DISABILITY COMPENSATION: CURRENT ISSUES AND OPTIONS FOR CHANGE

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PREFACE

In recent years, the Congress has focused much attention on disability compensation programs, questioning their high costs, their effectiveness, and the adequacy of program benefits. This paper, prepared at the request of the House Budget Committee, describes the major disability compensation programs and analyzes the gaps and overlaps in disability compensation, and the effects of current program provisions on the costs and adequacy of benefits and on work disincentives. The paper also presents options for changing federal disability programs, but in keeping with the Congressional Budget Office's mandate to provide objective and impartial analysis, makes no recommendations.

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SUMMARY

Public disability programs have been the subject of much scrutiny. In past years, concern was focused on their rapid growth and on the expanded role of the federal government. While the growth of the programs has been slowed as a result of recent legislative and administrative efforts, a number of problems remain.

Current issues focus on two contrasting problems: the high costs of disability compensation on the one hand and the adequacy of the benefits on the other. The costs of disability compensation continue to be high because of persistent problems in administering programs and because of provisions that automatically raise benefit levels. Other problems are associated with the lack of benefits for some disabled persons and high benefits for others, especially when the high benefits are the result of payments from more than one program. Work disincentives are also a major concern, particularly where benefits replace a high proportion of predisability earnings.

CURRENT DISABILITY PROGRAMS: OBJECTIVES AND CHARACTERISTICS

The disability compensation system consists of various public--federal, state, and local government--and private insurance and cash assistance programs. They include Social Security Disability Insurance (SSDI), civil service disability retirement, federal and state workers' compensation, veterans' compensation, and many private insurance programs. In addition, the federal government provides welfare payments to poor disabled persons through programs such as Supplemental Security Income (SSI) and veterans' pensions. In 1981, the major federal programs paid more than $37 billion in disability cash benefits to about 8 million disabled persons (see Summary Table 1).

Disability programs seek first to insure persons against the risks--especially income losses--of work-limiting disability impairments, and also to aid in the recovery process by providing services such as medical care and vocational rehabilitation. Cash benefits are paid to replace disabled workers' lost wages, to compensate for loss of limbs or physical capabilities, or to provide

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SUMMARY TABLE 1. CASH BENEFITS FROM FEDERAL DISABILITY COMPENSATION PROGRAMS, FISCAL YEAR 1981

Compensation Programs[a]	Payments (billions of dollars)	Primary Beneficiaries[b] (thousands)
Social Security Disability Insurance	16.9	2,840
Veterans' Compensation	6.9	2,280
Civil Service Disability Retirement	3.1	340
Supplemental Security Income (for Blind and Disabled)	4.4	2,160
Veterans' Pensions	2.4	890
Other Federal[c]	3.8	500
Total	37.5	8,000[d]

SOURCE: Appendix to the Budget of the United States Government, Fiscal Year 1983 and CBO calculations.

a. The programs listed include long-term disability compensation systems and exclude all general sick-leave programs. Payments for dependents and payments originally based on disability to persons aged 65 and over are also included, although payments to their survivors are generally excluded.

b. Numbers of beneficiaries represent average program totals during the year. Dependents and survivors are excluded.

c. Other federal programs include Black Lung Benefits, Federal Workers' Compensation, military disability retirement, and railroad disability retirement.

d. The total is less than the sum of all beneficiaries because it makes a rough allowance, based on limited information, for those receiving concurrent benefits from more than one federal program.

cash assistance for the needy disabled. While some benefits are temporary, others are awarded on a long-term basis--often for the disabled person's lifetime. When provided, medical care benefits are generally available for the duration of the disability; public funding for vocational rehabilitation services is sufficient to serve only a small proportion of the disabled population, however.

The major programs differ in their eligibility criteria, benefit formulas, and termination criteria. The most significant variation is with respect to a program's definition of disability or what constitutes a disabling condition. Definitions of disability are more restrictive in programs like SSDI and SSI than in others, so similarly impaired persons often receive different treatment when applying for benefits. To qualify for long-term payments from SSDI, for example, persons must have lasting disabilities and have suffered a reduction in functional capabilities affecting their ability to work; when such limitations no longer apply, benefits are terminated. The determination of lost capacities or inability to work is difficult, however, often leading to litigation and reversals of denied disability claims.

