

President's Commission  
to Strengthen Social Security

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*President's Commission To Strengthen Social Security*

November 9, 2001

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P R O C E E D I N G S

(10:10 a.m.)

**WELCOME AND OPENING REMARKS**

*by Senator Moynihan, Chair*

CHAIRMAN MOYNIHAN: November 9 meeting, and this is the -- I think we are right in the middle aren't we, Richard?

CO-CHAIRMAN PARSONS: Yes.

CHAIRMAN MOYNIHAN: That we have a meeting later this month, and then December 11th. And so, our first item on our agenda, and the first matter, as our practice has been, is to have opening statements. They can be as extensive or curt -- no, no, curt, brief, as anybody wishes. And why don't we begin with you, Lee.

**I. OPENING STATEMENTS**

MS. ABDNOR: Thank you. Thank you, Mr. Chairman.

I have been thinking a little bit about what I feel is very important to talk about from my experience. And having been on this commission, I think the most recent commissioner, but I have had the privilege of being able to listen to all of the witnesses who testified, and read all of the statements that have been submitted, which have been very, very helpful.

There is two things that stick out in my mind. There is a lot of things, but the two that I think are most

important are the following:

First of all, we have been most appreciative of those people who have come before us, or presented statements in which they are willing to put forward what they believe is the best way to meet the fiscal imbalances in the future of social security.

We have been appreciative, and we have looked closely at what all of those have presented. It has also been very clear then that how important it is for everyone who is involved in this debate to be willing to put forward what they believe is the best way to achieve fiscal sustainability of social security, and ensure that benefits will be paid in the future.

And I guess what I am trying to say is that there are some groups who are very critical of personal retirement accounts. That is fine, and we welcome all views. But I would just like to point out how important it is to me and some of the other members of the commission that those who are critical of personal retirement accounts, and the principles laid out by the president, in order to be considered by us, and I think the rest of the public need to put forward their own plan for what they would do to meet the promised benefits and sustained system in the future.

Without that, very little is offered to the debate. And so, we continue to ask and encourage those

groups to come forward with their own plans and not vague ideas, but specific plans. And we will continue to encourage that and look for that. And if these groups want to be considered, that's what we will need from them and appreciate it.

The other point that I would like to make has to do with women. I have been thinking a lot about this lately. I am very, very grateful to all that those who have fought for women's rights have done for the last hundred years or so, and we have certainly come a very long way in recognizing the rights of women and the value of women in our society.

I think the reason that this has come forward to me real recently is all of these news reports that we have in the last few weeks about women in other countries. And seeing some of the horrific experiences of women in other countries who don't have rights, and who in fact in some countries have to -- are not allowed to go out in public, and some who are fleeing just to save their own lives.

And I think it breaks all of our hearts to see that, and reminds us of how important it is to not forget that we have come a long way, and we have got a ways to go as well. And I think that, in that light, the frontier left that I think of most that women need to gain in order to achieve real value and independence in our society is

financial security.

And we have got a ways to go there. We have come a long way, but we have got a ways to go. But that freedom that comes from financial security is imperative in order to have true freedom in our society. I think that we have two very, very important goals along those lines.

First, is to eliminate poverty among the elderly. and the majority of those who are still in poverty in old age are women, and this is not okay. And I think that this has to be our first and foremost priority and goal. And that may include strengthening that safety net from social security, not that ensuring that it stays, but strengthening it to raise even more people out of poverty in old age.

But the second point is that I also believe very strongly that we have to give women the choice on whether or not they are going to take part of their payroll taxes and invest it in 401-type (k) accounts. And begin, for some women, to have the opportunity to create ownership and wealth for the first time.

We are talking about financial freedom. We are talking about a voluntary program. How do you argue? How do you oppose a voluntary program? And I think that if we are truly wanting to help create more financial security for everyone.

And we have got to be able to give choice to all

workers, and that includes -- obviously, it includes women.

And I have talked before about my disappointment with some women's groups who are opposed to giving women this choice.

And I think we have to stand firm in favor of giving workers this choice.

So, those are the two points that I want to make that I think are critically important as we move forward as a commission, and develop our own plans for putting this system back on a fiscally sustainable path. Thank you.

CHAIRMAN MOYNIHAN: We do thank you. And I think you would agree, and I think the commissioners would agree that this is a matter which we might help resolve for the social security system itself, if we think about it in terms of the individual accounts.

As our commission, Gwen, will agree we are still stuck in that mode, if you are married for 9½ years and divorced, you get no social security benefits. If you are married for 10½ years, you get half. Well, it is more complicated than that. And so, we will get to that point. Professor Mitchell.

DR. MITCHELL: Yes, sir. Good morning, Chairmen Moynihan and Parsons, fellow commission members, and ladies and gentleman. I am very happy to have an opportunity to speak today about some of the positive aspects of personal accounts at this meeting of the Commission to Strengthen



Social Security.

I would like to emphasize several positive aspects about personal accounts within the context of a strengthened social security system. I support personal accounts because I think they can play a very important role in giving workers choice and control over retirement saving.

I also think they serve another function which is that they will serve to educate workers regarding retirement saving and retirement responsibility. Today's social security taxes workers on their earnings. But recent surveys show people, most people, even people near retirement have no idea of what these taxes will produce in terms of eventual benefit.

One reason that people have such misinformation and misunderstanding is that this system is amazingly complex. Even in the process of serving on this commission, I have learned a great deal about the system, and I worked on this for 22 years. Maybe that testifies to my small intellect, but we'll move on.

A personal account I think will provide participating workers with one piece of the retirement system that is simpler to understand than the current alphabet soup of AMEs, PIAs, NRAs, EEAs, and other terms that frequently confuse us within social security.

A second reason that workers don't know what they

will receive in retirement is that, as Lee mentioned, the system faces insolvency. When the baby boom generation retires, benefit payments will rise, or at least promise benefit payments will rise, but there is too little payroll tax revenue to pay for it.

So, no one can honestly promise today's workers that current benefit formulas will apply to any of us when we are ready to retire. The system therefore imposes substantial risk on today's workers, while it gives them a very low return and no choice about how much risk they would like to bear.

Personal accounts I believe can help, because they offer the promise of limiting political uncertainty associated with old age benefits. This is because these accounts will be funded plans in which people will be able to invest in well-managed, low cost retirement accounts.

Having funded personal accounts also gives workers an additional saving amount when they contribute more. This is beneficial, particularly, compared to today's environment where many people, especially women, get little or nothing in return for paying additional social security taxes.

Another positive outcome for instituting personal accounts will be that workers will begin to become more financially literate. It is critical for both workers and retirees to understand better, and to take more

responsibility for their retirement well being.

One reason I think we are here today is that social security participants in the past were told that benefits could be raised and covered, increased without anybody figuring out how to pay for it. We know today that this is not responsible. And we also know that participants should have been better educated from the beginning.

Personal accounts I think can enhance the need for, and the provision of, retirement education. Finally, and most importantly, having personal accounts will permit workers to choose the level of risk and return in their investment portfolios that suit them.

One study, for example, has found that women's lifetime earnings patterns are uncorrelated with stock market returns. So, this would imply that women might be particularly benefitted by diversifying into the stock market.

Of course, people's choices wouldn't have to remain fixed over their lifetimes. They could be adapted as their plans change. For example, younger people might want to take additional risks with higher expected returns, and others, perhaps, such as myself, will elect to put their money in more secure investments such as inflation linked bonds which provide a very important component of their retirement portfolio.

The bottom line is that adding choice to the retirement portfolio via personal account gives account gives people much needed choice over risk and return, and a very critical element of control. Some people say to me don't worry. Just let future Congresses take care of us when the money runs short.

But, as a baby boomer, I believe it is irresponsible to put this burden on future Congresses and on our children and grandchildren. In 30 years time, many of us will have far fewer degrees of freedom than we have today.

It is much more responsible to fix the system now, to make promises that can be sustained so that when other legitimate needs of the future press, we won't need to pit one generation against another to protect the elderly at the expense of the young. I believe we can do better, we must do better, and personal accounts play a role in that reform.

Thank you, sir.

CHAIRMAN MOYNIHAN: We thank you. It is new to me to encounter baby boomers insisting that they take responsibility. But that's ensuring indeed. Fidel.

MR. VARGAS: Good morning, Chairman Moynihan, Chairman Parsons, and fellow commission members. And my brief comments are that I am excited to be here, grateful for the opportunity that we have been afforded to continue

our work, and to continue to move forward.

We have a lot of work today, and I am looking forward to that. I also would just amend my comments by adding the comments of Leanne and Olivia, and I'm sure the majority of members. But my point is I am looking forward to the work that we have to do today, and looking forward to pushing ahead and coming up with what we were charged to do within a few short months. Thank you.

CHAIRMAN MOYNIHAN: Thank you, sir. Jay Parsky.

MR. PARSKY: Thank you, co-chairman, and it is a pleasure to be here. First of all, I would like to associate myself with both Leanne's comments and Olivia's comments, and I won't try to repeat them. I think they were very good. The only general comments I would make are that as we now try to come together and put forward some recommendations, I think that we should maintain kind of an outlook of some general objectives that we have, what we are seeking to do, and perhaps what we are not seeking to do.

I think one of our objectives is to try to strengthen our social security system. We are not here to destroy it. We are not here to privatize the system. We are here to put it on a road to sustainability. So, what is deemed to be, or thought to be a promise can be a reality.

And part of that, I strongly believe, is increasing the ability for individuals to have a choice.

The concept of providing within the social security system, choice, I think is an important concept.

And the establishment of personal accounts, and the ability to voluntarily choose a personal account, I think is an important principle, and one in which, certainly, from my perspective, is one of the main reasons that I wanted to try to participate in this.

I think as we look at it, I would just emphasize that not only is it a choice, but it needs to be voluntary; that an element of personal control over that choice I think is very important as we move forward. And people that do not want to choose a personal account ought to be free not to. And we ought to, as much as possible, be able to outline and detail what it means if they do choose to have a personal account.

The final point I would make is I feel quite strongly that if someone selects a personal account, that the government is not the appropriate body to be investing those funds; that to the maximum extent possible, we should assist the system in not being politicized. The more the government is involved, the more the potential is for politicizing the investment process.

Just from a personal standpoint, I have had an opportunity to sit on the Board of Regents for the University of California. And I have watched, both in the

public pension fund system within California, and even for the University, efforts on the part of some government officials to make investment decisions that are more involved in politics than they are in what I would call sound investment -- on a sound investment basis.

I think that is a danger. So, I would be a very strong advocate of making sure that part of our choice, which people can select or not, is that they maintain a stake in their own future. They have a stake in their own retirement, and they can choose how those funds are to be invested.

CHAIRMAN MOYNIHAN: I see my distinguished co-chairmen much agreeing. Of course, we did hear testimony from the director of the Thrift Savings Plan and of TIAA-CREF, and they managed to do what you insist on. But, of course, you come from California and we cannot explain things.

MR. PARSKY: Well, I am not quite sure I can explain all of California either, Co-chairman. But, and at times, we may be ahead of the curve, but in this arena I think we should be quite cautious.

CHAIRMAN MOYNIHAN: Well, and, John Cogan, do you want to testify to that matter?

DR. COGAN: More often than not, we are around the bend. Thank you, Mr. Chairman. It is a pleasure to be

here. I would like to use this opportunity to state why I think personal accounts represent sound policy. The bottom line is that there are two reasons: One, personal accounts are good for American workers; and, second, personal accounts are good for social security.

Personal accounts provide workers within the framework of social security with a safe and a sound opportunity to build financial wealth and financial security in retirement. That everybody knows. But the benefits to workers of personal accounts extend far beyond purely financial considerations. Workers would own their personal accounts.

And, as every American knows, with ownership comes security, and with ownership comes greater freedom. Retirement income derived from real financial assets that an individual owns are far more secure than income that is derived or based upon unfunded promises by politicians.

Ownership of personal accounts provides individuals with greater freedom; gives freedom to workers to choose when they want to retire; gives greater freedom to workers to choose the economic lifestyle they wish to pursue; and it gives workers much greater freedom to pass wealth on to their children.

Social security is a universal program, so every worker would have an opportunity to gain value, security,



and freedom with personal accounts. But those that would benefit most are young persons, and persons who today lack the resources to provide for their own financial security, primarily low income people.

Social security is headed for significant financial trouble, as we all know, and I believe that personal accounts would be good for the financial health of the program. Experience has taught us that a sound retirement program is based on investment.

In its current form, social security is not an investment program. It's an income transfer program. Now, there is widespread belief that social security will be strengthened by giving it an investment component, but government investment is not the answer.

It is dangerous to a free economy. It is also a reality that in the countries that have tried it, it hasn't worked. As we heard from the World Bank, countries that have centralized government investment returns have actually been negative.

Experience also teaches us that private personal accounts will work to strengthen social security. Nearly two dozen countries have embraced personal accounts. They're working. They have worked for federal workers, federal employees, and they strengthen the civil service retirement system.

And, as we have heard, they have strengthened the retirement systems for municipal workers in San Diego and Galveston. We hear that young people lack confidence in social security. As we move through time, the confidence that people have in social security is eroding.

The reason that it is eroding is because over time the program has provided less value and less security. Personal accounts by providing social security with greater value and greater security will end up restoring young people's confidence in the social security program. That is why I support a personal account system. Thank you, Mr. Chairman.

CHAIRMAN MOYNIHAN: Thank you, sir. And Sam.

MR. BEARD: Both our chairmen, welcome, and thank you, and to everybody out here, welcome. I look at social security reform as a non-partisan issue. And I was proud in 1996 through 2000 to be working the Clinton Administration to seek to reform social security, and thrust was to add individual accounts.

I am now thrilled to have the opportunity of working on President Bush's commission to seek to do the same thing. People of good will on both sides of the aisle need to figure out a way to do this. I think it is especially true after 9-11, but we need leadership. It needs to be bipartisan, both abroad and at home.

On our current course with social security, if you go into multiple levels of either tax increase or cutting benefits, you can absolutely harm the future economic economy, and we cannot do that. Now, there are going to be some hard choices, but we need to do them all together.

We have got to go beyond pandering and sort of demagoguery. Now, I have here a letter -- I am a Democrat.

Here is a letter sent by the chairman of the Democratic Party. As you read this letter, he says, "To all Democrats," that's me. "George Bush and his advisors are preparing to introduce their plan to put social security funds in the stock market. We are fighting to defeat the president's plan to invest part of social security in the stock market."

It is really embarrassing demagoguery. That is what President Clinton was trying to do. That is what President Bush is trying to do. All of us, as Americans, we know social security faces serious troubles.

Now, what is interesting is President Clinton's Social Security Advisory Council of 1994 and 1996, total range, women's groups, labor unions, liberal left, minorities, centrists, business interests, every member of that panel agreed you have to have the extra rate of return from the private sector. That was the one thing they all agreed on.

In the debate, there is no longer a question of whether to utilize the extra rate of return of the private sector. It is a question of how to. The real choice for the country is, do you so trust the federal government that you want them to invest trillions of dollars, the extra rate of return of which we will try to keep the current system as solvent as possible? Or, since the money comes out of our individual payroll checks, do you want to open up individual accounts? That is the choice.

Now, fundamentally, on a bipartisan basis, we need to figure out a way to come up with a plan, change the law in 2002, or no later than 2003. I agree with Lee. I would call on people who disagree with what we might come up with here, come up with a very specific plan.

Congressman Matsui sent us a letter saying create a plan which is actuarially sound by social security. But Congress is the final arbiter, we aren't. I would welcome Congressman Matsui, and Roger Hickey, Hans Riemer, come up with a plan. Let's all of us come up with a plan, serious plan, discuss it, and then pass it 2002, and no later than 2003.

Now, the last thing is just the vision. As a Democrat, I am very excited about opening up the opportunity for savings and wealth accumulation to all Americans. When I started working with Senator Robert Kennedy and had the

privilege of doing that in the 1960's, I was afraid we were becoming two separate societies.

I am more afraid today we're becoming two separate societies. One of the big divisions is those with financial assets and those without. All together on a nonpartisan basis, we need to figure out how to open up savings to everybody.

CHAIRMAN MOYNIHAN: Well said, sir. I am not someone who knows something about the subject. Bob.

MR. JOHNSON: Thank you. Thank you, Mr. Chairman, and members of the commission, ladies and gentlemen. Like Sam, I am a yellow dog Democrat. I have never given money to any Republican in my life, save, Bill Cohen, and he's from Maine, so you can understand, and he is a good friend.

But I share Sam's opinion completely that to turn this into a Democrat versus Republican, liberal versus conservative, white versus black issue is demagoguery.

Frankly, when I got on this commission, the word went out Bob Johnson has become a Republican. I have made a lot of money, but it does not mean I am a Republican. And, as Bill Clinton said at the inauguration, if you want to live like a Republican, vote like a Democrat, so I am doing both.

The point I want to make here is that I got on this commission for one reason and one reason only, is

because President Bush hit on a point that I totally agree upon; that is, the money that goes into social security, or the money that goes in to pay taxes really belongs to the people. And if the money belongs to the people, they should have the right to maximize the return on their money.

And it would seem very simple to me that if the government under the present system is only delivering you two percent, and you by making an individual decision to invest your money in a private account can make more, it would just seem a logical exercise of your right to control your money in a free market economy to maximize wealth.

That is the fundamental reason I think this country is greater than any other country on the face of the globe, is that we believe in the free market economy, and the free enterprise system, and the right of people to benefit from their wealth creation.

And for me, as an African American, this is fundamentally the reason why I am here. Because African Americans, as a whole, are at a complete disadvantage in wealth accumulation because they are not invested in the stock market to the level that White Americans are. That gap has created a huge difference in the net worth of the average African American versus the average White American.

