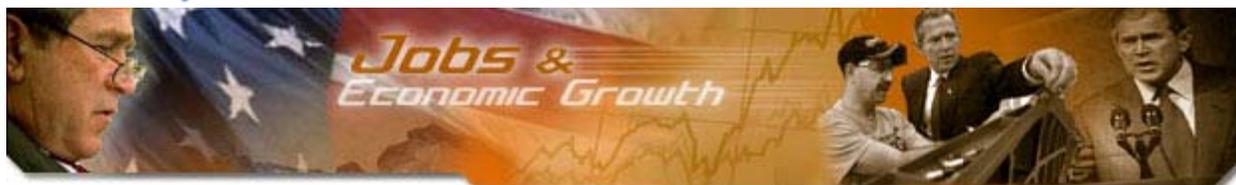




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President Discusses Budget, Tax Relief at White House Conference

Ronald Reagan Building and International Trade Center
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[In Focus: Economy](#)

9:32 A.M. EST

THE PRESIDENT: Thank you all. (Applause.) Thank you all for coming. Last night I had the honor of attending a reception for those who have participated in these series of panels, and I had a chance to thank them. I said something I think is true, which is, citizens can actually effect policy in Washington. In other words, I think people who end up writing laws listen to the voices of the people who -- and can be affected by citizen participation. So I want to thank you all for doing this.



VIDEO Multimedia

President's Remarks

 [view](#)

We're talking about significant issues over the course of these couple of days. We'll talk about an important issue today, which is, how do we keep the economy growing; how do we deal with deficits. And I want to thank you all for sharing your wisdom about how to do so.

One thing is for certain: In all we do, we've got to make sure the economy grows. One of the reasons why we have a deficit is because the economy stopped growing. And as you can tell from the previous four years, I strongly believe that the role of government is to create an environment that encourages capital flows and job creation through wise fiscal policy. And as a result of the tax relief we passed, the economy is growing. And one of the things that I know we need to do is to make sure there's certainty in the tax code -- not only simplification of the tax code, but certainty in the tax code. So I'll be talking to Congress about -- that we need to make sure there is permanency in the tax relief we passed, so people can plan.



If the deficit is an issue -- which it is -- therefore, it's going to require some tough choices on the spending side. In other words, the strategy is going to be to grow the economy through reasonable tax policy, but to make sure the deficit is dealt with by being wise about how we spend money. That's where Josh comes in -- he's the -- as the Director of the OMB, he gets to help us decide where the tough choices will be made. I look forward to working with Congress on fiscal restraint. And it's not going to be easy. It turns out appropriators take their titles seriously. (Laughter.)

Our job is to work with them, which we will, to bring some fiscal restraint -- continue to bring fiscal restraint -- after all, non-defense discretionary spending -- non-defense, non-homeland discretionary spending has declined from 15 percent in 2001 to less than 1 percent in the appropriations bill I just signed, which is good progress. What I'm saying is we're going to submit a tough budget, and I look forward to working with Congress on the tough budget.

Secondly, I fully recognize, and this administration recognizes, there -- we have a deficit when it comes to entitlement programs, unfunded liabilities. And I want to thank the experts, and the folks here, who understand

that. The first issue is to explain to Congress and the American people the size of the problem -- and I suspect Congressman Penny will do that, as well as Dr. Roper -- and the problems in both Social Security and Medicare.

The issues of baby boomers like us retiring, relative to the number of payers into the system, should say to Congress and the American people, "We have a problem." And the fundamental question that faces government, are we willing to confront the problem now or pass it on to future Congresses and future generations. I made a declaration to the American people that now is the time to confront Social Security. And so I am looking forward to working with members of both chambers and both parties to confront this issue today before it becomes more acute.



And by doing so, we will send a message not only to the American people that we're here for the right reason, but we'll send a message to the financial markets that we recognize we have an issue with both short-term deficits and the long-term deficits of unfunded liabilities to the entitlement programs.

And I want to thank the panelists here for helping to create awareness, which is the first step toward solving a problem. The first step in Washington if you're interested in helping is to convince people that there is a problem that needs to be addressed. And once we have achieved that objective, then there will be an interesting dialogue about how to solve the problem.

I've got some principles that I've laid out. And, first, on Social Security, it's very important for seniors to understand nothing will change. In other words, nobody is going to take away your check. You'll receive that which has been promised. Secondly, I do not believe we ought to be raising payroll taxes to achieve the objective of a sound Social Security system. Thirdly, I believe younger workers ought to be able to take some of their own payroll taxes and set them up in a personal savings account, which will earn a better rate of return, encourage ownership and savings, and provide a new way of -- let me just say, reforming -- modernizing the system to reflect what many workers are already experiencing in America, the capacity to manage your own asset base that government cannot take away.

So with those principles in mind, I'm open-minded -- (laughter) -- with the members of Congress. (Laughter and applause.)

Anyway, thank you all for coming. I'm looking forward to the discussion.

DIRECTOR BOLTEN: Mr. President, thank you. Thank you for convening us. It warms my budget heart -- (laughter) -- that you've taken the time to come and talk about fiscal responsibility, which is so important, especially at this time. We've come through some tough years, Mr. President, during your tenure.



As you entered office the economy was entering recession, we had the attacks of 9/11, we've had the war on terror, we've had corporate scandals that undermined confidence in the business community. All of those, together, took a great toll on our economy, and especially on our budget situation, as you mentioned. And we've started to turn it around. The economy is well out of recession, it's growing strongly, as I think our panelists will talk about. And as a result of that we are seeing a dramatically improving budget situation.

We originally projected our 2004 deficit to be about 4.5 percent of GDP, and when we got the final numbers just a few weeks ago, it was down to 3.6 percent of GDP, a dramatic improvement. Now, that's still too large, but it's headed in the right direction. You mentioned, Mr. President, the 2005 spending bills that you just signed last week. I think those have to be regarded as a fiscal success, because you called on the Congress almost a year ago to pass those spending bills with growth of less than 4 percent overall, and especially to keep the non-national security related portion of that spending below 1 percent, and they delivered. And that's the bill that you signed just last week. We're working now, Mr. President, as you know, on the 2006 budget. And I'm hopeful that

we will keep that momentum of spending restraint going.

