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1995 ANNUAL REPORT OF THE SOCIAL SECURITY AND DISABILITY TRUST FUNDS

HEARING

BEFORE THE

SUBCOMMITTEE ON

SOCIAL SECURITY AND FAMILY POLICY

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

ONE HUNDRED FOURTH CONGRESS

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1995 ANNUAL REPORT OF THE SOCIAL SECURITY AND DISABILITY TRUST FUNDS

FRIDAY, APRIL 7, 1995

U.S. SENATE,
SUBCOMMITTEE ON SOCIAL SECURITY
AND FAMILY POLICY,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:30 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Alan K. Simpson (chairman of the subcommittee) presiding.

Also present: Senators Chafee, Breaux, and Conrad.

OPENING STATEMENT OF HON. ALAN K. SIMPSON, A U.S. SENATOR FROM WYOMING, CHAIRMAN OF THE SUBCOMMITTEE

Senator SIMPSON. The subcommittee hearing will come to order. Let me first say how pleased I am to convene the hearing of the Subcommittee on Social Security and Family Policy, and particularly recognize the Ranking Member, Senator John Breaux.

John and I have worked together during our entire time here in the Senate. We also played with another third rail of politics; he was Chairman, and I was the Ranking Member of the Nuclear Regulations Subcommittee. So, we get all the wonderful work. That was always a tough one, filled with emotion, and anguish, and elements of just plain fear as we dealt with that.

That was always a great pleasure, so I look forward to working with him once again as we enter into another area that is filled with plenty of emotion, plenty of distortion, plenty of fear, and try to do something.

I would say, in my memory of the Senate, whoever Chaired this committee was targeted for disaster politically. I believe that it was finally abolished so that no one else would get hung up in the meat house after doing their work in this area. So, this is kind of like the gathering of the third rail Chowder and Marshing Society, or something of that nature.

Senator Bob Kerrey will be here to testify this morning, and we will look forward to that. When he comes we may interrupt some of the activities so we will take his statement at that time.

But in my mind, the real third rail is not what will happen to politicians, it is what will happen to people between 18 and 50. There is the third rail. When you visit with your own children and your own grandchildren and they say, I am not planning on anything out of Social Security, and they are dead serious, absolutely dead serious, and to think that they are paying in more in Social

Security tax than they pay in income tax, and they are still saying that, knowing they are getting nothing, it will not be long until their disgust reaches a proportion which I think will be disruptive in society.

When they know that there are 3.3 people paying in today and in 20 years there will be two people paying in. When I was a freshman at the University of Wyoming in 1950, and John was very young then, just a child, there were 16 people paying into the system and one taking out; now we have 3.3 people paying into the system and one taking out.

They are paying in more, as I say, than they are paying in income tax, and it will not last long before that wellspring of frustration comes from the younger persons in this country.

So, today we are going to focus on the recent report of the findings of the Social Security and Medicare Board of Trustees. I reviewed that and the summary. It will be with respect to the Social Security Retirement and Disability programs.

At a later date, the full Finance Committee will hold a hearing which will be solely on the financial status of the Medicare Trust Fund, which is headed for more imminent disaster, and much faster than any other program, because the doomsday date now for that program has been moved to 2002, which is not too far away, 7 years.

I guess the cheery note is that last year, it was 2001. So, it would be like telling a cancer patient, you lucky person, you have, instead of 5 months to live, you have six months to live.

So, I am going to leave that all to Robert Packwood and Pat Moynihan, and they will do a beautiful job, and John and I will police up after them with regard to that one.

This is an excellent committee that works in a very smooth way, without bipartisan bickering, without trying to figure out how to lay a land mine under the troops on the other side, and it is a very, very fine work atmosphere, and it is work. We have a fine staff. They work closely together.

It is a pleasure to be a part of the committee. I came to the committee simply because I wanted to do something with what I learned on the Entitlements Commission. It seemed absurd to remain on the Entitlements Commission for nearly a year and not go somewhere you could do something with it, because the President ignored every single sentence of it. I am not trying to lay partisan bait, but I would have thought, since he appointed the commission, appointed the Chairman, Bob Kerrey, of his party, and John Danforth, a member of this committee—a very able pair, they were—that some part of the recommendation would find its way into the State of the Union Address.

Not only was not a single word of it included—and we know what is happening, we know where the engines are that are driving us to where we are going—but you will note, because you pay close attention, they dropped all reference to the intergenerational aspects, which was in last year's budget, which was a very serious section of the law for the budget.

It said we are to be aware that there are severe transfer issues between generations which will be critical. It was a powerful statement. I admire that greatly. There was no reference to that whatsoever. So, those are things we will pursue.

On Monday, the Trustees gave their report regarding the financial solvency of Social Security and Medicare. The news is sobering, it is stark. It ought to send shock waves through anyone who cares about future generations of Americans. All present and future retirees should be aware of the information in the Trustees' report. They must pay attention to it. It shows that a day of reckoning is most surely coming. There will be no more games of "dodge-'em."

The Trustees are not some band of extremists. We have the study of Robert Rubin, the Treasury Secretary; Robert Reisch, the Labor Secretary and fellow thespian; the spirited Donna Shalala, HHS Secretary; the conscientious Shirley Chater, as Social Security Administration Commissioner; and two Public Trustees that are here today with many years of public policy expertise, Stanford Ross and David Walker.

According to these Trustees, none—not one—of the trust funds meets the long-range test of financial solvency. In other words, none—none of them—will be solvent in 75 years, and we all know that.

Under the best estimate—and I hope we will see how those are defined a bit, best estimate, high, low, intermediate—of what the future holds, which assumes moderate inflation and economic growth—and I have been here 16 years and have never seen any of those figures ever correct, not once have I seen inflation figures correct for economic growth, but we are not going to use those this time, I hope, in the budget debate, because those often shade the issues. I am not talking about this debate.

So, the Trustees report that the Social Security Retirement trust fund will be exhausted in the year 2031. That date moved since last year, 2 years. It is difficult sometimes. But that, again, is like being told, you lucky fellow, you have got 6 months to live instead of five.

The Disability trust fund will run out in 2016, and the Medicare trust fund, as I say, will be depleted, gone, exhausted in 2002. I like the word that the Trustees use, exhausted; we call it flat busted broke out in the Wild West. That will be depleted in the year 2002.

Here comes my colleague, so I am going to wind up. John will have a comment and then we will go directly to Senator Kerrey.

But these figures are not based on hysteria, fiction, or partisan advantage, because I know the respect that you two have, with all of us, in the political community. Even though you are selected on the basis of a "Republican" and a "Democrat," you are much more than that, you are solid thinkers and you have done a beautiful job in your time for 5 years.

So these are cold, hard, painful facts. No one can refute them. And if we all care about our children and our grandchildren we will take appropriate action and we will take it now, thoughtfully, incrementally, slowly, so that we do not wait until 2005 to do a six percent payroll tax hike, or whatever we might do at that time. So we have to do that now to prevent the Trustees' forecast from coming true.

Some of us may well disagree on what specific action should be taken, but we must all come together in acknowledging that a most serious problem exists and that corrective measures are long overdue and very necessary. We must act now, before the crisis is fully upon us so we do not just wait around and do what we always do, and that is just slap a little more tax, and reduce a little more benefit, and go on.

I would just conclude and recognize my colleague with the thought of my first memories of what was occurring here when Senator Moynihan and company tried to save the system, and did, in the early 1980s.

Guess what was the date they gave us for the doomsday date when they did that fine work. The doomsday date was 2063. Since the early 1980s now, the doomsday date is 2031. Something is very wrong. We are expecting the people that know the system best to give us some very direct answers, exceedingly direct answers, as to what we do.

So, John, if you have a few comments, then I will introduce Senator Kerrey.

OPENING STATEMENT OF HON. JOHN BREAUX, A U.S. SENATOR FROM LOUISIANA

Senator BREAUX. Well, thank you very much, Mr. Chairman. It is my pleasure to once again join you as a member of your subcommittee. The last time we did it, as you said, I was the Chair, you were the Ranking, and you have turned the tables on us, but I trust that we will still have the superb relationship that we had in those previous days.

You mentioned that I Chaired the Nuclear Regulatory Subcommittee. I would think that the Social Security Subcommittee is also nuclear, as are many aspects of the tough issues that we have to deal with. I hope that we can really make a very serious contribution to both discuss the problem and also propose solutions that are realistic.

Clearly, the Social Security system has some very serious problems facing it. Fortunately, I think we have a little bit of time in order to look at various options, and to do so in a very studied fashion, as opposed to being forced to rush to judgments in a 24-hour or a three-week emergency period. That is not to say we do not have to act and act very promptly, but I think that we do have some time to make some very serious proposals and have them considered.

The Social Security system will be able to pay all of the benefits fully for the next 35 years. I think a lot of people do not really realize that. That is a short time, but it is not running out of money tomorrow. So, we do have some time to make recommendations that are going to be good recommendations and that can be enacted.

I would point out that the problems are very clear, but the solutions are not clear, the answers are not clear, and they are certainly not easy. It is going to call on the Congress to make some very difficult political recommendations and decisions if we are going to ensure that future generations will have the system available to them.

I am looking forward to the panel. I am particularly interest in the problems associated with Medicare. We have proposals that are now pending in this Congress to cut Medicare by anything from $100 billion over 5 years, to $150 billion over the next 5 years.

I personally think that we cannot tinker around the edges. It is not a question of shifting money from one account to another account, or combining Part A and Part B premiums.

That is not going to solve the Medicare problem; it is a much larger problem. It is a fundamental problem with how we treat people who are ill in their senior years.

A fee-for-service program under Medicare is the most inefficient that we could possibly ever have written, and I think fundamental substantive changes in Medicare are going to have to be made in order to help get the system back into balance. So, the challenges are many.

I will quit talking so we can start finding some solutions to the problem. Thank you, Mr. Chairman.

Senator SIMPSON. Thank you, much, John.

Let me just read into the record a very short statement of Chairman Packwood, stating that he is pleased that I am calling this subcommittee hearing, and that we will explore the financial status of the Social Security program as presented by the report. He regrets he is unable to attend the hearing, but will be very interested in the information and suggestions obtained here.

The release of this report at the same time as the Annual Reports on the Social Security trust funds, as he describes it, is a serious financial crisis for the Medicare program and calls for immediate action.

Due to a full hearing schedule, he is unable to hold a hearing on the Annual Reports on the Medicare trust funds this week. Finance Committee Members will have the opportunity to explore the financial condition of the Medicare program at a hearing on April 25, 1995, shortly after the Senate returns from the spring recess.

He has invited all of the Trustees of the Medicare trust funds to appear at the hearing and engage in a discussion with Finance Committee members on possible solutions for addressing this serious situation.

He concludes, "Putting the Medicare program on a sound financial footing to secure it for future generations will be one of the highest priorities of the Finance Committee over the next several months." I know the man; that will be done.

So, now if we could go to Hon. Robert J. Kerrey, Senator from the State of Nebraska. You have obviously spent a great deal of your time studying this grave insolvency issue we address today. I admire you greatly, admire your guts and your courage, even though I was out campaigning for your opponent last fall. But I was never saying anything bad about you, I was just always speaking on her behalf, you see. A very fine distinction. Right, John?

Anyway, I guess the admiration comes from all of us on both sides of the aisle, that you were up for election last year and you took on this political hot potato and you voiced the unpopular in talking about Social Security, Medicare, and Medicaid, and Federal retirement, and you are charging ahead again with it with the entitlement reform torch and a long Olympic run, and have other duties within your own party.

So, it is a great pleasure to have you here, and you will share with us some of your thoughts.

STATEMENT OF HON. J. ROBERT KERREY, A U.S. SENATOR FROM NEBRASKA

Senator KERREY. Thank you very much, Mr. Chairman, Senator Breaux. Yes, I appreciate your not saying anything bad about me when you came out in Nebraska, particularly since both you and I know that there is plenty that you could have both said and used.

Let me begin by asking that my statement could be included in the record, and then make some observations about Social Security, in particular.

Senator SIMPSON. Without objection.

[The prepared statement of Senator Kerrey appears in the appendix.]

Senator KERREY. I will not comment on Medicare, although Medicare, in many ways, is a much more pressing problem. But I would like to comment, instead, on Social Security, since it is the most controversial and difficult one to approach.

Senator Danforth and I, when we made our recommendations and put our proposal out, were accused of proposing something that dismantled Social Security and eliminated a very important social insurance program. No rational examination of our proposal would reach that conclusion, but unfortunately that was the response.

So, I am very much aware that any proposal to reform Social Security is apt to be greeted with unfair and inaccurate attacks and, thus, I think it might be more useful for the committee to hear my own observations about Social Security as opposed to focusing on Medicare.

First, I think it is significant, although we still did not make it on page one with the Trustees' report—when the Trustees came out with the report this week it was on page D-23 of The New York Times—it was at least a lengthier story than would normally be given to the Trustees report.

I find the Trustees' report to be a very straightforward evaluation of what the current status of the various trusts are in, and reinforces my very strong belief that action sooner, rather than later, is needed.

Second, let me observe that this really is not an ideological problem. This is not a problem that was created by Ronald Reagan, or George Bush, or Bill Clinton. The liberals did not do this, the conservatives did not do this. This is a demographic problem. We have a very large generation of baby boomers, about 45 million, that in roughly, over a decade, are going to retire.

The simple way of describing that generation is that my generation did not have as many babies as our parents thought we were going to have. Had we had as many as they had, why, perhaps we would not have this problem that we have got today.

But we are going, in a single decade in the State of Nebraska, to see significant changes. In one decade, from 2010 to 2020, the "under-65" population of the State will increase by slightly less than 2 percent, and that is an optimistic forecast. It has been relatively flat for the last 50 years. But the number of retirees will increase 28 percent. In a single decade, that will happen.

The third thing I will say is, we focus a great deal on the benefits. The people will come up to me and say, gosh, I hope you will protect my Social Security benefits. Make sure you protect my COLA, they will say. Make sure you give me what has been promised me, because I am counting on that benefit.

Well, what is very often left unsaid to the individual or to the country in that environment is, in order to have a benefit I have to have a contribution. There must be a contribution that enables me to make the benefit.

And though the Trustees' analysis shows some reason for optimism since we have, in the Old Age and Survivor Trust, in excess of $400 billion, roughly 1 year of required payments, it must be said and understood by the country that the 12 percent tax that we levy on wages does not represent savings. It does not represent savings. I emphasize that.

It represents a need on the part of the Social Security system to generate the money to be able to make payments. So, even though we have $400 billion in the trust, Social Security is not operated like a private pension system.

The benefits that are being paid out are not being paid out as a consequence of us setting aside income that has been deferred for the purpose of waiting until there is a retirement need when our productivity drops off, for whatever the reason.

So that is a very critical observation to me, because not only do I think the Social Security system needs to be reformed—or, more properly stated, the Federal retirement systems need to be reformed—as a consequence of the Trustees' evaluation of what the long-term actuarial balance is, but I believe the system needs to be reformed as a consequence of the Nation needing a much higher rate of savings, and of individuals needing higher rates of savings.

So we understand this, one of the most painful observations in the current system is that the Social Security investment accounts include only one investment, Treasury bonds, a very low-yield investment. In fact, I think the real rate of return is 1-2 percent, or slightly more than 2 percent, somewhere in that range. It is a very low rate of investment.

Well, if you have said, well, gee, why do we not convert that, why do we not convert that to a higher yielding account? That would be an attractive thing to do. Why do we not take the money that we take from wage earners and put that in, let us say, S&P 500s, or put it in some kind of an equity fund that might return 8-10 percent?

Well, the answer is, you cannot do that, because we are using the revenue not only on a pay/go basis, but we are also using the money that is coming in to fund our deficit. Thus, we are compelled to say, in addition to it not being a savings program, in addition to it basically being one of a transfer payment for people who are currently in the work force, we are not able to get a higher rate of return because we have the need to use this money to keep our deficit lower than it otherwise would be.

Mr. Chairman, Senator Breaux, and now Senator Conrad, I would make three recommendations in general. One, we need to bring the Social Security Retirement system into balance sooner rather than later, for two reasons.

One, the demographic problem that is unique. This is not like we faced in 1983, where we could wait right to the last moment and then get together Republicans and Democrats and say, we have to do it because we are going broke.

Now I have a big change in demographics heading our way, where the number of people working per retiree is going to go from roughly five to one down to three to one in a relatively short period of time. It is not like previous moments that we have had.

Second, if you are trying to save money for retirement, one of the most painful things that you face in that kind of a scheme is, there are two variables. One, the amount that you contribute, and the time that you contributed. The longer the period of time you contribute, the more that you have got at the end.

If somebody going into the work force today at age 20 set aside $75 a year over a 45-year period, that individual will have more at the end of 45 years than somebody who sets aside $1,500 a year, starting at age 50.

There is magic in compounding interest rates, if you get it on your side and get it early on your side. So, both for demographic reasons and for mathematical reasons, there is a need for us to address this problem sooner rather than later.

The second recommendation I would make is—I hope not disrespectful of the Trustees—I believe we should change the law and create an independent Trustee arrangement. I am not saying that I think that political appointees are going to come in and cook numbers, but I do believe that we must recognize that we are running the largest insurance company in the world, paying out some excess of $300 billion a year in benefits, receiving over $400 billion a year in income.

We are receiving a tremendous amount of cash coming in, cash going out, and we have obligations, not just today, but we have obligations to every one of the 265 million Americans living right now. They will be future beneficiaries.

It is an insurance program, and we have to operate as an insurance program. If it was operated as an insurance program, in my judgment, with independent Trustees, those independent Trustees would come in and say, Senator Kerrey, you have a fiduciary obligation to act now, today.

Do not come in and try to say, well, it is not really a serious problem because I will have enough cash to pay out until the year 2010, then I start using interest. I do not really run a deficit until 2020. We are running an insurance company. We have future obligations that we cannot meet.

If we had an independent board, in my judgment, that was running this thing like a pension, running this thing like an insurance program, they would be coming to us and saying, you members of Congress write the law that governs this, and you have got to change the law sooner.

Again, I hope I am not being disrespectful of the Trustees. They would not giving us a signal that they are not encouraging a delay with Medicare, but they are giving us a signal, in my judgment, with their language, that it is all right to kind of wait a little while longer which, in my opinion, strongly felt, that is very bad advice.

Third, I believe that the Social Security system needs to be changed so that it begins to resemble a private pension. I am not arguing that it be privatized, I am arguing that if we want to increase the power of the economy of the United States of America there is no sure way to do that than to increase national savings.

Imagine the impact of this program if a large percentage, if I was withholding 12 percent of wages and that really was savings, accumulated as deferred income until the moment of retirement, you would have an extremely powerful savings program and an extremely powerful impact upon the economy of the United States of America.

It is not that, it is a defined benefit program. It has been operated as a pay/go system, and I think it would be enormously beneficial, both to the economy and to the individuals who are retiring, if we change the law and made Social Security begin to resemble more of a private pension system.

Mr. Chairman, Senator Breaux, and Senator Conrad, I appreciate the opportunity to testify. I look forward to any questions that you might have of me.

Senator SIMPSON. Thank you very much. Let us set the clock for 5 minutes, and we can go a couple of rounds if we want to. But I want to assure that we all have an opportunity, in the order of appearance, like we do here in the committee.

Let me ask you, do you really think that we can get some kind of a bipartisan correction here in this year?

