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# Intelligent Money

Current thinking from Haven Financial Advisors

## The Growing Ranks of the Disabled



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### Special Notes of Interest:

Some 47.6 million people, or nearly 15% of the population, get food stamps, according to the most recent data. In 2007, only 26.3 million, or 8.7% of the population, got food stamps.

The Centers for Medicare and Medicaid Services (CMS) project the health care share of GDP by 2022 will rise to 19.9% from its 2011 level of 17.9%.

The job market in this country is often a prominent subject in the nation's political debate. On September 6<sup>th</sup>, the latest government employment report offered mixed signals. The headline unemployment rate fell to 7.3% but the number of jobs created was subpar. One of the confounding factors that policy makers must contend with is the changing size of the labor pool.

The unemployment rate cited above is the number of unemployed workers divided by size of the labor force. The labor force is measured as the sum of the number of people over the age of 16 with jobs plus the number actively looking for work. Thus, the labor force excludes large numbers of people. Among those excluded are caring for family members, attending school, the retired, and the disabled. Many of these folks move out of the labor pool due to financial incentives.

This edition of *Intelligent Money* will take a closer look at one part of the labor pool that is not counted among the nation's unemployed – the disabled. This is a rapidly growing segment of the population and we'll try to understand why that is.

### The Issue at Hand

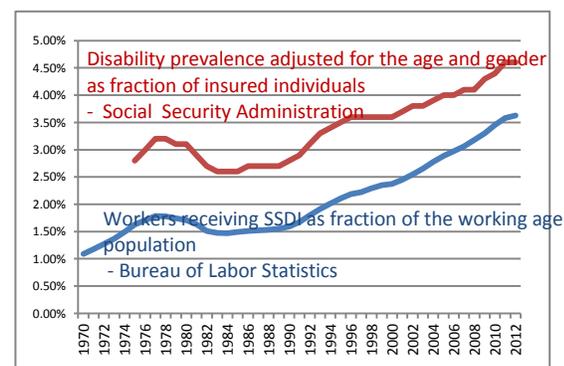
The country's labor participation rate measures the ratio of employed people to the population over the age of 16. This ratio has been declining steadily for the last 15 years. The process accelerated with the latest recession. In fact, it's reached its lowest level since 1978, before women were fully integrated into the workforce.



Demographics and cyclical economic conditions certainly play some role in the decline. But there is an elephant in the room and its numerical momentum is unmistakable. The number of individuals who have qualified for federal benefits as disabled workers has skyrocketed.

Today, there are 6.6 people on disability for every 100 people actively working. That's double what it was 20 years ago. Heritage Foundation research estimates that increased disability claims account for as much as one third of the fall in the labor participation rate between 2007 and 2011.

We've used government data to capture the growth in the ranks of the disabled from two different perspectives. The blue line adjusts for the population size while the red adjusts for age and gender evolution in the workforce. In both cases, the trend is obvious.



Researchers at the Federal Reserve Bank of San Francisco and the Congressional Budget Office conducted a rigorous statistical study of the impact of demographic trends and found that they explained about half of the increase in the disability rate. They postulated that the remainder of the increase could be attributed to policy changes in the program and to the relative increase in the value of disability benefits.

### History of the Federal Disability Program

The federal disability program operates as part of the Social Security Administration (SSA). It did not formally become part of that system until 1956, more than 20 years after the original Social Security Act. It




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became known as the Social Security Disability Insurance (SSDI) program. In its initial years SSDI paid benefits only to workers who were fifty years of age or older. Consequently, the program's original design did not focus on rehabilitation and return to the workforce.

In 1960, the minimum age requirement was removed. The benefits and scope of the program gradually expanded until the late 1970s. Alarmed at rising deficits, members of the Carter cabinet and congress took steps to control the program's cost. In 1980, Congress passed an amendment to the SSDI that mandated periodic "recertification" of beneficiaries every 3 years.

Disability rolls declined in the early 80s as people could no longer qualify for benefits. Inevitably, the press seized upon some high profile, if anecdotal, evidence of apparently disadvantaged people being thrown off the disability rolls. The political backlash was strong.

The response was fairly swift and eligibility for SSDI was relaxed. In 1984, Congress passed the landmark Social Security Disability Benefits Reform Act. It placed the burden on the SSA to demonstrate that an individual could return to work. Prior to 1984, the disability determination process turned on whether an applicant's condition met or exceeded a *listed* impairment. The new legislation directed the SSA to assign more weight to the claimant's own statements as well as the cumulative effect of multiple non-disabling conditions.

In 1991, the SSA adopted the "treating physician rule" which gives controlling weight to the disability determination of the treating physicians. The treating physician was presumed to know the claimant's condition best. Sounds reasonable, at first.

Of course, the treating physician is predisposed to be sympathetic to the claimant. In fact, he may only have been engaged to provide testimony regarding the disability. Gone are the days when family physicians maintained relationships with patients over decades. Administrative law judges must often sift through contrary medical opinions in disability appeal hearings. If the treating physician's view is plausible, it typically carries the day.

The net effect of legislative and regulatory reform in the 80s and 90s was to create a more arbitrary claims process. A cottage industry of attorneys sprouted up to advocate for disability

claimants. The number of disability cases increased as well as the incidence of disorders with a higher subjective component. Mental illness and musculoskeletal disorders (usually back pain) now comprise as over half the claims.

There are five stages to the disability application process. The first is a direct application to the SSA. The second is a request for reconsideration by the same agency. The third is an appeal to an administrative law judge (ALJ). The fourth is an appeals council. If these forums do not award benefits, the claimant can appeal to federal court. If the claimant wins at any stage, disability benefits are awarded retroactively.

