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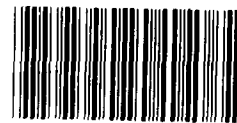
BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Federal Employees' Compensation Act: Benefit Adjustments Needed To Encourage Reemployment And Reduce Costs

Increasing numbers of long-term disability cases among Federal employees have contributed significantly to rising costs under the Federal Employees' Compensation Act. Many long-term disabled beneficiaries are, in effect, retired. The act's benefit structure creates incentives for workers to retire on compensation and results in inequities among beneficiaries. In some instances, benefits are higher than preinjury take-home pay.



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Department of Labor proposals for legislation to resolve these problems are being considered by the Office of Management and Budget. Labor's proposals would subject Federal workers' compensation benefits to Federal income tax, eliminate increased benefits for dependents, and provide for transfer of beneficiaries to the Civil Service retirement program. However, Labor should revise the proposals to provide (1) additional economic incentives to return to work and (2) for transfer to retirement before age 65.

If Labor does not revise its proposals or legislation is not introduced, GAO recommends that the Congress take appropriate actions.



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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-201930

To the President of the Senate and the
Speaker of the House of Representatives

This report summarizes the results of our review of Federal workers' compensation cases on the Department of Labor's long-term disability rolls. It discusses our belief that there is a need for economic incentives to encourage re-employment of Federal workers' compensation beneficiaries and to reduce program costs.

Our review was undertaken to determine (1) whether benefits under the Federal Employees' Compensation Act (5 U.S.C. 8101, as amended) are adequate and equitable compensation for wages lost by Federal employees because of their on-the-job injuries, while providing an economic incentive for them to be rehabilitated and return to work, and (2) the kinds of claimants being compensated for long-term disabilities and evaluate their chances and incentives for returning to work.

We are sending copies of this report to the Director, Office of Management and Budget, and the Secretary of Labor.

A handwritten signature in black ink, appearing to read "Thomas A. Stearns".

Comptroller General
of the United States



COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

FEDERAL EMPLOYEES' COMPENSATION ACT:
BENEFIT ADJUSTMENTS NEEDED TO
ENCOURAGE REEMPLOYMENT AND
REDUCE COSTS

D I G E S T

The increasing number of long-term disabled beneficiaries under the Federal Employees' Compensation Act, together with increased benefits and changes in economic conditions, have caused program costs to increase sharply. In 1979, benefits for long-term disabled workers made up about two-thirds of the total \$700 million in compensation costs incurred under the act. Between 1966 and 1979, the number of long-term disability cases under the program increased from 20,286 to 45,348 and Federal outlays for the program rose from \$26.4 million to \$463.6 million. (See p. 4.)

To determine the types of beneficiaries on the long-term disability rolls, GAO randomly selected and reviewed 239 Federal compensation cases as of February 28, 1979, at the three Department of Labor district offices administering the most long-term disability cases. (See p. 6.)

FEDERAL WORKERS' COMPENSATION BENEFITS
PROVIDE LITTLE INCENTIVE TO RETURN TO
WORK AND ARE INEQUITABLE

The high compensation benefit structure provides little financial incentive for the injured employees to return to work, as originally intended by the Congress. Injured GS-11 workers or below receive workers' compensation ranging from about \$18 to \$41 less than their usual net biweekly take-home pay. Above this level, compensation exceeds net take-home pay. (See p. 9.)

The structure of Federal workers' compensation benefits is inequitable, primarily because tax-free benefits are based on gross salaries and Federal income taxes are progressive. As a result, lower paid Federal workers receive a smaller percentage of their net take-home pay in compensation benefits than higher paid Federal workers. (See p. 12.)

INCREASED COMPENSATION FOR DEPENDENTS
DIFFICULT TO JUSTIFY

One cause of the high level of Federal workers' compensation benefits is the rate at which benefits are paid--66-2/3 percent of gross salary for beneficiaries without dependents and 75 percent for those with one or more. Increased compensation for dependents is a relatively unique feature of the Federal workers' compensation program which is not usually present in most workers' compensation programs since it incorporates welfare program factors in an insurance program. Of 239 cases in GAO's sample, 196 (82 percent) were receiving the extra 8-1/3 percent for having dependents. (See p. 11.)

MANY COMPENSATION BENEFICIARIES
HAVE, IN EFFECT, RETIRED

One of the Federal workers' compensation program's major objectives is to help injured employees recover and eventually return to work.

However, many long-term disabled beneficiaries are, in effect, retired. They are close to or beyond the average age when most Federal employees retire, have been on the long-term disability rolls for years, and have extremely limited employment possibilities. (See p. 17.)

In GAO's sample of 239 beneficiaries, 121 (51 percent) were over 55 years old and, of these, 75 were over 60 and 37 were older than 65. One hundred and thirteen had

received compensation for 5 years or less, 73 had received compensation for 6 to 10 years, 18 had received compensation for 11 to 15 years, and 35 had received compensation for 16 years or more.

Based on each long-term disabled beneficiary's physical impairment and other factors, it seems likely that 203 of the beneficiaries (85 percent) will never return to work. (See p. 19.)

Of 186 beneficiaries in the sample for whom years of Federal service data were available, 73 (39 percent) were eligible for Civil Service retirement, based on the combination of age and years of Federal service. An additional 32 (17 percent) would be eligible within 5 years. (See p. 23.)

LABOR'S PROPOSALS

Labor has drafted proposed legislation, which is being considered by the Office of Management and Budget. Currently, plans are to have legislation introduced early in the 97th Congress. The proposals provide for taxing benefits to remedy inequities among beneficiaries, raise benefit levels from 66-2/3 and 75 percent to 80 percent of gross pay, and have the Government pay the employees' health insurance premiums. (See p. 13.)

The proposals also provide for integrating the Federal workers' compensation and retirement systems by transferring beneficiaries to a retirement system at age 65 or after 5 years of workers' compensation benefits, whichever is later. (See p. 21.)

Taxing Federal workers' compensation benefits would reduce inequities among beneficiaries; however, increasing benefits from 66-2/3 and 75 percent to 80 percent would not provide sufficient economic incentives to return to work as the Congress originally intended. (See p. 14.)

Although GAO is not sure what the benefit level should be, it believes that, if the 66-2/3 percent called for in the initial legislation had validity, it would be a more reasonable level to work toward, than one which allows for compensation close to 100 percent of take-home pay. (See p. 15.)

Labor's proposed integration of Federal compensation and retirement systems is basically sound. However, revisions to allow transfer of beneficiaries from the Federal workers' compensation program to the retirement systems, at a point somewhat closer to the time the employee would be eligible to retire, would permit the program to more effectively accomplish its major goals. (See p. 23.)

RECOMMENDATIONS TO THE SECRETARY OF LABOR

Although GAO generally agrees with Labor's legislative proposals, it recommends that the Secretary revise the Department's legislative proposals to:

- Delete the increase of benefits from 66-2/3 and 75 percent to 80 percent and reconsider what Federal workers' compensation benefits should be, probably near the original 66-2/3-percent level, but retain a single percentage as proposed, to eliminate increased benefits for dependents.
- Provide for the transfer of workers' compensation beneficiaries to the retirement program within 3 years of the time they would be eligible to retire. (See p. 29.)

AGENCY COMMENTS AND GAO EVALUATION

Labor responded that, since the Administration is currently reviewing options for reform of the program, it did not believe it appropriate to comment on proposed recommendations

which urge reconsidering policies that have not yet been decided. It did believe that a number of aspects of the report (such as Labor's ability to improve initial claims adjudication and postadjudication administration and employing agencies' activities in promoting reemployment) required a more detailed analysis than that set forth. (See p. 26.)

The Office of Personnel Management (OPM) disagreed with GAO's proposed recommendation that Labor reduce its level of benefits and convert beneficiaries from compensation to retirement benefits at an earlier age than 65. (See p. 27.)

OPM stated that benefits approximating pre-disability income are justified because workers' compensation benefits have traditionally been considered substitutes for tort action.

Almost any benefit level above or below what now exists or is proposed by Labor can be argued pro and con. However, when the 66-2/3 percent of gross pay benefit level was included in the initial Federal workers' compensation legislation, that level was considered a reasonable balance between the somewhat conflicting goals of adequate income protection and sufficient incentives to return to work. It also seems to better recognize a basic concept of workers' compensation that there ought to be some sharing of the risk between both employee and employer for work-related illness or injury. (See p. 28.)

OPM stated that GAO failed to recognize that only about 23 percent of new Federal employees stay in Federal service until voluntary retirement. (See p. 27.)

