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Is Military Disability Compensation Adequate to Offset Civilian Earnings Losses from Service-Connected Disabilities?

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Summary

Introduction

Casualties in Iraq and Afghanistan have heightened concern about whether disability compensation and programs provide adequate support for military veterans. The Departments of Defense and Veterans' Affairs pay about \$35 billion in disability compensation to about 3.2 million veterans each year. Their disabilities range from battlefield injuries to health conditions like diabetes and asthma.

This research looks at the adequacy of disability compensation to offset the reduction in civilian earnings opportunities that are associated with service-connected disabilities (SCDs). Compensation is based on a schedule of ratings that nominally reflects the average loss in civilian earnings related to each disability. Until recent years, research has not directly compared disability payments with the actual civilian earnings losses of veterans.

Our analysis focuses on recent cohorts of veterans who left active military service between fiscal year (FY)1993 and FY2004. We track their civilian earnings and labor force participation (LFP) for up to 12 years, from 1994 through 2005.¹ We follow civilian labor-market outcomes for veterans in these cohorts and compare the labor-market success of veterans with and without SCDs.

This research addresses four questions:

1. How do civilian LFP and earnings vary with SCD rating? We examine whether disability compensation is sufficient to offset civilian earnings losses.
2. Are earnings losses larger for some groups of veterans than for others? Veterans vary substantially by education, age at military separation, and other factors, so earnings losses might be adequate for some groups and inadequate for others.
3. Do earnings losses differ for those in the DoD and VA compensation programs? Christensen et al. (2007) argued that DoD underrates disabilities relative to the VA. If that is so, then we would expect veterans in the DoD program to have greater earnings losses than veterans with the same rating in the VA program.
4. How do civilian earnings losses vary over time? Disabled veterans might have more difficulty than others in finding a good civilian job match. If so, they may have large initial earnings losses (i.e., take more time finding a civilian job or have lower initial wages)

¹ The analysis does not track more-recent separations and earnings of veterans, because we were unable to obtain civilian earnings data for years beyond 2005.

than other veterans, but these problems may abate after an initial transition period. Disabilities might hamper a veteran's transition to civilian employment and have a smaller effect on subsequent labor-market success. In addition, some SCDs might become more limiting over time, so initial market outcomes might provide a distorted indication of how SCDs are affecting earnings losses.

Background on Disability Compensation Programs

DoD and VA have separate programs that compensate veterans for SCDs. The DoD program compensates servicemembers with SCDs who receive a disability separation from active military duty because they are medically unfit to perform their duties.² The VA compensation program compensates veterans who have a SCD and receive a nondisability separation from active duty. Some nondisability separatees are eligible for military retirement (i.e., career members), but most serve fewer years and leave at the end of the term of service. In addition, many veterans in the DoD program apply for and receive disability benefits through the VA program soon after leaving active duty. The VA benefits offset disability payments available from the DoD.

Our research also compared features of the DoD and VA system with civilian disability programs.

VA Disability Program

The VA spends about \$34 billion per year on compensation to over 3 million veterans with SCDs. Compensation amounts are based on the Veterans Affairs Schedule of Rated Disabilities (VASRD). Ratings are assigned in 10-percentage-point intervals associated with specific medical conditions for each veteran with a SCD. Medical evaluations are conducted by DoD as part of active duty separation procedures, but many veterans are reassessed by the VA.

By federal regulation, the VASRD is based on the “average impairment in civilian occupational earning capacity” associated with each SCD (see 38 CFR §4.1, 2010). SCDs are broadly defined for active duty personnel, so the injury or condition is not necessarily related to military training or deployment. For example, servicemembers who are injured in an off-duty automobile accident are eligible for disability compensation. The key factors in determining the eligibility for compensation for a SCD are that the condition is related to time served on active military duty and is not self-inflicted.³

The VA program has faced several types of criticism in recent years:

- *VASRD is out of date.* Several recent studies have argued that the schedule does not reflect current medical practices or the current limitations of medical conditions. Furthermore, the payment schedule is only nominally related to actual earnings losses.

