REFORM PROPOSAL OF SENATOR ALAN K. SIMPSON AND CONGRESSMEN J. ALEX MCMILLAN AND PORTER J. GOSS

INTRODUCTION

We commend Chairman Bob Kerrey and Vice-Chairman Jack Danforth for their willingness to confront the runaway entitlement spending that is projected to occur in the absence of changes in current law. While we have some substantive differences with the contents of the Chairmen's mark, we do not differ with the central outlines and objectives embodied in it. We are disappointed that the Commission was unable to reach agreement on specific substantive recommendations, and believe that given additional time, it might have been possible to reach a compromise solution between the Chairmen's mark and our alternative presented here. However, given the absence of support from 60 percent of the Commission for the goal of producing such a compromise, we believe that our best course is to offer our alternative as a basis for further discussion and development.

First, we state our support for the focus by the Chairmen on attempting to solve only that portion of our deficit problem that is *directly attributable to entitlement spending*. Restated, this means that there is no proposal either here or in the Chairmen's mark to balance the budget through cuts in entitlement spending, but rather to place entitlement spending on a course so that it does not by itself force long-term deficits to grow dramatically as a share of the economy. We view it as unfortunate that efforts to shore up the long-term solvency of these entitlement programs have been mischaracterized by opponents of reform. Neither our proposal nor the Chairmen's mark would target entitlement programs as a means of resolving imbalances in other parts of the Federal budget. On the contrary, both of these proposals would leave the projected budget deficit for the year 2030 at 2.3 percent of GDP, just as it is projected to be for the coming year, leaving full latitude for future Congresses to achieve budget balance through preferred actions in the areas of discretionary spending or revenues.

We further agree with the view implicit in the Chairmen's mark that the problem is primarily one of runaway spending rather than insufficient taxation. We have thus also chosen to focus our package on restraining the growth of entitlement spending.

We believe that the contents of the Commission's August 8 report confer on every member of the Commission the obligation to offer proposals to avert the impending fiscal crisis that will result from uncontrolled entitlement spending. We remind the Congress and the Administration that these findings demonstrate that by the year 2012, every penny of Federal revenues will be necessary to pay for projected entitlement spending plus interest on the debt. It is a shocking and scandalous abdication of responsibility to willfully require future Congresses to add to the public debt simply to fund such fundamental obligations as the national defense, highway repair, or childhood vaccination. The August 8 findings, we believe, make it impossible for any Member of Congress to honestly suggest that restraints on entitlement spending can be omitted from serious efforts to assure future Federal solvency.

Our alternative attempts to improve upon the Chairmen's mark by removing provisions which we believe are unrelated to the causes of entitlement spending, as well as those provisions which would assess involuntary charges on program beneficiaries without compensating benefits in the form of improved behavior incentives.

RETAINED FROM THE CHAIRMAN'S MARK:

1) Population Aging Provisions.
   Percent of Goal: 15.7%
2) Index Part B Premium.
   Percent of Goal: 9.4%
3) Cap Employer-Paid Health Insurance Deduction.
   Percent of Goal: 9.4%
4) Congressional, FERS, and CSRS Pension Reduction.
   Percent of Goal: 0.6%
5) Technical Correction of the Consumer Price Index (CPI).
   Percent of Goal: 15.8%
6) 10% Cut and Cap on Other Entitlements at Population plus CPI.
   Percent of Goal: 10.5%

Many of these proposals are no more popular with the authors of this alternative than with the public at large, and we retain them solely because of the impossibility of resolving the long-term spending problem without such adjustments.

A brief word about each of these. Adjustments for the aging of the population are absolutely critical to a solution of the long-term spending problem, which is fundamentally one of demographic change, in the form of the aging of the population. Social Security was enacted with an eligibility age greater than the projected lifespan of the average American at the time (borrowing the figure of 65 years from a 19th-century proposal by Otto von Bismarck!), yet we have still made only sparing adjustments to eligibility ages even though the average lifespan is now greater than 75 and rising. We regret that even the modest, slowly phased-in increase in the eligibility age for Social Security and Medicare, which in this form would affect no one over the age of 50, the full Normal Retirement Age of 70 affecting only those recipients of 28 years of age and younger, provokes opposition from those senior-advocacy groups whose current membership would remain unaffected by the change. Further, the younger Americans who would see their Normal Retirement Age raised to 70 are those who, under current law, would receive no benefits at all from an insolvent Social Security system.

