

Temporary employment subsidies in industrialised market economies

C. J. AISLABIE *

1. Introduction

Over the past decade the industrialised market economies have experienced rising unemployment levels and a declining confidence in the efficacy of demand-management measures. This has led to calls for governments to take steps which have an immediate effect on levels of employment in the private sector. At the same time governments are also being urged to pursue industrial, regional and structural adjustment policies to ensure that the right kind of jobs are available in the medium term.¹ However, there are differences of opinion as to the relationship between short-term² and medium-term measures. To some, short-term measures are needed until those with medium-term outcomes make themselves felt,³ while to others these short-term measures are expedients, possibly counter-productive in their effects,⁴ which encourage ad hoc⁵ interventions in the economy. There is also a school of thought which treats the distinctions drawn immediately above as illusory, reasoning that industrial, regional and structural adjustment policies have themselves become, as a result of the pressure of rising unemployment levels, short-term expedients.

The discussion raises a number of issues as to the status of short-term measures to relieve unemployment. Firstly, there is the definitional problem. We do not want to have to consider every measure which is said to have a short-term influence on employment levels. Secondly, assuming that the government has determined upon some microeconomic intervention in the economy, the question arises whether short-term measures are necessarily inferior to their medium-term counterparts. Finally, attention has to be paid to the role of these short-term measures in the light of the other available instruments of economic policy.

In this article we shall first explain the concept of temporary employment subsidies (TES), paying particular attention to the reasons

* Senior Lecturer in Economics, University of Newcastle, New South Wales, Australia.

why they should be distinguished from an industrial, regional or structural adjustment policy. Secondly, we examine the three main classes of subsidy: those concerned with job retention, those concerned with job creation and those concerned with providing investment inducements. Thirdly, possible limitations of TES are discussed and this is followed by a section which examines the rationales advanced for their use. Finally, it is suggested that a clarification of the role of TES will make them more effective and place the criticisms which have been levelled against them in better perspective.

2. Forms of assistance to industry

State aids: a taxonomy

To understand what is meant by TES it is necessary to know something of the different forms of assistance provided by government to industry in industrialised market economies.

To begin with, we are not concerned with all governmental involvement in industry, only with what has been termed an intervention. What is meant by an intervention is captured by Article 92(1)⁶ of the Treaty of Rome establishing the European Economic Community. It involves four elements: government funding, an interference with market forces, a preference for certain enterprises⁷ and an impact on international trade.⁸ The intervention is usually on the supply side through, in effect, the provision of subsidised inputs, although interventions on the demand side or directly affecting the profitability of the enterprise have also occurred.⁹

It is also useful to make a distinction between a "general aid scheme",¹⁰ which is potentially available to all enterprises without discrimination, and aid schemes which only apply to a restricted range of enterprises through being, for example, sectorally or regionally specific. The latter are termed "selective interventions".

To complete our taxonomy it is necessary to note that both general aid schemes and selective interventions can be classified according to the principal goal being pursued, such as full employment, a healthy balance of payments, low rates of inflation or distributional equity. Furthermore, within each such classification a distinction can be made between short-term measures on the one hand and medium-term measures on the other.

State aids for temporary employment purposes

TES are state aids whose principal purpose is to reduce the level of unemployment. It is true that many selective interventions in industry offer, as an apparent side-benefit, increased employment and it is certainly

claimed that these are, in effect, employment subsidy schemes of either a temporary or a permanent nature. This is an issue which we shall take up in the next section, where we shall also consider whether these schemes are likely to last for longer than a limited period of time.

It is useful to note that TES can be either selective interventions or general aid schemes. This fact has been the source of some confusion and possibly misinformed comment. As we shall see below, the differing economic rationales advanced for these schemes would imply recourse to selective interventions in some cases and to general aid schemes in others.

Other state aids

During a period of rising unemployment it may at first sight appear to be difficult to identify forms of assistance which are principally concerned with alleviating unemployment. This is because emphasis is likely to be placed on the employment implications of almost any form of assistance to industry. Nevertheless, a distinction can be drawn between cases where the primary object of providing the assistance is to reduce unemployment and cases where some other concern predominates. Where it is difficult to draw such a distinction a test which can be applied is to consider what the government would do if, for some reason, it could not proceed with the assistance in question. If, as a last resort, it would be willing to provide a quite different form of assistance in order to be able to achieve the same anticipated impact on unemployment, then there can be little doubt that the state aid in question is an employment measure.

