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### CURRENT ISSUES IN U.S. SOCIAL SECURITY AND MEDICARE PROGRAMS

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MR. BRUCE D. SCHOBEL: I work in the Social Security Division of Mercer Meidinger Hansen in Louisville, Kentucky, which disproves the notion that all Social Security knowledge is in Washington, DC. I previously worked at the Social Security Administration in Baltimore, Maryland, for nine and one-half years, during which time I had the opportunity to work with and get to know the panelists.

Our first speaker today, John Wilkin, is also a refugee from the government, having worked for the Social Security Administration twice as long as I did -- 18 years. He worked across the range of Social Security and health programs and has broad knowledge of all of them. He is now with the Actuarial Research Corporation in the Washington area. He is also chairman of the Committee on Social Insurance of the Society of Actuaries. The Committee recently released a statement recommending how the actuarial balance of the Social Security program should be computed. John is going to talk about that, some of the reasons that led to the need for that statement, and how the statement was developed.

Next is someone who needs no introduction: Bob Myers. He's one of the people who was around when Social Security began in 1934 and can speak authoritatively about the original intent of the people who designed the program. He worked for the Social Security Administration for 38 years and was Chief Actuary for two-thirds of that time, until 1970. He returned during the Reagan Administration to be Deputy Commissioner for Programs. At that time, I had the great pleasure of working for Bob. He was also Executive Director of the National Commission on Social Security Reform in 1982-1983.

Last, but not least, is Roland King, who has been the Chief Actuary of the Health Care Financing Administration for about ten years. He has had a very active 18 months since the enactment of the Medicare Catastrophic Coverage Act of 1988. He has fought valiantly for the integrity of actuarial cost estimates in the face of all sorts of other numbers floating around from the Congressional Budget Office and other sources. He is rumored to have retained his sanity through all of this, which you can judge for yourself.

MR. JOHN C. WILKIN: Over the last several years, the long-range actuarial balance of the OASDI program has been slipping closer and closer to being "out of close actuarial balance." Last year, in the 1988 OASDI Trustees Report, only a change in the method of calculating the actuarial balance prevented the program from being described as "out of close actuarial balance." Many eagerly awaited the release of the 1989 Trustees Report to see if the program would still be considered financially sound. The Report was released on April 24, 1989. Those who turned quickly to the summary or the conclusion found no mention of close actuarial balance, let alone whether or not the program was out of balance.

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A more careful reader of the Report will find mention of the concept of close actuarial balance in the introduction to the section "Actuarial Estimates," soon after reading that the Social Security Act requires that the annual report include "a statement of the actuarial status of the Trust Funds." Nevertheless, the Report states that the Board has decided

to drop the concept of "close actuarial balance" from the report beginning in 1989. The Board does not want to put undue emphasis on the concept of close actuarial balance by continuing to report on whether the actuarial balance falls within an arbitrary range of values. The Board is of the opinion that the "close actuarial balance" test, by itself, might inappropriately influence the decision as to whether and when changes in the program's financing or benefit provisions are needed in the future. The system may be out of close actuarial balance because of projected deficits in the very long run, even though benefits could be paid for many years into the future, and immediate action may not be required.

A very thorough reader will find, in a footnote to the above section, this statement:

The Social Security Administration's Chief Actuary (Harry Ballantyne) believes that "close actuarial balance" is a valid concept, that it is generally accepted by the actuarial profession in evaluating the actuarial status of the OASDI program, and that it should be included in the report, continuing the practice in effect since the late 1950s. Furthermore, the Chief Actuary wishes to note that the General Accounting Office in an independent study recognizes the importance of the concept of "close actuarial balance" but also recommends adding other measures to it to serve as an early-warning device. A program is out of close actuarial balance if its actuarial deficit or surplus is greater than 5% of its cost rate. If the concept were continued this year, it would show (using the alternative II-B assumptions) that the Old Age and Survivors Insurance (OASI) program (long-range actuarial deficit equal to 4.4% of its cost rate) is in close actuarial balance, the Disability Insurance (DI) program (deficit equal to 11% of its cost rate) is out of close actuarial balance, and the OASDI program combined (deficit equal to 5.1% of its cost rate) is just barely out of close actuarial balance.

In addition, Harry Ballantyne qualified his Statement of Actuarial Opinion in the report, stating:

The decision of the Board of Trustees, as stated herein, to eliminate the explicit test of "close actuarial balance" should, in my opinion, be reconsidered. A specific criterion for assessing the adequacy of long-range program financing is desirable in order to satisfy the "statement of actuarial status of the Trust Funds" that is required by law. The test of close actuarial balance is one such criterion and, in fact, has been included in each annual report since the late 1950s. This test has had a positive influence in maintaining the actuarial balance of the OASDI program or in restoring actuarial balance when required. In addition, this test is generally accepted within the actuarial profession as a valid criterion for use in evaluating the actuarial status of the OASDI program. Although "close actuarial balance" cannot characterize all aspects of the actuarial status of the program, in my professional opinion, it should continue to be used as a primary test of the long-range actuarial soundness of the program. For these reasons, I am qualifying my certification statement for this annual report.

This is the first time that the Chief Actuary of the Social Security Administration has attached qualifying language to the Statement of Actuarial Opinion since the opinion was made a part of the annual reports in 1981 (which was accomplished largely through the efforts of the then-Chief Actuary, Dwight Bartlett). Clearly there is a controversy brewing at the Social Security Administration on matters that are near and dear to actuaries. What is the story behind the controversy and who is right?

Well before the 1989 OASDI Trustees Report was released, the Committee on Social Insurance of the Society of Actuaries (following the suggestion of Bob Berin, who is the Society of Actuaries Vice-President who oversees the Committee) had been debating this issue. The Committee strongly agrees with the statements made by Harry Ballantyne. However, those who quickly criticize the Trustees' actions as strictly politically motivated, ill conceived, and foolish may be a bit hasty. The Trustees sense weaknesses in the test and do not understand the total reliance on it to resolve all of the complex financing issues surrounding Social Security.

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Whenever the OASDI program has been out of long-range actuarial balance in the past, many have taken this to mean that the system is in financial trouble that requires immediate modification. This year, the system would be described to be out of balance, yet the funds are expected to increase by \$59 billion. Further, within a few years, the funds are expected to be increasing by over \$100 billion per year. Based on the alternative II-B assumptions, the funds will be sufficient to pay benefits for the next five and a half decades. To the Trustees, there appears to be no convincing need for action, and certainly not for immediate action.