What I think we will be able to show when we present your budget, about six or seven weeks from now, is that we are ahead of pace to meet your goal of cutting the deficit in half over the next five years. And I think that's very important. And I think our panelists will talk a little bit about why that is.

So let's step back a little bit from the Budget Director's preoccupations and talk more broadly about the economy. Our first panelist is Jim Glassman, who is senior U.S. economist at JP Morgan Chase. He's a frequent commentator in the financial press; I think well-known in the financial community.

And Jim, let me open it with you and ask you to talk about how the budget situation is related to the economy overall, because that's really what people care about.

MR. GLASSMAN: All right. Thanks, Josh. Thanks, President Bush, for inviting us here to participate in this discussion. It's a privilege.

The federal budget is tied very closely to the fortunes of the economy. When the economy is down, revenues are down. When the economy comes back, revenues come back. In the last several years, we've seen that link very closely. The economy slowed down, revenues dried up, the budget deficit widened. It's happened many times before. And in Wall Street, Wall Street understands this link between the economy and the budget, and that's why -- we anticipate that these circumstances are going to be temporary, and that's why long-term interest rates today are at the lowest level in our lifetime, even though we have a budget deficit that's widened.



And in fact, now, with the economy on the mend, the revenues are coming back, and the budget deficit appears to us to be turning the corner. So I think the prospects are looking quite good for the budgets going into in the next several years.

Now to me, the link between the economy and the budget tells you there's an important message here, and that is: Policies that enhance our growth potential are just as important for our long-run fiscal health as are policies to reform Social Security and health care reform. We know how to do this, because over the last several decades, we've been reforming our economy -- deregulating many businesses, breaking down the barriers to trade. And it's no surprise that countries all around the world are embracing free market principles. Free markets is the formula that has built the U.S. economy to be the economic powerhouse that it is.

Now, I realize the last several years have been challenging for a lot of folks, and it's hard for folks to step back and appreciate the amazing things that are going on in the U.S. economy when they're struggling with this, with the current circumstances. But I have to tell you, what we are watching around the U.S. economy is quite extraordinary, and I would like to highlight two things in particular that are important features of what's going on in the U.S. economy, because it tells us -- that basic message is it tells us that we're on the right paths, and number two, it tells us how we might build on the policies that are helping to encourage growth.

The first important observation: productivity. Productivity in the U.S. economy is growing almost three times as fast as the experts anticipated several years ago, a decade ago. Now, we know why that's happening: Economic reform has strength competition; the competition has unleashed innovation; that innovation is driving down the cost of technology; and businesses are investing in tools that allow us to do our jobs more efficiently. Why that's important? Because most of us believe that what's driving this productivity is information technology.

Now, in my mind when we're at an extraordinary moment like this with rapid changes in technology, it opens up a lot of frontiers. Who is it that brings that technology and creates growth? Who is that drives the economy? It's small businesses. That's where the dynamic heart of the economy is. And so policies that focus on making the business environment user-friendly for small businesses, like the tax reform, are an important element of building on this productivity performance that's going on, and building on the information technology.

Second important aspect of what's going on in the U.S. economy -- everybody knows we faced an incredible number of shocks in the last several years. These shocks, which, by the way, destroyed almost half of the stock's

market value in a short period of time, for a moment, were potentially as devastating as the shocks that triggered the Great Depression. And yet, the experts tell us the recession we just suffered in the last several years was the mildest recession in modern times. That tells you something about the resilience of the U.S. economy. It tells you that we have a very flexible economy to absorb these kinds of shocks. And I personally think that this is the result of a lot of the reforms that we've been putting in place in the last several decades. It has made us much more resilient.

I find this an even more incredible event because when you think about it, we had very little help around the world. The U.S. economy was carrying most of the load during this time. Japan, the number two economy, was trapped by deflation. Many of our new partners in East Asia have linked the U.S. economy, and they're depending on their linkage with the U.S. economy to bring -- in hopes of a better future. The European region has been very slow growing. They've been consumed by their own problems. So, frankly, we've been in a very delicate place in the last several years; the U.S. economy was the main engine that was driving this. And yet, we had this incredible performance. I think it's quite important.

Now, when you ask economists to think about the future, where we're likely to go, it's very natural -- the natural tendency is to believe that we're going to be slowing down eventually -- and we can give you all kinds of reasons why this is going to happen -- demographics, productivity slows down. My guess is we would have told you this story 10 years ago, 20 years ago, 100 years ago.

And I think what's quite incredible -- I'm, frankly, somewhat skeptical of this vision that we all have, because, if you think about it, we've been growing 3.5 percent to 4 percent per year since the Civil War. If we can match that performance in the next 50 years -- and I don't see why that's so hard to do, given the kinds of things we are discovering about our economy and the kinds of benefits we see from all this reform -- then I think the fiscal challenge that we see in our mind's eye will be a lot less daunting than is commonly understood.

So, of course, I don't want to say that growth can solve all our problems. It won't. There clearly are challenges on the fiscal side, and it's important that we strengthen the link between personal effort and reward. And that's why it's right this forum should be focusing on Social Security reform and health care reform. Thank you.

THE PRESIDENT: May I say something?

DIRECTOR BOLTEN: Mr. President. (Laughter.)

THE PRESIDENT: Thank you. (Laughter.) Who says my Cabinet does everything I tell them to? (Laughter.)

You know, it's interesting, you talked about the Great Depression, and if I might toot our horn a little bit, one of my predecessors raised taxes and implemented protectionist policies in the face of an economic downturn, and as a result, there was 10 years of depression. We chose a different path, given a recession. We cut taxes and worked to open up markets. And as you said, the recession was one of the shallowest.

And the reason I bring that up is that wise fiscal policy is vital in order to keep confidence in our markets and economic vitality growing. And that's one of the subjects we'll be talking to Congress about, which is wise fiscal policy. And that is the direct connection between the budget and spending and confidence by people who are willing to risk capital, and therefore provide monies necessary to grow our job base.

