Active Labour Market Policies: Theory and Danish Experiences

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Active labour market policies/workfare (ALMP/WF):

Activity/participation requirements as part of the eligibility conditions for transfers (unemployment benefits, social assistance)

- Generous social benefits – can incentive structure be maintained by ALMP?

- More acceptance of ALMP than benefit reductions?

- Work first: Target transfers to those working, but having low income (working poor)

- Easier to get support for a ”pro-active” social safety net
Aims of ALMP

• Targeting:
  Ensuring that transfers go to the intended recipients (“deserving”)

• Job-search incentives:
  Strengthen incentives to search for regular jobs
  (job search intensity, and reservation demands/wages)

• Qualifications:
  Address skill constraints/barriers (technical, cognitive, non-cognitive/social) lowering job finding chances
Targeting – the selection problem

• Target transfers to individual with low earnings ability

• Unconditional transfers: Some high-ability individuals may claim benefits

• ALMP-conditions: Higher opportunity cost for individuals with high earnings ability to claim transfers
  - high-ability types self-select not to claim transfers
  - transfers better targeted to the ”deserving”

• Possible to implement higher transfers for given fiscal costs
ALMP and labour supply

Extensive margin:
- Transfers not a “passive” alternative to work
- ALMP lowers the reservation wage
- Higher labour force participation for given transfer and tax levels
ALMP and targeting

• Workfare does not have to be productive (direct treatment effect) to affect labour market outcomes!

• It is a screening device!

• Screening paradox:
  – The target group for transfers is exposed to the ordeal of ALMP
  – The problem was the “non-deserving” claiming the transfer
  – The mechanism works by making it unattractive for the non-target group to claim the transfer!

• Welfare case for ALMP?
  – Higher transfers
  – Disutility from ALMP (less leisure time)
Job search

• Trade-off insurance vs incentives

• Generous benefits = insurance protection income/consumption

• Reduces incentives to search for jobs (search intensity, reservation demands to jobs)
Search and ALMP

• Search
  – Prior to participation: more search (threat/motivation effect)
  – During participation: less search (locking-in)

• Wages – outside option is changed = wage moderation

• General equilibrium effects: search and wages affect job-creation
ALMP and employment

- ALMP improves employment for given benefit levels
- (Utilitarian) Welfare may improve
- Optimal policy – small intensity (few) but demanding activity
Qualifications

• Overcome barriers for job-finding
  – Individual characteristics and market developments
  – Targeting problem (who and what?)

• Duration dependent loss of human capital
  – Strengthens the incentive to search up-front
  – ALMP may be a carrot (will solve my problems)

• Ex post to participation
  – Improved qualifications
  – Changed reservation demands
General equilibrium effects via wage formation and job-creation

Threat/motivation effect:
Active job search/
lower reservation demands

Locking-in
Less active
job search

Improved
qualifications

More narrow
job search

Screening:
Deserving vs non-deserving

Unemployment spell
Programmes are costly time profile: stepping up

• How to avoid deadweight losses?

• Programme assignment (profiling)

• Administration – incentives and monitoring
The Danish case:
Low unemployment and extensive use of ALMP

Unemployment

- Boom-Bust pattern: Larger GDP drop than OECD average

ALMP costs, % of GDP, 2009
The three pillars of the Flexicurity-model

- Lax employment protection = *flexibility* for firms
- Generous unemployment benefit scheme = *insurance* / *security* for workers
  
  but
  
  reduces incentives to be actively searching for jobs

- The model presumes that unemployment is a *temporary* state

- Balanced via ALMP

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Flexible hiring/firing rules

Unemployment Insurance

Active labour market policy
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Labour market reforms in the 1990s

- Shorter duration of the benefit period
- Stricter eligibility conditions
- Activation (workfare)
  - Condition for eligibility
  - Not qualifying for UIB

Short term insurance elements maintained, but incentives strengthened

Flexible hiring/firing rules

Unemployment Insurance

Active labour market policy
The Danish System: Unemployment insurance benefits, Social assistance and ALMP

Replacement rate %

Unemployment benefits

Low income groups

Social assistance

APW

Active job search

Activation offer: right and duty

Full time activation

Active job search

Activation offer: right and duty

NB duration period shortened to 2 years + stricter eligibility conditions
The Danish labour market

• High level of job-turnover

• High incidence of short term unemployment

• "Entry friendly" Relatively low level of long-term and youth unemployment

• High level of perceived job security (=ability to find a job)
High incidence of unemployment but short duration

Unemployment: Affected and full-time equivalents

Average duration and ratio of affected relative to full-time equivalents

- Number of persons affected by unemployment
- Full-time equivalents
- Average duration - left scale
- Affected relative to unemployment full-time equivalents - right scale
Quick transition out of unemployment – also in the current crisis

Survival rate unemployment

In employment after initiated unemployment spell

- 2006.4-2007.3: 360,000 spells
- 2009.4-2010.3: 520,000 spells

In employment after initiated unemployment spell:

- 2009.4 - 246,000 initiated spells
- 2006.1 - 160,000 initiated spells
Low level of long-term and youth unemployment
ALMP – requirements and activities

- Up-front job search requirement
- ALMP within first 9 months, different rules for the young
- Activation rate = 1/3 for unemployed
- Most programmes are short (< 13 weeks)
- Most in work related ALMP (intership, employed with wage subsidy)

- Continuous change in requirements and contents
  - Business cycle situation
  - Evidence
- Recently much focus on interviews and monitoring of jobs search
- Increasing demands on the young
  - Youth package – earlier and more demanding ALMP (=education)
  - Immediate full-time activation for the very young
ALMP -administration

• Specific institutional structure: Unemployment insurance funds (Unions) and municipalities

• One-stop shop
  - Job-centres (municipalities): For all unemployed (Social Assistance and Unemployment benefits)
  - Easier for the unemployed

• Incentive structure for job-centres
  - Reimbursed based on quantitative measures. What about quality?
  - Effect on job counselling (area vs skills)
  - More lean administration?
Requirements and programme assignment: Match-groups

- Group I (job-ready): No problems except unemployment.

- Group II (ready for activity): Not ready to start working, but is capable of participating in a program activity aiming at later employment.

- Group III (temporarily passive): Neither ready for a job nor for participation in a program activity aiming at later employment.
The achilles heel: Long-term unemployment

- Extended welfare state critically dependent on maintaining a high employment rate!

- Financial crisis = increasing inflow into ALMP

- How to maintain programme effectiveness?

- How to identify problems (different composition of the pool of unemployed, structural shifts)?

- Maintaining political support for ALMP when unemployment is high?
Concluding remarks

• ALMP has important effects on the incentive structure in the labour market

• Can be used to balance incentives with insurance (distributional goals)

• Programmes are costly – programme administration and assignment are critical

• Danish experience:
  - ALMP can be used to support a flexible labour market which is ”entry-friendly”
  - Continuous adaptation of policies to curb costs and maintain effectiveness
  - It has coped reasonably with the crisis – implicit work sharing
  - Can it prevent a significant increase in long term unemployment?