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MySocialSecurity.org

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Social Security has emerged as a key election year issue. Proposals have been introduced in Congress to allow younger workers to save a portion of their payroll taxes in personal retirement accounts. To help you understand how such personal accounts could affect retirement benefits, the NCPA has developed a Social Security calculator that compares the return from the Social Security payroll tax with the return if the entire amount were invested in a personal retirement account. (The calculator is not based on any of the proposals, all of which call for investing only a portion of the total payroll tax.)

Why the Calculator Is Important to You. The NCPA's calculator is designed to let you see your personal stake in the Social Security system. After you enter a few facts about yourself and your job, the calculator at http://www.mysocialsecurity.org will show:

- How much you and your employer are likely to pay in Social Security taxes and what you are likely to receive in benefits.
- How much you would accumulate if those same tax dollars were instead deposited in a private account invested in stocks and bonds.
- The rate of return you can expect from the current system compared to market alternatives.
- And how high the payroll tax burden will have to be in the year of your retirement if the government is to keep all its promises to the elderly.

Why the Calculator Is the Most Accurate Available. The calculator is based on an economic model developed for the National Center for Policy Analysis by economists at the Private Enterprise Research Center (PERC) at Texas A&M University. Using the earnings profiles of 750,000 workers from the most recent 15 years of the Census Bureau's Current Population Survey, the model projects earnings until retirement for men and women at various ages in 500 occupational categories. The result is more realistic estimates of wages and benefits.

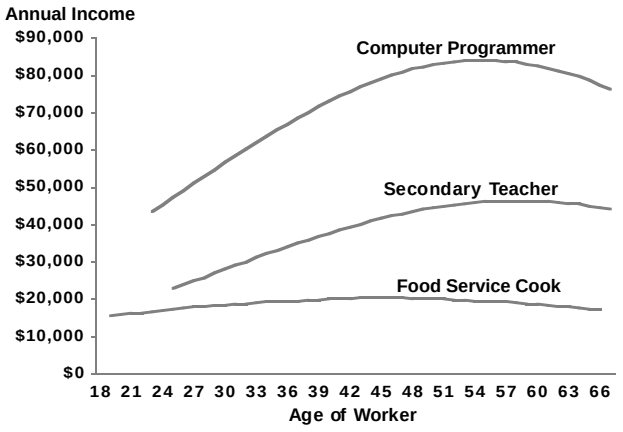
- Historical data are used to estimate past taxes and wages paid.
- Future real wage growth for each occupation, birth year and sex is projected to retirement.
- Benefit and earnings projections can be displayed with or without adjustment for inflation.

Figure I shows how patterns of real lifetime earnings differ by occupation. Failure to account for these patterns can lead to serious prediction errors. For example, benefit projections made by the Social Security Administration assume you will continue to earn your current wage without any real income gains over your working life. Some private sector calculators allow for an increase in your real income, but assume that everyone's income grows at the same rate — regardless of occupation.

FIGURE I

Projected Earnings Curve

(Males Born in 1965)



Source: NCPA Social Security Calculator.

How the Calculator Estimates Taxes and Benefits. The calculator estimates your past and future tax payments based on the earnings experience of people of the same age, sex, occupation and current income as you. Calculations of expected taxes assume you will live to your chosen retirement age, and calculations of expected benefits assume you will enjoy the normal lifespan of a male or female, given that you reach your chosen retirement age. The estimate of your monthly Social Security benefit is calculated by applying the formulas used by the Social Security Administration to your estimated lifetime earnings.

Payroll Tax Needed to Pay Social Security Benefits. On each dollar you earn up to $76,200 in the year 2000, the Social Security payroll tax for retirement and survivors benefits is 10.6 percent. If you are self-

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employed, you must pay this tax directly. If you are an employee, half the tax (5.3 percent) is deducted from your paycheck and the other half (5.3 percent) is paid on your behalf by your employer. The other 4.7 percent of your payroll taxes pay for Medicare and disability benefits.

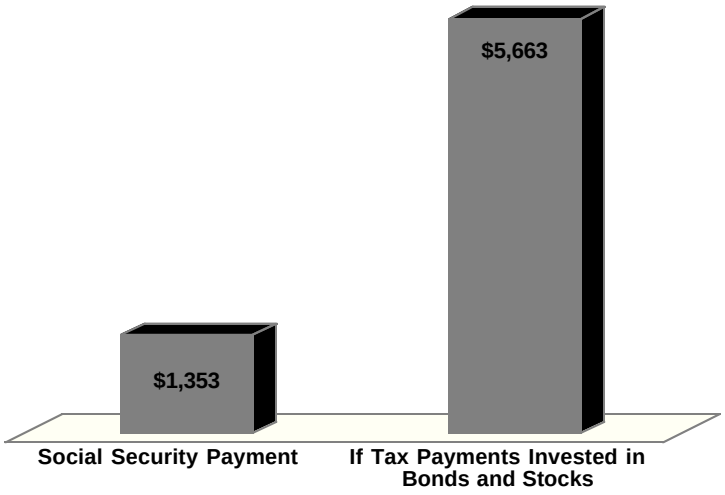
Because Social Security operates on a pay-as-you-go basis, today's payroll tax payments are spent to pay the benefits of current retirees. Any excess of payroll tax payments over benefits payments is spent on other government programs. Thus when you retire the government will have to collect taxes from future workers to pay your benefits. By 2050 payroll tax rates have to rise to 30 percent of payroll to pay all the benefits (Social Security plus health care) promised under current law — based on the Social Security trustees' intermediate forecast. (If the pessimistic forecast proves correct, the tax rate must climb to 48 percent.)

Earnings Profile for Construction Workers. A 30-year-old male construction worker with current annual earnings of $30,000 who retires in 2037 at age 67 can expect to receive $4,692 per month from Social Security. In today's dollars, adjusted for inflation, that equals $1,353. By comparison, had the worker invested the 10.6 percent payroll tax conservatively (60 percent stocks and 40 percent bonds), the monthly benefits would be $5,663, or $4.19 for every $1 he will receive from Social Security. [See Figure II.] In order for Social Security to keep its promises in the year he retires, the tax burden will equal 28 percent of payroll.

FIGURE II

Monthly Payments at Retirement

(Male Construction Worker)



Source: NCPA Social Security Calculator.

What Rate of Return Can I Expect? The estimated growth of privately invested Social Security taxes is based on the historic rate of return on stocks and bonds. On the average, over the last 40 years, AAA corporate bonds have an inflation-adjusted annual rate of return of 2.5 percent, while stocks from the S&P 500 have returned 6.3 percent. In comparing a funded system with Social Security, the calculator assumes payroll tax payments were used to fund a personal retirement account from the year you began working. It assumes the funds are invested in a combination of stocks and bonds yielding an annual return of 4.8 percent. Social Security, on the other hand, has a rate of return between 1 and 2 percent for most younger workers.

Conclusion. Social Security pays a rate of return between one-half and one-fifth of historical market rates. If two to three percentage points of payroll taxes were placed in personal retirement accounts invested in productive assets, the future of the Social Security program could be secured while giving people choice in their investments, control over their future and the security of having savings exceeding anything the average American now has. You can check out how your own benefits would compare under Social Security and a private account at www.MySocialSecurity.org

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