DIRECTOR BOLTEN: Mr. President, let's talk a little bit about how investors see those issues that you and Jim Glassman have just been talking about. Liz Ann Sonders is chief investment strategist to Charles Schwab and Company. She's a regular contributor to TV and print media on the market issues that investors care about.

And Liz Ann, let me just open it to you and ask you, how do investors see those broad macroeconomic issues that Jim was just talking about?

MS. SONNERS: Thanks, Josh. Thanks, Mr. President. I do spend a lot of time out on the road talking to individual investors. And I will say that the deficit issue is probably, if not the number one, certainly in the top three questions I get. I think there is a terrific amount of misunderstanding, though, about the nature of deficits, how you get there, how do you get out of a deficit situation, the cause and effect aspects of it, and I'll talk about that in a

moment.

And we know that higher deficits are a burden on future taxpayers, but I think what, in particular, the market would like to see is the process by which we go about fixing this problem. And I think the markets are less concerned about the number itself and don't have some grand vision of an immediate surplus, but the process by which we solve that problem.

There's a lot of ways to do that. It is all about choice. And certainly, there's one theory, that the only way to solve it is to raise taxes. I don't happen to be in that camp, and I would absolutely agree with Jim and certainly with this administration that the policies absolutely have to be pro-growth.

And I think the other benefit that we have right now, and Marty Feldstein talked about this yesterday, the difference between the Waco Summit and this conference today as representing a very strong economy right now versus a couple of years ago. And what that allows you to do is have this much stronger platform from which you can make a sometimes tougher decision. And I think that's a very important set of circumstances right now. I would agree with Jim, also, at the bond markets perception of this, the fact that long-term interest rates are low so we have at least have that camp of investors telling you that maybe the risks aren't quite high as some of the pessimists might suggest.

Forecasting is also difficult. I know your Administration suggested that going beyond five years is a tough task. And it is. The market, however, builds itself on making forecasts for the future, and often times will develop a consensus about something, and I will say that I think the consensus is one maybe of a little bit -- maybe not pessimism, but not a lot of optimism from a budget deficit perspective. So, I think the opportunity comes with showing some effort. And you can really turn the psychology of the market very, very quickly under a circumstance where maybe market participants are actually pleasantly surprised by the turn of events.

Typically, when you look back in history, and you look at processes by which we've improved a deficit situation, those that have been accompanied by better economic growth have typically been those where the focus has been on spending restraint, entitlement reform. Those times where we have improved the deficit, but it's been in conjunction with weaker economic growth are typically those periods where tax increases have been the process by which we have gotten there.

And I also think that many investors misunderstand the relationship between deficits and interest rates, and there is a theory building now that higher deficits automatically mean higher interest rates. Well, case in point, it's just the most recent experience, but we can even go back to the late '90s -- the reason why we went from deficit to surplus was because the economy was so strong. Because the economy was strong, the Federal Reserve was raising interest rates, the reason why we went into deficit was because the economy got weak, which is the reason why the Federal Reserve had to lower interest rates. So you have to understand, again, the cause and effect here.

The path of least resistance, of course, is to make everybody happy. But something has to give. You've all talked about this, the "no free lunch" idea. But I'm just a strong believer that entitlement reform and long-term priorities take precedent right now over short-term fixes, certainly if it required tax increases. And I think that, Mr. President, you talked about having political capital, I'll go back to this idea that we now have economic capital that allows us to not disregard the short-term fixes for the deficit here, but really take this opportunity for long-term structural reform.

I'm a big believer in personal accounts, empowering investors. My firm built by "the Man," Chuck Schwab, is all about empowering individual investors. And I think these long-term adjustments that need to be made, which is really a part of this whole conference, are so important right now. And I think that's absolutely what the market wants to see.

Thanks.

THE PRESIDENT: Good job. You're not suggesting that economic forecasts are as reliable as exit polling, are you? (Laughter.)

MS. SONNERS: I'm not going there. (Laughter.)

DIRECTOR BOLTEN: Mr. President, I'm going to move on. (Laughter.) I'm glad that Liz Ann raised the distinction, as you did in your opening remarks between our short-term picture and our long-term picture. Our short-term picture is, indeed, looking a lot better. I think we'll be able to show a very clear path toward your goal of cutting the deficit in half over the next five years. But the long-term picture is very challenging. We're very honored to have with us Tim Penny, who is a professor and co-director of the Hubert Humphrey Institute of Public Affairs. He's also a former Democratic Congressman and an expert on a lot of the long-term issues we're talking about.

And, Congressman, let me turn it over to you and ask you to talk a little bit about what are these entitlement programs, and why are they important for our long-term budget picture?

CONGRESSMAN PENNY: Well, I think -- thanks, Josh, and Mr. President. I think the first thing to note is that the long-term picture is rather bleak, that the status quo is unsustainable. And when you talk about the difference between discretionary and entitlement spending, that tells the story.

Discretionary spending, as you referenced earlier, is the part of the budget that we control annually. It comes out of the general fund; it's education, it's agriculture, it's defense, it's a whole lot of stuff that we think about as the government.

But the entitlement programs are those that are on automatic pilot. They're spelled out in law and the checks go out year in and year out, based on the definitions in law. So if you're a veteran, you're entitled to certain health care benefits under this system. If you're a farmer and you grow certain crops, you're entitled to subsidies. There are some that are means-tested. In terms, we give them to you only if you need them; and that's where our welfare programs and much of our Medicaid spending comes into play. And then there are the non-means tested entitlement programs, and among those are Medicare for the senior citizens and Social Security for senior citizens. So, they're age-based programs.

And those entitlement programs are the biggest chunk of the federal budget. I think it's constructive to look back over history. In 1964, all of these entitlement programs, plus interest on the debt, which is also a payment we can't avoid, consumed about 33 percent of the federal budget. By 1984, shortly after I arrived in Congress, they consumed 57 percent of the federal budget, and today they consume 61 percent of the federal budget.

