

Benefits Cliffs and Aggregate Fluctuations

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I am grateful to the Georgia Center for Opportunity (GCO) for access to their Benefits Cliffs Workbook and data. The views expressed are those of the presenter and do not necessarily reflect those of the GCO or their donors.

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Estimating how much workers reduce hours to avoid benefits cliffs

Embedding results in a macroeconomic model to estimate business cycle and welfare effects

Future research agenda

Estimating how much
workers reduce hours to
avoid benefits cliffs

Theoretical Background

Given that benefits cliffs incentivize workers to reject pay increases and/or reduce working hours if wages increase to maintain benefits...

Workers *approaching* benefits cliffs may reduce hours

Individuals may “hedge” working hours to avoid losing benefits

Theory also implies that the larger the cliff, the more hedging

How much do working hours appear to be reduced by cliffs?

How much income is apparently forgone?

Are these apparent effects larger for larger cliffs?

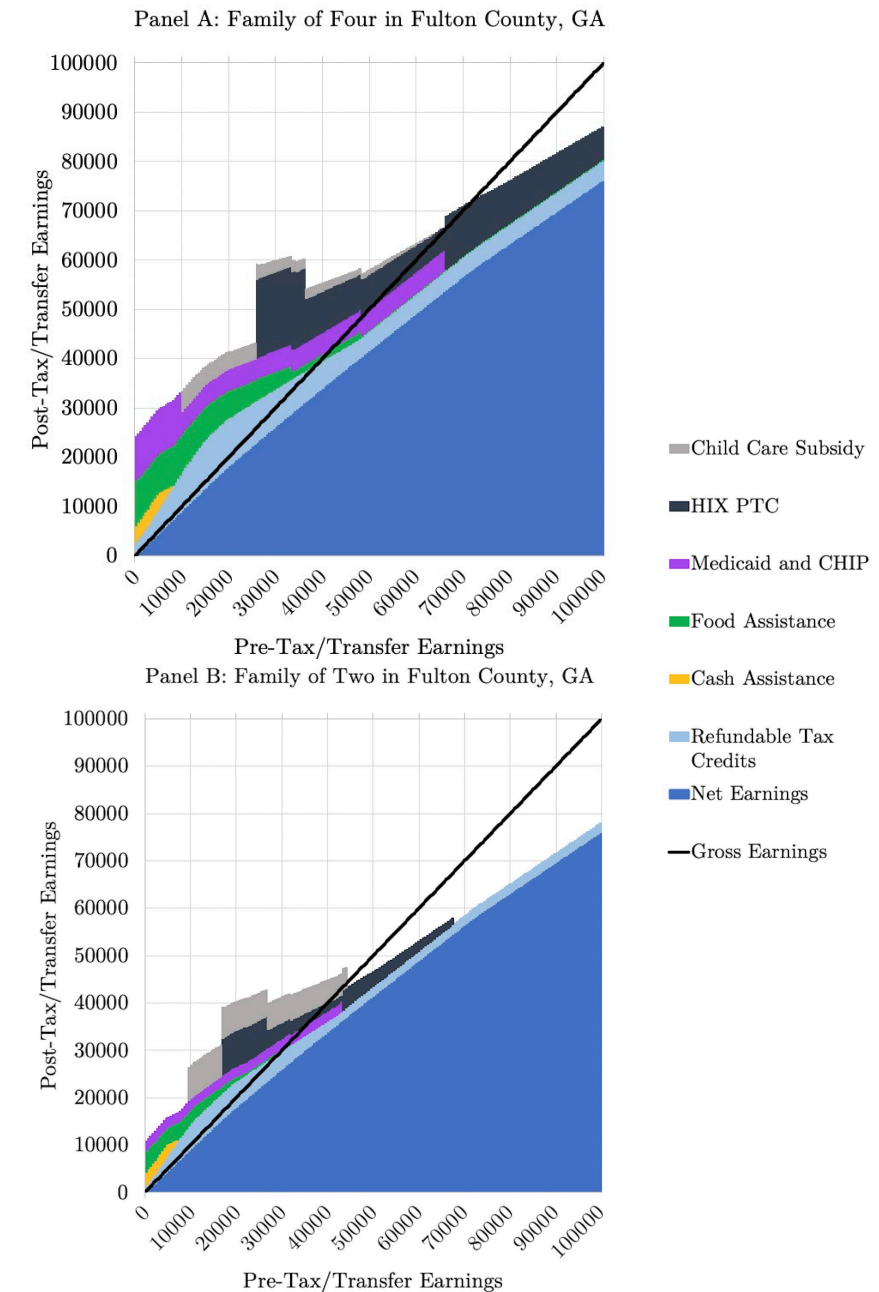
Data

Benefits Cliffs Workbook (BCW) from the Georgia Center for Opportunity (GCO)

- Generates tax-and-transfer schedules over 16 local, state, and federal benefits programs based on household location and demographics

American Community Survey (ACS)

- Public Census Bureau survey sent to 3.5 million households annually, covering household location, demographics, income, and employment information



Map all available demographic and geographic variables for every household in the 2015-2019 ACS to the BCW to locate their nearest statutory cliff

With combined dataset, estimate average number of hours worked and incomes by persons based on household's proximity to nearest benefits cliff

Multiple empirical methods for robustness:

- binning households in \$5,000 increments (shown today)
- a regression discontinuity design (RDD)
- a system of equations

Empirical Results

Baseline: being within \$10,000 behind a benefits cliff is associated with a reduction in about 43-65 working hours annually

- At wages in these bins, implies a \$1,031-\$1,560 loss (3.1-5.4% of household annual income)

Larger cliffs are associated with larger reductions in working hours

- Smallest cliffs (up to 1.75% of income): reductions of about 2-35 working hours
- Largest cliffs (above 15.41% of income): reductions of about 44-82 working hours

Embedding results in a
macroeconomic model to estimate
business cycle and welfare effects

Overview of the Model

Households

- Choose labor supply and consumption to maximize expected lifetime utility (allows estimates of welfare effects)
- Heterogenous (differentiated) in productivities, family composition, ability to save, and benefits cliffs

Supply Side

- Uses labor as a factor of production with uncertain aggregate productivity (allows estimates of output and business cycle effects)

