

July 2010

Supporting labour demand

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This *Position Paper* reviews different policy measures to support labour demand adopted by OECD countries during the recent recession and early phase of the subsequent recovery. Particular attention is devoted to analysing the appropriate mix of different types of *employment subsidies* and how that mix evolves as the contraction phase of a recession gives way to recovery. A first strategic choice to be made is whether the subsidy should apply to the full stock of jobs, only to a subset of jobs, such as jobs that are at risk of being destroyed, or jobs held by newly hired workers (or the subset of new hires associated with net employment gains). A second strategic choice is whether the subsidy is limited to the employment/recruitment of designated groups of disadvantaged workers or employers. These choices should be made in light of labour market needs and the policy goals being pursued, both of which are likely to vary across countries and with the stage of the business cycle. The main conclusions are as follows:

- *Short-Time Working (STW) schemes.* The introduction or extension of STW schemes has been one of the key short-term policy responses to support labour demand during the 2008-09 recession. New OECD analysis shows that STW schemes significantly reduced job losses during the downturn while providing income support to workers on reduced working hours. However, in part due to different design choices intended to limit STW subsidies to support jobs that would otherwise be lost but which will be viable once business conditions recover, the economic importance of STW differs importantly across countries. It is also important to attach clear and credible time limits to these measures to avoid locking workers in unviable jobs, especially as the recovery gathers strength.
- *Stock subsidies.* *Stock subsidies* (e.g. general reductions in employer social security contributions) have also been used extensively by OECD countries to support labour demand. They may be effective in the short run, especially in the period of falling output when fiscal stimulus is desirable. However, these subsidies are very expensive. The low cost-effectiveness of these subsidies, particularly in the long-run, underlies the importance of ensuring that such reductions are temporary.
- *Gross hiring subsidies.* Gross hiring subsidies are less expensive than stock subsidies, but also appear to be less effective in promoting net employment gains. However, these subsidies can be a useful tool to distribute the unemployment burden more equally, when they are targeted on the most disadvantaged jobseekers. Good programme design, including careful targeting on disadvantaged groups and controls to prevent employers from gaming the subsidy by “churning” workers, can have an important impact on their performance.
- *Marginal employment subsidies (MES).* MES are targeted at raising net employment via either the preservation of jobs at risk or the creation of new jobs. They tend to be more cost-effective than either stock or gross hiring subsidies, because leakages via deadweight and churning can be reduced significantly. They are thus well suited for strengthening job creation in the early phases of a recovery, but they also are rather complex and difficult to administer which often reduces their take-up rates.
- *Public sector direct job creation.* While direct job-creation schemes have frequently been used in recessions, past evaluations have found that they often failed to assist the unemployed to find regular jobs once their public sector job came to an end. However, with better design, it is possible that

they may provide a useful way to help prevent hard-to-place job losers from becoming disconnected from the labour market. They may also provide an essential source of income support to those at risk of poverty in emerging economies where social protection systems do not cover the vast majority of job losers. Nevertheless, such programmes should always be temporary to guard against them becoming a disguised form of subsidised permanent unemployment.

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Introduction

The world economy is emerging from the worst financial and economic crisis of the post-war period, but it will take time to overcome its negative impact on the labour market. While the economic recovery is broadening and strengthening, employment growth is still lagging. In the two years to the first quarter of 2010, employment fell by 2.1% in the OECD area and the unemployment rate increased by just over 50%, to 8.6%, corresponding to 17 million additional persons in unemployment. Moreover, a broader measure of unemployment encompassing inactive persons who wish to work and involuntary part-time workers is nearly twice as large as the official unemployment rate.

Recent data suggest that unemployment may have peaked in the OECD area and the latest OECD projections have revised upward the economic outlook for this year and next. Nonetheless, the recovery is unlikely to be sufficiently vigorous to reabsorb rapidly the current high levels of unemployment and under-employment. Indeed, the latest projections suggest that the OECD unemployment rate may still be around 8% by the end of 2011.

