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The jobs compact

Why the reform is right

Bruce Chapman

THE centrepiece of the government's White Paper is the Jobs Compact. It represents the guaranteed offer of work or training options for those continuously unemployed for eighteen months or more, and encourages the institution of a training wage. In the context of the history of Australian labour market policy it is a radical intervention. But given the strength of the case for reform, and the possible modesty of the likely success of the program to be implemented, it can also be seen to be a moderate change.

There is an overwhelming argument for intervention in the directions proposed. The very long-term unemployed are disadvantaged for reasons above and beyond the effects of long unemployment itself.

There are other reasons as well for the compact. The macroeconomy works less well, in several dimensions, when long term unemployment is high. These points are considered briefly in the next section.

The third section examines the changed targeting of programs and the increase in expenditure on the current wage subsidy scheme, JOBSTART, that make up the important part of the compact. This is a considerable reorientation of Australian government expenditure related to unemployment, away from the passive and towards the active.

In the fourth section the issue of the training wage is explored. There are sound reasons for considering changes in Australian awards in this direction, to increase the extent and quality of both off-the-job and on-the-job training. While the training wage is unlikely to be the panacea for long term unemployment over the next few years, it at least addressed one of the main challenges for the compact: how to assist the new arrangements so as to maximise the chances for bringing long term unemployed back into the mainstream of the skilled labour force.

The paper then discusses some major challenges for the compact. The first is for the policy approach to deliver permanent changes in the actual and perceived skill levels of the long-term unemployed. It is suggested that the efficacy of the so-called 'new work opportunities'

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will be fundamental to the likely success of the compact, since JOBSTART will not be sufficient. The second is that without considerable economic growth in the next few years the chances of the compact delivering what is needed is close to zero; how to ensure that the recovery is sustained must now be the major preoccupation for policy.

The case for targeting policy to long term unemployment

The essence of the compact is the targeting of additional expenditure on employment and training options on people unemployed continuously for eighteen months or more. It amounts to an eventual job guarantee. There is, however, a 'reciprocal obligation', in that those refusing 'reasonable' offers of assistance will have social security benefits withdrawn for a period. The latter aspect is not new, representing only a further development of arrangements introduced in the Active Employment Strategy in 1990.

There are three compelling reasons for increasing targeted assistance for the long-term unemployed. The obvious one concerns equity: members of the group are some of the least advantaged people in Australia. Compared to the rest of the labour force they are more likely to be immigrants from non-English speaking backgrounds or from Aboriginal and Torres Strait Islander communities, to have low levels of educational qualifications, and by definition they are not accumulating on-the-job experience. These issues are explored further in the White Paper, and in Junankar and Kapuscinski (1992) and Chapman (1993a).

The second reasons is less well understood but no less important. It is becoming clear that high levels of long term unemployment make the macroeconomy less efficient. There are two related dimensions of this issue.

One dimension concerns the structural mismatch between measured unemployment and job vacancies when long term unemployment is high. Those experiencing on-going unemployment are losing skills, or at least will be perceived to be less productive by prospective employers. As a result, the long-term unemployed are considered less relevant to the filling of new job openings. This suggests that at any given level of labour demand, as measured by job vacancies, there will be higher unemployment the greater the proportion of the unemployment pool that has high unemployment duration.

There is now compelling evidence on this issue for Australia. For example, three separate studies of the impact of long term unemployment over the 1980s put the range of the possible reduction of the unemployment rate from a more even spread of unemployment duration to between 0.5 and 1.25 percentage points (Fahrer and Pease,

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1993; Hughes, 1993; and Williams, 1989). This means that if policies or fortune had meant a significant reduction in long term unemployment over this period there would have been a closer match between the available labour supply and job openings, implying increased employment of perhaps 40,000 to 110,000.

It follows that long term unemployment is costly in lost output, and for the Budget. Chapman (1993a, 1993b) has used the above estimates in calculations of the impact of long term unemployment on both in the 1980s. With conservative assumptions it is suggested that if unemployment had remained at the level actually observed in this period, but with normal levels of long term unemployment, output would have been $1.3 billion per annum higher, and the structural budget deficit about $750 million lower.

