption that you are to break out the Part A implies that there is only the Part A Trust Fund that is in surplus in the Contingency Fund when, in fact, there are more than three dozen.

Mr. LEVIN. Could I just say, then, we need a figure as to how the 842 is derived and what trust funds are included within the 842. Because then you are saying if you are not going to use Part A except for Part A, then you are going to use other trust funds.

So we should get from you, if I might say respectfully, and from the administration, a clear outline of table S and what in the world is in that Contingency Fund.

Chairman THOMAS. I told you what I heard from the Secretary was the Medicare Trust Funds and the Social Security Trust Funds should be used only for Medicare purposes and Social Security purposes. That is what I heard the Secretary say.

Mr. LEVIN. But then they wouldn't be included in the 847.

Chairman THOMAS. Does the gentlewoman from Washington, Ms. Dunn, wish to inquire?

Ms. DUNN. Thank you, Mr. Chairman.

Mr. Secretary, we like it when you return to be with us so often. It is really a pleasure to have you. I too worry about, referring to what Mr. McCrery said as thinking outside the box—as we reform Medicare and Social Security, I worry a lot about the Medicare system being a typical bumbling bureaucratic agency that is nonresponsive to the needs of the real world and lagging way behind it, becoming like a stone around the neck of what we are really doing out there in health care these days.

I think, for example, of innovative technology that Medicare is so slow in being able to accept when new devices and new drugs provide a choice for seniors and add no greater expense. So I am sympathetic on that discussion.

I wanted to ask you a question, Mr. Secretary, with regard to Social Security and with regard to the gender inequity problems that we run into in Social Security. As I began to study this system over the last few years, I learned time after time that there are inequities that arise from the systems having been written in the midthirties when women stayed at home. In fact, married women could rarely get jobs out of the Depression. Single women, including my own mother, had to go to Alaska to get a job teaching.

So it was written in a way that protects women who stay at home—certainly a massive safety net, more I think than we needed to.

The system currently continues to discriminate against married working women to the extent that where their salaries generally during their lifetimes are less than their husbands, and often they take time away from work to stay at home caring for children or elderly parents or for one reason or another. At the time of retirement, most women are going to get as their Social Security benefit 50 percent of their husband's Social Security. And so, during the time that the woman is working, if she is married, she is continually giving out of her paycheck month after month after month large amounts of money that are being wasted if you figure that a stay-at-home mom, who never goes into the workplace, will get exactly the same 50 percent of her husband's Social Security. That is one example.

I am wondering if there is any thought as we move toward reform in your shop about how this works? I am wondering if you could just give us some of your thoughts on these problems and if there are ways to find solutions to them.

Secretary O'NEILL. Well, you know, I think you put your finger on a problem that we see even in the broader tax system with the convention of the so-called "marriage penalty." We have got lots of artifacts of the change in the way we really live, compared to when these things were started 65 years ago. And it does seem to me that we need to begin to treat human beings as human beings, independent of their gender.

And we clearly have not gotten around to that completely yet. But it is something we should have high on our priority list, that we not penalize people based on a convention that existed long ago that no longer holds for most of us and our families.

Ms. DUNN. Thank you very much, Mr. Secretary. Thank you, Mr. Chairman.

Chairman THOMAS. Thank you. Does the gentleman from Maryland, Mr. Cardin, wish to inquire?

Mr. CARDIN. Thank you, Mr. Chairman, I do. Then I will yield to one of my colleagues.

Let me make an observation: I don't think there is a disagreement from the Trustees' report or from the experiences I have heard on both sides of the aisle that we have serious, long-term problems in both Social Security and Medicare that need to be addressed. I guess my disappointment is that there isn't more attention paid to the one solution that I think would be the best at this point, and that is a bipartisan budget, so we have agreement as to what the economic plan of our Nation should be.

And we are moving forward, I regret, in a partisan way, Mr. Secretary. We have already passed some bills out of this Committee that speak to taxes without speaking to an overall game plan, and in the Budget Committee it looks like we are moving toward a Republican budget and a Democratic substitute. And personally, I think the best thing we could do now is to reach bipartisan agreement on the budget that speaks not only to tax cuts but also speaks to Social Security and Medicare.

