SOCIAL SECURITY
APRIL 2023

JVL WEALTH STRATEGIES
MORE THAN FINANCIAL ADVISORS

SOCIAL SECURITY

Social security is one of the foundations of retirement income. As more and more baby boomers move towards retirement age, the "security" in social security takes on an increased level of importance. Recently the Trustees of the Social Security Fund issued their annual report for 2021 and it concluded that the fund would not be able to pay full benefits in the year 2034. So, what does that really mean? We'll explore that question by reviewing the programs history, how we got where we are today, and finally what are the potential solutions for securing the program beyond 2034.

ORIGINATION:

The idea of "securing" or "insuring" the welfare of those who could not provide for themselves has deep roots in our nation's history. While families and communities took primary responsibility for assisting those in need, the original colonies and later state governments followed the European practices of taking care of "the poor". After the Civil War, the federal government provided pensions for disabled soldiers who could not work and the widows and orphans of soldiers who were killed in the war. As the U.S. moved into the industrial age corporations began to establish pensions that paid benefits to their retired workers. The election of Franklin D. Roosevelt during the great depression brought the issue of "securing" the financial future of retired workers into the national spotlight.

The Social Security Act was signed into law in August, 1935. It originated as a reimbursement to states who adopted their own state plan to pay benefits to retired workers. The cost came out of the Federal Treasury. Michigan was the very first state to have their plan approved by the national Social Security Board. The first checks to retirees went out in 1936.

Beginning in January, 1937 employees and employers became subject to a payroll tax – 1% of the first $3,000 in wages. The taxes were collected at the Federal level and at the same time employees began to earn "credits" towards future retirement benefits.

In January, 1940, the Federal Old-Age and Survivor's Insurance Trust Fund took over payment of benefits and brought Social Security under the Federal government's control. (1)

PROGRAM EXPANSION:

Over the next 50 years, Social Security was expanded many times to include benefits beyond retired workers age 65 and older. The expansions included paying benefits to surviving spouses and dependent children of deceased workers and later added benefits to divorced spouses. In 1956, under President Eisenhower, disabled workers were included under the Act. At the same time the qualifying age for benefits to widows and surviving female parents was lowered from 65 to 62. In 1961, under President Kennedy, the early retirement age for all workers was lowered to 62. President Nixon added the COLA (Cost Of Living Adjustment) provisions in 1972. Finally, President Clinton brought the program into the modern banking area by requiring that benefits be paid by EFT (Electronic Funds Transfer) and later changed the payment date from the first of the month to be based on the recipients' day of birth to spread out the payments within the banking system. (1)

[1] Information obtained from - History of Social Security - Social Security Administration website: http://www.ssa.gov

PARTICIPANTS AND BENEFITS:

The following table summarizes the number of workers paying into the program ("covered workers") versus the number of beneficiaries receiving benefits out of the program. At its origination, there were 42 workers for every 1 beneficiary. In 1965 there were 4 and currently there are 2.8 workers paying into the program for every 1 beneficiary receiving benefits out of the program. The latest projection estimates that by 2075 there will only be 2.1 workers paying into the program for each beneficiary. (2)

	Covered Workers / Beneficiaries In Millions				Covered
Year	# Covered Workers	# of Retired Beneficiaries	# of Disabled Beneficiaries	Total # of Beneficiaries	Workers Per beneficiary
1945	46.4	1.1	0.0	1.1	42.2
1965	80.5	18.5	1.6	20.1	4.0
1985	120.4	32.8	3.8	36.6	3.3
2005	159.0	40.0	8.2	48.2	3.3
2015	168.2	48.7	10.9	59.6	2.8
2021	179.3	55.5	9.5	65.0	2.8
2035	188.7	71.9	9.8	81.7	2.3
2055	200.2	78.8	12.5	91.3	2.2
2075	215.3	91.4	13.0	104.4	2.1

