

## **Recent Research Findings on Retirement and Aging from the Urban Institute**

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### **Adding Individual Accounts to Social Security**

- Our research shows that outcomes in individual accounts will be sensitive to administrative costs. The average administrative cost across all mutual funds is 1.1 percent, but the cost of a centralized system could be much lower. The Social Security actuaries, in fact, suggest that costs could be as low as 0.3 percent. Although the difference between 1.1 percent and 0.3 percent may seem small, over an entire career it can create a 20-percent differential in the size of a typical individual account balance.
- Realized rates of return would also play an important role in outcomes under individual accounts. The real rate of return will depend on individual investment decisions and the market returns realized during an individual's career. Most analyses of individual account proposals assume constant rates of returns for stocks and bonds, but actual returns vary over time. Individuals retiring during a market slump, for example, could realize significantly less from their accounts than those retiring during a bull market.
- Under a voluntary system of individual accounts, outcomes also depend on who opts in and who stays out. Recent data from the Survey of Consumer Finances show that younger people, those in good health, those with more education, and those with substantial assets are more likely to take risks than their counterparts, and thus may be more likely to participate in individual accounts. A voluntary system will also need to establish rules about whether individuals can change their participation decisions over time.
- A system with individual accounts would probably spur broader development of the annuities market. Greater variety in annuity options will be necessary to encourage lifetime benefit protection comparable to what is offered by Social Security today. Only about 10 percent of older workers with 401(k)-type plan assets annuitize their balances now when they retire. In fact, many employers do not offer annuitization options. Basic life annuities transfer resources from those with shorter life expectancies to those with longer life expectancies. A broader annuity market that offers features such as joint and survivor annuities, period certain annuities, and cash refunds would reduce these transfers and probably would be required to increase participation.

- Policymakers also will need to decide whether to require annuitization of individual account balances or to make annuities the default payout option. One popular option is to require annuitization up to the point at which the reduced Social Security basic benefit plus the annuity from the individual account produces an income stream equal to the federal poverty level.
- Guaranteeing benefits in an individual account system could be quite costly. If individual accounts promote economic growth, they would raise the guaranteed benefit, eroding the improvement in budget balance achieved by other parts of Social Security reform.
- Restoration of financial solvency over a 75-year period will require cuts in benefits even in a system with individual accounts. For example, the Social Security trustees estimate that financial solvency would require an immediate and permanent benefit cut of 13 percent, a payroll tax increase of 15 percent, or some combination. Implementation of benefit cuts must be sensitive to effects on poverty and the most vulnerable elderly groups. Plans that incorporate a new minimum benefit in Social Security could help to alleviate adverse effects on these groups.
- Many reform proposals include across-the-board cuts in Social Security's cost-of-living adjustments (COLAs), which are now set equal to the percentage change in the Consumer Price Index (CPI). Our research shows that these reductions would disproportionately hurt the oldest and poorest retirees. For example, reducing COLAs today to one-half percentage point below the change in the CPI would reduce average incomes in 2040 by 12 percent for those age 85 and older in the bottom 10 percent of the income distribution. These cuts would also leave nearly 2 million additional older people with little income.
- Other reform proposals that cut benefits (such as increasing the normal retirement age or converting from wage to price indexing of initial benefits) can have substantially different distributional effects. Results from simulations of some of these reforms underscore the importance of how reform proposals treat Disability Insurance beneficiaries.

### **Protecting Vulnerable Populations in Retirement**

- Women are much more likely than men to live in poverty at older ages. Our models show that increasing survivor benefits in Social Security would raise income for older and widowed women, but if these increases are not capped much of the additional resources would go to high-income women. In addition, these reforms would not benefit women who never marry. Raising minimum benefits in Social Security would better target resources to those with the greatest needs.
- Fully one in five older divorced women lived in poverty in 2000. Our models project that the share of older women who are divorced will grow over time,

rising from 13 percent for those born between 1931 and 1935 to 20 percent for those born between 1956 and 1960. One-third of divorced women in the younger group will not be able to collect Social Security benefits through their former husbands' employment, because their marriages will not have lasted 10 or more years. Our models predict that divorced women will continue to receive lower income in retirement than other groups.

- Single mothers face special economic challenges in old age, because they often have limited employment histories and cannot rely on husbands for financial support. Our research shows that women who spent at least 10 years raising children outside of marriage are five times more likely to live in poverty at older ages than women who were continuously married when their children were young. However, recent increases in employment among young single mothers are likely to improve their future retirement prospects.

### **Retirement Preparedness Among the Baby Boomers**

- Our research shows that baby boomers will retire with more wealth and income than previous generations, but they will not be able to replace as much of their pre-retirement income as current retirees. We project that median household wealth at age 67 will grow from \$448,000 among current retirees to more than \$600,000 (in constant dollars) among boomers. In addition, median household income at age 67 will increase from \$36,000 today to \$50,000 for the boomers (assuming current-law Social Security benefits). However, boomers' median replacement rates will decline from 87 percent for current retirees to 80 percent for those born between 1956 and 1965.
- Health care costs are likely to take a bigger bite out of retirement income in the future. Our projections show that, if current policies continue, typical older families will devote about one-third of their income to health care costs, up from about 17 percent today.

### **For Additional Information:**

(Unless noted, all documents are available at [www.urban.org](http://www.urban.org))

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