

12

Active Labor Market Policies

Active labor market policies (ALMPs) have a long-standing tradition in many countries. At the beginning of the twentieth century employment offices were built up. In the depression of the interwar years government programs were established to put the unemployed to work. Later, labor market retraining was organized to stimulate occupational and regional mobility to facilitate structural adjustments.

Currently ALMPs aim at improving the functioning of the labor market by enhancing labor market mobility and adjustment, facilitating the redeployment of workers. ALMPs intend to overcome market failures arising from generous unemployment benefit and welfare benefit schemes. There are four basic functions of ALMPs: to raise output and welfare by putting the unemployed to work or having them invest in human capital, maintain the size of the effective labor force by keeping up competition for available jobs, help reallocate labor between different submarkets, and alleviate the moral hazard problem of unemployment insurance (Calmfors 1995).

There are four main types of ALMPs: (1) training, (2) subsidized employment, (3) public employment services (PESs), and (4) activation. *Labor market training* concerns training for unemployed adults, those at risk of losing their jobs, and employed adults. *Subsidized employment* consists of targeted measures to promote or provide employment for the unemployed and other priority groups. It also concerns wage subsidies paid to private-sector firms in order to encourage the recruitment of targeted workers or continued employment of those whose jobs are at risk, and support of unemployed persons starting enterprises, as well as direct job creation in public or nonprofit organizations for the benefit of the unemployed. PESs concern placement, counseling and vocational guidance, job search courses, and administration of unemployment benefits. ALMPs also include *activation*, measures that provide incentives for the unemployed to increase job finding either directly through benefit sanctions or through mandatory participation in training or subsidized employment. Key examples of activation programs are requirements that unemployed individuals attend intensive interviews with employment counselors, apply for job vacancies as directed by employment counselors, independently search for job vacancies and apply for jobs, accept offers of suitable

work, participate in the formulation of an individual action plan, and attend training or job creation programs. If unemployed workers are unwilling to participate in the activation programs, they may lose their benefits entitlement permanently or temporarily (in case of benefit sanctions). Some activation programs are *workfare* in the sense that they do not deliver further services except for keeping the unemployed busy. The main motivation for workfare schemes is that they enable a distinction between involuntarily and voluntarily unemployed persons. Most OECD countries' activation strategies in principle aim not to use workfare: all programs are intended to have employment service functions (OECD 2005b).

ALMPs may eliminate mismatch in the labor market, promote more active search behavior on the part of jobseekers, and have a screening function because they substitute for regular work experience in reducing employer uncertainty about the employability of job applicants. Placements in labor market programs may provide a work test as an alternative to eligibility for unemployment benefits, since some of those who are not genuinely interested in work will prefer to lose registration rather than participating in a program. An adverse side effect of ALMPs is that workers are locked in to training and job creation programs: because of their participation, they reduce their search intensity.

ALMPs are part of a comprehensive strategy to help transitions from unemployment or inactivity to work and smooth transitions from job to job. The behavior of unemployed individuals is also influenced by payroll tax schemes and in-work benefits (chapter 4) and unemployment benefits (chapter 11).

12.1 Measures and Cross-Country Comparisons

ALMPs are often but not always expensive. Depending on the amount of money, there may be few workers in expensive programs or many workers in cheap programs. Therefore, to indicate the importance of ALMPs at a country level, two measures are used. First, the number of workers participating in ALMPs as a share of the labor force; second, the amount of money spent on ALMPs as a percentage of GDP.

There are large cross-country differences in the share of the labor force participating in ALMPs, in 2005 ranging from a low of 1.2 percent in the Czech Republic to a high of 7 percent in Belgium. As shown in table 12.1, expenditures on ALMPs measured as a percentage of GDP differ greatly between countries. Whereas Mexico only spends 0.01 percent of GDP on labor market training, Denmark spends 0.51 percent. While Korea spends 0.03 percent of GDP on PES and countries like Italy, Luxembourg, and the United States devote little more to the public employment service, the United Kingdom spends 0.38 percent of GDP on the PES. With respect to expenditures on subsidized jobs, the differences between countries are also quite large. Italy, Korea, Mexico, New Zealand, the United

Table 12.1 Active Labor Market Policies: Participation (Percentage of Labor Force), Public Expenditures (Percentage of GDP), and Sanction Rates (Percentage of Unemployment)

	Active labor market policies						Sanction rates
	Labor force involved (%)	Public expenditures (percentage of GDP)					
		Total	Training	PES	Job creation	Other	
Australia	1.8	0.45	0.04	0.26	0.08	0.07	3.3
Austria	–	0.62	0.33	0.17	0.04	0.08	–
Belgium	7.0	1.08	0.20	0.23	0.39	0.26	0.8
Canada	2.5	0.32	0.08	0.16	0.02	0.06	6.1
Czech Republic	1.2	0.25	0.01	0.12	0.03	0.11	–
Denmark	5.2	1.74	0.51	0.32	–	–	2.1
Finland	3.7	0.89	0.37	0.20	0.07	0.25	10.2
France	3.6	0.90	0.29	0.25	0.18	0.18	–
Germany	4.7	0.97	0.25	0.35	0.10	0.27	1.1
Greece	–	–	0.03	–	–	–	–
Hungary	–	0.29	0.04	0.09	0.06	0.10	–
Ireland	3.6	0.63	0.24	0.12	0.21	0.06	–
Italy	–	0.54	0.20	0.08	0.01	0.25	–
Japan	–	0.25	0.04	0.19	–	–	0.02
Korea	–	0.13	0.04	0.03	0.01	0.05	–
Luxembourg	–	0.52	0.13	0.06	0.13	0.20	–
Mexico	–	0.02	0.01	–	0.01	–	–
Netherlands	4.2	1.33	0.13	0.49	0.18	0.53	36.0
New Zealand	1.9	0.39	0.17	0.12	0.01	0.09	0.4
Norway	2.7	0.75	0.37	0.12	0.07	0.19	7.3
Poland	–	0.43	0.10	0.07	0.03	0.23	–
Portugal	–	0.69	0.29	0.17	0.03	0.20	–
Slovak Republic	5.5	–	0.02	–	0.06	–	–
Spain	–	0.78	0.17	0.13	0.09	0.39	–
Sweden	4.4	1.32	0.34	0.23	–	–	0.6
Switzerland	2.5	0.76	0.29	0.14	–	–	38.5
United Kingdom	–	0.49	0.09	0.38	0.01	0.01	5.5
United States	–	0.13	0.05	0.03	0.01	0.04	35.4

Sources: OECD (2006a); Boone and Van Ours (2004); Grubb (2000).

