

**WHAT WORKS AMONG ACTIVE LABOUR MARKET POLICIES:  
EVIDENCE FROM OECD COUNTRIES' EXPERIENCES**

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## INTRODUCTION

High and persistent unemployment has been a major blot on the economic and social record of most OECD countries since the early 1970s: the OECD average standardised unemployment rate rose from just over 3 per cent in 1973 to 7.1 per cent in 1998. In response to growing political concerns about the seemingly inexorable rise in unemployment, OECD Ministers gave the Organisation a mandate in 1992 to analyse the causes and consequences of high and persistent unemployment and propose effective remedies to deal with the problem.

The first fruits of this work, published in 1994 under the title *The OECD Jobs Study*, included a list of more than 60 detailed policy recommendations backed up by two volumes of research – see OECD (1994*a, b*). Ministers then mandated the Organisation to pursue its analytical work in certain areas, including an examination of how to make active labour market policies a more effective weapon in the fight against high and persistent unemployment. They also asked the Organisation to take the detailed policy recommendations and match them to the needs and circumstances of each individual OECD country, and to monitor progress in the implementation of these recommendations and their impacts on labour market performance.

This paper does not report on progress in the implementation of the OECD Jobs Strategy recommendations by individual OECD countries<sup>1</sup> and the effects on labour market outcomes. Instead, it confines its remit to a narrower topic: what is the potential contribution which active labour market policies can make as part of a strategy to combat high and persistent unemployment and the problems of low pay and poverty among the working-age population? In order to answer this question, it is vital to know *what works* among active labour market policies and *in what circumstances*. The OECD Secretariat has been working intensively on these questions in recent years and this paper summarises the main results of our work to date.<sup>2</sup>

The structure of the paper is as follows. The second section provides some factual background on public spending on labour market policies in OECD countries over the past decade, drawing on an internationally comparable data set which the OECD has developed to monitor trends in this field of public spending. The bulk of the paper then summarises the main results of on-going OECD research into the effectiveness of active labour market policies. This review mainly exploits two sources: i) the recent literature on the evaluation of labour market programmes and

ii) in-depth country reviews which the OECD has conducted over the past seven years on the interactions between active and passive labour market policies. The final section draws some conclusions.

## RECENT TRENDS IN PUBLIC SPENDING ON LABOUR MARKET PROGRAMMES

Public spending on labour market programmes absorbs significant shares of national resources in many OECD countries, these policies being expected to achieve a variety of economic and social objectives. For analytical and policy purposes, the OECD splits this spending into so-called “active” and “passive” measures where the former comprise a wide range of policies aimed at improving the access of the unemployed to the labour market and jobs, job-related skills and the functioning of the labour market while the latter relate to spending on income transfers (see Box 1)

The OECD has been collecting comparable data on public spending on labour market measures since 1985. Figure 1 shows that the typical OECD country spent over 2¼ per cent of its GDP on active and passive labour market measures in 1997. There is also a wide variation across countries in the share of public spending on labour market measures, ranging in 1997 from a low of under 0.5 per cent of GDP in the Czech Republic, Japan, Korea and the United States to a high of almost 6 per cent in Denmark.

### Indicators of the spending effort on active labour market policies

Within the total public spending on labour market policies, the main focus of this paper is on the fraction devoted to *active* measures. Using the OECD data set, it is possible to compute three different indicators of the “spending effort” which countries devote to active policies: *i*) the share of public spending on active measures as a percentage of GDP; *ii*) spending on active measures per person unemployed relative to average earnings; and *iii*) the number of participants on active programmes relative to the size of the labour force. The three indicators in question are all highly correlated with each other (see Box 2).

Data on the first indicator are shown in Table 1. These data show a wide disparity in spending on active measures in 1997, ranging from a low of 0.2 per cent of GDP or less in the Czech Republic, Japan, Korea and the United States to a high of over 2 per cent in Sweden. There has been almost no trend since 1985 in the OECD average spending devoted to active measures, compared with a slight upward trend in the EU.

### Box 1. The OECD data base on labour market programmes

The OECD data base covers five main categories of “active labour market programmes” (ALMPs) as follows:

- **Public employment services and administration.** This includes the activities of job placement, administering unemployment benefits, and referring job-seekers to available slots on labour market programmes.
- **Labour market training** is divided into two categories: *a)* spending on vocational and remedial training for the unemployed; and *b)* training for employed adults for labour market reasons.
- **Youth measures** include: *a)* training and employment programmes targeted to the young unemployed; and *b)* apprenticeship training, which is mainly for school leavers, not the unemployed.
- **Subsidised employment** is divided into three categories: *a)* hiring subsidies, *i.e.* subsidies paid to private-sector employers to encourage them to hire unemployed workers; *b)* assistance to unemployed persons who wish to start their own business; and *c)* direct job creation for the unemployed in the public or non-profit sectors.
- **Measures for the disabled** include both vocational rehabilitation – training and related measures to make the disabled more employable – and sheltered work programmes which directly employ disabled people.

While the data base mainly provides annual time-series data on public spending on all these separate labour market programmes from 1985 onwards, it also includes data on the numbers who participate on the programmes.

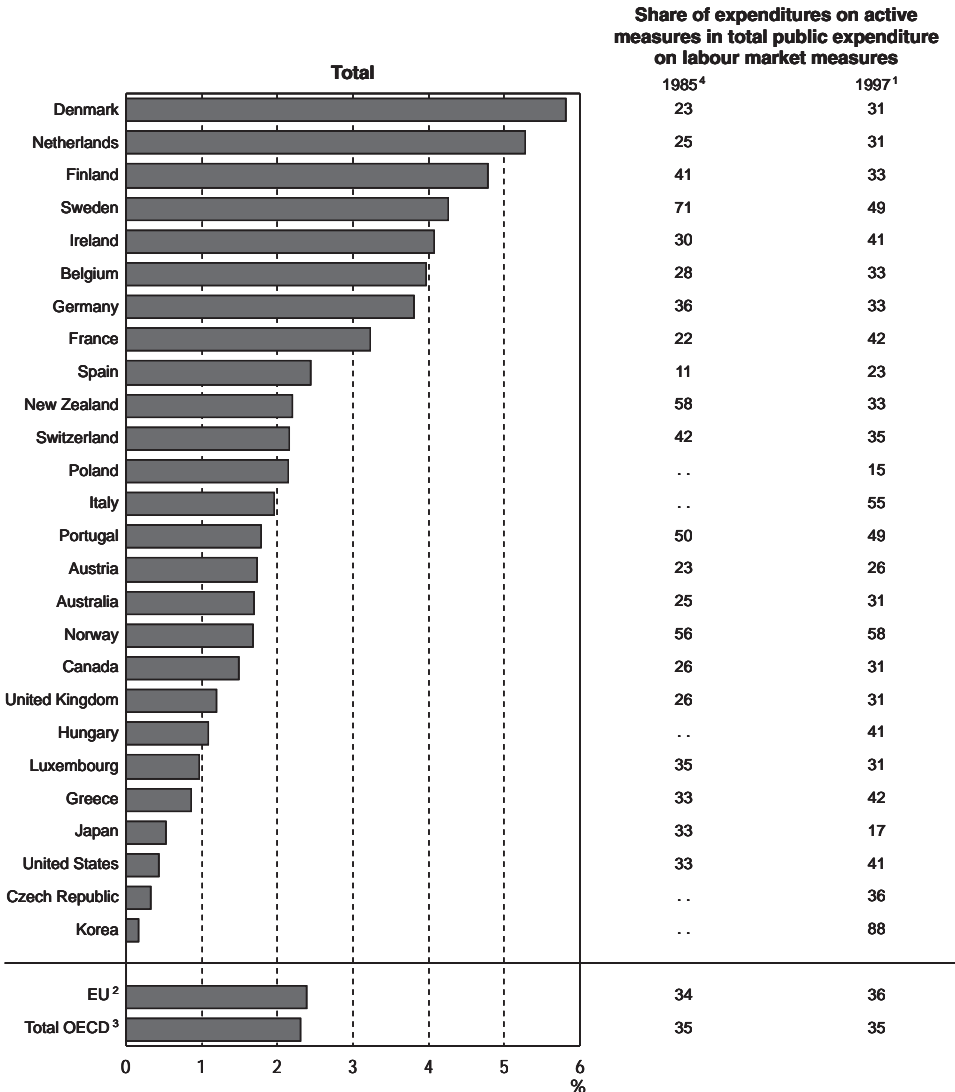
The data base also includes two categories of “passive” spending on labour market programmes:

- **unemployment benefits;**
- **early retirement pensions paid for labour market reasons.**

While the data base is very useful for comparing trends in public spending on labour market programmes across OECD countries, some caveats about its coverage should be noted. First, it only covers public spending on labour market policies. For example, private-sector spending on apprenticeship and training which is very substantial in countries such as Austria, Denmark, Germany and Switzerland, is not included. Second, only spending for labour market reasons is included. Hence, training organised along industrial lines and financed by special payroll taxes is often excluded. Third, spending on labour market policies by sub-national levels of government may sometimes not be fully captured in the data. Finally, the data on participant numbers relate to annual inflows to slots on various labour market programmes. They do not tell us anything about the average length of time which a participant spends on the programme nor do they provide any information on repeat spells on programmes. Danish data for 1997, reported in Madsen (1999), show that the average participant on an ALMP spent just over four months on the programme.

