President's Commission to Strengthen Social Security

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PRESIDENT'S COMMISSION TO STRENGTHEN SOCIAL SECURITY

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Keynote: "---" indicates inaudible in the transcript.

M O R N I N G   S E S S I O N

(10:07 a.m.)

CO-CHAIRMAN MOYNIHAN: The meeting of the President's Commission to Strengthen Social Security will come to order. If Fidel will just --- here.

DR. MITCHELL: I can't hear you, sir.

CO-CHAIRMAN MOYNIHAN: You don't have to, I'm not saying anything.

(Laughter)

CHAIRMAN MOYNIHAN: As is our custom, I have the honor to turn the gavel over to our distinguished co-chairman, Mr. Richard Parsons. Welcome.

MR.   : Right on time.

CHAIRMAN PARSONS: Good morning, ladies and gentlemen. We have quite a full agenda today. Those of you who have acquainted yourself with it know what I am talking about, so other than to extend greetings on behalf of my fellow commissioners to all of you in attendance today and to thank you for your attendance, I am going to -- oh, okay. Other than, as I say, to extend greetings on behalf of all of us on the Commission and to handle one small administrative matter, we are going to get right into the meat of things. We are going to dispense with what we have done in the past, which is give all of the commissioners an opportunity to make an opening statement.

The one administrative item is, due to the fact that several of our members are going to have to absent themselves from the afternoon session for personal reasons, it is the recommendation of the Chair that we flip the agenda. We indicated we might do this in the agenda that was published, but I now formally want to flip the agenda and to take up as the first order of business the report of the subcommittee on fiscal sustainability, and then to deal with administrative matters secondly.

CO-CHAIRMAN MOYNIHAN: I so move.

DR. MITCHELL: Second.

CHAIRMAN PARSONS: We all come to that without objection. We are going to amend the agenda in that way. Again, thank you to all in attendance. We appreciate it. As I say, we have got a full agenda today. What I am going to do is ask our Executive Director, Mr. Chuck Blahous, to take us through the thinking of the subcommittee on fiscal affairs -- or fiscal sustainability, so that we can have a full discussion of that subject. Chuck.

MR. BLAHOUS: Thank you, Mr. Chairman. I would like to beg the indulgence of the Commission, by beginning by thanking all of you. It has been a pleasure for several months to serve all of you. I have been particularly honored in the last few weeks. I think you have all conducted yourselves with great dedication and great integrity, and done a heck of a lot of work. I haven't had the chance to thank you all as I would like to, individually. There's just too many of you. So I would like to extend that thanks now on behalf of myself and the rest of the staff while you are all gathered.

Let me try to make a brief summary of the work of the fiscal subgroup and state up front that there are about to be errors in the following presentation. Those errors are mine. I again beg the indulgence of the Commission as a whole, and in particular the fiscal subgroup, whose work I will probably unintentionally misrepresent at various points. I look forward to being interrupted and corrected when those points occur. Interruptions are good. I can't think of anything more damaging to the long-term prospects of Social Security reform than a two-hour soliloquy by me, so I look forward to a vigorous exchange with the commissioners as we walk through it.

I thought it would be appropriate to begin with a restatement of the principles for reform that have undergirded the Commission's work and as outlined in the Executive Order. Although they are well-known in many quarters, it is very important to emphasize them at all points, because everything that this fiscal subgroup has done has been in the service of those principles.

One is that modernization of the Social Security program must not change Social Security benefits for retirees, people in retirement, or people on the verge of retirement. All of our work looks at the long-term prospects for the program and does not make any changes or threaten any benefits for people who are now in or near retirement.

Secondly, the entire Social Security surplus must be dedicated to Social Security only. What this means in practice, for this Commission, is that all of the money that is collected for the Social Security program, be it payroll taxes and benefit taxation, is available to us to use to reform and strengthen Social Security.

If we did not create personal accounts, for example, and simply continued to use surpluses to issue bonds to the Social Security Trust Fund, that would mean that down the line the government of course would honor 100 percent of those bonds. The payroll taxes, if we choose to place them in personal accounts, can fund Social Security benefits through those accounts, but one way or another, we are going to honor the commitment of the Federal government to use all of the Social Security money for Social Security.

Thirdly, Social Security payroll taxes must not be increased. Fourth, the government itself must not invest Social Security funds in the stock market. Fifth, modernization must preserve Social Security's disability and survivors components. And sixth, modernization must include individually controlled, voluntary personal retirement accounts which will augment the Social Security safety net.

(Overhead)

MR. BLAHOUS: Now, I would like to step back for a bit, Mr. Chairman, and give kind of a big picture overview of what the fiscal subgroup has been asked to do and the philosophies that it has looked at in trying to do it.

I think it is fair to say that every member of the fiscal subgroup has come to the conclusion that personal accounts must be a part of any proposal to reform Social Security. I think we all recognize that the Congress and the President, after a substantial period of debate, a year or more - we don't know the right amount of time, they face a wide range of choices to bring the Social Security system to fiscal balance.

This Commission's report can help to educate the Congress, the public and other interested observers as to the nature of the choices that are faced. We are not the last word in how those choices will be made, but we do have an important goal in explaining the ramifications of any such choice. What the fiscal group has tried to do is to show the ramifications of various different ways that this problem could be solved. There is a spectrum of different ways the Congress could go.

We could choose to live entirely within the current revenue stream that is dedicated to Social Security and determine how we can maximize benefits within that revenue stream. Or, on the other extreme, we could choose to try to fulfill, or perhaps even exceed, every benefit promise now in the books in the Social Security system for both current and future retirees, and commit ourselves to coming up with the additional revenues to do that. There is an infinite range of possibilities within those two extremes, but I think it is fair to say that the fiscal subgroup has found that no matter where Congress chooses to go, whether they go towards one extreme or the other or somewhere in the middle, that every projection we have come up with is that benefits for individuals will be higher if we create personal accounts than if we do not create them. This is an underlying, unifying principle behind all of the recommendations that we have developed.

Further, the subcommittee I think informally found themselves guided by values and objectives that have been implicit in a lot of the work that they have done. For example, each of the options that will be presented today will reduce poverty among low-income Americans, indeed among all Americans. At least one of the options does this by keeping the current revenue -- excuse me, the current benefit promises in place and exceeding those benefit promises through the personal account option. Other options do this by making directed and specific changes to the benefit formulas to create more benefits for vulnerable populations, whether they are widows, low-income wage earners, or other elderly at risk of poverty. So you will see throughout the Commission's work this unifying principle illustrated as well.

I think another principle that has undergirded the fiscal subgroup's work is that the personal accounts should be established in a way that helps beneficiaries. It would not do us any good to establish personal accounts in a manner such that individuals lost benefits if they took the accounts. That would not be a very attractive or desirable outcome. So all of the options put forward by the fiscal subgroup would seek to establish personal accounts in a way that would improve treatment for beneficiaries who were given that option. Very specifically, there are some things that the fiscal subgroup has looked at to improve treatment of specific populations.

(Overhead)

MR. BLAHOUS: Let me get into women first of all. One of the problems we face with elderly poverty among women is that women tend to have lower wages throughout their working lifetimes relative to men, and consequently, if it is desired to ameliorate this difficulty, added progressivity in the basic benefit formula and added guaranteed protections against poverty can be added to the Social Security system, and are added in several of the options before the Commission today.

Secondly, a great concentration of poverty among the elderly is with women who have lost their spouses: widows. The Commission's options include several provisions that would increase benefits for widows, some by as much as 50 percent.

Through the personal accounts in particular, additional protections can, and I believe "should," quoting the fiscal subgroup, be offered to divorced women, by establishing a property right in the accumulations in personal accounts of a married couple, so that there is some right to benefits for a woman who is divorced based on the joint earnings of a couple, which is not the case for the current system if the marriage lasts for less than 10 years.

(Overhead)

MR. BLAHOUS: In particular, the fiscal subgroup has also given careful attention to how to make sure that the system works effectively for classes of Americans who are traditionally of lesser income. Again, I would reiterate that some of the proposals do this by adding protections against poverty in the basic benefit formula. Also, the Commission's recommendations look very directly at the fact that certain demographic groups within American society do not tend to hold as much in the way of private financial assets as the American population as a whole. All of the options put forward by the fiscal subgroup would give opportunities to these demographic groups to accumulate a meaningful measure of wealth through the accounts.

Let me skip over a few pages in the presentation to discuss the range of options that faces policy makers in the absence of personal accounts.

(Overhead)

MR. BLAHOUS: In the absence of personal accounts, the options aren't very difficult to understand. If we aren't going to create a funded component within Social Security, then we would only be left basically with two options: either cut benefits, or raise revenues. In your packet you see some charts that show the ramifications of going to either extreme. We could either limit ourselves to the benefits that are payable within the current system, or we could raise revenues to meet every benefit promise made by the current system. But that is the range of options in the absence of personal accounts.

(Overhead)

MR. BLAHOUS: The fiscal subgroup has been charged with developing measures and fiscal sustainability for the Social Security system and applying them to various options for reform that include personal accounts. I would like to make a brief review of what those measures are. Some of them were touched on at the last meeting.

The first one, and a very important one, is the goal of having positive annual cash flows for the Social Security system within the valuation period. We know that within the current system under current law, by 2016 the program will enter cash deficits; there will not be enough tax revenue coming in to fund all the benefits that the system has promised.

Now, in that scenario, the government would have to come up with additional revenue to pay back money owed to the Social Security Trust Fund and pay full benefits. I think it is fair to say that almost under any scenario conceivable for the

Social Security system, at some point it is going to face a year where it faces a cash deficit. That is the nature of having a trust fund. It is the nature of the government's obligation to meet its Social Security obligations through the Trust Fund when the program faces a cash deficit.

But the question I think that the fiscal subgroup has looked at is whether that situation is ever turned around. Under current law and under the current system, it never would be. The cash deficits would start small in 2016, and they would grow without bound forever. That is clearly an untenable, insupportable situation.

Given that it is probably inevitable that the system will face some cash deficits at some point, one test of a reform proposal is whether ultimately the system is in the long-term on a track that enables it to have cash surpluses, and that is a measure by which each of these reform proposals will be evaluated.

DR. MITCHELL: Quick interruption. Excuse me. By emphasizing this cash flow criterion, how does that relate to the picture that you just talked about a moment ago? If you could just illuminate us.

(Overhead)

MR. BLAHOUS: Sure. If you go to the previous page, if you look at the picture on the right, for example, that just assumes that we raise taxes to support the Social Security system, by some measures we would have made the system actuarially sound. The surpluses attributed in the past to the Social Security Trust Fund and surpluses that it would experience over the next couple of decades would in present value terms balance the size of the deficits that the system faces in the latter portion of the valuation period.

But you can see in this picture that that does not necessarily lead to a sustainable system. You would still have a situation where you are having large, short-term deficits followed by large -- excuse me, large short-term surpluses followed by large out-year deficits, which as I alluded to before, would grow without bound. So it is possible to have a system that is in one sense solvent but another sense not sustainable, because the program has not moved towards cash surpluses in its long range projections.

DR. MITCHELL: So what you mean is the lines would not cross in that right-hand graph.

MR. BLAHOUS: That's right.

DR. MITCHELL: Okay.

MR. BLAHOUS: They don't cross. Once the cash deficits begin, the lines never come together again under that scenario.

DR. MITCHELL: Thank you.

(Overhead)

MR. BLAHOUS: I just referred to another measure of the system's fiscal health, for which we always turn to the gentleman on my left, Mr. Goss, the Social Security actuary, and he tells us whether the Social Security system is solvent or not. Under current projections, that would be through 2038. What solvency measures is whether the revenues that have been committed to the Social Security system are sufficient to fund the benefits that are promised from it. That is a slightly different question from whether the Federal government has a means of generating the revenues to pay those benefits, but it does measure within the framework of Social Security whether there are sufficient revenues committed to the program to fund its benefit promises, and under current law that is through 2038.

Thirdly, one measure studied by the fiscal subgroup is to reduce the rate of growth and long-term system costs as a percentage of the gross domestic product. This is very important if we are to understand the system as being sustainable. If the program and its costs are growing faster than the economy that must support it, then there is a sense in which it is not sustainable.

I think Dr. Saving has said at one point or another that the real trust fund is the American economy, because that is where the resources come from to support the Social Security system. If that economy is not growing as fast as the system is, then we have a problem. So all of the proposals and examples that have been looked at by the fiscal subgroup will be evaluated according to how big of a dent they make on the currently unsustainable rate and cost growth relative to the country's gross domestic product.

Fourth is the 75-year actuarial balance of Social Security. This is related to the concept I just discussed, the system solvency, but this measure is typically in terms of the nation's taxable payroll: what is the gap between the system's benefit obligations and its revenue commitments throughout the next 75 years. Under current law, it is about 1.86 percent of the nation's taxable payroll.

Fifth, another matter of great importance to the fiscal subgroup is that the actuarial balance of the Social Security system should not be deteriorating at the end of the valuation period. This is very important if we are to consider whether the system is actually sustainable.

If you look at any period of time, whether it is 10 years, 75 years or 100 years, if 1 year after you enact a proposal to reform Social Security you find that it is projected to be insolvent again, some people would say that we have not done our job.

One way of gauging whether we would have this problem is to look at the very end of the valuation period and to see whether the actuary's projections are telling us that the Trust Fund's balance is going up or going down at the end of that valuation period. If it is going down, then we are going to have what is called a cliff effect. One year later we are going to get a projection from the Social Security actuaries telling us that the system is out of balance again, which is in fact precisely what happened after the 1983 reforms.

Finally, another important measure of the fiscal sustainability of the system is whether or not we have reduced the currently unfunded obligations of the program. I think this is intended to take kind of a global, perpetual view of Social Security. There is an inherent flaw whenever you look at any truncated valuation period. There is a truncated time window, and if you have taken an action that has a certain effect within that time window, or perhaps an opposite effect after that time window, you really don't have a sense of whether or not you have improved the system's operations as a whole, in a perpetual sense. So the fiscal subgroup has placed some importance on looking in a global sense at whether the system's overall unfunded obligations have been reduced under the various options for reform.

(Overhead)

MR. BLAHOUS: Now let me turn to three different methods that the Commission -- the fiscal subgroup has looked at to address these various issues. I am going to try to step back for a moment and do something I am not terribly good at, which is to get out of the weeds of Social Security reform and look at things from a very big picture perspective. Each of these three approaches, Mr. Chairman, really looks at things from a very fundamentally different point of view but asks a different question. Therefore, it reaches a different answer, and it shows a different aspect of the trade-offs that are facing policy makers as they deal with Social Security.

The first example would be to simply create a voluntary option for individual participants in Social Security to invest a portion of their taxable payroll in a personal account. What we have shown here for the purposes of illustration is a two-percent account, but it doesn't have to be a two-percent account. There are proposals on the table that would have bigger accounts or accounts that would be progressively funded. You could build various means of doing this into this framework and reach fiscally very similar results. I don't want to give the impression that this two-percent contribution is set in stone as the only way of doing it within this framework. You could also perhaps supplement the two-percent account with some type of kick start contribution to maximize the account gains for younger workers. Proposals like that have been put forward, and we can discuss them here if you like.

But the ethic of this particular framework is to simply say, if we leave the old system alone and recognize that it still has some fiscal challenges that have to be met, and this particular framework would not by any stretch solve all of those fiscal problems, but simply set up the accounts in a way that they would be reasonably attractive to participants so that they would be likely to increase their benefits if they took the accounts, and if participants took the accounts, the system would be moved slightly in the direction of fiscal sustainability over the long-term.

The particular example before you shows that if you set up this account so that the individual faces an election where, in exchange for the opportunity to get benefits from this account, they give up a certain fraction of their Social Security benefits, which is equal to the contributions to that account compounded by an interest rate of three and one-half percent, you could construct this in a way so that simultaneously we would project that individuals who took the accounts would do better than they would under the current system, but the system would be moved slightly in the direction of fiscal sustainability as individuals took the accounts.

I don't want to slide past the very fundamental issue with this proposal, which is that this framework by no stretch would solve all of Social Security's financing problems. There would be remaining issues confronting the Congress and policy makers if this is all that they chose to do. But, this is one step that could be taken to set up personal accounts.

The second example approached it from a different perspective. It says, what, first of all, can we do to get the Social Security system back on track and to make it fiscally sustainable within the current revenue stream. We are not going to raise payroll taxes. We are not going to require individuals to put more money into the system. But basically, what can we do to make the system run as effectively as possible within the current revenue stream.

