

# Unemployment benefits and activation

as influences on labour market outcomes

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# 1. Benefit system characteristics and indicators

# Benefit system characteristics

Quantitative entitlement parameters for various benefits:

- UI
  - contribution months required/replacement rate and benefit ceiling/benefit duration
- UA - Unemployment Assistance
- SA - Social Assistance
  - partners of full-time workers are often disqualified from assistance due to the combined income test
- Supplementary benefits (e.g. housing benefit)



# Benefit system indicators

Measure relative generosity in terms of:

- benefit replacement rates (zero in some cases)
- averaged across a basket of cases (by family situation, former earnings, duration of unemployment, etc.)
- with weight for cases reflecting approximately the structure of “potential unemployment”
  - The envelope for “potential unemployment” can be identified from international experience (e.g. duration of unemployment, workers not above retirement age)
- OECD model rates assume a 40-year-old with 22-year contribution record: an important limitation (cases considered could include different ages and contribution records e.g. 6 months, 1, 2, 4, 8 years)

# Social Assistance as unemployment benefit

- Do unemployed people qualify for SA?
  - SA 100% financed at national level in a large country (e.g. France) probably acts as UB
  - SA 100% financed at municipality level (e.g. Norway, Sweden) is more-restrictively managed
  - SA financed at regional level (e.g. Canada) or with 50/50 financing (e.g. Denmark) are intermediate cases
  - SA in Japan is not generally paid as UB (paid to about 0.1% of non-aged, non-disabled, non-sole-parent households)
- Housing benefit (a benefit that covers rent) is regarded as part of the standard benefit package in the UK, not necessarily in other countries – what should be included?

# Restrictions on entry to benefit

- Exclusion of seasonal or short-term work – e.g. in Japan, workers expected to be unemployed for less than a year were not allowed to contribute before 2009
- Experience-rating - in the US employers assert that separations are due to voluntary quit or for fault
- Procedural constraints – in Spain until 2002 a UI application (based on dismissal) required a mandatory “conciliation hearing” procedure
- Collective dismissals – in Italy, Mobility Allowance is restricted to mass layoffs in the manufacturing sector
- Administrative discretion – e.g. assistance not paid to applicants who appear to be able to find work
  - ➔ Such factors limit the “generosity” of particular national unemployment benefits

# Extensions of benefit

- Automatic requalification for another period of UI through participation in an ALMP
  - Existed in Denmark from 1979, Sweden from 1986, Finland from 1987
  - Potential UI duration became indefinite in Finland and Sweden and 9 years in Denmark
- Requalification can also occur *via* subsidised jobs in the private sector, or when municipalities hire SA recipients temporarily as regular employees (but some UI systems attempt to exclude such cases)
- ➔ Requalification for UI not based on unsubsidised work increases “generosity”

# Behavioural conditions

- E.g. definition of
  - voluntary quit
  - suitable work: a job involving a change of occupation?  
involving 4 hours commuting per day?
  - job-search requirements: frequency of reporting? how  
many job-search actions per fortnight?
- The formal strictness of legislation is not a reliable  
indicator since the strictest formal conditions tend to  
not be applied



# Activation

“Activation” includes:

- Quality and effectiveness of employment services and ALMPs
- Restrictions on *ongoing* access to unemployment benefits
  - Behavioural conditions, compulsory participation in job-search assistance, compulsory referrals to job vacancies and ALMPs
  - Abolition of automatic requalification for UI (see above)
- (can include) restrictions on *entry* to “inactive” benefits

➔ “Activation” is not entirely different from “reducing benefit generosity”

## 2. Influences on unemployment

# Benefit caseloads vs. LFS unemployment

- Benefit generosity and activation influence primarily unemployment benefit caseloads (B), which partly coincide with LFS unemployment (U)
- In OECD countries with comprehensive benefit systems (UI and UA or SA), B/U ratios are mainly in the range of 0.6–1.4 – and benefits and activation are major influences on LFS unemployment
- At lower B/U ratios, benefits and activation are less influential

