BIPARTISAN COMMISSION ON ENTITLEMENT AND TAX REFORM

Senate Hart Building Room 825 ● 120 Constitution Ave., N.E. ● Washington, D.C. 20510 ● 202/224 – 2300

July 28, 1994

Dear Commission Member:

Enclosed is a revised version of the Commission findings that will be discussed at the August 8, 1994 Commission meeting. This version incorporates comments we have received to date from members. The meeting will be held in room 210 Cannon House Office Building at 1:00 p.m. (the same location and time as the previous Commission meetings).

Sincerely,

J. Robert Kerrey

John C. Danforth

Enclosures

July 28, 1994

Draft Commission Findings

> ***"This Commission will be asked to grapple with real issues of entitlement reforms.... This panel, I expect, will ask and answer the tough questions.... [M]any may regard [this] as a thankless task. It will not be thankless if it gives us a strong and secure and healthy American economy and society moving into the 21st century."*** President Bill Clinton

Throughout America's history, each succeeding generation has enjoyed the promise of a better standard of living. The goal of this Commission is to help maintain that promise -- to help secure for America's children a standard of living that is better than that which we enjoy today. To achieve this goal, the Commission will assess the need for entitlement and tax reform and make specific recommendations for reform to the President in December.

These findings are the Commission's first step in achieving its goal. The findings describe the economic future that will confront Americans during the first quarter of the 21st century if the nation fails to act. The picture that they paint is unsettling. The findings are not, however, a prediction of the future. They are the product of simple arithmetic if our current economic policies are not changed.

A better future for America can be secured if the country embarks on the course of long-term reform. We can help Americans save and invest in themselves and the country. We can make the essential public investments in our workers and our children. And we can maintain the strength of vital government programs that support and protect many Americans.

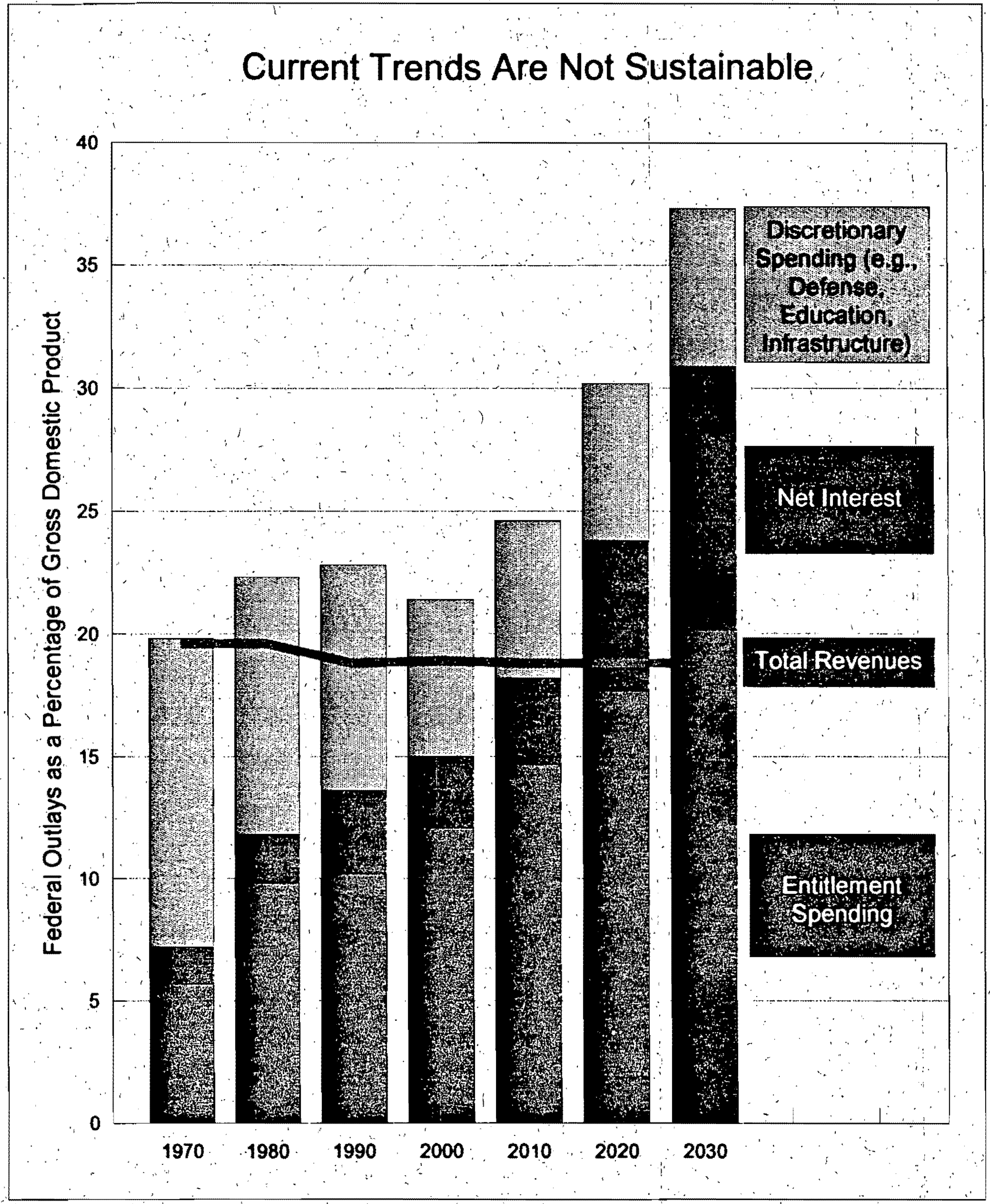
Finding #1: To ensure that today's debt and spending commitments do not unfairly burden America's children, the government must act now. A bipartisan coalition of Congress, led by the President, must resolve the long-term imbalance between the government's entitlement promises and the funds it will have available to pay for them.

- Although the short-term fiscal outlook has improved, the long-term situation requires immediate attention. For the next five years, the Federal deficit is projected to average 2.5% of the economy, its lowest level since the 1970s. After 1998, however, Federal spending is projected to grow faster than revenues which will cause Federal deficits to rise rapidly.

- In 2012, unless benefit growth is reduced or revenues are increased in the interim, projected outlays for entitlements and interest on the national debt will consume all taxes collected by the Federal government.

- In 2030, unless benefit growth is reduced or revenues are increased in the interim, projected spending for Medicare, Medicaid, Social Security, and Federal employee retirement programs alone will consume all taxes collected by the Federal government. Even if all other Federal programs (except interest on the national debt) grow no faster than the economy, total Federal outlays would exceed 37% of the economy. Today, outlays are 22% of the economy and revenues are 19%.

- To put the long-term fiscal imbalance in perspective, in 2030, if no action is taken in the interim, reducing the Federal deficit to 2.5% of the economy will require a choice between increasing every Federal tax by 85% and cutting every Federal program and entitlement by more than half.



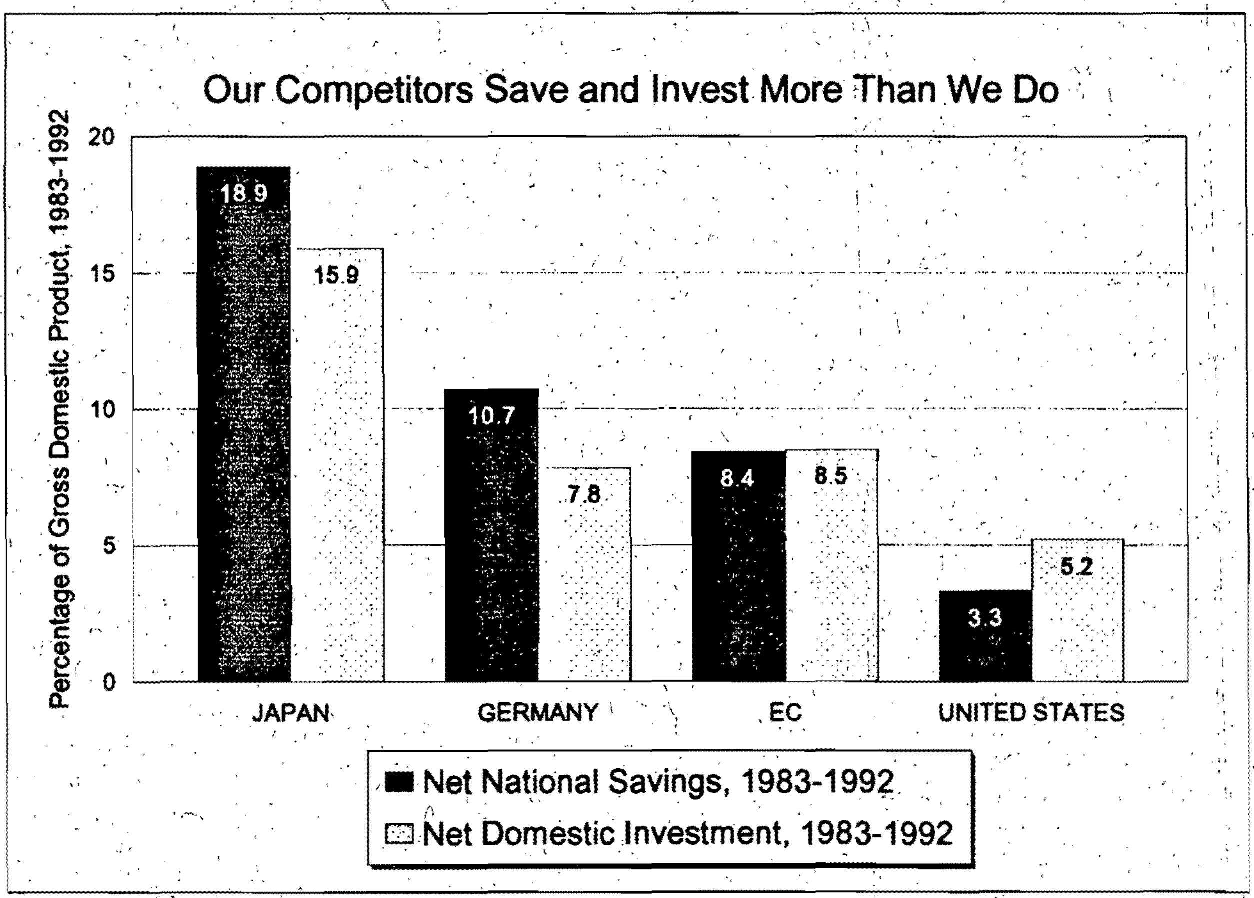
This chart shows the long-term budget implications of current spending and tax policies. In projecting entitlement spending, Medicare and Social Security outlays follow the Medicare and Social Security Trustees' "best estimates." Medicaid outlays are assumed to reflect demographic changes and the increases in health care costs that underly the Medicare projections. All other spending and revenues are assumed to follow CBO projections through 1999 and to grow in proportion to the overall economy thereafter.

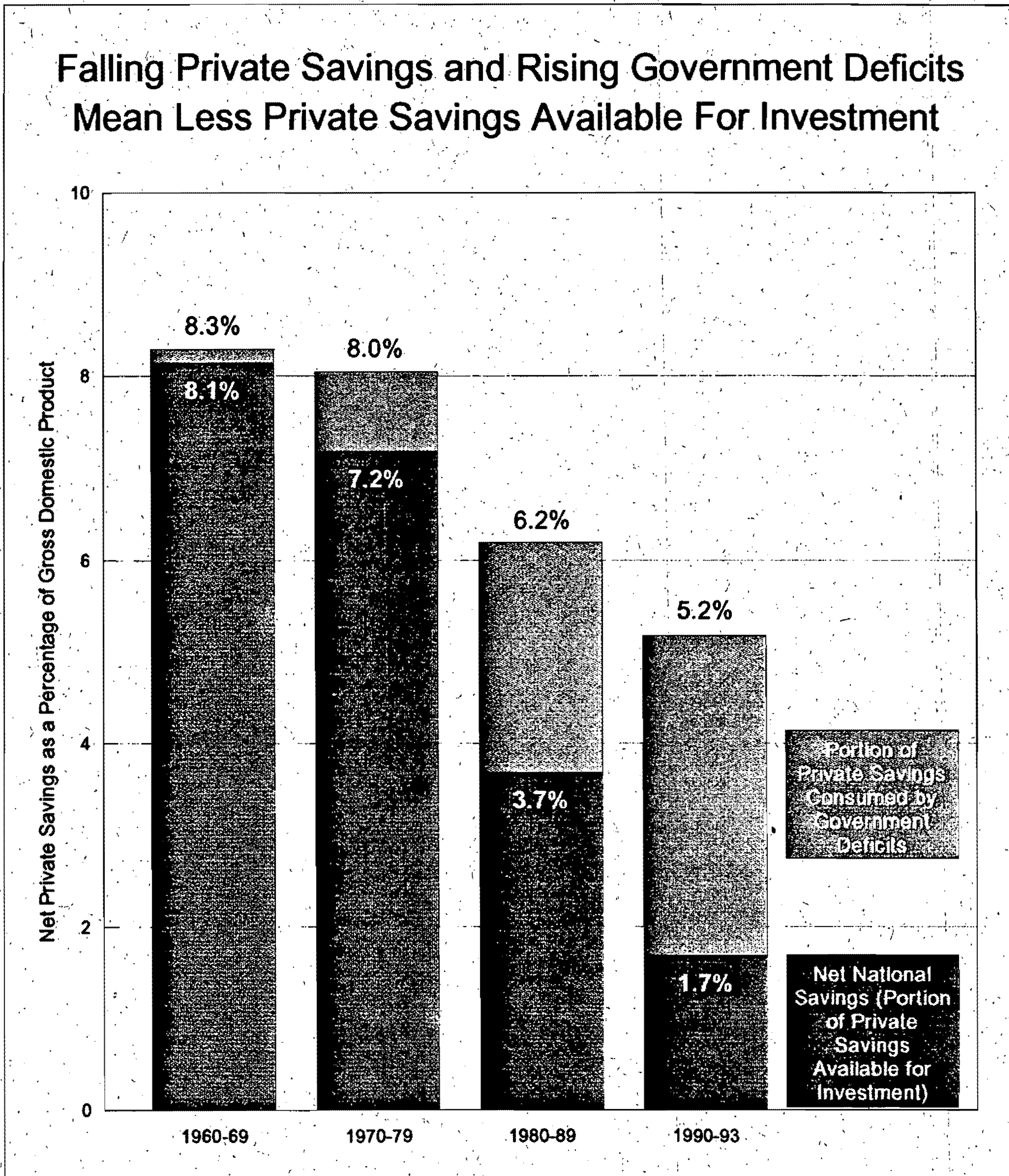
Finding #2: To ensure the level of private investment necessary for long-term economic growth and prosperity, national savings must be raised substantially.

- Countries that save and invest more grow faster and have more rapid improvements in the standard of living of their citizens. In the United States, declining private savings and large government deficits limit investment, productivity, and economic growth.

- Since the 1960s, private savings have fallen from more than 8% of the economy to about 5% today. At the same time, government deficits have increased from less than 1% of the economy to more than 3% today.

- As a result, the supply of savings available for private investment, "net national savings," has dropped from more than 8% of the economy to less than 2% today. This restricts American productivity and growth.