GAO does not agree with OPM's position that Federal employees should receive workers' compensation until age 65 before conversion

to retirement benefits. GAO believes its proposal is not out of line with what is occurring in the private sector. A recent survey of private industry employees showed that 62 percent of those retiring in 1978 were younger than 65. Social Security Administration statistics show that about 30 percent of those who are eligible retire at age 62, with almost 50 percent retiring before age 65. Also, 39 percent of beneficiaries in GAO's review of 186 were eligible for Civil Service retirement at the time of its review. Another 17 percent were within 5 years of being eligible for retirement. (See p. 29.)

RECOMMENDATIONS TO THE CONGRESS

If the Secretary of Labor does not make the revisions that GAO recommends to the Department's legislative proposals or if the proposed legislative package is not introduced, GAO recommends that the Congress:

- Make Federal workers' compensation benefits subject to Federal income taxes and reconsider at what level Federal workers' compensation benefits should be set (probably near the original 66-2/3-percent level). At whatever level decided upon, the Congress should incorporate a single percentage, as this will eliminate the increased benefits for dependents.
- Integrate the Federal workers' compensation and Federal retirement programs to provide for the transfer of compensation beneficiaries to the retirement program within 3 years of the time the employee would be eligible to retire. (See p. 30.)

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ABBREVIATIONS

GAO	General Accounting Office
GS	General Schedule
OPM	Office of Personnel Management
OWCP	Office of Workers' Compensation Programs

CHAPTER 1

INTRODUCTION

We reviewed the benefits program under the Federal Employees' Compensation Act (5 U.S.C. 8101, as amended). Our review was undertaken to determine

- whether benefits under the act are adequate and equitable compensation for wages lost by Federal employees because of their on-the-job injuries, while providing an economic incentive for them to be rehabilitated and return to work, and
- the kinds of claimants being compensated on the automatic roll 1/ for long-term disabilities and evaluate their chances and incentives for returning to the job market.

Our review was prompted by congressional concern about the increasing costs of the Federal workers' compensation program.

Near the end of our review, the Department of Labor drafted legislative proposals regarding the Federal workers' compensation program, which are being considered by the Office of Management and Budget. This report, which deals with the impact of the act's benefit levels on program participants, discusses Labor's proposed amendments to the act and the parts of the proposals that we believe should be modified. We have issued 10 other reports pertaining to the Federal workers' compensation program. (See app. III.)

In general, the act covers all civil officers and employees of any branch of the Federal Government. About 3 million Federal employees (and certain non-Federal employees, such as law enforcement officers injured in connection with Federal crimes) are currently eligible for benefits if they sustain a work-related injury.

BENEFITS

The act provides compensation for the disability or death of Federal civilian employees injured or killed while performing their duties. These benefits include compensation for

1/The automatic roll is used for paying compensation every 28 days for disabilities lasting 3 months or more.

wage losses, monetary awards for bodily impairment or disfigurement, medical care, rehabilitation services, and survivors' compensation.

The act defines the term "compensation" to include both the money allowances payable to an employee or his dependents and other benefits, such as medical care and vocational rehabilitation services. The two kinds of money allowances are:

--Payments for specified time periods (called scheduled awards) for loss, or loss of use, of a member or a function of the body (e.g., loss of the use of an arm or loss of hearing).

--Monthly payments for wage losses for as long as the disability continues.

The basic tax-free money allowance is 66-2/3 percent of the employee's monthly pay in cases of total disability and 66-2/3 percent of the difference between the employee's monthly pay and wage-earning capacity, as determined by the Secretary of Labor, in cases of partial disability. The allowance increases to 75 percent for injured employees with one or more dependents. If the employee dies as a result of work-related injuries, compensation is payable to the spouse, children, and certain other dependents. The maximum amount payable (as of January 1981) is about \$3,132 each month (75 percent of the maximum pay for a Federal General Schedule (GS) employee at the GS-15 level); the minimum for total disability is about \$559 each month (75 percent of the minimum pay for a Federal employee at the GS-2 level), or the employee's actual pay in cases where an employee earns less than 75 percent of the lowest step of a GS-2. Labor officials have testified that benefits (under the act) are "most generous"--as high as any compensation system in the country.

LEGISLATIVE BACKGROUND

The Congress has amended the act several times since its enactment in 1916; generally, these amendments have increased maximum and minimum levels of benefits. The original act set Federal compensation at 66-2/3 percent of an employee's salary or lost wage-earning capacity, subject to a monthly maximum of \$66.67 and a minimum monthly payment of \$33.33 (or actual salary, if less). It set no minimum for partial disability awards. The act also prohibited other remuneration from the United States except for military pensions.

Originally when setting the benefit level at 66-2/3 percent, the House Committee on the Judiciary report stated, "It is believed that any smaller percentage will not enable the injured employee to maintain his standard of living, and that a loss of one-third of the wages will be adequate inducement to the injured man to go back to work, thus avoiding the danger of malingering." 1/

The act's compensation benefits remained basically the same for 33 years; they were altered only once, in 1927, to raise the monthly maximum and minimum levels of compensation to \$116.66 and \$58.33, respectively.

Amendments enacted in 1949 increased the maximum monthly compensation benefit to \$525 and the minimum benefit to \$112.50, except for partial disability, which may be in a lesser amount. The 1949 amendments also provided an additional payment of 8-1/3 percent of gross wages to disabled employees with one or more dependents. This additional benefit was to give recognition to the supposedly greater need of the disabled employee with a dependent than that of a single employee and was to serve to prevent families from falling behind financially during the crisis occasioned by occupational injury. This change created the present two-tier Federal compensation benefit structure--66-2/3 and 75 percent of gross salary.

In 1960 the Congress again increased the act's minimum compensation benefit, except for partial disability, to \$180. With the 1966 amendments, the Congress discarded fixed dollar levels, tied maximum and minimum benefits to GS pay rates, and authorized cost-of-living increases. Since that time, the act's compensation benefit levels have been based on the maximum and minimum salaries of a GS-15 and a GS-2, respectively.

Under the original act, the amount of the award could be reduced at age 70, if the wage-earning capacity of the employee could be expected to diminish, regardless of the injury. In 1974 the Congress eliminated the requirement for reviewing and reducing Federal compensation awards when beneficiaries reached age 70.

1/H. Rept. 678, 64th Cong., 1st Sess. 9 (1916).

The legislative history shows that this requirement was originally placed in the law in the belief that such persons have a decreased wage-earning capacity. The Senate Committee on Labor and Public Welfare found that such a review placed an unnecessary burden on both the employee receiving compensation and Labor. Furthermore, in the Committee's opinion, the fact that an employee reached age 70 has no bearing on his or her entitlement to benefits and considered it discriminatory. 1/

GROWTH OF LONG-TERM DISABILITY COSTS

From 1966 through 1979, even though Federal employment remained fairly constant, annual compensation costs for the Federal workers' compensation program increased by 831 percent, from \$75.2 million to \$700 million.

Increased benefits and changes in economic conditions, such as inflation, have contributed materially to the rapid growth in program costs. A major factor, however, has been the increasing number of long-term disability cases. From 1966 through 1979, the number of long-term cases under the program has increased from 20,286 to 45,348. (See table 1.)

The long-term disability cases accounted for about two-thirds of total Federal workers' compensation costs in 1979. Direct compensation payments to long-term disabled Federal employees rose from \$26.4 million in 1966 to \$463.6 million in 1979. The average time a long-term disability case had been in payment status in 1978 was about 9 years. In February 1977, Labor estimated that the Federal Government will incur future costs estimated at over \$6 billion for cases on Labor's long-term rolls. In addition, costs are incurred for medical treatment and, according to Labor, the bulk of medical cost expenditures are for long-term disabilities.

The table on the next page shows the growth in the Federal workers' compensation program since 1966.

1/S. Rept. 93-1081, 93rd Cong., 2nd Sess. 7 (1974).

Table 1

Federal Employment and Federal
Workers' Compensation Benefits

<u>Fiscal year</u>	<u>Federal civilian employment</u>	<u>Number of long-term disability cases</u>	<u>Federal workers' compensation benefits</u>		
			<u>Long-term disability</u>	<u>Medical costs</u>	<u>Total compensation costs (note a)</u>
————— (thousands) —————					
1966	2,617,500	20,286	\$ 26,400	\$11,485	\$ 75,175
1967	2,882,300	21,150	31,932	13,597	89,148
1968	3,036,000	21,230	37,216	14,990	98,185
1969	3,073,000	22,665	43,530	16,320	111,192
1970	3,036,000	23,462	54,472	20,307	131,536
1971	2,919,000	25,149	75,527	24,658	163,215
1972	2,811,779	27,502	93,436	26,355	190,025
1973	2,774,710	29,114	113,761	31,732	217,770
1974	2,867,200	33,244	153,079	34,587	270,676
1975	2,925,000	36,479	215,820	48,084	367,544
1976	2,936,200	42,401	286,784	63,118	477,387
1977	2,908,847	45,216	359,574	69,471	552,085
1978	2,925,800	46,178	405,645	86,208	626,433
1979	2,876,017	45,348	463,594	98,617	700,028

a/Total compensation costs includes short-term disability, death, and other miscellaneous benefits.

