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New Research From EBRI:

Study Shows How Policy Options, Other Variables Could Affect Benefit Levels in Social Security

WASHINGTON—Future Social Security benefits that include individual accounts would vary significantly, depending on when recipients are born, how much they earn, the investment choices they make, and actions by federal policymakers, a new study by the nonpartisan Employee Benefit Research Institute (EBRI) shows.

Among other things, the study found that workers with low incomes could expect higher annual Social Security benefits under a system of individual accounts (structured to follow a 2001 presidential commission model) than through three other policy options that also were studied. But the study warns that individual account benefit levels would vary widely, even among people of the same age. The full report, "Comparing Social Security Reform Options," is published in the May 2005 *EBRI Issue Brief* and is available online at www.ebri.org

The study, presented today at EBRI's spring policy forum, compared the annual dollar amount that Social Security beneficiaries might receive under each of four policy options—including individual accounts—with variations for the impact of age, earnings, and investment choices included in each result.

The policy options were:

- Creating voluntary individual accounts as part of Social Security, as President Bush has proposed.
- Maintaining benefits at the level provided in current law.
- Maintaining current-law benefits until the Social Security Trust Fund is exhausted and then cutting benefits sharply to restore the federal retirement program to balance. (The study used the Social Security Trustees' 2004 assumptions, which placed this date at 2042).
- Gradually reducing current-law benefits to account over time for the program's funding deficit.

The study uses "Model 2" of the 2001 President's Commission to Strengthen Social Security as the basis for comparing the impact of individual accounts with the other three options. President Bush has not spelled out the details of his individual account proposal, but Model 2 embraces the basic principles the administration favors and is closest to what Bush has proposed.

"This study shows there is no simple answer to the question of whether individual accounts or any other policy option would be best for all Social Security recipients," said Dallas Salisbury, EBRI president. "Social Security is the largest entitlement program in the nation and affects the lives of millions of Americans. As this study demonstrates, any changes to the program—whatever they are—will affect different people in different ways, based on age, income, and other factors."

In broad terms, the EBRI study came to these conclusions:

- Lower-income people are more likely to do better under an individual account plan structured like Model 2 than higher-income individuals, compared with the other options.
- Those in their 20s and younger individuals (born in 1985 and after) would benefit the most from action to correct Social Security's solvency problem now, as opposed to waiting until the Trust Fund is exhausted.
- Model 2 benefits, with historic rates of return, are the *average* level of many possible scenarios. Because there can be wide variations around an average, the benefits would vary significantly for individual beneficiaries.

The EBRI study includes a chart showing 42 examples of possible Social Security benefit levels for the four policy options. The study and chart are posted on the EBRI Web site, www.ebri.org. EBRI is independent and does not lobby or endorse legislation and does not have a position on any plan to change Social Security.

One of the 42 examples in the study shows that an individual who is 30 years old today and is earning $16,000 a year could expect these differing levels of Social Security benefits starting at age 65:

- $11,200 a year for the option of maintaining benefits provided under current law by removing the current $90,000 annual wage cap on Social Security taxes.
- $11,200 a year for the option of maintaining benefits provided under current law until the Trust Fund is exhausted and then cutting benefits to the level that money being paid into the system would support (because a 30-year-old today will begin drawing benefits before the sharp benefit cut is imposed).
- $9,600 a year if benefits were cut gradually over time to account for the shortfall in the Trust Fund.
- $12,500 a year under the Model 2 individual account plan, assuming historic investment returns for a mix of stock and bonds. However, if an individual decided to invest only in Treasury bonds to avoid stock market risk, the amount would be $10,400 a year.

The study provides additional information for these other age groups:

20-Year-Olds

For someone 20 years old today (born in 1985) also earning $16,500 a year, Social Security benefits under current law would be $12,500 at age 65. Because this person will reach normal retirement age *after* the date when Social Security's revenues will fall below its costs, benefits would be cut sharply, to $7,700 a year. By contrast, if policymakers decided to cut benefits gradually over time, annual Social Security payments would be $9,800. Under Model 2, the individual account plan, annual Social Security benefits would range from $10,800 to $15,700, depending on how the account assets were invested.

50-Year-Olds

What about a high-income, older individual, such as a 50-year-old (born in 1955) earning $72,500 this year? This person would receive an annual $23,200 Social Security payment if current law was maintained. Payments would be the same if policymakers waited for the Trust Fund shortfall to hit and then cut benefits. Under the gradual reduction of benefits option, the annual Social Security payment would be $22,900. Under Model 2 individual accounts, the benefit would range from $21,000 to $21,300, depending on the investment choice.

Those Not Yet Born

Finally, the study looks at the case of an individual who will be born in 2015. Assuming this individual had average annual earnings of $55,000 (in 2005 dollars), his or her Social Security benefit would be $36,500 under current law. That benefit would be $22,700 under the option of waiting until the Trust Fund is exhausted and then cutting benefits sharply. Cutting benefits gradually over time would leave benefits of $24,500 a year. The Model 2 individual account plan would provide benefits ranging from $19,500 to $31,700 depending on investment choice.

Since individuals face uncertainty in their earnings patterns as well as the number of years they will work and their specific retirement date, the study notes that benefits could vary substantially, depending on individual circumstances.

The study also provides results detailing the percentage of a worker's pre-retirement income that Social Security would replace under the different policy options. In addition, the study contains information about the probability that the benefit levels from Model 2 individual accounts would be higher than the other three policy options.

Craig Copeland, director of EBRI's Social Security Reform Evaluation Research Program, was the chief author of the study. His work was based on assumptions contained in the 2004 Social Security Trustees report, the final report of the President's Commission to Strengthen Social Security, and through the use of SSASIM and GEMINI, computer-based simulation models developed by the Policy Simulation Group.

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