

Tax Considerations in a Mandatory Universal Pension System

Adam Carasso
The Urban Institute

Jonathan Barry Forman
Alfred P. Murrah Professor of Law
University of Oklahoma
College of Law

Presented at
Re-Envisioning Retirement in the 21st Century
Society of Actuaries

May 3–4, 2006

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Abstract

A confluence of demographic and economic pressures are challenging the ability of the U.S. retirement system to deliver the standard of living in old age that retirees have come to expect in the post-war era. The major pressures are various and include increased longevity in retirement and unsustainable growth built into benefit promises. Our retirement system can be thought to have four pillars—Social Security, employer pensions, private wealth and retiree health benefits—all of which are straining to provide adequate income in old age. In a nutshell, the present retirement system threatens to fall short in providing the aged with financial security just as we call upon it to do more than it ever has before. How will the breach between the retirement we desire and the retirement current systems can finance be filled? One way might be to establish a mandatory universal pension system (MUPS) to ensure that *all* workers are covered by a pension and are able to save more during their working years to provide them with adequate incomes when they retire. The simplest design for a MUPS would be to piggyback a system of individual retirement savings accounts onto the existing Social Security withholding system. MUPS pensions would be fully portable, could boost the stock of private savings, and could ease the burden on Social Security to meet presently unrealistic benefit commitments *without* altering the current program—merits which ought to find common ground among both liberals and conservatives.

This paper develops such a mandatory pension system and estimates its revenue and distributional consequences. More specifically, this paper develops options for a system of mandatory individual accounts in which, starting in 2006, each employee or self-employed worker is required to contribute 3 percent of covered payroll to an individual account (i.e., 3 percent of up to \$94,200 in 2006). These accounts would be held by the government, invested in secure equity funds and annuitized on retirement.

In the long-run, we estimate that a MUPS could replace an additional 14.5 percent of final wages for men, 13.3 percent of final wages for women, 14.5 percent for one-earner couples, and 13.9 percent for two-earner couples, over and above their Social Security benefits. (Estimates under a MUPS option that provides subsidies are higher for low-wage earners). This paper also shows that targeted subsidies or grants could result in even greater supplemental retirement benefits for most low- and moderate-income workers.