SUPPLEMENTAL TRANSITION ACCOUNTS FOR RETIREMENT

A Proposal to Increase Retirement Income Security and Reform Social Security

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ABSTRACT

This proposal would establish mandatory add-on savings accounts known as Supplemental Transition Accounts for Retirement (STARTs) that each worker would be required to exhaust before receiving Social Security benefits. STARTs would help workers delay claiming Social Security benefits, thereby mitigating the effects of actuarial reductions for claiming early and potentially allowing workers to gain additional monthly Social Security benefits through the delayed retirement credits.

Both employees and employers would make contributions to workers' STARTs equal to 1 percent of earnings (2 percent combined contribution) up to the annual maximum amount of earnings subject to Social Security payroll tax. The federal government also would make progressive contributions of up to 1 percent of earnings to the STARTs of low-income workers. Over time, the government contributions would be fully financed with revenues generated from applying current-law income taxes to START withdrawals. START assets would be professionally managed in a pooled account with an emphasis on keeping administrative fees as low as possible. An independent board would serve as the fiduciary and set the investment guidelines for the pooled assets. Individuals would not be allowed to select investments.

Beneficiaries could begin to receive monthly START benefits at Social Security's earliest eligibility age but would not be required to do so. The amount of monthly START benefits payable under the proposal would be limited to the Social Security benefits the beneficiary would have received under current-law claiming rules. At full retirement age (age 67 for people born in

START assets would be professionally managed in a pooled account with an emphasis on keeping administrative fees as low as possible.

1960 or after) and up to age 70, beneficiaries could use START assets without restriction (e.g., lump sum). At age 70, account holders with START assets would be required to take a full lump-sum distribution, or roll the balance into a retirement account or a beneficiary's START. Any money remaining in a START at the time of the account owner's death would go to a designated beneficiary.

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INTRODUCTION

Social Security is arguably the most successful federal program in US history. The program has substantially reduced senior poverty, enabled millions of older Americans to live independently, and provided vital support to families who lose income because a loved one dies or becomes too ill or injured to work. With rising life expectancy and the shift away from traditional pension plans, Social Security's inflation-protected lifelong benefits are likely to become increasingly important for old-age economic security in the decades ahead.

Despite Social Security's successes, the program could do more to improve the financial health of older Americans by facilitating the delayed claiming of benefits. For individuals who are between the ages of 62 and 70, monthly Social Security benefits increase by about 7 percent to 8 percent for each one-year delay in claiming, holding work history constant. This increase is reflected in higher monthly benefits over the life of the beneficiary. Monthly benefits may increase further to the extent that delayed claiming leads to longer working lives. Delayed claiming can also result in higher benefits for surviving spouses.

In this paper, we propose Supplemental Transition Accounts for Retirement (STARTs) to serve as a bridge to receiving Social Security benefits. STARTs would be mandatory add-on savings accounts funded by employees, employers, and a progressive government contribution. STARTs would be fully integrated into the Social Security program. Every individual with a START would be required to exhaust that account's assets before receiving retired worker benefits, or age-based spousal or survivor benefits (special rules would apply to workers receiving disability benefits). For many people, STARTs will serve to raise the age at which Social Security benefits are

first paid. Thus, our proposal reduces the total actuarial reduction or increases the delayed retirement credits that would apply, resulting in higher monthly benefits over the life of the beneficiary.

This proposal builds on Social Security's comparative advantage to mitigate the key factors that undermine economic security at older ages: longevity risk, market risk, and inflation risk.

The Urban Institute, using its microsimulation model DYNASIM (Dynamic Simulation of Income Model), estimates that by 2065 this innovation would increase per capita net cash income, on average, by 4.4–6.7 percent for people ages 62 and older (with the median increase between 8.2 percent and 10.3 percent). The range of estimates reflects different assumptions about whether participants would reduce other retirement plan contributions in response to START. People ages 62 and older in the lowest lifetime earnings quintile would see the biggest percentage increase in income—on average, about 10 percent (with a median increase of about 15 percent)—and the highest lifetime earnings quintile would see the smallest increase—on average, 1.7–4.9 percent (with the median increase between 2.5 percent and 6.1 percent). Those increases in income are achieved while reducing Social Security's 75-year actuarial deficit by about 12 percent, based on the Urban Institute's modeling assumptions, which use data from the 2015 Social Security Trustees Report.

Importantly, this innovation would increase monthly benefits without affecting beneficiaries' expected actuarial lifetime Social Security benefits or limiting their access to essential income at early retirement ages. This proposal builds on Social Security's comparative advantage to mitigate the key factors that undermine economic security at older ages: longevity risk, market risk, and inflation risk.

ADEQUACY OF SOCIAL SECURITY BENEFITS

Researchers have long recognized the role Social Security benefits play in a secure retirement.[1] Social Security retirement benefits provide income security for tens of millions of Americans. In 2014, 85 percent of married couples and 84 percent of non-married people age 65 or older received Social Security benefits. About 61 percent of all aged beneficiary units[2] rely on Social Security for 50 percent or more of their income, and 33 percent rely on Social Security for 90 percent or more of their income (US Social Security Administration, 2016a). Not surprisingly, reliance on Social Security benefits increases with age. Research using the Current Population Survey shows that while 33 percent of people ages 65 to 69 rely on Social Security for 50 percent or more of their family income, that number climbs to almost 56 percent for those ages 80 and above (Shelton, 2016). Social Security was never designed to be the only source of income people would receive in retirement; for an average worker, Social Security replaces about 40 percent of annual preretirement earnings, with additional income coming from an employer-provided pension and personal savings.

Social Security's full retirement age (FRA), currently 66 and 2 months, is in the process of rising from age 65 and will reach age 67 for people born in 1960 or later.[3] With that increase, the total actuarial reductions for claiming Social Security benefits early at a given age are increasing, and the program's replacement rates are falling. That is, raising the full retirement age results in a reduction in annual and lifetime benefits—about a 6 percent to 7 percent decrease for each one-year increase in the FRA. Over the period that the FRA is increasing, average longevity is also expected to rise. Increases in average longevity result in greater lifetime benefits, holding annual benefits constant. The actuarial reductions are designed so that

1 For a summary of research work on this area, see Burkhauser, Gustman, Laitner, Mitchell, and Sonnega (2009).

2 An aged unit is either a married couple living together or a non-married person, which also includes persons who are separated or married but not living together. A married couple's age is defined as the age of the husband—unless he is under age 55 and the wife is 55 or older, in which case it is the age of the wife. The example in the paper refers to aged units that are 65 years of age or older. In this case, the age of the married couple is the age of the husband if he is 65 or older; if the husband is younger than 55 and the wife is age 65 or older, the age of the married couple is the age of the wife. Social Security Administration, https://www.ssa.gov/policy/docs/chartbooks/income_aged/2014/iac14.html#definitions, accessed on January 9, 2018.

3 Social Security Administration, https://www.ssa.gov/planners/retire/retirechart.html, accessed January 9, 2018.

lifetime benefits, on average, are roughly the same regardless of the age at which a person claims benefits. The total reduction, however, often results in a monthly benefit that is inadequate, especially for those who live to or beyond the average life expectancy. Raising the FRA further—a possible component of any future Social Security reform effort—will only make a bad situation worse for many by increasing the actuarial reductions and, therefore, further reducing the monthly benefit amount received relative to current law if claiming Social Security retirement benefits early.

