The Irish Labour Market Review 2006

A FÁS review of Irish labour market trends and policies

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The Irish Labour Market Review is prepared and published by FÁS as a contribution to understanding and debate about Irish labour market developments and issues. The Review was first published in 2002 and has been published annually since. It has addressed a range of issues including the labour market participation of disadvantaged groups, up-skilling of the employed, older workers, immigration, gender pay gaps and incentives to work. This year's Review presents an overall assessment of labour market developments in Ireland (Chapter 1), addresses three labour market policy issues in Chapter 2 and contains a special article on replacement rates written by three authors from the ESRI in Chapter 3. A summary of statistics on the Irish labour market is presented in the Appendix. The Review has been prepared by the Planning and Research Department of FÁS[1].

Chapter 1 - Labour Market Trends and Developments

Ireland's economy has again performed strongly in 2006, generating high employment growth with the numbers employed passing the two million mark for the first time in the recorded history of the State. In fact, over the last five years the numbers at work have increased by 300,000, with the majority of the jobs being created in the services and construction sectors. By the second quarter of 2006 annual employment growth was 4.6%, an exceptional performance by any standards. However, not all sectors of the economy have experienced employment growth. Notwithstanding the continued economic success of the manufacturing sector, employment in manufacturing has declined by 30,000 jobs since 2001. Much of the economic growth in the last few years has been driven by the strength of domestic demand, which in turn has been boosted by low interest rates and favourable demographic trends.

Immigration has been an increasingly important factor in our labour market success, with net migration into the labour market increasing from 11,000 in 2003 to 52,000 in 2006. The main source of this increase has been EU enlargement with approximately 300,000 PPS numbers issued to EU10 workers since the New Member States joined the EU on May 1st 2004[2]. The increase in immigration, combined with increased participation (especially amongst women), has, in spite of strong labour demand, kept labour shortages at a manageable level in recent years.

The number of unemployed has risen by 26,000 from a historic low of 65,000 in 2001 to 91,000 over the last five years. Despite this increase, the unemployment rate has increased only slightly from 3.6% to 4.3%. While the Irish unemployment rate still compares very favourably to the EU average of 7.9%, the difference between the

[1] The principal author is Mr Brian McCormick
[2] The number of immigrants who stay for a sustained period of time is much less than the PPS numbers might suggest.

two has narrowed as unemployment has been falling in many EU countries (especially in the EU10 countries).

Strong labour demand contributed to an acceleration in the rate of earnings growth over the 2000-2005 period compared to the 1995-2000 period, with earnings growth fastest in the construction and public sector but more moderate in manufacturing. Productivity growth was negative in the sector where employment growth was strongest (construction) and strongest in manufacturing where employment declined. When earnings and productivity trends for the economy as a whole are taken together, we have been losing competitiveness vis-à-vis our main trading partners. The Central Bank estimates that relative[3] unit wage costs increased by 6% in 2005 and by 23% over the longer 2000-2005 period.

The strong performance of the economy looks set to continue in the short-term with average GNP and GDP growth rates of 5-6% forecast for both 2006 and 2007. The maturing of the SSIA accounts and likely fiscal policy suggest that domestic demand is likely to remain robust out to 2008 at least, while the continued recovery in the international economy augurs well for our export sector. This will help to create more jobs over the coming year. However, output in the construction sector, a major driver of employment growth in recent years, is expected to slowdown. Following very high employment growth of 4.5% in 2006 (88,000 extra jobs) we are forecasting a slower, though still very positive, rate of 2.8% (57,000) in 2007. The vast majority of the employment growth in both years is expected to come from the services sector, while the contribution of the construction sector is forecast to change from being strongly positive in 2006 (+19,000 jobs) to being broadly neutral in 2007 (+1,000 jobs). Unemployment is estimated to rise marginally from 94,000 in 2006 to 99,000 in 2007. However, the unemployment rate is forecast to remain unchanged at 4.4%. While immigration is expected to be remain strong in 2007, it will probably moderate slightly from 2006 levels.

Medium-term prospects for both the economy and the labour market are less certain. A number of commentators have highlighted possible risks to Ireland's success; a slow-down in the US (and hence world) economy, an end to Ireland's housing boom, a decline in Ireland's competitiveness or an energy crisis. The ESRI Medium-Term Review (MTR) contained two alternative forecast scenarios; a low growth scenario and a high growth scenario. The low growth scenario is premised on a 'correction' in the US economy[4]. This would have a negative impact on both the Irish economy and the labour market. Under this low-growth scenario, there would be a slowdown in employment growth, with the number of jobs created falling to 20,000 per annum over the 2006-2012 period and the numbers unemployed increasing by 70,000. Under the ESRI MTR high-growth scenario, employment is forecast to grow by 15% between 2006 and 2012[5]. If the ESRI employment growth rate associated with the high-growth scenario holds then we estimate that this would lead to 314,000 jobs being created over the next 6 years, an average of 52,000 jobs per annum. This represents a strong employment performance of 2% employment growth per annum.

Chapter 2 - Policy Issues

The ESRI's medium-term economic outlook suggests that the period of high employment and low unemployment in Ireland of recent years may be threatened sooner or later. Chapter 2 presents a'what if' analysis of the Irish labour market in the belief that the threats to Ireland's continued success have increased during 2006. Looking into the future, and considering

[3] Adjusted for the exchange rates of our main trading partners.
[4] Such a correction would be driven by the need to reduce the US deficit and would necessitate a sharp depreciation of the dollar leading to higher interest rates and slow US economic growth.
[5] The ESRI MTR forecast was based on PES figures, whereas our forecast here is based on ILO

what policies may be needed, is the best approach to overcoming any new challenges that lie ahead. The chapter is divided into three sections. The first section considers the impact of an external economic shock on the labour market. The next section looks at an issue that has gained prominence in 2006, and that would become increasingly relevant in the event of any shock, namely displacement. The final section reviews a labour market approach called 'flexicurity' which aims to reconcile the potentially competing objectives of job security and labour market flexibility.

Prepare to Slowdown

As the pace of globalisation increases, and given the Irish economy's openness, so too does the potential for negative external events to impact the Irish economy. We consider the implications of two possible slowdown scenarios for the labour market, namely a slowdown in the construction sector, and a euro appreciation vis-à-vis the dollar as the US economy corrects its large trade balance. The housing sector merits special attention given its importance to both the economy and, in particular, the labour market, and given that concerns about a 'housing bubble' have been increasingly voiced through 2006. In particular, we consider the possible effects of a house price decline on the labour market and conclude that this could, in certain circumstances, lead to a significant increase in unemployment. A slowdown in the construction sector might also affect the ability of the labour market to absorb migrant labour. Given the dependence of the labour market on the construction sector, we suggest that plans need to be put in place that would help the re-employment of any construction workers made redundant in the event of significant falls in employment in the housing sector.

A 'correction' in the US economy would also have serious implications for the Irish labour market and would, like the housing scenario, threaten Irish economic growth. It would be important to maintain competitiveness and avoid a wage-price spiral prolonging such a recession. There may be a need to review wage bargaining approaches in such circumstances. More generally, new policies which make the labour market more responsive to global events may need to be devised.

Recommendations

In general, Government departments and agencies should assess the need for a contingency plan which would outline specific policies or measures that should be put in place to help address the threats facing the economy and to mitigate the impact of any slowdown.

Specifically, FÁS, in consultation with the relevant stakeholders, needs to assess the implications for construction employees, especially apprentices, of a slowdown in the housing market and prepare a contingency plan accordingly.

In the event of any deterioration in the economic environment, new approaches to national wage bargaining may be needed that are flexible enough to allow for a significant short-term moderation in earnings growth, which would help facilitate a more rapid economic recovery. The precise method for achieving such an adjustment would need to be decided by the social partners.

Displacement

Research indicates that immigration's overall effect has been positive for the Irish economy. Looking to the future, estimates suggest that gross immigration levels of about 50,000 p.a. are expected over the medium term to sustain economic growth and avoid labour and skill shortages. However, experience in other countries and academic research indicates that immigration can also

have some negative consequences. In particular, immigrants may cause displacement of some local workers, resulting either in job losses or reduced wages. The international research suggests that the impact of immigration on a country depends significantly on the types of persons who immigrate and the economic situation of the country. While the research findings vary from country to country, in general it is concluded that in the short-run immigration tends to depress earnings, but that this process may reversed in the long-run. Research by the ESRI on the Irish experience of immigration over the 1997-2003 period is consistent with this view.

We examined official data on employment and earnings for possible evidence of displacement. While firm conclusions could not be drawn from the available data, the statistics suggest that displacement is not a major or widespread issue in the current circumstances of the Irish economy. The two main pieces of evidence for this conclusion are the continued low levels of unemployment and the continued rise in wage levels across all the main sectors of the economy. However, displacement could become an issue for low-skill workers should there be an economic slowdown. Much would depend, in such circumstances, on the extent to which immigration to Ireland fell rapidly and existing foreign nationals returned home. International research suggests that higher-skilled workers are more likely to return home.

There are a number of ways to minimise the threat of displacement and maximise the benefits of immigration to our country. Firstly, it is essential that rigorous systems are in place to ensure compliance with labour legislation and so avoid exploitation. As agreed in Towards 2016, major improvements are underway in this area. Secondly, there is a need to have in place a suitable system for the recognition of foreign qualifications. While ideally such a system might be operated on an international basis across the whole of the EU, a national system has been recently established by the NQAI. This will help highly-qualified foreign nationals work in jobs commensurate with their skills, thereby reducing the risks of an oversupply of migrant workers in the market for low-skilled labour. However, the time and resources needed to operate such a system are significant, especially given the increasing number of workers entering the country. The third aspect of importance is English language ability. This has been identified as a major reason why foreign nationals earn less than Irish ones. Organisations, including FÁS, have developed policies in this area over the last few years as the demand for English language training has increased. The issue of the extent and funding of such provision is a matter of on-going debate.

The issue of displacement gives an added focus to the need to enable Irish workers to up-skill and re-skill in the context of changing labour market requirements. As indicated in Towards 2016, and building on existing programmes, there is a need for strengthened efforts to train employees, particularly those with low levels of qualifications.

Recommendations

The arrangements agreed in Towards 2016 to ensure an employment rights compliance system that is effective and has the confidence of all interested parties should continue to be implemented.

There is a need for a well-developed system of qualifications recognition for foreign nationals. However, the time and resources needed to operate such a system, especially in the context of increasing immigrant numbers, should not be underestimated.

English language training for workers from non-English speaking countries is important to help

integration and maximise the benefits to the Irish economy and the immigrants themselves. There is a need for Government and its agencies to re-examine policy in this area and develop a clear approach to provision and funding.

Efforts by FÁS and others to up-skill and re-train existing Irish workers in jobs or sectors under threat need to be continued and extended. There is a need to review the various approaches underway to develop a best-practice model including guidance and appropriate training. Generic skills development is likely to be an important part of such training.

Better research on displacement would be enabled by the collection and provision of data on wages, jobs and nationality by the CSO. The various parties concerned should, therefore, review existing data and possible improved approaches.

Flexicurity

Globalisation implies often rapid economic restructuring and more frequent job changes by workers. This creates a dilemma for the EU if it wants to maintain competitiveness while at the same time preserving the European social model, given that a more flexible labour market is likely to have negative implications for job security. Recently, there has been increased interest in the concept of 'flexicurity', which is seen as a way of reconciling labour market flexibility with employment security. Flexicurity rests on the fundamental idea that flexibility and security are not necessarily contradictory but mutually supportive. The flexicurity approach was endorsed by the European Commission at the Spring 2006 European Council.

While several countries have incorporated elements of the flexicurity approach, the classic example is found in Denmark. The Danish flexicurity model is comprised of 'The Golden Triangle' made up of the following: (1) high mobility between jobs, (2) a comprehensive social safety system, and (3) a strong emphasis on activation and active labour market policies. In the Danish model employees can be fired with just 3 days notice, but they can (in the case of low-paid workers) receive up to 90% of salary for a maximum of 4 years. The emphasis on activation facilitates the flow of workers from unemployment to employment by increasing work incentives for the unemployed, as well as upgrading the skills of unemployed people through training programmes. As a result, one third of the Danish workforce changes jobs every year. Despite this 'hire and fire' approach, Danish employees feel secure. This is because the security provided is not against the loss of their existing job but against struggling to manage on a low income if unemployed and being without a job for a long period. Despite the perceived merits of the Danish model, the exportability of the system to other countries could be problematic as the success of the Danish system may be dependent upon historical factors including strong public-spiritedness - which can be absent in many other countries.

We examine the relevance of the flexicurity approach to Ireland and find that some aspects of the Danish model are either already present in, or seem destined to be incorporated into, the Irish model. One 'flexicurity' policy that may be relevant to Ireland can be found in the Austrian 'backpack' principle for redundancy payments. The main benefit of the Austrian scheme is that entitlements to redundancy payments acquired in one job can be carried to subsequent jobs (like a backpack). As a result, workers don't have to stay in the same job to ensure entitlement to redundancy payments and individual employers don't face the financial risks associated with possible lay-offs.

We note that the cost implications of transferring the Danish model en masse to the Irish context would be significant given that we spent only 0.9 per cent of GDP on unemployment payments in 2004 compared to the Danish figure of 2.7 per cent despite having comparable unemployment rates. Providing welfare payments to a level of up to 90% of previous income for 4 years (in the case of low-income workers) could have a negative effect on work disincentives in the Irish context. However, the activation component of flexicurity is consistent with the greater emphasis in the Irish social welfare system that is being placed on job-search and early intervention (for example by the recent reduction in the threshold for activation of the unemployed from six to three months). This strong emphasis on activation could potentially counter-balance the disincentive effects of high social welfare payments.

In conclusion, we do not recommend the wholesale adoption of the Danish model of 'flexicurity' for Ireland. Nevertheless, we do believe that the essential notion of flexicurity which emphasises protecting workers rather than jobs provides an excellent guiding principle for Irish labour market policy. As we considered in detail in last year's Review, there are many issues to be resolved at the inter-face between the labour market and social welfare systems in Ireland (as in many countries). We need to continue to look at ways that we can increase the flexibility of the labour market while we ensure that workers are protected as best as possible against the economic fluctuations to which a small open economy in a large monetary union is susceptible.

Recommendation

Continued efforts are required to achieve a flexible labour market while also providing adequate social supports. Attempts to draw on the principles of the Danish flexicurity system, tailored to take account of the particular characteristics of the Irish system, warrant further consideration. The introduction of the Austrian 'backpack' principle may be one form of flexicurity that could be examined further to determine as to whether it might benefit the Irish labour market by encouraging greater job mobility.

Chapter 3 - Replacement Rates and Unemployment

A considerable part of last year's Irish Labour Market Review was devoted to issues relating to work incentives, including the potential loss of Rent Supplement and medical cards upon taking-up employment. In this year's Review we are pleased to include a special article written by three researchers from the ESRI, Tim Callan, Kieran Coleman and John Walsh, entitled "Replacement Rates and Unemployment: From Bust to Boom". They investigate how financial incentives to work have evolved during the transformation of the Irish labour market over the last decade. The analysis includes the impact of secondary benefits such as Rent Supplement and the medical card. They argue that if replacement rates are still a potentially important influence on unemployment rates, then their evolution would need to be carefully monitored to avoid triggering a rise in unemployment, perhaps associated with a cyclical slowdown. If, on the other hand, the Irish system is becoming more like the Danish one, where strong activation policies enable high replacement rates to coexist with low unemployment, then excessive caution about the evolution of replacement rates would not be warranted.

They find that there was a strong positive relationship between the replacement rate and the unemployment rate over the 1975-2000 period, but since 2001 the replacement rate has risen, while the unemployment

rate has remained relatively unchanged. It may be difficult to prove a change in the relationship at this stage, but there is other evidence to suggest that high replacement rates need not lead to higher unemployment. They argue that the experience of Denmark, in particular, is that high replacement rates are compatible with low unemployment and high employment participation rates. Overall, their results suggest that one area where further research could prove fruitful is the balance between the effects on unemployment of labour market activation and the "conditionality" of unemployment payments and the effects relating to replacement rates.

Labour Market Trends and Outlook

1 Labour Market Trends and Outlook

1.1 Introduction

This chapter reviews trends in the Irish labour market. It covers the following areas: macroeconomic context, employment, unemployment, the labour force, immigration, labour shortages, earnings, productivity and future prospects.

1.2 Macroeconomic Context

In 2005 the Irish economy registered real growth rates of 5.4% and 5.5% for GNP and GDP respectively (Table 1.1). The GNP growth rate was the fastest so far this decade and the latest data suggests that economic growth could be even stronger in 2006. According to the CSO Quarterly National Accounts the annual rate of growth for GDP and GNP were running at 5% and 9% respectively for the second quarter of 2006. The large increase in the GNP growth figure for the second quarter can partly be explained by large net factor outflows (i.e. profit repatriations by MNCs) that took place in the second quarter of the previous year (2005).

The main driver of recent economic growth has been the strength of domestic demand. There has been a steep decline in export growth since 2001 and as a result domestic demand, and particularly the construction sector, has been responsible for an increasing proportion of national economic growth each year. Related to this increasing reliance on the domestic economy has been a growing concern that certain sectors may have begun to overheat. Energy prices (for external reasons) and house prices have risen noticeably in 2006, and the overall inflation rate could average close to 4% for the year as a whole. Although the strength of the euro vis-à-vis the dollar will help lessen the inflationary impact of high oil prices, it brings another problem – namely a loss in export competitiveness outside the Eurozone. Nevertheless, the nascent recovery in the Eurozone, combined with the maturing of SSIA accounts, should provide a stimulus to the economy in the short-term.

TABLE 1.1
ANNUAL RATE OF IRISH ECONOMIC GROWTH 1998-2005

YEAR	GDP %	GNP %
1998	8.5	7.7
1999	10.7	8.5
2000	9.2	9.5
2001	6.2	3.9
2002	6.1	2.7
2003	4.4	5.1
2004	4.3	3.9
2005	5.5	5.4

Source: CSO, National Accounts

1.3 Overview of Labour Market Trends

The strong economic performance has been positive for the labour market, with the numbers employed passing the two million mark for the first time in the recorded history of the State in Q2 2006, up 87,800 on Q2 2005 (Table 1.2) and almost 300,000 more than in Q2 2001. Despite the substantial growth in employment over the last five years, the numbers unemployed have also risen, from a historical low of 65,100 in Q2 2001 to 91,400 in Q2 2006. When the increases in employment and unemployment are added together, we get the total labour force growth which amounted to about 320,000 over the last 5 years of which 93,500 was added during the year to Q2 2006. The unemployment rate has risen from 3.6% in Q2 2001 to 4.3% in Q2 2006, while the participation rate rose from 59.2% to 62.6% over the same period.

TABLE 1.2
Summary of Labour Force Statistics

Statistic (000s)	2001 Q2	2005 Q2	2006 Q2
Employment	1,721.9	1,929.2	2,017.0
Unemployment	65.1	85.6	91.4
Labour Force	1,787.0	2,014.8	2,108.3
Unemployment rate %	3.6	4.2	4.3
Participation rate %	59.2	61.5	62.6

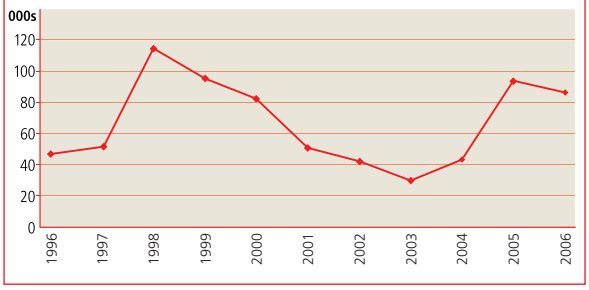
Source: CSO, Quarterly National Household Survey

1.4 Employment Trends

Employment growth strengthened considerably in 2005 after moderating significantly over the 2001-2004 period (Fig 1.1). By Q2 2006 the annual growth was 4.6%, an extremely strong rate of growth, albeit marginally less than the 5.1% growth rate registered in the year to Q2 2005.

The number of women at work has increased by 22% over the 2001 to 2006 period from 703,000 to 855,000, while the number of men at work increased by 14% from

FIGURE 1.1
Year-on-year Employment Growth in Quarter 2



Source: CSO, Quarterly National Household Survey, various issues

1,019,000 to 1,162,000 (Table 1.3). During this period, the numbers in part-time work increased by 23% from 287,000 to 332,000 while the numbers in full-time work increased by 16% from 1,435,000 to 1,665,000.