Furthermore, the test for close actuarial balance seems to be arbitrary. It has been changed in the past, and it is not applied to the health insurance (HI) program, which uses the same 75-year projection period as the OASDI program. The Trustees would like to have more certainty on the meaning, the purpose, and the implications of the test for close actuarial balance. Thus, although they have dropped the test from their report, they have requested that the current Social Security Advisory Council appoint a panel of experts to provide advice regarding the measures that should be used to judge both the program's short-range and long-range financial soundness. In addition, the two members of the public who are Trustees of the Trust Funds have commissioned their own study of measures that might be used to determine the financial status of the funds. They have put together a working group, including two actuaries, that has already begun this study.

The Committee on Social Insurance saw that what was needed was more than just a strong statement of support for SSA's chief actuary. This was an opportunity to clear up the confusion surrounding the test and to address its weaknesses. The members of the Committee believed that not only should the old test be continued, but also that the test should be strengthened.

The Committee on Social Insurance of the American Academy of Actuaries, which is chaired by Bob Myers, had also been studying the same issues. In fact, they issued a report entitled "Measurement of the Actuarial Status of the Social Security System" in January 1987, while under the chairmanship of Ken Steiner. The Committees joined forces and, after developing a stronger test of actuarial soundness that they believed would be generally accepted by the actuarial profession, issued a public expression of actuarial opinion on their findings in August. The statement applied to the OASI program, DI program, and HI program.

The Committees recommended the following tests for determining the actuarial status of each of the funds:

1. The trust fund will be considered to meet minimum short-range contingency-reserve requirements over the first five years of the projection period, under the following conditions:
  - (a) when the fund ratio is currently over 50%, it is projected to remain above 50%, or
  - (b) when the fund ratio is currently below 50%, it is projected to move above and then remain above 50% and, in addition, the trust fund balance is able to meet all of its obligations when due, and
2. The trust fund will be considered in long-range close actuarial balance if the 75-year income rate is between 95% and 105% of the 75-year cost rate.

The first test addresses the major weakness of the current test -- its inability to deal with the short-range period. This addition is of particular importance to the Committees. I have seen high-level policy planners make the following statement: "a trust fund was considered to be in close actuarial balance, and hence financially sound, if its projected income over 75 years did not vary more than 5% from its projected outgo." I do not believe that this represents the intent of the old test. The 1989 OASDI Trustees Report states that the 75-year actuarial balance is used to measure the "long-range" financial status of the trust funds, while in the "short-range," the adequacy of the trust fund level is measured by the contingency fund ratio. What has been missing in the short-range is a critical value against which the adequacy of the fund can be tested. It is interesting to note that contingency fund ratios have been presented in the Trustees Reports for years, but their significance in measuring the financial soundness of the system has been lost because there is no critical value against which the ratio is tested to determine whether or not the system is financially sound. The inability of the long-range test to apply to the short-range was seen by many as a flaw in the test.

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The second test applies the same criteria for testing for long-range close actuarial balance that has just been dropped. The opinion, however, specified that the calculation of the 75-year cost rate should take into account interest, the starting fund balance, and an ending target fund balance equal to one year's outgo. The specification of a desired target fund ratio is considered very significant for the OASDI program, since the current test implies a balance at the end of 75 years of zero. The 5% test for close actuarial balance is considered significant for the HI program, since currently no such test is applied (mostly because the HI program has had such a large long-range deficit ever since 75-year projections have been made that it has been considered obviously out of balance).

The purpose of the short-range test is to determine whether the current funding schedule presents an unacceptable level of risk that a trust fund would be unable to meet its obligations in the near future -- thus, requiring immediate action to improve the funding situation. The purpose of the long-range test is to determine whether the program is financially viable over the long range and to give early warning if changes will likely have to be made (although those changes may not have to become effective for many years into the future). Whenever the long-range test is failed, the Trustees Report should include a description of when the deficit or surplus occurs and of the timing and magnitude of changes that could be made in order to eliminate the actuarial imbalance.

Both of the Committees would like to hear from interested actuaries on their reactions to the proposed tests. In fact, we have already heard some comments. One criticism of the proposed test is that it ignores the imbalances after the end of the 75-year projection period. Thus, from one report to the next, the long-range actuarial balance is likely to change even if actual experience is exactly as was assumed. Another criticism is that the test does not explicitly address specifying the funding basis intended by Congress. A permanent advance-funding basis would require a modification to the test.

When judging the appropriateness of tests of the actuarial soundness of OASDI and HI, however, I believe that one should keep in mind that an actuarial analysis of the financing of Social Security has two main goals: 1) that the costs of the program be fully disclosed, and 2) that provision be made to meet those costs or to reduce them. If the tests of financial soundness are to meet their goals and aid in determining the appropriate financing of Social Security, they must, I believe, have three characteristics: 1) universal acceptance, 2) simplicity in application, and 3) clarity of results. These are needed for the tests to lead to good decisions on the financing of the Social Security programs.

Universal acceptance means that the test is not just calculated and used by actuaries but that it is also used by policy planners when analyzing the financing of Social Security and by policymakers when making financing decisions based on the test. The test should be used to determine the financing of legislation on Social Security. History shows that tests of financial soundness have been very effective when they have been universally accepted and have been virtually useless when they have not been accepted.

Throughout the decades of the 1940s, the 1950s, and the 1960s, financing decisions were based on the goal of obtaining a long-range actuarial balance of zero. Decisions in Congress and discussion between the administration and Congress focused on the long-range costs of the program and of amendments to it. Changes were made only when adequate provision was made for the financing of those changes. Policymakers exercised financial discipline by adhering to specific financing goals that all agreed upon, thus taking much of the arbitrariness out of the decision-making process. I believe that Bob Myers, chief actuary during much of this period, should be given much of the credit for the smooth operation of the financing of Social Security then. Not only did Bob develop the tests for long-range actuarial soundness, but he also had much to do with the test being accepted and used by policymakers.

