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# **Social Security Benefit Changes Under Individual Accounts: Offsets**

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# Worker-Specific Offsets

- ◆ Plans that allow workers to shift Social Security taxes to individual accounts on a voluntary basis involve worker-specific offsets
- ◆ Purpose: To compensate SS trust funds for foregone taxes and to equitably distinguish between those who do, and those who do not, shift Social Security taxes to personal accounts

# Typical Offset Design

- ◆ Social Security taxes shifted from trust funds to individual account are recorded in a hypothetical (shadow) account
- ◆ The “funds” in the shadow account accrue interest over the work life of participant
- ◆ Reduction in traditional Social Security benefits based on hypothetical account balance

## Offsets Based on Hypothetical Individual Account Balances

Annuity value of hypothetical account relative to actual individual account annuity

	(1) Actual Account Annuity Larger Than Hypothetical Account Offset	(2) Actual Account Annuity the Same as Hypothetical Account Offset	(3) Actual Account Annuity Smaller Than Hypothetical Account Offset
Traditional Social Security retirement benefit	\$1,200	\$1,200	\$1,200
Hypothetical annuity value reduces Social Security benefit	-300	-300	-300
Net traditional Social Security benefit	\$900	\$900	\$900
Plus actual individual account annuity	+450	+300	+150
Total retirement income	\$1,350	\$1,200	\$1,050

# Offsetting Traditional Social Security Benefits Raises Complications

- ◆ Non-retiree benefits paid from same primary insurance amount (PIA) as retiree benefits
- ◆ Would offsets apply to disability benefits, or only to retirement benefits?
- ◆ Would offsets affect bequests when workers die and no traditional benefits are payable?

# Other Offset Designs

- ◆ Offset could reduce individual account instead of traditional Social Security benefit
- ◆ Offset could be based on *actual* individual account balance
- ◆ Offset could be based on a ratio of actual (or hypothetical) individual account balance and the present value of expected traditional Social Security benefits for life

# Calculating and Applying An Offset Rate

- ◆ (a) Determine value of individual account (either actual or hypothetical)
- ◆ (b) Calculate present value of all future traditional Social Security benefits expected to be paid from account holder's earnings record
- ◆ Divide (a) by (b) to determine offset rate that will reduce all future benefits paid from account holder's earnings record

## Example of *Offset Rate* Calculation

- ◆ Bachelor Bob's IA balance is \$30,000; he is expected to receive \$145,000 total in traditional Social Security benefits; his offset rate is 20.7% ( $\$30,000/\$145,000$ )
- ◆ Husband Harold's IA balance is \$30,000; he is expected to receive \$145,000, and wife Wanda is expected to receive \$55,000 in traditional Social Security benefits from Harold's work record; Harold's offset rate is 15% ( $\$30,000/\$200,000$ )