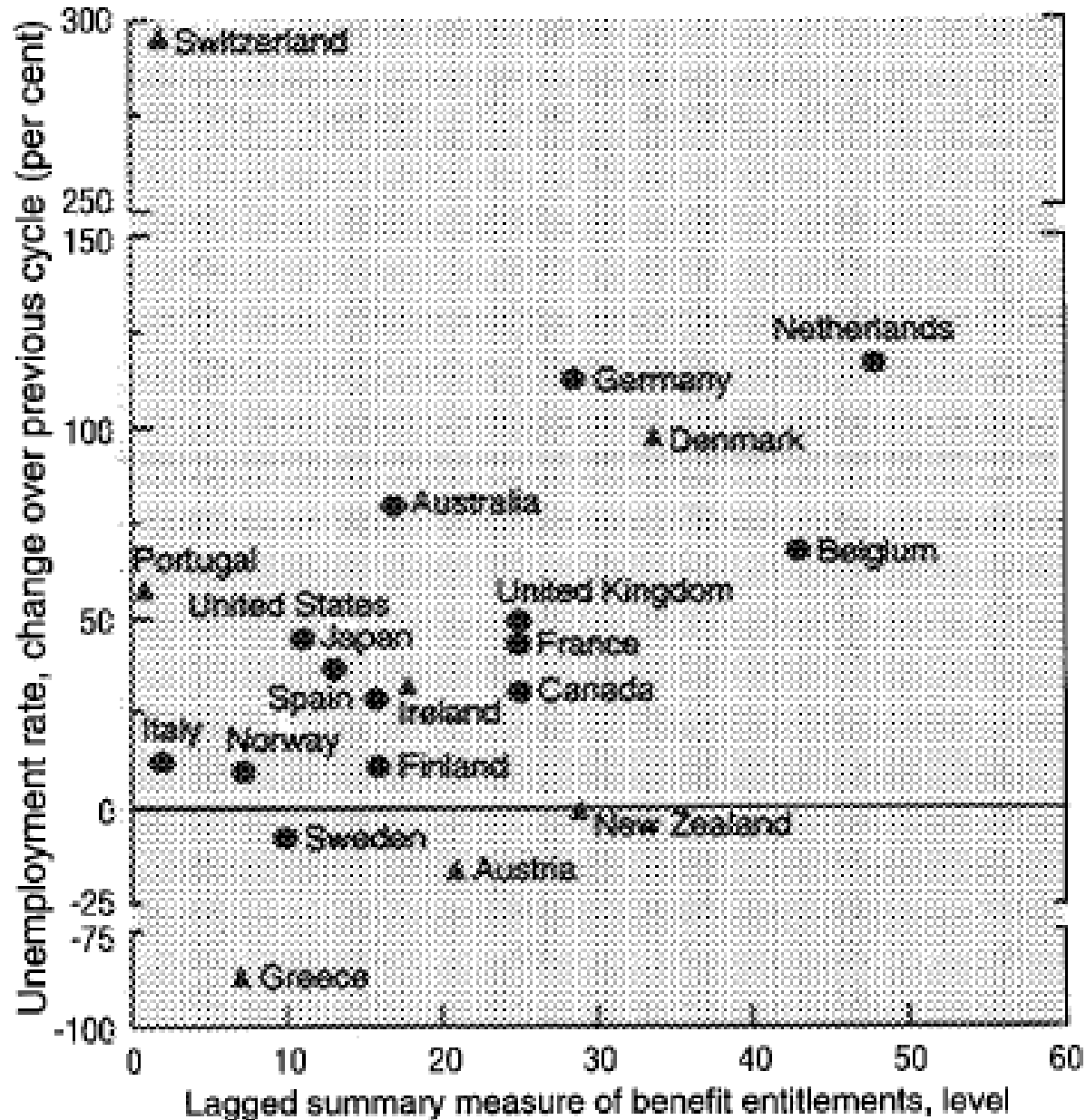
# 1970s-early 1990s (OECD Jobs Study)

- Rises in unemployment early in the first oil crisis (from 1967-71 to 1973-1977) and second oil crisis (up to 1979-1985) were positively correlated with the level of the summary measure of benefit generosity
- In the early 1990s (1987-1993), *changes* in unemployment were correlated with *changes* in the summary measure of benefit generosity



