

BACKGROUND

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Disability Insurance Fails Short-Term Solvency Test Even After Transfer from Social Security

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Abstract

The Social Security Disability Insurance (SSDI) Trust Fund is on course to run dry in 2023, at which point it will be able to pay only about 89 percent of current benefits. Despite health improvements and technological advancements, the SSDI rolls have continued to rise, with more than 5 percent of working-age individuals now receiving benefits. Substantial inefficiencies, adverse incentives, outdated standards, and widespread fraud and abuse plague the program. These problems should not be ignored just because SSDI was given a temporary reprieve through access to the Old-Age and Survivors Insurance Trust Fund. Congress should return the SSDI program to its original purpose of poverty prevention for individuals with physical and mental disabilities that prohibit them from working.

Status of the SSDI Trust Fund

According to its Trustees, the Social Security Disability Insurance (SSDI) Trust Fund is on course to run dry in 2023. That is seven years later than the Trustees reported last year, when the SSDI Trust Fund was slated for insolvency in 2016. What happened?

In October 2015, Congress passed a temporary patch to shore up the SSDI program, allowing it to take about \$150 billion in revenues over the next three years from Social Security's Old-Age and Survivors Insurance (OASI) Trust Fund. Despite that significant transfer in revenues, the Social Security Trustees reported that the SSDI program still fails the test of short-term financial adequacy, as its reserves will remain below its annual costs over the next 10 years—even under the Trustees' low-cost assumptions.

KEY POINTS

- Despite a \$150 billion transfer from Social Security's retirement program, the SSDI Trust Fund will run dry in 2023. At that point, the disability insurance program will be able to pay only about 89 percent of current benefits.
- Despite health gains and technological improvements, SSDI rolls have been rising for decades. Since 1990, the percentage of the working-age population that receives SSDI benefits more than doubled from 2.3 percent to 5.1 percent.
- SSDI suffers from a multitude of problems and inefficiencies, including adverse incentives, outdated standards, and widespread fraud and abuse.
- Lawmakers should not delay SSDI reform once again but should immediately work on returning the program to its original purpose of poverty prevention for workers who are unable to work.

This paper, in its entirety, can be found at <http://report.heritage.org/bg3147>

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The SSDI program registered its seventh straight deficit in 2015 as the Trust Fund declined by \$28 billion, from \$60.2 billion in 2014 to \$32.3 billion. Each dollar in benefits was met with only 80 cents in payroll tax contributions.¹ These deficits have been possible because the program has been cashing in on interest payments that are due to the Trust Fund as a result of previous borrowing. Since those interest payments come out of general revenues, they *add* to the federal deficit.

Looming Insolvency. On its current path (which includes many assumptions about the program and economy over the future), the Trustees report that the SSDI Trust Fund will run dry in 2023, at which point incoming revenues will be sufficient to cover only 89 percent of expected benefits.²

Absent reform, disability benefits will be cut across the board by 11 percent when the SSDI Trust Fund runs dry. This would reduce the average disabled worker's benefit by \$128 a month, from \$1,166 to \$1,038. With almost one of every three SSDI recipients already considered to be living below the federal poverty level, and SSDI benefits making up more than 75 percent of beneficiaries' incomes, an 11 percent cut in benefits could cause significant financial hardship.³

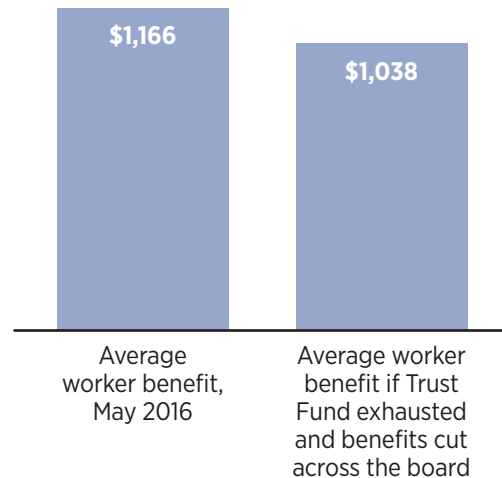
While the projected 11 percent reduction in benefits in 2023 is lower than last year's projected 19 percent cut in benefits if the Trust Fund ran dry in 2016, the difference is primarily the result of demographics as opposed to programmatic changes. By 2023, many of the current baby boomers who are receiving SSDI benefits will have shifted to receiving OASI retirement benefits, leaving a smaller gap in SSDI's shortfall than would have existed if the program had become insolvent in 2016.

