

OLD-AGE AND SURVIVORS INSURANCE AND DISABILITY INSURANCE TRUST FUNDS: 2006 TRUSTEES' PROJECTIONS

Introduction

The Trustees of the Old-Age and Survivors Insurance and Disability Insurance (OASDI) programs project in their 2006 report¹ that the combined trust funds are sufficient to pay full benefits for the next 34 years, until 2040.

Traditionally, the Trustees have measured the trust funds' adequacy in terms of short-range (10 years) and long-range (75 years) valuation periods.² According to the intermediate or best estimate assumptions of the 2006 Trustees' Report, the trust funds are in short-range actuarial balance.³ The combined assets of the Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI) trust funds are projected to increase from \$1,859 billion in early 2006 to \$3,932 billion (in current dollars) at the beginning of 2015. While the combined trust funds are sufficient to pay full benefits for the next 34 years, the Trustees also report that both OASI and DI programs continue to face long-term deficits.

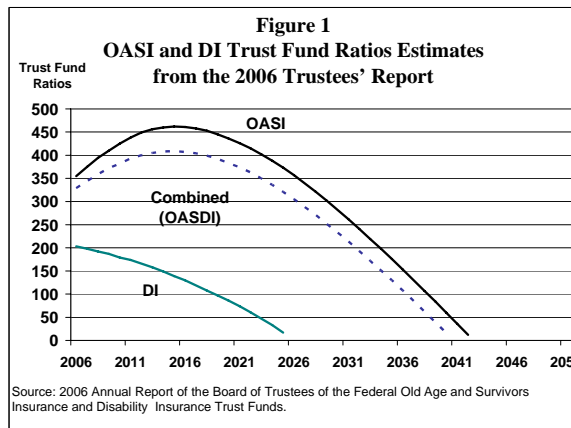
Trust Fund Ratios

The OASDI trust fund ratio, the number that represents projected trust fund assets at the beginning of the year as a percentage of that year's expenditures, is projected to rise until 2017.

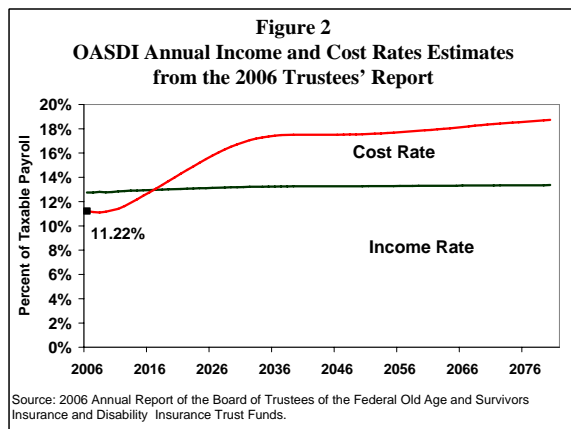
In 2017, a portion of the fund's annual interest earnings will have to be combined with tax revenue to pay annual benefits on time and in full. This approach will suffice until 2027, when total income, including tax revenue and interest earnings, will fall short of expenditures. At that time, the trust fund principal along with accruing tax revenues will have to be spent. If no action is taken, the combined funds will be exhausted⁴ in 2040. (See Figure 1.)

Annual Cost and Income Rates

Another indicator of the financial status of the trust funds is a series of projected annual income and annual cost rates. The 2006 Trustees'



Report shows trust fund income rates rising slowly through 2080 due to a flat payroll tax and the increasing effect of the taxation of benefits. (See Figure 2.)