The services sector has been the main provider of employment growth over the last five years, with the numbers employed in the sector increasing by 23% (250,000) from 1,101,000 in Q2 2001 to 1,351,000 in Q2 2006, with over 70,000 of the growth coming in the year to Q2 2006. Given the size of the service sector, it can be helpful to break it down into two sub-categories; the non-market services sector (health, education, public administration & defence) and the market services sector (all other services). The market services sector employed over 900,000 people in Q2 2006 and accounted for 45% of total employment while the non-market services sector accounted for another 440,000 or 22% of total employment. In the 12 months to Q2 2006, employment grew by 39,100 in the market services sector and by 32,600 in the non-market services sector (Figure 1.2).

The goods-producing sector is a term sometimes used to categorise all non-services sectors. The goods-producing sector accounted for 667,000 jobs in Q2 2006 compared to 621,000 in Q2 2001, an increase of just 46,000 jobs over a five year period. Employment growth in the goods-

TABLE 1.3
Summary of Employment Statistics

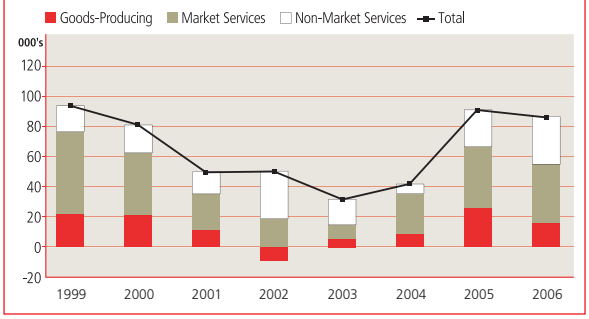
STATISTIC (000s)	2001 Q2	2005 Q2	2006 Q2	CHANGE 2001-2006	% CHANGE 2001-2006
TOTAL EMPLOYMENT	1,722	1,929	2,017	+295	+17%
EMPLOYMENT BY SECTOR					
-AGRICULTURE	123	114	115	-8	-7%
-MANUFACTURING	318	294	289	-29	-9%
-CONSTRUCTION	180	242	263	+83	+46%
-SERVICES	1,101	1,279	1,351	+250	+23%
EMPLOYMENT BY GENDER					
-FEMALE EMPLOYMENT	703	819	855	+152	+22%
-MALE EMPLOYMENT	1,019	1,110	1,162	+43	+14%
EMPLOYMENT BY DURATION					
-PART-TIME EMPLOYMENT	287	332	352	+65	+23%
-FULL-TIME EMPLOYMENT	1,435	1,598	1,665	+230	+16%

Source: CSO, Quarterly National Household Survey

producing sector has occurred exclusively in the construction sector (Table 1.4). The exceptional performance of the construction sector has created 83,000 net new jobs over the last five years, an increase of 46%, with the majority of that growth coming in the last two years. Yet despite increasing by 21,000 in the most recent 12-month period to 263,000, the annual rate of jobs growth in the construction sector has moderated to 8% in the year to Q2 2006 after peaking at 18% a year previously.

Much of the growth in the construction sector over the last 5 years has been counter-balanced by job losses in the agricultural and manufacturing sectors. The largest job losses have been in the manufacturing sector which has seen a reduction of nearly 30,000 (-9%) in employment over the Q2 2001 - Q2 2006 period. The numbers employed in agriculture fell by almost 8,000 over the 2001-2005 period, before making a very slight recovery in the first half of 2006 to 115,000. It remains to be seen whether or not this recovery represents a bottoming out of the long-term decline in agricultural employment. One possible reason for the recent upturn could be the inflow of large numbers of migrant workers from countries where there is a strong agricultural tradition (i.e. Poland and the Baltic States).

FIGURE 1.2
Components Employment Change 1999-2006



Source: CSO, Quarterly National Household Survey, various issue

The importance of the non-traded sector of the economy to create employment over recent years is somewhat surprising given that Ireland is a small open economy, heavily dependent on trade, and strongly pursuing an industrial policy designed to attract multi-national corporations to set up their European bases here. Events outside our control on the money markets, namely the

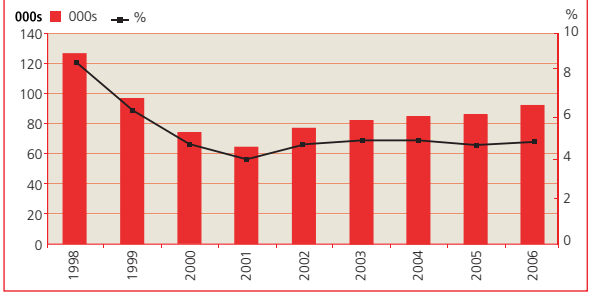
strength of the euro and low interest rates in the Eurozone, have contributed to the contrasting performance of the manufacturing and construction sectors. The strong value of the euro has made our manufacturing exports less competitive outside the Eurozone, while low interest rates have contributed to the housing boom. In fact, when the contribution of sectors with a degree of 'export potential' (namely agriculture, manufacturing, hotels & restaurants, finance & business and transport & communications) is combined, they account for only 15% of employment growth in the year to Q2 2006. For a small open economy, this is not a situation that can be sustained for the long-term.

1.5 Unemployment Trends

Since Q2 2001, when the jobless figure was at an historic low of 65,100 and the unemployment rate was 3.6%, the number of unemployed persons has risen by over 26,000 or 40%, to 91,400 in Q2 2006 and the unemployment rate has reached 4.3%. Both the numbers unemployed and the unemployment rate began to rise over the 2002-2003 period in the wake of unanticipated events such as the dot.com crash and September 11th. Then, over the period from 2003 to the present, while the absolute numbers unemployed continued to rise (albeit relatively slowly) the unemployment rate remained within a narrow range of 4.2% to 4.4% (Figure 1.3). The relative stability of the unemployment rate in recent years despite a rise in the numbers unemployed can be explained by the strong growth in employment which has absorbed most of the increase in the labour force. Foreign nationals have accounted for most of the recent rise in unemployment, with the number of unemployed foreign nationals increasing by 3,600 in the year to the second quarter of 2006. The unemployment rate for Irish nationals was 4.0% in Q2 2006 while the unemployment rate for foreign nationals was higher at 6.8%.

Over the 2001-2006 period, short-term unemployment increased by 17,500 to 61,800 and long-term unemployment increased by 8,800 to 29,600. The long-term unemployment rate was 1.4% in Q2 2006, only slightly up from 1.2% in Q2 2001 when it was at an historic low.

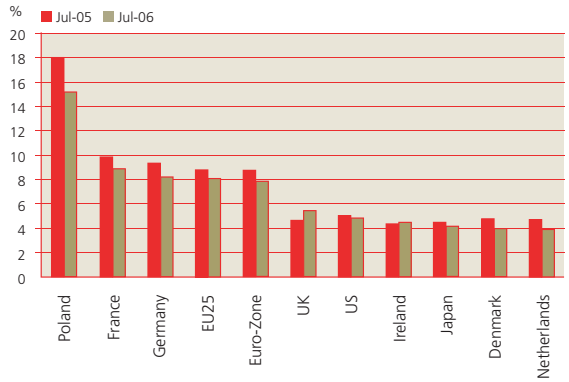
FIGURE 1.3
Unemployment Trends 1998-2006



Source: CSO

Despite the slight rise in recent years, the Irish unemployment rate is still extremely low by EU standards, although we no longer have the lowest rate of any Member State as both the Netherlands and Denmark have unemployment rates of 3.9% (Figure 1.4). The unemployment rate for the EU25 as a whole fell to 7.8% in July of this year down from 8.7% a year previously (Figure 1.5). In fact, the unemployment rate has been falling in nearly all EU25 countries. While Poland has the highest unemployment rate in the EU (15%), it has seen, along with the other new Member States, a noticeable reduction in unemployment since joining the EU. Much of this fall in unemployment can be explained by the large scale economic migration to Western European countries, most notably Ireland, the UK and Germany. The EU youth (under-25) unemployment rate was 17.2% in July, compared to 8.1% for Ireland (which ranks as the second lowest in the EU).

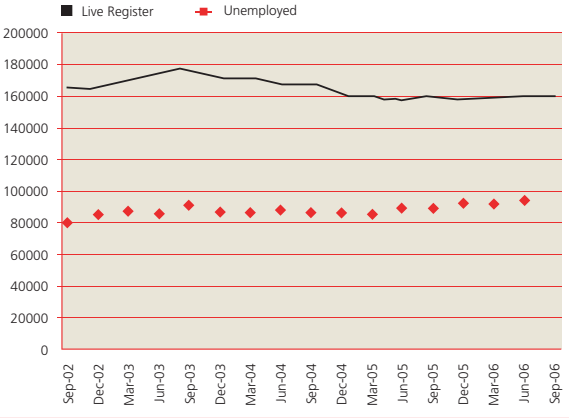
FIGURE 1.4
International Unemployment Rates



Source: Eurostat

While the Live Register is primarily a measure of benefit entitlements rather than unemployment (as it includes people who are working part-time and signing on part-time)[6], Live Register data provide a more recent indicator of unemployment trends than the QNHS. The ratio of Live Registrants to the numbers unemployed was 2:1 three years ago, but this ratio has lessened since then (Figure 1.5). After a two-year period (Sep-2003 to Sep-2005) where the numbers on the Live Register declined steadily, the figure has reached a relative plateau, only deviating within a narrow 155,000-160,000[7] range since September 2005.

FIGURE 1.5
Seasonally Adjusted Trend in Live Register and Unemployed



Source: CSO, QNHS, Live Register Analysis

1.6 Labour Force Trends

Over the last five years the labour force has grown by about 320,000 to 2.11 million, with the majority of the growth occurring in the last two years. The labour force now accounts for 62.6% of all persons aged 15 or over compared to 59% in Q2 2001. The components of labour force growth in recent years have been as follows:

(I) Demographic Change

Which in turn is comprised of:

- The net growth (inflows less retirees) in the domestic population of working age, commonly referred to as the natural increase.
- Net inflows into the working age population from the rest of the world (net migration)

(II) Participation Rates

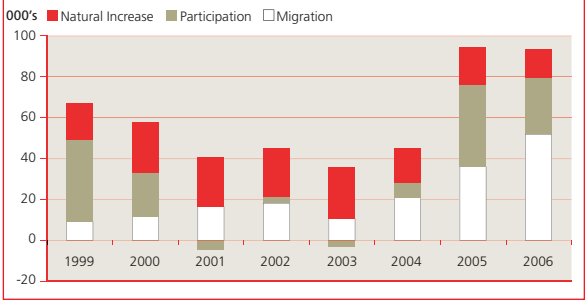
- The proportion of each working age cohort participating in the labour force, either in employment or actively seeking work.

The most important factor in labour force growth in recent years has been immigration. Figure 1.6 below shows how immigration's contribution to the labour force has increased since before EU enlargement from 11,000 in 2003 to 52,000 this year according to CSO estimates[8]. By contrast, the other component of demographic change, the natural increase, has lessened in recent years in both absolute and relative terms. The contribution of the natural increase peaked at 25,000 in the year to Q2 2003 before falling gradually to just under 14,000 in the year to Q2 2006.

The participation effect, which was a major factor in the strong labour force growth at the end of the 1990s, has regained importance adding almost 67,000 to the

[6] See www.inou.ie/empmeasure/ for a detailed comparison of the Live Register and the QNHS.
[7] When seasonally adjusted.
[8] However, the CSO notes that current migration estimates are 'tentative' and may be revised upwards in the future..

FIGURE 1.6
Labour Force Growth in 2nd Quarter



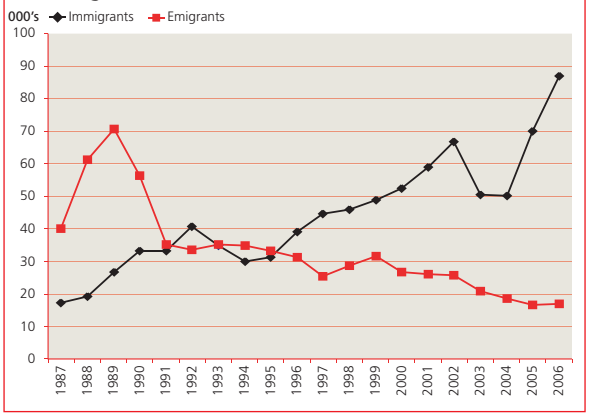
Source: CSO, QNHS Second Quarter, various issues.

labour force over the last two years. This contrasts sharply with the 2000-2004 period when there was a negligible increase in the underlying participation rate. Underpinning the recent increase in participation has been an increase in the female participation rate from 51.4% to 53.5%, while the male participation rate has increased from 71.8% to 72.8%. There has been a particularly noticeable increase in the number of older women (aged 45+) in the workforce over the last two years (+38,000). Over the longer 2000-2006 period participation rates have risen by about 13 percentage points for women aged 45-59 while participation rates for males of the same age have risen only marginally (see Table 1.4).

1.7 Migration Trends

As mentioned previously migration has been extremely important to the growth of the labour force in recent years. Immigration has risen steadily since 1994, apart from a slight pause in the run up to EU enlargement, with a noticeable acceleration taking place thereafter. At the same time, emigration has fallen fairly steadily. As a result, there has been a dramatic rise in net inward migration over the last 12 years reaching 69,900 in the year ended April 2006 (Figure 1.7).

FIGURE 1.7
Gross Migration Flows



CSO, Population and Migration Estimates April 2006

TABLE 1.4
Labour Force Participation Rates Classified by Age and Sex

		All	15-19	20-24	25-34	35-44	45-54	55-59	60-64	65+
Males	2000 Q2	71.0	32.8	78.9	94.1	93.3	88	74.8	53.5	15.1
	2006 Q2	72.8	30.2	79.9	93.2	93.9	89.0	76.4	58.3	14.5
	*Change	*1.8*	*-1.6*	*1.0*	*-0.9*	*0.6*	*1.0*	*1.6*	*4.8*	*-0.6*
Females	2000 Q2	46.7	25.2	70.4	75.9	62.2	51.4	34.6	19.1	2.4
	2006 Q2	52.5	22.8	68.8	78.5	66.7	64.1	48.6	31.2	4.2
	*Change	*5.8*	*-2.4*	*-1.6*	*3.6*	*4.5*	*12.7*	*14.0*	*12.1*	*1.8*
Total	2000 Q2	58.6	29.1	74.7	85	77.6	69.8	55	36.3	8.0
	2006 Q2	62.6	26.6	74.4	86.0	80.4	76.6	62.6	44.8	8.7
	* Change	*4.0*	*-2.5*	*-0.3*	*1.0*	*2.8*	*6.8*	*7.6*	*8.5*	*0.7*

*Percentage point change, source: CSO.

TABLE 1.5

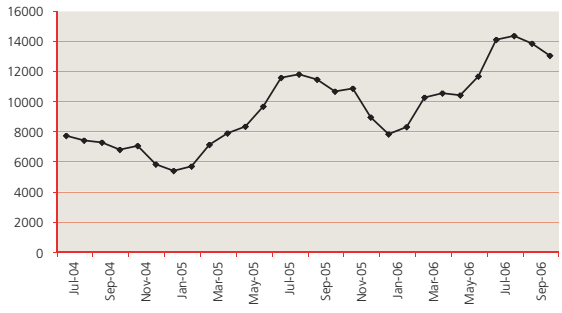
Inward Migration by Nationality 2000-2006

	2000	2001	2002	2003	2004	2005	2006
IRISH	24.8	26.3	27.0	17.5	16.9	19.0	19.7
UK	8.4	9.0	7.4	6.9	5.9	6.9	7.5
REST OF EU15	8.2	6.5	8.1	6.9	10.6	7.1	9.6
USA	2.5	3.7	2.7	1.6	1.8	1.6	1.3
REST OF WORLD, OF WHICH:	8.6	13.6	21.7	17.7	14.9	35.4	48.9
EU10						*26.4*	*37.8*
OTHER						*9.0*	*11.1*
TOTAL	52.6	59.0	66.9	50.5	50.1	70.0	86.9

Source: CSO, Population and Migration Estimates April 2006

The composition of immigration flows by nationality has changed in recent years, as shown in Table 1.5. In the year 2000, almost half of all immigrants were Irish people returning from a period abroad; by 2006 this group accounted for less than a quarter of the inflow. Inflows of UK nationals, nationals of the remainder of the original EU15 and American nationals have been broadly stable. The main source of immigration growth has been from the 'Rest of the World' countries, most notably the 10 new EU member states[9]. The EU10 accounted for 43% or 37,800 of all immigrants in the year to April 2006.

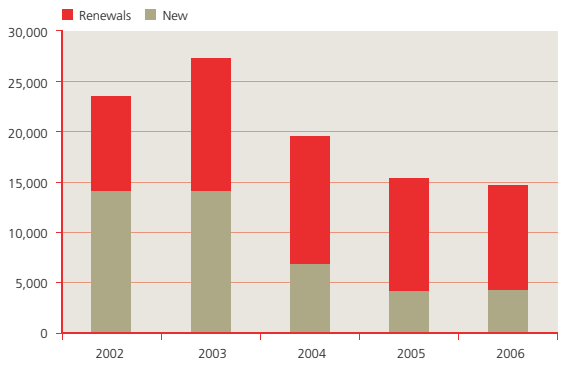
FIGURE 1.8
PPS Allocations to Immigrants from New Member States (3-month moving average)



Source: DETE

While CSO migration estimates suggest around 64,000 EU10 nationals came to live in Ireland in the two years since EU enlargement began (Table 1.5), 205,000 Personal Public Service Numbers (PPSN [10]) were issued to EU10 nationals by the Department of Social and Family Affairs over this period. Another 84,000 were issued over the May-06 to Sep-06 period, of which 56,000 were for Polish nationals. The large discrepancy between the CSO migration estimates and the PPSN figures suggests that many of the EU10 immigrants entering Ireland are choosing to return home after only a relatively short time working here. It also seems that there is a significant seasonal component to immigration patterns in the size of inflows over the summer months (Figure 1.8). In particular, many, typically Polish students, appear to work here for the summer before returning home to continue

FIGURE 1.9
Work Permits Issued 2002-2006 (for the period of Jan-July)



Source: DETE

[9] Migrants from the EU10 have only been identified separately in the immigration figures since 2005.
[10] PPSN are necessary to take up employment.

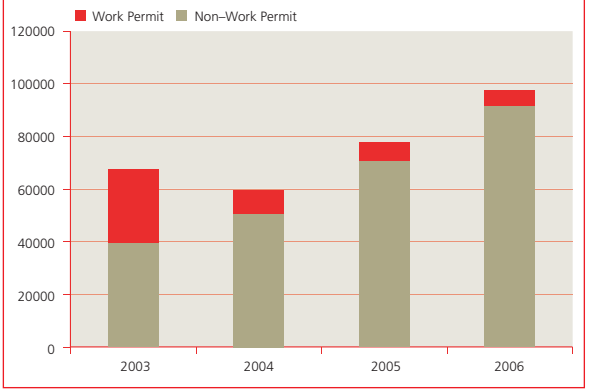
their studies in the autumn. In addition, evidence suggests that some who obtain a PPSN never actually take up employment in Ireland (approximately 23% based on 2004 figures)[11]. Nevertheless, even when seasonal factors and other caveats are taken into account, the underlying trend in the inflow of workers from the new Member States has been increasing since EU enlargement began.

EU enlargement has had a noticeable impact on the number of work permits being issued with the number of work permits issued in Jan–July 2006 less than half the number issued for the corresponding period in 2003 (Figure 1.9).

