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*Social Security Reform: Growing Real Ownership for
Workers (GROW) Act of 2005, H.R. 3304*

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Abstract. H.R. 3304 would establish voluntary individual accounts, called GROW accounts, as part of Social Security. It would also reduce the traditional Social Security benefits of account owners. If accounts are invested in Treasury bonds, account owners would have combined account payments and reduced Social Security benefits that are equal to their current law Social Security benefits. If other investment options are offered, account owners are expected to receive higher combined payments on average (though their combined payments could also be lower than under current law). Social Security currently runs a surplus, though over the long term it faces a funding shortfall. Under H.R. 3304, bonds equal to Social Security's annual cash surplus (i.e., taxes not needed to pay current benefits and costs) would be credited to the Social Security Trust Funds, as they are under current law. General funds equal to the amount of this surplus would also be used to fund GROW accounts. Social Security Administration (SSA) actuaries estimate that each account would be credited with 2.22% of its owner's taxable earnings in 2006, declining to 0.22% in 2016, after which the actuaries project no more surpluses. H.R. 3304's sponsors have called the bill a first step, but have not outlined plans to expand GROW accounts or restore system solvency. Both the SSA actuaries and the Congressional Budget Office (CBO) project that H.R. 3304 would slightly improve Social Security solvency. SSA and CBO also project that the plan would increase annual budget deficits and the national debt by roughly \$1 trillion over 10 years. H.R. 3304 is similar to S. 1302, Senator DeMint's plan. However, S. 1302 would directly transfer Social Security's cash surplus into individual accounts. SSA's actuaries project similar solvency effects for both plans, and nearly identical budgetary effects.

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CRS Report for Congress

Social Security Reform: Growing Real Ownership for Workers (GROW) Act of 2005, H.R. 3304

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Summary

H.R. 3304 would establish voluntary individual accounts, called GROW accounts, as part of Social Security. It would also reduce the *traditional* Social Security benefits of account owners. If accounts are invested in Treasury bonds, account owners would have combined account payments and reduced Social Security benefits that are equal to their current law Social Security benefits. If other investment options are offered, account owners are expected to receive higher combined payments on average (though their combined payments could also be lower than under current law).

Social Security currently runs a surplus, though over the long term it faces a funding shortfall. Under H.R. 3304, bonds equal to Social Security's annual cash surplus (i.e., taxes not needed to pay current benefits and costs) would be credited to the Social Security Trust Funds, as they are under current law. General funds equal to the amount of this surplus would also be used to fund GROW accounts. Social Security Administration (SSA) actuaries estimate that each account would be credited with 2.22% of its owner's taxable earnings in 2006, declining to 0.22% in 2016, after which the actuaries project no more surpluses. H.R. 3304's sponsors have called the bill a first step, but have not outlined plans to expand GROW accounts or restore system solvency.

Both the SSA actuaries and the Congressional Budget Office (CBO) project that H.R. 3304 would slightly improve Social Security solvency. SSA and CBO also project that the plan would increase annual budget deficits and the national debt by roughly \$1 trillion over 10 years. H.R. 3304 is similar to S. 1302, Senator DeMint's plan. However, S. 1302 would directly transfer Social Security's cash surplus into individual accounts. SSA's actuaries project similar solvency effects for both plans, and nearly identical budgetary effects. This report will be updated as events warrant.

H.R. 3304, the Growing Real Ownership for Workers (GROW) Act of 2005, was introduced on July 14, 2005, by Representative Jim McCrery and several cosponsors.

This report describes the provisions of the bill. It also analyzes the effect of H.R. 3304 on benefit levels, trust fund solvency, and the overall (unified) budget.¹ Finally, it compares H.R. 3304 to S. 1302, a similar individual accounts plan.²

Major Provisions of H.R. 3304

Account Financing. Currently, annual Social Security tax revenues exceed program costs. Surplus revenues are credited to the trust funds as Treasury bonds, which Social Security can redeem to pay future benefits. In other words, Social Security's surpluses (like proceeds from all government bonds) become part of the Treasury's general fund, which can be used for tax cuts, spending, or repaying debt.

Under H.R. 3304, bonds equal to Social Security's annual cash surplus would be credited to the trust funds, as they are under current law. General funds equal to this surplus would also be used to fund individual accounts, called GROW accounts. The same money cannot be spent twice, so H.R. 3304 would require new spending.

