

Labour market snapshot #71 November (19) 2020

Jeff Borland
Department of Economics
University of Melbourne

Would a rise in JobSeeker affect incentives for paid work?

Overview

Opponents of increasing the JobSeeker payment argue it would adversely affect incentives to search for and take up paid work. The main evidence cited in support of this argument (as far as I can tell) is anecdotal. Examples of individual employers saying that the COVID-19 JobSeeker Supplement is making it more difficult to hire are interpreted as proof that a permanent increase in JobSeeker would damage incentives for paid work.

In this Snapshot, I examine economy-wide evidence on how incentives would be affected by an increase in the JobSeeker payment. This is done taking particular account of evidence on the impact of the COVID-19 JobSeeker Supplement on labour market dynamics and outcomes in Australia.

The main conclusions drawn are:

1] No significant financial disincentive for jobseekers to shift into employment should result from increasing JobSeeker – including, by way of example, by the amount of the current COVID-19 supplement (\$125 per week);

2] The COVID-19 JobKeeper Supplement has not affected the speed with which jobs are being filled or caused a large-scale shortage of labour. Hence, experience with the Supplement does not provide evidence that a permanent increase in JobSeeker would harm labour market efficiency; and

3] The main drivers of labour supply in Australia since the onset of the pandemic have been macroeconomic conditions and direct effects of COVID-19.

1] No financial disincentive effect

Decisions about whether to take up extra work occur on different margins. The extensive margin is whether to move into work from unemployment – for example, a JobSeeker recipient who is not in paid work may have the opportunity to move into full-time employment. The intensive margin is the amount of time worked – for example, a JobSeeker payment recipient who is currently working may need to decide whether to agree to extend their current amount of work by an extra day.

Shift from no work to full-time employment

The size of the JobSeeker payment could increase by a substantial amount without significantly reducing the relative monetary returns from working compared to receiving only the payment.

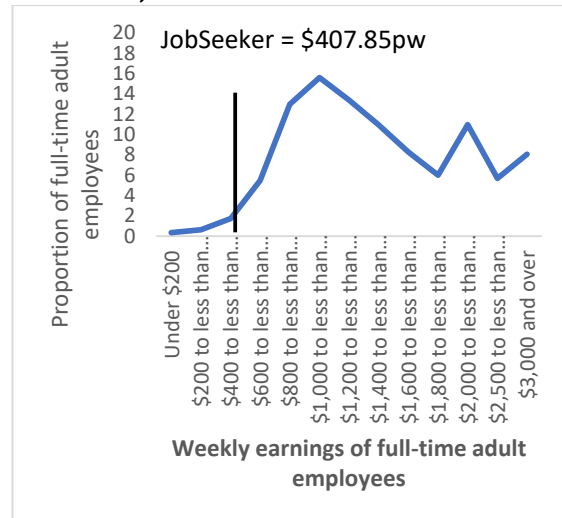
One comparison is with the National Minimum Wage (NMW). Currently, the NMW is \$753.80. Was JobSeeker to increase by \$125 per week, it would be only 54.1 per cent of the NMW. Increases in JobSeeker of \$100 and \$200 per week would make it 50.8 per cent and 64 per cent of the NMW, respectively.

Comparison with weekly earnings of the current workforce provides an even stronger message about the minimal disincentive effect from an increase in JobSeeker. Chart 1 shows the distribution of weekly earnings of full-time adults in Australia in 2019. An increase in the JobSeeker payment of \$125 per week would place a recipient at just the 1st percentile of the distribution. That is, 99 per cent of full-time employees are earning more than the increased JobSeeker payment.

Even if it was thought that JobSeeker recipients were mainly likely to move into jobs at the bottom of the distribution of earnings, there would still be a substantial gain in their incomes from doing that. For example, a worker at the 10th percentile had weekly earnings of \$848 per week in 2019. So only moving to a job at the 10th percentile would still more than double the income of a JobSeeker recipient, even with a \$125 per week increase.¹

¹ In fact, the majority of JobSeeker recipients are likely to obtain employment with higher earnings. For example, while the average education attainment of employed persons is above unemployed persons, there are still sizable proportions of unemployed persons who have high

Chart 1: Jobseeker payment (increased by \$125 per week) compared against the distribution of full-time adult weekly earnings, Australia, 2019



Source: ABS, Characteristics of Employment 2019, Tablebuilder.