And the second point I would raise as we talk about efficiency within the Medicare system is that the trustees' report contains a very interesting observation. And that is that 17 percent of our Medicare beneficiaries are in a Medicare+Choice managed care plan, and 17 percent of the trust fund is spent in those plans. So I would say to those who think that the private sector plans are bringing about savings, that doesn't bear out.

So we really do need to take a look at what we are going to do to deal with the Medicare system itself, rather than just throwing seniors into managed care and believing that will be the solution.

Let me, if I might, yield the balance of my time to Mr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Cardin.

I sit on the Budget Committee. This evening we are going to get a document and tomorrow we are going to mark it up. So I have a very important question to ask you and that is about the assumptions made by the trustees and by the President's budget. Because you sit with two hats, I want to know which one of the Paul O'Neills I should believe.

We have a trustees' report here on page 54 on last year's Medicare Trustee Report that says that the real GDP is assumed to average 2.3 percent over the short-range projection, 1999 to 2009. Now, if you go to this blue book on which we are supposed to write a budget tonight, on page 199 it says that the assumption for real GDP growth is 3.1 percent. Now, that is a conflict for me; 2.3 versus 3.1 is a whole bunch of money. I made the mistake of reading the Washington Post this morning before I came in here.

What they say is that the surpluses would virtually disappear under the economic predictions used by the Trustees.

So which prediction of growth are you going to use, 3.1 or 2.3, so that tomorrow when we mark up, I will know what to tell Mr. Nussle in the Budget Committee.

Secretary O'NEILL. Well, as I am sure you appreciate, these are separate preparations and the Trustees' report is a consequence of decisions that were put in place by the last administration. And——

Mr. MCDERMOTT. You had a chance to look at them and change them.

Secretary O'NEILL. But in order not to create even the possibility of someone thinking that these matters that are reported by the Trustees are political or that we would change in a way without having an opportunity to examine the underlying assumptions which have been worked on by some of the best economists in the world for 61 years now, it didn't seem to me it was appropriate to change the assumptions.

Do I have a question about long-run assumptions about rates of productivity and real growth? I do. But it frankly didn't seem appropriate to bring—to change the assumptions of the Democratic administration without careful, considered, deliberate thought process.

And so I am here to represent to you, I think if one looks at the numbers that you have in front of you from this report for a 75-year period, they make the point very clearly—and it is not a partisan point, I hope—that we, the people who are supposed to be doing the business of the American people, have a serious need to make substantial modifications in Social Security and Medicare.

In the budget documents that you got, you got our best judgment about what the near-term rates of growth are, and there is no doubt that there is an expectation that they are going to be better than the numbers that were used by the last administration to calculate forward 75 years' worth of prospective obligations and benefits for the American people. I don't find it remarkable at all that for these two very different purposes, one near-term and one very long-term, that you have different things in front of you.

Chairman THOMAS. The gentleman from Maryland's time has expired. Our last inquiry will be the gentleman from Georgia, Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. It is always refreshing to have a witness that talks about cash flow, because that is what this whole system is about. That is what each one of these programs is about, cash flow, individual cash flow. That is where it originates. That is where the money comes from.

There have been several questions, the same question asked several times this morning: Where does the money come from, whether it is closing the gap from Part B to Part A in Medicare or whether it is Social Security or what. But let's take a look at it. Where does Social Security insurance funding come from, Mr. Secretary?

Secretary O'NEILL. It comes right from the American people.

Mr. COLLINS. In the form of a payroll tax, sir?

Secretary O'NEILL. That is right.

Mr. COLLINS. And the Social Security insurance program that we have today is formally known as a pay-as-you-go system; is that not true?

Secretary O'NEILL. That is true.

Mr. COLLINS. What is the definition of a pay-as-you-go system, Mr. Secretary?

Secretary O'NEILL. In this case what it means is that we are collecting money from the working population and we are using it to pay benefits for people who are already beneficiaries.

Mr. COLLINS. And that has been the system all along, has it not?

Secretary O'NEILL. Yes, sir, it has.

Mr. COLLINS. What has happened in the past when we ran short of funds in the pay-as-you-go system, in the payroll tax?

Secretary O'NEILL. We raise taxes.

