NATIONAL ACADEMY OF•SOCIAL INSURANCE

NOVEMBER 2016 • No. 47

SOCIAL SECURITY: ONE SYSTEM, TWO FUNDS, THREE INSURANCE PROTECTIONS

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SUMMARY

Social Security is one system. It consists of two funds that provide three forms of insurance. Its disability, retirement, and survivors protections work together to cover many of the economic risks families face every day. Social Security provides this insurance through two trust funds: the Disability Insurance (DI) Trust Fund and the Old Age and Survivors Insurance (OASI) Trust Fund. OASI protects against the loss of family earnings due to old age or the loss of a breadwinner. DI protects workers against loss of earnings due to a significant, work-limiting impairment. The OASI fund can cover scheduled benefits through 2035, and around three-quarters of benefits through 2090. The DI fund can pay full benefits through 2023, and around four-fifths of benefits through 2090. On a combined basis, Social Security can provide all benefits for both programs through 2034, and around three-quarters of benefits thereafter. Congress has repeatedly proven its commitment to this combined system of Social Security protections by periodically rebalancing contributions to the system's two funds, most recently in 2015. Social Security is stronger than the sum of its parts, and American families are more economically secure because of it.

Social Security provides protection against economic risks Americans face across the life course. From the young child whose working parent is disabled or deceased, to the worker who is worried about how his family would make ends meet if something happened to him, to the 80-year-old who does not want to have to turn to her children for financial support – Social Security is there for them. The diversity of situations in which Social Security provides a foundation of economic security is one of the program's greatest strengths.

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This brief will discuss how Social Security covers families by protecting against three major risks to worker income: disability, retirement, and death. It will lay out how these protections are funded, and will conclude with an assessment of the Social Security system's long-term financial outlook.

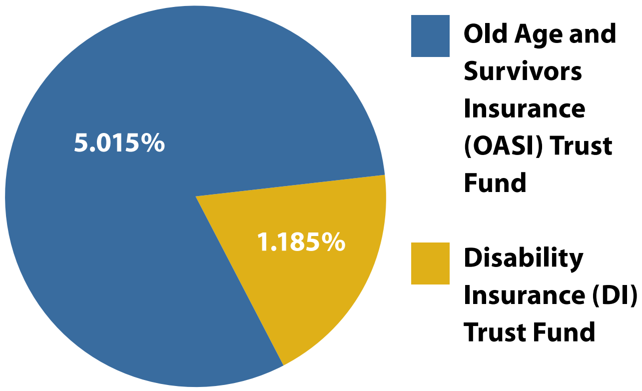
Contributing to Social Security Earns Workers Protection Against Three Risks

Through their contributions to Social Security, workers earn a measure of protection—not just when they reach old age, but throughout their adult lives. Workers and their families are insured against loss of income due to three sets of risks: disability, retirement, and death. As with auto, homeowner's, or fire insurance, no one knows in advance when – or whether – they will end up relying on their insurance. Some experience disability and need to turn to the system's disability insurance; some live very long lives and rely more heavily on Social Security's old-age insurance; and others lose a spouse and rely more on the system's survivors insurance. Some workers benefit from more than one of these protections over the course of their lives. The system replaces a portion of lost family earnings in all three cases.

Two Funds within Social Security

Social Security's finances operate through two trust funds: the Disability Insurance (DI) Trust Fund and the Old Age and Survivors Insurance (OASI) Trust Fund. Contributions to both funds are made through the Social Security payroll tax, known as the Federal Insurance Contributions Act (FICA) tax. Under the FICA tax, workers and their employers each pay 6.2 percent of earnings up to an annual cap – $127,200 in 2017 – that is adjusted annually for wage growth. Self-employed workers pay 12.4 percent and can deduct the employer half as a business expense for income tax purposes. Of the 6.2 percent of earnings that workers and employers each pay into Social Security, the vast majority goes to the OASI Trust Fund, and a small share goes to the DI Trust Fund. Currently, 5.015 percent goes to the Old Age and Survivors fund, and 1.185 percent goes to the DI fund.

