



“Twas brillig, and the slithy toves  
Did gyre and gimble in the wabe:  
All mimsy were the borogoves,  
And the mome raths outgrabe.

From *Jabberwocky* in *Through the Looking Glass* by Lewis Carroll

I know this quote from Lewis Carroll sounds like Senator Blusterduck debating the Social Security program. Facts never seem to get in the way when a Senator speaks. I did my own homework, unfortunately after I was asked by a reporter at the *Arizona Republic* what I thought about the current discussion. My response, without prior research, was that both sides on the issue were exaggerating. I stated the proposed private accounts would help but not enough and staying the course with the current program would not be the disaster currently outlined. Now that I have had a chance to dig into the numbers, my position has changed dramatically. President Bush's plan doesn't go far enough.

Social Security is such a mess that nothing can save it. The current program that takes money from the working, giving it to the non-working, should be abandoned sooner rather than later in favor of mandatory private investment accounts. Government doesn't believe the bumper sticker, "If you find yourself in a hole, stop digging." Government never stops digging. It just brings in more shovels. And while you are digging, spray some more air freshener on the corpse. Raise taxes, reduce benefits, and raise the retirement age. Anything but admit an error. Demographic studies show that in the near future only two workers' taxes will support one retiree. Why this fact is lost on politicians is beyond comprehension.

Every year Social Security sends participants a statement showing what has been deposited and what the depositor can expect in the way of benefits. My last statement was from 2002 so I used my W-2 forms to update the Social Security records. Adding my last two years' "contributions," to my statement shows I have "contributed" \$93,091 since I started working in 1960 and my employer has "contributed" \$85,970 for a total of \$179,061 over the last forty-five working years. I didn't "contribute" anything. I paid an unavoidable tax. Unfortunately, this money has been spent and my statement is nothing more than bookkeeping to make me feel that someone is keeping track. While I wait for retirement age, not one dime of this money earns interest. Not one dime. And I'm supposed to be grateful.

Most of the concern about changing the current system toward private accounts is for the transitional costs, by some estimates as much as two trillion dollars. No one was concerned about transitional costs when Senator Gore, during his failed 2000 Presidential bid, wanted to create a "lock box" for Social Security to eliminate the financial hokey pokey. (♪ You put your money in. They take your money out. You put your money in and they shake it all about ♪). Gore's proposal was an admission that Social Security money is not saved for the future. It never has been.

The best way to illustrate how the system works today is to imagine your own personal "lock box" in the back of your closet. You dutifully put \$50 of every paycheck into the box for your retirement. A week later you remove the \$50 and put a Post-It Note in the box with the scribble "IOU \$50" and then you spend the cash. Using government accounting, you have created an asset, an account receivable, worth \$50. Every thinking person knows there is no asset in this box, but government has the temerity to call their box full of Post-It Notes the Social Security Trust Fund. Government takes your money out of their box, puts in Treasury notes paying a very low rate of interest, and spends the cash. A Treasury note is an IOU. At some point the Treasury must redeem those IOUs with real money. The only place government can get money is through taxation. Taxes must go up to redeem all those Post-It Notes.

To learn how private accounts would have performed during my working years, I simulated my own private investment account using all the money put into my Social Security "account" since 1960. The methodology is quite simple. Using the Social Security statement as a base and the tax rate schedule from Social Security's web site, I was able to calculate how many dollars my employer and I paid into the System each year since 1960. All of my fictional payments were invested in the well-known Standard & Poor's 500 stock average at the beginning of the following year. No buying low and no market timing. Just do it in January the following year. This is not a speculative investment posture. In 1971, for example, the \$912 in taxes bought 8.8 units of S&P index fund at 103.3. In 1986 the \$6,308 in taxes bought 23.8 units at 264.5, and so on. At the end of 2004, I owned 657.7 units

of S&P 500. Each unit was worth 1171.5 on March 25, 2005 for an accumulated value of \$770,496. Compare that to my Social Security statement showing \$179,061. And that \$770,496 does not include dividends. With dividends, compounding produces another \$30,000 in value bringing the total to \$800,000.

Another sore point. Since 1966, the records show I paid more than \$62,000 into Medicare. Now they tell me Medicare is broke. For me, and everyone else, taxes for social programs aren't going down any time soon.

The Social Security Administration tells me that I will collect \$1,895 a month when I reach 65 years and 10 months. That is \$22,740 per year. In a world where two workers support me, each will pay me almost \$12,000 a year before they start saving for their own retirement! In ten years after my retirement, those two workers will have paid me more than \$200,000 out of their own pockets. This fact will lead to generational warfare sooner rather than later.

Readers with long memories will recall that, in 1981, President Reagan created a bipartisan commission to study Social Security and to recommend reforms (raise taxes). Alan Greenspan, then an economist, was chairman. This august group decided to raise the retirement age, reduce benefits, raise the tax rate and tax Social Security up to 50 percent for "high income" beneficiaries in 1983. (At the time, "high income" was anyone making more than \$25,000 a year. It hasn't changed in twenty years.) This tax program was supposed to put the Social Security System on a sound path for seventy-five years. Twenty years later we are hearing the same moaning about solvency and Alan Greenspan making the same noises about prudence and fiscal responsibility. "Let's empower another Commission!"

I am doing something to assure a secure retirement for myself. I stopped contributing to my IRA three years ago even though there are tax savings if I do contribute. The logic is simple. These retirement plans are government-controlled contraptions. Government tells you how much you can put in and when. It tells you how much you can take out and when. At a certain age you must take money out of the plans whether you need it or not, but none of the money belongs to you until it is taxed. I can't tell you how many people I have seen during financial planning meetings who have no liquid assets outside of very large IRAs or 401(k) plans. Until my epiphany I was in the same boat as my clients - no after tax savings. I'm trying to change that before it is too late by building my after tax portfolio, currently taxed at favorable 15% rates.

The second thing I am doing, long before I have to, is taking money out of my IRA when the markets are up. Yes, the withdrawals are taxed at rates up to 30% including Arizona's income tax but I'm paying my income taxes now at low rates instead of waiting for Congress to enact higher taxes on retirement savings withdrawals. The way things in Washington are going, I can see a time when plan withdrawals will carry a surtax. IRA and 401(k) plans are the largest pool of untaxed assets ever. It is just too attractive for politicians to leave alone. You can hear the spiel now. "Those of you who have been fortunate enough to save part of your income have an obligation to those who did not have your advantages. This modest surtax will enable you to do your part to bring help to those in need, to bring equity to the Social Security System."

The opening quote from Lewis Carroll is gibberish, certainly, but no more gibberish than what you hear on the daily news from our elected representatives. Congressional decisions on the Social Security and Medicare taxes will have a significant impact on the stock and bond markets and on inflation. Your income taxes may not go up but other taxes will to keep the social programs afloat. The economic impact will be the same as an income tax hike. Slower growth.

I recommend that you review your own circumstances to make sure your portfolio includes a large portion of private after tax investments, assets outside the control of Congress. The more money you can keep out of the hands of politicians, the more likely you are to have a decent retirement income. What I am doing personally may not fit your situation but I hope my thoughts have inspired you to do some financial planning of your own. Unlike the Easter Bunny, you don't have to keep all your eggs in one basket, particularly when that basket is held by politicians.

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