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The Case for State Supplemental Social Security

Washington faces a crisis of low-income elderly residents in the coming decades, with many residents at risk of living out their years with a diminished quality of life and more reliant on the public safety net. It doesn't have to be this way: states have long pioneered innovative retirement security policies for their residents. Washington is well-positioned to establish a state Supplemental Social Security system that creates a new foundation of economic security for every retiree.

America's private retirement system is failing workers

While Social Security provides sufficient income to keep most seniors above the federal poverty level, alone it is not enough to retire with a comfortable standard of living and cover the increasing health care and other costs associated with aging. [1] Traditionally, workers have been expected to rely on private, employer-sponsored plans to fill the gap between what Social Security provides and what they need to be economically secure – but that is no longer feasible.

By and large, employers have cancelled defined benefit retirement plans, replacing them with defined contribution plans. Although 401(k) and other defined contribution plans can theoretically help workers accumulate substantial account balances, in practice such plans often fall short.[2] Among Washington residents closest to retirement (age 55-64), 41 percent have no projected income from a workplace-based retirement savings program (either defined benefit or defined contribution); another 42 percent have DC plans projected to replace a median of just 10 percent of their pre-retirement income.[3]

Significant economic and other policy barriers have created this crisis:

- **Lack of access to workplace-based retirement plans:** People with a retirement savings plan at work are 15 times more likely to save for retirement. Yet in Washington, 2 million Washington workers (61 percent) didn't have access to such a plan in 2014.[4] Latinx workers were particularly disadvantaged: 79 percent didn't have access.[5]
- **Slow growth in wages and rising expenses:** 56 percent of Washington households aren't able to set aside money on a month-to-month basis because they either spend more than they make or just break even.[6] Four in ten U.S. households had a sizeable and unexpected medical, car, tax or other payment within a 12-month period – and one in four U.S. participants in defined contribution plans will tap in to some or all of it for non-retirement needs.[7]
- **Increasing student debt:** Bachelor's degree-holders who have student loans have significantly lower retirement assets at age 30 than those without loans.[8] In 2017, 52 percent of Washington students graduated with debt, with an average $24,164 per borrower.[9] As of 2016, Washington's student loan borrowers collectively owed $24.4 billion – an increase of more than 35 percent from 2006.[10]

- **High risk of financial losses:** Building a substantial retirement fund in a defined contribution, 401(k)-style plan hinges on too many factors that are outside of a worker's control or expertise, including:
    - being provided low-fee investment options that match employee needs,
    - making adequate contributions, choosing appropriate investments, and
    - following a structured withdrawal plan.

  Even if both employee and employer take the right steps, market forces will intervene. During the financial crisis of 2008, the value of Washingtonians' hard-earned nest eggs plummeted when markets crashed, destroying trillions of dollars of household wealth. That's not a reliable way to ensure people can retire with dignity.

States are responding, but results are mixed

Since 2011, 40 states have enacted or proposed policies to help overcome barriers and provide access to retirement savings accounts for more private sector workers.[11] These policies can be grouped into four categories:

- **Auto-IRA plans** provide retirement savings accounts to private-sector workers who do not have access to such a plan at work. Designated employers automatically deduct a percentage of their workers' pay and forward it to state-facilitated, not-for-profit individual retirement account (IRAs). Accounts are owned by the workers, managed by professionals, and usually administered by state-appointed trustees heading an independent board. Employees have the right to change their contribution rates or opt out.

  Auto-IRA policies have been enacted in five states – California, Connecticut, Illinois, Maryland, and Oregon – and proposed in 12 others – Ohio, Arizona, Louisiana, Indiana, Kentucky, Michigan, Rhode Island, New York State, Colorado, Pennsylvania, Montana and North Carolina.

- **Small-business marketplace plans** are online exchanges set up and managed by the state to connect small businesses with providers of retirement savings plans. These plans seek to reduce cost, complexity and other barriers. Plans offered on the marketplace must meet requirements by the state, such as limits on fees. Participation is voluntary. Washington was the first state to create a marketplace for small businesses to connect with certified retirement savings vendors.