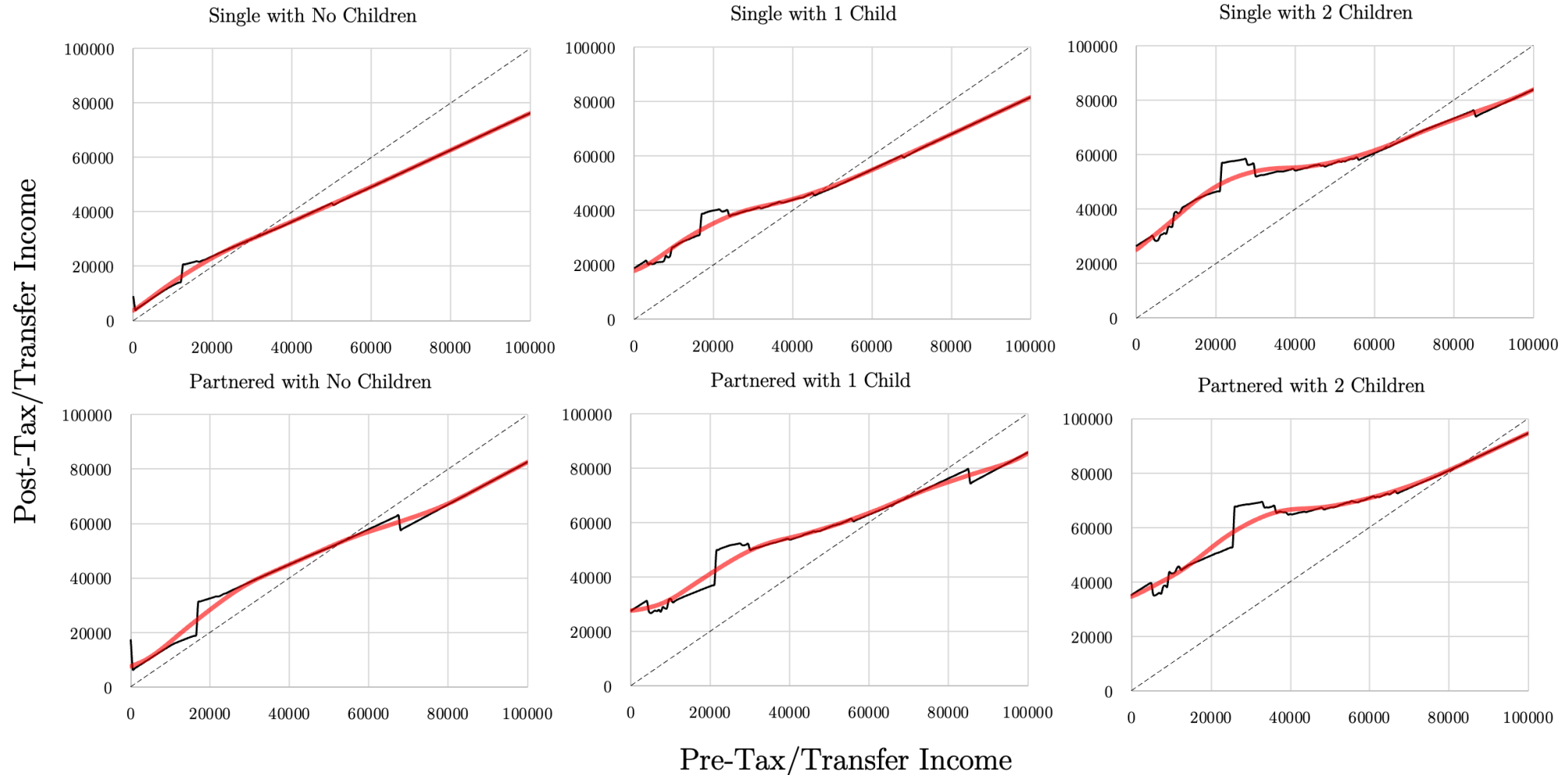
Government

- Collects taxes and distributes transfers
- Taxes and benefits are calibrated to match tax rates and benefits cliffs in the data

Parameters are calibrated and estimated to match empirical results

Experiment with the Model

Grow the economy and wages with a positive productivity shock, compare baseline model with cliffs to a counterfactual model that smooths over cliffs so that no households are constrained



Model Results

Output gains are modest

- Increases 1.6% more on impact (i.e. \$100 gain → \$101.60 gain)

Welfare gains are more substantial

- Overall increases $\approx 9\%$ more on impact (i.e. \$100 gain → \$109 gain)
- For households formerly on cliffs, welfare improves nearly 182% (\$100 gain → \$282 gain)
- Even households never on cliffs benefit: increases $\approx 6\%$ on impact

Paper includes a host of other counterfactuals and sensitivity checks to calibrated and estimated parameters

- Output gains never improve more than 4% compared to baseline
- Welfare gains for those formerly on cliffs always at least doubles

Future research agenda

Policy Implication: Although hours/income reductions primarily affect those near benefits cliffs, **eliminating benefits cliffs would help productivity gains flow through to everyone**, though most substantially for those near/at cliffs

Where I feel more research is needed:

- Non-pecuniary (that is, non-monetary) values of benefits
 - Placing different values on different types of benefits would change the salience (perceived risk) of cliffs, altering both hedging behavior and welfare gains
- Cost/benefit analyses of alternative schemes for eliminating benefits cliffs

“Smoothing out” vs. timed phase-out vs. insurance schemes vs. skill upgrading, etc.

Thank you!

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