Using Trusts as a Means to Reduce Retirement Funding Shortfalls

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ABSTRACT

Many persons depend to a large extent on social security to fund their retirement. Yet according to the Social Security Administration (SS Advisory 2008), the average beneficiary age 62-64 receives benefits equal to only 50% of income. Some 40% of those over age 80 depend on social security for 90% of their total income. Furthermore, without significant changes in anticipated revenues or expenses, social security will likely become unable to pay 100% of scheduled benefits within the next twenty years (SS Administration, 2012). This of course could leave many retirees in difficult financial situations. The Congressional Budget Office had forecast that due to the weak economy and reduced tax revenue, the Social Security trust fund will be cash flow negative in 2010, many years ahead of previous forecasts. Ignoring interest income, that is now the situation (SS Administration, 2012).

Given current economic conditions, secular trends in employee benefit plans, and federal government financing shortfalls, individuals in the future will likely have to become more self-sufficient in funding their own retirement. The long-term trend in employee benefits is a continued shift to defined contribution plans from defined benefit plans. Research suggests many people underfund their defined contribution plan and invest too conservatively. The foreseeable trend in government financing is larger deficits, not smaller. The Federal Government's budget is likely to be under stress for many years, making it unlikely that social security benefits will expand. Benefits are more likely to contract for future retirees. In all probability, individuals will have more responsibility to fund their retirement going forward, not less. In such an environment, time will be a key ingredient for individuals to successfully fund their retirement goals.

In this paper, we examine the idea of a funding mechanism to start infants on a path to retirement security that simultaneously could be used to reduce some of the Social Security Administration's unfunded obligations to future retirees. To begin, we provide a review of the three legs of retirement funding: Social Security, employer-based plans, and private savings. We then consider the concept of "adequate" retirement funds, the financial constraints faced by the Social Security Administration, and finally the use of Trusts to address the long-term societal problems caused by insufficient retirement funding.

Based on our prior work, under reasonable nominal rates of return we found that funding of approximately $1000 per newborn per year for five years could alleviate a great degree of retirement funding uncertainty and shortfall. Extending this prior work, in this paper we introduce a more realistic simulation, considering this funding program on a present value basis with comparison to an "average" Social Security recipient.