Increasing current time worked by a day

Should the JobSeeker payment be increased by \$125 per week, recipients would retain a significant financial incentive to work extra days. Table 1 (on the final page of the Snapshot) shows financial gains from extra days of employment - the total gain compared to no work and the marginal gain from an extra day of work. These are shown for the pre-COVID-19 JobSeeker payment without the Supplement (1); and under the scenario where the JobSeeker payment is increased by \$125

levels of attainment – 19.2 per cent with a Bachelor degree or above and 25.6 per cent with Certificate III/IV or Advanced Diploma (compared respectively to 32.3 per cent and 30.0 per cent for employed persons) (ABS, Characteristics of Employment 2019, Tablebuilder).

per week (2). Calculations reported assume income testing arrangements remain the same as they were pre-COVID-19; and make adjustments for income tax and the Medicare levy.

Under both scenarios, the gain from an extra day of employment is always positive. Was JobSeeker to be increased by \$125 per week, the marginal gain from working an extra day is similar to pre-COVID-19 arrangements for the 1st to 3rd days of work, and smaller for the 4th and 5th days. The smaller gains from working on the 4th and 5th days are due to the JobSeeker payment cutting out after 3 days at present, but only cutting out on the 5th day if the payment was increased by \$125. However, calculations reported in Table 1 assume income test arrangements remain as at present. Hence, by also adjusting income test arrangements at the same time as increasing the JobSeeker payment, it would be possible to smooth the marginal financial gain from an extra day of work across days – thereby increasing the financial gain from working on the 4th and 5th days.

Non-financial incentives for work

Comparing the monetary earnings from work to the JobSeeker payment substantially understates the incentive to move from unemployment to work. There is by now a substantial body of empirical research that establishes a significant positive causal impact of employment on health and psychological well-being. These impacts are generally estimated to be large – for example, some studies of the determinants of happiness find that the non-financial returns to work outweigh the financial returns.²

A positive incentive for work from higher JobSeeker?

Searching for work takes time and costs money. A higher level of JobSeeker payment would reduce financial stress and therefore allow recipients more time and ‘bandwidth’ to commit to job search. It would also provide greater capacity to pay for job search-related costs such as paying for transport to or clothing for interviews.³

² For reviews of this research, see Rainer Winkelmann (2014), ‘Unemployment and happiness’, *IZA World of Labor*, October; <https://wol.iza.org/uploads/articles/94/pdfs/unemployment-and-happiness.pdf>; and Colin Mathers and Deborah Schofield (1998), ‘The health consequences of unemployment: The evidence’, *Medical Journal of Australia*, 168(4): 178-82.

³ On time and bandwidth effects, see Sendil Mullainathan and Eldar Shafir (2013), *Scarcity* (Picador), p.4. On cost effects, see John Daley et al. (2020), ‘The recovery book: What Australian governments should do now’, Grattan Institute Report; accessed at: <https://grattan.edu.au/report/recovery-book/>

2] No evidence of impact of COVID-19 Supplement on incentives to work

Does the impact of the COVID-19 JobSeeker Supplement suggest that there would be a significant disincentive effect from a permanent increase in JobSeeker?

The COVID-19 Supplement adds a specified amount (initially \$250 and currently \$125 per week) to the usual payment. The whole of the Supplement is retained until the last dollar of the JobSeeker payment is lost. This latter feature has created a 'benefit cliff', where a JobSeeker recipient's total income drops by the entire amount of the COVID-19 Supplement. For a single adult on the minimum wage, the cliff occurs when a JobSeeker recipient shifts from working 27 hours to 28 hours.⁴

There are two potential incentive effects associated with the COVID-19 Supplement:

i] The higher payment level (for hours of work up to where the Supplement is removed) could reduce the incentive to move from unemployment to work; and

ii] The benefit cliff causes a large negative incentive to increase hours of work from just below to above the

number of hours at which the JobSeeker payment is exhausted.

