



# Welfare to work: lessons from OECD experience

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# Outline

- This presentation focuses on conclusions – the evidence is complex and open to debate.
  1. Decentralization – feasible limits and optimal extent
  2. Benefit systems, activation and the cycle as influences on unemployment
  3. Three remarks on the objectives of active labour market policy



# 1. Decentralization – feasible limits and optimal extent

# National vs. local administration of benefits

- Local management of assistance (means-tested) benefits *combined* with local responsibility for financing the benefit payments results in low benefit caseloads.
  - the highest net replacements are paid in some European countries (NO, CH, etc.) where municipalities are responsible for benefit financing, and benefit administration is restrictive.
- National management of assistance benefits, even when combined with national financing, tends to results in higher benefit caseloads.
  - Even when employment services are in principle under national management, the final delivery of services is local (by local PES officers, local doctors, etc.), so there a degree of misalignment of the institutional incentives (national financing is combined with not-entirely-national management).

## Misaligned institutional incentives


- In BE, ES and CA, UI benefits are nationally financed, but employment services are managed by regional governments.
  - In these countries, the national benefit administration attempts to monitor clients' job search behaviour and availability for work without help from the employment services, but this is not effective.
  - The misalignment of institutional incentives tends to cause high structural unemployment.
- Labour market policy can be the Achilles' Heel of political devolution.
  - Historically, reforms that shifted responsibility for benefit financing to the local level have been followed by caseload falls. (Welfare in CA and US in 1996; social assistance in NL in 2004; unemployment assistance in FI in 2006).
  - SK (Slovak Republic) had probably the highest social assistance benefit caseload in the OECD, due to a combination of national benefit financing with local management. After a reform (2004), the caseload fell dramatically.

# Examples of successful decentralisation

- DK (until 2007), CH and probably AT (Austria) are examples of successful *partial* decentralization of the PES:
  - 1) Legislation, strategic management, IT systems and performance management are national.
    - Regions with population below a few million (including some small OECD countries) tend to lack resources for good IT systems, systematic evaluation, and well-considered strategic management
  - 2) Regional bodies are largely responsible for the implementation of individual labour market programmes.
    - The quality of management inputs (including engagement of local social partners, local governments, etc.) that can be assembled at regional level is important for success.
- In these “successful decentralisation” countries, municipalities and/or regions finance and manage social assistance benefits - they do not bear the cost of UI benefits, but they do they have an established interest in tackling unemployment.

# Decentralisation in the UK

- “Jobcentre Plus (JCP) is the only substantial government service delivered directly to the public in Scotland that is still administered from London (or Sheffield)” (Crighton et al., 2009).
- UK/DWP is promoting some decentralisation of powers and implementation of strategies adapted to local needs - Local Area Agreements, City Strategy Partnerships, Working Neighbourhoods Fund, etc.
- Policy-making needs to keep in mind that:
  - 1) Employment services should be kept under national management as long as benefits are nationally-financed ; and
  - 2) Local-area initiatives will not be able to engage with many unemployed clients unless JCP enforces participation requirements on them. This issue should be thought through when planning and funding the local initiatives.



## **2. Benefit systems, activation and the cycle as influences on unemployment**

# Activation measures counteract benefit disincentives...

- When enforcement of eligibility conditions is weak, benefit caseloads grow (this often generates high headline (LFS) unemployment rates as well).
- But when benefits are linked to strict requirements (to search for work, attend interviews, participate in programmes, etc.), unemployment can be sharply reduced. Unemployment has sometimes been for many years kept *below* the levels that arise in a “laissez-faire” economy without a benefit system.

## ...but activation measures are affected by the economic cycle

- During an economic upswing, activation measures are intensified – since there are progressively more job vacancies, more counselling resources, and more programme places per client – and benefit disincentive effects decline.
- During a recession, this mechanism goes into reverse.
  - higher unemployment reduces the frequency of interventions in the unemployment spell; overwhelmed administrations no longer check individual eligibility for benefit; and it becomes possible to spend long periods passively on benefit.
- The reduced effectiveness of activation measures tends to increase unemployment further, which may even lead to a new equilibrium where unemployment is permanently higher.
  - In recessions, the view that “the unemployed are innocent victims” needs to be balanced with a view that “in these tough times, the unemployed should take whatever jobs are available”.

