

# Work Incentives: Perceptions and Realities

CIRANO 2025RP-11 Project Report

**English Summary**

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# Motivation

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Governments implement numerous tax incentives aimed at influencing decisions to participate in the labour market. In addition to the tax schedule, various credits, benefits, and clawed-back support measures can create high marginal effective tax rates (METR) and effective participation tax rates (EPTR), reducing net gains from work. This study primarily aims to evaluate, in Québec, both the evolution of these (dis)incentives from 2017 to 2023 and the understanding that Québec taxpayers have of them. A poorly understood incentive is unlikely to generate a behavioural response.

# Analysis

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Two sources and methods are used for this study. First, an analysis of individual tax data from Statistics Canada's Longitudinal Administrative Databank (LAD) measures the actual evolution of METRs and EPTRs in Québec between 2017 and 2023 according to household characteristics. These measures are calculated using the Disposable Income Simulator (Simulateur de revenu disponible, or SRD), which accounts for the main provincial and federal tax measures in Québec.

Second, an original survey was conducted among 2,510 people aged 18 to 69 in Québec in November 2024. This survey assesses the understanding of basic tax concepts (marginal rate, average rate); knowledge of key tax-based support measures; and the consideration of these elements in decisions related to labour supply.

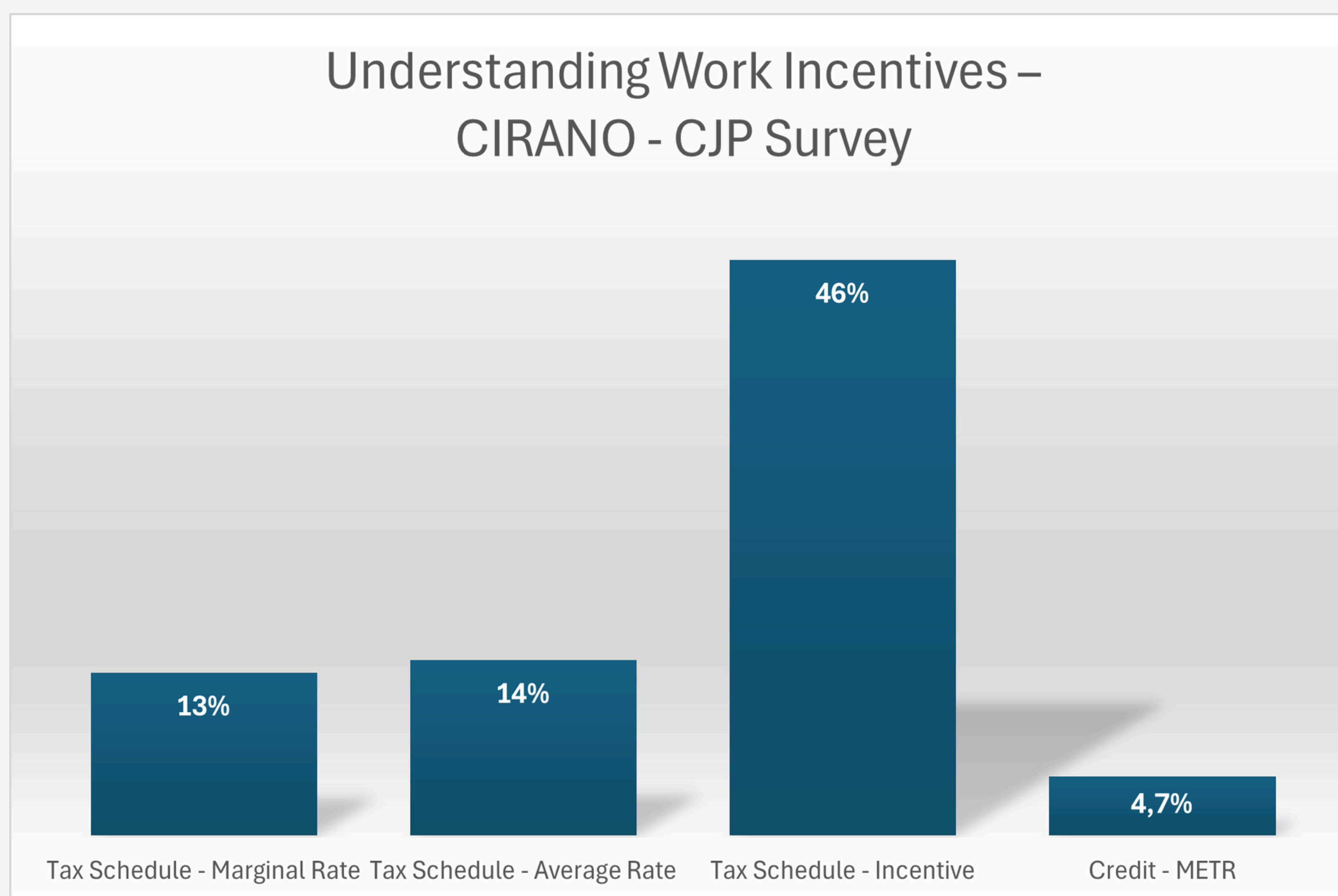
# Results

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- **Observed evolution of disincentives:** Tax disincentives to participation have generally changed little from 2017 to 2023. They have decreased for low incomes but increased for moderate incomes. The average EPTR has slightly declined across the population (-0.7 percentage points), while the average METR has remained stable. However, there is significant heterogeneity depending on household type. For example, two-parent families saw their average METR decrease by 1.6 pp, while childless couples experienced an increase of 2 pp. The stability of averages hides marked changes for certain individuals, mainly due to changes in their income, their family situation, and tax parameters.
- **Tax literacy:** The concepts of tax credit and deduction are poorly understood. On average, respondents get 1.1 correct answers out of 3 questions. The majority does not understand the differences between types of tax measures.
- **Knowledge of measures:** Fewer than 5% of respondents correctly identify the name of at least one tax-based support measure. The most recognized are those associated with childcare expenses, but they remain poorly known even among parents with young children.
