THOUGHTS FROM THE FRONTLINE

Social Security Is Dying Because Baby Boomers Aren't

By John Mauldin | October 4, 2019

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I'm filing this letter on the day I turn 70 which, among other things, means I start receiving Social Security benefits this month.

The good news, at least for me, is I am getting a whale of a deal from Social Security compared to later generations. Frankly, I was surprised at my monthly benefit amount, because I never really paid attention to what it would be. That one payment will put me and Shane within shouting distance of the US median household income, and I am still working. It's a far cry from my humble roots. I have been both blessed and lucky.

Unfortunately, my good news is also bad news for younger Americans, who won't get nearly as much as my age cohort is collecting. Worse, they could actually see negative real returns despite having paid proportionally more into the system. In investment terms, they are getting screwed.

This is not a good situation, obviously, and is even more frustrating because it's easily fixed. Back in 2006, Alan Greenspan said a group of experts could easily fix Social Security in about 15 minutes "only because 10 minutes was used for pleasantries." And he had actually led such a group decades earlier: the 1981 Greenspan Commission which Ronald Reagan formed to recommend fixes to the system that was ailing even then.

Fixes for today's problems are elusive because change is politically hard, especially when it requires sacrifice. But, as we will see, the sacrifice is going to happen anyway if we do nothing. You can't take blood from a turnip and that's what Social Security is becoming. Our present course will make the end (in the not-too-distant future) far uglier than it has to be.

Today we will discuss this exasperating situation, using my own situation as a convenient example. As you will see, the Social Security system is not working as intended. Its internal contradictions will soon be undeniable.

Off the Rails

Social Security is a textbook illustration of how government programs go off the rails. It had a noble goal: to ***help*** elderly and disabled Americans, who can't work, maintain a minimal, dignified living standard. Back then, most people either died before reaching that point or didn't live long after it. Social Security was never intended to do what we now expect, i.e., be the primary income source for most Americans during a decade or more of retirement.

Life expectancy when Social Security began was around 56. The designers made 65 the full retirement age *because* it was well past normal life expectancy. No one foresaw the various medical and technological advances that let more people reach that age and a great deal more, or the giant baby boom that would occur after World War II, or the sharp drop in birth rates in the 1960s, thanks to artificial birth control. Those factors produced a system that simply doesn't work. A few modest changes back then might have avoided today's challenge. But lacking a time machine to go back and make them, we are left with a crazy system that rewards earlier generations at the expense of later ones.

I am a perfect example. I've long said I never intend to retire, if retirement means not working at all. I enjoy my work and (knock on wood) I'm physically able to do it. As presently configured, Social Security let me delay collecting benefits until now, in exchange for which I will get a higher benefit—$3,588 monthly, in my case.

It turns out that when you file for Social Security benefits you get a call from the Social Security Administration verifying your details. I got mine this week. They asked why I had no income in 1981 and 82, as well as 1990. The simple answer is those were recession years and I didn't make money. But in 81–82, a self-employed person could deduct everything that moved and a lot that didn't. I actually had cash flow in those years but deductions took my taxable income to zero. 1990 was just a pretty ugly year.

(Sidebar: My research associate Patrick Watson, who helped with this letter, actually worked for me in 1990 in Arlington, Texas. Because he was an employee, he actually paid more Social Security taxes that year than I did. Again, I had enough cash flow and savings to make all the normal payments and keep the kids in school.)

Looking back over the years on the Social Security form was a trip down personal memory lane. There was the random over-the-top year followed by subpar ones. I spent some time reviewing what happened in all those years. But my income mostly rose over time, except in the early 2000s when I launched a new business that consumed every penny I had. Income-wise, not a good few years, but long-term, one of the best things I've ever done.