In practice it may be much easier than the above suggests to distinguish employment subsidy schemes from state aids provided as part of industrial, regional, structural adjustment and similar policies. This is because the former seek to make an immediate impact while the whole thrust of the latter is towards effecting more enduring changes in the economy. This is not to suggest that government programmes in support of the former may not extend over a considerable number of years or that programmes in support of the latter will necessarily last longer than the time between one budget and another. It should be noted that, in some cases, governments accept the fact that subsidising employment will only provide jobs for a limited period of time while, in others, there is an expectation (or at least a hope) that even when the subsidy is withdrawn workers will be able to keep their jobs or find new ones thanks to the training and experience gained during the period of subsidisation. Even in this latter case, however, the employment subsidy should be regarded as a temporary measure.

3. The main purposes served by TES

It is possible to distinguish three broad approaches to the development of TES. A firm may be encouraged to retain workers it might otherwise have declared redundant, it may be given an incentive to provide employment (albeit of a temporary nature) to the unemployed (and particularly to those lacking adequate work experience) or it may be provided with an inducement to invest (in plant and machinery, or even in inventories, better methods and new products). Each of these approaches will be discussed in turn below with the aid of appropriate examples.

Employment retention

While it is very tempting to visualise the unemployment problem as one of preventing redundancies (and the elimination of positions previously held by those who resign or retire), it is better understood as relating to the inability of those who seek it to find gainful employment. Rising unemployment levels can be consistent with stable and even rising levels of employment when the proportion of the population seeking employment increases. In these circumstances the elimination of unemployment may require more positive measures than an elimination of redundancies. It may be that the road to full employment will entail more rather than less structural adjustment in the economy. But, even putting dynamic considerations to one side, TES can raise some awkward problems in a static framework.

From a static point of view the employment subsidy appears at first sight to offer lower unemployment for a moderate budgetary outlay. The difficulty lies in devising practicable methods of administering a scheme so that the government is not offering a larger inducement than necessary, is not subsidising employment in some firms at the expense of jobs elsewhere and is not paying for workers declared redundant simply in order to obtain the subsidy.¹¹ The significance of these problems is a matter for conjecture¹² but there can be little doubt that their existence encourages variability in scheme design as governments strive to obtain the maximum reduction in unemployment levels for a given budgetary outlay.

The United Kingdom scheme provides an example of a subsidy which is available without the restrictions on eligibility to be found in some schemes.¹³ With a nil displacement effect,¹⁴ the flat-rate subsidy of £20 per week would lower unemployment and provide the Government with two valuable offsets: assuming average earnings of £45 per week, a reduction in expenditure on unemployment-related benefits in the region of £16 per week plus, on the income side, approximately £17 per week in additional income tax and social security contributions. The actual cost to the Government can only be a subject for speculation but the budgetary outlays amounted to £275 million between August 1975 and March 1978,

at which time 180,000 workers were being subsidised each week. It should be noted that this subsidy is only granted for three months at a time but that any firm can enjoy extensions up to 18 months.

A number of variants on this basic strategy of giving the firm a subsidy to avert redundancies can now be briefly considered. Firstly, it is possible to defer redundancies to a more favourable time of the year from the point of view of employment prospects. The National Labour Market Board (AMS) of Sweden has placed public orders with industry in order to postpone local shutdowns of industrial plants from winter to the spring or summer.¹⁵ Secondly, it may be possible to ensure that employees receive adequate notice of termination of employment. The AMS can support a bankrupt firm for up to six months with this end in view.¹⁶ Thirdly, the subsidy can be confined to workers expected to have particular difficulty in finding new employment. Among the measures taken to support the Swedish textile and clothing industries is a subsidy of 15 kronor¹⁷ per hour for employees over 50 years of age, who form one-third of the workforce in these industries.¹⁸ Fourthly, the subsidy can be made conditional upon the provision by firms of training to their employees: Swedish firms in financial difficulties can receive a subsidy of 25 kronor per hour for each participating employee up to a maximum of 960 hours per person.¹⁹

The interesting common feature in most of these examples is that they minimise the displacement effect and the danger that redundancies will be declared solely in order to obtain the subsidy. However, these schemes have not grappled with the problem of obtaining the highest possible employment retention for a given budgetary allocation by reducing subsidy payments to those firms which, had they been given a smaller subsidy, would have retained all or part of the workforce declared to need subsidisation.

Job creation

Two basic policy options are available in job creation. The emphasis can be placed on the recruitment of employees in nominated categories or on raising the firm's total level of employment.

Because of the "catch-22" situation faced by many of the unemployed, and particularly the young unemployed, i.e. the fact that they are frequently not considered for the available vacancies because they lack the experience and training which they might have gained had they been employed, there exists a wide variety of TES which seek to overcome this obvious barrier to employability. Nevertheless, the widespread interest taken in them²⁰ should not blind us to the fact that they, like most job creation schemes, experience much the same administrative problems as employment retention schemes. This helps to explain the variety of arrangements to be found in practice. The most obvious difficulty is confining the subsidy to those who really need it. Indeed, even if the subsidised employer does not recruit the trained

and experienced, he is tempted to take on employees whose other qualifications make them employable or who only just fail to meet his usual standards. This is not to argue that the unskilled and the semi-skilled are unemployable but simply that they form a group which is very vulnerable to recession, very difficult to help through selective employment programmes²¹ and, as a group, most likely to need a general expansion of the economy as a prerequisite for improved employment prospects.