If you take the net worth of the typical African American family, it will give you a net worth of probably

\$30,000. If you take that same net worth of the average white family, it is about \$300,000, a ten-fold spread. You can understand clearly the ramifications of that wealth disparity, access to better health care, access to education, access to retirement income.

And all of the things that flow from that wealth disparity come back to us in other kinds of problems whether they are increase in teenage pregnancy, increase in drug abuse, increase in single family households, all of these things are a part of a pattern of not having access to the wealth accumulation that this country can create.

So, I would not be on this commission if it did not take as a primary objective the creation of private accounts, because private accounts will introduce millions of African Americans to the stock market in a way that nothing in this country has ever done before.

They will see the benefits of their account growing. They will then, in my opinion, if they are smart, and I think they are very smart, will then increase their savings and investments because they will know that they are investing in the growth of their own income. And I think that is the fundamental objective of this commission and taking that on.

Now, I do have one concern. It is a kernel of a concern, in that we are in some way saying that we trust the

American people to manage their money in private accounts. We are going to give them options. We believe that they will understand the value of it. They will recognize the benefit of this in enhancing and making social security as sustainable.

But, at the same time, we are saying, when you accumulate this money in private accounts, your access to it is controlled by the government. Now, to me, that smacks as a little bit paternalistic and a little bit talking out of both sides of your mouth.

I am going to talk about that when we get to certain key issues in the proposals. But I want to make it clear that I fundamentally believe that private accounts will sustain social security; private accounts will enhance the wealth creation opportunity for African Americans; and private accounts will add value to the overall retirement opportunities for all Americans.

But I do believe that you can't say, on one hand, that you are a smart investor, but you are not a smart person when it comes to making sure that investment is used properly for your retirement of what other purposes you might choose for. And I hope we will recognize the twin goals of control of your investment for private accounts, and control of that wealth for your personal need as decided by you not the government. Thank you.



CHAIRMAN MOYNIHAN: Thank you, Bob. And we will be getting to just that, among other subjects, when we finish our opening round here, in which we are hearing an awful lot of agreement. And let's hope we hear it from Gwen King, the really only real commissioner around.

MS. KING: Good morning, Mr. Chairman. Good morning, Chairman Parsons. I would like to associate myself with the likes of Mr. Johnson, everything, except that democratic part.

Yesterday, in Wilmington, Delaware, I met Jeanie. Jeanie is a retired restaurant manager, who is on social security and living in a senior citizens high-rise in the city. And I met Jeanie because she was driving the taxi that took me from the station to my destination.

Jeanie began talking about how her social security check was inadequate, and so she had to work even after retiring. Whereupon, I confessed that I knew a little something about social security. And she told me that she was not so much concerned for herself, she was more concerned for her 50-year-old daughter, because she really did not think social security was going to be there for her daughter when she retired.

I let her know that there was a group of very valiant and intelligent people called the President's Commission to Strengthen Social Security working hard on

this issue; and that we were going to go about the business of making sure that this program was going to be there not only for her daughter, but for the millions of other people who are going to need it in the future.

So, I think, Mr. Chairman, the most important contribution I can make at this time would be to shut up, and let's get through these opening statements, and get on with the work that we had to do, because time is short and our work is very, very important to people like Jeanie and others who rely so heavily on this program. Thank you.

CHAIRMAN MOYNIHAN: Well said. And, indeed, we are closing in on decision points, and we would be making some this morning. Bill Frenzel, I think, is of that view.

MR. FRENZEL: Thank you, Mr. Chairman Moynihan, and Mr. Chairman Parsons. I want to begin by saying that my neighbor to my right, who made some money and did not become a Republican disturbs me, I want to know where we went wrong. Perhaps, I am the balance. I did not do very well, but I stayed Republican.

Mr. Chairman, I think that all of the speakers so far, and all of us jointly are demonstrating the fact that we believe that we have the responsibility to make serious recommendations to improve a program in which we all very strongly believe can be improved.

And I think we pretty firmly believe that standing

back of leaving the status quo is not a way to fulfill the charge that has been laid upon us. It is true that all of us seem to favor person retirement accounts. And if that is what comes out, so be it.

But I think it is also true that I have not talked to any member who is interested in destroying or even harming a hair of social security's head. And we have had a number of our meetings and ourselves criticized on that point.

But it seems to me everyone here is serious minded and spending a lot of their own time and resources to try to produce the kind of report that we can be proud of, and that will carry the nation forward a bit on its social security program.

Some decisions need to be made promptly. We have been through that before. We have talked about the difficulties that occur first in 2016, and later in the mid-'30s. Some decisions need to be deferred probably, because we need to see how the system reacts to the initial changes that we suggest if in fact our suggestions are accepted.

And one of the caveats that I would like to lay out this morning is that we have an awful long way to go before any changes are going to be made in the system. We are not much of an event in a very long process that began two-thirds of a century ago. We are going to make a

recommendation --

CHAIRMAN MOYNIHAN: Bill, could I say, you are talking about the larger social security system?

MR. FRENZEL: I am talking about the larger social security, Mr. Chairman. And we are going to make some recommendations which we think will be useful to make that program better, but those recommendations go to a chief executive, ultimately, go to the Congress, and there are lots and lots of hurdles so that we do not need to be dilute, but we are writing law here, or that what we do is going to actually effect change.

On the other hand, we also ought to be proud of our responsibilities, in that what we do can be very important. If our report is right, people will be effected by it. It will begin a national debate which may in fact lead to improvement in social security.

And for that reason, I would like to suggest, just for a moment, that some time in our considerations we need to take into account the possibilities and probabilities for actually making those changes. We do not want, in my opinion, to produce a technically perfect plan that is going to be indignantly rejected by all of the policy makers of the future.

And we do need to make certain that the plan is one that is workable, can be acceptable, and can be sold at

least to a majority of the American people. I think this commission has the ability to perform in that way, and I expect it to do so. Thank you, Mr. Chairman.

CHAIRMAN MOYNIHAN: Thank you, Bill. And Bob Pozen.

MR. POZEN: Thank you very much, Mr. Chairman. I just would like to review three quick points about my, I guess I would say, focused support for personal accounts. The first is that I believe that we have a long-term financing problem in social security that grows out of certain demographics, and that the events of September 11th have now accentuated that problem to the extent that people believed that there was a "lock box" that was going to save us. I guess that fiction is now down the table, and it is probably good. So, now we realize that we won't be saved by the lock box.

The second point is that this is a very difficult problem. I think all of us on the commission, who have struggled with the numbers have realized that there is no easy solution, that there is no magic bullet. If there was, I can assure you we would have figured it out, if not other people.

And so, when you approach this you ultimately have to figure out how you can have some constraint on the future growth of the divine benefit portion of social security, and

try to do that in a way that will help the lower income groups. And, as I think Olivia said, right now we don't have a minimum benefit for social security. That is surely one thing that we could do.

But for those who say, "Oh, we can just solve this problem by modest changes," I don't think they run the numbers. If there were modest changes that could solve the problem, we would have done those modest changes. In fact, these are difficult changes.

And once you realize that there have to be some slow down in the growth of benefits, the attraction of personal accounts is that it gives people who want to a chance to get back some, if not all of those benefits, maybe even a little more, and to put them in a better situation, and to me that is the real attraction of personal accounts.

If you realize that there have to be some painful choices here, it gives people a chance to come back in.

The third thing that we hear all of the time is that these personal accounts would be much too risk, and they would be much too costly. I think we have heard a lot of testimony from the thrift plan, and from other types of people to say that we can do this. And I think we are convinced that we can start off doing this at a relatively low cost.

And for those who think, well, this is just going

to be a way in which people are going to throw away their money, I think there is a consensus that we will not be allowing people the full range of investments that are in, say, IRAs where people can put their money in an individual stock, in an individual country.

What we are talking about is a relatively modest set of diversified pools which really have relatively low risk. And for those people who say, "Look, I am not even sure among these four or five diversified pools what I can do, I am not knowledgeable enough," we are going to have a default option that is going to be something like a conservative balanced funds that will provide them with the comfort that if they really feel they do not know what they are doing, here is something that will provide them with a reasonable balanced approach, one that should get them a reasonable return.

So, in short, I think that personal accounts if structured within this context can be very useful, and we can come up with a system that is administratively efficient, and while not perfect, will have diversified pools, and the sorts of choices for people that will fit all different levels of investors sophistication. Thank you.

CHAIRMAN MOYNIHAN: Bob, I thank you. And you won't mind me suggesting that we might find another term for the default option.

MR. POZEN: Okay. I definitely yield to the chairman on that.

CHAIRMAN MOYNIHAN: Estelle.

DR. JAMES: Well, 20 countries have already adopted personal accounts around the world. So, this idea that we are talking about is not a completely new and untried idea. In these countries that have adopted personal accounts, the adoption of the new system has usually been preceded by a very intense discussion period of debate and a period of consensus building.

So, during the past year, I have been traveling around the United States speaking to many different people about social security. And I have begun to take stock of the points of agreement and the points of disagreement. Because if we are going to move forward, we also have to build a consensus.

I would like to take this time to just very briefly summarize many points of agreement. I think there are many points of agreement on all sides of aisle, and all sides of this issue. And I would also like to summarize two major points of disagreement that I think we have to debate and resolve in order to move forward.

The points of agreement: First of all, everyone agrees that, in principle, it is desirable to make the system financially stable and solvent for the long run. In



principle, no one can disagree with that, and everyone -- there is general agreement to that premise.

We know that when the baby boomers begin to retire, expenditures will begin to exceed revenues, and we know that by 2038, the expected revenues will cover only 72 percent of the promised benefits.

Now, that is not a very secure system. If you do not have a solvent system with revenues covering expenditures, you know that that is not going to provide old age security, and everyone agrees we do something about that.

Now, point number two: It would be desirable in changing the system to change it in ways that improve output and productivity in the economy. This is particularly important as there are more older people who may not be working. We need greater productivity to maintain consumption levels, both for the older retirees, as well as for the workers.

Point number three: I think there is general agreement that improved protection for low earners would be beneficial, and you heard several people make comments about that in the past hour.

Point number four: Gradual change would be better than sudden change. No one wants to have the rug pulled out from under them just as they are about to retire. And the

sooner we begin, the more degrees of freedom we have, the more time people have to adjust to whatever changes are coming down the road. So, again, I do not think you will find people to take issue with that.

Point number five: Prefunding. Some building up of a fund to cover some of our pension obligations is desirable. It is desirable for a number of reasons:

- First of all, your system is more secure. If you have assets covering your liabilities, there is something there to meet those liabilities.
- And, second of all, from the economy-wide point of view, this helps build national saving which will increase productivity and outcome.

And, finally, the sixth point of agreement: If personal accounts are included, they should be only part of the total social security system, and they should be carried out in a way that keeps costs and risks low. Bob Pozen just spoke about that, as did some of the other commissioners.

So, I think, you know, people around the country could agree on those six general points. However, there are two major points of disagreement that I think we need to come to grips with, and we need to debate publicly, and decide how we are going to resolve them.

Now, the first point of disagreement is, how do you manage the funds?

If you are going to prefund that means you are going to accumulate funds, and someone has to manage them during the period when they are being accumulated. And the big issue is should they be managed publicly or privately? Which way is best for the social security system? And which way is best for the economy as a whole?

And I think this is a point in which different people will give different answers. The argument for a personal account basically stems from a belief that private management is better than public management. Now, in other countries that I have worked in that have accumulated pension reserves, when those reserves had been publicly managed, we have generally seen very poor results.

We have seen politically motivate investments that lead to low rates of return, often even negative real rates of return that lead to a bad, wasteful allocation of capital that does not enhance the productivity of the economy, and leads to excessive investment and government bonds that may increase national deficit which is also bad for the economy.

So, those are some of the outcomes that we see around the world when public management has been used. In the U.S., we have better governance, better trusteeship laws than many of these other countries have, but we also have pressure groups.

We have intense lobbying; we have campaign

contributions playing an important role. And my fear is that the allocation of capital will become politicized if we have public management of large pension funds. And this is a major rationale for private ownership, private control of those funds.

Now, as I said, I know that there are many people who take issue with this point of view. I think it is very important for us as a society to debate this issue and decide where we stand.

Do we want public or private management of the pension funds that many of us agree should be accumulated to back social security?

I think that public management would be bad for the system, bad for the economy, and bad for the government.

And that is one of the reasons why I strongly favor personal accounts where workers control the funds.

Now, the second major point of disagreement has to do with how we deal with the solvency issue. As I said at the beginning, most people, in principle, would support the idea that solvency is important, and it is important to make gradual changes that restore solvency to the system.

However, there is a great deal of disagreement about the specifics of how you do this, and even about the willingness to pay specific, as Lee mentioned in her very first remarks. When you have a 30 percent gap between

revenues and projected expenditures, the specifics are bound to be difficult. They are bound to be painful.

Any specific method that you may consider to close that gap is likely to hurt someone, and therefore to be painful and people like to avoid pain. Now, I think personal accounts help to close that gap in a constructive -- in one of the easiest ways.

But, nevertheless, any plan to restore solvency is going to be difficult and painful. And all of us who have grappled with the numbers, as Bob Pozen said, realize that it is very easy to attack someone else's plan, but it is much more difficult to come up with your own plan because any plan involves difficult decisions and some pain.

Now, I hope that next month when we meet and we discuss plans for achieving solvency, we open the door to a construction discussion among all parties on this topic. And I hope that people who do not like the plans that we propose will come up with their own plan, so as a society we can debate the pros and cons of specific plans and move forward toward a stronger system.

CHAIRMAN MOYNIHAN: Thank you, Estelle. And, now, Mario, and you are at your end.

MR. RODRIGUEZ: Thank you, Senator. I just have a couple of points I would like to make. First of all, near retirees and retirees do not be scared. You have absolutely

nothing to worry about. The system is fine for you. You do not have to worry. Your benefits are not going to be cut. Everything will stay the same. Do not let people scare you, the papers scare you, the rhetoric scare you. It can be stopped right now. You have nothing to worry about.

One of the concerns I have is I am very, very concerned about -- this is about helping people that need to be helped, in particular, the minority community. It is alarming to me to hear that Hispanics have \$1200 put away for their retirement. That is a shame. That is something we have to absolutely do something about. The African Americans, \$3,000 put away.

We have to do something to help the people that need to be helped. And that is what this commission is all about. And being on this commission with all of the individuals, I cannot tell you how proud I am of everybody here, and the commitment that everybody here is making, and that the president is taking the bold steps to allow us to debate this and come up with something to help the American people. Thank you.

CHAIRMAN MOYNIHAN: Thank you, Mario. And I want to repeat what you have to say about the quality of our members. But there is one -- we might as well be open about it. Every time I call Tom Saving, his secretary tells me he has gone fishing. And it may be he finds he does a lot of

deep thinking out on the ranch, or maybe his secretary does not want me to know where he is. But if you want to help us on that, Tom, you wrap up for the morning.

DR. SAVING: Thank you, Senator Moynihan. That is a wonderful introduction to the person who gets to be last.

And the advantage of being last is that everyone presumably has said the important things that have to be said, and then you can be brief. And, presumably, if we are as successful here as I am with fishing, we will an excellent outcome, assuming I actually get to do any of this fishing that we talk about.

Anyway, this commission is about social security and I think the operative word of that is security. And I would modify this operative word with the word "individual" security, because this is about individual security. Everyone in the aggregate might worry about retirement security, but each individual is worried about their individual security.

And we are about individual security, because after all each of us is an individual. And the only security you have for your retirement, if your retirement will be there because of the way this system is imbalanced, is if you have an account of your own that is in your name, and where you, and not your Congressman, has the one and only key, and I think that is important.

No matter how well meaning our Senators and Congressional members are, they legally cannot write a social security lock box contract that binds themselves or any future members of Congress. I want to say the personal accounts represent the only way Congress can put social security tax revenues into a lock box.

And I think that is the simplest way to talk about this issue, and to say that what we want to do is to put the security back in social security. And the way to do that is to take the key away from our Congressional members. As well meaning as they all are, they are pressed always with current events. And, unfortunately, social security is about the future. And someone has to worry about the future, and we can do that with individual accounts. Thank you.

CHAIRMAN MOYNIHAN: Thank you, sir. And just before we go now, ahead of time, which is a good sign, to our first substantive discussion of the administration of personal accounts, to make two points that we have only two meetings left. This is not a three year hitch. The president in the outset asked us to have our last report by our last meeting December 11. And if our report comes a week later that will be no matter, but we finish up this year.

As you all know, he wants to raise this subject in



the State of the Union message, and would be receptive to everything he has heard this morning. But we have to know that the time is at hand to make some decisions about what we propose.

## **II. ADMINISTRATION OF PERSONAL ACCOUNTS**

CHAIRMAN MOYNIHAN: Now, our next subject is the Administration of Personal Accounts. And I am going to, first -- my God, he has disappeared. If Steve Goss has disappeared, we are in trouble. Steve, where are you?

MR. : He is close.

CHAIRMAN MOYNIHAN: Steve, get back, so we know if we say something absolutely awful, you can you know keel over. It is an honor to have you here. And everyone should know that if there is such a thing as double time and triple time, Steve has put it in for us without a moment's hesitation.

to you and to your colleagues.

I would also like very much to thank the Treasury Department's Office of Tax Policy, with regard to the help they have given us on this subject, and the document which would be yours to date. John Cogan and others pointed out that two dozen countries in the world have introduced individual accounts.

It is an idea that you can see developing in the way that social insurance itself developed. And it does not

happen in a week, but you can feel it coming. In this overview of Treasury work on administrative issues of social security personal accounts says the summary, "This document provides an overview of work performed from 1998 to 2001 by the Treasury Department's Office of Tax Policy, introduction in the fall of 1997. The Clinton Administration began to analyze proposals to create a system of individual retirement accounts either as part of the social security program or outside it."

