# STATEMENT OF COMMISSIONER RICHARD L. TRUMKA

## BIPARTISAN COMMISSION ON ENTITLEMENT AND TAX REFORM

When I was appointed last year by the President to serve on the Bipartisan Commission on Entitlement and Tax Reform, I welcomed the opportunity to work with you to explore ways to balance projected Federal revenues with expected expenditures for health and social insurance programs. In our work together we agreed that there is a need to address the rapidly increasing cost of health care; to strengthen the long-term financing of Social Security and Medicare; to encourage a course that reduces long-term deficits; to encourage increased savings and investment; and, by doing this, to secure a better future for our children and our Nation.



While I agreed with some of the initial findings, I dissented from the sweeping conclusions of the Interim Report that couched the problem of future Federal budget deficits almost entirely in terms of the size of the Baby Boom generation and their future retirement benefits. The one-sided Interim Report took very little account of the effect of runaway health care costs on the Federal budget or of the tax revenues lost from unjustifiable tax loopholes enjoyed by corporations and wealthy individuals. Moreover, I felt that lumping social insurance and entitlement programs together was a major analytical mistake. Each program has different revenue sources, different budgetary outlooks, and very different effects on the productive capacity of the economy.

Last week, I joined seven members of the Commission who were unwilling to sign a letter that restated the findings contained in the Interim Report and outlined several principles for reforming entitlement programs. I continue to believe that there is a need for greater balance than either our deliberations or the computer game achieved. We need far less rhetoric about our so-called "entitlement crisis" and a more balanced discussion of the benefits, costs, and challenges arising from the Nation's commitment to provide Social Security, Medicare, and other entitlement programs.

I regret that the approach was one-sided and that the needs of working Americans were overlooked in our discussions. This can be seen in the way we defined problems associated with entitlement spending, and in the recommendations of Senators Kerrey and Danforth to radically restructure and reduce Social Security and Medicare protection. These recommendations were advanced without spending so much as one hour of our year-long deliberations assessing the implications of these and other policy options on the everyday lives of average American families.

My proposal is based on my conviction that health care costs must be dealt with before any major restructuring of Medicare and Medicaid can be considered. In addition, I will show that actuarial balance can be achieved in the Social Security program without departing from its basic principles.

## 1. THE BIPARTISAN COMMISSION: A ONE-SIDED GAME

What has been hailed as the crowning achievement of the Commission — the computer game — is a metaphor for all that is wrong with the Commission. I regret that Commission members were not asked to vote on the computer game, nor were we given any input into its design.

For all its complexity, Americans playing the game can manipulate only one side of the budget equation. They can save money by cutting Social Security, Medicare, unemployment insurance, and programs for the poor. However, the computer game does not show the increased costs on employers, States, and households that will result from the decreased protection for the middle class and the increased poverty of others. In addition, while the game allows the player to cut domestic income support programs, it is not programmed to show what cutting defense, raising taxes on the wealthy or corporations, closing loopholes, or systematically controlling health costs would do for the Federal budget.

Lumping all entitlements together as one large problem creates a false sense of crisis and distracts us from addressing the real budget issue, sky-rocketing health care costs. The rising cost of health care, including Medicare and Medicaid, not overall entitlement spending, is the major cause of the projected growth in the Federal deficit.



Rather than addressing the need to control health care costs, our discussions focused on cutting Medicare and Medicaid, which will only shift costs to beneficiaries, employers, and hospitals, and reduce the quality and quantity of care to those who need help the most. *Projected long-term deficits are driven primarily by rapidly increasing health care costs. But even here, the Commission overstated the effect of the Baby Boom generation on the Federal health care budget.*[15]

15 The Interim Report wanted to prove that demographics alone causes entitlement spending to exceed sustainable levels in the year 2030. This is simply not the case. It is uncontrolled growth in health care costs, not the size of the Baby Boom generation that is the problem. The Interim Report assumes our Nation will be unable to control health care costs. As a result, the Commission overstated the implications of population aging on Federal deficits.

