

## From unemployment to work

**How can jobseekers be activated?**

**Do activation programmes increase employment and wages?**

**How do activation strategies work best?**

**How can work be made to pay?**

**Do work incentives matter?**

**How can in-work benefits be made effective?**

**For further information**

**For further reading**

**Where to contact us?**

### Introduction

All OECD governments recognise the need to provide income support for the unemployed. But how do they ensure that income support provides a cushion for a brief period to enable the person to find a new job, without becoming a permanent alternative to work? Cutting benefit levels would automatically increase the incentive to move from welfare to work, but it would not help people to find suitable employment and would aggravate social hardship for those who do not enter employment at all. Providing income support for jobseekers while at the same time strengthening their incentive to work is a puzzle that most OECD countries are still trying to solve.

To resolve this puzzle, countries are using a combination of two methods. First, governments encourage jobseekers to become more active in their efforts to find work by providing job-search support, and by requiring contact with employment services as well as participation in programmes after a certain period of unemployment.

Common activation measures include requirements for unemployed people to attend intensive interviews with employment counsellors, to apply for job vacancies as directed by employment counsellors, to independently search for job vacancies and apply for jobs, to accept offers of suitable work, to participate in drawing up an individual action plan and to participate in training or job-creation programmes.

Second, income supplements can be provided to low-income individuals who accept a job – so-called “in-work benefits”. However, to be effective, activation strategies and in-work benefits need to be well-designed. This Policy Brief looks at what measures work best to help unemployed people to find a new job and keep them in work. ■

### How can jobseekers be activated?

Almost all OECD countries have free public employment services to help jobseekers find work. But people can choose whether to use them. Activation strategies, by contrast, involve a requirement on the individual job-seeker to participate in programmes. The main target groups for activation strategies are recipients (or claimants) of income-replacement benefits which are conditional on availability for work. This includes most recipients of unemployment benefits. Comparable availability-for-work conditions often apply to recipients of lone-parent and social assistance benefits.

Activation programmes can have a large impact on employment and unemployment outcomes, particularly where benefit entitlements are of long or indefinite duration:

- activation requirements increase levels of participation in employment services, thus making participants' job search more effective and/or enhancing their skills.
- given the prospect of having to participate in activation programmes, some people leave benefits for work or drop their claim earlier than they would otherwise have done, and some potential claimants do not initiate a benefit claim – so-called “motivation effects”.

It is sometimes argued that although activation strategies may make it easier to match the people and skills on offer with the available jobs, this does not necessarily lead to higher employment. For instance, there may be cases where programme participants take jobs that would otherwise have gone to non-participants, with no overall gains. While this possibility of little or no aggregate gains exists in theory, empirical experience suggests that effective activation strategies can have a meaningful impact on aggregate unemployment. Welfare caseloads in the United States and unemployment benefit rates in Denmark, Ireland, the Netherlands and the United Kingdom have fallen by more than half from their peaks in the recessions of the early 1980s or early 1990s. Australia and New Zealand have recently experienced 25% to 30% falls over a shorter period. These improvements seem to be closely related to the timing of the introduction of activation programmes.

But limits to activation strategies also need to be recognised. In Nordic countries, which have a high level of social protection and have already used activation measures intensively for many years, there are some signs of declining returns. Evaluations in Finland have reported only moderate impacts from the cheaper programmes such as job-search training. Denmark's activation measures in the 1990s, although they reduced unemployment significantly, were expensive relative to those used in some other countries. Testing and evaluation is needed to devise activation programmes that are effective, affordable and reasonable in terms of requirements on participants. ■

### Do activation programmes increase employment and wages?

The benefits of labour market programmes may go beyond reducing the duration of job search. Programmes may help improve the match between the skills of jobseekers and available jobs, thus enhancing earnings prospects and job stability.

