

Senate Democratic Policy Committee Hearing

“An Oversight Hearing on President Bush’s Social Security Privatization Plan: Will You and Your Family Be Worse Off?”

**Friday, May 13, 2005
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Transcript of Hearing

SEN. DORGAN: The hearing will come to order.

I’m Senator Byron Dorgan, the chairman of the Democratic Policy Committee.

At the beginning of the hearing today, Senator Dayton is going to chair. We’ll be joined momentarily by Senator Bingaman, as well as Senator Pryor, we believe. I am going to excuse myself in a moment. We have some base-closing news that has just been announced within recent minutes by the Pentagon. And so I appreciate very much Senator Dayton and his willingness to chair.

I want to just begin by saying the purpose of this hearing is to discuss once again a very important issue called Social Security. The president has been traveling across the country following his suggestion in the State of the Union address that Social Security is heading towards bankruptcy. He’s been traveling across the country talking about his plan to partially privatize the Social Security system by borrowing a rather substantial amount of money, investing it in private accounts and at the same time concurrently reducing Social Security benefits for most recipients. Last week he indicated a more specific part of that proposal, which we believe will result in beneficiary cuts; that is, cuts in payments to Social Security beneficiaries.

This is a complicated, controversial issue. Let me just say from my standpoint that Social Security has been a remarkably successful program. And at a time when Social Security did not exist, we had one-half of our senior citizens living in poverty. Social Security has pulled tens of millions of senior citizens out of poverty. It has been the guaranteed portion of retirement security, that portion of retirement security that you could count on, not only for retirement but for disability benefits and dependent benefits. It has worked remarkably well.

It is not, as the president suggests, headed towards bankruptcy. It is not broke, it is not flat busted, it is not belly up, as others have suggested. It will, in fact, continue to pay full benefits until President George W. Bush is 106 years old if no one does anything to make any changes. That ought to describe that while we do face some crisis in some areas of public policy, it is not in Social Security.

I think I speak for virtually everyone in Congress that we will, should and can make adjustments along the way as we consider people living longer and as adjustments are necessary in the Social Security program, but I personally don’t believe that we should move towards private accounts. I

know that this is not a function of an economic debate, it's more a debate about philosophy. I say that because the president ran for Congress in 1978, and when he did, he said that Social Security will be busted in 10 years -- that was in 1978 -- and he said we ought to move towards private accounts. That tells me that with the president, at least, this is not about economics, it's about philosophy.

Well, I respectfully -- I say respectfully -- disagree. I think it's very important for us to commit ourselves to keeping Social Security as the guaranteed portion of retirement security; strengthen it, improve it, do not privatize it; and I think we will do this country a great service by having an aggressive discussion about it and then making the right choice and the right decision.

So the purpose of this hearing is to add to that discussion, especially by evaluating what the president announced within the last week or so about some additional recommendations he has that many of us believe would result in Social Security cuts for a large portion of the Social Security recipients.

Again, Senator Dayton, thank you very much for being willing to chair at the outset of this hearing, and let me turn it over to you.

SEN. MARK DAYTON (D-MN): Thank you, Senator Dorgan, for the outstanding leadership you've given our policy committee on this and so many other issues. And you've really focused us, both in these public hearings as well as in our own caucus meetings, on these critical decisions that are ahead of us.

Both of my colleagues have indicated that they're going to have to be stepping out and talking with constituents back in their respective states about the base-closing impacts that have just been announced. So since Senator Reed has stepped out, I'll turn -- ask Senator Stabenow from Michigan if she'd like to make opening remarks.

SEN. DEBBIE STABENOW (D-MI): Well, thank you, Senator Dayton, and welcome to all of who -- our panelists, our experts that are with us today. We do apologize in advance for doing, as often we have to do as senators, attempting to be two places at once, with this very important hearing going on and at the same time important news regarding base closings in each of our states. So we are stepping in and out, and that does not reflect our interest or the seriousness of this issue or our gratitude for your being with us.

From my standpoint, I'm hopeful today that you will speak, in terms of privatization, about what it means in terms of privatizing an insurance system. One of the important points, I think, that is often missed about Social Security is that it's not a 401(k), it's an insurance system. It's an economic insurance policy that happens to be an excellent deal for each of us as Americans. It's a retirement policy, but it's also disability. Heaven forbid that a worker become disabled or that there be a loss of life in their family by the breadwinner. But Social Security steps in as a life insurance policy, a disability policy or a retirement policy.

And so I would be interested in knowing what happens -- common sense tells me that if you take dollars out of an insurance policy, that you would affect the rest of the policy; that it's impossible to say we'll protect one portion of those who are covered by this insurance policy, even though we're taking dollars out. If you took dollars out of your auto insurance policy, everybody else in the plan would be affected. Everybody else would pay more or get less benefits. That's the same thing with Social Security, from a common-sense standpoint.

So I would welcome your thoughts on that, also would welcome your thoughts in terms of the administrative costs. The other part that's a good deal on Social Security is it only costs a half a percent to administer -- one-half of 1 percent to administer. And I understand and know from my own personal experience that going to the private sector, whether it's annuities, whether it's other investments, certainly costs more than that. So that's another issue.

And then finally, this whole debate about raising taxes or cutting benefits -- and deep benefit cuts have been proposed. The president's proposed a formula that would require deep benefit cuts not only to upper-income and middle-income but lower-income working people, certainly in my state and across the country.

And as a member of the Budget Committee, I'm deeply concerned about the huge explosion in the national debt that we would see; \$5 trillion over the next 20 years. And so there are a lot of red flags in this proposal on privatization. And we certainly welcome your thoughts.

I come to this having looked at this very, very closely, and feeling very strongly that this is a bad idea for my family and for the people that I represent in Michigan. And I know that we need to work together to keep Social Security secure, but we can do that without unraveling and undermining the system. And so I would welcome your thoughts on that, and I think -- in the end analysis -- I'm hopeful that the Congress will celebrate, along with the American people, the great American success story called Social Security.

Thank you, Mr. Chairman, and thank you for your leadership as well.

SEN. DAYTON: Well thank you for yours, Senator Stabenow. You've chaired the caucus's Medicare initiative, and you've been in the forefront of this issue as well on behalf of the senior citizens in Michigan. And I hope you can rejoin us later as your schedule permits.

SEN. STABENOW: Thank you, and yes.

SEN. DAYTON: I'm going to give my colleagues, when they do arrive, a chance to make opening statements themselves, since they'll be coming and going. Let me make a brief one myself, and then we'll get started with our distinguished panel here.

It's ironic in a way that all of us are responding to the administration's proposal to close various military bases in our respective states, which are going to have devastating impacts on many Americans, and we're also holding -- simultaneously -- this hearing today of the Democratic Policy Committee regarding another presidential proposal with devastating consequences for many Americans.

The president's proposal to privatize Social Security and drastically cut future Social Security benefits for millions of middle-income workers when they retire is going to have profound implications, for decades and for generations. You could call it, in a way, President Bush's nuclear option for Social Security.

His indexing plan, which he's finally put forth, would, according to one analysis, cut benefits for workers earning between \$30,000 and \$90,000 a year by an average of 40 percent over the next several decades. And then, workers who chose one of his private accounts schemes would suffer additional benefit cuts, which they would then be trying to make up in the financial markets. So we would be going from a system of Social Security to one of retirement roulette.

Funding those private accounts and paying the earned benefits for present and future retirees would add an additional \$4 trillion to the national debt in the first 20 years of the president's plan, and it would move up the projected date of Social Security's so-called insolvency by 11 years. That's, by my reckoning, four strikes and everybody's out.

Today, we have 5 nationally-renowned economists, experts on Social Security, and financial-investment advisors to provide all of us on this panel and the American people with the truth. The truth as each of you perceives it about Social Security's future, and what must be done to keep it secure for all Americans, for today, for tomorrow, and for generations to come.

Each of you were invited for your expertise, not for any particular ideology. You may or may not agree with the president. You may or may not agree with one another, and you may or may not agree with any of us up here. But there's far too much at stake for far too many people to subject Social Security to political propaganda, or half-truths and half-lies, or sweet sounding slogans at campaign-style events that hide their harsh consequences on people who must depend on Social Security for much of, most of, or even all of their retirement incomes for the last years and -- hopefully -- decades of their lives.

And they in turn, our constituents, the American people are dependent upon all of us sitting here, their elected representatives, to do this right. Not to do it the president's way, not to do it our way, not to do it anyway except the right way. So, I ask that each of you today will show us, all of us, the right way.

Not in any order that I had any reckoning on, we will proceed according to the way that you're lined up here, which means that Professor Shiller, you're our first witness. Professor Robert Shiller is the Stanley B. Resor professor of economics at the Department of Economic and Cowles Foundation for Research in Economics at Yale University. He's also a fellow at the International Center for Finance at Yale's School of Management. He's the author of Irrational Exuberance, and The New Financial Risk in the 21st Century. Professor Shiller, welcome. I -- the clock's I believe are set up to indicate five minutes. That's so that senators will hopefully stop somewhere after about fifteen minutes. So, in your respective cases, why don't we say seven to eight minutes would be appropriate, what you need to give us your expertise.

Welcome.

MR. SHILLER: (Off mike.)

SEN. DAYTON: Turn the microphone on.

MR. SHILLER: Thank you, Senator Dayton. I'm very pleased to have this opportunity to present my information that I have about the president's proposal and about other proposals.

I want to put the president's proposal for Social Security in the context of risk management, and particularly to focus on the life cycle accounts that were the most original part of the president's proposal. And I want to argue that these life cycle accounts don't protect people as well as one might have thought from the risks of investments turning badly.

I also have a proposal at this time when people are talking about switching to the CPI, away from the AWI or average wage index, that I -- I'm including in my present -- in my printed comments. I think it's a mistake to switch to the CPI for indexing, that we should go the other way and make more comprehensive wage indexing.

SEN. DAYTON: Professor, your full statement -- each of yours -- will be inserted in the record in its entirety.

MR. SHILLER: What I want to emphasize though is about risk management. This is an important field. It has developed greatly over the decades, and it's really an art. It has -- it's very serious business, and it has serious consequences. I want to comment the president and his administration for thinking creatively about our Social Security system, and trying to take account of our better risk management technology. But I also want to warn that the president's plan would entail serious risks that some workers would find difficult to bear.

This is especially important to consider at this time in the United States when income inequality has been getting worse and threatens to get even worse again in the future.

The president has articulated a vision for America that he calls the ownership society. This is the vision of getting more Americans involved in ownership and hence involvement in the capital of the system. I think this is a good thing. We should keep in mind the idea of getting people more involved in investing and saving and learning more about investment technology. But the reality is that not everyone will get involved in the ownership society, and that the concept of social insurance is essential to a well functioning society.

Senator Dorgan at the beginning referred to the fact that Social Security has been a wonderful pillar of our society, and I agree very strongly with that. Insurance is a venerable capitalist institution. Social insurance is part of that, and as we move toward a more financially advanced society, we want to strengthen that.

Now, I'm particularly concerned about the offset that the president's plan has. There's a three percent offset rate, and the result of that offset rate is to decimate the guaranteed benefits of the original Social Security system, and to make retirees who choose the personal accounts option dependent on their investments for their retirement. The problem is that the stock market could do badly in the future, and it could leave people who chose the personal accounts behind and suffering difficult times in retirement.

