HOW TO SURVIVE THE STOCK MARKET TIME BOMB AND PROTECT YOUR FINANCIAL FUTURE

Thornton Parker

WHAT IF BOOMERS CAN'T RETIRE?

How to Build Real Security, Not Phantom Wealth

An Excerpt From

What If Boomers Can't Retire?: How to Build Real Security, Not Phantom Wealth

by Thornton Parker

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Introduction:

Beware of Phantom Wealth

THE IDEA OF USING STOCKS to solve the Social Security problem seems like a "good, long-term, quick fix." The idea is so alluring, it just keeps coming up. But before jumping to that conclusion, we should be sure that we understand the problem, retirement plans in general, and what stocks really do.

The Five Main Messages of This Book

This book was written to present five major messages.

1. Much of the country's economy and many of its retirement plans are built on a structure of phantom wealth that depends on stock prices.

2. Stock prices are based on projected future events or what people hope will happen, not on actual corporate accomplishments. Using stock prices to measure wealth is like counting chickens before they've hatched.

3. The drive to create phantom wealth by inflating stock prices helps some people, but it distorts the economy and hurts society as a whole.

4. Demographic trends and retirement plans are helping to build the phantom wealth structure. But unless the structure is replaced with one that is more sustainable, those same trends will eventually make it fail, and that in turn will drag down the retirement plans and the economy.

5. Individuals and organizations can help prevent retirement plans and the economy as a whole from collapsing—or protect themselves in case there is a collapse—by creating real wealth based on work, earnings, and solid accomplishments, instead of just hopes. But doing this requires a different mindset that includes new values, goals, and ways of thinking about living, aging, investing, and running companies.

These five messages apply to individuals and their retirement plans, to all the country's retirement plans in the aggregate, and to the whole economy.

What Is Phantom Wealth?

A *phantom* is something that appears to be but has no real or physical existence. Like an apparition, a shadow, a dream, or a vision, a phantom is not what it seems to be.

Throughout this book, we use the term *phantom wealth* to refer to the returns from corporate stocks that are based on market prices. Individuals, companies, investors, retirement plans, and the country as a whole are ignoring the transient or ephemeral nature of trillions of dollars of phantom wealth. The opposite of phantom wealth is *real wealth*, and it has very different characteristics. We will explore how phantom wealth is created, how unreal it is, and how quickly it can vanish.

Will Baby Boomers Have Enough Money to Retire?

Nearly everybody knows the conventional explanation of how capitalism works. It starts with people saving money, which they invest in companies, which use the money to build plants, buy tools, develop new products, and create jobs. The companies grow, their stock prices go up, the investors are happy, the economy prospers, and all is well.

Based on that explanation, millions of American workers—who can expect to live longer than any previous generation—are being told that their formula for years of comfortable retirement is simple: just be guided by the history of the stock market, buy stocks,

and retire on the gains. Companies, state and local governments, and many other employers are using the formula to reduce the costs of pensions that they have promised their employees.

But the explanation is insidious. It sounds right and it seems to explain why the economy is doing so well. The concept has endured for decades. It has few detractors and even the collapse of the Soviet Union increased its general acceptance. It is particularly appealing to those who are benefiting the most from today's stock-driven economy. And it contains enough truth to save it from being labeled fiction.

For many reasons, however, the explanation has gradually become more fiction than fact. One reason is that little of the money that most people use to buy stocks for retirement accounts ever gets to the companies. Instead, it goes to previous stockholders through trades that often help increase stock prices, thus increasing the base on which phantom wealth is built.

As we will see, there are few positive links between the stock market and large companies. There are negative links, however, that work backwards from the conventional explanation. Important parts of the economy are running *in spite of* the stock market rather than because of it.

Even the prevailing formulas that are used to manage retirement accounts have a fatal flaw. Based on these formulas, baby boomers are buying large quantities of stocks and inflating the prices. But nobody knows what prices they will receive when they have to sell their stocks for retirement income. We will explain why there are serious risks that the stock-based retirement formulas may turn out instead to be formulas for an economic depression.

Money Isn't Everything

We in this country are constantly being bombarded by magazines, television programs, Internet sites, investment advisory services, brokers, and even banks purporting to explain how easy it is to make money with stocks. The financial services industry has large advertising budgets to convince us that if we save and invest in stocks, we can plan to enjoy years of retirement. All we need to do is buy enough of them soon enough and build a kitty that is large enough.

If you sense that something is missing in all this advice, you are right. As this book goes to press, the appealing idea that one can get something for nothing and create wealth out of thin air is working. But for baby boomers' retirement plans, the idea is fundamentally flawed, because it rests almost entirely on phantom wealth and transfers of money from workers to retirees.

Some members of the baby boom generation will have enough money to retire in comfort when they choose to. But as we will discuss, millions of other boomers will have meager retirement incomes, and many of them who hope or expect to retire will find that they have to work well beyond their mid-sixties.

It is important to understand that a sustainable system for older people involves a lot more than just money. It must provide adequate supplies of the things that money is used to buy, including the broad array of goods and services that are needed by most people of limited means. The economy now serves affluent people of all ages better than those who are less well-to-do.

A sustainable system must provide opportunities for millions of people to work at jobs that are appropriate for their interests, capabilities, and limitations. As a growing fraction of the country's adults live longer, they will have to help make the pie from which they will receive their slice.

