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National Health Policy Conference 2005
Future Entitlements: When Push Comes to Shove
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MALE SPEAKER: When we were thinking of this plenary panel to look at the future of entitlements, we could think of no one other than Jack to help us organize it.

JACK EBELER: Thanks David. It is great to be here. I wanted to start with a little story from my favorite movie "The Wizard of Oz" and well into that movie just after the Wizard has been literally outed from behind the curtain by Toto he realizes he has to get Dorothy back to where? Kansas. How is that for transition? He is there in his hot air balloon and Dorothy looks at him and asks him how he is going to get her back to Kansas. He says he is going to take off in this balloon and he is going to go hobnob with his fellow wizards. That is what we in health policy do. We hobnob with our fellow wizards.

In fact, we dance around the health care fires mumbling terms like HSAs, POS plans, BRGs, PRGs minus one, CPT and ID9 codes, TIFFA and 11-15 waivers, and how could I forget this UPL. I am sure you have most of these terms today or you will hear them tomorrow. This is the lexicon of the health policy wizard. It includes most of you and it includes me. About a mile East of here another set of sorceress meet regularly. They work at places like CBO, the Joint Tax Committee, Ways and Means, Senate budget, and OMB a few blocks in the other direction. Their vernacular contains things like budget

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resolutions, market ups, and budget reconciliation. They deal in five and ten-year forecasts even 30-year forecasts. They talk about budget deficits and current account deficits and have huge battles over tax policy. The point I am getting too is that these two sets of wizards each have their own language and they rarely meet. The value of this session as I see it, and I credit the Academy for putting it together, is to bring these worlds together in this session and expose all of us who are health care wizards to some excellent wisdom from two of the best budget and federal tax policy experts and macro economists that I could think of Rudy Penner and Alice Rivlin. I am going to say a word or two about them in a moment but I just wanted to lead off this session by saying that I think we face looming challenges in health care that were well captured by my college Henry Aaron who works at the Brookings Institution. His new book last year was called *Coping with Methuselah*. I can't think of another caption for the challenge that we face in an aging society with an explosion of technology that we will describe briefly. We have had a 30-year increase in life expectance over the 100 years. How long will it be before we have the next 30-year increase? We have had a revolution of Molecular Biology. We are on the threshold of the stem cell transplants, cross-specie transplants, ways to encourage the human body to generate new blood vessels, stopping the growth of new cancer cells. Indeed the mapping of

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human gene is opening up vistas of which we can hardly even dream. All this will lead to wondrous benefits and substantial costs. We lack good mechanisms for evaluating and assessing the new technology that will emerge from this basic research.

We also lack a set of ethical guidelines. Meanwhile superimposed on these projects is a set of federal entitlement programs that were born in a different era. Well-intentioned and well designed for the era they grew up in. Different demographics different science and other important differences.

We also have expectations about retirement inherited from an era that could be traced to Bismarck in the late 19th century. We may need to reexamine all of this. We may need to reassess and modernize our social contract and the entitlements that embody it and in ways that are fair, efficient and reflect intergenerational compact. To help educate all of us about the likely trends in federal budget outlays, taxes implications of those trends, and some possible options for addressing them. Because these trends will be affecting the world we live in. Our isolated insulated world of health policy will be more and more affected by the changes that we make and don't make to the federal entitlement program and that is the premise of this session. We can learn about this from people who are non-partisan, objective, and very knowledgeable. We have turned to two people who were the earliest directors of the Congressional Budget Office Alice Rivlin and Rudy Penner. Both have served

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in high positions at the Office of Management and Budget. They have had important positions. They are well respected on Capitol Hill.

Alice is at the Brookings Institution. Rudy is at the Urban Institute. They work with people in the Congress and administrations and have served in these administrations that I mentioned. And, they are reliable. I am delighted to turn to them now for a two or three part presentation. I will let them take that in the order that they wish. Alice will be first and then we will take your questions. Thanks.