Most of the employees recruited in nominated categories are usually young although it has not been unknown for schemes of this sort to cater for, or be extended to, other workers who have special difficulty in obtaining employment. For example, there was the United States' Job Opportunities in the Business Sector (JOBS). Its objective was to encourage the employment of members of disadvantaged groups who needed on-the-job training and support services in jobs requiring a significant level of skill.²² Here, however, although the target of 500,000 jobs within three years starting in mid-1968 was almost met, the retention rate was only 47 per cent.²³

More recent schemes can be divided into those which also involve on-the-job training and those which do not. All these schemes usually have age limits, requirements relating to minimum periods of employment and other eligibility conditions pertaining to the employee and, sometimes, the firm.²⁴ In some cases, for example in Norway and Sweden, schemes involving training run side-by-side with those which do not.²⁵ Almost all schemes have rules which insist that the new recruit be under 25 years of age²⁶ although lower maximum ages are quite common.²⁷ Several schemes seek to cater for apprentices whose training is in danger of being interrupted.²⁸

The remaining job creation schemes to consider are those which place no restriction on the employee who may be recruited except that he or she may have had to be unemployed for some stated period of time before becoming eligible for assistance. The firm has to satisfy eligibility conditions which usually are designed to ensure that its total level of employment increases, even if only for a specific length of time.²⁹ Most countries³⁰ which have an unrestricted scheme also have one where the subsidy is limited to the recruitment of employees in nominated categories.³¹

Investment inducements

Most of the TES considered so far have an impact on aggregate employment because lower real wage-costs for marginal employees induce an increased use of the labour factor. In the case of some other TES an induced increase in output necessitates a greater employment of factors but no change in factor proportions.

Undoubtedly the best known among the latter group of TES is that which operates in Sweden to allow tax relief on profits which are placed in

an account with the Central Bank. These can only be drawn upon for investment purposes in accordance with prescribed rules.³² Other methods of encouraging investments which serve as cyclical equalisers are to bring forward planned projects in the public sector,³³ or the use of inducements in the private sector.³⁴

Valuable as these incentives to investment may be, they only have a limited impact on the available spare capacity in the economy. However, in a Swedish scheme, inventory levels are subsidised in order to encourage the maintenance of employment levels.³⁵ It is interesting to note in this regard that when the British machine tool industry sought a stockpiling assistance scheme the Department of Industry preferred to help it to modernise and develop new tools.³⁶

Finally, mention should be made of structural or trade adjustment assistance, which inhabits a borderland between industrial policy and temporary employment policy. Whereas industrial policy is more usually regarded as involving product diversification, this form of assistance more often than not encourages process differentiation. This enables the firm to compete more effectively in its own industry rather than transfer its resources elsewhere. Furthermore, the aid, whatever its ostensible rationale, can be both a compensation for adverse government decisions (e.g. a reduction in the level of protection) and a form of temporary assistance to allow time for adjusting to changed circumstances.³⁷

4. Possible limitations of TES

Effectiveness in general

TES have been strongly criticised on the grounds of limited effectiveness. It is argued by some that no acceptable analysis of the unemployment problem would suggest that it could be solved by creating temporary jobs, and by others that TES divert funds away from measures which would ensure higher levels of employment in the medium term.

As far as the first of these arguments is concerned, the rationales advanced in support of TES will be examined in more detail below. However, it can be noted in passing that there would appear to be quite strong evidence that much unemployment in industrialised market economies is of a temporary nature. There are plausible reasons for believing that the recession will end, even if it cannot be predicted when this will occur, and that, in the subsequent economic expansion, the level of unemployment will be substantially reduced. Similarly, experience suggests that, given sufficient time, serious pools of unemployment do tend to dry up. Furthermore, although TES are short-term in nature, subsidies can be given right through an extended period of recession. Consequently, it is difficult not to believe that TES make some contribution to reducing

unemployment. Of course, this is not to claim that TES deal with the underlying causes of unemployment or that only TES should be used to "cure" or alleviate unemployment.