Finally, a sustainable system must encourage people to find satisfaction and fulfillment by living more simply and within their means, limiting the amount they consume. This will be both an economic and an environmental necessity. Indeed, the consequences of this country's aging population will reinforce points that environmentalists have been making for decades.

Related Views

Many books have already discussed some aspects of what we will discuss here. Three of the best present a triangle of concerns.

- In *The Post-Corporate World*, David C. Korten explains in extensive detail how large corporations are shaping the world to serve their own ends and the ends of their stockholders as opposed to communities, society, and the environment.[1]

- In *The Emperor's Nightingale: Restoring the Integrity of the Corporation in the Age of Shareholder Activism*, Robert A. G. Monks explains how large corporations are out of control from a social standpoint and suggests that large institutional stockholders such as pension funds should bring them into line to better serve society.[2]
- In *Gray Dawn*, Peter G. Peterson explains how the populations of most developed countries are aging even faster than America's, and he discusses the social, political, and economic dislocations that may be expected to occur throughout the developed world.[3]

These are strong books by responsible authors who have wide business experience and deep concerns for this country. They have different ideas about what should be done, but in combination they show the need to review where the country is today, where it is going, and why effective actions must be taken while there is still time to prevent disaster. The themes about corporations, investments, and aging populations that run throughout these books provide a good background for the five main messages of this book.

The Challenge

Those three books present the country with a challenge, but the challenge is even bigger. In *The Fourth Turning*, William Strauss and Neil Howe explain five hundred years of Anglo-American history as a series of cycles.[4] Each cycle includes four seasons or turnings. As the authors describe them:

- The *First Turning* is a *High*, an upbeat era of strengthening institutions and weakening individualism, when a new civic order is implanted and the old values regime decays.
- The *Second Turning* is an *Awakening*, a passionate era of spiritual upheaval, when the civic order comes under attack from a new values regime.

- The *Third Turning* is an *Unraveling*, a downcast era of strengthening individualism and weakening institutions, when the old civic order decays and a new values regime is implanted.

- The *Fourth Turning* is a *Crisis*, a decisive era of secular upheaval, when the values regime propels the replacement of the old civic order with a new one.

The authors say that the cycles tend to be repeated roughly every eighty to one hundred years because no one lives long enough to remember and avoid the mistakes that were made during the corresponding phase of the previous cycle.

Strauss and Howe assert that, at the beginning of the twenty-first century, the United States is about to enter the Fourth Turning, or the crisis phase, of the current cycle. This cycle began as World War II came to a close, just before baby boomers started to appear. The authors predict that the next crisis phase will be similar to the crisis phases of the two previous cycles: one that included the Civil War and the other that included the Great Depression and World War II.

They predict the next crisis will start early in the twenty-first century—just when demographic trends are going to roil most developed countries, according to Peterson. Strauss and Howe don't think the next crisis can be prevented because they don't believe people can learn from the earlier crises and act to prevent it.

They may be right. But do they have to be?

What If Boomers Can't Retire? was written in the belief that if enough Americans understand what is happening and where their actions are leading them, they will be able to make the changes necessary to prevent another crisis that could include the depression that Strauss and Howe predict.

This country is exceptionally lucky as it enters the twenty-first century for three reasons:

- Rarely is it possible for people to see an impending national disaster in time to prevent it from happening. This is one of those few times.

- As the five major messages of this book show, the present situation is easy to understand.

- America has a history of responding to challenges.

Will the United States rise to this challenge as it has risen to challenges so many times before?

Highlights

Each chapter in this book includes one or more *Highlights*, brief summaries of important points made in the chapter. The Highlights form a logical chain to support the book's five major messages. The following list of chapters and their Highlights provides a summary of the book.

Chapter 1: Social Security: The Tip of the Retirement Iceberg

1. Today, there are about 35 million people over age 65. By 2030, that number is expected to double.

2. The Social Security problem is that more people are living longer and expecting to receive retirement benefits during their additional years that will have to be paid by relatively fewer workers.

3. Stocks can't solve the Social Security problem because to help pay retirement benefits, they would have to be sold to the same workers who can't continue the program as it operates today.

4. The so-called solutions that would use stocks to solve the Social Security problem would have far worse consequences and would make the program even weaker.

Chapter 2: Can Stocks Help Baby Boomers Retire?

5. The stocks-for-retirement (SFR) cycle has a front, or build-up half, and a back, or selling half. Today everybody is concentrating on the front half and ignoring the back half.

6. Demographic projections and stock-buying patterns indicate that only about half of the workers who will be contributing to

Social Security will have enough income to buy retired boomers' stocks.

7. System-failure analysis shows that the stocks-for-retirement cycle probably can't work for most baby boomers because the most critical requirement of the cycle—adequate buying power—will be missing.

8. There are just two possible sources of returns from stocks—from within a company and from outside. The difference is critical.

Chapter 3: Views from Eight Other Books

9. Investment advice varies widely and is often contradictory.

10. Much investment advice for boomers is irrelevant or wrong.

Chapter 4: How Baby Boomers' Later Years Will Unfold

11. Many boomers are going to find themselves surprised when they learn they can't retire as they anticipate.

12. The effects of aging baby boomers may cascade throughout the economy.

13. The trend toward retirement self-sufficiency will force many boomers to decide how long they expect to live. That is the Impossible Decision.

