Mr. Chairman, Senator Breaux, and Members of the Committee, I appreciate the opportunity to present the Administration's views on the topic of general revenue transfers to Social Security and Medicare. These transfers play an important role in the Administration's thinking about how to address the long-term financing challenges confronting these programs, as well as an important role in our budget framework, and I am pleased to discuss them with you today.

The Social Security and Medicare programs are the cornerstones of American social policy. Social Security benefits are the largest source of income for nearly two-thirds of Americans age 65 and older, and the only source of income for nearly one-fifth of them. And Social Security is more than just a retirement plan; it is, in addition, a family protection plan, paying survivors' benefits and disability benefits to millions of Americans under age 65.

Medicare plays an equally important role in the lives of older Americans. In 1963, nearly half of Americans over the age of 65 had no health insurance. Today, virtually all older Americans have health insurance through Medicare, and thereby have access to the kind of high-quality, dependable medical care that can help extend their lives and improve the quality of their lives.

Today, nearly everyone agrees on the importance of Social Security and Medicare, and the crucial role they will continue to play for senior citizens in the 21st Century. Unfortunately, while both programs are on solid financial ground in the near term, they both face financing challenges over the longer term. The key factors behind the funding shortfall are the aging of the U.S. population and, for Medicare, the projected increase in spending per beneficiary due to rapid advances in health care technology. As a result, significant steps will need to be taken to put these programs on a secure foundation for the long term.

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The Administration believes that, while they are by no means the whole solution, general revenue transfers are an appropriate and important *part* of the solution to the financing problems faced by Social Security and Medicare. A comprehensive solution should include structural reforms to these programs. The President has expressed his desire to work with Congress in a bipartisan fashion on broader Social Security reform. And he has put forward a specific proposal for Medicare reform that would: make the program more competitive and efficient; modernize its benefits, including the addition of a long overdue prescription drug benefit; and extend the life of the trust fund.

In my testimony today, I will address three topics:

• first, the opportunity for pre-funding provided by our favorable budget outlook;

• second, the proposal that the President has put forward for limited and prudent general revenue transfers into Social Security and Medicare; and

• third, the way that the transfers would help to prepare the economy and the budget for the coming demographic changes.<

The Budget Outlook and the Opportunity for Pre-Funding

The Current Situation

The American economy is now enjoying its best performance in decades. The unemployment rate has been below 5 percent since July of 1997, and inflation has averaged just over 2 percent during the same period. Productivity growth in nonfarm businesses has averaged nearly 3 percent over the past four years - the strongest performance for any such period since the late 1960s. Real wages have increased, even for low-wage workers who had not previously experienced proportionate increases in their earnings. Altogether, the economic expansion has now become the longest in U.S. history and remains quite robust.

The Federal budget picture is equally bright. The skills and efforts of American workers and businesses have combined with a policy of fiscal discipline to produce budget surpluses that even optimists would not have predicted 7 years ago. In the budget agreements of 1993 and 1997, the President worked with Congress to balance the budget, and he is now working with Congress to save the surpluses. Strong economic performance has boosted revenues and reduced outlays, and our continued focus on fiscal discipline is helping to sustain the expansion.

Last year, the budget was balanced even leaving aside the operations of the Social Security system, the first time in nearly 40 years that this occurred. In 1998 and 1999, we paid down $140 billion of public debt; during this fiscal year alone, we expect to pay down $157 billion more. Perhaps most encouraging of all, we have forged a bipartisan consensus in favor of using the Social Security surpluses exclusively for the purpose of paying down the debt held by the public. Indeed, under the projections of the President's policies that were presented in the budget, we are on a path toward eliminating this debt, on a net basis, by 2013.

The Challenge

Nevertheless, the aging of the U.S. population and the resulting demands on the Social Security and Medicare trust funds are hard upon us. The oldest members of the baby boom generation will reach the age for earliest eligibility for Social Security benefits within this decade. They will become eligible for Medicare benefits a few years later. All told, the number of Americans over age 65 is projected to double by 2033, and seniors will represent about 20 percent of the population compared with roughly 12 percent today.