Share of Earnings Contributed by Workers and Their Employers to Social Security's Trust Funds*



*Workers pay 6.2 percent of their earnings up to a cap, which is $127,200 in 2017. Employers pay a matching amount for a combined contribution of 12.4 percent of earnings.

All Social Security benefits are paid out of these two funds, which are separate from the rest of the federal budget. Typically, both funds are referred to collectively as Social Security, or by the official term "Old-Age, Survivors, and Disability Insurance" (OASDI). While funded by a single FICA tax, the two funds are separate entities that cannot borrow from each other by law.[1]

Social Security Old Age and Survivors Insurance

Old Age and Survivors Insurance protects against the loss of family earnings due to old age or the loss of a family breadwinner. Workers earn this insurance protection for themselves and their families by having worked and contributed to Social Security for at least 10 years. Between the ages of 62 and 70, workers may claim a retirement benefit that pays benefits every month until they die. Spouses and young children of family breadwinners can claim survivors benefits when a worker dies. Social Security also provides a disabled widow(er) benefit and a Disabled Adult Child (DAC) benefit. Disabled widow(er) benefits are paid from the OASI fund;[2] DAC benefits are paid from the OASI fund to the adult child of a retired or deceased worker or from the DI fund to the adult child of a disabled worker.[3] About 41 million retired workers receive benefits from OASI along with 3 million of their children and spouses. In addition, 6 million children and widow(er)s of deceased workers receive benefits from OASI.[4]

Social Security Disability Insurance

Disability Insurance protects a worker against loss of earnings due to a significant, work-limiting impairment. Workers earn DI protection by having worked and contributed to Social Security.[5] The disability standard is strict: Only individuals who have a medically determinable physical or mental impairment that precludes substantial work activity and is expected to last at least a year or result in death are eligible for benefits. Cash benefits are paid only after a five-month waiting period, and most beneficiaries become eligible for Medicare through DI only after a two-year waiting period. Applicants meet the test only if their impairments are of such severity that they are not only unable to do their prior work at a substantial level, but are also unable – considering their age, education, and work

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experience – to engage in any other substantial gainful activity that exists in the national economy. The Social Security Administration (SSA) considers someone to be engaged in substantial gainful activity if the person earns more than $1,130 a month.[6] About 8.9 million disabled workers receive DI.[7] The average benefit is about $1,170 a month, or $14,000 a year.[8]

Social Security Protects Families Against Loss of Earnings Across the Life Span

Throughout our lives – as children, workers, and retirees – we all face the economic risks against which Social Security insures us. As children, we generally rely on our parents' income to support us. If something happens and a parent is unable to provide for us, Social Security's disability or survivors insurance protections are there to help. About 9 percent of all American children, or 6.4 million, receive benefits directly or indirectly from Social Security.[9] During our working lives, we face a multitude of risks that may reduce our ability to work and provide for ourselves and our families. A working-age individual faces a 1-in-3 chance of dying or experiencing a disability that qualifies for Social Security before retirement, meaning many of us and our families may have to turn to Social Security's disability or survivors' protections to make ends meet.[10] Almost 9 million working-age adults receive Social Security benefits due to a disabling condition that makes them unable to work. In

A working-age individual faces a 1-in-3 chance of dying or experiencing a disability before retirement.

addition, 6 million survivors of deceased workers, 3 million children and spouses of retired workers, and 1.8 million children and spouses of disabled workers receive benefits.[11] And when we reach old age, our health is unpredictable and will most likely eventually make it impossible for us to continue working and support our families. Forty-one million retired workers receive retirement benefits.[12] Social Security's protections ensure that we have a foundation of economic security in all of these situations.

