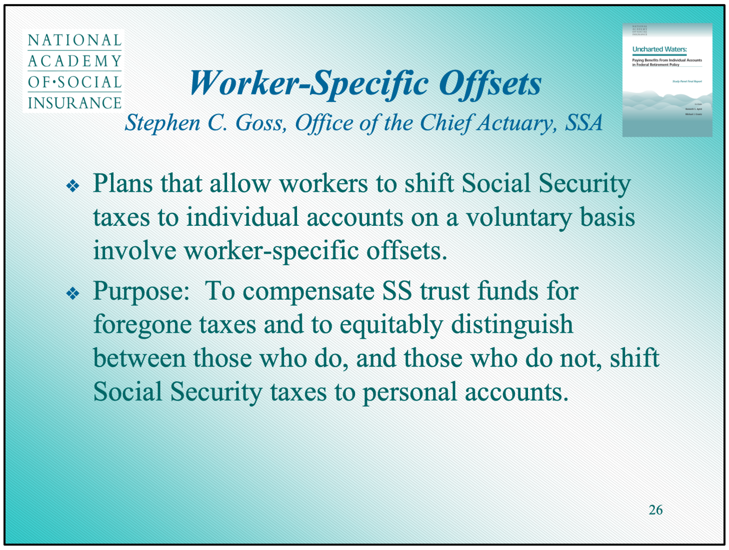
Slide 26



As [Michael/Ken] mentioned earlier, benefit offsets arise in proposals that shift scheduled Social Security taxes to individual accounts. A simple example illustrates this idea. Suppose that one dollar was shifted from John's Social Security taxes and deposited into his personal account. If there were no adjustment to John's traditional Social Security benefit, then John would be made better off by one dollar. John would still have the same benefit from Social Security as he had before; in addition, he would have one dollar in his individual account. As a result of transferring this dollar to John's account, the Social Security trust fund balance would be reduced by one dollar. The deterioration of Social Security's long-fun finances means that this one-dollar gain to John must eventually result in a one-dollar cost to John or to other taxpayers or beneficiaries, because traditional benefits will continue to be paid from the trust funds.

Instead of having other taxpayers or beneficiaries pay for John's one-dollar gain, policymakers might reduce John's future claim to traditional Social Security benefits by one dollar. This foregone future benefit is the "benefit offset" associated with the individual account.

Slide 27

In terms of basic design, should the offset reduce the account holder's scheduled Social Security benefits, or should it reduce the size of his or her individual account? Offsetting traditional Social Security benefits has advantages and disadvantages. If the intention of the offset is to compensate the trust funds, in full or in part, for Social Security taxes shifted to individual accounts, it may seem logical to reduce individual account holders' future Social Security benefits in exchange for their reduced participation in traditional Social Security. However, because Social Security provides life insurance (to surviving spouses and children of deceased workers) and disability insurance, reducing traditional benefits could mean that these non-retiree benefits are also reduced.

An offset could be designed to reduce a worker's individual account instead of his or her traditional Social Security benefit. This type of offset, commonly referred to as a *clawback*, would shift at least part of a worker's individual account into the Social Security trust funds. While this offset design is less common in recent proposals, it would avoid reducing family Social Security benefits paid from individual account holders' earnings records.

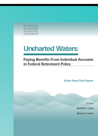
An offset could be based on a worker's actual individual account. In this case, an annuity could be calculated from that balance at retirement (whether or not the worker actually purchased an annuity), and the worker's Social Security retirement benefit could be reduced by this monthly annuity amount. The retiree's traditional Social Security benefit could be reduced, or offset, by this amount for life.

An offset based on an actual account balance would be consistent with a plan that odes not allow individual account withdrawals prior to retirement.