² Active-duty personnel retire from the military with either a nondisability or disability retirement. Nondisability retirement is based on length of service—usually 20 or more years. A number of nondisability retired veterans have a service-connected disability and are eligible for military disability compensation from the VA. These retirees are “nondisability retired veterans with a disability,” but the disability was not severe enough to preclude them from satisfactorily completing their military service.

³ In the past couple of years, VA physicians have begun reviewing the ratings of members declared unfit by Physical Evaluation Boards. This new policy is designed to create more consistency between DoD and VA ratings for members leaving active duty, but the effects of the policy have not yet been evaluated.

- *“Average impairment” may shortchange some.* Veterans have diverse skills and opportunities in the civilian sector. Reimbursement based on “average impairment” at each ratings level may leave considerable variability in how compensation benefits offset the earnings losses of veterans with different levels of experience and education.
- *VASRD includes quality of life (QOL).* The compensation payments under VASRD are not a linear function of the rated disability percentage. The payments for high rating are disproportionately large relative to those for smaller ratings. Some argue that the VASRD implicitly includes payments for reduced QOL. QOL is not necessarily proportional to earnings losses for particular SCDs, however, so it is unclear how the schedule could effectively blend QOL with earnings loss.
- *Disability compensation “crowds out” retirement compensation.* Until recent years, most military retirees received the maximum of their retirement entitlement and their disability entitlement. This policy is being phased out under a new “concurrent receipt” law that allows veterans with highly rated disabilities to receive full disability and retirement payments.⁴

DoD Disability Program

DoD provides disability compensation to servicemembers who sustain an SCD that renders them unfit to perform their military job. These members receive a disability separation from active duty. DoD has two disability separation alternatives—disability severance and disability retirement. Members with SCDs rated below 30 percent receive a disability severance—a one-time lump sum payment based on member experience and pay grade (irrespective of the rating level). Members with ratings of 30 percent or more receive a disability retirement where ongoing monthly payments are a function of the disability rating, years of experience, and military paygrade.

Most recipients of disability severance and retirement payments apply to the VA for disability payments soon after their separation from active duty. The high application rate is driven by three factors. First, the DoD payments are generally taxable, whereas VA disability compensation is tax-free. Second, DoD assigns a rating based solely on the condition that makes a servicemember unfit to remain on active duty. Most veterans leave with multiple conditions, so they may receive a higher rating from the VA than the DoD. VA disability payments offset the DoD payments. Third, DoD severance is a one-time lump sum while VA disability compensation is a lifetime annuity. Many members perceive the annuity as being worth more than the lump sum payment, perhaps because their rating may be increased in the future.

Civilian Disability Programs

A wide variety of civilian programs provide benefits to disabled employees. Many of the programs are government-sponsored insurance. Some cover job-related injuries; others cover injuries or illnesses outside the workplace.

A common feature of most programs is that most are means-tested (i.e., payments are proportional to pre-injury earnings up to some cap) and payments end when a worker returns

⁴ The new law applied to veterans who received a nondisability retirement and have a disability rating of 50 percent or more. Veterans with a disability retirement are still subject to having their retirement benefits offset by their disability benefits.

to work. The premise of the programs is that they replace employment earnings while a worker is out of work.

Military compensation differs from these programs in several respects. First, servicemembers receive full military pay and benefits while recovering from an injury. If a member retires from the military with an injury, the benefit is based on a disability rating assigned using the VA's schedule. Second, military disability compensation for veterans continues for life, irrespective of civilian earnings.