Senator KERREY. Well, Mr. Chairman, let me answer that by becoming religious for the moment. I believe in God. I waver every now and then, I must confess. I am very appreciative that my church believes in the Doctrine of Original Sin.

But I had a recent moment that I can site as testimony to my constant need to leap and acquire faith. When you, sir, ran for the Majority Whip and lost, the rumor was—and I will report the rumor, not necessarily the fact—the new Majority Leader wanted you to be on the Finance Committee in place of a not-to-be-named other Senator. You made it to the Finance Committee and, low and behold, had a sufficient amount of seniority to be Chairman of the Social Security Subcommittee.

I, on the other hand, in a weak moment, said yes to the new Democratic leader, Senator Daschle, to be Chairman of the Democratic Senatorial Campaign Committee, charged with the responsibility of electing Democrats to the United States Senate.

When you and I discovered that we have a shared interest in attacking this problem and presenting a solution to the American people, we now have, I think, an opportunity to break the ice, to break the log jam, to go to the American people; the Republican Chairman of the Social Security Subcommittee, and Democratic Chairman of a committee designed to go get people like yourself that are up for election in 1996, and instead say, on this issue, it will not be partisan.

On this issue, the need to be responsible about taking action today so that our children know that we are putting our political money where our mouths are, so as to make sure that we take action as quickly as possible to increase the national rate of savings which, again, I emphasize, is the source of our capacity, that is where we get money to invest in plant, equipment, training, to lift our productive capacity, so that hopefully, with two or three workers instead of five workers in the work place, we have got the productive capacity to be able to support the increasing number of retirees.

That is where the wealth comes from, our willingness to defer and to invest. As a consequence of this rather unique position that you and I are both in, and our shared interest, I feel much more optimistic today than I was a year ago that we might, in fact, be able to change the law, if not in 1995, hopefully in 1996.

Senator SIMPSON. Would you share with all of us the hideous deficiency when we discuss the word "cut" of these programs? In other words, I have used it, Senator Breaux just used it. How are we ever going to get the American public to know that when we do take the Medicare down from 10.5 percent increase per year, to let it go up only five percent per year, and the media will describe it as a savage 50 percent cut in Medicare, and when something goes up five percent and is described to the poor, old American public as a savage cut, and children and old people thrown out onto the street, how are you going to handle that one?

Senator KERREY. Well, the only way that I, in my limited, short, and sometimes happy experience in politics, have been successful at getting that kind of thing done, is to take the partisan nonsense out of the room. The only way that can be done is if Democrats and Republicans begin together and say, this needs to be changed.

I say that, Mr. Chairman, because I think you and I are approaching it right on retirement. I am not sure, although I am not on the Budget Committee, that that is happening when it comes to approaching overall entitlements.

I believe the President made a serious mistake in the beginning of 1993 with deficit reduction by beginning the proposal as a Democratic proposal and then going out and trying to get some Republican to support it rather than beginning and saying, I am a Democratic President and I think the deficit is a serious problem, and I want to ask Republicans to join and accept Republican ideas. Republican ideas are, on some issues, different than Democratic ideas. It seems to me, when it comes to making the Medicare system not only work for Americans who need to have their bills paid, but also works in terms of making sure that we do not extract so much out of the economy that we kill the goose that lays the golden egg, that we are going to have to start with Republicans and Democrats saying, all right, we will tell the American people there is a problem, we are going to solve it together, there is going to be ideological differences, we will identify what those ideological differences are.

But, when it comes to the point that you make, which is that nobody that I have heard yet is making any proposal that would cut Medicare—even the really hard-nosed proposals merely reduce the rate of growth—the only way that we are going to get that message out, in my judgment, in a fashion that educates the people, is for it to begin with Republicans and Democrats together.

Senator SIMPSON. My time has expired. Let me ask you about your personal situation with time. Are you able to stay here for a time?

Senator KERREY. Sure.

Senator SIMPSON. Because I have the other people that have not yet testified. But I would like to quickly finish this round with you and then, with your approval, we will hear from the other witnesses.

Senator KERREY. I would be pleased.

Senator SIMPSON. Senator Breaux, please.

Senator BREAUX. We will excuse him if he has to leave. Thank you very much.

Senator KERREY. Depending on your question.

Senator BREAUX. Yes. Well, this is sort of typical of Bob Kerrey, where he is willing to get out front and get shot at. If he is still standing after a few months, the rest of us may join in and follow him. We will see what happens to him, first. If he survives, others will follow.

Thank you for your contribution. You have had the courage to say things. And, as Senator Simpson has said, even in your election year, which is, I think, very, very commendable on your part, you still won quite handily. So, it can be done.

I guess the only question I would have to you, Bob, is, when you look at solutions to this huge problem we have, are you recommending what you would term massive changes in the system, or can we accomplish it by tinkering around the edges? I happen to believe in the former, that you are going to really have to have some fundamental changes here, which are not going to be easy.

I would just like to have your thoughts. Have you looked into the crystal ball as to what type of changes we are going to have to make in order to get this whole problem resolved? What are your thoughts about where we should be headed?

Senator KERREY. Well, I think you can do a combination of both, is what I would propose. I would propose that the actuarial balance problem be done with some tinkering. You may not feel like it. That means you have to adjust age of retirement, either the normal or early retirement, or both. That means you have to change the calculation of CPI.

You have to change the internal calculation to affect, not current beneficiaries, but future beneficiaries. Again, the sooner you do it, the more you can give people an opportunity to plan for their own private pension and their own individual savings.

Second, I also think that I would like to look at some basic change, some more radical change. Again, not to alter the Social Security system, but to get it so that it more closely resembles a private pension.

In a private pension system I defer today's income, I put it into savings, it goes either into equity or somebody's debt that I am buying, and I am deferring my income today in favor of being able to have it at a later time, trusting that if I invest it wisely I can actually compound and get substantially more than I otherwise would have had.

I think it would be very wise for us to change at least a part of the Social Security system so it began to resemble more of a private pension. You do not have to privatize it to do that, but you do have to treat it as savings.

You have to take a piece of it and say, this is not going to be pay/go, it is going to be your account, you can watch it grow, you can make a range of investment decisions, perhaps, enable Americans to learn in a very clear way that if you want a benefit you do have to make a contribution, and the earlier you start to make that contribution, the more powerful the compounding is.

Senator Breaux, one of the reasons I like that idea is, in spite of our rhetoric to the contrary, there are not very many situations where the interests of the individual and the interests of a Nation intersect.

And one of those where it intersects very, very sharply is in the area of savings. It is in the interest of the individual to save and to defer income, both for health care and for retirement in any unexpected bill that may come their way, and it is also in the interest of the Nation.

Senator BREAUX. Well, I thank you for your contribution. The thing that really disturbs me, as the panel will testify, we have 35 years left in the Social Security Retirement Fund that you can pay benefits out with no changes, and then it collapses. But in the Medicare hospital insurance, we only have 7 years.

Boy, we have all wrestled with that, you and all of us, in our mainstream forum, trying to do something about health care. We have only got 7 years of money left in that account to pay for Medicare for hospital insurance. That is the real tough one. It is a very, very immediate problem. Thank you.

Senator KERREY. And I will bet you, Senator, if we went out and picked 1,000 Americans at random and asked them, are you aware that we had to essentially transfer a piece of the Old Age money last year into Disability to restore the Disability Insurance Fund, my guess is, out of 1,000, maybe 10 would be aware that in 1994 we did that.

Senator BREAUX. Thank you. Thank you, Senator.

Senator SIMPSON. That is so true. One of the things we all get at the town meetings is, they get up and say, you guys stole from the Social Security Fund. You thugged it, you have spent it; it was not for you to spend. What happened to our trust fund? They do not even know that in these past years we have reallocated billions of their money to other accounts and nobody even told them.

Now, that is something that ought to come up, something I explain to them. There it is, it is all right here. A reallocation, I believe they call it. It comes from the Retirement money and goes to the Disability, and the Disability is all out of whack because it was originally there for the elderly, the blind, and the poor. Children are eating up the seed corn of it. It was never to be part of that. Enough. I have digressed.

Senator CONRAD, PLEASE. Kent Conrad.

Senator CONRAD. Thank you, Mr. Chairman.

I just thought I would try to put in perspective how big the problem is just over the next 7 years if we are talking about balancing the budget because, in my own view, we have a window of opportunity here to balance the budget before this demographic time bomb that Senator Kerrey was just discussing hits us.

That demographic time bomb is, we are going to see, in 15 years, a doubling of those eligible to receive these benefits. That is what is different about what we have seen in the past.

Just over the next 7 years, the blue, $1.2 trillion is what is necessary to balance the budget on a unified basis. If we do not do anything to dig the hole deeper before we start, no tax cuts, no increases in spending in any category, we need $1.2 trillion on a unified basis to balance the budget over the next 7 years.

That assumes we use $636 billion of Social Security surpluses. You add that in, and now you are up at $1.8 trillion to balance over the next 7 years. On top of that, our friends on the House side have just passed $345 billion of tax cuts. Now the hole is about $2.2 trillion to balance over the next 7 years.

Just to put it in perspective, we are getting ready to spend, over that period, $13.2 trillion. But, of course, the interest on the debt cannot be cut; that has got to be honored. On the other side, they have said defense is off limits, and Social Security is off limits.

You take those three combined, that is more than half of the $13.2 trillion we intend to spend over the next 7 years. So now you have about $6.6 trillion to cut from and you have got to cut $2.2 trillion if you are going to balance the budget honestly.

That gives us some idea of the dimensions of the challenge that we face. Let me go to testimony we heard yesterday. I spoke about this with you briefly last night privately.

Yesterday we had Dale Jorgenson, who is the chairman of the Economics Department at Harvard, testify to this committee that there are two serious problems with CPI.

Number one, he says CPI over-adjusts by 1 percent. That over-adjustment makes a difference in our deficit, over 7 years, of $280 billion. It affects both the spending side of the equation because it increases payments, like Social Security payments, and it also reduces government revenue because it is used to index the income tax system.

So, if he is correct—and, by the way, there were four other witnesses, all of whom said it is over-indexed by 0.8 to 1.7 percent, but Dr. Jorgenson said 1 percent—one percent would mean $280 billion over those 7 years.

In addition, he said there is an error in the base that is used to calculate CPI which amounts to $350 billion over 7 years because the housing index that is at the base of CPI calculations is wrong. $350 billion a year over 7 years. Just in those two areas, we are talking $630 billion.

I wanted to just draw that to your attention and ask if that is something that should not be explored as we seek to try to deal with a problem of this dimension. I mean, if we are going to be honest with the American people and describe how big the problem is that we must deal with, I personally think a tax cut, in light of a $5 trillion debt and a hole this deep to fill just to balance the budget over the next 7 years, does not make any sense. That is my own view.

I also believe we should not be raiding trust funds. I mean, you are in business. If we raided your retirement funds of your employees to balance your restaurant's operating budget, I do not think anybody would be very impressed with that. But what is your reaction to the testimony we heard yesterday?

Senator KERREY. I completely agree with it. I do not know if it is half, or one, or 1.2, but there is no question, in my judgment, that we are overstating CPI and we should adjust it. I do.

Senator CONRAD. And this additional item that was provided to the committee yesterday, that the base itself has an inappropriate adjustment in it that goes back to 1983, that that, too, could provide $350 billion of savings over 7 years, seems to me to be an area to be explored.

Senator KERREY. I think it is. That is a benefit calculation. Senator, the point that I am trying to make in addition to that is, when it comes to paying the bills of somebody else, there is no free lunch. One of the most powerful calling cries against health care reform last year was a bumper sticker that said, "If you think health care is expensive now, wait till it's free."

The problem with retirement, is mathematical. If I do not save, I do not have retirement. If I do not have retirement and I want to have some income, I have got to transfer somebody else's income to pay my bills. That is basically what we do.

I do not mind doing that for people who are, particularly, low-income, or disabled, or life has dealt them a tough blow, but increasingly that is not what we are doing.

One of the simple tests on this compounding interest rates—and you made a point on interest—we now have compounding interest working against us as a consequence of the borrowing that we are doing.

We all have seen the increase of net interest. It is stunning, when you think that you are not really getting anything for it. But compounding interest, when it works for you, can be very powerful.

One of the most simple ways to kind of test how this things works, I have been told, is that if you take the rate of return and divide that into 72, that will give you the number of years in which your investment will double.

Well, we currently earn about 2 percent with Social Security, I believe. You can perhaps ask the other witnesses here to come up with that number. But that means it doubles every 36 years, basically. Well, if you got a 10 percent rate of return it doubles every 7 years. Again, there are two variables here that we really have to keep in mind.

It is very difficult for us to do it because we are dealing with people who come up and say, I want something right now. I do not want it 50 years from now, I want it right now. But, if you are going to have that retirement income, you have got to start thinking about it 50 years ahead.

We had a staff meeting yesterday where we were talking about the legislation that Senator Simpson and I was going to introduce, and we had a little sign that would be held up every now and then, "That is a goofy idea."

I would just alert you that the sign was held up when I mentioned the following, which is, if we took $4 billion a year from people like myself who have incomes over $136,000 and open a $1,000 investment account for every new baby in America, and particularly if it was into an equity account of some kind, they are going to get two doublings before they even go in the work force. You are money ahead the quicker you start to save money.

So, what I keep getting to is, in addition to changing the way we calculate what the benefit is going to be, I think we really need to examine the method that we use to make contributions.

Senator SIMPSON. Senator John Chafee. You have been a very prime contributing part of this. Then we are going to go and hear from the panel their presentations, and then we will go around again.

Senator Chafee?

Senator CHAFEE. Well, thank you, Mr. Chairman. I just want to pay tribute to Bob Kerrey, who not only has studied this issue, but is willing to speak out, and speak out during an election year when he is running.

I think it is a tribute to the people of Nebraska that they were willing to listen and to re-elect a person like Bob Kerrey. You are a great person, but your constituents are good, too, because they saw what you were talking about and recognized the problem that is out there.

There are several statements that you make that I think we have got to get across to the public. On page two, "Seniors today enjoy a lower rate of poverty than any other age group." If you take sections by 10-year segments of the population, children from 0-10, 10-20, and so forth, the group with the lowest rate of poverty are those over 65.

Pat Moynihan, on this committee, frequently says that we are the only society in history where children are the group with the highest rate of poverty. That is something we have got to pay attention to.

The statement you make on page one, "while our overall population increases by 2 percent, our retired population will increase by nearly 30 percent" is one that should set off quite a few alarm bells.

I would hope everybody would bring to the public's attention that in the tax cut that passed in the House of Representatives, they eliminate the 35 percent that is on Social Security. That 35 percent all goes into the Medicare trust fund. Is that not right, Dr. Chater?

Dr. CHATER. I am sorry.

Senator CHAFEE. The 35 percent that was added in President Clinton's tax bill, and which is eliminated in the House tax bill, all goes into the Medicare trust fund. Is that correct?

Senator KERREY. Yes.

Dr. CHATER. That is correct.

Senator CHAFEE. So one of the reasons we are holding this hearing today is to look at the Medicare trust fund. And if we, in the Senate, should approve that tax measure in the House, we eliminate the revenue from the tax on the additional 35 percent on Social Security. Am I right?

Dr. CHATER. Well, we never had it in the first place, because it always went into the hospital trust fund.

Senator KERREY. But his question is, if you change the tax law, you would lose that money.

Senator CHAFEE. If you do what they did in the House——

Dr. CHATER. Yes.

Senator CHAFEE. [continuing]. Where they eliminated that tax on the 35 percent of Social Security, obviously you lose that revenue that is currently going into the Medicare trust fund, right?

Dr. CHATER. That is correct.

Senator CHAFEE. And how much is that a year, do you have any idea?

Mr. BALLANTYNE. It is about $5 billion per year when it is fully eliminated. It is phased in over a few years.

Senator CHAFEE. What, the 35 percent?

Mr. BALLANTYNE. Right.

Senator CHAFEE. We do not tax on the 35 percent now?

Mr. BALLANTYNE. Right. If you eliminate that tax, eventually it will be $5 billion.

Senator CHAFEE. Oh. You mean the elimination does not take place immediately.

Mr. BALLANTYNE. It is phased out over about four years.

Senator CHAFEE. All right. But the point I am making here is, anybody who supports that is, at the same time, eliminating income into the Medicare trust fund. All right.

Senator SIMPSON. Big time.

Senator CHAFEE. That is all I had. Thank you. Thank you, Senator.

Senator SIMPSON. Thank you, John. Thank you, Senator Kerrey, very much.

Now we will go forward with our panel. The Honorable Shirley S. Chater, the Commissioner of the Social Security Administration here in Washington. She is accompanied by Mr. Harry Ballantyne, Chief Actuary of the Social Security Administration, Washington, DC; Mr. Stanford Ross, the Public Trustee from Washington, DC; and Mr. David Walker, the Public Trustee from Atlanta, Georgia. It is very good to have you here. We appreciate your consistent and steady work.

Now, if you will testify, please. We will have the time limitation, but we will read your statement. I think questions are important, and we will try to go forward. Thank you very much.

Dr. Chater?

STATEMENT OF HON. SHIRLEY S. CHATER, COMMISSIONER OF SOCIAL SECURITY, WASHINGTON, DC, ACCOMPANIED BY HARRY BALLANTYNE, CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION, WASHINGTON, DC

Dr. CHATER. Thank you, Mr. Chairman. I especially want you to know about Harry Ballantyne. He is not only our Chief Actuary, but he has been with the Social Security Administration for 37 years. So, he is a walking historian as well as an actuarial expert, and I hope that he will answer your questions today.

I want to tell you that I do appreciate being here today to present this testimony, because I think it is particularly important that we bring this issue to the forefront of public discussion.

What I would like to do today is to talk about some of the aspects of the Trustees' report that has just been released so that I can also talk with you a little bit about the Disability trust fund and touch on how we might proceed in the future.

The pertinent facts, of course, are in the 1995 Trustees' report for calendar year 1994. We know that income to the combined trust funds totaled $381 billion, and expenditures—that is, the amount paid in benefits as well as administrative expenses—totaled $323 billion.

I do want to interject here that I am pleased, as always, at the cost efficiency that we have maintained in Social Security in administering the OASDI program; the $2.7 billion spent in administering the program amounted to less than 1 percent of benefits paid during the year.

The Trustees developed estimates based on difficult-to-predict factors such as fertility rates, mortality rates, net immigration rates, productivity increases, unemployment rates, and cost-of-living increases.

They developed three alternatives, as you know: the low-cost, the intermediate, and the high-cost. The intermediate set of assumptions reflect the Trustees' best estimate of what will happen.

Now, under the 1995 intermediate assumptions, the assets of the combined OASI and DI trust funds are expected to grow until the year 2020, and then to decline until they would be exhausted in 2030, 1 year later than was predicted in last year's report.

I would like to say something about last year's report, Mr. Chairman, because, in the 1994 report, we estimated that the combined OASI and DI trust funds would be exhausted in 2029, which was 7 years earlier than the 1993 report, and that is a concern.

But approximately half of that change was due primarily to improvements in estimating methodology, and the other half was due to updated assumptions. Because of those changes, some may have been concerned that the 1995 Trustees' report would push the year of the trust fund exhaustion even earlier but, instead, just the opposite has occurred, and this year's report moved the year of exhaustion to 2030, 1 year later than last year's report.

This is, of course, primarily due to the result of economic and demographic experience. We have had faster growth in the labor force, faster growth in real wages, faster economic growth, increased immigration numbers, and lower unemployment than we expected last year.

