

Episode 64: Social Security's Future: Hint: It's Not Going Away

00:00

Bob French

The purpose of Retire with Style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to Risaprofile.com/Style and sign up to take the industry's first financial personality tool for retirement planning. More people believe in UFOs than that. Social Security will be there for them when they retire. Sounds like Wade has been spending too much time on the National Mall. I'm Alex.

00:59

Alex Murguia

I'm here with Wade. I'm Alex. I'm here with Wade. And Wade, I think I hit the record button a hair too soon. Just to give you a little practical review of what we're talking about as we go through this Social Security arc. Wade, I think I hit the record button a hair too soon. You had said hang on. Did I hit it too soon or are we good?

01:29

Wade Pfau

No, we're good. I was going to double check that I'm talking to the right mic, but I'm 99.9% sure that I am, so let's just go with it.

01:37

Alex Murguia

Okay? I don't know. What do you think, Brian? Wade, has anything happened since the last episode has been released?

01:45

Wade Pfau

I had my.

01:50

Alex Murguia

All right. Since we did have some time passed between the last podcast and we got so many wonderful write ins about how much they enjoy these personal snippets of our lives that serve as a preamble to this podcast. Wade, has anything happened since the last episode has been released?

02:09

Wade Pfau

Well, if you're watching, you see, I've shaved and that was more due to the lack of symmetry, was trying to shave without a mirror. So I just decided to start over. So that explains the current situation. That's only if you're watching on YouTube, which is one of the outlets.

02:26

Alex Murguia

What was a movie? So thank you for bringing that up.

02:29

Wade Pfau

Yes, we don't get a lot of YouTube, watchers it's mainly through podcasting services, but that sounds good if anyone would like it visual.

02:40

Brian Bass

You look great.

02:46

Alex Murguia

What was a movie? I think it was modern problems. Like Daphne Coleman, who's I think a hugely underrated actor. I think it was Daphne Coleman, Nick Carter and Chevy Chase. An old movie. Wade, you're a damn good looking guy without that beard on. Inadvertently encouraging the YouTube channel today. I must have seen it like so many times. There's a piece where he's walking down the beach bedabnikov and he's like, recording a biography or something, and he ends up his closing statement is, and I'm a d*** good looking guy. Wade, you're a d*** good looking guy without that beard on.

03:23

Wade Pfau

Congrats inadvertently encouraging the YouTube channel today. Yes.

03:31

Alex Murguia

All you that want to see the real deal, go to YouTube and check them out. Please write on the comments. I

beg you to write in the comments on the YouTube. That'd be awesome. What about you, Brian? It's been a while since we've seen you lately. What's been happening, man? What's the trajectory of a day in the life of a financial advisor at this time of the year?

03:54

Brian Bass

April 18. We're good to go. Q four every year.

04:03

Alex Murguia

Okay. Do you want to take a guess, among us three, which one of us was most likely to file an extension?

04:08

Brian Bass

I already know the answer to that one.

04:14

Alex Murguia

Which one was like, I don't have enough time. Let me just file an extension and move on. Does not sound like something that was Wade. For all you listeners, it was Wade.

04:25

Wade Pfau

No, I'm on top of that in.

04:28

Alex Murguia

A manner that no, it was me. It was me. But I blame my knee surgery.

04:33

Wade Pfau

This is a hot mess, which thank.

04:34

Alex Murguia

You for asking me how I'm doing. I really appreciate the empathy.

04:38

Wade Pfau

That was weeks and weeks ago at this point.

04:41

Alex Murguia

Weeks ago? What are you talking about? That was, like, last Monday. I don't know. Ten days ago.

04:47

Wade Pfau

Old hat.

04:47

Brian Bass

At this point, it feels like months ago, man.

04:52

Alex Murguia

Yeah, right. Well, this is my second one, so there we go. All right, so what are we talking about today, Wade?

05:00

Wade Pfau

Wade, I could have sworn we're going to talk about how passive investing is like fielding a baseball team. The last item was this fear that Social Security is about to disappear and therefore it's important to get out something from the system while you can before it's too late. We said, well, we'll have a whole episode about that point, kind of getting into what Social Security is all about in terms of its history, its outlook, reform possibilities and so forth, really, to discourage people from thinking they're not ever going to get any Social Security benefits. To give, like, a realistic assessment about Social Security's future prospects, just driven by what we've seen happen in the past as well.

05:49

Alex Murguia

Wade, I could have sworn we're going to talk about how passive investing is like fielding a baseball team.

05:57

Wade Pfau

The brainstorming list, right?

05:59

Alex Murguia

Isn't that why Brian's here?

06:01

Wade Pfau

What's going on, Brian?

06:02

Alex Murguia

Right? Isn't that what we're talking about today?

06:05

Wade Pfau

Brian is pushing on Bob to be our most frequent guest. Have we ever mentioned Brian is a former Major League Baseball pitcher? I don't know if that's come up.

06:16

Alex Murguia

He's very special regardless of that, so I don't think it works.

06:21

Brian Bass

Right?

06:24

Alex Murguia

No, we'll hit him up with a podcast like that in a future time. Right, Brian?

06:28

Brian Bass

I'm into that one.

06:31

Alex Murguia

Yeah, but no, today is the Social Security one, and we thought Brian would be a great guest simply because we're going to go through the history of it. Wade has some trivia about who the first person was on Social

Security and the like, not just the trivia reasons. Riveting okay, there you go. All right, bated breath. We're all bobbing, but I think it's helpful for Brian to give his two cent with regards to what are the conversations that you have with folks when it comes to, oh, my goodness, how do I plan for Social Security? Not the claiming strategy, but is Social Security going to be around and what emotional components do you hear around that, and how do you guide them towards that? I think it's a good way to add color to this. All right, Wade, my man. Take it away, man. Do you think?

07:31

Wade Pfau

Yeah, I mean, it all starts in 1935. That's when Social Security was.

07:40

Alex Murguia

Sorry. That had an in the beginning kind of vibe to it.