Now, let's look forward a few decades and see where we're going to be with entitlement spending. By the year 2040, just three -- well, actually four of these sort of mandatory programs are going to eat up every dime -- income taxes, payroll taxes, all other revenues that we collect for the federal government: Medicaid, Medicare, Social Security and interest on the debt will eat up everything. There won't be a dollar left in the budget for anything else by the year 2040. That tells you the long-term picture, and it is bleak. So something has to give. Doing nothing is not an option.

Let's look at Social Security alone. And this is something that my colleague, Mr. Parsons, will speak to in a few minutes. There are huge unfunded liabilities here. We haven't honestly saved the current Social Security trust fund. Even though extra payroll tax dollars are coming in each year, they're not honestly being set aside for this program. Just by the year 2040, there's about \$5 trillion of unfunded liability in that program. Now, we've got to come up with the money somehow to replace those promised dollars. And it's no easy task. And I know that a million, a billion, a trillion sort of gets lost on the average listener, so I always like to explain that if you're looking at a trillion dollars, just imagine spending a dollar every second, and it would take you 32,000 years to spend a trillion dollars. So even in Washington, that's big money. (Laughter.) Or as we say in farm country, it's not chicken feed. (Laughter.)

So the other way you can look at this is your Social Security statement comes in the mail every year, and it gives you some sense of your promised benefits in the Social Security system. But on page two of this statement, there's an interesting asterisk. And the asterisk says, "By about the year 2040, we're not going to be able to pay you all of the benefits that we're promising you. We're going to be about 25 percent short of what we need to pay those benefits." So, what does that mean we would have to do if we wait until the last minute to fix this program? We'd either have to cut benefits dramatically, or we'd have to impose the equivalent of a 50-percent payroll tax increase on workers to get the money into the system to honor the promised benefits.

So huge benefits cuts or a huge tax increase -- I don't think that's where we want to go, especially since 80 percent of Americans now pay more in payroll taxes than income taxes. I don't think that's a solution that they're

going to applaud. But, frankly, it is the kind of solution we're left with if we wait too long to fix the mess. We waited too long 20 years ago. When I first arrived in Congress in 1983, we had a Social Security shortfall. We were borrowing money out of the Medicare fund to pay monthly Social Security checks. So what did we do, because we were already in a crisis? We cut benefits by delaying cost-of-living adjustments; we cut benefits by raising the retirement age, first to 67 and -- 66, and ultimately to 67; and we increased payroll taxes, significantly, during the 1980s. And so we basically said to future workers, based on that legislation in 1983, you're going to pay more and get less.

I mean, to me, that's the problem with waiting until the last minute to fix this, is that you give people a worse deal. So my view on this is that, for the long-term -- we can't wait until the crisis hits to address the issue. We have to look at these challenges now and give the next generation a better deal. And if we plan ahead and plan appropriately, we can do that.

So we need to act before it's too late. And then I think we send all the right signals, and we do a better deal for younger workers than -- sort of the same old, cut benefits raise taxes, a solution that's been imposed in the past.

THE PRESIDENT: I appreciate that. I think the issue has shifted. I think there are more people now who believe they'll never see a check than people are worried that they'll have their check taken away. And I think it's important for Congress to understand that. And my attitude is, exactly like Congressman's, and that is, is that now is the time to deal with it. And it's going to be very important that we reassure our seniors who depend upon Social Security that nothing will change as -- and that's been part of the political problem. And any time anybody mentioned the word, Social Security, the next thing that followed was -- yes, he's saying that because he's going to take away your check. And really what we're talking about is a new generation. I appreciate you pointing that out, Tim.

CONGRESSMAN PENNY: If I can just add this one point, if we had saved these surpluses honestly in personal accounts over the last 20 years, we'd be well on the way to fixing this problem by now. And so we may be a little late in getting this done, but it's still important to move in that direction.

THE PRESIDENT: Thank you.

DIRECTOR BOLTEN: Somebody who's been directly involved in -- and a leader in trying to formulate a solution for the Social Security problem is Dick Parsons, who is CEO and chairman of TimeWarner. And he was chairman of the President's commission on Social Security, co-chair with late Senator Patrick Moynihan, whom I know we all miss at this time.

Mr. Parsons, we're grateful that you're here, and I wonder if you would follow on Congressman Penny's remarks and talk a little more specifically about your commission's work, what problems you saw, what solutions you saw.

MR. PARSONS: Thank you, Josh, Mr. President. The President said earlier that we have to recognize that we have a problem with Social Security. I think everybody does. And I don't know that they share the urgency that Tim just spoke to, and the President just spoke to, or really understand the nature of the problem. So, let me take a step back and talk about -- approach it from a slightly different angle, talk about what is the problem with the Social Security system, which was created in 1935 as what they call a pay-as-you-go system.

Now, most people here know that, but it was amazing to me when we had our Social Security Commission, they were all around the country, we had a number of public hearings, and the people would come and say, "Well, what are they doing with my money?" Well, what most people didn't know is they were taking your money that you pay in every day, or every week when you get a paycheck, and within a very short period of time it's going out the other door to pay benefits, pay-as-you-go -- money comes in, it goes out to pay the benefits.

Now, that system was created at a time when for every person who is eligible to participate, retirees, let's call them, there were 40 people in the work force. There were 40 people working to support one. It was also created at a time when the average life expectancy for males was such that the average man would not live to see the day that he could qualify for Social Security. So, you would pay in -- and the system was built in part -- this is not cynical, this is just fact, on the notion that half the people who paid in would never get anything out because they would be dead.

So, where are we today? Today there are three people in the work force for everybody who's eligible for Social Security. Today life expectancy is expanded anywhere from five to seven years, depending on gender, since the time the system was created, so that the great majority of people who participate will live to see benefits. The fastest growing part of our population is 85 and up. So, we have a totally different set of circumstances that we're dealing with. And it's only going to get worse in the sense of -- or more distant from the way the situation that existed when the system was created. By the year 2020, you'll have two people in the work force for every person eligible to receive benefits. And life expectancies will be even greater then.

