



## Supporting Work:

### A Proposal for Modernizing the U.S. Disability Insurance System

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David H. Autor, Massachusetts Institute of Technology and NBER  
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*A paper jointly released by The Center for American Progress and The Hamilton Project*

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# Introduction and Summary

A wealthy, compassionate nation should have a fair and efficient disability insurance program that protects workers and their families from poverty and loss of medical care in the event of work-limiting disability. In the United States, the Social Security Disability Insurance (SSDI) program has played this role since its inception in 1956. Currently providing disability insurance to 152 million nonelderly Americans and paying monthly disability insurance benefits to 8.1 million workers with disabilities, the program has become a crucial piece of the U.S. safety net. Without this protection, the country would be substantially worse off.

However, SSDI is ineffective in assisting workers with disabilities to reach their employment potential or maintain economic self-sufficiency. Instead, the program provides strong incentives to applicants and beneficiaries to remain permanently out of the labor force, and it provides no incentive to employers to implement cost-effective accommodations that enable employees with work limitations to remain on the job. Consequently, too many work-capable individuals involuntarily exit the labor force and apply for, and often receive, SSDI.

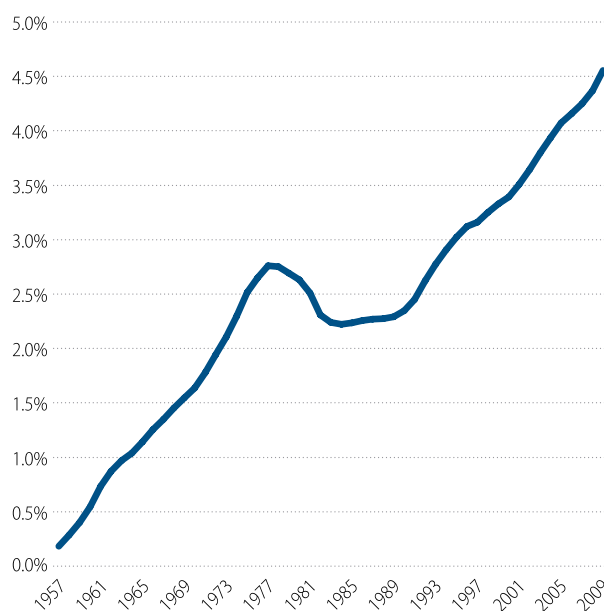
When Congress created SSDI in 1956, disability and employability were viewed as mutually exclusive states. As a result, the 1956 law defines disability as the “inability to engage in a substantial gainful activity in the U.S. economy”—in other words, the inability to work. The SSDI program still uses this definition, providing income support and medical benefits *exclusively* to workers who are out of the labor force and can-

not be expected to work in the future, as determined by the Social Security Administration (SSA).

The Social Security definition of disability may have been suitable five decades ago, when a substantial fraction of jobs involved strenuous physical activity, assistive technologies

FIGURE 1

Percentage of individuals receiving SSDI disabled worker benefits, ages 25–64, 1957–2009



Source: Social Security Administration (SSA), Table 5d3, available at <http://www.ssa.gov/policy/docs/statcomps/supplement/2010/5d.html>; Bureau of the Census, Census Population Estimates, available at <http://www.census.gov/popest/estimates.html>

were limited and crude, and medical interventions rarely significantly prolonged life or improved its quality. But today, individuals with work-limiting disabilities often can participate in the labor force and maintain economic self-sufficiency if given appropriate support. The Americans with Disabilities Act of 1990 (ADA) forcefully articulates this contemporary view of disability: “Physical or mental disabilities in no way diminish a person’s right to fully participate in all aspects of society... The Nation’s proper goals regarding individuals with disabilities are to assure equality of opportunity, full participation, independent living, and economic self-sufficiency for such individuals.”

The SSDI program’s failure to support the ongoing employment and economic self-sufficiency of workers with disabilities is, unfortunately, only one of two major policy challenges presented by the program. It also faces mounting expenses that it cannot sustain.

Between 1989 and 2009, the share of adults receiving SSDI benefits doubled, rising from 2.3 to 4.6 percent of Americans ages twenty-five to sixty-four (Figure 1). In the same interval, real annual cash transfer payments to SSDI recipients rose from \$40 to \$121 billion, and Medicare expenditures for SSDI recipients rose from \$18 to \$69 billion (Figure 2).

Due to its rapid growth, SSDI has come to encompass an ever-larger share of the Social Security system budget. In 1989, approximately one in ten Social Security dollars was spent on SSDI. By 2009, this number had risen to almost one in five Social Security dollars (18 percent), as shown in Figure 3. SSDI expenditures currently exceed the payroll tax revenue the program collects, and analysts project that the SSDI trust fund will be exhausted in 2018, twenty-two years ahead of the trust fund for Social Security retirement (the so-called Old-Age and Survivors Insurance, or OASI).<sup>1</sup> The rapid expansion of SSDI contributes significantly to the deteriorating financial health of the overall Social Security system since both depend on the Social Security payroll tax.

The expanding size and cost of the SSDI program would not be inherently problematic if this expansion reflected a rising rate of disability among working-age adults and if the program’s mounting expenditures enabled these individuals to maintain employment and self-sufficiency. Unfortunately, neither is the case. Figure 4 shows that the fraction of middle-age adults reporting a disability has been roughly stable

over the last two decades, averaging approximately 10 percent among both men and women. What has changed greatly, however, is the fraction of individuals who receive disability benefits. Figure 5 shows that between 1988 and 2008, the fraction of middle-aged men and women ages forty to fifty-nine receiving SSDI benefits rose by 45 percent among males (from 3.9 to 5.6 percent) and 159 percent among females (1.9 to 5.0 percent).<sup>2</sup>

This steep increase has coincided with a substantial decline in the employment rates of working-age individuals with disabilities. As documented in Figures 6a and 6b, the employment rate of males in their forties and fifties with a self-reported disability fell from 28 percent in 1988 to 16 percent in 2008 (approximately a 40 percent decline). The employment rate of comparably aged males without a disability held roughly constant at 87 to 88 percent. For females in this same age range with disabilities, the employment rate declined slightly (from 18 to 15 percent) while the employment rate of their counterparts without a disability rose from 66 to 76 percent.

The simultaneous occurrence of these two trends—declining employment among working-age people with disabilities and rising SSDI receipt—underscores that the two key policy challenges of the SSDI program are two sides of the same coin. The SSDI program is growing in size and cost because it is supporting a rising rate of dependency and a declining rate of labor force participation among adults with disabilities. In our assessment, addressing the twin policy challenges of poor incentives and mounting expenses will require amending the flawed incentive structure at its core. Unless and until the program’s incentives are realigned to discourage dependency and support work, SSDI is likely to continue expanding in size while reducing the employment of workers with disabilities.

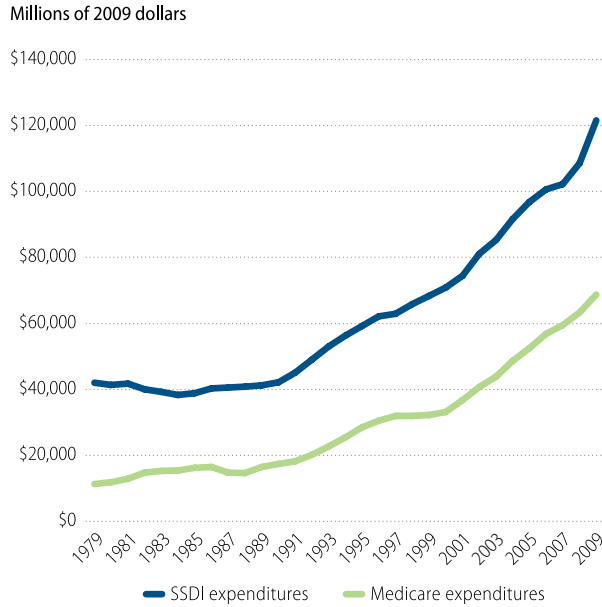
## Two non-explanations for the falling employment of individuals with disabilities

Is a rise in the incidence or severity of disability causing the declining employment rate of working-age people with disabilities? We see little evidence that the underlying health of the working-age population in the U.S. is deteriorating. For example, one of the most common and rapidly expanding diagnoses for individuals receiving SSDI awards is mental illness, which comprised more than 20 percent of SSDI awards over the past decade. A recent study in the *New England*



FIGURE 2

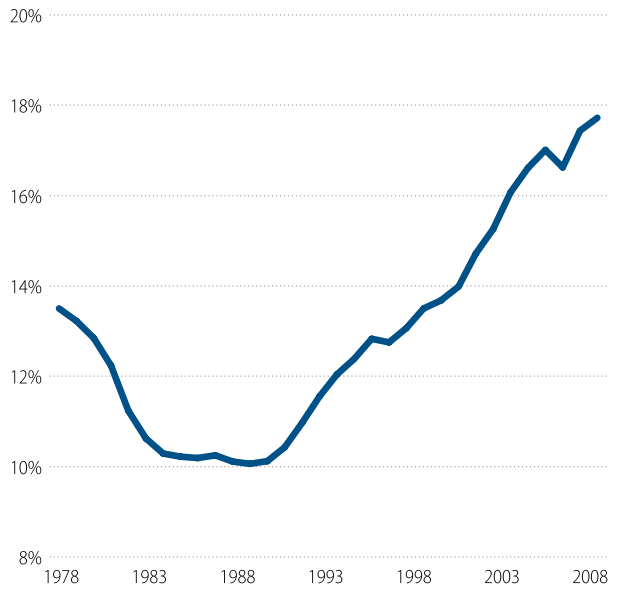
Real annual expenditures for SSDI Recipients, 1979-2009



Note: CPI Used to adjust to 2009 dollars. Source: SSA, Office of the Actuary, available at <http://www.ssa.gov/OACT/ProgData/funds.html>; Center for Medicare and Medicaid Services.

FIGURE 3

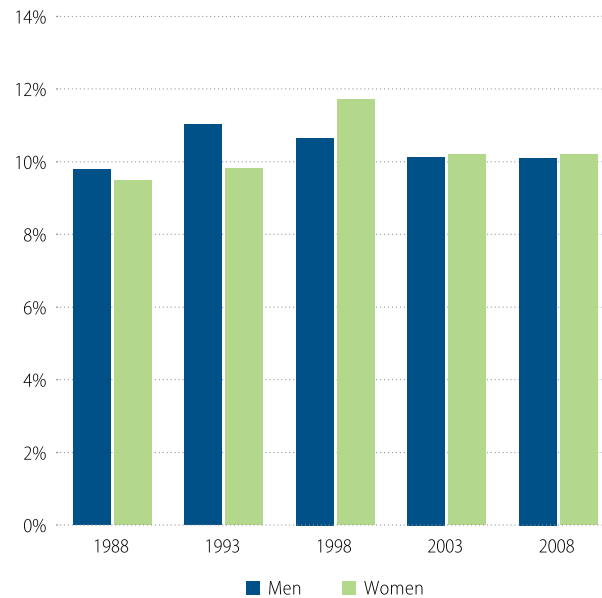
SSDI expenditures as a share of total OASDI expenditures, 1979-2009



Source: SSA, Office of the Actuary, available at <http://www.ssa.gov/OACT/ProgData/funds.html>

FIGURE 4

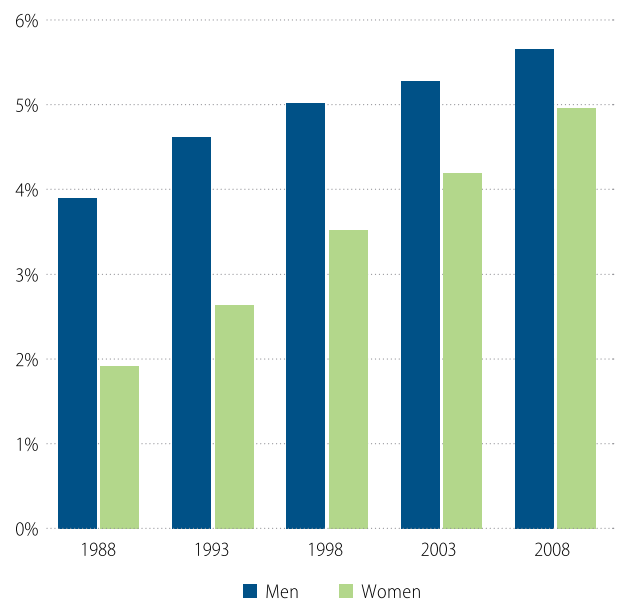
Percentage of people reporting a work-limiting health condition or disability, ages 40-59



Source: Current Population Survey (CPS), Census and Bureau of Labor Statistics (BLS), available at <http://www.nber.org/data/current-population-survey-data.html>

FIGURE 5

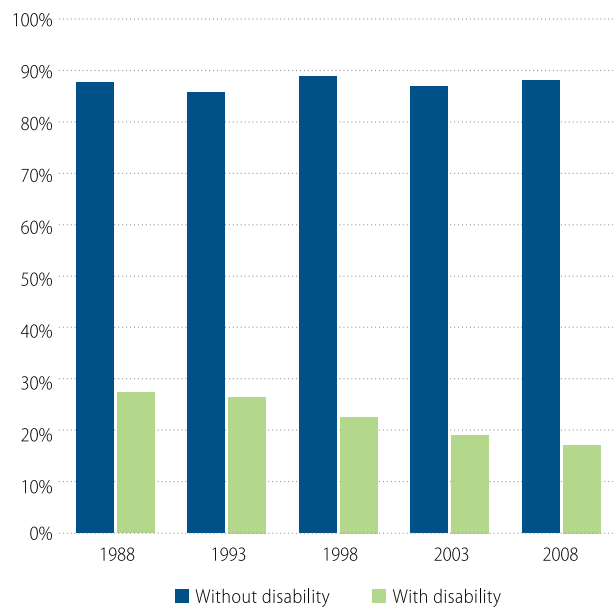
Fraction of individuals receiving SSDI benefits, ages 40-59, 1988-2008