07:47

Wade Pfau

In the Great Depression, the Franklin Del Nor Roosevelt's New Deal was meant to help bring prosperity to Americans struggling during the depths of the Great Depression. As a part of that, Social Security was social insurance to provide initially retirement benefits. In terms of it's not a welfare system. It was never meant to be welfare. It was always you contribute into Social Security and you're entitled to then receive a benefit from Social Security to fund your retirement. It was designed to be pay as you go. The whole idea of the trust fund wasn't part of the initial idea. It was always the current workers payroll taxes would fund the benefits to the current beneficiaries. That's really what it's tried to do. Now, we did we'll get to this point and try to tell a linear story here. We do have a trust fund now because of some of the demographic changes going on, but that was always the idea.

08:47

Wade Pfau

Current workers payroll taxes, which entitles them to a benefit in the future, but we're not trying to just save that money or set that money aside. That money would then be used to pay the benefits to the current beneficiaries. It started with retirement benefits. That was in 1935 and 1939. They added spousal benefits and dependent benefits to minor children for survivors when the survivor benefits, they've added disability benefits over the years. They've added the cost of living adjustment in 1972. They're always tweaking the system, always trying to get it on track. Ideally, they want to have Social Security be balanced over the next 75 years, just meaning that over the next 75 years, the projected inflows of contributions through payroll taxes will fund the promised benefits over that time period. Now, that can be a struggle because of demographic changes in that regard. People are living longer.

09:51

Wade Pfau

We have now the baby boomer cohort is a very large cohort of individuals who are in the process of retiring we'll talk to Jason Pikner next, I believe, in the next episode. He coined the term peak 65, which is just that in 2024, we're going to have 12,000 people a day reaching the age 65. It's a huge cohort of individuals. Those are people who are now all going to be claiming Social Security benefits at some point. They're living longer, and they've had fewer children. You look at the number of beneficiaries to the number of current workers contributing into the system, that's coming down, which in a pure pay as you go system, makes it harder to fund benefits because you have fewer workers contributing per beneficiary. And then for that trivia. The next time you're on Jeopardy, she was the first recipient of Social Security benefits.

10:45

Wade Pfau

Who is IDA May Fuller? I wanted to bring that up not for the trivia of it, but because it shows another problem. I started with the idea that Social Security was created during the Great Depression, and so today it's based on your top 35 years of earnings. They didn't want to start off that way right away in terms of, okay, here's Social Security, but no one's going to get any benefit till they've contributed for years and years. IDA Fuller was the first recipient of Social Security. She contributed into the system for three years before retiring and starting her benefits. In the end of January 1940, she contributed \$24.75 into the system, and I would think this kind of stuff would be private, but it is on the Social Security Administration website. Guess they didn't have. Her initial monthly benefit was \$22.54. In just a little over a month, she already had a positive rate, internal rate of return on her contributions.

11:50

Wade Pfau

She ended up living to age 100. She's somewhat unique in that regard in that not everyone, especially at that time, was living to be 100, but she paid almost \$25 into the system and over her lifetime received \$22,888.92 in benefits from the system. It's unique in that regard, but it points to early recipients got a lot more out than they paid in. That's the other funding issue that we have to deal with as well, is not only do we have fewer workers contributing to pay for current beneficiaries, but we've always been having to fund those early cohorts who are getting much more out of the system than they contributed.

12:37

Alex Murguia

You're saying in the pantheon of great investments of all time, it's opening up a pack of cars and getting onus Wagner, being an original investor with Warren Buffett when he opened up his investment group, and IDA Fuller?

12:57

Wade Pfau

Yes. Being the first recipient of Social Security contributing for three years and getting a lot more out of the system than you contributed into it. Yeah. In terms of the implied rate of return on her contributions, it's

just astronomical. That's then the system and the situation. It's hard to keep Social Security in balance over the next 75 years. In 1975, that was the last time there was really becoming an emergency, that in 1975, the trustees reported Social Security would be out of funds. Not not out of funds. That's where, because it was pay as you go, there would not be enough incoming contributions to pay for beneficiaries. As of 1979, they made some.

13:47

Alex Murguia

But this is an important point. This is an important point. Wade and I just want to interrupt it just for a second, just to have more of a conversation. This is an ongoing theme that you've seen, right? Not just since the was established, and there need to be some adjustments, but once it got going, you could say since the 70s, there have been echoes of, hey, this is effectively not sustainable, and it's only a matter of time. Let's throw out a lot of skepticism with regards to relying on this system for your retirement. That a correct statement on my part?

14:24

Wade Pfau

Yeah. It was never meant to be the sole source of income in retirement. It was meant to just make sure people had enough to get by on, not to necessarily maintain the same lifestyle pre retirement.

14:39

Alex Murguia

Well, one of the stools, if you will, right?

14:41

Wade Pfau

Yeah. That three legged stool or one of.

14:42

Alex Murguia

The legs of the stool.

14:46

Brian Bass

That wasn't the point.

14:48

Wade Pfau

It's not meant to be the whole stool. It was meant to be a leg. Yeah, I mean, at that time, they just the

reforms, which this will be a reoccurring theme, increased taxes and maybe reduce benefits . That got the system back on track. By the early 1980s, again, same situation. And then here's some more trivia. Alan Greenspan, who became probably the most famous Federal Reserve chairman we've had headed a commission to reform Social Security. The 1983 reforms were really kind of guided through his commission enacted through Congress, that set up a lot of what really Social Security looks like today. In terms of that's when the full retirement age was pushed from 65 towards 67, though very gradually, the first people who have that age, 67 retirement age, were born in 1960. We still haven't got to the point where that's the full retirement age.

15:49

Wade Pfau

They were 23 years old at the time of the reform that suddenly, if you're 23 years old, you read in the paper, well, I thought Social Security was going to start at 65. It's not going to start until 67. That's a benefit cut. They did other changes. They introduced well, they increased payroll taxes. They introduced the taxation of Social Security benefits. It wasn't the complete system we have today, where up to 85% of your benefits were taxed. They were going to tax benefits up to 50% of your benefit.