Mindful that high unemployment reduces welfare in a myriad of ways that go beyond the declines of output and income, many governments have taken, or are considering, targeted policy measures to limit the impact of the recession on job destruction and encourage job creation in the recovery. In this context, many OECD countries have introduced or scaled up measures to support labour demand during the economic crisis. In particular, a large majority of countries has used short-time working schemes to encourage companies retain workers; more than half of countries have introduced or scaled up job subsidies, recruitment incentives and public-sector job creation schemes, often targeted at disadvantaged workers (youth; older workers; long-term unemployed); and more than half have also temporarily reduced social security contributions for all workers or, in a few cases, for new hires. It should be emphasised, however, that a balanced package of policy measures to speed the restoration of high employment typically would also need to include measures to support aggregated demand and reinforce job-search assistance for jobseekers combined, when appropriate, with vocational training.

Policy-makers can choose from a variety of different forms of labour demand measures to support employment in the recession and in the recovery. This Position Paper focuses on three types of targeted measures to support labour demand, namely, short-time working (STW) schemes, jobs subsidies and direct public job creation. The paper is structured as follows. It starts by discussing the key strategic choices that need to be addressed when determining the appropriate mix of labour support measures and how this depends on the phase of the business cycle. It then proceeds with a detailed discussion of the use of STW schemes during the 2008-09 crisis, its initial impact on employment and its potential longer-run implications for labour market efficiency. While this suggests that the STW schemes may be quite effective in the short-term in helping to contain the social costs of recessions, it is likely that these measures are most useful for maintaining employment in the early stages of a recession when jobs losses tend to be high and are of less relevance for promoting employment in a recovery. The final part of this paper focuses on measures that have the potential to be more effective at stimulating hiring during the early recovery phase when employers are often hesitant to expand their workforce. These include hiring subsidies and direct public job creation.

How to determine the appropriate mix of labour support measures?

Policy goals to support labour demand and minimize the hike in unemployment evolve as the economy moves from a downturn to a recovery phase. In a major downturn, layoffs tend to drive the hike in unemployment. But their importance tends to diminish gradually as the downturn bottoms out and the recovery begins. In the recovery, job creation tends to play a decisive role in driving down unemployment and avoid it from becoming entrenched. This suggests that policy-makers concerned with unemployment should focus on measures to reduce the pace of layoffs by protecting viable jobs during the downturn, but should shift towards measures to promote job creation and help to re-integrate the unemployed into the workforce in the recovery phase.

In this context, different policy measures could be considered. General employment subsidies (stock subsidies) or subsidies directed at jobs at risk (*e.g.* short-time work subsidies) tend to be more effective in a downturn and even in the early phases of subsequent recovery. Stock subsidies, generally in the form of general reductions in employer social security contributions, tend to be relatively easy to implement and relatively effective in supporting employment in the short-run. However, their associated employment gains come at a significant cost in lost tax revenues (see Box 1). The fact that the subsidy is paid for all jobs, including jobs that would have survived even in the absence of the subsidy, results in important deadweight losses. This may not be a major drawback in a recession, when firms are confronted with deteriorating market conditions and a fiscal stimulus may be useful. However, it is likely to become a drawback in the recovery, when firm prospects improve and fiscal consolidation becomes an urgent priority to bring back public finances on a sustainable track.

By contrast, focusing on job creation becomes a key objective as the recovery gathers speed and/or fiscal consolidation becomes more urgent. A first strategic choice is whether the hiring subsidy should be provided to all new hires or only to or the subset of new hires associated with net employment gains (gross and marginal hiring subsidies, respectively). While gross hiring subsidies are easier to implement and may achieve larger overall effects, they also tend to be more costly and involve significant deadweight costs as many firms would have created new jobs even in the absence of the subsidy. A second, related, strategic choice is whether the subsidy is limited to the recruitment of designated groups of disadvantaged workers (*e.g.* the long-term unemployed) or employers (*e.g.* SMEs). Targeting subsidies on disadvantaged groups is more appropriate when the concern is to improve the employment and earnings prospects of groups who face structural barriers in the labour market. However, targeting can also be of salience in recessions and early recovery phases to prevent the burden of unemployment from being borne disproportionately by certain workforce groups and to reduce the risk of disadvantaged groups becoming permanently disconnected from the labour force.

Box 1. Stock subsidies may be effective in the short-term, but are very expensive

The fiscal stimulus packages enacted by a majority of OECD countries included broad cuts in employer social security contributions intended to support overall labour demand. As shown in OECD (2009a), general reductions in employers' contributions (stock subsidies) are likely to have a significantly larger short-term impact on employment than is indicated by a simple multiplier analysis for a tax cut, due to the relative price effect associated with a general reduction in unit labour costs. However, the long-run effect of a reduction in employer social security contributions on equilibrium employment is likely to be small, due to offsetting real wage adjustments. A "back-of-the-envelope" calculation suggests that a 1% reduction in unit labour costs, as a result of a reduction in employers' contributions, may increase employment by 0.6% in the short-run but only 0.2% in the long-run. This means that the cost per additional job created is 1.7 times average total compensation costs per job in the short-run and seven times average compensation in the long-run.

