Social Security in the Cross Hairs: How Large Are Benefits?

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Critics portray the system as providing generous benefits.

The *Wall Street Journal* ran an op-ed recently by Andrew Biggs entitled "**New Evidence on the Phony Retirement Crisis**." The thrust of Biggs' argument is that the average guy gets a pretty high benefit from Social Security; couple those benefits with 401(k) saving and he will be fine in retirement. So where's the crisis?

The description of benefit generosity is couched in terms of replacement rates – benefits as a percentage of pre-retirement earnings. The Social Security actuaries report a replacement rate of 39 percent for the typical worker retiring at 65 today. Biggs, who has done numerous studies of his own producing extraordinarily high replacement rates, this time reports a number **from the Congressional Budget Office (CBO)**. According to the CBO, a typical middle-income worker retiring today would be eligible for a benefit equal to about 59 percent of late-life earnings. (I simply averaged the CBO replacement rates for workers born in the 1940s with those born in the 1960s).

The calculations are based on different approaches. The actuaries relate the benefits for a hypothetical worker who consistently earned roughly the average wage to wage-indexed career earnings. The CBO relates the benefits to the last five years of substantial earnings indexed for prices.

The Social Security actuaries **undertook a study** that incorporated both approaches. They took a random sample of 200,000 workers claiming benefits in 2011 and calculated replacement rates using an array of replacement rate definitions. The average retirement age for this group was 63.75. At the mean, the replacement rate for this group was 38.8 percent using wage-indexed career earnings and 39.7 percent using the last five years of significant earnings indexed by prices.

The point is that, when dealing with actual workers, the two approaches provide the same picture. So, the high CBO numbers cannot be explained by methodology alone. Their underlying assumptions must differ from the experience of actual individuals.

Perhaps a simpler way to think about the generosity of Social Security benefits is to look at dollar amounts paid. The most recent published data show that the average benefit for a newly retired worker in 2014 was $1,363 or $16,356. Since this number reflects people retiring before 65, say the average benefit at 65 was $17,000. If the CBO is right, the average worker would have earned $28,810 ($17,000/0.59) before retirement. If SSA is right, the average worker would have earned $43,590 ($17,000/0.39) before retirement. According to the *Current Population Survey*,typical earnings for all workers ages 55-65 were $42,000 and for full-time workers $48,000. It is very hard to believe that the recent CBO replacement rate number is a good representation of reality.

The replacement rate debate has now been going on for several years. It is part of a concerted effort to show the Social Security program is too generous and too expensive and needs to be cut. My sense is that the correct replacement rate is close to 40 percent. If the replacement rate game is too arcane, just remember that the average benefit is $17,000.