What Vision of Retirement Income Security Will Guide Policy?

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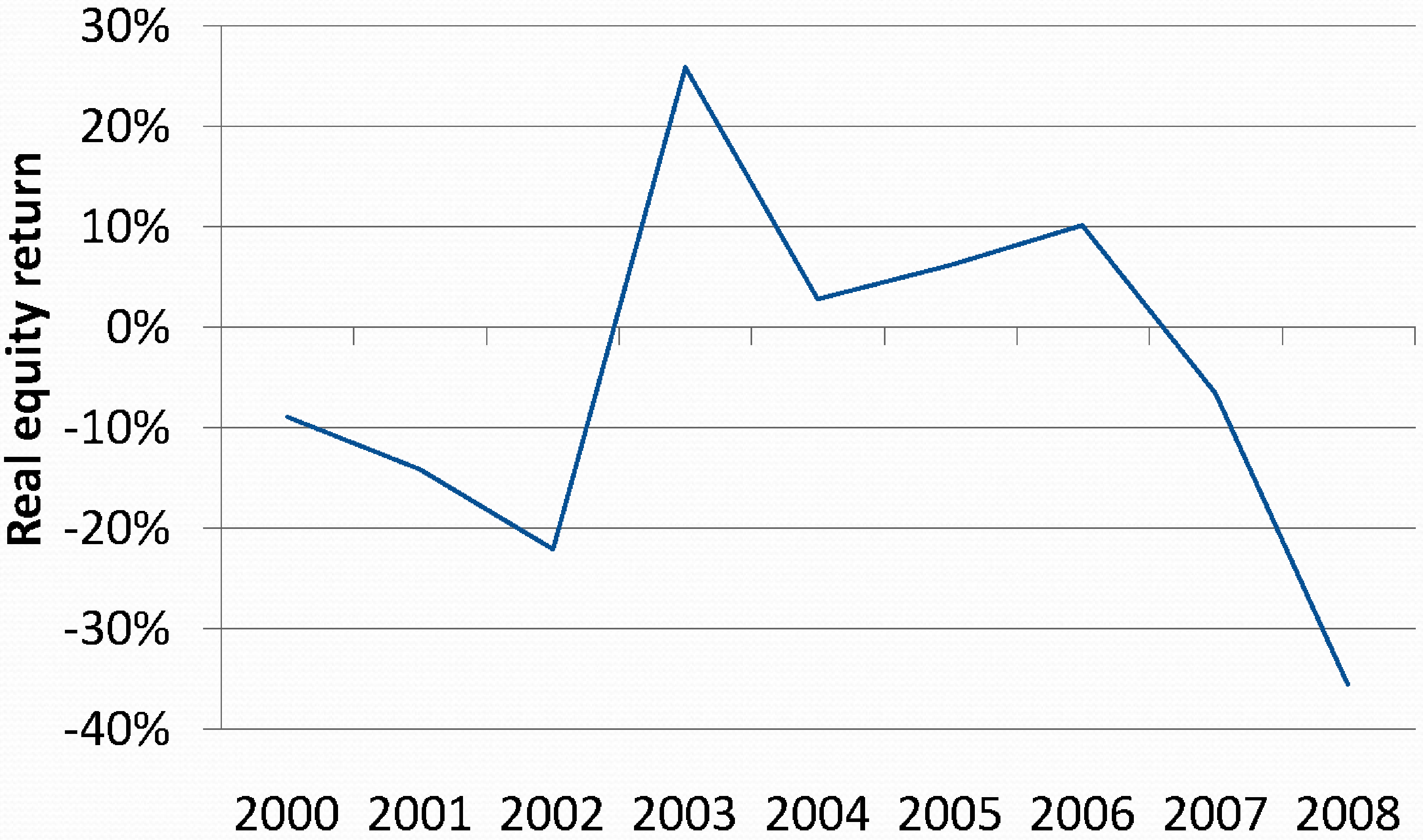
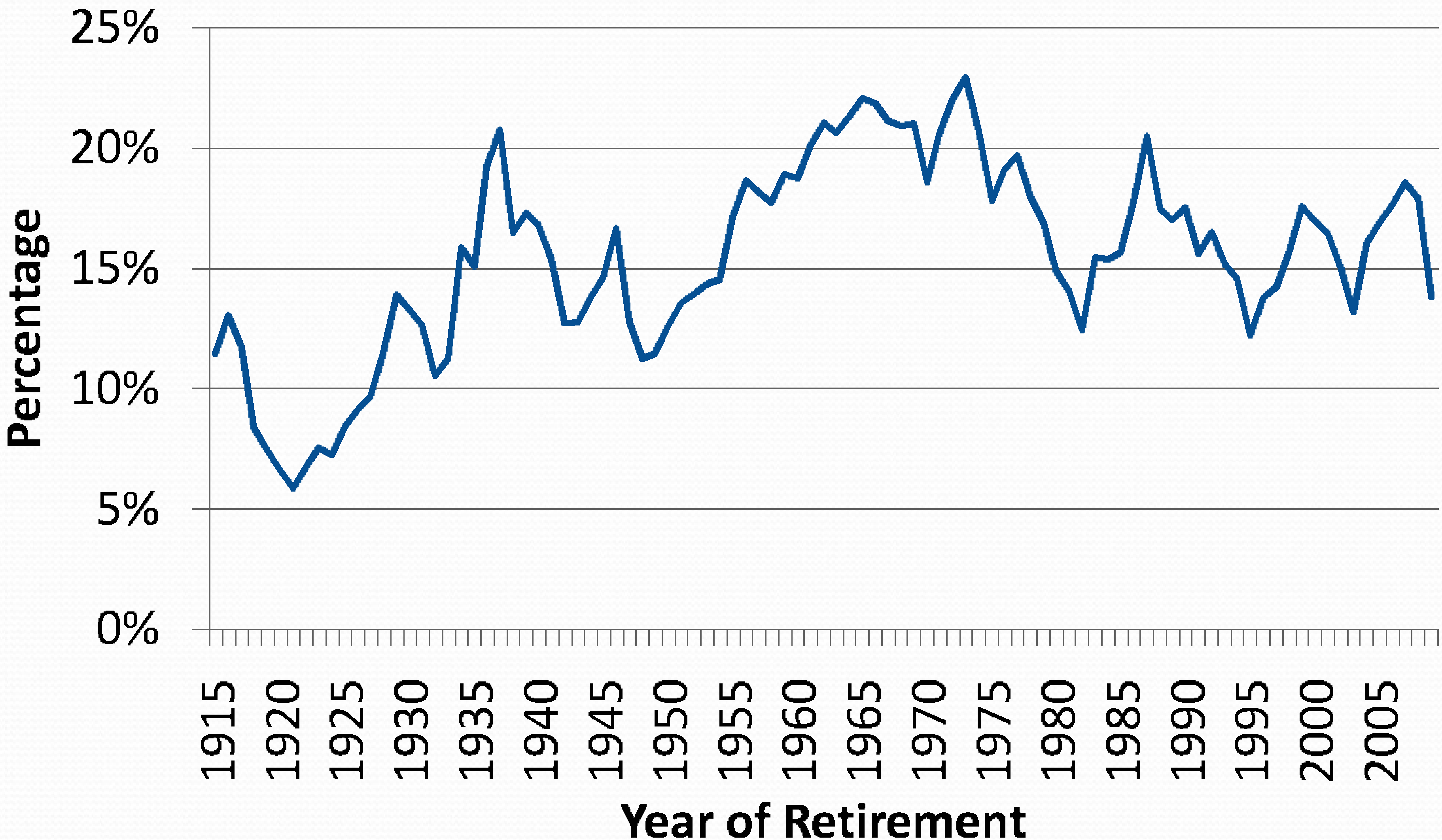
Outline

