

Replacement Rates 2011

Introduction

1. This paper updates TSG paper 10/04. Findings from an analysis of current hypothetical replacement rates (for a number of household types at a variety of income levels) are presented and related issues discussed.
2. Replacement rates, or replacement ratios, are typically used to measure unemployment traps. Such traps occur when a person's income when unemployed compares favourably with his/her net income when employed thereby resulting in a disincentive to work. The higher the ratio, the greater the disincentive to work.

$$\text{Replacement Rate:} \quad \frac{\text{Income when unemployed}}{\text{Net Income when employed}}$$

3. For this paper, hypothetical cases are used and a number of replacement rates produced for various household types and at a range of in-work income levels.

Replacement rates matter

4. General labour market economic theories support the view that replacement rates act as disincentives to work while evidence from empirical studies is mixed but on balance shows a link between replacement rates and duration of unemployment.

Replacement rates should be interpreted with caution.

5. Financial incentive effects vary with individual circumstances and characteristics e.g. sex, age, presence of dependents, household makeup and location. Replacement rates depend entirely on what is included in their calculation e.g. the particular social welfare payments, the timing of the claim or in-work income comparators. Non-quantitative factors such as a person's location and the existence of individual job opportunities are also important. Some caution is required therefore in interpreting replacement rate results and their use in changing policy proposals.

What is a high replacement rate?

6. Given the individual nature of the decision to work there is no specific cut-off level of replacement rate that constitutes a disincentive. It is generally prudent to pay particular attention to replacement rates of 70% or more given the basis of the calculations in this analysis. Changing trends in replacement rates should also be monitored.

Current Context

7. Since 2008 we have experienced a sudden acceleration in unemployment with levels now at 14.5%¹. The experience of previous high unemployment rates raises

¹ Seasonally adjusted Standardised Unemployment Rate (SUR) August 2011.

concerns particularly in terms of the lagged rates of recovery in employment relative to economic recovery. High unemployment rates of between 13% and 17% were seen in Ireland from the early 1980s right through to the mid-1990s. Even with GNP growing annually by generally more than 5% between 1987 and 1992 a sustained fall in unemployment was not seen to begin until 1994. One of the factors which contributed to this was weak employment incentives due to the tax/benefits system.

8. Jobseeker rates of Social Welfare payments almost doubled in the last ten years over the period 2001 to 2009 from €106.66 to €204.30. The rates are now €188 weekly. The level of Social Welfare payments to those of working age still needs to be monitored particularly in the medium term given the disincentive effects associated with high replacement rates. This is particularly relevant in the context of high unemployment and particularly rising long-term unemployment in terms of striving to avoid a repeat of the lagged response seen in the 1980s.

9. High replacement rates are often cited as contributing to the persistence of unemployment. Current unemployment policy needs to keep people close to the labour market so that when employment opportunities arise they are in a position to take them up. It needs to pay particular attention to the risks of long-term unemployment. Replacement rates represent just one strand in labour market activation policy. Measures such as increased interventions in a period of unemployment, training and education, targeting of those at risk of long-term unemployment, improved anti-fraud initiatives and stronger enforcement of conditions attached to entitlements all contribute to labour market activation.

Approach to compilation of 2011 replacement rates²

10. In-work income levels used are National Minimum Wage (NMW), 67% of Average Industrial Earnings (AIE), Average Industrial Earnings, 150% Average Industrial Earnings, and 200% Average Industrial Earnings.

11. The family structures³ used relate to Jobseekers (one-earners in the case of couples) and One Parent Families. For Jobseeker households replacement rates are produced for a single person, a couple with no children and couples with one, two, three and four children while for One Parent Family households replacement rates are produced for those with one, two and three children.

12. Included in the calculation of in-work income are income from employment, taxation (couples treated as married), Pay Related Social Insurance (PRSI), Universal Social Charge (USC), Spouse's entitlement to Jobseekers Allowance (Spousal JA) for a couple with no children, Family Income Supplement (FIS) or Spousal JA for a couple with children, depending on which payment is more beneficial, One-Parent Family Payment and FIS (for a one-parent family) if applicable and Child Benefit.

² Full details of the calculations are available separately.

³ Relevance of family size: Child Benefit data for 2010 shows that 42% of families had one eligible child, 35% had two, 16% had three and 5% had four eligible children. Jobseeker data relating to 2010 increases for qualified children (IQCs) shows that Jobseekers with between 1 and 4 children account for almost 98% of cases while 95% of OFP recipients have 3 or fewer children.

