

THE BOARD OF TRUSTEES OF THE FEDERAL
OLD-AGE AND SURVIVORS INSURANCE
AND DISABILITY INSURANCE TRUST FUNDS

THE **2004** ANNUAL REPORT



COMMUNICATION

FROM

THE BOARD OF TRUSTEES, FEDERAL OLD-AGE AND SURVIVORS INSURANCE
AND DISABILITY INSURANCE TRUST FUNDS

TRANSMITTING

THE 2004 ANNUAL REPORT OF THE BOARD OF TRUSTEES
OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE
AND THE FEDERAL DISABILITY INSURANCE TRUST FUNDS

LETTER OF TRANSMITTAL

BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND
SURVIVORS INSURANCE AND DISABILITY INSURANCE TRUST FUNDS,
Washington, D.C., March 23, 2004

The Honorable J. Dennis Hastert
Speaker of the House of Representatives
Washington, D.C.

The Honorable Richard B. Cheney
President of the Senate
Washington, D.C.

Gentlemen:

We have the honor of transmitting to you the 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund, the 64th such report.

Respectfully,

/S/ John W. Snow,
Secretary of the Treasury, and Managing
Trustee of the Trust Funds.

/S/ Elaine L. Chao,
Secretary of Labor, and Trustee

/S/ Tommy G. Thompson,
Secretary of Health and Human Services,
and Trustee.

/S/ Jo Anne B. Barnhart,
Commissioner of Social Security, and Trustee.

/S/ Thomas R. Saving,
Trustee

/S/ John L. Palmer,
Trustee.

/S/ Thomas R. Saving,
Trustee

/S/ James B. Lockhart III,
Deputy Commissioner of Social Security,
and Secretary, Board of Trustees.

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THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND DISABILITY INSURANCE TRUST FUNDS

I. INTRODUCTION

The Board of Trustees reports each year on the current and projected financial condition of the Social Security program, which is financed through two separate trust funds. The Old-Age and Survivors Insurance (OASI) Trust Fund pays monthly benefits to retired workers and their families and to survivors of deceased workers. The Disability Insurance (DI) Trust Fund pays monthly benefits to disabled workers and their families

The report on the current financial status of the funds includes an accounting of the actual income and expenditures for the last year. The projections for future years reflect the Trustees' considered judgment about all the demographic, economic, and program factors that affect income and expenditures. Projections are presented separately for the next 10 years (the short range) and for the next 75 years (the long range). All projections are based on current Social Security law and do not anticipate any future changes that Congress might make.

Because any projection of future experience is uncertain, the Trustees use three alternative sets of assumptions to show a range of possible outcomes. The intermediate set of assumptions, designated as alternative II, reflects the Trustees' best estimate of the trust funds' future financial outlook; the low cost alternative I is more optimistic, and the high cost alternative III more pessimistic. As a further illustration of the uncertainty associated with projections, this report includes a stochastic, or probabilistic, projection that provides a distribution of possible outcomes around the intermediate case. This projection is described in some detail in appendix E.

In recent years the Trustees Report has characterized sustainable solvency as maintaining a trust fund balance that is positive and either level or increasing as a percent of the annual cost of the program at the end of the 75-year period. The report also provides measures of the financial status over the infinite future

For this report, moving the valuation date from 2003 to 2004 has increased the program's actuarial deficit and unfunded obligation. Demographic, economic, and programmatic factors have also been updated with the most recently available information. Compared to the results shown in last year's report, projected annual balances for the Social Security program (income minus costs) are somewhat improved for years after about 2045. Overall, the projected financial status of the program shows little change

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II. OVERVIEW

HIGHLIGHTS

The report's major findings are summarized below.

In 2003

At the end of 2003, 47 million people were receiving benefits: 33 million retired workers and their dependents, 7 million survivors of deceased workers, and 8 million disabled workers and their dependents. During the year an estimated 154 million people had earnings covered by Social Security and paid payroll taxes. Total benefits paid in 2003 were \$471 billion. Income was \$632 billion, and assets held in special issue U.S. Treasury securities grew to \$1.5 trillion.

Short-Range Results

The OASI and DI Trust Funds, individually and combined, are adequately financed over the next 10 years under the intermediate assumptions. The combined assets of the OASI and DI Trust Funds are projected to increase from \$1,531 billion at the beginning of 2004, or 306 percent of annual expenditures, to \$3,584 billion at the beginning of 2013, or 442 percent of annual expenditures in that year. Combined assets were projected in last year's report to rise to 309 percent of annual expenditures at the beginning of 2004, and 461 percent at the beginning of 2013.

