President's Commission to Strengthen Social Security

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President's Commission To Strengthen Social Security

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P R O C E E D I N G S

(10:12 a.m.)

WELCOME AND OPENING REMARKS

by Richard Parsons, Co-Chair

CHAIRPERSON PARSONS: Good morning, ladies and gentlemen. Welcome to the, I think, fourth in a series of meetings and hearings by the President's Commission to Strengthen Social Security. My name is Dick Parsons, and I am one of the co-chairs of the commission.

Those of you who are particularly alert this morning will note that I am sitting here by myself without my trustee wing man and co-chairman, The Honorable Daniel Patrick Moynihan. Unfortunately, Senator Moynihan is down with the flu bug or a cold. We spoke last night. He was going to try and make it, but I am informed this morning -- he did not know whether he was going to do it or not. He said he would try, but this morning he felt under the weather.

So, what we had done last evening was sort of jointly worked on a little statement. I normally do not read things, but I am going to read this statement that we worked on together, so that even though he could not be here in person, Senator Moynihan will be here virtually, which seems appropriate in the digital age, through his words.

But, let me first say, good morning and welcome to all of my fellow commissioners. I know that moving around the country and coming to Washington is a bit more difficult now than it has been in the past, reasons we are all familiar with. So, we particularly appreciate your attendance this morning and your participation in what is still a very important effort for our country.

So, let me start with this statement that the senator and I thought would frame these hearings today. Welcome to the October meeting of the President's Commission to Strengthen Social Security. I want to thank our witnesses for their testimony; and to thank the members of the press for their attention to our work; and, of course, to thank the audience for being here with us, the members of the public who are interested in our work. We look forward to a productive meeting of the commission.

I would like to specifically request -- this we put in as a detour, we put in, since the last time we had a public hearing, several people felt compelled to be in touch with the outer world and had their cell phones on. And at key times during the meeting these things go off, and everybody had their own distinct ring, and some are musical, and some are chimes, and some are bells, so we would ask everybody to extend to our witnesses the courtesy of turning off you cell phones.

The Senator and I thought it would be appropriate to, first, say a few words about the environment in which the commission is now meeting and operating. In many ways, the world has changed dramatically since September 11th. The events of the last month which have included deeds, both of great evil and of selfless heroism, deserve our acknowledgement.

In a substantive sense, the task before this commission remains largely as before. We have always been obligated by the charter, by the charter that set up this commission, that the president gave us, to take a long-term view and not base our recommendations on day-to-day events.

We would have been right to suspect, even as we begun our work, that over the long-term the nation would face wars and recessions and other unforeseen challenges. But the events of the past month bring those realities home in ways that are more vivid than any of us expected.

We, on the commission, wish to be appropriately respectful of the environment in which we now must work. We recognize that many individuals who hold starkly different views about how best to strengthen and safeguard social security for the 21st Century are coming together to provide for the common defense of our nation, its citizens, and our way of life.

We cannot know when Congress and the President will deem it right, or the right time to bring the work of the commission to fruition. What we can do, however, is to continue our work with collegiality and mutual respect, and to express different viewpoints and appropriate differences from each other in a respectful way.

This is not a time to charge one another with base motivations or to treat the important subject as a political opportunity. Americans have responded to the current challenges with the very best that is in them, and we on the commission are determined to emulate that spirit in our work.

Historians may recall that Ida May Fuller claimed and received the first check from the social security system in January of 1940. This was in between Adolph Hitler's conquest of Poland and the fall of France. These were dark times for democracy and for the world. And, yet, our national still devoted some of its resources and talents to providing secure retirement incomes for its senior citizens.

Moreover, the first major increase in benefits to recipients took place in September of 1950, after the beginning of the Korean War. So, we are not the first to wield the responsibility of safeguarding retirement security at a time when national security concerns are also paramount.

That said, our current circumstances should not prompt introspection regarding social security. The commission is pondering a number of approaches to safeguard the social security program for the future, some of which may find agreement, others opposition.

We want to hear from all sides. Now is not the time for ranker and division. It is the time for participation in a debate that offers solutions from different perspectives and from different voices. And we have to consider these suggestions in an atmosphere of dignity of respect for each other, and I believe that we can.

As much as we are divided, several important points seem clear. Nearly everyone agrees that we should move social security from its traditional "pay as you go" financing to "partial prefunding of future benefits," not with rhetorical lockboxes, but with real savings that can be drawn down in the future to pay benefits.

Doing so would help us prepare for the aging of society and earn better returns for the system. To accomplish this new saving, some favor allowing the government to invest directly in the stock market while others favor individual accounts. That is a legitimate debate.

So, let us have the debate and hear from both sides of that argument in a way that will show Americans and the world that we can disagree without being disagreeable. Likewise, there is a growing consensus that personal retirement accounts either integrated into social security or added on top of it are feasible and desirable.

The Clinton Administration, for example, proposed investment accounts on top of the traditional system, while others want workers to be able to invest part of their social security taxes in these accounts. Again, it is a legitimate debate, so let's discuss the issue.

What we cannot and should not do is pretend that the status quo is a viable option; it is not. We cannot by inaction allow social security to swallow up the rest of the budget, particularly, when other needs may be so pressing. In this sense, our work is perhaps more important today than it was just a few weeks ago, not only for the sake of social security, but for the sake of future generations ability to respond to the challenges that confront them.

Social security must be placed on a self-sustaining path. I can promise that if all sides air their concerns and their goals, we will do our best to answer them and to meet them. There are different ways to address social security's problems, but idleness is not one of them.

So, let us discuss and debate them in a manner demonstrating the strength, vitality, and civility, of our mature democracy. Now, with that, I again want to say, welcome, to everybody and to introduce our first panel.

What we are doing today is we are continuing something we started in San Diego at the end of the summer of hearing from those different voices, and different perspectives, and different points of view about how to strengthen social security, how to move forward into the 21st Century with a system that instills confidence and answers to questions that all of you who are members of the social security system have.

Our first panel is going to speak to us from the perspective of the viewpoint of young people. And so, I am particularly interested, and I know my fellow commissioners are particularly interested to hear from them, because at the end of the day they have got the biggest stake.

The panel consists of four individuals:

- Amy Holmes, who is a journalist who has written and commented on this issue; previously was associated with the Independent Women's Forum, and has testified on the Hill in that prior incarnation on this issue;

- Meredith Bagby, who represents the Third Millennium, a youth advocacy organization, who also has substantial background and knowledge on social security issues;
- Maya MacGuineas, Maya is with New America Foundation, which is a think tank, and has done a lot of work in thinking with her colleagues on the subject of social security reform, and, in fact, was an advisor to Senator McCain in terms of his views and positions when he was running; and
- Hans Riemer, who was formerly with the 2030 Center, and is now with the Institute for America's Future, which is an impressive sounding name, if ever there was one, and will give us some views that he has formulated over the course of time in thinking on this.

What we have done is we have asked each of our panelists to limit their formal statements. They have all had an opportunity to submit written statements which could be longer, but to limit their formal statements before the commission to five minutes each, so that we can then engage them in a letter Q&A.

So, without further ado, Amy, why don't you start us off?

PANEL I: SOCIAL SECURITY AND YOUNG AMERICANS

by Amy Holmes

MS. HOLMES: Thank you, Mr. Chairman. Mr. Chairman, and distinguished members of the commission, good morning. My name Amy Holmes, and it is an honor and a privilege to be invited to speak to you today.

I come before you today as a private citizen and patriot and would like, first of all, to express my deep sympathy for the families who lost loved ones in the attacks on the World Trade Center and the Pentagon. We will never forget them. We will never give up, and America will prevail.

But we are here today to talk about a different type of battle, the battle on old age poverty launched nearly 70 years ago under the leadership of President Franklin Delinor Roosevelt.

As the chairman mentioned, the first person ever to receive a social security check was a woman named Ida Fuller. She ultimately received $20,000 in benefits from the federal government, not a bad return for a three year investment of $22 in social security taxes, but what a difference this 60 years makes.

According to conservative estimates from Economic Security 2000, baby boomers social security entitlements threaten to push my lifetime tax rate up to an astonishing

70 percent. And then, having paid out these taxes over my working lifetime, when I retire there will be fewer than two workers to support my social security benefits, as compared to 8.6 workers for every beneficiary in 1955.

And, as an African-American woman, I am statistically among those who are most dependent on social security for future retirement income. Before my generation is forced to invest in lottery tickets, we must take bold steps to reform the system now. Conservative, diversified, private retirement accounts are the surest path to retirement security.

As you, as a commission, review the many options for reform, you will hear from groups that claim to speak for people like me, like the National Organization for Women, for instance, which downplays social security concern.

NOW calls the social security crisis nothing more than a "Chicken Little" atmosphere and opposes reforms that would truly liberate American citizens from government dependents and offer us real choice and ownership over our financial futures.

According to a statement by its former president, "The threat our families face is not the imminent collapse of social security funding, but a possibly shortfall in

2032." Well, even if she is right, and the commission knows that the trust fund is filled with paper promises, I cannot wait until I am 57-years-old to shore up my retirement money with money I do not have because 70 percent of it was paid in taxes.

The Feminist Majority, another group claiming to represent the interest of women, warns that, "Having a private account means that we bear all of the risks of investing." As it stands, we bear all of the risks of social security meltdown and know we have no way to hedge against it.

According to the 1998 Social Security Trustee Report, if we stay with the status quo, we will either have to cut benefits by 25 percent, raise taxes by 50 percent, drastically cut government spending on other programs, or increase the federal debt, or we can choose to take the necessary steps now to reform the system. Which will our leaders choose?

I guess I am most baffled by the support for government investment in the stock market. Such ill-advised investment would give an enormous advantage to large traded companies with all of their allegedly problems of wage inequities, glass ceilings, and old boys clubs.

According to the National Foundation of Women

Business Owners, as of two years ago, women owned 9.1 million businesses in the United States representing 38 percent of all business, and employing 27.5 million, and generating over $3.6 trillion in sales annually.

Female owned businesses are growing more rapidly than the overall economy, and are more likely to have remained in business over the past three years than the average U.S. firm. It just does not make sense, from a women's point of view, to tip the scales against female entrepreneurs in favor of Fortune 500 companies.

There is much more to be said on this topic, I am sure we will, including the inadvisability of putting the nation's stock market in the hands of government bureaucratic, but let me close with this.

One-hundred and fifty years ago, Elizabeth Katie Stanton argued before the New York legislature that we are "persons, native, free-born citizens, property holders, taxpayers, and that a woman has 'a right to the property she inherits and the money she earns.'"

How far we have strayed from the cause of true liberation that in 2001, the possibility of private ownership and control of our retirement assets is controversial, that women are painted as timid and easily duped, and that the freedom to choose and plan for ones retirement is better left to the wisdom of government officials.

Reforming social security to take into account the differences in women's work history, longevity, and poverty rates, will take imagination and resolve. Earnings sharings, for example, where spouses split retirement savings in separate accounts is one such reform.

Ensuring a safety net for elderly women who are most likely to suffer from poverty must also top any reform agenda. But do not be fooled by those who would use these differences to thwart honest effort. Social security reform is a women's issue now more than ever. Thank you.

CHAIRPERSON PARSONS: Thank you, Amy. Maya, do you want to go next?

by Maya MacGuineas, New America Foundation

MS. MACGUINEAS: Good morning, Mr. Chairman, members of the commission. Thank you for the opportunity to testify before you today. And I realize that most of the country's attention is focused on more immediate threats, as is only appropriate. But it is important that at the same time we take action to address the longer term threats that we know exist to our nation's retirement program.

So, I thank you for going forward with the important work of the commission. I will focus my remarks today not only on why a reformed social security system is necessary to provide a secure retirement for younger generations, but also on an area I think is key to creating a workable solution, and that is how to make the accounts more progressive.

First, as the commission has rightly pointed out, the single most important step in strengthening social security is to boost national saving. Higher savings rates channel more money into productive investment creating higher economic output and wages. A large economic pie, in turn, will reduce the burden of paying mounting retirement costs.

Theoretically, a plan to increase saving need not incorporate personal accounts. The government could increase its contribution to national saving by running large surpluses, paying down the debt, and over time acquiring private assets.

Practically, however, this approach presents serious problems. And, first, there is the important distinction between prefunding the social security program on paper, and actually putting aside the resources to cover future benefits.

As we have seen over the past few decades, the government has proven to be an ineffective mechanism for actually saving the social security surpluses. If the country were to proceed with the plan for government to invest in the stock market, I believe we would encounter a host of problems from the pressures to make socially responsible investments with there being as many definitions of socially responsible as there are politicians, to how proxies would be voted to the liquidity restraints involved in investing a single mass of fund.

The better option then is to do the saving privately by allowing individuals rather than the government to own their savings shifting part of the program from a defined benefit to a defined contribution plan.

And I might point out that a universal defined benefit plan, as we currently have, actually makes little sense since the risks cannot be shifted beyond the participants.

Private investment accounts, if structured properly, can have many advantages from helping to protect against demographic risks, to over time increasing returns, to enhancing flexibility, to creating a way to bring low income workers who currently have little or no savings into asset owning class, and they can make the system sustainable on an ongoing basis.

There are three concerns regarding private accounts that I believe are valid. The first two, higher administrative costs and investment risks, can and should be addressed through prudent regulation. The third has to do with the progressivity of the system, and some critics of private accounts are concerned that implementing investment accounts would reduce an important redistributional element that currently exists in social security, and I share this concern.

I am submitting today with my testimony the details of a reform package I call "Progressive Privatization." And the proposal includes a structure whereby the system would be made more progressive through government matches for the contributions of low income workers.

Matches would be provided not only for voluntary contributions on top of the payroll tax to create an incentive for additional saving, but recognizing that many workers at the lower end of the income spectrum are already stretched to the limit and cannot afford to save, it will provide government matches for the mandatory saving coming from existing payroll taxes starting at the first dollar.

The plan includes investment accounts of 2½ to 5 percent of covered payroll, and progressive matches ranging from 2 to 1 to _ to 1, depending on income level.

The specifics of the matches and income cutoffs can obviously be altered depending on the desired level of progressivity.

Progressive personal accounts are desirable for the following reasons:

- First, there is wealth building. By allowing lower income workers to invest a greater portion of their wages, progressive accounts build wealth more quickly for those who need it most;
- Second, there is the administrative cost issue. And progressive accounts will ensure that each account is of sufficient size to be administered efficiently, resolving the problem of high administrative costs eating away at small account balances.
- Thirdly, in terms of annuities, larger accounts will reduce the adverse selection problems which are exacerbated by the fact that the longest living individuals have larger savings and purchase larger annuities. If each individual's account were closer in size, adverse selection will be reduced and the annuity costs would go down.
- Fourth, in terms of public confidence, questions are now being raised about whether social security effectively aids the least advantaged in society. By making the personal accounts progressive, the public will clearly

understand that social security and personal investment accounts can aid lower income Americans.

- And, finally, most importantly, national saving. If the accounts are funded on a straight percentage of wages, then high wage workers will have proportionately large account balances, larger than low income workers. But because these individuals already have private savings, they may choose to reduce their personal saving, reducing the benefit to the economy.

Low income workers, on the other hand, did not have social security savings to offset, so their contributions will be a net increase to national saving. Person accounts weighted towards low income workers may be the most economically efficient, as well as the most progressive reform option.

Obviously, other changes will be needed during the transition, and the "Progressive Privatization" plan I am submitted is structured to:

(1) Spread the costs fairly between individuals and generations;

(2) Protect the benefits of recipients who rely on them;

(3) Compliment the new system of private accounts; and

(4) Benefit the economy.

The mix I propose includes a combination of spending reductions and revenue increases, and you will find the details in the report.

Let me just point out one thing that I think is particularly important, and that is that progressive privatization does not rely on government borrowing during the transition.

Given that one of the most important advantages of prefunding the program is the positive effect it can have on national saving, borrowing creates an investment -- to create the investment account would undermine the economic benefits.

Therefore, I think it is important that we are willing to make the changes necessary to keep the social security system balanced now rather than shifting the costs to the future, and that is what this task is really about, shoring up the system for the future.

Private accounts, if structured to meet their full potential, can provide more revenues by increasing saving, and more appropriately balancing investments. Through a form of progressive privatization the social security system can be made progressive enough that all workers can afford to retire with dignity, and at the same time fair enough that all who participate will receive adequate returns on what they contribute.

This is the legacy we should leave to the next generation of retirees. So, I appreciate the chance to appear before you today, and thank you for all of the hard work you are doing to save social security.

CHAIRPERSON PARSONS: Thank you, Maya, appreciate it. Meredith.

by Meredith Bagby, Third Millennium

MS. BAGBY: Thank you, Mr. Chairman, and to the commission, first, I would like you to know how honored I am to be here on behalf of Third Millennium, not only because the decisions you make will effect my generation, but also because it is a proof of the strength of this democracy to keep on working and to do the business of government despite our challenges and our great tragedies in this country.