Also, based on recent experience, the report projects a higher-than-expected mortality rate over the 75-year estimating period, as well as higher birth rates, through at least the year 2010. These factors combine to yield higher trust fund accumulation estimates and a later fund exhaustion date.

Now, a word about the Disability Insurance Trust Fund. As you are aware, the disability program has expanded significantly in recent years, with the number of people receiving benefits increasing from 2.9 million in 1989, to 3.9 or almost four million in 1994, representing a 37 percent increase.

However, the rate of growth seems to have slowed somewhat, with disability applications and awards remaining about the same in 1993 and 1994, making it difficult to draw long-term conclusions at this point.

So, I would say in summary, in addition to the leveling off of the growth of the disability program the Trustees' report makes two points: that the Social Security trust funds are not sufficiently financed for the 75-year period, and, according to intermediate projections, there will be adequate funding to pay benefits until 2030. I would say that that means we have time to take measured and thoughtful action concerning the fiscal future, that this is not a short-term crisis.

Nevertheless, I hasten to say that it does not mean that we should delay the process. I believe we should develop a bipartisan consensus, a consensus that is supported by a well-informed public, and, if we work together, we can address successfully the challenges that confront us.

My priority has been, and will continue to be, developing the environment that will lead us to that consensus. I look forward to the Advisory Council's report, which is due to be written this summer, and with that, an opportunity for further discussion and dialogue within the Executive Branch, and with members of Congress. Thank you.

Senator SIMPSON. Thank you very much, Dr. Chater.

[The prepared statement of Dr. Chater appears in the appendix.]

Senator SIMPSON. Now, Mr. Stanford Ross.

STATEMENT OF STANFORD ROSS, PUBLIC TRUSTEE, SOCIAL SECURITY AND MEDICARE TRUST FUNDS, WASHINGTON, DC

Mr. ROSS. Thank you, Mr. Chairman, and members of the committee, for this opportunity to appear before you to testify on the 1995 trust fund reports.

Mr. Walker and I have provided you with a statement as public trustees, and, in order to maximize the value of our limited time before the committee, I would ask that you enter our statement into the record and then Mr. Walker and I would like to each make some remarks on our own behalf.

Senator SIMPSON. Without objection, that is so ordered.

Mr. ROSS. Thank you.

[The prepared statement of Mr. Ross and Mr. Walker appears in the appendix.]

Mr. ROSS. I am sorry Senator Kerrey left, but I assume that he has staff here. Before I make some remarks on my own, I would like to respond to a couple of points he made, because I was taken with the thoughtfulness and sincerity of the effort that the Chairman and Senator Kerrey are making.

First of all, I would note that on the idea of having totally independent trustees, that the two public trustees were added in 1983 as a start towards that concept. You might look at our jobs as a start down that path.

You now have about 12 years to evaluate, and particularly the last five when Mr. Walker and I have tried, through both a Republican and Democratic administration, to provide a measure of independence, to consider going further with that concept. I think that is an intriguing thought that was presented this morning.

I would also point out that, however he may read the official trust fund report signed by, first, five, and this year, six, trustees, including the ex-officio trustees, the public trustees have made clear for several years that we are not in favor of delay in addressing these programs, but that we favored acting sooner rather than later. So, the spirit of what Senator Kerrey has said is very much the spirit of what the public trustees have been saying for several years.

We would note in this regard that Congressman Pickle and Chairman Rostenkowski, who, of course, have gone, responded to the calls for sooner rather than later by presenting well-developed bills to address these problems, and we are now very pleased that the Chairman and Senator Kerrey seem like they are going to move forward on this.

I both commend you for your courage and efforts in seeking to provide leadership and assure you that, even though my term as public trustee has expired with the issuance of this report, I personally would do everything within my power to help you with this very important effort that you are undertaking.

I would like to emphasize today, in the few minutes I have, some historical aspects of the long-term effort to adapt the OASDI program to changing economic and social conditions, drawing particularly on my experience as Commissioner of Social Security in the late 1970s, and as a public trustee the last 5 years.

When viewed in an historical perspective, the long-term financing problems that are before us today are not recent occurrences, and the solutions are likely to be complicated to conceive and difficult to enact.

The Social Security program was first enacted by the Congress in 1935 in a limited form. The program expanded slowly over the next 37 years and, in fact, did not reach full maturation until the amendments of 1972.

The extraordinary prosperity of the post-war period from 1945 to roughly 1972 allowed benefits to be expanded and the elderly to share in the economic success of the immediate post-war period.

The result of the matured Social Security program was to remove many elderly from poverty and generally to enhance the security and well-being of workers who were disabled or retired.

However, beginning shortly after 1972 with the oil shocks, stagflations, and the more unsettled circumstances of the 1970s, the Social Security system reflected the economic and social stresses of the time. It became clear that changes were necessary to adapt the program to these changed circumstances and those projected for the future.

Thus, major retrenchments in the program came in the form of amendments in 1977 and 1983. On each occasion, the Congress, on a bipartisan basis, in a complex package of structural changes, both raised payroll taxes and reduced benefits in the interest of providing long-term financial stability to the program.

In addition, the Congress, on two occasions during this period, made significant structural reforms in the interest of improving the programs. Both of these amendments, the Disability insurance reform amendments of 1980 and the OASI amendments contained in the Omnibus Budget Reconciliation Act of 1981, had their genesis in proposals made by President Carter in January of 1979 when I was Commissioner. They were enacted after several years of consideration on a bipartisan basis in the House and Senate, and signed into law by Presidents Carter and Reagan, respectively.

I believe it is clear from even this briefly capsulized history that it is entirely possible—indeed, absolutely necessary—to successfully adapt the Social Security system to changing circumstances and, in particular, to the economic and social conditions that are anticipated to prevail in the next century.

The key to this, in my judgment, is to make programmatic changes. That is, changes in which the programs are reformed on their own terms to provide long- term financial stability for them.

I realize I have overstayed my time, but your staff said I might have an extra minute.

Senator SIMPSON. If you could. Yes, please.

Mr. ROSS. Thank you.

History shows that changes proposed essentially to achieve deficit reduction, or as part of any kind of a legislative program that is not perceived by the public to preserve and maintain these programs for the benefit of not just current beneficiaries but workers who will become beneficiaries in the years ahead, do not fare well.

In my judgment, deficit reduction and Social Security reform, which are both vital priorities for the Nation, can best be achieved when pursued independently of each other. I am not suggesting that they are not interrelated, but I am suggesting that legislative strategies need to take account of the need to develop bipartisanship and broad consensus.

I firmly believe that the problems these programs presently face are serious and need to be addressed promptly. Perhaps the most important step we can take right now is to find ways for people of all persuasions to work together to bring these programs into long-term financial stability, for looking at history almost assuredly tells us that a complex package of structural changes will be needed that involves both benefit reductions and revenue increases, and construction of this package will require a great deal of good will and trust on the part of many people.

Finally, I would submit that, despite the difficulties over the last 20 years in achieving needed adaptations, our present Social Security program has continued to serve the country well.

It is my strong belief that the Social Security program is fundamentally sound, but that it is vital to the welfare of the Nation in the 21st century that it be adapted now in ways to keep it sound in changing circumstances. By making relatively small changes soon and gradually, more radical, disruptive changes can be avoided.

I will be happy to answer any questions you may have about either our statement submitted for the record, or my personal testimony today. I thank you once again for the opportunity to appear before you, and appreciate your sincere commitment in holding these hearings and in trying to provide leadership vital to achieving the needed reforms that are in the Nation's interest.

Senator SIMPSON. I thank you very much, Mr. Ross.

Now, Mr. David Walker, please.

STATEMENT OF DAVID WALKER, PUBLIC TRUSTEE, SOCIAL SECURITY AND MEDICARE TRUST FUNDS, ATLANTA, GA

Mr. WALKER. Thank you, Mr. Chairman, members of the committee. It is a pleasure to be before you today. My comments today will be based upon my experiences as a former Public Trustee of Social Security, a former Assistant Secretary of Labor for ERISA, head of the PBGC, and hopefully an informed private citizen as of the present point in time.

As noted in our written statement, Stan and I recently completed a 5-year term as Public Trustees of the Social Security and Medicare system. During our tenure we attempted to discharge our responsibilities in a professional and nonpartisan manner.

All of our efforts were designed to ensure the integrity of the Social Security and Medicare annual reports, and to improve communications with the Congress and the American people regarding these important social programs.

Among other things, we assured that each of the five annual reports with which we were associated were summarized in a clear, concise, and user-friendly booklet for widespread distribution, and I have a copy of that here, which I imagine all the Senators have been provided.

We also assured that this summary contained a separate and distinct message from the Public Trustees. In these statements we attempted to present certain views that we shared in a professional and nonpartisan manner. These statements, including the 1995 statement, speak for themselves.

As a result, I will focus the balance of my remarks on certain additional matters which, for the most part, go beyond the statement and which represent my personal views.

In my view, when viewed on a combined basis, our current Social Security and Medicare programs promise significantly more than this Nation can reasonably be expected to deliver in the next century, given current and projected budget deficits, known demographic trends, projected health care costs, and other factors.

At the same time, the timing, nature, and magnitude of the financial imbalances facing each of these individual programs—the OASI program, the DI program, the HI program, and the SMI program—are distinctly different.

As a result, in addition to addressing the financial imbalances in each of the respective programs, policy makers need to establish a clear set of program priorities and assure that all related legislative and regulatory actions are consistent with those priorities.

In doing so, I believe that maintaining the financial integrity of, and assuring the public confidence in the OASI program—the Old Age and Survivors Insurance program that provides for retirement income—should be priority number one.

In my opinion, it is the most important of the four programs, both from a social policy and a political perspective. It is in need of reform, but it can and should be placed on a sound financial footing for future generations of retirees. But that reform should begin now, as noted in our 1995 Public Trustees statements, and as we have said for several years.

Unfortunately, recent legislative actions have served to strengthen the financial integrity of the DI and HI programs at the expense of the OASI program. This type of action must not be allowed to continue.

However, given these past actions, while enacting the necessary reforms to the OASI program is important, it is also important that Congress enact much-needed reforms relating to the DI and Medicare programs in order to protect the long-range financial integrity of the OASI program.

This is essential, since Congress has a history of taking from the better financed programs—I might note, better financed over the short-term—and shoring up those programs that are threatened financially, both in the short-term and long-term, some would say, throwing good money after bad.

With regard to the Social Security and Medicare programs, the DI program is in need of reform to address increasing program costs and related disincentives to work. In addition, both of the Medicare programs are clearly unsustainable in their present form and are in need of fundamental and dramatic reform.

All of the needed program reforms should be undertaken sooner rather than later, since delay will only serve to increase the difficulty and the severity of the much-needed program changes.

In addition, we need to provide clear, concise, candid, and timely information to American workers and retirees so they can take the necessary actions to plan for retirement.

In summary, Mr. Chairman, as a baby boomer and a father of two, I am extremely concerned regarding the failure of most, but not all, policy makers, with some noticeable exceptions of people in this room, to stop the process of mortgaging our children's future.

I am also very concerned that we face a looming retirement and intergenerational crisis in this country, and a very real savings deficit that must be addressed. We must have the courage, the vision, and the commitment to address this looming retirement and intergenerational crisis in a timely, effectively, and, most importantly, nonpartisan manner. Doing so is critical to the long-term competitive posture of this Nation, to its economic security, and to the retirement security of American workers and retirees.

Mr. Chairman, that concludes my statement. But let me state for the record that I would be willing, as a private citizen, to do whatever is necessary—within reason, given that I wear many hats—to try to help you address this emerging crisis. I think it is critical. I am happy to help you, and I would be happy to answer any questions you might have.

Senator SIMPSON. Thank you, Mr. Walker. That was very powerful testimony in every way. All of you have presented very good testimony.

Let me set the clock, and we will do 5 minutes per round here with all of the panel.

I would ask Dr. Chater, on March 31st of this year, just a few days ago, the Social Security Administration was given independent status, something worked on by members of this committee, Senator Moynihan, Senator Packwood, and many of us here. Totally independent status.

I congratulate you. You are no longer tethered to the administration. You should be no longer at the whim of political power and influence, at least supposedly. You are independent. No more oversight by the administration. Is that correct?

Dr. CHATER. Mr. Chairman, I have studied this issue carefully, and I need to quote for you the line in the legislation that says "Social Security becomes an independent agency within the Executive Branch."

Now, there is also in the legislation the whole idea that the Commissioner of Social Security will serve a six- year term and that, of course, takes away some of the politics of the appointment.

There is also a third point in the legislation that speaks to your question, and that has to do with how we present our budget to you. In the past, our budget went to OMB, and the President, together with other budgets, did what he desired with our budget.

The new legislation enables us to send to you, through the President, a budget unchanged by OMB. In other words, we send one to the President, who will then fold it into other budgets, so that through the legislation, we are able to submit a budget directly to you unchanged by OMB through the President.

So, I am taking those three features of the legislation—independent within the Executive Branch, a 6-year term, and an opportunity to present to you a budget—as a way of being independent.

Yes, we are independent from the Department of Health and Human Services. No, I am not independent of the Executive Branch, literally because of the law. And, of course, I am not independent from Congress and its oversight committees.

Senator SIMPSON. Was your testimony today reviewed or edited by OMB?

Dr. CHATER. Yes, sir.

Senator SIMPSON. Well, maybe we ought to change a word there in the mission and say, an independent agency from the Executive Branch instead of in the Executive Branch. Maybe we will get a little further over the years. What do you think of that?

Dr. CHATER. Well, Mr. Chairman, I really am quite comfortable knowing that my leadership of the Social Security Administration will be what I describe as persistent persuasion.

I see myself as the person to go to the Administration with suggestions, with remedies for this problem, and lay before them the intellectual basis for recommending changes. Similarly, I look forward to working with you and other members of Congress to do the same thing.

I would like to see myself as a facilitator, as a consensus builder, and certainly as one seeking a bipartisan approach to the solution of these very important problems before us.

Senator SIMPSON. I think that is the conflict from your appearance here before the full committee several weeks ago. We want more than that from you. We want to hear from an administrator of a totally independent agency telling us about the doomsday scenario and what we are going to do about it, specifically. That is what we want to hear from you.

The budget of your internal operation is interesting. I would think any organization could get along on one percent administration if 1 percent was 1 percent of $381 billion. That is what the administration of this organization is, 1 percent of $380 billion. That is pretty good administration, I guess.

But those are frustrating things for the Chairman and for the Ranking Member; you were aware of that the last time. But we made it independent so we could learn more, hear more. Everybody in this room knows how you use Social Security to blow your opponents out of the water.

Let us just get right to it. We all know that that is what it is, how to detonate your opponent in an election because they touched Social Security and, therefore, should be destroyed.

Senator Conrad's chart was about Republican tax cuts. I wish he were still here; I would have asked him about the President's tax cuts. We cannot get this done if there is a tinge of partisanship in it. It will not get done.

It seems to me that you are going to have to lead us—and I mean lead with a capital "L"—if we are going to let our colleagues know where we are going here and not get into the situation where we just utilized the very two words, Social Security, to immobilize and paralyze ourselves and then do nothing.

So, with that, we can come back around.

Dr. CHATER. Senator Simpson, please.

Senator SIMPSON. Yes.

Dr. CHATER. If I might just say to you, I do not feel that Social Security is a partisan program. It has never been a partisan program and it has not been solved through partisan politics.

Senator SIMPSON. We know that.

Dr. CHATER. I do not see myself as a partisan leader, and I want to work with you in just the way that you described. I promise you that I will do that.

Senator SIMPSON. I was not trying to indicate that. I am telling you the political realities of how we use the system on each other. That is not your problem, that is our problem. But when we do that we need to know, what are some of the realities within this system, and how someone like you or the actuaries can inform us as to how best to extricate ourselves from this situation.

Senator Breaux?

Senator BREAUX. Oh, boy. This is terrific stuff. It is hard to understand, but it is so very important and we have an obligation to do something with it.

Thank you for your testimony. You point out that the surplus in the Social Security trust fund, of course, is invested in securities of the United States. "Invested in special-issue U.S. Government securities, guaranteed as to both principal and interest, and backed by the full faith and credit of the United States."

We just got into one heck of a big political fight, as you are all well aware, on the debate on the Balanced Budget Amendment, and everything else, as to whether we should include Social Security surplus funds that we invest in governmental bonds and securities and considering that as a reduction of the deficit of the U.S. Government.

Can you comment on whether doing that, as we have done for a long period of time, does violence to the integrity of the Social Security trust fund, or not? Dr. Chater?

Dr. CHATER. My opinion on this is, we should take care of the Social Security solvency problem on its own, that we cannot really put the two together. I do understand and agree with others who have testified today that there is a tremendous interrelationship here, and, of course, if the budget is balanced it makes the long-term picture for Social Security even better, but I would like to recommend that we look at Social Security and solve its problems on its own merit.

Senator BREAUX. I understand that. I am just questioning, do we do violence to the whole system of Social Security by taking the surpluses right now that are in the trust fund and investing them in government securities that earn interest and counting that interest as a reduction on the deficit? That is the real question that people were scared to death of.

I think that, obviously, the interest, the surplus, should not be put in a mattress, it should be invested, and we limit it to be invested in government securities that earn interest. Does it do violence to the integrity of the system for us then to count that interest earned as a reduction of the deficit?

Dr. CHATER. I think it undermines the public's confidence in the Social Security program.

Senator BREAUX. I agree with that. But should it? I mean, the majority of the people think, oh, my God, you are ripping off the Social Security trust fund by investing in government securities and using that to reduce the deficit. I know the public is scared of that. The question is, from an economic standpoint, does that do violence to the trust fund? Mr. Walker?

Mr. WALKER. First, it is absolutely critical that we balance the Federal budget. That is critical, from an economic standpoint. Second, there is a lot of information and disinformation out there about whether or not Americans should be concerned because the surplus is invested in government securities.

The way that I typically handle that is to say, there are many people in this country and around the world, and there are many entities, that buy U.S. Treasury securities that are backed by the full faith and credit of the United States Government.

One could debate whether or not all of the surplus ought to be invested in Treasury securities, and some of the things that have been talked about is maybe moving toward a two-tiered system and maybe moving towards a portion of the assets in the trust funds being invested in passive investment vehicles, such a stock index fund, or other index funds, in order to get a better return, which I think would help with the issue of public perceptions.

The fact, is if one is concerned about the government securities in the trust funds you are basically saying you are concerned about the full faith and credit of the U.S. Government. We have bigger problems if you are concerned about that, I think, one big footnote. So they are unduly concerned, I think. I think we ought to look at what we ought to do going forward, we ought to separate the wheat from the chaff there.

But I think we need to recognize one other thing, and that is the interest income on the Trust Fund assets. We run out of funds in 2030, but we turn negative cash flow in 2012, and turning negative cash flow in 2012 has very serious financial implications for this country. So you really just cannot look at 2030, you have to look at 2012.

Senator BREAUX. Mr. Ross?

Mr. ROSS. I will try not to repeat and just add a couple of things that I think are germane to answering your very important questions.

One, is there is a long history to this, going back to the beginnings of the program in 1935. One of the basic reasons, even before our present situation, for investing in U.S. Government bonds is that it is a secure investment and it allows you to assure beneficiaries that, although it is not the greatest rate of return that you could get, it is a riskless investment and you are not putting their funds in jeopardy. That is very important. I do a lot of consulting for international organizations. And you look around the world, and many countries have dissipated Social Security trust funds and undermined their whole system. So, there is something to be said for the U.S. Government bonds as a measure of reassurance.