14. Before the country increases its dependence on the stocks-for-retirement cycle, it should do and publicize a due-diligence, system-failure analysis that shows how the cycle can work.

Chapter 5: Stocks, Wealth, and Phantom Wealth

15. Productive investors provide money that companies use to create real returns and real wealth. Parasitic investors don't

know or care who gets their money, and the returns they seek come primarily from outside the company as phantom wealth.

Chapter 6: The Drive to Create Phantom Wealth

16. Phantom returns can make a few people appear very rich—at least for a while.

17. The drive to create phantom wealth hurts people, companies, communities, and society.

Chapter 7: Why Stock Prices Don't Create Real Wealth

18. Only shares of a public corporation's stock that trade set the price, but all shares are treated as being worth the price of the last trade.

19. Stock prices result from the balance between supply and demand, but the balance is not as freely determined as market theorists say it is.

20. Stock prices aren't a realistic basis for evaluating either companies or retirement portfolios.

Chapter 8: How Phantom Wealth Hurts the Economy

21. The drive to create phantom wealth has many hidden costs.

Chapter 9: How We Can Meet Our Real Needs

22. The phantom wealth structure is based on false expectations. The way to replace the structure is to remove the expectations.

Chapter 10: What Individuals Can Do

23. Millions of individuals can help change the course of history by looking ahead and acting in their own interests and the interests of the country.

Chapter 11: What Organizations Can Do

24. The most important steps that organizations can take are to evaluate the national stocks-for-retirement cycle and, if they find that it is unreliable, to evaluate retirement portfolios realistically.

25. There are vast opportunities for organizations that pioneer new types of sustainable investments, investment instruments, financial institutions, and business organizations.

Chapter 12: Conclusion: How to Change a Very Big System

26. The key is to change a few critical things that will cause many other changes to ripple out and eventually to cascade.

PART I

Baby Boomers and Their Retirement Plans

Life can be delightful on a volcanic tropical island—until the volcano erupts again. The situation of millions of Americans today appears to resemble life on that island.

They are following the formula that says they will be able to enjoy years of comfortable retirement if they work hard, save enough while they are working, and use their savings to buy stocks. After all, that's the American Way.

Unfortunately, they are ignoring the volcano. And it's rumbling.

Part I of this book looks at the volcano from the standpoint of individual baby boomers and their retirement plans. As we will see, when too many people follow the same formula—that is, rely on stocks to pay for their retirement—they create problems with the formula and, in a broader sense, they create problems with the concept of retirement itself.

The discussion in Part I is on two levels. The first, of course, is the financial or technical level. The second is the conceptual level—the prevailing mindset.

People are following the formula because they have been led to believe, and they want to believe, that it is sound. Moreover, few good alternatives to the formula have been developed or made available for people to see and use.

As we will see, however, the conceptual foundations of the formula are very weak.

Chapter 1

Social Security: The Tip of the Retirement Iceberg

The basic idea of Social Security is simple. Started during the Great Depression, it was devised to help all Americans prepare for their later years, particularly older people who had little chance of helping themselves.

The program takes in money from workers and their employers through payroll taxes and then pays most of it out to beneficiaries. It is called a *pay-as-you-go* or *pass-through* program because most of the money that comes in goes right back out again. It is also called an *intergenerational transfer* program because, in the main, the younger, working generation transfers money to the older, retired generation.

Social Security really includes two programs, Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI). OASI pays monthly benefits to retired workers, their families, and survivors of deceased workers. DI pays monthly benefits to disabled workers and their families. About 85 percent of all Social Security benefits are paid by the OASI program. In this book, we will treat the two programs as one (OASDI).

America's Aging Population and the Social Security Problem

HIGHLIGHT 1

Today, there are about 35 million people over age 65. By 2030, that number is expected to double.

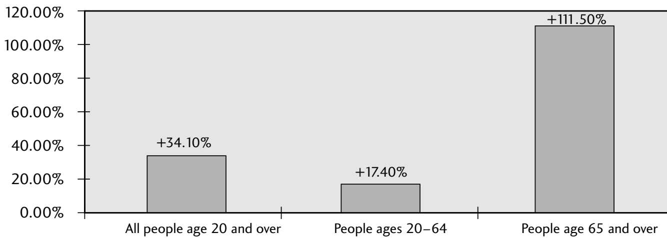
Americans today are living longer. As stated in the American Academy of Actuaries' *Public Policy Monograph No. 1*, 1998, "Financing the Retirement of Future Generations,"[1]

> When Social Security began paying benefits in 1940, only about half of 21-year-old men could expect to reach 65 to collect benefits, and those who did could expect to collect benefits for 12 years. By 1990, nearly 75 percent of them could expect to reach 65 and collect benefits for 15 years. These trends are expected to continue at least until the middle of the 21st century. At that time, an expected 83 percent of 21-year-old men will reach 65, and they can expect to live another 18 years.

Figure 1-1, which is based on Census Bureau projections, shows how the percentage of people age 65 and over is expected to increase in relation to those ages 20 to 64.[2] This trend will have important effects on the economy, society, and the country as a whole for decades.