We are living in a society that is overconfident about the stock market. It's done well, and people now are assuming it has to continue to do well. But the truth is, nobody knows what the stock market will do in the future. Worldwide experience shows that the stock market has been risky. And at this time in history there are a lot of fundamental changes going on. We're seeing globalization. We're seeing the emergence of China and India and Other countries as competitors. We're seeing instabilities from environmental changes, from resource depletion and even such things as global terrorism. We are coming into a new century, the 21st century, and it's not possible even to enumerate all of the risks that investors face.

I don't want to be negative about the future, but there are risks. And asking our retirees to bare these risks is not acceptable. The president proposes to deal with the riskiness of the plan by giving people a life cycle portfolio, a portfolio that is more heavily invested in stocks when young than when old. And in fact, the president has proposed that when a worker reaches the age of 47, he or she will automatically be switched into the life cycle portfolio, unless the worker and spouse sign a waiver acknowledging risk.

So, this is really unusual. Other countries have life cycle parts of their Social Security private accounts, but it's not so well entrenched as this.

The president is hoping that he can take account of the risk created by the personal accounts by putting the accounts into a life cycle portfolio. The problem is that it's not necessarily going to work. (Chuckles.)

Incidentally, it's not clear what the life cycle portfolio will be. Academic finance people have studied life cycle portfolios and have not reached any consensus on what one ought to do over one's lifetime, whether one should have more stocks when young or less stocks when young.

What I did in a simulation is I took what I call a benchmark life cycle portfolio, and this is a portfolio that resembles life cycle portfolios that are currently offered privately. So I have a portfolio that starts out when the worker is young with 85 percent of the investment in the stock market, and then it reduces that gradually over the worker's lifetime so that at the time of retirement only 15 percent remains.

Now I did long historical simulations using data to 1871. Now this may seem like a long time, but it's important to use long historical simulations so that we can get away from overreliance on the recent behavior of the stock market, which has earned over nine percent a year real since 1982.

That is historically unusual. I know it. So what I did is I did simulations of a -- for a worker born in 1990 who begins working at age 21 and retires at age 65. I did 91 separate simulations using actual returns for 44-year periods, for all 44-year periods since 1871. And I did it with both historical U.S. returns and with U.S. stock market returns adjusted to reflect the experience of the world in the 20th century.

The U.S. stock market was about the most successful stock market in the world in the 20th century. And I believe it's a mistake to assume -- take it as a given that the U.S. will be the most successful again in the 21st century.

So I found first, using U.S. historical returns, that a benchmark life cycle portfolio, if invested for a lifetime, would lose money 32 percent of the time. That is, 32 percent of the time the internal rate of return on the portfolio is less than the 3 percent offset rate that the president has proposed. The median rate of return is only barely above 3.4 percent, above the three percent.

I believe, however, that these numbers are too optimistic because we want to correct for the fact that the rest of the world's stock market experience has not been as good as the U.S. So if we do that correction using more realistic adjusted returns, I find that the benchmark life cycle portfolio loses money 71 percent of the time; that is -- and has a median rate of return of only 2.6 percent, which is less than the three percent offset rate.

So the conclusion is that the president's personal accounts, even with the life cycle portfolio, would subject Americans to serious risks. The ownership society is at best a long-term and elusive goal, and we should not expose people to unnecessary risks in an over-ambitious attempt to reach this goal.

In conclusion, we at the present time ought to be thinking of how improved financial technology can manage the risks of the nation's workers more effectively. We ought to expand our programs that encourage saving and investment, and encourage Americans to become more involved in the financial system. But we should not do this at the expense of good risk management, as the president's personal account proposal implies. The bottom line is I would urge Congress to consider how to strengthen, not weaken, the risk management implicit in Social Security.

SEN. DAYTON: Thank you very much, Professor Shiller.

We're joined here by Senator Jeff Bingaman from New Mexico, who is a member of the Senate Finance Committee who gets to tackle these complexities in real time in the not too distant future. You've indicated you -- to let the panel panel continue, or is there anything you would like to say to --

SEN. JEFF BINGAMAN (D-NM): Let me just say very briefly I very much appreciate all the witnesses. I've read some of the testimony and had the chance to hear particularly Peter Orszag testify on this issue in the Finance Committee. But many of the rest of you I know have written extensively, and I've tried to read some of what you've written.

So thank you, Mr. Chairman, for being here and conducting the hearing. And thank you all very much for your very useful insights into this very important issue. It's extremely important in my state, and I hear about it every time I go home from a lot of people who are very worried about the exact issues that Professor Shiller is talking about.

So thank you again.

SEN. DAYTON: Senator Bingaman and I ran for the Senate the first time together back in 1982. The difference was that he won and I lost. So every time I see his committee assignments and role of seniority, I'm reminded of his success, well earned, in contrast to my own. But our next --

SEN. BINGAMAN: Mr. Chairman, yours are well earned, too. Don't --

SEN. DAYTON: (Chuckles.) Our next witness is cross-continent. Thank you very much for coming from the University of California- Berkeley. Professor J. Bradford DeLong is professor of economics at the University of California at Berkeley. He is also co-editor of the Journal of Economic Perspectives, a research associate of the National Bureau of Economic Research, and a visiting scholar at the Federal Reserve Bank of San Francisco. Professor DeLong served as deputy assistant secretary of the Treasury for economic policy from 1993 to 1995.

Professor DeLong, welcome. Thank you for taking the trip.

J. BRADFORD DELONG: Thank you very much. I do get to see my mother and father and grandfather who live in D.C., so there are compensations other than the pleasure of appearing before you.

Mr. Chairman, Senator Bingaman, America today has three fiscal policy problems: first, the current five percent of GDP on-budget deficit, its risks of economic crisis, recession, and slowed long-run growth; second the explosion of federal health care costs over the next two generations, whether we're going to find a way to provide all Americans with future medical miracles or just those with thick wallets; third, the likelihood, not the certainty, that the Social Security system will be in substantial deficit by mid-century.

Of these three problems, Social Security is both the least urgent and the smallest. It's at least a generation further out than the other two. Its projected 75-year deficit is 0.6 percent of GDP, while on the same methodology the projected 75-year deficit of the government as a whole is roughly 5 percent of GDP.

I think what's going on is that we're focusing on Social Security because the administration has no idea what to do with health. And with that I sympathize; I have no idea what to do with health, either. (Laughter.) And because the administration's unwilling to talk about the current on-budget

deficit because it made the mess. It's the three-year-old approach; say, what broken jelly jar on the kitchen floor? And I don't think this is the best use of our collective time.

Nevertheless, it's what we as a country are doing. So let me start by saying that in my view a plan needs to clear five hurdles before it's worth considering.

First, if it offers private accounts, the private accounts need to be a good deal.

Second, the plan needs to raise national savings.

Third, the plan needs to restore long-run solvency to the system.

Fourth, the plan must preserve the valuable defined benefit nature of the current program.

And the plan must be competently implemented.

Now Robert Shiller has said that at a 3 percent claw-back offset, private accounts are not a good deal. He's right. I find this distressing. I am in one of my hearts of hearts an Eisenhower Republican who believes in private accounts, some -- that is, I agree with Marty Feldstein that the equity premium tells us that the stock market does not mobilize America's risk-bearing capacity fully, and we need to broaden and deepen stock ownership. I agree with former Bush the second Deputy Assistant Secretary of the Treasury Kent Smetters that it is an outrage that the poorest half of Americans do not make automatic, straightforward and trustworthy low-fee investments in diversified portfolios of stocks. But private accounts that are a bad deal, they can't be a good idea.

Now we know that Alan Greenspan, among others, is worried that the Bush plan will not raise but might lower national savings. In his view, arguments that it will be neutral -- will neither help nor harm national savings and interest rates -- are based on what we guess, not what we know. As he said earlier this year, you might go without any response in interest rates, but we don't know that. And if you were to go forward in a large way, and if you were wrong, it would be creating "more difficulties than I could imagine," unquote.

You know that the Bush administration's plans do not restore expected fiscal balance. Robert Pozen's version of progressive price indexing envisions funding some of the Social Security system out of income tax or other revenues. But the Bush administration has been very careful to say that it's not endorsing all of Pozen's plan, merely that Pozen is directionally consistent with its ideas.

Most important in my view, however, is the defined-benefit nature of Social Security. Social Security returns a certain inflation-adjusted stable monthly benefit check that replaces a reasonable although sliding scale proportion of preretirement income. Defined-benefit retirement programs are very valuable things. People like them a lot.

These days, defined-benefit programs are very hard to get elsewhere than Social Security. Businesses are hesitant about taking on the risks, and are right to be hesitant. Indeed, businesses are not large and stable enough to be able to offer this product. Ask the steelworkers or the pilots of United Airlines this morning about their defined-benefit pensions.

The government, however, is large enough to bear the risks of offering a defined-benefit-like program. And when there is something that people value very much that only the government can provide, I think it is the government's business to provide it. For in another of my heart of hearts I am, after all, a social Democrat who believes in a government that is a good servant of the American people.

Thus I find myself skeptical of progressive price indexing, for over the long run it, A, cuts average benefits relative to current law by about 40 percent; and, B, changes Social Security from a defined-benefit program to which you contribute a share of your income to something very much like a simple flat benefit check for everyone, same amount for everyone at roughly 22 percent of the average wage.

It's important to register the magnitude of these proposed cuts relative to current law. Medicare premiums are already taken out of Social Security checks. Deduct the claw back for private accounts as well, and by late in this century Social Security would no longer be a universal program, and a great many Americans would have lost a key element of what Social Security currently provides, a defined-benefit pension program. And I do not see anything they could do to compensate for and replace that as they do their retirement planning.

I want to make one more point about implementation. I find myself extremely skeptical of the way that the administration is rolling out this plan, about numbers that you expect to see that aren't there, and things that should have been checked but have not.

Let me give one example about the staff work underlying George W. Bush's Social Security statement on April 28th, when the president said, quote, that "because some Americans have reservations about the stock market, I propose that one investment option consist entirely of Treasury bonds that will make voluntary personal retirement accounts a safer investment that will allow an American to build a nest egg," unquote.

But on April 28th, the 20-year inflation-protected Treasury bond yielded a real rate of return of 1.87 percent per year. Under the Bush plan, money diverted into private accounts is charged against the normal Social Security benefit at the real claw-back rate of 3 percent per year. If interest rates stay where they are, if you were 25 now, if you made an average of 80,000 (dollars) a year over your career, if you diverted 4 percent of your wages into your private account, and followed the advice for those wanting safe investments and invested them in inflation-protected Treasury bonds, then when you reached 67 and retired, your Social Security benefit, normal plus the annuitized check from your private account balance, would be 514 a month less than if you had simply said no thanks to private accounts.

I mean, this isn't building a nest egg. This is taking 514 (dollars) a month of your Social Security eggs and kind of rolling them out of the nest so they smash on the ground.

And did nobody inside the White House bother to run the underlying numbers before this was brought forward? And this also I find heartbreaking because the devil in this really is in the details. The issues are complicated, and specifics matter. And in yet another of my heart of hearts I really am a technocrat who believes it is important to have an executive branch that gets the details and numbers right, for only so can it be a good servant to the American people.

Thank you.

SEN. DAYTON: Thank you, Professor.

In fairness to the president, he suffers from the disadvantage of having graduated from both Yale and Harvard. And I followed him by one year at Yale. He was the president of my fraternity in college. I say back then he and I were often in the same party. (Laughter.)

Mr. Max, thank you for being here. You also have a very distinguished background as the executive director now of the Alliance for Worker Retirement Security, and the executive director

and member of the board of the Coalition for Modernization and Protection of America's Social Security, known as COMPASS. Prior to assuming this position, you served for three years as director of government affairs at the Cato Institute. Before joining the Cato Institute, Mr. Max worked on both the Senate and the House side, first for -- second for Senator Tim Hutchinson, and prior to that served for four years as a professional staff member and economist for the Committee on Education and Workforce at the House of Representatives.