The low cost-effectiveness of stock subsidies, particularly in the long-run, and their large budgetary cost underlies the importance of ensuring that such reductions are temporary, when they are undertaken as an anti-recessionary measure, rather than being viewed as a structural reform to the tax system. This consideration is all the more compelling

Why has policy interest in short-time working been so strong during the 2008-09 recession?

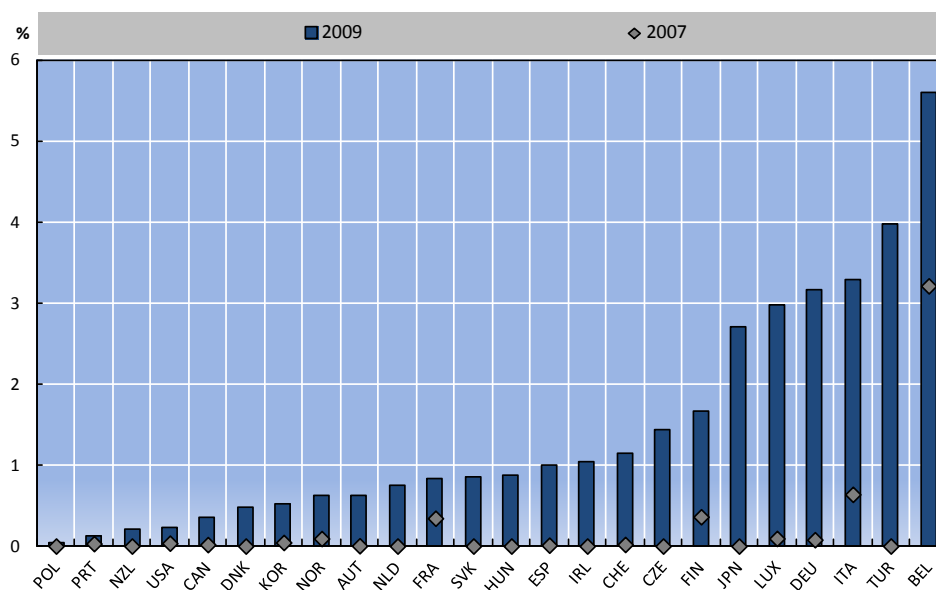
currently since fiscal consolidation has become urgent for many OECD countries. However, there may be a stronger case for retaining reductions of employer contributions which are *targeted on low-wage workers* since they may have important long-run benefits by permanently raising employment rates of some groups on the margin of the labour force. A number of OECD countries have implemented such targeted measures in response to the 2008-09 crisis, notably, Belgium, France and the Czech Republic.

Short-time work programmes are public schemes that are intended to preserve jobs at firms experiencing temporarily low demand by encouraging work sharing, while also providing income-support to workers whose hours are reduced due to a shortened workweek or temporarily lay-offs. More precisely, the purpose of STW schemes is to avoid “excessive” layoffs, that is, the permanent dismissal of workers during a business downturn whose jobs would be viable in the long-run. In principle, a well-designed STW scheme can promote both equity and efficiency: *i)* equity, by sharing the burden of adjustment more equally across the workforce; and *ii)* efficiency, by preventing transitory factors from destroying valuable job matches. A crucial aspect of all STW schemes is that the contract of an employee with the firm is maintained during the period of short-time work or the suspension of work.

Short-time work schemes have received an unusual degree of policy interest during the downturn of 2008-09. Twenty-two OECD countries reported either setting up new measures or adjusting existing measures in response to the current downturn. Crisis-related reforms to short-time work schemes typically intended to increase their economic impact by encouraging take-up (*e.g.* relaxing entry requirements; weakening behavioural requirements for programme participants and raising programme generosity). Indeed, countries that already had short-time work schemes before the crisis, or have introduced them in response to the crisis, have seen participation in such schemes escalate dramatically since 2007 (see Figure 1). Take-up has been highest in Belgium, Turkey, Italy, Germany and Japan, accounting for over 3 to almost 6% of all employees. With the exception of Belgium and Italy, few employees were participating in short-time work schemes prior to the onset of the crisis.