More recently, during the deliberations of the National Commission on Social Security Reform which led to the 1983 amendments, little progress could be made until agreement was reached on the financing goal, that is to increase revenue and/or cut benefits by \$150-200 billion during the period 1983-89 and, in addition, to bring the system into long-range actuarial balance. For these deliberations, this was the test of financial soundness. It was universally accepted, simple in application, specific, and it led to a good decision, saving Social Security from immediate bankruptcy.

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Simplicity means that the tests must use just a few numbers that summarize the results of literally thousands of calculations. This may involve making some compromises with perfection. Obviously, such a summarization will not be perfect in every situation, because a few numbers cannot present all of the information contained in thousands of numbers. A rigorous analysis of whether all future obligations of the trust funds can be met when due entails a detailed projection of the year-by-year income and outgo and trust fund balances (which are already contained in the Trustees Reports). The display of all this detail is useful in analyzing the nuances of a financing scheme, but is unlikely to lead readily to financing decisions. Again, the National Commission ignored the details presented in the Trustees Reports and opted for the simple goal of raising \$150-200 billion.

Clarity of results means that the test must state unequivocally whether the program is considered financially sound and provide a specific financing goal. It is not enough to just calculate the trust fund ratio or the long-range actuarial balance. The resulting ratios and balances must be compared to critical values that determine whether or not the system is financially sound. In addition, whenever the system is found to be underfinanced, the test must establish a specific goal for putting the system back on a sound financial basis. It is better to have some arbitrariness in the establishment of the goal than to have the arbitrariness in the financing decision process itself.

The test must lead to good decisions. Although it is important to strive for rigorous tests, using analytic efforts to establish the best measures, the most appropriate critical values, the best assumptions, and the best methods, it is even more basic that the tests (whatever their accuracy may be) lead to high-quality decisions. While we are waiting for the perfect test, therefore, it is important to have a test in place that will lead to good decisions on the financing of Social Security in the debates that are going on today and in the near future.

I believe that the test set forth by the Committees on Social Insurance meets the criteria that I have set forth. Another test could do so also, but I believe that its ultimate success depends on how well it meets the goals and characteristics that I have laid down.

When the Social Security program was new and future costs were expected to increase significantly over present costs, the sole emphasis on the long-range actuarial balance in order to determine the financial soundness of the program was appropriate. Now that the program is more mature, the test should include the short-range condition of the trust funds as well. In fact, the relative emphasis should shift towards the short-range.

The lack of a short-range test contributed to the delay and to the inadequacy of the financing solutions contained in the 1977 amendments. Although, at the time, it was clear that the system (after the amendments) did not meet the long-range financing objectives, not enough was said about short-range objectives. As a consequence, shortly thereafter, the system fell again into financial trouble and had to be rescued once more in 1983. The test that is proposed by the Committees would have shown in the 1974 Trustees Report that the OASDI system was not financially sound and that the 1977 amendments did not put the program back on a sound financial basis.

The test proposed by the Committees covered the OASI, DI, and HI programs. The Supplementary Medical Insurance (SMI) program is different in that its financing does not depend on legislation. A mechanical procedure exists that, if allowed to operate in the future as it has in the past (with the exception of the 1970 premium promulgation), will provide for adequate financing. The current report, however, does not completely meet the first goal of an actuarial analysis, i.e., that the cost of the program be fully disclosed. Although the federal government has promised to pay the major share of the cost of SMI into the indefinite future, estimates of this cost are not made for more than a few years into the future. The nation needs to know the level of the long-range financial commitment that is being made through the SMI program.

**MR. ROBERT J. MYERS:** First, I would like to discuss the current and projected growth of the OASDI Trust Funds. In 1983 and 1984, after the reform legislation was passed, there were many people who, remembering what had happened after 1977 and the financial statements made about the system then being solid for the next 50 years and actually having problems within five years, said the same thing was going to happen again. Among them were such prominent and reliable outfits as the Committee for Economic Development. Well, the current financial health of the

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OASDI Trust Funds is excellent, the balance at the end of last year was \$110 billion (about three times as large as it was estimated to be in 1983). The balance at the end of this year will be some \$170 billion. Even in Washington, that is a fair sum of money.

Looking ahead, the Trust Fund is expected to build very rapidly in the next two decades when the cost picture is relatively favorable and the people currently reaching retirement age are from the low birth years of the 1930s. The Trust Fund will build up eventually under the current intermediate estimates to something like \$12 billion and then will go down a roller coaster slope until it is exhausted in roughly the year 2045 or 2046. This is hardly any way to finance a pension plan whether it be a private plan or a social insurance plan. This was something that in the crisis of 1983 was not looked at deeply. It was thought that we would just look at the average actuarial balance of the system, which was adequately financed over the long range. Later, the year-by-year financing would be examined carefully. Now is the time when we should look at the system, see how it should be financed, whether a fund should be built up, whether it should be current cost, and if a fund is built up should it later be drawn down to zero as would happen under present law under the intermediate estimate.

Another problem is the relationship of Social Security and the OASDI Trust Funds to the federal budget, particularly to the Gramm-Rudman-Hollings targets. Strangely enough, Social Security is out of the budget, as a result of the GRH law enacted in 1985. But in determining how to meet the budget deficit targets specified by the GRH law, the operations of the Social Security system are included -- i.e., the excess of the income over outgo of Social Security is being used to see if budget targets are being met. This is some of the smoke and mirrors that goes on in Washington.

When this was first done in the 1985 legislation, the budgeteers were delighted because it made their job easier. It has been a growing concern in Washington, however, that this is really just hiding the true budget deficit. It is likely that Social Security will be separated out, the real budget deficit will be recognized, and maybe something will be done about it. At the same time, it would free the financing of Social Security from the constraints of the budget.

Perhaps Congress will reconsider how Social Security is being financed and will go, as I think it should go, to a current-cost basis. The reasons for current-cost financing are not actuarial. Most actuaries would agree that current-cost financing is quite possible and feasible, but they wouldn't say that it was necessary. I think that it is necessary more for political reasons. The trouble with the big Trust Fund, assuming that you've solved budget difficulties in other ways, is that the beneficiaries will put irresistible pressure on Congress to liberalize benefits in the "fat" years of the 1990s and early 2000s when the demographic situation is favorable and plenty of money is coming in to make liberalizations. Any liberalizations made then, however, would make the future financing problems that much more difficult to solve when the baby boomers come along and the costs are really much higher.

