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PRIVATIZATION SLASHES BENEFITS AND ADDS TRILLIONS TO SOCIAL SECURITY'S LONG-TERM COST

BUSH ADMINISTRATION EXAGGERATES SOCIAL SECURITY'S FINANCIAL PROBLEM

Introduction and Summary

The Bush Administration has launched a new rhetorical campaign in support of Social Security privatization that exaggerates the financial problems with the current system and misrepresents the effects of privatization. While admitting that privatization would cost trillions of dollars in the near-term, the Administration claims that spending that money today would avoid spending far more in the future. The reality, however, is that private accounts do nothing to close Social Security's gap—in fact they increase it. The privatization plan cited by the President as a "good blueprint" for reform only improves the solvency of Social Security by substantially cutting Social Security guaranteed benefits. Adding private accounts actually increases the cost of Social Security by $2.2 trillion over the next 75 years; they do nothing by themselves to reduce the long-range shortfall.

Exaggerating the Problem

Despite the Administration's rhetoric, there is no imminent Social Security crisis. The program will remain solvent for nearly fifty more years.[1] Thereafter, Social Security would be able to pay about 70 to 80 percent of benefits.[2]

The Administration cites a highly speculative figure of $10.4 trillion (sometimes rounded up to $11 trillion) as the size of the Social Security shortfall. But that number is based on projections over an infinite future, with almost two-thirds of that shortfall occurring after 2078.[3] The official estimate by the Social Security Administration (SSA) for the 75-year planning horizon typically used for Social Security puts the shortfall at $3.7 trillion.[4] Congressional Budget Office (CBO) estimates suggest a smaller 75-year deficit of about $2 trillion.[5] (All of these figures are expressed in "present value," which expresses a stream of annual surpluses and deficits lasting many years in a single number.)

To be sure, $3.7 trillion or even $2 trillion is a lot of money. But those amounts are not overwhelming when expressed relative to the size of the economy. The SSA shortfall estimate is equivalent to 0.7 percent of gross domestic product (GDP), and the CBO figure is equivalent to about 0.4 percent of GDP—only about 2 percent to 4 percent of total federal spending.[6]

A program shortfall of that size is well within the range of past and possible future policy adjustments. For example, making the Bush Administration's four enacted tax cuts permanent would cost about 2.0 percent of GDP over the next 75-years, 3 to 5 times as much as the Social Security shortfall.[7] In 75-year present value terms, the cost of making the Bush tax cuts permanent is $10 to $12 trillion.[8] Put another way, the entire Social Security shortfall (0.6 percent of GDP) is about equal to the cost of making permanent the Bush tax cuts for the highest income taxpayers.[9]

All analysts agree that 75-year projections are uncertain. Thus, the $10.4 trillion figure over eternity touted by the Administration is fanciful. It makes no sense to incur trillions of dollars of costs today to address possible shortfalls hundreds of years into the future.

Misrepresenting What Privatization Would Accomplish

The Bush Administration has not yet offered a specific privatization plan. However, estimates based on a proposal by the President's Commission to Strengthen Social Security (CSSS) that the President has called a "good blueprint" for reform show that privatization would raise costs, not lower them. In particular, the privatization component of that proposal would increase the Social Security shortfall by an additional $2.2 trillion over the next 75 years, to $5.9 trillion, according to calculations by Joint Economic Committee Democrats (Table 1).[10]

Table 1

Privatization Slashes Benefits and Adds to Social Security Costs

	Trillions of Dollars	Percent of GDP
Current Law Shortfall [1]	-3.7	-0.7
"Blueprint" Privatization Plan [2]		
1. Establish private accounts		
Diversion of revenues to private accounts	-4.2	-0.8
Social Security benefit cut for account holders	2.0	0.4
Net cost of private accounts	-2.2	-0.4
Current Social Security shortfall plus private accounts	**-5.9**	**-1.1**
2. Cut in guaranteed benefits for all	3.6	0.7
Shortfall after entire privatization plan	**-2.3**	**-0.4**

Sources:
1/ 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, Table IV.B6, p. 57.
2/ Calculations by the Joint Economic Committee Democratic staff based on: Social Security Administration, Memorandum Re: Financial Effects for Three Models Developed by the President's Commission to Strengthen Social Security (Jan. 31, 2002), p. 4-6, 59, 69.

The private account element of the plan has two pieces: the diversion of Social Security revenues to the private accounts, and an offsetting reduction in guaranteed Social Security benefits for those who have an account. (This reduction in benefits is in addition to the cuts in benefits for all recipients described in further detail below.) The diversion of revenues costs the Trust Funds $4.2 trillion over the next 75 years. This reduction in guaranteed benefits for those with an account, however, only saves the Trust Funds $2.0 trillion. Thus, the creation of private accounts leaves the Trust Funds worse off by $2.2 trillion.

