Older Americans' Economic Security

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Minimum Benefits in Social Security Could Reduce Aged Poverty

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Although Social Security ties benefits to lifetime earnings, it also redistributes income, replacing a higher share of preretirement earnings for low earners than for high earners. However, it does not guarantee a minimum benefit, and many long-service, low-wage workers receive benefits that leave them below the federal poverty level.[1] African Americans, Hispanics, and unmarried women are especially vulnerable.

This brief considers the effect of a Social Security minimum benefit on the program's adequacy. With benefit cuts looming in the face of Social Security's long-term fiscal deficit, an effective minimum benefit could help protect the highest-risk groups.

Effects of Minimum Benefits on Poverty Rates

Despite Social Security's success at bolstering retirement security, many older Americans remain mired in poverty. Almost 8 percent of Social Security beneficiaries ages 65 and older had incomes below the poverty level in 2004, with some groups especially vulnerable. For instance, almost 10 percent of older beneficiary women—and 17 percent of all unmarried older women—had incomes below the poverty level. Poverty rates approach 24 percent for older African Americans and 19 percent for older Hispanics (Social Security Administration 2006).

Productivity gains will likely reduce old-age poverty over time. The federal poverty level increases each year with prices, but productivity improvements drive wages (and hence Social Security benefits) even higher. Assuming Social Security pays all benefits scheduled under current law, the poverty rate for all Social Security beneficiaries ages 65 and older will decline to about 5 percent in 2025 and 3 percent in 2050 (table 1). However, unmarried women, African Americans, and Hispanics are expected to remain high-risk groups. (Estimates are based on Urban Institute's Dynamic Simulation of Income Model, DYNASIM3.)

Actual poverty rates are likely to exceed these projections, however, because Social Security's long-term financing problem makes future benefit cuts likely. Although it is impossible to predict how policymakers will choose to balance the system, we assumed that changes would be split equally between benefit cuts and tax increases. Under this scenario, an across-the-board benefit cut of 12.45 percent would cut the long-term Social Security deficit in half by 2050. This benefit cut would raise the 2050 poverty rate among older Americans by about 1 percentage point above the rate projected under current law.

A minimum benefit could mitigate the cutback's potential effects on women and racial and ethnic minorities, but the impact depends on how the minimum benefit is structured. We considered two alternatives. The first approach sets a minimum Social Security benefit equal to the poverty level for someone with 40 years of covered earnings who begins collecting at the normal retirement age (67 for future retirees). Because this minimum benefit would increase with prices, it loses relevance over time as average wages and Social Security benefits outpace price hikes. The second, more generous approach would provide full Social Security benefits equal to 120 percent of the poverty level to beneficiaries with 40 years of work, and would rise over time with average wages. Both minimums would be prorated for those with shorter work histories and would be financed by across-the-board cuts in Social Security benefits.

The standard price-indexed minimum benefit would offer relatively little security, reducing overall poverty rates at older ages by about half a percentage point in 2025. The impact would be even smaller in 2050 because average benefit growth would have eroded much of the protection.

However, the more generous minimum that increased with average wages could lift substantial numbers of older Americans out of poverty. For example, poverty among African Americans in 2050 would decline to 2.9 percent, compared with 6.2 percent for benefits scheduled under current law. A generous wage-indexed minimum benefit would cut poverty rates nearly in half for Hispanics and unmarried women.

TABLE 1. Poverty Rates among Beneficiaries Ages 65 and Older, under Current Law and Alternative Minimum Benefit Designs, 2025 and 2050 (percent)

	Current law scheduled	Alternative Benefit Formula		
		Current law reduced[a] 1	Standard price-indexed[b] 2	Generous wage-indexed[c] 3
Poverty rate, 2025				
All	5.4	6.8	6.4	4.8
Unmarried women	9.8	11.7	11.5	8.9
African Americans	12.9	15.4	15.0	11.6
Hispanics	13.7	17.9	17.0	12.1
Poverty rate, 2050				
All	3.1	4.2	4.0	1.5
Unmarried women	5.6	7.4	7.1	3.0
African Americans	6.2	8.1	7.7	2.9
Hispanics	5.7	7.4	7.1	2.7

Source: Authors' calculations from DYNASIM3.

a. Benefit cuts of 12.45 percent take place during the calculation of the primary insurance amount (PIA) and are effective for all retirees taking up benefits after 2007.

b. Workers with 10 years of covered earnings receive a PIA of 55 percent of the poverty level. Each additional year of work adds 1.5 percent of the poverty level, up to a maximum of 40 years. A benefit cut of 12.81 percent, larger than under alternative 1 in order to finance the minimum, is applied during the calculation of the PIA and is effective for all retirees taking up benefits after 2007.

c. Workers with 10 years of covered earnings receive a PIA equal to 80 percent of the poverty level. For the next 10 years, they receive 2 percent for each additional year, and from 21 to 40 years they receive 1.0 percent for each additional year. A benefit cut of 18.62 percent, larger than under the standard minimum (alternative 2), is applied during the calculation of the PIA and is effective for all retirees taking up benefits after 2007.

See Favreault, Mermin, and Steuerle (2006) for additional details on the alternative.

Conclusions

A minimum benefit that improves the adequacy of Social Security benefits could be an important part of a Social Security reform package that cuts benefits. But how much a minimum benefit would reduce poverty depends on how it is designed. For example, would it cover only people with long work histories? How would it increase with prices? (See Favreault, Mermin, and Steuerle 2007.) A minimum benefit that increases with average wages could significantly reduce poverty rates, even if combined with across-the-board benefit reductions.

Note

1. Social Security technically does include a "special minimum PIA" under current law, but less than 0.5 percent of the OASDI caseload receives benefits on this basis. Coverage by the special minimum has declined in large part because its parameters are indexed to prices (rather than wages).

References

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