

Centre For Health Economics Seminar Series 2018

ADJUSTMENT COSTS AND INCENTIVES TO WORK: EVIDENCE FROM A DISABILITY INSURANCE PROGRAM

Presenter: Dr Arezou Zaresani, University of Melbourne
Date: Wednesday 28th November
Time: 12.00pm - 1.00pm
Venue: RB Scotton Room
Centre for Health Economics



Abstract

How important are adjustment costs for individuals when they face a change in work incentives induced by a policy change? I provide the first estimate of heterogeneous adjustment costs by exploiting a policy change that substantially increased work incentives. The policy change increased the exemption threshold in a disability insurance program. I document strong responses to work incentives as I observe excess mass –“bunching”– right below the exemption threshold where the marginal tax on earnings is low. A puzzling observation is that individuals continue bunching at the former threshold after the policy change. This finding suggests that they face adjustment costs when changing their labor supply. I use the amount of bunching at the new and former threshold to estimate adjustment costs that vary by individuals' ability to work. The estimated adjustment costs are higher for individuals with lower ability; varying from zero to twenty percent of their potential earnings, with an average at eight percent. The estimated elasticity of earnings respect to net-of-tax rate – accounting for heterogeneous adjustment costs – is 0.2, which is double the size of the elasticity estimated with no adjustment costs. I find that individuals who already work, work more, and those who did not work, start working. Policies designed to increase labor supply will work if the induced work incentives are large enough to offset the adjustment costs.

Presenter

Arezou Zaresani is a Research Fellow at the Melbourne Institute for Applied Economics and Policy Research at The University of Melbourne. Arezou is an empirical microeconomist with interests in labor, public and health economics. Arezou's research involves design-based analysis where she exploits quasi-experimental variation to study economic questions of interest. She uses existing theoretical models to motivate the research question or to interpret the results of the empirical analysis

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