

***Unemployment-Related Benefits Systems in the  
Organization for Economic Co-operation and  
Development (OECD) Countries***

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# CONTENTS

	<i>Page</i>
<b>Executive Summary</b>	
<b>Part 1 - Introduction</b>	<b>1</b>
Background	1
Objectives and Scope	1
Methodology	2
<b>Part 2 - Key Features of Unemployment-Related Benefits Systems and the Tax Treatment of Unemployment Insurance Benefits in the Organization for Economic Co-operation and Development (OECD) Countries</b>	<b>3</b>
Key Features of Unemployment-Related Benefits Systems	3
<i>Unemployment Insurance</i>	3
<i>Unemployment Assistance</i>	4
<i>Family Benefits</i>	4
<i>Housing Benefits</i>	4
<i>Child-Care Benefits</i>	4
<i>Lone-Parent Benefits</i>	4
<i>Social Assistance</i>	6
Unemployment Insurance	6
Unemployment Assistance	9
Family Benefits	11
Housing Benefits	11
Child-Care Benefits	14
Lone-Parent Benefits	14
Social Assistance	16
<b>Part 3 - Replacement Rates in the Organization for Economic Co-operation and Development Countries</b>	<b>19</b>
Replacement Rates and the Level of Employment	19
Gross and Net Replacement Rates	19
Considerations in Setting Replacement Rates	21
<b>Part 4 - Major Developments of Unemployment-Related Benefits Systems in the Organization for Economic Co-operation and Development Countries</b>	<b>23</b>
Policy Developments	23
<i>Tightening Eligibility Conditions for Unemployment-Related Benefits</i>	23
<i>Extending the Possibilities for Part-time and Occasional Jobs</i>	23
<i>Implementing Employment-Conditional Benefits</i>	24
<b>Appendix</b>	<b>25</b>
<b>References</b>	<b>28</b>

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## EXECUTIVE SUMMARY

1. Twenty-five Organization for Economic Co-operation and Development (OECD) countries covered in a 1996 study operated an unemployment insurance (UI) system which provided temporary compensation for lost earnings if certain conditions were met by the claimant. As the UI system was based on insurance principles, the claimant had to have contributed to the insurance fund for a given period of time to be eligible for receiving the unemployment insurance benefit. Claimants had to be involuntarily unemployed and were required to be looking for employment.
2. The level of UI benefits was generally calculated according to previous earnings but might also be influenced by other factors such as employment record, age and family situation. The level of benefits varied from 40% to 90% of previous gross earnings, or might be flat in some countries. The UI benefits were taxable and might be subject to minimum and maximum limits. The duration of UI benefits varied from six months to indefinite. UI benefit payments started after a short waiting period of three to seven days.
3. When the unemployment insurance benefits lapsed, the unemployed worker might have to depend on unemployment assistance (UA). UA payment might also be conditional on employment history and had a limited duration in most cases. Those not eligible for either UI or UA would have to rely on social assistance (SA). The countries studied all provided SA benefits.
4. Two countries studied, Australia and New Zealand, provided unemployment benefits with characteristics of both UA and SA for an unlimited duration. Claimants did not need to have an employment history but were required to be looking for a job.
5. Family benefits were paid to families with dependent children in nearly all of the countries. Low-income households in most countries might also qualify for receiving housing benefits. Child-care benefits might help parents who were working or looking for work to pay for their child-care expenses. Lone parents in some OECD countries could also rely on a separate benefit system.
6. The OECD calculated replacement rates (i.e. unemployment benefit entitlements relative to the worker's earnings) for its member States, taking into account of the benefit levels and durations for different types of households. The rate was commonly used as an indicator of the generosity of a country's unemployment-related benefits system. The higher the replacement rate, the more generous would be the unemployment-related benefits system.

7. The average values of net replacement rates (unweighted) for single person and couple with no children in 17 countries studied were 60 and 62, respectively. The net replacement rates for these two family types were mainly in the 40% - 70% range. On average, the net replacement rates were around ten percentage points higher than those measured before tax. Hence, the net replacement rates had a larger impact on the ratio of incomes in and out of work.
8. The OECD conducted studies to try to determine whether unemployment-related benefits had any negative impact on the level of employment. However, the OECD was unable to reach a definite conclusion regarding the exact impact of unemployment benefits on the level of employment.
9. The OECD advised that the risk aversion of workers, relationship between wages and benefit levels, benefit financing, job search, public employment service, active labour market policies, and marginal effective tax rates should be taken into account in setting replacement rates.
10. Some countries reformed their unemployment-related benefits systems in the 1990s by tightening eligibility conditions for unemployment-related benefits, extending the possibilities for part-time and occasional jobs, and implementing employment-conditional benefits to avoid any possible negative effects on the economy.

# UNEMPLOYMENT-RELATED BENEFITS SYSTEMS IN THE ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) COUNTRIES

## PART 1 - INTRODUCTION

### 1. Background

1.1 In October 1999, the Panel on Manpower and the Panel on Welfare Services requested the Research and Library Services (RLS) Division of the Legislative Council (LegCo) Secretariat to conduct a study on unemployment-related benefits systems.

### 2. Objectives and Scope

2.1 The objectives of the study are:

- to examine the experience of Mainland China, Taiwan, Malaysia, Singapore, South Korea, the United Kingdom (UK), and the United States (US) in implementing their unemployment-related benefits systems; if any
- to outline the research findings of the Organization for Economic Co-operation and Development (OECD) and the Conventions and Recommendations of the International Labour Organization (ILO) in unemployment benefits systems; and
- to make an overall comparative analysis of the experience in the above places in implementing their unemployment-related benefits systems, and study current provisions in helping the unemployed in Hong Kong.

2.2 The scope of the research, as agreed by the Panels, covers

- historical development;
- main features and components;
- eligibility requirements;
- types of benefits and amounts;
- duration of payment of benefits;
- tax treatment of the benefits;
- source of funds for the benefits; and
- administration of the unemployment-related benefits systems.

2.3 In this report, we outline the research findings of the OECD on various aspects of the unemployment-related benefits systems of its member countries. It is worth noting that OECD studies have often been quoted by the Hong Kong Special Administrative Region (HKSAR) Government in its considerations of manpower and welfare policies.

2.4 This report is part of the series of studies discussing unemployment-related benefits systems. There are 11 separate research reports (RP13/99-00 to RP23/99-00) on this subject.

2.5 In this research, "unemployment-related benefits" refer to unemployment benefits and related welfare benefits. Unemployment benefits comprise unemployment insurance and unemployment assistance. Unemployment benefits are available to the unemployed only. In other words, these benefits are not available to people who are not unemployed. The recipient must be currently unemployed, able to work, willing to work and looking for work. Where there are no unemployment benefits or where these benefits are exhausted, welfare benefits may be made available to provide subsistence for those in need. These related welfare benefits, as defined in the 1996 OECD study of *Benefit Systems and Work Incentives*, include family benefits, housing benefits, child-care benefits and social assistance. They are made available to all citizens subject to a means test, and are not specifically targeted at the unemployed.