13. Out-of-work income includes the main Social Welfare payment (maximum rate payable of Jobseeker's Allowance or One-Parent Family Payment), Fuel Allowance, Child Benefit.

14. A variety of replacement rates were produced in addition to the standard replacement rates, to consider (i) maximum disincentive effects relating to rent supplement (ii) CE Scheme income for One Parent Family Payment recipients, and (iii) two-earner household disincentives.

Main Findings

(a) Impact of Budget 2011 Changes

Main Budget 2011 changes

15. Reductions of 4.1% were applied to payments to those of working age, for example the maximum rate of Jobseeker's Allowance was reduced from €196 to €188 per week. Child Benefit was reduced by €10 per month per child with an additional €10 reduction for the third child resulting in rates of €140 per month for the first and second child, €167 for the third child and €177 for fourth and subsequent children (cuts of between 6.5% and 8% depending on the family size).

16. Tax bands and credits were reduced by around 10%, the health levy and income levy were abolished and the USC was introduced.

17. The smokeless fuel allowance of €3.90 per week (paid for the 32 week fuel allowance season) was abolished in July 2011⁴.

Impact of changes on Replacement Rates

18. For jobseekers the effect of Budget 2011 measures has been to reduce basic replacement rates in most cases by between 0.1 and 2 percentage points. The replacement rate reductions were greatest for single persons at NMW and AIE, for couples at AIE and for couples with 4 children at earnings between NMW and 150% AIE.

19. For one-parent family payment (OFP) recipients, the basic replacement rates were reduced by around 1.7 percentage points for in-work income levels up to AIE while smaller reductions applied above these earnings levels.

Budget 2011 measures have generally resulted in reduced replacement rates.

⁴ The smokeless fuel allowance, although payable from January to May 2011, is not included in the calculation of replacement rates for 2011.

Other Budget 2011 Measures

20. New Jobseeker Allowance claimants under age 25 and without child dependents are, since Budget 2010, only entitled to reduced maximum personal rates of payment. In Budget 2011 the maximum rate for those aged 22 to 24 was reduced from €150 to €144 per week while the maximum rate of €100 per week for those aged 18 to 21 was not changed. These reduced rates of payment would clearly have a significant downward impact on replacement rates for such claimants.

21. Penalty rates introduced in the Social Welfare Act 2010 mean that the maximum personal rate of Jobseeker's Allowance and basic Supplementary Welfare Allowance is reduced to €144 per week where job offers or activation measures have been refused. This translates into lower replacement rates for such individuals and so a stronger financial incentive to work.

Falling Nominal Wages – potential upward impact on replacement rates

22. The AIE figures⁵ used for this analysis show very small reductions in wages compared with what average weekly earnings data shows. The CSO Earnings and Labour Costs data for quarter 1 of 2011 shows average weekly earnings across all sectors fell by 1.3% against the previous year while in 2010 average weekly earnings declined by 2.2%. It is possible therefore that replacement rates are slightly understated. To illustrate, a 2% fall in AIE would, all other things held constant, translate into an increase in basic replacement rates of on average 0.5% for the various Jobseekers households (excluding those at NMW).

(b) Jobseekers

Jobseeker One-earner families (One earning compared with no-one earning)

23. Prior year earnings data relating to Jobseeker Assistance and Jobseeker Benefit claimants previously pointed to the significance of the three lower in-work income levels i.e. AIE and below. Of the six Jobseeker one-earner households examined at these income levels, eight of the eighteen basic replacement rates calculated are over 70% as illustrated in the table below⁶.

Jobseeker One-Earner Basic Replacement Rate 2011					
	NMW	67% AIE	AIE	150% AIE	200% AIE
Gross:	€17,542	€22,308	€33,296	€49,944	€66,592
Single	62%	53%	38%	30%	24%
Couple	69%	65%	59%	44%	36%

⁵ The figures used in determining replacement rates are based on the latest available CSO AIE data at the time the replacement rates were compiled. For 2009, the four quarters to quarter 1 2009 were used (average €646.80 weekly) and for 2010 calculations the four quarters to quarter 2 2009 (€643.37 weekly). For 2011 €640.31 weekly is used – this figure is based on the four quarters to quarter 1 2010 (more recent data is not available from the CSO). Given that the CSO is moving away from AIE it may be appropriate to use a different earnings figure in future analysis.