  This model has since been adopted by New Jersey and proposed in Maine, Arkansas, Connecticut, North Dakota, and Oklahoma.

- **Publicly-administered defined contribution (DC) plans** (a.k.a. open multi-employer plans, or MEP), allow multiple employers to pool their resources to maintain a single plan, managed by a public agency or independent board. This simplifies administration for employers, and provides economies of scale that reduce related fees and expenses for participants.

  Three states have enacted or proposed this policy model: Massachusetts, New Jersey and Vermont.

- **Hybrid/MEP vehicles** pair publicly-administered DC plans with auto-IRAs. Under this policy, states can offer plans that suit different employers. If employers choose not to participate in a prototype or open MEP, they are required to provide coverage through an auto-IRA program.

  Three states and one city have proposed hybrid retirement reform models: Massachusetts, Minnesota, Texas and New York City.

These policy innovations have yielded mixed results. For example, Oregon's auto-IRA program – called OregonSaves – is one of the most successful state initiatives so far, but it falls short in crucial areas. The program seeks to provide a retirement savings vehicle to more than 1 million workers (60 percent of the workforce) who lack access to an employer-sponsored retirement savings plan.[12] A pilot program started in July 2017, and since full rollout, it has added an average of nearly 2,000 actively contributing employees per month. As of November 2018, approximately 22,000 workers in the program had balances in their accounts, totaling more than $10 million in assets.[13]

Nonetheless, 33 percent of eligible workers have chosen not to participate – either by formally opting out of the program (29 percent), or setting contributions to zero (4 percent). Workers who chose not to participate offered three main reasons: 30 percent said they could not afford to save, 19 percent said they had their own or another retirement plan (e.g. through a spouse), and 12 percent said they did not want to save through this particular employer. Another troubling trend: only about a third of registered employers have begun submitting their employees' contributions, so it's taking longer than anticipated for workers to actually start saving.

In Washington, the state-run Retirement Marketplace web portal only offers plans to businesses with fewer than 100 employees. That excludes an estimated 228,000 Washington workers without a workplace-based retirement plan.[14] The Marketplace has not performed well, with only 4,571 visitors since launching in March 2018, resulting in just 489 referrals (255 employers and 234 individuals) to financial providers.[15]

State Supplemental Social Security is a better option

The various approaches adopted by states to date share the same goal: ensure workers have access to a retirement plan at work, and by extension, a greater degree of economic security in retirement. These policies offer an incremental improvement for some workers, but they do not go far enough. They are built on defined contribution plans, where the more you make the more you can save, and individuals invest in speculative asset markets. There's little protection for people retiring during a long market downturn, and survivor and dependent benefits are limited.

Social Security is usually thought of as a federal program, but when it was enacted in 1935, 28 states (including Washington) were operating their own "old-age pension" programs.[16] Colorado and Alaska still fund and administer such programs today.[17] A state Supplemental Social Security program could be designed with a number of policy advantages over existing state retirement policies, including:

- universal coverage,
- auto-enrollment with no opt-outs,
- full portability from job to job,

- participation by both employees and employers,
- an ability to provide progressive and dependent benefits, and
- professionally-managed assets that are pooled to minimize both fees and risk.

The operational parameters of such a program are fairly straightforward:

- **Revenue Collection:** Use a system similar to Washington's Family and Medical Leave Insurance to collect a small payroll premium (shared between employer and employee).
- **Coverage and Benefits:** Every worker (including sole proprietors and the self-employed) would contribute, and every worker contributing would be covered. Lifetime benefits could begin one to two years after revenue collection starts, with retirees receiving a monthly payment equivalent to a fixed percentage of their federal Social Security check for their lifetime, based on a formula accounting for their years of participation in Washington's program.
- **Management and Oversight:** Like Social Security, assets would be pooled. This fund would be managed and overseen by the Washington State Investment Board, which has long experience managing public funds, and investing in public equity, fixed income, and alternative markets.

