

## OECD EMPLOYMENT OUTLOOK 2005, BACKGROUND MATERIAL FOR CHAPTER 3

### LIMITATIONS OF THE METR APPROACH

Despite being an extremely useful tool to measure financial incentives to work, tax and benefit systems rules are extremely complex and it would be impossible to calculate METR without some assumptions and simplifications.

The most relevant assumption is that out-of-work benefits are not affected by the decision to reject a job offer. In several countries, unemployment insurance rules are such that rejecting a “suitable” job offer would bring about a reduction or withdrawal altogether of the benefits. In this case, it does not make much sense to compare the wage offered by a new job with benefits that would be reduced to zero if the job was not accepted.

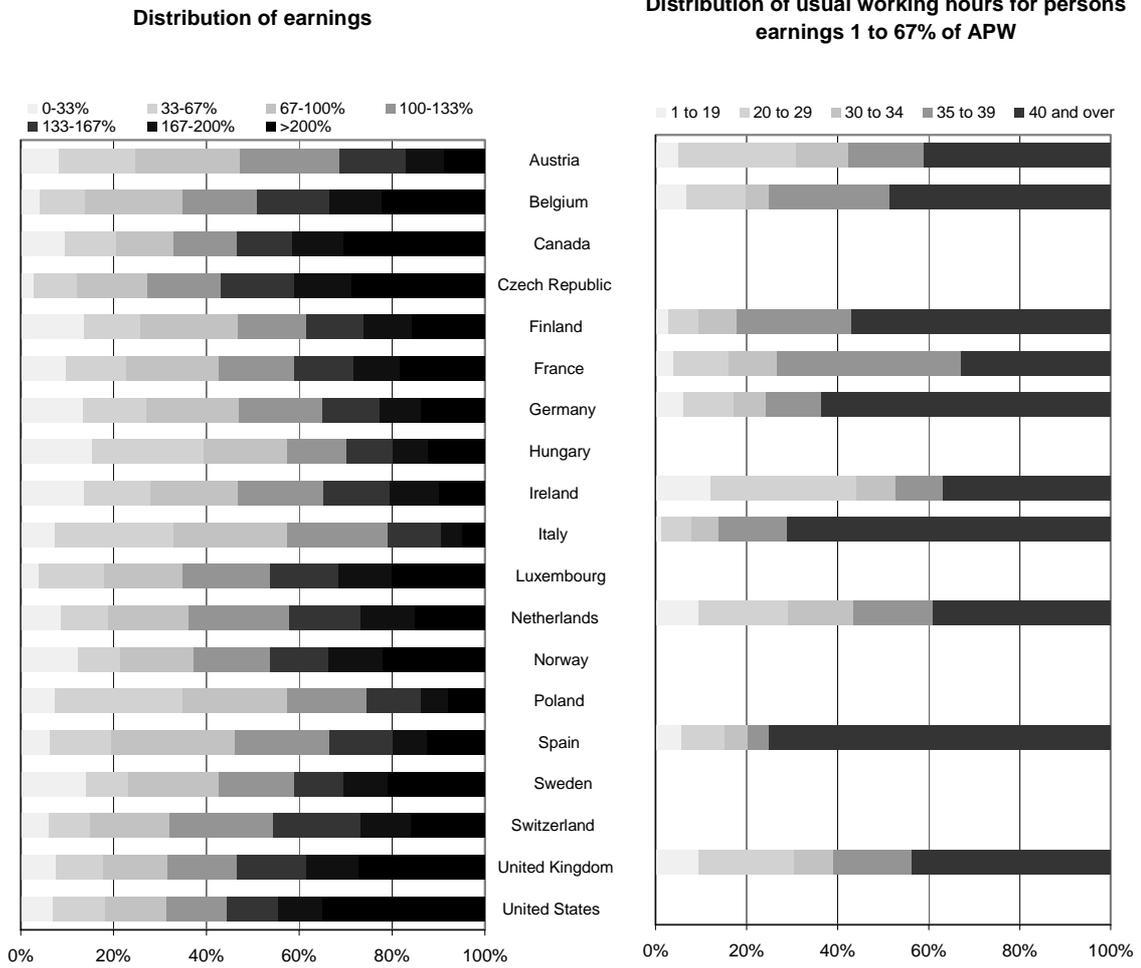
Besides, calculations assume that everyone gets their full legal entitlements and that take-up is 100 percent. A recent study conducted by Hernanz *et al.* (2004) finds that take-up rates of social assistance and housing programmes span between 40% and 80% and are only slightly higher for unemployment compensation ranging between 60% and 80%.

In addition, METRs can only be calculated once an assumption has been made about hours worked and hourly earnings. Indeed, for certain benefit schemes, an increase in earnings due to a rise in hours worked is not equivalent to the same increase coming from a higher hourly wage. For example, some countries set a minimum number of hours worked to be eligible for in-work benefits – notably, the United Kingdom. Others, like Italy, have a system of family benefits that depend on the number of days worked in a week. In total, 13 OECD countries have rules that depend on the number of hours in one direction or the other. This implies that, in order to take account of these rules in the calculation of METRs, an assumption has to be made as to what gross earnings mean in terms of hours and hourly earnings and as to whether increases in earnings come from working longer hours or from a higher hourly wage.

Assuming that hourly earnings are constant makes it easier to incorporate minimum wages into the story by setting an hourly wage that is above the minimum wage in all countries examined and assuming that all gains in earnings arise because people are working more hours. While this may be a reasonable assumption in some cases, it implies the strong underlying assumption that low wages reflect short work weeks rather than badly paid jobs and low-skill endowment. The right panel of Chart 3.A1.1 shows, for the countries for which this information is available, that a large share of individuals earning less than 67% of APW earnings are indeed working full-time.

**Chart 1. Distribution of earnings and usual weekly working hours**

Persons aged 15 to 64



Source OECD (2004), "Benefit Coverage Rates and Household Typologies: Scope and Limitations of Tax-Benefit Indicators", Social, Employment and Migration Working Paper, OECD, Paris; OECD Labour Force Statistics Database.

As a result, the analysis in the chapter uses the assumption of changing working hours only to calculate low-wage traps and show how tax and benefit systems can provide disincentives to work longer hours or to move from part-time to full-time work. For the unemployment and inactivity traps, it is assumed that non-employed individuals return to work on a full-time basis but at different levels of hourly earnings, keeping in mind that only earnings per hour above the minimum wage are feasible.