

The Administration's USA Account Proposal (Part 1 of 3)

Part One: Genesis

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Document date: May 24, 1999

Released online: May 24, 1999

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The Clinton administration's proposal to establish USA accounts has received little press attention so far and apparently is going nowhere this year. That's too bad. Using some of the projected budget surplus to try to set up individual accounts provides one possible way around an impasse on social security reform. That impasse arises not just because of philosophical differences among elected officials but because current social security revenues simply are insufficient to do everything wanted by most people—those who like the current system and those who want to reform it significantly.

Although seldom stated as a goal, the administration's plan would increase the share of private wealth and of private pension wealth owned by the middle- and lower-income classes. The proposal, therefore, can be viewed as a partial reform of both social security and the private pension system.

Not that all is positive about the proposal. As a practical matter, it really doesn't work. No subsidy system is going to be perfect, but this one is too complicated by one—a consequence of all the constraints imposed before it was even developed. Some of those complications could be removed in a well-developed legislative process, but neither a process nor one that is well-developed seems likely.

The administration apparently has decided not to deal with the much wider set of issues surrounding reform of the social security and the private pension systems, and USA accounts really must be addressed within that broader context. Congress, meanwhile, seems to have neither the will nor the way to bring such reform by itself.

Before examining the opportunities and problems with the USA account proposal, it is best to recall the constraints imposed on Treasury even before it was asked to design the plan. The first problem was perhaps the biggest: the broad outline of the proposal was determined before any serious analysis had even been performed. President Clinton was approaching the State of the Union address this year without having made much advance on the social security front, as promised. Something had to be said and put together quickly.

The Kosovo crisis hadn't accelerated, so it was not yet a significant threat to the surplus. The impeachment process was still alive, reducing the time and attention given to domestic policy initiatives. Finally, the administration was focused as much on trying to prevent the Republicans from using the larger surplus to pay for an across-the-board tax cut than on any particular policy advance.

Clinton chose not to try to put forward any options to change the benefit or tax structure in social security, despite the large imbalances projected for the long-run. Efforts to reduce promised benefits or raise taxes misleadingly appear to create losers only, even though they only make explicit the losses implied by an imbalanced system. Nonetheless, they bring a lot of political flak. Besides, it would take considerable effort to put together an adequate proposal and, so close to the State of the Union address, there was not time.

Clinton decided that a quicker and surer strategy would be to try to save "more" of the surplus than Congress might if left to its own devices. Interest saving on a smaller debt to the public could then be devoted to social security (and Medicare) in the future. (For prior coverage of the USA proposal, see Tax Notes, Apr, 19, 1999, pp. 329-332.)

We are not interested here in the administration's broader strategy, which largely involved trying to obligate future Congresses to "save" future surpluses by granting government bonds to social security. Through interest and principal payments on those bonds, the Treasury would then pay general revenues to the trust funds to meet the high level of benefit promises that could not possibly be met by social security revenues alone. At the same time, the administration proposed spending some of those potential future surpluses on a

type of individual account.

Individual accounts had formed part of many other social security plans. Two features of the administration plan are worthy of note. First, in the language of social security, USAs would be established by the add-on, rather than carve-out, method. A "carve-out" implies that some of the existing social security tax would be allocated away from social security's benefit structure. An "add-on" would increase the revenues flowing to some combined social security/individual account system.

Before the unified budget surplus had become more apparent, add-ons were quite difficult to finance. In general, they would require some new mandate on wages, whether a higher social security tax rate or some additional mandate on employers and employees. With a carve-out, the money for accounts almost inevitably had to come out of other reforms or as a substitution out of the social security benefit structure itself. Moreover, once one got into the game of benefit reform, it would be hard not to go the whole way toward bringing the system into balance. Otherwise, the funds for the accounts would appear to be coming out of money that wasn't there.

A second distinction from many (but not all) previous individual account proposals was that all of a sudden the surplus offered an opportunity to consider funding some type of private saving account out of general revenues rather than out of an additional tax or mandate. Moreover, by using a different source of revenue, the administration dodged dealing with the issue that social security revenues were already inadequate to pay for promised benefits.

This type of add-on requirement would also give the administration some ammunition in any tax debate. The money for the accounts would formally be treated in the budget as a tax cut, and the administration believed that subsidized saving would more likely be "saved" than other forms of tax cuts. Moreover, should a tax bill get some steam behind it, the administration would have some proposals of its own to play with in any bidding war.

I also think the administration wanted a compromise with those who favor private accounts as a part of any social security reform. USA accounts were an effort to reach this goal.

In the debate over carve-outs versus add-ons, the economic and political analysis begins to get murky. From one standpoint, the current social security system is so out of balance that its implicit tax rate—the tax rate necessary to come up with sufficient revenues to pay promised benefits—is eventually going to be about 5 percentage points higher than what is currently collected. The focus on keeping the tax rate precisely what it is now, therefore, is more of an arbitrary line in the sand than any line that is determined through some process of comparing what we want with what we are willing to pay. Indeed, many Republican proposals would also use some general revenues to "fix" the system.

Implicitly, using general revenues is equivalent to devoting some income taxes to social security and can be likened to an increase in taxes or mandates collected for social security. Only if one believes that other program spending would decline by a similar amount does the net tax burden not change.

This is not to argue that the debate over carve-outs versus add-ons is without merit. My own view is that too much of government is scheduled to be dedicated to the consumption of baby boomers in retirement, and too little to our real problems and the more pressing needs of society. My only point here is that it's hard to go to war over what amounts to a fairly modest difference in tax revenues devoted to any one program, especially when both sides of the aisle appear ready to devote more tax revenues to retirement programs in general.

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