Excessive Growth in SSDI. Over the past 60 years since its inception, the SSDI program has grown far beyond its original goal of protecting dis-

CHART 1

Absent Reform, Average Disability Benefit Could Fall by \$128 per Month

AVERAGE MONTHLY BENEFIT



SOURCES: Author's calculations based on data from the Social Security Administration's Monthly Statistical Snapshot, June 2016, http://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/ (accessed July 6, 2016), and *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, <https://www.ssa.gov/oact/TR/2016/index.html> (accessed July 6, 2016).

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abled workers and their families from poverty. In 1960, just 0.5 percent of the working-age population (ages 16 to 64) received SSDI benefits. Yet, despite significant improvements in health and life expectancy,⁴ as well as less physically demanding jobs, the percentage of the working-age population who

1. Social Security Administration, *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, Table III.A2.—Operations of the DI Trust Fund, Calendar Year 2015, June 22, 2016, <http://www.socialsecurity.gov/OACT/TR/2016/index.html> (accessed June 22, 2016).

2. Social Security Administration, *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*.

3. Gina Livermore and Maura Bardos, "Why Are Some SSDI-Only Beneficiaries Poor? Insights from the National Beneficiary Survey," Mathematica Policy Research, July 30, 2014, <https://www.mathematica-mpr.com/our-publications-and-findings/publications/why-are-some-ssdionly-beneficiaries-poor-insights-from-the-national-beneficiary-survey> (accessed June 27, 2016).

4. David H. Autor and Mark G. Duggan, "The Growth in the Social Security Disability Rolls: A Fiscal Crisis Unfolding," *Journal of Economic Perspectives*, Vol. 20, No. 3 (Summer 2006), pp. 71-96, <http://www.aeaweb.org/articles.php?doi=10.1257/jep.20.3.71> (accessed June 22, 2015).

receive SSDI benefits has skyrocketed, rising to 2.3 percent in 1990 and 5.1 percent in 2014.⁵

A study by the Federal Reserve Bank of San Francisco found that roughly half of the increase in SSDI beneficiaries is the result of demographics, such as increased labor force participation of women and the aging baby-boomer population.⁶ However, half the growth—roughly 3 million SSDI beneficiaries with about \$42 billion in benefits—is likely the result of greater accessibility to benefits and a higher relative value of benefits.⁷

The SSDI program has increasingly become an early-retirement and long-term-unemployment program serving not only the disabled who truly cannot work, but also the marginally disabled who could hold down certain jobs or work part time. Furthermore, the program is impaired by outright fraud and abuse. Such misuses and abuses undermine the integrity and financial stability of disability insurance.

It is the SSDI program's unintended growth, and not a lack of tax revenues, that has caused the program's shortfalls. When the SSDI program first began, the SSDI payroll tax rate was just 0.5 percent. This rate was estimated to be sufficient to provide SSDI benefits to the working population. Despite a significant improvement in health and a shift to more sedentary jobs, the cost of the SSDI program has more than quadrupled. Today, the SSDI tax rate is 2.37 percent including the transfer it is receiving from the OASI program. Although it will revert back to 1.8 percent in 2019, fully funding the program is estimated to cost 2.17 percent of payroll in 2017, and to rise to 2.25 percent of payroll—four and a half times its original cost—by 2085.⁸