# Early in the first oil crisis

Unemployment increase 1973-77/1967-71, and the level of the summary measure of benefits entitlements (2-6 year lag)



# Benefit/activation explanation

- In the late 1960s and continuing into 1970s
  - there was a broad policy drive to free employment services from responsibility for managing benefits (which was said to undermine the placement function). A number of countries separated the placement service from the benefit administration
  - demand shocks reduced vacancy/unemployment (V/U) ratios, making the PES placement function less effective
- In the second half of the 1980s
  - renewed support for activation policies started to emerge, but concrete policy changes were minor
  - at least five countries (FR, FI, NO, ES, CH) further increased benefit generosity - by 1993 or 1994 they all had unprecedented unemployment rates

# Benefits and activation in the 1990s

- Great variability in outcomes: from 1990 to 1998, unemployment fell by about 40% in DK, IE, NL, NO and 10-20% in UK, US, but tripled or quadrupled in FI, SE
  - DK, NL, NO, UK started activation measures in the 1980s, but except in the UK, their larger-scale reforms were in the early 1990s
  - FI, SE introduced automatic requalification for UI in the late 1980s

# In the 2000s (before the recession)

- In the decade up to the mid-2000s, Portugal was the only OECD country that clearly increased generosity (extended UI duration, introduced social assistance).
- Unemployment increased from 5.2% (1998) to 8.5% (2007) in Portugal - Luxembourg was the only other country with a significant increase over these years.
- A number of countries (AU, CA, DK, NL, NO) cut back benefits somewhat, and unemployment fell. AU, DK, and NL also made some further activation reforms.
- In AU, NL, UK and probably other countries, attention partly turned towards “activation of the inactive” (e.g. sole parents and disability benefits), which is not expected to reduce unemployment.



# Benefits and activation in 2007-2010

- The largest increases in unemployment 2007-2010 were in IE, EE, ES and US (where unemployment doubled or tripled) and the smallest in Germany (unemployment fell). The increases correlate with benefits:
  - IE and US increased benefits more than all other OECD countries (between early 2000s and 2009)
  - EE (Estonia) first paid a UI benefit in 2003
  - ES did not create new entitlements, but in 2007 its B/U ratio reached 80%, mostly on UI benefit
- Germany cut the UI duration in the mid-2000s, but also extensively reformed the PES and labour market programmes

# Macroeconomic correlations conclusion

- After the OECD *Jobs Study (1994)*, changes in unemployment continued to be correlated with changes in UI generosity
- Major falls in unemployment have been related to benefit cuts in some cases, but also often to large-scale activation reforms

### 3. Lags between policies and labour market outcomes

# Caseload patterns for individual benefits

- After the creation of a new benefit, particularly assistance benefits, its caseload often grew by 2.5 or 3 times over the next 10 to 20 years (OECD, 2003).
- Strict administration or active measures can limit the initial caseload of a new benefit, and may slow caseload growth. National Assistance in the UK (created 1949) was restrictively administered at first, but its caseload then grew steadily for 35 years. FI and SE had large-scale ALMPs in the 1950s and 1960s. They introduced generous UI benefits in the mid-1970s and kept unemployment low throughout the 1980s, but not the 1990s.
- Changes in the parameters of an existing benefit tend to have an immediate impact.



# Interactions with the cycle

- Benefit increases in mid-cycle sometimes appear to have an impact delayed until the next recession
- New activation measures sometimes appear to accelerate cyclical falls in unemployment, and then perhaps prevent rises during the next recession
  - US Welfare Reform reduced the welfare caseload from about 3% to 1% of the working-age population over the recovery period 1993 to 2000. Then the “surprise” was that the caseload scarcely increased in the next recession.

