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WHICH WAY TO REFORM

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QUESTION & ANSWER SESSION

P R O C E E D I N G S

MR. AARON: --of the new book written by Peter Diamond and Peter Orszag on Social Security reform. We're going to begin with a description of that book and its major recommendations and analytical contributions by the two Peters.

Then, we're going to have comments from Maya MacGuineas, who is the new director of the Committee for a Responsible Federal Budget, a term that is increasingly sounding like an oxymoron.

[Laughter.]

MR. AARON: Maya has also worked on Social Security, a topic on which she was an aide to Senator John McCain during his campaign for the Republican nomination for President in 2000.

Ned Gramlich is a member of the Board of Governors of the Federal Reserve system, an affiliation which he tells me should not be brought up today, but instead we will emphasize that he was the chair of the 1995-1996 Advisory Council on Social Security.

It's worth noting that we have not stacked the deck in favor of our authors. Both of the discussants have recommended rather different approaches to Social Security reform that includes reliance on one form or another of individual accounts, an option that is not part of the program that Peter Diamond and Peter Orszag recommend.

Rather than my telling you any more, we're going to turn it over now to them. They will describe their book, and then you will have discussion. Following the two discussants, there will be time for floor comments and questions.

MR. ORSZAG: Thank you. Thank you very much. Our plan to restore balance to Social Security has several key features.

First, it does restore long-term sustainable solvency to Social Security, putting the system on a solid financial footing for the long term, and it does not destroy the program in order to save it. In other words, we do not think it is necessary to completely overhaul the program in order to put it on a sustainable basis.

So, when we say Social Security, we mean saving it both from its financial problems and from those who would use those financial problems as an excuse to completely overhaul a system that we think in structure is actually a fairly good one.

In addition, there are no accounting gimmicks or magic asterisks in the plan. So there is no reliance on general revenue transfers, and there's no ignoring the risks associated with stocks relative to other financial assets. This is I think in marked contrast to some of the other recent plans that have been put forward even in the last few days, and that may be the subject of some discussion after this presentation.

Finally, we combined benefit reductions and revenue increases rather than relying solely on one or the other, trying to follow the precedent of the 1983 Greenspan reforms, which again did involve both benefit reductions and revenue increases.

It's also a progressive reform. We protect the most vulnerable beneficiaries, disabled workers, young surviving children, lifetime low earners and widows. We ask average earners to accept some modest sacrifices in restoring long-term balance to this program and then ask higher earners who have enjoyed particularly rapid earnings growth over the past two decades and who just enjoyed some tax cuts,

also, to play a somewhat larger role in reaching long-term balance within Social Security.

I'm going to present the bottom line from our plan.

The first bottom line is that we do restore sustainable solvency to Social Security. This graph shows you the ratio of the trust fund to benefits paid each year. And what you see is the red line, the red dotted line under current law. The trust fund is expected to be exhausted in 2042, at which time incoming payroll revenue would only be sufficient to pay about three-quarters of promised benefits or scheduled benefits.

Under our proposal, instead what you see is that the trust fund ratio remains positive throughout the projection period and is actually rising slightly at the tail end of that 75-year period so that we're not falling off a cliff out in 2078.

It's also important to realize that we don't raise the trust fund ratio that much. So we're not building up a huge trust fund and living off the interests. The major feature of this graph is rather that we're stretching out the trust fund rather than raising it substantially.

The bottom line for medium earners, basically average earners, is, again, I mentioned a modest degree of sacrifice. Let me give you some quantification of that. We protect benefits, that is, there are no benefit reductions whatsoever for all of those age 55 and above in 2004--this has been a feature of many recent reform plans--and then phase in gradually a series of benefit reductions that collectively add up for average earners the numbers that I present here. For a 45-year-old, it would be less than a 1-percent benefit reduction relative to the current benefit formula; for a 35-year-old, it would be a 4.5-percent benefit reduction.

Several things are worth noting about these numbers:

First, the benefits, say, for a 35-year-old would still be substantially higher than for the 55-year-old because of ongoing productivity growth. We would allow, as under the current system, ongoing wage increases to feed through into the benefit formula. So the 35-year-old, even though it's a 4.5-percent benefit reduction, relative to the current benefit formula, would still be receiving 18-percent higher real or inflation-adjusted benefits than the 55-year-old.

The benefit reductions are somewhat larger for higher earners and somewhat smaller or are mitigated for lower earners, which reflects the progressive nature of the plan I mentioned earlier.

And to put in context some of these changes, the 8.6-percent benefit reduction for the average 25-year-old earner is smaller than the benefit reduction for 25-year-olds at the time of the 1983 reforms. So, again, just to sort of put things in context.

The bottom line on the payroll tax--again, we combine benefit changes and revenue changes--on the payroll tax, we have a gradual increase in the payroll tax rate so that the combined employer/employee rate would go from 12.4 percent today to 13.2 percent in 2035 and 13.7 percent in 2045 and would continue increasing modestly thereafter.

Again, to put these things in context. If the 2045 increase were implemented this year, immediately--and again it wouldn't actually take effect for four decades, but if it were in effect immediately--a $35,000-a-year earner, which is about the average earner, would pay an extra $37 a month in combined employer and employee payroll taxes.

For the 25-year-old average earner, the increase in combined employer-employee payroll taxes over his or her entire career, as a share of career wages, would

be less than 0.3 percent in present value. That means less than a half a percent increase in combined employer-employee payroll taxes. So, again, there is some sacrifice that's required of average earners but, in our opinion, it's quite modest.

Those were the bottom lines for the plan, but the plan itself actually takes three causes of the long-term deficit in Social Security and proposes reforms to the program in each of those three areas to restore long-term balance, and the three areas are ongoing improvements in life expectancy, which imposes additional costs on the program, increases in income and equality, and the program's legacy debt, which reflects the fact that previous and even current beneficiaries received benefits that were larger than their contributions accumulated at a market rate of interest, and Peter Diamond will tell us more about each of these three factors and what we do in each of the areas.

MR. DIAMOND: First, I'm going to talk about the changes that restore solvency. They more than restore solvency because they also have to finance the progressive elements which I will talk about.

Second, and you may have noticed from the graph of the trust fund ratio that was put up, we end up with a trust fund ratio of 175 percent of expenditures. Actuarial balance is defined as 100 percent. So there's a little bit extra in there that ends up in the trust fund at the end.

Everyone knows life expectancy has been going up steadily for a long time. It's expected to continue going up, and obviously that raises the cost of Social Security as it's now structured.

Our goal was, first of all, to index, since the ability to predict improvement of life expectancy is limited, and in that automatic adjustment to hold Social Security harmless for any changes of life expectancy, where we define harmless

as within the 75-year-horizon. A number of other plans have gone for automatic indexing for life expectancy, but as far as we're aware, every plan that has done that does 100 percent of the adjustment through a reduction in benefits.

