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POLICYNOTE

SOCIAL SECURITY REDUCES RETIREMENT WEALTH INEQUALITY

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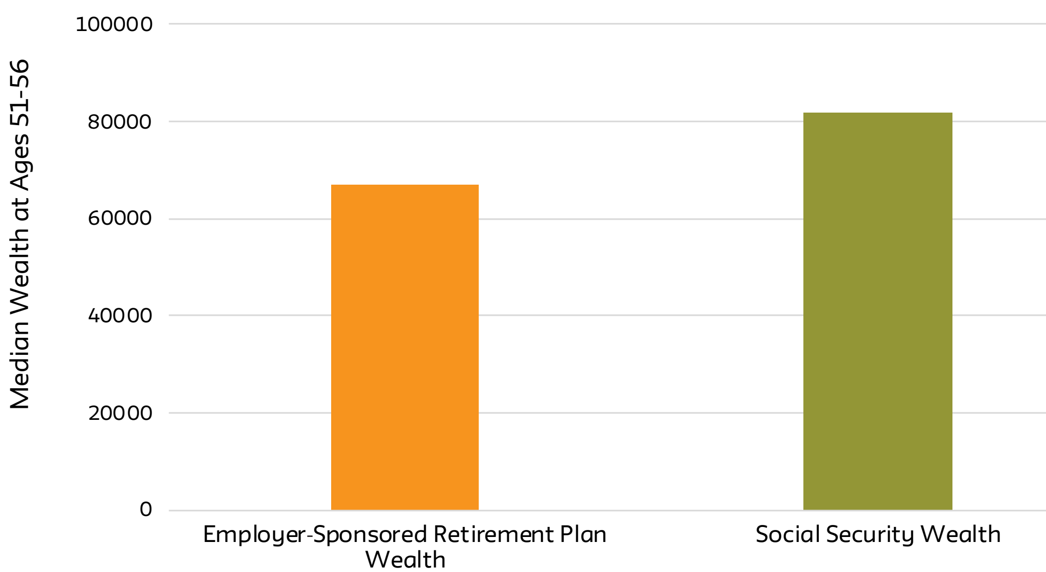
ELEVATOR PITCH

Social Security benefits are progressive and offset the unequal distribution of retirement wealth generated by a broken employer-based retirement system. Though Social Security benefits keep retirees out of poverty, American workers still face a retirement income crisis. Policymakers need to strengthen and expand Social Security and mandate employer-sponsored retirement plans to ensure universal coverage and adequate retirement income.

KEY FINDINGS

- For typical workers age 51-56, accrued Social Security benefits exceed employer-sponsored retirement wealth. Median Social Security wealth amount to $81,900 compared with $67,000 in employer-sponsored retirement plans.
- At ages 51-56, the typical low-wage worker (in the lowest 20% of earnings) has no retirement wealth. The typical high-wage worker (in the highest 20% of earnings) has wealth equal to almost two and a half times their earnings.
- Adding accrued Social Security benefits to retirement wealth decreases the retirement wealth gap between low and high earners from two and a half times earnings to just over half a year's earnings.

Figure 1: Median Social Security Wealth Exceeds Retirement Plan Wealth



Source: Authors' calculations.

Notes: All amounts are in $2010. Retirement plan wealth comprises balances in 401(K), IRA, and similar plans and accrued defined benefit wealth. Analysis uses HRS self-reported and administrative data for 2010, the most recent year for which administrative data are available, and HRS Social Security weights.

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SOCIAL SECURITY MATTERS FOR EVERYONE

Our retirement system relies on employers to sponsor retirement plans in forms of traditional pensions or retirement savings accounts like 401(k)s. But employers of low-income workers are less likely to offer any retirement plan, and many low-income employees are not able to save enough or withdraw their small savings in the face of economic shocks such as job-loss.[1]

