

Low skilled jobs through job creation and wage subsidies

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Abstract

Direct job creation and wage cost subsidies are increasingly used to reduce unemployment at the lower end of the labor market. The Dutch programs usually do not feature a maximum duration and therefore do not promote the transfer to unsubsidized, regular work. Both marginal wage cost subsidies aimed at recipients of unemployment benefits and wage subsidies for all workers earning low hourly wages raise employment for the target group.

Samenvatting

Directe werkgelegenheidscreatie en loonkostensubsidies worden in toenemende mate toegepast om de werkloosheid aan de onderkant van de arbeidsmarkt terug te dringen. De Nederlandse programma's op dit terrein kennen niet altijd een maximale duur, wat niet bevorderlijk is voor de doorstroming naar ongesubsidieerd werk. Zowel op werklozen gerichte loonkostensubsidies als algemene lastenverlichting voor lage uurlonen leiden tot extra werkgelegenheid voor de doelgroep.

Introduction

The labor market position of low-skilled workers is a cause for concern in both Europe and the United States. Various developments over the last few decades have caused the growth of low-skilled jobs to lag that of higher-skilled jobs. Explanations include skill-biased technological change and international trade, which forces low-paid workers in the western economies to compete with cheap labor in the developing countries and Eastern Europe (see e.g. Snower and Dehesa, 1997). At the same time, improved education has reduced the supply of low-skilled workers. On balance, however, the labor market position of low-skilled workers has deteriorated.

General labor market policy stimulates employment growth by reducing the burden of taxes and social security premiums on labor income, moderating wage and non-wage labor costs, and establishing an appropriate mix between flexibility and commitment in labor market relationships. While this general policy can contribute to improving the labor market position of low-skilled workers, it seems unable to address the specific problems facing low-skilled workers. Although enhancing skills is a

promising instrument in the long term, it offers little relief in the short term. Moreover, some low-skilled workers are not receptive to training.

This article explores specific policy measures aimed at enhancing the labor market position of low-skilled workers in the short run, namely creating jobs in the public sector and providing wage subsidies to employers in the private sector. The key question in this context is how to improve the labor market position of the low-skilled while at the same time avoiding inefficiencies that either impede the transfer from subsidized to unsubsidized work or discourage investment in new skills. With respect to low-skilled labor, two kinds of problems appear to exist. First, on the demand side we have a shortage of jobs for the low-skilled. Second, on the supply side we find a lack of incentives to enter the labor market. The measures explored in this article boost demand for low-skilled labor. If effective labor supply falls short of demand, additional measures are required to enhance the incentives to supply labor by widening the income gap between being out of work and being employed.

The rest of this article is structured as follows. We start with a brief discussion of the economic effects of targeted employment programs. Subsequently, we discuss job creation programs and wage cost subsidies in the Netherlands.

Economic effects of targeted employment programs

Direct job creation, wage cost subsidies and other forms of active labor market policies (such as training programs) can strengthen the labor market position of those in the target group. These are unemployed people whose productivity is perceived to fall short of the hourly minimum wage. The effective minimum wage in collective wage agreements may exceed the statutory minimum wage. Low productivity may be due to a low level of education, but also to loss of skills and demoralization during long-term unemployment. Stigmatization may play a role as well. Participation in and the successful completion of a labor market program allow those in the target group to gain work experience, improve their skills, and to return to the effective labor supply. The wage-depressing effect associated with the additional labor supply may in due course expand the number of unsubsidized jobs.

Labor market programs impact not only the target group, but also the labor market more generally. In particular, labor market theory identifies several important effects of these programs on the labor market (see e.g., Pissarides, 1990). First, hiring unemployed persons within the context of a labor market program allows the employer to select, at little risk, suitable candidates for permanent

jobs. This effect is relevant only if the placement within the program is temporary. Matching supply and demand on the labor market thus becomes more efficient, thereby reducing unemployment. Against this, however, participants in a labor market program will tend to exert less effort to look for another job, especially if they can stay in the program for an unlimited period. This causes matching between labor supply and demand to become less efficient. Finally, labor market programs make those that are already working less fearful of losing their jobs assuming that they prefer participating in the program over being unemployed. This strengthens the position of employees in wage bargaining, thereby boosting wage costs and reducing employment.

Measuring the effects of employment policies targeted at low-skilled workers is difficult. Evaluation studies of the programs yield information mainly about the direct effects. In particular, they tend to measure which share of the target group actually participates in the program and the extent to which participants in the programs move on to regular jobs. These studies sometimes estimate also the share of program participants who would have found work without the program (the so-called "deadweight loss"), and the extent to which program participants take jobs from people who do not benefit from the program (the so-called "displacement" or "crowding out"). The sum of the latter two effects, called the "efficiency loss," measures the share of program participants that does not represent additional employment.