Account Contributions. H.R. 3304 stipulates that workers born in 1950 or after would be eligible to enroll in accounts starting in 2006. Eligible workers would be automatically enrolled. (Workers could opt to disenroll once; those who disenroll could re-enroll once.) Social Security benefits would not change for people born before 1950.

The SSA actuaries estimate that each account would be credited with 2.22% of its owners' taxable earnings in 2006, declining to 0.22% in 2016, after which the actuaries project no more surpluses.³ At that time, contributions would cease, though interest would continue to accumulate in the accounts. In the case of divorce before retirement, account contributions made during a marriage of a year or more (as well as earnings on those contributions) would be divided equally between spouses.

Account Administration and Investment. The President would appoint a seven-member board to oversee GROW account administration. Between 2006 and 2009, all account assets would be collectively invested in a marketable Treasury bond fund. The board would develop a plan to expand investment options in 2009, and Congress would have 90 days to disapprove it before it took effect.

¹ For H.R. 3304, benefit and solvency analysis is based on the Social Security Administration memorandum to Reps. McCrery, Shaw, Johnson, Ryan, and Shadegg from Stephen C. Goss, Chief Actuary, and Alice H. Wade, Deputy Chief Actuary, "Estimated Financial Effects of the 'Growing Real Ownership for Workers Act of 2005' H.R. 3304," July 15, 2005, at [http://www.ssa.gov/OACT/solvency/McCrery_20050715.pdf]. Budgetary analysis is based on Congressional Budget Office memorandum to Sen. Max Baucus from Director Douglas Holtz-Eakin, "H.R. 3304: Growing Real Ownership for Workers Act of 2005," Sept. 13, 2005, at [<http://www.cbo.gov/ftpdocs/66xx/doc6645/09-13-BaucusLetter.pdf>].

² The analysis of S. 1302 is based on the Social Security Administration memorandum to Sen. Jim DeMint from Stephen C. Goss, Chief Actuary, and Alice H. Wade, Deputy Chief Actuary, "Estimated Financial Effects of a Proposal to Finance Individual Accounts with the OASDI Cash-Flow Surplus," June 23, 2005, at [http://www.ssa.gov/OACT/solvency/DeMint_20050623.pdf].

³ Taxable earnings are all earnings covered by Social Security, up to the taxable maximum, which increases annually by average wage growth. In 2005, the taxable maximum is \$90,000.

GROW account owners would be assessed up to 0.3% of account assets each year in administrative costs. During the first five years, general funds would cover any administrative costs above this amount. Social Security's actuaries project that the Treasury bond fund would yield average annual returns of 3.0% over inflation (i.e., real), or 2.7% after administrative costs. They project that a diversified portfolio (if offered) would earn average annual real returns of 4.9%, or 4.6% after administrative costs.⁴

Benefit Offset. The Social Security retirement benefits of workers who contribute to GROW accounts would be reduced using a benefit offset. The total benefit offset would be equal to a worker's GROW account balance if it had been invested only in the Treasury bond fund. At retirement, the total benefit offset would be converted into a lifetime, inflation-adjusted monthly amount, called an *annuity*. This monthly offset would be subtracted from participants' Social Security benefits.⁵ Because pre-retirement account access would not be permitted, offsets would not be deducted from non-retirement benefits, such as disability and young survivor benefits.

If an account owner's monthly offset were larger than his or her Social Security benefit, the remaining offset would be deducted from the benefits paid to the owner's spouse (if the account holder is married at retirement). For example, if a married man's monthly offset exceeds his Social Security benefit, his wife's Social Security benefit would be subject to two offsets: (1) an offset based on her contributions to her own account, if any, and (2) an offset based her husband's contributions to his account.

Account Distributions. Workers could access their GROW accounts when they begin to collect old-age benefits — including spousal and survivor benefits and benefits for disabled workers, whose disability benefits convert to retirement benefits when they reach full retirement age. Pre-retirement account access would not be permitted. Workers not eligible for traditional Social Security benefits (i.e., those with less than 10 years of work covered by Social Security) could access their accounts at their full retirement age.

At retirement, workers would be required to make withdrawals from their accounts in the form of inflation-indexed annuities so that their monthly annuity payments combined with their reduced Social Security benefits were at least equal to the federal poverty level. Any remaining account balance could be withdrawn as the worker chooses. There would be one exception to the poverty-level annuitization requirement. Beneficiaries whose combined benefits and annuities would be below the poverty level would not have to annuitize. Married GROW account owners would be required to purchase joint and two-thirds survivor annuities with their entire account balances, unless both spouses consent to another arrangement. (A joint and two-thirds survivor annuity provides monthly payments to its owner for life, then two-thirds of the owner's payment to a survivor beneficiary.)