In order to separate the effects of population aging and unreasonable health care costs the Commission Staff had to make some assumptions. The Staff had to decide what portion of future health care costs would be the result of more people using health services and how much could be attributed to extraordinary health care cost inflation due to expensive technology, waste, and the health market's power to raise prices.

The Interim Report makes the argument that even if we reform health care — even though there is no particular plan in mind — the Medicare and Medicaid portion is still too high. The Staff decided it is reasonable to reform health care so costs grow "no more than the general growth rate of the economy." We agree. The difference between our view and the Staff view is what "the general growth rate of the economy" means.

The economy grows at about 2 percent a year (adjusted for inflation). The CBO is projecting large growth in the middle of the 1990s (about 2.3 percent a year) and a tapering off by about 1.3 percent a year between 2010 and 2070. We use these projected growth rates in the GDP as "the general growth rate in the economy." Using the cost of Medicaid and Medicare in 1994 we projected how much increasing numbers of people would cause spending in these categories to increase over time. Then we presumed that health care costs would go up by the growth rate of the economy. We get health care costs that are pretty high in terms of GDP, but they eventually fall to 5.5 percent of GDP, compared to the 4.5 percent of GDP today.

On the other hand, the Commission Staff used a much larger number to inflate health care. Instead of the real growth rate of the economy, they used the real growth rate of the economy *and* the inflation rate and then divided it by the number of workers, which makes the index grow even more. Having health care costs grow by the rate of inflation plus the real growth rate in the economy is just too high. Our reforms should do better. Their estimate is 7.2 percent in 2030.

We do not know how much we can succeed in curbing the rate of increase in health care costs. But neither does the Commission. By assuming a rate that is very large, the Commission skewed the representation to make the future size of the elderly group, and not skyrocketing health care costs, appear to be the problem.

The two major programs — Social Security and Medicare, which together account for 60 percent of entitlement spending — have long-range financing problems, but for different reasons and in different ways. Social Security has not contributed one cent to the deficit or the debt of the United States. It is in fact a contributory program that is entirely supported by its own funding.

Contrary to the views advanced by Commission documents, Social Security is in good financial condition. Since 1937, when Social Security first collected earmarked contributions from employers and employees, $4.3 trillion has been paid in and $3.9 trillion has been paid out, including administrative expenses (now running at one cent for each dollar of benefits). This leaves nearly $400 billion in reserve.

By only looking at the cost side, the Commission's report ignores the fact that Social Security keeps 15 million people out of poverty and many millions more from near poverty. But it is more than a poverty program. Social Security is the only pension system for 6 out of 10 workers in private industry and is the base on which other retirement systems and individual savings are built, making it equally important for employers.



Families are protected by Social Security insurance against the total disability or death of a worker. The $12.1 trillion in life insurance protection provided by Social Security exceeds by $1.3 trillion the financial protection provided by all other types of private life insurance combined. It is a mistake to think of Social Security as primarily for the elderly. It is family protection for all, providing benefits for nearly 3 million children every month.

The Commission advanced a list of over 50 options, many of them dealing with Social Security. But at no point — not at its meetings or in its Staff work — did the Commission carefully examine how altering Social Security and other entitlement programs might affect the security of average families.

The computer game and many of the Commission's documents imply that entitlements and the growing number of older Americans are "THE PROBLEM" — the causes of Federal deficits and reduced savings and the real threat to the well-being of the economy and our children. This explanation of our current economic and budgetary problems is wrong and leads inescapably to irrational reductions in Social Security, Medicare, Medicaid, and other critical programs.

## 2. THE KERREY-DANFORTH PROPOSAL: UNDERMINING THE WELL-BEING OF WORKERS AND THEIR CHILDREN

The Kerrey-Danforth proposal fails to live up to the Senators' own promise not to hurt younger generations or current retirees and to balance long-term spending with revenue. By cutting the payroll tax, the proposal forces cuts in Social Security far beyond what is needed to maintain the solvency of the Trust Funds. In fact, their expenditure cuts are three times greater than would be needed to bring Social Security into balance. This package represents a fundamental attack on the idea of Social Security, arguably the most fundamental attack in its 60-year history.