Turning to the diversion of funds argument, this may be expressed in terms which stress the folly of undertaking palliative measures within the present economic structures or in terms which stress the areas in which it is claimed the funds would be better spent. The first approach is based on the contention that unemployment has its source in changes in the economy (such as advances in technology) which mean that consumers are never likely to buy as much as some industries are capable of producing. The difficulty with this contention is that while changes of this kind do occur and do contribute to unemployment problems, there is no way of proving that market economies will not be able to surmount these problems in the future as they have in the past. Furthermore, while there may be some truth in this claim in respect to some industries, even in its most extreme form it does not imply that most industries will not offer much the same kind of employment opportunity as they always have when the recession does come to an end.

The second approach to the diversion of funds argument places stress on the need to give priority to measures with a medium- to long-term effect undertaken as part of a, say, growth, industrial or regional policy. Now, while it is undeniable that funds spent with some temporary purpose in view frequently do not achieve any lasting effect, such an argument is only decisive if it can be demonstrated that the government cannot better attain some policy goal through the use of a temporary measure or that by some quirk of the budgetary process the allocation of funds does not reflect the government's real priorities. It is not possible to accept that one or both of these conditions generally hold. Consequently, TES cannot be ruled out on these grounds.

The discussion suggests that TES should not be discarded on the grounds of limited over-all effectiveness. The arguments advanced to discredit them involve claims that there is more to an understanding of the unemployment problem than is usually taken into account in devising TES. However, there is nothing in the thinking underlying TES which precludes government action being directed against other aspects of the unemployment problem.

Effectiveness in attaining stated objectives

The above claims that TES are ineffective were couched in very general terms. Politicians and administrators are far more interested in evaluations of the ability of TES to achieve their stated objectives.

The first of the principal stated objectives is to even out the business cycle. This objective has its roots in contemporary thinking which does not accept that the alternating phases of expansion and contraction in the

economy are beyond government control. We should note here that there is an inconsistency in a government placing faith in the employment-generating powers of the additional funds expended on TES if it has no confidence in higher levels of government expenditure as a general cure for unemployment. Nevertheless, the effect of reducing unemployment during a recession may be obtained from TES even though the government is not able to find a budget formula which allows it to achieve its over-all employment (and other economic) goals.

The second objective is to minimise the budgetary cost of unemployment by reducing the total outlay on unemployment benefits. Now, whether TES do this depends on the precise nature of each scheme. In particular, the extent to which the scheme reduces unemployment by eliminating employment prospects elsewhere in the economy is crucial in determining the real cost of these schemes. It can be noted, in passing, that more might be done in the way of sharing the available work more evenly. However, there appears to be little doubt that TES can be devised which, if they can be made to function as they are expected to, should reduce the budgetary cost of unemployment.

The third main objective is to reduce the total number of unemployed by providing work for, or protecting the jobs of, persons who satisfy particular criteria. This has its origin in contemporary manpower policy with its concern about "mismatches" between the skills and experience of the unemployed and those likely to be required by employers with vacancies to fill. This objective would appear to be the one which dominates current thinking on the question of employment subsidies. However, a considerable variety of opinion exists as to which of the unemployed should benefit. In some cases this reflects a desire to achieve the greatest possible reduction in unemployment for a given expenditure level by making the subsidy scheme as attractive as possible to the employer. In other cases the government is assumed to have a better knowledge of the longer-term needs of industry than is to be obtained from current market signals or to be working on the assumption that the most disadvantaged need the most assistance. It is unfortunate that, while TES seek to reduce aggregate unemployment by reducing unemployment in particular areas, there is no clear understanding of the relationship between attempts to reduce unemployment in these areas and their effects on aggregate unemployment. But it is likely that this problem does more to restrict the wide use of TES than to affect the workings of particular TES.

Side-effects

Besides criticisms of TES which cast doubts on their effectiveness, there are others which suggest that they can have adverse side-effects. In particular, it is claimed that TES are detrimental to the process whereby

countries specialise in producing those goods in whose production they have some inherent advantage and to the process whereby economies adjust to allow this specialisation in production. These points will be examined in turn.

Government assistance to industry which affects its international competitiveness can be divided into two categories. The assistance can be provided as part of a process whose ultimate aim is to ensure that domestic industry specialises in producing those goods in which it has some inherent advantage. Alternatively, it may be given in accordance with a policy which seeks to ensure that all, or part, of particular domestic markets are reserved for domestic producers even though this intention may not be frankly acknowledged. Where the assistance falls into the first category it is difficult not to accept assurances that the most expedient path to a more efficient allocation of resources is being taken.

It may be objected that, whatever the intentions may be, subsidies are unlikely to be removed until the economy has actually adjusted so that the domestic industry can compete once more on international markets. If this is so, they are suspect because they provide, if not an incentive not to adjust, at least some compensation for not having done so. This argument would be more plausible if most TES were, in practice, selective interventions. However, since most are general aids it would appear more reasonable to argue that the continued existence of TES is likely to be encouraged at least as much by the persistence of unacceptable levels of unemployment as by the problems facing particular industries.

