What are the Social Security trust funds, and how are they financed?

Q. What are the Social Security trust funds, and how are they financed?

A. They provide cash benefits to the elderly and disabled as well as their spouses and dependents, and they are funded chiefly through payroll taxes.

There are two Social Security trust funds: old-age and survivors insurance (OASI) and disability insurance (DI), though the two are often analyzed together as Old-Age, Survivors, and Disability Insurance (OASDI). The funds finance benefits for eligible retired and disabled workers and their spouses, dependents, and survivors. When revenue dedicated to financing OASI and DI exceeds program expenses, the surplus is credited to the respective trust funds, which invest in special interest-bearing Treasury bonds. When program costs exceed receipts, the Social Security Administration can redeem its bonds to cover expenses, until it runs out of bonds. The US Department of the Treasury pays its obligation to the trust funds from general government funds.

TABLE 1

Social Security Trust Fund Receipts, Expenditures, and End of Year Assets

Billions of Dollars, 2017

Source	OASI	DI	Total
Asset reserves at the end of 2016	**$2,801**	**$46**	**$2,848**
Total income in 2017	**$826**	**$171**	**$997**
Net payroll tax contributions	$707	$167	$874
Reimbursement from General Fund of the Treasury	*	*	*
Taxation of benefits	$36	$2	$38
Interest	$83	$2	$85
Total expenditures in 2017	**$807**	**$146**	**$953**
Benefit payments	$799	$143	$942
Railroad Retirement financial interchange	$4	$0	$5
Administrative expenses	$4	$3	$7
Net increase in asset reserves in 2017	$19	$25	$44
Asset reserves at the end of 2017	**$2,820**	**$72**	**$2,892**

Source: Social Security Annual Trustees Report, 2018, Table II.B1.

* Less than $50 million

OASDI = old-age and survivors insurance; DI = disability insurance

What are the Social Security trust funds, and how are they financed?

PAYROLL TAXES: FICA AND SECA

The Social Security trust funds are financed chiefly through payroll taxes on workers covered by the OASDI program. Employers and employees each contribute 5.3 percent of the employee's taxable wages for OASI and 0.9 percent for DI coverage as part of what are sometimes called Federal Insurance Contributions Act (FICA) taxes. Up to $128,400 in wages is subject to FICA taxes, a threshold updated for average wage growth each year. (Revenue from a separate 1.45 percent FICA tax is dedicated to the Medicare hospital insurance trust fund. There is no wage cap for the Medicare tax.) Because the employer portion of the tax raises the cost of hiring workers, economists believe that this tax is passed on to workers in the form of lower compensation. Thus, workers effectively bear the entire tax.

Self-employed workers covered by Social Security contribute both the employer and employee portions of the tax under the Self-Employment Contributions Act (SECA) but can deduct the employer portion from their federal taxable income, just as other employees exclude employer FICA contributions from their taxable income.

OTHER FINANCING SOURCES

Social Security benefits are partially taxable for beneficiaries whose incomes exceed a threshold. The revenues are remitted to the OASI, DI, and HI trust funds. The trust fund balances also earn interest from special interest-bearing Treasury bonds. Congress sometimes adds to the trust funds directly from general funds. For example, when the payroll tax was cut temporarily as a stimulus measure in 2011 and 2012, the general funds reimbursed the trust funds for lost revenue.

TRUST FUND SOLVENCY AND GOVERNMENT-WIDE DEFICITS

Both the OASI and DI trust funds face shortfalls as benefits currently exceed the taxes paid into each (figure 1). In the near future, benefits from the combined OASDI trust fund will exceed revenues, including interest payments from the Treasury. In the 2018 Trustees' Report, Social Security's actuaries projected that the DI trust fund will be exhausted by 2032 and the OASI trust fund will be exhausted by 2034. If either event occurs, the Social Security Administration will only be able to pay a portion of benefits from payroll taxes collected—about three-quarters of promised benefits in the case of Social Security.

When the DI fund came close to depletion in 1994, Congress diverted some of the OASI fund's payroll tax receipts to the DI fund to maintain its solvency. Legislators took this step again in 2015, transferring funds from the OASI trust fund to extend the DI fund's solvency.