ALICE RIVLIN: We are terrific experts on everything except technology. We want to get the first set of slides up first and that will be in just a minute. Good.

Rudy and I are not health experts although we know something about the subject. We are certified budget wonks as Jack explained with a shared concern about the nation's finances. We were recruited for this panel primarily to give you the big picture view of the federal budget future - the context within which health programs must operate. And, in a word the big picture is disturbing. The federal government is spending nearly a half a billion dollars more than it is raising in revenue. Now, that is the bill for current government services of all kinds that we are currently passing on to future taxpayers. The projections that I will share with you in a minute indicate that unless current policies are

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changed deficits will continue to grow over the next decade. There are only two ways to reduce projected deficits - spend less or tax more. Unfortunately, as we look into the further future the prospects for balancing the budget don't get any better. As you all know, they get dramatically worse. The deteriorating big picture results from a combination of increased longevity and the rising cost of health care, especially the latter. The long run federal budget pressures reflect the triumph of health policy. It is basically a good story. We are all living longer in part because medical care is increasingly effective as well as increasingly expensive. This triumph is cause for celebration, but it also poses extremely difficult choices. Many of which are starkly illustrated in federal budget projections. I will talk a little bit about the numbers and what they mean and then I will turn to Rudy.

The federal deficit for fiscal year 2004, which ended in September, was \$412 billion. This year's will likely be about the same or a few billion higher. The administration has just asked Congress to appropriate an additional \$80 billion for the war in Iraq, which suggests that this year's deficit could be as high as \$492 billion. That is roughly how big a bill we are passing on to future taxpayers for services that the government is performing for us. This bill would be higher were it not for the fact that the Social Security and Medicare

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Trust Funds are currently running a surplus, which offsets part of the deficit in the rest of the budget. The recently released ten year projections of the Congressional Budget Office adjusted to reflect plausible assumptions do not give us any reason to hope to getting back to balance in four years as both candidates promised in the election. Or even in ten.

The top line in this chart shows CVOs official deficit project as a percent of GDP. It shows the budget returning to balance, the tax cuts of 2001 and 2003 sunset, and tax provisions return to tax code of 2000. That is not going to happen. The president wants those tax cuts to be made permanent and so does most of Congress. The flatter middle line assumes that the tax changes are made permanent. That awful thing called the alternative minimum tax, which the least one knows about it the better, is adjusted by Congress so that we aren't all paying and discretionary spending rises somewhat faster than the CVO is required to assume. That line just doesn't get any better as a percent of GDP. That is what we are looking at over the next ten years. Now ten years is a long time but the ten-year window actually is a misleadingly favorable picture of a longer run outlook. The Social Security and Medicare Trust funds, as I mentioned, continue to run surpluses all through that period, surpluses that will disappear as the bulk of the baby boom generation moves into retirement. If you took those surpluses out and said let's

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look at the rest of the budget, then you would get that lower line that is an even more dismal picture as a percent of GDP than the middle one. We used to talk about balancing the budget without Social Security not so long ago about five years ago, but nobody is talking about it any more.

The dismal deficit outlook is as you see on this chart not due to unusually high federal spending. Spending is now about 20 percent of the GDP about a fifth of everything that we produce close to the average for recent decades. Revenues were a combination of tax cuts and slower economic growth have dropped below their historic average and are very likely to stay there assuming recent cuts are extended and the AMT is reformed.

Chart three shows that spending other than Social Security and Medicare is not at a particularly high level relative to the GDP. I show this mainly because a lot of people think we have high spending because of the war in Iraq. The war in Iraq has increased the defense budget, but if you look at that lower blue portion of this chart, you see that it is a relatively small percentage of GDP compared to what it has been historically.