ORGANIZATIONAL RESPONSIBILITIES

The Secretary of Labor has delegated responsibility for administering the act to the Office of Workers' Compensation Programs (OWCP) in Labor's Employment Standards Administration. Within OWCP, a headquarters Division of Federal Employees' Compensation (which develops policies and procedures) and 15 district offices administer the program. Generally, the district offices adjudicate and service claims submitted by Federal employees in their geographic areas.

To obtain workers' compensation benefits, an employee must report any injury sustained on the job to the employing agency and to Labor. Labor is responsible for adjudicating the claim and for paying any benefits.

A claims examiner in the OWCP district office examines and develops the claim and decides whether the claimant is entitled to benefits. Claims examiners have the responsibility also for monitoring the condition and status of injured employees who are awarded money allowances for wage losses. Their monitoring activities include obtaining medical reports on the employee's condition, referring injured employees for appropriate vocational rehabilitation services, initiating wage-earning capacity determinations when medical reports indicate that the employee has regained the capacity for some work, and decreasing or terminating the awards as appropriate.

OBJECTIVES, SCOPE, AND METHODOLOGY

To determine the types of beneficiaries on the long-term disability rolls, we selected for review the three OWCP district offices with the most long-term disability cases. These three district offices had a combined total of 21,005 long-term cases, or about 45 percent of OWCP's nationwide long-term caseload of 46,905 cases. Within these offices, we randomly selected for detailed review 253 cases being compensated on the long-term disability rolls as of February 28, 1979. Of the 253 long-term disabled beneficiaries included in our sample, 14 were receiving scheduled awards mostly for partial loss of hearing due to occupational noise exposure. Benefits paid under these awards are for a fixed time period and are based on physical impairment rather than work disability. Thus, these beneficiaries were excluded from this review and we analyzed only the other 239 long-term disability case files.

We made our review at OWCP headquarters in Washington, D.C., and at its district offices in Atlanta, New York City, and San Francisco.

We reviewed the act and its legislative history, Labor's regulations pertaining to the act, OWCP's implementing policies and procedures, Labor's internal audit reports, and other Labor and OWCP reports pertaining to the act. We also interviewed headquarters and district office personnel.

We reviewed and analyzed Labor's proposals to amend the act. The proposals were sent to the Office of Management and Budget on May 18, 1979, and to various Federal agencies in September 1979 for comment. Labor provided a draft response to the Office of Management and Budget regarding the comments of the Federal agencies on February 7, 1980.

Recent meetings have been held between Labor, Office of Management and Budget, and various Federal agencies to refine Labor's proposals. Currently, plans exist to have a legislative package introduced early in the 97th Congress.

CHAPTER 2

LITTLE INCENTIVE FOR BENEFICIARIES

TO RETURN TO WORK

Two objectives of workers' compensation are to provide the injured worker enough money to maintain a standard of living, somewhat comparable to that which existed before the injury, while providing a sufficient financial incentive to seek rehabilitation and reemployment, where possible. The benefit structure of the Federal Employees' Compensation Act provides tax-free benefits to injured employees which are close to net take-home pay and provides little financial incentive for the injured employee to return to work.

Although Labor has drafted legislative proposals to amend the act, the proposals do not adjust the benefit structure to provide a greater incentive to work. The reasons why the benefit structure provides payments which are close to, or exceed, preinjury take-home pay are (1) changes in Federal and State taxes since the act was initially passed in 1916, (2) the augmentation for dependents in 1949, and (3) the several increases of the maximum benefit levels, which in 1966 became tied to GS pay rates.

OBJECTIVES OF WORKERS' COMPENSATION

Two objectives of workers' compensation are to provide reasonable income to injured workers and to encourage worker rehabilitation and reemployment. The benefit level is a crucial factor in accomplishing these objectives.

Conceptually, an ideal benefit level would (1) maintain a standard of living somewhat comparable to the worker's standard of living before the disability, (2) account for any reduced costs from not incurring work-related expenses, and (3) provide sufficient incentive to seek rehabilitation and prompt reemployment, when possible. ^{1/} The National Commission on State Workmen's Compensation Laws stated in its 1972

^{1/}"White Paper on Workers' Compensation," prepared by an interdepartmental group from the Departments of Labor, Commerce, Health and Human Services, and Housing and Urban Development, working on workers' compensation, May 1974.

report 1/ that compensation must balance incentives to employers to improve safety (thus reducing compensation costs) with incentives to the disabled to use rehabilitation services and return to work (by fixing benefit levels below employees' preinjury net pay).

FEDERAL COMPENSATION BENEFITS ARE CLOSE
TO OR EXCEED NET TAKE-HOME PAY

The high Federal workers' compensation benefit structure provides little financial incentive for the injured employee to return to work. This lack of incentive occurs at all salary levels, but it is most pronounced at the higher grade levels, where Federal compensation is greater than net take-home pay. The benefit structure offers these beneficiaries a financial disincentive to return to work.

To illustrate how substantial the disincentive can be, take the extreme situation, which would involve an employee who had one dependent and receives the maximum tax-free benefit (75 percent of a GS-15, step 10). As of September 1979, this employee would receive biweekly compensation of about \$1,346--\$240 higher than preinjury net take-home pay. At this level, disability benefits exceed net take-home pay by over \$6,200 per year.

According to Labor, the amount that tax-free benefits exceed preinjury net take-home pay decreases with each drop in GS grade. The GS grade must drop to between GS-8 and 11 (depending on the number of dependents) before workers' compensation benefits are less than preinjury take-home pay. The GS level at which benefits exceed preinjury net take-home pay is lowered whenever Federal employees receive a pay increase and move into higher tax brackets.

As shown in table 2, the \$642 biweekly benefit level is the point at which compensation equals net take-home pay. Most injured employees below this level (GS-11 and below) receive compensation ranging from about \$18 to \$41 less than their net biweekly take-home pay.

1/"The Report of the National Commission on State Workmen's Compensation Laws," July 1972.

In considering adjusting benefit levels to provide an economic incentive to return to work, it should be realized that rehabilitation and reemployment of the injured employee would not be possible when the beneficiary is totally disabled and physically unable to work.

Table 2

Labor's Comparison of Biweekly Net
Pay and Current 75-Percent Tax-
free Compensation Benefits

<u>GS grade</u>	<u>Biweekly net pay (notes a and b)</u>	<u>Amount of benefit (note b)</u>	<u>Percent of net pay replaced</u>
GS- 2/1	\$231	\$ 190	82
GS- 3/1	258	217	84
GS- 4/1	287	247	86
GS- 5/1	319	279	87
GS- 6/1	352	314	89
GS- 7/1	388	352	91
GS- 8/1	426	392	92
GS- 9/1	465	482	94
GS-10/1	506	482	95
GS-11/1	550	532	97
GS-12/1	642	642	100
GS-13/1	738	768	104
GS-14/1	836	912	108
GS-15/1	939	1,077	115

a/Biweekly net pay was computed for a Federal employee claiming four exemptions. Totals rounded to the nearest dollar or percent. Deductions from gross biweekly pay were Federal withholding, an average graduated State income tax, 7-percent retirement, and group life insurance.

b/A deduction of \$24 is made to columns two and three for high-option health insurance, which under Labor's legislative proposal will be provided by the Government as a benefit. (See p. 13.)

This table was prepared by Labor in support of its legislative proposals.

INCREASED COMPENSATION FOR
DEPENDENTS DIFFICULT TO JUSTIFY

One cause of the high level of compensation benefits for injured Federal workers is the rate at which benefits are paid--66-2/3 percent of gross salary for injured workers without dependents and 75 percent for beneficiaries with one or more dependents. Of the 239 cases in our sample, 196 (82 percent) were receiving the extra 8-1/3 percent in compensation for having one or more dependents.

The 8-1/3-percent dependents' allowance that is paid to many beneficiaries contributes to their relatively high level of benefits. However, according to the former executive director for the National Commission on State Workmen's Compensation Laws staff, ¹/ the desirability of a dependents' allowance--and of one that is paid proportional to the wage--is not clear. Most States provide no such allowance in unemployment insurance or workers' compensation.