It is encouraging to me as a young adult that you are working now to reform social security for my generation and our children. I think that this commission has a unique opportunity. After years of not facing the music on social security, Americans finally seem to be hearing the message from our economists, actuaries, and gentrologists.

We have come to accept the monumental shortfalls that social security will face in 2016 and beyond. Today we see the white elephant in the room. We are looking at him squarely in the eye and we will take him on. And your excellent interim report only strengthens our resolve.

Now, the immediate challenge facing this commission is to craft a plan that meets the president's objectives set forth in his May 2nd executive order. Put simply, you need to simultaneously design a system of personal accounts, return social security to sound actuarial footing, and do so without raising payroll taxes or effecting the benefits of current or near retirees.

Now, that may seem like a monumental task; it does to me, but it can be done. The key element is to call upon my generation to sacrifice. If you treat us like the adults that we now are, we will rise to the occasion. You must ask us to accept a plan that could raise our eligibility age, index it to average life spans, lower our future benefits by altering the ways they are calculated, and tax our future benefits at a higher rate.

If you do this I believe that my generation will not oppose you. It will not oppose you because we realize the need for sacrifice; and it will not oppose you if you take the time to explain and communicate to my generation exactly why the sacrifice is needed.

And the logic here is simple. Due to demographic changes, the expansion of life spans, the baby boomers, will be creating an unprecedented financial burden that we generation X'ers and millennials will have to meet.

What our peers need to hear from you, from this commission, over and over and over again is why we need to act now to solve a problem that won't erupt for decades to come. And once you have conveyed the urgency of that task and the cost of doing nothing now, you need to explain how your plan resolves the problems head on.

Mr. Chairman, if this commission is willing to make the case, our generation is willing to listen and willing to sacrifice. We ask for one thing, however, give us the capacity to build meaningful retirement resources through a system of personal accounts. In other words, let us grow some wealth as well as redistribute it.

Why is this so important? Well, according to the Employee benefits Research Institute 2001, the report entitled, "Retirement Confidence Survey," people between the ages of 26 and 36 are doing a lousy job of saving for retirement, this despite the proliferation of 401(k)s and other savings plans.

Twenty-one percent of this age group say explicitly that they have invested nothing for retirement; another 21 percent say they do not know how much they have earmarked for retirement or refuse to answer the question at all; and another 22 percent say they have invested under $10,000, a very modest amount, given their ages.

Taken together, nearly two-thirds of my peers are failing to build retirement security, a sad phenomena that mirrors the situation faced by older generations. However, given our young ages, we have the ability to reverse that by creating a system of personal accounts now.

To me, as a young person, the most important step you can make in formulating policy is to help secure a viable savings reserve for our future. America is known worldwide, and unfortunately to have a pathetically low savings rate, both collectively and individually, compared to other industrialized nations, and any reform you implement has to address this issue.

The importance of national savings cannot be overestimated. We all rely on our capital stock to build roads, schools, to pay medical bills, to fight the wars that are now waging. If we are going to have long-term success, America needs to reverse the role of selling off our assets in order to pay for our own rabid consumption. If we can alert people to, in their own lives with this needs of savings, then we can take a valuable step towards bringing about a more financially secure future.

Furthermore, the relative youthfulness of generation X'ers gives us time to weather the fluctuations of the market. Data from Wharton professor, Jeremy Segal, the guru of long-term investment, that since 1801 owning stocks for a 35 year period gave an average after inflation annual rate return of 6.8 percent.

Even the worse 35 year spell returned an average of 3.4 percent per year. By the Office of the Actuaries own calculation, this is two to four times what many generations can expect to see from social security. Of course, the notion of private accounts invested in the market may have lost favor in recent months -- I know I lot a lot of money in the market -- given the volatility and recent drops in the market.

However, if we keep our wits about us, we will know historically and for the long term the market works, and American corporations work, and American equity works. As a cushion, we can also create a system that guarantees that if a retiree's personal account in conjunction with his or her social security defined benefit does not meet a predetermined minimum threshold the government can step in and make the difference.

The generation X firefighters, and policemen, and now military personnel, who are losing their lives and lost their lives on September 11th, made the ultimate sacrifice for democracy. A request to their contemporaries sitting here and those who will see the reform of social security to forego a small amount of social security money decades from now would be a well-timed, yet small sacrifice by comparison, and I believe would not be rebuffed by my generation. Thank you for this opportunity to speak.

CHAIRPERSON PARSONS: Thank you, Meredith. Hans.

by Hans Riemer, 2030 Center

MR. RIEMER: Thank you, Chairman Parsons, members of the President's Commission for the opportunity to speak today about the impact of social security privatization on young adults.

My name is Hans Riemer, and I am the founder and chairman of the 2030 Center, a public policy organization for young adults based in Washington. I am also a senior policy analyst at the Institute for America's Future, where I help to organize a broad coalition of groups in opposition to privatization.

Since our founding in 1997, the 2030 Center has been a strong advocate for young people who want to see social security strengthened, not dismantled, for future generations. I appreciate that the commission has chosen to focus so directly today on the impact that social security reform will have on younger generations. No group of Americans has more at stake in this debate than today's young workers.

I would like to use my time today to raise a flag of caution about what may emerge from this commission's deliberations. In saying this, I am not referring generally to the fact that the commission is going to propose a plan to privatize social security.

While I do not share the opinion that privatization would improve social security for younger generations, I respect the fact that the present has committed himself to a course of action on the issue, and that the commission will pursue that objective.

I oppose privatizing social security on general principle. I believe that the level of guaranteed protection that social security provides today is about right. Americans need a guaranteed safety net that protects individuals and families from ill-fortune; and the country needs a guaranteed safety net that protects everyone from the shocks of severe economic dislocation.

My purpose today is to discuss why the mandate this commission has been given by the president is uniquely problematic from the perspective of how it will effect younger generations. There are many ways to privatize social security, and I am concerned that the course this commission has been mandated to follow will necessarily be among the worse possible for today's younger generations.

According to the executive order establishing this commission, it is final recommendations must adhere to a set of guidelines. For the purposes of my discussion, the first and the fifth principle are the keys to understanding the unique impact on young people.

The first principle states that modernization must not change social security benefits for retirees or near retirees. For the purposes of my testimony, I will approximately age 55 as near retirees.

The fifth principle states that modernization must preserve social security, disability, and survivor's components. Under privatization, contributions that would normally go to pay social security benefits are instead directed towards private investments.

As a result, the system is no longer able to meet its promised obligations, and its guaranteed benefits must be scaled back. The private investment accounts are intended to make up for the difference in lost social security benefits.

The reduction in social security benefits that is caused by privatization is significant. Private accounts totalling just two percentage points of FICA in an amount that is significantly less than both the president and many members of this commission have discussed as a possibility would drain approximately $1 trillion out of social security over only the next ten years, and many trillions more after that.

Under such a scenario, an immediate and permanent benefit cut of about 25 percent will be necessary in order to maintain solvency over 75 years. However, the commission's principles specify that not everyone would share in this burden. Instead, according to the fifth principle, social security survivors and disability components must be preserved.

Disability and survivor's benefits constitute about one-third of social security outlays, a substantial portion of the program that has been walled off from the downside costs of privatization. Therefore, all necessary benefit cuts must be borne by the retirement portion of the program.

More significantly, the first principle states that all individuals who are either near retirement or in retirement must also be held harmless from necessary reductions; that is, all necessary benefit cuts must be borne by the retirement benefits of workers who are currently under the age of 55. This mandate means that the burden of pain will not be spread equally among the generations, but instead backloaded onto today's young adults.

A recent study by the Century Foundation presents some basic calculations about the impact on young people of an approach to privatization constrained in an identical manner as this commission. The results are striking. For a worker who is age 29 today, as I am, the cuts to social security's benefits, guaranteed benefits, would total 54 percent.

Of course, the individual investment account totalling two percent of wages is designed to offset the cuts, but the account simply cannot bear the load. Even assuming an optimistic scenario for investment returns and administrative costs, today's 29-year-old worker with average earnings will still wind up with 20 percent less income than social security would have provided; and for low earners they would have wind up with 29 percent less income than they would have normally been provided.

The loss of 29 and 20 percent of retirement income for low and average earners, respectively, would be a disastrous outcome no doubt, but the situation is in fact considerably worse. Because the result is an average, nearly half will do poorer.

The issue of average outcomes is particularly important because the promise of guaranteed protection against poverty cannot be averaged out if someone feasts on the rewards of a rich stock account while others cannot afford to eat.

Social security is supposed to be there for everyone regardless of whether they have good luck or know how to manage investments. With the clear framework established for this commission, I fear that we are headed down a road that forces young Americans into a no win situation.

I do not see how under the commission's principles young people will be better off at all. Yet, for years the campaign to privatize social security has focused its message on the supposed benefits for today's younger generations.

Today this message is echoing in the halls of Congress and the White House, throughout the media, and in the think tanks. It would indeed be tragic if, at the end of the day, a policy was adopted that exploited young people's lack of political power to exact an unshared economic sacrifice of great proportion.

While I do not expect this commission to abandon its directive to pursue a privatization plan, I hope that the commission will directly confront the constraints that had been established and seek an outcome that treats young people more fairly.

And, for the record, I will also point out that there are better options to strengthen social security for future generations, options that involve both shared sacrifice and reward. Redirecting general revenues that are projected to go to the recently enacted tax cut to social security would go a long way towards closing its projected shortfall.

Raising the payroll tax caps so that high earners pay social security taxes on more or all of their income like the rest of us would also help, as would using private fund managers to diversify the social security trust fund's investment strategy.

In the end, strengthening social security for future generations is not a matter of affordability but rather a matter of priorities. This country needs a strong safety net and there is only one entity that can provide a real guarantee of social security, the U.S. government.

We should sustain this valuable program rather than start toward the path of dismantling it. On behalf of the 2030 Center, I thank the President's Commission for inviting me to present my views today.

CHAIRPERSON PARSONS: Thank you, Hans. I think I speak on behalf of all my fellow members of the commission saying this has been as thoughtful a set of presentations as we have heard so far. But I know it is also provocative, and there will undoubtedly be some questions members of the commission will have. Olivia.

QUESTIONS AND ANSWERS

DR. MITCHELL: Thank you very much. It is a great pleasure to have you here speaking as eloquently and articulately as you have, and I very much appreciate your presentations. I am pleased to hear that there is a concern about the role of women in the potential set of reforms that we are talking about.

I know there has been a great deal of discussion publicly about the fact that the American people may be somewhat financially illiterate. There is a lot of concern about people not knowing how to invest, not knowing how to make financial calculations.

I had one comment which is that the current, the most recent evidence, suggest actually that women are somewhat more sophisticated in their investment behavior than many men. For example, there is evidence that shows that women are less likely to churn and turn over their accounts when they are investing.

So, as a consequence, they can get their retirement with actually a bigger account rather than the account eroded over the years. There is other research that shows that women's earnings patterns are actually fairly uncorrelated with the stock market, so that of all groups women might in fact benefit the most from diversification vis-a-vis the stock market.

So, I am just curious what kind of reaction, what kind of background information input you have gotten in terms of women being able to invest effectively or not in the market? Thanks.

MS. HOLMES: Well, I have read some reports that women are more conservative investors and what you have said about not turning over their accounts as much. I do not know if this boils down to any sort of hardwired gender differences. I certainly would not want to go that far.

But I also am aware and have read much about the problem of women who choose not to go into the work force being concerned that they will not be able to have the same types of benefits as men under private retirement account systems.

I mentioned the reform of earning splitting which would actually also be in effect if there were to be divorce between two married people, that a woman would have 50 percent of the household income, and that would be invested in her name until she retires. So, you know, I think some of the ways that women are characterized to try to oppose reform on social security are unfair and do us a disservice.

CHAIRPERSON PARSONS: Tom.

DR. SAVING: Hans, I have just loved your statement and I am very pleased that you guys came, and you have done a superb job of presenting your material. As the chairman said, I think you have set a standard for the way I think all the presentations that we have heard should try to match up to.

I am going to just read something that you said at the very end of your comments, Hans. "This country needs a strong safety net." Certainly, I agree with that. "And there is only one entity that can provide a real guarantee of social security to the U.S. government."

And let me ask you how you look at the 1983 changes in social security as being the strong guarantee since it significantly raised taxes and significantly reduced benefits?

MR. RIEMER: Well, I thought the 1983 --

DR. SAVING: That is your government at work in preserving your social security benefits.

MR. RIEMER: I thought the 1983 effort was a laudable initiative. It was a commission that brought both sides together, a shared agreement of principles, and I think it reached an outcome that was very solid. It put the program onto a financial path of security for several decades and sustained the guaranteed benefit, and I hope the commission will -- this commission will emulate that model.

DR. SAVING: Oh, you mean reduce benefits and raise taxes which is what that -- which as '83 did? I would assume that what you meant by guarantee is maintain benefits without raising taxes. I do not know what anyone means by those words, but that is the way I would describe those words. But that's, okay, that is my question.

MR. RIEMER: I am certainly willing to consider anything. I would not put any policy off the table, as along as the conversation is focused around preserving the guaranteed benefit. But if the conversation is focused around how to cut back on the benefit for privatization, then I do not believe that those options are good ones to consider.

DR. SAVING: I am sorry. My question was not about that. My question was simply how does a proposal that in 1983 that significantly raised taxes and significantly reduced benefits suggest to you that the U.S. government is the best person to maintain your social security?

That is not what they did in '83, and that was what my question was about. It had nothing to do what we are proposing, or what any other proposal would be like. It simply said that past history suggests that there is very significant political certainty about what will happen to social security if we do not do something.

MR. RIEMER: Right, and my impression is that the '83 reforms had been broadly and widely accepted by the public, and, therefore, they have some measure of political certainty.

DR. SAVING: Well, I did not suggest acceptance. I simply said, you said the government is the best person to guarantee social security. In 1983, they reduced benefits and raised taxes.

CHAIRPERSON PARSONS: I think in the law, Tom, we say asked and answered.

DR. SAVING: Yes, glad you did. Thank you. Lee.

MS. ABDNOR: Thank you, Mr. Chairman. Can you hear me? Is this on?

CHAIRPERSON PARSONS: It is now.

MS. ABDNOR: Okay. Thank you. Thank you all for coming. We greatly appreciate especially hearing from your generation who have the most at stake. I would like to address my question to the women on the panel. Ms. Holmes made a reference in her testimony to a few of the women's groups that have made statements against private accounts over the past few years, and that jogged my memory of something I would like to ask your opinion about.

A few years ago when I was here, there was a press conference held by a number of women's organizations including National Organization of Women with Patricia Ireland there, and a three or four other women panel at the National Press Club, and they were roundly opposing personal accounts as being terrible for women for a host of reasons.

But I stood and I asked the question then, well, how would you feel if -- about giving women the choice, to let women decide for themselves what they would like to do if these accounts were voluntary? And they said absolutely not. They wholly and unanimously disagreed.

And I was shocked and very disappointed to hear these groups who supposedly support women's rights say no, women should not have the choice and the right to do that. And it just sounded to me very much like they trusted women to be smart enough to make decisions about other things in their lives than to be able to make choices about other things but not about their bank accounts and their financial future.

So, my question is how do you understand that? It makes no sense to me, and if you could give us some insights. Maybe there is something about it that I do not understand that I wish I did, but I was not able to get a clear answer from them on why.

MS. HOLMES: Yes, and when I gave testimony on the Hill in the subcommittee that is representative, I believe, of NOW, and she said that she would support the government investing on our behalf. And, as I mentioned in my remarks, this seems to me to greatly disadvantage female small business owners. Their companies are not publicly traded; their companies are not being invested in.

Maya has also made reference to the political problems of putting this large a chunk of our economy in the hands of people with political agendas and motivations, and how they would deal with investing our money.

As far as these organizations opposing even a choice, I know having worked with Sam Beard that that is also an option of reform; that certain citizens like the Chilean example would have the opportunity to choose to stick with the status quo or set up a private retirement account. These groups oppose it. Frankly, it is baffling and puzzling. There does not seem to be any real explanation.

MS. ABDNOR: Do either of you other two women have any other insights on that?

CHAIRPERSON PARSONS: I will bet they do.

MS. BAGBY: I mean to me I think it has to do with traditional political alliances and where different groups fall. And I think that often people -- often I think one of the problems of our democracy and the way it works is that people claim to represent constituencies sometimes without ever listening to the constituencies that they represent.

And so, I think that there is a necessity, especially among our generation. Our general, for the most part, does not trust organizations and does not trust the institutional, you know, the lobby groups of Washington. And so, I think in order to regain that trust, those lobby groups and those constituencies, the leadership really needs to listen to what their people want, and I think that the avenues of communication need to open.

And I think, particularly with women, it is a perfect example that women are and have become more willing to invest for themselves to plan their own futures. And I think given the opportunity they would choose a plan that incorporated private accounts.

MS. ABDNOR: Okay. Thank you. That is helpful.

Can I ask one more quick question?

CHAIRPERSON PARSONS: Certainly, you may.