To restore long-term trust fund solvency, policymakers will need to change Social Security through some combination of raising the payroll tax rate, reducing benefits, and tapping other sources of revenue. To ameliorate the ever-growing gap between benefits relative to taxes, which adds to total government deficits, policymakers need to act soon. The sooner policymakers make adjustments, the less dramatic those adjustments will need to be.

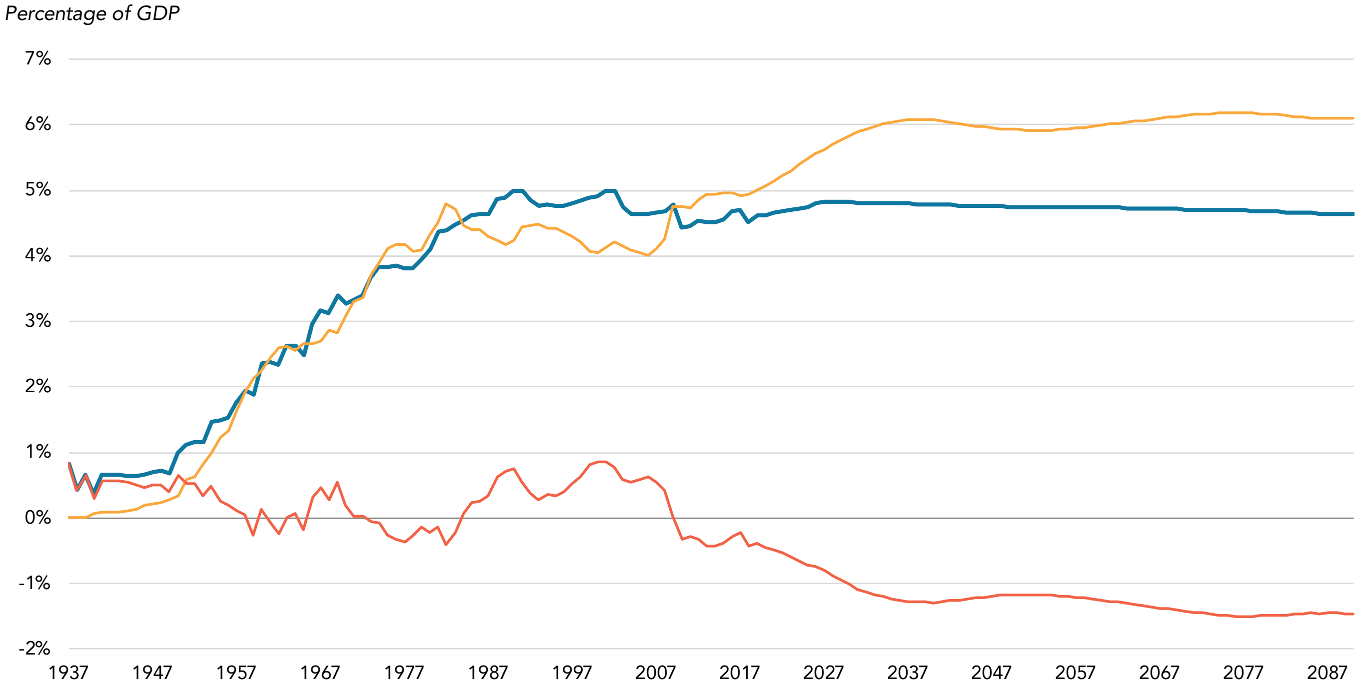
Key Elements of the U.S. Tax System

What are the Social Security trust funds, and how are they financed?

FIGURE 1

OASDI Cost and Income as a Percentage of GDP

1937–2090



Source: Calculations from data from 2017 OASDI Trustees' Report, *Annual Supplement to the Social Security Bulletin*, and BEA.

Data Sources

Social Security Administration. *Annual Statistical Supplement to the Social Security Bulletin*, 2018. Table 4.A1. "Old-Age and Survivors Insurance, 1937–2017"; and Table 4.A2. "Disability Insurance, 1957–2017."

———. "Single-Year Tables Consistent with 2018 OASDI Trustees Report."

Further Reading

Munnell, Alicia H. 2018. "Social Security's Financial Outlook: The 2018 Update in Perspective." Boston, MA: Center for Retirement Research.

Social Security Administration. 2017. *2017 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*. Washington, DC: Social Security Administration.

———. 2018. *2018 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*. Washington, DC: Social Security Administration.