GROW accounts can be inherited when their owners die. When married workers die before retirement, their surviving spouses would inherit their GROW account balances, which would count toward their surviving spouses' offsets. When married workers die

⁴ The actuaries assumed a 50% stock, 25% corporate bond, and 25% Treasury bond portfolio.

⁵ In H.R. 3304, the total benefit offset is called a *benchmark account*; the monthly offset is called an *excess GROW account credit*.

after retirement, their surviving spouses would inherit the balance of their GROW account balances (if any) and/or the survivor payment from a joint annuity (if one was purchased). The surviving spouse's benefits would also be reduced by an offset two-thirds the size of the deceased spouse's offset. When unmarried account owners die, their accounts would be inherited by a person they designate (or, in the absence of a designated heir, by their next of kin). These heirs would not be subject to offsets based on the inherited accounts.

Analysis of the GROW Accounts Plan

Benefit Impact. Under H.R. 3304, account owners would receive their individual account assets as well as reduced (i.e., offset) Social Security benefits. Only the offset would directly affect the way traditional Social Security benefits are calculated. The following section compares current law Social Security benefits to projected payments from GROW accounts and reduced traditional benefits under H.R. 3304.

Table 1. Annual GROW Account Contribution Rates, Annual Contribution Amounts, Cumulative GROW Account Balances, and Cumulative Offsets for Medium Scaled Earner, 2006-2016
(real 2005 dollars)

Year	GROW Contribution Rate	Annual GROW Contribution	GROW Account Accumulation	Offset Accumulation
2006	2.22%	\$286	\$290	-\$290
2007	2.12%	\$315	\$633	-\$633
2008	2.06%	\$371	\$1,055	-\$1,055
2009	1.85%	\$384	\$1,539	-\$1,515
2010	1.70%	\$389	\$2,061	-\$2,004
2011	1.55%	\$380	\$2,611	-\$2,509
2012	1.30%	\$338	\$3,146	-\$2,989
2013	1.04%	\$282	\$3,646	-\$3,423
2014	0.76%	\$212	\$4,088	-\$3,788
2015	0.50%	\$142	\$4,465	-\$4,078
2016	0.22%	\$63	\$4,757	-\$4,275
Final balance in 2050	n/a	n/a	\$20,817	-\$10,298

Source: Estimates by the Congressional Research Service.

Note: These estimates assume that stocks and bonds earn constant rates of return (i.e., the same rates every year). In practice, the rates of return on stocks and bonds vary over time.

Table 1 above shows estimated annual GROW account contribution rates as a percent of taxable earnings, annual GROW contribution amounts, cumulative GROW account balances, and cumulative offsets in real 2005 dollars. These estimates use the SSA actuaries' projections for H.R. 3304 and the actuaries' scaled medium earnings

pattern.⁶ The worker in this example is assumed to be born in 1985, to begin work in 2006, to earn average lifetime wages, to have average patterns of work and earnings, and to retire at age 65 in 2050. The *GROW account accumulation* column shows the expected cumulative balance of the account if additional investment options are offered in 2009 and the account is diversified at that time. (If the worker invests only in the Treasury bond fund, the cumulative balance would be the same as what is shown in the *Offset accumulation* column, only the value would be positive.)

People who invest their accounts in the Treasury bond fund and purchase annuities with their entire accounts would receive combined monthly payments under H.R. 3304 that are equal to their current law Social Security benefits, since their GROW annuity payments and the reduction to their benefits would be equal. If the worker in the example invested only in the Treasury bond fund, his or her GROW account would contain an estimated \$10,298 at retirement. This sum could be used to buy an inflation-adjusted single-life annuity of \$62 a month. The worker's benefit offset would reduce his or her Social Security benefit by \$62, so the combination of reduced benefits and annuity payments under H.R. 3304 would be equal to current law Social Security benefits.

If account owners had investment choices beyond the Treasury bond fund and opted to diversify their accounts, their retirement payments would depend on the returns those investments earn. Stocks and corporate bonds have higher average returns than Treasury bonds, but also greater risk. If a participant's average returns were greater than the Treasury bond rate, his or her combined payments under H.R. 3304 would be greater than current law benefits; if average returns were less than the Treasury bond rate, his or her combined payments would be lower. The bill has no minimum benefit guarantee.