MS. ABDNOR: Hans, thank you for your testimony, and for being so direct and clear about what your position is, and what the position of your organization is including some of the options you would prefer to see considered on the table such as government investment in the stock market, and that sort of thing.

You mentioned at the end that you have been working on this for four years now, is that right, since '97?

MR. RIEMER: Well, the 2030 Center was founded in 1997. I actually started at a group called the National Academy of Social Insurance in 1995.

MS. ABDNOR: Before that.

MR. RIEMER: And I worked for Arthur Fleming at the Save Our Security Coalition after that.

MS. ABDNOR: Okay, and your organization though for four years, the 2030 organization. Have you all come up with a plan for how you would sustain the system that has been scored by the actuaries as we are all having to do the 75 year plan?

MR. RIEMER: Yes, if you will look through our publications going back to the beginning, we have always proposed options to strengthen social security. And we usually draw from actuarial tables to make our numbers add up.

MS. ABDNOR: So when you raise payroll taxes, how high do you raise payroll taxes in your plan?

MR. RIEMER: We have actually never put out a plan that specifically called for raising payroll taxes, although we have always thought that it was a reasonable option considering that our generation will live longer than any other generation before us, it could not come for free.

MS. ABDNOR: What was in your plan then for -- what is in your plan? And that's been scored?

MR. RIEMER: We have actually never sent our plan to the actuaries to score it, but we would not be opposed. We were drawing from actuarial tables, so the numbers were fairly consistent with what you would expect.

MS. ABDNOR: Would you be willing to do that so that we could be able then to compare what you all are suggesting with what others are suggesting? It would help us, because we have to look at the apples and apples. And if we had a plan there that your organization was willing to put forward on the table that would be helpful.

MR. RIEMER: If this commission were to put forward a plan that was scored by the actuaries to balance over 75 years, I might be willing to consider doing the same thing.

MS. ABDNOR: Okay, that's a no. Thank you.

CHAIRPERSON PARSONS: That's an asked and answered also. All right. Bob.

MS. ABDNOR: Thank you.

MR. POZEN: Well, I think we will be putting forward a plan that will be scored by the actuaries, so you can count on it I think. Steve Goss will definitely do it. So, I think if that is your precondition, we will be putting forward a plan that will be scored by the actuaries, and we have to live within the constraints.

And I guess I think that what Leanne is trying to suggest is that we have found that when these things are scored that it is a lot tougher. The various ideas turn out when you really run all the numbers not to be as easy or as attractive. And so, I think we will be doing it. We have to do it, so I would suggest that.

But I was also going to ask you another question which was provoked by something you said. I think we would all agree that there has to be burden sharing. This is a difficult problem, and one in which there is no easy solution. If there was people would have been there many years ago, and so that different groups have to share.

But I guess I was concerned one thing that you said you thought the mandate that we had not to touch people's benefits in retirement was concerning to you and/or near retirement. And I guess I think a lot of us on the panel have children, and some of us may even have grandchildren, but I think we all are sympathetic with the generational issue.

But I guess I was surprised to hear that I think we are also sympathetic with the notion that people who are in retirement or very close to retirement, it is very difficult to change the rules on them at that point.

And I was wondering whether you were really suggesting that that is what we ought to do, and you were criticizing the fact that -- seemed to be criticizing the fact that the president's mandate sort of really said to us we should not be changing the rules of the people who are already in retirement.Your testimony suggested that you thought that that was an inappropriate constraint.

MR. RIEMER: Thank you for that question. It is important. The purpose of my testimony was not to necessarily advocate that you should reduce disability benefits or survivor's benefits, or that you should reduce benefits for people who are currently retired.

It is to illustrate the constraints that are put on younger people's benefits when you do wall those portions of the program off, and to urge the commission to consider what paths there might be to offset that constraint. And I do not necessarily know what those paths would be, but I think it is incredibly important that the commission consider how those constraints will effect today's younger people's today's benefits; and then what could be done to offset the fact that the cuts are necessarily loaded onto to today's younger people.

MR. POZEN: Well, I think in any actuarial analysis, the fact that we are constrained, and most of us think properly so, not to cut benefits of people in retirement, that is an actuarial reality that we have to all deal with. So, we are forced to take that into account.

There is no other way that we can avoid that, so it is there in the numbers. So, I think you should be assured that we are taking that into account because the impact of that is built into all of the calculations.

MR. RIEMER: Right, I was only trying to express that if you were to wall off those portions of the program that you would necessarily cause younger people today to have much larger reductions in their guaranteed benefits, and that the accounts could not make up for the difference. And so, there needed to be some mitigating policy to get young people at least back to even if not to some level of greater wealth.

MR. POZEN: Thank you.

CHAIRPERSON PARSONS: John.

DR. COGAN: Thank you all for coming to testify. Like Olivia said, your testimony, as far as I am concerned, is among the best we have heard so far. You really have honed in on a couple of very important issues that are confronting anyone who deals with social security reform.

There is this sort of emerging consensus that if you are going to fix social security for the future, the funds have to be invested. We can no longer go along without an investment program. We have got to make it an investment program.

And you really have two choices:

- One is to have the government invest it;
- And the other is to have individuals invest it.

And I know many of us have expressed concerns, as many of you have, about the dangers associated with government investment and the benefits associated within the individual investment.

We heard testimony in San Diego from a person from the World Bank who had conducted a study of countries that have chosen the government investment route, and countries that have chosen the personal investment route, and her conclusions were very, very striking.

The countries that had chosen personal investments had enormous success, high rates of return. The countries that had chosen the government investment model, they actually had negative returns on balance. It actually lost money.

And so, philosophical considerations aside, the practical reality is that individual investment seems to work and government investment does not seem to work. There is a very important difference between the two that I would like you to comment on.

It does seem to me that if you have a government investment model, you really do not give individuals ownership; and if you have an individual investment approach you do. And I would like to ask you all if you think that is a correct characterization of the difference between the two. And does it help explain why government investment models, or government investment approaches do not tend to work and individual investment approaches seem to work?

MS. MACGUINEAS: Well, that is absolutely right that it is not just the difference of is it individuals or the government who is going to own the money. Part of the question is is this going to be a defined benefit or a defined contribution plan?

And one of the myths out there is that these defined benefit plans do not have risks associated with them. They have tremendous risks associated with them, and you can ask my generation that is paying increasingly large payroll taxes as we absorb the risks of what happens in a "pay as you go" defined benefit plan.

As it matures, as the returns are reduced, we know that there is a ceiling on what returns are going to be able to achieve. There are going to be no greater than productivity growth in terms of labor and a growing population, and when the population has a baby bust instead of a baby boom that risk is very pronounced.

So, I have a problem with people saying we need to have the government invest it, because that is going to make the system risk-free. One, the markets are always going to have swings. The markets are going to go up and down. It does not matter who is investing, individuals or the government, but over the long-term it is very hard to pick. You cannot find a period where you would have been unwise to be in the stock market.

So, the government cannot insulate people from some risks, and it can insulate individuals from some personal investment risks by regulating their accounts which

I think is a wise thing to do.

I also just want to point out one concern I have, and I am not an expert on this. But most of us are talking about investments being in passive investments, indexes, rather than letting people pick their own stocks and bonds, and I think that is a very smart idea. If the government were doing this, one massive centrally invested fund, there would be huge compromising of our financial markets which are currently the most efficient and the most liquid.

For the same reason though, I am even concerned if individuals can never get out of passive investment funds. And one of the specifics I have in my report, which I think is just something to think about, is is there a point once people have invested and saved enough -- say, they are required to invest only in index funds initially.

But is there a point when they have enough savings and the administrative costs would not be overly burdensome that they should have some more freedom in what they are investment? And I believe that is going to help the efficiency of the financial markets which really is important to maintain.

MS. BAGBY: I would agree with all of that, and I would probably just add one other thing. And that is that one of the big concerns for me, and I think a lot of people in my generation, is the fact that our savings rates are so low, and that by handing over responsibility to an individual and saying, look, you are responsible for building your own nest egg, there is the possibility that we can increase our savings rate in the U.S.

And that, I think, is huge just because our savings rate in the U.S. is under four percent. It is less than half of the mean for industrialized countries, and that is a real concern because what it means is that we are selling off a lot of our assets in order to pay for a kind of rabid consumption to buy VCRs, and televisions, and makeup, and I mean these ridiculous things that we buy as Americans.

Not to abuse us too much, but we do have to reconsider and really save for things that are important like our kids education, and our health care, and to buy homes, and to build businesses.

So, I think that anything you can do to put responsibility into the hands of someone and say, this is what you can do for your future, and encourage them to save and pop up that savings rate is a good thing. And I think that is why private accounts are really beneficial to us.

CHAIRPERSON PARSONS: I think we have time for one more question. Sam.

DR. COGAN: Can I get just a quick response from Hans?

CHAIRPERSON PARSONS: Okay. Hans, quick response.

MR. RIEMER: One thing I have always been concerned about was that when you set up a system of individual accounts -- I would not concerned about, sorry. But one thing I would like to point out is that when you set up a system of individual accounts, you have to be aware that the financial structures will be quite similar to a government invested approach because you have large funds, and then therefore someone has to pick which stocks go into which fund that individuals are allowed to choose from.

So, whatever approach it is that is devised to solve that problem from the individual accounts perspective, I would just advocate that we replicate a similar approach for the collective investment model.

DR. COGAN: Would you agree that the difference is in ownership, that in a personal account approach individuals own their accounts, but if you have government investment individuals do not own the accounts?

MR. RIEMER: I think I would agree to that to an extent. I would also point out that checks are written in the name of each individual beneficiary, and that is an equivalent factor in my mind.

CHAIRPERSON PARSONS: All right. We are going to divide that one last question into two very quick questions. Sam and Bob.

MR. BEARD: John actually stole my question, so I want to go back to Leanne. Hans, we are wrestling with all of the balances and the costs, and we will come up with a system that is scored; and then we are not the United States Congress.

We are just making a suggestion and trying to increase the public debate, because we think that social security has to be saved. It would be very valuable and I heard you -- I think I heard you say that if we created a scored plan that you would, and I think it would be valuable if you would do that.

And I am sure that we could make Mr. Goss available because he loves scoring things and does not have enough to do. And I think it would be very valuable because fundamentally we will go to the United States Congress and we will say, here are some options, and so we will score ours. Will you score yours and produce it?

MR. RIEMER: I think the 2030 Center will be quite willing to do that, yes.

MR. BEARD: Great.

CHAIRPERSON PARSONS: Bob.

MR. JOHNSON: Real quick. Ms. MacGuineas, you pointed out that progressive privatization of accounts is the best way to go, and that the result would mean obviously, and I think it is right, that lower income workers would have a chance to build a larger nest egg for retirement as well as for inheritance potential.

But, you know, I think you also stated that with progressive privatization the transition costs would be covered or would not be a problem. How do you arrive -- oh, you did not say that. I thought that is what I read in your testimony that this would sort of eliminate that issue. Because if you could then I was going to say we can all go home.

MS. MACGUINEAS: Oh, yes. I wish I could do that for you. I think we have to be very clear about the fact that there is transition cost. If we want to grow the economy, we have to save more. The only way you save more is you consume less, and that is a cost.

Now, it is not a cost that goes nowhere. We are saving it. We own that money. We defer that consumption for later, that is what saving is; and there is a public good that comes from that saving and we grow that economy over time. But the transition to progressive privatization is even going to cost slightly more than normal accounts, because I am suggesting that we subsidize the accounts of low income workers.

Perhaps, Mr. Goss would like to score that sometime. I do not know how much it costs exactly, but a rough estimate is that it would be roughly $30 billion a year. And I would just point out that that is significantly lower than the $100 billion a year we spend in tax expenditures creating incentives for savings for middle- and high-income workers through things like favored tax treatment of pensions and IRAs.

So, I think the costs are manageable. But nobody should say that reforming social security is going to be cheap, going to be easy. You cannot reform a system that is facing trillions of dollars of deficit in a pain-free manner.

The point about creating private accounts, I believe is while it costs more initially to save more, those benefits are huge over the long run and it will be the only thing that ends the need for ongoing tax increases and benefit cuts.

CHAIRPERSON PARSONS: Now, Congressman Penny would like to just place some questions before you on the record, not get a response right now.

MS. KING: Yes, but if you could respond in writing, I would appreciate it, just in the interest of time because we have another panel that is waiting. My first question for Meredith Bagby.

You very courageously put some suggestions on the table to trim benefits for future retirees as a way of keeping the system solvent, raising retirement age, taxing benefits, reducing benefit calculations. I would like you to speak to the issue of payroll tax hikes and general fund transfers, and why you did not suggest those, why you might prefer the other options to those approaches.

Then, for any of you, many critics of using social security to crate private accounts say that we really ought to do that elsewhere. Why should we do that within the social security system rather than simply relying on other tax breaks and tax incentives to encourage savings?

And then for Mr. Riemer, I did not hear a lot of shared sacrifice in your testimony as to how we shore up the system for the long-term. It sounded to me like a lot of general fund money, and government invests, and raise the wage cap so the wealthy put more into the system. That does not sound to me like shared sacrifice at all.

Actually, most of your reforms turn this into more and more of a general fund program. Why shouldn't we just make it a general fund program given all of the general fund money you want to put into it?

MS. KING: Mr. Chairman, may I just ask one other question?

CHAIRPERSON PARSONS: Oh, on the record?

MS. KING: On the record. They do not have to answer now. But I would like very much to hear from you, from those of you who have advocated personal retirement accounts. Under what circumstances, if any, would you urge early distribution from those accounts?

Social security you do not get early distribution. You wait until you retire. Are there circumstances you would hope we would consider to change that tradition?

CHAIRPERSON PARSONS: Thank you, Gwen. It is obvious from the questions that your panel has --

4: Mr. Chairman, can I just do one more? First of all, I want to thank everyone here. But I think it is important to bear in mind as we look at the current system, what the current system promises and what it can afford to pay. And I noticed in Hans' testimony that you cited a study I think that said that if you invested two percent of your wages in a personal account, your benefits would be 20 percent lower than the current system.

My understanding is it is 20 percent lower than what the current system promises, not 20 percent lower than what the current system can afford to pay. So, I would like just a written commentary to identify that issue because it is an important part of what we are going to be considering as we go forward.

It is one thing for the system to promise something, it is another thing that we can afford to pay, and if we want to achieve the promises what impact it will have to have in terms of increasing taxes.

CHAIRPERSON PARSONS: Thank you, Jerry. I think that is a fair point. Senator Moynihan has admonished us on every occasion we have met not to be sort of trapped into using words that convey meanings that are not really there. And we talk about a guaranteed benefit, there is no guaranteed benefit.

There is a promise of a benefit, and that was the implication of Tom's question, you know, that benefit in the past has been reduced and it could be reduced again on the whim of the Congress. And so, our challenge is to figure out how to make the promise real.

And, as you can tell from all of the questions and the spirited back and forth, this is not a challenge without some complexity, but you guys were terrific. And we wish we could sort of stay here and engage with you all afternoon, but we have another panel coming.

Actually, I am feeling like maybe I should be out there and you should be up here. You have got more wisdom on this than I do for sure. But thank you very much for your participation. We look forward to your further input and you have been very helpful. We appreciate it.

(All thank you)

CHAIRPERSON PARSONS: If we could have our next panel join us.

(Off the record)

(On the record)

PANEL II: EXPERT TESTIMONY ON TECHNICAL ISSUES IN SOCIAL SECURITY REFORM

CHAIRPERSON PARSONS: We are going to get right into it, since we ran over a little bit with our last panel. The second panel of the morning is a panel of experts in what I will call the technical aspects of social security reform, folks who have spent a better part of their professional lives understanding the system, and can help us think through some of the nitty gritty in terms of if you move this piece what happens to this piece over here.

But having sort of preannounced them as experts, I will tell you you have got a challenge to rise to the level of the last panel that we heard from who were really quite thoughtful and informative, but I know you will make it.

So, let me introduce each of our panelists and we will get going. First, is Syl Schieber, who is formerly a member of the 1994/96 Social Security Advisory Council, and is currently on the Social Security Advisory Board, who is with Watson Wyatt Worldwide Consulting Firm.

He is joined by Gene Steuerle, who is with the Urban Institute, and who chaired a technical panel on Social Security Advisory Board in 1999, I guess it was, Gene.

And the third panelist is Alicia Munnell, who is a distinguished professor at Boston College, and who has spent a good deal of time sort of studying the system and is here to share some of her insights with us.

So, ground rules, lady and gentlemen, are we would ask you to restrain yourselves to five minutes in terms of your delivered remarks; we have your written statements; and then make yourself available to a barrage of questions.

MR. SCHIEBER: Thank you, Mr. Chairman.

CHAIRPERSON PARSONS: Syl, why don't you kick it off?

by Sylvester Schieber, Watson Wyatt Worldwide

MR. SCHIEBER: Thank you very much, Mr. Chairman, members of the commission for inviting me here this morning to testify. Given other things that are going on, it might be easy to lose sight of the importance of social security.

But as we look to the future, it is still extremely important and deserves the attention that you are giving it.