We do half of the adjustment through a reduction in benefits, and approximately the other half through an increase in the payroll tax rate. So each year the Office of the Actuary would look at the change in the period mortality tables, calculate how much that would cost in increased costs to Social Security, reduce benefits for everyone age 60 and under, so it gets locked in place for you a couple years before you can retire, to offset half of that and then have a percentage increase in the payroll tax rate to offset the rest.

Income and equality. Two elements here. One that everyone is aware of: the share of earnings above the maximal taxable earnings base has grown quite a lot since the 1983 reform.

The second element, everybody knows that higher income people measure better as higher- educated people, live longer than less-educated people. What the demography community is aware of, and we researched and nailed down, is that gap in life expectancy has been growing and growing rapidly.

So, on a lifetime basis, Social Security has been getting steadily less progressive because the higher earners are living longer relative to the lower earners. We want to address each of these two elements in changes which will help restore balance.

For the decline in the percentage of earnings subject to tax, we do the obvious. We very slowly raise the maximal taxable earnings base until we get up to 13 percent of projected earnings below the maximum, a little over halfway between the

current 10 percent and the 15 percent back in 1983. This takes a long time to happen. It's not all the way up there until 2063. At that point, the increases stop.

And, secondly, we slowly bring down the slope of the top piece of the benefit formula. Right now for earnings above the $44,000 limit, you get 15 percent in monthly benefits for monthly lifetime earnings. We slowly bring that down to 10 percent. That takes until 2031 to carry out.

These two are roughly of the same size in their impact on actuarial balance--not exact, but rough.

The legacy debt, the third part. The early beneficiaries, as Peter said, received far more than could have been financed with their contributions. Obviously, history is history. We're not about to take it back. Moreover, most plans don't affect or don't affect, in a significant way, those already retired or those near retirement.

So we can measure the assets that aren't there on a cohort basis through the generations who are not going to be affected by our plan through the people turning 55--older than 55. And the assets that aren't there on this cohort basis is the legacy debt. It's what all of the other cohorts have to finance, given the constraint on the system that over the infinite horizon there is a budget constraint, a present discounted value of zero.

This is a familiar picture to analysts of Social Security. The dotted line, cohort-by-cohort for birth years, is how much more they received compared to what be financed by their taxes.

The red lines, against the right axis, is the cumulative sum, and you see it's somewhere around $11-, $11.5 trillion in assets that aren't there today, because of the generosity to early generations. We, of course, do not criticize that generosity. We're

saying, given that generosity, we now have to address the implications of this for the future of taxes and benefits.

The idea here is to spread that financing over all of the future cohorts in a way that's reasonably fair. If we were to go to a fully funded system, then this full $11.5 trillion would have to be paid by the transition generations. If we don't do anything, then, in time we're pushing further and further back, that the bearing of the legacy debt will get heavier and heavier on younger people.

We think the right thing to do is just to spread it out, and the concept we particularly focus on is the legacy cost, rather than the legacy debt, the assets that aren't there aren't earning interest, but as taxable payroll is growing, it becomes a bit less important relative to taxable payroll. The analogue you can think of is the relationship between the national debt and GDP. One reasonable target for a sustainable level of public debt would be to hold roughly constant the ratio of the public debt to GDP or, alternatively, recognizing that interest rates change and growth rates change, you could think of holding constant the interest costs on the public debt relative to GDP.

So the idea here is that the legacy cost has to be paid. We're going to spread it as fairly as we can, and we have to recognize that as the growth of the economy slows down, as the growth of the labor force slows down, the difference between the interest costs and the growth rate is going to get larger. This should be viewed as a bit more of a problem further out. So we have a couple of steps in spreading the legacy debt fairly.

The first, the legacy debt comes from generosity to all of the early cohorts, and we think everybody should be sharing in the cost of the legacy debt. That

includes the state and local workers who are now outside the system, so we mandate inclusion.

Secondly, we think a fair way to spread the cost of the legacy debt is relative to total earnings, not just taxable earnings. So paralleling the financing of Medicare, we introduce a 3-percent tax on earnings above the taxable maximum. Three percent is a ballpark figure of what it would take to preserve a legacy debt to taxable payroll ratio.

And, thirdly, we introduce a set of universal legacy charges, balanced through benefit reductions and tax-rate increases on everybody to stabilize the system. We don't start that until the completion of the increase in what's called the normal retirement age, a little bit more accurately thought of as the age for full benefits.

As you know, the '83 legislation phased in a set of increases. Those are large benefit cuts, and we didn't think it was appropriate to be having additional benefit cuts at the same time. So we start this universal legacy charge in 2023 right after that.

Now, that restores actuarial balance, and that finances the changes to improve social insurance. First, starting in 2012, low earners with long careers will have benefits at least as large as the poverty line, and since benefits grow with wages and the poverty line grows with prices, they will be moving steadily above the poverty line.

Second, we make sure we focus on the concept of a survivor replacement rate, the ratio of what a survivor has to what the couple had before, and we use the revenues raised in the first part to have a survivor replacement rate of 75 percent for people with low benefits.

For people with high benefits, we also think a 75-percent survivor replacement rate makes sense, but we finance that out of the benefits the couple had when they were both alive. So that's not coming out of the general revenues.

We calculate, given the changes to restore balance, how much contribution to balance is made by the reduction in benefits to disabled workers and young survivors, and then we recycle 100 percent of that money, over the 75-year horizon, into increased benefits for disabled workers and young survivors.

We do that in a way that focuses the benefits more on the people who are collecting benefits a long time. The idea that a worker disabled at age 25 and surviving all the way to the normal retirement age has had 40 years of falling behind the growth of wages in the economy, that seems to us is not a good pattern. So we basically give disabled and young survivors more than just a COLA to bring that forward.

Everyone who has studied Social Security knows there's a gap in the indexing for inflation; that is, wage indexing is focused on wage levels in the year you turn 60. CPI increases, COLA increases before benefits, after you are eligible for benefits, start when you're 62. There's a 2-year gap.

If we had high inflation in that 2-year gap, the workers suffering that would have a huge drop in their real benefits. We think that's a design flaw. So we're going to use CPI indexing starting at 60, but we're going to reduce benefits across the board to exactly offset that. So this is a revenue-neutral change.

Individual accounts, as Hank said at the start, there are none in the plan. We think they're inappropriate for the foundation of retirement income. They also create a very large cash-flow problem for Social Security, unless they're fully financed outside

Social Security. We think individual accounts a great thing. They're just not a replacement for what Social Security is about.

Conclusions. We've got benefit and revenue adjustments. You know what the conclusions are. You've heard it twice already. You don't have to hear it a third time.

[Laughter.]

MR. AARON: Thank you very much to both Peter Orszag and Peter Diamond.

Our discussants are going to obviously respond to the recommendations in the plan. I also asked them if they would address another issue, which strikes me as politically and economically important. Virtually, every critic, supporter, commentator on Social Security thinks that the sooner the financing problems and any structural changes that will be enacted are actually legislated the better. It gives more time for gradual introduction of changes, avoiding the need for abrupt shifts that could hit people at a time in life when they have little time to adjust to them.