Measuring Earnings Losses

We have longitudinal measures of labor force participation and civilian earnings for all active duty veterans leaving military service from 1994 through 2005. We compare the labor market outcome for all veterans from these cohorts with and without SCDs. We examine how these labor-market outcomes changed from year to year as veterans settled into the civilian labor market. This tracking is useful because, although new veterans (with and without SCDs) may have transition issues as they switch from military to civilian employment, these problems may abate as they adjust to civilian employment. In addition, veterans with SCDs may have different short- and long-term losses in the labor market. Our analysis includes a measure of civilian labor-market experience that separates the short- and long-term effects of SCDs on earnings.

Civilian labor-market opportunities vary systematically with an individual's education, age, race/ethnicity, and gender. Two broad classifications differentiate veterans from one another and are likely to shape their subsequent civilian labor-market opportunities. First, enlisted members have different backgrounds and experience than officers. Enlisted members generally enter the military with little or no college preparation. Officers generally have more professional or management responsibilities in the military than enlisted members, and this experience translates into different civilian opportunities after leaving the military. Second, many members serve one or two terms in the military and leave without earning a nondisability retirement. Nondisability retirees are older than other veterans and have considerably more military experience. The retirees enter civilian employment at midcareer and often have well-defined occupational skills. In contrast, most in the nonretiree group have often served on active duty only about four to six years, and these members have skills more suited for entry-level positions in the civilian labor market.

Based on these considerations, we divided veterans into five broad groups that are likely to characterize different portions of the civilian labor market: enlisted males (excluding enlisted nondisability retirees), enlisted females (excluding enlisted nondisability retirees), enlisted nondisability retirees, officer nondisability retirees, and other officers (e.g., officers leaving the military before reaching eligibility for a length of service retirement). Each group includes some veterans with SCDs who successfully completed their military service (some receiving a retirement based on length of service and some leaving before retirement eligibility). Disability retirees were grouped with enlisted males, enlisted females, and other officers, since these veterans were generally much younger than enlisted and officer nondisability retirees.

We examined how SCDs affected the civilian labor force participation and earnings of veterans by comparing the earning losses of veterans without SCDs to those of veterans with various disability ratings. We conducted separate analyses for each of the five groups. Each model contained disability ratings (VA ratings except for DoD retirees who did not apply to

the VA) and specific controls for separation cohort (FY1993 through FY2004) and years of civilian experience after leaving active duty. Subsets of specifications included controls for age at separation from active duty, education level, race/ethnicity, gender (where applicable), disability retirement or severance (where applicable), Armed Forces Qualification Test (AFQT) score (where applicable), service branch, participation in the Afghanistan or Iraq conflicts from 2001 to 2004, and whether the individual had a competitive promotion in the top 25th percentile of their entry cohort.⁵

Results

The earnings losses for most active duty veterans with SCDs are much smaller than the disability compensation provided by the VA or the corresponding component of DoD retirement pay. For example, veterans with a 30-percent disability are better off financially than other similar veterans with no SCD. The loss in civilian earnings for veterans with SCDs is more than offset by the size of disability payments, the tax-free status of those payments, and the availability of concurrent receipt for nondisability retirees with ratings of 50 percent or greater. The “extra” payments increase with disability ratings and are higher for enlisted veterans than for veteran officers. The disability payments associated with the VASRD are generally higher than the actual earnings losses for each rating level and across most types of veterans.

These overpayments might be interpreted as some QOL compensation for veterans with SCDs. This explanation has two weaknesses. First, current law dictates that disability payments should cover only average civilian earnings loss. Second, the disability schedule does not identify QOL in any way, so overpayments are unlikely to appropriately reflect QOL impairments across veterans. Adding QOL adjustments would require a new or revised disability schedule that measure how QOL was affected by each SCD. Some injuries (e.g., a facial scar) might be detrimental to QOL and have little effect on civilian earnings. Similarly, limited knee mobility from a SCD might have little effect on the civilian earnings of a veteran working as a computer programmer and have a large effect on the veteran’s recreational activities.