“Work-first” programmes, which encourage benefit claimants to enter work as fast as possible rather than prolonging job search or undertaking training, have a large impact in terms of reducing benefit caseloads with typically some but not all of the caseload fall being reflected in higher employment rates. Participation in substantive employment services takes longer to have an impact, but in some cases it seems to increase employment rates by as much as or more than it reduces benefit caseloads, i.e. it increases or at least does not reduce total labour supply. At the same time, two well-known experimental programmes which offered intensive counselling and

job-search assistance, the Portland welfare-to-work programme in the United States and the SSP Plus programme in Canada, in the fourth and fifth years after client entry to the programmes also increased total annual earnings proportionally more than they increased employment. And studies have found positive impacts that continue for many years after participation in certain labour market training programmes. ■

### How do activation strategies work best?

In the first months of unemployment, for people with a solid record of recent employment, employment services should focus on offering services such as job information and matching, job-search training, individualized counselling and vocational guidance and vocational training, largely on a voluntary basis. But for longer periods of unemployment, in countries which provide indefinite-duration benefits, these services increasingly need to be used as activation measures, i.e. participation needs to be made *obligatory* to increase the volume of services delivered and generate motivation effects that prevent a drift into passive benefit dependency. If participants do not fulfil their side of the bargain, they can be subject to financial sanctions in the form of benefit cuts.

Participation requirements should be reasonable so that they deter some but not all benefit claims, thus targeting benefit payments more precisely on the individuals who need them most. Although any participation requirements tend to have some effect on claims, programmes should be designed to deliver substantive services which maximise the positive impacts on employment and earnings for their participants. These services should be open on a voluntary basis to jobseeker groups that do not qualify for unemployment benefits and are not subject to any participation requirements.

### **Making the most of public employment services**

For activation strategies to be successful, it is essential to monitor and improve the performance of the Public Employment Service (PES). Many programmes such as job-search monitoring, employment counselling and intensive interviews, and individual action plans, are in fact regular procedures implemented by local offices of the PES. Moreover, to effectively use and manage long-term programmes such as vocational training, the PES needs to handle the functions of jobseeker referral, tracking of pre-programme and post-programme outcomes and replacement of ineffective programmes.

A general principle of performance management is that labour market programmes or changes to PES procedures should be introduced when their benefits exceed their costs for society as a whole. Because lower unemployment and higher earnings after the return to work improve the welfare of the individuals concerned, as well as saving on unemployment benefit budgets and increasing tax receipts, effective performance management can improve government financial balances at the same time as increasing social welfare.

General principles for the governance of employment services are:

- Measures of outcomes and impacts must be hard to “game” (outcomes should not be measured only in terms of job placements, because employment services colluding with employers can increase reported placements by placing the same person repeatedly into the same job). When employment services are subcontracted to private providers (both profit and not-for-profit), government agencies should assess outcomes from employment services in terms of the

number of their clients who remain on benefits and/or who are in employment on average over subsequent months and years, based on official data sources rather than data reported by the service providers themselves.

- “Creaming” (i.e. selection by service providers of which clients to serve) should be prevented. Government should measure employment outcomes across all persons originally referred to each service provider, so that service providers cannot improve their reported success rate by diverting less-easily-employable clients to other service providers or other welfare benefits.
- Employment services should have an incentive to report evidence that clients are not available for work or refuse to participate in a labour market programme, but government should continue to administer benefits so as to protect valid entitlements.

These principles will help ensure that the providers or services that have the most positive impact on jobseeker outcomes can be accurately identified. Then providers or services that have little positive impact should be systematically reformed or replaced, by market or administrative mechanisms. Although this is an obvious recommendation, it may be difficult to implement in practice because in centralised systems staff resist restructuring, and in decentralised systems the actors that currently receive financing tend to oppose change. ■

### How can work be made to pay?

Because of the structure of tax and benefit systems in most OECD countries, certain individuals face reduced incentives to return from unemployment to work (these incentives are measured as the marginal effective tax rate, or METR, which is a comprehensive indicator for the extent to which work is financially rewarding – see Chart 1). This is particularly true for single parents and couples with only one earner. Indeed, an unemployed individual whose spouse is not working faces a very high effective tax rate for accepting a job offer at the same salary as the last job, in most cases higher than 80%. This is due not only to the withdrawal of unemployment benefits but also to the phasing out of additional social assistance to which this household type is entitled to. The introduction of schemes that supplement income from work when the latter is too low can make the return to employment more attractive.