While TES in some cases may be associated with a protective attitude towards domestic industry, it is more likely that their protective use reflects a desire to insulate domestic industry from international market forces than that the schemes themselves encourage protective attitudes. Eliminating TES would only change the garb with which protective impulses are clothed.

A new policy instrument

Most of the arguments advanced to support the claim that TES are ineffective have been shown to be based on an inadequate appreciation of what governments are seeking to do with these schemes. It is true that TES are not based on any profound analysis of the sources of, and possible remedies for, unemployment. This is because, paradoxical though it may seem, TES have *not* been dedicated to the goal of eliminating unemployment. Such schemes depend for their usefulness on the assumption that governments need a policy instrument which allows them, by producing some immediate alleviation of the problem, to "buy time" during which other policy instruments and/or the market mechanism will reduce unemployment to more acceptable levels. In particular, governments are reluctant to consider medium-term solutions to a problem

which may be transitory, to abandon mildly deflationary policies which are believed, rightly or wrongly, to have at least a short-term adverse effect on employment, and to retreat from a commitment to international specialisation in production which is considered to provide a significant boost to growth and to demand for labour in the medium term.

This interpretation of TES is not accepted by those who point to the wide variety of TES, the evidence that they are sometimes introduced hastily as political palliatives, and the retarding effect they can have on structural adjustment in industry. But any argument that governments react to higher levels of unemployment by arbitrarily guaranteeing long-term job security in some cases and not in others must fail as a general proposition not because they have never done so but because so much of the relevant intervention in industry is short-term in character and consistent with expectations that certain kinds of short-term measures are likely to be efficacious in practice.

5. Economic rationales for the use of TES

Most discussions of TES have centred more on the technicalities of devising effective measures than on exploring fundamental questions relating to the causes of, and cures for, unemployment. These discussions tend to imply that TES should function satisfactorily provided adequate administrative procedures can be developed.

Cyclical equalisation

The cyclical equalisation rationale is based on an assumption as to the nature of the economic environment in which TES will operate. In this rationale stress is laid on the likelihood that any period of recession is merely an interlude before the economy begins expanding again. Consequently, social, if not private, benefits can be gained by bringing forward investment, production and training into the recession period so as to reduce pressures on the economy during the upswing. Since, in general, it presumably does not matter whereabouts in the economy cyclical equalisation occurs, this rationale encourages the use of TES as general aid schemes.

While this rationale appears to be little more than a particular application of the general proposition that governments should seek to control the level of aggregate demand at all stages of the business cycle in order to damp down fluctuations in aggregate employment, TES can be regarded as institutional arrangements whereby governments seek to offset the deflationary forces at work in the economy in such a way that any increase in government expenditure is concentrated on giving an immediate stimulus to employment. In recent years the need for TES has become more apparent as, in many industrialised market economies, periods of sustained

expansion, particularly periods coupled with dramatic declines in the number of those unemployed, have become less frequent.³⁸ This change in economic circumstances has led to changes in expectations which have effects on both the supply and the demand side of markets. For example, there is some evidence that both employers and employees are increasingly reluctant to train and be trained solely or primarily at their own expense.

Labour immobility

The cyclical equalisation rationale for TES was developed at a time when it was assumed that governments could effectively control the level of economic aggregates such as employment, demand and investment. While a decline in confidence in this ability does not diminish the value of the contribution TES can make to cyclical equalisation, it does lead to TES being also seen as part of the answer to that part of the unemployment problem which reflects a malfunction of the economy in some "structural" sense. Attention has been focused on the general slowness with which labour resources respond to changes in market signals, and this has been advanced as a major reason why governments should seek to intervene on a temporary basis in the private sector. In particular, it is argued that labour markets function imperfectly, imposing costs on those looking for employment. Consequently, it is considered desirable to allow those facing redundancy as much time as possible to obtain a new post before they lose their old job. This is regarded as being particularly important in cases where a large number of employees are likely to be made redundant at the same time. It should be noted that although this rationale should, and to some extent does, encourage the design of TES as selective interventions, many TES which appear to be more readily explicable in terms of this rationale are designed as general aid schemes. This results from a desire to assist as many of the unemployed as possible, thus forcing an emphasis on administrative simplicity in scheme design.

