Proposal 4: An Evidence-Based Path to Disability Insurance Reform

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Deficit Reduction (10-year): **$10 billion – $20 billion**

Broader Benefits: **Potential to increase employment and economic engagement of workers with disabilities and provide more rapid and reliable resolution of disability insurance claims for those who cannot work. Results of the pilots would inform broader reforms of the disability insurance system, leading to additional longer-term benefits.**

Introduction

Disability insurance is the leading edge of the demographic tsunami that is starting to flood U.S. social insurance programs. Americans who are between the ages of fifty and sixty-five are four times more likely than those between the ages of twenty and forty-nine to be receiving disability insurance benefits. For the past decade, the same baby boomers who are just beginning to create fiscal challenges for Medicare and Social Security have been in their peak years of disability insurance receipt. Spending on disability benefits through the federal Disability Insurance (DI) and Supplemental Security Insurance (SSI) programs has increased from 0.7 percent of GDP in 1980 to 1.2 percent of GDP in 2013. Spending on Medicare and Medicaid benefits for DI and SSI recipients is also slightly more than 1 percent of GDP.

The good news is that spending on disability cash benefits appears to have peaked. With baby boomers transitioning off disability benefits and onto Social Security retirement benefits, and with the next cohorts slightly smaller than the baby boomers, the Congressional Budget Office (CBO) projects that spending on DI will fall by 0.1 percent of GDP between now and 2022 (CBO 2012).

But even though the fiscal burden of disability insurance is not expected to worsen, the program is in significant need of reform. This policy note summarizes the conclusions of a year-long research project designed to establish an evidence-based path to disability insurance reform. Our complete findings are available in Liebman and Smalligan (2013). The project was motivated by the observation that, while a consensus is emerging that changes are needed to the U.S. disability insurance system, there is no agreement around any specific reforms, nor does there appear to be a path in place that will lead to such agreement. Moreover, in most cases we lack the evidentiary base necessary to judge whether specific reforms would do more good than harm.

We therefore recommend a path that identifies promising reforms that are administratively realistic, pilots them or otherwise acquires the evidence necessary to judge their merits, and then rolls them out more broadly if proven benefits are established.

Two immediate steps are needed to start down this path. First, Congress should authorize three demonstration projects centered around early intervention. The key to reducing disability insurance costs is to intervene as early as possible

DISCLAIMER: Jack Smalligan's contribution to this paper is based on work that he performed while on sabbatical from OMB as a guest scholar at the Brookings Institution and a research fellow at the Harvard Kennedy School. The views expressed in this paper are solely those of the authors and not of any institutions or government agencies with which they are or have been affiliated.

to assist individuals in remaining at work. Waiting until after an individual has been approved for benefits is too late. Second, Congress should give the new Social Security commissioner the tools necessary to improve the disability determination system. Most important, funding for state disability determination services should be placed on the mandatory, rather than the discretionary, side of the budget. This will allow the Social Security Administration (SSA) to make investments in administrative capacity that will reduce spending on benefits—for example, by reducing the backlog of continuing disability reviews.

Like reforms to other social insurance programs, these changes will have a relatively small budget impact over the next ten years, but have the potential to produce much larger savings in later years. A package with these two reforms could save $10 billion to $20 billion over the coming decade, mostly through more thorough initial reviews. If the early intervention pilots are successful and taken to scale, annual savings of as much as 0.1 percent of GDP would be possible.[1]

The Challenge

There are three main reasons why disability insurance is in need of significant reform:

First, there is a sizable minority of the beneficiary population who would be better off with a form of assistance that is different from the one they are receiving today. These individuals need assistance that helps them back on their feet and returns them to employment, instead of receiving the current benefit package that essentially provides lifetime cash benefits in exchange for a promise never to do substantial work again. Changes in the disability insurance program and in low-skill labor markets, along with the decline in other forms of public assistance, have made this subset a larger fraction of the DI and SSI beneficiary population.

Second, many of the actors in the disability insurance system have misaligned incentives. Employers and private disability insurance companies have incentives to sign workers up for DI rather than to help them get back to work. States have incentives to encourage low-wage workers to sign up for SSI and DI so as to shift both assistance costs and health-care costs to the federal government. Because its administrative budget is discretionary spending while benefits are mandatory, the SSA has an incentive to underinvest in administrative capacity even when doing so increases total program costs. And labor supply disincentives are inherent in any transfer program with imperfect screening for need. Reforms that improve the alignment of incentives have the opportunity to both improve program outcomes and reduce costs.