Notes: Active labor market expenditures: 2005; sanctions and benefit refusals for behavior during benefit periods as a percentage of the average stock of benefit claimants, 1997–1998. The numbers refer to sanctions for labor market behavior conditions (not to administrative infractions).

States and the United Kingdom spend 0.01 percent of GDP on subsidized jobs, while Belgium spends 0.4 percent of GDP on this ALMP. The evolution of ALMP spending is also markedly different across countries. In Denmark, for example, public expenditures on labor market training went up from 0.4 percent in the second half of the 1980s to 0.99 percent in the second half of the 1990s. At the same time, in Ireland these expenditures went down from 0.5 percent to 0.2 percent of

GDP. In Sweden the expenditures first went up from 0.5 percent in the second half of the 1980s to 0.8 percent in the early 1990s and then down to 0.6 percent in the second half of the 1990s. At the lower end of the distribution, Japan kept expenditures on labor market training constant at a level of 0.03 percent of GDP. Similar differences occur with respect to public expenditures on subsidized jobs. In Belgium these expenditures were always at a high 0.4 percent of GDP, while in Ireland and Sweden there was a major increase from about 0.3 percent in the second half of the 1980s to 0.9 percent in the second half of the 1990s.

Finally, table 12.1 provides an overview of sanction rates (expressed as a percentage of the stock of unemployment benefit claimants) for some of the OECD countries. The sanctions refer to behavior during benefit periods.¹ The sanction rates range from very low in Belgium, Japan Sweden and New Zealand to quite large in the Netherlands and Switzerland. The Swedish system is sometimes considered one where there is pressure on the unemployed, including possible denial of benefits, both to look for work and to accept suitable job offers. Nevertheless, Björklund and Holmlund (1991) report that yearly benefit denials amount to no more than approximately 1 to 2 percent of all those who receive unemployment compensation during a year, and this rate has recently been falling. Thus, whereas the Swedish system is known for its active labor market policy, in terms of benefit sanctions it is the least strict of all the OECD countries represented in table 12.1. In principle, there are two reasons why observed sanction rates in a country are low. First, it may be that sanctions are seldom imposed because the system is lax and not credible. Second, a low sanction rate can be due to the (equilibrium) reaction by workers to comply with the search guidelines. In the case of Sweden, there are indications that the first reason is the cause. Since the sanction is a 100 percent reduction in the unemployment benefit, monitors are very reluctant to impose this sanction (see Björklund and Holmlund 1991 for details).

12.2 Theory

Figure 12.1 illustrates how ALMPs might affect the functioning of a labor market using the well-known Beveridge curve (box 12.1), the empirical relationship between unemployment rates and vacancy rates (unfilled vacancies as a percentage of the labor force). Curve BC_1 in figure 12.1 slopes downward because in a boom there are many vacancies and few unemployed, while in a slump there are many unemployed and few vacancies. As an economy experiences cyclical fluctuations, the unemployment-vacancy combination moves up and down the curve BC_1 . At a particular moment it may be that the labor market has an unemployment rate of u_1 and a vacancy rate of v_1 . The exact location of the Beveridge curve depends on

¹ Other sanctions may concern a lack of effort to prevent job loss (voluntary unemployment). In terms of the flow of initial benefit claims, these sanctions range from 3.4 percent in Finland to 13.5 percent in the United States See Grubb (2000) for details on the system of benefit sanctions in various countries.

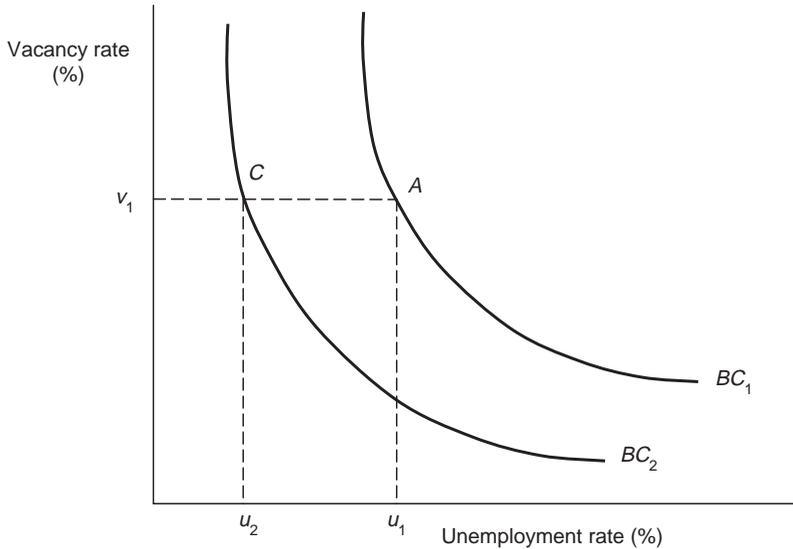


Figure 12.1 The Beveridge Curve

how efficient the labor market is. ALMPs may improve the efficiency of the labor market, causing an inward shift of the Beveridge curve, for example from BC_1 to BC_2 . If that is the case, conditional on the vacancy rate v_1 , the unemployment rate will go down from u_1 to u_2 .

Box 12.1 The Beveridge Curve and the Matching Function

In many labor markets there appears to be an inverse relationship between unemployment rates and vacancy rates. The graphical representation of this relationship is named the Beveridge curve after William Beveridge (1879-1963), a British economist who was the first to note this empirical regularity (in 1942). Later, theoretical foundations for the Beveridge curve were provided in which the labor market was described by a matching process (Pissarides 1979; Blanchard and Diamond 1994). Through this matching process vacancies are filled and unemployed workers find jobs. The process may be described by a matching function:

$$m = A(U)^{1-\alpha}V^\alpha,$$

where m is the number of matches per time period, $U(V)$ is the number of unemployed workers (vacancies) at the beginning of that time period, A represents the efficiency of the matching process, and α is usually assumed to be equal to 0.5. In a dynamic labor market individuals change position frequently. Not only do unemployed workers find jobs, but also many employed workers lose their jobs

(continued)

Box 12.1 (continued)

because firms reduce their workforce temporarily or permanently. The reallocation of labor across different firms causes a regular flow of workers into and out of unemployment. Often the flow of workers from employment to unemployment is assumed to be a constant fraction of total employment:

$$F_{in}^u = \delta^s L,$$

where F_{in}^u is the inflow into unemployment, δ^s is the job separation rate, and E is the number of employed workers. In a steady state labor market there are constant stocks of unemployed workers and vacancies; the inflow into unemployment F_{in}^u equals the outflow from unemployment m , and therefore

$$\delta^s L = AU^{1-\alpha} V^\alpha,$$

or

$$\frac{\delta^s}{A} = \left(\frac{U}{L}\right)^{1-\alpha} \left(\frac{V}{L}\right)^\alpha \approx u^{1-\alpha} v^\alpha,$$

where u is the unemployment rate and v is the vacancy rate. If δ^s and A are constant, there is a stable hyperbolic relationship between the unemployment rate and the vacancy rate, the Beveridge curve as depicted in figure 12.1. If the matching process becomes more efficient, for example, through ALMPs, the parameter A increases and the Beveridge curve shifts inward.