Long-Range Results

Under the intermediate assumptions the combined OASI and DI Trust Funds are projected to become exhausted in 2042. For the 75-year projection period, the actuarial deficit is 1.89 percent of taxable payroll, 0.03 percentage point smaller than in last year's report. The open group unfunded obligation for OASDI over the 75-year period is \$3.7 trillion in present value, \$0.2 trillion more than the obligation estimated a year ago.

The OASDI annual cost rate is projected to increase from 11.07 percent of taxable payroll in 2004, to 16.83 percent in 2030, and to 19.29 percent in 2078, or to a level that is 5.91 percent of taxable payroll more than the projected income rate for 2078. Expressed in relation to the projected gross domestic product (GDP), OASDI cost is estimated to rise from the current level of 4.3 percent of GDP, to 6.3 percent in 2030, and to 6.6 percent in 2078.

Between about 2010 and 2030, OASDI cost will increase rapidly due to the retirement of the large baby-boom generation. After 2030, increases in life expectancy and relatively low fertility rates will continue to increase Social Security system costs, but more slowly. Annual cost will exceed tax income starting in 2018 at which time the annual gap will be covered with cash from redeeming special obligations of the Treasury, until these assets are exhausted in 2042. Separately, the DI fund is projected to be exhausted in 2029 and the OASI fund in 2044.

Solvency

The combined OASDI Trust Funds are projected to become insolvent (i.e., unable to pay scheduled benefits in full on a timely basis) when assets are exhausted in 2042 under the long-range intermediate assumptions. For the trust funds to remain solvent throughout the 75-year projection period, the combined payroll tax rate could be increased during the period in a manner equivalent to an immediate and permanent increase of 1.89 percentage points, benefits could be reduced during the period in a manner equivalent to an immediate and permanent reduction of 12.6 percent, general revenue transfers equivalent to \$3.7 trillion (in present value) could be made during the period, or some combination of approaches could be adopted. Significantly larger changes would be required to maintain solvency beyond 75 years.

CALENDAR YEAR 2003 OPERATIONS

Income based on taxation of benefits amounted to \$12.5 billion in 2003, a decrease of about 3 percent from 2002. Nearly 99 percent of this income represented amounts credited to the trust funds, based on estimated Federal personal income taxation of benefits, generally in advance of the actual receipt of taxes by the Treasury. The remaining 1 percent of the total income from taxation of benefits represented amounts withheld from the benefits paid to nonresident aliens

Table III.A1.—Operations of the OASI Trust Fund, Calendar Year 2003
[In millions]

Total assets, December 31, 2002.....		\$1,217,497
Receipts:		
Contributions:		
Employment taxes.....	\$457,530	
Payments from the General Fund of the Treasury for contributions subject to refund.....	-1,453	
Net contributions.....		456,077
Income based on taxation of benefit payments:		
Withheld from benefit payments to nonresident aliens.....	146	
All other, not subject to withholding.....	12,351	
Total income from taxation of benefits.....		12,497
Investment income and interest adjustments:		
Interest on investments.....	75,228	
Interest adjustments ¹	9	
Total investment income and interest adjustments.....		75,237
Gifts.....		2/
Total receipts.....		543,811
Disbursements:		
Benefit payments:		
Gross benefit payments.....	400,870	
Offset for collected overpayments.....	-978	
Reimbursement from the general fund for unnegotiated checks.....	-50	
Net benefit payments.....		399,842
Transfer to the Railroad Retirement "Social Security Equivalent Benefit Account".....		3,580
Payment for costs of vocational rehabilitation services for disabled beneficiaries.....		3
Administrative expenses:		
Costs incurred by:		
Social Security Administration.....	2,252	
Department of the Treasury.....	306	
Offsetting receipts from sales of supplies, materials, etc.....	-1	
Miscellaneous reimbursements from the general fund ³	-5	
Net administrative expenses.....		2,553
Total disbursements.....		405,978
Net increase in assets.....		137,833
Total assets, December 31, 2003.....		1,355,330

¹ Includes (1) interest on transfers between the trust fund and the general fund account for the Supplemental Security Income program due to adjustments in the allocation of administrative expenses, (2) interest arising from the revised allocation of administrative expenses among the trust funds and (3) interest on reimbursements to the trust fund for costs associated with union activities and pension reform.

² Less than \$500,000.

