

The Impact of the Substantial Gainful Activity Cap on Disability Insurance Recipients' Labor Supply

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Key Findings and Policy Implications

This paper examines the impact of Austria's "substantial gainful activity" (SGA) cap on the earnings of disability insurance beneficiaries. Under the program, if DI beneficiaries earn one Euro more than the SGA cap of 440 Euros per month, then their disability benefits are reduced by up to 50 percent in that month. The paper explores the degree of "bunching" on the low-earnings side of the SGA cap. It uses longitudinal labor market history data from the Austrian Social Security Database, linked to the income and benefit reports that are submitted annually to the Austrian tax office. The paper finds that:

- The earnings distribution of DI beneficiaries exhibits large and sharp excess bunching just below the SGA cap. This suggests that the SGA notch reduces earnings significantly. We estimate that DI beneficiaries who earn just below the SGA cap would increase monthly earnings by up to 342 Euros if the notch at the SGA cap did not exist. This represents an 85 percent increase relative to the SGA earnings level. Bunching is very persistent over time; almost 60 percent of those who bunch have done so for at least five years in a row.
- Observed bunching responses are strongly attenuated by frictions such as adjustment costs and inattention. About 55 percent of beneficiaries in the earnings range just above the SGA cap range are unresponsive to the SGA cap, implying that bunching would be about twice as large without frictions compared to observed bunching.
- Women and younger DI recipients are more responsive to financial incentives, compared with men and older age recipients.

The significant response to the SGA cap has important implications for the design of disability insurance policies. For example, we estimate that an abolition of the SGA earnings cap – by increasing earnings, as well as taxes on earnings – would reduce annual net government expenditures by as much as 15 percent.

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