16:18

Alex Murguia

You're seeing a theme where it starts so you're seeing these themes though, arise, right? It's almost like when there's shortfall in financial planning, there's only so many things you can do. Right, Brian? I mean, the first one would be retire later. Lo and behold, Alan Greenspan, in all his wisdom, in all his rational exuberant, said, hey, let's extend the retirement date. Sound familiar? If you're going to throw in tax at a higher rate, well, that's like invest a little more, say, your savings rate. If it was analogous to a plan, it's like increasing your savings rate.

16:56

Brian Bass

Yeah, exactly right.

16:57

Alex Murguia

I mean, there's only so many things.

16:58

Wade Pfau

That can be done, right?

17:00

Brian Bass

You can save more, spend less, work longer.

17:05

Wade Pfau

Yes, government policy, retirement planning in a nutshell. Exactly. It's that easy.

17:13

Brian Bass

I don't understand.

17:17

Wade Pfau

Also that's when the trust what would you say just before go ahead.

17:22

Alex Murguia

Yeah, well, this is about the trust fund. And what are your thoughts here, Wade? Look, we're a firm in DC, so we get it. We want to be as politically agnostic as possible. That being said, what are your thoughts of the argument that, well, you're taxing this or you're extending this, but this is my money that I've paid into and I'm going to exaggerate to make the point it's my God given right to get every penny that I put in out to the maximum extent. What is the government's kind of view on that without us kind of picking sides, if you will?

18:01

Wade Pfau

Well, the formal view that's actually there is a Supreme Court case, the Nester v. Fleming. You don't have any property rights to your social jeopardy. Again, by the way, I believe that's a name, but you don't have any property rights. Did you see that flex right there? Clarified? You do not have a property right to your presently legislated benefit. Congress does have the authority to change your benefits as they'd like to. It's not a welfare program you contribute in to receive a benefit from the system, but you don't have any property right over the idea that when I made these contributions, congress was promising me this. They have no right to reduce what they promised me. Congress is allowed to reduce the promises, reduce the legislative benefit that you're entitled to, change the formula for how your benefit is calculated and so forth.

19:03

Alex Murguia

They have a not so fast kind of button, right? Effectively.

19:08

Wade Pfau

Now, of course it's politically unpopular to do that. They do these types of reforms, and this was kind of hinting at this with the 1983 reforms, they don't necessarily reduce benefits for existing beneficiaries all that much. They push it off to the younger generations. We'll talk more about that too with the different types of reforms and how different reforms who they impact more current beneficiaries versus future current contributors.

19:40

Alex Murguia

Because the point you made with the Greenspan commission was when they pushed it from 65 to 67, in reality, is the people that faced the full brunt of that impact. They were just 23 years at the time. It wasn't like the people that were 60, 65 all of a sudden are like, oh, what just happened?

20:02

Wade Pfau

Right? If you were 64 in 1983, it wasn't like, oh, I thought I could start my benefit next year, now I have to wait two more years. Those people were not impacted by the increase in retirement age.

20:14

Alex Murguia

It was more the people who weren't voting yet or not, they were less of it, but most likely weren't voting as frequently.

20:20

Wade Pfau

Or the less cynical way to frame it would just be that people who still had a longer runway to make adjustments so that they would be able to kind of get back on track with the change in the policy.

20:33

Alex Murguia

Yes, there you go.

20:37

Wade Pfau

Also there was this recognition of the demographics, so that's when they started to say, okay, we should build up the trust fund now because in the future there'll be fewer and fewer contributors. To anticipate

these sorts of funding problems, let's build up a trust fund to be able to manage the pressures in the future that the number of beneficiaries in the future will be higher. And that's where we're saying the government.

21:05

Alex Murguia

Kind of saw the peak 65 coming.

21:09

Wade Pfau

Yes, the peak 65 was known to the people back in 1983 as well. Although it was in the distance, it was still 60 years in the not 40 years in the future at that point. 41 years. Yeah.

21:22

Alex Murguia

There was still some foresight with regards to that.

21:25

Wade Pfau

Recently the 2023 trustees report came out and in talking about there's the disability insurance trust fund, there's the Old Age and Survivor Benefit Trust fund. Sometimes people need to clarify which one they're time out, but the combined and it's okay to combine them because Congress also can just move back and forth. The combined Old Age Survivors and Disability Insurance Fund is now anticipated to deplete in 2034. And that's where the headline is. Oh, there will be no more Social Security after 2034. Because it's a pay as you a system. That's not what it means. It's after 2034. The incoming contributions immediately can fund close to 80% of the promised benefits. Over the subsequent 25 or 75 years, you'd have to have across the board benefit cut of 25% to get the system into balance over the next 75 years so that the payroll taxes from that smaller tax base are able to fund the benefits promised in a sustainable man.

22:38

Alex Murguia

The next 75 years. That's always been that like year 76, we're back in action, we're back in the game, right?

22:44

Wade Pfau

Yes, after 75 years, and even after a few years, you're no longer in a 75 year balance anymore if it's an ongoing downward spiral. Wade, I'm kind of trying to reframe here. Over the next 75 years, a 25% benefit cut is projected to keep the system in balance if nothing else is done.

23:06

Alex Murguia

Brian, just to bring it start interweaving of client communication piece. If someone hears the term or someone hears the phrase off hand in 2034, Social Security is caput. Wade, I'm kind of trying to reframe here. You're really saying it's not that it's caput, it's just yeah, benefits will be reduced. And, according to the machinations that you just laid out right. I fear getting it wrong, so I'll just leave it at that. The essence of what you're saying is, yes, but. The but is what you just said now, well, really, it'll be a 25% haircut for everyone for a certain number of years, and that's if there are no adjustments made by the government, which will most likely not be the case. That when you start hearing clients come up to you or prospects come up to you and start saying, hey, 2034 is the witching hour in terms of Social Security, so we can't plan past that.

