

## SOCIAL SECURITY FINANCES: FINDINGS OF THE 2018 TRUSTEES REPORT

By Elliot Schreur and Benjamin W. Veghte\*

### SUMMARY

The 2018 Report of the Social Security Trustees projects that revenues will be sufficient to pay all scheduled benefits until 2034 and roughly three quarters of scheduled benefits thereafter. In 2017, Social Security income from payroll contributions, tax revenues, and interest on reserves exceeded outgo by \$44 billion. Reserves, now at \$2.9 trillion, are projected to begin to be drawn down in 2018 in order to pay full scheduled benefits. The Disability Insurance (DI) Trust Fund is projected to cover scheduled benefits until 2032, and the Old-Age and Survivors Insurance (OASI) Trust Fund until 2034.<sup>1</sup> On a combined OASDI basis, Social Security is fully funded until 2034, but faces a projected shortfall thereafter. After the projected depletion of the combined OASDI trust funds, Social Security contributions and tax revenues would continue to be received and would cover about 79 percent of scheduled benefits (and administrative costs, which are less than 1 percent of outgo). The long-range actuarial shortfall over 75 years is projected to be 2.84 percent of taxable payroll – that is, 2.84 percent of all earnings that are subject to Social Security contributions. This projected long-term revenue shortfall is substantially unchanged from the 2.83 percent of taxable payroll reported in the 2017 Trustees Report. Timely revenue increases and/or benefit reductions could bring the program into long-term balance, preventing the projected shortfall.

### What is the Trustees Report?

The Social Security Act established Boards of Trustees for the Social Security and Medicare trust funds,<sup>2</sup> respectively, and requires the Boards to report annually to Congress on the status of the funds.<sup>2</sup>

The 2018 Social Security Trustees Report updates projections of the finances of Social Security's two trust funds, the Old-Age and Survivors Insurance (OASI) Trust Fund and the Disability Insurance (DI) Trust Fund. The Trustees Report is a tool to help Congress and the public gauge the financial status of the Social Security system. Social Security's financial balance is projected over 75 years, longer than almost all other government or private-sector

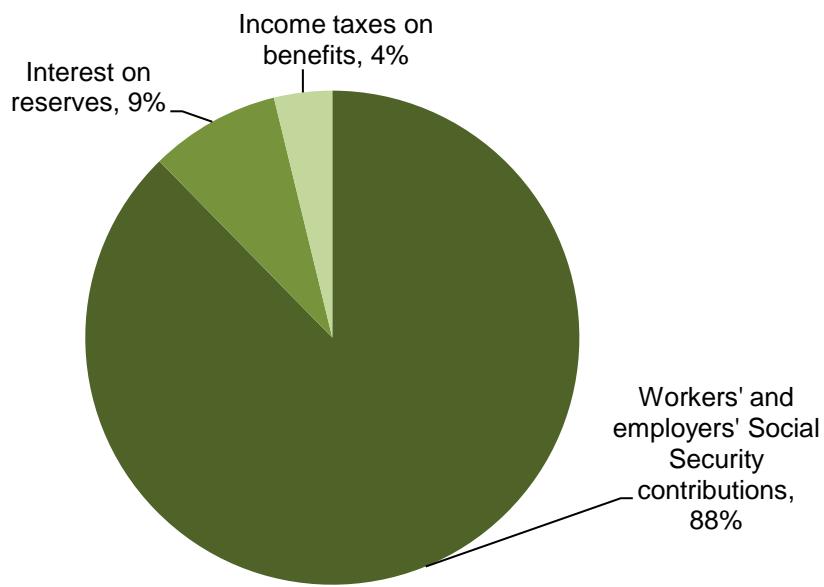
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projections. This requirement reflects the long-term commitments of Social Security and the critical importance of this program to American workers. Any projection over so long a period is inherently uncertain. Nonetheless, the Trustees' projections provide policymakers the information they need to plan for the future. The 2018 report is the 78th to be issued and is available on the website of the Office of the Chief Actuary of Social Security: [www.ssa.gov/OACT](http://www.ssa.gov/OACT).