The second thing is, the Congress and people looking at this issue have always been concerned that because of the size of the trust funds, if you begin to invest them in the private markets, taking risks and seeking higher rates of return, you may interfere in those markets. That is why you got, when you reformed the civil service retirement plan, indexed bond and stock funds, so as to take away many of the attributes of ownership, such as voting and the rest. So it is a very complicated issue to get into other kinds of investment.

Third, and I am not a macroeconomist, but there are different schools of thought among economists as to the effect, if you invested the Social Security trust funds in the marketplace; whether the effect would not be to displace some of the government borrowing onto other investors. So, you are just moving the higher rates of returns perhaps to the trust funds from others in the market.

There are a lot of interactions here which are quite subtle and difficult to figure out. It is not an easy question to answer, but I think that the three thoughts I have given you are important ones in trying to answer it. Thank you.

Senator SIMPSON. Thank you very much.

Senator Chafee?

Senator CHAFEE. Thank you, Mr. Chairman.

Dr. Chater, tell me if I am being unfair in my question to you. I see us with a very serious situation in the OASI, and I think Senator Kerrey pointed it out pretty clearly in his statement. Maybe his statement is wrong. If so, please tell me. But where he says, on page one, "In a single decade, while our overall population increases by two percent, our retired population will increase nearly 30 percent."

And then Mr. Ross and Mr. Walker, in the report of the public Trustees, point out what I consider to be the perilous situation. Let us just stick with the OASI, in which they say, on page nine, "In the short range, is it all right? Yes, 10 years. In the long range, is it satisfactory? The answer is, no. It actually is no for every one of the groups." The years until exhaustion is 36. Now, 36 is not a very long time.

I cannot see that you, in your capacity as head of Social Security, have used your office as a bully pulpit and have tried to alert the rest of us. I think Senator Kerrey, Senator Danforth, and Senator Simpson are the only ones trying to call the American people's attention to what is happening.

I think the point that is made, and Senator Kerrey makes it in his statement, is that the longer you put this thing off, that is a solution to this problem, the harder the resolution will have to be. I and others here remember very well what happened.

Mr. Ross, perhaps you were head of Social Security at the time when a bipartisan commission was appointed. And you are right, you cannot do this in a partisan way. Everybody knows that.

But, if we are going to do something, we have got to have a commission appointed, like the Greenspan Commission. As Mr. Ross and Mr. Walker pointed out, you cannot do anything in connection with Social Security with a view to doing something about the deficit. Clearly, you can only do it in an attempt to save Social Security.

I am worried about this situation. I have five children and 11 grandchildren, and all of the rest of us are in somewhat the same situation. Now is the time to start. When you, yourself, say the year of exhaustion is 36 years from now, that is not very fair, because the problem will take that long to solve.

What do you say, am I being unfair?

Dr. CHATER. I, first of all, would tell you that I agree with you; we need to do something about it very soon. But I also feel that it is not a short-term crisis that we need to do something right this very moment, and I will tell you why I believe that.

As I talk to people and I travel all over the United States and visit with older Americans, they are fearful that the language that they are hearing about Social Security now means that their benefits are going to be lost tomorrow. I do not like the fear that I see expressed by those folks.

So, I think what needs to be done, first of all, is to create an environment of an informed public who can understand what the situation is, because they do not. There is so much mythology out there, and so much misinformation, and so many organized groups spreading that misinformation.

Now, what has Social Security done? In the 16 months that I have been here we have, first of all, had the pleasure of appointing an Advisory Council for Social Security.

Together, with Secretary Shalala, we made sure that that particular council that is working as we speak, and will finish their work this summer, was fully representative of diversity and age. It is a very, very good Advisory Council.

We gave to them the charge of looking at long-term solvency as the number one priority for the Social Security Administration right now. We have asked them to look at long-term solvency in relation to other savings programs, in relation to public and private retirement programs.

We have asked them to come to us with packages of recommendations; in other words, how a group of recommendations would fit together so we could minimize the adverse impact on particular population groups, if you will. So, that is the first item, the first priority—to be sure that the Advisory Council is doing what we have given them as a charge.

Second, one of my objectives for the Social Security Administration is to increase the public's confidence in the Social Security program. To do that, first of all, they need information. This is a point to be stressed. The Trustees' report summary is a wonderful document written in layman's language, as opposed to the thicker actuarial report, so that people can understand it, read it, and know what is going on.

In connection with my public agenda, I have given speeches, I have been on C-SPAN, I speak to anybody who asks me to. We have a program with public schools to get to the younger people about Social Security, putting forth a public education program that will inform them so that our citizens can participate fully in the dialogue that needs to go on simultaneously with these changes.

Senator CHAFEE. Well, it may well be that this advisory group that you formed is the alter ego to the Greenspan Commission; I do not know. Is that what you are suggesting, that they are going to come forward with these recommendations to you, is that correct? I am sorry. I am a little over my time, but I just want to get this point straightened out.

In other words, are you saying that is your Greenspan Commission?

Dr. CHATER. You could say that. According to the law, an Advisory Council for Social Security is appointed every 4 years, and this is that council for this time with that particular charge. Other councils have, of course, had other charges in the past, but this is such an important issue it has become the charge for this particular council.

It is bipartisan, and the report will be shared with you, members of Congress, and we will use the report as a platform to do exactly as you say, talk to the public and have people know what is going on.

Senator CHAFEE. Well, I do not want to denigrate the advisory group you have got at all. I think the virtue of the Greenspan Commission was that it was very high profile. As I recall—maybe Mr. Ross can correct me—but Lane Kirkland was on it, the head of Prudential, or one of the big insurance companies.

Mr. ROSS. Right.

Senator CHAFEE. Senator Moynihan was on it, Senator Heinz was on it.

Mr. ROSS. Senator Dole.

Senator CHAFEE. Senator Dole was on it. That is going pretty high profile. Here is a list. Bob Beck, chairman of Prudential, was on it, as I mentioned; Sandy Trowbridge, head of the NAM; as always, Mr. Ball, Mr. Ballantyne's predecessor, I guess; Bob Conable, Ranking Member on the Ways and Means, Martha Keyes, Lane Kirkland, I mentioned, Pat Moynihan, Bob Dole, Bill Armstrong, and John Heinz.

Well, that is the way to do it, I think. As a result of that, we got something done around this place in connection with Social Security and we made the changes, all to do with Social Security, nothing to do with deficit reduction. That is what I think we need, Dr. Chater.

I look forward to the report of this group, but I worry that it is not going to have the bang that is required to get the public's attention. You say this is an instructive book. Yes, it is a book that will, I think, scare the dickens out of you if you read it the way I read it. Am I reading something wrong here on page nine?

Dr. CHATER. No, you are not.

Senator CHAFEE. I mean, you, yourself, say that the HI, Medicare Part A, is going to be bankrupt in seven years. Seven years is one Senator's term around this place.

Dr. CHATER. May I submit to you, please, a list of the people who serve on the Advisory Council now so you know who they are? I would like to do that.

Senator CHAFEE. Sure. Do you know them? Can you just rattle off a couple of names? I guess I should not ask you that, because I am sure they are terrific citizens. Are there any Senators or Representatives on it?

Dr. CHATER. No, there are not.

Senator CHAFEE. Well, I think that was one of the virtues of this. This was a high-class group of Representative of Senators from the ones I know. I mean, people like Bob Conable, Senator Moynihan, and so forth.

Senator SIMPSON. Thank you.

Senator Conrad?

Senator CHAFEE. And I want to make it clear that I am sure you have a very high-class group, and I support them. But, perhaps not as high-profile, I should say, as this.

Senator SIMPSON. Do you have the list? If you do, you could share it with us, or later. If you have it now, you may share it.

Dr. CHATER. I do not have it with me now. I will share it with you.

Senator SIMPSON. Fine. Thank you.

[The list follows:]

1994 ADVISORY COUNCIL ON SOCIAL SECURITY MEMBERS

Edward Gramlich, Chairman. Director of the Institute of Public Policy Studies and professor of economics and public policy at the University of Michigan; former chairman of Michigan's Economics Department and acting director and deputy director of the Congressional Budget Office.

Robert Ball. Former Commissioner of Social Security (1962–1973); member of the 1991 Advisory Council on Social Security and the National Commission on Social Security Reform (Greenspan); chair of the board, National Academy of Social Insurance.

Joan Bok. Chairman of the New England Electric System; member, boards of directors of Avery Dennison Corporation, the Federal Reserve Bank of Boston, John Hancock Mutual Life Insurance Company and the Monsanto Company.

Ann Combs. Principal, William M. Mercer, Inc.; former deputy assistant secretary for Policy, Pension and Welfare Benefits Administration, Labor Department (1986–1993); staff member, National Commission on Social Security Reform (Greenspan).

Edith Fierst. Attorney, Fierst & Moss, P.C., and member of the Advisory Committee of the Pension Rights Center; chair, Technical Committee on Earnings Sharing; specialist in federal and military pension litigation.

Gloria Johnson. Director of the Department of Social Action, International Union of Electronic, Electrical, Salaried, Machine and Furniture Workers and vice president of AFL–CIO Executive Council; president of the Coalition of Labor Union Women.

Thomas Jones. President and COO, Teachers Insurance and Annuity Association—College Retirement Equities Fund (TIAA–CREF); member, boards of directors of Thomas & Betts Corporation and Eastern Enterprises; trustee of Cornell University, Brookings Institution and Committee for Economic Development.

George Kourpias. President, International Association of Machinists and Aerospace Workers, AFL–CIO; member, boards of directors for the National Council of Senior Citizens, Space Cause and the American Association for the Advancement of Science; member of Overseas Private Investment Corporation (OPIC).

Sylvester Schieber. Vice president and director of the Research and Information Center, The Wyatt Company; former director of research, Employee Benefits Research Institute; a senior economist and deputy director of policy analysis for the Social Security Administration.

Gerald Shea. Director, Department of Employee Benefits for health care, pensions, Social Security and child care, in AFL–CIO; previously, assistant to the president for government affairs for the Service Employees International Union and organizer for SEIU in Massachusetts.

Marc Twinney. Director of pensions for the Ford Motor Company; member of the American Academy of Actuaries and the Pension Research Council of the Wharton School; previously, a consultant at Hewitt Associates, Milliman and Robertson, and Hansen Consulting Actuaries:

Fidel Vargas. Mayor of Baldwin Park, Calif., and senior policy analyst to Los Angeles Mayor Richard Riordan; past vice president of Phillips Brooks House, the community service organization of Harvard College.

Carolyn Weaver. Director, Social Security and Pension Studies, The American Enterprise Institute; member, 1987 Social Security Disability Advisory Council and senior advisor, National Commission on Social Security Reform (Greenspan); former staff member of Senate Finance Committee and the economics faculties of Tulane University and Virginia Tech.

Senator CONRAD. I have really enjoyed this, Mr. Chairman. This is the first time I have heard, really in years, Senators and members of the House of Representatives characterized as high-class.

Senator SIMPSON. We have to do it for ourselves. [Laughter.]

Senator CONRAD. This is really a breakthrough.

Well, I wanted to go back to the questions I was asking Senator Kerrey, because the testimony yesterday by Dr. Jorgenson was very interesting and I would like to ask witnesses who are here, on the two matters I was mentioning to Senator Kerrey, number one, Dr. Jorgenson's contention that there is an error in the underlying base for the calculation of the Consumer Price Index in the housing sector that makes a difference of $50 billion a year in terms of that part of the Federal budget that is indexed by the CPI.

Are you familiar with that testimony, Dr. Chater, and that argument? If you are, what is your analysis of it?

Dr. CHATER. I am familiar with the issue. I would like to ask Mr. Ballantyne to respond, our Chief Actuary.

Senator CONRAD. Very good.

Mr. BALLANTYNE. Senator Conrad, I believe there have been several ranges that have been suggested as the overstatement in the CPI. I think the Congressional Budget Office has mentioned a range of 0.2 of 1 percent to 0.8 of 1 percent. So, I think there is not very well- established agreement overall as to how much the overstatement is.

Also, I'm sure the Bureau of Labor Statistics is looking at the problem, and is attempting to make adjustments and to measure the Consumer Price Index in the best way that it can be done. We, of course, rely on their measurement of it. The law requires that the COLA be based on the Consumer Price Index. To the extent that it is changed, perhaps reduced to remove overstatement, we will be reflecting that in the estimates.

Senator CONRAD. Well, there are two issues that Dr. Jorgenson raised.

Mr. BALLANTYNE. Right.

Senator CONRAD. He raised the over-indexing that occurs, according to his analysis, in the CPI. He asserts that is 1 percent a year. Witnesses we had here yesterday said anywhere from 0.8 of 1 percent to 1.7 percent. He said 1 percent.

There is a whole separate issue. The base upon which the CPI is calculated, he asserts, is flawed, which adds an additional $50 billion a year of cost to those areas of the Federal budget that are indexed. That, he says, flows from a mistake that is made in the housing component. Are you familiar with that argument?

Mr. BALLANTYNE. Well, there has been a problem with the housing component in the Consumer Price Index. I was not aware of any current problem there.

Senator CONRAD. He asserts it was a mistake that was made in 1983. I talked to Senator Simon about this. Senator Simon told me he got an amendment passed back at about that time that altered the CPI base because, at that time, it assumed somebody would buy a house every year.

Mr. BALLANTYNE. Right. There was a problem, but it has been corrected.

Senator CONRAD. Well, now, Dr. Jorgenson says, since 1983 it has still not been fully corrected, and that the housing base is still overstated and that, as a result, it is costing the Federal Government and additional $50 billion a year. You are not familiar with the argument that he made yesterday here.

Mr. BALLANTYNE. Not that particular argument, no. I have not heard that from the Bureau of Labor Statistics, or other places.

Senator CONRAD. Well, he is certainly an eminent person. He is chairman of the Economics Department at Harvard.

Mr. BALLANTYNE. Yes.

Senator CONRAD. But you are not aware of that assertion of his. Well, I think it is something we have got a responsibility to pursue. Obviously, the CPI is used to adjust many things in this society, and if it is flawed we have got a responsibility to make it right.

Mr. Ross?

Mr. ROSS. I am not an actuary or an economist, and I am not highly familiar with Dr. Jorgenson's point about the housing component. But I would point out again, providing some institutional memory at this hearing here today, that this debate over the proper indexing for Social Security is not new, it goes back to at least 1972 when the program was first automatically indexed for inflation.

The theory of the indexing is that, once you set a benefit, you ought to keep it whole for a person who has retired, so there is no question that you need some indexing. We did not get it right in 1972, and there was what was called double indexing throughout the 1970s. That is why the 1977 Act corrected it, with bipartisan support.

A lot of debate has continued over what the proper method of indexing Social Security is, and it has continued to this day with the questions of wage indexing, price indexing, or some combination of both.

I would simply submit to you that, as you go into this cave, and it is a deep, dark cave, keep in mind the ultimate goal, which is, you are trying to fix the indexing so it is proper in a Social Security system. Does it have deficit reduction aspects? Yes. But, as Senator Chafee said, who has now left us, and I do not think you were in the room, it is very important——

Senator CONRAD. I hope he has not left us in a permanent way.

Mr. ROSS. No, no. I think he just left the room. It is very important, as you fix the indexing for Social Security, to do it in terms of making it right for this program. Will that have deficit implications? Yes. But, in order to make the people affected by it satisfied that you are doing the right thing, do it within the parameters of this important program.

Senator SIMPSON. Thank you, Kent.

Senator CONRAD. Thank you, Mr. Chairman.

Senator SIMPSON. All right. I have further questions.

I think we have to build a record here, or something that the American people can understand for the first time in any time in politics, not, again, about partisanship, but about reality of a system they all believe in.

Will you please tell the American people that you have no choice but to invest the reserves of Social Security in Federal securities? I mean, that is the law, is it not?

Mr. WALKER. That is correct, Senator.

Senator SIMPSON. Tell them that, so that I do not have to go to the next town meeting and hear them say, why are you putting all that money in that Federal stuff when it should be done in something else? Why do you do that?

Mr. WALKER. It is required by law.

Senator SIMPSON. That is right. That was the original law; is that not correct?

Mr. ROSS. Yes.

Senator SIMPSON. That all reserves in Social Security, whatever they were, were to be invested in the securities of the U.S. Government and backed by the full faith and credit of the U.S. Government. Right? I would like to hear an audible comment.

Mr. WALKER. Right. Correct.

Mr. ROSS. Yes.

Senator SIMPSON. At least maybe they will understand that. Now, whether it is a 2 percent yield, or a 4 percent yield, or a 4 percentyield, I do not know. I guess you are just investing it in the "safest" security of the Federal Government, right?

Mr. ROSS. Actually, the law provides an amalgam of the long-term interest rates, so it is the best long-term interest rate provided by the Federal Government. So, in that sense, it is a good or preferential interest rate. That, again, is prescribed by law.

Senator SIMPSON. Now, let me ask Dr. Chater. When you were out giving these speeches and talking to these people who are fearful and these seniors who are anguished, pained, frightened, and they ask you, what is going to become of Social Security, do you ever tell them—especially with what this commission has been doing, the Entitlements Commission, that has got them spooked up, and Kerrey and Simpson spook them up plenty bad, too—that all of the recommendations of the Entitlements Commission never, ever affect one single penny of their Social Security benefit, and that nobody over 50 will be affected by a reduction in their benefit in any way? Do you tell them that?

Dr. CHATER. I do not tell them, first of all, that their benefits will not be affected.

Senator SIMPSON. Do you tell them that their benefit will not be reduced in Social Security under the recommendations of the Entitlements Commission? Because that is the truth. Do you tell them that?

Dr. CHATER. I have not been talking about the Kerrey Commission report when I am out talking to seniors.

Senator SIMPSON. But they are. That has got them hyped up.

Dr. CHATER. They are talking about the commission report in different ways. They express fear, but they do not quite understand what the report said. If you remember, the report, though signed by a majority of the commission, did not make specific recommendations as a report for a specific package of changes.

Senator SIMPSON. But you know, because of your energy and brightness, that in that report, as to what we were suggesting with regard to Social Security, which was a phasing up of the retirement date and accelerating that between the year 2000 and 2020, that no one over 50 would have any reduction in their Social Security benefit. There might be a change in their cost-of-living allowance, yes. There might be a change in Part B premiums, yes. There might be other things.

But it would seem to me, if you wanted to allay their anguish, you could tell them that nothing that has been proposed to date, either by the commission or in legislation, is going to reduce a single penny of the benefit of anyone over 50.

Dr. CHATER. I do explain in some detail the effect of the increase in retirement age. So, yes, that message is getting to them.

Senator SIMPSON. Well, I think you could help do that. That is what we are talking about. You are the Commissioner of Social Security. This is your job. When we talk about COLAs—they confuse COLAs with benefits—and they get up at the town meetings and say, what are you guys doing to our benefits? And I say, nothing. They say, yes, you are. I say, no. We might do something to your COLA, but that was never part of the original contract.

In the pitch, the mantra, sent out by the AARP and the National Committee for Preservation of Social Security and Medicare, the mantra is, they are cutting your benefit. We ain't cutting a single benefit, not one. We are going to do something with COLAs, we do not know what.

We might tie it to the lowest 20th percentile of the American public and then that dollar amount might go to everybody else as a COLA, the dollar amount, not means testing, not affluence testing, which seems to have a repugnancy about welfare or something.