The recent policy interest in short-time work is unusual as past experience suggests that such schemes may be difficult to operate effectively. These difficulties have often arisen in the past when short-time working often was used to deal with structural adjustment. However, if used during severe economic downturns, the balance of costs and benefits associated with short-time work schemes may become more favourable. Like other types of job subsidies, STW schemes are subject to *deadweight* and *displacement* effects that reduce their cost effectiveness. Deadweight occurs when STW subsidies are paid for jobs that employers would have retained even in the absence of the subsidy, implying that this spending is a pure transfer which does not limit total job losses. Displacement effects can be said to occur when STW schemes preserve jobs that are not viable without the subsidy, even after business conditions recover. If these subsidies are maintained they lock workers in low productivity job matches and thus represent a barrier to job creation by firms with the potential to grow and efficiency enhancing labour mobility. The efficiency cost of STW may be temporarily reduced during a recession since many more viable jobs are at risk in a steep recession, especially one in which firms’ access to credit is limited, while the social cost of locking workers in unviable jobs is temporarily lower since there is little prospect they could move quickly into more productive jobs. The gains from preventing “excessive” layoffs during a recession may also increase due to the longer expected duration of unemployment and its adverse impact on future careers.

Figure 1. Annual average stock of employees participating in short-time work schemes as percentage of all employees^a



a. Countries shown in ascending order of the share of participants in short-time work schemes in 2009.
 b. Until 2009 Q3 for Austria and the Netherlands; August 2009 for Portugal and Spain; September 2009 for the Slovak Republic; and October 2009 for Luxembourg and New Zealand.
 Source: OECD (2010).

What has been the initial impact of short-time working on employment during the 2008-09 recession?

A commonly heard conjecture is that the vigorous promotion of work sharing via STW schemes deserves much of the credit for limiting the rise in unemployment during the 2008-09 crisis. Indeed, the rise in unemployment has been small in many countries compared with what would have been expected given the size of the decline in output and this is due in large part to reductions in average hours having accounted for an unusually high share of the total adjustment in labour input. However, to what extent these labour adjustment patterns may indeed be attributed to the intensive use of short-time work schemes during the crisis is not clear, since there has been little systematic evaluation of the effectiveness of STW schemes in preserving jobs during the crisis so far.

The *OECD Employment Outlook 2010* presents first evidence on the initial impact of short-time work during the crisis across 19 OECD countries of which 11 countries operated a short-time work scheme already before the crisis, five countries introduced a new scheme during the crisis period and three countries never had a short-time work scheme. The basic idea of the econometric analysis is to relate differences in labour-adjustment patterns across countries before and during the crisis to differences in the intensity with which STW schemes are used. This allows one to derive an explicit and economically realistic counterfactual against which the role of STW schemes can be assessed. By benchmarking the cross-country comparison during the crisis to the period that preceded it, the analysis takes account of the role of factors other than STW, such as employment and hours regulations, that affect labour-demand adjustment but whose impact is independent of the crisis. A key feature of the analysis is further that it consistently distinguishes between permanent and temporary workers. This is crucial for analysing the implications of STW during the downturn since temporary workers are much more likely to lose their job in an economic downturn, but are less likely to participate in STW.

The evidence suggests that short-time work schemes indeed helped preserve permanent jobs during the economic downturn, while also increasing average hours reductions among permanent workers. However, the contribution of short-