What it does is, it chooses to balance the traditional Social Security system via a number of measures, and while doing so, targets the resources of the traditional Social Security system a bit more directly on low-income individuals. From within that framework of a balanced Social Security system, the second example would create an option for individuals to invest four percent of their payroll taxes in a personal account up to an annual maximum of $1,000. That $1,000 figure would be indexed for wages after the first year.

Now, there are a couple ramifications of choosing this approach. One is that because the underlying Social Security system has been made sustainable, the personal accounts can be made more attractive to the individual relative to the first option, because there is no fiscal hole there and there is therefore less risk to the system, if you do not construct a bigger or tougher offset associated with a personal account.

CHAIRMAN PARSONS: Let me stop you there and just have you take us through that more explicitly. In other words, in the first example you gave us --

MR. BLAHOUS: Right.

CHAIRMAN PARSONS: -- which we will call plan one, and

I understand all these plans are illustrative of different approaches, but in plan one you take a two-percent personal account, and it has the advantages of now that's two percent of the money you otherwise would put into the payroll taxes that you redirect into a personal account, and it has some of the advantages of now being yours and investable in higher yielding assets. But in exchange for that, you agree to give up three and a -- that amount of money compounded by three and a half percent interest.

MR. BLAHOUS: That's right.

CHAIRMAN PARSONS: On your ultimate Social Security benefits. So you have to put the two back together, and your claim was that, as we have modeled it out, nevertheless persons who would take the personal accounts would come out better off than if they had not. Now we are talking about a four-percent account, and you say the offset is less because we don't have to fill the hole.

MR. BLAHOUS: That's right.

CHAIRMAN PARSONS: I just want you to explain the sustainability hole, how that is created and how this new plan fills it.

MR. BLAHOUS: Under the second approach, the offset associated with the personal account election is two percent, interest rate. There is a logic to that figure. Basically, we know based on various calculations that have been done that a typical rate of return that people get on their Social Security payroll taxes is two percent. So the ethic of this particular option is to say to the individual, a two-percent rate of return is basically what the Social Security system can give you. Now, if you think you can get better than a two-percent rate of return, here is a personal account option that is available to you. I have been admonished to clarify it is a two-percent real rate of return, in case that is not clear.

Under the second option, plan two, if the individual beats a two-percent rate of return on their personal accounts, they are going to get a benefit increase. I think it is fair to say that most participants are likely to think that they can get higher than a two-percent rate of return. So the personal account can be more attractive under this scenario, because it is overlaying a balanced system, than it can be under the first scenario.

CHAIRMAN PARSONS: That is what I want you to illuminate for us. Why is it three and a half percent interest rate in scenario one or plan one, and two percent in plan two? There must be something else going on.

MR. BLAHOUS: Sure. It basically has to do, Mr. Chairman, with the underlying finances of the Social Security system. In the first plan, you are basically saying to participants, you can stay in the old system and we really are not going to balance it. So the finances of that system still have some holes in it, and because those holes are bigger, you have to be careful not to dig that hole any deeper by making the offset associated with the personal account election too small.

Under the second example, however, the traditional Social Security system is completely balanced. In fact, it is going to move towards cash surpluses within the valuation period. So by almost any of the criteria put out by the fiscal subgroup, the system as a whole would be put on a sustainable path. So because the system's finances are in order, you can make the personal accounts more attractive to participants without creating an enormous revenue liability to the taxpayer.

DR. JAMES: Could I ask a follow-up question? As I look at these two examples, it seems to me that a major difference, and that it is important to bear in mind, is that in example one the people who don't take the individual accounts remain in jeopardy, because the system is financially unbalanced, and in the future something else will have to happen to balance that system. On the other hand, in example two, the underlying system has been fiscally balanced, so that the people who remain in it are in a less risky situation. They then have the option of taking individual accounts which will enhance their benefits.

MR. BLAHOUS: That's right. Perhaps, Mr. Chairman, this is what you were getting to as well, is that there is a sort of an unresolved question in the first example, which is what has yet to be done and proposed to bring the traditional system to sustainability for people who don't take the accounts. Under the second example here, that uncertainty would not exist, because a number of measures are spelled out to bring the system toward sustainability, even for individuals who do not take the accounts.

CHAIRMAN PARSONS: And those are?

MR. BLAHOUS: Well, there is a number of them. The biggest one is to move from wage indexing of the initial benefit formula to price indexing. This has been something that has been opposed by various advisory boards and technical panels of the Social Security Administration for a number of decades, and some of the commissioners here know better than I do the lengthy pedigree that this proposal has. That price indexing would begin in the year 2009, in keeping with the charge not to make any changes to the current system that would affect anyone near retirement.

Basically, what price indexing does, it says that each subsequent cohort of retirees will see benefits that are comparable in real terms to the generation before them, the preceding cohort. Currently the system is constructed so that the benefit levels from year to year grow with national wage growth. That, for a variety of reasons, is an unsustainable projection, given the demographics that we are facing.

I want to be clear, though, that that is not the only change to the benefit formula that exists under this proposal. There are a number of directed measures that would be taken under this proposal to affirmatively increase benefits for low-income individuals. The benefit formula is gradually changed over the period through 2018, so that an individual, if they work for 30 years at the minimum wage, they are guaranteed a benefit level in retirement that is 120 percent of the poverty level, which is a considerable increase over current law. This proposal also would increase benefits for widows to 75 percent of the couple's benefit.

So the price indexing is one mechanism to bring the system to balance, but there are a number of elements within this proposal to target the current system's resources more effectively so that they reach those in need. Should I go to example three?

CHAIRMAN PARSONS: ---

DR. COGAN: Mr. Chairman, could I just interject a thought here and a little chart? Andrew, could you give me a hand to pass out a chart?

(Chart distributed)

DR. COGAN: I wanted to illustrate what Chuck has been saying. In the current system, the benefits that have been promised to the future retirees are growing in real terms, or the purchasing power of benefits that have been promised to retirees in the future are increasing. How much are they increasing?

Well, if you take a 45-year-old person today who is going to retire in 20 years roughly, the benefits that are promised to that individual in real terms, after taking on inflation, are about 20 percent higher than the benefits that are paid to a similar worker today.

Take a person who is 35 years old today. When that person retires, the benefits that have been promised for that person are about 35 to 40 percent higher in real terms than the benefits that are promised -- that are being paid to a current retiree.

If you take a person who is just entering the labor force today, the benefits, the monthly benefits that are promised to that individual are about 60 percent higher in real terms than the benefits that are being paid to a retiree today. That is what this chart shows. What the chart shows is that the typical retiree today gets about $1,000 a month, and what this chart shows is for each age group how much the promised benefits rise in real terms.

Congress instituted this policy of increasing real benefits over time, to try to maintain a wage replacement rate. They put this automatic provision in place about 25 years ago. If you look at the Trustees' Reports of the Social Security system for the last 25 years, every report except 2 have shown that the system is insolvent. So this automatic wage indexed system has, as it turns out, because of demographics and other factors, proven to be for 25 years to be unsustainable. What this policy that we have proposed for consideration in this option does, is to say let's modify the promises of the system to live within our means. Let's get rid of the increases, if you will, in the promised benefits that would require us to impose taxes in the future on our sons and daughters that we are unwilling to impose on ourselves.

If this policy were put in place, no future retiree would get benefits that are in real terms any lower than the benefits that are given to today's retirees. So this would preserve, if you will, the purchasing power at a minimum of all benefits to future retirees. Then in addition, individuals would have an option to gain even higher benefits with a personal account.

MR. BLAHOUS: Mr. Chairman, before I go on to the particulars of the various proposals and what they achieve, let me describe the third plan before the Commission. Again, let me try to step back a bit and say that everything that is before the Commission is intended to serve an educational role to show the ramifications of fundamentally different philosophical approaches that one could take.

Under the first option, we asked what could be done if we basically do not directly make changes to the traditional Social Security but just try to set up personal accounts in a way that benefits individuals and indirectly partially benefits the system finances in the long-term.

Under the second example, we attempt to, as Dr. Cogan said, live within our means and maximize the amount of benefits that we can pay through the current system without raising taxes, without requiring additional contributions from individuals.

The third example shows another objective that could be pursued, and that is to make as a target the full amount of present law benefit promises, as distinct from what the current system can actually pay, but to try to make that the target to be achieved through the personal accounts. I don't think it would be any secret to the members of this Commission or anyone else who studied this issue to discover that that requires some additional revenue to come from somewhere.

In the particular case of this third option, what is required is that individuals would be given the opportunity to put another one percent of their income into the system, and they would have a match made from their payroll taxes by the government of 2.5 percent of their payroll to create a 3.5 percent account.

Now, in the particular scheme before the Commission, this voluntary add-on would be subsidized via various means by the Federal government in a way that is targeted towards low income, so that they don't have to reach into their pockets and come up with money that perhaps they cannot afford. So there is an incentivized way of generating the one percent add-on for those who have lesser means.

Now, like the second option, the third option makes some changes to bring the system, the underlying traditional Social Security system, to a path of solvency. It makes changes in the indexing of the benefit formula, not to go to price indexing but to do something that is called life expectancy indexing, which is to basically put in a mechanism for calculating the benefit formula over time to reflect the actuary's projections for expected changes in lengthening lifetimes over the 21st century. That results in less cost savings than going to price indexing, and other measures are needed to balance the traditional system.

Among the measures in this proposal are measures to correct the actuarial incentives for early and late retirement, slightly changing the adjustments made for early retirement and for late retirement as a means of improving work incentives. Because most individuals tend to retire early rather than late, that winds up being a net cost saver for the system. Beyond that, there are elements of this proposal that would commit additional revenue to the Social Security system as a means of enabling it to offer higher benefits as a whole, and we can discuss those as we move forward.

Like the second proposal, this proposal would make increases in the guaranteed benefits for low-income individuals through 2018, so that an individual who works for 30 years at the minimum wage does not retire into poverty, and like the second proposal, it would increase benefits for widows.

DR. JAMES: Chuck, could I just add a comment.

DR. MITCHELL: Speak into the mike.

DR. JAMES: If you are finished with your brief description, I just want to pick up on John's earlier point about wage replacement. As I see it, the basic philosophy behind example three is to try to maintain the wage replacement rate, and of course, to do that requires additional revenues. So that kind of basic distinction between the approach in two and the approach in three, and the additional revenues in -- when I say maintain the existing wage replacement rate, I am including the benefits that would come from the two parts of Social Security, that is from the individual account and from the defined benefit. So some of the additional revenues would go to the individual account in the form of the add-on that you mentioned, and some of it would go to the traditional DB, and the two together would enable the current wage replacement rate to be maintained.

Similarly, the minimum benefit for the low-wage worker would also be able to rise through time with wages -- partially with wages, as a result of the additional revenues that have been put into the system.

CHAIRMAN PARSONS: Bob.

MR. POZEN: I would like to make two further points on plan three. One is, in terms of the relationship to life expectancy, I think we all know that the demographics are such that people are living longer, which is a very good thing. What we have tried to do here is to give people choice. We are not saying you have to retire at any different age than you do now. We are keeping the normal retirement age the same, but what we are saying is, if you choose to retire earlier and you have a longer life expectancy, then there will be some adjustment of your benefit. So we believe that this is a proposal that is consistent with both changes in life expectancy and trying to maximize individual choice.

The other thing that I think is relevant here is, as Estelle says, we are adding two sources of revenue. One is from the, what I would call, incentivized add-on for the personal account, plus some amount of dedicated additional revenues. I think, Mr. Chairman, you know that there has been some discussion about where those additional revenues could come from. There are some of us who feel that it should come from an increase in the wage base for payroll tax, not an increase in the rate, and it might be useful at least to have some discussion on that point.

CHAIRMAN PARSONS: Let me say first of all, just by way of clarification, as various people who participated at the subcommittee level in the construction of these options are now illuminating further some of the thinking, they are using terms like "we," "felt," and "proposed." This is all to be taken in the context of that is the thinking behind individual plans that are being part of this mix. What we are here to do today is to discuss them and determine which of the plans or options or approaches the Commission as a commission feels should be included in its final report.

Secondly, to the point that Bob Pozen has raised, again just for purposes of making sure that those members of the public who are listening to this discussion understand the issue that is being raised, and then we can have some discussion around the table about it, in the six criteria or guidelines that were given to the Commission by the President at the time of the creation of the Commission, one was that we develop plans and proposals and approaches, but none of which, however, could increase payroll taxes for the purpose of funding Social Security or meeting shortfalls, deficits.

And the question that is raised is whether an increase in the wage base, that is to say in the level wages that are subject to the current FICA taxes, which is I think $80,400, if you increase that wage base to say, I'll pick a number, $86,000, are you increasing taxes and therefore on the wrong side of the limitation that the President set for us, or is that simply not an increase in taxes, just an increase in the taxable wage base?

There has been a healthy debate within the subcommittee of this, and perhaps we should hear from members of the full Commission, starting with my co-chair, the distinguished Senator Moynihan.

CO-CHAIRMAN MOYNIHAN: I thank you, Mr. Chairman. Simply to make a point with respect to Dr. Pozen's proposal, this I think Steve Goss will agree with, or correct me, that we have had a fluctuating ratio in the past 20 years. In 1982 we were at 90 percent, and it dropped -- not 1982, 1983. And then it dropped to about 87. Change in the income structures in the country do this.

But I can speak to -- as someone, just as one member of the Finance Committee over 24 years, we never looked upon this as a tax. This was an aspect of the way the tax was, 12.4 percent or whatever, as it changed over time. But this was one of the variations internal to the system which we adjusted as occasion arose, but we are now, I do believe we are now down to about 83 percent -- 84. Well, we were at 90 and we slowly dropped down to 84. I would offer the thought that this does not change the nature of the calculation.

CHAIRMAN PARSONS: Clearly the rationale as you had articulated, Senator, is that having the wage base bear the same relationship to total wages over time from a policy point of view may be a good thing. Having said that, I am going to, in the interest of sort of moving the discussion along, suggest that this was one, it seems to me, and unless the Commission is of a different mind, this was a specific limitation imposed on the Commission by the guy who set up the Commission, namely the President. Probably, at least in the first instance, the issue having been raised and the rationale having been articulated for making a change here, the next best thing to do is for us in some orderly way to check back with the President who set up the Commission, find out what he had in mind, then report back and complete the discussion from that point of view. So if that is acceptable to all --?

(No audible verbal response, but gavel pounded several times)

CHAIRMAN PARSONS: Are there other questions or comments that people want to make with respect to these options, before Chuck takes us through the specifics? Gwendolyn.

MS. KING: Thank you, Mr. Chairman. Following on this plan three where the indexing is tracking life expectancy, would you, Dr. Pozen or Dr. James or Dr. Blahous, just speak a moment about what that means with regard to people whose life expectancy has traditionally not even gotten to retirement age, and I speak here to a focus on African American males. How does that work? Do you discount it so that they start getting benefits at age 50, or is there --?

MR. JOHNSON: I vote for that.

MS. KING: Is there some explanation for how that might impact people whose life expectancy has traditionally not taken them to retirement age?

DR. JAMES: Can I answer that question?

CHAIRMAN PARSONS: Well, it is directed to you and Bob, so why don't you start off.

DR. JAMES: Let me say that all of current Social Security as well as all of these plans face that problem and have not been able to find a solution for that problem.

MS. KING: You have answered my question. I wondered if this were any better. I mean, I like it.

MR. POZEN: I think it is better in one respect and that is, what we have tried to is by building in this fairly large personal account, which for lower income people would be up to $1,000, that account will be available to people if they have a longer -- excuse me, a shorter longevity than other people.

MS. KING: In other words, it is an account that can be passed on to their heirs.

MR. POZEN: Correct. Correct. So I think we have an improvement, because at least we now have a significant -- for those people under the current system who if, God forbid, they died at the age of 45 and would have nothing essentially --

MS. KING: That's right. If they don't have --

MR. POZEN: -- even though they had paid in, say, for 25 years.

MS. KING: If they don't have children under --

MR. POZEN: Right.

MS. KING: -- the age of 18.

MR. POZEN: Correct. Now we have done two important things. One is, we have the personal accounts so they have that

that can be passed on, and I think both proposals do improve the survivor benefits. So it's not a perfect solution, but I think those are two important steps in the right direction.

