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Acquiring Financial Assets to Fund Future Entitlements

Spending on Social Security and other federal entitlement programs is expected to grow rapidly over the coming decades. In financing those programs, the federal government largely follows a pay-as-you-go approach: it uses its current receipts to pay current benefits. Continuing that approach implies that either future taxes will have to be raised or spending promises curtailed. In contrast, private pension plans generally fund future obligations by investing their resources in private securities and other financial assets. Some observers have suggested that the government could avoid the difficult choices of raising taxes or curtailing benefits by adopting the same practice.

Such a practice envisions having the current generation of workers fund more of its own federal entitlement benefits, and, by boosting saving, increasing the size of the future economy from which the benefits will be drawn. However, economic and practical obstacles exist.

First, the government is currently dissaving by running budget deficits, and continued borrowing to cover them could crowd out private investment. If the government used some of its current receipts to buy financial assets, it would simply have to borrow more to meet its other obligations. Its acquisition of financial assets would not have added new money to the nation's pool of investment resources. Without that addition, economic growth would not likely be affected. Thus, in the long run, there would be little to distinguish buying and eventually selling off stored up securities from raising future taxes.

Second, even if the government had surplus receipts to invest, it is doubtful that a process to protect them would be sustainable. A future Congress, confronted by war, recession, or other urgencies, could spend the invested resources or could run larger budget deficits or smaller surpluses that offset the effect of boosting saving. No trust fund, lockbox, or other accounting device has yet proved effective in protecting funds that have been set aside for future commitments from the fiscal demands that arise from one Congress to the next.

Moreover, even if the government could run surpluses and devise an effective means to save them, the issue of having the government own private businesses would remain. Government ownership of stocks could affect corporate decisionmaking, interfere with the nation's competitive market system, and impede the efficient operation of financial markets—potentially limiting economic growth.

The Benefits of Greater National Saving

The looming increase in entitlement spending will not be a temporary phenomenon but one that could affect future generations indefinitely. Under current projections, the number of people age 65 or older will nearly double between 2000 and 2030, and the ratio of workers to people age 65 or older will drop from 4.3:1 to 2.6:1.[1] (By 2075, the ratio will drop to 2.1:1.) To a large extent, the goods and services that society will consume in 2030 will have to be produced then, and with the demographic shift, greater demands will be imposed on the nation's workers. A larger base of production would make meeting those demands easier.

The nation's investment resources and the economy's long-term capacity would increase if society consumed less and saved more. However, the government's purchasing of private securities and other financial assets would not, by itself, accomplish those goals. The federal government does not have surplus receipts to invest today, and if the government's acquisition of financial assets was financed with more federal borrowing, the only obvious result would be a reshuffling of the financial portfolios of the government and the private sector.

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1. See Social Security Administration, *The 2003 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (March 17, 2003).

Some policymakers have suggested that in a time of budget surpluses, the government could credit the Social Security trust funds with more government bonds. When money was eventually needed to pay benefits, the government could sell the bonds. While that strategy may appear to be reasonable, the eventual sale of those bonds would have the same effect as the government's borrowing the money then. If the strategy rendered positive economic effects, they would likely be the result of the budget surpluses themselves.

The Separation of Saving from Budgetary Decisions

Even if there were surplus federal receipts to save today, it is uncertain what budgetary device or procedural constraint could effectively protect those resources from being diverted when priorities changed. No law can bind one Congress to the policies of a preceding one, and the goal of setting resources aside to fund long-term commitments can dim among the pressing fiscal demands that arise from one year to the next.

Over the years, policymakers have pursued measures to set aside resources to fund long-term commitments. However, no effective barrier between immediate budgetary demands and resources earmarked for future expenses has been conceived. The designation of trust funds and lockboxes and the compartmentalizing of the federal budget to create "off-budget" accounts have not precluded the use of earmarked receipts for other purposes. And even with those receipts, the government has more often run overall deficits than surpluses.