Figure 1-1: America's Aging Adults, 2000–35

(In percent)



Source: U.S. Bureau of the Census, *Resident Population of the United States*, 1996

Table 1-1 shows the same picture in more detail. Bands of shading show five major population groups as they advance in age from the year 2000 to 2035. The group shown in the darkest band includes the baby boomers, who were born during the years 1946 through 1964.

The table is divided into three large sections for those ages 65 and older, which includes retirees; those ages 20 to 64, which

Table 1-1
America's Aging Population 2000–35
(In millions)

Five-year age groups	Population as of July 1							
	2000	2005	2010	2015	2020	2025	2030	2035
100 and over	0.1	0.1	0.1	0.2	0.2	0.3	0.3	0.4
95 – 99	0.4	0.4	0.5	0.6	0.8	0.9	0.9	1.1
90 – 94	1.2	1.4	1.6	1.9	2.0	2.0	2.3	3.0
85 – 89	2.7	3.0	3.4	3.5	3.5	3.9	4.9	6.5
80 – 84	4.9	5.5	5.6	5.4	5.9	7.4	9.6	11.1
75 – 79	7.4	7.4	7.1	7.7	9.4	12.1	14.0	15.8
70 – 74	8.7	8.3	8.9	10.9	13.9	15.8	17.8	17.9
65 – 69	9.4	10.0	12.1	15.4	17.5	19.6	19.6	17.7
60 – 64	10.7	12.8	16.2	18.4	20.5	20.5	18.5	17.4
55 – 59	13.3	16.8	19.1	21.2	21.2	19.0	17.9	18.3
50 – 54	17.2	19.5	21.7	21.6	19.4	18.2	18.5	20.2
45 – 49	19.8	22.0	21.9	19.6	18.4	18.7	20.4	21.5
40 – 44	22.5	22.4	20.0	18.7	19.1	20.7	21.9	22.6
35 – 39	22.2	19.8	18.6	18.9	20.5	21.7	22.4	21.9
30 – 34	19.5	18.2	18.6	20.2	21.4	22.1	21.6	21.7
25 – 29	17.7	18.1	19.7	20.8	21.6	21.0	21.2	22.1
20 – 24	18.3	20.0	21.1	21.9	21.3	21.5	22.4	23.6
15 – 19	19.8	21.0	21.8	21.2	21.3	22.3	23.5	24.4
10 – 14	20.1	20.8	20.2	20.4	21.3	22.5	23.4	23.9
5 – 9	19.9	19.3	19.5	20.4	21.5	22.4	22.9	23.5
Birth to 5	19.0	19.1	20.0	21.2	22.0	22.5	23.1	23.9
All ages*	274.6	286.0	297.7	310.1	322.7	335.1	346.9	358.5
20 – 64*	161.2	169.6	176.8	181.4	183.4	183.4	184.8	189.3
65 and over*	34.7	36.2	39.4	45.6	53.2	62.0	69.4	73.4
% over 20 who are over 65	17.7	17.6	18.2	20.1	22.5	25.3	27.3	27.9

shows those born before 1946.
shows those born 1946 through 1964 (the baby boom).
shows those born 1965 through 1979 (most of Generation X).
shows those born 1980 through 1999 (the last year of Generation X).
shows projected births for 2000 and later.

*Totals may not add because of rounding.

Source: U.S. Bureau of the Census, *Resident Population of the United States*, 1996.

includes most workers; and those under age 20, or the young. Obviously, some people's lives don't fall neatly into these groups. Many college students are in the working-age group, some people retire before they turn 65, and others work well beyond that age.

The dark band that contains the baby boomers shows how the number of people in the 65 and over age range will grow as the boomers age. The public discussion of the Social Security problem and how to fix it is a direct result of this demographic trend.

As members of the younger groups age, their numbers are projected to increase. This is due to anticipated immigration.

The summary under the body of the table shows that from the years 2000 to 2035:

- The total resident population of the country (all ages) is projected to grow from 274.6 million to 358.5 million, or by 83.9 million people (30.6 percent).
- The number of people ages 20 to 64 is projected to grow from 161.2 million to 189.3 million, or by 28.1 million people (17.4 percent).
- The older population of people ages 65 and over is projected to increase from 34.7 million to 73.4 million, or by 38.7 million people (111.5 percent).
- The combined effect of these increases in the population groups will be that the percentage of adults over age 20 who are 65 and over will rise from 17.7 percent to 27.9 percent. (See again Figure 1-1.)

Census Bureau projections are affected by changing immigration rates and mortality rates, and they will be revised by the 2000 census.

Nevertheless, the estimates of the number of people who will be 65 and over by 2035 are quite reliable because all of these people are alive today. The estimates for the people who will be born after 2000 (shown at the lower right of the figure) are more tentative.

HIGHLIGHT 2

The Social Security problem is that more people are living longer and expecting to receive retirement benefits during their additional years that will have to be paid by relatively fewer workers.

Now that we have a feel for how the population is expected to age, we can see how the aging population will affect Social Security. Today, retirees are receiving Social Security benefits from taxes that are being paid by the large number of working baby boomers, so the program seems OK. But this situation is not expected to continue.