One other view about the accumulations of the Trust Fund is of interest. Several economists at the Brookings Institution are strongly in favor of building up a large Trust Fund, but they recognize the difficulties involved in drawing it down beginning some 40 years from now. They suggest maintaining the Trust Fund at a high level. Of course, the only way to do that is to have an increase in the tax rate just as you would if you had current-cost financing and wanted to maintain the current benefit provisions. The Brookings people say that they favor that too, but for an extraneous reason. They say, and I think that they are right, that there is not enough savings in the country and that this is a way to increase national savings. I am in favor of more savings, but I don't think that it should be done indirectly through the Social Security system. Interestingly enough, if this were done, we would have gone full circle, because the financing basis of the original Social Security Act was just that -- to build up a huge trust fund, use the interest on it to hold down the contribution rate, and maintain that trust fund. There was some very interesting actuarial debate in the late 1930s about this matter. Most of the actuaries came to the conclusion that current-cost financing was preferable, that you shouldn't have this huge trust fund of \$47 billion in that far-distant year 1980. Those are different dollars than we have today, but our Trust Fund now is three or four times \$47 billion.

Next let me turn to measuring actuarial status. John Wilkin gave a very good description of what the Joint Committees did. By and large I think it is excellent, but the Joint Committees realize that it is not the last word. I would move a little further because of one anomaly that results under the present method of measuring the long-range actuarial balance. Even if the experience is

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exactly the same as the estimates, under the present system the actuarial balance gets a little bit worse each year. The reason is that you substitute for each year that elapses a high-cost year in the future when there is a large difference between income and outgo. The way I would like to solve this problem is not to limit the evaluation period to 75 years, but rather go back to what we did years ago and run it out to perpetuity.

Another change that I would suggest would be to have a smaller margin of acceptable variations, again as there was back in the 1950s and 1960s. Also, Congress should do something when the program gets out of balance. It doesn't mean that Congress will immediately reduce benefits or raise taxes, but action could be taken in the future. If you need higher tax rates 50 or 60 years from now, you can put a schedule in the law now. A lot will happen between now and then, but it gives the public an indication of where the cost trends are going. If the public thinks these costs are too high, there is always one very good safety valve: where you set the normal retirement age. If you have demographic problems because of increasing longevity, you can solve them by demographic means.

Next, I will briefly mention the Advisory Council that is operating. First, it is interesting to note that an excellent tradition of the Advisory Council running many years into the past has been maintained. They have always had at least one actuary. This time the actuarial member is Phil Briggs from the Metropolitan Life. This Advisory Council, because of the wish of the chair, Deborah Steelman, a Washington attorney, is putting much more emphasis on healthcare, including medical-care delivery systems. It is not even focusing just on Medicare, which the statute says to do, but going way beyond that and in essence is running competition with the so-called Pepper Commission as to how health and medical care should be delivered in the United States. The Advisory Council is planning toward the end of its deliberations to look at the question of OASDI financing. I hope that they will be able to get around to it, and I hope they will look at how the system should be financed. I hope that the Advisory Council will study this matter seriously and get together with Congress and try to develop a permanent funding basis.

On Medicare, I won't say too much because Roland King is following me and I wouldn't want to pre-empt him, but there are two ideas I will present briefly. The first concerns HI financing. The system is way out of long-range actuarial balance because of the sharply rising costs of hospital care. I would like to see placed in the law a tax schedule that matches the cost rate. This would give the public some indication of the financing problems involved 30 or 40 years from now, especially when the baby boomers reach retirement age. The HI Trustees Report shows these figures, but I would like to see appropriate tax rates put in the law so that people see what the problem is. Of course, one possibility for the HI program is that maybe five or ten years from now there won't be any. I am not advocating this, but it is possible that we might have some national health insurance system, because the problems affect not only Medicare costs but costs for active workers. The situation for HI is unlike that of OASDI, which I think will have perpetual life.

Now I will turn to the Catastrophic Medicare Program that is now in its last stages of its life, because there is very little of it that is going to survive the next month or two. I believe the benefits that were provided were very desirable. I might not have done exactly what was done, but certainly most actuaries would agree that catastrophic benefits is the purpose of insurance, rather than first-dollar protection. The trouble was the financing, which was very confused in my opinion, although not in some other people's opinion, and not particularly inequitable. As to the confused financing, there was money coming from all sorts of various sources falling in various directions, including a fund that was called the Hospital Insurance Catastrophic Coverage Reserve Fund, into which money went but never came out! It just built up and up and up. Well, that of course didn't make sense. Congress knew that too and said that sometime later they would get from there to actually paying benefits.

Now, as for equity, it should be noted that the highest income beneficiaries of Medicare will receive this year \$1,004 on the average out of the general fund of the Treasury and -- the way the law is, which will shortly be dead -- they would have to pay up to \$848 for the new catastrophic benefits. They are still ahead of the game, even though some of the big windfall is being taken away. You can tell people that all you want, particularly if they have paid-up postretirement health insurance from an employer, and they say, "Why don't you leave us alone, leave the situation the way it was, we liked the windfall." This pressure from the upper 5-10% of the income ladder was an amazing political science illustration of how a small number of people can

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influence public opinion. In hindsight, what should have been done was more of a balance. In other words, catastrophic benefits should have been put in, premiums should have been increased somewhat, but at the same time some of the first-dollar benefits should have been reduced to provide a better package of protection. This compromise of some people giving up a little in various ways and not having too serious an effect on anybody would have been preferable to the actual financing, with the supplemental premium, or income tax surcharge.

MR. ROLAND E. KING: I would like to switch gears here and talk about the willing suspension of disbelief. The willing suspension of disbelief is a literary phrase applying to a reader (or viewer) who desires to enjoy or be entertained by a fictional work of art, such as a novel, movie, or play. The phrase refers to the willingness of the reader or viewer to voluntarily suspend his or her disbelief in facts known to be untrue or in acts known to be impossible. For example, in order to enjoy a *Superman* movie, you would have to suspend your disbelief that a man could fly. In the same vein, in order to enjoy a *Star Wars* movie, you would have to suspend your disbelief in, among other things, Wookies, Ewoks, Jedi Warriors, and intergalactic space travel. Those of you with teenage children know what I am talking about.

