

**Highlight**

This note gives a brief summary of activation policies in OECD countries, where this type of policy approach has some tradition and has been in use for some time. While countries share the objective of strengthening employment and reducing dependency and vulnerability, the balance of policy measures differs widely.

Activation Policies in OECD Countries

An Overview of Current Approaches

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Introduction

This note summarizes activation policy strategies in OECD countries.¹ Policy makers can choose from a broad menu of options. Each of them comes with potential strengths and weaknesses, but there can also be important links between them. To understand countries' overall activation stance, it is useful to look across individual policy measures. For the purpose of this note, activation is therefore defined broadly as *a combination of policy tools that support and incentivize*

- job search and job finding,
- *productive participation in society, and*
- *becoming and remaining self-sufficient and less dependent on public support.*

The menu of policy instruments includes (i) measures that aim at strengthening the **motivation** for making use of existing earnings opportunities (e.g., work incentives, job-search requirements, benefit sanctions); (ii) training and related active labor market programs (ALMPs) that seek to improve the **capabilities** of jobseekers and other activation "clients"; and (iii) employment services and programs that support labor demand by expanding the set of earnings **opportunities** available to jobseekers (e.g., wage subsidies, direct job creation).

In high-income and developing countries alike, there is increasing demand for well-designed "active" or "activating" social and labor market policies. However, as a policy approach, activation has a longer tradition in the OECD area. Here, early activation measures have tended to focus on specific groups facing labor-market difficulties in a context of relatively strong overall labor-market performance (such as low-skilled urban youth). More recently, activation principles have been applied more broadly, to a range of different

¹ The scope is limited to prime-age recipients of unemployment and minimum-income benefits. Policies for the disabled, for youth and for older jobless people raise additional issues. Readers are referred to www.oecd.org/els/disability, to OECD (2010), *Off to a Good Start? Jobs for Youth*, and to OECD (2006), *Live Longer, Work Longer*.



population groups, and increasingly in a co-ordinated manner across policy domains.

In part, the current interest stems from a largely cyclical, but nonetheless persisting, labor-market weakness. With government budgets under stress, employment and earnings growth are essential, both for reducing benefit spending, and for shoring up government revenues now and in the longer term. In particular, patterns of benefit reciprocity following earlier labor market downturns in the OECD area show that expanding “inactive” benefit programs, such as disability or early retirement benefits, is very costly in the longer term. But it is also very difficult to cut social expenditures without further increasing inequality. The downturn has pushed up the numbers of people living in “low-work intensity” households requiring support, and this has heightened concerns about inequality trends and the situation of the poorest families in particular. In restoring incomes at the bottom, a key policy challenge is therefore to facilitate employment and earnings growth that benefits low-income groups. In addition to crisis-related factors, longer-term trends also point to a greater role for activation policies. In most of the OECD area, population ageing and the associated pressures on social expenditure budgets make active labor-market participation of working-age individuals a necessary ingredient of policies that seek to restore the fiscal sustainability of social protection systems.

The note considers benefit generosity and work incentives (Section 2); eligibility conditions and obligations of job seekers and benefit recipients (Section 3); and ALMPs (Section 4). Section 5 characterizes aspects of countries’ overall policy stance by discussing the balance of policies and links between them. A concluding section suggests priorities for knowledge work in World Bank client countries.

Financial work incentives: Benefit generosity and make-work-pay policies

A frequent starting point for debates on activation is a concern about adverse work incentives that may result if out-of-work benefits are “close” to the income that someone might otherwise earn in the labor market (Box 1 summarizes available evidence on the relevance of work incentives for people’s labor-market decisions). Benefit generosity, as well as the tax treatment of in-work and out-of-work incomes indeed vary widely across countries.

Unemployment benefits

For those entitled to unemployment benefits (UB), a simple way of summarising many of the relevant policy parameters is by means of benefit net replacement rates (NRR), which express net income of a beneficiary as percentages of net income in a previous job. The OECD reports NRR at different

Box 1. How important are financial work incentives for employment outcomes?

Although results are not available for all OECD countries, there exists a wealth of empirical evidence on the sensitivity of people’s employment decisions to financial work incentives, such as the net income gain of working one hour more or of working at all.^a Among the main findings are the following:

- Financial incentives affect overall labor supply mainly through their influence on labor force participation (the decision whether or not to work), while the hours worked in a job are typically less responsive;
- Low-income groups and lone parents react strongly to financial incentives; and
- Labour supply is more responsive for women than for men.

These results provide essential guidance for targeting make-work-pay policies (*e.g.*, for a given amount spent on in-work benefits, targeting these resources on women and low-income groups, especially when children are present, is likely to create the biggest payoff in terms of stronger employment and higher earnings). But while some general patterns can be identified, there are large country differences. One study reports that single women in Hungary and Poland are only about 1/4 as responsive to incentives as women in Ireland and the United Kingdom.^b Concerns about work disincentives can therefore be well justified in some countries and for some groups. In others, different employment barriers may be more pressing.