24:04

Brian Bass

Basically, yeah. It's so sensationalized in the media that anytime you see the big headlines from any of the big networks, the phone will start ringing, you'll get some emails. A lot of it is just clickbait. They don't take the time to explain the story. They don't go into the depth, obviously, is what Wade is doing. It leads to those awkward conversations that you have to kind of explain how the system is working and how it's built and what that actually means. Wade, I've seen a couple of presentations that you're doing this, and I don't know if you do it as a goof or if actually you look this up and this is the case. Because people do they get scared for no reason. Not necessarily for no reason, but for unfounded reasons. Sometimes you just have to explain and lay out the groundwork of what's really going on, and it usually helps calm people down.

24:53

Alex Murguia

Wade, I've seen a couple of presentations that you're doing this, and I don't know if you do it as a goof or if actually you look this up and this is the case. Do more people believe in UFOs than Social Security? Than believing that they can't rely on Social Security? I don't know if you're just saying that as a guru.

25:10

Wade Pfau

No, that's an actual fact. When I was doing an internship in Washington, DC. In the late 1990s, just walking around the Mall, National Mall on the weekend, I received a brochure that was making this point. It was from an advocacy group. No, it said the survey was more people believe in UFOs than believe they can rely on Social Security. That was in the late 1990s. This is a concern that's not new at all. It's been around.

25:40

Alex Murguia

All right, so, Wade, what I get out of that one is so you're telling me you're walking in the Mall and you use this for all your presentations. You're walking in the Mall of Washington DC. Someone gives you a pamphlet that says more people believe in UFOs than the stability of UFO than the stability of Social Security, and

your conclusion is, hey, this must be true. Let me put this on presentation. Yeah, maybe not so much for citations.

26:15

Wade Pfau

Or anything like Wikipedia. Probably shouldn't use for sure as I pick up on the national, but it illustrates this point. It's from an advocacy group that was trying to encourage reform before it's too late, I suppose, at that time in the late 1990s.

26:36

Alex Murguia

No, I'm messing with you, man.

26:40

Bob French

Are you up for the challenge? We've just opened registration for Retirement Researchers Retirement Income Challenge starting on Monday, May 22, at noon. Eastern. During this free four day challenge with Wade, Alex, and I, you'll get to take the Risa and discover how you approach retirement income. Run and analyze your own funded ratio to understand where you stand relative to your retirement goals. If you put in the work, come out knowing how you can put yourself on a course to bridge that gap. We only have a limited amount of seats in the challenge, so head over to [Risaprofile.com/podcast](https://risaprofile.com/podcast) to learn more and sign up today. Again. That's [Risaprofile.com/podcast](https://risaprofile.com/podcast). See you in the challenge.

27:27

Alex Murguia

All right, so where were we then with that? You said Social Security as is, but until 2034 we're fine. What are some things that as opposed to kind of revamping the whole thing, or everyone taking a huge haircut, where are we?

27:44

Wade Pfau

Well, yeah, until 2034, we're fine, so to speak. And also just one other point. I mentioned the idea that Congress can change benefits, but Congress would have to do that. It's not a matter of in 2034. We just have an across the board 25% benefit cut. People are entitled to their presently legislated benefits and could sue to get them. Congress would actually have to step in and legislate a 25% benefit cut. If they're going to go to that effort, that's probably not going to be the final proposal that they stick with. It's likely they're going to have a broader package of reforms like what happened in past cases as well, that ultimately is probably going to be some mixture of benefit cuts and tax increases, but also benefit cuts that wouldn't necessarily be applied to existing beneficiaries, but more that are introduced over time. Let's talk about what those reforms could potentially be, I think is the easiest way to go forward with that.

28:57

Wade Pfau

There's certain reforms that would not impact current retirees, and then there are certain reforms that would impact current retirees. If we're talking about not impacting current retirees or people who are close to retirement, just increasing the payroll tax rate, that doesn't impact current retirees. Just full stop. Great. The numbers on that in the current Trustees report, congrats in the 2023 Trustees report, they say right now the combined payroll tax for Medicare, so I guess not including Medicare is 12.4% for the Social Security, Old Age Survivors and Disability Fund. If you increase that by 3.61% immediately, that would give you the 75 year balance. If you wait but you're talking percentage points increase, 12.4 would become, what is that? 16.1%.

29:58

Alex Murguia

So you're welcome again.

30:01

Wade Pfau

Thank you for that clarification. If we wait and this is where the sooner things get going, the better off people are, if we wait till 2034, it would require an immediate tax increase of 4.15 percentage points to 16.55 percentage points to get balanced projected balance over the next 75 years. That would solve it all by itself. You could increase the tax rate by that over four percentage points. You could cut benefits by 25%, or you could do some balance of those and you probably draw from some different pieces of this something else.

30:39

Alex Murguia

What would be the limit of income on that payroll?

30:41

Wade Pfau

Well, yeah, I mean, something else that's discussed is this idea of just raising the cap on the maximum taxable earnings in 2023. That 12.4% payroll tax rate shared between employees and employers. Or if you're self employed, you pay that full amount. That's capped though, at \$160,200, and that could be raised. It currently increases each year.

31:05

Alex Murguia

So, to be clear, what that means is anything you earn above that is not taxed, is not added to that mix. You're just taxed on that 1st, 167.

31:14

Wade Pfau

And something we want 100 and 6200. We have heard a number of proposals that would reintroduce that tax after, say, it drops to zero. If you're earning more than \$450,000, that's usually the number I hear for that. It gets reintroduced again at that point. Or you simply could remove the cap entirely, or there's different ways you could play around with that. That is a pretty hefty tax increase. Of course it applies to those higher income individuals, but 12.4% is quite a bit, and if you just remove that cap entirely, that would work towards solving much of the long term trust fund problems. It would be a big tax increase for those individuals, obviously, as well. So that's another angle there. Just increase the payroll tax up to the existing cap or increase the existing cap or a combination of the two. You could gradually raise the full retirement age, like which was done in 1983.