Thank you for being with us today, Mr. Max.

DERRICK MAX: Thank you.

Well, it's not Cinco de Mayo, but I do have the feeling that I am the proverbial pinata in today's party. And I'm welcome to be here, and I appreciate your allowing me to speak.

As you said I am the executive director of the Alliance for Worker Retirement Security and the Coalition for the Modernization and Protection of America's Social Security. Combined, these two organizations have led the charge for common-sense reform to Social Security. In fact, COMPASS' Generations Together campaign now boasts chapters in 23 states and 19 congressional districts, working hard on the reform of Social Security.

Before I address the very politically charged title of today's hearing, let me begin by discussing the areas where I hope that this panel can find agreement.

First, Social Security has to be fixed. The falling ratio of workers to retirees has pushed the system towards insolvency. In fact, in less than three short years, Social Security's surplus will begin to shrink, forcing Congress to come up with other revenues to meet its growing appetite for taxpayer dollars.

Six years after that Social Security will begin running cash-flow deficits. These deficits will grow dramatically, and within five years will consume \$118 billion. This is an amount equal to the funding for HHS, Homeland Security and the Department of Justice combined.

Second, the sooner we act, the better. Every year we wait to address this problem, the cost of fixing it grows. While Social Security reform inevitably involves difficult choices, there is no future date at which those choices are any less difficult than they are today.

Third, Social Security taxes ought to be used for Social Security. For the next 12 years workers will pay more into Social Security than is needed to pay current benefits. Because the federal government can't save this surplus, the so-called trust fund is really a debt, not an asset.

Prudence calls for directing those resources into personal accounts owned, managed and protected by American workers. Such accounts would constitute a true and meaningful lockbox. It is time to stop using workers' Social Security cards as the government's credit card.

I'm always baffled that opponents of reform will claim that diverting \$100 billion of surplus payroll taxes into personal accounts is, quote unquote, "robbing" Social Security while using those same resources to fund other government programs and replacing the funds with IOUs is "protecting" Social Security. That logic is baffling.

Fourth, personal savings accounts ought to be a part of Social Security reform. Knowing what we know today about demographics, I can't believe we would have ever established an unfunded pension system. While most of my fellow panelists will argue that the sources of the funding for the personal accounts is critical and will want to know if the funds are being carved out or added on,

I would argue that this is a debate that is mostly lost on the American public. In fact, as long as overall federal tax rates are held constant and the fundings of the accounts is derived from existing revenue or spending sources, there is little if any difference between the two.

Now, will workers be better off under the emerging proposals of this administration? Any comparison needs to begin with apples-to-apples comparisons, not the apples-to-kumquats comparisons that have dominated the debate today. Specifically, it is pointless to compare to any reform to an unreformed and unfunded Social Security system. Comparing reform to fantasy I think serves no one.

With that, let's begin to look at what we might call the do-nothing option. This analysis will then be compared to the president's proposal to provide a fair comparison.

Absent reform, Social Security benefits will have to be cut 26 percent in 2041, growing to over 32 percent in 2079. According to a recent study by the Social Security Administration, these cuts would lead to a doubling of the poverty rate, with almost 60 percent of those added to poverty being black or Hispanic, and over 60 percent being women. The greatest impact would obviously fall on the young.

Alternatively, Congress could opt to increase taxes and maintain promised benefit levels. This would require an eventual 50 percent increase in taxes, which would have a dramatic impact on our economy. Social Security is already the largest and most regressive federal tax most families pay. It is a head tax on employment that is paid on the first dollar of wages earned whether or not the company is profitable. When Social Security taxes go up in the United States, they do not go up in China. The trade implications of increasing the taxes would be immense. I think it is an underappreciated fact that increases in payroll taxes, particularly increases in the wage gap in a competitive economy, will lead to dramatic reductions in employment.

Let me assume, then, that doing nothing is not an option. With the system approaching crisis, choices have to be made. These choices have to be made whether or not personal accounts are part of the solution.

The administration has opted to do two things for which I think it ought to be applauded, particularly from those with traditional Democratic leanings. First, the president has opted to protect those already in or near retirement. And second, the administration has opted to place the burden of reform on higher-wage workers while protecting middle- and low-income workers.

Now let me be clear, and let me say something that you might find radical. Every future retiree, by definition, under any plan that indexes benefits based on prices, will be guaranteed a benefit in real dollars at least equal to the benefits received by today's retirees. The president's recent embrace of progressive indexing improves on this by promising lower- and middle-income workers substantially more than current retirees today while giving the highest-wage workers an amount equal to today's retirees. Considering the size of the shortfall we face, this seems to me to be a reasonable and what should be a non-controversial adjustment.

Despite this, the supporters of the do-nothing approach have made irresponsible claims that indexing will lead to drastic cuts for low- and middle-income workers. I have heard opponents claim that workers making an annual income of \$36,000 are low wage, and someone earning \$59,000 are average. And then the benefit cuts that they derive for these individuals are derived by assuming that these people make those wages every year of their working life from day one to the

final day. The absurdity has gone further to say that someone earning \$90,000 every year they work is solidly middle class, when only 1 percent of the population will have an income, lifetime income, that approaches this amount. I think that's unfortunate.

Rather than look at stylized workers who do not exist, the better methodology is to look at a sample of actual workers, as is done by Social Security in the MINT analysis. By looking at individuals in the top, middle and bottom of the income quintile, we can get an accurate picture of what progressive indexing would look like when compared to what the current law can afford to pay those same workers. We can then include in this analysis what workers could expect to get in retirement if we included a personal account.

The benefits of this approach are evident in the charts I've included in my written testimony. All workers -- low, middle and high -- do better under progressive indexing than the current system can afford to pay, and even better when the accounts are considered. By isolating out low-income workers, we can see that their benefits too grow over time under progressive indexing without accounts, and even more with the accounts. We can again isolate out widows and divorcees to see a similar analysis, which is also included in my written testimony.

Let me conclude by just reiterating Social Security, I think everyone on this panel is going to agree, has to be fixed. Absent reform, our economy will suffer. This is not a Democrat or a Republican issue; it is an American issue.

This issue is too important to be used as a political tool to score short-term political points. It is time for Democrats and Republicans to come together and begin the hard work of addressing this problem.

I'm sure that every panelist will agree the solution to what ails Social Security will only get harder, and choices more painful. Acting now is imperative. The do-nothing option, I believe, has to be defeated.

Thank you for your time.

SEN. DAYTON: Thank you, Mr. Max, and I thank you for your excellent testimony. All good ideas are welcome here. I mean that sincerely. And your testimony contained -- you looked at this very carefully, so I thank you for that.

I hope, because this is so complex and confusing to I think most members of Congress, and certainly to most of the American people, that we somehow can divine the collective wisdom to do what's the right thing to do, and then figure out how to explain that to people in ways that they can understand. But I appreciate what you said, thank you.

Our next panelist is Mr. Peter Orszag of the Brookings Institution, the Joseph A. Pechman of Economic Studies at Brookings, co-director of the Tax Policy Center, a joint venture of the Urban Institute and Brookings Institution; a director of the Retirement Security Project; and research professor at Georgetown University. Mr. Orszag previously served as special assistant to the president for economic policy, and is (sic) senior economist and senior adviser on the Council of Economic Advisers in the Clinton administration.

Welcome, Mr. Orszag.

PETER ORSZAG: Thank you very much.

I'd like to talk about the two components of the White House's proposals. One is so-called progressive price indexing, and the second is the individual accounts that the White House has proposed. Both are very seriously flawed in their own special way.

First, with regard to progressive price indexing, the proposal involves surprisingly large benefit reductions, even for middle earners. Someone earning \$36,000 a year today retiring at age 65 in 2045 would receive a 16 percent benefit reduction. Someone earning \$59,000 a year would experience a 31 percent benefit reduction. And those benefit reductions increase over time.

I want to make two comments on Mr. Max's testimony.

The first was with regard to characterizing these workers. In February, 2001, a leading policymaker characterized a, quote "typical working family," end quote, as anyone earning between \$35,000 and \$75,000 a year. That leading policymaker was the president of the United States. I do not think that referring to someone earning 35 (thousand dollars) or \$59,000 as middle class or typical is at all misleading.

Second, in terms of the basis of the comparisons. The numbers I gave you were compared to the current benefit formula. Mr. Max would like you to compare them to the lower benefits that are available if you reduce benefits to eliminate the projected actuarial deficit. But in doing that he's then comparing the benefit level under the president's proposal, which does not eliminate the long-term imbalance in Social Security. So that is an unfair comparison by his own accounting rules in the other direction. I think every comparison should be to the current scheduled benefit formula, a common set of assumptions, a common set of projections. And that provides the clarity that allows us to examine each proposal on its own merits. And I'd be happy to talk about that in more detail.

Second, significance law and progressive price indexing is, and I hate to break it to us, but the current projections are going to be wrong in one direction or the other. We are virtually certain -- I would say more certain than anything else -- to be wrong in one direction or the other about things like real wage growth in the future.

We are all pretending that whatever the actuaries are currently assuming will turn out to be exactly correct, and that is wrong. Any basis for indexation of this system should be very carefully designed to respond appropriately in the future when that future turns out to be different from what we currently expect.

Progressive price indexing gets it exactly backwards. In particular, the faster we raise real wage growth in the future, the better able we are to afford Social Security benefits, and the smaller is the projected 75-year actuarial deficit in the program, and yet the larger the benefit cuts under this proposal.

The Congressional Research Service, not known as a particularly partisan entity, noted on this point, quote, "somewhat paradoxically, if real wages rise faster than projected, the proposal would result in deeper benefit cuts, even as Social Security's unfunded liability would be shrinking."

Let's not put in place a system for the next 75 years and thereafter that responds wrong to forecast errors, to the future not turning out as we currently expect.

Third point. Progressive price indexing isn't actually all that progressive over many ranges of income. It treats someone at \$90,000 a year precisely the same as someone at \$9 million a year or \$90 million a year. And I think any sensible reform plan is going to wind up treating those two workers differently; progressive price indexing does not.

Finally, let's talk about the magnitude of actuarial effects from progressive price indexing by itself. Many opponents of -- many proponents, I'm sorry, of the president's approach highlight the 2017 date. That is the date at which the cash flow associated with Social Security's incoming revenue falls below projected benefit payments. I don't happen to think that that date is particularly important, but the people who support the president's approach do. Progressive price indexing delays that date by two months. So if you think that is the crisis date, progressive price indexing basically does nothing to alter the time path of when that, quote, "crisis," end quote, hits.

Second, we're all familiar with the projected date of trust fund exhaustion, 2041. Progressive price indexing by itself extends that date by only six years, to 2047, doing very little to improve and extend the life of the trust fund.

Now I haven't yet talked about the president's individual accounts. All of those numbers actually get worse when we include the individual accounts. And in particular it's very important to realize, as Professor Shiller and Professor DeLong and others have emphasized, the accounts are not a nest egg. They are more like a loan for investing on margin. In fact, most of the terminology that surrounds the account is taken almost directly from margin investments. You get a dollar in your account today, but you pay that dollar back plus interest at a 3 percent real interest rate when you retire through a reduction in your traditional Social Security benefit. In the meanwhile the government is out the cash, and that means a very substantial increase in public debt.