# No “automatic stabiliser” effect of benefits

- In theory, generous benefits maintain the incomes of the unemployed during a downturn, and stabilize the economy.
- But the caseload for generous benefits, with disincentives not reliably offset by activation arrangements, can be unstable.
- In practice, the countries with generous benefits experienced the largest rises in unemployment in the 1970s and early 1980s. Experiences in the early 1990s and again in late 2000s have been partly similar (see above).
- Bassanini and Duval (2006), using 1970-2003 data for 19 countries, regressed unemployment rates on year dummies (representing the international cycle) interacted with the level of benefit generosity. These estimates imply that unemployment rates fluctuate much more in countries where benefits are generous.

# Benefits and activation in recession

- High benefits act as disincentives for labour hoarding *i.e.* workers prefer layoffs to wage cuts, especially for a wage-related UI benefit
- The disincentive impact of UI benefits is greatest at the start of a recession (by the time of UI exhaustion, it is harder to find work)
- In recession, activation measures that previously were strong enough to counteract benefit disincentives are weakened
  - Three small countries with generous benefits (AT, NO, CH) always kept unemployment fairly low, even through recessions - but no large countries

# Cyclical and structural unemployment

- Many OECD countries recognized at some point in time that unemployment was “structural”, and tackled it with supply-side reforms (e.g. wage restraint, benefit reforms and activation).
- Yet the “structural” unemployment usually started with a recession that was attributed to other (non-labour-market) factors (e.g. oil crisis, banking crisis, natural resources).
- Any strict dichotomy between demand-side drivers of recessions, and labour market policies that tackle structural unemployment, is illusory. Benefits and activation also influence outcomes in recessions.



# The early 1990s in Finland

(an example all macro and labour economists should know)

- After a UI increase in 1985, and 1987 job guarantee legislation, Finland arguably had the most generous benefit system ever. People with no contribution record were (until 1992) entitled after 12 months of unemployment to a 6-month job at regular wage rates, then wage-related UI benefit (and further cycles).
- PES work was dominated by implementation of the job guarantee. Patterns of transitions in the labour market changed dramatically.
- Finland experienced the sharpest unemployment increase in postwar history (3% in 1990, 16% in 1993, +13 points in 3 years). This could hardly occur just by coincidence.
- Activation strategies in Denmark (1994), Sweden (2001, and partly earlier) and Finland (1997), abolished automatic requalification for UI through participation in ALMPs.



