

# SOCIAL <sup>IN</sup> SECURITY

## How the Social Security Calculator Works

The Bush privatization plan proposes two benefit reductions:

- (1) **Sliding-scale benefit reductions.** On April 28<sup>th</sup>, the President endorsed “sliding-scale benefit reductions” modeled on a proposal developed by Robert Pozen. The White House also released a fact sheet essentially making it clear that the President’s proposal had the same magnitude of benefit reductions as the Pozen proposal. Under the Pozen proposal, everyone making over \$20,000 (in 2005 dollars) would see their benefits reduced. The percentage reductions in benefits for middle-class workers are nearly as large as they are for maximum earning workers. Maximum earners would be subject to full “price indexing.”
- (2) **Privatization tax.** Specifically, anyone who chooses to contribute to the Bush private accounts would have to repay all their contributions – plus the rate of interest earned by Treasury bonds – out of their traditional Social Security benefit. This further reduction in your traditional benefit as a result of the private account is the “privatization tax.” So taxpayers will have an individual account that they can keep upon retirement, but it is funded at the expense of their traditional benefits.

This website illustrates what these two benefit reductions would do to your total annual retirement benefit. If you enter your average annual income and birth year, the calculator estimates your benefit based on these benefit reductions.

In addition, the website calculates the value of your private account. Specifically, the President’s proposal would allow contributions of 4 percent of taxable earnings up to an annual maximum of \$1,000 in 2009, and growing by \$100 plus wage inflation thereafter. The calculator follows Congressional Budget Office assumptions on the investment returns to the accounts: “Contributions to IAs are expected to earn an annual return of 3.0 percent—the 3.3 percent expected return on Treasury bonds less 0.3 percent owing to administrative costs.” (CBO’s featured analysis adjusts the rate of return for the greater risks associated with investing in stocks, a factor that everyone from the investment bank Goldman Sachs to the conservative Nobel Prize winning economist Gary Becker have said is appropriate. The actual value of your account could be higher or lower depending on how your investments perform.) Finally, the calculator converts your individual account into equal annual payments (e.g., if you have \$100,000 in your private account, that can buy an inflation-adjusted annual benefit of about \$7,000).

Note that the calculator is based on your average annual salary. For example, a relatively young worker’s current salary will likely be significantly *below* his or her lifetime average annual income, whereas a worker close to retirement may have a current salary that slightly *overstates* his or her lifetime average. You can try different income levels to get a sense of how the Bush privatization plan will affect your total annual benefits. (In contrast, the Social Security Administration’s benefit calculator [<http://www.ssa.gov/OACT/quickcalc/index.html>] is based on your earnings in a single year and then extrapolates backwards and forwards. As a result, estimates of your future benefit on that website may differ from the ones shown here.)

For simplicity’s sake, this website assumes all workers will retire at age 65, although the full retirement age is gradually increasing under current law, to reach age 67 for those born in 1960 and thereafter. All numbers are presented in inflation-adjusted 2005 dollars.

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