Roughly one in two new beneficiaries who first claimed retirement benefits in 2014 were age 62, the earliest eligibility age.[4] More than two-thirds were younger than the FRA. One way to increase the adequacy of Social Security benefits (and income for rising life spans) is by having people delay claiming retirement benefits. For individuals who are between ages 62 and 70, monthly Social Security benefits increase by about 7 percent to 8 percent for each one-year delay in claiming (**see table 1**).

For example, consider someone who turns age 62 in 2022 and whose current full retirement age is 67. Assume that person would be eligible for a $1,300 monthly benefit at the FRA. Delaying claiming until age 70 results in a 24 percent higher monthly benefit, or $1,612 per month, while claiming at age 62 would result in a monthly benefit of only $910, or 30 percent less. Note that delaying claiming until age 70 instead of claiming at age 62 results in a monthly benefit amount that is 77 percent greater.[5]

STARTs could complement efforts to educate people about the benefits of delaying claiming, but education efforts alone may have limited success. Many people cannot afford to delay. Others may be reluctant to give up current income for what they perceive as a small increase in their lifetime monthly benefit.

Because Social Security benefits act as inflation-protected annuities, those who delay claiming are essentially purchasing an additional inflation-protected annuity benefit. In the private sector, companies that sell annuities generally adjust their payouts and make them less generous when life spans increase or when interest rates decrease, in order to maintain the lifetime value of annuity payouts. In contrast, Social Security doesn't adjust monthly benefits this way—its benefit formula and age adjustments are fixed by law. As longevity increases, on average, and interest rates fall, the lifetime value of

4 Authors' calculation based on table 6.B5 of the Annual Statistical Supplement to the Social Security Bulletin (US Social Security Administration, 2016b). The percentages exclude disability conversions at the FRA.

5 The US Social Security Administration's publication *When to Start Receiving Retirement Benefits* (2017) provides consumers with information about the factors they should consider when deciding when to receive retirement benefits and how monthly benefits change the longer a person waits to claim benefits.

TABLE 1. Percentage Increase in Social Security Retirement Benefits by Claim Age*

Claim Age	Monthly Benefit as Percentage of Full Retirement Age (67) Benefit	Increase in Monthly Benefit from One-Year Delay	Cumulative Increase Compared to Claiming at Age 62
62	70%		
63	75%	7.1%	7.1%
64	80%	6.7%	14.3%
65	86.67%	8.3%	23.8%
66	93.33%	7.7%	33.3%
67	100%	7.1%	42.9%
68	108%	8.0%	54.3%
69	116%	7.4%	65.7%
70	124%	6.9%	77.1%

* Full retirement age for this example is 67; assumes annual earnings at age 62 and after are not large enough to change benefit amount (i.e., the earnings are not among the worker's 35 highest annual earnings).

Source: Social Security Administration, https://www.ssa.gov/OACT/quickcalc/early_late.html, accessed January 9, 2018.

benefits for any given claim age increases as well. This also means that if life spans continue to increase and the economy continues to exhibit a sustained period of low interest rates, then delaying the initial Social Security claim will become more financially valuable over time. The START program would encourage individuals to take advantage of this provision.

Further, the continued movement away from defined-benefit plans to defined-contribution plans, by both private- and public-sector employers, has shifted much of the burden and risk of paying for retirement onto the individual, increasing the relative importance of monthly Social Security benefits in retirement.

BARRIERS TO WORKERS DELAYING SOCIAL SECURITY RETIREMENT BENEFITS

Research published by AARP's Public Policy Institute used the Health and Retirement Study to analyze those who claimed Social Security benefits at age 62 and those who claimed later. Those claiming benefits at age 62 were found to have lower earnings and be less educated, more likely to work in physically demanding jobs, and, importantly, likely to be less healthy (Li, Hurd, and Loughran, 2008). According to the research, one in five (19 percent) early claimers reported they had a work-limiting condition at the time of claiming early Social Security retirement benefits.

Working longer may not be realistic or desirable for all members of society, and this possibility merits careful consideration when it comes to reforming the US retirement income system.

Research published by the University of Michigan Retirement Research Center finds evidence that those with physically demanding jobs face many challenges and barriers to extending their working careers (Neumark and Song, 2012). Further, workers who develop cognitive impairment in their later working years may face significant barriers to working throughout their 60s. A Boston Retirement Research Center report, referencing data by the Alzheimer's Association, states that "over half the cases of mild impairment progress to dementia, which erodes all cognitive functions irreversibly." While the incidence of Alzheimer's disease (the most common type of dementia) in one's 50s and early 60s is low—less than 4 percent of people under age 65—it rises to 15 percent of 65- to 74-year-olds (Belbase and Sanzenbacher, 2016).

Additional research by the Boston College Retirement Research Center notes that the bottom third of the income distribution—those who tend to have lower employment skills and higher levels of unemployment as they approach retirement—face significant barriers to working later in life and extending work past normal retirement age (Munnell, Sanzenbacher, and Sass, 2009). As the authors note, "The bottom line is that working longer may not be realistic or desirable for all members of society, and this possibility merits careful consideration when it comes to reforming the US retirement income system."

The retirement landscape is changing, and the likely reality is that people will need to save more and work longer, either retiring later or working for pay during retirement. Any barrier to extending one's working career will likely create additional financial stress on the ability to save for and have enough financial resources in retirement. Retirement policy reforms that increase the ability of workers to delay claiming Social Security benefits, thereby mitigating the effects of actuarial reductions for claiming early and potentially allowing workers to gain additional monthly Social Security benefits through the delayed retirement credits, would increase the financial security of millions of Americans in retirement.

SOLUTION: SUPPLEMENTAL TRANSITION ACCOUNTS FOR RETIREMENT

The goal of STARTs is to allow a delay in claiming of Social Security benefits for about two to three years from the date the worker would have otherwise claimed benefits. This delay increases monthly Social Security benefits by between 14 and 25 percent, depending on the original claim age. Importantly, we achieve an increase in monthly Social Security benefits without limiting access to essential income at early retirement ages.

In essence, the proposal increases the early eligibility age for Social Security retired worker benefits, spousal benefits, and widow(er) benefits to mitigate the impact of actuarial reductions and to increase monthly benefits, which will help future retirees finance consumption over an increasing life span. But by the proposal's design, the increase in the early eligibility age is flexible, depending on the amount of assets a person has in his or her START.

Our proposal also helps workers receiving Social Security Disability Insurance (SSDI), whose benefits are not subject to actuarial reductions or delayed retirement credits (DRC). While the rules governing STARTs are generally similar for SSDI beneficiaries as for other beneficiaries, there are some important differences. First, we adjust the benefits of an SSDI beneficiary up by an actuarially fair factor to reflect the time period that START assets were used instead of SSDI trust fund assets. Second, we allow an SSDI beneficiary with a severe medical condition that meets any of the conditions set forth in the Social Security Administration's Compassionate Allowances program to take a lump-sum distribution from her START regardless of age.[6] The special rules for SSDI beneficiaries are discussed in more detail below.

STARTs differ from other mandatory private savings account proposals in some important ways. First, our proposal would not require that assets in the START be used to purchase a private-sector annuity. Rather, our proposal would use the START assets implicitly to purchase additional inflation-protected annuitized income through the Social Security program. As noted above, the annuities provided by higher Social Security

6 For a full listing of the Social Security Administration's compassionate allowances conditions, see Social Security Administration, https://www.ssa.gov/compassionateallowances/conditions.htm, accessed on January 9, 2018.

benefits are superior to those offered by the private sector in several ways. Second, we do not reduce Social Security benefits for money distributed from the account. Our focus is on improving benefit adequacy for rising life spans, not on solvency, although our proposal does modestly reduce the long-term funding shortfall in Social Security.