1.8 Labour Demand Indicators

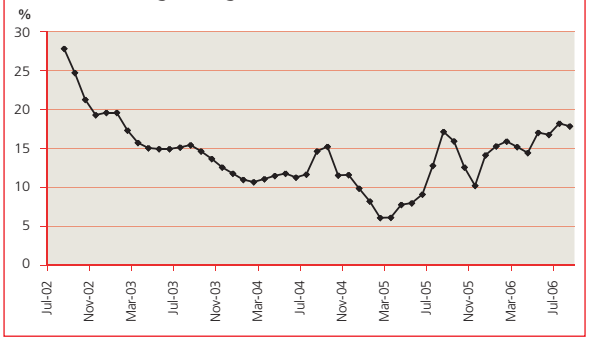
There were almost 100,000 vacancies notified to FÁS in the first 8 months of 2006, up 26% from the same period of 2005 which in turn was up 31% on the corresponding period in 2004 (Figure 1.10). The growth in the number of vacancies has occurred in spite of an 18% fall in the number of work permit-related vacancies. Since 2003, the professional & clerical category has increased its share of FÁS vacancies from 13% to 18% in 2006, while manufacturing's share of FÁS vacancies has fallen from 11% in 2003 to 5%. These trends are indicative of the shift towards a service-based economy that has gathered pace in recent years.

FIGURE 1.10
Vacancies Notified to FÁS (Jan-Aug)



Source: FÁS

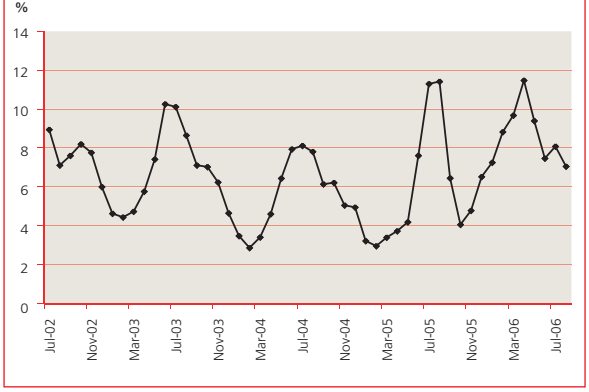
FIGURE 1.11
Percentage of Firms Reporting Vacancies (3-Month Moving Average)



Source: FÁS\ESRI Employment and Vacancies Survey

According to the FÁS\ESRI Employment and Vacancies Survey (Figure 1.11) there has been an increase in the percentage of firms reporting vacancies since the beginning of 2005, when vacancies reached their lowest point in the last four years. This is consistent with the strong jobs growth that has taken place over the last two years. While vacancy trends are a good proxy for trends in labour demand, the proportion of these vacancies that are 'difficult-to-fill' provides additional information on the extent of labour shortages. When seasonal factors are accounted for (difficult to fill

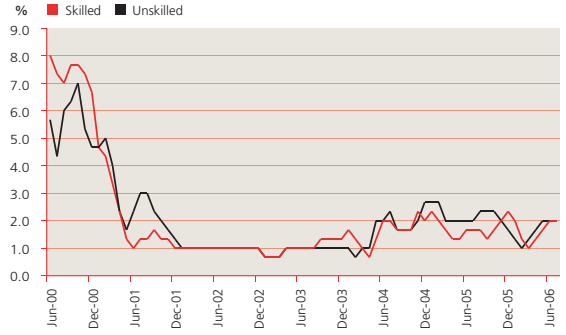
FIGURE 1.12
Percentage of Firms Reporting Difficult to fill Vacancies



Source: FÁS\ESRI Employment and Vacancies Survey

[11] Based on a matching of PPSN data with P35 data for 2004. The matching exercise undertaken by the DSFA found that 77% of PPSNs issued to EU-10 nationals in 2004 appear in the P35 data for 2005. A full year's P35 data is not yet available for 2005.

FIGURE 1.13
IBEC/ESRI Survey of Labour Shortage Production Constraints (3-Month Moving Average)



Source: IBEC/ESRI Monthly Industrial Surveys

vacancies tend to peak at the beginning of the summer and subside after Christmas) the underlying trend suggests that labour shortages have increased only marginally over the last four years (Figure 1.12).

Similarly, the IBEC\ESRI Monthly Industrial Survey found that the incidence of labour shortages in the manufacturing sector has seen little change over the last five years. Only 1-2% of manufacturing firms had their production constrained by a shortage of either skilled or unskilled workers over the last 5 years compared to 8% in 2000 (Figure 1.13).

The overriding conclusion drawn from the labour demand indicators is that while labour demand has remained strong, the increase in immigration has kept labour shortages at a manageable level. Given the large number of vacancies, one might expect the unemployment level to be even less than it currently is. The co-existence of around 90,000 unemployed with a large number of vacancies across the economy implies that the unemployment is either frictional (i.e. short-term unemployment as people move between jobs) or structural (i.e. there is a mismatch between the recruits that employers want and the jobseekers that are available).

1.9 Earnings and Productivity

Generally, the rate of earnings growth has been greater over the 2000-2005 period compared to the 1995-2000 period (Figure 1.14). Earnings grew fastest in the construction sector during both the 1995-2000 period (48%) and the 2000-2005 period (47%) – the rates were similar during both periods. The most significant acceleration in earnings growth rates occurred in the banking & financial sector and the public sector, which grew by 24% and 26% respectively over the 1995-2000 period, before accelerating to 44% and 40% respectively over the 2000-2005 period. Perhaps significantly, the public sector and the banking & financial sector have been least affected by immigration over the 2000-2005 period and, therefore, it could be argued that immigration has been having a moderating influence on earnings in other sectors. (Chapter 2 considers displacement and earnings trends in more detail.) Earnings growth was lowest in the business and distribution services sector (27%) in 2000-2005 (no data is available for the 1995-2000 period). Earnings growth in the manufacturing sector was also relatively sluggish (30%) for the 2000-2005 period, although this still represents a slight acceleration compared to the 1995-2000 period when earnings grew by 27%.

FIGURE 1.14
Earnings growth by sector 1995-2005

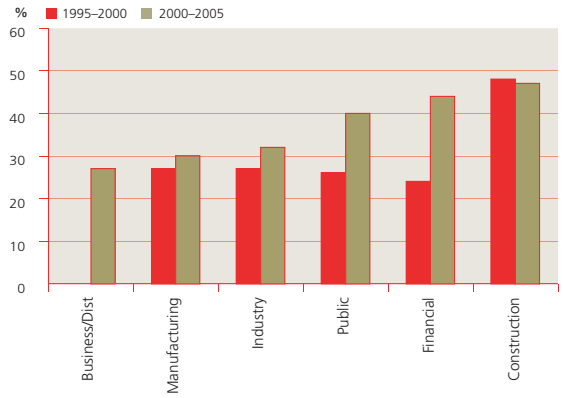


FIGURE 1.15
Sustaining Progress Private Sector Pay Increases

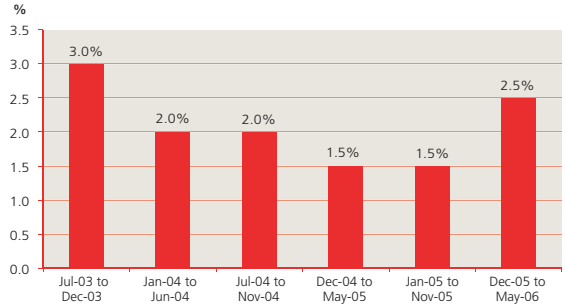
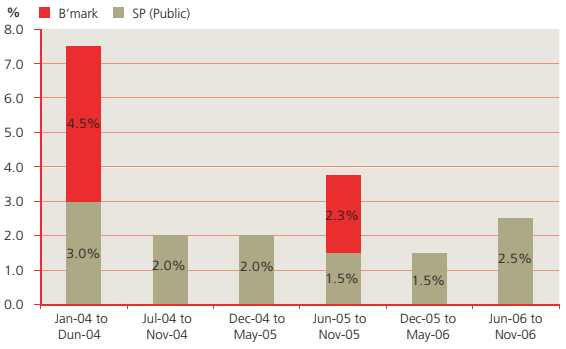


FIGURE 1.16
Public Sector Pay Increases



Figures 1.15 and 1.16 below show the earnings increases agreed at a national level under Sustaining Progress and benchmarking for the private sector and public sector respectively. Also presented in Table 1.6 are the increases in the National Minimum Wage. It is useful to keep in mind these formalised earnings increases when analysing earnings trends. The most recent increases under Sustaining Progress amount to just over 4% for the year ending May-06. The timing of the public sector pay awards under Sustaining Progress were lagged slightly (3-6 months) vis-à-vis the private sector. The cumulative increase in nominal pay (Public Sector) from July 2003 to June 2006 under Sustaining Progress and Benchmarking was 20.6% and the real increase was 7.7%.

TABLE 1.6
NATIONAL MINIMUM WAGE

Date	€	Increase
01-Apr-00	5.58	N\A
01-Jul-01	5.97	7%
01-Oct-02	6.35	6%
01-Feb-04	7.00	10%
01-May-05	7.65	9%

The increases in the National Minimum Wage have been much more pronounced than those agreed under Sustaining Progress, rising by 10.2% over the 15 month period to May 2005 and by a further 9.3% since May 2005 (Table 1.6).

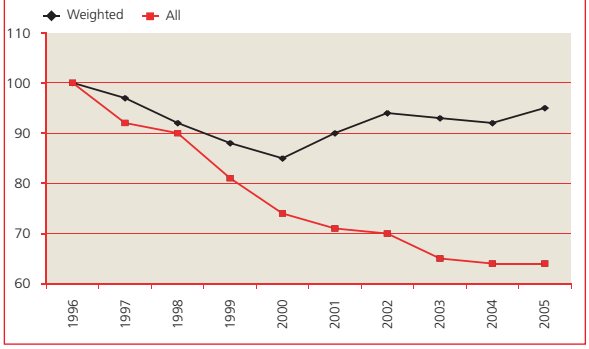
Productivity growth, like employment growth, has varied significantly by sector. In fact, there appears to have been an inverse relationship between productivity growth and employment growth at the sectoral level in recent times. Productivity growth was strongest in the sector experiencing negative employment growth, namely the manufacturing sector, while it was negative in the sector where employment growth was the strongest, namely construction.

Unit wage costs measure developments in productivity along with changes in earnings. Over the period 1996-2004, unit wage costs in the manufacturing sector fell by 40% as productivity growth outstripped earnings growth (Figure 1.17). This downward trend stopped in 2005 when earnings growth matched productivity growth in the manufacturing sector, with unit wage costs remaining at their 2004 level. When unit wage costs are weighted to account for the disproportionate influence of the chemicals sector[12], the fall in unit wage costs was much less pronounced over the last 10 years. When the weighted measure is used, manufacturing unit wage costs showed a rise of 2.5% in 2005.

[12] The chemicals sector has a very high share of manufacturing output relative to its total share of manufacturing employment and this can result in misleading conclusions about unit wage costs for the manufacturing sector as a whole. To control for this, the Central Bank weight the contribution of the chemicals sector by its share of total manufacturing employment.

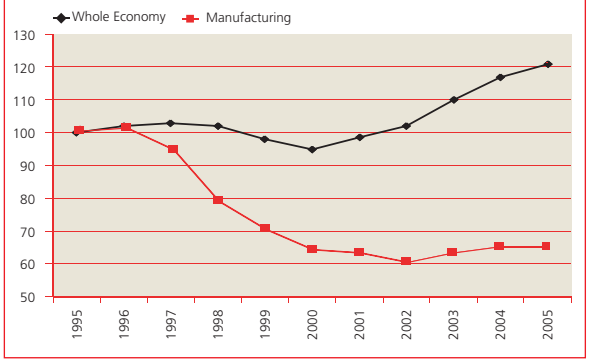
Central Bank relative[13] unit wage costs estimates for the economy as a whole showed an increase of 6% in 2005 and an increase of 23% over the longer 2000-2005 period (Figure 1.18). This is in stark contrast with the performance of the manufacturing sector, although if weighted for the 'chemical factor' the difference would not be as pronounced.

FIGURE 1.17
Index of Unit Wage Costs in Manufacturing



Source: Central Bank

FIGURE 1.18
Irish Relative Unit Wage Costs



Source: Central Bank

1.10 Future Prospects

Short-term Outlook

The strong performance of the economy looks set to continue in the short-term with average GNP and GDP growth rates of 5-6% forecast for both 2006 and 2007.

The maturing of the SSIA accounts and likely fiscal policy suggest that domestic demand is likely to remain robust out to 2008 at least, while the continued recovery in the international economy augurs well for our export sector. The overriding strength of the economy should provide an extremely positive environment for further job creation. Given the strength of labour demand and immigration, we see employment growth remaining strong for the remainder of 2006, before moderating somewhat in 2007 primarily due to a slowdown in the construction sector. Specifically, we are forecasting employment to rise by 4.5% (88,000) in 2006 and by a further 2.8% (57,000) in 2007 (Table 1.7).

The majority of employment growth should continue to come from the services sector. Our forecast for services sector employment growth is 5.5% (+72,000) in 2006 and 4.1% (+56,000) in 2007.

Higher interest rates are likely to impact on the construction sector in 2007 and this, when combined with a significant fall in planning permissions in the first half of 2006, point to a significant moderation in employment growth in 2007. Therefore, our employment forecast is for construction to grow by 7.8% (+19,000) in 2006 before slowing to only 0.4% (+1,000) in 2007.

Employer sentiment has been positive in manufacturing according to the NCB-PMI surveys of the sector. However, both a strong euro and high oil prices will limit the ability of firms to expand and create new jobs. On balance, we expect the level of manufacturing employment to fall slightly in 2006 by 1.4% (-4,000) with little or no change expected in 2007.

Immigration in 2006 looks set to exceed last year's levels and this should lead to strong labour force growth of

[13] Adjusted for the exchange rates of our main trading partners

around 4.6% (+93,000). While immigration is expected to remain strong in 2007 it is likely to moderate somewhat in response to slower employment growth. The contribution of labour force participation and the natural increase are also expected to be reduced, resulting in a moderation of the labour force growth rate to about 3.5% (+62,000) in 2007. This forecast takes into account the Government's decision to restrict access to the Irish labour market for workers from Romania and Bulgaria.

Unemployment is forecast to rise by 5,000 to 94,000 in 2006 and by a further 5,000 in 2007. However, the unemployment rate should remain within the 4.4%-4.5% range over the 2006-2007 period.

Medium-Term Outlook

While the short-term prospects remain positive (notwithstanding the moderation in employment growth in 2007), medium-term prospects are more ambiguous. When considering the medium-term prospects for the labour market, we turn to the ESRI Medium-Term Review (MTR) for some baseline estimates. The ESRI MTR has two forecasts, one based on a high-growth scenario and the second based on a low-growth scenario. The low-growth scenario is premised on the belief that there will be a correction in the US economy which will have a negative impact on the Irish economy. However, under either scenario, the medium-term prospects are for a moderation in the rate of both economic and employment growth.

Under the ESRI MTR forecast high-growth scenario, employment is forecast to grow by 15% between 2006 and 2012[14]. If the ESRI employment growth rate associated with the high-growth scenario holds then we estimate that this would lead to 314,000 jobs being created over the next 6 years, an average of 52,000 jobs per annum. This represents a strong employment performance of 2% employment growth per annum, although it is a considerable moderation from the annual employment growth rate of 4.5% experienced over the last two years. Most of the net jobs growth would be accounted for by the services sector (+273,000), although the construction sector would still make a significant contribution (+35,000). Manufacturing employment would increase by 23,000 while employment in the agricultural sector would fall to below 100,000.

Under the low-growth scenario, the slowdown in employment growth would be more pronounced, with the number of jobs created over the 2006-2012 period (164,000) just over half the number envisaged in the high growth scenario. In this more pessimistic scenario, the services sector and the construction sector are the worst affected. In terms of unemployment, the high growth scenario would result in a reduction of approximately 20,000 in the numbers unemployed while the low growth scenario would lead to an increase of 70,000 in the numbers unemployed. This would imply an unemployment rate of nearly 7% in 2012 and (not shown here) a further rise to about 10% in the longer-term. Both forecasts assume a relatively elastic supply of labour from abroad, with net migration falling significantly in the case of the low-growth scenario. A less elastic supply of labour from abroad could be expected to increase unemployment further than is forecast.

The implications of the forecasts for the labour market vary significantly depending on which one prevails. The labour market policy implications of a slowdown to the Irish economy will be among the topics considered in the next chapter.

[14] The ESRI MTR forecast was based on PES figures, whereas our forecast here is based on ILO

TABLE 1.7

Employment & Unemployment Projections 2005-2012

	2005	2006	2007	2012 (H)	2012 (L)	2006 - 2012 (H)	2006 - 2012 (L)
AGRICULTURE	115	116	116	99	99	-17	-17
CONSTRUCTION	245	264	265	299	270	+35	+6
MANUFACTURING	294	290	290	313	300	+23	+10
SERVICES	1,298	1,370	1,426	1,643	1,534	+273	+164
TOTAL EMPLOYMENT	**1,952**	**2,040**	**2,097**	**2,354**	**2,204**	**+314**	**+164**
UNEMPLOYED	89	94	99	75	164	-19	+70
LABOUR FORCE	2,041	2,134	2,196	2,430	2,383	+296	+234
UNEMPLOYMENT RATE	4.4%	4.4%	4.5%	3.1%	6.9 %	-1.3%	+2.5%

Source: FÁS and ESRI. The ESRI MTR 2012 forecasts were adjusted to ILO rather than PES basis.

Labour Market Policy Issues

2 Labour Market Policy Issues

Introduction:

The medium-term outlook suggests that the period of high employment and low unemployment in Ireland of recent years could be threatened sooner or later. Chapter 2 presents a 'what if' analysis of the Irish labour market in the belief that the threats to Ireland's continued success have increased during 2006. Looking into the future, and considering what policies may be needed, is the best approach to overcoming any new challenges that lie ahead. Realism suggests that this current era of full employment will only be maintained if labour market policy adapts to reflect changing circumstances. Certainly, the profile of employment growth, which has been dominated by the non-traded sectors, is likely to change in the future. In particular, our dependence on the construction sector to generate significant jobs growth may not be sustainable in the medium to long-term. Similarly, our capacity to absorb immigration flows will be tested if current migration trends continue and labour demand, for whatever reason, moderates. The chapter is divided into three sections. The first section considers the impact of an external economic shock on the labour market. The next section looks at an issue that has gained prominence in 2006 and would become increasingly relevant in the event of a slowdown, namely displacement. The final section reviews a labour market approach 'flexicurity' which aims to reconcile the potentially competing objectives of job security and labour market flexibility, objectives which could come into sharper focus in the event of a slowdown.

2.1 Prepare to Slowdown

As well as increasing the impact of events in the world economy on national economies, globalisation has increased the rapidity with which the impact of political and economic events is transmitted from the global to the local, with the political instability in the Middle East and the concomitant rise in energy prices being an obvious example. The IMF noted in 2006 that Ireland is particularly vulnerable to unfavourable external events (IMF, 2006). In particular, the economic well-being of the US is likely to have a disproportionate impact on the Irish economy compared to the Eurozone given that the US accounts for almost 20 per cent of our total exports compared to the Eurozone average of 3 per cent (Lombard Street Research, 2006). In an article published in a previous Irish Labour Market Review, Leddin analysed Ireland's economic adjustment in the Eurozone over the 1999-2003 period by looking at how the labour market has interacted with financial exchange and money markets in adjusting to economic fluctuations (Leddin, 2004). The results of his research indicate that, because of its economic openness, the level of Irish economic

activity is particularly sensitive to external fluctuations. The recent rise in the inflation rate and strong employment growth in the non-traded sector suggest that we may be in a period of overheating. If this is the case, it is possible that this might be followed by a period of over-cooling. The transition from over-heating to over-cooling could be triggered by a number of events – high oil prices, depreciation of the dollar, higher interest rates, a house price fall or a slowdown in the IT sector. Suffice to say that there are several transmission mechanisms through which negative external effects could be administered to the Irish labour market.

The main purpose of this section is to consider the implications of two slowdown scenarios for the Irish labour market, both of which relate to our membership of the Eurozone, namely a rise in interest rates and a euro appreciation vis-à-vis the dollar. Honohan and Leddin note that while both the interest and exchange rate were potential stabilisers in the pre-euro era, they are now both sources of shocks (Honohan and Leddin, 2006).

