

# Retirement Finance in the Wake of the Bubble and Longer-Term Implications

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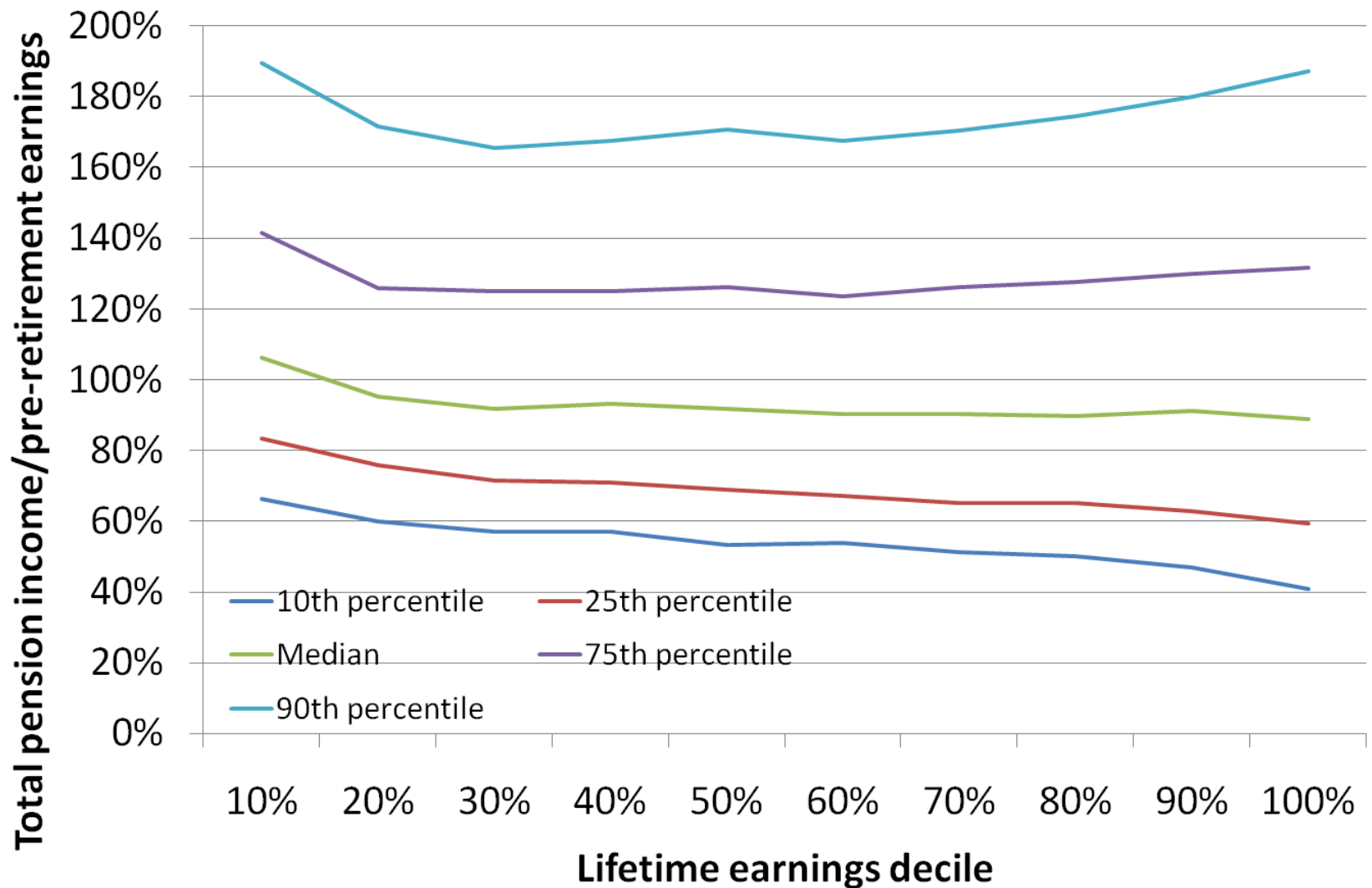
American Enterprise Institute

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# Don't overstate "retirement crisis"

- Perception that current/future Americans face significant retirement income shortfalls
- Current retirees – *not counting effects of recession* – are overwhelmingly well prepared
  - Median replacement rate adjusted for household size/composition: 92%; few low earners have grossly inadequate replacement rates
- Future retirees face larger challenges, with lower Social Security benefits and fewer DB pensions
- But if future retirees work even a year or so longer, their replacement rates can approach current retirees'