When we include the individual accounts and progressive price indexing collectively, what we can call the administration's proposal altogether, what happens to all those key dates surrounding Social Security's actuarial solvency? The 2017 date that many of Mr. Max's colleagues highlight moves to 2011, six years earlier than under current law. If 2017 is a crisis, why would we want to move it to 2011? The 2041 date of exhaustion for the Social Security trust fund is accelerated to 2030, more than a decade earlier than if we did nothing.

The actuarial deficit in Social Security over the next 75 years is reduced only from 1.9 percent of payroll to about 1.3 or 1.4; in other words, only about a 30 percent reduction. Again, a very substantial remaining deficit that exists there.

And finally public debt is increased from now until 2067. Think about that for a moment. That's a period of about 60 years. That would be the equivalent of saying that we put this plan in at the end of World War II, we actually stuck with it over the past 60 years with all the benefits offsets coming back from those accounts not being -- no backbiting against them. Only now would we be experiencing any net reduction in public debt as a result of the plan.

I think it is absurd to put in place a plan that raises public debt for a period of six decades on the hope and prayer that future senators and future members of Congress will fully enforce those benefit offsets coming back from the accounts when in all likelihood there will be some backsliding along that dimension, especially given the design of the accounts, as Professor Shiller and Professor DeLong have already noted.

Let me just wrap up by saying that again, both components of the president's approach are seriously and deeply flawed, but there is a much better way forward. There is a place for accounts. That's on top of Social Security. We can come together and make the accounts that we already have, 401(k)s and IRAs, work a lot better. And actually, with all due respect to Mr. Max, I think the American public does understand the difference between a 401(k) and an account that is

effectively borrowing against their future Social Security benefits. That is something that I think most people actually do understand.

We could take the 401(k)s and IRAs that we already have and make them work a lot better by making them easier and simpler to use, and by increasing the incentives for middle- and lower-income families to take them up. Senator Bingaman has been thinking about many of these ideas. I know other policymakers have. We should move forward on that immediately, and we should have bipartisan agreement on that.

With regard to solvency, the progressive price-indexing proposal is simply the wrong way to go about addressing the problem. It gets the response to future events wrong, it is too reliant on benefit reductions, and it doesn't differentiate between the very highest earners, those at \$9 million and people at \$90,000. So again, I think both components of the administration's proposal are very seriously flawed.

Thank you very much.

SEN. DAYTON: Thank you, Mr. Orszag.

And our next panel's Ms. Kobliner, I note is the author of the book, Get a Financial Life: Personal Finance in Your Twenties and Thirties, which was on *The New York Times* and *Business Week* bestseller lists. And I will be going out shortly to get two copies for my two sons, who are in their 20s. I know my father wishes that one had been available before I launched my political endeavors. Ms. Kobliner was a staff writer at Money Magazine for eight years and has been a repeated guest on "Today," CNN, MSNBC, ABC's "World News This Morning" and NPR's "Talk of the Nation" and "Marketplace." Ms. Kobliner is currently a contributor to *The New York Times* and writes a monthly column for *Glamour* magazine.

Welcome to our panel.

BETH KOBLINER: Thank you very much for this opportunity to speak to you all today.

I wanted to talk a little bit about the attitudes of people in their 20s and 30s and how a privatization plan would affect people of that age group. The current administration has been actively courting young people in their 20s and 30s to support privatization. And a conventional wisdom of sorts has sprung up, which basically is that young people strongly support it. But I found when you dig into the polling data, the opinions of people in the 20s and 30s are much more complex, and the supposedly strong support is actually quite soft. There's no question the administration has been actively wooing young people. The president, in a recent speech, called Social Security a "vinyl LP" versus the iPod of private accounts.

The president said at the White House press conference last month that Congress has made promises it cannot keep to a younger generation. And at first glance, it seems like the president's rhetoric is quite effective. If you look at the data from recent years, it shows that young people say that they support privatization.

In February, a study by the Pew Research Center for People and the Press, found that 66 percent of 18- to 29-year-olds say that they favor the president's privatization plan. It's important to note, though, if you look at that survey, almost half of this age group said they hadn't heard anything about the plan at all. So a significant fraction of these supposedly strong supporters aren't aware of what they're endorsing.

In fact, it seems to be the case that as young people learn more about the details of privatizing the plan, they support it less. The president recently went on his “60 cities in 60 days” tour to tout privatization to the country. And late in March, about a month into the president’s tour, the Pew Center again did another survey, and they found this time that support for privatization among young people dropped quite significantly. It was 66 percent, and now it was down to 49 percent.

Interestingly, those who consider themselves well-informed about Social Security reform are now more than twice as likely to oppose privatization as those who haven’t heard about it at all. So the question is, why are young people initially enthusiastic about privatization, and why has this support started to decline pretty dramatically?

The first part is easy. The rhetoric over the years has led them to believe that the system is essentially bankrupt. The administration and the president repeatedly say Congress will be unable to keep its promises to young people, and young people believe them. Poll after poll shows that the vast majority of people in the 20s don’t think they will get any benefit at all.

Of course, we know that’s not true. Even if no changes were made, the trust fund, as we know, is projected to run out somewhere between 2041 and 2052. And even if nothing were done, the system would take in what they -- the actuaries predict now to pay out 74 cents on the dollar; which isn’t great, but it’s not zero. But it’s really this overblown language that has led young people to believe they don’t really have a stake in the system. So of course if you ask them, gee, would you want private accounts versus something you’re never going to get, of course they’ll say private accounts, at least at first.

But when you dig into the polls, you see that support for privatizing drops very dramatically when they’re made aware of the trade-offs. A February AARP/Rock the Vote survey showed that 68 percent of young people, again at first, say that they favor private accounts. But the poll also showed that the majority of this young group, the 18- to 39-year-olds, oppose private accounts if it means a cut in their guaranteed Social Security benefit.

So the research shows that young people actually like the idea of a guaranteed monthly benefit, and it’s not surprising. The idea of a safety net or bare minimum to ward off poverty is a good thing. Without Social Security, half of all older Americans today would be living below the poverty line. Young people, as Professor Jamanga said, don’t have the defined benefit plan that their grandparents may currently enjoy.

People in their 20s and 30s today know with their 401(k)s, they’re at risk in that their own investment choices are at play and also the performance of the markets. On top of that, if you have a Social Security payout that’s dependent on the market, it gets people nervous. Now of course, everybody has heard over the long term stocks have done well, and equities certainly play a significant role in retirement portfolios. However, the strong economic minds on this panel as well as the best minds on Wall Street agree there are no guarantees in the stock market, even over the long term.

One particular time frame I like to look at is between 1966 and 1982, stocks on average lost value after adjusting for inflation. A thousand dollars put into an account in ‘66 would have been worth -- would be \$934 after you adjust inflation 17 years later. I like that example in particular because that’s roughly when I was born, and if my parents had put the money, a thousand dollars in, they would have had less by the time I was ready to go to college.

Also, as we've seen in Japan, the Nikkei 225, Tokyo's equivalent of the S&P 500, has lost 69 percent of its value in the last 15 years. So a thousand dollars in 1989 in nominal terms would be \$306.

So it's really a chilling thought for a 30-year-old today. It's the year 2042. I'm 67 years old. The Dow is down 16 percent. And where will I be if my retirement money, including my Social Security, is invested in the stock market?

I recently gave a financial workshop to young people at -- young employees at MTV, and I sort of did an informal poll of what they're thinking. The majority said they don't like the riskiness of privatization. They've come of age during a bull market and seen it come crashing down. They're overwhelmed currently with their 401(k) choices, and they wonder how am I going to do this for Social Security. And also, they all mention things like Enron and are concerned about losing it all.

If the administration is fully interested -- really interested in helping young people invest, they shouldn't dismantle a program intended to help keep people out of poverty. They might want to consider creating better incentives to invest in IRAs. Or Congress should also make sure to reauthorize meaningful programs like the retirement savings tax credit, which is like basically a government matching program for people who wouldn't otherwise save.

Meanwhile, as we know, there are a number of alternatives to help shore up the trust fund. The majority of young people, in polls, show that they favor increasing the cap on wages subject to payroll tax. Congress should also consider dedicating proceeds of a revised estate tax to the Social Security trust fund. Steps should also be taken to keep the trust fund out of the unified budget so it's not used to mask federal spending elsewhere and ensures the money is there for future retirees.

In conclusion, even the president has admitted privatization will not shore up the trust fund. Focusing on real solutions will go a long way to convincing young people that their Social Security benefits will be there for them when they need them.

Thank you.

SEN. DAYTON: Maybe I could start with what you just said about the way -- and I think it's very unfortunate that Social Security has been mischaracterized to particularly younger people as something that is going to be nonexistent when they retire. What would you say is, in your view, a fair and accurate way to represent to 20-, 30-year-old workers what the -- is probable for them regarding Social Security?

MS. KOBLINER: Well, I think it is an issue that is problematic. They're getting statements - young people are getting statements that say that 75 percent of your benefit won't be there. I think a lot of it involves education. I think it's sort of stepping away from the rhetoric. And I think that's happening. I think the one positive thing that's happened in the last year is there has been a dialogue going on, and the polls are showing that people - the more they learn about what Social Security is, particularly young people, the more they don't want to give up something. But of course, it's, you know, important to make sure that those funds are there.

MR. ORSZAG: Senator, if I could just ask one more thing about the nature of the current system with special regard to younger Americans. Many of those younger Americans do face very, very positive futures, and I've been talking a lot to college campuses -- especially those who are lucky enough to enroll in higher education and complete college face very promising futures. But unfortunately, the world may not turn out quite the way they expect, and Social Security provides

important forms of lifetime earnings insurance, which you can't purchase on private markets. If your lifetime earnings don't turn out not to be quite as wonderful as you hoped that they would be, Social Security partially makes up the difference. That's basically impossible to purchase on private markets.

To come back to a point that Professor Shiller made before, Social Security provides important risk management tools and devices, and we can surely, actually, improve it rather than dismantle it. But unfortunately, many of these proposals are moving in the opposite direction. And that, frankly, is something that I think college students and other young people very well understand. They do understand that they are facing a risky world.

SEN. DAYTON: Not to mention that over a fourth of the Social Security system's benefits are paid to people on disability or survivors of those who have died, which, of course, no one young believes is going to happen to them, but the statistics show. And that's also difficult and expensive to purchase -

MR. MAX: If I could comment on that as well. I think -- you know, I have also traveled around to college campuses and spoken to young people. First of all, almost every single poll shows that young people overwhelmingly support the idea of some kind of a personal account as part of Social Security. But second of all, I think most kids I talk to on college campuses, far from worrying about retirement, are worried about jobs. They're worried about what they're going to do now. And I think they understand, rightly, that if we don't reform Social Security, the weight of this system -- or if we reform Social Security in the way the gentleman to my left has proposed, it's going to be in the form of taxes. Increased taxes mean less jobs and a slower economy. And I think that's a right concern on their part.

SEN. DAYTON: How is that less or more so, that tax burden in the future than it is presently and has been?

MR. MAX: Well, for example, you know, the Benton (ph) Orszag plan -- you know, it gets to solvency, but for every \$6 it contributes toward solvency, five of those are in the form of higher taxes. I think that has a real cost; it means less jobs. And I'd be worried about that if I were a young person.

MR. ORSZAG: Senator, if I can make two comments. First, I find it quite troubling that supporters of the current administration talk about the future that young people are facing at the same time that they are doing nothing to correct the crushing fiscal gap that Professor DeLong delineated, the more than five percent GDP fiscal gap over the next 74 years. That is the fundamental burden that future workers and that young people today will face. And so to talk about an intergenerational responsibility on this tiny little piece, that actually is a very small share of the overall picture, while doing nothing to address the very much larger problem of giving away, in many cases, unwarranted breaks currently at the expense of future generations, which is precisely what we're doing. We're taxing the future by running the kind of fiscal policies that we are running today.