House Price Decline

The availability of credit at historically low interest rates has been a major contributor to Ireland's business activity and in particular to the housing boom. If Ireland had not joined the Eurozone, it is extremely unlikely that the Irish Central Bank would have permitted interest rates to remain so low given the rate of house price growth. It has been estimated that interest rates were 3 percentage points lower than appropriate for the Irish market in mid–2006 (Coleman, 2006). In fact, at a time when the Irish property market needed higher interest rates to choke off excess demand, the European Central Bank (ECB) undertook to lower interest rates in order to stimulate a flagging Eurozone economy, thereby adding further upward pressure on house prices. However, Eurozone interest rates reached a floor towards the end of 2005. Since the beginning of 2006 interest rates have risen by 1.5 percentage points to 3.5% (as of December 2006) and rates may rise further in the short-term as concerns about inflation linger and the Eurozone shows signs of an economic recovery. If the ECB continues to raise interest rates in the short-to-medium term, the primary channel through which this will be transmitted to the Irish labour market is via the construction sector. In the Irish context, the concern is that the rise in interest rates has come too late and that house prices are already artificially high. Hence, should the rise in interest rates continue, it could result in a weakening of demand in the Irish property sector and, in the worst case scenario, a fall in house prices.

The housing sector merits special attention for two reasons:

1. The robust performance of the Irish economy and, in particular, the labour market, has been strongly correlated with the strength of the construction sector.

2. Concerns about the sustainability of housing demand have increased through 2006.

In 1997 construction output accounted for 12 per cent of total economic output. By 2005 this figure had doubled to 24 per cent, while almost half (48%) of total investment in Ireland (€43.6 billion) in 2005 was accounted for by housing. In employment terms, the sector has seen a doubling of its workforce over the 1997-2005 period with over 260,000 persons now directly employed in construction. The property boom has also assisted employment growth in other related

sectors such as financial and business services. Earnings in construction are above the average industrial wage, with annual earnings averaging €40,000 compared to just over €30,000 in the manufacturing sector.

As well as being a major source of employment and income, the construction boom has also provided an important source of revenue for the Government from a combination of stamp duty, capital gains tax, V.A.T. and income tax. It is estimated that the sector now accounts for just over 21% of the total tax take from the economy, compared to 11% in 1997 (O'Leary, Irish Times, 7/7/6).

The property boom has also generated sizeable wealth for many homeowners who have seen their homes increase in value by a multiple of the original purchase price. This has created what economists call a 'wealth effect', whereby the perception of financial security brought about by an increase in wealth gives individuals the confidence both to borrow and to spend more.

When all these factors are taken into account, the importance of the construction sector for both the economy and the labour market is fairly obvious. Is the threat of a slowdown in the construction sector a real one, and, if so, what are the implications for the labour market? On the positive side, it can be argued that much of the recent housing boom can be explained by factors that are likely to persist into the future; namely, positive demographic trends and a fall in the average size of households. Indeed, the strength of population growth in recent years has been greater than had been originally anticipated and provides a good platform for housing demand in the future (Davy, Summer 2006), with the Irish population possibly reaching 4.8 million over the next ten years (CSO, 2005).

Nevertheless, the number of household completions is expected to peak in 2006 at around 100,000 before moderating to about 50-60,000 over the medium-term and, as a result, construction's current 24 per cent share of GNP (ESRI, 2006) can be expected to decline. More to the point, the longer that house price growth continues unchecked the greater the chance of a correction in the future. The IMF carried out a survey of almost 39 cases of housing booms during the 1980s and 1990s and found that in every country that experienced a house price boom of a similar magnitude to Ireland's, a subsequent fall in house prices followed (IMF, 2000). The study was undertaken in 2000, since which time Irish property prices have doubled. A more recent IMF report (2006) has observed that Irish economic growth has become increasingly unbalanced, with a heavy reliance on the property sector. Although the IMF believes that the expected slowdown in the construction sector is likely to be a smooth one, they do not rule out the possibility of a 'sharp correction'.

Honohan and Leddin (2006) model Ireland's adjustment to the 'shock' of excessively low interest rates in recent years, taking into account the impact of the construction sector and migration. They argue that since joining the EMU "adjustment mechanisms in the labour market seem to have been weak…. Instead of wage-price responses, migration flows have continued to represent the major form of labour market adjustment…The interest rate fall has had a lasting effect on property prices, construction activity and on the capacity of the labour market to absorb sizable net immigration, despite a sharp deterioration in wage competitiveness since 2002". If the ECB continues to raise interest rates in the short-to-medium term, then this loss of wage competitiveness could come in to sharper focus as the construction sector may no longer be able to absorb increases in the labour

force, especially from abroad (the direct implications of migration on the labour market are considered in the next section).

Thus commentators take different views about the future prospects for the construction sector. However, it is worth considering what might happen to the Irish labour market should house prices decline. In the first instance, this would probably result in a reduction in construction employment followed by a fall in construction-related services employment. Consumer demand could also be expected to weaken as a direct result of higher interest rates. A negative wealth effect might also have to be factored in as the value of houses declines, which could result in households reducing their borrowing and spending. Furthermore, higher interest rates could cause financial problems for some existing mortgage holders, depressing consumer demand even more and, as a result, impacting negatively on services sector employment. Such a reduction in employment and/or construction activity would in turn lead to a fall in tax receipts from some or all of the following: stamp duty, capital gains, V.A.T. and income tax receipts. An increase in the average tax rate might have to follow in order to raise some of the tax revenue foregone and to fund the increase in social welfare payments for the unemployed. However, this chain of negative consequences is by no means inevitable. The implications of such a scenario would depend on a number of factors including the following:

1. The housing supply response to any decline in house prices. While a significant fall in price would reduce profitability, given the significant profit margins currently enjoyed in the sector the supply response might be muted when compared to other sectors of the economy where margins are tighter. However, even in the absence of a house price decline, the ESRI projects a more generalised tapering off in the demand for housing from its current level to an average of 72,000 house completions per annum over the 2007-2011 period. In either case, some combination of lower prices and declining medium-term demand trends would result in a significant reduction in housing output.

2. The demand for home-improvements. This is more labour-intensive than the construction of new home dwellings. The extent to which the home-improvement sector would soak up some of the excess supply of labour in the new homes sector would have a bearing on the extent of employment declines in the construction sector as a whole.

3. The National Development Plan (NDP) – 2007-2013 (with a likely budget of €9.5 billion per annum). The NDP should utilise a portion of the existing labour from the residential sector – however, the construction of infrastructure is much less labour-intensive than the housing sector.

4. The immigration response to the slowdown. Currently 12.4% of construction employees are foreign-nationals. Their response would partly determine the unemployment rate in the construction sector. More generally, immigration has been a significant component of housing demand in recent years, and a fall in immigration would also serve to weaken the demand for housing. The ESRI MTR estimates that immigration will account for about 12.3 per cent of total housing demand over the 2007-2011 period.

5. The ability of construction workers to work in other sectors of the economy or, indeed, overseas. This partly depends upon the strength of the construction sector in the UK and other EU countries. In relation to moving to other sectors within Ireland this may be less of a problem for electricians whose skills may be more readily transferable. However, those employed in the 'wet' trades may need more intensive retraining.

6. The mobility of labour. Ireland has one of the highest rates of home ownership in the OECD. High rates of home ownership are often associated with low degrees of mobility across regions. This can increase the unemployment impact of any slowdown. However, it remains to be seen what impact home ownership will have on the mobility of labour within Ireland, given the relatively small size of the country.

In truth, it is impossible to estimate the possible impact on the labour market with a great degree of accuracy. Nevertheless, the ESRI[15], the Central Bank[16] , and Davy Stockbrokers[17] have all estimated that the unemployment rate could reach 10% in the event of various slowdown scenarios which incorporate declines in house completions to around 50,000-60,000 per annum over the next few years. The slowdown scenario outlined here does not purport to measure the magnitude of job losses precisely. Instead it is designed to illustrate that the labour market's dependence on the construction sector could result in a significant negative impact on employment and that significant indirect/second round effects could follow.

US Slowdown; Dollar Depreciation – Euro Appreciation

Of course an economic slowdown does not have to be triggered by a decline in housing demand. Other possible catalysts include persistently high oil prices, a slowdown in the ICT sector or a corrective depreciation of the dollar in order to lower the US trade deficit. The last of these scenarios is particularly relevant given the belief among some economists that the probability of a corrective depreciation has increased. It is to this scenario that we now briefly turn.

Currently, the US trade deficit is running at 7% of GDP. Many commentators believe that this is unsustainable. In order to correct this deficit, most analysts believe that the dollar will have to depreciate significantly vis-à-vis its main trading partners (most notably China). The Autumn of 2006 has seen a significant fall in the exchange rate of the dollar – but whether this is the beginning of a sustained decline is too soon to call. The effects of a dollar depreciation vis-à-vis the euro could be transmitted through to the Irish labour market in the following way.

The depreciation of the dollar would increase the price of our exports in countries whose currencies are tied to the dollar either explicitly or implicitly. This would reduce our export competitiveness vis-à-vis 'dollar countries'. At the same time the price of imports from these countries would be reduced, thereby lowering the imported component of inflation. However, if earnings do not adjust in response to lower inflation then the real wage would increase, reducing our competitiveness. A dollar depreciation would also increase the cost base of American MNCs located in Ireland vis-à-vis 'dollar countries'. And unless the ECB reduced nominal interest rates in response to the lower inflation linked to the

[15] ESRI (2005), Medium-Term Review 2005-2012.
[16] McGuire, M. & Smyth, D., (2005), "The Implications of a `Correction` in the Residential Construction Sector" in Central Bank Financial Stability Report 2005.
[17] Kelleher, R., & White, R., (2006), The Irish Economy: An Assessment of Risks and Forecasts 2008-2010, http://www.davydirect.ie/other/pubarticles/dotiejuly2006.pdf

euro appreciation, then real interest rates would also increase. Even if the ECB were to reduce interest rates, a significant growth moderation could still be expected to occur given our loss of competitiveness. In addition, it must be noted that the US economy would be slowing down and thus one of the accepted 'key engines of world economic growth' would not be firing on all cylinders. A US-driven slowdown would be likely to have a negative multiplier effect on consumer expenditure in Ireland, and hence the housing market, giving rise to some of the effects described in the previous section. Unemployment would be expected increase as a result.

In the event of a slowdown, tax revenues would be reduced and this could have negative implications for public sector expenditure. Non-traded sectors of the economy which rely heavily on government finance (Health, Education and Public Administration) would come under pressure. As highlighted in Chapter 1, these sectors accounted for two-thirds of the net growth in employment of Irish workers over the last year.

If the economy were to slow down significantly it would be important that an adjustment in either nominal interest rates and/or nominal earnings took place. However, nominal interest rates are at the discretion of the ECB and we do not know what the ECB would choose to do in response to a slowdown in the U.S. Nevertheless, Ireland does have some autonomy over nominal earnings growth. In the low growth scenario, the ESRI sees the economy and labour market recovering over a long period (10-15 years) due in part to a moderation in earnings. A preferable scenario would be for the economy to return to stable growth in a much shorter time frame. This might be possible if earnings adjusted rapidly to the economic slowdown. Currently, earnings increases negotiated at a national level tend to be based on the sum of expected productivity and inflation increases in the economy. Under such a 'mark up' system of wage bargaining it is hard to see how earnings growth would adjust rapidly to an unforeseen slowdown. Hence, the onset of an economic slowdown may require a change in the way that wage agreements are based.

Conclusion and Policy Implications

As the pace of globalisation increases, so too does the possibility of negative external events impacting the Irish economy. While most economists are predicting a 'soft landing' for the Irish economy, there is still some concern that a more pronounced slowdown may occur, and, if so, that it is likely to be transmitted through the construction sector. To help prepare for, and hence avoid, a serious slowdown we have assessed the chain of events involved. We have examined the effects of a house price decline on the labour market and concluded that this could lead to a significant increase in the numbers unemployed. Equally serious would be a major slowdown in the US economy which would lead to a recession in Ireland. Given the dependence of the labour market on the construction sector, a contingency plan could be valuable that would help re-employ construction workers who became redundant. Maintaining competitiveness would be also key in the absence of a booming construction sector as more of Ireland's growth would have to be generated from the traded sector. More generally, policies which allow the labour market to adjust rapidly to global events need to be strengthened.

Research by the OECD suggests that public spending on active labour market programmes reduces the unemployment impact of shocks (OECD, 2006a). A contingency plan that anticipates the possible

consequences of an economic slowdown is prudent, even if the probability of one occurring is low. For FÁS, this would involve planning for a situation where the number of jobseekers doubles and the number of construction apprentices declines significantly (there are currently just under 20,000 construction-related apprentices). In a slowdown scenario, a significant demand for re-training could be expected to materialise mainly, although not exclusively, from the construction sector. More generally, a greater investment in training would be needed to help the unemployed back into work.

Flexibility could also be incorporated into national wage agreements which might allow for a moderation in pay increases in the event of a slowdown. Such a flexible approach could speed up the recovery from an economic slowdown.

Recommendations

In general, Government departments and agencies should assess the need for a contingency plan which would outline specific policies or measures that should be put in place to help address the threats facing the economy and to mitigate the impact of any slowdown.

Specifically, FÁS, in consultation with the relevant stakeholders, needs to assess the implications for construction employees, especially apprentices, of a slowdown in the housing market and prepare a contingency plan accordingly.

In the event of any worsening in the economic environment, new approaches to national wage bargaining may be needed that are flexible enough to allow for a significant short-term moderation in earnings growth, which would help facilitate a more rapid economic recovery. The precise method for achieving such an adjustment would need to be decided by the social partners.

2.2 Displacement

Immigration has been, and will probably continue to be, an essential component of Ireland's successful economic performance. Research indicates that its overall effect has been positive. However, experience in other countries and academic research indicates that immigration can also have some negative consequences. In particular, immigrants may cause displacement of some local workers resulting either in job losses or reduced wages. The section is intended first to examine any evidence of such displacement in Ireland and to then postulate the likelihood of it occurring in the future. Our analysis is based on a review of theoretical international literature on the matter, previous Irish research and an examination of available Irish statistics. While it is not possible to prove or disprove the existence or magnitude of displacement from these sources, the results can provide some indications of the situation.

Overview of Theory and International Research

There is a large body of theoretical and empirical research in respect of the impact of immigration. Much of this research has analysed the situation in countries with long-established immigrant inflows including, of course, the USA. The Expert Group on Future Skill Needs' report on the role of migration in meeting the skill needs of the Irish economy provides a brief summary of the research (EGFSN, 2005). Martin Ruhs in his report on Irish immigration policy summarises the foreign research, but also notes an absence of empirical research on the Irish situation (Ruhs, 2005). Two reports published by NESC in 2006 also provide a very large amount of

information on the issue (NESC, 2006a, NESC 2006b). ESRI researchers also have attempted to evaluate the impact of immigration on the Irish economy, employment and wages (see below).

The EGFSN report states "While there is no definitive methodology available to measure the full impact or value of migration, it is known that inward migration tends to contribute positively to GDP and has a somewhat neutral impact on GDP per capita. Furthermore, the skills mix of the migrant community is an important determinant of the impact of immigration of national income: the more highly skilled the migrants, the greater the positive impact on GDP. High levels of immigration will increase aggregate variables such as the size of the labour force, investment and gross incomes but do not necessarily impact on per capita income. Furthermore, reliance on immigration to relieve labour shortages can become a self-perpetuating phenomenon."

The report further states "Although there are limits to the economic benefits, migration does offer a range of other benefits to the host country:

- Gains from trade are facilitated by the interaction of individuals from diverse backgrounds who possess different knowledge sets;
- Economists also attribute a value to ethnic diversity in terms of an improvement in innovation capability through knowledge sharing; and
- A policy of attracting high skilled migrants increases the likelihood that migrants will be equipped with the necessary tools to facilitate integration (e.g. local language skills), minimising social costs.
- In parallel with the economic case for immigration, it is also important to consider the social costs attributed to migration. These primarily concern issues such as integration, healthcare costs, housing requirements and the impact that migration has on the sending countries. The consequences of immigration are felt over several generations and so, policies encouraging integration must extend over the long-term."

Whereas the above brief summary related to the broad aspects and implications of immigration, we now concentrate on the possible displacement impact of immigration on Irish workers. Such displacement could, in essence, happen in two ways – (1) Irish workers losing jobs or being unable to find jobs and hence becoming unemployed, or (2) the wage rates for jobs being lowered and hence Irish workers receiving lower wages. These two possibilities are the focus of this analysis.

Economists work within a paradigm that sees wages as the outcome of the balance between the demand for, and supply of, labour. While economists recognise that sometimes there are other forces at work determining wage levels (e.g. Government, unions, legislation), in general they take the view that in the medium to long-term wage rates will reflect demand/supply balances. There are four main reasons why immigration can lower wages. First, because immigrants often come from countries where wages are much lower, immigrants may be willing to work for less. If immigrants do underbid locals for jobs, then in order to remain competitive in the labour market, locals may have to reduce their own wage expectations. Second, immigrants may be seen as more desirable workers by employers. If this is the case, locals will have to choose between offering their services for lower wages or suffering higher unemployment. The third reason is that employers may be able to use the threat of further immigration as a way of holding down

the wages and benefits of workers. The more open the immigration policy, the more credible such a threat becomes. The fourth, and probably the most important, underlying, reason why there may be an impact of immigration on locals is that immigration increases the supply of labour. Basic economic theory predicts that the wages of those in competition with immigrants will decline as immigration increases the number of workers competing for jobs.

In general, strong economic growth should lead to strong recruitment demand for employees, which tends to increase wages. Equally, an increase in labour supply due to immigration may lead to lower wages than would otherwise be the case. In practice, the actual level of wages (and changes in wage levels) should reflect the relative strength of changes in demand and supply. This has been the situation in Ireland in recent years where greater demand has been accompanied by greater supply (not just from immigrants but also from increased participation of females). It is important also to emphasise that there is a loop mechanism at work here – if wage rates fall, competitiveness increases, and so demand for labour increases.

As indicated, immigration may result in reduced wages or lower employment of locals. Which of these happens in practice depends upon the reaction of the locals. Some may decide not to seek work at the new (reduced) wage levels, while others may keep working at lower wage levels. There are a range of factors which could affect these choices, e.g. the existence of other job options, the availability of social welfare supports to unemployed persons, whether wage rates actually fall or just increase by a lower than expected amount.

An important distinction in the literature is drawn between immigration of persons at low and higher skill levels. In general, any negative impact on the wages of locals is likely to be felt at the level where the majority of immigration occurs. Thus, if most immigration is at high skill levels, wages of high skill workers should be less, but wages and employment prospects of low skill workers should increase. This should, therefore, reduce income inequalities. An inverse situation can arise if most of the immigration is of low-skilled persons. For example, in the US most immigration is low-skilled and hence its effect is more likely to reduce the wages and job prospects of low-skilled native groups (particularly Afro-Americans).

Researchers have estimated very different levels of impacts of immigration on wages. A review of the international literature by New Zealand authors in 2004 found that the impact was generally small – an increase in the proportion of immigrants in the workforce by one percentage point may reduce wages by no more than 0.1 percent[18]. However, other research shows larger impacts. For example, the US immigration economist Borjas estimated a 0.3 percent wage decline for each one percent increase in the supply of immigrants[18]. Recent German research, on the other hand, following the Borjas methodology found the impact at less than 0.1 percent[20].

The November 2005 issue of the Economic Journal contains a special feature on the labour market effects of immigration. One article[21], by David Card, reviews the US literature on the subject. He disputes the findings of Borjas that immigrants lower the wages of natives. He carries out a detailed analysis of wage trends and immigrant supply across US cities. He finds little evidence that wages are related to the extent of immigrants in an area and looks at the two reasons given to explain this – outward mobility of natives and a changing sectoral mix

[18] 'Measuring the Economic Impact of Immigration: A Scoping Paper', J. Poot and B. Cochrane, Dept. of Labour, New Zealand, 2004.
[19] 'The Demand Curve is Downward Sloping', G. Borjas, QJE, 2003.
[20] 'Wages and Employment Effects of Immigration to Germany' H. Bonin, IAZ, December 2005.
[21] 'Is the New Immigration Really So Bad?', D. Card, EJ, November 2005.

of cities. The former explanation states that natives leave the area where there are lots of immigrants – so no impact on wages. The latter contention is that demand changes occur to take advantage of the increased supply of labour. His contention is that there are demand shifts within companies. Thus, the increased availability of particular types of labour leads companies to employ a skill mix which uses more of the available labour.

Another article in the Economic Journal looks at British data (Dustmann et al, 2005). Using UK Labour Force Survey data, including data on wages, the authors estimate the impact of immigration on UK employment and wages. They find no measurable impact on wages and a small negative impact on employment of intermediate skill workers and a positive employment impact on the better qualified.