- What does the current market say about personal accounts?
- How well does Social Security spread risk?
  - Within cohorts
  - Between cohorts
- How should we think about the future of social insurance?

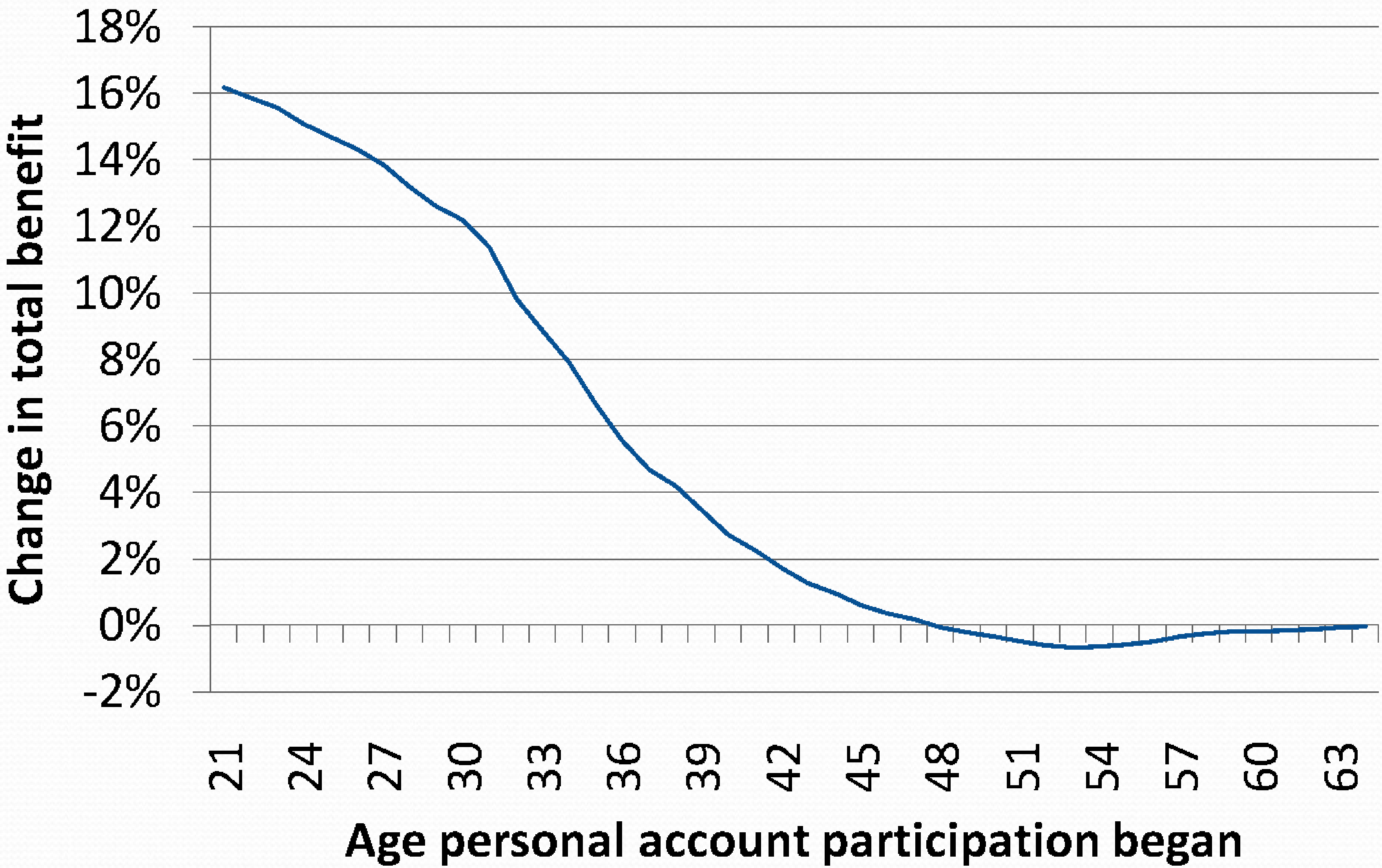
Should the stock market spell the end for personal accounts?