The OECD is co-operating with Eurostat and DG V of the European Commission in an effort to extend the range of information available on public spending on ALMPs and participants on programmes and to improve its comparability.

Figure 1. **Public spending on total labour market measures, 1997<sup>1</sup>**  
Percentage of GDP



.. Data not available.

1. Data refer to 1996 for Ireland, Italy, Poland and Portugal.

2. Unweighted average, excluding Italy.

3. Unweighted average, excluding Czech Republic, Hungary, Italy, Korea and Poland.

4. Data refer to 1986 for Denmark and Portugal, to 1987 for Japan. Germany refers to Western Germany.

Source: OECD Database on labour market programmes.

### Box 2. Correlations between the three indicators of spending effort on ALMPs

Looking at all three indicators together, it is clear that there is a strong positive correlation in the country rankings. This is confirmed by computing Spearman rank correlation coefficients between the indicators using 1997 data:

	ALMP/GDP	ALMP/RR	NNR
ALMP/GDP	–	0.72*	0.60*
ALMP/RR	0.72*	–	0.66*
PART/LF	0.85*	0.68*	0.61**

\* = correlation significant at the 1 per cent level.

\*\* = correlation significant at the 5 per cent level.

where ALMP/GDP = spending on ALMPs as a proportion of GDP;

ALMP/RR = average spending on ALMPs per person unemployed relative to APW earnings;

PART/LF = participants on ALMPs as a percentage of the labour force;

NNR = net replacement rates.\*

It is also interesting to note from the final column that all three indicators of the spending effort on ALMPs are positively and significantly correlated with a summary measure of the net replacement rate, an indicator of the generosity of unemployment and related welfare benefit systems in OECD countries.

\* The data refer to the OECD summary measure of benefit entitlements which is an average of *net* (i.e. after-tax) replacement rates for two earnings levels, three family situations and three durations of unemployment. The data refer to 1994/95. For further details, see Martin (1996).

The second indicator measures public spending on active measures per person unemployed relative to the earnings of an average production worker (APW) in the manufacturing sector. This indicator is a crude proxy for the average compensation paid to participants on active labour market programmes relative to their expected earnings in work, *i.e.* it is equivalent to the replacement rate for unemployment benefits.<sup>3</sup> However, the data in Table 2 are less than ideal for this purpose since they do not relate to that fraction of the unemployed who participate on active measures, but instead relate active spending to the *total* stock of the unemployed in a given year irrespective of whether they participated in a programme or not. In addition, the spending data include items other than the compensation or training allowances paid to programme participants. Be that as it may, the data in Table 2 reveal a high disparity in spending effort per person unemployed relative to APW earnings across countries in 1997, ranging from around 5 per cent or less in

Table 1. **Spending on active labour market policies, 1985-97**

Percentage of GDP

	1985	1990	1994	1997
Australia	0.4	0.3	0.7	0.5
Austria	0.3	0.3	0.4	0.4
Belgium	1.3	1.2	1.4	1.3
Canada	0.6	0.5	0.6	0.5
Czech Republic	..	0.2 <sup>4</sup>	0.2	0.1
Denmark	1.1 <sup>2</sup>	1.1	1.8	1.8
Finland	0.9	1.0	1.7	1.6
France	0.7	0.8	1.3	1.4
Germany <sup>1</sup>	0.8	1.0	1.4	1.2
Greece	0.2	0.4	0.3	0.4
Hungary	..	0.6	0.6	0.4
Ireland	1.5	1.4 <sup>5</sup>	1.6	1.7 <sup>6</sup>
Italy	..	1.4 <sup>4</sup>	1.4	1.1 <sup>6</sup>
Japan	0.2 <sup>3</sup>	0.1	0.1	0.1
Korea	..	0.1	0.1	0.1
Luxembourg	0.5	0.3	0.2	0.3
Netherlands	1.2	1.3	1.6	1.7
New Zealand	0.9	0.9	0.7	0.7
Norway	0.6	0.9	1.3	1.0
Poland	..	0.3 <sup>5</sup>	0.4	0.3 <sup>6</sup>
Portugal	0.4 <sup>2</sup>	0.6	0.7	0.9 <sup>6</sup>
Spain	0.3	0.9	0.6	0.6
Sweden	2.1	1.7	3.0	2.1
Switzerland	0.2	0.2	0.4	0.8
United Kingdom	0.8	0.6	0.5	0.4
United States	0.3	0.2	0.2	0.2
EU <sup>7</sup>	0.9	0.9	1.2	1.1
Total OECD <sup>8</sup>	0.7	0.7	0.9	0.8

.. Data not available.

1. Data are for Western Germany only, prior to 1990; they are for the whole of Germany from 1991 onwards.

2. 1986.

3. 1987.

4. 1991.

5. 1992.

6. 1996.

7. Unweighted average excluding Italy.

8. Unweighted average of above countries excluding Czech Republic, Hungary, Italy, Korea and Poland.

Source: OECD Database on labour market programmes.

the Czech Republic, Japan, Poland and Spain to a high of over 50 per cent in Sweden. Given that the average participant on an ALMP may well spend only a fraction of a year on the programme in question (see Box 1), it is likely that these data underestimate significantly the replacement rate which programme participants face.

Table 2. **Spending on active labour market policies per person unemployed,<sup>1</sup> 1985-97**

	Percentage of APW earnings			
	1985	1990	1994	1997
Australia	8.8	5.9	11.6	9.7
Austria	16.3	20.5	20.5	22.9
Belgium	16.7	24.9	18.7	18.8
Canada	9.8	10.9	9.6	8.3
Czech Republic	..	..	10.1	5.7
Denmark	29.5 <sup>3</sup>	18.8	33.4	42.8
Finland	33.7	56.3	15.4	19.0
France	15.6	23.7	26.6	26.3
Germany <sup>2</sup>	16.8	29.5	25.7	20.1
Greece	5.1	12.4	7.8	8.5
Hungary	..	17.1	15.0 <sup>6</sup>	19.5
Ireland	13.8	19.2 <sup>5</sup>	20.0	28.9 <sup>7</sup>
Italy	..	28.2 <sup>4</sup>	26.9	20.1 <sup>7</sup>
Japan	10.4	11.5	6.3	4.6
Korea	..	..	5.2 <sup>6</sup>	7.1
Luxembourg	58.6	65.3	18.9	31.8
Netherlands	20.8	26.7	36.1	46.4
New Zealand	38.4	18.1	14.8	17.5
Norway	49.8	33.6	49.5	46.7
Poland	..	..	5.1 <sup>6</sup>	5.1 <sup>7</sup>
Portugal	8.8 <sup>3</sup>	32.9	25.7	31.9 <sup>7</sup>
Spain	3.1	11.6	5.5	5.7
Sweden	146.8	205.1	76.5	50.8
Switzerland	..	18.9 <sup>4</sup>	18.0	29.0
United Kingdom	9.8	17.5	9.0	8.6
United States	7.0	8.5	7.0	7.8
EU <sup>8</sup>	28.2	39.5	24.4	25.5
Total OECD <sup>9</sup>	26.0	32.6	21.9	22.9

.. Data not available.

1. This variable measures spending on ALMPs per person unemployed as a percentage of the average production worker (APW) earnings.

2. Data are for Western Germany only, prior to 1990; they are for the whole of Germany from 1991 onwards.

3. 1986.

4. 1991.

5. 1992.

6. 1995.

7. 1996.

8. Unweighted average excluding Italy.

9. Unweighted average of above countries excluding Czech Republic, Hungary, Italy, Korea, Poland and Switzerland.

Source: OECD Database on labour market programmes for data on spending, GDP and labour force; OECD *Labour Force Statistics* for data on unemployment; OECD *The Tax/Benefit Position of Employees* for APW earnings.