### a. The Effects of Raising the Social Security Retirement Age to 70

Raising the retirement age proposal represents a 20 percent benefit reduction, even for people who retire at age 70. Older workers in poor health, widows, widowers and spouses with limited resources will bear the brunt of these changes. Raising the age will have an especially severe impact on low-income workers, who generally have shorter life expectancies, are generally in worse health, and have fewer employment opportunities. For example, the life expectancy of African-American males has actually been declining and is now 65.

If increasing the retirement age causes one-half of those aged 65 and over to look for work, the economy would have to create millions of additional jobs in the next decade alone. Raising the retirement age will generate millions of new workers, but it will not generate the 25 million additional jobs that will have to be produced by the year 2030 to accommodate these extra workers. *In other words the raising retirement age could create a deficit of another sort: a jobs deficit.* As a result, young people could face higher rates of unemployment and lower pay.



### b. Raising the Medicare Retirement Age

Raising the medicare eligibility age is even more devastating than raising the Normal Retirement Age for Social Security. Making 65- to 69-year-olds ineligible for Medicare will leave millions of older Americans without health insurance and at risk of impoverishment due to an unexpected hospitalization or other health emergency. Many people in this age group have one or more chronic health conditions and are uninsurable in the private market. Even if private insurance coverage is offered, many people will find it too expensive to purchase.

The Kerrey-Danforth proposal would allow people under age 70 to purchase Medicare, an option that simply amounts to a further cut in Social Security. Given the high rate of poor health among minority and low-income individuals, an increase in the Medicare eligibility age will be particularly harmful to minority and low-income persons.

### c. Other Medicare Proposals

The Kerrey-Danforth proposal also raises premiums; creates a new tax; raises deductibles and copays; reduces Medicare provider payments; and caps employer-provided health insurance. Together, these proposals would mean an enormous benefit cut for many of today's elderly and disabled, violating the promise made by the Chairmen not to harm current beneficiaries.

Under these proposals, by the year 2000, middle-income beneficiaries would pay $1,000 more in out-of-pocket expenses for medicare. The elderly already pay more than any other group on health care. In fact, they pay half of their own medical costs even when covered by Medicare.

Moreover, deductible and coinsurance increases are regressive and fall hardest on sick persons who lack Medigap or Medicaid coverage, individuals who are normally just above Medicaid eligibility levels. Providers have been squeezed to the point that many are already reluctant to accept Medicare beneficiaries.

The Kerrey-Danforth proposal also includes a cap on employer deductions for contributions to employee health insurance. This will cause many employers to rachet down coverage and in effect would penalize workers who have already given up wages to maintain their health care benefits. Our government should be enacting policies that expand access to health care, not erecting additional obstacles.

Finally, the proposal calls for means testing and the partial privatization of Medicare — yet another tragic retreat from America's progress toward universal health insurance. Means testing would transform Medicare into a welfare program, rendering it more expensive to administer and making it more vulnerable to political attack. Upper-income retirees who lose benefits may opt to leave the system altogether, thereby eroding the universal support it now enjoys.



### d. The Kerrey-Danforth Social Security Cuts

The Kerrey-Danforth proposal would cut Social Security benefits by the following amounts: 33 percent for low-wage earners (under $10,000 per year); 43 percent for average-wage earners (between $25,000 and $40,000 per year); and 50 percent for maximum-wage earners (over $60,600). Without question, this is the most extraordinary package of Social Security cuts ever proposed.

Another factor overlooked by the Commission is interaction between the Social Security system and employer retirement planning. In fact, it is likely that if Social Security and Medicare were cut, private sector costs would increase. For example, private industry would incur much greater costs to induce people to retire.

### e. Mandatory IRAs — Partial Privatization

The Kerrey-Danforth plan would compel people to direct 1.5 percent of the Social Security payroll tax to individual savings accounts — the so-called mandatory IRAs. On an individual level, personal savings accounts are popular. Unlike Social Security, IRAs allow individuals to see their savings grow. But savings accounts are not insurance, and shift an enormous risk to the individual. Even with today's average return on savings, a 50-year-old making the average wage today would have only $7,379.62 by the time s/he is 62.[16]

Among the biggest losers will be the disabled, whose benefits will be based on a smaller Social Security benefit. A worker's account will provide sufficient retirement income only if s/he does not die

16 We assume a 2 percent wage growth and fund earnings of 7 percent.

or become disabled before the account has had sufficient time to grow; if s/he is employed continuously; does not make bad investment decisions; and leaves the workforce when the market is strong.

