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IssueBRIEF

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Increasing Employer Responsibility for Disability Benefits: Analysis of an Approach to Social Security Disability Insurance Reform

INTRODUCTION

The declining economic status of people with disabilities and the predicted 2016 depletion of the Social Security (SS) Disability Insurance (DI) Trust Fund have generated considerable interest in proposals for reforming the DI program. Some proposals would hold firms partially responsible for a portion of the DI benefits paid to their recent employees. We analyze the implications of this approach for employers and workers in general and specifically consider two prominent reform proposals: one would require employers to carry short-term disability insurance (STDI); the second would apply an experience rating to the DI portion of the Federal Insurance Contributions Act (FICA) premium. We find the proposals would place a relatively large burden on the labor costs of many relatively small (fewer than 500 workers), low-wage firms. Firms with high potential liabilities might react by seeking to accommodate and retain workers with challenging medical conditions but might also reduce hiring or retaining workers at high risk for medical problems. Hence, although these proposals would likely reduce DI expenditures, they might have less desirable unintended consequences.[1,2]

THE PROBLEM

The DI program, administered by the Social Security Administration (SSA), is the nation's primary income insurance program for workers who must stop or severely limit work for long periods because of major medical problems. The DI caseload has grown from 2.9 million beneficiaries in 1980 to 8.9 million in 2013. Although changes in the size and age/sex composition of the labor force explain most of the growth, a large share is due to other factors (Stapleton and Wittenburg 2011). SSA projects depletion of the DI Trust Fund—from which all DI benefits are paid—sometime during late 2016 (SSA 2014). Workers pay into the DI Trust Fund through FICA taxes; 1.8 percentage points of the 12.4 percent payroll tax on all wages under the SS wage base is currently allocated to the DI Trust Fund (hereafter called the *DI payroll tax*). The projected gap between the Trust Fund's 75-year expenditures and

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revenues is equal to 0.33 percent of SS taxable wages—equivalent to $19 billion for 2014.

BACKGROUND: REFORM PROPOSALS

The DI Trust Fund's impending depletion has led to numerous ideas for reforming the U.S. disability support system. Some proposals suggest fundamental reforms that would significantly alter the program's benefits, funding source, or eligibility determination process. Many experts have recommended adopting early intervention strategies to reduce the volume of workers exiting the labor force due to disability and entering into DI. These strategies assume that the best time to intervene is before workers are separated from their employer and that, to be successful, the reforms must increase the willingness of employers to support disability prevention and continuation of work after the onset or worsening of a significant medical condition. A subset of the early intervention strategies would rely, at least partly, on making employers—and their employees—liable for a share of the costs associated with DI entry by their current or recent employees. In economic terms, this approach internalizes part of the external costs of behaviors that might lead to DI entry.

We considered two prominent reform proposals that would make employers partially liable for the DI benefit payments of recent former employees. David Autor and Mark Duggan's 2010 proposal would require all employers to purchase or provide private STDI that would provide employment supports and replace a fixed share of lost wages up to a cap[3] after disability onset, with the exception that workers with the most severe conditions would receive compassionate DI allowances immediately. Richard Burkhauser and Mary Daly's 2010 proposal would apply experience ratings to each employer's contribution to the DI Trust Fund based on the number of that employer's workers who enter the program, similar to the way employer unemployment insurance (UI) contributions are calculated. The authors of both proposals recommend conducting studies, pilot tests, and demonstrations to quantify the likely consequences for workers, employers, and the DI funding gap before adopting any components of their proposals.

