

Unemployment payments and work incentives: An international comparison

A study of 33 OECD countries shows that Australia could substantially lift its unemployment payments without any meaningful disincentives for working.

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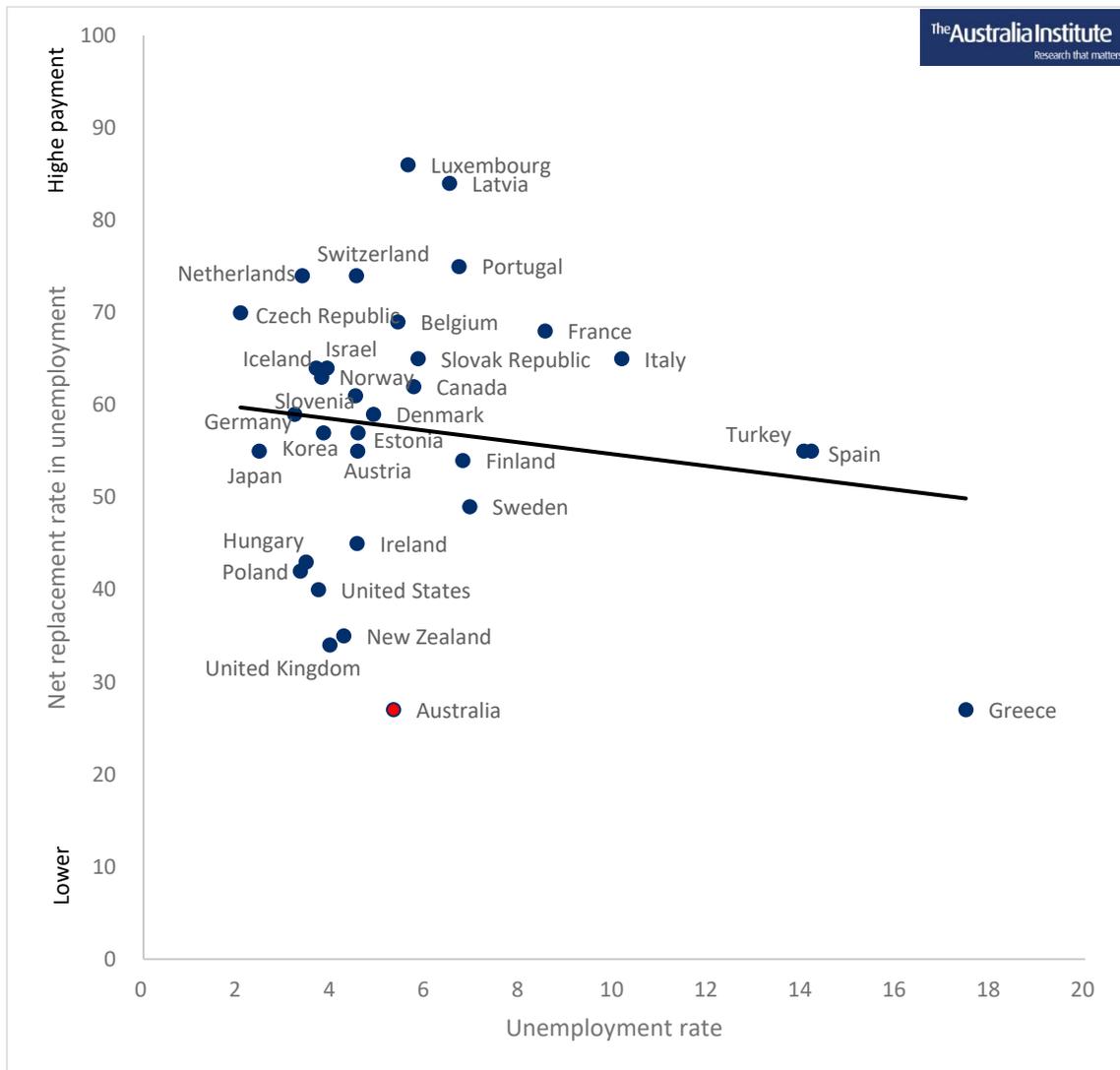
Summary

The Government has argued that Australia's internationally low unemployment payments are needed, in part as an incentive to encourage the unemployed to look for and accept work.