# Labour market outcomes vary greatly across countries

- After the first oil price shock (1973), by about 1977 unemployment rates had doubled in only a few countries - mainly those that already had generous unemployment benefit systems in place (BE, DE, DK, NL, followed by AU, UK).
- In the early 1990s, unemployment rates tripled or quadrupled in FI, SE and CH. These countries previously had little or no unemployment benefit system, but had introduced generous systems between 1970 and 1985.

# In the current recession...

- Since 2007, unemployment has doubled in the US and more than doubled in IE, ES – three countries that recently increased benefit levels and/or coverage, with few activation measures.
  - Since mid-2008, the US has increased the maximum UI benefit duration from 26w to 79w in most States. The federal government reimburses 100% of State expenditures for 33 weeks, removing institutional incentives for tight management. In most States, benefit claims are continued with only phone or internet contact. The US benefit coverage rate (B to U ratio) is now 60%, similar to the UK's.
- Elsewhere in the OECD, unemployment rates have so far increased much less: +0% to +50%.
  - In GDP terms this is a hard recession, but many European countries (+AU, NZ) have adopted or strengthened activation measures since 2000, which is limiting the rise in unemployment.
- Benefit systems and activation measures influence outcomes at all times – but *a fortiori* in times of recession.

# Recession in the UK

- Probably related to its large financial sector and a flexible labour market, recession in the UK has been relatively early and deep.
  - Conditions remain difficult for JCP and other provider staff, for the unemployed, and for some people still in work such as the self-employed facing slow business.
  - However DWP and JCP, with additional funding, have reacted rapidly to maintain the intervention regime (regular interviews, the roll-out of the Flexible New Deal) for claimant unemployment.
  - The UK - like some other countries – seems set to pull through with unemployment rates below their 1980s/1990s peak levels, with the recent policy reforms to “activate the inactive” (bring lone parents and people with disabilities into the labour market) intact.



## **3. Three remarks on the objectives of active labour market policy**

# 1. Unemployment is not always bad

- Some job losers take a few months to re-enter work for the good reason that searching helps them to find a better-quality job.
- However, this argument does not justify unemployment spell durations of more than about six months. Longer spells involve losses of human capital and of potential earnings that exceed plausible gains from a better-quality job match.
  - Activation measures should ensure that most unemployment spells last less than 6 months. If spells are often longer, activation measures should be intensified until they are shortened.
  - A requirement that unemployed workers should accept any job - even in the early months of their unemployment spell – seems excessively rigorous. Countries that require this may get unemployment down to artificially low levels in years of peak demand, but it is liable to bounce back up.

## 2. Employment is the aim

- Policies tend to focus on reducing unemployment for two simple reasons: (a) individual unemployment status, but not employment status, is recorded in the PES register; and (b) unemployment is the headline measure and political concern.
- However, “threat effects” that push people into inactivity, or entries to short-term jobs soon followed by re-entry to unemployment, are not necessarily desirable outcomes.
- Labour market policies should remove the need for unemployed people to work in the informal economy, and contribute to the suppression of undeclared work. By increasing tax revenues, they can pay for themselves (even though no official accounts show this). If informal work is widespread, benefit systems are open to abuse and costly.
- Employment service providers should be encouraged to maximise the average employment rate achieved by their clients over the next few years. This can be measured using tax/social insurance contribution records.

### 3. Know your limits

- Imagine that in a few years' time active policies have been successful, and concerns about high unemployment have faded. If the active policies are maintained (perhaps refreshed from time to time) the happy scenario will continue. Right?
- Quite possibly wrong, unfortunately. When unemployment stays low for many years, people begin to believe that:
  - Benefit levels can be increased;
  - The minimum wage and other employee rights can be improved;
  - More people on “inactive” benefits can be transferred to an unemployment status (treated as being available for work); etc.
- Such policies can make it progressively more difficult for the employment service to place its clients. Outcomes may begin to falter even during the upswing, followed in the next recession by an explosion of unemployment - from which recovery takes` more than a decade.
- When a low-unemployment situation has been established, take care to preserve it!