

HIGH UNEMPLOYMENT

A CHALLENGE FOR INCOME SUPPORT POLICIES

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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A national expert's meeting on "Unemployment Insurance Issues and Alternative Uses of Unemployment Benefit Funds", jointly sponsored by the OECD and the Bundesanstalt für Arbeit, was held in Nuremberg, Germany, on 8 and 9 November 1982. Six papers presented at this meeting are included in this volume. They include analytical studies on factors underlying the growth of expenditure on unemployment insurance, the statistical documentation and commentaries on the papers. Four important topics discussed at the meeting were:

1. The "Costs" of Unemployment;
2. Major issues in Unemployment Compensation policy in the present labour market situation.
3. The Wage-Replacement function of unemployment compensation programmes;
4. OECD Member countries' practices in alternative uses of unemployment insurance funds.

The conference led to two days of debates about the costs of prolonged unemployment, alternative uses of unemployment insurance funds, and general policy prescriptions. Broadly, there were two schools of thought. One argued in favour of restrictive policies being continued to combat inflation. The rationale behind this view was that the ultimate benefits of such policies would eventually outweigh the costs attached to long periods of low or zero economic growth. According to the other school of thought, the importance of stabilizing or lowering unemployment has risen relative to that of pursuing anti-inflation efforts with vigour. Two reasons were cited: the sharp fall in inflation and the non-linear rise of economic and social costs flowing from protracted unemployment.

There was general agreement that the structural component of unemployment has increased over time largely reflecting demographic trends, higher female participation rates, continued advances in real total labour costs, and accelerated obsolescence of the capital stock due to feeble economic growth. Cuts in real wages relative to productivity were seen as desirable to improve profitability. Given the initial deflationary effects of such cuts, restrictive policies needed to be eased, at least temporarily as a bridging operation.

In other respects policy conclusions diverged sharply. Proponents of the first school of thought showed little inclination to consider the costs of prolonged unemployment in all of their dimensions. In

their view, special labour market policies create economic problems because of their expenditure-raising character. Adherents to the second one viewed such policies as increasingly important, given prospects of low medium-term growth and the attendant danger of skill erosion and lack of job experience.

According to this latter group, there are various avenues other than unemployment compensation through which unemployment tends to raise public spending: prolonged unemployment adversely affects physical and mental health; given the strong concentration on low paid employees, it increases poverty over time, and with it, crime and family disorder; and through the erosion of skills and the obsolescence of the capital stock unemployment tends to raise the full capacity unemployment rate weakening the cyclically adjusted public sector's financial position. Furthermore, through capital shortages and skill mismatches, protracted unemployment affects the cyclical behaviour of inflation in periods of expansion - a point often overlooked by those who assign a high priority to bringing inflation under control through pronounced economic slack.

Most participants were ready to agree that the quantification of the above effects presented formidable theoretical and empirical problems. They also tended to share the view that judging from circumstantial evidence they were important and growing in strength over time, especially in countries with a high proportion of long-term unemployment.

Placed into the above context, the alternative use of unemployment insurance funds was regarded as a means of avoiding some of the public expenditure-raising effects of prolonged unemployment, i.e. skill erosion is attenuated, and the health consequences are mitigated. Member countries' experience in this area, however, was found to be limited and, often, lacking in coherence. In general, scepticism tended to prevail among some participants as to possible generalisations concerning which alternatives, for whom, at what net cost for governments and with what effectiveness and economic efficiency implications. All countries appeared to be well aware of the problems of balance they were facing between the fiscal side of government worries about costs and how to reduce growing spending, and social concerns about the impact of government programmes and services to people. It was, however, felt that the cost/benefit sides of the various labour market programmes alternative to unemployment compensation were not sufficiently explored and results not yet firmly established. This area of research was indeed suggested as a major area of work for the Secretariat. But, apart from clarifying the questions involved, it was obvious that because of the state of the art, the meeting could not yet produce

the answers policy-makers would need for more effectively and efficiently integrating income and active labour market policies.

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INTRODUCTION

by
W.R. Dymond

Unemployment compensation concerns people: people made vulnerable and insecure by an indefinite loss of employment and, consequently, their main if not only source of income; but also people suffering a temporary interruption in employment, such as seasonal workers, or a reduction in hours worked, or who are in the process of changing jobs. In some Member countries, even first time job-seekers may be covered.

In OECD Member countries, cash payments to unemployed workers for unemployment compensation have risen over the years 1970-81, on average from about 0.39 per cent to over 1.2 per cent of GDP and from 1.03 per cent to 2 $\frac{3}{4}$ per cent of public expenditure.

In spite of its high annual growth rate since the first oil shock, unemployment compensation cannot be regarded as a large expenditure area compared to other income-maintenance programmes. Yet, behind the relatively low expenditure figures for unemployment compensation there is a programme whose effects are spread widely throughout the population and the economy.