MS. KING: Thank you very much.

CHAIRMAN PARSONS: Fidel.

MR. VARGAS: On plan three it says "commits additional dedicated revenues to Social Security." Is that where we are talking about the idea of increasing the wage base?

(No audible response)

MR. VARGAS: And so I guess my point is, it seems to me that you have argued among the fiscal subcommittee whether it is a tax increase or not a tax increase, but obviously in this plan there is a need for additional revenues.

CHAIRMAN PARSONS: Yes.

MR. VARGAS: So one way to do it is that way. And I think -- and my clear understand that you are also saying if there is another way that people can figure out to get those additional revenues, that that is acceptable as well, as long as it meets whatever the need is for the plan.

MR. POZEN: I think if the consultation leads to the fact that we can't increase the payroll base, then we would accept another alternative source of dedicated revenues.

MR. VARGAS: And frankly, I think it is a healthy debate to have, and I am glad that you have had it in the fiscal subcommittee, because I think it is a debate that is going to happen in Congress, and whether we recommend it or not I don't think is going to stop that debate from happening, and I also think that Chairman Moynihan brings up a good point in that there is some underlying justification for looking at where it has been traditionally and where it is now. We could kind of argue back and forth, well, it's really not a tax increase, or yes, it is, or no, it's not, but ultimately, I think what you are trying to do in plan three is be as -- to pursue fiscal sustainability and be very progressive in terms of establishing some substantial personal savings accounts. In order to do that, as opposed to plan two, you have to figure out another way to get revenues.

DR. JAMES: Yes.

MR. VARGAS: So I think maybe the solution is, I think you are right, to go forward and check back, but at the same time, understand that what you are talking about is additional revenues, and where that comes from we might not decide here, but it is clear that that is something that needs to be included.

MR. POZEN: I think plan three will have dedicated additional revenues.

MR. VARGAS: Sure.

MR. POZEN: We can debate later what the source will be.

CHAIRMAN PARSONS: Just to frame it somewhat differently, but I think you are right on the point, Fidel, we talked at the last meeting about when you have a system that is in major deficit like it is currently, three and a half trillion dollars, if you are moving toward sustainability you have to do one of two things. You either have to reduce the outflow on a go-forward basis to bring it back into balance, or increase the inflow. So this is sort of the anchor of these two points. Chuck, did you have a point? We have a few more commissioners who have some questions for you, but you were looking --

MR. BLAHOUS: I was going to give a technical answer to Fidel's question, but we can --

CHAIRMAN PARSONS: Technical answers only confuse the issue. Tim.

(Laughter)

MR. VARGAS: Don't confuse me, Chuck. I think I got it now. So you can go ahead.

CHAIRMAN PARSONS: Tim.

MR. PENNY: If we were to move from 84 percent to 90 percent or to recommend such a move, does that as a dedicated source of revenue adequately cover the additional costs that are proposed in example three?

MR. BLAHOUS: Well, what we have done is scored example three in a method that gets to balance, in order to resolve this somewhat vexatious question. We had Steve stay up all night and break out the components of it, and when it came to this missing piece of it, he was to identify the amount of revenue required on an annual basis and separate that out. I have tried to put in this presentation enough information about how the proposal looks with that revenue assumed in there, not from that specific way of getting there, but with that revenue assumed in and also without it, so that the budgetary ramifications of the third proposal can be seen with some ---

DR. JAMES: As indicated --

MR. PENNY: Yes, but we obviously know the cost.

DR. JAMES: Yes.

MR. POZEN: I think the scoring --

MR. PENNY: And we obviously know --

DR. JAMES: It's 86.

MR. PENNY: -- or should know what the incremental amount would be of new revenue if we increase the wage base.

MR. GOSS: If I might just suggest, the additional revenue that has been identified here as being required or desired for the example three is not as much as you would get from what you suggested, pulling the taxable maximum up to a level that would capture 90 percent of all earnings ---.

MR. PENNY: It is less than that.

MR. GOSS: It is less than that.

CHAIRMAN PARSONS: Okay.

DR. JAMES: It is 86 percent.

MR. BLAHOUS: That is because it is a net figure. If you were to increase the cap on taxable wages, it would have an effect both on revenue and on expenditures, because you have to pay benefits on that. So what Steve has done is, he has given you the net figure, which is the size of the hole that has to be filled in to make the proposal balance.

MR. POZEN: But the net figure, Tim, that Steve has used, and correct me if I am wrong, is the net figure is going from 84 to 86.

CHAIRMAN PARSONS: Okay.

DR. JAMES: Eighty-six percent --

CHAIRMAN PARSONS: Time out.

DR. JAMES: -- is the number.

CHAIRMAN PARSONS: Time out. Because once again, those of you who have wanted to know what has gone on in the fiscal sustainability subcommittee, welcome to my world.

(Laughter)

CHAIRMAN PARSONS: We quickly get down into the weeds and the technicalities. Let's just get this back up to the level, though, that not only the commissioners but those of you in attendance can understand it. The third plan as it is called, which envisions, as Fidel has put it, more revenues coming in to the system, has an element that can be filled in several ways. One of the ways which some members of the Commission would like to explore is by increasing the taxable wage base. We are not clear as to whether that is in bounds or out of bounds in terms of that original guidance we were given, so we are going to go back and check on the guidance. If it is out of bounds, we will find another way of putting those revenues in. We will find another source that is in bounds, to put those revenues in so that the plan stays intact. Is that fairly stated, Steve -- or Chuck and Steve?

MR. BLAHOUS: That's fair. And actually, there's two points I would like to make now. I will try to make them by not getting down into the weeds too much.

Stepping back and looking at the big picture again, what we have tried to do is show the ramifications of the range of options that confront the Congress. Some of the things that have been suggested by congressional sponsors' plans and others can be sort of molded into these basic frameworks. There are ways to change the construction of the personal accounts under the first plan so that it is closer in shape to some of the things that have been developed on the Hill. With the third plan, this also recognizes that some of the proposals that have been put forward by congressional sponsors and others do tap some general revenues in order to finance the system.

That brings me to my second point, which is that I would hasten to clarify that the general revenues implicit in this proposal and the way that Steve scored it to be commensurate with the President's principles, that is not in any way a function of or correlated with the personal account element of this. That is a component of the program to balance the traditional Social Security system and bring it to balance, and so it is not a problem that is in any way introduced or created by the personal accounts, but rather a means of bringing the traditional Social Security system to balance among the range of options available.

CHAIRMAN PARSONS: I think most of the Commissioners understand that. All right. Now I think the next part of Chuck's presentation is now to go into a little bit more depth on each of the three plans. Is that correct?

MR. BLAHOUS: That's right.

CHAIRMAN PARSONS: So that we get to revisit all three plans as we get a little bit more texture on them. But does anybody have any further comment or question before we get into the specifics? Estelle.

DR. JAMES: Yes. I just want to mention one other underlying philosophy in example three, which is to remove some of the sources of uncertainty in the finances of Social Security. Part of the reason that Social Security is in the financial bind that it's in is that things have not turned out the way we might have expected 10 years ago or 20 years ago. For example, people have been living longer and longer, and, for example, the wage base has been shrinking. So many of these changes are designed to remove some of these sources of uncertainty from Social Security in the future, so that as time moves on and the future unfolds and we are faced with surprises, there is an automatic adjustment process. If people suddenly start living longer and longer, the benefits automatically adjust, so Social Security doesn't become sustainable, and that is also part of the rationale behind the thinking about setting the wage base as a proportion of the total wage bill. That is also a reason for the incentives to induce people to continue working longer, so if -- the finances of Social Security won't suddenly be thrown off by people's decisions to retire earlier and earlier, and then we would find ourselves back in this room again 10 or 20 years ago because life hasn't unfolded exactly as we expected. We are trying to move some automatic stabilizers into the system.

CHAIRMAN PARSONS: Okay. Now proceed.

MR. BLAHOUS: Yes. I am surprised there wasn't a rush toward the exits when you said I was going to go into further depth now in the three plans.

CHAIRMAN PARSONS: Well, some people are leaving, Chuck.

(Laughter)

MR. BLAHOUS: Just as long as none of the Commission leaves, I'm doing all right. Let me just direct the Commission's attention to the charts for plan one or example one.

CHAIRMAN PARSONS: Put us on a page.

MR. BLAHOUS: Page 12. Page 12.

DR. MITCHELL: Can you show the picture you are referring to?

MR. BLAHOUS: Yes. I should have had these page numbers.

(Overhead)

MR. BLAHOUS: Basically under the first example, again, this is the option before Congress and other policy makers which would leave the current system on its current course, so there will be no changes to the current system for people who choose not to take the accounts. As you can see on the left, if you assume that there is no participation in the accounts, the cost and income rate lines look exactly as they do under current law. Effectively nothing is changed from a fiscal perspective.

Now, what the picture on the right shows is that simply by virtue of setting up these accounts in a way that is structurally relatively sound, you do start to move this system slightly in the direction of fiscal sustainability, simply because you have created these funded accounts and they are going to start financing a portion of Social Security benefits in the future. On the right side of that chart you see the extent to which the system finances are improved in the out-years of the valuation period.

(Overhead)

MR. BLAHOUS: Turning to the next page, I'll review a little bit more explicitly some of the implications of that particular policy option. The current system would remain on its unsustainable course.

CHAIRMAN PARSONS: I guess the question would be, these charts have been constructed to capture the traditional 75-year measuring period.

MR. BLAHOUS: That's right.

CHAIRMAN PARSONS: And as you indicated, the chart on the right that shows that everybody took the personal account that is implicit in plan one, there is some improvement in the financial soundness and sustainability of the system within that 75-year period. The question I would have is, do the lines ever, as someone put it here, ever cross? In other words, if you stay with this long enough, do you ever get to a place of permanent sustainability?

MR. BLAHOUS: The answer is no. You have to take further actions beyond this.

CHAIRMAN PARSONS: All right.

MR. BLAHOUS: Both for 0 percent and 100 percent participation in the accounts.

DR. COGAN: Mr. Chairman, can I ask a question? If I look at the chart on the right side of 12 which shows the net impact of the policy, one way to think about this transition cost is really to think about personal accounts as an investment. So you have an investment period and then you have a period later on where you recoup that investment. It seems to me that if you have a truncated or a 75-year or a 50-year fixed window, then what the calculations off of that fixed window of time reflect is sort of all of the investment period but only part of the recoupment period. It would be like evaluating an IRA contribution or investment plan by calculating all of the contributions as of costs to the individual because they are foregoing consumption, but then only calculating as a benefit the first 2 or 3 years of the returns on those IRAs and then truncating them. So it does seem to me that we need to think about this measure of solvency that we use in this investment world that we would be in with a personal account proposal.

MR. BLAHOUS: Well, I think those realities are in many ways reflected by the fiscal subgroup's commitment to using measures beyond simple 75-year solvency or actuarial balance in order to measure the fiscal health of the program. There will be inherent limitations and flaws with any time-limited look at the system, and that is one reason why it is particularly important to look at whether on the long-term basis you have made progress towards long-term sustainability, whether in an absolute sense you have reduced the system's unfunded obligations. And even though there is, you could say, dubious progress within the valuation period under an option like this, over the long range you clearly are moving in the direction of fiscal sustainability by many of the measures that are important to the fiscal subgroup and which I assume are appointed to the Commission as a whole.

Let me just go back to the ramifications page. Some of them I have touched on already, but under this plan, Mr. Chairman, as you asked, there would be additional actions required to bring the system towards true sustainability.

One other ramification of this option I alluded to at the beginning of the presentation, which is that the individual participants in personal accounts can expect to see gains from participating in the accounts, but these gains are much more modest under this scenario than they would be under both of the other two plans put forward by the Commission, largely because of the improved finances of the traditional Social Security system for the other two options. It is harder to construct a personal account option so that it is attractive to individuals as long as the current system remains out of balance.

Now, we have made it attractive by design under this scenario and under our projections individuals' benefits will increase, but the amount of the gains from the accounts is smaller than it is in the other two options, and that will undoubtedly have an impact on individual decision making on whether to participate in these accounts.

Finally, I would just reiterate that this is a framework. There is nothing set in stone or sacred about this two percent illustration that we have put forward. There are proposals in the Congress, for example, to say do something like this but make the accounts bigger, or make them bigger particularly in the case of low-income people, or make them bigger still and require individuals to invest a part of their account in Federal securities. There are different ways to structure these accounts, and you can put within this framework some of the ideas and some of the very interesting conceptions that members of Congress have put together, and fit it within those frameworks.

Another possibility is you could create kind of a kick start or seed money for these accounts for younger individuals, whether people when they hit age 21 or perhaps even an earlier age, to create an initial larger investment in these accounts to improve the progress later in the valuation period that this advance funding would make. So I would just stress that it is very easy to massage and modify this basic framework to be consistent with many of the ideas that have been sent to the Commission for our consideration.

(Overhead)

MR. BLAHOUS: On the next page we show benefit projections for this example, and these bear out what I said at the beginning of the presentation, that this example was constructed so that individuals would be likely to see increases in total benefits if they took the accounts.

Now, what we have done here for your edification is to show on two of the lines the uncertainty that resides under the current Social Security system. The middle line on these charts shows the current system's promises, and the dotted line shows what it can effectively pay under its current legal limitations. Because those uncertainties remain under this system, you would certainly have to treat the overall benefit projections as having that inherent uncertainty residing in them. But, within that basic point, you can see that relative to what is currently scheduled, we would project that individuals who took this account would get higher benefits than they would by remaining in the current system, subject of course to the limitation that the current system's benefit promises are likely to have to be renegotiated at some point in the future.

(Overhead)

MR. BLAHOUS: Let me briefly review how this option stacks up by measures of fiscal sustainability. In terms of its impact on the long-term cash operations of the system, as was asked earlier, the cost and income rate lines never cross again. This plan does not get you there. It leaves some of those problems for another day. However, as we have constructed it, the cash deficits in the out-years under this proposal would still be reduced by 37 percent relative to current law, late in the valuation period. When you consider that we have done nothing to the system other than establish personal accounts, that is a fairly impressive degree of progress relative to the current system.

Now, the solvency and actuarial balance numbers are a little bit fuzzier, and this reflects that fact that there is a variety of ways that this account could be constructed. It could be constructed as a two-percent investment from the current payroll tax stream, it could be one percent from the payroll tax and one percent from general revenues. How we decide to finance it doesn't really affect the cash flow picture, but it does affect the solvency and actuarial balance picture because it affects how much money is attributed to the Social Security Trust Fund. Under any scenario on a perpetual basis, the perpetual solvency of the system would be improved. Only under some of the scenarios would they be improved within the 75-year valuation period, and those are outlined here.

Finally, this system would reduce the long-term costs of the Social Security system, including, I would hasten to add, these charts include the annual investment in personal accounts. So this isn't just a reduction in costs for the traditional Social Security system but the new system as a whole. It reduces the growth in costs relative to the economy by 30 percent through 2075. Again, considering that we have done nothing other than set up these accounts, that is a fairly impressive rate of progress relative to the current system.

I think my previous hope that the Commission wouldn't start to leave during the presentation has been partially born out. I still have an 85 percent rate I think.

DR. SAVING: How much do you have to go?

(Laughter)

MR. BLAHOUS: Okay. Let's go to plan two, unless there are --

MR. : Objections.

MR. BLAHOUS: -- objections or further commentary on the first plan.

DR. COGAN: Chuck, one point. You say here on page 15 that if you were to structure this personal account as one percent from the payroll tax and one percent from general revenues that the 75-year actuarial imbalance would be reduced by 28 percent, and that is true. But we have to be very careful here, don't we, because from the Federal government's standpoint, you are just taking it out of some other pot of money. So two percent out of payroll taxes from the Federal government's finances is no different than a one percent out of general revenues and a one percent out of payroll taxes.

MR. BLAHOUS: That is absolutely right, and I would say in some respects that is a parable on the limitations of what solvency and actuarial balance really tell you. One of the things that I did not do in the first item on the cash flow was to differentiate between the two-percent investment on payroll taxes and the one and one, because if you recognize the reality that the government still has to come up with one percent of general revenues in either case and come up with it from somewhere, it really ought not to be counted as some kind of new revenue to the system or revenue that is mitigating a cash flow problem. So in the chart on the previous page, the system is not given any credit for structuring this with general revenue diffusions, but that particular construction will change how our actuaries score the solvency and actuarial balance of the program.

