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GUARANTEED RETIREMENT ACCOUNTS OFFER RESCUE PLAN FOR FAILING RETIREMENT SECURITY SYSTEM

New approach will avert rising threat of declining living standards and poverty among the elderly

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The continuing erosion of traditional defined-benefit pension plans, in the absence of an adequate alternative, leaves growing numbers of Americans facing a retirement defined by deprivation: rising poverty among the elderly and sinking living standards for middle-class retirees. Without a comprehensive new approach, we are entering a period marked by a significant decline in elderly Americans' standard of living, even as living standards rise for prime-age workers – the first such period since World War II.

A new proposal for Guaranteed Retirement Accounts, released today by the Economic Policy Institute as part of its Agenda for Shared Prosperity, offers such a plan. Developed by retirement security expert Teresa Ghilarducci, this proposal would provide a guaranteed supplement to Social Security that is reliable, affordable, and both actuarially and economically sound. The new accounts would correct the distortions and inequities that have multiplied in the shift from defined-benefit pension to defined-contribution plans like 401(k)s, a shift that has exacerbated the growth of retirement insecurity and inequality for most American workers. The details are laid out in Ghilarducci's policy paper: "**Guaranteed Retirement Accounts: Toward retirement income security**."

Guaranteed Retirement Accounts would be administered through the Social Security Administration to take advantage of systems and low administrative costs already in place. In combination with Social Security, this new plan would raise the percentage of pre-retirement income replaced in retirement for the vast majority of workers. For average earners working 40 years--those earning $40,000 at retirement--GRAs would contribute 26% which, added to the 45% from Social Security, would bring retirement income up to over 70% of pre-retirement earnings. Low earners making $20,000, whose Social Security would replace about 63% of that income, would receive an additional 26% from their GRAs, bringing their combined replacement rate to 89% of pre-retirement income.

The program would be funded through payroll deductions of 5%, half from employees and half from employers, with the employee contribution offset through a flat $600 refundable tax credit. Mandatory deductions would continue to the Social Security income cap. Employers with a defined benefit plan at least as good would be exempt. The federal government would guarantee returns of 3% above inflation. If the trustees determine that actual investment returns have been consistently higher than 3% over a number of years, the surplus will be distributed to participants, though a balancing fund will be maintained to ride out periods of low returns. At retirement, workers' accounts would be converted to inflation-indexed annuities to protect people from outliving their savings, the chief cause of today's high poverty among the very elderly.

Ghilarducci describes the current system as a failure, one that rewards years of work not with security but with rising risk. The Guaranteed Retirement Accounts she proposes would, in combination with Social Security, provide a way to assure that the people whose hard work built our nation's economic prosperity continue to share equitably in the benefits of that prosperity once their working years are over.

She shows that the system falls short, in varying degrees, on the ten chief measures of a successful retirement system. Guaranteed Retirement Accounts would improve the overall

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retirement system on every key measure, including income adequacy, fairness to all income levels, retirement age flexibility, reward for work, risk reduction, efficiency, targeting of resources to retirement, portability of benefits, steadiness and predictability of contributions, and benefits to the overall economy.

The growth of retirement insecurity is directly linked to tax policies that favor riskier individual retirement savings that fluctuate with the stock market, and which are overwhelmingly utilized by only the highest earners, over traditional pensions that guarantee a steady, reliable income in retirement. As a policy aimed at improving retirement security, the use of tax incentives to spur greater savings has failed: the $110 billion in tax breaks for 401(k) plans in 2006 went primarily to households in the top tax brackets, who can shift existing savings to take advantage of financial incentives without increasing overall savings. These tax breaks will be converted to flat refundable tax credits for GRA accounts, so the GRA program can be instituted without raising taxes or increasing the federal debt.

If GRAs are meant to supplement Social Security, this raises the twin questions of what to do about the anticipated Social Security shortfall, and whether retirement security can be achieved simply by expanding Social Security rather than creating a new kind of retirement plan, questions addressed in two companion papers also released today.

In "**Protecting Social Security's Beneficiaries: Achieving Balance Without Benefit Cuts**" Nancy Altman shows how Social Security can be brought into close actuarial balance without cutting benefits. Her three proposals retain Social Security's distinctive character, increase its progressivity, maintain benefit levels, have no effect on 94% of workers, and increase the cost of the highest paid six percent of workers only modestly. First, she proposes raising the limit on taxable earnings in order to restore the practice of assessing Social Security contributions on 90% of all covered earnings nationwide. Second, she suggests making permanent the federal estate tax as it will be structured in 2009, and converting it into a dedicated Social Security tax. Finally, she proposes diversifying the Social Security portfolio and investing some of it in stock funds, a change that would permit Social Security to capture the historically higher returns from investment in equities without exposing participants to the risks associated with individual accounts.

In "**Building on Social Security's Success**" Virginia Reno makes the case for expanding Social Security benefits, showing that U.S. seniors have lower replacement rates from Social Security and are more likely to be poor than are seniors in other advanced economies. Benefit cuts already enacted and growing obligations for Medicare cost-sharing mean that seniors will need higher benefits in the future just to maintain replacement rates that retirees have attained for the past 25 years; and the rest of the retirement system is becoming less adequate and is subjecting workers to more risks.

About the Authors:

Teresa Ghilarducci, after 25 years as a professor of economics at the University of Notre Dame, will be the Schwartz Chair in Economic Policy Analysis at the New School for Social Research in January 2008. She holds the 2007-2008 Wurf Fellowship at the Labor and Worklife Project at the Harvard Law School.

Nancy Altman chairs the board of directors of the Pension Rights Center and is author of "The Battle for Social Security: From FDR's Vision to Bush's Gamble."

Virginia Reno is Vice President for Income Security at the National Academy of Social Insurance.