From the employer's standpoint, the dependents' allowance seems illogical because the same wages are paid to a worker whether or not that worker has dependents. However, from the employee's standpoint, the dependents' allowance may seem entirely appropriate. Because of the income tax, two workers with the same pretax wages may have different posttax wages: the family with more dependents will have the larger income after taxes. It can be argued that workers' compensation benefits should reflect differences in net remuneration among workers with different numbers of dependents. This would be taken care of by taxing compensation benefits.

Workers' compensation is meant to be an insurance program, not a welfare program. Benefits are not to be dependent on a beneficiary's economic needs, but should rather be related to the beneficiary's loss of income. In our opinion, the 8-1/3-percent dependents' allowance should be eliminated. This provision moves the program out of the realm of insurance, since it is based on a presumed need without requiring true dependency, and there is no economic need test.

Though apparently based on the belief that beneficiaries with dependents require greater income, the act makes no distinctions between, for example, a disabled employee with a working spouse and no children and one whose spouse is

¹/From Dr. Peter S. Barth's August 1977 paper, "Benefits Under the Federal Employees' Compensation Act."

engaged full time in rearing children. Both receive the same benefit percentage--the act does not recognize degrees of dependency.

If adequacy is the primary justification for a dependents' allowance, then it would seem proper that some earnings test should be applied to the dependent(s). Yet no such test is made, and the presence of another dependent in the household--typically a spouse, whether working or not--meets the dependency requirement. To effectively compensate for dependents, it would seem reasonable to augment compensation for additional dependent children, which the act does not. The presence of children in the employee's household elicits no additional compensation, while it may well preclude the spouse from working.

FEDERAL WORKERS' COMPENSATION BENEFITS ARE INEQUITABLE

As shown in table 2 (see p. 10), the present tax-free benefit structure replaces varying amounts of net take-home pay--the smallest percentage of net pay is replaced at the lowest salary level and at higher salary levels benefits are equal to or exceed net take-home pay. This is primarily because tax-free benefits are based on gross salaries and Federal income taxes are progressive.

Federal income tax deductions above approximately the GS-6 level cause the biggest deduction from most Federal employees' gross salaries. Thus, the benefit structure is regressive, because lower paid Federal workers receive a smaller percentage of their net take-home pay as workers' compensation benefits (from 82 to 89 percent), while higher paid Federal workers (GS-7 and above) receive a greater percentage (from 91 to 115 percent). These differences are more pronounced at the 75-percent level than at the 66-2/3-percent level because of the higher rate of wages replaced.

INCOME TAX, BENEFIT LEVEL, AND OTHER ECONOMIC CHANGES MAKE WORKERS' COMPENSATION FINANCIALLY ATTRACTIVE

Economic changes have made it increasingly financially attractive for beneficiaries to remain on the workers' compensation rolls rather than seek rehabilitation and reemployment. Today many beneficiaries lose little income when receiving Federal workers' compensation because increases in Federal, State, and local income taxes have widened the gap

between gross and net income. Because Federal workers' compensation is based on a beneficiary's gross wage, increased taxes have resulted in relatively higher replacement of net wages. Therefore, tax increases have lessened beneficiaries' financial incentive to seek rehabilitation and reemployment that the Congress originally established for the program.

Workers' compensation benefits have traditionally been considered substitutes for tort action and have been tax free. In past years, the tax structure and other economic factors offered greater financial incentive for beneficiaries to return to work--for example, when the workers' compensation program began, there was little or no difference between gross and net pay. Income taxes were small and limited to high-income families, and benefits were based on two-thirds of the gross wages and approximately equaled two-thirds of net take-home pay and thus provided greater financial incentive to return to work.

Beneficiaries also do not incur work-related expenses while receiving compensation. Median family income has increased over the years, but so have work-related expenses. For example, in the past many workers lived near their places of employment; today, many workers live farther away, paying increased commuting costs. Child care costs have also become more common because there are more multiple-wage-earner and single-head-of-household families. Since beneficiaries no longer have these work-related expenses, they, in effect, have greater spendable income with workers' compensation than with preinjury wages.

LABOR'S PROPOSAL FOR CHANGING THE BENEFIT STRUCTURE

Labor is considering legislative proposals, which are now being discussed with the Office of Management and Budget, to amend the act because it believes that inequities in benefits exist and incentives to return to work are inadequate. To remedy the benefits' inequities, Labor's proposal would increase both the 66-2/3- and 75-percent compensation rates to 80 percent of gross pay (eliminating augmented benefits for dependents) and subject the benefits to Federal income taxes. Labor's proposal would further amend the act to have the Government assume the employees' share of health insurance premiums after disability (estimated to cost about \$100 million during the next 5 years).

Labor recognizes that putting a Federal tax on benefits is a significant departure from the traditional treatment of benefits and would require an amendment of the Internal Revenue Code, but it believes that the tax is the best way

to ensure reasonable compensation and treat beneficiaries equally. The tax would also ensure that such benefits are the same net level of income replacement relative to preinjury wages for all workers at different income levels, and that equity would be maintained without additional amendments to the act as changes occur in the tax code.

OUR ANALYSIS OF LABOR'S PROPOSAL

The proposals to pay health insurance, increase the disability compensation rates from 66-2/3 and 75 percent to 80 percent of gross pay, and subject benefits to Federal income taxes would reduce inequities among beneficiaries, but they would not provide economic incentives to return to work as the Congress originally intended.

Under Labor's proposal, beneficiaries at or below GS-11, step 1, would receive increased workers' compensation which would be close to their net take-home pay. This would eradicate what little economic incentive to return to work that currently exists at these levels. Compensation benefits for higher graded beneficiaries would be reduced somewhat, but at the GS-14 and 15 levels they would still remain above current net take-home pay. The following table shows the relationship of net pay to workers' compensation benefit levels under the present benefit structure and under Labor's proposal.

Table 3
Labor's Comparison of Biweekly
Net Pay and Federal Workers' Compensation Benefits
For GS Salary Levels

GS grade	Biweekly net pay (notes a and b)	Present 75-percent tax-free benefit		80-percent taxed benefit without Government payment of health insurance		Proposed 80-percent taxed benefit with Government payment of health insurance	
		Amount of benefit (note b)	Percent of net pay replaced	Amount of benefit (note b)	Percent of net pay replaced	Amount of benefit	Percent of net pay replaced
GS- 2/1	\$231	\$ 190	82	\$204	88	\$228	99
GS- 3/1	258	217	84	233	90	257	99
GS- 4/1	287	247	86	258	90	282	98
GS- 5/1	319	279	87	288	90	312	98
GS- 6/1	352	314	89	319	91	343	97
GS- 7/1	388	352	91	353	91	377	97
GS- 8/1	426	392	92	389	91	413	97
GS- 9/1	465	435	94	427	92	451	97
GS-10/1	506	482	95	468	92	492	97
GS-11/1	550	532	97	510	93	534	97
GS-12/1	642	642	100	604	94	628	98
GS-13/1	738	768	104	706	96	730	99
GS-14/1	836	912	109	819	98	843	101
GS-15/1	939	1,077	115	941	100	965	103

a/Biweekly net pay, present and proposed benefits were computed for a Federal employee claiming four exemptions. Totals rounded to the nearest dollar or percent. Deductions from gross biweekly pay were Federal withholding, an average graduated State income tax, 7-percent retirement, and group life insurance.

b/A deduction of \$24 is made to columns 2, 3, and 5 for high-option health insurance, which under Labor's proposal will be provided by the Government as a benefit.

Economic incentives can be misleading, if the issue is restricted to specific compensation versus net take-home pay and at what point one exceeds the other. A worker is not necessarily discouraged from returning to work only when his or her full wages are replaced. Even without accounting for savings from work-related expenses, such as transportation and child care, some employees will prefer to remain away from employment for less than 100 percent of their net wages, especially in multiple-income households. Other employees will return to work as soon as physically possible, regardless of the economic disincentive to do so.

The current level of total disability benefits has nothing to commend it other than its widespread use. In all States except two, workers who are temporarily or totally disabled receive at least 66-2/3 percent of their predisability wages with maximum benefit limits based on a percentage of the State's average weekly wage. Dr. Peter Barth, an expert in workers' compensation, has stated that nothing indicates that 66-2/3 percent of wages is high enough to be adequate and simultaneously offer some inducement to return to work as promptly as medically possible. The same statement applies to any other wage percentage. Thus, Dr. Barth believes that the two-thirds figure is used only because it is widely accepted and, in turn, widely recommended.

As explained on page 3, the Congress originally set the benefit level at 66-2/3 percent to enable the injured employee to maintain his or her standard of living and to provide an incentive to return to work.

