Economic Opportunity Institute

A Tale of Two Reforms

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Preface

In May 2001, President Bush appointed a commission charged with submitting a Social Security reform plan including individual investment accounts. During his election campaign, Bush's advisors described a possible reform package that would encourage diversion of 2% of the 12.4% of payroll that currently goes to Social Security into individual investment accounts controlled by workers. A number of economists have calculated the results of such reforms for typical Americans, based on the long range economic assumptions that Bush relied on to justify such sweeping reforms – the intermediate assumptions used by the Social Security trustees in their 2000 annual report. Those assumptions forecast very slow economic growth through the 21st century averaging only 1.6% annually (compared to over 3% average during the 20th century), resulting in a short fall in Social Security funding by about 2038.

EOI shares the belief of number of analysts across the political spectrum that the Social Security intermediate forecast are unduly pessimistic. The trustees' alternative set of forecasts based on a long term annual GDP growth rate of 2.4% is more realistic. It projects the system able to finance the retirement of the baby boomers and the expected longer life-spans of Gen Xers without ever running short of funds. Consequently, we have proposed modest reforms to strengthen benefits for lower income recipients within the existing social insurance structure of Social Security. Our proposed reforms are:

1. Increasing survivors benefits for seniors to 75% of the couples' combined benefit (currently ranges from 50% to 67%).
2. Adjusting the benefit formula to replace 100% (instead of 90%) of the first $561 of monthly income.
3. Restoring the age for full retirement benefits to 65.
4. Eliminating the cap on taxable income.
5. Creating a new, universally accessible retirement savings plan ***in addition*** to Social Security (currently half of workers do not have access to an employer sponsored retirement plan).

"A Tale of Two Reform Plans" contrasts the future for a typical middle class family under these two reform proposals.

The Tale

Becky and John live in Vancouver, Washington. They are 46 years old and have two children, Charley, age 22, who just graduated from the University of Washington, and Jen, age 20, who attends Washington State University's Vancouver campus and still lives at home. John makes $50,000 a year

at a small software company, and Becky earns about $20,000 as a substitute teacher. For the past five years, John has been investing 3% of his income in his company's 401(k) plan, which his company matches. In the late 1990s, John and Becky watched their retirement nest egg grow quickly, and dreamed of an early retirement, but in 2000 their 401(k) barely broke even, even with that year's new deposits, and now they are less optimistic.

Becky's parents, Jim and Charlene, live nearby. They have a comfortable income with Social Security and Jim's defined benefit pension from his years as a school janitor. Becky's grandmother, Bernice, age 94, recently moved to a modest retirement home. Bernice's monthly Social Security check of $900, which has increased annually with the cost of living, has been sufficient to cover her living expenses over the years. Therefore, Jim and Charlene have not had to dip into their own savings to help support her. John and Becky have been free to focus their spending on raising and educating their children, along with their own retirement savings.

John and Becky's Future: Year 2025, After the Retirement Security Reforms of 2003

In 2003, Congress passed the Retirement Security Act, with the goal of eliminating poverty and near poverty among American seniors. The reforms recognized that Social Security was a proven success and financially sound, and that half of American workers lacked a pension through their employer. The reform package included:

- Increasing survivors benefits for seniors to 75% of the couples' combined benefit (currently ranges from 50% to 67%).
- Adjusting the benefit formula to replace 100% (instead of 90%) of the first $561 of monthly income.
- Restoring the age for full retirement benefits to 65.
- Creating a new retirement savings plan in addition to Social Security, called Universal Voluntary Accounts.

It's 2025, and John and Becky have been retired for five years (grateful that Social Security's full retirement age returned to 65). Their Social Security benefit in 2001 dollars is $2,337 per month, or $28,044 annually (in year 2021 dollars, $5,222 per month, or $62,664 annually).[1] After Jen finished college, they were able to save more aggressively for retirement in a mix of investments, ending with a total of $150,000 saved. They withdraw $625 per month[2] giving them a total month income of $2,962. They watch the stock market and other investment returns as they calculate how much to take from their retirement account each year, knowing that Becky could well live to100, but also knowing that their Social Security check will go up along with inflation and will cover basic living expenses as long as they live.

Charlene, who has been a widow now for nine years, lives in an apartment and is financially independent and relatively healthy at age 94. In addition to the stipend she gets from Jim's pension, she receives 75% of the combined Social Security benefit she and Jim used to get (or $1,050 per month in 2001 dollars), as have all elderly survivors since the reform package of 2003. Thanks to that same reform package, Charley, now a married tax attorney, and Jen, now a single community college instructor, started their own additional retirement savings through the government's Universal Voluntary Accounts while still in their 20s. Now in their 40s, they are well ahead of where their parents were in 2001.