So the whole factual basis that underlies this pay-as-you-go system has changed. And what happened is, and Tim mentioned, that we have huge underfunded shortfalls in the system. If you -- they usually do this on an actuarial basis out 75 years. If you look out 75 years and say, how

much does the system promise it will pay, and you look out 75 years and say, under the existing tax scheme, how much money are we going to be able to have to pay it, in current dollars, in actual dollars, it's about an \$11 trillion to \$12 trillion shortfall over 75 years. If you roll that back into the current dollars and you say, what would it take today to close that, it's about \$4 trillion. So that's the problem.

The problem is we've promised more than the revenues that we have, or that we can look to, to pay. So what's the solution? The traditional solutions are, as Tim just indicated, either we increase the taxes so you get more revenues in, or you decrease the benefits so you get less money out. The problem with that is it's a BAND-AID. And given these demographic shifts that we're talking about that we see, it simply can't last. You might be able to put one more BAND-AID on the wound and patch us over for another five or six years.

But for example, some people say, why don't you just lift the wage cap? Only the first \$90,000, as of the beginning of the year, is subject to Social Security taxes. Well, even if you eliminate the wage cap, that only buys you four, five, six more years, and then you're back in the same problem. We have to face up to the fact that the country is in a different place than it was when this system was created. And the fix needs to be structural. It needs to be fundamental. We need to change the architecture of Social Security.

And what I mean by that is we gradually have to move from a system that is based on a pay-as-you-go basis when you had 40 people in the work force for everyone not, to a system that is on a fund-as-you-go basis, where people can begin to start to fund and put away the money that they will look to in their later years for their support and sustenance.

Now, this is not unprecedented. This is exactly what's happened in the business world. Every corporation in America, mine included, has been engaged over the last 20, 25 years in a migration from pay-as-you-go kind of pension arrangements, to funded arrangements. Now, nobody has gotten there -- very few have gotten there -- probably Charles Schwab has gotten there -- in terms of fully funded arrangements right now. But putting the money away now to pay liabilities in the future. This is what private accounts is all about. And that's why the Commission came down recommending in all of the options that we put forward, private accounts. It's the beginning of shifting from complete pay-as-you-go to starting to fund some of our future liabilities now.

And that's -- at the end of the day, while the government is, in law and in sort of a forced social reality, a different entity than the business community, economically, it's not. Economically, it's going to have to step up to the same reality that business had to step up to, that we can't continue a system that puts a huge burden on future generations that they're not going to be able to meet. We're going to have to start saving and funding our responsibility to ourselves on a current basis.

And that's why we made private accounts as a beginning step -- this is not privatization of Social Security. What it really is, is -- and again, this isn't unprecedented; this is what business has done -- it's beginning to have a hybrid system where you have a floor, a base, below which no one can go that is funded on what they call a "defined benefit" basis -- that you will get this money, this minimum amount of money, no matter what. But then you have an ability above that to enhance that on a defined contribution basis -- i.e., you put money away now, invest it wisely, and it will come back to you and give you an even better standard of living in a future time.

So that's essentially the nature of the problem and why we thought that it was time for structural, architectural change to Social Security, not just tinkering. You can't -- you know, tinkering can't work anymore. The demographics -- this was Pat Moynihan's point. He would say, demography is your destiny. We just can't do what

we've done in the past any longer. We've got to do something different, and this was an idea that made sense.

DIRECTOR BOLTEN: Mr. President, you mentioned that for current seniors, this is not a debate for them, that those at or near retirement, this discussion that's going on now, should not affect what they -- what they've been promised and what they can expect to get. It's the next generations that this is debate -- that this debate is about, and who should be concerned about it. You mentioned, Mr. President, that a lot of the next generation doesn't think that there will be benefits there for them.

Sandy Jacques is somebody, obviously, from that younger generation. She's a single mom from West Des Moines, Iowa, and she's active in a group called, Women for Social Security Choice. And Sandy, let me ask you to speak for the -- speak for regular folks and younger regular folks -- (laughter) -- and tell us why you got involved in this organization, why are you active on Social Security issues?

MS. JACQUES: Sure, Josh. Well, I think the President stated it the best when he said, most people in my generation believe that we're more likely to never get a benefit than to have our check taken away from us. I guess it would be nice to get to the point where we had a check and then we're worried about it being taken away.

So I guess I'm here because I want to make sure that we do get to the point where my generation retires and we do have Social Security around and intact for us. But more importantly, as you mentioned, I have a daughter at home. Her name is Winter; she's 10 years old. And I want to make sure that she has Social Security when she retires, as well.

And I believe that the only way to really get to that point is with personal retirement accounts. They're really the only way to update or modernize Social Security in a real way without tinkering it, as Mr. Parsons talked about and as Congressman Penny when they were in Congress, because then you only resort to a tax increase or benefit cut. With personal retirement accounts you have money in an account and that money is allowed to grow, and it's that growth that actually will help to fix Social Security for future generations.

Without that, if we wait, we will have to resort to raising payroll taxes or cutting benefits like they did in the '80s. To speak to raising payroll taxes on a personal level, I can't afford a payroll tax increase. In fact, I think I definitely pay more than enough right now, and that's another reason why I support Social Security reform. I am not one of these young people that is willing to give up on that money I'm already paying into the system. I want to see the system fixed so that I can get that money back when I retire.

And as Tim mentioned, by 2040 -- I actually retire in 2044 -- unless the retirement age is raised again, but in 2044 we're already at the point if we do nothing, I will get 25 percent less than what I should get under the current system right now. So, that is why this issue is very, very important to me.

But I also want to talk about current seniors right now. My grandma is already retired, my dad actually plans to retire next year, and my mom a couple years after that. It's very important to me to make sure that their benefits remain intact for them. It's too late for them to invest in a personal retirement account. But because of that we need to make sure that we guarantee their benefits through their retirement, because it's something that they've been relying on. And it's, I think, our duty to make sure that we make sure that happens.

