WORKING PAPER
Executive Summary

OCTOBER 2003, WP # 2003-17

CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE

SIMULATING THE DISTRIBUTIONAL CONSEQUENCES OF PERSONAL ACCOUNTS: SENSITIVITY TO ANNUITIZATION OPTIONS

BY CORI E. UCCELLO, MELISSA M. FAVREAULT, KAREN E. SMITH, AND LAWRENCE H. THOMPSON

Recent Social Security reform efforts focus predominantly on the establishment of personal retirement accounts either to supplement or partially replace the current Social Security program. Unlike the traditional Social Security system, which is based on a defined benefit model, the personal accounts created under these proposals would function like defined contribution plans. Contributions would be made to the accounts during working years, and balances would accumulate until retirement.

An important issue related to these personal accounts is whether they will redistribute income and how any redistribution compares to that under the current Social Security system. The answer depends in part on how personal accounts are disbursed upon retirement. In particular, it depends on how mandatory annuitization would impact different groups, especially those with shorter life spans, and whether certain annuity features would offset the drawbacks associated with forcing even those with short life expectancies to annuitize.

This paper presents a first step toward answering these questions. The authors use the Urban Institute's Dynamic Simulation of Income Model (DYNASIM), which projects Social Security outcomes through 2050, to examine Model 1 of the President's Commission to Strengthen Social Security. They first compare the distributional impacts of personal accounts to the current system. They then examine how different strategies for annuitizing personal account balances might change these distributional impacts. Of particular interest is whether certain annuity features can benefit workers with shorter life spans.

Under the current Social Security system, women and less educated and lower income persons tend to gain relative to men and more educated and higher income persons because of its progressive benefit formula. The current Social Security program also pays benefits in the form of life annuities, thereby transferring resources from those with shorter life expectancies to those with longer life expectancies. Personal accounts would reduce the redistribution that results from the benefit formula by tying benefits more closely to work histories. In addition, if certain annuity features were included in personal accounts, such as joint and survivor annuities, period certain annuities, annuitizing balances only up to the poverty level, and cash refunds, they would reduce the size of transfers for those with long life expectancies.

The choice of a particular annuitization strategy for personal accounts would change the distribution of the personal account benefit. But the total amount of Social Security benefits, including both the traditional benefit and the annuitized personal account benefit, would basically remain unchanged. As long as the theoretical annuity values that are used to offset the traditional Social Security benefit are calculated assuming the same annuity features as the actual personal account annuities, the distributional impacts of different annuity options will essentially net out.

© 2003, by Trustees of Boston College, Center for Retirement Research. All rights reserved. The research reported herein was performed pursuant to a grant from the U.S. Social Security Administration (SSA) funded as part of the Retirement Research Consortium. The opinions and conclusions expressed are solely those of the authors and should not be construed as representing the opinions or policy of SSA or any agency of the Federal Government, or the Center for Retirement Research at Boston College.