HOUSE BUDGET COMMITTEE

Democratic Caucus

The Honorable John M. Spratt Jr. ■ Ranking Democratic Member

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Social Security Privatization

Dear Democratic Colleague:

Advocates of partially replacing Social Security with private stock market accounts have argued that privatization will not require severe cuts in traditional Social Security benefits. At the same time, they claim that defenders of the existing Social Security system do not recognize how its unfunded liability might require adjusting the future course of traditional benefits to make the system sustainable. Neither claim is true.

Those who advocate strengthening the current system, rather than replacing it, acknowledge that sustainability requires difficult choices. But it is also undeniable that diverting dedicated resources from Social Security to fund new private accounts makes the existing problem worse and requires choices among even harsher alternatives. The level of budgetary resources needed both to make the current system sustainable ***and*** to fund private accounts is necessarily larger than what is needed solely to make the current system sustainable. Doing two costly things is more expensive than just doing one of them.

The Misguided Republican Budget Eliminated the Resources Needed to Avoid Benefit Cuts

Defenders of the current Social Security system do not ignore the fact that the system faces a fiscal challenge over the next 75 years — that's what it means to have an unfunded liability. There are only three ways to address such a challenge: (1) cuts in benefits relative to what is currently promised, (2) increases in revenues relative to what is currently planned, or (3) infusions of resources from outside of Social Security.

Unfortunately, the Republican budget squandered all the resources outside of Social Security — and then some. Last January, CBO predicted that we would have a non-Social Security, non-Medicare surplus of $2.730 trillion over the decade. These resources could have been used to strengthen Social Security and Medicare for the long-term, as Democrats proposed.

Now, however, CBO says the budget outside of Social Security and Medicare shows a \$1.227 trillion ***deficit*** for those same years, with last year's tax cut being the largest single contributor to the deterioration. Not only are all of the budgetary resources outside of Social Security and Medicare gone, but the surpluses dedicated to those two bedrock programs for the elderly are now being diverted to pay for general government operations.

Last year's promising vista of surpluses as far as the eye could see has been replaced by this year's grim prognosis of chronic deficits, and that means that using resources outside of Social Security to address our demographic challenges is now out of the question.

Diverting Even More Social Security Money into Private Accounts Only Makes the Problem Worse

Using payroll taxes to fund private stock market accounts increases the size of Social Security's unfunded liability and therefore requires more severe action than just righting the current system. After all, the very existence of the unfunded liability means that the stream of revenues coming into the trust fund over the next 75 years doesn't cover the stream of expected benefit payments. Reducing the inflow of revenues even further makes the problem worse, not better.

It should be fairly obvious that doing two things is more expensive than doing just one of them. The elimination of outside resources by last year's misguided budget may now require growth of inflation-adjusted Social Security benefits to be trimmed relative to current law, but it also means that privatization requires even more severe cuts in current law benefits.

Privatizers obscure this by using a double standard when comparing strengthening the current system with partially replacing it using stock market accounts. For instance, a *Washington Times* editorial last week ("Social Security Falsehoods" June 21, 2002) argues that, to make the current system sustainable, it would take "cuts" — that is, increases in inflation-adjusted benefits smaller than those promised in current law. However, when the editorial discusses a privatized system, it argues that there would be no cuts to benefits — relative to benefits paid today.

The *Washington Times* holds the two options to different standards to make privatization look better. A fair "apples-to-apples" comparison would show that traditional benefits in a privatized system must be smaller than in a reformed Social Security system, whether that is relative to current benefit levels or to the path of future benefits promised in current law.

Will Benefit Cuts or Stock Market Gains Win the Race?

Privatizers could make a legitimate argument that the eventual returns to private accounts will outstrip the sharp cuts in traditional Social Security benefits they require. However, they seem reluctant to do so in the current “bear market”, with the S&P 500 stock market index down more than 30 percent from its peak 21 months ago. This market slump has highlighted the possibility that near retirees might find their plans overthrown in a system relying on private investments.

Nonetheless, it is still the case that the S&P 500 has achieved inflation-adjusted returns averaging 7.6 percent over the last 40 years. This should be the core of the privatizers’ argument: Strong stock market returns over long periods of time ***might*** make up for (1) the required cuts in traditional Social Security’s progressive structure of benefits, (2) the increased risk faced by near-retirees, (3) the costs and complexities of administering private accounts, and (4) dissociation of disability and survivors’ benefits from Social Security’s retirement protections.

This is a debate worth having, provided the debate is carried out fairly and without distortions. Democrats welcome such a debate — not about gauzy generalities but about specific proposals in which the real trade-offs involved in privatization are honestly confronted. This debate about specific hard choices should begin immediately. As GAO Comptroller General stated at last week’s Budget Committee hearing on Social Security: Congress must address Social Security’s challenges, and “the sooner the better....There is no free lunch.”

Sincerely,

John M. Spratt, Jr.
Ranking Democratic Member