

Do Disability Benefits Discourage Work?

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disability examiners for review. We discuss assignment of applications to examiners in greater detail in the Section 3.1 and in the appendix.

Disability examiners follow a five-step review process in order to determine whether applicants are unable to perform SGA given the severity of their impairment and/or vocational background (age, education and work experience). Two types of allowances are made: medical allowances (at step 3, for individuals with specific impairments deemed severe enough to warrant allowance into the program regardless of vocational background) and vocational allowances (at step 5, for individuals with impairments severe enough to prevent them from performing any SGA in the national economy given their vocational background). Vocational allowances are made in consultation with a medical-vocational grid which provides guidance for allowance decisions based on residual functional capacity, age group, education and type of work experience (i.e., skilled, unskilled). Practically, the grid generates a large increase in the allowance rate at age 55 (see Chen and van der Klaauw, 2008, for more details). Disability examiners are not medically trained but may consult with a medical consultant (a physician or psychologist) in order to assess an applicant's residual functional capacity, or ability to work given their physical and/or mental impairments. Denials are issued to applicants engaging in SGA (step 1), impairments that are obviously temporary and non-severe (step 2), and if the individual has the residual functional capacity to perform any of their past jobs (step 4) or any work in the current economy (step 5).

Denied applicants can appeal their initial determination within 60 days by applying for reconsideration by the original DDS office.² Applicants denied at reconsideration have an additional 60 days to file an appeal to have an administrative law judge (ALJ) review their case. The ALJ must consider the application using the same steps in the same order as the initial determination, but the applicant may present new information. Applicants denied by an ALJ have additional opportunities to appeal to an SSA Appeals Council (AC) and finally to Federal Court. In our data, roughly one-third of applicants are allowed in the initial determination (divided approximately evenly among the two types of allowances), and just under two-thirds of applicants are ultimately awarded SSDI benefits. An audit study performed by the Office of the

² Since 1999, ten "prototype" states have eliminated the reconsideration step of the appeals process; they are: Alabama, Alaska, California (Los Angeles North and Los Angeles), Colorado (West), Louisiana, Michigan, Missouri, New Hampshire, New York and Pennsylvania.

Inspector General (2008) found that in 2006 the average processing time for cases in the initial determination phase was 131 days, or just over a third of a year. Average (cumulative) processing times for cases reaching the appeals phases were 279 days (0.76 years) for reconsideration, 811 days (2.22 years) for ALJ, 1,053 days (2.88 years) for AC and 1,720 days (4.71 years) for Federal Court. Just under a third of cases made it to the ALJ level, where approximately 61% of denials were overturned (GAO 2004). Less than 5% of cases progressed to the AC level and less than 1% of cases progressed to Federal Court.

Individuals who apply for SSDI benefits must stop working or reduce their earnings below the SGA threshold for a period of five months before they are entitled to receive benefits, or until the allowance decision is made (whichever comes later). Up to 19 months of back payments are available depending on the onset and allowance decision dates. The average monthly benefit was \$1,120 in 2009 (Social Security Administration, 2010, Table 36). Once benefits commence, beneficiaries begin a nine-month Trial Work Period (TWP) which allows individuals to “test” their ability to return to work by relaxing the restriction that earnings may not exceed the SGA threshold. The TWP is followed by a three-month Grace Period before individuals earning above the SGA threshold have their benefits suspended. Thus, SSDI beneficiaries may engage in SGA for up to twelve months (not necessarily consecutively) while receiving their full benefits without any penalty. Over the next three years, during an extended period of eligibility (EPE) benefits are paid for months in which earnings are below SGA, and not paid when earnings are above SGA. Finally, upon reaching the Social Security Full Retirement Age, SSDI benefits are automatically converted to Social Security retired worker benefits and the SGA earnings restriction is lifted. Very few beneficiaries leave the rolls for a reason other than death (35% in 2009) or automatic conversion to retired worker benefits (54%). In 2009, only 8% of worker beneficiaries’ benefits were terminated because they no longer qualified for benefits; of those, 39% failed a medical review (Continuing Disability Review, or CDR) whereas 61% were found to earn more than SGA (Social Security Administration, 2010, Table 50).

3. Empirical Strategy

The goal of this paper is to estimate causal models of labor supply of the following form:

$$y_i = X_i\beta + \gamma DI_i + u_i, \quad (1)$$

where y_i is earnings (or labor force participation) of applicant i , X_i denotes observed characteristics (e.g., age, type of impairment) that may influence labor supply, $DI_i = 1$ if the applicant was allowed (i.e., is observed to be a SSDI beneficiary at any time after the initial determination), and u_i is an error term. In observational data, inference is hampered if some unobserved characteristic, such as severity of the impairment, impacts both labor supply and SSDI allowance. For instance,

$$y_i = X_i\beta + \gamma DI_i - s_i + \varepsilon_i,$$

where s_i denotes unobserved severity, which can be thought of as the (unobserved part of) earnings loss associated with the individual's impairment, and which is uncorrelated with any remaining idiosyncratic element ε_i . Then in the regression above $u_i = -s_i + \varepsilon_i$, and if $E[s_i | DI_i] \neq 0$, ordinary least squares (OLS) regression gives a biased estimate of the average treatment effect, γ . In particular, OLS estimates $\gamma - [E[s_i | DI_i = 1] - E[s_i | DI_i = 0]]$. As observed by Bound (1989), assuming $\gamma < 0$ and severity positively correlated with SSDI receipt, OLS overestimates the magnitude of the coefficient on DI and provides an upper bound on the labor supply effect of SSDI.

From SSA's point of view, in an ideal world SSDI is awarded to individuals whose potential earnings – in the absence of SSDI benefits – are less than the SGA threshold:

$$X_i\beta - s_i + \varepsilon_i < SGA.$$

In practice, however, cases are assigned to disability examiners who have imperfect information, and so the assignment rule becomes based on the contrast:

$$X_i\beta - \hat{s}_{ij} < SGA,$$

where \hat{s}_{ij} denotes the estimate by examiner j of the severity of individual i 's impairment. This estimate is a function of both the individual's impairment severity – which the examiner observes in greater detail than the econometrician, through medical records and test results – and characteristics of the examiner assigned to the case, such as previous experience or personal perceptions/tastes. Let

$$\hat{s}_{ij} = s_i + \sigma_j + \nu_{ij},$$

