

The new work incentive for Spain's national Minimum Income Benefit

Policy issues and incentives in the international comparison

Note contributing to output 6, Project 20ES15

This note offers a preliminary assessment of the new Work Incentive of the new Minimum Income Scheme in Spain, based on information shared with the Secretariat in October 2022. It discusses key policy issues associated with similar programmes across the OECD, and compares the work incentives of the new programme with similar programmes in other OECD countries, using the OECD TaxBEN model.

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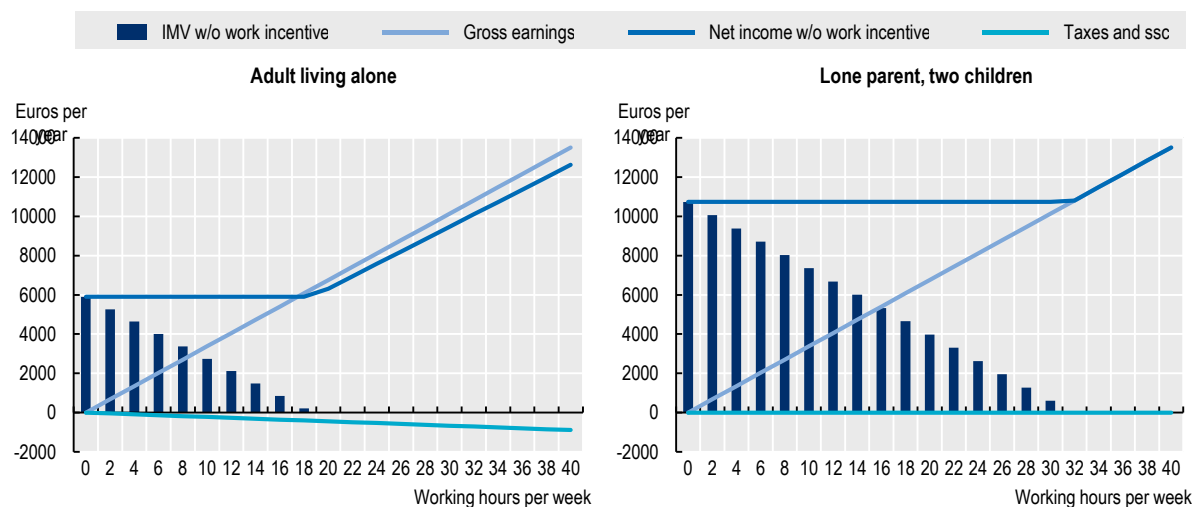
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1 Introduction

The new Spanish national minimum income benefit *Ingreso Mínimo Vital* (IMV) was introduced in 2020, against the backdrop of the COVID-19 emergency. It provides a common minimum income floor across Spain, with benefit amounts depending on household size and composition. Until the introduction of the work incentive in 2022, the benefit was withdrawn against labour income on a one-to-one basis. Thus, as working hours increase, total income remains flat until the benefit is phased out completely and total income starts to increase with working hours see Figure 1. For a single person earning the minimum wage, the benefit is phased out at about two days worked at the minimum wage; for a lone parent with two children, the benefit amount is phased out at about 30 hours worked per week. Thus, taking up a job with working hours below these thresholds does not increase net income.

Figure 1. *Ingreso Mínimo Vital* without work incentive: benefits are completely withdrawn against earnings

Benefit amount, earnings and total income by working hours at the minimum wage, by household type, 2022



Note: Children are four and six years old. The lone parent benefits from the tax credit for large families, which offsets social security contributions up to 1,200 Euros per year

Source: OECD TaxBEN model

On the 27th of September 2022, Spain introduced the *incentivo al empleo* (work incentive) to encourage increased labour market participation among IMV recipients, to be implemented from January 2023 (Ministerio de inclusión, seguridad social y migraciones, 2022^[1]). It will benefit IMV recipients who increase their working hours or who take up a job, and is designed to guarantee that income increases with working hours, at least in the first year after an increase in labour supply. As the work incentive is only granted in the first year of increased labour supply, it is an into-work benefit, meant to incentivise finding a job or increasing hours, rather than support low incomes in the long term.

