



MERCATUS CENTER
George Mason University

Bridging the gap between academic ideas and real-world problems

**ECONOMIC
PERSPECTIVES**

SOCIAL SECURITY'S DISABILITY INSURANCE FINANCING CRISIS: Why Another "Quick Fix" Funds Transfer May Cost Far More Than Advertised

Social Security's trustees have long warned Congress to address the troubled finances of the Disability Insurance (DI) program. Given the DI trust fund's [projected exhaustion date](#) of 2016, legislation will be required during this Congress to prevent large, sudden benefit cuts.

Some have suggested shoring up the DI trust fund by shifting payroll tax funds from Social Security's much larger Old-Age and Survivors Insurance (OASI) trust fund, which is projected to remain solvent through 2034. By itself, however, such a reallocation would merely put off necessary substantive repairs, delay the financial reckoning for the disability program, and hasten the insolvency of the retirement fund. Absent near-term, fundamental reform, Social Security's broader financing problem could grow too large to solve at all. Policymakers should not squander this opportunity to begin critical reforms of DI.

A [new rule](#) adopted by the House of Representatives prevents consideration of a payroll tax reallocation from Social Security's OASI trust fund to its DI trust fund except in the context of legislation that improves the overall actuarial balance of the combined Social Security (OASDI) trust funds. To be clear, the House rule does not require significant repairs to Social Security's financing shortfall, only that there be an overall improvement in the actuarial balance of the combined trust funds (i.e., even if only a \$1 improvement). For example, a [bill](#) introduced in the House to prevent individuals from receiving both DI and unemployment benefits at the same time would save enough money to slightly improve the actuarial balance of the combined trust funds, and thus would alone be enough to satisfy the House rule. In his fiscal year 2016 budget President Obama proposed a [similar policy](#) to prevent so-called double-dipping by receiving both disability and unemployment benefits.

For more information, contact
Robin Walker, 202-550-9246, rwalker@mercatus.gmu.edu
Mercatus Center at George Mason University
3434 Washington Boulevard, 4th Floor, Arlington, VA 22201

The ideas presented in this document do not represent official positions of the Mercatus Center or George Mason University.

THE DISABILITY INSURANCE FINANCING CRISIS

Charles P. Blahous, a senior research fellow for the Mercatus Center at George Mason University and a public trustee for Social Security, explains DI's funding dilemma in a recent column, "[Warning: Disability Insurance Is Hitting the Wall.](#)"

- By law, DI can pay benefits only to the extent there is a positive balance in its trust fund, which the program's trustees project will be depleted in late 2016. Upon depletion, incoming payroll taxes will cover just 81% of benefits, resulting in an immediate 19% cut for all recipients.
- The suggestion that DI's financing crisis would be best addressed by simply transferring taxes from OASI to DI stems from a misdiagnosis of the problem.
- The problem is not that DI commands too small a share of the tax relative to its obligations: while DI's financing crisis is more immediate, OASI's financial condition is worse from a long-term perspective.
- DI is hitting the wall before OASI largely because the baby boomers are reaching their peak disability years before their peak retirement years.
- DI's financing crisis is simply the first triggered by the unsustainable financing arrangements threatening Social Security's disability *and* retirement programs.

Jason J. Fichtner, a Mercatus Center senior research fellow and former chief economist and acting deputy commissioner of the Social Security Administration, further explains the unintended consequences of another interfund transfer in "[Social Security Is in Crisis.](#)"

- Diverting financial resources from OASI to DI is "robbing Peter to pay Paul": "it doesn't fix the underlying problems with the disability program, and it will hasten the insolvency of the retirement program."
- Relying on a simple fund transfer would also give a false impression that DI's financial problems have been solved—a dangerous illusion that would lessen pressure on policymakers to enact real, necessary reforms.
- A better approach would be requiring DI to pay back any money borrowed from OASI in full and with interest at the same rate any borrowed money would earn if it remained in the retirement trust fund.
- Such interfund borrowing has been done [before](#). In 1982, the retirement trust fund had to borrow from the disability trust fund in order to pay full benefits.

LESSONS FROM HISTORY

“Rearranging the deck chairs, rather than slowing cost growth, would be an inadequate response with potentially ruinous implications for [Social Security].”

