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For the Intelligent Investor
Answers to questions you may not even know you have.

Social Security by the Numbers

Ron first wrote about Social Security in his October 1992 newsletter. In 2000 he updated his 1992 argument, and then in response to the questions it generated, he wrote a follow-up essay entitled "Social Security Revisited: A Plan to Fix It." The two essays were then updated in 2005. We present here the 2005 updates to Ron's two-part series on Social Security.

This first essay in the two-part series discusses Social Security on a per-person basis. It shows why Social Security cannot continue the way it is and how it got into this mess, and discusses some of the options we face at this point.

In 1992 we published an essay entitled "Social Security by the Numbers." As with all government programs, the numbers are much more understandable when viewed on a per-person or per-family basis. So we set out to answer two basic questions: "What did I pay into it?" and "How much can I expect to get?"

As the topic of Social Security is now on the agenda in Washington, D.C., it seems like a good time to update the data. This is particularly true as increasing numbers of people are becoming aware that Social Security, as presently configured, is unsustainable.

First, the numbers:

What Did I Pay into It?

Figure 7.2 shows the maximum Social Security tax paid by an employee each year since the system started in 1937. Equal amounts were paid by the employer. If you want the exact numbers for your account, call the Social Security Administration at (800) 772-1213 or visit their website at www.ssa.gov to get a request form. (Note: It's unlikely that people paying Social Security taxes today also paid them in 1937—68 years ago—but we believe it's useful to print the entire table.)
Our regular readers know that historic numbers must be adjusted for inflation. This we have done for you; thus, the 1937 contribution of $30 represents $384 in 2004 purchasing power. Totals for each column are shown at the end of the table.

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Figure 7.2 Social Security Taxes

Year	Maximum Covered Earnings	Tax as % of Covered Earnings	Tax ($)	Inflation-Adjusted Dollars for 2004
1937	$3,000	1.00%	$30	$384
1938	$3,000	1.00%	$30	$379
1939	$3,000	1.00%	$30	$386
1940	$3,000	1.00%	$30	$391
1941	$3,000	1.00%	$30	$388
1942	$3,000	1.00%	$30	$369
1943	$3,000	1.00%	$30	$334
1944	$3,000	1.00%	$30	$314
1945	$3,000	1.00%	$30	$309
1946	$3,000	1.00%	$30	$302
1947	$3,000	1.00%	$30	$278
1948	$3,000	1.00%	$30	$243
1949	$3,000	1.00%	$30	$226
1950	$3,000	1.50%	$45	$342
1951	$3,600	1.50%	$54	$406
1952	$3,600	1.50%	$54	$376
1953	$3,600	1.50%	$54	$369
1954	$3,600	2.00%	$72	$488
1955	$4,200	2.00%	$84	$566
1956	$4,200	2.00%	$84	$568
1957	$4,200	2.25%	$95	$630
1958	$4,200	2.25%	$95	$608
1959	$4,800	2.50%	$120	$752
1960	$4,800	3.00%	$144	$895
1961	$4,800	3.00%	$144	$881
1962	$4,800	3.13%	$150	$909
1963	$4,800	3.63%	$174	$1,043
1964	$4,800	3.63%	$174	$1,030
1965	$4,800	3.63%	$174	$1,017
1966	$6,600	3.85%	$254	$1,459
1967	$6,600	3.90%	$257	$1,437
1968	$7,800	3.80%	$296	$1,609
1969	$7,800	4.20%	$328	$1,707
1970	$7,800	4.20%	$328	$1,619
1971	$7,800	4.60%	$359	$1,674
1972	$9,000	4.60%	$414	$1,852

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Figure 7.2 Social Security Taxes (continued)