Mr. COLLINS. Yes, sir. And that is possibly what could happen again if we don't address the system itself.

As Chairman Alan Greenspan, whom we all hope to hear some good words from this afternoon, stated in this Committee—it was January the 20th of 1999—if you are ever going to solve the Social Security problem, you have to end the pay-as-you-go system and devise a new system.

But where does the Medicare Part A come from Mr. Secretary? Where does that cash flow come from?

Secretary O'NEILL. It also comes from the payroll tax.

Mr. COLLINS. And what has happened in the past when we had a shortfall of cash flow there?

Secretary O'NEILL. We either raised taxes or we moved objects of expenditure out of the fund into another fund.

Mr. COLLINS. What happened in 1993? Was that not the last tax increase on Medicare Part A, for Medicare Part A?

Secretary O'NEILL. I believe, yes.

Mr. COLLINS. It raised the tax liability on Social Security receipts as well as took the cap off of earnings; did it not?

Secretary O'NEILL. That is right.

Mr. COLLINS. I believe we also had a report along the same time, around 1994–95, that we would have a negative cash flow and the Medicare Part A fund would be bankrupt prior to this date; is that not true?

Secretary O'NEILL. That is right.

Mr. COLLINS. In the 1997 Balanced Budget Act I believe we had some measures in there that revised some of the Medicare system, it extended the life of it; did it not?

Secretary O'NEILL. Right.

Mr. COLLINS. If hasn't hurt one benefit, has it?

Secretary O'NEILL. No.

Mr. COLLINS. What about Part B, Mr. Secretary? Where do those funds come from?

Secretary O'NEILL. A little piece of it comes from the payroll tax and the rest comes from the general revenue and—that is to say, from the taxpayers, from all of the taxpayers.

Mr. COLLINS. I believe 25 percent of it is deducted from Social Security checks; is that not true?

Secretary O'NEILL. That is right.

Mr. COLLINS. The other 75 percent comes from general taxation, general funds right?

Secretary O'NEILL. Correct.

Mr. COLLINS. Those are all entitlement programs, are they not?

Secretary O'NEILL. They are.

Mr. COLLINS. What is the definition of an entitlement program, Mr. Secretary?

Secretary O'NEILL. It means—as I understand the term, it means you will get it.

Mr. COLLINS. If you fit the criteria to the plan, you are entitled to the funds; is that not true?

Secretary O'NEILL. That is right.

Mr. COLLINS. It has been said that we should move with caution, Mr. Secretary. Do you agree with that? I do.

Secretary O'NEILL. I believe we ought to move with deliberate speed caution.

Mr. COLLINS. I agree with that, speed but with caution.

But I am also reminded of the cash flow of this system in 1995. In January of 1995 the Congressional Budget Office estimated over the 10 years from 1995 to the year 2004 we would have a $200 billion a year negative cash flow and that was above and beyond the payroll tax. In fact, it was equivalent to over $3 trillion in the 10-year gap.

Now, I believe Mr. Crippen back there has testified before this Committee on the budget, and we hear reports that over the next 10 years, we will have over $5 trillion positive cash flow; is that not true?

Secretary O'NEILL. That is true.

Mr. COLLINS. That includes Social Security and Medicare, as well as other taxation?

Secretary O'NEILL. It does.

Mr. COLLINS. So there are plenty of funds in this cash flow that we could do and meet all of these programs, but we would have to revise some of the systems themselves in order for it to be long-range solvency of each, right?

Secretary O'NEILL. That is true.

Mr. COLLINS. We can also give tax relief to those who are paying out of their cash flow into this Treasury, with the funds to meet all these programs. Sir, I believe fully if we look after the cash flow of individuals at home, the cash flow of the Treasury will take care of itself. Thank you for being here. Thank you for your commonsense approach to government.

Secretary O'NEILL. Thank you.

Chairman THOMAS. I thank the gentleman.

I do want to thank the Secretary. I want to thank all members and apologize to those who were not able to inquire at this particular hearing. But we will have additional hearings.

And I especially want to thank the chairman of the Senate Finance Committee for his willingness to go forward for the first time in more than 75 years with a joint hearing. My hope is that we found this useful and would do it again, Mr. Chairman.