Personal note: I came from the wrong side of the tracks in Bridgeport, Texas, except that Bridgeport was too poor to have tracks. I started actually working at age 11, doing door-to-door sales and paper routes. I mostly worked odd jobs but at 16 actually got a paycheck and Social Security says I made $979 that year. I basically got room and board growing up after age 12. I bought my own clothes and everything else. Just what we did. Never thought anything of it. That $979 is $7,662.19 in 2018 dollars. Inflation was just beginning to kick in and in the next 54 years truly eroded the value of that first $979.

I was lucky and got a full tuition scholarship to Rice University, and loans at 3% interest for room and board, though I still had to work throughout college for everything else. I went to seminary, earned a Master of Divinity (that and four dollars will get you a cup of coffee at Starbucks), and went into business for myself shortly thereafter. In the late '70s and early '80s there were times I woke up at night wondering whether to pay the electric bill, buy groceries, or pay a business invoice. I actually had a bank account in North Dakota (I think it was) that I would write checks on because I knew it would take almost two weeks to clear. I ran my payables to 60+ days because my customers ran me to 60-90+. It was the best business school education ever. Real world, not hypotheticals.

A lot of people would look at my life today and not understand that I really get tough times and doing what you have to do just to get by. People just assume that somehow it has always been rainbows and unicorns for me. And it pretty much has been a great life. But being forced to build from the literal ground up made me truly appreciate my blessings.

Now, back to Social Security.

Your Social Security Return on Investment

Now, that $3,588 I will be getting each month isn't random. It comes from rules that consider my lifetime income and the amount of Social Security taxes I and my employers paid. That amount comes to $402,000 of actual dollars, not inflation-adjusted dollars. More on that later. (I also paid $572,000 in Medicare taxes. Again, actual dollars, not inflation-adjusted dollars.) I first paid into Social Security and Medicare in 1966. For most of my life I've been self-employed, so I paid both sides. (Economically speaking, everyone does. Employer contributions are part of your compensation, even though you never touch them.)

What did those taxes really buy me? In other words, what if I had been allowed to invest that same money in an annuity that yielded the same benefit? Did I make a good “investment” or not?

That is actually a very *complicated* question, one that necessarily involves a lot of assumptions and will vary a lot among individuals. But my friend Larry Kotlikoff’s Maximizer software helps. According to his calculations, if I live to age 90 (a good bet since my parents and grandparents on average did a lot better) and benefits stay unchanged (not such a good bet, as we’ll see below), the internal real rate of return on my Social Security “investment” will be 3.84%. If I only make it to 80, that real IRR drops to 0.75%.

While this may not sound like much, it actually is. Even 1% real return (i.e., above inflation) with no credit risk is pretty good and 3.84% is fantastic. If I live past 90 it will be even better.

Alas, this is not due to my investment genius. According to Larry Kotlikoff, four things explain my high returns.

- Double indexing of benefits in the early 1970s (thank you, Richard Nixon).
- I delayed claiming benefits until age 70, which I could afford to do but isn’t an option for many people.
- I will probably live longer than average, due to both genetic factors and maintaining good health (thank you, Shane!).

But maybe most of all because

- The system is massively screwing the next generation. From a Social Security benefit standpoint, being an early Boomer is a pretty good deal.

Social Security structurally favors its earliest users. The big winners are not the Baby Boomers like me, but our parents. They paid less and received more. But we Boomers are still getting a whale of a deal compared to our grandchildren.

Larry ran another hypothetical case for me. Consider a male who is presently age 25, and who earns $50,000 every year from now until age 67, his full retirement age. Such a person is not going to get anything like the benefits I do. The money won’t be there, necessitating benefit cuts Larry estimates will be 24.5%. That will be politically unpopular, to say the least, so Congress will likely change the law first, but things will clearly have to change.

So, if this person lives an average lifespan and gets only those reduced benefits, his real internal rate of return will be -0.23%. I suspect very few in the Millennial generation know this and they’re going to be mad when they find out. I don’t blame them, either.

The Next Quadrillion

The reason Millennials won't see anything like the benefits today's retirees get is simple math. The money simply isn't there.

