THIRD WAY

BLOG *Published December 7, 2023 • 3 minute read*

Projected Savings and Social Security Income Fail to Replace Non-College Seniors' Earnings

***Anthony Colavito**, Former Economic Policy Advisor*

The income a retiree will receive from Social Security and retirement savings is a key determinant of their retirement security. Another is whether that income can afford them their pre-retirement standard of living. Financial advisers, researchers, and government analysts use a number of metrics to compare retirement incomes against pre-retirement earnings to assess this possibility. [1] Using past Third Way projections, we see across all metrics that current savings and Social Security income alone are insufficient for keeping non-college retirees comfortable in retirement, unlike for the college educated. This means non-college workers will be more reliant on earnings, means-tested public assistance, and help from family to get by in retirement relative to their college-educated peers. [2]

Retirement incomes are typically compared against pre-retirement earnings through a metric called a replacement rate—retirement income expressed as a percentage of pre-retirement earnings. Since workers have expenses that retirees don't—like higher taxes, work expenses, and mortgage costs—seniors often require less income than working people to afford the same standard of living. Hence, retirement incomes can replace less than 100% of pre-retirement earnings for workers to retire comfortably.

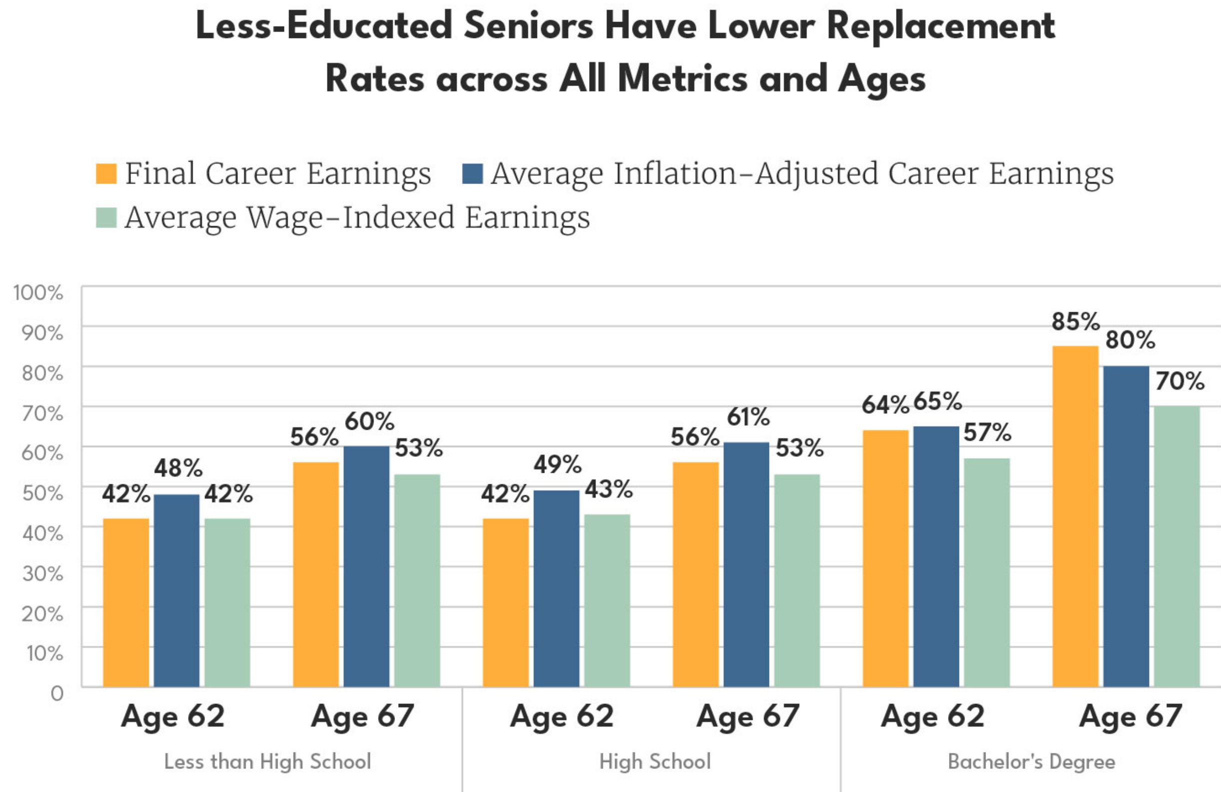
Different analyses use different definitions of pre-retirement earnings, however. The three most commonly used are:

