
Replacing Those Disputed Replacement Rates

By Kerry Pechter Thu, Sep 11, 2014

What was so important about a tiny column of numbers, missing from Table V.C7 of the 2014 Social Security Trustees Report?

Touch the third rail of American politics, and you'll shock someone. In early August, during the Retirement Research Consortium at the wood-paneled National Press Club in Washington, D.C., that someone was Alicia Munnell, director of Boston College's Center for Retirement Research.

"Outraged" was the word she used. From the podium—she chaired the Consortium—and in sidebars with select conference attendees, Munnell expressed her outrage at the elimination of certain data from Table V.C7 of the 2014 edition of the Social Security Trustees Report.

The missing data involved Social Security's "replacement rates." Earlier Trustees Reports showed how much of a person's pre-retirement income Social Security benefits would replace. In 2013, the percentages (at full retirement age) ranged from 82.6% for the lowest-earning Americans to 29.6% for the highest.

The unexplained absence of those rates from the 2014 Report made Munnell furious. She suggested that behind-the-scenes maneuvering by people with an anti-Social Security agenda had led to the change. She [blogged](#) about it and, given her prestige in the retirement field, like-minded columnists in the *Los Angeles Times* and *The Economist* magazine picked up the story. She even had navy blue T-shirts printed up, with the words "Restore Table V.C7" silk-screened on the chest (See cover photo).

"The deletion is the culmination of a concerted effort by a band of critics who argue that all is right in the world: People will have plenty of money in retirement," Munnell (right) asserted in her blog, which was reprinted on the *Wall Street Journal's* well-read [MarketWatch](#) website.



RIJ could find no evidence of a conspiracy per se. From one perspective, the whole matter boils down to a wonkish actuarial disagreement among reasonable people about whether Social Security payouts should keep up with U.S. prices or wages. Several knowledgeable insiders think she over-reacted.

But, as one observer pointed out, Munnell may have had reason to read a larger motive into the change in Table V.C7. Her research center is funded by the Social Security Administration. It publishes a National Retirement Risk Index, sponsored by Prudential Financial, that presents a gloomy view of Americans' preparedness for retirement. The index is based in part on a particular replacement rate calculation. It frequently gets picked up in the press.

Her positions have vigorous opponents, and they regularly publish articles and research papers too. In mid-2014, articles appeared in the *Wall Street Journal* and the *Journal of Retirement* critical of the way Munnell calculated replacement rates. In late 2013, an article by one of the Social Security trustees warned of the danger of Social Security to the future of the U.S. economy. There were links between two authors of those articles and two conservative think tanks—the American Enterprise Institute and the Mercatus Center—that receive funding from the right-wing billionaire Koch brothers.

The appearance of those articles created “some sensitivity” in the pro-Social Security world, a leading Ivy League academic who is close to the situation told *RIJ*. “There’s been some weak research coming out of conservative think tanks that benefits are too high and should be cut,” he said. “They calculated pre-retirement incomes by averaging in years when people aren’t even working. In the context of that prior effort by the think tanks, the timing [of the removal of the replacement rate column from Table V.C7], and the fact that the Trustees report was delayed, looks strange. It could be a coincidence.”

The dispute over the replacement rates is important, he added, because “it’s a leading indicator of the policy debate that the country is likely to have over social insurance programs. It’s showing us the way in which the debate over social insurance is likely to evolve, and what arguments the different sides will be taking.”

Unstable table

To grasp this situation, you need to compare the 2013 version of Table V.C7 of the Trustees Report with the 2014 version. (See boxes.) Both versions show the projected Social Security benefits for five categories of recipients (those with very low, low, medium, high and maximum pre-retirement incomes) and for about 15 sample years between now and 2090. Both do so for those claiming at age 65 and those claiming at full retirement age. Both charts show that, in inflation-adjusted dollars, Social Security benefits will rise over time.

**Table V.C7.—Annual Scheduled Benefit Amounts^a for Retired Workers
 With Various Pre-Retirement Earnings Patterns
 Based on Intermediate Assumptions, Calendar Years 2013-90**