The second macro-economic dimension concerns the possible effects of long term unemployment on the relationship between unemployment and wage inflation. The higher is long term unemployment, the greater is inflation at any given unemployment rate (Flatau, Lewis and Rushton, 1991; Pitchford, forthcoming). The reason for this is that the higher is the proportion of the unemployment pool that is of high duration, the lower is the effective labour supply, essentially because employers assume that the long-term unemployed are not particularly relevant to the filling of vacancies. Thus when the economy grows quickly firms compete against each other for employed and short term unemployed labour without much reference to the high duration group. Changing the actual and perceived skills of the long-term unemployed then allows a larger pool of prospective labour for employers to choose from, reducing the potential for wages pressure given economic expansion.

The third argument for targeting policy to the long-term unemployed is that rapid economic growth, while essential, will not be sufficient to reduce considerably the numbers by the end of the decade Chapman (1993a), Junankar and Kapuscinski (1992). Figures 1 and 2 illustrate the issue under the sanguine assumption that in the rest of the 1990s both male and female job growth replicates the very healthy experience of 1984–90.

The data suggest that under the above scenario male long term unemployment will fall from its current level of about 230,000 to around 120,000 in the year 2000, and that female long term unemployment will fall from about 120,000 in 1994 to about 80,000. In other words, even with very favourable output and employment growth, in the absence of new policies, the number of long-term unemployed would still be of the order of 200,000 at the end of the century. This figure lies above the absolute number inherited from the recession of 1982–83, then the highest absolute number of long-term unemployed recorded.

These projections, show that it would be expensive to do nothing new for the long-term unemployed. They are sufficient to make the

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Figure 1: Male Long Term Unemployment Projections
Assuming 1984–90 Male Job Growth is Reproduced in 1994–2000

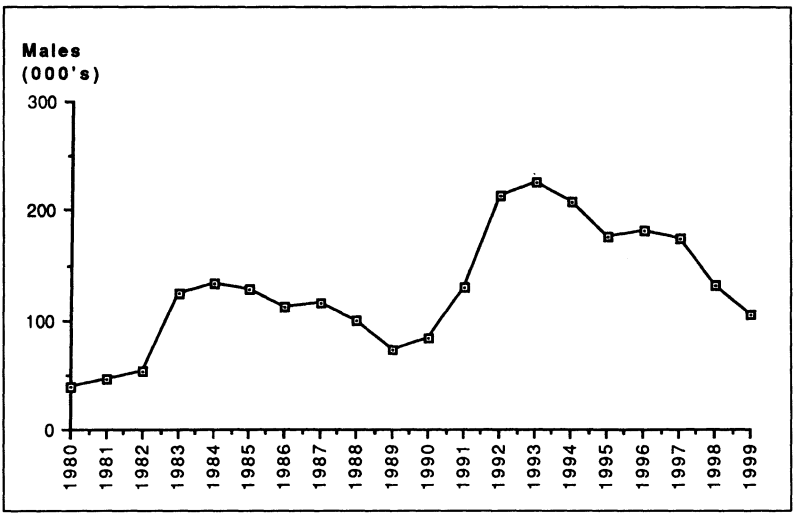
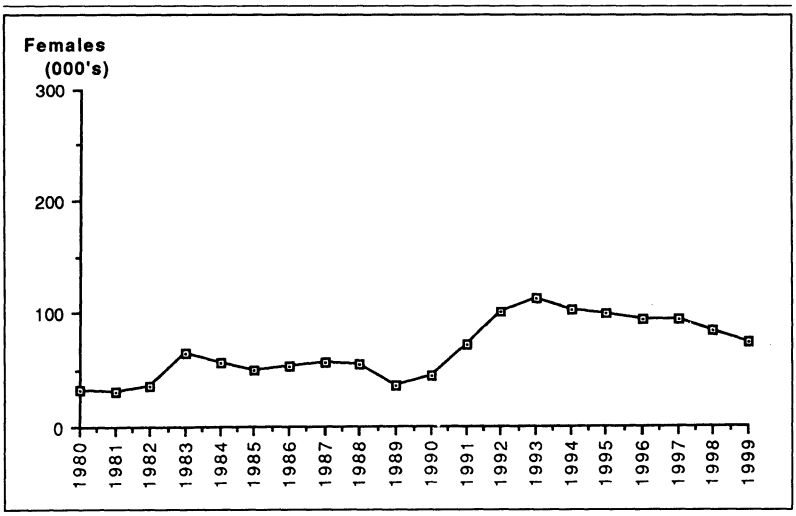


Figure 2: Female Long Term Unemployment Projections
Assuming 1984–90 Female Job Growth is Reproduced in 1994–2000. *Sources: Chapman (1993a)*



case for doing something quite different to the past. To this extent the Jobs Compact is getting it right.