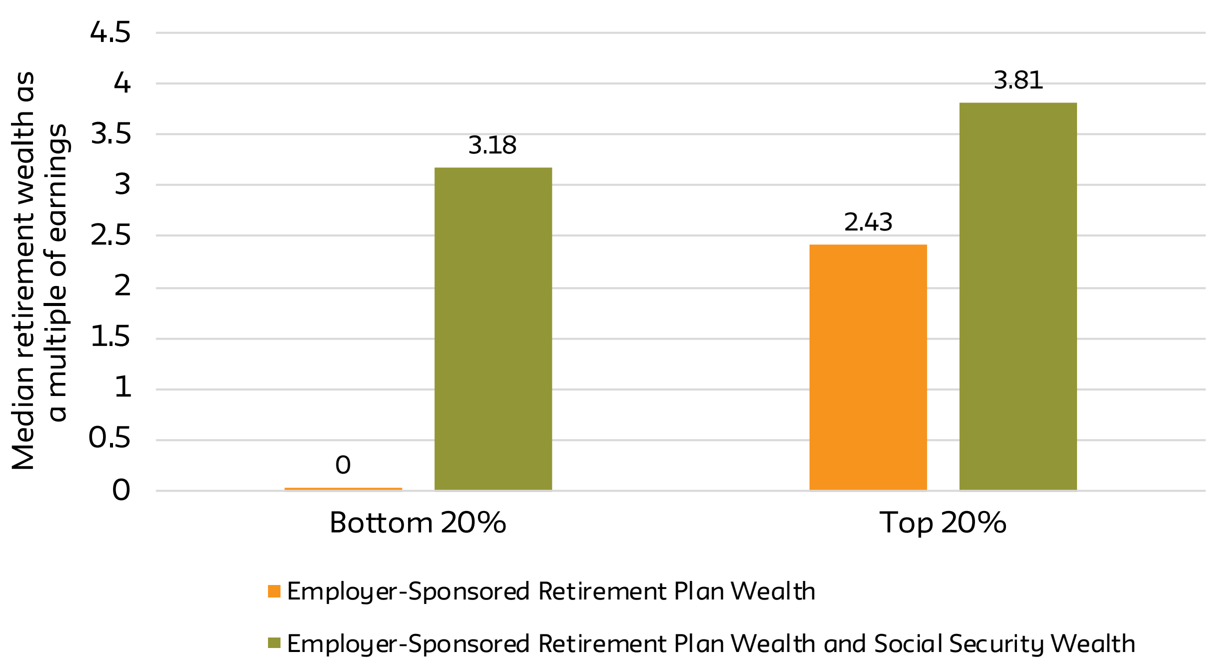
Social Security is designed to partially fill this gap and provide necessary retirement income to keep people out of poverty in older ages. But today, Social Security plays a major role in helping all workers prepare for retirement and maintain their living standards after a lifetime of work.

For typical workers approaching retirement, Social Security wealth exceeds their savings in employer-sponsored retirement plans. At ages 51-56, median Social Security wealth equals $81,900, compared with $67,000 for median employer-sponsored retirement wealth (Figure 1).

EXTREME RETIREMENT WEALTH INEQUALITY

ReLab has documented steep and sustained inequalities in employer-sponsored retirement plan wealth of workers nearing retirement.[2] Among workers ages 51-56, the typical worker in the lowest 20 percent of earners has zero employer-sponsored retirement plan wealth, compared with the retirement wealth for the typical worker in the highest 20 percent of earners that is 2.43 times their earnings (Figure 2).[2]

Figure 2: Social Security Reduces Retirement Wealth Gap Between High and Low Earners



Source: Authors' calculations.

Notes: See Figure 1. The figure reports median wealth-to-earnings ratios for the lowest and highest 20 percent of earners. Earnings are the average of the last 10 years' inflation adjusted earnings.