(Overhead)

MR. BLAHOUS: Moving now to plan two. What these charts show on page 16, the chart on the left, I think it is very important that people understand what this illustrates. This basically illustrates in a certain sense what the world looks like without personal accounts in a way, because what we have done here is shown the benefits that can be paid exactly under the current system unless you begin to raise payroll taxes or require additional contributions.

The chart on the left has an actuarial balance of exactly 0.00. It is exactly balanced. So the moral of this story I think when you look at the chart on the left, it is not that this is something so specific to plan two for those who don't take the accounts, but it really is in some ways a measure of what the world looks like if we didn't create a personal account system.

What you see on the right is how the system will look if we move to a personal account system in combination with a balanced Social Security system. As you can see, there is a -- the transition investment that Dr. Cogan referred to is a little bit bigger under the current system, but qualitatively it is not much bigger than the current system. You can see that you reach your cash surpluses a little bit sooner and they become a little bit bigger than the current system. So even though we have made the personal accounts very attractive for the individual under this scenario so that they are likely to get considerable increases in benefits through the accounts, nonetheless, the long-term fiscal health of the Social Security system would be simultaneously improved as individuals take the accounts. So this is a very I think instructive pair of charts for showing how personal accounts can integrate with a valid Social Security system and improve treatment of individuals, and help repair the system's long-term finances.

CHAIRMAN PARSONS: Just so we are all clear, this example, the chart on the left is the projections, we have our standard projection of the existing current costing rate, and then the graph or the line underneath that is what would happen if we implemented what I will call the price indexing of initial benefits and the other changes that were suggested in option two.

MR. BLAHOUS: That's --

CHAIRMAN PARSONS: It would bring the system -- without personal accounts.

MR. BLAHOUS: Without personal account.

CHAIRMAN PARSONS: Implementing that package of reforms, that, you say, brings the system into actuarial balance and puts it on a long-term sustainable basis. And then if you overlay the personal accounts element of that, you get the chart on the right, which further improves the picture.

MR. BLAHOUS: Right, in the long-term.

MR.   : Long-term.

(Overhead)

MR. BLAHOUS: On the next page you can see a comparison of projected benefit levels. There's three lines on this chart. One shows you what the current system can pay in a literal sense if we don't do anything to the system and then watch benefits be cut in 2038. Another line shows basically what the current system can pay on a sustainable basis if the particular policy choices are made inherent in this plan. I think what you can see on these charts is that this particular plan directs more of the resources towards low-income individuals. You can see that relative to the current system, low-income individuals are for the most part well above what the current system can actually pay. For those who don't take the accounts, a little bit has been taken away from the high earners from the current system. But for all participants in accounts, you can see that if they take the accounts, their overall benefit levels would be much, much higher than if personal accounts were not integrated into the system.

MS. ABNOR: Chuck, can I ask -- Mr. Chairman, can I ask a question about this?

CHAIRMAN PARSONS: Please.

MS. ABNOR: If I understand this correctly from Steve

Goss's numbers, with this example, after moving from wage indexing to price indexing, we then took a look at the minimum wage worker and the low wage worker and what benefits actually -- we looked even at what their current benefits would be without any changes, and we decided that in those cases, those benefits were too low. Under this example or this plan, we have hiked them back up again.

So an example, a minimum wage worker under the current system would receive at retirement $7,344, but under this example that benefit would go up to $10,308 - almost an additional $3,000 a year in increased benefits from what the current system would pay for minimum wage, and almost the same increase for low wage workers. So the benefits under this example for minimum and low wage workers are significantly higher than under the current system, and I think that is a really important point going to the philosophy of a lot of us, that the most important function of the Social Security system is to -- most important function really is insurance against poverty in old age. What we are attempting to do is raise even more of our elderly out of poverty in the future than is already done by the current system or projected to do. I think this is maybe the strongest point in this sample plan, and I think it is something that needs to be highlighted. I think it is really important to look at the actual dollars that we are talking about. So, I mean in some, $3,000 a year increase from the current level.

MR. BLAHOUS: And it is worth stressing that there are increases for low-income earners --

MS. ABNOR: Thank you.

MR. BLAHOUS: -- relative to the current system, whether or not they take the account.

MS. ABNOR: Thank you. Yes.

MR. BLAHOUS: That ---.

MS. ABNOR: Without even adding on the personal account on top of it, which they would be able to do.

CHAIRMAN PARSONS: Tim.

MR. PENNY: Mr. Chairman, if I can tag on to that comment. You have a really good page that summarizes the various ways in which we can look at sustainability, and I think that is great. We ought to keep that, and in the final report we need to do as you have done here and illuminate how each of these examples or options or plans measures up against those criteria. But I think what Lee is getting at is there are some other important criteria that don't relate specifically to sustainability but relate to benefit levels for different categories, and that would be the lowest income workers, that would be surviving spouses, women who have been through divorce. There are changes within each of these plans that lead to different outcomes for those categories, and in many cases much better benefits than current law or promised law or certainly payable benefits under current law, and I think those also need to be highlighted more than you have done so in this report.

MR. BLAHOUS: I would stress a couple of things. One is that if the -- in the design of this plan, the Commission could have chosen to have a rate of benefit growth that would have just simply balanced the system as a whole exactly. It just so happens that if you were to go to complete price indexing, you would save a little bit more money than you actually needed to to balance the system. Instead of simply having an overall rate of growth that was higher than that, higher than inflation for everyone including higher wage earners, both in this plan and in the other plan, the fiscal subgroup basically sat down and said how do we target the resources of this system so that it most effectively reaches those who need these benefits --

MS. ABNOR: Right.

MR. BLAHOUS: -- to keep them out of poverty. These provisions to increase the widows' benefit, to increase the guaranteed minimum benefit for people as a function of their work history, these all are in these plans as a result of that.

CHAIRMAN PARSONS: Gerry and then Tom.

MR. PARSKY: I will have some comments at the end, but I just want to make sure I understand the comparative tables. This example two table that you are talking about now, initial benefit at 65, I think I understand the relationship between the red line and the blue line. Right?

(Background conversation)

MR. BLAHOUS: My copy is in black and white.

MS. : We just have black and white, Gerry.

MR. PARSKY: Black and white?

CHAIRMAN PARSONS: You got the one original.

MR. PARSKY: Okay. I think I understand the relationship between the present law benefit payable and the benefit that is without the account. There is a spread there. Okay. Is that right?

MR. BLAHOUS: That's right.

MR. PARSKY: There is a spread, suggesting that you don't deliver under this the same level of benefits that is payable under the current system. Is that correct?

MR. BLAHOUS: Under -- I'm sorry. You are comparing the benefits --

MR. PARSKY: I am just looking at the average earner, just for example.

MR. BLAHOUS: Oh, the average earner. That's right, because more of that money has been given to the low-income people.

MR. PARSKY: The low income. That I understand. Now if you just flip back to the same example -- I mean the same page but under example one. Since I have the benefit of colors I won't do that, but the relationship between present law payable and the benefit, I gather it is the benefit without the account. Are you saying under example one that the -- what will be provided would be greater than what is currently payable?

MR. BLAHOUS: Not really, Mr. Parsky, because example one acknowledges that future actions have to be taken to balance the system.

MR. PARSKY: Okay.

MR. BLAHOUS: And we don't know what they are going to be under option one, because we are not outlining what they are going to be. They are basically left for another day, another time. If under option one you visualize a particular means of balancing the system, you might well come up with something that looks like the benefit line that you see in example two.

MR. PARSKY: I see.

MR. BLAHOUS: But not knowing what that is, under option one what we do is we show the benefits promised and then what would happen in 2038 without reform. And then under example two we show a particular way of getting to a level of sustainable benefits in the old system that the fiscal subgroup thought was an effective way of targeting benefits for those who most needed it.

MR. PARSKY: Well, I think that we ought to consider -- I would certainly be very supportive of having this example as part of our presentation. I think it is very important. But I would think that we would want to make it very clear that the only way to achieve this line that you are talking about is by making significant additional changes at some point in time, because if you just look at these two together --

MR. BLAHOUS: Sure.

MR. PARSKY: -- I think it is a little bit distorted.

CHAIRMAN PARSONS: Tom and then Olivia. Tom.

DR. MITCHELL: I just wanted to elaborate on (away from microphone)---.

CHAIRMAN PARSONS: No.

DR. MITCHELL: Sorry. Thanks. I would just propose that you get rid of the line for benefit without account, because if you haven't specified what you are going to do to make it be there, then I just think you ought to get rid of it. Thank you.

MR.   : For example one.

MS.   : One.

DR. MITCHELL: In one. In one.

MR. BLAHOUS: Yes.

DR. SAVING: I think a point that we ought to make clear here is that at least plans two and three that we're discussing, plan three we still haven't discussed in detail, we made very conservative investment assumptions, return assumptions on investment, and we made very conservative annuitization rates. If we were to make more -- and rely a little bit on equity markets, still in a very conservative way, and a little bit more on equity markets in the annuitization phase, we can make these benefits of people with the accounts significantly greater than what is currently promised. And what is currently promised to a new person entering the labor force is a 50 percent increase in real benefits when they retire. We can do even better than that with still fairly conservative investment assumptions. We have made even more conservative investment assumptions than that, and I think that's important, and we have been able to accomplish in both of those plans a very significant -- an even bigger increase for lower income people than the currently promised law. So we have been able to accomplish a lot.

MR.   : That is a very important point.

CHAIRMAN PARSONS: Okay. John and then --. John.

DR. COGAN: I want to echo what Tim said and what Lee said about changing or adding to the criteria for evaluating these plans. I will give an example of just how powerful this option two is for low-income people. If you take a person who is 25 years old today and you give them a personal account with these conservative assumptions, the purchasing power of benefits for that low-income person, a person who has an average income of about $15,000, the purchasing power of the retirement benefits for that person will be the same as the purchasing power of benefits that are provided to a medium-income worker today. The average benefit to a worker today is around $1,000 a month. A low-income worker under this plan that chooses personal accounts who is 25 years old today and has a chance for the accounts to grow, will get a benefit in real terms that is the same as this middle class worker, even though their average income is around

$15,000. So that kind of example I think very well illustrates the power of personal accounts and the power of this proposal. I think when you start asking people to evaluate proposals, I think it is very important to have a criterion that reflects that fact.

CHAIRMAN PARSONS: Bob.

MR. POZEN: I just want to confirm with Steve that the conservative equity -- excuse me, the conservative investment assumption was a 50/50 portfolio, bonds and equity with roughly -- Chuck, am I right, with roughly a return of about 4.6 percent real, 4.7 percent real?

MR. GOSS: Yes. The sort of average portfolio was assumed to be 50 percent equity, 30 percent corporate bond, 20 percent government bond, with an overall net yield of about 4.6 percent real.

DR. COGAN: 4.6 percent.

MR. GOSS: 4.6 percent real. That's net ---.

DR. COGAN: I just think it was useful for the public to realize that we were talking about a 4.6 percent annual real return.

MR. GOSS: Net of administrative cost.

DR. COGAN: Net of administrative cost.

MR. PARSKY: And just to follow on that, what we heard from the Thrift Plan that now exists is what would be -- what was the average -- or what was the mix in the plan that currently exists?

CO-CHAIRMAN MOYNIHAN: (Away from microphone) You mean the mix of stocks --

MR. PARSKY: Of stocks and bonds in there.

CO-CHAIRMAN MOYNIHAN: Well, they have about seven plans now.

MR. PARSKY: But I -- is that --

CO-CHAIRMAN MOYNIHAN: ---

MR. BLAHOUS: Steve tells me it's, as of this moment it is closer to a 60/40 mix overall.

MR. PARSKY: That was my point. I think Tom has made an excellent point here, and I do think that it is important to lay out exactly the kind of assumptions that are used relating to these personal accounts, the mix, the return, and in relationship to what you might determine to be comparable areas.

CHAIRMAN PARSONS: Olivia, and then we are going to move to plan three. Just so that we are all -- we have a framework with which to work, I am hoping to conclude the morning by about 12:15, which is about 45 -- 40 minutes from now. We will then take a 1-hour lunch break. Senator Moynihan and I, just so that everybody knows, will probably do an informal press briefing at 12:45, and we will reconvene here at 1:15 and probably run to 3:00. So we all have a sense of time. Olivia.

DR. MITCHELL: I just wanted to extend what Gerry said, that in all of the plans, examples, options and so forth we have been looking at, we have been very consistent to always use the same assumptions across plans, so that nobody gets brownie points for deviating in an alternative direction. We have been I think very careful to compare apples and apples, and I would say that after our Commission's work is over and as other people take these discussions to Capitol Hill and the rest of the country, it is going to be very important to score these using a common set of benchmarks, or otherwise I think people will be very confused about where we are going.

CHAIRMAN PARSONS: Fair enough.

MR. BLAHOUS: Mr. Chairman, before I go to the last one, just a brief summary on the fiscal characteristics of the second plan --

CHAIRMAN PARSONS: Sure.

MR. BLAHOUS: -- I think are important. One is that this is a plan that would get to positive annual cash flows within the valuation period and they would be permanent. That is very important. I think it is interesting and worthwhile to note that if no one took the accounts that would happen by 2062, but if everyone did, it would happen by 2057. So in other words, the more people take the accounts, and the accounts are designed to be attractive, the sooner the system gets to positive, permanent cash flows. That is a very important result.

Solvency and actuarial balance would be improved under all participation rates for the accounts. The traditional Social Security system for those who don't take the accounts, or if you assume no one takes the accounts, that would be entirely balanced. The amount of revenues required to balance the system as a whole would be reduced by approximately 40 percent relative to the current system, and then I would -- that is 40 percent relative to a 75-year figure then, and that is important to note, because under the current system that figure is increasing without bound after the 75 years, whereas this plan would reduce that by 40 percent and then it would be over. You would be in permanent surpluses after that.

As for reducing the rate of growth and long-term costs as a percent of GDP, this program would solve that matter entirely. As a matter of fact, the total system costs would be lower as a percent of GDP at the end of the valuation period than they are today. So that problem would be entirely solved. And actuarial balance under all participation rates would be improving at the end of the 75-year valuation period. So you can see that this program meets a number of tests for fiscal balance, plus the progressive and distributive aspects the commissioners have outlined.

(Overhead)

MR. BLAHOUS: Going now to the third system, you see here two charts that show --

DR. COGAN: Chuck, can I interrupt you just for one second? A question about this third example. You say that it has a voluntary contribution. Is it that the contribution, the individual gets a personal account and then can add their own money to it, or is the out-of-pocket money required in order to get some access to their payroll taxes?

MR. BLAHOUS: My understanding of the construction of it, and commissioners should correct me if I am mistaken, is that the one-percent voluntary add-on is a trigger, as it were, for the personal account, that the individual chooses to put up one percent and then that is effectively matched by the government at two and a half percent from payroll taxes. So there is an incentive there. You don't get the investment of the payroll taxes unless you put the one percent in.

Now, there are other incentives as well that are put forth through the tax credits and other specifications that have been put forward, but it is sort of a triggering mechanism for the investment of the payroll taxes.

MR. POZEN: I think that is correct, but I think the incentive, there are tax incentives provided for people to put up the one percent including refundable tax credits for people who would not be otherwise paying income tax.

MR. BLAHOUS: Right. And in the case of low-income people, the particular incentive mechanism as I understand it is to do it through the year-end income tax credit.

MR. PARSKY: But just so that I understand it. I think this a very important point relating to this plan, plan three or example three. It is voluntary but you have pay something in order to be part of it? Is that what you are saying?

MR. BLAHOUS: That's correct.

MR. PARSKY: Oh.

MR. BLAHOUS: It is kind of a --

CHAIRMAN PARSONS: In order to be in the personal account side of it.

MR. BLAHOUS: In order to --

MR. POZEN: I think this is what is traditionally called an add-on plan, that you have to add on something --

CHAIRMAN PARSONS: Right.

MR. POZEN: -- in order to get matched by the goverment.

CHAIRMAN PARSONS: Right.

MR. PARSKY: Or kind of in short hand, you have to pay to play?

MR. : Yes.

CHAIRMAN PARSONS: But going back to again --

MR. POZEN: But you are tax incentivized to play.

CHAIRMAN PARSONS: Our conceptual dichotomy, Gerry.

MR. PARSKY: Okay. I think I -- pardon me?