Chart four shows that revenues excluding payroll taxes are also low relative to the past. After the ten-year window, which is a window only because it is a tradition to do our budget ten years at a time. After that due to a combination of

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two factors - the age of the population and the rising cost of medical care there is enormous upward pressure on federal spending. CVO estimates that the cost of Medicare, Social Security, and Medicaid will raise from 9 percent of the GDP in 2010 to 14.3 percent in 2030 to 17.7 percent in 2050. That is an additional 8 percent of GDP, twice the current defense budget added to the federal budget if we don't change the nature of these programs. These projections are based on a relatively moderate, a very conservative as a matter of fact, about the growth of medical care prices. These assume that medical care prices grow 1 percent faster than the GDP. Now, since 1969 on the average medical care prices have risen 2.5 times as fast as GDP. It would be an extraordinary feat to reduce medical inflation to such a moderate rate. Now, 2030 and 2050 are a long time from now so why should we take these projections seriously? I think two reasons. One is that the demographics are not uncertain. People who will be of retirement age in 2050 are already born. I have a five-year-old granddaughter. We already know about her. She won't be retired in 2050. She will still be doing whatever she does. Second, the cost of medical care will certainly rise faster than incomes or GDP, but as medical care is getting more effective and also more expensive, as everybody in this room knows, the only question is how much faster than the GDP will it rise? One percent, which is the basis for these rather

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extraordinary projections, is very conservative assumption.

Six illustrates the huge difference that the rate of medical price makes for the projected cost of Medicare and Medicaid. The top line is the historic average, the middle is the conservative line that I just showed on the previous chart, and the bottom is rising at only the rate of GDP. So, if I have scared you sufficiently I am going to turn it over to Rudy and who will talk about why we should care about all of this.

RUDOLPH PENNER: Happy Ground Hog's Day everybody. I think by the time Alice and I are finished you will want to crawl down some hole somewhere and cuddle up with that Ground Hog.

Alice has explained how rapidly the programs for the elderly are going to be rising in the coming decade. I am just going to be a little repetitious because I want to drive home a point here. These programs have grown rapidly in the past as well. They are now a little over 8 percent of the GDP. Whereas, fifty years ago Medicare and Medicaid hadn't been invented and Social Security cost very little. So one obvious question is how did we finance this big increase in programs over the past fifty years? It didn't really seem all that painful so why can't we do the same thing yet again over the next thirty years.

Let me say first how we did not finance it. This is very important, as Alice's diagrams showed and mine will too,

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we did not raise taxes. Indeed the tax burden has been remarkably constant over the past fifty years. The total burden in 2003 was 16.3 percent of the GDP. Actually a bit less than it was fifty years ago in 1955. I drew that line in there at 19 percent it seems to be almost a magical rule that whenever the tax burden goes above that level the Congress cuts taxes. That last happened in 2001 after the burden exceeded 19 percent for five years. Longer than it has really any time since World War II. Well, because we came closer to balancing the budget in the 50s and 60s than we have recently, one might say that we financed some of the increase in cost by letting the budget deficit rise. You can see from this chart that the budget deficit is very erratic. It is a little hard to say what the trend is, but no matter how you do the arithmetic you can't say it is financed as much as one-half of the past increases in cost.

As Alice's Chart 3 implied, the most important source of financing for Social Security, Medicare, and Medicaid over the past fifty years comes from a secular decline in the relative importance of defense spending. On my chart here you can see on the left-hand side that the rise in Social Security, Medicare, and Medicaid is almost a mirror image of the decline in defense. Defense was about 10 percent of the GDP after the Korean War and now it is about 4 percent despite the wars in Iraq and Afghanistan. The really important point that I think

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both of us want to drive home is that unless we take defense negative, and we can't do that unless we start renting out our Armed Forces, we're really coming to the end of using defense as a source of financing for old peoples programs. Therefore, what we need is radical departures from history in order to solve these future budget problems. If the programs aren't reformed significantly, either all taxes will have to be increased dramatically, and we are talking about increases over the next thirty years of one-third to fifty percent, or you have to take the rest of government spending to virtually nothing or deficits will reach intolerable levels.