In addition to the private account component, there is a second component to the "blueprint" proposal that would cut guaranteed Social Security benefits over the next 75 years by $3.6 trillion—almost the identical figure to the current shortfall. That cut in benefits—not privatization—is the source of any savings in the plan.

This cut arises from a change in how benefits are calculated for new beneficiaries. Instead of benefits being tied to prevailing standards of living during the course of the worker's career, the change would freeze Social Security benefits at today's standard of living. Thus each future generation of retirees would have lower and lower benefits compared to their wages during their working life.

This cut would apply to all beneficiaries, whether or not they had chosen to have a private account. Moreover, both CBO and the Social Security actuaries project that payouts from the private accounts would not be able to make up for this loss of benefits from the change in how benefits are calculated for new beneficiaries. The CBO estimates that the combination of private account payouts and substantially reduced guaranteed benefits in the blueprint plan would cut total benefits promised under current law by 45 percent for average earners retiring in 2065.[11]

Thus, the net effect of the cost of the private accounts, combined with the savings of $3.6 trillion from the cuts in guaranteed benefits for all, is a remaining deficit in Social Security of $2.3 trillion. In other words, private accounts themselves do nothing to address Social Security's shortfall. Rather, the reduction in the long-range shortfall is due entirely to the cuts in guaranteed benefits.

Conclusion

By emphasizing uncertain projections of shortfalls that may occur centuries from now, the Administration's rhetoric misleads the American people about Social Security's solvency. They create the false impression that there is a Social Security crisis and divert attention from the real costs of privatization. Claiming that privatization saves rather than costs money ignores the reality of the plan presented by the President's own Social Security Commission. Under the plan, all of the savings come from cuts in guaranteed benefits. Adding private accounts to the program increases the cost of Social Security by $2.2 trillion over the next 75 years.

Endnotes

[1] 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, p. 8; Congressional Budget Office, *The Outlook for Social Security* (June 2004), p. 8.
[2] Ibid.
[3] 2004 Trustees Report, Table IV.B7, p. 59.
[4] Ibid.
[5] CBO Outlook, Appendix A, p. 31.
[6] 2004 Trustees Report, Table IV.B7, p. 59.
[7] Center on Budget and Policy Priorities, *The Implications of the Social Security Projections Issued by the Congressional Budget Office* (June 14 2004), p. 2.
[8] Center on Budget and Policy Priorities, *Understanding the Social Security and Medicare Projections* (March 22, 2004), p. 2.
[9] CBPP Implications of Social Security Projections, p. 2
[10] Joint Economic Committee Democratic Staff calculations based on: Social Security Administration, Memorandum Re: Financial Effects for Three Models Developed by the President's Commission to Strengthen Social Security (Jan. 31, 2002), p. 4-6, 59, 69.
[11] Congressional Budget Office, *Long-Term Analysis of Plan 2 of the President's Commission to Strengthen Social Security* (Updated September 30, 2004), Table 2.

Appendix

How the leading privatization plan works

In early 2001, President Bush established the President's Commission to Strengthen Social Security, which presented three models for reform. Of the three, it was "Model 2" (hereinafter "the Commission plan") that President Bush referred to when he suggested that the Commission's report would serve as a "good blueprint" for privatization.[1]

The Commission plan for privatization would work as follows:

- Workers could voluntarily deposit one-third of their Social Security payroll taxes (4 percentage points of the combined 12.4 percent tax), up to $1,000, into private accounts.
- For workers who elect private accounts, traditional Social Security benefits would be cut back by the amounts deposited, plus interest (at a rate one percentage point lower than the Treasury rate).

In addition to creating private accounts, the Commission plan would make changes to traditional Social Security benefits:

- The Commission plan would substantially cut traditional Social Security benefits for everyone – even for workers who do not elect private accounts. Under current law, benefits paid in the first year of retirement are indexed to grow with wages. The Commission's plan would index these benefits to grow with prices, which typically rise slower than wages.
- The Commission plan would enhance benefits for some low-wage workers and raise survivor benefits for some widow(er)s. However, these increases would be overwhelmed by the loss in benefits due to the change in the calculation of basic benefits described above.

Finally, the Commission plan would transfer general revenue from the non-Social Security budget to the Social Security trust fund whenever its balance becomes negative.

Endnotes

[1] Matt Moore, "Social Security Blueprint," The Washington Times, Nov. 7, 2004, p. B01.

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