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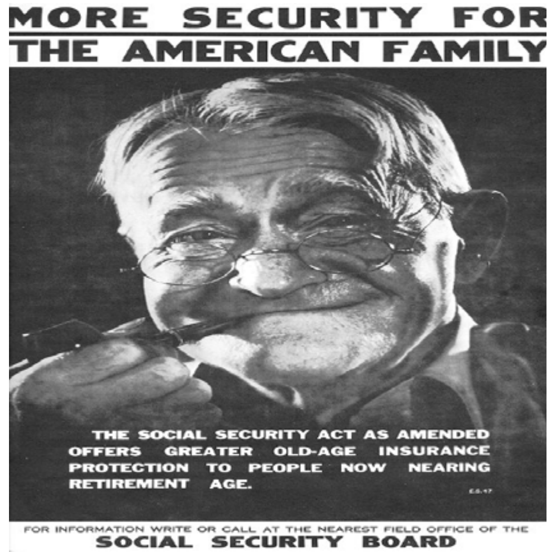
Social Security

This year marks the eightieth anniversary of social security. There will be no celebratory parades and very few grand pronouncements or soaring speeches. It has come to be taken for granted, something simply in the background, a known but vaguely understood entity which most people think will be their major comfort, however disappointing, which will carry them through their final years. We often hear dramatic, apocalyptic statements to the effect that it is going bankrupt, insolvent, broke—‘I won’t ever see it’, but that is nonsense. Some of the confusion arises from the idea that social security is ‘insurance’, since that is exactly the name that it carries and because there are insurance like aspects to it. We pay in over the course of our working lives and we expect a pension at the end, just as if we were buying an annuity from a private insurance company. If social security is like a public insurance company then it is not a stretch to say that it is broke, since, depending on how we calculate it, it is already paying out more than it takes in and its’ ‘reserves’ are merely federal government promissory notes. But social security is not an insurance company, it is a political institution, and as long as senior citizens vote it will be paying out pensions. It doesn’t matter where the money comes from, the government will get it.



Social security was originally intended as a quite modest affair, meant only to keep old people from starving. In the first year when enrollees were actually paid, 1937, there were barely 50,000 recipients and the total benefits were just over $1 million. In 1940 the average benefit was $17.50 per month. Today there are almost 60 million recipients and the annual disbursement in 2014 was $864 billion, making it the largest federal program. From its’ initial quite limited horizons, and covering just some categories of workers, it has become the foundation of most retirees’ finances and now covers nearly all employees.

Absent social security most people 62 and over would be in pretty sad shape. Our retirement preparations are not lush. Only half the population has any private pension coverage. Among those who are 75 and over only 29% have a retirement account. The cohort with the best coverage is the 55-64 year olds, 60% have something put away for retirement. But the amounts are small. The average is barely $100,000. For those with no coverage retirement savings are virtually non-existent. The average amount is somewhere around $6,000.

Social security keeps 20% of Americans over 65 above the poverty line. For more than half of married beneficiaries and three quarters of single beneficiaries it constitutes more than 50% of income. For over one-fifth of married and almost half of the unmarried it provides at least 90% of their income. Benefits as a percentage of income would be even higher if so many people were not still working. Among beneficiaries aged 65-69 fully one-third continue to work. The comparable share in 1992 was 21%; clear proof of the decline in private pensions.

Benefits are reasonably generous for retirees whose earnings were middling to average. The average retired worker gets about $1,300 per month but if there is also a spouse who has never worked outside the home then that amount is increased by half. For two retired workers, much more likely, the amount then is $2,600. In most parts of rural America that qualifies as a solidly middle class income.

Even for those much better situated social security can be a substantial contribution to family income. Someone who paid in the maximum amount over the course of a working life can retire at age 66 with a benefit of around $2,500 per

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month. If there is a spouse who has very little covered employment then the total pension amount is $3,750. A couple who paid in the maximum would get $5,000. Lots of people have in fact paid close to the maximum most of their lives because the upper limit began to rise dramatically only in the last couple of decades. In 1975 social security tax applied to just the first $14,100 of earnings.

A couple who has $1,000,000 in liquid retirement assets might get a return on that money of $40 to $50,000 annually. Add an equal amount from social security and it totals to a fairly comfortable retirement. Upper middle class people are much too inclined to treat social security as an afterthought in their retirement planning.

