Would a Refundable Tax Credit Increase the Labor Supply of Impaired Adults?

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Key Findings and Policy Implications

This paper examines the potential labor supply response to a Disabled Worker Tax Credit (DWTC) originally proposed in 1996 by the National Academy of Social Insurance. The empirical analysis uses the Survey of Income and Program Participation to examine the change in participation, employment, and hours among impaired adults after three exogenous policy changes: the Earned Income Tax Credit (EITC) expansions of 1991 and 1994 and the creation of the 10 percent tax bracket in 2002. The paper finds that:

- Using difference-in-differences regressions for the 1991 and 1994 EITC reforms, there is very little impact of the more generous EITC tax incentives on the labor force participation of impaired adults. Nearly the same proportion of the sample is in the labor force before and after each reform: 63 percent in both 1990 and 1991, and 60 percent in both 1993 and 1994. Employment is also flat between 1990 and 1991, though it does tick up – from 54 percent to 56 percent – between 1993 and 1994. Hours worked actually fall from 1990 to 1991, though they rise by 0.7 hours per week (2.8 percent) after the 1994 EITC expansion.

- Reduced-form regressions indicate that hours and entry into the labor force and employment actually increase statistically significantly for those who experience an increase in tax liability for each of the three policy reforms. But these counterintuitive results may be explained by the fact that workers who increase their labor supply in response to a cut in the effective tax rate might actually end up paying more in taxes, if their income is sufficiently higher.

With the fiscal challenges currently facing the SSDI program, the appeal of a DWTC program is clear, provided that workers are responsive to the financial incentives associated with the tax credit. The results of the paper are important to the policy discussion, because they suggest that more than financial incentives may be necessary to induce disability beneficiaries to return to the labor force.

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