This remarkable demographic shift will push up both Social Security and Medicare outlays. Medicare costs will be boosted further by continued improvement in the types and quality of medical care that will be available. To be sure, some of these advances in pharmaceutical treatments, bioscience, and medical technology will reduce costs, but many others are likely to raise the cost of providing state-of-the-art care.

In this context, the question arises: Could general revenue transfers be one part of the solution to the long-term funding challenges confronting Social Security and Medicare? The Administration firmly believes that they *could*, and they *should*./P>

The President's Proposal for General Revenue Transfers

Social Security

The President proposes in this year's budget, as he did in last year's budget, to transfer resources from the government's General Fund into the Social Security Trust Funds. The amount of these transfers is motivated by the interest savings that would be achieved by using the Social Security surpluses to pay down debt. These transfers would begin in 2011, after a decade of debt reduction, and continue through 2050. The transfers would extend the projected solvency of Social Security to 2050, or - if combined with the modest amount of equity investment proposed by the President - to 2054.

The transfers would shift resources from the on-budget account to the off-budget account, and thereby reduce the on-budget funds available for spending or tax cuts. At the same time, they would augment the Social Security funds protected by the President's proposed lockbox by an equal amount. Thus, the transfers would be matched dollar-for-dollar by an increase in government saving and - accordingly - an improvement in the government's balance sheet.

Medicare

The President also proposes to transfer additional resources over and above current law from the General Fund into the Trust Fund for Medicare Part A. These transfers would begin in 2001 and continue through 2015. Together with the President's comprehensive proposal for Medicare reform, the transfers would extend the projected solvency of the Medicare trust fund to at least 2025. The President's program would also combine general revenue with beneficiary premiums to pay for the new prescription drug benefit, analogous to the current financing arrangement for Medicare Part B

The Medicare transfers take place within the on-budget account, so they would not represent an on-budget outlay in the traditional sense. However, the President's Medicare legislation would require the reported on-budget surplus to be reduced by the amount of the transfers. In parallel with the approach we are recommending for the transfers into Social Security, our proposed accounting treatment of the transfers into Medicare would ensure that these funds are, in fact, used to improve the government's balance sheet and not for other purposes.

Relation to Pre-Funding Under Current Law

To summarize, the transfers proposed by the President would bring new resources into the Social Security and Medicare Trust Funds, allowing them to better meet their existing commitments. The transfers would also cause the government to run a bigger surplus than otherwise, because the amounts transferred could not be used for new spending or tax cuts. An essential aspect of the President's policy is that the transfers to the respective trust funds over and above current law would be backed dollar-for-dollar by increments to the unified budget surplus, and hence by equal-sized improvements in the government's balance sheet.>

I also want to emphasize the close conceptual relationship of these actions to the pre-funding already provided for in current law. It is enormously important that a bipartisan consensus has now coalesced around the idea that Social Security surpluses should be used to pay down the debt held by the public. The core economic principle behind both this approach to pre-funding and the framework for general revenue transfers that we have proposed is exactly the same: that Trust Fund accumulations should be matched dollar-for-dollar by an improvement in the government's balance sheet.

Comprehensive Reform

Transfers of general revenue to Social Security and Medicare would make an important contribution to the long-term financial soundness of these programs. But I want to emphasize that we view these transfers as only *part* of the solution to the projected funding shortfalls. As the President has consistently stated, structural reforms are another essential part of preparing these programs for the 21st Century.

The President has made clear his interest in working with the Congress to enact reasonable changes that would extend Social Security solvency still further while reducing poverty among elderly women. As the President said last week, we should build on the bipartisan spirit evidenced in the elimination of the retirement earnings test for people over the age of 65 by enacting our proposed transfers as a down-payment on comprehensive Social Security reform.