4. In “equilibrium”, countries with generous benefits have activation measures, not high unemployment

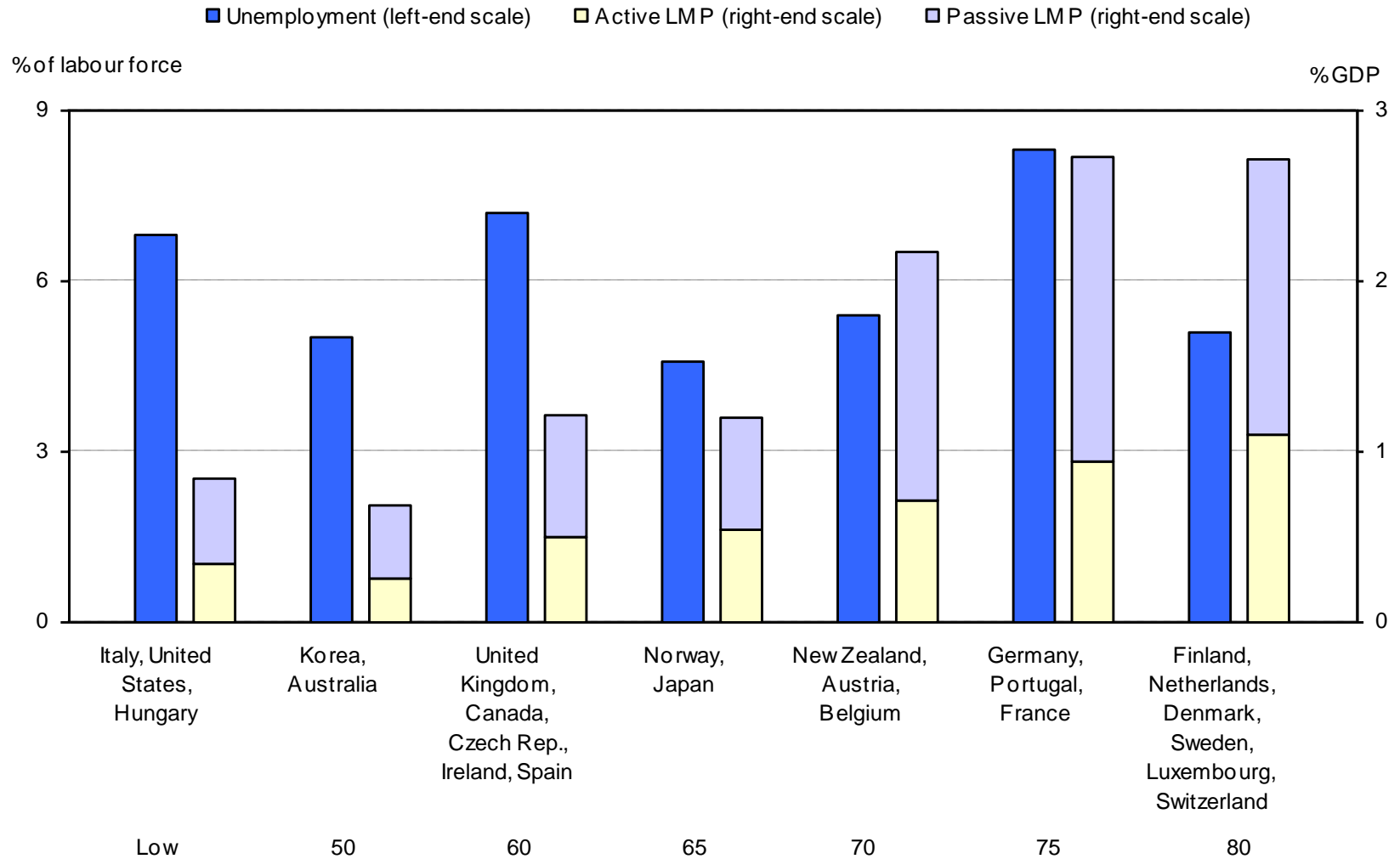
# Making generous benefits sustainable

- High benefits without activation cause high unemployment. This is too expensive to be politically sustainable.
- But agreement on what the problem is and how to solve it has often taken a decade or more to develop.
- Although activation is the main “solution”, it remains difficult and/or expensive to manage successfully. After many years of intensive activation efforts, Nordic countries (except Iceland) recently also reduced benefit generosity.

# The low-unemployment equilibrium

- The optimistic model for the impact of activation
  - the authorities make benefit payment conditional on active job search
  - higher benefits can be used to “buy” higher levels of job search
  - countries with high benefits then achieve *lower* unemployment than countries with low or no benefits.
- In practice
  - the intensive activation that is needed when benefits are generous is difficult to achieve and tends to involve high spending on ALMPs.

# Unemployment and LMP expenditure by benefit generosity



## 5. Examples of activation interacting with benefits



# Activation affects hazard rates (1/3)

Monthly earnings prior to unemployment:

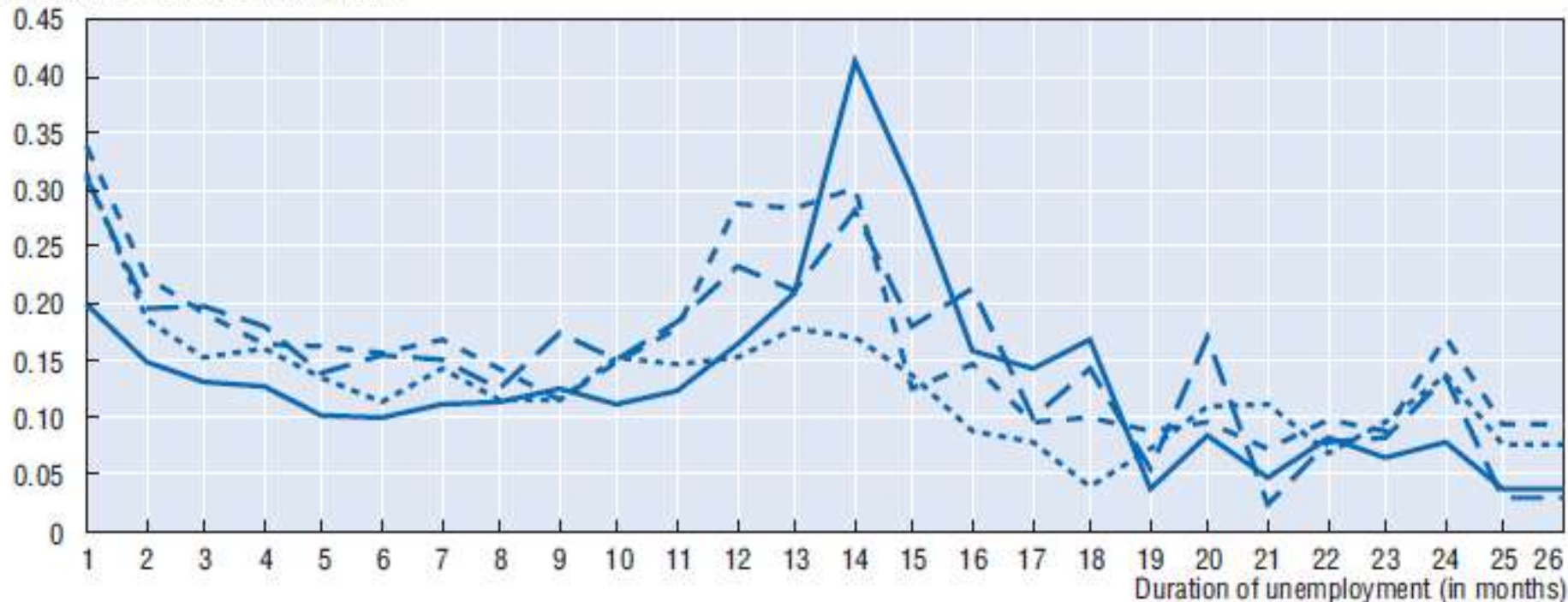
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Monthly rate of entry to employment



Monthly rates of entry to employment for people with 14-month UI entitlement, France, 1986-1992.

# Activation affects hazard rates (2/3)

- Card et al. (2007) report that in Austria data there is no “spike at benefit exhaustion”, *i.e.* UI recipients find jobs at the same rate before, during and after benefit exhaustion – they claim this is representative for other countries.
  - This pattern is likely to be related to active management by the Austrian PES, referring unemployed workers to jobs irrespective of their UI entitlement
  - Finland from 1995 to 1999 also had no “spike” in entries into unsubsidised jobs, but it had a large “spike” in entries to ALMPs (Koskela and Uusitalo, 2004, Figure 9).
- In most other OECD countries, PES interventions in the unemployment spell are less significant and job-finding rates do increase around the time of benefit exhaustion.