Average benefit change, account holders retiring 1915-2008



Average benefit change, 2008 retirees, by age accounts began



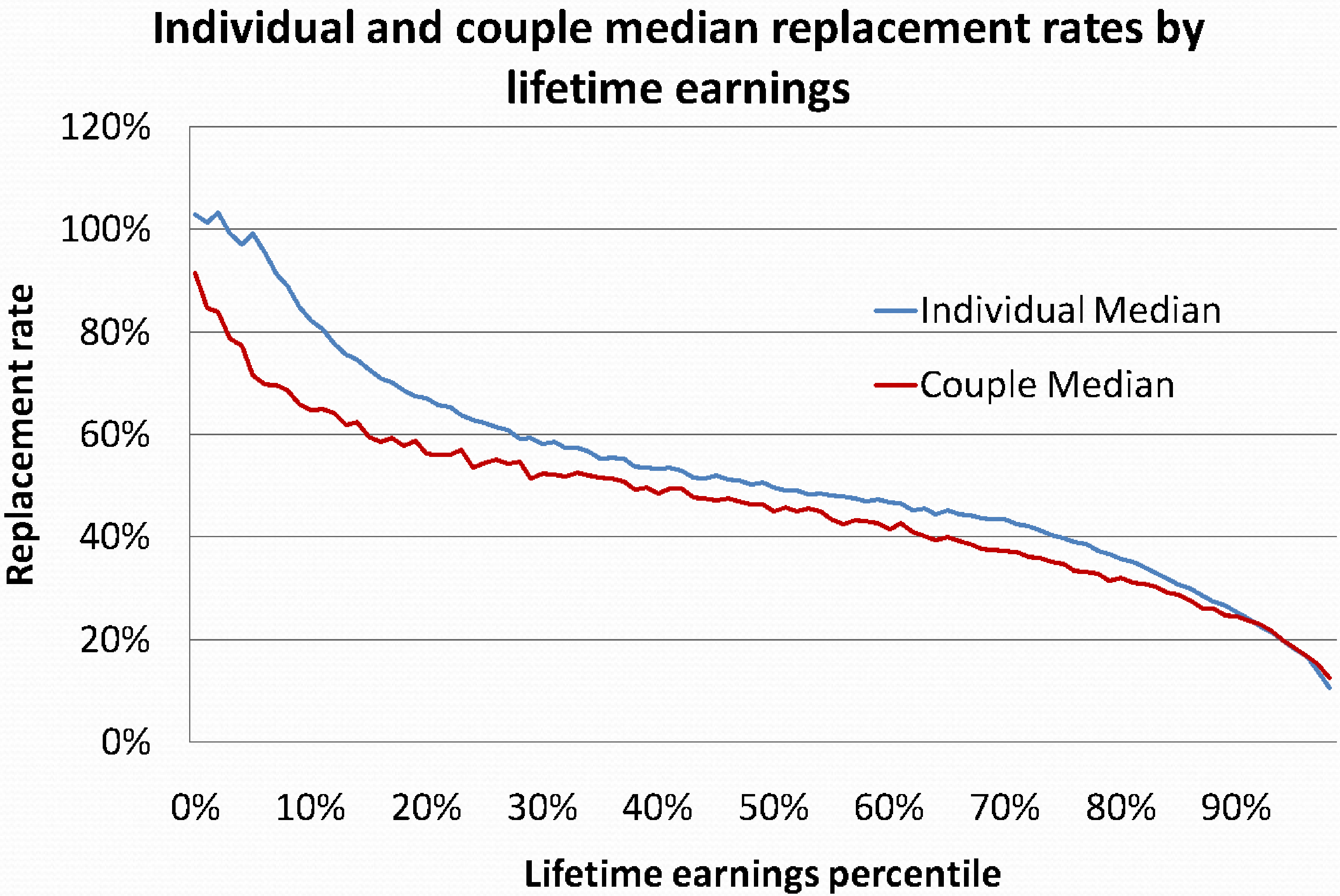
Social Security can spread risk…

- …within generations: from rich to poor within a given cohort
- …between generations: from relatively rich to relatively poor cohorts
- Non-governmental structures not good at either
  - But how *well* does Social Security accomplish these goals?