Of these potential effects, it is the impact of a higher payment level that is relevant to assessing how a permanent increase in JobSeeker would affect incentives. (This is because the benefit cliff can easily be removed by tailoring the income test appropriately.⁵)

Hence, it is most relevant to assess the impact of the COVID-19 Supplement on incentives using measures of labour market outcomes that only (or mainly) reflect the impact of the higher level of payment, and not the benefit cliff.

Labour market flows from unemployment to employment

Labour market flows from unemployment to employment is one such measure. Any incentive effects from the COVID-19 supplement should be evident in a reduced likelihood of movement from unemployment into jobs with hours of work at which the Supplement is received.⁶ On average about 60 per cent of flows from unemployment are into part-time work (that is, jobs with hours of work where the relative monetary return from taking paid work should be affected by the COVID-19 supplement). Hence, any

⁴ See the analysis in Peter Whiteford (2020), 'When the Coronavirus Supplement stops, JobSeeker needs to increase by \$185 per week', *The Conversation*, May 21; <https://theconversation.com/when-the-coronavirus-supplement-stops-jobseeker-needs-to-increase-by-185-a-week-138417>

⁵ It follows that the benefit cliff is not a justification for not making a permanent increase to the JobSeeker payment.

⁶ Above that number of hours there should be no difference in incentives compared to before the Supplement was introduced, because the Supplement has cut out.

substantial effect from the COVID-19 Supplement on incentives should be observable in a slower rate of transition from unemployment to employment.

But monthly gross flows data from the ABS show that there has been no decrease in flows from unemployment to employment following the introduction of the Supplement. Charts 2a and 2b show monthly data on the proportion of unemployed persons who moved into employment in 2020 and 2017-19 – respectively for all labour force participants and participants aged 15 to 24 years.

In both Charts it can be seen that – as would be expected due to the severe downturn – the proportion of unemployed persons moving into employment decreased from March to April. But with the commencement of economic recovery, the proportion flowing into employment has returned to the same level as in 2017-19. For young people the flow has been slightly higher in 2020 than the earlier years. Hence, there is no evidence from labour market flows data that the COVID-19 Supplement has decreased the speed of movement from unemployment to work.

Chart 2a: Flows from unemployment to employment, February to September, All labour force participants

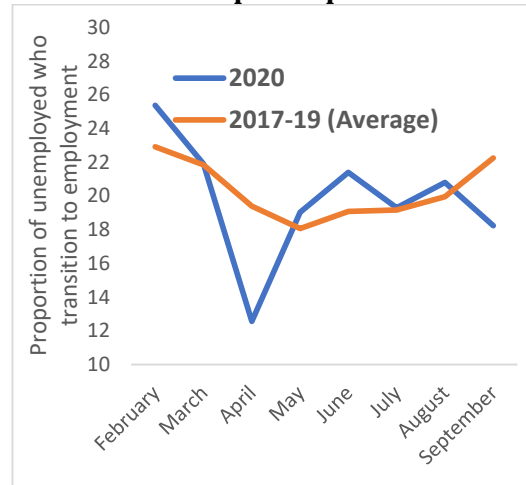
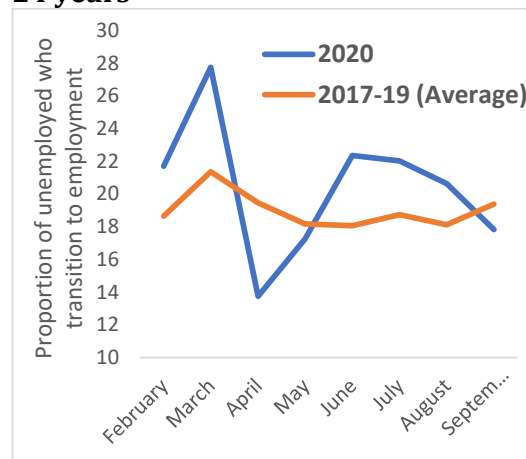


Chart 2b: Flows from unemployment to employment, February to September, Labour force participants aged 15 to 24 years



Source: ABS, Labour Force Australia, GM1.