At the same time, the current and projected fiscal situation of the federal government is not exactly rosy, which creates a tension. We would like to act soon. The resources to do it are hard to come by. So I would hope that we will have some focus on this, what I see as tension between the need to act early and lack of resources to support such action.

Let's start with Maya MacGuineas, and then we'll move on to Ned Gramlich.

MS. MacGUINEAS: Thank you.

I'm going to make four points about this plan, the first one being that it is a plan, which I think doesn't sound like high praise, but actually it really is. Recently, the Social Security debate has been dominated by factions that ignore the problem, thereby sort of wishing it away, and those that kind of limit their ideas to meaningless principles of do not raise taxes, do not raise the retirement age, don't touch benefits for anybody who's currently retired or over 55 or alive, and these kind of principles go on and on until it just gets silly and, furthermore, they back us into a corner. They create a false impression about what reform will entail.

So what really we need to get this national discussion going is policymakers and politicians either signing on to existing plans or creating plans of their own so that we can move forward with a discussion of the trade-offs between the different alternatives to reform. And so I think by developing their plan, the "Peters," as I will refer to them, have taken a large step really in moving this ball forward.

Secondly, and I want to emphasize this, this is a gimmick-free plan. And stemming from all of these promises of what people will not do, we've come with just a new slew of have it all or free lunch proposals that involve new hard choices, and they confront none of the actually tradeoffs involved in reform.

Of course, these plans cannot work practically. They require a huge amount of general revenues, either from the rest of the budget or through borrowing, which in essence then pushes all of the real decisions off onto others about where to find those general revenues. We might as well not have a reform plan at all if that's all one is going to entail.

So, plain and simply, these are the choices: How much are we going to raise revenues, and what taxes are we going to use to raise them? How much are we

going to reduce spending and through what reductions? And how much are we going to borrow, thereby leaving someone else to figure out those choices?

So, in terms of the specific policies--I guess I'll just say them for a third time, but quickly--they raise payroll taxes, they raise the maximum taxable earnings base, they use a legacy tax on earnings above the maximum taxable earning base, they reduce benefits in a very progressive manner, and they expand benefits for the groups that they see as vulnerable, low earners, widows and widowers, disabled workers and young survivors.

Overall, I would agree that this is a reasonable approach. There are obviously other equally justifiable alternatives, but there are only a few issues out of their choices that I would flag for questions.

The first is I wondered why they didn't actually raise the retirement age or at least the early retirement age, and they gave a good reason for why they didn't, and they include that in their proposal. However, such a change, if it were implemented across the board, and it reflects this obvious concept that as a country, as we live longer, we have to work longer. A change that actually deals directly with the retirement age would help the other entitlement programs of Medicare as well. So it's something that I generally favor.

Two, they choose to protect all participants over 55. And, yes, people do need time to adjust to change, but they also need the means to adjust to changes, and there are plenty of retirees who can actually afford to be part of reforms. And by exempting them from being part of the solution, we push more of the tax increases and the benefit reductions onto younger people who may not necessarily be as able to handle financially these changes.

Also, I would just point out that the group of people that's retired today or close to retirement has benefited in the past two decades from the fact that payroll taxes have been going up; thereby, reducing income taxes. They have benefited from those lower income taxes, and I think that they should be included or at least considered as part of the solution.

Finally, Social Security reform gives us an opportunity to get rid of some of the outdated subsidies that exist in Social Security, and the one I would point to is spousal benefits, where we subsidize non-workers, which turns out to be a very regressive windfall for a number of people who do not work. I think reform is a great chance to sort of shed some light on the subsidies that exist and question whether they're still appropriate in the modern workforce, and this is one that may not be.

So I also think some people would just say they're being politically realistic in not including these types of changes, but I think there's a great opportunity for the policy community to put forward good policies that may not seem politically realistic, but hopefully we can push politicians to look at them at least a second time.

The important points I do want to stress are they do not depend on general revenues, and specifically they do not depend on non-specified general revenues, and they do not borrow directly to finance their plan. This means that the "Peters" willingly spell out all of the choices involved in paying for the level of benefits they support, making it an extremely honest approach to reform.

Also, they rely both on revenue increases and benefit reductions, and I think plans that use only one or the other are far less realistic. So they do, the one issue here is they do use the trust funds more aggressively than I would, and I'll address that point in just a second.

My fundamental problem with their approach is that they push too many of the changes into the future. So they take the important step of claiming we cannot continue to delay reforms, and no doubt it's certainly important that we do make them as soon as possible because it spreads the costs more fairly, it can potentially help the economy if pre-funding is part of a plan, and it's a necessary component of leadership. We know there's a problem, so we should address it.

Where my views diverge from theirs is that it's not enough just to make the changes legislatively, but we actually need to make those policy changes as soon as possible. Just like if you want to go on a diet, you can't just circle a date on the future when you will, you have to actually start dieting today.

So, as a result of their approach, the cash flow deficits are actually only pushed forward two years, moving them from 2018, under the current plan, to 2020, under their plan. And then at this point we'll have to find room in the rest of the budget to accommodate the repayments owed to the trust funds. Also, I would note that they do find a way to phase in the benefit expansions that they recommend more quickly than the benefit reductions.

So, then, I'm going to just take a moment to discuss individual accounts. People like accounts for different reasons. They like them because of the ownership, they like them because they're a way to build bequeathable assets, they like them as a way to diversify investments, and the list goes on. And I give different levels of credibility to these reasons, but I do think they can play a crucial role, and actually have to play a crucial role, in providing a way to pre-fund the system; thereby, increasing saving, strengthening the economy and lowering the burden of meeting retirement obligations in the future without relying on trust funds, and that's important because I

would argue that the trust funds are not an effective way of pre-funding the system from an economic perspective. Yes, they are from an accounting perspective, but not from an economic perspective because I believe those Social Security surpluses affect budgeters, and they see the surplus dollars as theirs to spend either on tax cuts or spending increases or, these days, both.

So this, in effect, leads to higher government consumption than would otherwise occur, rather than higher saving, and in the end it obligates younger workers not only to repay the trust funds, but to continue to finance the new government spending that has come from the presence of the surpluses.

So, just as an example, ask yourself how much the deficit was last fiscal year, and for people who follow it, they're probably saying it's $374 billion, as most people in Congress would, but obviously this number doesn't include the Social Security trust funds, and in our mind, these revenues are still part of the whole budget process.

Now, others have argued that the trust funds do increase saving because of who is taxed through the payroll tax in order to build them up. However, I think this is actually a very regressive approach to increasing saving, and I'm not convinced that it works, though I would say one can legitimately argue that accounts don't necessarily increase saving, and that's absolutely true. If, for instance, the money to create an individual account as part of Social Security is borrowed, the likely effect is to decrease saving.

So there are a number of structures we need to build into accounts I think to make them useful in pre-funding, and those would be not borrowing to create them, targeting them to low-income people or creating progressive accounts because there's

going to be less of a problem of substitution there, and making the off-setting benefit reductions transparent because that will help people from substituting their saving.