John and Becky's Future: Year 2025, After the Bush Commission Reforms of 2002

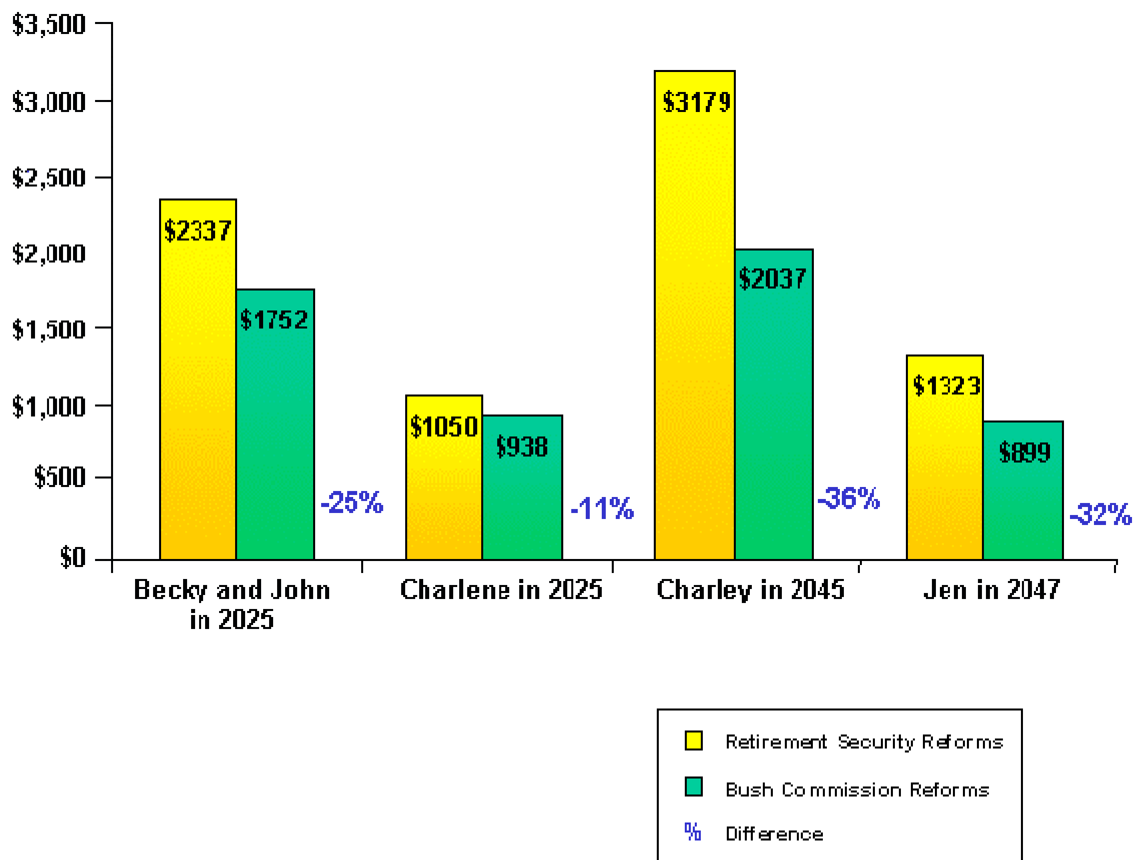
In 2002, Congress passed a Social Security reform package following the recommendations of the commission appointed by President Bush. The reforms were premised on a bleak view of the future for the American economy, and the belief that individuals would be better off planning their own retirement than with social insurance that guaranteed all workers and their families a basic income. The reforms included:

- Diversion of 2% of the Social Security tax into individually controlled private accounts.
- Reduction of base retirement benefits on a sliding scale of 25% for people age 55 in 2002, 33% for people age 45, 46% for people age 35, and 54% for people 30 or younger.
- Maintaining the phased in rise in full retirement age to age 67.
- Maintaining the disability and survivors insurance programs.

It's 2025, and John and Becky have been retired for three and a half years. Their Social Security benefit in 2001 dollars is $1,565 per month, or $18,780 annually.[3] Their individual Social Security Investment accounts, which had accumulated a total of $39,000, yield an additional $187 per month.[4] After Jen finished college, they were able to save more aggressively for retirement in a mix of investments, ending with a total of $150,000 saved. They withdraw $625 per month, giving them a total monthly income of $2,377.

Charlene, who has been a widow now for nine years, lives in an apartment and is financially independent and relatively healthy at age 94. In addition to the stipend she gets from Jim's pension, she receives 67% of the combined Social Security benefit she and Jim used to get (or $938 per month in 2001 dollars). Charley, now a married tax attorney, and Jen, now a single community college instructor, watch the sluggish stock market anxiously, knowing that their core Social Security benefit will be much lower than their parents', and that their only hope for financial security in retirement is high yields on their Social Security Investment Accounts and their 401(k)s.

Projected Monthly Social Security Income (in current dollars)
Under Retirement Security Reforms and Bush Reforms



Participants	Retirement Security Reforms of 2003	Bush Commission Reforms of 2002	% Difference
Becky and John in 2025	$2,337	$1,752	-25%
Charlene in 2025	$1,050	$938	-11%
Charley (in 2045)[5]	$3,179	$2,037	-36%
Jen (in 2047)[6]	$1,323	$899	-32%

Endnotes

[1] Calculated from the Social Security Administration's Benefit Calculator, entering ages of 46 and annual incomes of $50,000 and $20,000.

[2] They withdraw 5% of the account's original balance annually.

[3] Based on calculations by Henry Aaron, et al, for a partially privatized Social Security system, based on 2% of payroll

going to private accounts and phased in benefit reductions. Using Social Security trustees' intermediate projections, they projected the 45 year olds in 2002 would see core benefits reduced by 33%, and 25 year old would see benefits reduced by 54%. Henry Aaron, Alan Blinder, Alicia Munnell, and Peter Orszag, "Governor Bush's Individual Account Proposal: Implications for Retirement Benefits," Issue Brief No. 11, The Century Foundation, June 2000.

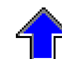
[4] Based on calculations by Dean Baker in "Governor Bush's Individual Account Proposal: A Reassessment Using Realistic Stock Return Projections," Center for Economic and Policy Research, p. 6 and 15.

[5] Ibid., p. 7. Based on Baker's calculations for a high-earning married person.

[6] Ibid., p. 7. Based on Baker's calculations for an average-earning single person.

Related Link(s)

- EOI Economic Security Policy - Social Security



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