



CENTER ON BUDGET AND POLICY PRIORITIES

820 First Street, NE, Suite 510, Washington, DC 20002
Tel: 202-408-1080 Fax: 202-408-1056 center@cbpp.org www.cbpp.org

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SENATOR MISREPRESENTS CBO REPORT IN LAUNCHING MISLEADING ATTACK ON FISCALLY RESPONSIBLE SOCIAL SECURITY PLAN

Attack Suggests an Emerging Effort to Tar Plans that Raise Some Revenue and Do Not Include Private Accounts

by Robert Greenstein

On December 22, the Congressional Budget Office released an analysis of a Social Security plan designed by M.I.T economist Peter Diamond, one of the world's foremost experts on retirement issues, and Peter Orszag, an economist at the Brookings Institution.¹ On one measure after another, the CBO report demonstrated the soundness and fiscal responsibility of this plan, which contains a series of carefully designed changes in Social Security phased in over many years, including relatively modest adjustments in Social Security benefits and payroll taxes. For example, CBO found that the plan would restore Social Security solvency both over 75 years and into perpetuity, would do so without borrowing money or transferring funds from the rest of the budget, and would provide substantially higher benefits than the principal plan that the President's Social Security Commission proposed, even when the income from the private accounts under the Commission's plan are taken into account.

Nevertheless, within hours of the CBO report's release, Senator Larry Craig, outgoing chairman of the Senate Special Committee on Aging, used the report to launch an attack on the Diamond-Orszag plan that generated some media coverage portraying the plan in an unfavorable light. Senator Craig, who had requested the CBO report, claimed the report showed the Diamond-Orszag plan would injure the American economy. Craig also stated that an earlier CBO report showed the plan the President's Commission designed would expand the economy.²

Craig suggested the CBO findings mean that private account plans would be better for seniors and would result in more Social Security benefits than a plan such as the Diamond-Orszag proposal. "A stronger economy means more protection for seniors and their Social Security benefits," Craig declared.

The Senator's remarks suggest that any plan to restore Social Security solvency that includes revenue measures, no matter how modest, and does not include individual accounts is likely to be denounced in coming months as causing damage to the U.S. economy.

¹ Congressional Budget Office, "Long-Term Analysis of the Diamond-Orszag Social Security Plan," December 22, 2004.

² Senator Craig's statements appear in a press release issued by the Senate Special Committee on Aging ("New CBO Report Finds Leading Liberal Social Security Reform Plan Would Shrink U.S. Economy," December 22, 2004).

Craig Statements Distort CBO Report

The Craig statements distort the CBO findings. CBO projected that both the Diamond-Orszag plan and the principal plan that the President's Commission designed would have tiny effects on the economy. Where CBO found large differences between the two plans was in the level of benefits that seniors would receive. The benefits would be much larger under the Diamond-Orszag plan than the Commission plan. Benefits would be cut substantially under the Commission plan, even when income from the plan's private accounts was factored in.

Furthermore, the large difference in benefit levels between the two plans is itself the main reason that CBO projected even small differences in the long-term economic effects that the plans would have. CBO projected that because retirement benefits would be reduced so much under the Commission plan, workers would feel compelled to consume less and reduce their standard-of-living during their working years in order to save a bit more. This modest addition to saving would produce a tiny long-term economic gain.

Even this very small gain would, in CBO's words, be "very uncertain." In its analysis of the Commission plan, CBO warned, "it is important to note that they [the economic effects CBO projected the plan would have] are very uncertain. Estimates that were based on different assumptions or that were produced by using another economic model could differ substantially."

The most striking finding from the CBO analyses is not the marginal (and uncertain) difference in economic growth rates between the plans, but the dramatic differences in benefit levels: CBO projected that future retirees would be much worse off under the Commission plan than under the Diamond-Orszag approach, and would receive several thousand dollars less in benefits each year. (See box on page 3.) Senator Craig's suggestion that the CBO report indicates seniors and their Social Security benefits would be better protected under the Commission plan, with its private accounts, is the opposite of what CBO actually found.

The Specific CBO Estimates

In two separate CBO reports, the December 22 report on the Diamond-Orszag plan and a July 21 report³ on the principal plan that the President's Social Security Commission designed (sometimes referred to as the "Model 2" plan), CBO made projections for three scenarios:

- the Commission plan,
- the Diamond-Orszag plan, and
- a "do nothing" plan under which full Social Security benefits would be paid until the Social Security Trust Fund reserves are depleted, and benefits would be reduced after that to match annual Social Security revenue.