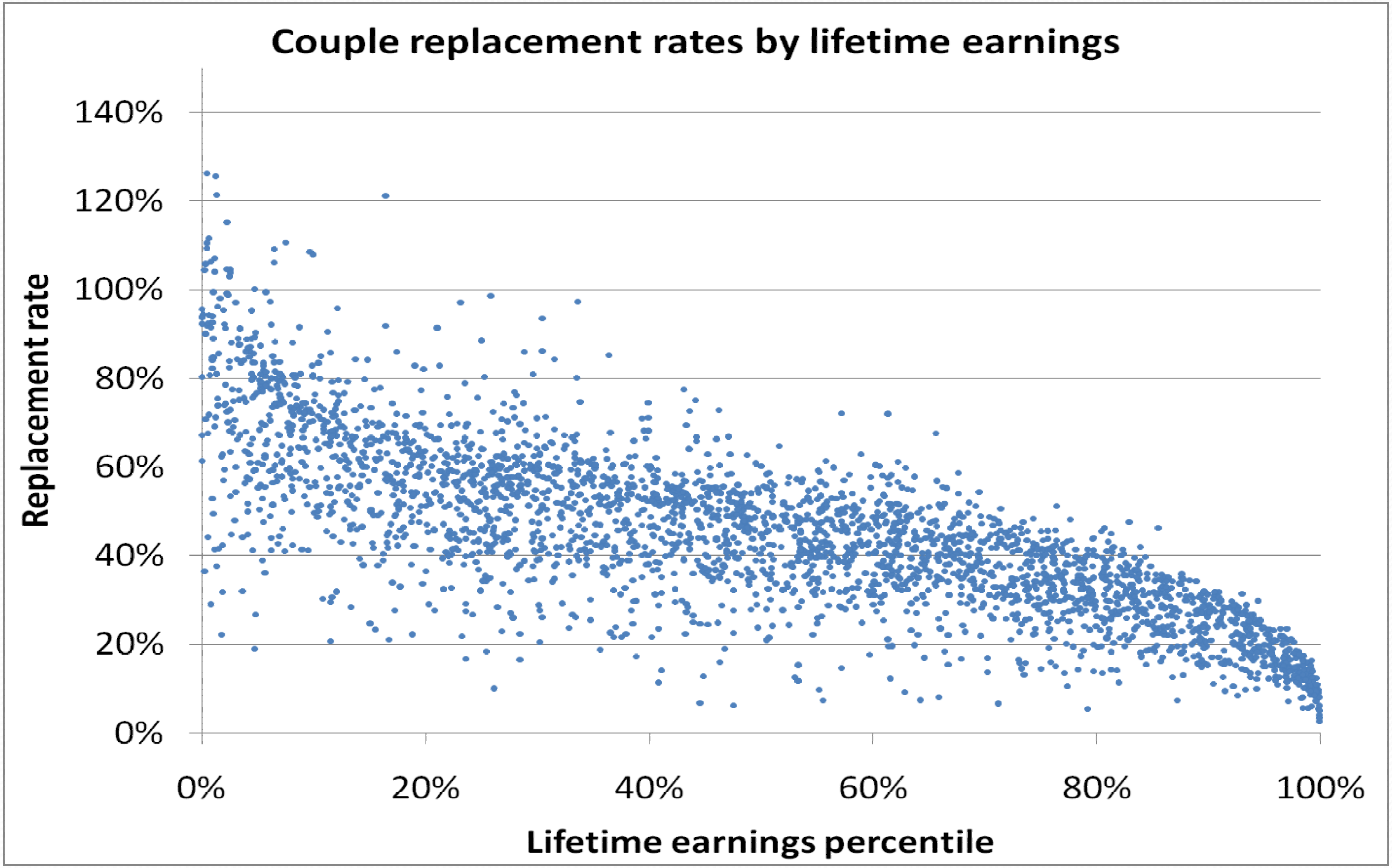
Risk sharing *within* generations

- Redistribution can insure against low lifetime earnings
- Social Security is progressive *on average*
- But if not *consistently* progressive, then insurance value of progressivity is lost.