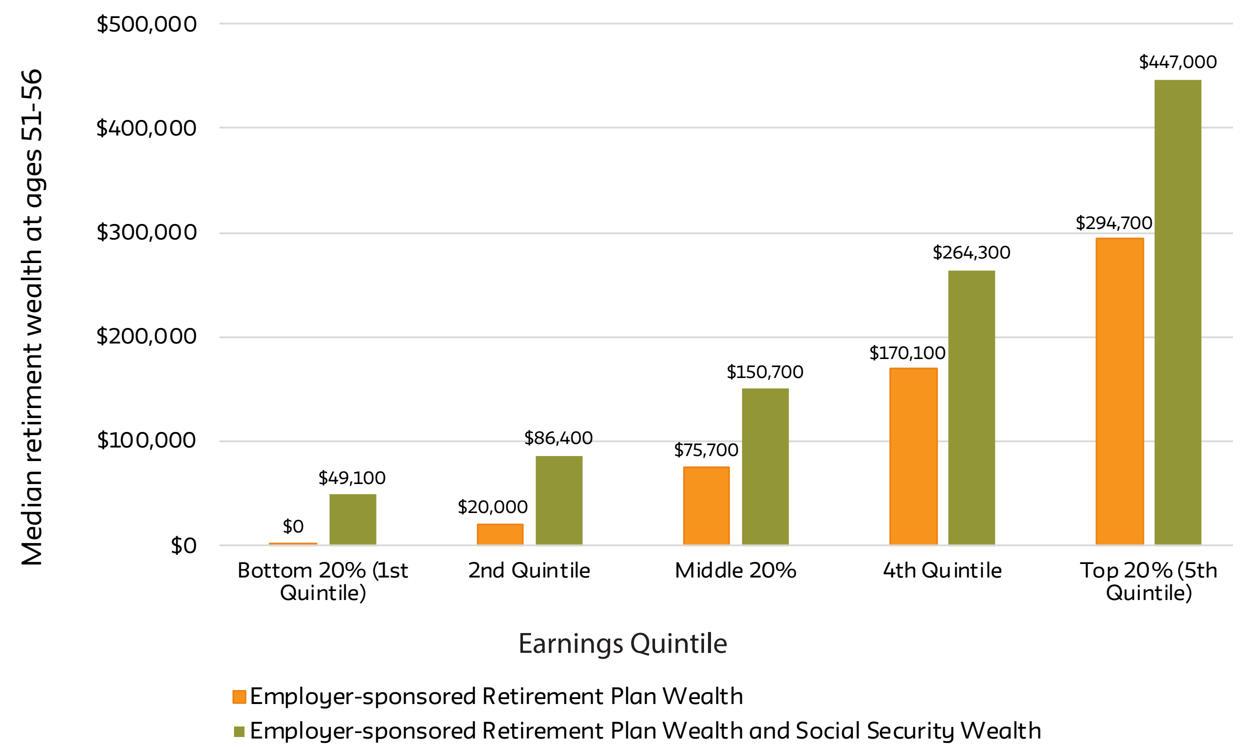
SOCIAL SECURITY SHRINKS RETIREMENT WEALTH INEQUALITY

By design, Social Security benefits are progressive. To fill this gap caused by lack of retirement plan coverage and capability to save, Social Security benefits make up a larger share of low earners' pre-retirement earnings (even though their benefits are still smaller than high earners' in dollar terms). But the unequal distribution of employer-sponsored retirement plan wealth far exceeds that which would result from differences in earnings and Social Security replacement rates.

Our analysis of the retirement wealth of workers ages 51-56 shows that Social Security reduces - but does not eliminate - retirement wealth inequality. We examine inequality in two ways: by measuring the employer-sponsored retirement plan wealth gap, defined as the difference between the wealth-to-earnings ratios of high and low earners and by comparing the dollar value of wealth of high and low earners.

Social Security narrows the retirement wealth gap from 2.43 times earnings to 0.63 times earnings by providing low earners with a base of income (and wealth) in retirement. Adding Social Security to retirement wealth increases the median wealth-to-earnings ratio of low earners from zero to 3.18 times earnings and increases the median wealth-to-earnings ratio of high earners from 2.43 to 3.81 times earnings. The retirement wealth gap narrows from 2.43 times earnings (2.43 minus zero times earnings) to 0.63 times earnings (3.81 minus 3.18 times earnings) (Figure 2).

Figure 3: Impact of Social Security on Median Wealth in Dollar Terms



Source: Authors' calculations.
Notes: See Figures 1 and 2.

In dollar terms, adding Social Security to employer-sponsored retirement plan wealth increases the wealth of high-earners more than that of lower earners. For the bottom 20 percent of earners, median employer-sponsored retirement plan wealth is zero. Social Security increases their median wealth from zero to $57,000. The top 20 percent of earners have median employer-sponsored retirement wealth of $339,000. Social Security increases their median wealth by $176,000 to $515,000 (See Figure 3). Although high earners have greater Social Security wealth than low earners, Social Security replaces smaller shares of high earners' pre-retirement earnings. They earn higher benefits by making higher Social Security contributions, yet many are still financially unprepared for retirement.