Boone and Van Ours (2004) present a theoretical search-matching model in which they distinguish three types of ALMPs: training of unemployed workers, subsidized employment, and public employment services. They model training as a subsidy to training costs of unemployed workers. The idea is that placement workers help unemployed workers find the most suitable courses for them so that they do not waste time and effort enrolling in less effective courses. Furthermore, the government sometimes creates courses that are directly relevant to targeted groups of the unemployed. This is less costly for the unemployed than doing bits and pieces from different courses, one of which is targeted at them. The effect of employment services is modeled as a subsidy to search costs of workers. Here the placement workers help filter all vacancy information so that only the vacancies most relevant for an unemployed worker come up. This reduces the search cost for the unemployed. Finally, subsidized employment is modeled as a subsidy to the value of the match of low-productivity jobs. In the model of Boone and Van Ours there are two channels through which ALMPs can potentially reduce unemployment. First, the job-finding rate may be increased. Second, through training the unemployed can get better jobs (with higher wages and lower job destruction rates). If ALMPs cause more unemployed workers to end up in high-skilled jobs, this reduces unemployment by decreasing the

flow from employment to unemployment. It turns out that the effects of ALMPs on the job-finding rate are theoretically ambiguous. However, the mechanism via the quality of the job and the flow from employment to unemployment discriminates between the different ALMPs. Boone and Van Ours (2004) show that training may do very well in reducing unemployment, while subsidized jobs and public employment services may not be as effective in reducing unemployment. They also show that there may be an interaction effect of unemployment benefits and training: training is more effective if unemployment benefits are more generous.²

Boone and Van Ours (2006) present a theoretical framework to analyze the impact of benefit sanctions, an activation measure to increase job-finding rates of recipients of unemployment benefits. They present a search-matching model in which benefit sanctions affect the intensity with which unemployed workers search for a job. Benefit sanctions may affect unemployment duration through two channels: the first operates *ex post*, and the second *ex ante*. Benefit sanctions will increase the search intensity of the sanctioned because of the reduction in the value of being unemployed. This effect is the *ex post effect*: an actual benefit reduction stimulates a worker's search efforts. Furthermore, the nonsanctioned may also increase search intensity because of stricter enforcement of job search requirements. This second effect is the *ex ante effect*: the risk of getting a benefit sanction influences the search behavior also of unemployed workers who have not been sanctioned. To illustrate how penalties and monitoring intensity affect the labor market, we performed some simulations of which the results are shown in the graphs in figure 12.2 (see technical annex 12.8 for details).

The upper graph in figure 12.2 shows how the size of the penalty affects unemployment rates. Increasing the penalty has an *ex ante* effect (workers are more eager to avoid being penalized and hence search harder) and an *ex post* effect (once penalized, they gain more from accepting a job and therefore search harder). The size of the penalty effect becomes smaller if the penalty increases. However, even if it is equal to 100 %, the unemployment rate will still be above the level it would have been in the absence of benefits. After all, even with a 100 % penalty, the unemployed receive benefits before they get a sanction imposed. The lower graph of figure 12.2 shows how the intensity of monitoring affects unemployment rates. The effect of an increase in monitoring intensity is similar to the effect of an increase in the penalty. If the monitoring rate goes up, search intensity will increase to avoid being penalized; after a sanction is imposed, search intensity may be lower than before because through the increase in monitoring intensity the value of being unemployed is reduced, and therefore the value of having a job is also lower.

² See Bassanini and Duval (2006) for similar results.

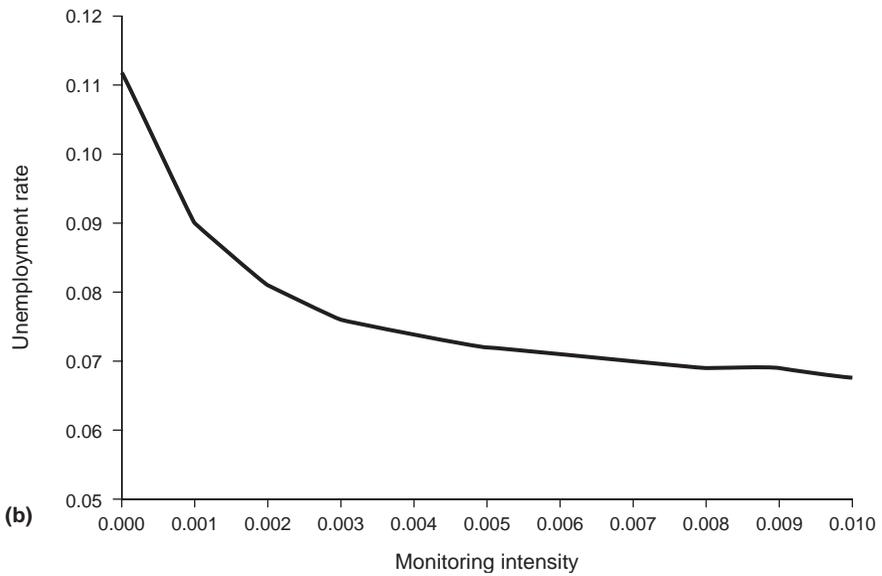
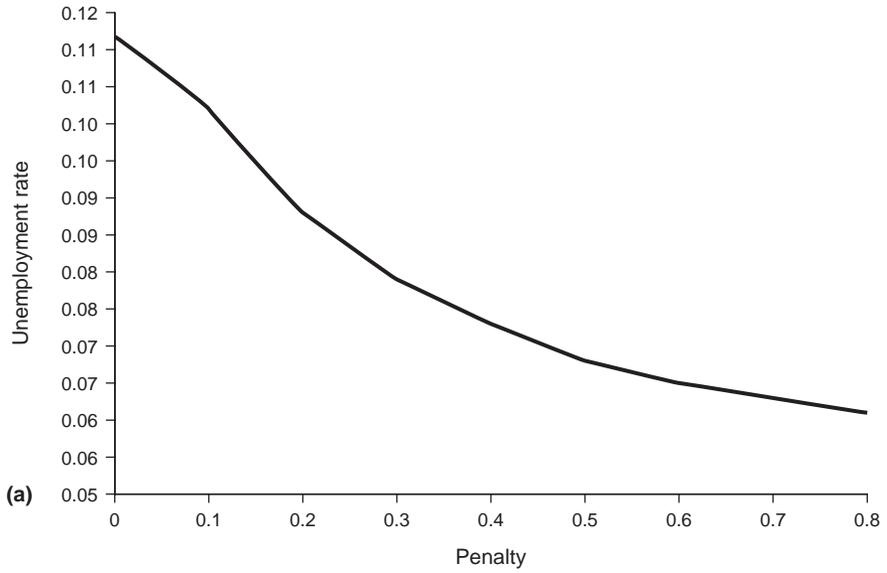