- **Final career earnings:** The average annual earnings a worker receives in the final few years before retirement. Retirement planners typically advise clients to plan to replace 70-85% of this figure. [3]

- **Average inflation-adjusted career earnings:** The average of a worker's annual career earnings, adjusted for inflation. This metric is informed by economic theory, which suggests people seek to smooth consumption over the course of their life. [4]

- **Average wage-indexed career earnings:** The average of a worker's annual career earnings, indexed to average wage growth. This measure, used in past Social Security Administration trustees' reports, reflects the idea that workers save more—and consume less—early in their careers to save against unpredictable drops in income resulting from unemployment, sickness, and old age. [5]

A previous Third Way analysis projected the income that near-retirees will be able to live off of from Social Security and annuitized wealth. [6] This information plus data on lifetime earnings reveals that these two components of retirement income are insufficient to afford non-college seniors a comfortable retirement.



Source: Author's calculations.

While different measures show different degrees of preparation, across all of them, seniors with less than a college degree can replace no more than 61% of their pre-retirement earnings, however they are measured, if they retire at 67. At the same time, the lowest possible replacement rate that a college educated retiree can achieve at 67 is 70%. And since lower-education retirees typically have to replace a higher share of their pre-retirement earnings than higher-education retirees (as they tend to have been lower-income workers who consume most of their income), these low replacement rates reflect an even greater gap in retirement preparedness.

The age at which a worker retires also impacts how much of their earnings their retirement income can replace. Claiming Social Security earlier than when a worker hits their Full Retirement Age reduces their monthly benefit, and stopping work at an early age can force a retiree to accrue fewer savings and to rely on them for longer. Across all measures, projected retirement incomes at 62 fail to cover at least 50% of retirement earnings for near-retirees without degrees.

What these numbers show is that Social Security and savings is not be enough for a non-college senior to get by in retirement. They will either have to keep working, even when it may not be healthy for them to do so, rely on public assistance, or seek help from family members just to maintain the lives they were used to. This experience is not something the college educated have to go through based on the numbers presented here. Policymakers must continue searching for ways to help non-college workers prepare for a fulfilling retirement.

ENDNOTES

1. Biggs, Andrew G. and Glenn R. Springstead. "Alternate Measures of Replacement Rates for Social Security Benefits and Retirement Income." *Social Security Bulletin*, Vol. 68, No. 2, 2008, https://www.ssa.gov/policy/docs/ssb/v68n2/v68n2p1.html#:~:text=Specifically%2C%20it%20is%20commonly%20accepted,rate%20of%20roughly%2040%20percent. Accessed 27 Nov. 2023.

2. Colavito, Anthony. "Peaceful or Stressful? America has Two Kinds of Retirement." *Third Way*, 12 Sep. 2023, https://www.thirdway.org/blog/new-numbers-on-the-non-college-retirement-challenge. Accessed 27 Nov. 2023.

3. "Retirement Security: Better Information on Income Replacement Rates Needed to Help Workers Plan for Retirement." *Government Accountability Office*, 1 Mar. 2016, https://www.gao.gov/products/gao-16-242. Accessed 27 Nov. 2023.

4. Modigliani, Franco. "Life Cycle, Individual Thrift, and the Wealth of Nations." *American Economic Review*, Vol. 76, No. 3, Jun. 1986, https://www.nobelprize.org/uploads/2018/06/modigliani-lecture.pdf. Accessed 27 Nov. 2023.

5. Carroll, Christopher D. "Buffer-Stock Saving and the Life Cycle/Permanent Income Hypothesis." *The Quarterly Journal of Economics*, Vol. 112, No. 1, Feb. 1997, https://www.jstor.org/stable/2951275. Accessed 27 Nov. 2023.

6. Colavito, Anthony. "Peaceful or Stressful? America has Two Kinds of Retirement." *Third Way*, 12 Sep. 2023, https://www.thirdway.org/blog/new-numbers-on-the-non-college-retirement-challenge. Accessed 27 Nov. 2023.