Older Americans' Economic Security

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Minimum Benefits in Social Security

Design Details Matter

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Social Security does not currently guarantee low-wage workers a minimum retirement benefit. Using the Urban Institute's dynamic microsimulation model, we analyze different minimum benefit designs and show that such policies could help reduce poverty among older Americans. We also find that the effects that minimums could have on poverty differ greatly depending on their design features. Understanding the effects that a well-designed minimum benefit could have is especially important now, when the program's long-term fiscal deficit threatens future benefit reductions.

Design Features within Minimum Benefits

In 1998, the bipartisan National Commission on Retirement Policy proposed reforms that contained a minimum benefit within Social Security. More recently, numerous congressional proposals and a commission set up by President George W. Bush have also included a minimum benefit as part of reform packages.

A minimum could take many forms, influencing its ability to reduce poverty. Important dimensions of a minimum benefit's design include the following:

- benefit level (often expressed as a percentage of the poverty level) and how it varies with years of service;
- number of service years required (usually based on work, but could be based on combinations of childrearing and work, for example);
- definition of a service year (e.g., four covered quarters, 1,000 hours at the minimum wage, care for a child under age 5);
- permissibility of partial service years (for example, people earning half the designated threshold receive half a credit);
- whether and how disabled persons qualify;
- treatment of future benefit levels (e.g., does it grow with wages or prices, or something in between, and if indexed, when does indexing begin?);
- computation method (e.g., is it attached to the primary insurance amount [PIA], or does it occur after actuarial adjustments?);[1]
- whether it confers an additional spousal right;
- whether it unintentionally creates windfalls for groups without strong attachment to Social Security–covered work (e.g., uncovered state and local workers, immigrants living in the United States for a short time) and whether prorating can address these issues; and
- how well it coordinates with means-tested assistance (e.g., does the minimum remove people from—or move people onto—Medicaid and other programs?).

