Social Security, Saving for Retirement, and the Future Retirement Outlook

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Why?— insufficient private saving for retirement

PRINCIPLE ROLE of Social Security in the recent Macro literature

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U.S. Social Security Program: Anecdotal Facts

- In 2004 (Trustees’ 2005 Report)

  157 million workers paid $658 billion in aggregate taxes
  48 million beneficiaries received $493 billion in aggregate benefits

  3.3 workers per retiree

  “Social Security Trust Fund” $1.7 trillion as of 2004

  22% of total U.S. Government spending (largest expenditure)


  Ratio of U.S. Social Security expenditure to other countries' GDP
  - France: $1,732 billion GDP, 0.28
  - Canada: $1,009 billion GDP, 0.48
  - Australia: $641 billion GDP, 0.76
  - Taiwan: 1.01, Argentina: 1.02

  Ratio of U.S. Social Security expenditure to U.S. GDP
  - In 2004: 0.042
  - By 2017: 0.049 projected
  - By 2041: 0.063 projected

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The Pay-As-You-Go System

Social Security sent a picture and letter from the retired guy we support.
Changing Demographics (Trustees’ 2005 Report)

- Worker-to-retiree ratio falls to 2
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- Worker-to-retiree ratio falls to 2
  - Declining population growth rates

![Graph showing the worker-to-retiree ratio from 1990 to 2080. The ratio falls from 3.5 in 1990 to 1.5 in 2080. The graph includes historical and estimated data.]
Changing Demographics (Trustees’ 2005 Report)

- Worker-to-retiree ratio falls to 2
  - Declining population growth rates
  - Increasing life expectancy, 78 million “baby boomers” retiring, etc.

![Graph showing worker-to-retiree ratio from 1990 to 2080, with 'Historical' and 'Estimated' labels.](image-url)
Effects of a Fall in the Worker-to-Retiree Ratio

- In 2017
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- Benefits exceed taxes
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- Trust Fund exhausted in 2041

Income and Cost Rates (as % of taxable payroll)
Benefits will drop by 33% (Feldstein and Liebman 2002)
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Implication for retirement consumption?
Future Retirement Consumption Crisis

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Social Security Financial Crisis
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- Implication: Future retirees more reliant on a social security system that faces significant challenges
S.S. Crisis for Rule-of-Thumb Agent ($s = 5\%$)

Findley (2008)
S.S. Crisis for “Hand-to-Mouth” Agent (s = 0%)
Overview of Policy Options to Maintain Current Benefits

- Reform

Reform

- Increase Earnings Cap—currently around $100,000
- Increase Retirement Age—currently 67 if born after 1960
- Increase Payroll Tax Rate—currently OASDI 12.4%; DI 1.8%; OASI 10.6%

Raise OASI to 15.9% =

Trade-offs:
The first two are tax increases; the second is also a benefits cut.

Decreases aggregate capital accumulation =

long-run permanent
costs to economy

All come with significant political costs

Funding the System (i.e., private accounts that utilize higher rates of return in financial markets)

Require Govt to borrow heavily during transition

"Dead in the water" politically

Future Outlook—POLITICAL GRIDLOCK!!!

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Social Security Financial Crisis 10/08 10/18
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- **Future Outlook**—POLITICAL GRIDLOCK!!!

Trust me with your Social Security!

Damned if you do, damned if you don't.
MY POSITION...

PAINFUL!!

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WWW.GORRELLART.COM
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I'll let him bring something to the table first.
IN OTHER NEWS, THE SENATE VOTES ON A RESOLUTION TO APOLOGIZE SEVENTY YEARS IN ADVANCE FOR FAILING TO PASS ANY LEGISLATION TO REFORM SOCIAL SECURITY...
Can households offset the S.S. benefits fall?

- Households react optimally to the expected benefits fall?


Life-Cycle Optimization—hard problem to solve in practice?

Very hard! (even for professional economists)

“Learning by doing”? Most only get to learn once!

Evidence (Choi et al. 2006)

Switch from defined-benefit to defined-contribution plans
Most consider themselves inadequate savers
Few have the willpower to follow through

Banks et al. (1998) and Bernheim et al. (2001) evidence drastic falls in consumption at retirement

Cannot be explained by the standard theory

Data reflects the behavior of bounded, rule-of-thumb agents

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- Outside help needed?
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Wage raises usually "trigger" the higher contribution rates. Capitalizes on key behavioral tendencies:
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Congress legislated SMarT defaults on saving plans (Pension Protection Act of 2006).

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Real Wage Growth offsets the Crisis?

“Growing” the economy out of the crisis

- Historical annual rates of real wage growth:
  - 10-year Average: 1.1%
  - 20-year Average: 0.2%
  - 30-year Average: -0.1%

Risky to hope for Real Wage Growth?

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