Figure 12.2 Benefit Sanctions and Their Effect on the Unemployment Rate: Effects of Penalty (a) and Monitoring Intensity (b)

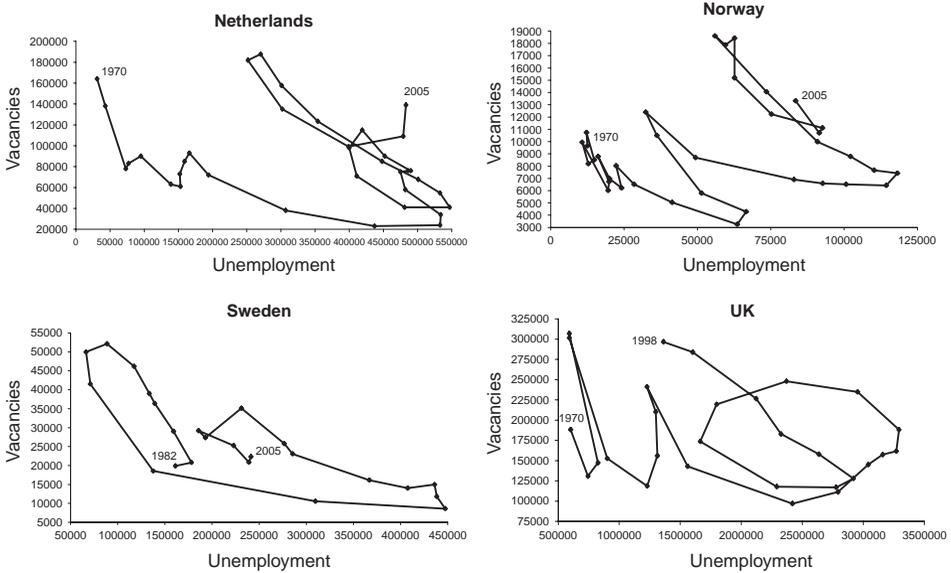


Figure 12.3 The Beveridge Curve in Four Countries

12.3 Empirical Evidence

Figure 12.3 provides empirical examples of the Beveridge curves for the Netherlands, Norway, Sweden, and the United Kingdom.³ In each of these countries the relationship between unemployment and vacancies has a hyperbolic curvature. There are also fluctuations and shifts outward of the curve, indicating a deterioration of the functioning of the labor markets.

However, it is difficult to draw conclusions on the effectiveness of ALMPs on the basis of shifts in the Beveridge curves. This is a general problem since the effectiveness of ALMPs is not obvious. Not only are there direct effects of ALMPs, but also there are indirect effects that can be quite important (Calmfors 1994). First, there are *displacement effects* because jobs created by one program can replace other jobs. Second, there are *deadweight effects* because labor market programs subsidize hiring that would have occurred anyway in the absence of the program. Third, there are *substitution effects* because jobs created for a certain category of workers replace jobs for other categories as wage relativities change. Finally, there are the effects of taxes (*fiscal substitution effects*) required to finance the programs on the behavior of everyone in society.

³ Many OECD countries do not have long series of vacancy data, which makes it difficult to generate Beveridge curves for more than a few countries.

12.3.1 Experimental Studies

Some studies exploit an experimental setup to address the effectiveness of ALMPs. Gorter and Kalb (1996) analyze the effects of intensive counseling and monitoring. By way of experiment, in seven employment offices in the Netherlands some unemployed workers were exposed to more intensive counseling and monitoring than others who got the usual treatment. The unemployed themselves were unaware of being part of the experiment. The allocation to more intensive counseling and monitoring was done randomly and at the start of the unemployment spell; the only way out of the experiment was through finding a job. Both the unemployed in the treatment group and in the control group had monthly meetings with staff of the employment office. The control group had traditional meetings in which progress in finding a job was discussed and occasionally the information provided by the unemployed worker was checked. The treatment group had longer meetings because the applications were more thoroughly discussed and there was more advice on potentially suitable vacant jobs and direction of search. Furthermore, the employment office staff spent more time checking information given by the unemployed. People who did not make sufficient applications and/or listed false applications to disguise their lack of search effort had a larger probability of being detected and penalized accordingly. Gorter and Kalb find that the treatment group had a higher application rate and a higher job-finding rate with a somewhat smaller matching probability—for the unemployed who previously had a permanent job, the application rate increased by 20 percent, while the job-finding rate increased by 15 percent. Thus more intense counseling and monitoring stimulated unemployed workers to make more applications for a job. Because of this, the job-finding rate increased. This shows that the additional applications were not fake applications.

Dolton and O'Neill (1996) present an analysis of the British Restart program, which consisted of a series of compulsory interviews every six months for unemployed workers starting after they has been registered as unemployed for six months. During this mandatory interview the counselor assessed the recent unemployment history of the worker, offered advice on search behavior and training courses, and sometimes initiated direct contact with employers. Unemployed workers were randomly assigned to the treatment group or the control group, whose members were eligible but did not have to attend the first interview. Those who were assigned to the treatment group were faced with the possibility of having their benefits reduced if they did not attend the Restart interview or if they were considered not to be making sufficient effort to find a job. Dolton and O'Neill find that the Restart interviews significantly decreased unemployment durations. Some individuals left the unemployment registers without having found a job; this was common among women and other groups “who are most likely not to be genuinely available for work.” This type of outflow from unemployment was particularly high around the timing of the first Restart interview, which indicates a threat effect. However, measured over a period of 18 months, exits to a job were also

significantly different for the treatment group and the control group. In a follow-up article Dolton and O'Neill (2002) investigate the long-run effects of the Restart program and find that the Restart interviews reduced the male unemployment rate five years later by 6 percentage points compared with a control group for whom participation in the first interview took place six months later.