But at the same time, I also think it's the country's duty to make sure that we fix Social Security now so that it's around for when future generations retire because personal accounts are really the only way to give us retirement security in the future for me, and more important, my daughter. Because if I am faced with a 25-percent benefit cut when I retire they may be looking at raising payroll taxes on my daughter and younger generations at that time. So really, that's why this is very important to me, Josh.

THE PRESIDENT: You know, one of visions of personal savings accounts is that Sandy will be able to pass her account on to Winter as part of Winter's capacity to retire, as well. It is a novel concept, clearly different from the current system where you don't pass anything on.

MS. JACQUES: That's a great point. That's also very important to me because if you do get to the point where you're raising payroll taxes, or cutting benefits to make Social Security solvent at that time, you still don't own your benefits. With a personal account, you own the money that's in that account. And I'm sure Winter will be hoping that I have a very modest retirement so that there is some left for her -- (laughter) -- when I die. But -- so that's a

very important aspect, as well.

THE PRESIDENT: One of the things on personal accounts that listeners must understand is that you cannot take -- if a personal account, in fact, exists, you can't take it to the race track and hope to really increase the returns. (Laughter.) It's not there for the lottery.

In other words, there will be reasonable guidelines that already exist in other thrift programs that will enable people to have choice about where they invest their own money, but they're not going to be able to do it in a frivolous fashion, which will mean two things. One, it's more likely there will be a rate of return higher than that which is in the Social Security trust; and secondly, more likely to be actual money available when you retire.

DIRECTOR BOLTEN: Mr. President, we've been focused on -- principally so far on the retirement security of today's and future seniors. It's also very important that seniors have some security about their health care situation. And so we're privileged to have with us Dr. Bill Roper, who is Dean of the School of Medicine at the University of North Carolina, in Chapel Hill. And he's also head of the UNC health care system. Dr. Roper also served in a previous Bush administration as, among other things, as the head of the Medicare system. So he knows a lot about this stuff. And let me just ask Dr. Roper to bring us out of the retirement system and into the health care system, and tell us what are the challenges we face there, and what do they mean for our budget situation.

DR. ROPER: Thanks, Josh. And thank you, Mr. President. I think that is my role, is to say, remember health care; remember Medicare. Surely, the focus on Social Security is important, but there's this other large and, indeed, faster-growing entitlement program called Medicare. Just a few numbers to make the point: This year the Medicare program is one-eighth of the entire federal budget. Ten years from now, that's projected to be one-fifth of the federal budget. And by 20 years from now, Medicare will be larger than Social Security, so it will be the largest federal entitlement, under current growth rates.

Another point: This year, 2004, the trust fund that our payroll taxes go into that pays for hospital and related benefits in Medicare, more money is going out of that trust fund to pay for current needs right now for seniors and others in the Medicare program than payroll taxes are going into it. So the balance in the trust fund is beginning to go down, and it's projected to be entirely exhausted, under current spending patterns, by the year 2019.

All of that is driven by changing demographics. We're aging as a society and we have a more expensive health care system. Now, a lot of times we in the health policy community beat up on ourselves, saying that's a terrible thing that we're devoting so much to health care. I think it's important to point out that health care is something that we value tremendously as a society. The ability to spend so much on health care is part of our being a very healthy economy and a society that says, we want to invest in our health, especially to help seniors.

And many good things result from health care. A very careful study a few years ago by some economists showed that if you look carefully and count the costs and count the benefit that technology -- technological advances in health care are worth the cost. The benefits far outweigh the costs. And so we ought to continue to feel good about that, especially those investments in prevention that end up paying rich dividends down the line.

Projections about how much we're going to spend in Medicare is more difficult than the projections for Social Security. Everybody who is going to be a senior citizen 50 years from now has already been born. So we know how to project Social Security numbers. But we don't know what medical advances are going to occur, what new technologies, new treatments, new drugs, whatever, are going to be there. We don't know how much they're going to cost. Some will surely save money; some will cost more. The benefits there are substantial. But the simple point is, the growth rate for Medicare is unsustainable. We just can't devote the entire federal budget to health care.

So the question becomes, how do we constrain that growth? What do we do about it? And broadly speaking, we face two options. One is to do what Medicare has done over the last several decades, and I was there in the '80s and the '90s, and we put in place what are called, administered price systems, which is the government deciding how much to pay hospitals and how much to pay doctors, and running those systems so that we try to restrain the rate of growth to the extent possible.

The alternative, which many people, myself included, and you, sir, are advocating is a much greater reliance on

individuals and empowering them to make choices, helping them see the value of investing in preventive behavior, better health for themselves long-term, providing information on who are the quality health care providers so that people can make choices about where to go for themselves, and moving us towards a time when we will see head-to-head competition between alternatives to Medicare and the traditional Medicare program. The Medicare Modernization Act of last year took us important steps in that direction. But we have much more to do.

In general, we need to see that the philosophy of private accounts applies to Medicare just as we've been talking about Social Security. So we need to move towards more choices for individuals, more competition in market forces and health care, and more organized integrated care -- especially for people with chronic illnesses, because they're the ones who end up costing so much. If we can intervene early with preventive techniques, as I said, we can lower that rate of growth in spending and end up with a program that we value just as much as the one that we value today, but doesn't cost as much.

THE PRESIDENT: Thanks for mentioning the Medicare bill. One of the reasons I was strongly for it was because it did begin to interject a sense of choice for seniors into the marketplace. And secondly, it recognized that medicine has changed. And when you have a kind of a static system where government makes the decisions, it's hard sometimes to get bureaucracies to adjust to the reality. And the reason why I believe the prescription drug benefit was a vital component of a new and modern Medicare system was so that we could prevent hospital stays, for example, by the judicious use of prescription drugs. And Medicare -- I've said this a hundred times around the country -- Medicare would pay for hospitalization for a heart attack, but wouldn't pay for the prescription drugs the could prevent the heart attack from occurring in the first place, which didn't seem like a very cost-effective way to try to provide good health care.

