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Performance  
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# Active Labor Market Policies in Europe

Performance and Perspectives

With 30 Figures and 28 Tables

 Springer



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## Foreword

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Essen, September 2006

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## Executive summary

Against the background of at least two decades of unsatisfactory European labor market performance, at the Luxembourg Jobs summit in November 1997 the European Commission initiated what has become known as the Luxembourg Process. The Amsterdam Treaty introduced a new Employment Title, which for the first time raised employment issues to the same status as other key goals in the formulation of European Union economic policy. The Treaty represents a critical step in the development of the European Employment Strategy. Article 2, for instance, states that “member states [...] shall regard promoting employment as a matter of common concern and shall co-ordinate their actions”. Article 3 formally recognizes that high employment should be an explicit goal “in the formulation and implementation of Community policies and activities”.

The Lisbon European Council in the year 2000 updated the European Employment Strategy, specifying that by 2010 the Union should regain conditions for full employment and strengthen cohesion. In particular, by 2010 the overall EU employment rate should be raised to 70%, and the average female employment rate to more than 60%. The Stockholm Council in 2001 stated intermediate targets (67% average employment rate by 2005, and 57% for women). The Barcelona Council in 2002 confirmed that full employment was the overarching objective and called for a reinforced Employment Strategy to underpin the Lisbon targets in an enlarged European Union.

Active Labor Market Policies – including measures such as job search assistance, labor market training, wage subsidies to the private sector, and direct job creation in the public sector – are an important element of this European Employment Strategy. While such policies have been in use for many years in most countries, there is a growing awareness of the need to develop scientifically-justified measures of the effectiveness of different Active Labor Market Policies (ALMPs). Indeed, concerns about the effectiveness of ALMPs have become an increasingly important feature of the EU’s Broad Economic Policy Guidelines, the Employment Guidelines, and the Recommendations for Member States’ employment policies.

A substantial number of evaluations of ALMP effectiveness has been conducted in Member States, by independent researchers, by researchers commissioned by government bodies, as part of ESF programs, or as national studies contributing to the European Employment Strategy evaluation. In most cases, the focus of these evaluations has been on the short term employment effects of active measures, disregarding the possibility of positive or negative interactions between ALMP participants and other employed and

unemployed workers (so-called “general equilibrium” effects). But even within this narrow focus the evidence from existing evaluations remains inconclusive: there is little consensus on whether Active Labor Market Policies actually reduce unemployment or raise the number of employed workers, and which type of program seems most promising. It is also not evident what any one country can learn from ALMP experiences in another country. Few overview studies exist, and their largely descriptive nature precludes any firm policy conclusions.

It is the objective of this study to overcome this deficit, by utilizing an appropriate conceptual framework that allows drawing systematic conclusions and deriving policy recommendations from the available cross-country evidence on ALMP effectiveness. The main part of the analysis is set against the backdrop of three frames. First, we discuss the role of the European Employment Strategy in shaping member states’ labor market policies, and describe the current situation on European labor markets regarding core indicators such as the unemployment rate and GDP growth. The second frame is given by a discussion and definition of active labor market program types, and program expenditure by country and type of measure. The most important ALMP categories across European countries are (i) training programs, which essentially comprise all human capital enhancing measures, (ii) private sector incentive schemes, such as wage subsidies to private firms and start-up grants, (iii) direct employment programs, taking place in the public sector, and (iv) Services and Sanctions, a category comprising all measures aimed at increasing job search efficiency, such as counseling and monitoring, job search assistance, and corresponding sanctions in case of noncompliance. It is important to note that many active labor market programs in European countries specifically target the young workers (25 years of age and younger) among the unemployed. Whereas several countries also have specific active labor market programs for the disabled, very few evaluations of these measures exist.

The third frame regards the methodology of program evaluation. Since the cross-European analysis of ALMP effectiveness must necessarily rely on credible evaluation studies from all countries involved, appropriate outcome variables and cost measures, as well as feasible identification strategies that can help solve the so-called “evaluation problem” (i.e. the inherent unobservability of the counterfactual no-program situation) must be discussed and properly specified.