Cost-benefit analysis

Both the rationales considered so far assume that TES will yield a worth-while reduction in unemployment in return for the funds expended. In the cost-benefit analysis rationale it is argued that many TES will be justifiable if costs are compared with benefits (even if this is done in rather informal terms). This rationale comes in one of two forms. Either it is argued that there will be no net cost to the government from a properly administered scheme or it is argued that there will be no net social cost once all the costs imposed on society by unemployment are taken into account. But, as we saw in the case of the British TES scheme discussed above,³⁹ calculations of this nature tend to be heavily dependent on an

assumption that the scheme operates in an "ideal" way, for example that there is no displacement effect. Once the cost of the subsidy increases, the government will be interested not only in determining whether the benefits outweigh the costs but also in the different cost-benefit ratios characterising alternative approaches to reducing unemployment, with possibly lower costs of subsidy per additional person employed. It should be noted that this also is a rationale which might well encourage the design of TES as selective interventions. However, given the informality of most approaches to cost-benefit analysis in this area, there is a considerable willingness to believe that most schemes would pass the cost-benefit test and, consequently, that net benefits are maximised by extending the subsidies to as many of the unemployed as can be plausibly included in one scheme or another.

Comparative cost disadvantage

The final rationale, which is more controversial than the three discussed above, holds that subsidies can lead to an increase in aggregate employment by partly offsetting the immediate comparative cost disadvantages affecting many industries that are shedding labour.

The objections made to this rationale are that subsidies which seek to increase employment at the expense of a trading partner abroad invite retaliation in the form of comparative programmes of subsidisation, discourage the process of structural adjustment in industry and are a poor substitute for a devaluation should domestic and foreign cost levels be seriously out of alignment. While admitting the force of these arguments, there may well be a case for using TES for a limited period in a small number of industries which cannot be effectively assisted in other ways (provided competitive subsidisation is unlikely or is controlled by international agreement) in order to "buy time" to allow an industry and its employees to adjust to changed circumstances. Once again it may be noted that the rationale tends to suggest that TES should be selective interventions even though the element of selectivity in TES design may be missing in practice.

6. Improving the efficacy of TES

The role of TES

While the discussion of the rationales for the use of TES may suggest that circumstances exist in which these subsidies have something to contribute, none of the rationales considered can be said to provide a convincing explanation of the role TES are expected to play in the relief of unemployment. One reason for this must surely be that, with declining

confidence in the efficacy of demand-management methods, governments in industrialised market economy countries are losing faith in their ability to reach their immediate employment and other major economic goals such as stable prices, high levels of economic growth and a healthy balance of payments. Reduced unemployment is increasingly seen as a goal which will be attained only after other economic goals have been reached.

The existence of TES does not necessarily contradict this point of view. An examination of the case for subsidies in the previous section indicates that the role of TES in reducing unemployment is unclear. Cyclical equalisation emerges as only part of a programme of counter-cyclical expenditures, the labour immobility argument is frequently thought to be equally applicable to the medium and to the short term and a cost-benefit approach is concerned with reducing government expenditure as much as with reducing unemployment. And, whatever else might be said about the comparative cost disadvantage rationale, it is very doubtful whether current levels of unemployment in the industrialised market economies arise primarily from any loss of competitive advantage in international trade.

Our discussion has also suggested that the implementation of TES reflects a misunderstanding of the most appropriate role for these subsidies. Unless TES are to be seen solely as cyclical equalisation measures, they are only likely to be effective when used selectively in the most appropriate circumstances. Despite this, many TES are clearly conceived as if the coverage of particular schemes (rather than the number of well designed schemes) should be one of the principal criteria by which the TES contribution to reducing unemployment should be judged.

Developing a satisfactory role for TES will involve a re-examination of government expenditure priorities at various stages of the business cycle. Even if we must accept that a tight rein has to be kept on aggregate levels of government expenditure, this does not preclude the development of more flexible policies towards the composition of this expenditure. Three things in particular need to be done. Firstly, labour-intensive expenditures need to be reserved as far as possible for periods of recession. Secondly, TES need to be funded in ways which allow the level of funding to vary directly with the level of unemployment. This allows the labour supply to respond more readily to pressures for structural adjustment during periods of expansion. Finally, the on-going obligations incurred by all government expenditure programmes need to be carefully monitored, particularly during expansionary phases when controls over public expenditure tend to be relaxed.

In an ideal world the composition of government expenditures would vary in labour intensity over the business cycle. In practice, governments have to take specific steps to encourage labour-intensive expenditures during periods of recession and this provides a role for TES in economic policy. Since it is unlikely that the labour intensity of government expenditures in each industry at a particular point in time can be identical, it is to

be expected that TES will take the form of selective (labour-intensive) interventions rather than general aids.

Overcoming the suggested TES limitations

We did not accept above that any of the criticisms levelled at TES demonstrated that they suffered from major shortcomings or justified refusing to use them. Nevertheless, it is interesting to look again at the suggested limitations of TES because, having clarified the role played by these subsidies, it is possible to see the criticisms in better perspective.