And the reforms in the modernization program that we've got there has begun, I think, to address the inadequacies of Medicare as a result of decisions being made at the federal level. But you're right, we've got more to do.

DR. ROPER: A lot more to do, but it's a step in the right direction.

THE PRESIDENT: Thank you.

DIRECTOR BOLTEN: Mr. President, I want to bring our economists back in now, because we've heard about some daunting challenges in the Social Security system, in the health care system -- and let me ask Liz Ann first, what are markets and investors looking to the federal government to do at this point?

MS. SONNERS: Let me stay on Social Security reform from a minute. NBC/Wall Street Journal just had an interesting poll out this morning, that was reported showing about 50 percent of the surveyed population was not for private accounts. What I found more interesting was a little bit later in the report, there were more questions asked than just that, and there was another more general question asked about, if these same folks had the opportunity to put more money in the stock market, would they? And 80 percent said, yes.

So I think this goes back to this idea of a lot of misunderstanding, I think. One of the problems that we're dealing with now is because many in the Wall Street community very much believe in private accounts, there's this natural assumption that it must only be because Wall Street is going to be a huge beneficiary of these private accounts. And certainly what I think makes the most sense -- and the person for whom I work, Chuck Schwab, thinks makes most sense, is that you are very controlled. As you said, Mr. President, a thrift savings plan kind of program where your options are very limited, it's very index in nature. The fees are structured to be so minimal that in fact even the studies have show that under any set of proposals Wall Street doesn't make any money on this for another seven or eight years. I think there is this natural assumption that if Wall Street is for it, it must mean that they are going to be big financial beneficiaries of it.

I just think, again, it goes back to what I know you're a big supporter of, which is the democratization of the markets for individuals, putting more control in people's hands. And I think this, much like 401(k)s did as we moved from a benefit part of the non-Social Security retirement to more of a contribution style -- it's really been one of the reasons why net worth has gone up. And I think Sandy made some wonderful points about the power that that puts in your own hands. And the fact that you can actually pass it on to future generations makes all the sense in the world to me.

DIRECTOR BOLTEN: Liz Ann has focused on those personal accounts in particular. Let me ask Dick Parsons to say a little more in detail about what your commission concluded about personal accounts, and what's the right way to do this thing.

MR. PARSONS: Fair enough. The point I was making earlier is that we've got to migrate from an unfunded plan, right, that assumes there are always going to be enough people in the work force to take care of those who are not, to a funded plan where folks who are out of the work force have had a chance, over the course of their working lives, to take care of themselves.

Now, that can be done one of two ways. The government could do it. In other words, the government could hang on to the money and actually save it instead of spend it, or you could give people the power to do it on their own behalf. And after -- we went around the country, we talked to, literally, scores of people representing scores, and scores, and scores more. And clearly, I think, the sense of our fellow Americans and our sense as a Commission was, the better of those two choices is to begin to let people fund their own programs so that they, A, had a sense of ownership, of wealth creation. The object ought to be, at the end of the day, to put everybody in America in a place where, while the government is the place of last resort when everything goes wrong, there are fewer and fewer of them because more and more of us can take care of ourselves, right? So that's the objective; that's the direction the commission felt that this migration to a funded world should go.

Now, there are lots of examples of how you can do that. Sure, the President just said you don't want to say everybody, well you just -- you can hang on to 2 or 3 percent of your money, and just put it in your pocket, do what you want with it. There's some people who would go to the track. People aren't ready for that just yet. But there are lots of examples of ways in which this can be done cost effectively. The Federal Thrift Savings plan which the President referred to and which Liz Ann just talked about is a great example. That is a program that exists for people who work for the federal government who have this right. And it's been run for a number of years. This result is superior, particularly compared to the returns you would get leaving that money with the government. And the beneficiaries of that are the people who participate in that plan.

So we think that there ought to be, at least initially, limitations on how much discretion you have in terms of investing the funds and creating some kind of trust arrangement where there -- where there are people who are investment professionals who help structure and manage the costs of the initial options. But clearly, people ought to be able to start to save on their own behalf to create wealth for themselves so that they have that wealth to look to in their later years, as opposed to a government promise only, which at some point in time is going to have to come up empty because you won't have a big enough revenue base to draw from to satisfy the problems.

DIRECTOR BOLTEN: Congressman Penny, the -- one of the critiques I've heard about taking some of the steps that Dick -- Dick Parsons is talking about is that -- look, this isn't the problem for decades to come. It may be a problem by the time Sandy retires, but certainly not a problem now, why do we have to wrestle with this tough political issue now? How do you answer that?

CONGRESSMAN PENNY: You can pay me now, or pay me later. Wasn't there a commercial on TV once where -- and the purpose of the commercial was to say that you can spend a little bit now and fix this thing permanently, or you can just pay me forever. It's sort of like a credit card where you can pay it off now and be done with it, or you can pay the minimum payment forever. And that's sort of the choice we're facing here.

And if we choose not to address Social Security reform now, and we let this thing drag along until we do get to a point of crisis, then we're going to be cutting and pasting, and cutting and pasting year after year after year well into the future. It's going to unsettle the markets, because they're going to look at a fiscal house that is not in order. So that's the reason it's important to address this now.

I gave an example during my initial remarks about what did happen when we waited until the crisis was already upon us. We've now got a window of opportunity to address this issue, and I think we ought to take it.

And I do want to just add one point about polling data, because depending on how you word the question, you get widely disparate responses. But I've seen polling data that indicates that for younger people like Sandy, support for Social Security reform that includes personal accounts is about 80 percent.

THE PRESIDENT: That's right.

CONGRESSMAN PENNY: So it's huge. And, frankly, the support for personal accounts as part of the solution -- and it has to be part of a package. And that's what we tried to address in the commissions -- how do you put this all together in order to make it work for the long-term, in order to pre-fund as much of this as we can while retaining a basis safety net under the traditional system. It has got to be a package. But when you talk about reform that includes personal accounts, it's strongly favored by everyone that currently is ineligible to join the AARP. (Laughter.)

