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Disability Insurance Side of Social Security Raises Questions

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DISABILITY insurance could be the Achilles' heel of President Bush's efforts to carve personal accounts out of Social Security (although there is a lot of competition for that distinction). The program faces challenges that are at least as daunting as those on the retirement side of Social Security, and fitting the existing program into a system of personal accounts could have serious unintended consequences.

Disability insurance is the Eisenhower-era program added to Social Security to provide financial support for people with a disability that prevents them from working. Some 90 percent of workers are covered. The program is financed by a 1.8 percent payroll tax and has a trust fund that, on paper, is separate from the Old Age and Survivors Insurance trust fund. Benefits are computed using the Social Security retirement benefit formula.

Although President Bush has stated only broad principles for changing Social Security and has yet to negotiate with Congress, he indicated in an interview with The Washington Post in January that he did not plan to change the disability or survivors components of Social Security.

Two major problems would result from maintaining the existing disability program in the face of private accounts. First, disabled workers currently start receiving Social Security retirement benefits when they reach age 65. Because their disability benefits equal their Social Security benefits, the transition is seamless.

Presumably, under President Bush's plan, the disabled would move off disability benefits and draw on their personal accounts and (smaller) guaranteed Social Security benefit when they reach retirement age. But most disabled workers would not have accumulated much wealth in their personal accounts because they would have had a shorter work life than other retirees. Their benefits would drop sharply at age 65 and, in many cases, their incomes would fall below the poverty line.

This is no small problem. David Autor, an economist at the Massachusetts Institute of Technology, points out that one in eight people who start receiving Social Security retirement benefits each year are coming from the disability rolls.

If disability benefits were continued at their current level after retirement age, a different problem would arise: disability would be more lucrative than retirement for workers who had poor investment returns on their personal accounts. The disability program already has difficulty in making consistent judgments as to whether workers are disabled - in one study, one in six cases were judged differently by different state disability examiners - so many marginally disabled workers who applied would probably be allowed benefits. Older workers could flood into the disability program, weakening its already frail financial health.

The second problem is that leaving disability insurance alone abdicates responsibility for fixing its financial difficulties, which are much more imminent than the retirement program's financial problems. According to a forecast by the Social Security trustees, the Old Age and Survivors Insurance trust fund will last until 2044, while the disability trust fund will be exhausted in 2029.

Integrating the disability program into a system of personal accounts is complicated because it is inherently an insurance program. Disabled beneficiaries take out far more from the system than they put in. Workers collectively insure the risk of disability. It is inconceivable that personal accounts could fulfill this role. Moreover, only about a quarter of workers have employer-provided long-term disability insurance, so it is unlikely that the private sector could provide adequate insurance by itself.

The disability program poses a major obstacle to changes in Social Security because a large number of workers apply to and are accepted into the program; 17 percent of all Social Security recipients are on disability benefits. Despite improvements in health and life expectancy, the number of workers and their dependents receiving disability benefits increased to 8 million in 2004 from 3.9 million in 1985 because of weak earning opportunities for low-skilled workers and more expansive coverage of disabilities, according to research by Professor Autor and Mark Duggan of the University of Maryland.

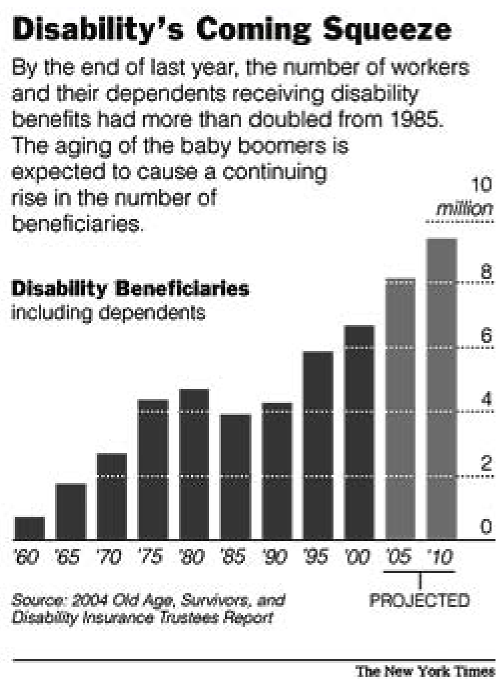
Unfortunately, research by various economists suggests that transforming the disability program to encourage work and self-sufficiency the way that welfare was transformed may not be possible. Susan Chen of Duke University and Wilbert van der Klaauw of the University of North Carolina at Chapel Hill recently produced the latest study of the work behavior of those whose applications for disability insurance were rejected. They argue that rejected applicants have better health and work prospects than accepted applicants, and, therefore, their experiences provide an upper bound on how well disability beneficiaries could be expected to fare in the labor market if they were not on the program.

The economists find that in the 1990's only a quarter of rejected applicants age 35 to 64 worked in the two years after their applications were denied. One objection to these results is that rejected applicants may refrain from working to strengthen a subsequent appeal for benefits, but Professors Chen and van der Klaauw found that the employment rate of rejected applicants was not higher if the window was expanded to 11 years after the application was denied.

A further indication that raising employment among the disabled is difficult comes from early results of the 1999 Ticket to Work program, a federal initiative that increases access to rehabilitation and employment services, gives providers of those services a stronger incentive to place participants in jobs, and makes it easier for beneficiaries to go back to work without immediately jeopardizing their benefits. Fewer than 1 percent of disability beneficiaries have used these new services.

From all appearances, disability beneficiaries are indeed a group largely incapable of substantial gainful employment, at least in the current labor market.

As President Bush barnstorms the country for his plan to convert part of Social Security into personal accounts, he should not overlook the consequences for the disability insurance program. Unfortunately, he did not heed the advice his Social Security Commission gave him three years ago and set up a "separate policy development process" to address the disability program.



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