An individual educational investment account:

A Swedish proposal

by Gunnar Eliasson[1]

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Mature industrialized economies, are currently facing radically increased competition in their traditional production technologies. Many of these economies are also having severe difficulties in building new industry to compensate for the consequent decline in their mature industries. The net effect has been that the capacity of industry to generate value added expressed in foreign currencies is not sufficient to maintain past growth rates of many European economies and to satisfy the demands on continued economic welfare of its citizens. The reason is partly due to lacking managerial and technical competence in existing firms. But where such industrial competence exists, the ability of the mature industrial nations to shift onto a new, high value added competence or technology base has been severely constrained by social factors, notably manifest in the labour market.

To successfully meet this transformation challenge, excellence in three areas (see Eliasson 1992a,c) is needed;

1) *education* to upgrade the competence level of the workforce.

2) *labour market performance* to stimulate competence development and to allocate competence

3) *social insurance,* to reduce the negative allocational consequences for risk groups.

The educational, labour market and insurance functions all have to work well in one context and cannot be viewed in isolation. This highlights the fact that the efficiency of school depends critically on a functioning labour market and a social insurance system that makes people willing to move and to take on private labour market risks. Performance in these three dimensions is of critical importance for individual performance and welfare. The individual is the first to suffer from the adjustment consequences of radically changing economic structures and will have to do the job. The policy maker is more or less unable to influence the individual outcomes of the restructuring process, and with badly undermined finances in most mature industrialized economies the public sector can no longer afford, as before, to generously compensate individuals affected by the unpredictable market outcomes. As a consequence the real responsibility for coping with change will be increasingly shifted *from* Government *to* the individual, and it will become increasingly important to reorganize educational, labour market and social insurance institutions to facilitate this change. This is the reality of the currently very serious labour market situation in Europe, facing the prospect of job-less-growth or the possibilities that investments will go elsewhere, to places offering a potentially more competent, flexible and less expensive labour force.

How to make Europe more attractive for investment

A competent, flexibly available and not overpriced labour force is the decisive attraction for new investment. At the same time the unpredictable labour market situation in Europe, and the unfamiliarity with that situation on the part of individuals and policy makers will not help to increase labour market flexibility. Under such a situation of labour market uncertainty *competence development* naturally becomes the preferred policy solution to the growth and unemployment problem facing the mature industrialized economies. For a competence-oriented labour market policy to succeed, however, not only significant rethinking of policy is needed. Particular competencies on the part of policy makers, beyond disbursement of public money, are required. Above all, the management of public educational, labour market and social insurance institutions will have to be radically reorganized. Misconceived policy may otherwise do more harm than good, as we are now beginning to understand (cf. Per Skedinger's article in this issue). The critical questions are: *what* new competencies are needed, *who is competent* to organize the appropriate training, *who* should be and who is most competent to provide the complementary labour market insurance? Furthermore, *how* should the labour market be organized to make the allocation of competence efficient and how should continued competence development be financed? The only clear answer to all these difficult questions is that without a decisive and motivated input of effort from the concerned individual, policies will fail. To achieve that mobilization of effort and competence the individual has to command a significant part of the resources needed, and be allowed to take financial responsibility for his or her own future.

Since the individual, not the policy authority, is normally the most competent actor to decide, resources previously controlled (through the tax system) by public authorities should be made available to the individual. The reform necessary to put the stagnating mature industrial economies back on a growth path thus has to incorporate, as a key feature, new institutions allowing individuals to take significantly increased economic responsibility for their own economic future and welfare, and to remove the same responsibilities from Government, i.e. shifting a significant part of the financing of education, retraining, labour market insurance and social insurance from taxes to mandatory charges on the individual. The critical questions are: who should provide credible labour market insurance for labour and how exactly should the financing of labour market training be organized? How should less responsible individuals be prevented from becoming parasites on the system or from letting immediate concerns make them risk their longterm wellbeing? Formulated in this way, the suggested solution to this problem is very general, and refers to all kinds of education and insurance, even though the specific proposal to be presented below was developed as an instrument to make vocational training and unemployment insurance for workers more efficient.