TRENDS IN EXPENDITURES

Cash benefit expenditures from federal disability programs grew rapidly between calendar years 1965 and 1975, but have slowed since then. Increases were most noteworthy in the SSDI program, which had an annual growth rate of 18 percent between 1965 and 1975--increasing spending from $1.6 billion to $8.4 billion. Between 1975 and 1980, however, cash benefits in SSDI grew at an average annual rate of less than 13 percent. The increases in federal expenditures were caused primarily by liberalizations of program eligibility criteria, the beginning of new disability programs for welfare recipients and black lung victims, lenient administration of the larger programs, and increased benefit levels. The subsequent slowing of growth resulted primarily from tighter administration of public programs, the end of the startup period for new programs, and the completion of adjustments to higher benefit levels and eased eligibility rules.

Growth could slow further in the short term because of recent legislation designed to accomplish this goal. New laws designed primarily to contain disability expenditures in the SSDI, SSI, and Black Lung Benefits programs were enacted in 1977, 1980, and 1981. On the other hand, the possible addition of new programs to compensate other occupational-disease victims along with the aging of the population, high unemployment rates, and reversals of denied disability cases may prevent further declines in the real level of expenditures.

LACK OF COVERAGE AND BENEFITS

Although a few programs like SSDI potentially cover almost all workers for total disability, many persons are prevented from receiving benefits because of special eligibility requirements, such as length and recency of covered employment. For example, about one-fifth of those in current civilian employment lack eligibility status for SSDI and other public disability benefits, primarily because they have not worked in covered employment, or have not worked long enough or recently enough. A significant portion of this group consists of new entrants and women with little attachment to the labor force.

Some disabled persons receive retirement benefits or public assistance rather than benefits based on disability. While three-fourths of persons claiming to be severely disabled when surveyed in 1978 reported receiving some type of public transfer payments, less than half reported receipt of cash benefits based on their disabilities. According to survey data, disabled persons not receiving disability benefits are mostly female; they are also more likely to have higher family incomes than beneficiaries, yet about one-fourth of persons claiming to be the most disabled report total family incomes below poverty levels, whether or not they receive any public cash benefits.

INCOME REPLACEMENT AND BENEFIT AMOUNTS

Disability payments replace widely varying amounts of beneficiaries' earnings before disability, even when they are based on previous earnings. For example, state workers' compensation programs generally pay at a rate of two-thirds of weekly wages for total disability, as long as the amount does not exceed preset maximums, which vary greatly by state. Benefits in other programs like SSDI reflect a portion of average career earnings. Benefits such as veterans' compensation, on the other hand, are not based on previous earnings but rather on lost earnings capacities estimated by the severity of the disability.

Concern over the adequacy of disability benefits focuses on two problems--very low and very high replacement rates. Low replacement rates are often defined as less than half of previous take-home pay. Benefits above predisability take-home pay certainly represent a high replacement rate, since this amount was the disabled person's previous contribution to family income, and benefits are generally tax-free. Moreover, disabled persons usually do not incur additional work-related expenses that would further reduce predisability spendable income, although their out-of-pocket medical expenses may be higher. On balance, however, adequate replacement levels are probably lower than predisability take-home pay.

Low earnings replacements can occur for several reasons. For example, benefits based on average career earnings that are low compared with earnings immediately before the onset of the disability result in low replacement rates. Another cause is payments, such as those from workers' compensation, that are based on a schedule of impairments for partial disabilities.

Disabled workers' benefits are usually not high relative to previous take-home pay, as measured by 60 to 70 percent of gross earnings in the year before disability. For example, survey analyses indicate that about 73 percent of disability beneficiaries have replacement rates of 60 percent or less.[1] Almost forty percent of disabled beneficiaries replace less than 35 percent of their previous earnings, and 31 percent of those claiming to be "severely" disabled have replacement rates this low (see Summary Table 2).[2]

On the other hand, about 12 percent of beneficiaries--mostly those with low predisability earnings--report benefits replacing more than 100 percent of previous earnings. In future years, however, fewer beneficiaries will have replacement rates above 100 percent because of recent legislative changes affecting SSDI benefit levels.[3]

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1. To the extent that survey-reported incomes do not accurately reflect actual incomes, the distributions of actual replacement rates could vary from those given.

2. In addition to beneficiaries with low replacement rates, about 25 percent of severely disabled survey respondents report receiving no transfer payments.