Among private long-term disability insurance programs, the evidence indicates that high compensation rates increase disability incidence rates. Private insurance plans with compensation rates over 70 percent of gross income have incidence rates two-thirds above the average, while plans with compensation of 50 percent or less have incidence rates one-third below the average. Private insurers generally attempt to limit disability benefits to 50 or 60 percent of gross earnings because of this finding.

Various studies on adequacy do not agree on adequate compensation. Some believe that the poverty level of income is adequate. Other studies have been unable to define adequate compensation. Despite the difficulty in determining what adequate compensation should be, under the current Federal program and revisions proposed by Labor, compensation approaches or exceeds the injured worker's take-home pay in

most cases. If there is to be any financial incentive to use rehabilitation services to return to work, a level of compensation should be fixed at some point below what it is now or what is proposed by Labor. Although we are not sure what the benefit level should be, we believe that, if the percentage called for in the initial legislation--66-2/3 percent of gross preinjury wages--had validity, it would be a more reasonable level to work toward, than one which allows for receipt of compensation close to 100 percent of take-home pay.

CHAPTER 3

MANY BENEFICIARIES USE WORKERS'

COMPENSATION AS A RETIREMENT SYSTEM

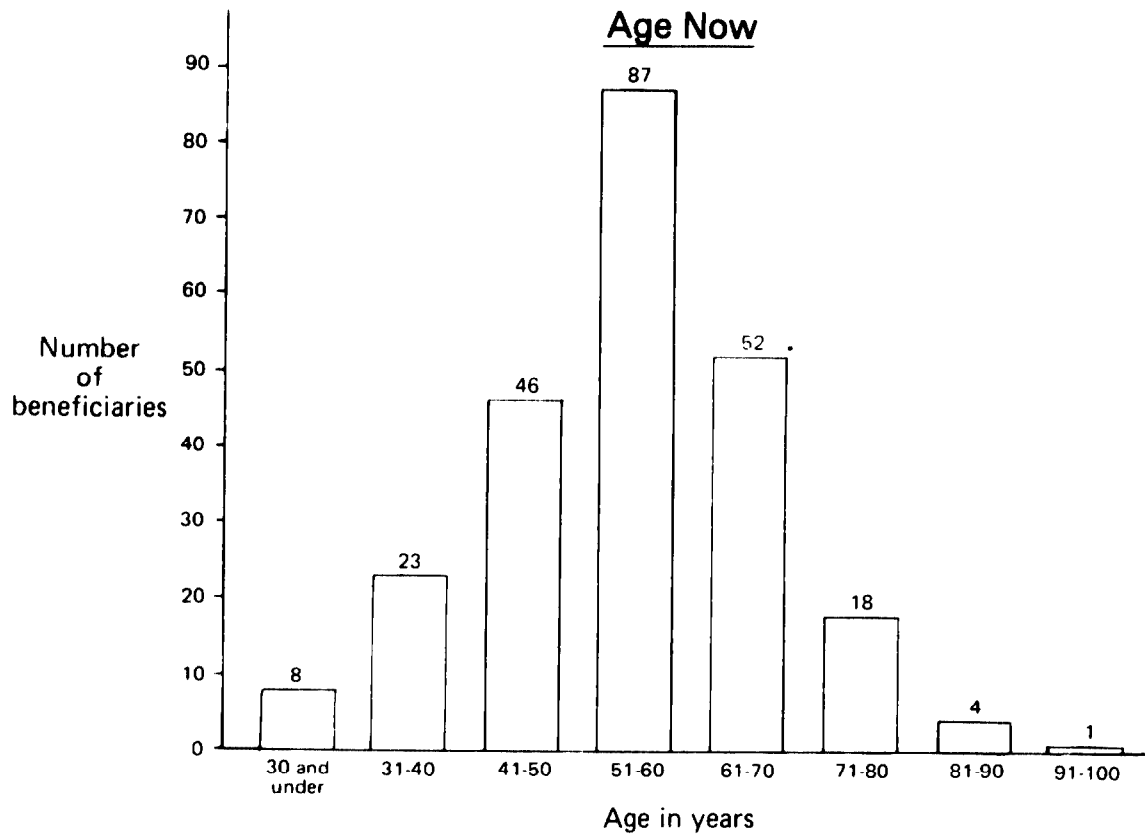
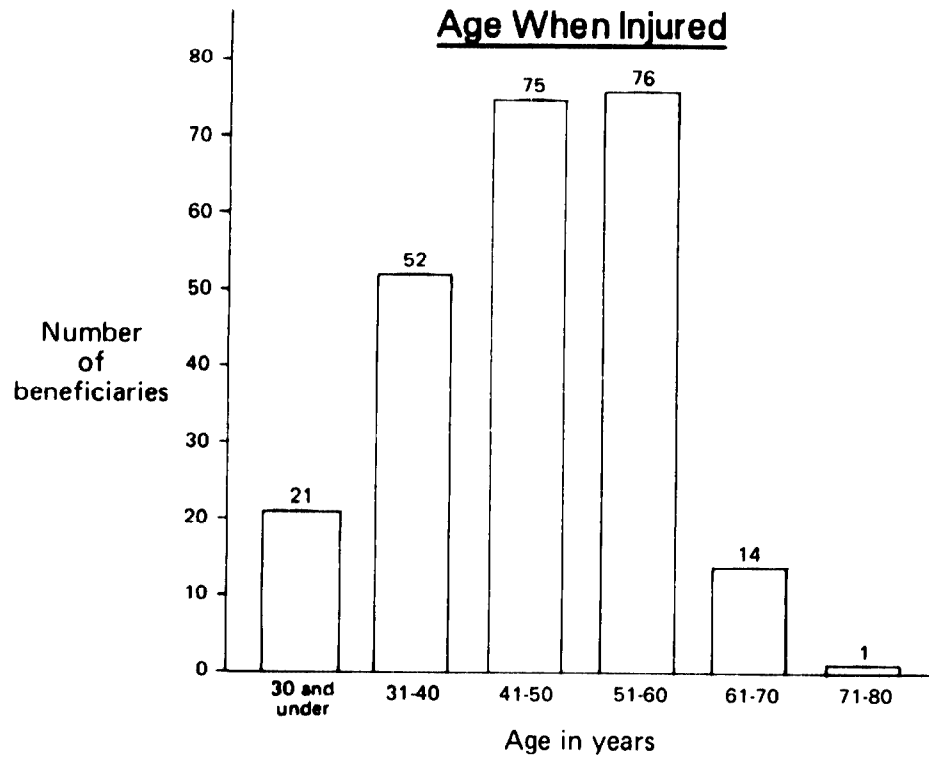
It appears that 85 percent of the Federal workers' compensation beneficiaries in our sample will never return to work. Many beneficiaries have reached the average Federal retirement age, have been on the workers' compensation rolls for many years, and have limited or no reemployment possibilities. Also, 39 percent of the beneficiaries for whom data were available were eligible for Civil Service retirement at the time of our review. Trends in both the Government and private industry have been toward earlier retirement.

The substantial economic advantages to retiring on Federal workers' compensation benefits instead of Civil Service retirement benefits appear to be a major reason for the increased number of beneficiaries on the long-term disability rolls. Labor has drafted a legislative proposal for integrating Federal compensation and Federal retirement systems, which we believe should be modified.

MANY FEDERAL WORKERS' COMPENSATION RECIPIENTS HAVE, IN EFFECT, RETIRED

Of 239 long-term disabled beneficiaries in our sample, 121 (51 percent) were over 55 years old; of these, 75 were over 60 years old and 37 were older than 65. The following graphs show (1) the ages of the beneficiaries, (2) that most cases in our sample were over age 41 when injured, and (3) that many have reached or are near normal retirement age.

Both workers' compensation experts and vocational rehabilitation experts generally agree that the older a person is and the longer he or she remains disabled and out of the work force, the less likely he or she is to return to work. Age is an important influence on whether people prefer to work or to retire, and even on whether they can work or find work (since age affects employment possibilities). Besides age, medical conditions can limit the type and amount of work long-term disabled beneficiaries can perform. Other factors also affect employment possibilities. These include beneficiaries' qualifications for other employment (e.g., work experience, education, and occupational training); availability of



suitable jobs nearby; and such factors as work orientation and personal motivation, which can be influenced by economic incentives and length of time on workers' compensation.

In our sample of 239 long-term disabled beneficiaries

- 113 had received compensation for 5 years or less,
- 73 had received compensation for 6 to 10 years,
- 18 had received compensation for 11 to 15 years, and
- 35 had received compensation for 16 years or more.

The average length of time the beneficiaries in our sample had received compensation was 8.5 years, with a range from 2 months to 40 years.