⁶ Spousal JA is the spouse/partner's residual entitlement to Jobseekers Allowance. For families with children the more beneficial of either FIS or Spousal JA is included in the replacement rate calculation.

Couple + 1Child	72%	69%	63%	49%	41%
Couple + 2 Children	75%	72%	67%	55%	46%
Couple + 3 Children	78%	75%	69%	60%	51%
Couple + 4 Children	76%	74%	68%	62%	56%

24. The table also illustrates that replacement rates can be expected to fall as in-work income levels rise and that they typically rise as household size increases (due mainly to the fact that social welfare payments take dependents into account while direct income from employment does not). This trend does not hold for couples with 4 children in 2011 even though it was true in 2010. This appears to be because 4 child families potential in-work income includes FIS entitlement as it would be worth more than Spousal JA. FIS entitlements would have increased in 2011 giving a net weekly loss on in-work income of €13 to €15 in 2011 compared with a €27 loss on out-of-work income for such cases

2011 RR figures show disincentives to take up employment at low income levels even where in-work income at these levels may be supplemented by social welfare payments in the form of FIS or Spousal JA.

Impact of Inclusion of Rent Supplement

25. When rent supplement⁷ was included in out-of-work income figures, replacement rates were shown to rise significantly across all categories of Jobseeker (by approx. 30 percentage points in many cases using Dublin rent levels and 20 percentage points using rural rent levels). The impact on replacement rates for one parent families was similar.

26. Data from the Department of Social Protection indicates that the proportion of Jobseekers on the live register and in receipt of rent supplement is approx 12%.

27. The inclusion of differential rent has been shown to have a far less distortionary effect on replacement rates Differential rent is calculated based on the level of household income be it income from Social Welfare or employment. Recently there has been a shift towards local authority rental accommodation schemes where, like for differential rent, accommodation is long-term and when a person gets work they remain in the scheme but pay more.

The rules underpinning differential rent schemes are preferable to rent supplement from a work incentive perspective.

Two-Earner Replacement Rates

28. Replacement rates for two-earner households in these examples are shown in the table below to be notably high across all categories in terms of the disincentives for

⁷ Rent supplement is included to show the maximum disincentive effect using maximum rent levels in place from June 2010. Unless unemployed for more than a year and subject to a means test, many unemployed would completely lose their entitlement to rent supplement if they took up work at greater than 30 hours per week. This has implications in terms of discouraging a return to full-time work. Maximum disincentive effects however will not apply to a significant number of recipients.

the second spouse to take up employment at NMW. It should be noted that for almost all households where Spouse 1 is earning 150% AIE (c. €50,000) or above there is no entitlement to FIS or to Spousal JA. For most couple categories shown below spousal JA is payable at reducing rates up to where Spouse 1 is earning at AIE (€33,455). FIS is more beneficial than Spousal JA for couples with 3 children where the spouse is working at AIE and for couples with 4 children.

29. The impact of Budget 2011 measures on two-earner replacement rates has been reductions of between 0.1 and 2.8% with small increases for couples with four children between NMW and 150% AIE.

Two-Earner Basic Replacement Rate 2011					
(Based on Spouse 1 earning at various levels and Spouse 2 potentially taking up NMW job).					
	NMW	67% AIE	AIE	150% AIE	200% AIE
Couple	73%	71%	66%	72%	75%
Couple + 1Child	79%	77%	69%	74%	77%
Couple + 2 Children	84%	81%	74%	75%	78%
Couple + 3 Children	85%	84%	79%	76%	79%
Couple + 4 Children	86%	87%	88%	80%	79%

The figures indicate potentially quite strong disincentives for the Spousal JA claimant to take up work at NMW (even without considering additional in-work costs such as childcare).

30. For example a couple with 2 children where one spouse works at 67% AIE and the other spouse claims Spousal JA has a net weekly income of €622.86 compared with €765.10 were the second spouse working at NMW (RR of 81%). The Spousal JA payment of €158.24 is no longer payable and additional tax/PRSI/USC of approx. €36.86 become payable on taking up employment. Conditionality attached to Spousal JA is also an issue that needs to be considered (see more under (c) below).

31. Department of Social Protection claims data from February 2011 suggested that a significant number of Jobseeker couple claimants (up to 79,285 or 58%) had one person in receipt of a JA/JB payment, while the other had income from employment⁸. This points to the relevance of examining replacement rates for two-earner households and also the relevance of issues relating to Spousal Jobseeker entitlements. The data also points to the heterogeneity of cases and so highlights that it is very difficult to generalise for many cases. Nonetheless the replacement rates calculated are useful indicators of potential disincentives.