The only clear winners are money management firms. If these mandatory IRAs existed in 1993, $39 billion would flow out of the OASDI Trust Fund into the hands of private sector financial managers. In three years the total would be over $126 billion dollars.

#### f. The Kerrey-Danforth Proposal Places False Hope in the Private Pension System

Sixty percent of retirees have no retirement income other than Social Security. Middle-class workers (annual earnings between $25,000 and $40,000) expect to get about 57 percent of their total retirement income (including earnings) from Social Security. As we pointed out, the Kerrey-Danforth proposal would cut these benefits by over 43 percent.

The private pension system and private savings cannot make up for this. In fact, the trends in private employer-provided pensions point in the opposite direction. Participation in employer-provided voluntary pensions held steady at around 45-46 percent throughout the 1970s and 1980s, but declined to 44 percent in 1993. Only 39 percent of current workers have defined benefit plans they can count on.



#### g. Women Retirees Face Special Problems

The Kerrey-Danforth proposal takes a backward step away from gender equity because it disproportionately hurts women workers and retirees. There are three reasons women are particularly harmed by Social Security cuts: women are more likely to be lower-income workers; they depend more heavily on their spouses for retirement income; and women live longer than their husbands. For these reasons, women experience higher rates of poverty in old age and get a larger percentage of their income from Social Security.

By the time today's 38-year-old female reaches age 65, she has a 40 percent chance of living alone and in poverty at some point in her old age. The Kerrey-Danforth proposal greatly increases their chances of living in poverty and makes a bad problem worse.

The Kerrey-Danforth proposal lacks any analysis of the critical role Social Security plays in the lives of older women. Before Congress moves ahead with Social Security reforms, I hope it will take account of the following facts about the income needs of older women: (1) nearly three out of four of the Nation's elderly poor are women; (2) one in four women over age 65 depend on Social Security for 90 percent of retirement income; (3) women are largely left out of the private pension system — women are half as likely to receive a pension as men; and (4) non-married women 65 and older experience poverty at three times the rate of older couples.

### h. The Kerrey-Danforth Proposal and National Savings and Investment

Rather than achieving their goal of increasing national savings, the creation of mandatory IRAs may actually lower national savings by eliminating from the savings pool the fees that will be collected by IRA managers. Moreover, once people have individual accounts they will likely cut back their saving elsewhere.

Means testing will also discourage private savings. Savings are already taxed as income; if Medicare benefits are reduced because workers have assets, the tax rate may become so high that workers will not bother to save.

Finally, the Commission's analysis hinges on the unsupported assumption that increasing national savings will in turn increase investment. However, the link between national savings and job-producing investment is theoretical at best.



There are other equally plausible scenarios that were never explored. Not once did the Commission seriously address how Federal spending — even if it requires deficits — could increase productivity and economic growth by investing in education, basic research, and infrastructure. In fact, the historical evidence points in this direction — in times when Federal spending is high, business confidence tends to be high and investment spending increases. Investment spending by business is not necessarily related to the Federal deficit.

Furthermore, the proposition that savings automatically leads to more investment is refuted by one of the major tenets of modern economics. Supply does not create its own demand. The forces that make capital available for investment are not the same as those that produce enough business optimism to spur investment.

### i. Entitlement Cap

The Kerrey-Danforth proposal cuts programs designed to help the poor by imposing a cap on future spending for entitlement programs other than Social Security and Medicare. While I agree that the welfare system is in need of reform, for the benefit of both recipients and taxpayers, it is unlikely that there will be major savings from this effort.

Moreover, any savings to the Federal government will likely be matched by increases in spending by the States. The fact is, programs designed for the poor need to be better financed, not cut. We should begin by patching the leaks in our tax system — for example, by closing tax loopholes for the well-off and subjecting all other tax expenditures to a rigorous review. ★