Based on the nature and degree of each long-term disabled beneficiary's physical impairment, in conjunction with the above-discussed factors, it seems likely that 203 of the 239 beneficiaries in our sample (85 percent) will never return to work. The following are cases from our sample.

Example one

--A nursing assistant at a Veterans Administration hospital suffered a back injury in 1956 at age 69 and has been receiving workers' compensation for the past 23 years. She has been in a nursing home for the past 11 years.

Example two

--A 58-year-old former Air Force warehouse worker sustained a back injury in 1960 when he was 39 years old. His 10-percent impairment kept him from returning to his Federal job, but in 1962 he returned to work as manager of a State liquor store and for 15 years thereafter continued to receive workers' compensation benefits for partial disability. However, in 1977 he was awarded total disability benefits after quitting the liquor store job because of increasing back pain. A letter in his file indicated that he had also been approved for Social Security disability benefits as of February 1978.

Example three

--In June 1976, a 51-year-old mail carrier, who had previously been disabled for 2-1/2 years because of an injury to his right knee in 1972, tripped and fell while on his mail route, this time injuring his left knee. For 13 months beginning December 1, 1976, he received Civil Service disability retirement benefits; but during that time he wrote several letters to Labor and others, stating in effect that he had retired on disability, but wanted to be placed on Labor's automatic roll to receive workers' compensation benefits. His request was granted. When we contacted him in February 1979, he stated that he still had pains in his legs, that he was definitely retired because of his leg problems, and that he could not hold a steady job.

Labor estimates that 65 percent of the more than 46,000 long-term disabled Federal workers' compensation beneficiaries can be expected to remain on workers' compensation for life, at a cost of more than \$6 billion.

CURRENT RETIREMENT TRENDS-- FEDERAL AND PRIVATE INDUSTRY

Even though Federal employees no longer have to retire at a certain age, statistical data compiled by the Office of Personnel Management (OPM), 1/ show that Federal employees generally choose retirement on regular Civil Service benefits at about age 61. On the average, those that enter the Civil Service disability retirement system do so between ages 53 and 54.

OPM statistics show that most Federal employees retire within 3 years of their eligibility. This trend has been slowly moving to an earlier retirement age; the average retirement age for an employee with 30 years of service at age 55 was 57.8 in fiscal year 1960 and 56.8 in fiscal year 1979. Social Security Administration statistics indicate that 77 percent of those eligible to retire at age 65 on social security benefits do so.

Private industry employees covered by private pension plans also generally retire before age 65, even though the

1/Formerly the Civil Service Commission.

Age Discrimination in Employment Act permits most employees to work until age 70. The trend to retire earlier than age 65 has developed over several years. A survey conducted by Charles D. Spencer & Associates, Inc., of Chicago, covered 1.5 million employees in a cross-section of large corporations nationwide. During calendar year 1978, 62 percent of the employees who retired from 100 major companies surveyed were younger than age 65.

Under the current Federal compensation system, an employee with a permanent job-related disability is not part of the Civil Service retirement system. Neither the employee nor the employing Federal agency makes retirement contributions, and it is possible for the employee to elect the higher Federal workers' compensation benefits and withdraw all contributions from the Civil Service retirement system.

Retired Federal employees who receive minimum benefits from the Civil Service retirement system receive much lower benefits than Federal workers' compensation beneficiaries--the lesser of (1) 40 percent of high-3 ¹/_{average pay} or (2) an annuity computed under the general formula after adding service from date of separation to age 60. The maximum benefit paid under a regular Civil Service annuity is 80-percent taxed, based on 41 years and 11 months of Federal tenure.

LABOR'S PROPOSAL FOR INTEGRATING FEDERAL COMPENSATION AND RETIREMENT SYSTEMS

Labor believes that a significant number of claimants are entering the Federal workers' compensation system late in their working careers. Our sample showed, of the 186 beneficiaries for which service computation dates were available, 100 (54 percent) had 20 or more years of Federal service, 68 (37 percent) had 25 or more, and 43 (23 percent) had 30 or more. Moreover, Labor maintains that many of the program's beneficiaries are receiving benefits well beyond the age they could have expected to retire. Of the 239 beneficiaries in our sample, 121 (51 percent) were over 55 years old, 75 (31 percent) were over 60, and 37 (15 percent) were over 65. Labor states that 30,000 of the 46,000 beneficiaries on its long-term disability roll can be expected to remain there for life.

¹/High-3 average pay is the highest average basic salary earned during any 3 consecutive years of service.

Labor proposes to remove retired beneficiaries from the long-term disability rolls by integrating the Federal workers' compensation and Civil Service retirement systems. This would reduce workers' compensation benefits after age 65 or at the end of a proposed 5-year guaranteed reemployment right, 1/ whichever occurs later. The reduction would result from converting workers' compensation benefits to retirement system benefits, with minimums to protect low-wage workers with few years of Federal service.

Labor believes that the rationale for compensating legitimate long-term permanent disability cases beyond normal work-life must be examined. At some point, the Government's obligation to replace a disabled workers' wages should end, and retirement income should begin, because the act was not intended to provide a permanent income. Eventually, disability income should be replaced by "retirement income" commensurate with that of an uninjured worker.

Labor does not wish to convert a disabled worker to a retirement system before the worker would have chosen to retire, and Labor considers 65 as a generally accepted retirement age. Labor also wants to ensure that all disabled workers have an opportunity to exercise their reemployment rights before being placed in "retirement" status and that an integrated disability and retirement system is consistent with the Age Discrimination in Employment Act, which prohibits discrimination in employment on the basis of age.

Labor has proposed minimum benefits to protect beneficiaries in the lowest grades and those with few years of Federal service from the financial hardship that might otherwise accompany integrating the two systems. For employees in the lowest grades, Labor suggests that Civil Service benefits for converted employees not be less than the salary of a GS-2, step

1/Labor also proposes to add to the existing 1-year reemployment right for the rehiring of individuals who recover and are able to return to their previous or equivalent job, a new provision which would provide an additional 4-year guaranteed employment right to a job within the former employing department or agency if the individual is able to perform any position with the employing agency. (Placement of a returning disabled employee in another department or agency would be deemed as fulfilling the reemployment obligation of the former employing agency.)

1--generally the same minimum for workers' compensation beneficiaries under the act.

Labor does not foresee any serious administrative problems in linking the Federal workers' compensation and retirement systems, but it notes that several cost implications need to be addressed. For example, a method of financing the Civil Service retirement fund for the retirement benefits for older workers transferred from the workers' compensation system is needed. Labor recommends that the employing agencies pay both the employee's and the Government's share of the contributions to the Civil Service fund as long as the disabled employees draw workers' compensation benefits. Medical costs would still be paid under the Federal Employees' Compensation Act.

Such a transfer is inherent in the workers' compensation program of Saskatchewan, Canada, where workers' compensation benefits cease once a claimant reaches age 65. The premise here is that, even in the absence of a compensable disability, a worker would no longer be employed at this point, and the industrial accident would not be depriving him or her of income. Once a worker reaches age 65, the Canada Pension Plan provides the worker with an income.

OUR ANALYSIS OF LABOR'S PROPOSAL

Labor's proposal is, in our view, basically sound, but we believe it does not allow for early enough transfer from compensation to retirement and, therefore, does little to end the substantial economic incentive for workers to effectively retire on compensation rather than on Civil Service retirement. Labor's proposal for the Federal workers' compensation program falls short by allowing beneficiaries to use the system for interim retirement until they reach age 65.

As discussed on page 20, OPM data show that most Federal employees retire within 3 years of their eligibility--i.e., at age 55 after 30 years of service. It would seem reasonable to transfer Federal workers' compensation beneficiaries from the workers' compensation program to the Civil Service retirement program somewhat closer to the time they would have been eligible to retire rather than at a predetermined age 65.

Data on years of Federal service were available for 186 of the 239 beneficiaries in our sample; the range was from 3 to 43 years, the average was 21.7. Seventy-three (39 percent) of the 186 were eligible for Civil Service retirement at the time of our review, based on the combination of age and years of Federal service. An additional 32 (17 percent) of the 186 were within 5 years of being eligible for Civil Service retirement. Thus, within 5 years, 105 (56 percent) of the 186 would be eligible for Civil Service retirement.

OPM is considering significant changes in its retirement system which should be considered in any integration plans. Proposed changes include legislation to further limit earnings by persons who have retired under the program and to eliminate disability retirement for employees who are eligible for voluntary retirement. OPM's study also calls for improved policing of the disability rolls and priority re-hiring for those who recover sufficiently to return to work after receiving a disability retirement.