Policy makers should make changes to Social Security to address the program's 75-year financing deficit. We believe, however, that any adjustment to Social Security benefits to achieve solvency should not be related to START assets so as not to reduce public support for START or to penalize those with higher START assets.

FUNDING

START contributions would be required for all workers with taxable earnings covered under Social Security who have not reached their FRA. Required contributions would not apply to earnings beginning on January 1 in the year the worker achieves the FRA. We would not impose a minimum age requirement, so as to enable younger workers to take full advantage of compounding of interest and earnings.

Both worker and employer would contribute 1 percent of earnings (2 percent combined), up to the annual maximum subject to Social Security payroll tax ($127,500 in 2017), to the worker's START. A self-employed individual would make required contributions as both employer and employee.[7]

The Social Security Administration (SSA) would enroll all Social Security–covered workers in START. START contributions would be collected in the same way and under the same schedule as payroll taxes. In the case of an employee, the worker's employer would forward the employer and employee contributions with other payroll taxes. Self-employed workers would also submit START contributions with their payroll taxes. This typically occurs through quarterly estimated tax payments and is reconciled on the tax return.

Both worker and employer would contribute 1 percent of earnings (2 percent combined), up to the annual maximum subject to Social Security payroll tax ($127,500 in 2017), to the worker's START.

The tax character of START contributions will be the same as Social Security payroll taxes. Employer contributions are pretax, while worker contributions are after-tax. The self-employed will be allowed to deduct half of their START contributions from

7 Contributions made on earnings in excess of the taxable maximum ($127,500 in 2017) will be treated in the same way as Social Security payroll taxes. The employee portion of the overpayment will be refunded to workers through their tax returns. The employer portion is not refunded, and this amount will be credited to the Social Security trust funds.

taxable income, identical to the way the self-employed treat payroll taxes today.[8]

The federal government would contribute to the STARTs of low-income workers. The maximum government contribution would be 1 percent of earnings for married couples filing jointly with adjusted gross income (AGI) less than $40,000, single filers with an AGI less than $20,000, and head of household (HOH) filers with an AGI less than $30,000. The government contribution would be phased out over an AGI range of $10,000, $7,500, and $5,000 for joint filers, HOH filers, and single filers, respectively. For example, the government contributions for joint filers with AGI of $42,500 would be 0.75 percent and with an AGI of $45,000 would be 0.5 percent. Workers in low-income households would receive a total START contribution of up to 3 percent of earnings. The government contribution would be treated like an employer contribution and would not be included in current taxable income.

The progressive government contribution is needed to replicate the progressive structure of the Social Security benefit formula. As shown in **table 2**, Social Security replaces a higher percentage of career-average earnings of low lifetime earners than of high lifetime earners. Because distributions from START assets will equal the Social Security benefits that would have otherwise been paid, lower earners need higher START assets as a percentage of their earnings than do higher earners to "buy" an equivalent amount of delay. For example, low-earning workers who turn 62 in 2022 need START assets equal to 40.7 percent of their career average earnings to "buy" one year of delay, compared with START assets of 30.2 percent of career average earnings for medium earners.

For married couples, total contributions (employer, employee, and government) to each spouse's START would be split equally between the spouses based on the married couple's combined earnings (what we refer to as *deposit splitting*). Deposit splitting would occur regardless of whether the spouse had Social Security taxable earnings. We take this approach because women are more likely than men

TABLE 2. Social Security as a Percentage of Career Average Earnings, Age 62 in 2022

Career Average Earnings	Replacement Rate
Very Low Earnings ($11,922)	56.1%
Low Earnings ($21,459)	40.7%
Medium Earnings ($47,687)	30.2%
High Earnings ($76,299)	25.0%
Steady Max Earnings ($116,123)	19.8%

Source: Social Security Administration, https://www.ssa.gov/oact/NOTES/ran9/an2016-9.pdf.

8 Allowing the self-employed to deduct half of their START contributions from taxable income provides for similar treatment as employees who do not include their employers' START contributions in taxable income.

to have years without earnings, often as a result of caregiving responsibilities. Further, the additional annuitized income that comes from delayed claiming is particularly important for women, who on average live longer than men and rely on Social Security for a higher percentage of income. Finally, this approach makes administering the accounts easier because there is no need to split the assets at divorce or retirement.[9]

DISTRIBUTIONS

Prior to the full retirement age, START assets must be distributed and exhausted before an individual could receive Social Security benefits that are subject to actuarial reductions if claimed before the FRA. Social Security benefits that meet these conditions include retired worker benefits and spousal benefits of a retired or disabled worker, which a person can claim as early as age 62, and survivor benefits of an aged widow or widower, which a person can claim as early as age 60.[10]

An individual could elect to first receive START benefits at the earliest age of eligibility but would not be required to do so.[11] The amount that any individual could withdraw in a given year would be limited to the Social Security benefit payable under today's Social Security rules.[12] The annual cost-of-living-adjustment applicable to Social Security benefits would also apply to START benefits once distributions from the accounts begin.

Social Security benefits would begin once beneficiaries exhaust their START assets or reach the FRA and elect to stop receiving START distributions. The Social Security benefit would be subject to actuarial reductions and delayed retirement credits, if applicable, as under current law. Individuals could access START assets without restrictions and without any effect on Social Security benefits beginning at the FRA and until age 70; this would include taking the full amount of START assets as a lump-sum distribution. At age 70, beneficiaries would be required to liquidate the accounts either by taking a full lump-sum distribution, or rolling the assets into a qualified plan or Individual Retirement Account (IRA) or a beneficiary's START.

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9 Note, this approach means that spouses working in uncovered employment (e.g., certain state and local government workers not covered under Social Security) will have contributions made to a START in their name.

10 For a description of the types of Social Security benefits, see Social Security Administration, https://www.ssa.gov/oact/progdata/types.html, accessed January 9, 2018.

11 START distributions are treated like Social Security income for eligibility and benefit amounts under the Supplemental Security Income (SSI) program—that is, these distributions are included as unearned income for SSI determination but excluded from the SSI asset test. The SSI is a federal means-tested program that provides cash assistance to people with little or no income who are ages 65 and older, are blind, or have a disability.

12 If a worker does not qualify for Social Security, he or she would still have access to START assets without restriction, beginning at age 62.

Consider the example of someone whose FRA is 67 but decides to claim benefits at age 62. If her monthly benefit at FRA was $1,300, her monthly benefit at age 62 would be $910. Under our proposal, the SSA would pay $910 per month funded from her START assets beginning at age 62. Once the SSA distributes all of the START assets, it would begin paying Social Security benefits. If the START assets were sufficient to cover just two years of delayed claiming, the SSA would pay this beneficiary $1,040 per month in Social Security benefits, or a benefit that is 14 percent higher.

Any START assets remaining at the time of the account owner's death would go to her designated beneficiaries. These assets could be transferred to the beneficiary's START or paid directly as a lump-sum distribution. A lump-sum distribution would be included in the beneficiary's taxable income. Assets transferred to a START, however, would become taxable only when the beneficiary began taking distributions. The tax character of START assets (pretax and after-tax) would transfer from the original account holder to the beneficiary.

SPECIAL RULES FOR WORKERS WHO QUALIFY FOR SOCIAL SECURITY DISABILITY INSURANCE

Social Security disability benefits are not subject to actuarial reductions or DRCs, so workers who become disabled get no benefit from a delay in claiming. Nonetheless, our goal for START is to increase economic security at older ages for all workers through the Social Security system. Consistent with this goal, we would apply similar START rules to SSDI beneficiaries as those that would apply to retired workers, with two important exceptions. First we discuss the similarities.