Falling Private Savings and Rising Government Deficits
Mean Less Private Savings Available For Investment
Net Private Savings as a Percentage of Gross Domestic Product
10
8
6
4
2
0
8.3%
8.1%
8.0%
7.2%
6.2%
3.7%
5.2%
1.7%
1960-69
1970-79
1980-89
1990-93
Portion of Private Savings Consumed by Government Deficits
Net National Savings (Portion of Private Savings Available for Investment)

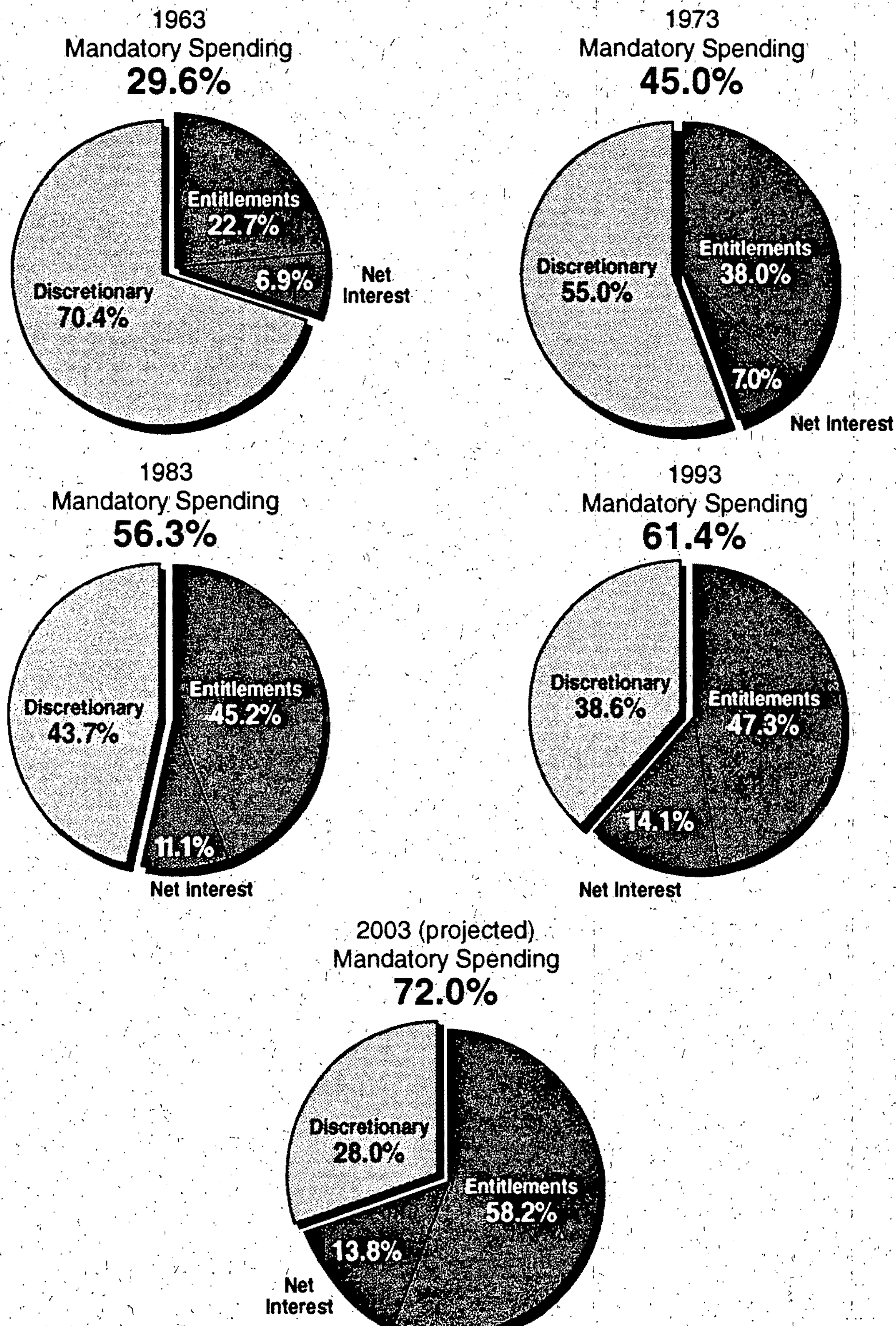
Finding #3: To ensure that funds are available for essential public investments and other important needs such as education, children's programs, highways, and national defense, the nation cannot continue to allow entitlements to consume an ever-increasing share of the Federal budget.

- Entitlement spending and interest on the national debt consume more than 60% of Federal outlays today, double the percentage of just 25 years ago.

- The Congressional Budget Office projects that entitlement spending and interest payments will exceed 70% of total Federal outlays by 2003.

- By 2003, less than 15 cents of every dollar the Federal government spends will be available for non-defense discretionary programs that can raise productivity and contribute to economic growth; programs such as job training and Head Start.

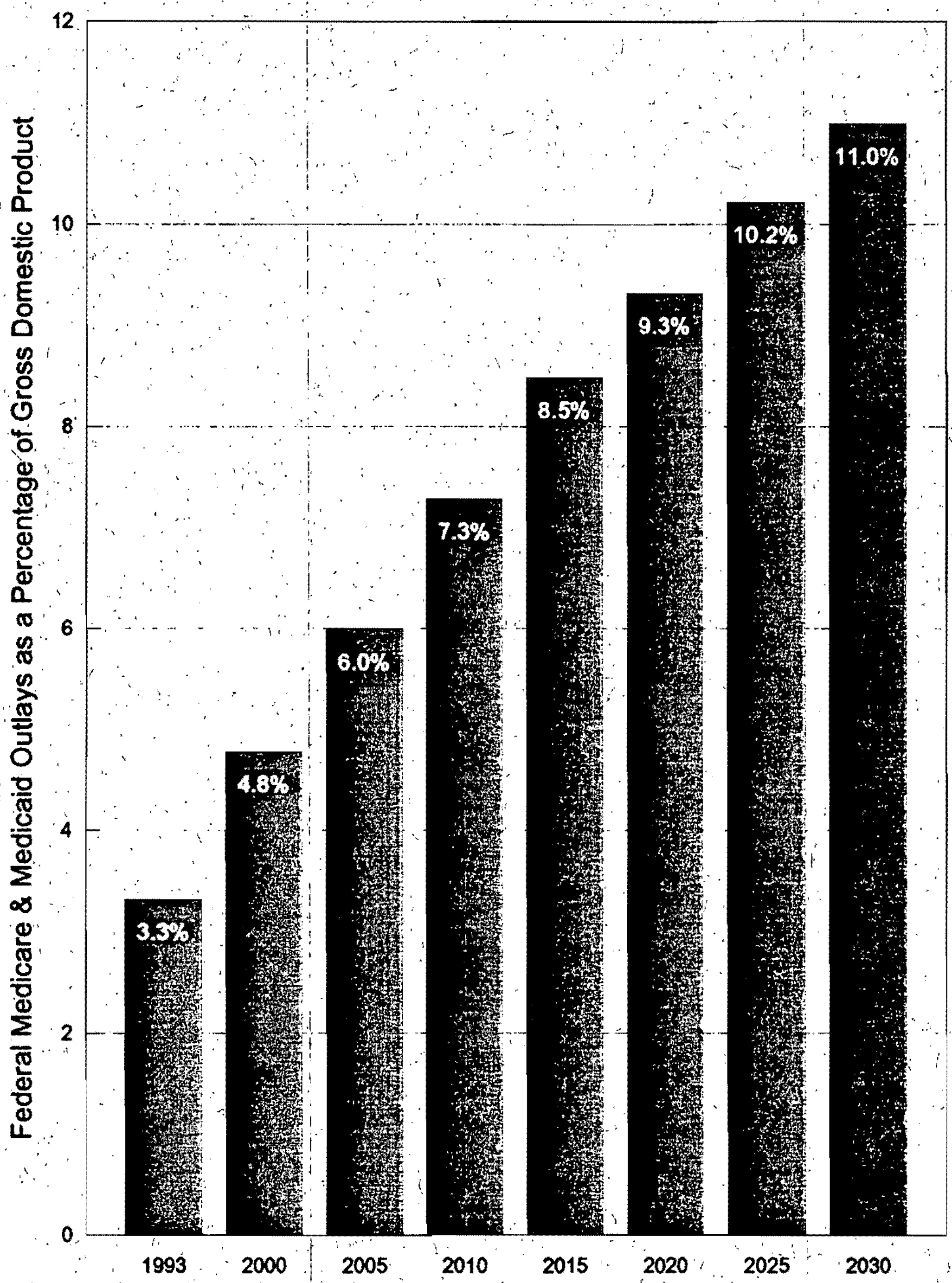
Growth of Mandatory Spending In The Federal Budget



Finding #4: To be effective, any attempt to control long-term entitlement growth must take into account the projected increases in health care costs.

- The growth of public and private health care costs poses an immediate problem that must be addressed.
- Federal health care spending has been increasing at annual rates averaging 10% or more during the last five years, far in excess of overall economic growth.
- If the increase in health care costs is not restrained, Federal spending on Medicare and Medicaid is projected to triple as a percentage of the economy by 2030. Federal health care spending is projected to increase from 3.3% of the economy today to 11% by 2030.

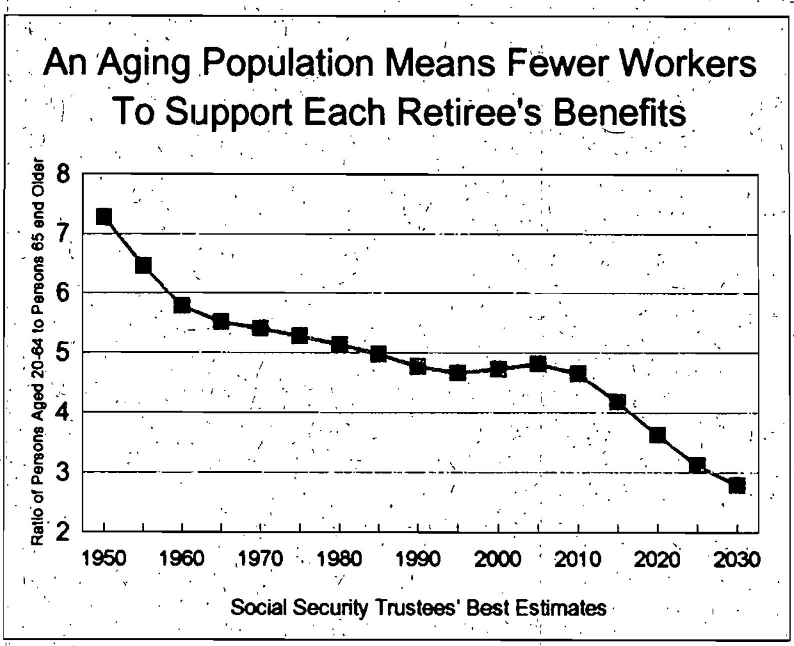
Federal Spending on Health Care is Projected to Triple by 2030



This chart shows the projected long-term growth of Federal health care spending as a percentage of the economy. Medicare outlays follow the Medicare Trustees' "best estimates." Medicaid outlays are assumed to reflect demographic changes and the increases in health care costs that underlie the Medicare projections.

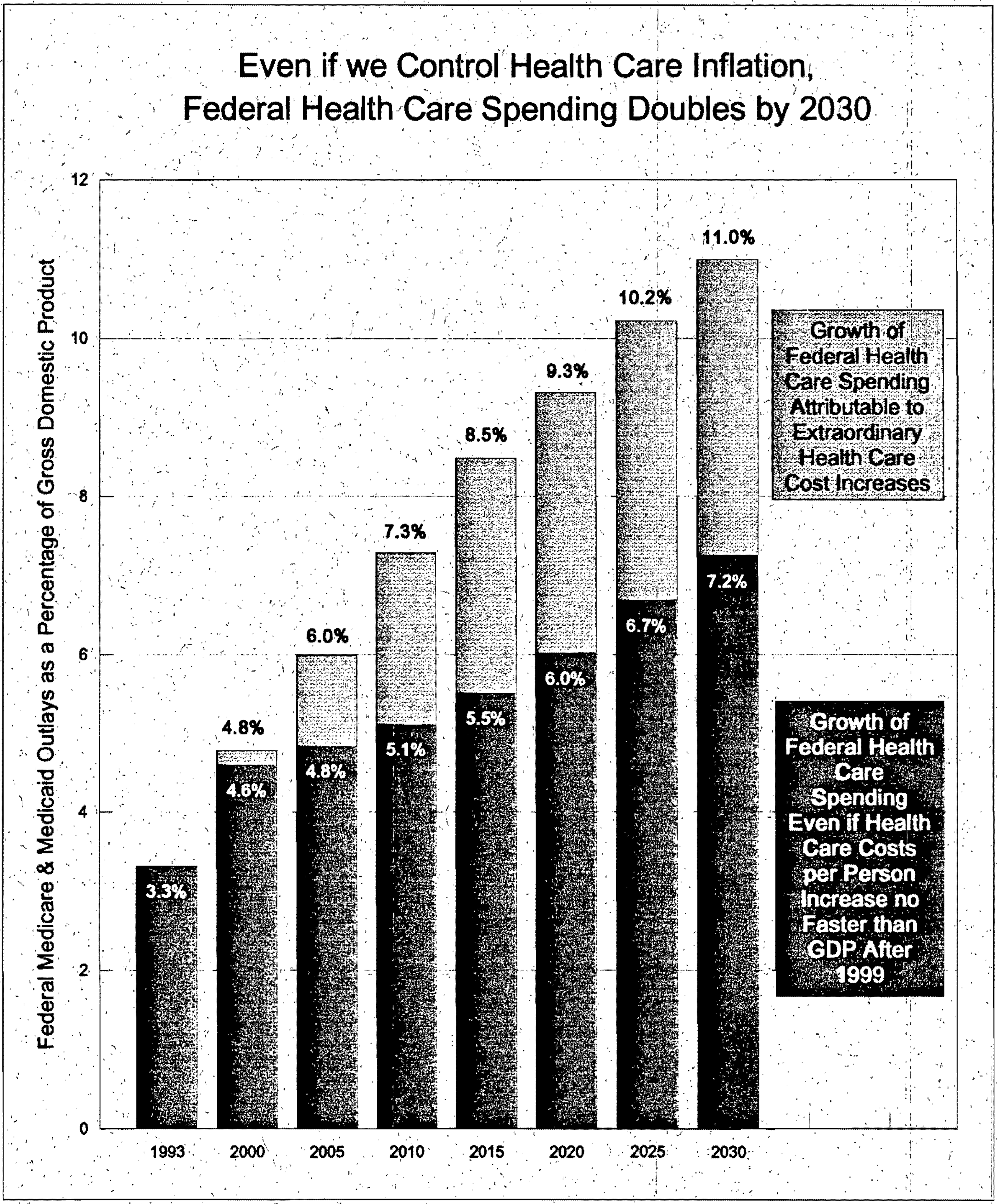
Finding #5: To be effective, any attempt to control long-term entitlement growth must also take into account fundamental demographic changes.

- America's population is growing older because of longer life expectancies and the aging of the baby boom generation. Today, there are almost five working-age persons for each person over 65. In 2030, when today's workers have retired and today's children are in their prime working years, the Social Security Trustees project that there will be fewer than three working-age persons for each person over 65.



- The aging of the population will significantly increase Federal health care and retirement outlays. Even if the extraordinary increases in health care costs were eliminated after 1999 (so that costs for each person of a given age grew no faster than the economy), Federal outlays for Medicare and Medicaid would still double as a percentage of the economy by 2030. The aging of the population drives combined Medicare, Medicaid, and Social Security spending from about 8% of the economy today to about 14% of the economy in 2030.

- To fund the annual increases in Medicare, Medicaid, and Social Security spending, every Federal tax would increase by more than 30% by 2030.



This chart divides the projected long-term growth of Federal health care spending into the portion that is attributable to the extraordinary health care cost increases and the portion that would remain even if health care costs for each person of a given age grew no faster than the economy after 1999.

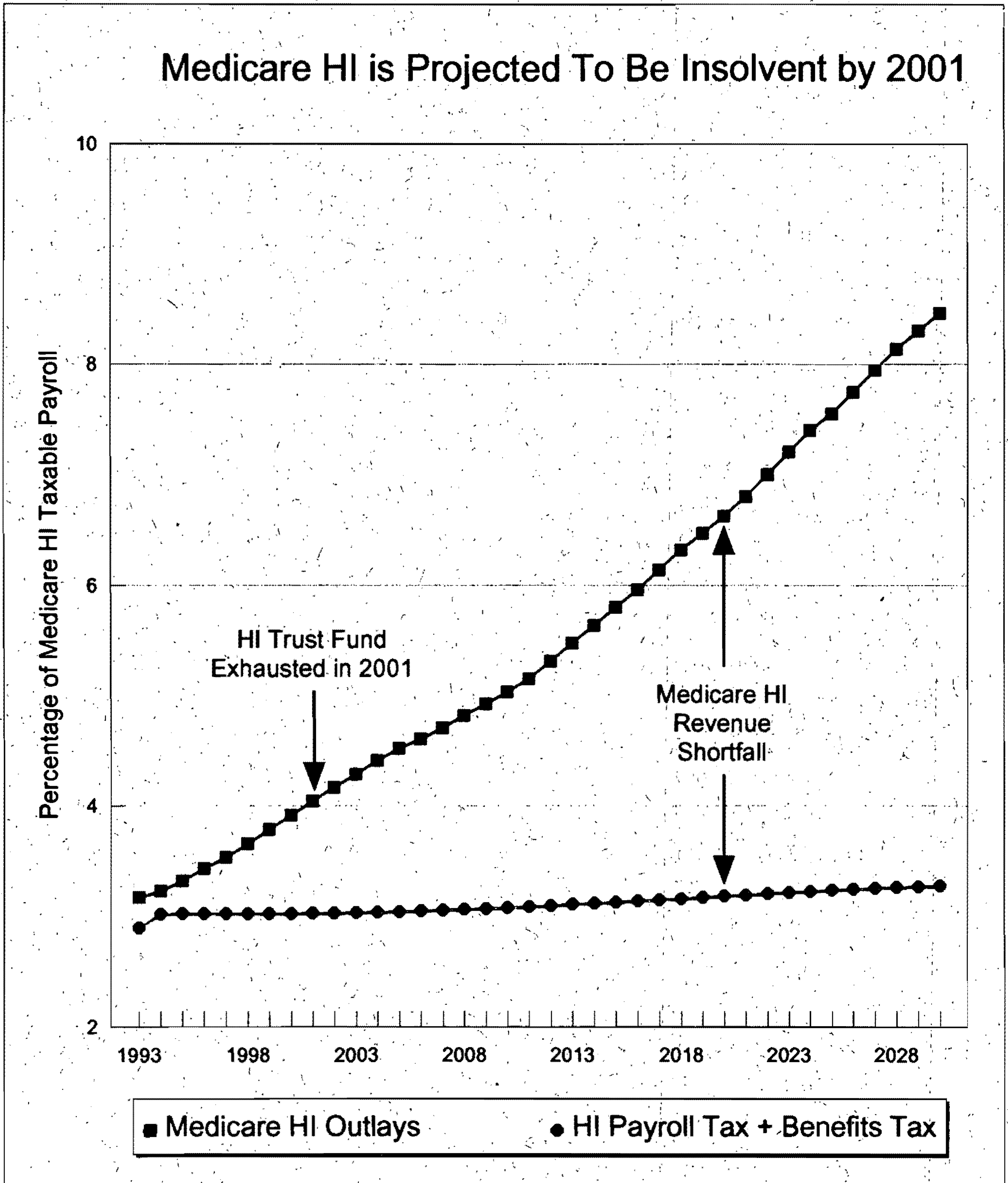
Finding #6: To respond to the Medicare Trustees' call to action and ensure Medicare's long-term viability, Medicare spending and revenues available for the program must be brought into long-term balance. Health care spending must be reduced, revenues raised, or a combination of both.