(c) Spousal JA and FIS

32. For Jobseeker families with children the more beneficial of FIS or Spousal JA is included in the calculation. A claim for the more beneficial payment is typically what would result where a spouse in receipt of JA and claiming an increase for an adult dependent and child dependent(s) takes up employment. FIS and Spousal JA are

⁸ The rules which apply where a spouse is working are different on Jobseeker Allowance (JA) and Jobseeker Benefit (JB). The replacement rate calculations in this document are based on JA.

therefore serving a similar purpose by contributing to low income households with children even though these payments are devised for very different purposes.

33. For larger families FIS is more beneficial while Spousal JA is generally more beneficial for families with up to three children. The calculations point to inequities between alternative benefits which are in effect achieving the same purpose but at different costs. The Spousal JA means test was reviewed approx three years ago in order to encourage activation of the second spouse. However given the inequities between FIS and Spousal JA it may now result in Social Welfare payments which are too high.

The Spousal JA means test should be re-examined, possibly with a view to aligning the payment level more closely with FIS. Reductions to Spousal JA payments will however have the effect of increasing replacement rates and this should be considered in any review. Enforcement of conditionality relating to Spousal JA should be strengthened as this may result in establishing more appropriate entitlements for households as well as possible Exchequer savings.

(d) One Parent Families

34. For one-parent families the basic replacement rates are low. The highest replacement rates for one-parent families occur at 67% AIE where replacement rates are 53%, 55% and 57% respectively for a one, two and three child family. The fact that the highest replacement rates occur at the second income level is evidence of a poverty trap which is discussed in the next section. Similar to Jobseekers, when maximum rates of rent supplement are included in the calculations, replacement rates are seen to rise significantly. Data from the Department of Social Protection indicates that the proportion of one-parent families on the live register who are in receipt of rent supplement is approx 20%.

35. While one-parent families in general face low replacement rates, those participating in CE scheme employment face particularly high replacement rates even compared with earnings at AIE level (where, for example, the replacement rate is 83% for a one parent family with two children). While this category of one-parent family is significant in terms of their replacement rates, at approximately 5,000 they are not a huge proportion of One-Parent Family Payment (OFP) recipients. They do however make up approximately a quarter of all CE scheme participants.

One-parent families on CE schemes therefore face a particularly strong incentive to favour CE scheme employment over other forms of employment and this should be examined with a view to encouraging OFP recipients into more general forms of employment (i.e. those not subsidised by the State).

(e) Poverty Traps and High Marginal Effective Tax Rates

36. The detailed replacement rate calculations illustrate that poverty traps⁹ exist for one parent families between earnings at NMW and 67% AIE. For example, a one-

⁹ A Poverty Trap occurs when an increase in gross income, which may be due to working increased hours or for increased wages, results in a decrease in net income.

child one-parent family working at NMW (€17,542) would have a net weekly income of €517.76 while their net weekly income would fall to €495.91 if working at 67% AIE (€22,308). This is due mainly to the loss of OFP payable.

37. Related issues in the form of high Marginal Effective Tax Rates¹⁰ (METRs) exist for one parent families and couples with and without children at the three lower income levels. For example, the difference between net in-work income at 67% AIE (gross c. €22,308) and at AIE (gross c. €33,296) is significantly less than the difference in gross pay. For a couple with one earner and no children, net weekly in-work income is €499 on 67% AIE and €555 on AIE, a difference of just €56 per week or €2,912 per annum net versus €11,000 gross increase in income. In 2010 examples the difference in net income between the two income levels was smaller (an equivalent couple's net income in 2010 was €521 weekly on 67% AIE (gross c. €22,400) and €565 on AIE (gross c. €33,500) a difference of €44 weekly or €2,282 per annum). The reason for the improved METR is mainly because the couple at 67% AIE has seen a bigger increase in tax/PRSI/USC (compared with tax/PRSI/Income levy) and a bigger reduction in their Spousal JA payment than the couple at AIE.

38. Couples with children see similar effects with c. €50 difference in weekly income where there are one or two children or c. €2,600 p.a. For a couple with 4 children the effect is a difference of c. €68 weekly or c. €3,550 p.a. yet this still illustrates a disincentive to earn more income, representing just 32% of the extra €11,000 in gross earnings. To put it another way the household is losing 68% of the additional gross earnings due to tax/benefit interactions.