CHAPTER 4

CONCLUSIONS, AGENCY COMMENTS, OUR EVALUATION, AND RECOMMENDATIONS

CONCLUSIONS

The high level of wage replacement benefits under the act is a major contributing factor to the high number of long-term beneficiaries and cost of the program. The tax-free nature of workers' compensation, augmented benefits for dependents, and the growth of multiple family income in recent years have reduced the financial incentive for workers' compensation beneficiaries to return to work. When benefit levels are set at amounts close to an individual's take-home pay, they create a disincentive to return to work and an incentive to remain on workers' compensation.

Increased use of long-term disability benefits is evidenced by significant growth in the number of beneficiaries and workers' compensation costs.

The growing number of long-term disability cases lends credence to Labor's contention that Federal employees perceive the workers' compensation program as a retirement system. Most long-term beneficiaries are beyond the scope of the program's objectives of helping injured employees recover physically and eventually return to work. Using the program as a seemingly never-ending benefit system results in increased cases and damages Labor's ability to control program costs and accomplish program objectives.

In essence, the Federal workers' compensation program has objectives which are difficult to resolve--adequate compensation on the one hand, and rehabilitation and return to work on the other. The program must compensate injured workers and insure them against the economic consequences of such losses without serving as a retirement system and providing negative motivation for returning to work.

Workers' compensation benefits should be set at a level that injured Federal employees, who are medically able, would have financial incentives to rehabilitate themselves and return to the work force. The original intent of the Congress in establishing a 66-2/3-percent benefit level was to enable

the injured employee to maintain his or her standard of living and to provide an economic incentive to return to work and avoid the danger of malingering.

Labor's proposal to tax Federal compensation benefits would lessen inequities among beneficiaries and would increase somewhat the financial incentive to return to work. Furthermore, by establishing a single percentage of preinjury pay, Labor's proposal eliminates the increased benefits for dependents, a provision of the current benefit structure which we believe is not warranted. However, Labor's proposal to increase benefits from 66-2/3 and 75 percent to 80 percent would not restore the original congressional intent to provide sufficient economic incentive to return to work because such benefits would still replace between 88 and 100 percent of net pay. (See table 3, p. 14.) We believe that the original 66-2/3-percent level would be a more reasonable level to work toward.

Long-term Federal workers' compensation beneficiaries should be transferred to the retirement system for which they are eligible. Labor's proposed integration of Federal compensation and retirement systems is basically sound, but revisions to allow transfer before age 65 would permit the program to more effectively accomplish major goals. Labor should consider proposing the transfer of beneficiaries from the compensation program to a retirement program at a point fairly close to when the injured employee would have been eligible to retire. On the basis of OPM data discussed on page 20, such a transfer within 3 years of eligibility would seem reasonable.

The major goal should be to prevent the Federal workers' compensation program from becoming a retirement system--to the detriment of its objectives--and, therefore, to better define the relationship between workers' compensation and retirement. Currently, the beneficiary chooses the program with the more financially advantageous benefit for which he or she is eligible.

In any plans for integrating Federal compensation and retirement programs, any proposed changes by OPM in its retirement system should also be considered.

AGENCY COMMENTS

Labor stated in its December 3, 1980, response to our draft report that the administration is currently reviewing

options for reform of the Federal Employees' Compensation Act program, and it did not believe it was appropriate to comment on proposed recommendations which urge that it reconsider policies that have not yet been decided. However, there were several aspects of the proposed report which Labor believed required a more detailed analysis than that which was set forth. (See app. I.)

For example, Labor said that any discussion of the reemployment rate after disability must consider factors in addition to benefit rates. Including such factors as Labor's ability to improve initial claims adjudication and postadjudication administration, and the activity by employing agencies in promoting opportunities for disabled employees to return to full or partial employment. Labor believes that any discussion of the relationship between benefits and predisability take-home pay needs to be placed in the context of determining the rate that maximizes both income protection and reemployment incentives.

OPM, in its November 17, 1980, response to our draft report, stated that our proposed recommendation to reduce the proposed benefit level because it does not provide an adequate incentive for workers to return to work implies that everyone is capable of recovering and returning to work or that there are substantial numbers receiving compensation by choice. OPM believes that, if this is true, the appropriate remedy is stricter application of disability criteria in claims adjudication, more vigorous policing of the periodic rolls, and increased emphasis on rehabilitation programs. OPM also believes that benefits approximating predisability income are justified because workers' compensation benefits have traditionally been considered substitutes for tort action. (See app. II.)

According to Labor, any discussion of the current average retirement age for Federal employees should consider the (1) impact that changing economic and social conditions might have on that figure and (2) requirements of the Age Discrimination in Employment Act. OPM also takes exception with our proposed recommendation that conversion from compensation to retirement benefits should occur earlier than age 65. OPM states that our rationale fails to recognize that only about 23 percent of new Federal employees stay in Federal service until voluntary retirement age, and thus might have spent most of their careers in the private sector under the social security system, working until age 65, had they not become disabled.

OUR EVALUATION

We understand Labor's position of not wanting to comment on our proposals at this time, but we believe that the points discussed in our report should be considered before finalizing the administration's legislative package.

We agree with Labor and OPM that other factors must be considered, such as Labor's administration of the program and increased emphasis on rehabilitation, including the employing agencies providing reemployment opportunities to beneficiaries who are able to return to work. We have discussed thoroughly these issues in previous reports and have made recommendations for improving their effectiveness--including that benefits be denied in all cases in which there is inadequate evidence and employing agencies be given specific monitoring and vocational rehabilitation responsibilities and the authority to appeal questionable claims.

We also agree with Labor's statement that any discussion of the benefit rate must be in the context of determining the rate that maximizes both income protection and reemployment incentives. However, we believe that Labor's proposal to increase benefits from 66-2/3 and 75 percent to 80 percent (replacing close to 100 percent of net pay) would fail to provide sufficient economic incentive to return to work as originally intended by the Congress.

OPM commented that benefits approximating predisability income are justified because workers' compensation benefits have traditionally been considered substitutes for tort action. However, when this tradition started in the early 20th century, the benefit level was established at 66-2/3 percent of gross pay, which at the time, closely approximated 66-2/3 percent of predisability net pay.

Almost any benefit level above or below what now exists or what is proposed by Labor can be argued pro and con. However, when the 66-2/3 percent of gross pay benefit level was included in the initial Federal workers' compensation legislation, that level was considered as a reasonable balance between the somewhat conflicting goals of adequate income protection and sufficient incentives to return to work (see p. 3). Further, that level seems to better recognize a basic concept of workers' compensation that there ought to be some sharing of the risk between both employee and employer for work-related illness or injury than one that provides the employee close to or more than 100 percent of take-home pay.

We recognize that changing economic and social conditions could have an impact on the average retirement age for Federal employees. It should be noted, however, that over the past several years, even with the periods of increasing inflation, the trend has been toward earlier retirement--in both the Federal and private sectors. We are also well aware of the requirements of the Age Discrimination in Employment Act and believe our recommendation is consistent with them.

OPM states that our rationale fails to recognize that only about 23 percent of new Federal employees stay in Federal service until voluntary retirement. OPM contends that our analysis should assume that if a Federal employee did not become ill or injured because of work, he or she would eventually end up in a non-Federal job covered by the social security system and work until age 65. Due to this possibility, an injured Federal employee should receive workers' compensation until age 65 before conversion to retirement benefits.

We do not concur with OPM's position and believe our proposal to transfer workers' compensation beneficiaries to the retirement program, for example, at age 58 for a person eligible to retire at age 55, is not out of line with what is occurring in the private sector. A survey of private industry employees who retired during calendar year 1978 showed that 62 percent were younger than age 65. (See pp. 20 and 21.) Social Security Administration statistics show that about 30 percent of those who are eligible retire at age 62, with almost 50 percent retiring before age 65. Also, the long-term Federal workers' compensation roll does not generally consist of the young or short-term Federal employee. Of the 239 beneficiaries in our sample, 166 (69 percent) were 41 years of age or older (see p. 18) when injured. Of the 186 beneficiaries for whom years of Federal service data were available, 100 (54 percent) had 20 or more years of Federal service (see p. 21). Our review also showed, that for these 186 beneficiaries 73 (39 percent) were eligible for Civil Service retirement at the time of our review, and an additional 32 (17 percent) were within 5 years of eligibility. (See p. 24.)

