Quarterly Newsletter

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Kicking The Can

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My son Abe loves his pacifier(s). He cannot seem to get enough of them and slightly melts down when he wakes up in the morning and all his pacifiers have fallen through the slots of the crib. In an act of desperation to try to prevent this, my wife Ellie and I now keep four or five pacifiers in his crib at any one time. We have successfully limited pacifier use to sleep-time or long road trips (little victories!) but there will come a day when he needs to leave the pacifier behind for good. Ellie and I dread the day in which we must begin that process. Though we've surveyed friends and family who have gone through the process before, we still are uncertain when and at what age that tough process will have to begin. To avoid thinking of that period, we like to say that it is "future Eric and Ellie's problem."

It is human nature to procrastinate and "kick the can" down the road. The United States Congress seems to really enjoy playing this "can-kicking" game; in particular, as it relates to Social Security and the long-term financing shortfalls projected in its recently released 2021 Trustees Report (though this relates to Medicare as well, we are focusing on Social Security in this missive.)

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The Bad News

The bad news first: per the Report (and to the surprise of few), Social Security will experience "cost growth substantially in excess of GDP growth through the mid-2030s due to rapid population aging." It is estimated that this cost growth will cause the Old-Age and Survivors Insurance (OASI) Trust Fund to be depleted in 2033. Does this mean that Social Security payments will stop in 2034? **No.** It just means that, assuming no other changes, benefits will not be able to be paid in the **full** amount – the current estimate is that continuing Social Security tax payments would be sufficient to pay 76% of scheduled benefits (meaning benefits would get cut by a quarter, roughly.)

For many years (especially during the forty-year period from 1970 – 2009), Social Security taxes incurred by workers/companies were greater than Social Security benefits paid out to retirees – this surplus caused the growth of the Trust Fund. However, over the past decade or so, that growth has stalled as Baby Boomers began retiring and taking benefits. In 2020, Social Security benefits paid out to retirees outpaced Social Security taxes incurred by roughly $65 billion. Yet, it's worth noting there was $76 billion in interest incurred on the reserves in the Trust Fund (whose balance was $2.8 trillion at the end of 2019), which saved the year from being in the red. However, it is expected that total cost will exceed total income including interest in every year going forward.

During the forty-year period discussed above, there were more than three workers paying taxes into the Social Security system for every one retiree receiving benefits. Over the next couple of decades, it is expected that this ratio will decrease to a figure of closer to two workers per benefit recipient.

If you're starting to think of the term "Ponzi scheme," I would recommend leaning away from such a phrase. You see, every component in a Ponzi scheme is fake – meaning there are no fundamentals behind the cash flows coming into or out of such a scheme. Conversely, with Social Security, funding for the system comes from U.S. citizens' productive output and the taxes based on said output. This is a real source of funding that I highly doubt goes away.

Consider The Solutions

We have discussed the bad news: if nothing happens in the next decade or so, the Social Security system will potentially get to the point where it can only fund 75% of its obligations. So, why am I not worried?

The easiest answer I have points to data from the 2020 presidential election. When you look at voting turnout rates based on age groups, you can clearly see an upward slope as it relates to the percentage of an age cohort that votes. Per the US Census Bureau, 18- to 24-year-olds voted at a roughly 50% clip. For 65- to 74-year-olds, (arguably the age group that, if push came to shove, would be at the forefront of changes to Social Security), were the highest voting bloc with 76% voter turnout. I have high confidence that the U.S. citizens in their golden years would make sure their voices are heard since they arguably have the most political power in the country (see also the ages of our President and party leadership on both sides of the aisle.)

So, what can be done about what is obviously an impending problem? There are four major options, and all but maybe one of which is in consideration to "plug the leak" in the OASI Trust Fund:

1. **Partially-privatize Social Security.**

This is basically the non-starter. After George W. Bush won re-election in 2004, he stated that Social Security reform was his top domestic priority. His idea: give Americans the option to invest part of their Social Security contributions in private accounts – basically creating government retirement accounts for workers. Similar to the overwhelming shift made by employers from defined benefit plans (i.e., pension plans) to defined contribution plans (i.e. 401(k) plans), the idea was to give additional responsibility to the individual. This sounds nice, but public disapproval was rampant as the idea was discussed in 2005 and the initiative failed to gain traction. I believe this is probably still the case.