And, Sam, I think you indicated that you had been involved in some of that thinking. Here it is. And the nice part of it, they cite that paper by Elmendorf, Liebman, and Wilcox, which was given up at Cambridge earlier last summer, and which we had at I guess our first meeting.

The good news is -- well, the good news is right here. It can be done. It works. They have figure out it, figured it all out. And for three basis points, it is one of those things that I am not sure I fully understand. It is all right.

They were down to the number of keystrokes it would take, and the answer is that there are enough keystrokes. I do not know where you store a keystroke. Well, I am, you know, liberal arts, that kind of thing, forgive me.

And then, something else of consequence in the

previous administration was planning this. They had a succession of plans, what was the USA account, and so forth.

Then in the year 2000 election, both candidates of the major parties proposed one form or another of individual accounts.

Vice President Gore was, perhaps, more specific than any of the candidates. And there were, as we know, more than two. NPR, all things considered, June 20, Vice President Al Gore outlines a new plan designed to help low- and middle-income Americans, Bob, Robert.

And it says, "Savings accounts can let your parents build a haven on the bed rock of social security. So they cannot only make ends meet, but also live to old age of peace and plenty. If a young couple saved just \$20 a week, they could reasonable expect to save as much as \$400,000 extra by the time they retire 35 years later."

The magic compound interest, I know that word because --- about as much as I get to, but all candidates were there. Other countries, I have got there before us. I guess Bismarck had an old age retirement in place by 1888, and we were a half century later.

President Roosevelt's message to the Congress on social security, all three-and-a-half pages, in those brief days when they got things directly, began of course with unemployment insurance which was the pressing issue in 1934

-- well, '35 message, and then went to old age retirement.

As I mentioned he had -- he said that the old age retirement should be associated with personal annuities. He anticipated something like we are doing here, and that he called for unemployment insurance.

Well, the British adopted this in 1911, the liberal government. Churchill, as Home Secretary, proposed it. The Torrie benches opposite said that if you do this, the workers will spend the money on drink. And he said it is their money, and which was a good liberal proposal in those days, but we won't get into that detour.

But we will begin, if you are ready, Chuck Blahous, and Kent, who has done so much work for us in these matters. And I think we will now turn to Section II, Administration of Personal Accounts.

MR. : I don't like that idea, but absolutely.

CHAIRMAN MOYNIHAN: Yes, sir. Very well, I think the way we go is that, Kent, you have prepared some talking points and questions for us. And with the permission of the commission, I would like to ask if Chuck Blahous, our indefatigable Chief of Staff might want to say something at this point, Your Honorable Self, and Kent Smetters.

MR. BLAHOUS: Thank you, Mr. Chairman. As you have pointed out, I am joined at the table by Steve Goss, on

my right. We will try to heed your admonition to leave him undisturbed during the December holidays by completing our work.

And on my left, by Kent Smetters, who, as you alluded to, has performed a tremendous amount of work with the Treasury Department in outlining the distinguished pedigree of personal account administration.

I would like to, if I may, simply summarize some of the fact-finding that has been done by the administrative subgroup, and then allow Kent to make a brief summary of the work that was begun under the Clinton Administration to administer personal accounts.

CHAIRMAN MOYNIHAN: Please do.

MR. BLAHOUS: During the past several months, Mr. Chairman, the administrative subgroup for the President's Commission to Strengthen Social Security has worked closely with nonpartisan experts in the executive branch departments in order to outline options for the best design of personal accounts. These experts have investigated the administrative aspects of personal retirement savings accounts dating back --

CHAIRMAN MOYNIHAN: Might I just interject to say that in that report that has been prepared for us, the Treasury turned to -- have I got it right -- First Boston for Counsel and --

DR. MITCHELL: State Street I think.

CHAIRMAN MOYNIHAN: State Street, State Street, sorry. And then, this new name for Arthur Andersen which is?

DR. MITCHELL: Accenture.

CHAIRMAN MOYNIHAN: Accenture. Thank golly you are here, Olivia. But, I mean, so we have reserves not just in Washington, but they are up in State Street in Accenture. They are authorities as well.

MR. BLAHOUS: Yes, sir.

CHAIRMAN MOYNIHAN: Excuse me. I just want to make that point.

MR. BLAHOUS: Indeed, this work dates back to previous administrations and made use of experts, both inside and outside of the government. The motivating question of the review of the administrative subgroup is whether personal accounts can be implemented in a cost-effective manner, and give Americans a good value for the services they receive.

While not all details of this analysis have yet been finalized, it is already very clear that the answer to this general question is positive. Personal accounts can be administered in an efficient and effective manner. The international experience has also confirmed this conclusion regarding personal accounts.

More than 20 countries spanning five continents have now created personal accounts to either augment or replace their public pension systems, as some have alluded to here. Personal accounts have been created in Australia, Switzerland, and the UK. They have also been implemented in Chile, Mexico, Argentina, and Poland.

Numerous other countries are also now in the process of creating personal accounts including both Russia and China. Even Sweden, a nation that traditionally has a large amount of publicly provided welfare, has also recently implemented personal accounts. Experience in the United States --

CHAIRMAN MOYNIHAN: Might I interject just to say that the Swedish experience has not been a very happy one, has it not?

They began by offering individuals 565 options, and not including the default option, and even Swedes got confused. This is not a risk-free enterprise. Am I wrong about that, Kent?

MR. SMETTERS: No, you are right. It just emphasizes the importance of the default option in all of this.

MR. BLAHOUS: The standard option.

CHAIRMAN MOYNIHAN: Called the orange option, but there are 565 choices.

MR. SMETTERS: Yes, there is quite a few. It is growing every day.

CHAIRMAN MOYNIHAN: And just too many.

MR. BLAHOUS: Experience in the United States, Mr. Chairman, with 401(k) plans and investment retirement accounts has given the U.S. financial providers a tremendous amount of experience in administering personal accounts. But by any measure the United States, a country whose approach to social security was copied throughout the world in the 20th Century, is now behind in terms of modernizing our system for the 21st Century.

Both the international experience and the subgroups own examinations have provided two valuable lessons. First, personal accounts can indeed be administered in a cost effective fashion. But, second, as you just indicated, Mr. Chairman, the design details are very important.

The UK system, for example, has been criticized for high cost and accounts earning, and the government there has had to re-reform this system in order to solve these problems. Moreover, many of the basic design choices involve difficult value-based decisions.

For example, how to divide assets in the occasion of divorce. And these cannot be settled by economists and actuaries alone, with apologies to our actuaries at the



table. Instead, these issues -- and our economists around the room, yes.

Instead, these issues have to be discussed and debated thoughtfully in a public setting, as we are about to do. And this fact motivates today's discussion on the administrative aspects of personal accounts.

Before I turn the microphone over the Kent, I want to say a few words about these general principles that have undergirded the administrative subgroups investigations thus far:

(1) Administrative fees must be reasonable. Any fees must be in proportion to the services that are provided to the owners of personal accounts.

(2) Real assets, as much as possible, are the foundation of retirement security, and personal accounts must be designed with this retirement security in mind, and a number of commissioners today have talked about what are the components of real retirement security.

(3) Widows and widowers, too, often fail to live in financial security during retirement. Personal account ownership must help with providing protection, additional protection to survivors.

(4) Divorce too often spells the beginning of financial insecurity for spouses with a limited work history. Personal account ownership must help provide

former spouses better protection relative to the existing social security system.

(5) People with below average life expectancies are being forced too much to contribute during their working years exclusively to a retirement system from which they will receive few benefits upon retirement.

CHAIRMAN MOYNIHAN: Now, sir, you are not speaking of individuals, but of social group beings?

MR. BLAHOUS: Indeed, Mr. Chairman. If you have a demographic group for a classification where individuals are less likely to live well into their retirement years, the unfortunate fact for many of these people is that they spend a good portion of their lives putting taxes into the system, and neither they nor their heirs receive much out of it due to their shorter lifetimes.

CHAIRMAN MOYNIHAN: Due to simply an actuarial reality for this group, as against a destiny for an individual?

MR. BLAHOUS: You are correct. That's right.

(6) The fact that, at most, only half of U.S. households currently own a meaningful level of financial assets is unacceptable. A system with personal accounts must be constructed in a manner to help all Americans to materially share in the dream of financial security upon retirement.

(7) Financial education and information must be provided to Americans in order to encourage them to save the resources that they need to retire in dignity. Personal accounts must, therefore, be implemented with this education in mind.

(8) Protection must also be provided to those who are unable or unwilling to make investment choices by implementing a set of reasonable -- and it says here in my text, "default choices." I will correct that for the record.

CHAIRMAN MOYNIHAN: Can we agree the "x" choice?

MR. BLAHOUS: For the moment, the "x" choice.

(9) Every personal account owner is entitled to have his or her contributions credited to his or her account in a timely and accurate fashion, but without imposing large compliance costs on large or small employers.

(10) The government must be diligent in ensuring that any personal account system is operating efficiently and fairly.

And, Mr. Chairman, as you indicated in your opening remarks, we have already done, as the previous administration has already done, substantial work to ensure that these objectives are met. And with your permission, we will allow Kent Smetters to review a bit of the work that was conducted under the Clinton Administration.

CHAIRMAN MOYNIHAN: Please do. Is that agreeable to the commission? We are right on schedule. Kent Smetters.

MR. SMETTERS: Thank you, Mr. Chairman. In the fall of 1997, the Clinton Administration began to analyze proposals to create a system of individual retirement accounts, either as part of social security, or outside of it. By early 1998, working groups were formed within Treasury and other departments to study issues related to such proposals.

A primary issue is how a feasible system of accounts could be administered, and what would be the associated costs. As a result, work was done to estimate the range of administrative costs associated with various administrative structures. Additional work was done to assess the feasibility and cost of using the IRS to process individual account data.

In May and June of 1998, Treasury staff undertook a study of the potential administrative costs associated with government-based, employer-based, and individual-based and individual retirement systems. A government-based system was assumed to centralize the collection record keeping and individual management functions of the system within the government provider or a contractor similar to the Thrift Savings Plans for federal employees.

And employer-based system was assumed to require an employer role in collecting contributions and managing investments similar to a 401(k); and an individual based system was assumed to be decentralized in the sense that individuals could choose from many competing account providers similar to an IRA.

The costs were extrapolated using existing data and typical costs of TSP, 401(k), and IRA accounts adjusted for any relevant indifference such as the costs of nondiscrimination testing from 401(k) fees. By mid-1998, various proposals from outside administration had suggested using the IRS to collect information on workers individual account contributions and investment choices as part of their annual filings.

In June, July, and August of 1998, the Treasury staff policy had multiple meetings and conversations with the IRS staff regarding the feasibility and cost of using the IRS to collect individual account paper work.

The feasible and cost study was very detailed requiring assumptions such as the number of forms filed on paper versus electronically, and the marquis structure required to enter taxpayers name, social security number, routing, and account numbers.

Let me move on. In January of 1999, as part of the development of the Administration's budget, the

development of the Universal Savings Accounts began. The USA proposal was released in April of 1999, and did not include details regarding account administration. And, nonetheless, Treasury staff had done a considerable amount of work on the USA account administration.

In October of 1999, Treasury's new USA cost estimates were generally in the range of about \$13 to \$15 per account per year. In the late 1999, early 2000, as was alluded to earlier, as part of the Administration's budget proposals, the USA proposal was modified to a new proposal for individual accounts that became known as Retirement Savings Accounts.

During the spring of 2000, Treasury published a request for information asking any interested vendor to submit qualifications for a competitive bid to design and operate an online database similar a system to administer RSAs.

In September of 2001, the President's Commission to Strengthen Social Security, requested information related to administrative costs of a personal account system within social security.

In response, Treasury staff utilized their administrative cost model for a large individual account system based on the information learned from prior contacts with State Street Bank industry consultant now called

Accenture, as well as Treasury's own work on the USA and RSA proposals. The cost estimates provided by Treasury suggest a range below \$13 per account.

So, the work that we are doing today for the commission is really in a continuum of a long history of work that has been done from previous administrations, and we have constantly modified the process, but enhance it to make it always more accurate. But it is part of a long history and continuum.

CHAIRMAN MOYNIHAN: Well, thank you very much, Mr. Smetters. And you have put together for the commission a series of questions. And I think we all have these in front of us, do we not? Well, I have the questions, if you have the answers.

MR. : You have the questions, we have the answers.

CHAIRMAN MOYNIHAN: Where is it? Why don't I look? Obviously, there are people on the administrative group who have views on this. So, I will read the question, then the people involved, or anybody else involved will make their question.

(1) Without necessarily deciding the exact administrative structure today, which key features of the centralized, mixed, or decentralized structures do you believe are the most important in any system or personal

accounts?

And we have -- Beard and Frenzel seem to be of the same view, then Pozen, then James, and Cogan, maybe Mitchell.

MR. FRENZEL: Thank you, Mr. Chairman.

CHAIRMAN MOYNIHAN: Sir.

MR. FRENZEL: Thank you, Mr. Chairman. On our group, we had a number of discussions on this question. And because of the cumbersome nature of how we must deal with the question, we of course had no votes. While we tried to share information with one another, sometimes in the whole group, sometimes one-on-one, it appeared that probably more members favored what we will come to call the centralized version rather than the other suggestion, or even the hybrid.

And the reasons most often stressed by those who spoke in favor of the centralized system was that we had a very good model which was highly successful and was praised by participants and groups alike, and that was in the thrift plan of the federal government.

It seemed to work. The players liked it, et cetera. And if we are talking about overcoming political hurdles in the future, why challenge success? Here is one that not only the participants like, but the Congress likes as well.



Item number two, by those who seem to favor it, was the cost is obviously less, and I will yield to Treasury or anybody else on that score later if they have some good figures.

But, again, going back to the thrift plan and looking at what they allege their costs are, the significant number of basis points could be achieved by the centralized plan rather than a more individualized or decentralized plan.

Finally, we did discuss other countries' experience. Sorry, not quite finally. We did discuss other countries' experience, and we noted problems in at least the countries that were discussed. Chairman Moynihan has already suggested that some of the Swedish problem.

We know that the problem in the UK about allowing money managers to solicit people on the streets resulted in some extensive situations which I think is wise to avoid. And it does seem to me that wherever we look, our own thrift plan gave us a better model than those we found overseas.

I think members also considered that there is a certain lack of sophistication on the part of probably a number of these participants and potential investors at least. And even the most sophisticated of us would not know how to approach the 500, and then later 700 Swedish choices that we had.

And looking a little further at the British one, we noted there was a bit of rapacity, you might say, on the part of the money managers, who were anxious to get the business at whatever cost, --- the people who favored central systems favored it very strongly.

And when it was suggested that, well, maybe you need a tier two down the line, in which you should offer more choices to people said, "Okay. But let's not slay that dragon today." Let's let that happen. If that development is to occur, we can express this in our opinion that that would be desirable.

But not to stage it, and say that it has to occur after year 10, or when your assets get to be "x" dollars, rather to say, "Let's see what develops and the board will certainly be able to make recommendations, and so will other observers."

So, Mr. Chairman, that expresses the point of view of the people who thought that system was the best. But it is by no means the decision of the administrative, nor may I say that there was any vote taken? And it is finally fair to say that there were other opinions expressed, and I would leave that for others to make at this point.

CHAIRMAN MOYNIHAN: Good. Thank you. So, others?

MR. BEARD: Bill stated the issue very well. And one of the objectives we all agreed to is here is an

opportunity for all Americans to build well. So, we are all very sensitive to the issue of administrative costs. Because as administrative costs go up, your wealth accumulation is not. So, there is a whole discussion about how to open up wealth accumulation and come up with plans to keep administrative costs low.

On the issue of choice, on the federal Thrift Savings Plan, as we heard when they testified, it is a competitive process, and Barkley's International has won. So, it is one provider for the country.

And I think that most of our commissioners just in the discussion we have heard rather like the idea of having some choice; and having more than one provider so that, in effect, if you define here are the kinds of limited and diverse types of portfolios and systems like the federal Thrift Savings Plans, if more than one vendor wants to offer those limited choices they may, and then you get more than one provider.

So, that is what I will comment. And Bill's comments were excellent.

MR. POZEN: Well, I would just like to express agreement on certain points, but then just raise a few questions. I think I would agree that the collection of the money through the government system makes a lot of sense. I also think that starting off with a thrift plan with a

limited number of choices, low cost alternatives, makes a lot of sense.

I guess I would just like there to be an expressed recognition. And maybe this is not very different than what Bill Frenzel said, that down the road, once we have had experience with a thrift plan, and once we understand the range of choices that people are interested in, that we at least ask the Board that administers the system to try to develop a tier two in which you would still have the collection through the government, but that maybe people who had accounts of a certain size would then be allowed to go into a tier two.

I think we would also ask that the tier two not just have every possible investment like the Swedish system.

But, again, that the tier two be limited to some concept of diversified -- a limited number of diversified pools with some orange options provided also.

CHAIRMAN MOYNIHAN: Bill.

MR. FRENZEL: Can you sort of describe the range of options in the discussion that you had that might be in the initial plan?

MR. POZEN: Well, I think in the initial plan, the thrift plan has five options. It has a diversified U.S. stock fund; it has a diversified U.S. stock fund; it has a diversified international fund; it has a bond fund; it has a

money market fund; and it has a diversified small-cap fund, so that it has that sort of diversified group of --

CHAIRMAN MOYNIHAN: It began, I believe, with three.

MR. POZEN: With three, and then it added two.

MR. FRENZEL: We are talking about adding a couple of balanced funds.

MR. POZEN: And then, I think we were talking about adding a couple of balanced funds for people who wanted what I would call a one fund solution. They did not want to have to allocate between funds. They just said, "Well, I would like either a moderate or a more growthy balanced funds, so a more growthy."