This briefing note tests the Government's theory by comparing Australia's unemployment payments and unemployment rate (pre-COVID) to that of other countries in the Organisation for Economic Co-operation and Development (OECD). Since Australia had the lowest unemployment payments in the OECD, if the Government's theory is correct then Australia should also have one of the lowest unemployment rates.

Instead, Australia's unemployment rate is worse than that of most OECD countries. In fact, as shown in Figure 1, across the OECD *higher* unemployment payments (the "net replacement rate of unemployment") are correlated with *lower* unemployment rates.

Figure 1 - Comparing net replacement rates of unemployment with unemployment rates in 2019 for OECD countries



Source: OECD.Stat (2021) *Net replacement rate in unemployment and Rate of Unemployment as % of Labour Force*, Organisation for Economic Co-operation and Development, available at <https://stats.oecd.org/>

This study suggests that the Government is being unnecessarily cruel to the unemployed and that lower unemployment is possible even with much higher unemployment payments.

Government’s theory

The Government has argued that if Australia increases its unemployment payments, unemployed people will be less motivated to find work – leading to higher unemployment and businesses unable to find workers.

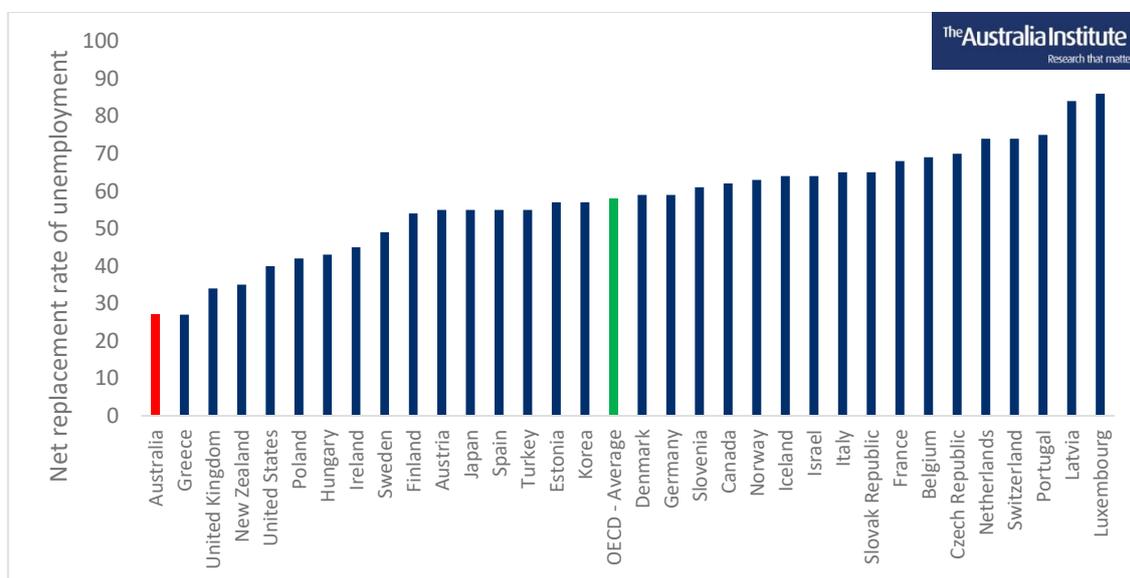
The Minister for Families and Social Services Anne Ruston was asked what factors she considered when deciding to increase unemployment payments. She said:

But we also needed to make sure we had the right incentives in place and didn’t have disincentives for people to actually go out and look for work and to take work.¹

Comparing the level of unemployment payments

The Government has used this theory as part of its justification for keeping unemployment payments, known in Australia as JobSeeker, at very low levels. Australia has the lowest net replacement rate of unemployment of 33 OECD countries. This is shown in Figure 2.