The Importance of Disability and Retirement Insurance to Older Americans

Social Security is particularly important to older Americans. The risk of work-limiting health problems rises sharply with age, and hence most people receiving DI benefits are in their 50s or early 60s. Three-fourths of DI beneficiaries are over age 50, and one-third are over 60.[13] While benefits are modest, they are of vital importance to the families that receive them. Over half of DI beneficiaries in their 50s and 60s rely on DI benefits for 75 percent or more of their total income.[14] Furthermore, the majority (61 percent) of households receiving Social Security rely on it as their main source of income, and one-third get almost all (90 percent or more) of their income from Social Security.[15]

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Without Social Security, Most Workers with Disabilities Would be Poor in Old Age

Because Social Security is one system, workers with disabilities transition seamlessly from Social Security's disability into its retirement benefits upon reaching full retirement age, currently 66.[16] Every year, 2.8 million people begin receiving Social Security retirement benefits for the first time.[17] Of these, 16 percent, or about half a million people, benefit from the fact that Social Security is one system by experiencing a conversion of their benefits from disability to retirement benefits without any change in their payments.[18] Since 1985, 7 million older adults have made this transition.[19] For many of these seniors with disabilities, Social Security is all that stands between them and destitution. An individual with a debilitating condition who has been unable to work for a number of years will likely have been unable to accrue enough assets to make ends meet in old age.[20] Even with DI, one in five beneficiaries currently lives in poverty, but without DI, half of current beneficiaries would be living in poverty.[21]

What is the Long-Term Financial Outlook for Social Security's Two Funds?

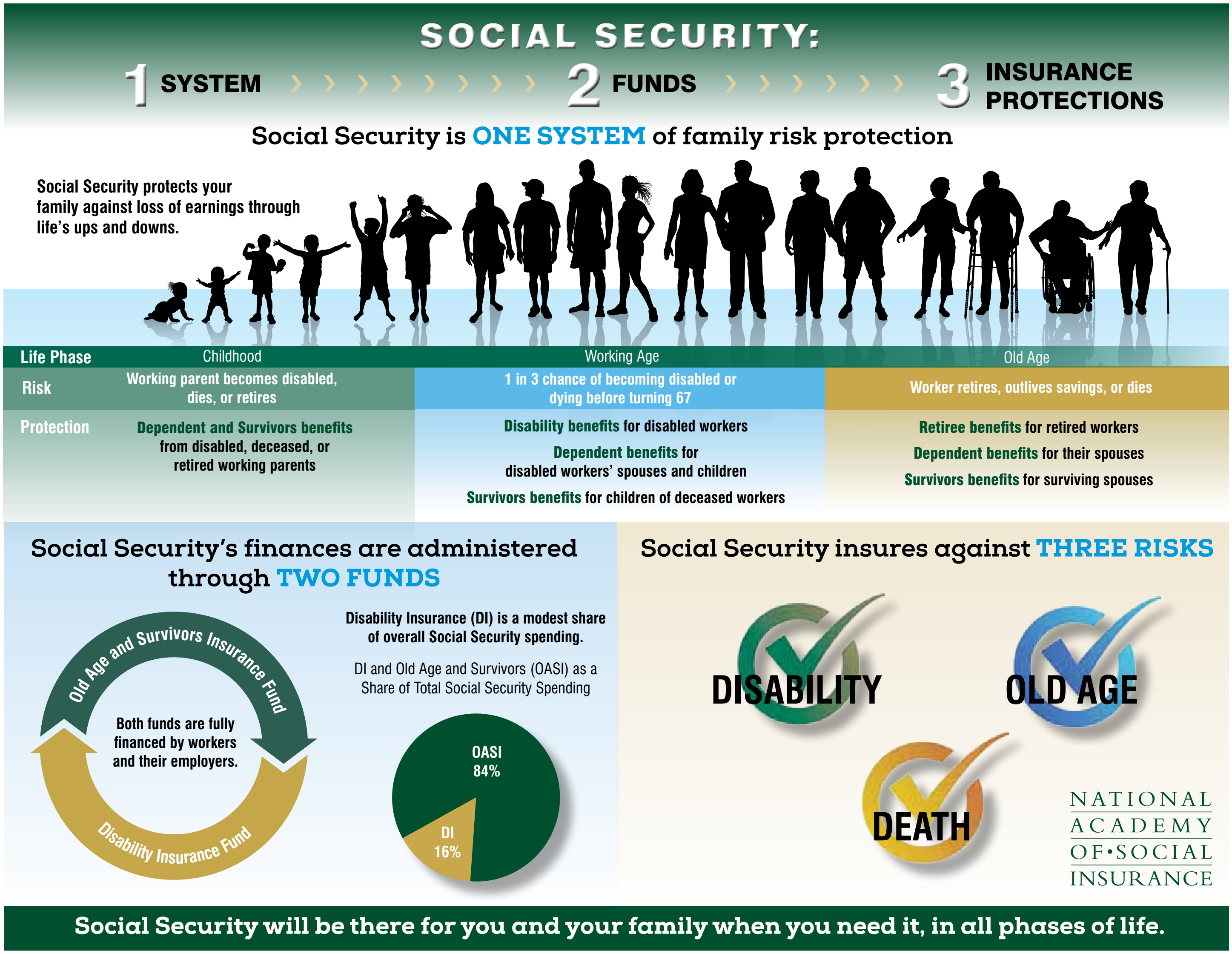
The financial status of the Social Security system as a whole is stronger than many people realize. The OASI fund can cover scheduled benefits through 2035, and around three-quarters of benefits through 2090. The DI fund can pay full benefits through 2023, and around four-fifths of benefits through 2090.[22] On a combined basis, Social Security can provide all benefits for both programs through 2034, and around three-quarters of benefits thereafter.[23] The magnitude of the projected long-term shortfall is 2.66 percent of taxable payroll; in other words, if Social Security contributions were increased by 1.4 percentage points (from 6.2 to 7.6) for workers and employers each, Social Security could pay more than 100 percent of benefits for the next 75 years.[24] There are many other options for closing the long-term shortfall, as well, whether by increasing revenues, cutting benefits, or a combination of the two.[25]

