

**Real World Graduation: Question 88: Social Security**

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Question 88

A man graduated from high school in June of 1972, and went to work in an office immediately afterwards. His initial salary was \$10,500 per year. Over time, he received raises and promotions. His income rose on average 3.5% per year. He died suddenly in 2006 at age 52. During his working life, he paid in 7.35% of his income in Social Security payroll taxes, and his employer paid in an equal amount. Both types are required by law, with certain exception for agricultural workers, which did not apply to this man. At the time of his death at the end of 2006, his equivalent hourly wage was \$16.57 (annual salary = \$33819.03). The Figure shows his income by year (in red), and the total Social Security taxes paid in over his working lifetime (in black). The total FICA Social Security tax paid during his lifetime was \$82,108.07; half was paid by the man, and half was paid by his employer. The earliest age at which Social Security retirement benefits can be paid is 62. Since he did not live long enough to collect any Social Security retirement benefits, how much did his estate receive from the Social Security Administration after his death?

- a) His estate received a total slightly more than \$82,108.07, since FICA contributions are invested in U. S. treasury bonds, which earn a small amount of interest. It is difficult to calculate exactly because of the bond maturation schedule. No taxes are due.
- b) His estate received exactly \$82,108.07 (the total paid in by the man and on his behalf by his employer) since Social Security benefits are not invested, and do not earn interest. No taxes are due.
- c) His estate received \$41,054.04, which is the amount the man contributed. It would not be fair for him to receive contributions made by his employer. No interest is paid, but no taxes are due.
- d) His estate received \$34,895.93, which is his contribution without interest (\$41,054.04), but with income taxes taken out (15% marginal rate).
- e) His estate received an amount equal to the last 40 quarters (10 years) of his contribution, less 15% income taxes. In the last 10 years of his working life, his contributions totaled \$18,048.43; this amount less 15% comes to \$15,341.16, which was paid to his estate.

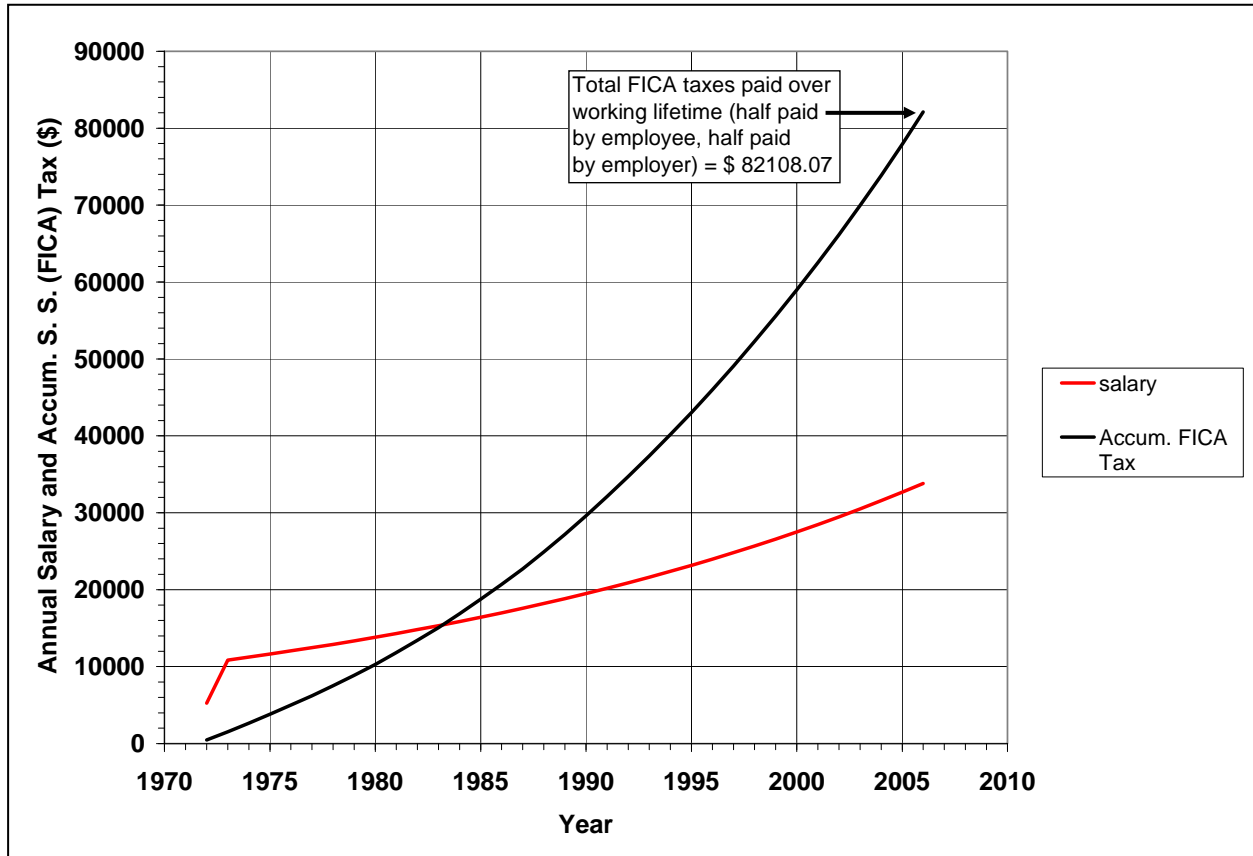


Figure for Question 88

### Answer to Question 88

This is a trick question. All of the answers are incorrect.

The man's estate received a \$250 "death benefit" from the Social Security Administration. Pretty good investment, don't you think? This will also help some of his beneficiaries get out of debt and pay for a good education for their children, don't you think?

So where did the all the money he and his employer paid in all those years end up? In reality, it is already gone; it was given out to people who were already retired when the man was working. Had this man lived to retirement, he would receive his benefits from those still working. Had he lived to retirement, his retirement benefit over his retired lifetime would probably be less than he would have if he had been allowed to keep the tax money and invest it. The younger you are, the more Social Security is a rip-off. Aren't you glad Congress is looking out for you by forcing you to pay into a system that will, in the long run, have a decreasing benefit compared to the amount paid in?

Some critics have called Social Security a "Ponzi scheme". A Ponzi scheme is designed to defraud investors by paying high returns to those who get in early; they are paid by those who begin investing later. Usually the so-called money manager is simply robbing most of the investors, and there comes a time when he cannot attract enough new investors to fulfill the promises he made to the existing investors. The scheme then collapses. Social Security is not a Ponzi scheme, since first, no claim is made that anything is being invested, and secondly, there is no means to withdraw from the system.

Social Security is often advertised as "old age insurance", but it is not insurance, because there is no formal contract between you and the Social Security Administration specifying the legally binding terms of payments and benefits. It does not function like an annuity that has a specified death benefit.

Social Security is not a savings program, since although you pay in all your working life, you do not have any control of any account.

Social Security is a transfer-of-payments scheme in which people now working pay benefits indirectly to those who are retired, with the U. S. government acting as intermediary. The initial idea was to mitigate poverty in old age as a supplement to normal savings, but has since been transformed into a politically untouchable "entitlement". It behaves like every other well-intentioned government program: the government makes promises it cannot keep in order to buy votes, and in the long run finds that it cannot raise sufficient taxes to fulfill those promises, so it simply reduces the benefits accordingly. In the long run, the taxes paid in will increase, and the benefits paid out will decrease when considered on an individual basis.