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IN FOCUS

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# Social Security Trust Fund Investment Practices

## Background

Social Security is a self-financing program that provides monthly cash benefits to retired or disabled workers, and to the eligible family members of retired, disabled, or deceased workers. There are 63 million beneficiaries.

Workers gain benefit eligibility for themselves and their family members by working in jobs covered by Social Security, among other requirements. An estimated 176 million workers (93%) are covered by Social Security. Covered workers and their employers must pay Social Security payroll taxes, which are the program's primary source of income. The program also receives income from the federal income taxes that some beneficiaries pay on a portion of their benefits. Together, these dedicated tax revenues represent 91.7% of Social Security's total income.

Social Security operates with a trust fund financing mechanism. The Social Security trust funds are accounts within the U.S. Treasury that (1) track income and expenditures for the program and (2) hold the accumulated assets for the program. As such, they represent funds dedicated to pay current and future Social Security benefits. (There are two separate trust funds: the Old-Age and Survivors Insurance [OASI] Trust Fund and the Disability Insurance [DI] Trust Fund. They are referred to here on a combined basis as the Social Security trust funds.)

As required by law, Social Security tax revenues are invested in interest-bearing U.S. government obligations. Currently, the trust funds hold more than $2.9 trillion in U.S. Treasury securities. In 2018, the trust fund holdings earned $83 billion in interest, representing 8.3% of Social Security's total income.

In the past, attention has focused on alternative investment practices in an effort to increase the interest earnings of the trust funds, among other goals. This In Focus explains current Social Security trust fund investment practices.

## The Trust Funds

Section 201 of the Social Security Act (42 U.S.C. 401) requires the managing trustee of the Social Security trust funds (the Secretary of the Treasury) to invest Social Security tax revenues in special "nonmarketable" federal public-debt obligations called *special issues* (i.e., securities available only to the trust funds, not to the general public). The Secretary may invest in marketable federal securities, which are available to the general public, if that is determined to be "in the public interest."

The Social Security tax revenues that are exchanged for the U.S. government obligations go into the general fund of the U.S. Treasury, and they are indistinguishable from all other revenues in the general fund. Social Security benefits and administrative expenses are also paid from the general fund of the U.S. Treasury. When Social Security payments are made from the general fund, an equal amount of U.S. government obligations are redeemed from the Social Security trust funds.

### Key Points

- Social Security is a self-financing program, with 91.7% of its total 2018 income from dedicated tax revenues.
- Social Security tax revenues are invested in interest-bearing U.S. government obligations held by the Social Security trust funds, as required by law.
- Trust fund holdings—more than $2.9 trillion in U.S. Treasury securities in 2018—represent funds dedicated to pay current and future Social Security benefits.
- The effective interest rate earned on all obligations held by the trust funds in 2018 was 2.9%; the average interest rate on new special issues was 2.9%.
- The trust funds earned $83 billion in interest in 2018, representing 8.3% of Social Security's total income.

The holdings of the Social Security trust funds represent the amount of money that the U.S. Treasury's general fund owes to the Social Security trust funds. There is no separate pool of cash set aside for Social Security purposes. However, that is not to say that the holdings of the Social Security trust funds are not "real" assets. The U.S. government obligations purchased by the trust funds are backed by the full faith and credit of the United States and guaranteed with respect to both principal and interest by the United States, as specified in Section 201(d) of the Social Security Act (42 U.S.C. 401[d]).

Stated another way, the holdings of the Social Security trust funds (the asset reserves) represent the accumulated total of surplus Social Security tax revenues collected for the program over the years, plus the interest earned on securities held by the trust funds. Over its 84-year history, the program has collected $21.9 trillion and paid out $19.0 trillion, leaving trust fund reserves of more than $2.9 trillion available for future program spending. As long as the trust funds have a sufficient balance, they represent the authority and an obligation for the U.S. Treasury to issue benefit payments scheduled under current law.

Since 2010, Social Security has relied on trust fund reserves to supplement current tax revenues to pay benefits scheduled under current law. Those reserves are projected to be depleted in 2035. (2019 Annual Report of the Social Security Board of Trustees, intermediate assumptions.) Following depletion of trust fund reserves, the program would operate with current tax revenues; however, they are projected to cover only about three-fourths of scheduled benefit payments. It is unclear how the U.S. Treasury would handle the payment of benefits under such a scenario.

## Investment Guidelines

Section 201 of the Social Security Act (42 U.S.C. 401) provides the following guidelines for trust fund investment:

- 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.
- Obligations are to be purchased at the issue price or at the market price for outstanding obligations.
- 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 when the Secretary determines that the purchase of marketable federal securities is "in the public interest."
- 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.
- Marketable federal securities purchased by the trust funds may be sold at the market price. Special issue obligations may be redeemed at par plus accrued interest (without penalty for redemption before maturity). (Investment in special issues gives the trust funds the same flexibility as holding cash.)

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, they currently hold special issues only.

Interest earned on the trust fund holdings is credited semiannually (June 30 and December 31) by issuing additional securities to the trust funds. In calendar year (CY) 2018, interest earnings totaled $83 billion (8.3% of total income for the Social Security trust funds). The effective interest rate earned on all obligations held by the trust funds in CY2018 was 2.9%. (The effective rate reflects the entire portfolio of securities held by the trust funds.) The average interest rate earned on new special issues in CY2018 was 2.9%. (Social Security Administration, Office of the Chief Actuary, *Average and Effective Interest Rates*, at https://www.ssa.gov/OACT/ProgData/annualinterestrates.html.)

The maturity dates of new special-issue securities 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. In general, the maturities of the 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.

## Issues

Although some policymakers have questioned whether the current investment practices have constrained the trust funds' earnings, various advisory councils, congressional committees, and other groups have generally endorsed the practices over the years. These practices have been justified as a way to ensure safety of principal and stability of interest and to avoid intrusion into private markets. These practices have also been regarded as a way to avoid the political influences that would be inherent in investing outside the U.S. government. In general, the goal 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.

Policymakers interested in ways to potentially increase interest income to the trust funds (or, as in past years, to prevent any surplus Social Security tax revenues from being used for other, non-Social Security spending purposes) have introduced legislation to alter trust fund investment practices. Some past proposals would have provided for the investment of a portion of the trust fund reserves in equities.

The Social Security Administration's Office of the Chief Actuary provides estimates of how various provisions to alter trust fund investment practices would affect the financial status of the Social Security trust funds. See *Individual Changes Modifying Social Security*, Category G: Investment in Marketable Securities, at https://www.ssa.gov/OACT/solvency/provisions/index.html.

## Related Resources

CRS Report RL33028, *Social Security: The Trust Funds*

Social Security Administration (SSA), *Frequently Asked Questions about the Social Security Trust Funds*

*Social Security Trust Fund Cash Flows and Reserves*, by David Pattison, *Social Security Bulletin*, vol. 75, no. 1, February 2015

SSA, Office of the Chief Actuary, Actuarial Note 142, *Social Security Trust Fund Investment Policies and Practices*, by Jeffrey L. Kunkel, January 1999

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