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Revised August 2, 2005

PRIVATE ACCOUNTS WOULD SUBSTANTIALLY INCREASE FEDERAL DEBT AND INTEREST PAYMENTS

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Summary

All of the major proposals to replace a portion of Social Security with private accounts would require large increases in federal borrowing for many decades. This increased borrowing is not necessary to restore Social Security solvency. Instead, the increased borrowing would be needed to finance the creation of the private accounts, which by themselves would not do anything to restore solvency, and under some circumstances would worsen solvency.

Some plans with private accounts, like the President's, would shrink the solvency gap by reducing Social Security benefits (over and above the benefit reductions that are designed to compensate for the loss of payroll taxes diverted to private accounts). These benefit reductions would partially offset the increased borrowing that would result from the private accounts. Even when these benefit reductions are taken into account, however, all of the proposed plans that include private accounts would substantially increase the federal debt and the interest payments on the debt. For instance:

- The President's plan would create $17.7 trillion in additional debt by 2050.[1] This additional debt would be equal to 19.3 percent of the Gross Domestic Product in 2050. By comparison, the *total* federal debt currently equals 38 percent of GDP. Thus, by 2050, the President's plan would require more than half as much borrowing as the federal

KEY FINDINGS

- **All of the private account plans that have been proposed would substantially increase federal debt and interest payments.**
- **Despite the increases in debt, none of the private account plans would achieve Social Security solvency without large transfers from the rest of the budget, but the rest of the budget is in deficit and has no surplus resources to transfer.**
- **The two Social Security plans that do not include private accounts would reduce, rather than increase, federal debt.**

[1] CBPP estimates of the President's plan are based on estimates made by the Social Security actuaries of the effects of the President's plan through 2015, and on the actuaries' estimates of the effects in subsequent years of private account and progressive-indexing proposals included in other Social Security plans that are similar to what the President has proposed. The actuaries' estimates of the effects of these other plans are adjusted for comparability to reflect the assumptions of the 2005 Social Security Trustees' report and the assumption that private accounts would take effect in 2009, as the President's plan proposes. See Appendix B for a discussion of the methodology used in developing these estimates.

government has undertaken for all purposes in its first 216 years. In 2050, the interest on the additional debt created by the President's plan would be equivalent to $133 billion in today's economy, or more than the federal government will spend this year on all education, veterans' health care, science, conservation, pollution control, and job training programs combined.

By 2050, the cost of the interest payments on the additional debt that the President's plan would create would be equivalent to $133 billion year today

- The plan proposed by Robert Pozen, an investment company official who served on the President's Social Security Commission, would create $3.5 trillion in additional debt (equal to 3.8 percent of GDP) by 2050. Interest on that additional debt in 2050 would be equivalent to $29 billion in today's economy.

- The plan proposed by Senator Lindsey Graham (R-SC) in 2003 would create $19.1 trillion in additional debt (equal to 20.8 percent of GDP) by 2050. Interest on that additional debt in 2050 would be equivalent to $145 billion in today's economy.

- The plan proposed by Senator Chuck Hagel (R-NE) would create $24.2 trillion in additional debt (equal to 26.5 percent of GDP) by 2050. Interest on that additional debt in 2050 would be equivalent to $182 billion in today's economy.

- The plan proposed by Senator John Sununu (R-NH) and Representative Paul Ryan (R-WI) would create $85.8 trillion in additional debt (equal to 93.7 percent of GDP) by 2050.[2] Interest on that additional debt in 2050 would be equivalent to $635 billion in today's economy.

These estimates and comparable estimates for other Social Security plans are shown in the table on page 5.

Why do these private accounts plans create additional debt? Currently, all payroll taxes paid into Social Security are used by the federal government. These taxes are used to the full extent needed to pay Social Security benefits to current beneficiaries. The Social Security trust funds loan any revenues not needed for this purpose to the Treasury and receive Treasury bonds in return. Since total federal revenues — including Social Security taxes — are now less than total federal expenditures, the government runs a deficit each year. Thus, the funds borrowed from Social Security are used to help cover these deficits. (If the rest of the budget were balanced, the Treasury would use the revenues borrowed from Social Security to pay down the federal debt.)