### **3. Methodology**

3.1 This report is mainly based on the information available from OECD publications.

## **PART 2 -KEY FEATURES OF UNEMPLOYMENT-RELATED BENEFITS SYSTEMS AND THE TAX TREATMENT OF UNEMPLOYMENT INSURANCE BENEFITS IN THE ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) COUNTRIES**

### **4. Key Features of Unemployment-Related Benefits Systems**

4.1 The Organization for Economic Co-operation and Development (OECD)<sup>1</sup> conducted a study of the unemployment-related benefits systems in its 27 member countries in 1996<sup>2</sup>. The findings are summarized below and tabulated in Table 1 (page 5) to give a broad overview of the different elements of the unemployment-related benefits systems and the tax treatment of unemployment insurance (UI) benefits in these countries. In this study, Mexico and Turkey, also OECD member countries, were not covered.

#### Unemployment Insurance

4.2 Of the 27 countries, 25 operated an unemployment insurance system (Column 2) which provided temporary compensation for lost earnings if certain requirements were met by a claimant. As the UI system was based on insurance principles, a claimant had to have contributed to the insurance fund for a given period of time to be eligible for receiving the benefit. In addition, in accordance with relevant International Labour Organization recommendations, claimants were required to be involuntarily unemployed and looking for employment in the period when they received UI benefits. UI benefits would not be issued if these requirements were not met.

4.3 UI benefits were taxable in all OECD countries, except Austria, the Czech Republic, Germany, Japan, South Korea, and Portugal (Column 3).

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<sup>1</sup> There are 29 OECD member countries, comprising Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, New Zealand, the Netherlands, Norway, Poland, Portugal, South Korea, Spain, Sweden, Switzerland, Turkey, the United Kingdom (UK), and the United States (US).

<sup>2</sup> OECD, *Benefit Systems and Work Incentives*, 1998.

### Unemployment Assistance

4.4 When the UI benefits lapsed, the unemployed recipients might have to rely on financial support in another form. Financial assistance for those no longer eligible for UI benefits took one of two forms -- unemployment assistance or social assistance -- depending on the country. Unemployment assistance (UA) was provided in 12 countries (Column 4). Except in Australia and New Zealand, the UA was designed as a follow-up benefit for UI, and was paid at a lower rate. Payment might also be conditional on employment history and had a limited duration in most cases. Similarly, as unemployment assistance was considered an unemployment-related benefit, claimants were required to be involuntarily unemployed and looking for employment in the period when they received UA benefits. If these requirements were not met, UA benefits would not be issued.

### Family Benefits

4.5 Unemployed people with dependent children usually receive an increase in their unemployment benefits. Family benefits were paid to families with dependent children in 25 countries, exceptions being Canada and South Korea (Column 5).

### Housing Benefits

4.6 Low-income households, including the unemployed, were eligible to receive housing benefits (Column 6) in 19 countries. Housing benefits were usually administered through a separate benefit scheme which helped people on low income pay their private rents and housing costs. Payment of housing benefits depended on rent and family composition.

### Child-Care Benefits

4.7 Child-care benefits were provided to unemployed parents who were looking for work to help pay their child-care expenses. A total of 16 countries provided child-care benefits to both the working and the unemployed parents (Column 7). Some countries required the recipient family to pass a means test.

### Lone-Parent Benefits

4.8 Lone parents might be entitled to a separate, additional benefit. A total of 16 countries provided lone-parent benefits to both the working and the unemployed lone parents. In some countries, unemployed lone parents were means-tested for such benefits but recipients were not required to look for work. In Australia, France, Ireland, Japan, New Zealand, and Sweden, lone parents could rely on a separate benefit system (Column 8).



**Table 1 - Main Elements of the Unemployment-Related Benefits Systems and  
Income Tax Treatment of Unemployment Insurance Benefits, 1996**

OECD Countries	Unemployment Insurance	Income Tax Treatment of Unemployment Insurance	Unemployment Assistance <sup>1</sup>	Family Benefits	Housing Benefits	Child-Care Benefits	Lone-Parent Benefits	Social Assistance <sup>1</sup>
	Column 2	Column 3	Column 4	Column 5	Column 6	Column 7	Column 8	Column 9
Australia <sup>2</sup>	-	Not applicable	Y	Y	Y	Y	Y	Y
Austria	Y	*	Y	Y	-	-	-	Y
Belgium	Y	Taxable	-	Y	-	-	-	Y
Canada	Y	Taxable	-	-	Y	Y	-	Y
Czech Republic	Y	*	-	Y	-	Y	-	Y
Denmark	Y	Taxable	-	Y	Y	Y	Y	Y
Finland	Y	Taxable	Y	Y	Y	Y	Y	Y
France	Y	Taxable	Y	Y	Y	Y	Y	Y
Germany	Y	*	Y	Y	Y	Y	Y	Y
Greece	Y	Taxable	Y	Y	-	-	-	Y
Hungary	Y	Taxable	-	Y	Y	Y	Y	Y
Iceland	Y	Taxable	-	Y	Y	-	Y	Y
Ireland	Y	Taxable	Y	Y	Y	-	Y	Y
Italy	Y	Taxable	-	Y	-	-	Y	Y
Japan	Y	*	-	Y	Y	Y	Y	Y
South Korea	Y	*	-	-	-	-	-	Y
Luxembourg	Y	Taxable	-	Y	Y	Y	Y	Y
Netherlands	Y	Taxable	Y	Y	Y	-	-	Y
New Zealand <sup>2</sup>	-	Not applicable	Y	Y	Y	Y	Y	Y
Norway	Y	Taxable	-	Y	Y	Y	Y	Y
Poland	Y	Taxable	-	Y	Y	Y	-	Y
Portugal	Y	*	Y	Y	-	-	-	Y
Spain	Y	Taxable	Y	Y	-	-	-	Y
Sweden	Y	Taxable	Y	Y	Y	Y	Y	Y
Switzerland	Y	Taxable	-	Y	Y	-	-	Y
United Kingdom	Y	Taxable	-	Y	Y	Y	Y	Y
United States	Y	Taxable	-	Y	Y	Y	Y	Y

Notes: "Y" indicates that the specific benefit was available in this country, "-" otherwise.

"Taxable" indicates that beneficiaries had to pay income and/or payroll taxes on benefit income, "\*" indicates that unemployment benefit recipients did not pay tax, either because their benefits were not taxable or because the tax system was so structured that full-year recipients did not pay tax.