CHAIRMAN PARSONS: Because the money comes from somewhere. Going back to our conceptual way of looking at this, this plan assumes more inflow. So part of that inflow comes out of an individual's pocket. In other words, you have put up an additional one percent to get that match by two and a half percent of your Social Security money in your personal account, and to incentivize somebody to put that money in, various features of the plan have been created that make it attractive for you do so. But yes, you have to pay to play.

DR. JAMES: The basic idea of this goes back to the basic philosophy that it is important to maintain or even exceed the current wage replacement rate. In order to do that, you need additional revenues. You have to get the additional revenues from somewhere. The add-on is one piece of that additional revenue. The tax source, whether it is from a stabilization of the wage base or from some other source of public money, is another piece of that. So that is the general approach in plan three.

MS. KING: May I just ask one question of Estelle, and that is, the refundable tax credit part of it is purely for incentive? That is to say, if you didn't -- you don't need it in order for your -- for the plan to go forward. You're thinking it is like a sweetener, like a ---.

DR. JAMES: Well, yes, but especially for low earners. It is going to be difficult for them to come up with the additional one percent. I mean, one percent of, say, $10,000 is only $100, but that may be a lot of money for that person who is only earning $10,000.

CHAIRMAN PARSONS: Undoubtedly is.

DR. JAMES: The tax credit and the fact that it is refundable is designed to make it attractive and affordable, even for the low earners.

MS. KING: Okay. I just need somebody to correct my memory. I remember a number of tax proposals with the term "refundable" in them, but it seems to me that they have not traditionally been terribly successful in passing. Am I missing something here?

MR. PARSKY: They're not.

MR. POZEN: This one already exists. I mean, we are building off the one that exists, and it essentially would say if you are already eligible --

MS. KING: The earned income tax credit.

MR. POZEN: -- the earned income tax credit. Just to give a simple example, if you are already eligible for the earned income tax credit and you had to put, as in Estelle's example, $10,000 -- you are at $10,000 and you had to put in an extra $100, this would give you a refundable tax credit of, say, $50 toward the $100, so you would get partially subsidized by the existing -- in accordance. You wouldn't create a new program; you just use the existing program.

MS. KING: I see. Thank you.

CHAIRMAN PARSONS: John.

DR. COGAN: Now this earned giving of a tax credit is for people primarily who don't pay any income taxes.

MS. KING: Exactly.

DR. COGAN: And so it seems to me that the proposal as it is structured uses somebody else's money for the person's personal account. Why wouldn't you modify the proposal, or would you think it would be a good idea to modify the proposal, to instead say for low-income people, allow them to use an additional one percent of the payroll tax, so they are using their own money that they pay in taxes creating, thereby, ownership? Why have you gone the route of using somebody else's money?

DR. JAMES: Well, the basic idea is that we are using the tax system, which is a very traditional way in the United States to encourage retirement savings. Everyone is expected to put up something if they want to play, and this includes low earners. But everyone gets some kind of a tax incentive, but low earners get it in the form of a refundable tax credit which covers part of that add-on, although not all of it.

MR. POZEN: I think the answer is this, that we provided that the match will be 2.5 percent but up to $1,000, which gives a larger account for lower-income people, but if we had taken out another 1 percent for low-income people, it would have hurt these solvency type of --

DR. JAMES: ---

MR. POZEN: -- calculations, and the basic philosophy here is that we want to bring new revenue in the system. We want to do this change for longevity, but we also want to bring new revenue in the system, and this was considered to be a modest way to bring in -- an incentivized way. If we took out an extra one percent, which we could do, it would change all the solvency numbers in a negative way.

CHAIRMAN PARSONS: I think, John, the value of this is it highlights the public policy issues --

DR. JAMES: Right. That's right.

CHAIRMAN PARSONS: -- that various approaches to solving this problem create, and that these are the kinds of issues I think the Congress and ultimately the President need to wrestle with and grapple with in terms of how do we bring this thing back into solvency.

DR. JAMES: Right.

DR. COGAN: But I think one of the important points is, to go back to what I said earlier, that is we shouldn't confine ourselves to narrow measures of solvency. A dollar out of the Federal Treasury is a dollar out of the Federal Treasury. When thinking about solvency issues, it is important to consider the Trust Fund but you don't want to make, I won't say, inferior policy, but you don't want to be driven too much by this, by being tied to the 75-year solvency of the Trust Fund.

MR. PARSONS: Tim.

DR. JAMES: Could I just mention that in terms of the numbers, the earned income tax credit refund, which is what we have been discussing here, would cost about a billion dollars a year. So in the infinite scheme of things, compared with the trillions that are under discussion, we are not talking about a huge impact on the general budget.

CHAIRMAN PARSONS: A billion here, a billion there.

MR. : Is that the right number?

MR. PENNY: But we are. But we are talking about an impact.

DR. JAMES: Yes.

MR. PENNY: And whether it's EITC or getting back to our earlier discussion about expanding the wage base or just an outright general fund --

CHAIRMAN PARSONS: Transfer.

MR. PENNY: -- transfer, somehow in our analysis of the fiscal impact of these various examples or options, we need to be honest about that, so that we are not comparing apples to oranges. So find a way to do that in the way you draft our final report, and then we can approve or disapprove of how you recommend, but we need to find a way to do that, because it is sort of hidden and we are looking at this as if there is solvency that's, you know, solvency that isn't quite the same as the solvency we have described in the previous option.

(Background conversation)

MR. PENNY: Because this requires some money to come from somewhere, and it is not accounted for in quite the same way that we accounted for it in the previous option.

CHAIRMAN PARSONS: Better put, it requires some money to come from a bunch of places --

MR. : Yes.

CHAIRMAN PARSONS: -- and we ought to be clear in terms of how much actually is coming additional contribution from workers, how much is being tax subsidized, how much is coming from some other place that shows up on the Federal budget or somebody else's budget.

MS. : Right.

CHAIRMAN PARSONS: Just be clear where the money comes from.

MR. BLAHOUS: I also want to be clear on a couple of technical points. One is the --

CHAIRMAN PARSONS: Oh, no. Here we go.

(Laughter)

MR. BLAHOUS: Sorry. We are and have been working on trying to get a more precise estimate of the size of the EITC subsidy. We are working with OMB and the Treasury to do that. Secondly, and this I think is responding to Commissioner King's question basically about the nature of the one percent add-on, again stepping back to the big picture, there is kind of a basic ethic, if you will, residing under each of these plans. The way that this one percent add-on is structured, there is no offset associated with the one percent add-on, and if it were not there, the basic systemic finances within the Trust Fund would still be the same. So where this cost shows up and the reason it is present is because the underlying ethic that went into the drafting of this option was to hit as a target the current law benefit promises, and that is the main function of this one percent add-on. It is not so much to interact with the system finances, which are basically the same without it because it is not offset. So the cost of the EITC subsidy really shows up on the Federal government's books as a whole and is sort of inherent in the benefit projections for individuals, more than it is with the finances of the traditional Social Security system.

DR. JAMES: Chuck, isn't it true that we are developing measures on the unified budget? I think that would address Tim's concerns.

MR. BLAHOUS: That would be included.

DR. JAMES: That is one of the indicators that is important to look at. That should capture all of these things.

MS. KING: Just so I am clear --

MR. : Speak into the mike.

MS. KING: What I thought I heard you just say, and I could be wrong, that using the EITC is in fact tantamount to a tax increase, and --

MR. : I don't --

DR. JAMES: No.

MR. BLAHOUS: No.

(Background conversation)

CHAIRMAN PARSONS: It is more equivalent to a transfer of general revenue. It is more equivalent, conceptually equivalent.

MS. KING: But using the EITC doesn't -- does have a sort of reverse impact for where we said we would be going with the revenue program aspect.

CHAIRMAN PARSONS: I don't think so, Gwen. I think what -- the way to think about it is, you would give -- some people if they chose to put up an additional one percent of the their earned income base would get a bigger tax break than they currently get.

MS. KING: Okay.

CHAIRMAN PARSONS: So it is equivalent to at the end of the day a general funds transfer, as opposed to a tax increase.

MR. PARSKY: I think that is a valid point. In order to have apples compared to apples, I think if you considered doing what John I think was suggesting, which is if you allowed this to be an additional amount of payroll taxes but then had to identify the amount of general revenue transfer you would have to make in order to deal with the sustainability issue, then you will have -- there will be some general revenues needed in transition for plan two.

CHAIRMAN PARSONS: Yes.

MR. PARSKY: And certainly there will be additional revenues needed for plan one, even though it is not quite identified in terms of how much. So you would then have at least the basis for doing an apples-to-apples comparison, it seems to me.

MR. BLAHOUS: That's right. And we have tried within the restrictions of a fairly simplified presentation here to show these different aspects. It is inherent in the plan to commit these revenues, so the initial presentation of the plan shows it with these revenues in there, but there are various --- risks and qualifications that basically show the net amount of revenues -- net of these revenue commitments, and Steve has also been asked at every step of the way to separate out the various components so that commissioners can see the revenues committed from different sources.

CHAIRMAN PARSONS: Okay. Let me --

DR. JAMES: There is a policy decision about where the revenues should come from. We are not going to make that choice. That choice will be made by Congress and by the White House. So there is a difference between a plan that visualizes the money coming from the payroll tax versus the money coming from the general revenues. There are different distributional impacts. The money will ultimately come from somewhat different sources, so I think it does make a difference how you specify that. At the same time, it is important to capture all of these cost elements, and that is the reason for including the impact on the unified budget.

CHAIRMAN PARSONS: Chuck, let me ask you to take the next five minutes to finish the last I think it is two pages of this presentation, and then I want to throw it open for some general discussion, because I think we need to begin to drive this to a point where it will be helpful to the staff in terms of next steps.

MR. BLAHOUS: Okay. Terrific. Let me just summarize very briefly the benefit projections for this proposal. As you can see, individuals who take the accounts under this proposal would vastly exceed what they would expect to get from the Social Security system lacking the accounts. The one thing that I would point out here is that the underlying ethic, as I said before, of this proposal is that if people took the accounts, they would be able to reach or exceed what the current system even promises, and that is why it has to tap additional revenues to do that.

Now, the other thing I would point out is that when this proposal was first devised we were making some even more conservative assumptions on the rates of return. So these actually all exceed current law benefit promises by more than they did when this proposal was first developed. So even if you scale back these projections to an even more conservative rate of return, you are still going to be beating what the current system promises, just because of the timing of our work and the way we did our projections.

(Overhead)

MR. BLAHOUS: Finally, on the last page, interestingly, this system will return to cash balances in the out-years if everyone participates in the accounts, and there is ample incentives for them to do so, especially because the two-percent offset is only applied to a portion of the total of account investments, and so individuals are likely to come out, as you saw before, very far ahead, and if they do, the system will reach permanent annual cash balances in 2062.

Under all participation rates for the accounts, the solvency and actuarial balance picture would be improved about 50 percent of -- 54 percent of the current gap would be filled in terms of the revenue commitments remaining yet to be devoted to the system to bring it to solvency. What I have done in the double asterisk below is to net out some of the other revenues for those commissioners who wanted to look at the proposal without the credits for the transfers of those revenues.

Like the previous proposal, the total system's costs would not be growing faster than the gross domestic product by the end of the valuation period. That problem would be wholly solved, and the system would be absolutely sustainable as a function of the growth of the American economy. And like the previous proposal, the actuarial balance of the system as a whole would be improving and not deteriorating at the end of the valuation period.

So those in sum, Mr. Chairman, are three different examples that are before the Commission for their consideration. They each serve different philosophical approaches to attaining fiscal balance within Social Security, and they each show how personal accounts can benefit beneficiaries as well as the system as a whole.

MR. POZEN: Could I just add one --. Again, this point on the low earners, if you look at example three, initial benefit at age 65, from 2036 on the benefit of low earners is very much higher than you would have under the current system, and unlike plan two, that continues - and continues essentially forever. In plan two they come back together, but because of the wage replacement feature of the way we have structured this, low earners continue to have a substantial benefit on the DB only, just assuming they don't even take the personal account. They are going to have a lower benefit essentially throughout this whole period. So I think this is a very important feature of the plan.

CHAIRMAN PARSONS: Okay. Let's have a period of general comment on these three plans, and then hopefully, what I would like to do is in the next 15 minutes drive it to a point where we could be at a point where we give staff guidance in terms of whether we want to now construct this sustainability part of our report around these three options or we don't like these options, we want to modify them. Sam, kick us off.

MR. BEARD: I would like to, Mr. Chairman, make a totally nontechnical comment.

CHAIRMAN PARSONS: It would be welcome.

MR. BEARD: I have had the privilege of participating in this whole process over the six months, and I just want to give an overview. What's going on today from my vantage point is very exciting. What we are saying is, Social Security as it is is in serious imbalance. We have done the work. We have put together three alternative plans. It is very important that in the three alternative plans there are some tough choices. If there is a serious imbalance, tough choices need to be made.

What is exciting here is that the -- when I go back to 1998, President Clinton pulled us all to the White House and said, "For the good of the country we have to change Social Security. Don't get tied up in any position you are in, because we are going to have to do something significant." It is very exciting that President Bush has picked up that and he is saying on a nonpartisan basis with the Congress, let's get going here. It is essential for the good of the country.

What we are putting together here is three plans, and the message really is it is exciting. In a short period of time, one, two years, we need to address this on a nonpartisan basis, and basically, anybody could take parts of any one of these plans and carp at them, they can demagogue at them, but there is an exciting message here. The vision part: let's put wealth on the table for all Americans, let's save Social Security, save the social component part. So basically, part of the message is, everybody get serious. If you don't like what we are doing, no plan, no play. You have got to come up with something which reflects the degree and depth of the work that has gone in here, or else it is not responsible dialogue.

MR.   : It is taking a life of its own.

CHAIRMAN PARSONS: Yes. Fidel.

MR. VARGAS: You said 15 minutes, but -- and maybe sooner, at least I hope, because one of the things that I got from this discussion was, number one, I want to thank the fiscal subcommittee and staff for doing the work, because I think you did capture kind of the range of options. What I see it really is is as a continuum. You have three plans that are presented before us today, but really there is a fourth, and that fourth is the "do nothing plan" which you talked about, which is obviously that there is no one that can argue everything is sustainable for the long-term. Yes, current and near retirees are going to be taken care of, and we --- right away to take care of them if we don't do nothing, but the "do nothing" option means increasing taxes or cutting benefits.

But the three plans that are presented here today, again, are along a continuum, from modest I would argue, to more progressive, and also progressive in the terms of sustainability. The way to get there is -- there's different paths to get there. Frankly, I think that the fiscal subcommittee did the work that we were charged to do.

Now there are details that need to be illuminated in each of these plans I think for the final report, but I don't -- I would recommend or I would move that the Commission direct staff to illuminate some of the potential issues in the plans that have been addressed today but that to come back with those three proposals as potential plans or paths to follow as recommendations to the President in our final report.

CHAIRMAN PARSONS: Is there a second to that motion?

DR. MITCHELL: Second.

CHAIRMAN PARSONS: Now live for discussion. Keep going.

MR. VARGAS: Then I will just keep going with that discussion.

CHAIRMAN PARSONS: Keep going.

(Laughter)

CHAIRMAN PARSONS: Just being efficient.

MR. VARGAS: As a former Mayor, I am used to moving things along in this manner, so I apologize if I seem a little too pushy. The things that we talked about in terms of the President's directives and then more importantly some of the issues that were discussed today. How I am looking at this from my perspective, because I actually rank them a little differently than were discussed today, but the first which I think is important is each of these establishes substantial personal savings accounts. You can argue again about the size or the depth, but essentially we are talking about, as Senator often says, personal property, accounts that are people -- that people can see, that they can touch, that they can feel, that they can direct, that they can own, that they can pass on to their heirs, and that will make a significant impact regardless of what plan they are included on the economic well-being of all Americans, especially low-income and low-wage earners.

The second is financial sustainability. Again, you could argue that even plan one to some degree addresses it, although obviously there are still questions that need to be resolved, and that plan three and plan two address it as well but in different ways. We are protecting current and near retirees. Nowhere here have we said that we will not continue to honor those promises that are made to current and near retirees. That was a given, and that's something that we are emphasizing again today.