Source: SSA, Annual Statistical Supplement; U.S. Census Data

FIGURE 6A

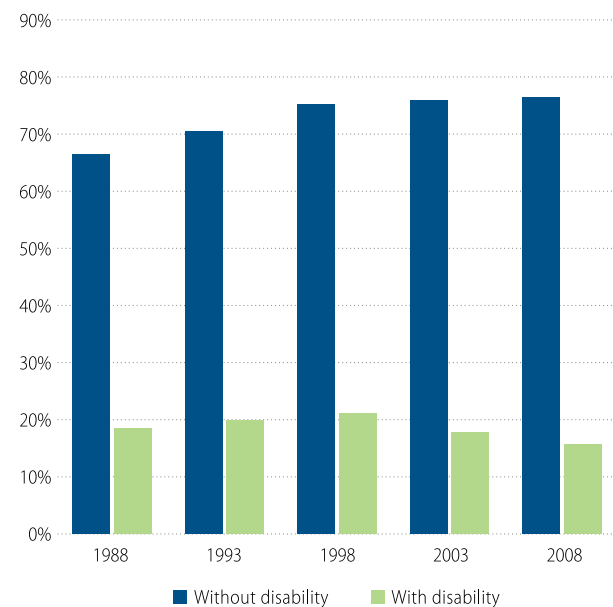
### Employment rates of men with and without disabilities, ages 40-59, 1988-2008



Source: CPS, Census and BLS, available at <http://www.nber.org/data/current-population-survey-data.html>

FIGURE 6B

### Employment rates of women with and without disabilities, ages 40-59, 1988-2008



Source: CPS, Census and BLS, available at <http://www.nber.org/data/current-population-survey-data.html>

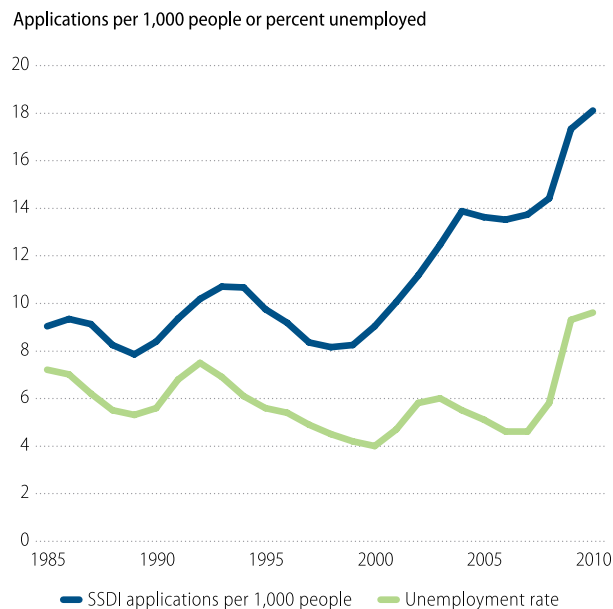
*Journal of Medicine* reports that the prevalence of mental disorders in the U.S. population was unchanged between 1990 and 2003. In the same interval, the rate of treatment of mental illness substantially increased—which in turn should have contributed to improved work-readiness among individuals coping with mental illness.<sup>3</sup>

Using self-reported health data from the National Health Interview Survey, Mark Duggan of the University of Maryland and coauthor Scott Imberman of the University of Houston find a substantial improvement between 1984 and 2004 in the average health of U.S. adults between the ages of fifty and sixty-four.<sup>4</sup> This age group is especially relevant because it accounted for 62 percent of all SSDI recipients in 2004. Reinforcing these conclusions, demographers Kenneth Manton and XiLiang Gu of Duke University find that the share of the population age sixty-five and older suffering from a chronic disability fell by one third between 1982 and 1999 (from 26.2 to 19.7 percent), with the largest drop between 1994 and 1999.<sup>5</sup> Thus, there is little reason to believe that the work capacity of adults with disabilities has declined in recent decades.

Nor are the adverse trends in the employment rates of Americans with disabilities due to mismanagement of the SSDI program by the SSA. The unfortunate interaction between the SSDI program structure and the employment rates of workers with disabilities is endemic to a program that legally only can provide income support and medical benefits to workers with disabilities who exit the labor force. Moreover, the recent deep recession and the secular deterioration in labor market prospects for non-college workers exacerbate these challenges. These job market trends have made it particularly challenging for workers employed in declining industries to obtain and retain employment. Previous research has established that workers are most likely to apply for SSDI benefits following job loss, a fact underscored by the pronounced positive relationship between the national unemployment rate and the SSDI application rate (Figure 7).<sup>6</sup> Thus, it is paramount that the United States' disability insurance system be reoriented toward supporting employment—opposite its current configuration.

FIGURE 7

### SSDI applications per 1,000 adults and U.S. unemployment rate, ages 25-64, 1985-2010



Source: SSA Annual Statistical Supplement, various years; 2010 data from SSA Office of the Actuary; BLS

### A proposal to modernize the SSDI program structure

This paper proposes a mechanism for modernizing the structure of the SSDI program to better support individuals with disabilities in the workplace, encourage their self-sufficiency, and reduce the dual wastes stemming from too few societal resources spent on assisting individuals with disabilities to remain employed and too many societal resources spent on supporting unnecessary long-term dependency. Even if this proposal does not succeed in reducing program expenditures, we believe it would still provide a net benefit to U.S. workers—both those who pay into the SSDI system and those who draw benefits from it.

### Three-part “front-end” package to accommodate workers with disabilities in the workplace

In brief, the systemic change that we propose is to add a “front end” to the SSDI system offering the following key provisions:

- workplace accommodations, rehabilitation services, partial income support, and other services to workers who suffer work limitations, with the goal of enabling them to remain in employment;
- financial incentives to employers to accommodate workers who become disabled and minimize movements of workers from their payrolls onto the SSDI system;

Our proposed reform does not seek to replace SSDI. We conceive of the current SSDI program as providing the long-term disability component (the “back end”) of a far more flexible and responsive disability assistance process. The structure of this proposed program would not affect current beneficiaries.

We model this three-part package of direct assistance to workers with disabilities and appropriate incentives for employers and employees on the U.S. workers’ compensation (WC) and unemployment insurance (UI) systems. These two programs support workers in the event of workplace injury and job loss, respectively, while discouraging workers from overusing benefits via appropriate screening. They also discourage employers from passing high costs onto the system by charging lower rates to employers that have a history of low claims costs—a practice known as experience rating. Our proposal would incorporate these features.

## Harnessing the private disability insurance system

Building this front-end capacity onto the large and overtaxed SSDI system would appear a daunting task. Rather than suggesting to create it by scratch, we propose to harness an existing, private-sector institution that currently provides large-scale employment support and work incentives to workers with disabilities as well as their employers. This institution is private disability insurance (PDI), which is sold to employers by private insurance carriers and provides a long-term disability policy for workers with disabilities.

Our proposal envisions extending PDI coverage to the vast majority of U.S. workers, in much the same way that UI and WC benefits are universally provided to workers who participate substantially in the labor market. PDI coverage under our proposal would form the first line of defense in the U.S. worker disability system. Its primary goal would be supporting work. Thus, in contrast to the traditional SSDI system—but similar to the PDI plans numerous employers purchase—it would treat disability and gainful employment as potentially compatible conditions rather than mutually exclusive states.

The proposed policy would support workers from 90 days to 2.25 years following onset of disability, providing partial income replacement and supports geared toward helping individuals maximize work readiness and self-sufficiency. After receiving PDI benefits for twenty-four months, individuals who are unable to engage in substantial gainful employment would transition into the SSDI system. The screening criteria for SSDI would be unchanged.

It is instructive to consider the average amount paid for private long-term disability coverage in the market at present. Using data from the Bureau of Labor Statistics on the average hourly cost of PDI coverage (\$0.04) and the fraction of workers with long-term disability coverage (32 percent), we estimate that the average policy costs approximately \$250 per year—about \$20 per month.

This is likely an upper bound on the average cost of policies under our proposal, as current PDI policies are, on average, significantly more generous than the one we propose. For

example, the median maximum monthly benefit of these policies is \$7,500, which is three times greater than the corresponding maximum in our plan. Additionally, our proposed coverage would pay benefits for a maximum of just two years, while existing policies are typically long-term and may provide at least partial benefits to the worker until he or she reaches full retirement age.

## Specifics of the PDI policy

We quickly summarize the nuts-and-bolts of the proposed universal PDI policy and follow with substantially more detail in subsequent sections:

- *What is the goal of the PDI policy?* The PDI policy would assist workers with work-limiting disabilities to remain in their current jobs or to transition to more suitable jobs and would assist employers to accommodate workers to perform their jobs in accordance with the guidelines of the ADA.
- *What conditions qualify?* Benefits under the policy would be triggered when sickness or injury limits a worker from performing the material and substantial duties of her regular occupation. Benefits would commence within ninety days of disability onset at the discretion of the employer and/or insurer.
- *What benefits are provided?*
  1. Vocational rehabilitation services.
  2. Workplace accommodations mandated by the ADA.
  3. Partial wage replacement equal to 60 percent of monthly salary and capped at \$2,500 monthly.
  4. Wage replacement at the state's UI replacement rate for workers who develop work-limiting disabilities while unemployed.

Note that PDI will *not* pay medical costs of disability. Under the Affordable Care Act of 2010, all workers will hold health insurance policies that cover medical costs.

- *How long can a worker receive benefits?* Benefits under the PDI plan would be limited to twenty-four months (twenty-seven months following onset of the disability).
- *When does traditional SSDI kick in?* Workers whose conditions continued to prevent employment in month twenty-two following onset would be permitted to apply for SSDI. This would allow a six-month period in which PDI benefits are paid while the worker awaits an SSDI determination.
- *What about severe disabilities?* SSDI would provide benefits almost immediately for medical conditions that are severe and readily diagnosed. Specifically, conditions covered by the SSA's List of Compassionate Allowance Conditions would be eligible for immediate SSDI application at the onset of the disability. The PDI policy would not shoulder claims costs except during the relatively brief Compassionate Allowance determination period.
- *What would a PDI policy cost?* Using data on the average hourly cost of PDI plans currently sold (\$0.04), we estimate that the policy would cost approximately \$20 per worker per month. This is less than 5 percent of the cost of a typical employer-provided individual health insurance plan. At present, workplace PDI policies cover 32 percent of U.S. workers, and these policies are almost invariably more generous than the policy outlined above. In these cases, the PDI plan would not have any cost implications. The PDI policy proposal should ultimately reduce total employee and employer disability insurance costs by assisting some workers with work-limiting disabilities to remain in the labor force rather than becoming long-term beneficiaries of the SSDI system.
- *Would all employers have to buy insurance?* The PDI policy would take the form of a disability policy carried by and paid by employers. Employers would be allowed to require employees to pay up to 40 percent of the cost of their coverage. Policies would be competitively sold, and employers would have the option to self-insure. Premiums would be experience-rated for firms with fifty or more full-time equivalent employees. Premiums for smaller firms would be industry-rated. Insurers would be allowed to vary the

premium with the average age of employees at a firm as well as with firm industry.

## Is the proposal realistic?

Such coverage would of course not come for free, and readers will naturally be concerned that the policy proposal would impose substantial costs on employers and employees. Several considerations assuage this concern:

- The universal PDI plan that we envision would offer more limited—and hence less expensive—coverage than most PDI plans private-sector employers currently purchase. For employers offering more generous coverage, our policy proposal would be entirely non-binding.
- The proposed universal PDI coverage would shield employers from catastrophic insurance costs. Under our proposal, PDI policies would hand off responsibility for ongoing disability coverage to the traditional SSDI program two years following the onset of disability. While employers will face a financial incentive to reduce PDI claims, they will not be exposed to the long-term costs of a permanent, work-limiting disability.
- Five U.S. states already mandate that employers provide temporary disability insurance to their workers.<sup>7</sup> Although little studied, the available data on these mandates suggest that they have not substantially hindered labor market operation but have provided valuable insurance to workers. While our proposal is more expansive than these state programs, it has a similar flavor. There are also international precedents. Faced with a disability system that was growing inordinately large and expensive, the Netherlands implemented a programmatic change that is similar to what we envision. While it is too early to render a final judgment, inflows into the Dutch disability system have fallen substantially since this reform.<sup>8</sup>
- Alongside lost income, medical care is one of the most costly aspects of disability. Private-sector disability policies do not pay for medical care. Instead, they serve to partially insure lost earnings as well as reimburse workplace accommodations and certain rehabilitation services that a traditional health insurance plan would not cover. Our proposed PDI coverage likewise would not cover medical care. Such

coverage is unnecessary because health insurance is slated to become nearly universal and much more affordable for American workers over the next several years as a result of the recently enacted Patient Protection and Affordable Care Act.<sup>9</sup>

- We anticipate that reduced demands on the traditional SSDI program ultimately will counterbalance the upfront costs of providing universal PDI coverage, in part or in full. The present value of an average SSDI award, including the Medicare coverage that comes with it, is approximately \$270,000 in 2009 dollars.<sup>10</sup> If universal PDI coverage successfully enabled individuals with work-limiting disabilities to remain in the labor force, this would avert very large expenses elsewhere in the disability system. It bears emphasis that we believe workers with disabilities would be better served by such a system.
- The expected per-worker policy cost of universal PDI coverage is surprisingly modest, in the range of \$150 to \$250 annually. As a reality check, we have benchmarked this number against current PDI premium costs a leading PDI insurer charges. The cost estimate that we offer is in line with current private-sector policy costs.