So I'm just going to conclude with two points:

The "Peters" argue that their plan is balanced, and I think in many ways it is. However, I do worry about relying too heavily on additional revenues before we determine how to balance the existing structural budget deficits and to fix Medicare just because, generally, people who support using significant amount of revenues to fix Social Security feel the same way about Medicare and the deficit, and those who support using benefit reductions feel the same way about those. So I think we have to think about this comprehensively and make sure that, in the end, the size of the federal government, and the resources it absorbs, reflects the amount that we think it should. Otherwise we could end up with a significantly larger government, at which point I start to worry it hurts the economy.

Then, second, to your question, Henry, does the current environment lend itself to this plan? And I would say clearly it does. The loss of the budget surpluses make it much more difficult to implement any plan that relies heavily on pre-funding, either through accounts or the trust funds, and it makes shifting the policy changes into the future actually a much easier sell.

However, I still think it would be a suboptimal policy. Also, I have written that I thought that we should actually trade the tax cuts as a way to jump start individual accounts, use that money, still be owned by people, but as a part of individual accounts because that would help with the financing of the transition in the early years when you need additional money.

I continue to think today that such an approach of greater fiscal responsibility today and pre-funding of Social Security through accounts would lead to a far fairer and more economically beneficial system. However, disagreements aside, I think this is an honest comprehensive plan that deserves serious consideration, and I really think the two authors did an impressive job in developing it, and thanks for the chance to comment.

MR. AARON: Thank you, Maya.

Ned?

MR. GRAMLICH: Thank you.

I'm going to hit some of the points that Maya made, perhaps a little differently. She looks to me like she's less than 55, and fortunately I may not be, so I might be a little more sympathetic to the over 55-year-olds.

[Laughter.]

MR. GRAMLICH: On the plan, and this will repeat some of the things that both of the "Peters" said and that Maya said. There is a lot to like about this plan. It retains most of the elements of Social Security, and Social Security has actually, as the authors point out in the book, been a system that has been with us for a long time and is adapted to a lot of the changes that have already happened economically and socially over that time, and they in effect keep that going. It's a plan that adapts to some of the new changes.

As everybody up here has said, it does not use general revenue transfers, and I think that's a very good idea, and that I would contrast to the one that we read about in the Wall Street Journal last week, where there is very extensive use of general

revenue transfers in a way that you don't, unless you read the fine print, realize what's going on.

It doesn't use equity investments. There are two issues on that, one of which is associated with Chairman Greenspan, which is whether, if you had Social Security investing in equities, that could be managed. Even apart from that, even if you decide that it could be managed, there is a question of what rate of return you would use. And as they point out in the book, the outsized equity returns should be largely a function of the added risk in the stock market, and they should be discounted for that in some way, and they're not usually when the plans are priced out. So they, in effect, the "Peters" keep their hand out of that cookie jar, and I think that's great.

And they also, arguably, in their plan there is an increase in national saving. And if you work through all of the capital-augmenting productivity change and so forth, there's arguably an increase in income, but they I think, thankfully, keep their hand out of that cookie jar too; that I think we ought to just make these assumptions based on some normal economic forecast.

As you've heard, when they describe the plan, they notice two or three problems with the system. There's life expectancy, there's earnings and equality, there's the legacy debt, and they have approaches that are more or less mapped to those problems, which I like. We might quibble, as Maya does, and as I might as well, about their specific mapping, but I like the idea of here's a problem, and here's how we solve it in a way that tries to make everybody who should pay for that particular problem pay some amount, and so it's a very well-rationalized plan in that sense.

They didn't talk much about what I'll call the vulnerability aspects of the plan, but I think those are important. Making the survivor benefit three-quarters of the

couple benefit is an important and long overdue change. Frankly, I recommended that in my plan a few years ago.

The wraparound poverty benefit I think is important. I think that was first due to Gene Steuerle [ph], but maybe somebody else was a prior suggestor of that. And their early disability benefit I think is also important, and they gave a good rationalization for that. So it's a plan that covers everything. It is balanced, and it is, in the sense that I just talked about, rationalized.

Now, let me talk about a few of Henry's issues, and then go on with another one. Hank wants to get us into the politics of all of this, and you should hear what we're saying with the usual grains of salt here because when economists try to play politician, that's probably worse than when almost anybody else tries to play politician, but here we go.

[Laughter.]

MR. GRAMLICH: Should we have early action? Well, I think all of us think so, and indeed I think just about everybody who has looked at Social Security thinks so. And I think the conservatives ought to think that particularly because the way, from an equity standpoint, the way you make changes in Social Security is if you're going to do it on the benefit side by cutting benefits, you've got to phase it in slowly. You can't just go to people who are already retired and cut their benefits, and you can't even cut the benefits of people who are close to retirement. You have to announce these well ahead of time and phase them in very slowly.

Taxes you can raise overnight. And so if we do not have early action, we can respond to this, as actually historically Social Security has, by raising taxes. If you want to do it on the benefit side, if it's going to count at all in the forecast horizon, it's

got to start pretty early because it's got to be phased in slowly. So I think that people who have looked at this have always felt that early action is important. I do. I think everybody up here does.

Is the present state of the budget a factor? I don't think it's frankly a huge factor if we agree not to use general revenue transfers. Obviously, if we're going to use general revenue transfers, it is a factor because we don't have them. At least if there is any constraint on the overall federal budget, which many of us are wondering if there is, we've gone past it.

So, if we were thinking of paying for anything in any part of the plan by general revenue transfers, now is not the time. But the "Peters" now pay for things that way, and I think that's good discipline. I thought it was good discipline in the early '90s, when our counsel acted, and we didn't use any general revenue transfers.

I, frankly, thought it was a mistake. Some of the programs that came along in the late '90s, when there was fleetingly a surplus, used general revenue. I thought that was a mistake and argued that at the time. Now, we're back to the other world, if not worse, and so at least there is not dipping into that.

There may be a problem in the sense that Maya said, where they do phase in some of the benefit increases before the tax increases, and you might argue that given the overall situation, that ought to be tempered. But at least if we're looking at original sin here, they don't make it.

So what is the political problem here? Well, I'll call it the "tax" thing.

[Laughter.]

MR. GRAMLICH: Most of us realize that, given the situation of Social Security, and given the desire to spread burdens appropriately and all of this, that it

probably will be necessary to raise taxes, at least a little bit. And I think Maya is right on point in saying that just setting that up as an absolute restriction really does constrain a lot of good choices.

On the other side, I think most of us realize that the historical pattern of Social Security is that we don't do anything, we don't do anything, we don't do anything, and then problems get close. And what can you do in the short run? Well, you can really essentially raise payroll taxes, and that isn't a good way to operate either. So it strikes me on this tax thing, some sort of middle ground is appropriate.

Now, I, frankly, confronted this problem a few years ago. It actually seemed like only yesterday, but it was, in fact, seven years ago when we had our council, and my approach to it was add-on individual accounts. They were add-on; they weren't carve-out. We just, in my view, then and now, we cannot afford to carve anything out. There's nothing to carve out of. That turkey is gone, in effect. So they ought to be add-on. I didn't want to finance them out of the budget either, so I made them compulsory payments.

