Retirement Researcher

Calculating Social Security Retirement Benefits

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I will discuss the philosophy of claiming strategies later, but it is meaningful to first consider how retirement benefits are calculated.

The Social Security Administration has now followed the same approach for calculating benefits since 1979.

1. **Determine Eligibility**. To be eligible for benefits, a minimum amount of taxable earnings must be recorded for at least 40 quarters (10 years). The Social Security statement shows the lifetime taxable earnings for a worker. This statement used to be mailed annually, but now goes out every five years. You can find a copy of your statement online at **http://www.ssa.gov/myaccount**. It's good to check this document to ensure Social Security has a proper recording of your earnings history, keeping in mind that the earnings listed are only up to each year's maximum taxable amount ($118,500 as of 2015).
2. **Calculate Average Indexed Monthly Earnings (AIME)**. The AIME is the average of the top 420 months (35 years) of earnings, up to maximum taxable amounts, with past earnings through age 60 indexed to higher amounts to account for economy-wide average wage growth. For someone whose career was shorter, this can include months with $0 earnings. For someone who has already logged 35 years of earnings and continues working, payroll taxes continue, but new wages must be higher than wages from the top 420 months in order to have an impact on benefits.
3. **Calculate Primary Insurance Amount (PIA)**. Next, the PIA is calculated to determine the amount of available benefits at the full retirement age (FRA). The FRA is 66 through 2020, at which point it will begin a gradual increase toward 67 for those born in 1960 and later. This calculation translates the AIME using a progressive benefit formula

which provides a higher percentage of the AIME to lower waged workers and less for higher waged workers. The PIA formula provides a 90% replacement rate for the lowest range of the AIME, a 32% replacement rate for the middle range, and a 15% replacement rate for the upper range. The average benefit is about 40% of average wages in a given year.Andrew Biggs of the American Enterprise Institute has pointed out why this widely publicized 40% number is **not how most people think about replacement rates**. He calculates that the average benefit replaces about 53% of average inflation-adjusted lifetime earnings. Because of the progressive nature of the benefit formula, those with less than average earnings – or higher earnings for a smaller number of years – would experience higher replacement rates, while those with a lengthy record of above average earnings would experience a lower replacement rate.

4. **Translate PIA into a benefit amount based on claiming age**. The PIA provides the benefit available at the full retirement age. Benefits adjust upward or downward depending on when they start relative to the full retirement age.
   For each month of delay beyond the full retirement age, the benefit increases by 0.67%. This sums to an 8% increase in benefits per year (not compounded). For each month of early uptake relative to the FRA, the benefit reduces by 0.56% per month for the first 36 months of early uptake, and by an additional 0.42% for any months beyond that.These adjustments were designed to be actuarially fair –claiming early means more years of benefit receipt while claiming late means fewer years – so it shouldn't matter when one claims their benefit. However, those calculations for actuarial fairness were made long ago and they no longer hold for today's retirees. Retirement benefits can be claimed as early as age 62, and delay credits are provided up to age 70.The following table summarizes how the claiming age adjusts the PIA to determine the actual retirement benefit.

Adjustments By Age

Claiming Age	Full Retirement Age = 66	Full Retirement Age = 67
62	75%	70%
63	80%	75%
64	87%	80%
65	93%	87%
66	100%	93%
67	108%	100%
68	116%	108%
69	124%	116%
70	132%	124%

5. **Account for additional spousal and dependent benefits**. A worker's record can also be used to support spousal, dependent and survivor benefits. Dependent benefits are available to children under 18, children who became disabled before 22, and even parents who rely on the earner for more than 50% of their income. Divorcees who were married for at least 10 years are also eligible for benefits based on an ex-spouse's record. These adjustments for additional benefits are provided up to a family maximum, which is the highest total amount of benefits one worker's earnings record can support (divorce benefits exist outside these limits).
6. **Adjust benefits for inflation**. It is easier to refer to Social Security benefits in terms of their value expressed in dollars at age 62. In other words, these are the real inflation-adjusted value of benefits. In practice, Social Security benefits will grow in nominal terms to reflect changes in consumer prices. In particular, Social Security benefits adjust for the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) starting at 62, which is the age of eligibility for retirement benefits.