| Year attain age 65 ^b | Retirement at normal retirement age | | | Retirement at age 65 | | |
|--|-------------------------------------|---------------------------------------|---------------------|----------------------|---------------------------------------|---------------------|
| | Age at retirement | CPI-indexed 2013 dollars ^c | Percent of earnings | Age at retirement | CPI-indexed 2013 dollars ^c | Percent of earnings |
| Scaled very low earnings:^d | | | | | | |
| 2013 | 66:0 | \$9,055 | 82.6 | 65:0 | \$8,463 | 77.4 |
| 2015 | 66:0 | 8,784 | 76.4 | 65:0 | 8,191 | 73.2 |
| 2020 | 66:2 | 9,352 | 73.3 | 65:0 | 8,618 | 68.6 |
| 2025 | 67:0 | 10,332 | 76.1 | 65:0 | 8,959 | 67.4 |
| 2030 | 67:0 | 10,918 | 75.8 | 65:0 | 9,458 | 67.2 |
| 2035 | 67:0 | 11,564 | 75.9 | 65:0 | 10,017 | 67.2 |
| 2040 | 67:0 | 12,245 | 76.0 | 65:0 | 10,615 | 67.4 |
| 2045 | 67:0 | 12,948 | 76.1 | 65:0 | 11,221 | 67.4 |
| 2050 | 67:0 | 13,678 | 76.2 | 65:0 | 11,857 | 67.5 |
| 2055 | 67:0 | 14,434 | 76.2 | 65:0 | 12,510 | 67.5 |
| 2060 | 67:0 | 15,230 | 76.3 | 65:0 | 13,200 | 67.5 |
| 2065 | 67:0 | 16,059 | 76.3 | 65:0 | 13,918 | 67.5 |
| 2070 | 67:0 | 16,929 | 76.3 | 65:0 | 14,673 | 67.5 |
| 2075 | 67:0 | 17,845 | 76.2 | 65:0 | 15,466 | 67.5 |
| 2080 | 67:0 | 18,824 | 76.1 | 65:0 | 16,315 | 67.4 |
| 2085 | 67:0 | 19,877 | 76.1 | 65:0 | 17,226 | 67.4 |
| 2090 | 67:0 | 20,998 | 76.1 | 65:0 | 18,198 | 67.4 |

The biggest difference between the two versions is that the right-most column in the 2013 table (right) shows the percentages of pre-retirement earnings that Social Security benefits replaces and the right-most column in the 2014 table (below) shows the National Average Wage. The wages have replaced the replacement rates, which are missing from this year’s table.

For the people involved, that’s significant. The 2013 chart illustrates a trend toward declining replacement rates; for the medium earners who file for benefits at age 65, the rate drops to 36.3% in 2030 from 41.7% in 2013—mainly because age requirement for full benefits will be going up.

That supports the liberal position that the Social Security safety net is sagging. The 2014 chart has no such rates, and therefore nothing explicit to counter the impression that Social Security benefits are going up in real terms: from \$19,477 in 2014 to \$24,140 for the medium earner who claims at normal retirement age.

Ironically, despite the fact that the government bases your Social Security benefits on your personal earnings history, there’s no accepted standard for calculating the average rates at which Social Security replaces pre-retirement income.

Table V.C7.—Annual Scheduled Benefit Amounts for Retired Workers With Various Pre-Retirement Earnings Patterns Based on Intermediate Assumptions, Calendar Years 2014-90