—Charles Blahous, “[A Guide to the 2014 Social Security Trustees Report](#)”

As the previous DI funding crisis in 1993–1994 makes clear, Congress’ reliance on the quick fix of shifting funds from OASI to DI will only exacerbate the problem if it permits lawmakers to put off substantive repairs:

- In 1994, Social Security’s [trustees emphasized](#) that the reallocation of taxes from OASI to DI should not be viewed as a sustainable solution. Instead, it was to be seen as “providing time and opportunity to design and implement substantive reforms that can lead to long-term financial stability.”
- Yet in the 20 years since, Washington has failed to follow the trustees’ recommendation by reforming DI to make it sustainable.
- The 1984 loosening of eligibility standards contributed to the program’s shortfall nearly doubling over the past 30 years. The program’s cash flow deficit—which began in 2003 and is projected to continue indefinitely—is symptomatic of its financial challenges.
- As Social Security’s [trustees have noted](#), lawmakers should address these financial challenges “as soon as possible,” and “earlier action will also help elected officials minimize adverse impacts on vulnerable populations.”
- Further delay in enacting comprehensive reforms would force still larger adjustments to taxes and benefits, and could make it practically impossible to correct Social Security’s shortfall.

THE CAUSE OF THE CRISIS

The DI shortfall reflects the fact that the program’s costs are growing faster than its revenue base.

This trend results mainly from an increase in the number of program beneficiaries:

- [According to Blahous](#), the pivotal factor is “the historically large baby boom generation moving through their ages of peak disability incidence ([ages] 45–64).” He adds, “today more women have been employed long enough to be insured for disability benefits than was the case in earlier decades.”
- Even after adjusting for age and gender, Social Security’s [chief actuary reports](#) a 42% increase in the prevalence of disability among covered workers from 1980 through 2010.
- More recent data reveal an even larger spike in disability prevalence. In a forthcoming study for the Mercatus Center, “Modernizing the SSDI Eligibility Criteria,” Mercatus visiting scholar Mark J. Warshawsky and MA fellow Ross Marchand report that “the [age- and gender-adjusted] prevalence rate increased from 2.8% to 4.6%” between 1990 and 2013, despite evidence that “trend-line rates of disability have declined” over the same period.

- [Blahous reports](#) that the increasing occurrence of disability “reflects causes ranging from a liberalization of eligibility criteria in 1984, to a surge in disability benefit applications when unemployment rose during the Great Recession.”

As Fichtner and his coauthor Jason S. Seligman document in “[Saving Social Security Disability Insurance](#),” the DI program’s structure is a large part of the problem.

- DI has morphed into an early retirement program for many Americans. Workers can protect the higher retirement benefits available by taking DI benefits at the early retirement age of 62 and waiting until their [full retirement age](#) to collect OASI.
- DI also creates disincentives for people to return to work: individuals who qualify for DI can also apply for Supplemental Security Income and government health benefits that they may lose if they return to the workforce. Fichtner and Seligman explain, “Successful transition to the workforce eventually detaches them from the health insurance they likely received through the Medicare and Medicaid systems, especially because few low-wage jobs currently offer such benefits.”

POTENTIAL REFORMS

While it is unlikely lawmakers will be able to enact the fundamental reform necessary for DI’s long-term solvency before 2016, they must take some steps. In “[Saving Social Security Disability Insurance](#),” Fichtner points to three key targets for reform:

- improving the program’s long-term solvency,
- improving incentives for those who can work to do so, and
- providing a reliable safety net for temporarily or partially disabled individuals.

As Warshawsky and Marchand conclude in their forthcoming study, DI has far outgrown its original role as a safety net, and this expansion threatens its solvency. They suggest the following specific reforms to DI’s vocational grid, the framework that guides determinations about whether to grant DI benefits:

- The grid should reflect an individual’s actual ability to work. Thus, the outdated criteria it currently relies on—such as age, education level, and language proficiency—should be eliminated. Failing that, relevant ages should be increased by at least five years.
- To improve the accuracy and relevance of disability claims, the program’s list of medically disabling conditions should be updated frequently to ensure it takes into account “the latest medical and technological knowledge in a rapidly changing field.”
- To prevent the system from being used for early retirement, disability benefits should be converted to retirement benefits at age 62.