Logically building on these three frames as a backdrop, our subsequent analysis of ALMP effectiveness concentrates on two focal points. The first focus regards a set of country studies from selected EU member states. Specifically, we discuss Austria, Denmark, Estonia, France, Germany, Italy, The Netherlands, Poland, Spain, Sweden, and the UK. While taking into account idiosyncrasies of each country, for purposes of comparability the studies follow a homogeneous structure to the extent possible, discussing (a) the economic context, (b) labor market institutions, (c) ALMP practice, and (d) ALMP evaluations. Unsurprisingly, both the economic background and the institutional set-up vary substantially across countries, from currently well-performing (e.g. Denmark, Estonia) to rather sluggish economies (e.g.

Germany), and from fairly flexible (e.g. the UK) to rather heavily regulated labor markets (e.g. France, Germany). Substantial differences exist with respect to ALMP practice, too. Some countries spend a substantial share of GDP on active measures (e.g. The Netherlands, Denmark, Sweden) and run a comprehensive set of various types of ALMP (e.g. Germany), while other countries spend considerably less (e.g. the UK, Italy) and run a relatively narrow set of programs (e.g. Estonia, Spain). Denmark certainly has the most comprehensive ALMP strategy with substantial effort to activate all unemployed persons.

Similar to differences in the implementation of ALMP, also the evaluation practice varies across countries. Sweden is well-known to have a long tradition of running and thoroughly evaluating ALMP, possible also because of a correspondingly comprehensive collection of data. The Netherlands and the UK, along with the one existing study from Hungary – stand out as countries implementing some evaluations based on randomized experiments. These experimental studies analyze the effects of job search assistance programs. On the other hand, in Spain and Italy, for instance, an “evaluation culture“ hardly exists, which is probably in line with a limited ALMP practice that is only just emerging. Germany is an example of a country in which – despite a fairly long tradition of running ALMPs – program evaluations were almost nonexistent until few years ago, and in which a practice of evaluating labor market policies has developed very rapidly. It is true for all countries that almost every evaluation study exclusively discusses microeconomic treatment effects, and that only very few macroeconomic studies exist.

Succeeding the country studies, the second and main focus of our analysis regards the appropriate summarizing of the available evidence. In this regard, we first review the experiences from the country studies and other evaluations from the remaining member states (as well as Norway and Switzerland) in a descriptive manner, and then concentrate on a meta-analysis of the available evidence. Before turning to a summary of that quantitative analysis, the following paragraphs present an overall assessment of the cross-country evidence.

Training programs are the most widely used active labor market measure in Europe. The assessment of their effectiveness shows rather mixed results; treatment effect estimates are negative in a few cases, and often insignificant or modestly positive. Still, there are several indications that training programs do increase participants’ post-treatment employment probability, in particular for participants with better labor market prospects and for women. However, this pattern does not hold for all studies. Locking-in effects of training are frequently reported, though it remains unclear to what extent these are really entirely undesirable, and not rather a necessary element of this type of program.

The more recent literature on the evaluation of training emphasizes the need to consider long-run impacts. Such an assessment has become increasingly possible due to extended data. There are indeed indications from these studies that positive treatment effects of training exist in the long-run. Moreover, if negative locking-in effects were to matter, these would be outweighed by the long-run benefits of program participation. The existence and

direction of a relation between the business cycle and the effectiveness of training programs is not clear from the evidence: Some studies report a procyclical pattern, while others report the opposite.

Private sector incentive programs entail wage subsidies and start-up loans. Whereas the latter have rarely been evaluated in European countries, several evaluations of wage subsidy schemes exist. The findings are generally positive. Virtually all studies that evaluate private sector wage subsidy programs – such as several studies from Denmark, but also evidence from Sweden, Norway, Italy, etc – assert beneficial impacts on individual employment probability. These encouraging findings, however, have to be qualified to some extent, since the studies usually disregard potential displacement and substitution effects or deadweight loss that may be associated with wage subsidy schemes.