## Who pays for Social Security?

Workers and employers pay for Social Security through mandatory contributions under the Federal Insurance Contributions Act (FICA). Workers and employers each pay 6.2 percent of earnings up to an annual cap, which is \$128,400 in 2018. Of the 6.2 percent of earnings that workers and employers each pay into Social Security, 5.015 percent goes into the OASI Trust Fund and 1.185 percent goes into the DI Trust Fund. The Bipartisan Budget Act of 2015 set these rates effective for the period January 1, 2016 through December 31, 2018. After 2018, the allocation of Social Security payroll contributions will revert to what it had been since 2000: 0.9 percent to the DI Trust Fund, and the remaining 5.3 percent to OASI. Self-employed workers pay both the employee and the employer share and can deduct the employer share from their taxable income. Higher-income beneficiaries pay income taxes on part of their benefits. Part of this income-tax revenue goes to the Social Security trust funds, and part goes to the Medicare Hospital Insurance Trust Fund.<sup>3</sup> Interest on Social Security's reserves provides an additional source of program income. The reserves are invested in special-obligation U.S. Treasury bonds, which earned an effective interest rate of 3.0 percent in 2017.<sup>4</sup> Worker and employer contributions accounted for about 88 percent of trust fund income in 2017, while interest on reserves accounted for about 9 percent, and income taxes paid by beneficiaries accounted for about 4 percent (Figure 1).<sup>5</sup>

**Figure 1. Shares of Income to the Trust Funds, 2017**



**Source:** Board of Trustees, 2018: Table IV.A3.

**Note:** Percentages do not total 100 due to rounding and exclusion of certain reimbursements to the trust funds from the general fund of the Treasury.

<http://www.socialsecurity.gov/OACT/STATS/table4a3.html>

## Who receives Social Security?

Social Security pays monthly benefits that replace part of the earnings that are lost when a worker who has paid into the program for specified periods becomes disabled, retires, or dies. In January 2018, 62 million Americans, or almost one in five, received Social Security benefits.<sup>6</sup> Approximately one family in four receives income from Social Security.<sup>7</sup> In 2017, the system paid out \$644 billion to 42.4 million retired workers, \$98 billion to 4.1 million widows and widowers, and \$31 billion to 2.5 million spouses.<sup>8</sup> About \$34 billion was paid out to 4.2 million children either under the age of 18 (19 if still in high school) or disabled since childhood. About 8.7 million disabled workers received benefits, totaling \$134 billion in 2017.<sup>9</sup>

## How much does Social Security pay?

The average monthly benefit paid to all retired workers in January 2018 was \$1,407, or about \$16,884 annually (Table 1).<sup>10</sup> The average monthly benefit was somewhat smaller for disabled workers (\$1,197) and for widows and widowers age 60 or older (\$1,341). Benefits are higher for families. For example, widowed mothers or fathers with two children received \$2,729 a month, on average, or about \$32,748 a year, while disabled workers with one or more children received \$1,846 a month, on average, or about \$22,152 a year.<sup>11</sup> For comparison, the 2018 federal poverty guideline for an individual is \$12,140 a year; for a family of two it is \$16,460; and for a family of three it is \$20,780.<sup>12</sup>

**Table 1. Average Monthly Benefits, January 2018**

<b>By Beneficiary Type:<sup>a</sup></b>	<b>Benefit</b>
Retired workers	\$1,407
Disabled workers	\$1,197
Widows or widowers (60 or older)	\$1,341
<b>By Family Type:<sup>b</sup></b>	<b>Benefit</b>
Retired worker and spouse (62 or older)	\$2,346
Widowed mother or father and two children	\$2,729
Disabled worker and one or more children	\$1,846

<sup>a</sup> SSA, 2018b. <sup>b</sup> SSA, 2018c.

Social Security is the main source of income for most beneficiaries age 65 and older.<sup>13</sup> For almost half of married beneficiary couples and over two-thirds of unmarried beneficiaries age 65 and over, Social Security accounts for more than half of total income.<sup>14</sup>

Social Security benefits are adjusted each year by an automatic cost-of-living adjustment (COLA) that is based on the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). Because the CPI-W increased 2.0 percent from the third quarter of 2016 to the third quarter of 2017, Social Security benefits increased by 2.0 percent in December 2017.<sup>15</sup>

Retirement benefits may be claimed as early as age 62. Benefits increase by approximately 6-8 percent for each year a worker defers claiming up to age 70. At age 70, the monthly benefit is 176 percent of that payable at age 62. About one third of retirees who claimed benefits in 2016 claimed at age 62, a share that has been declining since the early 2000s.<sup>16</sup> Those who claimed at 62 received 25 percent less than they would have received had they claimed at age 66 and 43 percent less than if they claimed at age 70, but their benefits are payable over a longer expected payment period.