### How much might employment among non-elderly workers with disabilities rise?

Currently about 80 million Americans are between the ages of forty and fifty-nine. Based on the survey data tabulated in Figure 4, we estimate that about 10 percent of these individuals have a work-limiting medical condition. Relative to individuals of the same age without a work-limiting medical condition, their employment rate fell by approximately 11.5 percentage points between 1988 and 2008 (Figures 6a and 6b).<sup>11</sup>

If, hypothetically, the proposed policy returned the employment rate of work-limited individuals in this age group to its 1988 level, close to one million working-age individuals would return to the workforce. If work-limited individuals in their thirties and early sixties, who have contemporaneously seen similar relative declines in employment, were included in the calculation, the numerical employment gains would be higher still—in excess of 1.5 million.

In our view, an intervention that allowed 1 million–1.5 million work-limited individuals to remain in the labor market would represent a substantial welfare gain for these individuals as well as their families, employers, and society at large. It would also potentially generate considerable savings for the SSDI program. Let us assume, plausibly, that half these work-limited individuals would otherwise be receiving SSDI benefits—between one-half and three-quarters of a million individuals. This represents between 6 and 10 percent of the current SSDI beneficiary population (representing between 12 and 18 billion dollars in annual SSDI expenditures).

While this calculation is speculative, there are a number of reasons to think it is conservative. First, we see no reason to believe that merely reversing the employment losses of the last two decades among adults with work-limiting disabilities presents an upper limit on what is achievable. The proposed policy would offer substantial assistance to work-limited individuals who remain employed; such supports have never been broadly available to Americans with disabilities. In addition, the universal health care coverage extended by the Affordable Care Act of 2010 should make it feasible for work-limited individuals with costly medical conditions to obtain and retain health insurance. This reduces their incentive to seek SSDI benefits to obtain Medicare. Finally, we anticipate that ongoing advances in assistive technology, made available to workers with disabilities through the ADA accommodation component of the PDI policy, will reduce the share of workers whose work-limitations become disabling. These considerations suggest that there is considerable headroom for increasing the fraction of work-limited individuals who are able to enjoy the benefits of employment.

### Proposal strengths should outweigh complexities and unknowns

Numerous complexities and unknowns will affect the implementation, operation, and cost of this proposal. We do not claim to have addressed all these complexities, though we do hope to refine our proposal as these complexities come into focus. Nevertheless, we believe the proposal has five strengths that make it worth pursuing:

- It supports work and thereby has the potential to slow inflows into the SSDI program. Slowing these inflows, in our view, is the only way to reduce the growth and expense of the SSDI program over the medium and long run.
- It builds on an extant, commercially successful, and widely-used capacity for supporting workers with disabilities in ongoing employment as well as providing employers with the incentive to accommodate otherwise work-capable workers and reduce the societal costs of disability.
- It preserves the key elements of the SSDI program that work well—specifically, providing long-term wage replacement and medical benefits to individuals who cannot be expected to reenter the labor force. Similarly, the proposal does not seek to shrink the SSDI system by terminating benefits to incumbent beneficiaries. We believe that such an approach would be unwise and infeasible.
- It profoundly reshapes the public assistance offered to workers with disabilities to make their treatment consistent with the values that we believe the vast majority of Americans hold and that federal law articulates: “The Nation’s proper goals regarding individuals with disabilities are to assure equality of opportunity, full participation, independent living, and economic self-sufficiency for such individuals.”
- It reduces the adverse selection problem that employers currently face when considering whether to offer PDI coverage to their workers. An employer that offers PDI coverage at present faces some risk that this coverage will differentially attract workers with disabilities, which will in turn lead to correspondingly higher claims rates and policy premiums. This adverse selection may be one reason that employer-based PDI coverage is only offered to one-third of U.S. workers at this time. Requiring all employers to offer such coverage, as is currently the case with unemployment insurance and workers’ compensation insurance, will eliminate this adverse selection problem.

The policy proposal proceeds as follows. We begin by explaining why we believe the current SSDI program structure encourages escalating disability expenditures and reduced labor force participation among adults with disabilities. We next discuss why prior reforms to the SSDI program that were intended to raise labor force participation of beneficiaries and slow program growth have been almost wholly unsuccessful. We then lay out our proposal in detail and discuss numerous practical design considerations, including cost estimates, implementation challenges, and areas of uncertainty that pilot studies potentially can address.

## How the Current SSDI Program Design Discourages Employment

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At present, a worker with a disability seeking income and medical benefits from the SSDI program is subject to a disability determination process that has three undesirable features. First, the program is unable to move rapidly to support workers experiencing work-limiting disabilities who wish to maintain employment. An SSDI award takes more than a year on average to obtain; in the interim, the applicant receives no assistance from the program. Arguably, the first months following the onset of a disability are when expert assistance might have the greatest efficacy in enabling an individual to adapt to their disability while maintaining employment.

Rather than assisting workers with disabilities to stay employed, however, the SSDI program effectively bars them from participating in the workforce while seeking benefits. By law, the SSDI program can only award benefits to those who are “unable to engage in a substantial gainful activity.” Hence, workers who participate in significant employment during the application period, even on a trial basis, are automatically denied benefits. This is the second undesirable feature of the disability determination process.

The rationale for this program feature is not hard to understand: by requiring that only non-workers be considered for benefits, Congress reduced the incentive for individuals who are capable of working to apply for SSDI benefits. Quitting work is a costly and risky proposition. This rule did not appear to pose a trade-off when the SSDI program was enacted in 1956 since disability was viewed as an all-or-nothing condition.

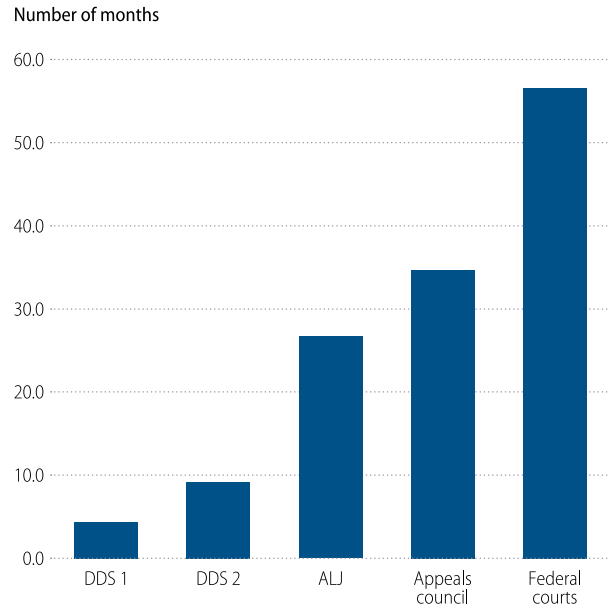
From the contemporary perspective, however, this requirement is costly. Workers coping with a work-limiting disability face a choice between striving to remain in the labor force while receiving no income or medical support from the public disability insurance system or effectively forgoing efforts at maintaining employment and self-sufficiency so as to be eligible for SSDI consideration. This potentially creates a catch-22 for workers who develop health limitations that are significant but not necessarily career-ending: it may be difficult or infeasible for them to remain employed and economically self-sufficient absent disability assistance, but it is not possible for them under the current SSDI program to obtain this assistance without first leaving the labor force.

The third undesirable feature of the SSDI determination process is that it is lengthy. Figure 8a depicts the average cumulative durations of each stage of the SSDI application process. The flow chart in Figure 8b shows the percentage of applications allowed, denied, and appealed if denied at each stage of the process. In recent years, approximately 35 percent of SSDI applicants have been awarded benefits at the first stage of applications. The average time to a decision in this stage of the process is 4.3 months. More than half of the 65 percent of applicants rejected at this stage appeal their decision. This appeal leads to a reconsideration, which takes five months on average. This lengthy reconsideration process is mostly pro forma, however. The SSA only awards 10 percent of appeals at this stage.



FIGURE 8A

Cumulative average processing time in 2006 by stage of the application process for SSDI and SSI disability applications



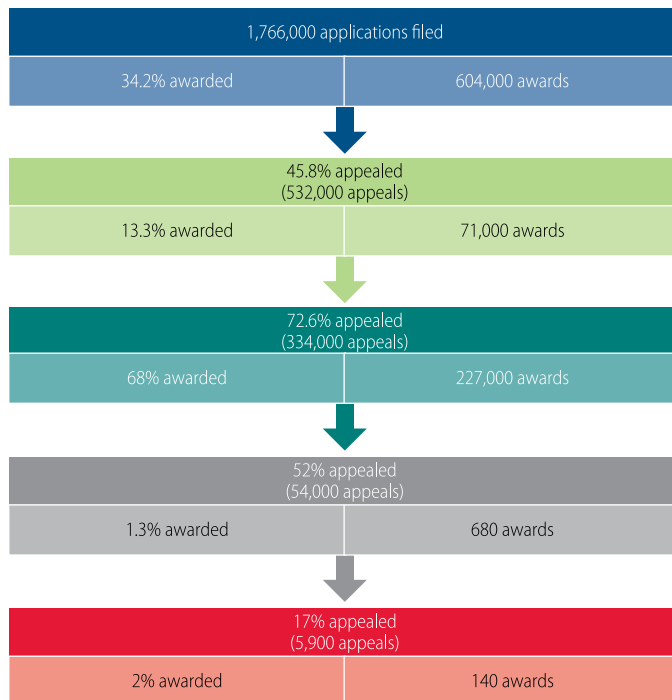
Source: SSA Office of the Inspector General, "Audit Report: Disability Claims Overall Processing Times," (December 2008).

The vast majority of applicants who are rejected at the reconsideration stage appeal their rejection. They ultimately appear before an administrative law judge (ALJ) who adjudicates their claim. The average wait time from the initial application to an ALJ decision is two years and three months. Notably, ALJs overturn SSA's initial rejections in approximately 75 percent of cases that reach them. As documented by economists Eric French of the Federal Reserve Bank of Chicago and Jae Song of the Social Security Administration and shown in Figure 9, there is substantial variation across ALJs in the award rate. Of ALJs with more than 100 decisions, one-quarter have awarded less than 55 percent of appeals and one-third have awarded more than 75 percent.<sup>12</sup> Many of those rejected at the ALJ stage will appeal again, first to the federal appeals council and ultimately to the federal courts, with average overall processing times of thirty-five months and fifty-seven months, respectively.

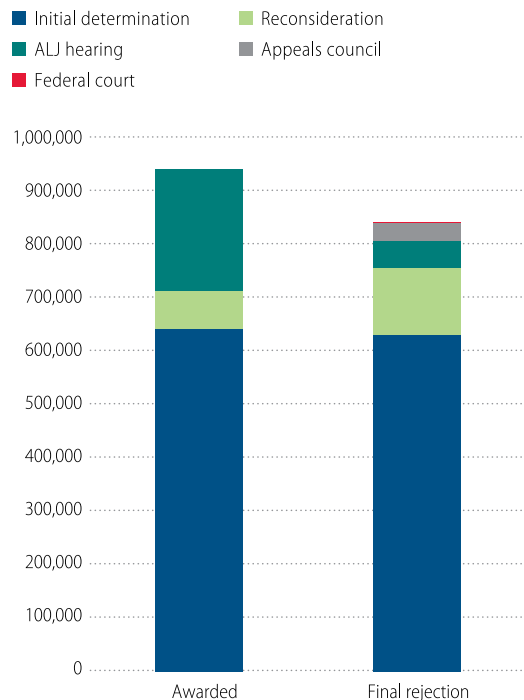
FIGURE 8B

SSDI benefit allowance and appeals process, 2005

A. Applications, appeals, and awards by determination stage



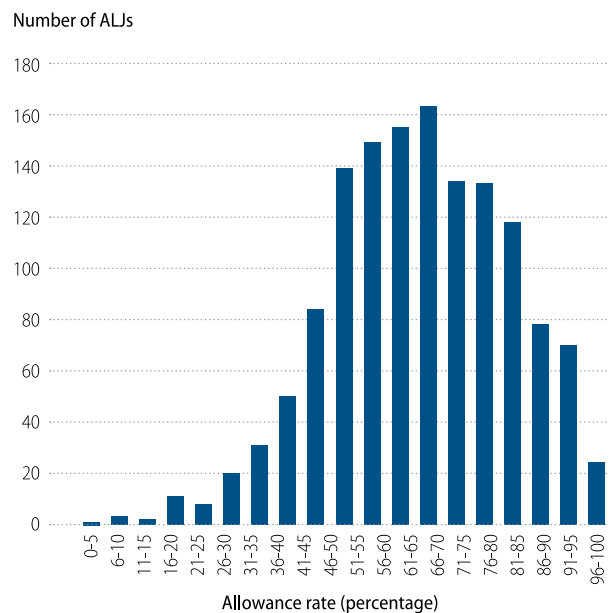
B. Final disposition of applications by determination stage



Source: SSA

FIGURE 9

### Distribution of ALJ allowance rates, FY 2010, 100 decision minimum



Source: SSA

The net effect of these many stages of adjudication is that those awarded SSDI benefits wait an average of 12 months for an award, and almost 40 percent of awards are made on appeal. During the applications and appeals process, claimants receive no income support, workplace accommodations, or medical benefits from the SSDI program. But they face strong incentives against participating in the labor force—even on a trial basis—since evidence of gainful employment would disqualify their claim.

### Benefits of early intervention

While waiting is intrinsically costly for applicants with pressing medical and financial needs, applicants who might be able to continue working with the aid of prompt intervention bear the greatest costs in forgone employment. At present, SSA is able to render a decision rapidly under its Compassionate Allowance program for applicants who have severely disabling disorders.<sup>13</sup> By contrast, the cases that are most difficult for SSA to adjudicate—and hence those that are most likely to be decided on appeal—are those of comparatively younger

adults who are suffering from what are commonly called subjective and non-verifiable disorders. These disorders include mental illness, musculoskeletal disorders (for example, back pain), and soft tissue pain. Such disorders are intrinsically difficult for medical professionals to verify and, consequently, the evaluations are heavily reliant on patient self-reports.<sup>14</sup>

If appropriate supports were provided, such disorders could potentially be accommodated in the workplace. These disorders are not generally life-threatening, nor are they intrinsically incompatible with ongoing employment. Unfortunately, applicants with these disorders are unlikely to meet SSA's screening criteria. Consequently, they are especially likely to be rejected at the initial determination stage. Naturally, rejected applicants often will appeal these determinations because they may believe that SSA has not given due weight to their impairments, and they are aware that persistent appeals result in awards in more than two-thirds of cases. As these determinations extend over many months and, in many cases, two or three years, the best opportunity for these work-limited individuals to reintegrate into the workforce is lost; skills and job connections atrophy, and the likelihood that the work-limiting disability becomes career-ending rises (even if SSDI benefits are not ultimately awarded).