Like retired workers, SSDI beneficiaries would have unrestricted access to their START assets beginning at their FRA. Also like retired workers, SSDI beneficiaries who apply for and receive disability benefits between ages 62 and the FRA would be required to first exhaust their START assets before receiving Social Security payments from the SSDI trust fund.[13] We take this approach to ensure that our proposal does not change the relative value of claiming disability benefits compared to retired worker benefits between ages 62 and FRA.[14]

After a beneficiary exhausts her START assets or reaches FRA and elects to stop receiving START distributions, the SSA would begin paying monthly benefits that

13 The payments may not come directly from the START; rather, the Social Security Administration could continue to pay benefits from the SSDI trust fund and then later be reimbursed from the worker's START assets.

14 Due to the actuarial reduction factors associated with early claiming of Social Security retirement benefits, there exists a perverse financial incentive to apply for disability benefits before the FRA because SSDI benefits are not subject to actuarial reductions for age. Proposals that would increase the FRA would increase this perverse incentive. For a more detailed discussion, see Fichtner and Seligman (2016, 140).

reflect actuarially fair credits for the time the beneficiary received START assets instead of Social Security.[15] SSA will need to determine the actuarially fair credit, which provides that benefits paid over the life of the beneficiary, on average, are about the same regardless of whether a person's SSDI benefits had been suspended and temporarily replaced with START assets. For purposes of modeling the distributional effects of this proposal, we asked the Urban Institute to use the delayed retirement credit—that is, two-thirds of 1 percent for each month delay, or 8 percent annually—to adjust SSDI benefits.[16]

Because of the unique circumstances of workers with a disability, we allow them greater flexibility accessing their START assets than we do retired workers. First, an SSDI beneficiary who has a condition on the Compassionate Allowance list will have unrestricted access to his START assets regardless of age. The SSA's compassionate allowance program identifies diseases and serious medical conditions that clearly meet Social Security's definition of disability and allow for an expedited approval process. The SSA adds new conditions to the list annually. We take this approach to balance the need for financial resources that often accompanies a serious disability against the underlying goal of our proposal to improve financial security at older ages. Second, SSDI beneficiaries who are in pay status when they turn 62 can elect to use their START assets to "purchase" additional Social Security annuity income, but they would not be required to do so.

An SSDI beneficiary who has a condition on the Compassionate Allowance list will have unrestricted access to his START assets regardless of age.

Consider the example of a beneficiary who first receives SSDI at age 59 equal to $1,000 per month. Let's assume $24,000 in START assets at age 62. Beginning at age 62, the beneficiary could elect to receive the $1,000 monthly payment from START assets instead of Social Security. The START assets would replace two years of SSDI payments. Beginning at age 64, this person would receive SSDI benefits again, but the payment after adjusting for inflation would be $1,160, or 16 percent higher, to reflect the actuarially fair credit (for this example, we used the DRC).

ACCOUNT STRUCTURE AND ADMINISTRATIVE CONSIDERATIONS

STARTs would be professionally managed in a pooled account with an emphasis on keeping administrative fees as low as possible. An independent board would

15 Under current law, the SSA converts SSDI beneficiaries to OASI (Old-Age and Survivors Insurance) at FRA. This conversation has no implications for the benefits received by the beneficiary, but it does change the trust fund from which benefits are paid from the SSDI trust fund to the OASI trust fund.

16 Our intention is to have the SSA determine an actuarial fair rate based on life expectancy of SSDI beneficiaries. One possibility would be to use the DRC rate of 8 percent or the rates associated with the actuarial reductions for claiming early.

serve as the fiduciary. The board would select the private investment firm(s) responsible for managing START assets and set the investment guidelines for the pooled assets.[17] Individuals would not be allowed to select investments.

We expect the investment guidelines to structure the accounts at the participant level like target date funds. The independent board would set the glide path to manage longevity and market risks as well as provide guidance on allocations across and within investment classes. The board could elect to use the Federal Thrift Savings Plan (TSP) target date funds as a model. For purposes of the dynamic simulations discussed below, we used the TSP's target date funds as the investment for START assets.

Because STARTs are integrated with Social Security, the SSA can take advantage of existing systems and benefit from economies of scale in administrating these accounts.[18] The SSA's tasks would include maintaining account records, such as tracking individual account balances and transactions, communicating with participants, and answering their questions. More generally, the SSA would be responsible for educating participants about how STARTs work and interact with the Social Security program. We recognize that this is a significant undertaking for the SSA, and the agency would require additional funding to carry out these new responsibilities; such costs could ultimately be funded by a small administrative fee on the START assets.

TAX TREATMENT OF START DISTRIBUTIONS

Distributions from STARTs, including amounts rolled into a qualified plan or IRA, would be included in taxable income to the extent they represent pretax contributions and earnings. Revenue from taxing START distributions would be credited to the Social Security trust funds, and it is more than adequate to cover the 75-year cost of the government contributions.

17 The board could choose to distribute participant's assets across multiple fund managers to mitigate against the risk that participants' asset returns will vary by fund manager.

18 For a full discussion of administrative and record-keeping issues associated with individual accounts related to Social Security, see Whitman (2006).

DISCUSSION AND OVERVIEW OF THE DYNASIM ANALYSIS

This section provides a discussion and highlights results from DYNASIM, the Urban Institute's dynamic microsimulation model. The model projects income and assets through the year 2087 by age, gender, race and ethnicity, income, earnings, education, and a number of other characteristics. DYNASIM is well suited to model the changes in income and assets from START, which is highly dependent on the asset value of the accounts at older ages—a process that will take many years.

The Urban Institute ran four sets of START simulations that reflect two assumptions regarding benefit levels (scheduled benefits and payable benefits) and two assumptions on the effect of START on participants' contributions to employer-provided defined-contribution plans (no offset and dollar-for-dollar offset). The scheduled benefit baseline assumes that current-law Social Security benefits will continue to be paid in full even after the Social Security trust funds are exhausted. The payable benefits baseline assumes that once the Social Security trust funds are exhausted, the amount payable will be limited to current revenue coming into the system (mainly via payroll taxes). The two sets of assumptions regarding benefit levels and offsets to other saving are intended to represent extremes, so that the four scenarios bound the range of plausible outcomes.

Each simulation projects the distributional effects of START for the years 2025, 2035, 2045, 2055, and 2065. The Urban Institute did not model any change in labor force participation.

Below, we detail the effects of our proposal on poverty and income. First, we make some general observations from the simulations:

- STARTs would raise the income of the lowest lifetime earners the most. Mean and median increases in net per capita cash income for this group are about 10 and 15 percent, respectively, in 2065. Not surprisingly, the effect increases substantially over time as the accounts receive more contributions and the assets grow.

- The proposal is fully funded by employee and employer contributions and by crediting the Social Security trust funds with the revenue from taxing START

distributions. The last item more than offsets the cost of the government contributions—thereby reducing Social Security's 75-year actuarial deficit by about 12 percent, based on the Urban Institute's modeling assumptions using data from the 2015 *Social Security Trustees Report*.

- The overall average increase in net per capita income depends on whether workers reduce their other retirement saving in response to START contributions. However, the different overall results are driven by higher-income households that are much more likely than lower-income households to be making contributions to an existing retirement plan. The change in average income for low-income households and overall poverty rates are almost identical under the assumptions regarding saving behavior.