Adjustments to the CPI calculations ought to be a component of any entitlement reform proposals considered by Congress, for the basic reason that these adjustments would correct inaccuracies in our current method of calculation. The CPI inadequately measures price inflation because the market basket is too seldom updated. Our proposal, therefore, would require annual adjustments to the market basket to more accurately reflect changes in the cost of living. We believe this rationale of structural improvement is preferable to arbitrarily targeting the benefits of any particular sector of the beneficiary population.

Adjustments to Federal retirement pensions — especially congressional pensions — must be included, for reasons of equity, in any reform proposal that affects Social Security recipients. We feel strongly that the smack of hypocrisy can only be avoided if Members of Congress lead with their own pensions. An appropriate way to start would be to place congressional retirement eligibility ages, contribution rates, and accrual rates on a par with those in the executive branch. While the higher contribution and accrual rates for Members of Congress have a basis in policy, that being the expected shorter tenure of those in the legislative branch, these formulas inevitably result in enormous pensions for those Members who serve the longest, of such size that they cannot defensibly be held harmless when measures are adopted affecting Social Security.

A global entitlement cap is not a substitute for specific programmatic cuts, but we have retained the Chairman's provision because we agree that restraints must be placed as well on the growth of entitlement programs other than retirement and health care programs. We believe that appropriate entitlement reform must include re-evaluating the goals and approaches of Federal entitlement programs as much as affecting savings measures within existing structures. Thus we affirm that a complete Commission report must include not only specific provisions to achieve budgetary savings, but suggestions for programmatic reforms to deal with the sources underlying cost growth. Thus, while we have retained the provision effecting an entitlement cap that would affect welfare and agricultural programs, we have attached additional views on the implementation of this cap to the end of our specific cost-saving provisions.

Finally, we take fundamental issue with those who suggest that entitlement reform embodies a form of heartlessness or indifference to the welfare of those affected by policy changes. Government does not create wealth by distributing entitlement benefits; rather, it is engaging in a willful choice to take dollars from one segment of the population and to distribute that money in the form of benefits for others. It is, therefore, incumbent upon government to confront the many instances when this redistribution is inappropriate, as it certainly is when working taxpayers are compelled to turn portions of their income over to nonworking recipients of greater means. Federal caring and concern is not measured by the zeal with which government reaches into the pockets of one group of Americans to give to others.

SUGGESTED DELETIONS FROM THE CHAIRMAN'S MARK:

1) 1.5 percent Social Security payroll tax decrease and required contribution to personal savings/IRA.

— We endorse the principle behind this proposal and we include it in our own plan, in a voluntary, revenue-neutral form that does not increase the magnitude of the task of restoring long-term solvency to Social Security.

2) Add a graduated Part A premium.

— While measures are necessary to restore the actuarial balance of the Medicare HI fund, headed for insolvency in the year 2001, we believe that measures taken to restore this solvency must also attack the sources of cost growth, and provide incentives for beneficiaries and providers to use their health care dollars more wisely. Because Part A participation is mandatory, this provision equates to an unavoidable assessment on seniors which they cannot avoid by making different choices.

3) Raise the Part B deductible.

4) 20 percent coinsurance for clinical lab services and home health care.

5) Reduce Medicare provider payments.

— We appreciate the necessity of measures such as 3), 4), and 5) within the existing Medicare system, and we assert to all Members of Congress that measures such as these will be unavoidable in the absence of a structural overhaul of these programs. In particular, we believe it is a wise policy choice, wherever possible and equitable, to replace premium payments with deductibles and copayments, to introduce consumer choice into a market where it is too often absent. However, because we have included a provision for a more thorough overhaul of the Medicare and Medicaid systems, the above provisions are duplicative of other reforms which we suggest are more worthy of study.

— The replacement of 3), 4), and 5) with a more comprehensive alternative helped to alleviate other specific concerns of authors of this report. Congressman Goss objected strongly to the proposals to raise the Medicare Part B deductible and to reduce provider payments. The first of these two provisions was deemed a significant involuntary hit on seniors currently dependent on Part B services, many of whom are already having difficulty making ends meet, while the second was objectionable because of the belief shared by many that Medicare provider payments are already too low by many measures. Senator Simpson and Congressman McMillan agreed that cost increases in the health care area need to be confronted on a more fundamental level than by these particular assessments, and thus supported the inclusion of Congressman McMillan's voucher proposal as a possible means of slowing these increases instead of passing them on undiluted to beneficiaries and providers.