Klepinger, Johnson, and Joesch (2002), who study the effects of alternative work search requirements in Maryland, find that imposing additional search requirements speeds up the job-finding process (see box 12.2 for details). Black et al. (2003) present an analysis of an experiment from Kentucky. Unemployed workers were ranked in 20 categories according to a profiling score based on the expected unemployment duration. Local budgets available for reemployment services were allocated to the unemployed according to profiling scores, starting with the highest score, that is, the longest expected duration. In case there was insufficient funding for all the unemployed and the marginal group could not be covered completely either, there was a random allocation of reemployment services to the unemployed in the marginal group. By comparing the treated with the nontreated, the authors find that the reemployment services stimulated workers to leave unemployment more quickly; those who left unemployment quickly did not earn lower wages, which suggests that there is “no long-term harm from the treatment provided by the program.” The main action caused by the mandatory reemployment services was at the beginning of the unemployment spell. The unemployed who were notified of their obligations to attend the reemployment service program left unemployment quickly to avoid having to enter the program. In other words, the threat effect was driving the results. Apparently, many unemployed workers consider the reemployment service programs sanctions that they prefer to avoid.

Box 12.2 ALMPs in the United States

Daniel Klepinger, Terry Johnson, and Jutta Joesch present the results of an experimental evaluation of alternative work search requirements imposed on unemployment benefit recipients in Maryland. Assignment to control and treatment groups was random, based on Social Security numbers. The control group of unemployed workers had the standard obligation to contact two employers per week and report those contacts in order to remain eligible for unemployment benefits payments. The Maryland experiment distinguished four treatment groups who were informed about their duties within one week after registering for a benefit claim. The first group had to make four employer contacts per week, the second group was informed that they had to search actively without specifying the number of contacts they had to make, and the third group had to attend a four-day job search workshop lasting 16 hours early in the unemployment spell. The fourth group was informed that their claimed employer contacts would be verified. As discussed in the main text, there are two effects of increased work

(continued)

Box 12.2 (continued)

search requirements. First, the treatment effect: the unemployed may make more job contacts, which increases the job-finding rate. Second, the threat effect: the additional requirements raise the nonmonetary costs of remaining unemployed, which leads to more intense job search or a reduction in reservation wages (or both). Comparing the four groups allows a distinction between the two effects. The results for various outcome measures in the first year after the start of the unemployment spell are as follows:

Outcome Measure	Control group	Treatment group effects			
		Additional contacts	No reporting of contacts	Workshop	Verify contacts
Total UI benefits paid (\$)	2,085	-116*	34	-75*	-113*
Weeks of benefits	11.9	-0.7*	0.4*	-0.6*	-0.9*
Exhausted benefits (%)	28.3	-2.5*	1.5*	-1.1	-2.8*
Percentage worked	80.0	1.1	0.8	-0.8	1.3
Earnings (\$)	8,407	54	347*	-163	124

Note: * means significantly different from the control group at the 5 percent level.

The nonmonetary costs of imposing additional search requirements are important for the duration of benefit claims. Increasing the required weekly number of employer contacts from two to four and indicating that employer contacts would be verified reduced the duration of unemployment benefit spells by almost a week, which is a substantial effect since the average unemployment benefit duration was about 12 weeks. Eliminating a specific number of required contacts increased unemployment benefit duration. Finally, the obligation to attend a job search workshop also reduced unemployment benefit duration. This was at least partly because many unemployed workers left unemployment shortly before their search workshop was planned. Effects on the quality of postunemployment jobs in terms of employment and earnings were small or absent.

Source: Klepinger, Johnson, and Joesch (2002).

Van den Berg and Van der Klaauw (2006) analyze the outcome of a small-scale experiment on counseling and monitoring in the Netherlands. They distinguish between two types of job search, formal and informal job search. Formal job search is search through personnel advertisements and public employment offices. Informal job search refers to direct contacts with employers and search through friends, relatives, or employed workers. They argue that counseling and monitoring only affects formal job search. Monitoring leads to a substitution of effort from informal to formal search, which reduces the effectiveness of monitoring. At the time of the experiment in the Netherlands, at the start of the unemployment spell unemployed workers were classified into one of four types on the basis of objective characteristics and subjective evaluation. Types 2, 3, and 4 unemployed are offered assistance to find a job, while type 1 unemployed are expected to

have sufficient skills to find a job without assistance. The experiment was limited to type 1 unemployed, who were randomly assigned to a treatment group and a control group. The control group had to report on search activities every week, while in addition to this requirement the treatment group had regular meetings with counselors during which initially quality of application letters and résumés were examined and a plan was made, while during follow-up meetings plans from previous meetings were evaluated and planning for the next period was made. Unemployed workers who did not comply could be punished with a benefit sanction, a reduction of UI benefits by 10 percent for a period of two months. In their baseline estimate Van den Berg and Van der Klaauw find no significant treatment effect; that is, counseling and monitoring do not help the unemployed find a job more quickly. However, they also find that counseling and monitoring affect the type of search: unemployed workers who are subject to counseling and monitoring shift their search from informal to formal channels. Van den Berg and Van der Klaauw conclude that focusing monitoring on the unemployed with less favorable characteristics may make more sense because these individuals have less scope for substituting informal for formal search channels. Finally, Graversen and Van Ours (2008) show that mandatory programs help Danish unemployed workers find a job more quickly (see box 12.3 for details).

