Republican budget writers say they may have found a way to cut the federal deficit even if they borrow hundreds of billions more to overhaul the Social Security system: Don't count all that new borrowing.

As they lay the groundwork for what will probably be a controversial fight over Social Security, Republican lawmakers and the Bush administration are examining a number of accounting strategies that would allow the expensive transition to a partially privatized Social Security system without -- at least on paper -- expanding the country's record annual budget deficits. The strategies include, for example, moving the costs of Social Security reform "off-budget" so they are not counted against the government's yearly shortfall.

White House budget office spokesman Chad Kolton stressed that no final decisions have been made about how the cost of changing Social Security will be handled. The administration has not decided whether it will even embrace a specific Social Security overhaul, beyond advocating the creation of personal investment accounts that would be financed by diverting some portion of Social Security taxes from the current system.

But Judd Gregg (R-N.H.), the incoming chairman of the Senate Budget Committee, said concerns about the deficit should not be allowed to stand in the way of an overhaul that would put the ailing Social Security system on the path to solvency.

"You cannot look at Social Security in the context of a five-year budget," the window that current White House and congressional spending plans cover, Gregg said. "To do so is naive and foolish. . . . If this is simply scored as a five-year exercise, we're never going to solve the problem."

Gregg's thinking mirrors sentiments within the White House, according to administration officials and White House advisers. "The budget should reflect that this is an investment, a
down payment that will have very positive implications," said White House spokesman Trent Duffy.

Within 20 years, the retiring baby-boom generation will begin earning more in Social Security benefits than workers are expected to be paying in taxes, a shortfall forecast to increase every year from then on. To ease the long-term shortage, the Bush administration wants to slow the growth in benefits but allow people to divert about a third of their share of Social Security taxes into personal retirement accounts.

In the years before the slower growth in benefits compensates for the loss in revenue, the government would have to borrow, raise other taxes, or cut other spending to maintain benefits for Social Security recipients. An analysis of one plan produced by Bush's Social Security Commission concluded that the interim financing would cost as much as $104.5 billion the first year, balloon to $194.4 billion in the 10th year and would peak in roughly 20 years at $258 billion.

Any accounting mechanism that obscures or minimizes those costs is sure to be controversial. John M. Spratt Jr. (S.C.), the ranking Democrat on the House Budget Committee, called it "the budgetary equivalent of having your cake and eating it too."

Social Security can be put on a stronger financial footing at a fraction of the cost of partial privatization, say critics, who note that borrowing hundreds of billions of dollars on top of already large deficits could spell fiscal disaster.

"We're entering the theater of the absurd, where you spend money, but it doesn't count, you borrow money, but you deny it," said Kent Conrad (N.D.), the ranking Democrat on the Senate Budget Committee. "Republicans are becoming further and further detached from reality."

To cope with the cost, while still helping the White House at least appear to be moving toward its goal of cutting the deficit in half by 2009, White House and congressional budget experts are looking at a variety of accounting mechanisms, said Michael Tanner, a Cato Institute Social Security expert who has worked closely with the White House.

They include treating the cost of Social Security reform not as a present-day expenses, but more as a prepaid benefit for future retirees that should not be counted against current deficits. Or they may take the costs "off-budget," meaning Social Security spending would not be included in the calculation of the annual budget deficit.

"How they label it is going to be somewhat of an exercise in creative budgeting," Tanner said.
Gregg and other allies of the president argue, in fact, that transition costs of $1.5 trillion or more over the next 10 years should not be considered an increase in the nation's debt. Instead, they say, such borrowing would be a prudent recognition of future obligations.

"The diversion of a portion of payroll taxes to personal accounts is akin to prepaying a mortgage," R. Glenn Hubbard, former chairman of Bush's Council of Economic Advisers, wrote in the current issue of Business Week. "If the transition costs are borrowed, the resulting higher explicit federal debt in the near term is offset by lower implicit debt (Social Security obligations) in the longer run."

The U.S. government may already be borrowing more than $400 billion a year, but supporters argue that international lenders will not punish the Treasury for additional borrowing because they already have factored Social Security's future obligations into the interest rates of today.

"The market is rational, and they are already nervous about all these unfunded obligations in Social Security and Medicare," said Kent Smetters, a former Bush Treasury Department economist now at the University of Pennsylvania. "Resolution of that uncertainty is actually going to be a positive."

To Democrats and some economists, that may be true in theory, but in reality, it is flirting with trouble. No matter how the borrowing is accounted for in the budget, lenders will have to be found to raise the money to pay the bills.

Already, there are concerns that foreign creditors in particular are growing tired of the U.S. government's constant need for cash, Conrad said. If lenders are reluctant to finance the president's Social Security plan, interest rates may have to rise sharply to entice them to do so. That could harm the overall economy.

"This is more than political blather," Conrad said. "This gets to the markets, and people who are in the markets can add and subtract."