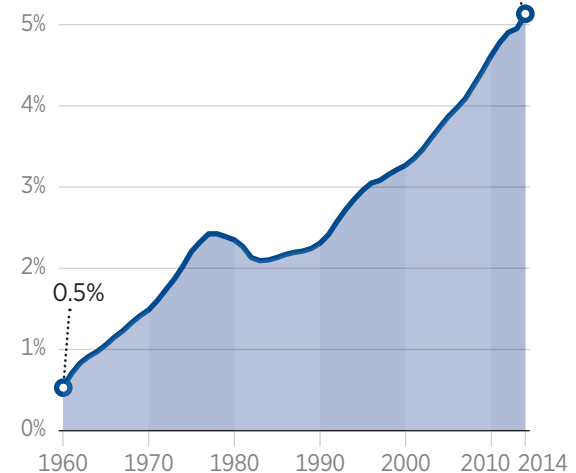
Past Time for SSDI Reform

While the current reallocation from the OASI Trust Fund to the SSDI Trust Fund prevented an

CHART 2

More People Receiving Disability Insurance from Social Security

DISABILITY INSURANCE BENEFICIARIES AS A PERCENTAGE OF TOTAL POPULATION AGES 16-64



NOTES: Beneficiaries include workers, widowers, and adult children of workers.

SOURCE: Author's calculations based on data from the U.S. Census Bureau, "Annual Statistical Report on the Social Security Disability Insurance Program, 2014," November 2015, https://www.ssa.gov/policy/docs/statcomps/di_asr/ (accessed July 6, 2016).

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across-the-board cut in SSDI benefits beginning in 2016, it did almost nothing to improve the SSDI program's drastic inefficiencies, abuses, or long-run insolvency. Congress should not allow this temporary relief for the SSDI program to delay much-needed reforms as it has in the past.

5. Author's calculations using data from the U.S. Census Bureau Population Estimates and the 2014 "Annual Statistical Report on the Social Security Disability Insurance Program," Table 1, "Disabled Beneficiaries and Nondisabled Dependents," https://www.ssa.gov/policy/docs/statcomps/di_asr/ (accessed June 30, 2016). The reciprocity rate equals the percentage of the population ages 16 to 64 that receives worker, widower, or adult-children disability insurance benefits.

6. Mary C. Daly, Brian Lucking, and Jonathan A. Schwabish, "The Future of Social Security Disability Insurance," Federal Reserve Bank of San Francisco *Economic Letter*, June 24, 2013, <http://www.frbsf.org/economic-research/publications/economic-letter/2013/june/future-social-security-disability-insurance-ssdi/> (accessed June 22, 2015).

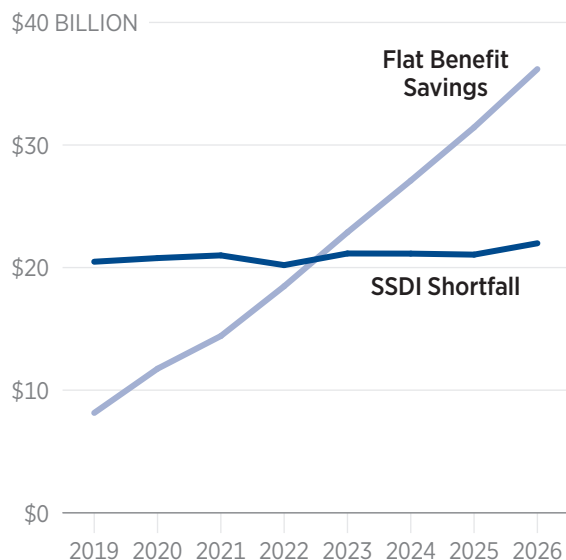
7. Rachel Greszler, "Social Security Trustees: Disability Insurance Program Will Be Insolvent in 2016," Heritage Foundation *Backgrounders* No. 3033, July 24, 2015, <http://www.heritage.org/research/reports/2015/07/social-security-trustees-disability-insurance-program-will-be-insolvent-in-2016>.

8. Social Security Administration, *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*.

CHART 3

Flat Benefit Would Repair SSDI Insolvency

Implementing a flat anti-poverty benefit for all new SSDI beneficiaries would generate \$170 billion in savings between 2019 and 2026, compared to a projected \$168 billion SSDI shortfall over that same period.



SOURCE: *The 2016 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds* and author's calculations based on 2017 implementation of a flat anti-poverty benefit applicable to all DI beneficiaries with initial awards in 2017 and later.