The basic design is as follows: if a recipient's income *increase* – as compared to the previous year – is below 60% of their IMV entitlement, they receive the full amount of their net earnings as a work incentive. Thus, effectively, earnings below 60% of the IMV entitlement do not count towards the means-test. Earnings increases between 60% and 100% of the previous IMV entitlement partially add to the work incentive depending on the household composition of the recipient household, and whether the earnings increase is due to a new job (extensive margin) or an increase in working hours (intensive margin). For instance, adults without children receive 30% of any earnings between 60% and 100% of their previous IMV entitlement (in addition to the first 60% of their earnings), see Table 1.

These taper rates are designed to vary according to empirical estimates of labour supply elasticities – the responsiveness of individual labour supply to changes in net wage rates – in the empirical literature. Women with children, especially lone parents, tend to have higher labour supply elasticities than women without children, since for parents, taking up a job tends to be associated with higher costs (such as childcare, see, e.g. (Bargain, Orsini and Peichl, 2014^[2])). Empirically, elasticities are also higher for those taking up work than for part-time workers – this is due to in-work rigidity, the fact that workers often cannot increase their working hours with the same employer at-will, but need to find a new job offering more hours, which is costly (Gong and Breunig, 2014^[3]).

Table 1. New Work Incentive for the IMV: taper rates

Share of increases in earned income recipients can keep for income increases between 60 and 100% of their (previous) IMV entitlement, 2023

	Extensive margin (new job)	Intensive margin (increase in working hours)
Able bodied adults living without children	30%	20%
Couples with at least one child	35%	25%
Single parents / disabled adults	40%	30%

Source: Legal text published 28th of September 2022, (Ministerio de Inclusión, Seguridad Social y Migraciones, 2022^[4]).

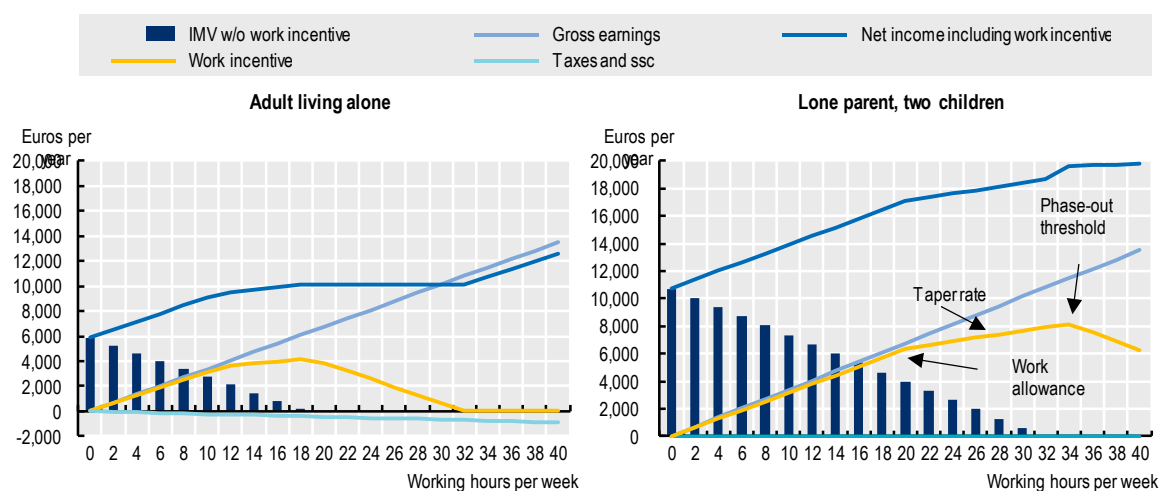
Income above the threshold of the (previous) IMV amount is withdrawn against the work incentive on a one-to-one basis. Thus, while the work incentive tapers off, there is no hard threshold, and net income still increases or remains flat with an increase in working hours (Figure 2).