While compensation exceeds earnings loss for most veterans, some do suffer civilian financial losses from their SCD, and some veterans with medical separations fare worse than others with comparable ratings. The disability payments are proportionately less generous for former officers than for former enlisted members and are insufficient to offset earnings losses for some groups. This gap reflects the fact that veteran officers have higher civilian earnings than enlisted veterans, but the disability compensation schedule does not differentiate on prior rank. Junior officers with low ratings are worse off than comparable junior officers without SCDs, i.e., the disability compensation for these veterans is not sufficient to offset their earnings loss.

We found that veterans with disability separations from active duty have much lower earnings than do comparable other veterans with the same rating. For some reason, disability retirees and members with military severances have worse civilian labor-market outcomes than

⁵ Some controls are not relevant in some groups for various reasons. We have separate groups for enlisted males and females, so we do not control for gender in these models. The AFQT is only given to enlisted personnel, so AFQT controls are not used for officers. By construction, veterans with disability retirement or severance are grouped with enlisted males, enlisted females, and other officers. Therefore, these controls are only relevant for these groups.

do comparable veterans who successfully complete their term and leave active duty with similar SCDs.

We found substantial differences between labor market outcomes of nondisability retirees and veterans who completed their enlistment term and left before retirement eligibility. The incidence of SCDs is higher for nondisability retirees than for others who successfully complete their enlistments, but the comparable ratings have a smaller effect on nondisability retirees than on these other veterans. The higher incidence reflects both that the retiree has spent more time at risk of a SCD and that many health conditions are inherently tied to aging. The reasons for the better labor-market outcomes are less clear. Perhaps the older retirees work in less physically demanding jobs than the other veterans, so their SCDs have less effect on their job productivity. Alternatively, older veterans have a different mix of conditions than young veterans, and those conditions may relate to civilian opportunities differently. We did not have access to medical conditions, so we were unable to compare the mix of conditions across the two groups.

Finally, we looked at the timing of possible earnings losses as veterans transitioned to civilian employment after leaving active military duty. We found that veterans with SCDs fared no worse in the first two years of civilian employment than they did in subsequent years. While SCDs do reduce earnings opportunities, they do not disproportionately decrease them in the first few years of civilian experience. We also found that civilian labor-market outcomes were not very sensitive to increases in veteran ratings over the first several years of civilian experience.

Conclusions

Based on our findings, we strongly suspect that disability compensation for all cohorts of veterans with SCDs exceeds the average earnings losses for those veterans. Since we only look at earnings for 12 recent cohorts, it is possible that the “extra” compensation in these cohorts is entirely offset by “insufficient” compensation for veterans from earlier cohorts. Many veterans who left active duty before FY1993 are now retiring from the civilian labor force. Veterans with SCDs are better off financially than other veterans when they retire from the civilian workforce because they receive disability compensation with no current civilian earnings loss.

Perhaps disabled veterans’ payments compensate for QOL losses over and above the earnings losses associated with their injuries, but we are not convinced that the VASRD reflects QOL loss in any meaningful way. DoD and VA do not collect information on how SCDs impede the functionality of veterans. This type of information would be needed to quantify QOL losses and is not reflected in the VASRD.

We have several recommendations for policy.

Better Define Objectives of Disability Compensation

Congress and program managers should better define the goals and objectives of disability compensation. Policymakers and researchers struggle with what exactly “average earnings loss” means and the implicit intent of disability regulations. The regulations should spell out the purpose of the program and exactly what should be the basis of compensation awards. Perhaps this would include such things as compensation for QOL or loss of functioning.

Update VASRD

VASRD should reflect changes in modern medicine and the limitations of SCDs in the current labor market. The VA should explicitly measure how SCDs affect veteran functionality and integrate this information into the VASRD. If QOL or nonwork limitations are objectives of disability compensation, then these factors should be explicitly built into the VASRD along with earnings losses. Regular review of the VASRD is needed to ensure that the ratings are consistent with the goals and objectives of disability compensation.