

SAVING SOCIAL SECURITY DISABILITY INSURANCE Reforms within the Context of Holistic Social Security Reform

The Social Security Disability Insurance (DI) program is running short of money. Under current projections, its trust fund will be exhausted by the end of 2016, causing an automatic benefit reduction of about 20 percent if no legislative action is taken—a significant financial shock for those on the disability rolls.

To prevent these benefit cuts, some have proposed supplementing DI from the larger Social Security retirement trust fund. A new study published by the Mercatus Center at George Mason University argues, however, that policymakers should use this opportunity to adopt much-needed reforms of the Disability Insurance program. DI reform should (1) take account of the current retirement program and (2) not inhibit future retirement program reforms. This strategy has the potential to return DI to its original purpose—providing income support for those who cannot work due to permanent disability—while also putting the program on a path of fiscal sustainability.

Below is a brief summary. Please see “[Saving Social Security Disability Insurance: Reforms within the Context of Holistic Social Security Reform](#)” to read the entire study and learn more about authors Jason J. Fichtner, a senior research fellow at the Mercatus Center, and Jason S. Seligman, an assistant professor in the John Glenn School of Public Policy at Ohio State University.

DISABILITY INSURANCE'S UNSTABLE FINANCING

Social Security has two trust funds, financed through a 12.4 percent Social Security payroll tax:

- The larger fund finances the retirement program and receives 10.6 of that 12.4 percent of Social Security taxable earnings.
- The smaller fund finances the disability insurance program with the remaining 1.8 percent of payroll withholding.

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Under existing law, each program can pay benefits only up to the level of total revenues received, including dedicated payroll taxes and assets in its own trust fund. When DI becomes insolvent at the end of 2016, it will be able to finance benefits up to the full amount of its revenue at the time, but will have no reserve to draw upon, causing an automatic benefit reduction of about 20 percent.

Even a temporary solution to address the financing shortfall requires legislation, which could come in one of three forms: (1) merging the two trust funds, (2) reallocating payroll tax revenue from the retirement trust fund to DI's trust fund, or (3) having the DI trust fund borrow from the retirement trust fund. Although these might temporarily shore up the DI trust fund, they would hasten the exhaustion of the retirement trust fund, currently projected to reach insolvency in 2034. Current proposals to reallocate the payroll tax would change both trust funds' insolvency dates to 2033, as would simply combining the two trust funds. From an opportunity cost standpoint, buying 17 years of DI trust fund solvency would come at the expense of one year of trust fund solvency for the retirement program.

However, none of these options would, by itself, solve the long-term financial challenges or the underlying disincentives inherent in both the disability program and the retirement program that discourage work, saving, and investment. Without meaningful structural reform, these changes would only delay the day of fiscal reckoning for the DI program.

CAUSES OF THE CURRENT DISABILITY INSURANCE FINANCING CRISIS

Like other recessions since 1965, the Great Recession of 2007–2009 dramatically increased the number of disability applications and awards. But during this period, the acceptance rate of DI applications was higher than during previous recessions.

Although unemployment has declined since the depths of the Great Recession, labor force participation has also fallen—declining by more than 3 percentage points since the recession’s onset, from 66.2 percent in March 2007 to 62.7 percent in December 2014. This means that recent declines in unemployment mask the true percentage of working-age people without jobs.

The economic factors are just part of the problem, however. DI itself creates disincentives for people to return to work because once a person qualifies, he or she can also apply for additional government benefits that might be lost upon returning to work. Those who apply for DI may also apply for the government’s Supplemental Security Income and for Medicaid. In addition, two years after qualifying for DI, recipients may enroll in Medicare. Thus DI can serve as an early retirement program for many forced out of work before the full Social Security retirement age of 67.

All these factors, both cyclical and structural, have contributed to destabilizing DI’s finances. In 2002, the program’s outlays totaled just under \$68 billion while revenues exceeded \$87 billion, resulting in a surplus of \$19 billion. Ten years later, in 2012, DI’s outlays totaled \$140 billion with revenues of only \$109 billion—leaving a deficit of \$31 billion (paid for through a reduction in trust fund assets). Trust fund assets are limited and will soon run out.

POTENTIAL REFORMS

Past Social Security reforms have often focused on changing the retirement program and sometimes provided less attention to DI (consider the 1983 Greenspan Commission, the 2001 Bush Administration plan, and the 2010 Bipartisan Policy Commission proposal). Using a similar strategy today would be a mistake, because reducing retirement benefits would make disability insurance relatively more attractive, increasing its already unsustainable burdens.

Any reform of DI should give primary consideration to helping those with disabilities who can work return to or remain in the workforce while also securing the program's long-term solvency. The following potential reforms could satisfy these goals.

Expand Employer Responsibility

Currently, nongovernment short-term disability insurance is available to only 37 percent of the civilian workforce, and just one-third of civilian workers have access to long-term disability coverage through their employers. If employers were required to cover the first two years of worker disability through private market insurance, they might have more incentive to either keep workers employed or improve working conditions to reduce the incidence of disabilities.

- One problem with this approach, however, is that it could raise the cost of labor and create a perverse incentive that would discourage employers from hiring disability-prone workers in the first place.
- Therefore, this strategy could only work if it incorporated certain safeguards. These might include penalties that increase premiums for employers with implausibly low disability claim rates and premium discounts for hiring and maintaining previously disabled persons returning to the workforce. A tax credit to offset some or all of the employer cost of insurance premiums should also be considered.

Improve the Financing of Disability Reviews

Under current law, the Social Security Administration must periodically review beneficiaries receiving disability benefits to assess whether their condition has improved and benefits should cease. Disability reviews are financed through the Social Security Administration's operating budget, creating a possible perverse incentive to rush the process so that managers appear to be prudent—because it's easier to keep people on benefits than it is to remove them. This can extend the duration of marginal awards that overburden the trust fund. Better financing of the process could reduce the number of questionable awards.

Provide for Partial or Temporary Awards

Currently, an applicant is determined to be either fully disabled or not at all disabled; there is no middle ground. Consequently, a person who suffers back pain but could work part time with some income support is denied this opportunity.

- One option for reform would allow those with disabling conditions who can still work part time to receive a partial disability award, limited to one or two years.

- Similarly, if an individual suffers a disability that precludes any work but the individual could recover with time and treatment, that person could receive a temporary award, again limited to one or two years.