The allocation of contributions to Social Security is periodically rebalanced between its OASI and DI funds. This has been done 12 times since 1968, roughly the same amount of times in each direction.[26] Most recently, as a result of the Bipartisan Budget Act of 2015, Congress rebalanced contributions from the OASI fund toward the DI fund to extend the solvency of the latter.

Currently, of the 6.2 percent of wages employers and employees each pay, 5.015 percent goes to the OASI fund, and 1.185 percent to the DI fund. After 2018, the contributions will go back to their previous allocation of 5.3 percent to the OASI fund and 0.9 percent to the DI fund. The periodic rebalancing of Social Security contributions between the two funds has ensured that all families are protected against the risks of a worker's disability, old age, and death. Rebalancing does not in any way affect the solvency of the Social Security system as a whole.

The Integrity of the Disability Insurance System is Strong

The rate of fraud in the DI program is significantly less than in the insurance industry. While definitive data are lacking, the available evidence suggests that the rate of fraudulent payments in DI is much lower[27] than the estimated 10 percent rate of the property/casualty insurance industry's incurred losses and loss adjustment expenses, and lower than the 3 to 10 percent of fraud in total (public and private) healthcare expenditures.[28] Fraud is a significant problem throughout the insurance industry, but appears to be much less prevalent in the DI program.



SSA has a zero-tolerance policy towards fraud, and the agency works continuously to maintain program integrity. To ensure program integrity, SSA has a rigorous application process for disability benefits and periodically evaluates the disability status of beneficiaries when their condition is expected to improve. After all reconsiderations and appeals, fewer than 4 in 10 DI applications are allowed.[29] And after beneficiaries begin receiving benefits, they are subject to Continuing Disability Reviews (CDRs), which SSA regularly conducts to evaluate ongoing disability status.[30]

As contributors to and potential beneficiaries of Social Security Disability Insurance, all workers have a vested interest in safeguarding the integrity of the program, while at the same time ensuring that these modest but vital earned benefits are available to all who suffer a significant work-limiting disability.

Decisions about When to Claim Social Security Should be Based on One's Personal Situation, Not Political Debates

There are many factors to consider in deciding when to take Social Security retirement benefits: savings, home equity, ability to work, life expectancy, marital status, and health, among other considerations.[31] Political debates about Social Security's financial outlook should not impact that decision. First, as discussed earlier, Social Security is in much better financial shape than most people think; it is able to pay 100 percent of benefits through 2034 and about three quarters of benefits throughout the remainder of the century.[32] More importantly, though, throughout its history, Social Security has never failed to meet its obligations, having paid all scheduled monthly benefits in full and on time since the system began paying benefits in 1940. In the past, Congress has typically phased in changes to Social Security gradually, over many years, and has only rarely made changes that affect current beneficiaries. This approach has generally allowed workers to plan and to have confidence that Social Security will be there for them when they need it. For this reason, political reform discussions should not affect a worker's decision about when to claim Social Security.[33]