- Medicare Hospital Insurance (HI). The Public Trustees conclude that the Medicare HI program "is severely out of financial balance and is unsustainable in its present form." Medicare HI outlays already exceed tax revenues dedicated to the program and are rapidly depleting Trust Fund assets. The Trust Fund is projected to run out of money by 2001.

- In the long run, the situation gets even worse. By 2030, projected Medicare HI outlays exceed dedicated tax revenues by more than 5% of the payroll tax base. If the increase in Medicare HI outlays were paid for by increasing payroll taxes, the Medicare payroll tax rate would increase from 2.9% today to more than 8% by 2030.

- Medicare Supplementary Medical Insurance (SMI). The Public Trustees urge "prompt, effective, and decisive action..." to ensure the long-term financing of Medicare SMI. Today, 75% of Medicare SMI spending is funded from general revenues, while 25% is from premiums paid by beneficiaries.

- In the long run, the Trustees project that Medicare SMI outlays will rise from just over 1% of the payroll tax base today to more than 7% of payroll by 2030. If individual income taxes were used to pay for this increase in Medicare SMI, income taxes would increase by more than 30%.



Medicare HI is Projected To Be Insolvent by 2001
Percentage of Medicare HI Taxable Payroll
10
8
6
4
2
HI Trust Fund
Exhausted in 2001
Medicare HI
Revenue
Shortfall
1993
1998
2003
2008
2013
2018
2023
2028
Medicare HI Outlays
HI Payroll Tax + Benefits Tax

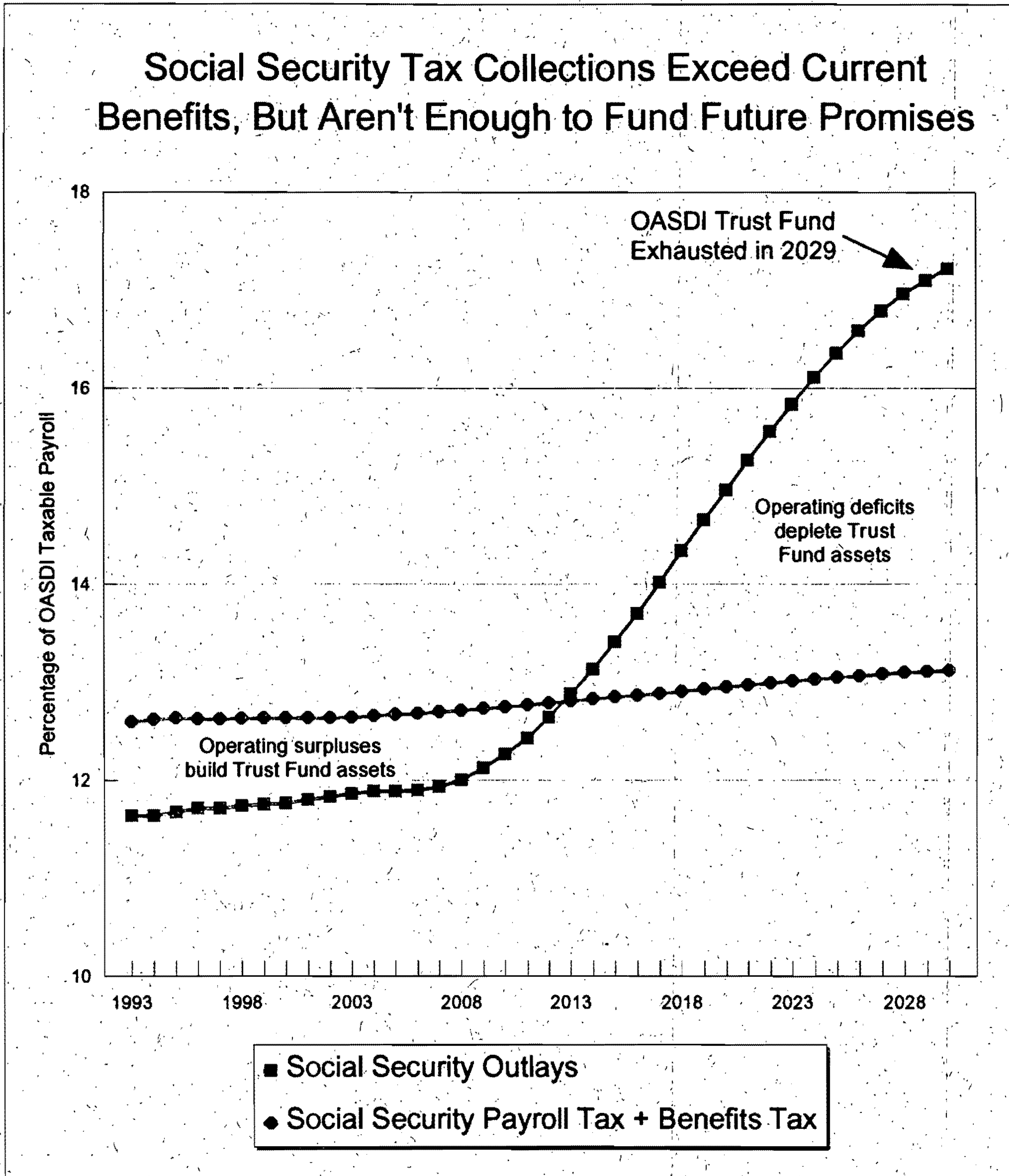
Finding #7: To respond to the Social Security Trustees' call to action and ensure the long-term viability of Social Security, Social Security spending and revenues available for the program must be brought into long-term balance. Social Security spending must be reduced, revenues raised, or a combination of both. Any savings that result should be used to restore the long-term soundness of the Social Security Trust Fund.

- Social Security is an important source of support for many of the nation's citizens. Today, the poverty rate for senior households is about 13%, but without Social Security, it would increase to about 50%. Social Security provides 90% or more of the total income for almost half of the senior households below the poverty line.

- The Public Trustees believe that "legislative action is needed to ensure the long-range financial integrity of the [Social Security] program."

- Once the baby boom generation begins to retire in 2010, the cash flow surplus from Social Security will rapidly decline. By 2013, Social Security benefit payments will exceed the tax revenues dedicated to the program. At that time, the cash flow shortfalls in Social Security will cause the total Federal deficit to increase unless taxes are raised or programs are cut.

- The Trust Fund is projected to run out of money in 2029. At that time, projected outlays will exceed tax revenues by more than 4% of the payroll tax base. If this shortfall were paid for by increasing payroll taxes, the Social Security payroll tax rate would rise from 12.4% today to more than 16.5% by 2030.


Social Security Tax Collections Exceed Current Benefits, But Aren't Enough to Fund Future Promises
OASDI Trust Fund Exhausted in 2029
Operating deficits deplete Trust Fund assets
Operating surpluses build Trust Fund assets
Percentage of OASDI Taxable Payroll
18
16
14
12
10
1993
1998
2003
2008
2013
2018
2023
2028
Social Security Outlays
Social Security Payroll Tax + Benefits Tax

"Are these the shadows of the things that Will be, or are they shadows of the things that May be, only?... Men's courses will foreshadow certain ends, to which, if persevered in, they must lead... But if the courses be departed from, the ends will change. Say it is thus with what you show me!" Charles Dickens' A Christmas Carol

America can change course. If the government acts soon, it can ensure that future generations are not unfairly burdened with today's debt and spending commitments. It can ensure public and private investments that are needed for America's future prosperity. And it can ensure the solvency of the Medicare and Social Security Trust Funds that are an important source of support and security for many Americans.

Sources and Assumptions

The projections presented here are intended to illustrate long-term trends in the direction and magnitude of future outlays and revenues. The approach is simplified to provide clarity. The projections should not be viewed as precise dollar estimates.

Finding #1 ***Current Trends Are Not Sustainable***

The economic and demographic projections (e.g., population, GDP and nominal interest rates) used in the analysis are from the 1994 Annual Report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds, including unpublished annual data ("1994 Social Security Trustees' Report"). **Entitlement Spending** includes outlay projections for Social Security from the 1994 Social Security Trustees Report. The outlay projections for Medicare and Medicaid are from the chart accompanying Finding #4. Outlays for entitlements other than Social Security, Medicare, and Medicaid are projected through 1999 based on CBO estimates from CBO's The Economic and Budget Outlook: Fiscal Years 1995 - 1999, January 1994 ("1994 Budget Outlook"). After 1999, these other entitlements are assumed to grow in proportion to GDP (e.g., Federal civilian and military retirement programs are projected to be a constant .9% of GDP). **Discretionary Spending** is projected through 1999 based on CBO estimates in the 1994 Budget Outlook (which assume that the discretionary caps are met). After 1999, **Discretionary Spending** is assumed to grow in proportion to GDP. In determining annual deficits and **Net Interest,** Federal revenues are assumed to follow CBO projections from the 1994 Budget Outlook through 2004 and to remain a constant percentage of GDP (18.8%) after 2004.

Finding #2 ***Our Competitors Save and Invest More Than We Do***

The data are from the OECD's National Accounts, Main Aggregates 1960-1992, Vol. I (1993).

Falling Private Savings and Rising Government Deficits Mean Less Private Savings Available For Investment

The data are derived from the Economic Report of the President, February 1994 ("1994 Economic Report"). **Net Private Savings** is the sum of personal saving and gross business saving, reduced by consumption of fixed capital (i.e., depreciation). **Net National Savings** is **Net Private Savings** reduced by Federal deficits and increased by state and local government surpluses (which were .04%, .86%, 1.06% and .18% of GDP in the four periods).

Finding #3 ***Growth of Mandatory Spending In The Federal Budget***

Data on outlays by type are from 1994 Budget Outlook. For simplicity, the total for **Entitlements** includes spending that is generally referred to as mandatory spending (other than interest), as well as offsetting receipts and deposit insurance premiums. For this purpose, **Mandatory Spending** is the sum of **Entitlements** and **Net Interest.**

Finding #4 ***Federal Spending on Health Care Is Projected to Triple by 2030***

Outlay projections for **Medicare** are from the 1994 Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund and the 1994 Annual Report of the Board of Trustees of the Federal Supplementary Medical Insurance Trust Fund, including unpublished annual data ("1994 Medicare Trustees' Reports"). Medicare spending is reduced by SMI premiums paid by enrollees. The Medicare Trustees project SMI premiums through 2006. After 2006, the chart maintains the relationship between SMI premiums and Medicare SMI outlays that the Trustees project for 2006. **Medicaid** outlays are assumed to follow CBO estimates through 2004 from the 1994 Budget Outlook. After 2004, Medicaid spending is projected using a simplified outlay model. The model assumes that Medicaid costs per member of specific population groups (e.g., persons 65 to 84, persons 85 and over, and the disabled) grow in proportion to the projected increases in Medicare costs (after adjustment for demographic change). The model adjusts total Medicaid costs to reflect projected changes in the demographic composition of the population from the 1994 Social Security Trustees' Report.

Finding #5 ***An Aging Population Means Fewer Workers To Support Each Retiree's Benefits***

Population history and projections are from the 1994 Social Security Trustees' Report. The Social Security Trustees' Reports generally present a similar chart which compares covered workers to beneficiaries. If the chart were formulated in that manner, the ratio of covered workers to beneficiaries would be 16.5, 3.4, and 2.3 for 1950, 1990, and 2030, respectively.

Even If we Control Health Care Inflation, Federal Health Care Spending Doubles by 2030

The outlay projections for **Medicare** and **Medicaid** through 1999 are the same as in Finding #4. For years after 1999, Medicare HI, Medicare SMI, and Medicaid spending are projected based on simplified outlay models. The models assume that Medicare and Medicaid costs per member of specific population groups (e.g., for Medicare HI and SMI, persons 65 to 69, persons 70 to 74, persons 75 to 79, persons 80 to 84, persons over 84, and the disabled) grow in proportion to GDP per worker. The models adjust total Medicare HI, Medicare SMI, and Medicaid costs to reflect projected changes in the demographic composition of the population from the 1994 Social Security Trustee's Report. Medicare SMI spending is reduced by SMI premiums paid by enrollees. After 1999, the chart maintains the relationship between Medicare SMI premiums and outlays that the Trustees project for 1999.

Finding #6 ***Medicare HI Is Projected To Be Insolvent by 2001***

Projected **Medicare HI Outlays** and **HI Payroll Tax and Benefits Tax** revenues are from the 1994 Medicare Trustees' Reports. Benefits Tax revenues are projected income tax receipts from the taxation of Social Security benefits that are allocable to the Medicare HI Trust Fund.

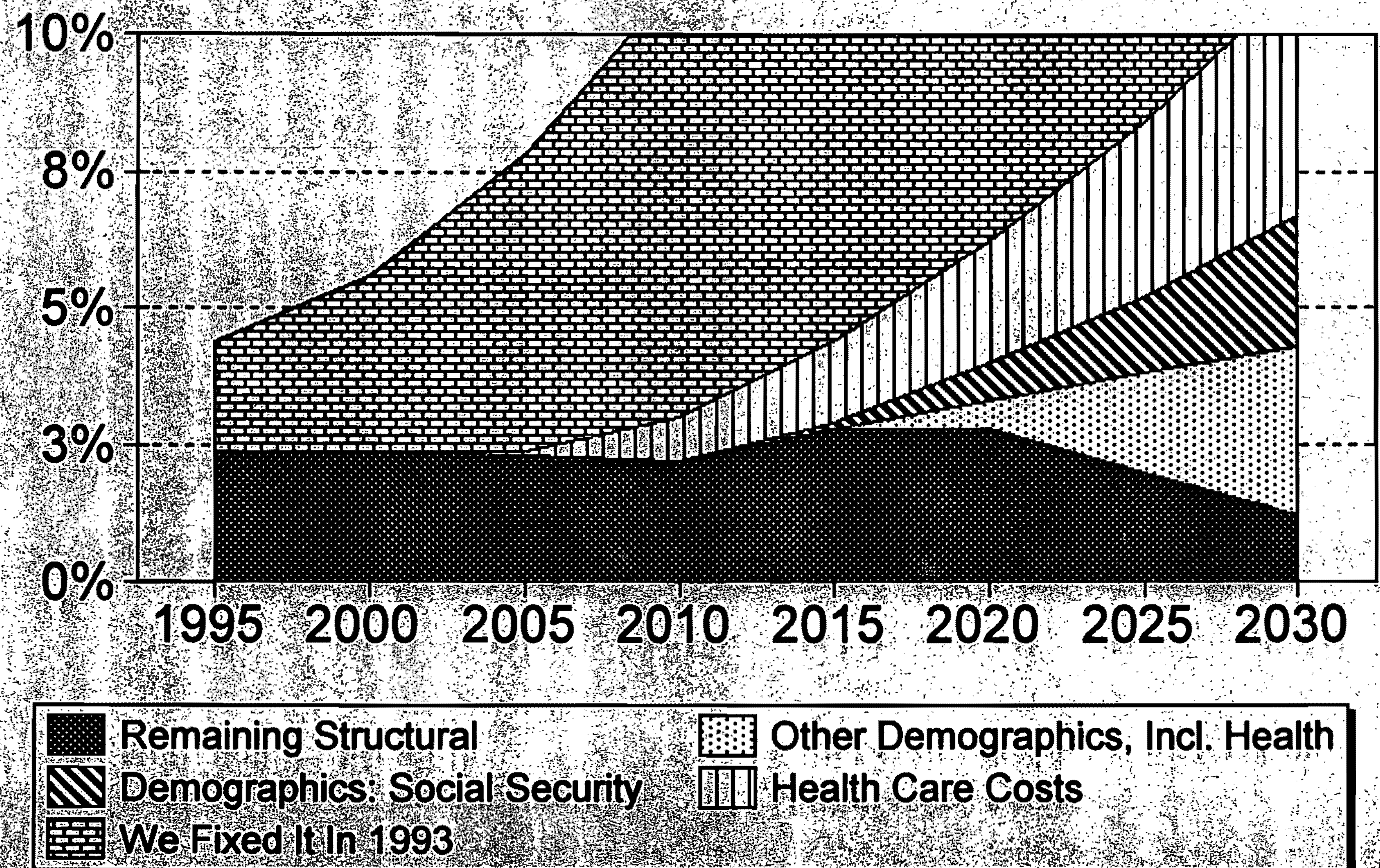
Finding #7 ***Social Security Tax Collections Exceed Current Benefits, But Aren't Enough to Fund Future Promises***

Projected **Social Security Outlays** and **Social Security Payroll Tax and Benefits Tax** revenues are from the 1994 Social Security Trustees' Report. Benefits Tax revenues are projected income tax receipts from the taxation of Social Security benefits that are allocable to the Social Security Trust Fund. Arguably, receipts associated with the Social Security payroll tax are overstated because they are not reduced by the lost income tax revenues resulting from employers deducting their portion of the payroll tax.

