Promptly updating cash benefits saves government money and improves consumption smoothing*

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Abstract

Households face significant month-to-month volatility in their earnings, but nearly all means-tested benefits systems operate based on annual earnings data. As a result, benefits are paid even in months where income is relatively high and in some cases are not paid in months where income is relatively low. Beginning in 2016, the United Kingdom initiated a reform wherein means-tested benefits are updated each month based on recipients' most recent earnings data. Using two quasi-experimental research designs and bank account data, we show that high-frequency benefit determination cuts income volatility in half. These designs are underpowered for measuring effects on consumption volatility; but a different research design shows a reduction in consumption volatility. Updating benefits monthly provides recipients with both liquidity and with direct, clear, frequent signals how their earnings affect their benefits. We calculate that recipients would pay about 4 percent of average consumption to achieve the volatility reduction that is caused by the transition from annual to monthly benefits. Finally, by using up-to-date earnings data, the government reduces overpayments, generating savings equal to 4 percent of program expenditure. Because the reform benefited both recipients and taxpayers, it appears to have been Pareto-improving.

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