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Implications of the Bush Commission Pension Reforms for Married Couples

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In December 2001 the President's Commission to Strengthen Social Security published a report describing plans to reform Social Security through the introduction of new, privately managed, defined-contribution pension accounts. The new accounts are to be financed by diverting a portion of payroll taxes that are now used to finance pensions under the existing defined-benefit public pension system. This paper evaluates the overall impact of the Commission's second plan on the distribution of retirement income and rates of return on pension contributions within and among future generations of married couples.

The plan will have modest impacts on the distribution of retirement income *within* future generations of retired couples. The plan liberalizes traditional benefits for workers with low but steady lifetime wages, and these workers are thus spared some benefit cuts that would be imposed if all OASDI benefits were cut by a fixed percentage amount. Moreover, the plan reforms surviving spouse benefits in a way that improves many widows' pensions. In addition, that plan places an annual cap on workers' contributions to individual retirement accounts in a way that is more favorable for low- and averagewage workers than it is for high-wage workers. On balance, the reductions in couples' retirement incomes somewhat favor couples with low combined lifetime wages relative to a reform plan that proportionately increases future contributions and reduces future benefits to maintain solvency under a pay-as-you-go rule.

The biggest distributional impact of the Commission's proposals is on the distribution of income *among* generations. Compared with a Social Security reform plan that preserves the existing system through equal tax increases and benefit reductions, a solvent version of the Commission's second plan will favor workers who retire after the new individual retirement system is fully mature, in about 40 years, at the expense of workers who retire before contributing to the new system over a full career. During the accumulation phase of the new system, workers reaching retirement age must accept significantly lo wer traditional pensions if the existing system is to remain solvent, but they will not receive large individual account pensions.

Future retirement income flows will be subject to much greater financial market risk under the Commission's proposals. If workers maintain individual account investment portfolios that have equal proportions of U.S. equities and government bonds, we estimate that the standard deviation of annual pension flows will eventually become very large compared with the expected benefit workers receive under the remaining guaranteed pension program. This significantly increases the likelihood that workers could retire with combined Social Security and individual account pensions that are substantially lower, relative to lifetime wages, than workers have historically received under the existing Social Security program.

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