- **Consideration in decisions:** Only 28% of respondents say they take tax measures into account in their work-related decisions. This proportion decreases with age, from 35.4% among 18-34 year-olds to 19.5% among 60-69 year-olds. Over 54% do not consider taxation.
- **Tax rates (columns 1 and 2 in figure):** Respondents have a limited understanding of how tax schedules work. About 55% fail both questions assessing their understanding of the marginal rate, and a similar proportion for the average rate. For each concept, only a minority of 13% to 14% answer both questions correctly.

# Results (continued)

- **Work incentives (columns 3 and 4 in figure):** Nearly half (46%) of respondents succeed in both questions measuring their understanding of the effect of marginal rates on the incentive to work more. This suggests a better relative understanding of incentives than of underlying tax mechanisms. Indeed, when it comes to considering the disincentive effect of a tax credit clawback, only 4.7% of respondents manage to correctly solve two scenarios – even though half of the sample found themselves in a second scenario where understanding marginal effective tax rates (METR) *was not necessary*.
- **Sensitivity to financial incentives:** Although most individuals have a labour supply that is not very sensitive ("inelastic"), certain categories of respondents say they are sensitive to a *perceived* change in net financial gain. For example, non-retired non-workers exhibit some sensitivity; for students, sensitivity is greater for part-time work (20 hours/week). Workers are quite unwilling to increase their working hours: survey results suggest that a 10% (net) salary increase would only increase their working time by 1.25%.



Source: Survey conducted in November 2024 among 2,510 people aged 18 to 69 residing in Québec.

# Conclusion

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Results reveal a widespread misunderstanding of the tax system and its impact on work incentives. Although a significant portion of the population shows some sensitivity to financial incentives in their labour supply, the substantial lack of knowledge about tax mechanisms and measures limits their potential effect. The low level of tax literacy, particularly regarding marginal rates and incentive measures, complicates optimal labour supply decision-making.

The effectiveness of tax incentive measures depends not only on their design but also on the public's understanding. Improved simplification and communication strategies could help strengthen their effect. Without this understanding, work incentives included in the tax system are likely to have a much less pronounced effect than desired on behaviour. It is also crucial to accurately target individuals who are genuinely likely to respond to incentive measures in order to avoid very costly measures.