



How Do Disabilities Affect Future Retirement Benefits?

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Workers who develop health problems in their 50s and 60s risk derailing their retirement preparations. Serious medical conditions raise out-of-pocket health care spending and sometimes force people to retire early or cut back their work hours, leaving them with less money to save for retirement. Early retirees must stretch their retirement savings further than those who retire later. Social Security, however, provides an important retirement safety net for Americans with work disabilities.

Health Shocks

Health problems become increasingly common as workers approach traditional retirement ages. One-quarter of workers ages 51 to 55 in 1992 developed work disabilities—defined as health problems that limit the amount or type of work they can perform—before age 62 (Johnson, Mermin, and Murphy 2007). The risks are especially high for workers with limited education. Nearly one-third of workers who did not complete high school developed health problems before age 62, almost twice the disability rate for college graduates. Women and African Americans are more likely than men and other racial groups to experience health shocks before age 62.

Work disabilities often force people to curtail their work hours or leave the labor force earlier than planned. Consequently, disabilities tend to reduce Social Security retirement benefits, which depend partly on how much people earn over their lifetimes. Dealing with a disability can also erode financial wealth, because people with health problems may have to dip into their retirement savings to cover their medical bills or other living expenses, especially if they are unable to work.

Health problems often shrink expected benefits from traditional pension plans, which still cover about one-fifth of private sector workers and nearly all government workers (Cushing-Daniels and Johnson 2008). Most traditional plans tie benefits to years of service

and earnings received near the end of a person's career. As a result, the value of future benefits tends to grow rapidly just before retirement age. People forced to stop working because of health problems can suffer substantial losses in pension plan benefits.

Effects on Future Retirement Benefits

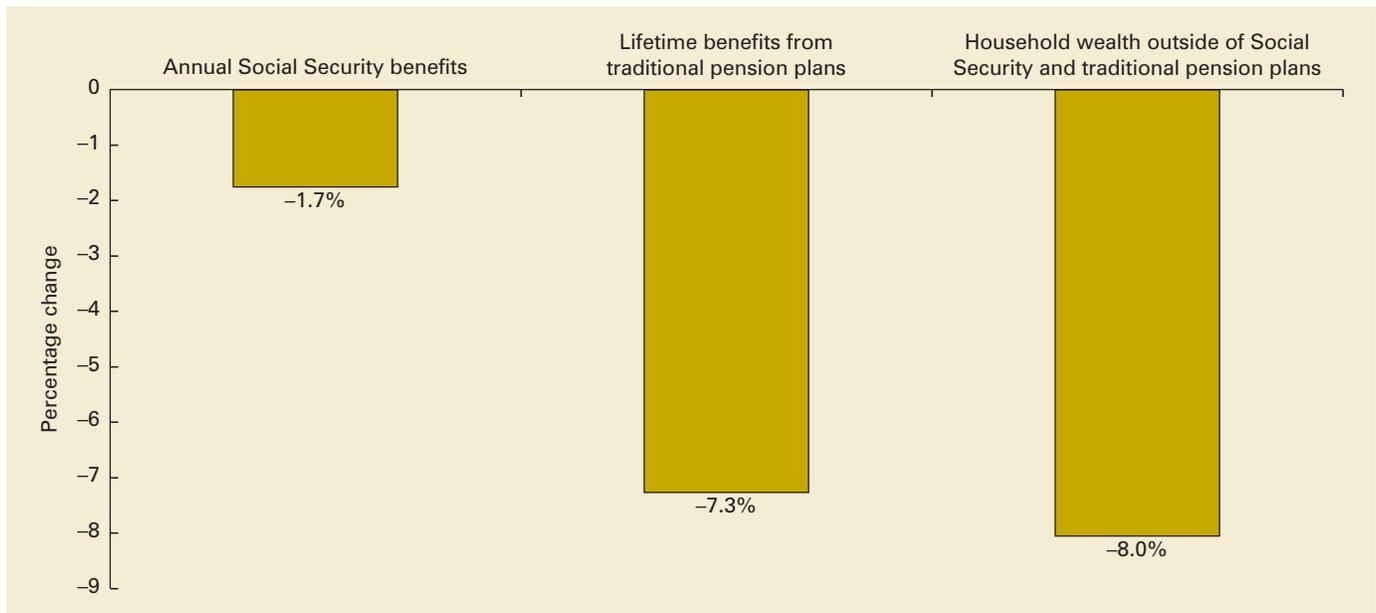
Health problems have a significant effect on financial wealth and traditional pension benefits. After other factors are controlled for, the onset of work disabilities between ages 51 and 61 reduces household wealth (including financial assets and the value of housing, other real estate, and businesses, but excluding Social Security and traditional pension plans) by 8 percent at ages 63 to 67 (figure 1). It lowers the value of lifetime benefits from traditional pension plans by about 7 percent (among those with coverage).

Health shocks between ages 51 and 61 only modestly reduce future Social Security retirement benefits. After earnings, education, and other factors are controlled for, the onset of health-related work limitations reduces Social Security retirement benefits at ages 63 to 67 by only about 2 percent. The impact is small partly because the system provides disability benefits to some who can't work because of a serious health problem. Social Security disability benefits are based on lifetime earnings adjusted for the relatively short work lives of people with disabilities. Unlike other beneficiaries, those receiving disability payments are not penalized for taking up benefits before the normal retirement age.

Only about one-quarter of workers who report work disabilities in their 50s and early 60s ever receive Social Security disability benefits. The take-up rate is low because eligibility rules are strict and the application process is arduous, involving disability, earnings, and work history requirements.

Other protections built into Social Security cushion the impact of midlife health problems for those who do not qualify for disability benefits. The share of earnings that the system replaces in retirement falls rapidly as lifetime earnings increase, boosting replacement rates for people with relatively short careers. Social Security considers only the top 35 years of earnings, further protecting people who are unable to work for more than 35 years. Additionally, people may collect benefits based on their spouses' earnings histories instead of their own, if their spouses earned substantially more than they did. Because of these protections, health problems at age 51 and older reduce annual Social Security retirement benefits by only about 3 percent for those who do not receive disability benefits.

FIGURE 1. Impact of Late-Career Work Disabilities on Social Security Benefits, Traditional Pensions, and Household Wealth at Ages 63 to 67



Source: Johnson, Mermin, and Murphy (2007).

Note: Estimates show the effect of work disability onset between ages 51 and 61 for a sample of workers from the Health and Retirement Study, expressed as a percentage of benefits or wealth at ages 63 to 67. The analysis controls for earnings and health at ages 51 to 55; education; gender; race and ethnicity; marital status; and job layoffs. Work disabilities are defined as health problems that limit the type or amount of work that people can perform.

An Uncertain Future

Although Social Security safeguards old-age benefits for those who develop health problems late in their careers, people with disabilities continue to face economic challenges. The many people with disabilities who fail to qualify for disability benefits often endure financial hardship before retirement benefits begin at age 62 (CBO 2004). The growing backlog of disability claims, which doubled between 1996 and 2007, is stretching waiting times for benefits and deepening economic distress (GAO 2007). The soaring costs of Social Security's disability program create additional uncertainty. Disability benefit payouts already exceed tax revenue, and the imbalance will worsen as the population ages (Social Security Trustees 2008). The carefully crafted provisions that protect people with work disabilities should be maintained in any revamped system.

Acknowledgment

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