Now, unfortunately we made the problem a good deal worse with the recent Medicare Prescription Drug Bill, which had very few savings to pay for the huge additional costs of prescription drugs. President Bush is bravely talking about Social Security reform and he will tonight at length I gather; but his fellow republicans in Congress are very nervous and the Democrats have already announced opposition before they know what the plan is. So, it is very hard to get real optimistic about all of this.

Now, the question is given these problems, why are financial markets so happy? If you read Standard & Poors report on our sovereign debt, they give us, and they give other Western democracies, which have even worse aging problems, they give us all the highest possible credit rating. They do stress

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the need in the US report to reform Social Security and Medicare, but they put enormous confidence in our flexible markets and our transparent political system.

More generally they have a lot faith that western democracies will reform the programs, and though I love democracy, I am taken back to Winston Churchill's comment that the democracy is the worst form of government except for all the others. I think democracy is at its weakest when dealing with special interest groups and the elderly is about potent a special interest group as one can imagine. That is why this whole thing becomes so challenging politically. A lot of European countries have reformed, but only when they were prodded to do so by a financial crisis. Britain, Sweden, and Italy have essentially solved their demographic problem, if they have the courage to persist with the reforms that are on the books.

Well, when might a crisis occur here absent reform? Its financial markets are really too fickle to forecast. The budget projections that I find most credible have our debt passing the 100 percent of the GDP in the 2020s. Though I think an important question is if financial markets wait to see it actually happening before panicking or whether they'll be convinced before projections before the fact. Alice and I have just put forth such projections, and as I said, financial markets are still pretty happy. What are some possible

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solutions to this dilemma? First, let me mention some non-solutions. You hear a lot from a certain party that we can grow our way out of this problem. There is no doubt that faster economic growth would help a little. It is hard to imagine a sufficient addition to growth to put a really big dent in the problem. The basic problem is that Social Security benefits, at least your initial benefit, is indexed to wages over your working life. So, the faster we grow the faster the Social Security promises grow. You get helped a little bit by growth because at age 60 you start indexing the benefit by prices not by wages; but you are helped a very little bit. I think even though it is more controversial to say so you see same sort of thing in the Medicare program because I think that faster growth is going to increase the demand for health care more rapidly. We would then see health costs grow even faster than they are today.

Another thing people talk about a lot is immigration. Now, immigration is extremely important to the American economy. It is in fact the only thing that will keep our labor force growing in the future. The trouble with immigrants is that they get old too. Immigration would have to rise continually relative to the size of the labor force in order to solve the problem. I guess I think that is politically implausible.

What are the real solutions? I think a really

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important element of all of this is to have to get people to work longer. Then they would be taxpayers for a longer portion of their life and beneficiaries for a short portion of their life. Now, it shouldn't be hard to get people to work longer because they used to. If you look back to 1950 the average age at which people started to apply for Social Security was about 68. Today it is about 63. I think it quite remarkable that you had longer work at an earlier time when the elderly population was much less healthy than it is today and when many more of the jobs in the economy were physically demanding. Now, there are many ways to induce longer work; but there are many political and institutional barriers to doing so. Obviously if you take out the stick and start reducing the growth of Social Security benefits say by indexing with prices rather than wages or if you increase the normal retirement age, that would probably induce somewhat more works. But there are many other options. Unfortunately, I don't have time to go into them now, but we could talk about it more in the question period if you like.

I think a second component of the solution for Social Security is to try and reduce our dependence on pay as you go financing. I mean, Social Security has been a wonderful program in the past; but I don't think it is going to work very well as the number of taxpayers go from a little of above three for every beneficiary, as it is today, to a little over two by

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2030. You all better find out the two people who are supporting you and look after them very carefully. The basic point is if you look at the ratio of benefits received to taxes paid over a lifetime, Social Security has been just a tremendous deal for past retirees. I think that is one of the reasons it is so popular. That ratio is falling very fast. For my wife and I, depression babies, the annual rate of return on our tax payments I think is probably something to about 2 percent above the rate of inflation. For similar retirees in the future, the rate of return is going to sink for even more and for many groups it will be even negative. Now some say you shouldn't look at the problem that way you should look at the return that workers get on their own payroll tax payments rather you have to look at the return as being the good done raising the welfare of current retirees. Looking at it that way doesn't allow us to escape the inexorable demographic trends. Whatever good is done for today's retirees it will require much higher tax burdens in the long run to accomplish the same amount of good because of the rise in the ratio of beneficiaries to taxpayers.