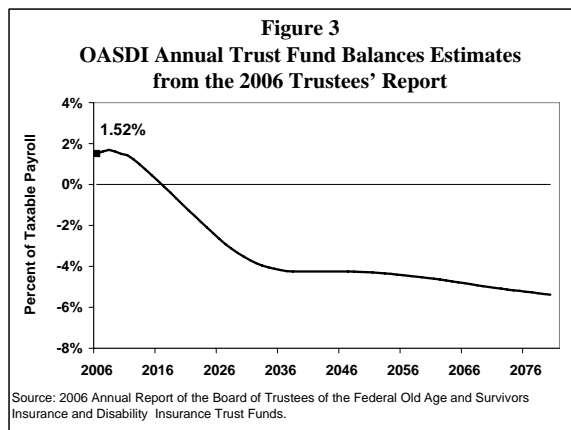


Cost rates are also projected to rise slowly with faster increases starting in 2010. Cost rates will then increase rapidly from 2010 until about 2030 as the baby boomers retire. Thereafter, cost rates rise steadily but slowly, reflecting projected increases in life expectancy and continued relatively low birth rates. Over the 75-year long-term projection period, the difference between the summarized income and cost rates for OASDI is a deficit of 2.02 percent of taxable payroll. This deficit was 1.92 percent in the 2005 report.

Annual Trust Fund Balances

The OASDI trust funds are in short-range balance and are projected to remain positive until 2017.

Thereafter, the deficit increases rapidly, reaching 2.38 percent of taxable payroll in 2025. The deficit continues to increase to 5.38 percent of taxable payroll in 2080. (See Figure 3.)



Trust Fund Assets

The U.S. Treasury invests assets of the trust funds, primarily FICA and SECA⁵ taxes not needed to pay current benefits, in special issue, interest-bearing government securities. The securities can be redeemed at any time to pay benefits or administer the Social Security program.

From 2006 until 2017, large sums of money will be flowing into the trust funds, and thus the U.S. Treasury will borrow large sums of money from Social Security. The situation changes in 2017, when the interest earned on the trust funds will supplement contributions.

Infinite Horizon Forecasts

With its 2003 report, the Trustees introduced the concept of an “infinite horizon” estimate of the status of the trust funds. Instead of a 75-year valuation period, this estimate projects future liabilities into the indefinite, infinite future. As one might expect, with this method the Trustees estimate a much larger deficit of \$13.4 trillion in present value terms; it was \$11.1 trillion in 2005. Two-thirds of this amount occurs in the years from 2080 to infinity. The 2006 infinite horizon shortfall is \$0.6 trillion larger than in 2005 primarily due to the change in the first valuation year from 2005 to 2006. The Trustees report that a change in projected trust fund real interest rates, from 3.0 to 2.9

percent, increased the deficit by \$1.4 trillion, and other changes in data, methods and assumptions resulted in a net deficit increase of \$0.3 trillion.

The Trustees express the infinite horizon shortfall in the context of the overall economy as 3.7% of future taxable payroll and 1.3% of future GDP; these measures relative to the economy have changed slightly since last year’s report. The infinite horizon estimates are problematic; the Social Security Administration provides no statistical evaluation of the infinite horizon forecast and a change in the valuation year is often interpreted as an increase in the cost of closing the shortfall. For these reasons, it is difficult to see the utility of this concept or take such estimates seriously.

Conclusions

In the 2006 report, the OASDI trust funds are projected to be adequately financed until 2040 when annual income is projected to be about 74 percent of the cost of benefits. There are numerous options for improving the long-term solvency of the program. If careful consideration is given now, Social Security’s fiscal challenges can be met with relatively modest adjustments to the program, provided action is taken sooner rather than later to address them.

¹ 2006 Annual Report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds. <http://www.ssa.gov/OACT/TR/TR06/index.html>

² For definitions of short-range and long-range actuarial balance, see the 2006 Trustees’ Report, pages 30 and 40 respectively.

³ All discussion, unless otherwise noted, is based upon the alternative II or intermediate assumptions. These are the Trustees’ best estimates of future economic and demographic conditions.

⁴ The year of exhaustion is the first year that a trust fund is unable to pay benefits on time and in full.

⁵ Federal Insurance Contributions Act and Self-Employment Contributions Act.

Written by Laurel Beedon and Lisa Southworth
AARP Public Policy Institute, May 2006
 601 E Street, NW
 Washington, DC 20049
 © 2006 AARP
 Reprinting with permission only.
www.aarp.org/ppi