39. In the case of one parent families, 2011 data suggests that those on low-incomes (earning less than €425 per week) were a significant proportion of OFP recipients (35%). Even though they do not appear to face high replacement rates (due to OFP retention when working, their particular tax status and possible entitlement to FIS) they face significant financial disincentives in terms of increasing their earnings from employment at certain levels.

The tax/welfare factors which contribute to poverty trap/high METR issues for one parent families and couples at income levels at or below AIE need to be reviewed. The high taper rate of 60% associated with FIS would be a factor in this.

Replacement rate interactions with the National Minimum Wage, Taxation and Activation Measures

National Minimum Wage (NMW)

40. The NMW has remained at the same level since July 2007. Replacement rates at NMW level were shown in the analysis to be high for most categories of jobseeker (70% or more for couples with children, almost 70% for couples without children and 62% for single persons). However it is important to note that almost all categories of

¹⁰ Marginal Effective Tax Rates (METRs) or Effective Marginal Tax Rates measure the proportion of additional earned income which is lost by way of the combined effect of increased taxes and other charges and decreased benefits

Jobseeker or OFP recipient who face replacement rates at NMW have seen reductions in those replacement rates due to Budget 2011 changes.

41. Persons on reduced rates of Jobseeker payments will face lower replacement rates at NMW than those shown in this analysis.

Taxation

42. Replacement rates also have implications for tax policy. To put it simply, increases in income tax (whether achieved by reducing tax credits or standard tax bands or by increasing tax rates) will cause replacement rates to rise. Any policy changes toward further broadening of the tax base using tax on incomes need to be cognisant of this.

43. It is important to note that at low income levels there are low levels of tax payable e.g. at NMW no PRSI is payable, tax of €4 weekly applies to single persons only and the USC payable is €10.51 for all example cases. At AIE (€640.31 gross weekly) total tax, PRSI and USC varies from €118.85 for a single person to €69.54 for a family with children. Many jobseeker households at the lower income levels are shown to face high replacement rates despite low levels of tax paid.

Achieving the right balance between the level of the NMW, labour legislation, social welfare rates, taxation and levels of activation is crucial to avoiding work disincentives.

Activation

44. As regards when income support can act as a disincentive to work there are two key aspects - the level of payments and the conditionality attached. Replacement rates relate to the former, though they are not entirely confined to it. Activation relates to the latter - Activation policies attempt to address the passivity associated with social welfare transfers by encouraging people into employment, training and education. They can take the form of job search assistance, personal development or skills training, formal educational qualifications, work schemes etc. Generally the higher the level of conditionality of payment imposed, the stronger the activation policy.

High replacement rates and low unemployment can coexist if activation is strong

45. It is generally accepted that where countries have high replacement rates and low levels of unemployment they have introduced and implemented strong activation measures. Such systems however, bring with them costs in terms of higher unemployment payments and higher activation costs. In the Irish system there are high replacement rates for some but not all cohorts of the unemployed, but the activation process for the unemployed is not coherent or consistent.

46. As regards the impact of high replacement rates on the labour market Grubb (2007) has pointed out that there can be benefits to high replacement rates. These arise in the form of an improved earnings distribution (in terms of the low-paid) as

well as, when combined with strong activation measures, increased productivity and increased labour force participation. However such systems required effective activation policy and implementation.

Co-ordinated approach to Labour Market Policy

47. The Programme for Government identified a range of measures to support employment and to assist unemployed people. The *Jobs Initiative* provided for a range of additional labour market supports for unemployed people. Furthermore, a fundamental restructuring of the institutional framework for labour market activation is being put in place through the establishment of the National Employment and Entitlements Service (NEES) and the new further education and training authority (SOLAS). Deeper and more regular engagement with unemployed people through these new structures will bring our labour market activation strategy into line with best international practice and fully address criticisms of our previous passive strategies by organisations such as the OECD (2009) and the ESRI and NESC (2011).

48. The Department of Social Protection are committed to having in place by end-2012 a case management labour market engagement process deployed nationwide so that systematic interventions are made with people on the Live Register which is informed by a profiling system developed in conjunction with the ESRI.

49. In terms of looking to the longer term, there is much consensus that improved activation is a key element in a strong labour market policy. Ultimately strong activation strategies help to establish if people are involuntarily unemployed.