In order to reliance on the pay as you go system, it would be nice to move toward a funded system where the payments that you make could be invested in real capital. Then the rate of returns to those payments would depend on the rate of return to capital as opposed to demographic factors. This involves

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some pain the so-called transition problem. Current workers can't completely walk away from the promises made to those already retired or even to those near retirement, but while you are asking those workers to continue to support those people, you would suddenly ask them to deposit monies to pay for their own retirement as well. So, they suffer a double whammy as it were. In theory moving toward a funded system can be accomplished either by government saving more or by a well-designed system of individual accounts. Those of us too cynical to believe that our government is actually capable of saving money tend to favor the latter approach. Individual accounts are not foolproof either. By my definition a well-designed system would be one that creates a high probability of increasing national savings quickly. That means someone somewhere has to consume less. Americans don't like the notion of consuming less. It is painful. Now, many of the proposals that you see on the street try to avoid any short run pain whatsoever on current retirees or even current workers. You see proposals for individual accounts that are 100 percent financed by using some of the existing payroll tax. The pain involved in the proposal comes very much later as traditional benefits are lowered to reduce the drain on the payroll tax revenues and to make the system whole. In some of these plans not much progress is made toward increasing national savings for many decades and I think that risky. I think it is

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generally safe to say if there is no pain there will be no gain. I don't mean to rule out all (inaudible) but I do think people living right now have to bear a bit of the pain of this transition.

Another possible reform is to introduce some kind of means testing into the system. You could do that with either Social Security or Medicare. My wife and I get almost \$30 thousand per year in Social Security benefits and a health insurance system that is worth many thousands more. Mind you, I like all that. I am not sending any money back and certainly thank all you taxpayers who are here for your generosity. It does seem to me a kind of weird use of our nation's tax capacity to send us on a few more luxurious vacations or to allow us to have an extra good meal occasionally at a good restaurant.

However, means testing must be done very carefully. Otherwise anyone foolish enough to save for his or her own retirement can be severely punished. Australia invented an individual account system, but they had a very generous means tested safety net that provided a floor pension. That resulted in many lower middle class people to blow their individual accounts on the consumption binge and throw themselves into the safety nets just before retirement. That raises a lot of questions. One major question is if you do have individual accounts should people be forced to buy an annuity with their

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individual accounts. That is just one thorny question among literally hundreds that will have to be solved in designing an individual account system.

Now I will turn back to Alice and she will solve the Medicare and Medicaid problems and make some concluding comments.

ALICE RIVLIN: Rudy has talked quite a bit about Social Security. That is very tempting because Social Security is a relatively easy problem to deal with. I think the president is right to have put Social Security up front as a high priority for his second term. Not because it is so difficult or because it is in crisis but because it is far easier to think about and deal with than our Medicare and Medicaid.

I am not going to argue with Rudy in front of this audience but I just want to alert you to the fact that not everybody takes the position that he is espousing that is really necessary to reform Social Security to forward funded. It would be nice if we had the resources to do it but getting from here to there is a very expensive thing just for the reasons he expounded. If you divert the funds that our now going into Social Security and paying for the benefits of existing retirees that you divert those into private accounts you have to make up the money. Nobody has figured out how to do that except very large borrowing on top of the very large borrowing that we are already doing, which seems to me

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undesirable. The basic argument about Social Security is not whether we should have forward funding or personal or private accounts, it is just how do we make the situation in Social Security solvent. That is not so hard. Every once in awhile we get into the situation where thanks to the health care world people are living longer than was anticipated but the system therefore is not funded adequately.