### SSDI determination process undermines applicants' work capability

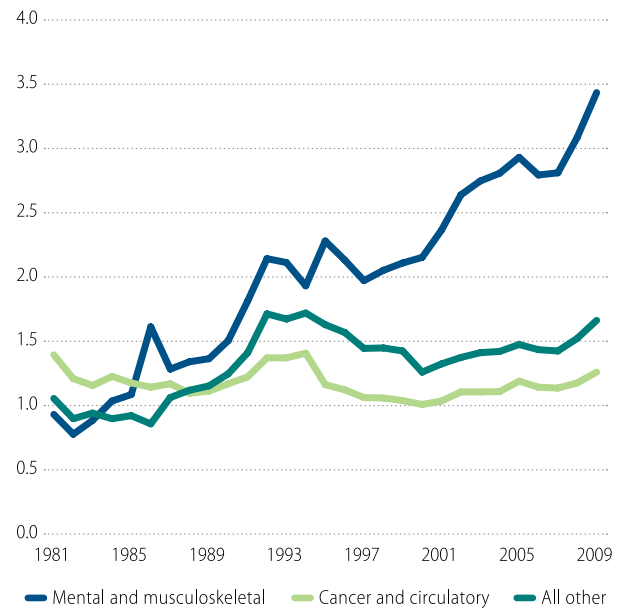
The economic costs of prolonged disability determinations would not loom large if these cases were infrequent. However, they are now the majority of the cases SSA considers. As shown in Figure 10, mental and musculoskeletal disorders currently comprise 54 percent of all SSDI awards, and this share has been trending up for decades. In 1981, only 27 percent of all SSDI allowances were made for mental and musculoskeletal disorders. Recent research by economists Till von Wachter of Columbia University, Jae Song of the Social Security Administration, and Joyce Manchester of the Congressional Budget Office finds that such claims are most frequent among young applicants and are most often decided at the hearing level.<sup>15</sup> These researchers also document that applicants with these disorders appear to have the greatest potential for ongoing labor force participation, whether or not they are awarded SSDI benefits.

On net, the SSDI determination process unintentionally but nevertheless effectively undermines the work capability of individuals with disabilities by failing to provide supports when they might be most effective, barring work during the application process, and requiring an extended period of non-employment while a determination is rendered. If the SSDI determination leads to an SSDI award, the claimant faces strong ongoing incentives to refrain from substantial labor force participation so as to maintain benefits.<sup>16</sup> If the SSDI claim is denied, the claimant faces the daunting prospect of returning to the labor market after many months or even years of extended absence.

It is difficult to overstate the role that the SSDI program plays in discouraging—or, if reconfigured, fomenting—the ongoing employment of non-elderly adults. During the past three years, the SSA has received more than 8 million applications to the SSDI program, representing more than 5 percent of the U.S. labor force. Recent research suggests that, if anything, these application rates will grow further in the years ahead, as for example the shrinking value of Social Security’s retired worker benefits makes SSDI more attractive.<sup>17</sup> Preventing work-limiting disabilities from needlessly ending careers and, by the same token, adding significantly to the public debt, requires reforming the nation’s disability insurance system so that it better supports work rather than encouraging dependency.

FIGURE 10

SSDI awards per 1,000 insured by diagnosis, 1981-2009



Source: SSA, DI Annual Statistical Report; SSA, Office of the Actuary

# Why Past Efforts to Reform the SSDI Program Have Failed

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SSA administrators and the U.S. Congress have attempted to slow or reverse the growth of the SSDI program over the past fifty years with three categories of reforms: tightening the program's screening criteria; aggressively removing beneficiaries deemed work-capable from the rolls; and providing financial incentives for current beneficiaries to return to the workforce. None of these efforts has had a lasting impact on the program's growth trajectory, nor have they slowed the steady decline in the labor force participation of adults with disabilities (Figures 6a and 6b). We believe that these efforts have been largely fruitless because they make one or more fundamental mistakes: limiting SSDI awards by denying applicants rather than reducing applications; revoking benefits of individuals who have no other means of financial support; and reducing the penalties for gainful employment when these penalties are, by and large, too late to matter. We briefly review the history of SSDI reforms below to highlight how reforms should not proceed.

## Public backlash against Reagan-era program retrenchment

During the first twenty years of its existence, SSDI experienced steadily increasing enrollment, as shown in Figure 1. Partly in response to concerns that the program was growing beyond its appropriate size, Congress introduced a series of reforms in the late 1970s to tighten the program's medical eligibility criteria. Shortly after President Ronald Reagan took office in 1980, the administration enhanced the stringency of these criteria. The popular press widely reported this pro-

gram retrenchment. Partly in response, the number of SSDI applicants declined by 19 percent in the two years between 1980 and 1982. Simultaneously, SSA vigorously pursued so-called Continuing Disability Reviews with the goal of removing from the rolls beneficiaries they judged to be no longer disabled. Nearly 40 percent of these reviews led to benefits revocation, with the fraction of recipients dropped from the program nearly tripling from 2.2 percent in 1980 to 6.1 percent in 1982 (Figure 11).

Unfolding against the backdrop of a deep national recession with an unemployment rate exceeding 10 percent, SSA's summary revocation of the income and medical benefits of tens of thousands of SSDI beneficiaries provoked a fierce public backlash. Congress responded in 1984 by reversing and then further liberalizing the 1980 changes to the program's medical eligibility criteria. Perhaps most critically, Congress made it substantially easier for applicants with subjective and non-verifiable disorders—most importantly, pain and mental illness—to qualify for SSDI benefits.<sup>18</sup> Thus, the net effect of the retrenchment was to make SSDI benefits accessible to a larger set of claimants.

## 1996 clampdown on drug and alcohol addiction

More recent efforts to terminate benefits for current beneficiaries have had a similar trajectory. Following passage of a 1996 law outlawing the provision of SSDI benefits for drug and alcohol addiction, the SSA removed from the rolls

approximately 130,000 beneficiaries whose primary impairment was drug and alcohol addiction. It is estimated that in the ensuing years, two-thirds of these terminated claimants eventually requalified for SSDI benefits under other impairments, primarily mental illness.<sup>19</sup>

The examples of the 1980s SSDI retrenchment and the 1996 clampdown on drug and alcohol addictions suggest that efforts to reform the SSDI program by simply tightening the program's medical eligibility criteria or aggressively terminating beneficiaries are unlikely to succeed in slowing program growth or raising the employment rates of individuals with disabilities. The reasons are twofold. First, revoking benefits en masse from needy beneficiaries could cause significant suffering and is not politically viable, whether or not this would be desirable from an efficiency standpoint. While SSA should periodically review the eligibility of current beneficiaries, the goal of such reviews should be to reduce fraud, not to "right-size" the program.

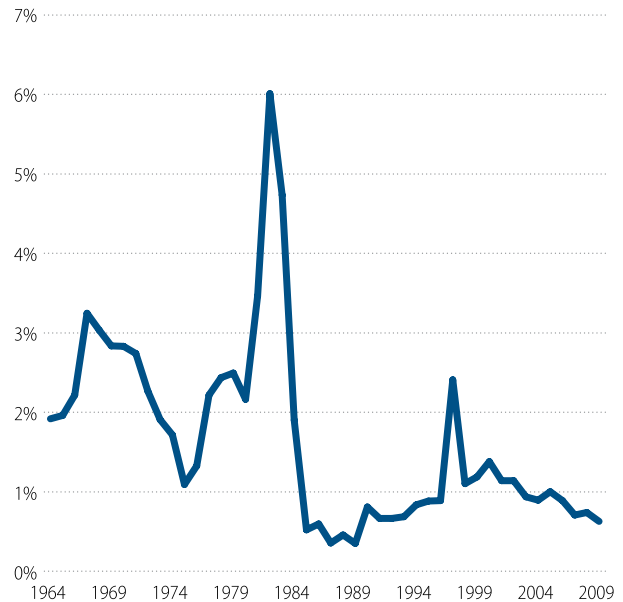
The second lesson, evident from the drug and alcohol addiction experience, is that highly-motivated applicants in many cases eventually will succeed in obtaining benefits, particularly because of the 1984 liberalization of the criteria for pain and mental illness. While this latter observation highlights that the SSDI disability determination system is also in need of review, our main conclusion is that better gatekeeping cannot be the centerpiece of effective SSDI reform.

### Ticket to Work program

It appears plausible that SSA and Congress have learned their lesson from prior ineffective sets of reform. More recent reforms to the SSDI program have focused on improving the incentive for SSDI recipients to rejoin the workforce. In 1999, Congress authorized the Ticket to Work program, which permitted SSDI beneficiaries to engage in a trial work period of up to nine months without forfeiting their benefits, provided them with eight years of ongoing Medicare eligibility following return to work, and guaranteed three years of automatic benefit reinstatement if claimants' workplace earnings fell below the Substantial Gainful Activity threshold. Each step reduced the implicit tax imposed by the SSDI program on beneficiaries' labor force participation. Despite these incentives, fewer than 1,400 tickets (0.01 percent) of 12.2 million

FIGURE 11

### Percentage of SSDI recipients leaving program for not meeting medical criteria, 1964-2009



Source: SSA, Annual Statistical Supplement, various years

tickets issued in the first seven years of the Ticket to Work program led to successful workforce integration.<sup>20</sup> And as shown in Figure 11, the medical recovery rate on SSDI has trended steadily downward over the last decade.

At present, SSA's policy efforts are focused on a Benefits Offset policy for SSDI beneficiaries, which Congress mandated that SSA study as part of the Ticket to Work authorization. Under this policy, an SSDI recipient's benefits would be reduced by \$1 for every \$2 of earnings above a disregard amount, following a trial work period and a grace period. Thus, SSDI recipients would be able to keep fifty cents of every dollar of benefits for every dollar of labor earnings. The goal of this policy, as with the previous Ticket to Work provisions, is to stimulate workforce reentry by current SSDI beneficiaries by reducing the penalties to working.

While we laud the objectives of the Benefits Offset policy, we suspect that it will be at best moderately more successful than the prior components of the Ticket to Work program. The simple reason is that the financial inducements (or, more precisely, penalty reductions) for workforce reentry under such a policy arrive too late to be relevant for the bulk of SSDI

beneficiaries, including those who might have been able to work at the time benefits were awarded. After individuals have been out of the workforce and receiving benefits for several years, their readiness and enthusiasm for reentering the labor market are likely to have severely eroded. The best chance for assisting these individuals to remain in the labor force will likely have passed several years earlier.

Our conclusion from this brief review of thirty years of SSDI reform efforts is that an entirely different approach is needed to increase the employment of individuals with disabilities and stem the growth in program enrollment and expenditures. Specifically, we believe that the goal of SSDI reform should be to increase the odds that individuals with work-limiting disabilities remain in the labor force. This will raise their well-being and reduce the odds that they apply for long-term SSDI benefits. The cost savings that we envision under this proposal accrue from better supporting individuals with disabilities in the workplace rather than denying them benefits months or years after they have exited the labor force.

# Supporting Work: A Policy Proposal

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The proposed reform will change the SSDI process in two critical ways: by accelerating the process of disability assistance and providing a mechanism for employer responsibility.

## Accelerating the process of disability assistance

Disability assistance under our proposal will commence within ninety days of disability onset—while the worker is still employed—with the goal of accommodating and redressing the disability before it leads to job loss and labor force withdrawal.

Early intervention leverages the existing economic and social ties between the worker, the employer, and his or her coworkers in service of supporting the worker’s ongoing employment. The importance of these ongoing ties is hard to overstate. It is a widely-shared view among vocational rehabilitation practitioners that maintaining the worker’s link to the current employer is critical to successful labor force reintegration; once the current employment tie is severed, the hurdle to reentering becomes substantially higher.

## Providing a mechanism for employer responsibility

The proposed reform would provide employers with an incentive to recognize the costs that their decisions whether to accommodate workers with disabilities have on the broader disability system. As with unemployment insurance and workers’ compensation, the proposed policy would provide employers with economically meaningful signals on the costs of their actions. It would, however, strictly limit their expo-

sure to the potentially substantial costs of a work-limiting disability. The SSDI system would continue to bear the bulk of the cost and risk of work-limiting disabilities.

Under the Americans with Disabilities Act, employers are required to provide “reasonable accommodations” to allow their employees with disabilities to perform essential job functions and enjoy the benefits and privileges of employment. In practice, the requirement is difficult to enforce because the definition of a “reasonable accommodation” is not clear-cut and many workers will not have the wherewithal to ensure that their legal protections are respected.<sup>21</sup>

Under our proposal, private disability insurers, contracted by employers, will ensure that employers comply with the ADA in the event of a work-limiting disability, pay for reasonable accommodations, provide limited and temporary income replacement to workers with disabilities, and assist employers to limit the cost of disability claims through cost-effective interventions. Employers also will have the option to apply for the right to self-insure, as many large firms currently do for health insurance, rather than contract with a private insurer for this coverage.

These insurer and employer costs will be time-limited and not prohibitively expensive, either on average or in any specific case. Employers will, however, face an incentive to minimize the economic costs of disability to keep their insurance premiums low. As we shall discuss, preemptively terminating workers with disabilities will not be a cost-effective way to minimize costs. This is because a worker’s employer-based PDI policy will remain in force for up to a year following the date of job termination.

