

## Spotlight

# Ireland

## The Labour Market

Randall S. Jones

Economic activity in Ireland since 1993 has grown by almost a quarter, more than three times the average increase in the rest of Europe. Rapid growth of output has been accompanied by substantial gains in employment, creating more jobs in three years than in the previous thirty. Employment growth in Ireland is thus much higher than in the rest of Europe and North America (Figure 1). In addition, net emigration – a persistent phenomenon in Ireland over the past two centuries – has been reduced, and in 1996 Ireland experienced a net inflow of population. At the same time, the labour-force participation rate has risen as more women have joined the labour force.<sup>1</sup>

This buoyant growth has reduced the unemployment rate from 15.6% in 1993 to 11.3% in 1996, but it remains well above the OECD average (Figure 2). The problem is essentially one of long-term unemployment: almost 60% of the unemployed have been out of a job for more than one year, which is one of the highest rates in the OECD area. The duration of unemployment has a strong effect on the probability of finding work: although two-thirds of the unemployed find a job within a year, someone who has been jobless for more than two years has only a one in four chance of securing employment.

Unemployment is concentrated among people with only a primary or lower-secondary school education. This group, which makes up about half of the labour force, had an unemployment rate of 18% in 1995, compared to only 4% for those with a university education. Consequently, those with only a lower-secondary education or

less accounted for two-thirds of the unemployed. Many of the poorly educated are young: in 1995, a third of the unemployed were people under the age of 35 who had failed to complete upper secondary school.

The high rate of unemployment is partly a result of the interaction of the tax and social-welfare systems, which has weakened the work incentives of many individuals, particularly those with low educational qualifications. The government has substantially increased benefits in real terms since 1979, while taxing relatively low incomes at high marginal rates. The lack of co-ordination between tax and welfare policies has reduced the gap between the amount of income support available to the unemployed and net income from work, thus making the transition from unemployment to work less attractive and lessening the incentives for low-paid workers to remain in employment.

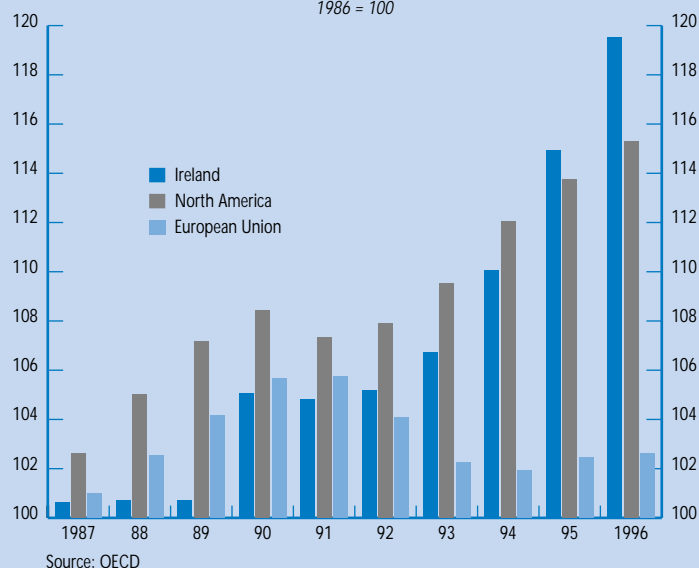
### The Tax and Welfare Systems

Although the share of taxes in employee earnings is slightly below the OECD average, Ireland's tax system is marked by very high marginal rates at low incomes. In 1996, for example, a single person entered the top tax-bracket of 55.8%

(including social-security contributions) at an annual income that was 10% below average earnings. In addition, one-sixth of taxpayers, primarily low-paid workers, faced a marginal rate of 47.8%.

These disincentives are compounded by aspects of the social welfare system and its interactions with the tax system. People who are unable to find a job are entitled to receive un-

Figure 1  
Employment Growth  
in Ireland, North America and the European Union, 1987-96  
1986 = 100



employment assistance, a means-tested payment with no maximum duration. In view of the established link between the duration of unemployment benefits and the average length of joblessness, the indefinite duration of assistance in Ireland is likely to have increased long-term unemployment. In addition to the basic flat-rate benefit, allowances for adult dependants, such as non-working spouses, and for children are provided. Moreover, with the increase in benefits between 1979 and 1994, unemployment assistance for a married couple without children increased by 56% in real terms, although the net

1. *OECD Economic Surveys: Ireland*, OECD Publications, Paris, 1997.