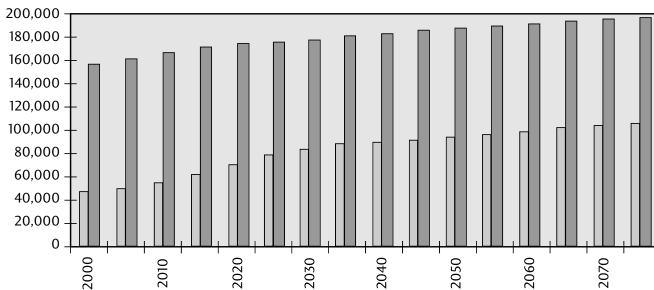
Every year, the Social Security Administration publishes three projections of how the program may operate for the next seventy-five years. Figure 1-2 is based on the year 2000 intermediate, or most likely, projection.[3] The double bars show how the number of Social Security beneficiaries (short bars) will increase at a faster rate than the number of contributing workers (tall bars). (To clarify, it should be noted that by *workers' contributions* we are referring to the payroll taxes that workers and their employers pay.)

Figure 1-3 depicts graphically how the number of contributing workers will decline in relation to the number of beneficiaries.

Table 1-2 provides the numbers on which Figures 1-2 and 1-3 are based. The right-hand column shows that, on average, the Social Security payments to each beneficiary in the year 2000 come from the contributions of 3.4 workers. But because the

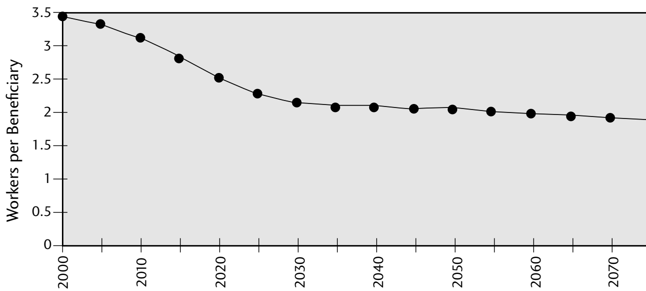
Figure 1-2: Projected OASDI Contributing Workers and Beneficiaries, 2000–75

(In thousands)



Source: Social Security Administration, *Annual Report of the Board of Trustees*, 2000.

Figure 1-3: Projected Contributing Workers per Beneficiary, 2000–75



Source: Social Security Administration, *Annual Report of the Board of Trustees,* 2000.

number of beneficiaries is expected to increase faster than the number of contributing workers, there are expected to be only 2.1 workers per beneficiary by 2030, when the last of the baby boomers reach age 65.

Some observers have likened the baby boom generation to a pig in a python. That was the image that came to mind when schools had to be opened for the boomers and then closed once they graduated. The python analogy is not valid for Social Security, however, because boomers will affect it differently. According to the projection shown in Table 1-2, as they pass through their mid-sixties, between the years 2010 and 2030, the number of workers per beneficiary will decrease rapidly.

But unlike the schools that had to be closed after they graduated, the workers-to-beneficiaries ratio will not return to what it was before the boomers passed through; that is, it is not expected to go back up. This is because most younger people who are following the boomers are also expected to live long lives. As far as anybody can see, longer life spans are here to stay. Thus, for Social Security, the boomers are more like a step up to a higher plateau of operations than a passing blip on a radar screen.

Baby boomers did not cause the Social Security problem. Rather, it was caused by people living longer than they did when the program was established in the 1930s *and* expecting to spend their additional years in retirement. Indeed, the problem could even have occurred if birth rates had remained stable and there had not been a baby boom.

Table 1-2
Projected OASDI Contributing Workers and Beneficiaries, 2000–75

Year	Contributing Workers	Beneficiaries	Contributing Workers per Beneficiary
2000	153,560	44,819	3.4
2005	159,274	48,141	3.3
2010	164,900	53,322	3.1
2015	169,123	60,536	2.8
2020	171,935	68,803	2.5
2025	173,948	76,617	2.3
2030	176,126	82,705	2.1
2040	181,619	88,341	2.1
2050	186,120	91,780	2.0
2075	195,274	105,143	1.9

Note: Contributing workers and beneficiaries in thousands.

Source: Social Security Administration, *Annual Report of the Board of Trustees*, 2000.

After Social Security established the idea of retiring at 65, it was used as a precedent for thousands of labor contracts and retirement plans. As people who were born during the 1930s and early 1940s started living longer because of improved health care and lifestyles, many of them retired or will retire in their mid-sixties. Boomers will defer the problem as long as they continue working, but they will make it arrive quickly if they too retire in their mid-sixties and expect to spend many years receiving benefits.

The Financial Aspect of the Social Security Problem

In financial terms, the problem will occur when baby boomers, who are pouring record amounts of money into the program through payroll taxes, stop contributing and start receiving benefits. Anyone who has an income from a salary or wages, has sav-

ings that earn interest, and pays living expenses can understand how the program works. In a year when there is more income than expenses, there is a surplus to add to the savings. If the expenses are greater than the income, there is a deficit and the savings go down. That's how Social Security's finances work. In this case, the accumulated savings are called *the trust fund*.