A common way to assess benefit levels is to compare workers' benefit amounts at retirement with their earnings over their working careers. Under current law, the replacement rate for a medium earner (with career-average earnings of \$50,021 in 2017) retiring at age 65 is projected to generally decline from 39 percent of career-average earnings in 2018 to about 36 percent in 2025 and thereafter.<sup>17</sup> The replacement rate for a medium earner retiring at the early age of 62 is projected to decline from 32 percent in 2018 to 30 percent in 2022 and thereafter.<sup>18</sup> The drop in replacement rates is a result of the 1983 Social Security amendments that gradually increased the age at which unreduced benefits are paid from age 65 to 67 for workers born in 1960 and later, with the full shift first taking effect for workers who will reach 62 in 2022 and later. When considering options to close the projected Social Security funding gap, it is useful to take into account reductions in benefits already scheduled under current law.

## How do actuaries project the future?

Each year the Social Security actuaries review the performance of the economy, take into account new laws and regulations, modify and improve projection methods, and reassess assumptions about future economic and demographic trends that will affect the Social Security system — such as employment, wage levels, productivity, inflation, interest rates, birth rates, death rates, and immigration.

The actuaries make projections using three scenarios agreed upon by the Trustees: intermediate, low-cost, and high-cost. The intermediate scenario receives the most attention. In general, the low-cost estimate uses assumptions that generate higher revenues or lower overall costs (such as higher economic growth, lower unemployment, higher fertility rates, more net immigration, and lower life expectancy), while the high-cost estimate uses assumptions that generate lower revenues or higher spending. For each scenario, the Trustees Report separately projects the status of the funds for the short term (10 years) and long term (up to 75 years).

## What do the Trustees project for the short term?

In 2018, the Social Security trust funds are projected to collect \$1,001.1 billion and pay out \$1,002.8 billion, decreasing asset reserves by \$1.7 billion (Table 2). Almost all outgo will be used to pay benefits; less than 1 percent of outgo will be spent on administration. Income consists of revenues – contributions from workers and employers and income from taxation of benefits – plus interest earned on the trust fund reserves.

By law, income in excess of what is needed for current outgo is invested in interest-bearing securities guaranteed as to principal and interest by the U.S. Treasury. These assets, accumulated since 1937, make up the trust fund reserves. Since 1937, Social Security has collected \$20.9 trillion in revenues and interest and has paid out \$18.0 trillion in benefits and administrative costs (as of December 31, 2017), leaving a reserve balance of \$2.9 trillion in its trust funds. Under the intermediate assumptions, Social Security outgo will begin to exceed income in 2018 and hence reserves will begin to be drawn down to pay benefits.

**Table 2. Social Security at a Glance, 2016-2018**

	<b>2016</b>	<b>2017</b>	<b>2018 projected</b>
Income (in billions)	\$957.5	\$996.6	\$1,001.1
Outgo (in billions)	\$922.3	\$952.5	\$1,002.8
Change in trust fund reserves (in billions)	\$35.2	\$44.1	-\$1.7
Trust fund balance <sup>a</sup> (in billions)	\$2,847.7	\$2,891.8	\$2,890.1
Covered workers <sup>b</sup> (in thousands)	171,287	173,568	175,271
Beneficiaries <sup>c</sup> (in thousands)	60,907	61,903	63,250
COLA <sup>d</sup>	0.0%	0.3%	2.0% <sup>e</sup>
Taxable maximum	\$118,500	\$127,200	\$128,400 <sup>e</sup>

**Source:** Board of Trustees, 2018.

<sup>a</sup> Trust fund balances shown are as of the end of the year indicated.

<sup>b</sup> Workers who are paid at some time during the year for employment on which OASDI taxes are due.

<sup>c</sup> Beneficiaries receiving benefits on December 31 of that year.

<sup>d</sup> COLAs shown are effective beginning with benefits received in January of the year indicated. Benefit checks are actually received the month after the benefits are payable. SSA records a COLA for the month payable, thus for December of the prior year.

<sup>e</sup> Actual.

## What do the Trustees project for the longer term?

The Trustees Report provides summary measures of projected program income and outgo over the next 25, 50, and 75 years. The Trustees recognize that the reliability of the financial projections declines as the projection period increases. Under intermediate assumptions:

- Over the next 16 years, Social Security income and trust fund reserves can cover all scheduled payments.
- Over the next 25 years, Social Security finances are projected to cover 93 percent of expected outgo.
- Over the next 50 years, Social Security finances are projected to cover 87 percent of expected outgo.
- Over the next 75 years, Social Security finances are projected to cover 84 percent of expected outgo.

