

Earnings bunching at benefit abatement thresholds: evidence from recent policy changes

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Executive summary

Income support policies face challenges and trade-offs between delivering adequate income support to recipients, maintaining work incentives, and limiting the fiscal costs of the support. Recent policy changes to the abatement thresholds for main benefit recipients attempt to positively address the first two objectives, at the possible expense of the third. Abatement thresholds for main benefits such as Jobseeker Support (JSS), Sole Parent Support (SPS), and Supported Living Payment were raised in April 2020 and April 2021. In this study we analyse the effects of these changes on recipients' employment and earnings behaviour, and their net incomes.

The research focuses primarily on weekly earnings of Single JSS recipients, as their non-benefit income is assessed on a weekly basis, and their benefit entitlement and income assessment are not complicated by the presence of a partner. However, the research also considers the outcomes for Sole-parent recipients (both JSS and SPS recipients), who may choose to have their non-benefit income assessed on an annual basis.

Under the abatement policy, benefit recipients can earn up to the abatement threshold with no effect on their main benefit payments. But earning above the threshold results in main benefit payments being reduced, by 70 cents per dollar of earnings for Single JSS recipients; for Sole-parent recipients, benefits are reduced by 30 cents per dollar of earnings above a first (lower) threshold and by 70 cents per dollar of earnings above a second (higher) threshold. These benefit abatement rates potentially provide little incentive to earn more than the threshold levels. Because of this, recipients who otherwise might earn more, may try to manage their earnings so that they do not earn more than the threshold amount. This may result in a 'spike' or 'bunching' of earners around that level in the earnings distribution.

Data sources

The analyses use various data sources stored within Statistics New Zealand's Integrated Data Infrastructure (IDI). We use Inland Revenue earnings information for MSD benefit



recipients to estimate their weekly wage and salary earnings rates. (See full paper for Data disclaimer.)

Results

First, over the sample period of the abatement threshold policy changes, we find clear evidence of weekly earnings bunching around the abatement thresholds for Single JSS recipients – i.e. there is bunching around \$80 before April 2020, at \$90 between April 2020 and March 2021, and at \$160 after March 2021. Although there are clear signs of bunching, we estimate this occurs for only modest numbers of recipients: about 1 percent of those with earnings, and about 0.1 percent of all recipients.

For Sole-parent benefit recipients, we also observe some weekly earnings bunching around the lower (part-time, 30%) abatement thresholds over the period – i.e. at \$100 before April 2020, at \$115 between April 2020 and March 2021, and at \$160 threshold after March 2021. However, we see no bunching in Sole-parents' weekly earnings around the higher (full-time, 70%) abatement thresholds (at \$200, \$215 and \$250 respectively).

Second, despite the clear bunching, our estimates of the behavioural responses to the abatement threshold incentives are relatively small. We estimate the elasticity of bunching with respect to the change in effective marginal tax rate around the abatement threshold. The elasticity measures the relative change in the number of recipients near the threshold in response to a 1 percent change in the effective marginal tax rate that recipients face when earning just above versus just below the threshold. For Single JSS recipients, the estimated elasticity is about 0.07 before April 2020, and about 0.02 after March 2021. For Sole-parent recipients, we estimate slightly higher response elasticities around the part-time thresholds, of about 0.11 before April 2020 and 0.07 after March 2021. These estimated responses are small, which is consistent with the modest estimates of the number of recipients who bunch their earnings at the thresholds. For Single JSS recipients, an elasticity of 0.07 implies that there are about 10% more recipients with earnings at the threshold than would be expected based on how many have earnings near that level.

These elasticities are also smaller than bunching estimates obtained in other contexts in New Zealand and in other countries. We hypothesise three possible reasons for this: (1) estimated bunching behaviour in other contexts tends to be concentrated among those with self-employment income who have more scope to manage their reported income, whereas our analysis is on tax-withheld wage and salary earnings, with limited scope in this respect; (2) the higher frequency of the weekly assessment further reduces recipients' scope to align their labour supply and earnings choices to the abatement thresholds; and (3) for Sole-parents who choose annual abatement assessment, the weekly earnings may provide a relatively poor measure of their behavioural responses to the abatement threshold incentives. In addition, awareness and understanding of the thresholds may be low. We hypothesise that the relatively greater responsiveness of Sole-parents is associated with them having typically longer benefits spells than Single-JSS recipients: this enables them both to better understand the abatement policy rules and to benefit more from responding to the incentives in the rules. Lags in understanding the changes is one possible reason for the decrease in estimated bunching behaviour.

Third, although the abatement threshold policy changes could potentially have led to large increases in net earnings and incomes of benefit recipients, we find they had relatively little

effect on recipients' net incomes. For single JSS recipients, we estimate the changes increased average incomes by less than \$7 per week (about 3%); for Sole-parent recipients, the changes increased incomes by about \$6 per week (less than 2%). In contrast, policy changes that increased the weekly benefit rates over the study period increased average net incomes by over \$50 per week for single JSS recipients, and over \$60 per week for Sole-parent benefit recipients.

Finally, we estimate the fiscal cost of the policy changes for Single-JSS recipients are \$22-24 million annually, resulting from increased benefit costs, offset to a small degree by increased tax revenue. These fiscal costs represent increased transfer payments to benefit recipients.

Implications for policy

The recent abatement policy changes resulted in about \$6-7 per week on average more total income support for benefit recipients with earnings. However, as most recipients do not have earnings, the proportion of recipients who benefited from these changes was low, and there is no sign that more recipients chose to participate in paid work because of the more lenient abatement rules. For working recipients, the results suggest that recipients do not change their behaviour significantly in response to changes in the main benefit abatement rate. Furthermore, these net income gains were relatively modest compared to the contributions of recent benefit rate increases.

Summary

The increases in the abatement-free earnings thresholds enabled main benefit recipients to substantially increase their incomes. Although some recipients tend to bunch their earnings at the thresholds and so increased their earnings as the thresholds increased, this applies only to a small fraction of recipients and has only a small overall effect on recipient earnings.