According to the social security actuaries under current law in present value terms, social security is currently underfunded over the 75 year projection period by $3.2 trillion. That takes into account the current trust fund plus all anticipated revenues relative to anticipated benefits over this period.

Per the discussion with the prior panel, the traditional fixes when the system is out of balance is either to raise taxes or to cut benefits. Anyone who says that these benefits are guaranteed is either trying to mislead or has not been paying attention.

Even to assume that there are promised benefits suggests that someone is not paying attention. The law is very specific. Congress has reserved the right to change the benefits in this program any time it pleases, and that has been tested before the Supreme Court.

Because of the funding problem we are now facing, there are quite a number of people that have suggested that maybe we ought to turn to funding. To truly fund the program in the way that Franklin Roosevelt originally envisioned that the program would be operated.

And why do you want to fund a retirement program?

Well, one of the reasons you do is that the assets you contribute, the contributions you make over time generate a rate of return that help finance the benefits when people get to retirement age.

You take a young worker who starts to contribute to a retirement program early in their career, by the time they get to retirement easily two-thirds to three-fourths of the money that is paid out during their retirement actually can come from return on the assets rather than money that they have had to take out of their paycheck. So, there is very important reasons for why we might want to do this.

Some people have looked at this and they have said, well, we are already beginning to accumulate a fund under current law, and we simply should invest some of that in equities, and that would help -- that would solve our problem.

Well, part of the problem is we are not funding at a high enough rate, even if we invest in equities that were going to solve our $3.2 trillion deficit. And if all we do is take the current fund and invest it differently than we are investing now, we really have not changed anything in our overall economic perspective. We have simply arbitraged within existing markets. We are taking high returns from one group of savings and giving them to another.

Really, what we need, as we try to address this problem, is we need new savings. Now it is very difficult just to raise taxes under this program. We have gotten taxes to a rate that there is considerable resistance, and there is a concern about the drag they might have on the economy.

So we need to think about adjusting the program, and there has been a lot of discussion. There has been discussion this morning about transition costs, and how we adjust the program. We are facing a $3.2 trillion transition costs no matter what we do. Even if we stay with the current structure, we are facing a $3.2 trillion cost.

Now, if we adjust the program in some fashion such that we raise benefits over time, or reduce the revenues that are now coming into the program, then the $3.2 trillion would be more than $3.2. But unless we raise benefits or cut the sources of revenue already coming into the program, it should not change that amount.

Who pays depends upon the structure of the reform. We heard in the last panel, Mr. Riemer, say that -- he referred to an analysis that Dr. Munnell and some associates of hers have done that looked at a 29-year-old, and said that if you establish the two percentage account that they attribute to your panel, that a 29-year-old would receive a benefit reduction relative to current law of 54 percent.

Now, they do acknowledge, finally, that the individual account itself would generate some benefits. And so, the ultimate benefit reduction would only be 20 percent. But 20 percent relative to what? Twenty percent relative to a benefit that is in current law, that is neither guaranteed nor promised.

Now, if you look at the benefits that are actually being funded for a 29-year-old today, over their retirement period their benefits, if we are going to fund at the current rate we are willing to pay, would have to be reduced by 30 percent. So, the two percent reform option would actually raise their benefits relative to what we are currently financing.

So, let's be very careful when we are talking about transition costs, and keep track of where the pea is under the walnut shell as the walnut shell moves around. Because if you do not, you will end up playing a game that we have all seen played on television that really does not seem quite fair.

As we look around at other nations around the world that have addressed this issue, they have dealt with the transition costs in a variety of ways:

- Chile has tapped general revenue surpluses to pay the transition costs as they move from an underfunded system to one that is funded on the basis of general accounts.

- The United Kingdom is largely using the reduction in benefits over time to finance the transition costs.

- Canada has adopted a change in their system where they are raising the payroll tax over time.

- Sweden has done a little bit of both, increasing contribution rates and reducing benefits. Again, Sweden is moving toward an individual account type program.

Now just because you move to an individual account type program does not mean that you have to abandon the fundamental principles that are embedded in the social security system that you have in tact. I would say many of these other countries have maintained the fundamental principles that they had in their old system as they have moved from one structure to another structure.

Now, there certainly are issues about how you restructure the benefit in both elements of the program if you keep a defined benefit base and a defined contribution element to the program, but you can design structures that take into account financial market risks for lower income people and offer them protections can be completely redistributive in the nature of our current program.

Now, in closing, I would say that one of the things I think that you ought to consider if you are considering options, because we do need to get additional money into the system.

There is a tremendous reluctance on the part of policy makers in this country, and the taxpayers in this country to pay higher taxes. I think somehow you need to figure out how to get some additional money into the system on a voluntary basis in keeping with the president's principles.

And, in that regard, I would suggest that you pay attention to what has been the most successful and the most popular voluntary retirement savings program in the history of mankind, the 401(k) system that has been established in this country, and has now operated for more than 20 years, so there is a lot of experience with it.

Today, as many as half of the workers in the United States have these types of plans. On average, 70 percent or more of the eligible participants participate in them. On average, contributions going into them exceed seven percent of pay.

David Wise and some colleagues -- David is at Harvard, and some colleagues of his, have estimated that this totally voluntary system by 2030 is going to be throwing off benefits that exceed the social security program in 2030, a totally voluntary system throwing off benefits that are costing about seven percent of pay, larger benefits than this mandatory system that is costing around 12½ percent of pay, on its way to 16 or 17 percent.

I would very seriously advise that you look at this structure. I have submitted a proposal to the commission with some elements of such a proposal. Thank you very much.

CHAIRPERSON PARSONS: Thank you, Syl. Gene.

by Eugene Steuerle, Urban Institute

MR. STEUERLE: Chairman Parsons, and members of the committee, it is a privilege for me to be here with you today. I know many of you personally, and I would like to thank you for your own support during my own difficult period. I applaud also the efforts that you make to engage in the very task of bringing the nation's priorities into balance.

And make no mistake about it, it is this broader task of redefining national priorities to which you have been called in the context of dealing with social security. Under most projections, spending on the elderly would soon comprise up to 80 percent or more of noninterest domestic spending.

As has continued to demand a growing share of federal taxes, social security has steadily been pushing aside other domestic spending whether measured as shares of the budget or of gross domestic product. Today, a new demand has been place on both and private budgets, the need to combat terrorism, and public expenses are only the tip of the iceberg.

In economic slow down, hundreds of thousands of workers have been idled, and hundreds of billions of dollars of dollars in output have already been lost. Meanwhile, the private sector will be transformed by new requirements for architecture, for revamping transportation systems, handling chemicals, and many other items.

Other unmet shifts in demands are also not going to reverse themselves. For far too long the nation has failed to ensure an adult presence for each child throughout most of the day, a task not easily met when the federal budget spends six times more on each elderly person than on each child.

And in the elderly budget itself, the needs of single heads of household and of the oldest of the old are increasingly being ignored so as to provide retirement support to healthy middle aged Americans. While the terrorism threat is being newly engaged, the requirement for flexible budgets that respond to current needs is not new.

Every fiscal crisis in the nation's history reflects nothing more than the simple need to find resources to meet new priorities. In this context, the principal problem of social security is that at the margin it grows independently, both in the needs of the nation, and of the elderly themselves.

The new sense of national urgency cannot be ignored. We all know that in politics a frequent goal is to claim to do something for someone without ever admitting the costs. Within the social security debate, some claim that larger shares of the national pie for the elderly programs should never be admitted to channel resources away from other priorities.

Meanwhile, others argue, just as naively, that if we shift around a bit of money to individual accounts that no one loses. In a period when there is a call for new national sacrifice and lives have been lost and more will be lost, when the needs of the unemployed are large, and when many businesses face failure, this type of rhetoric gets us nowhere.

The fundamental issue, I repeat, is how can the nation shift priorities to meet its most important needs?

The commission's practical task then is to leave some level of resources free to apply in the future to new emergencies and needs.

This can be done, in part, by indexing benefit growth so that it fits within available resources and revenues from workers, as has been done by other countries such as Sweden. One method I understand the commission is considering is to index growth in social security benefits of future retirees by prices rather than wages.

While, in my view, better than nothing, in the short run, a preferable method would be determine an affordable rate of growth in lifetime rather than annual benefits while encouraging later retirement so that workers are more likely to have increased annual benefits when they truly become old.

I would like next to mention two important issues that I believe have been given short shrift in the recent debate, retirement age, and poverty issues. In my view, the employment incentives within social security seriously threaten economic growth in the future, and economic recovery from modern recessions.

The primary problem is that social security now encourages most individuals to retire in late middle age when the nation needs their talents. About one-quarter of a century of support is now provided to the longer living spouse of a typical couple who retire.

Anyone who looks closely at the cost of social security knows that it is not the size of the annual benefit that costs so much, it is the number of years of support that is involved. Your mandate as a commission could be interpreted narrowly to look mainly at each individual's social security benefit structure.

But, in fact, the affordability of social security to society is affected as much, if not more, by whether people work, by whether they work and produce national output in income, and whether they work and then contribute social security taxes as well as income taxes that then place less demand on the federal budget as a whole.

Over the post-war period, the trend toward more and more years in retirement was fortuitously offset by the increase in female labor force participation, allowing for continual growth in the percentage of adults who are employed, but that era is over.

The danger now is that once the early baby boomers hit their sixties, the adult employment rate could fall precipitously causing a recessionary hit from the labor force every year for more than two decades running. Indeed, I also suggest in my testimony that social security employment incentives already could dampen the ability of the economy to recover from a current downturn.

If this commission wishes to increase future economic resources, its surest methods are:

- First, to adjust the early retirement age; and
- Second, to reconfigure lifetime benefits so that more are received later in retirement.

These measures would increase the supply of labor. Although I also favor attempts to increase saving for retirement, relying upon them to solve what is essentially a labor market problem is risky.

I recognize that the retirement age issue is highly sensitive. However, in good faith can we build social security reform on the presumption that a 16th, or a 20th, or 25th year in retirement is a higher national priority than many other needs such as restructuring our buildings, providing new opportunities to the newly unemployed, paying for the transformation that our society is now undertaking, or even to meet the needs of our children, I think not.

I would like to suggest a way perhaps to cut the guardian knot over retirement age. I believe the commission should redefine retirement age policy by setting the earliest retirement age, and then increasing it gradually so that the system stays within budgetary balance, taking into account such factors as life expectancy, and indeed demographic factors such as fertility rates.

Sweden recently did this in their own reform. There should be no normal retirement age. Instead, there should be a systematic actuarial adjustment in benefits, one more generous than current law which does not take into account the taxes that people contribute.

The systematic actual adjustment should be made for anyone who works beyond the earliest retirement age. Again, I provide more details in my testimony. My suggested version of retirement age reforms symbolically does not sound as harsh as increases in the normal retirement age.

Over the next few decades, it merely moves up the earliest retirement age toward what is now already slated to be the normal retirement age. It also allows any reform package to provide significantly higher annual benefits, both because it will generate higher social security taxes, and because affordable lifetime benefits will then be spread over fewer years.

For many reasons, the current social security system does an increasingly inadequate job also directing new resources to meet the needs of the elderly poor. Among its primary defects is that social security discriminates very strongly against single heads of households who work, pay taxes, raise children, and get lower benefits than many individuals who do none of these contributions to society.

This is an issue related to the design of spousal and survivor benefits which are a pure transfer component of the system, in the sense that no additional contributions go for these benefits.

Today, the projected reduction in elderly poverty under social security is very modest relative to the scheduled increase in benefit payments of hundreds of billions of dollars. This commission is also considering reform in the form of individual accounts.

While I am quite comfortable with that type of reform as a matter of good budget policy, and as a matter of private pension policy, this tact by itself does impose risks that cannot be undertaken well by those with low income.

Hence, I strongly urge this commission to pay particular attention to the needs of the poor among the elderly, set up a decent minimum benefit that ensures that the bottom one-third or so of the income distribution is better off no matter what happens within any individual account or private pension. A minimum benefit is also one of the surest ways to ensure that lower income women and minorities fair well in any reform.

I simply do not believe you can solve many related problems, the removal of a net addition to risk flow income individuals, a fair allocation of what is now spent on spousal and widower benefits, and an ensured improvement in the status of lower income women and minorities through a means tested approach. Means testing additionally involves all sorts of enforcement problems in saving disincentives.

In sum, social security's current dilemma is that it is inflexible in meeting the national priorities of the nation whether they be combatting terrorism, addressing the needs of children, or addressing the needs of the oldest and the poorest among the elderly themselves.

Whatever reform you undertake, I urge you not to dodge the problems associated with the retirement age policy that suggests that a 15th, 20th, or 25th year in supported retirement, middle aged retirement, is the nation's higher priority that threatens economic growth by scheduling large declines in adult employment rates, and introduces many to retire when their income becomes inadequate decades after they retire.

At the same time, I also urge you to increase resources for the poorest of the elderly. Our system does have the means and the resources to provide a basic benefit for everyone at above a poverty level, and that should be the first goal of any reform. Thank you.

CHAIRPERSON PARSONS: Thank you, Gene. Alicia.

by Alicia Munnell, Boston College

MS. MUNNELL: Chairman Parsons, members of the commission, thank you so much for the opportunity to appear before you today.

I would like to use my time to argue strongly against cutting back on social security's defined benefit promises, and replacing them with individual accounts. Individual accounts will not solve social security's long run financial problem, and they are unduly risky for people's basic retirement benefit.

Consistent with your introductory remarks, Mr. Chairman, I want to clarify what I am not arguing about. I am not here to debate the merits of prefunding social security's commitments. I think using social security system to increase national saving is a good idea.

Similarly, I am not here to dispute the merits of broadening the investment portfolio to include equities. I would like to see social security participants, particularly those with no other assets, have access to higher returns.

I am not here even to argue against individual accounts. Once you have restored balance to social security to preserve most of today's pension promises, supplemental accounts through social security would be an easy and efficient way to increase saving.

I am here today to urge you to adopt three guidelines as you put together your recommendations:

- First, restore 75 year balance to social security so that people can regain confidence in the program;

- Second, retain the programs defined benefit structure so that retirees will have predictable retirement income; and

- Third, consider any individual account provisions as add-ons to the programs not carve-outs.

Let me just take a minute and expand on each of these points. First, the most important thing you can do is to restore balance to the social security program over the next 75 years. This program is crucial to the economic being of all older Americans, and constant debate about its viability hurts the very people you want to help.

Restoring balance to a system where expenditures are projected to exceed income requires changes in cash flows. The only way to improve cash flows is to increase revenues, lower outlays, or improve returns on trust fund assets.

Notice that this list does not include individual accounts. They are not on the list because by themselves individual accounts do nothing to improve cash flows and the financial position of the program. Since individuals accounts are no magic bullet, restoring balance will require painful choices. Outlays will have to be cut and revenues raised.

There is no rule for how much to do of each, but historically both increases in revenues and cuts in outlays have been part of legislation to make social security financially sound. For example, in 1983, a commission headed by Alan Greenspan recommended a balance package of revenue increases and benefit cuts to restore 75 year solvency.

The same approach should be taken this time, and a list of both outlay and revenue options is extensive. Some steps that are both inherently fair and would also improve the long run financial outlook include extending coverage to uncovered state and local workers, taxing social security benefits like private pension benefits, eliminating the CPIs so-called upper level substitution bias in the cost of living adjustments, extending the period for calculating social security benefits, maybe accelerating the rate at which the so-called normal retirement age reaches 67.

Many would also argue for an increase in the social security maximum earnings base to bring the proportion of earning subject attacks more in line with the 90 percent figure established in 1983. It is not difficult to identify a whole host of changes that will close the 75 year financing gap. It is just difficult to come up with a package and make a proposal.

I am also one of those that would argue that investing a portion of the trust fund inequities should be part of any program to restore balance. By reducing the size of other required changes, equity investments would improve the returns through the system.

This proposal has met with opposition from those who fear that it would lead to government interference in private sector activities. My view is that such pressures are easy to guard against. I have some specifics in my testimony, and it is also an area that I have looked into a lot, and I would happy to discuss some later.

But Canadians are already investing some of their social security trust funds and equities and have not encountered any serious problems. We certainly could do the same.

The second guidelines that I would like to urge you to adopt is that in the process of restoring 75 year balance, you retain social security's define benefit structure. It is possible to have equivalent amounts of funding in the social security program and in assistance of individual accounts, and equity investment is possible in either scenario.

So, the question comes down to whether a defined benefit or a defined contribution arrangement is better for people's basic retirement income. Here it seems to me the economics are clear. Social security's defined benefit plan is better than individual accounts for providing the basic retirement pension.

Because social security is a defined benefit plan, it can spread risks across the population and across generations. This means that people's basic benefits do not depend on what stocks they pick, or when they buy and sell. They are assured a predictable basic retirement income, an amount that they can add on to.

Retirement income that depends on one's skills as an investor is not consistent with the basic goals of a mandatory social security program. Remember that social security is the major source of income for two-thirds of the population, and virtually the only source for 30 percent.

