

# **Supplemental Social Security-Based Retirement Savings Accounts: An Introduction**

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## **Supplemental Social Security-Based Retirement Savings Accounts (RSAs):**

The Institute for SocioEconomic Studies has developed a supplemental Retirement Savings Account (RSA) concept aimed at facilitating the partial pre-funding of retirement as soon as possible. Already, partial pre-funding of retirement is undertaken in 20 countries and for 80 million workers as part of their national retirement system.<sup>1</sup>

In the United States, opinion polls show sharp divisions concerning the concept of allowing workers to transfer a portion of their payroll taxes into personal savings accounts<sup>2</sup> from which they would invest the funds. Nevertheless, partial pre-funding is critical to ensuring retirees sufficient income. “I believe that, as the baby boom generation begins to retire in a few years, it will become increasingly important for the nation to boost resources available in the future through greater national saving and enhanced incentives for participation in the labor force,” U.S. Federal Reserve Chairman Alan Greenspan explained.<sup>3</sup>

Partial pre-funding would likely increase national saving and beneficial capital formation. CBO Director Douglas Holtz-Eakin told the House Budget Committee, “Prefunding retirement benefits has the potential to increase the nation’s capital stock, boost productivity, and raise GDP in the long run.”<sup>4</sup>

The Institute for SocioEconomic Studies has devised a Retirement Savings Account (RSA) concept that would operate as follows:

- Voluntary contributions would be in addition to social security taxes.
- Contributions would supplement those made in the form of payroll taxes.
- Each year, a person could contribute an amount of up to 50% of the total payroll tax attributable to his/her income.
- Contributions would be tax-deductible.
- RSA assets could be invested in broad-based equity, bond, money market, commodity index, and real estate investment trust portfolios as the RSA account owner chooses.
- RSA investments grow tax free.
- Distributions commence at the time one becomes eligible for Social Security.
- Distributions could be taken as a lump-sum or as an annuity.
- Distributions would be taxed at half one’s income tax rate for the year in which such distributions are received, as only half the distributions would be included in one’s ordinary income.
- Tax revenue on distributions would be directed to the Social Security Trust Fund.

## Starting Retirement Pre-Funding Now is Advantageous:

Given the compounding of interest, the earlier one begins to make contributions to one's RSA, the larger one's accumulated assets grow. Even relatively small contributions would generate a fairly sizable portfolio after 30-40 years.

Assuming annual investments of \$1,000 made in monthly installments of approximately \$83.33 and applying historic real rates of return<sup>5</sup> on Treasury securities and equities, a portfolio comprised of 50% Treasuries and 50% equities would grow to \$72,204 after 30 years. After 35 years, it would be almost 40% larger. After 40 years, it would be more than 90% larger than the 30-year figure.

### *The Growth of Assets:*

Investment Term	50% Treasuries/50% Equities	50% Treasuries/50% Corporate Bonds
30 Years	\$72,204	\$50,756
35 Years	\$100,790	\$65,157
40 Years	\$139,159	\$82,114

## More Assets = More Retirement Income:

In general, the greater one's assets at the time of retirement, the higher one's retirement income. The following two tables provide the annual income stream made possible from portfolios comprised of 50% Treasuries/50% Equities and 50% Treasuries/50% Corporate Bonds over investment terms<sup>6</sup> ranging from 30-40 years.

Upon one's retirement, it is assumed that the portfolios have been converted into very low-risk securities. As a result, the historic real rate of return on Treasuries is employed during the annuity term<sup>7</sup>. Annuity terms ranging from 15-30 years are employed.

### *50% Treasuries/50% Equities:*

Investment Term	30 Years	35 Years	40 Years
Annuity Term			
15 Years	\$5,983	\$8,352	\$11,532
20 Years	\$4,805	\$6,707	\$9,261
25 Years	\$4,108	\$5,735	\$7,918
30 Years	\$3,652	\$5,099	\$7,040

***50% Treasuries/50% Corporate Bonds:***

Investment Term	30 Years	35 Years	40 Years
Annuity Term			
15 Years	\$4,206	\$5,399	\$6,804
20 Years	\$3,377	\$4,336	\$5,464
25 Years	\$2,888	\$3,707	\$4,672
30 Years	\$2,677	\$3,296	\$4,154

**Benefits of the RSA Concept:**

The above concept offers several advantages in that it is politically and fiscally viable and personally and economically beneficial:

- It bridges the political divide concerning partial pre-funding and offers a meaningful opportunity to facilitate the partial pre-funding of retirement in the very near-term.
- It offers powerful up-front and back-end tax incentives to facilitate private retirement saving.
- Given the compounding of investment returns, tax revenue from distributions would exceed that which would be foregone from the tax-deductibility of RSA contributions.
- The RSA concept helps shore up the Social Security Trust Fund with an additional revenue stream that does not involve a payroll tax increase.
- The RSA concept does not preclude Social Security benefits reforms.
- To the extent that RSAs would increase real national saving, they would help promote increased long-run economic growth, elevated productivity, and higher incomes.

## Endnotes

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<sup>1</sup> Estelle James, “Social Security Reform Around the World: Lessons from Other Countries,” National Center for Policy Analysis, August 2002, p.2.

<sup>2</sup> A March 10-13, 2005 ABC News/Washington Post poll revealed that 56% of respondents supported an option by which they “could invest some of their Social Security contributions in the stock market” while 41% opposed it. A February 24-28, 2005 CBS News/New York Times poll provided the opposite result with 43% supporting the ability of individuals to invest part of their Social Security taxes and 51% opposing it.

<sup>3</sup> Testimony of Chairman Alan Greenspan before the President’s Advisory Panel on Federal Tax Reform, March 3, 2005.

<sup>4</sup> Douglas Holtz-Eakin, CBO Testimony before the Committee on the Budget, U.S. House of Representatives, February 9, 2005, p.7.

<sup>5</sup> The SSA’s Office of the Chief Actuary estimated nominal rates of return of 6.3% for Treasuries, 6.8% for corporate bonds, and 10% for equities. The OMB uses a discount rate of 3.0% and the CBO uses a discount rate of 3.3%.

<sup>6</sup> Investment term: the amount of time over which a person makes contributions to his/her RSA.

<sup>7</sup> Annuity term: the period during which regular withdrawals are made from the RSA, at the end of which the RSA’s balance is brought to \$0.00.