- Note that Unemployment Assistance and Social Assistance could also be taxable but this was not indicated in the table.
- In Australia and New Zealand an assistance type benefit was payable which had characteristics of both Unemployment Assistance and Social Assistance.

Sources: OECD, *Benefit Systems and Work Incentives*, 1998.

### Social Assistance

4.9 The unemployed who were not eligible for either unemployment insurance or unemployment assistance would have to rely on social assistance, which were provided in all 27 countries (Column 9). Social assistance was available to all eligible people in these countries, not just the unemployed. In providing social assistance, the government acted as a provider of last resort for the claimant to secure a basic standard of living. There was only one requirement: passing a means test. In contrast to UI or UA, the entire family, rather than the individual unemployed, was counted as one unit when resources were measured in the means test.

4.10 Australia and New Zealand provided unemployment benefits with characteristics of both unemployment assistance and social assistance for an unlimited duration. Claimants did not need to have an employment history, but were required to be looking for a job.

## **5. Unemployment Insurance**

5.1 Table 2 (page 8) examines the calculation of UI benefits. The information in the table was in respect of a 40-year-old single worker with a long employment history, previously earning an average income. An average income as defined by the OECD was equal to the income level of the average production workers.

5.2 In order to be eligible, the unemployed person had to contribute to the insurance fund for a specific period (Column 2). However, there was no requirement of prior employment in Norway and the UK.

5.3 In some OECD countries, benefit payments did not start immediately upon the recipient becoming unemployed but rather after a short waiting period (Column 3). This waiting period was to ensure that no unnecessary administrative work would be incurred as a result of the claimant finding employment within that short waiting period. In general, the waiting period ranged from three to seven days.

5.4 The level of benefits (Column 4) was generally calculated according to previous earnings but might also be influenced by other factors such as employment record, age and family situation. The level of benefits varied from 40% to 90% of previous gross earnings. The governments of Iceland, Ireland, and Poland administered flat-rate benefits.

5.5 The level of benefits might also be subject to minimum and maximum limits (Columns 5 and 6). Out of 25 countries which provided UI benefits, 11 of them did not stipulate the minimum level of UI benefit. The maximum benefit might depend on employment history and age. It could vary a great deal from the level of minimum benefit.

5.6 The duration in which unemployment insurance benefit was payable varied from six months to an indefinite period (Column 7). The maximum duration of benefit payments might depend on the employment history (e.g. Belgium, France, Japan, the Netherlands, and Switzerland) and age (e.g. Austria, France, Germany, the Netherlands, and Sweden).

**Table 2 - Unemployment Insurance Payment Rates and Benefit Duration, 1996**

OECD Countries	Employment Conditions	Waiting Period	Payment Rate (%) <sup>1</sup>	Minimum Benefit (Yearly) <sup>2</sup> in US Dollars	Maximum Benefit (Yearly) <sup>2</sup> in US Dollars	Duration (Months)
	Column 2	Column 3	Column 4	Column 5	Column 6	Column 7
Austria	20 weeks in 1 year or 52 weeks in 2 years if first claim. Maximum duration if 156 weeks in 5 years	7 days	57	1,429	10,836	12
Belgium <sup>3</sup>	312 days in 18 months rising to 624 days in last 3 years, depending on age	-	60	6,712	10,682	Indefinite
Canada	20 weeks in 1 year	2 weeks	55	-	18,873	12
Czech Republic	12 months in the last 3 years	7 days	60	-	3,887	6
Denmark <sup>4</sup>	26 weeks in 3 years	-	90	-	15,404	84
Finland <sup>4,5</sup>	26 weeks in 2 years	5 days	80	5,067	-	23
France	4 months in the last 8 months	8 days	75	7,653	54,067	60
Germany <sup>6,7</sup>	360 days in 3 years	-	60	-	27,181	12
Greece <sup>6</sup>	125 days in the last 14 months	6 days	40	3,418	-	12
Hungary	12 months in the last 4 years	-	75	1,509	3,158	12
Iceland	425 hours in the last year	Variable	Flat	7,156	-	12
Ireland	39 weeks in 1 year	3 days	Flat	5,000	-	15
Italy	52 weeks in 2 years	7 days	80	-	11,327	12
Japan <sup>8</sup>	6 months in 1 year	7 days	80	-	16,858	7
South Korea	12 months in the last 18 months	14 days	50	2,792	20,349	6
Luxembourg	26 weeks in 1 year	-	80	-	32,944	12
Netherlands	26 weeks in 1 year for basic benefit, 4 years in 5 years for extended benefits	-	70	-	25,119	54
Norway <sup>4</sup>	-	3 days	62	-	15,361	43
Poland	180 days of work in the last year	1 day	Flat	2,238	-	18
Portugal	540 days in 2 years	-	65	5,115	9,974	21
Spain	12 months in 6 years	7 days	70	5,263	15,437	14
Sweden	80 days in the last 5 months	5 days	80	6,389	14,708	10
Switzerland	6-18 months in 2 years	5 days	70	-	33,018	18
United Kingdom	-	3 days	45	-	3,604	12
United States	26 weeks total	7 days	50	2,184	15,236	6

## Notes:

1. The payment rate was expressed as a percentage of gross earnings, unless indicated "flat" which meant a flat rate.
2. Minimum and maximum benefits were calculated from yearly earnings ceilings. 1995 purchasing parities were used to calculate US dollar values (1994 for the Czech Republic).
3. Belgium: the payment rate for single person was reduced to 42% in the second year.
4. Denmark, Finland and Norway had a voluntary UI system.
5. Finland: the benefit was restricted to 80% of previous earnings.
6. Germany and Greece: payment rates were higher when dependants were present.
7. German payment rates were expressed as a percentage of net income.
8. Japan: the payment rate depended on age and previous earnings level.

Source: OECD, *Benefit Systems and Work Incentives*, 1998, p. 16.

## **6. Unemployment Assistance**

6.1 When an unemployed individual was either not eligible or no longer eligible for unemployment insurance (UI) benefits, the person might seek unemployment assistance (UA) benefits in some countries. Table 3 (page 10) provides information on UA payment rates and benefit duration in 27 countries. For easy comparison, the information applied in Table 3 is also in respect of a 40-year-old single worker with a long employment history, previously earning an average income.

6.2 Twelve of the countries covered in the OECD study, namely, Australia, Austria, Finland, France, Germany, Greece, Ireland, the Netherlands, New Zealand, Portugal, Spain and Sweden, provided UA benefits to the unemployed. Payment of UA benefits was conditional on previous employment in Austria, France, Germany, Greece, the Netherlands, Portugal, Spain, and Sweden (Column 2). In Austria and Spain, unemployed workers could claim UA benefits when they had exhausted UI benefits. UA benefits were paid to all unemployed persons in other countries.