Social security is not only very important but it is also very complicated. Retirees ordinarily go to the Social Security Administration, announce they plan to retire, and then take whatever the Administration hands them. Unlike with tax there is no industry dedicated to helping people get through the process, no one who has your best interests at heart and can walk us through the various options. There are 700,000 people who work privately in the field of tax preparation and planning. Wouldn't it be odd if we simply went to the IRS every year and said: 'Please tell me how much I owe'.

Let's look at just a few important choices we need to make. The first is deciding at what age to begin taking benefits. Age 66 is considered full retirement age, FRA, and all benefits are calculated initially on the amount (the PIA) to be paid at that age. We have the option of starting to collect anytime between 62 and 70. The choice has a dramatic impact. Beginning at age 62 involves a serious penalty, we get just 75% of the amount we would get at 66. If the PIA is $2,500 per month, as in the example above, then the actual benefit would be $1875. If we postpone collecting past age 66 then the benefit increases 8% per year until age 70. That means a maximum of $3,300. Eight years results in a difference of 76% over the lower amount.

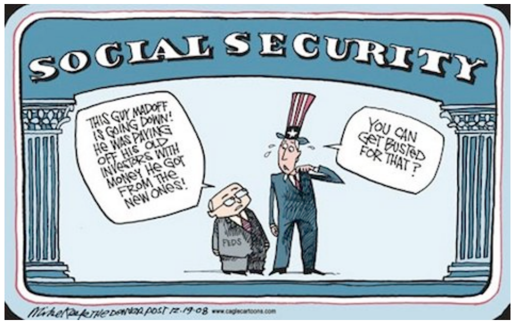
Of course the sooner we start the sooner we get the money. It takes about thirteen years to make up for the four years of income lost by not taking a benefit at 66 and instead waiting until age 70. If you start collecting at 66 you will be 79 before you begin to benefit from having waited.

There is a new strategy which is becoming quite popular among higher income couples. These are just the people who can afford to wait until age 70 to begin receiving benefits. This involves one of the two filing for a pension at age 66 then immediately suspending receipt.

By virtue of the one partner having filed the other spouse can file for a spousal benefit, typically one-half of the partner's PIA. This gives them income while waiting as the first spouse's ultimate benefit increases by 32%. If the one getting the spousal benefit has an independent work record that justifies a higher amount, then that spouse can also wait until age 70 to begin collecting in his/her own right.

Take the example above. Both spouses are 66 and each independently is eligible to receive $2,500 per month. They will both wait until age 70 to begin collecting the $3,300. In the interim one can receive a spousal benefit, in this case one-half of $2,500, or $1,250 monthly. This means that over the course of four years they will receive $60,000; money that they simply would not get otherwise and which in no way reduces their ultimate pensions.

One last observation which may be particularly relevant for people in the Bay Area. Here we have lots of people who are making comfortable incomes but did not begin doing so until somewhat later in life. This could be due to long years of school, unexpected career changes or lengthy periods of spiritual exploration. The point is that the monthly benefit, the PIA, is calculated on the basis of the average wage over the 35 years of highest income. Earnings could have been low to non-existent for a substantial period during that time. Many people now continue to work



well past age 66, often because they have to. For them there is the consolation that every additional year at a higher income replaces a lower income year in the 35 year average. This can result in important increases in the pension amount, even if benefits are already being collected.

In lieu of paid advisers we are dependent upon social security personnel for advice as to the best way to maximize our benefits. 'Advice' isn't even the right word because they are barred by law from giving advice. At least in theory they can only provide information. We have to know what questions to ask and we have to maintain a skeptical attitude about the information we get. Since the law can be quite complicated a lot of administrative personnel just are not going to have a firm grasp on it all. This puts a very large responsibility on us. We have to find ways to inform ourselves. The Social Security Administration is a very good place to start but it is only that. The next step is independent investigation. Probably the best book is the very recent Get What's Yours: The Secrets of Maxing Out Your Social Security, written by Laurence Kotlikoff, Philip Moeller and Paul Solman. As the title implies it is strategically oriented, marshalling a huge amount of detail but focusing on themes rather than administrative detail. A couple of others are more down to earth, focusing on procedure and calculating amounts. They are Social Security Made Simple by Mike Piper and Social Security for Dummies by Jonathan Peterson. Reviewing any of them will give you a better idea of what to look for. Two of the most overlooked benefit areas are related to divorce and survivorship. If you were ever married for over ten years and are now divorced it would be advisable to check with social security. If you were ever married and then widowed there may be some lost treasure waiting to be found.

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