The new work incentive significantly increases net incomes for recipients. Because it starts to phase-out when earnings increases are equal to the (previous) benefit amount, for a single adult without children it reaches its maximum of about EUR 4 000 per year at about three days of work at the minimum wage. Total IMV payments are maximised at about ten hours of work, because the work allowance means that the work incentive completely compensates for the means-test of the IMV. Increases in net income are therefore strongest for the lowest income increases, but net income remains flat or increasing up until full-time working hours (Figure 2).

A single parent with two children has both a higher work allowance, and a higher threshold for withdrawal, because IMV base amounts are higher for this household type. In addition, they also benefit from a lower taper rate (Table 1). For this household type, the work incentive increases until four days of work at the minimum wage, at almost EUR 8 000 per year. Even a full-time worker would still receive over EUR 6 000 (Figure 2).

Figure 2. The new work incentive increases incomes for low working hours

Benefit amount, earnings and total income by working hours at the minimum wage, by household type, 2023*



Note: * The new work incentive will be paid out from January 2023, but calculated based on wage increases between 2021 and 2022. In TaxBEN, it is implemented as an into-work benefit, and counted towards 2022 net incomes, see section 3. Children are four and six years old. The lone parent benefits from the tax credit for large families, which offsets social security contributions up to 1,200 Euros per year.

Source: OECD TaxBEN model: IMV work incentive module.

This note offers a preliminary assessment of the new Work Incentive of the new Minimum Income Scheme in Spain, based on information shared with the Secretariat in October 2022. It discusses key policy issues associated with similar programmes across the OECD (Section 2), and compares the work incentives of the new programme with similar programmes in other OECD countries, using the OECD TaxBEN model (Section 3).

2 Combining benefit receipt and work: policy issues

The IMV work incentive shares design features with a number of different programmes across the OECD: is designed to incentivise transitions into work (at the intensive and extensive margins) and can thus be described as an **into-work benefit**. Similarly, **partial unemployment benefits** enable workers to work while receiving benefits. Because it is paid in the year following a transition into work, it also has similarities with **refundable tax credits**. Finally, because it benefits only low-wage workers, it can also be described as an **in-work benefit**.

Most OECD countries operate at least one of these benefit types, this note does therefore not attempt an exhaustive overview of similar policies across OECD countries; see the TaxBEN policy tables (<https://www.oecd.org/social/benefits-and-wages/>) for such an overview. Instead, this section raises some of the trade-offs and design issues of benefits meant to incentivise (re-) employment.

In-work benefits can promote employment ...

Partial unemployment benefits allow jobseekers to keep part of their benefit entitlement when taking up a job that satisfies the eligibility criteria: most often minimum and / or maximum weekly working hours (typically between ten and 30 hours per week), sometimes minimum hourly wage criteria, and often only new jobs are subsidised. Benefit amounts often vary with household size, underscoring the dual poverty prevention and work incentive approach of these programmes. Furthermore, in the majority of OECD countries, earnings below a certain threshold do not trigger a reduction in benefits, while benefits reduce for earnings beyond this threshold. In France, almost half of all unemployment-benefit recipients work while claiming support (Cahuc, 2018^[5]) and part-time unemployment benefits are also widespread in Belgium, Finland, Austria, and Germany (OECD, 2022^[6]).

The goal of such partial benefits is to cushion the benefit loss that results from a move into employment, and thereby overcome the disincentives that this entails. They can also help keep up workers' social and job-related skills, and thus serve as a stepping stone to more permanent or hours-intensive employment. They may also incentivise taking up formal (and hence most often higher-quality) work as they reduce the effective tax wedge between formal and informal employment for recipients. In-work benefits, that may also be received by low-wage workers without a history of unemployment benefit receipt, can alleviate poverty, and cushion earnings losses by topping up incomes of those unable to find full-time or sufficiently paid work.