The dollar amounts here are not very large. An retired individual with a history of average earnings who retired in January of 2000, received a benefit of about $900. In my view, that does not make sense to put that dollar amount at risk.

Finally, advocating a defined benefit program for the basic retirement benefit does not rule out a role for individual accounts. Once balance is restored to the existing program, it is possible to consider changes that would improve the likelihood that future retirees will have adequate incomes.

One option is to introduce voluntary supplemental accounts within social security for those who would like to set aside more money. Thus, the debate is not about whether individual accounts are good or bad. Once people are assured basic retirement protection, individual accounts may be a perfectly reasonable addition.

What opponents to individual accounts object to, and what I object to, is cutting back on existing social security benefits and replacing those benefits with a risky and costly alternative. Introducing individual accounts as an add-on to social security is a good idea; substituting individual accounts for existing social security benefits is not.

In short, accumulating reserves is a good idea. Investing in equities is a good idea. Even individual accounts are a good idea, but not if they involve major reductions in the protections offered through today's social security program. We should be talking about adding on savings options not cutting back on existing benefits. Thank you very much.

CHAIRPERSON PARSONS: Thank you. Well, at least so far you have rise to the task, quite thoughtful presentations. But, again, I know there will be questions. So, shall we have at them? Who is going to start us off? Estelle.

QUESTIONS AND ANSWERS

DR. JAMES: Yes, I have a question that comes both out of -- is this working?

CHAIRPERSON PARSONS: Yes.

DR. JAMES: Both out of Syl's and Alicia's comments. Syl referred to the fact that additional revenues are needed to maintain existing benefit levels. And, of course, those revenues can come from a variety of sources, but increasing individual savings through individual accounts is one way. And Alicia referred to individual accounts as possible voluntary add-ons.

Now, if we were to have individual accounts, if we want to encourage them on a voluntary basis, I am wondering what mechanisms you would recommend for doing that particularly at the low end of the income scale.

Syl, you referred to the 401(k) experience and it has been very successful at all income levels, but it has been more successful at the upper income levels than the lower income levels.

So I would be interested in, from the entire panel, what mechanisms could be used to induce voluntary individual accounts as add-ons particularly at the low end of the income scale?

MR. SCHIEBER: First of all, let me say that I agree with Gene, that if you are going to have individual accounts and the restructuring of the residual defined benefit program, you need to provide a more robust relative defined benefit for the lower income people than the higher income people, and that partially takes away the need for the low income people to save at the same rates that the higher income people do.

In my prepared proposal that I submitted to the commission, I suggested that we could give refundable tax credits at the bottom end of the earnings distribution if we really were very concerned about getting relatively high rates of participation at the low income level, so that would be a mechanism.

Now, that costs money and it would be a new entitlement, but it has been proposed. It was proposed, in essence, by the Clinton Administration, and there have been a number of people that have endorsed it. I think you do want to be careful about getting too much exposure at the low income end of the spectrum to financial market risks.

I think the low income end of the spectrum would benefit significantly from having a vehicle where they could have some real capital accumulation. But I am not nearly as concerned about high rates of savings there, as I am by encouraging people further up the earnings distribution to save and to take some of the income transfer that is really eating away at the other things that government can do because of the high transfers that are going to middle- and upper-income people today.

MR. STEUERLE: As I mentioned very briefly in my testimony, I view individual account reform primarily as a private pension reform. Today, we only have perhaps one-third of the population, at best, that really saves at any rate adequately for retirement. I am using rough numbers here.

We have another one-third at the bottom that no matter how much they save they would not have that much of a retirement, and no matter how you mandate of them they would not have much built up in an individual account.

But we do have this difficulty that we have this middle -- I do not it is a third -- but we have this middle group of mainly middle class people including lower middle class people who I believe must have to share more of the burden of saving for their own retirement, and that seems to me the group that you are mainly trying to induce to save more through a voluntary approach.

The people at the bottom, for the most part, I believe you have to take care of through some sort of minimum social security benefit, simply because they have scattered work histories, often rough marriage histories. They often need money for even more important needs than retirement. It is just going to be hard to solve their problem at the bottom.

So, I think the very bottom you solve with a minimum benefit; the middle you pull along through subsidies for possibly matching 401(k) plans. I had a suggestion one time, at least in one of my reports, where I suggested you might think about a match to employers and employees.

I do not care which one does it -- I would not make it an employer mandate -- who would contribute some minimum amount into private pension plans, say, 6 or 8 percent of wages. The government would match, perhaps, 2 percent of wages.

This is complicated because you are going to have to get into things like discrimination rules, and you may not want to get into private pensions. But, quite bluntly, when you are in individual accounts, you are in the private pension world already. That is the type of direction I would look. As I say, it is complicated, but there is just not time today in fairness to go through all of it.

MS. MUNNELL: I think the best thing you can do for low income individuals is to maintain social security's defined benefit promise and progressive benefit formula. I agree with Gene. If you want to think about individual accounts, it should be to help the private pension system.

Many employers do not offer any supplementary pension plans. Allowing people to contribute individually additional amounts through their social security payroll tax deductions would be a good way to enhance the private pension system that we have now.

CHAIRPERSON PARSONS: Bob.

MR. POZEN: Gene and Syl, you spoke about a minimum benefit. Right now, as you know, there is no minimum benefit in social security. I was wondering whether you could give us a little more detail as your thinking about what level you ought to think this minimum benefit ought to be. Some people could argue poverty line; other people could argue other things. And I think it is a subject that we would really like to have your thinking on.

MR. STEUERLE: We did a study -- I would be glad to give you the draft chapters -- on social security and the family where we tried to examine at least a few options. I want to indicate they are not perfect options. You really need to have Steve and his people really -- Steve is -- when is he going to get time to do this -- but run some of these options for you.

But the type of minimum I would have, I would push very strongly on it. I mean I would so something like a poverty level minimum. I think because of resources, you are probably going to have to define it as poverty level at some point in the future. I am not sure you can quite get there today, but, say, 2008 or whenever you think your reform is going to be more fully implement. And, after that, quite honestly, I would wage index it.

So I would push pretty strongly. And I would have that at about a poverty level, and I would use that as a base of support. If you do that I think you can gradually erode -- you can gradually make the exchange at the top of the social security defined benefit for whatever you may want to do in the form of individual accounts, and you leave open options for the future by providing this strong base of support.

So, I would push very strongly on this getting rid of poverty. I also think that, just as a practical political matter, if you could say to the public that you have essentially reduced poverty among the elderly -- and we already pay out more per person than the poverty level of each individual and the system is wage indexed, so it is growing over time substantially.

We already pay out more than enough to get rid of poverty among the elderly. If you could make a claim that you are going to make a substantial headway in that direction, I think it would significantly increase the salability of whatever else will be in your proposal.

MR. SCHIEBER: The proposals that I have worked on have used a flat benefit as the internal floor. And the benefit that we have derived would give a long career worker, someone who worked some period of time, year-in and year-out, for a relatively full career, and their guaranteed benefit, or their inside benefit something about two-thirds to three-fourths of the poverty line with the assumption that the savings on top of that through these other mechanisms would get them to the poverty line.

I have actually said that, you know, if you are really committed to the poverty line, you could have your internal benefit give a poverty level guarantee of the sort that Gene has advocated in some of the work that he has done.

If you have that internal benefit being larger, I think it diminishes the size of the individual account benefit that you can have, and there are certain tradeoffs, and some of them relate to some of the other things that Gene favors.

If you have a larger individual account benefit, it significantly changes the retirement incentives that a worker faces when they get to be 60, 62, 65, or you know some other advanced age. And part of my goal has been, in this structure that I have suggested, that for the middle class and the upper middle class you try to get those incentives in the system to encourage them to keep working, and provide a big enough floor benefit for the low income people that if they get out they are not going to live a retirement period in poverty.

The thinking behind my approach is these low income people have had a miserable life in the labor market to begin with. And the reason they have had low wages over their whole career is that their marginal product is very low. Their contribution in terms of our total output is very low. If we lose them to retirement because they simply do not have the stamina to keep going back and fighting the system we have not lost much.

The people where we are really losing value are the middle class workers and the upper middle class, and the higher class workers, who today are bailing out of the labor market in their late fifties or their early sixties. We really need to change the incentives for them very significantly, because I agree wholeheartedly with the things that Gene was commenting on in his prepared remarks.

MS. MUNNELL: Bob, can I just add a different perspective on the minimum benefit? Because it sounds harsh to be against the minimum benefit. But I would argue against making social security more progressive than it already is. We have other programs such as SSI to deal with the property issue.

I think that the most important thing is to maintain support for the program as a whole. I think you run into a danger if you make it too progressive. And I think the program as it is, for this current degree of progressivity, has been phenomenal in reducing poverty because of its existence.

So, I know it sounds nice to sort of say, you know, let's have minimum benefit help low income people. That is not clear to me that making it more progressive is going to help low income people over the long run.

MR. SCHIEBER: While most people would not believe it, social security has been my hobby through most of my career. I have spent most of my career working in the private sector with employers. And if you look at the overwhelming majority of employers, middle and larger size employers in the United States today, they are running either purely at a defined contribution plan, but it certainly among the larger ones.

They are running both a defined benefit and a defined contribution plan. And when they communicate those benefit packages to their workers, they are talking about the retirement package. And they fully understand, and the workers fully understand that one element of the package provides certain kinds of securities and opportunities, and the other provides a different set of opportunities but they work together.

And the people who participate in these plans do not curse the one and love the other because it just does not work that way. I think if you have got a coordinated package, and you go to the American people and you explain to them what you are doing here and why you are doing it, I think the American people will buy it.

One of the things we have tried to do with social security over the years is we have had a whole variety of different policy goals, equity and adequacy, that have gotten all jumbled up because we have tried to hide them. And all I believe that it has done is create resentment, because many people believe it is nothing but a welfare program.

Well, it is not just a welfare program, but it has got welfare elements, but we cannot explain it because we have put all of this together. We have mashed all of the potatoes up, and when we go back and we try to describe the people, the individual potatoes, and they cannot sort them out. Well, let's help them sort them out because we can define these things somewhat more discreetly.

CHAIRPERSON PARSONS: Okay. I have got Olivia, Mario, and Bob Johnson, and then we will see where we are.

DR. MITCHELL: Thank you very much. I, again, wanted to add my appreciation to all three of you for coming today, and also for your career long commitment and creativity and effort on this extremely important topic. And so, we are greatly appreciative of all of your work, and we hope to continue to draw on you again in the future.

I guess I wanted to address my question to Alicia. It seems like the major point of your testimony it seems to me that social security benefits should be provided on a defined benefit basis rather than a defined contribution basis, namely, that the benefit should be specified rather than having people receive the returns on their investment account whatever they may be.

As has been noted in this session, also the previous session, the current system has not provided specified benefits nor specified taxes, that is, there is a lot of political risks. The future holds tremendous political risks because of the insolvency that the system faces.

And, of course, also, as was previously noted, the system has no minimum benefit, so that people can readily fall through the safety net if they do not happen to have enough years of coverage to be eligible for DI or for full insurance.

So there is a tremendous amount of political risk in the current system, and I think we should just recognize that. But the main point I wanted ask had to do with your perception of individual accounts. I guess, you know, the president's charge to us was to design a system which had voluntary individual accounts.

So, my point is that your concern about individual accounts may be superseded by the fact that they are voluntary, namely, the people that wanted to remain in the first pillar defined benefit system could do that. The people that wanted to have a partial defined contribution system would have that and still have the first pillar defined benefit program.

So, I guess my question is if we can establish accounts that are voluntary, that if we can establish a system that even potentially enhances progressivity for people at the bottom, what is wrong with giving workers the option to move into a voluntary account?

MS. MUNNELL: Just a couple of points, Olivia. A national pension system cannot be set in stone. It does not matter whether it is defined contribution, defined benefit, you are going to have economic and demographic changes over decades, and all systems have to be adjusted to meet those changes.

And so, there have been some changes in social security over time. But if you compare the stability of the replacement rate onto the social security system with what you would have gotten with a defined contribution account invested in 60 percent equity at 40 percent bonds, you would find that one has been remarkably more predictable than the other.

And so, we are really arguing over a degree here in terms of what portion of people's retirement income do you want to make predictable. And I guess when we are talking about an average benefit of $900, I want to make that predictable; and then $900 a month is not enough for the average person to live on. I am happy to have them have the opportunity to save above that and would encourage it.

So, what I want to do is keep the social security program in tact because I think it is valuable. I do not want it to turn into a system of individual accounts, and then a means tested program, because I do not trust means tested programs. I think to thing strong about social security is everybody has an interest in it. Everybody is committed to it. It is relatively stable, as government programs go, over time.

And, in terms of allowing some people to opt out, I mean, there is the obvious problems that if you are a high income person, you are much more likely to opt out because you do not get as good a deal in social security; and then you are leaving in more and more low income people, and it makes it more difficult to have a progressive benefit formula.

But, basically, I just want some portion of people's retirement income to be predictable, and my judgment is that the level we provide now through social security is relatively the right level.

MR. STEUERLE: Olivia, can I speak just briefly? I mean I do think you have got some technical issues here. I do not disagree with the nature of your question, but I mean among them are it is going to be extremely hard.

If this option is too widespread and too open, it is going to be extremely hard to predict any degree of certainty with what is going to happen, to say what happens in the remaining defined benefit system, or the defined contribution system.

If this option is badly designed, you know, you could create massive revenue and expenditure estimating problems that I do not think you would be able to resolve. And you do have to also deal with the issue, I think in fairness, to say although I favor the idea in principle, you also have to deal with the issue that I think Olivia and Syl raised too which is some people in this system, most people in the system do contribute to tax.

They are being taxed to support a progressive redistribution. You cannot sort of have some people opt out of that progressive redistribution, and other people opt into it because that also does not work. I mean if we are going to tax people to support a progressive redistribution that burden has to be fairly distributed.

So, these are among I think the technical issues you have to deal with if you are thinking about optional accounts. If it is really something you can -- a subsidy system you can opt in to over and above something else that may be a different matter.

MR. SCHIEBER: There is actually good empirical evidence on people's choices when they are given the choice to opt in or out of the system. You can look at public sector employees where they are not covered today and their attitudes about coming into the system. There is extremely strong reluctance to come into the system.

A number of years ago, I was on a commission that looked into whether or not federal workers should enter the system. And the federal unions, especially the mail carriers, the postal workers, were adamantly opposed to being covered by social security because they had their own pension system. So, you know, we have some empirical evidence on what people do if they are given the choice to opt out or to be out and stay out.

DR. MITCHELL: Just as a footnote, I would only note that the military has just been given the opportunity move into the federal thrift savings plan, and that has become a very popular additional defined contribution bit. So, there is again a piece of evidence.

MR. STEUERLE: They are opting into a subsidy rather than out of a tax.

CHAIRPERSON PARSONS: Okay. Mario, Bob.

MR. RODRIGUEZ: This is for Sylvester. Some say that we now can reform social security through personal accounts because of this year's budget balance. You remember the 1994/96 Advisory Council on Social Security, and you advocated reform of the system at a time that government faced substantial budget deficits.

Why didn't you give up on the reform at the time when the government faced these deficits?

MR. SCHIEBER: Well, in the proposal that we put together, I was part of the group that put together the large personal security accounts. It would have been a five percent account. And I have continued to argue that we should have larger rather than smaller accounts.

We acknowledge that there would be transition costs. And, in that regard, we were unique in terms of designing proposals. Some people that have designed proposals have tried to find ways to hide the transition costs. Many of the people who advocate that we should stay with the current system have tried to hide the transition costs of staying with the current system.

I think our proposal was somewhat unique in that we explicitly acknowledged this transition cost, and we actually advocated that there should be an explicit charge. And we estimated with Steve Goss's abled help -- and be careful about how much you put on him. I know how hard he works, and you can kill the guy if you are not careful.

Steve estimated that the cost of the transition in our plan would be 1½ percent of payroll roughly over a 75 year period. And so, we were going to quite explicitly levy that on people which took that out of kind of the general revenue financing issues.

And I think it is consistent with my philosophy that somehow we have to get more money into this system. At that juncture, because of the players I was willing to say we ought to mandate it. Under the current principles, I believe that we ought to devise a voluntary mechanism that encourages people to put more in. And so, that is why I have advocated that we have a voluntary contribution with matching type option.

MR. RODRIGUEZ: So, basically, what you are saying is over the long term, social security reform will reduced costs rather than introduce new costs?

MR. SCHIEBER: A funded system over time will require a much lower payroll contribution rate than a "pay as you go" system given our demographic structure, and what appear to be the inherent rates of return and wage growth rates that we have. It looks like both the economics and the demographics of our economy favor more funding, and that should reduce the payroll costs rates of financing a given level of retirement.

CHAIRPERSON PARSONS: Bob.

MR. JOHNSON: I want to give Professor Munnell one more chance to sort of answer Olivia's question, because I did not quite understand if you were saying you are absolutely, adamantly against private accounts, or you are saying you are against private accounts if the tradeoff is a significant reduction in what you call as defined benefits.