Sometimes at the Fed, when we are confronted with tricky regulations, we, for example, if you're into a question like disclosing the interest rate on home mortgages, which is one we dealt with recently, you try to worry about politics a little bit by getting something that will get equal fire from community groups and the banks, equal fire, but hopefully not a lot of fire, but equal on both sides.

Well, my individual accounts approach in a way achieved that, but I think I achieved too much.

[Laughter.]

MR. GRAMLICH: The liberals were mad at it because it tainted Social Security with a new thing that was individualized, as opposed to general. Peter was mad at me because it was very costly to run these individual accounts. Others were mad at me because, if you're going to do it, why don't you do it on a bigger scale, and I tried to distinguish, well, individual accounts are your money. They're not quite the same as taxes. But conservatives were mad at it because that was any contribution increase--compulsory contribution increase--was viewed as like a tax, and so I'm just trying to change the label.

So I achieved this equal fire, but unfortunately my equal fire was 50 percent of the people over here were firing, and 50 percent of the people over here were firing, and so it seems to be an approach that pleases no one. So, anyway, I haven't talked about it much lately.

[Laughter.]

MR. GRAMLICH: Now, the "Peters" come along with a different approach. They call everything balanced. If you did a word count on both their blurbs and their oral contributions today, the word "balance" would appear more than any other.

Secondly, the book, if you notice the book, we have a jigsaw puzzle here, and this is the last piece. So I think the spin guys have been working on this.

[Laughter.]

MR. GRAMLICH: The tax increases, as Maya points out, are far in the future, and they're loaded onto high-income people much more than onto everybody else. So the question is will this work? It does violate what I might call as the Wall Street Journal view of the world, which is that if you tax any American, any small

amount of money any time in the near or far distant future, that is a tax increase and is viewed as off-limits.

This one is a balanced approach. Some of us might quibble with the exact structure, but I'm actually interested to see if this approach works. I think it will be a problem, but I actually hope it is not a problem, and I hope we can, like mature people--I was going to say mature adults, but Social Security really involves anybody, and the kids more than anybody--mature people talk about this and think whether it is, in fact, really balanced.

I will quit there.

MR.: Well, we will now demonstrate that we now have an audience of mature people, and it is your turn to talk about it. I ask that any questions you ask not follow too lengthily on an initial comment and that you begin by identifying yourself and your affiliation. You can address your comments or questions to anyone on the platform.

The gentleman at the very rear?

MR. KILPATRICK: Thank you. Lance Kilpatrick, AARP.

First of all, I'd like to say that even though the "Peters'" program may be--

MR. AARON: The "Peters" principles.

[Laughter.]

MR. KILPATRICK: The "Peters" principles, yes. --may be characterized as a fair and balanced approach. I'm very happy to say that it does not look like a Fox News approach to Social Security reform.

My question is actually for each panelist. If you had the opportunity to ask one question to the presidential candidates regarding Social Security and its future,

what question would that be, keeping in mind that a broad question obviously allows a lot of dancing and spin to take place?

MR. AARON: I'm going to start on my right and move to my left, and that will also give the "Peters" an opportunity, if they wish to respond to the comments that were made initially.

Ned?

MR. GRAMLICH: I'm the right-winger here.

[Laughter.]

MR. GRAMLICH: I think I would ask not what their plan is because that immediately bogs down in a welter of, "Well, what are you going to do about this person and that person?" But I would ask them their principles. I think the discussion today has been pretty illuminating because here's the problem, and here's what we'd like to do about it, and I think I would ask just that question to the candidates.

MS. MacGUINEAS: Okay. My answer is going to be actually just the reverse, and I've had a chance to talk to some of them about Social Security, and I said, you know, truly, the time for principles is over. We have been doing this for a decade. We know what they are. They don't fit together. There is no missing piece with all of these principles. We've created an impossible task, so how could we get everybody to do a detailed plan, at which point the political advisers usually hustle me out of the room, and that's the end of the conversation.

But if there were a way to create an environment where everybody had to come up with more details, not fewer, that's what I would like to see because this is an issue that's primarily about leadership. It's going to have to come from the top, and I think it's a shame that we have elections where we can't ask the people who are running

to put forward really reasonably detailed ideas of what they would do to contend with this problem.

MR. ORSZAG: What I would do is, after spending a moment explaining what I meant by the legacy debt, I think the fundamental question is, I could phrase it as principles, but how do you see paying off that legacy debt? How do you see financing that legacy debt because I think that illuminates the trade-offs in a much clearer way than just asking what would you do about Social Security.

We've had plans that have been put forward. Some people mentioned them this morning in which, frankly, the legacy debt is just assumed away or assumed that we can just reduce non-defense discretionary spending in practice by half, on a permanent basis, to finance the legacy debt. Completely implausible.

We have others who don't want to face up to reforming the program at all, and as Peter Diamond had mentioned, that would push the cost of the legacy debt far into the future. We think something intermediate makes sense, but I think this is the essential issue in Social Security reform or at least one of the most essential issues, and it's a prism, an additional prism through which reforms should be evaluated, and it's not one that gets enough attention, and it's one that frankly involves trade-offs across generations, trade-offs within generations, the kinds of things that presidents and policymakers should be grappling with. So that is a long answer to a short question.

But I do want to just briefly say one thing about individual accounts that replace part of Social Security. I think we have this tendency, and we talk a little bit about this in the book. This is partly in response to some of the comments. We have this tendency to compare the real world Social Security program to this sort of idealized version of individual accounts that someone dreamed up and wrote down on a piece of

paper that won't necessarily conform to what would actually happen in practice if you had this system of individual accounts after policymakers get through with it and after political pressures are brought to bear on it.

In particular, I think it's very unlikely that we would avoid a situation with individual accounts where we would require people to fully transform their accumulated balances into inflation-adjusted annuities that last as long as the beneficiary is alive. I think it's very unlikely that we would constrain people in a restricted investment choice environment in which you can avoid very high administrative costs. In other words, we would wind up with individual choices over individual investment decisions and very high administrative costs.

I think it would be very difficult to avoid pressure for pre-retirement withdrawals, when you've got money sitting in that account, and the kid is sick, you need to buy a new home, you want to go to school, you want to pay for health care or something else, the pressure for pre-retirement withdrawals will be substantial, all of which means you wind up with a system that isn't actually providing any retirement security or not very much So just a caution about comparing the idealized version of an individual account plan to the real world of how people actually behave.

MR. DIAMOND: I want to pick up on Maya's suggestion that it would be interesting to move beyond principles and toward plans. So the question is how could we do that? And the natural thing is to take the candidate for president in 2004, who laid out principles in the last campaign, who appointed a commission that came up with several plans that satisfied those principles and asked the president to go on the record with what he thinks of the plans that came from the commission he appointed.

And then after there's an answer to that, then the Democrats could be asked either to respond about those plans or to respond about being more specific of how they would do something different from those plans, but I think the sequencing would be critical.