Chairman GRASSLEY. I found it very useful and I do look for an opportunity to do it again when it is convenient for both of us.

Thank you very much for your hospitality. I look forward to this process and other communications we have to bringing a closer working relationship between the Ways and Means Committee and the Senate Finance Committee and, in turn, between the U.S. Senate and the U.S. House of Representatives on the substance of the issue of Social Security and Medicare.

I would use Medicare as an example, when ladies—usually ladies that are older—come up to you in your town meetings and say, "Just leave my Social Security alone," and that is generally not said in anger. But we can no longer allow the idea to be out there that if you just leave my Social Security alone, everything will be all right.

We have to take that opportunity to explain that probably as far as that lady today is concerned we can leave her Social Security alone and she will be okay. But we have to ask the question, does that lady want Social Security for her children and grandchildren that are coming on; if that is the case, we must do something and the sooner we do it, the better.

Thank you for your hospitality.

Chairman THOMAS. We can't escape the fact that we are both going to have to do it together, or it doesn't get done. I thank the gentleman. This hearing is adjourned.

[Whereupon, at 12:08 p.m., the hearing were adjourned.]

[Submission for the record follows:]

Statement of the Healthcare Leadership Council

The Healthcare Leadership Council (HLC) thanks the House Committee on Ways and Means and the Senate Committee on Finance for the opportunity to submit this statement for today's hearing on the 2001 Medicare Hospital Insurance Trustees' Report.

The 2001 Trustees' report, at first glance, sends a positive message that the exhaustion of the Hospital Insurance Trust Fund is being pushed further and further off into Medicare's future. Indeed, Medicare solvency through 2029 reduces the urgency we felt just five years ago when bankruptcy was anticipated by 2002.

But, unfortunately, while lawmakers are relieved of the immediate pressure to reformulate Medicare for longevity, current and future beneficiaries are being deprived of the potential that a revitalized Medicare program has to offer.

While focusing on the financial health of the Medicare program today, we believe there are two important points to keep in mind. First, there are numerous accounting and other caveats to consider before giving the HI Trust Fund an absolute clean bill of health, several of which the Trustees wisely acknowledge in their report. And second, trust fund solvency, no matter how extensive, does not translate into value for Medicare beneficiaries or taxpayers.

I. The Reality of the Numbers

There are a number of contributing factors to Medicare's increased life span. They include recent and temporary program changes, the likes of which cannot sustain Medicare solvency forever, as well as—what may be—tenuous estimates of economic growth and medical inflation.

(1) Major program changes affecting the life of the trust fund include:

The Balanced Budget Act. Provider payment reductions resulting from passage of the BBA has dramatically slowed Medicare spending—more so than was projected at the time of passage. From 1998 to 2002, annual spending growth is expected to average only 3 percent. The substantial documented hardship these reductions have created demonstrate that continuing provider cuts in the current Medicare program cannot be depended on to sustain Medicare in the long run. While the Medicare, Medicaid, and SCHIP Balanced Budget Refinement Act of 1999 (BBRA) and the Medicare, Medicaid, and SCHIP Benefits Improvement and Protection Act of 2000 (BIPA) slightly eased some of these provisions, "the overall net impact of all these Acts still reduces HI expenditures substantially," according to the Trustees' report.

Transfer of Home Health Benefits from Part A to Part B. Immediately upon passage of the BBA, the Medicare trust fund bankruptcy projection was changed from 2001 to 2007. What many do not realize is that barely two of these additional years were attributed to provider cuts. The majority of the solvency extension was due the transfer of $174 billion in home health spending over 10 years from the Part A trust fund to the Part B trust fund.

Relieving the Part A trust fund of this high cost item—has contributed significantly to the healthy *appearance* of the Hospital Insurance Trust Fund. However, transferring the responsibilities of the Part A trust fund to the mostly tax-payer funded Part B trust fund is not an option for ensuring that the Medicare program can continue to provide high quality health care benefits in the future.

"Fraud and Abuse". Major fraud and abuse enforcement efforts, including expensive lawsuits, have led providers to billing Medicare even less than they legitimately could. The Chairwomen of the Medicare Payment Advisory Commission expressed strong concern before this committee last week that evidence of hospital "downcoding"—or billing Medicare below the cost of their services in order to avoid investigations—could be very harmful to both hospitals and patients in the long term.