According to the Urban Institute's modeling, STARTs would reduce poverty by less and raise income by less for people ages 80 and older than for those ages 70 to 79.

- According to the Urban Institute's modeling, STARTs would reduce poverty by less and raise income by less for people ages 80 and older than for those ages 70 to 79. This is a transition issue: older participants in 2065 would have had fewer years to accumulate assets in STARTs. Someone age 85 in 2065 who left the labor force at age 65 in 2045, for example, would have had only about 26 years to contribute to his START (contributions could be made from 2019 until 2045). By comparison, a 75-year old in 2065 who retired at age 65 would have contributed for 36 years (2019 through 2055). It is important to note that this transition issue decreases the overall estimated effects of STARTs on poverty and net per capita income in the year 2065, as well as the estimated effects by category, such as earnings and marital status.

POVERTY

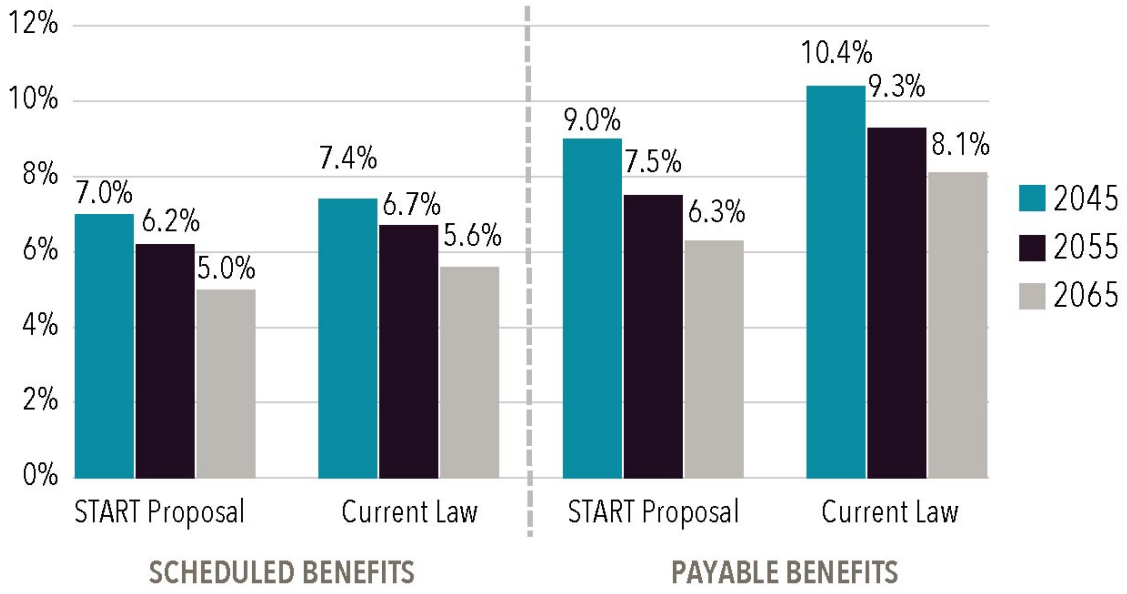
START would reduce poverty significantly for people ages 62 and over (**see figure 1**). The reduction is due to the increased monthly Social Security benefit people would receive from a delay in claiming.

Under the scheduled benefit scenario, STARTs would reduce poverty for people ages 62 and over from 7.4 percent to 7 percent in 2045, and from 5.6 percent to 5 percent in 2065.

STARTs would reduce poverty by even more under the payable benefits scenario. For people ages 62 and over, poverty would fall from 10.4 percent to 9 percent in 2045 and from 8.1 percent to 6.3 percent in 2065.

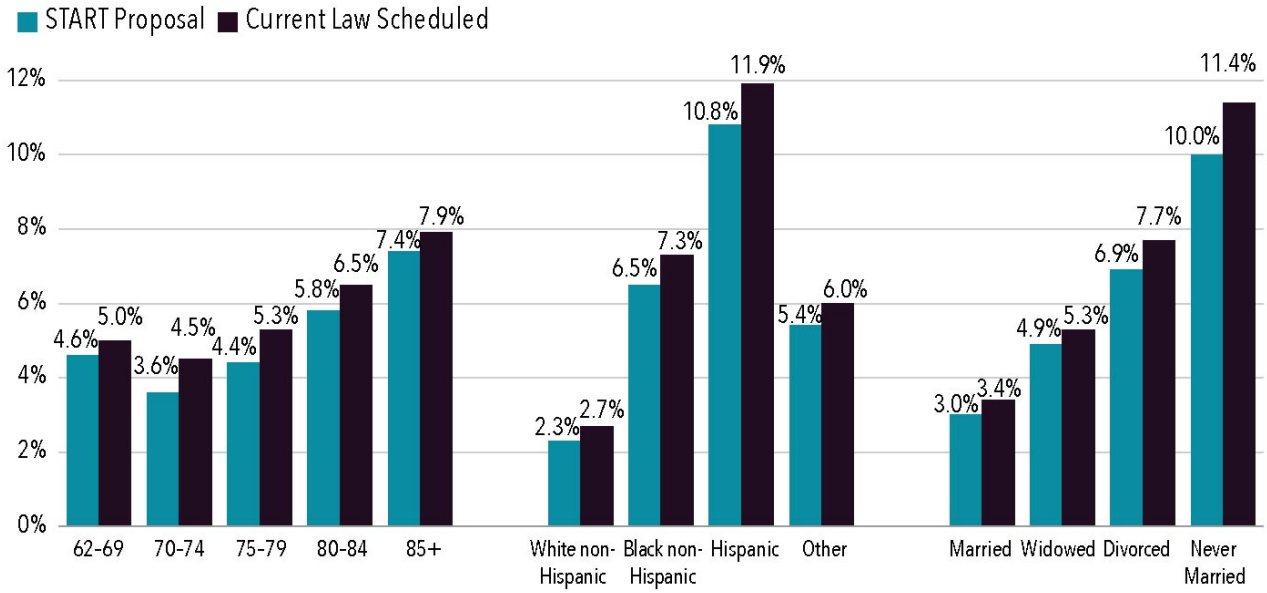
Focusing on estimates for 2065 under the scheduled benefit scenario, STARTs reduce poverty rates in all age groups ages 62 and over, all racial categories, and all marital status categories (**see figure 2**).

FIGURE 1. Poverty Rates for People Ages 62+ in Select Years



Source: Urban Institute analysis of START proposal using DYNASIM.