## Proposal for private disability insurance

Box 1 details the basic provisions of the private disability insurance policy that we envision. The proposed PDI policy is closely modeled on existing private long-term disability policies that are already widely in use, with two key differences. First, the proposed policy will have lower maximum benefits and a shorter duration than most policies already in force. Second, the policy will be more tightly integrated with the SSDI system than existing policies, including provisions for managing a worker's transition from PDI to SSDI if needed and provisions whereby SSDI will assume liability immediately for workers with severe and unambiguously disabling impairments. This proposed PDI policy would serve as a floor, not a ceiling, on what employers could offer to their workers. At present, most U.S. workers covered under private disability insurance already have much more generous coverage.

After describing these provisions, we turn to cost estimates and implementation issues. Note that the cost of the proposed PDI policy is modest for reasons that we discuss below. Preliminary calculations using premium data from private-sector private disability plans suggest that the annual policy cost will be under \$250 per worker for most employers.

### Policy triggers

The policy's benefits are triggered when a worker, whose coverage has vested, develops a medical condition that inhibits her from performing her normal job functions. The condition must be medically documented, and the worker must notify the employer and the PDI insurer of the condition. Ninety days after the onset of the documented disability, the worker would become eligible for benefits.

During this ninety-day period, the worker, employer, and insurer could develop a strategy to pursue appropriate medical treatments that would allow her to return to work in the near future. In many cases, the worker's health might improve sufficiently quickly that PDI policy would not pay any benefits. It is also worth noting that many employers might also offer short-term disability coverage, and thus some workers might receive cash benefits during the ninety-day waiting period.

## Covered conditions

The medical eligibility criteria for PDI coverage would be less stringent than those SSDI uses: that the person is "unable to engage in substantial gainful activity because of a medically determinable physical or mental impairment that is expected to last at least 12 months." The PDI policy would strike the requirement that the impairment must have an expected twelve-month duration. The previously mentioned variation across ALJs in their award rates suggests that different individuals can have different interpretations of this standard. It therefore would be important to provide insurers with the necessary information to have consistent and reasonable standards.

Insurers also would be free to use more lenient medical eligibility criteria than those the proposed policy mandated. Applying more lenient standards could be a profit-maximizing policy for insurers, as early interventions might improve a person's health and keep them in the labor force. People who were denied by their insurer would have the option to appeal to a state agency, just as individuals can do currently with workers' compensation claims.

Individuals with extremely disabling conditions (e.g. stroke, late stages of certain cancers, etc.), with very limited prospects of returning to the workforce, could be permitted to apply immediately to SSDI. As noted, SSA's Compassionate Allowance program provides expedited decisionmaking for eighty-eight conditions that almost always result in an SSDI award. Similar exceptions could (and should) be made in the proposed PDI policy, though care would need to be taken to ensure that this was a rare occurrence and only warranted in clear-cut cases.

### Benefits provided

The PDI policy would cover three categories of benefits: vocational rehabilitation, workplace accommodations, and partial wage replacement. All three are part of the standard package of benefits provided by private disability insurers.

Vocational rehabilitation is a set of services intended to enable individuals with disabilities to maintain or regain employment. Such services can include:



## BOX 1

## Key provisions of the proposed PDI policy

### Policy triggers

- A health limitation prevents worker from performing normal job functions
- Worker obtains medical documentation and notifies employer and PDI insurer
- 90 days after onset of disability, benefits commence (earlier at discretion of insurer)

### Conditions covered

- Covered: Objectively verifiable disorders that limit work
- Covered: Work-limiting subjective and non-verifiable disorders (soft-tissue pain, mental illness) in accord with standard PDI practices
- No coverage: Parental leave, eldercare and family-care duties

### Benefits provided

- Vocational rehabilitation services
- Workplace accommodations mandated by ADA
- If employed: Partial wage replacement of 60 percent of monthly salary capped at \$2,500 per month (indexed to SSA wage index). Note that \$2,500 is 60% of monthly pay of \$50K/yr worker
- If not currently employed: Partial wage replacement at state unemployment insurance (UI) rate
- Medical costs are not covered by PDI (paid by health insurance)

### Premium payments

- Employer pays premiums to PDI insurer (group coverage)
- Up to 50 percent of premium may be charged to earnings
- Two months of premiums are paid in each of the first 12 months of employment. (After one year of employment, worker has full additional year of pre-paid coverage)
- Continuation after pre-paid coverage expires—COBRA or state pool

### Waiting period and benefits time limits

- Coverage vests on 91st day of employment
- First possible benefits payments 180 days after employment begins
- Benefits provided for up to 24 months (27 months following disability onset)

### Backstop provisions for SSDI

- Severe disabilities that fall under SSA's Compassionate Allowance guidelines are eligible for SSDI application at onset
- Benefits for backstopped disabilities paid by PDI up to 90 days (to allow for SSDI determination)

### Handoff Provisions to SSDI

- Worker may apply for SSDI 21 months after onset of disability (18 months into PDI benefits)
- PDI insurance benefits terminate 27 months after onset of disability (earlier if Compassionate Allowance)

- Diagnostic evaluations
- Interest and aptitude testing
- Counseling and guidance
- Supported work
- Skills training
- Job coaches and tutors
- Vehicle modifications
- Housing modifications
- Assistive and rehabilitation technologies
- Consultation to employers

Workplace accommodations, in turn, are specific modifications made to the work site or work environment to enable workers with disabilities to perform critical job functions. Examples include purchasing specialized computer hardware or software, modifying the work site to improve physical accessibility, or providing infrastructure for certain medical equipment to be used at work. As previously noted, the ADA requires reasonable workplace accommodations. But many employers, particularly small employers, do not have the expertise to know what is required under the law. A key role of the PDI insurer is to guide clients in complying with the law as well as paying the cost of mandatory accommodations.

Note that our proposed PDI coverage would not extend the ADA mandate—it would simply require that employers pay ADA compliance costs prospectively through the insurance policy rather than on a one-off basis. If insurance markets operate competitively, the policy cost of ADA compliance should be roughly comparable to the employer’s expected ADA compliance costs. Thus, this component of the coverage is not, for the most part, an added employer burden.

The third component of the PDI coverage is partial wage replacement. Specifically, the proposed policy would pay 60 percent of lost wages during the policy period up to a monthly maximum of \$2,500. This benefit cap—equal to 60 percent of the monthly earnings of a worker earning \$50,000 annually—is approximately equal to the maximum monthly SSDI benefit that a worker can claim at present.

Two considerations are paramount. First, the cap should be indexed to inflation or to median or mean earnings so that the benefit does not erode in value with the passage of time. Second, the replacement rate should be kept at a modest level. A high replacement rate necessarily increases the attractiveness of claiming disability benefits instead of working;

conversely, a modest replacement rate provides an ongoing incentive for individuals with disabilities to resume employment where possible. For example, a typical PDI prorates its beneficiaries’ monthly wage replacement benefits so that they are rewarded at the margin for working. Consider a worker earning \$2,000 per month who becomes disabled. If this worker stops working completely, her monthly PDI benefit will equal \$1,200 (that is, 60 percent of \$2,000). If, however, she continues to work half time, her monthly income will be \$1,600: \$1,000 in salary plus \$600 in PDI benefits. Hence, a 60 percent replacement rate means that the worker receives an additional forty cents on the dollar for every hour that she works.

It is critical to observe that the PDI policy will not cover the medical expenses associated with disability. These expenses will instead be paid by private health insurance for workers who are not receiving SSDI and by Medicare for workers who are receiving SSDI. Because a separate mechanism provides coverage, the cost of the proposed PDI policy is greatly reduced relative to a setting in which this cost would have to be rolled into PDI. The separation of health insurance and disability insurance also accords with the current structure of PDI in the United States. All private-sector disability insurance policies of which we are aware cover vocational rehabilitation, workplace accommodations, and wage replacement, but not medical benefits.

## Policy costs

Ninety percent of employers that currently offer private long-term disability coverage to their workers do not require an employee contribution. Under our proposal, however, to provide employers and their workers with additional flexibility, employers would be allowed to require employees to pay up to 40 percent of the cost of their coverage. Premiums would be experience-rated for firms with fifty or more full-time equivalent employees that contracted with private insurers, while premiums for smaller firms would be industry-rated. Insurers would be allowed to vary the premium with the average age of employees at a firm and with the firm’s industry.

It is instructive to consider the average amount paid for private long-term disability coverage in the market at present. Using data from the Bureau of Labor Statistics on the aver-

age hourly cost of PDI coverage (\$0.04) and the fraction of workers with long-term disability coverage (32 percent), we estimate that the average long-term disability policy costs approximately \$250 per year—about \$20 per month.

This is likely an upper bound on the average cost of policies under our proposal because current PDI policies are, on average, significantly more generous than the one we propose. For example, the median maximum monthly benefit is \$7,500, which is three times greater than the corresponding maximum in our plan. Additionally, our proposed coverage would pay benefits for a maximum of just two years, while existing policies are typically long term in nature and may provide at least partial benefits to the worker until he or she reaches full retirement age.

Three factors, however, cut the other way. Those currently receiving long-term disability coverage through their employers are likely healthier on average than the 68 percent of workers without private long-term disability policies. If so, their claims rates will likely be lower. Second, most long-term disability policies have a 180-day waiting period from disability onset until benefits are provided rather than a ninety-day waiting period. This waiting period is called the elimination period in industry parlance. We believe that keeping the elimination period at a relatively brief ninety days raises the likelihood that a worker receives assistance in time to prevent the work limitation from causing labor force exit. Finally, most current long-term disability policies are structured so that if the beneficiary is awarded SSDI, their long-term disability benefits fall one-for-one. Thus, the insurer is exposed to less risk than it would be in the absence of this plan feature. However, because the long-term disability plan coverage is strictly capped at twenty-four months of benefits—at which point, the SSDI system provides benefits if the claimant meets its criteria—the insurer’s maximum exposure on a policy is modest.<sup>22</sup>

Which factor described above will dominate depends on the magnitudes of these many countervailing factors. To investigate this issue more rigorously, we have obtained data on existing long-term disability policies from a large private insurer. These data allow us to explore how premiums for long-term disability policies vary with the plan’s replacement rate, its maximum monthly benefit, and the elimination period. Further, we can explore how these premiums vary with the characteristics of enrollees, including their age, industry, and skill level.

Using these data, we estimate that the average cost of a PDI policy with a 60 percent replacement rate, a \$2,500 maximum monthly benefit, and a 90-day elimination period would be approximately \$150–\$250 per year. This is somewhat smaller than the average cost of PDI policies currently in effect, with the much lower maximum monthly benefits in our policies driving the difference. The premium cost would be somewhat higher for firms employing a larger share of older workers as well as firms in the construction and mining industries. These industries tend to have higher claims rates, all else equal.

Note that the cost variation in health insurance premiums dwarfs the corresponding variation in the cost of PDI premiums. Adding PDI coverage will not result in a massive additional financial burden for either workers or their employers. Additionally, by using only industry rating (rather than experience rating) for small employers, we greatly reduce the risk to small employers stemming from variation in their claims rates.

Over the longer term, the PDI policy has the potential to pay for itself and may generate net savings by reducing SSDI costs. We estimate the present value of an SSDI award at \$270,000. This is approximately one thousand times the annual per worker cost of the proposed PDI policy. To put these numbers in common terms, note that SSDI applications stood at 18 per 1,000 insured workers in 2009 (Figure 7). In recent years, more than 60 percent of SSDI applicants (eleven out of eighteen) have eventually received an award (Figure 8b). If the PDI program succeeds in allowing one in eleven would-be SSDI beneficiaries to remain gainfully employed, the program will have paid for itself. Additionally, SSDI expenditures would be mechanically lower because PDI policies would pay for the first two years of benefits, thus greatly improving Social Security’s financial health.

These sources of cost reductions, if realized, will result in either a decline in Social Security’s OASDI payroll tax or an increase in the longevity of the OASDI trust funds.<sup>23</sup> Further, this calculation puts no weight on the additional financial security and employment assistance PDI provides to workers with disabilities or the psychological benefits they obtain from remaining gainfully employed rather than dependent on transfer income. We believe these gains are at least as economically significant as the possible reduction in SSDI program costs.

## Waiting period and benefits duration

Our proposal specifies a minimum level of plan generosity in terms of replacement rates and maximum monthly benefits. Plans would also be required to have an elimination period of no more than ninety days and a maximum duration of at least two years. The elimination period is similar to that used in many existing PDI policies. According to industry representatives, 90- and 180-day elimination periods are about equally commonplace, with the shorter elimination period typically raising a policy's cost by about 30 percent. The maximum benefits duration of twenty-four months is much shorter than is used in most current PDI policies, as noted above, which will lower the insurer and employer exposure to the financial risk of long-term disability.

PDI insurers would have some flexibility in making these parameters more generous. For example, a plan could have an elimination period shorter than ninety days. However, the time from disability onset to the end of benefits could not be lower than twenty-seven months. Similarly, plans might allow the maximum duration to be extended if, for example, a person was able to work part-time during their receipt of benefits.

To reduce the chance that workers could abuse the employer-provided PDI coverage by claiming benefits at the outset of employment, plans would be permitted to stipulate a minimum vesting period of no more than ninety days. A worker whose disability commenced prior to vesting would not be eligible for benefits under the employer's PDI policy.

To illustrate how our proposed policy works for individuals applying for PDI, Appendix Scenarios 1, 3, and 4 display the timing of premium payments and benefit receipt, along with the integration with SSDI, for three hypothetical PDI applicants. Appendix Scenario 2 provides similar information for a worker who does not apply for PDI.