These measures of financial self-sufficiency illustrate the extent to which the program's assets and income are projected to meet future obligations.<sup>19</sup> The 25-, 50-, and 75-year projections indicate that remedial actions will be needed to ensure that all legislated benefits will be paid. The Trustees Report highlights other key dates about Social Security's future finances:

- In 2018, revenue from payroll contributions, interest on reserves, and taxation of benefits is expected to be less than total outgo for the year. If action is not taken immediately, reserves will start to be drawn down to pay benefits this year.
- Trust fund reserves are expected to be depleted in 2034, provided that Congress takes no action between now and then to lower outlays or increase revenues. Even if Congress does nothing, after reserves are depleted, revenue will continue to be received in the form of contributions from workers and employers, as well as from the taxation of benefits. This revenue is projected to cover about 79 percent of scheduled benefits and administrative costs in 2034 and 74 percent of benefits in 2092. By law, Social Security cannot pay benefits in excess of its income and reserves.

## **What has changed since last year's projections?**

Social Security's projected long-term revenue shortfall increased slightly from 2.83 percent of taxable payroll in 2017 to 2.84 percent in the 2018 Trustees Report. The year in which the combined OASDI trust funds would be fully drawn down in the absence of congressional action has remained 2034. For the Disability Insurance Trust Fund, that projection has been extended from 2028 to 2032.

Year-to-year changes in the estimates are to be expected. Reasons for the changes between the 2017 and 2018 projections are described in Table II.D2 and Section IV.B7 of the Trustees Report.

Some of the changes with the largest effects include changing the 75-year projection period by one year (worsens the shortfall by 0.06 percent of taxable payroll), improving program data and projection methods (improves the shortfall by 0.05 percent of taxable payroll), updating demographic data and near-term assumptions (worsens the shortfall by 0.01 percent of taxable payroll), updating economic data and near-term assumptions (worsens the shortfall by 0.01 percent of taxable payroll), and updating disability data and near-term assumptions (improves the balance by 0.01 percent of taxable payroll).

The Trustees' projection for the year of depletion of the DI Trust Fund has extended 4 years since last year's report. Causes for the DI Trust Fund's improved outlook include the continuing decline in the number of applications and awards for disability benefits, as well as lower average benefit levels for disabled workers newly awarded benefits in 2017, a trend that is expected to continue in the near future.

The long-range actuarial shortfall is projected to be 2.84 percent of taxable payroll – that is, 2.84 percent of all earnings that are subject to Social Security contributions. To put this in perspective, the projected shortfall would be eliminated if the contribution rate paid by employees and employers each were 7.7 percent instead of 6.2 percent over the next 75 years.<sup>20</sup> Such an increase would cover not only the cost of achieving solvency over the next 75 years, but also a reserve sufficient to cover the cost of benefits in the 76<sup>th</sup> year.

## **What do the high-cost and low-cost projections show?**

In the Trustees' high-cost scenario, Social Security's reserves would be depleted in 2030 (instead of 2034 in the intermediate scenario), and during the first 25 years, the program's finances would be sufficient to cover 83 percent (instead of 93 percent) of its outgo. In the low-cost scenario, Social Security would be fully financed throughout the 75-year projection period, and during the first 25 years, Social Security's finances would cover 105 percent (instead of 93 percent) of program outgo. The difference among these estimates reflects the great uncertainty about what the distant future holds.

## **What will happen if Congress does nothing to restore Social Security's long-term solvency?**

The longer lawmakers wait to address Social Security's long-term shortfall, the more severe the revenue increases and/or benefit cuts required to restore solvency will become. To give a sense of the magnitude of the measures needed to restore solvency, and how these become more severe the longer Congress fails to address the issue, one can consider what their magnitude would be if undertaken this year compared to at the time of projected depletion of the trust funds in 2034.

If Congress were to take action this year, in order to restore 75-year solvency, it would need to:

- Raise revenues by **an amount equivalent to** an immediate and permanent payroll tax rate increase from today's 6.2 percent rate on workers and their employers to 7.6 percent; or
- Cut scheduled benefits by **an amount equivalent to** an immediate and permanent reduction of about 17 percent, applied to all current and future beneficiaries, or about 21 percent if the reductions were applied only to those who become initially eligible for benefits in 2018 or later; or
- Adopt some combination of revenue increases and benefit cuts.