In addition to improving economic security for retirees, Supplemental Social Security would provide economic benefits for local economies and support public investment throughout the state:

- **Economic Stimulus:** Among elderly Social Security beneficiaries, 48% of married couples and 69% of unmarried persons receive 50% or more of their income from Social Security, with an average monthly benefit of just $1,413.[18] Not surprisingly, most people who receive Social Security benefits don't save that money for a rainy day; they spend it on goods and services.

  Businesses use that income to purchase more goods and services, realize profits and hire more employees. Those employees spend their wages on more goods and services, which in turn creates more spending and income for more people. This creates a powerful multiplier effect that benefits the economy, businesses and workers. Every dollar of Social Security paid out translates to almost two dollars in spending in the United States.[19] Supplemental Social Security would likely yield similar benefits across Washington.
- **Investment of Surplus Funds:** Because the majority of Washington workers would contribute premiums for many years before collecting benefits, the program would accumulate surplus revenue. The Washington State Investment Board could invest surplus funds in government bonds or similar securities that underpin state investment in infrastructure, school construction, rapid transit, and affordable housing – boosting the state's economy and yielding substantial improvements in quality of life for Washington residents.

A preliminary projection indicates that a state Supplemental Social Security program enacted in 2020 (with revenue collection in 2021 and the first benefits paid in 2022) would be operable to at least the year 2060.[20]

STATE SUPPLEMENTAL SOCIAL SECURITY: PROJECTED AVERAGE PREMIUMS AND BENEFITS

With 0.75% total premium and 1% of federal Social Security benefit per year participating (15% max.)

Year	Average Yearly Wage	Average Yearly Premium (worker only)	Years of premiums paid	Average lifetime yearly benefit for worker retiring in year shown*
1	$63,047	$236	0	n/a
5	$66,890	$251	4	$895
10	$72,214	$271	9	$2,278
15	$78,353	$294	14	$4,008
20	$85,576	$321	19	$4,859
25	$94,208	$353	24	$5,498
30	$104,749	$393	29	$6,220
35	$117,625	$441	34	$7,037
40	$133,157	$499	39	$7,962

With 1.0% total premium and 1.5% of federal Social Security benefit per year participating (20% max.)

1	$63,047	$315	0	n/a
5	$66,890	$334	4	$1,342
10	$72,214	$361	9	$3,416
15	$78,353	$392	14	$5,726
20	$85,576	$428	19	$6,479
25	$94,208	$471	24	$7,330
30	$104,749	$524	29	$8,293
35	$117,625	$588	34	$9,383
40	$133,157	$666	39	$10,616

With 1.25% total premium and 2% of federal Social Security benefit per year participating (25% max.)

1	$63,047	$394	0	n/a
5	$66,890	$418	4	$1,789
10	$72,214	$451	9	$4,555
15	$78,353	$490	14	$7,158
20	$85,576	$535	19	$8,098
25	$94,208	$589	24	$9,163
30	$104,749	$655	29	$10,367
35	$117,625	$735	34	$11,729
40	$133,157	$832	39	$13,270

With 1.5% total premium and 3% of federal Social Security benefit per year participating (28% max.)

1	$63,047	$473	0	n/a
5	$66,890	$502	4	$2,684
10	$72,214	$542	9	$6,833
15	$78,353	$588	14	$8,017
20	$85,576	$642	19	$9,070
25	$94,208	$707	24	$10,262
30	$104,749	$786	29	$11,611
35	$117,625	$882	34	$13,136
40	$133,157	$999	39	$14,863

**Retirement benefit only, assuming minimum of 35 years of earnings in Washington, with federal Social Security benefit calculated per current formula. Projection based on historical demographic, economic, and other trends derived from data provided by the Washington Office of Financial Management, Washington Employment Security Department, U.S. Social Security Administration, and U.S. Census Bureau.*

Next Steps

While Washington already has many of the administrative tools necessary to operationalize state Supplemental Social Security, important policy design choices remain, including:

- **Balancing individual equity and social adequacy of benefits:** Individual equity is the degree to which benefits payable are based on a participant's contributions. Social adequacy is the degree to which benefits payable are based on a participant's need. The federal Social Security benefit formula assigns higher benefits for workers with a history of higher pre-retirement salaries (though not on a one-to-one basis, and benefits are effectively capped) while also providing a proportionately greater benefit for lower-income workers.

