A Very Simple "Minimum Benefit" Idea for Social Security

November 29, 2016 **MarketWatch Blog** by Alicia H. Munnell

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Eliminating the actuarial reduction for a portion of benefits provides a basic income.

The rise in Social Security's Full Retirement Age from 65 to 67 has raised concerns about the adequacy of benefits of low-wage workers, who generally claim at 62 or 63. The rise in the Full Retirement Age will cut benefits claimed at any age by about 13 percent, which could push a significant number of low-wage early claimers below the poverty line. The primary response to the specter of rising elderly poverty has been renewed interest in establishing a meaningful "minimum benefit." (Social Security currently has a "special minimum benefit," but, since it was indexed for prices not wages, its value has eroded and few are eligible.)

Steve Sass, my colleague at the Center for Retirement Research, has a proposal that would help low-income early claimers by not actuarially adjusting the first tranche in the benefit calculation. Let me explain what that means.

Steve’s proposal would modify the third step in the following 3-step process that Social Security uses to set benefits:

1. Social Security first calculates the worker’s Average Indexed Monthly Earnings (AIME) –basically the average of the worker’s highest 35 years of taxed earnings, with prior earnings indexed to the present by the growth of average wages.
2. Social Security then calculates the worker’s Primary Insurance Amount (PIA) – the worker’s benefit at the Full Retirement Age. This calculation is basically done by dividing the worker’s AIME into 3 parts: the worker’s AIME below 22 percent of the national average wage when the worker was age 60; between 22 and 133 percent of the average wage; and above 133 percent of the average wage. The PIA replaces 90 percent of the worker’s AIME in the first tranche, 32 percent of AIME in the second tranche, and 15 percent of AIME in the third.
3. Social Security then sets the worker’s benefit by actuarially adjusting the worker’s PIA based on the age the worker claims.

Steve’s proposal modifies the third step so that Social Security would actuarially adjust just the second and third tranches of the PIA, but not the first. The first tranche would provide a basic retirement income that is not adjusted, up or down, based on when a worker claims. Thus, workers with AIME below 22 percent of the national average wage – $10,582 in 2015 – would receive a benefit equal to 90 percent of pre-retirement earnings even if they retire early. Higher earners who claim early would also see a benefit increase, since the first tranche of their benefit would not be actuarially reduced either. The benefits of those who claim after their Full Retirement Age would be reduced, as they would not receive a delayed retirement credit on the first tranche of their benefit.

Treating the first tranche of the Primary Insurance Amount as a basic retirement income that is not actuarially adjusted could dramatically reduce, if not eliminate, any increase in elderly poverty due to the rise in the Full Retirement Age. It would do so without introducing a "minimum benefit" overlay to the current program that complicates retirement planning. On the other hand, benefit outlays would increase, as most workers claim benefits before their Full Retirement Age, so other changes would be required to make the proposal cost neutral. And the change to the actuarial adjustment might reduce incentives to work longer. But the proposal's simplicity and the intuitive appeal of a "basic" income benefit argue for putting it into the hopper with other minimum benefit proposals.