Slide 28

NATIONAL ACADEMY OF·SOCIAL INSURANCE

Offsets Based on Hypothetical Individual Account Balances



Annuity value of hypothetical account relative to actual individual account annuity

	(1) Hypothetical Account Offset Larger Than Actual Account Annuity	(2) Hypothetical Account Offset the Same as Actual Account Annuity	(3) Hypothetical Account Offset Smaller Than Actual Account Annuity
Traditional Social Security retirement benefit	$1,200	$1,200	$1,200
Hypothetical annuity value reduces Social Security benefit	-450	-300	-150
Net traditional Social Security benefit	$750	$900	$1,050
Plus actual individual account annuity	+300	+300	+300
Total retirement income	$1,050	$1,200	$1,350

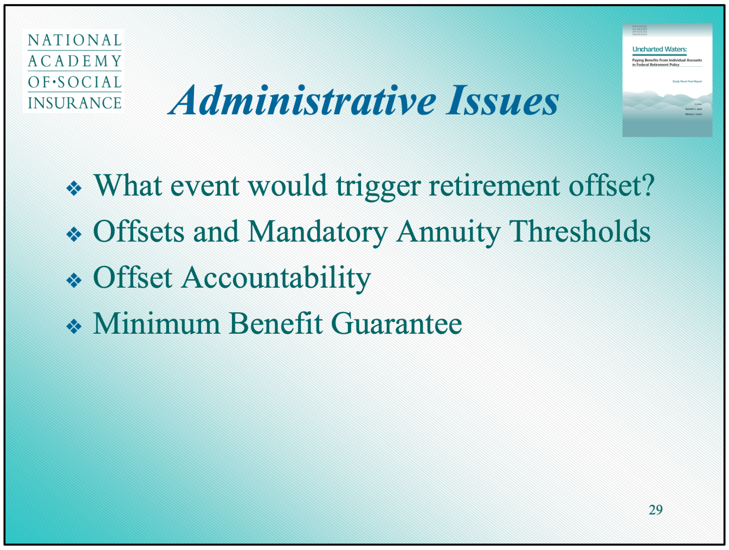
28

A number of proposals that would permit workers to shift Social Security taxes to personal accounts would base an offset on a hypothetical account – that is, the offset would be based on the value of Social Security taxes put into the actual account plus some predetermined interest rate, such as the rate for U.S. Treasury bonds. Contributions to the actual account plus the accumulated predetermined interest are tracked in hypothetical, or shadow, accounts.

In this example, Joan's traditional Social Security benefit is $1,200 and the annuity value of her actual individual account is $300 per month. If the returns on her hypothetical account exactly matched the returns on her actual individual account (as in scenario 2), her offset would reduce her traditional benefit by $300 and her combined retirement income would be increased by her $300 individual account annuity, resulting in no change in net retirement income. Scenarios 1 and 3 illustrate Joan's combined retirement income if her hypothetical account annuity did not match the returns to her actual account.

The predetermined interest rate used to calculate the value of the hypothetical account, which differs depending on the proposal design, is generally set so that plan participants would have a chance of achieving a better realized yield on their actual account investments (but that still fully compensates the Social Security trust funds). How an account actually performs, of course, depends on a participant's investment choices and on market performance.

Slide 29



An offset proposal would need to specify what event would trigger the calculation and application of a worker-specific offset. If an offset were to reduce traditional Social Security benefits, it would make sense to calculate the offset no earlier than when benefits were initially claimed. This policy would insure that the offset is based on all the taxes shifted to the individual account and that no retirement benefits could be received without offset.