Implementing changes sooner would allow more generations to participate in the needed revenue increases and/or reductions in scheduled benefits, thereby spreading out the necessary changes among more current age groups and lowering the magnitude required. Postponing action to address the issue would concentrate the necessary reforms on fewer generations, thereby increasing the required magnitude of the changes. If lawmakers were to take no action to address Social Security's solvency before the combined trust funds are projected to be depleted in 2034, restoring 75-year solvency at that time would require Congress to:

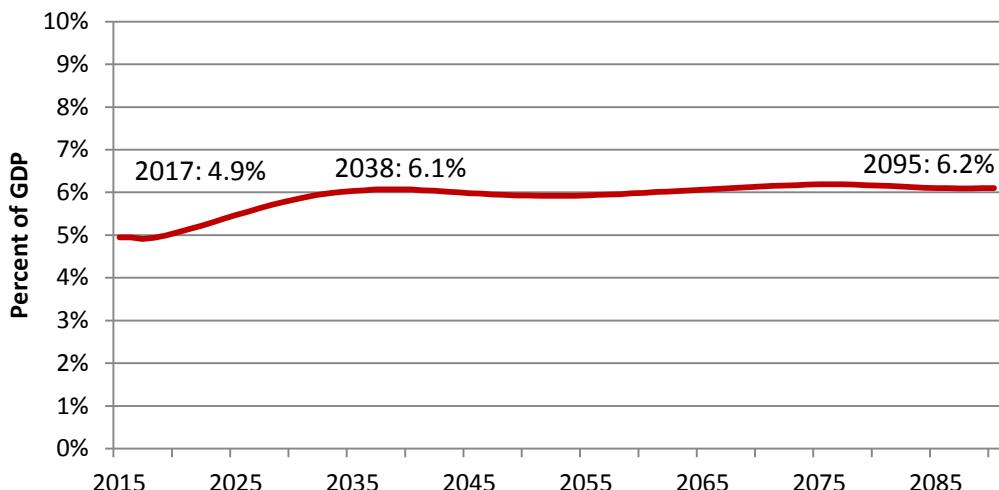
- Raise revenues by **an amount equivalent to** an increase in the payroll tax from 6.2 to 8.1 percent on workers and their employers; or
- Cut scheduled benefits by **an amount equivalent to** a 23 percent reduction in benefits to all current and future beneficiaries; or
- Adopt some combination of revenue increases and benefit cuts.

In short, the sooner lawmakers undertake measures to restore long-term solvency to Social Security, the more modest the necessary reforms will be.

## What will Social Security cost as a share of the total economy?

A widely accepted way to assess Social Security's future affordability is to compare benefits scheduled to be paid under current law with the size of the entire economy – gross domestic product (GDP) – at the time. In 2017, Social Security outgo was 4.9 percent of GDP. It is projected to rise to 6.1 percent of the economy in 2038. The projected increase is driven by the growth in the beneficiary population as the Boomer generation retires.<sup>21</sup> The increase in outgo is lower than it would be otherwise, due to a decline in benefits relative to projected earnings. This is a result primarily of the ongoing increase in the retirement age from 65 to 67, as well as additional factors such as a projected decline in the share of total worker compensation subject to the payroll tax.<sup>22</sup> After 2038, Social Security outgo as a percent of GDP will remain steady between about 5.9 and 6.2 percent of the economy (Figure 2).

**Figure 2. Social Security Outgo as a Percent of the Economy (GDP), 2015-2095**



Source: Board of Trustees, 2018: Table VI.G4.

## What happens to the Social Security reserves?

The yield on Social Security's reserves averaged 3.0 percent in 2017.<sup>23</sup> Interest earned on individual securities ranges from 1.375 percent to 5.250 percent, depending on the year when issued.<sup>24</sup> The annual interest earned on these securities is credited to Social Security's trust funds. Unlike other Treasury securities, those held by the Social Security trust funds can be redeemed at par whenever needed to pay Social Security benefits.<sup>25</sup> The Treasury bills, notes, and bonds that make up most of Social Security's reserves are considered extremely safe investments because they are backed by the full faith and credit of the United States. Private pension funds maintain large investments in U.S. bonds, as do many institutional investors and foreign governments.