This next table summarizes the U.S. population by those under age 20 (below full time working age), those age 20 – 64 (normal full time working age) and those age 65 and over (normal retirement age). The data shows that in 1945 only 7.4% of the U.S. population were at retirement age while currently this percentage is almost 17% and projected to reach 20.7% by 2035. (2)

	U.S. Population In Millions				Percentage
Year	Under Age 20	Ages 20-64	Ages 65 & Over	Total Population	Age 65 & Over To Total
1945	49.1	87.9	10.9	147.9	7.4%
1965	80.0	104.9	19.2	204.1	9.4%
1985	72.9	144.6	29.1	246.6	11.8%
2005	83.9	181.1	37.0	302.0	12.3%
2015	84.5	193.4	47.6	325.5	14.6%
2021	83.0	194.9	56.6	334.5	16.9%
2035	85.4	204.1	75.6	365.1	20.7%
2055	96.6	217.0	85.1	398.7	21.3%
2075	105.3	230.3	100.2	435.8	23.0%

[2] Information obtained from The 2021 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance And Federal Disability Insurance Trust Funds - Calendar Years 1945 - 2100.

PARTICIPANTS AND BENEFITS:

There are many factors that go into the data shown above but one of the main drivers of the data is that American seniors are living longer. A male born in 1945 had an actuarial life expectancy of less than 63 years and if they did reach retirement at age 65 they were expected to survive another 12.6 years. A female born in 1945 had a life expectancy of 68.4 years and if they reached age 65 they were expected to survive another 14.4 years.

Contrast that with today, when a male born in 2021 has a life expectancy of 74.2 years and upon reaching age 65 is expected to survive another 16.9 years. A female born in 2021 has a life expectancy of 79.5 years and if they reach age 65 are expected to survive another 19.5 years.

Life Expectancy				
Year	Male At Birth	Female At Birth	Male At Age 65	Female At Age 65
1945	62.9	68.4	12.6	14.4
1965	66.8	73.8	12.9	16.3
1985	71.1	78.2	14.4	18.6
2005	74.8	80.0	16.7	19.5
2015	76.1	80.9	17.8	20.3
2021	74.2	79.5	16.9	19.5
2035	77.6	82.5	19.1	21.6
2055	79.7	84.3	20.3	22.7
2075	81.6	85.8	21.5	23.7

Looking out another 50 years we see from the table above that life expectancy at birth and upon reaching age 65 is expected to be extend by another 3-6 years. (2)

Social Security Tax			
Year	Maximum Wage Base	Tax Rate	Maximum Tax Paid
1945	$ 3,000	1.00%	$ 30
1955	$ 4,200	2.00%	$ 84
1965	$ 4,800	3.63%	$ 174
1975	$ 14,100	4.95%	$ 698
1985	$ 39,600	5.70%	$ 2,257
1995	$ 61,200	6.20%	$ 3,794
2005	$ 90,000	6.20%	$ 5,580
2015	$ 118,500	6.20%	$ 7,347
2021	$ 142,800	6.20%	$ 8,854

TAX ASSESSED:

Workers pay into the Social Security program through a payroll tax deduction withheld from their paycheck. The tax is computed on all earnings up to a maximum annual limit. Employers are required to match the employees' tax withheld resulting in a doubling of the amount paid into the program. Self-employed persons pay both the employee and the employer share. Since the program's inception both the wage base and the tax rate have been increased as the table to the left shows. (2)

[2] Information obtained from The 2021 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance And Federal Disability Insurance Trust Funds - Calendar Years 1945 - 2100.