3. In 1977, 1980, and 1981, changes in SSDI benefit levels were enacted for newly entitled beneficiaries. The new benefits (continued)

SUMMARY TABLE 2. PERCENTAGE DISTRIBUTION OF 1977 REPORTED EARNINGS REPLACEMENT RATES FOR SURVEY RESPONDENTS DISABLED BETWEEN 1972 AND 1976, BY RECIPIENT CATEGORY

	Replacement Rates[a]				
Recipient Category	0	.01-.34	.35-.60	.61-1.0	Greater than 1.0
All Disabled Persons	69	12	11	5	3
Disabled Beneficiaries	--	38	35	15	12
Severely Disabled Persons[b]	50	15	20	8	7
Severely Disabled Beneficiaries[b]	--	31	39	16	14

SOURCE: CBO tabulations of the Social Security Administration's 1978 Disability Survey data.

a. The replacement rate is defined as the ratio of disability cash benefits to wage-indexed predisability gross earnings. Earnings in the year before the occurrence of disability were used in the computation and were derived from responses as to usual weekly earnings before work-limiting disability.

b. Severely disabled persons were identified in the survey data as those persons claiming to be unable to work at all or unable to work regularly because of a chronic health problem.

There are three main causes of high earnings replacement rates. First, additional benefits for dependents--sometimes fixed amounts but usually a percentage of the beneficiary's payment--can

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3. (continued)
provide lower replacement rates for many low earners, younger disabled workers, disabled workers with dependents, and certain recipients of public benefits from more than one program. Beneficiaries on the rolls before the new laws became effective are not affected.

make benefits high relative to the disabled person's previous earnings. Second, benefits based on the severity of the impairment, rather than on previous earnings, can cause high replacement rates, especially for low earners. Third, if benefits are received from more than one program (without offsetting reductions), replacement rates can again be high.

A combination of survey and administrative data suggests that about 15 percent of federal disability beneficiaries receive benefits from more than one program, including significant proportions of SSDI and veterans' program beneficiaries. A provision of the Omnibus Budget Reconciliation Act of 1981 that places a cap on combined benefits applies to some new SSDI recipients, but will not significantly lower the percentage of disabled persons with high replacement rates in the near future, mainly because those already on the rolls and recipients of veterans' compensation were not affected by the new law.

WORK DISINCENTIVES

Common to all disability programs is the problem of providing adequate benefits without creating work disincentives. In fact, work disincentives may be inherent in any disability program that provides benefits only if the beneficiary's earnings are less than a specified amount, or that uses the criterion of whether or not a person is working as a major determinant of whether that person is able to work.

Specifically, disabled persons who can work are discouraged from doing so if benefits are cut when earnings increase, especially if there is fear that earnings may not continue or that medical coverage will also be lost. Similarly, high benefits relative to past or potential earnings can diminish the attractiveness of work relative to leisure activities. Although other factors--such as the severity of the disability, the availability of jobs, or a person's age and other family income--may influence decisions, the greater the replacement of earnings, the less attractive work becomes.

OPTIONS FOR CHANGE

The Congress could follow two basic approaches in dealing with the issues raised in this study. First, it could alter and retarget disability coverage to ensure that those most in need of help would be served. Second, it could reduce benefit levels of certain federal programs with the aim of cutting outlays in a time of budget stringency, promoting similarity of treatment, and increasing work incentives.

Altering and Retargeting Program Coverage

This approach would address two often conflicting policy objectives: reduction of public disability expenditures and expansion of total disability coverage. The former objective could be achieved by retargeting and limiting program eligibility to those most disabled or eliminating future awards from certain programs that duplicate services provided by other major programs. The latter objective could be achieved by extending Social Security coverage for disability to all workers.

One way to target benefits would be to eliminate payments to persons with less severe disabilities. For example, approximately 1.3 million veterans now receive veterans' compensation benefits based on disability ratings of 20 percent or less. All of these veterans are considered employable, and it is doubtful that many suffer reductions in their earnings as a result of their low-rated disabilities. Maintaining their eligibility for medical benefits, but ending periodic cash payments to these persons, would save $1.2 billion in 1983 federal expenditures (see Summary Table 3). Opponents of this approach view the periodic benefits as indemnity payments owed to veterans disabled to any degree while serving in the armed forces.

Phasing out the veterans' pension program and consolidating coverage under SSI would end the current duplication between the two programs. Under this option, veterans' pensions would be retained by those currently receiving them; in 1983, needy veterans or survivors of wartime veterans would apply for SSI instead of pensions. Applicants who were not aged or disabled according to SSI definitions would be denied federal cash benefits; however, some might be eligible for Aid to Families with Dependent Children (AFDC) or other local government welfare benefits. Savings to the federal government would be $100 million in 1983 but would accumulate to $6.5 billion in 1983-1987, and could be substantially larger if some or all current beneficiaries were also affected.

