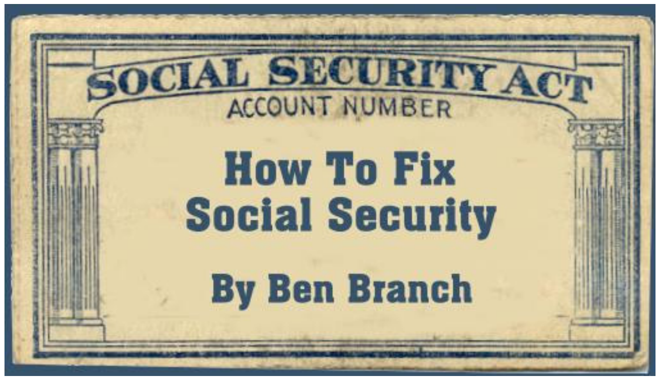

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Much attention has been given to the looming crisis (?) in Social Security that is expected to be brought on by the forthcoming retirements of the baby boom generation. While the current payments into the system exceed the current level of benefit payments, in the not too distant future, (e.g. 2018 or soon thereafter), benefit payments are projected to exceed the amount paid in by current workers. Some years further down the road (e.g. 2042 or so), the accounting surplus that had been built up will be exhausted. Clearly, the system's financial balance is threatened.

All of the proposed solutions to this problem have serious drawbacks. Reducing benefits is thought to be politically impossible, or nearly so, as is any further increase in the SSI tax rate. Increasing the return on the trust fund may be possible, but it has huge transition costs. Moreover, only one of the approaches deals with the reality that a growing percentage of the population in retirement will consume an increasing percentage of the goods and services produced by the shrinking percentage of the population who remain in the labor force. And that approach, of increasing the "standard" retirement age, is thought to be very difficult, if not impossible, to implement in the current political environment.

Raising the "standard" retirement age would, to be sure, increase the ratio of workers-to-retirees. A larger economy and fewer people drawing benefits would result. Not only would the fiscal balance of the Social Security System tend be restored, but the economy would also produce more of the goods and services needed to supply our population. In other words, in addition to having the desired impact on the SSI trust fund, such a change would also have a very beneficial impact on the real economy's ability to provide for our aging population.

But as previously noted, increasing the "standard" retirement age (for standard benefits) is thought to be almost impossible to accomplish politically. Moreover, trying to force people to remain in the workforce beyond their currently scheduled retirement age would have the unintended consequence of tending to force everyone, regardless of their individual circumstances, to put off their retirement. Some people are much better positioned to remain in the workforce as they move past their mid 60s than are others.

Under current law, the SSI retirement age is already scheduled to rise. One born in 1937 or earlier can begin to receive full SSI benefits at 65. The standard age for retirement rises for those born in 1938 and later. It will be 66 for those born between 1943 and 1954 and rise to 67 for those born after 1960. No further increases in the standard retirement age are currently scheduled for those born after 1960.The system also provides that one may begin drawing reduced benefits as early as 62. This minimum age for drawing benefits has not been raised. Those who do choose to retire and begin drawing benefits before the "standard" age can do so, but the level of monthly benefits is reduced such that the total lifetime payout is approximately equal for one with normal life expectancy, regardless of whether benefit checks begin at 62, 65, 67 or some other age. Similarly, the system provides an option for those who would like to stay in the labor force past the scheduled retirement age. Those who put off drawing benefits past their scheduled standard age for drawing full benefits receive higher monthly payments when they do begin to draw benefits. Again, the payment schedules are set such that the system on the average pays out about the same amount to the retiree. The monthly payments are higher but, since they begin at a higher age, the number of payments are fewer. As a result, the total amount a person receives is, on average, equivalent regardless of when he or she chooses to begin drawing payments.

So, we see that under the benefit provisions of SSI, a standard retirement age is set based on one's date of birth. One can retire and start drawing benefits prior to reaching the standard retirement age and receive a reduced monthly benefit amount. One can retire at the standard age and receive the standard benefit check (standard for that person's earning history). Or one can retire at an age after the standard retirement age and begin drawing benefits at a higher rate than that set for those who retire at the standard age. In all three cases the monthly benefit rate is set such that for one with as average life expectancy, the total benefit payments are about the same.

Suppose the "standard" retirement age (for full benefits) which is now slated to rise to 67 was reset so that it would rise to 70. When fully implemented, that change would increase the average workers' number of working years and reduce his or her years of retirement. Given the increase in average life expectancy and general health, such a shift might well be justified for many workers. For many others, however, this shift would not seem fair. Very generally those who do manual labor or other physically challenging jobs are ready to retire at earlier ages than those whose work is less physical challenging. Put another way blue collar workers tend to want and need to retire earlier than white collar and professional workers. Individual preferences and physical wellbeing also cause substantial variations in the potential for continuing to work past the "standard" retirement age.