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Last year was not the first time the SSDI program faced insolvency and received a bailout from the OASI program. In 1994, facing growing SSDI costs, the SSDI program received a 50 percent increase in tax revenues through a permanent payroll tax reallocation. At that time, the Trustees warned that the reallocation would not be enough to make the program financially solvent over the long run, and advised Congress to reform the program. Instead of

reforming the program, Congress simply sat by and watched it continue to grow until passing another payroll tax reallocation in 2015.

If Congress does not act soon to reform the SSDI program, it will once again become depleted and likely receive another transfer from the OASI Trust Fund. Despite having more IOUs in its trust fund, OASI is *more* insolvent than SSDI as it faces a roughly 20 percent deficit over the next 75 years compared to SSDI's 14 percent deficit.⁹

What Should SSDI Reform Include?

Improving the efficiency and integrity of the SSDI program should not be difficult. There are, after all, so many problems that grabbing just the low-hanging fruit could more than solve SSDI's shortfalls and improve the program for those who truly need it.

A Flat Benefit. For starters, the SSDI program could better serve its original purpose of poverty protection by providing a flat anti-poverty benefit. This would lift many disabled beneficiaries out of poverty, ensure the same level of protection for all workers, and appropriately leave the role of income replacement to the private market.

Even without addressing the SSDI program's multitude of other problems, a flat anti-poverty benefit alone would more than solve the program's long-run shortfalls.¹⁰

Elimination of the Medical-Vocational Grid Rules. SSDI is intended for people who are physical or mentally unable to work. Age, education, level of experience, and ability to speak English do not determine an individual's ability to work (especially not with the SSDI program's low standard of any job in the national economy). Yet, the Grid rules¹¹ allow individuals to receive SSDI benefits simply because of a combination of being age 50 or older, and having limited skills or education, or an alleged inability to speak English.

These non-medical rules come into play in more than half of all SSDI awards, and when an individual meets the Grid standards, an administrative law judge has no choice but to award SSDI benefits. Congress should eliminate the Grid rules and limit SSDI qualifications to strictly mental or physical disabilities.

9. Ibid.

10. Rachel Greszler, "Improving Social Security Disability Insurance with a Flat Benefit," Heritage Foundation *Backgrounder* No. 3068, October 23, 2015, <http://www.heritage.org/research/reports/2015/10/improving-social-security-disability-insurance-with-a-flat-benefit>.

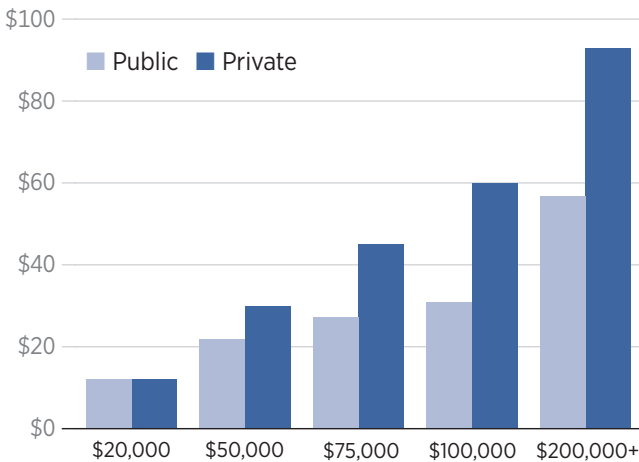
11. Social Security's Grid Rules, "Grid Rules Home," <http://www.gridrules.net/> (accessed July 7, 2016).

