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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...

**Individual and couple median replacement rates by lifetime earnings**

- **Replacement rate**
  - **Individual Median**
  - **Couple Median**

- **Lifetime earnings percentile**
  - 0%
  - 10%
  - 20%
  - 30%
  - 40%
  - 50%
  - 60%
  - 70%
  - 80%
  - 90%
  - 100%
  - 120%
...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

Couple replacement rate by lifetime earnings; personal account plus flat dollar benefit, 1990 birth cohort

- Coupled replacement rate against lifetime family earnings percentile.
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