Figure 2 – Level of unemployment payments (net replacement rate of unemployment) in 2019 for 33 OECD countries



Source: OECD.Stat

¹ Ruston (2021) *Afternoon Briefing, ABC24, Interview with Patricia Karvelas*, <<https://iview.abc.net.au/video/NU2122V017S00>>

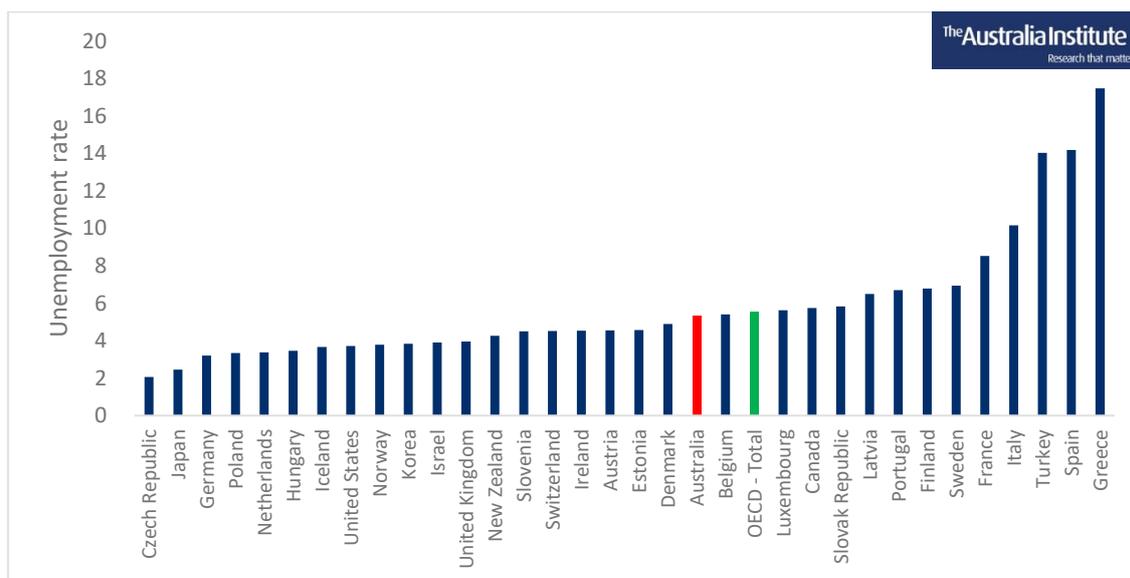
The net replacement rate of unemployment compares a country’s unemployment rate to the average wage in that country. A lower net replacement rate of unemployment means the country’s unemployment payment is relatively low compared to the average wage.²

Australia’s net replacement rate of unemployment is 27 per cent. This is less than half the OECD average (58 per cent).

Unemployment rates

Despite having the lowest unemployment payment, Australia did not have the lowest unemployment rate – or even place in the top half of OECD countries for low unemployment. In 2019 Australia had the 20th lowest unemployment rate of 33 OECD countries. Australia’s unemployment rate of 5.2 per cent was just below the OECD average of 5.6 per cent.