The transition from unemployment to work becomes even less financially attractive when the new job pays less than the previous one. This is due to the fact that, in many countries, unemployment benefits are calculated as a percentage of the previous salary. On the other hand, METRs decrease as the post-unemployment wage rises. This suggests that activation policies that provide training and help skill improvement can help make work more financially attractive to the unemployed.

For low-income individuals who have a job, working longer hours or earning higher wages often entails little additional net income. Indeed, as Chart 2 shows, high METRs may also discourage the move from part-time to full-time employment. This is particularly the case for one-earner families with two children in the Slovak Republic, Finland, and the United Kingdom, where METRs exceed 80%. In addition, the tax and benefit systems in the United Kingdom, New Zealand and Australia tend to provide single parents with low financial incentives to move to full-time. In this case in-work benefits may show their double-edge nature: the improvement in financial incentives to work has the drawback of reducing incentives to work longer hours for those individuals who are already in part-time work. ■

### Do work incentives matter?

OECD analysis suggests that reducing the marginal effective tax rates faced by individuals will increase the likelihood of their transition to work. In line with other empirical studies, the analysis finds moderate labour market effects of METRs.

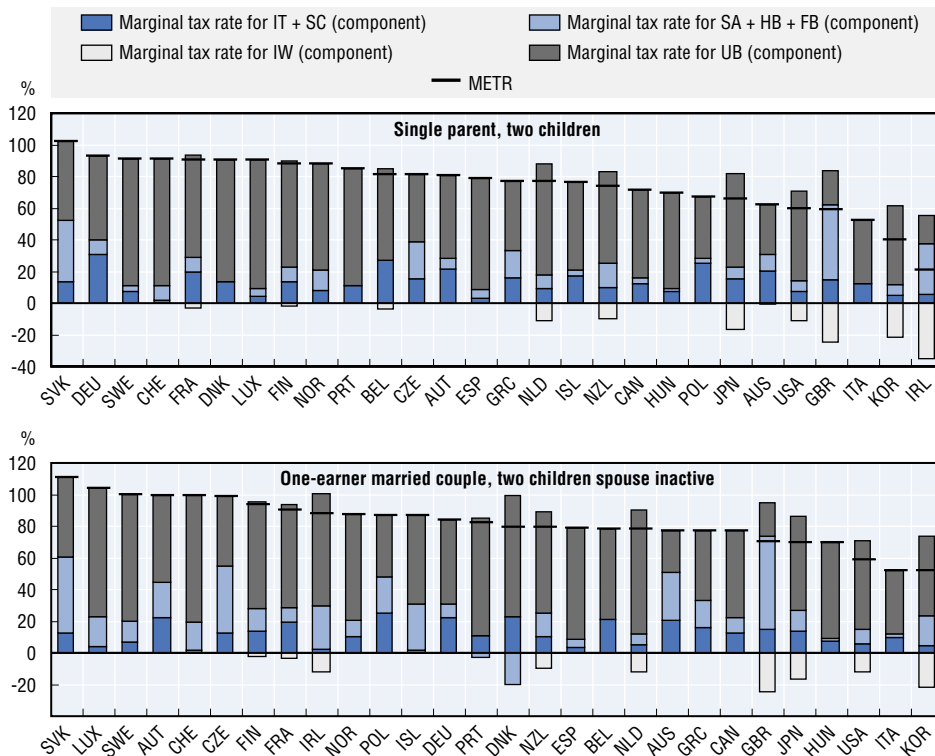
A 20% reduction in marginal effective tax rates (which is what some of the most ambitious reforms have tried to achieve) implies a rise in the probability that an individual moves from unemployment to employment in a given year from 45% to 49%. The strongest effects are found for the unemployed with a working partner, whose re-employment probability would increase by seven percentage points, from 51% to nearly 58%. The evidence on transitions from inactivity to work is more mixed. Significant effects are only found for single women: for this group, the probability of moving from inactivity to work would increase by almost 13%. Finally, the reduction in marginal effective tax rates is also found to encourage transitions from part-time to full-time work or promote moves to higher-paid jobs, especially for second earners in couples without children.