POLICY RECOMMENDATIONS

Despite the fact that Social Security shrinks the retirement wealth gap, American workers still face a retirement income crisis. Forty percent of middle-class workers ages 50-60 (those earning more than twice the 2019 Federal Poverty Level of $12,490 for singles, $16,910 for couples) will fall into poverty or de facto poverty in retirement, with incomes of less than twice the Federal Poverty Level.[3]

Social Security provides workers with a secure retirement income that lasts a lifetime. But, benefits are shrinking. The increase in the Social Security Full Retirement Age from 65 to 67 is equivalent to an across-the-board 13.3 percent cut in benefits. Proposals to increase the Full Retirement Age above 67 are equivalent to a further across-the-board cut in benefits. Low and moderate earners are unlikely to be able to increase their retirement savings to compensate for these proposed cuts.[4] Instead of cutting benefits and eroding the foundation Social Security provides, policymakers should increase benefits. The retirement savings gap is too big for workers to bridge on their own. Social Security revenues also need boosting by expanding the tax base[5] or increasing FICA taxes.[6]

Though Social Security keeps most retirees out of poverty, almost all workers also need income from employer-based retirement savings to maintain pre-retirement living standards. Current employer-sponsored retirement savings programs fall short. Only 65 percent of workers nearing retirement have any retirement wealth (an IRA or 401(k) account or a defined benefit pension from a current or past job).[7] Median retirement wealth falls 84% short of what people would accumulate in a system with mandated coverage, a 6% contribution rate, mandated employer matching, and no pre-retirement leakages.

Guaranteed Retirement Accounts (GRAs) are a public option retirement account requiring employers and employees to contribute with a fair and effective refundable tax credit provided by the government. GRAs provide a safe, effective vehicle for workers to accumulate personal retirement savings over their working lives.[8]

ENDNOTES

1. Ghilarducci, T., Radpour, S., & Webb, A. 2019. New Evidence on the Effect of Economic Shocks on Retirement Plan Withdrawals, The Journal of Retirement.

2. Ghilarducci, T., Radpour, S. and Webb, A. (2019). Retirement Plan Wealth Inequality: Measurement and Trends. Schwartz Center for Economic Policy Analysis and Department of Economics, The New School for Social Research, Working Paper Series 2019-1.

3. Ghilarducci, T, Papadopoulos, M, and Webb, A. 2018. 40% of Older Workers and Their Spouses Will Experience Downward Mobility in Retirement. Schwartz Center for Economic Policy Analysis Policy Brief.

4. Moon, M., Wang, Y., & Guo, J. 2016. How Social Security and Medicare Reduce Inequality. American Institutes for Research Center on Aging.

5. Arno, P and Moore, K. 2016. Reducing Inequality through Social Security: An Exploration of Two Policy Proposals. Schwartz Center for Economic Policy Analysis and Department of Economics, The New School for Social Research, Working Paper Series 2016-2.

6. Social Security Administration, Office of the Chief Actuary to Rep. Larson. 2017 accessed Nov. 22, 2019 https://www.ssa.gov/oact/solvency/JLarson_20170405.pdf

7. Ghilarducci, T, Papadopoulos, M, and Webb, A. 2017. Inadequate Retirement Savings for Workers Nearing Retirement. Schwartz Center for Economic Policy Analysis Policy Brief.

8. Ghilarducci, T., & James, T. 2018. Rescuing retirement. Columbia University Press: New York.

APPENDIX: HOW TO VALUE SOCIAL SECURITY AND DEFINED BENEFIT PENSIONS

The current value of defined contribution retirement wealth such as IRAs and 401(k) s equals the account balance. Since Social Security and defined benefit retirement plan entitlements cannot be bought or sold, we value their projected income streams in today's dollars.

The value in today's dollars of Social Security or defined benefit retirement plan entitlements equals the sum of each month's projected benefit, multiplied by the probability of being alive to receive it, and discounted back to the present at a rate of interest. The final step of the calculation is to make an apportionment of this sum between years worked to date, and years to the worker's anticipated retirement age.

Social Security benefits are calculated by 1) determining Average Indexed Monthly Earnings (AIME), the monthly average of the claimant's highest 35 years' earnings, indexed by increases in average wages, and then 2) calculating Primary Insurance Amount (PIA), benefits payable at the individual's Full Retirement Age by summing 90 percent of the first $926 of AIME, 32 percent of the amount between $926 and $5,583, and 15 percent of the amount over $5,583 (The dollar amounts are for 2019. They increase each year in line with changes in the Average Wage Index). The effect is to give higher Social Security replacement rates to workers with lower AIMEs. We follow convention and discount Social Security benefits are discounted using a conventional 3 percent real rate of interest. The expected present value of Social Security wealth would be higher if we discounted it back to the present using lower current interest rates.

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