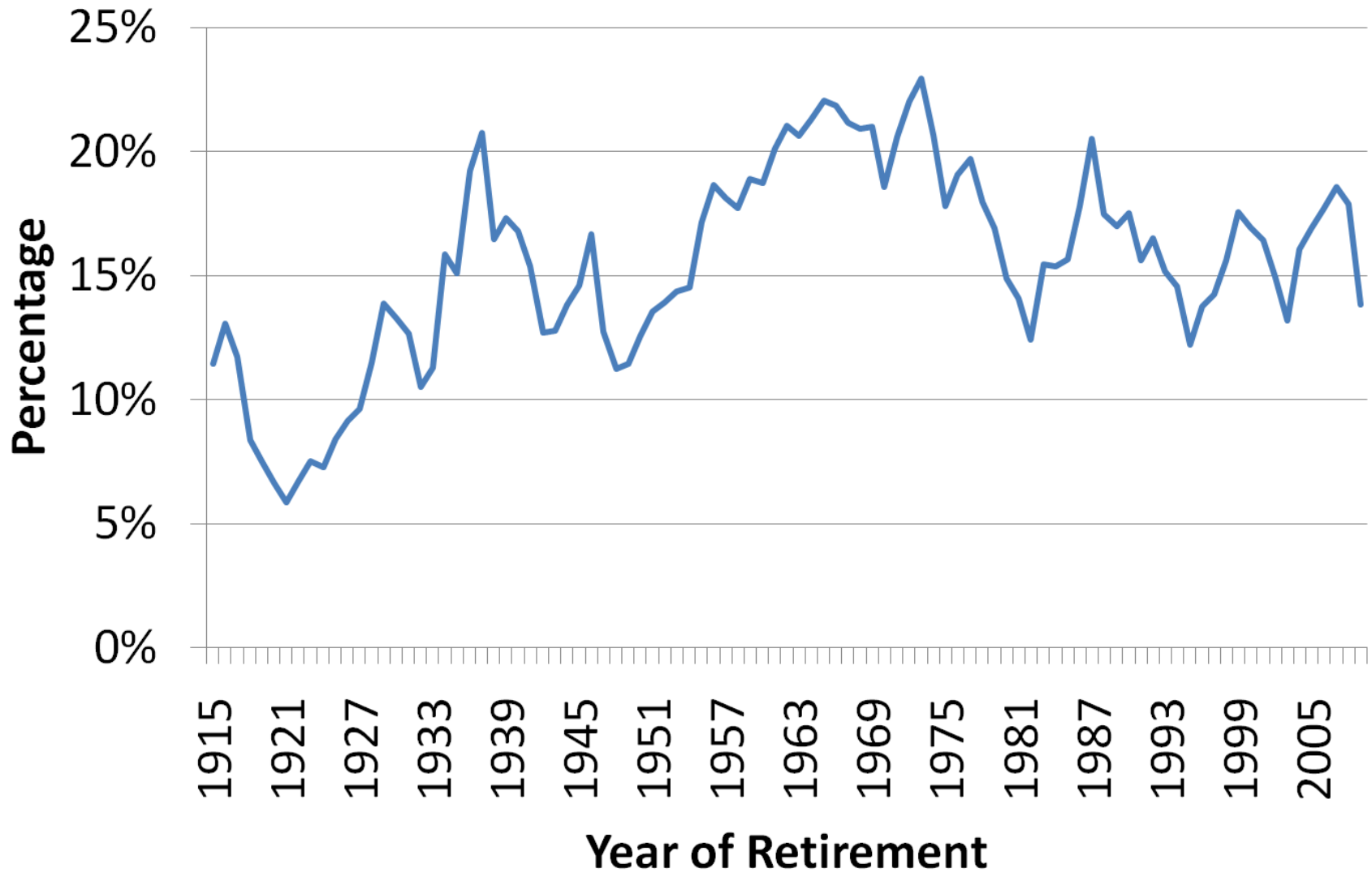
## Social Security plus pension replacement rates, 1940 birth cohort as of age 67 (Gemini model)



# Don't overstate market risk

- Simulation of Bush-style Social Security reform plan using return data 1871 to Sept. 2008
- Workers invest 4 percent of earnings in personal account;
- Give up traditional benefits equal to account contributions compounded at realized government bond rate
- Accounts hold 85% stocks through age 29; declining to 15% stocks by age 55
- Annuitized at retirement to form combined DC/DB Social Security benefit

**Percent change in total Social Security benefits for account holders retiring 1915-2008**



# Don't overstate social insurance protections

- Social Security replacement rates higher for low earners on average – but *only* on average
- Quirks in benefit formula can mean very different benefit levels even for households with identical earnings
  - Relative earnings between spouses; length of working career; length of marriage;
- Many low earners receive low replacement rates; many high earners receive high rates

