

SUMMARY OF THE 1986 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND DISABILITY INSURANCE TRUST FUNDS

March 31, 1986

Highlights

The actuarial estimates shown in the 1986 Annual Report indicate that the assets of the Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI) Trust Funds will be sufficient to permit the timely payment of OASDI benefits for many years into the future. The long-range 75-year estimates indicate that, under the intermediate assumptions, the OASDI program will experience about three decades of actuarial surpluses, with continuing actuarial deficits thereafter. The surpluses in the first part of the 75-year projection period approximately offset the later deficits, so that the program, as a whole, is said to be in close actuarial balance.

Trust fund assets grew more rapidly in 1985 than was estimated in the 1985 Annual Report, reflecting both continued growth in the economy and a \$3.2-billion transfer from the general fund of the Treasury for the costs of pre-1957 military-service wage credits. As a result, the trust fund levels are higher than had been expected, and the ability of the OASDI program to withstand temporary economic downturns has improved significantly. The estimates for each trust fund, separately, indicate that both the OASI and the DI programs can operate satisfactorily for many years. During the next several years, however, the assets of the DI Trust Fund could decline to a relatively low level, if experience is very adverse.

For the long-range 75-year projection period, the OASDI program has an average annual deficit of 0.44 percent of taxable payroll, based on the intermediate II-B assumptions. (The long-range deficit under alternative 11-B in the 1985 report was about the same-0.41 percent of payroll.) The long-range deficit represents about 3 percent of the average annual cost rate. The program is therefore in "close actuarial balance," although imbalances occur in the 25-year subperiods.

For OASI and DI, separately, the average long-range deficits, based on the II-B assumptions, are 0.29 percent and 0.15 percent of taxable payroll, respectively. The deficit for DI represents about 10 percent of the average annual cost rate; thus, the DI program is not in close actuarial balance. The DI program could be brought into close actuarial balance by a small reallocation of the contribution rate from OASI to DI, in such a way that the OASI program would remain in close actuarial balance. While such a reallocation is not recommended at this time, the financial condition of the DI program will need to be carefully monitored for the next several years.

1. Program Description

The OASDI program consists of two separate parts, which pay monthly benefits to workers and their families:

- (1) Old-Age and Survivors Insurance (OASI) pays benefits after a worker retires and to survivors after a worker dies.
- (2) Disability Insurance (DI) pays benefits after a worker becomes disabled.

The Board of Trustees of the trust funds is required by law to report annually to the Congress on the financial condition of the funds and on estimated future results. The Board has five members, three of whom serve in an ex officio capacity: the Secretaries of the Treasury, Labor, and Health and Human Services. The Board also includes two members of the public, Mary Falvey Fuller and Suzanne Denbo Jaffe, who are serving 4-year terms which began on September 28, 1984.

Most OASDI revenue consists of contributions paid by employees, their employers, and the self-employed. (Additional contributions are paid into a separate trust fund for the Hospital Insurance part of Medicare. This summary focuses on OASDI and does not discuss Medicare except in the context of interfund borrowing.) The contribution rates are established by law. Contributions are paid on earnings not exceeding the earnings base-\$42,000 in 1986. The earnings base will rise in the future as average wages increase. The current and future OASDI contribution rates for employees and employers, each, are shown below (as percentages):

Year	OASI	DI	Total
1986-87	5.20	0.50	5.70
1988-89	5.53	.53	6.06
1990-99	5.60	.60	6.20
2000 & later	5.49	.71	6.20

Since 1984, a portion (not more than one-half) of OASDI benefits may be subject to Federal income taxation under certain circumstances. The revenues collected as a result of this provision are transferred from the general fund of the Treasury to the trust funds, in advance of their actual collection.

The outgo of the OASDI trust funds consists of benefit payments and administrative expenses. Trust fund assets may not be used for any other purposes.

During periods when outgo temporarily exceeds income, trust fund assets are used to meet the shortfall. In the event of recurring shortfalls, the trust funds can allow time for legislation to be enacted to restore balance to the program. The assets of the trust funds are invested in U.S. Government securities bearing rates of interest similar to those for long-term securities issued to the general public.

2. Recent Results

During 1985, about 122 million workers made contributions to the OASDI program. At the end of September 1985, 36.9 million persons were receiving monthly OASDI benefit payments. Administrative expenses represented about 1.2 percent of benefit payments in fiscal 1985.

Income to the OASDI trust funds in fiscal 1985 was \$197.9 billion, while outgo was \$188.5 billion. In addition, \$1.8 billion was transferred from the OASI fund to the Hospital Insurance (HI) fund, as partial repayment of interfund loans made in 1982. Thus, the assets of the OASDI funds increased by \$7.5 billion during the fiscal year. A summary of the OASDI financial operations in fiscal 1985 is shown below (in billions):

Trust fund assets at end of fiscal 1984	\$32.2
Income during year:	
Contributions	192.2
Revenue from taxation of benefits	3.4
Payments from general fund	.1
Net interest	2.2
Total income	197.9
Outgo during year:	
Benefit payments	184.0
Administrative expenses	2.2
Transfer to Railroad Retirement program	2.3
Total outgo	188.5
Loan repayment to HI fund	1.8
Net increase in assets during year	7.5
<u>Trust fund assets at end of fiscal 1985</u>	<u>39.7</u>

Note: Totals may not equal sums of components, due to rounding.

