

SOCIAL ^{IN} SECURITY

How the Social Security Calculator Works

All numbers are annual benefits adjusted for inflation. Calculations are based on Congressional Budget Office (CBO) economic assumptions. The President has said that individual accounts would do nothing to restore long-term solvency and that further benefit cuts are necessary. Since he has not made a specific proposal, these estimates assume that benefits are "price indexed," a proposal made in Plan 2 of President Bush's Social Security Commission.

Calculations and Assumptions:

The Bush privatization plan proposes two benefit cuts:

- (1) **Price indexing:** Several leading administration officials have discussed a switch to "price indexing" starting in 2012. An annual cut in benefits that grows substantially over time, price indexing would result in 50 percent benefit cut for Americans who are born this year. It would result in the same percentage cut in benefits for everyone born in the same year, regardless of income.
- (2) **Privatization tax:** Specifically, anyone who chooses to contribute to the Bush private accounts would have to effectively repay all their contributions – plus the rate of interest earned by Treasury bonds – via a cut to their traditional Social Security benefit. This further cut in your traditional benefit as a result of the private account is the "privatization tax." So you *will* have an individual account that you can keep upon retirement, *but* it is funded at the expense of your traditional Social Security benefit.

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

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 assumes that your investments get a rate of return of 3 percent above inflation, the same assumption used by the CBO for its Social Security analysis. (This rate of return adjusts for the greater risks associated with investing in stocks, a factor that everyone from Goldman Sachs to the conservative Nobel Prize winning economist Gary Becker have said is appropriate.) The rate of return is also adjusted to reflect an annual administrative cost of 0.3 percent. The actual value of your account could be higher or lower than that shown here 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 calculator is based on your earnings in a single year and then extrapolates your earnings backwards and forwards. As a result, estimates of your future benefit on the SSA calculator 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, reaching age 67 for those born in 1960 and thereafter. All numbers are presented in inflation-adjusted 2005 dollars.

Thanks to Jason Furman of the Center on Budget and Policy Priorities for the underlying calculations, and Jeff Faski of RavenCreative.com for web page design.