Year	Maximum Covered Earnings	Tax as % of Covered Earnings	Tax ($)	Inflation-Adjusted Dollars for 2004
1973	$10,800	4.85%	$524	$2,268
1974	$13,200	4.95%	$653	$2,664
1975	$14,100	4.95%	$698	$2,565
1976	$15,300	4.95%	$757	$2,550
1977	$16,500	4.95%	$817	$2,600
1978	$17,700	5.05%	$894	$2,673
1979	$22,900	5.08%	$1,163	$3,231
1980	$25,900	5.08%	$1,316	$3,284
1981	$29,700	5.35%	$1,589	$3,493
1982	$32,400	5.40%	$1,750	$3,512
1983	$35,700	5.40%	$1,928	$3,618
1984	$37,800	5.70%	$2,155	$3,919
1985	$39,600	5.70%	$2,257	$3,938
1986	$42,000	5.70%	$2,394	$4,032
1987	$43,800	5.70%	$2,497	$4,126
1988	$45,000	6.06%	$2,727	$4,341
1989	$48,000	6.06%	$2,909	$4,447
1990	$51,300	6.20%	$3,181	$4,640
1991	$53,400	6.20%	$3,331	$4,595
1992	$55,500	6.20%	$3,441	$4,577
1993	$57,600	6.20%	$3,571	$4,568
1994	$60,600	6.20%	$3,757	$4,666
1995	$61,200	6.20%	$3,794	$4,579
1996	$62,700	6.20%	$3,887	$4,577
1997	$65,400	6.20%	$4,055	$4,649
1998	$68,400	6.20%	$4,241	$4,781
1999	$72,600	6.20%	$4,501	$4,995
2000	$76,200	6.20%	$4,724	$5,134
2001	$80,400	6.20%	$4,985	$5,274
2002	$84,900	6.20%	$5,264	$5,466
2003	$87,000	6.20%	$5,394	$5,497
2004	$87,900	6.20%	$5,450	$5,540
		Total	**$94,925**	**$157,248**
2005	$90,000	6.20%	$5,580	
2006	$94,200	6.20%	$5,840	
2007	$97,500	6.20%	$6,045	

Source: www.ssa.gov

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How Much Can I Expect to Get?

The Social Security Web site (www.ssa.gov) states that a single person retiring in 2004 at age 66, who had always paid in the maximum, would receive $21,924 per year. A married couple with a nonworking spouse ("Family") would receive $32,880 (see Figure 7.3). Those who paid less than the maximum would receive less. For current numbers, call (800)772-1213.

Figure 7.3 Benefit Analysis

Maximum SSA Benefits 2004$			**Years to use**
	Monthly	**Annual**	**Contributions**
Individual	$1,827	$21,924	14.3
Family	$2,740	$32,880	9.6

Maximum SS Taxes Contributed (assume contributing maximum since 1937):

	Tax $	**2004 $**
Individual	$94,925	$157,248
Employer	$94,925	$157,248
Total	**$189,850**	**$314,496**

Assumes normal retirement age 66, individual and family receives full benefit and individual paid in maximum amount.
Source: Information derived from www.ssa.gov

It's interesting to note that the average Social Security wage earner earned $34,731 in 2003; he and his employer would have paid 2 x 6.20% or $4,307 in 2003 to Social Security. Figure 7.3 also demonstrates that dividing the maximum annual benefit into the inflation-adjusted total contribution from employee and employer of $314,496, an individual retiring today can expect to get all of his/her money back in 14.3 years, a married couple in 9.6 years. But the life expectancy of a male age 66 is 16 years, a female is 20 years, and these benefits are promised for life.

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The Social Security problem is a result of two inherently incompatible viewpoints:

First, Social Security was established as, and is viewed as, social insurance—a way of providing for those in need. It is a Depression-era program designed to keep older people out of the poorhouse. Any discussion of benefits soon becomes a discussion of those who need the money for subsistence living.[1]

Second, Social Security has come to be viewed as a pension plan whereby "I'm entitled" to benefits because "I paid in all those years."[2] This was not the original purpose of the program. In fact, FICA, which is the heading for your Social Security "contribution" on your W-2 form, stands for "Federal *Insurance* Contributions Act."

When we ask people to describe the primary purpose of Social Security, those over 50 tend to focus on social insurance and those under 40 tend to focus on the pension plan, but nearly all believe that both aspects are important.

But insurance plans and pension plans are very different concepts using very different assumptions. A pension plan involves setting money aside over a period of years, investing it to grow its value in real terms (i.e., vs. inflation and eventual taxes) so that assets available in retirement are a direct result of the assets set aside and the returns earned on those assets in the interim. The person receiving the pension can spend more than he put in (in real purchasing power), only if the invested returns exceed the interim inflation and the taxes paid upon withdrawal.