³ Reimbursements for costs incurred in performing certain legislatively mandated activities not directly related to administering the OASI program.

Note: Totals do not necessarily equal the sums of rounded components.

Table IV.A1.—Operations of the OASI Trust Fund, Calendar Years 1999-20131
 [Amounts in billions]

Calendar year	Income				Cost	
	Total ²	Net contributions	Taxation of benefits	Net interest	Total	Benefit payments
Historical data						
1999	\$457.0	\$396.4	\$10.9	\$49.8	\$339.9	\$334.4
2000	490.5	421.4	11.6	57.5	358.3	352.7
2001	518.1	441.5	11.9	64.7	377.5	372.3
2002	539.7	455.2	12.9	71.2	393.7	388.1
2003	543.8	456.1	12.5	75.2	406.0	399.8
Intermediate:						
2004	562.7	471.0	12.8	78.9	421.5	415.2
2005	603.5	504.2	14.4	85.0	433.7	427.3
2006	636.5	528.1	15.4	92.9	449.3	443.2
2007	675.1	554.8	16.9	103.3	468.6	462.4
2008	717.6	581.8	19.7	116.1	492.4	486.2
2009	759.9	610.0	20.0	129.9	521.3	515.0
2010	805.7	639.2	22.1	144.4	554.1	547.7
2011	855.5	669.6	26.1	159.8	589.8	583.5
2012	904.5	699.9	29.0	175.5	630.0	623.4
2013	953.3	729.8	32.1	191.4	673.8	667.0
Low Cost:						
2004	563.8	472.0	12.8	78.9	421.3	415.0
2005	607.2	508.0	14.3	84.9	432.2	425.9
2006	639.2	531.3	15.3	92.5	445.1	439.0
2007	677.5	558.4	16.7	102.4	460.8	454.6
2008	718.6	585.1	19.2	114.3	479.9	473.8
2009	759.5	612.7	19.3	127.5	502.7	496.6
2010	803.9	640.9	21.1	141.9	528.8	522.7
2011	852.5	670.4	24.7	157.4	557.3	551.2
2012	899.1	698.1	27.2	173.9	589.5	583.2
2013	944.7	723.9	29.7	191.1	624.5	618.2
High Cost:						
2004	558.0	466.7	12.8	78.4	421.7	415.4
2005	598.3	497.2	14.6	86.5	440.8	434.5
2006	636.1	524.5	15.9	95.8	461.4	455.2
2007	669.0	546.6	17.4	105.1	482.2	475.9
2008	715.6	575.2	20.5	119.9	514.0	507.5
2009	785.7	620.0	21.4	144.3	558.2	551.6
2010	847.5	659.5	24.2	163.8	607.0	600.2
2011	903.1	695.6	29.1	178.4	656.2	649.2
2012	956.4	731.6	32.6	192.2	706.8	699.3
2013	1,010.7	767.7	36.2	206.7	761.3	753.5

Cost**Assests**

Calendar year	Administrative costs	RRB interchange	Net increase during year	Amount at end of year	Trust fund ratio3
Historical data					
1999	\$1.8	\$3.7	\$117.2	\$798.8	201
2000	2.1	3.5	132.2	931.0	223
2001	2.0	3.3	140.6	1,071.5	247
2002	2.1	3.5	146.0	1,217.5	272
2003	2.6	3.6	137.8	1,355.3	300
Intermediate:					
2004	2.7	3.6	141.2	1,496.6	322
2005	2.7	3.6	169.9	1,666.4	345
2006	2.6	3.5	187.2	1,853.6	371
2007	2.6	3.6	206.5	2,060.1	396
2008	2.6	3.6	225.2	2,285.3	418
2009	2.6	3.6	238.6	2,523.9	438
2010	2.7	3.7	251.7	2,775.6	456
2011	2.7	3.6	265.7	3,041.3	471
2012	2.7	3.9	274.4	3,315.7	483
2013	2.8	4.0	279.5	3,595.2	492
Low Cost:					
2004	2.7	3.6	142.5	1,497.8	322
2005	2.7	3.6	175.0	1,672.8	347
2006	2.6	3.4	194.1	1,866.9	376
2007	2.6	3.6	216.7	2,083.7	405
2008	2.6	3.5	238.6	2,322.3	434
2009	2.6	3.5	256.8	2,579.1	462
2010	2.6	3.5	275.1	2,854.2	488
2011	2.6	3.4	295.2	3,149.5	512
2012	2.7	3.6	309.6	3,459.0	534
2013	2.7	3.7	320.1	3,779.1	554
High Cost:					
2004	2.7	3.6	136.3	1,491.6	321
2005	2.7	3.7	157.5	1,649.1	338
2006	2.6	3.5	174.8	1,823.9	357
2007	2.6	3.7	186.8	2,010.7	378
2008	2.7	3.8	201.6	2,212.3	391
2009	2.8	3.8	227.6	2,439.9	396
2010	2.8	4.1	240.4	2,680.3	402
2011	2.9	4.2	246.9	2,927.3	408
2012	2.9	4.6	249.6	3,176.8	414
2013	3.0	4.8	249.4	3,426.2	417