And then one other point: My reading of the public opinion suggests very strongly that when push comes to shove, the American public -- and the American public realizes that there is a trade off between -- on the benefit and the revenue side -- that the American public does prefer at the margins dedicating some additional revenue to Social Security, whether it comes from a reformed estate tax or some other source, to excessive benefit reductions. We can have that debate. But at

least it's my reading of public opinion that those who believe that some additional revenue -- in order to attenuate the necessary benefit reductions would win. I think that that's what would happen.

SEN. DAYTON: Professor DeLong and then Ms. Koblner.

MR. DELONG: Well, just -- I at least read Mr. Max's testimony somewhat differently than my good friend Peter to the left did -- that Derrick Max is one of the dwindling group of genuine small government Republicans who really is deeply concerned about the current deficit and America's long-run fiscal future. And you can see that in the kind of somewhat arcane code in his references to private accounts as a true and meaningful lockbox, meaning that the hope is that once you start the private account system up and running, and once the headline federal deficit number goes from the unified deficit -- currently \$412 billion or so -- to the on-budget deficit of \$540 billion or so, then you'll create a politics in which, say, Representative Hastert is less easy to require in conference that a Medicare drug benefit prohibit Medicare from bargaining for lower drug price, that presidents will be more eager to veto bills that extend expiring tax breaks that Treasury and OMB regard as dubious, that the government be more willing to take a tough look at Pentagon spending requests, and we'll wind up with a better and less profligate fiscal policy if you move a large chunk of what's currently Social Security tax revenue off the books and into private accounts. And this is a sincere and genuine belief on Derrick Max's part and on the part of his faction, dwindling as it is. (Laughter.) I think it's likely to be wrong; that is, it sounds to me very much like what David Stockman, President Reagan's OMB director, was saying in 1981, that we do the tax cuts now and then it will generate a large headline deficit number, so large that then we'll be forced into fiscal responsibility two, three and four years down the road.

And so to the extent that an underlying argument for private accounts is precisely that it's an indirect way of focusing attention on the fiscal deficit. I think it's very unlikely to succeed. I think that attempts to do things like reintroduce Budget Enforcement Act provisions -- procedural provisions -- would be a much more aggressive and much more successful way of dealing with what are our current serious fiscal problems.

SEN. DAYTON: Ms. Koblner.

MS. KOBLINER: Yeah, I just wanted to reply to Mr. Max's comment about showing that -- (laughs) -- that young people favor privatization. As I pointed out, not only current polls but past polls have also shown that when questions are asked of young people and framed in a way that make it clear that private accounts would cut a portion of their monthly benefits, the majority doesn't favor privatization anymore. So I think it's important to realize that when the details come out -- and as recent polling is showing, that support by young people for privatization is declining as they're learning more about the fact that that would mean a cut in their monthly benefit.

SEN. DAYTON: Well, my guess is young people, like most of the rest of us, are for any proposal or program that's going to increase their income, now or in the future, and are not supportive of a program that's not going to increase their income or decrease. And of course, the question is, you know, who has the crystal ball to determine how, you know, what's going to produce what result.

One of my, you know -- and I agreed with what you said, Mr. Max, about -- I think you said apples -- and was it -

MR. MAX: Kumquats.

SEN. DAYTON: Yeah, kumquats, thank you. I think the use of -- and Professor Shiller, you addressed this -- the use of projections of how the economy is going to perform over the next 30 to 60 years is critical on any of these plans, whether it's the continuation -- as the Social Security trustees do -- of the present system, which they call it the high-range scenario, but it's really pretty much the increase in the real GDP over the last 30 to 40 years extended forward. That generates a certain rate of -- presumably a certain rate of return in the private equity markets that is going to be favorable as well.

So you've got in the best-case scenario, where the U.S. economy is performing in the future as it has in the past, you're going to have -- again, I haven't seen the 2005 report, but the 2004 Social Security Trustees Report showed the fund very close to being able to meet current obligations and actually, I believe, ends up in 2080 with \$18 trillion in assets. The stock markets, presumably, would also generate the kind of returns that you cited, Professor Shiller. Conversely, if the U.S. economy performs in the mid-range projection of the trustees, at about half of what it has in the last 30 to 40 years, the fund is going to be short of funds for present obligations, but I assume the stock market is not going to be performing and generating the kind of returns.

So both sides, or all sides, tend to be guilty of taking a blue-sky scenario for their own calculations on their side and then less than that for the other side. And I wish we could get somebody that we could all rely on to just -- to do a true apples-to-apples comparison of how these funds would perform under, you know, the same set of economic assumptions and how the markets going to be expected, and the like. Then, it seems to me, we'd have a sense of what the alternatives really are.

Professor Shiller --

MR. SHILLER: Yeah, Ms. Koblener points out that people's support of the president's plan can be changed by rephrasing it or explaining it in different ways. I think that young people would be much less likely to support -- if the president's plan were described -- and I think accurately it is -- as a plan for the government to get into the margin lending business. Right now, anybody who wants to can go to a stockbroker and ask to buy stocks on margin. You are, however, restricted to a 50 percent margin requirement, and the president wants to change that and wants the national government to be making margin loans. They call it -- the loan balance in the brokerage industry is called the debit balance, and they've reinvented a new word for it: they call it offset. But it's the same thing. But the real change is that the president is allowing you to use your future Social Security benefits as collateral for a margin loan. A broker can't do that. The broker -- if you lose on your margin loan, he can't say, "I'm going to take your Social Security benefits." That's a projection that we now have that would be taken away under this plan.

I think if it were presented this way, there would be a lot less enthusiasm for it. Most people think margin -- buying stocks on margin is a risky thing, because it in fact is risky. And that's the problem with this proposal.

SEN. DAYTON: We're joined by Senator Lincoln of Arkansas. Welcome. And I wanted to give you an opportunity to make any opening statement you care to make and then also question our panel here.

SEN. BLANCHE LINCOLN (D-AK): Good.

Well, I want to say a special thanks to our chairman, Chairman Dorgan, and to you, Senator Dayton for -- and all the members for coming together today so that we can really continue the discussion on such an important issue to all Americans, and that is our Social Security program.

I'm especially appreciative that we've chosen to focus today's hearing on the impact of the president's private accounts proposal on our American families. Families have depended on Social Security for decades, and not only is Social Security a source of retirement income, but it's also a vital safety net for our nation's sick, widowed and disabled.

Some of you may have noticed that there were several women senators yesterday that sent a letter to President Bush to express our deep concern at the reports that we were seeing that in addition to reducing benefits for an estimated 70 percent of all retirees, the Social Security privatization plan would actually cut benefits for some of the most vulnerable Americans that the president had indicated to us would have remained safe, and that's our widows and our survivors.

And so we have some grave concerns in terms of what's going to happen in that case. And I think we all share that concern, because as Americans we are proud. We're proud of our nation and the values that it holds, the fact that our nation is a nation that prioritizes and is willing to wrap its arms around those who are most vulnerable, those that are the elderly, those that are the widowed, the orphaned and the disabled. And so I think we first and foremost should approach this program as something that we're very proud of, that we want this sustained, the incredible values that it presents for us as Americans, and that we want to do so in a very thoughtful way. So I'm very proud of the commitment that our country has made all of these years, both to themselves and to future generations of Americans by establishing Social Security as an insurance program.

I've been guided by the needs of Arkansans from the very beginning of this debate. And I think that's what we're all really here to do, certainly to represent the constituencies that have sent us here and to look at our nation as a whole in the programs that are there and how we can reinforce them. The needs of Arkansans will continue to guide me as I join my colleagues in addressing so many of these long-term challenges that Social Security faces. And I'm very proud and really reinforced when I go home to Arkansas and listen to the very thoughtful people of my home state who tell me the stories of how Social Security has truly made a difference in their lives and in the lives of their family and in the lives of their children. Being able to care for an aging parent -- I think we've all -- if we haven't been through that, we certainly recognize or have seen friends and neighbors who have lost a spouse perhaps and needed survivor benefits, and we've certainly seen, many of us as women, the issue of a survivor spouse and how important it is for them to have those benefits as a caregiver and then as a survivor.

This is a very important debate. I hope that we will as members of this body take it very seriously and very thoughtfully to come up with the solutions that will without a doubt deal with whatever challenges we face in Social Security but do so in a way that does not put at risk a program that has meant so much to so many over these years.

Mr. Chairman, I'd like to ask a couple questions, if I may --

SEN. DAYTON: Please.

SEN. LINCOLN: -- I guess best addressed to Professor Shiller and perhaps Mr. Orszag.

I'm sure both of you have heard that retirement -- you know, our retirement in this nation referred to as "that three-legged stool." And obviously one leg is private savings; one leg is our

employer benefits and pensions, and the last leg is Social Security. And American workers bear the risk for the first two legs, and we want to do everything we can to ensure that those legs are as stable as they possibly can be. But Social Security is supposed to be the one leg of that stool that is stable and that is without risk. And I believe that one of the key points in today's discussion is who should bear the risk when it comes to Social Security, the government or the American worker? It's my belief that the leg of the stool representing Social Security should remain stable. It is essential for the peace of mind that Americans need as they grow older. And this belief, I think, was solidified further by what's happened this week with United Airlines pension plans. I don't know if you all have mentioned that or talked about it yet here at the hearing, but recognizing that there are multiple risks out there that exist that workers are faced with as time goes on. And without having a system like Social Security, where the risk is not fully borne on the worker, we've got a real problem with the quality of life that individuals can lead in their golden years.

So it seems to me that privatization would shift the risk of retirement savings to the American worker -- Dr. Shiller, I know you touched a little bit on that when you talked about margin -- leaving millions of our workers no secure source of retirement income or safety net. And that's some of what we really are talking about here. You know, if there's three shaky legs in that proverbial stool, it does no one any good, whether it's the growth of our country and the economy or the quality of life that we want seniors to lead.

So I guess perhaps -- and certainly the question is open to anyone -- but do you feel that the president's private accounts proposal would really shift that risk associated with Social Security from the federal government to the American worker, and what is the greatest -- in shifting that risk, what is the greatest risk to the people of this country?

SEN. DAYTON: Professor Shiller why don't we start with you, and then we'll give each of you a chance to respond as you wish to.

MR. SHILLER: I think we can view Social Security either as a risk-management institution, like an insurance institution, or we can view it as a structure that we -- through which we fulfill our commitments to each other. We Americans care about each other. We care about our children; we care about the working people, and we care about the adults -- the retired adults. That's what Social Security represents. In a way, it's an extension of the family. Within the family we care about our elderly parents; we care about our children, and we make sure that they're all doing all right. The family has done that function for thousands of years, and it continues to do that function. But Social Security augments that by making it a national commitment, not just a family commitment. And so if the family members die or something happens or the family does poorly, the family can't do it all. That's why we have Social Security. And so it's very important to keep that going. I view it as a moral imperative. We have -- not just because we've promised it; it's because we want that. We want to protect the elderly and the children and everybody, and that's what Social Security represents.

Now what's happened now with the president's proposal is that people have gotten so in love with the stock market that they start thinking well, these family obligations are just a drag on me; if I could just chuck that, not worry about other people, I can just go out and invest and I can get rich. That's the kind of thinking which is very misguided, I believe. Ultimately the reason the Social Security system has a low internal rate of return is because it's an obligation, and that obligation has to be maintained. I think it's a big mistake to start thinking that the stock market will replace our social coherence as a way of guaranteeing our security.