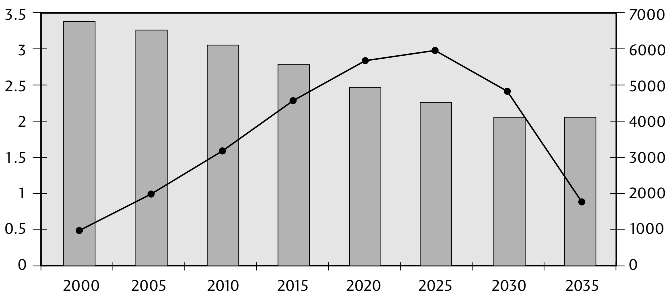
Figure 1-4 is based on the year 2000 Social Security report and provides a quick glimpse of what can happen from 2000 through 2035. The bars show the number of contributing workers per beneficiary. The curving line shows how the balance of the Social Security trust fund is expected to peak and then decline.[4]

Table 1-3 provides more detail on the financial ramifications. It shows annual projections for every fifth year. The annual surplus (deficit) column shows the Social Security problem.

The largest annual surplus is projected to occur between 2010 and 2015. By 2015, when boomers are expected to begin shifting from contributors to beneficiaries, the annual surplus will start to decline. Then, by about 2025, the outgo will start to exceed the total income, there will be an annual deficit, and the trust fund balance will start to decline.

The trust fund is projected to be fully depleted by 2037. The dates when events like the depletion are projected to occur change a little every time that Social Security updates its figures.

Figure 1-4: Contributing Workers per OASDI Beneficiary and Year-End Trust Fund Balance, 2000–35



Note: Bars show contributing workers per beneficiary; line graph shows current dollars in billions.

Source: Social Security Administration, *Annual Report of the Board of Trustees,* 2000

Table 1-3
Social Security Financial Projections, 2000–35
(In billions of current dollars)

Year	Income Excluding Interest	Interest Income	Total Income	Outgo	Annual Surplus or (Deficit)	Year-End Trust Fund Balance
2000	500.7	64.9	565.7	410.3	155.4	1,051.5
2005	635.1	120.1	755.3	538.6	216.7	2,022.0
2010	810.3	194.0	1,004.3	737.2	267.1	3,262.9
2015	1,034.5	280.5	1,315.0	1,045.2	269.8	4,640.4
2020	1,309.9	352.2	1,662.1	1,491.5	170.6	5,738.7
2025	1,649.8	376.0	2,025.9	2,065.7	(39.8)	6,007.7
2030	2,077.9	316.2	2,394.0	2,762.4	(368.4)	4,866.2
2035	2,620.4	136.3	2,756.6	3,571.7	(815.1)	1,726.6

Source: Social Security Administration, *Annual Report of the Board of Trustees*, 2000.

For example, the 1999 projection indicated the trust fund would be depleted in 2034. The 2000 projection pushed depletion back to 2037. This was heralded by some as showing that the problem had become less serious.

But the pattern is consistent. Under current law, the program is expected to take in more than it pays out until sometime in the twenties, then change and pay out more than it takes in. Regardless of *when* it happens, that change will be the most important event. The annual deficits are expected to continue through 2075, or as long as Social Security makes its projections. The projections show that the problem can't be expected to just go away.

When the program was created it was known that annual income and benefit payments could not be projected accurately, so a reserve for contingencies was set up to handle the difference. That reserve was called the trust fund. But the term has turned out to be misleading. It implies more durability than is really there. At its projected peak near 2025, the trust fund will have only enough money to pay benefits for about three years.

But despite the claims or fears of some, Social Security will not just go broke and quit. It could still limp along even if it is not changed and the trust fund balance runs out completely. Based on the year 2000 projection, in 2037 the total income would still be sufficient to cover about 72 percent of its annual payments.

As noted, nobody can predict the exact date when Social Security will shift from surplus to deficit. Each year, the program uses different assumptions for the Gross Domestic Product (GDP), inflation and interest rates, the unemployment rate, growth of the labor force, and other factors to make its projections. The data in Table 1-3 are from the intermediate, or most likely, projection made in 2000. The low cost projection made that year indicated that there wouldn't be a problem because the outgo would not exceed the income for the next seventy-five years. In contrast, the high cost projection showed that the trust funds would be fully depleted by 2025.

Social Security and the Federal Budget

The federal budget has two main parts or subbudgets—the operating budget and Social Security. Either can have an annual surplus or deficit.

Imagine for a minute that the Social Security trust fund was your own money. If you earned more than you spent, you could protect some of your savings by buying government bonds. This is what many pension plans do with some of their funds, and it is what Social Security is required by law to do with its annual surpluses.

If the operating budget has a deficit when Social Security buys bonds, the program's purchases help offset the operating deficit and so the combined budget deficit is reduced. This happened during the latter part of the twentieth century, when the operating budget had deep deficits and the trust fund was being built up, supposedly to have boomers pay for their own retirements. If the net of the two subbudgets is a surplus, then the federal budget has a surplus; this is what appeared to be the case in early 2000.

The important question is what will happen when boomers retire, the ratio of workers to beneficiaries declines, and the bonds in the trust fund must be cashed in. Table 1-3 shows that in the

single year 2030—when the youngest of the boomers will start to retire—Social Security will have to cash in bonds worth $368.4 billion to get money to pay its beneficiaries (in current dollars). Where will the Treasury get the money to pay for the bonds?

