

DO PEOPLE CHANGE THEIR EARNINGS TO AVOID LOSING BENEFIT PAYMENTS?

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Should future reform to the JobSeeker Payment increase how much JobSeeker recipients can earn before their payment is reduced (the income free threshold)? Unlike a payment increase, an increase in the income free threshold both puts more money in the hands of low income workers and may encourage part-time workers to work more. In this micro note we find there is limited evidence people will change how much they work if the threshold is adjusted.

For those on the JobSeeker Payment, financial disincentives to work can take two forms:

- a high benefit payment discourages non-working JobSeeker recipients from participating in the labour market (the extensive margin).
- a greater withdrawal of benefits encourages working JobSeeker recipients to work less (the intensive margin).

We are examining the intensive margin. Specifically, we investigate whether the 23% of benefit recipients who are employed choose to work less due to the withdrawal of the benefit - and the high tax rate that implies.

Australians can earn up to \$150 per fortnight and receive the full unemployment benefit. This is known as the 'income free threshold'. Above this threshold, a recipient faces an effective marginal tax rate (EMTR) of 50 per cent because the JobSeeker payment is reduced by 50 cents for each additional dollar of income earned. How does a 50% tax rate change the work incentives of beneficiary recipients?

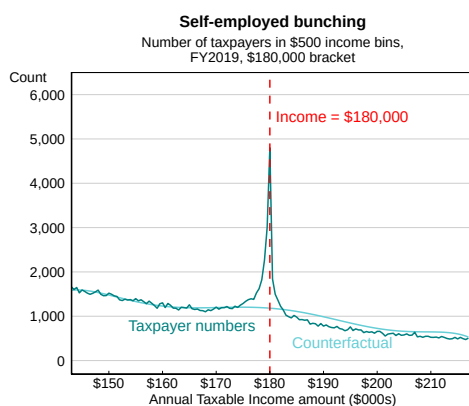


Figure 1

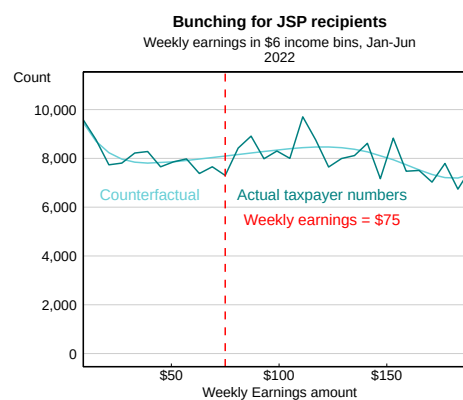


Figure 2

The above graphs show the distribution of taxpayers around two income thresholds where tax rates change. If individuals 'bunch' near the income where the higher tax rate starts, then tax matters for their choice about how much to work.

1. High income self employed

High-income earners clearly 'bunch' around the top tax threshold (Figure 1). For self-employed earners at the top tax rate this bunching is equivalent to an **elasticity of taxable income of 0.18** - for a 1% increase in the net of tax rate people reduce their reported income by 0.18%. This is not a large response, but is in line with estimates from Australia and overseas.

2. Working JobSeeker Payment recipients

Low-income JobSeeker Payment recipients show no clear bunching at the income free threshold level (Figure 2). Beneficiaries are not obviously reducing their taxable income in response to an increase in the marginal tax rate from 0% to 50%.

These graphs show that an 8 percentage point increase in the marginal tax rate for high income self-employed individuals leads to the sharp bunching observed above – while a 50 percentage point increase for benefit recipients shows no visual bunching. Similar non-responses have been observed in the Netherlands, New Zealand, and the United States.

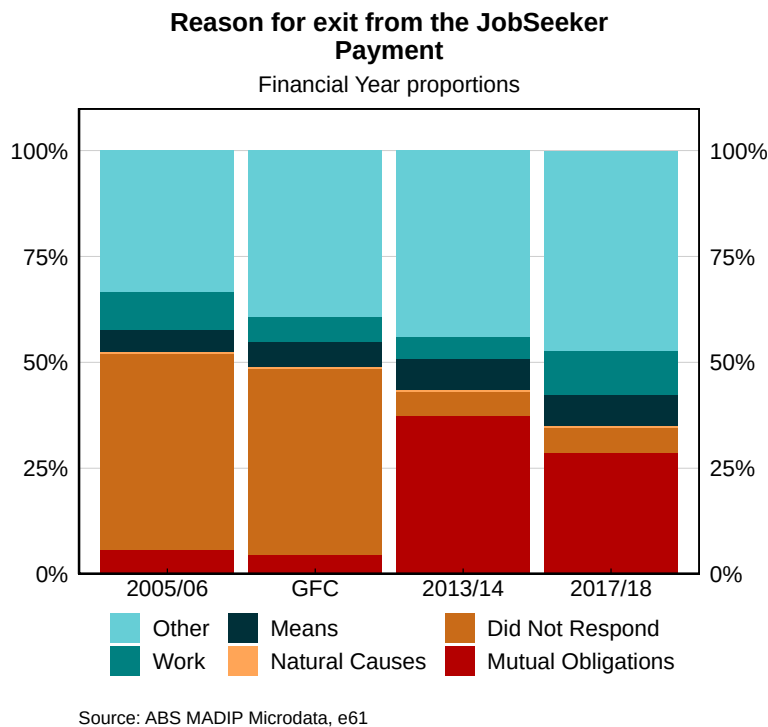


Figure 3

This does not necessarily imply that recipients are inattentive to the high tax rates. Instead the mutual obligations system, or inflexible offers from employers, may be driving this behaviour - especially as the application of mutual obligations to those on the JobSeeker payment has risen (Figure 3).

Mutual obligations require that JobSeeker recipients have to take up job offers they receive - or risk losing the payment entirely. This combined with minimum wages gives employers sufficient power to set hours of work without consideration of the tax paid by employees.

If recipients' work decisions are genuinely unresponsive to the marginal tax rates, then targeting may be effective at reducing fiscal costs without distorting labour supply behaviour.

However, if the mutual obligation system or employer behaviour are driving this result, the income support system may still be distorting labour market choices - forcing people into dead-end work that doesn't match their skills or career prospects.

Currently, a single Australian working part time on the minimum wage at a department store will pay a higher effective tax rate (including both tax and the loss of benefit income) than someone earning in the low six figures at a large investment bank. If we don't believe this is right, then increasing the income free threshold will go some way to address that. However, it won't increase support to those unable or unwilling to find work and our research indicates it won't change how much those that are employed are able and willing to work.

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