

Summary

Reducing Health-Related Labor Force Exits Among Elderly Workers

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**A summary of a report in Swedish with the title "Hur kan tidiga hälsorelaterade utträden ur arbetslivet minskas?" (SNS Förlag)*

On December 14, 2017, the Swedish parliamentary committee for pensions proposed an increase in the earliest retirement age. The hope is that a later retirement age will lead to higher pensions for retirees and to lower costs for the government. However, the proposal has also highlighted the challenges of poor health and limited work ability at the end of the working life. What happens to those who are unable to work, even though they would want to?

Ideally, the disability insurance system should support people who are permanently unable to work. However, it has proved challenging to design a disability insurance system that simultaneously provides strong income protection for those in need, while avoiding a high number of disability claims. In the early 2000s, disability claims were running high in Sweden, which led to a set of reforms that

tightened the eligibility requirements for disability insurance. The reforms succeeded in reducing the number of disability claims. However, this came at the price of more workers claiming their public pension earlier. This has primarily been true for low-income workers with a history of sick leave absenteeism, which suggests that the public pension has become a safety valve for those unable to work.

With an increased pension age, this safety valve will be closed, which creates a dilemma for the disability insurance system. Either the more generous eligibility criteria are reinstated, which would risk raising the disability claims back to the high levels of the early 2000s, or the stricter criteria are maintained, which could force elderly people to turn to welfare when they are unable to work. In other words, there is a need to develop new strategies for income protection among the elderly.

The conflict between private and public interests

This report shows that a key challenge for the disability insurance system is the conflict of interest that arises when the state, rather than the employers, bears the bulk of the disability insurance costs. The report focuses on the local government sector. In a numerical example, we show that when a municipal worker goes on disability insurance from a job that pays SEK 20,000 per month, the state is directly burdened with costs of approximately SEK 196,000 per year, while the municipality primarily faces indirect costs of finding a new employee. Thus, local governments have relatively weak economic incentives compared to the state in keeping disability claims down, for example through an improved work environment, and/or by providing the authorities with complete information regarding the work abilities of their employees.



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In our view, a well-functioning disability insurance system cannot exclusively rely on rules and controls that regulate the supply of social insurance. It is also important to regulate the demand for social insurance through measures that affect the incentives for employers to retain elderly workers. One way to regulate the demand for social insurance is to let employers participate in the financing of the disability insurance for their employees.

Policy proposal: self-insurance for local governments

We propose a system where local governments are responsible for the disability insurance costs of their employees whenever these are higher than a benchmark value that is based on the disability insurance costs in comparable units. Conversely, local governments receive a positive transfer when the actual costs are less than the benchmark value. A local government's expected disability costs can, for example, be calculated based on the gender, age, and occupational composition of the employees.

The proposal is a form of self-insurance, and is based on the well established economic principle that units should be evaluated in relationship to a benchmark, so-called yardstick competition. In the US, large private employers often use self-insurance systems to finance the health care costs of their employees. In other Northern European countries, employers typically also have a greater responsibility for disability insurance costs than in Sweden.

The system does not impose any extra costs on the local government sector as a whole, since local governments only pay for the costs in excess of their expected costs. Hence, despite increased economic incentives for individual local governments, the full cost of the disability insurance is still financed by the state. The system is also transparent, and is possible to implement in the context of the current financial equalization system for local governments. The system would also require relatively less control of employers fulfilling their requirements for facilitating the return of workers to work, since the employers now have stronger economic incentives to retain workers.

The proposal in practice

We use data on the disability insurance claims for local government employees from 2014 to calculate the distributional impact of our proposal. For

municipalities, we find that the total transfers in the system on average correspond to 17 percent of the transfers in the local government equalization system. Only in a handful of cases do municipalities have to pay more than 1 percent of their total tax revenues. For counties, the transfers correspond to between 0.1 and 9 percent of the total equalization transfers (on average 2 percent), and less than 0.2 percent of their total tax revenues. Our proposal somewhat increases the fiscal inequality between municipalities. Municipalities that pay into the equalization system will, on average, receive transfer payments from the self-insurance system. However, the relationship is weak.

The relatively small payments might be interpreted as the self-insurance system is not providing strong incentives. However, the size of the transfer payments is not a measure of the strength of the incentives, but of the similarity in disability insurance costs between different local governments, once we have corrected for the composition of the workforce. Whenever transfers are small, this can instead be seen as a sign of local governments being sufficiently similar so that strong incentives can be applied without large distributional consequences.

The report also discusses practical issues that need to be addressed if the system is to be implemented. For example, the value of stronger incentives needs to be balanced against the risk of individuals with health problems being disfavored in employment decisions. However, the aim of the report has not been to propose a fully designed system. Rather, the aim has been to demonstrate how the current social insurance system creates a large conflict of interest between the state on the one hand, and the local governments on the other hand. We have also shown how a simple self-insurance system can reduce this conflict of interest. The report has focused on the disability insurance system, but the same logic is applicable to other forms of work-related social insurance, such as the sickness leave insurance.

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