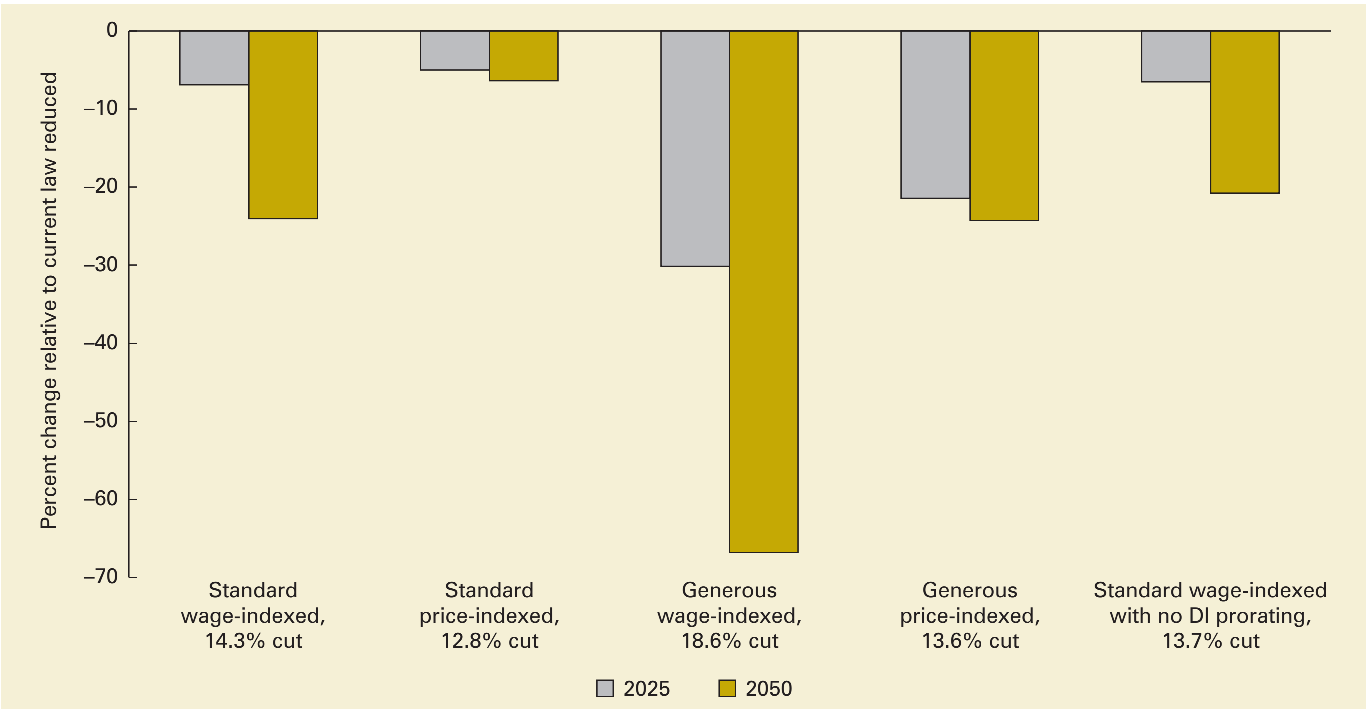
Five Alternative Benefit Options

We examine two basic types of minimum benefits. A **standard** benefit pays 55 percent of the poverty level for a single person age 65 or older for 10 years of work and an additional 1.5 percent of the poverty level for each additional work year up to 40, so a worker with 40 years of covered earnings would receive a primary insurance amount at least equal to the poverty level. (The years requirements are prorated based on age at onset of disability for those who receive Social Security disability benefits.) A **generous** minimum benefit provides 80 percent of the poverty level for 10 years of work and 120 percent of the poverty level for 40 years of work. We examine these two minimum benefits separately with a poverty level that is price-indexed and then one that is wage-indexed. A final option is equivalent to the standard wage-indexed minimum, but it does not prorate the work years requirement for individuals on disability insurance. Each of the five options is accompanied by an across-the-board benefit cut so the Social Security deficit in 2050 is cut in half. Because the minimum benefit packages we simulate are cost-equivalent in 2050, the cuts are smallest for the least generous benefit (12.8 percent for the standard price-indexed minimum) and largest for the most generous benefit (16.8 percent for the generous wage-indexed minimum) (figure 1).

Conclusions and Policy Implications

The more generous wage-indexed minimum benefit leads the pack, reducing poverty by about one-third in

FIGURE 1. *Percent Change in Poverty under Five Options (Relative to Current Law Reduced to Meet Half the Social Security Deficit in 2050), Beneficaries Age 62 and Over*



Source: Authors' calculations from DYNASIM3.

Notes: Under current law reduced benchmark, benefit cuts of 12.45 percent take place during the calculation of the primary insurance amount and are effective for all retirees taking up benefits after 2007. See Favreault, Mermin, and Steuerle (2006) for additional details on the alternative.

2025 and two-thirds (or over 2.2 million people) in 2050. In general, our simulations show that the minimum benefits designed with high requirements for qualification—large numbers of work years, for instance—have more modest impacts (see Favreault et al. 2007 for impacts on high-risk groups). The broader reach of the more generous minimum, however, raises issues of equity for long-term workers and adequacy of work incentives.

Several important lessons for designers of Social Security policy become clear from these simulations. Many minimum designs would lose relevance over time if not tied to wage growth. Approaches that best alleviate poverty tend to reward work less. Also, minimum benefit designs that do not take into account the truncated work histories of disabled workers will have less success at alleviating poverty. Finally, different approaches to cutting benefits (e.g., across-the-board cuts versus cost-of-living-adjustment cuts, increasing computation years, or cuts that shield the bottom) have very different implications, both on their own and when combined with the minimums. In sum, design details can make a substantial difference in prospects for poverty reduction.

Note

1. The primary insurance amount is the benefit disabled workers receive and retired workers receive if they claim benefits at the normal retirement age.

References

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