| Benefits in 2014 dollars ^a with retirement at normal retirement age | | | | | | | |
|--|-------------------|---------------------------------------|----------------------------------|-------------------------------------|-----------------------------------|--------------------------------------|--|
| Year attain age 65 ^b | Age at retirement | Scaled very low earnings ^c | Scaled low earnings ^d | Scaled medium earnings ^e | Scaled high earnings ^f | Steady maximum earnings ^g | National Average Wage Index in 2014 dollars ^h |
| 2014 | 66:0 | \$9,031 | \$11,814 | \$19,477 | \$25,821 | \$31,338 | \$46,787 |
| 2015 | 66:0 | 8,910 | 11,668 | 19,227 | 25,483 | 31,000 | 48,120 |
| 2020 | 66:2 | 9,592 | 12,549 | 20,698 | 27,409 | 33,549 | 53,266 |
| 2025 | 67:0 | 10,546 | 13,799 | 22,744 | 30,132 | 37,096 | 56,522 |
| 2030 | 67:0 | 11,192 | 14,645 | 24,140 | 31,978 | 39,407 | 59,997 |
| 2035 | 67:0 | 11,878 | 15,542 | 25,623 | 33,948 | 41,855 | 63,635 |
| 2040 | 67:0 | 12,600 | 16,482 | 27,173 | 35,997 | 44,351 | 67,311 |
| 2045 | 67:0 | 13,324 | 17,437 | 28,740 | 38,078 | 46,933 | 71,119 |
| 2050 | 67:0 | 14,084 | 18,427 | 30,369 | 40,236 | 49,529 | 75,056 |
| 2055 | 67:0 | 14,860 | 19,443 | 32,047 | 42,461 | 52,171 | 79,193 |
| 2060 | 67:0 | 15,683 | 20,518 | 33,815 | 44,803 | 55,001 | 83,525 |
| 2065 | 67:0 | 16,538 | 21,637 | 35,663 | 47,253 | 58,018 | 88,061 |
| 2070 | 67:0 | 17,439 | 22,815 | 37,601 | 49,820 | 61,175 | 92,817 |
| 2075 | 67:0 | 18,380 | 24,047 | 39,631 | 52,511 | 64,489 | 97,905 |
| 2080 | 67:0 | 19,390 | 25,367 | 41,807 | 55,391 | 68,029 | 103,369 |
| 2085 | 67:0 | 20,472 | 26,783 | 44,141 | 58,483 | 71,826 | 109,194 |
| 2090 | 67:0 | 21,625 | 28,293 | 46,628 | 61,778 | 75,875 | 115,390 |
| Benefits in 2014 dollars with retirement at age 65 | | | | | | | |
| 2014 | 65:0 | \$8,459 | \$11,077 | \$18,251 | \$24,198 | \$29,209 | \$46,787 |
| 2015 | 65:0 | 8,336 | 10,895 | 17,968 | 23,817 | 28,851 | 48,120 |
| 2020 | 65:0 | 8,840 | 11,572 | 19,078 | 25,270 | 30,806 | 53,266 |
| 2025 | 65:0 | 9,134 | 11,954 | 19,710 | 26,115 | 31,901 | 56,522 |
| 2030 | 65:0 | 9,696 | 12,690 | 20,917 | 27,714 | 33,904 | 59,997 |
| 2035 | 65:0 | 10,297 | 13,471 | 22,202 | 29,417 | 36,016 | 63,635 |
| 2040 | 65:0 | 10,916 | 14,287 | 23,545 | 31,199 | 38,169 | 67,311 |
| 2045 | 65:0 | 11,547 | 15,114 | 24,909 | 33,001 | 40,398 | 71,119 |
| 2050 | 65:0 | 12,202 | 15,966 | 26,317 | 34,867 | 42,639 | 75,056 |
| 2055 | 65:0 | 12,879 | 16,851 | 27,774 | 36,800 | 44,912 | 79,193 |
| 2060 | 65:0 | 13,590 | 17,781 | 29,305 | 38,829 | 47,352 | 83,525 |
| 2065 | 65:0 | 14,334 | 18,754 | 30,906 | 40,953 | 49,952 | 88,061 |
| 2070 | 65:0 | 15,113 | 19,774 | 32,587 | 43,178 | 52,670 | 92,817 |
| 2075 | 65:0 | 15,930 | 20,841 | 34,346 | 45,508 | 55,522 | 97,905 |
| 2080 | 65:0 | 16,804 | 21,985 | 36,232 | 48,005 | 58,570 | 103,369 |
| 2085 | 65:0 | 17,742 | 23,212 | 38,256 | 50,684 | 61,839 | 109,194 |
| 2090 | 65:0 | 18,742 | 24,520 | 40,411 | 53,542 | 65,324 | 115,390 |

Depending on how you calculate it, you can make the replacement rate look high or low. That means you can make Social Security look generous or stingy, overfunded or in need of more funding. You can also make the degree to which America faces a retirement “crisis” look large or small. And by implication, if there’s a big crisis, the 401(k) system isn’t “working.”

A conspiracy?

The decision to tweak the table is up to a working group that consists of the Social Security Trustees and the actuaries and staff members who advise and support them. There are six trustees, all administration appointees. They include the Secretary of the Treasury, Secretary of Labor, Secretary of Health and Human Services, and the Commissioner of Social Security, as well as two public trustees.

The question is why, in the summer of 2014, the Trustees decided to change the table. Munnell believes that it didn’t happen accidentally or for purely technical reasons. She and others suspect that it was driven by politically- or ideologically-inspired pressure, both within the working group and from outside of it. Others close to the process say that isn’t so.

The obvious person of interest was Charles Blahous, one of the two Social Security public trustees and the only clearly identifiable conservative on the board. Blahous is a senior fellow at the conservative Mercatus Center at George Mason University. Mercatus received its start-up money from the ultra-conservative billionaire Koch brothers, and its co-founder, Richard H. Fink, is an executive vice president of Koch Industries. Fink and Charles Koch sit on the Mercatus board and Koch-funded DonorsTrust and Donors Capital Fund have given millions of dollars to Mercatus in recent years.