Clearly, a further mandated increase in the standard retirement age would be a very crude approach to dealing with the current problem. And, yet, consider all of the advantages to the Social Security system and, indeed, the economy if more people could be persuaded to put off both retirement and when they begin to draw their Social Security checks.

Let's explore, as an example, a typical worker currently earning $40,000 a year who could retire now at standard benefits. Such a retiree would draw SSI benefits of about $14,000 annually and have a life expectancy of 15.5 years (17 for female, 14 for male). If retirement was put off by three years, the SSI benefit rate would rise to about $17,600 with an estimated 12.5 years of payments. Multiply 15.5 X $14,000, and the total becomes $217,000. Multiply $17,600 by 12.5, and the total becomes $220,000. So we see in this example how the total lifetime SSI payments are structured to come out about the same for one who puts off retirement as for one who does not. SSI seems approximately to break even on the defer/not defer option. But let's look a little closer. If the worker chooses to continue working and defers drawing SSI benefits:

1. The payment streams are different through time. SSI delays the beginning payment for three years. The time value of money works to SSI's advantage.

2. The worker would continue to pay into the System for three additional years. In our example the employee with $40,000 in income together with his or her employer, would pay a total SSI of $5,160 a year. So instead of paying out $14,000 a year, SSI would be collecting over $5,000 a year for the three years that this person defers retirement.

3. By continuing to work, this employee would also continue to pay into the medicare system to the tune of $1,160 a year.

4. IRS would also benefit from increased tax collections. In the example of a $40,000 income, if married filing jointly and using the standard deductions, this worker's income tax payments would total about $2,700 annually.

5. State and local income and sales tax collections would also tend to be higher as a result of the additional earned income.

6. Many private pension plans would also benefit by having some of their participants defer their retirement. Depending on how the formulas worked, the retirees would probably draw significantly higher monthly payments when they do retire.

7. Those with defined contribution pension plans would tend to build up larger retirement nest eggs and, because they would draw benefits for fewer years, could buy annuities with appreciably larger monthly payments.

8. By far the largest benefit would be the impact on the overall economy of having additional years of work performed by older members of the labor force. GDP would be higher by about the amount of additional earned income.

What about the downside? Might this change increase unemployment and reduce advancement opportunities for younger workers? Perhaps, but realize that by having more workers in the labor force, the overall economy would be enlarged. As a result, aggregate national income would be increased, thereby raising the demand for goods and services and the workers needed to produce them. With proper economic policy, the jobs available in the economy should rise commensurately with the increase in the size of the labor force. As for advancement opportunities, the deferred retirement of some members of the labor force would indeed postpone the availability of some openings at the upper end of the job market. Workers do tend to advance up the ranks as their experience increases. So the tendency for older workers to stay in their high paying jobs for extra years might well reduce advancement opportunities for some younger workers. The magnitude of this effect is difficult to gage, but it would probably be rather modest. Moreover, any potential slowdown in advancement opportunities should be measured against all the advantages of having a Social Security System and an economy that is in better balance vis a via its ratio of labor force to retirees. That improvement in the system would be a real advantage for younger workers.

So we see that encouraging workers to defer their retirement until an older age would have very beneficial affects on the economy and the Social Security System. But forcing deferred retirement on a reluctant population of older people is likely to be politically very difficult and rather unfair in its differential impacts. Is there a way around this problem? I submit that there is.

Note that viewed through the narrow lens of the impact on the SSI trust fund, having someone defer drawing benefits may be close to a wash. But viewed from the overall impact on the economy and federal government revenues, having someone remain in the labor force and defer drawing benefits is a huge gain. Further, gains accrue to the affected state and local governments as well employers' retirement plans. Deferring retirement is very likely to result in the worker retiring in better financial health; so it can be a win-win situation for all involved.

As I see it, the incentives to the worker for deferring retirement are out of line with the benefits to the economy. The solution is obvious: The incentives to defer should be increased. Deferring retirement and the initial drawing of SSI benefits should be made more attractive to those nearing retirement age. Since almost everyone who works pays the taxes to the IRS, tax relief is the obvious place to provide the incentive. **I suggest that everyone who continues to work and thereby defers beginning to draw their Social Security benefit payments past the age set for standard benefits be given a generous tax credit.** Perhaps a credit equal to 20 percent of the forgone SSI payment would be sufficient to encourage retirement deferral by those best positioned to do so. Those who are not paying taxes should get a direct payment.

Returning to the previous example, we see that 20 percent of the $14,000 in forgone SSI payments would amount to $2,800, which is very similar to the amount of tax liability that this worker would have paid on his or her $40,000 of earned income. The federal government would still be ahead by the amount of the medicare tax and SSI payments. Would such a tax credit be sufficient incentive to change behavior? I don't know, but it's worth a try. It should be accompanied by a vigorous advertising campaign designed to encourage people to defer beginning their retirement.

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