Thus, in summary, the international research shows very different impacts and hence leads to very different policy conclusions. Some authors conclude that the negative impacts are marginal, others that they present serious challenges to equity in policy. In general, Martin Ruhs, in reviewing the international research on the impact of immigration on a country's economy and labour market, noted that the evidence was very inconclusive. He concludes "If it is possible to draw a general conclusion from the existing literature on the impacts of immigration on the labour market, it is probably this: immigration may cause wages to fall (or unemployment to rise) in the short term, but these developments may be reversed in the long term after labour demand has adjusted to the immigration-induced increase in labour supply. Of course, whether or not this general statement holds for a particular country is a question that can only be answered by empirical analysis of migration to that country."

Irish Results

A study conducted by Barrett et al in the ESRI early in 2005 found that, over the period studied (1997-2003), on average immigration to Ireland was high skilled[22]. Using a simulation model, the authors estimated that immigration had reduced average wages of high skill workers by about 4%-5% compared to what they would otherwise have been. This increased the employment of both high and low skill workers and left low skilled wages broadly unchanged. The authors warn, however, that if most of the immigration had been low skilled, then wages of low skilled workers would have been reduced.

The headline data would suggest that displacement is not a major, or widespread, issue in the current circumstances of the Irish economy. The two over-riding reasons for this view are the continued low levels of unemployment and the continued rise in wage levels across all the main sectors of the economy. Thus, while the statistics show that employment of Irish persons has declined in certain sectors, they also show increases in other sectors. Economy-wide, in the year to the second quarter of 2006, although foreign-national employment increased by 47,800, the number of Irish in employment still increased by 39,900.

Nevertheless, a more detailed analysis of labour market data is warranted on the basis that if displacement were occurring in specific sectors and/or sub-sectors, this would not necessarily show up in the headline data. We have conducted a detailed analysis of CSO data on employment and earnings to see if any of the sectoral trends are consistent with the possible existence of displacement. However, it is important to emphasise that this analysis can not definitively prove the existence or otherwise of displacement or the magnitude of any such

[22] The Labour Market Characteristics and Labour Market Impacts of Immigrants in Ireland', A Barrett, A Bergin, D Duffy, Economic and Social Review, Spring 2006.

displacement effects. This is because there are so many other factors and changes occurring within the economy that it is not possible to fully isolate the impact of any one factor such as immigration and what would have happened in the absence of it. In particular, the lack of comprehensive Irish migration data makes only tentative conclusions possible. That said, if displacement is occurring, one would expect, all other things being equal:

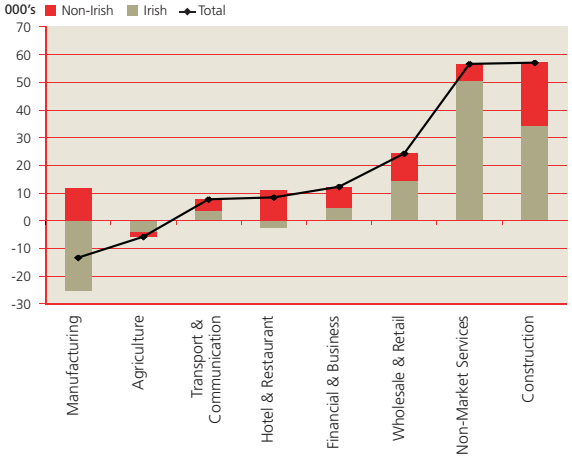
1. A reduction in the number of Irish workers in the sectors where non-national workers are being increasingly employed.

2. A significant moderation in wage growth in the sectors where non-national workers are being employed.

While this would by no means prove the displacement hypothesis, it would be consistent with displacement. What follows is a brief overview of what the analysis of the CSO data has shown about each of these points.

The CSO data was analysed in the following way. First, stock employment figures were analysed by sector (at NACE 1 level) and nationality status (Irish or foreign) to ascertain the incidence of migration by sector. Then net inflows into these sectors over the last two years (Q2 2004 to Q2 2006) were broken down by nationality status to see if there were any sectors where the number of Irish workers was decreasing while the number of foreign workers was increasing (see Figure 2.1 below). This process was then repeated at the sub-sectoral level (NACE 2 Level) (over the period Q2 2004 to Q2 2006 and the longer period Q2 2001 to Q2 2006) to get a more detailed picture of the flow of migrants and Irish workers within each sector. Earnings trends were also analysed over the 1995-2005 period to see if any particular sectors were experiencing a moderation in earnings in recent years (as would be suggested by the displacement hypothesis). An analysis of more recent earnings trends was also undertaken in respect of sub-sectors where migration trends have been significant.

FIGURE 2.1
Change in Selected Sectors by Nationality Q2 2004-Q2 2006



Source: CSO, QNHS

As Figure 2.1 shows, in only two sectors has employment of non-Irish persons increased and Irish persons fallen; manufacturing and hotels & restaurants. In all other sectors, the trend has been in the same direction for both Irish and non-Irish. Tables 2.1 and 2.2 below show sub-sectoral trends in selected manufacturing areas and Figure 2.2 shows earnings trend in sectors where some displacement may have taken place. In fact, within manufacturing, food processing is the only sector which has exhibited significant signs of displacement. In this sector (i) the number of foreign workers has increased (up 5,000 between Q2 2004 and Q2 2006), (ii) the number of Irish workers has declined (down 4,000 between Q2 2004 and Q2 2006), and (iii) annual earnings growth has shown a gradual moderation since the beginning of 2005 when it was 5.9% to 2.8% in Q2

2006 (Figure 2.2). Tentative signs of possible displacement were also in evidence in the chemicals and chemical products sector, but on a comparatively small scale. In this sub-sector there was (i) a modest increase in foreign nationals (+1,000) and (ii) a decrease in the number of Irish workers (-3,000) between Q2 2004 and Q2 2006, while (iii) earnings growth has also moderated, albeit from a very brief spike in earnings towards the end of 2004. While there has been a significant decrease in the number of Irish workers in the radio, television and communications equipment sub-sector in the last five years (Q2 2001 to Q2 2006), as well as some earnings moderation over the post-enlargement period, the net inflow of foreign workers into this sub-sector has not been significant.

Table 2.1
Employment Change in Selected[23] Manufacturing Sectors by Nationality Q2 2004 - Q2 2006

Sector	Non-Irish	Irish
Manufacture of food products and beverages	5,000	-4,000
Manufacture of fabricated metal products	1000*	
Manufacture of chemicals and chemical products	1000	-3,000

*denotes number was too small to be statistically reliable.
Source: FÁS Skills and Labour Market Research Unit- derived from CSO data.

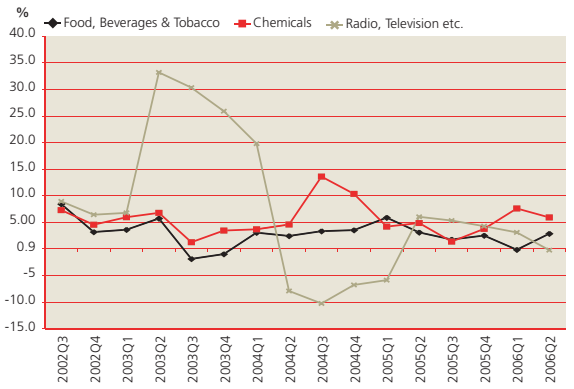
Table 2.2
Employment Change in Selected Manufacturing Sectors by Nationality Q2 2001 - Q2 2006

Sector	Non-Irish	Irish
Manufacture of radio, television & communications equipment & apparatus	*	-10,000
Manufacture of fabricated metal products	*	-9,000
Manufacture of food products and beverages	6,000	-7,000

*denotes number was too small to be statistically reliable.
Source: FÁS Skills and Labour Market Research Unit- derived from CSO data.

[23] Values of other sub-sectors were too small to merit selection

FIGURE 2.2
YoY% Earnings Growth in Selected Manufacturing Sectors



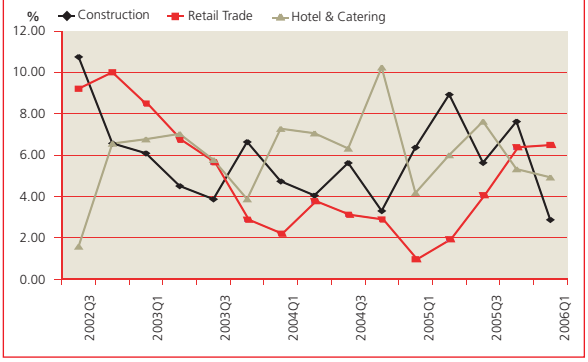
Source: CSO

In the construction industry, while there has been a large increase in employment of non-Irish nationals in the two years to Q2 2006 (up 22,800) there has been an even larger increase in employment of Irish workers (up 34,200). This is not suggestive of displacement. Also, up to the end of 2005, annual earnings growth in the sector was strong; running at almost 8%. However, preliminary hourly earnings statistics for the third quarter of 2006 show a significant moderation down to just 2.5% annually, but such quarterly statistics have shown a tendency in the past to experience significant variations. Therefore, it is not clear whether the latest figures represent a sustained downward trend or just a blip. Earnings data will need to be carefully monitored in the coming months, as will the composition of the sample used to estimate these earnings, before any clear conclusions can be drawn.

Within the services sector only the hotels & restaurants and the retail sub-sectors were found to exhibit any tentative signs of displacement. Statistics for the period Q2 2004 to Q2 2006 show a fall in the number of Irish workers (-2,500) in the hotel and restaurants sector occurring in tandem with an increase in the number of foreign national workers (+11,000). Over the same

period, in the retail sector, there was a decline in the number of Irish nationals (-2,000) and an increased number of non-Irish nationals (+7,000). However, earnings trends in these sectors are not suggestive of displacement (see Figure 2.3 below). Earnings growth in the hotels & restaurants sector has been fairly strong post-enlargement (averaging around 6% per annum), while earnings growth in the retail sector has recently recovered from a 2-year slump that started prior to EU enlargement. These earnings trends are not suggestive of a scenario where low-paid workers from abroad are displacing better-paid Irish workers. However, the increases in the National Minimum Wage (outlined in Chapter 1) may partly explain the recent strength of earnings growth in these sectors.

FIGURE 2.3
YoY% Change in Earnings



Source: CSO

Nor did similar analyses of employment, earnings and vacancies trends conducted in the first half of 2006 by the ESRI (Doyle et al, 2006) suggest that displacement was a widespread phenomenon. The authors note that the incidence of vacancies has actually been increasing over the post-enlargement period, which is inconsistent with the displacement hypothesis. They point out that labour is not a homogenous factor of production and that immigrant labour can serve to complement rather than substitute the native workforce, resulting in an overall increase in the wages of native workers. It seems to be the case that migrant workers have in recent years been taking up jobs at the lower skill spectrum in sectors such as the food processing and hotel & restaurants; sectors that Irish workers are less eager to work in. These sectors would experience significant labour shortages without the inflow of foreign-national workers, given the current low unemployment rate. Hence, the available evidence would tend to support the view that to the extent that displacement has taken place, it has largely been part of a natural process whereby migrant workers fill posts vacated by Irish workers moving on to jobs with higher skill levels. This reallocation of labour should increase the overall output of the economy.

Is Displacement Likely in the Future?

Having asked whether displacement has occurred since EU enlargement, an important question is how likely it is to occur in the future and what steps can be taken to reduce the likelihood of it happening. PPSN figures show the rate of immigration from the EU10 rising over the post-enlargement period with the number of PPSN issued in the second year of enlargement up 46% on the first year and further growth expected during the third year. This would suggest that the flow from the EU10 has now become well established and is likely to continue, although not necessarily at the current rate.

In the context of future displacement, it must be kept in mind that Romania and Bulgaria are set to become members of the EU in 2007. The Government has decided not to open up our labour market to these countries. Doing so would probably have led to a further step change in immigration levels. The Institute for Public Policy Research (IPPR) predicted that 56,000 Romanian and Bulgarian workers would have come to work in the UK in 2007 had the British Government allowed them

unconditional access to the labour market. The IPPR said that its 56,000 figure was based on what happened in the UK after the 2004 EU expansion. Currently, the number of PPSN numbers issued to EU10 workers in Ireland is approximately half the UK figure. If this ratio remained the same for Romanians and Bulgarians, then, based on the IPPR estimate, Ireland could have expected to issue an additional 28,000 PPS numbers per annum in the short to medium-term.

The major determinant of the magnitude of future immigration flows is likely to be the health of the Irish economy and, in particular, the construction sector given that a large proportion of EU10 workers are employed in this sector. Should there be a slowdown in construction then the flow of EU10 workers coming to Ireland would be likely to moderate. The rate of this moderation would depend partly on the knock-on effects that the construction slowdown would have on other sectors of the economy. If the services sector was also affected, then the attractiveness of Ireland vis-à-vis other possible EU destinations would diminish significantly. In particular, many foreign-national construction workers might be tempted to migrate to London where the demand for construction workers is likely to remain robust given that the city will be hosting the Olympics in 2012.

Nevertheless, the health of the labour market is just one factor determining migration flows. The existence of established migrant networks acts as another pull factor for EU10 migrants when deciding their destination, as does the fact that Ireland is an English speaking country.[24] Naturally, the economic success of the new EU member states will affect their citizens' interest in emigrating while the opportunities available nearer to home will also be an important factor for some. So, all in all, even if there is a slowdown in the Irish economy it is far from clear whether or not there will be a large-scale exodus of foreign-nationals and a dropping-off of immigration to Ireland.

Assuming immigration remains relatively strong in the short-to-medium-term, any subsequent change in migration flows precipitated by an economic slowdown would need to be quite dramatic to avoid either high unemployment and/or displacement. This is especially true given that the sector most susceptible to a sudden correction is probably construction, where a large number of foreign-nationals are currently employed. In the event of a slowdown in the housing sector (as outlined in the previous section), there could be a large number of workers, both native and foreign, competing for a smaller pool of construction jobs unless there is a sharp reversal of the current inward migration patterns.

Traditionally, highly-skilled migrant workers[25] tend to leave a host country when there is a slowdown in the economy, often returning home, while low-skilled workers tend to become more embedded in the host country and are less likely to leave in the event of unfavourable economic circumstances. The high-skill migrants probably leave because they are more marketable, having gained valuable experience in the host country. However, in the case of migrant workers from the EU10, although many are highly-qualified, many are not working in occupations commensurate with their skills and they may not, therefore, be fully benefiting from the value-added experience traditionally gained from working abroad. Working in jobs that do not involve using skills previously acquired can result in 'brain waste'. The longer the process of brain wasting continues the less likely the worker is to progress to a job commensurate with his/her skills. This implies that the migratory response of highly-skilled EU10 workers in Ireland may be less sensitive to economic fluctuations than is traditionally the case for skilled

[24] Research shows that highly educated migrants have a preference for English speaking countries.
[25] Foreign-nationals in Ireland are highly educated with over 40% having degrees compared to 20% of Irish nationals (Barrett and McCarthy, 2006).

workers. Should that prove to be so, this would increase the probability of displacement becoming an issue during a recessionary period.

How Can the Risk be Minimised?

Given the possibility of displacement in the future, an effective employment rights compliance system, as outlined in Towards 2016, will be essential to ensure that the risk of existing workers being displaced is kept to a minimum. As NESC points out:

"..it is not the legitimacy of standards that is in dispute, but the effectiveness of earlier approaches to monitoring and enforcing them" (NESC, 2006).

We agree with NESC that it is important that, when developing the new compliance regime, the Office of the Director of Employment Rights Compliance (ODERC) should take cognisance of innovative approaches around the world to labour standards that do not rely on a 'command and control' approach but place greater emphasis on sophisticated monitoring techniques.

Future immigration trends will also need continuous monitoring and Towards 2016 makes provision for this in the setting up of a monitoring group to track labour market trends as well as to keep a check on employment standards. Up until now, the lack of comprehensive earnings data linked to data on the occupations and the skills of migrants has reduced the possible sophistication of analyses of displacement. Fortunately, more comprehensive earnings data should be available soon and this will greatly assist the work of the proposed monitoring group.

The risk of displacement occurring in the event of an economic slowdown can also be reduced by helping immigrants work at a level commensurate with their potential and this includes the recognition of qualifications gained overseas (and possibly recognition of their prior work experience). Evidence suggests that even after spending a long period in a host country, immigrants are still much more likely to work in employment that is below their skill level than their native-born counterparts (OECD, 2006b)[26]. However, a majority of shortages in the future are forecast to be in high-skill occupations. Hence, a system of qualifications recognition would help to overcome the problem of skills shortages and avoid an excessive supply of migrant workers in low-skill occupations, thereby reducing the potential for displacement. A large supply of skilled workers, regardless of their nationality, will help to attract investment in Ireland and be economically beneficial in the round.

It has already been noted that during the last decade highly-skilled immigration into Ireland helped reduce income inequality as it narrowed the gap between the earnings of low-skilled workers and those of high-skilled workers. However, if high-skill workers work at lower levels then they end-up competing for low-skill jobs. This would tend to depress the earnings of low-skill workers vis-à-vis high-skill workers leading to increased income inequality.

Qualifications recognition for migrants can also increase flexibility by increasing access and mobility between jobs. Essentially, employers will be quicker to hire workers if they can trust their qualifications, thereby facilitating job switches. While this might not have any direct impact on displacement, it could help mitigate the negative consequences of a slowdown. How the labour market responds to shocks will in part depend on how easily workers can move from one job to the next.

[26] Although the ESRI has recently shown that the gap between Irish and non-Irish wages decreases over time (Barrett and McCarthy, 2006)

According to Claire Byrne of the National Qualifications Authority of Ireland (NQAI):

"The NQAI received applications for qualification recognition from over 70 nationalities in 2005, with 47% of such applications originating from new EU Member States and the Russian Federation. In the absence of an EU-wide recognition programme, it is vital that Irish employers, educational institutions and migrant bodies all work together to further develop the recognition system in Ireland and ensure that Ireland is benefiting from the skills of migrant workers." [27]

In May 2005, European Ministers for Higher Education meeting in Bergen adopted the Framework for Qualifications of the European Higher Education Area (the Bologna Framework). The NQAI is in the process of verifying the compatibility of the Irish National Framework of Qualifications with the Bologna Framework. This represents a significant step in the right direction for qualifications' recognition of foreign workers in Ireland.

However, despite the desirability of a qualifications' recognition system there is some doubt as to whether it is best undertaken by individual countries, especially small countries with limited resources. If it is to be done comprehensively, the amount of work involved is substantial. It would involve documenting and comparing numerous qualifications from a large number of countries. The European Commission has been attempting to tackle this problem at EU level for many years, with only limited success. It would also be necessary to overcome existing barriers to entry and the possible opposition of professional and trade union interests.

The move towards greater qualification recognition for foreign nationals is currently under way in Ireland with a new procedure established by the NQAI in 2006. This will help enable foreign workers to obtain recognition for their qualifications. However, the time and resources needed to operate such a system are considerable, especially given the increasing number of foreign workers entering the country.

Arguably one of the most important factors for migrants acquiring employment in high-skilled and better-paid jobs is the ability to speak English. Recent research on the Irish labour market has found that immigrants from English-speaking countries tend to earn similar wages to Irish workers, while workers from non-English-speaking countries are estimated to earn almost a third less than Irish workers (Barrett and McCarthy, 2006). It is hardly surprising then that the demand for English language training among immigrants is very strong. In relation to English language training for foreign workers, FÁS stated in the Irish Labour Market Review 2004 that English language training:

"…could be the most important factor in helping someone to get a suitable job. Against this, it could be argued that it is not FÁS's role to provide language training and that the possibility of (free) English language training would cut across existing commercial providers. Thus, it is recommended that FÁS does not provide stand-alone, extensive, language training per se. However, it is recommended that FÁS provides a certain amount of technical English within vocational training courses where participants need it."