Moving away from passive income support for the long-term unemployed

This section considers Australian public sector approaches to unemployment expenditure, in both historical and internationally compara-

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tive contexts. It reveals that, notwithstanding recent changes, compared to some other periods and many other countries Australian policy puts a relatively high emphasis on income support (the paying of unemployment benefits) compared to directing expenditure more towards employment or training. That is, the Australian approach is 'passive'.

The major difference between passive and active programs is that the former approach has no potential to decrease unemployment, either directly or through effects on the longer run operation of the macroeconomy. Indeed, if anything, passive labour market expenditure, particularly if there are no real obligations on the part of the unemployed, could prolong unemployment duration.

Before the early 1970s in Australia active labour market programs as now understood did not exist. The expenditure approach to unemployment was based, quite reasonably, on the presumption that joblessness was a short 'frictional' experience requiring some income support only to tide the unemployed over until they found a new job. But with the doubling of the unemployment rate in 1974 the Whitlam government embarked on an ambitious program of direct public sector job creation known as the Regional Employment Development Scheme (REDS). A shortcoming of REDS—in contradistinction with most programs since—is that it was not targeted at those with long unemployment duration.

In general, with the marked exception of REDS, Australian governments have chosen to deal with unemployment through income support. To illustrate this point, Figure 3 shows for the last twenty years public sector outlays on active labour market intervention as a proportion of total expenditure on the unemployed.

Except only for 1974/76, Australian governments have allocated a considerable proportion of outlays on income support for unemployment rather than active programs. For eighteen of the twenty years, less than 25 per cent was spent on active intervention. Even with the large expansions of the Commonwealth Employment Program (CEP)—a public sector direct employment program—in 1983/84, and the current wage subsidy program, JOBSTART, in 1992/93, the proportions directed to active programs have been relatively small.

It might be argued that active expenditure rises with recession (Jarvie and McKay, 1993), and that this explains the fluctuations in Figure 3 to allow for this effect, the average active labour market expenditure on each long-term (twelve months or more) unemployed person is presented in Figure 4. (Information on long term unemployment is not available before 1978).

Active labour market program expenditure per long-term unemployed as a proportion of GDP is currently low compared to the average of the last 15 years. (The 1993 long-term unemployed proportion of unemployment is around the highest recorded).

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Figure 3: Australian Government Expenditure on the Unemployed 1973/74–1992/93: Active as a Proportion of Total (per cent)

Source: Stretton and Chapman (1990) and DEET (1991, 1992, 1993)

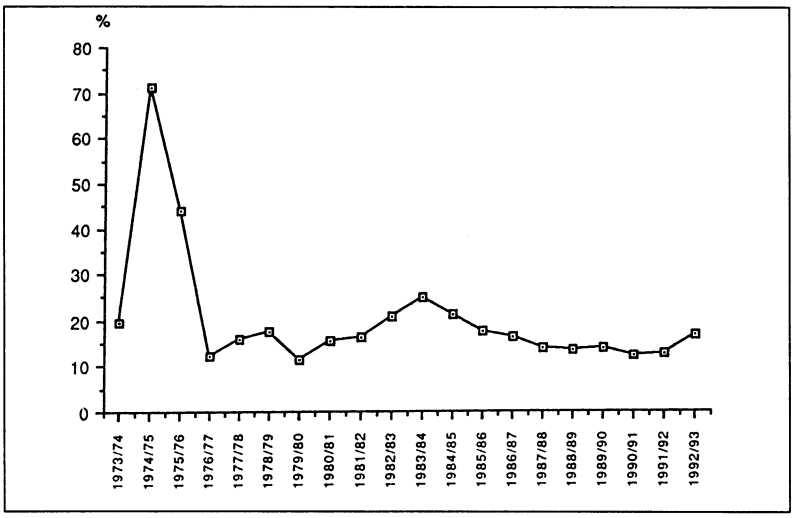
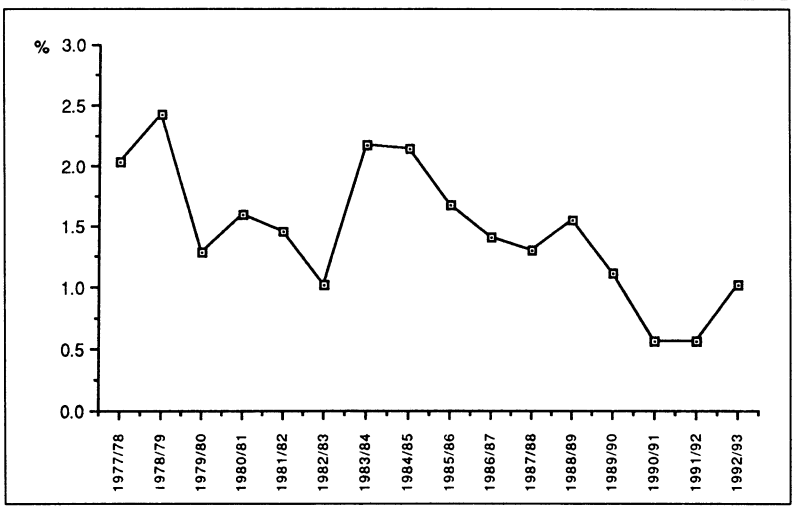


