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SHIPMAN: Raising retirement age won't work

Benefits still meager compared to market-based reform

By William G. Shipman - The Washington Times

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The co-chairmen of President Obama's debt and deficit commission, Erskine Bowles and Alan Simpson, recently warned that our country's current fiscal path - primarily the cost of entitlements - unless reversed, "will destroy the country from within." Given such an ominous prophecy, it is almost certain that Social Security, the country's larges entitlement, will go under the government's budget knife.

One fiscal fix gaining support is increasing the retirement age. If this is the only change, grave harm will be done in the name of putting Social Security on a secure financial footing. More important, we again will have lost the opportunity to give all workers the fundamental right to earn benefits that are in line with their costs and that are the personal property.

At first blush, increasing the retirement age seems logical. When Social Security started in 1935, life expectancy wa 61; it's now about 78. Given that people are living longer, the argument is that they should receive full benefits at a later age. There is precedent for this. During the Reagan administration, the normal retirement age was increased from 65 to 67.

If it were increased again by the future expected increase in life expectancy, say hypothetically five years, the fix sti would provide benefits for the same 18 years of retirement that the system provides now on average, and the unfunded liability would fall, leaving our children and grandchildren with less debt. However, if it were the only fix workers would suffer needlessly for at least two reasons.

First, an increase in the retirement age is simply a cut in benefits, which already are low relative to their cost. Secon it does not address why Social Security's benefits are so low in the first place. They are so low because they are financed by taxing wages. Because benefits are linked to wages, which increase about 1.5 percent per year on average, benefits increase about the same. This is somewhat akin to saving and investing and receiving a real rate o return of 1.5 percent. Until we migrate to saving and investing in capital markets, whose long-run returns are significantly higher than 1.5 percent, benefits always will be unnecessarily low and Social Security will never be fixed.

To compare one financing system to the other, consider an average-wage worker who entered the labor force at age 20 in 1964, worked 45 years and retired at the end of 2008. His wage history provided him a first-year Social Security benefit of $18,324. Under present law, his benefit will increase with inflation and will be paid until his dea - about 13 years based on estimated life expectancy.

Now assume he invested the same amount he paid in taxes, employee and employer combined, in a diversified portfolio of stocks and bonds with a 70-30 balance for 35 years and then a conservative 50-50 balance for the remaining 10 years. He retired at the end of 2008, when he suffered a significant loss because stock markets around the globe collapsed, down 37 percent in the United States alone. Yet even after the loss, his accumulated wealth stil would provide more than Social Security's $18,324 benefit, namely $30,000 in the first year, and indexed for inflation for 19 more years. If he chose to withdraw just $18,324 initially, his portfolio would last 39 years. And thi assumes that his portfolio during retirement earns just a 1.7 percent real rate of return.

If life expectancy increases five years and he works another five years, the portfolio provides $48,000 in the first year, again indexed for inflation for the next 19 years. Or if he withdraws the original Social Security benefit of

$18,324, the portfolio would not be exhausted until his 134th birthday. In stark comparison, an average-wage worke who is stuck in Social Security and works and pays taxes an additional five years would receive little more than the original $18,324 in his first year of retirement, and it is indexed thereafter.

Because Social Security's benefits are so low relative to their costs, all workers suffer. Social Security is simply a ba deal. That is why it's mandatory.

The president's commission has the opportunity to propose fundamental reform along market-based principles, including personal property rights. If instead it promotes raising the retirement age or cutting benefits by some othe formula such as progressive price indexing and its proposal is enacted, American workers and America will suffer a high price. Hopefully, the commission's recommendation will not further destroy the country from within.

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