CONCLUSION

Social Security is one system. It consists of two funds that provide three forms of insurance. Its disability, retirement, and survivors protections work together to cover many of the economic risks American families face every day. In one system, it insures us and our families against lost earnings due to disability, old age, and death. This breadth of Social Security's protections under one umbrella is achieved by ensuring the solvency of the combined system. Congress has repeatedly proven its commitment to this goal. Social Security is stronger than the sum of its parts, and American families are more economically secure because of it.

ENDNOTES

1 Congress passed legislation in 1981 allowing inter-fund borrowing and extended this authority in 1983, but this authority expired in 1989. In 1982, the Old Age and Survivors fund borrowed from the Disability fund and the Medicaid fund; both loans were repaid by 1986. Larry DeWitt, 1998, "Research Note #4: Inter-Fund Borrowing among the Trust Funds," SSA Historian's Office, December 17, 1998, https://www.ssa.gov/history/interfundnote.html.

2 Social Security Administration, 2016, "Disability Planner: Benefits for Disabled Widows or Widowers," https://www.ssa.gov/planners/disability/dqualify9.html.

3 Social Security Administration, 2016, "Disability Planner: Benefits for a Disabled Child," https://www.ssa.gov/planners/disability/dqualify10.html.

4 Social Security Administration, Office of the Chief Actuary, 2016, "Beneficiary Data: Number of Social Security recipients at the end of July 2016," http://www.socialsecurity.gov/cgi-bin/currentpay.cgi. This 6 million children and widow(er)s of deceased workers includes 260,000 disabled widow(er)s who receive disabled widow(er) benefits paid from the OASI fund. 1.1 million adult disabled children of retired, deceased, or disabled workers receive DAC benefits. The disabled adult children of retired and deceased workers receive benefits from the OASI fund and the disabled adult children of disabled workers receive benefits from the DI fund.

5 Eligibility for Social Security OASI and DI benefits depends on the number of Social Security credits a worker has earned and, in the case of DI benefits, on how recently those credits have been earned. For DI, younger workers need fewer credits to qualify than older workers do, and thus may qualify with a less extensive work history. For details, see Social Security Administration, 2016, "Benefits Planner: Social Security Credits," https://www.ssa.gov/planners/credits.html.

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8 Ibid.

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11 Social Security Administration, 2016, "Beneficiary Data."

12 Ibid.

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15 Social Security Administration, Office of Research, Evaluation, and Statistics, 2016, "Income of the Population 55 or Older, 2014," Tables 2.A1 and 9.A1, https://www.ssa.gov/policy/docs/statcomps/income_pop55/.

16 DI beneficiaries may also voluntarily convert their DI benefits to OASI benefits upon reaching age 62. This decision, however, will result in reduced Social Security benefits because of the reduction for early claiming of retirement benefits. Some beneficiaries may still choose to convert, however, for reasons involving workers' compensation offsets and maximum family benefit rules. Tim Zayatz, 2015, "Social Security Disability Insurance Program Worker Experience," Actuarial Study No. 123, Social Security Administration, Office of the Chief Actuary, https://www.ssa.gov/oact/NOTES/pdf_studies/study123.pdf.

17 Authors' calculations of: Social Security Administration, Office of Retirement and Disability Policy, 2016, "Annual Statistical Supplement, 2015," Table 6.B5, https://www.ssa.gov/policy/docs/statcomps/supplement/2015/6b.html#table6.b5.

18 Ibid.

19 Ibid.

20 Nicole E. Conroy, Katherine E. McDonald, Michael Morris, and Elizabeth Jennings, 2014, "Financial Capability of Adults with Disabilities: Findings from the FINRA Investor Education Foundation 2012 National Financial Capability Study," National Disability Institute, http://www.realeconomicimpact.org/data/files/reports/ndi_financial_capability_report_july_2014.pdf.

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24 Ibid.

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