# Social Security

***How it Began:*** Before we delve too deep into the current day conundrum, let's first take a look at how Social Security came about.

For centuries, farming and agriculture were the foundation of most families' economic security. Farms provided food, shelter and other resources for families to survive. As people aged, they were cared for by the younger generation on the farm.


However, economics began to change as a part of the industrial revolution. More and more people began moving to cities and working for someone else. As a result, they became less capable of caring for their own wellbeing as they aged, especially during difficult economic times. These demographic shifts coupled with the Great Depression paved the way for the Social Security system, which was signed into law by Franklin D. Roosevelt on August 14, 1935.[1]

***How it works:*** The Social Security system helps give protection to millions of Americans through unemployment compensation, retirement benefits, and disability income for qualified individuals.

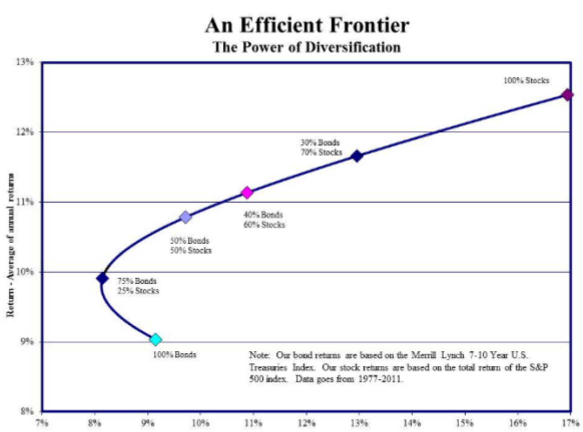

Social Security is financed through a dedicated payroll tax called FICA. It stands for the Federal Insurance Contributions Act and is deducted from each paycheck. Employees and employers each pay 6.2% wages, for a total of 12.4%, up to the maximum taxable amount ($168,600 in 2024). Self-employed individuals also pay the full 12.4%.[2] *Please note that FICA tax is only assessed on ordinary earned income, and not on passive income, such as dividends and interest, or other types of investment income.

As you work and pay FICA taxes, you earn credits for Social Security benefits. Contrary to what some might think, the money you pay in FICA taxes is not held in a personal account for you to use when you become eligible to receive benefits. Instead, it is used to help pay the benefits of individuals currently receiving Social Security. In other words, today's workers pay for current retirees' and other beneficiaries' benefits. Any unused money goes into the *Social Security Trust Fund*. These dollars are then invested in U.S. Treasury securities, which provide a small amount of interest for the Fund. (Treasuries are considered to be among the world's safest investments).

***Current Day Concern:*** The issue we currently face, however, is that the baby boomer generation is beginning to retire, and there are more retirees than there are working-age individuals. Due to the way that the system was set up, this means that more money is going out of the trust fund than is being put into it. Unless legislation is passed (which I believe it will), the Social Security pension fund is set to run out of money in the year 2035.

***Possible Solutions:***

1. ***Increase Full Retirement Age.*** Due to medical advances, the average life expectancy continues to increase, meaning there is a longevity risk to individuals during retirement. i.e. individuals need more money to live on during retirement because they're living longer. This puts an added strain on Social Security funds. We have already seen this strategy put in place, as legislation was passed in 1983, to gradually increase the full retirement age, also called the "normal retirement age" from 65 to 67. In order to make this strategy more effective, however, congress may need to make yet another adjustment to the FRA for younger individuals.
2. ***Provide incentives to delay taking Social Security.*** This is yet another strategy that we've seen taking place. If you delay receiving Social Security Income (SSI) benefits beyond Full Retirement Age (FRA), the benefit amount increases by a certain percentage for each month you delay starting your benefits. Currently, upon reaching the age of 70, individuals receive the maximum SSI benefit possible if delaying beyond FRA. In order to see more progress with this strategy going forward, congress may need to increase the age of the maximum benefit to 72 or beyond.
3. ***Increase the risk of Investments in the Social Security Trust Fund.*** Any Financial Advisor will tell you that having 100% of your retirement savings in a cash asset class is a recipe for disaster. Due to inflation risks, and the compounding time value of money, you will end up with far less purchasing power that you would if you had a diversified portfolio.




The efficient frontier (the set of optimal portfolios that offer the highest expected return for a defined level of risk or the lowest risk for a given level of expected return) actually states that a portfolio of 100% cash or bonds assumes more risk than that of one with even just 10-25% equities (stocks).[3] By making a few simple adjustments in the investment strategy, the fund could potentially sustain itself well beyond the breaking point.

4. ***Privatize Social Security.*** I can recall former congressman and U.S. House Speaker, Newt Gingrich, coming to the campus of Luther College when I attended their school of business (back in the early 2000s). His wife Callista was a Luther alumni, so he would frequently visit the campus. He spoke of the Social Security concerns back then, and was part of a "think tank" that proposed a plan to privatize Social Security. This plan would create investment accounts for each individual worker. Similar to a company 401(k) plan, you would then be able to pick and chose your own investments for your individual SSI fund. The money that you put in, and the performance of the investments would then determine the amount of Social Security benefits you receive. Workers could have the option to increase their contributions to retire earlier or to increase their payouts in retirement. While the logistics of this all might be a bit daunting, I do believe there is some validity to this plan.
5. ***Reduce or Eliminate Benefits.*** There has been talk of reducing or eliminating benefits for individuals who have over a certain dollar amount of assets. Although I personally don't wish to see this method, this would be one of the quickest ways to save Social Security for those who rely on it most for their well-being.

Regardless of the way in which congress chooses to solve the Social Security dilemma, the way I like to think of Social Security is like an inheritance from a wealthy relative – it would be nice if it happened, but you shouldn't count on it – especially not as your sole source of retirement income, as unfortunately so many Americans do.

Plan as if you won't receive any SSI benefits, and then when (or if) you do, you will be that much better off. You can use this for your "fun money" for some of those bucket list ideas you may have, or to pass wealth down to the next generation, but NOT for your basic daily living expenses. Personally, I have faith in our government and lawmakers, and I think they will come up with a plan to save Social Security for U.S. citizens.

1. Retirement Planning and Employee Benefits by James Dalton & Michael Dalton, 16th Edition.
2. "How is Social Security Financed? www.ssa.gov > factsheets
3. Young Research – How to Graph Efficient Frontier in Excel, December 2022