One type of balanced funds might be 60 percent equity, and 40 percent; and another might be 40 percent equity, and 60 percent bonds, so to give them a choice for two one fund solutions.

Most of these, as in the thrift plan, I would expect to be index funds. But I think we go to a tier two that we could contemplate a similar range of diversified goals with some similar orange options, and but perhaps allow some active management and a little variety in terms of approaches.

And I would agree that it would probably take several years to get this plan off, you know, develop with

all of the systems issues, et cetera, and then we will know a lot more after a few years. I would not, as Bill Frenzel, I would not put a specific time date on it, but I would like to see a general guidance to this Board to try to develop a tier two at some point down the road with these constraints.

CHAIRMAN MOYNIHAN: Estelle.

DR. JAMES: I, basically, agree with Bob's point of view, and I would just like to quickly summarize how I get to that point. It seems to me that because we are so concerned about keeping administrative costs low, and also keeping risks low for workers who are just beginning to learn how investment works, I think a Thrift Savings Plan type model is very advantageous for us to start with.

In this kind of model, it has two features that enable us to keep costs and risks low. First of all, only a limited number of options are chosen. These are very broadly diversified investment options. They are indexed investment options.

As you know, that is the lowest cost way to go. And the provider, the asset manager, is chosen in a competitive bidding process, and all of these lead to very low administrative costs per account, and also relatively low risk because of diversification. So, I think that is the way we should get started.

Now, this kind of system also potentially poses

some dangers because it is a quite centralized concentrated system. The danger that I mentioned in my opening remarks about political manipulation, I think could reappear there over time; also, the dangers that Sam Beard mentioned of monopoly, power, concentration of control over a large amount of assets appears, as we know, in the Thrift Savings Plan.

One provider manages the portfolios, and I think it would be desirable ultimately to have more competition from the outside to obviate the dangers, both of political manipulation and monopoly power. So that's why I support the development of eventually a second tier.

This will take time. I don't think we have to spell out the details. I think that is something the Board will do in the course of time, as Bill Frenzel said, as we learn how the system works.

But I think one thing is very important that tier two should also consist of very diversified portfolios, again, for risk reasons, and portfolios that are not too different from what is in tier one, obviously, not identical.

There would be no point in having identical portfolios, but not too different, because the more differentiation you allow, the greater the danger that costs will escalate, that marketing will lead to this outcome.

So, I think that is something we have to grapple with, what we mean by sufficient diversification, and not too different. And I do not even have an answer to that at that point. I think the board of experts that works in the next five years will have hopefully come up with answers.

CHAIRMAN MOYNIHAN: Well, fair enough. It is a good thing to know what we do not know. Olivia.

DR. MITCHELL: Thank you. I find myself in agreement with a number of the points that have been made. I guess I would like to emphasize the points of disagreement just to get the discussion open a little bit.

I guess I find a severe conflict of interest problem with the notion that the board of a centralized government monopoly like the thrift saving plan, as it would be amended, there is a conflict between the notion of that sort of single unitary money manager, and the notion that it might at some future date decide to vote for its own demise, or allow competition into its fold.

I think that it would be a reasonable proposition to say that some sort of starter plan would involve a TSP sort of a model. But you have to build in from the beginning the role of privately managed funds, because if not it will never happen. It will never come to pass.

I also want to offer some caveats regarding the function of the thrift saving plan. We know, for example,



that the thrift saving plan has, only recently with great energy and pressure behind it, moved to more investment options. And it is slowly moving to a more nimble investment portfolio and allowing more choices and more movement of funds.

But, you know, you could argue that its offerings are still fairly limited. And, in fact, I would not have gone the direction they went in terms of adding small-cap and international, when they do not even have an inflation index bond fund which it seems to me is fundamental for the range of offerings about to be in a personal account plan.

We also have, of course, a history of social targeting of investments in government run accounts. Now, the folks in TSP will say they have been fairly successful in resisting that pressure, but we have a long history of state municipal pension plans that have not resisted that pressure. The Navy pension plan, other kinds of pension plans have not resisted that pressure. So, I think we have to be extremely careful.

My final point is that there are private, low cost providers. I am a member of the TIAA-CREF pension plan. They are one of the cheapest in the business and give great service. Vanguard is another one. There are other companies out there that do this very well. I think we really need to think carefully about more of a hybrid plan.

CHAIRMAN MOYNIHAN: Well, I am going to suggest that we do not quite have agreement here. We are getting close. I mean, I have not heard anything that is just incompatible. Can we hope that the administrative group might present a decision that we will reach?

I hope we do not have to vote, but that we will agree to after discussion at our next meeting. Yes, sir.

MR. FRENZEL: Mr. Chairman, I think that is the way the people on our subgroup expected it to go, that our staff would pick on the comments that were made today, and receive other comments from members who may have them later, and give us a write up from which we can later make our selection.

CHAIRMAN MOYNIHAN: Present a consensus view.

MR. FRENZEL: However it works out, I think that is the right way to proceed. Otherwise, then we would talk about each one of these 11 questions all day.

CHAIRMAN MOYNIHAN: Of course. Is that agreeable?

MR. : That's fine.

CHAIRMAN MOYNIHAN: Sure, all right. But there are more questions come, and we are on schedule, and you will get lunch -- maybe.

The subgroup is investigating the benefits and costs, the different possible methods of collecting contributions, collecting contributions. An early analysis

suggests that a 15-month reconciliation delay in the current system would lead to only a very small reduction in retirement balances in a personal account system, relative to something called real time reconciliation.

How do you feel about these matters? There are trade offs. But, obviously, put simply, from the moment a deduction is taken from a payroll, to the moment that that amount of money is invested in a stock or a bond that produces revenue, there is an interval called bookkeeping. It is a lot quicker than previously. Do people have a short answer to this subject? Well, Fidel.

MR. VARGAS: Again, as Commissioner Frenzel alluded to, we have done some work on all of these questions, and by no means is our work conclusive. And I think what we are doing here today is sharing it with the commission as a whole. But on this issue I think there are three principles that I look at, that I think are critical.

The first you mentioned which was to minimize the time lag between the time that, you know, someone's check is debited, and the time that their accounts are credited, or maybe the other way around. And apologies to my accounting professor at business school. But, and so we want to minimize that.

And, secondly, and I think just as important, we want to minimize any unreasonable burdens that we may place

on employers, because while I would favor real time reconciliation that the mechanics of it are quite complicated. And so, we want to make sure, especially on small businesses, that we do not place any unreasonable burdens on them.

And, finally, to maximize the simplicity and to facilitate implementation, I think we all want to see personal accounts established, the sooner the better, and I think those are the three principles. So, while real time reconciliation is desirable, it is not I believe currently feasible, at least not in light of the principle that I outlined above.

So, I think, therefore, I believe that it makes sense to utilize a current reconciliation process. However, I also believe that we need to explore real time reconciliation, the technology required to make it feasible.

And, perhaps, as we are talking about the tier two program, we could look into the implementation of a pilot project that could establish a test to see what the process would work. But, in the meantime, I think it makes sense for simplicity, and also for implementation sake, to go with the current reconciliation.

CHAIRMAN MOYNIHAN: But you are not quite ready to tell us, this is --

MR. VARGAS: No, but I think that that's kind of a

-- from our work, I think that's a general overview. And, obviously, there are other views. And I am sure that the folks that were not participating in our panel would have other views as well, but that seems to have been a consensus, not a consensus, but a general view that we shared, and we wanted to put forward.

CHAIRMAN MOYNIHAN: Good, good. Jerry.

MR. PARSKY: I just wanted to get a clarification of what the -- of this 15 month issue. Is that 15 months after the funds would actually get into an account? Or is it 15 months from the time you make the choice?

Let's just say you made the choice January 1. You contribute January 1, '01. Correct me if I'm incorrect, but it is 15 months from the time the contribution is not already made by the individual until it is actually credited in the accounts and considered to be invested in the appropriate choice.

DR. MITCHELL: No, because the employee who makes a contribution out of his paycheck, 1/1/01, the employer might not actually deliver that dollar to the social security system until the following year when the taxes are sent in. So, it might 15 months or 16 months. From that point, it could be another 15 months till the reconciliation.

MR. SMETTERS: No, no, no.

DR. MITCHELL: No?

DR. JAMES: It is like the year 2000, the reconciliation of most, it would take place by September 2001. And in coming up with a 15 months period, we are assuming the money has come in throughout the year 2000.

DR. MITCHELL: I am just asking the very simple question to the extent, if you put in a dollar January 1st, that is, you are contributing that, how long does it take to get to the market? What is the longest possible time it could take?

MR. SMETTERS: If it was literally January 1st, then it would be like 18 months. The 15th is kind of taking the average. In other words, you are exactly right. During the year of 2001, all of the employers were doing is sending in money. But they are not sending enough information to actually --

CHAIRMAN MOYNIHAN: They do not give names.

MR. SMETTERS: They do not give names, right, and that comes at the end of the year. That would come at the end of the year. And it will take another additional five or six months for everything to be reconciled to go to the personal account, but once it is in the account it is there.

MR. POZEN: Could I answer Jerry? I think it is not necessary that the investment choice be made at the time of contribution.

MR. PARSKY: Right.

MR. POZEN: Which may be responsive to your question. For instance, if we have a system -- and I think all of us would like to see a faster reconciliation.

MR. PARSKY: Right, that is my point.

MR. POZEN: I think everyone would. But let's assume that it takes till September of the year after till we actually have all of the names, we have the reconciliation, we could provide the investment choice season to be over the summer so that people would -- if between January 1st of this year, and September of next year, it would be, say, in a money market deposit account, or in something like that.

And then, in the summer of next year, we could then provide people the chance to make the choice. We would not want them to make the investment choice 15 months or 18 months, I don't think, before they actually -- the money goes in, because by that time lots of things can happen in the market.

But I think that your question points up the great difficulty that the subgroup has had with the fact that we would all like to see a much faster reconciliation. From my personal experience in the private sector, I do not think we want daily contributions, or perhaps even monthly contributions, but it would be nice.

It would be, and I think, a good goal to try to get to quarterly contributions, or at least every six months so that we could start to get the system to work faster.

MR. PARSKY: I think really at the heart of what I was driving at was really two things. One, At what point does a person who made the choice earn money on his money? At what point does that happen?

MR. POZEN: I think they start to earn money in the day it is deposited, but they are earning money probably in some sort of money market rate until it is fully reconciled, and then invested.

MR. PARSKY: That is helpful. I mean, at first, I thought, well, it was only upon reconciliation that you would really get the benefit of the system. And I think that if we could avoid that, that would be very helpful.

DR. JAMES: Yes, you get part of the benefit before then; that is, you get the money market, right, but you do not get the full benefit of a balanced portfolio.

MR. PARSKY: Right, I understand that. And the second aspect of it is there is a reference here to, in order to shorten this period, there may be higher costs. I think it would be helpful to know what that really means. You know, what incremental costs would result in shortening the period?

MR. POZEN: Well, my understanding is, and Kent



may want to address this, that this is part of a more general project that the Treasury has undertaken to try to shorten the reconciliation time. So, I am not sure what their time frame is, or what their objective is here. But I think part of this should not be allocated just to this system. I mean, I think it is a good idea for the Treasury to shorten that time as a general matter.

MR. FRENZEL: I think part of the problem is that it is hard to accelerate the contributions, particularly, for small employers who are a little bit upset about the government bookkeeping they have to do as it is.

CHAIRMAN MOYNIHAN: Could I just reinforce what Bill has just said, just the comments you pick up? Small employers are anxious about this program. They needn't be if we attend to their concerns. But if we act like everybody is General Motors, they are not, few are, and social security has handled that well, Gwen, and it can be done.

MR. POZEN: I think over time one of the other things to realize is we are talking about the yearly flow. Over time, if you are in the system for 20 years, then most of the monies will be in the store, will be in the fund, and won't be in the flow.

If you think of it as a one year start up problem, then it looks very difficult. But after awhile, you have

this big amount of money in the fund, and then you have this one year -- then the money that comes in the flow comes in relatively slowly. We give you this money market deposit account. It would be nice to do it faster, but it is the only -- it would be then one year against the 20 year build.

CHAIRMAN MOYNIHAN: Good point. Good point.

John.

DR. COGAN: Let me thank the subcommittee for the work they have done. This really helps me in my thinking about how we want to approach this issue.

Bob, you mentioned that during this interregnum, where the individuals contribute the money to the government, but there has not been a reconciliation, the individual would receive a money market return.

My question is: What does the government do with the money during that 15- or 18-month period? Have we, as the subcommittee, talked about what the government would do with that money?

MR. BLAHOUS: Dr. Cogan, this is actually sort of a corollary decision point that is related to the one that is before you right now. Certainly, there are different options before us. We could, as has been suggested here, assume that the money is invested in some type of money market fund and earning that rate of return.

An alternative idea would be to have it assumed to

be invested in the portfolio allocation that the individual had in the past; and that you would assume, at least during that temporary period, that it had not changed. So, it would be sort of a bit of a delay, as it were, in any new investment allocations that they were choosing to be implemented.

But, again, that is something that is subject to your deliberation and decision. But, certainly, however you would determine that would determine the answer to your question.

DR. COGAN: Right. My general concern is, of course, we do not want to end up, because of the administrative concern, having the government invest the money.

MR. POZEN: I think it would be possible. I think that it is a good point, John. And I think that it would be possible to hire a private manager to do that during the interim. I think the question that we have been struggling with is whether there was some way to reasonably have an estimate that we could get the money to work faster.

It is not just the question of whether the individual, you know, had changed an amount that would do it the same. The problem is in many cases we do not know who the money -- which individual it is attributed to. Then, if the person changes jobs in the middle of the year, it is

more complicated.

I think all of us would like to see the money invested faster, and if we could make a reasonable estimate, do it. But I think your point is well taken to say that, in any event, we ought to bid out that sort of short-term money manager just like we bid out the index fund for equity.

CHAIRMAN MOYNIHAN: John, do you want to follow up?

DR. COGAN: Yes.

CHAIRMAN MOYNIHAN: And then we have Tom Saving.

DR. COGAN: The second question: If we go through the government, that is, the government is the collector, then we have this reconciliation problem. If an employer has a pension fund or a 401(k) plan that satisfies the requirements that people would want to impose diversified plan, let's say on the investments, one way to achieve a real time reconciliation is to simply not send the money to the Treasury; but if the employer and the employees agree to send the money directly to the private fund manager, and never have it go through the middle man and incur the 15 month delay.

Now, the question is: When the subcommittee took up this question of collection, like did you all consider that, and you are kind of leaning against it, and maybe you could sort help me understand why it was rejected.

CHAIRMAN MOYNIHAN: Well, we want to move on. But, Estelle, do you want to respond to John, because Tom Saving had --

DR. JAMES: I think we had two concerns about that kind of approach. One concern is the compliance problem. It is how would you be sure that, in fact, all of the employers sent the money in, and/or did not make private deals with the workers to avoid this payment? So, that is one problem.

Another problem, again, is the cost that this would imply for small employers, or the difference of access that it might imply for large versus small employers. It would be relatively easy for a larger employer to do this. It would be much more difficult, more onerous, for small employers to do this.

It would add to their paper work, to their costs. And we thought that, for that reason, the simplest thing was to simply have them treat it as part of the payroll taxes they submit now, and the system could then divide that part off. So that was the rationale.

CHAIRMAN MOYNIHAN: Tom.

DR. SAVING: I think, as I listen to this, not having been part of this, the administrative group doing this, someone may get the impression that this is a whole new set of things that the Treasury is going to have to do,

when actually they already do all of this.

I mean, this is exactly what they do. They do collect this money. They get it. They do not reconcile it.

But what do they do with it? Well, what actually happens to it is, of course, if revenues are coming in faster than expenditures, as they roll over parts of the debt which they are doing every week, they roll over less of it.

And that means they are actually earning the rate of return on that, of the mean duration of the debt they are rolling over. And so, that is what is actually happening. That is the rate of return they are getting.

And if that is the rate of return you gave individuals, this is already in place, and they are already doing it, and the only real costs is that this other portfolio might be earning slightly more than this so-called safe portfolio, which would be the mean duration of rollovers during that year.

So, this is not some new, on top of everything else we are doing cost. It is already there, and it is just a matter of when you get it. And I think that while it is important that it would be nice to have it faster, it is not a giant issue, and we are not introducing a new cost --

CHAIRMAN MOYNIHAN: It is a management issue.

DR. SAVING: Yes. And at the current point it is free, because we are already doing it.

CHAIRMAN MOYNIHAN: And Gwen will agree with me, I think you all will, that our social security system is a miracle. I mean, 45 million people get a check on the same day of the month all over this country. Huh?

MS. KING: Well, they used to get it on the same day. The miracle, Senator, is really the 63,000 people who put their shoulder to the wheel every day and make the system work. That is incredible.

CHAIRMAN MOYNIHAN: Yes, I think Olivia, and then, Jerry, you wrap up.

DR. MITCHELL: I just had a question, or a comment to follow up on Fidel's point. I have done a fair amount of work in Mexico with its privatized model, and it is not one that we are going to follow because it has certain other issues. But I just wanted to make a point on this management question.

In Mexico, the money, by law, must be in the market seven business days after it is deposited. And if Mexico can do it, surely, we, one of the most financially sophisticated, riches countries in the world, can do this. How did it happen?

Social security there designed a software program, a database, and then social security folks go out and help the small employers put their data into the database and make sure the money gets in effectively. It is beneficial

because the record keeping is centralized. It is submitted electronically. The employers have help putting it together.

And the other piece of it that is very beneficial is that the supervisory agency which in Mexico is called ---, has daily reports coming in from the employer. So, they know the money is getting in. It is getting in efficiently, and how it is being managed.

So it helps from the point of view, not just of the investment side, but the supervision and monitoring side. But I think we really ought to think further about making some stronger recommendations on making management more streamline.