Vacancy rates

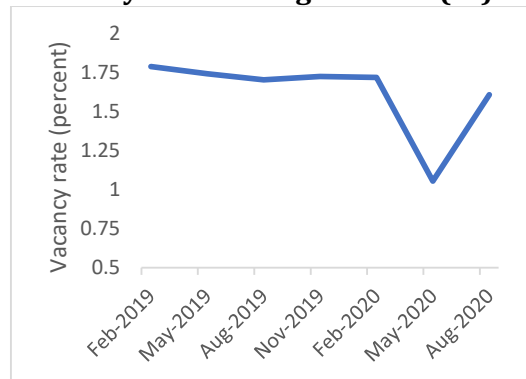
A disincentive effect of the COVID-19 Supplement on JobSeeker payment recipients taking up paid work would imply more difficulty in filling job vacancies. Any disincentive effect again should mainly reflect the increase in the level of JobSeeker due to the Supplement (although perhaps the

benefit cliff might also have a minor impact by reducing incentives to take on an extra job that would push total hours of work above the cliff).

Charts 3a and 3b show vacancy rate series from February 2019 onwards from (respectively) the ABS and Department of Employment, Skills and Education. The vacancy rate is measured as: $\text{Vacancies}/(\text{Employment} + \text{Vacancies})$. It provides a measure of the extent to which jobs which are available in Australia are remaining unfilled.

Both series show that the vacancy rate decreased in the initial months of the downturn in economic activity due to COVID-19; and since then has returned to be close to previous levels. But there is no evidence of a large upward shift in the vacancy rate, as would be expected if the COVID-19 Supplement was having a major impact on incentives to work.⁷

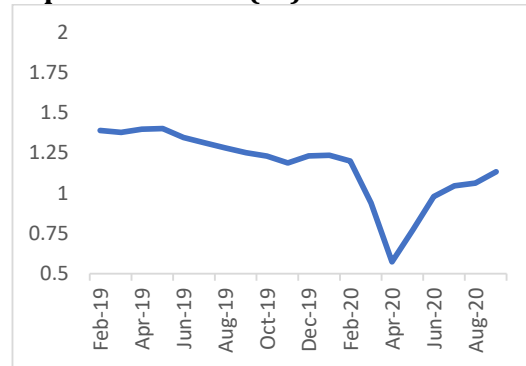
Chart 3a: Vacancy rate (ABS), February 2019 to August 2020 (sa)



Source: Employment – ABS, Labour Force Australia, Table 1; Vacancies – ABS, Job Vacancies Australia, Table 1.

⁷ In recent months, the vacancy rate has increased a little relative to the rate of unemployment. This pattern of movement is what is predicted during the initial phase

Chart 3b: Vacancy rate (DESE Internet ads), February 2019 to September 2020 (sa)



Source: Employment – ABS, Labour Force Australia, Table 1; Vacancies – Department of Employment, Skills and Education – Vacancy Report: <https://lmip.gov.au/default.aspx?LMIP/GainInsights/VacancyReport>

The state of the aggregate labour market

During 2020, the Australian labour market has been through its most rapid period of adjustment ever. Chart 4 shows that monthly hours worked decreased by 10.4 per cent from March to May, and then recovered by 5.3 per cent through to September. Never before have hours of work in Australia decreased and increased so rapidly.

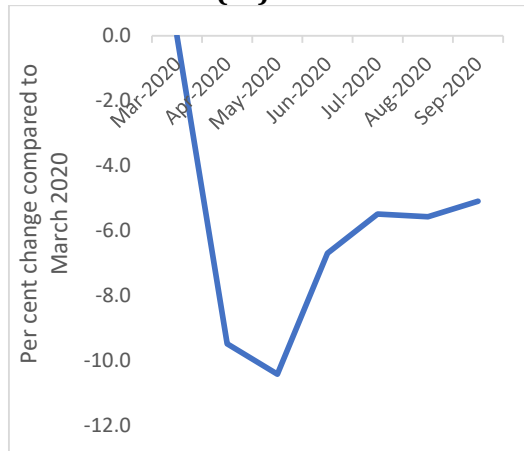
This pace of adjustment shows remarkable flexibility in the Australian labour market – especially taking into account the difficulty of rehiring of so many workers in such a short period of time. With adjustment to recovery occurring so rapidly, it seems impossible to regard the JobSeeker

of economic recovery by standard models of the Beveridge curve (see for example, Pierre Cahuc and Andre Zylberberg, 2004, *Labor Economics*, MIT Press, pp.547-48).