32:15

Wade Pfau

Sometimes you'll hear suggestions around the full retirement age. Instead of being 67, maybe it should be 70. That would be what that kind of reform would do. That would probably be gradual like it was in 83.

32:31

Alex Murguia

Obviously you can see a mix of everything, right? That kind of you're talking 40 years ago at this point. And so you're talking with advances. In longevity and the like. You could see that being actually a lot of meat on that bone, if you will.

32:46

Wade Pfau

Yeah. A number of other countries do formally make a link where the retirement age will be linked to longevity improvements. As people keep living longer, the full retirement age will be raised accordingly. I guess the idea is intergenerationally to let everyone have the equal amount of retirement because it does get costlier and costlier. When Social Security was created, people turning 65 were not expected to live into their 90s all that frequently. That's becoming more and more common today. The only thing about increasing the full retirement age is it's considered a regressive reform, meaning that it impacts people who have to do manual labor versus office workers. It's harder to work to those later ages. Such individuals are more negatively impacted by an increase in the retirement age. From an equity perspective, that's not always on the top of the list of desired reform options. Sure.

33:45

Alex Murguia

I guess the flip side to that could be and again, this is just us having a conversation could be. Well, but if they do some of that and then they adjust the payroll tax cap because you would think the payroll tax cap

will affect the knowledge workers more than the workers that you just mentioned, it kind of begins to balance out a bit.

34:08

Wade Pfau

Yeah. You can develop your own package of proposals and send it off to your local great negotiator. The great negotiator.

34:20

Brian Bass

That's going to be an interesting to the younger generations, though. No one wants to hear retirement age going to 70 or 75. Everyone wants it to go younger. They're looking at retiring younger and trying to make as much money as possible early.

34:31

Alex Murguia

Well, I don't think younger is going to be an option, though. Right.

34:34

Brian Bass

Through the lens of who you sell this to in Washington, DC, it's going to be who's the constituents that is going to buy into this program.

34:45

Alex Murguia

Yeah. I think we should introduce these ideas first in France and see how they react.

34:50

Wade Pfau

I was just thinking that, too.

34:53

Alex Murguia

We adjust, of course. Correct. What do you think?

34:59

Wade Pfau

We could try that. We did it in 83 without any riots. I don't remember any riots happening when we

increased the retirement age last time. In France, it's 62 to 64. It was the current idea in France and that created a lot of upheaval.

35:19

Alex Murguia

62 to 64 and no croissants on Sunday, something like that. Weird.

35:25

Wade Pfau

Well, there you go. Another option, one that I don't like and one that's actually harder to understand and so it's easier to trick people with it, is to switch from wage indexing to price indexing. I think in the next episode we're going to have Mary Beth Franklin on as a guest who's going to do some of those topics. I skipped over about specifically the mechanics of how benefits are calculated and so forth. We did talk about wages tend to grow faster than prices. To explain this in one sentence, the switch from wage indexing to price indexing just means the younger you are, the lower your benefits going to be in the future because you're not getting to benefit from those wage increases anymore. It's going to permanently lock in benefits at the price level when that reform happens. Whereas over time we project standard of living to improve.

36:18

Wade Pfau

People, their Social Security benefits would become smaller and smaller as a replacement rate of their earnings.

36:24

Alex Murguia

There a quick example that you have with that just so they fully appreciate price index?

36:29

Wade Pfau

Well, the price index is inflation. The consumer price index.

36:35

Alex Murguia

There like a general CPI or is there a specific batch?

36:40

Wade Pfau

Social Security uses the CPIW, not the CPIU that is commonly quoted whenever we talk about CPI. That's

for now, I might mix, I think Urban and Clerical Workers, or it's the CPIU is the commonly used price index, but Social Security uses a CPIW to be different. Let's just leave it at that.

37:00

Alex Murguia

I don't remember, is there a jeopardy answer for a CPIW or we'll pass on that one. We'll let Mary Beth answer that one for you.

37:15

Wade Pfau

Yeah, we'll do that. Okay. Those are the main things. Just real brief. What they talked about in the 1990s was investing the trust fund in stocks. It's kind of interesting about the trust fund. It's invested in non tradable US government securities, which I lived overseas for ten years and focused more on pension systems in developing countries. The IMF and the World Bank are active in kind of providing guidance to governments about things like this. They highly discourage using the pension fund of a country to fund government spending. So the US. Doesn't exactly pass muster with IMF recommendations in this regard because we have non tradable US government debt being used to the trust fund is not able to trade their securities. They just put them in a filing cabinet at the Social Security Administration in Baltimore. Just the idea there is let's not do that.

38:22

Wade Pfau

Let's invest in asset classes that may offer a higher risk adjusted return.

38:28

Alex Murguia

But you think that's possible?

38:30

Wade Pfau

That was a reform proposal considered in the 1990s that didn't really end up making it very far. In hindsight, I don't know, it's tough because Social Security is big, so it becomes a very major player and then you get into all the issues around how do you vote with the shareholder meetings and so forth and so on?

38:54

Alex Murguia

I think it was, I think it was I remember when the Gore Bush campaign, if I remember correctly, something that exists.

39:00

Wade Pfau

You mean the Clinton Gore. Sorry.

39:04

Alex Murguia

Yeah, exactly. I remember. No, they were talking about like there was like, hey, we're good here. Let's push it here. A few years later, you had the.com crash. I think they just silenced all of that up real fast.

39:18

Wade Pfau

Yes. It switched to the second Bush. George W. Bush talked about personal retirement accounts carving out part of Social Security and investing it like a 401K plan. That didn't make it very far either. We talked about these, like the unfunded liabilities that IDA May fuller, that we're having to pay for. That does make it hard to carve out and privatize Social Security into personal like a 401K plan, because we also are supposed to pay for all the promised benefits of existing workers and beneficiaries. That makes that reform harder to do. It also did not get very far either. Right now we're just talking about reform ideas that don't impact current retirees and that wouldn't unless they say, okay, we're going to privatize Social Security and there's no more money for current beneficiaries, so you're out of luck, which is probably not how such a reform would end up being structured.