In the past, Blahous has linked America's fiscal red ink to entitlement programs, including Social Security. In a November 2013 paper entitled, "[Why We Have Federal Deficits: The Policy Decisions That Created Them](#)," he wrote, "Any strategy that fails to adjust the 1965-72 policy decisions—specifically, those creating the current designs of Medicare, Medicaid, and Social Security—will inevitably fail to correct the federal government's fiscal imbalance."

In a phone interview with *RIJ*, Blahous (right) said that politics and ideology played no role in the trustees' work. "No one in the process is interested in or concerned with policy debates. We just try to represent the numbers accurately. It's not true that the table isn't in there. It's not missing. In fact, it contains more information than before," he said. "We decided to put the growth in the real dollar value of benefits alongside the growth in average wages.



"There had been issues about what the presentation of replacement rates was saying. We changed it to make sure people wouldn't misread it. We were trying to take the 'thumb off the scale' and make it more transparent," he added. As for the accusations of conspiracy, Blahous told *RIJ*, "That's pretty fantastical. Some of the speculation is misinformed and irresponsible."

This version was supported by someone who was privy to the preparation of the Trustees report and who told *RIJ* in an e-mail: "Several times and at some length, we discussed and e-mailed about the strengths and weaknesses of the traditional measure and the alternatives.

OACT and Treasury developed some interesting analysis of alternative measures. We had several discussions of whether to include one or more alternatives along with the traditional measure in the report or in an appendix and whether to have an expanded discussion of replacement rates somewhere in the report.

“As you can guess, several participants had strong and different feelings about the desirability of the traditional measure and the alternatives. The agreement for this year at least was to go with what you see in the report and on the OACT web page. I suspect that the issue will be revisited in the next round. “Outrage,” “conspiracy” “suppressed” or “ideology” are not words that I would use in describing what took place. ‘Lively debate by strong willed experts’ would be more appropriate.”

Outside views

Blahous’ position was supported by several other academics who have written about retirement and Social Security. One of them was Olivia Mitchell, director of the Pension Research Council at the University of Pennsylvania’s Wharton School.

“I don’t find [the conspiracy theory] to be a credible argument,” she told *RIJ* in an interview. “The issue is that the conventional approach used by SSA to compute replacement rates uses hypothetical workers rather than actual earnings histories. Additionally, the SSA grows earnings over time by the average rate of earnings growth, which is normally 1-1.5% above inflation.

“For both reasons, the SSA earnings series tend to be quite a bit higher than what real workers earn. As a result, they come out with too-low replacement rates. In our work, we found that replacement rates were quite a bit higher for actual earners tracked using the Health and Retirement Study. Bottom line: replacement rates based on true earnings are quite a bit higher than the SSA reports using hypothetical workers.”

Sylvester Schieber (below), a former chairman of the Social Security Advisory Board, also told *RIJ* that there is no conspiracy, and he spoke as one who had been implicated in it. He identified himself as one of the “band of critics” that Munnell wrote about in her blog.



“I know Alicia Munnell at Boston College thinks there was some sort of conspiracy behind the change to replacement rate presentation in the report this year and has suggested to me that I was somehow involved. [But] I don’t think anyone considers me an advisor to the Obama Administration much less an insider,” he wrote in an e-mail.

“The idea that we have an organized group and blew up this table in the Trustees report is ridiculous. We’re trying to look as fairly as we can at the numbers. I am not privy to the inside dealings of the Trustees, but my impression is that they have been questioning whether or not the prior presentation was confusing for at least a year or two. I assume that those concerns led to the change in presentation in this year’s report.”

Another Social Security expert, Jeff Brown of the University of Illinois, also doubted any type of ideological collusion or pressure behind the change in Table V.C7. He believes that changes to the table were justified by the facts.

“The way SSA has been doing this calculation for the past decade or so is *not* the way I would do it if I were allowed to include only one such measure,” he told RIJ in an e-mail. “Most people think replacement rates are relative to some measure of what a person’s income was near retirement. The critics of the actuaries’ 2013 numbers say that they are not this at all. Rather, they are based on ‘stylized workers’ that are essentially arbitrarily chosen points in a distribution of earnings based on the average wage index. There is absolutely nothing special or even particularly insightful or meaningful about the 2013 measure.”

He added, “The real question is ‘Why only show one?’ If it were up to me, I would show several replacement rates under different combinations of assumptions. I see no substantive reason why the Trustees could not do this. If someone wants to keep computing it the way it has been done for the past decade, then let’s keep reporting it, but let’s do so alongside a couple of other measures that demonstrate the richness of the replacement rate concept.”

The ‘social insurance’ view

People who believe that Social Security is under attack, and that social insurance, as opposed to free markets, represents the best way to ensure basic protection against old age poverty for the majority of Americans, voiced their support for Munnell.

