The Long-Term Externalities of Short-Term Disability Insurance

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Key Findings and Policy Implications

This paper examines the effect of employer-provided short-term disability insurance (STDI) on the take-up of long-term disability insurance (LTDI), based on employer-provided STDI plans in Canada. It uses new data linking administrative tax and benefit records in Canada, which can be used to identify STDI availability and LTDI enrollment at the individual level.

- In theory, STDI benefits could reduce LTDI enrollment by giving employers a financial incentive to provide workplace accommodations, and by giving workers who develop work limiting disabilities time to adapt to their disabilities or, in some cases, to regain functional ability. But STDI might also raise LTDI enrollment by lowering the cost imposed on LTDI applicants during the waiting period when their applications are being evaluated.
- The paper finds that employer-provided short-term disability insurance increases long-term disability insurance take-up and imposes a negative fiscal externality on the government budget. The net effect of STDI plans is to raise two-year flows onto LTDI by 0.07 percentage points, or a 33 percent increase.
- Extrapolating these incentive effects to Canada's entire population, private STDI generated 18,300 LTDI recipients and CA$230 million dollars of public LTDI spending in 2015.

Five U.S. states provide STDI coverage, and about 25 percent of workers outside these states have STDI coverage. Some have advocated for universal STDI. This study informs that policy discussion by demonstrating a significant spillover effect on long-term plans, such as SSDI.

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