Finally, although there has been some recent progress, the disability determination system remains a problem. Beneficiaries wait too long for decisions. Too many decisions are appealed. Different standards are applied within and across the stages of the claims process. There is a backlog of more than 1.4 million continuing disability reviews. What is needed is a set of reforms that invests in getting decisions right initially and reduces the need for appeals.

The Proposal

After spending a year interviewing experts, reading research, conducting original data and policy analysis, and observing program operations in the field, we believe even more strongly than we did when we began the project in our original premise that program improvements are needed; we also believe, however, that we currently lack the evidentiary basis for judging which fundamental changes should be implemented. We therefore recommend a path that identifies promising reforms that are administratively realistic, pilots them or otherwise acquires the evidence necessary to judge their merits, and then rolls them out more broadly if proven benefits are established.

We have two specific recommendations: demonstration projects and new tools for the Social Security commissioner.

RECOMMENDATION 1: DEMONSTRATION PROJECTS

First, Congress should give SSA and its partner agencies authority for three demonstration projects centered around early intervention. Research consistently shows that it is too late to intervene after a person has begun receiving disability insurance benefits. Extensive programs like the Ticket to Work program have had little success helping current beneficiaries return to work. Even going through the extended process of applying for benefits—which expects that a person not engage in substantial work while the application is pending—has been shown to cause real harm to the future earnings potential of workers whose disability applications are turned down.

One demonstration would screen disability applicants and target those who appear likely to be determined eligible for benefits but who also have the potential for significant work activity if provided with a proper range of services. In exchange for suspending their disability insurance application, these applicants would be offered a package of benefits including targeted vocational and health interventions, an Earned Income Tax Credit (EITC)-like wage subsidy, and, potentially, a few months of an emergency cash diversion grant. By substituting work supports and wage subsidies for cash benefits, the demonstration would aim to improve the well-being of applicants while simultaneously achieving near-term cost neutrality and long-term savings. For this intervention to be cost-effective, it will be important to retain tight eligibility criteria for the new work supports, concentrating services on individuals who otherwise have a high probability of being approved for benefits.

Interventions are likely to be even more effective if they occur well before an individual reaches the point of applying for benefits. The other two demonstration projects try to move the early intervention to earlier points.

A second demonstration would allow states to reorganize existing funding streams to target populations that are likely to end up receiving a lifetime of SSI or DI benefits in the absence of assistance. Today a wide range of funding streams including vocational rehabilitation funding, Medicaid, Temporary Assistance for Needy Families (TANF), and workers compensation reach individuals who may be at risk of being disability insurance beneficiaries. States would be given the flexibility to reorganize these funding streams to target specific at-risk populations in a coordinated way and would receive incentive funding if they demonstrated success at improving outcomes and reducing participation in DI and SSI. In many ways, where we are with disability insurance today is similar to where we were with cash welfare in the 1980s before the welfare waiver demonstrations. To make progress in early intervention and inform future reform efforts, we need to unleash a wave of innovation and learning at the state level similar to what occurred in the late 1980s and early 1990s when states were given waivers to experiment with their Aid to Families with Dependent Children (AFDC) programs; the lessons learned then informed the 1996 federal welfare reform.

For example, a state could propose to provide integrated employment supports to all persons with severe mental illness who meet certain criteria. The state would propose to allocate a given percentage of its federal vocational rehabilitation and mental health funding to cover the costs of these services, as well as a given percentage of Medicaid state matching funds. The federal government would provide some additional funding for the start-up costs of this initiative through a grant, and would offer the state bonus payments if the effort achieved a significant reduction in new DI/SSI awards based on mental illness as of the third year, with rewards and penalties if that target level was surpassed or not achieved. In effect, the bonus payments would allow the federal government to share the DI/SSI savings achieved, thereby aligning incentives between the two levels of government. States would be encouraged to use randomized evaluation designs where administratively feasible.

A third demonstration would target employers. Autor and Dugan (2010) and Burkhauser and Daly (2011) have proposed reforms to disability insurance that create incentives for firms to help keep their workers employed rather than having them stop working and receive disability insurance. Specifically, Autor and Duggan proposed that mandatory private disability insurance replace federal benefits for the first two years of disability, and Burkhauser and Daly proposed a system of experience rating similar to that used in the unemployment insurance system. We think it will be difficult to test the potential of employer-based incentives in a way that restricts existing benefits or imposes new mandates or penalties on firms. Therefore, we propose a demonstration program that would provide a tax credit against their DI payroll tax for firms that can reduce the disability incidence of their employees by at least 20 percent.

