

Replacement Rates and Unemployment

1. Introduction

Return to work patterns are often a function of more than financial rewards and include such considerations as work availability, family commitments, travel to work time and the type of available employment. However, financial incentives are important and these depend on the balance between the individual/family's disposable income when employed and when unemployed.

The replacement rate for given income levels measures the proportion of out-of-work benefits received when unemployed against take home pay if in work. While there is no pre-determined level of replacement rate which would influence every individual's decision to work, clearly the higher the replacement rate, the lower the incentive to work. A replacement rate in excess of 70% is considered to be excessive.

High replacement rates are usually considered to be unsustainable in the absence of relevant and timely labour activation such as appropriate education, training or job placement measures and where sanctions are imposed where such are not availed of.

Replacement rates should however be interpreted with caution as they can vary significantly depending on what is included in in-work and out-of-work income, the family types chosen, level of in-work income, the timing and duration of unemployment etc. In drawing conclusions it is therefore important to be aware of the implications of the assumptions behind the analysis and to look beyond the headline replacement rate figure.

2. Unemployment traps, Replacement Rates and Poverty Traps

Unemployment traps occur when a person's out-of-work family disposable income compares favourably with his/her in-work family disposable income, thereby resulting in disincentives to work.

Replacement Rates measure unemployment traps and are calculated as follows.

$$\text{Replacement Rate} = 100 \times \frac{\text{Out of work family disposable income}}{\text{In work family disposable income}}$$

The higher the replacement rate the greater the disincentive to take up offers of employment.

Poverty Traps occur for those in employment when an increase in an employed person's gross income results in a reduction in net income, thereby resulting in disincentives to work for higher earnings or work for increased hours. This can arise because of a move into a higher tax bracket or because of withdrawal of social benefits as gross income crosses certain thresholds. The analysis of replacement rates at various in-work income levels can highlight poverty trap issues.

3. Methodology for this Analysis

Definition of income

Included in the calculation of in-work income are income from employment, Taxation, PRSI (including Health Levy), Income Levy and Child Benefit. For a couple with children the more beneficial of either FIS or Spouse's Jobseeker's Assistance is included. For a one-parent family One-Parent Family Payment (OFP) and FIS are included if applicable.

Included in the calculation of out-of-work income are the main Social Welfare payments (maximum rate payable of Jobseeker's Assistance (JA), One-Parent Family Payment including personal, adult dependent and child dependent rates as applicable), Fuel Allowance, Smokeless Fuel Allowance and Child Benefit.

Rent Supplement and Local Authority Differential Rent were included for the analysis of specific situations.

Live Register Analysis

Live Register data was analysed to determine the extent to which replacement rates reflected the actual position of those on the Live Register. In particular:

- i. An extract from the Live Register database was taken in September and recipients of Jobseeker Assistance and Jobseeker Benefit (279,058 cases) were examined to determine the extent to which means is assessed against them and the extent to which they receive supplementary payments (rent supplement, mortgage interest supplement or local authority mortgage interest supplement). Recipients of One Parent Family payment (83,226 cases) were similarly examined.
- ii. Prior year earnings data for Jobseeker Assistance and Benefit (JA/JB) claims registered since January 2009 and also for claims registered in 2008 and still on the live register in March 2009 was examined to understand the extent to which the income data used to calculate Replacement Ratios matched real life income data.

4. Summary Analysis of Live Register & Income levels

The Live Register analysis was used to identify the most relevant in-work income levels, family types and supplementary benefits for this analysis.

What in-work income levels are significant?

The Live Register earnings data for claims registered in 2008 and 2009 (to September) provides some information with regard to individual earnings for those becoming unemployed. The data would seem to suggest that most of the unemployed who lost their jobs earned under €30,000. The exact detail of individual salaries is not available as the data does not indicate whether the wages received related to full or part-time employment or the length of time worked in that specific year. Therefore the focus of this analysis is on replacement rates calculated for in-work income levels at national minimum wage (gross €17,542), two thirds average industrial earnings (€22,535) and average industrial earnings (€33,634).

What family types are significant?

Single cases represent 58% of JA/JB cases on the live register (161,773).

Married or co-habiting claimants make up the remaining 42% of JA/JB cases (117,285). 57% of these have no children while 30% have either one or two children. Of all married or co-habiting claimants 42% rely on basic JA/JB payment as their main source of household income while for 58% the claimant is in receipt of JA/JB while his/her spouse has income from employment.

One-Parent Families amount to 83,226 cases of which 66% have one child.

What supplementary payments are significant?

14.5% of all JA/JB recipients are in receipt of a supplementary benefit (mortgage interest relief or rent supplement).

The overall percentage of individuals on rent supplement is 12% (33,273) of total JA/JB numbers in payment in September 09, while the number on Mortgage Interest Supplement was 2.5% (7,006).