MR. AARON: The gentleman in the rear of the room.

MR. KELLY: I'm Art Kelly with 60-Plus Association.

Maya talked a little bit about the, alluded to the raid of the Social Security trust fund. I'd like to ask the authors of this plan and the others how their plan interacts with the fact that Social Security surpluses are being spent now, rather than being saved, and that currently the federal government owes the Social Security trust fund about $1.4 trillion in meaningless IOUs, and if the rate of the trust fund continues to 2018, when the amount of the payroll tax will not be enough to pay full benefits, the amount of those IOUs could be as much as $6 trillion and where they see this money coming from, in order to be able to pay full benefits beyond 2018.

MR. AARON: Having had a discussion on this very topic repeatedly with Peter Diamond, I'm going to bounce it to him.

MR. DIAMOND: Well, I think there's absolutely nothing meaningless about the assets in the trust fund. I think just as if you have any government bonds in your retirement account, you're inclined to rely on them, so too Social Security can rely on the rest of the federal budget handling the problem associated with those assets. The payroll taxes have been paid to build up those assets, and I cannot imagine politicians saying, "Well, you paid those taxes, but those assets are meaningless, so we're going to wipe them out, and we're only going to give you benefits on the taxes that are going to be paid from here on after." That's obviously not going to happen.

So, first of all, they're totally meaningful within the structure of how we're going to pay for Social Security.

The second issue is how does it evolve with the economy as a whole? Obviously, the federal government can finance its past expenditures by borrowing from people other than Social Security. If Social Security had not been either running surpluses in the '80s and early '90s, when we had those large deficits, or if Social Security were investing in German government bonds instead of U.S. government bonds, the U.S. government could have borrowed exactly the same amount of money in the market. The interest rate might have changed a little bit, but probably not a whole lot.

So the question of how much difference has it made for the position of the government as a whole, it seems to me, as I lived through reading the newspaper--I did not live inside the Beltway, I did not work for the government--reading the problem Congress had with deficits that everyone was agreeing was too large, Congress said it's very hard to vote tax increases. Congress said it's very hard to vote spending cuts. You can't vote a change in the deficit. You vote a tax increase. You vote a spending cut.

Congress wanted to do that up to the limit of where it became politically costly. I think the presence of the surpluses, the fact that the newspapers reported unified deficits that were enormous, instead of colossal--or maybe it's colossal instead of enormous--

[Laughter.]

MR. DIAMOND: --made very little difference to what happened. So I think most of, not 100 percent, not every last dollar, most of the surpluses through the

'80s and '90s, in fact, showed up in national savings, showed up in a decrease in the debt held by the public.

As we go down the road, Congress has to face the deficit, and part of that is going to be faced as it's doing right now with borrowing. Part of it eventually is going to have to be faced by a combination of tax increases and spending cuts because, at some point, if they don't come along, people will stop being so willing to lend to the federal government. That's the point of course we don't want to go anywhere near, and so sooner or later these things will be addressed out of those sides, and when they are, it will be within a process in which the level of benefits projected over the future will be viewed politically--

[Tape change.]

MR. DIAMOND: --financeable by the assets in the trust fund, and therefore the problem for the rest of the budget will recognize that.

MR. AARON: Maya would like to comment in response.

MS. MacGUINEAS: No, it's a real question. But the question is, since you do believe that, but you also create a plan that doesn't build up the trust funds, would you have supported making more of the policy changes earlier and using the trust funds and building them up, given that you think they do contribute to national saving or, put differently, how come you are so careful--and I think it's a good plan for this reason--but not to rely on the trust fund so much more than the current system does?

MR. DIAMOND: The problem that Peter and I started with, the problem that Ned identified, the place where there's essential unanimity among analysts, is we want something done sooner not later, and our plan is a huge boost in national savings compared to doing nothing.

And so we asked ourselves the question, if we do more for national savings, how do you do more for national savings? You have a bigger tax increase or you have larger benefit cuts. Given that we already have tax increases, which we expect to be criticized for by hopefully less than 50 percent of the populace, and we already have benefits cuts that we expect to be criticized for by hopefully less than 50 percent of the population, to do more of them seemed to us to be a bad tradeoff of having more delay and less national savings.

In other words, and Maya and I have gone around on this, I think there are two very distinct roles for analysts in pushing along the political addressing of economic issues. One is to stand up four square for exactly what you think right and you would like to do if you had all of the political power, and the other is to put forward proposals that fit, that are good policies and recognize the political salability issue in designing them.

Maya stands up for a big increase in national savings. She recognizes there's no way this Congress is going to restore the tax cuts, much less restore the tax cuts and have them contribute nothing to the non-Social Security deficit because they'd all go into individual accounts, but she thinks it's important to remind people that this is an issue. I agree it's important to remind people of this issue, and I'm glad Maya's doing it. We're doing something different, and I think it would be a mistake if all of the analysts were in this continuum between being realistic and being for what would be your ideal if all of this were in the same place.

MR. AARON: Peter Orszag swears he will take no more than 30 seconds.

MR. ORSZAG: I think just one other point that's very important in the context of national saving; people always talk about the offsets within the government sector, and I agree with Peter that it's unclear exactly how large those are. People don't talk enough about the offsets in individual accounts, reduced saving in other forms by individuals and especially if there's pressure for pre-retirement withdrawals, the saving not even occurring in the first place.

So I think it's again an example of doing an unbalanced comparison to hold up an idealized version of individual accounts and assume there will be a massive increase in national saving that results from it.

MR. AARON: Gene Steuerle had his hand up, and since his name was mentioned earlier, he deserves equal time.

MR. STEUERLE: I'd like the "Peters" to respond to what I consider a couple of questions that came up very quickly from Maya and Ned. One of them is this issue--Maya put it in terms of spousal benefits, but I'd put it in terms of the extraordinary discrimination against single heads of households, which everyone in this room recognizes exists in the system because they don't get this pure transfer part of the system that has no relationship to earnings.

I understand the political constraint on saying, well, gee, that's another issue, but sort of if we don't deal with it when there's a crisis that has to be solved, then when do we ever deal with it. Do we really want to create a permanent system that has this type of discrimination in it?

The second issue maybe relates to politics too. In terms of not doing anything for those over 55, there are a variety of reasons for worrying about delay, one of which is that the economic impact of this retirement system, if you want, starts hitting

in about 2008, when there's a slowdown in the rate of growth of the economy. So, if we're delaying very long to make some adjustments--economic adjustments--we're going to have that slower economic growth rate hit us sooner than that.

And if we're talking about legacy costs which you raised, certainly taking into account life expectancy, the very riskless nature of the Social Security system, and in particular the huge amount of windfalls all of us are getting, everybody in this room, even over 20, is getting in Medicare, it seems to me one can make a very strong case for having some burden borne by those over 55. So I wonder if you could respond to those two issues.