The so-called trust fund (which is really an accounting fiction, but go with me here) exists because the payroll taxes coming into the system long exceeded the benefits going to retirees. That is no longer the case. Social Security is now "draining" the trust fund to pay benefits. This can only continue for so long. Projections show the surplus will disappear in 2034. A few tweaks might buy another year or two. Then what?

Well, the answer is pretty simple. If Congress stays paralyzed and does nothing, then under current law Social Security can only pay out the cash it receives via payroll taxes. That will be only 77% of present benefits—a 23% pay cut for millions of retirees.

This has been building for a long time. Look what Alan Greenspan said in 1996.

> As longevity improved far beyond that contemplated by the creators of the system, and productivity growth slowed after 1973, the original premise of the system of intergenerational balance began to fail. Today the official unfunded liability for the Old Age, Survivors, and Disability funds, which takes into account expected future tax payments and benefits out to the year 2070, has reached a staggering $3 trillion.

That $3 trillion Greenspan found so staggering is mere pocket change now. Social Security's unfunded obligations on what they call "infinite horizon" (the entire future) are a staggering $43.2 trillion, according to the 2019 Trustee's report.

We can fill that hole by raising FICA "contributions," benefit cuts, or some combination of both. We could also raise the retirement age. This would simply stabilize the system, not enhance it. But anything less means going deeper into the hole.

And please understand, there is no trust fund. Congress already spent that money and must borrow more to make up the difference.

Again, let me stress: This IS going to happen. Math guarantees it. You might say a huge benefit cut will bring riots in the streets, starving seniors, and assorted other ill effects. You're probably right so we should obviously do something. Instead, we—both voters and elected officials—are doing nothing at all despite the mathematical certainty that catastrophe is coming 15 years from now. Would we be similarly paralyzed if a world-ending asteroid were approaching on the same timetable?

Anytime I bring up benefit cuts, I hear indignant cries: "I *earned* that money!" Let's talk about that.

Social Security looks a lot like some kind of insurance plan or annuity. We put money in now, we get money out later, according to some formula. A complex and unfair formula, as described above, but there is a method to it.

The vast majority of workers view Social Security as a kind of moral promise. We did our part and we deserve to get what we were assured would come. But as a *legal* matter, that's not what it is. Our FICA "contributions" are really a tax. The Supreme Court ruled on this in the 1960 Flemming vs. Nestor case, which established no one has a legal or contractual "right" to Social Security benefits.

I don't think this is a design flaw. I suspect FDR and team thought it would constrain future congresses from disassembling their creation. If so, they were right. But it's also caused anxiety that *prevents* Congress from making important repairs to the program.

These challenges will get worse, not better, if the life extension technologies I anticipate reach the market in the 2020s. If you think Social Security is unsustainable now, wait until 100-year lifespans are commonplace. My personal IRR goes up even more if I live to 100 or more. Assuming I still get paid…

Missing Opportunities

These problems would be somewhat less serious if more people saved for their own retirements and viewed Social Security as the supplement it was intended to be. There are good reasons many haven't done so. Worker incomes have stagnated while living costs keep rising.

But more important, telling people to invest their own money presumes they have investment opportunities and the ability to seize them. That may not be the case. The prior generations to whom Social Security was so generous also had the advantage of 5% or better bond yields or bank certificates of deposits at very low risk. That is unattainable now. And let's not even talk about mass numbers of uninformed people buying stocks at today's historically high valuations. That won't end well.

So, if your solution is to put people in private accounts and have them invest their own retirement money, I'm sorry but it just won't work. It will have the same result as those benefit cuts we find so dreadful: millions of frustrated and angry retirees.

So, what is the answer if you are in retirement or approaching it? The easiest answer is to raise the retirement age. Yes, that's really just a disguised way to cut benefits, but making it 70 or 75 would get the program a lot closer to its original intent. Today's 65-year-olds are in much better shape than people that age were in 1936 or even 1970.

