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BE CAREFUL TO READ THE FINE PRINT WHEN SUPPORTERS CLAIM THEIR SOCIAL SECURITY PLANS RESTORE SUSTAINABLE SOLVENCY

by Jason Furman

The Social Security Administration's Office of the Chief Actuary has certified that at least 11 proposals restore "sustainable solvency" to Social Security.[1] The certification of "sustainable solvency" does *not* mean, however, that a plan is sound. The actuaries are responsible for scoring whatever provisions are included in a Social Security plan. If a plan requires taking trillions of dollars from the rest of the budget and simply transferring it to Social Security to eliminate Social Security's shortfall, the actuaries will assess the plan's impact on Social Security solvency, not ask whether the assumption that trillions of dollars are available for transfer is realistic or fiscally responsible.

All but one of the proposals that the actuaries have certified as achieving sustainable solvency include the transfer of substantial sums from the rest of the budget to the Social Security trust fund. (The one exception is a plan designed by economists Peter Diamond and Peter Orszag.)[2] Such transfers restore solvency without a plan's having to include the level of benefit reductions or payroll tax increases that restoring solvency otherwise would entail. Plans that would restore solvency through transfers, and the amount of those transfers, are listed in the table on page 4.

Several plans include a provision that *mandates* automatic transfers to the trust fund *whenever it falls short of money*. According to the Social Security actuaries, the automatic transfers would "guarantee solvency and sustainable solvency for the trust funds in any circumstance."[3] Automatic and unlimited transfers of this nature were included in the two solvency plans developed by the President's Social Security commission and have been included in plans subsequently developed by investment executive Robert Pozen and Senator Chuck Hagel, among others.

[1] The actuaries define "sustainable solvency" as a trust fund that is sufficient to cover benefits each year for the next 75 years and that is stable or rising in the 75th year.

[2] A plan developed by former Social Security Commissioner Bob Ball also would achieve sustainable solvency without general revenue transfers if future Congresses follow "the recommendation of the proposal to provide continued adjustments to the balancing tax rate." Social Security Administration, Office of the Chief Actuary, "Estimated OASDI Financial Effects for a Proposal With Six Provisions That Would Improve Social Security Financing – INFORMATION," April 14, 2005.

[3] Social Security Administration, Office of the Chief Actuary, "Estimated Financial Effects of a Comprehensive Social Security Reform Proposal Including Progressive Price Indexing – INFORMATION," February 10, 2005.

These unlimited general-revenue transfers are fiscally unsound; they allow plans to claim credit for restoring sustainable solvency without including sufficient benefit reductions, tax increases or other specific non-Social Security policy changes to achieve that goal. Instead of genuinely restoring solvency, such plans either shift the burden to unspecified future reductions in government programs or increases in taxes (in order to fund the transfers) or they entail substantial increases in deficits and debt that ultimately could be dangerous for the economy.

The Congressional Budget Office recently stated that giving Social Security an unlimited claim on general revenue:

> "...would not address the broader budgetary and economic issues stemming from the fiscal imbalances in the Social Security system. Borrowing money to pay benefits would not be a sustainable option in the long run. By contributing to the growth of federal debt, it could have a corrosive effect on economic growth and could eventually lead to a sustained economic contraction. Repaying that debt would ultimately require cuts in spending or higher taxes somewhere in the budget."[4]

These automatic and unlimited transfer provisions would result in a profound shift in the nature of Social Security. Instead of being a self-financed program, it would have an unlimited claim on the non-Social Security portion of the budget. The annual Trustees' Report would become a meaningless exercise. Even if the economy weakened or the demographic situation unexpectedly turned for the worse, Social Security would still be sustainably solvent — it would automatically get more transfers. Furthermore, this provision could remove constraints on future benefit expansions or payroll tax cuts. If Congress decided to raise benefits (or to undo previously enacted benefit reductions), that would not hurt solvency — it would simply lead automatically to even larger general-revenue transfers.

How the Unlimited and Automatic Transfer Provision Works

The President's Social Security Commission included the following provision in both of its plans that restored solvency:

> "For any year in which the combined OASDI Trust Funds would fall below 100 percent of annual program cost, transfers would be made from the General Fund of the Treasury to maintain the Trust Funds at a level equal to annual outgo."[5]
>
> This provision was included in the plans because their benefit cuts were insufficient to pay for the private accounts and eliminate the existing Social Security shortfall.

The same provision has been included in plans developed by Robert Pozen and Senators Hagel, among others. In all three of these plans, the benefit reductions fall well short of the amount

[4] Congressional Budget Office, *Options for Social Security: Budgetary and Distributional Impacts*, 2005.

[5] Social Security Administration Office of the Chief Actuary, "Estimates for Financial Effects for Three Models Developed by the President's Commission," January 31, 2002.

needed to restore solvency. Nevertheless, the automatic transfer provision ensures that the actuaries "score" the plans as achieving sustainable solvency.
By itself, this unlimited and automatic transfer would restore sustainable solvency. The Social Security actuaries would certify *any* plan that included this provision as achieving sustainable solvency. They would do so even if the other provisions of the plan *increased* benefits and *cut* taxes.

