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FINANCING DISABILITY BENEFITS IN A SYSTEM OF INDIVIDUAL ACCOUNTS: LESSONS FROM INTERNATIONAL EXPERIENCE

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In recent years, many countries with mandatory defined benefit pay-as-you-go ("PAYG") systems have modified their systems to include individual accounts for financing retirement pensions. In most of these countries, a portion of the mandatory pension system's contribution rate has been "carved-out", and contributions earmarked by the carve-out are channeled into retirement accounts. Upon reaching retirement age, the contributions and accumulated interest in an individual's account are used to finance all or part of that individual's total retirement pension. Although an individual account may be a useful vehicle for financing retirement income, it may not prove sufficient for financing disability benefits. In a pension system that depends solely or partly on individual investment accounts, individuals who become disabled at a young age might lack sufficient capital in their individual accounts to finance adequate disability pensions. Generally, therefore, the implementation of "carveout" accounts for financing retirement benefits will necessitate changes to the financing mechanism for disability benefits.
A wide range of policy options exists for adapting disability benefits to operate in a pension system with carve-out retirement accounts. The purpose of this paper is to examine how countries with carve-out individual retirement accounts have approached disability reform, and to assess the applicability of these approaches in the United States.

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