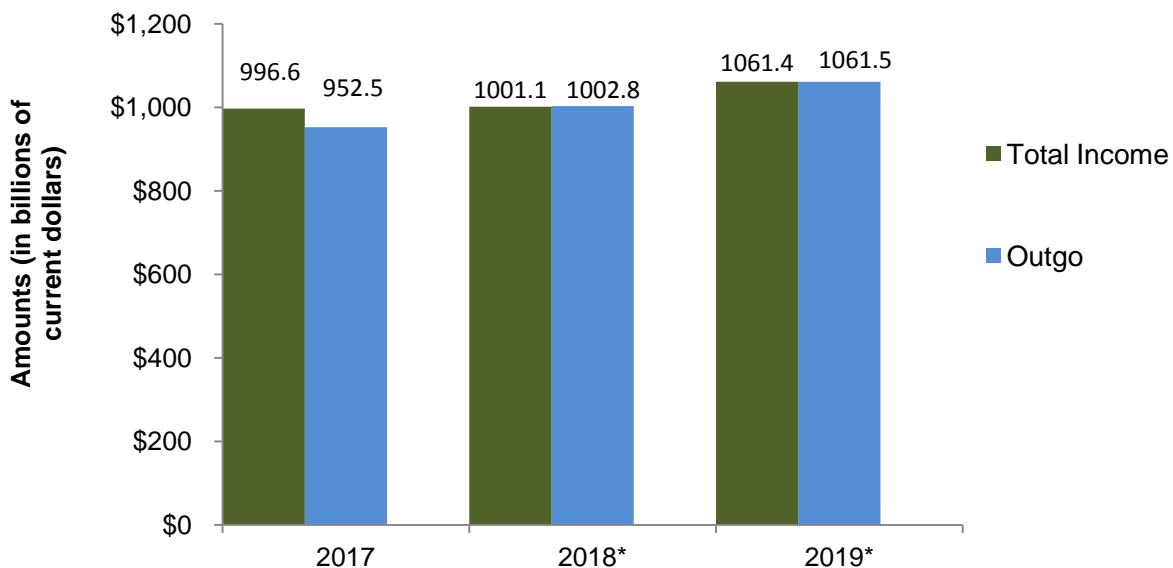
The sum of all Treasury securities makes up the gross national debt. Most of the debt (approximately 72 percent) is held by (that is, owed to) the public: individuals, corporations, and other investors in the United States and abroad who have lent money to the government by investing in government securities.<sup>26</sup> At the end of 2017, about 14 percent of the national debt was owed to the Social Security trust funds, and another 14 percent was owed to all other federal trust funds or accounts.<sup>27</sup>

Some people express concern when they hear that Social Security's reserves are lent to the U.S. Treasury. This is not a misuse of Social Security funds. This procedure has the advantage of investing Social Security's reserves in one of the safest financial instruments available.<sup>28</sup> The Treasury securities held by the trust funds are a binding legal commitment requiring the Treasury to redeem the securities with interest when the money is needed to pay Social Security benefits. The promise of the U.S. Treasury to pay its obligations has never been broken.

## What is the relationship between Social Security's income and outgo?

Social Security's total income exceeded outgo by \$44.1 billion in 2017, and outgo is projected to slightly exceed income starting in 2018. Figure 3 shows Social Security's income — from payroll contributions, interest on reserves, and taxation of benefits — and outgo for 2017 and as projected for 2018 and 2019.

**Figure 3. Social Security Income and Outgo, 2017-2019**



\*Amounts for 2018 and 2019 are projected

**Source:** Board of Trustees, 2018: Table VI.G8.

**Note:** Total income includes income from payroll contributions, interest on reserves, taxation of benefits, and certain reimbursements to the trust funds from the General Fund of the Treasury.

Starting in 2018, Social Security will begin to draw down its reserves, currently at \$2.9 trillion, to pay full scheduled benefits.

### How can policymakers address Social Security's projected long-term shortfall?

Policymakers have many options to prevent the Social Security trust funds from becoming depleted over the 75-year projection period and beyond.<sup>29</sup> In doing so, Congress must also keep in mind the purpose of Social Security, which is to provide a solid foundation for retirement income adequacy. With the decline of the defined benefit pension system, decades of wage stagnation, and growing income and wealth inequality, half of today's workers are at risk of being unable to maintain their pre-retirement standard of living in retirement.<sup>30</sup> Hence, the policy options enacted in the next round of Social Security reform will likely include some measures that raise revenues, some that cut benefits, and some that improve benefit adequacy for certain vulnerable groups.

