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THE DEMINT SOCIAL SECURITY PLAN

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On June 23, Senator Jim DeMint announced a new private accounts proposal, under which Social Security's current annual surpluses would be shifted to private accounts, rather than used to purchase Treasury bonds for the Social Security Trust Fund. Reps. Jim McCrery, Clay Shaw, and several other House members announced a similar (but not identical) plan on June 22. Under both plans, the shifting of revenues to private accounts would end when the Social Security surpluses disappeared. By Senator DeMint's own admission, the plan would do nothing to restore solvency to Social Security. Its purpose instead is to serve as a foot in the door for more extensive private accounts in the future.

For those who are under age 55 today, the new proposal would establish carve-out private accounts, which would start at 2.2 percent of a worker's taxable earnings in 2006 and phase down to 0.2 percent of taxable earnings by 2016. As an analysis of the DeMint plan issued by the Social Security actuaries shows, the plan would make Social Security's financing problems worse, were it not for the inclusion in the plan of an assumption that large general revenue transfers would be made from the rest of the budget to Social Security. The actuaries show that the plan relies upon $1 trillion (in today's dollars) in assumed general revenue transfers, despite the fact that the budget is in deficit as far as the eye can see and has no surplus revenue to transfer. The actuaries' analysis also shows that the plan would add to deficits and the federal debt (i.e., the "debt held by the public") each year for the next 75 years and beyond.

The following analysis is based on the descriptions of the plan that its sponsors have provided and on the analysis issued by the actuaries.

1. **By shifting substantial sums (i.e., the Social Security cash surpluses) from the Social Security trust fund to private accounts, the plan would worsen Social Security's solvency problems both over the short run and over a longer horizon. These solvency problems are masked under these plans through budget gimmicks, including the assumption that large revenue transfers will be made from the rest of the budget. The House version also "double counts" the Social Security surplus revenues.**

   - The actuaries' analysis finds that if Social Security's cash surpluses are shifted to private accounts, $1.1 trillion will be drained from the Social Security trust fund in the first 10 years the proposal is in effect and $1.7 trillion will be drained in the first 20 years the proposal is in effect. The actuaries' analysis also shows that in the

absence of general revenue transfers, the year in which Social Security would become insolvent would be pushed forward by three years, from 2041 to 2038.[1]

- The plan masks these negative effects on Social Security solvency. The House version of the plan "double counts" the Social Security surplus. Under the House version, the full Social Security surplus would continue to go into the Social Security trust fund and be invested in Treasury bonds, just as it is today. This means that none of the surplus actually would go into private accounts, despite what the House plan's sponsors have said. Instead, those accounts actually would be funded by general revenues from the rest of the budget that are equal in size to the Social Security surpluses. Those transfers would be deficit financed.

  Stated another way, the same money would be counted twice under the plan — once to fund the bonds provided to the Social Security Trust Fund and a second time to fund the bonds that would be placed in the private accounts. Rep. Clay Shaw, one of the House plan's sponsors, has acknowledged that the plan would result in "two sets of bonds issued on the same money." [2]

- This is why the House plan's sponsors claim it would push Social Security's insolvency date back two years from 2041 to 2043, rather than accelerating it to 2038. Under the plan, when workers retired, their Social Security benefits would be reduced by the amount of income they could receive from their private accounts. Social Security would pay out less in benefits as a result but would still have the same amount of assets. Social Security's assets thus would last two years longer. This supposed two-year improvement in solvency rests, however, upon the double-counting gimmick and the assumed transfer of hundreds of billion of dollars in revenue from the rest of the budget to the private accounts, even though the rest of the budget is in deficit as far as one can see and consequently has no revenue to transfer.

- While the Senate version of the plan appears less contorted, it relies on gimmickry nonetheless. The Senate plan does directly shift $1.1 trillion over 10 years from Social Security to private accounts. The Social Security Trust Fund would be made poorer as a consequence. To avoid accelerating Social Security insolvency from 2041 to 2038, the Senate plan then relies on large general revenue transfers. In this case, the transfers would be made directly to Social Security, rather than to the private accounts. According to the analysis issued by the Social Security actuaries, the DeMint plan assumes that $998 billion (in today's dollars) in general revenue transfers would be made from the rest of the budget to Social Security to avoid

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[1] Specifically, Table 1a of the actuaries' analysis shows that with the transfers, the trust fund would have $799 billion at the end of 2038. The same table shows that the cumulative transfers would total $1,107 billion in that year. Without the transfers the trust fund would have been $308 billion in deficit. See Social Security actuaries, "Estimated Financial Effects of a Proposal to Finance Individual Accounts with the OASDI Cash-Flow Surplus – INFORMATION," June 23, 2005.