6.3 Some of the UA benefits systems included a waiting period (detailed in paragraph 5.3 above), which was only applied to first-time claimants (i.e. the unemployed who did not qualify for UI in Ireland and Sweden; all unemployed in New Zealand) (Column 3). The length of the waiting period in New Zealand was calculated according to previous earnings and varied between two and ten weeks.

6.4 The determination of gross benefit levels varied across OECD countries. The payment rate (Column 4) was flat in nine countries, namely, Australia, Finland, France, Ireland, the Netherlands, New Zealand, Portugal, Spain, and Sweden. However, in Austria and Greece, the payment was calculated according to previous UI benefits or as a percentage of previous earnings.

6.5 Some countries, namely, Australia, Austria, Finland, France, Germany, Greece, Ireland, the Netherlands, New Zealand, Portugal Spain, and Sweden, imposed minimum and maximum UA benefit rates (Columns 5 and 6). The payments of UA benefits might be subject to a means test with the financial resources of the household being taken into consideration in the assessment. The level of benefits might further differ regionally in some OECD countries.

6.6 There was no limit to the duration of UA payments (Column 7) in seven countries (Australia, Austria, Finland, France, Germany, Ireland, and New Zealand) but limits were imposed in five countries (Greece, the Netherlands, Portugal, Spain, and Sweden).

**Table 3 - Unemployment Assistance Payment Rates and Benefit Duration, 1996**

OECD Countries	Employment Requirements	Waiting Period	Payment Rate (%) <sup>1</sup>	Minimum Benefit (Yearly) <sup>2,3</sup> in US Dollars	Maximum Benefit (Yearly) <sup>2,3</sup> in US Dollars	Duration (Months)
	Column 2	Column 3	Column 4	Column 5	Column 6	Column 7
Australia	-	-	Flat	-	5,999	Indefinite
Austria	To have exhausted UI	-	92% of UI	1,315	9,969	Indefinite
Belgium	-	-	-	-	-	-
Canada	-	-	-	-	-	-
Czech Republic	-	-	-	-	-	-
Denmark	-	-	-	-	-	-
Finland	-	-	Flat	5,067	-	Indefinite
France	5 years in the last 10 years	-	Flat	4,023	-	Indefinite
Germany <sup>4</sup>	6 months in the last year	-	53	-	24,009	Indefinite
Greece	60 days in the last 2 years	-	36% of UI	3,076	-	3
Hungary	-	-	-	-	-	-
Iceland	-	-	-	-	-	-
Ireland	-	3 days	Flat	5,000	-	Indefinite
Italy	-	-	-	-	-	-
Japan	-	-	-	-	-	-
South Korea	-	-	-	-	-	-
Luxembourg	-	-	-	-	-	-
Netherlands	3 years in the last 5 years	-	Flat	8,743	-	12
New Zealand <sup>5</sup>	-	2-10 weeks	Flat	-	4,768	Indefinite
Norway	-	-	-	-	-	-
Poland	-	-	-	-	-	-
Portugal	6 months in 1 year	-	Flat	3,580	-	10.5
Spain	To have exhausted UI, or to have worked 6 months	-	Flat	5,263	-	30
Sweden	75 hours in the last 5 months	5 days	Flat	6,389	-	5
Switzerland	-	-	-	-	-	-
United Kingdom	-	-	-	-	-	-
United States	-	-	-	-	-	-

## Notes:

1. The payment rate was expressed as a percentage of gross earnings, unless indicated "flat" which meant a flat rate equal to the value in the minimum column or "% of UI" which meant that the UA benefit was calculated as a percentage of the previous UI benefit.
2. Minimum and maximum benefits were calculated from the previous yearly earnings.
3. 1995 purchasing parities were used to calculate US dollar values.
4. Germany: the payment rate was expressed as a percentage of net income and was higher when dependants were present.
5. New Zealand: waiting period depended on previous earnings.

Source: OECD, *Benefit Systems and Work Incentives*, 1998, p. 18.

## **7. Family Benefits**

7.1 The presence of dependent children might qualify a household for supplementary benefit payments (i.e. family benefits). Unemployed people with dependent spouse and children might also claim family benefits.

7.2 Table 4 (page 12) shows the yearly amount of family benefits granted for one child, as well as additions for further children. The table also indicates that additional unemployment benefits were granted when there were dependants. The tabulated amounts were based on the assumption of there being one child under the age of 13 in a one-earner couple family.

7.3 With few exceptions, family benefits were paid as fixed amounts per child and were not means-tested. In some countries (Greece, Iceland, Italy and the US), family benefits were subject to a means test, other incomes being taken into account.

7.4 Additions to unemployment benefits for dependants were paid in eight of the 27 countries studied. Family benefits were also paid for dependants other than children (e.g. in Greece, New Zealand, Norway, and the UK, additions were paid for a dependent spouse).

## **8. Housing Benefits**

8.1 To help people on low income pay their private rents and housing costs, most countries operated a separate benefit system (see Table 5 on page 13). Housing benefits were broadly distinguishable in three groups: separate benefit, tax credit, or social assistance. Thirteen countries (Denmark, Finland, France, Germany, Hungary, Iceland, the Netherlands, New Zealand, Norway, Poland, Sweden, the UK and the US) administered housing benefits as a separate benefit. Greece, Italy and South Korea were the countries where rents were neither covered in a separate system nor by social assistance, but these countries allowed a tax credit for rent payments. Some countries included a special allowance for housing in social assistance.

8.2 The amounts of payments under both types of housing benefit depended on the amount of rent being paid and family composition. The maximum amount of rent covered by the systems varied from country to country, between 30% (Sweden) and 100% (in Canada, Germany, Ireland, Luxembourg, and Switzerland) (see Column 2).