The growth of the trust funds in calendar year 1985 was such that the entire \$10.6 billion in interfund loans owed from the OASI Trust Fund to the HI Trust Fund in January 1986 was repaid then—a year sooner than had been expected. The \$2.5 billion currently owed from the OASI fund to the DI fund is scheduled to be repaid in April 1986.

While some decline in the *invested* assets of the trust funds occurred late in 1985 because of debt-limit problems, the assets are now fully invested. Legislative action by the Congress, with the support of the Administration, restored the long-term bonds that had been redeemed and prevented any losses of interest earnings to the funds.

3. Actuarial Estimates

The annual report contains 75-year estimates of each fund's financial operations and status. Because precise prediction of the future is impossible, alternative sets of assumptions, representing a reasonable range of possible future experience, are used to make short- and long-range estimates. Future experience could, however, fall outside the range indicated by these assumptions.

Future OASDI income and outgo will depend on a variety of economic and demographic factors, including economic growth, inflation, unemployment, fertility, and mortality. Economic factors affect the levels of workers' earnings and OASDI benefits, while demographic factors affect the numbers of people making contributions and receiving benefits.

This year's estimates were prepared using four alternative sets of assumptions. Two sets—alternatives II-A and II-B—are designated "intermediate." These sets share the same demographic assumptions, but differ with respect to economic assumptions; somewhat more

robust economic growth is assumed for alternative II-A than for alternative II-B. One set—alternative I—is designated "optimistic," and another—alternative III—is "pessimistic."

No single measure is used to assess the actuarial status of the OASDI funds. Short-range measures usually focus on the adequacy of reserves available to pay benefits. Long-range measures usually focus instead on the balance between income and outgo during the projection period.

The *contingency fund ratio* is the usual measure of the OASDI program's ability to pay benefits on time in the near future. This ratio is the amount in the trust funds at the beginning of the year, including advance tax transfers for January, divided by that year's expenditures. Thus, if the trust fund ratio is 25 percent, the amount in the fund represents about 3 months' outgo. At the beginning of 1986, the fund ratio for OASDI was about 29 percent. A ratio of 8-9 percent is required to pay benefits at the beginning of each month.

In analyzing the actuarial status of OASDI for the next 75 years, several different measures are commonly used. The *income rate* is the combined OASDI employee-employer contribution rate scheduled in the law, plus the income from taxation of benefits expressed as a percentage of taxable payroll. The *cost rate* is the annual outgo expressed as a percentage of taxable payroll. Average income and cost rates can be compared directly to measure the adequacy of the program's financing.

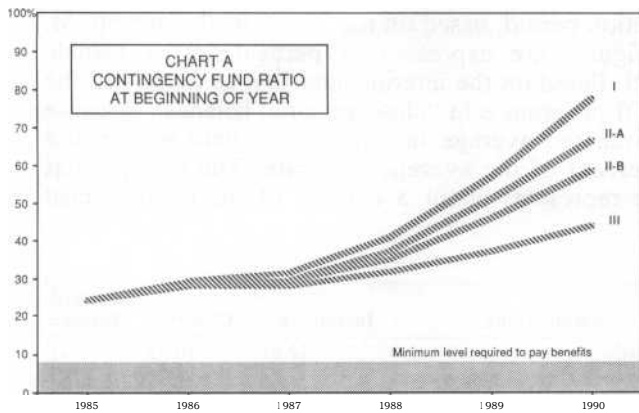
For the 75-year long-range projection period, the *actuarial balance* is the difference between the estimated average income rate and the estimated average cost rate. If this actuarial balance is positive, the program is said to have an actuarial surplus, and if negative, an actuarial deficit. Such a deficit is a warning that future changes may be needed in the program's financing or benefit provisions, although it does not present a complete picture without the other measures of financing discussed here. The program is in "close actuarial balance" for the long-range period if the average income rate is between 95 and 105 percent of the average cost rate.

4. Short-Range Financing (1986-90)

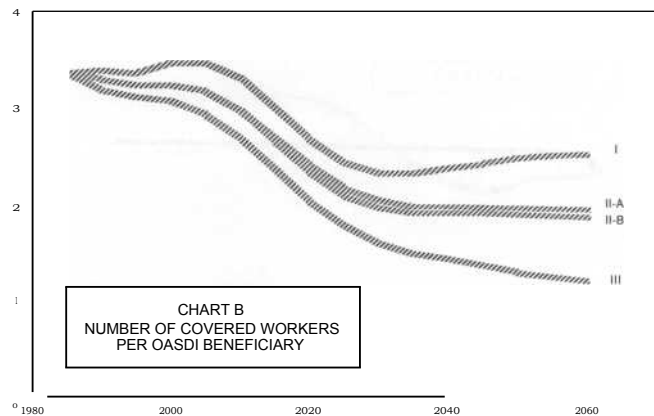
Estimates for the next 5 years are used to assess the adequacy of OASDI financing in the short range. In this period, the numbers of persons receiving OASDI benefits can be estimated fairly accurately. Changes in the national economy, however, which are difficult to predict, can have major effects on income and outgo.

