Economic Policies of the Bush Administration

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Overview

- Social Security Reform
- Private Pension Reform
- Tax Reform
- Fiscal Discipline
- Legal Reform
- Energy Initiatives
- International Trade Agreements
Social Security Reform
Social Security’s Financing Problem

Social Security: Annual Cash Flow
Billion USD

- 2018 - inflection point at which annual cash flow becomes negative

Source: SSA
The Administration’s Proposal

Four key principles:
- No changes for current or near retirees (55+ years old)
- No increase in payroll tax rate
- Include personal retirement accounts in Social Security
- Permanently fix the system

Exactly how to accomplish these goals, however, will involve extensive consultation with the Congress.
- To ensure the system becomes solvent will require some combination of difficult options
**Personal Retirement Accounts (PRAs)**

- Workers can opt to direct up to 4% of earnings into a PRA
  - Phased in for workers of different ages
  - Amount increases over time
- PRA accounts will have strict guidelines:
  - Limited investment options, including “lifecycle” fund
  - Cannot “opt out” after “opting in,” can invest in just govt securities
  - At retirement, options guarantee coverage for remaining life
  - Keep administrative costs low, about 0.3% per year
- At retirement, social security payments under traditional system will be “offset” by amount invested in PRAs
  - Approx. 3% offset rate
  - Individuals can pass on PRAs to heirs
- Implications for budget
  - Transition financing of $664bn ($754 w/interest) for next 10 yrs
Impact of Making SS Solvent

- Raise national saving
  - May increase fiscal discipline, further increasing public saving
  - Accurate expectations could cause individuals to increase private saving

- Impact on financial markets
  - Lower interest rates, positive for equities and bonds
  - Smaller trade deficit, positive for dollar

- Caveats:
  - Any effects will occur slowly over time and are likely to be small
  - Any effects determined by how reform is accomplished (transition financing? credibly address solvency? )
Impact of PRAs

- Likely to decrease implicit government debt, but increase explicit debt in short-run
  - Will require transition financing

- Will change composition of national saving
  - Greater share of saving in private accounts and less by government

- Effect on level of national saving is unclear
Impact of Personal Accounts on Markets

First-Order Effects
- Diversify out of Treasuries
- Diversify into corporates
- Diversify into equities
- *Uncertain* effects on FX

Second-Order Effects
- Deeper markets, lower spreads
Private Pension Reform
Defined Contribution Plans

- Administration Proposals:
  - Lifetime Savings Accounts (LSAs)
  - Retirement Savings Accounts (RSAs)
  - Employer Retirement Savings Accounts (ERSAs)

- Included in Administration’s budget
  - Have also been introduced in Congress by members of the tax-writing committees

- Currently part of tax reform discussion
Problems with Defined Benefit Pensions

- The system has weakened significantly in recent years
- The airline industry has been hardest hit
  - 12/30/04: United Airlines ($1.4 bn liability)
  - 02/02/05: US Airways ($3.0 bn liability)
- Costs of private pension failures
  - Risk of public costs of pension bailouts
  - Effect on corporate incentives – moral hazard
  - Effects on investor incentives – underpricing risk
Net Worth of PBGC

Source: PBGC.

Note: Data are for single employer pension programs.
2004: estimated unfunded liabilities of \( \approx \$450 \) billion

Source: PBGC.
## Administration Proposals for Reform

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Tax Reform
Current Status

- Last major tax reform occurred in 1986
- Bipartisan commission to study options and present conclusions by end-July 2005
- President Bush has set forth principles for tax reform: fairness, simplicity, and growth
- A variety of options for reform exist – some smaller-scale and others more ambitious
Problems with Current Tax Regime

- Complexity & costs of tax compliance
  - 6.5 billion hours spent annually (OMB)
  - Annual compliance costs of fed inc. taxes of $200 billion

- Lack of transparency creates distortions

- Narrowing of tax base over time

- Inefficiencies and “excess burden” costs
  - Double taxation of corporate profits
  - Outdated depreciation rules
  - Alternative minimum tax

