AARP Public Policy Institute
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DATA DIGEST

OLD-AGE AND SURVIVORS INSURANCE AND DISABILITY INSURANCE TRUST FUNDS: 2005 TRUSTEES' PROJECTIONS

Introduction

The Trustees of the Old-Age and Survivors Insurance and Disability Insurance (OASDI) programs project in their 2005 report[1] that the combined trust funds are sufficient to pay full benefits for the next 36 years, until 2041.

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 2005 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 $1,687 billion in early 2005 to $3,697 billion (in current dollars) by 2014. While the combined trust funds are sufficient to pay full benefits for the next 36 years, the Trustees also report that both OASI and DI programs continue to face long-term deficits.

Trust Fund Ratios

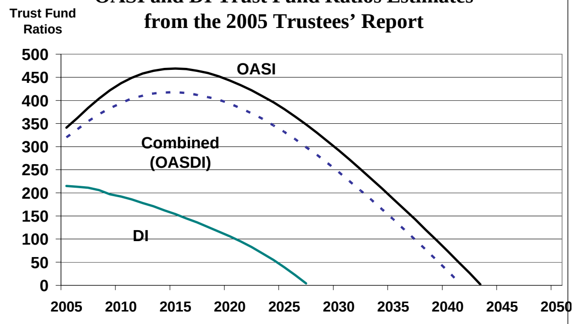
The OASDI trust fund ratio, the number that represents projected trust fund assets at the beginning of the year as a percentage of that year's expenditures, is projected to rise until 2017.

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 exhausted[4] in 2041. (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 2005 Trustees'

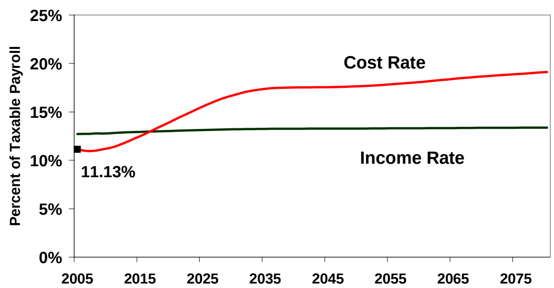
Figure 1
OASI and DI Trust Fund Ratios Estimates from the 2005 Trustees' Report



Source: 2005 Annual Report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds.

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.)

Figure 2
OASDI Annual Income and Cost Rates Estimates from the 2005 Trustees' Report



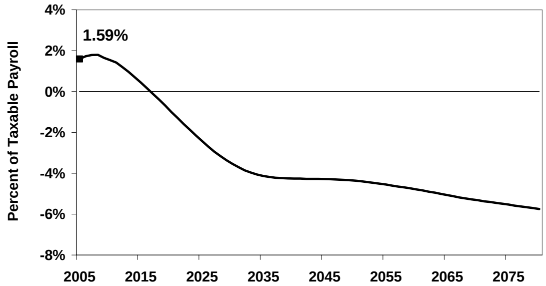
Source: 2005 Annual Report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds.

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, then decline slightly as the baby boomers age and the small birth cohort of the late 1970s leaves the workforce. 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 1.92 percent of taxable payroll. This deficit was projected to be 1.89 percent in the 2004 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 2.4 percent of taxable payroll in 2025. The deficit continues to increase to 5.75 percent of taxable payroll in 2080. (See Figure 3.)

Figure 3
OASDI Annual Trust Fund Balances Estimates from the 2005 Trustees' Report



Source: 2005 Annual Report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds.

Trust Fund Assets

The U.S. Treasury invests assets of the trust funds, primarily FICA and SECA[5] 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 2005 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 $11.1 trillion in present value terms. Two-thirds of this amount occurs in the years from 2080 to infinity. The 2005 infinite horizon shortfall is $0.7 trillion larger than in 2004 primarily due to the change in the first valuation year from 2004 to 2005.

Because $11.1 trillion over infinity is an incomprehensible figure, it should be expressed in the context of the overall economy. The Trustees put the infinite horizon shortfall as 3.5 percent of future taxable payroll and 1.2 percent of future GDP; these measures relative to the economy have not changed since last year's report. Given that the Social Security Administration provides no statistical evaluation of the infinite horizon forecast, the evident uncertainty of an "infinite horizon," the pitfall that a change in the valuation year is often interpreted as an increase in the cost of closing the shortfall, and the speed of economic change, it is difficult to see the utility of this concept or take such an estimate seriously.

Conclusions

In this report, the OASDI trust funds are projected to be adequately financed until 2041 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.

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[1] *2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds.*
[2] For a definitions of short-range and long-range actuarial balance, see the 2005 Trustees' Report, pages 29 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,
Alison Shelton and Lisa Southworth
AARP Public Policy Institute, March 2005
601 E Street, NW
Washington, DC 20049

www.aarp.org/ppi

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