But you, I think, have to tell them that the COLA was never part of the contract. That was something concocted by Wilbur Mills and the President of the United States who, at that time, was Richard Nixon. That little thing has eaten through the whole system. The cost-of-living allowance on Social Security, there is where the politics begin, right there. If you just voted for that, you could get right on the right track.

So, I just share with you that it seems to me, if you are dealing with fearful Americans, there is something you could tell them to allay their fears, which is truth. It would be an awfully good opportunity to do that, I think. Thank you.

Senator BREAUX. Thank you, Mr. Chairman.

Just one final observation and a question. I think that it is really disturbing, and should be to all of us, that there are a number of people in the country that are very leery of their future with regard to Social Security.

I mean, you paid out, $317 billion last year, you had income of $380 billion, you have projected for the next 35 years in the retirement program as being enough funds in it to pay those benefits. Most people get a lot more back than they ever put in. Most people do not believe that.

So, I think there is a balance about how good this system is. I happen to think it is pretty darn good. It is a good deal for the American people. Are there problems out there? Absolutely.

One of the biggest ones is Medicare, and that is not 35 years from now, that is 7 years from now. That is health care, and how we handle it. The fee-for-service system, with Social Security paying doctors and hospitals for procedures done is effective, but it is inefficient, from a cost standpoint, of any system we could probably devise. So, that has to be, clearly, changed.

Let me ask a question. The House has passed a tax bill. One of the provisions in it repeals what we did in 1993 with regard to increasing the percentage of earnings that are taxed, moving it from 50 percent, gradually up to 85 percent. That, I think, raised about $24 billion over 5 years for the Social Security system. It has been repealed by the House tax bill.

Does that repeal help the Social Security system, in your opinion, or does that repeal hurt the Social Security system, in your opinion? Dr. Chater?

Dr. CHATER. The 85 percent tax that is being repealed went to the hospital——

Senator BREAUX. It is not an 85 percent tax. It is very, very, very important not to create that impression. It is not an 85 percent tax.

Dr. CHATER. I understand.

Senator BREAUX. It is a tax on earnings, and a percentage of that. That is a common error and it is creating some very difficult problems. So, let us not say that.

Dr. CHATER. Well, I apologize. I did not mean to say that. The income from that particular tax did not come to Social Security in the first place, it went to the Hospital Insurance Trust Fund.

So, will it have an effect on Social Security right now? If it is abolished there will not be an obvious effect, except that my understanding is that, during the repeal periods, the money from that particular tax will help offset the cost of increasing the earnings limit for Social Security folks. So, in that sense, it could help Social Security because we would be able to increase the earnings test for folks who are working.

Senator BREAUX. All right. What does that repeal do to the Medicare trust fund——

Dr. CHATER. Well, that is my great worry.

Senator BREAUX. [continuing]. Which goes away in 7 years.

Dr. CHATER. It goes away. Of course, it makes the problem even more urgent. It is a great worry to all of us.

Senator BREAUX. Mr. Ballantyne?

Mr. BALLANTYNE. I think the Health Care Financing Administration has estimated that it would advance the date of exhaustion of the Hospital Insurance Trust Fund by 8 months. Now, I am not sure if that means exhaustion in 2001 or if it would still be in 2002, but it is certainly earlier as a result.

Senator BREAUX. All right. So your thought is, whether it helps or harms the integrity of the hospital insurance fund.

Mr. BALLANTYNE. Well, as far as the hospital fund is concerned, it certainly does harm the financing, I would say.

Senator BREAUX. Do you all have any comments on that, Mr. Walker?

Mr. WALKER. For short-term, it definitely does not affect OASI. Long-term, I think it may be a plus, because I think one of the things we have to look at is, what can we do to reduce disincentives to work beyond normal retirement age. I think that is very important. We need to do that not only with regard to public sector programs, but private sector programs as well.

Senator BREAUX. And what does it do to the Medicare fund?

Mr. WALKER. It does reduce money going to the Medicare fund, there is no question about it.

Senator BREAUX. What is the condition of HI?

Mr. WALKER. It is in very serious financial difficulty. It is projected to run out of money in the year 2002. However, I think we need to put it in context. With regard to the nature, severity, and the timing of HI's problems, they are much more fundamental than this $5 billion. Much more fundamental.

Senator BREAUX. $5 billion?

Mr. WALKER. $5 billion a year.

Senator BREAUX. Still, that is almost $25 billion over 5 years.

Mr. WALKER. $5 billion per year by the year 2000. My only point is, the hole in Medicare is so deep that, yes, one has to be concerned to the extent that you might have revenues moving away from it, but this is highly immaterial as compared to what needs to be done with regard to the Medicare program. We need to fundamentally shake it up and dramatically reform it.

Senator BREAUX. Only in Washington is $25 billion over 5 years immaterial.

Mr. WALKER. It is not a matter of it not being a significant amount of money. My point is, we need to do much, much, much more than that.

Senator BREAUX. I agree with that.

Mr. Ross?

Mr. ROSS. I would just point out in addition, so as not to repeat things that have been said, that there has always been an issue as to how much of the Social Security benefit should be subjected to tax, whether it should be 50 percent, 85 percent, or some other percentage.

One thing that is clear though, whatever that amount is should be recycled through the OASDI trust funds. It was put in the HI trust fund to help it, and also because there were some fire wall rules that made it easier to do that. But, in principle, this money should not have been in the HI trust fund to begin with, it should have been in the OASDI trust funds. The issue still remains, which I think is the difficult one for the Congress, which is, what is the correct percentage of earnings to subject to the income tax.

Senator BREAUX. One final point then, if I may, Mr. Chairman.

How does it compare to the tax laws regarding private pension funds?

Mr. ROSS. Generally speaking, private pensions on receipt are fully taxable, except for the capital amount. So, the question is, what you think the capital investment in Social Security is. The reason for the 50/50 was that roughly half of the tax is paid by the employer and half is paid by the employee. That is generally where that came from.

The 85 came from the notion that, at the present time, most beneficiaries contribute an amount equal to about 15 percent of their benefits so, therefore, it parallels the private system.

However, as Mr. Ballantyne's predecessor, Robert Meyer, the actuary in the history of Social Security, has pointed out that percentage tends to change over time, and so the 85 percent is just a rough number. The issue always will remain, what is the correct percentage from a tax policy standpoint to subject to taxation?

Senator BREAUX. Thank you.

Senator SIMPSON. Did you want to give a further response?

Mr. WALKER. Just to clarify, Senator Breaux. With regard to private pensions, you do not pay tax on any employee after-tax contributions that are made, you do pay tax on everything else. In other words, employer contributions and earnings on both employer and any employee contributions.

Senator SIMPSON. Well, I would not miss this opportunity to ask a couple of more questions. Thank you. An old pro.

Senator Breaux really hit one there between the eyes. This is the kind of distortion that we cannot stand to have from people who know. Let the record show that we do tax Social Security benefits. Yes, we do. We tax the benefits of those single persons who earned over $34,000 a year and couples who jointly earn over $44,000 a year. These are pretty good figures for retirement. That is what we did.

We did that and we said that the Social Security benefits received by people in this income stream in retirement will have 85 percent of their Social Security benefits exposed to tax.

It did not say anything about an 85 percent tax on those proceeds, it said 85 percent of the benefits for people over this much money are going to have the 85 percent exposed to tax. What will the tax be? Probably 15 percent. The effective tax rate would probably be 12. You know why we set it at 85? Because these people have only paid in 15 percent of the benefits. Got it? That is why it was set at 85. Because if you are going to do it like you do an ordinary pension, like private pensions, then the excess is exposed to tax.

So if you have only put in 15 percent and you are going to get this much money through Social Security, we thought it might be a good idea to tax that.

So the effective tax is on the 85 percent of the Social Security benefits exposed to tax, the effective tax rate of 12, 13, maybe 15 percent. Now, that is what we are doing. And the House—it is just as shocking to me as it is to my good friends on the other side of the aisle—has knocked that back to exposing only 50 percent of the benefits to tax, which then will be the same effective rate, or a little less, 12 or 13 percent, or whatever, which is really going to come totally out of the Health Insurance trust fund. Is that correct? Would anyone argue with what I just said?

Mr. ROSS. No, that is right.

Senator SIMPSON. That is correct?

Mr. WALKER. Yes, that is correct.

Senator SIMPSON. Kind of hard to believe. Well, I ought to quit, but I cannot. But I think that that has to be expressed to the American people, if they cannot understand the basics of how they are going to be just ripped to shreds.

The fact that these people over 50 are being treated in a way like no other country on earth treats its senior citizens, you would think, listening to the national debate, somehow everyone over 65 is foraging in alleys for sustenance. I am tired of that one. I am not going to go much further with it, or listen to it.

Do you have a response?

Mr. WALKER. Senator Simpson, that is a correct statement. But I think, to reinforce something that Mr. Ross said, if we are going to tax those amounts, if we are going to have income inclusion, in effect, for that 85 percent, then the revenues that are received from that ought to go into the OASDI trust fund, not the HI trust fund.

Senator SIMPSON. Oh, I agree with that totally. How we ever directed it to that was an error. That was a mistake. I would agree with that. I certainly would.

Now, I have a question. On page seven of the Trustees' summary, this is it, your baby, it says, "The year of exhaustion of the OASI—Old Age Survivors Insurance—trust fund under intermediate assumptions," the ones you have chosen, "does not occur until 2031," and then it says very clearly, "36 years from now." I guess that is there to cheer us. But then here comes the rest of it. "For the combined OASI and DI trust fund—Disability Insurance—the year of exhaustion would be 2030, in 35 years. However," and this is so key, and if the people cannot understand this we are all out to lunch and there cannot be much hope for us, "combined OASDI expenditures will exceed current tax income beginning in 2013." You have just testified to that. You are so right.

"Thus, as chart C illustrates, current tax income plus a portion of annual interest income will be needed to meet expenditures for years 2013 through 2019, and current tax income, annual interest income, plus a portion of the principal balance in the trust funds will be needed for the years 2020 to 2029."

Do you realize that in any investment circle, if you were to describe a long-range or short-range approach which dipped into principal you would be fired on the spot? Any other trustees would be sacked if you were to dip into principal, and just do it without giving us any explanation about what to do with it.

We know what you have said, do it promptly, not too late, do it soon. But that is what you have told us. If that appeared in any other report in private sectors of this Nation, people would be subject to dismissal. Am I wrong?

Mr. WALKER. It depends upon what the nature of the trust is, Senator.

Senator SIMPSON. I know. This is the biggest trust in the world.

Mr. WALKER. I think the fact is, this is something that Stan Ross and I fought to get included into the Annual Report when we became Public Trustees.

Senator SIMPSON. Did you, really?

Mr. WALKER. Because before it was just focusing on the date of exhaustion including the principal amount, and we said, no—I, myself, in particular—said, no, you have to start focusing on when you turn a negative cash flow. We need to start getting that message out, to let people know that that has serious financial consequences.

Senator SIMPSON. Who talked you out of your position?

Mr. WALKER. Nobody.

Mr. ROSS. Nobody.

Mr. WALKER. It is in there.

Mr. ROSS. Let me just add, Senator Simpson, that you make a very good point. The statute that created the job of Public Trustees, I believe, calls us fiduciaries, but I clarified before I accepted this job, we have no personal liability responsibility, or no one would ever be able to hold this job.

Senator SIMPSON. Very good. You bet.

Mr. ROSS. But one of the first things that Mr. Walker and I did was to go to work on this, with the help of the Office of the Actuary, so that the cash flow consequences of this funding situation would be made visible to the American public and the Congress.

I want to thank you today, because this makes me feel that the 5 years we have been at this were not in vain, because this is the first time, to my knowledge, at least, that anybody in a hearing of this importance has focused on this and picked up this very important point, which I think is something that needs a great deal of attention.

Senator SIMPSON. You see, the American people do not understand when you talk about, the decline will begin. But you people all understand that when this date comes, 2013, which means there ain't no more reserves, now you are going to go get the bonds cashed, are you not?

You are going to go and say, all right, the reserves that maybe even got up to $2.5 trillion—that could happen; those reserves could reach $2 trillion—and you are going to go to the American people and say, I am sorry, the $2 trillion in reserves, the one you have been talking about for 10 or 15 years, is gone, but do not worry, they are not going to go broke until 2031. But now we are going to start dipping into principal, and now we are going to go and ask that the bonds be redeemed.

Guess who pays for the bonds? The citizens of the United States of America, the little people that everybody is talking about all day long to help. And the people most savaged in that process will be the elderly and the poor, and that is the most curious, strange, bizarre scenario I can ever imagine.

Then it goes to hell because you cashed the bonds and there is not enough revenue coming in, and you know it, because there are not enough human beings paying in, and you know it.

On the other side of the issue is all these people waiting there saying, I am in the line now, I want mine, and I expect to have it. Boy, it would not matter if I got dusted out of here on my head

2 years from now, if I had to go home and watch that scenario unfold. Yes?

Mr. WALKER. Senator, we have been trying, as Public Trustees—which theoretically was envisioned back when our positions were created—to get the message out, not only through this document, but also in speeches and in other presentations.

But, quite candidly, until recently—and yourself being, obviously, one of the leaders who are involved and trying to help in this regard—we really have not gotten much help from Congress, and virtually zero help from the press.

This is a tremendous crisis that is looming above us and we need to get the message out. We have tried, and we very much appreciate your leadership, and other Senators, and other members of Congress, to try to be able to help do that, because the time to act is now.

Senator SIMPSON. Well, to give credit to Senator Bob Kerrey and Senator Jack Danforth, who had the guts to sit down and take on every single one of these powerful groups and listen to them complain, howl, shriek, twitch, and all the rest of it, it was something to see; I was there.

Well, now, just a couple of more here. I have never had an actuary before me, but I want to ask a question I have asked all my years in looking at this system. Having a father who lived to be 95 and who was a self-employed lawyer in Cody, Wyoming, who I suppose put in the absolute minimum because of his age, and if people do not even know—and they do not—somebody should tell them. I think the somebody is the Commissioner of Social Security, to say to them, when they raise their hands at the town meeting and raise hell and say, I put in it from the beginning, you big jerk, I want it all out, what I say to them is, if you put in it from the beginning then you must remember, if you please will, that you did not put in over $30 a year for the first 8 years.

Then you never put in over $174 a year, and get this figure. You never put in over $174 a year for the next 18 years. Self-employed. Then you got stuck $300 a year, $500 a year, and then up, and up, and up it went. I have my own with me, which I am very pleased to share with people. I am 63 years old.

Here is Alan K. Simpson, first year of productive life—at least according to my parents—was when I went to work at the Cody bakery. I have told you that story. I put the pink stuff, that globular junk, that pink, sugary business in the middle of sweet rolls. I have never eaten another sweet roll since.

This was my job. I was paid $583, and I paid $5 in Social Security, then I paid $5 the next year. In college I never earned enough in the summer to pay it because of the exemption, $3,600. Then in the Army I did not pay.

Then, in the most productive years of my life practicing law in Cody, Wyoming, I never paid over $816 a year in Social Security, and I was paying the maximum. I was paying not only the employee's share, but the employer's share because that is what self-employed were paying. There it is, right here. Then it went up to $1,200 the year I came to the Senate. Then it dropped back down.

Now I am paying about $3,600 a year, $4,000 a year, to Social Security. I pay Social Security. People come to us and say, well, you jerks do not pay any Social Security, so what do you worry about? I have paid Social Security since I was 14, and I shall continue.

So, in my most productive years I never put in over $816 a year. Guess what? For jackpot time at the old lottery, if I retire at 65, I will receive $1,170 a month, which is more in 1 month than I put in in 1 year in my most productive years of life.

Now, something is very sick when people are not told this. Thank God for Pat Moynihan, who at least passed the law that nine million of these forms are going to go out to people this year. Well, I hope so.

Then 18 million are going to go out next year to people over 60, and I hope so. I hope we can get it to everybody. I hope so, so that we can get away from the whining, the howling, the shrieking, and the phoniness of the groups that misuse this issue.

Now, obviously I feel a little strongly about that issue. I want to put that in the record once again. It has been in there a long time. They say, I know what he is going to do, he is going to reach in and get his form. I had to get a new one, the other was so tattered and shredded. This one is crisp, new. There it is.

[The information appears in the appendix.]

Senator SIMPSON. Now, I forgot to tell you that if I wait till 70 I will get $1,555 a month. Boy, I will tell you, my dad lived to be 95, and my mother 94. I am going to hit the jackpot here for what I put in and what I am going to get out.

That is the way with most Americans who are in their 60's. The poor people who are 20, 30, and 40 now will have nothing. What a tragic situation. I am ready to talk about it, and there are plenty of us ready to talk about it on both sides of the aisle.

I do not want to take anyone with me over the cliff, but I want to ask a question of Mr. Ballantyne. How does something that started as an income supplement—because that is what Social Security was, it was an income supplement, nothing more, during the Depression—suddenly become the Nation's pension plan when it has no real or sound actuarial basis whatsoever?

In fact, the retirement age at the beginning of Social Security was set at 65 because that was higher than the current life expectancy rate. Those pretty shrewd old forefathers of ours knew that they had diddled the system when they had it so that people would not get paid till they were 65 and the life expectancy was less than that. That was their version of not having to pay out very much. Then along came the things that you have all described, and the oil, and the opening, and the COLAs, and all the rest of it.

But how does something that started as an income supplement and never really had much statutory change ever get to be something that an actuary can wrap their hand around as making it actuarially sound?

Mr. BALLANTYNE. Senator Simpson, it is not easy to keep it actuarially sound, as you know. But I think, over the years as the program has developed and as Mr. Ross said awhile ago, it took quite awhile for it to mature, not reaching maturity until the 1970's. When changes were needed in the program to either make the benefits more adequate or to provide the necessary funding in the long range, I believe that Congress acted responsibly, in both the Ways and Means Committee and the Senate Finance Committee, to do what was needed.

Whenever there was a short-term crisis in the program, such as at the time the 1977 amendments were developed, and also the 1983 amendments, the long-range problem was also dealt with. Both the short-range and the long-range financing changes have been based on the estimates of the Office of the Actuary, for better or for worse. We do the best we can with the long-range estimates.

Senator SIMPSON. It must be very difficult.

Mr. BALLANTYNE. It is difficult, yes.

Senator SIMPSON. Almost nigh impossible, is it not, to take something that never had any actuarial beginnings?

Mr. BALLANTYNE. Well, I would say that it was based on actuarial projections at the beginning.

Senator SIMPSON. But it was an income supplement.

Mr. BALLANTYNE. Well, I am not sure. I would look at it still, I guess, as an income supplement today.

Senator SIMPSON. Well, people do not look at it as an income supplement, they look at it as their pension, their Social Security pension from the USA. That is what they look on it as.

But at least I want to commend one group. They have dropped the issue of Notch babies from the national lexicon, which was one of the phoniest things I had ever sat through. These were the people who got the most and paid the least, and just howled, and shrieked, and snorted through the building for 20 years.

So, I want to thank the National Committee for the Preservation of Social Security and Medicare publicly, and Martha McSteen publicly, for dropping away from an issue which was so out of touch with reality. I commend them. They have dropped it. They have sent copies of the Notch Commission report, a four-page summary, to all of their membership. I commend that, and there has got to be more of that.

We are going to have a little hearing with the AARP president. We want to find out why they have a yield on their investments of over $30 million. We want to find out what the cash flow is in nine businesses.

We want to find out how they get 3 percent of every premium they place for their Medigap policies from Prudential, 3 percent of every premium they place with New York Life, what cut they get from Scudder when they invest this, what is the cut on home insurance, car insurance, and the pharmacy? They are going to say, that is not material to this. I say, yes, it is.