If additional investment options were offered in 2009, SSA's actuaries project that workers would have higher combined payments, on average. If a worker chose the diversified portfolio used in the actuaries' projections, the account would contain an estimated \$20,817 at retirement. This sum could be used to purchase an inflation-adjusted, single-life annuity that pays \$126 a month. The worker's benefit offset would reduce his or her Social Security benefit by \$62 a month, leaving the worker with a combined monthly payment under H.R. 3304 that is \$64 greater than current law benefits.

Solvency Impact. Under current law, SSA's actuaries project that the Social Security Trust Funds will not be able to pay the full amount of scheduled benefits after 2041. Under H.R. 3304, the actuaries estimate that the trust funds will be solvent through 2043.⁷ This improvement is due to the general fund transfers to GROW accounts, which would reduce the trust funds' obligation to pay benefits (since offsets are based on account contributions). Two additional years of trust fund solvency would allow some future beneficiaries to receive fully scheduled benefits for two more years than they would have in the absence of any changes to Social Security.

⁶ Social Security Administration, Office of the Chief Actuary, Actuarial Note 2004.3, "Scaled Factors for Hypothetical Earnings Examples Under the 2004 Trustees Report Assumptions," by Michael Clingman and Orlo Nichols, Dec. 2004, at [<http://www.ssa.gov/OACT/NOTES/ran3/an2004-3.pdf>].

⁷ The actuaries project a 75-year trust fund deficit of 1.92% of taxable payroll under current law, and estimate that H.R. 3304 would decrease this gap by 0.23% to 0.24% of taxable payroll.

Unified Budget Impact. The unified budget is the total federal budget, including the Social Security Trust Funds. H.R. 3304 would not change the transfers from the trust funds to the general fund. However, to fund GROW accounts on top of the existing trust funds, the government must raise taxes, cut spending and/or borrow (thus adding to annual deficits and the national debt). Since H.R. 3304 would not raise taxes or cut spending, GROW accounts would likely be funded through borrowing. CBO estimates that from 2006 to 2015, H.R. 3304 would increase annual budget deficits and the national debt by more than \$1 trillion in real terms. This estimate includes about \$6 billion for administrative costs (above those charged to GROW accounts) and over \$200 billion for increased debt service.

Ultimately, it is the government's overall fiscal position — not the size of the trust funds — that will determine whether Social Security benefits can be paid. Borrowing to fund GROW accounts would reduce the government's fiscal position by increasing the national debt. CBO projects that relative to current law, the national debt would increase by over 6% of gross domestic product (GDP) by 2015, and by 24% of GDP by 2080.

Even if H.R. 3304 were not debt-financed, the cost of GROW accounts would exceed the savings from the offset for two reasons. First, offsets would not apply in certain cases, such as when unmarried workers die before retirement. Second, fully recouping the cost of the accounts over the long term would require an offset calculated with the Treasury bond rate. H.R. 3304 uses the Treasury bond rate *minus* administrative costs. That way, account owners who invest in the Treasury bond fund would receive monthly payments equal to current law. As CBO explained, "In effect, the 0.3 percentage points administrative costs would be paid from the Social Security Trust Funds."

How GROW Accounts Compare to Senator DeMint's Plan

H.R. 3304 is very similar to S. 1302, Senator Jim DeMint's plan. The contribution rates, eligibility requirements, enrollment rules, offset amounts, and payout provisions in the plans are nearly identical (though S. 1302 may offer diversified investments a year earlier, in 2008). The primary difference is how the accounts are financed.

Under S. 1302, surplus Social Security revenues would go directly into individual accounts. The surpluses would *not* be credited to the Social Security Trust Funds, as they are under current law and would be under H.R. 3304. Without other changes, diverting surpluses into accounts would accelerate the date of insolvency. S. 1302 would transfer general funds to the trust funds to maintain solvency through 2041 (as under current law).⁸ Though the source of account funding in S. 1302 and H.R. 3304 is different, the amount of funding is the same. Thus, SSA's actuaries project that the two plans would have a nearly identical effect on the annual budget deficit and the national debt.⁹ However, some economists believe that the trust funds mask the true size of annual budget deficits and the national debt, so trust fund-financed accounts (like S. 1302) might spur policymakers to reduce other spending.

⁸ The actuaries project that S. 1302 would narrow the solvency gap by 0.15% of taxable payroll.

⁹ SSA's actuaries project that both H.R. 3304 and S. 1302 would increase annual budget deficits and the national debt by \$929 billion in real terms over 10 years, and by about \$1.4 trillion in present value terms over 75 years.