Table 3. Participant inflows to active labour market programmes, 1986-97

Percentage of the total labour force

	1986	1990	1994	1997
Australia	3.6	3.2	8.0	5.3
Austria	..	2.4	..	..
Belgium	..	10.9	13.5	15.1
Canada	2.4	2.5	3.2	2.7 <sup>6</sup>
Czech Republic	..	1.3 <sup>3</sup>	0.9	0.6
Denmark	9.5	11.0	18.4	24.5
Finland	4.5	5.3	12.0	13.1
France	6.1	7.7	11.5	10.1
Germany <sup>1</sup>	3.8 <sup>2</sup>	4.0	4.1	3.5
Greece	..	2.5	2.5	..
Hungary	..	3.8 <sup>4</sup>	4.2	4.8
Ireland	7.8 <sup>2</sup>	6.9	11.5	11.3 <sup>6</sup>
Italy	..	..	..	..
Japan	..	..	..	..
Korea	..	0.2	0.6	2.7
Luxembourg	..	..	..	..
Netherlands	2.3	3.2	4.1	5.8
New Zealand	..	8.4	10.4 <sup>5</sup>	..
Norway	..	..	..	..
Poland	..	..	4.6	3.9 <sup>6</sup>
Portugal	1.5	4.7	4.7	10.0 <sup>6</sup>
Spain	6.6	7.6	2.0	4.4
Sweden	4.7 <sup>2</sup>	3.7	14.4	13.4
Switzerland	0.4	0.5	2.1	..
United Kingdom	..	2.2	2.6	2.1
United States	3.0 <sup>2</sup>	2.7	..	..
EU <sup>7</sup>	..	6.1	9.0	10.3
Total OECD <sup>8</sup>	..	4.9	7.2	8.1

.. Data not available.

1. Data are for Western Germany only, prior to 1990; they are for the whole of Germany from 1991 onwards.

2. 1987.

3. 1991.

4. 1992.

5. 1995.

6. 1996.

7. Unweighted average excluding Austria, Greece, Italy and Luxembourg.

8. Unweighted average excluding Austria, Greece, Italy, Japan, Luxembourg, New Zealand, Norway, Poland, Switzerland and the United States.

Source: OECD Database on labour market programmes.

The third indicator reports data on the numbers engaged in labour market programmes (Table 3). Over 8 per cent of the labour force in the typical OECD country participated in these programmes in 1997, up from 5 per cent in 1990. Data on inflow rates reveal a similar wide disparity across countries to that

shown by the other indicators, ranging from 3 per cent or less of the labour force in 1997 in Canada, the Czech Republic, Korea and the United Kingdom to almost 25 per cent in Denmark.<sup>4</sup>

### **Has there been a shift from passive to active measures?**

In recent years, it has become a common theme in the political debate on remedies to tackle the unemployment problem that Governments should shift the balance of public spending on labour market policies away from passive income support towards more active measures designed to get the unemployed back into work. At first sight, this seems an eminently sensible proposal: why should our societies pay the unemployed to be idle when the public funds in question could be used instead to supply them with a range of labour market services which should raise their chances of getting a job and their future earnings prospects?

The basic principle of shifting public resources from income support to active labour market policies has been endorsed on several occasions in recent years by OECD Labour Ministers, most recently at their meeting in Paris on the 14-15 October 1997.<sup>5</sup> The same principle also forms part of the EU Employment Guidelines, which were formulated following the Amsterdam Summit in 1997.

Have countries managed to switch resources into active measures in line with the principle endorsed by Ministers? Progress has been extremely limited in terms of this goal: for the typical OECD country, Table 1 shows that spending on active measures rose only from 0.7 per cent of GDP in 1985 to 0.8 per cent in 1997. More disappointingly, the share of spending on active measures as a proportion of total public spending on labour market programmes was stable or declined between 1985 and 1997 in over one-third of the countries (see Figure 1).<sup>6</sup> Furthermore, Italy, Norway, Portugal, and Sweden were the only OECD countries where spending on active measures was equal to or exceeded spending on passive measures in 1997.

One obvious reason for the very limited success in switching resources into active measures over the past decade is the rising trend in unemployment in many countries. As unemployment and related welfare benefits are entitlement programmes, increases in unemployment bring in their wake an automatic increase in public spending on passive income support. Spending on active labour market programmes, on the other hand, is discretionary. In addition, as the next section makes clear, the track record of many active programmes is patchy in terms of achieving their stated objectives. This has led many policy-makers to be wary of authorising large spending increases on new or existing programmes.<sup>7</sup>

## ACTIVE POLICIES: WHAT WORKS AND WHAT DOES NOT

### Macroeconomic evaluations

Since the ultimate aim of active policies is to cut overall unemployment and/or raise earnings, an obvious approach to assessing their effectiveness is to seek to establish robust econometric relationships between key macroeconomic aggregates such as unemployment or real wages and various measures of the spending effort on active policies. There is, indeed, a small but growing empirical literature on this approach: Calmfors (1994, 1995), Calmfors and Skedinger (1995), Danish Ministry of Finance (1999), Forslund and Krueger (1994), Jackman *et al.* (1990), Jackman (1994), Layard *et al.* (1991), Nickell (1997), Nickell and Layard (1997), have all published articles on this topic recently. The OECD Secretariat has also contributed to this literature – see Chapter 2 in the 1993 edition of the OECD *Employment Outlook* and recent articles by Scarpetta (1996) and Elmeskov *et al.* (1998).

This literature is not reviewed here. However, it is fair to conclude that the jury is still out on the matter: the results of the various econometric analyses are inconclusive, some studies appearing to show robust effects of active policies in terms of lowering the natural or equilibrium rate of unemployment or real wage pressures, others appearing to show zero or insignificant correlations. This literature is bedevilled by a number of data and technical difficulties, notably simultaneity bias since cross-country comparisons reveal that the amount of spending on active programmes is positively related to the unemployment rate.<sup>8</sup> Because of these uncertainties, the rest of this section concentrates on the main findings from the evaluations of *individual* labour market programmes.

### The literature on evaluation of individual programmes

There is a large literature, which seeks to evaluate the outcomes of individual programmes. These evaluations can be divided into two main types. The first type seeks to measure the impact of programme participation on individuals' employment and earnings after they have left the programme, judging the outcomes against the experiences of a benchmark or control group of similar individuals who did not participate in the programme. This type of evaluation makes sense for those active programmes which attempt to make participants more productive and competitive in the open labour market, *e.g.* training and job-search assistance.

The second type of evaluation attempts to measure the net effects of programmes on aggregate employment and unemployment by estimating what are called in economists' jargon "dead-weight", "substitution" and "displacement" effects. These evaluations are mostly relevant for employment programmes, *i.e.* programmes that attempt to stimulate job creation in the private sector (including self-employment), as well as direct job creation in the public sector. Since sub-

sidised employment programmes have the explicit objective of increasing the number of jobs in the economy at large and/or raising the employment prospects of the target group, evaluations must determine whether the subsidised jobs would have been created anyway in the absence of the subsidy (so-called dead-weight effects). They must also seek to quantify whether improved employment prospects for the target group come at the expense of worsened employment prospects for other non-subsidised workers (so-called substitution effects), or whether the subsidised jobs have displaced, or have been substituted for, unsubsidised jobs elsewhere in the economy (so-called displacement effects).

### **Caveats to bear in mind when assessing the literature on programme evaluation**

Before turning to the main findings from the recent evaluation literature, it is important to stress some caveats concerning the reliability and generality of the conclusions that can be drawn from this literature.

First, much of the evaluation literature relates to the United States and Canada where there is a long-standing tradition of evaluating labour market programmes. Indeed, in both countries, there is effectively a mandatory requirement on the public authorities to evaluate their programmes. Few European countries have carried out rigorous evaluations until recently. This unsatisfactory situation is changing slowly, as tight fiscal constraints make it imperative to get better value for public spending on active labour market policies. As a result, some European countries (I would single out Norway, Sweden and the United Kingdom in this regard) and Australia are beginning to undertake rigorous evaluations of their labour market programmes. However, in other countries, the most common method of “evaluation” consists of simply monitoring the labour market status and earnings of participants for a brief period following their spell on a programme. While this sort of exercise provides useful information, it cannot answer the vital question of whether the programme in question “worked” or not for participants.<sup>9</sup>

Second, one must recognise that there is almost never a *stable* set of active programmes to evaluate. Countries are continuously chopping and changing the mix of programmes. For example, Grubb (1995) highlights the strong tendency on the part of the US Congress to respond to specific new problems with a specific new programme rather than to incorporate new purposes into existing programmes.<sup>10</sup> This leads to a proliferation of programmes, many of which are overlapping, may tend to cancel each other out, are costly to administer and confusing to both employers and the unemployed they are supposed to assist. Such programme “innovation” complicates the task of the evaluator greatly.