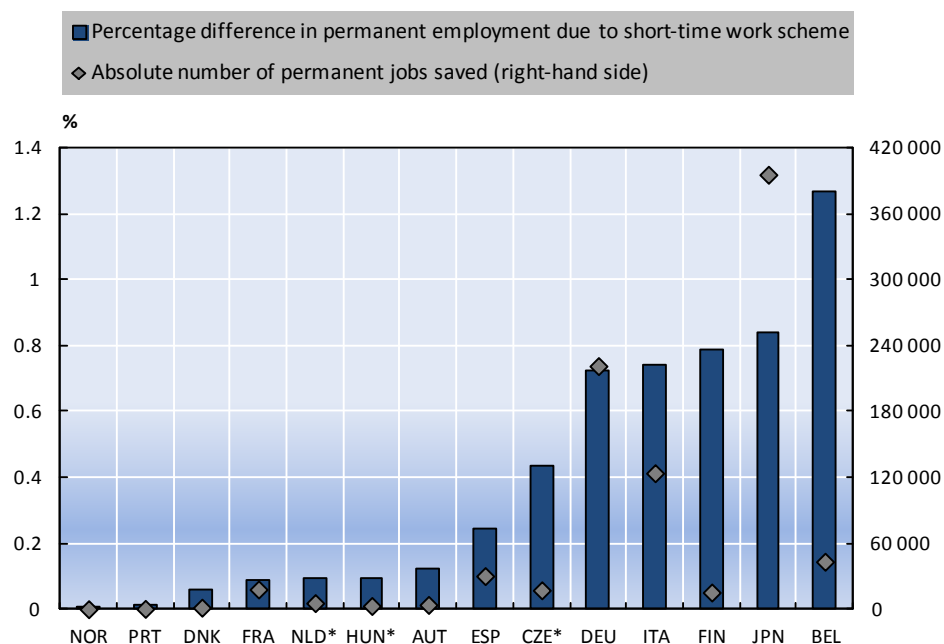
time work to preserving jobs differed significantly across countries. Figure 2 provides estimates of the permanent employment in 2009 Q3 that may have been preserved through STW schemes during the crisis period. Both proportional and absolute job impacts are reported. Differences in the proportional impact of short-time work across countries reflect both differences in the size of the decline in aggregate demand during the crisis period and differences in the average take-up rate, while cross-country differences in the absolute jobs impact of short-time working also reflect differences in the size of their workforces. The country-specific estimates therefore do not take account of the role of differences in the design in short-time work across countries that may have an impact on employment beyond its impact on take-up. In countries where short-time work schemes were only established after the start of the crisis, the impact of short-time work programmes is calculated from the time when the scheme became operational. The following patterns emerge:

- The Belgian short-time work scheme is estimated to have had the largest proportional impact on permanent employment during the recession. The estimates suggest that the decline in permanent employment from the start of the crisis to the end of 2009 Q3 was 1.3 percentage points smaller than what it would have been in the absence of the STW scheme. However, this estimate is based on the implicit assumption that short-time work is used exclusively as a means to deal with the crisis, while before the crisis it is effectively assumed to be zero. Since the pre-crisis take-up values were low or zero in most countries, that appears to be the appropriate baseline for judging the impact of STW schemes during the recession (see Figure 1). However, Belgium is an exception because short-time work was already being used quite extensively prior to the start of the crisis. This means that the jobs impact of crisis-related short-time work in Belgium may be overestimated substantially.
- Short-time work schemes in Finland, Germany, Italy and Japan are also estimated to have substantially reduced the proportional impact of the crisis on permanent employment. The reduction in permanent employment is likely to have been about 0.75 percentage points smaller than it would have been in the absence of short-time work. In Finland, the relatively large proportional impact of STW is primarily attributable to the large reduction in output during the crisis period. The fall in output and the use of STW during the crisis are quite similar in Germany, Italy and Japan with the fall in output amounting to about 5% and the average take-up rate during the crisis being about 1.7%. Among the countries that established a new STW scheme during the crisis period, the proportional impact is estimated to have been largest in Czech Republic.
- The absolute jobs impact is estimated to have been particularly large in Germany and Japan, a reflection of their large workforces and moderately large proportional impacts of STW schemes in preserving permanent employment. Short-time work is estimated to have reduced the loss of permanent employment by over 200 000 in Germany and by almost 400 000 in Japan.

These estimates support the conclusion that short-time work schemes had an economically important impact on preserving jobs during the economic downturn. Comparing these estimates of the net effect of STW schemes in preserving permanent jobs with the full-time equivalent number of employees on short-time work provides an indication of the size of deadweight effects. The full-time equivalent number of employees on short-time work in Germany suggests that the potential increase in employment from STW in 2009 Q3 was about 350 000. Comparing this value with the estimate for Germany in Figure 2 suggests that deadweight losses may have accounted for about a third of the subsidy.

Figure 2. Short-time work schemes helped to preserve permanent jobs in the 2008-09 recession

Proportional and absolute impact on permanent employment due to short-time work schemes from the start of the crisis to 2009 Q3



* indicates countries that introduced a new short-time work scheme in response to the crisis. The estimated jobs impacts refer to period from which the short-time work scheme became operational until the end of 2009 Q3.

Source: OECD (2010).

What are the risks of using public short-time work schemes too intensively or for too long?