6) Include State and local workers in Social Security.

— This proposal would bring new revenue into the Social Security system, but would also increase obligations in the long run, and is unrelated to the causes of Social Security cost growth. The system does not suffer in any total sense from the lack of coverage of State and local workers.

7) Re-index Social Security "bend points" for CPI.

8) Create an additional Social Security bend point.

— We believe that the Chairman's proposals to re-index the bend points have merit, because the current indexing system causes the excess of benefits over contributions to grow at a rate far surpassing inflation. Moreover, we appreciate that the creation of an additional bend point has been included to target some of the reduction in cost growth on those recipients least in need. However, we are concerned that a change in the bend-point formulas will in some way hit beneficiaries at all levels of the income scale, and also that changing the formulas themselves may be interpreted as an alteration of the Social Security contract. For this reason we have focused on COLA growth, as outlined in our alternate proposal.

9) Limit itemized deductions to 28 percent.

— We believe that the entitlement problem is not one of insufficient taxation but of uncontrolled government spending. While we appreciate that the inclusion of such a provision is intended to focus the burden of entitlement reform on those upper-income taxpayers most able to absorb the burden, we believe that it is better government policy to control the payment of entitlement benefits to the wealthy than to perpetually turn to them for additional tax revenue. We note that many advocacy groups who make an issue of the importance of seeking additional sacrifice from the wealthy, by forcing higher taxes upon them, are strangely silent about the unending stream of benefits which are distributed to upper-income recipients each year. The government needs to fundamentally rethink its obligations to all taxpayers, and re-evaluate whether it makes sense to continually turn to taxpayers for more revenue so that it may simply pay those monies out again in the form of government benefits.

10) Means-test Medicare and other non-means-tested entitlements.

— We believe that some means testing may be necessary as a consequence of the challenge of adhering to the level of entitlement spending restraint mandated separately in both the Chairmen's mark and our alternative. However, we are sensitive to the various policy challenges associated with means testing, in particular the possibility of creating a disincentive for individuals to plan for their own retirement income, and the difficulty of accurately measuring the affluence of entitlement recipients. We have, therefore, focused our means test only on a voluntary program, Medicare Part B, as indicated in the listing of our alternative proposals.

SUBSTITUTE PROVISIONS

1) Provide a personal investment plan option for all workers in lieu of 1.5 percentage points of the payroll tax.

Percent of Goal: 0.0%*

— This option permits current workers under age 55 to reduce their Social Security payroll taxes, make mandatory contributions to their own personal retirement account, and receive lower Social Security benefits in retirement.

— Once a worker chooses the personal investment plan option, the decision would be irrevocable. The reduced Social Security benefits depend on the age at which the worker makes the election. For example, the benefit formula for a person age 25 making the election would be the sum of:

> Ninety percent of the first $422 of AIME, 19 percent of the next $2,123 of AIME, and 2 percent of AIME above $2,564. Thus, under the alternative benefit formulas, Social Security benefits (excluding funds in the personal investment account) for the lowest wage workers would not be reduced. Low-wage persons would still receive benefits calculated using 90 percent of the first bracket of the PIA formula.

— We have included this option because we concur with the Chairmen that younger workers should be offered an alternative means of investing for their retirement. This option is based in principle on Congressman Porter's plan, and differs from the Chairmen's mark in that we have offered it in a way that would be scored as deficit-neutral, even though the actuarial balance of Social Security would only improve whenever a worker selected the personal investment plan option.

— The inclusion of such a provision is crucial because of the concern of many that current Social Security surpluses are not being saved to be ultimately available to pay Social Security benefits. This perception makes it difficult to enact measures to shore up Social Security's long-term solvency, for the reason that many retain the belief that the real problem is government's misuse of the current surplus. Giving workers the option of contributing to the surplus or saving directly for their own individual retirement appears a desirable method of coping with this problem.

* [The goal referred to here would keep entitlement spending at the same percentage of Gross Domestic Product as now and reach actuarial balance in the Social Security Trust Funds. This method of scoring was established in the Commission Staff Report, which can be found at page 153. Ed.]