You may be wondering at this point what connection a literary expression such as this has with social insurance. Well, the willing suspension of disbelief (or WSD, as we'll call it for short) plays an increasingly prominent role as an instrument of social insurance policy. An excellent example of WSD at work is the enactment of the Medicare Catastrophic Coverage Act of 1988, particularly the prescription drug benefit that was part of the legislation.

When Congress held hearings initially on making the prescription drug benefit part of the program, the American Association of Retired People (AARP) testified that the cost of prescription drug coverage was a significant financial burden for its members. The AARP pointed out that their 1986 survey of the elderly population revealed that they spent over \$9 billion on prescription drugs in 1986 (this amounts to over \$300 per capita) and that the elderly population consumed more than 30% of all the prescription drugs in the United States. Independent estimates of prescription drug spending in the U.S. were also available in a study done by Trapnell and Genuardi. The Congressional Budget Office (CBO) ignored these studies and surveys and based its cost estimate on prescription drug spending of \$200 per capita in 1989 -- or only two-thirds of what AARP estimated for 1986. They estimated that a prescription drug plan with a \$500 deductible and a 20% coinsurance payment could be financed in 1989 for a mere \$2.40 per month. To my knowledge, not a single member of Congress or staff questioned the huge discrepancy between what AARP was saying and what the CBO was saying. From their point of view, they had a financial problem of immense proportions for the elderly, and they could solve it for almost nothing. Well, this situation was tailor-made for WSD! You can imagine the Congress' extreme displeasure when we came in with our estimate of \$20.00 per month.

We were definitely trifling with the Congress' WSD, and politicians have subtle ways of punishing people who try to spoil their fun. We were invited to make the one-hour drive from Baltimore to meetings in Washington. When we arrived, we were told that they had forgotten to invite the appropriate people from the CBO. We were also told that our methodology was flawed, that we were using inappropriate statistical techniques, and that our data were not representative. And, of course, we were subjected to the most crushing criticism of all -- that our cost estimates were politically motivated. Virtually endless reams of documentation were demanded by the Congress and supplied by us. And each round of answers led to a new round of questions. To make matters even worse, Blue Cross/Blue Shield organizations and commercial insurers began reporting their data for prescription drug plans for the elderly, and their costs were even higher than ours! However, in the best tradition of WSD, the Congress easily dismissed this information by proclaiming that the data represented people who were "sicker than average" and, thus, not representative.

Initially, our cost estimates were so far out of the conventional wisdom they were even questioned by the Office of Management and Budget (OMB). Now, to put this in perspective, you have to remember that, in the Reagan administration, almost no cost estimate for expansion of a social insurance program could be considered too high. Even after the OMB inspected our estimates and examined our methodology and assumptions and became convinced that our cost estimates were reasonable, the White House was still skeptical and wanted reassurance before going out on a limb with cost estimates that were so radically different from the "conventional wisdom." So I was invited to the White House for what a friend in the OMB referred to as a "sanity check." I must



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have passed the test, because soon rumblings of a possible veto began to emanate from the White House, and three cabinet officers wrote a letter to the Congress stating that they would recommend a veto to the President unless, among other things, the prescription drug benefit was removed from the legislation.

I think most of you know the rest of the story, and it's not a happy one. In early June 1988, Congress enacted the Medicare Catastrophic Coverage Act, and it had a prescription drug benefit in it, although this benefit was scaled back somewhat as compared to the earlier versions. Over the course of the debate, the CBO's cost estimates had quadrupled, so that our estimates were a little more than double the CBO's, instead of being over eight times greater, as they had been at the beginning of the debate. Now, the Reagan administration had threatened a veto because of two other facets of the catastrophic legislation besides the prescription drug benefit. It objected to what was termed the "staggering long-term tax and premium increase" and the "use of a complicated and unnecessary surtax." But despite that fact that the legislation contained these three objectionable features that had threatened to result in a veto, the President went ahead and signed the legislation anyway. Some observers have said that if the same ideologies had been advising the President in 1988 that had advised him early in his administration, he would have vetoed the Catastrophic bill. However, his advisors realized that if he were to veto the bill it would become a major election year issue, and, as most of you know, politicians do things differently in years divisible by four. Although a veto was closely debated within the White House, the political pragmatists won, and the President signed the legislation into law on July 1, 1988.

This could have been the end of the story if the elderly had just used a little WSD, but the cold, hard reality of the surtax began to sink in even before they filed their first tax return that would have included the new surtax, in 1990. There was a highly vocal protest of the surtax by the elderly, and by April 1989, Senator Bentsen, Chairman of the Senate Finance Committee, decided he'd better do something about it before it derailed his presidential ambitions. The CBO, ever accommodating, had recently raised its estimates of the revenue generated by the surtax and announced that the catastrophic legislation had a \$9 billion surplus. On April 20, 1989, Senator Bentsen held a press conference to announce that he wanted to use the surplus to reduce the supplemental premium. The following day, he wrote to the Secretary of the Treasury to ask him if he concurred with the CBO's assessment that the supplemental premium was too high. Not only did the Secretary of the Treasury reply, but President Bush responded with a letter of his own. But in a slap in the face to Senator Bentsen, President Bush addressed his letter to Chairman Rostenkowski of the House Ways and Means Committee rather than to Senator Bentsen. If this had been a *Star Wars* movie, Senator Bentsen would surely have seen Darth Vader as an actuary, because President Bush made specific reference to the actuary's concern that the financing of the catastrophic legislation was inadequate and to the actuary's projected costs of the prescription drug program.

To add fuel to the fire, on May 8, the administration sent to Congress a congressionally mandated report updating the drug estimates based upon new survey data that had become available since the legislation passed. This report indicated that the actuarial estimates were virtually unchanged after two years of debate. In addition, we had hired an independent consulting actuary to critique our methodology and assumptions. The report of the independent actuary confirmed the reasonableness of our projections and even hinted that they might be too low. This gave rise to a new round of actuary-bashing by the Congress. This time, though, the criticism was, in effect, directed at the methods and assumptions generally employed by actuaries who did health actuarial work, not just the actuaries in the Health Care Finance Administration (HCFA).

