

Sustaining Social Security:
An Economic Case for Reforming U.S. Disability and Retirement Insurance

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1. The Need for a Program

The Social Security system, encompassing both retirement and disability insurance, is essential to the financial security of millions of Americans. Initially created during the Great Depression, the system now serves over 66 million people each month (SSA, 2023). However, demographic shifts have put the system under strain. The ratio of workers paying into Social Security relative to beneficiaries is declining, raising concerns about long-term sustainability. Simultaneously, disability benefit recipients often face long delays for eligibility determinations and receive benefits that do not meet the cost of living. These challenges highlight the ongoing need for a federal program that provides stable, equitable support for retirees and disabled individuals.

2. Market Failures Addressed by the Program

Social Security addresses several market failures. First, it combats adverse selection and moral hazard present in the private insurance market by mandating participation and pooling risk. Second, it corrects for information asymmetries that make it difficult for private insurers to assess disability claims fairly. Third, it resolves issues of incomplete markets where private disability and retirement insurance either do not exist or are prohibitively expensive. Lastly, the program provides income smoothing across the lifecycle, which private markets often fail to do efficiently or equitably.

3. Alternatives to the Program

Several alternatives have been proposed, including privatized retirement accounts, expanded employer pensions, or state-administered disability programs. While privatization may increase individual control and potential returns, it introduces volatility and places risk on the individual, particularly affecting low-income workers with less capacity to save. State-level alternatives could create inconsistency and gaps in access. A purely private disability insurance model would likely leave out high-risk individuals or be unaffordable for those most in need.

4. Particular Design Features of the Program

Social Security's retirement and disability insurance components are contributory, progressive, and indexed to inflation. Retirement benefits are based on a worker's top 35 years of earnings. SSDI eligibility requires meeting strict medical and work history requirements, and recipients must wait five months before receiving benefits. These design features control fraud and ensure long-term solvency, but also lead to inefficiencies and hardships for legitimate claimants. The program's trust fund model and pay-as-you-go financing structure have also contributed to concerns over future funding shortfalls.

5. Private Sector Responses

The existence of Social Security has influenced the behavior of both individuals and the private sector. Some employers offer supplemental disability and retirement insurance, but many rely on Social Security to provide the baseline coverage. The presence of the program may have crowded out demand for private products, especially for low- and middle-income individuals who view Social Security as their primary or sole source of retirement income. At the same time, the private sector benefits from a stabilized consumer base that receives predictable monthly payments.

6. Efficiency Consequences

The SSDI program faces efficiency challenges, particularly due to the backlog in case processing. In 2022, applicants waited an average of over seven months for a decision (SSA, 2022). This delay increases personal hardship and may push individuals toward other public assistance programs. Additionally, because benefits are modest, recipients often remain in poverty, limiting the program's ability to reduce dependency. Meanwhile, the program's retirement benefits, while relatively efficient to administer, may not be adequate to support longer life spans without adjustments.

7. Distributional Consequences

Social Security is broadly redistributive, favoring lower-wage workers through a progressive benefit formula. However, disparities in life expectancy by income and race can result in regressive outcomes, as higher-income individuals tend to live longer and collect more in lifetime benefits. The SSDI program disproportionately affects people of color and those with limited educational attainment, who are more likely to apply for benefits but also more likely to face denials or longer wait times due to systemic inequities in the determination process.

8. Equity-Efficiency Trade-offs

Improving access to SSDI or increasing benefit amounts would enhance equity but could reduce incentives to work and increase costs. Conversely, tightening eligibility criteria could improve efficiency but harm vulnerable populations. Raising or eliminating the payroll tax cap would improve progressivity and solvency but might introduce efficiency losses by affecting high earners' labor market participation. Policymakers must carefully balance these trade-offs to preserve both program integrity and fairness.

9. Public Policy Objectives

The core objectives of Social Security are to provide income security, prevent poverty in old age, and protect individuals from income loss due to disability. These goals remain relevant and necessary in today's economic environment. Reforms should aim to preserve the universal nature of the program while improving its responsiveness and adequacy. Policymakers should consider automatic stabilizers, like indexing benefits to wage growth, and funding adjustments, like gradually increasing payroll taxes, to ensure long-term sustainability.

10. Political Process

Efforts to reform Social Security are consistently shaped by political polarization. Proposals to cut benefits or raise the retirement age face opposition from advocacy groups and voters. At the same time, proposals to expand benefits or increase taxes meet resistance from fiscal conservatives. Disability program improvements often receive bipartisan support in theory but are hindered by budgetary constraints and bureaucratic inertia. The political challenge lies not in the lack of viable solutions, but in the lack of consensus on which trade-offs are acceptable.

References

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