CHAIRMAN MOYNIHAN: Down the line. A final remark on this question from you, sir.

MR. PARSKY: I think work along the lines that Olivia suggested would be proper. I think the main point, at least that I was trying to raise, I think Tom responded to, and that is I think we need to give people the comfort that neither the government is going to take the funds and invest it somewhere else before reconciliation, and that they will be earning their same rate of return that Tom described from the moment they make their choice. Reconciliation can come later, as long as they are going to earn that return.



CHAIRMAN MOYNIHAN: Fair enough, fair enough. Now, another question, which again I think will have to be resolved, but it does not seem to me that our mission necessarily has to do. We, obviously, have to point to it which is: What would be the range of investments, of portfolios?

You have the TSP which began with three and now expands, and some suggested that it is expanding in ways that are a little curious. Do you have the TIAA that must have zillions of options? Fidelity is known for the impenetrability of this management and extraordinary results that it gets accordingly.

MR. POZEN: Thank you.

CHAIRMAN MOYNIHAN: But do we want to be specific on this, or say let experience be the guide of the Board that would eventually be responsible?

MR. FRENZEL: In the subgroup when this was discussed, we looked to Bob Pozen for guidance because of his experience. You know, I do not know how much time you want to spend on this because we have already discussed it a little bit. But I think he really can tell you what we talked about. Most of us said, "Oh, yeah, whatever you say, Bob. That's really nifty."

MR. PARSKY: We all started that way. It's okay.

MR. FRENZEL: But, as I recall, Bob, it was sort

of the thrift plan business of passively managed funds. And then with the addition of a couple of balanced funds, and the X fund being perhaps several funds age rated, but you describe it.

MR. POZEN: No, I think you did a good job. I think the thrift plan for this type of system is appropriate. I do not think it is appropriate to have 200 choices. I think the thrift plan is a good start. I think Olivia's point of having an inflation index bond fund is good, if we still inflation index bond, which is itself an issue.

And I do think having two balanced funds or lifestyle funds would give us the appropriate range to start with. I think that that would be about right. We are trying not to overwhelm people, but to give them some degree of choice. This is well tested with a thrift plan.

The only thing we are really suggesting is that there be through these two balanced funds or something like that, one fund solution, so that for people who say, "I want a little stock. I want a little bond, but I am not sure how to do it, and we just give them a one fund solution."

CHAIRMAN MOYNIHAN: Sure. Can we then hope for a proposal from the subgroup when we next meet?

MR. POZEN: Yes.

CHAIRMAN MOYNIHAN: I think you are so close to

this, and it is so plain. Then there is the question of, in terms of the range of services, a personal account system might offer, there are questions of, should allocations be made once, every 12 months, once a year?

Some, I think, mutual funds let you do it weekly if you --

MR. POZEN: Daily.

CHAIRMAN MOYNIHAN: Daily, if you have a mind, but they charge you for it. And that's a fair exchange. And if you do not do it daily --

MR. POZEN: And we discourage it, too.

CHAIRMAN MOYNIHAN: Oh, you discourage it. I see. What do we think on this? Is this a subject do we have a view, or need a view? Fidel.

MR. VARGAS: And this goes back to, in some ways, ties into the point of reconciliation. Because, at this point, now we are saying, "Well, at how many points during a year are people going to be allowed to change their allocation?" And you very well, Senator, outlined the range of possibilities.

And I think, again, I mean the fundamental point here is this is a social security personal retirement savings account. This is not a 401(k). This is not a day trading account. And while we would love for people to be able to have as much choice as possible, the constraints

that we are dealing with, you know, keeping administrative costs low.

And also, really, essentially is what we are saying is we are counting on long-term consistent returns from the market, you know, along with the idea that if you invest in the stock market over the long-term, and you are a long-term player, and you are not banking on making quick, you know, returns over a week, or a day, or anything like that, that over the long-term that this will work out.

So, I think that, you know, there was a range of discussion. But I think the conservative approach or the safest -- I do not want to call it the safest, but the approach I think we -- the views kind of coalesced around was to limit the amount of -- the ability for people to be able to make their asset allocations.

So, limit it to a one time per year, or over a period, say, the summer, as Bob suggested, and do it once a year, so that they can, you know, have the ability to change their allocations.

And the other point is that if people want to after they have begun, as Commissioner Johnson has pointed, they begin to see their growth in their accounts. And my believe, as well, is they are going to open up 401(k)'s, and they are going to open up, you know, accounts online.

And, at that level, they will be able to make

their choices, and do it as many times as they would like. But I think that is where the discussion at this point --

CHAIRMAN MOYNIHAN: That is where you are heading?

MR. VARGAS: Yes.

CHAIRMAN MOYNIHAN: Gwen.

MS. KING: Mr. Chairman, I would agree with Fidel.

I think that the biggest point of disagreement would very likely be that people say, "Gee, I can only change once in a 12-month period." But I think he very nicely laid out the reasons for that.

If we are intent on keeping administrative costs low, we also need to point out that that helps people, because that gives them a higher return on their investment by not having to pay out their money in administrative fees.

So, I think this is about right. And I certainly would think that this might be something that the Board when they are reviewing how the whole system is working after a period of time might look at. And if technology allows it without any increase in administrative costs, there may be some recommendations for change. But I think this is about right this time.

CHAIRMAN MOYNIHAN: Well, it sounds to me like we are coming along very well here, and we are going to hear from you in two weeks. Now, I am going to make a suggestion which you can agree with or not. We are doing very well on

this matter of administration.

Would you like to just stay with it, go to a brief lunch, and then come back and we are on to the big -- not that these things are not essential, but the big question and the most difficult question which involves social security as well, is the achieving a fiscally sustainable system. Would that be all right?

MR. FRENZEL: If you feed us lunch, we will follow you anywhere.

CHAIRMAN MOYNIHAN: If I promise to feed you lunch? This is a sustainable discussion.

Now, we get to a question of genuine social consequence quite apart, I think, from the prudence and efficiency of a management system. And that expression of what do we do with a husband and wife arrangements where divorce is so widespread?

Not as quite as widespread I think as people -- as the averages will mislead you, because about two-thirds of marriages are quite permanent, and another third are very serial monogamy, I think is the word.

MR. PARSKY: You are digging deeper, Mr. Chairman, keep going.

CHAIRMAN MOYNIHAN: But this is a subject we have not resolved. And I think Gwen would, I would respectfully say, we haven't already resolved in social security, which

begins in another era, and you have a look of someone who has been there, your remark just now.

We ought to come out with something important and equitable which will I think be new. Now, who wants to resolve this? Sam.

MR. BEARD: I will get it started. On the administrative task force we have talked about this. And we start from the viewpoint that in whatever we do, one of the things that we should do is look at the rights of women in protecting women in what would be a new modern system.

And although it is not an administrative question, one of the things we have talked about is within social security is keeping some kind of base payment, because on the issue of poverty most of the instances of remaining poverty and old age are widows and women.

So, though it is not an administrative issue, we start with a view that discussing a need for a base payment.

When you continue on the issues of women, one of the things that comes up in discussions around the country is, if you go to a partial system with accounts, is it a disadvantage for women when they leave the work force during child rearing years whether it be short or long?

And just one of the things that we have discussed in that regard is when women leave the work force during child rearing on a voluntary basis the family should

certainly have the right to keep the payments going into the account. Because where the woman leaves the child for the work force during child rearing, she is going to retire.

CHAIRMAN MOYNIHAN: And you are saving.

MR. BEARD: And you are saving, and you do not want to be penalized for child rearing years, so that is an option.

Now, on the issue of divorce, there has been good discussion about pretty much during the marriage years, there are two options: One is, when you get married, you pay equal amounts of money into the two accounts. Let's say the wife is earning more than the man. Equal payments enter the account throughout the whole period of the marriage.

Then, in case of divorce, during the marriage the accounts have grown equally and there is a fairness. The other option is the accounts during marriage grow, and then if the marriage ends up in divorce, do a community property kind of settlement at that time.

So, those are the kinds of issues that we have. And starts with if we go to a partially funded system what do we do to protect the rights of women?

CHAIRMAN MOYNIHAN: Can we look for a proposal from you all in three weeks time? Oh, yes, Estelle.

DR. JAMES: You know, we discussed these options at considerable length. Again, we have not take a vote, and



do not have -- I think that many people in the group feel that the most equitable thing would be to say, the assets that were contributed during marriage, and the investment income that was earning during marriage should, as a default position, should be divided equally between the spouses in the case of divorce.

So, that would be what people could expect to happen. That is consistent with the community property idea, in addition to those accounts during marriage would be split equally in the event of divorce.

Now, I think there was also some feeling that if the parties chose to agree otherwise, as part of the overall divorce settlement, they should have the right to do that. But that would be the presumption, the starting point, that were accumulated during the marriage would be split equally.

CHAIRMAN MOYNIHAN: Good. Well, I think we are very close to agreement here, and just get it out and put it on paper. Fidel, that is your job.

The next question is one that Bob Johnson raised earlier which is: Should there be pre-retirement access to these resources? And can you classify the circumstances in which that would take place?

This is a very serious matter. Well, I will just put it to you this way. I am glad nobody ever let me touch my TIAA-CREF, and but there you are.

MR. JOHNSON: Mr. Chairman, we talked about this.

And I think it seemed to be the consensus of the group that -- and I agree with it, that social security is fundamentally a retirement account; and that we, in this country, because of a culture of not saving, the government basically mandates savings for in the best interest of everybody concerned.

And there is a part of me that concurs with that, and there is a part of me that says it smacks a little bit of, to be somewhat paternalistic. But I guess there is a time when paternalism makes sense, and this may be that case.

However, I think once you move into private accounts, you are sending to the citizenry a message that says, "We want you to have more control over your retirement funds. And, therefore, we want to give you options to invest it in the market, and various types of instruments that will allow you to maximize a return. And that will give you greater security and greater benefit when you retire. And it will also provide sustainability to an entire retirement social security system."

That is what we are telling them, and we propose to educate them on that process. When we do that, I think we are implying to the citizenry that this private accounts fund can be used for you in other ways as well,

particularly, if there happens to be a catastrophic disability, or some other problem that would allow you to reach into it. And I believe that, like with your 401(k) and your IRAs, where under certain conditions of disability, you can reach into those accounts.

And I think we should allow that for the private account part of the social security system, so that if you have a situation, for example, where you have a family of kids and their mom put them through college, and they now have jobs, and they are working, and they are young people, and they are building up this private account, and their mom is now sick. She is suffering from something, and they want to provide a nurse for her.

It is expensive, and they happen to have in their account a certain amount of funds that they can draw on for that. I think that would be an appropriate way to do it; or a catastrophic illness where a father's daughter was suffering from needing a kidney transplant, going into that account could be a way of addressing that problem.

I do not think we would see this abused on a wholesale basis if people understand, and if we educate them, as we say we will do, that this for your retirement. And so, people are not going to use it on, you know, frivolous trips to the doctor or dentist.

So I believe that, particularly, with African

American families that are likely to face disability early on, that having access to this would simply be a way that they could exercise their own judgement in when to use it, and at the same time provide them with some sense of control over their own financial well-being.

CHAIRMAN MOYNIHAN: Right. Could I just make the point? I am sure you agree, that we are not I think primarily involved here in personal account in a retirement system. We are talking about a system of wealth accumulation that is in a state that is passed on, that if is known people die at 55.

Well, if you die at 55, with such an account, it is your money. Whereas, social security, no, and that is what the -- I said what I have to say. Estelle.

DR. JAMES: Yes, I would just like to respond to the point that Bob raised. I mean, the problems, the kinds of situations he mentioned are really difficult situations, and I think they have to be addressed.

But I think they have to be addressed, not by a retirement security system, but by other parts of the social safety net that is by our disability system, by our medical insurance system.

And I think we are talking about a retirement system here, a system of savings for a retirement account, for retirement purposes which will, in part, replace the

benefits that people have now from the defined benefit account. And my concern is that once you open the door to other uses of these funds, however, you know, well-meaning, there is the danger that people will withdraw the funds early, will find real needs for the funds.

Because many people have real needs for that money, that's true, but the problem is the money won't be there later on when they retire. And they may be fortunate enough to live 10, or 20, or 30, or 40 years after retirement. That is what I am planning to do. And if that money is not there --

CO-CHAIRMAN PARSONS: Which one, Estelle?

DR. JAMES: Oh, 50, 50, I did not get to that. I have good genes. But, you know, if I had taken my money in my social security account out earlier, I might be in trouble in that 40th or 50th year. And the problem is this poses a problem for the individual, for the individual's family, and for society, because we do not want to be left with a lot of poor old people who have used up their retirement accounts earlier before they even retired.

And that is why I would really favor being really holding the line and saying, "These personal accounts --

CHAIRMAN MOYNIHAN: Fidel, and then John.

MR. VARGAS: No, as a member of the administrative subgroup, you know, I struggle with this as well, only

because -- I think and Bob made such a strong and passionate case with this that in principle it would seem that this is your money, you can do what you want with it.

On the other hand, you know, the other side of me is thinking about, you know, what we are trying to do here, and, as you said, Senator, in terms of establishing, you know, wealth over the long-term. And there is no easy answer. However, we are going to have to recommend something.

And I think this is an issue where we, on the administrative committee, were going to do some more work, and we are going to try to you know come back with a recommendation that makes sense. And so, but again, you know, it is crystal clear, and it makes sense in principle.

What we are struggling with, on the other hand, is what are we trying to accomplish? Because I know in my case, in my community, similar to Bob, and the African American community, there are folks whose life expectancies are not as long. They need the money. And so, we are struggling with that, but we will be back to the whole group with that. Thank you.

CHAIRMAN MOYNIHAN: Do it. Do it. Bill.

MR. FRENZEL: As far as what Fidel says, I hope we can work something out. But I did want to question something that Chairman Moynihan said about the personal

account versus the retirement account.

We are talking about laying this system, whatever it is, across our federal retirement system, the social security system where either some of these funds are supposed to take the place of some on social security, or augment it.

We won't know that till we see what kind of a plan we have got, but this is a retirement program. And if you start to devote it to education or health or other projects, you are going to diminish the effect, and you are going to cause our critics to be more nervous about whether those retirement benefits are going to be there.

Secondly, the government is the insurer of last resort in this program, and we are going to get these people one way or another. Either we will be called upon to beef up social security; we will have greater demands for SSI; we will have somewhere else in the system.

So, I think we need to be careful that if private accounts cannot carry every burden. And if we want to make them work, we have got to have something simple that everybody understands without too many options, and we cannot let too many people get in there however worthy their desires. Thank you, Mr. Chairman.

CHAIRMAN MOYNIHAN: A fair point, and we look forward to your final proposal. I have one last question.

And the others, there are some others, but they easily are handled in the same mode we have here, and by canvassing if need be. But there is this question about the choices available for taking account distributions during retirement.

Now, here is where Bill and I may just be having a language problem. We envision a savings system that provides a measure of individually controlled wealth at an age which we also equate with retirement, but it needn't be retirement. Is anybody here going to stop working at 65?

So, we will have to ask ourselves, do you get this money at a fixed age regardless of what your employment status is? And then, can you choose to have it annuitized, which means it will have disappeared at the end of -- you know, as long as you live? But it does not pass on as property. Do you have a series of choices?

Somebody answer that question quickly please. As soon as the question is answered, we can have lunch.

MR. JOHNSON: Let me answer that one if I can. If I was ambivalent about the other one, I am firm on this one.

CHAIRMAN MOYNIHAN: If you were ambivalent, I want to see firm.

MR. JOHNSON: This one clearly goes to the point of the reason why President Bush talked about this as wealth accumulation that could be passed on to your family as an



estate.

And here, if you go through the system, you work to the full age of 65, whatever the retirement age will be at the time we get around to approving this, you have accumulating -- we will take Vice President Gore's, you know, argument through compound interest, you get a nice nest egg of \$400,000.

And, again, using what Senator Moynihan said that you are not going to retire. You are going to do something else. So, you have got \$400,000, and you want to -- you and your wife want to open a bed and breakfast. It cost you \$200,000.

What's wrong with you taking \$200,000 of your money? You have retired. You are entitled to it. You could leave it to your kids or whatever, and go out and continue and have a nice retired life running a nice bed and breakfast and/or buying a boat, whatever you want to do with it, it is your money.

And I firmly believe that if we tell people it is their money, but the government says you cannot have it until you either die over time, or until we decide that you can annuitize it, and then you know roll the dice that you are going to live so long as you have got it, or it is really not your money.

I understand the retirement point, and I

understand there is a way to sort of allocate a portion for retirement. But after you sort of reach the threshold, whether you means test how much you should have, or some other way, the rest of the private accounts fund should be absolutely available for anyone to use to put it in the market at a higher yield than they have been having it before or whatever.

And I think fundamentally to not do this would really be making this something of a charade, and we would not be serving our goal of creating wealth, and wealth that can remain as an estate or an asset to the family after retirement.

So, we need to look at this one real hard and see if we can come up with something that gives a great deal of flexibility to people who have complied with all of the requirements of the system, but now want access to their own money.

CHAIRMAN MOYNIHAN: There you are, sir. I do not think -- Gwen.

MS. KING: I concur.

CHAIRMAN MOYNIHAN: There isn't much to add, isn't there?

MS. KING: I think lump sum distribution ought to be option, absolutely.

CHAIRMAN MOYNIHAN: There just isn't much to add.

Mario, and then Olivia, and Estelle. Mario.

MR. RODRIGUEZ: I concur with you, too, Bob, and Gwen. But my question I have for maybe Steve, if everybody at 65, they retire at 65 years of age, decided to pull out all of their money, what would that do to the system on the private account?

MR. GOSS: Well, I guess I am happy to be able to report that we can't really say because that would depend upon what your other subgroup does, in terms of the nature of the system, and how it interacts with the individual account. There are a lot of possibilities here.

