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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 (i.e., revenues in excess of the program's expenditures) to be invested in U.S. government securities (or U.S. government-backed securities). Over the past decade or so, 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 explains current trust fund investment practices. It will be updated periodically.

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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 also are 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 checks during periods when the program's expenditures exceed revenues. At the end of calendar year 2008, the trust funds were credited with holdings of $2.4 trillion.[1] By the end of calendar year 2015, trust fund assets are projected to reach $3.0 trillion (in constant 2009 dollars).[2] 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.[3]

(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).

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[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 combined. Historical trust fund data are available on the Social Security Administration (SSA) website at http://www.ssa.gov/OACT/STATS/table4a3.html.

[2] Projected trust fund assets are shown in The 2009 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, May 12, 2009, table VI.F7 (intermediate assumptions), available on the SSA website at http://www.ssa.gov/OACT/TR/2009/lr6f7.html.

[3] Although not specifically authorized by the Social Security Act, the Attorney General has ruled that certain federally sponsored agency obligations may be purchased by the trust funds. Such securities include those issued by the Federal National Mortgage Association (Fannie Mae), the Government National Mortgage Association (Ginnie Mae), and other federal credit entities. Currently, the trust funds do not hold such securities.

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 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.[4]

The interest earned on these holdings is credited to the trust funds semiannually (on June 30 and December 31), and it is done by issuing additional federal securities to the trust funds. In calendar year 2008, net interest totaled $116.3 billion.[5] The effective annual rate of interest earned on all obligations held by the trust funds in calendar year 2008 was 5.1%.[6] The interest rate earned on special issues purchased by the trust funds in December 2008 was 2.75%.[7]

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 June 30 of each year. On June 30, certificates of indebtedness that have not been redeemed are reinvested in longer-term special issue bonds. The maturities of these bonds range from 1 to 15 years—the goal is to have about one-fifteenth of them mature each year. This means that the average maturity of these long-term bonds is about 7½ years.

Issues

Although 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 "ensuring the most safety of principal and stability of interest," and as a way of avoiding 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 has not been a major factor in the financing of Social Security. However, over the past decade or so, growing trust fund surpluses and the increasing role of interest income in program financing (as well as interest by some policymakers in preventing the annual Social Security surpluses from being used for other government spending purposes) have focused attention on alternative investment practices.[8] In recent years,

[4] The DI trust fund held a small amount of public issues until February 15, 2005. At the end of calendar year 2004, public issues represented 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.

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

[6] 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.

[7] 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.

[8] For more information on the current financial outlook for Social Security, see CRS Report RL33544, *Social Security Reform: Current Issues and Legislation*, by Dawn Nuschler.

for example, legislation has been introduced that would replace the special issues held by the trust funds with marketable federal securities or allow surplus Social Security revenues to be invested in assets other than U.S. government obligations.

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