This article examines whether labor market programs expand employment for the target group. If this happens in part at the expense of employment among less disadvantaged groups, this need not be judged as detrimental. Indeed, if people who were initially not part of the effective labor supply (the so-called "outsiders") displace other workers (the so-called "insiders"), this may reduce wages and thus boost overall employment.

Direct job creation

One of the ways of getting disadvantaged groups, such as the long-term unemployed, into work is to create jobs for those groups in the public sector. These jobs are open only

to those who belong to a specific target group, for example those who have been collecting unemployment benefits for a particular length of time. The government, or an organization appointed by it, decides which jobs are suitable and where they should be created. This is a major reason why, with only a few exceptions, these jobs are created in the public sector. Another reason is that preventing new jobs from displacing regular work may be easier in the public sector than in the private sector. These jobs are considered as "suitable work" for recipients of social assistance or an unemployment benefit. Accordingly, an unemployed person who collects benefits but is not actively looking for work may lose the benefit if he or she does not accept such a job. For some benefit recipients, this prospect could be an incentive to intensify their efforts to find a regular job.

We evaluate the programs on the basis of their contribution to improving the labor market position of the participants. The programs may have also other objectives, such as social reintegration of the long-term unemployed and the execution of useful tasks.

The stipulation that the jobs created by the programs should be additional to regular work may conflict with the aim of the programs to prepare the participants for a non-subsidized job. Moving on to regular work is more likely if the tasks in the programs are more demanding, but such work is more likely to displace existing jobs. The additionality requirement reduces deadweight loss and crowding out.

Table 1 contains an overview of direct job creation programs in the Netherlands. The *Youth Employment Guarantee (JWG)* scheme is targeted at unemployed young people. Most jobs are created in the public sector. The aim is to facilitate the transfer to a regular job or training. Around one quarter of the target group has not been reached, although participation is compulsory. The maximum sanction for young people who are dismissed or who do not make themselves available is three months' suspension of the welfare benefit. It is not clear how strictly this sanction is applied in practice. An evaluation study of the JWG shows that, according to employers of JWG participants, more than one quarter of the participants would have found

work without the program (see Olieman, 1996). This provides an indication of the deadweight loss. The same study shows that displacement is only limited, but (certainly in the case of private sector jobs) not negligible. The outflow rate is around 70%, with most of the youngsters moving into regular work and the rest into education and training.

Table 1 Direct job creation programs in the Netherlands (1997)

Name	Target group	Maximum duration	Remuneration	Private-sector share
JWG	young people unemployed for > 6 months	1 year, repeat possible	minimum wage	19%
Job pools	unemployed for > 3 years	unlimited	minimum wage	0%
Melkert (1)	unemployed for > 1 year	unlimited	120% of minimum wage	0%
Melkert (3) ^a	benefit recipients		benefit	0%

^a This scheme involves voluntary, unpaid work. It involves temporary experiments in a small number of municipalities.

Table 2 Wage cost subsidies in the Netherlands

Name	Target group remuneration	Maximum duration	Maximum share	Private-sector
Vermeend-Moor ^a	unemployed for > 3 years	market rates	4 years	72%
KRA-RAP ^a	unemployed for > 2 years	market rates	4 years	60%
Melkert (2)	unemployed for > 1 year	120% of minimum wage	2 years	100%
VLW	unemployed for > 1 year	130% of minimum wage	4 years	
WEP	unemployed for > 1 year	lowest wage scales from collective labor agreements	1 year	30%
WL0M ^a	employees	minimum wage	4 years	
SPAK	employees	115% of minimum wage	unlimited	72%

^a These schemes are no longer in operation.

Unemployed people who have been out of work for at least three years are the target group of the so-called *job pools*. The main aim is to reduce social isolation rather than to move the participants on to a regular job. There is no limit to how long a person may hold a place in a job pool.² The estimated efficiency loss is only small (13%). The same holds true for the outflow rate: only 7% of the participants eventually finds a regular job.

The *Melkert (1)* scheme intends to create 40,000 new jobs in the public sector by the end of 1998. These jobs are reserved for the long-term unemployed collecting unemployment benefits. These jobs are created by the municipalities and in the health care sector. As in the case of the jobs pools, there is no limit to how long a person may participate in the program. Indeed, transfer to other work is not an explicit objective. It is not yet possible to determine the outflow rate because the scheme has been in operation only for a short period.