These issues require further scrutiny. Also, it should be kept in mind that financial incentives, as measured by METRs, only partly explain labour market transitions. In particular, unemployment benefit system rules are not fully accounted for in calculating METRs – notably, in some countries, refusing to accept a job offer might entail benefit withdrawal. In addition, entry jobs might be seen as a stepping stone into the labour market. These features would add a dynamic dimension to the analysis but cannot easily be incorporated in METRs. ■

Chart 1.

#### IS WORK FINANCIALLY ATTRACTIVE COMPARED WITH UNEMPLOYMENT AND OTHER NON-EMPLOYMENT BENEFITS?

Unemployment trap indicator: decomposition of the METR moving from unemployment to full-time work at wage level = 67% APW (wage before unemployment = 67% APW), 2002



IT: Income tax; SC: Social security contribution; SA: Social assistance; IW: In-work benefits; HB: Housing benefits; FB: Family benefits; UB: Unemployment benefits.

Note: The chart shows how much of the wage earned following a move to work from unemployment is taken away in the form of taxes and lower welfare benefits. For example, a value of 100 for the indicator shows that moving from unemployment to work leads to no additional net income. A value bigger than 100 indicates that net earnings in work are less than total out-of-work benefits.

Source: OECD (2005), OECD Employment Outlook, Paris.

**How can in-work benefits be made effective?**

In-work benefit programmes are one of the tools that OECD governments have used as a means of raising the financial returns to working. These programmes vary widely in terms of characteristics such as their generosity and the income level at which benefits are withdrawn. In this respect, only in-work benefit programmes that are sufficiently generous are likely to translate into significant increases in employment rates. Generosity has to be accompanied by targeting, in order to channel help to the neediest families and keep programme costs at a reasonable level.

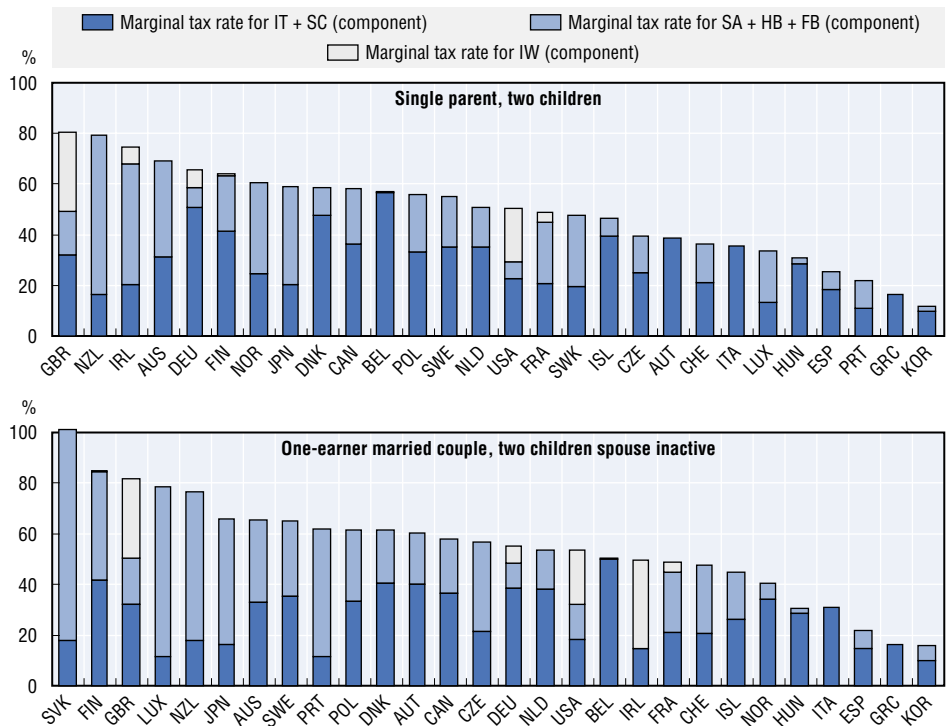
In-work benefits should also be designed to reduce the waste of budget resources arising from the fact that some beneficiaries would have found a job (or increased work effort) even in the absence of the scheme. Well-designed targeting, and conditions on the number of hours worked to become eligible, are effective responses to this concern.