One of the things that was critical for me is we are essentially talking about raising the benefit levels, real or not real, for low-wage earners in each one of these proposals in different ways. That is critical. That to me is critical. A fifth is we are protecting survivors. We talked about it again. We have dealt with those issues. And finally, protecting minorities and women to some degree. Again, we can argue that we could do it better in one plan versus another, but in each one of these it is addressed in that way. So I think that from my perspective the fiscal subcommittee did its work, and again, we would just reiterate that we -- and it has been seconded, that we direct staff to go ahead and work on the specifics of each of those so that when we have a final report that all of those issues are illuminated properly.

CHAIRMAN PARSONS: Further discussion on the motion? Bob.

MR. JOHNSON: I just have a question that will relate to something I want to talk about in the administrative portion this afternoon, which may if answered correctly permit me from being the weakest link in this discussion. Question: assuming everyone were to take out that personal retirement portion of their Social Security account, only that part, at retirement, would that damage or destroy the sustained viability of the system?

MR. BLAHOUS: No, actually.

MR. JOHNSON: Thank you.

(Laughter)

MS. : Yes or no. That's very good.

CHAIRMAN PARSONS: Gwen.

MS. KING: Mr. Chairman, at our last meeting I complained that --

CHAIRMAN PARSONS: I guess Chuck is the weakest link.

(Laughter)

MS. KING: At our last meeting I complained that the economic group hadn't come forth with plans, and I just want to publicly take back that statement. I would eat the piece of paper if I still had it. I think you have done a fabulous job. I would only add to the motion that I think it would be so important as staff begins to take on this assignment that we keep in mind the importance of communicating clearly, of trying not to lapse into jargon, of writing with a voice that people will understand and be very clear, not ambiguous, so that our report can get the receptivity that it will and people will understand it.

CHAIRMAN PARSONS: Will you accept that as a friendly amendment, Mr. Vargas?

(No audible response)

CHAIRMAN PARSONS: Mr. Seconder?

CO-CHAIRMAN MOYNIHAN: Second.

CHAIRMAN PARSONS: Okay. Bill and then Mario.

MR. FRENZEL: I --

CHAIRMAN PARSONS: Speak into the mike please. Thank you.

MR. FRENZEL: I intend to support the amendment. I would hope, however, the staff and in fact the members of that committee or the members of that subgroup who have performed so well might not give up attempts to expand. I think there are things that we have all talked about both inside and outside of that committee, which may well go in here as some options. Obviously, we cannot bring in a whole new plan from left field and have it actuarially assessed, and I don't mean that, but I would like to give the staff a fair amount of scope, Mr. Chairman, and I would ask the maker of the amendment if he has that in mind.

MR. VARGAS: I envision that staff would have that latitude in, for example, talking about each one of the plans, talking about different iterations of that particular plan; in other words, different revenue sources or different ways that the accounts could be structured, or larger versus smaller in plan one and plan two, and how that impacts the finances -- in plan three as well, of those plans. So I would agree that we should give staff that latitude. The only thing, and I think you mentioned it, is not to just bring in plans from the outside. But there are plans that have been -- that I have seen or have been discussed that could easily fit within the frameworks, one of the three frameworks, and can be further illuminated and discussed as other options.

MR. FRENZEL: Thank you.

MR. VARGAS: Is that what you had in mind?

MR. FRENZEL: Thank you, gentlemen, for that assurance. I just want to point out we have here a work in progress. The vote that we make on this motion does not bless any of these plans, nor all of them.

CHAIRMAN PARSONS: That's correct. That's correct.

MR. FRENZEL: We are still fumbling and groping our way toward nirvana.

CHAIRMAN PARSONS: I think that is well said and importantly said, that we are working our way to a final report. This is not the final report. Mario.

MR. RODRIGUEZ: Well, I would just like to commend the fiscal group for really addressing the individuals that really, really need to be benefited by this reform that we are doing. That is the lower income workers in this country, that we are really addressing their need, because those are the individuals that really, really are going to be affected by what we are doing. So I would like to commend the group for all the hard work that they have done.

CHAIRMAN PARSONS: Olivia and then John.

DR. MITCHELL: I will be brief. I guess I first wanted to thank the fantastic staff. I really think that all of us owe -- the nation owes a huge debt to these people, not an unfunded debt, however.

(Laughter)

DR. MITCHELL: But I think Chuck has been masterful in his work. Steve has done amazing -- he is a superman.

MR. POZEN: Steve doesn't sleep. We have all realized Steve does not sleep.

DR. MITCHELL: I have gotten emails from this man at

2:00 a.m., 3:00 a.m., 4:00 a.m., 5:00 a.m. When does he sleep? Jeff and Kent Smetters are both doing excellent work, and I am really very grateful. I think we should all be.

Having said that, I now have a request for their future work. Maybe I buttered them up enough. I guess I would like to ask that the staff prepare the information that we look forward to to be discussed at our next meeting along two lines, at least two things that I would like to look forward to. First of all, I would like all the benefit estimates that are going to be generated to be always compared to what today's retirees are receiving, so that we always get a sense of relative proportions. And I also would like to get a sense of what those benefit forecasts under the different plans would be in terms of benefits payable according to the current system. So that's a benefit structure request.

Then the second part of the request was, could the staff prepare, and I think they are going to do this but I just want to support it, the results in terms of the different plans in terms of the unified budget, that is, what is the overall cost after all is said and done? Because we really can only in that sense look at the big picture.

CHAIRMAN PARSONS: I think that's fair.

MR. BLAHOUS: Sure.

CHAIRMAN PARSONS: John.

DR. COGAN: Let me just follow up on something that

Bill Frenzel said.

DR. MITCHELL: Mike.

DR. COGAN: I think it is very important that if we are going to consider modifications that the public keep in mind that an implication of that is the options or the plans that are before the Commission now are not final by any means, and there very well may be significant modifications in them. There will be a tendency for the press to report that the Commission has locked on to three plans. That would be a premature conclusion.

CHAIRMAN PARSONS: I am going to ask you to be very brief, because I want to give the last word to my distinguished co-chair. Bob and Estelle.

MR. POZEN: I just want to emphasize the plans two and three both bring the system back to solvency, and they do that regardless of whether or not people adopt the personal accounts. I think that is critical. The changes in Social Security that are proposed are not there to finance personal accounts. First we get to solvency, and then personal accounts are a way to make those changes more attractive to people - and that's a big difference.

CHAIRMAN PARSONS: Thank you, Bob. Estelle.

DR. JAMES: I just want to add to the burden that we are placing on the staff that Olivia raised. Olivia suggested various ways that the benefit numbers could be presented. Since one of the objects of one of the plans, plan three, is to maintain or exceed current wage replacement rates, I think it is very important to present these numbers also as benefits in relation to wages on average in the economy, so we get that aspect of the picture, because we don't get that aspect if you are just looking at dollars.

CHAIRMAN PARSONS: I think some of these charts may find their way into an appendix, so that we can refer to it.

DR. JAMES: Fine. Fine.

CHAIRMAN PARSONS: Gerry, and then Tim and then Senator Moynihan.

MR. PARSKY: Just one kind of specific request, and see if we can't add this. I think it would be helpful with respect to each of these three plans if the staff could look at the potential element of progressivity in each and how that could be configured into it, if that is all right with my colleague. I would like to kind of add that to the proposal.

And second, just more generally, I also want to compliment the staff. They have really done a fabulous job for this group. I think it is important that at least from my perspective, the message out of -- one message general in nature out of this group is that none of these proposals are calling for the privitization of Social Security. None of them. That is not what this subcommittee is suggesting to the full Commission. But each of these plans, and this is a point that staff has made that

I think is very important to come away with, each of them establish personal accounts that provide additional benefits to those people that choose them. That is, I think, a very important point. The personal accounts does not mean privitization of the entire system.

CHAIRMAN PARSONS: Okay. Tim, very quickly.

MR. PENNY: Yes. Thank you, Mr. Chairman. It has already been referenced that we would like something specific to deal with the other revenues that some plans might call for. Olivia described it as maybe unified budget. There might be other ways of illuminating that, and I think it has been agreed that that will be added to the criteria.

Secondly, Gerry just mentioned this progressivity piece, and Estelle mentioned minimum benefits.

DR. JAMES: And wage replacement rates.

MR. PENNY: That is a part of how we are doing progressivity. That needs to be better illuminated. Then the third would be safety net, which is some of those other categories, widows, those who have been divorced. That needs to be better illuminated. Fidel I think has accepted all three of these as sort of friendly amendments to his initial motion. If that is the consensus, then I guess that can be incorporated into the motion we are voting on.

CHAIRMAN PARSONS: Senator.

CO-CHAIRMAN MOYNIHAN: I move that further --

CHAIRMAN PARSONS: There is a motion on the table.

CO-CHAIRMAN MOYNIHAN: Then may I suggest that the debate come to an end, for the simple reason, sir, that we have 12 days, and we have put these folks through an awful lot, but if we let them know it is only another 12 days. But I think we have a superb product here and we all should be very proud, but don't get beyond that capacity. We will be here, wherever we are, in 12 days time with something that will be historic.

CHAIRMAN PARSONS: All right. There is a motion upon the table that has been friendly amended I don't know how many times, but somebody is keeping track of all that.

MR. : There's no objections I don't think.

CHAIRMAN PARSONS: Are there any objections? Can we say --

(No audible response)

CHAIRMAN PARSONS: Moved without objection.

CO-CHAIRMAN MOYNIHAN: All right. Vargas plan.

CHAIRMAN PARSONS: We will back at 1:15. Senator Moynihan and I will be available for the press I guess in a half an hour in some room nearby.

(Luncheon recess)

A F T E R N O O N S E S S I O N

(1:22 p.m.)

(Away from microphone, simultaneous conversations)

CHAIRMAN PARSONS: We are going to talk through the remaining administrative issues so we can give staff guidance as to how to --- this forward. Chuck, I am going to turn it over to you.

MR. BLAHOUS: Well, Mr. Chairman, I think there is a general desire and the possibility that we can move through several of these issues very quickly. Remember, 7 of the 11 issues on the administrative front have already been debated by this Commission, so we just need to bring ourselves to a point where we can decide whether there is a consensus view for a particular choice, or if there is not, we can just decide to present the multiple options in the final report.

The very first one is the most major subject, which is the overall structure for administering the personal account system. There are multiple options for doing so, which should be in front of every commission member, including a centralized system modeled on the Thrift Savings Plan and a mixed system. Those are the two options. Now I would leave it to the Commission to determine whether or not it wants to bring this decision to a point today and select between these two choices, or simply present both in the final report.

CO-CHAIRMAN MOYNIHAN: Mr. Chairman.

CHAIRMAN PARSONS: Senator Moynihan.

CO-CHAIRMAN MOYNIHAN: Mr. Chairman and fellow commissioners, this seems to me to be just the kind of question we ought to leave the President and the Congress. It is not as if it is an amorphous set of propositions. The Thrift Savings Plan is in place. It is stable. We have heard the testimony. On the other hand, a perfectly good place to be made for administering this through the Social Security Administration which is a free-standing Administration with an administrator headed by the President. He may want to have a board appointed by the President. These are good choices both. Let us leave them to the decisions that follow, the principles we are trying to establish.

CHAIRMAN PARSONS: Would it be consistent with your thinking to this Chair, that subcommittee, that we simply describe both and lay out pluses and minuses, and let the policy makers make the policy?

CO-CHAIRMAN MOYNIHAN: Exactly, sir.

CHAIRMAN PARSONS: Is the Commission comfortable with that?

MR. FRENZEL: I think we had an awful lot of fun arguing about it --

CHAIRMAN PARSONS: All right. Speak into the microphone.

MR. FRENZEL: -- at subgroup. I think there was absolutely very little variance in the members' feelings about the matters on this afternoon agenda, save one item which dealt with how you -- well, let me go back.

Most of the members expressed a preference for a tier one, tier two, a mixed program. At tier one you would start something like the Thrift Plan, and as the Senator says, that's enough of a description. They can figure out what they want to offer. But then there was a strong feeling by a number of members, both in the subgroup and in the other subgroup, that we needed competition and market action as soon as possible. So ideas were floated about having a tier two occurring after three years I think was the time frame. There was a lot of discussion on that and quite a lot of argumentation.

Brother Beard raised the question this morning to some of us that we needed to be careful about this, because we needed to control the costs. After all, all of our assumptions, all of our run-outs require that we have a low cost, and yet we have a lot of people that believe that the best way to low cost is competition. We weren't interested in price caps, and we had to find our way through with some language. I think there is relative consensus, but we need to get certain individuals together with certain other individuals to work out some language. I think the thought here would be that as you went into tier two you would not have a lot of other offerings of products.

CHAIRMAN PARSONS: Okay.

MR. FRENZEL: You would have a slight expansion over what you had in tier one, but there would be more managers injected in the system under a system -- under a standard set by whoever the trustees are that are managing the place, and I think the language with respect to those standards needs to be worked out. Perhaps if staff might proceed, we could then do what Senator Moynihan suggested, that I think the thing is relatively controversy-free, leaving that part open for discussion.

CHAIRMAN PARSONS: Let me make the following suggestion then. To the extent -- and I know that you reflect the sense of the subcommittee, that there was consensus around most of these issues, and most of them were discussed fully at the last meeting, what I would ask Chuck to do is to just tick through in relatively efficient order the items on the administrative list and what you believe the consensus view to be, and then we can proceed by objection. If someone has an objection to the statement of the consensus, they can articulate that objection at that time. Then we save for the end the one on which you acknowledge there isn't consensus and we have some discussion around that. Does that make sense as a way to approach it?

MR. FRENZEL: Fine.

CHAIRMAN PARSONS: Now, can you do that, Chuck?

MR. BLAHOUS: Yes, I can do so. The thing that is giving me pause is the very first issue happens to be the one where I am least confident of giving voice accurately to the Commission consensus, but I'll give it a shot.

CHAIRMAN PARSONS: Then put that at the bottom of your list.

MR. BLAHOUS: Well --.

CHAIRMAN PARSONS: Go over the easy ones first, Chuck. It is a management principle.

MR. BLAHOUS: Okay. All right.

CHAIRMAN PARSONS: Get some momentum.

MR. BLAHOUS: Let me start with issue two then, which actually happened to be the subject of the longest discussion last time. It had to do with this question of whether or not we should restructure the collection mechanism in order to reconcile payroll tax contributions with personal accounts more rapidly than the current system can do. Your basic options are to leave that unchanged and to leave that reconciliation period as it is before. The second one is to require more from employers in the way of reporting in order to speed it up. The third option is what I believe is probably the prevailing viewpoint, and that is that there shouldn't be any changes to the collection mechanism up front but that the governing board of the system would be instructed to investigate the feasibility of shortening the reconciliation period.

CO-CHAIRMAN MOYNIHAN: Mr. Chairman, I think that is agreeable with the exception that I think we should specify that we are not intending to add any burden to employers in this process. And I would note, sir, that we have a paper here which anybody can have on the Treasury work on administrative issues on Social Security personal accounts. In the fall of 1997, the Clinton Administration began to analyze the proposals to create a system of individual retirement accounts, either as part of Social Security or outside it. --- has given a long paper --- inside the administration of ---.

CHAIRMAN PARSONS: With that emendation, are we all comfortable with that statement of issue two?

(No audible response)

CHAIRMAN PARSONS: Issue three.

MR. BLAHOUS: Issue three. The first part of issue three was I think the subject of apparent consensus on the Commission last time, that the centralized tier one system should be modeled after the Thrift Savings Plan, and participants could choose from a combination of specialized index funds that is very similar to the five choices now in the Thrift Savings Plan.

What was not settled was whether -- what would be the character of the investment opportunities available in an eventual mixed system. One possibility is for the private sector account administrators in a mixed system to offer the same passively managed funds as are offered in the TSP system, and possibly actively managed or broadly diversify mutual funds certified by the governing board according to some criteria and nothing beyond those. However, there have been some specific suggestions as to what should be the exact language of the choices, and perhaps we should throw that open for a little discussion before resolving it.

CHAIRMAN PARSONS: Well, let's find out first if we are all comfortable with the concept, because I don't want to turn this into a 15-member drafting session.

MR. BLAHOUS: Right.

CHAIRMAN PARSONS: So, would you restate what you thought the approach would be?

MR. BLAHOUS: I think the basic approach is that if and when there is a mixed system developed and another tier added to the basic Thrift Savings Plan model, that private sector account administrators would basically be told to offer the same passively managed funds that are available through the Thrift Savings Plan model, possibly actively managed or broadly diversified mutual funds certified by the governing board according to criteria outlined by the board.

CHAIRMAN PARSONS: But they develop at that time. Right. Now. Bob.

