JOINT ECONOMIC COMMITTEE DEMOCRATS

SENATOR JACK REED (D-RI) – RANKING DEMOCRAT

ECONOMIC POLICY BRIEF

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THE NEGATIVE IMPACT OF PRIVATE ACCOUNTS ON FEDERAL DEBT, SOCIAL SECURITY SOLVENCY, AND THE ECONOMY

EXECUTIVE SUMMARY

President Bush's plan to replace part of Social Security with private accounts would lead to a massive increase in federal debt, weaken the solvency of Social Security, and fail to increase national saving in preparation for the retirement of the baby boom generation. If a prominent proposal favored by the Administration to switch to price indexing in setting initial retirement benefits were added, the President's plan also would result in large cuts in guaranteed benefits for everyone—not just for those who choose to open a private account.

Private Accounts Require a Massive Increase in Federal Debt

The Administration estimates that the President's privatization plan, which would not go into effect until 2009, would add $754 billion to the public debt in the current budget window (2006-2015). However, an estimated $1.4 trillion would be added in the first 10 years of implementation (2009-2018), followed by another $3.5 trillion in the second decade (2019-2028).

Adding price indexing of initial retirement benefits to the plan would do little to offset that cost. Debt would still grow by close to $5 trillion over the first 20 years. That increase in debt is not simply a transition cost that would go away. Debt would continue to increase relative to the size of the economy, reaching 35 percent of gross domestic product (GDP) in 2060.

Federal debt held by the public was 37 percent of GDP at the end of 2004. Thus, starting from today's level, private accounts would double the size of the debt to over 70 percent of GDP—a level not seen since the end of World War II.

Private Accounts Weaken Social Security Solvency

Diverting payroll tax receipts into private accounts instead of putting them into the Social Security Trust Fund would reduce trust fund assets by about $5 trillion in the first 20 years. That would move up the date the trust fund could no longer pay full benefits by about 11 years, to 2030 from 2041.

The President's private accounts plan would add another $1.6 trillion in present value to the $4 trillion that the Social Security Trustees estimate is the current Social Security shortfall over the 75-year planning horizon typically used for such estimates. (The "present value" of the shortfall is the amount of money that would have to be on hand today to cover the shortfall.)

That $1.6 trillion is the difference between the $4.7 trillion the trust fund would lose from payroll tax revenues diverted to private accounts and the $3.1 trillion the trust fund would save from the "privatization tax" that reduces guaranteed benefits for those who choose private accounts.

Private Accounts Do Not Increase National Saving and Could Lower It

The new private saving created in private accounts would be completely offset by the increased government borrowing to fund those accounts, leaving no net increase in national saving.

To the extent that people treat their private accounts as new saving and reduce their contributions to 401(k)s, IRAs, and other saving plans, the net increase in private saving would be smaller than the increase in government borrowing, and national saving would actually fall.

The President's Full Plan Would Cut Guaranteed Social Security Benefits

Although he has not offered a plan to restore Social Security solvency, the President has called the plan developed by his Commission to Strengthen Social Security a "good blueprint" for reform. That plan achieves solvency through large cuts in traditional Social Security benefits produced by changing the way initial retiree benefits are calculated.

The Social Security Administration estimates that the Commission's proposal to substitute price indexing for wage indexing in determining initial benefits would cut guaranteed benefits by 46 percent for average-earners retiring in 2075.

The Congressional Budget Office estimates that private accounts would not make up for the cuts in guaranteed benefits. Combined, the reduced guaranteed benefit and the likely private account benefit would be 45 percent less than the benefits promised under current law for an average-earner retiring in 2065; they would be 27 percent less than the benefits that could be paid from projected trust fund revenues in that year under current law.

Conclusion

The President's plan for private accounts would increase federal debt, weaken Social Security solvency, and not increase national saving. If combined with the benefit cutbacks President Bush seems to favor, future generations would face the double burden of large cuts in their guaranteed Social Security benefits and paying down the higher federal debt.

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