[2] Larry Lipman, "Shaw Co-sponsors Social Security Plan Stepping Towards Private Accounts," *Palm Beach Post*, June 23, 2005

making insolvency come sooner.[3] (According to the actuaries memo, the same amount of general revenue transfers – without the private accounts – would extend the life of the trust fund by three years to 2044.[4])

- In addition to resting upon accounting gimmicks, the plan also would impose two new long-term costs on Social Security, each of which would weaken Social Security's finances to some degree.[5]

    i. **Administrative Costs.** Social Security would have to cover the administrative costs associated with the private accounts, which would be substantial.

    ii. **New inheritance benefit.** The framers of the proposal have said that the accounts would be "inheritable." Any such inheritances would, however, reduce the amounts repaid to Social Security through the reductions in the Social Security benefits of workers who had elected the accounts. That would worsen Social Security solvency, because it would result in Social Security not being compensated in full for the funds shifted from it to the private accounts.

2. The plan would substantially increase budget deficits as well as the debt that the federal government owes to outside creditors (i.e., the debt "held by the public").

- According to the Social Security actuaries, "The total debt held by the public is increased indefinitely due to the incomplete compensation of the trust funds through benefit offsets… Annual unified budget balances remain worsened throughout the [75 year] period."

- Under both the House and Senate versions of the plans, the deficit in fiscal year 2006 would be about $89 billion higher as a result of the plan than the deficit otherwise would be. The Treasury would have to borrow approximately $489 billion in private credit markets to cover the deficit in 2006, instead of borrowing an estimated $400 billion as under current policies.[6]

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[3] The $1 trillion in transfers (in today's dollars) would be made between 2033 and 2036. (In net present value terms, the transfers would amount to $422.5 billion.) See actuaries' memo, Table 1a.

[4] This is shown in the furthest right column of Table 1a of the actuaries memo which shows "theoretical Social Security" with the plan's general transfers.

[5] The actuaries project that Social Security currently has a deficit of 1.92 percent of taxable payroll over 75 years. The DeMint plan claims to reduce the deficit to 1.77 percent of payroll. But this improvement is more than accounted for by the general revenue transfers. Without the transfers, the plan would enlarge Social Security's 75-year deficit to 1.96 percent of taxable payroll.

[6] "Current policies" refers to the CBO projection of the deficit adjusted to assume the continuation of Alternative Minimum Tax relief, the approval of the President's defense request, and the cost of ongoing operations in Iraq, Afghanistan, and the global war on terror as estimated by CBO.

- In addition, the debt that the federal government owes to outside creditors would increase by $1.1 trillion over the proposal's first 10 years and $1.7 trillion over 20 years, unless the proposal were accompanied by offsetting cuts in other programs or tax increases.[7] The proposal does not specify any such budget cuts or tax increases.

3. The proposal would be highly inefficient, as it would require the hiring of thousands of new federal employees and cause the government to incur large new administrative costs in order to administer millions of mostly modest or small accounts.

- The added administrative costs would amount to at least $25 billion over the first 10 years the plan was in effect and possibly much more than that.
- Thousands, and possibly tens of thousands, of new federal employees would be needed to administer the accounts.
- Even though contributions to the accounts would stop being made after only 11 years — because the Social Security surpluses would have run out — the added administrative costs would continue to be incurred every year through at least 2080, since millions of small accounts would remain and have to be administered until the account-holders died. For example, a 21-year old individual who began working in 2016 and earned $25,000 that year would be able to contribute a total of $50 that year — about $1 per week — to an account. No further contributions to the account would be made after 2016, since the surpluses would be gone. But this worker's $50 account would have to be tracked, the worker's investment choices implemented, and regular statements provided to the workers every year for the next half century. The administrative costs almost certainly would exceed the size of the account several times over.