MR. POZEN: I generally agree. Two quick points. In the Thrift in tier one, I think a lot of us have suggested that there should be an inflation-protected bond fund which is not in the Thrift Plan now, and I think we should say something about that. Second of all, I feel strongly if we are going to have a tier two, we have to offer something other than the same exact passive index funds that are in the tier one, otherwise there is no real point in doing it.

CHAIRMAN PARSONS: But I thought conceptually what I heard was that you could consider more actively managed things, but according to criteria developed by whatever governing board was there at the time, which seems sensible. Fidel.

MR. VARGAS: I was going to say on issue three, two of the three points, there's 3A, B, and C. On two of them there is a consensus, and on the third -- or on the second point is where there is the issue. My suggestion would be that we move forward with those that have consensus, and on the third just include both of the options that we have said, and, again, outline the pros and the cons of each, leaving those to the governing board as they decide to make those decisions, because I think the details of each of these need to be worked out in sufficient fashion that it would be -- we could possibly do it here, but I think it might be better left for those folks at that point.

MR. POZEN: I would respectfully disagree. I think if we say that we leave it to the board to develop the criteria for these other funds, that's -- there is a consensus that we need to at least contemplate the possibility of a second tier, and that we need to leave to the board after several years of experience the criteria. I think we can leave it that way and that's pretty good general --.

MR. VARGAS: That's direction that you can provide. Sure.

MR. FRENZEL: It is true that we can probably agree on this quite quickly, but John and Gerry who are not with us have an abiding interest in this. So we need to have our opinion conditioned on their approval.

CHAIRMAN PARSONS: I think where we should leave this one, because I am actually hearing an awful lot of agreement --

MS. : Right.

CHAIRMAN PARSONS: -- is that we -- obviously the wordsmithing is going to be important here, but that is not the purpose of our meeting today to wordsmith. I think conceptually you have got your marching orders, and I suggest you move to number four, or move to the ones you can move through quickly first.

MR. BLAHOUS: Okay. Well, issue four happens to be one where the Commission did reach a consensus last time and gave very clear direction. It had to do with the frequency of investment reallocations, and they decided, the full Commission decided, in public debate to basically limit it to a once-a-year open season. Staff was instructed to produce that, and we will.

The fifth issue has to do with distribution of assets in the event of divorce, and there are three options before the Commission. I would draw your attention to the second one, which I am told probably most reflects opinion, and that would be that all account balances attributable to contributions during the marriage and interest earned on the account balances brought into the marriage are split equally, but account balances brought into the marriage are not shared. That is probably what we took away as being the most likely consensus view on the last meeting.

CHAIRMAN PARSONS: It seems to me --

DR. MITCHELL: Question?

CHAIRMAN PARSONS: Olivia. The one thing that was left off of here, not to nitpick, is interest earned on account balances brought into marriage. You might just want to clarify where those go.

MS. : Those are split equally.

MR. : They are split equally. Correct.

DR. MITCHELL: No. Interest earned -- oh, I beg your pardon. I take it back. Thank you. Sorry.

CHAIRMAN PARSONS: Are you cool with that?

DR. MITCHELL: Add cool.

CHAIRMAN PARSONS: Okay. Number five.

MR. POZEN: I think you have, Chuck, all earnings, not just ---.

CHAIRMAN PARSONS: Number six.

MR. BLAHOUS: The sixth issue had to do with pre-retirement access to account balances. I think there was a general consensus not to allow this, but there was some discussion of whether some concurring views on this -- whether individual commissioners might want to give voice to those in the Commission's report without taking apart the consensus against such withdrawals.

MR. JOHNSON: Mr. Chairman, six, and I guess, Chuck, seven, six and seven go the issue of what flexibility would the recipient have in access to his or her account. On six it goes to this is before retirement, and the question is should there be some exception to access to this account pre-retirement as there exists now under the current Social Security system. My argument is for certain limited circumstances, and specifically aimed at disabilities in a family, there should be some access. I would suggest that the governing board have the direction from the Commission to implement certain exceptions similar to those that exist under the system today. I mean, we are not doing anything radical here on this one.

CO-CHAIRMAN MOYNIHAN: Sir, could I suggest that the governing board be asked to take this under prayerful consideration.

MR. JOHNSON: Prayerful is the word.

MR. BLAHOUS: All right, sir.

MR. JOHNSON: Seven is for me a little bit more an issue of just philosophy, and I just can't come to grips with the Commission's position -- the most of the majority of the commissioners' position on this, and I will sort of try to give it my backdrop of how I approach it.

Several years ago this country passed a welfare reform law, and we basically said, the Congress and the nation basically said to welfare recipients is that we are going to provide you with training and incentive to get off of welfare. We are no longer going to be paternalistic toward you where you can stay on welfare forever, but we are going to help you, and we are going to give you a certain period of time at which at the end of that time period and with the help we presented to you, we are going to eliminate you from the welfare system. They called it some form of tough love that goes with the system of where you are not guaranteed permanent welfare, but we are not going to be callous; we are going to create a system to encourage you, to help you, and in some instances we are going to always protect your infants, but you, the recipient, are going to get off welfare. Well, that I think is an appropriate way to encourage people to be as productive as they can.

Now we flip that over to Social Security, and we say that we are going to create a system of private accounts, because we believe that the American worker should have the flexibility of maximizing his or her investments in the Social Security system which goes to their retirement, and we trust the people because ultimately at the end of the day, as the President said, it is the people's money.

So we create this idea of private accounts that go towards retirement, and we trust the people by giving them more than just a simple option to invest in a bond fund or a CD; we come up with very flexible approaches to investment so that they can be -- take some added risk for some higher return, by providing them different tiers of investment opportunities, because we trust the people to make prudent investments with their money. And we allow this as part of their retirement that they would have this account, that if it builds up they can pass it on to their heirs and it's a wealth accumulation vehicle.

So you take a worker who goes into the system for 25, 30 years, 40 years, at the end of that 40-year period of industriously working every day to build up this retirement account, 45, 40 years in the work force, they reach the age of 65. They are retired. They have accumulated this money in their personal retirement account. Again, this is not the portion of the account that goes into the Social Security system as part of their defined benefits, only the personal retirement portion. And as you pointed out this morning, Chuck, there's no threat in the event that this money is taken out to the overall viability of the system for every other worker.

So now the worker is 65. He or she now says, I want to take out in a lump sum my personal retirement account money, but the Commission members are suggesting we say to that worker now, we don't trust you. We don't believe that you will be prudent in the use of this money. So now we are going to sort of the opposite of what we do with welfare recipients. We're going to say, welfare recipients, you got to get on with your life and get a job or else we are going to cut you off. But to people who work 40 or 30 years of their lives who have demonstrated the responsibility in the work force, now retired, we are saying, we think if you got your money you'll blow it and you'll come back to us with your hand out.

Well, we don't say that to welfare recipients. We say, if you blow it, that's tough. You're out of the system. But to people like the people in this room who are responsible people who would have a chance to take their own money out, it's their own money, it's the people's money, take their money out, move it from the four percent that we talked about, the conservative, play the odds game, move it up to seven percent, they've made themselves three percent better off with their own money. Or if they wanted to do whatever they wanted to, do it.

Perhaps if we wanted to be just emphatic about it, we could have them sign a document that says, if you take your money and you blow it in Vegas, don't come back here. We can lay it out any way we want, but ultimately at the end of the day, I fundamentally believe you can't say to one group of the population we're going to treat you with tough love and say to another group of the population we don't respect your ability to manage your money so we're not going to give it to you. If we are going to do that, then let's not call it a personal retirement private account. Let's call it what it is: the government will invest your money, you'll do it but we'll encourage you to do it, and we'll control when you get and how you get it.

I frankly don't see how the Commission members could accept a system that says to the public we don't trust you to manage your own money after you have been in the work force for 40 years. I don't understand it. So I would strongly, strongly urge the commission members --

CHAIRMAN PARSONS: All right.

MR. JOHNSON: -- to allow the public to have access to their own money after they have retired and are free to do with their money as they so choose.

CHAIRMAN PARSONS: Is there an opposing view? And then let's see where we go with this. Estelle.

DR. JAMES: I am not going to be nearly as eloquent as Bob, but I do want to present a different point of view. Under the system of Social Security that we have today, which has many problems, one of its good features is that it gives you in effect an annuity that lasts your entire lifetime. So if you live many, many years after retirement, you will be getting some money that is indexed to inflation to every year.

Now, as we discussed this morning, in two out of the three plans that we have been developing, the individual accounts would be replacing part of that defined benefit. So they would not be on top of, but they would be in place of. Now we think individual accounts would improve the well-being of people and enable them to achieve a higher benefit level than would be possible with any given resources from the DB, so we all support that, but the fact of the matter is, that the money in the individual account is replacing part of the DB.

So now we have the situation where people reach retirement age. They may live 30 years after retirement. The wife of a retiree who is dependent on survivors' benefits from that -- from the work of that retiree may live 40 years after the spouse or after the husband retires. So we have to weigh about many lasting for the entire expected lifetime and in fact beyond the expected lifetime, because many people will live beyond expected lifetime, to the age of 90 or to the age of 100. During that time inflation will increase the number of dollars that you need to live on. If we have a 3 percent rate of inflation, after 40 years you need 4 times, almost 4 times as many dollars to maintain the same standard of living that you did initially.

Now, unfortunately, many people may not take that into account fully. They may not fully realize how much longevity has been increasing. They may not fully realize how much inflation can erode the value of your initial benefit. And we as a society will be -- may be left in an uncomfortable position if people withdraw their individual account money at the age of 65, expecting to live until the age of 80, but then they live until the age of 90 or 100 and the money is gone.

So that's the basic reason for limiting access to the money, to assure that it will last over the full lifetime of both spouses in the case of a marriage, and that's the reason for the discussions we have been having around this wording which says that in order to -- people should have some access to withdrawals but only after they have satisfied a threshold which ensures that from the DB plus the joint annuity people will not outlive their resources, and in fact, the resources will last throughout their lifetime adjusted for inflation.

CHAIRMAN PARSONS: Let me suggest we have had two, both eloquent, statements of perspective here, and I don't think that it is likely that Estelle who speaks for a fair portion of the Commission is going to persuade Bob of the merits ultimately of her argument, or vice versa. I wonder if this isn't one of those subjects on which there isn't consensus view - there is in fact a split view - and that the report ought to reflect the two different ways of looking at this and lay out the pros and cons. Fidel.

MR. VARGAS: Yes. Actually, on that specific point, on issue six, I think I am clear unless I am totally just not on the same page, that everyone but Bob believes that people should not have access during their --

MR. : Accumulate.

MR. VARGAS: -- before retirement. And there's different reasons why people believe that, but ultimately that's

I think the recommendation. However, I don't think it precludes us from including in the report the argument for studying, as was suggested by Senator Moynihan, having a government board study if at some point what would be those circumstances, but our recommendation at least initially from the Commission would be, because I think there is a majority here that believes that. So that would be my sense of more where we are at on issue six, that we should move forward with a recommendation on that issue.

Then on issue seven, I think similarly we are -- that's an issue where it is the same kind of a breakdown in terms of where we are all coming down on the issue. So I don't want to -- I don't know if we need to have everybody, if that's what we are looking for, or if we are looking for a general recommendation and additional commentary on these issues.

CHAIRMAN PARSONS: To tip my hand bit, what I would like to avoid are sort of votes, split votes. I don't think that is helpful to presenting a kind of unified and thoughtful front. I think in wording, however, we could use wording saying that, while the majority of the Commission felt that this may be the way to go, others felt that there is another way to go, and these are the pros and cons around it, or these are the rationale.

CO-CHAIRMAN MOYNIHAN: (Away from microphone) Mr. Chairman, can I volunteer to try to draft language which we clear with Bob and clear with Estelle and clear with you?

CHAIRMAN PARSONS: You can if you want to. I don't know that I would do that if I were you. You are my friend.

CO-CHAIRMAN MOYNIHAN: I learned early in life not to volunteer, so I haven't until this moment.

CHAIRMAN PARSONS: In other words, I think we can handle it --

MR. VARGAS: That's fine. Sure.

CHAIRMAN PARSONS: -- without ---. Olivia.

DR. MITCHELL: I think Bob had a ---

MR. JOHNSON: No, I just wanted to point out one point about Estelle's response. She's absolutely right, that those people who do live longer would have the benefit of an annuitized distribution, but one of the concerns I have is that the African American population is going to not live as long, and so we still have this ongoing subsidy of workers who have a higher mortality rate subsidizing those who have a lower mortality rate. So getting access by those workers to their personal private retirement account seems to me to go a long way towards addressing that problem.

CHAIRMAN PARSONS: Now.

MR. JOHNSON: And I think it's, again, imperative that we deal with the question of equitable distribution as well as this whole question about the paternalism of that they may not be smart enough to realize that they are going to live longer than they think they are going to live and therefore not save their money properly.

CHAIRMAN PARSONS: Fortunately for all, Senator Solomon -- I mean Senator Moynihan, has volunteered to try to find some language --

CO-CHAIRMAN MOYNIHAN: And we have the data on the point ---.

CHAIRMAN PARSONS: -- that leads us through this thicket. Bill.

MR. FRENZEL: We trust Senator Moynihan to do a perfect job, but I think it is fair to remember what Fidel says is true. Everybody except Bob.

(Simultaneous conversation)

MR. FRENZEL: It failed in the subgroup.

MS. KING: Bill, on that subject, on number six that might be true, but on number seven, that is not true.

MR. FRENZEL: Yes. Yes. Yes.

MS. KING: That is not true.

CHAIRMAN PARSONS: Okay. This is helpful for the public to know that we --

MR. JOHNSON: I'll trade six for seven.

(Laughter)

CHAIRMAN PARSONS: Actually, I -- yeah, right.

DR. MITCHELL: Mr. Chairman.

CO-CHAIRMAN MOYNIHAN: No wonder he ---.

CHAIRMAN PARSONS: Olivia.

DR. MITCHELL: Thank you. I am not going to speak directly to that point. I am going to speak to seven more particularly. It seems to me that we have a huge opportunity to educate people about this issue of longevity risk, and the fact is that life expectancies are going up and that we need to think seriously about better ways to try to protect against that, so that in this discussion around seven, what choices should be available for taking the account distributions, I think we need to spend some time in the report talking about annuities, what good are annuities, what role they play.

Estelle mentioned in her comments that Social Security currently is a price indexed annuity, so even if you live a long time, your benefits go up with prices. Now, there are other annuities which are nominal fixed annuities, so they don't go up with prices. There are variable annuities which go up and down, say, with the stock market. So it seems to me that we need to talk about results potentially in our report, results which at least give us price indexed annuities as one of the metrics to look at the benefit outcomes, and if there's other metrics as well, other forms of annuities, we can go that route, but we definitely need to talk about price indexation for the annuities, because that is what Social Security does now.

CHAIRMAN PARSONS: I think that can be accomplished within the context of how we are talking about dealing with this issue. Tom.

DR. SAVING: To go with Olivia's comments and to address Bob's more directly I think, because Bob's comments come from the fact that the annuity markets themselves don't appropriately or at least there may not be markets that appropriately account for expected longevity for different groups, and if those annuity markets did that appropriately, then you don't have this problem. But the issue is, now if you have unisex, unirace, unieverything annuities, then of course those individuals who have lower life expectancies are going to lose, because they are subsidizing everyone else. But the issue is -- and that's why I think Olivia's point of the report addressing these annuity issues is important.

I don't mind having different views as to what we ought to be able to do at the end, because I think this is a really important point for people who know they have a shorter life expectancy, and, for example, an AIDS sufferer or any number of things which you know you have a shorter life expectancy, the annuity markets ought to adjust for that. If they don't exist, there may be some other way to do it. I think it is important to recognize these differences and say that in this report, this discussion and Olivia's suggestion about annuities and educating people on annuities. Bringing up these issues is important.

DR. MITCHELL: I know I had asked Jeff to offer a few words. I don't know if now is the appropriate time. Since we are on the topic. I had asked that at the last Commission meeting.

CHAIRMAN PARSONS: This was a request you made to Jeff?

DR. MITCHELL: Yes.

CHAIRMAN PARSONS: Well, then I think we ought to honor it.

DR. MITCHELL: So I am wondering if he can tell us now the executive summary of the deliberations.

CHAIRMAN PARSONS: Jeff isn't as sure as I am.

