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CRS Report for Congress

Social Security: Trust Fund Investment Practices

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Summary

The Social Security Act has always required that surplus Social Security income (i.e., income in excess of the program's outgo) be invested in U.S. government securities (or U.S. government-backed securities). Over the past decade or so, increasing attention has been focused on whether to change this practice in order to increase the program's revenue. This report explains current trust fund investment practices and briefly describes the issues involved in changing how the trust funds are invested. This report will be updated periodically.

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's income exceeds its outgo, 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 authority and an obligation for the U.S. Treasury to issue benefit checks in those periods when the program's outgo exceeds its income. At the end of calendar year 2007, the trust funds were credited with holdings of $2.2 trillion.[1] By the end of calendar year 2012, trust fund

[1] Social Security has two programs — Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI) — with separate trust funds. The amounts cited 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].

assets are projected to reach $3.0 trillion (in constant 2008 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).

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

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[2] Projected trust fund assets are shown in *The 2008 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, March 25, 2008, table VI.F7 (intermediate assumptions), available on the SSA website at [http://www.ssa.gov/OACT/TR/TR08/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.

[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].

trust funds. In calendar year 2007, net interest totaled $110.2 billion.[5] The effective annual rate of interest earned on all obligations in the trust funds in calendar year 2007 was 5.3%.[6] The interest rate earned on special issues purchased by the trust funds in December 2007 was 4.0%.[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 into 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.

Although interest income was not a major factor in the financing of the Social Security program for most of its history, over the past decade or so, growing trust fund surpluses and the increasing role of interest credited to the trust funds — 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 the question of alternative investment policies.[8] In the past several Congresses, for example, bills have been introduced that call for replacing the special issues held by the trust funds with marketable federal securities (such as H.R. 219 in the 110th Congress). There also have been calls for investing a portion of the trust funds in investment vehicles other than obligations of the U.S. government (such as H.R. 581 in the 110th Congress).

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[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.