FIGURE 2. Poverty Rates for People 62+ by Selected Characteristics, 2065



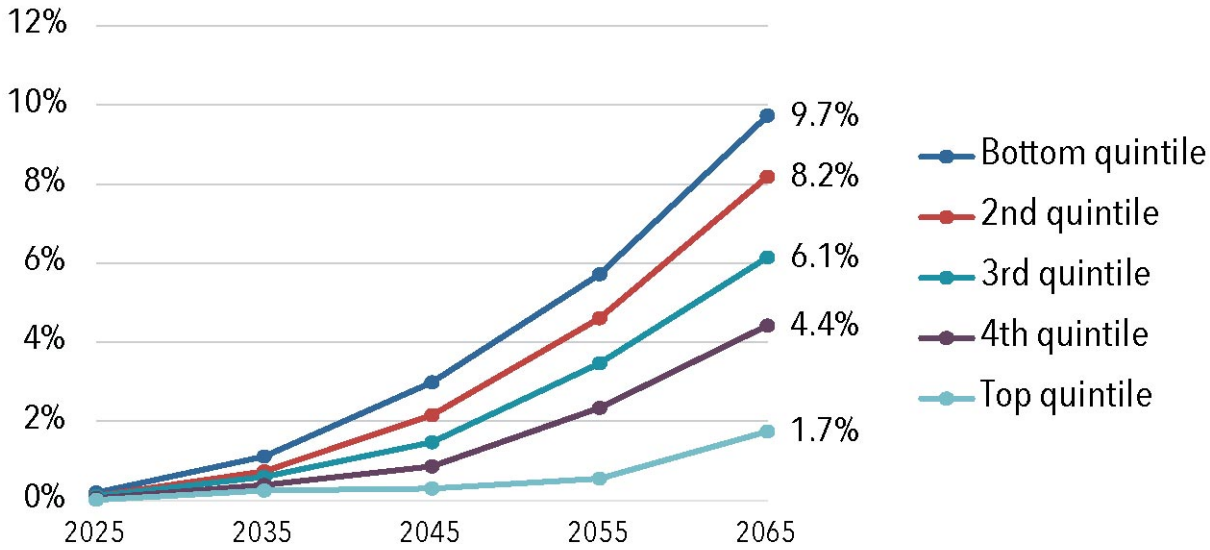
Source: Urban Institute analysis of START proposal using DYNASIM.

INCOME

STARTs would raise net per capita cash income considerably among people ages 62 and over.[19] Assuming there is full offset of START contributions with reductions to saving in other employer-provided retirement accounts, average household income in 2065 would still rise in each quintile, with the lowest lifetime earnings quintile exhibiting the greatest proportional increase: 9.7 percent (**see figure 3a**). The proportionally bigger increase in income for low lifetime earners likely reflects their greater reliance on Social Security income. Higher earners are more likely to have other sources of retirement income than Social Security, so a 10 percent increase in that group's Social Security benefits, for example, will represent a smaller percentage increase in net cash income than it will for low earners, whose only source of income may be Social Security.

Figure 3b shows similar data as **figure3a**, but here we assume that there is no reduction in private saving as a result of START

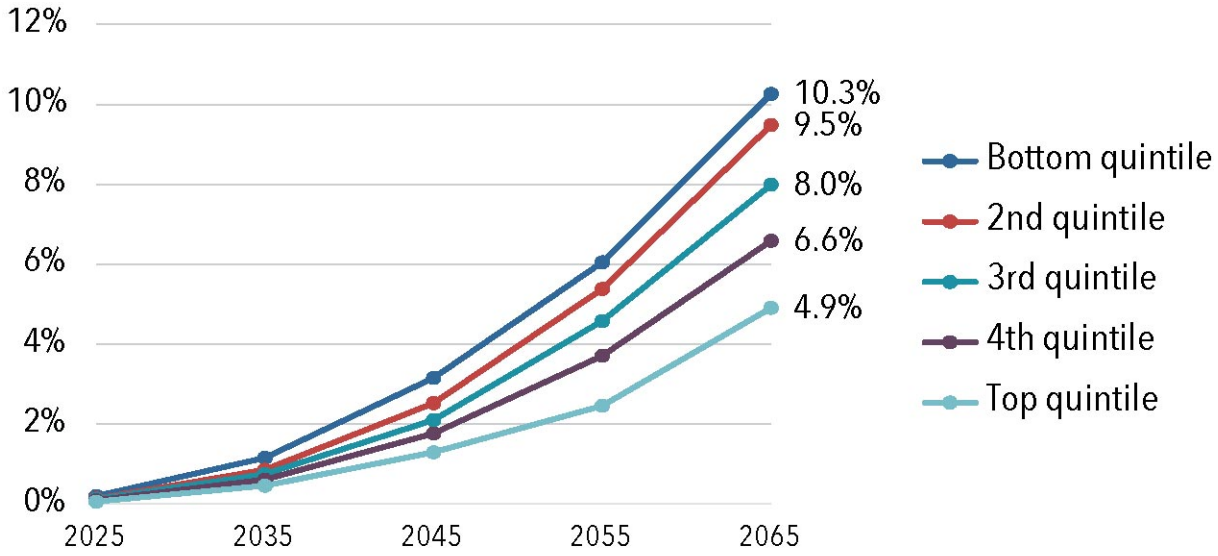
FIGURE 3A. Percentage Change in Average Net Per Capita Cash Income Individuals Ages 62+ by Shared Lifetime Earnings



Source: Urban Institute analysis of START proposal using DYNASIM.

19 The Urban Institute's measure of net per capita cash income includes earnings, Social Security, defined-benefit pensions, interest, dividends, rental income, retirement account withdrawals, Supplemental Security Income, and other means-tested and non-means-tested benefits, less federal income tax, state income tax, Social Security and Medicare payroll taxes, Medicare surtax, and Medicare Part B and Part D premiums.

FIGURE 3B. Percentage Change in Average Net Per Capita Cash Income Individuals Ages 62+ by Shared Lifetime Earnings (No Offset)



Source: Urban Institute analysis of START proposal using DYNASIM.

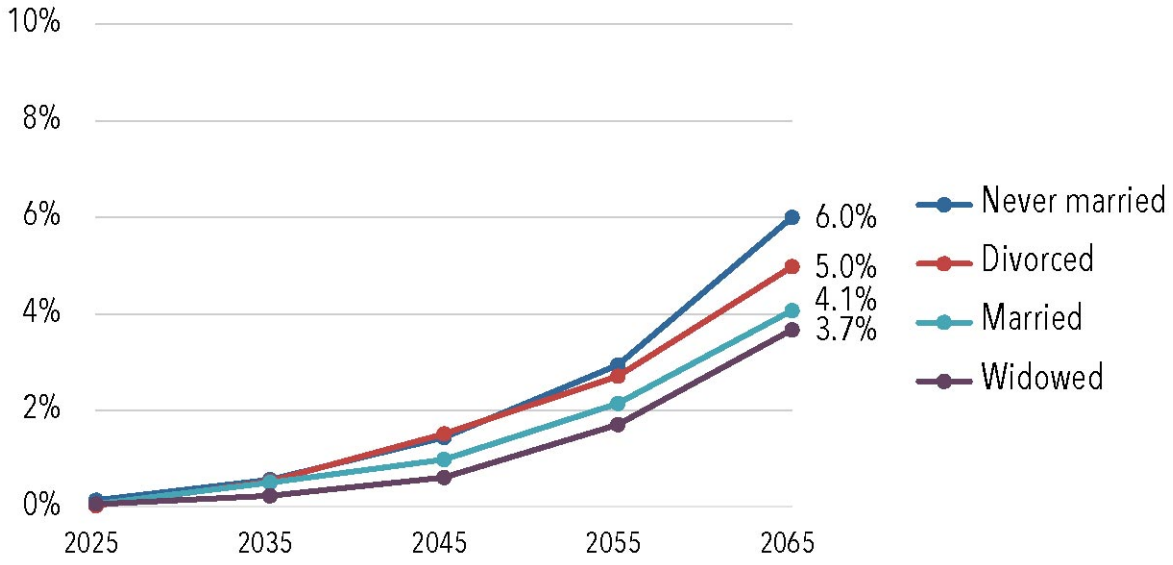
contributions. Under this assumption, the percentage change in average net cash income is higher for all quintiles than under the full-offset assumption shown in **figure 3a**.

Average net cash income also rises for households in each marital category for those ages 62 and over. **Figure 4a** presents the results assuming a full dollar-for-dollar offset, while **figure 4b** assumes no offset.