Third, there is very little evidence on the *long-run* effects of active programmes. The vast majority of rigorous evaluations only provide evidence on short-run outcomes, covering at best one to two years after the person has participated in the

programme.<sup>11</sup> This may well be too short a period for a full assessment of the private and social returns to public investment in many active measures.

Fourth, “outcomes”, in the evaluation literature, are invariably expressed in terms of programme impacts on future earnings and/or re-employment prospects of participants, and this stress is reflected in this paper. There is little or no evidence available on potential social benefits which could flow from programme participation such as reduced crime, less drug abuse or better health.

Fifth, there is an issue about the *scale* of programmes, even those which appear to work. Many programmes, which have been evaluated rigorously, tend to be small-scale programmes – sometimes called “demonstration” programmes. Even if such programmes “work” in terms of producing statistically significant outcomes for participants, it is unclear from the existing literature how cost-effective they would be if they were greatly extended in terms of scale of participation or geographic coverage.

Sixth, many evaluations are undertaken by public sector agencies. While there are good reasons for this, it does give rise to concerns about independence of findings. Therefore, where evaluations are undertaken by public sector agencies, it is important to check whether there has been any *external* validation of the evaluation results in question.

Finally, while the evaluation literature tells us quite a lot about *what* works, it is not very instructive in answering other equally important and related questions, such as why do certain programmes work for some groups and not for others (see below), and in what circumstances? It is not helpful in explaining what combination of employment services is likely to work. For example, there is almost no evidence on which types and content of training programmes work best. Do skill-enhancing activities *e.g.* via classroom training and/or on-the-job training, work best or must they be combined with personal counselling, job-search assistance and mentoring services in order to work? Policy-makers want to know the answers to such questions, but the evidence is simply not there for the moment.

## Findings from the evaluation literature

The OECD has reviewed the available evaluation literature in OECD (1993a) and this review was updated in Fay (1996).<sup>12</sup> What does this latest OECD review of the evaluation literature tell us about what works and what does not? Table 4 summarises the main lessons in terms of what works for which groups.<sup>13</sup>

### Public training programmes

Training usually accounts for the largest share of spending on active measures: on average, OECD countries devoted 24 per cent of their total public spending on

Table 4. **Lessons from the evaluation literature**

Programmes	Appears to help	Appears not to help	General observations on effectiveness
Normal classroom training	Women re-entrants	Prime-age men and older workers with low initial education	Important that courses signal strong labour market relevance, or signal "high" quality to employers. Keep programmes relatively small in scale.
On-the-job training	Women re-entrants; single mothers	Prime-age men (?)	Must directly meet labour market needs. Hence, need to establish strong links with local employers, but this increases the risk of displacement.
Job-search assistance (job clubs, individual counselling, etc.)	Most unemployed but in particular, women and sole parents		Must be combined with increased monitoring of the job-search behaviour of the unemployed and enforcement of work tests.
<i>f</i> which: re-employment bonuses	Most adult unemployed		Requires careful monitoring and controls on both recipients and their former employers.
Special youth measures (training, employment subsidies, direct job creation measures)		Disadvantaged youths	Effective programmes need to combine an appropriate and integrated mix of education, occupational skills, work-based learning and supportive services to young people and their families. <i>Early</i> and <i>sustained</i> interventions are likely to be most effective. Need to deal with inappropriate attitudes to work on the part of youths. Adult mentors can help.
Subsidies to employment	Long-term unemployed; women re-entrants		Require careful targeting and adequate controls to maximise net employment gains, but there is a trade-off with employer take-up.
<i>f</i> which: Aid to unemployed starting enterprises	Men (below 40, relatively better educated).		Only works for a small subset of the population.
Direct job creation	Severely disadvantaged labour market groups (?)	Most adult unemployed	Typically provides few long-run benefits and principle of additionality usually implies low marginal-product jobs.

Source: The above table was filled out based on evaluation results presented in DOL (1995), Fay (1996), Friedlander *et al.* (1997), Grubb (1995, 1999), HRDC (1997), Lerman (1997), OECD (1993c) and Stanley *et al.* (1998).

active measures to training programmes in 1997, up from 21 per cent in 1985 (see Table 5). But evaluations of public training programmes in OECD countries suggest a very mixed track record. Some programmes in Canada, Sweden and the United States have yielded low or even negative rates of return for participants when the estimated programme effects on earnings or employment are compared with the cost of achieving those effects.<sup>14</sup>

However, some public training programmes do work. Recent comprehensive reviews of public training programmes for disadvantaged groups in the United States by Friedlander *et al.* (1997) and Stanley *et al.* (1998) highlight quite a number of successful programmes in terms of earnings gains and positive rates of return for participants. It is noticeable that the most consistently positive results were recorded for adult women. The findings were less optimistic with regard to adult men: some programmes gave positive results, others not. The most dismal picture emerged with respect to out-of-school youths: almost no training programme worked for them. Two further findings are noteworthy. First, most of the gains took the form of improved employment opportunities rather than higher hourly earnings. Second, even for those groups for whom participation in the programmes yielded a positive rate of return, the estimated annual earnings gains were typically not large enough to lift most families out of poverty.

As noted above, the available evaluation literature can tell us whether training programmes work for particular disadvantaged groups or not. However, it does not provide satisfactory answers as to why they appear to work for some target groups (*e.g.* adult women) and not for others. Until we have answers to this question, it is going to be extremely difficult to design effective public training programmes.

Such evidence as exists highlights three crucial features in the design of public training programmes in order to enhance their effectiveness: *i)* the need for tight targeting on participants; *ii)* the need to keep the programmes relatively small in scale; and *iii)* the need to have a strong on-the-job component in the programme, and hence to establish strong links with local employers. At the same time, training programmes which foster strong links with local employers are likely to encourage displacement, an outcome which arises when those who participate on the programme get jobs at the expense of individuals who did not participate on the programme.<sup>15</sup>

#### *Job-search assistance*

Unfortunately, it is not possible in the OECD data base at the moment to separate out spending on job-search assistance from the administrative costs of running the public employment service (PES): in 1997, the average OECD country devoted 23 per cent of active spending to PES administration, but much of this comprises the fixed costs of running the service. Job-search assistance comprises many different types of services, for example initial interviews at the PES offices,

Table 5. **Composition of public expenditures on active labour market measures, 1985 and 1997<sup>1</sup>**

Percentage of total public expenditures on active measures

	PES administration		Labour market training		Youth measures		Subsidies to private sector employment <sup>2</sup>		Direct job creation in public sector		Measures for the disabled	
	1985	1997	1985	1997	1985	1997	1985	1997	1985	1996	1985	1997
Australia	27	40	4	13	15	11	17	12	28	13	8	11
Austria	38	31	31	39	10	4	9	7	3	8	8	11
Belgium	13	15	15	22	1	1	2	13	58	39	11	10
Canada	37	39	55	33	5	6	0	7	3	10	0	6
Czech Republic	48	72	3	5	4	5	39	3	6	12	1	3
Denmark	7	7	39	54	20	6	5	4	16	13	12	16
Finland	9	9	29	35	6	15	5	8	41	26	10	8
France	20	12	39	25	25	19	9	23	0	14	8	6
Germany	26	17	25	29	4	6	6	6	15	21	24	22
Greece	40	34	12	18	16	27	26	17	4	0	1	4
Hungary	24	30	24	19	0	0	36	18	15	33	0	0
Ireland	11	15	42	13	34	14	6	15	6	38	1	5
Italy	3	4	1	1	38	39	57	52	0	4	0	0
Japan	17	37	16	35	0	0	61	25	6	2	0	1
Korea	52	26	10	27	36	33	1	2	0	0	1	11
Luxembourg	8	12	0	4	18	46	23	23	0	1	50	15
Netherlands	22	24	11	21	3	6	1	4	3	12	59	32
New Zealand	11	20	16	44	1	11	5	15	65	6	2	4
Norway	19	16	16	14	7	4	3	5	28	2	27	59
Poland	7	7	5	7	49	30	19	31	5	21	14	4
Portugal	18	12	51	33	10	36	3	9	7	4	10	6
Spain	25	14	7	34	1	12	37	26	28	11	2	3
Sweden	12	15	24	21	10	1	5	13	15	20	34	30
Switzerland	40	19	7	30	0	0	1	1	0	29	53	20
United Kingdom	22	43	9	19	35	31	4	0	25	0	4	6
United States	25	34	42	22	12	17	4	1	3	5	14	21
U <sup>3</sup>	18	18	22	25	16	18	13	15	15	14	16	12
Total OECD <sup>3</sup>	22	23	21	24	14	15	15	13	15	13	14	12

<sup>1</sup> Instead of 1985, data refer to 1986 for Denmark and Portugal, to 1987 for Japan, to 1990 for Korea, to 1991 for the Czech Republic and Italy, to 1992 for Hungary and Poland. Instead of 1997, data refer to 1996 for Ireland, Italy, Poland and Portugal.