We read into this in 1983 pulled together a group of people to say how do we fix this, and as in most compromises yes there was a little bit of tax increase and a little bit of benefit cut. We could do that right now. The shortfall over the foreseeable future in Social Security is less than 2 percent of the GDP. That is not a big deal especially in comparison to these big numbers that we have been talking about. Rudy left to me the question of what do we do about Medicare and Medicaid. In the first place the question should be how do we contain medical care costs looking forward. This is the really important challenge - shifting them from the government to the private sector and from the private sector back to the government is not going to solve the problem. We need to figure out how we can have adequate health care with the costs rising at a sustainable level. We have had very rapid increases as you all know. We now spend 15 percent of our GDP on health care and the outcomes are not all that great by comparison to other advanced countries - Germany, France,

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etc. who spend much less. We are not that much healthier. So we've got to figure out what to do about that. The sessions of this conference are all devoted to various solutions to that problem. Consumer choice, competition, tort reform, malpractice form, and most particularly and importantly best practices and rewarding performance. Which do we choice? It is not a choice. We do all of those things and do them as well as we possibly can and hope that future breakthroughs of health science well be cost saving rather than cost enhancing. Briefly on the federal programs. The governor spoke eloquently about Medicaid and the choices for limiting expenditures on Medicaid are fairly limited. They are reducing eligibility. None of which is attractive. All of these are needy people. It is reducing reimbursement rates, which is practically fatal because then you loose the providers or other ways of pushing the cost from the federal government to the states that have their own problems.

Medicare similarly is somewhat daunting. Yes, we could all work longer and we have already raised the age of full retirement benefits in Social Security; but to raise the age of full retirement under Medicare is to get oneself into a host of other problems. Many people do retire early and it is that 50 to 65 group that are singularly ill covered by private insurance. One could move toward cost sharing, move toward more means testing; but in general all of that means cost

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shifting. The politics are quite adverse, as we have both been discussing. If everybody is getting older and older people vote, it is going to be increasingly difficult to cut back on Medicare.

Let me just close with thinking about the really big picture. We're facing very large upward pressures on spending from the combination of aging and medical cost increase. The big question for the future is just how to deal with the increased costs. Consider the polar options that we won't do any one of these things, but we will do some combination of them give or take a few billion dollars over the next few years. Faced with the rising costs one option is to pare back drastically the historic commitment to the elderly and to health care for low-income families. That would mean cutting Social Security, Medicare and Medicaid benefits or expecting the states to pick up the bill. This doesn't sound acceptable morally or politically to very many people. Another option is to keep a large part of the commitment to Social Security, Medicare, and Medicaid but slash the rest of the government drastically. You would have to practically close down the rest of the government to accommodate even that middle range projection of the costs of Medicare and Medicaid. The third is to absorb at least a part of the cost of aging and medical care by allow total government spending to rise from that historic 20 percent to say 25 or 26 percent. It is still low by

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comparison with other advanced nations. We would still have to keep a very tight lid on all spending and all costs of health care and we would probably need another revenue source that would be damaging to growth and employment to load an additional burden on the income tax. So, we should begin considering whether we should have a national sales tax or value added tax as many nations do. Somehow we will get through this. I think it is appropriate to think about what is the right tone for talking about these choices? Right now we are sort of varying back and forth between denial and hysteria. It is not happening or the sky is falling - one or the other. That is ridiculous. We are not alone in facing the aging of the population or increasing cost of medical care. Most other countries are facing this - all the lucky ones. We are the luckiest of all. We are a rich, powerful country with the good fortunes to be aging and enjoying more effective medical care. We are not aging as fast as the Europeans or the Japanese. What is unique to us is not these problems but our especially high-income level. We just have to decide how we want to use these resources in the face of a changed situation. Thank you.