The President has also put forward a detailed and comprehensive proposal for Medicare reform. This proposal would modernize Medicare by adding a prescription drug benefit, and it would give the program more flexibility to use private-sector purchasing mechanisms. The proposal would also require traditional fee-for-service Medicare and managed-care plans to compete head-to-head on price and quality. By improving efficiency in Medicare, we believe that it is possible to both raise quality and reduce costs. Yet, even with comprehensive reform, extending solvency to at least 2025 without the proposed transfers would require severe cuts in benefits, sharp increases in payroll tax revenues, or drastic cuts in provider payments.

Clearly, general revenue transfers are a complement to structural reforms of Social Security and Medicare, not a substitute. Just as clearly, the scale of the future demands on both programs implies that structural reforms will not be enough. These programs will need the additional resources that general revenue transfers would provide.

It is also worth emphasizing that our proposal preserves fiscal discipline at its core, because under the approach we are proposing, each dollar of transfer effectively must be funded out of available on-budget surpluses. To illustrate, consider the situation in 2011, when we project that the combined Social Security and Medicare transfers would be $122 billion. With these transfers, there would be $122 billion less in on-budget resources available for policies that reduce receipts or increase outlays. This is simply not a situation, contrary to what is sometimes charged, where arbitrary amounts of bonds can be added to the trust funds.

Indeed, when all is said and done, the lion's share of funding for Social Security and Medicare would still come through the traditional channels. For Social Security, the present value of our proposed general revenue transfers would represent less than 7 percent of the present value of all projected Social Security revenues over the next 75 years. And for Medicare, the proposed general revenue transfers would represent a similarly small portion of the total resources projected to flow into the Part A trust fund over the next 25 years.

Preparing the Economy and the Budget to Meet Future Commitments

The transfers that the President has proposed would improve the budget outlook and better prepare the Federal government to meet our existing commitments to Social Security and Medicare. And because additional government saving would boost national saving, the transfers would better prepare the economy as a whole to meet the challenge posed by an aging population. Let me elaborate briefly on these points.

Improving the Budget Outlook

Paying down the debt improves the budget outlook in several ways. First, it will reduce interest payments, creating future "fiscal space" that can be devoted to Social Security, Medicare, or other government functions. We now spend more than $200 billion each year making net interest payments on the debt held by the public. If we pay off the debt, that amount will be freed up for other uses - such as paying Social Security and Medicare benefits as the baby boom generation retires.

Second, paying down the debt now puts us in a stronger position for any future contingency. The extra government saving can be thought of as an important insurance policy against the possibility that the future turns out to be less bright than we currently project.

Strengthening the Economy

Paying down the debt also strengthens the economy. For the nation as a whole, the central challenge of population aging is to provide a high standard of living for both workers and retirees, even though a smaller share of the population will be in the workforce. A natural solution is to make workers more productive in the future by increasing saving and investment now.

Reducing government debt raises national saving, because private saving is supplemented by public saving rather than being drained by public borrowing. More resources are made available for private investment, and capital accumulation proceeds more rapidly. Over the long run, national wealth and the productive capacity of our economy will be that much greater, leading to higher standards of living. At the same time, a larger economy will generate more tax revenue at the same tax rate, making it easier to meet our existing fiscal obligations.

Less government borrowing also helps to hold down interest rates. Of course, interest rates are affected by many factors, including inflation, international developments, and private saving and borrowing decisions. However, a broad consensus of economists believes that reducing the government's public debt will allow for lower interest rates over time than if the debt increased or were held steady.

Conclusion

In conclusion, the President has proposed a disciplined program of general revenue transfers to Social Security and Medicare, in which each dollar of transfer would be matched dollar-for-dollar by a reduction in debt held by the public. This policy would result in incremental government saving, over and above what would happen if we merely agreed to balance the on-budget account. The additional government saving this policy would generate would make both the economy and the government better able to meet the demands of the growing number of retirees.

The Administration believes that dedicating the benefits of debt reduction to Social Security and Medicare is the best use of those funds. Simply put, we should be sure that we can finance our existing commitments before launching new programs or tax cuts. And we should work together to enact the structural reforms to these programs that are also needed. This is why the President has consistently grounded his budgets in a framework of debt reduction, fiscal responsibility, and prudent stewardship of our long-term economic prospects.

Thank you.