OUR PROJECT

Our analysis begins the process the authors suggest by examining the proposals' implications for firms and employees. We first constructed a baseline measure of each employer's DI benefit experience relative to the wages it pays. Then we constructed measures of changes to employer labor costs, relative to current levels, under policies that are similar in spirit, but not identical in every detail, to the two proposals. The simulated STDI policy we used assumed that STDI wage replacement benefits would be identical to DI benefits rather than proportional to wages up to a cap and that all eligible claimants would receive the STDI benefit; that is, there are no compassionate allowances for DI recipients with severe conditions. Because both proposals lack many details critical to our analysis and require some information not available in our data, we made numerous assumptions to complete the analysis. We did not model how employers and workers would change their behavior if the proposed reforms were implemented. This brief summarizes findings only for firms with at least 50 workers during the year. Findings for smaller firms, which accounted for about 16 percent of benefits of DI entrants from the 2005 workforce, are highly erratic, reflecting unobservable idiosyncrasies.

METHODS

We used records from three SSA administrative data sources to create an analysis file that links records for individual firms, employees, and DI applicants. Our data are from 100 percent samples of the Master Earnings File (MEF), the 831 Disability File (831 File), and Number Identification File (Numident) from 2000 through 2007. The MEF includes earnings information for all workers with a Social Security number (SSN); the 831 File contains DI applicant information; and the Numident contains the sex, birth date, and death date (if known) for every individual ever issued an SSN.

For each employer, we first constructed a benchmark measure of the DI benefit experience of recent employees relative to current year SS wages (Table 1). The benchmark measure assigns a share of a former employee's DI benefits to an employer even if employment ended up to three years before DI entry. The measure for each employer consists of a share of 24 months of DI benefit payments to all current-year

Three firm-level cost statistics		**Numerator**	**Denominator**
	Benchmark relative DI experience	Share of future DI benefits paid to current-year workers entering DI in current year or next two years	SS wages paid in current year
	Simulated STDI premium	Predicted DI benefits paid to current-year workers entering DI in current year or next two years times administrative cost factor that increases with firm size	SS wages paid in current year
	Simulated experience rate	DI benefits paid to recent workers over previous three years	SS wages paid over previous three years

Table 1

employees who enter DI in the current year or the next two years divided by all SS wages paid by the employer during the year. The share is equal to the amount of wages the employer paid to the beneficiary in the current year divided by all wages paid to the beneficiary over the three years ending in the DI entry year. The DI benefit amount used for the calculation was the primary insurance amount (PIA)—the monthly benefit amount for the disabled worker, excluding any adjustments for dependent benefits or other factors.

For the STDI analysis, we produced estimates of employer premiums relative to SS wages in two steps (Table 1). We first projected expected benefit experience relative to SS wages conditional on certain firm size, mean wages, mean worker age, and prior year benefit experience. We then multiplied the projected experience by an administrative cost factor, which reflects the loss ratio experience in the long-term private disability industry, to calculate the STDI premium. The administrative cost factor for relatively small firms is substantially greater than for larger firms.

For the experience-rating analysis, we simulated employer experience rates (Table 1), adopting an approach currently used by 18 states to calculate UI payments (U.S. Department of Labor 2013). The experience-rate statistic is the ratio of DI

benefits paid over the past three years to the employer's recent workers divided by SS wages paid to all workers over the same period. Each worker's benefits are attributed to the most recent employer. The DI entrants who contribute to a firm's experience rate started receiving DI benefits sometime in the previous three years, applied for benefits within 12 months of leaving the firm, and did not work for any other firm between leaving the firm and applying for DI. To facilitate valid comparisons between the distributions of the experience-rate statistic and the other employer statistics, we rescaled the calculated rate so its median would equal the median of the benchmark benefit experience measure.

FINDINGS

The benchmark measure of benefit experience relative to SS wages varies substantially across employers with 50 or more workers and has a large positive skew; that is, although most firms have values that are not very large, some have very large values. The benchmark measure for firms in the top quarter of the distribution is at least 1.4 percent of SS wages (Table 2). However, these firms have far fewer workers on average than those in the three lower quarters and thus account for just 18.6 percent of all DI entrants despite their high DI experience. Mean wages for firms in this group are low enough to suggest that most jobs are low-skill,

part-time, or part-year. The exceptionally high percentage of their DI entrants with no more than a high school education is consistent with this interpretation.