Figures 5a (offset) and **5b** (no offset) provide similar results by age category for those ages 62 and over. START raises average net per capita cash income the most for people ages 70 to 79 (almost 7 percent with full offset and about 11 percent with no offset). The increases for those age groups represent the most accurate picture of the full potential of our proposal on economic security at older ages. As mentioned earlier, people ages 80 and over in 2065 will have less than a full career of START contributions and asset accumulation. Further, many individuals ages 62 to 69 are receiving smaller START benefits compared with the adjusted Social Security benefits they will receive.

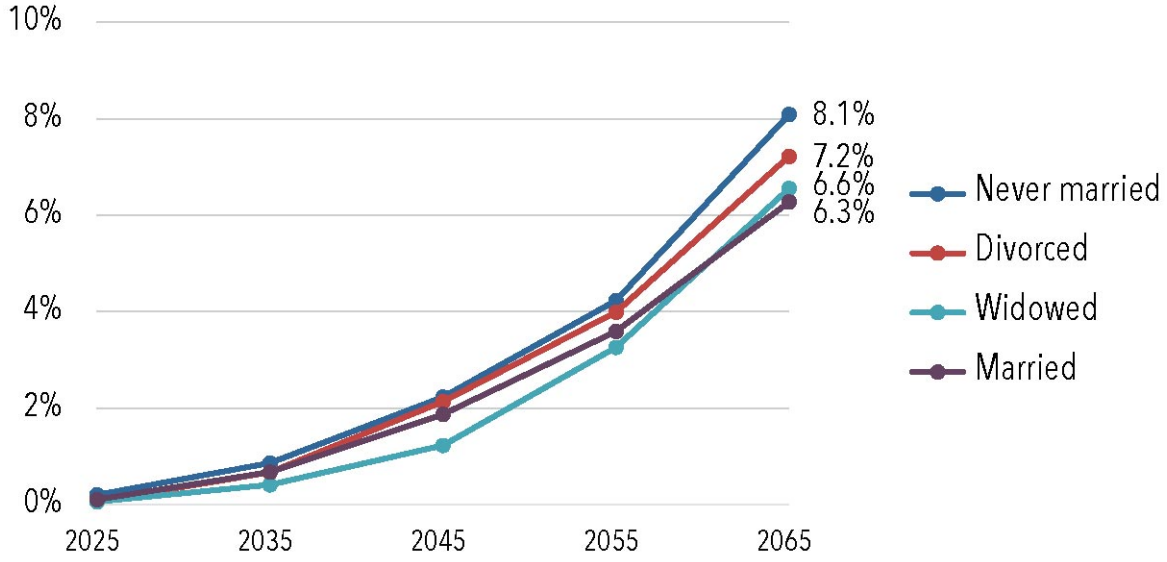
Figure 6 shows the effects of our proposal on people ages 70 to 79 in 2065 by shared lifetime earnings quintile under the full-offset assumption. Those results show the average impact of our proposal after eliminating, to the extent possible, the cohort and transition effects mentioned in the paragraph above. At all lifetime shared earnings quintiles, the average increase in income is substantially larger (50 percent or more) for those ages 70 to 79 compared with people ages 62 and older. For example, the average increase in net income for people in the lowest lifetime earnings quintile rises from about 10 percent for those ages 62+

FIGURE 4A. Percentage Change in Average Net Per Capita Cash Income Individuals Ages 62+ by Marital Status



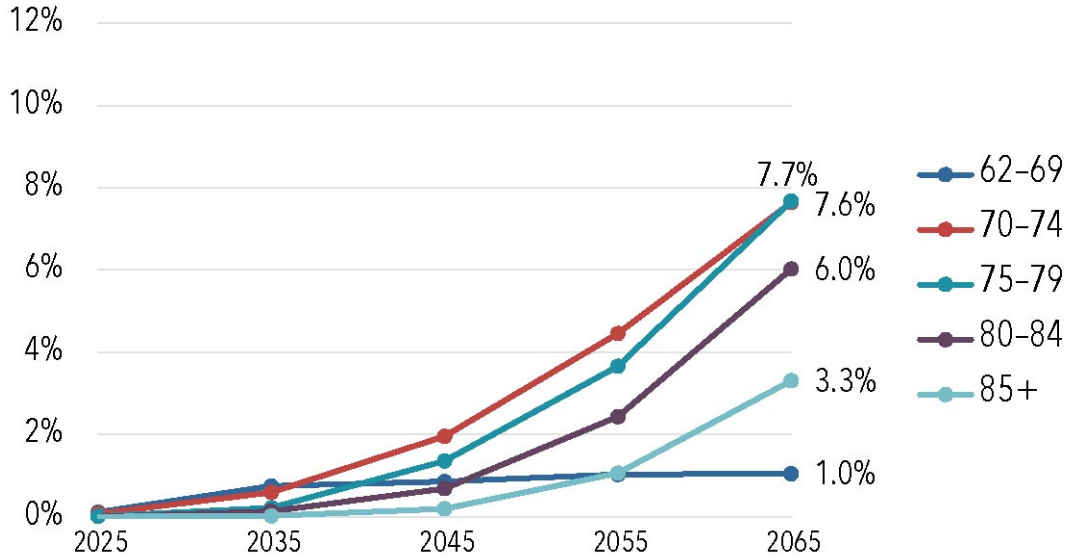
Source: Urban Institute analysis of START proposal using DYNASIM.

FIGURE 4B. Percentage Change in Average Net Per Capita Cash Income Individuals Ages 62+ by Marital Status (No Offset)



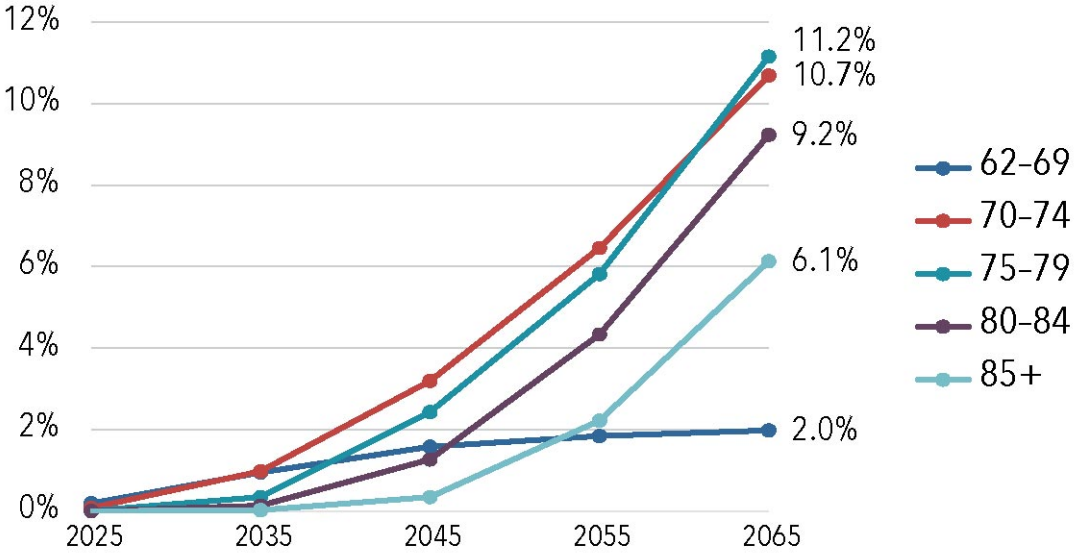
Source: Urban Institute analysis of START proposal using DYNASIM.