Available statistics for the seven largest OECD Member countries put the number of weeks of compensated unemployment at about 330-380 million in 1980; and at well over 20 million the number of unemployed workers whose income was supported. Including dependents, the number of persons relying on unemployment benefit can be estimated in the region of 40-45 million persons. Clearly, few other government programmes affect the life of as many people as unemployment compensation. Indeed, if financing arrangements were to be taken into account and employers and employees paying contributions to UI funds are included, the number of persons and groups affected by what governments decide on unemployment compensation is much greater than the 40-45 million figure.

In this context, the array of views concerning the role, functions, effectiveness and impact on the economy of unemployment insurance is bound to be wide and divergences to be sharp. A corollary of this is that to reflect in unemployment insurance programmes the needs of the existing economic and social environment; and the

view of governments, of workers (as beneficiaries as well as contributors), and of trade union and business representatives is a major and difficult task - as indeed many governments have discovered.

Reforms of unemployment insurance programmes of one type or another have been advocated and tried, often on a piecemeal basis, over a number of years now in several Member countries, e.g. United States, United Kingdom, France, Canada and Finland. The reasons have been many and varied. Changes which were easy to implement when systems were liberalised in the early '70s have, however, met with increasing resistance as greater stringency and less generosity have come to be required. Two conclusions seem to emerge from these attempts in Member countries. The first is that it is important to recognise that insistence on maintaining policies developed at a time of low and mainly frictional and cyclical unemployment is not only ineffective and inefficient but also leads to compounding the budget problem facing UI systems. The second is that the implementation of successful reforms requires an effort to reach public consensus by expanding the area of discussion of economically necessary and politically feasible options.

Two fundamental questions require careful analysis and review as a basis for thinking about the nature of the reform problem and to expand the area of public debate:

- the original role and functions of unemployment compensation programmes;
- changed labour market conditions and needs and how unemployment compensation schemes could be improved by adapting them to new conditions within the limits imposed by present economic prospects and public sector financial constraints.

a) Original Role and Functions of Unemployment Compensation Schemes

Three quarters of a century have passed since the first scheme of unemployment compensation was enacted in an OECD country. This event signalled the beginning of a new trend in industrial countries: away from the dole method of relief, with its pauper stigma, towards compensation as a right for all persons unemployed through no fault of their own.

By the end of the 1940s, practically all Member countries had adopted a programme of unemployment compensation although the proportion of covered workers remained limited - often to no more than half of those in the labour force. Only in the late '60s and early 1970s did programmes expand to reach coverage figures of over 70 per cent (1).

Unemployment compensation developed as an alternative to "relief work" which had begun to be criticised, to quote from William Beveridge, on grounds:

"...of the expense; as involving interference with independent labour; as weakening the incentive to self-help and individual or collective thrift; as demoralising men by accustoming them to earn only half their wages".(2)

The failure of "relief work" as a policy for poverty had become evident as events shook the belief that any man who really wanted employment could always obtain it. The steady, if gradual, growth of the sense of public responsibility for the unemployed led at first to the removal, in their special case, of most of the disqualifications of the Poor Law until then attached to relief work (e.g., in the United Kingdom, with the 1905 Unemployed Workmen's Act) thus leading to the inclusion of unemployed workers among the "deserving" poor. Later on, as relief work showed its limits, such as the cost of unemployed labour and its productivity being much above and much below, respectively, that of ordinary labour (3). Events gradually led to a recognition that unemployment and not the unemployed is the problem, the income support and job provision policy functions of government were separated: employment and the creation of jobs became an economic policy aim; income maintenance a social policy objective.

By the end of the 1930s, this separation between economic ministries' responsibility for the level of unemployment (i.e. the full employment goal) and social ministries' responsibility for a more equitable distribution of the economic risk of unpredictable unemployment had already been established in a number of Member countries. For instance, in 1935 a U.S. President's Committee on Economic Security report described the role of unemployment insurance in the following way:

"There is considerable misunderstanding as to what unemployment insurance can be expected to do in solving the problem of unemployment. Unemployment insurance will not furnish jobs for idle workers, nor will it eliminate unemployment. The primary function of unemployment insurance is to distribute more equitably the economic risk of unemployment ... in this respect (it) is analogous to fire insurance"(4)

and a 1937 pamphlet published by the U.S. Social Security Board emphasized that:

Unemployment compensation is a method of safeguarding individuals against distress for a short period of time after they become unemployed. It

is designed to compensate only employable persons who are able and willing to work and who are unemployed through no fault of their own. Instead of making the individual get along on a steadily descending level of living until he has exhausted the last shred of his savings, credit, and the generosity of his relatives and friends, thus reaching a point of destitution at which he is eligible for relief, unemployment compensation sets aside contributions during periods of employment and provides the individual with benefits as a legal right when he becomes unemployed. During the periods of prosperity a fund is built up, to be available for the payment of benefits in the periods when industry fails to maintain employment. Unemployment compensation is not a system under which every unemployed person is assured of benefits for any and all unemployed time. It provides protection primarily for the persons who normally are steadily employed"(5).