4. The DeMint proposal would reduce traditional Social Security benefits, potentially leaving workers worse off.

- Like the President's private accounts proposal, the DeMint proposal would reduce the traditional Social

Is Social Security Being Raided?

Supporters of the new proposal argue that the Social Security surplus is being "raided" because the surplus is being used to help cover the deficit in the rest of the budget. The claim that Social Security is being raided and its finances weakened as a result, however, is demonstrably incorrect. The Social Security trust fund is fully compensated, in the form of Treasury bonds that are universally regarded as one of the world's safest and more secure investments, for the surplus funds that the rest of the budget borrows. Moreover, if the rest of the budget were in surplus rather than deficit, the Treasury would still borrow the Social Security surplus (using it in that case to pay down the federal debt) and give the Social Security Trust Fund the exact same Treasury bonds that it now receives.

One effect that the DeMint plan would have on Social Security's finances would be to deprive Social Security of several hundred billion dollars in Treasury bonds that Social Security otherwise would hold, because Social Security's surplus revenues would be diverted to private accounts rather than used to purchase Treasury bonds for the trust fund. It is difficult to understand how depriving the Social Security system of hundreds of billions of dollars of assets it otherwise would possess can be described as "stopping a raid on Social Security."

[7] Estimates are from Table 1b.c and are adjusted to current dollars, as in conventional in 10-year budget estimates.

Security benefits provided to workers in retirement in order to pay back the Social Security system for some (but not all) of the loss of assets that Social Security would face as a result of the diversion of funds from the Social Security Trust Fund to private accounts.

- The plan initially would allow participants to invest their account balances only in Treasury bonds. Starting in 2008, however, broader investments would be allowed, presumably in stock and corporate bond mutual funds.

- Under the plan, if a worker's private account did not earn a rate of return of more than 2.7 percent above the inflation rate (i.e., above about 5.5 percent overall), the worker would lose money — his or her Social Security benefits would be cut by more than the worker's private account would provide in retirement income. (The DeMint plan has no guaranteed benefit. According to the Social Security actuaries, "the potential for higher or lower benefits in retirement would exist.")

  In an analysis of the President's Social Security plan, noted financial economist Robert Shiller projected that the median rate of return on private accounts would most likely be slightly *lower* than 2.7 percent above the inflation rate. This suggests that a large percentage of workers could lose money as a result of the accounts.

- In short, the plan would shift benefits from traditional Social Security to private accounts and thereby introduce significant risk into the core tier of retirement security.

A Deliberately Slippery Slope to Permanent Private Accounts

For the reasons examined here, it would make little sense to establish accounts into which people could contribute for only 11 years (from 2006 through 2016), especially since administrative costs would continue to be incurred for another 60 years or so. Yet this anomaly may be one of the very reasons the plan's proponents are advancing it. Supporters of the plan do little to hide the fact that they view it as a foot in the door. Their stated goal is to get private accounts in place. Once in place, supporters of such accounts would argue that it made no sense to halt contributions to the accounts and that the shift of Social Security payroll tax revenues to private accounts needed to be continued even after the Social Security surplus was gone.

Senator DeMint, for example, said "Our whole intention is to come back and add reform on top of this – at least [my intention] – is for larger accounts, a permanent solution."[8] At the press conference announcing the plan, Representative Sam Johnson (R-TX) said, "The bill is an achievable first step towards private accounts." Other supporters of the DeMint and House plans have consistently made similar statements.

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[8] Keith Koffler, "DeMint Unveils Bill To Tap Surplus; Grassley Noncommittal," CongressDailyPM, June 23, 2005.

Conclusion

Whether one supports private accounts or not, the DeMint proposal fails on the merits. Its design, structure, and costs make little sense from a policy standpoint. To the degree that the plan includes unpaid for general revenue transfers, it masks the problems that it creates and opens the door for truly "free lunch" solvency plans that achieve solvency on paper without making any improvements in the long-term fiscal situation. The DeMint plan represents a distraction from three important debates: the debate over whether permanent private accounts that are funded by payroll tax contributions ought to be established; the debate over what measures should be instituted to restore solvency to Social Security; and the debate over what should be done to reduce the troubling budget deficit outside Social Security both in the near term and especially in the long term.