JACK MEYER: Thank you both for all of that education and wisdom about possibilities for dealing with this problem. You have all been very patient. I would like to offer you the chance to make some comments or raise some questions. We'll let this go for a little while. We don't want to spend too long

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between you and a nice reception. We do have time and I am sure Rudy and Alice would welcome a few questions, comments, or challenges. If you would please go to the microphone if you have a comment that you would like to give, we would be happy to entertain it.

ALICIA PEREZ: Alicia Perez from Traverse County, Texas. First of all I would like to comment to Ms. Rivlin that she served as a role model for many career women, and I thank you for that. Secondly, I wanted to ask even the panel today gave a mixed message. We hear from President Bush and the urgency in a lot of the material we read - the tremendous urgency to go ahead and do something about Social Security because reality shows that the working employee population will go down and then elderly and people who will receive or depend on Social Security will go up. Then you have someone like Paulocoy (sp) who says Social Security is not in crisis. At least a lot of us proletariats continue to work and take our Social Security taxes in hopes that we will some day be able to draw from those and wonder about the people in power and knowledge where are we with Social Security? Are we indeed in crisis or is it prudent to plan for the future?

MALE SPEAKER: I guess I am distraught at how much argument there is over the word crisis. Whatever you call what we are in, I think that almost every policy person who looks at the person says it will be a lot easier to fix the earlier we

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work on it. The kind of benefit or tax change we need would be much less abrupt. You would be able to give longer notice. So whether you want to call it a crisis or not, I think the argument for acting as quickly as possible is very powerful and indeed that argument has frankly existed for the last 30 years. When we realized that the baby boomers were not having enough kids to support them well in their retirement, we knew we had a problem. We should act. Why act on Social Security first when Medicare and Medicaid are quantitatively much more difficult problems? I think it is as Alice said. As hard as Social Security is to deal with, it is the low hanging fruit. We know what the options are. We know what the options will do. We just don't know as much about how Medicare works.

ALICE RIVLIN: I agree with that. It is not a crisis in the sense that something terrible will happen if we don't act tomorrow. But, if we care about the long-run solvency of the situation the Social Security system, we should act as quickly as possible. We should have acted ten years ago, but we didn't. Now we can. We ought too and then move on to the harder problem about what to do about Medicare and Medicaid.

SAL OPSTON: Sal Opsten, the Lewin Group. If you go back to '83, the last time we made adjustments, and you compare the problem that we have now is it like an order of magnitude to our (inaudible) twice, three times, or can you even make that comparison? Because we made the '83 adjustments almost

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seamlessly and on Social Security are we like a lot bigger or about the same as the adjustments were made back then?

ALICE RIVLIN: I think it is roughly the same and it depends on how long you want to fix it for, if you want to fix it for seventy-five years which was what they elected to do in '83. It is not as big a problem as if you want to fix it forever meaning an infinite time horizon. In neither case are the adjustments very large. If you fix the current system by adjusting the inflow and the outflow a little bit. The thing that is hard to do is what the president has taken on in addition, namely shifting from a largely pay as you go system to forward funding. That is very expensive.

MALE SPEAKER: I guess I disagree a little bit. In '83 the difference between the inflow and outflow was very small. The problem was the trust fund was empty and they had to do something about it. I don't think that the people that served on that commission would agree that it was real easy to do it. They did fight their way through to a solution. The main thing they did at that time was increase the normal retirement age, but they didn't do it for anyone—or let me put it another way, they gave eighteen year notice before anyone's normal retirement age was being increased. I don't think we have that time today. If I am right and we do nothing, there will be some sort of financial crisis in the 2030s or maybe even in the 2020s. We've really got to move very, very fast to

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change the trajectory of benefits and revenues. See I don't see this at all as a trust fund problem. The trust fund will last until 2042 according to the most estimates. I think the world is going to end before that, because you put the Social Security problem on top of the Medicare and Medicaid problem, current policy, in my judgment, can't possibly last until 2042.

