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HOW TO SURVIVE

THE FALL OF SOCIAL SECURITY

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How to Survive the Fall of Social Security

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In early 2010, for the first time in decades, the Social Security Trust Fund began paying out more than it's taking in. Though there is some debate over exactly when the Fund started losing money, there will be no such discussion over the next few years… or maybe ever again.

As recently as its 2009 projections, the Congressional Budget Office expected the Trust Fund to briefly recover before the full brunt of retiring baby boomers made its red ink permanent.

Now, even the CBO projects indefinite withdraws and an eventual bottoming out of the Fund. In the words of the SS Board of Trustees, "the program costs will permanently exceed revenues."

That means that as soon as the Fund runs out, current law requires immediate slashes in benefit payments. Of course, current law could be changed.

The last time Social Security entered deficit, back in the early 80's, the U.S. government instituted all sorts of aggressive reforms. Most of them resulted in retirees receiving fewer benefits and paying higher taxes. For example:

- Social Security tax rates (including Medicare taxes) rose from 9.35% in 1983 to over 15% by 1990.
- The minimum age to file for full benefits was slowly raised from 65 to 67.
- The cost of living adjustment (COLA) was re-engineered to track growth in wages or inflation, whichever is lower. Previously, COLA just rose with inflation.
- The taxable wage base rose dramatically. In 1983, all individual income over $32,400 was not subject to Social Security taxation. Today that base level is $106,800.

No one knows exactly what the government will do to "fix" Social Security this time around, but it's hard to picture any scenario that will make your retirement more comfortable. Most likely, they'll do what they did 30 years ago… raise taxes and cut benefits.

Those tax hikes and benefit cuts this time around will likely be even bigger, thanks to the Baby Boom generation. The largest demographic America has ever known began hitting retirement age this year, and is already putting the largest strain on Social Security in its history. By 2030, when the majority of Baby Boomers are in retirement, there will be 1 Social Security beneficiary for every 2 workers contributing to the Fund. This is the primary reason for the projected depletion of the Fund.

And it's the number one reason you need to plan for a retirement without Social Security support. By the time you're ready to stop working, who knows how little benefits the government will be able to offer... or if there will be any money left in the Fund at all.

Dave Gonigam, our colleague and editor of the 5 Minute Forecast, a free supplement that goes out daily to our paid newsletter subscribers, wrote last year about one way the program might be salvaged.

Read on…

The Awful Way Social Security Might Be "Saved"

By Dave Gonigam

In 1990, the pollsters from Gallup started asking working Americans how likely it is Social Security will be there for them when they retire.

By 2010, 60% said they didn't expect to receive a cent.

It's not quite that bad, according to the actuaries who keep an eye on the Social Security program. Last year, they projected Social Security reserves would run dry by 2033. After that, incoming Social Security taxes would pay only 75% of currently scheduled benefits.

Still, the younger you are, the more raw the deal is. According to the Urban Institute, someone who turned 65 in 1980 paid $96,000 into the Social Security system… and got back $203,000. Meanwhile, someone turning 65 in 2030 will pay $398,000 into the system… and get back only $336,000.

And what if medical science continues galloping along and extends the life span of the average baby boomer by, say, another 10 years? Our newly formed Apogee Research Group here at Agora Financial plans a comprehensive study exploring the impact of longer life spans on our various social insurance programs.

Today, we take on a counterintuitive proposition: Social Security will remain solvent and still pay full benefits for another three or four decades.

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Don't breathe a sigh of relief. The way we'd get there isn't pretty.

All over the Western world, well-educated high earners are staying in the workforce longer than they used to. In the United States, nearly two-thirds of men with a professional degree ages 62–74 are still working, if not necessarily full-time. Among high-school graduates, it's only one-third.

"Employment rates are falling among younger unskilled people, whereas older skilled folk are working longer," asserted *The Economist* last April. "The divide is most extreme in America, where well-educated baby boomers are putting off retirement while many less skilled younger people have dropped out of the workforce."

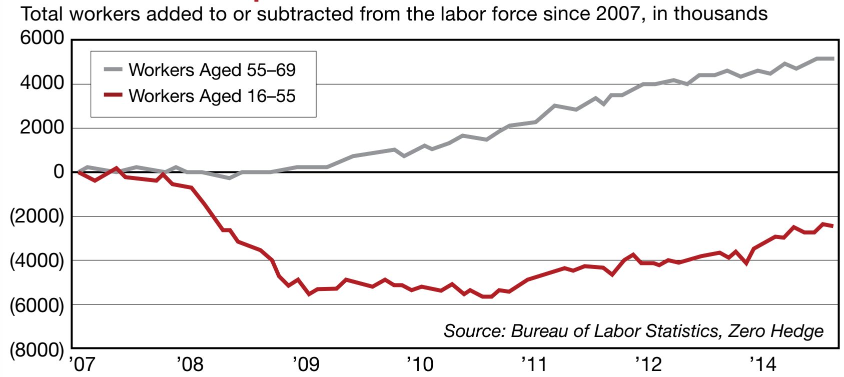
Example: Software trainer Charles Morris of Beaverton, Oregon. At age 66, he's not letting up. "Frankly, my continuing to work is all about my wife, to ensure she will have the funds needed to sustain her if I pass away first," he tells Yahoo Finance. "We have been married 46 years and my wife has been primarily a stay-at-home mom." He's socking away 40% of his salary in his 401(k).

More central to our point, he's still paying into the Social Security system.

Nor is he alone: Check out the nearby chart from the Labor Department. No matter their education level, the 55-and-over workforce has grown by 5 million since the start of the "Great Recession." But the under-55 crowd still has 2.5 million jobs to make up.