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income of a worker earning the average manufacturing wage remained constant. Indeed, payments to the unemployed are now considerably higher in Ireland than in the United Kingdom. Consequently, the net replacement rate – unemployment benefits as a share of previous pre-tax earnings – has risen sharply. For example, the net replacement rate for a two-child family earning two-thirds of the average wage increased from 57% in 1979 to 83% in 1991 before then declining marginally.

A recent study of 17 OECD countries confirmed the direct link between the generosity of unemployment benefits and the rate of unemployment,<sup>2</sup> as do estimates of net replacement rates for different segments of the Irish population. For people with replacement rates of less than 50% – about three-fifths of the labour force – the unemployment rate is about 8%. But it rises to more than 25% for the more-than-a-quarter of the labour force with replacement rates above 60% (primarily those with low educational qualifications). The disincentive effect is exacerbated by the withdrawal of other benefits, such as medical cards (which entitle the low paid to free health care) and housing-related subsidies. In addition to its effect on unemployment and participation rates, the interaction of the tax and welfare systems also reduces the incentives of low-paid employees to seek better-paid jobs or to work longer hours.

### Reducing Unemployment

In recent years, the government has improved incentives to work by reducing tax rates and by keeping the rise in unemployment benefits below the increase in average earnings. In addition, it has introduced further active labour-market poli-

2. Stefano Scarpetta, 'Assessing the Role of Labour Market Policies and Institutional Settings on Unemployment: A Cross-country Study', *OECD Economic Studies*, No. 26, OECD Publications, Paris, 1996.



cies (ALMPs), such as training programmes, job-search counselling, job-brokerage services and subsidised employment, to assist the unemployed. Total spending on these programmes, which now number more than thirty, amounts to 1.8% of GDP, almost double the OECD average, reflecting a large public-employment initiative which provides public services through voluntary and community organisations. There are also numerous programmes providing training, job-search assistance and employment subsidies. The Department of Education, too, has introduced reforms to help schools respond more effectively to the requirements of students from lower socio-economic backgrounds and thereby reduce the number of early school-leavers.

Although there has been some progress, work incentives should be further improved by a more thorough overhaul and integration of the tax and benefit systems. The key is to reduce the high marginal tax rates imposed on low-income workers. The issue of unemployment benefits also has to be addressed. At present, benefits to jobless persons are viewed as long-term income support rather than temporary assistance to workers between jobs. The authorities should consider allowing benefits to decrease over time, a policy which would help reduce the wage expectations of the long-term unemployed. With unemployment benefits in Ireland having in-

creased to near the OECD norm, they should not continue to rise (in real terms) more rapidly than net income in work, as they have during much of the past 15 years and again in 1997. In addition, the unemployed should be required to search for work and to accept any job offers in return for continued receipt of benefits. The experience of some other OECD countries suggests that programmes designed to ensure that unemployed persons are looking for work and to help them search do indeed reduce the extent of unemployment – especially the case when job-placement services are accompanied by effective monitoring of the job-search activity of the unemployed.

In addition, the current system of child benefits, which are larger for unemployed families than for those at work and thus create disincentives, should be addressed. One solution would be to combine the existing benefits into a single, unified payment for all children. Aspects of housing-related benefits have likewise to be reformed to improve incentives. One approach would be to let unemployed persons retain rent and mortgage subsidies for a period of time after beginning work, followed by a phased withdrawal. The link between income and rents for local authority housing should also be weakened.

A rationalisation of the numerous ALMPs would be beneficial, since many of the existing programmes overlap. As a result, different agencies administer schemes aimed at the same groups of people, obscuring the division of responsibility; and the complexity of the system may lead to administrative failure and increase costs. In particular, the separation of benefit administration from job-placement service makes it difficult to enforce eligibility requirements for unemployment benefits. Studies of other OECD countries suggest that the integration of these activities in 'one-stop shops' in Ireland would increase efficiency. More rigorous analysis would help determine which programmes are most effective in order to help the government concentrate its efforts where they will have the most

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