Average progressivity looks good…



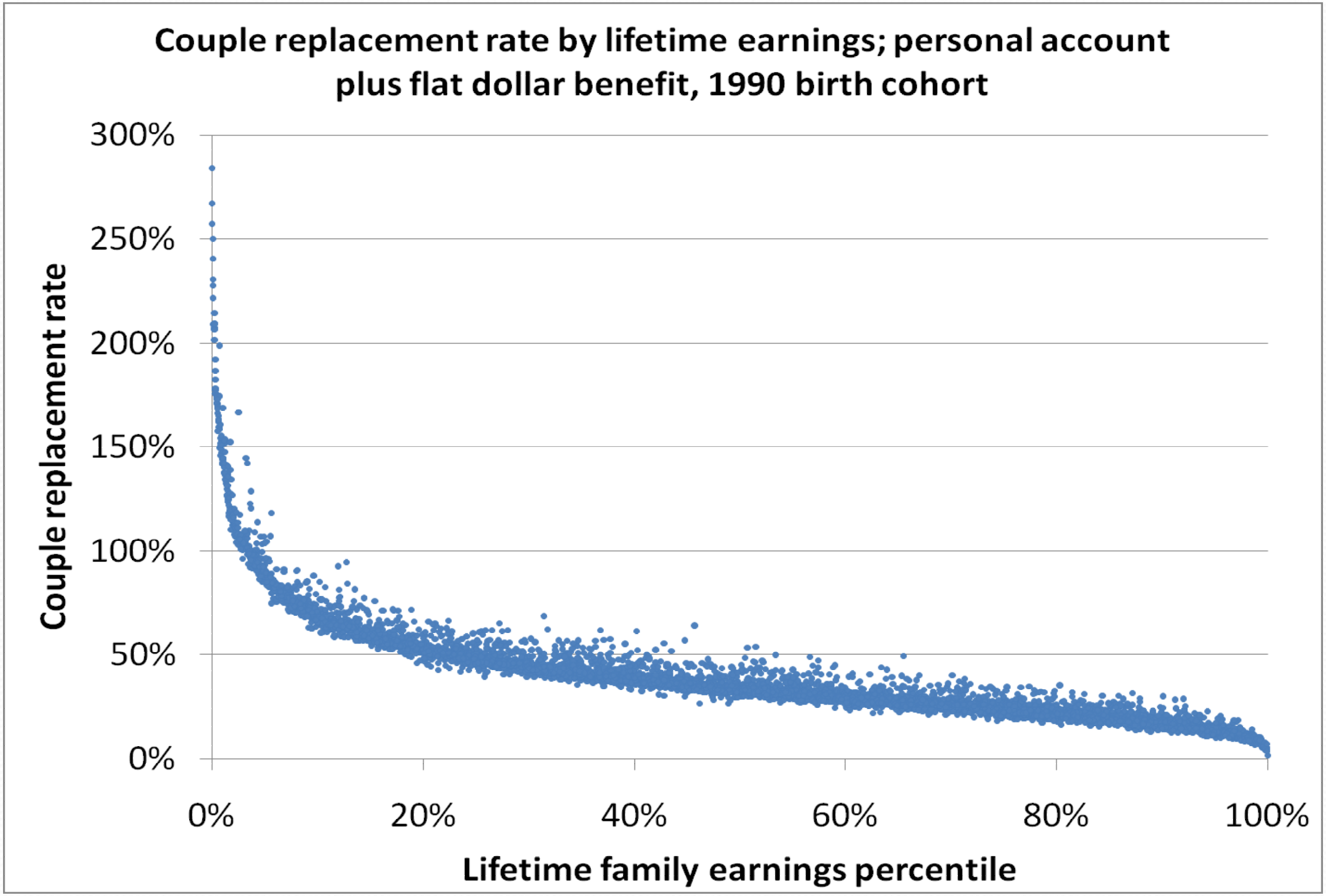
…but targeting is poor



Can a simple reform plan do better?

- Flat dollar benefit to all retirees equal to 20% of average wage *at the time*.
  - Similar to New Zealand plan, "universal pension"
- Individuals save 3 percent of earnings in personal account, invested in government bonds; annuitized at retirement
  - Could be 'add on', 'carve out,' auto-IRA, notional defined contribution, etc.

Better targeting of progressivity



Redistribution *between* generations

- "Compact between generations"; in pay-as-you-go program, relatively poor generation can be compensated by relative rich one that follows
- In practice, however, inter-cohort risk sharing is modest
  - A given generation's retirement benefits are based upon wage growth during *their* working years; wage growth of following generation has little effect

Better inter-generational risk sharing

- Average retirement benefits could depend upon *future* average wages, not past wages
  - E.g., flat benefit equal to 20% of average wage *at the time*.
- If future generation richer than expected, benefits rise; if poorer, benefits decline
- Economic risk shared between generations

Financing issues

- Social Security current a mix of insurance and “saving”
- To control costs, individuals should be encouraged/required to save more on their own
  - Universal 401(k)s, IRAs, etc.
- Social Security benefits targeted where most needed: low earners
- Key points: 1. What would social insurance look like if everyone “did what they should”; 2. How do we encourage people to “do what they should”
  - Result: Social insurance should focus more on being *insurance*