**Table 4 - Family Benefits, 1996**

OECD Countries	1 <sup>st</sup> Child (Yearly) <sup>1</sup> in US Dollars	Extra for Additional Children	Extra in Unemployment Benefit
Australia <sup>2</sup>	1,714	Increases per child	-
Austria	1,321	Amounts per child	US\$45 month/child
Belgium	829	Benefits increased until the third child, and increased by age	Family benefit amounts were increased in 7th month of unemployment
Canada	-	-	-
Czech Republic	701	Increased with age (means-tested)	-
Denmark	1,113	Amount related to the child's age	-
Finland	1,069	Increased per dependant	Lump sum additions US\$1,031 for the first child
France	1,205	Amount increased with age	-
Germany <sup>3</sup>	407	Progressively increasing until the third child, then US\$1,594 per child	UI was raised with 7 percentage points, UA with 5 percentage points
Greece <sup>3</sup>	-	Same amount for each of the first three children plus 10% for a dependent spouse	UI was raised with 10 percentage points for each dependant
Hungary	482	Amounts per child increased with the family size	-
Iceland <sup>3</sup>	506	Increased for low income families	US\$1.1/day per dependent child
Ireland	498	US\$591 from the third child	US\$1,065 for each dependent child
Italy <sup>3,4</sup>	1,681	The amount reduced with increases in taxable income; different rates for single parents	-
Japan	341	The amount was doubled for third and subsequent children	-
South Korea	-	-	-
Luxembourg	992	Increased with the number for children	Increased with 5 percentage points
Netherlands	548	Increased per child and with age	-
New Zealand	1,335	US\$858 for each other child under 13 years old	UA amounts depended on family type
Norway	1,128	Increased per child	A flat rate addition for each dependant
Poland	187	Same amount for each child	-
Portugal	254	-	UA was increased for dependants
Spain	288	Increases for each child	-
Sweden	903	US\$240 for the third child, US\$720 for the fourth child	-
Switzerland	1,025	Amounts per child	UI was increased by 10 percentage points if there were dependants
United Kingdom	807	81% of this amount was paid for subsequent children	Additions for a dependent spouse
United States <sup>3</sup>	1,056	Increased per child	-

Notes:

- 1995 purchasing parities were used to calculate US dollar values (1994 for the Czech Republic).
- Additional Family Payments paid out extra, age-related amounts per child. Receipt of this benefit entitled to additional benefits.
- Family benefits were means-tested.
- Benefits might be received from the second child onwards.

Source: OECD, *Benefit Systems and Work Incentives*, 1998, p. 19.



**Table 5 - Housing Benefits, 1996**

OECD Countries	Housing Benefits (Maximum Payments in % of Rent)	Benefit Reduction Rate (% of Net Income)	Treatment of Housing Costs in Social Assistance
	Column 2	Column 3	Column 4
Australia	Rent was added to Additional Family Payment if it exceeded certain amounts.	50%	-
Austria	-	-	-
Belgium	-	-	-
Canada	Housing costs were added to SA payment rates up to maxima (100%)	100%	SA was the only possible way to cover housing expenses
Czech Republic	-	-	-
Denmark	Separate means-tested system (75% subject to a maximum)	16% - 27%	Rent in excess of housing benefits was added to SA payment rates
Finland	Separate means-tested system (< 80%)	28%	Rent in excess housing benefits and certain other housing costs were added to SA payment rates
France	Separate income-related system (80%)	-	-
Germany	Separate means-tested system (100% subject to a maximum)	21%	Rent in excess of housing benefits was added to payment rates and was conditional on receipt of at least a part of SA
Greece	Rents could be deducted from taxable income	-	-
Hungary	Separate system (100%)	35% of gross earned and replacement income	-
Iceland	Separate scheme (50%)	100%	-
Ireland	100%	100%	Rent included in SA means test
Italy	Tax credit for rent was available	-	-
Japan	Rent was covered up to certain amounts as part of SA (US\$120/month)	100% of net income exceeding threshold values regressively increasing with gross earnings	SA was the only possible way to cover housing expenses
South Korea	-	-	-
Luxembourg	100%	100%	Total coverage up to US\$126/month conditional on receipt of at least a part of SA
Netherlands	Separate means-tested system (80%)	Progressive, 0-100%	Housing costs exceeding individual subsidies were covered by standard SA rates
New Zealand	Separate system (65%)	25% in restricted range of earnings	-
Norway	US\$107/month on average	100%	-
Poland	US\$46/month	100%	-
Portugal	-	-	Additions to social assistance were possible
Spain	-	-	Rent allowance was part of social assistance
Sweden	Separate system (30-75%, depending on rent)	10%-33%, depending on family type	Rent in excess of housing benefits was added to SA payment rates
Switzerland	Housing costs were added to SA payment rates up to maxima (100%)	100%	SA was the only possible way to cover housing expenses
United Kingdom	100% of rent was covered for SA claimants	65% for people not receiving assistance	100% of rent was covered for SA claimants
United States	Local initiatives existed	-	-

Source : OECD, *Benefit Systems and Work Incentives*, 1998, p. 20.

8.3 The maximum benefit amounts were reduced according to a certain percentage of present income (see Column 3 of Table 5). In most countries, housing benefits were an integral part of social assistance (Column 4). In some countries (Denmark, Finland, and Sweden), maximum benefits for both the separate housing benefit system and the assistance related system could be received at the same time.

## **9. Child-Care Benefits**

9.1 The cost of sending children to approved day care nursery centers might be partly or totally compensated through benefit payments, including unemployment benefits payments. The child-care benefits for a single parent in work with two children under four years old in approved day care centres are shown in Table 6 on page 15.

9.2 A number of countries had a separate benefit system in which benefits payments were made to parents who made use of approved child-care facilities (Australia, New Zealand, and Norway). Some countries provided allowances either in the tax system (Australia, Canada and France), in family benefits (Germany and the UK) or reduced the child-care fees according to the parents' incomes (Finland, Japan, and New Zealand). In Sweden, child care might be provided without fee for the parents (Table 6).

## **10. Lone-Parent Benefits**

10.1 Lone parents might be entitled to a separate benefit. The nature of lone-parent benefits and the maximum value for a lone parent with two children under four years old are shown in Table 7 (page 17).

10.2 In countries such as Australia, France, Ireland, Japan, and Sweden, applicants for lone-parent benefits were means-tested but recipients were required to look for work. Supplements to family benefits, such as those in Denmark, Finland, Hungary, Iceland, Italy, Norway, and the UK were paid under the same conditions as the family benefits. Lone-parent benefits could be received in these countries until the oldest child reached the age that is indicated in the table. In the Netherlands, a separate benefit for lone parents did not exist but lone parents receiving social assistance were not required to look for work until the oldest child reached the age of five. In the US, lone parents qualified for regular family benefits.

**Table 6 - Child-Care Benefits, 1996**

OECD Countries	Child-Care Benefits
Australia	Subsidised provisions; means-tested benefits; tax rebate
Austria	-
Belgium	-
Canada	Child care was treated as a work related expense and was thus deductible from taxable income (up to a maximum)
Czech Republic	There was a benefit allowing mothers to care for children at home; no benefit for care centre fees
Denmark	Actual cost if earnings were below a ceiling (80% of average production workers' earnings)
Finland	Contributions in child-care costs depended on present income
France	The subsidy was equal to the social security contributions of the applying parent; separate programmes and tax reductions also existed; different tax credits also existed
Germany	Could be covered by social assistance
Greece	-
Hungary	There was a benefit allowing mothers to care for children at home; no benefit for care centre fees
Iceland	-
Ireland	-
Italy	-
Japan	Contributions in child-care costs depended on present income
South Korea	-
Luxembourg	Payment were made for home child care
Netherlands	-
New Zealand	Means-tested scheme, reduced payable fees
Norway	Flat-rate means-tested benefit: US\$7,041 per annum
Poland	Flat-rate means-tested benefit: US\$46 per month per child
Portugal	-
Spain	-
Sweden	Free care provided universally
Switzerland	-
United Kingdom	US\$60/week per child in care could be added to net income apart from the Family Credit formula; some locally subsidised day care centres
United States	Some locally subsidised day care centres

Source: OECD, *Benefit Systems and Work Incentives*, 1998, p. 22.