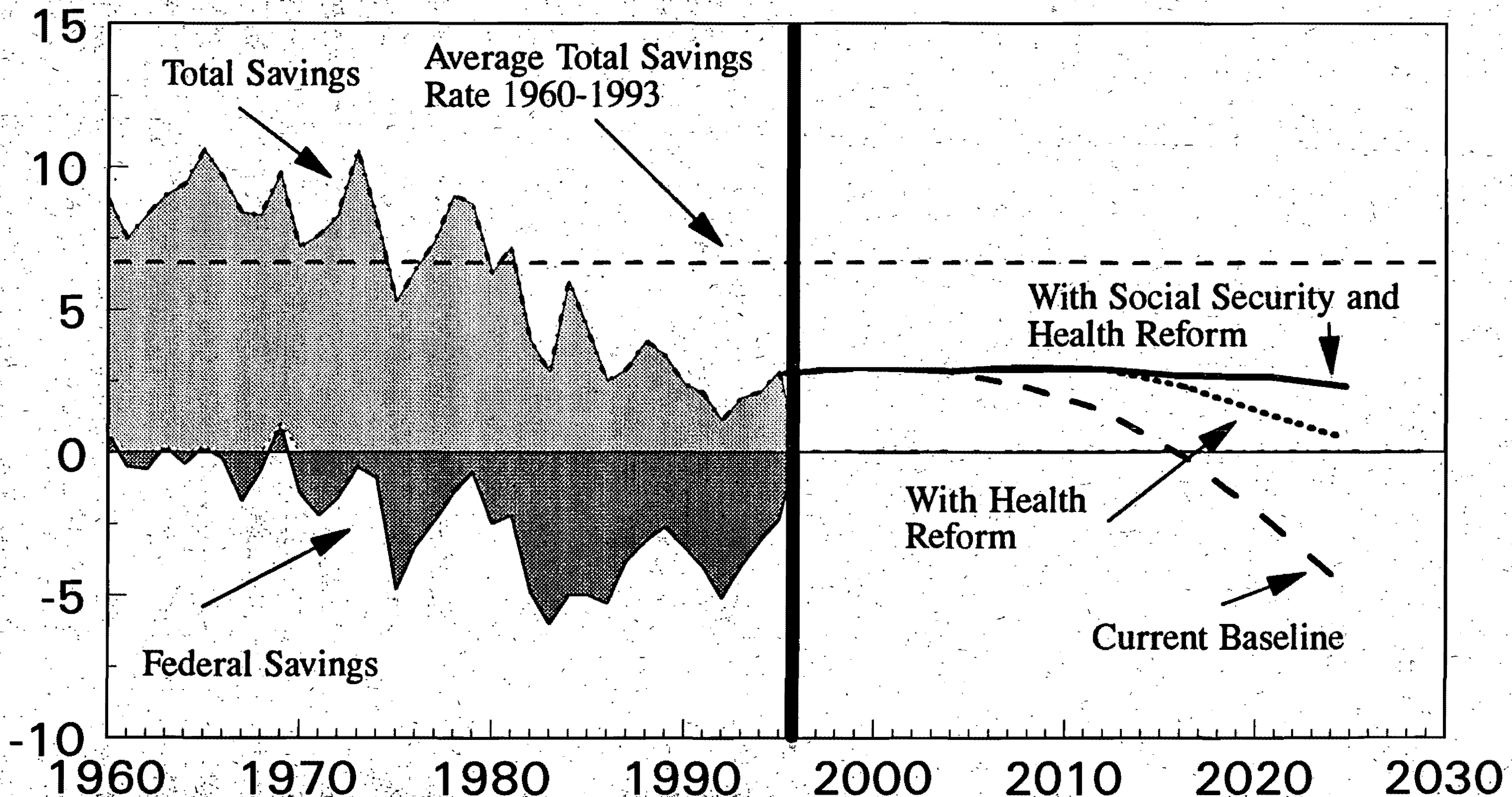
Chart A

Sources of Deficit Problem

Percent of GDP



The Federal Deficit and Net National Savings
(Percent of Net National Product)



ILLUSTRATIVE BUDGET OPTIONS

STAFF DRAFT

	Impact in FY 2000			Illustrative funding and magnitude in FY 2000	
Option	Likely deficit (vs. $167B in FY95)	Investment increase over FY 1995	Nat'l savings rate	Sources ($B)	Uses ($B)
"Steady state"	$223 B	$20 B*	3.0%	--	• Incremental increases in current investments, incl. financing of crime bill
"Modest redirection" Limited increase in public and private investment	$190 B	$32 B	3.4%	• Tax savings: $22 B • Entitlement savings: $15 B • Debt service savings: $8 B (including adjustment of retirement age to solidify funding of Social Security)	• Increment above steady state to be applied to children's programs (including education, school-to-work, and urban initiatives)
Requires $45 B of budget savings in FY 2000, $169 B over five years					
"Significant new priorities" Greater change in allocation of resources	$159 B	$44 B	3.7%	• Tax savings: $44 B • Entitlement savings: $29 B • Debt service savings: $15 B (including more extensive reforms)	• Increment above steady state to be applied to children's programs (including education, school-to-work, and urban initiatives) • Plus life-long learning and infrastructure
Requires $88 B of budget savings in FY 2000, $330 B over five years					
"Truly bold" Dramatic increase in public and private investment	0	$60 B	5.4%	• Tax savings: $132 B • Entitlement and discretionary savings: $85 B • Debt service savings: $46 B (including bold reforms)	• Allows full implementation of original investment program, including national service, school-to- work, etc.
Requires $263 B of budget savings in FY 2000, $633 B over five years					

*Assumes continued incremental shifting of discretionary spending toward the Administration's investments through 1998, and use for investment of all of the assumed upward inflation adjustment for discretionary spending in 1999 and 2000.

8/3/94, 6:14 PM

ILLUSTRATIVE SOURCES OF BUDGET SAVINGS

Revenues:

Item	FY 1999 Revenue (Billions)
Suspend indexing for one year	$10.7
Repeal indexing	$50.9
Eliminate lower corporate rate	$3.7
Cap mortgage deduction at $300,000 of debt	$5.0
Cap mortgage deduction at $20,000 of interest ($12,000 for single persons)	$7.6
Limit State and local tax deductions to excess over 1 percent of income	$7.7
Limit charitable contributions deduction to excess over 2 percent of income	$9.5
Limit value of itemized deductions to 15 percent	$67.9
Decrease limits on contributions to pensions and profit-sharing plans	$1.4
Impose 5 percent tax on inside pension/IRA buildup	$13.6
Tax employer-paid life insurance premiums	$3.5
Tax 85 percent of all of Social Security benefits	$23.8
Tax 50 percent of all of Social Security benefits below current 85 percent threshold	$11.6
Tax inside buildup of life insurance products	$8.3
Expand Medicare to all State/local employees	$1.5
Expand Social Security to all State/local employees	$2.9
Tax 30 percent of capital gains from home sales	$5.5
Enact carryover basis for capital gains	$3.8
Cut the estate tax unified credit by about half	$4.8
Tax credit unions over $10 million in assets	$0.7
Repeal tax preferences for extractive industries	$2.2
Eliminate private-purpose tax-exempt bonds	$1.9
Capitalize costs of producing timber	$1.3
Repeal alcohol fuels credit and partial excise tax exemption	$0.7
Impose a 5 percent value-added tax with exemptions for food, housing, and medical care	$96.9
Increase motor fuel taxes by 10 cents per gallon each year for 5 years	$42.2

Chart D
(Continued)

Spending Cuts:

Item	FY 1999 Savings (Billions)
Reduce agriculture deficiency payment target prices by 3 percent per year	$4.1
Eliminate the 0/92 and 50/92 programs	$0.4
Increase "triple-base" acreage to 25 percent	$1.0
Limit deficiency payments to $40,000 per person	$0.3
Eliminate the Export Enhancement Program	$0.9
Eliminate the Market Promotion Program	$0.1
Increase dairy assessments	$0.3
Charge for airport takeoff and landing slots	$0.3
Establish user fees for air traffic control	$1.7
Impose user fees for inland waterways	$0.7
Charge in-school interest for Stafford loans	$2.1
Reduce the Federal share for Medicaid, AFDC, and foster care and adoption assistance to 45 percent	$8.8
Defer Federal retiree COLAs to age 62	$2.5
Reduce the agency match on thrift plan contributions to 50 percent	$0.5
Raise CSRS contributions from 7 to 9 percent	$1.0
Reduce Social Security replacement rates	$2.7
Eliminate Social Security benefits for children of retirees aged 62-64	$5.0
Lengthen the Social Security benefit computation period from 35 to 38 years	$1.5
Consider veterans' comp when determining Social Security Disability Insurance benefits	$0.1
Prospectively end veterans' disability and death awards for disabilities unrelated to service	$0.4
End veterans comp for low-rated disabilities	$0.7
Eliminate COLAs for one year	$12.4
Limit COLAs to two-thirds of the CPI	$20.7
Limit COLAs to CPI minus 2 percent	$39.7
Subject all entitlements to individual income tax	$70.0
Impose Concord Coalition clawback of entitlements	$52.1
Deny all entitlements over $120,000 of income ($100,000 for single persons)	$11.1

E X E C U T I V E   O F F I C E   O F   T H E   P R E S I D E N T

02-Aug-1994 02:03pm

TO: (See Below)

FROM: Margaret P. Smith
Economic and Domestic Policy

nec/Kerry Commission

SUBJECT: NEC Meeting with the President

On Thursday, August 4 the NEC has a meeting scheduled with the President. Issues relating to the Kerrey Commission will be discussed. This is a "PRINCIPALS ONLY" meeting with no substitutes. The meeting will be held in the Cabinet Room from 10:30a.m. to 12:30p.m. Participants in this meeting will be:

Vice President
Secretary Bentsen
Secretary Brown
Secretary Reich
Laura Tyson
Alice Rivlin
Carol Rasco
Leon Panetta
Roger Altman
Bob Rubin
George Stephanopoulos

Distribution:

TO: FAX (9622-0073,Secretary Bentsen)
TO: FAX (9395-6958,Laura Tyson)
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TO: Kristin A. Schneeman
TO: Patricia E. Romani
TO: Heather Beckel
TO: Linda J. McLaughlin
TO: Elisabeth L. Lindemuth
TO: Paul A. Deegan
TO: Matthew L. Miller

CC: Sylvia M. Mathews

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE DIRECTOR

MEMORANDUM FOR THE PRESIDENT

From: Alice M. Rivlin AMR

Re: Meeting on budget and economic agenda for 1995 and 1996

The purpose of this meeting is to start a discussion about the major focus of economic and budget policy for 1995 and 1996.

The time is right. We are coming up on the midpoint of the first term. This is the moment to take stock of how far we have come, what remains to be done, and what policies we want to have in place or well underway as we move into the 1996 election.

There will be both opportunities and pressures in the next few months to articulate new themes and emphases and translate them into concrete proposals. Final decisions on the FY 1996 budget (the last full budget of this Presidential term) will be made in December. The Kerrey Commission is due to report on December 15 and we will want to respond. The State of the Union address will mark the mid-point of the term. If we let this window of opportunity pass, we will not have another window in which to formulate policies with a significant chance of implementation before the 1996 election.

We have already accomplished a lot and have much to be proud of:

* the deficit has come down faster than any of us believed possible when we put the economic plan together;

* The economy is growing at a healthy--but not too rapid--rate and inflation remains low;

* we have increased funding for a wide range of productivity-increasing public investments--in infrastructure, skills and education, and technology;

* we have launched significant reforms, such as GOALS 2000 and School to Work, and improved tools for fighting crime;

* we are reducing the size of the federal work force and demonstrably moving toward a government that works better, costs less and merits increasing public confidence;

* we have strengthened American export prospects with NAFTA and (soon, we hope) GATT.

Given these accomplishments, the magnitude of the legislative agenda still pending on the Hill, and the prospect of a less hospitable Congress after the election, it would not be unreasonable to devote 1995 and 1996 to implementing health care reform, passing welfare reform and reemployment legislation and consolidating the gains already made on other fronts. Indeed, this "steady as we go" policy may well be the wisest course.

But there is also a case for a bolder policy that takes major new steps to improve the economic future of average Americans. Polls show the public is still deeply concerned about the longer run economic outlook, which may help explain why we have gotten so little credit for the accomplishments of the last eighteen months. Moreover, there are real bases for these fears about the future:

* without significantly higher growth in productivity, the standard of living of average Americans will continue to grow extremely slowly even when the economy is not in recession--and those with low skills are likely to fall further behind;

* the increased private and public investment needed to accelerate growth in productivity and wages is unlikely to materialize without further action;

* private investment will be inadequate because our low private savings rate combined with continuing federal deficits will restrict national saving--and even if health reform successfully controls future increases in federal health costs, deficits are projected to remain substantial. (Our current forecast assumptions put national savings at less than 3% of GDP into the next century vs. 8.4% between 1947 and 1980, and net private domestic investment at 4 to 4.5% of GDP, down more than a third from its 7.3% average in the 1950s, 1960s and 1970s) (See charts A and B attached on the long-term deficit and savings outlook).

* public investment will be inadequate because freezing discretionary spending to restrain deficits--combined with Congressional resistance to further cuts in other spending--will continue to make increases in federal investments agonizingly difficult to achieve.

Hence, bolder steps designed to put the economy on a more certain track toward a brighter long-run economic future should be seriously considered. Indeed, we may feel freer to examine such steps this year as opposed to last, when our need to assure a clear Congressional focus on health placed a premium on an uncomplicated budget (i.e with no reconciliation bill). The overarching threshold question is whether we believe the "steady as we go" scenario is politically and substantively adequate. Within this context, at least three basic and interrelated questions ought to be discussed, and assessed in light of the political and substantive issues they raise:

1. **Should further deficit reduction--involving entitlement reform or tax changes, since more cuts in discretionary spending are likely to undermine public investment--be undertaken now? If so, how much and what kind?**

Substantively, if we are serious about raising national savings and thus the domestic funds available for productivity-enhancing private investment, then further deficit reduction is required. Options to increase private savings may be worth examining as well, but none increase national savings as reliably as deficit reduction does. There may also be short-term economic benefits to a second round of deficit reduction, including lower long-term interest rates, as Rob Shapiro and others have recently argued.

Politically, further deficit reduction may be attractive or even imperative. If a health plan passes that is no more than deficit neutral, we will face projections of rising deficits as we go into the 1996 election and no longer be able to point to deficits "on a downward path." Moreover, if we have no deficit reduction plan of our own we may lose control of the action in the next Congress. Successors to Penny-Kasich and "A to Z" could lower the discretionary caps and decimate our investments; stringent entitlement caps could force entitlement changes not of our own design.