Senator Bentsen's WSD was completely unaffected by either the President's letter or the new report to Congress. He pushed ahead with his plan to reduce the catastrophic supplemental premium and scheduled a Senate Finance Committee hearing on the issue for July 11. However, he was rudely brought back into touch with reality by startling new revelations from, of all places, the ever-accommodating CBO. Having originally invited Senator Bentsen to crawl out on this limb with their estimate of a \$9 billion surplus, the CBO now proceeded to saw off that limb by revising upward its prescription drug estimates. As a result, the \$9 billion surplus had not only evaporated but also had turned into a huge deficit. By the way, the only reason given by the CBO for the increased estimates was "increases in prescription drug costs and higher use of drugs by the elderly." This new development literally knocked the WSD out of Senator Bentsen, but he went

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ahead with the hearing anyway, placing the blame for the entire embarrassing episode at the feet of the "so-called experts" who had disappointed him.

This was, indeed, a remarkable statement coming from a U.S. Senator. Whether they liked it or not, Congress had received the best available advice on the issue of prescription drug benefits. The foremost Medicare financing experts in the country (the HCFA actuaries) had provided advice. The Health Committee of the American Academy of Actuaries had provided advice. Prominent actuarial consultants had provided advice. The National Blue Cross/Blue Shield Association and commercial insurance carriers had provided advice. Well-known health-policy think tanks had provided advice. And all of these experts had unanimously agreed that the Congress had seriously underestimated the cost of the prescription drug program. Senator Bentsen hadn't been the victim of bad advice from the experts. He was the victim of his own WSD. Instead of relying on the advice of experts, he had relied upon the advice of people who told him what he wanted to hear.

Now, given this remarkable turn of events, as well as the unexpectedly vocal resistance of the elderly to the income-related premium, it's not surprising that on October 4 the House of Representatives voted 360-66 to repeal the catastrophic program entirely. Two days later, the Senate voted 99-0 for the McCain amendment which strips out all the major benefits from the legislation and leaves only the hospital benefit restructuring and a few minor ancillary benefits in its place. It also does away with the income-related premium. The ultimate fate of the catastrophic legislation now rests in the hands of the conference committee. Many observers expect that the emerging compromise will be closer to the McCain bill than it will be to total repeal. The House conferees have been chosen and a vote to instruct the conferees to accept nothing less than total repeal was defeated, so that increases the likelihood of a compromise.

Now we would like to hope that the Congress might have learned from its experience with Catastrophic, but I'm not optimistic. The last time I testified on a discrepancy between our estimates and CBO's estimates was on a Medicaid issue where CBO's estimate was \$475 million and our estimate was \$5.2 billion. Representative Wyden made this statement at that hearing: "HCFA opposes each of the Medicare initiatives for which we are about to hear its cost estimates. Obviously, each member should draw his or her own conclusion, but it is hard for me to escape the conclusion that, in developing their estimates, the HCFA actuaries picked a nice high number and worked backwards from there into a justification." It's apparent from this statement that Mr. Wyden never considered the possibility that the administration's opposition to the bill might have arisen from the high-cost estimates rather than the other way around. It's also apparent that he has no interest in making an objective evaluation of the real differences in the cost estimates.

Although I am not optimistic that Congress has learned anything from this experience with Catastrophic, I think that perhaps they learned some things that will affect their dealings with the administration and their consideration of future expansions of social programs. First and maybe most important, they learned that AARP doesn't necessarily speak for the elderly population. AARP supported the legislation and would have preferred to have the cost of the catastrophic program spread around for all the taxpayers, but it was a decision of the Reagan administration, a principle of the Reagan administration, that the cost of the program would be met entirely by the people who would benefit directly from it -- namely, the aging population. There were also members of Congress -- most notably, Senator Durenberger -- who feel strongly about generational equity and wanted to avoid raising taxes in order to finance additional benefits for the elderly. So there are some changes to the Medicare program that this change in thinking may affect in the future, and long-term care is one of them. Some Members of Congress have said that it is going to be a long time before they are going to address the issue of long-term care because of their experience with Catastrophic and that may be the case. My own personal belief is that the compromise that does come out of the conference committee will be much closer to the Senate version than to total repeal. We'll hope that as time goes on we will see that Congress has learned something from this experience.

MR. SCHOBEL: I will make a few comments and then open the session for questions from the floor.

It is interesting to observe that most actuaries have the pleasure of operating in an environment where they are regarded as the "experts." Most actuaries work for insurance companies and pension consulting firms, and there is not anyone else buzzing around saying, "We can make

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actuarial estimates, too." Even if there were such a group, the senior management people who have to use the actuarial numbers probably wouldn't listen to them. But actuaries in the government work in a very different environment from that, and it's difficult for most actuaries to appreciate how great the difference is.

I have a few observations on which the three panelists may like to comment. One is that in 1987 the Committee on Social Insurance of the American Academy of Actuaries recommended that these government programs be overseen, in certain respects, by a board of independent actuaries who would not be under the control of the politicians who run government agencies. That recommendation seems to have fallen between the cracks somewhere. I wonder if any of the panelists would like to comment on whether that would be helpful to them or hurtful to them.

Second, Bob Myers made an observation about the possibility of a national health insurance program coming along in the next 5-10 years and taking the place of Medicare. It is very interesting to note that employers, who for many years have been very strong opponents of national health insurance, have been indicating recently that they might actually prefer national health insurance to the uncontrolled cost increases that occur under the present system and the mandated benefit plans of the type that Congress has been considering recently. So it may be that some of the strongest opponents will actually choose national health insurance, which is a very interesting turnabout.

Finally, last but not least, we have mentioned how the financial status of Social Security is measured, whether we should advance-fund for the cost of the baby boomers, and whether we should accumulate a very large fund and keep it at some giant size for all time to come as a form of national savings. My own observation of these issues may be different from that of the panelists. I try to look behind the Trust Fund at the underlying economic reality. In 1989, for example, American workers paid \$290 billion to Social Security, mostly in payroll taxes. Social Security will pay out about \$230 billion in benefits and administrative expenses. The difference, \$60 billion, gets invested in U.S. government bonds, but I am not convinced that it represents real savings. If you left that \$60 billion in the hands of American workers and their employers, you might actually have a better chance of having some of that money saved and resulting in some benefit to the economy. Ultimately, as far as the baby boomers are concerned, when we retire, the goods and the services that we are going to want to consume will have to come from the workers then. I am not sure how to store in my basement the food that I am going to eat or the electricity that I am going to use and all the other things, clothing and whatnot. It will all have to come from the workers in the year 2020 and 2030, and I am not sure that all of this paper shuffling in the Trust Fund is really accomplishing anything that has underlying economic reality. I wonder if any of the panelists would like to talk about any of these issues.