An insurance plan is entirely different. In an insurance plan, such as fire and casualty insurance, those who suffer the loss receive more than they paid in because those who don't meet the criteria (i.e., suffer the loss) receive nothing. I do not want to collect on my fire insurance, nor do I feel "entitled" to collect, unless I have a fire. Similarly, I do not want to "need" Social Security benefits, but they've been promised to me whether I need them or not.

[1] I've been told by a man who was in his late 20s at the time that the reason Congress made all the wage earners eligible was that they feared that benefits based on need would be considered welfare and they wanted to avoid the stigma of welfare. (This implies that there is no stigma to welfare if everyone is on it.) The fact that benefits have been promised to everybody who paid in may help explain why some have come to view Social Security as a pension plan.

[2] In Fleming v. Nestor (1960) the Supreme Court ruled that Americans have no property right to the money we've paid in Social Security taxes.

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In 1935, when the Social Security Act was passed, life expectancy was 63 years. Congress set the age at which benefits began at 65 in the full expectation that more than half the people would receive no benefits (because they would die before age 65). This is how an insurance plan works: a minority receives more than they paid in because a majority receives less than they paid in.

Back in the 1930s, there were 40 workers for each retiree, so it was easy to give a retiree a useful benefit because it was spread among 40 workers. Referring back to Figure 7.2, we see the rate of 1% on the first $3,000 in annual pay is equal to $30 per year or $384 per year in current dollars, matched by the employer. Sounds like a valid insurance plan, doesn't it? And it was, as long as the assumption held. But as life expectancies improved, the number of workers per retiree fell to 5:1 in the 1960s and 3:1 in the 1990s. That's why the contribution per worker increased by four times from 1937 to 1968 and has tripled since. In 30 years, the expected ratio of two workers per retiree will require a 50% increase from today's workers' contributions if current promises are to be kept.

But it's only a promise.

Social Security has never been run as either a pension plan or as an insurance plan. It has always been "pay as you go," a transfer of money from workers to retirees. One man explained to me that it's both a pension plan and an insurance plan, ". . . except for the fact that there are no assets, only IOUs in the trust. The IOUs in the trust will have to be paid with increased tax revenue or new taxes."

Exactly! Social Security has no assets. The benefits promised are simply a political promise—a political promise to raise taxes on our children and our grandchildren. But that assumes that our children will continue to work and continue to hire others, regardless of the tax rate.

But *we* didn't.

In the 1970s, when the top tax rate in the United States was 70%, we had 10% unemployment and a stagnant economy because it didn't pay the most productive members of our economy to hire other people. So they put their money into unproductive schemes designed to minimize taxes (tax shelters) and took time off to play golf. Over the past 20 years, I've asked thousands of people, "How many would continue to work at a 50% tax rate?" In the 1980s, 2%–5% raised their hands. Lately I'm getting no one. If we aren't willing to work at a 50% tax rate, why do we assume our children will be willing to work at a 50% tax rate?

The real choice today is not how to save Social Security in its present form. It can't be done without driving us to the stagnation of the 1970s.

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The real choice is: Would you rather live in the economy of the 1970s with 10% unemployment and rely on the promise of Social Security, or would you rather live in the economy of the 1980s and 1990s and not need Social Security?

The benefits of Social Security can be saved by splitting it into two parts: a pension plan and an insurance plan.

1. A pension plan—which allows private accounts the individual owns and is able to invest for decent returns. While participation in the private plan can be voluntary, once chosen, the contribution would be mandatory (people must fund it) and carved out of the Social Security contribution. These accounts would look much like IRAs.

2. An insurance plan—for which the benefits are need-based. For example, anyone with annual income greater than twice the national average, or assets greater than 20 times that (which at a 5% rate would support spending at two times the national average income) would not receive Social Security. Should their income or assets fall below these levels, they would once again be eligible for benefits. Today, those levels for an individual would approximate $70,000 in income or $1.4 million in assets.

For the multimillionaire who reads this and fears that I'm cutting off your benefits, you're right. But consider that you're now paying income tax on these benefits at a 28%–35% rate and can expect your estate to pay tax on the remainder at 30%–48%. So the dollar which is promised to you will become $0.65–$0.72 after income taxes, and $0.33–$0.50 after estate taxes. Under my plan, the promise is more likely to be kept should you actually need Social Security.

Muhlenkamp & Company, Inc.
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5000 Stonewood Drive, Suite 300 • Wexford, PA 15090 • (877) 935-5520 • www.muhlenkamp.com

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