If such considerations outweigh those urging that we stick to our original budget blueprint, the question of "how big a package and with what components?" remains. Since entitlement reform or tax (including tax expenditure) changes would be essential to reach any significant amount of deficit reduction, one threshold question is whether the political climate after the fall elections will permit the bipartisan effort needed to achieve this, and what role the Kerrey Commission can or should play in this regard. Alternatively, is there a one-party package that would still deliver enough further deficit reduction to show meaningful progress? Should any package include a fix for Social Security's long-term problems (see more below), or should this issue be deferred until after 1996?

2. **Should the long-run structural problem of Social Security be addressed now, possibly in conjunction with private pension reform?**

The interest in entitlement reform could be focused on restructuring public and private provisions for retirement to increase future individual security and raise national saving at the same time. Comprehensive reform of Social Security could restore that system to actuarial balance and reassure currently contributing baby boomers that adequate benefits will be there for them when they retire. Such reform might make a contribution to near-term deficit reduction, as well. Simultaneously, changes could be made in private pension systems to make them both more affordable and more portable, and to make saving in the form of pension contributions more attractive at all income levels.

Although touching Social Security is thought to be a political "no-no," restoring the system to health and assuring that it will be there for the baby boomers in retirement could turn out to be a big political plus.

3. **Should the Administration's investment program be refocussed (or increased) to make a more substantial and visible impact on some aspect of the Nation's future--for example, a bolder effort on education and training or a more concentrated attempt to revitalize cities?**

The public investment agenda we have been able to enact is arguably incremental compared with our view of the nation's needs. Moreover, we may want to develop in the next two budgets compelling themes that capture your vision for America backed by the resources to achieve them -- a focus that showcases you fighting for results average Americans care about.

It is critical to consider possible options for such an emphasis or initiative and to *choose among them*, rather than risk diluting our impact and resources by trying to do everything. A renewed and larger scale *human capital/investing in people* agenda has already been suggested. Stressing areas most likely to increase long-term productivity growth and the improvement of opportunities for those in the lower half of the income distribution suggest some illustrative options that might be developed further (with associated financing alternatives) for the fall. For example:

- **Investment in children.** We could focus heavily on increasing opportunities for children, especially those who are likely to fall behind. We could build on Head Start and WIC increases and the immunization initiative, for example, by working to improve child care and expanding both Head Start and opportunities for low income children in elementary school.

- **Education and training.** Almost everyone agrees that if we could pull it off, radical improvement in schooling and skills would be the greatest possible contribution to future productivity and expanding opportunities for low income and minority children. Hence, we might want to move beyond goal-setting and planning in education to launch a major federally sponsored partnership to spur more dramatic state/local reform. Training initiatives might build on the school-to-work idea, using innovative ways to leverage federal dollars to promote greater local efforts.

- **Urban decay and concentrated social problems.** We might propose new ways to leverage the federal role to address problems of urban poverty, crime, and black male unemployment; and explore ways to use federal dollar availability to create greater incentives for regional cooperation between cities and suburbs on housing (and mobility), education, transit and training.

- **Infrastructure bank/financing.** We might target high-priority infrastructure through creation of new taxable infrastructure bonds, tax-credit bonds, a Federal loan facility, or other credit enhancement techniques, all designed to leverage Federal resources. Potential targets of such an initiative include: severely congested highways/bottlenecks, important international border crossings, intelligent-vehicle highway deployments, wastewater or clean water treatment plants that severely miss EPA standards, pavement and bridge deficiencies on the National Highway System network, and important intermodal transportation connections (e.g., ports of-entry, rail/truck terminals).

- **Technology.** We could increase our focus on commercially-applicable defense R & D; extend efforts to disseminate technology more broadly; more seriously target several priority areas for increased funding; and launch higher-profile efforts to link schools, hospitals and other public facilities with the emerging information highway.

- **Environment.** We might build on current progress with further clean air/clean water initiatives; heavier emphasis on environmental technologies as part of a productivity growth strategy; and an expanded public land preservation agenda.

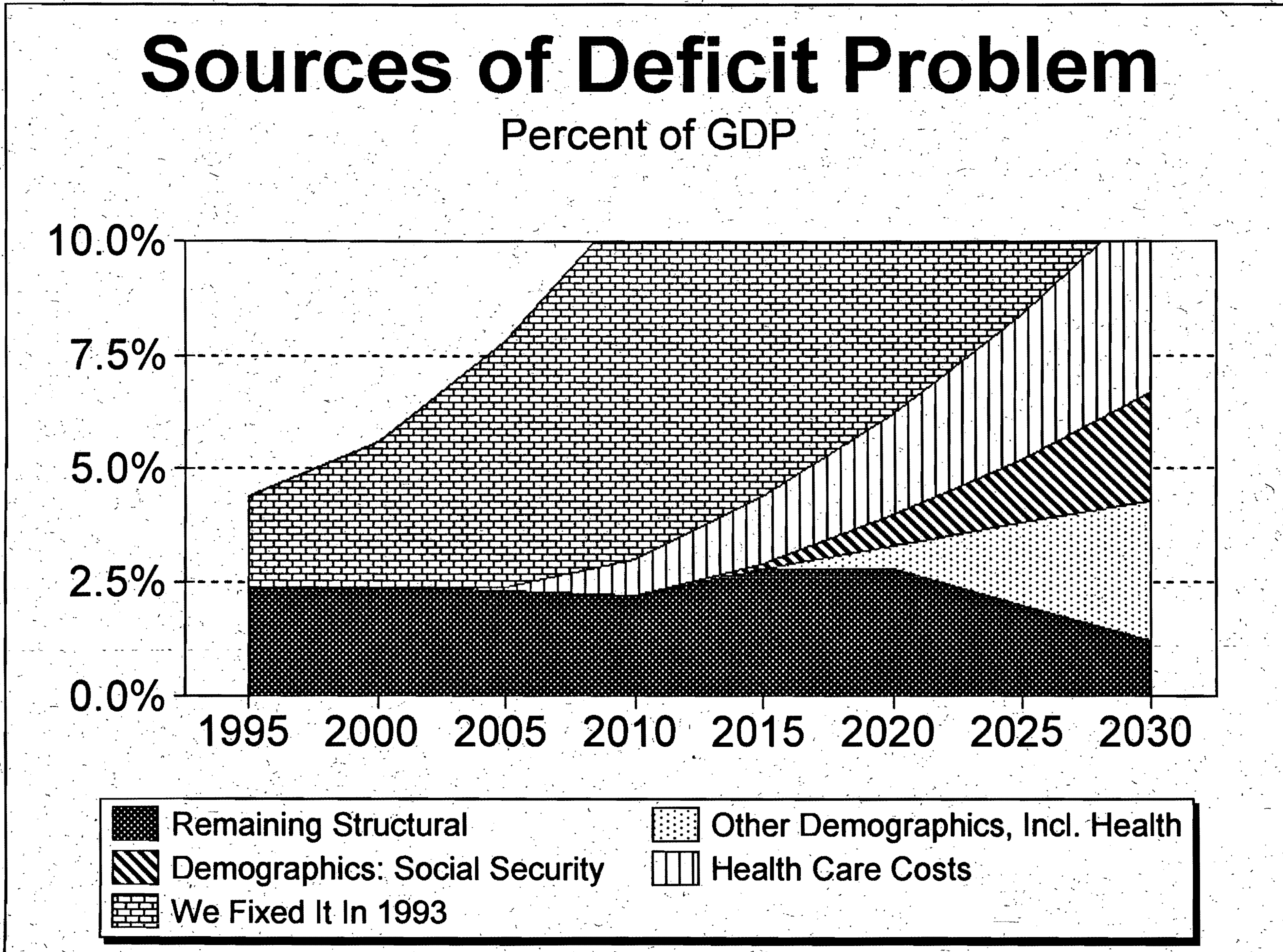
- **International leadership.** The U.S. today ranks 17th of the 18 major aid donors in the share of GDP we devote to foreign aid; the *Economist* notes wryly that Americans spend more on potato and tortilla chips each year than on foreign economic assistance. We could arguably stake a new claim to leadership in a changing world with a package that echoed the scale of American initative in the post-war period, when we were half as rich but did ten times more. A Truman-style summoning to our real long-term interests might be substantively wise and, as with NAFTA, politically beneficial.

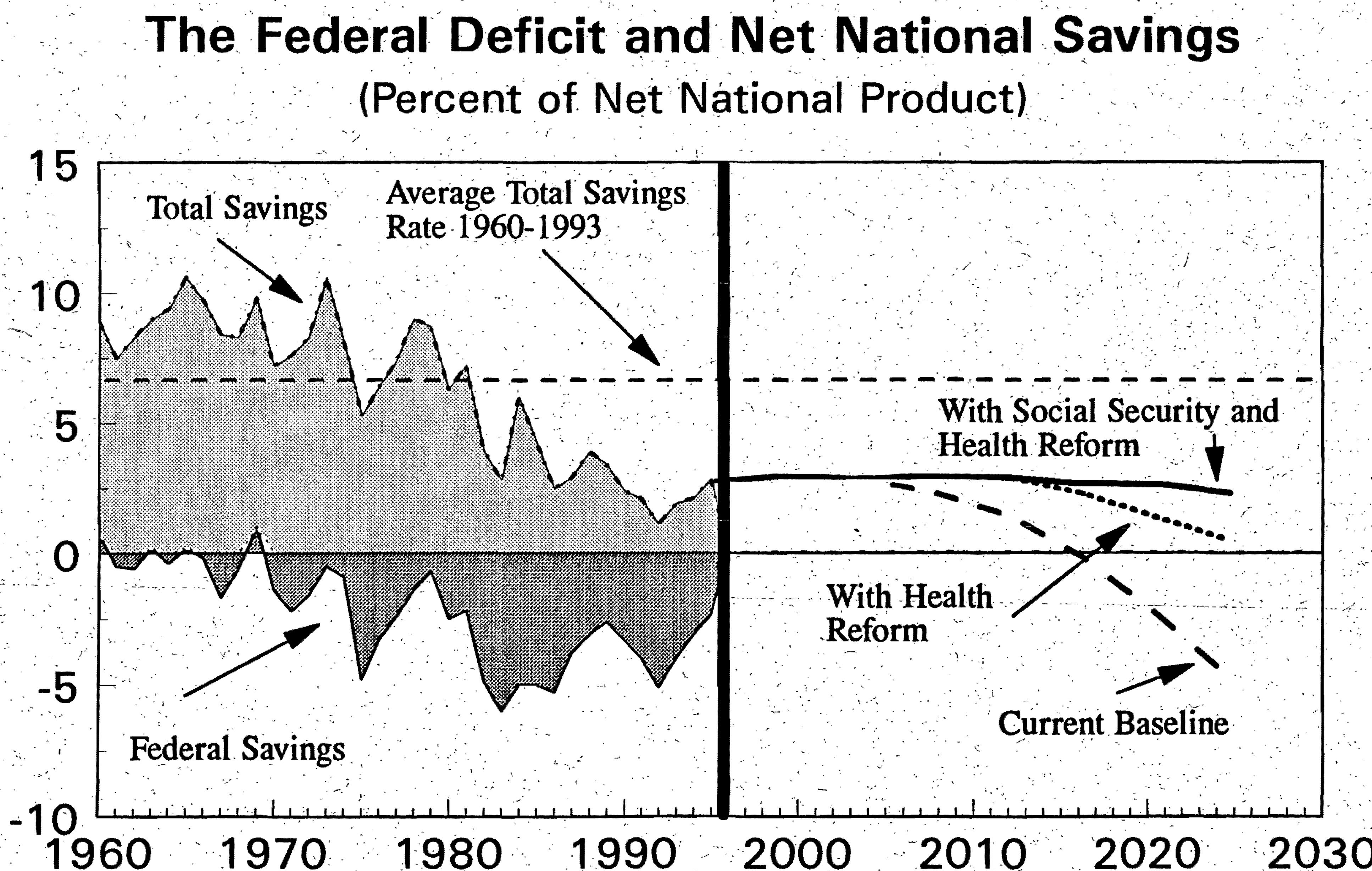
* * *

The spectrum of choices for our last full budget of this term ranges from the "steady as we go" scenario to a truly bold package that involves a major reconciliation bill (with entitlement and tax changes) and BEA cap amendments (to accomodate significant investment increases funded by part of the entitlement savings achieved). There is also clearly a "nonoption" that our team should understand and rule out as we begin this discussion -- namely, the illusion that we can increase investments substantially without cutting substantially elsewhere to make the resources available to fund them. With deficit projections already heading from $167 billion this year to $223 billion in 2000 and $281 billion in 2005, we should not have a discussion that contemplates raising deficits further.

The three questions above are highly interrelated and need to be considered together. For example, further near-term deficit reduction could (but need not necessarily) involve an initiative to fix social security's long-term problems; a focus on particular investment themes could be achieved with significant new resources made available by a bold successor to our original blueprint, or instead be more a matter of rhetorical or bully pulpit emphasis and marginal dollars in the steady-state scenario (charts C and D attached may help start your thinking on the range of potential options and magnitudes involved). Fitting the many moving parts into an integrated package with substantive merit and political appeal would be the essential challenge of our team's effort in coming months.

Chart A


Sources of Deficit Problem
Percent of GDP
10.0%
7.5%
5.0%
2.5%
0.0%
1995
2000
2005
2010
2015
2020
2025
2030
Remaining Structural
Other Demographics, Incl. Health
Demographics: Social Security
Health Care Costs
We Fixed It In 1993


The Federal Deficit and Net National Savings
(Percent of Net National Product)
15
10
5
0
-5
-10
1960
1970
1980
1990
2000
2010
2020
2030
Total Savings
Average Total Savings Rate 1960-1993
With Social Security and Health Reform
With Health Reform
Current Baseline
Federal Savings

ILLUSTRATIVE BUDGET OPTIONS

STAFF DRAFT

Option	Impact in FY 2000: Likely deficit (vs. $167B in FY95)	Investment increase over FY 1995	Nat'l savings rate	Illustrative funding and magnitude in FY 2000: Sources ($B)	Uses ($B)
"Steady state"	$223 B	$20 B*	3.0%	--	• Incremental increases in current investments, incl. financing of crime bill
"Modest redirection" Limited increase in public and private investment *Requires $45 B of budget savings in FY 2000, $169 B over five years*	$190 B	$32 B	3.4%	• Tax savings: $22 B • Entitlement savings: $15 B • Debt service savings: $8 B (including adjustment of retirement age to solidify funding of Social Security)	• Increment above steady state to be applied to children's programs (including education, school-to-work, and urban initiatives)
"Significant new priorities" Greater change in allocation of resources *Requires $88 B of budget savings in FY 2000, $330 B over five years*	$159 B	$44 B	3.7%	• Tax savings: $44 B • Entitlement savings: $29 B • Debt service savings: $15 B (including more extensive reforms)	• Increment above steady state to be applied to children's programs (including education, school-to-work, and urban initiatives) • Plus life-long learning and infrastructure
"Truly bold" Dramatic increase in public and private investment *Requires $263 B of budget savings in FY 2000, $633 B over five years*	0	$60 B	5.4%	• Tax savings: $132 B • Entitlement and discretionary savings: $85 B • Debt service savings: $46 B (including bold reforms)	• Allows full implementation of original investment program, including national service, school-to- work, etc.

*Assumes continued incremental shifting of discretionary spending toward the Administration's investments through 1998, and use for investment of all of the assumed upward inflation adjustment for discretionary spending in 1999 and 2000.

