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SHORTCHANGING THE NEXT GENERATION

Proposed Social Security cut would index benefits to 2006 living standards level, eroding retirement income for everyone thereafter

by Christian Weller

President Bush's Commission to Strengthen Social Security convened behind closed doors on August 22, unwilling to meet under the watchful eyes of the public as it begins to look for ways to cut Social Security benefits. One such cut being considered—a change in the way benefits are calculated—would mean that the living standards of future generations will begin to resemble the lower living standards of the past.

The benefit cut in question is an obscure yet substantial change in the way benefits are calculated. Instead of basing benefits on an individual worker's actual wage and the average wages prevalent at the time of retirement, benefits would be determined by price changes relative to an arbitrarily set year, in this case 2006. This would be a dramatic change in the way initial benefits for retirees are currently calculated. As a result, Social Security benefits, after adjusting for inflation, will stay fixed forever thereafter, never to increase in step with the future improvements in living standards that occur over time.

Because wages generally grow faster than inflation, Social Security benefits, compared to today's benefits, would be continuously reduced for anyone retiring after 2006. In other words, each new group of retirees would receive lower benefits relative to their earnings. A recent study by the Congressional Research Service calculates that this would cut benefits by 13% for those retiring in 2020, and by 41% for those retiring in 2070. Under current law, a worker with a lifetime of average earnings retiring in 2020 can expect a monthly benefit of $1,390 (in 2001 dollars). If this new indexation scheme is enacted, the same worker's monthly benefit would be reduced by $180. For a worker retiring in 2070, the cut would amount to a benefit of $924 (in 2001 dollars).

Productivity and wage growth allow the living standards of the average worker to rise over a typical 30 to 40 year work life. Indexing benefits to workers' wages, as is the case now, means that they will receive retirement benefits that reflect the living standards they experienced during their careers. If benefits instead become indexed to prices (i.e., inflation), retirees would be forced to revert to some past living standard level. Thus, a worker who is 40 years old today and who retires at 66 in 2027 would have his or her Social Security benefits calculated on the wages that prevailed in 2006, not in 2028. If this had been a feature of Social Security since its inception, today's retirees would receive a benefit that was linked to a basic living standard set in 1935, when a large share of households did not even have indoor plumbing.

There is no economic or social rationale for forcing retirees to accept living standard levels that are several decades old. Seniors should benefit from the economy they helped to build. For three or four decades prior to their retirement, workers are productive members of society, helping to raise the living standards for everybody and to lay the foundation for further improvements by future generations.

A large and increasing cut to retirement benefits would leave future generations with inadequate retirement incomes. This would make a bad situation even worse—current research on retirement income already shows that a large share of today's workforce is inadequately prepared for retirement. Although these estimates on the adequacy of retirement savings vary, most recent studies show that about half of all workers won't have enough income to sustain themselves in their retirement.

Social Security is the largest and most important component of retirement savings for Americans, providing about 58% of total income for the average retiree over 65. Most workers cannot increase their savings enough to compensate for the proposed loss of Social Security benefits. Increasing retirement savings would be particularly unrealistic for low- and moderate-income families, who already struggle simply to meet current basic needs. And even if they could somehow set aside some money for retirement, there is no way for such families to know how much to save or where to invest it in order to make up for the proposed reduction in Social Security benefits. Leaving future generations worse off than current retirees runs counter to America's long-held commitment to ensuring that each generation—young or old—is better off than the one before it.