Because I am having trouble understanding why, if take an African-American worker, who has a higher mortality rate, would have an option of diverting part of his social security payroll tax into private accounts that they are going to yield a higher return over the period of his working life, and then have the ability to pass that on to his family as an asset, would not benefit from an option of having private accounts and become a part of the middle class, which we talked about here, that has a significant investment, far greater than most African-Americans in the equity market.

And I think what we are trying to do is trying to bridge that tradeoff between a certain level of continuation of defined benefits and the flexibility of seeking a higher return over the life of the worker in the market, and thereby creating solvency for the entire system. And I am just wondering if you are opposed to that concept, as long as we can reach some level of guaranteed benefits?

MS. MUNNELL: People have called me a lot of things, but never unclear. I do not want to see you --

MR. JOHNSON: I went to Princeton, so that is probably the reason.

MS. MUNNELL: Debate, cut back on social security's defined benefit promise as they are now, and replace that with individual accounts. I think that will harm people, and I think that will harm the program.

Am I against individual accounts in general? No, how can you hate individual accounts? There is nothing wrong. I do not hate 401(k) plans. I just do not want to see you cut social security benefits. That is what I do not want to see done. And I do not believe that African-Americans are going to better with individual accounts than with a defined benefit program.

Yes, you have lower life expectancy. But also, as a group, African-Americans have lower incomes and they benefit from the progressive benefit formula. So, and if you look at where most of the civil rights groups are, they are against privatization.

So, I do not think it is an answer for women. I do not think it is the answer for African-Americans. I do not think it is an answer for anybody. If you want to have individual accounts, I think that would be a good thing that there is not universal pension coverage in this country.

I think it would be great if everybody had a way to save in addition to social security. So, add individual accounts on to social security, but do not cut back on the defined benefits that we have in place now.

MR. JOHNSON: You are opposed to cutting benefits. Are you in favor of raising taxes?

MS. MUNNELL: I would sit down with you today to eliminate the 75 deficit for social security, and it is going to take some changes in flows going in, and some changes in flows going out. And there are tons of things that we could do that would not upset me at all.

I do not think bringing in state and local workers would upset me. I think that would be fair. I think making some small adjustment, technical adjustment on the CPI, which would be fair. I think extending the average period in which calculate benefits would be fair.

I think that there are tons of things that we could do that change these flows that are not that important. And it does not require that big a change, as we could solve that problem.

CHAIRPERSON PARSONS: We have Estelle, and then Gwen, and then we are going to struggle, but wrap it up.

DR. JAMES: Okay. I would like to a point that both Gene and Syl have referred to, which is the importance of increasing the labor force keeping people in the labor market for longer, especially as longevity increases.

Now, we have been warned by all sides of the political spectrum to avoid that issue, and, in particular, to avoid tampering with the retirement age. This question is going to apply to everyone.

And so, but we do face the problem that, both from the point of view of the economy, the output of the economy, and from the point of the finances of the social security system, both of these would be better off if people stayed in the labor market longer instead of shorter which is what they are doing now.

So, my question is what kinds of incentives can be build into the system to get them to do this? If we do not change the retirement age, what other mechanisms are there to create incentives for people to continue working longer, which I think many of us agree would be good for the broader economy, and would also be good for the system? That's for all three of you.

MR. SCHIEBER: Well, I think the greater dependence as you approach retirement age on defined contribution accounts really significant changes the incentives. In a defined benefit plan, if you do not retire and you are not getting full actuarial adjustments, if you do not take a benefit once you are eligible, you lose a year of eligibility.

Now, the problem you have is that not everybody is average when they are assessing their own expected remaining life. And so, people were relatively, who believe they are going to die sooner than their life expectancy, are going to be better off taking benefits earlier rather than later because there is a hedge that is built in here that they can take advantage of.

In the defined contribution type arrangement, by deferring retirement a year has two effects. One is it gives you an additional year of work and contribution into the system, so your account grows. It grows because your contribution grows because of the interest, and it shortens the life expectancy period over which benefits are going to be paid, so you are going to get a higher year-in, year-out annuity in retirement.

So you are going to get a higher year-in, year-out annuity in retirement. So, there is really some pretty strong incentives in these types of plans to encourage people to keep working. Whereas, there are incentives in defined benefit plans that encourage people to require at a given point.

If you look at a country like Sweden, Sweden has stayed with a fairly large social security program, but they converted it from a defined benefit plan to a notional account and defined contribution plan much like the cash balance plans that employers are putting in in the United States here now except it is now funded, whereas, these are funded.

They allow people to retire at age 60, but they give an actuarial adjustment if they stay in the plan longer. So, people are now putting in an additional year of contribution. They are getting an additional year of interest accrual if it is on a notional account, but the account is growing just the same as though it were funded, and they have got a shorter period over which -- so it has drastically changed the incentives for people to retire.

And it has done another even more favorable thing, I believe, for policy makers. It has completely taken off of the table for the policy makers telling people when they should retire. People now make up their own mind when they retire. And if the system does not have enough to fund benefits because life expectancy is expanding, life expectancy is automatically going to adjust the annuities.

So, I think some of these things are so difficult, and we have seen here the discussion, the debate about retirement age is so ugly we ought to get it out of the -- we ought to get it off the table, so we can solve our problems instead of creating an environment where we use these things as schedules to beat each other in the head. I almost said something bad.

MR. STEUERLE: Estelle, I am glad you asked a question on something besides individual accounts. In fact, my great fear for this commission is that it is focused on individual accounts.

And, by the way, both sides of the debate have such a focus on this that this is sort of like focusing on the hind of the dog. I am reminded of a dog pound owner in Kentucky who allegedly wanted to get people to buy more dogs and heard about the world wide web. And he kept taking pictures of these dogs, thought that would be cute, but he kept taking them from the behind.

And, first, people said, oh, that is not selling many dogs. So, then he and his wife decided to adjust the thing. They said, well, let's exercise these dogs and they will have sleeker behinds; and then, they said, well, let's put pants on these behinds and that will sell the dog. And it just did not do much.

And it was not until they finally turned the dog around that you saw the face, and the body, and the whole dog that you saw what it didn't -- and my bottom line is individual accounts are the hind of the dog. They ain't the tail, but they ain't the dog either.

And if that is the focus of this commission, I do not think -- I just do not think it sells. Even though I favor them, it is not the main issue of social security. Social security faces a labor market issue. If we are going to be honest with the public, it is a labor market issue that is causing the shortfall. It is the shortfall of workers to retirees that is forcing the issue.

Yes, saving has been an issue throughout the history of social security, but the shortfall we face is a labor market issue. And to go to the public and say we can solve a labor market issue with a saving solution is extremely risky. We have never been able as a government to mandate saving because individuals can offset anything we do.

Now, to the question of what we can do on the labor market. As I said, I think we should increase the earliest retirement age. If you are not willing to go as far as I am, you should at least index it for increases in longevity, and perhaps some past increases in longevity.

The other thing to do is to move benefits a little more on the tail end rather than the front end, because a lot of people are misled as to the level of benefits they have. They look at the benefit they get when they are 62. In the retirement, if you take out the disabled, most people are now retiring at age 62 on social security.

They look at that benefit and they do not realize that they, especially if they are married, they and their spouse on an average are going to live 25 years, some 30 years, and that benefit level at 62 is not going to mean the same in an economy 30 years down the road that has growth, and the cost of nurses have grown by a few percent per year for 30 years compounded.

Their private pension is probably not indexed if they have a defined benefit plan, and they end up much, much worse off. And so, I think the signal, honest signal up front, is less benefits early and more benefits late. You could do that by giving, figuring out the lifetime benefit you want to give people which is I think the right way to do it.

You do not start with the annual benefit. You start with a lifetime benefit you want to give them, and then figure out how you want to give that. You could give less up front, more later. You could wage index it, if you are willing to cut back on the up front benefit enough, or you do not want to wage index it, wait a few years, and bump the benefit up a little bit.

But do something to provide more of an incentive to work at those younger ages when people are capable, and then you do not have to worry so much about the fact that you are providing a higher benefit down the road for the same lifetime benefit later when they are less capable of work in the first place. Those are the tricks I think you have to play with on changing labor incentives.

DR. JAMES: But if you use that mechanism you run into distributional issues again because you are giving less money in the earlier years, and low earners are more likely to die before they reach the later years.

MR. STEUERLE: But, you know, changing somebody from getting, say, 20 years -- say one group is likely to die, has 10 years of support, and another group 20. They are cutting it back to 19 and 9, or 18 and 8. That does not make a lot of difference in how well off they are.

And this answer is to you, Mr. Johnson, as well. Most minorities are really losing social security because they die before they even get to retirement age. So, adjusting retirement age is not one of the issues that mainly effects them at all.

The way you are going to solve their problems if they are going to live to retirement age is bumping up something like a minimum benefit. The change you make in the retirement age does not make that difference on that calculation. You have got to go to other parameters to deal with that issue.

MR. JOHNSON: Wouldn't private accounts add to their likelihood of getting a higher return during their working life if they are going to retire anyway?

MR. STEUERLE: It is about balance. The study I did with Lee Cohen at Social Security, and some others, show that in terms of rates of return, minorities had, at least low income minorities had some of the -- about the same rate of return under some analyses as other people.

What happened is the distributional part of the social security formula and the benefit formula roughly offset the mortality differences, so it depends. I mean that does say that the system that purportedly redistributes to low income people does not do as much as we said it does.

On the other hand, you do not want to --- that distributional formula either. You have got a balancing act

I think to pull here.

DR. JAMES: Besides changing the retirement age, what other incentives?

MS. MUNNELL: Well, we are doing something good already which is phasing in fully the delayed retirement credit. So, we are getting out at least the negative incentives.

And I would support Gene's notion that as you move the "normal" retirement age up to 67, that it might be appropriate to consider moving the 62 age as well, or else you are going to have people with very, very low benefits who opt for early retirement.

CHAIRPERSON PARSONS: Gwen.

MS. KING: Maybe I am just getting cranky because it is lunch time. Gene, I am just a little bit grateful to you for all that you have done, and a little bit curious about the distinction you made about retirement age and African-American males, who do not live to retirement age, but you persist in saying we should move that age out.

So, and I draw the distinction very clearly that African-Americans does not necessarily mean low income. But I think that is probably something, a subject I would rather not shoot a question at you and have you rush through an answer; something, if you may, if you will, I would like to talk to you about at some point in the future, and we can do that.

But, clearly, I do not necessarily agree with that perspective. But there is something on the record, and, again, maybe I am just grumpy, but it seems to me that we had an earlier discussion about lower wage workers and the importance of moving them out of the work force and keeping the "more valuable higher wage workers."

Syl, here we go. I have got to tell you --

MR. SCHIEBER: I knew somebody was going to get to it.

MS. KING: And maybe I misunderstood what you had to say, but I think about all of the people who are in charge of security machines at airports who are not necessarily the highest paid workers. And I think about people who care for our children and drive our school buses, and all of those others who are lower wage workers, and I see them as very valuable people.

And I know a lot of mid-managers, my dear, that I would have asked to leave early on when I was in the work force, and we would not have lost a step at all. So, maybe that too is the subject of a longer discussion, and I hope I did not hear you correctly.

And for all of you who think that it is important to continue to give contracts for our security and for transporting our children to the person who gives you the lowest bid, I think perhaps we all need to rethink that way of moving. But tell me I misunderstood you.

MR. SCHIEBER: Well, anytime you are designing a retirement plan, there is a whole variety of dynamic variables that are moving around. By the very fact that you are giving people a wealth accumulation vehicle that converts into a stream of income at some point when they quit working, it is going to have incentives that encourage people -- that give people encouragement to quit working, and to spend the rest of their life in what economist call "leisure."

Now, it may not be all leisure. We know that. I was not saying we should encourage lower income people to quit early. What I was saying is, as you deal with these tradeoffs, I am not as worried about structuring a system that might give lower income people the opportunity, or not have strong as incentives to keep them in the labor market, as I think that it is important to give higher income people the incentives to stay in the labor market.

Yes, these people are valuable, but we have told them through our market mechanisms throughout their whole life that they are not nearly as valuable as other people.

In purely economic terms, and I am not putting a dollar value on anybody's life. I am talking about the rate of return they get for an hour of labor.

So, I think as you deal with these tradeoffs people with the ability to make a major contribution to the economy to this society ought not be encouraged to withdraw from making that contribution prematurely.

MS. KING: Whether they are high income or low income?

MR. SCHIEBER: Well, I think you are going to have some incentives in a retirement plan, no matter what, that give some encouragement to people to retire, to withdraw. All I am saying is I am not as bothered if there might be a little more incentive at the lower income levels than at the higher income levels. I think it may be the tradeoff you have in a plan design.

I think we also have to be careful, if you look at people who earn lower income levels throughout their working careers, they have often had a much harsher experience in the labor market than people who earn a lot of money. And to design plans that almost require that they stay in the labor market for an extended period of time may border on being inhumane.

MS. KING: Like lengthening the retirement age?

MR. SCHIEBER: There are certainly some people who work at physical jobs, who work out in elements over most of their career, who work in back breaking kinds of activities even inside over their whole career. By the time they get to be in their early sixties, their ability to continue to do those kinds of things become somewhat limited.

And I think we have to be a little bit careful about forcing them to stay in the labor market for some significantly extended period of time, because they may not be able to continue to perform.

And, again, it comes down to these very difficult tradeoffs that you have when you are designing a retirement plan, and every word deals with them day in and day out. I mean, if you think about it, even social security with which you have some experience as a manager, social security last year, and I believe the year before, ran early retirement incentives for parts of their work force.

Now, here is kind of an irony. You had social security which was raising the retirement age, the normal retirement age for all of the citizens, or the overwhelming majority of citizens in the United States at that juncture, encouraging their own workers to retire early, because there were some very practical things that they were trying to deal with.

So, you have got to look at these tradeoffs, and we are kind of forced at times to try and come up with one size fits all. And we know that one size does not exactly fit all, so you are forced to make the tradeoffs.

CHAIRPERSON PARSONS: All right. Syl, we are going to have to bring this to a close. Have you got one last sort of silver bullet, Gene?

MR. STEUERLE: Just very quick. The issue on minorities and dying early is not really an issue so much as social security versus individual accounts. It is an issue of annuitization. Once people either voluntarily or mandatorily are forced into annuities, the people with shorter lives lose out in that type of system.

You will face the same issue even with individual accounts. Because if you want to guarantee that people have adequate income in retirement and they are low income, you have individual accounts and you want to depend on that money to get some minimum benefit, you may be led either towards forced annuitization, or you may want them voluntarily to take an annuity, in which case they get a low return too.

So, the issue actually does not go away in either case. You have got to deal with the question of whether you are going to annuitize or not, whether you are in the social security world, defined benefit or a defined contribution world.

MS. KING: I appreciate that. Thank you.

CHAIRPERSON PARSONS: I was going to say. You get the last word, because you are the lady.

MS. KING: Well, I would only offer to Eugene -- and, again, I would love to continue this discussion -- that the attraction of having an account which you can leave to your beneficiaries, as most of us do with our savings plans, is something that it may just be a dream, but it is something that people are thinking about.

And when I hear the younger people talking about how important it would be for them because they can see the value over a longer period of time, I am still convinced that perhaps it might be a worthwhile way to go.

CHAIRPERSON PARSONS: Okay.

MS. KING: Anyway, since I have the last word, ha, ha.

CHAIRPERSON PARSONS: Thank you. This is another outstanding panel. I am not entirely sure I got the part about the dogs with the pants. But other than that I thought it was quite illuminating, obviously provocative, and helpful to the commission. We appreciate it very much.

We are now going to take a short lunch recess, and we will be back here about quarter after, twenty after one, for the next panel. Thank you very much.

(Whereupon, the meeting was adjourned for a luncheon recess at DR. COGAN:42 p.m.)

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

(1:35 p.m.)

CHAIRPERSON PARSONS: We have got to apologize to our distinguished panelists for being a little late in getting going again. But it certainly does not indicate any diminution in our enthusiasm for hearing what you have to share with us this afternoon. So, let me introduce the panel.

PANEL III: OTHER PERSPECTIVES ON SOCIAL SECURITY

CHAIRPERSON PARSONS: This is the third panel we have for today, and one we are calling, "Other Perspectives." We have heard from some representatives of generation X, as they like to call themselves, and some so-called experts on the system, and now we are interested in getting a broader view from other perspectives around the points on the compass.

We have with us Mr. Michael Tanner, who was with the Cato Institute. I think he is the director of Health and Welfare Studies for the institute, who has done quite a bit of thinking about social security reform.

We have got Vincent Sombrotto, who is the president of the National Association of Letter Carriers, and will give us some perspectives from the labor point of view. Mr. Sombrotto is also a member of the Federal Thrift

Retirement Investment Board. So, he has lots of perspective on this subject.

Mr. John Goodman, who is the president and founder of the National Center for Policy Analysis, who also has spent a lot of time kind of thinking about this subject, personal accounts, in particular.