Box 12.3 ALMPs in Denmark

Brian Krogh Graversen and Jan van Ours analyze data from a Danish experiment that randomly assigned unemployed workers to control and treatment groups on the basis of their birth date. The treatment group was confronted with mandatory activities, whereas the control group was not. The unemployed in the treatment group were informed by letter about their duties within 1 to 2 weeks after becoming unemployed. The letter gave a short description of the activities contained in the program. After 5 to 6 weeks of unemployment individuals had to participate in a job search program that lasted 2 weeks. After the program individuals had to attend meetings once a week or once every second week. The purpose of the meetings was to assist individuals in their job search and to monitor job search efforts. Individuals could also receive job offers mediated by the PES. Before individuals were unemployed for 4 months, they had to receive an offer to participate in an activation program with a duration of at least 3 months. Longer classroom training courses (with a duration of more than 3 months) could not be offered at this stage. Individuals who did not find a job after 6 to 7 months had to participate in a longer meeting with a caseworker, and a new job plan was made. The job plan contained a description of the activities to improve the chances of finding a job. The services offered to the control group during the early stage of the unemployment period were much less intensive than the services offered to the treatment group. Unemployed workers in the control group could voluntarily participate in some

(continued)

Box 12.3 (continued)

of these activities, but this did not happen frequently. Individuals in the control group typically would have to participate in an activation program after one year of unemployment. Graversen and Van Ours find that already before the start of the job search program the job-finding rate in the treatment group was higher than in the control group.

Figure 12.4 presents the survival functions separately for the treatment group and the control group. As shown, the treatment group left unemployment more quickly than the control group. After 3 months 47 percent of the control group and 54 percent of the treatment group had left unemployment. After 6 months 28 percent of the control group was still unemployed, while only 21 percent of the treatment group was still unemployed. The difference between both survival functions increased up to 13 weeks of unemployment, stayed constant until 26 weeks, and declined after that. Figure 12.4 also shows that the median unemployment duration for the control group was about 14 weeks, while for the treatment group it was 11.5 weeks. Clearly there is a substantial treatment effect.

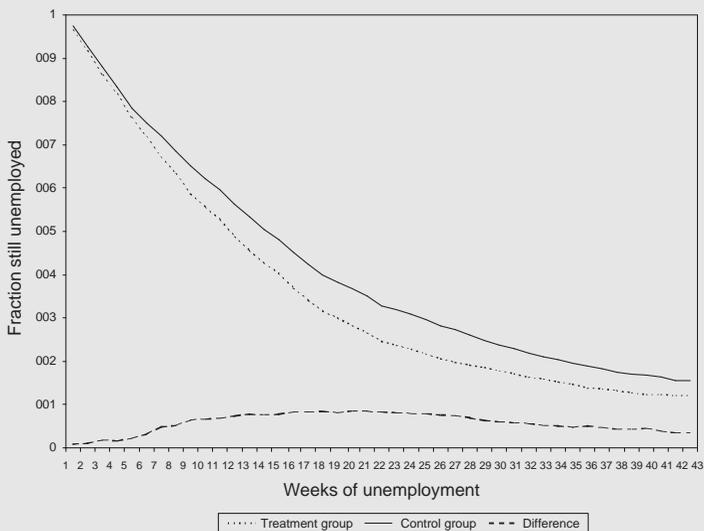


Figure 12.4 Effects of a Danish ALMP Experiment on the Survival Function of Unemployed Workers

Source: Graversen and Van Ours (2008).

12.3.2 Nonexperimental Studies

Nonexperimental studies are based on cross-country comparisons or micro-oriented evaluation studies. Recent evaluation studies, however, are not very optimistic about the benefits of many of these programs. Heckman, Lalonde,

and Smith (1999) provide a detailed overview of microeconomic evaluation studies. They conclude that ALMPs have, at best, a modest impact on participants' labor market prospects. Furthermore, there is considerable heterogeneity in the impact of these programs, so that for some groups of workers the programs are more effective than for other groups of workers. Finally, when programs are implemented on a large scale, displacement and general equilibrium effects may be sizable. This means that if they are not incorporated into a macro framework, micro treatment effect evaluations will provide poor guidance to public policy. Calmfors, Forslund, and Hemström (2001) conclude that the evidence on the effectiveness of Swedish ALMPs is rather disappointing. Labor market retraining, for example, has no or negative employment effects. Martin and Grubb (2001) draw similar conclusions in their overview of what works and what does not work among ALMPs in OECD countries. They conclude that subsidies to employment and direct job creation have not been effective in helping the unemployed get permanent jobs.

If one can draw a general conclusion from the empirical studies based on micro data, it is that the effects of ALMPs on job-finding rates are rather small.⁴ An important drawback of many ALMPs is that they stimulate workers to reduce their search efforts rather than increase them. This is due to the so-called locking-in effect (Van Ours 2004a). Other effects are important too. What is effective for an individual unemployed worker may not be effective in terms of the aggregate level of unemployment. One reason for this may be crowding out. If a training program brings an unemployed worker back to work more quickly at the expense of another unemployed worker finding a job more slowly, the training program is not very efficient. Another reason for the differences between individual and aggregate effects is that a training program may make workers more attractive for firms, which stimulates job creation. It may also be that a training program induces a better match between a worker and a job. In that case job tenure will increase, causing a reduction of unemployment through a reduced inflow into unemployment.

Activation measures seem to be more effective than training programs or employment subsidies. From recent micro studies on the effect of benefit sanctions in the Dutch labor market, we know that a reduction of unemployment benefits may have a substantial effect on the outflow from unemployment to a job. Abbring, Van den Berg, and Van Ours (2005) study the effect of financial incentives by comparing the unemployment duration of individuals who faced a benefit reduction with that of similar individuals who had not been penalized. In the Netherlands people who receive UBs have their benefits reduced if they do not follow the rules related

⁴ Kluge and Schmidt (2002) and Kluge (2006) present overviews of many evaluation studies concerning ALMPs in Europe. They conclude that providing job search assistance and counseling and monitoring accompanied by appropriate sanctions for noncompliance are especially effective, and they are often quite cost-effective because they are rather inexpensive.