(2) Economic factors that could affect Medicare's projected life span:

Range of Trustees' Assumptions. The Trustees note in their report that under a less promising, higher cost economy, Medicare bankruptcy could occur as early as 2016 instead of the 2029 predicted under the intermediate economic scenario. By the Trustees' own admission, projecting the health of the trust fund, even a short time into the future, can yield precarious estimates.

CBO Cost Assumptions. In its recent *Long-Term Budget Outlook*, the Congressional Budget Office noted that the Medicare Trustees' assumptions regarding health care expenditures were far more optimistic than their own: "The Medicare trustees remain more optimistic: they assume that cost growth in excess of wages and demographic changes will slow not by half [as CBO predicts] but to zero in 2025 and thereafter."

Trust Fund Revenues. Today's robust economy means higher wages and more employment. For Medicare, this means that the 2.9% Medicare tax has applied to a much larger base of payroll in recent years. Employment taxes flowing into the HI trust fund increased dramatically by 8% in 2000 (from $132.3 billion in 1999 to $144.3 billion in 2000). Such revenue increases cannot be depended on in the coming years. Besides the possibility of the economy slowing down, the number of people working and paying the Medicare tax will soon begin declining as baby boomers begin retiring in 2010. Once the baby boom generation has fully entered retirement by 2030, workers paying the Medicare tax for each beneficiary will decrease from the current 4.0 to 2.3.

Medicare Part B Expenditures. The Hospital Insurance trust fund report paints only a fraction of the picture of Medicare's overall well being. The expenditures described in this report represent little more than half of overall Medicare program spending, the other portion of which is derived from over $100 billion in general tax revenues and beneficiary premiums. Unlike the Hospital Insurance Trust Fund spending, Medicare Part B spending is not policed for solvency and therefore is allowed to grow unrestrained.

II. Solvency Does Not Equal Value for Beneficiaries

The optimistic trust fund numbers reported this week give no indication of the value these Medicare expenditures are providing to Medicare beneficiaries. An important question to ask is: Should the delay in Medicare's bankruptcy placate the need to improve this program for Medicare beneficiaries now? While the trust fund report provides a warning for the beneficiaries of the future, it indicates nothing about whether today's beneficiaries are receiving the best health care that can be purchased with the expenditures indicated by the Trustees.

Even more dire than Medicare's budgetary problems is Medicare's inability to keep up with private insurance coverage or with advances in health care technology. An explosion in research has made the control and prevention of disease more veritable than ever. Yet Medicare beneficiaries do not have access to prescription drugs, limits on catastrophic out-of-pocket spending, many preventive benefits, and a number of other health care products and services that are now enhancing and saving the lives of those with employer health insurance including those enrolled in the Federal Employees Health Benefits Program.

Despite the optimism expressed in the Hospital Insurance Trustees' Report, comprehensive Medicare reform is still necessary to ensure high quality of care for today's and tomorrow's Medicare beneficiaries. Today's dated Medicare program needs to be replaced with a private, value-based, competitive system. Under such a system, plans and providers would compete with one another to offer the most efficient, high quality, and user friendly care. By embracing the innovations in health care delivery, benefit design, and cost management techniques that have occurred in the private sector, Medicare can expand its benefit package and still serve the huge number of enrollees that will come with the baby boom retirement.

The Healthcare Leadership Council urges the Committees overseeing Medicare to work in a bipartisan manner to develop a plan for restructuring Medicare for the long term. The members of the Healthcare Leadership Council stand ready to assist in your efforts to move Medicare toward assuring that, in the near future, its beneficiaries are able to take advantage of the full potential our health care system has to offer.

The Healthcare Leadership Council is a coalition of chief executives of the nation's leading health care innovators including teaching hospitals and other hospital systems, pharmaceutical manufacturers and benefit managers, medical technology companies, and insurance companies. The HLC was formed in 1988 to give leaders across the health care industry the opportunity to work together to achieve a health care system that fosters quality and innovation and provides access for all Americans to affordable coverage and high quality health care.