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ILLUSTRATIVE SOURCES OF BUDGET SAVINGS

Revenues:

Item	FY 1999 Revenue (Billions)
Suspend indexing for one year	$10.7
Repeal indexing	$50.9
Eliminate lower corporate rate	$3.7
Cap mortgage deduction at $300,000 of debt	$5.0
Cap mortgage deduction at $20,000 of interest ($12,000 for single persons)	$7.6
Limit State and local tax deductions to excess over 1 percent of income	$7.7
Limit charitable contributions deduction to excess over 2 percent of income	$9.5
Limit value of itemized deductions to 15 percent	$67.9
Decrease limits on contributions to pensions and profit-sharing plans	$1.4
Impose 5 percent tax on inside pension/IRA buildup	$13.6
Tax employer-paid life insurance premiums	$3.5
Tax 85 percent of all of Social Security benefits	$23.8
Tax 50 percent of all of Social Security benefits below current 85 percent threshold	$11.6
Tax inside buildup of life insurance products	$8.3
Expand Medicare to all State/local employees	$1.5
Expand Social Security to all State/local employees	$2.9
Tax 30 percent of capital gains from home sales	$5.5
Enact carryover basis for capital gains	$3.8
Cut the estate tax unified credit by about half	$4.8
Tax credit unions over $10 million in assets	$0.7
Repeal tax preferences for extractive industries	$2.2
Eliminate private-purpose tax-exempt bonds	$1.9
Capitalize costs of producing timber	$1.3
Repeal alcohol fuels credit and partial excise tax exemption	$0.7
Impose a 5 percent value-added tax with exemptions for food, housing, and medical care	$96.9
Increase motor fuel taxes by 10 cents per gallon each year for 5 years	$42.2

Spending Cuts:

Item	FY 1999 Savings (Billions)
Reduce agriculture deficiency payment target prices by 3 percent per year	$4.1
Eliminate the 0/92 and 50/92 programs	$0.4
Increase "triple-base" acreage to 25 percent	$1.0
Limit deficiency payments to $40,000 per person	$0.3
Eliminate the Export Enhancement Program	$0.9
Eliminate the Market Promotion Program	$0.1
Increase dairy assessments	$0.3
Charge for airport takeoff and landing slots	$0.3
Establish user fees for air traffic control	$1.7
Impose user fees for inland waterways	$0.7
Charge in-school interest for Stafford loans	$2.1
Reduce the Federal share for Medicaid, AFDC, and foster care and adoption assistance to 45 percent	$8.8
Defer Federal retiree COLAs to age 62	$2.5
Reduce the agency match on thrift plan contributions to 50 percent	$0.5
Raise CSRS contributions from 7 to 9 percent	$1.0
Reduce Social Security replacement rates	$2.7
Eliminate Social Security benefits for children of retirees aged 62-64	$5.0
Lengthen the Social Security benefit computation period from 35 to 38 years	$1.5
Consider veterans' comp when determining Social Security Disability Insurance benefits	$0.1
Prospectively end veterans' disability and death awards for disabilities unrelated to service	$0.4
End veterans comp for low-rated disabilities	$0.7
Eliminate COLAs for one year	$12.4
Limit COLAs to two-thirds of the CPI	$20.7
Limit COLAs to CPI minus 2 percent	$39.7
Subject all entitlements to individual income tax	$70.0
Impose Concord Coalition clawback of entitlements	$52.1
Deny all entitlements over $120,000 of income ($100,000 for single persons)	$11.1

BIPARTISAN COMMISSION ON ENTITLEMENT AND TAX REFORM
Senate Hart Building Room 825 ● 120 Constitution Ave., N.E. ● Washington, D.C. 20510 ● 202/224-2300

July 28, 1994

Dear Commission Member:

Enclosed is a revised version of the Commission findings that will be discussed at the August 8, 1994 Commission meeting. This version incorporates comments we have received to date from members. The meeting will be held in room 210 Cannon House Office Building at 1:00 p.m. (the same location and time as the previous Commission meetings).

Sincerely,

J. Robert Kerrey

John C. Danforth

Enclosures

July 28, 1994

Draft Commission Findings

> ***"This Commission will be asked to grapple with real issues of entitlement reforms.... This panel, I expect, will ask and answer the tough questions.... [M]any may regard [this] as a thankless task. It will not be thankless if it gives us a strong and secure and healthy American economy and society moving into the 21st century."*** President Bill Clinton

Throughout America's history, each succeeding generation has enjoyed the promise of a better standard of living. The goal of this Commission is to help maintain that promise -- to help secure for America's children a standard of living that is better than that which we enjoy today. To achieve this goal, the Commission will assess the need for entitlement and tax reform and make specific recommendations for reform to the President in December.

These findings are the Commission's first step in achieving its goal. The findings describe the economic future that will confront Americans during the first quarter of the 21st century if the nation fails to act. The picture that they paint is unsettling. The findings are not, however, a prediction of the future. They are the product of simple arithmetic if our current economic policies are not changed.

A better future for America can be secured if the country embarks on the course of long-term reform. We can help Americans save and invest in themselves and the country. We can make the essential public investments in our workers and our children. And we can maintain the strength of vital government programs that support and protect many Americans.

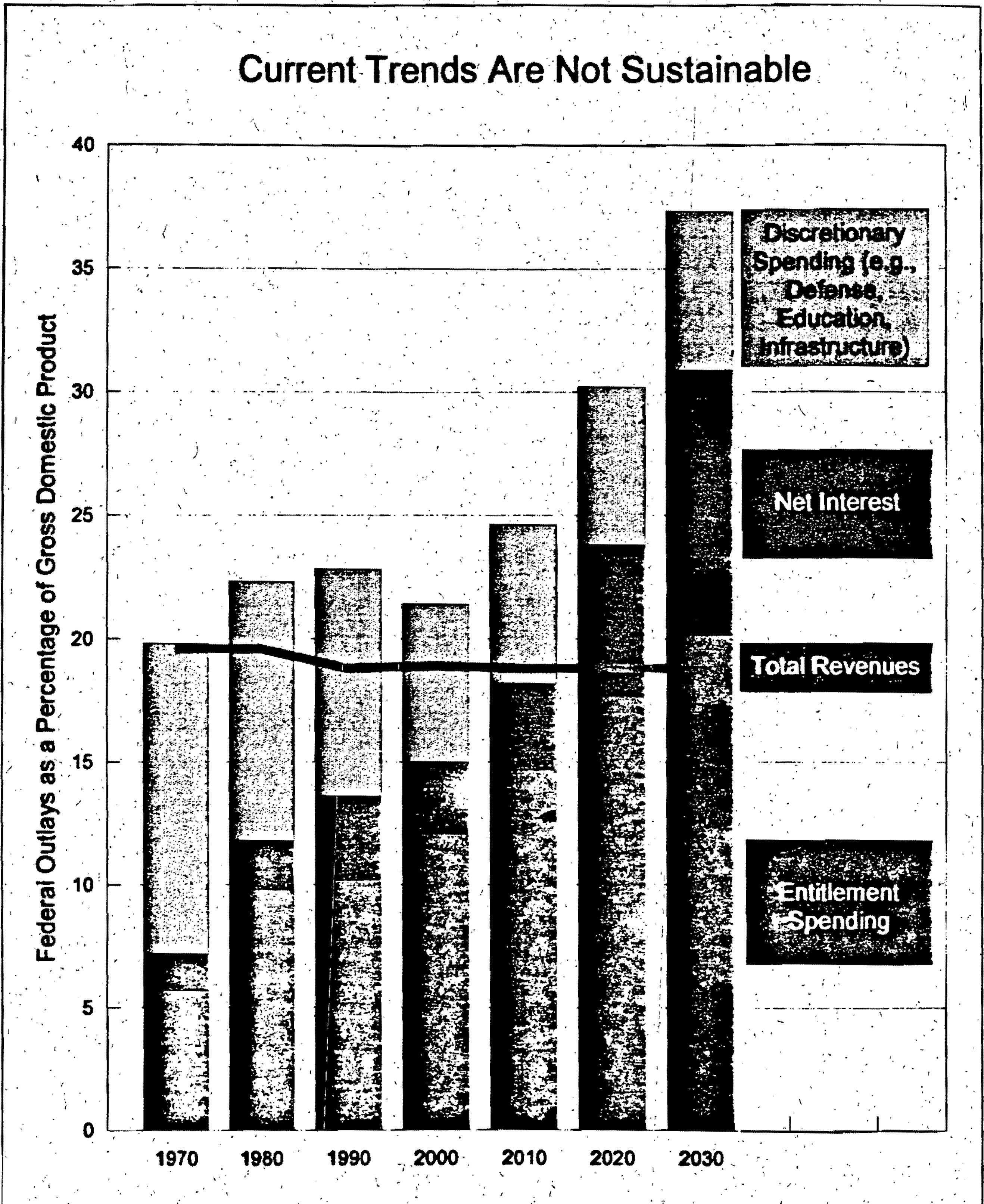
Finding #1: To ensure that today's debt and spending commitments do not unfairly burden America's children, the government must act now. A bipartisan coalition of Congress, led by the President, must resolve the long-term imbalance between the government's entitlement promises and the funds it will have available to pay for them.

- Although the short-term fiscal outlook has improved, the long-term situation requires immediate attention. For the next five years, the Federal deficit is projected to average 2.5% of the economy, its lowest level since the 1970s. After 1998, however, Federal spending is projected to grow faster than revenues which will cause Federal deficits to rise rapidly.

- In 2012, unless benefit growth is reduced or revenues are increased in the interim, projected outlays for entitlements and interest on the national debt will consume all taxes collected by the Federal government.

- In 2030, unless benefit growth is reduced or revenues are increased in the interim, projected spending for Medicare, Medicaid, Social Security, and Federal employee retirement programs alone will consume all taxes collected by the Federal government. Even if all other Federal programs (except interest on the national debt) grow no faster than the economy, total Federal outlays would exceed 37% of the economy. Today, outlays are 22% of the economy and revenues are 19%.

- To put the long-term fiscal imbalance in perspective, in 2030, if no action is taken in the interim, reducing the Federal deficit to 2.5% of the economy will require a choice between increasing every Federal tax by 85% and cutting every Federal program and entitlement by more than half.



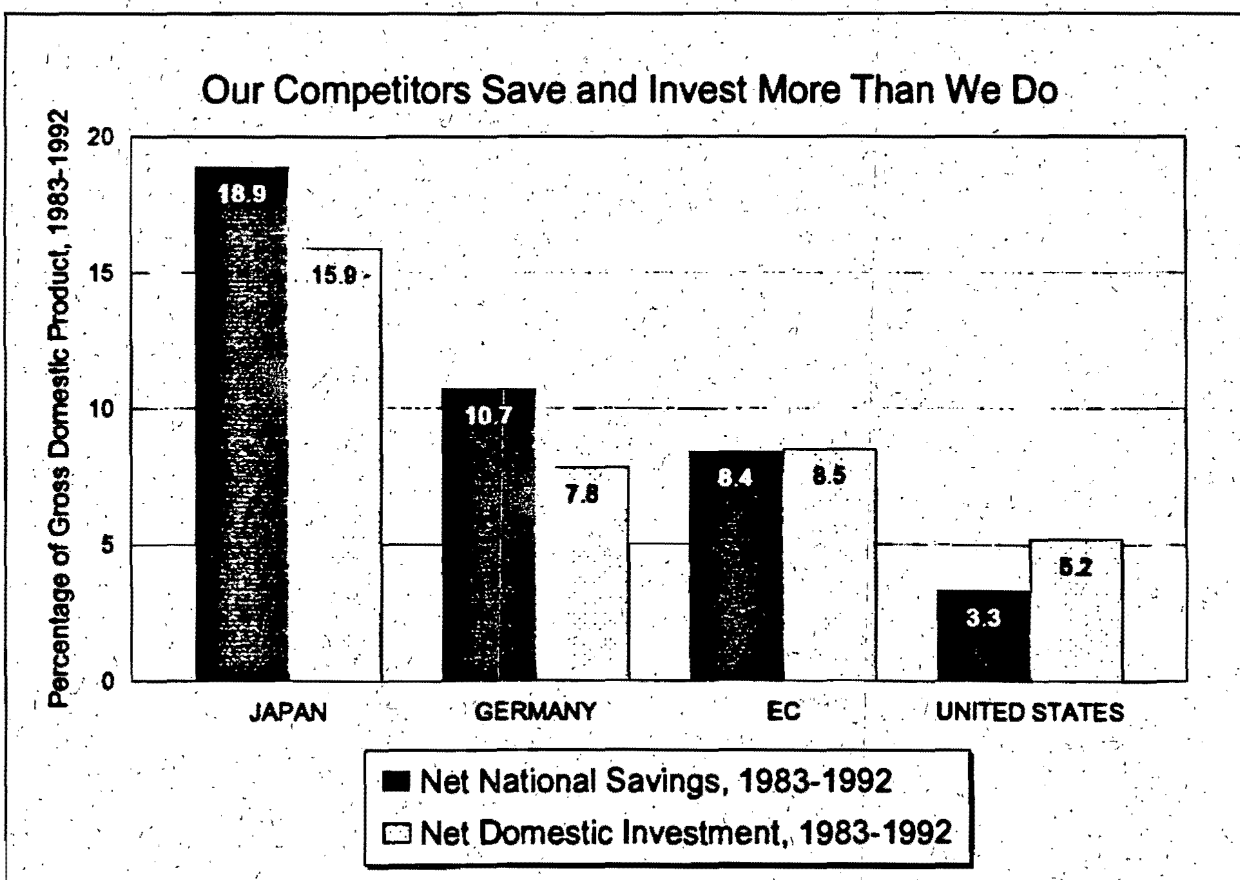
This chart shows the long-term budget implications of current spending and tax policies. In projecting entitlement spending, Medicare and Social Security outlays follow the Medicare and Social Security Trustees' "best estimates." Medicaid outlays are assumed to reflect demographic changes and the increases in health care costs that underly the Medicare projections. All other spending and revenues are assumed to follow CBO projections through 1999 and to grow in proportion to the overall economy thereafter.

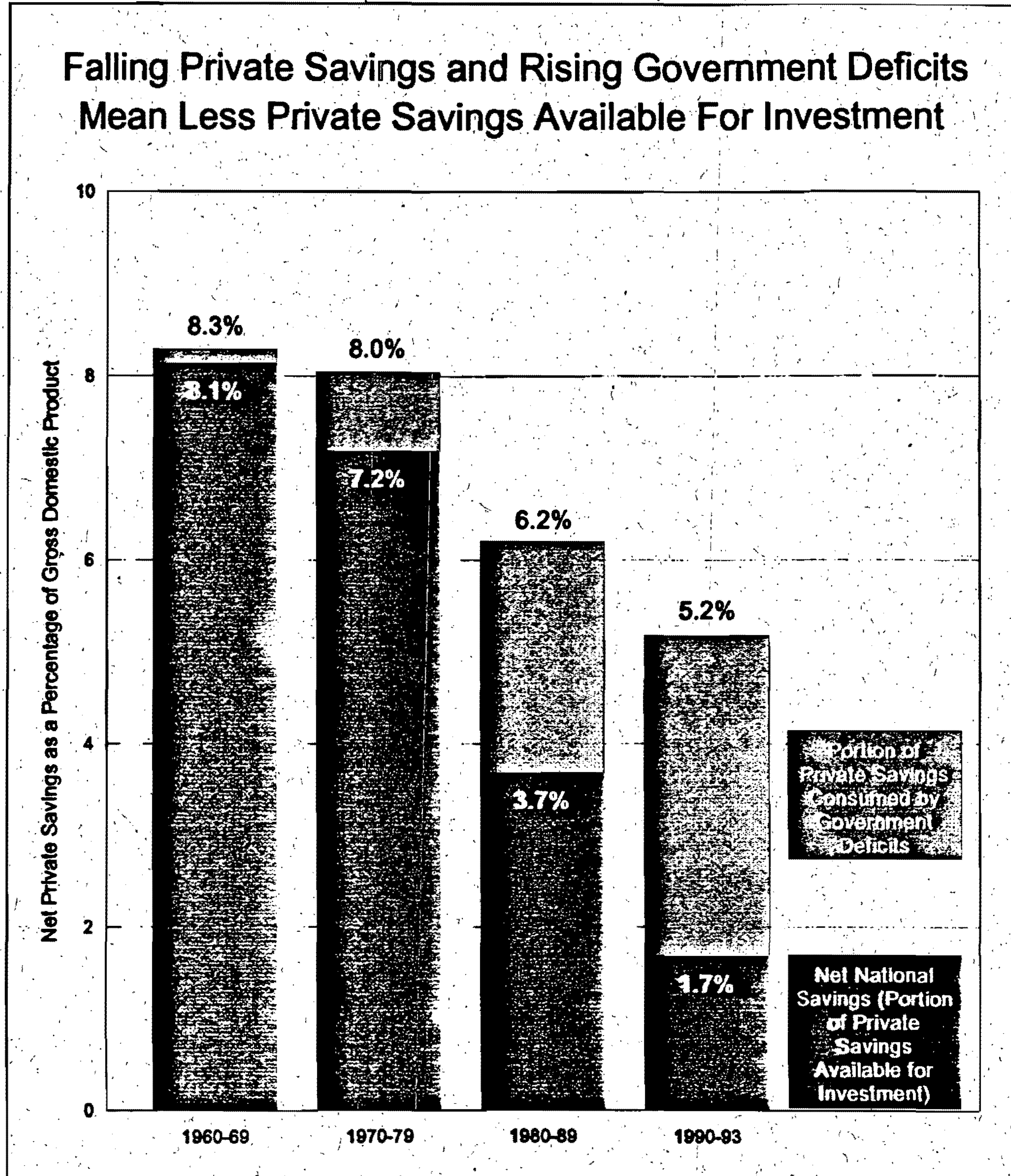
Finding #2: To ensure the level of private investment necessary for long-term economic growth and prosperity, national savings must be raised substantially.