The actuarial estimates shown in the 1986 report indicate that the assets of the OASI and DI Trust Funds will be sufficient to pay OASDI benefits on time throughout the 5-year period and for many years thereafter, based on all four sets of assumptions. In addition, the estimates indicate that the OASI and DI programs, separately, can operate satisfactorily for many years. During the next several years, however, the DI contingency fund ratio could decline to a relatively low level, as shown by the pessimistic estimates.

Chart A shows the OASDI contingency fund ratio for 1985, 24 percent, and the projected OASDI ratios for 1986-90, on the basis of all four sets of assumptions. The fund ratios are generally estimated to increase each year.



than the number of covered workers.



5. Long-Range Financing (1986-2060)

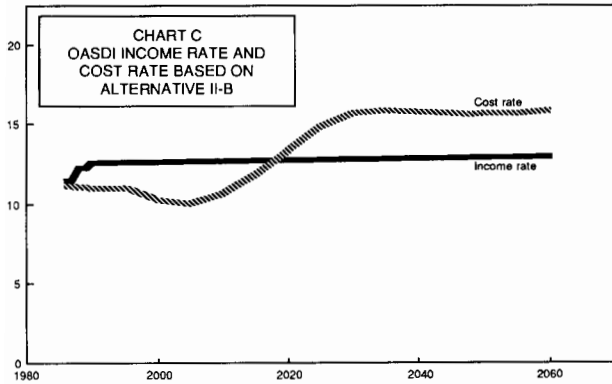
Long-range 75-year estimates for OASDI, although sensitive to variations in the assumptions, indicate the trend and general range of the program's future financial status. During this long-range period, income and outgo are greatly affected by demographic, as well as economic, conditions. Most of the beneficiaries during the next 75 years have already been born, so that their numbers are projected mainly from the present population. The numbers of workers involved in these projections, however, depend on future birth rates, which are subject to more variability.

Several important demographic trends are anticipated to raise the proportion of the aged in the population during the next 75 years. First, because of the large number of persons born in the two decades after World War II, rapid growth is expected in the aged population after the turn of the century. Second, assumed declines in death rates also would increase the numbers of aged persons. At the same time, birth rates, which began to decline in the 1960s and are assumed to remain relatively low in the future, would hold down the numbers of young people.

Chart B shows the long-range trend in the number of covered workers for each OASDI beneficiary. ("Beneficiaries" includes not only retired workers, but also disabled workers, spouses, children, and survivor beneficiaries.) This ratio declined from 5.1 in 1960 to 3.3 in 1985. It is estimated to reach about 2 by the middle of the next century, based on the intermediate assumptions, as the number of beneficiaries increases more rapidly

Chart C shows the estimated OASDI income and cost rates for the long-range projection period, based on the intermediate II-B assumptions. During the first three decades of this period, the estimates indicate that the income rate will generally exceed the cost rate, resulting in substantial actuarial surpluses each year. Beginning about 2020, the reverse is true, with the cost rate exceeding the income rate, thus resulting in substantial deficits. These actuarial surpluses and deficits do not reflect interest earnings, which result in trust fund growth continuing for about 15 years after the first actuarial deficits occur. The cost rate is estimated to increase rapidly after the first half of the 75-year projection period, primarily because the number of beneficiaries is projected to increase more rapidly than the number of covered workers.

The long-range OASDI actuarial deficit of 0.44 percent of taxable payroll, based on the intermediate II-B assumptions, consists of an average annual surplus of 2.12 percent of taxable payroll for the first 25-year subperiod, and average annual deficits of 0.89 and 2.56 percent for the second and third 25-year subperiods, respectively. Thus, in the absence of other changes, the long-range actuarial balance will tend to decline slowly in future annual reports, as the valuation period moves forward and near-term years of surplus are replaced by distant years of deficit. The actuarial deficits in the later years of the 75-year projection period are caused primarily by the demographic trends described above.



The table below presents a comparison of the average annual income and cost rates for the 75-year long-range projection period, based on the four sets of assumptions. The figures are expressed as percentages of taxable payroll. Based on the intermediate II-B assumptions, the OASDI program is in "close actuarial balance," because the estimated average income rate is between 95 and 105 percent of the average cost rate. The 0.44-percent deficit represents about 3 percent of the average cost rate.

Assumptions	Income rate	Cost rate	Actuarial balance
Optimistic	12.82	10.52	2.31
Intermediate II-A	12.92	12.64	.28
Intermediate II-B	12.96	13.40	-.44
Pessimistic	13.16	17.64	-4.49

Note: Income rate, cost rate, and actuarial balance are defined in the text.