Figure 4: Proportion of GDP Spent on Active Programs Per long-term unemployed Person In Australia: 1978—1993*

*Source: OECD (1993) and DEET (1993). * For clarity the scale has been adjusted by multiplying the figures by 100000.*



Interestingly, in 1983/84 when long term unemployment as a proportion of total unemployment was not very different to now, the government was spending over double the proportion of GDP on active programs per long-term unemployed person than in 1992/93. In part this comparison reflects the cost of direct job creation schemes—such as the CEP—relative to wage subsidy schemes such as JOBSTART. In

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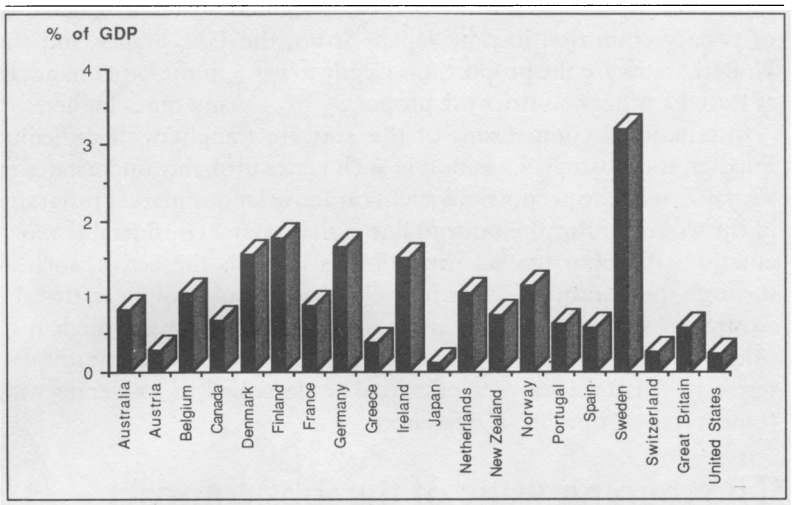
other words there are likely to be more of the long-term unemployed covered by programs now than simple comparisons of the data might imply.

The message from the above is clear. Australian government expenditure on income support for the unemployed has dominated outlays on active labour market programs over the last few decades. While 1974/75—and, to a slightly lesser extent 1983/84—are exceptions, Australian unemployment expenditure over the last two decades has been essentially passive.

Across OECD countries, there were many different approaches to support for the unemployed (Stretton and Chapman, 1990; OECD, 1993; O'Reilly, 1993). There are several problems with comparative data such as those presented now in Figure 5. One is that OECD figures probably understate Australian active expenditures, in part because of the absence of State government expenditures. The numbers remain at best indicative.

Figure 5: Proportion of GDP Currently* Spent on Active Labour Market Expenditure: OECD (per cent)

*Source: OECD (1993) and DEET (1993). * For most countries the figures are annual for a year in the early 1990s.*



The data suggest that Australian proportions of GDP currently spent on active labour market programs are neither very high nor very low, but are probably less than the median. Eight countries apparently spend more in this area.

It is useful to adjust the number to take into account relative unemployment. Thus the date of Figure 6 illustrate the proportion of GDP spent on active programs per unemployed person.