In contrast to the positive results for private sector incentive programs, direct employment in the public sector rarely shows positive effects. The evidence across countries suggests that treatment effects of public sector job creation on individual employment probabilities are often insignificant, and frequently negative. Some studies identify positive effects for certain socio-demographic groups, but no clear general pattern emerges from these findings. Potentially negative general-equilibrium effects are usually not taken into account. Though these measures may therefore not be justified for efficiency reasons, they may be justified for equity reasons, possibly exerting positive social impacts by avoiding discouragement and social exclusion among participants. Corresponding outcome measures, however, are difficult to assess empirically, such that the literature has focused on treatment impacts on actual employment.

A general assessment of Services and Sanctions across countries indicates that these measures can be an effective means to reduce unemployment. The results appear even more promising given that these measures are generally the least expensive type of ALMP. Moreover, several experimental studies exist for this program type, producing particularly robust evaluation results. There are some indications that services such as job search assistance or counseling and monitoring mainly work for individuals with sufficient skills and better labor market prospects, but less so for the more disadvantaged individuals. This pattern, however, is not entirely clear, since some studies conclude that the opposite is the case.

Whereas in many countries some type of sanction for non-compliance with job search requirements exists, only few sanction regimes have been evaluated. The studies generally find a positive effect on re-employment rates, both for actually imposing sanctions and for having a benefit system including sanctions. The “New Deal” programs in the UK appear to be a particularly well-balanced system of job search services and sanctions, combined with a set of other active measures such as training and employment subsidies. This points to the conjecture that the interplay between the services provided by the PES, the requirements demanded from the unemployed individual, and the portfolio of active measures plays an important role regarding ALMP effectiveness. The comprehensive activation approach implemented in Denmark, for instance, also appears promising, even though it clearly requires substantial effort.

For youth programs, no clear pattern arises from the cross-country summary of studies. There are some indications that wage subsidies work for young unemployed individuals, especially the ones with a more advantaged background. However, some studies do not find this effect, and again potential general-equilibrium effects are disregarded. Youth training programs sometimes display positive treatment effects on employment probability, but negative results are also reported. Whereas the extensive “New Deal” in the UK illustrates the potential effectiveness of Services and Sanctions for youths, this result is not found in evaluations from other countries (e.g. Portugal).

Regarding programs for the disabled, due to a lack of evaluation studies no conclusive evidence exists. The results of the limited empirical evidence available are rather disappointing. Vocational rehabilitation programs seem to have no positive and significant impact on the employment rates of disabled unemployed.

The limited set of available macroeconomic evaluation studies also does not point to a consistent pattern. There are some indications for positive effects on net employment for training programs in general and also for youth, while other results indicate that these programs only reduce unemployment but do not enhance employment, or have no net employment impact due to crowding out effects. Several macro studies, however, underline the dismal performance of direct job creation schemes in the public sector. Rather mixed results are reported for wage subsidies in the private sector. Some studies reveal an overall positive net employment effect, but substitution effects may outweigh a positive employment effect. Finally, job search assistance and counseling exert positive direct effects on the employment rate, but may have negative effects through shifts in wages and job search behavior as well. Monitoring and sanctions have the potential to improve welfare. These results underline the importance of collecting further empirical evidence on an aggregate level, since some macroeconomic results confirm corresponding microeconomic evidence, whereas other results indicate reinforced or even reversed effects. The number of macro studies is quite small relative to the set of microeconomic program evaluations in Europe.

In summary, looking at the overall assessment of the available evidence, it is difficult to detect consistent patterns, even though some tentative findings emerge: Services and Sanctions may be a promising measure, direct job creation in the public sector often seems to produce negative employment effects, training measures show mixed and modestly positive effects.

On the basis of these tentative findings, it is the objective of the meta analysis to draw systematic lessons from the more than 100 evaluations that have been conducted on ALMPs in Europe, and to complement the more descriptive analyses and country-level summaries in the preceding parts of our study. Most of the evaluation studies considered have been conducted on programs that were in operation in the period after 1990. This reflects the fact that the past 15 years have seen an increasing use of ALMPs in Europe, and some improvement in the methodologies used to evaluate these programs. Thus, we believe that lessons drawn from our meta-analysis are highly relevant to the current policy discussions throughout Europe on the appropriate design of ALMPs.