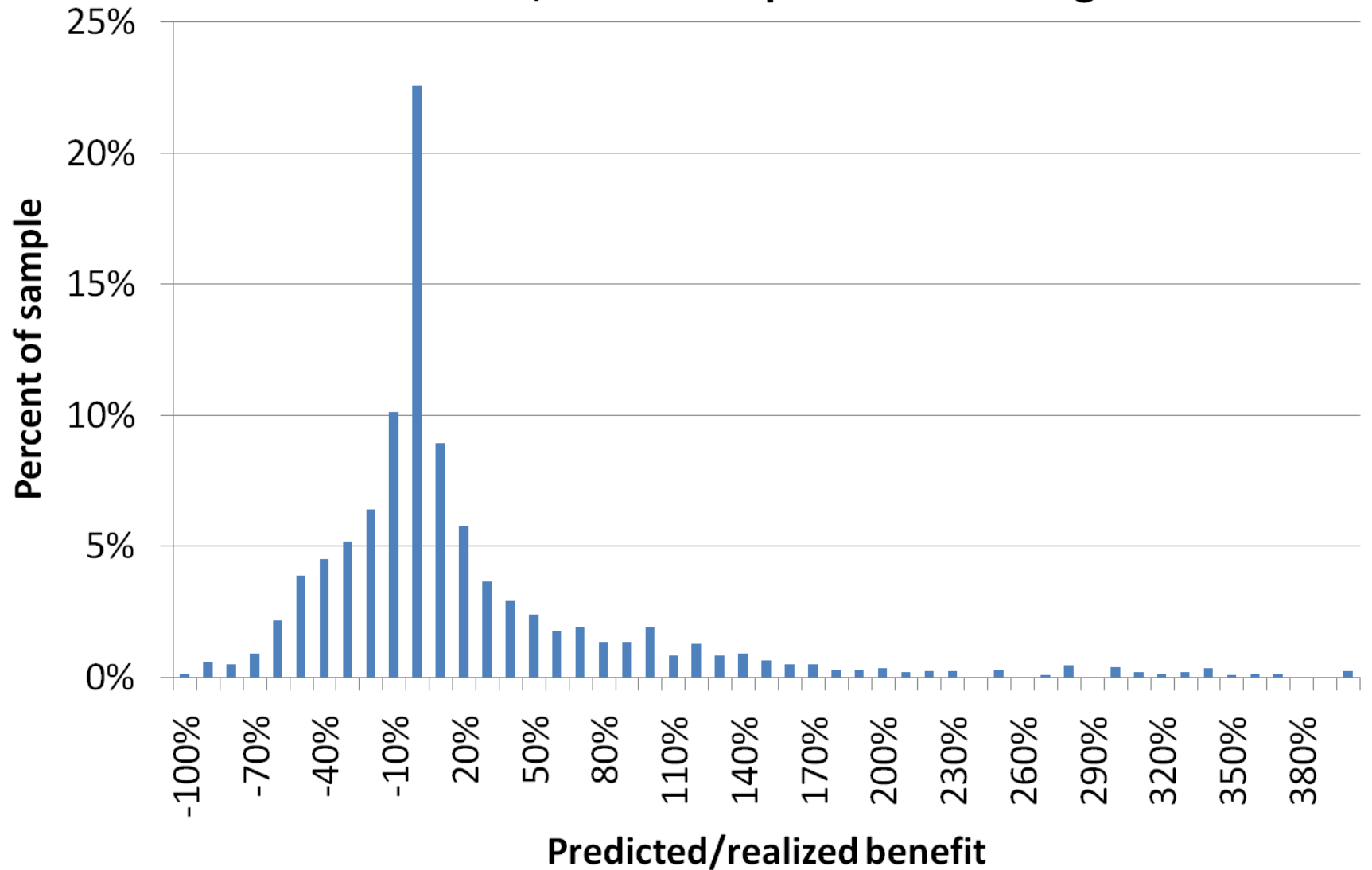
## Couple replacement rates by lifetime earnings



# Do you know what your Social Security benefit will be?

- Advantage of DB over DC is predictability; if you know what your Social Security benefit will be, you can plan your other saving
- But complexity in benefit structure makes benefit predictions hard
- In HRS, one-quarter of near-retirees couldn't even guess what their social security benefit would be
- Those who did guess were often far from the mark

## Predicted benefits as percentage of realized benefits; HRS 2000-06, one wave prior to claiming



# Does it pay to keep working?

- Marginal return: How much extra Social Security benefit does a person receive if he delays retirement and pays taxes an additional year?
- Complicating factors: progressive benefit formula; 40 quarter requirement; spousal benefits; 35 year averaging period.
- Simulated using SSA MINT model; added year of extra earnings to each individual work history, then calculated change in benefits
- Result: median male receives only 9.4 cents in benefits for each extra year of taxes paid; median female receives no extra benefits for working longer.