Creation of a system of private accounts would not change the amount of revenue coming into the federal government, but it would *increase government spending*, because the federal government would be making regular payments into the private accounts. These payments would represent new government spending. This increase in spending, unaccompanied by an increase in revenues, would widen annual deficits. The federal government would have to borrow more to cover these larger deficits, and that added borrowing would increase both the national debt and the cost of interest payments on

[2] These estimates do not take into account the potential effect of proposed caps on non-Social Security spending proposed by Senator Sununu and Representative Ryan. See Appendix A for a description of the Sununu-Ryan proposal and an explanation of why the potential effects of the proposed caps are not included in these estimates.

Temporary Private Account Plan Would Permanently Increase Debt

On June 23, 2005, Senator Jim DeMint (R-SC) introduced S. 1302, "The Stop the Raid on Social Security Act of 2005." (A similar bill, H.R. 3304 — the "Growing Real Ownership for Workers Act of 2005" — was introduced by Representative Jim McCrery (R-LA) on July 14, 2005. Senator DeMint also introduced a more comprehensive Social Security plan in 2003, when he was a Member of the House of Representatives; see the description of that plan in Appendix A.) Unlike the other proposals described and analyzed in this paper, the new plan offered by Senator DeMint would neither make permanent changes in Social Security nor establish a permanent system of private accounts. Instead, it provides for voluntary private accounts funded by diverted Social Security payroll taxes only for as long as Social Security has a cash-flow surplus (i.e., a surplus not counting the interest that the trust funds receive on their bonds). According to the most recent report of the Social Security Trustees, cash-flow surpluses will exist only through 2016.

Under the DeMint plan, the total amount of Social Security payroll taxes diverted to private accounts each year would be equal to the Social Security cash-flow surplus for that year. The contribution rate for each participant would be determined by dividing the total amount that could be placed in private accounts in a given year by the total taxable earnings in that year of the workers eligible to make contributions to these accounts. All workers born after 1949 could participate.

When a worker who has chosen to participate in the private account plan became eligible to receive retirement benefits under Social Security, the worker would have to repay Social Security for the payroll taxes diverted to his or her private account. The repayment would be made in the form of a reduction in the worker's monthly Social Security benefit that is actuarially equivalent to the total payroll taxes diverted, plus interest on the diverted taxes compounded at an annual rate equal to the yield from long-term U.S. Treasury bonds minus 0.3 percent.

Although the private accounts funded in this manner would continue to exist as long as participants remained alive, there would be no new contributions to those accounts — and no new accounts established — after cash-flow surpluses in the Social Security trust funds ceased to exist.

By themselves, the DeMint plan's private accounts would slightly increase (by 2 percent) the 75-year Social Security shortfall.[a] The DeMint plan also contains a provision requiring automatic transfers from the General Fund of the Treasury to the Social Security trust funds sufficient to ensure that full scheduled Social Security benefits could be paid until 2041 (the year that the Social Security Trustees estimate the trust funds will become insolvent under current law). These General Fund transfers would guarantee Social Security solvency through 2041, but would be paid entirely with borrowed money.

Although it provides only for temporary contributions to private accounts and would do nothing to improve Social Security solvency, the DeMint plan would permanently increase the federal debt. The increase in debt resulting from the DeMint plan would total $1.3 trillion (5.5 percent of GDP) by 2018, and $3.5 trillion (3.8 percent of GDP) in 2050. The McCrery proposal has somewhat different effects on Social Security because it proposes to fund individual accounts from General Fund revenues, but it has exactly the same effect on federal debt as the DeMint plan.

a. For an analysis of the 2005 DeMint plan and the McCrery plan, see Jason Furman and Robert Greenstein, "The DeMint and McCrery Social Security Plans," Center on Budget and Policy Priorities, revised July 19, 2005.

the debt. (If the budget outside of Social Security were balanced and the Treasury were using the payroll taxes borrowed from Social Security to pay down the debt, diverting those revenues to private accounts would still result in higher levels of debt than would occur if the taxes were not diverted).

Proponents of private accounts dismiss the increased borrowing and interest costs caused by private accounts as "transition costs," since the cost of establishing the accounts would eventually be offset by reductions in Social Security benefits for workers who opened a private account.[3] However, the additional debt created by President's plan would continue growing as a share of GDP until 2044, when it would peak at 20.5 percent of GDP, and would remain as high as 10.6 percent of GDP in 2061. A problem that will not begin to recede for four decades is difficult to dismiss as simply a "transition cost."