Assets set aside to fund future obligations are most likely to be insulated by a system in which ownership and control rest with individuals. In that circumstance, each participant has property rights and legal recourse to guard against the diversion of resources. An approach in which the government invests collectively on behalf of program beneficiaries is less likely to succeed. If the money did not belong to individual participants, future policymakers could find alternative uses for it—to create a new benefit, fund a new program, or perhaps cover a budget gap.

But even if resources were set aside in an individualized system, the effect on saving would remain uncertain. Giving people resources or greater incentives to invest directly might induce them to draw down other saving or to borrow more. The government, too, could modify property rights in private accounts by taxing them more or changing restrictions on early withdrawals.

The Issue of Government Control of Businesses

Assets amassed by the government would also raise the practical issue of what it means for the government to own private resources. Over the past 75 years, federal programs with earmarked resources have largely avoided investing in private securities. The vast majority of their surplus resources have been held in U.S. Treasury securities—that is, as obligations that the government makes to itself. That approach has allowed for an accounting of the earmarked funds but has generally kept the government from investing in private financial assets.

Holding private equities would give the government ownership rights, ownership responsibilities, and the potential for involvement in a business's affairs. Suppose a company in which the government had a controlling interest announced its intent to shut down a plant. Plant closings are usually undertaken to enhance the financial health of a company; however, with the government as a stockholder, the company could be pressed to operate the plant at a loss in order to protect jobs. Pressure for a bailout or other form of subsidy could follow.

Federal investment in equities also increases the potential for public policy and political considerations to affect investment decisions. A private pension fund must put the economic interests of the fund's participants first. However, if the fund was for Social Security or Medicare, there would be a clear "public" interest. Why, some might ask, should the fund own tobacco stocks or those of companies whose products harm the environment? A 1996 study of 123 state and local government pension plans found that 41 percent had applied "social screening" in their choice of investments.[2] Social screening can create opportunities to pursue interests that differ from those of participants and potentially reduce returns.

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2. Celinda Franco, Edward Rappaport, James Storey, *State and Local Pension Plans: Economically Targeted Investments and Social Responsibility Screening*, CRS Report for Congress RL 30218 (Congressional Research Service, May 25, 1999).

Passive rather than active government ownership also raises difficult issues, even with a system in which an independent board administers the holdings. For example, the board's appointments would be determined by the legislative process. Thus, at some stage, political decisions could enter into the board's composition, procedures, and operations.

Because of its potentially large scale, federal investing could also create biases in the financial markets. If, for instance, federal investments were limited to publicly traded companies, privately held companies could be disadvantaged, as could small businesses, municipal entities, and issuers of lower-graded bonds. Moreover, some companies would inevitably be left out. Stock-index mutual funds do not try to invest in every type of company; they tend to avoid companies whose stock is traded infrequently because trading and tracking costs are prohibitive and thin trading makes fair pricing difficult. The omission of those companies from a government-owned fund might make their access to capital more difficult, and a perception of lower liquidity could reduce the value of their shares.

Conclusion

Policies to increase national saving require that society as a whole consume less so that more resources are available for investment. Effective measures that the government can take would be to reduce its debt owed to the public (which would return funds to investors for private reinvestment) and increase incentives for people to save more. Government acquisition of financial assets to meet promises of future entitlements may distract attention from the steps needed to enhance investment. Indeed, the accumulation of financial assets by the federal government may render a false sense of having taken effective action to provide for future needs.

Related CBO Publications: *Evaluating and Accounting for Federal Investment in Corporate Stocks and Other Private Securities,* CBO Paper (January 2003); *Social Security Reform: The Use of Private Securities and the Need for Economic Growth*, Long-Range Fiscal Policy Brief No. 7 (January 3, 2003); and *The Looming Budgetary Impact of Society's Aging*, Long-Range Fiscal Policy Brief No. 2 (July 3, 2002).

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