In this respect, several countries – notably Australia, Belgium, and Ireland – target long-term social security beneficiaries to reduce the likelihood that non-entitled individuals change their labour market behaviour in order to become eligible. For the same reason, full-time work is required for eligibility in Australia and the Netherlands, while other countries – Belgium, Germany, Ireland, Japan,

Chart 2.

**METRs ASSOCIATED WITH THE TRANSITION FROM PART-TIME TO FULL-TIME, 2002<sup>a</sup>**

Decomposition of the marginal effective tax rate when moving from a part-time job (20 hours a week) at a wage level = 50% APW to a full-time job (40 hours a week) at a wage level = 100% APW



IT: Income tax; SC: Social security contribution; SA: Social assistance; HB: Housing benefits; FB: Family benefits; IW: In-work benefits.

Note: The chart shows how much of the wage rise following a move from part-time to full-time employment is taken away in the form of higher taxes and lower welfare benefits. For example, a value of 100 for the indicator shows that moving from earnings 50% of APW to 100% of APW leads to no additional net income.

a) Part-time is defined as earnings at 50% of APW earnings and full-time as earnings at 100% of APW earnings.

Source: OECD (2005), OECD Employment Outlook, Paris.

Korea, New Zealand and the United Kingdom – impose at least half-time work requirements to allow lone-parents and women with children to take up work. To prevent individuals who are working full-time from reducing their working hours in order to become eligible, the United Kingdom has a system of in-work benefits for those working at least 15 hours with a special bonus payment for those working full-time.

The level of in-work benefits and phasing-out rates (i.e. the speed at which benefits are withdrawn as incomes rise) should be set depending on what governments want to achieve. If the main objective is that of getting individuals into work, a moderate benefit withdrawn at relatively low rates may be most appropriate. This is the case of the Earned Income Tax Credit in the United States. However, this implies that benefits will continue to be paid at relatively high levels of income, creating some disincentive effects higher up in the earnings distribution. As a result, a government which is more concerned about the incentives for career advancement or longer working hours of those who are already in work would choose higher benefit levels and a faster phasing-out rate. Putting a time limit on in-work benefits provides an incentive for recipients to become fully self-sufficient – though, of course, there is also a risk that, when in-work benefits are phased out, work becomes less attractive than unemployment.

Finally, in-work benefits are most effective when they are targeted on low-income people. Availability of the scheme should be made widely known to the target group and administrative procedures to receive in-work benefits should not be excessively bureaucratic. The system should also be responsive to changes in family needs. In this respect, integration with the tax system and payment through the wage package could be an improvement for recipients, and a cost-saving solution for governments.

### **A comprehensive strategy to make work pay**

In-work benefits should not be seen in isolation but rather as one component of a comprehensive strategy to help the transition from welfare to work. The provision of childcare subsidies would be an appropriate accompanying policy, particularly since single parents and spouses with young children are especially sensitive to welfare-to-work policies. In addition, under certain conditions, a minimum wage, set at an appropriate level, can be one of the options to prevent employers from pocketing the earnings subsidy introduced by these programmes. And, effective active labour market policies are necessary to help people find jobs.

Indeed, job-search assistance or training programmes tied closely to local labour market needs – some of the most successful schemes among active labour market policies – may reinforce the role of in-work benefits. For instance, they can prevent skill loss over the unemployment period, thus helping the unemployed get a better paid job and improving financial incentives to work. In addition, public employment services can play a crucial role in directing the unemployed to in-work benefit programmes. ■

### **For further information**

For further information on the OECD's work on Active Labour Market Policies, Public Employment Services and In-Work Benefits, please contact:  
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### For further reading

- OECD (2001) **Labour Market Policies and the Public Employment Service**, ISBN: 92-64-18597-6, € 69.00, \$89.00, 416 p.
- OECD (2003) **OECD Employment Outlook**, available on line free of charge at: [www.oecd.org/els/employmentoutlook](http://www.oecd.org/els/employmentoutlook).
- OECD (2004) **OECD Benefits and Wages**, ISBN: 92-64-01515-9, € 24.00, \$29.00, 142 p.
- OECD (2005) **OECD Employment Outlook**, ISBN: 92-64-01045-9, € 65.00, \$81.00, 270 p.

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