FÁS is currently running technical English training courses in certain locations and, of course, many other organisations are also providing English language training. Undoubtedly, the demand for English language training is very high. In its recent report on migration NESC noted that "Given Ireland's strong reliance on EEA migrants .. a focus on raising language competency

[27] Speaking at the NQAI Annual Conference 2006, Dublin Castle.

among migrants already in the country should be a priority" (NESC, 2006b, p190). The report went on to argue that language training should be available as widely as possible, with a strong focus on the language training needs of migrant family members not currently in the workforce. However, it is interesting that while NESC endorsed the provision of technical English language training to migrants, it stated that "priority access to general English language training at taxpayer's expense should be for migrants at particular risk of social exclusion (e.g. the legally resident family members of low-waged workers) and in instances where the State formally assumes responsibility for the integration of migrants – as when it grants refugee status or is supporting their education as minors" (NESC, 2006b, p180). Thus, NESC does not recommend free English language training for all. (Interestingly, after providing free English language courses in the UK for some years, the Learning and Skills Council recently announced that this would be curtailed.) In conclusion, from a labour market viewpoint there is little doubt that English language training would be valuable for many persons in employment or seeking employment in Ireland. However, the issues of who should provide this, and to what extent and with what funding, have to be addressed and may require a fresh look across the range of Government Departments and agencies concerned.

Helping Irish Workers to Adjust

Whether through displacement, or the more general effects of globalisation and a possible economic slowdown, it must be expected that a proportion of the existing Irish workforce will face job loss and the need to seek alternative employment. Hence, measures should be put in place to assist Irish workers employed in sectors most at risk of displacement to move on to better jobs. For example, these workers could be re-trained to work in other growth sectors of the economy such as IT, customer service and financial services, where fluency in English is usually a prerequisite, or in the various other expanding parts of the services sector. Towards 2016 recognises the need to target upskilling efforts at lower-skilled and vulnerable workers. FÁS has expanded its provision for up-skilling very significantly in the last two years and FÁS currently provides a range of supports to help employees to up-skill or re-skill. There is an on-going need to continue these, with whatever modifications would be desirable, to meet changing needs. Specifically, in response to Towards 2016, FÁS should review its existing programmes and, drawing on these, pilot comprehensive approaches to guidance, mentoring and training for low-skilled workers in vulnerable sectors. Other organisations also have an important role to play in training and educating the workforce to meet change and move up the qualifications' ladder.

However, it is impossible to know the exact types of jobs that workers at risk of displacement will obtain. Therefore, an important component of any upskilling for workers at risk of displacement will be generic skills such as communications, interpersonal skills and team-working which will improve general employability. Soft skills are particularly relevant for the growing services sector, where many of the job opportunities will be in the future.

Conclusions

This section has concentrated primarily on the topic of displacement. It did not attempt to consider all the implications of immigration for the Irish economy, as they have largely been addressed in previous Reviews and other publications. The section began with a review of the international research of the impact of immigration. The international research suggests that the impact of immigration on a country depends significantly on the

types of persons who immigrate and the economic situation of the country. While the research findings vary from country to country, in general it was concluded that in the short-run immigration tends to depress earnings, but that this process may be reversed in the long-run. Research by the ESRI on the Irish experience of immigration over the 1997-2003 period showed a positive impact of immigration.

CSO data on employment and earnings were then analysed for suggestive evidence of displacement in Ireland. While definitive conclusions could not be drawn from the data, the statistics would suggest that displacement is not a major or widespread issue in the current circumstances of the Irish economy. The two over-riding reasons for this conclusion are the continued low levels of unemployment and the continued rise in wage levels across all the main sectors of the economy. Thus, while the statistics show that employment of Irish persons has declined in certain sectors (most notably food processing), they also show increases in other sectors alongside increases in non-Irish workers.
The final part of this section then considered the likelihood of displacement occurring in the future and what could be done to minimise its incidence. It was concluded that displacement could be significant for low-skill jobs in the event of an economic slowdown. A number of ways to minimise the potential for future displacement were outlined. These include English language training, an effective employment rights compliance system and a well-developed system for qualifications recognition for foreign nationals. In particular, the latter would reduce the risk of a large supply of highly-qualified migrant workers competing in the market for low-skilled labour. However, the time and resources needed to operate a qualifications recognition system should not be underestimated. A significant effort will also be needed to help Irish workers at risk of displacement or redundancy because of globalisation to progress into growth sectors of the economy.

Recommendations
The arrangements agreed in Towards 2016 to ensure an employment rights compliance system that is effective and has the confidence of all interested parties should be continue to be implemented.

There is a need for a well-developed system of qualifications recognition for foreign nationals. However, the time and resources needed to operate such a system, especially in the context of increasing immigrant numbers, should not be underestimated.

English language training for workers from non-English speaking countries is important to help integration and maximise the benefits to the Irish economy and the immigrants themselves. There is a need for Government and its agencies to re-examine policy in this area and develop a clear approach to provision and funding.

Efforts by FÁS and others to up-skill and re-train existing Irish workers in jobs or sectors under threat need to be continued and extended. There is a need to review the various approaches underway to develop a best-practice model including guidance and appropriate training. Generic skills development is likely to be an important part of such training.

Better research on displacement would be enabled by the collection and provision of data on wages, jobs and nationality by the CSO. The various parties concerned should, therefore, review existing data and possible improved approaches.

2.3 Flexicurity

The EU's Lisbon Strategy on jobs and growth places a strong emphasis on competitiveness in the context of globalisation, including accelerated structural change. Globalisation requires many workers to change jobs frequently within a flexible labour market. This creates a dilemma for the EU if it wants to maintain competitiveness, while at the same time preserving the European social model, given that a more flexible labour market is likely to have negative implications for job security.

Flexicurity rests on the fundamental idea that flexibility and security are not necessarily contradictory but can be mutually supportive. While several countries have incorporated elements of the flexicurity approach, flexicurity in its purest form can be found in Denmark. Variations on the flexicurity theme are also evident in other North European countries, but the primary focus here will be on the 'classic' Danish model.

Flexicurity was first introduced in Denmark in 1993 in the context of very high unemployment (a 12% unemployment rate). In Denmark the flexicurity model is comprised of three elements, often referred to as 'The Golden Triangle'. These three elements are:

1. **High mobility between jobs:** largely due to weak employment protection legislation which facilitates the easy hiring and firing of workers.

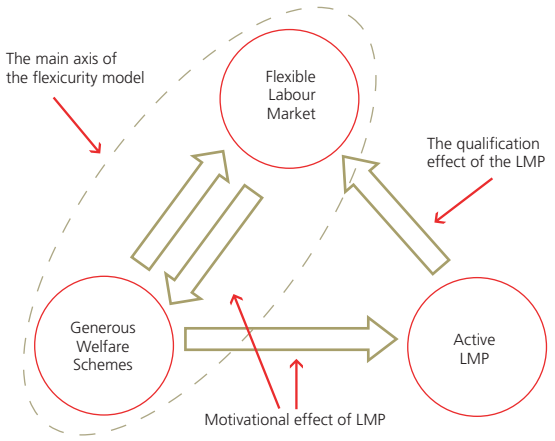
2. **Comprehensive social safety net:** that guarantees a high level of unemployment insurance.

3. **A strong emphasis on active labour market policies:** which facilitates the flow of workers between unemployment and employment by motivating work search by the unemployed, as well as upgrading the skills of unemployed people through training programmes.

These three components of the Golden Triangle are designed to complement each other in a dynamic way as Figure 2.4 (below) illustrates. The main axis of the flexicurity triangle runs from the flexible labour market (characterised by a liberal 'hire and fire' approach) to the generous welfare system (which lessens the risks associated with redundancies).

In the Danish model, employees can be fired with just 3 days notice, but they can (in the case of low paid workers) receive up to 90% of salary for a maximum of 4 years (this was reduced from 9 years in 1994).[28] As a result, one third of the workforce changes jobs every year and the average duration of tenure is just under 8 years (see Figure 2.5 below), the third lowest in the OECD (the US has the lowest average duration of tenure at 6 years).

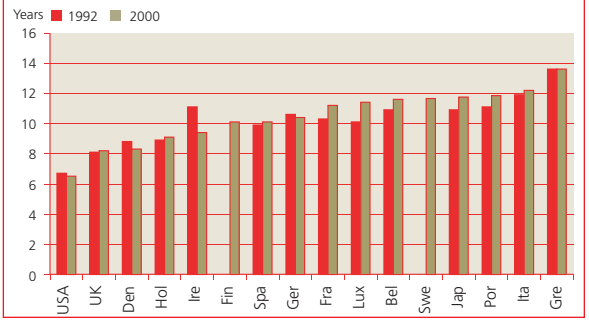
FIGURE 2.4
The Danish Flexicurity 'Golden Triangle'



Source: Flexicurity – the Danish labour market model, Andersen & Svarer, 2006

[28] However, the average unemployment payment is approximately 55% of previous salary.

FIGURE 2.5
Average tenure with the same employer in selected OECD Countries



Source: Auer & Casez (2003)

At first glance, the fairly weak employment protection legislation (EPL) might seem to leave Danish workers in a rather precarious position. However, as the OECD points out, the evidence would suggest that Danish employees actually feel secure, notwithstanding the high level of job mobility and low average job tenure (OECD, 2006a). This is because the flexicurity system places the emphasis on worker security as opposed to job security. This is based on the belief that 'a job for life' is a thing of the past.

From the perspective of the individual employee, the security provided is not against the loss of his/her existing job but against struggling to manage on a low income if unemployed and being without a job for a long period. Lundvall (2002: 82) sees the high rate and the long period for which benefits can be drawn (that characterise unemployment compensation in Denmark) as integral to the country's successful innovation system rather than as handicaps to the efficient functioning of its labour market. The generosity of unemployment payments, he argues, contributes to the workforce being willing to practice a high level of mobility between jobs and employers, and to the population at large valuing a permanent (if periodically interrupted) attachment to the labour force. In fact, according to the Danish Prime Minister Anders Fogh Rasmussen "We have flexibility because we have a labour market with social security".

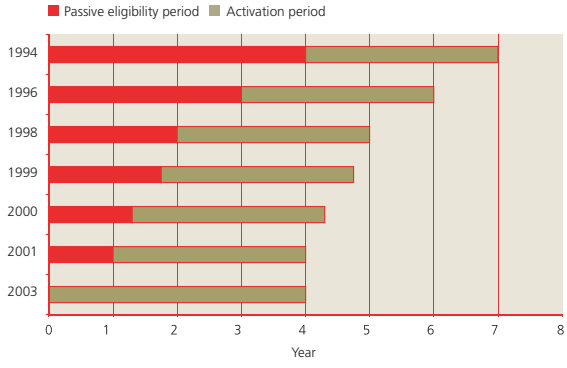
People protected by benefits may embrace more change and take more risks than they would otherwise do, with outcomes that are positive for the functioning of the labour market and economic performance it is claimed.

Young people and women returning to the labour market find it easier to gain a foothold on the Danish labour market because of the high job turnover associated with flexicurity. Youth unemployment in Denmark has been low in recent years (currently 8.5%) and the employment rate (71.9% in 2005) and the participation rate for women are among the highest in Europe. However, a high degree of numerical flexibility can also have a number of negative consequences. For example, there would be little incentive for an employer to invest in training if there is a high probability that the employee will move on. Yet in the Danish case, company expenditure on training is the highest in the EU. In fact, this is largely because the Danish government provides employers who invest in training with a tax refund as well as contributing to the employers' wage costs while their employees are training.

The third element of the Golden Triangle is the activation component. The aim of this aspect is, on the one hand, to provide the unemployed with the qualifications needed to get back into employment, and on the other hand to ensure that unemployed persons are searching actively for employment rather than taking advantage of the generous social welfare system. The activation approach involves early intervention, intensive job-search assistance courses, a focus on adult vocational training, individual action plans and a strong emphasis on sanctions for those who don't seek or take up employment. When the flexicurity system was first introduced in Denmark in 1994, the unemployed were allowed to claim benefits for up to 4 years before being

obliged to take up a training/employment offer. However, as part of a drive to 'tighten' the flexicurity system, the unemployed are now obliged (if offered) to take up training/reskilling offers from the day they are made redundant, while still receiving generous welfare payments. Figure 2.6 outlines how both the duration of passive eligibility for benefits and the activation period have shortened since 1994, in an effort to tighten the Danish model. In practice, an instantaneous offer of re-training is not usually made unless immediate job prospects are poor (Andersen and Svarer, 2006).

FIGURE 2.6
Development of the Danish Social Security System - eligibility and periods of activation



Source: Andersen and Svarer (2006)

While the activation component seems to achieve the desired results (Denmark has an employment rate of 76% - the highest in the OECD, an unemployment rate of 3.9% and a long-term unemployment rate of 1.2%) it is a very expensive approach. In fact, Denmark has the highest spend on activation programmes for the unemployed as a share of GDP (1.5%) in the EU. It could be argued that the fall in unemployment had as much to do with the tightening of the social welfare system over the last decade (via more stringent activation conditions and the shortening of the duration of unemployment insurance) as the flexicurity model itself. It has also been argued that the expenditure on activation is excessive given that research has found that the threat effect associated with the activation process is the main reason for its success (Andersen and Svarer, 2006).

The Austrian Backpack Principle

Austria is another country which is becoming increasingly 'flexisecure'. Austria held the EU presidency in the first half of 2006 and put flexicurity at the top of the EU's agenda. Over recent years the Austrian government has been forced to accommodate structural change in order to maintain competitiveness, given the openness of its economy. With an unemployment rate of less than 5%, and an employment rate of 68%, Austrian proponents of flexicurity argue that that the system has been successful. One element of the Austrian 'flexicurity' system stand outs: the 'backpack' principle for redundancy payments. This is a severance scheme introduced in 2002 designed to increase job mobility for employees and financial predictability for employers. Under the scheme, employees acquire entitlements to severance payments after two months' employment with the same employer (whereas previously such rights would have only been acquired after three years of service). These entitlements can be kept when a worker moves on to another employer, regardless of whether they change jobs voluntarily or are dismissed and can be built up over the entire working life. The employer, instead of making costly severance payments upon laying off employees, pays a constant redundancy tax each month to an independent staff provision fund, regardless of whether or not redundancies actually occur. Rather than the employer making severance payments, these are paid out of the staff provision fund. On the employee side, the main benefit of the scheme is that entitlements to redundancy payments acquired in one job can be carried to subsequent jobs (like a backpack).

As a result, workers don't have to stay in the same job to build up entitlements to redundancy payments. On the employers' side, the advantage of this system is that they do not bear any redundancy cost of dismissing their employees as the cost is spread across all employers. This reduces the financial risk involved with hiring new staff. On the negative side, however, the tax will increase, in general, employers' ongoing labour costs. A similar backpack principle is also in place for acquiring and retaining pension entitlements as employees move along their career path. Overall, it is claimed, the economy benefits from the backpack system as it increases labour mobility, resulting in a more flexible labour market.

Challenges facing the System

Regardless of the perceived merits of the Danish model, the exportability of the system to 'non-flexicure' countries is problematic. The success of the Danish system has depended a lot on strong public-spiritedness which is absent in many other countries. The precursors to the introduction of flexicurity in Denmark included the September Compromise of 1899 between business and unions, a labour market that had for decades been characterised by a high level of mobility between jobs and a well-developed social safety net. According to Wolff "the miracle is not easily shared" (Wolff, 2005). Algan and Cahuc (2005) state that civic attitudes are key to the success of a flexicurity system. They argue that:

"the flexicurity model is hardly sustainable in countries displaying weak public-spiritedness because the unemployment insurance design raises moral hazard issues that are much more difficult to overcome in countries where individuals are more prone to cheat over government benefits." (Algan and Cahuc, 2005)

Another major problem with the Danish flexicurity model is that it is extremely expensive to fund. In 2004, Denmark spent the highest proportion of GDP on unemployment compensation and labour market programmes of any EU-25 or OECD country. The combined spend amounted to 4.4% of GDP in 2004, almost twice the EU-25 average of 2.3%. Significantly, since the introduction of flexicurity in 1993, the generosity of the Danish system has decreased, with the duration of unemployment benefit falling from 9 years to 4. In fact, the continued viability of the generous benefit system is being called into question given that the Danish population is ageing, and this is putting increased pressure on the social expenditure budget. Immigration also brings challenges to the system in terms of what level of rights to benefits should be accorded to immigrants.

Relevance to Ireland

To what extent is the flexicurity model relevant to Ireland? For both Ireland and Denmark, a flexible labour market is particularly important to economic prosperity given that both countries are small open economies subject to the vagaries of the world economy and to fluctuations in the value of the euro[29] . Also, our tradition of social dialogue, which began in the 1970s, would a priori seem to offer hope that a consensus, similar to the one that prevails in Denmark, could be reached to introduce flexicurity, should it be deemed beneficial. However, Ireland already has a relatively flexible labour market. In terms of employment protection legislation (EPL), the OECD estimates that our EPL is less strict than Denmark's (see Figure 2.7), even though average tenure in Ireland is slightly higher at 9 years (compared to just under 8 years in Denmark). The slightly longer length of tenure in Ireland probably reflects the fact that Irish regulation mainly benefits permanent workers, whereas our protection of temporary workers is low compared to Denmark and the OECD average. Over the last decade, Ireland has moderately tightened job protection by

[29] While Denmark is not, strictly speaking, a member of the eurozone, it has pegged the Krona to the euro, which amounts to a de facto transfer of monetary control to the ECB.

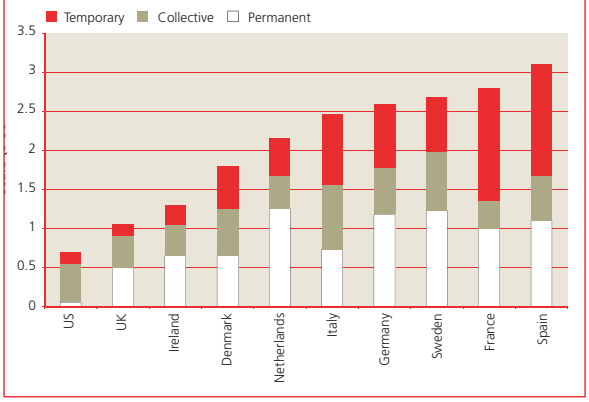
limiting the use of temporary employment and reducing the duration of temporary employment to a maximum of four years (OECD, 2006). A move in Ireland towards the Danish approach would imply a shift in emphasis away from the protection of permanent workers towards further protection of temporary workers, rather than a loosening of EPL per se.

However, reform of EPL is rarely popular, as evidenced by the aborted labour market reforms in France earlier in 2006 which sparked the riots. The proposed reforms, which involved easing the hiring and firing of young employees, had been inspired by the Danish flexicurity system. According to the IMF, the most recent social partnership agreement Towards 2016 involves a slight increase in firing costs, but these costs are only expected to affect a small number of firms[30] (IMF, 2006).

Of course, the Danish flexicurity system, while being the 'classic model', is not the only example of flexicurity that could be emulated. The 'backpacking' initiative in Austria has much to commend it in the Irish context as it would make temporary work more financially secure (currently, entitlement to redundancy payments only accrues to an employee after two years of service with a company). Under the current Irish system employers who make redundancy payments are entitled to a 60% rebate from the Social Insurance Fund, into which they make regular payments themselves through P.R.S.I. contributions. While this reduces the financial risk of hiring, the Austrian system would reduce the risk even further. Backpacking pension entitlements gained in a previous employment could also go someway to alleviate the problem of pension coverage for private sector employees who change employers.

