



Social Security Reform and Union Households in Iowa

by David Hogberg

Public Interest Institute recently released a new Policy Study entitled “Social Security Reform and Union Households in Iowa.”¹ This study examines how union households in Iowa would fare under a reformed Social Security system that includes the option of personal retirement accounts (PRAs).

It is no secret that the Social Security system in the United States is headed toward an insolvency crisis in the coming years. The reason is that as the baby-boom generation begins to retire early in the next decade, there will not be enough workers paying payroll taxes to support full funding of Social Security benefits. In anticipation of this, the Social Security Trust Fund has accumulated trillions in government bonds to help finance the Social Security benefits for the baby boomers. However, this is only a temporary fix. According to the Social Security Trustees Report, the Social Security Trust Fund will deplete its store of government bonds in the year 2042. Once the trust fund is exhausted, “present tax rates would be sufficient to pay 73 percent of scheduled benefits” in 2042, and “65 percent of scheduled benefits in 2077.”²

Yet even this understates the magnitude of the problem. Under the best assumptions, the Trustees estimate that Social Security will begin to pay out more in benefits than it collects in payroll taxes by 2021. While the bonds in the Trust Fund can be used to make up the difference, the Federal Government *must find the additional revenue to fund those bonds*. According to the Trustees “pressures on the Federal Budget will thus emerge well before 2042.”³

One reform that holds considerable promise is PRAs. Under this reform, workers would have the option of diverting a portion of their payroll tax into their own PRA, much like a private 401(k). The funds in these accounts would be invested in portfolios including equities and bonds which offer better returns than the current Social Security system. In exchange for using these accounts, part of the return on the investment would be used to cover the deficit in Social Security.

The Institute study examines what PRAs would yield for various income levels of union households, aged 25 and 35, in Iowa. The accounts were invested in both funds from Fidelity, a well-respected investment firm, and the Thrift Savings Plan, the retirement program for Federal employees. Three different types of personal accounts were considered.⁴ The results from the 4% Plan, modeled on Plan II of the President’s Commission to Strengthen Social Security, are presented here. The results for a low income household, \$9,000 annual earnings, and the median household, \$37,950 annual earnings, are displayed in Tables 1 and 2, below. The return on the accounts is compared to both the promised benefits from Social Security and the payable benefits.⁵

Table 1 shows how union households in Iowa would do with PRAs invested in Fidelity funds. Only the Spartan Florida fund for a 35-year-old household earning \$9,000 yields less than the promised benefits

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600 North Jackson Street

Mt. Pleasant, Iowa 52641-1328

Phone: 319-385-3462 Fax: 319-385-3799

E-Mail: public.interest.institute@limitedgovernment.org Web Site: www.limitedgovernment.org

under Social Security. All of the funds yield more than the payable benefits. For all households listed in Table 1, the PRAs yield an average of \$1,121 more than promised benefits and \$1,329 more than payable benefits.

Age	Income in 2003	Monthly Benefit for:						
		Promised Social Security	Payable Social Security	Contrafund	Dividend Growth	Spartan Florida	Diversified International	Fidelity Fifty
25	\$9,000	\$366	\$267	\$1,060	\$1,010	\$370	\$1,226	\$1,036
25	\$37,950	\$1,099	\$802	\$4,152	\$3,942	\$1,241	\$4,861	\$4,054
35	\$9,000	\$385	\$281	\$624	\$611	\$332	\$659	\$616
35	\$37,950	\$1,226	\$895	\$2,636	\$2,578	\$1,405	\$2,784	\$2,600

Table 2 shows how the same households fare with PRAs invested in Thrift Savings Plan funds. Here the I Fund does not yield as much as promised benefits, but does outperform payable benefits. And with the exception of the G, I, and F Funds for the 35-year-old household making \$9,000 annually, PRAs invested in the other funds yield more than promised benefits. For all households listed in Table 2, the accounts yield an average of \$339 more than promised benefits and \$546 more than expected benefits.

Age	Income in 2003	Monthly Benefit for:						
		Promised Social Security	Payable Social Security	C Fund	F Fund	G Fund	I Fund	S Fund
25	\$9,000	\$366	\$267	\$935	\$446	\$395	\$299	\$625
25	\$37,950	\$1,099	\$802	\$3,626	\$1,566	\$1,349	\$1,093	\$2,288
35	\$9,000	\$385	\$281	\$596	\$366	\$347	\$328	\$468
35	\$37,950	\$1,226	\$895	\$2,224	\$1,253	\$1,174	\$1,094	\$1,682

Unless Social Security is reformed, future generations are likely to face large tax increases, large benefit cuts, or a combination of both. Personal retirement accounts are one reform that can yield greater benefits and offers a solution to the impending crisis. As the new study from PII demonstrates, union households in Iowa are one group who would fare better under a reformed system.

ENDNOTES:

¹For a copy of the Policy Study "Social Security Reform and Union Households in Iowa," contact PII or visit our website at <<http://www.limitedgovernment.org/>>

²The Board of Trustees, "The 2003 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds," U.S. Government Printing Office, March 17, 2003, p.8.

³Ibid.

⁴The 4% Plan used in the study permits a worker to invest 4% of payroll, up to \$1,000 into a PRA. In exchange, traditional Social Security benefits are offset based on a 2% return to the personal account. The other two plans examined were a 2.5% plan that allows a worker to invest 2.5% of his payroll in a PRA, and a 3%-Bond Plan that permits a worker to invest 3% of payroll plus and additional 2% that must be invested in government bonds into a PRA, up to \$2,100.

⁵Promised benefits are the Social Security benefits that the system *promises* to pay. The expected benefits are based on the Trustees' projection that when the Social Security Trust Fund runs out of bonds in 2042, Social Security will only be able to pay out 73% of benefits. Thus, the expected benefits are simply the promised benefits multiplied by 73%.

David Hogberg is a Research Analyst with Public Interest Institute.

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