The information reveals that the Australian government currently spends a relatively small proportion of GDP on average on active la-

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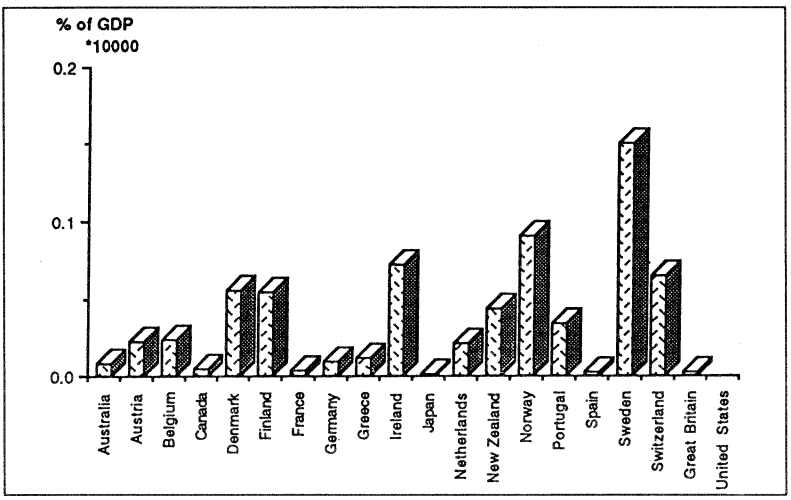
Figure 6: Proportion of GDP Currently spent on Active Programs per Unemployed Person: OECD (per cent)

Source: OECD (1993) and DEET (1993).



bour market programs for each unemployed person. The figure is probably less than about a fifth of the unweighted OECD average. Out of twenty countries, in only Japan, Spain, the UK, France and the United States are the proportions clearly lower. On the other hand, in at least 11 other countries the proportions are many times higher.

International comparisons of this sort are fraught with difficulty. Further, the Australian position in such tables probably understates to a small extent the proportions spent on active labour market programs in this country. But the bottom line is that even a considerable reorientation of labour market expenditures towards the active, such as through the institution of the Jobs Compact, would not mean that the Australian system would be substantially different to the median of other OECD countries. Thus such a change, while arguably radical in terms of Australia's recent past, can be described as moderate with respect to other points of reference.

The training wage of the jobs compact

A major difference between the Green and White Papers is that the latter introduces the concept of a training wage, in which employers will be able to pay less than the existing award for nine months so long as the job entails accredited on or off-the-job training. This is quite different to the notion of the training wage examined in the Green Paper as part of the expansion of JOBSTART. In this latter option the new employee would have been receiving lower wages than the award, but the savings would not go to the employer.

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Training wage savings in the Green Paper version would instead have been realised by the government in that the wage subsidy would have been adjusted to the full extent of the wage decrease. That is, the training wage first discussed in the earlier version of the Jobs Compact is best understood to be a financing option for the government, since its institution would have allowed more JOBSTART places (and/or a lower budget deficit) than otherwise.

The fact that the new training wage means a potential for a decrease in real labour costs to employers, increases the likelihood of there being some employment creating effects. But it is unlikely that the training wage *per se* will provide for many of the long-term unemployed, since the training wage is to apply to all new employees, not just the long-term unemployed.

The notion of the training wage, like other main parts of the compact, is supported by mainstream labour economics in Australia. It is commonly said that the level, particularly the entry-level, of award wages in Australia inhibits the provision of structured on-the-job training. To help understand this claim it is useful to examine briefly some theoretical issues.

Conventional labour market theory emphasises the relationship between the rate at which remuneration increases with individual's labour market experience, and the provision of on-the-job training. Training is seen to be an investment, suggesting that the costs of skill acquisition are recouped by the worker in the future in the form of higher wages and increased labour productivity.

In many cases the acquired skills are useful in other firms, meaning that trained workers are able to command higher wages elsewhere after training is completed. The theory suggests that workers will have to pay for this type of general training since it is not in the interests of firms to finance skill development embodied in workers who can easily take their higher productivity elsewhere. The way in which the worker pays for the training is assumed to be by taking low wages in the training period. The essence of the issue is illustrated in Figure 7.

The figure shows the investment process for workers undergoing transferable—usually accredited—training. The low initial wages are associated with increases in the skill level through training, which begets greater wage increases in the future. In this example investment in the first period is given by the distance AB, which measures the difference between the wage received and that available in a non-training job.

This simple model can be used to analyse two important, related questions in the current Australian debate and, in particular, the rationale for the introduction of the training wage as part of the Jobs Compact.