- Disincentives to save and build wealth
Approaches to Tax Reform

- Modify current “hybrid” tax regime
- Replace with a new tax regime

Whether revised or replaced, a new tax regime is likely to place greater emphasis on private incentives to save.
International Tax Comparisons

Source: Economic Report of the President (February 2005)
Impact of Consumption Tax

- Saving
- Treasuries
- Corporates
- Equities
- FX
Fiscal Discipline
President’s Budget

- President’s goal stated in 2004: cut deficit in half in 5 years
  - Accomplish by economic growth & controlling spending

- President’s FY2006 budget:
  - Cut non-security discretionary spending by 1%
  - Eliminate or substantially reduce 150 programs

- Deficit projections:
  - 4.5% of GDP was projected for 2004; now 1.5% for 2009
  - $521 billion was projected for 2004; now $233 billion for 2009
Working with Congress

Congressional budget resolution:
- House last week largely followed President’s lead
- Senate last week passed budget with more spending
- Differences will be reconciled after recess

Transportation spending bill:
- President has been firm on $284 billion (over 6 years)
- Some in Congress started at $375 billion
- In past two weeks full House and Senate committee have passed bills at $284 billion
U.S. Entitlement Spending

Source: Social Security/Medicare Trustees and Congressional Budget Office
Entitlement Spending: Proposals

- Social security reform
- Medicare reform
  - Greater choice for seniors
  - Greater competition among private providers
- Medicaid reform
  - Close loopholes; more regulatory flexibility for states
- Medical liability reform
  - Reduce health care costs
Legal Reform
Legal Reform

- Class action reform:
  - President signed bipartisan bill last month
  - Stops attorneys from venue shopping

- Bankruptcy reform:
  - Senate passed bill two weeks ago
  - Keeping Chapter 7 bankruptcy for those who truly need it will reduce borrowing rates and increase access to financing

- Next up: asbestos and medical liability reform
Energy Initiatives
Increased Oil Demand

Change in World Oil Consumption, by Region 1999-1H2004

- China
- Middle East/Africa
- United States
- Europe & FSU
- Other Americas
- Other Asia

Source: Bailey and Kirkegaard, IIE, 9/15/04
President’s Energy Policy

- Early priority in Administration
  - Many changes made administratively
  - Still need Congress to act on bill (58 votes in Senate last year)

- Energy bill:
  - Incentives for efficient and environmentally friendly development *and* conservation
  - Allow environmentally responsible oil and gas development in ANWR
Modernize Electricity Grid

A forgotten problem

The energy bill would:
- reform outdated laws
- promote open access to transmission grid
- encourage greater regional coordination
- encourage deployment of new technologies
- Repeal Public Utility Holding Company Act (PUCHA), allowing more capital and greater rates of return for investing in transmission
International Trade
Immediate Priorities

- Congress reaffirm membership in the WTO
- Renew trade promotion authority (TPA)
- Congressional approval for CAFTA
- Global trade negotiations in the Doha Development Round
- Numerous FTAs in progress
Free-Trade Agreements

- Recently completed FTAs
  - Singapore (2004)
  - Chile (2004)
  - Australia (2004)
  - Bahrain (2004) – awaiting congressional approval

- In negotiation and/or announced intent
  - Free-trade Area of the Americas – FTAA (34 nations)
  - Botswana, Lesotho, Namibia, South Africa, Swaziland – SACU
  - Oman
  - United Arab Emirates (UAE)
  - Thailand
  - Panama
  - Columbia, Bolivia, Peru, Ecuador
Training & Adjustment Assistance

- Trade Adjustment Assistance (TAA)
- Jobs for the 21st Century
  - Community college programs
- Personal Reemployment Accounts
- Opportunity Zones
- Over $20 billion in 2005 budget for worker training and reemployment opportunities
Final Thoughts
Average GDP Growth in G7

Source: Blue Chip Indicators (March 2005)