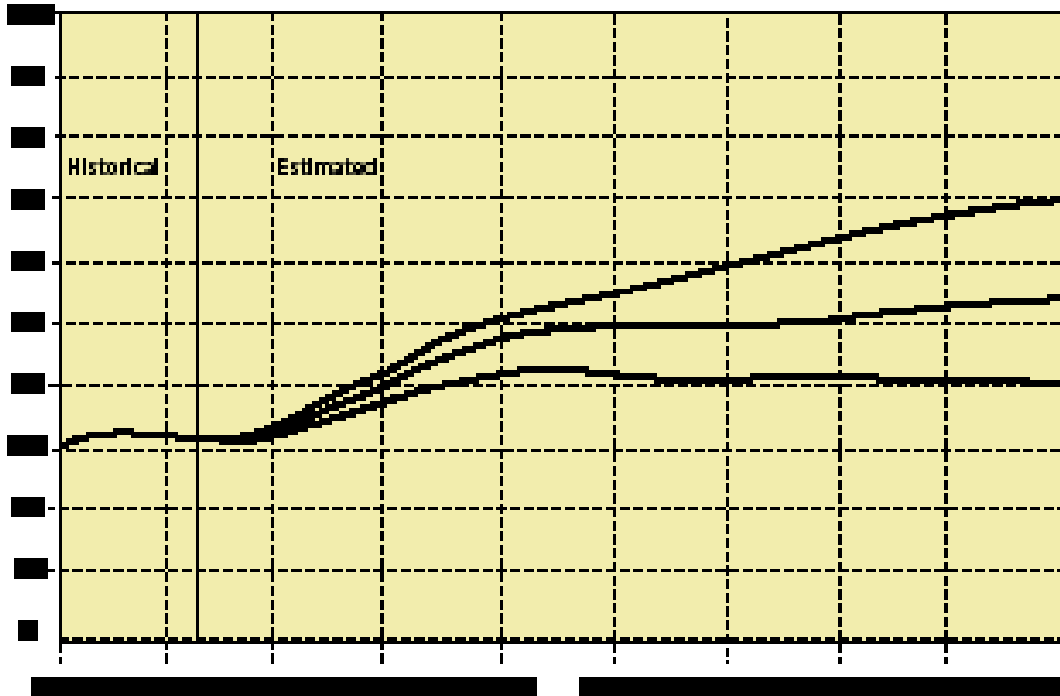


Table IV.B2 also shows that the number of covered workers per beneficiary, which was about 3.3 in 2003, is estimated to decline in the future. Based on the intermediate assumptions, the ratio declines to 2.1 by 2031, and 1.9 workers per beneficiary by 2062. Based on the low cost assumptions, for which high fertility rates and small reductions in death rates are assumed, the ratio declines to 2.3 by 2032, and then rises back to a level of 2.4 by 2044. Based on the high cost assumptions, for which low fertility rates and large reductions in death rates are assumed, the decline is much greater, reaching 1.8 by 2037, and 1.4 workers per beneficiary by 2074.

3. Trust Fund Ratios

Trust fund ratios are useful indicators of the adequacy of the financial resources of the Social Security program at any point in time. For any year in which the projected trust fund ratio is positive (i.e., the trust fund holds assets at the beginning of the year), but is not positive for the following year the trust fund is projected to become exhausted during the year. Under present law, the OASI and DI Trust Funds do not currently have the authority to borrow. Therefore, exhaustion of the assets in either fund during a year would mean there are no longer sufficient assets in the fund to cover the full amount of benefits scheduled for the year under present law.

The trust fund ratio also serves an additional important purpose in assessing the actuarial status of the program. When the financing is adequate

for the timely payment of full benefits throughout the long-range period, the stability of the trust fund ratio toward the end of the period indicates the likelihood that this projected adequacy will continue for subsequent Trustees Reports. If the trust fund ratio toward the end of the period is level (or increasing), then projected adequacy for the long-range period is likely to continue for subsequent reports.