Figure 8 suggested that the imposition of binding minimum wage legislation, resulting in a legislated minimum wage of MW, reduces

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Figure 7: Worker Investments in Training

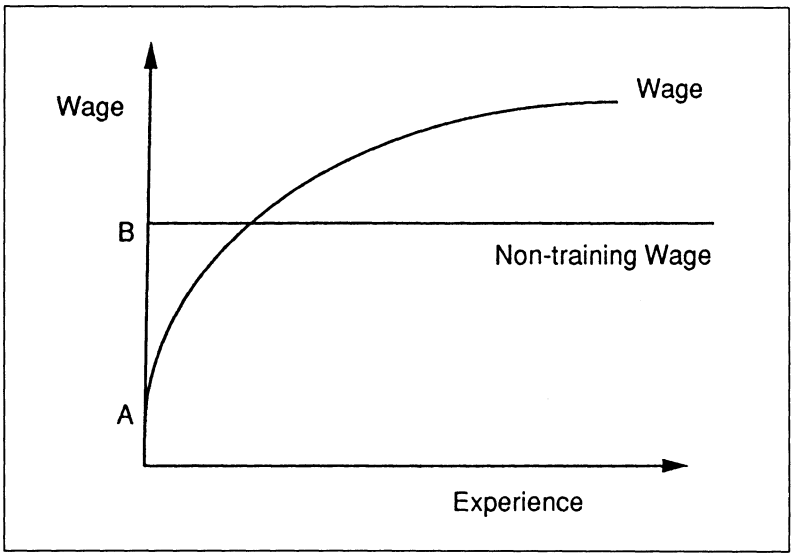
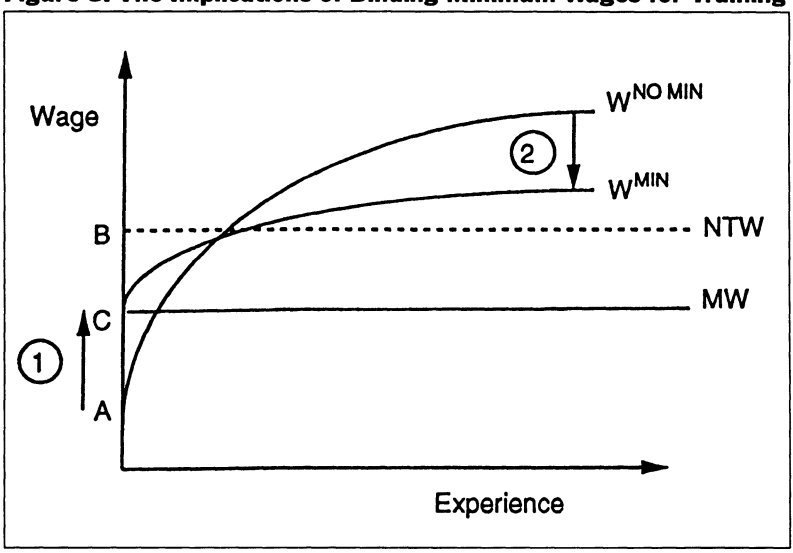


Figure 8: The Implications of Binding Minimum Wages for Training



worker-financed training investments of AB, at the beginning of the job, to CB. Two empirical predictions follow: starting ('training') wages will be relatively high, and consequently, subsequent wage growth with labour market experience will be relative low. Put differently, binding minimum wages reduce the slope of workers' experience-wage profiles, from WNO MIN to WMIN.

Thus a possible cause of under investment in training is that minimum wage awards influence workers' wage profiles so that they may be unable to pay for the costs of training by accepting relatively low wages

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in the potential training phase of their careers. An obvious implication is that the imposition of binding minimum wages leads to reduced skill acquisition (Hasimoto, 1980; Leighton and Mincer, 1980). If not, firms will be paying for some part of accredited training, which in models of this type is not consistent with profit-maximising behaviour, and therefore won't happen in any continuing way.

Tan (1982) provides additional insight into the training-wage nexus. In this view technological change starts in one firm and slowly diffuses through the industry, with workers acquiring technology-specific skills which are eventually useful in alternative employment. Such transferable investments need to be paid for in large measure by workers (by taking relatively low wages in the training period) who, again, will be rewarded through relatively high rates of wage growth.

From the above it follows that if the entry-level award is too high to encourage the appropriate amount of training, an important consequence may be the reduction of incentives for firms to introduce technological change at the shop floor. This could have important long-run consequences for labour productivity and economic growth more generally.

There is also a literature which suggests that the extent and quality of training are important determinants of technological progress at the firm level. Innovations need to be modified and adapted to the particular production structure of each firm (and/or industry), and trained workers are more able to assist this process. This suggests that long-run growth processes are influenced directly by labour market institutional arrangements in ways not usually suggested in mainstream theory. Indeed, belief in relationships similar to these has led a host of commentators to argue the merits of job-rotation and enterprise-identification by workers, pointing to the success of large Japanese firms, alleged to be due in part to such arrangements.

