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WHITE HOUSE PRESS SECRETARY'S DESCRIPTION OF ADMINISTRATION'S PRIVATE ACCOUNTS MAY LEAVE MISIMPRESSIONS

by Jason Furman

In a briefing today, White House Press Secretary Scott McClellan contended that a story on the Administration's Social Security plan printed in today's *Washington Post* was inaccurate.[1] McClellan said: "The story is wrong. Individuals get to keep everything they set aside in personal accounts, plus the increased rate of return they'll realize on their investment."

Mr. McClellan, however, omitted the key detail of the President's proposal: *Any person who sets up a private account would get an automatic reduction in their Social Security benefit*. This automatic reduction in their Social Security benefit would offset much or all of the value of their account. The fundamental issue is not where the benefit reduction comes from but what happens to the *net* benefit at retirement.

A senior Administration official, giving a background briefing on February 2, was more forthright on this point:

> "…in return for the opportunity to get the benefits from the personal account, the person foregoes a certain amount of benefits from the traditional system. Now, the way that election is structured, the person comes out ahead if their personal account exceeds a 3 percent real rate of return, which is the rate of return that the trust fund bonds receive. *So, basically, the net effect on an individual's benefits would be zero if his personal account earned a 3 percent real rate of return*. To the extent that his personal account gets a higher rate of return, his net benefit would increase as a consequence of making that decision." [emphasis added]

The senior Administration official made it clear that individuals do *not* get to keep everything they have deposited in their accounts plus the earnings on the account. He made it clear that in *net*, they get to keep only the earnings on the account, if any, that exceed a rate of return three percent above the inflation rate. Everything else would effectively have to be repaid, with the repayment accomplished through a reduction in Social Security benefits.

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[1] Jonathan Weisman, 2/3/2005, "Participants Would Forfeit Part of Accounts' Profits," *Washington Post*.

What the Plan Would Mean For Social Security Beneficiaries?

A more detailed CBPP analysis describes the mechanics of the accounts.[2] To give one example, consider a worker who turns 21 in 2011 and will earn average wages over his or her career. If the worker wants to participate in the private accounts, he or she would have to agree to an $11,000 annual reduction in his or her annual Social Security benefits in retirement — that is, to a reduction in the individual's Social Security benefits of approximately 50 percent.[3] Over the course of the worker's retirement (assuming he or she had normal live expectancy), this benefit reduction would total $152,000. (All numbers cited here are in inflation-adjusted 2004 dollars.)

If the worker earned a 3 percent real rate of return on his or her private account — which is the risk-adjusted rate that the Congressional Budget Office assumes in its analysis of Social Security plans that include private accounts — the worker would end up with an average account balance of exactly $152,000. It would take this entire $152,000 account, turned into an inflation-indexed annuity, to make up for the worker's $11,000 annual reduction in Social Security benefits. As a fact sheet that the White House issued today acknowledged: "If the account earns a 3% real rate of return — the worker would be right back where he started . . ." (see footnote 3).

Even if the worker's account did better than this, the worker still would need to use the majority of the account just to make up for this automatic reduction in her Social Security benefit.

It should be noted that these Social Security benefit reductions would *not* contribute to the solvency of the Social Security system; they would, as the senior White House official acknowledged in the February 2 briefing, be neutral with regard to Social Security's finances, neither making them better nor worse. And if the President has ruled out revenue options as a way to help restore Social Security's solvency, then solvency would have to be restored entirely through other cuts in Social Security benefits that would be *in addition to* the automatic 50 percent reduction in Social Security benefits imposed on people who chose the private accounts.

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[2] Jason Furman, "How the Individual Accounts in the President's New Plan Would Work," Center on Budget and Policy Priorities, February 3, 2005.

[3] The White House has a fact sheet that provides an example of a worker who would have to accept a $5,000 Social Security benefit reduction in exchange for a private account. It is not clear if this is a hypothetical number or based in the details of the Administration's plan (White House, "Setting the Record Straight," February 3, 2005). Note that the White House fact sheet again acknowledges that: "If the account earns a 3% real rate of return - the worker would be right back where he started - at $15,000 of combined benefits per year."