## 11. Social Assistance

11.1 In all 27 countries studied, all people without resources could rely on government-provided financial assistance. Table 8 (page 18) shows the maximum social assistance (SA) payment rates for three different family types.

11.2 Social assistance payments depended on decisions of regional governments. Other than unemployment insurance benefits, and in some cases unemployment assistance, social assistance (UA) was paid to the entire household and the resources of the entire household were considered for the assessment. In other words, the benefit unit (i.e. the group of persons to whom the benefit was paid) and the resource unit (i.e. the group of persons whose resources were considered in the assessment) for SA were the household, but the resource unit and the benefit unit for UI were the individual. UA benefits might be paid to the individual but the household was the resource unit (e.g. Germany).

11.3 The regional variation of the payment rates is indicated in the last column of Table 8. The words "national rates" refer to uniform rates that were paid throughout the country (e.g. Belgium, Denmark, Germany, South Korea, and New Zealand).

11.4 Where national rates were recommended with flexibility allowed for regional differences, the table indicates "national guidelines". Hungary, Iceland, Ireland, Sweden, and Switzerland used this method to determine the social assistance rate.

11.5 Where there was regional variation in payment rates, two approaches might be followed: the national average was used (in Finland), otherwise a representative region ("regionally determined") was used (in Austria, Canada, Italy, Japan, Norway, Spain, and the US).

**Table 7 - Lone-Parent Benefits, 1996**

OECD Countries	Type of Benefit	Rate (Yearly) <sup>1</sup> in US Dollars	Income Test
Australia <sup>2</sup>	Separate benefit, and tax rebate for children under 16 years old	7,160	50% of earnings
Austria	-	-	-
Belgium	-	-	-
Canada	-	-	-
Czech Republic	-	-	-
Denmark	Family benefit supplement for children under 6 years old	3,363	No
Finland	Family benefit supplement	3,348	No
France	Separate benefits for children under 3 years old	4,215	100% of net income
Germany	Increases in social assistance supplements for children under 16 years old	1,542	100% of net income
Greece	-	-	-
Hungary	Family benefit supplement for children under 16 years old	88	No
Iceland <sup>3</sup>	Family benefit supplementary and separate benefit for children under 16 years old	934	No
Ireland	Separate benefit for children under 18 years old	7,428	-
Italy	Increases in family benefits from the third child onwards for children under 18 years old	151	No
Japan	Separate benefit for children under 18 years old	3,165	No
South Korea	-	-	-
Luxembourg	Non-refundable tax credit in taxable income	-	-
Netherlands	-	-	-
New Zealand	Separate benefit for children under 18 years old	7,450	18% - 30% of earnings
Norway	Additional amounts in family benefits for children under 16 years old	14,070	No
Poland	-	-	-
Portugal	-	-	-
Spain	-	-	-
Sweden	Separate benefit per child for children under 16 years old	2,824	No
Switzerland	-	-	-
United Kingdom	Addition to child benefits for children under 16 years old	488	No
United States	Lone parents received family benefits for children under 19 years old	-	-

## Notes:

1. 1995 purchasing parities were used to calculate US dollar values. The examples assumed two children younger than 4 years of age.
2. Means test was less stringent than for unemployment beneficiaries.
3. There was a supplement for people with low incomes which was means-tested.

Source: OECD, *Benefit Systems and Work Incentives*, 1998, p. 24.

**Table 8 - Maximum Social Assistance Monthly Amounts, 1996**

OECD Countries	Single <sup>1</sup> In US Dollars	Couple Plus Two Children <sup>1</sup> in US Dollars	Lone Parents, Two Children <sup>1</sup> in US Dollars	Determination of Rates
Australia <sup>2</sup>	Not available	Not available	Not available	Not available
Austria	374	708	552	Regionally determined
Belgium	534	712	712	National rates
Canada	421	954	880	Regionally determined
Czech Republic	216	625	476	National rates
Denmark	770	1,027	1,027	National rates
Finland	336	1,016	780	National average
France	351	738	632	National rates
Germany	286	860	714	National rates
Greece	120	120	120	National rates
Hungary	98	98	98	National guidelines
Iceland	558	1,004	892	National guidelines
Ireland	402	828	578	National guidelines
Italy	392	998	833	Regionally determined
Japan	462	1,095	871	Regionally determined
South Korea	186	186	186	National rates
Luxembourg	782	1,404	1,013	National rates
Netherlands	641	915	824	National rates
New Zealand <sup>3</sup>	-	798	798	National rates
Norway	542	978	-	Regionally determined
Poland	145	145	145	National rates
Portugal	164	164	164	National rates
Spain	125	435	384	Regionally determined
Sweden	346	967	730	National guidelines
Switzerland	478	1,024	767	National guidelines
United Kingdom	301	714	607	National rates
United States <sup>4</sup>	119	916	759	Regionally determined

## Notes:

1. 1995 purchasing parities were used to calculate US dollar values (1994 for the Czech Republic).
2. The OECD had not provided the figures for Australia.
3. Only available as guaranteed income to full-time employees with family benefits.
4. Amounts included Food Stamps.

Source: OECD, *Benefit Systems and Work Incentives*, 1998, p. 26.

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## **PART 3 - REPLACEMENT RATES IN THE ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT COUNTRIES**

### **12. Replacement Rates and the Level of Employment**

12.1 The Organization for Economic Co-operation and Development (OECD) calculated replacement rates (i.e. unemployment benefit entitlements relative to the worker's earnings) for its member States, taking into account the benefit levels and durations for different types of households. This index is commonly adopted to measure the generosity of an unemployment benefits system. For details of replacement rate, please refer to Appendix I.

12.2 The OECD had conducted studies to try to determine whether unemployment-related benefits had any negative impact on the level of employment. The OECD concluded that "growth in unemployment benefit entitlements from the 1970s to 1990s could have contributed to the rise in unemployment over the period. However, there was a long time lag of many years before the full effects were felt. Although there was not an immediate statistical link between unemployment rates and unemployment benefit entitlements, the hypothesis of a longer-term link was plausible. However, using the same data, Blondal and Pearson<sup>3</sup> found that higher benefits were statistically associated with high labour force participation and that there was no statistically significant effect of the index on the employment-to-population ratio."<sup>4</sup> In sum, the OECD was unable to reach a definite conclusion regarding the exact impact of unemployment benefits on the level of employment.