MR. KING: Since I am the only one here who is currently employed by the government, I guess that it is my place to talk about the independent board of actuaries. I've given a lot of thought to it and come to the conclusion that nobody, actuaries in particular, likes people looking over their shoulder. Obviously we can't get away from people looking over our shoulders and I would much rather have competent people looking over my shoulder than having incompetent people looking over my shoulder. So, after much soul searching, I have come to support the idea of creating an independent board of actuaries, although not without misgivings.

The addition of two public members to the Board of Trustees in 1983 was supposed to remove, or at least reduce, the level of politics in the functioning of the Board of Trustees. That is just like Congress, isn't it? They think there is too much politics involved in a certain function so they decide that they will fix the problem by interjecting more politics into it. Because the two people who are public trustees are politicians, the functions of the board have become more politicized by their addition, not less politicized. I would certainly hope that the actuaries who are appointed to look over our shoulders would be truly independent. I know that we do have some independent ones. One is sitting right next to me. So if some truly independent actuaries are to look over our shoulders, who aren't going to become captives of the political process, I would be all for it.

MR. MYERS: I cannot add to what Roland said about the independent board of actuaries. He said it very well. I would like to comment on the matter that Bruce mentioned, as to the number of large employers now favoring national health insurance. Another reason, besides the ones Bruce mentioned, is what the Financial Accounting Standards Board did by saying that the liabilities for postretirement health benefits should appear on the balance sheets of companies.

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The balance sheets of many companies would improve if there were a national health insurance system. There would be no liabilities on the part of the companies for postretirement health benefits. A lot of liabilities that they had would go up in smoke. There was a very good precedent for this some 50 years ago. The original Railroad Retirement Act was passed in 1934, but it was declared unconstitutional. President Roosevelt asked the railroad carriers and the railroad labor unions to get together to see if they couldn't agree on something that the carriers would not try to challenge in the courts. They worked out a package. One of the provisions which helped the carriers accept the Railroad Retirement System provided that the existing railroad pension plans, which were unfunded pay-as-you-go systems, would be taken over by the Railroad Retirement System and paid for and financed in the future by employer/employee contributions. All the liability that the railroads had for these pension plans would just vanish in the smoke. At the time they didn't have to include them on their balance sheets, but those liabilities were there. So the railroads got that, among other things, into the Railroad Retirement Act that was then passed and the constitutionality of which was not challenged.

MR. WILKIN: I have one comment on the independent board of actuaries. I can also see situations where they could be a good influence. It seems a shame that the time has come that they are felt to be needed. The Office of the Actuary, Social Security Administration, and the Office of the Actuary, HCFA, always operated as unbiased, giving unbiased estimates. It seems like a willing suspension of disbelief that after all those years of providing unbiased estimates, now people feel that they are biased and we need an independent board to oversee them.

MR. KING: I have a comment on the issue of national health insurance. The main emphasis for the business sector advocating national health insurance has been the rise, the acceleration, in health-care costs. Health-care costs are 11% of our GNP, and people expect them to be 15% of our GNP by the year 2000. If corporate America thinks that by placing the burden of financing health care on the federal government they are somehow going to escape that burden and it is somehow going to be brought under control, they should examine the experience with the existing program over the years. I would be all for national health insurance if I thought it were really going to affect our competitiveness with countries abroad. But we haven't seen that the federal government is capable of controlling health-care costs, and therefore I don't see any real benefits that we can gain from national health insurance right now.

MR. SCHOBEL: I believe that the government has done a very good job in controlling its costs for hospital benefits, but it is largely because the hospitals have been able to shift some of their losses on Medicare patients to other third-party payers. If there weren't any other third-party payers, if the government were the only payer, then we might see a lot of hospitals going broke. Do you agree with that?

MR. KING: Yes.

MR. EDWIN B. LANCASTER: I have a comment on the independent board of actuaries. I realize that the parallel that I am going to mention is a little simpler than Washington's, but the State of New York has a group known as the Actuarial Advisory Committee, which deals with all the actuarial aspects of the public employees retirement systems, which includes all state employees, except teachers, and all employees of municipalities except New York City. Of course, New York City has its own huge public employee retirement system. Some of you are familiar with this.

I have been a member of the Actuarial Advisory Committee now for about 13 years. The Committee is very effective, and I believe as a consequence that New York has probably one of the best funded of the state public employees' retirement systems. The controller of the State of New York uses this board of "independent senior actuaries" to fend off political thoughts in connection with the funding of the system. So, maybe this is simplistic for the Washington scene, but it has been very effective in New York.

MR. GERALD R. SHEA: I wonder whether, as a result of their very public misestimates, the CBO and some of the other more technically-oriented congressional staff members are becoming more sophisticated and trying to get advice from the people who could give them accurate advice or whether they are still going to produce the same sometimes random estimates that have apparently been coming out in the past? And have they learned anything from the experience?

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MR. KING: It is a little too early to tell if they have really learned anything from the experience. I can tell you that the analysts at CBO have become extremely aware (after all they are not irresponsible people) of this reputation they have developed for understating the cost of social insurance programs. Preliminary signs show that they may have actually gone overboard in the opposite direction, which is probably just as bad. With regard to your question, I might point out that turnover of CBO analysts has always been very heavy, at least among people who work on health issues. These people do not come from the private sector where they were doing similar work and when they leave the Congressional Budget Office are not going to go back to doing similar work. I don't mean to impugn their competence -- they all may be very competent in their field -- it is just they are not actuaries and they are not trained to do cost estimates.

With respect to the staffers who are in a position to put pressure on the CBO, in the past, a lot of those people had worked for the administration and went to work for Congress. That connection is gone now, and the turnover among congressional staffers who work on these issues is almost as great as it is among CBO staff. My observation is that those staffers who used to help the CBO correct their estimates aren't doing that anymore. They are not as numbers-oriented as the people who were there many years ago.

MR. JAMES R. SWENSON: I want to thank the panelists for an excellent and very interesting presentation. I have a couple of comments and then a question for Roland. I think that this would be an excellent time for the Society and the Academy Committees on Social Insurance to underscore the importance of the independence of the actuary and the use of the actuary in making public policy decisions. The facts that Roland has presented really underscore the need for competent actuarial advice, and Roland should be commended for hanging in there. But, I do think that it would be appropriate for both the Society and the Academy to issue a statement to the effect that they are very supportive and recommend that actuaries and the independent board of actuaries be the first source for advice for public policy decision-making. I think that just outlining facts as Roland outlined them today supports that position, which was very useful.