<sup>2</sup> Including support to unemployed persons starting their own enterprises.

<sup>3</sup> Unweighted average.

Source: OECD Database on labour market programmes.



in-depth counselling at some stage during an unemployment spell, re-employment bonuses, jobs clubs, *etc.* Such services may also be combined with increased monitoring and enforcement of the job-search requirements for receipt of unemployment benefits.

Job-search assistance is usually the least costly active labour market programme. Evaluations from several countries show consistently positive outcomes for this form of active measure.<sup>16</sup> It seems that investment in active placement efforts and raising the motivation of the unemployed, as well as taking steps to encourage and monitor their job-search behaviour, pay dividends in terms of getting the unemployed back into work faster.<sup>17</sup> While the optimal combination of additional job-placement services and increased monitoring of job seekers and enforcement of work tests is unclear, the evidence suggests that both are required to produce benefits to unemployment insurance claimants and society.

One particularly interesting form of job-search assistance is re-employment bonuses, *i.e.* cash payments to unemployment insurance recipients who find a job quickly and keep it for a specified length of time. Such a scheme exists in Japan and Korea and has been experimented with in several US States. The US evaluations show that the bonus payments did reduce the average duration of unemployment benefit receipt significantly. Hence, this form of incentive to the unemployed to find a job quickly is worthy of consideration as part of an arsenal of job-search assistance measures. However, such bonuses can give rise to negative effects too. Their existence may have an effect on the size of the group claiming the bonus. In particular, they may induce workers with a high probability of finding a new job quickly to arrange with their employers to be laid off so as to collect the bonus. In order to minimise such abuse, Japan has several safeguards and controls in place, monitoring the behaviour of both the bonus claimant and his or her former employer.

### *Special youth measures*

On average, OECD countries devoted 15 per cent of spending on active policies to special youth measures in 1997. One of the most disappointing conclusions from the evaluation literature is that almost all evaluations show that special measures are not effective for disadvantaged youths. This holds not only for public training programmes (see above), but also for targeted wage subsidy measures too. Given the depth of public concern about youth unemployment and the large public spending devoted to special youth measures, a high priority must be assigned to discovering the reasons for the dismal track record of such measures and designing and implementing more effective programmes.

Among the large number of negative evaluation results, there are a few hopeful signs. Job Corps in the United States did yield statistically significant earnings gains for disadvantaged youths. However, it had to rely on savings from reduced

criminal activity among the target group to produce a net social benefit, given that it is a high-cost programme.<sup>18</sup> In addition, within national demonstrations such as JOBSTART in the United States, it is possible to identify specific sites where the programme appeared to work for disadvantaged youths. One such example of a site that appeared to deliver large gains is the Center for Employment Training (CET) in San José, California; it was the only one of the 13 JOBSTART sites which delivered statistically significant earnings gains for youths. However, we do not know precisely what factors distinguished the CET site from the other sites or how feasible it would be to replicate their positive results elsewhere.

Grubb (1999) has reviewed the evidence on the few successful education and training programmes for disadvantaged youths in the United States and distilled from it the following five precepts for success:

- i) effective programmes have a close link to the local labour market and target jobs with relatively high earnings, strong employment growth and good opportunities for advancement;
- ii) they contain an appropriate mix of academic education, occupational skills and on-the-job training, ideally in an integrated manner;
- iii) they provide youths with pathways to further education so that they can continue to develop their skills and competencies;
- iv) they provide a range of supporting services, tailored to the needs of the young people and their families; and
- v) they monitor their results and use this information to improve the quality of the programme.

In addition to these precepts, the evidence from Canadian and US evaluations suggests that the biggest pay-offs for disadvantaged youths come from *early* and *sustained* interventions. This involves not only intensive efforts to boost their performance in primary and secondary schooling and reduce drop-out rates, it also reaches back to early childhood including the pre-school period. The limited empirical evidence that is available suggests that early childhood interventions of high quality can have lasting effects on the employment and earnings prospects of disadvantaged children, especially if they are sustained over time and not limited to one-shot interventions.<sup>19</sup> It is also important to target support not only at the youngsters themselves but also at their families and local communities. It cannot be over-emphasised that if young people leave the schooling system without qualifications and a good grounding in the 3Rs, it is well nigh impossible for labour market programmes to overcome these handicaps later on.

Finally, several authors, *e.g.* Lerman (1997), highlight the importance of poor attitudes towards work among disadvantaged youths as a major factor in explaining the dismal record of special youth measures. It is not easy for many programmes to

influence attitudes in ways that improve the jobs and earnings prospects of disadvantaged youths. But mentoring programmes, by providing for both on-going contacts with an adult over an extended period of time and elements of monitoring the behaviour of the young people themselves as well as providing support, can help overcome negative attitudes to work.

### *Subsidies to private-sector employment*

Employment subsidies accounted for 13 per cent of total spending on active measures in the typical OECD country in 1997. Subsidies to private-sector jobs may have a number of objectives other than creating additional jobs. They may seek to enhance effective labour supply by helping individuals to keep in contact with the world of work, thereby maintaining their motivation and skills.<sup>20</sup> For equity reasons they may also be intended to provide the long-term unemployed with jobs, even if this happens largely at the expense of the short-term unemployed. These other goals of wage-subsidy schemes may still be important even if the *net* employment gains of these programmes are very small or zero.

Indeed, most evaluations show that subsidies to private-sector employment have both large dead-weight and substitution effects. As a result, most such schemes yield small net employment gains, particularly in the short term when aggregate demand and vacancies are fixed. For instance, evaluations of wage subsidies in Australia, Belgium, Ireland and the Netherlands have suggested combined dead-weight and substitution effects amounting to around 90 per cent, implying that for every 100 jobs subsidised by these schemes only ten were net gains in employment.

The evaluation evidence also suggests it may be possible to raise the size of net employment gains associated with private-sector wage subsidies to 20-30 per cent or more via tight targeting of the measures to particular groups among the unemployed and close monitoring of employer behaviour in order to curb abuses. However, there is a difficult trade-off for policy-makers here: the evidence also suggests that the more controls are multiplied in order to curb abuse and maximise the net employment gains from wage subsidies, the less willing are firms to participate in such programmes and employer take-up drops off sharply, defeating the ultimate goal of the exercise. In addition, the more tightly the programme is tied to characteristics of "disadvantage", the greater the risk of so-called "stigma" which may discourage the unemployed from availing of such schemes or convey a negative signal to potential employers concerning the expected productivity and motivation of the individual job-seeker in question.

One specific form of wage subsidy that appears to be successful for a small group of unemployed individuals is aid to starting a small business. Controlled experiments in the United States suggest that such schemes result in employment

gains for men, primarily between the ages of 30 and 40, who have relatively high levels of education. Evidence from less rigorous evaluations of such schemes in other countries such as Australia, Ireland, Norway and the United Kingdom tends to confirm longer-term survivability, but only for a relatively small share of all enterprises started up in this manner.

#### *Direct job creation in the public sector*

Spending on direct public sector job creation accounts for relatively similar amounts to public spending on subsidies to private-sector jobs in many countries: on average, the typical OECD country devoted 13 per cent of its spending on active measures to public-sector job creation measures in 1997. The evaluation literature shows fairly conclusively that this measure has been of little success in helping unemployed people get permanent jobs in the open labour market. As a result, there has been a trend away from this type of intervention in recent years, but it appears to be making a comeback now in some OECD countries, especially in Europe, usually as part of a "reciprocal obligation" on the unemployed in return for continued receipt of benefits (see below).

However, OECD countries continue to spend large amounts on public-sector job creation programmes and the policy debate about the utility of this intervention is still alive. Temporary employment programmes in the public sector can be used as a work test for unemployment benefit claimants and as a means of helping the unemployed maintain contact with the labour market, particularly in a recession when aggregate demand is depressed and vacancies are scarce. But since most jobs provided through direct job creation schemes typically have a low marginal product, they should be short in duration and not become a disguised form of heavily subsidised permanent employment.