2) Limit cost-of-living adjustments for Social Security, Federal civilian retirement, and military retirement.

Percent of Goal: 15.3%.

— This option would limit COLAs to the adjustment for the Social Security beneficiary, the Federal civilian retiree, and the military retiree, in the 20th percentile of benefits, beginning in the year 2000.

— COLAs were not an original feature of Social Security, and in no way represent a part of the implicit Social Security "contract." Similarly, Federal retiree pensions include annual COLA adjustments when many comparable pensions in the private sector do not. When COLAs enable recipients to keep up with annual increases in the cost of living, they are appropriate, but actual living expenses do not increase proportionally with income. This proposal would protect the full amount of the COLA for those most in need of it, and it would not penalize those who receive more in benefits, giving them just as large a COLA, but no more than those at the 20th percentile level. For purposes of equity, we propose that this COLA limitation be placed on retirees at the 20th percentile level for each program individually, because the pay scales for each program are not directly comparable with one another.

— We have chosen this option instead of altering the bend-point formulas themselves, so as to hold harmless those at the bottom end of the benefit scale, and because we are concerned that an alteration in the bend-point formula could be construed as altering the terms of the Social Security contract. We further believe that an income-based correction such as this avoids the "notch" problems that can be associated with age-based solutions.

3) Provide for Medicare/Medicaid vouchers.

Percent of Goal: 18.9%

— This option would replace the Medicaid matching formula with a "per capita" grant starting in the year 2000. State voucher amounts would be determined by multiplying the "per capita amount" for each State by the number of "mandatory" Medicaid recipients in the State. The per capita amount would be the total Federal budgetary resources appropriated annually, divided by the number of mandatory Medicaid recipients in all States. States would be required to provide a Federal-State health insurance voucher only for the mandatory Medicaid population. If States have remaining Federal funds after providing vouchers for the mandatory population, they must use these funds to expand access to health insurance for persons with income under 200 percent of the poverty line.

— This option follows the general outline of Congressman McMillan's H.Con.Res. 508, except that it would also include vouchers for current Medicare beneficiaries. Such vouchers would be initially equal to 100 percent of baseline per capita benefit amounts under current law for both Medicare HI and Medicare Supplemental Medical Insurance (SMI) programs. Insurance premiums and deductibles are determined as in Congressman McMillan's plan, as a function of family income, age, and family size.

— This option would limit costs by placing the growth of Federal health care expenses under the explicit control of the congressional budget process. Congress would annually appropriate the funds to provide for each program. While it is expected that a voucher system of reasonable deductibles and copayments in conjunction with systematic health care reform would slow health care cost growth relative to the projected baseline, the total cost of the voucher system would be controlled in any event by being a part of the appropriations process. For purposes of scoring the savings in this option, the total cost growth of the voucher program is set to allow for demographic growth, growth in GDP, and two-thirds of current projected excess health care cost growth above that which would be expected from the first two factors. That is, if only one-third of this excess health care cost inflation were eliminated by such a substantive overhaul of the system, individual vouchers would in the year 2030 be able to purchase 100 percent of today's benefits in current health care dollars. Even if nothing is accomplished in reducing health care cost growth, and the purchasing value of the voucher lags behind health care cost inflation, the vouchers would retain a purchasing power in 2030 of 87 percent of today's level if the savings projected here are achieved.

— This provision introduces a concept into our alternative plan which we believe must be a central feature of health care reform proposals. It moves, though it does not initially reduce, the flow of Federal health care dollars to an earlier stage of the health care purchasing process, changing the dynamics of the market by enabling seniors and the impoverished to make self-regarding financial choices when buying health care.

— We have offered this measure not because we believe that the Congress can make such a fundamental overhaul of the health care system without significant further study of the concept, but to make the fundamental point that drastic curtailments of individual health care benefits will be necessitated in the absence of sweeping reform of the Federal health care system. Congress and the Administration must return to the drawing board in structuring Federal health care programs if the burdens of excess cost growth envisioned in the August 8 document are not to be arbitrarily passed on to beneficiaries and providers as outlined in the Kerrey-Danforth plan. Either those severe cutbacks will be necessary, or a comprehensive reform proposal such as this will be. It is also unacceptable to respond to this problem by adding to Federal health care cost burdens by building additional health care entitlement programs on top of existing ones.

4) Means test Part B premium.

Percent of Goal: 3.2%.