## Post-employment coverage

An indispensable feature of our policy design is that PDI coverage must not end immediately when the employment spell terminates. This is critical for two reasons. First, employers must not have an incentive to keep their policy costs low by terminating workers who appear likely to make a disability claim.<sup>24</sup> Second, the incentive effects of the PDI policy in

keeping workers with disabilities actively engaged in vocational rehabilitation and searching for new employment become even more pivotal when employment ends. As noted above, workers are most likely to apply for SSDI benefits following job loss. It is therefore critical that PDI coverage does not lapse at the time of job loss.

To ensure ongoing coverage under the employer's plan after a worker leaves employment, we propose the following prepayment mechanism: During the first twelve months of employment, *two months* of PDI premiums would be paid monthly. After twelve months, normal monthly payments would commence. Due to this prepayment mechanism, a worker who exited his job after one or more years of employment would have one full year of ongoing, prepaid PDI coverage through his employer's plan. A worker whose job ended after three to eleven months of employment would have that many months of post-employment PDI coverage. Finally, a worker whose job ended in less than three months would not have post-employment coverage since his policy would not have vested. In this case, insurers would refund employers or employees the extra premiums paid.

Prepayment creates a number of relatively minor problems. For example, a worker who changes employers after one year of employment without entering unemployment will simultaneously have prepaid coverage from the prior job and new coverage from the current job. Clearly, insurance premiums should not be paid twice for the worker for the same coverage period. It should be straightforward, however, for insurers to permit workers or employers to obtain a refund of prepaid PDI premiums if they can demonstrate that the worker is covered under a new policy. In addition, workers transitioning between jobs would potentially benefit from overlapping coverage for the first three months of employment since this would provide active PDI coverage until their new policy vests.

## Unemployed workers or workers without coverage

If PDI policies are purchased exclusively through employers, individuals who become unemployed and then subsequently suffer a disability will lack PDI protection if the disability's onset occurs after their prior PDI coverage lapses.<sup>25</sup> To

address this issue, our proposal would allow workers to purchase coverage from insurers at no more than 110 percent of the rate that their most recent employer previously paid. This is similar to COBRA health insurance coverage and would lead to a greater fraction of potential SSDI applicants being insured.

Of course, some non-employed individuals might elect not to purchase this coverage, in which case they would be without PDI. These individuals, if they were insured for SSDI benefits, would have access to PDI policies that could be financed, as in New York's temporary disability insurance (TDI) program described below, through a surcharge on insurers in proportion to their share of the market. The policies would be less generous than other PDI policies with respect to both the replacement rate and the maximum monthly benefit, so that individuals had a financial incentive to purchase coverage on their own. And these individuals would face the same constraints on applying for SSDI as their counterparts with employer-sponsored or individually financed PDI policies.

What should the wage replacement rate be for an unemployed worker with a disability? We are strongly of the view that having the PDI insurer replace 60 percent of the former wage for a currently unemployed worker would invite moral hazard. We suggest that the wage replacement rate follow the unemployment insurance formula in the worker's state of employment (which is typically capped at 50 percent and is generally considerably lower for high wage workers). While UI payments are not negligible, they are generally unattractive relative to employment. Of course, a PDI policy should not pay wage replacement benefits while a worker is receiving UI.

An additional virtue of using the UI payment scheme to set PDI payments to the unemployed is that it would protect employers from facing double indemnity from the UI and PDI systems. Since UI premiums are experience rated, an employer that lays off a worker expects to pay higher UI premiums in the future.<sup>26</sup> If the laid-off worker subsequently were to make a disability claim against the employer's PDI policy, the claim would additionally affect the employer's PDI experience rating. If, however, PDI and UI payments for unemployed workers were set at the same level and workers were not allowed to collect both benefits simultaneously, the

employer's UI rating would not rise if PDI paid wage benefits, and the employer's PDI rating would not rise if UI paid wage benefits.<sup>27</sup> Thus, linking UI and PDI wage replacement payments to unemployed workers with disabilities solves many practical problems with little cost in complexity.

## Handoff provisions to SSDI

Many individuals who receive PDI benefits would return to work before they reached the maximum benefit duration of twenty-four months. However, for some recipients, return to work might be impossible or so burdensome to the worker that the benefits do not justify the costs. These individuals would have the option to apply for SSDI after twenty-one months following the onset of disability (eighteen months after the start of PDI benefits). Thus they could receive up to six additional months of PDI benefits while they waited for a determination from SSDI. This waiting period for SSDI approval would allow the insurer up to eighteen months to assist the worker in returning to the workforce. During this time, insurers have an incentive to aid workers with disabilities to return to employment to reduce income replacement payments. Similarly, employers have an incentive to accommodate their disabled employees since this will lower the insurer's payments and hence the employer's experience-rated PDI policy costs. If after eighteen months it appears that the worker's condition is likely to persist or worsen, the worker can apply for SSDI.

How would this waiting period be enforced? Currently, SSA checks each SSDI applicant for program eligibility by determining whether, for example, the person has sufficient earnings history to be income-eligible. A similar check could be performed to ensure that the worker had been receiving PDI for at least 18 months before the application is considered.

As above, there would be exceptions to this requirement. Conditions that are severely and unambiguously disabling would be granted expedited consideration and would not require PDI receipt. It would be logical for this set of severe conditions to be determined by SSA's List of Compassionate Allowance Conditions.<sup>28</sup>

One potential complication with the twenty-one-month delay from disability onset to SSDI application is that some applicants might not receive a determination from SSA

within six months of application—for example, if their cases were initially denied and then appealed. With a twenty-four-month PDI duration, the applicant would be faced with the prospect of no replacement income if the determination process extended beyond six months. If the SSA ultimately approved the application, the worker would be entitled to benefits for this intervening period, as under the current system. Employers also would have the option to enhance their PDI policies through longer durations.

It is also likely that SSA will subsequently deny SSDI benefits to some individuals who qualify for and then exhaust their twenty-four months of PDI benefits. Although this will generate dissatisfaction among some SSDI applicants, we do not see that this scenario places individuals in a more precarious position than they currently face when applying for SSDI. On the contrary, the PDI policy would provide them up to eighteen months of rapidly accessible benefits following the

onset of disability and prior to the SSDI application—as well as up to an additional six months of ongoing benefits during the SSDI application process. Thus, even rejected SSDI applicants are better off than they would be absent PDI: they will have received additional benefits from PDI, and these benefits may enable them to retain employment.

Finally, it is critical to recognize that the PDI and SSDI programs will function differently because they will serve different goals. Our proposed PDI program is geared to providing responsive, employment-oriented support to work-limited individuals at the onset of a disability. As such, it is likely to be more lenient in awarding benefits than SSDI since its goal is to provide rapid assistance rather than a once-and-for-all disability determination. When a worker applies for the long-term SSDI benefit, however, it is understood that this will typically signify permanent labor force withdrawal and payment of SSDI benefits until retirement or death. The eligibility criteria for such a substantial benefit, with present value currently roughly equal to \$270,000, should logically be enforced rigorously.

# Challenges for Implementation

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## Hiring and retention incentives

One potential challenge for our proposal is that the costs of PDI vary to some extent with a worker's characteristics. For example, older workers are more likely to claim PDI benefits than are younger workers and thus will tend to have higher PDI premiums. Requiring firms to purchase PDI might give them a financial incentive to favor groups whose PDI coverage costs are relatively low. Of course, this issue affects the provision of all fringe benefits, including employer-provided health insurance. And as discussed above, the average cost of PDI coverage would be about one-twentieth the average cost of employer-provided health insurance. Little evidence suggests that rising employer-sponsored health insurance costs in recent years, which increased by more than 70 percent in inflation-adjusted terms between 1999 and 2009 (and in dollar terms, by much more for the near elderly), has reduced employment differentially among the near-elderly. It therefore seems unlikely that the comparatively modest cost of the proposed PDI policy would affect firms' hiring practices substantially with respect to age and gender.

A potentially greater concern exists, however, for individuals with a preexisting health condition or with a history of disability, some of whom may have much higher probabilities of claiming PDI benefits. An employer might infer that hiring such a person would result in higher PDI premiums in the future. Partly for this reason, our proposal does not experience rate firms with fewer than fifty full-time equivalent employees. Instead, these firms would be rated by their

industry's experience. For firms with more than fifty employees, the increment to expected average PDI costs from hiring someone with a health condition would be relatively small.<sup>29</sup>

## Workers and firms deserving special consideration

While the proposed reforms would benefit the vast majority of workers with disabilities and improve the economic security of all workers who face some risk of disability, it is unrealistic to anticipate that every citizen will be made unambiguously better off. Below are some key considerations that may affect the net benefit accruing to specific groups.

### Workers lacking sufficient work history to qualify for SSDI benefits

To be insured under SSDI, workers must have paid into the system through payroll taxes in twenty of the last forty calendar quarters (five of ten years). If an individual lacking a qualifying work history develops a work-limiting disability, he or she will not be entitled to SSDI benefits.

Under the current PDI proposal, individuals with work limitations will qualify for up to twenty-four months of PDI benefits after only three months of employment. Moreover, because receipt of PDI benefits may allow them to remain gainfully employed (and hence paying payroll taxes) for up to

four subsequent quarters, it may allow them to subsequently qualify for SSDI benefits (or SSDI coverage, which may become relevant at a later date).

### Workers with very low earnings

The SSDI replacement schedule replaces 90 percent of approximately the first \$750 of insured monthly earnings, 32 percent of the next \$3,000, and 15 percent of the remainder. For individuals with very low monthly earnings, the replacement rate under SSDI would be higher than the 60 percent replacement rate under the PDI program.<sup>30</sup> Offsetting this consideration is that PDI benefits would come into force earlier—within ninety days—and would potentially provide income support during up to six months of the SSDI application process (if relevant). Moreover, if the worker transitioned to SSDI, they would receive benefits at the SSDI rate. Thus, we do not see this feature of the policy as substantially reducing the lifetime benefits for even low-earning workers.

### Workers with non-meritorious claims

Private disability insurers employ specialists to determine effective interventions for supporting the employment and rehabilitation of workers with disabilities. Similar to SSA, these specialists must first determine whether a claim is meritorious. If they judge it to be non-meritorious, the insurer will deny benefits. While one legitimately may be concerned that private-sector insurers will err on the side of denying claims, many private-sector insurance markets already manage this problem effectively; one notable example is private health insurance. Under current law, workers may appeal a PDI insurer's denial of their claim under the provisions of the Employee Retirement Income Security Act of 1974. And of course, individuals may adjudicate their claims in court.

Private insurance carriers also have an incentive to provide fair treatment to covered workers lest the employers that purchase PDI policies take their business to a competitor. We also find it plausible that private insurers will be more effective—and certainly more rapid—than SSA in triaging claims and denying the less meritorious ones; indeed, the PDI policies that we have inspected guarantee a claim determination within forty-five days. Rapid and effective screening discourages non-meritorious and fraudulent claims. It also potentially provides workers with an early indication of whether

they would be likely to qualify for SSDI benefits were they to apply. Since individuals may spend years applying for benefits and appealing SSDI denials, it would be especially valuable to provide an early read on the application prospects to individuals who are not likely to receive an SSDI award.

### Firms employing workers with disabilities

Under the proposed policy, the PDI premiums for employers with more than fifty workers would be experience-rated. Firms that employed relatively many individuals with disabilities potentially would then be exposed to higher premiums. Of course, employers already face this type of risk through their employer-sponsored health insurance and workers' compensation insurance. Given the low cost of the typical PDI policy (5 percent of the typical employer-sponsored health insurance policy) and the limited claims that can be made against such a policy (twenty-four months of benefits, strict benefits caps, no medical costs), this additional burden should be modest.

We also expect that firms employing workers with disabilities will benefit from our proposal in two ways. First, PDI coverage should enable firms to retain valuable employees who are experiencing work limitations. At present, many such workers face an incentive to exit employment to qualify for SSDI benefits. Second, we anticipate that the PDI program will ultimately reduce the total cost of the disability insurance system and improve the solvency of the combined Social Security Retirement and Disability trust funds. These cost reductions will lead to lower payroll taxes over the long term, which is a benefit to both firms and workers.

### Firms in high-risk industries

Data from real-world PDI policies indicate that claims rates (and hence premiums) vary significantly across industries. For example, workers in the construction and mining industries are more likely to claim PDI benefits than workers in service industries. PDI coverage for employers in these industries is consequently more costly. Based on detailed exploration of this cross-industry cost variation using confidential policy data provided by a large private disability insurer, we have concluded that the variation in policy costs is surprisingly modest. Even firms in the riskiest industries face premiums



that do not exceed twice the mean overall system-wide cost of \$150 per worker per year (\$12.50 per worker per month). A key reason why cross-industry discrepancies are not greater is that workers directly employed in risky occupations (e.g., construction, mining, manufacturing) typically have earnings below the economy-wide median. Thus, their higher claims rates are in part offset by their lower claims costs.<sup>31</sup>

It finally bears emphasis that we view it as a benefit of the proposed PDI plan that employers will face higher or lower PDI premiums in accordance with the costs they impose on the system. Employers in high-risk industries are potentially best positioned to lower flows by their employees onto SSDI. Through the experience rating of PDI policies, these employers will face a financial incentive to recognize and internalize these costs.

## The Value of Pilot Evaluations

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Given the inevitable challenges and uncertainties associated with rolling out a major program innovation, it would be desirable to phase in the universal PDI plan over several years and potentially run pilot programs in a limited number of states, as has been done with welfare, Medicare, and Medicaid reforms. The purpose of such a process is to build capacity and refine program policies, parameters, and performance.

One natural way to phase in the PDI plan is to target PDI coverage initially to younger workers. This group has much lower claim rates on average, so the costs for PDI policies would be quite low. An additional advantage of focusing initially on younger workers is that they have more potential years of work remaining, and thus the long-run employment benefits of PDI coverage are correspondingly higher. Conceivably, workers under the age of forty-five could be enrolled in the first year, those under age fifty in the second year, and so forth. Employers would have the option to cover a larger-than-required fraction of their workers in these early years. A similar phase-in could occur with respect to employer size, with smaller firms initially exempt from the requirements. Such an exemption seems desirable given that smaller employers are currently much less likely than larger firms to offer PDI coverage to their workers.