### **13. Gross and Net Replacement Rates**

13.1 Table 9 (page 20) gives gross and net replacement rates for a single person and a married couple with no children and with average earnings from work for 17 OECD countries studied in 1994. The net replacement rates took account of taxation and social security contributions on work.

13.2 The average values of net replacement rates (unweighted) for single person and couple with no children in 17 OECD countries studied were 60 and 62, respectively. The net replacement rates for these two family types were mainly in the 40% - 70% range.

13.3 On average, the net replacement rates were around ten percentage points higher than those measured before tax. Hence, the net replacement rates had a larger impact on the ratio of incomes in and out of work. It was worth noting that the Swedish net replacement rate was lower than its gross replacement rate because of the provision of earned income tax allowance.

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<sup>3</sup> Blondal and Pearson, "Unemployment and Other-employment Benefits", *Oxford Review of Economic Policy*, 1995, Vol. 11, No. 1, p. 136-169.

<sup>4</sup> OECD, *Implementing the OECD Jobs Strategy: Member Countries' Experience*, 1997, p. 52-53.

13.4 The difference among countries was due to the level and structure of taxes and social security contributions. In those countries where both benefits and earnings were subject to full taxes and social security contributions, net replacement rates were only slightly lower than gross replacement rates (the average difference in replacements being around ten percentage points).

13.5 In countries where benefits were taxed but either reduced or no social security contributions were payable, net replacement rates were significantly higher than gross rates. The largest differences were found in Australia, Belgium, France, Germany, Japan, and New Zealand.

**Table 9 - Gross and Net Replacement Rates by Family Type, 1994**

OECD Countries	Single Person		Couple with No Children	
	Gross Rates	Net Rates	Gross Rates	Net Rates
Australia	34	49	43	66
Belgium	38	65	38	57
Canada	55	58	55	64
Denmark	60	70	60	70
Finland	52	63	52	63
France	58	67	58	70
Germany	37	68	42	61
Ireland	34	49	38	49
Italy	30	36	30	42
Japan	52	63	52	61
New Zealand	38	50	37	50
Norway	62	66	62	67
Spain	70	72	70	73
Sweden	77	75	77	75
Switzerland	70	73	70	73
United Kingdom	34	38	39	52
United States	50	58	50	60
<b>Average (unweighted)</b>	<b>50</b>	<b>60</b>	<b>51</b>	<b>62</b>

Sources: OECD, *Making Work Pay: Taxation, Benefits, Employment and Unemployment*, 1997, p. 23.  
OECD, *Employment Outlook*, July 1996, P. 30 - 33.



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## 14. Considerations in Setting Replacement Rates

14.1 According to *Employment Outlook* published by the OECD, the question of whether or not benefits paid to those out of work are "too high" involves considerations of economic efficiency and social preferences. Social policy objectives are best served by high levels of benefits, but this may have negative labour market consequences. However, it is difficult to quantify the exact impact of unemployment-related benefits on the level of employment. The general consensus is only that an unusually high level of benefits will have unfavourable effects on the economy. Hence, the OECD advised that the following seven factors should be taken into account in setting replacement rates to avoid any possible negative effects.<sup>5</sup>

- Risk Aversion of Workers: Risk aversion varies between individuals and over time. Benefits should be high when people want to insure themselves against loss of earnings arising from unemployment or other risks such as disability. The degree of risk aversion may also vary between countries: people in some societies may be more prepared to gamble with their incomes than those in others.
- Relationship Between Wages and Benefit Levels: If benefits are high, wages may be pushed higher, increasing the cost of labour and causing unemployment. The responsiveness of wages to out-of-work benefit levels will depend on regulatory requirements and the degree of competition in labour and product markets.
- Benefit Financing: Higher benefit levels require high taxes or social contributions to finance them. If taxes on labour are high, there may be a risk that the cost of labour will be increased, causing unemployment.
- Job Search: Most people wish to work not just for financial reasons, but also because of a strong work ethic, or because of the social interactions work provides. Where this is the case, high replacement rate will not reduce the effort the unemployed put into searching for work. Otherwise, benefit systems will have to rely upon administrative controls to ensure that the unemployed search for work. If these controls are effective, high replacement rates will not extend the duration of unemployment unduly. Where they are ineffective, some may adapt to living off benefit income, and not look for work, so increasing unemployment and its persistence.

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<sup>5</sup> OECD, *Employment Outlook*, July 1996, p. 38.

- Public Employment Service: If public employment services or their private sector equivalents are effective, jobs appropriate to the abilities of the unemployed will be rapidly brought to their attention. Benefits will only need to be sufficient to cover a short period of unemployment as longer job-search will not find better job-offers. If the unemployed have to rely on their own resources in searching for jobs, benefits have to be sufficiently high to support a reasonable length of job-search. Otherwise the unemployed may be forced by financial considerations into accepting inappropriate jobs for their skills.
  
- Active Labour Market Policies (ALMPs): By improving the productivity and employability of the unemployed, active labour market policies can reduce the disincentive effects of any given replacement rate. Conversely, if the level of unemployment benefits is high or if the system is poorly managed, such as paying a flat rate and not checking whether the recipient is in fact looking for employment, it is very difficult to operate ALMPs in ways which increase labour market efficiency and reduce structural unemployment.
  
- Marginal Effective Tax Rates (METRs): Increases in earnings may bring little net increases in family incomes. The result is a reduced incentive to increase earnings. The higher the out-of-work benefit, the higher the METR will have to be and/or the larger the income range over which high METRs apply, so deepening or widening this work disincentive.

## **PART 4 - MAJOR DEVELOPMENTS OF UNEMPLOYMENT-RELATED BENEFITS SYSTEMS IN THE ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT COUNTRIES**

### **15. Policy Developments**

15.1 Some member countries of the Organization for Economic Co-operation and Development (OECD) reformed their unemployment-related benefits systems in the 1990s. The major changes, in particular those which altered the functioning of the tax and benefit systems, hence the incentive-structure of working and unemployed households, are discussed below.

#### Tightening Eligibility Conditions for Unemployment-Related Benefits

15.2 Against the background of persistently high unemployment in the 1990s, many countries reviewed the role of tax and benefit system as a source of financial incentives to work. Some countries have reformed their unemployment-related benefits systems. Austria has tightened the requirement for employment/contributions record for repeat unemployment insurance claims. Finland, Iceland, the Netherlands, and Norway tightened eligibility criteria for all claimants. Denmark and Sweden reduced benefit payments.