Work Till You Drop

Total workers added to or subtracted from the labor force since 2007, in thousands



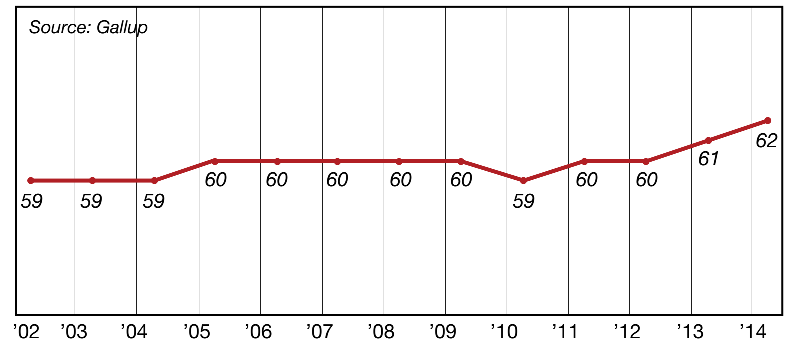
Here's another Gallup snapshot. Since 1991, the pollsters have asked retirees at what age they retired. They asked the question most recently last April. The average answer was 62 — the highest ever.

"Gallup conducted several polls in the early 1990s," reads the summary, "and found that the average retirement age was 57 in both 1991 and 1993. From 2002–2012, the average hovered around 60. Over the past two years, the average age at which Americans report retiring has increased to 62."

"Pay has risen sharply for the highly educated," *The Economist* adds, "and those people continue to reap rich rewards into old age because these days the educated elderly are more productive than their predecessors… At the other end of the social scale, however, things look grim. Manual work gets harder as people get older, and public pensions look more attractive to those on low wages and the unemployed."

Reluctant to Retire

Average actual retirement age among retirees



All the talk about growing life expectancy? It doesn't apply to the least-educated Americans. In 1990, a white woman who lacked a high school diploma could expect to live to 78. By 2008, only 73.

Those figures come from a study led by longevity researcher S. Jay Olshansky at the University of Illinois-Chicago. The numbers are awful no matter the gender or ethnicity. Again, this is among Americans who didn't graduate from high school…

- White men have a life expectancy no better than they did in 1972
- White women have a life expectancy no better than they did in 1964
- Black women's life expectancy is no better than in 1962
- And for black men, it's no better now than it was in 1954.

"It is an unheard-of drop for a wealthy country in the age of modern medicine," wrote Monica Potts in *The American Prospect* last September. "Lack of access to education, medical care, good wages, and healthy food isn't just leaving the worst-off Americans behind. It's killing them."

Professor Olshansky is less certain about Potts' conclusion. Pressed by *The Washington Post* for explanations behind the trend, he could only speculate: "I'm not sure the least educated members of the population are missing out on the advances in medical technology as much as they are adopting harmful behavioral habits that shorten their life. I've argued for quite some time that the only control we have over the duration of our lives is to shorten it, and we exercise that control often and with increased frequency (smoking, obesity, etc.)."

Nor is education the only factor correlated with longevity. Men who make more than the median income and reach the age of 65 are living six years longer than they did in the late 1970s. Remember, higher earners are the ones more likely to keep paying into Social Security.

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Men who make less than the median? They're living only about 16 months longer.

So there you have it. Well-educated high-earning Americans will work till they drop… and pay into Social Security the whole time. Meanwhile, the least-educated Americans will die off before they can collect much in the way of benefits. Problem solved.

Well, maybe. The Apogee Research Group will have to run the numbers and see whether our hypothesis holds up. Many variables are at work here — including the fact you can collect reduced benefits once you reach "full retirement age" no matter how much you earn on the job.

But as matters stand now, white men with no high school diploma typically live to only 67 — which happens to be full retirement age for anyone born after 1959.

A final thought: Social Security might make it through the next few decades unscathed. But Medicare and Medicaid are another matter entirely.

We broke down the numbers in early 2012: Health care took up 6.2% of federal spending in 1970. By 1990, the share had doubled to 12.4%. And by 2011, it had nearly doubled again, to 24.3%.

That's a doubling every 20 years or so. If you're 55 now, you need to think about how likely it is health care will take up half the federal budget by the time you're 75… or whether something in the system will break catastrophically between now and then.

If the medical system descends into chaos and you can't get the care you need when you need it, your Social Security benefits will be of little comfort, no?

Regards,

Dave Gonigam
for *The Daily Reckoning*

How to Build Your Own Retirement Fund

Peter here again.

There's no way to opt out of paying your Social Security taxes, save denouncing U.S. citizenship and moving abroad. But you can build up a fund of your own… here's how:

1. Minimize your tax footprint: It's never too late to take advantage of tax-deferred accounts like 401(k)s, IRAs and 529 plans. That's not just for you... be sure your family owns and contributes to accounts like these.
2. Stop trading. Brokers and banks make their money when you move yours around. Unless you are a very knowledgeable and experienced trader, stick with stable, long haul companies that you won't need to buy and sell every month. Some companies even allow you to buy shares directly, allowing you to skip brokerage fees all together.
3. Start investing in companies that pay sizable, reliable dividends. Instead of relying just on share-price growth, you can purchase dividend yielding companies that will reward you for your ownership once a quarter. Plus, when you enter retirement, those companies will supplement your income with their dividends.

If you build your portfolio carefully, you can have companies writing you dividend checks every week… and believe me, they'll add up.

If you want some help surviving the plight of Social Security, keep reading your Daily Reckoning. Each issue contains the valuable investing and economic analysis you'll need to prepare for your retirement… plus a healthy dose of contrarian thinking and dark humor.

Cheers,

Peter Coyne
Managing Editor, *The Daily Reckoning*