If you are just going to drive the American people over a cliff, 33 million people paying eight dollars dues, bound together by a common love of airline discounts, automobile discounts, and pharmacy discounts, and they have not the slightest idea what the organization is asking for.

And what the organization is asking for is long-term health care for everyone in the U.S., regardless of your net worth or your income. That would truly break the country to its knees. But that is them, and they are out there.

I hope there is a slow, sobering process, because I am going through their books, their records, and their manuals, how they hire their people. Their field representatives, if they do not agree with the national board, are subject to immediate dismissal. Their board is selected by the lobbyists. That is really an operation.

And you would think that they were just there doing God's work. That has got to come to the fore. This is one that is bigger than those groups. I intend to exert my considerable energies, even in this emaciated form, into this particular activity.

I want to, finally, add one thing. I just want to ask now, we are going to go to a new Advisory Council. Last year we had every 4 years the 12-member Advisory Council which reported to the Commissioner regarding the issues on Disability and Medicare.

Then we got rid of that last year and, instead, we have a seven-member advisory board, charged with advising the Commissioner on policies related to Social Security and the two disability programs, and Medicare is not mentioned. Why was Medicare dropped from the Advisory Board's jurisdiction, anyone know?

Dr. CHATER. The legislation, as you know, did not provide for it. I suppose that is one of the reasons that our Trustees at our meeting this last week recommended that an advisory council be established to study the Medicare program.

Senator SIMPSON. That is very good. Again, that is, the politicians are afraid to touch the issue, is what that is, because they know where that one is going. That one is going broke in one Senate term, practically, so they want to get that baby shoveled downwind somewhere.

Is there any insight as to why the Advisory Council was rejected in favor of the Advisory Board? I am just curious.

Dr. CHATER. Well, my impression is, when the Advisory Board was constructed as part of the legislation, the board, which meets four times a year and is an ongoing group of people, was intended to provide a more steady, if you will, group of advisors, as opposed to once every 4 years, as the old law provided.

Senator SIMPSON. I just wondered how that had occurred. I know I am trespassing on your time but, as I say, I do not want to have a separate hearing. I really appreciate your being here.

Let me just take another 10 minutes here, so you will at least know when it is going to stop. This is very important stuff and I have decided to invest some time in it, and have, just because I was on the Entitlements Commission and admired so the work of Senator Kerrey and Senator Danforth.

I have got to ask again, the actuary, Mr. Ballantyne. We were talking about CPI. Boy, we are talking about that. That is big time, in the logarithm bias, which I had not heard of, but now am fully aware of. But the slightest change in the CPI has a huge revenue effect on Social Security because it is used to provide the COLAs for the benefits.

CBO told us that a 0.5 percent uptick in the CPI would cost Social Security more than $7 billion in 1 year. Is that a low figure? The intermediate assumptions in the Trustees' report expect that CPI will exceed 4.0 percent annually over the next 75 years. What would happen if your short-term, long-term estimates during the next 10 years were to see double digit CPIs like the 1970's and 1980's when the CPI hit a high of 13.4 percent? Then where do we go?

Mr. BALLANTYNE. Well, yes. Certainly if we return to double digit inflation, and if wages did not rise as much so that the real wage gain would be lower, that would have a negative effect on the program.

[The following was subsequently received from Mr. Ballantyne:]

In regard to your earlier point, if the automatic increase in Social Security benefits that become effective for December 1995 was 3.5 percent instead of the 3.0 percent increase assumed for the intermediate estimates, Social Security benefit payments in calendar year 1996 would be about $1.7 billion higher.

Senator SIMPSON. But, I mean, negative is not the word. It would have a destructive effect. I mean, it would be a cataclysmic effect, would it not?

Mr. BALLANTYNE. Well, it depends on the magnitude of the change. But we do not expect to get double digit inflation for a very long period. We did not have it, even in the early 1980's, for a very long period.

Senator SIMPSON. You see, I have not heard anybody talk yet about inflation or the rate of growth. In my 16 years here, those projects have never been correct, either up or down, ever. Those things really dent this system in tremendous ways.

Do you have any comment on that?

Mr. WALKER. Senator, it is inherently difficult to try to project what anything is going to do 75 years out, which is, in effect, what we are trying to do.

I think an important follow-up to your comment on CPI, while there are clearly some problems with the measurement that needs to be looked at and addressed by the Congress, I think with regard to the projected financial integrity of these social insurance programs, there are two things that are important that relate to CPI, one of which is the Consumer Price Index as it relates to benefit payments, and the other one is, real wage growth because, obviously, you grow on the income side as well as the expense side, so you need to understand what the interrelationship of that might be. There is also a generational effect, too, as to what the dispersion of the covered population would be.

Mr. BALLANTYNE. If the inflation rate were higher, as Mr. Walker said, benefits would be higher. But if the real wage gain does not go down by an equivalent amount, then revenues coming into the system would be higher as well. In fact, the revenues would come in a little faster than the higher benefits paid out because the wages are affected immediately by the inflation rate, while benefits are based on the previous measurement of the Consumer Price Index.

Senator SIMPSON. But would that not be lessened by less numbers of people paying in?

Mr. BALLANTYNE. Well, that is a separate factor, certainly, yes. Fewer workers per beneficiary in the future is——

Senator SIMPSON. I mean, you are never going to escape that one, so the other figures do not really mean that much.

Mr. BALLANTYNE. Unless the fertility rates are higher than we think they will be.

Senator SIMPSON. Well, that takes awhile. You have got to go right home and work.

Mr. ROSS. Could I add one thing, Senator Simpson?

Senator SIMPSON. Yes.

Mr. ROSS. That is, I think your point is well taken, that if you get economic conditions that are unanticipated you do have problems. Indeed, the reason that the 1977 actions did not fix things for the time projected was that there were economic adversities that happened that had not been anticipated, even in doing the three ranges of assumptions, to sort of try to box things in.

As a result, by 1983 when the Greenspan Commission was appointed, and we had a discussion of that situation, the reason that the second retrenchment happened so quickly was that there had been unanticipated economic consequences, as you point out so quickly.

Senator SIMPSON. May I ask just a final question about the CPI? Do you, Dr. Chater, or Mr. Ballantyne, who is your very able assistant here and does this work, feel the CPI is somewhat overstated?

Mr. BALLANTYNE. Well, I suspect that it is somewhat overstated, but I am not sure what the degree of overstatement is because of the inconclusiveness of that measurement. But I would agree, there probably is some overstatement.

Senator SIMPSON. We have had testimony that it ranges from 0.2 to 2.2. One fellow testified that it was over two percent.

Mr. BALLANTYNE. Yes, I believe so. The estimates are in that range.

Senator SIMPSON. Anyway, I believe that is correct. We think that we can do something there. We think there is an important thing to do there, and the testimony all shows it.

Well, let me thank you. I just would conclude and say I appreciate it very much. This is very important to me to see this and to hear what you say, and I agree totally with what, I believe it was you, Mr. Walker, said. We will not have a well-informed public until we have a well-informed media.

And I notice that most of the people that interview me from the media are below 50. I say, oh, are you going to put a senior citizen, rip them up tilt on this question? Well, yes. What are you doing to seniors? I say, what do you care, you ain't going to get nothing. I would think you would begin to use something different than the word cut. They ram a mike under your snoot and say, what are you going to do, you are going to cut Medicaid, you are going to cut Medicare. Hell, we are not cutting anything. We are trying to slow the growth for a good reason, to keep it from going broke.

If the media wants to continue to report that, and all their minions, and their talk shows, that we are cutting Medicare, cutting Medicaid, cutting school lunch——how about that caper the other day?

We are breaking catsup bottles over kids' heads, throwing bed pans out in the street. What do they do? Instead of letting the school lunch program go up 5.4 percent, they let it go up only 4.5 percent and send it off to the States. It was described nationwide as a savage cut. Well, if a 4.5 percent increase is a cut, have one on me.

And when we get into Medicare, Medicaid, and Social Security and are told that we are cutting things, we are not cutting a thing, we are trying to slow the growth of systems for a specific purpose, to keep them from going broke. People like you have told us when it will go broke. And if we cannot understand that, well, then Jefferson was right. It will be a society of the dead instead of the living, because we will not have taken care of our children and our grandchildren. I am not going to see that.

So, I hope this goes as a start as an all-points bulletin to people between 18 and 50 to get in the game. We gave you the right to vote when you are 18, and 15 percent of you use it. Better sober up. Better figure out what is happening.

Well, other than that, I have no strong feelings on these subjects. I want to thank you so much. I want to thank the staff for their patience. Thank you for your extraordinary dedication that you have given to the Trustee work, and all the work. I appreciate it very much. The hearing is concluded.

[The prepared statement of Senator Packwood appears in the appendix.]

[Whereupon, at 12:12 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED

PREPARED STATEMENT OF SHIRLEY S. CHATER

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to appear here today to discuss the status of Social Security's Old Age and Survivors Insurance (OASI) and Disability Insurance (DI) trust funds.

I would like to focus first on the findings published in the 1995 Annual Report of the Board of Trustees, which was issued several days ago. I would then like to discuss steps we have taken, with the help of Congress, to address the short-term insolvency of the DI fund, and finally, I will also discuss the need to establish a climate of bipartisan consideration to ensure the long-term financial solvency of both the OASI and DI trust funds.

THE 1995 TRUSTEES REPORT

The Trustees' Report notes that, during calendar year 1994, OASDI benefits amounting to $316.8 billion were paid to retired and disabled workers and their families, and to survivors of deceased workers. At the end of last year, almost 43 million people were receiving OASDI benefits. In addition, almost 140 million people worked in jobs covered by the OASDI program and paid OASDI contributions on their earnings. Income to the combined trust funds totaled $381.1 billion in 1994, and expenditures—the amount paid in benefits and administrative expenses—totalled $323 billion. I am pleased that the $2.7 billion cost of administering the OASDI program in 1994 was less than 1 percent of benefits paid during the year.

The Trustees develop three alternative sets of estimates based on varying economic and demographic assumptions to show a range of possibilities regarding the financial conditions of the trust funds. Designated as alternatives I, II, and III, these estimates range from low cost (alternative I) to high cost (alternative III). Alternative II, the intermediate set of assumptions, reflects the Trustees' best estimate of what future experience will be. I would like to stress, however, that these projections are not certainties, but only estimates based on anticipated trends and occurrences. The projections take into account fertility rates, mortality rates, net immigration rates, productivity increases, labor force participation rates, unemployment rates, Consumer Price Index and other factors difficult to predict.

Under the 1995 Trustees' Report's intermediate assumptions, the assets of the combined OASI and DI trust funds are expected to grow until 2020, and then to decline until they would be exhausted in 2030, one year later than was projected in last year's Report. While in my testimony I will focus on the intermediate assumptions, it is worth noting that, even under the high-cost alternative III assumptions, the combined funds would be sufficient to pay benefits for more than 20 years.

The Trustees also project the status of the trust funds over the next 75 years—the period which is considered long range for program evaluation purposes. The OASI and DI programs, considered both separately and on a combined basis, are out of what the Trustees call close actuarial balance, for the period 1995–2069. Actuarial balance is essentially the difference between annual income and costs summarized over a given period. If the balance is negative, as it is now, the fund has an actuarial deficit.

The deficit is generally expressed in terms of a percentage of taxable payroll. The deficit in this year's Report for the OASDI program is 2.17 percent of taxable payroll, slightly larger than the difference of 2.13 in last year's report.

REALLOCATION OF TAX RATE FROM OASI TO DI

As you know, Mr. Chairman, the Social Security Domestic Employment Reform Act of 1994, which was enacted on October 22, 1994, changed the portion of the OASDI tax rate which is allocated to the DI fund for wages paid after December 31, 1993, and for self-employment income for taxable years beginning after that date. For 1994 through 1996, the rate allocated to the DI Trust Fund was increased from 0.6 percent to 0.94 percent for employers and employees each. This reallocation resulted in transfers of $14.2 billion from the OASI trust fund to the DI trust fund in October and November for the retroactive period. For 1997 through 1999, the DI rate increased from 0.60 percent to 0.85 percent, for employers and employees each, and beginning with the year 2000, from 0.71 to 0.90 percent.

With respect to last year's reallocation, I would like to note that, historically, reallocation of rates has been used on occasion to alleviate temporary funding problems encountered by the trust funds. The 1977 Amendments reallocated money from OASI to DI to help resolve temporary financing problems encountered by DI in the late 1970s. Conversely, funds were reallocated from DI to OASI in 1980 and 1983 to avoid depletion of the OASI Trust Fund. Had the funding for the DI program in the 1977 amendments been retained, the DI trust fund today would actually have an actuarial surplus over the next 75 years.

I want to point out, Mr. Chairman, that Congress has always been willing to protect the financial solvency of the trust funds by shifting income from one fund to the other as temporary solutions to financing problems, and I want to thank the members of this subcommittee for their help last year in ensuring that the DI fund can continue to pay benefits to disabled workers and their families, until 2016. While reallocation alone does not solve the problems facing the disability program, we now have time to carefully study the recommendations of the bipartisan Social Security Advisory Council, expected later this year.

IMPACT OF TRENDS AND THE TRUSTEES' REPORT

Mr. Chairman, as you requested in your letter of invitation to today's hearing, I would like to address the issue of past or future trends, and how we view their impact.

Every year the Trustees' Report takes a "snapshot" view of the status of the trust funds based on both positive and negative economic and demographic assumptions over a 75-year period. These assumptions take into account future trends that are supported by recent experience and future expectations, and, as I mentioned previously, represent estimates of what impact such trends will have on the Social Security program in both the short range and the long range. Of course, it is not possible to predict with certainty whether experience or expectations based on a few years represents a long-term trend or an unusual occurrence. Thus, the Report does not necessarily signal either the beginning of a trend or the continuation of one.

For instance, one of the most widely publicized trends in recent years is the growth in the number of people receiving disability benefits, which rose from 2.9 million in 1989 to 3.9 million in 1994. This growth represents an increase of 34 percent. However, while there are some indications that the growth in the program has slowed (applications and awards for disability benefits have remained about the same in 1993 and 1994), it is not appropriate to draw irrevocable conclusions for the long term based on this experience because the Trustees reevaluate these assumptions every year.

The 1994 Trustees' Report estimated that the combined OASI and DI trust funds would be exhausted in 2029. Because the 1993 Report had estimated that the trust funds would be exhausted in 2036—7 years later than the 1994 Report—there were concerns that the 1995 Trustees' Report would change the projected year of exhaustion to a still earlier year. This proved not to be the case, however, since the year of exhaustion improved slightly to 2030, one year later than last year's Report.

This change is primarily the result of recent economic and demographic experience which was more favorable than was assumed in last year's report. The economic experience included faster growth in the labor force, a lower unemployment rate, faster economic growth, faster growth in real wages, and slower growth in prices.

The demographic experience included revised intercensal estimates of the historical population and new postcensal estimates by the Bureau of the Census, which show fewer people at older ages than did earlier estimates. Other demographic changes include higher projected mortality rates, reflecting the latest data that show higher than expected mortality in 1992 and 1993. Also, near-term birth rates were projected to be slightly higher based on recent experience.

A key change in the long-range intermediate assumptions is an increase in annual net immigration. The net number of immigrants assumed to enter the U.S. population each year was increased by 50,000, an increase consistent with estimates based on recent data from the Immigration and Naturalization Service.

While we need to be concerned about short-term trends such as the growth in the disability program, and understand the factors that underlie them, we should be careful to keep them in perspective. Our most important goal should be to ensure the long range solvency of the Social Security program. The value of the Trustees' Report is that it provides us with the best estimate of the program's long-range status.

MAINTAINING FINANCIAL SOLVENCY

Clearly, the long-term financing issue that confronts Social Security requires careful consideration. Fortunately, we have the time we need to take measured and thoughtful action. In fact, the current Trustees' Report estimates reinforce the idea that we have time for thoughtful measured bipartisan Consideration. No short term crisis exists and we should avoid creating an atmosphere where potentially rash and hasty decisions might be made.

This is not to say that reforms should be delayed until a crisis occurs—they should not. Social Security is very important for everyone in the Nation. After careful deliberation, any adjustments necessary to strengthen the program should be made in a way that will allow time for individuals to make the necessary changes in their future retirement.

Mr. Chairman, history has shown us that successful efforts to reform the Social Security system are the fruit of careful evaluation, bipartisan concern, and discussion of the issues among the Congress, the Administration, and the public. To ensure there is sufficient funding of the Social Security program for all future generations, we should take a comprehensive, bipartisan approach to considering changes in the program.

The Advisory Council on Social Security is currently examining proposals for improving the Social Security program and the new Social Security Advisory Board will also be looking at these important issues. When I met with the Advisory Council, I emphasized the importance of their primary task, which is to focus on Social Security financing and to develop recommendations for improving the long-range financial status of the OASDI program.

It is impossible to overstate the importance of the work now being done by the Advisory Council. Reform of Social Security has generally not taken place without being preceded by recommendations from the Advisory Council on Social Security or a similar bipartisan panel. The Advisory Council is nearing completion of its work and I look forward to their findings and recommendations which we will review with the Congress.

Mr. Chairman, I strongly believe that changes in the Social Security program should be made solely to strengthen the program, not to meet short-term budgetary goals. It is unacceptable to make changes in Social Security in order to make a contribution to reduce the general fund deficit, including deficits in other entitlement programs. As a self-financed program, Social Security has always paid its own way. Any adjustments must be designed to ensure the adequacy of the program for future generations, not to achieve short-term budgetary goals.

Thank you again for the opportunity to discuss the status of the Social Security trust funds. I look forward to working with you to strengthen the program for future generations of American workers and their families.

PREPARED STATEMENT OF SENATOR BOB KERREY

I appreciate the opportunity to testify today, Mr. Chairman, on the financial status of the Social Security and Disability Trust Funds.

As you know, I had the honor of serving recently as Chairman of the Bipartisan Commission on Entitlement and Tax Reform. In August of 1994 the Commission adopted by a 30–1 vote an Interim Report that graphically laid out the economic and social future this country faces if prompt action is not taken to control the growth of spending on federal entitlement programs.

In preparing the Interim Report, we discovered that it is easy to acquire false optimism when we look only five years ahead, as we do with our traditional budget process. That is why the Report released this week by the Social Security and Medicare Trustees is so important. Only when we look at the next 30 or 40 years—the horizon of our children—does the complete budget picture come into view.

The budget landscape changes dramatically by 2010 when the "baby boom" generation begins to retire. In a single decade, while our overall population increases by 2 percent, our retired population will increase nearly 30 percent. The ratio of the number of Americans working versus Americans retired will be cut by 40 percent, from 5:1 to 3:1. It is then that the inexorable laws of demographics and arithmetic begin to weigh heavily on our retirement and health entitlement programs.

According to the Trustees' best estimate, interest earned by the OASDI Trust Fund will be necessary to meet benefit outlays by 2012. These cash flow shortfalls will cause the total Federal deficit to increase rapidly. By 2020 it will be necessary to redeem the Trust Fund assets themselves to pay benefits, and by 2030 the Trust Fund will be exhausted. Clearly we have promises on the table to our kids and grandkids that we simply cannot keep.

The closer the Trust Fund gets to bankruptcy, the more excruciating our choices become. Should they reach bankruptcy, the choices will be severely constrained: continue to fund retirement benefits at current levels by radically raising taxes on the working population, or slash benefits dramatically. I do not relish the thought of either of these actions.