FIGURE 5A. Percentage Change in Average Net Per Capita Cash Income Individuals Ages 62+ by Age Group



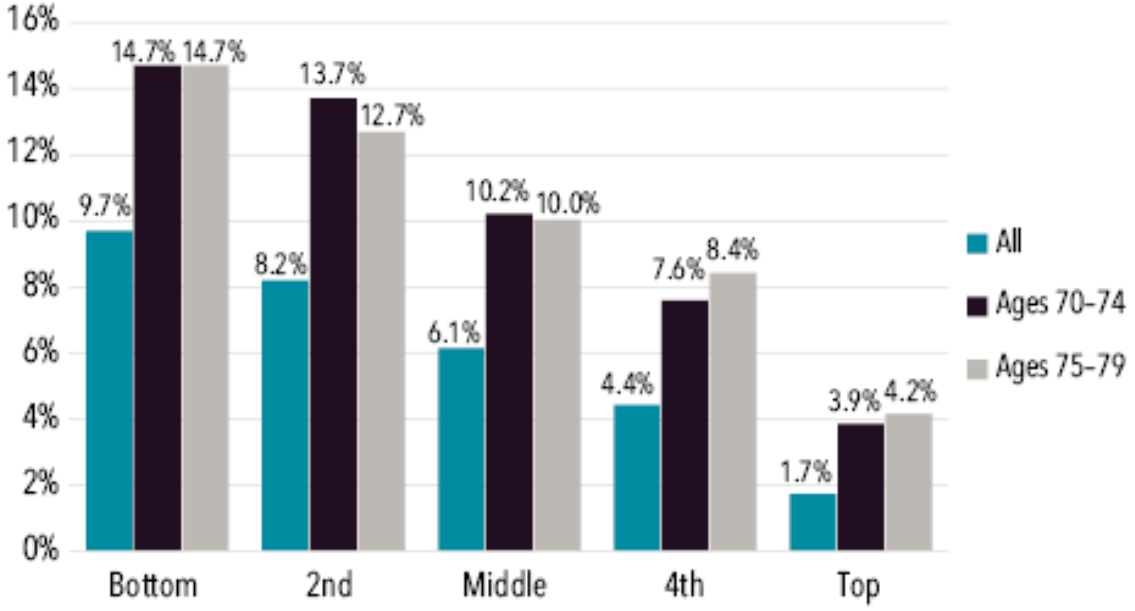
Source: Urban Institute analysis of START proposal using DYNASIM.

FIGURE 5B. Percentage Change in Average Net Per Capita Cash Income Individuals Ages 62+ by Age Group (No Offset)



Source: Urban Institute analysis of START proposal using DYNASIM.

FIGURE 6. Percent Change in Average Net Per Capita Cash Income by Certain Age Groups and Shared Lifetime Earnings Quintiles, 2065



Source: Urban Institute analysis of START proposal using DYNASIM.

to almost 15 percent for those ages 70 to 79. At the middle lifetime earnings quintile, average income increases from about 6 percent to 10 percent for people ages 62+ compared with those ages 70 to 79.

The increase in cash income as a result of STARTs would be a significant improvement in the retirement security of older Americans.

Table 3 provides a summary side-by-side comparison of the percentage and dollar increase in net per capita cash income of people ages 62 and over by selected characteristics, based on the Social Security scheduled benefits scenario (no reduction in benefits due to trust fund depletion).

The results show the effects under the two assumptions about whether or not START contributions displace contributions to an employer-provided retirement savings plan.

The Urban Institute's projections show that women and men experience similar increases in income under our proposal, but there are notable differences by education and race/ethnicity. For example, Blacks and Hispanics have larger percentage increases in cash income than do Whites, on average, but smaller dollar increases. The average percentage increase in cash income falls as educational attainment rises.

TABLE 3. Percentage and Dollar Increase in Average Net Per Capita Cash Income of People Ages 62 and Older by Selected Characteristics in 2065 (2015 dollars)

Scheduled Benefits		With Offset		No Offset	
		%	$	%	$
All		4.4%	$1,884	6.7%	$2,874
Age	62–69	1.0%	$511	2.0%	$970
	70–74	7.6%	$3,543	10.7%	$4,955
	75–79	7.7%	$3,142	11.2%	$4,566
	80–84	6.0%	$2,210	9.2%	$3,388
	85+	3.3%	$1,097	6.1%	$2,035
Sex	Female	4.5%	$1,899	6.8%	$2,884
	Male	4.3%	$1,868	6.6%	$2,862
Education	No high school diploma	7.7%	$1,474	9.3%	$1,775
	High school graduate	5.5%	$1,862	7.7%	$2,612
	Some college	4.6%	$1,940	7.0%	$2,961
	College graduate	3.5%	$1,990	5.9%	$3,347
Race/ Ethnicity	White non-Hispanic	4.0%	$1,958	6.4%	$3,139
	Black non-Hispanic	5.5%	$1,924	8.0%	$2,808
	Hispanic	5.3%	$1,774	7.2%	$2,414
	Other	4.1%	$1,656	6.2%	$2,472

Source: Urban Institute analysis of START proposal using DYNASIM

LABOR FORCE PARTICIPATION

This proposal has the potential to increase retirement security more broadly by encouraging work for two main reasons. First, START benefits would not be subject to the retirement earnings test (RET). The RET is a widely misunderstood feature of the Social Security program that most beneficiaries view as a pure tax (US Government Accountability Office, 2016). As a result, researchers have found some evidence that it discourages work (Engelhardt and Kumar, 2014). Second, the proposal could provide additional incentives for working longer, through its unrestricted access to START assets at the FRA, including a lump-sum distribution. While this could have a positive effect on the labor supply of workers who otherwise would have left the labor force prior to the FRA, it could encourage people who otherwise would have left employment after the FRA to leave sooner.

In a separate study, the Urban Institute estimated that for each additional year of work, annual consumption in retirement increases by 9 percent. And the benefits to working longer are larger for lower-income households. One additional year of work could increase annual consumption at retirement for the bottom lifetime earnings quintile and the second quintile by 16 percent and 12 percent, respectively (Butrica, Smith, and Steuerle, 2006). Working longer not only means higher Social Security benefits but also increased retirement savings and fewer years of retirement that have to be covered by those savings. Longer working lives will also improve the financial position of the Social Security program because the additional work will increase payroll taxes.

CONCLUSION

The retirement landscape has evolved over the past few decades. A movement away from defined-benefit plans to defined-contribution plans by both private- and public-sector employers has shifted much of the burden and risk of paying for retirement onto the individual.

Financial security in retirement is still obtainable. However, the likely reality is people will need to save more on their own and work longer, either retiring later or working for income during retirement. Social Security's inflation-protected annuity feature could help millions of Americans achieve a more financially secure retirement by facilitating later claiming of Social Security benefits to maximize the inflation-protected annuity value that Social Security provides.

Supplemental Transition Accounts for Retirement would provide the necessary bridge and allow individuals to delay claiming Social Security benefits. This, in turn, would mitigate the effects of actuarial reductions for claiming early and potentially allows workers to gain delayed retirement credits. The result would be higher monthly Social Security benefits and income—on average, about 5 percent to 7 percent overall and 10 percent for the lowest earning workers—that cannot be outlived or eroded by inflation.

A movement away from defined-benefit plans to defined-contribution plans by both private- and public-sector employers has shifted much of the burden and risk of paying for retirement onto the individual.

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