SEN. DORGAN: Mr. DeLong, do you care to --

MR. DELONG: I think that the three-legged stool is indeed a very good way to think about a set of issues. And Senator Lincoln is certainly completely correct, that the news of this week reinforces what we economists have been talking about for a while but has not really penetrated public consciousness -- that the employer-sponsored pension program, especially the defined-benefit component of it, is in real trouble. In the past decade it was the steelworkers; this week it's the pilots of United Airlines. Three or four years from now there is at least a reasonable if not yet a 50 percent chance that it will be the auto companies General Motors and Ford that will suddenly find that the risks of running a defined-benefit program are too great for their companies to stand up. And it's in that context that we want to strengthen the other two legs.

And I think that perhaps the principal objection that the -- to which the outnumbered Mr. Max's support of the president's private accounts plan meets here is that from at least our perspective, he wants to strengthen the private savings component of Social Security, the third leg of the stool, by kind of sawing off some of the wood from the Social Security leg and the defined benefits, certain risk-free parts, and pounding, nailing those pieces of wood onto the private savings leg in order to make it stronger. You know, and it's certainly the case that we do need to have a stronger private savings leg to the retirement income stool. As I said before, every time I run into Wharton professor Kent Smetters, he buries me in statistics about how little savings -- and especially how little high-return savings -- the poor half of Americans are able to kind of accumulate during the course of their working lives.

But this makes me think that what -- that we want to move not in the direction of transferring money out of Social Security as currently structured in to private savings; not, as Robert Shiller put it, to put government into, effectively, the business of making margin loans for stock market investments, but to make it extremely easy, transparent and trustworthy for Americans to add to their retirement savings -- little boxes on your Form 1040 saying that if you don't check this box, half of your tax return is deposited into something like the Thrift Savings Plan with a government match. Things like that to actually increase the total resources devoted to the kind of retirement savings system. You know, not simply trying to say, look, we've strengthened this leg of the stool and ignore the fact that the extra pieces of wood to strengthen that leg have come out of one of the other ones.

SEN. DORGAN: Mr. Max, on your behalf, I think the residents of Berkeley, California, may not have an accurate perception of your relative numbers to the rest of the country. (Laughter.) I'll give you a chance to respond.

MR. MAX: I would argue first, Senator -- and thank you for being here --

SEN. LINCOLN: Thank you.

MR. MAX: I think there's some confusion as to the ability to transfer risk from individuals to the government, as if the government itself is a money tree whereby, you know, we can just generate income from unknown sources. At the end of the day, this is all about income sources that come from, in one way or another, the American worker, whether that's through a defined-benefit plan, a defined-contribution plan or a government-sponsored tax and transfer program. You can't get rid of that fact. Money -- you guys don't make money.

SEN. LINCOLN: No, we don't. (Laughter.)

MR. MAX: All right? It's the membership -- you know, it's my members. It's the members of national association -- it's the workers, at the end of the day, that make that money. And the idea that we can just, you know, transfer all this risk to the government and everything's going to be hunky dory is just false on its face.

As far as the three-legged stool, I would just argue that absolutely I agree we need a three-legged stool, and one of them -- two of them, I would say, are sorely broken, particularly amongst young people. People under-save, dramatically under-save, and it's not easy to get them to save. Fifty-one percent of Americans make less than \$25,000 a year, and you're going to those people and saying, "Why aren't you putting money into IRA or 401K?" After they give 12.4 percent to you for the other leg, where are they going to get the money? They're buying diapers. You know, they're trying to meet their rent. It's not an easy calculus for them.

I think all we're trying to do here -- I would separate out the two issues. One is Social Security. Understand that if you do nothing, that worker will suffer -- low income and wealthy alike. This system will go broke; it will fall on the American taxpayers; it will mean a dramatic increase in taxes over time.

SEN. DORGAN: Can you define your term? Apropos of what Ms. Kobliner said, could you define your term when you say it will go broke?

MR. MAX: Well, by going broke I mean, you know, we're running a \$11 trillion -- or if you want to do it over 75 years, a \$4 trillion deficit. That money has to be made up. By going broke, I mean we're going to start taking in less than we're putting out.

SEN. LINCOLN: Forty years from now.

MR. MAX: Well, if you believe that there are assets to which you can cap in 2018 to pay off the bonds which have been written to the Social Security Administration.

SEN. LINCOLN: Are you advocating we shouldn't -

MR. MAX: I'm advocating that those -

SEN. LINCOLN: -- and that we wouldn't?

MR. MAX: Well, let me finish. I'm advocating, first of all, that the trust fund itself is an accounting device; it's not an asset.

SEN. LINCOLN: Well, you know, my question --

MR. MAX: And if you're here --

SEN. LINCOLN: -- to you would be from what you've just stated, if in fact you think that the Social Security is not a good place to invest American workers' dollars, that it, you know -- that it's a good solid investment. Well, I mean, you're saying that they can do better. They can put it somewhere else --

MR. MAX: No, I'm not saying that.

SEN. LINCOLN: And they --

MR. MAX: Clearly, I'm not saying that.

SEN. LINCOLN: -- make more. But, my point to you would be, how would the American government been able to manage since 1983 if we had not been able to access all \$1.7 trillion

dollars worth of increase that's been put on the American workers? I mean, we're operating at an incredible deficit right now.

MR. MAX: Absolutely.

SEN. LINCOLN: We have historic debt out the wazzoo, and we're squabbling over here about eight million dollars additional to a highway bill when we just spent \$82 billion in emergency spending that went straight to debt. I mean -- so --

MR. MAX: You're preaching to the choir. I absolutely agree. We have a fiscal mess in this country, and Mr. DeLong earlier, I think, harkened to where my view is on that. I think we have to get that in order.

SEN. LINCOLN: But if we put --

MR. MAX: And I understand that.

SEN. LINCOLN: -- at risk the very workers that are the foundation of this nation by saying to them, We're going to jeopardize the security of your retirement by allowing you to take these dollars out and put them into a risky system where there is no assurance --

MR. MAX: First of all, I did not say that. I did not say that. What I said was -- and first of all, if we're running a deficit, the government ought to be honest in tax and spend to cover that deficit without calling it Social Security. It seems to me immoral --

SEN. LINCOLN: I would disagree. I voted for lockboxes. I voted for paygo. I voted for all of those fiscal responsible tools that we've been allowed to.

MR. MAX: (Cross talk) -- refer you to -- (inaudible) -- testimony. I have no problem with lockboxes, but the truth of the matter is the government can't lock away resources. It has no real ability to save. So, all I'm saying is for the next twelve years, or in some way, let's find a way to make Social Security taxes go towards retirement. Not towards the rest of the government.

So understand the first thing we need to do is shore up the one leg, which is Social Security, the government pension plan. And I think the president has put forward a reasonable idea to say --

SEN. LINCOLN: Don't the private accounts -- they do nothing for solvency.

MR. MAX: Well, I would agree, although I do think they generate wealth. They're good for the economy, and that may have tax revenue effects in and of itself, but on a --

SEN. LINCOLN: Almost every economist that we've talked to or CBO or OMB, whoever all those groups out there, they've all told us that -- (laughter) -- all the actuaries have indicated to us that it does nothing for solvency.

MR. MAX: You're not going to get a big argument from me on that topic. I do think they are important for wealth creation over time.

And I do think for low-income workers who -- in the president's proposal, they're protected; they will get the benefits tomorrow that they're promised today. On top of that, they will have an opportunity to invest in a personal account.

Now, if you think it's too risky -- the thing that always confuses me about my fellow panelists is they go out there and they say the whole world will lose under personal accounts. Well, if that's the case and these are voluntary, no one will partake in them.

SEN. LINCOLN: No, I don't -- again, I think that, you know -- you mentioned those people, and many of which I represent -- 50 percent of Arkansans have an adjusted gross income of less than \$25,000, and 80 percent of them have an adjusted gross income of less than \$50,000. So you're right, these people don't have a lot of expendable income, but they also don't have a lot of expendable time, and many of them are working hard. They don't have the time nor the resources to spend towards investigating and figuring out and becoming economists to invest those dollars. There's no doubt that they want to have appropriate places where they can put their savings. But, you know, without someone to match it or perhaps provide the kind of guidance, they're going to be the low man on the totem pole when it comes to creating this wealth that you're talking about. They're the ones that are going to be subjected to more risk, and they're the ones that need it the least, in terms of risk.

You know, the ultra-wealthy being able to invest their dollars --

MR. MAX: Why would you say subjected when it's voluntary?

SEN. LINCOLN: Because you're painting it as if it's something that's going to be easy to do. And for somebody that's making \$25,000 a year, I don't think it's easy to do. But if you paint a picture that it's going to be, you know, cotton candy and ice cream --

MR. MAX: I've certainly not done that, and --

SEN. LINCOLN: Well, maybe you haven't, I don't know. I'm just saying that in most instances, a lot of people say, well, you can take this 2 percent, and boy, it's going to really magnify and do great things for you.

MR. MAX: And I would hope my fellow panelists would agree. I have never been one to say that the modest reforms on the personal account side of this administration are going to turn all of our low-income individuals into millionaires. I've tried to be very careful in my analysis.

SEN. LINCOLN: Well, most of the --

MR. MAX: I'm not one of those that think there's a free lunch. I am one that thinks there needs to be trade-offs. But I want to point out that there's trade-offs if you do nothing, okay? There's costs of doing nothing.

SEN. LINCOLN: Yeah. And I don't think anybody wants to do nothing. I just think that what we really want to emphasize is that this needs to be a thoughtful process, it needs to be one that looks at absolutely every option, and more importantly, the consequences that every member of our great nation will be subjected to and those consequences.

MR. MAX: I think we agree.

MR. ORSZAG: Senator Lincoln?

SEN. LINCOLN: Yes?

MR. ORSZAG: If I could just add a couple of points quickly. One is that I think it is important to talk about the, quote, "voluntary," end quote, nature of these accounts. As proposed by the administration, there would be a one op election; you would choose at one point in your life whether you're in the accounts or not. Let's say, you know, you -- I don't know what you were like at 18 or 20 or 25. I wouldn't want to be making a lifetime decision at that point as to now that I'm a

little bit older, and hopefully a little bit wiser, looking back and seeing whether I made the right choice or not. So I think it's going to be very easy for people to make mistakes.

Secondly, for those workers at \$25,000 a year in earnings, I am very strongly in support of individual accounts for them -- 401(k)s and IRAs.

SEN. LINCOLN: IVAs.

MR. ORSZAG: And IVAs.

SEN. LINCOLN: We've got a lot of tools we can use out there.

MR. ORSZAG: There are a lot of tools, and the evidence very strongly shows, including a new pathbreaking study that I was a co-author of just last week, showing that -- well, we used randomized assignment of different -- (word inaudible) -- showing that moderate and low earners will save if you make it easy, and if there's a strong financial and -- strong and transparent financial incentive to do so.

We do not need to be encouraging moderate and low earners to borrow against the one solid piece of their retirement income in order to build assets. That does not make any sense.

Another point that I want to make is that you had talked earlier about survivors, and with regard to both components of the president's proposal, both the progressive price indexing and the accounts, there are very important implications for survivors. As you noted, there are many lower income survivors who could get hurt by the progressive price indexing proposal. So when you hear the bottom 30 percent are protected, that's not actually true, as the administration's own analysis has shown.

Secondly, with regard to the accounts, many people don't realize that that debt backed to Social Security would be owed by a survivor. So, your husband's half passes away, and the president keeps talking about this bequest that you're going to get, or this account that you're going to get --

SEN. LINCOLN: But you also get the debt.