Figure 3 – Unemployment rates in 2019 for 33 OECD countries



Source: OECD.Stat

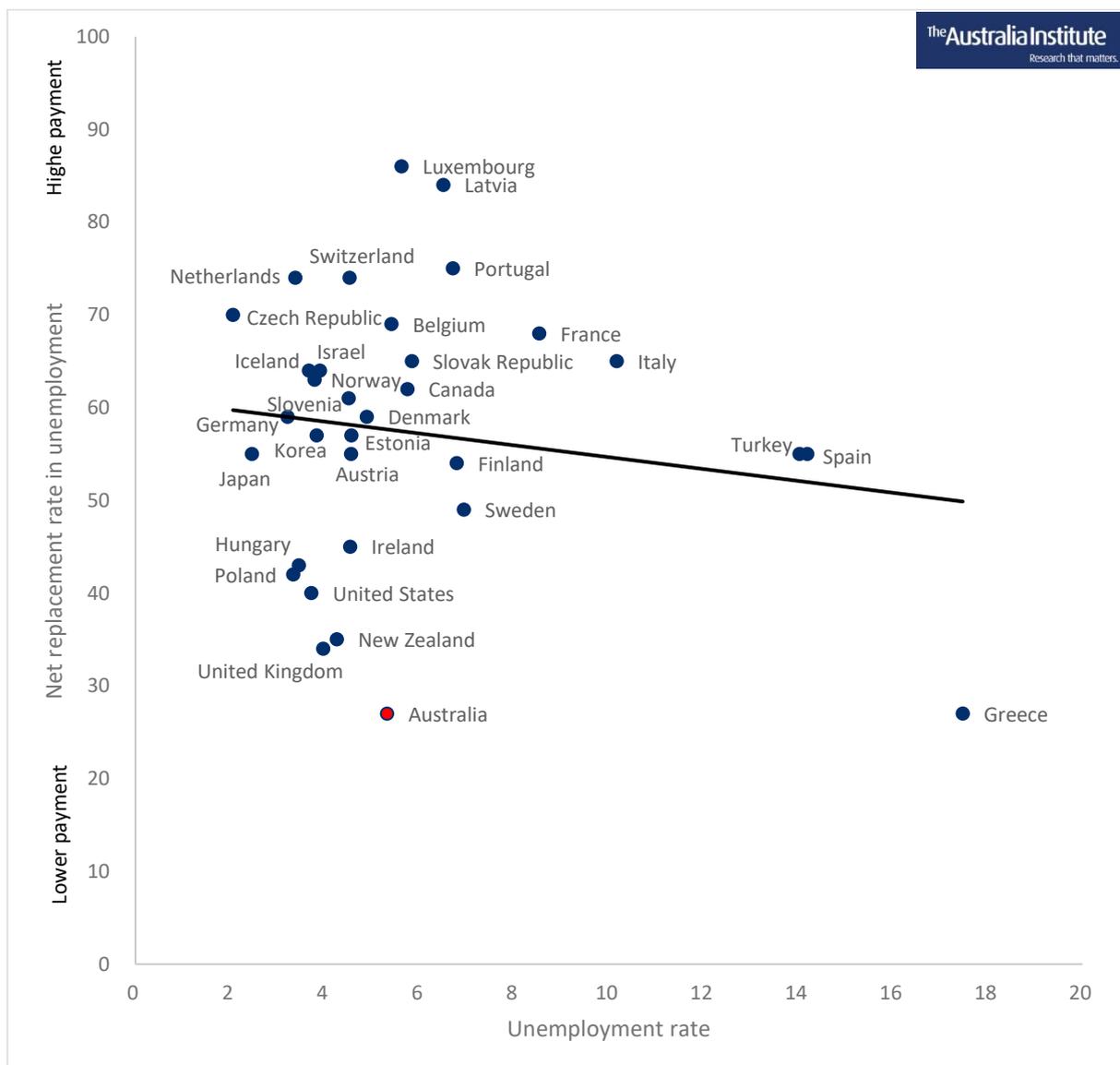
² More information on the assumptions behind the net replacement rate of unemployment can be found in the methodology section at the end of the paper

Correlation between level of unemployment payments and unemployment rate

If the Government’s theory that higher unemployment payments are a disincentive to work is correct, then comparing countries’ level of unemployment payments and their unemployment rate should show that countries with higher unemployment payments also have higher unemployment rates.

A study of 33 OECD countries does not support the Government’s theory. On the contrary, it shows that countries with higher unemployment payments are more likely to have lower unemployment rates.

Figure 4 – Comparing net replacement rates of unemployment with unemployment rates in 2019 for OECD countries



Source: OECD.Stat (2021) *Net replacement rate in unemployment and Rate of Unemployment as % of Labour Force*, Organisation for Economic Co-operation and Development, available at <https://stats.oecd.org/>

There were 19 countries in the study that had higher unemployment payments but lower unemployment rates than Australia. The line of best fit shows a negative correlation between unemployment payments and the unemployment rate.