While short-time working schemes are a potentially valuable tool for stabilising the incomes of workers on reduced working hours and reducing inefficient layoffs during a temporary labour market downswing, care needs to be taken that the intensive use of short-time work does not deepen labour market segmentation and does not impede labour market efficiency in the longer run.

The OECD’s initial assessment of short-time work suggests that the impact of STW on preserving employment is limited to workers with permanent or open-ended contracts, while no impact is found for workers on temporary contracts. This may indicate that despite the elevated risk of job loss in a recession among temporary workers, such workers participate relatively little in STW schemes. One reason for this is that some countries limit eligibility to regular workers or workers meeting social security contribution thresholds, which many workers in non-regular jobs may not meet in practice. A number of countries have therefore attempted to increase coverage of non-regular workers by relaxing eligibility requirements (e.g. France, Germany and Japan). However, even if workers in non-regular jobs are eligible for short-time work in principle, the incentive for firms to place them on STW is likely to be considerably weaker than for their core workforce. Participation in these schemes tends to be costly for employers, while hiring and firing costs tend to be low for workers in non-regular jobs. In principle, work-sharing requirements (e.g. minimum participation requirements or maximum limits on hours reductions) may help to encourage work-sharing and thereby spread the burden of adjustment across a larger group of workers. Denmark and Switzerland promote this goal directly by requiring that short-time work apply to at least an entire production unit.

By encouraging workers to stay in their jobs, there is a real risk that STW schemes reduce the movement of workers towards higher productivity jobs (i.e. efficiency enhancing labour reallocation) and thereby slow economic growth. Recessions typically entail structural changes that require significant adjustments in terms of

labour-force composition. There is therefore a trade-off between the immediate concern of supporting existing jobs, and the longer-term objective of facilitating the reallocation of jobs and workers toward the most productive firms and sectors. Effective targeting of support to “viable” jobs is difficult, even more so in times of rapidly deteriorating labour market conditions, when support is needed quickly. Moreover, this trade-off between supporting existing jobs and facilitating labour reallocation becomes less favourable in the recovery as firms become better able to retain viable jobs without public subsidies and the efficiency cost of retaining workers in non-competitive jobs increases. To prevent STW schemes from protecting unviable jobs and hindering the required reallocation of labour in the recovery, it will be important to ensure that firms and workers have good incentives to move out of short-time work schemes when the economy recovers; to impose clear and credible time limits to short-time working arrangements, and phase out temporary measures in response to the crisis to encourage STW. The increasingly tight fiscal constraints confronting many OECD governments provides an additional reason to shift progressively towards emphasising greater cost-effectiveness.

The strong interest in combining training and short-time work during the 2008-09 recession may be seen as an attempt by governments to reduce the potential adverse effects of short-time work by enhancing the jobs prospects of workers on short-time work and thereby encouraging worker mobility. However, preliminary figures for countries where short-time work can be combined with training in principle (but is not compulsory) suggest that only a small portion of those on short-time work participated in training. The low take-up rate of training during short-time working may partly be due to the requirement imposed by some countries that training is provided externally. This requirement reflects the desire to promote job mobility, while avoiding subsidising firm-specific on-the-job training. However, in practice, it may not be straightforward to combine external training courses with variable work schedules in the context of short-time working schemes. The difficulty of combining training courses with variable work schedules also raises questions about the effectiveness of training, in countries where this is a compulsory requirement, in improving skills and enhancing worker mobility.

How to make the most of job subsidies to encourage job creation?

In addition to STW subsidies intended to preserve existing jobs, job subsidies may also play a role in helping firms and workers weather the storm of a deep recession. This is likely to be particularly true in the later stages of a recession and the early stages of the subsequent recovery, when the priority is to assure that the rebound in production translates into job creation and recruitments. The main advantage of hiring subsidies relative to general reductions in employers’ social-security contributions or “stock” subsidies more generally is that they tend to be more cost-effective. While stock subsidies may be relatively easy to implement, the fact that the subsidy is paid for all jobs, including jobs that would have existed even in the absence of the subsidy, results in important deadweight losses. By concentrating exclusively on newly created jobs, hiring subsidies have the potential to be significantly more cost-effective.