Originally, therefore, unemployment insurance was only intended to alleviate the distress consequent on unemployment; not to prevent unemployment nor to be a welfare programme for minimum income. In general terms, then, it was introduced to perform two explicit functions:

- a) an aggregate income maintenance function or inter-temporal redistribution of aggregate purchasing power. Reserves are accumulated in time of full employment and used to pay out partial compensation in time of unemployment. Contributions and benefits are negatively and positively related, respectively, to unemployment and should, in principle, function as an automatic stabilizer steadying fluctuations in the economy;
- b) an insurance against personal losses function or between groups' redistribution of purchasing power. The risk of unemployment being widely shared and unpredictable, an analogy exists with private insurance principles of pooling of personal risk.

Subsequently, however, especially in the post-World War II period, other functions have been attributed to unemployment insurance, such as:

- i) improving the functioning of labour markets, and
- ii) employment stabilization at enterprise level.

Some would argue that these are not functions intrinsic to unemployment insurance but specific functions or effects dependent upon a number of institutional aspects such as financing methods, interaction with other welfare

programmes, eligibility requirements, level and duration of benefit and so on. It is, however, clear that in today's systems all these various objectives are intertwined no matter how implicitly or explicitly they are stated. Their balance can change across countries and over time, but nowhere can the important connection between the income protection and the labour market roles of UI be denied.

b) Changed Labour Market Conditions

Even to a casual observer it is obvious that labour market conditions have been changing dramatically since the early 1970s.

Unemployment which was generally low and mostly frictional and cyclical until the late 1960s, is now high and has an important structural component. Even with the resumption of economic growth, unemployment will still remain substantially above the levels prevailing before the first oil shock, for at least some time.

In the post-World War II period and in the '60s the greatest proportion of unemployed came from the rank of workers with low education and skills. Nowadays white-collar workers and workers with higher education also suffer unemployment. Bread-winners as well as secondary or other earners are found among the unemployed. The proportion of women and youth among those looking for a job is substantial. Redundant workers are increasingly numerous(6). Also characterising today's labour markets is the development of a number of additional income support schemes, such as redundancy pay schemes and an array of selected labour market programmes.

What do these changes mean for unemployment insurance systems? Labour market conditions, as well as policies, have clearly grown in complexity and become more diversified. When unemployment was low and mainly frictional and cyclical, providing money and thus time to find another job also helped to bring about a better match between workers and jobs. Now that unemployment is high and has a substantial structural component this complementarity of income support and labour market functions of unemployment insurance schemes is no longer clearly apparent. Indeed, the balance between these two functions in current unemployment insurance schemes can be questioned as it seems it is not doing enough to promote employment and the efficient functioning of labour markets. In the present juncture of economic conditions, therefore, an imbalance has developed in unemployment insurance schemes between income support and labour market functions; thus the need for a reconsideration of the unemployment insurance systems in terms of their basic function, design, target groups and levels and duration of benefit.

The reform task ahead will not be easy. Maintaining the status quo, however, needs to be set against issues such as:

- i) higher payroll taxes for unemployment insurance which in various Member countries are required to ensure correspondence between contributions and benefit or to avoid increases in unemployment insurance fund deficits. Can, however, industry and business sustain higher payroll taxes with their adverse effects on employment?
- ii) possible effects of unemployment insurance on the rate of money/wage inflation and on real wage flexibility. Current research does not lead to a firm conclusion on whether unemployment benefits affect the reservation wage. Nevertheless, this very important question cannot be ignored.
- iii) great disparities amongst the unemployed, some of whom have their income maintained through unemployment insurance, redundancy payments, etc., and some not (e.g. many youth and females); some get very high wage replacement rates and some very low ones.
- iv) respective role of unemployment insurance and labour market services. Can present relationships be considered satisfactory? Are there co-ordination problems?
- v) Does paying cash out of unemployment insurance funds best serve the interest of unemployed workers? Is this the only option permitted by current unemployment insurance systems? Or, if more effective and efficient alternatives are possible, what are they? What is implied by them in terms of integrating cash and services, identifying qualifying people, policing for availability for employment and so on?

Processes of questioning current unemployment schemes can, and sometimes rightly so, be feared in that they may hide attempts to put the clock back and thus seriously undermine social protection programmes which took over fifty years to be universalised to the working population. The intent, however, can be quite the opposite, namely to search for indications and ideas throughout the industrialised world in order to help policy makers improve on current systems so that the tasks assigned to unemployment insurance schemes can be implemented better and possibly at a lower cost and without seriously sacrificing human welfare.

FOOTNOTES

1. See Chapter I, Table 3.
2. See W.H. Beveridge, Unemployment: A Problem of Industry, Longmans Green and Co., London, 1917, p.191.
3. On this point see W.H. Beveridge, op. cit., Chapter VIII, especially pp. 176-180.
4. See Toward Economic Security, quoted in C. Warden, Jr., "Unemployment Compensation in Massachusetts", in O. Eckstein (ed.) Studies in the Economics of Income Maintenance, The Brookings Institute, Washington, D.C. 1977, p.26.
5. U.S. Social Security Board, Unemployment Compensation, What and Why? Publication No. 14 (1937) p.7.
6. See OECD Employment Outlook, Paris, 1983.