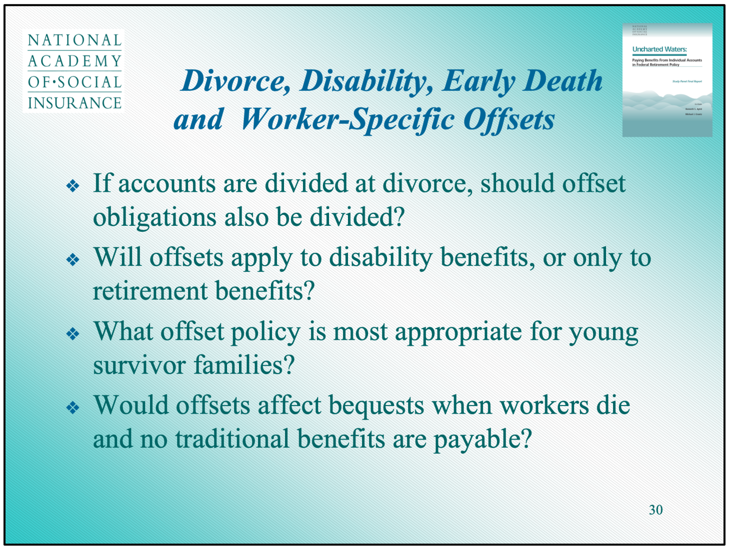
If initial withdrawal from the individual account triggered the offset, the proposal would need to ban early withdrawals.

If an individual account proposal requires annuitization of the account up to a prescribed level, this intent would need to be coordinated with the application of a worker-specific offset to determine the actual level of benefits.

When designing an offset mechanism, the decision must be made whether each individual account holder would be legally responsible for his or her entire offset, or if it would be assumed that any overall target offset amount would be met across the entire individual account population. If a worker dies before his or her entire offset is recovered, other workers might be called on to make up the difference. Conversely, long-lived workers might incur a greater offset than indicated by his or her account.

If an individual account proposal includes a minimum benefit guarantee, the offset mechanism would be expected to apply firsts, with a subsequent determination on a case-by-case basis of whether additional payments were needed to meet the guarantee.

Slide 30



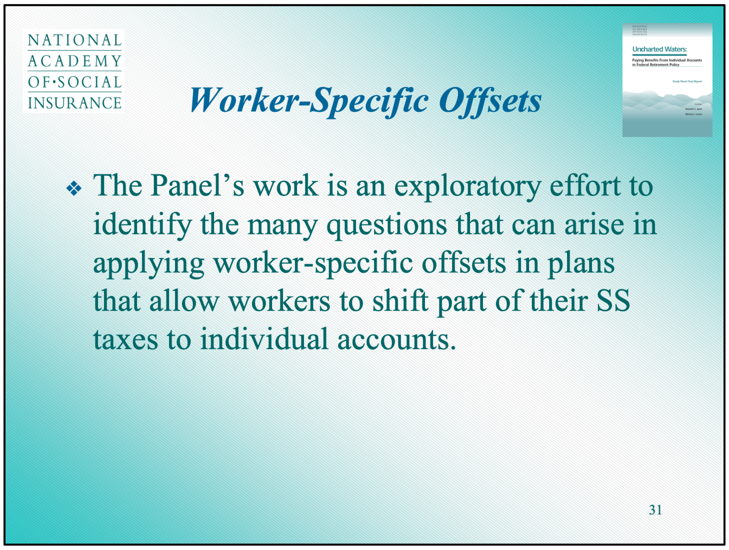
At divorce, if the proposal mandates (or permits) a division of accounts between husbands and wives, some conforming rules might be needed for worker-specific offsets. For example, if the personal account is viewed as an "asset' in divorce proceedings, should the accompanying offset be viewed as a "debt?" Would the debt transfer with the asset, or remain with the original account holder? A case might be made for either approach.

Worker-specific offsets could be designed to exempt disabled-worker beneficiaries from the offset until they reach retirement age.

Similarly, when a worker dies leaving minor children (or disabled adult children), policymakers could decide to not reduce the benefits payable to the children. A key question is whether a worker's decision to shift Social Security taxes to a personal account should affect family life insurance protection otherwise provided by the worker's earnings and contribution history.

If the account is bequeathed to heirs, but no traditional benefits are payable, how, if at all, would the offset apply?

Slide 31



The application of worker-specific offsets could produce many different outcomes. Chapter nine in this report is a first step toward exploring details of worker-specific offsets and their consequences for workers and families in different circumstances. We believe we have succeeded in posing thoughtful questions, even if the Panel does not offer answers to all of them.