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TREASURY SECRETARY PAUL H. O'NEILL TESTIMONY BEFORE A JOINT HEARING OF THE HOUSE COMMITTEE ON WAYS AND MEANS AND SENATE COMMITTEE ON FINANCE
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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.

<u>Social Security</u>

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.