  By calculating state Supplemental Social Security benefits as a percentage of federal benefits, that particular balance of individual equity and social adequacy is maintained. However, benefits can be calculated in other ways. For example, Washington's Family and Medical Leave Insurance program utilizes a more progressive benefit structure but does not provide dependent benefits.

- **Establishing survivor's benefits:** When a wage earner eligible for benefits dies, some or all of their benefit goes to their spouse, former spouse or dependent children.

- **Determining premium rate, wage base, and cost-sharing:** The premium rate and wage base directly influence revenue collection – and by extension, scheduled benefits. The premium itself is usually collected via payroll deduction, and the cost is shared between the employee and employer, though the ratio varies. For example: Social Security and Medicare premiums are split equally; premiums for Washington's Family and Medical Leave Insurance are split 37 percent employer/63 percent employee; and up to one-half of Workers' Compensation premiums may be paid by employee contribution. These programs only tax income below an established level ($132,900 in 2019), but Medicare taxes all wages.

- **Developing program forecasts and tracking beneficiaries:** The Social Security Trustees and actuaries review the program's projected finances annually. They prepare decade-by-decade projections of life expectancy and birth rates, wage growth, inflation, labor force growth, interest rates, and other relevant variables – along with careful explanations of how these numbers are derived and the sensitivity of the calculations to each assumption.

  Washington will need to develop a similar forecast (including baseline, optimistic and pessimistic economic scenarios) for Supplemental Social Security. The state's Office of Financial Management, Economic Revenue and Forecast Council, and Employment Security Department are potential resources. A partnership with the Social Security Administration could provide additional insights, and help ensure benefits reach eligible residents who move out of state.

Lawmakers should begin working with government, community, labor and business partners to determine answers to these and other policy design questions. After a lifetime of hard work, aging shouldn't beget economic hardship. Establishing and operating a state Supplemental Social Security program will make Washington a better place for every resident to live, work and retire.

Endnotes

[1] The Center for Retirement Research at Boston College estimates that a middle-income two-earner couple born between 1960-1962 will need to replace 76 percent of their income excluding health care and long term care costs, and 98 percent including these costs. See: Center for Retirement Research at Boston College, Long-Term Care Costs and the National Retirement Risk Index, Issue Brief No. 9-7, March 2009.

[2] Center for Retirement Research, Pension Participation, Wealth, and Income: 1992-2010, https://crr.bc.edu/wp-content/uploads/2016/07/wp_2016-3-1.pdf.

[3] Washington Department of Commerce, Retirement Readiness, November 2017 Report to the Legislature.

[4] Employee Benefit Research Institute, unpublished estimates of the 2004 Survey of Income and Program Participation Wave 7 Topical Module (2006 data) for workers earning between $30,000 and $50,000, 2006, as cited in AARP Public Policy Institute Fact Sheet: Access to Workplace Retirement Plans by Race and Ethnicity, February 2017. (Via Washington Dept. of Commerce, Retirement Preparedness Study Summary, http://www.commerce.wa.gov/wp-content/uploads/2018/02/Retirement-Preparedness-Exec-Sum-Handout.pdf.)

[5] Boston College Center for Retirement Research, 2016. Calculations from Current Population Survey, March Supplement 2015 (reflecting 2014 calendar year data). Note: Weighted using the Current Population Survey, March Supplement weights. Workers are not in the military, are not unpaid family workers, and are in the pension universe. Includes both private and public sector workers. All public sector workers are considered as working for an employer offering a plan. (Via Washington Dept. of Commerce, Retirement Preparedness Study Summary, http://www.commerce.wa.gov/wp-content/uploads/2018/02/Retirement-Preparedness-Exec-Sum-Handout.pdf.)

