Disabled people in a dynamic model of labour supply and labour market transitions

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As part of the background to government policy to increase employment, it is important to understand the factors which govern moves in and out of paid work, and in particular the role of financial incentives in such labour market transitions. This report presents the results of a project aimed at building a model of labour market transitions, which includes disabled people. Including disabled people is important because a large proportion of working age people who are not in work are disabled; and because of the specific policy interest in increasing the employment rate of disabled people.

The model uses data from two key sources. The UK Labour Force Survey, which operates as a rolling panel survey, provides detailed information on labour market transitions. The Family Resources Survey provides detailed information on income in various states.

The model controls for, among other things, childcare expenditure and incomplete take-up of tax credits. It takes great care to model the receipt of Incapacity Benefit, Disability Living Allowance, Disabled Persons' Tax Credit and Income Support Disability Premium as accurately as possible.

Key findings

- Financial incentives to move in and out of work help to explain observed labour market flows over recent years. Many other factors however are also important: for example age, presence of children, previous unemployment.
- Disabled people in couples, conditional on a given level of financial incentives, are more likely to exit and less likely to enter employment. Among single people however the opposite is true: disabled people, conditional again on a given level of financial incentives, are less likely to exit and more likely to enter employment. This most probably reflects the degree of difference in financial incentives between disabled and non-disabled people, yet the result is still surprising and will require further analysis.
- The effects of the financial incentives could be estimated more precisely for single individuals than for couples. This is likely to be due at least in part to the heavier data requirements and smaller sample sizes for the models for couples. It may also be due to a more complex decision making process in couples, leading to difficulties in identifying the effect of financial incentives. Our estimation suggests that decisions of people in couples are correlated in such a way that people tend to choose the same labour market state.
- The main use of estimating such a model is that it can be used to predict the impact of changes to the tax and benefit system. The model suggests for example that a 2p cut in the basic rate of income tax would lead to a long run increase in employment of 15,000. It also predicts that moving from Family Credit to Working Families Tax Credit increased overall employment by around 40,000, broadly in line with other studies, although the model predicts that the proportion of parents in couples who were in work fell, while the proportion of lone parents in work rose.

- Simulating a modest increase in the Disabled Persons' Tax Credit suggests that this would have a small positive effect on the employment of disabled people.

The full report of these research findings is published for the Department for Work and Pensions by Corporate Document Services (ISBN 1 84123 863 5. Research Report 274. July 2005).

It is available from Paul Noakes at the address below.

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