#### **Assessment**

In sum, our review of the evaluation research highlights the following five principles which should guide the selection of active policies in order to maximise their effectiveness:

First, rely as much as possible on in-depth counselling, job-finding incentives (*e.g.* re-employment bonuses) and job-search assistance programmes. But it is vital to ensure that such measures are combined with increased monitoring of the job-search activity of the unemployed and enforcement of the work test.

Second, keep public training programmes small in scale and well targeted to the specific needs of both job seekers and local employers.

Third, early interventions, reaching back to pre-school, can pay dividends for disadvantaged youths, but they must be sustained. This should include steps to

reduce early school-leaving targeted on at-risk students combined with policies to ensure that they leave the schooling system equipped with basic skills and competencies that are recognised and valued by employers. It is also important to improve poor attitudes to work on the part of such young people and adult mentors can help in this regard.

Fourth, as the duration of unemployment spells lengthens, various forms of employment subsidies may serve to maintain workers' attachment to the labour force. However, employment subsidies should be of short duration, targeted and closely monitored.

Fifth, use subsidised business start-ups for the minority among the unemployed who have entrepreneurial skills and the motivation to survive in a competitive environment.

Finally, if we are to expand the range of international knowledge on "what works" and "why" among active labour market policies, it is vital that more countries begin to evaluate their labour market programmes systematically. Indeed, evaluation should be built into the design of programmes at the beginning rather than being viewed as an *ex-post* exercise. Evaluations should also be undertaken in a rigorous way that allows one to draw useful inferences about the effectiveness of the interventions in terms of their impacts on the employment and earnings prospects of the programme participants and that cover a sufficiently long period so that one can assess whether the programme yields any long-term private or social benefits.

## **INTERACTIONS BETWEEN ACTIVE AND PASSIVE POLICIES**

Recent OECD research also suggests that it is vital to focus on the interactions between active and passive labour market policies if one seeks to enhance the effectiveness of active labour market policies. This research draws heavily on reviews of labour market policies in 17 OECD countries (Austria, Belgium, Denmark, Finland, Germany, Greece, Ireland, Italy, Japan, the Netherlands, Portugal, Norway, Spain, Sweden, Switzerland, the United Kingdom and the United States).<sup>21</sup>

Why is this an important topic? Unemployment and related welfare benefits provide income support to the unemployed while they are searching for jobs. It is well known that such benefits can have significant effects on work incentives for the unemployed and on the wage-setting behaviour of workers and employers. Active labour market policies aim to help the unemployed get back into work and raise their future earnings prospects by providing them with a range of employment services. But they also provide income support to the unemployed while they participate in an active programme and such participation can affect future entitlements to unemployment benefits, thereby influencing the behaviour of labour market

actors.<sup>22</sup> For this reason, it is important to pay attention to the interactions between active measures and unemployment benefit systems.

### Gross and net replacement rates in OECD countries

An obvious starting point to analysing these interactions is the relative generosity of income support to the unemployed via unemployment benefits or the compensation paid while they participate on an active programme. Unfortunately, we do not have data on the latter, only on the former. But it is likely (see Box 2 above) that both forms of income support are highly correlated. Indeed, it seems to be the case in many countries that participants on some active measures are paid unemployment benefits, sometimes with a small top-up. Hence, trends in the generosity of unemployment benefit systems are likely to be mirrored closely in the average compensation paid to programme participants.

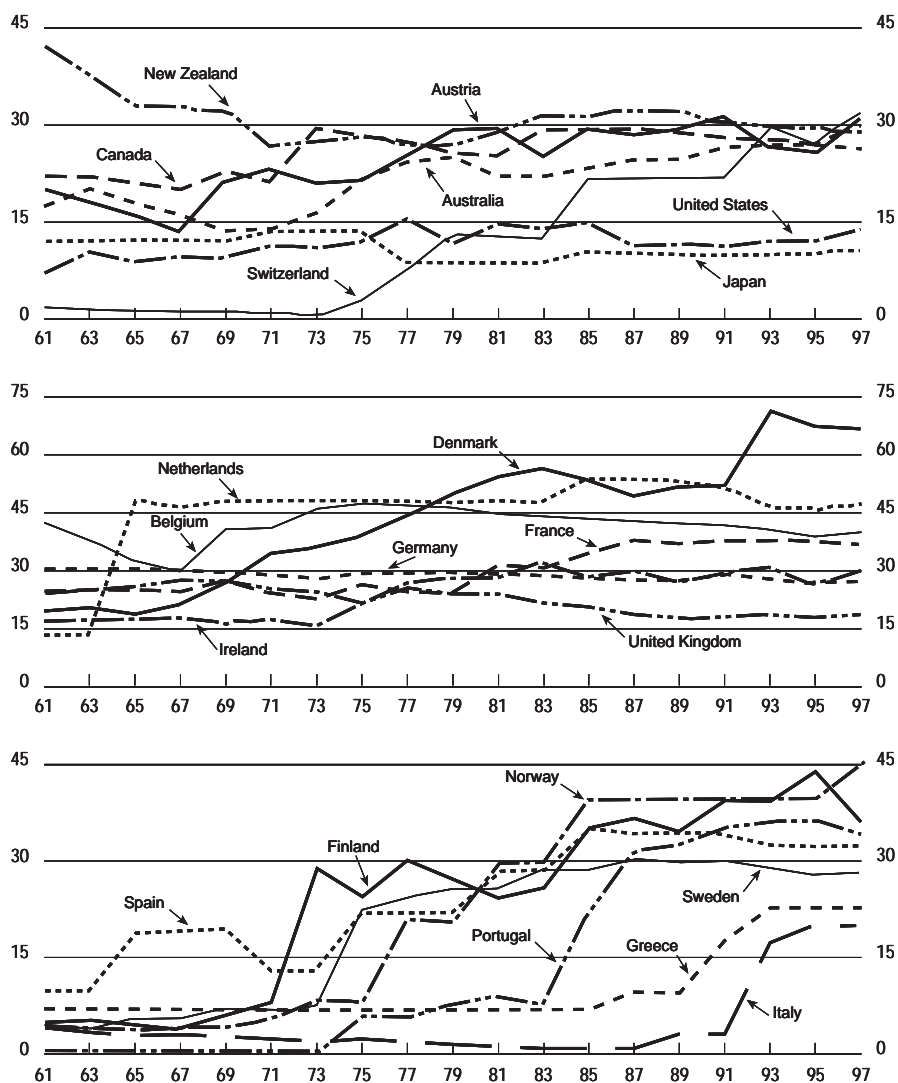
The standard indicator of the generosity of an unemployment benefit system is the so-called "replacement rate", *i.e.* the proportion of expected income from work which is replaced by unemployment and related welfare benefits. The OECD has devoted much effort in recent years to developing a range of *gross* and *net* (*i.e.* after-tax) replacement rates for the purposes of international comparisons.

Figure 2 presents time-series data on the OECD summary measure of unemployment and related welfare benefit entitlements over the period 1961-97. The summary measure in Figure 2 is an average of 18 separate *gross* replacement rates covering a variety of household types, a range of earnings possibilities and different durations of an unemployment spell.<sup>23</sup> It shows that few OECD countries have taken steps to roll back the generosity of their benefit systems in recent years in terms of cutting benefit levels and/or reducing the average duration of benefit payments: the OECD average of the summary measure doubled from 16 per cent in 1961 to 31 per cent in 1997.

At the same time, *net* replacement rates are typically much higher than *gross* rates for a variety of reasons described in Martin (1996). Table 6 shows a selection of net replacement rates from the OECD data base for three different earnings levels: *i*) the earnings of an average production worker (APW); *ii*) two-thirds of the APW level; and *iii*) the first decile of the earnings distribution. These data show that net replacement rates in excess of 80 per cent are quite common in many OECD countries once social assistance benefits, housing benefits and the effect of the tax system are taken into account. While we do not have time-series data on net replacement rates to parallel the data in Figure 2, it seems likely that they too have tended to drift upwards in many OECD countries over the past three decades.

In sum, the available evidence suggests that replacement rates, whether provided through unemployment and related welfare benefit systems or active

Figure 2. The OECD summary measure of benefit entitlements,<sup>1</sup> 1961-1997<sup>2</sup>  
 Percentages of expected earnings in work



1. The OECD summary measure is defined as the average of the gross unemployment benefit replacement rates for two earnings levels, three family situations and three durations of unemployment. For further details, see OECD (1994, Chapter 8) and Martin (1996). The earnings data used to compute replacement rates for 1997 are OECD Secretariat estimates.

2. Final-year data refer to 1995 for Italy and Greece.

Source: OECD data base on unemployment benefit entitlements and replacement rates.