MR. ORSZAG: You're going to get a debt too, and you better hope your husband was a really good investor, because if Professor Shiller is right, you're going to wind up in, you know, more likely than not, in the hole as a result. You're inheriting a debt along with an account. I don't think that makes any sense either.

SEN. LINCOLN: Well, I think as Americans in the midst of this debate, it's important for us to talk about the survivors and the disabled. I mean, in Arkansas, it is a disproportionate number. We think the number, nationally, is about 31 percent of Social Security benefits go to the disabled and survivors. In Arkansas, it's 40 percent, right at 40 percent. A lot of that is for different reasons. We are disproportionately elderly. Those elderly are disproportionately women, and we know -- I mean that's a fact of life. We live longer and we tend to be caregivers, and we're the survivors.

The other is that we're a rural state. So, many of our workers are not only lower-income workers, but they're more physical jobs. Which means they are more likely to be disabled at an earlier age, and to have to depend on those disability payments, because they're in more physical jobs, and it takes its toll earlier.

So, I think it's really critical that we look at all of the aspects of the plans, and the consequences for everybody in this country that contributes to the wonderful things that we all enjoy, being a part

of this great land. And so, you know, particularly in terms of women and those that live in rural areas, those are some of the, again, the conversations that I have that guide me with the constituents that I represent.

Mr. Chairman, I had one more question --

SEN. DAYTON: Please go ahead.

SEN. LINCOLN: -- if you don't mind. I'm sorry to be so --

(Laughter.)

SEN. DAYTON: No, this is --

SEN. LINCOLN: I -- (chuckles) -- don't want to hog. Okay. (Laughs.)

SEN. DAYTON: Short of the week's earlier evacuation, you've added more adrenaline to the room than anything so far.

(Laughter.)

SEN. LINCOLN: (Laughing) -- Okay well, I'll calm down a little bit. (Laughs.)

SEN. DAYTON: No, no -- no, no, I'm all for it!

SEN. LINCOLN: (Laughs.) Well, Professor DeLong, the White House officials had said earlier this week that about 15 percent of all retirees would likely not be able to pass along a Social Security inheritance under Bush's plan. We talked a little about, you know, whether or not this really is going to be an ownership situation that people can pass on, and they would have spent their entire personal account on an annuity to make sure they remain above the federal poverty level in their older years.

And according to tentative -- this is all according to a tentative administration projection -- we can assume that this figure will be quite a bit higher for those with lower lifetime wages, and therefore, as I mentioned, impacting many people in my home state of Arkansas.

In addition, I think the reports show that someone who cashed out a personal account and used those proceeds to buy an annuity in 2003 would have received 60 percent less in retirement income than a similarly situated person retiring at the beginning of 2000, based on stock prices falling and the prices of annuities rising because of lower interest rates; obviously, the riskiness that we talk about of where these investments go.

I guess my question is, really, how is this a good idea for lower- and middle-income Americans to be subjected to that kind of a risk, particularly when being forced into an annuity, without that ownership quality or really the ability to use those resources to their best advantage? Have you already addressed that?

MR. DELONG: No, but let me first, actually, go back to the previous question --

SEN. LINCOLN: (Laughs.) We were having so much fun! Okay. (Laughs.)

MR. DELONG: -- and endorse the remarks of Mr. Max and Mr. Orszag. Derrick Max is right; he is not Peter Ferrara, and not all of Peter Ferrara's views --

MR. MAX: Thank you. (Laughter.)

SEN. LINCOLN: Well, we know that because we know Mr. Max from a previous -- he's got some good connections to Arkansas.

MR. DELONG: And, you know, Peter Orszag and Emmanuel Saez, six doors to the north in Berkeley, are also right that we do now know a lot about how to provide incentives that will actually get the poorer half of Americans to save for retirement, which we desperately need to get them to do.

As to the 15 percent of all retirees not being able to pass on a bequest because their private account will have been completely annuitized, that number strikes me as significantly low --

SEN. LINCOLN: It is.

MR. DELONG: Right. That is, as based on assumptions about stock returns that not only fail to recognize the current relatively high level of price dividend and price earnings ratios, but also that, you know, assume historical patterns of returns that Robert Shiller says are extremely unlikely to be duplicated in the future. The United States is unlikely to have as good luck over the next 50 (years), economically, as it has in the past. And so I think it's not 15 percent. It's going to be something more like 40 (percent). And that's even with full annuitization only down to the poverty line.

And I mean this, through your question, connects with a reason why at least the Bush administration private accounts plans are, in many ways, rolling a boulder uphill because they have no way to effectively spread out the risk involved in retiring in a down stock market year -- retiring in 2003 relative to 2000 -- except for this life cycle -- right, this life cycle portfolio account that Robert Shiller talked about, which is in its turn extremely expensive in terms of passing up, right -- expect of passing up the higher expected returns in stocks by moving yourself into a very safe portfolio quite early.

And indeed, Mark McClellan, now director of Center for Medicare and Medicaid Services, and you know, a stalwart Texas Republican, at one point in the past decade was actually a Democratic political appointee in the Rubin-Summers Treasury in charge of preparing plans for Social Security reform. And if I recall correctly, that inability to deal with the down market problem was one thing that led him and his bosses to focus on -- right, to the extent that investments in stocks are made, shouldn't they be made by the trust fund as a whole, rather than by individuals? Right? Because even though the government is not a money tree, nevertheless it's a very good device for spreading risk across years, across cohorts, across individuals, across generations.

And as you move into private accounts, yes, you can give people a sense of ownership -- and yes, Mr. Max at least hopes that then you can make the government think more fiscally responsible sense, although I doubt whether that will be important -- but you give up enormous abilities to spread risk. And those are, I think, a very valuable thing and a tremendously high cost to pay, which is I think one reason why it's proving so very difficult to make -- for the administration to make all the numbers come out right as it tries to move forward with the private accounts proposal.

MR. MAX: If I could just --

MS. KOBLINER: I just wanted to say -- oh.

MR. MAX: I'm sorry; go ahead.

SEN. DAYTON: (Inaudible.)

MS. KOBLINER: I was going to say one point, that -- just to what Professor DeLong just said - - you know, what about that down market? You know, you're ready to take out your retirement funds. And the polls have shown that the general public, those people who support private accounts, say that if they were in a situation where they're ready to retire or they take their money out and the market's down and they would have gotten less now than they would have under traditional Social Security, that they would then expect the government to come in and make up the difference for them.

So, you're sort of back to where you've started. (Chuckles.)

SEN. LINCOLN: Started. (Chuckles.) That's exactly right.

MR. MAX: If I could just clarify one point, I don't think there's a disagreement on this panel that savings accounts are important. Regardless of our concerns about the risks over time, whether and how they're incentivized, I think the concern is over where the money comes from to put into those accounts.

SEN. LINCOLN: Mm-hmm.

MR. MAX: In fact, I think Peter and I, for the most part, when he says he wants a simple, easy way not, you know -- that's a noncontroversial point. I agree. I think the concern that Peter has is where we get the resources to do that, and how do we incentivize? And so the question -- I think Professor Shiller raised a valid concern about the offset rate. Obviously, if you're below, you know, the pegged rate of 3 percent, you know, this makes a very -- you know, this is a very real problem for investors down the line.

I think Professor Shiller in some of his other writings recently has marked -- has to come up with his own answer. Instead of having a pegged offset rate, you could do it, the real returns over time, so that if a person had just invested in the lowest risk option available, you'd come out at least even. That seems like a reasonable alternative.

And I guess that's the kind of thing I'm trying to get as we talk about this debate. I think there's a lot of agreement. I think there are things in the president's plan that can be improved. I think there are things in what we're all talking about that can move this ball forward rightly. And my concern is that if we quibble over a lot of the details and just throw bombs at each other from the far Right or the far Left, this system will continue to slide towards what I consider to be bankruptcy or insolvency. I know those are hot words, but we have to act, and it will never get easier to fix than it is today. It'll only get harder.

SEN. LINCOLN: Well, I don't disagree with you that we all agree on savings, but I think it's more than just a small quibbling piece to say that allowing the diversion of payroll taxes into private accounts, creating greater trepidation, insolvency, greater debt for our children to have to deal with is not a small piece of this overall conversation. But I think you're right; I think we do all agree on the savings aspect of it. And I know that it's a huge part of what my concern is, and that is to make sure that we are creating better tools and better available ways for everyone in this nation to save because we are at an abysmal spot in our history in terms of savings. But I think that creating greater debt and not helping solvency and diverting those payroll dollars is a big difference --

MR. MAX: I would just --

SEN. LINCOLN: -- that we've got to get past if we're going to start getting to the more creative things.

SEN. DAYTON: Mr. Orszag and then Mr. Max.

MR. ORSZAG: Just to return to your original question about the annuitization. I think it underscores that, especially given the way these accounts are being sold with an ownership and control theme, there is likely to be a very severe backlash against a lot of the rules that the American public probably doesn't know -- surround these accounts.

The accounts would be administered by a government agency, a so-called central administrative authority. There would be very restricted choices in portfolios, about what you could choose. You would have to annuitize part of your account upon retirement. You would not be allowed access to the account before retirement, even if your kid was sick or you needed a new car or your kid had just gotten into college and you didn't have any other money. All sorts of things that, while they may be sensible for policy wonks to design, I think are very unlikely to be sustained over time, especially given the way that the accounts are being sold and/or advertised.

And that underscores another concern. The point is, even if all those restrictions stayed in place, the accounts don't make sense. But as you loosen them, they make even less sense for that core bottom tier of retirement. Maybe it does make sense to take money out of an account for a new car or for a new refrigerator, but it doesn't make sense to take money out of that account when that's the bottom tier of your retirement income, and the money's then not there for retirement. Let's, again, just to keep beating this dead horse, build the accounts on top of a solid foundation, not try to introduce them where they don't belong.

SEN. LINCOLN: Well, it's just marginalizing that retirement just as you would be when -- private --

SEN. DAYTON: Let me get Mr. Max, and then we'll go down the table this way, if you can just respond?

MR. MAX: I would just -- again, I think we're getting too locked into the idea that there are different tax streams, and that it all impacts people completely differently. At the end of the day, if you're creating private accounts and you're incentivizing it in some way through a government subsidy or some kind of a government payment, that money has to be accounted for in some way. So, that will deal also with the overall budget of this country. It may not affect what you call the Social Security balance sheet, but it will affect the U.S. balance sheet.

SEN. LINCOLN: But --

MR. MAX: And you guys, with all due respect, are not trustees of the Social Security Administration. You are trustees of the budget as a whole, and that ought to be the concern.

SEN. LINCOLN: And, you know, you make a very good point when you say the -- or you're saying that, you know, we make too much about these different tax streams. Well, we have borrowed considerably from a very regressive tax stream to pay off a very progressive tax stream with the tax cuts that have been instituted in 2003.

I mean, the tax cut to the ultra-wealthy in this country are being paid for by the debt that is incurred in the Social Security trust fund from a very regressive tax stream. So I mean, I think that there -- the payroll taxes in this country are largely paid by the working people of this country who make less than \$100,000, and that's a regressive stream of tax resource which we are using to pay for the tax cuts and other things. I mean, there are some very real tax streams there that are getting commingled and cohabitating and becomes very dangerous, I think.

MR. MAX: I agree with most of what you --

SEN. DAYTON: Professor DeLong? Sir.