And, lastly, it was Mr. Michael Sherraden, who is a professor from Washington University, and has an interesting perspective on low income people and how they respond to the opportunity to accumulate wealth, which is something we have talked about here, and it would be good to get some academic analysis and thoughtfulness under our theories and presupposition. So, we look forward to hearing from you.

The ground rules are that we have asked all of you to submit a written submission. And we would ask you to make a brief, five or so minute presentation to the commission; and then we will go into what I know will be a lively question and answer session.

And just so we are all on the same time frame, we are going to conclude this within an hour after having started. We will end a little late, but we will end about 3:30 or so -- excuse me, 2:30 or so. So, with that, Mr. Tanner.

by Michael Tanner, Cato Institute

MR. TANNER: Thank you, Mr. Chairman, distinguished members of the commission. I want to thank you for this opportunity to testify today. And I want to thank you for your willingness to undertake the difficult work of tackling an issue as controversial as social security reform.

I think it is an unfortunate statement about current political life that you have had to suffer so much unfair criticism and such vitriolic criticism for simply daring to tell the truth about the need to reform social security.

The Cato Institute's position on the need for social security reform is pretty well known. For more than 20 years, we have attempted to educate the public on the need to transform social security from a "pay as you go" program to one based on real savings and investment.

And, in that regard, we have conducted a wide variety of research over the years. I know you have all been provided with volumes of that research, probably more than you care to read in any one sitting. So I will spare you all of that today, and just try to set out for you if I can what I think should be some guidelines for reform, five principles, if you were, for what I hope will guide your efforts for reform.

The first is that solvency is not enough. I understand that none of us would be here today is social security were not facing a serious financial crisis. And I think the commission is to be commended for having point out the depths of that problem and the fact that it begins in the year 2016 when social security begins to run a deficit, an issue for which you have been much criticized, but for which the commission is correct.

But solvency is not the only issue when it comes to social security reform. If all we cared about was solvency, it is possible to raise taxes enough, or to reduce benefits enough to keep the program actuarially solvent for whatever period of time you want.

But the social security is facing many additional problems beyond solvency. Social security is providing a poor rate of return to young workers, and that rate of return is getting steadily worse. Workers get a far worse rate of return from social security than they can hope to get from private markets.

And, in fact, from many young people, they can actually expect close to a negative rate of return, or a zero rate of return from social security. A social security form that is adequate must address this issue and provide higher retirement benefits and a better rate of return for young people.

The current social security system contains a wide variety of inequities. It penalizes women who work outside of the home through the dual entitlement rule. It penalizes low income workers. It penalizes African-Americans and other minorities with shorter life expectancies.

And, most of all, under the current social security system workers have no ownership of their social security benefit. They have no right, contractual, legal, or otherwise to social security benefits, meaning that they are entirely at the mercy, as it will, of the government to decide what it is that they will have to retire on. They have no ownership that they can pass on to their heirs. They have no way to accumulate real wealth.

Social security reform must address all of these issues. It cannot simply focus on how can we prop up the current system a little bit longer? How can we eke it out for another few years? We must come up with the best system for Americans retire on.

The second principle I would suggest is that individuals not government should invest; that if we decide that allowing investment in real assets is the way to go to reform social security, it should be done by individual workers not the government as a whole.

To allow the government to invest is to allow political entry into our economy in a way that I think none of us would enjoy. One simply has to look at the history of other foreign countries as documented by the World Bank to see the problems there, or within our own country to look at the experience of state, local, municipal governments and their pension funds.

Forty-four percent of state and local pension funds contain some sort of mandated investment requirement. You must invest in in-state industries, or renewable energy, or so forth.

Approximately, 25 percent of state and local pension funds have some sort of investment restriction. You cannot invest into tobacco stocks, or companies that make nuclear weapons, or companies that do not have union contracts, and so on.

To allow the government to make these investment decisions is to invite every social policy decision to become a question of retirement security. After all, the day that the federal government invests in, say, Walt Disney stock, I would imagine Jesse Helms and Barney Frank going to the floor of Congress for a debate that may never end.

The third principle is that we should maximize consumer choice. I would urge the commission not to limit individuals to simply one fund investment options, or two, or even three.

Now, while it is likely that initially they are going to have to have a single fund, at least until reconciliation can take place, and that after that you may wish to have a limited variety of investment options.

At some point, I would urge that once accumulations in an account have reached a particular level that you deem adequate, that individuals be able to open their investment decisions to a wider range of options.

I think this is important for the efficient functioning of capital markets, and I think that it also avoids any prospect of government decision making in the investment process.

The fourth principle I would urge is simply called, "Don't touch grandma's check." I think all of us can agree, and it is part of the president's charge to you that we should not be touching the benefits of retirees or near retirees.

Now, in order to do this and make the transition to a system of individual accounts, it will require input of general revenue. And I think most advocates of individual accounts recognize that some measure of general measure is going to have to be transferred into the program in order to make this work.

The Cato Institute would be happy to provide ways that we think that this can be done without raising taxes. However, I would point out that whatever of my own money that you put into general revenue to transition to a system of individual accounts, over the long run it will be less money than is necessary to prop up the existing system, a system which fails to meet the earlier criteria I was talking about.

Finally, a last principle I would suggest is that more privatization is better than less. If the goals of the commission are to go beyond solvency and to look at things like how can we allow low income workers to accumulate wealth, and that wealth be allowed to be passed on to their heirs, two percentage points accounts simply do not make it.

For a minimum wage worker, or someone earning $15,000 or $20,000 a year, two percent of their income is not going to allow them to accumulate a substantial nest egg. And if we are attempting to create national savings, then more national savings increase is better than less national savings increase.

And if we know that you get a higher rate of return from individual investment, then more individual investment is better than less. One thing I would like you to consider if you are unwilling to go, as I would like sort of the "Full Monty," and allow individuals to invest all of their funds which is unlikely; or even a substantial portion is to allow at least low income workers to invest a substantial portion of their money.

This can be done either in a graduate method, say, allowing 6 percent of the first $20,000, and 4 percent of the next $20,000, and so on; or it could be done up to a flat dollar amount which I think would probably be the most administratively simple, say, up to $2,000 a year that you could put into an individual investment account.

This would have the effect of coming close to full privatization for the lowest income individuals while upper income individuals would have a much smaller portion going into individual accounts. And, after all, they are not depending on social security, so for them it is not as big a deal to be able to accumulate this wealth.

That said, I want to just close with this. In the wake of September 11th, it perhaps seems trivial to be talking about social security with all of the things that have happened. But all of the problems that effected social security before September 11th were still true on September 12th.

And something else was true as well, the attack that we suffered on September 11th really was an attack on our way of life and our belief in individual dignity of every person. And, in a sense, when we look at social security, the current system requires people to remain dependent on the government.

A system of individual accounts is a system consistent with our belief in individual dignity. It is a system that allows people to own wealth and accumulate it. And I can think of no finer tribute to our way of life and reputation of the attacks upon it than to move to a system that guarantees that kind of dignity for every individual. And I would urge the commission to move forward with its work. Thank you very much.

CHAIRPERSON PARSONS: Thank you, Mr. Tanner. Mr. Sombrotto.

by Vincent Sombrotto, National Association of Letter Carriers

MR. SOMBROTTO: Thank you, Mr. Chairman, and distinguished guests of the commission. I am glad you were wearing your clothes when you talked about the "Full Monty."

My name is Vincent Sombrotto. I am president of the National Association of Letter Carriers, AFL-CIO, and a senior member of the Executive Council of the AFL-CIO as well. The union I am proud and privileged to be the president of represents 312,000 active and retired letter carriers that worked for the United States Postal Service.

I appreciate the opportunity to appear before the commission today, especially during this difficult time for all of us, and it is a difficult time. And God bless America that we have a government that protects all of its citizens.

In addition to being NALC president, I serve as chairman of the Employee Thrift Advisory Council. The council advises the Federal Retirement Thrift Investment Board, an independent agency of the federal government that manages the thrift savings plan, the TSP, as often described as a 401(k) for government workers, and has some 2½ million participants.

In actuality, it is part of a three-tiered retirement plan that also includes a defined benefit pension -- which also includes defined pension benefit and social security. As those who know, we can tell you, I have worked hard to convince every letter carrier in America to invest prudently through the federal thrift savings plan, and most of them do.

Nevertheless, the NALC would oppose any proposal to divert existing FICA or federal insurance contribution taxes into individual accounts because the risks are too great and the costs are too high. The TSP is designed, that is, the thrift savings plan, is designed to supplement the guaranteed benefits provided by social security in a basic annuity program.

All worker investors, whether they are in the private or public sector, have been reminded of the risks of stock market investment in recent months. The 1990's bull market has come to a definite end, and the value of Standard and Poor's 500 stocks has declined significantly since the spring of 2000.

Federal employees have seen their TSPC fund, which is their equities fund, investment fall by nearly 27 percent alone this year. Had portions of their social security funds had also been invested in stocks, their losses would have even been greater.

Finally, as many other observers have noted, there is the problem of paying for an individual investment plan that would require one of three choices: raising taxes, using funds from any long-term budget surplus, or cutting benefits.

With tax increases seemingly off the table, and given recent events to the uncertainty of budget surpluses, we need to know how to pay for the transition to individual accounts, and what benefits would have to be cut. NALC could support a so-called social security plus program structured along the lines of the thrift savings plan with Social Security Administration handling administration of individual accounts invested in a limited number of index funds.

The additional funds would belong to individual contributors and could be invested by private sector managers under contract with the SSA. A social security plus program would actually boost national savings and would not endanger the social sophisticated communication system -- oh, excuse me.

Did you take a page away from me here? Oh, on page 6. That full monty has got me now.

The low cost of administrating the TSP accounts, which is less than six basis points, stems from the federal government's unique capabilities which include computerized payroll, sophisticated communication systems, and professional human resource managers.

However, while these approaches may address the savings crisis in the United States, they do not address the issue of solvency of the social security trust fund. According to the latest report of the social security trust fund, relatively modest changes could restore actuarial balance to the system. Revenue increases or benefit cuts or some combination of both would be required.

The commission could reject the notion that taxes can never be raised to overcome the projected shortfall of social security. Nobody, including the members of the NALC, including myself, want to pay more taxes. However, if we had to, I believe we can afford to modestly raise payroll taxes.

Other changes such as removing the cap on wages subject to payroll taxes, or subjecting investment, and using general revenues or a portion of the federal budget surplus to bolster social security should also be considered.

Finally, rather than establish individual accounts, the trust fund could make collective investment in private sector assets on behalf of all social security recipients and participants. Trust fund diversification is fundamentally different from replacing social security benefits with individual accounts.

It is much more cost-efficient than individual accounts, and retains the unique risk and cost-sharing features of social security, features that are not provided by an employer-based pension system.

Although I understand some are concerned about the federal government only, the private sector assets, and injecting politics into the capital markets, the 14 year record of the thrift savings plan shows that it is possible to avoid this pitfall.

I would like to make one last point. Letter carriers and other public sector retirees are the victims of particularly onerous flaws in the social security system. Under the windfall elimination provision, the government pension officer, public sector annuitants can lose some, if not all, of their social security benefits whether they be spousal benefits or through their own work in the private sector.

We believe that Congress should act immediately to address these issues. And, quite frankly, many retirees cannot afford to wait to see action on any proposal by this commission with regard to these issues.

However, should no action be taken prior to the issuance of a report by this commission, we strongly urge that you address these anomalies in the current system. Such a move would not only provide public servants with the benefits they have earned, but also would provide much needed stimulus to our economy. These are people who could use and will spend these benefits if they were made available to them. Thank you.

CHAIRPERSON PARSONS: Thank you, Mr. Sombrotto.

Mr. Goodman.

by John Goodman, National Center for Policy Analysis

DR. GOODMAN: Thank you, Mr. Chairman, and members of the commission. Over the last several years, there have been a number of reform plans put forth by various individuals. There was a Graham-Dominici plan; there was an Archer-Shaw plan; there was a bipartisan plan in the House, and another one in the Senate; and then there was a separate Moynihan-Cary plan.

At the NCPA, we asked this question. What if we went through all of these plans and picked out what we thought were the most attractive features of every one of them and discarded all of the rest, and put it all together in a hybrid plan. If we did that, we thought we would have the most persuasive case that one could make for setting up a system of private accounts, and that is what we proceeded to do.

We came to the conclusion that if people could put 2 percent of their payroll tax, or 2 percentage points in the private account every year over their work life, that by the time today's teenagers reached retirement age, about mid-century, that they would be able to pay more than half of today's promise of benefits under current law, promise under current law.

More than half of those benefits would be paid from the private account. And, furthermore, the government could guarantee the total benefit, could guarantee that people receive exactly what they are promised under current law with a payroll tax no higher than the one we have today.

All this assumes that the funds are invested properly. And I hope that we will be able to spend a little bit of time talking about what it means to invest these funds properly.

But it seems to me that if government is going to guarantee the result, the risk preference that should count is not the risk preference of the individual worker or retiree, but rather the risk preference of taxpayers, or if you like of society as a whole.

If the taxpayers are guaranteeing the result, then the portfolio that should be selected is not the one preferred by the individual worker or the retiree, but the portfolio preferred by society as a whole. And what is the portfolio preferred by society as a whole, the one they are now holding, or if you like the market as a whole?

So, if the funds are invested in portfolios that reflect broadly the market as a whole and kept there, even during the retirement years, then we can achieve these objectives. I hope I have an opportunity to talk about why that is a desirable way to do this.

We found that we could adopt some other attractive features in this plan. We could have earnings sharing, dividing the contributions between husbands and wives, and therefore eliminating a lot of the inequities that exist, especially for women under the current system.

We found that we could make as part of our plan the provision that dependents would inherit, or heirs would inherit the PRA of someone who died before reaching the retirement age provided that the PRA account is not needed to pay dependents benefits.

We found that -- and this won't happen soon -- but on down the line for, perhaps, some of today's 20-years-olds, and certainly for some of today's newborns that if their funds accumulate to the point where they can annuitize their promised benefits that we can allow them to take any excess funds in their accounts and use them for whatever personal reason they wanted to put them to, or to invest them at will.

We relied upon a model developed under the supervision of Professor Tom Saving, a member of the commission to do some simulations. And one of the projects that we made was that today's 20-year-olds should be able to fund 52 percent of their promised benefits with these accounts. Today's newborns should be able to fund two-thirds of their promised benefits with the private accounts.

These simulations assume some injection of infusion of funds from general revenues similar to the way that the Graham-Dominici plan worked. We assume that there is a larger capital stock due to the expanded PRA accounts, and that we would therefore have higher corporate income taxes because of this higher capital stock; and therefore we recapture some of this for social security; and therefore fund the deposits.

We also assume very low administrative costs. And to get administrative costs low, we assume that social security does the record keeping, and even the depositing of the money in the accounts for small businesses.

But we are perfectly happy to see larger companies that now have 401(k) plans make deposits directly if they are willing to bear the excess administrative costs. But we think administrative costs for the funds themselves ought to be kept to 20 basis points or .2 percent.

Finally, we think this should be voluntary. But for those who stay within the current system, we think that the set of benefit reforms outlined in the Moynihan-Cary proposal, and several of the bipartisan proposals is appropriate.

And what that means is that we should go ahead and raise the retirement age in future years, adjust COLA payments, and make such other changes as were recommended for those who stay within the current system. But if you opt for the private account, if you are willing to have your funds invested, and pay as much as possible your own way, you are guaranteed all of the benefits under current law. Thank you.

CHAIRPERSON PARSONS: Thank you, Mr. Goodman. Mr. Sherraden.

by Michael Sherraden, Washington University of St. Louis

DR. SHERRADEN: Thank you, Mr. Chairman, members of the commission, for inviting me to give this testimony. As you have requested, I will speak about assets and the poor with implications for individual accounts. I have spent a good part of the past 15 years thinking, studying, and writing about assets and people of low income.

From the outset, I suspected that sooner or later this work would connect with a discussion about individual accounts and social security. Today is apparently that day. I am glad to have this opportunity to tell you what I have learned.

Income support has been the signal idea of the welfare state of the 20th century. It is an industrial era idea. The goal has been to support people when they did not have income from industrial labor markets. The primary form of income support for the non-poor has been social insurance, and for the poor it has been means tested transfers or welfare.

As the members of this commission know very well, income-based policies comprised most of social policy, and social policy comprises most of federal spending. On reflection, it is remarkable that one idea has defined so much public policy.

The world has changed considerably since income-based policies were initiated to be sure people still require income security when they are not employed, but income alone is no longer enough. The labor market of the information age requires that people have resources to invest in themselves throughout their lifetimes.

In effect, people will require greater control and flexibility of their own social policy decisions, far beyond retirement security. Also, policy should promote accumulation across generations so that more children begin life with at least some financial resources. Asset accounts are better suited for this.

Although assets will be increasingly important for well-being, many Americans are asset poor. In 1998, two out of five U.S. households had a total net worth minus their home equity of less than $5,000. Two out of five did not have enough liquid assets to live at the poverty level for three months.