5. 2009 Replacement Rates and Live Register Analysis Results

Based on the analysis above the following Replacement Rates are most relevant:

		Replacement Rate In-Work Income Level:		
RR Basis	Family Type	NMW €17,542 Gross	.67 AIE €22,535 Gross	AIE €33,634 Gross
Basic RR	Single Person	66%	55%	41%
	Couple	70%	66%	61%
	Couple 1 child	74%	70%	63%
	Couple 2 children	76%	73%	67%
	One-Parent Family 1 child	45%	49%*	41%
Out of work on CES	One-Parent Family 1 child	88%	95%	79%
Rent Supp Dublin (max rate)	Couple	102%	96%	89%
Differential Rent Dublin	Couple	72%	67%	62%
Two earner couple**	Couple - spouse on JA taking up NMW job	76%	73%	67%

* RRs can normally be expected to decrease as earnings increase. This increase in the RR between NMW and .67 AIE illustrates a poverty trap.

** RRs for couples are for households dependent on social welfare payments vs one spouse taking up employment except for a two earner example. For a two earner couple in-work income is based on one spouse earning at various income levels and the other spouse earning NMW and out-of-work income is based on one spouse earning at various income levels and the other spouse in receipt of means-tested JA.

6. Conclusions and Policy Implications.

In the Economic Survey of Ireland 2009, the OECD notes that “there is a risk that the high rate of unemployment could be sustained due to a combination of weaknesses in activation policies and replacement rates from unemployment benefit for those with below average wages that are likely to become even higher as wages fall.”

It is clear from the analysis that we have conducted that there are significant numbers of people on the Live Register who are in a position where the difference between in-work income and out of work income reduces the incentive to work. The degree of financial disincentive varies very significantly depending on individual circumstances.

Summary

Single people in general face high replacement rates at the national minimum wage, although below 70%. Replacement rates are not an issue for higher earning single people.

Couples with no children where both are not working face high replacement rates at each income level up to AIE, though these are under 70% except at NMW. However, the net benefit from working may be limited taking into account work-related outgoings such as travel costs etc.

Couples with children where both are not working have higher replacement rates again. These are 70% and above for couples with one or two children who would earn at two thirds AIE (c. €22,500) or less.

One-Parent Families have low replacement rates except where out-of-work income is supplemented by CE Scheme earnings. This would illustrate a strong financial incentive to work at basic rate, but a strong disincentive to move from CE Scheme employment. This is because One-Parent Family Payment entitlement ceases altogether when earnings reach €425 per week.

Poverty Traps

Replacement rates illustrate poverty trap issues for one-parent families should they move from earnings at NMW to two thirds AIE.

Related issues exist for couples with and without children. There are significant disincentives to seek better paid employment up to AIE. There are relatively small

increases in net income which are due mainly to loss of Social Welfare benefits as income from work increases.

Spouse's entitlement to JA

There are significant welfare benefits for couples for one working at NMW or two thirds AIE; as the other spouse can claim entitlement to means tested JA.

At NMW this amounts to €173.50 for a couple with no children. In the absence of the JA payment there would be a negative return from work on NMW for a couple, which would mean a replacement rate greater than 100%.

Replacement rates calculated for couples without children where the unemployed spouse (in receipt of means-tested JA) is considering taking up a full-time NMW job shows the unemployed spouse facing replacement rates of 76% and 73% where the working spouse is on NMW and two thirds AIE respectively.

OFP recipients on CE Schemes

One-parent families generally face low replacement rates. However where out-of-work income is supplemented by CE Scheme earnings it results in very high replacement rates (due to the retention of most of the One-Parent Family Payment while on the scheme).

While those on CE Schemes are not a large proportion of OFP recipients, OFP recipients are significant as a proportion of those on CE Schemes (approx. 25%).

Rent Supplement

The overall percentage of individuals on rent supplement is 12% (33,273) of total JA/JB numbers in payment in September 09. For some of these, rent supplement may be a significant impediment to returning to work (or to continuing work).

This is reflected in replacement rates which could be over 100% depending on the individual circumstances. For example, of couple claimants in receipt of rent supplement 43% have no children and they could face replacement rates as high as 102% if the maximum rate of rent supplement (based on Dublin rates for a couple with no children) was paid out-of-work and no rent supplement paid while in-work.

Replacement rates calculated for differential rent show differential rent to have a low impact.

Policy Implications

- Social welfare reductions could help reduce high replacement rates for some categories and improve the benefit for working for other categories.
- Labour activation measures should be more focussed and expanded for all groups so that individuals are retained as near to the workforce as possible.
- The means test for JA where one spouse is working and one person claiming means tested JA should be re-examined.

- Rent supplement has the potential to introduce significant disincentives to work. Ways of moving individuals/families from rent supplement into social housing/RAS more quickly should be examined, with a view to returning rent allowance to being an emergency housing payment.
- The strong incentive for one-parent family payment recipients to favour Community Employment Schemes over other low-paid employment should be examined.