### Conclusion

Projections indicate that scheduled Social Security benefits can be paid in full over the next 16 years with no change in current law. If nothing is done to restore long-term balance during the next 16 years, benefits will be abruptly cut in 2034. To avoid that eventuality, Congress would need to act before then to close the funding gap. The sooner lawmakers act, the more modest the revenue increases and/or benefit cuts required to bring the program into long-term balance will be. Timely action will ensure that cumulative Social Security revenues cover all statutory benefits for the next 75 years and beyond, just as they have done over the last 78 years.

## Endnotes

- <sup>1</sup> Board of Trustees, 2018: Table IV.B4.
- <sup>2</sup> The Act calls for a Board of six members: the Secretaries of the Treasury, of Labor, and of Health and Human Services; the Commissioner of Social Security; and two Trustees representing the public who must be from different political parties, are appointed by the President, and confirmed by the Senate. At present, the two Public Trustee positions are vacant.
- <sup>3</sup> Beginning in 1984, Federal law subjected up to 50 percent of an individual's or a couple's OASDI benefits to Federal income taxation under certain circumstances. Treasury allocates the revenue derived from this provision to the OASI and DI Trust Funds on the basis of the income taxes paid on the benefits from each fund. Beginning in 1994, the law increased the maximum percentage from 50 percent to 85 percent. The Hospital Insurance Trust Fund receives the additional tax revenue resulting from the increase to 85 percent. Board of Trustees, 2018: Glossary.
- <sup>4</sup> Social Security Administration (SSA), 2018a.
- <sup>5</sup> Board of Trustees, 2018: Table IV.A3.
- <sup>6</sup> SSA, 2018b; U.S. Census Bureau, 2017a.
- <sup>7</sup> U.S. Census Bureau, 2017b.
- <sup>8</sup> SSA, 2018b; SSA, 2018h; SSA, 2018i.
- <sup>9</sup> SSA, 2018b; SSA, 2018i.
- <sup>10</sup> SSA, 2018b.
- <sup>11</sup> SSA, 2018c.
- <sup>12</sup> U.S. Department of Health and Human Services, 2018.
- <sup>13</sup> SSA, 2016: Table 9.B1.
- <sup>14</sup> SSA, 2016: Table 9.A2. Recent research suggests that the data on which SSA relies to calculate these statistics on the importance of Social Security may undercount other sources of retirement income and thus overstate retirees' reliance on Social Security. However, even taking into account estimates of additional retirement income, Social Security still remains a major source of retirement income for beneficiaries (Bee and Mitchell, 2017).
- <sup>15</sup> SSA, 2018d.
- <sup>16</sup> SSA, 2018e: Table 6.B5.
- <sup>17</sup> SSA, 2018j.
- <sup>18</sup> SSA, 2018j.
- <sup>19</sup> These measures of actuarial solvency draw on work by Kenneth Buffin (2002). They compare the resources available to the program (beginning balance plus future revenues and interest) over a period of time to scheduled obligations over the same period. This technique arrives at the indicated percentage by dividing expected income over the specified period (expressed as a percent of taxable payroll) by the expected benefits to be paid out over the same period. For this purpose, obligations do not include a target fund at the end of the period. The estimates are derived from information in Table IV.B5 of the Trustees Report (Board of Trustees, 2018).
- <sup>20</sup> The combined increase is slightly higher than the actuarial deficit due to the assumed response of employees and employers to an increase in the contribution rate.
- <sup>21</sup> Board of Trustees, 2018: Table V.A3.
- <sup>22</sup> Board of Trustees, 2018: Table VI.G5.
- <sup>23</sup> SSA, 2018a.
- <sup>24</sup> Board of Trustees, 2018: Table VI.A4.
- <sup>25</sup> SSA, 2018f. The Social Security trust funds now hold only special-issue securities issued by the federal government, rather than a mix of special-issue and public-issue securities.
- <sup>26</sup> U.S. Department of the Treasury, 2018: Table FD-1.
- <sup>27</sup> U.S. Department of the Treasury, 2018: Table FD-3.
- <sup>28</sup> Van de Water, 2014.
- <sup>29</sup> SSA, 2018g; Reno and Lavery, 2009.
- <sup>30</sup> Munnell, Hou, and, Sanzenbacher, 2018.

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