2. **Take the cap off (or at least increase) the amount of income that is eligible for Social Security Taxes.**

Currently, in 2021, only the first $142,800 of income/earnings is subject to Social Security tax (6.2% borne by the employee, 6.2% borne by the employer.) This maximum dollar amount of earnings has increased over time (by roughly 3% per year over the past decade) based on changes to the national average wage index. If there was a one-time increase to the maximum, or a change in how the annual increase is calculated, that could cause higher-income individuals to pay more into the system. This seems like a likely solution, as it primarily affects younger individuals in the prime of their careers instead of near-term retirees (who we've noted have a strong voting bloc.)

As a quick note, Medicare taxes are not capped for income (and there are additional Medicare taxes imposed on high-income individuals.)

3. **Increase the retirement age**

The retirement age refers to the age you must reach to be eligible to receive full benefits from Social Security. It was last adjusted with the Social Security Amendments of 1983, which initially gradually increased the "full retirement age" from 65 (for those born in 1937 or earlier) to 66 and then finally to 67 (for those born in 1960 or later.) The rationale for this change was because of "improvements in health of older people and increases in average life expectancy." Well, thankfully those improvements have kept on coming, with life expectancy for American women a little above 80 and American men a little below that. It is not outside the realm of possibility that the retirement age for younger age groups could be increased (and with it, a possible decrease to how much it benefits a person to wait until age 70 to take Social Security benefits).

4. **Change the Cost-of-Living-Adjustment (COLA) for those receiving benefits**

Currently, the COLA (or inflation rate) for Social Security benefits is based on the "Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W)." There are plenty of versions of the Consumer Price Index that could be used for the calculation - for example, there's a version for Americans who are 62 Years of Age and Older (CPI-E). Interestingly, using the CPI-E index makes the COLA higher rather than lower due to the index's higher weighting on healthcare, which, in turn, actually increases the amount of benefits being paid out. As such, this option probably wouldn't be the answer to the problem at hand. Another thought is they could substitute a "chained" index, which allows for more of a "substitution" effect (i.e. adjusting the index to buy more products/services whose relative prices have declined, while buying less of those whose prices have increased.) This is more of a "sleight of hand" that wouldn't make the biggest dent.

It is worth noting that it was announced on October 13, 2021, Social Security cost-of-living increase will boost benefits by 5.9% in 2022, meaning those receiving benefits will receive a bit more in next year.

A Combination Approach

Some combination of the above is most likely in the cards whenever "the can" cannot be kicked any further down the road. We have seen a lot of political finagling over the past couple of weeks as it relates to the debt ceiling and there will surely be more to come when the Social Security issue (eventually) comes up.

Until then, we would recommend not allowing the anxiety of potential benefit cuts to mess with your living today. Instead, turn off the television, enjoy the beautiful fall weather, and celebrate the holiday season ahead of us. We are so thankful to be a part of your lives and we pray that you and your families have a safe and wonderful Fall!

Around The Office Updates

It's the Most Wonderful Time of the Year

Believe it or not, Kaylee turns 4 this month! There will be a grand celebration in our household (a princess themed birthday party) filled with cake, music, and a jump house. Maggie (who turns 2 this coming January), is equally pumped because her passion in life is to eat cake! Who can blame her?! Both girls are growing fast and have a very special bond. Thankfully, they love spending time with each other!

Big News!

Eric and Ellie have some big news to share! They are excited to announce that their family is expanding - they are expecting another boy in early 2022! Abe, who turns 2 next February, is already in the process of learning what it means to be a big brother. As you can tell from the picture, he's very excited! We're happy to share that Ellie is feeling great and everyone in the family is healthy.

Crafty Man

Pete's woodworking ability isn't limited to just custom acoustic guitars. His "summer workshop to-do list" demanded something new this year. So, he completed a "mobile collapsible workbench." Now, I'm not really sure what he needs this for, but he has emphasized that it is necessary and important 😊. (I don't even understand what it does…) And if you are really interested, I'm sure he'll explain it to you in detail.

Looking Into Q4

Capital Gains Distributions

Mutual Funds are required to distribute 95% of the gains realized over the taxable year. The distributions typically take place in November or December. There is nothing you need to do – we monitor those distributions, and we will keep you posted if there are any tax ramifications you need to be aware of.

Our Phone Line

As a quick reminder, our phone number (281) 973-8816 is a landline. As such, we cannot receive text messages on this line. If you are looking to get in touch with us and cannot make an outbound phone call, please send us an email.