There are four possible sources for this money.

- Social Security payroll taxes on workers and their employers can be increased.
- Operating programs like defense and disaster relief can be reduced to transfer money from the operating budget to Social Security.
- General taxes (other than Social Security) and user fees can be increased.
- The Treasury can sell bonds to the public.

Now, consider how each of those sources will work.

- If Social Security payroll taxes are increased, the cost of retirement benefits will become a direct levy on workers.
- If operating programs are cut while general taxes and user fees are maintained, those who pay the taxes and fees will pay for the retirement benefits. Because most taxes and fees come directly or indirectly from those who are working, workers will pay for the benefits that are provided to retired older people.
- Similarly, if general taxes and fees are increased to pay the retirement benefits, they will largely be paid by workers.
- Finally, if the Treasury sells bonds, the primary domestic buyers will have to be people with disposable incomes, who are, of course, once again workers. (The reason why foreign buyers may not fill the gap will be explained in the next chapter.)

All four alternatives will have the same result. In each case, workers will have to pay more to provide benefits to retirees, and Social Security will remain a pay-as-you-go, pass-through, intergenerational transfer program.

Stocks and Social Security

There have been proposals to privatize Social Security by using some or all of the money that is flowing into it to buy corporate stocks. The reasons that are offered for doing this include the following:

- Stocks have historically produced higher returns than bonds.
- The country should encourage long-term investments in its wealth-creating private sector.
- Using retirement savings to buy stocks would be a step toward severing connections between Social Security and the government's operating budget. Some see this as a desirable step toward reducing the role of government.
- Some believe that government assistance to retirees should be replaced with retirement plans that would operate entirely in the private sector.

As this book goes to press, however, there has been no adequate, publicized explanation of how any of the proposals to buy stocks could work.

Stocks provide returns in only two ways—through dividends and price increases. We will briefly examine each way here and then consider them more extensively in the next two chapters.

Dividends

Today, most companies pay small if any dividends. In 1998, Social Security paid $382.3 billion to OASDI beneficiaries. Federal Reserve Board data show that companies paid a total of $279.2 billion in dividends that year.[5] Thus, even if Social Security had owned every share in the country that paid dividends, the sum of all the dividends would have been less than three-quarters of the benefits it actually paid.

Social Security obviously could never have acquired all those stocks. So it seems that dividends can't be much help in solving the problem.

Stock Price Increases

Advocates of privatization say that stocks could help Social Security through price increases. However, there is a glitch that few of them seem to recognize or mention. If the Social Security program buys stocks, the only way it can get the money it will need to make benefit payments would be to sell the stocks.

HIGHLIGHT 3 **Stocks can't solve the Social Security problem because to help pay retirement benefits, they would have to be sold to the same workers who can't continue the program as it operates today.**

In other words, the Social Security program's selling of stocks would raise the same basic question as its cashing in bonds to the Treasury: Who will have enough money to buy them? A possibility might be wealthy people, but most of them will already own securities and have little uninvested cash lying around. Therefore, the primary source of domestic buying power must be workers with adequate incomes. But when stocks are sold to workers to pay retirement benefits, the amounts of money that workers pay to buy them are pass-through intergenerational transfer payments.

HIGHLIGHT 4 **The so-called solutions that would use stocks to solve the Social Security problem would have far worse consequences and would make the program even weaker.**

The history of trying to put Social Security on a sound foundation is revealing. As John B. Shoven wrote in his paper "The Retirement Security of the Baby Boom Generation," published in the *TIAA CREF Research Dialogues*:[6]

> In 1983, Congress adopted Social Security amendments suggested by the Greenspan Commission. At the time, it was thought the changes would keep Social Security solvent until 2063, when the youngest of the baby boom survivors would be almost 100 years old.

> The idea behind some of the amendments was that the baby boom generation would prefund a portion of their own retirements. The Social Security system departed from being almost completely pay-as-you-go and adopted a plan that collected more taxes than were needed to pay contemporaneous benefits, at least during the work lives of most of the baby boomers.
>
> The initial forecasts in 1983 were that the system would accumulate a massive $20.5 trillion trust fund by roughly 2040, which would then be decumulated, finally being exhausted in 2063. Even though the system would ultimately require increased taxes or reduced benefits, 2063 was sufficiently distant that it could be legitimately claimed that the Social Security system was set for the long run.

Unfortunately, as the preceding figures and tables show, the changes made in 1983 didn't work as well as expected.

Like the 1983 revisions that failed to put Social Security on a sound financial footing, using its funds to buy stocks will not change its basic nature as a pay-as-you-go, pass-through, intergenerational transfer program. However, buying stocks will subject the funds to the vagaries of the stock market and remove the guarantee that money will be available when it is needed.

When baby boomers retire, the actions of all their retirement plans are more likely to cause stock losses than gains, as the next two chapters will explain.

What You Can Do to Raise Awareness of the Problem

Before your senators and congressional representatives allow Social Security funds to be used to buy stocks, the best thing you can do is to ask them to explain to you how stocks could solve the Social Security problem. There are five main questions to ask them.

1. Is there any way that stocks could help Social Security pay retirement benefits without the stocks being sold?

2. If the program buys stocks that must be sold, who could the primary buyers be, other than those who are still working?