If it turns out that the other group recommends a plan as some have in Congress where the solvency of social security depends strictly-speaking on what is available in accounts over time, with some kind of a mechanism for reducing benefits in a very direct sense, this could have negative implications.

It could have positive implications if at the time when people take the money out there is some kind of a permanent reduction in benefits. So, as I understand it, you have a long way to go in the other subgroup to work this out. And I think in about a month we will probably be able to answer that question.

CHAIRMAN MOYNIHAN: Thank you, sir. You have been here all morning. And, thank you, Mario, for turning to the

authority on these matters.

DR. MITCHELL: I would just like to in our next meeting ask Jeff Brown to talk a little bit about the role of annuities in retirement, because it seems that he has done a great deal of research, some of it with me. That is the best stuff, of course.

But what seems to be the case is that, first of all, annuity markets can work very well; that annuities are very valuable; that inflation index annuities are very valuable. And we also know that annuities do not have to exhaust the whole sum.

There are ways to design alternative products. You would still have a bequest. So, I would like to ask that Jeff come back with a little bit of a discussion on the role of annuities and the payout.

CHAIRMAN MOYNIHAN: Fair enough. Fair enough. Estelle, right quick.

DR. JAMES: Yes, I would like to revert to a comment that I made before about making sure that old people stay out of poverty. And I think we all share that objective. So, I do think in whatever we ultimately decide about the distribution, we have to bear that objective in mind.

Now, my concern is that, again, depending on what eventually comes out of the Cisco subgroup, there is the

possibility that if you allow people to use up their entire individual account as soon as they reached the age of 65, some of them would be left in poverty. The bed and breakfast may fail.

We know that many small businesses succeed, but many of them fail. So, it is not a sure thing. And I would want to make sure in our distribution rules that we say that enough money has to stay in the individual accounts so that between the DB, the defined benefit, and whatever annuitized income or gradual withdrawal income you might get out of the individual accounts, it should be enough to keep you out of poverty.

Now, to be sure that it is enough to keep you out of poverty throughout your life, that really means that at age 65 it has to be more than the poverty line for two reasons: First of all, you may not purchase a price indexed poverty annuity. And, therefore, as prices go up, you will need some additional money more than you did initially to maintain that same poverty line real value. And, second of all, it is possible that the poverty line would go up in real terms if you lived 20, 30 years.

So, therefore, I think I would like to see us adopt some threshold which could be 120 percent or 150 percent of the poverty line. And we require that enough money be kept in the individual account so that the

annuitized value of that account plus the DB at least gets you to that threshold. Now, once you are over that threshold, I agree that people should have greater discretion.

CHAIRMAN MOYNIHAN: I think we may have come up a difference of view that is clearly more than managerial.

MR. PARSKY: Also, Mr. Chairman, I think that we ought to also wait and see how the fiscal group is coming out, because there are some issues that intertwine with the issue of poverty.

CHAIRMAN MOYNIHAN: Exactly. And can I say I was around when we started the war on poverty? And we decided to figure out, you know, what's poor. And a wonderful gal in the Census Bureau came up with the idea that it is three times the city worker's family food budget which Labor Department used to calculate. Well, if you did that today, nobody would be poor. That is a pretty arbitrary number, too.

Johnson, you are in charge. With that, have a good day. Lunch time. I will connect you all, and we will be here. Can we just say we will be back here in 45 minutes?

(Whereupon, the meeting was recessed for lunch at 12:50 p.m.)

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

(1:50 p.m.)

**III. ACHIEVING A FISCALLY SUSTAINABLE SOCIAL SECURITY SYSTEM***Senator Richard Parsons, Chair*

CHAIRMAN PARSONS: Okay. I realize we are missing some of our distinguished members of the press and public, but we are going to push off. And what we are going to do this afternoon, in the interest of having this full and comprehensive discussion at this meeting of all of the issues, is we are going to --

MR. : Mr. Chairman, may we have order?

CHAIRMAN PARSONS: I know, please. We are going to, sort of picking up from this morning, acknowledge that there were a number of issues, questions that were being agitated on by our administrative subcommittee, some of which you heard discussed this morning, which we will go back to that subcommittee for further thought and reflection; and yet another discussion when they come to some consensus that they want to present to the whole commission for its deliberation and action at our next meeting.

And there were several questions which we had intended to get into before the administrative subcommittee that we thought, in the interest of time, we would simply wait for that second turn of discussion around those

administrative issues and move into a discussion of the fiscal soundness issue, which seems to be a matter of some interest to the now absent press. I guess they are upstairs.

And so, I am going to chair the second half of this. Senator Moynihan, having chaired the open session is now, having set a fine example, turned it over to me. And let me say a few words about in the fiscal sustainability issue.

As I think everybody knows, we had organized ourselves into two subgroups to take a first look at some of these issues, and then come back to the full commission with some thinking that we could then debate, discuss, and hopefully make some conclusions around.

The fiscal subcommittee has been looking at the issue of the soundness of the social security system over the long haul. And they are going to share with you, and with all of us, actually, the state of their thinking at this point and time.

But just to frame it for you a little bit, I thought I would start by making reference back to what the charge of this full commission was from the president, and the limitations which the president put on us. Because I think that is what has guided us heretofore, to this point and time, and that is what is guide us going forward in



terms of ultimately developing and concluding a final report.

The mission of the commission, as set forth in the executive order, was to submit to the president bipartisan recommendations to modernize and restore fiscal soundness to the social security system.

Now, that is the broad mission. What the president then did was set up six, what he called principles, that should guide our deliberations in respect to that broad mission:

- The first was that modernization, which he asked us to think about, must not change social security benefits for retirees or near retirees. You heard that earlier this morning, that we are not in the business to change the benefits of anybody who is currently a recipient of social security, or who is close to retirement.
- The second principle was that social security payroll taxes must not be increased.
- The third principle was the entire social security surplus must be dedicated to social security only.
- The fourth principle was the government must not invest social security funds in the market. That is to say, the government must not do it directly.
- Fifth, that modernization must preserve social security's disability and survivor components.

- Sixth was that modernization must include individually controlled voluntary personal accounts which would augment the social security safety net.

So, those were the guideposts that the president set up for us in terms of coming back to him with a set of recommendations designed to enhance the soundness of the overall system.

Now, this commission has spent the last several months going across the length and breadth of this country hearing from a host of interested experts and commentators on exactly how we should fulfill that charge.

And one of the things I think it is fair to say, that the subcommittee on fiscal sustainability has determined is that there is within that broad mandate in those six principles, there is probably more than one way to achieve what the president has asked us to achieve.

The difference is between these so-called different alternatives, or approaches, or some people use the term options. I do not particularly care for that term myself, because I think they shortchanged it, but there are lots of ways that you can fix the system.

Not all of them fall within the six guidelines that the president gave us, but more than one of them do. However, each of those ways involve different policy implications, ramifications, and tradeoffs.

And so, as we have thought about this, we feel that our job has come forward to the president, and to the policy making body, that is to say, the Congress, with a series of recommendations, or a set of recommendations that each of which raises a different set of policy implications or issues, but any of which will enhance the fiscal soundness of the system if adopted.

The reason we are doing it that way is because we are not the elected policy makers. We are here to find ways that within various policy tradeoffs the objectives the president set out for us can be achieved. So, just to give you an example, I mean, one easy way, very easy way, that we could come back and recommend that we restore the system to fiscal soundness is you would say simply raise payroll tax.

Now, that falls outside of the guidelines we were given by the president. It is, moreover, I think those of you who have attended these hearings would know, not a long-term solution. Because, as a number of people in the work force who are supporting the number of people out of the work force shrinks in relation to the latter, at the end of the day, that is not a system that can sustain itself.

Alternatively, at the other end of the spectrum, you could simply say never raise taxes, simply reduce benefits. But even that system after a fashion, politically impalatable to most, also would fall off its own weight.

Because if you extrapolate it out into time, eventually benefits would have to be reduced to close to zero, well below the poverty line, well below what the system was set up to accomplish in terms of lifting Americans out of poverty, Americans, elderly Americans.

So, what we have done is we have tried to work with it well within those two ends of the spectrum and come up with a set of approaches that lean, some more heavily towards finding ways to modify the growth in benefits going forward, others which change some of the criteria that relate to the amount of revenues that come into the system, but all of which are consistent with the six objectives that the president gave us, and that will lead at the end of the day to a sounder, more sustainable, more assured social security system.

And I am going to ask two of my colleagues to sort of speak to that a little bit more, and then have staff. What we tried to was develop a set of criteria by which any plan, or approach, or alternative that we come forward with at the end of the day by way of recommendation would have to measure up against, so that we would know with confidence that whatever comes out of this commission by way of recommendation will be four square within the objectives set forth, and mission set forth by the president, and consistent with the charge that it be responsible, it be

sustainable, and it be sort of fiscally alive.

So, John, do you want to say a word, and then Olivia, and then we will have our staff walk us through?

DR. COGAN: Thank you, Mr. Chairman. What I would like to do is just tell a little story about that underscores the importance of achieving a fiscally sound system, and then turn it over to Olivia to lead the staff presentation of the criteria.

My story is about President Franklin Roosevelt, and the development of the original social security plan. President Roosevelt in 1934, put together a commission that was headed by Edwin Witty, was the executive director, a professor from Wisconsin, to develop the social security plan.

After six months of deliberation, the committee reports its plan to the president. The president in reviewing the plan found, lo and behold, that the plan proposed large deficits for social security, permanent deficits in the future. The program would be a permanent drain under the committee's proposal on the federal treasury.

The president at first thought there must be some mistake. No plan of his would impose a permanent drain on the federal treasury. Professor Witty informed him, of course, that there was no mistake, and this was in fact the

committee's plan.

The president, thereupon, ordered the committee to go back to the drawing boards and come up with a plan that was self-financing. The committee did so, and a few months later presented that plan with the president's approval, for the United States Congress.

Ever since then, for decades, the guardians of the committee's finances on the Ways and Means Committee, and on the Senate Finance Committee, have tried to ensure that the program remains fiscally sound. Unfortunately, in the last couple of decades, it has become unsound.

The president's charge to us, I view as very consistent with President Roosevelt's charge to his Social Security Commission. Develop a plan or set of plans, recommendations that will restore social security's fiscal soundness, is the way the president put it to us. And I am sure that is the way President Roosevelt meant it to his committee.

The subgroup that I have been part of has spent the last three months developing approaches for dealing with the fiscal soundness, and Olivia will take you through a general description of what we have been trying to do, and then we will turn it over to the staff to talk about some specifics.

DR. MITCHELL: Thank you. Let me just say by way

of getting the discussion going, I think it is very important to take note that this is the first time that a personal accounts proposal has been really seriously discussed at the federal level.

Other commissions have made comments to that effect. The Advisory Council has talked about this, but what is very important in this debate and the discussion we are having today is that this is the first time at the federal level that we are talking about really adding something important to the social security system.

In the process of putting together a plan with a personal account in it, our broader mission is one really of financial strengthening and fiscal sustainability for social security. Now, I have to emphasize at the beginning that our mission is an education mission. In fact, as Senator Moynihan has reminded me, our mission is education not legislation.

And so, that is very pertinent to where we are going next. Because where we are going next is we are going to be talking about how to attain fiscal sustainability, not necessarily with one plan worked down to the minutest details.

But we are going to be trying to talk about sensible courses of action, which may or may not achieve all of the different fiscal sustainability criteria that we are going to talk about.

But, in order to get to the point of being able to lay out a small number of courses of action, we really have to give I think the president and Congress some clear options regarding what the tradeoffs are. So, to show what the tradeoffs are, we have made some progress. We have had a number of discussions about what the objectives should be against which all plans should be compared.

And so, really, this is the framework for fiscal sustainability that we are offering today. Our courses of action will not reflect our ability to attain all of the goals and all of the standards. As other people have said, if it were easy, if we could do everything simply, cheaply, and immediately, other people would have done so before this.

But our goal is to offer alternatives, and to tell you where the tradeoffs are. We have a set of fiscal sustainability objectives. I think we have a poster on this, if you would be kind enough to put it up. And I am just going to run through these very briefly, and then ask the staff to help us in summarizing our discussions around these points.

I would say that Chuck Blahous and Jeff Brown have done the work of yeomen, along with Steve Goss, in helping us organize our thoughts, and particularly in summarizing the key points. So, let me just run through these very



quickly, and then I will turn to Chuck to lead the discussion going into a little bit more depth.

The criteria, the objectives that we have decided are most important are listed up here at six. The first is that any system which is moving toward fiscal sustainability must have positive annual system cash flows with an evaluation period. These are technical terms, and we will get some elucidation in a moment.

We also think that improvement in system solvency is the direction we need to go. Many of us have argued that we need to reduce the rate of growth in system costs as a fraction of GDP. You cannot have the system growing unbounded forever.

We need to think seriously and clearly about improving the 75 year actuarial balance. And, further, do not stop there. Do not stop at 75 years, but have things look good beyond the 75 year window so that we are not back in the red the moment the window moves forward a year.

And then, finally, we need to think very, very carefully about how to reduce system liabilities already accrued. So, let me with that general introduction ask Chuck to go into more detail. Thank you.

MR. BLAHOUS: Thank you. Mr. Chairman, actually, I would like to ask Andrew, first, if you could put up the cost and income rate chart as well, because we have them

both to refer to.

As John and Olivia have pointed out, there are a number of measures of fiscal sustainability that the fiscal subgroup feels need to be looked at when evaluating reform proposals. And one thing that is very instructive, first of all, is to see what an unsustainable system looks like.

And if you want to see an unsustainable system, you can look at that picture up there, and see our current social security system. And under current law, we would experience cash surpluses every year until 2016, and then the cost and income lines would cross, and there would be perpetual and widening deficits after that point, increasing without bound, and without limit in perpetuity.

This clearly is an unsustainable situation. It is not tenable for a systems --

MR. : Are you planning to stand there and hold that?

MR. BLAHOUS: It is clearly unsustainable over the long haul for the program's annual obligations, and the revenue coming into the program to be pulling apart as distantly as they would under the current system. The fiscal subgroup has made it very clear that it is guided by certain values and principles as it looks at fiscal sustainability.

For one thing, they believe that any plan that

moves towards fiscal sustainability in a sense is strengthening the social security system, because the benefits that are promised from the system are thereby more secure.

I am having great difficulty keeping track of this chart. Olivia, are you going to hold that up?

CHAIRMAN PARSONS: I think the objective is to place it so that nobody --

DR. MITCHELL: Carry on, Chuck.

MR. BLAHOUS: Yes, okay. Does anybody understand me?

And, as the commission looks at various approaches towards attaining fiscal sustainability, it is important to remember that perhaps not every approach will enjoy equal success. Some might address one form of fiscal sustainability more than another, and that is one reason why it is important to look at more than one measure.

Just to go in some depth through the criteria and measures that Olivia outlined. The first of them is just that a fiscally sustainable system has to, at some point, return to annual positive cash balances, at some point during the valuation period.

And what I mean by that is that if you look in this chart, those of you who can now see it in its apparent placement, there is going to be a period of time under

almost any scenario where the cost rate of the system exceeds the income rate. And that is the nature of having a system that relies to some degree on a trust fund.

At some point, the system goes into cash deficit, and the social security program can turn to the rest of the federal government and say, "Make good on some of the bonds and the funds, so that we can continue to make full benefit payments."

But that cannot go on forever, and it cannot go on without limit. And one possible measure of success in reforming the system is whether those lines, while they may cross at some point, they need to cross back again some time within the 75 year period. And if those two lines never cross again, then you clearly have a untenable situation, and an unsustainable program.

Now, while that is an important measure, that is certainly not the only measure. It is a snapshot in time. It does not give you a sense of whether or not the program has added the national saving in the past sufficiently to justify running deficits in the future, and measures that look across time, but it is a very important measure nonetheless.

A second measure which is commonly cited is the systems period of solvency. Under a current projection, the system would be solvent through 2038. Now, solvency is a

very important measure. It measures whether the program has the legal authority to draw upon sufficient revenues to make full benefit payments, but it also has great limits as a definition and this chart shows why.

You can manipulate the definition of solvency with some clever accounting on intergovernmental accounting and transfers of intergovernment accounts. That does not necessarily improve your actual fiscal situation. You could, in theory, make the program solvent just by issuing several trillion dollars to the trust fund today and calling it a day.

So, while it is an important measure of the program's fiscal health, and certainly measures the programs legal entitlement to enough revenues to pay benefits. Again, it is not a measure that tells you everything that you might need to know.

The third measure Olivia alluded to was a reduction in the rate of growth of long-term system costs as a percent of GDP. The reason that this is important is simply that what sustains the social security program in the long run is the American economy. And if the program is growing faster than the economy that has to support it, in my definition it is not going to be a sustainable program.

Right now, the program costs a little over four percent of the gross domestic product in order to pay full

benefits. Under the current system, that would rise to 6½/6¾ percent within the valuation period, and that would be growth that really is 50 percent faster than the rest of the economy would be growing during that time.

At some point, we have to get this program to a point where the economy that has to support the program is growing at least as fast as the program itself, or else it is not on a sustainable path.

The fourth measure is the 75 year actuarial balance. Now, Chairman Moynihan made reference earlier today to the fact that 75 years is a somewhat arbitrary window of time. Nothing is written in stone suggesting that 75 years, as opposed to 50 or 100 years is the perfect measure of the program's finance.

It is used somewhat out of custom and tradition, but it is intended to capture the fact that this is a long-term program with long-term financing needs. And overtime what has evolved, as a matter of standard practice, is that we measure the present of the system's cost and its income over 75 years and judge the gap between them.

It is certainly very important for the system's fiscal health that we reduce the gap over 75 years between the program's dedicated revenues and its cost obligations. But that, in and of itself, may not answer every question.