Clarifying the role of TES is important because unless we identify their expected contribution to economic policy-making it is impossible to determine criteria by which they may be judged. Where these subsidies are represented as being not only an "answer" to unemployment but one which might even reduce government expenditure, it is only to be expected that TES will tend to be judged in the light of such exaggerated claims. Once a meaningful role has been established for TES attention is focused on the real question at issue. This is whether TES, implemented as part of some anti-unemployment policy, can realistically be expected to make a significant contribution to the furtherance of that policy.

Accepting that TES have a role to play in reducing unemployment blunts the diversion of funds argument. The case for government funding of medium-term measures is different from that for short-term measures and each has to be argued on its merits. By the same token, although TES might be used for various other stated objectives of government policy and, consequently, must be judged in relation to the relevant objective, we would prefer to focus attention on one which makes most sense within the broad framework of economic policy.

Specifying a role for TES does not preclude these subsidies from exercising a protective influence vis-à-vis domestic industry. However, it does identify the stages of the business cycle during which structural adjustment measures should be concentrated. Finally, it can be noted that the proposed role for TES places more emphasis on the contribution these subsidies can make to reducing unemployment and less emphasis on their "buying time" aspects which have tended to dominate contemporary official thinking.

A specific proposal

The main conclusion of this paper is clearly that TES represent an important new development but that they have met with a very mixed response because of the lack of a persuasive rationale for their use. The clarification of the role of TES will be pervasive in its effect and little is gained by trying to speculate on the various ways in which it might have

some impact on these schemes except to suggest that, in the short term at least, a reappraisal of the rationale(s) underlying present TES might lead to their modification or abandonment. We would expect this to happen because it is possible that a re-evaluation of the contribution some TES are making would raise doubts as to whether they are actually reducing unemployment at all. These doubts would tend to be encouraged by a realisation that what was intended as a selective intervention in the economy has often become a general aid likely to be used both in areas where it may be effective and in areas where its effectiveness is less certain.

The taxonomy of state aids developed above is more than just an explanatory device since it has implications for the type and resource demands of the administrative processes necessary to implement them successfully. In broad terms a general aid seeks to obtain the advantages which flow from administrative simplicity and a neutral effect (as between different sectors of the economy) at the risk of influencing the incentive structure in areas to which the economic intervention in question was not deliberately directed. By the same token, a selective intervention may well have the implied advantages—and disadvantages—of not being a general aid. On balance, we would consider the ability to devise more specific instruments of economic policy and to confine intervention to those areas of the economy which are policy-relevant would outweigh any losses arising from administrative costs and departures from a more efficient pattern of resource allocation. But to make selective interventions truly selective, governments need to establish a sufficiently detailed planning machinery to enable them to discriminate, on the basis of a close knowledge of the particular employment markets and industrial technology, between cases where TES can significantly reduce unemployment and cases where they would affect the composition but not the level of unemployment.

Notes

¹ Approximately, from two to five years.

² Up to about two years.

³ Or until the economy picks up of its own accord or as a direct result of demand-management techniques.

⁴ By imposing costs on other firms, by discouraging structural adjustment at the firm level and by competing for the limited funds available for microeconomic interventions.

⁵ Ad hoc, in this context, can be taken to imply either that all selective interventions (or even all microeconomic interventions) in the economy are wrong or that such interventions should only be undertaken in order to produce specific desired medium-term effects.

⁶ "... any aid granted by a Member State or through state resources, in any form whatsoever, which distorts or threatens to distort competition by favouring certain enterprises or the production of certain goods shall, to the extent to which it affects trade between Member States, be incompatible with the common market".

⁷ Or, as the Article cited in note 6 adds, "the production of certain goods".

⁸ For further discussion of what state aids mean in the EEC context see G. Schrans: "National and regional aid to industry under the EEC Treaty", in *Common Market Law Review* (Alphen aan den Rijn), May 1973, pp. 175-181.

⁹ For a list of measures considered state aids in the EEC context see A. Dashwood and T. Sharpe: "The Industry Acts 1972 and 1975 and European Community Law: Part I", *ibid.*, Feb. 1978, p. 12.

¹⁰ Defined by Dashwood and Sharpe (*loc. cit.*) as "a scheme whereby state assistance is granted to undertakings in whatever business or location for purposes which are typically ill-defined but which are normally expressed in terms of encouraging economic growth or modernisation of the national economy or some such broad formula".

¹¹ For a discussion of these points see OECD: *A medium term strategy for employment and manpower policies* (Paris, 1978), pp. 67-68.

¹² The OECD Secretariat has prepared estimates of the net cost to the British Government of allocating £260 million to its temporary employment subsidy scheme on the basis of 270,000 subsidised workers with assumed average earnings of £45 per week. The subsidy is £20 per week and the net cost would be -£185 million (i.e. a gain to the Government of £185 million) if no unsubsidised workers were displaced but would rise to +£60 million if 60 per cent of the jobs involved represented a displacement of unsubsidised workers. *Ibid.*, p. 69.