Past evaluations indicate that gross hiring subsidies can be quite effective, but also that performance has been highly variable (Martin and Grubb, 2001). While it appears to be possible to enhance their effectiveness through careful targeting on disadvantaged groups and stricter conditions for employers in some cases (see below), the overall effectiveness of such measures to improve net employment appears to be quite limited, whereas they appear to be more effective in bringing about a more equal distribution of unemployment across labour force groups. This equity consideration may be of considerable importance in recessions, when the chances of regaining employment after displacement are particularly low for disadvantaged groups, due to the large inflows of newly unemployed, including increased numbers of well-qualified job losers. Targeted recruitment subsidies may also be needed in a deep recession to keep job-search requirements associated with UI credible, at a time when the immediate returns to job-search assistance is likely

to be unusually low for harder-to-place job seekers.

Marginal employment subsidies refer to labour demand policies that are explicitly targeted at raising net employment via either the preservation of jobs at risk or the creation of new jobs. This suggests that they have the potential to be much more cost-effective in raising total employment, than either stock or gross hiring subsidies because leakages via deadweight and displacement effects are largely avoided. While this would appear to be a programme design that is especially well suited for strengthening job creation in the early phases of a recovery (*i.e.* in preventing a “jobless recovery”), there has been only relatively limited use of such schemes during the current downturn and recovery, many of them targeting vulnerable jobseekers such in the long-term unemployed or youth (see Box 2). This probably reflects the relative complexity of such schemes and the widespread impression that the marginal employment schemes which operated in a number of countries in the past proved to be difficult to administer effectively.

Box 2. Marginal employment subsidy schemes in OECD countries

Belgium has marginal hiring subsidies that pre-date the 2008-09 recession. An employer who hires a first, second or third employee pays reduced social security contributions (with the largest reduction for the first employee and successively smaller reductions for subsequent employees) if the new employees do not replace someone who resigned or was dismissed in order to receive the subsidy.

Between 2007 and 2011, *Finland* is conducting an experiment with marginal employment subsidies in peripheral regions with difficult employment situations or those that have suffered from large job losses due to the closure of a local factory. A subsidy of 30% of wage costs in the first year and 15% in the second year is paid to self-employed people who hire their first paid employee. The job has to have a permanent contract and working time must be at least 25 hours per week.

Portugal has introduced a temporary programme called the *Programa Iniciativa Emprego* during 2009 and 2010, which eliminates employer social contributions for net new hires of long-term unemployed (registered with PES for more than six months) or young people (aged up to 35 years looking for their first job) for the first three years of employment (or for the first two years in addition to a EUR 2 500 hiring subsidy). Firms must have net hiring over a three-year period, meet certain accounting standards, fulfil tax and social security obligations and not have wage arrears.

The *Employer Jobs (PRSI) Incentive Scheme* in *Ireland* eliminates employer social security contributions for one year for new hires in addition to existing staff of people unemployed for six months or more. The new job must last for at least six months, otherwise the firm must pay back the subsidy. Participation is capped at 5% of the existing workforce.

Hungary's SME+ programme exempts small businesses and non-government organisations from social security contributions for one year for net employment increases resulting from new hires of employees affected by collective layoff, someone who has been registered as a jobseeker for at least three months or who has not been employed for at least one year. Firms must employ the subsidised employee for at least twice as long as the duration of the subsidy.

Turkey waives employer social contributions for the first five years of employment for employers that hire women or youth (18-29 years) who have been unemployed for at least six months before July 2008 or in December 2008 and January 2009. Employment must be additional to average employment in the firm over the past 12 months.

A key question that is particularly important for governments who are considering to implement a marginal employment subsidy at present but face increasingly tight fiscal constraints, is whether such schemes should be targeted at all new workers or only at the unemployed. Restricting eligibility to the unemployed will reduce the total cost of the programme by reducing its scope (*i.e.* the number of subsidised jobs), but also the cost per worker as many of the additional hires will result in a reduction in public expenditure on UI or other income-transfer benefits. However, restricting eligibility in this way is also likely to reduce the impact of the scheme on

overall employment and unemployment. This could happen if restricting eligibility increases the effective cost of recruiting workers under the scheme by reducing the pool of potential candidates. Nonetheless, past experience with the Canadian Employment Tax Credit Program suggests that restricting eligibility to unemployed workers can be compatible with achieving a significant scale when subsidies are sufficiently generous.