MR. DELONG: Well, I just wanted to note that while we here on this panel are all agreed on the importance of boosting national savings, you know, it's not clear that the administration, at least as it puts forward its plan for carving private accounts out of Social Security, is concerned in the same way. That is, even those like, say, Greg Mankiw, who are under extremely tight message discipline, don't go out there and say that this private accounts will actually boost national savings. The most they say is that it won't reduce national savings because, yes, the federal budget will go up as the money is diverted out of Social Security, but that will be exactly offset by the fact that private savings will go up because people will now be contributing to their private accounts.

And that argument rests on the belief that when people look at the balances accumulating in their private Social Security accounts, they won't also look at their contributions to other part of savings and say: Oh, I've already saved this much this year; I don't need to fully fund this 401(k), I don't need to expand what's going into my 527. I can actually spend a little bit more because I own this particular nest egg.

And, as -- let me wheel out Alan Greenspan again. As Alan Greenspan said on this point, we think this is likely; nevertheless it's something we guess, not something that we know. And, quote, "if we were to go forward with this in a large way and we were wrong, it would be creating more difficulties than I could imagine," unquote.

And this kind of feeds in to my worries about implementation because as far as I can see, there's no plan B. There's been no thought within the administration's plan at all about what do we do if we do indeed find that people regard their private Social Security accounts as close substitutes for other pieces of retirement savings, and we start down this road and find in 2015 that people are draining their other savings as they watch their Social Security balances accumulate. What then?

SEN. DAYTON: Professor Shiller?

SEN. LINCOLN: Mr. Chairman, I have to excuse myself --

SEN. DAYTON: All right. Please do.

SEN. LINCOLN: But I want to offer a very heartfelt thanks to all of the panel for a very genuine discussion, and I hope that you won't stray far, that we can keep all of you all engaged in this discussion because there are some real problems and challenges that we face, and we want to come to those conclusions in a very thoughtful way.

So thanks to all of you all. We appreciate it. Thanks.

SEN. DAYTON: Thank you, Senator Lincoln. Thank you for demonstrating how well you know your state; very impressive. (Laughter.)

Professor Shiller.

MR. SHILLER: I think we shouldn't lose sight of the ultimate vision that underlies the president's proposal. It's the ownership society. It's a good vision in the sense that we want people to get more involved in our financial and capitalist institutions. But unfortunately, there's a bit of a wishful thinking about that. Just as the Soviet communists had the hope that they could change human nature and make everyone into a Soviet man, it's not going to happen here either. And the

problem is that real people, they vary and they differ, and they're going to interact, some of them well with this proposal and some of them badly with this proposal. And there's going to be some bad outcomes.

The real significant problem that we face has been -- I think we agree here -- is that Americans are not saving. Many of them, most of them are not saving enough. And the problem -- why are they not saving? This is a difficult thing, but it's partly I think because we've gotten into a very optimistic frame of mind and we think that our home price appreciation is going to make us millionaires -- (chuckles) -- by the time we retire or that the stock market is going to save us.

And there's a possibility that some of this is not going to work out well for everybody. And there's going to be some people who are lulled into a complacency by their personal account and by the optimistic talk about it, and they'll save even less with the personal account system. And then there's the possibility that, you know, the market will drop right after you -- right before you retire, and it's -- people are going to be surprised to see that I'm earning only half as much as somebody who retired two years ago. And they're going to think, why did the government allow -- I thought the government prevented this kind of nonsense from happening? Isn't this America? Well, it is America -- (laughs) -- and we shouldn't do a system that will create that kind of hazard.

SEN. DAYTON: That's one of my concerns for sure. You know, the difference between investing for asset appreciation, for retirement based on surplus income, and investing money that's borrowed for that purpose is enormous in terms of the risk and also the probability that the investor is going to come out ahead. And both individually here, but really collectively, if we're talking -- and Professor DeLong, Mr. Max, you both cited earlier the, maybe, hierarchy of concerns that we ought to have. One is for the current deficits. If we're going to be defining the Social Security trust fund as, quote, unquote, "going broke", or "bankrupt" in some year in the future when the income starts to be less than the expenditures, then we ought to be using the same terminology, it seems to me, to be talking about the federal government in the much larger primary operating budget that, as you've noted, is raiding the trust fund, the lockbox. As you know, you've got a trapdoor that, you know, loses everything. And, as you pointed out, Professor DeLong, we've got the medical problems.

I mean, it seems to me we are setting ourselves up to in addition to the borrowing that's going to be ongoing for the operating deficits. If we're then going to borrow whatever the number is: three, four trillion dollars -- I believe that's your number, Mr. Orszag, if that's, you know, in the ballpark.

MR. ORSZAG: Higher than that over --

SEN. DAYTON: The first 20 years. An additional \$4 trillion, I don't know of many examples, individually or collectively, where people have borrowed themselves into prosperity.

It may be, if the market is conducive to that, or they're again Microsoft at the right time or whatever. But this is not going to be the Lake Woebegone of financial investing. We're not going to all come out better than average. And we ought to be concerned about - my father is a successful business-investor used to say the difference between evening the score and making a score. And if we're going to make a better score for these investments, whatever form they take, as well as for the additional personal income for savings as well as for collections, revenue stream from whatever sources that are going to be able to meet these obligations, then getting our fiscal house in order in the immediate realm is much, much more going to affect the future, it seems to

me, than some of the things that all of these various notions are addressing for years and decades into the future.

So I'll give each of you a chance to make, if you want to touch one final point. I think we've covered this extremely well, and I appreciate your forbearance. I appreciate your comity with one another.

And we'll take all the good ideas and welcome them.

I do want to just raise one question, because we held a hearing in this committee earlier this year to examine the extent to which current employees at the Social Security Administration are serving as advocates for the president or his administration's privatization plan.

I'd just like to know if any of you have consulted with anyone in the Social Security Administration with regard to the preparation of your written testimony for today's hearing?

MR. MAX: I certainly, obviously, talk to people in the administration, at the Social Security Administration. I was in the wedding of a gentleman who was detailed, I believe, to the White House. He certainly was given a copy of this, and provided thoughts and insights. But I consider him a friend more than a work colleague.

SEN. DAYTON : So has anybody currently employed with the Social Security Administration reviewed, edited or made changes to your written testimony?

MR. MAX: I'd have to ask what his employment status is. I don't know if he's at SSA or the White House.

SEN. DAYTON: Okay, thank you. Anyone else?

MR. DELONG: I believe I've changed a couple of emails with the gentleman in question in the past few months, but didn't ask him for any edits.

SEN. DAYTON: Let me start with you, Ms. Kobliner, and ask if you want to make a one-minute summation.

MS. KOBLINER: Sure. I just wanted to say that clearly the issue of savings is important for our country for young people, and - but dismantling a system that is supposed to provide a base of moderate reserve there for people to fall back on doesn't seem like the way to go.

I just wanted to mention the retirement savings tax credit is something that is encouraging people to save a little bit more, people who otherwise wouldn't have. And I think that's worth Congress reauthorizing.

But I think the notion of jeopardizing the safety net with this promise of possibly doing better than they would have under the current system just is not something that makes sense. And I think as more information comes out, educating young people in particular about that is going to be very important.

MR. ORSZAG: Senator, I want to thank you and other members of the committee for holding this hearing, and just in closing emphasize that we should be focusing our attention, I think this is actually possible in a bipartisan way, focusing our attention on improving the accounts where they belong, and where we already have them, the 401(k)s and IRAs that we already have can be made to work a lot better, and should not require a Ph.D. in financial economics to navigate the pension system, and it currently does.

We can make it easier for households to save, and we can increase the incentives for them to do so. We could come together and get that done. Instead, we're having a debate over accounts where they don't belong, and where they would cause massive fiscal problems and other difficulties.

There is a better.

SEN. DAYTON: Well, assuming none of you want to be federal judges, we can continue these conversations in a bipartisan fashion.

Mr. Max.

MR. MAX: Yeah, I would just close by saying, we've got tough choices that have to be made. Doing nothing should not be an option.

I think we have two crises in this country. One is a certain ongoing imbalance in Social Security. That needs to be addressed. You can do it through slowing growth in benefits, raising taxes, or some combination thereof. Those choices don't change much over time, and they have to be made sooner rather than later.

The other problem is savings. We horribly under save in this country, young people in particular. They have an attitude that they are going to be fine forever, and that's not a wise way to head into work or into retirement.

And I applaud the administration's effort to tackle both of these in one way, and I applaud the panelists for coming up with ideas to improve upon that and to try to work together to make our retirement system stronger and better for all workers.

SEN. DAYTON: I thank you for your contributions as well. Thank you .

MR. DELONG: I'd like to thank you, Senator, for inviting us all here today. I'd like to note to Peter, Peter Gosselin of the Los Angeles Times had an article last week about how even people with Ph.D.'s are not successfully managing - getting their way to pension systems.

MR. SHILLER: And Nobel Prizes.

MR. DELONG: Including our Nobel Prize winning colleague, George Akerlof.

I'd like to say that I though find myself much more depressed than Peter Orszag is about the likelihood for successfully making progress in addressing our serious Social Security challenges, which are serious even though they aren't the most serious fiscal problems, in the current political environment.

That is, the administration has been rolling out -- (inaudible) -- plan which has private accounts that do not seem to be a very good deal when you run the numbers for beneficiaries, and yet is having enormous problems admitting to itself that that is the case.

They're having enormous problems coming out with a plan that would restore solvency, at least the current plan does not unless you take it as a backhanded way of accepting Robert Tozen's proposal to place some of the burden of financing Social Security on general tax revenues.

There are all the worries about implementation in staff work under this administration.

And there is the great and serious worry that we're throwing away something valuable, the defined benefit nature of Social Security, for benefits that are extremely vague and inchoate. And so I'm much less optimistic about how this can be moved into a piece of legislation that will

surmount, that it will successfully leap all five of the hurdles that a reform worth doing will actually have to do.

SEN. DAYTON: Well, I hear your concern. And if you look at the difficulty we have getting to an agreement on something that is much more immediate and urgent like the operating deficit now, and our extreme ingenuity at evading those problems and solving them. Same thing with Medicare. Talk about trying to come to a consensus, and even with the best of intentions that we would all have, something that has the uncertainties of the kind of different views that all of you and others like you have expressed, this is an Herculean task.

I agree with you, Mr. Max, about to some extent about doing nothing, but the first axiom, the medical axiom, is first do no harm. And doing the wrong thing is worse than not acting.

Professor Shiller, you get the last word.

MR. SHILLER: Thank you. Glad to have the last word here.

I'm hopeful that good things will come from this discussion. I am particularly inspired by the ideas that Peter Orszag and Brad DeLong both raised about improving our 401(k) and IRS savings plans.

Another issue that I just want to mention in closing is that we've brought up the indexation of Social Security. And the proposal I think goes a long way of moving toward CPI indexation.

I want to again point out I have in my written testimony an argument that we should take this opportunity to rethink the indexation, because it's a fundamental and important thing. And I believe that in order to make the Social Security function better as a risk-management device, we should move the other way toward emphasizing the average wage index rather than the CPI.

The CPI is fixing the benefits of retirees, regardless of what happens to the whole national pie that we're dividing up, and it's just backwards.

SEN. DAYTON: Mr. Max, could I ask you for the name of the friend you mentioned, the one who may be at SSA?

MR. MAX: That would be Andrew Biggs. I don't know, as I said, I don't know whether he's employed at SSA or the White House.

SEN. DAYTON: Right. Just his name.

MR. MAX: I just gave it to you, Andrew Biggs.

SEN. DAYTON: Oh, I'm sorry, I didn't hear it. Thank you.

Well, I thank you all very, very much. And it's been extremely informative, and appreciate your travels and your making changes to be here. And I'm heading to B. Dalton to get the report, two copies.

Thank you.