15.3 The requirement that a claimant should be looking for work in order to qualify for unemployment benefits was more rigorously enforced. This was especially the case in Finland (especially for the young unemployed) and the Netherlands. Unemployment insurance and assistance benefits in the UK were combined into one single benefit (Jobseeker's Allowance, in 1996) which forced the unemployed to search for work. Changes to the unemployment insurance benefit in Switzerland in 1996 were aimed at a speedier reintegration to work of beneficiaries.

#### Extending the Possibilities for Part-time and Occasional Jobs

15.4 Part-time and occasional jobs would help beneficiaries maintain contact with the labour market and increase the likelihood of re-employment. However, the OECD found that the structure of the tax and benefits systems in most of its member countries did little to encourage the beneficiaries or their family members to enter short hour or temporary employment.

15.5 Some countries reformed their unemployment-related systems to improve work incentives. The means test of unemployment-related benefits in Australia was redefined on an individual basis so that the family members' earnings did not disqualify others from entitlements. The changes in the Australian benefits system were based on the same principle of individual means testing.

15.6 Canada re-defined eligibility for unemployment insurance benefits on hours-based requirements in 1997, allowing for part-time jobs to contribute to meeting insurance eligibility requirements. The beneficiary might earn up to 25% of the benefit income without being subjected to the means test. The benefit reform in the UK in 1996 extended possibilities for recipients and their family members to work in part-time employment.

#### Implementing Employment-Conditional Benefits

15.7 Some benefits are only paid to people in a full-time or part-time job. They are paid directly to the employee upon taking up paid employment. These employment conditional benefits increase the net income from work and the difference between in-work and out-of-work income, and thereby create an incentive to leave a situation of benefit dependency.

15.8 Several countries introduced employment-conditional benefits of some form or other with varying payment rates and qualifying requirements. They were mostly in the form of a tax credit. In the US, the value of the earned income credit increased as gross earnings rose, and reached a plateau at the maximum credit. Canada introduced a more modest tax credit for working families with children. The UK provided a "Back-to-Work Bonus", which was paid to long-term recipients who left unemployment benefits for paid employment.

## Appendix I

### "Replacement Ratio" or "Replacement Rate"

#### What is "Replacement Ratio" or "Replacement Rate"?

A.1 Replacement ratio or replacement rate is an index which summarizes unemployment benefits entitlements relative to earnings. It can be expressed in brief by the following mathematical expression:

$$\text{Replacement ratio} = \text{Unemployment benefits entitlements} \div \text{Earnings}$$

A.2 This index shows in brief how much of a person's previous earnings is replaced by his or her unemployment benefits entitlements when he or she is unemployed. If 60% is replaced, it means this unemployed person loses 40% of his or her previous earnings through unemployment.

A.3 This index is also an indicator of how generous the unemployment benefits system is. The higher the proportion of previous earnings is replaced, the more generous the system is.

#### What Determines the Generosity of Unemployment Benefits System?

A.4 The "unemployment benefits entitlements" in the nominator of "replacement ratio" comprises all incomes to which an unemployed person is entitled. It can be mathematically expressed as follows:

$$\text{Unemployment benefits entitlements} = \text{Incomes out of work}$$

A.5 Incomes out of work include: Unemployment Insurance payment until exhaustion of benefit duration where applicable + Unemployment Assistance payment until exhaustion of benefit duration where applicable + Social Assistance (which must be measured with care as Social Assistance is usually of indefinite duration).

A.6 It can be seen that the longer the benefit duration is, the higher the nominator becomes, and in turn, the higher the replacement ratio is. Similarly, the higher the level of benefit payment is, the higher the nominator becomes, and in turn, the higher the replacement ratio is.

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### Is there One Replacement Ratio for One Country?

A.7 It should be noted that replacement ratio differs for different types of family: single individual, couple and couple with children. The aggregate replacement ratio of a country is arrived at only after complicated statistical applications.

A.8 Replacement ratios are commonly used to compare the generosity of the unemployment benefits system of different countries. It is also a commonly used index to determine domestic unemployment benefits.

### Net Replacement Ratio or Net Replacement Rate

A.9 Where the effect of taxation is not included in either the denominator or the nominator, the replacement ratio summarizes gross unemployment benefit entitlements relative to gross earnings.

A.10 Taxation (including Social Security contributions), benefits to children (i.e. Family Benefits), Social Assistance and Housing Benefits can have large impacts on the level of replacement rate. The net replacement ratio can be expressed in brief by the following mathematical expression:

A.11 Net replacement ratio = (Unemployment benefits entitlements – tax – social security contributions + Family Benefits + Social Assistance + Housing Benefits) ÷  
(Earnings – tax – Social Security contributions + Family Benefits + Social Assistance + Housing Benefits)

A.12 It should be noted that net replacement ratio differs for single individual, couple and couple with children. The aggregate net replacement ratio of a country is arrived at only after complicated statistical applications.

### What is the Significance of Net Replacement Ratio?

A.13 As tax and social security contributions lower both the nominator and denominator in the net replacement ratio, it may result in different replacement ratios before and after tax, depending on the taxation structure. In most Organization for Economic Co-operation and Development (OECD) countries, the net replacement ratio is about ten percentage points higher than the gross replacement ratio. This means that the unemployed effectively loses less income if he or she becomes unemployed. In other words, taxation effectively increases the generosity of the unemployment benefits system. Sometimes, taxation may act in the other direction and will penalise the unemployed by resulting in lower unemployment benefits. This index is useful where there is a need to study the relationship between taxation, unemployment benefits system and the level of unemployment.

Is there any Effect of the Replacement Ratio on the Level of Unemployment?

A.14 The unemployment benefit system provides insurance against job loss which individuals would find extremely difficult, if not impossible, to obtain from private insurers. Benefits also allow the unemployed to search for a job which matches their abilities, rather than being forced by financial hardship into accepting the first available job offer. Having the right people in the right jobs raises productivity and reduces the chance of them becoming unemployed in future. In this way, unemployment benefits can help labour markets work more effectively.

A.15 But unemployment benefits can also have negative effects on labour markets and social welfare. By “freeing” the unemployed from having to take less ideal jobs, they increase the duration of unemployment spells. Unemployment benefits also alter incentives in wage bargaining. If the financial consequences of unemployment are harsh, workers will be wary of pushing up wages and so risking their jobs. Furthermore, unemployment benefits can subsidise seasonal employment patterns. Without countervailing factors, the higher benefits are relative to earnings, the higher unemployment will be.<sup>6</sup> Hence, a higher replacement ratio might result in due course in higher unemployment.

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<sup>6</sup> OECD, *Employment Outlook*, July 1996, p. 28.

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