A third option would expand disability coverage to all workers. About 10 percent of the working population would be affected by universal Social Security disability coverage,

SUMMARY TABLE 3. SUMMARY OF THE IMPACT OF OPTIONS TO CHANGE DISABILITY PROGRAMS ON FEDERAL EXPENDITURES IN FISCAL YEARS 1983-1987 (In billions of dollars)

Option	Federal Programs Affected	Savings 1983	Savings 1983-1987
ALTER COVERAGE:			
Restrict Entitlement to Veterans' Compensation	Veterans' Compensation	1.2	7.4
Phase In a Consolidation of SSI and Veterans' Pensions	SSI, Veterans' Pensions	0.1	6.5
Expand Coverage of SSDI	SSDI, Civil Service	1.1[a]	9.0[a]
MODIFY BENEFITS:			
Reduce COLAs	All indexed to CPI	0.5	17.0
Amend Workers' Compensation Benefit Formula	FECA	0.05	0.2
Limit Combined Payments	SSDI, Veterans' Compensation	0.01	0.2
Tax Benefits	All, except means-tested	1.8	14.0
Raise SSI Payment Levels[b]	SSI, Medicaid, Food Stamps	-1.3	-7.0

a. Estimated savings for this proposal represent increased revenues, net of costs, from Social Security taxes.

b. A minus sign (-) indicates increased costs rather than savings from the proposal.

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including about six million federal, state, and local government employees. Those not already covered by SSDI would contribute to the program and, over time, become insured under Social Security against income loss from total disability. Since eligibility for benefits requires meeting other criteria, such as length of coverage and recency of work, not all newly covered persons would be immediately eligible. If enacted in 1983, this proposal would increase 1985 outlays by less than $50 million and revenues by $2 billion.

Modifying Benefit Levels

Options that would reduce disability expenditures include:

- Reducing cost-of-living adjustments over the next five years to a proportion--for example, two-thirds--of the current level in order to restore the level of benefits relative to wages that existed in the middle 1970s;

- Limiting a federal worker's compensation award to 80 percent of previous after-tax income so that benefits would replace less than previous take-home pay and thereby increase work incentives for many temporarily disabled workers;

- Limiting combined payments from SSDI and veterans' compensation--that is, broadening the 1981 megacap provision and thereby integrating the two federal programs that have the most overlap.

Together these proposals would save about $600 million in 1983 and about $17.4 billion through 1987. They would be criticized by some, however, as providing inadequate compensation to certain beneficiaries--disabled veterans or federal workers with dependents, for example.

Alternatively, since the general tax-free status of disability benefits reduces revenues and acts as a work disincentive, some or all of them could be included in a disabled person's gross taxable income. By taxing half of disability benefits, for example, about $1.8 billion would be added to federal revenues in 1983. Taxing disability benefits rather than reducing benefits across the board would target benefits on those most in need. On the other hand, some disabled persons or their spouses might reduce their work effort in order to lower their taxable incomes.

Other Options

Several other options could be considered separately or in combination with those described above.

To improve the adequacy of benefits to needy disabled persons, SSI payment levels for individuals could be raised. In July 1982, the federal SSI guarantees represent about 73 percent of the national poverty level for individuals and about 82 percent of the poverty standard for couples. Raising the federal SSI guarantee for individuals to 80 percent of the poverty level would treat these two groups similarly and would increase the incomes of those most in need. In 1983, this option would increase federal SSI payments by about $1.3 billion. Increased Medicaid costs would be roughly offset by food stamp savings if neither of those programs was changed. Some would oppose this measure as being too costly in a time of budget stringency; others would favor a larger increase such as raising the federal SSI guarantee for both individuals and couples to 100 percent of the poverty line.

Alternatively, stricter definitions of disability could be used in federal programs to target benefits on those most disabled. Two general approaches have been suggested:

- o Using SSDI definitions of total disability in all federal disability retirement programs, and

- o Imposing even stricter requirements in SSDI or SSI programs.

One drawback to both proposals is that elderly disabled persons who may actually be unable to work would be affected disproportionately if age or the inability to do one's previous work were not taken into account in disability determinations.

In addition to the options described above, current rehabilitation practices could be changed to encourage more disabled persons to work. For example, state-federal vocational rehabilitation programs could place greater emphasis on providing the disabled with skills that are in demand, and on early job placement. More services could also be made available to or targeted on older, experienced workers, which would provide them with continued incentives to work.