[6] FINRA Investor Education Foundation, Financial Capability in the United States 2016, July 2016, http://www.usfinancialcapability.org/downloads/NFCS_2015_Report_Natl_Findings.pdf.

[7] Sizeable – which is called "extraordinary" by the JPMorgan Chase Institute – is defined as at least $400, more than 1 percent of income, and more than two standard deviations from the family's average monthly expense in the relevant spending category. See: Coping with Costs: Big Data on Expense Volatility and Medical Payments, February 2017, JPMorgan Chase Institute, https://www.jpmorganchase.com/corporate/institute/document/institute-coping-with-costs-report.pdf. (Via Washington Dept. of Commerce, Retirement Preparedness Study Summary, http://www.commerce.wa.gov/wp-content/uploads/2018/02/Retirement-Preparedness-Exec-Sum-Handout.pdf.)

[8] Center for Retirement Research, How Does Student Debt Affect Early-Career Retirement Saving?, September 2016, http://crr.bc.edu/working-papers/how-does-student-debt-affect-early-career-retirement-saving/.

[9] LendEDU, Student Loan Debt by School by State, August 2018, https://lendedu.com/blog/average-student-loan-debt-statistics#Washington.

[10] Washington State Attorney General, Borrowers in Crisis: Student Debt in Washington, https://agportal-s3bucket.s3.amazonaws.com/uploadedfiles/Another/News/Press_Releases/Student%20Loan%20Report%2012.1.17%20v18.pdf.

[11] Schwartz Center for Economic Policy Analysis, The New School for Social Research, State Retirement Reform: Lifting up Best Practices, http://www.economicpolicyresearch.org/images/docs/research/retirement_security/States_of_Reform_FINAL.pdf.

[12] Center for Retirement Research at Boston College, Oregon Market Research Report, July 2016, https://www.oregon.gov/retire/SiteAssets/Pages/Newsroom/ORSP_Market_Analysis_13JULY2016.pdf.

[13] Center for Retirement Research at Boston College, How Have Workers Responded To Oregon's Auto-IRA?, December 2018, http://crr.bc.edu/wp-content/uploads/2018/12/IB_18-22.pdf.

[14] Economic Opportunity Institute calculation based on Washington State Retirement Marketplace guidelines and data from Bureau of Labor Statistics, Employee Benefits Survey, March 2017,

https://www.bls.gov/ncs/ebs/benefits/2017/ownership/civilian/table02a.htm and Washington State Employment Security Department, Establishment Size, https://fortress.wa.gov/esd/employmentdata/reports-publications/industry-reports/establishment-size.

[15] Information provided by Washington State Department of Commerce, January 2019.

[16] Social Security Administration, Agency History, https://www.ssa.gov/history/bortz.html.

[17] See: Colorado Dept. of Health Care Policy and Financing, Old Age Pension and Medical Care Program, https://www.colorado.gov/pacific/hcpf/old-age-pension-health-and-medical-care-program-oap; Alaska Dept. of Health and Social Services, Alaska Senior Benefits, http://dhss.alaska.gov/dpa/Pages/seniorbenefits/default.aspx.

[18] Social Security Administration, Facts and Figures About Social Security, 2018, https://www.ssa.gov/news/press/factsheets/basicfact-alt.pdf.

[19] AARP Public Policy Institute, Social Security's Impact on the National Economy, https://www.aarp.org/content/dam/aarp/research/public_policy_institute/econ_sec/2013/social-security-impact-national-economy-AARP-ppi-econ-sec.pdf.

[20] Projection based on historical demographic, economic, and other trends derived from data provided by the Washington Office of Financial Management, Washington Employment Security Department, U.S. Social Security Administration, and U.S. Census Bureau.