Nancy J. Altman, co-director of StrengthenSocialSecurity.org, author of, “The Battle for Social Security” (Wiley 2005), and a former Harvard Law School lecturer and assistant to Alan Greenspan, defended Munnell’s position on replacement rates, and supported her contention that there are political overtones to this controversy.

Regarding the replacement rates, “It’s really unprecedented to remove that kind of information,” she said. “It’s widely accepted information. The OECD [Organization for Economic Cooperation and Development] calculates [replacement rates] this way.”

As for the motivation behind the changes to table V.C7, Altman said, “It’s a political fight. There’s only one reason to make the replacement rates come out, and that is to make it look like the benefits are growing out of control and that you need to cut them.”

Jeff Liebman, a Social Security policy expert at Harvard’s Kennedy School of Government and coordinator of Social Security reform in the Clinton White House, believes that the debate over replacement rates has significance as a microcosm of a larger debate.

“Replacement rates are the most important summary statistic for assessing the adequacy of benefits in a social insurance system, so I think it was a mistake for the Trustees to remove the replacement rate information from the Trustees’ Report. If there are disagreements about the best way to construct replacement rates, it is better to present multiple measures than to suppress the information,” he told RIJ.

“There is a fundamental disagreement,” he added, “between people who believe that Social Security is a social insurance program that is designed to replace a certain fraction of pre-retirement income—and therefore that benefits should rise with wage levels—and people who believe that Social Security should be a welfare program where benefits keep up only with inflation and therefore decline over time as a share of pre-retirement income.”

Dueling articles

As for Munnell’s sense of a “concerted effort by a band of critics” to attack her positions, it may have been inspired two recent articles. One was a July 14 *Wall Street Journal* article by

Andrew Biggs and Sylvester Schieber. The other was a research article by Schieber and Gaobo Pang of Towers Watson in the Summer 2014 issue of the *Journal of Retirement*, an Institutional Investor publication underwritten by Bank of America Merrill Lynch.

Both appeared shortly before the Trustees report came out and both attacked replacement rates that made Social Security look skimpy rather than generous. Evidence of collusion or a partisan agenda is largely circumstantial. But it could have come from the fact that Schieber was associated with both articles, and that Biggs, a formal Social Security economist, works for the conservative American Enterprise Institute.

Like the Mercatus Center, where Blahous works, the AEI receives funding from the Koch brothers or their charities. Biggs has lent his expertise to conservative arguments before. For instance, he has contended that public pensions should use a risk-free discount rate to calculate their funded ratios—a rate that automatically puts them deep in the red. In the *Wall Street Journal* article, he mentioned that Social Security faces a \$10 trillion shortfall—without noting that the shortfall is only three percent of America’s payroll during the period in question.

The 401(k) factor

The largely unmentioned participant in this debate is the 401(k) system, of which Munnell has been a gadfly. Her organization’s gloomy National Retirement Risk Index, which Prudential underwrites, suggests a looming retirement crisis in America. And if there’s a crisis, it implies that the 401(k) system may not be working. In her blog about Table V.C7, she went so far as to write that, “If Social Security replaces less, then future workers must depend on what is now a fairly wobbly 401(k) system for more.”

Social Security proponents and fans of the 401(k) system aren’t necessarily mortal enemies, but in the zero-sum bloodsport of Washington politics, people tend to be on one side or the other. “People like me who argue in favor of expanding Social Security believe that the 401(k) isn’t up to the job,” Altman told *RIJ*. “We think the solution is to expand Social Security and pay for it in a fair way. I think of it as a piece of the privatization fight.

“‘Privatization’ has come to mean diverting your FICA payroll taxes into private accounts. The reality is that if you let Social Security benefits decline, and diminish the public sector’s role in retirement, then people will have to increase their level of private savings,” she added.

Such positions are insults, and represent potential threats, to the 401(k) system.

Publications from organizations that have a stake in the 401(k) system, like the Investment Company Institute or the American Society of Pension Professionals and Actuaries, support the notion that the Americans are generally headed for retirement well-prepared, thanks to their 401(k) plans.

Little wonder, then, at the emotion spent on replacement rates. They're at the eye of a high-stakes storm. "The whole purpose of the attack on Social Security replacement rates is an attempt to provide a rationale for cutting benefits," Munnell wrote after the 2014 Social Security Trustees Report was published. "If Social Security replacement rates are really as high as critics allege, then they would be ripe for reduction." If benefits go down, taxes won't have to go up as much, and more money will be left for deferral into 401(k) accounts.

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