In the current climate of high inflation and increasing cost of living, in-work benefits also provide an infrastructure countries can use to target income support not only to the jobless, but also to low-wage and marginally employed workers, who may be as much at-risk of poverty as unemployment benefit recipients.

Some recent empirical work has found that partial unemployment benefits can have a significant impact on the propensity to work while claiming benefits. For instance, (Ait Bihi Ouali, Bargain and Joutard, 2020^[5]) show that a decrease in the maximum hours condition for partial unemployment benefits in France in 2006

increased the likelihood of workers to take up a job working just below or at the new (lower) maximum hours threshold.

... particularly for some groups and when labour demand is strong

In-work benefits are often particularly important for single parent and one-earner families with children because lost benefits and childcare costs can significantly erode the additional net income from work. The empirical literature also shows that single parents' labour supply reacts more strongly to financial work incentives (Bargain, Orsini and Peichl, 2014^[2]). However, financial incentives will only translate into increased employment if a lack of work incentives is the main barrier to employment jobseekers face. For some individuals, multiple barriers prevent them from taking up stable employment. They may have health issues, care duties, or skills deficiencies; alternatively, there may be limited demand for their skills and experience, or limited labour demand in their local market. In these cases, policy design to reinforce work incentives risks pushing individuals into jobs that ill match their skills and experience, or pushing individuals into poverty (OECD, 2022^[6]).

But they can also lock recipients in low-paid, part-time or low-quality jobs

With the exception of the re-employment provision in the Portuguese unemployment benefit system, that only benefits full-time workers, all work-related benefits across the OECD are either explicitly targeted to part-time work, or target low-wage or part-time work through a means-test on earnings (OECD, 2022^[8]).

While in-work benefits can incentivise workers to take up low-paid work that may be a stepping stone to better quality employment, they can also decrease the effort of workers to look for better jobs, thus locking them into part-time, low-paid or other irregular work arrangements. For instance, (Benghalem, Cahuc and Villedieu, 2021^[9]) show for France that a 6% increase in the probability that unemployment benefit recipients take up a job increases the likelihood of them remaining unemployed until the last month of their claim by 1.5% -- a significant effect.

Subsidising low-quality and part-time employment is a concern

Decreased incentives to look for stable, full-time employment is especially relevant as the incidence of alternative work arrangements – such as temporary, part-time, and platform work – increases. Part-time and unstable work has been increasing steadily, especially among the young – by 5 percentage points between 2008 and 2018 across the OECD on average, and by 8 percentage points in Spain (OECD, 2020^[10]). In-work benefits may become a de-facto subsidy for jobs that are not sufficient to lift workers out of poverty. Especially new forms of work, such as platform work, offer very flexible hours, and can enable individuals to game the system so as to maximise benefit receipt.

When in-work benefits are only means-tested to income, and not working hours, they can also subsidise part-time work, especially when not underpinned with any or sufficient activation policies (such as job-search monitoring) that encourage workers to find full-time work. Because of these lock-in effects and their potential to act as a subsidy to low-quality jobs, in-work benefits should ideally be time-limited, and not permanent, which is the case for the IMV work incentive.

Underpinning in-work benefits with activation policies might stretch PES resources

Successful work-related benefits couple passive (cash benefits) with active (active labour market policies) support. For example, recipients of the UK in-work and out-of-work benefit Universal Credit are assigned a “work-coach” (PES caseworker) upon claiming the benefit. If they are capable of working full-time (i.e. they do not have any health conditions that would hinder employment, and are no caring responsibilities) they are expected to actively look for suitable employment. If their earnings fall below an Administrative

Earnings Threshold (AET), they are required to attend interviews, to discuss work activities and be available for (more) work alongside the unemployed. Those earning above the AET but less than the Conditionality Earnings Threshold may be required to attend interviews and prepare for further work (OECD, 2022^[6]). If the incidence of benefit receipt is high, however, suitable activation support increases the burden for the PES. This is particularly problematic for some local offices if claims are geographically concentrated.