40:16

Alex Murguia

As we have it so far in terms of reforms that will not impact. Brian has a client who's retired and they're talking about Social Security reforms. You would think I'm going under the assumption of retirees vote more, for lack of a better word, than others. Things that could happen and this would come. The people that carry the way here would be folks like us, right? To a large extent. This would be increase payroll tax, increase the maximum taxable earnings, increase retirement age, wage indexing, switch from the wage indexing to the price indexing, potentially expand the investments in what can be invested in the purview of what's invested in, or possibly even maybe creating personal retirement accounts. That's kind of the gist of what you're saying, Wade?

41:05

Wade Pfau

Yes, you nailed it.

41:07

Brian Bass

Nice work.

41:08

Alex Murguia

I can read a slide, Brian. Did you see that? Did I make it sound natural? Did it sound natural? Maybe off the top of your head, like it just rolls off the tongue.

41:22

Brian Bass

Well played.

41:25

Alex Murguia

What about reforms that would impact current retirees?

41:28

Wade Pfau

Yeah, so that's if we're going in that direction too, just when you're hearing about Social Security reform, things that would impact current retirees reduce the cost of living adjustments. Currently every year, the Social Security benefit is adjusted for that CPIW index that came up earlier in the conversation. And you could change that. You could change to a price index that doesn't increase as rapidly. You could just say whatever that price index is, but less one percentage point. If inflation was measured at 5% last year, your benefit increases by 4% instead of 5%. Something that would just cause the benefits to grow more slowly over time. That's a benefit. All these are going to benefit reductions because that's the only way you can impact current retirees. That's one way you could reduce benefits, you could change the formula. Right now, your top 35 years of average index monthly earnings are used to calculate your benefit.

42:29

Wade Pfau

You could increase that number. To the extent that people may not have worked as long or starting to add zeros to the calculation and so forth, that would be another way to reduce benefits. This did come up before you could actually link benefits to as people live longer, it automatically reduces benefits. You might start that sooner rather than later to distinguish it from just raising a fixed increase in the full retirement age. It's more like, okay, starting now, whenever we see longevity improving, we're going to raise the full retirement age accordingly would be the idea of that reform you could introduce means testing for benefits. This is the one idea that people may have a greater justification to be concerned about, especially if they're deemed like, a higher earner within the system. It would turn Social Security into more of a welfare program. It would be somehow ruling that if either your modified adjusted gross income exceeds a certain threshold or however they want to do it, you just simply wouldn't be entitled to the benefits that you've been promised.

43:39

Wade Pfau

That seems unlikely because it goes against the whole history of Social Security not meaning to have any stigma. It wasn't meant to be a welfare program. It was meant to be you paid into the system, you get something out of it. I have heard politicians I don't think so. It's not completely off the table. It's a reform possibility, but I think.

43:58

Alex Murguia

You're being nice by saying, oh, we don't want it to be a stigma, so we don't want to do it. I think it's more the other way around that we don't want to have to just exclude a whole subset of people because we will not be reelected.

44:11

Wade Pfau

I think that's any benefit cut that's, the better. It's not going to be politically popular, of course, yes, I get it.

44:20

Alex Murguia

That one seems more draconian.

44:21

Wade Pfau

Raise the maximum taxable earnings and means test the benefits. That's really a double whammy.

44:29

Alex Murguia

Yeah. What we're not doing in this podcast is you could take any one of these points and really say if we increase it by 1%, it puts us into the black by this many more years, et cetera. All of these have a lot of sway. Which one of these weighed? Without getting into the specific Excel optimizations and things like that, because we just don't need to here which one of these move the needle the most for the least amount of effort, if you will, in your opinion, or what?

45:02

Wade Pfau

That's a good question. Actually should have looked this up before we had the podcast and we could put it into the notes.

45:08

Alex Murguia

Don't worry about it.

45:09

Wade Pfau

The Public Policy Institute made a nice website that lets you play around because, yes, there have been simulations about how much these different reform options would improve the situation. You can create your own combination of reforms to get up to that.

45:26

Alex Murguia

Do you imagine the people doing it and writing to the congressman? What a nightmare. Thank you, Brian.

45:34

Wade Pfau

That's great.

45:36

Alex Murguia

Duly noted.

45:38

Wade Pfau

If you're going to cut benefits, one that may have the least amount of inequity involved in it is that reduction in the cost of living adjustment. That doesn't solve the full trust fund problem by any means, but it does take a big chunk out of the issue.

45:55

Alex Murguia

I think it takes a village here, let's go to that.

45:58

Wade Pfau

Ultimately it is probably going to be some payroll tax increase, some benefit cut, whether or whether that's simply raising the full retirement age, but something along those lines. The other just on the means testing point, there are stealthier ways to means test besides just telling people you don't know you don't get any

benefit because your income is too high. Taxing Social Security is a way to means test, and now up to 85% of your benefits are taxable that could simply be made 100%.

46:29

Alex Murguia

Taxing Social Security? Yeah. Did you see how he said a stealthier way that's like all right, in Lethal Weapon Three when Joe Pesh is like they screw you in the drive through. That's effectively what you're saying there.

46:43

Wade Pfau

You can also play around with the formula that calculates the primary insurance amount where there's these different bendpoints and they have different replacement rates for each range of your average index monthly earnings. They could play around with those bendpoints to make the system more progressive. Higher replacement rate for lower earners, lower replacement rate for high earners. There's lots of ways to play around with a system without doing an outright means testing.

47:09

Bob French

Are you up for the challenge? We've just opened Registration Community retirementresearcher.com retirement income Challenge starting on Monday, May 22, at noon. Eastern. During this free four day challenge with Wade, Alex and I, you'll get to take the Risa and discover how you approach retirement income. Run and analyze your own funded ratio to understand where you stand relative to your retirement goals. If you put in the work, come out knowing how you can put yourself on a course to bridge that gap. We only have a limited amount of seats in the challenge, so head over to Risaprofile.com/podcast to learn more and sign up today. Again, That's Risaprofile.com/podcast. See you in the challenge.