Supplement as constituting a major impediment to employment in Australia.

At the same time, it is important to be aware that adjustment in a labour market is never instantaneous. The process of recruiting for and filling job vacancies takes time – and that time will usually be longer when a larger scale of adjustment is required, such as at present. The rapid increases in labour demand that have occurred as COVID-19 has been brought under control and restrictions on economic activity relaxed, and the extent of structural change occurring in labour demand and supply due to COVID-19, make it almost inevitable that there will be some sectors where adjustment takes longer than usual – regardless of the COVID-19 Supplement.

Chart 4: Monthly hours worked, Australia, Per cent change compared to March 2020 (sa)



Source: ABS, Labour Force Australia, Table 19.

Employers' perceptions of the difficulty in finding labour

It is important to note that employers expressing difficulties in finding labour is a constant feature of the labour market. For example, in 2018 and 2019, well before the introduction of the COVID-19 Supplement, about 45 per cent of employers expressed that they had recruitment difficulty in their most recent recruitment round. Yet at the same time, there was an average of about 20 applicants per job.⁸ Hence, instances of employers finding it difficult to recruit workers in 2020 cannot be taken as evidence of a disincentive effect from the COVID-19 Supplement.

3] Drivers of labour supply during the COVID-19 pandemic

Changes to labour supply during the COVID-19 pandemic have primarily reflected direct impacts from COVID-19 and the flow-on effects to macroeconomic activity.

First, job search activity of individuals wishing to work has responded strongly to perceptions of the likelihood of obtaining work. In particular, many jobseekers appear to have been discouraged from active search during the initial phase of the COVID-19 recession. One way this can be seen is in an increased proportion of

⁸ See National Skills Commission (2020), Survey of Employers' Recruitment Experiences: 2019 Data Report, Table 4.

individuals who, having lost their jobs, did not undertake any job search.

Table 2 shows the proportion of individuals who moved out of the labour force directly from employment for March to May 2020– both for 2020 and the average for 2017-19. That proportion increased substantially from March to April and April to May – consistent with a large deterrence effect on job search due to the decline in economic activity.

Table 2: Proportion of monthly flows into out of the labour force accounted for by flows from employment, March to May

	All	
	2020	2017-19 (average)
February to March	42.7	51.2
March to April	63.8	49.0
April to May	64.1	49.7

Second, with the closure of international borders following the onset of COVID-19, the available supply of labour from temporary immigrants has decreased substantially. The number of temporary visa holders in the categories most likely to be employed (students; working holiday makers; temporary employment (skilled and general)) was 259 thousand lower in September 2020

⁹ Department of Home Affairs (2020) – Excel file on ‘Number of temporary visa holders in Australia at 2020-9-30’.

¹⁰ In Victoria, the decrease in the Labour Force Participation rate from March to

than a year previously.⁹ This is likely to be making it more difficult to fill vacancies in occupations where temporary migrants make up a large proportion of the workforce – such as fruit picking.

Third, shutdowns due to COVID-19 have caused some withdrawal from the labour force and decreased hours worked – especially for females – due to the need to care for children. This likely explains why Australia-wide there were larger decreases in the labour force participation rate for females than males from March to May; and why that pattern has persisted in Victoria where a shutdown was reimposed in July.¹⁰

September 2020 was 3.1 ppts for males and 4.4 ppts for females (ABS, Labour Force Australia, Table 12).

Table 1: Gains from part time employment for a single adult on Jobseeker Payment

Days worked per week at minimum wage	0	1	2	3	4	5
Gross earnings (\$pw)	0	151	302	452	603	754
(1) Pre-COVID Jobseeker rate & income test						
Jobseeker Payment	287	236	146	55	0	0
net gain from employment	0	100	159	203	274	395
marginal gain from working an extra day		100	59	44	71	125
(2) \$125pw increase in base Jobseeker rate & pre-COVID income test						
Jobseeker Payment	412	361	271	180	90	0
net gain from employment	0	93	148	182	221	270
marginal gain from working an extra day		93	55	34	39	49

Source: Plunkett model, from @DPlunky.

Note: Includes income tax and Medicare levy.