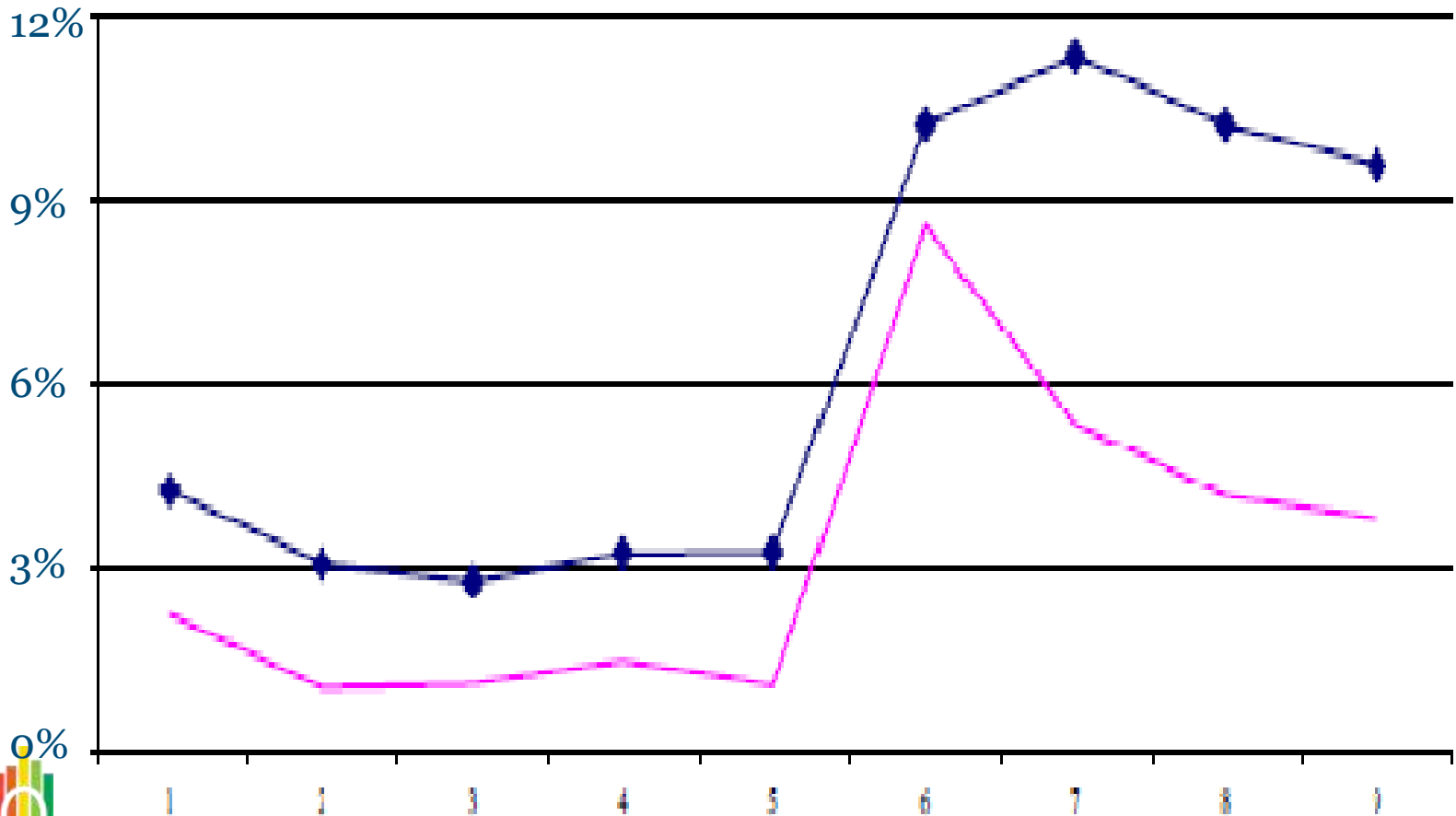
# Activation affects hazard rates (3/3)

In Spain, rates of job-finding approximately quadruple at benefit exhaustion. This shows that activation measures do little to offset the disincentive effects of receiving benefits.

**Monthly rates of entry to employment in the same firm (pink) or a different firm**

**Females  
with 6-  
month UI  
entitlement**

Source:  
Sanz (2010)



# Activation and inactive benefits (1/2)

- When activation measures combined with moderately generous unemployment benefits achieve low unemployment, gate-keeping for inactive benefits (e.g. disability benefits) can be tightened, diverting claimants towards an unemployment benefit.
  - Activation measures move claimants from unemployment benefit into work. As long as this process continues, activation measures for the unemployed are in effect reducing inactive benefit caseloads, not reducing unemployment.
  - In this perspective, the optimal level of unemployment is not zero. If unemployment fell to a low level, more people could be diverted from an inactive benefit status towards the unemployment benefit status.



# Activation and inactive benefits (2/2)

- Examples where activation and low unemployment have supported reductions in inactive benefit caseloads
  - In the Netherlands, from 1990 to 2010 the male unemployment rate averaged 4% and the male employment rate rose by 4 points - contrasting with a fall in nearly all other countries - as incapacity and early retirement were reduced.
  - In Australia, from 1993 to 2003 the unemployment rate fell from 11% to 6%. After 2003 there was little further reduction in unemployment, but the caseloads of a range of inactive benefits were reduced by nearly 3% of the working-age population, through closures and transfers of clients to unemployment benefit status.



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