Q&A: Stanford economist: Delaying retirement key to getting the most from Social Security benefits

July 11 2012, By Brooke Donald

John Shoven is director of the Stanford Institute for Economic Policy Research. Credit: L.A. Cicero

Many of the economic crises plaguing governments around the world today can be traced to one thing, says Stanford economist John Shoven. We're living longer than ever.

"All of these economies, from Europe to the U.S. to Japan to China, are aging. Birthrates are coming down, mortality rates are coming down," says Shoven, director of the Stanford Institute for Economic Policy Research. "But there's been a big failure to adjust institutions to this fact."

And if we don't adjust and fix antiquated retirement systems that cannot support longer life spans, Shoven says, "it's going to stress our economies even more."

Meantime, in an interview with the Stanford News Service, Shoven offers guidance, based on recent research, to get the most out of current Social Security benefits and explains what problems are at the heart of the retirement crisis.

What are some of the biggest issues now when it comes to saving for retirement?

Low interest rates make it harder. You have to save more than you would have in normal times. The kind of return you can expect on your pension, savings or retirement accounts are lower than they would have been a decade ago. I think you have to get used to mid-single digit returns, whereas people used to think they could expect 10 percent. I think that's an unrealistic expectation today.

The other thing that people have to think about, which is basically good news, is just how long they might live. However, the bad news is that it takes a tremendous amount of resources to fund such long retirements.

So young people, especially, not only have to save more but will have to work longer. The retirement that they thought they would take in their early 60s may have to be postponed to closer to 70.

At what age do people typically retire?

There's no official retirement age but a very common age of retiring is 62. Another large group of people retire at 66. But in some jobs, people are retiring at 55. To my mind, those are rather young ages to be retiring.

How does the Social Security system handle this relatively young age of retirement when lifespan is longer than ever?

I think there's going to have to be a set of policies that encourage people to work longer. That's probably the most important adjustment we're going to have to make in the next 20 or 30 years.

The economy already is forcing people to work longer, correct?

Yes, and I think that need to work longer will continue. That doesn't mean, by the way, that you're going to have a shorter retirement than your parents, because this extra longevity is pretty substantial.

When you start thinking, I'm going to retire at 62 and live for 30 more years, that's a long time to save for. What I'm saying is we have to adjust institutions for the great news that people are living longer, and then we also have to adjust to today's lower interest rates and rates of return on investments.

All of this says: Save more, work longer. Those are really the two keys to the whole thing.

Some people may find that a bit depressing.

On the other hand, a lot of people get satisfaction from work. Some people find retirement a real challenge. They lose their contacts, their self-esteem. I think working longer is not such a bad thing if you're in good health.

Today's 65-year-old has the same mortality and health that 54-year-olds had in 1947. So 65 really is approximately the new 55. It's not just a joke on a card.

So what does all this do to the Social Security system?

It wasn't built for this. There's going to have to be changes. One of the biggest failures of the Clinton administration and the Bush administration and now the Obama administration is that they haven't fixed Social Security. All three of those presidents knew that the system was out of whack yet they didn't do anything about it.

What can be done?

First of all, the age where you can get your full Social Security benefits – currently 67 – almost certainly has to be raised. Adjustments to the formula for benefits need to be made as well. Currently the initial Social Security benefits that people receive go up when wages in the economy increase. If they were tied to price increases instead of wage increases, it would improve Social Security's solvency dramatically.

Basically, Social Security benefits are going to have to be cut and they're probably going to be cut most for high earners. People who have a long and lucrative career will almost certainly get less than in the current law.

Would Washington pass such changes that cut benefits and raise taxes?

There is a version of the price indexing rather than wage indexing called "progressive price indexing." I think that it could be enacted with the right leadership.

The nature of the problem is that we have promised benefits that exceed the revenues we've promised to collect. The two laws – the laws promising benefits and the laws promising taxes – don't match. They don't work together. But both of those – cutting benefits or raising taxes – are bad news politically, and so politicians just tend to kick the can down the road. They don't do either and the problem just keeps getting worse.

In the next four years, the president, whoever it is, needs to tackle Social Security reform. It's a shame that we have known that it needed fixing for 20 years and we haven't done anything about it.

And still, you don't hear about it on the campaign trail this year.

We have not had good leadership on this issue, and there's bipartisan blame.

Knowing all this, your research shows that Social Security is a good investment?

Yes, all that being said, Social Security is quite secure for people who are 55 and older.

Social Security gives you a choice of when you start your benefits. It has always realized that if you start earlier, you're likely to live longer and get more checks, and if you start later, you're likely to get fewer checks. So they made what is called an actuarial adjustment for the people who start late – they get bigger checks. Lots bigger. And so, for instance, if you start Social Security at 70 instead of 62, your monthly check is 76 percent larger.

That's huge – much bigger than a return over eight years on a current savings or retirement plan.

Yes. Gradually, if anything, the benefits for deferring have improved. They're better today than they were anytime in the past 50 years.

Two things have happened: One is people are living a lot longer and that makes deferral more attractive. The second thing is that interest rates have gone through the floor. Interest rates are zero or close to it. And we still have inflation. So if you're getting no interest and facing inflation, you're actually losing money. Social Security is offering you 76 percent for an eight-year deferral, so it has become quite advantageous to delay collecting your Social Security. The bottom line is that if you have other assets, use them first and postpone collecting Social Security.

Are there any exceptions to delaying?

The exceptions would be those in poor health. If you're in really bad health, don't defer; take the money as early as you can. But for people in average health or even in a little worse than average health, deferring Social Security makes sense.

Do people usually delay?

Most people have this great opportunity of earning high returns by delaying Social Security and they're not taking it. We have statistics on how many people delay after retiring and it's almost no one. People seem to think retiring and starting Social Security are the same decision. And I'm saying, nope. There are two decisions – when do you want to retire and when do you want to start Social Security. And I'm saying that if you can afford to, if you can live without Social Security for a while, then you should do so. You should delay.

Provided by Stanford University