Table 6. **Net replacement rates at different earnings levels<sup>1</sup>**  
1996-1997

	Initial unemployment			Long-term unemployed <sup>2</sup>		
	APW earnings	2/3 APW earnings	1st decile earnings	APW earnings	2/3 APW earnings	1st decile earnings
Australia	74	86	86	74	86	86
Belgium	60	76	77	63	90	91
Canada	69	69	80	77	77	77
Denmark	77	96	96	96	96	96
Finland	84	94	94	97	97	97
France	74	86	85	50	60	60
Germany	74	74	73	52	61	61
Ireland	62	73	75	62	73	75
Italy	54	52	52	18	22	23
Japan	56	64	69	65	95	95
Netherlands	85	90	90	79	94	94
New Zealand <sup>3</sup>	63	78	86	63	78	86
Norway	73	74	74	55	73	69
Spain	74	78	81	43	61	71
Sweden	84	90	90	100	100	100
Switzerland	84	84	84	90	93	91
United Kingdom	64	83	87	74	89	89
United States	61	51	51	48	61	61

1. It is assumed that the worker is 40 years old, has a dependent spouse and 2 children, and started to work at 18. The figures represent replacement rates for newly and long-term unemployed persons. Housing costs are assumed to be 20 per cent of gross APW earnings.
2. Replacement rates for the long-term unemployed relate to persons in the 60th month of their unemployment spell.
3. Data refer to 1995.

Source: OECD data base on taxation and benefit entitlements.

programmes, are sufficiently large to have potentially significant effects on work incentives and on wage-setting behaviour. This, in turn, has led to attempts in recent years to curb the so-called “unemployment trap”.

### **Actions taken by OECD countries to curb unemployment traps**

The most direct step to curb the unemployment trap is to cut replacement rates. However, where actions were taken to cut replacement rates, they were usually motivated by budget considerations rather than out of concern about the possible emergence of benefit dependency or work disincentives. Given the political difficulties with dismantling benefit entitlements, the preferred approach to curbing the unemployment trap in the majority of OECD countries has been to make only marginal cuts in the generosity of benefit entitlements, but to tighten up on eligibility conditions for receipt of benefits and to develop “activation” strategies for the unemployed.<sup>24</sup>



The aim of activation strategies is to encourage the unemployed to be more active in job search and keep more in touch with the labour market. Such strategies range from attempts to provide more effective job-search assistance to the unemployed and monitoring their search activity at one end of the spectrum to making it obligatory on the unemployed to satisfy work tests or participate in active programmes or in education and training if they are to continue to draw benefits. Such activation strategies are becoming quite common for young people in OECD countries (*e.g.* Australia, Denmark, Ireland, United Kingdom), and they are even being extended to other groups of the unemployed in some countries.<sup>25</sup> The recent US welfare reform, with its emphasis on work requirements, time limits for benefits and sanctions for non-compliance, can be viewed as an extreme example of this approach.

The role of active labour market policies changes subtly in the context of an activation strategy. They can then be viewed as a vehicle for enforcing a work test on the unemployed, especially in cases where the supply of job vacancies is low. In such cases, continued receipt of unemployment benefits becomes conditional on programme participation, as is the case in Denmark or Switzerland, and/or by offering a sufficiently wide range of programmes so that a maximum number of the unemployed will choose to enter them voluntarily. In a related manner, there is a growing interest in many countries in the potential role which the rules used to control job-search behaviour and curb benefit abuse by claimants of unemployment benefits can play as part of an effective activation strategy. As noted in the previous section, the evaluation literature suggests that these rules, if used intelligently and supported by effective sanctions, can help stimulate job search and serve to keep benefit claimants in touch with the labour market.<sup>26</sup>

Of course, the key question concerns the effectiveness of such activation strategies. It is impossible at this stage to draw any definitive conclusions since most of the initiatives taken by countries are relatively recent and there are almost no rigorous evaluations of them available yet.

However, some scattered evidence does suggest that activation strategies, combining elements of carrots and sticks, can work in terms of producing better labour market outcomes for the unemployed. The UK Restart programme, which was started in 1987, can be viewed as a prototype for such strategies. Under this programme, all persons unemployed for six months were obliged to attend a Restart interview at the PES. The interview assessed the individuals' job-search behaviour and motivation and assisted them with availing of other services and programmes to help them find a job. A rigorous evaluation indicated that Restart did work and, as a result, the periodicity of Restart interviews was increased during the 1990s.<sup>27</sup> The recent steps taken in Denmark to introduce activation strategies have been evaluated by the Danish authorities. Madsen (1998) argues that the preliminary evidence from the evaluations suggests that the activation strategies have

been successful in terms of improving employment prospects for the unemployed, especially for the young unemployed.

Finally, many workfare experiments were designed and operated by individuals US states in the 1980s and 1990s in advance of the 1996 welfare reform. Solow (1998) reviews the rigorous evaluation evidence on the effectiveness of these workfare initiatives and concludes that they did have statistically significant effects in raising the employment and earnings prospects of welfare recipients, but the effects were not large. Of course, as Solow recognises, one cannot generalise from the results of these individual workfare experiments to draw conclusions about the likely effects of the 1996 welfare reform. There has been a sharp drop in welfare rolls since the reform, but there is an on-going debate as to how much of this decline is due to the booming US economy and how much to the policy changes. Research by the Administration, summarised in OECD (1999c), suggests that almost one-third of the decline in welfare rolls since 1996 can be attributed to the reform, with most of the policy-induced effect being the result of sanctions for non-compliance.

In sum, while it is too early to judge the effectiveness of the range of activation strategies that have been introduced by some OECD countries in recent years, the early signs are quite promising.<sup>28</sup> It seems that a mix of carrot-and-stick elements in such strategies, combining use of active labour market policies and benefit sanctions in case of non-compliance, may well contribute to better labour market outcomes for benefit recipients.

### **The importance of integrated management of benefit systems and active labour market policies**

There is a close interaction between active and passive measures which is central to the trade-off between equity and efficiency. If the unemployment benefit system is generous and poorly managed, it is very difficult to operate active programmes in ways that increase labour market efficiency and reduce structural unemployment. Conversely, if active measures are used on a large scale and mainly serve to re-establish benefit entitlements, they risk becoming a *de facto* passive measure. They thus need to be better managed and linked more closely to the benefits system.

OECD research suggests that the public employment service has a central role to play in achieving this better management. It can play this role most effectively if it operates as a fully *integrated* agency combining the three core functions of job placement, benefit payments and placing participants on active programmes. Such integration is desirable for the following reasons:

- A close co-ordination between placement and benefit work is needed in order to apply work tests effectively and hence to fulfil one of the key pre-conditions for benefit entitlement;

- A close co-ordination between job broking and ALMPs is needed in order to ensure that the unemployed can acquire the attributes necessary to fill available job vacancies; and
- A close co-operation between benefit administration and referral to ALMPs is needed in order to avoid long-term dependency on benefit receipt and programme participation for the sole purpose of renewing benefit entitlements.

However, it should be noted that many OECD countries do not have a fully integrated public employment service in this sense, though Australia has taken a large step in this direction recently with the establishment of Centrelink, and New Zealand has fully integrated the delivery of income support with the delivery of employment services in a single agency.

### Assessment

The recent history of active and passive labour market policies in the 17 OECD countries which have been reviewed suggests the following eight lessons for the design of future policies in order to make them more effective:

First, integrate the referral to active programmes as closely as possible with benefit and placement work. Ideally, all three basic functions should be provided by the same front-line public employment office (so-called “one-stop” labour offices).

Second, use “profiling” for new benefit claimants to identify those at risk of becoming long-term unemployed; provide the latter (but not the others) immediately with counselling and job-search assistance.<sup>29</sup>

Third, make passive income support as “active” as possible by using instruments like re-employment bonuses, in-work benefits, regular contacts of claimants with the public employment service, job clubs, etc.

Fourth, use “availability for work” (to be controlled by work tests) and “job-search initiatives” (to be confirmed by employers) as independent criteria which must be met in order to qualify for continued benefit receipt (*e.g.* both criteria have to be fulfilled in Switzerland).

Fifth, make continued receipt of income support conditional on accepting to participate in active programmes after a certain minimum duration of an unemployment spell (say after six or eight months); do not, however, guarantee a slot in a programme by that time, but handle the referral flexibly in accordance with the availability of slots which correspond to the needs of the job seeker in question.

Sixth, ensure that participants in training and public sector employment programmes continue to be available for work in the open labour market; encourage them to engage actively in job search.