More generally, the OECD notes that in relation to EPL *"Partial reforms that aggravate labour market dualities should be avoided, including by better protecting the rights of workers on temporary contracts in countries where they have substantially worse employment conditions than workers in permanent jobs or poor prospects for moving into more stable jobs" (OECD 2006).*

FIGURE 2.7
Strictness of EPL in 2003 in selected OECD countries



Source: OECD Employment Outlook 2006

Job-search requirements have become more stringent in Ireland over the past decade since the introduction of the Employment Action Plan (EAP) activation process between the DSFA and FÁS in 1998. The increasing emphasis on job-search in the EAP process would seem to be consistent with the activation aspect of the 'flexicurity system'. In 2006, the Department of Social and Family Affairs renamed Unemployment Benefit and Unemployment Assistance 'Jobseeker's Benefit' and 'Jobseeker's Allowance' respectively. While this has not led to any substantive changes in the nature of the payment, the name change suggests further emphasis on the job-search requirement for unemployment support. Moves are also being made to introduce a greater degree of conditionality for the One Parent Family Payment and Disability Allowance (see Towards 2016). Moreover, the Government has recently reduced the time

[30] The IMF does not explicitly state what these firing costs refer to. Presumably, they are connected to the proposal to address collective redundancy situations in the context of EU enlargement.
[31] This was achieved in Budget 2007 when the rate for Jobseekers Allowance was increased to €185.60 for a single adult.

period for activation from 6 to 3 months on the Live Register. This will bring the Irish period of activation closer to the Danish instant intervention approach

It is arguable as to whether or not the generous welfare benefits characteristic of the Danish model could be replicated in Ireland, given that we spent only 0.9 per cent of GDP on unemployment benefit in 2004 compared to the Danish figure of 2.7 per cent. Towards 2016 (page 52) sets out recommended increases in social welfare payments based on the National Anti-Poverty Strategy recommendation of €150 per week in 2002 terms by 2007 (equivalent to approximately €180 per week [31]) and to be maintained over the lifetime of the agreement subject to available resources. This is considerably less than rates in Denmark. Providing welfare payments up to a level of 90% of previous income in the case of low-paid workers could result in significant work disincentives. A recent OECD study of policies affecting labour market performance found that two of the most important determinants of employment rates were replacement rates (ie. out of work income as a proportion of in-work income) and the tax wedge (i.e. the difference between what it costs an employer to recruit a worker and what the worker receives in take-home pay) (OECD, 2006).

However, it should be pointed out that while Irish unemployment payments are currently low relative to the EU average they have been rising and, when secondary benefits such as Rent Allowance are factored in, the total welfare package can be significantly higher. The ESRI study in Chapter 3 estimates that the proportion of unemployment compensation recipients facing a 90% replacement rate in 2005 was 22%, when secondary benefits are taken into account, compared to 4% when secondary benefits are excluded. The ESRI study also notes that in recent years (2000-2005) replacement rates in Ireland have increased while the unemployment rate has remained relatively unchanged. One possible reason for this could be that the increased emphasis on activation\job search has reduced the negative disincentive effects of higher replacement rates.

It might also be argued that the 'flexicurity system' is more financially viable in Ireland than in Denmark as our population is younger and, as result, we have a lower dependency rate than the Danes, allowing us greater scope for the increases in social welfare expenditure associated with flexicurity. However, previous research by Callan et al (2004) suggests that sizeable increases in social welfare rates, and (consequently) tax rates, would be needed if relative income poverty in Ireland was to be brought down to Danish levels. Hence, it could be argued that it seems unlikely that the tax rates needed to fund a Danish-style system would be able to gain sufficient political acceptance in the Irish context. Also, the implications of post-EU enlargement migration trends for the viability of the model are not positive; the generous nature of the benefits proposed could lead to 'welfare tourism' unless regulations were put in place to restrict entitlement of non-native workers. Any such regulations would be likely to be severely contested in the European Court of Justice.

However, in spite of the potential cost involved, NESC *"supports the deliberate development of an Irish form of Denmark's flexicurity"* involving a 'participation income' (NESC, 2005). The participation income would involve the merging of various contingency-based social assistance payments (although NESC does not state at what level the participation income should be set). NESC advocates flexicurity on the basis that such a system would facilitate innovation and restructuring. It argues

that the generous welfare payments would only be for the short-term (presumably less than 4 years) and would need to be backed up by 'high quality employment services'. While noting the concern about high replacement rates, NESC believes that an integrated approach of high welfare rates combined with greater services for labour market progression are preferable to low welfare rates. NESC also argues that in such a system activation should not involve coercion or time limits as these rarely result in a satisfactory job match. Instead they call for 'supportive conditionality' or 'sensitive activation'. However, one may question whether activation of the unemployed based on purely voluntary participation is a workable model.

The European Commission's report, Employment in Europe 2006, argues that there are now a number of flexicurity models of which the Danish (or more broadly Nordic) model is just one. In fact, Ireland is classified along with the UK as a country characterised by an Anglo-Saxon model of flexicurity characterised by "a high degree of flexibility (i.e. looser employment protection legislation), relatively low security (i.e. intermediate-to-low spending on labour market polices) and low taxation" (European Commission, 2006).

Conclusions

In summary, some aspects of the Danish model are either already present in, or seem destined to be incorporated into, the Irish model. These include strong social consensus, a relatively loose employment protection legislation regime, a move towards earlier activation, a greater emphasis on the job search requirement for unemployment payments as well as higher rates of social welfare payments. However, the kinds of very high levels of social welfare payments in Denmark would not seem to be feasible in an Irish context because of their costs and potential disincentive effects.

One area that might merit further consideration is a shift in the balance of current EPL legislation away from permanent workers towards temporary workers. The Austrian 'backpacking' approach could also offer greater flexibility to employers than our current redundancy system, while at the same time increasing financial security for temporary workers.

More generally, Ireland should, guided by the spirit of flexicurity, look at ways that we can increase the flexibility of the labour market so that we can ensure that workers are protected as best as possible against the economic fluctuations to which a small open economy in a large monetary union is susceptible. The forthcoming European Commission's report on flexicurity, due out at the end of 2007, should provide a clearer understanding of whether or not improvements are needed to improve Ireland's current balance between flexibility and security policies.

Recommendation

Continued efforts are required to achieve a flexible labour market while also providing adequate social supports. Attempts to draw on the principles of the Danish flexicurity system, tailored to take account of the particular characteristics of the Irish system, warrant further consideration. The introduction of the Austrian 'backpack' principle may be one form of flexicurity that could be examined further to determine as to whether it might benefit the Irish labour market by encouraging greater job mobility.

Replacement Rates and Unemployment: From Bust to Boom

3 Replacement Rates and Unemployment: From Bust to Boom

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3.1 Introduction

Rising unemployment in the 1970s and 1980s led to extensive research as to possible causes. One factor which was extensively investigated was the potential impact of a weakening of the financial incentive to work, arising from increases in welfare payments relative to after-tax income. Evidence as to the role of replacement rates – measuring the ratio between net income when unemployed to income when employed – was gathered in a number of national and cross-country studies. The results were quite mixed. Some time series studies found quite large effects,[32] others much smaller or negligible impacts. On average, Nickell et al. (2005) reports that cross-country studies indicated a rise of 1.1 percentage points in equilibrium unemployment for a 10 percentage point rise in the replacement ratio. Microeconometric studies, based on cross-section or panel data, typically found effects which were statistically significant but small. For Ireland, the results of Layte and Callan (2001) were in line with this general trend, with the estimated effect being significantly different from zero but even smaller than the international findings.

Unemployment has fallen sharply in Ireland as the economy and the labour market have grown rapidly. From a peak of over 17 per cent, the unemployment rate has fallen to around 4 per cent. How have financial incentives to work evolved during Ireland's transformation from a high unemployment, high emigration economy to a low unemployment, high immigration economy? We investigate this issue with a particular focus in mind. If replacement rates are still a potentially important influence on unemployment rates, then their evolution would need to be carefully monitored to avoid triggering a rise in unemployment, perhaps associated with a cyclical slowdown. If, on the other hand, the Irish system is becoming more like the Danish one, where strong activation policies enable high replacement rates to coexist with low unemployment, then excessive caution about the evolution of replacement rates would not be warranted. Evidence from Callan et al. (2004) suggests that attaining a relative income poverty rate as low as that in Denmark would require substantial increases in welfare payment rates, which would involve higher replacement rates. This might not be feasible if the incidence or duration of unemployment were to respond strongly; so a careful review of national and cross-country evidence is needed to establish the likely implications of a move in this direction.

The rest of the paper is structured as follows.[33] Section 3.2 deals with the definition and measurement of replacement rates. In Section 3.3 we examine how

[32] The study which attributed the greatest importance to replacement rates in the Irish case was Scarpetta (1996). His results indicated that increases in the replacement ratio accounted for about half the rise in structural unemployment between the 1970s and the mid-1990s.
[33] The paper draws on results from a more detailed study, Callan et al. (2006).

replacement rates facing the unemployed have evolved over time.[34] We also consider how net replacement rates evaluated at average industrial wages have evolved for various family types. We also use SWITCH, the ESRI tax-benefit model, to estimate replacement rates for the unemployed in cash terms, so that they can be compared with earlier results. Section 3.4 extends these results to include the value of the Rent and Mortgage Supplement and the estimated value of a medical card, to see how these affect replacement rates. The concluding section draws on these measures to assess how recent changes in replacement rates and unemployment might be interpreted and inform future policy.

3.2 Measurement of Replacement Rates

The financial incentive for an individual to move from unemployment into employment can be viewed as depending on the balance between the family's disposable income when the individual is unemployed and the family's disposable income when the individual is employed. The focus is on the effect on family income, in order to take account of the possible impact of an individual's move from unemployment to employment on the social welfare entitlements and income tax liabilities of his or her spouse or partner. The replacement rate summarises this information by taking out-of-work income as a proportion of in-work income:

$$100 \times \frac{\text{Out of work family disposable income}}{\text{In work family disposable income}}$$

Two main approaches have been taken in implementing this measure in both the Irish and international literature.

(1) Using social welfare payment rates and average industrial earnings to calculate replacement rates for a set of hypothetical cases and constructing indices by weighting these different cases. Examples include Hughes and Walsh (1983) and reports from the Departments of Finance and Social and Family Affairs.

(2) Microsimulation modelling of in-work and out-of-work incomes for a large sample of households to estimate replacement rates for those currently unemployed or employed. For the unemployed, it is necessary to estimate the wage they would be likely to command in the labour market: typically this is below the average industrial wage. For employees, correspondingly, it is necessary to predict the unemployment compensation they could obtain if unemployed.

Callan, Nolan and O'Donoghue (1996) compared the different approaches used to measure Irish replacement rates over time. Their results from microsimulation showed that the average replacement rate facing unemployed persons was roughly constant between 1987 and 1994, with a small rise for those on UA offset by a decline for those on UB. Similar findings obtain for method (1) based on hypothetical cases. Comparing the approaches ability to study the distribution of replacement rates, they showed that a detailed matrix of hypothetical cases can be of some help in identifying trends in mean replacement rates but is not likely to be able to identify shifts in the distribution of replacement rates of the type that policy may be aimed at achieving - for example, a rise in unemployment compensation for those on lowest incomes, while reducing replacement rates for those facing the greatest disincentives to work. However, microsimulation modelling, in addition to providing a better measure of the overall trend in replacement rates, offers the best chance of monitoring the achievement of such targets, and can be used to assess the likely impact of policy. Microsimulation results showed that the incidence of cash replacement rates of

[34] Analysis of incentives facing one-parent families and claimants or potential claimants of disability benefits could also be of interest, but these are outside the scope of the present paper. See Gannon (2006) for analysis of the growth in disability payments and potential contributory factors. See FÁS (2005) for a discussion of policy options to make disability allowance and one-parent family payment more "work-friendly". Government proposals for a wide-ranging reform of one-parent family payment can be found in Department of Social and Family Affairs (2006).

over 80 per cent fell between 1987 and 1994 but the numbers facing rates between 70 and 80 per cent rose.

This paper builds on this approach, presenting microsimulation results for 2000 and 2005. The data comes from the 2000 Living in Ireland survey, with incomes and policy values appropriately uprated for the 2005 analysis. We outline three key issues in the measurement of replacement rates here (for greater depth and for other issues see Callan, Walsh and Coleman (2006).

Since evaluating replacement rates at average wages may not capture factors which are important at the lower wages typically relevant to the unemployed, the approach taken here is to predict the in-work wage of those who are currently unemployed based on their age, gender, marital status and education. This method allows for individual differences in the wages that can be expected and takes account of the fact that the unemployed would expect to earn lower than average wages.[35] A draw from the error distribution is also included as failure to do so might underestimate the numbers with very low wages, likely to lead to higher replacement rates.

Given that FIS is a benefit for low-income working families it is important to include FIS entitlements in the calculation of replacement rates. However this scheme is estimated to be taken-up by only a third of people who are entitled to it. Therefore, the results presented here are based on this low take-up assumption, under which one in three of those entitled to FIS is attributed that benefit.

Finally, this paper improves on the earlier work by including for the first time the value of the medical card and the Rent and Mortgage Supplement (RMS) in the calculation of replacement rates. The impact of these secondary benefits is presented in section 3.4. First, however, we turn to an examination of replacement rates in "cash" terms, excluding RMS and medical cards, so that results can be compared with those for earlier years.

3.3 Cash Replacement Rates

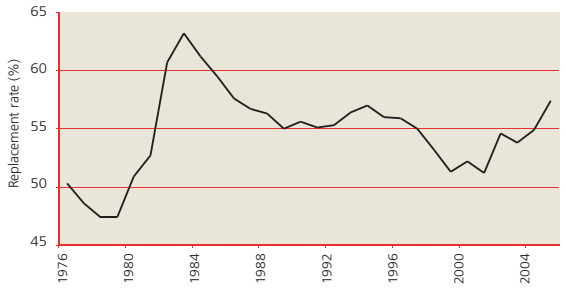
Before detailing the results from microsimulation, we present changes in replacement rates for a central hypothetical case – a married couple, with one earner and two children. Other cases (a single man, a single woman, a one-earner couple with no children and a one-earner couple with four children) were examined in Callan et al. (2006). The broad shape of the changes is similar in each case, with the level of the replacement rate being higher for cases with more dependants. Figure 1 illustrates the evolution of the replacement rate for a couple with two children, and one earner at the average male industrial wage.

The illustrative replacement rate calculated here rose sharply between the late 1970s and the early 1980s, as net earnings were affected by recession and increased taxes, while social welfare incomes, including unemployment compensation, were protected from the impact of recession. The replacement rate fell sharply between 1983 and the beginning of the 1990s, followed by a small rise in 1993-94. The replacement rate fell sharply to the turn of the century. It rose just as sharply during the years 2002 to 2005. The end result was that the replacement rate for this case was about the same in 2005 as in 1994 – and slightly above the lowest rates which were in the years 1989 to 1992. A major part of the explanation for these movements in replacement rates between 2000 and 2005 is that

[35] Callan, Nolan and O'Donoghue (1996) found that the mean predicted wage facing the unemployed in Ireland between 1987 and 1994 was about two-thirds of the average industrial wage. In recent years, the examples used by the OECD in its analyses of replacement rates have included cases at different proportions of average wages, rather than simply the average wage itself.

during those years the rates of UB for singles, couples and couples with children increased by between 40 and 57 per cent while the average industrial wage increased by only 33 per cent.

FIGURE 3.1
Illustrative replacement rates for married couple, one earner, two children: Unemployment Benefit compared with disposable income from average industrial wage, 1976-2005



Notes: Series based on average earnings for male/female industrial workers in manufacturing industry, June of each year. In-work disposable income takes account of income tax, PRSI and levies and includes Child Benefit and Family Income Supplement where applicable. Out of work income is based on (flat-rate) Unemployment Benefit, and also includes Child Benefit. See Callan, Nolan and O'Donoghue (1996) for details of construction of the series.

The fact that the increase in this ratio was proportionately greater for couples without children, because child dependant additions to welfare payments were frozen in nominal terms from 1995 onwards, explains at least part of the divergence in the replacement rates for single women and married men.

While this case is, as noted above, fairly typical of the results for other family types using the same approach, this cannot be taken as indicating that it is representative of replacement rates facing the whole unemployed population. Firstly, the wage that can be commanded varies considerably across individuals, depending on educational qualifications and age or length of work experience. Second, the replacement rate varies depending on family circumstances – whether a partner is also unemployed, or is in employment. In order to take account of this variability in replacement rates, and to be able to focus on cases where replacement rates are particularly high, we need to use a tax-benefit model, based on a large-scale nationally representative model. SWITCH the ESRI tax-benefit model allows us to do just such an analysis. Table 3.1 gives the estimated distribution of replacement rates for the years 1987, 1994, 2000 and 2005. The figures given here are based on the assumption of a 33 per cent take-up of Family Income Supplement (FIS). This low rate of take-up for FIS is in accordance with latest results, which suggest a take-up rate of 30 to 40 per cent. The higher the take-up of such an in-work benefit, the lower the replacement rates would be expected to be.

These figures show that the proportion of the population with high replacement rates fell from 1987 through 2000, but rose again in 2005. Although replacement rates rose in 2005 in relation to 2000, the proportion of unemployment compensation recipients with rates over 70 per cent is much lower in 2005 when compared with both 1987 and 1994, as illustrated in Figure 3.2. Thus, the movements in the estimated proportion of the population unemployed individuals with high replacement rates has something in common with the simple illustrative case (couple with two children, one earner at average industrial wage). The share falls from 1994 to 2000 and then rises – but unlike the simple case, the rise is not sufficient to bring the share back to the 1994 level. Again, relative movements in wages and unemployment compensation are major drivers of the trends observed.

TABLE 3.1
Incidence of high replacement rates, estimated using predicted wages, assuming 33 per cent take-up of FIS, 1987, 1994, 2000, and 2005

	1987	1994	2000	2005
70<80	13.9	22.0	4.8	8.1
80<90	13.1	9.1	3.9	9.8
90<100	5.4	4.6	0.2	2.4
Over 100	4.0	1.6	0.3	1.8

Source: Callan, Walsh and Coleman (2006).

FIGURE 3.2
Proportion of unemployment compensation recipients with estimated replacement rates above alternative high cut-off values

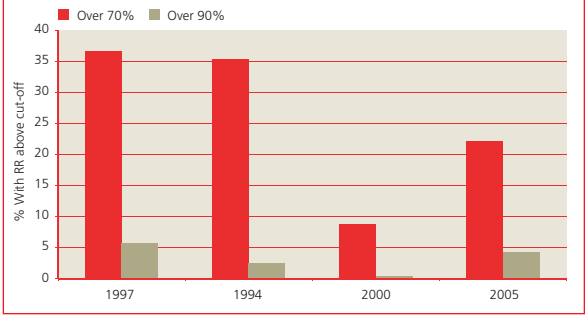


Table 3.2 gives the distribution of replacement rates for the population of unemployed 2005, classified by family type. As with the hypothetical analysis, these microsimulation results show that replacement rates tend to be higher for married people, especially those with children.

Unlike hypothetical family analysis which assumes full take-up of FIS the microsimulation analysis is based on a take-up rate of 1 in 3. In order to examine the impact of differences in take-up assumptions on the distribution of replacement rates, Table 3.3 shows the incidence of high replacement rates for the family type "married with children" under alternative take-up assumptions (33 per cent take-up, in line with the most recent estimates, and 100 per cent or full take-up of the benefit).[36] These results suggest that non-take-up of FIS has a substantial impact on the distribution of replacement

TABLE 3.2
Distribution of Replacement Rates Classified by Family Type, 2005

Replacement rate category	Single no Children	Married no Children	Married with Children
<10	1.2	0	0
10 <20	12.2	0	0
20 <30	6.1	0	0.6
30 <40	13.4	0	0
40 <50	13.4	0	3.2
50 < 60	53.8	42.9	14.7
60 < 70	0	24.4	10.9
70 < 80	0	16.7	23.6
80 <90	0	16.0	30.7
90 < 100	0	0	9.4
Over 100	0	0	7.0

TABLE 3.3
Incidence of high replacement rates for those married with children, under alternative assumptions regarding FIS take-up, 2000 and 2005

Replacement category	33% Take-up of FIS		Full Take-up rate of FIS	
	2000	2005	2000	2005
70 < 80	11.6	22.9	14.4	34.4
80 <90	16.3	31.4	12.6	11.5
90 < 100	1.2	9.4	1.2	8.3
Over 100	2.2	7.0	0	0

rates. Higher take-up of FIS, or the substitution of a scheme with similar structure but higher take-up, would reduce the number of cases with higher replacement rates.

3.4 Impact of Medical Cards and Rent and Mortgage Interest Supplement on Replacement Rates

We now consider two additional benefits which could have a significant impact on the incentive to work. The first is a non-cash benefit, namely the Medical Card; and the second is a cash benefit linked to housing, namely the Rent and Mortgage Interest Supplement (RMS). This

[36] For an analysis of non-take-up of welfare benefits in OECD countries see Hernanz et al. (2004).

section outlines why these are important when examining replacement rates, how they are modelled and their potential impact on replacement rates in a 2005 context. It is important to state at the outset that the estimates given can be regarded as an upper bound on the impact of these schemes, as it has not yet been possible to model some features of the schemes which operate to reduce the impact on replacement rates. Further detail on this is given at the end of this section.