CHART 4

Private Disability Insurance Proves More Advantageous

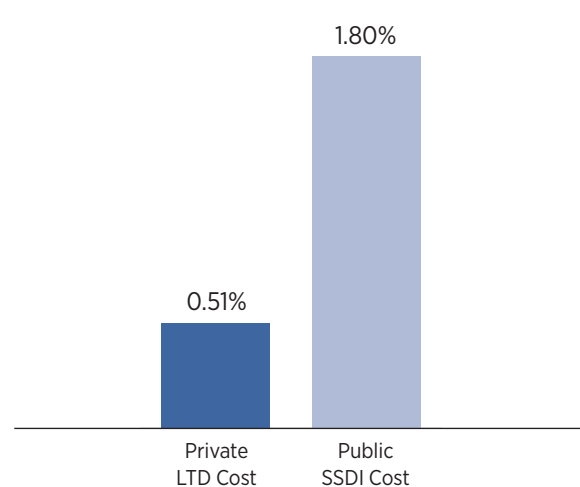
HIGHER BENEFITS. Private disability coverage provides significantly higher benefits than SSDI in all but the lowest of earnings brackets.

ANNUAL INDIVIDUAL BENEFITS,
IN THOUSANDS, BY EARNINGS LEVEL



LOWER COSTS. Private coverage costs about 0.51 percent of a worker's earnings, and SSDI is funded by a 1.8 percent payroll tax. To make SSDI solvent, the payroll tax would have to rise to 2.12 percent.

PERCENT OF ANNUAL EARNINGS



NOTE: SSDI benefits are capped at \$56,849 for anyone earning \$118,500 or more in 2015, and most private DI programs place a monthly cap on benefits ranging from \$5,000 to \$10,000. In the charts above, a cap of \$7,750 was used.

SOURCES: Author's calculations using Social Security Administration's benefit calculation formula and typical private DI benefits equal to 60 percent of prior earnings with a \$7,750 monthly benefit cap; author's calculations based on average private LTD cost of \$245/year (Gen Re, *Disability Fact Book*, 7th ed., 2013-2014), and average \$48,186 wage of private LTD recipient, David Autor, Mark Duggan, and Jonathan Gruber, "Moral Hazard and Claims Deterrence in Private Disability Insurance," *American Economic Journal: Applied Economics*, Vol. 6, No. 4 (2014), pp. 110-141.

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Optional Private Disability Insurance. Not only does the SSDI provide benefits to too many people, it also fails to provide effective disability insurance to those who truly need it. After having to wait five months between becoming disabled and applying for benefits, SSDI beneficiaries often wait a year or more before they receive a disability determination. This leaves the truly disabled without necessary income support and can cause those seeking disability benefits to deteriorate in health, attitude, and employability.

The private disability insurance market offers a far superior disability insurance product, aimed at helping workers stay on the job or rehabilitating them into a new job. Moreover, it provides higher benefits at a lower cost than the SSDI program. Providing an optional payroll tax credit for employers who offer qualified private disability insurance could significantly improve the well-being of disabled workers (and non-disabled workers who may be considered disabled by SSDI's flawed determination process), as well as the efficiency of the SSDI system.¹²

12. Rachel Greszler, "Private Disability Insurance Option Could Help Save SSDI and Improve Individual Well-being," Heritage Foundation *Backgrounder* No. 3037, July 20, 2015, <http://www.heritage.org/research/reports/2015/07/private-disability-insurance-option-could-help-save-ssdi-and-improve-individual-well-being>.

Needs-Based Period of Disability. Some disabilities are permanent, some temporary, and some unknown, yet the SSDI program largely treats all disabilities as permanent. While the SSDI system is supposed to assess changes in disabling conditions through continuing disability reviews (CDRs), these reviews often constitute nothing more than a check-the-box postcard, asking the beneficiary to confirm that he is still disabled. The SSDI system should adopt a needs-based period of disability that better reflects the individual's condition and acknowledges future work capacity.¹³ This would mean establishing an expected period of recovery—or lack thereof—alongside beneficiaries' initial disability determination.

The SSDI program is broken, both financially and in practice. Allowing SSDI to continue unchecked harms taxpayers who finance the program, and beneficiaries who are often stigmatized as a result of widespread fraud and abuse within the program. Congress must not delay SSDI reform once again, and should act now to address the program's multitude of problems.

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13. Romina Boccia, "How Do We Get Those Able to Work Off of Disability?" *National Review*, April 9, 2015, <http://www.nationalreview.com/article/416680/why-us-should-adopt-needs-based-period-disability> (accessed July 7, 2016).