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Social Security: Trust Fund Investment Practices

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Summary

The Social Security Act has always required surplus Social Security revenues (revenues in excess of program expenditures) to be invested in U.S. government securities (or U.S. government-backed securities). In recent years, attention has been focused on alternative investment practices in an effort to increase the interest earnings of the trust funds, among other goals. This report describes Social Security trust fund investment practices under current law.

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Background

Social Security is financed primarily by payroll and self-employment taxes, as well as by a portion of the proceeds from the income taxation of Social Security benefits. The revenues are deposited in the U.S. Treasury. Social Security benefits and administrative expenses are also paid from the U.S. Treasury. By law, if Social Security revenues exceed expenditures, the “surplus” is credited to the Social Security trust funds in the form of U.S. government securities. The money itself, however, is used to pay for whatever other expenses the government may have at the time. There is no separate pool of money set aside for Social Security purposes. That is not to say that the trust funds are ephemeral—as long as the trust funds show a positive balance, they represent the authority and an obligation for the U.S. Treasury to issue benefit payments during periods when the program’s expenditures exceed revenues. At the end of calendar year 2013, the trust funds were credited with holdings of \$2.8 trillion.¹ Section 201 of the Social Security Act provides the following guidelines for trust fund investment.

1. Funds not immediately in demand for benefits or administrative expenses are to be invested in interest-bearing obligations guaranteed as to both principal and interest by the United States.
2. Obligations are to be purchased at issue at the issue price or at the market price for outstanding obligations.
3. The Managing Trustee of the Social Security trust funds (the Secretary of the Treasury) is required to invest in special “nonmarketable” federal public-debt obligations—special issues to the trust funds that are not available to the general public—except where he or she determines that the purchase of marketable federal securities is “in the public interest.”
4. Special issues shall have maturities fixed with due regard for the needs of the trust funds and will pay a rate of interest, calculated at the time of issue, equal to the average market yield on all marketable interest-bearing obligations of the United States that are not due or callable (redeemable) for at least four years.
5. Marketable federal securities purchased by the trust funds may be sold at the market price and special issue obligations may be redeemed at par plus accrued interest (without penalty for redemption before maturity).²

The Treasury Department has determined that the purchase of marketable federal securities (i.e., public issues) would be in the public interest only when it might serve to stabilize the market for Treasury issues. Because an “unstable market” would be characterized by falling bond prices, purchases of marketable federal securities at these times would appear to be advantageous for the

¹ The Social Security program has two separate trust funds—the Old-Age and Survivors Insurance (OASI) trust fund and the Disability Insurance (DI) trust fund. The amounts cited in this report are for the OASI and DI trust funds on a combined basis (referred to as the Social Security trust funds). Historical trust fund data are available on the Social Security Administration (SSA) website at <http://www.ssa.gov/OACT/STATS/table4a3.html>.

² For more information, see Social Security Administration, Office of the Chief Actuary, Actuarial Note Number 142, *Social Security Trust Fund Investment Policies and Practices*, by Jeffrey L. Kunkel, January 1999, at <http://www.ssa.gov/OACT/NOTES/n1990s.html>.

trust funds. In practice, however, open market purchases have been rare. Although the trust funds have held public issues in the past, the trust funds currently hold special issues only.³

The interest earned on these holdings is credited to the trust funds semiannually (on June 30 and December 31); it is done by issuing additional federal securities to the trust funds. In calendar year 2013, net interest totaled \$102.8 billion, representing 12% of total trust fund income.⁴ The effective annual rate of interest earned on all obligations held by the trust funds in calendar year 2013 was 3.8%.⁵ The interest rate earned on special issues purchased by the trust funds in August 2014 is 2.375%.⁶

The maturity dates of newly issued special issues are set by a standardized procedure. Revenues are invested immediately in short-term issues called certificates of indebtedness, which mature on the next June 30. On June 30 of each year, certificates of indebtedness that have not been redeemed are reinvested in longer-term special issue bonds. Generally, the maturities of these bonds range from 1 to 15 years; the goal is to have about one-fifteenth of them mature each year, depending on the needs of the trust funds.⁷

Issues

While some critics have questioned whether the current investment policy has constrained the earnings of the trust funds, over the years various advisory councils, congressional committees, and other groups generally have endorsed it. It has been justified as a way to ensure safety of principal and stability of interest, and as a way to avoid intrusion into private markets. It also has been regarded as a way to avoid the political influences that would be inherent in investing outside the U.S. government. Generally, the goal espoused has been to place the trust funds in the same position as any long-term investor seeking a safe rate of return by investing in U.S. securities, and neither advantage nor disadvantage the trust funds relative to these investors or other parts of the government.

For most of the program's history, interest income to the trust funds has not been a major factor in program financing. In recent years, however, the increasing role of interest income, as well as interest by some policy makers in preventing any surplus Social Security tax revenues from being used for other government spending purposes, have focused attention on alternative investment

³ The DI trust fund held a small amount of public issues until February 2005. At the end of calendar year 2004, public issues represented about 0.002% of total investments held by the trust funds. Data on investments held by the trust funds are available on the SSA website at <http://www.ssa.gov/OACT/ProgData/investheld.html>.

⁴ Data on trust fund receipts, including net interest, are available on the SSA website at <http://www.ssa.gov/OACT/STATS/table4a3.html#income>.

⁵ Data on effective interest rates earned on assets held by the trust funds are available on the SSA website at <http://www.ssa.gov/OACT/ProgData/effectiveRates.html>.

⁶ Data on nominal interest rates earned on special issues purchased by the trust funds are available on the SSA website at <http://www.ssa.gov/OACT/ProgData/newIssueRates.html>.

⁷ The Social Security Board of Trustees (the Trustees) project that the DI trust fund assets will be depleted within 15 years (specifically, under the intermediate assumptions, the Trustees project that such assets will be depleted in 2016). Therefore, DI trust fund bond purchases have a shorter maturity period. (*The 2014 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, July 28, 2014, page 33, <http://www.socialsecurity.gov/OACT/TR/2014/tr2014.pdf>. Hereinafter cited as 2014 Trustees Report.)

practices.⁸ For example, there have been proposals to replace the special issues held by the trust funds with marketable federal securities, as well as proposals to allow any surplus Social Security tax revenues or a portion of trust fund reserves to be invested in assets other than U.S. government obligations, including equities.⁹

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⁸ The Social Security trust funds ran annual cash flow surpluses from 1984 to 2009. Beginning in 2010, however, annual cash flow deficits emerged. The Trustees project that the Social Security trust funds will continue to run annual cash flow deficits in 2014 and each year thereafter through the end of the 75-year projection period (under the intermediate assumptions). For more information on the financial outlook for the Social Security trust funds, see the 2014 Trustees Report at <http://www.socialsecurity.gov/OACT/TR/2014/index.html>. In addition, see CRS Report RL33028, *Social Security: The Trust Fund*, by (name redacted) and (name redacted).

⁹ See, for example, H.R. 5306 in the 113th Congress.

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