The two proposal measures perform differently relative to the benchmark. For large firms (1,000 or more workers), the distribution of STDI premiums is quite similar to the distribution of the experience measure, but for small firms (50 to 99 workers) the distribution differs, reflecting high annual variability in their experience and high administrative costs. In fact, some small firms with very low experience would pay higher premiums than larger firms with very high experience because of high administrative costs. A compassionate allowance provision, like that proposed by Autor and Duggan, would reduce costs relative to our STDI program simulation. If STDI benefits were 60 percent of wages, as they proposed, rather than equal to the current DI benefit, the policy would put less of a burden on labor costs for high-experience firms and low-skill workers at high risk for disability. Because of DI progressivity, however, the STDI benefits paid to low-skill workers under the Autor and Duggan proposal would be lower than our simulated payments while the benefits paid to high-wage workers would be higher.

The analysis of experience rates for the DI payroll tax reveals that experience-rate distributions are much less sensitive to firm size than the benchmark measure. This presumably reflects the averaging of experience over three years, which levels out experience variation for small and medium-sized firms relative to large firms. In contrast to STDI premiums, the lack of administrative costs for experience rates does not

burden small and medium-sized firms relative to larger firms.

IMPLICATIONS

Compared to policies that increase DI Trust Fund revenues by increasing the payroll tax for all firms, policies that partially internalize employer DI experience would place a relatively larger burden on the labor costs of many relatively small (fewer than 500 workers), low-wage firms whose workers' DI benefits are high relative to their SS wages. Conversely, the percentage increase in the labor costs of many large firms or of high-wage firms with low relative DI experience would be very small.

It seems likely that firms with relatively high DI experience would try to reduce that experience. Those steps might be in the desired areas of attempts to prevent illness or injury and to retain workers with challenging medical conditions, but these firms might also reduce hiring or retention of workers at high risk for medical problems. Conversely, firms with low relative experience might not respond at all, though large firms with relatively low experience might be an exception because their DI experience might be large in an absolute sense even if not large relative to SS wages.

These proposals are likely to increase the cost of employing low-skill workers with high risk of DI entry, especially for relatively small firms with high relative DI experience. The result could mean lower employment and other consequences for low-skill workers, including DI entry, reliance on other benefits, and criminal activity. Autor and Duggan (2010) partially addressed this issue by

Selected employer statistics for relative DI experience, firms with 50+ workers

Quarter	Relative experience (%)	Mean workers	% of workers	% of DI entrants	Mean wage ($)	% entrants with 12 or fewer yrs. education
1st	0.0–0.1	771	21.4	4.9	36,900	46.8
2nd	0.1–0.5	1,875	52.0	45.9	28,330	59.9
3rd	0.5–1.4	718	19.9	30.6	14,242	70.7
4th	1.4+	241	6.7	18.6	7,206	72.2

Table 2

making their mandatory 24-month STDI benefit proportional to wages, up to a cap. That would reduce the impact on costs for low-skill workers and reduce the high financial incentive that low-skill workers have to claim benefits. However, it would also eliminate the progressivity of cash benefits for the first 24 months (until the worker transitions from STDI to DI) and increase the incentive for high-wage workers to claim benefits.

Although the principle of internalizing an external cost of behavior is an appealing reason to consider these reforms, it is important to consider that behavioral change might create other, unintended external costs, such as greater wage inequality and reduced employment for low-skill workers. The social consequences of such unintended effects undermine the social value of partial internalization. Developers of policies that rely on partial internalization of DI benefits to employers should consider how to address such consequences in ways that do not conflict with its objective—encouraging employers to change their behavior in response to costs they previously did not have to pay.

It is desirable to have a better understanding of the consequences of specific partial internalization policies before implementation. Although more might be learned from existing data, research on existing data has significant limitations. Pilot tests designed to address the most important knowledge gaps might be the best approach to overcoming the limitations of existing data.

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