Racial differences in asset holding and net worth are great. The median net worth of whites versus African-Americans is 11 to 1. As a comparison, the figures for median income are 1.6 to 1. The pattern is much the same between whites and hispanics.

There is reason to believe that a shift to asset-based policy is underway. Around the world, it is uncommon to encounter a new or expanding system of social insurance, but very common to find a new or expanding policy based on asset accounts.

In the United States, this can be seen in the introduction and growth of 401(k)'s, 403(b)'s, IRAs, Roth IRAs, the federal thrift savings plan, educational savings accounts, individual training accounts, college savings plans in the states, and proposed individual accounts and social security.

Some of these are public, and some are called private. But it is important to bear in mind that the private sector plans are typically defined by public policies regulated by government and receive substantial subsidies through the tax system.

All of these asset based policies have been introduced in the United States since 1970. Overall, asset accounts for various purposes are the most rapidly growing form of domestic policy, and it seems likely that the shift to asset based policy will continue.

Unfortunately, the shift to asset accounts is considerably more regressive than income based policies. The reasons are two-fold:

- First, the poor do not participate in the asset based policies that currently exist; and
- Second, asset based policies operate primarily through tax benefits or tax expenditures that benefit the poor little or not at all.

In other words, asset based policies have the potential to exacerbate inequality, and indeed are doing so, because the poor are being left behind. To illustrate, in 1999, two-thirds of tax benefits for pension accrue to the top 20 percent of households while only 2.1 percent went to the bottom 40 percent.

As asset based policies are created, a major challenge will be to aim for inclusion. This is especially true for policies that purport to be universal. The goal should be to bring everyone into the system with adequate resources in their accounts for social protections and household development.

Recent innovations that match savings for low income and low wealth households such as individual development accounts are a step in this direction. IBAs demonstrate that the poor can save and benefit from progressive asset accumulation.

The data show that poverty level IBA participants have saved on net $25 per month. These savings are matched at 2 to 1 on average, so the accumulation is about $75 per month, or about $900 per year. It is interesting to note that the saving amount in IDA programs is not statistically related to income.

This is, perhaps, similar to how people save in 401(k)'s. They save a certain amount each month because those are the rules and expectations. Many of the poor can do this if they have opportunity and incentive.

Why not give the poor at least as much subsidy for saving as everyone else?

The challenge is to incorporate this principal into the large-scale asset based policies that exist and the new ones that are being proposed. Social policy for the poor has been focused almost exclusively on income. The assumption is that income transfers will support a certain level of consumption. This is a nobel and necessary goal, but it is not enough.

Even for the vast majority of households, the pathway out of poverty is not through income and consumption, but through savings and accumulation. Simply stated, not many people manage to spend their way out of poverty.

When people begin to accumulate assets, their thinking and behavior changes as well. Accumulating assets leads to important psychological and social effects that are not achieved in the same way or degree by receiving and spending an equivalent amount of regular income.

These behavioral effects of asset accumulation are important for household well-being. They are likely to include more long-range planning, better care of property, increased learning about financial affairs, and increased social and political participation at the local level.

To mention only a few examples from research:

- There is convincing evidence that controlling for other factors, home ownership is associated with residential stability, maintenance and upkeep of the home, and social and political involvement in the community;
- There is convincing evidence that controlling for other factors, home ownership and financial assets are

associated with marital stability and reduced domestic violence;

- There is convincing evidence that controlling for other factors, home ownership and financial assets are associated with higher educational attainment in children.

The appendix to my testimony provides a review of research on effects of assets.

Based on the above information and perspectives, I recommend the following:

The first policy priority should be to bring the poor into 401(k)'s, IRAs, state college savings plans, and all of the other tax advantaged asset based strategies that now benefit the non-poor but not the poor. Because they do not receive tax benefits, the poor should receive direct deposits into these assets accounts.

The principle should be that public expenditures for asset accounts should benefit the poor at least equally in dollar terms. If a new policy system of individual accounts is to be created, it should be above and beyond the current contribution and benefit structure of social security. The reasons are three-fold:

- First, social insurance provides important protections that cannot be replaced by individual accounts. The goal should be not to reduce social insurance but to increase asset building.

- Second, a good case can be made for saving an asset accumulation above and beyond the current social insurance structure. Household savings are low, and people save best in contractual savings systems. One can imagine American workers saving an additional two or more percentages of pay with progressive government subsidies.
- Third, removing a portion of the current social security revenues will exacerbate the challenge of long-term financing. It is better to leave that system in place and build on top of it. If there are to be individual accounts carved out of the current social security, these accounts should be progressively funded. So far, no proposal has been adequate in this regard.

The proposal for matched savings in H.R. 1793, that is Kobe and Stenholm, is very good. It is very good to see, because it highlights the importance of asset subsidies for the poor, but it is not nearly sufficient. The policy should include an initial deposit into the accounts of low paid workers and government matching funds beginning with the first dollar deposited.

In conclusion, the United States and most other nations are likely to have expanding policies of individual accounts. The biggest issue before this commission is not individual accounts outside of social security or within it.

The biggest issue is whether the poor are included in these policies, and whether they have sufficient asset accumulations in their account for their social protection and household development.

Taking the long view, I am reminded of Hugh Hecklo's observation of the welfare state of the 20th century. If there has been a direction of our century struggle, it seems to have been mainly a question of expanding presumptions of inclusive, of assuming that more people matter and they matter as equals.

Trends at the beginning of the 21st century raise serious questions about inclusiveness. The pronounced shift toward asset based domestic policy in the United States has excluded the poor. If new asset based policy is being considered in relation to social security, the challenge will be to see that the poor matter as equals.

This is not only about fairness, but about enabling all Americans to become stronger and more productive citizens. Thomas Jefferson was essentially correct about the positive effects of property holding. It is time to extend this vision to include the entire population. Thank you for considering my testimony.

CHAIRPERSON PARSONS: Thank you, Mr. Sherraden.

All right. Tom, you wanted to kick it off.

QUESTIONS AND ANSWERS

DR. SAVING: I feel I ought to say something. Because although I appreciate very much the testimony here, and I found it very interesting, I often say that because Dr. Goodman used a model that I developed, I should disassociate myself. Because I had nothing to do with either preparing or doing any of the calculations in his testimony.

I was afraid that there may be a misconception. He did not mean that to be a misconception, because he clearly specified that he had used a model that I had a part in writing some two years ago in doing these calculations. But I am not involved in any way in his testimony.

CHAIRPERSON PARSONS: You have no questions about any of it either? John.

DR. COGAN: Thank you, gentlemen, for coming. Question for Mr. Goodman. John, you and I both know that social security does not provide any guarantee right now, no legal guarantee, there is no economic guarantee, and you have proposed a new system. And you say that under the new system you would provide a guarantee. Can you tell me how you go about achieving that guarantee?

DR. GOODMAN: I was not talking about a guarantee different from the one that is in the current law.

DR. COGAN: That's enough. Michael, can I ask you a question?

You had intimated that under a proposal that you would favor, the government would continue to collect contributions for personal accounts, and that after a reconciliation then the government would somehow invest them for people, and if their accounts got big enough, then eventually individuals would be able to direct their own accounts to, or direct their own contributions to private fund managers. I think I have got it right.

The question I have is why don't we just allow individuals to take their payroll tax contributions that they want to contribute to personal accounts, and if they have a fund manager that meets some specified criteria, and they have a fund that meets a specified criteria, why not let them invest those funds directly and not send them to the Internal Revenue Service?

MR. TANNER: Actually, I would think that that would be the best alternative. And to the degree that you can build on existing structures for companies that have, for example, 401(k) programs, and so on, I think you should build on that. The problem exist primarily with small businesses that do not have such programs today who file their social security statements primarily on paper.

And you have this problem within the current system, whereby, the money is essentially deposited on a lump sum basis and not reconciled with the W-2's for some 18 months after the money is collected. And if you are investing in a system in which you might have significant fluctuations if individual's accounts are not credited the day before the market goes up 200 points, people are going to be very unhappy. So, you have got to find some way to deal with that.

I think for companies that have operations in place that can do that, you should let them do it. For those that do not there should be some sort of default system, perhaps, a money market fund, something that will hold that money until reconciliation takes place.

Thereafter, I think people should be able to invest in as wide a range as possible if you decide that initially that is going to be only a few funds. I think certainly after people accumulate a significant amount of assets, they should be able to move beyond those few funds.

I am concerned that as far as the efficiency of capital markets go, that directing all money into an index fund, or a small number of index funds does ont allow capital to go to where the market decides it is most efficient, and that that over the long term could lead to distortions.

You also do not want to end up in a situation such as the Canadian savings program just ended up in where they had a mandate that you had to invest in an index approximating the Toronto stock exchange. While as Nortel went up in value, it began to dominate the Toronto stock exchange. They ended up with about a third of their assets, or somewhere like that, in Nortel.

As Nortel stock fell, they could not sell it. They were forbidden by law from unloading this stock, and they just had to watch it fall, and they lost some $800 million. So, I do not think you want to lock people into that sort of situation.

DR. COGAN: Got it, got it. So, you would be in favor of allowing individuals immediately if they have a private pension fund that meets some governmental specified criteria to put their payroll --

MR. TANNER: Yes, it seems no reason to reinvent the wheel. If you have a system that works and you can piggyback on to it, I think that that is a very good move.

DR. COGAN: Great, thank you.

CHAIRPERSON PARSONS: Gwen.

MS. KING: Yes, Dr. Sherraden, you radical, you.

I am fascinated by your recommendation to us, and I sort of want to make sure I understand it. You say the first policy priority should be to bring the poor into the asset system. Who are the poor, working poor? You did not say the working poor. Who are we talking about?

DR. SHERRADEN: Well, I think it applies to everyone of low income. The current structure of asset accumulation policies is that the government assists with the accumulation through tax benefits. But for people with very low or no tax liabilities, then they are not eligible for these benefits. So, my suggestion would be that in those cases, the government make a direct deposit into similar accounts.

MS. KING: Well, that was going to be my next question. But I am tracking with 401(k)'s, and you are in a 401(k) if you work for someone.

DR. SHERRADEN: Right.

MS. KING: And so, that is how you gain access to the 401(k).

DR. SHERRADEN: I am sorry to interrupt. You gain access to 401(k), but not to the tax benefit if you do not have a tax liability.

MS. KING: So, where would the money come from to make the deposit into the accounts of the poor that you are recommending be covered?

DR. SHERRADEN: I think it should come from general revenues.

MS. KING: General revenues. And would you also continue to keep the SSI program in tact?

DR. SHERRADEN: Yes, I would not recommend cutting any of the income support programs.

MS. KING: So this would be new revenues, yes?

DR. SHERRADEN: Yes, and the reasoning is because in my interpretation, the tax benefits are large expenditures that are enormously regressive. It is not a matter of providing the poor with something that other people do not have. What I am suggesting is bringing the poor into a system of government subsidy that already exists.

MS. KING: I see. Thank you very much.

CHAIRPERSON PARSONS: Lee.

MS. ABDNOR: Thank you. Thank you all for coming. Dr. Sherraden, if I could also direct my question to you. You made reference in your testimony about other positive effects of investment beyond financial security, positive effects of accumulating assets.

Could you reference some of those for us, some of the secondary benefits?

DR. SHERRADEN: I have included an appendix to the testimony that reviews a fairly substantial amount of research.

MS. ABDNOR: Can you mention what a few of those might be?

DR. SHERRADEN: What the effects are?

MS. ABDNOR: Yes.

DR. SHERRADEN: Well, I did mention some on my testimony. The greatest knowledge that we have about this is in relation to home ownership. And it is very clear that home ownership has positive effects on people's stability, both their residential stability, and their marital stability.

It has positive effects on how their children do in school, and with interactions with the law, and with pregnancies, as in teenage years. And this is statistically controlling for other factors such as income, and race, and age. These effects exist for home ownership.

MS. ABDNOR: Thank you.

CHAIRPERSON PARSONS: Olivia.

DR. MITCHELL: I had a question for Mr. Sombrotto. In your capacity on the Thrift Savings Plan Advisory Board, I know that recently you have moved to adopt two additional investment options from the original three that have been around for awhile.

One of the investment options I do not see, and I am curious why not, is that of inflation protected bonds. It would seem to me that as people move into retirement that focus on inflation is a very legitimate concern.

Is that something that you think could be incorporated as one of the investment options in the future? And how would you help us think about that in terms of modeling an individual account investment portfolio?

MR. SOMBROTTO: Well, you hit the nail on the head. We are looking at a wide variety of investment instruments that members of the thrift savings plan can invest in. They can make those selections. And, as we go along -- when we started off we really only had three. We had the G Fund, which was the government fund, which was guaranteed by the full credit of the government; and then we had the C Fund which was for equities, and so on.

So, yes, we continue to try to find a broader array of opportunities for folks to invest and have these opportunities to look at various investment instruments.

DR. MITCHELL: But if I could just follow up on that. It would seem that, to me, at least, if you are talking about retirement security that inflation protected bonds could arguably come before small cap, or international, or any other sorts of fairly narrow portfolio options; that is, inflation protected bonds will help protect consumption over the 20-30 plus years of retirement. I am just wondering why that is not on your plate right now.

MR. SOMBROTTO: Well, because we already have the G Fund which is guaranteed.

DR. MITCHELL: But they are not inflation protected.

MR. SOMBROTTO: Well, no. In fact, I am a participant in a plan, and my money is not in equities, it is in the G Fund. I believe in government. I think there is a reason for it. I am a product of The Depression. I grew up in The Depression.

I understood and still understand the effects of The Depression on society in our country, and we do not want to return to that kind of an era. Social security was a safety net back when Roosevelt thought of it. And we do not want, those of us that understand how important it is, do not want to see it tampered with and gambled with.

DR. MITCHELL: No, but, with all due respect, the inflation protected bonds are government bonds.

MR. SOMBROTTO: No, that is okay.

DR. MITCHELL: Right, so I think we are on the same page.

MR. SOMBROTTO: I am not dismissing that. I am just saying that that will be a subject. See, there is -- we are the advisory board, and there is a commission that makes those decisions. It is headed by a CEO. In fact, I know that somebody here, Frank Cavanaugh, was the original CEO, and I had the opportunity to work with him.

But what we do is then make recommendations after they give us a wide variety of options, and we look at them, and then we try to decide what is prudent and which is safe for the people, the folks that we represent.

CHAIRPERSON PARSONS: Other questions. Tim.

MR. PENNY: Just one quick question for Mr. Tanner, regarding the general fund transfer to take care of those who are currently in the system. Have you put a fence around that to define how many people for how long we provide that kind of a transfer?

MR. TANNER: I do not think it is possible without knowing the size of the accounts, essentially, that you are going to create, the size of the carve-out, and how fast that is going to be phased in; and in addition to other projections in terms of the sizes, for example, future social security surpluses, so I cannot put a dollar amount on it.

What I can suggest is that in the long term it will be less general fund transfer than is necessary if you are going finance the current shortfall entirely for --- of the general fund.

In any sense, what you have for the portion that you move to an individual account is that you are taking out revenue, but you are also reducing obligations. And, at the same time, you have people who have obligations and not the revenue.

But, eventually, this cohort with obligations and no revenue will go away. People will eventually die and leave that cohort. This cohort goes on forever. At the same time, with the current system what you have is a system in which you have an unfunded liability and that cohort never goes away.

The unfunded liability continues into infinity, so if you move -- whatever cost you have of making that transition it eventually goes away. There is no painless way of doing it, at least not painless for the politicians. But it is going to be less painful than doing nothing, absolutely.

CHAIRPERSON PARSONS: Okay. Well, we are coming in just on time. We thank you, gentlemen. We appreciate your input. And we thank you, ladies and gentlemen, who have joined us today to hear this. To sort of conclude where we started, every member of this commission is keenly aware that the events that have sort of overtaken our deliberations in our country over the last month.

But we are, I think, to the woman and man, convinced that those events and our national response to them only highlight the importance of what we are trying to do here which is to figure out how to create a national social security system that current members can look at for the next hundred years and have confidence that the promises that that system offers for them in their retirement are promises that can be kept and will be kept.

And, additionally, to echo something Mr. Sherraden said, a system that enables not just the maintenance of a certain level of income in their retirement years, but enables them to develop a certain level of wealth that they can, not only assure their own position within the economy, but perhaps even pass on to future generations.

It is a big challenge, and it is a big challenge particularly at a time where other challenges are placing new and unanticipated demands on government revenues. But we appreciate the input of all of those who came today, and this panel in particular, in terms of helping us think it through. And we are going to do our best to try and come up with as responsible a recommendation to the president as we can within the mandate we were given.

Having said that, I will let you all know that the next meeting of the commission which will be under the appropriate federal sunshine laws, a public meeting, is on November 9th, probably here in Washington. We will put that on the website. We look forward to seeing those of you who maintain a current and ongoing interest in our deliberations at that time. We stand adjourned.

(Whereupon, the meeting was adjourned at 2:29 p.m.)