Take-Up and Labor Supply Responses to Disability Insurance Earnings Limits

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March 22, 2021

Disability insurance programs often have earnings limits: if a beneficiary earns above a certain level, she loses part or all of her benefits. In the United States, the Substantial Gainful Activity (SGA) threshold is an extreme version of an earnings limit: if a beneficiary earns above the SGA ($1,260 for non-blind applicants in 2020), she gets no benefits. The rationale behind earnings limits is that they help screen out beneficiaries who have substantial remaining working capacity. In the U.S. case, the thinking is that if someone can earn more than the SGA amount in the labor market than they do not need to be on DI benefits. However, earnings limits create work disincentives and have potentially negative welfare impacts. For example, a disability beneficiary who can earn at the SGA plus $1 by working 40 hours a week, will likely opt for receiving benefits of a similar magnitude with no work, rather than working full-time and receive no benefits. In less extreme cases, where beneficiaries don't completely lose their benefits, the implicit tax rate can still inefficiently distort their labor supply. The trade-off between the screening and the labor supply effects of earnings limits is a key ingredient in setting these limits optimally.

In this project, we will develop a framework to understand the trade-off between the selection and the labor supply effects of disability insurance earnings limits. We will then empirically estimate the key parameters of the trade-off using a reform in Hungary that decreased the disability insurance earnings limit. In 2008, the earnings limit was reduced from 80% of the pre-disability wage to 80% of the minimum wage for new entrants in the

disability insurance program for moderately disabled beneficiaries, while it remained the same for beneficiaries who were already approved and beneficiaries in other programs. We will exploit this policy change to understand how selection into the program and labor supply once in the program changed. We will compare individuals who enter the program pre-reform and post-reform, along a number of dimensions. Most importantly, we will ask whether the characteristics of individuals entering the program change (e.g., does the composition shift towards lower-wage or less-healthy workers?) and whether individuals entering the program change their labor supply (e.g., do fewer of them work or do they work fewer hours?).