The Plans Would Transfer Substantial Sums Without Paying For Them

Social Security faces a 75-year deficit of $4 trillion in present value terms. A proposal could restore 75-year solvency simply by crediting the trust fund with $4 trillion — that is, by transferring $4 trillion from the general fund to the Social Security trust fund. Many private account plans include general revenue transfers that would close a substantial portion of this deficit.

In most of these plans, the revenue source for the transfers is not specified. In a few plans, the transfers are presented by proponents of the plans as reflecting savings that would be achieved through reductions in government spending, but these plans fail to propose specific reductions in any government programs. Furthermore, the proposed transfers under these plans would take place *even if the government spending reductions never materialized.*[6]

A Major Change in the Philosophy of Social Security

Currently, Social Security is designed to be self-financing, with Social Security's dedicated tax revenues paying for benefits. The Annual Report of the Social Security Trustees projects future imbalances or shortfalls between revenues and benefits and provides an important mechanism to encourage policymakers to bring revenues and benefits into line.

If the automatic and unlimited transfer provision were enacted, the annual Trustees Report would become meaningless. Regardless of the economic and demographic outlook, Social Security would always be sustainably solvent. If the demographic situation took an unexpected turn for the worse, higher general revenue transfers would result automatically. This means that the general fund of the budget would automatically pay for the adjustment, rather than forcing policymakers to confront changes within Social Security itself.

Furthermore, the new transfer mechanism would remove a major impediment to benefit expansions and payroll tax cuts. Right now, a proposal to expand benefits or cut payroll taxes would be scored as worsening solvency and advancing the date of the trust fund's exhaustion. If the unlimited transfer provision were in effect, then proposed benefit expansions or tax cuts would have no impact on solvency. If the benefit expansions took place outside of the traditional five- or ten-year budget window, there would be no major institutional mechanism to assess their costs.

[6] In contrast, some analysts and policymakers have proposed dedicating a specific revenue source to Social Security, such as revenue from retaining the estate tax. This is a specific proposal (i.e., a proposal with specific exemption levels and other tax parameters), and the transfers would be contingent on the estate tax actually being reformed and retained. Such transfers would be financed and would be strictly limited to the revenue raised by the specific proposal.

Transfers Under Alternative Social Security Reforms

	Years of Transfers	75-year Total Transfers (net present value in trillions)
Plans with Automatic and Unlimited Transfers		
DeMint	2019 through end of period	$8.0
Johnson	2014 through end of period	$7.1
Hagel	2025 through end of period	$3.7
President's Proposals[a]	2026 - 2069	$3.2
Commission Model 2[b]	2025 - 2054	$2.4
Commission Model 3[b,c]	All years	$2.0
Pozen	2031 - 2074	$2.0
Plans with Other Transfer Mechanisms		
Ryan-Sununu[c,d]	All years	$10.0
Shaw[e]	All years	$4.7
Graham[c,f]	All years	$3.7
Kolbe-Stenholm[c,f]	All years	$1.8

a. Required transfers to restore solvency, given the President's benefit reduction and private accounts proposals to date; additional benefit reductions or revenue increases would reduce the required transfers. See Jason Furman, "The Impact of the President's Proposal On Social Security Solvency and the Budget," May 10, 2005 for more details.

b. Uses actuaries' estimates assuming that two-thirds of Social Security beneficiaries participate in private accounts.

c. Includes transfers meant to reflect specific spending reductions or tax increases. The transfers, however, are not contingent on spending cuts or tax increases actually being enacted.

d. The general fund transfer reported here for the Sununu-Ryan plan differs from the $8.5 trillion figure cited in another CBPP paper, Richard Kogan and Robert Greenstein, "The Ryan-Sununu Social Security Plan: 'Solving' the Long-Term Social Security Shortfall by Raiding the Rest of the Budget," April 26, 2005. The $10.0 trillion figure used here reflects the actuaries' risk-adjusted estimate. The $8.5 trillion reflects the actuaries' estimate not adjusted for risk.

e. Does not achieve solvency assuming risk-adjusted rates of return.

f. Includes money from partial taxation of Social Security benefits currently dedicated to the Medicare Hospital Insurance Trust Fund.

Sources: Calculations based on memoranda by the Social Security Administration, Office of the Chief Actuary. Uses the actuaries' estimates assuming a risk-adjusted rate of return on equities. Amounts are adjusted to reflect consistent assumptions based on the 2005 Trustees Report.

This would be especially problematic for the President's approach to Social Security. His plan (i.e., the combination of the private accounts and the changes in benefits that he has proposed to date) envisions having the federal government borrow substantial sums to finance the plan for about 50 years. The borrowing would total $4.9 trillion in current dollars just in the first 20 years the plan was in effect and additional large sums for several decades after that. Proponents of the President's plan contend that this large added debt would not affect the economy because it would eventually be paid back through steadily deepening reductions in Social Security benefits. But politically, benefit reductions of that magnitude could ultimately become difficult to sustain. These benefit reductions likely would become even more difficult to sustain if reversing them had no impact on measures of Social Security solvency because of the presence of an automatic transfer mechanism.