to the benefits. According to the UB Law, an unemployed worker has three obligations in order to be entitled to UBs. First, the worker has to prevent unnecessary job loss. Second, the worker has to take actions to prevent staying unemployed (search for a job and accept appropriate job offers, register as a job searcher at the public employment office, participate in education and training, et cetera). Third, the worker has to keep the administrative organization informed about everything that is relevant to the payment of the UB. Related to these obligations are four categories of infringements for which workers can have benefit sanctions imposed: (1) blameworthy unemployment after dismissal, (2) lack of effort to find a job (search intensity too low, declining job offers), (3) administrative infringements (reporting too late), and (4) other infringements (fraud, inaccurate information). The sanction is temporary or permanent (full or partial) reduction of the benefit level. In practice, the temporary partial reduction of the benefits ranged from 5 percent during 4 weeks to 25 or 30 percent during 13 weeks. Abbring, Van den Berg, and Van Ours (2005) analyze how benefit sanctions affect the transition out of unemployment and find that reemployment rates are significantly and substantially raised by imposition of a sanction, from 58 to 67 percent. Van den Berg, Van der Klaauw, and Van Ours (2004) perform a similar analysis on the effects of sanctions on the behavior of Dutch UA recipients in the city of Rotterdam. A benefit sanction raises the transition rate from welfare to work substantially: the job-finding rate more than doubles. A straightforward comparison between individuals who got a benefit sanction imposed and those who did not is incorrect. If this is done, the selectivity of the imposition of a sanction (workers with low motivation who have a low job-finding rate anyway are more likely to get penalized) is not taken into account. Then the estimated sanction effect is seriously underestimated. Although the benefit sanction itself is temporary, the effects turn out to be long-lasting. Even after the sanction period expires, the transition rate from welfare to work is higher than before the sanction was imposed. Similar effects of benefit sanctions are found for the Swiss labor market. From an analysis of Swiss data on benefit sanctions, Lalive, Van Ours, and Zweimüller, (2005) conclude that imposing a benefit sanction reduces unemployment duration by roughly three weeks. They also find evidence of the existence of an ex ante effect.

12.4 Policy Issues

The 1994 OECD *Jobs Study* recommended that governments strengthen the emphasis on active labor market policies and reinforce their effectiveness (OECD 1994). In the reassessment of the Jobs Strategy the OECD concludes “that well-designed programs can have a positive impact . . . but that many existing programs have failed to do so.”⁵ Nevertheless, the OECD concludes that “enough successful

⁵ OECD (2006c), p. 72.

programs have been documented to confirm that an appropriate mix of properly designed ALMPs can reduce unemployment by improving the efficiency of the job-matching process and by enhancing the work experience and skills of those who take part in them.”⁶ This section discusses the main policy issues concerning employment services and activation policies.

12.4.1 Do We Need Public Employment Services?

Employment services are usually provided by government agencies, although there are also private employment services. Public employment services are provided to unemployed workers to assist them in finding jobs. Services range from assistance in locating relevant vacancies and help in job finding to training programs in order to update the skills of the unemployed worker. In order to benefit from market mechanisms, some countries set up quasi-market arrangements in the provision of public employment services and other ALMPs. The OECD (2005b) argues that in order to implement a quasi-market, public employment services have to make a split between a public authority and multiple employment service providers. The public authority is responsible for the determination of individual eligibility for benefits and services, the assigning of the unemployed to specific service providers, and measuring the outcome of the service provision. The local employment service providers can choose their own strategies aimed at bringing their unemployed back to work. The main idea is that through the survival of the fittest, successful strategies will remain even when it is difficult to identify why these strategies are successful. In public employment services the issue of profiling of unemployed workers is important. For an optimal allocation of resources, unemployed workers, with longer expected durations of benefit receipt should receive more or different employment services. There is room for improvement in the functioning of public employment services with regard to profiling of unemployed workers. Lechner and Smith (2007) show that Swiss caseworkers do no better in their profiling than random assignment.

12.4.2 Do We Need Activation Policies?

Activation policies put requirements and obligations on unemployed benefit recipients, such as the obligations to attend intensive interviews with employment counselors, search actively for a new job, and accept job offers. Activation programs differ from public employment services because participation is obligatory for unemployed workers who want to remain entitled to unemployment benefits. Therefore, activation policies make it less attractive for unemployed workers

⁶ OECD (2006b), p. 74.

to collect benefits. This may affect both the inflow of benefit recipients (some unemployed workers will not apply for benefits) and the outflow of benefit recipients (either because the unemployed find jobs or because they drop their benefit claims). Workfare programs provide unemployed workers with temporary jobs in exchange for the payment of unemployment benefits but do not provide additional services. A workfare program may act as a screening device but does not stimulate the unemployed worker to search more intensively. Benefit sanctions imply temporary or permanent reductions of unemployment benefits in order to increase the difference between benefits and postunemployment wages. This will stimulate job search activities. Instead of sticks, like benefit sanctions, carrots, such as wage subsidies, may be used to make it more attractive for workers to search for a job.

12.5 Why Do Active Labor Market Policies Exist?

Active labor market policies exist because unemployment benefits provide disincentives for unemployed workers to find a job. These disincentives may lead to a number of traps (OECD 2005b). The *unemployment trap* arises because benefits paid to unemployed workers and their families are high relative to net income from work. This may discourage job search and put upward pressure on wages (see also chapter 10 on unemployment benefits). The *inactivity trap* is similar to the unemployment trap but concerns individuals of working age who are not receiving unemployment benefits. Often income-related benefits will be lost upon taking paid work. This will reduce the net gains from work. The *poverty trap* is also called the *low-wage trap* because it discourages those already in low-paid work from increasing working hours or moving into higher-paid employment. An increase in gross earnings fails to translate into an increase in net income because of the withdrawal of income-tested benefits. From a cross-national perspective there is a positive correlation between unemployment benefits and ALMPs. Countries with a relatively generous UB system also spend much on ALMP (see also chapter 13). ALMPs stimulate those who are voluntarily unemployed to find a job more quickly than they otherwise would have. However, even without the existence of unemployment benefits, ALMPs can improve the efficiency of the labor market. Unemployed workers who stay unemployed too long may lose some or all of their skills. Involuntarily unemployed workers who want to invest in themselves to acquire the skills necessary to find a job will not always find it easy to finance this investment. Then governments may step in and provide financial support.

12.6 Suggestions for Further Reading

Lars Calmfors (1994) presents a theoretical framework to understand how ALMPs operate. Jim Heckman, Robert LaLonde, and Jeffrey Smith (1999) present a

detailed discussion of the measurement of the effectiveness of ALMPs. Jochen Kluge and Christoph Schmidt (2002) provide a nice overview of many studies exploring the effectiveness of ALMPs. In various years the OECD *Employment Outlook* contains overviews and discussions of ALMP topics.

12.7 Review Questions

1. Why might one criticize subsidized jobs as a policy instrument to bring the unemployed back to work?
2. Why is training possibly more effective in reducing unemployment than subsidized jobs or public employment services?
3. Through what mechanisms do benefit sanctions affect unemployment?
4. How do ALMPs affect the Beveridge curve?
5. In what way does the lump-of-labor fallacy affect the discussion concerning the effectiveness of ALMPs?
6. How do intensive interviews with employment counselors affect the behavior of unemployed workers?
7. What is the relationship between the unemployment trap and upward pressure on wage levels?
8. Why would training be more effective in countries where unemployment benefits are high?
9. The main elements of a system of benefit sanctions are the monitoring intensity and the size of the penalty. Explain the different ways in which these two components affect the behavior of unemployed workers. Use the concepts of *ex ante* and *ex post* effects in your explanation.