MR. ORSZAG: I think, on the first one, and actually Peter Diamond, in his presidential address at the American Economic Association, talks about the rationale for some family benefit as part of Social Security. That's not to defend all of the details of the spousal benefit, about which I think both Peter and I have some concerns, but it is to say, if I interpret your question as saying, should there be any additional benefits for family members, as opposed to single workers, that there is a rationale for, and Peter might mention it briefly.

On the legacy costs, again, we are partially accepting a political constraint that we can't substantially reduce benefits for current beneficiaries or those on the verge of retirement. There also is something of a principle involved in avoiding at least dramatic, unexpected changes for those who are already receiving benefits, and I think it's again, coming back to the point that Peter mentioned, which is, if anything, as Ned emphasized, we're stretching the bounds here already.

We may well have gone beyond the bounds of what is politically feasible, even in the next several years, let alone immediately, and pushing harder along that

dimension would, in my opinion, let the perfect be the enemy of the good and undermine the chances for getting anything actually done.

MR. DIAMOND: A couple of pieces of response. In going to a survivor replacement rate of 75 percent, we put a lot of the costs of that on the benefits of married couples by reducing the benefits while both are alive in order to finance larger benefits when there's only a survivor.

The only exception is for the low benefits to protect vulnerabilities. So, to that extent, we're doing something which is progressive that is needed. The evidence on widows is a 30-percent drop in living standards on becoming a widow. And we're going to finance for high earners, where the problem exists as well, we're going to do that without exacerbating any of the family issues.

The second thing is I've been working on Social Security since I guess it's just 30 years right now, coming up on 30 years since the over-indexing days, and I'm struck at the number of panels and commissions who try to address dealing with spouse benefits and the repeated failure when you have a diverse set of views on a panel to come out with an answer.

And so given our goal of having something where we would focus attention on the main message, which is there is a way of doing this without gimmicks, it does have pain, the pain is not very large, and you can spread it in a fair way to instead get into the crossfire between encouraging and discouraging stay-at-home parents seems to me to be trying to undercut our message.

And I think part of the complication comes--and here I'll fill in what Peter alluded to--we have a progressive benefit formula. When you have a progressive benefit formula, you're trying to identify need in some way. A one-earner couple and a single

person with the same earnings have different degrees of need. So if you are going to adjust your progressive structure and change the current spouse benefits--and I'm not fan of the current structure of spouse benefits--you would get into something that, A, has not been seriously researched. How would you try to design this? And, B, you would get into something that would I think necessarily be complicated. It's obviously analogous to the issue with the income tax. We have the tension of wanting the income tax to treat couples independently of how the earnings are divided between the two of them and treat individuals on the basis of individual earnings when we go to tax them, and we want a progressive income tax, and we all know these three principles cannot be combined. It's impossible.

Well, the same rule happens in Social Security. I think to do an overhaul, and I think your analysis of how we can make things better is just very cogent analysis, but I think to get from that to acceptable political principles and a design, we took on a lot, and we put in a lot of time for the book as it exists. That I think would have been another six months of work to come up with something that would then have sunk the whole ship.

So I'm very sympathetic with you. I would love to see some changes, but I'm not sure what changes I would like to see, and I'm not sure how to bring them about.

MR. AARON: We have time for two more questions.

Bob Greenstein from the Center on Budget and Policy Priorities.

MR. GREENSTEIN: One quick comment and two questions, one for the "Peters" and one for the moderator, Henry Aaron.

Comment. Up until now, whenever a new Social Security plan comes out, the principal categorization that's made is, is it is a plan that replaces part of Social

Security with private accounts or not? Almost all other issues are seen as subsidiary. I hope with the release of this plan we move to a point where an equally large initial categorization of any plan is where it falls on the dimension of whether it either avoids any general revenue transfers out of a budget already deep in deficit as far as the eye can see or, if it has general revenue transfers, specifically finances them through specific reductions in programs or specific increases in particular taxes that are actually part of the plan or whether, on the other side of the dimension, it just has funny money without indicating how it's going to be provided from the rest of the budget.

Two questions. For the two "Peters," what was your thinking on, and why did you not include in the plan the only thing that I think might be discussable that does affect people 55 and over, which would be to move both Social Security, all benefit programs that have COLAs and the tax code that has a COLA, to the new, improved superlative CPI?

My attraction to that is not simply within a Social Security context, but that it would help us over time, with the rest of the budget, given its impact on other benefit programs in the tax code as well, but I don't see any way to do it government-wide unless Social Security were included in it.

And my question to Henry Aaron is whether you could comment on the point that Maya posited that free funding through individual accounts inherently will lead to more fiscal responsibility and better national saving than other approaches, such as a trust fund. I'm skeptical of the point, both because in the experience of the '90s, and the last few years, in the '90s, we had big surpluses in the end of the '90s, and we had fiscally responsible policies.

We now have deficits, and we're doing fiscally irresponsible policies. Beyond that, I suspect that if there were to be transfers from Social Security to individual accounts, the proponents would want the scoring arranged so that those were not considered outlays, which would entail considering the private accounts as quasi-governmental.

An argument could be made for that, given their relationship with claw backs to Social Security, but once you consider them quasi-governmental, then it's not clear they don't get considered in the unified budgeted surpluses just like the trust fund does.

MR. AARON: You're going to divide--

MR. ORSZAG: Yes. Just quickly on the superlative index. This is a new index that the Bureau of Labor Statistics has developed. This is actually one area in which the two authors of the book had some slight disagreements, and I think the reason it's not in the book is that implementing as part of Social Security would adversely affect relative to the current indexation system some of those particularly vulnerable beneficiaries, widows, those who wind up living a long period of time.

And there is a question as to whether the appropriate price index for the elderly is the same as the price index for the overall population. So I think that's the reason that it's not in the book, but this is one of the few issues along which the two authors had some disagreement with--my being somewhat more sympathetic to that proposal and Peter not being.

MR. DIAMOND: Well, let us bring our dirty laundry out into the public.

[Laughter.]

MR. DIAMOND: The U.S. indexes benefits after benefits for prices. Sweden does it for wages. Switzerland does it for a combination of prices and wages. So let's ask the question, on a revenue-neutral basis, so that if you have them grow faster, they've got to be smaller to begin with, how would you like to see them grow? And as life expectancy after 65 gets longer and longer, does that affect how you think about them?

We have a lot of people living 30 years beyond the start of retirement benefits. They're falling with price indexing farther and farther behind the general level of incomes in the economy. I think price indexing is not a rapid enough growth of benefits.

So if we could think about cutting initial benefits and having them grow faster, then I think you could say let's use the right price index and do a 50-50 weighted average of prices and wages and lower initial benefits which would also help with the incentive to go on working if the initial benefits were lower. I would sign on to that in a second, but to merely drop the slope, the rate of increase, it seems to me is moving in the wrong direction from what I think is the direction of better policy, and it's hard to do the package to bring about something better. So this was, to my mind, a "do no harm" rule, rather than a "design it yourself."

I also wanted to pick up on your issue about framing because what we did a little bit in the book, and I think there should be a lot more of, individual accounts, mandatory individual accounts of the kind Ned favored should be discussed in the context of all of our tax-favored retirement accounts.