RECOMMENDATIONS TO THE SECRETARY OF LABOR

Although in general agreement with Labor's legislative proposals addressed in this report, to provide economic incentive for Federal workers' compensation beneficiaries to return

to the work force, in accordance with original congressional intent, and to help reduce the use of the workers' compensation program as a retirement system, we recommend that the Secretary revise the Department's legislative proposals to delete the increase in benefits from 66-2/3 and 75 percent to 80 percent and reconsider at what level Federal workers' compensation benefits should be set, probably near the original 66-2/3-percent level established by the Congress. At whatever level decided upon, Labor should retain a single percentage as now proposed, as this will eliminate the increased benefits for dependents.

In addition, to help ensure accomplishing the objectives of the act and to better define the roles and responsibilities of the Federal workers' compensation program versus Federal retirement programs, we recommend that the Secretary revise Labor's legislative proposals integrating these programs, to provide for the transfer of compensation beneficiaries to the retirement program within 3 years of the time the employee would be eligible to retire, rather than at Labor's presently proposed 65 years of age.

RECOMMENDATIONS TO THE CONGRESS

If the Secretary of Labor does not make the revisions that we recommend to the Department's legislative proposals or if the proposed legislative package is not introduced, we recommend that the Congress:

- Make Federal workers' compensation benefits subject to Federal income taxes and reconsider at what level Federal workers' compensation benefits should be set (probably near the original 66-2/3-percent level) to lessen inequities among beneficiaries and to reestablish the original congressional intent of providing economic incentives to return to work. At whatever level decided upon, the Congress should incorporate a single percentage, as this will eliminate the increased benefits for dependents.
- Integrate the Federal workers' compensation and Federal retirement programs to provide for the transfer of compensation beneficiaries to the retirement program within 3 years of the time the employee would be eligible to retire. This would help ensure the act's objectives are accomplished and better define the roles and responsibilities of these programs.

U.S. Department of Labor

Office of Inspector General
Washington, D.C. 20210



Reply to the Attention of:

Mr. Gregory J. Ahart
Director
Human Resources Division
U. S. General Accounting Office
Washington, D.C. 20548

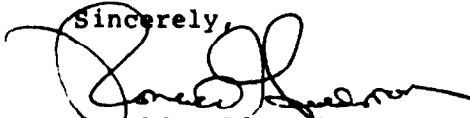
Dear Mr. Ahart:

This is in reply to your letter to the Secretary requesting comments on the draft GAO report entitled, "Federal Workers' Compensation Beneficiaries Need Economic Incentives to Encourage Reemployment and Reduce Program Costs."

The Department's response is enclosed.

The Department appreciates the opportunity to comment on this report.

Sincerely,


Ronald Goldstock
Acting Inspector General

Enclosure

U.S. Department of Labor's Response to
the Draft General Accounting Office Report
Entitled --

Federal Workers' Compensation Beneficiaries
Need Economic Incentives to Encourage
Reemployment and Reduce Program Costs

The Administration is currently in the process of reviewing options for reform of the Federal Employees' Compensation Act program, only two aspects of which are covered in this draft report. We do not believe it is appropriate to comment on recommendations which urge that we reconsider policies that have not yet been decided. There are, however, a number of aspects of the proposed report which require a more detailed analysis than that which is set forth.

For example, we think that any discussion of the rate of reemployment after disability must take into account factors in addition to benefit rates. Included among these factors are the ability of this Department to improve initial claims adjudication and post-adjudication administration, and the activity by employing agencies in promoting opportunities for disabled employees to return to full or partial employment. Any discussion of the relationship between benefits and pre-disability take-home pay needs to be placed in the context of determining the rate that maximizes both income protection and reemployment incentives. Similarly, any discussion of the current average retirement age for Federal employees should include consideration of the impact that changing economic and social conditions might have on that figure, and careful attention to the requirements of the Age Discrimination in Employment Act.



United States
Office of
Personnel Management

Washington, D.C. 20415

In Reply, Refer To

Your Reference

Mr. H. L. Kreiger
Director
Federal Personnel and Compensation
Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Kreiger:

This is in response to your request of October 16, 1980 for the Office of Personnel Management's views on a draft report entitled: "Federal Workers' Compensation Beneficiaries Need Economic Incentives to Encourage Reemployment and Reduce Program Costs."

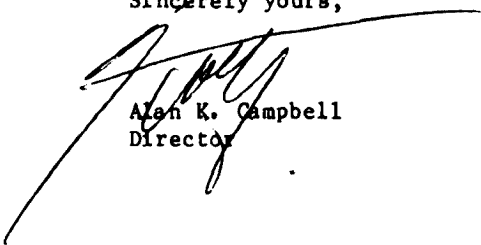
The report concludes that the high level of wage replacement benefits under the Federal Employees' Compensation Act (FECA) is a major contributing factor to the high claim load and the cost of the program. GAO expresses general agreement with draft legislation which the Department of Labor is developing to subject FECA periodic payments to Federal income tax, eliminate increased benefits for injured employees with dependents, and provide for transfer of FECA beneficiaries to Federal retirement systems after normal retirement age. However, GAO believes it is necessary to provide additional economic incentives for FECA beneficiaries to return to the work force and to help reduce reliance on the workers' compensation program as a retirement system. Recommendations to the Secretary of Labor include consideration of a benefit level closer to the present basic amount, which is 66 2/3 percent of gross salary, and transfer of FECA beneficiaries to Federal retirement systems at a point closer to earliest eligibility for voluntary retirement.

We have been closely following the development of the Department of Labor's proposed legislation to amend FECA and have provided technical comments on provisions which affect laws and Federal employee programs administered by OPM, including leave, retirement, life insurance, health benefits, and reemployment rights. Because a key part of the DOL proposal is the conversion of long-term disability beneficiaries to Federal retirement rolls after normal retirement age, we certainly share the general concern with the dramatic growth of the FECA periodic roll in recent years. However, GAO's recommendation that DOL reduce its proposed uniform, taxable benefit because it does not provide an adequate incentive for workers to return to work implies that everyone is capable of recovering and returning to work or that there are

substantial numbers receiving compensation by choice. If this is true, we believe that the appropriate remedy is stricter application of disability criteria in claims adjudication, more vigorous policing of the periodic rolls, and increased emphasis on rehabilitation programs. Employing agencies should be required to make every reasonable accommodation to retain or reassign disabled employees in accordance with the Selective Placement Program for other handicapped individuals before separating workers with job-related injuries or disability. We do not believe that individuals who have no prospects for recovery or rehabilitation following a work-related disability should suffer privation in the interest of encouraging anyone capable of returning to work to do so. Benefits approximating pre-disability income are justified because workers' compensation benefits have traditionally been considered substitutes for tort action.

We must also take exception to the GAO recommendation that conversion from compensation to retirement benefits should occur earlier than age 65. This recommendation is based on statistics which show that individuals subject to the Civil Service Retirement System normally retire voluntarily within a few years following earliest eligibility. This rationale fails to recognize that only about 23 percent of new Federal employees stay in Federal service until voluntary retirement age. Thus, a significant number of FECA beneficiaries might have spent the major part of their working careers in the private sector had they not become disabled. They would have been subject to the social security system which does not provide full retirement benefits until age 65. Accordingly, we believe that it is reasonable for DOL to designate age 65 as "normal retirement age."

Sincerely yours,



Alan K. Campbell
Director

OTHER GAO REPORTS PERTAINING TO
THE FEDERAL WORKERS' COMPENSATION PROGRAM

1. Letter to Congressman Tom Steed on "Hearing Loss Claims Processing Delays Under the Federal Employees' Compensation Act" (HRD-80-19, Jan. 21, 1980).
2. "Compensation for Federal Employee Injuries: It's Time to Rethink the Rules" (HRD-79-78, Aug. 22, 1979).
3. "Multiple Problems with the 1974 Amendments to the Federal Employees' Compensation Act" (HRD-79-80, June 11, 1979).
4. "Labor Department Is Strengthening Procedures to Recover Costs for Federal Employees' Injuries Caused by Third Parties" (HRD-79-36, May 9, 1979).
5. "Improvements Still Needed in Administering the Department of Labor's Compensation Benefits for Injured Federal Employees" (HRD-78-119, Sept. 28, 1978).
6. Letter to Chairman, Senate Committee on Human Resources, commenting on S.3060, the "National Workers' Compensation Standards Act of 1978" (A-14508 and A-14803, Sept. 4, 1978).
7. "To Provide Proper Compensation for Hearing Impairments, the Labor Department Should Change Its Criteria" (HRD-78-67, June 1, 1978).
8. "Administration of the Workers' Compensation Program" (GGD-77-45, July 8, 1977).
9. "How to Improve Administration of the Federal Employees' Compensation Benefits Program" (MWD-75-23, Mar. 13, 1975).
10. "Need for a Faster Way to Pay Compensation Claims to Disabled Federal Employees" (B-157593, Nov. 21, 1973).

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