Entry to the SSDI program is pretty much a one way street. The only way people leave is to become eligible for social security or to die. Congress created the "Ticket-to-Work" program in 1999, which allowed SSDI beneficiaries to return to work while keeping their health coverage. Over the next seven years, fewer than 1,400 claimants used the program to reenter the labor force.

Apart from the relaxation of disability criteria, the disability claims process itself has become sloppy. A US Senate subcommittee recently conducted an inquiry into the current methodology of disability award decisions. They focused on the second layer of the appeals process – the administrative law judge (ALJ). Their findings corroborated those of an internal review conducted by the Social Security Administration (SSA) itself. The most prominent conclusion was that close to one quarter of the award decisions made on appeal contained substantial errors and/or relied on insufficient evidence.

Senator Tom Coburn of Oklahoma is a practicing physician who co-chaired the investigation. He reviewed 100 disability applications himself and offered the following:

*"At least one-third of the people getting disability payments are able to work... They're a joke. Lawyer after lawyer just changed their diagnosis through time to finally get an administrative law judge to approve it."* – quoted in *The Economist*, September 16, 2013

The success of a disability appeal may rest on which ALJ is assigned to hear the case. There are about 1400 of them. About 100 ALJs reverse 90% of the cases referred to them. Overall, the reversal rate varies by ALJ from 8.6% to 99.7%. Regardless of what one thinks about disability, it does matter who hears the case.



*“The average monthly SSDI payment in 2013 is \$1,132.”*

The majority of cases that are reversed in favor of the claimant by ALJs are for causes of pain, anxiety and depression. About half the US population suffers from at least one of these maladies.

Where are we today? The government currently spends \$140 billion a year on SSDI payments—about 20% of Social Security’s budget. That’s about twice the ratio that prevailed in 1988.

The SSA uses a complex weighted formula in order to calculate benefits for each person. The amount is closely related to the amount each worker accrues toward their old-age pension. Since disability necessarily occurs prior to the completion of the worker’s career, the actual payout is less than the projected old-age pension. The average monthly SSDI payment in 2013 is \$1,132.

There are additional benefits. Under SSDI, a disabled person’s spouse and children are eligible to receive partial dependent payments. After receiving SSDI for two years, a disabled person will become eligible for Medicare, regardless of age. By 2009, \$70 billion of Medicare’s budget was allocated to disability-eligible recipients. The average disabled person receives lifetime benefits in the neighborhood of \$300,000.

There is an SSDI trust fund that is maintained separately from the retirement system. It is funded today with a portion of the payroll tax. Currently, the combined payroll tax rate paid by employers and workers is 12.4%. The disability program’s rate is 1.8%, while the retirement system’s rate is 10.6%. According to Social Security’s actuaries, the trust fund will be depleted within 3 years. Of course, the SSA can reshuffle the payroll revenues a bit to keep the program running.

**The Future ... and Possible Solutions**

A number of common sense solutions have been proposed for the system. Why not reduce the five step appeal system to two steps? A claimant could make an initial application to the SSA. If rejected, the worker has one avenue of appeal in front of a judge. No new evidence could be introduced at the appeal level. Both parties would be represented there.

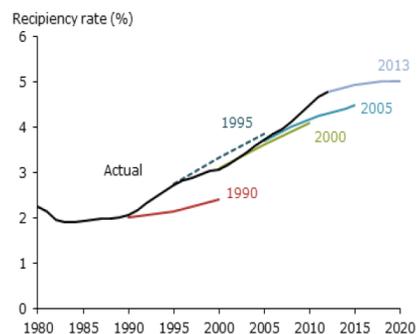
Given the impersonal nature of medicine today, it seems anachronistic that the “treating physician’s” opinion be given special weight. He’s just another expert witness and should be treated as such – on a par with other experts.

The accrual of disability benefits has been indexed to wages. Consequently, their real value has outstripped inflation. Perhaps a reindexation of disability benefits to inflation would be a better method. This rather technical fix has been recommended repeatedly to address shortfalls in Social Security’s larger retirement program.

SSDI might take some lessons from private disability insurance. These policies often have lower benefit levels that are triggered with a partial loss of income. The underlying idea is to keep the insured engaged in the workforce either at the front end or the back end of a disabling event. Perhaps the federal disability features could be modified to keep workers at least partially engaged in gainful employment.

Public expenditures on SSDI are expected to grow into the foreseeable future. But by how much? The latest report by the system’s trustees projects that the number of recipients will climb from 8.8 million to 9.5 million by 2019. The trustees assume no growth to the underlying rate of disability save for that attributable to an aging population. That may be too optimistic a projection given the trend of the last 20 years.

History indicates that the government agencies from the Census Bureau to the SSA have consistently underestimated the growth rate of disability in the US. The [Federal Reserve Bank of San Francisco](#) has charted past government forecasts of disability against actual experience. With one exception, the recent forecasts have all undershot realized experience.



Source: Authors’ calculations based on Board of Trustees of OASDI years), Bureau of Labor Statistics, and U.S. Census Bureau.

Medicare and Social Security’s retirement program are the headline items in the government’s effort to avert fiscal disaster. These are programs we hear about most often. But the disability program is an ever greater burden on the economy. Not only does it cost money but it diverts people from the work force.

*“ History indicates that government agencies from the Census Bureau to the Social Security Administration have consistently underestimated the growth rate of disability in the US.”*