We have a system that has grown in different legislation and different pieces. It's not integrated. The tax expenditures go overwhelmingly to high earners. I

think if we want to think about the role of something mandatory around individual accounts--an idea that goes back to the Carter years--the right context is in the context of individual retirement savings, not in the context of Social Security.

MR. AARON: The question to me was whether the prospects were better for boosting national saving by building reserves through individual accounts or by building reserves within the Social Security system. To that question, I will give a resounding answer: I haven't a clue, and I don't think anybody else does either, and let me explain why.

Well, actually, Peter Orszag explained why with respect to individual accounts. They will look an awful lot like other saving. We can encourage or even require saving through lead the horse to the individual accounts trough, but we can't prevent them people from foregoing saving in other forms. We have an historical record with respect to tax-sheltered savings of various kinds which have come on stream over the past couple decades. During that period, people have taken huge advantage of, and increased their balances in, tax-sheltered savings accounts enormously. Overall, household saving has dropped like a stone because people have shifted and stopped saving in other forms. Whether they would do so with individual accounts, t The extent to which they would do so, I don't know. There will, I believe, be assuredly some leakage. The same answer holds with respect to building up reserves in the Social Security trust funds.

We have not, as a nation seriously tried to use a trust fund mechanism as a device to raise saving. If we were serious about it, we would separate Social Security accounting as completely in publicly released budget projections, and organizationally, from. From the rest of the federal budget as possible., as we would know how to do, we

We could set up a quasi public-private entity that was separate from the federal government that managed to manage these accounts and separate them in various ways separately from the rest of the federal budget. That would create greater barriers to the kind of use of reserves as a cover for spending in the rest of the budget, to which the gentleman in the rear referred earlier.

If we did that, I believe reserve accumulation would add significantly to national saving, as it is quite possible that individual accounts would. Which would be more successful? I don't know. I don't think that the effect on national saving is a good basis for favoring individual accounts or trust fund accumulation. I think there are good bases for choosing between them, but that's not today's topic.

One more question. Virginia Reno, from the National Academy of social insurance.

MS. RENO: Thank you. This really builds on the point you were just making, Henry, and that is I have often wondered, if we did get increased national savings, presumably the goal was making the pie bigger, and just how much does that buy us, if one assumes a growth in national savings of some level. Do we know?

MR. AARON: That seems to me a question on which all four of the panelists may have something to say.

Ned, do you want to respond?

MR. GRAMLICH: [Off microphone.] Well, I said in my remarks, it is very complicated. You have to work out, number one, all of the offsets. The panel has been very eloquent on the offsets of whether you do it through trust funds or individual accounts. Then, you have to work out what that does to capital formation, and that issue is complicated these days by the open economy in question. You can't assume that

saving equals investment. There are all kinds of international linkages, and then you have to work out the productivity disaggregation into how much is due to capital-augmenting productivity and how much is due to the residual term, which is called "total factor productivity," and it's very, very complicated.

So, I mean, we can sit down and get some numbers, but they would have enormous standard error.

Whether that ought to be brought into this Social Security thing, I would say, no, as I said earlier. I just think it's too speculative, and I'd rather see everybody, whoever has a Social Security plan, just, I mean, if they raise national saving, that's great, but I think I would not like to see that brought into the economic and actuarial calculations.

MR. AARON: Maya?

MS. MacGUINEAS: Obviously, I focus a lot on national saving, and one of the reasons is because I'm actually worried about what will happen, as the other nations are also doing with their own baby booms. And so it's not so much how are we going to boost our saving, but once we have an even harder time borrowing from abroad and relying on the capital we've become so accustomed to, what happens to our economy there and how to smooth out the transition to a sort of global aging phenomenon.

But quantifying it, you know, incredibly challenging. It depends how much the productivity returns go to labor versus capital, and you also have to build in the fact that the Social Security benefits are indexed for wage growth. It increases the costs all along the way. So, if you really are going to rely strongly on gains in the economy bailing out Social Security, you have to change the way Social Security

benefits are calculated. However, I would always favor growing the economy as opposed to not growing it.

MR. ORSZAG: All four panelists agree.

MR. AARON: Before I turn for final comments from Peter Diamond and Peter Orszag, I would like to let you all know that, in light of the high praise, for honesty and for other features, that the book has received, it is on sale in the book store for 20-percent off.

[Laughter.]

PARTICIPANT: Is that spread across the generations?

[Laughter.]

MR. AARON: No, that is a benefit that accrues entirely to the people in this audience.

MR. ORSZAG: Just very briefly on national saving, without getting into the quantification issue. Two points. One is the one that Ned made, which is, to the extent that there is any effect, it should not be included in the scoring of Social Security plans. That's a form of dynamic scoring that will just lead to trouble, to gimmicks and to artificial assumptions. So that should be out of bounds. It is a part of some plans, it is a part of some recent plans, and it really shouldn't be.

The second point just is, while I think that raising national saving is a very important issue, it will raise future national incomes, looking only to Social Security as the mechanism for raising national saving or viewing Social Security reform only through that prism is mistaken. There are lots of other ways outside of the Social Security in which the federal government in particular could be contributing more to

national saving. And, similarly, there are lots of things going on in Social Security reforms that don't have to do with national saving, but that are still quite important.

So I think, while it's a very important criterion, it's something in the book we actually talk about different ways of evaluating reforms. This is on the list, but it shouldn't be the only item on the list.

MR. DIAMOND: Just very quickly, what is an increase in national savings about, business cycle held constant, assuming the Fed does it's job and it doesn't feed back? It's less consumption today in order to have more consumption in the future. That's what it's about, and the rate of return on the national savings tells you that tradeoff. That's half the story.

The other half of the story is how much more you'll like having a given amount of consumption in the present, relative to the future. So it's a tradeoff between the return on the capital and how much more you value it sooner, which makes it very clear you can't talk about it without asking the question whose consumption is lower now and whose consumption is higher in the future?

You could think it's great to increase national saving if we restore the tax cuts on the high earners in order to put money aside to have it grow, to then finance an enhancement of SSI in the future. And you could think the reverse--let's increase national savings by reducing the benefits in SSI and then use that in the future to have an even lower income tax. Both of those could give you the same level of national savings, and yet you might not feel the two policies were equivalent.

So I think this is a useful thing to check out how it's happening, but I think it cannot be a central prism for looking at it. It's got to be one of your secondary factors.

MR. AARON: I would just add that a little higher rate of economic growth, in general, makes difficult social problems easier to address and to solve and that, to the extent that a more rapid rate of capital accumulation, the distributional considerations that Peter raised held constant, the more rapid economic growth is, the easier time we're going to have dealing not only with Social Security, but with a host of other problems that we're going to confront.

So, on that, I hope, a mildly optimistic note, I'd like to thank you all for being here and, most of all, the authors for having written an honest and thought-provoking book, and our panelists for having provided equally honest and thought-provoking comments.

[Applause.]

[Whereupon, the proceedings were adjourned.]