3. If the primary buyers must be workers, why will Social Security not continue to be a pay-as-you-go, pass-through, intergenerational transfer program that continues to put the burden of retirement benefits on workers?

4. If the burden of paying retirement benefits would still fall on workers, what would buying stocks accomplish?

5. If workers must buy most of the retired baby boomers' stocks, to whom would the workers sell them when they retire? Why would that not be a pyramid scheme that would eventually fail?

If you ask these questions, you may be told about how in the past stocks have done so much better than other types of investments, including government bonds.

Don't accept that answer. Never before has the U.S. government attempted to make money in the stock market. As the next two chapters explain, nothing in the history of the market has ever come close to the planned waves of selling that virtually all boomers' pension plans and retirement accounts are designed to do. And as Part II of this volume explains, never before has so much of what this country considers to be wealth been dependent on stock prices.

There is no historical precedent for this situation. The only relevant answers to these questions will have to explain who will buy the stocks and where those individuals will get the money to buy them at the time when Social Security needs money to pay beneficiaries. Nothing else matters. If the primary buyers must be workers, then the Social Security problem will be worsened, because the program will have to sell its stocks at the same time that other retirement plans are selling them.

Appendix B provides a sample of a letter that asks the five questions shown here; readers may wish to send such a letter to their

senators or representatives. (Permission is granted to quote, copy, or reproduce the letter if its source, *What If Boomers Can't Retire?* by Thornton Parker, Berrett-Koehler Publishers, is identified.)

Summary

Social Security takes in money from working contributors and pays it out to retired beneficiaries. According to current projections, the number of retirees will increase in relation to the number of workers because Americans are living longer. Something will have to give:

- People who live longer will have to work longer, or
- Workers will have to pay more to provide the current level of benefits to a larger number of retirees, or
- The current level of retirement benefits will have to be reduced, or
- Additional money will have to come from sources other than workers.

Past attempts to make baby boomers pay for their own retirements will not work because their additional payments will have been used to buy securities that will have to be sold when they retire.

It doesn't matter whether the program buys government bonds, other types of securities, baseball cards, or beanie babies. The point is that its assets will have to be sold. The incomes of workers will make up the largest pool of money that can be used to buy the assets.

Social Security is just the tip of the retirement iceberg that millions of baby boomers are sailing toward. Few people understand that nearly all defined benefit pension plans, 401(k) plans, and individual retirement accounts have exactly the same flaw as Social Security does: they depend on buying stocks for gains. But the stocks will have to be sold to convert the gains to retirement incomes, and the largest potential pool of buying power for the stocks must be workers who have discretionary income.

In Chapters 2 and 3, we will get a good look at the iceberg.

The Ballad of Social Security

I wrote the following ditty to relieve an otherwise dreary discussion.

This is to tell
Of what befell
The program called Social Security,
Whose finances were found
To be too unsound
To care for us in maturity.

'Cause poor slobs
Still working at jobs
Couldn't help boomers quit and play,
Without a bigger
Social Security figure
Being deducted from their pay.

There were conservative cries
To privatize
All government programs in sight.
They wanted to let
The free mar-ket
Make all the world just right.

So Clinton began
What seemed like a plan
Discussed in the Union's State,
To dispel the gloom
Of the baby boom
With a scheme that sounded great.

The plan would buy
Stocks already priced high
Hoping prices would go even higher.
He made it seem
It would work like a dream
So the nation went on a flyer.

Brokers said, "Don't squirm
About the long term
When money's to be made right now,
And each higher price
Will do something nice
To the 500 and Dow."

So prices did rise
Near up to the skies
As billions more dollars poured in,
To Microsoft, Intel,
And the Dot-coms as well,
Helping fund managers win.

But nobody told
That the plan so bold
Had a fatal flaw.
There would be no gains
Left in the remains
When boomers needed cash to withdraw.

For stocks to pay
Income some day
They surely had to be sold.
But who would buy
Stocks priced so high?
Was something that never was told.

All went great
Till that fateful date
When selling hit the floor,
And struck with awe
Boomers tried to withdraw
Their savings and head for the door.

The prices of stocks
  Fell like boxes of rocks
  As boomers told their brokers to sell.
The ensuing crash
  Gobbled their cash
  In the Great Bear Market from Hell.

'Twas an awful sight
  That October night
  After the history-making crash,
When the fatal flaw
  That nobody saw
  Turned millions of plans into hash.

'Cause the poor slobs
  Still working in jobs
  Were called on to save the day.
But then we learned
  After having been burned
  They just didn't earn enough pay.

Then Generation X
  Put a hex
  On hopes they would follow like sheep,
When they decided to try
  Their own plan and buy
  Boomers' stocks when they were cheap.

Brokers shook in their boots
  As tobacco-like suits
  Were based on misrepresentation.
And lawyers were earning
  Bundles by burning
  The financial heads of the nation.

How better it would've
  Been had we understood
  The eternal lesson most plain,
To follow our hunch
  That there's no free lunch
  Or retiring on just stocks' gain.

This ends the tale
  Of the death of a whale
  Of a great American tradition,
And also of how
  The stock cash cow
  Was just a superstition.

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What If Boomers Can't Retire?:
How to Build Real Security, Not Phantom Wealth

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