State monopoly or individual investment accounts

The idea of making the individual responsible for his or her own welfare is not new. It was brought up already by Wicksell (1905) a century ago at a time when the welfare state was only an idea. Bismarck, being the realistic statesman he was, realized that the individual and the market would not at that time come up with the insurance solution that social and political stability in the emerging industrialized market economies demanded. He therefore created the first minimal welfare state in Prussia and this, it is well worth observing, was not a tax-based system. It was insurance-based but mandatory, very much like today's motorcar insurance. The problems of the welfare economies became more of an issue as the welfare tax states grew, increasingly depriving the individual, or the family of the financial capacity to care for their own insurance and educational needs. This worked reasonably well as long as economies were growing and the demands on state welfare provisions were modest. As benefit programmes expanded and economic growth slowed, macroeconomic problems began to emerge. The current situation is therefore exposing the public sector of some Western European countries to severe financing difficulties. Existing systems may furthermore be reducing incentives to find new jobs and to engage in continuous upgrading of skills, and may therefore be holding back labour supply. This possibility has long been foreseen, and remedies suggested. Individual tax shelter arrangements for insurance, retirement and education were suggested already by Eliasson (1976) and

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Rehn (1983). More recently this concern has become more ominous as the tax state has not only deprived the family of its resources to act on its own behalf but also suffered a deterioration in its capacity to provide the essential services of education, training and social insurance. The main reason for this lacking capacity on the part of the public sector is the perverse incentive arrangements associated with publically financed education, labour market training and social insurance, and the corresponding lack of individual motivation and commitment.

A Swedish proposal

The problems of financing the welfare state and of risk groups are perhaps most manifest in Sweden. In the last few years, furthermore open unemployment has increased dramatically, radically forcing a rethinking of costly retraining programs. The recent Swedish committee on vocational training, charged with the task of giving the programme a corporate status and preparing for its privatization (Eliasson 1992b and *Ett hav av möjligheter* 1992[1]) observed that social insurance related to unemployment, education, vocational training and retirement is, in a large measure, a form of redistributing income over individuals' life cycles through many public tax and subsidy accounts, and as such harbours social risk and is ineffective from an incentive point of view. To remedy this situation an *individual investment account* for education, continuous retraining and retirement was designed (see Eliasson 1992b) and then proposed by the Committee. A similar idea was later elaborated by Fölster (1993) and generalized to cover as well labour market insurance in Andersson, Carlsson, Eliasson et al. (1993) in the form of a citizen's account. Even though this individual investment account has been designed with the normal income earner in mind it is much more comprehensive and should cover the majority of income earners. For the disadvantaged the regular welfare system currently in place will apply. This is an advantage, since it allows welfare authorities to focus their attention on the small group of troubled people who needs help, and all research suggests (Eliasson 1992c) that small-scale, intensive and tailored attention is what they need, not money transfers and anonymous treatment in overextended Government bureaucracies. The idea is that only a minimal provision of educational, insurance and retirement services be covered over the public budget, and financed through taxes. To prevent endangering the socially weak this minimal public coverage will have to be significantly lower than currently provided over the public budget in western welfare economies. The rest, part of it being mandatory, will be financed privately, by allowing the individual to set aside, before tax, part of his or her earnings in an individual investment-education account. Deductibility essentially means that the corresponding tax money is moved to the individual investment account. Providing this is simple. Only deductibility, and well defined limitations on drawing rights are required. As suggested in Eliasson (1992b) and Andersson, Carlsson, Eliasson et al. (1993) the system can be gradually introduced by allowing anyone deductibility for deposits in such educational investment accounts and, as well, but not necessarily, the opportunity to terminate, through a paid-up policy, the current public tax finance commitment.[2] The arrangement is similar to profit carry forward rights for firms. It works as a private retirement scheme where retirement wealth can be prematurely activated for certain investments, like education.

The individual educational investment account

The individual investment account can be set up as follows. At birth the individual will have a limited credit line to draw on for education. During work life part of the money paid in goes to charges for health and unemployment insurance. The capital can be drawn on at any time for prespecified educational investments and to cover various insurance premiums (unemployment, accident, health etc.) There could be a complementary Government subsidy, and the employee could also negotiate a complementary benefit in his or her employment contract. To limit social risk, educational investment, for instance, will only be covered up to a preset limit. Capital remaining at retirement age will furthermore *all* be available for pension benefits, a provision that will

[1] *A Sea of Opportunities*, Swedish Government official publications, SoU 1992:123.

[2] It should be noted for the record that the gradual reduction of the progressiveness of the Swedish income tax system, and a general reduction in equalitarian ambitions among policy makers, mean that measures like this are no longer as politically sensitive as before.

counter social risk and prevent him or her from excessively using the benefits of the system during its accumulation phase, thus minimizing the need for Government control of misuse. To make the individual concerned about capital growth on this investment account he or she should be allowed significant influence on the management of his or her capital; whether privately or through a public account etc. There should be no restrictions on domestic investments. Rather the opposite, the management of this account *should be protected* from the short-term macroeconomic policy concerns of Government. It should be solely devoted to the long-term benefits of the individual. The design proposed by the Swedish Committee for vocational training (see again *Ett hav av möjligheter* and the more detailed preparatory analysis by Eliasson 1992b, and Andersson et al. 1993, Chapters 1, 5 and 6) included two particular features to make the investment account arrangement economically effective, and at the same time acceptable from an income distribution point of view.