— While we have not included a system of general means testing of all entitlement programs in our proposal, we believe that the voluntary Medicare Part B premium represents a clear instance in which means testing is appropriate. Under current law approximately three-quarters of these health care premium costs are paid by the taxpayers from general revenue, and only the remaining one-quarter by the beneficiary. The paradoxical result is that in many instances, beneficiaries see their benefits subsidized by a composite "average" taxpayer who is earning less than they are. This option would phase in a reduction in the Part B premium subsidy for enrollees with incomes above $40,000 for couples and $30,000 for individuals, with income thresholds indexed for general price inflation. The individuals at these thresholds would still see the majority of their benefits subsidized from general revenue, and adjustments would increase proportionally with income until they reached a maximum figure of 80 percent of Part B per capita costs for couples with incomes exceeding $100,000 and individuals exceeding $60,000. The option would be effective January 1, 2000.

5) Disability program reforms.

Percent of Goal: 1.2%.

— This year, Congressman Pickle introduced legislation, H.R. 4275, that included a provision to remove the incentive for individuals to file for disability status in the course of claiming Social Security benefits. We believe that the inclusion of this proposal is appropriate to link basic Disability Insurance (DI) benefit levels annually to the benefits for a worker retiring at age 65 in that year.

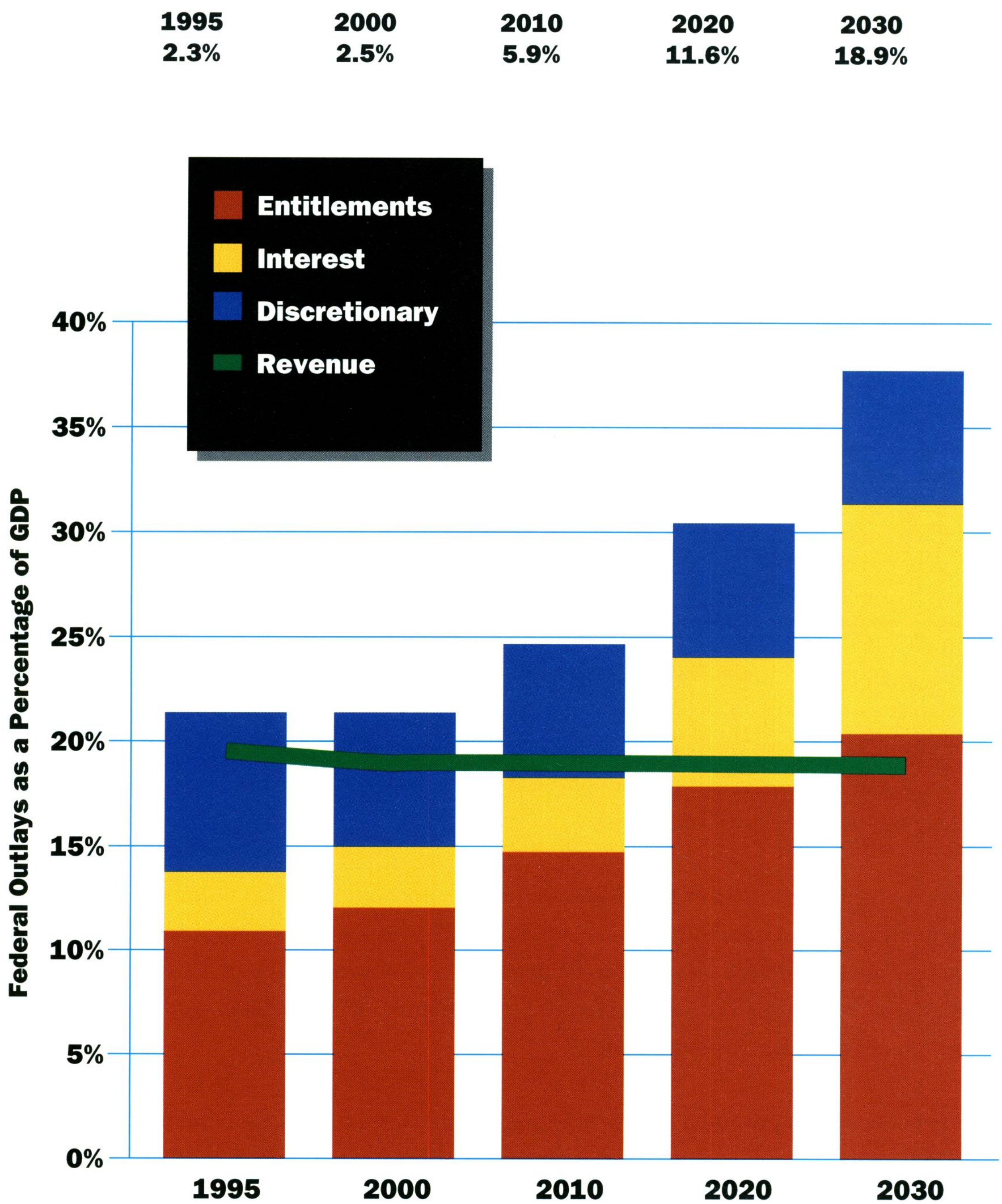
TOTAL: 100.0% of Goal

While the primary responsibility of the Entitlement Commission is to recommend specific provisions securing quantified savings, it should be re-emphasized that an enduring solution to the entitlement spending problem requires many reforms of a character that cannot yet be accurately measured in terms of savings generated. The Commission's work remains incomplete if we do not include language acknowledging the necessity of such action.

One example is in the area of health care reform. In the absence of structural reform of the health care system, the essential question remains merely one of dividing up spiraling costs between taxpayers, beneficiaries, and providers, a far cry from controlling those costs themselves. This is one reason why we believe that a voucher system containing sensible copayments and deductibles could represent a substantial improvement over the existing system.

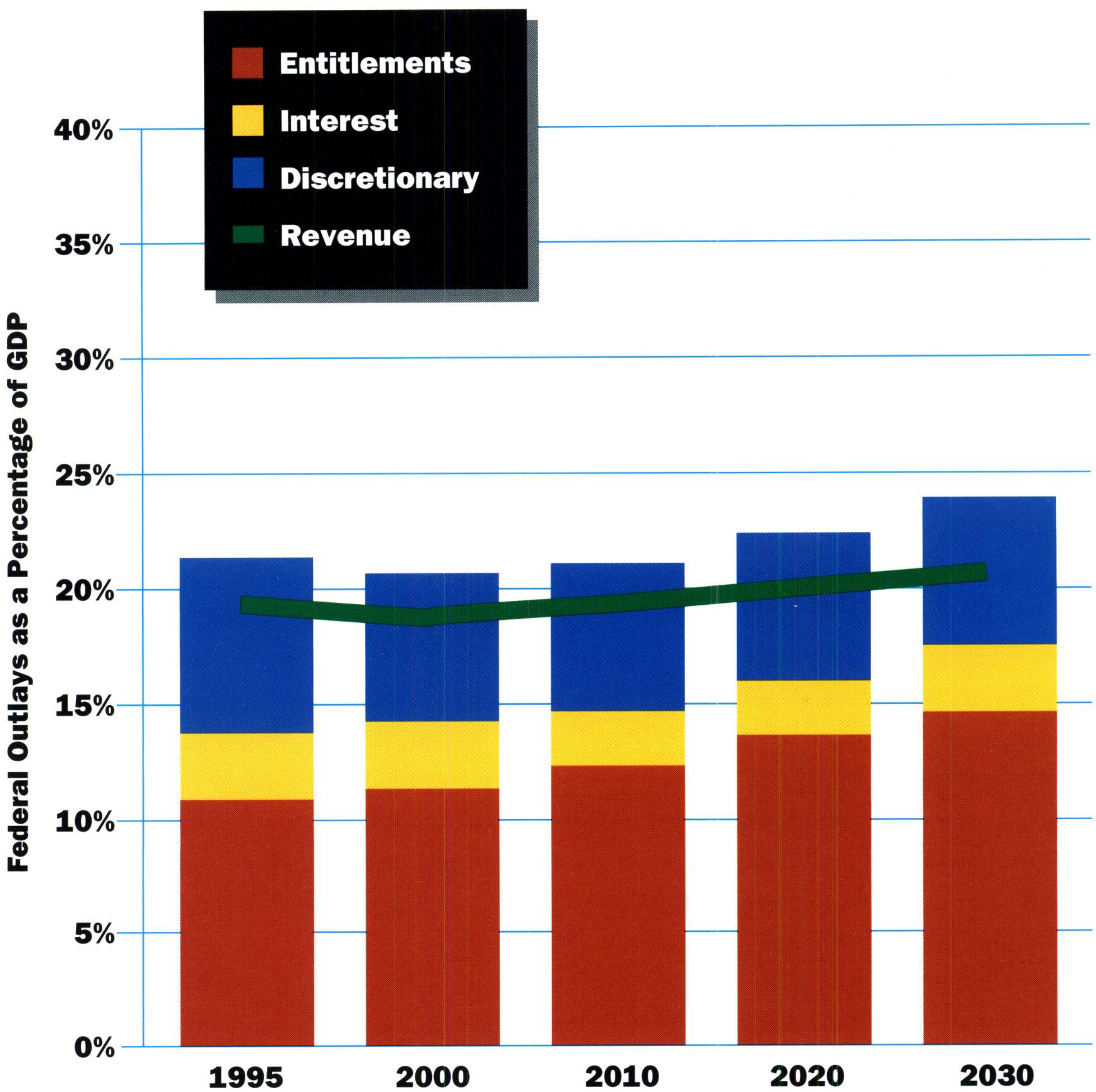
The voucher system proposed here is only one possible option for a fundamental overhaul of the existing Federal system of health care provision. It is proposed not because it necessarily represents the ultimate solution to the health care spending problem, but because we believe it more accurately exemplifies the fundamental point that the Federal government can no longer afford the unlimited automatic increases inherent in Federal health care spending, and must affirmatively determine on an annual