Firms would volunteer to participate in the demonstration. For each employer participating in the demonstration, a baseline predicted rate of DI enrollment would be established, using historical data and information on the current profile of employees. Current employees would be tracked for three years from the implementation date of the pilot, whether or not they continued to be employed by the firm. If the employee, current or former, becomes eligible for DI with a date of onset within three years of the implementation date of the pilot, the employee would be counted as part of the firm's DI enrollment rate. An evaluation contractor would compare DI participation against baseline projected participation. If DI participation falls by a statistically significant amount, the employer would be credited with three-quarters of the annual DI savings. In the pilot, firms would not be at risk if DI participation exceeded baseline projected participation. However, a two-sided risk-sharing approach could be used if the program were implemented more broadly. In some cases, employers might use the potential credit to underwrite the cost of private disability insurance policies that seek to reduce the incidence onto DI. In other words, employers and private disability insurance companies could enter into agreements to share any realized credit. Many employers who might volunteer would already offer private disability insurance, and it would be reasonable to expect private insurers to view this as a promising new area of business.

Any financial incentive for employers to avoid having their former workers claim DI creates a risk that the incentives will lead to hiring discrimination against workers from population groups with higher-than-average disability incidence or against specific workers who employers view as having a higher-than-average probability of claiming benefits. Such discrimination is illegal under the Americans with Disability Act (ADA) but could nevertheless occur in ways that are hard to detect. One option to address this concern would be to limit initial tests to the current workers in a firm. However, this would limit our ability to learn about the discrimination risk from the demonstration.

RECOMMENDATION 2: NEW TOOLS FOR THE SOCIAL SECURITY COMMISSIONER

Second, we recommend that Congress give the new Social Security commissioner the tools necessary to significantly improve the disability determination system.

Specifically, we propose that the funding for state disability determination services be switched to the mandatory side of the budget—matching how the administrative costs of TANF, Medicaid, and Food Stamps operate. Under the current system, SSA underinvests in administrative capacity, saving money in its capped discretionary budget in ways that significantly increase benefit payments that are mandatory spending. For example, SSA has a backlog of 1.4 million continuing disability reviews even though the SSA actuaries estimate that every $1 spent on continuing disability reviews saves $9 in future benefits (SSA 2012). With Disability Determination Services (DDS) funding transferred to the mandatory side of the budget, SSA would have the resources to reduce backlogs, perform continuing disability reviews, and, most important, develop sufficient evidence at the DDS stage so that more-accurate decisions are made up front and fewer cases are appealed. We also would recommend that SSA use this authority to enhance the level of review and claims development the DDSs perform when an initial denial is appealed. This additional DDS work would reduce the need for appeals to the administrative law judge stage of the process and improve the quality of the evidence for those claims that are appealed. This authority should be accompanied with an expectation that, to the extent SSA uses additional administrative funds, it must show that the expenditures more than pay for themselves in reduced benefits. When this new authority is up for reauthorization after five years, Congress would ask GAO and the Social Security Office of the Actuary to assess whether the reform has reduced overall costs. If SSA failed to meet that goal, the new authority should expire and DDS spending should revert to the discretionary side of the budget.

In order to encourage consistency in the disability determination process across states and to prevent states from using the mandatory funding authority to pad their workforces without improving quality and productivity, we also recommend that the commissioner be given the authority to move work across states.

This is a particularly auspicious time to start down the path toward disability insurance reform. First, the need for deficit reduction is leading to a broad discussion about the structure of U.S. social insurance programs and a budget deal could be the legislative vehicle for obtaining the legislative authority necessary to pilot disability insurance reforms.

Second, the confluence of a new presidential term and the appointment of a new Social Security commissioner makes it practical from an administrative standpoint to embark on reforms that are likely to take several years of sustained attention to implement. Past reform efforts have stalled when they have begun during the second half of a commissioner's term.

Finally, the DI trust fund is scheduled to be exhausted in 2016, implying that some legislation will need to occur before that date. Even if Congress follows the traditional approach and simply reallocates resources between the OASI and DI trust funds, the legislation will offer another vehicle for obtaining the necessary authorities, and indeed it seems possible that some members of Congress would demand steps toward more-fundamental reform as the price of voting for the trust fund reallocation.

Conclusion

The reforms discussed in this brief have the potential to improve outcomes for Americans with disabilities—by helping some get back to work and by providing more-rapid and more-reliable resolution of disability insurance claims for those who cannot work. Over the longer term, they have the potential to reduce budgetary costs. But realizing that potential is going to require sustained attention, experimentation, and evaluation over a decade. The sooner we start that process, the sooner we can realize the benefits.

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Endnotes

1. We reach this estimate by assuming that roughly one-third of DI recipients are potentially able to be targeted for employment services and that the services enable one-third of that one-third to work rather than receive benefits. Net of the cost of the employment services, the savings would be around 0.1 percent of GDP.

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