A related question is to what extent such schemes should target specific types of firms or workers. For example, small firms may not be able to hire as many workers as they would like early in the recovery because they are more likely to face tight credit constraints. The effectiveness of subsidies may also differ across different groups of workers. To the extent that the responsiveness of the demand for workers with low hiring and firing costs to changes in labour costs is larger – which is likely since such workers tend to compete in more competitive markets –, there may be a rationale for targeting hiring subsidies at workers that are least likely to be hoarded, *i.e.* low wage workers and workers with limited experience and skills. However, it is also possible that subsidies targeted at such workers will be less effective because they end up at the back of the hiring queue or because they reduce take-up.

Does public-sector direct job creation have a role to play to help dis-advantaged jobseekers?

Direct job creation in the public sector is another tool for expanding employment opportunities for hard-to-place job seekers. While direct job creation in the public sector may be considered as representing a 100% hiring subsidy from an accounting perspective, its implications are rather different from conventional marginal employment subsidies from a resource-allocation perspective, because the market mechanism no longer determines which jobs are created. It is also useful to differentiate between large-scale temporary public works programmes that were included in the fiscal stimulus packages enacted by a number of countries and more targeted programmes that are operated as labour market measures which are intended to provide work experience for persons who face particular barriers to integrating into employment (*e.g.* the long-term unemployed).

Large-scale temporary public works programmes have been used by a number of governments to tackle rising unemployment in past recessions. The fiscal stimulus measures adopted by many OECD and non-OECD countries in response to the crisis – particularly their infrastructure investment components – are to varying extents viewed as public works projects that directly create jobs and the direct employment effect can be substantial.¹ While it can be useful to concentrate such measures in recessionary periods characterised by excess labour supply, they must be justified in terms of the inherent value of the goods and services produced.

Evaluation studies of targeted direct job-creation programmes in OECD countries have generally been disappointing. They tend to conclude that that “workfare” schemes do not help much participants to later find permanent employment in the private sector (Martin and Grubb, 2001). The lock-in effect created by these programmes tends to be strong and inhibits mobility into non-subsidised jobs, because programme participation tends to reduce job search and the managers of these schemes typically have no incentive to help participants (*i.e.* their workforce) to find regular employment. In light of this disappointing experience, many OECD countries moved away from direct job-creation schemes in recent decades, although they continue to represent an important active labour-market policy measure in some countries. However, this generally negative assessment of direct job creation programmes in OECD countries may be less applicable in the context of a severe recession, when it is particularly difficult to place disadvantaged job seekers into regular jobs. In emerging economies, direct job creation can play an essential role in providing a post-crisis safety net to the newly unemployed who are

¹ Spain set up a State Fund for Local Investment in Spanish municipalities in 2008 with a total budget of EUR 8 billion, which by 30 June 2009 had invested nearly EUR 5 billion and reported the creation of nearly 400 000 jobs.

not covered by unemployment compensation schemes and are at risk of poverty.

Historically, direct job-creation schemes frequently have been scaled up strongly in recessions. Consistent with this pattern, a number of countries have announced expansions of public-sector job-creation programmes in response to the current downturn (*e.g.* Korea, Mexico, Spain). The main potential advantage of such measures in recessions is that temporary public-sector jobs may provide a useful way to help prevent hard-to-place job losers from becoming too disconnected from the labour market and, hence, could act as a backstop to re-employment programmes, helping to maintain the credibility of this policy orientation in the context of severe labour market slack. Good programme design may also help to reduce lock-in and dependency effects. One way of doing so may be to offer part-time work combined with job-search support and the obligation to look for work backed by the threat of moderate benefit sanctions. Financial bonuses may also be offered to public sector employers and NGOs to motivate them to provide general training to programme participants and help them find regular employment in unsubsidised jobs. Keeping wages sufficiently low, but high enough to prevent participants from falling into poverty will also help to limit such programmes to those who need it most and to maintain strong job-search incentives. However, such programmes should always be temporary to guard against them becoming a disguised form of subsidised permanent unemployment.

In sum, a temporary expansion of direct job creation may be able to play a useful role in backstopping re-employment policy measures through a period of labour market slack, but they appear to have limited value when labour market conditions are better, especially in OECD countries, and hence should be shrunk as the recovery progresses.

Further information

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Related reading

Hijzen, A. and D. Venn (2010), "The role of short-time work schemes during the 2008/09 recession", OECD Social, Employment and Migration Working Papers, forthcoming.

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OECD (2009a), *OECD Employment Outlook 2009*, Paris, <http://www.oecd.org/dataoecd/6/1/45219634.pdf>.

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