DR. MITCHELL: Just a quick factual question. Is

it not the case that Congress has asked social security actuaries to use the 75 year period as one of its criteria? Isn't that 75 years also comes from Congress?

MR. GOSS: That has not be, per se, put into the law. What has been requested in the past in legislation by Congress is that there be an assessment of the -- I believe it is actuarial status of the program, which has by the trustees been interpreted over the years in various way, but for a long time now it has been interpreted as a 75 year window.

DR. MITCHELL: Thank you.

MR. BLAHOUS: The fifth measure may sound like a subtle one, but it is really very, very important. And it is that the actuarial balance should not be deteriorating at the end of the valuation period. And the reason this is important is that it is possible in theory to get to a status of solvency or actuarial balance within 75 years. But, yet, the program would not really be on a sustainable or tenable course.

For example, if you can mentally move the lines around on that chart in your mind so that the period of surpluses in the near term is bigger, and the period of deficits in the long-term is only over the last half of the valuation period, you can imagine a chart that looks very much like that one in which the system is actuarially

balanced.

But that really would not be a sustainable or a tenable system. Because if you look one year later, come back around and look at the program again, one year of large surpluses would disappear from your time window, and one year of large deficits would have suddenly appeared within your vision.

And the difficulty here is that if you cut off your valuation period at any arbitrary period whether it is 75 years, 30, 10, or 100 years, if the program is in dire straits at the end of that valuation period, it is not on a sustainable path. And there are different ways to measure whether the trust fund balance is deteriorating at the end of the valuation period.

Steve uses a concept called the "Trust Fund Ratio," and we can do calculations to show how things look towards the end of the valuation period. But that is very important for all of you. Because if you enact a program, and then one year later it is deemed to be insolvent in Steve's calculations next year, that probably would not reflect very well on the work of the commission.

And, finally, a reduction in system liabilities or obligations already accrued. This, again, gets to the problem of having a time limited valuation period. We have a program that is not supposed to be time limited. It is



supposed to be paying benefits and meeting obligations to participants for as far as the eye can see, not just through 75 years.

And one of the issues that we face is that if we are going to move to a partially funded system, then we are going to have a period of time we are bringing some future costs into the present. So, even if in a permanent sense we have not made worse or made better the long-term fiscal balance of the program, there are timing issues that are introduced by moving to a funded system.

And so, therefore, other measures of accounting could create problems of incompleteness in moving to a funded system. You might actually take an action that would greatly improve the systems perpetual ability to pay its obligations, and yet it might look within 75 years as though you have made the system worse because you have started to move to a funded system.

So, it is also really important to look at just the overall liabilities and obligations of the program in a perpetual sense and whether or not they have been reduced or increased by actions that have been taken legislatively.

MR. POZEN: Could I ask you a question on that? I am not an expert on government accounting. But in the private sector we use the concept of a deferred asset where you know that the asset is coming into play, but it is not

yet there. It is sort of like if you had accounts receivable.

And here, if I understand you correctly, what you are saying is if there is some reduction, if people have committed to a reduction in the DB portion of their social security in exchange for taking something for a personal account, then we know that they are going to be paid out less from the social security system.

So, I mean, isn't it possible for us to sort of capture that in maybe a deferred asset account, or something so that we do not -- it feels like we get caught up in this crazy accounting that does not make any sense.

MR. BLAHOUS: Right.

MR. POZEN: And, I mean, for me, just looking at sort of more conventional pension accounting, no one would think of looking at this on a year-to-year basis you know, so if you have accrued assets, or assets coming into play. So, I was just wondering whether we could somehow reflect that in a deferred asset, or something like that?

MR. BLAHOUS: I think that is exactly the point and the intent of this last item. Because, as you indicated, if you move from a system where the same level of benefits -- or excuse me -- to a system where the same level of total benefits is provided in the current system, but less of it is provided from the defined benefit portion, and

more of it from the personal account, it would not make much accounting sense to say in some sense that you made the system worse from a fiscal perspective just because you have changed the method of funding.

But it may be that outside the valuation period, the benefits of moving to the funded system are seen and inside the valuation system period they are not visible yet.

So, in order to get a sense of that you have to capture this progress against unfunded liabilities in exactly the manner you are suggesting.

CHAIRMAN PARSONS: Chuck.

DR. COGAN: Steve, are you able to modify the 75 year actuarial balance to reflect this fact? Is something that you are able to do within the tools that you have available to you?

MR. GOSS: Are you talking about the specific aspect that was mentioned last?

I think as we are looking at this without getting into an awful lot of detail on this, as we are looking at this, I think it is really going to depend upon the exact nature of the kind of obligation we are talking about.

My expectation is that this may not be something that specifically addresses the concept of actuarial balance. But it certainly is something that can speak to some concept of an asset or a future reduction of liability

that would come into play.

It will really depend on the nature of the particular plans that will be developed. And, therefore, the nature of the obligation. And, again, without getting into a lot of detail, there are some kinds of plans for which this approach might actually literally result in a change of appearance system assets. In other cases, it might not result directly in a change in actual system assets. So, I think we really have to wait until we see exactly what plans are really developed.

DR. MITCHELL: Can I just follow up on that? When you think about accounting for personal account assets in a system that might have personal accounts, do those assets get counted as part of the big picture that you have been talking about, Chuck? Or are those somehow not counted at all in terms of the system going forward in the accounting?

MR. BLAHOUS: At the risk of descending into minutia a little bit, well, everyone will have to arrest me if I go too far on this, but there is some guidance on this point that we have received from the Congressional Budget Office in OMB, and other sources.

And, as Steve indicated, there is some dependence on really the type of personal account plan that has been created. Now, if you look at a pure defined contribution plan where the individual owns the entirety of the proceeds

in that account, and none of it is reclaimed by the government as a means of funding defined benefit promises.

What we are told by CBO, and OMB, and other sources, is that they will treat the investment in the account as an outlay from the federal government. But then once the assets are in the account and withdrawals are made from the account, or the account appreciates, those would be treated as a nonbudgetary event as far as the federal government is concerned because they are owned by the individual and not owned by the government.

Now, there are other species of plans out there in which the government is really using the personal account in a sense to guarantee a defined benefit promise, as it were.

And, in that instance, there is a little more ambiguity as to whether or not the personal account therefore should be treated as still being on the government books, and assets of the federal government, or whether they are really owned by the individual.

You can make the arguments either way. Some could argue that since those proceeds are in a sense being used to fund a defined benefit promise, they should still be on the federal ledger.

Now, there is one other aspect of this that I would mention, which is that we did a little research on this when we were looking at various ways to account. And

it turns out that the federal thrift savings plan trust fund, even though these are pure defined contribution accounts and belong wholly to individuals, they are counted as being in the federal thrift trust fund.

You look in the federal budget, and they will list the trust fund, and they will tell you how many assets are in this fund, how many assets are in that fund, and how many assets are in the other. And they all belong to individuals, but they are counted as being part of the trust fund.

Often I think it is assumed in public parlance that if money goes into personal accounts that somehow it is out of the trust fund. That is not necessarily the case. If you did it like the federal thrift savings plan, they would be in the trust fund.

DR. JAMES: But I suppose in the federal thrift plan, although they are in the trust fund, there are obligations against that. Because, actually, the individuals are owed whatever is in those account.

MR. BLAHOUS: Right. It is a measure of net assets accumulated at the time that measure was taken. And, of course, people are going to be making withdrawals from them later on.

But, as you know, Steve, the actuaries office, they do do projections on net accumulations in personal

accounts that do take into account the withdrawals that will be made as more and more of these individuals are in retirement. So, it is possible to do projections on the build up and the draw down of the personal account within a reformed social security system as well.

DR. JAMES: Could I just add that it seems to me that when we talk about what is in the individual accounts, more important than the question of how it enters from an accounting point of view, is the question of what the economic impact is. And I realize that goes beyond what we are discussing now.

But what we hope is that the build up of funds in the individual accounts represents increased saving that can be used productively and expand that GNP that we are concerned about that is ultimately going to back everything.

MR. PARSKY: Can I just ask one question? I am working my way through the principles and the fiscal sustainability objectives. And as I wander through these, I just want to ask one question first. How does the use of general revenues fit or not in this combination of factors in your mind?

MR. BLAHOUS: I should preface my remarks by saying this subject is not without controversy.

MR. PARSKY: Well, I figured at about 2:30, it would be appropriate to start a little controversy, but

that's okay.

MR. BLAHOUS: Certainly, what general revenues do is increase the revenues that are committed and obligated to the social security program. So, in that sense, they could be regarded as a revenue increase.

Now, what they do not answer, however, is the question of how that revenue is to be generated. It is an increase in commitments, but not necessarily a specification as to where that money is going to come from. It has to come from somewhere.

Certainly, in a cash starved federal budget it is a reasonable assumption that they would have to come from taxes or tax increases, although if there was room within spending totals, they could be created by cutting spending; or if the government were running an overall surplus at the time, they could be made available simply by running a smaller surplus.

But, with respect to the criteria here, I think it would be a subject of some controversy as to whether or not general revenue transfers help you with very many of these criteria. Certainly, they help you with measures two and measure four. They would not address measure 3, nor would they address measure 1.

MR. PARSKY: Well, I certainly agree with that. However, in trying to develop an approach, a combination of



personal accounts and what to do, or how to deal with the fiscal sustainability issue, I think it is important that we identify whether or not general revenues of any magnitude are going to be necessary under any set of circumstances.

And, if so, that may be a priority that this commission would say absolutely, no matter where you get them from. Then, we may say, we would not increase taxes to generate them. That would violate one of the principles. But we certainly could say the priorities that our political system ought to put forward should place that at the top of the list because social security is a system that everyone has said is a number one priority.

CHAIRMAN PARSONS: If I may, Jerry, I think you are right on the point of why the subgroup thinks we ought to have a range of approaches. Because, you know, you start from the irrefutable fact that we now have a system that promises to pay out more than it promises to take in. This is a problem.

So, you can solve that problem, growth measures, by saying, "Okay. We are going to reduce the level of what we promised to pay out to meet the level of what we got coming in which means reducing the level of growth and benefits going forward." Or you could say, "Well, we have got to somehow take in more, so we can keep the promise to pay out more."

Now, implicit in that, as Chuck would say, there are policy tradeoffs. If you say we are going to take in more, okay, well, where are you going to get it, and how are you going to raise it?

And those are issues that our policy makers, our elected policy makers should grapple with, because if they do not have good answers to that, then they may have to say, "Well, then we are going to have to reduce the level of benefit growth."

But those are the kinds of issues that, taking up from what Olivia said, we need to be very clear about what the tradeoffs are. We need to educate the American public as to what the current situation is; what the possible approaches to fixing that situation are; and then we need to encourage and help our elected officials choose from among the alternatives and come up with a plan which we can help them with that puts us on a sustainable course going forward.

MR. PARSKY: I think that is absolutely right. And many, if not most of those options, or alternatives, or tradeoffs, I think, will require the use of general revenues, many of them, if not all of them. And I think it is appropriate to identify that and not be afraid of it, because it is part of what we have been asked to do.

How they are used? Are they a direct transfer?

Are they alone? How are they used to work our way to a system of long-term sustainable is an issue that needs to be ironed out.

CHAIRMAN PARSONS: I think it is fair to say many of the approaches would require general revenue, but not all, and we will certainly explore both sides of that.

MR. BLAHOUS: One technical bit of information I would throw out in response to Jerry's question is that we do have a measure of the present value of the amount of general revenues that would be required to fill the hole under current law. And that is about \$3.3 trillion over 75 years in present value terms.

So, one thing we can certainly do in evaluating plans is to evaluate how they impact upon that \$3.3 trillion amount.

MR. PARSKY: That is exactly my point. If you set that out, if nothing is done, this is what it will cost.

MR. POZEN: I thought it was \$7 trillion.

MR. BLAHOUS: Well, this is the present.

MR. POZEN: By 2038, it will be \$7 trillion?

MR. BLAHOUS: Right. In real dollars starting in 2038, I do not know what the figure becomes. But one thing we have been trying to do in our projections is to smash everything down to what would happen in the present value today, 2001, for an easy snapshot look.

MR. PARSKY: Bring it down. Do not smash it down.

MR. GOSS: If I might, Chuck, as usual, is right on target. Actually, this year's number of \$3.4 trillion. And I would just suggest that the \$3.4 trillion amount is in fact exactly parallel with the concept of actuarial balance. It is sort of the present value dollar equivalent of the 1.86 percent of payroll actual deficit.

CHAIRMAN PARSONS: Would just expand on that a little bit? Because, again, I think from an educational perspective, just so people understand the nature of the problem. And we had such controversy around our interval report, which I actually thought was pretty clean vanilla.

But would you explain to those who care to listen what that means to be \$3.4 trillion, present value dollars, in deficit?

MR. GOSS: What that means essentially is if we look over the 75 year horizon, albeit, arbitrary in the scope, but selected in the 75 year period, and keeping in mind that the social security system as we have it today, and as it has been constructed by Congress over the decades, is an essentially pay-as-you-go system.

For that reason, its financial status is generally evaluated by looking over this 75 year horizon on the basis of what kind of asset values are available as counted in the trust funds today, and then adding to that all of the income

that is expected to accrue over the next 75 years by way of people's contributions through their payroll taxes, and then taking away from that the expected amount of benefits that will be paid out over the 75 year period.

And so, we are looking at the balance of all of those over the 75 year period and seeing where we come out at the end, and then expressing that all in present value.

Now, expressing it all in present value, what that really tells us is what is the dollar amount that if we had it in addition to our current trust fund levels would have us set for the next 75 years and fully able to pay the benefits over that period?

And the answer is essentially \$3.4 trillion over and above what we currently have residing in the trust funds.

CHAIRMAN PARSONS: Well, let me just ask. I think you have succeeded, Jerry, in creating at least some matter of interest.

MR. PARSKY: You asked me to do that.

CHAIRMAN PARSONS: I did. I did. Does that mean -- or I am interpreting that in the following way; that if we did not change the benefit level, or if we did not change the amount of in-flows, the level of taxes, payroll taxes, that we would come up short.

We would not be able to pay, in that 75 year

window, we would not be able to pay the existing promised level of benefits by \$3.4 trillion in present value dollars, which is some larger amount down the road.

MR. GOSS: Exactly. Keep in mind, this is over a 75 year period. So it is a lot of years, and a lot of people's benefits, but it will be \$3.4 trillion.

DR. SAVING: I would like to ask you, because Jerry's question was about general revenue transfers. And since you are actually counting the trust fund as if it is a general revenue money, actually, the trust fund balance when it gets turned in is actually a general revenue transfer.

So, the real present value of actual general revenue transfers that has to be made is, what, \$1.1 trillion, plus your \$3.4 trillion? Is that right?

Because if you are counting that as an asset, no money flows into the treasury from the trust fund view. It generates no income to the treasury, and the treasury actually has to pay the benefits. So, as a general revenue transfer -- now I know the accounting of it.

But I am just saying, as a real general revenue, monies that must come from the general revenue and taken away from education, and defense, and anything else that we are doing, actually, are four trillion.

Is that right, Steve, I think is the way you are doing this?

MR. GOSS: This particular question always sort of raises the issue of compared to what?

DR. SAVING: Yes, but it is general revenue. I am talking about money from the treasury that goes to social security. How much money does the treasury have to give social security? Forget from revenues that come in from taxes?

MR. GOSS: Over and above the cash flows that are expected for the next 75 years, you're correct. The trust funds would need not only the \$3.4 trillion, which is not currently funded, but it would also need to have the general fund provide the \$1.2 trillion.

DR. SAVING: Yes, well, they have to come back and give us that too. So, these are all --

MR. GOSS: That is currently are to be held in the --

DR. SAVING: And that is what Jerry was asking about, general revenue transfers. The source of them can be what you call the trust fund which still are just taxes; or they can be Defense Department lower expenditures. But that is what I meant. I wanted to make sure that people in the audience understood that. I know we understand it.

MR. GOSS: But this is a semantic, or perhaps --

DR. SAVING: Well, it is not semantic. This is money. This is real money. It is not semantic.

MR. GOSS: It is real money. But when you say a transfer, generally, people think in terms of if there is the trust fund obligation.

DR. SAVING: Right.

MR. GOSS: But if that money is paid, it is not thought to be a transfer.

DR. SAVING: Well, no, I think generally people think of a trust fund as something, the revenue from which actually accrues to them and they can spend. That is what generally everyone in the audience I think thinks that a trust fund is. And our trust fund generates no revenue for the treasury.

And I know you and I understand that. I just wanted to make sure that what we are talking about in general revenue transfers what we mean.

MR. BLAHOUS: Perhaps, I can summarize this by saying that this \$3.4 trillion figure that was referred to, you are correct, it is exclusive of the costs from 2016 to 2038, or redeeming all of the bonds in the trust fund which is above and beyond the \$3.4 trillion which is going to have to come from general revenue. From a comparative perspective, of course, every possible approach is going to be saddled with that problem so.

CHAIRMAN PARSONS: All right. I think we had Gwen, and Lee, and then --



MS. KING: This is going to be very quick. Steve, your projections, particularly for the defined benefit increases built in over the 75 year period are based on an assumption that the increases which are stated currently in the statute according to the consumer price index will kick in. Is that what you're looking at?

MR. GOSS: Absolutely. Currently, in the statute of the Social Security Act, there is this formula for the benefits that determines how much you get when you first become eligible at age 62 for retirement, for example. And then it also states that there will be the cost of living adjustment automatically every year at the rate of increase in the consumer price index.

All of our projections take fully into account those measures per the assumptions that our trustees, Tom Saving one of them, have suggested to us as being appropriate assumptions.

MS. KING: Okay. So, when you look at the actuarial balance, you are starting with the year 2001, and looking 75 years out.