BENEFIT COMPUTATION:

Social Security computes monthly benefits based on a formula. First, a worker's annual earnings (up to the maximum Social Security wage base) are indexed to take into account inflation over the workers' employment years. Second, the formula looks for the highest 35 years of these indexed earnings, adds them together and divides that number by 420 months (35 years x 12 months) to arrive at an average indexed monthly earnings amount. This average indexed monthly earnings amount is divided into 3 buckets. The first bucket contains up to the first $1,024 earned and is multiplied by 90%. The second bucket contains up to the next $5,148 earned (or less if the average indexed monthly benefit is under $6,172) and is multiplied by 32%. And the third bucket contains the next $5,174 earned (or less if the average indexed monthly benefit is under the maximum of $11,346) and is multiplied by 15%. The following chart shows the estimated monthly retirement benefit based on a person's hypothetical average annual earnings. (2)

	Hypothetical Average Annual Earnings				
	$ 25,000	$ 50,000	$ 75,000	$ 100,000	Maximum
Averages Indexed Monthly Earnings	$ 2,083.33	$ 4,166.67	$ 6,250.00	$ 8,333.33	$ 11,346.00
First Bucket - Up to $1,024 @ 90%	921.60	921.60	921.60	921.60	921.60
Second Bucket - Amount > $1,024 up to $6,172 @ 32%	338.99	1,005.65	1,647.36	1,647.36	1,647.36
Third Bucket - Amount > $6,172 up to $11,346 @ 15%	-	-	11.70	324.20	776.04
Total Monthly Benefit at Full Retirement Age	$ 1,260.59	$ 1,927.25	$ 2,580.66	$ 2,893.16	$ 3,345.00
Retirement Benefit as % of Average Earnings	60.5%	46.3%	41.3%	34.7%	29.5%

CLAIMING BENEFITS:

The decision of when to start claiming Social Security benefits involves a combination of math and guesswork. For individuals born in 1937 or earlier the FRA (Full Retirement Age) is 65. For persons born between 1938 – 1942 it is 65 + 2 months for each year over 1937. For those born between 1943 and 1954 the FRA is age 66. For persons born between 1955 – 1959 it is 66 + 2 months for each year over 1954, and for those persons born in 1960 or later the FRA is age 67.

FRA is important because that is the age when a person is entitled to claim 100% of their computed monthly benefit. An individual can claim earlier but their monthly benefits decrease by approximately 6% for each year they claim early. Thus, a retired person claiming at age 62 is entitled to 75% of the monthly benefit they would have received at FRA of 66. Conversely, delaying benefits will increase the monthly amount owed at FRA by 8% for each year the person delays - up to a maximum of 132% at age 70. (2)

The math part is easy – the guesswork involves "knowing" how long you will live. An individual who decides to start collecting Social Security benefits at their FRA 66 would have to live to age 78 before their cumulative benefits are greater than if they had started collecting early retirement benefits at age 62. Additionally, that individual would have to live to age 83 before taking delayed benefits at age 70 is better than starting at FRA 66. While Social Security payments last for the recipient's remaining lifetime, it has no residual value to be passed on to their heirs upon death.

Every individual has the right to claim benefits based on their own earnings record. As an alternative, a spouse always has the right to collect 50% of the higher earning spouse's FRA benefit, if that amount is greater than the benefit they would receive on their own earnings record. Thus, the decision of when to start claiming benefits in cases where there is one high wage earner and one low wage earner has an effect on both of the spouses' benefits. When the higher earning spouse dies, the program allows the lower earning spouse to receive the higher earning spouse's monthly benefit. (2)

[2] Information obtained from The 2021 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance And Federal Disability Insurance Trust Funds - Calendar Years 1945 - 2021.

STATUS OF SOCIAL SECURITY TRUST FUND:

The Social Security program operates as a separate "Trust Fund" on the Federal government's books. Collections of taxes and payments of benefits are included in the annual Federal budget, but the activities are separately accounted for to determine if sufficient assets exist to pay future benefits. Unlike a 401(k) plan, the taxes withheld from the employee and matched by their employer are not set aside in "your" account to be available to pay "your" future retirement benefit. Each month, the Trust Fund collects all taxes, pays all benefits and then "loans" the monthly excess to the Federal government in exchange for a note. Since the Federal government has borrowed all of the excess receipts, spent all of the money in the general fund, and issued a note back to the Trust Fund – we have to "Trust that the Fund" will be repaid out of future generation's tax payments. The following chart summarizes the activities of the Trust Fund for 2021. (2)