47:57

Alex Murguia

The way I'm reading all this is that it's just reinforcing. Look, it's not going away. There's things that could be done within the realm of possibility and within the realm of political appropriateness that will send Social Security along in its merry way for the next 35, 70 whatnot years. That's my takeaway. I mean, there's a lot of options here, Brian, but I didn't get your takeaway just on a personal level. Which one? If you're a betting man, what do you see here in the horizon?

48:32

Brian Bass

Just conversation is probably the easiest and least frictional way to do it. Ultimately it's a social program in the first place. Right. You're taking and cutting into a higher wage base of earner anyway.

48:54

Alex Murguia

I agree. I think that one I think the price indexing and.

49:00

Wade Pfau

Not the price indexing. That's one here too.

49:05

Alex Murguia

Really? But they can do that.

49:09

Wade Pfau

Yeah. It will not be understood. Yeah.

49:10

Alex Murguia

In my world people don't pay attention to that, so they can slip it in there. And the 85% tax.

49:19

Wade Pfau

Yeah. Of course what that ends up impacting is the oldest individuals because by the time you're in your eighties and nineties, you've had the most cumulative impact from a reduced COLA. That's the only concern there is whether or not such individuals are ready to handle a lower Social Security benefit in real terms. That's kind of the downside of it.

49:45

Alex Murguia

That's a good point because no, but to your point though, not thinking just longer term, they're not going to do something that's going to hurt the older population. If anything. They'll probably if they're going to err on the side of burdening a population, it'll be probably the younger folks, not necessarily the older ones, with a thinking that we'll solve it somewhere down the line or we'll quote unquote, resolve it somewhere down the line. But again, that's just yeah, I think.

50:12

Wade Pfau

Ultimately those reforms that impact current retirees are not going to be emphasized. They may there,

perhaps, but it's going to lean more towards reform options that don't impact current retirees. Again, in a non cynical manner, just because such individuals have a longer runway to make adjustments than people close to retirement.

50:34

Alex Murguia

Yes, in a non cynical manner.

50:38

Wade Pfau

Interpret it cynically in terms of voting patterns with different age groups.

50:47

Alex Murguia

Brian so this is we're doing this but we're not in the thick of it. We're talking about all these reforms, we're not in the thick of it. I get the whole point that it's easy for us to kind of be at arm's distance to this decision. Walk us through a prospect or a client comes up to you and yeah, let's say there's something on the legislative table on Social Security. Whatever their political proclivities are, it happens to emphasize the negative features of what's on the table to the degree that it looks like look, it's tenuous at best. That I can count on this. Take it away. What does that conversation look like? What are the pain points and counters that you bring up that help? What do you do in terms of working it into a planning context?

51:43

Brian Bass

I think the biggest part of the early conversation is just education. I think going back to the taxation piece of the pulling which lever and how do we make the system work. Hardly anyone understands how Social Security is taxed when they hear 85% of Social Security is taxed. The immediate assumption is, oh my God, I'm paying 85% tax rate on my Social Security benefit. Part of it is really just yeah, 100%.

52:10

Alex Murguia

Really?

52:11

Brian Bass

You talk about the wage base, no one understands what the wage base is, and they hear \$160,000. They don't understand how the entire system really is built and how the calculations work. A lot of it is education up front and really just turning those questions back around and say, really? Okay, what is it about this proposal or this language that you're seeing that is really bothering you? We kind of go into it of laying out

the actual framework of what's going on behind the scenes. For the people that do have a really good grasp of it turns into, okay, let's get into your, especially for tenured clients that have been around for a long time, and we have a really good understanding of their financial plan. It's a lot of stress testing. It's, okay, well, let's just assume you're correct and let's say your benefit gets slashed in half.

52:55

Brian Bass

What does that actually look like for you? That Wade, please be correct me if I'm wrong here. This is, in our opinion, probably not going to happen, but let's just take a look at it and see. If you really want to go down this road of being uber conservative and not relying on this stream of income anymore, what levers we have to pull around your financial plan to make this actually work in this scenario?

53:23

Alex Murguia

What effect does that have on them when you've shown them, like, okay, let's just assume 50% is gone. I would say I would put a wrinkle on that. That Wade, please be correct me if I'm wrong here. You said kind of at worst in 2035 2034, whatever the date was, everyone will take a 25% haircut, right? Was it 25%?

53:47

Wade Pfau

Yes.

53:48

Alex Murguia

Okay, so if in the plan, you do a 50% haircut, you're doing 100% more than, like, a worst case, if you will correct. If you do that, does that seem to allay their anxieties it's plan specific? They think it's going to zero. These people think it's going to zero.

54:12

Brian Bass

People do. Some people are very scared when they say, again, going back to kind of the media portrayal of what's actually happening, if you're in some of those threads on Twitter and whatnot, there's some scary things being thrown around that just don't have a lot of backing in reality.

54:30

Alex Murguia

But zero is a big number.

54:33

Wade Pfau

Yeah. Because Social Security benefit weigh your thing.

54:35

Brian Bass

Yeah.

54:36

Wade Pfau

So that's a very conservative it is.

54:39

Brian Bass

I mean, you read a headline that says the trust fund is going to zero, like, with no context and no real facts behind that statement. You get scared if you don't know what's going on, you don't know the system, you don't understand how it's really funded in the first place. That's a scary headline.

54:57

Alex Murguia

Okay, so then just because we're saying this, and you may have said this earlier way, but I think it's important because of the emotional connection right now. How should people interpret, interpret the headline Social Security is going to go bankrupt or is going to be unfundable or whatever the word is in 2034?