MR. BROWN: I would be happy to, though I will say that I think most of the important points have been made. So let me just say one or two things. There were really three points that I was going to make, and I will just make them and be brief on the follow-up.

The first is that because of what is often longevity risk, which is the fact that any individual, regardless of what their life expectancy is, faces great uncertainty about just how long they are going to live, has the potential to benefit from annuity payments, and annuities typically are considered to be a very important part of providing a secure source of retirement income. The main way to think about this is because if you just take an average individual in the population, for example, using SSA numbers, the typical male in the population using recent numbers at age of 65 can expect on average to live about another 16 years. However, that same individual, unfortunately, has a 1 in 8 chance of dying prior to the age of 70, but somewhat more optimistically, they have about a 1 in 5 chance of living to the age of 90 or beyond. So even if the life expectancy differs across different groups in the population, each individual, nonetheless, faces some significant uncertainty, and that requires that they make a tradeoff when they have a stock of wealth from which to allocate across the rest of their lifetime. They are not quite sure how quickly or how slowly to consume out of that wealth, and annuities are a very important vehicle for basically ensuring against that longevity risk.

The second point that I would make is that the current -- in the current system, Social Security is by and large the primary source of annuities for people currently in the United States, though in part that is largely because the existence of Social Security has likely crowded out a lot of the private annuity markets. In spite of that, there is a small but very vibrant life annuity market in the United States, and the private market is also quite capable of providing these things, along with what my third point would be, a very wide range of options that are available.

I think this discussion has highlighted some of the fundamental tradeoffs between pure life annuities and the ability to bequeath wealth or spend that wealth how one wishes. It should be noted, and we can discuss this in the report, that there are a wide range of annuity designs that allow people to find intermediate points along that way. For example, there are products which are quite popular through TIAA-CREF, for example, which allow for this life longevity insurance protection in an annuity, which also make provisions in the event that if the individual were to die shortly after annuitizing that payments would continue to their beneficiaries or their heirs for some number of years. So it's a way of finding that middle ground.

We are happy to discuss these options in the report. I am also happy to talk with any of you individually if you would like more information on that.

CHAIRMAN PARSONS: Let me add also, and I just conferred with the co-chair on this, we have been from the beginning struggling to come up with a consensus report that reflects the thinking of all of us and that we can all be comfortable within, but the "one size fits all" -- and that's still the route we're on, but the "one size fits all" sometimes binds a little bit. Just as Senator Moynihan and I will probably have a preface to the report from the co-chairs, I think it probably is appropriate, I want to offer it up for your consideration and we can revisit it before we conclude this, that perhaps at the end of the report we allow individual commissioners, those who choose to take the option, to sort of add additional thoughts, but the body of the report should be a consensus. If there are sort of additional things or points of emphasis to highlight as opposed to dissents. This way we don't want to -- that might be a useful thing to do, and we can take that around.

MR. JOHNSON: Mr. Chairman, I think that's a -- I agree with that, and I think that we could probably arrive at some, hopefully some consensus, but on the annuity issue, I think that we should point out that one of the objectives of the private accounts concept was to create wealth that could be passed on to heirs. If everybody takes the annuitized route, there is no pass-on of the accumulated wealth. So it argues that by having some methodology to take out lump sum amounts would put you in a position to have a wealth accumulation component that you could pass on in your estate. So we shouldn't see annuities as sort of the answer to the whole ---

DR. MITCHELL: But I think that it --

CHAIRMAN PARSONS: Whoa, whoa, whoa. Because this debate which has raged on, and as I say, no one is changing anyone's mind here, can continue to rage on, I think what we need to do is find a way to deal with it in the consensus report, and then to the extent that individual commissioners have further thoughts they want to share, as I say, not dissents but further perspectives, they will be given the option to do so.

CO-CHAIRMAN MOYNIHAN: On to your typewriters ---.

(Asides)

CHAIRMAN PARSONS: Point number eight, Chuck.

MR. BLAHOUS: The next one has to do with distribution rules for protection of surviving spouses. One of the options before the Commission is that a joint survivor two-thirds annuity as under Social Security would be required unless both spouses agree to an alternative arrangement. You have a couple of options before you, but I think that is probably the one that most commissioners have sounded interested in.

CHAIRMAN PARSONS: As proceeding by objections, seeing none, point number nine.

MR. BLAHOUS: Number nine, responsibility for financial education. Options before you include this being provided at the option of employers. Another option includes private sector account administrators, and another option is basically to have the governing board and the Federal government responsible for supplemental financial education. Probably the prevailing position that we have heard at the staff level is that the Federal government and the governing board be responsible for this.

MR. FRENZEL: May I? We keep talking about education.

CHAIRMAN PARSONS: Microphone.

MR. FRENZEL: We keep talking about education, and a lot of us have tried to be educated in this field for a lot of years with not a huge amount of success. I wonder if we shouldn't use the word "information" instead of education. We are not running any school of rocket science here. Just a suggestion.

CHAIRMAN PARSONS: I think --

CO-CHAIRMAN MOYNIHAN: I believe that was a motion, and

I would like to second it.

CHAIRMAN PARSONS: Without objection. Both your sense of the consensus and using the word "information" as opposed to education.

MR. BLAHOUS: Issue 10, structure of the governing board to protect it from political interference. One option is simply to model it after the Thrift Savings Plan and have it conduct in the same way.

CHAIRMAN PARSONS: And is that the option that your sense was --

MR. BLAHOUS: That is the option that --

DR. MITCHELL: I think we need some discussion.

CHAIRMAN PARSONS: Lead it off.

DR. MITCHELL: I wasn't part of that group, so I really don't have any insight into those issues. I would like to hear a little bit of discussion about the following. The notion of a TSP-type governing board making a decision about whether it will allow competition against itself in a hybrid sort of a model makes me sort of uncomfortable. That is, I could see some sort of supervisory, regulatory structure deciding that, yes, the time is ripe for private folks to come into the market, or that yes, these are the criteria that the different accounts should meet, but I worry when you have the TSP equivalent board deciding on its own whether it is ready to accept private competition, private sector competition. I just think there is a conflict of interest. So I would like to lay that issue out and ask whether there is some intermediate ground we might take, so that they wouldn't have to be making that decision about themselves.

CO-CHAIRMAN MOYNIHAN: Might I plead that this is an item for addendum, commentaries at the end, because there is a huge political -- why, I don't know, notion that we are going to turn this all over to Wall Street.

MR. FRENZEL: I think if the gentleman will yield, I think we can take care of that in our layout of tier three where direct -- tier two where we direct the trustees to broaden and to widen the number of managers based on reasonable criteria. It would seem to me it would be hard for them to freeze anybody out under the -- carrying the burden of that direction.

DR. JAMES: We could even specify a time period by which they are directed to do that, and I --

CHAIRMAN PARSONS: Mario.

MR. RODRIGUEZ: The consensus I am hearing is that we have some form of board but that we are completely against having some political influence, in other words, having Congress have this decision?

CHAIRMAN PARSONS: Well, on this point I think what Chuck was reporting was the consensus was that it should be a TSP-type board governmentally formed and appointed, but what Olivia is saying is that at some point that board is going to be constitutionally at a point of conflict if -- in terms of considering whether they should open up their process to marketplace competition, which we understand, but --

DR. MITCHELL: If I can just elaborate, it seems to me that the TSP model right now is one where they take the money in, they invest the money, they do the reporting, they do the whole thing, soup to nuts, and they are actually self-regulating. Now, if you take the private sector model, pension funds take the money in and invest the money and so forth, but there is a superstructure, ERISA. It is the law that -- and there are agents that -- agencies that look and correct the system when there is a problem. Seems to me you want to separate the supervisory and regulatory role from the money management role, because otherwise you have the folks regulating themselves.

CHAIRMAN PARSONS: Yes.

DR. MITCHELL: So that's really the point I am trying to make, is that you don't want a TSP self-regulating, because then you don't have oversight.

CHAIRMAN PARSONS: But I think what I am hearing is that that's probably not the consensus view.

DR. MITCHELL: Well, that was the consensus view of the subcommittee. I wasn't on that subcommittee.

CHAIRMAN PARSONS: I understand, but we --

DR. MITCHELL: That's why I am expressing my views.

CHAIRMAN PARSONS: That is where I was going.

MR. POZEN: I think that what Bill said was perhaps responsive for two things. One is if there was a direction to the board within, say, three years to develop such a system, then you couldn't -- then you wouldn't worry that they wouldn't do it. Then second of all, I think that we would contemplate that the entities that would be set up to manage this money would be subject to regulation by the SEC and the normal financial regulators, and I think we could do both of those things as a way to be responsive to your legitimate points.

CO-CHAIRMAN MOYNIHAN: Could I tell a war story? It is 1935 and the Social Security Act is on the Senate floor having passed the House, having passed out of the Finance Committee, and it provides, as did President Roosevelt ask, that there be annuities as part of the system, whereupon a Senator from Connecticut stood up and said, "We don't like this in Connecticut one least little bit, because Hartford is the insurance capital of the nation and we will provide annuities, thank you very much. I move to strike." And he won. So that's ahead of all of us.

CHAIRMAN PARSONS: All right. I think the message is that you can attempt to design to the nth degree here a system that inevitably is going to get beaten and reshaped. I think the point you raised, Olivia, is a fair point. I think the report should reflect it, and will reflect it, and that we can accomplish that without trying necessarily to redesign -- to lay out the complete design of how it should work.

CO-CHAIRMAN MOYNIHAN: Well said.

CHAIRMAN PARSONS: Point number 11, Chuck.

MR. BLAHOUS: Point number 11, voting of equity shares for the centralized system. Your basic options there are to have them voted by the fund managers, voted by the governing board, and simply voted in proportion to the votes of other shareholders. As reported to me, the leading view is to have them voted by the fund managers, but this could perhaps be subject to discussion.

CHAIRMAN PARSONS: We are proceeding by objection. I don't see one. Point number 12.

MR. BLAHOUS: Well, I only have 11, which brings us back to number one.

(Laughter, asides)

CHAIRMAN PARSONS: Dejà-vu all over again.

MR. BLAHOUS: Fortunately it is the only one left, and now you just have to decide whether to decide on number one and whether there is --

CHAIRMAN PARSONS: State the issue if you would please.

MR. BLAHOUS: -- a consensus view of multiple --

CHAIRMAN PARSONS: State the issue.

MR. BLAHOUS: The issue is the overall administrative structure, whether to just have a centralized system or a mixed system. I could read the entirety of it, but I don't want to bore the commissioners.

CHAIRMAN PARSONS: No, no, no. Just summarize the issue for us so we can have a ---.

MR. BLAHOUS: Basically, the centralized system is very similar to the Thrift Savings model. Collections are transferred to a central administrator through the current payroll tax system, and again, the Thrift Savings Plan model is the basic model there. The mixed system basically has a second tier which enables people to go out to private account administrators under certain guidelines, minimum account balances and the like.

CHAIRMAN PARSONS: But didn't I --

(Simultaneous conversation)

CHAIRMAN PARSONS: I thought I heard, yes, consensus that we would start with a centralized system, give them a period of time to come back.

MR. FRENZEL: We have tier one, and after three years a tier two.

CHAIRMAN PARSONS: Yes. By some number of years to come back.

CO-CHAIRMAN MOYNIHAN: Mr. Chairman, we have agreed on item one.

MR. BLAHOUS: You're done.

CHAIRMAN PARSONS: So ---.

MR. POZEN: A deferred tier two.

CHAIRMAN PARSONS: You got it.

MR. POZEN: According to reasonable guidelines.

CHAIRMAN PARSONS: Now, we have worked our way through the administrative portion of it. We have a second or two for any concluding remarks. Also, I saw one of my fellow commissioners wince when I suggested the potential for --

MR. PENNY: Addendums.

CHAIRMAN PARSONS: -- individual addenda. You want to speak to that? That's something we should --- agreed upon ---.

MR. PENNY: Well, it just seems to me that the few areas in which we seem to have some disagreement are areas that for the most part can be resolved. As an example, the Chairman has agreed to find some language and work things out, and I trust that that can be done. And it may be that if there is another contentious issue or two that may be more difficult than even the Chairman's talents can address, that maybe we might want to consider at our next meeting a punting on those issues. I would much rather do that than to have page upon page of additional comments and thoughts and "yeah buts." I want a report signed by all of us, and I don't want any of us issuing additional thoughts or comments that only confuse the issue.

MS. : Here, here.

(Applause)

CHAIRMAN PARSONS: Are there any thoughts on that? One more.

MR. VARGAS: No, I would agree with that, because I do think that we -- although our next meeting is 11, 12 days away.

CO-CHAIRMAN MOYNIHAN: We would be the first unanimous

Social Security Commission in history.

MR. VARGAS: Absolutely, and I think that we can get there. Secondly --

(Simultaneous conversation)

MR. VARGAS: Secondly, just as a kind of a procedural matter, I am assuming, and this is a question for the Chairs and for staff, that what we will have on the 11th is a draft, a cleaned up version, and that where there are issues that still haven't been addressed like this wording issue, those are the issues that we will spend some time on.

CHAIRMAN PARSONS: Hopefully by the 11th, all issues will have been addressed in one way, shape or form.

MR. VARGAS: No, absolutely.

CHAIRMAN PARSONS: To the satisfaction of the full group, maybe not, but --.

MR. VARGAS: No, absolutely. And so my point is that on those issues that were addressed today where it wasn't clear, that we will have to come back and say this is where we are going, this is the direction that we are going in.

CHAIRMAN PARSONS: Listen.

MR. VARGAS: Either everybody's onboard or they are not, and everybody is not completely satisfied with everything, but in general we have all -- we are all going in the same direction.

CHAIRMAN PARSONS: --- of the group. The sense of the group is that we can get there. I am for that. It would be historic. It may mean that we really have to wrestle with some of these wording issues, more than some of us who would be wrestling would care to contemplate right now, but if we are all comfortable to stay on the course that we have been on, that's fine with me. Is that fine with you, Senator?

MR. FRENZEL: As long as the Chairs aren't doing all that work.

CHAIRMAN PARSONS: That was implicit.

MS. KING: Mr. Chairman, am I clear that in addition to number seven, issue number seven where lump sum distribution is not specifically laid out, that the only other issue that is open is 3B, what investment opportunities should be available? Is that right?

CHAIRMAN PARSONS: Well, there's 6B.

MS. KING: I thought six was --.

MR.   : Six is gone.

CHAIRMAN PARSONS: No.

MS. KING: Six is the one the Chairman is going to --

CHAIRMAN PARSONS: Now six and seven --

MS. KING: -- solve.

CHAIRMAN PARSONS: -- are the ones the Chairs agreed to come up --

MS. KING: You are going to work on seven as well.

MR.   : I think six was conceded.

MS. KING: And 3D?

MR. FRENZEL: Actually, that isn't the issue as much as how you tell the trustees to arrange tier two, mandate that they do so, and how they select or the process they select to incorporate a number of managers to ensure rigorous competition. I think the product everybody has agreed can be expanded slightly, but I don't think anyone disagrees about that. There may be some well-diversified, actively managed funds added, but that would be about the main difference between tier one and tier two with respect to ---.

CHAIRMAN PARSONS: And I think, gentlemen, that to get more granular on this list now, you actually have to see the language.

MS. KING: Yes, I agree with that, because my concern is that we have some clear path about administrative costs and that we don't encourage a system where the offerings are so broad that administrative costs go up the charts.

CHAIRMAN PARSONS: Right.

MS. KING: So I want to really hammer that one.

CHAIRMAN PARSONS: I think we are all sensitive to that.

MR. FRENZEL: We have a drafting committee of 16.

MS. KING: That's what we need, Bill.

MR. FRENZEL: You're the last -- most recent recruit.

MS. KING: On the telephone, thank you.

CHAIRMAN PARSONS: Okay.

CO-CHAIRMAN MOYNIHAN: Thank you, Mr. Chairman.

CHAIRMAN PARSONS: I am sensing a desire to adjourn. Don't ask me why, I just am sensing this.

CO-CHAIRMAN MOYNIHAN: So moved.

MR. FRENZEL: Second.

CHAIRMAN PARSONS: Motion. All in favor?

(A chorus of ayes)

CHAIRMAN PARSONS: Opposed, same sign?

(No audible response)

CHAIRMAN PARSONS: We stand adjourned.

(Whereupon, the meeting was adjourned at 2:22 p.m.)