The PDI program could additionally target certain categories of medical conditions for coverage in the initial years. Individuals with musculoskeletal conditions, such as back pain and repetitive stress injuries, may be especially likely to benefit from early interventions aimed at supporting ongoing employment. For medical conditions not included initially,

federal funding could be provided for pilot projects that could shed light on which employer and insurer interventions are most effective at increasing return-to-work rates and stemming flows to the SSDI program. The Center for Medicare and Medicaid Innovation could serve as an example for a PDI Innovation Center. The recent health reform legislation created the existing center to identify interventions that improve quality and reduce cost.

A central goal of the pilot phase of the program's introduction is to benchmark key unknown parameters affecting the effectiveness of the program and to use this knowledge to refine the approach. The pilot project would inform the following areas of uncertainty:

- What fraction of workers with disabilities will be able to remain gainfully employed as a result of the program, rather than exiting the labor force?
- By how much will inflows onto the traditional (long-term) SSDI program be reduced by the PDI program?<sup>32</sup>
- What types of case management, vocational rehabilitation, and workplace accommodation supports are most effective (and most cost-effective) in assisting workers with disabilities to remain in employment?
- To what extent (if any) will the income replacement component of the PDI policy encourage work-capable individuals to claim benefits in lieu of working (or, in the case of unemployed workers, in lieu of job search)?

- As the PDI market reaches maturity, will average policy costs stabilize at the projected level? How much will costs differ across employers by industry, firm size, and prior claims experience?
- What are the net costs of the PDI plan, accounting for savings to SSDI?
- What are the net benefits of the PDI plan, accounting for the well-being of workers with disabilities who are able to remain productively employed and substantially self-sufficient?

## Examples and Evidence from Other Disability Programs

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While our proposal is ambitious relative to past reforms to the SSDI program, it is not unparalleled. Below, we briefly review three cases where similar hybrids of public and private insurance have successfully addressed disability among working-age adults. The first of these are state temporary disability insurance programs (TDI), which provide near-universal short-term disability coverage to workers in five U.S. states. We also consider state workers' compensation programs, which have seen no appreciable rise in costs in the last two decades, even as SSDI claims have grown rapidly. The final example is the national disability insurance system in the Netherlands, a country that paid transfer benefits equal to an alarming 4.2 percent of GDP in 1985. Over the last decade, the Netherlands implemented a series of disability reforms similar to the one we propose that experience-rated disability premiums to employers and also placed them in a gatekeeper role for access to disability benefits for the first two years following the onset of disability. Following these reforms, new disability inflows in the Netherlands fell by 40 percent between 2002 and 2004, and by another 50 percent from 2004 through 2006.

### State temporary disability insurance programs

Five U.S. states currently require employers to provide TDI benefits to their workers. In California, Hawaii, New Jersey, New York, and Rhode Island, workers can receive partial wage replacement for non-work-related conditions. These programs all have been in effect since the 1940s with the exception of Hawaii, which introduced its program in 1969. The

typical TDI income replacement rate is 50 percent or more, with additional benefit caps that limit the minimum and maximum weekly benefit. The waiting period for TDI benefits is quite brief at just one week, and the maximum duration of benefits is between twenty-six and fifty-two weeks.

The structure of the TDI plan market varies substantially across states. In Rhode Island, the government is the sole TDI insurer. In Hawaii and New York, employers either self-insure or contract with private insurers; there is no public plan. California and New Jersey offer employers the choice of government or private plans, and the government plan carries the bulk of policies in both states.

Perhaps the greatest similarity between our proposal and the existing state TDI systems is the requirement that all employers purchase disability coverage for all employees. The fact that these state PDI programs have persisted for several decades suggests that workers and employers generally regard them as worth their costs. Also relevant to our proposal is the fact that the two states with the lowest average duration of TDI claims (Hawaii and New York) are also the states that contract all of their TDI coverage to private insurers. We envision the same provision mechanism in our proposal.<sup>33</sup>

While the TDI policies share similarities with our proposed policy above, the policies also differ in several important respects. First, and perhaps most important, TDI policies are in no way linked to the SSDI program. It is therefore unlikely that TDI slows inflows onto the SSDI rolls, and TDI could actually increase flows by reducing the financial hardship for

workers who are out of the labor force and applying for SSDI benefits.

Second, TDI benefits commence almost immediately after the onset of disability, have a maximum duration of one year or less, and a cross-state average maximum of less than three months. By contrast, our proposed PDI policy features a three-month waiting period and a two-year maximum duration. Because of these differences, the conditions the TDI policy covers are likely to be quite different from the ones the PDI policy would. Indeed, the typical TDI spell is too short to be covered by PDI, which has a ninety-day waiting period.

A third important difference between our proposed policies and state TDI policies is that for most TDI recipients, employers have little financial incentive to limit TDI costs. In Rhode Island, for example, a monolithic government plan insures all TDI recipients, and past experience does not affect an employer's TDI premiums. Additionally, while private plans compete for TDI business in California and New Jersey, more than 90 percent of workers in both states belong to the public plan. Only in Hawaii and New York do private insurers cover the full TDI market. In these two states, employers will have a stronger incentive to limit TDI costs.

### State workers' compensation programs

State workers' compensation (WC) programs came into existence in nine states almost a century ago. Currently, all fifty states and the District of Columbia have WC programs, and these cover the vast majority of workers (131 million in 2008). State WC programs primarily provide cash benefits and health care to individuals with work-related injuries or illnesses, with medical benefits accounting for approximately half of the \$57 billion of benefits paid in 2008. In return for accepting WC benefits and health care, recipients agree not to file a lawsuit against their employer for any reasons related to their medical condition.

The payments and health care coverage provided under WC vary across states as well as with the severity and the expected duration of the condition. As with TDI, the market structure of WC programs mixes private and public provisions. However, private WC insurance or employer self-insurance covers the vast majority of workers. In 2008, private insurers

and self-insured employers paid 76 percent of all WC benefits.<sup>34</sup> And as with most state UI programs, even the state-run WC programs are often experience-rated.

A key difference between the WC program and either the SSDI program or most state TDI plans is that due to experience rating, WC provides employers with a financial incentive to reduce costs. In response to these incentives, an employer might invest in additional (non-mandatory) safety equipment, implement accommodations that allow an injured worker to return to her job, and pay for rehabilitative therapy or related services for an injured worker to permit the worker to return more rapidly to the job.

It is potentially instructive to contrast the growth in WC costs in recent decades with the corresponding growth in SSDI (including Medicare) expenditures. As shown in Figure 2, real SSDI and Medicare spending more than tripled between 1989 and 2009, rising from \$58 billion to \$190 billion. During the same twenty-year period, real WC expenditures rose by just 3 percent, from \$56 billion to \$58 billion.<sup>35</sup> Stated differently, WC benefits as a fraction of covered wages fell by more than one-third, from 1.49 percent to 0.97 percent. While changes in the structure of industries and occupations in the United States undoubtedly can explain part of this decrease, it seems likely that employer financial incentives also played an important role. Careful independent analyses by economists Robert Topel of the University of Chicago and Alan Krueger of Princeton University demonstrate that the financial incentives present in the WC and UI programs have a powerful impact on the workers' and employers' use of both programs.<sup>36</sup>

### Evidence from recent disability reforms in the Netherlands

In 1990, the Netherlands devoted a larger share of GDP to disability cash benefits than any other country in the Organisation for Economic Co-operation and Development (OECD).<sup>37</sup> The Netherlands' GDP share of disability benefit payments, 3.4 percent, was 150 percent greater than the OECD-17 median of 1.4 percent in that same year and more than five times greater than the U.S. share of 0.6 percent. Including sickness and work injury benefits into a measure of broad disability benefits in 1990, the OECD calculated that

the Netherlands' share was 5.7 percent in 1990, versus an OECD-17 average of just 2.7 percent. Strikingly, these 1990 GDP shares in the Netherlands were actually about 20 percent lower than the peaks reached there in 1985.

In response to rapid growth in public disability expenditures and disability enrollment, the Dutch government undertook a series of policies in the 1980s and early 1990s designed to slow the growth in program expenditures. Many of these policy changes took the form of benefit cuts, including a reduction from 80 percent to 70 percent in the program's replacement rate in 1985 and a change in the method of indexing benefits in the same year. Benefits were reduced still further in 1993 for those whose disability onset occurred at an earlier age. During this time, disability expenditures as a share of GDP fell from a peak of 4.2 percent in 1985 to 2.6 percent in 1995, with a reduction in average benefit generosity driving this decline almost entirely. By contrast, the decline in disability enrollment as a share of the Dutch labor force during this period was much less pronounced, declining by only one percentage point from 11 percent in 1985 to 10 percent in 1995. The fraction of workers in the Netherlands claiming disability was so high that the popular press began referring to disability claims as "the Dutch Disease."

The Dutch government responded by changing incentives so that employers would recognize some of the costs borne by the disability system when their workers made disability claims. Starting in 1994, the government required all employers to finance the first six weeks of their employees' sickness benefits.<sup>38</sup> Two years later, they lengthened the time to one full year.

These reforms continued in 2002 with the introduction of the "Gatekeeper Protocol," which required the employer, worker, and a consulting physician to jointly draft a return-to-work plan within eight weeks of a disability claim and appoint a case manager to coordinate this process. In 2004, mandatory

employer-paid sickness benefits were extended from one year to two years, as was the mandatory waiting period for access to public disability benefits. Thus, employers retained full financial responsibility for their employees' sickness benefits for two full years.

These two changes, along with the full phase-in of experience-rated disability insurance premiums, appear to have generated a sharp drop in the inflow to the Dutch disability program, which fell by 40 percent from 2002 to 2004 and by another 50 percent from 2004 to 2006. The number of disability recipients as a share of the Dutch labor force fell from slightly more than 10 percent in 2002 to 8.4 percent in 2007.

Though 8.4 percent seems high relative to the United States, the difference is not as large as it appears. The number of SSDI program recipients as a share of the labor force (rather than the population) is 5.3 percent, which is only 65 percent of the size of the Dutch program. However, adding into the U.S. count the non-elderly adults who are receiving disability benefits from the federal Supplemental Security Income entitlement program, which is distinct from SSDI, would raise this number to 7.1 percent. With the Dutch and U.S. programs now trending in opposite directions, it is indeed possible that the U.S. will pass Dutch disability enrollment in the decade ahead.

The Dutch experience provides compelling evidence that policies causing employers to recognize the costs of disability claims can influence the trajectory of disability claims. The focus on employer incentives and mandatory return-to-work plans seems almost certain to have boosted employment among individuals with disabilities in the Netherlands. However, we know little at present about how the Dutch reforms affected the well-being of individuals with disabilities in the Netherlands, and hence it would be premature to conclude that the Dutch example is one that the United States should emulate.

## Conclusion

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The Social Security Disability Insurance program has served to protect U.S. workers and their families from poverty and loss of medical care in the event of work-limiting disability since its inception in 1956. The program has become a crucial piece of the U.S. social safety net, and it creates substantial net benefits for citizens.

In the ensuing fifty years since the program's introduction, medical care and assistive technologies for treating and accommodating work-limiting disabilities have advanced, the physical demands of the workplace have lessened, and the societal consensus on the proper objective for treatment of disabled workers has greatly evolved. The SSDI program was designed to provide income support (and, after 1965, medical care) to workers transitioning from employment to early retirement and, in many cases, death. This goal was progressive for its time but is no longer aligned with current societal

objectives. A modern disability insurance system should properly focus on assisting individuals with disabilities to maintain economic self-sufficiency and to enjoy the many benefits of gainful employment.

We believe that our proposal for universal private disability insurance provides a blueprint for modernizing the structure of the SSDI program. Once in place, the reformed program will better support workers with disabilities to remain employed and encourage their self-sufficiency. It also will reduce the dual wastes stemming from spending too few societal resources on helping individuals with disabilities remain employed and too many societal resources on supporting unnecessary long-term dependency of individuals who could be self-sufficient with the appropriate accommodation and support.

## Appendix: Scenarios

### SCENARIO 1

#### Worker disabled at day 91 of employment with lower disc problem

In this scenario, a worker becomes disabled with a lower disc problem on her 91st day of employment, which is the first day she is vested. After the waiting period of ninety days, the worker begins receiving benefits through the PDI plan. 21 months after the disability's onset (24 months of employment), the worker may apply for SSDI benefits. 24 months after the onset of disability (27 months of employment), PDI benefits and premium payments cease. At this point, if the SSDI application has been approved, SSDI benefits begin as per current policy.

### SCENARIO 2

#### Worker exits employment after 1 year with no disability claim

In this scenario, a worker exits employment after 1 year without ever filing a disability claim. Premium payments immediately cease. However, because double premiums have been paid for the first 12 months of employment, this worker remains vested through the 12 months after exiting employment.

Months since hire	Employment status	PDI premiums paid	PDI status	SSDI status	Employment status	PDI premiums paid	PDI status	SSDI status
1-3	Working	2x regular	Not vested	N/A	Working	2x regular	Not vested	N/A
4-6	Disabled		Wait period	Wait period			Vested	
7-9			PDI benefits					
10-12								
13-15		Regular			Unemployed	None		
16-18								
19-21								
22-24								
25-27				SSDI app			No coverage	
28-30		None	PDI benefits					
31-33			N/A	SSDI benefits				
34-36	Disabled	None	N/A	SSDI benefits	Unemployed	None	No coverage	N/A



SCENARIO 3

**Worker suffers renal failure after 6 months of employment**

In this scenario, a worker suffers renal failure after 6 months of employment. Because the disability falls under SSA's Compassionate guidelines, PDI benefits begin immediately and the worker may apply for SSDI. As soon as the SSDI application is approved, SSDI benefits commence as per current policy.