Is there evidence that the current Australian arrangements have tended to inhibit training? The discussion so far tells us that the answer to this question will be affected by the rate at which wages increased for individual workers over time. Is this rate lower in Australia than in other countries? Table 1 (overleaf) presents some evidence.

The number can be understood as follows. Workers receive increases in pay through promotion and moving into better positions, implying that at different stages of the life cycle workers in particular countries face expected wage increases in the next year. It is presumed that countries with relatively high rates of wage increase are those in which work-related training is high.

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Table 1: International Comparisons of Wage Increases
(per cent increase in wages per year of additional labour market experience in the Late 1980s)

Country	At 10 years work experience	At 20 years work experience
Australia +	2.27	1.36
Switzerland +	3.50	2.58
US +	3.39	2.37
UK +	2.11	1.08
West Germany +	2.72	1.77
Austria +	3.35	1.70
Canada	2.61	1.20
Nehterlands	3.51	1.26
Israel	2.50	1.33
Japan	3.77	2.74

+ For both males and females.
Source: Borland, Chapman and Rimmer (1992).

If the rate at which pay increases declines as experience increases, the percentage increase in wages will fall at higher levels. This is why the data from the Table show increments at both 10 and twenty years of labour market experience.

An example is helpful: on the basis of these cross-sectional data, on average Japanese workers have in the past received around 3.8 per cent annual increases in wages after ten years employment, and 2.7 per cent annual increases in wages after twenty years of employment; in contradistinction, for the UK the increases are only about 2.1 and 1.1 per cent respectively.

Measured by the rate at which wages grow with labour market experience, the Australian labour market seems to be characterised by relatively low levels of on-the-job training. After 10 years of experience, for example, the average Australian worker can expect a wage increase over the next year of experience of about 2.3 per cent, which is the 9th lowest out of the ten countries considered. Five countries have increases of greater than one percentage point more than this.

Of course, binding occupational minimum wages may not be the only or even the most important reason for (apparently) relatively low levels of training. The narrowness, and occupational bases, of many awards may also be contributing factors (Borland, Chapman and Rimmer, 1992). If workers are restricted to a limited range of tasks, their training requirements will be low.

Just focusing on this evidence, the data and theoretical modelling seem to support movements towards the decrease in entry-level awards, that is, the introduction of training wages in Australia. To the extent that they are applied to the long-term unemployed as part of the Jobs Compact they increase the possibility of there being real effects

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on the perceived and actual skills of the targeted group. This last issue is fundamental to an overall assessment of the likely success of the policy, and is related ultimately to the efficacy with which it is instituted.

The untested challenges for the job compact

The Jobs Compact and the training wage are consistent with both labour market theory and Australian empirical reality. This does not mean, however, that these innovations will deliver important improvements to the functioning of the labour market. The big test for the compact lies in the future.

The macroefficiency case for the compact depends on the new arrangement raising the actual and perceived skills of those targeted from the long-term unemployed. If it does not happen at all, the compact affects only the distribution and not the level of unemployment, and the policy needs then to be compared to other forms of intervention based purely on equity grounds. If it happens to a large degree, it makes a case for making this arrangement a permanent feature of the Australian labour market.

Chapman (1993a, 1993b) has estimated the consequences of improving the effectiveness of active labour market programs through the re-skilling of the long-term unemployed. It is suggested that fixing up the structural mismatch in the labour market through effectively changing the skills of 25 per cent of the long-term unemployed in the 1980s could increase output in the longer term by about $300 million per annum in 1994 terms.

The case for outlaying substantial resources to help ensure that the compact works is powerful, so that the policy does not end up being a process to recycle large proportions of the long-term unemployed into and out of short terms jobs and training with no improvement in overall economic performance. Presumably it was reasoning such as this which promoted changes to the delivery of assistance through the institution of case management for those in the compact, including giving people a choice between the Commonwealth Employment Service and an outside private agency as case manager.