CBO projected there would be only tiny differences in economic growth under these plans. *Real economic growth between 2004 and 2025 would average 4.1 percent a year under all three plans.* The difference in economic growth that Senator Craig portrayed as being highly consequential turns out to be the following: the CBO projections indicate that real growth (i.e., growth above the inflation rate) would average 4.07 percent per year under the Diamond-Orszag

³ Congressional Budget Office, "Long-Term Analysis of Plan 2 of the President's Commission to Strengthen Social Security," July 21, 2004, updated September 30, 2004.

plan, 4.11 percent under the “do-nothing” scenario, and 4.13 percent under the Commission plan. (Stated another way, the CBO projections indicate that the economy would grow 131 percent in real terms by 2025 under the Diamond-Orszag plan, 133 percent under the do-nothing scenario,

**CBO PROJECTS LARGE BENEFIT REDUCTIONS UNDER COMMISSION PLAN,
MUCH SMALLER REDUCTIONS UNDER DIAMOND-ORSZAG PLAN**

CBO examined benefit levels for workers who will retire in future decades under the Commission plan, the Diamond-Orszag plan, the current benefit structure, and a scenario under which no action is taken and benefits ultimately must be reduced to match available revenue. CBO found that benefits for future retirees under the Commission plan, including the benefits from the plan’s individual accounts, would be much lower than the benefits paid under any of the other approaches.

- For example, for median (or typical) wage-earners⁴ born in *the 1970s* who retire at age 65, benefits would be reduced 5 percent under the Diamond-Orszag plan (as compared to the benefits that would be paid under the current benefit structure). Benefits for the same workers would be reduced 23 percent under the Commission plan.
- For typical wage-earners born during *the 1990s* who retire at age 65, benefits would be reduced 13 percent under the Diamond-Orszag plan, but would be cut 38 percent under the Commission plan.
- In dollar terms, median wage-earners born in the 1970s who retire at age 65 would receive over \$4,000 less each year under the Commission plan than they would receive under the Diamond-Orszag plan. Median wage-earners born in the 1990s who retire at age 65 would receive nearly \$6,000 less each year under the Commission plan than under the Diamond-Orszag proposal. (All dollar amounts are expressed in 2004 dollars.)

The benefits that would be paid under the Diamond-Orszag plan would be substantially higher than those that would be paid under a “do nothing” scenario once Social Security’s reserves were exhausted. By contrast, the benefits paid under the Commission plan, including the income from individual accounts, would be *lower* than the benefits provided under the do-nothing scenario.

- CBO projects that the benefits paid to median wage-earners born in the 1990s who retire at age 65 would be *13 percent higher* under the Diamond-Orszag plan than the benefits that would be paid to these workers under the do-nothing scenario.
- But CBO projects that the benefits paid to these workers under the Commission plan would be *20 percent lower* than the benefits under the do-nothing approach.

These large differences in future benefit levels that are the principal reason for the very small differences that CBO projects in economic growth rates under these plans.

and 134 percent under the Commission plan.) CBO projected similarly small differences over 75 years.⁵

Furthermore, contrary to Senator Craig’s assertions, the private accounts in the Commission plan have little or nothing to do with the marginal increase in economic growth that CBO projected

⁴ These estimates are for median wage-earners in the middle household earnings quintile, which is the way that CBO presents the estimates.

⁵ The CBO projections indicate that between 2004 and 2080, real economic growth would average 3.83 percent per year under the Diamond-Orszag plan, 3.85 percent under the do-nothing plan, and 3.90 percent under the Commission plan.

CBO on the Economic Effects of the Commission Plan

In its analysis of the Commission plan, CBO reported: “CSSS Plan 2 [i.e., the Commission plan often referred to as Model 2] would affect the economy primarily through its changes to scheduled benefits — which would alter households’ expectations. Under the plan, benefits (adjusted for risk) would be reduced for most of the first 50 years relative to those that people would receive under the baseline scenario [i.e., under the “do nothing” approach], even after including payouts from individual accounts. The cut in benefits would reduce households’ spending and boost their saving before retirement.”

under that plan. CBO found that the Commission plan would result in deep benefit reductions, even when the income from the plan’s private accounts is included. CBO assumed that workers would recognize that their retirement income would be substantially reduced and respond by consuming a bit less (and lowering their standard of living) during their working years in order to save a bit more for their retirement years. It is this modest increase in household saving, driven by large benefit cuts, that would cause the tiny economic growth increment CBO projected.

The Diamond-Orszag plan would provide much higher retirement benefits. To be sure, benefits would be lower under this plan than under the current benefit structure. But benefits would be significantly higher than under either a “do nothing” scenario or the Commission plan. Since benefits would be cut less under the Diamond-Orszag plan than under the other two approaches that CBO examined, CBO assumed that under the Diamond-Orszag plan, families would not reduce consumption as much during their working years. Accordingly, economic growth would be marginally lower. CBO also assumed that the payroll tax increases contained in the Diamond-Orszag plan would have small effects on economic growth.

Even the tiny differences in economic growth that CBO projected under these plans may be overstated. These differences rest largely on the assumption that workers will respond to reductions in future Social Security benefits by spending less and saving more during their working years. If this assumption proves incorrect — that is, if strapped consumers do not respond to cuts in retirement benefits by saving more and buying less while they are raising their families — much of the already very small difference that CBO projected in economic growth rates under these plans would disappear.