Complexity of policy design can lower take-up and weaken incentives

Intricate policy designs can result in (potential) recipients thinking that they are not entitled to the benefit or to miscalculate their entitlements. (Benghalem, Cahuc and Villedieu, 2021^[9]) show that a simple mailing to benefit recipients informing them of the possibility to keep part of their unemployment benefit entitlement when taking up a part-time job increased the likelihood of working while claiming benefits by 6% within three months of the mailings. For the Earned Income Tax Credit (EITC) in the US, it has been shown that few recipients opt for an early pay-out of their tax credit because they (mistakenly) fear overpayments (Nichols and Rothstein, 2015^[11]).

For the IMV work incentive, overpayments are impossible since both next year's benefit entitlements and the work incentive are calculated retroactively, using already realised employment decisions. However, if individuals do not expect the benefit, they cannot respond to the incentive it poses, especially if they do not receive the benefit on a regular basis. Thus, informing individuals about the benefit will be essential, but empirical studies show that uncertainty about the individual entitlement to the benefit can still be high even for recipients who are sent information about a benefit (Nichols and Rothstein, 2015^[11]).

Take-up of in-work benefits can also be a concern, particularly when the policy design is complex and opaque. The IMV work-incentive will be automatically paid to eligible IMV recipients, however, limiting non-take-up to those who did not claim the IMV in the first place.

Income support should be as timely and responsive as possible

Low-income households are typically liquidity constrained and may not respond to work incentives if benefit pay-outs are too far in the future, especially if taking up work / increasing working hours is associated with costs (such as transport, suitable clothing or childcare). For instance, in the UK, Universal Credit claims accounts are linked to the employer payroll tax reporting system, such that earned income is automatically transmitted, and payment amounts adjusted, each month – only the self-employed have to actively register their incomes. The fact that the new IMV work incentive is paid retro-actively will make it more difficult for claimants to react to the incentives it poses.

3 The new work incentive compared to similar programmes in other OECD countries

As mentioned in Section 2, most OECD countries operate at least one programme that falls into the category of partial unemployment benefit, into-work benefit, or in-work benefit. However, only a handful of countries operated a benefit that is targeted on social assistance recipients in 2022 (or may be received by very low earners who are not entitled to unemployment benefits, (OECD, 2022^[8])):

- *Canada Workers' Benefit*: a targeted refundable tax credit for low-income workers;
- *Subsistence Benefit (Estonia)*: social assistance recipients retain part of their social assistance payments for up to six months after taking up work;
- *Prime d'Activite (France)*: an in-work benefit for low earners;
- *Solidarity Income (Greece)*: social assistance recipients may retain part of their previous social assistance benefit for up to six months when moving into work;
- *Working Family Payment and Back to Work Family Dividend (Ireland)*: an in-work benefit for low-earning families with children, and a flat-rate subsidy for social assistance recipients moving into work;
- *Into-work Benefit for Recipients of Social Assistance (Italy)*: social assistance recipients continue to receive part of their social assistance benefits when moving into work, and pay lower social security contributions on their earnings for twelve to 24 months;
- *Universal Credit (United Kingdom)*: social assistance benefit that is smoothly phased out for increasing earnings;
- *Earned income tax credit (United States)*: fully refundable tax credit for low earners.

This section benchmarks the new IMV Work Incentive against these international programmes, as well as the IMV without the work incentive (that is, the regime in Spain in 2022). It uses a standard indicator of incentives for taking up work – the Participation Tax Rate (PTR). The PTR measures the fraction of gross earnings that a household loses to higher taxes and/or lower benefits when a household member makes a transition into work. The indicator is calculated as 1 minus the change in the net income relative to the change in gross family employment income, before and after the transition (OECD, 2020^[12]).