Seventh, ensure that participation in training and public-sector employment programmes does not serve mainly to establish new benefit entitlements. One way to ensure this is by making the duration of employment subsidies to the private sector shorter than the minimum contribution period required for benefit entitlements. These steps will minimise the so-called “carousel effect”, whereby a considerable number of the long-term unemployed move between spells of benefit receipt and programme participation. OECD research has shown that the carousel effect is a significant problem in many European countries. Some countries, *e.g.* Denmark, Finland, Norway and Switzerland, have taken steps recently to curb this possibility.

Finally, explore ways of making the public employment service more effective by giving greater play to the role of market signals. For example, many active measures, particularly training programmes, are provided by the public sector and this may not be the most efficient form of provision. Some countries are beginning to experiment in this area with a range of initiatives designed to give greater play to private sector agencies in the provision of active measures.<sup>30</sup>

Australia has gone further in this direction than any other OECD country with its recent initiative designed to make the market for job placements fully contestable, with specific incentives for both private and public employment services to compete to place the most at-risk job-seekers. However, it will be several years before it is possible to evaluate whether the new Employment Services Market in Australia improves significantly the employment and earnings prospects of at-risk job seekers compared with other, more traditional active measures.

## CONCLUSIONS

At first sight, the bottom line from recent OECD research on the effectiveness of active labour market policies is not terribly encouraging. The track record of many active measures is mixed in terms of raising the future employment and earnings prospects of job seekers and producing benefits to society. In addition, little progress has been made to date in shifting public spending from passive to active labour market measures in most OECD countries, despite the widespread endorsement of this goal by politicians.

While we cannot ignore the undoubted problems with active measures, it would be wrong to draw a pessimistic conclusion about their potential role in the fight against high and persistent unemployment and the problems of low pay and poverty. We now know a great deal more about what works and what does not work among the large array of active measures currently in use across OECD countries. We are also much more aware nowadays of the crucial nature of the various interactions between active and passive measures. Recent OECD research suggests

several practical steps which can be taken to enhance the effectiveness of active measures. At the same time, there is a crying need to expand the quantity and quality of evaluations of labour market programmes in a wider range of OECD countries so that countries can learn from each other's experiences.

However, even if all these steps were to be implemented, it is important to be realistic about their likely impacts on unemployment; one should not oversell the case for active labour market policies. More effective active labour market policies, as Lars Calmfors has rightly warned, are not a magic bullet on their own to solve the unemployment problem. Since one of the main objectives of active measures is to assist the unemployed to get back into work, they require a reasonably buoyant supply of job vacancies in order to be effective. If an economy is generating few vacancies, one should not be surprised if active measures prove to be relatively ineffective. Aggregate demand matters too. As *The OECD Jobs Study* has stressed, more effective active policies are only one element in a comprehensive strategy of macroeconomic and microeconomic measures required to cut unemployment significantly. Nonetheless, they remain a potentially important weapon in the fight against unemployment.

## NOTES

1. For detailed reviews of progress in the implementation of the country-specific recommendations, see OECD (1997d, 1998c, and 1999a).
2. This work is presented in OECD (1996a, 1997c).
3. Calmfors (1994) stresses the importance of the compensation levels paid to participants on active labour market programmes as one crucial design feature in assessing the effectiveness of active policies.
4. The data on inflow rates cover public training for employed adults as well as the unemployed. In a few countries, e.g. Denmark, Belgium, Ireland, Korea and Portugal, this accounts for a large proportion of the total inflow rate to all active measures, ranging from 20 per cent in Ireland to 40 to 50 per cent in Denmark, Korea and Portugal in 1997.
5. The relevant extract from the Press Communiqué issued at the end of the Ministerial meeting reads as follows: "When they last met in 1992, OECD Ministers of Employment and Labour stressed the need to shift public spending on labour market policies from passive to active measures. In most countries, more progress is needed in achieving this objective. Today, Ministers reiterate this policy objective while at the same time underlining the need to enhance the effectiveness of active labour market policies and to design and manage unemployment and related welfare benefits fairly, but tightly. Active measures must not become inadvertently "passive" in that they simply provide parking slots for the unemployed or serve to re-establish benefit entitlements. At the same time, so-called passive measures should be designed and rigorously managed so that active job search by benefit claimants is rewarded, thereby ensuring that they do not become overly dependent on income support".
6. However, the fact that inflow rates to programmes increased between 1986 and 1997 in many more countries than did spending/GDP ratios suggests that there was a shift to shorter-duration programmes over the period.
7. There is a nice illustration of this in recent US experience. When the national evaluation of the Job Training Partnership Act (JTPA) revealed that it had failed to provide earnings gains to disadvantaged youths, the US Congress eliminated nearly all of the funds for JTPA.
8. See Calmfors and Skedinger (1995) for a discussion of these problems.
9. There is a large literature on the appropriate methodology to use in evaluating labour market programmes. See Friedlander *et al.* (1997) for a good review of the issues.
10. OECD (1999b) points out that in 1995 there were 163 federal employment and training programmes for adults and out-of-school youths in the United States, administered by 15 federal agencies, compared with 125 programmes in 1991. These totals did not include the very large number of similar programmes at state level.

11. There are a few US evaluations that cover longer time periods, following individuals up to five to six years after their participation on the programme. See Grubb (1995, 1999) and Stanley *et al.* (1998) for reviews of these studies. Grubb (1999) argues that these studies show that any benefits from programme participation tend to evaporate after four or five years.
12. See Stanley *et al.* (1998) for a good review of the recent US literature.
13. Special employment measures for the disabled are not covered here since the OECD has not reviewed the recent evaluation literature in this field. Measures for the disabled accounted, on average, for 12 per cent of total public spending on ALMPs in 1997 (see Table 5).
14. See Forslund and Krueger (1994) for a review of the Swedish evaluation evidence on training programmes; Friedlander *et al.* (1997), Grubb (1995) and Stanley *et al.* (1998) for reviews of the US literature; and Park *et al.* (1996) for a review of some Canadian programmes.
15. Friedlander *et al.* (1997) point out that there is no evidence in the rigorous evaluation literature quantifying the size of displacement associated with training programmes for disadvantaged groups.
16. See Meyer (1995) for a review of the US evidence and Human Resources Development Canada (1997) for a review of the Canadian evidence.
17. However, Canadian evidence, summarised in Human Resources Development Canada (1997), suggests that any earnings gains from job-search assistance are likely to be transitory.
18. The evaluation results supporting this positive assessment of Job Corps were based on non-experimental methods and were done almost 20 years ago. A rigorous nationwide evaluation of Job Corps is now underway to try to settle the issue of whether it works or not.
19. See Heckman (1994) and Human Resources Development Canada (1997).
20. See Richardson (1998) for evidence, using a panel of Australian youths, that participation in subsidised jobs improved their employability.
21. See OECD (1993b, 1993c, 1996b, 1996c, 1996d, 1997b, 1998b, 1999b).
22. See Calmfors (1994) for a detailed exposition of this argument.
23. See Martin (1996) for a detailed discussion of these data.
24. It should be noted that the replacement rates in Figure 2 refer to a 40-year-old worker with a long contributions history since this case was considered a good approximation to the average situation of an unemployed worker in most countries. However, this assumption means that most changes in eligibility conditions for receipt of unemployment benefits will not show up in the OECD summary measure.
25. New Zealand has recently decided to work test not only the unemployed but also all other welfare beneficiaries of working age.
26. Abbring *et al.* (1996) is one of the few rigorous evaluations of the effect of unemployment insurance sanctions on the transition rate from unemployment to employment. They use a micro data set covering the population of individuals who started collecting benefits in the Netherlands in 1992. Their results show that the transition rates to employment are increased significantly by the imposition of a benefit sanction.
27. For details on the evaluation results, see Schmid (1997).
28. There is also macroeconomic evidence to back the argument that activation strategies can work. The Danish Ministry of Finance has developed a set of indicators for eligibility conditions to receive unemployment benefits and the availability criteria which benefit recipients must satisfy in order to continue receiving benefits. They have used these indicators as regressors in a cross-country regression designed to quantify the determinants of structural unemployment rates in 19 OECD countries. Their results indicate that tighter administration of unemployment

benefits/more stringent activation strategies served to lower the structural unemployment rate whereas higher net replacement rates tended to raise it. For details, see Danish Ministry of Finance (1998, 1999).

29. See OECD (1998a) for a review of experiences with different profiling approaches in Australia, Canada, the United Kingdom and the United States. It should be noted that there are strong differences of view about the relevance and reliability of formal profiling methods, and how central a role profiling can play in making active labour market programmes more effective.
30. See Fay (1997) for a review of these issues.



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