The aim of the *Melkert (3)* scheme is to make voluntary work attractive by providing some financial compensation to those long-term unemployed people without any perspective to find a regular job. The aim is to reintegrate the participants into society by allowing them to carry out socially useful tasks. This may over time enhance their chances on the regular labor market.

In contrast to similar programs in other countries, the Dutch programs (with the exception of the JWG) do not put a limit on how long one can participate in the programs. This does not facilitate the transition to other regular work. Moving on to a regular job is enhanced by gaining generally useful knowledge and skills. The programs seem to offer only limited scope for this, however, because the tasks are usually of a relatively simple nature.

With the exception of the JWG, the Dutch programs outlined here are not exclusively aimed at improving the position of the low skilled on the regular labor market. Other objectives are the social integration of the long-term unemployed and the execution of useful activities. One way to retain these goals while still promoting the outflow to other work is to preserve the permanent character of the jobs but to introduce a limit to the length of time any worker can participate in the program. In this way, the same number of jobs can benefit more people. The drawback is that some people will become unemployed again

and draw unemployment benefits once more after completing their term on the program. Indeed, participation in the job programs allows people to accumulate new rights on social insurance benefits.

Wage cost subsidies

The position of the low skilled can be improved also indirectly, namely by reducing the costs of employing low-skilled workers by providing subsidies to employers in the private sector. Employers can thus pay a higher gross wage at the same costs, which is the main purpose of such schemes in the United States. Alternatively, they can create more jobs at the same gross wage level, which tends to be the main objective in Europe.

An important question in this context is for which groups a subsidy should be provided. Should the subsidy be given for all employees below a certain gross hourly wage level (i.e. a general wage cost subsidy), or only to those enterprises that expand their employment or hire a person who was previously collecting unemployment benefits (i.e. a marginal wage cost subsidy)? Obviously, general subsidies are more expensive than marginal subsidies because the employer receives the subsidy also for the people who already hold a job. In other words, the deadweight loss is high.³ However, general wage cost subsidies are easier to administer and less susceptible to abuse. Moreover, not all enterprises will avail themselves of more targeted schemes, either because they are not familiar with these schemes or because they find the schemes too complicated.

Subsidies aimed at target groups suffer from the additional problem that every demarcation leads to distortions "at the margin." For instance, a demarcation in terms of length of unemployment of at least a year may cause enterprises to substitute long-term unemployed for short-term unemployed. Alternatively, firms may wait to hire a suitable candidate until the subsidy can be collected. If subsidies apply only up to a certain wage level, the employer's costs will increase sharply if a wage increase pushes the employee's gross wage beyond the ceiling. This adversely affects the incentives to upgrade skills and raises the danger that the subsidy creates only dead-end jobs from which employees cannot escape. In this way, the "skill trap" replaces the current "unemployment trap." This risk may be quite small for young people because they may see a

Table 3 Selected features of jobs paying up to 115% of the minimum wage in 1994

	<i>in % of total</i>
<i>Working hours per week</i>	
< 8 hours	23
8-16 hours	21
16-24 hours	19
24-32 hours	11
> 32 hours	25
	100
<i>Age</i>	
< 23 years	20
≥ 23 years	80
	100
<i>Gender</i>	
men	30
women	70
	100

Source: Statistics Netherlands (CBS), "Jaarlijks onderzoek werkgelegenheid en lonen" (JWL), 1994; adapted by CPB.

low-paid job as an investment in their future labor market position. For older people, however, the risk that the subsidized job becomes the final stop may be large, especially if the subsidy is open-ended. Another problem with the demarcation of target groups is that it may give rise to fraud. For instance, demarcation in terms of hourly wages can induce enterprises to record longer working hours, so that the subsidy can be collected also for part-time workers with high hourly wages.

The Netherlands has introduced several kinds of wage cost subsidies in recent years, some of which have been amended or renamed over time. The programs include both marginal wage cost subsidies, which are aimed at people out of work, and general wage cost subsidies, for which all employees up to a certain wage level are eligible. Table 2 provides an overview of the various programs.

The *Vermeend-Moor Act* and its successor, the *Work Placement Enabling Scheme --Regular Workplace Version (KRA-RAP)*, aimed at getting the long-term unemployed back into work. These schemes, which are no longer in operation, were targeted at women, the low skilled, and immigrants. Despite a subsidy of 20% of the wage costs for a four-year period and a one-off subsidy of 4,000 guilders, the take-up of the schemes was disappointing. The total efficiency loss amounted to 80%, more or less equally distributed between deadweight loss and crowding out. By national or international standards, the efficiency loss is not unusually high for programs that are concentrated in the private sector.