CURRENT BUDGET OVERVIEW



SIMPSON-MCMILLAN-GOSS

1995	2000	2010	2020	2030
2.3%	1.7%	1.6%	2.5%	3.7%



basis each year's health care budget. The price tag for such a voucher system would be willfully determined by Congress, preferably through the discretionary appropriations process, and a reasonable system of deductibles and copayments, as in the proposal here, would do much to improve the purchasing incentives in the current system. We commend legislation sponsored by Congressman Alex McMillan, H. Con. Res. 508, as worthy of congressional study.

Federal health care costs are driven up by a number of factors which cannot be eliminated solely by improvements in health care purchasing incentives. A classic example is the troubled area of medical malpractice, but action must also be taken in the areas of tort reform, product liability reform, antitrust law, and administrative overhead reduction, all requiring action beyond the scope of the Commission's ability to fully and knowledgeably recommend. The rate of growth in malpractice insurance rates and settlement awards is now absorbed by the system and passed on to taxpayers and beneficiaries. We believe that Federal health care insurance should tie premiums and deductible payments to the rate of health care program growth, but also that this concomitant burden is most fairly borne in combination with other reforms to slow that rate of overall growth.

Further, while the magnitude of individual Federal welfare programs are surpassed in size by such programs as Social Security and Medicare, we note that the aggregation of all programs perceived as "welfare" programs establishes them as among the largest entitlement categories. We, therefore, believe that we should specify that the programs affected by a global entitlement cap must include need-based programs. Whereas with some entitlement programs, the worst budgetary excesses are projected for future decades, we note that there is currently a high degree of bipartisan consensus that welfare reform is a policy challenge that must and can be met in the short term with the support of the American public. We, therefore, suggest that welfare reform must, not only for reasons of social policy but also budgetary need, be a component of the solution to the entitlement problem. We believe that the Entitlement Commission should be on record as asserting that Congress must review available proposals to consolidate and reduce the magnitude of all Federal welfare programs in the course of attempting to slow exploding entitlement spending. We would draw the attention of Congress to proposals advanced, in alternative budgets considered by Congress this past year, and by new Members of Congress, to consolidate existing welfare programs and to place them on an appropriated block grant basis.

Budget process reform, while not a substitute for specific spending provisions, must be a component of meaningful entitlement spending reform. Congressmen Cox and Stenholm have introduced legislation, also introduced by Senator Trent Lott, to streamline and improve the budget process in a number of ways that are important to the cause of restraining out-of-control entitlement spending. Of particular importance is the provision which would require Congress to vote each year on the spending embodied annually in entitlement programs. Even if, for political reasons, no Congress is ever likely to vote against bills containing that year's Social Security or Medicare budgets, it ought to be incumbent upon Congress to be held accountable for annual spending in all categories. For the majority of Federal spending to increase automatically each year without specific congressional or executive action is an abdication of governmental responsibility which should be corrected by budget reform legislation.