The individual investment account is superior to a collective funding arrangement through efficiently exploiting individual competencies and incentives

The committee *first* concluded that to stimulate the individual effort and motivation needed for successful training, an effective *incentive system* was needed. These accounts should be largely managed by the individual, so that he or she could avoid becoming unemployed before becoming eligible for the financing of retraining from the labour-market bureaucracy – as is currently the normal Swedish situation. Since the individual pays part of the costs by drawing on his or her retirement wealth social risk can be minimized. It then also becomes obvious that the individual has a strong incentive to choose the training that makes him or her more competent, and therefore more productive and capable of earning a higher income. In general the individual should also be more competent than a bureaucrat to make that choice. In case he does not consider himself sufficiently competent to make the appropriate investment decisions he can always ask for advice, if *he* considers it to be advantageous. Hence, there should on average be neither private nor social costs associated with the programme (Eliasson 1992b). The individual investment account overcomes the financing constraint on education and mobility and provides incentives for economically rational educational investments. If the individuals choose the right training which offers a high private return, macro output should increase as a consequence and so should his or her income, thus allowing the individual to recoup the investment, financed through his or her accumulated retirement wealth. *Second*, the committee argues, in this way, the problems of the disadvantaged and of stigma effects can be solved more efficiently and reasonably than in the current system.

Stigmatization is minimized

This is accomplished by allowing and stimulating the various vocational training units to compete with one another through innovative product development. Since some of these agencies have already been successful in attracting private, unsubsidized customers the techniques for successful training have been developed at reasonable costs. It is known that these programs tend to be staffed by the best teachers and are also high cost operations, but that firms are willing to pay a price that cover the higher costs for the high-quality educational services received. It may be the case, argues the committee, that training the disadvantaged is even more costly and requires extremely good teachers. This, of course, also has to be recognized by politicians if they want to help the disadvantaged. Paying the market rate for professional training of the disadvantaged would attract the best training institutions and solve the problems of the disadvantaged as well as it can be dealt with. Since the disadvantaged will now be involved in a market based private training program, the stigma effects will be minimized.[3]

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[3] The argument on the disadvantaged is most clearly spelled out in Eliasson (1992b).

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Eric Verdier

Deputy director of CEREQ - Centre d'Etudes et de Recherches sur les Qualifications

Vocational training of young people in France:

a resource difficult to exploit[1]

The eighties saw considerable qualitative and quantitative development of the technical and vocational training facilities for young people within the French educational system. The downgrading in job terms of those holding formal qualifications, above-average unemployment, and the perpetuation of public-sector assistance for the placement of young people in jobs testify to the growing cost of adjustment on the youth labour market. The weakness of institutional provision for recognising qualifications and the ambiguities in French educational strategy are causes of serious depreciation. Overcoming these difficulties will call for major structural changes in the training field, as also in employment and work organization.

Discussing "The emergence of a new production system", Boyer [1992] points out that education and vocational training could prove to be among the prime factors determining a country's ability to promote cumulative growth. However, this objective cannot simply be equated with an increase in human capital. Methods of developing education and training and making it an integral part of firms' practice and the operation of the labour market have an equal influence on the results obtained.

In France the proportion of young people attending school beyond the compulsory age of 16 has greatly increased over the last 20 years. In 1987 the figure for students in the 17 to 24 age group was on a par with that for Germany and higher than in the United States [Debizet 1990].

As the table 1 shows, progress in the fields of technical and vocational education has been considerable.

Moreover considerable efforts have been made to improve the quality of training offered both in order to reduce the number of examination failures and - even more important - to update vocational qualifications as rapidly as possible.

❑ The success rate in examinations qualifying for a basic vocational training certificate - the CAP or certificat d'aptitude professionelle - rose from 58% to 66% between 1982 and 1991. However, this figure is still well below the German one of 80% for those successfully completing an apprenticeship. The selectivity of theoretical examinations, which reflect the

Table 1

	1970	1980	1990
CAP	183 352	235 046	274 343
BEP	28 493	78 905	156 543
techn.+voc. baccalaur.	28 600	62 660	136 737
BTS + DUT	16 945	37 211	80 482
Total	257390	413822	648 105

Source: Ministry of Education and Culture, DEP