The Effect of Transfer Income on Labor Force Participation and Enrollment in Federal Benefits Programs: Evidence from the Veterans Disability Compensation Program

David H. Autor
Mark Duggan

National Bureau of Economic Research
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Policy Abstract

This is the second phase of a project on the interactions between disability policy and labor supply, focusing in particular on the Veteran’s Disability Compensation (VDC) program and its relationship to the Social Security Disability Insurance (SSDI) program and other Social Security benefits. A key aspect of VDC policy is that the benefits are largely non-contingent; they are received whether or not an eligible veteran continues working. Thus analyses of VDC policy enable us to isolate the income effect of disability benefits on work behavior. The VDC program currently provides income and health benefits to about three million veterans of military service. In July of 2001, the program was expanded to cover a broader set of conditions for veterans who had served in Vietnam with “boots on the ground.” This policy change allows us to use other veterans as a comparison group when estimating the effect of this program. We find clear evidence that the increase in VDC enrollment caused by the 2001 policy change had a significant negative effect on the labor supply of Vietnam veterans who became eligible for the expanded benefits. Almost thirty percent of individuals who became eligible for the VDC program dropped out of the labor force, even though they could have continued working at the same time as receiving the benefits. The policy change also had an effect on enrollment in benefits programs administered by the Social Security Administration. Most notably, it raised SSDI enrollment among veterans who became newly eligible for VDC benefits by a full percentage point. We also find suggestive evidence of spillovers from VDC to both SSI and OASI benefits.