There are two other major concerns affecting the success of the compact. The first relates to the apparent heavy reliance placed on the use of JOBSTART. The data typically used to assess the efficacy of wage subsidy programs are likely to be quite strongly biased in favour of finding positive effects of the schemes, effects that cannot be transferred unquestionably to large expansions. The reason is that the individuals involved in the program are 'creamed'—that is, chosen by employers because of their unusually good characteristics. In other words, past JOBSTART participants are likely to be far and away the most desirable prospective workers from the pool of long-term unemployed. To put this point in empirical perspective it is instructive to

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note that only about 10 per cent of those unemployed for two years or more were taken up in JOBSTART in the last financial year. Applying the scheme across the board to the vast majority of those unemployed for 18 months or more, many of whom will be less productive than the typical JOBSTART participants, necessarily suggests that the take-up will be lower, and/or the success rates not as high. This means that the costings are probably too low and/or that the 'new work opportunities' component of the compact needs to be given greater emphasis than is currently the case.

'New work opportunities' is the term used in the compact for the delivery of jobs outside JOBSTART. It potentially covers a plethora of possibilities, including regional environment projects, traineeships for youth, community initiated schemes, and expansions in local human services programs. Little detail is offered on how these might work, and the data are sparse on how important these approaches need to be, or could be. Nor does the White Paper offer any discussion of the economic and other incentives that might be required to encourage new work opportunities to be delivered propitiously, to cover the potentially large number of the long-term unemployed not taken up by JOBSTART, and to be able to ensure that members of the long-term unemployed so involved receive effective skill development.

Other possibilities for the delivery of employment opportunities outside new work opportunities and JOBSTART could have been suggested: offering firms profit tax decreases instead of wage subsidies, contingent on being involved in the compact; having private sector firms tendering for the provision of government contracts include a description of how their tender could help with the extra employment of the long-term unemployed; creative uses of financial incentives and borrowing mechanisms to assist some of the long-term unemployed help themselves in the setting up of small businesses; the short-term removal of the on-costs associated with employment for firms taking on the long-term unemployed; and the relaxation of those parts of existing awards that inhibit the potential for job sharing with the targeted group. Given the extraordinarily heterogeneous employment needs of the long-term unemployed manifested in part by their wide range of demographic characteristics (see the White Paper) and the likely plethora of requirements of prospective employers, considerable further innovation might be needed to address the problem.

Relatedly, there is little discussion of the role of immigration policy in rendering the compact effective. But immigrants from non-English speaking backgrounds fare poorly in employment terms in the initial stages after arrival. This suggests that long term unemployment is probably increased by having large numbers of particular types of immigrants entering in a recession compared to a boom, implying that policy in this area needs to show some sensitivity to the interaction

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between the business cycle, immigration and the likelihood of future long-term unemployment challenges (Chapman, 1993a).

There is a second major worry with the compact. No matter how attractive JOBSTART is in theory, and how creatively new work opportunities are delivered, without rapid economic growth there is no chance that significant inroads will be made into long term unemployment. This part of the story can be told most easily with reference to the projections data of Chapman et al (1992).

While rapid economic growth by itself reduces long term unemployment only slowly, economic stagnation has marked and quick implications for *increases* in members of the group. For example, the raw data and projections suggest that about a year after the economy stops growing strongly, the number of long-term unemployed increases by about two-and-a half fold. The evidence suggests that if unemployment falls to 9.4 per cent compared with a base case of 12.4 per cent, then around 180,000 individuals will not experience long term unemployment. Continuing rapid economic expansion is a fundamental prerequisite for sorting out the long term unemployment issue.

If the compact's assumptions on economic and employment growth are achieved over the next few years, the anticipated outcomes, although optimistic, might be delivered. But if growth is much lower, the compact will be unworkable in anything like its present form. This raises for urgent debate the best ways to ensure that high growth rates are maintained, and the right role and economic targets for Government in this endeavour.

The political economy of these challenges is worth thinking about. If the compact does not deliver, either because the institutional arrangements are not sufficiently robust or creative, or there is a stalling of economic growth, it will be argued by those interested in parsimonious government that such approaches have been tried and they failed. This will be the case even if the conceptual basis for the compact is watertight.

Conclusion

While economic growth is crucial, it will not be enough in the medium term to solve the long-term unemployment problem. A major concern relates to the distributional consequences, but a significant and permanent decrease in long term unemployment will also deliver considerable improvements in the economy.

The jobs compact is a conceptually correct response to the issue. For some it is a radical intervention in that it represents an eventual job guarantee, but given the compelling case for doing something quite different to the past it is arguably a moderate reform. Whether or not the methods and institutional arrangements underpinning the com-

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pact will work is yet to be tested, with the eventual evaluation of the scheme being of great social and economic importance. **AQ**

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