Table IV.B3 shows, by alternative, the estimated trust fund ratios (without regard to advance tax transfers that would be effected after the end of the 10-year, short-range period) for the separate and combined OASI and DI Trust Funds. Also shown in this table is the year in which a fund is estimated to become exhausted, reflecting the effect of the provision for advance tax transfers. The patterns of the OASI and DI trust fund ratios, over the 75-year period, are shown graphically in figure IV.B3 for all three sets of assumptions. A graphical presentation of the combined OASDI ratios is shown in figure II.D7 on page 15.

Based on the intermediate assumptions, the OASI trust fund ratio rises steadily from 322 percent at the beginning of 2004, reaching a peak of 500 percent at the beginning of 2015. This increase in the OASI trust fund ratio results from the fact that the annual income rate (which excludes interest) exceeds annual outgo for several years (see table IV.B1). Thereafter, the OASI trust fund ratio declines steadily, with the OASI Trust Fund becoming exhausted in 2044. The DI trust fund ratio follows a pattern that is similar but unfolds more rapidly. The DI trust fund ratio is estimated to rise from 223 percent at the beginning of 2004 to a peak of 226 percent for 2006, and to decline thereafter until becoming exhausted in 2029.

The trust fund ratio for the combined OASI and DI Trust Funds rises from 306 percent for 2004 to a peak of 448 percent at the beginning of 2015. Thereafter, the ratio declines, with the combined funds becoming exhausted in 2042. Based on the intermediate estimates in last year's report, the peak fund ratio for the combined funds was estimated to be 471 percent for 2016 and the year of exhaustion was estimated to be 2042.

The trust fund ratio for the OASDI program first declines in 2016, about 2 years before annual expenditures begin to exceed noninterest income. This occurs because the increase in trust fund assets during 2015, which reflects interest income and a small excess of noninterest income over cost, occurs at a slower rate than does the increase in the annual cost of the program between 2015 and 2016.

After 2015 the dollar amount of assets is projected to continue to rise through the beginning of 2028 because interest income more than offsets the shortfall in noninterest income. Beginning in 2018, the OASDI program is

projected to experience increasingly large cash-flow shortfalls that will require the trust funds to redeem special public-debt obligations of the General Fund of the Treasury. This will differ from the experience of recent years when the trust funds have been net lenders to the General Fund of the Treasury. The change in the cash flow between the trust funds and the general fund is expected to have important public policy and economic implications that go well beyond the operation of the OASDI program itself.

Based on the low cost assumptions, the trust fund ratio for the DI program increases throughout the long-range projection period, reaching the extremely high level of 1,270 percent for 2079. At the end of the long-range period, the DI trust fund ratio is rising by 19 percentage points per year. Thus, subsequent reports are likely to contain projections of adequate longrange financing of the DI program under a similar optimistic set of assumptions. For the OASI program, the trust fund ratio rises to a peak of 598 percent for 2019, dropping thereafter to a level of 375 percent by 2079. At the end of the period the OASI trust fund ratio is declining by 3 percentage points per year.

The long-term outlook for the DI program is improved more than for the OASI program largely because lower assumed disability incidence rates have a substantial effect on the DI program but little net effect on the OASI program. For the OASDI program, the trust fund ratio peaks at 572 percent for 2021, and then generally falls to 491 percent for 2079, and stays at that level. Thus, due to the size of the trust fund ratios and their near stability, subsequent Trustees Reports are likely to contain projections of adequate long-range financing of the OASI and combined OASI and DI program under the low cost assumptions. A stable trust fund ratio at the end of the valuation period indicates that the actuarial balance for Trustees Reports in subsequent years can be expected to remain about the same as long as assumptions are realized.

In contrast, under the high cost assumptions, the OASI trust fund ratio is estimated to peak at 418 percent for 2014, thereafter declining to fund exhaustion by the end of 2034. The DI trust fund ratio is estimated to peak at 215 percent for 2004, thereafter declining to fund exhaustion by the end of 2015. The combined OASDI trust fund ratio is estimated to rise to a peak of 349 percent for 2012, declining thereafter to fund exhaustion by the end of 2031.

Thus, because large ultimate cost rates are projected under all but the low cost assumptions, it is likely that income will eventually need to be increased, and/or program costs will need to be reduced in order to prevent the trust funds from becoming exhausted.