For example, Germany has unemployment payments twice as high as Australia's. The net replacement rate of unemployment in Germany is 59 per cent, compared to Australia's at 27 per cent. Germany's unemployment rate is lower than Australia's at 3.2 per cent compared to 5.2 per cent for Australia.

Another example is the Netherlands, which has an unemployment payment that is about three times higher than Australia's. Its net replacement rate of unemployment is 74 per cent, compared with Australia's at just 27 per cent. The Netherlands has an unemployment rate that is lower than Australia's. The Netherlands unemployment rate is 3.4 per cent while Australia's is 5.2 per cent.

OECD countries with higher unemployment payments but lower unemployment rates are included in Table 1.

Table 1 – Countries with higher net replacement rates of unemployment and lower unemployment rates

Country	Unemployment rate – difference to Australia	Net replacement rate – difference to Australia
Czech Republic	-3.3%	43%
Japan	-2.9%	28%
Germany	-2.1%	32%
Poland	-2.0%	15%
Netherlands	-1.9%	47%
Hungary	-1.9%	16%
Iceland	-1.6%	37%
United States	-1.6%	13%
Norway	-1.5%	36%
Korea	-1.5%	30%
Israel	-1.4%	37%
United Kingdom	-1.4%	7%
New Zealand	-1.1%	8%
Slovenia	-0.8%	34%
Switzerland	-0.8%	47%
Ireland	-0.8%	18%
Austria	-0.8%	28%
Estonia	-0.8%	30%
Denmark	-0.4%	32%

Source: OECD.Stat (2021) *Net replacement rate in unemployment and Rate of Unemployment as % of Labour Force*, Organisation for Economic Co-operation and Development, available at <<https://stats.oecd.org/>>

It is important to note that the correlation between the net replacement rate of unemployment and unemployment rates is quite small. This means that the size of unemployment payments and the level of unemployment do not strongly influence each other. This further weakens the Government’s claims that unemployment payments need to be kept low to encourage people to take on work.

At the beginning of the pandemic, in March 2020, the Government announced that it was doubling the base rate of unemployment payments, with the introduction of the coronavirus supplement. The figures discussed in this paper are from 2019, and so do not include any country’s response to the pandemic. Even doubling Australia’s net replacement rate of unemployment would still put it below the average for the OECD, of 58 per cent.

Correlation not causation

This study only shows correlation and does not establish a causal link between higher unemployment payments and lower unemployment. It shows that a country with a higher rate of payments to the unemployed is more likely to have a lower unemployment rate. But this is not evidence that higher unemployment payments cause lower unemployment.

It is possible that one might influence the other. It is also possible that some other factor is influencing both. Or it is possible that there is no causal link between the two, and it is mere coincidence that the two are correlated.

While the correlation between the two is not evidence of causation, it is evidence that the Government is wrong to assume that higher unemployment payments cause higher unemployment. If this was the case then, at a minimum, the correlation would go in the opposite direction.

Conclusion

International comparisons provide no evidence that Australia needs to be cruel to unemployed people to motivate them to search for work. There are many comparable countries to Australia that have far higher rates of unemployment payments but also have lower unemployment rates.

The Government has a real opportunity to reduce the rates of poverty in Australia. It has done so before at the beginning of the pandemic when it doubled the base rate of unemployment payments. Even if the Government were to double the base rate of unemployment payments, Australia's payments would still be below the OECD average.

Most OECD countries maintain higher unemployment payments than Australia, without experiencing unemployment rates as high as Australia's.

Methodology

The data used in this analysis comes from the OECD. The unemployment rate is the annual rate for 2019. This was the most recent data at the time this paper was published.

The net replacement rate in unemployment is for a single person without children who has been unemployed for two months and includes social assistance benefits and housing benefits. It represents the unemployment payments as a proportion of the

average wage in that country. The data comes from 2019, the most recent data at the time of publishing.

The 33 countries are all OECD countries that published OECD data for net replacement rates for unemployment and unemployment rates for 2019.