- Countries that save and invest more grow faster and have more rapid improvements in the standard of living of their citizens. In the United States, declining private savings and large government deficits limit investment, productivity, and economic growth.

- Since the 1960s, private savings have fallen from more than 8% of the economy to about 5% today. At the same time, government deficits have increased from less than 1% of the economy to more than 3% today.

- As a result, the supply of savings available for private investment, "net national savings," has dropped from more than 8% of the economy to less than 2% today. This restricts American productivity and growth.




Falling Private Savings and Rising Government Deficits Mean Less Private Savings Available For Investment
Net Private Savings as a Percentage of Gross Domestic Product
10
8
6
4
2
0
8.3%
8.1%
8.0%
7.2%
6.2%
3.7%
5.2%
1.7%
1960-69
1970-79
1980-89
1990-93
Portion of Private Savings Consumed by Government Deficits
Net National Savings (Portion of Private Savings Available for Investment)

Finding #3: To ensure that funds are available for essential public investments and other important needs such as education, children's programs, highways, and national defense, the nation cannot continue to allow entitlements to consume an ever-increasing share of the Federal budget.

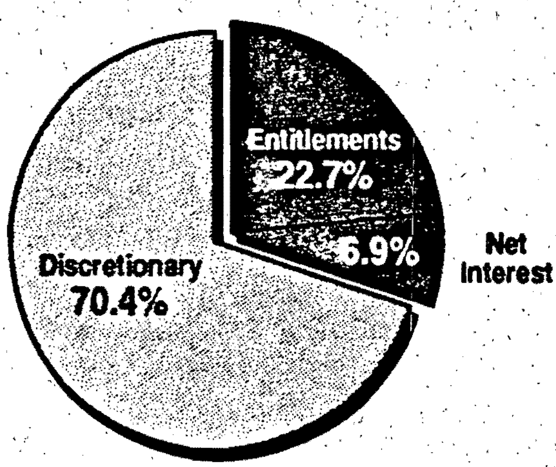
- Entitlement spending and interest on the national debt consume more than 60% of Federal outlays today, double the percentage of just 25 years ago.

- The Congressional Budget Office projects that entitlement spending and interest payments will exceed 70% of total Federal outlays by 2003.

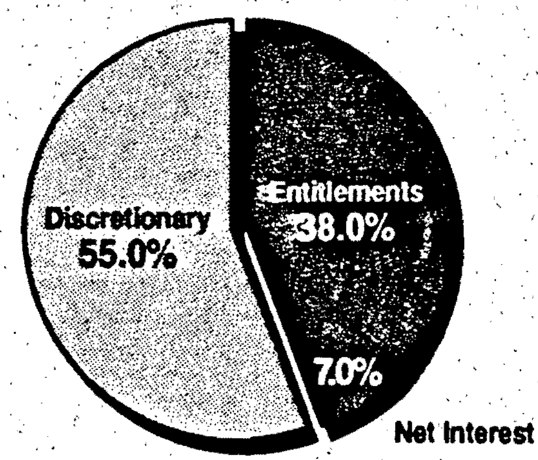
- By 2003, less than 15 cents of every dollar the Federal government spends will be available for non-defense discretionary programs that can raise productivity and contribute to economic growth; programs such as job training and Head Start.

Growth of Mandatory Spending In The Federal Budget

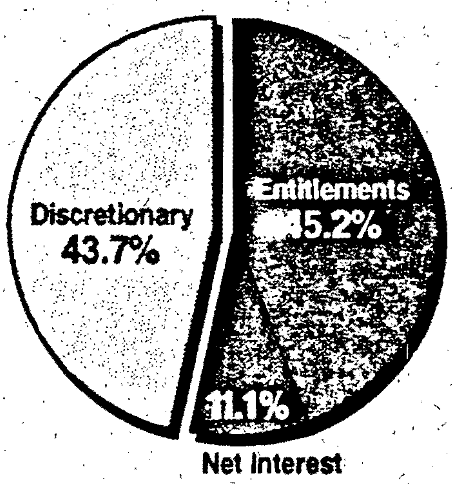
1963
Mandatory Spending
29.6%



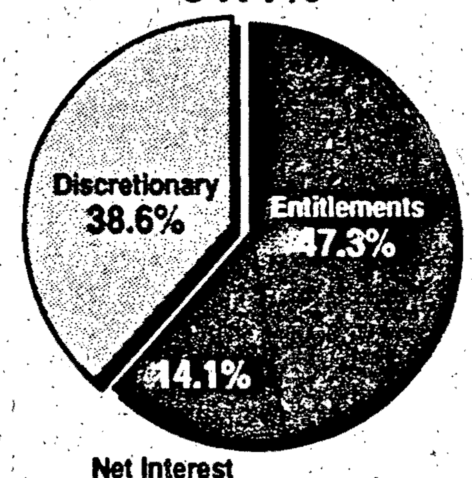
1973
Mandatory Spending
45.0%



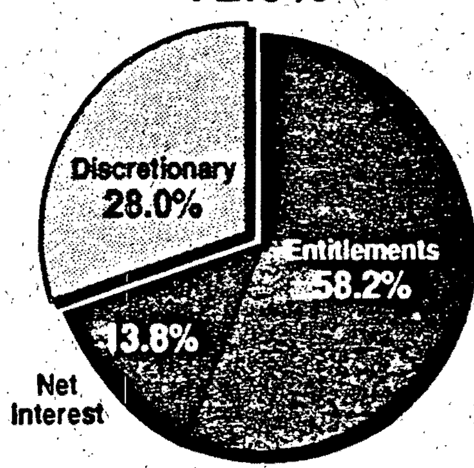
1983
Mandatory Spending
56.3%



1993
Mandatory Spending
61.4%



2003 (projected)
Mandatory Spending
72.0%

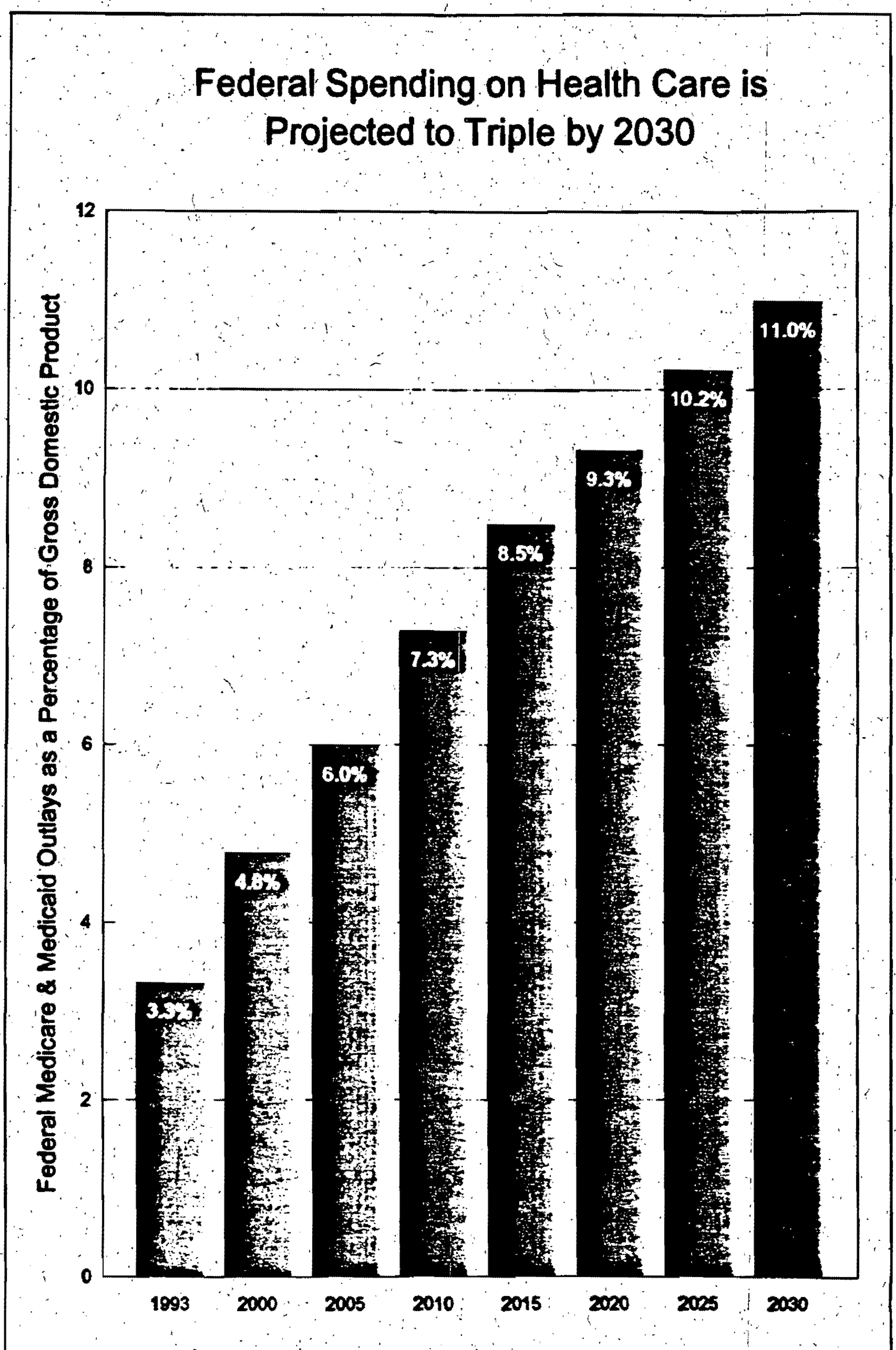


Finding #4: To be effective, any attempt to control long-term entitlement growth must take into account the projected increases in health care costs.

- The growth of public and private health care costs poses an immediate problem that must be addressed.

- Federal health care spending has been increasing at annual rates averaging 10% or more during the last five years, far in excess of overall economic growth.

- If the increase in health care costs is not restrained, Federal spending on Medicare and Medicaid is projected to triple as a percentage of the economy by 2030. Federal health care spending is projected to increase from 3.3% of the economy today to 11% by 2030.

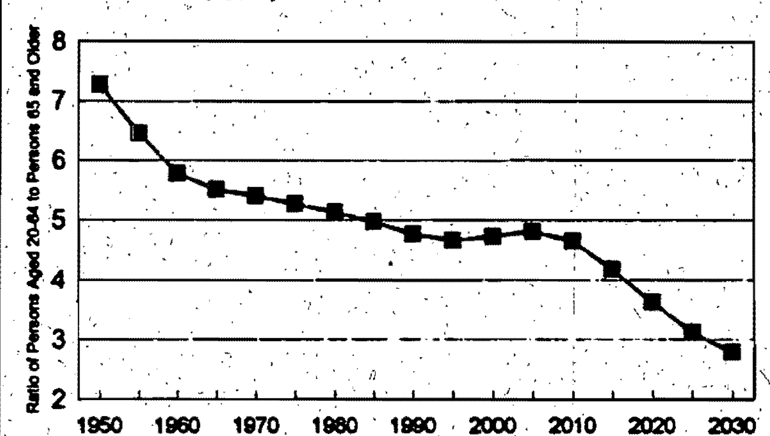


This chart shows the projected long-term growth of Federal health care spending as a percentage of the economy. Medicare outlays follow the Medicare Trustees' "best estimates." Medicaid outlays are assumed to reflect demographic changes and the increases in health care costs that underlie the Medicare projections.

Finding #5: To be effective, any attempt to control long-term entitlement growth must also take into account fundamental demographic changes.

- America's population is growing older because of longer life expectancies and the aging of the baby boom generation. Today, there are almost five working-age persons for each person over 65. In 2030, when today's workers have retired and today's children are in their prime working years, the Social Security Trustees project that there will be fewer than three working-age persons for each person over 65.

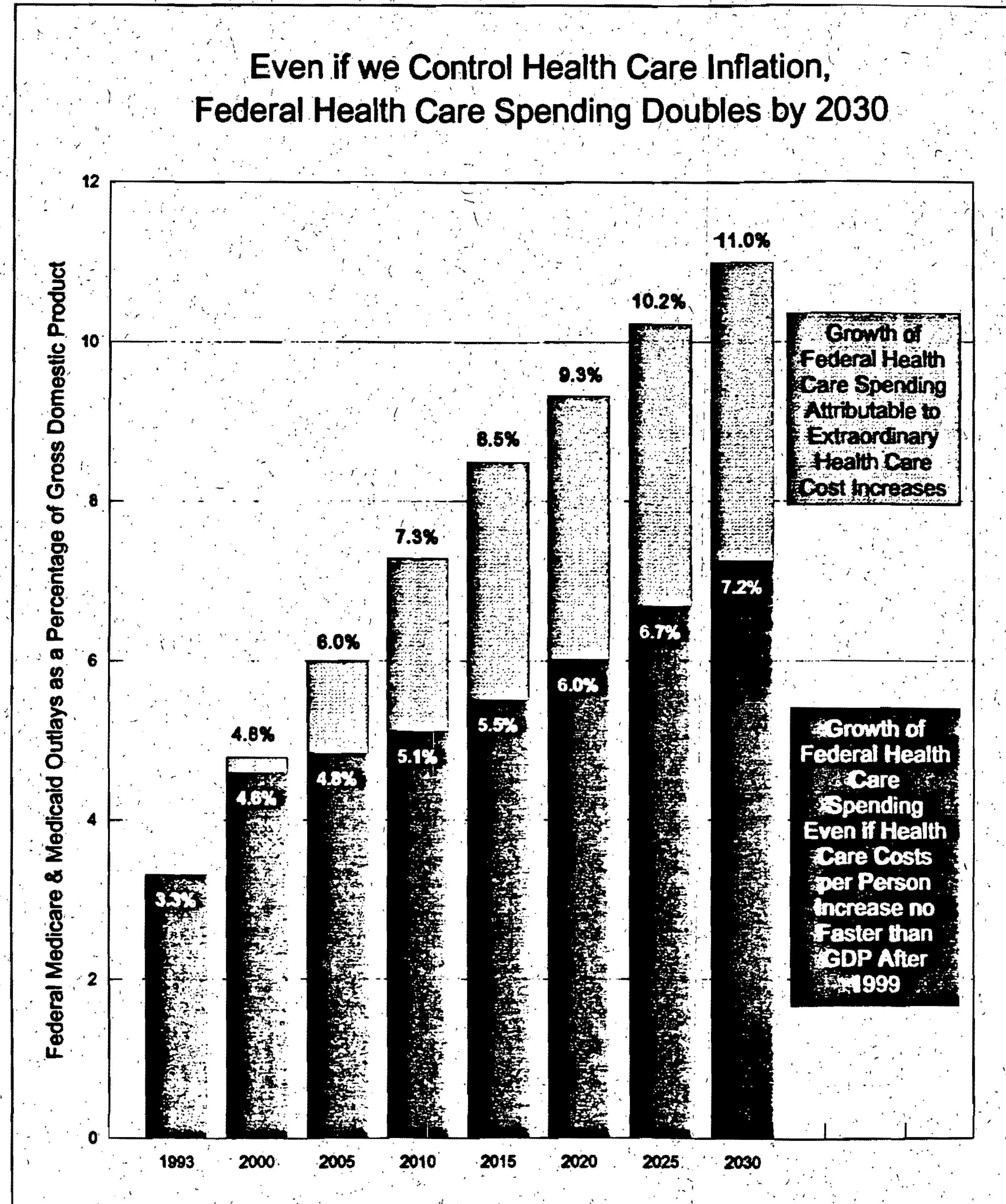
An Aging Population Means Fewer Workers To Support Each Retiree's Benefits



Social Security Trustees' Best Estimates

- The aging of the population will significantly increase Federal health care and retirement outlays. Even if the extraordinary increases in health care costs were eliminated after 1999 (so that costs for each person of a given age grew no faster than the economy), Federal outlays for Medicare and Medicaid would still double as a percentage of the economy by 2030. The aging of the population drives combined Medicare, Medicaid, and Social Security spending from about 8% of the economy today to about 14% of the economy in 2030.

- To fund the annual increases in Medicare, Medicaid, and Social Security spending, every Federal tax would increase by more than 30% by 2030.



This chart divides the projected long-term growth of Federal health care spending into the portion that is attributable to the extraordinary health care cost increases and the portion that would remain even if health care costs for each person of a given age grew no faster than the economy after 1999.