And it seems to me this is really who we're talking about, because, as you've said, we're not talking about any changes in the near-term; people who are eligible to join the AARP today are going to be protected under the traditional system. But we ought to, on a voluntary basis, give people working today the option of pre-funding part of their retirement, and then owning that retirement in a way that the government can't take it away from them.

DIRECTOR BOLTEN: Tim, the other thing I've heard -- and I'm going to ask Jim Glassman to come in here -- the other thing I've heard is, well, maybe you do have to deal with the problem now because it just gets harder to deal with it later -- but we can deal with this Social Security problem, and in fact, we can deal with most of our fiscal problems by raising taxes. How do you react to that as an economist? And how do you think markets would react to that kind of solution?

MR. GLASSMAN: Well, I think markets would worry about that, because markets would worry about, what does that do to growth incentives, and investment incentives, and savings incentives. And I think, in the markets, we're interested in -- we know it's a structural problem, and we know that if you come up with structural changes and structural reforms, we're going to be much more impressed by that, because we don't need promises to cut this and that; what we need is to see that the reform that's taking place will be changing behavior and will be bringing market discipline into the process. And I think people would be pretty disappointed if the only solution you could think of was raising taxes.

THE PRESIDENT: Why do markets matter to the person out there looking for work?

MR. GLASSMAN: You know, the markets are a barometer of this -- this is where we, collectively, think about the future. And the markets are a taste test of what people, collectively, think is going to be happening in the future. So it's -- for one thing, it's a barometer of what we think of your policies. And for another thing, it affects us when we go to take out a mortgage loan. Interest rates go up -- because we don't like what's happening, or we're worried about a policy that's not going to be fixing the problem then we home-owners pay a price.

DIRECTOR BOLTEN: Sandy, what -- there has been talk about personal accounts here, and you've been around Iowa, I guess, campaigning for them. Tell me a little more specifically what it is that attracts you about them, what you would do with it, and whether you have any concerns about the safety of that, of making an investment in a personal account, rather than letting the government keep your money.

MS. JACQUES: Well, Tim already mentioned earlier, by the time I retire I should expect a 25 percent reduction in what I should expect to get. So I have a hard time thinking that I could do worse in a personal account than I could with the current system. So I guess I'm not worried at all about the security of my investments in a personal account. Because, as others have mentioned, the choices would be limited. I'm not going to be able to invest the money at the race track or invest it -- you know open up the paper and pick one stock and cross my fingers and hope that it does well. I will be given limited options for how to invest that in very diversified funds. So I'm not worried one bit that I would do better in a personal account than I would do under the current Social Security program because of the demographic changes that will take place before I retire.

But on a more broader sense, why personal accounts are important to me -- it's very important to me because I think they're the only way to give me security in my retirement and my daughter's retirement without raising payroll taxes. I can look at paying the same percentage in payroll taxes until I retire, but have a bigger account when I retire, because of the growth that will take place over the next 40 years that I work. I have 40 more years to work before I retire.

And if you raise payroll taxes you're just going to be asking me to pay more, but give me less when I retire. But with a personal account I can pay the same amount in payroll taxes and use a portion of that go to into my personal account -- so I can pay the same and get back more. Now, paying the same and getting back more when I retire, I don't know why anyone else is considering any other option than that because I can't think of a

better deal than that.

DIRECTOR BOLTEN: Dick Parsons.

MR. PARSONS: Yes, just -- the other thing that I think people need to consider when Tim talks about a window of time to operate is -- the statistics we saw and the commission say by about the year 2020, you're going to have about two people working for every person retired. But that's still two to one. And where I come from that's a majority. And you've got to ask yourself, are those two going to let the Congress tax them sort of into oblivion to pay for the one that's not in the work force. I don't think so.

I think the limit -- there is a limit to how much you can tax, which means that either benefits will have to come down. That's inevitable. And people who have been promised something and who believe that they're entitled to something and who planned on getting it aren't going to get it; or, essentially, you sort of monetize it that you just issue more money to pay those promises. But by doing that, a dollar buys 50 cents of what it used to buy, so that we're on a collision or a train wreck course. And Tim is 100 percent right when he says that time to start to deal with that -- you can't fix this problem with no pain, without making some sacrifices. But the time to start making those sacrifices is now, so that they're manageable, so that the markets can have confidence that we're on a course that is going to avoid the train wreck. Because if we wait until later, it will be -- it will be a huge train wreck for our whole economy.

DIRECTOR BOLTEN: Mr. President, we're reaching the end of our time, and I'm going to do the smart thing and give you the last word. (Laughter.)

THE PRESIDENT: Thank you, Ambassador. (Laughter.)

I love the idea of people being able to own something. You know, one of the most hopeful statistics in America is the fact that more and more people are owning their own home. It is a -- it's just -- I met a lot of people on the campaign trail that said, I just bought my first home. And there's just such joy in their voice, that they were able to say, this is my home.

I love the fact that more and more people are starting their own business. I think one of the unique things about America is that the entrepreneurial spirit is so strong that people are willing to take risks. People from all walks of life, all income levels are willing to take risks to start their own company. And it's a fantastic experience to meet people who say, my business is doing well. I'm trying to do the best I can with my business.

And I like the idea of people being able to say, I'm in charge of my own health care. In other words, if I make a wise decision about how I live, I end up with more money in my pocket when it comes to a health care savings account. I particularly like the idea of a Social Security system that recognizes the importance and value of ownership. People who own something have a stake in the future of their country and they have a vital interest in the policies of their government.

And so I want to thank the panelists who are here for helping to illuminate the need to fix problems, but at the same time, recognizing the inherent optimism about promoting an ownership society in America. And I want to appreciate you helping advance this issue -- these issues, so that when we begin the session after the new year, these will be foremost and forefront issues for the Congress to consider. Now is the time to solve problems and not pass them on. This is my message today; it'll be my message to members of the United States Congress. We have come to Washington to serve, to solve problems, and do the hard work, so that when it's all said and done, they'll look back and say, well done, you did your job.

Thank you all for coming. (Applause.)

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