MR. GOSS: Exactly.

MS. KING: So, all of that could turn on a dime where some of those assumptions to be changed by statute, not necessarily by our recommendations, but by statute. For instance, if you did not use the CPI and you used some other

measure for indexing the 75 year actuarial balance figure would shift somewhat.

MR. GOSS: Absolutely true. I think the distinction that we would make though is that we would say that if somebody would say, for example, that the cost of living adjustment, which is now based purely on increases in the consumer price index, if someone were to say, for example, do not base it on the consumer price index, but say one-half percentage point each year less than the consumer price index, that would not be a change in assumption because the trustees would still say that they believe presumably that the consumer price index will grow at 3.3 percent per year.

The cost of living adjustment then would be operating at a small level not by assumption, but literally because of legislative change.

MS. KING: So, if you actually had some different measure, then your 75 year balance might change to some other?

MR. GOSS: Absolutely. Just for an example on the cost of living adjustment, if that were to be based not strictly on the CPI, but on the CPI minus one-half percentage point, that would change this actuarial deficit, which is 1.86 now, by about .7 percent.

MS. KING: Okay.

MR. GOSS: Take away a little over a third.

MS. KING: It would also shift, would it not, if there were some agreement for offsetting some portion of the currently existing or statutory defined benefit in order to achieve say a personal retirement account. I mean, the assumption is if you -- I hate to use the terms carve out.

But if you do not add additional money for an individual retirement account, but if there is agreement that we would take a portion of what we currently pay into social security to create an individual retirement account, and there is also some agreement therefore since you are not paying in the whole amount of the taxes you do not get the full defined benefit.

So, there is some offset to what you get, a lessening amount. Is that something you could score, or is that absolutely going to -- do you have to wait until you get a plan that is passed legislatively before you could figure it all out in the implications for a 75 year balance period?

MR. BLAHOUS: Could I take a crack at that?

MS. KING: Good luck.

MR. BLAHOUS: I do think it depends on the design specifications of what type of account you are talking about. From the standpoint of the actuarial scoring, there is different ways you can go.

If you create sort of a truly defined contribution

account, and then you are making offsets to the traditional defined benefit based on some sort of assumed rate of return in that account, and if the individual is entitled to the entirety of the proceeds from that account, then basically the transactions from the account are really sort of invisible accept insofar as the defined benefit obligations are now reduced because you have reduced them in the law proportional to the contributions to this account.

MS. KING: If we were not going to follow the thrift savings plan approach.

MR. BLAHOUS: And hold it in the trust fund. That's right.

MS. KING: And hold it in the trust fund. How is that to be decided though, Chuck?

MR. BLAHOUS: Well, it really depends on the law, and also I think to a degree on the recommendations coming from this commission. You could recommend to do it one way or the other way. You could specify that it should be accounted for exactly as the federal thrift savings plan and be considered to be assets within the trust fund and follow that model exactly, or you could leave it open for Congress to determine, or you can specify the opposite.

MR. GOSS: But just to add to that, I think a number of the questions here have sort of revolved around a distinction that I think is probably important. And that is

-- and Chuck and Jeff have both addressed this already really, whether we are thinking in terms of really the solvency of the trust funds, per se, just the narrow definition of the social security system versus the broader overall unified budget of the government.

And in those two different context, some of these questions like Mr. Parsky's questions earlier, might conceivably come up with different answers. But more specific really to Ms. King's question, if an individual account structure is developed that would in fact literally -- I think you used the word "carve out" some payroll taxes, that would of course have implications in terms of the scoring of social security financing.

And then if there were specified, and I think Chuck was correct on this also, if there were specified reductions to the defined benefits under the current systems by way of any kind of an offset that would obviously also be scored. So, the combination of those two would operate.

MS. KING: Thank you very much, both of you.

CHAIRMAN PARSONS: Lee

MS. ABDNOR: Thank you. I just had a quick question. I want to make sure I understand. Once the trust fund has built up the amount of IOUs, bonds that are going to go into it, what is it going to cost to pay it off?

You know, where they say that it will, you know,

we will run out those bonds by 2038. And I thought I heard you say 1.2, or something like that, but that is what I thought was in there now was \$1.2 trillion. What is it going to cost to pay off the trust fund in income taxes or general revenues?

MR. GOSS: Well, the current amount that are of assets.

MS. ABDNOR: Right.

MR. GOSS: And then some object to that reference. But with the current amount of obligations, in effect, that are being held, I mean, special issue bonds for the trust funds is \$1.2 trillion.

However, because between now and 2016, the trust funds will continue to run cash flow surpluses under the current and immediate assumptions, and even thereafter there will continue to be some increases in the trust funds. I believe somewhere in the order of a \$5 trillion will be the maximum level in current dollars.

MS. ABDNOR: Okay.

MR. GOSS: It is a quite a bit less than that. I think in CP index counts it was more like \$3 trillion will be the peak that will be reached. And, thereafter, between that point and 2038, that amount then will be redeemed and will have to be paid from the general fund of the treasury to the trust funds to make good on those bonds.

MS. ABDNOR: So about \$5 trillion, and then plus the \$3.3 trillion that we are going to be short after that.

MR. GOSS: Those are slightly different terms, but, yes.

MS. ABDNOR: Okay.

MR. GOSS: But more or less.

MS. ABDNOR: Okay.

CHAIRMAN PARSONS: John.

DR. COGAN: Jerry, you mentioned that in most of the plans that we have reviewed, I think from Capitol Hill and from groups that general revenue was part of their solution to ensuring that all of the benefits could be paid, I think it is important to distinguish between a permanent infusion of general revenues from some unspecified source, and a cheaparary infusion of general revenues that might be necessary to cover some transition period that would be associated with personal account investments.

I know when I think about solvency of the system, I think first independently of personal accounts. I think that what we should strive to do is to eliminate those permanent deficits without the use of general fund revenues if we can. I think that is what Roosevelt had in mind when he talked about having a self-financing system.

And so, it seems to me very, very important to distinguish between the idea of not having a permanent

general revenue flow, which is the drain on the treasury, and a situation where you have a temporary deficit perhaps to finance an investment followed by surpluses where over a period of time -- and I won't get into how long that might be yet. But over some period of time the deficits are balanced out by the surpluses, so the system is self-sustaining.

MR. PARSKY: I was just going to add one comment, and that is that I think John is right about certain policy alternatives would allow us to do that. And when I was referencing the possibility of treating under some systems it as a loan, the surpluses that would be created under what you suggested could serve as a resource to repay that loan, so that you might achieve exactly what you want. I think that is a very good point.

CHAIRMAN PARSONS: Gwen.

MS. KING: Thank you, Mr. Chairman. I am starting to feel like, the frustration you feel at a movie where two people keep passing each other and you keep waiting for them to meet.

MR. PARSKY: How many different commissions do we have on social security? Maybe that is kind of at the heart of this.

MS. KING: There is a sense, on my part, because I did not work with the fiscal group, that you guys have



something more to share. We are not getting to it. Maybe our questions are holding back. But I do not know about the rest of the people in this room, but I want to know how you get from where we are to where we need to be.

MR. JOHNSON: Along this line, let me ask a question, and try to put it in --

MS. KING: Sputter, sputter, sputter.

MR. JOHNSON: Let me try to put it in simple terms, and see we can get this. What we are trying to do is to provide a sustainable system or a system that is currently not sustainable. So, what we have suggested is that the private account approach will provide greater sustainability than not private accounts, right?

But no matter what we do, even with that system, if you go to your point three, there will be a reduction in benefits as related to the growth in the GDP. So, somewhere along the line, if you take the idea that the first cohort, the near retirees and retirees, will get what is so-called promised today. But that second group will see some reduction in benefits as proposed today.

MR. BROWN: Let me speak to this for a moment. You are absolutely right that personal accounts can be very useful in this regard, but that even with that you have a basic issue that either the income line needs to rise, or the cost line needs to fall.

And one thing to keep in mind when it comes to talking about what that means for benefit levels for individuals is that in the current system the benefits that are indicated by that red line are not currently paid for. These are benefits that are sort of written into law, but which we cannot pay for.

So, an important question is, what is the right basis for comparison when we think about the benefits that we are going to have under a reformed system versus the current system?

Should we compare it to a level of benefits that cannot be currently paid for, or it is a level of benefits that are actually payable under the current system?

I should also note that implicit in this because of the way the benefit formula works, that by the end of this valuation period 75 years from now the average benefit being paid out in social security in real dollars today, even after adjusting for inflation is on the order of 90 percent higher than what those benefits are today. So, there is a lot of room here for --

MR. JOHNSON: Today or projected?

MR. BROWN: Than what today's retirees receive.

MR. JOHNSON: Okay.

MR. BROWN: Than what today's retirees receive.

MR. JOHNSON: Right.

MR. BROWN: Real benefits are expected to close to double over the period that we are talking about here. So, there is an awful lot of room here to continue to allow for benefit growth in real terms, and to allow a system to deliver higher benefits than what today's retirees are getting, to deliver higher benefits than what is actually payable under current law; even though, obviously, if you are going to reduce the overall rate of benefit growth that you are slowing the rate of benefit growth relative to what is implicit in that red line.

MR. JOHNSON: But a final question. But within that period there still would -- it would still be necessary for some government transfers into the system to sustain its viability, as you describe it there?

DR. MITCHELL: Can I just speak to that momentarily? I mean, I think that there is commonly perceived -- many have the view, our critics certainly have argued, that personal accounts necessarily make the hole deeper. And I really think we have to reject that, that is, a hole already there. It is a very big hole. And if we are going to move towards sustainability, the hole needs to be reduced, needs to be filled.

Personal accounts can make the situation better. You know, in my nightmares I might imagine a personal accounts which will make it worse, but we are not going

there. So, personal accounts are not a panacea. They do not get rid of the hole on their own, but they are a mechanism to do all kinds of other good things that we talked about this morning.

So, that was really what I wanted. I wanted to support Jeff and say further they can be a mechanism to help us, but they are not going to get rid of the hole by itself.

DR. JAMES: Could I just add to that? Suppose that personal accounts, in fact, got you to sustainability at the end of the period. In between we would have the following problem if the personal accounts were financed by a redirection of some of the money now going in.

Temporarily they would have to fill in that hole, and that is where we could use general revenues temporarily to fill in that hole. Later on, we would be in better shape. But we would have -- and that's the transition cost problem to solve the transition cost problem. It is very likely that we will have to --

MR. JOHNSON: Yes, I guess the question I am asking. Should the person who is 12-years-old, 15-years-old expect that at some point they will have to bear an increase, tax increase, to maintain the viability of a 75 year social security system?

CHAIRMAN PARSONS: The answer to that question is it depends. Let me go back to where Gwen was. It depends

on what you propose.

MR. JOHNSON: Yes, I understand that.

CHAIRMAN PARSONS: Where Gwen was and the frustration you are experiencing is because the subgroup has not yet gotten to the point that we are coming forward with specific hard proposals that answer all of the questions. What we know, or what we discern, what we believe is that the current system is unsustainable on its current course for the reasons we have discussed.

What we also believe is that while adding a personal account element to supplement the current system will help, as Olivia puts it, fill in the hole. It won't fill in the hole completely. In order to fill in the hole more completely, we are going to have to do something more.

We are either going to have to increase the future growth of benefits, add additional revenues, whether they are general revenues or some other kind of revenues, or a combination of the two. And what the committee is saying, the subcommittee is saying is that we are at that point now of working through that something else down both of those variable lines.

And, presumably, Olivia and John, by the 29th, by the next meeting of this commission, we will be prepared to come to the full commission with some specific recommendations or alternative plans as to how you now

combine these two concepts, personal accounts plus other action to bring us to a place where these six objectives we can say have been met. Is that fairly stated?

CO-CHAIRMAN MOYNIHAN: Mr. Chairman, may I introduce a cautionary measure here to get us going?

John Cogan mentioned that President Roosevelt brought Professor Edwin Witty from the University of Wisconsin to devise this program, and he saw this long-term deficit. And so, Witty just wrote in a few lines about, well, it would have to be individual annuities one of these days.

One of these days has come. Witty's assistant at that time was a graduate student named Bob Myers, a distinguished predecessor of Steve Goss. It is almost 75 years later. Bob Myers was executive director of the Greenspan Commission, and at this very moment he is working on this problem. He is available to us for any thoughts he might have. But if you do not get yours to us by November 29, consider the fates might determine that 75 years hence you will still be working on the problem.

MR. PARSKY: Just one thing to add. I think you have pointed out, Dick, that there are a lot of choices. I do not think there is silver bullet that says this is the way to get there. And there are choices within what a personal account would look like, for instance, whether or

not people would be required to contribute money or not contribute money as a match.

There are a whole series of issues that would create variables in that category. And then, there are a series of issues that will create variables for those people. And I think everyone is in concurrence that the personal account program should be an option.

You can assume that everyone will take it if you would like, but I am not sure that that is totally realistic. So, you have to deal with what happens to those people that do not take it. And within that, there are a variety of approaches.

And so, I think we may be hard pressed not to lay out a series of those options of approaches so people can see the policy tradeoffs you are talking about. And I did notice in these fiscal sustainability objectives that there was not an objective, and maybe because it is not totally achievable in any of the options of eliminating that gap. That is not one of these.

So, that does not mean we cannot discuss it and try to include it, but that was not here. So, we definitely want to improve as much as possible, and move the ball forward down the playing field. But I do not think we would violate these objectives if we did not obtain absolutely parity between those lines.

CHAIRMAN PARSONS: Although, as I read item 1, at the end of the day we want to get the system back on a course that it could sustain itself going forward.

MR. PARSKY: Yes, that is true. But, again, there will be choices in terms of how you may or may not do that, and at what point and time.

CHAIRMAN PARSONS: Again, I think we have probably beaten this up pretty good unless Tom --

DR. SAVING: Well, one minor thing. Jerry, in fact, in our interim report, we did have the thing that eliminated this deficit. It was called payable benefits. Benefits payable eliminates -- nobody likes benefits payable, but it eliminates the deficit.

MR. PARSKY: There may be a choice that nobody likes that we also layout.

CHAIRMAN PARSONS: That is probably where we will come down. But let me suggest that we wanted to kind of debate around the issues. And I thank you, Gwen, and Bob, in particular, for sort of poking at where we are. And I think this subgroup, like the administration subgroup, still has work to do. This is the state of our thinking.

I think if there is "news" here, it is that we are not now thinking that the subgroup will propose to the full commission, and ultimately the full commission will propose to the president a "silver bullet," but rather different



approaches have different policy tradeoffs baked into them.

But we do not have those fully developed yet, and I suspect we will debate those at our next meeting on the 29th.

But just to kind of conclude, by putting this in the framework again, so that people can understand. I mean, this has been pretty dry and pretty down in the weeds. But it is a huge issue. I want to make reference to something that has already been, at least, tangentially touched on, you know, the events of September 11th.

You know, on that day, you know, this country was attacked and we now find ourselves at war. It is a different kind of war than we have had heretofore, but is war nonetheless. And it is a war that I think people are beginning to understand now could go on for quite some time, and demand quite a level of resource commitment from this government.

And while there are those who currently wonder whether we have the resolve and the will to hang in there until this thing is over, you do not see anybody writing stories about or questioning whether we have the resources to do it, whether we have the financial capacity to do it.

And, you know, in business you call that having a strong balance sheet. You do not run your business in such a way that you are so straining every revenue generator all of the time, that if something unforeseen happens you cannot

respond.

You run your business in a way that you always have some dry powder, a little gas in the tank, in case something comes along that you have not anticipated that requires a response, that requires more resources. And that is the strength of this country.

We have the ability to crank up our productive machine and respond to extraordinary circumstances like those we are faced with now. The problem that we are facing, the problem that that chart is evidencing, is that 30 years from now if we do not do something to fix the social security system, we are not going to have a strong balance sheet.

All of the excess capacity of this country is going to be going to providing benefits for people who have been promised a level of benefits we currently cannot pay for, and we will have to increase the level of taxation, or decrease the amount we spend on the rest of the government to cover those promises. That is the problem we are facing, and that is the problem that needs to be addressed.

Now, I mean, the discussion this morning about private accounts is relevant because one of the ways you do that is you start saving money now instead of waiting for some future time, but then call down that money from current revenues. You start putting money in the bank now, and that

is what private accounts is all about.

It is not just so individuals have individual wealth. It is so they won't be looking to the government and to the taxpayer to provide that level of support 30 years from now when we may need it for something else.

But the other part of the equation, Jerry, is what you were talking about. We have to find a way of putting the system on some sustainable basis where the amount going out matches up with the amount coming in, and we can keep the strength of our balance sheet for whatever the emergency, or the exigency, or the need is 30 years from now instead of having all of the resources flow into supporting an aging population.

So, we take the charge seriously. We think it is more relevant now than it has been. These subgroups are working hard to come back to the full committee with specific recommendations or ways to get there, both on the private account side, and on modification to the benefit rates.

We hope, as Senator Moynihan said earlier, we will probably in a concluding mode within a month. We have two meetings between now and the time we conclude. And we hope that the recommendations we come forward with will be viewed in the context of that larger picture, that this is not about politics.

This is not about or should not be about trying to gain next year's election, or a future year's election. It is about preserving the strength of the balance sheet of this country and making promises to people that we have confidence we can keep.

(Applause)

MR. VARGAS: Mr. Chairman, in that spirit, we have done a lot of work to this point before the meeting, and I think we got a lot accomplished today. And it is obvious we have a lot more to do. So, in the interest of letting us go and do that, continue to do that work, I motion to adjourn.

MR. PARSKY: Second.

CHAIRMAN PARSONS: So moved. Any objection?

(No audible response)

CHAIRMAN PARSONS: Hearing none, we stand adjourned.

(Whereupon, the meeting was adjourned at 3:05 p.m.)