



WAYS AND MEANS

CHAIRMAN KEVIN BRADY

CALCULATING SOCIAL SECURITY BENEFITS

BACKGROUND

- Social Security benefits are based on a worker's average lifetime earnings from jobs where the worker paid Social Security taxes.
- The Social Security benefit formula is meant to be progressive. This means that workers with lower average lifetime earnings receive a benefit that replaces a higher proportion of their earnings compared to higher lifetime earners.
- The benefit formula works well for people who have spent their whole careers in jobs where they paid into Social Security through payroll taxes.
- However, some federal, state, and local government employees – including teachers, fire fighters, and police officers – participate in separate pension plans and do not pay Social Security taxes.
- The Social Security formula does not work as well for individuals who spend part of their careers in jobs where they paid Social Security taxes and part of their careers in jobs where they paid into a substitute retirement system.

HOW ARE SOCIAL SECURITY BENEFITS CALCULATED?

Step 1: Determine The Worker's Average Lifetime Earnings

- A worker's Social Security benefit is based on her average lifetime earnings from jobs where she paid Social Security taxes.
- The highest 35 years of earnings from jobs where the worker paid Social Security taxes, adjusted for growth in wages over time, are used to calculate the worker's average indexed monthly earnings (AIME).
- A zero is used for years in which the worker does not pay Social Security taxes. These zeros decrease the worker's average lifetime earnings.
 - The zeros could occur for different reasons. For example, if the individual did not work for a few years or if she worked for a state or local government and paid into a substitute retirement system instead of paying into Social Security.

Step 2: Apply Social Security Benefit Formula

- The benefit formula is applied to the AIME to determine the worker's monthly benefit amount, known as the primary insurance amount (PIA).
- The dollar amounts used in the formula are adjusted annually for wage growth. In 2016, the benefit formula is:
 - 90 percent of the first \$856 of AIME,
 - 32 percent of AIME between \$856 and \$5,157, and
 - 15 percent of AIME above \$5,157 and up to \$9,875.
- The Social Security benefit formula is designed so that a worker with lower average lifetime earnings receives a benefit that replaces a higher percentage of her earnings as compared to a worker with higher average lifetime earnings.
- In other words, lower lifetime earners receive a higher “replacement rate” from Social Security than do higher earners.

HOW DOES THE WINDFALL ELIMINATION PROVISION FIT IN?

- A worker who spends part of her career paying into a substitute retirement system has zeros in her AIME for the years where she did not pay Social Security taxes. The zeros mean that she looks like a low lifetime earner even though she may not be.
- To adjust for these zeros, the Windfall Elimination Provision or WEP reduces the replacement rate for earnings in the first bracket.
- The WEP uses a different benefit formula. The 90 percent factor that is typically applied to the first bracket of earnings is replaced by a 40 percent factor. The other two factors remain the same.
 - Some individuals may be reduced less if they have more than 20 years paying Social Security taxes.¹
- The WEP only applies to someone who meets the following criteria:
 - Has earnings from a job where she paid Social Security taxes and from a job where she did not, and
 - Is receiving a pension from the job where she did not pay Social Security taxes, and
 - Has spent fewer than 30 years in jobs where she paid Social Security taxes.

¹ The 40 percent factor applies for those with 10 to 20 years paying Social Security taxes. The 40 percent factor increases by 5 percentage points for each additional year of paying Social Security taxes if earnings exceed a specified amount. This increase continues until the WEP is fully phased out for those with at least 30 years paying Social Security taxes.