I also want to make very clear, Mr. Chairman, that I understand the tremendous, positive impact Social Security has had on this country. I believe it is one of the most—if not the most—important program we operate. Social Security has done a remarkable job of supplementing retirement income and pulling seniors out of poverty. Seniors today enjoy a lower rate of poverty than any other age group. I am proud of this accomplishment and strongly believe that Social Security should be preserved for future generations.

That is why the Entitlements Commission echoed the Trustees call to action to address the impending insolvency of both the OASDI and HI Trust Funds based on the 1994 Report. It is why I am here today to repeat that call.

The Social Security program will be able to pay benefits on time for the next 35 years. Since this date is beyond the next budget cycle and the next political cycle, some have brushed it off as an "abstraction" or "a political lifetime away." However, I believe that we must act now to phase in changes to address these long-term problems. There is a window of opportunity for us to enact reforms now. Acting sooner rather than later enables us to protect current beneficiaries from financial hardship and allows future beneficiaries to prepare for the effects of any changes. We need to halt our natural tendency to procrastinate, put aside the rhetoric, fear-mongering and mis-information, and have an honest national conversation about how best to plan for a future in which our population will be fundamentally different from what it was when Social Security was designed. I look forward to working with you to meet this challenge.

PREPARED STATEMENT OF SENATOR DANIEL PATRICK MOYNIHAN

I want to take special note of the witnesses who will appear before the Subcommittee today.

Last year's legislation making Social Security an independent agency (P.L. 103–296) appropriately elevated the Commissioner of Social Security to membership on the Board of Trustees, along with the Secretary of the Treasury, who remains the Managing Trustee, and the Secretaries of Labor and Health and Human Services. Thus Commissioner Chater appears before us today not only as Commissioner of Social Security, but as one of the Trustees who is responsible for the 1995 Trustees' Reports. She is the first Commissioner to serve in this capacity.

I also want to note that the two public trustees who are here today, Stanford Ross and David Walker, have now contributed to five Trust Fund Reports. Under the terms of their appointments, this is their last one.

They have performed exemplary service, setting a high standard for all who follow. We owe them an enormous debt of gratitude for the many hours of public service they have contributed toward assuring the integrity and accountability of these Trustees Reports.

The Report on the status of the Old-Age and Survivors Insurance and Disability Insurance Trust Funds that was released on Monday of this week holds no major surprises. The projections are slightly better than last year. Under the actuaries' intermediate assumptions, the OASDI Trust Funds will be solvent for another 35 years—until 2030, instead of 2029, as was projected in last year's report.

Nonetheless, in the vocabulary of the actuaries, the OASI and DI trust funds are not in close actuarial balance over the long term (75 years). The Trustees recommend that the long-range deficits in these Trust Funds should be addressed.

This can and will be done.

In this regard I ask that a response by my distinguished friend, Robert J. Myers, to a recent *Time* magazine article be printed in the hearing record. Mr. Myers, as those here surely know, came to Washington in 1934 and was quite literally present at the creation of Social Security. He served as Chief Actuary of the Social Security Administration from 1947 to 1970, and as Deputy Commissioner from 1981 to 1982, after which he became Executive Director of the National Commission on Social Security Reform.

The article to which Mr. Myers has responded was entitled "The Case for Killing Social Security," and the cover of the March 20th issue of *Time* in which the article appeared depicts a Social Security card torn into pieces. The lengthy *Time* article argues that in the next two decades, Social Security will "be lurching into its final crisis."

I suggest that the "case for killing Social Security" is weak indeed, and Bob Myers has demonstrated this as only he can. His paper makes clear that, far from being close to demise, the Social Security system will remain solvent. Yes, reasonable, measured changes need to be made in order to assure solvency over the long term. But Congress and various Administrations have never shirked from this bipartisan responsibility in the past, and we will not do so in the future. Social Security is not at risk, and we need to say so—as Bob Myers has done with great clarity.

Attachment.

COMMENTARY ON TIME MAGAZINE'S COVER STORY ON THE SOCIAL SECURITY PROGRAM

[BY ROBERT J. MYERS]

The cover of Time, the Weekly Newsmagazine, for March 20 was captioned "The Case for Killing Social Security." The contents featured a nine-page article going into detail as to why the program should be drastically changed, even eliminated, by moving to an entirely different system based on individual savings accounts. Unfortunately, the article involves many half truths, errors, and omissions of pertinent facts and is not well balanced.

The general thrust of this article is well shown by its introductory sentence—"You know a government program is in trouble when it's less credible than a flying saucer." The basis of this remark is from the results of an opinion survey of persons aged 18–34 made by the Third Millennium. This showed that 46% of the respondents believed that UFO's exist, while only 28% thought that Social Security will still exist by the time that they retire.

A very knowledgeable senator has made the comment about this so-called analysis of the financial solvency of the Social Security program that those who believe in the existence of UFO's are "dopey." Accordingly, their views on such a complex matter as the long-range viability of the Social Security program cannot be taken too seriously. Or their views as to UFO's may be considered as an attempt to be funny—under the theory "ask a silly question, expect a silly answer."

The article then states that, in about 20 years, Social Security "will be lurching into its final crisis" and will "collapse altogether." It immediately contradicts this "certainty" by saying that this can be avoided by benefit reductions or tax increases, although asserting that these would have to be "stunning" and "huge." The article fails to recognize that the program is not—and has not, in the past, been unchangeable. Further, such changes (which, admittedly, are very likely needed) do not involve great shifts at one time, but rather deferred and gradual small ones. The Social Security program is not—and was never intended to be—one that is of an unchangeabie, contractual nature. Rather, it can be—and has been—adjusted from time to time to reflect changing demographic, economic, and social conditions.

Next, the article asserts that, beginning now, some retirees are getting a "bad deal," because the value of their benefits (taking into account interest) will be less than "the sum of their lifetime contributions, plus interest." And, further, it is stated that this deplorable situation will get much worse as time goes by.

Unfairly, it is not pointed out that by "contributions" is meant both the employer and employee contributions. Economists will generally say that employees really pay the employer contribution, because it is part of total remuneration. I assert that, while this may be true in the aggregate, it is not necessarily the case on an individual-by-individual basis. Many private employee benefit plans (such as defined-benefit pension plans and health benefits plans) do not give each employee benefit protection financed by the employer that has a cost as a percentage of salary which is the same for all employees. For example, health benefits plans have a higher value relative to salary for low earners than for high earners, because for persons of a given age and family composition, the value of the benefits in dollars is the same.

Even more importantly, Social Security is not—and never was intended to be—a system involving complete individual equity, under which each participant would get exactly his or her money's-worth in benefit protection, no more and no less. Rather, it is intended to contain elements of both social adequacy and individual equity.

Under the social adequacy principle, relatively large benefits in relation to contributions are paid to several categories: participants who were beyond the normal entry age into the labor market when they were first covered (a common practice in private pension plans); lower-paid workers; and workers with dependents. The individual-equity principle is present in that, for a particular category of workers, the larger the earnings on which contributions are paid, the larger will be the benefit amount, even though not proportionately so.

The money's-worth situation under Social Security is far less extreme than is the situation for school taxes. Such taxes are paid, directly or indirectly, without regard to whether the payer has children currently, or has had children, or will have children. Moreover, the amount of the taxes bears no relationship to the possible "benefit" protection.

Following this incomplete, even inaccurate, money's-worth discussion, the article goes on to state that, "almost unanimously," scholars and policy analysts believe that the Social Security program is doomed and is "ripe for retirement" now. This unsupported statement is outrageous! Scores of scholars and policy analysts (including those persons who have a good knowledge of the structure and history of the Social Security program) do not hold this view, and only a handful of persons who are qualified by their knowledge and experience would support it. I am confident that, if a survey on this matter were made among actuaries (who are the "social engineers" in the general pension area), no such "dooms-day view" would be overwhelmingly held, or even supported by many.

These "experts" whom the article has found proclaim that the present Social Security program should be replaced by a two-tier system—a public-assistance needs-tested safety net under a mandatory private savings plan involving complete individual equity. Ignored in this proposal are several important matters. One is the huge general-revenues cost of the safety net, whose costs would have to be met indirectly by the higher-paid persons, who would think only that they are getting their money's-worth from the mandatory savings plan. Further, there would be great disincentives for saving by lower-income (and even middle-income) persons, because they would get little more by doing so than they would by utilizing the safety net only. And, still further, fraud and abuse would abound as persons would be tempted to hide income or transfer assets to their children and receive the income back "under the table."

Moreover, the proposed "simple solution" fails to recognize the problem of providing adequate disability and survivor benefits for persons who have such an event occur at the young or middle ages. In such cases, the mandatory savings will not have built up to a high level and thus will not "purchase" adequate benefits.

Next, the article proclaims that the Social Security trust fund (another display of ignorance because there are two trust funds—one for retirement and survivor benefits and the other for disability benefits) is an "empty cookie jar," because "the Treasury has already raided it for hundreds of billions." This is patently false! The bonds and notes held by the trust funds are just as valid as any government securities held by banks, insurance companies, mutual funds, you, and me. They pay an equitable rate of interest and are part of the recorded National Debt. Certainly, the money that went for them (the excess of income over outgo of the trust funds) was spent. But the same thing is done by the Treasury with the proceeds of any bonds which it sells to the public—or, for that matter, the same as a corporation does when it sells its bonds, or a savings bank does with your deposit (it "spends" the money by lending it to somebody else).

The article then bemoans the problem, some 20–25 years hence, when under present law, the bonds will begin to have to be redeemed in mass. To do so, such action as raising income taxes or floating new loans from the public will be necessary. But this is no different than what has to be done when government obligations held by the general public come due. And it is most important to note that, if the trust funds had not had the money to purchase the bonds in the beginning, the general public would have had to have done so, and there would still be the same problem of redeeming the bonds at some time.

Further, if changes in the Social Security program are made in the next few years—as I believe that they should be—this situation of a dismantling of huge trust-fund balances would not occur. In fact, if Senator Moynihan's proposal, made about five years ago, to slightly lower contribution rates now and slightly raise ones many years hence—thus returning to pay-as-you-go financing—were adopted, this problem would not occur. And further, the true magnitude of our horrendous general-budget deficits would be apparent.

A minor error, and yet one that clearly displays the ineptitude of the article, is the statement that maximum Social Security payroll taxes "have already multiplied 10 times since 1950." Such tax in 1950 was $90 (3% of $3,000) and is $7,588.80 in 1995 (12.4% of $61,200). The correct "multiplying factor" is thus 84.3, not a mere 10!

The next cry of "doom and gloom" in the article is that, some 35 years from now, if nothing is done in the meanwhile, the trust funds will be exhausted, and the Social Security tax rate will have to be increased to 17%. This is reasonably correct (although I would have said 16% initially and 17% some years later) under the conditions stated. However, such conditions are most unreasonable! Congress, which almost always acts reasonably and responsibly (although not always promptly enough!), will undoubtedly act well in advance of such a cataclysmic event. True, an increase of about 4% in the combined employer-employee tax rate in a single year might "devastate the economy," as the article claims.

But what should be done—and likely will be done—is to transition in some benefit cost reductions (like an increase in the Normal Retirement Age, so as to recognize increased longevity) and some contribution rate increases (like 1% each on employers and employees, in steps over a period of years). This would have little, if any, adverse effect on the economy.

Next, the writers of the article had the temerity to wander into the actuarial field by quoting figures as to the probability of a new-born baby reaching age 65 (better would have been the higher probability for a person entering the labor force at age 20) and the expectation of life at age 65, for both 1940 and 1990. Not surprisingly, most of their figures are in error, as shown below:

Sex and Year	Percent Surviving to Age 65		Expectation of Life at Age 65	
	Time figure	Correct value	Time figure	Correct value
Male, 1940	54%	55.8%	13 years	12.1 years
Female, 1940	61%	65.5%	15 years	13.6 years
Male, 1990	72%	74.1%	15 years	15.1 years
Female, 1990	84%	85.1%	20 years	18.9 years

Out of eight figures, the article had only one which was even nearly correct.

Then, the article re-writes history by asserting that, in the early years of the Social Security program, Congress could increase benefits easily every few years (and thus garner votes), because there were few beneficiaries relative to the number of contributors. Not so! Most of the benefit increases were made to reflect changes in the cost of living, and they were financed by the accompanying increases in the level of wages that were taxed. At all times, Congress was very conscientious about the cost implications of the changes, not merely as to the next year or two, but also as to the long range (75 years).

Further, the article asserts that the 1983 Amendments were based on "rather minor cutbacks in benefits and very major increases in taxes, the last of which took effect only in 1990." In the first place, the 1983 Amendments did not increase the tax rate in 1990 over what it was in previous law. Further, reductions in benefits played a major role in saving the program by the 1983 Amendments. If the income taxation of benefits is considered as a "benefit cut" (because, in effect, the money remained in the trust funds), then 48% of the solution in the short range (10 years) was due to tax increases and 52% to benefit cuts, while for the solution over the long range (75 years) only 23% was due to tax increases, with 77% due to benefit cuts. On the other hand, if the income taxation of benefits is considered as a "tax increase" item, then 70% of the solution in the short range was due to tax increases and 30% to benefit cuts, while for the long range, 54% was due to tax increases and 46% to benefit cuts. In any event, the benefit cuts were by no means "minor."

The article next describes several ways to modify the Social Security program without "killing" it. Just before this, the article quite properly (and in contrast to the slogan on Time's cover) points out the disastrous weakness of the Heritage Foundation's proposal to let people opt out at will; this would set up a vicious circle of actuarial anti-selection, because the low-cost persons (young and high-paid) would drop out, and the high-cost ones would remain in, with resultant financial collapse.

The proposals for change include the following:

(1) Raise the Normal Retirement Age (which solution is my choice).

(2) Raise the Early Retirement Age (which may be desirable, but does not lower overall costs, because the reductions are on an "actuarial" basis).

(3) Reduce Cost of Living Adjustments, presumably by giving less than the CPI increase (which is undesirable, because it most adversely affects the oldest beneficiaries, who are least able to do anything about their situation—because of the compounding effect).

(4) Means-test the benefits (which is a bad idea, because it would discourage low- and middle-income persons from saving, and it would encourage fraud and abuse by beneficiaries).

Next, the article seed to look favorably at a proposal by Senators Danforth and Kerrey to reduce the employee Social Security tax rate (but not the employer rate) from 6.2% to 4.7 % and then require that the 1.5% reduction be put into a private investment fund, with future Social Security benefits being "reduced to reflect the drop in taxes." Certainly, IPAs and so-called 401(k) plans are very desirable and should be encouraged, but they should be kept separate and built on top of a uniformly applicable Social Security program. The actual mechanics of the foregoing proposal, however, are faulty (and really cannot be perfected). It would work out reasonably well administratively for high paid workers, but would be a disaster for low-paid, intermittently-employed workers. The proceeds from a 1.5% contribution, coming in dribbles over the year, would be "eaten up" by the administrative expenses of handling, recording, and reporting them. Mutual funds generally require fairly sizable deposits—not anything like the roughly $20 quarterly payments (varying each time) for a $5,000 worker.

The article mentions that the estimated long-range financial status of the Social Security program has worsened over the years since the 1983 Amendments. However, it fails to point out that the actual short-range experience has been more favorable than estimated in 1983 (the current fund balance being more than $100 billion higher than estimated).

In summary, it is really outrageous that, by incomplete and erroneous reporting, the article casts so much doubt on the long-range financial viability of the Social Security program. This is despite the fact that, by very careful reading of the end of the article, it could be concluded that reasonable small, gradual changes could be made without changing the basic nature of the program—that would very likely ensure its viability.

Finally, the article is supplemented by a note, "How Chile Got It Right." This describes the new Chilean social security plan instituted in the early 1980s. It replaced a traditional social insurance system that was some 60 years old, but that was in great financial and administrative difficulties due to inflation (which raised benefits greatly and, at the same time, made the accumulated assets worthless) and extensive coverage noncompliance.

The Chilean article is quite correct that the new plan reasonably well solved the problem, although this was not the only way in which that could have been accomplished. However, this article, too, contained many errors and omissions that glossed over some of the weaknesses in the new plan and other elements of it that make it not necessarily a desirable course to follow for other countries, let alone the United States.

A number of factual errors occur in describing the current Chilean plan. These cast doubt upon the credibility of the analysis. First, the contribution rate for retirement pensions is not 12%, but rather it is 10% (with an additional approximately 3.5% for the build-up of disability and survivor pensions).

Second, the plan is not a "two-tier" one, consisting of a small flat stipend funded from general revenues for only the poorest pensioners and the accumulation of employee contributions in private investment funds. Rather, it involves the accumulation of employee contributions in such funds, plus the provision of sizable prior service credits financed from general revenues, plus a guarantee of a relatively sizable minimum pension being produced for persons with at least 20 years of coverage, financed from general revenues. Such minimum pension is 85–90% of the legal minimum wage, which in turn is about 30–40% of the average wage in the country. Thus, the minimum pension is a quite large amount, so that many people will be affected.

Third, the article states that retirement benefits under the new plan at present are 40% higher than under the old one. Actually, they are about at the same level (as was intended), although disability and survivor pensions are much higher (because they are financed currently and are not as much affected by past inflation).

Several serious errors of omission are present, so that elements are not brought out that would argue against the Chilean approach being applicable in all other countries. First, there are the mammoth general-revenues costs to be met for prior service credits and for all time to come for the large minimum pensions. Few countries—and especially the United States—have large surplus amounts of general revenues readily available.

Second, the fact that employees contribute, and employers do not do so any more, is not what it seems. When the new plan was established, the government required all employers to give a more-than-offsetting 17% pay increase to all employees.

Third, the administrative expenses of the new Chilean plan are about 13% of contributions for the retirement portion—as against 1% in the U.S. system.

Fourth, coverage compliance is poor under the Chilean system. Only about 80% of those who should be contributing actually do so. Further, many low earners contribute on much less of their wages than the actual amount, because they will get the minimum pension in any event.

Fifth, by no means is all the money piling up in the investment funds being used to promote the economy. Much of the money is "laundered back" to the government to pay the huge costs of prior service credits and minimum pensions.

PREPARED STATEMENT OF BOB PACKWOOD

I am pleased that Senator Simpson has called this subcommittee hearing today to explore the financial status of the Social Security program as presented in the 1995 Annual Reports of the Trustees for the Social Security and Disability Trust Funds. I regret that I am unable to attend the hearing. I will, however, be very interested in the information and suggestions presented at this hearing on how to assure the long-range health of the Social Security program.

The 1995 Annual Trustees' Reports on the Medicare Trust Funds, released at the same time as the Annual Reports on the Social Security Trust Funds, describe a serious financial crisis for the Medicare program and call for immediate action.

Due to a full hearing schedule, I was unable to hold a hearing on the 1995 Annual Reports on the Medicare Trust Funds this week. Finance Committee members will have the opportunity to explore the financial condition of the Medicare program at a hearing on April 25, 1995, shortly after the Senate returns from the Spring recess. I have invited all of the Trustees of the Medicare Trust Funds to appear at this hearing and engage in a discussion with Finance Committee Members on possible solutions for addressing this serious situation.

Putting the Medicare program on a sound financial footing to secure it for future generations will be one of the highest priorities of the Finance Committee over the next several months.