A note on the implementation of the IMV work incentive in TAXBEN

For each year, the IMV is calculated based on **the previous year's earnings and assets**. The new work incentive will be calculated using the increase between the previous year's earnings and the earnings before that year. That is, for 2023, the IMV will be calculated using 2022 earnings, and the work incentive will be calculated using the difference between earnings in 2021 and 2022.

From the perspective of a claimant who was out of work in 2021, and has taken up a job in 2022, the timeline therefore looks like this:

- Apply for the IMV in January 2022 → the household is assessed based on 2021 income and assets.
- Because the claimant did not work in 2021, she receives the maximum amount of IMV given her household composition.
- The claimant takes up work in February 2022.
- In 2023, her IMV amount is recalculated using 2022 earnings, and thus decreases by the amount of her net earnings. However, she also receives a lump-sum work incentive, that completely or partially makes up for the decreased IMV amount, depending on her earnings.

In the TaxBEN IMV work-incentive module, this timeline is condensed, and IMV payments, as well as the work-incentive are counted towards 2022 household incomes. The change in earnings is implemented as an into-work benefit, assuming that earnings in 2021 for the principal household member, and the previous IMV amount that determines the work allowance is based on zero earnings for the principal (the spouse may have had earnings). The benefit is implemented as an into-work benefit, and can therefore only be implemented for one household member. Thus, while a spouse can be assumed to have had earnings, it is impossible to model both spouses taking up work simultaneously (OECD, 2020^[5]). In practice, since the work-incentive is based on earnings increases over the previous two years, it is possible to lose entitlement to the IMV, but still receive an employment incentive.

The new work incentive significantly decreases the cost of taking up work

In 2022, before the introduction of the IMV work incentive, the participation tax rate for IMV recipients taking up a job working eight hours at the minimum wage was 100% for all household types – the IMV was fully withdrawn against labour income (Figure 3). For a one earner couple with children, this participation tax rate was still 90% when taking up a full-time job at the minimum wage (Figure 3, Panel C). For adults without children, it was only 50%, because an adult without children would lose entitlement to the IMV already at about 16 hours of work a week (Figure 1).