Given that a Medical Card entitles a person to a range of health services free of charge, the possibility of losing such a benefit could have a significant influence on decisions concerning a move from social welfare to employment. Income guidelines for the award of Medical Cards are drawn up each year, previously by the Health Boards, and now by the Health Services Executive (HSE). People whose income is below the guideline figure for their circumstances get a Medical Card. In general, those whose income is above the guideline figure do not qualify. When modelling eligibility, SWITCH uses this income limit approach. Once eligibility is established, the value of the Medical Card is modelled taking into account the estimated value of hospital nights and the estimated value of GP services and medicines for each family. In each case, the predicted usage of services is based on the average usage level for an individual in the same age band.

There are provisions for the retention of the medical card for a period by those moving from unemployment into employment. The operation and impact of these provisions is worthy of further study; the results here can be seen as looking beyond this transitional measure to the long-run comparison between the financial and medical card situation in and out of employment.

However, Medical Cards may be granted to people whose income is above the guideline figure. For instance, to tackle the problem of the effect of the medical card on replacement rates, people who take up employment or who go on certain back to education and training courses or back to work schemes may be entitled to retain their medical card for a period. Also, the law provides that adults and their dependents have full eligibility for health services if they are "unable without undue hardship to arrange general practitioner, medical and surgical services". So the HSE may use their discretion to grant medical cards to people who, for example, have particularly high medical expenses or if there is other evidence of hardship. It is not possible to model such discretionary granting of medical cards.

Rent and Mortgage Interest Supplement is another benefit which tends to raise replacement rates, because it is a payment which is typically made to welfare recipients and is not available to those in employment. It is a weekly supplement for people whose income is too low to meet their rent or mortgage interest payments. One of the entitlement conditions of RMS is that people will not normally qualify for it if they are in full time employment, i.e. working for more than 30 hours per week. Moving from unemployment to working more than 30 hours per week means that an individual would lose RMS, so altering the balance between in-work and out-of-work income we wish to measure. Account had to be taken when modelling RMS of the fact that the different health boards set differing levels of payment. Also, disregards for having a part-time job, being on a training scheme, or receiving disability allowance, one-parent family maintenance or an old-age pension are included.

The impact of including RMS and the Medical Card on the incidence of high replacement rates is set out in

Table 3.4. More of the total population have higher replacement rates than when those policies are not taken into consideration.

TABLE 3.4
Impact of Rent and Mortgage Interest Supplement and Medical Card on incidence of high replacement rates, 2005

	2005 without Rent & Mortgage Interest Supplement or the value of Medical Card	2005 with Rent & Mortgage Interest Supplement and including value of Medical Card
70<80	9.2	9.2
80<90	8.7	9.1
90<100	2.4	13.6
Over 100	1.8	9.0

The combined impact of the two policies on those with high replacement rates is to lead to a near doubling of the per cent of cases above 70 from 22 per cent to 41 per cent., and an increase in the incidence of replacement rates above 90 per cent from 4 per cent to 23 per cent.

As noted earlier, the analysis does not incorporate special features of the Medical Card and Rent/Mortgage Interest Supplement schemes which allow certain individuals to retain (some) benefit from the scheme when moving from unemployment to employment. For example, long-term unemployed persons can retain the Medical Card for a substantial period after taking up employment. Similarly, those who take up work through approved employment support schemes, along with the long-term unemployed, can retain some benefit from Rent/Mortgage Interest Supplement when household income is below a modest limit.[37] These features are not taken into account here, nor is the "standard based assessment" available in certain circumstances, as described by FÁS (2005). On the other hand this group does face withdrawal of the Medical Card and/or Rent Supplement at a later date, if incomes are above the relevant limit; so the analysis undertaken here is still of relevance in the longer term. The recently introduced GP visit card ("doctor-only" Medical Card) is not included in the analysis. It could act to reduce replacement rates by allowing for a partial withdrawal of the benefit of a full Medical Card for some of those moving into employment – an issue which remains to be addressed in future research.

There are, of course, other factors which could affect the net reward from employment. The costs associated with childcare represent perhaps the most substantial of these. If a parent is not in employment, it is likely that they will be able to avoid the costs of purchased childcare by providing such care directly. But if a parent's move into employment means that no family member can undertake the required childcare, the costs of purchasing the required childcare could have a substantial impact on the net reward from employment. Despite these omissions, the replacement rates reported here represent a very substantial advance on measures of the financial incentive to work previously available in the Irish context.

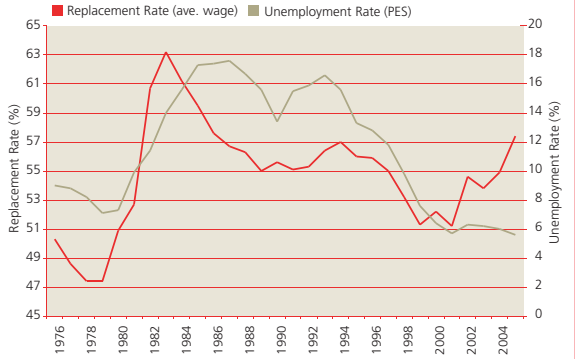
3.5 Conclusions

Ireland's unemployment rate[38] fell steadily from close to 15 per cent in 1994 to just over 4 per cent in 2000, and has remained close to that level since then. Over the same 1994-2000 period, the proportion of unemployed persons facing replacement rates higher than 70 per cent fell from 35 per cent to about 10 per cent. But since then about half of that fall in the incidence of high replacement rates has been reversed.

Figure .33 sets these findings in a longer term perspective. From 1975 up to the turn of the century there is a great deal of co-movement in the

[37] FÁS (2005) notes that this limit was unchanged in nominal terms for many years
[38] ILO definition, as measured in the Labour Force Survey and latterly in the Quarterly National Household Survey.

FIGURE 3.3
Replacement rate at average wage and unemployment rate, 1976-2005



replacement rate and unemployment rate series.[39] From 2001 onwards, however, there is a sharp difference in the behaviour of the two series, with the replacement rate rising strongly and the unemployment rate static or falling slightly. It may be difficult to identify a change in the relationship at this stage, but there is other evidence to suggest that high replacement rates need not lead to higher unemployment. The experience of Denmark in particular is that high replacement rates are compatible with low unemployment and high employment/participation rates. A key part of the Danish system, however, is a strong approach regarding "activation"

Overall then, these results suggest that one area where further research could prove fruitful is investigation into the balance between effects from policy measures which focus on labour market activation and "conditionality" of unemployment payments and effects relating to replacement rates. Atkinson and Micklewright (1991), in a major review of the impact of unemployment compensation on labour market transitions, concluded that both empirical and theoretical modelling of this phenomenon, concentrating on financial replacement rates, took "too simplistic a view of the way in which unemployment benefit works in the real world. The administrative constraints, restricting initial entitlement, or disqualifying claimants for job refusal or failure to carry out job search, may be at least as important." More recently, Blanchard (2006) summing up an overview of European unemployment experience argues that

"Modern economies need to constantly reallocate resources, including labour, from old to new products.....What is important in essence is to protect workers, not jobs. This means providing unemployment insurance, generous in level, but conditional on the willingness of the unemployed to train for and accept jobs if available."

This points toward a model similar to that operating in Denmark, a model sometimes termed "flexicurity". It involves high welfare payment rates (with replacement rates up to 90%) coupled with labour market activation, and controls to ensure that those in receipt of benefit are searching for work and/or engaged in suitable training. In these circumstances, a simple calculation of the ratio of benefits to employment income does not represent the alternatives available to the individual. Search or suitable activity requirements in Ireland have certainly become more stringent in the past decade.[40] One key question for the future is how this system will respond to a cyclical slowdown.

[39] The PES series is used here because the literature suggests that this concept is likely to capture the influence of the replacement rate on labour market behaviour more closely than the ILO concept.
[40] Walsh (2004) notes that "more stringent tests of the job search criterion were included in the Irish National Employment Action Plan (Department of Enterprise and Employment, 2002). Since September 1998 all those under 25 who have been unemployed for six months are called for interview to assess their suitability for an existing vacancy or training. This approach was subsequently extended to other age groups...".

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Statistical Appendix

Table A1: Annual Labour Force Trends 1992-2006

Period	Labour Force	Employment		Unemployment			
	Total	Total	Rate (15-64)	Total	Long-Term	Rate	Long-Term
	000s	000s	%	000s	000s	%	%
1992	1364	1155	51.1	209	132	15.4	9.7
1993	1386	1170	51.7	216	139	15.6	10.0
1994	1423	1220	53.0	203	138	14.3	9.7
1995	1452	1274	54.4	178	116	12.3	8.0
1996	1498	1324	55.4	174	111	11.7	7.4
1997	1560	1408	57.5	152	94	9.9	6.0
1998	1645	1522	60.6	123	64	7.5	3.9
1999	1713	1617	63.3	96	45	5.6	2.6
2000	1767	1692	65.2	75	28	4.3	1.6
2001	1810	1741	65.8	69	22	3.8	1.2
2002	1845	1765	65.6	80	24	4.3	1.3
2003	1882	1797	65.1	85	28	4.6	1.5
2004	1920	1836	65.5	84	26	4.4	1.4
2005	2015	1929	67.1	86	28	4.2	1.4
2006	2108	2017	68.1	91	30	4.3	1.4

Source: Employment in Europe 2004, CSO QNHS Various Issues

Table A2: Quarterly Labour Force Trends 1998-2006

Period	Population	Labour	Participation	Employment						Unemployment	
	Aged 15+	Force	Rate %	Total	Full-Time	Part-Time	Agriculture	Industry	Services	Numbers	Rate
	000s	000s	(aged 15+)	000s	000s	000s	000s	000s	000s	000s	%
1998 Q1	2852.7	1620.1	56.8	1481.7	1231.3	250.4	135.1	423.7	922.9	138.4	8.5
1998 Q2	2867.3	1620.4	56.5	1494.0	1243.8	250.2	136.0	428.4	929.6	126.4	7.8
1998 Q3	2883.9	1689.1	58.6	1560.2	1306.2	254.0	136.7	446.8	976.7	128.9	7.6
1998 Q4	2898.8	1653.3	57.0	1547.1	1297.0	250.1	138.0	443.3	965.8	106.2	6.4
1999 Q1	2904.2	1650.5	56.8	1555.6	1305.6	250.0	138.8	444.5	972.2	94.9	5.7
1999 Q2	2911.1	1685.9	57.9	1589.1	1322.2	266.9	137.3	449.8	1002.0	96.9	5.7
1999 Q3	2923.8	1766.1	60.4	1665.8	1388.7	277.1	143.5	470.2	1052.1	100.4	5.7
1999 Q4	2945.7	1735.7	58.9	1647.4	1376.8	270.6	142.2	467.1	1038.0	88.3	5.1
2000 Q1	2950.9	1729.9	58.6	1648.7	1375.1	273.6	135.5	471.4	1041.8	81.2	4.7
2000 Q2	2961.5	1745.9	59.0	1671.4	1390.0	281.4	132.9	475.7	1062.8	74.5	4.3
2000 Q3	2972.8	1813.3	61.0	1736.1	1457.4	278.7	132.5	500.3	1103.4	77.1	4.3
2000 Q4	3002.4	1781.0	59.3	1712.6	1432.8	279.8	125.3	499.0	1088.3	68.4	3.8
2001 Q1	3008.2	1776.2	59.0	1710.9	1427.1	283.8	124.0	497.3	1089.6	65.3	3.7
2001 Q2	3019.7	1787.0	59.2	1721.9	1435.4	286.5	122.5	498.1	1101.3	65.1	3.6
2001 Q3	3036.3	1867.4	61.5	1788.9	1495.1	293.8	129.2	516.8	1142.9	78.5	4.2
2001 Q4	3061.0	1831.6	59.8	1759.9	1471.6	288.3	127.2	504.4	1128.2	71.8	3.9
2002 Q1	3073.4	1832.7	59.6	1753.5	1458.0	295.5	124.7	495.6	1133.2	79.2	4.3
2002 Q2	3089.8	1840.9	59.6	1763.9	1471.6	292.3	124.0	487.2	1152.6	77.0	4.2
2002 Q3	3103.7	1894.6	61.0	1808.4	1514.3	294.1	125.9	506.6	1175.8	86.2	4.6
2002 Q4	3124.5	1866.3	59.7	1782.3	1487.5	294.8	123.1	496.3	1162.9	84.1	4.5
2003 Q1	3138.9	1868.7	59.5	1783.6	1482.5	301.1	117.4	494.6	1171.6	85.2	4.6
2003 Q2	3145.1	1875.5	59.6	1793.4	1488.2	305.2	116.6	497.5	1179.3	82.1	4.4
2003 Q3	3159.2	1935.3	61.3	1836.4	1525.7	310.7	121.4	507.8	1207.2	98.8	5.1
2003 Q4	3179.9	1914.8	60.2	1828.9	1524.1	304.8	123.4	498.0	1207.6	85.9	4.5
2004 Q1	3192.0	1919.5	60.1	1835.9	1527.1	308.8	118.9	499.8	1217.2	83.6	4.4
2004 Q2	3200.6	1920.3	60.0	1836.2	1525.1	311.1	117.0	506.5	1212.7	84.2	4.4
2004 Q3	3218.4	1987.5	61.8	1893.6	1576.2	317.4	119.9	527.3	1246.5	93.9	4.7
2004 Q4	3245.7	1979.7	61.0	1894.1	1577.5	316.5	112.5	528.5	1253.2	85.6	4.3
2005 Q1	3262.9	1990.5	61.0	1908.3	1581.0	327.4	112.5	530.4	1265.4	82.1	4.1
2005 Q2	3277.4	2014.8	61.5	1929.2	1597.5	331.7	113.7	536.6	1278.9	85.6	4.2
2005 Q3	3301.4	2086.5	63.2	1989.8	1647.0	342.8	119.6	546.7	1323.5	96.7	4.6
2005 Q4	3331.0	2071.9	62.2	1980.6	1639.8	340.8	115.3	541.3	1324.0	91.3	4.4
2006 Q1	3354.1	2086.3	62.2	1998.1	1654.7	343.4	115.5	538.8	1343.8	88.2	4.2
2006 Q2	3367.8	2108.3	62.6	2017.0	1665.4	351.6	114.5	551.2	1351.2	91.4	4.3
2006 Q3	3398.4	2178.1	64.1	2073.3	1724.7	348.6	121.7	574.4	1377.2	104.8	4.8

Source: CSO, QNHS, various issues

Table A3: Quarterly Regional Labour Force Trends 1998-2006

Period	Employment		Unemployment		Unemployment Rate	
	BMW	S&E	BMW	S&E	BMW	S&E
	000s	000s	000s	000s	%	%
1998 Q2	362.0	1132.0	33.1	93.3	8.4	7.6
1998 Q3	377.6	1182.6	33.5	95.4	8.1	7.5
1998 Q4	374.5	1172.6	30.1	76.1	7.4	6.1
1999 Q1	376.1	1179.4	27.6	67.3	6.8	5.4
1999 Q2	387.7	1201.4	28.6	68.3	6.9	5.4
1999 Q3	403.1	1262.7	29.0	71.3	6.7	5.3
1999 Q4	399.6	1247.7	27.3	61.0	6.4	4.7
2000 Q1	401.9	1246.8	25.9	55.3	6.0	4.2
2000 Q2	407.5	1264.0	24.4	50.1	5.7	3.8
2000 Q3	421.1	1315.0	23.8	53.4	5.3	3.9
2000 Q4	421.1	1291.5	20.6	47.8	4.7	3.6
2001 Q1	421.1	1289.8	20.8	44.5	4.7	3.3
2001 Q2	423.8	1298.2	19.8	45.3	4.5	3.4
2001 Q3	441.8	1347.1	24.2	54.3	5.2	3.9
2001 Q4	434.2	1325.7	23.4	48.3	5.1	3.5
2002 Q1	433.7	1319.8	25.0	54.2	5.4	3.9
2002 Q2	437.7	1326.2	24.8	52.3	5.4	3.8
2002 Q3	448.6	1359.8	25.8	60.4	5.4	4.3
2002 Q4	445.8	1336.5	24.3	59.7	5.2	4.3
2003 Q1	447.8	1335.8	25.1	60.0	5.3	4.3
2003 Q2	448.9	1344.5	24.5	57.6	5.2	4.1
2003 Q3	462.6	1379.9	26.4	72.4	5.4	5.0
2003 Q4	465.9	1363.0	23.8	62.1	4.9	4.4
2004 Q1	473.8	1362.1	22.3	61.3	4.5	4.3
2004 Q2	468.9	1367.3	22.3	61.9	4.5	4.3
2004 Q3	489.8	1403.8	25.2	68.6	4.9	4.7
2004 Q4	490.8	1403.3	23.4	62.2	4.6	4.2
2005 Q1	490.0	1418.3	22.2	60.0	4.3	4.1
2005 Q2	495.5	1433.7	22.1	63.5	4.3	4.2
2005 Q3	512.7	1477.1	23.8	72.9	4.4	4.7
2005 Q4	506.5	1474.1	24.8	66.4	4.7	4.3
2006 Q1	512.2	1485.9	23.1	65.1	4.3	4.2
2006 Q2	515.9	1501.1	24.2	67.1	4.5	4.3
2006 Q3	533.5	1539.8	29.9	75.0	5.3	4.6

Source: CSO, QNHS, various issues

Table A4: Migration Trends 1995-2006

Year	Out Migration	In Migration	Net Migration
	000s	000s	000s
1995	33.1	31.2	-1.9
1996	31.2	39.2	8.0
1997	25.3	44.5	19.2
1998	28.6	46.0	17.4
1999	31.5	48.9	17.4
2000	26.6	52.6	26.0
2001	26.2	59.0	32.8
2002	25.6	66.9	41.3
2003	20.7	50.5	29.8
2004	18.5	50.1	31.6
2005	16.6	70.0	53.4
2006	17.0	86.9	69.9

Source: CSO Population and Migration Estimates, various issues

Table A5: Monthly Live Register Figures 1995-2006

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Jan	281,700	288,000	268,900	246,500	214,000	176,200	142,100	160,000	170,700	174,500	160,500	160,100
Feb	280,500	286,800	264,300	241,800	207,600	172,100	139,500	162,300	171,400	173,100	158,600	159,600
Mar	276,600	281,300	262,400	234,800	201,200	163,500	135,900	162,300	168,100	168,900	157,700	155,500
Apr	276,000	281,300	255,500	231,300	196,500	161,800	136,600	156,200	170,900	164,700	151,600	154,600
May	269,000	274,800	248,100	223,900	192,200	152,900	133,700	154,900	166,100	162,000	150,800	152,600
Jun	276,100	282,900	254,900	228,900	195,500	156,800	140,900	164,300	177,900	169,000	159,300	163,100
Jul	280,200	288,400	259,000	232,800	200,600	159,900	147,100	172,100	185,400	177,500	168,500	168,900
Aug	281,100	287,600	258,500	230,500	198,700	159,000	149,400	173,600	186,000	175,800	169,400	169,600
Sep	276,200	278,700	249,300	219,200	186,200	144,900	140,600	161,400	170,800	160,500	153,300	152,300
Oct	275,700	267,600	244,000	212,500	177,900	139,200	141,800	157,700	166,600	155,500	149,600	148,500
Nov	274,700	263,300	240,000	207,200	171,800	137,000	147,100	158,600	164,500	152,000	150,100	
Dec	285,400	270,200	247,700	215,800	176,500	141,600	152,400	166,100	170,600	158,800	155,800	

Source: CSO, Live Register Analysis, various issues

Table A6: Employment Rates 1997-2005

	EU-25			Ireland		
Year	15-64	Female (15-64)	Aged 55-64	15-64	Female (15-64)	Aged 55-64
	%	%	%	%	%	%
1997	60.6	51.1	35.7	57.5	45.9	40.4
1998	61.2	51.8	35.8	60.6	49.0	41.7
1999	61.9	52.9	36.2	63.3	52.0	43.7
2000	62.4	53.6	36.6	65.2	53.9	45.2
2001	62.8	54.3	37.5	65.8	54.9	46.5
2002	62.8	54.7	38.7	65.5	55.5	47.1
2003	62.9	55.0	40.2	65.5	55.7	49.0
2004	63.3	55.7	41.0	66.3	56.5	49.5
2005	63.8	56.3	42.5	67.6	58.3	51.6

Source: Eurostat

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