SCENARIO 4

**Worker suffers congestive heart failure at 9 months and returns to work at 15 months**

In this scenario, a worker suffers from congestive heart failure after 9 months of employment and returns to work 6 months later (15 months after the start of employment).

Months since hire	Employment status	PDI premiums paid	PDI status	SSDI status	Employment status	PDI premiums paid	PDI status	SSDI status
1-3	Working	2x regular	Not vested	N/A	Working	2x regular	Not vested	N/A
4-6	Disabled	2x regular	Vested	Wait period	Disabled	2x regular	Vested	N/A
7-9			PDI benefits	SSDI app			Wait period	
10-12			PDI benefits	SSDI benefits				
13-15	None	N/A	SSDI benefits		Disabled	Regular	Wait period	N/A
16-18	Disabled	None	N/A	SSDI benefits	Working		Regular	
19-21					Vested			
22-24						Working	Regular	Vested
25-27								
28-30								
31-33								
34-36	Disabled	None	N/A	SSDI benefits	Working	Regular	Vested	N/A

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# Endnotes

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- 1 The Old-Age, Survivors, and Disability Insurance (OASDI) payroll tax is currently 12.4 percent of the first \$107,000 of wage and salary income. The DI component is 1.8 of these 12.4 percent.
- 2 An important contributor to rising female SSDI receipt is secularly rising female labor force participation, which enables more women to qualify for SSDI benefit. This trend is not present among males.
- 3 Ronald C. Kessler and others, "Prevalence and Treatment of Mental Disorders, 1990 to 2003," *New England Journal of Medicine* 352 (2005): 2515–23.
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- 6 David Autor and Mark Duggan, "The Rise in the Disability Rolls and the Decline in Unemployment," *Quarterly Journal of Economics* 118, 1 (2003): 157–206; and David Autor and Mark Duggan, "The Growth in the Social Security Disability Rolls: A Fiscal Crisis Unfolding," *Journal of Economic Perspectives* 20, 3 (2006): 71–96.
- 7 These states are California, Hawaii, New Jersey, New York, and Rhode Island. Puerto Rico has a similar mandate.
- 8 Richard V. Burkhauser, Mary C. Daly, and Philip R. de Jong, "Curing the Dutch Disease: Lessons for United States Disability Policy," Michigan Retirement Research Center working paper 2088-188 (Ann Arbor, MI: University of Michigan, 2008); and Philip R. de Jong, "Recent Changes in Dutch Disability Policy," working paper (Amsterdam, University of Amsterdam, 2008).
- 9 Our policy proposal would be far more costly and complex (and likely infeasible) if Congress had not enacted universal health care.
- 10 The average monthly SSDI benefit for new awardees in 2009 was \$1,120, and the average age of awardees was 48.8. Thus the average year-of-birth for SSDI recipients was approximately 1960. For this group, SSDI benefits can be received until the sixty-seventh birthday, which is the date at which they convert to retired worker benefits with the same monthly payment. Using an annual mortality rate of 3 percent (the actual rate in 2009), along with a real discount rate of 2 percent, yields a present value of \$163,228. A similar calculation that uses average Medicare expenditures for SSDI recipients of \$9,000 in 2009 yields \$106,724. In combination, these cash and in-kind benefits bring the present value of an SSDI award to approximately \$270,000. This estimate likely significantly understates the true present value of disability benefits because it does not include the value of Supplemental Security Income benefits or of the associated Medicaid coverage for those receiving benefits from both SSDI and Social Security Insurance.
- 11 While the employment-to-population rate of work-limited females was roughly stable in this time interval, it rose by 10 percentage points among non-work-limited females.
- 12 This variation raises questions about the efficiency and fairness of the current SSDI system because the appellant's odds of receiving an SSDI award depend to a significant extent on the ALJ to which he or she is assigned. See Eric French and Jae Song, "The Effect of Disability Insurance Receipt on Labor Supply," working paper 2009-05 (Chicago, IL: Federal Reserve Bank of Chicago, 2009).
- 13 Currently, eighty-eight conditions fall under this program, and applicants with these conditions receive rapid (and normally positive) benefits determinations.
- 14 Back pains resulting from herniated discs are straightforward to verify using X-rays. Conversely, pains resulting from potential nerve damage are diagnosed primarily from patient self reports.
- 15 Till von Wachter, Jae Song, and Joyce Manchester, "Trends in Employment and Earnings of Allowed and Rejected Applicants to the Social Security Disability Insurance Program," *American Economic Review*, forthcoming.
- 16 Recent policy initiatives, such as the Ticket to Work program, have attempted to reduce the disincentives to labor force participation among SSDI beneficiaries. We discuss why these policies have been ineffective in the paper.
- 17 See Mark G. Duggan and Perry Singleton, "Aching to Retire? The Rise in the Full Retirement Age and Its Impact on the Social Security Disability Rolls," *Journal of Public Economics* 91, 7–8 (2007): 1327–50.
- 18 In the ensuing years, the distribution of medical conditions among individuals awarded SSDI benefits changed dramatically. This change is depicted in Figure 9, which shows the number of awards per 1,000 SSDI-insured individuals by diagnosis category. The award rate for mental disorders and diseases of the musculoskeletal system steadily increased. Combining these two categories, the award rate increased from 0.9 in 1983 to 3.4 by 2009. In contrast, the award rate for cancers and circulatory conditions remained almost constant, rising from 1.2 to 1.3. During that same time, the fraction of non-elderly adults enrolled in the program more than doubled.
- 19 The Lewin Group, *Policy Evaluation of the Effect of Legislation Prohibiting the Payment of Disability Benefits to Individuals Whose Disability is Based on Drug Addiction and Alcoholism: Interim Report*, unpublished report, 1998.
- 20 David H. Autor and Mark G. Duggan, "Distinguishing Income from Substitution Effects in Disability Insurance," *American Economic Review Papers and Proceedings* 97, 2 (2007): 119–24. Unfortunately, more recent data on the number of workforce reentries through the Ticket to Work program are not available.
- 21 Title I of the ADA requires an employer to provide reasonable accommodation to qualified individuals with disabilities who are employees or applicants for employment, unless to do so would cause undue hardship. While this requirement applies in theory to the worker's current employer and any other employer to which she might apply, it is far easier to enforce this requirement with the current employer than with the set of potential employers. There are three categories of reasonable accommodations required: modifications or adjustments to a job application process that enable a qualified applicant with a disability to be considered for the position such qualified applicant desires; modifications or adjustments to the work environment, or to the manner or circumstances under which the position held or desired is customarily performed, that enable a qualified individual with a disability to perform the essential functions of that position; and modifications or adjustments that enable a covered entity's employee with a disability to enjoy equal benefits and privileges of employment as are enjoyed by its other similarly situated employees without disabilities (U.S. Equal Employment Opportunity Commission, Enforcement Guideline 915.002, issued October 17, 2002).
- 22 Twenty-four months of benefits payments at the maximum monthly rate of \$2,500 sum to \$72,000. Vocational rehabilitation and workplace accommodations may raise this total. However, the ADA generally would not consider an accommodation that has very high cost (for example, a \$100,000 retrofit of the employee's workspace) to be a reasonable accommodation, and hence it would not be covered.

- 23 Workers currently pay an average of 3 percent of earnings for SSDI and Medicare coverage: 1 percent in Medicare and 1.8 percent in SSDI, which should be rounded upward since SSDI is currently running a deficit. Of course, adding a two-year front end to the SSDI award process (in the form of the PDI coverage period) will mechanically reduce new SSDI awards payments during the phase in of PDI. But this is pure time shifting of awards and does not signify a real decline in SSDI costs unless steady state inflows are slowed by PDI.
- 24 If present, this incentive would serve to raise the probability that workers with disabilities lose employment and access to PDI supports. In contrast, if the employer's policy necessarily covers the worker for some months after employment ends, it will greatly reduce or eliminate the incentive for employers to engage in preemptive terminations.
- 25 As above, this coverage will lapse in three to twelve months depending on the length of the prior job spell.
- 26 If an employer is already at the statutory maximum UI premium, additional layoffs do not raise the employer's UI policy costs. Employers in highly cyclical industries such as construction and manufacturing often pay the statutory maximum.
- 27 Thus, the employer's experience ratings for UI and PDI would be affected only in the case where PDI benefits were paid after UI was exhausted.
- 28 These are currently found at <http://www.ssa.gov/compassionateallowances/>.
- 29 For example, the increment to average expected cost for a 100-worker firm from hiring someone with a 5 percent probability of claiming in the current year (almost ten times greater than the current SSDI average) and an average monthly benefit of \$1,500 would be \$18 (assuming maximum two-year duration) or less per worker. Nevertheless, one could consider subsidies to firms that hire such workers to ensure that PDI policies are not reducing the incentive to hire workers with disabilities.
- 30 To calculate monthly SSDI benefits, SSA uses average indexed monthly earnings, which are calculated using a worker's entire earnings history, rather than just current earnings. To the extent that a worker's recent earnings were higher or lower than average lifetime earnings, the PDI benefit would be relatively more or less generous than this comparison would suggest.
- 31 Ironically, holding policy parameters constant, the occupation that pays the highest PDI premium is that of physicians. Physicians have very high salaries and hence their wage replacement benefits invariably reach the benefits cap. Also noteworthy is that physicians have very high claims rates.
- 32 The PDI program will necessarily reduce applications to the SSDI program during the twenty-one-month period from the onset of disability to the allowed date of application. The question for evaluation is whether there is a net reduction in inflows rather than simply a retiming of inflows.
- 33 Average TDI claims durations (in days) are 3.7 in Hawaii, 7.5 in New York, 10.0 in New Jersey, 10.5 in Rhode Island, and 14.3 in California.
- 34 In approximately twenty states, a state fund competes with private insurers for WC coverage. Most states also allow employers to self-insure. In five states, private WC insurance is not allowed, though firms can still self-insure in three of these states. In the remaining states, WC is provided by either private insurance or employer self-insurance.
- 35 The WC costs are for the years 1988 to 2008 rather than 1999 through 2009, used for SSDI, because 2008 is the most recent year available for WC expenditures. See Social Security Administration, Office of Retirement and Disability Policy, Office of Education and Statistics *Annual Statistical Supplement to the Social Security Bulletin, 2010* (Washington, D.C., 2010), available at <http://www.ssa.gov/policy/docs/statcomps/supplement/2010/index.html>.
- 36 Robert Topel, "On Layoffs and Unemployment Insurance," *American Economic Review* 73, 4 (1983): 541–59; and Alan Krueger, "Workers Compensation Insurance and the Duration of Workplace Injuries," working paper 3253 (Cambridge, MA: National Bureau of Economic Research, 1990).
- 37 Organisation for Economic Co-operation and Development, *Transforming Disability into Ability: Policies to Promote Work and Income Security for Disabled People* (Paris, 2003).
- 38 Burkhauser, Daly, and de Jong, note 8.

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# Supporting Work: A Proposal for Modernizing the U.S. Disability Insurance System

## Summary of findings

The SSDI program has failed to support the ongoing employment and economic self-sufficiency of workers with disabilities, leading to rapid growth in program expenditures and declining employment of Americans with disabilities. This proposal offers a blueprint for reversing this needless employment decline and stemming the dramatic growth of the SSDI program.

When enacting the SSDI program in 1956, Congress defined disability as the “inability to engage in a substantial gainful activity in the U.S. economy”—in other words, inability to work. While this definition arguably made sense five decades ago, when many jobs involved strenuous physical activity and assistive technologies were limited, today, individuals with work-limiting disabilities can often participate in the workforce and enjoy the many benefits of employment if given appropriate, cost-effective supports.

This proposal aims to provide early support for individuals with work-limiting disabilities by building on an existing private-sector institution, the private disability insurance (PDI) system. The proposal would extend private sector PDI coverage to the entire workforce in much the same way that Unemployment Insurance and Workers Compensation benefits are universally provided to workers. Such coverage would provide expert vocational assistance, cost-effective workplace accommodations, and partial income replacement to workers with work-limiting disabilities.

Recent reforms to the SSDI, such as the Ticket to Work program, have focused on improving the incentive for SSDI recipients to rejoin the workforce. While laudatory, these return-to-work inducements arrive many months or years after individuals with disabilities have left the labor force—long after the best opportunity for their retaining or regaining employment has been lost.

By refocusing the SSDI program towards assisting individuals with disabilities to remain employed, and away from supporting unnecessary long-term dependency, this plan would improve the economic security and well-being of individuals with disabilities, as well as their families, employers, and society at large. It would slow the growth of the SSDI program by reversing the needless decline in the employment rates of work-capable adults, thereby improving the long-term solvency of the Social Security system.

## Fast facts

- Since its inception in 1956, the Social Security Disability Insurance (SSDI) program has grown rapidly. Approximately one in ten Social Security dollars was spent on the program in 1989; by 2009, the SSDI program accounted for almost one in five dollars.
- The system is broken: To even be considered for SSDI benefits, a worker must not be working to any significant extent. Those awarded SSDI benefits wait an average of 12 months for an award, and almost 40 percent of awards are made on appeal.
- This proposal extends coverage of private disability insurance (PDI) to all workers, adding a “front end” to the SSDI system. PDI policies would come into force within 90 days of the onset of disability, when the prospects for successful intervention are highest, to provide workplace accommodations, rehabilitation services and partial income support, with the goal of enabling workers who suffer limitations to remain in employment.
- Because firms will purchase PDI policies in the private marketplace, they will face appropriate incentives to minimize avoidable movements of workers onto the SSDI system and to cost-effectively accommodate those who become disabled, as required under the Americans with Disabilities Act.
- To shield employers from catastrophic insurance costs, responsibility for ongoing disability coverage will be handed off to the traditional SSDI program two years following the onset of a disability.
- The cost of the proposed policies would be modest—on the order of \$250 per worker per year—and would ultimately increase economic security for Americans with disabilities while promoting a more fiscally sound Social Security program.