FEMALE SPEAKER: Let's be clear what happens in 2042. The president likes to say the system goes bankrupt or blows up at that point. What actually happens at that point is that the funds flowing into the system can only pay for about three-quarters of the benefits that people are expecting. That is a big drop but it is not bankruptcy.

MALE SPEAKER: The gentleman about half way back and then this fellow closer.

SID MCBRIDE: My name is Sid McBride from Saint Louis University. I wanted to mention that I am glad that Alice Rivlin mentioned that we are sort of in denial here because it strikes me is that what we are facing as a country is a doubling of the aging population between now and full retirement age of the baby boom population. Given that, doesn't it seem quite fairly simple, as a country is that we need to raise taxes to pay for the baby boom generation? One of the graphs that you showed the tax burden on our country has dropped by 3, 4, or 5 percent in the last few years. How can we face the doubling of the elderly population without raising

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taxes at least a little bit to pay for Medicare and Social Security? It is just mind boggling to me that people don't think we could raise taxes to pay for these programs.

ALICE RIVLIN: It has been mind boggling to me too. I think we will have to do some of each. We will have to raise taxes. We will have to reduce the benefits somewhat not necessarily Social Security but certainly under the health programs. But, remember it is a lot worse than Japan. It is a lot worse than Germany. It is a lot worse than France in terms of the rapidity with which the population is aging. They are dealing with it. We can deal with it.

JACK MEYER: If it is all right with our sponsors, I am going to make this gentleman the last questioner and we'll wrap up.

BILL BRANINGTON: I am Bill Branington from the University of North Carolina, Charlotte. It is a long way from inside the beltway, and this is too good a chance to ask a question about a debate, which is generally as I can see, generated inside the beltway. It seems to me that some things that are important to me personally that aren't being raised. Speaking personally of all the retirement vehicles I have, the only which is indexed to prices is Social Security. That seems to me something really important. Even a defined benefit contribution doesn't automatically go up. If that is the case and we introduce private accounts that are based on the market,

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no one says it but I assume that those are not indexed to any automatic escalator either while you are contributing or after you drawing them down. If that is the case, then one basic element of security is gone. If everybody subscribes to that, what would be the magnitude of savings in Social Security? After all you would have only people who are for some part of their benefit what they have earned in the market place, and you have a fixed obligation part, which is in addition to that. If that is the case then that ought to be a source of savings and their big transition costs as you point out are upfront - trillions of dollars to borrow. That is a one time borrowing and that leads to is there not—and I salute both of you for your economics—in addition to taxing or spending less and that is inflation. Historically there have been countries that have managed to inflate the value of their money and thus do away with the cost of obligations incurred in the past.

MALE SPEAKER: First of all, I think that its more obvious than anything else that we will retain a substantial portion of the traditional Social Security System. Even the president's broad philosophical approach would do that. With regard to the individual account part of it, if you want to protect yourself against inflation you can of course by investing in inflation index bonds; but it will cost you a lower real rate of return. Might we inflate our way out of this? Certainly the kind of debt the GDP ratios one projects

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if we do nothing would create a huge temptation to do that. I have worked in a lot of countries that have done that - namely the former Soviet Union. In particular, I worked in Georgia just after the inflation rate was 10,000 percent one year. The interesting thing about that is that it works one year but after that nobody will hold your money any more no matter how much you print of it. So, it is a very limited solution to the problem. It may be one we try.

FEMALE SPEAKER: It is a tragic situation for older people as Russia and other countries have found out. When the pensions they thought they had are worth nothing.

JACK MEYER: Both of our speakers have guided the Congress and various White Houses through fiscal troubled times. In the case of Alice, this city in which we are meeting, she helped guide through extremely difficult times and we hope she will continue to do that and continue to educate us. I would like to have you join me in thanking them for sharing their wisdom today. I think we have some concluding remarks.

FEMALE SPEAKER: The reception is ready and waiting in Renaissance East and we hope to see you tomorrow morning for our popular and annual Congressional Staff Panel. Enjoy yourselves.

[END RECORDING]

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