55:15

Wade Pfau

How should they read that? They should just understand that Social Security was just always meant to be pay as you go and reform will be needed to keep the system in balance. That will likely involve some either tax increase and or benefit cut. Yes, at most we're talking about a 25% benefit cut. The reality is it's probably going to be quite a bit less and also it's probably going to be shifted more towards that younger population rather than the population close to or in retirement already. I'm still well away from my full retirement age. I do assume I'll get 75% of my presently legislated benefit. I do assume a 25% haircut, but I tend to assume very conservative assumptions and for me a 25% reduction is pretty conservative.

56:08

Brian Bass

That's a great point too. I was just going to say that's.

56:12

Alex Murguia
A great point too.

56:13

Brian Bass

When you're working with younger clients in their thirties and forties, you can reasonably assume a lower payout rate. It just helps bake into a different savings program. You're increasing your savings rate, you're increasing some of the different assumptions around the plan. If Social Security doesn't get cut and you get 100% of the benefit, you have a massive payday on the back end of the plan, which affects claiming age. It affects a lot of different levers on the back end that we can pull. Again, to your point, you just want to pay attention to how conservative you're being with those assumptions.

56:49

Alex Murguia

The other point I'd like to make that wade that you said in addition to this, is that.

56:56

Wade Pfau

Just because you.

56:57

Alex Murguia

Paid into it doesn't mean and I'm repeating what you said, I just want to make sure I did it correctly. Just because you paid into it doesn't mean that the government can't legislate it again for different benefits. If they do not legislate and this is what you're trying to get, if they do not legislate it again, you are entitled to the rights that are in there right now as law. The government literally has to legislate these reforms. If not, they actually have to pay you these numbers.

57:24

Wade Pfau

Yes, you would may have to sue for it, but yes, you would be entitled to what you've been promised. There's different laws and it's going to be a big mess. Effectively it's not so easy to just say benefits will be cut by 25%. If nothing is done, it's much more. Something has to be done to make that possible.

57:47

Alex Murguia

The other thing with this that I want to make sure everyone takes away, and you've said it, and I think it's one of these phrases that you hear, you said at the beginning and you explained it, but again, because of this

emotional recency right now, pay as you go, what exactly does that mean again? Everyone, after they listen to this podcast, will remember in a pure pay.

58:06

Wade Pfau

As you go system, there is no need for a trust fund. It's just every year you collect the taxes from people who are working, paying their Social Security contributions. You take those funds and you use them to pay the benefits to the current beneficiaries.

58:26

Alex Murguia

And that's what you're talking about. In order to make it solvent as a pay for your go system. These are the things that we need to tweak.

58:34

Wade Pfau

That's where the trust fund was built, because of the anticipation that because of the changing demographics, it would become harder and harder to run it as a paid ecosystem.

58:47

Alex Murguia

The demographics are turning into our favor now because the baby boomers will peak next year.

58:54

Wade Pfau

Actually, that's not in our favor from the perspective of funding Social Security.

58:58

Alex Murguia

No, after like years from now, not right now. Coming up?

59:03

Wade Pfau

Yeah, eventually going past 75 years and so forth.

59:10

Alex Murguia

I'm an optimist.

59:13

Wade Pfau

I'm sure you're getting at that once.

59:14

Alex Murguia

These baby boomers out of the way, is what I was thinking.

59:19

Wade Pfau

Yeah, we've got the population pyramids. It used to be a pyramid. Like, the biggest cohorts of individuals were at the younger ages. As you got older, it got smaller and smaller, and that's changing. And now you've got a different shape. Those population pyramids can't really be called pyramids anymore. There's bigger cohorts at older ages rolling in some scenarios or some cases.

59:47

Alex Murguia

So, Brian, when you do show the plan and all that, do you see a change in anxiety? Do you see a change in anything? Or is it one of these where they're like, okay, well, at least, okay, now I've solved for the worst case. Now I can build from there? Or do people believe what they believe and there's nothing you can do about that, really? You just got to accommodate that?

01:00:09

Brian Bass

No, for the most part, I would say 90% of the people, once you show them kind of a realistic picture and you explain the system and you show them there are different things in the way to fix their plan, they have just a general better outlook than they did before. A lot of times it's really just going to the conversation of how do we diversify income streams? Obviously, Social Security with a couple who's been together for a very long time. They've both worked for 30 or 40 years. They have a really good benefit for each of them that represents a big chunk of their retirement income that they rely on every year. Really it's going in and figuring out using the reset, really figuring out how they feel about their retirement income, what they want to see from their investment portfolio, and really dialing into that emotional side of if this one sleeve of my income dries up, what does that look like for my retirement?

01:00:58

Brian Bass

What does that do to my retirement income? Just helping them think through the different ways to structure things and different ways to go about creating, again, diversified safe income streams to pair with a volatile portfolio of stocks and bonds, or even using a different stroke in the top left in the bucketing time

segmentation piece. Just helping people understand that there are different ways to do things and building as much safety or as much risk into a plan as people are comfortable.

01:01:32

Alex Murguia

All right, that's great. Way do you want any parting thoughts here?

01:01:36

Wade Pfau

I think we had a good discussion about this and hit on most of the main points. Thank you, Brian, for joining us today and giving us that perspective of interactions with real individuals who are facing these decisions and complications. Really appreciate having you on the show and thanks everyone, for listening. We'll go ahead and wrap things up today and we'll have a few more episodes on Social Security, so make sure to stay tuned next week. Wade and Alex are both principals of McLean Asset Management and Retirement Researcher.

01:02:05

Brian Bass

Thanks for having me, guys.

01:02:07

Alex Murguia

Thank you. Thanks, Brian.

01:02:09

Wade Pfau

All right.

01:02:10

Bob French

Wade and Alex are both principals of McLean Asset Management and Retirement Researcher. Both are SEC registered investment advisors located in Tysons, Virginia. The opinions expressed in this program are for general informational and educational purposes only and are not intended to provide specific advice or recommendations for any individual or on any specific securities. To determine which investments may be appropriate for you, consult your financial advisor. All investing comes with a risk, including risk of loss. Past performance does not guarantee future results.