PREPARED STATEMENT OF STANFORD G. ROSS AND DAVID M. WALKER

Mr. Chairman and members of the subcommittee: It is our privilege to be here today to testify regarding the financial status of the Social Security and Medicare Trust Funds as shown in the 1995 Annual Reports of the Boards of Trustees of those funds. As you know, the Public Trustees are part-time officials appointed by the President and confirmed by the Senate to represent the public interest in this important process of public accountability. In our normal activities, Mr. Ross is a lawyer and consultant and Mr. Walker is a CPA and consultant, both with extensive public and private experience in tax, financial and retirement security matters.

As Public Trustees, our primary activities have been directed at assuring that the Annual Trust Fund Reports fully and fairly present the current and projected financial condition of the trust funds. During the preparation of the Annual Reports over the last 5 years, we have participated in the review of the proposed short-range and long-range economic and demographic assumptions and in the decisions made on those assumptions. We have attempted to test assumptions, question methodologies and work with the Offices of the Actuary of the Social Security Administration and the Health Care Financing Administration and others in and out of government to seek improvements in the projections. Specifically, we have sponsored roundtable discussions with expert panels on key assumptions, including the rate of change in fertility, mortality and real wages. We also sponsored a symposium and publication of papers on how methods and assumptions might be improved to better estimate the future income and health care needs of the elderly and disabled. The goal of these efforts has been to assure the American public of the integrity of the process and credibility of the information in these reports.

In addition to our efforts to ensure the integrity of the projections in the trust fund reports, we also have worked to improve communications with the Congress and the public regarding these important programs. We are particularly pleased to have provided leadership in returning to one set of intermediate projections, or "best estimates," in the reports, and in conceiving and instituting the increasingly popular Summary of the Annual Reports, including an annual "Message From the Public Trustees," as an important part of the reporting process. We have also testified before this committee, its corresponding committee in the House of Representatives, and other governmental commissions, and given speeches and briefings to congressional staffs and other interested parties. Our goal in these activities has been to enhance understanding of the current and projected financial condition of the Social Security and Medicare programs.

A key point we have stressed is that projections ultimately are only estimates and must necessarily reflect the uncertainties of the future. Nevertheless, the projections in the Trustees Reports are useful if understood as a guide to a plausible range of future results and if acted on in a timely and responsible manner. With this purpose in mind, we now turn to the projections in the 1995 reports released earlier this week.

SOCIAL SECURITY PROGRAM

In the 1995 report, the Old-Age and Survivors Insurance Trust Fund shows a deficit of 1.87 percent of payroll in the long run. It is by far the best financed trust fund, and we believe strongly that the OASI program can and should be maintained over the long term. Yet even here reforms should be undertaken sooner rather than later to ease the transition to providing financial stability in the next century. We note the recent work of the Bipartisan Entitlement Commission and the current work of the Advisory Council on Social Security regarding the long-term financing of the OASI program. We hope that this kind of work will continue and that this problem will be addressed in a timely fashion.

The condition of the Disability Insurance Trust Fund is more troublesome. While the Congress acted this past year to restore short-term financial balance to the DI fund, this necessary action should be viewed as only providing time and opportunity to design and implement substantive disability program reforms that can lead to its long-term financial stability. The research undertaken at the request of the Board of Trustees, and particularly of the Public Trustees, shows that there are serious design and administrative problems with the DI program. Changes in our society, the workforce and our economy suggest that adjustments in the program are needed to control long-range program costs. Also, incentives should be changed and the disability decision process improved in the interests of beneficiaries and taxpayers. We hope that this research will be completed promptly, fully presented to Congress and the public, and that the Congress will take action over the next few years to make this program financially stable over the long term.

MEDICARE PROGRAM

The most critical issues, however, relate to the Medicare program. Both the Hospital Insurance Trust Fund and the Supplementary Medical Insurance Trust Fund show alarming financial results. While the financial status of the HI program improved somewhat in 1994, the HI Trust Fund continues to be severely out of financial balance and is projected to be exhausted in about 7 years. The SMI Trust Fund, while in balance on an annual basis, shows a rate of growth of costs which is clearly unsustainable. Moreover, this fund is projected to be 75 percent or more financed by general revenues, so that given the general budget deficit problem, SMI is a major contributor to the larger fiscal problems of the nation.

The Medicare program is clearly unsustainable in its present form. We had hoped for several years that comprehensive health care reform would include meaningful Medicare reforms. However, with the results of the last Congress, it is now clear that Medicare reform needs to be addressed urgently as a distinct legislative initiative. We also believe that Medicare reform should be included as an integral part of any broader health care reform initiative which may be considered in the future. We strongly recommend that the crisis presented by the financial condition of the Medicare Trust Funds be urgently addressed on a comprehensive basis, including a review of the program's financing methods, benefit provisions, and delivery mechanisms.

PROJECTIONS AS A GUIDE TO ACTION

As this brief summary of the projections in the 1995 reports shows, the timing and magnitude of the financing problems facing the four trust funds are distinctly different. For the Medicare program, prompt, effective and decisive action to control program costs is necessary. The recent growth in the Disability program requires that it also be examined to find ways to control long-range program costs. The OASI program is in by far the best financial health of all these programs, and the changes that will be required in OASI can be relatively small and gradual if they are begun in the near future. However, the magnitude of those changes grows each year that action is delayed.

Mr. Chairman, we have attached to our statement the four-page "Message From the Public Trustees" that is included in the *Summary of the 1995 Annual Reports*, as well as our biographical information. We would be happy to answer any questions you may have.

THE PUBLIC TRUSTEES

Six people serve on the Social Security and Medicare Boards of Trustees: the Secretary of the Treasury, the Secretary of Labor, the Secretary of Health and Human Services, the Commissioner of Social Security and two members (of different political parties) appointed by the President and confirmed by the Senate to represent the public. The Boards are required by law to report to the Congress each year on the operation of the four Social Security and Medicare trust funds and the projected financial status of these funds for future years. The Public Trustee positions were created by the Social Security Amendments of 1983. Stanford G. Ross and David M. Walker began four-year terms as Public Trustees on October 2, 1990, and completed their terms with issuance of the 1995 reports on April 3, 1995. In addition to their duties overseeing the trust funds, they have worked to increase public understanding and public confidence regarding Social Security and Medicare.

STANFORD G. ROSS

Stanford G. Ross is a Senior Partner in the law firm of Arnold & Porter in Washington, D.C. Mr. Ross dealt extensively with public policy issues while serving in the U.S. Treasury Department, on the White House domestic policy staff, and as Commissioner of Social Security. He also served as Chair of an Advisory Council on Social Security.

Mr. Ross has taught law at the Georgetown, Harvard, New York University and Virginia Law Schools, and has been a Visiting Fellow at the Hoover Institution, Stanford University. Mr. Ross has served as Chairman of the American Bar Association Tax Section Committee on Social Security and Payroll Tax Problems. He has provided technical assistance to various foreign countries on Social Security and tax issues under the auspices of the International Monetary Fund, the World Bank, and the U.S. Treasury Department. Mr. Ross served as President of the National Academy of Social Insurance from January 1990-April 1992, and is a founding member and a member of its Board of Directors. He received a J.D. degree from Harvard Law School and a B.A. degree from Washington University (St. Louis). He is the author of many papers on federal taxation and income security and is a frequent participant in conferences on these subjects.

DAVID M. WALKER

David M. Walker is a partner and worldwide managing director of the compensation and benefits practice of Arthur Andersen LLP based in Atlanta, Georgia. Mr. Walker has held a variety of executive and policymaking positions in the Federal government, including serving as head of two of the three Federal agencies that administer the Employee Retirement Income Security Act of 1974 (ERISA). His most recent full-time government position was Assistant Secretary of Labor for Pension and Welfare Benefit Programs at the U.S. Department of Labor. Mr. Walker served at the Pension Benefit Guaranty Corporation (PBGC) before joining the Department of Labor.

Mr. Walker is a Certified Public Accountant and received his B.S. in accounting from Jacksonville University. He holds a number of leadership positions, including serving as a director of the Association of Private Pension and Welfare Plans (APPWP), chairman of the American Institute of Certified Public Accountants' (AICPAs) Employee Benefit Plans Committee, and vice-chairman of the Legislative Committee for the Southern Employee Benefits Conference. He is a member of a number of other organizations, including the National Academy of Social Insurance and the Editorial Advisory Board of *Journal of Accountancy and Journal of Taxation of Employee Benefits*. He is a frequent speaker, author and expert witness on a variety of compensation, benefits, investment, retirement and related issues.

Attachment.

[From *A Summary of the 1995 Annual Reports* of the Social Security and Medicare of Trustees]

A MESSAGE FROM THE PUBLIC TRUSTEES

This is the fifth set of Trust Fund Reports on which we have reported as Public Trustees. It is also, under the terms of our appointment, our last report, and we use this occasion to summarize our views on some major aspects of the Social Security and Medicare programs. As representatives of the public, our efforts have been to assure the American public of the integrity of the process and the credibility of the information in these reports. We feel privileged and honored to have been able to take part in this important exercise in public accountability, and want to provide our best advice on directions for change of these important programs in the years ahead.

The Need For Action

During the past 5 years there has been a trend of deterioration in the long-range financial condition of the Social Security and Medicare programs and an acceleration in the projected dates of exhaustion in the related trust funds. To some extent, this has been predictable because when doing annual 75-year projections, an additional deficit year in the 2060s is being added with each new projection. But to some extent, the increasingly adverse projections have come from unforeseen events and from the absence of prompt action in response to clear warnings that changes are necessary. These adverse trends can be expected to continue and indicate the possibility of a future retirement crisis as the U.S. population begins to age rapidly. We urge that concerted action be taken promptly to address the critical public policy issues raised by the financing projections for these programs.

Projections As A Guide To Action

We believe it is important for the public and the Congress to understand more about what the projections in the Trust Fund Reports really mean and how they are intended to be used. These projections represent the best estimates the Trustees can make based on the best available information and methodologies. We have, during our period of service, attempted to test assumptions, question methodologies and work with the Offices of the Actuary of SSA and HCFA and others in and out of government to seek improvements in the projections. We have also stimulated thought through a symposium and publication of papers on how methods and assumptions might be improved to better estimate the future income and health care needs of the elderly and disabled. Action should be taken to continue and extend survey and other data development efforts and to improve modeling capability regarding the income and health circumstances of future retirees. Such information is critical to the legislative and regulatory activity that will be required for both public and private income security and health care programs in future years.

However, with even the best data and models, projections ultimately are only estimates and must necessarily reflect the uncertainties of the future. They are useful if understood as a guide to a plausible range of future results and if acted on in a timely and responsible manner. They are not helpful if ignored, or if used improperly, or if distorted. We hope that more policymakers will come to grips with the strengths and limitations of projections such as those in the Trust Fund Reports and how those projections can be used most productively.

Social Security Program

The Old-Age and Survivors Insurance Trust Fund shows a deficit of 1.87 percent of payroll in the long run. It is by far the best financed of the trust funds, and we believe strongly that the OASI program can and should be maintained over the long term. Yet even here reforms should be undertaken sooner rather than later to ease the transition to providing financial stability in the next century. We note the recent work of the Bipartisan Entitlement Commission and the current work of the Advisory Council on Social Security regarding the long-term financing of the OASI program. We hope that this kind of work will continue and that this problem will be addressed in a timely fashion.

The condition of the Disability Insurance Trust Fund is more troublesome. While the Congress acted this past year to restore its short-term financial balance, this necessary action should be viewed as only providing time and opportunity to design and implement substantive reforms that can lead to long-term financial stability. The research undertaken at the request of the Board of Trustees, and particularly of the Public Trustees, shows that there are serious design and administrative problems with the DI program. Changes in our society, the workforce and our economy suggest that adjustments in the program are needed to control long-range program costs. Also, incentives should be changed and the disability decision process improved in the interests of beneficiaries and taxpayers. We hope that this research will be completed promptly, fully presented to Congress and the public, and that the Congress will take action over the next few years to make this program financially stable over the long term.

Medicare Program

The most critical issues, however, relate to the Medicare program. Both the Hospital Insurance Trust Fund and the Supplementary Medical Insurance Trust Fund show alarming financial results. While the financial status of the HI program improved somewhat in 1994, the HI Trust Fund continues to be severely out of financial balance and is projected to be exhausted in about 7 years. The SMI Trust Fund, while in balance on an annual basis, shows a rate of growth of costs which is clearly unsustainable. Moreover, this fund is projected to be 75 percent or more financed by general revenues, so that given the general budget deficit problem, it is a major contributor to the larger fiscal problems of the nation.

The Medicare program is clearly unsustainable in its present form. We had hoped for several years that comprehensive health care reform would include meaningful Medicare reforms. However, with the results of the last Congress, it is now clear that Medicare reform needs to be addressed urgently as a distinct legislative initiative. We also believe strongly that Medicare reform should be included as an integral part of any broader health care reform initiative which may be considered in the future.

There are basic questions with the scale, structure and administration of the Medicare program that need to be addressed. For example, is it appropriate to have a Part A and Part B today, or should this legacy of the political process that enacted Medicare in the mid-1960s be revised to create a unified program? Is it appropriate to combine participants' social insurance tax contributions for Part A and premium payments for approximately one-quarter of Part B with general revenues? If so, what should be the proper combination of beneficiary premiums, taxpayer social insurance contributions, and general revenues? How are each of these kinds of revenue sources to be justified and what rights to benefits and responsibilities to pay benefits are thereby established? How can the program become more cost-effective? How can fraud, abuse and waste be better controlled?

We feel strongly that comprehensive Medicare reforms should be undertaken to make this program financially sound now and over the long term. The idea that reductions in Medicare expenditures should be available for other purposes, including even other health care purposes, is mistaken. The focus should be on making Medicare itself sustainable, making it compatible with OASDI, and making both Social Security and Medicare financially sound in the long term.

We strongly recommend that the crisis presented by the financial condition of the Medicare Trust Funds be urgently addressed on a comprehensive basis, including a review of the program's financing methods, benefit provisions, and delivery mechanisms. Various groups should be consulted and reform plans developed that will not be disruptive to beneficiaries, will be fair to current taxpayers who will in the future become beneficiaries, and will be compatible with government finances overall.

Institutional Considerations

We have as Public Trustees tried over the past 5 years to provide continuity and improve the institutional framework surrounding the Social Security and Medicare programs. We have bridged two Administrations (one Republican and one Democratic), two Advisory Councils (one appointed by a Republican Administration and one by a Democratic Administration), and many changes in the ex officio Trustees. We have consulted with each of the Advisory Councils, as well as the working group of the prior Public Trustees, the Bipartisan Entitlement Commission, the Notch Commission and many other government entities. We have testified before both the House Ways and Means Committee and the Senate Finance Committee and held regular briefings for Congressional staff on the Trust Fund Reports. We know that with the advent of the new Social Security Administration as an independent agency, many of the institutional relationships in these areas will change. We hope that the Public Trustees in the future will continue to make a contribution towards a coherent institutional structure that serves the interests of the public.

Finally, we note that although the statute provides that one of the Public Trustees must be from each of the major political parties, we have operated as independent professionals on a nonpartisan basis. Every statement we have made over 5 years has been joint and consensual, and without partisan content or political dissonance. We believe these programs are too important to be politicized and urge

that a highly professional, nonpartisan approach continue to be followed in future reports to the Congress and the public.

STANFORD G. ROSS, *Trustee.*
DAVID M. WALKER, *Trustee.*

COMMUNICATIONS

STATEMENT OF THE AMERICAN ACADEMY OF PEDIATRICS

The American Academy of Pediatrics represents 49,000 pediatricians who are dedicated to promoting the health, safety and well-being of infants, children, adolescents and young adults. This statement reflects the Academy's positions on welfare reform in general, including the provisions of the Personal Responsibility Act passed by the House. We have submitted a separate statement on the Supplemental Security Income Program.

WELFARE REFORM—IN GENERAL

The American Academy of Pediatrics fully shares the goals of welfare reform—promoting the economic self-sufficiency of families, personal responsibility in child bearing and child rearing, and the wise expenditure of scarce public funds.

We especially support the need to address long overdue reforms associated with our welfare system that affects the lives of our youngest citizens and our vulnerable adolescents. Our children are a declining segment of our society. If we are to have a competitive workforce, we simply cannot afford to lose any of them. That is why the pediatric community views this public forum both as an opportunity and a responsibility to help shape pragmatic policies to help families be families.

In the attempt to reform a system as complex as this one, we are reminded of the oath we took as physicians to "first, do no harm." As pediatricians, our first and foremost concern is with the child who will be affected by the proposals under consideration by Congress. There are no easy answers, but there are answers, if all interested parties work together to fashion practical solutions. In the spirit of cooperation, we would like to point out some of the areas in which we have concerns.

To understand the problems, let's look at the faces and the environment of the children in need of the welfare system. Since the early 1970s, the poverty rate among children has steadily increased. Between 1987 and 1992, a staggering one million more young children became poor. Two-thirds of the nation's AFDC recipients are children. Even with the current welfare safety net, however, 25 percent of all children under age six, or six million children, now live in poverty. Most are the children of working parents.

Low-income children are more likely to live in dangerous neighborhoods and have a higher incidence of low-birth weight, asthma, infectious diseases, and exposure to lead than other children. They have lower immunization rates, poorer nutrition, and are more likely to attend below-average schools than non-poor children. As teens, low-income children have higher rates of suicide, drug abuse, and violent injuries and deaths, including homicide, than their more well-off counterparts.

We cannot abandon these children. For their sake, and the sake of our nation's future, we all want to break this cycle of poverty and dependence on welfare. How can this be done?

Unfortunately, we cannot supply you with an easy answer. We know that children generally do best in a healthy two-parent family, with adequate health care, nutrition, and financial security. Therefore, we encourage efforts to reduce teen pregnancy and promote economic self-sufficiency and parental responsibility—for fathers and well as mothers. We agree that it may be appropriate to require young parents to finish school, and in some cases, to live at home with their parents or, if that is not possible, in supervised group home settings.

OUT-OF-WEDLOCK AND ADOLESCENT PREGNANCY

With respect to the incidence of out-of-wedlock pregnancy, almost all economists and sociologists have found that the amount of welfare payments has an insignificant or no effect. And as practitioners serving teens, we know that part of adolescence is to engage in risk-taking behavior, and that early unprotected sex and early parenthood result from numerous and complex factors. Thus, we are concerned that withholding AFDC payments to children born to unmarried teenage mothers will not have a significant impact on the rate of teen pregnancy, but would simply deepen the level of poverty for affected families.

While no one has a simple answer to preventing teen pregnancy, the evidence indicates that the best approach is to give young people a sense that they have a future. A protected and nurtured early childhood, followed by a good education, job training and job placement will help. A strict work requirement alone, like that in the Personal Responsibility Act, will not solve the problem.

In practical terms, what will it mean to a young mother and her child if the mother is forced to work? We cannot assume that she will have a mother or grandmother who can care for her child. On the wages that most teen parents can expect, it will be very difficult to find high-quality, affordable child care. Consequently, the children of parents required to work may be forced into substandard—even dangerous—child care settings where they will not receive the attention and stimulation necessary for healthy emotional and intellectual development.

SUMMARY

In short, we fear that unraveling the federal safety net by eliminating entitlements to cash assistance, nutrition programs, child care for at-risk families, and other programs, will jeopardize the well-being of our nation's poorest and most vulnerable children—one-fourth of our future workforce.

We do not pretend to have all the answers. We do know, however, what children need to develop into healthy and productive members of society and are extremely concerned that these basics will be taken away from millions of children if some of the current welfare proposals are enacted.

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