Finding #6: To respond to the Medicare Trustees' call to action and ensure Medicare's long-term viability, Medicare spending and revenues available for the program must be brought into long-term balance. Health care spending must be reduced, revenues raised, or a combination of both.

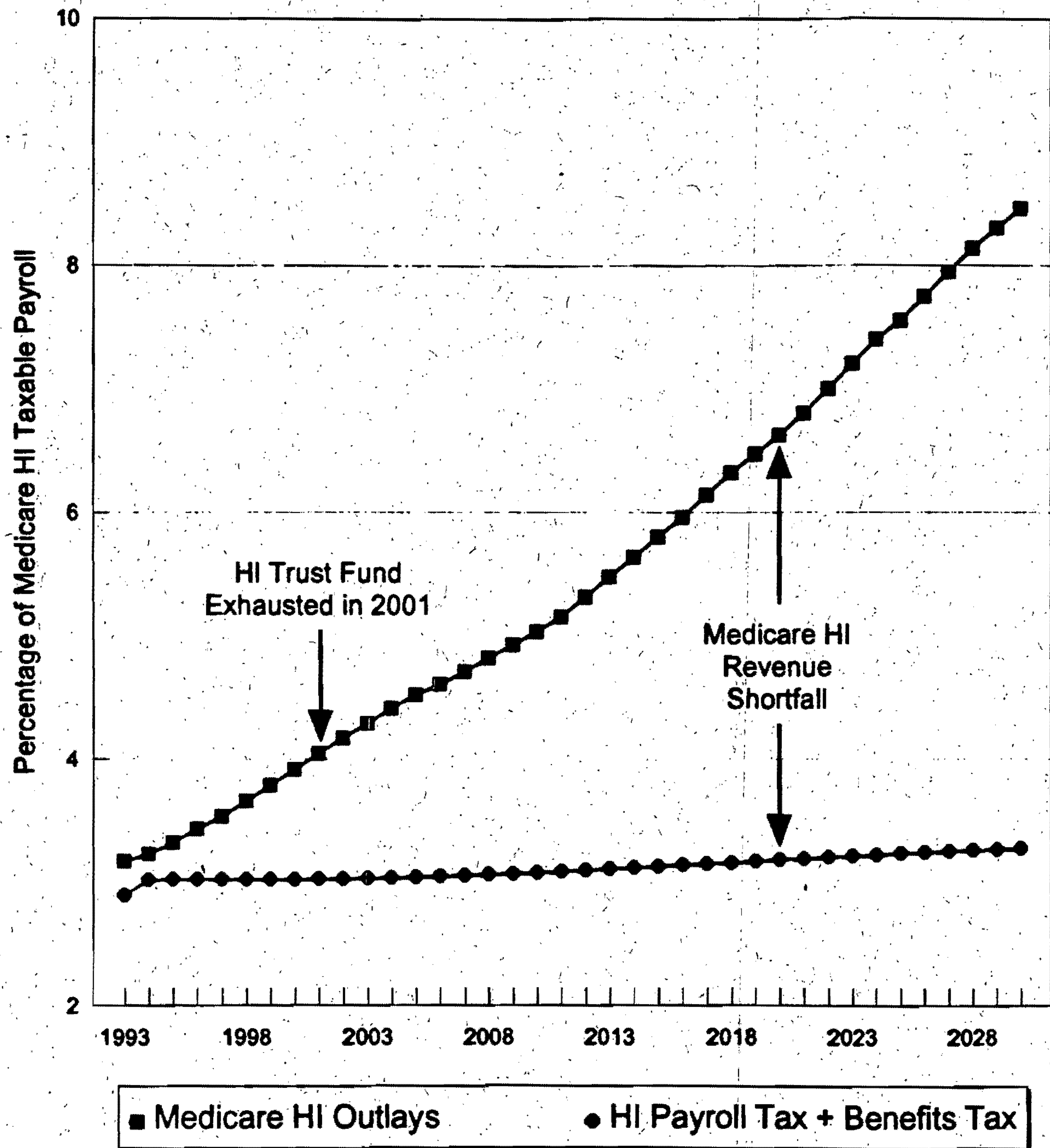
- Medicare Hospital Insurance (HI). The Public Trustees conclude that the Medicare HI program "is severely out of financial balance and is unsustainable in its present form." Medicare HI outlays already exceed tax revenues dedicated to the program and are rapidly depleting Trust Fund assets. The Trust Fund is projected to run out of money by 2001.

- In the long run, the situation gets even worse. By 2030, projected Medicare HI outlays exceed dedicated tax revenues by more than 5% of the payroll tax base. If the increase in Medicare HI outlays were paid for by increasing payroll taxes, the Medicare payroll tax rate would increase from 2.9% today to more than 8% by 2030.

- Medicare Supplementary Medical Insurance (SMI). The Public Trustees urge "prompt, effective, and decisive action..." to ensure the long-term financing of Medicare SMI. Today, 75% of Medicare SMI spending is funded from general revenues, while 25% is from premiums paid by beneficiaries.

- In the long run, the Trustees project that Medicare SMI outlays will rise from just over 1% of the payroll tax base today to more than 7% of payroll by 2030. If individual income taxes were used to pay for this increase in Medicare SMI, income taxes would increase by more than 30%.

Medicare HI is Projected To Be Insolvent by 2001



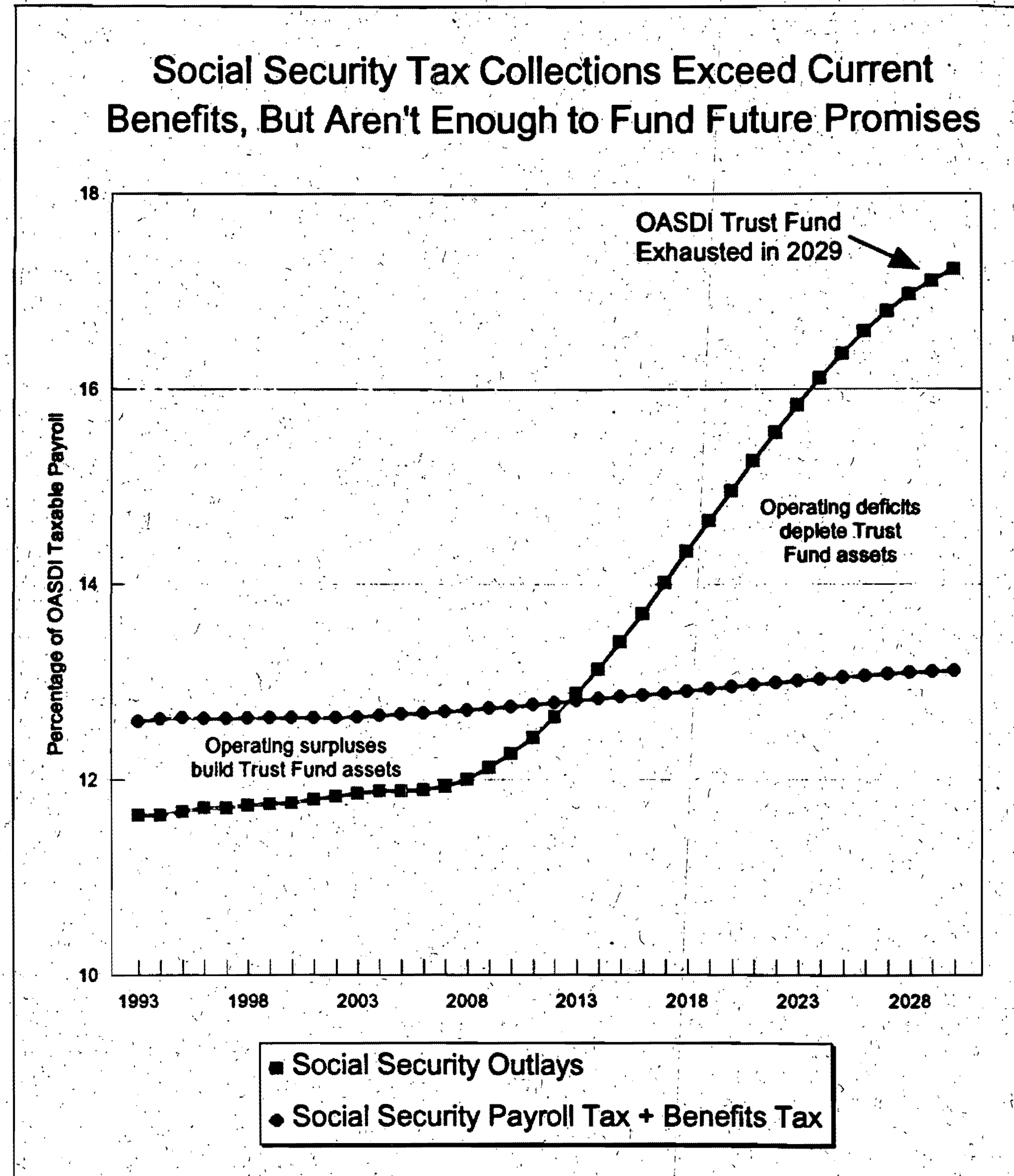
Finding #7: To respond to the Social Security Trustees' call to action and ensure the long-term viability of Social Security, Social Security spending and revenues available for the program must be brought into long-term balance. Social Security spending must be reduced, revenues raised, or a combination of both. Any savings that result should be used to restore the long-term soundness of the Social Security Trust Fund.

- Social Security is an important source of support for many of the nation's citizens. Today, the poverty rate for senior households is about 13%, but without Social Security, it would increase to about 50%. Social Security provides 90% or more of the total income for almost half of the senior households below the poverty line.

- The Public Trustees believe that "legislative action is needed to ensure the long-range financial integrity of the [Social Security] program."

- Once the baby boom generation begins to retire in 2010, the cash flow surplus from Social Security will rapidly decline. By 2013, Social Security benefit payments will exceed the tax revenues dedicated to the program. At that time, the cash flow shortfalls in Social Security will cause the total Federal deficit to increase unless taxes are raised or programs are cut.

- The Trust Fund is projected to run out of money in 2029. At that time, projected outlays will exceed tax revenues by more than 4% of the payroll tax base. If this shortfall were paid for by increasing payroll taxes, the Social Security payroll tax rate would rise from 12.4% today to more than 16.5% by 2030.



Social Security Tax Collections Exceed Current Benefits, But Aren't Enough to Fund Future Promises
OASDI Trust Fund Exhausted in 2029
Operating deficits deplete Trust Fund assets
Operating surpluses build Trust Fund assets
Percentage of OASDI Taxable Payroll
18
16
14
12
10
1993
1998
2003
2008
2013
2018
2023
2028
Social Security Outlays
Social Security Payroll Tax + Benefits Tax

"Are these the shadows of the things that Will be, or are they shadows of the things that May be, only?... Men's courses will foreshadow certain ends, to which, if persevered in, they must lead... But if the courses be departed from, the ends will change. Say it is thus with what you show me!" Charles Dickens' A Christmas Carol

America can change course. If the government acts soon, it can ensure that future generations are not unfairly burdened with today's debt and spending commitments. It can ensure public and private investments that are needed for America's future prosperity. And it can ensure the solvency of the Medicare and Social Security Trust Funds that are an important source of support and security for many Americans.

Sources and Assumptions

The projections presented here are intended to illustrate long-term trends in the direction and magnitude of future outlays and revenues. The approach is simplified to provide clarity. The projections should not be viewed as precise dollar estimates.

Finding #1 ***Current Trends Are Not Sustainable***

The economic and demographic projections (e.g., population, GDP and nominal interest rates) used in the analysis are from the 1994 Annual Report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds, including unpublished annual data ("1994 Social Security Trustees' Report"). **Entitlement Spending** includes outlay projections for Social Security from the 1994 Social Security Trustees Report. The outlay projections for Medicare and Medicaid are from the chart accompanying Finding #4. Outlays for entitlements other than Social Security, Medicare, and Medicaid are projected through 1999 based on CBO estimates from CBO's The Economic and Budget Outlook: Fiscal Years 1995 - 1999, January 1994 ("1994 Budget Outlook"). After 1999, these other entitlements are assumed to grow in proportion to GDP (e.g., Federal civilian and military retirement programs are projected to be a constant .9% of GDP). **Discretionary Spending** is projected through 1999 based on CBO estimates in the 1994 Budget Outlook (which assume that the discretionary caps are met). After 1999, **Discretionary Spending** is assumed to grow in proportion to GDP. In determining annual deficits and **Net Interest**, Federal revenues are assumed to follow CBO projections from the 1994 Budget Outlook through 2004 and to remain a constant percentage of GDP (18.8%) after 2004.

Finding #2 ***Our Competitors Save and Invest More Than We Do***

The data are from the OECD's National Accounts, Main Aggregates: 1960-1992, Vol. I (1993).

Falling Private Savings and Rising Government Deficits
Mean Less Private Savings Available For Investment

The data are derived from the Economic Report of the President, February 1994 ("1994 Economic Report"). **Net Private Savings** is the sum of personal saving and gross business saving, reduced by consumption of fixed capital (i.e., depreciation). **Net National Savings** is **Net Private Savings** reduced by Federal deficits and increased by state and local government surpluses (which were .04%, .86%, 1.06% and .18% of GDP in the four periods).

Finding #3 ***Growth of Mandatory Spending In The Federal Budget***

Data on outlays by type are from 1994 Budget Outlook. For simplicity, the total for **Entitlements** includes spending that is generally referred to as mandatory spending (other than interest), as well as offsetting receipts and deposit insurance premiums. For this purpose, **Mandatory Spending** is the sum of **Entitlements** and **Net Interest**.

Finding #4 ***Federal Spending on Health Care Is Projected to Triple by 2030***

Outlay projections for **Medicare** are from the 1994 Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund and the 1994 Annual Report of the Board of Trustees of the Federal Supplementary Medical Insurance Trust Fund, including unpublished annual data ("1994 Medicare Trustees' Reports"). Medicare spending is reduced by SMI premiums paid by enrollees. The Medicare Trustees project SMI premiums through 2006. After 2006, the chart maintains the relationship between SMI premiums and Medicare SMI outlays that the Trustees project for 2006. **Medicaid** outlays are assumed to follow CBO estimates through 2004 from the 1994 Budget Outlook. After 2004, Medicaid spending is projected using a simplified outlay model. The model assumes that Medicaid costs per member of specific population groups (e.g., persons 65 to 84, persons 85 and over, and the disabled) grow in proportion to the projected increases in Medicare costs (after adjustment for demographic change). The model adjusts total Medicaid costs to reflect projected changes in the demographic composition of the population from the 1994 Social Security Trustees' Report.

Finding #5 ***An Aging Population Means Fewer Workers To Support Each Retiree's Benefits***

Population history and projections are from the 1994 Social Security Trustees' Report. The Social Security Trustees' Reports generally present a similar chart which compares covered workers to beneficiaries. If the chart were formulated in that manner, the ratio of covered workers to beneficiaries would be 16.5, 3.4, and 2.3 for 1950, 1990, and 2030, respectively.

Even If we Control Health Care Inflation, Federal Health Care Spending Doubles by 2030

The outlay projections for **Medicare** and **Medicaid** through 1999 are the same as in Finding #4. For years after 1999, Medicare HI, Medicare SMI, and Medicaid spending are projected based on simplified outlay models. The models assume that Medicare and Medicaid costs per member of specific population groups (e.g., for Medicare HI and SMI, persons 65 to 69, persons 70 to 74, persons 75 to 79, persons 80 to 84, persons over 84, and the disabled) grow in proportion to GDP per worker. The models adjust total Medicare HI, Medicare SMI, and Medicaid costs to reflect projected changes in the demographic composition of the population from the 1994 Social Security Trustee's Report. Medicare SMI spending is reduced by SMI premiums paid by enrollees. After 1999, the chart maintains the relationship between Medicare SMI premiums and outlays that the Trustees project for 1999.

Finding #6 ***Medicare HI Is Projected To Be Insolvent by 2001***

Projected **Medicare HI Outlays** and **HI Payroll Tax and Benefits Tax** revenues are from the 1994 Medicare Trustees' Reports. Benefits Tax revenues are projected income tax receipts from the taxation of Social Security benefits that are allocable to the Medicare HI Trust Fund.

Finding #7 ***Social Security Tax Collections Exceed Current Benefits, But Aren't Enough to Fund Future Promises***

Projected **Social Security Outlays** and **Social Security Payroll Tax and Benefits Tax** revenues are from the 1994 Social Security Trustees' Report. Benefits Tax revenues are projected income tax receipts from the taxation of Social Security benefits that are allocable to the Social Security Trust Fund. Arguably, receipts associated with the Social Security payroll tax are overstated because they are not reduced by the lost income tax revenues resulting from employers deducting their portion of the payroll tax.