My second observation is that Social Security does have a major impact on saving. In fact, the entire fiscal policy of the federal government has a tremendous impact on saving, and it is a tremendous net dissaver since it is spending far more on government programs than is being collected by the Internal Revenue Service. The Social Security program seems to be one area where some additional revenues can be generated.

The question for Roland relates to Catastrophic. As a representative of an insurance department with a number of representatives in this room of Medicare supplement writers, I was wondering when the conferees are going to finally make a decision as to what is going to happen with Catastrophic care, because basically those writers of Medicare supplement policies, and we regulators, are waiting and are prepared to move promptly. But, the closer we get to January 1, 1990, the more difficult it will be to bring those policies into compliance with whatever changes are going to be made.

MR. KING: I am very sympathetic to that problem. I have received calls from actuaries all over the country who want to know the same thing and right at this moment I cannot give you an answer. When I came here, all I knew was that the conferees on the House side had been chosen, but the conferees for the Senate side had not even been chosen yet. I would imagine that one of the reasons for them putting it off like this is, having been once burned, they would like to go back and put their ears to the ground to find out what their constituents think before they decide what to do in Congress. I wish I could tell you that it was going to be sooner, but I don't know that it is going to be.

MR. RICHARD S. FOSTER: I would like to elaborate on a point that Bruce made. He indicated that he wasn't entirely sure that the excess of income over outgo as national savings was as effective as it would be in the hands of the workers and employers. That is really an economics question, as to what the effect is. I think that probably everybody knows the standard line. If you took all the economists in the world, they still wouldn't reach a conclusion. This is in fact one case where a great majority of economists agree that this current excess or surplus in Social Security, which is invested in Treasury securities and lent to the rest of the government, is then spent because we have an overall budget deficit. They generally agree that this does not contribute in any way to the national savings as long as we have an overall deficit.

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Bob Myers said that he would rather see us go back to current-cost or pay-as-you-go financing to avoid the financial and political pressures that will occur in the future. I would like to see us go back to pay-as-you-go financing, too, but for a different reason. We have the appearance today that we are doing something important: accumulating assets to cover the costs of the baby boomers' retirement. You can read newspaper articles and editorials, and everybody agrees that we need to keep the surplus because it will be necessary to help pay for the baby boomers. But, as we have already said, the actual excesses of income over outgo are lent to the rest of the government. Social Security gets an IOU that amounts to an important right to future government revenue, but that's all. So after the turn of the century, once the baby boomers retire and receive Social Security benefits, we will have to start drawing down the assets. Where will the money come from? The government doesn't have extra dollar bills lying around. The government will have to collect money from some other source and give it to the Trust Fund to pay benefits. Those other sources would be further borrowing or new tax revenue.

Imagine if you will that some worker under Social Security today agrees to pay a little higher tax rate than is necessary in order to help provide for the cost of the baby boomers retiring. I would be willing to do that, even though the tax rate is higher than normal. After the turn of the century, this fellow retires, and we say, "Look, we are running a big federal budget deficit because we have to pay back all these bonds held by Social Security. We are going to have to raise general income taxes to cover the redemption of assets, so you Mr. Retired Baby Boomer have to pay a higher income tax than you otherwise would have to help pay for this." He would say, "I already did that; I already paid higher payroll taxes. What's going on?" A lot of us will still be around then who are going to have to explain why it was that way back in the 1980s when the public thought that it understood the issue.

So my major complaint to current-cost financing is that, instead of misleading, we should be doing something meaningful to pay for the baby boomers. We are facing an overall budget deficit.

MR. SCHOBEL: This is a rather notable example of two people whose heights differ by more than a foot seeing eye to eye! Any other comments from anybody?

MR. THOMAS F. WILDSMITH: I would like to follow up on that. Another question is: What is the government doing with the money it is spending? There is a difference between the government spending the money on current consumption and the government using the money in a fashion that can be characterized as societal investment. If the government were spending the money in a manner that was building the infrastructure of the nation and enhancing the ability of the nation 40 and 50 years from now to produce more than it could otherwise, I think in that case we really would have an increase in savings in a very real sense. We would be doing something significant to fund the benefits of the baby-boom generation. I think what is unfortunate is that, at least in my opinion, the government is not spending money in a way that could be characterized as investment in the health or future ability of the economy to produce.

MR. MYERS: The problem here is that one can never be sure what would have happened if something had been done differently. The difficulty is that the \$60 billion excess this year of income over outgo of the Social Security system is going to the general fund of the Treasury, and you can't say just what that money is spent for. There is no possible way. It is all dumped into the fund and once it is in there, you can't say how the money is going out any more than when you have a savings account in a bank. You can't say what the bank does with the money you put in the savings account. It certainly doesn't hold it there in dollar bills, it lends it out to various people. Some of the people might say it's fine, they are doing productive things with the money. Others might not agree.

What also is an unanswerable question is, if Social Security this year were on a pay-as-you-go basis and instead of having \$60 billion of excess income over outgo had \$5 or \$10 billion, where would that other \$50 billion of debt come from? Would the government have spent less if it couldn't have borrowed the money that easily? If there was the same amount of spending, where would they have borrowed that \$50 billion? You just can't say in this world, because unlike in the field of chemistry, you can't do the same experiment several times over using just slightly different ingredients.

MR. KING: That was a very thoughtful comment, and Bob's response was very thoughtful too, but I would add that I think we can determine that most of the federal government's spending does go

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for current consumption rather than for something that will increase productivity in the years hence. Virtually all of the Medicare program, the Social Security program, Medicaid, and the defense budget go for current consumption. That is a very large part of the federal budget right there, and I think we can conclude that little of what the federal government lays out actually goes into the type of expenditure that could be considered a capital expenditure.

MR. SCHOBEL: To add to that, it is important to note that if the federal government did not collect that \$60 billion in 1989, the entire \$60 billion would not be put back into the hands of the individuals who might spend it. Exactly half of that money would be put into the hands of American businesses, which have a pretty good record of investing money and using it productively.