Moreover, the eventual reduction in the debt incurred in order to fund private accounts would depend on future reductions in Social Security benefits being carried out as planned. It is by no means certain this would happen, especially if the securities held by private accounts earned less than proponents predict and pressure consequently grew for the offsetting benefit reductions to be scaled back.

Additional interest payments resulting from private account plans would make it harder to maintain important federal programs and avoid unsustainable deficits.

The added interest payments during the several-decades-long "transition" period would place more pressure on the federal budget, which already faces growing shortfalls in coming decades because of demographic pressures, rising health care costs, and tax cuts. These additional interest payments would make it harder to maintain important federal programs and avoid unsustainable deficits. In addition, the increase in federal debt that resulted from a private accounts plan could contribute to or exacerbate a fiscal crisis that some experts fear may be triggered at some point by continuing high federal deficits.

It is important to note that Social Security reform plans exist that restore solvency and do *not* increase debt and interest payments. A plan proposed by economists Peter Diamond of MIT and Peter Orszag of the Brookings Institution that does not include private accounts would restore solvency and *reduce* federal debt in every year; by 2050, this plan would reduce debt by $23.7 trillion (or 25.9 percent of GDP) and reduce interest payments by $1.3 trillion (or 1.4 percent of GDP).

Changes in Debt and Interest Resulting from Proposed Social Security Plans

The table on the next page shows the increases in federal debt, and the interest payments on that additional debt, that would result from the private account plans discussed above and from several additional plans. (See Appendix A for a description of the plans included in the table and Appendix B for the methodology used to determine the estimates, which include adjustments to make all estimates consistent with the assumptions of the 2005 report of the Social Security Trustees and with the assumption that private account plans would start in 2009, as the President has proposed).

The table also shows the reductions in federal debt and interest payments that would result from two plans that do not include private accounts. Finally, the table shows the percentage reduction in the 75-year Social Security shortfall that each plan would achieve, excluding the effects of transfers from the rest of the government.[4]

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[3] Actually, under the President's plan, these benefit reductions would not fully offset the diversion of payroll taxes into the accounts, even over the long term. See page 11.

[4] The effects of transfers from the General Fund to the Social Security trust funds that are not paid for by spending cuts or new revenues are excluded because the General Fund is already in deficit, is projected to suffer growing deficits in the decades ahead, and would have to borrow every penny it transfers to Social Security. According to Douglas Holtz-

ADDITIONAL FEDERAL DEBT AND INTEREST IN 2050 RESULTING FROM PROPOSED SOCIAL SECURITY PLANS (Over and Above the Levels that Would Otherwise Exist)				
Plan	**Increase (+) / Reduction (-) in Debt by 2050**	**Increase (+) / Reduction (-) in Annual Interest Payments in 2050**		**Reduction (-) / Increase (+) in 75-Year Social Security Shortfall****
	Percent of GDP	Percent of GDP	Billions of Dollars based on 2005 GDP*	Percent Change
Bush	19.3%	1.1%	$133	-24%
Pozen	3.8%	0.2%	$29	-51%
Hagel	26.5%	1.5%	$182	-8%
Graham	20.8%	1.2%	$145	-49%
Johnson	65.3%	3.7%	$451	+30%
Kolbe-Boyd	1.2%	0.1%	$11	-66%
DeMint (2003)	79.7%	4.4%	$541	+120%
Shaw	40.1%	2.2%	$272	+7%
Sununu-Ryan	93.7%	5.2%	$635	+129%
Diamond-Orszag	-25.9%	-1.4%	-$173	-100%
Ball	-28.2%	-1.5%	-$188	-92%

* This is calculated by multiplying the estimated additional interest payments in 2050 as a percent of GDP by the GDP projected for 2005.

** Excluding the effect of proposed transfers to Social Security from the rest of the budget. These estimates of the effect of plans on solvency are based directly on estimates of each plan (other than the President's) by the Social Security actuaries, without any adjustment to reflect the assumptions of the Social Security Trustee's 2005 report or a delay in the start of private accounts until 2009. Such adjustments would have little or no effect on the estimated impact of the plans on Social Security solvency over 75 years. The estimate of the effect of the President's plan on solvency is by Jason Furman of the Center on Budget and Policy Priorities.

Eakin, the Director of the Congressional Budget Office, such transfers "would not address the broader budgetary and economic issues stemming from the fiscal imbalances in the Social Security system." Testimony before the Senate Committee on Finance, May 25, 2005, p. 7