

The Employment Effects of Social Security Disability Insurance in the Past 25 Years: A Study of Rejected Applicants Using Administrative Data

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There have been large and continuing increases in the number of individuals receiving federal Social Security Disability Insurance (DI) since the system was conceived in its current form in the 1950s and 1960s. During the same period, labor force participation of older and lower-skilled men has fallen steadily, with a slow-down only in the 1990s. These parallel developments have led to the recurring questions of whether the generosity of DI induces low-income workers to apply for and sometimes receive benefits, and whether these individuals would work in the absence of DI. In a widely cited 1989 study, Bound considered this question by looking at the subsequent employment of rejected DI applicants, which he interpreted as an upper bound for what new DI recipients would have done in the absence of DI. Bound found that the employment rate of older male rejected DI applicants was quite low. This suggests few new beneficiaries would be expected to have worked in the absence of DI.

Since Bound's seminal analysis, the federal DI system has undergone significant changes, making the screening process more favorable to applicants, and the system more accessible for individuals suffering mental health conditions. At the same time, the labor market prospects of low-skilled workers have declined. Thus the calculus of applying for DI assistance has changed. In this paper, we replicate and extend Bound's analysis to include men and women, older and younger. Also, by merging several administrative data sources from 1978 to 2004, we can assess whether our main comparison is robust to using workers with very similar characteristics; we can differentiate results by age, gender, impairment, industry and earnings groups; and we can analyze earnings and employment dynamics before and after DI application.

Our results confirm Bound's finding that rejected male applicants age 45-64 have weak labor force attachment; in fact, despite differences in the nature of the data, for the early 1980s our numbers are very similar to his. This finding is very stable over time despite large changes in the DI system. It also holds for women and within specific impairment, industry, or earnings groups. Similarly, it is not altered when we control for the systematic ex-ante differences between new beneficiaries and rejected applicants that we find. If we were to use employment of rejected applicants as an upper bound, we would predict little labor force attachment in the absence of DI for older workers, who are traditionally the largest demographic category of beneficiaries.

However, our further results suggest one has to be careful not to generalize from this group to all new DI beneficiaries. An increasing fraction of DI applicants is younger than 45 and in better health. We show that these applicants maintain substantial labor force attachment after rejection, albeit at a lower rate than before application. Thus, for younger DI beneficiaries, we cannot exclude potentially higher labor force participation in the absence of DI. To deepen our understanding of these applicants, we also look at the characteristics of those who were "on the margin" between receiving and not receiving DI,

identified by having been rejected initially, but accepted on judicial review. We find the mortality rate of these “on the margin” new beneficiaries is very similar to that of finally rejected applicants and much lower than immediately accepted new beneficiaries. This suggests that the potential labor market behavior of “on the margin” DI recipients will be much closer to the employment characteristics of rejected applicants than the labor market behavior of DI recipients who were accepted originally.

Last, we find that the rejected applicants and to some extent initially rejected new beneficiaries bear some signs of workers who have been induced to apply to DI because of worsening economic conditions. The average earnings prior to application of both of these groups have been declining, especially in the early to mid 1980s. Average pre-application earnings and employment of rejected applicants is considerably lower than that of new beneficiaries; a gap that widens in the years just prior to application. Thus the presence of the DI program appears to induce some low-wage workers to leave the labor force and apply to DI. Since rejected applicants bear considerable losses in employment and earnings, this process imposes substantial costs on these workers and on society as a whole in terms of lost output.

The large losses in average employment and earning at application that we find suggest that the application to DI in itself may be costly for workers. Those more at risk of being drawn out of the labor force by DI are workers on the margin between receiving and not receiving DI; our finding suggests many of these applicants end up rejected and without a job.

The full working paper is available on our website www.nber.org/programs/ag/rrc/books&papers.html as paper NB08-08.

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