TALKING POINTS FOR:

THE EFFECTS OF PRESIDENT BUSH'S PROGRESSIVE PRICE INDEXNG PROPOSAL FOR SOCIAL SECURITY

Overview:

- The current method of calculating retirees' initial Social Security benefits was first put in place in 1979, and since then the initial benefit level has risen with the growth in wages, ensuring that benefits reflect increases in living standards over time.
- Progressive price indexing would significantly cut Social Security benefits for people making more than $20,000 per year.
- Social Security would replace an ever smaller fraction of pre-retirement earnings for successive generations of workers under price indexing.
- Price indexing hurts middle-income workers much more than high-income workers.
- Price indexing would seriously undermine the retirement security of 40- to 50-year-olds.
- Price indexing does not restore Social Security solvency – it falls short by about 25 percent.

Chart 1: Most Workers Would Face Benefit Cuts under the President's Price-Indexing Proposal

- If a price indexing approach like President Bush's had gone into effect in 1979 instead of the current method, the benefit of middle earners retiring at age 65 today would be <u>$1,400 less per year than under current law</u>. (A middle earner makes about $37,000 in 2005.)
- These benefit cuts would grow larger over time. For today's 25-year-olds, the benefits for a middle earner would be 26 percent lower or $5,100 per year less when they retire.

Chart 2: Social Security Would Replace a Smaller Fraction of Earnings Over Time Under the President's Price-Indexing Proposal

- Over time, as the benefit cuts grow larger, Social Security would replace a smaller and smaller share of pre-retirement earnings.
- The replacement rate for today's middle earner aged 65 is 46 percent under current law.
- Because of already-enacted changes in the retirement age, the replacement rate for today's 25-year-olds who retires at age 65 is scheduled to decrease to 42 percent under current law.

- If the President's plan were already in effect, when today's 25-year-olds retire, the replacement rate of a middle earner would be less than one-third (31 percent) of pre-retirement earnings.

Chart 3: The President's Price-Indexing Proposal Would Hurt Middle-Income Workers More Than High-Income Workers

- Price indexing would hit middle-income workers much harder than upper-income workers, because middle-income workers rely on Social Security for a much larger percentage of their retirement income than do upper-income workers.
- If the President's plan were already in effect, the highest earners retiring in 2045 would experience a larger benefit cut than middle earners (46 percent compared with 26 percent), but their total retirement income would fall by less (10 percent compared with 17 percent).

Chart 4: The President's Social Security Plan Would Cut Benefits for Today's 40-Year-Olds

- For today's 40-year-old middle-class worker, price indexing starting in 2012 would reduce benefits at age 65 by 9 percent (from $17,000 to $15,450). <u>That's a cut of more than $1,500.</u>
- Workers with a private account would see a further cut in guaranteed Social Security benefits. Assuming the maximum contribution of up to 4 percent of earnings starting in 2009, today's middle-class 40-year-old workers would see an additional cut of 19 percent (from $15,450 to $12,470) in their guaranteed benefits because of the privatization tax.
- The guaranteed Social Security benefits after both price indexing and the additional privatization tax for those who invest in private accounts would be <u>27 percent less</u> than under current law for today's 40-year-old worker making about $37,000. The cuts would be larger for higher earners.
- If workers simply invested their private account in safe Treasury securities, they would actually be worse off with a private account than without one. The return on their private account after administrative expenses would not be enough to offset the privatization tax.
- In order to try for a higher return on their private account, people would have to make riskier investments. But an analysis by Congressional Budget Office economists suggests that over the short investment horizon available to 40-to-50-year-olds, they would have a good chance of ending up worse off than if they did not invest in a private account.

Chart 5: Late Baby Boomers Assuming More Risks as Participation in Defined Contribution Pension Plans Has More Than Doubled in 20 Years

- In the past 25 years, there has been a major shift away from traditional defined benefit plans to defined contribution plans.
- The late baby boomers are already assuming more of the risks of investing their own retirement assets than older generations did. Most baby boomers with pension coverage participate in defined contribution plans, so the amount of income that workers can expect from these plans is highly uncertain.
- Considering the benefit cuts from price indexing, the greater probability of losing money in a private account over a shorter investment horizon, and the additional tax on benefits for those who invest in private accounts, it's hard to see how today's 40- to 50-year-olds would come out ahead. Clearly, the President's proposals would seriously undermine the retirement security for these late baby boomers.

SOLVENCY

- The President's price indexing proposal does not even close the 75-year gap between promised Social Security benefits and the taxes expected to be paid into the system – it falls short by about 25 percent.
- Adding on private accounts would worsen Social Security solvency and increase federal debt enormously.
- If price-indexed benefit cuts were combined with private accounts, future generations would face the double burden of large cuts in their guaranteed Social Security benefits and paying down the higher federal debt.