(Note, I would still preserve the option for people who are truly disabled to retire younger. I get that not everybody is a writer and/or an investment advisor who makes their living in front of the computer or on the phone. Some people wear out their bodies and really deserve to retire earlier.)

I think the best choice is also the simplest: Don't retire as long as you are physically able to do things that generate income. It doesn't have to be back-breaking labor. Find an occupation that fits your skills and health conditions. Keep your spending under control, pay off debt, and save all you can.

Second, since Social Security is still here, make the most of it. Your benefits aren't etched in stone. There are things you can do to maximize your benefits. Larry Kotlikoff's software Maximizemysocialsecurity.com program costs $40 and can potentially raise your lifetime Social Security benefits by many thousands of dollars. Run it before you make any Social Security moves.

Larry's MaxiFiPlanner.com, costs $99 and will find additional tens of thousands of dollars of safe ways to raise your lifetime spending power. MaxiFi includes Social Security optimization, so no need to buy both. I write to you a lot about navigating the stock market. But these tools can make you money with no risk whatsoever. For $40 or $99, they can produce a huge return f*or sure!*

Third, and perhaps most important. If you've been blessed in life like me, remember that not everyone had your advantages, and particularly the younger generations. Find ways to help them. That doesn't have to mean giving them money; your wisdom and advice might be even more useful. But to the extent you can, offer a hand to those who need it.

Quick business mention: If you would like to find out what types of investments I think are interesting given my outlook, I invite you to visit Mauldin Securities and find out what my "Team Mauldin" network can do for you. We work with investors at all net worth levels, and who may be looking for either total wealth management or specific opportunities that fit my philosophical framework. There are a number of private partnerships and offerings that I find very intriguing, especially those that are geared toward producing income. (In this regard, I am president and a registered broker with Mauldin Securities, LLC, member FINRA and SIPC. I am also an investment advisor working with CMG.) Find out what my network and my partners at Team Mauldin can do for you.

The Best Birthday Present

"The good news is your retina is not detached. There is a slight tear but we can fix it with a laser in just a few minutes."

Wednesday night I learned I might have a detached retina. My personal doctor, Mike Roizen at the Cleveland Clinic, said it was quite urgent. I was remarkably lucky to get into one of the best ophthalmologists in Puerto Rico the next morning, top of her class at Harvard and Johns Hopkins. Turns out she is my neighbor here in Dorado and her specialty is retinas.

My sister lost sight in one of her eyes with a detached retina, so I was very nervous. The doctor worked very hard to keep me calm but she clearly did not want me to leave until she "tacked down" the area with laser surgery around that tear.

So, I wake up Friday morning to finish this letter, my eye feels great and I feel even more blessed. And then I get letters like this in my inbox from my longtime friend Art Bell, CPA, advisor and friend to many of the largest money managers in the world, who has always been free to lend me his wisdom. Here is just the first part of his letter.

> Oh my, another milestone birthday! I happily recall your 60th in 2009 and wish you well on this one, what is for you the "new 50!" You have lived every moment of your years, with joy and some with sadness, tested but never broken. You never let the highs fool you or the lows stop you; you made many friends and very few who took the low road. You wrote everything from books to emails to blogs to articles to newsletters and gave talks and speeches with fury and passion. You weren't always right in your interpretations and predictions, but if not right you wondered how the world could get it so wrong! You loved kids so much you adopted many without regard to origin or color, you loved women so much you married a few, proving sequentially is better than all at once. You stared down government agencies and tolerated their heavy hand when no amount of education would still them. So, start a new decade tomorrow, maybe a book of reflections, maybe a month with an Indian prophet in India or an Indian prophet in South Dakota….

I am grateful to have so many friends who make life a wonderful joy. And so many readers like you with me every week for the last 20 years. I hope you and I can walk another 20 together. I fully intend to.

And with that I will hit the send button. You have a great week. And reach out to a few friends and just share some time with them.

Your so grateful for everything analyst,

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