12.8 Technical Annex: Activating Unemployed Workers

This technical annex shows how a system of benefit sanctions intended to activate unemployed workers can be introduced into a search-matching model of the labor market. In a search-matching model unemployment arises because workers need time to find vacancies and employers need time to find unemployed workers to fill their vacancies. In our model labor is assumed to be homogeneous, and all jobs offer the same wage. The duration of unemployment depends on the intensity of search. The reservation wage is not an instrument of search because that would require heterogeneous labor and a wage distribution. If an unemployed worker and a vacancy match, they produce (nonstorable) output. Individuals and firms are assumed to be risk neutral.

To understand the behavior of workers, the concept of present discounted value (PDV) is used. The PDV of a continuous flow of wages w that lasts forever is

$$V_w = \int_0^{\infty} w e^{-\rho t} dt = \frac{w}{\rho}, \quad (12.1)$$

where ρ is the discount rate. The flow value of having a wage forever the product of the discount rate and the PDV:

$$w = \rho V_w. \quad (12.2)$$

We assume that all workers are homogeneous in the sense that they receive the same wage w net of taxes. Unemployed workers search with intensity s . A worker can adopt search intensity $s \in [0, 1]$ in looking for a job.

Unemployed workers receive unemployment benefits b , where generally $b < w$. In a model without benefit sanctions, the flow value of being unemployed equals the difference between the cost of search and the unemployment benefits and the expected benefits from finding a job

$$\rho V_u = \max_{0 \leq s \leq 1} [b - \gamma(s) + \mu s (V_e - V_u)], \quad (12.3)$$

where μs is the job-finding rate (see technical annex 3.8 for details on other parts of the model).

Activation measures are intended to overcome market failures arising from generous unemployment benefit and welfare benefit schemes. Activation can be introduced through unemployment benefit sanctions, G . We introduce benefit sanctions in a search-matching model (see Boone and van Ours 2006 for details of this model). We make the following assumptions: Each civil servant can monitor ϕ unemployed agents per period; e_g is the number of government officials monitoring the unemployed; u_u is the number of unemployed workers without a benefit sanction; u_s is the number of unemployed workers with a benefit sanction. The Poisson arrival rate of being monitored for an unemployed agent is $\frac{\phi e_g}{u_u}$; because monitoring is imperfect, the probability of being sanctioned, conditional on being monitored, is $(1 - s)$. Then we find that for workers,

$$\rho V_u = \max_{0 \leq s \leq 1} \left[b - \gamma(s) + \mu s (V_e - V_u) + \frac{e_g \phi}{u_u} (1 - s) (V_s - V_u) \right], \quad (12.4)$$

$$\rho V_s = \max_{0 \leq s \leq 1} [(1 - G)b - \gamma(s) + \mu s (V_e - V_s)], \quad (12.5)$$

where we assume that an unemployed worker can receive only one sanction. In this setup the additional term in the value of being unemployed is the term related to the sanctions, a term that reduces the value of unemployment and increases

search intensity. Now, optimal search intensity requires that

$$\gamma'(s_u^*) = \mu (V_e - V_u) - \phi(V_s - V_u), \quad (12.6)$$

$$\gamma'(s_s) = \mu (V_e - V_s). \quad (12.7)$$

We also have to make assumptions concerning the labor market. We assume that government jobs are never destroyed. Therefore, $\rho V_g = w^g$, and in equilibrium $V_e = V_g$. This determines the wage w^g that the government pays its monitoring officials. The labor force $e_g + e + u_u + u_s = 1$. In a steady state labor market the inflow into the stock of unemployed workers without benefit sanctions equals the outflow from that stock. The same holds for the stock of unemployed workers with benefit sanctions. From this we can derive

$$u_u = \frac{\delta^s (1 - e_g)}{\mu s_u + \delta^s} - \frac{e_g \phi (1 - s_u)}{\mu s_s} \frac{\mu s_s + \delta^s}{\mu s_u + \delta^s}, \quad (12.8)$$

$$u_s = \frac{e_g \phi (1 - s_u)}{\mu s_s}.^7 \quad (12.9)$$

The marginal wage tax t is adjusted endogenously in the simulations to satisfy the government budget constraint

$$etw = u_u b + u_s b(1 - G) + e_g w^g, \quad (12.10)$$

where on the right-hand side in the total government expenditures the costs of the benefits system and the monitoring system are included. Benefit sanctions may affect search behavior of unemployed workers in two ways, through the ex ante and ex post effects of benefit sanctions. The ex ante effect refers to the optimal search intensity of workers, which is higher than it would be if workers did not face the possibility of getting a sanction imposed. The ex post effect refers to the effect on the search of having lower benefits once a sanction is imposed. For some systems of benefit sanctions the ex ante effect turns out to be more important than the ex post effect, while for other systems the ex post effect is more important. The comparison between the two depends on the difference between the job arrival rate for workers and the intensity of monitoring. With a low monitoring intensity the possibility of suffering a sanction is small, and the search of the unemployed will not be affected very much. The main effect is after the sanction is imposed. In this case the ex post effect dominates. With a high intensity of monitoring the unemployed will try to reduce the sanction rate by increasing their search intensity. Then the main effect is the ex ante effect. It is even possible that the ex post effect is very small, which in micro research could lead to the erroneous conclusion that

⁷ To see this, note that the equations of motion in the labor market are given by $\dot{u}_u = \delta e - (\mu s_u + (e_g \phi / u_u) (1 - s_u) u_u - \mu s_s u_s)$, and that the steady state is defined as $\dot{u}_u = \dot{u}_s = 0$.

sanctions do not have an effect. They do, but the main effect is in the threat of a penalty, not in the imposition of a penalty.

To illustrate how benefit sanctions affect the labor market, we use the following additional parameter value: monitoring capacity: $\phi = 20$. This parameter value implies that a supervisor deals with 20 unemployed workers and has in a 40-hour week on average about 2 hours per week for every unemployed worker under supervision. This means quite intensive monitoring. The unemployed worker can only avoid benefit sanctions if that person's search intensity is at the maximum value ($s_u = 1$), which is not socially optimal. The results of the simulations are discussed in the main text.