It is essential that job opportunities, as the economy recovers, are taken up by those on the live register. To achieve this it is essential that we have a strong activation framework in place, and that the balance between unemployed income supports and in-work income does not discourage people from taking up jobs. The measures put in place in previous Budgets and the Jobs Initiative in restructuring income supports for young people, increasing opportunities for education and training, and clarifying the conditionality for income supports for the unemployed should be built upon in this context.

How does Ireland compare with other countries?

Long term unemployed face high replacement rates

50. The OECD has been critical of Ireland in terms of having weak activation measures and has referred to Ireland having relatively high replacement rates which encourage high benefit dependency ratios.

51. The latest published OECD figures relate to 2009 and show net replacement rates at two stages of unemployment (initial phase and long-term), for three different earnings levels – 67%, 100% and 150% Average Worker earnings, with two children and without children for three family types – a single person, one-earner married couple (i.e. dependant spouse) and a two-earner married couple (spouse in work). This results in 36 net replacement rates for each country.

52. The 2009 figures show 36 replacement rates for each of 32 OECD countries. It is difficult to draw comparative conclusions without determining the specifics of each calculation and in particular country-specific factors. However, looking at how Ireland compares with average figures the following is striking: Net Replacement Rates in the initial phase of unemployment show that for Ireland, 16 of the 18 replacement rates produced are lower than the average figure while two are slightly above average. Conversely in the long-term unemployment phase, Ireland has 15 replacement rates higher than average, two equal to average and one just above average. This reflects a criticism by the OECD of the indefinite duration of many Irish SW payments/ benefits compared with other countries and suggests particular disincentives for the long-term unemployed.

Consideration should be given to the introduction of working age primary payments and secondary payments which reduce with duration (tapered payment rates).

Composition of the Live Register

Numbers in long term unemployment continue to increase

53. The number of persons in long-term unemployment has increased greatly over the last few years. The long-term unemployment rate is now 7.7% according to the latest CSO Quarterly National Household Survey release. Long-term unemployment accounted for 53.9% of total unemployment in quarter two of 2011 compared with 43.3% a year earlier and 21.7% in the second quarter of 2009.

Part-time mix

54. A significant cohort on the Live Register work part-time. At the end of August 2011 there were almost 71,000 casuals/part-time workers (paid for part of the week) representing 15% of the total compared with 64,000 in August 2010. In addition there were 14,400 casuals/part-time workers who were on the register but not receiving a payment (total of 85,300 or 18%).

55. Generous income/means disregards which apply to Jobseekers Allowance and One Parent Family Payment are intended to actively encourage part-time work. There is a danger however that these may act as a barrier to the take up of full time employment and encourage long-term welfare dependency. Stricter enforcement of conditions for payment of jobseeker benefits for part-time work may be necessary to ensure that recipients only receive benefits where they are involuntarily unemployed. Other changes such as changing the payment week from a six to a five day week and counting Sunday as a day of employment need to be considered

Rules relating to the level of and calculation of all the different forms of income disregards for part-time work and receipt of welfare payments need to be reviewed with a view to encouraging individuals into full time work opportunities. Enforcement of the conditions on those in part time work to seek full time work opportunities also needs to be enforced.

Conclusion

Need for increased awareness of the impact of policy changes on replacement rates.

56. Given that replacement rates do matter and can act as disincentives to work there needs to be an increased awareness by policy makers of the impact of policy changes on replacement rates so that problems relating to high replacement rates are not exacerbated. Income tax, USC and PRSI increases, social welfare increases and falling average in-work incomes would all cause replacement rates to rise. Combine these with theories relating to job-search costs and falling reservation wages during a spell of unemployment and the effect is compounded.

57. Replacement rates of the type produced in this analysis are most useful in terms of identifying trends in net incomes vs. wages. It is not an exact science even in terms of when high replacement rates act as disincentives. While replacement rates do matter and high replacement rates need to be addressed, it is crucial to recognise how replacement rates link with conditionality of payments and activation measures and this may need to be the overriding issue.

58. In terms of the level of replacement rates, the monitoring of trends is very important but the level of replacement rates may have more to do with affordability by the State than with avoiding a particular threshold. High replacement rates don't absolutely have to be avoided – they can co-exist with low unemployment but only where activation is strong and well implemented. Improvements are being made in terms of activation in Ireland. We should aim to avoid any worsening of replacement rates and move toward increased activation so that there will be improvements in factors along with financial incentives which promote, ease and encourage take up of employment, particularly when economic circumstances improve.

59. The TSG is invited to discuss this paper.

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