¹³ *Ibid.*, pp. 68-69.

¹⁴ See note 12.

¹⁵ "Active manpower policy in Sweden", in *Fact Sheets on Sweden* (Stockholm), Oct. 1974, p. 3.

¹⁶ *Ibid.*

¹⁷ 1 Swedish krona = US\$0.23 or £0.11.

¹⁸ Study Group on Structural Adjustment: *Report* (Canberra, Australian Government Publishing Service, 1979), Vol. 2, pp. 11.1.26-27.

¹⁹ B. A. Ericsson: "The employment situation in Sweden: some main issues looking ahead to the 1980s", in *Current Sweden* (Stockholm), May 1979, pp. 4-5.

²⁰ A particularly valuable reference is OECD: *Youth unemployment* (Paris, 1978), Vol. II.

²¹ There are very few industrial plants in the industrialised market economies which have a labour-intensive technology using a high proportion of unskilled and semi-skilled workers. In cases where such an appropriate technology can be found it is difficult to act without adversely affecting the trading opportunities of the less developed countries. For this reason projects to assist young people are more likely to be in the public rather than the private sector. For example, the United Kingdom Job Creation Programme, which provides funds for community-sponsored, labour-intensive, non-profit schemes, seeks to give priority to young people and to emphasise projects which involve environmental improvement and the training needs of young people (OECD: *A medium term strategy*, . . . , *op. cit.*, pp. 72-73). This may also partly explain the negative attitude to employment subsidy schemes—whether for youth or others—taken by those who attended an OECD conference on youth unemployment. See *idem*: *Youth unemployment*, *op. cit.*, Vol. I, pp. 80-81.

²² For a brief summary of this scheme see Diane Werneke: "Job creation programmes: the United States experience", in *International Labour Review*, July-Aug. 1976, pp. 52-54.

²³ This scheme has been the subject of a number of evaluative studies, for example O. A. Davis et al.: "An empirical study of the NAB-JOBS program", in *Public Policy* (Cambridge (Massachusetts)), Spring 1973, pp. 235-262.

²⁴ For example, to qualify under the French scheme—which allowed an exceptional exemption from the employer's social security contribution for newly engaged young people under 25 years of age—a firm must not have laid off any personnel for economic reasons during a specified period of time (OECD: *Youth unemployment*, *op. cit.*, Vol. II, p. 58).

²⁵ *Ibid.*, pp. 116-118 and 128-129.

²⁶ Although there is a Swedish scheme where the trainee must be at least 25 years of age or have had five years' vocational experience. *Ibid.*, p. 129.

²⁷ The Norwegians experimented with a scheme in 1976 which was confined to those aged under 18. It was dropped (except for districts where difficulty was experienced in using

other measures) because it was feared that it would lead to demands for a subsidy for the engagement of young people in general. *Ibid.*, p. 117.

²⁸ In Ireland and Northern Ireland. *Ibid.*, pp. 76-77 and 159-160.

²⁹ In the case of the Small Firms Employment Subsidy in Great Britain the firm has to have employed fewer than 50 persons on a specified date and be located in a Special Development Area. *Ibid.*, pp. 145-146.

³⁰ For example, Belgium, Ireland, Norway, Sweden and the United Kingdom. *Ibid.*, *passim*; and Ericsson, *op. cit.*

³¹ An exception is New Zealand (OECD: *Youth unemployment*, *op. cit.*, Vol. II, pp. 103-106).

³² "Active manpower policy . . .", *op. cit.*, p. 3.

³³ For example, see Ericsson, *op. cit.*, p. 4; and OECD: *Youth unemployment*, *op. cit.*, Vol. II, p. 74 (for an Irish scheme).

³⁴ A. B. Philip: *Creating new jobs: a report on long-term job creation in Britain and Sweden* (London, Policy Studies Institute, 1978), p. 3.

³⁵ Study Group on Structural Adjustment, *op. cit.*, Vol. 2, pp. 11.1.16-17.

³⁶ Philip, *loc. cit.* This is one case, at least, where "good" industrial policy was not supplanted by "bad" employment policy.

³⁷ See Study Group on Structural Adjustment, *op. cit.*, Vol. 2, appendix 11.1 (overseas industry-specific policy); and G. Edgren: "Employment adjustment to trade under conditions of stagnating growth", in *International Labour Review*, May-June 1978, pp. 289-303.

³⁸ For a discussion see P. McCracken et al.: *Towards full employment and price stability* (Paris, OECD, 1977), pp. 37-99.

³⁹ See note 12.