	In Billions of $ Retirement Fund	In Billions of $ Disability Fund	In Billions of $ Combined Total
Asset Reserves - December 31, 2020	$ 2,811.7	$ 96.6	$ 2,908.3
Payroll Tax Collections	838.2	142.4	980.600
Interest Earned	67.5	2.6	70.100
Taxation of Benefits	37.2	0.5	37.700
Benefits Paid	(993.1)	(140.1)	(1,133.200)
Administrative Expenses	(4.0)	(2.5)	(6.500)
Other Expenses	(4.8)	(0.1)	(4.900)
Asset Reserves - December 31, 2021	$ 2,752.7	$ 99.4	$ 2,852.1
Increase (Decrease) In 2021	$ (59.0)	$ 2.8	$ (56.2)

On an annual basis the Trustees of the Social Security program prepare a report that projects the Trust Fund's ability to meet future obligations. The Report projects that starting in 2021, and every year thereafter, the benefits paid will exceed the amounts collected and the current reserves are projected to be depleted in 2034. For the 75-year period projected in the report the Trust Fund has unfunded future obligations of $20.4 trillion. Since the Fund has no authority to borrow, the benefits paid are limited to the amounts collected, which would equate to a 23% reduction in benefits paid.

It is difficult to believe that Congress will do nothing and allow a 23% across the board reduction in benefits. Seniors make up one of the largest voting blocks and cutting all recipients will not go over in either political party.

[2] Information obtained from The 2021 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance And Federal Disability Insurance Trust Funds - Calendar Years 1945 - 2021.

POSSIBLE SOLUTIONS:

While finding common ground is difficult in Washington there are a number of possible solutions being talked about. In no particular order the following is a list of possible solutions being discussed:

1) Increasing the maximum Social Security taxable wage base (currently $160,200)

   This was done with the Medicare taxable wage base in 1991 and places the higher tax burden on the highest earners.

2) Increasing the payroll tax rate (currently 6.2%)

   This spreads the higher tax burden over everyone paying in and therefore a future beneficiary.

3) Delaying the Full Retirement Age for younger workers (currently age 67)

   This has been done before and given longer life expectancies it theoretically reduces the number of years a person collects benefits

4) Subjecting a greater amount of benefits to Federal income tax (currently capped at 85%)

   Since you do not get a tax deduction for the social security taxes you pay, benefits were originally non-taxable. This changed in 1984 for taxpayers with income above a set limit, and the percentage was increased in 1993 to its current 85%.

5) Reducing the benefit formula for future retirees (see Benefit Computation above)

   This could be accomplished by reducing the percentage paid for each of the three buckets.

6) Inserting means-testing to make Social Security based on "need"

   Medicare premiums have been means-tested since 2003, thus higher income earners pay more for Medicare premiums than lower income earners. The same information could be used to reduce Social Security benefits for higher earners.

7) Eliminating the "Fund" concept and move Social Security entirely to the general fund and treat as any other Federal program

   If Social Security is a fundamental part of providing for the elderly, absorbing it into the general fund and eliminating the separate fund accounting moves the deficit into the general fund.

Given the magnitude of the problem some combination of the above may be the most likely course of action for maintaining the Trust Fund solvency.

CONCLUSION:

Social Security has been in existence for 85 years. There are 65 million Americans currently receiving monthly benefits and another 20 million are expected to be added over the next 20 years. It has become a significant portion of the retirement income for too many people who have not provided for their retirement years through savings and investments. Eventually Washington will have to come together to find a long-term solution to the impending funding shortfall.

At JVL Wealth Strategies, we deal with the uncertainties in life. Our planning can model retirement years with and without Social Security, assist you in selecting the best claiming strategies for your particular situation, and develop financial plans together with investment plans tailored to help meet your specific needs. If you know of someone who could benefit from our services please feel free to let us know.

You can learn more about us and our services on our website www.jvlwealth.com.

By: Jerry VanderLugt CPA, CFP®, CVA

JVL WEALTH STRATEGIES
MORE THAN FINANCIAL ADVISORS