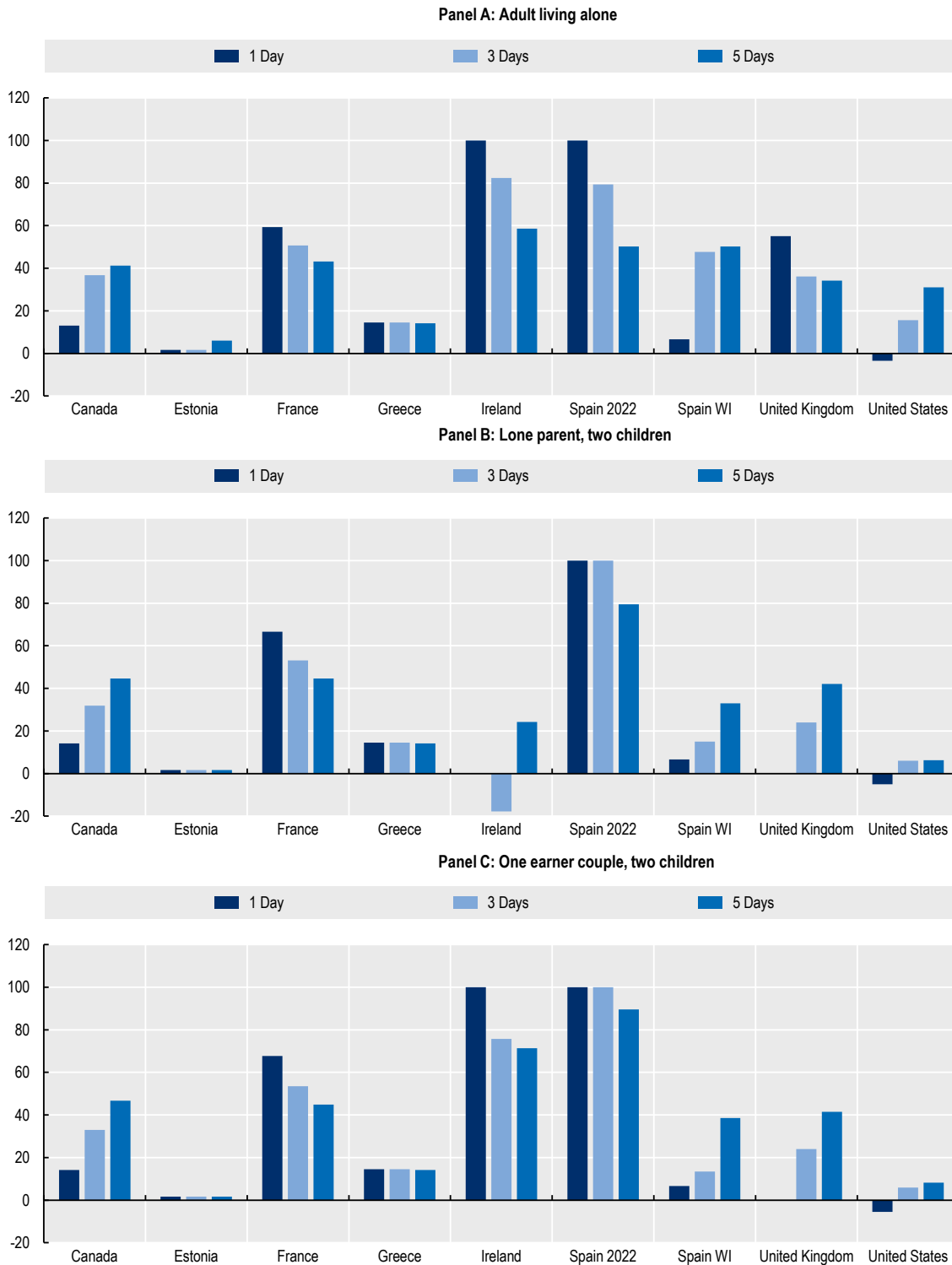
The new work incentive more than halves these participation tax rates for all household types. For an IMV recipient taking up eight hours of work per week at the minimum wage, the participation tax rate is only 7%, because earnings are still below the work allowance. Only households in Estonia and the United States would face even lower participation tax rates. In the United Kingdom, families with children have a work allowance, and the threshold for social security contributions and taxes is higher, leading to a participation tax rate of zero. In the United States, the Earned Income Tax Credit subsidises very low earnings, such that the participation tax rate is negative for very low hours of work. In Ireland, a subsidy for working lone parents leads to a negative participation tax rate for lone parent households (Figure 3, Panel B).

For recipients taking up jobs with longer hours – three and five days respectively – participation tax rates with the new IMV work incentive remain very low in Spain compared to other countries. For adults living alone, PTRs at substantial part-time (three days a week) and full-time work at the minimum wage are comparable to France, but still higher than in all countries except Ireland. For the households with children, however, taking up full-time work at the minimum wage is substantially more attractive under the new IMV work incentive scheme than in France, Canada or the United Kingdom. Families with children benefit from a higher work allowance (as their IMV base amount is higher), and from a lower taper rate than childless adults.

Thus, the new work incentive makes taking up work significantly more attractive, particularly for very low earnings (eight hours of work) as well as for families with children. Childless adults taking up full-time work at the minimum wage do not benefit from the subsidy however.

Figure 3. The new Work Incentive lowers effective tax burdens for low earners

Average participation tax rates for social assistance recipients taking up work at the minimum wage, by working time, 2022



Note: For (previous) social assistance recipients who were not entitled to unemployment benefits and are moving into work. PTR's include all benefits except housing support. The adult is aged 40, any children are aged four and six.
Source: OECD TaxBEN model, IMV work incentive module.

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