The *Work Experience Placements (WEP)* scheme, a successor to the KRA, is of relatively minor importance with only 3,000 participants in 1996. WEP subsidizes primarily workplaces in the public sector, which explains that crowding out is only 7%. Deadweight loss, in contrast, is relatively high at around 30%. The likely explanation is that WEP reaches relatively high-skilled people rather than the original target groups of the low skilled. The outflow to other work or training is high, namely around 63%.

Under the *Melkert (2)* scheme, the employer receives a wage cost subsidy equivalent to around half the wage costs for a two-year period. The target group consists of unemployment benefit recipients who have been out of work for at least one year. Contracts have been signed with 15,000 people. No evaluation study on crowding out and deadweight loss is yet available. This holds true also for the *Long-Term Unemployment Reduction (VLW)* scheme, under which an employer receives a subsidy of 4,500 guilders for hiring someone who has been unemployed for at least a year. For the long-term unemployed, this subsidy comes on top of the SPAK, discussed below. The general wage cost subsidy under the *Minimum Wage Level Wage Cost Reduction Act (WLOM)* was limited to employees who earned the statutory minimum wage. For these employees the employer received a subsidy equivalent to 10% of wage costs.

The tight limitation was a major reason for the limited success of this scheme. The *Low Wage Reduction scheme*, better known as the *Specific Social Security Contributions Concession (SPAK)*, covers all jobs that pay an hourly wage of up to 115% of the minimum wage. On the basis of figures from 1994, more than one million jobs (about 15% of the overall number of jobs) are eligible for the SPAK.

Table 3 provides some characteristics of the jobs eligible for the SPAK. It shows that the majority of these jobs are part-time jobs, which are occupied mainly by young people and partners of breadwinners.⁴ Accordingly, the scheme probably raises labor force participation rather than cutting the number of people collecting unemployment benefits. For the latter group, the difference between the financial rewards under the scheme and the unemployment benefits is only small. The SPAK scheme was reformed in 1998 so that more of the created low-paid jobs are occupied by recipients of unemployment benefits.

Conclusions

Direct job creation in the public sector can serve several purposes. One objective may be to enhance the labor market position of disadvantaged unemployed people. The new jobs offer these people an opportunity to gain work experience and to transfer to a regular job. This is the primary objective of the JWG. An important means of promoting this objective is the limited duration of the program for any participant. There are no such time-restrictions in other Dutch programs, such as the job pools and the Melkert (1) scheme. Indeed, transition to regular work is not the main purpose of these programs. Instead, social reintegration of the participants and executing useful tasks in the public sector are the main objectives. Similar programs exist in other countries, but most of these programs feature a maximum duration and thus promote the transition to unsubsidized work.

Subsidies for hiring unemployed people and lower labor taxes on low hourly wages are aimed at creating jobs for the low skilled. Both are more effective in creating employment for low-skilled workers than are general tax cuts, which accrue to high- and low-skilled workers alike. Marginal wage cost subsidies, such as the VLW and Melkert (2) schemes, are easier to target at unemployment benefit recipients. These targeted measures, however, may encourage stigmatization of claimants. Moreover, marginal subsidies may induce substantial crowding out. Wage cost subsidies, such as the SPAK, are less vulnerable to stigmatization and crowding out. These subsidies, however, create a high marginal tax wedge on higher hourly wages when they are phased out. This may harm the upgrading of skills. These subsidies may also imply substantial deadweight loss.

Well-designed direct job creation programs and wage cost subsidies can help to cut unemployment among the low skilled. However, no single panacea exists for enhancing the weak labor market position of the low skilled. Indeed, this requires a mix of instruments, which will raise not only labor demand but also the effective supply of labor (see e.g. Bovenberg, 1997).

References

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Notes

- ¹ The definition of this term is slightly different for general wage cost subsidies. In that case, it refers to the number of people who already held a job in the absence of the subsidy.
- ² When the job pools are subsumed under the Job Seekers' Placement Act (WIW) in 1998, people will be put on a two-year temporary contract. This temporary contract can be converted into unlimited employment only if they have no prospect of gaining work in the regular labor market.
- ³ This holds true also for other general forms of tax relief aimed at the lower end of the labor market, such as exempting employers from paying social-security contributions. However, the deadweight loss is still smaller than in a case of general tax burden relief for low- and high-income employment alike.
- ⁴ The 1994 annual report on employment and wages (Statistics Netherlands, 1994) provides no information on qualifications. Wage surveys by the Ministry of Social Affairs and Employment indicate that these jobs are occupied mainly by low-skilled workers.