^a Surveys are provided by Evers, de Mooij and van Vuuren, (2008), “The Wage Elasticity of Labour Supply: A Synthesis of Empirical Estimates”, *De Economist*, 156 (1), and by Immervoll, Kleven, Kreiner and Saez (2007), “Welfare Reform in European Countries: A Micro-simulation Analysis”, *Economic Journal*, 117 (517).

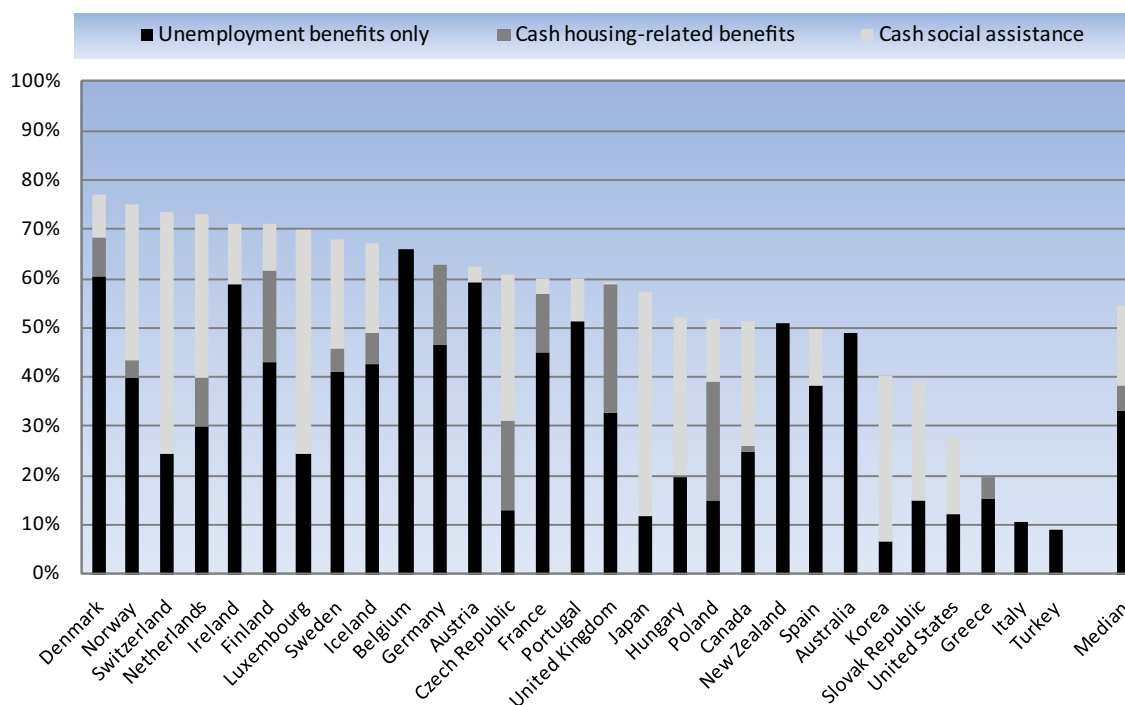
^b Bargain, O., A. Peichl, (2011b), “Labor Supply Elasticities in Europe and the US”, IZA Discussion Paper No. 5820.

stages during an unemployment spell (not shown here; see www.oecd.org/els/social/workincentives). This shows that, in close to half of OECD countries, those who lost their job early on during the financial crisis and were entitled to UB had NRR above 60% in the first year of unemployment.

But NRR typically decline during the unemployment spell. Long-term unemployed in Japan, Italy, Korea and Turkey lose their entire UB after 12 months or less (prior to crisis-related benefit extensions, insurance benefits in the United States also expired after 26 weeks in most states). In several

Figure 1. Social safety nets are important complements to unemployment benefits

Net replacement rates (NRR) resulting from 2009 policy parameters, in percent



Notes: Replacement rates are an average over five years of unemployment. They are calculated for a prime-age worker with a “long” and uninterrupted employment record. They are averages over four stylized family types (singles, one-earner couples, with and without children) and two earnings levels (67%, 100% of average full-time wage) and consider cash incomes, income taxes and mandatory social contributions paid by employees. Severance payments are excluded. “Social assistance” refers to cash minimum-income transfers. In the United States it also includes the value of a near-cash benefit (“Food Stamps”). Housing-related benefits are those available for rented accommodation. In some countries, housing-related support is covered by social assistance instead. For details, see www.oecd.org/els/social/workincentives.

Source: OECD tax-benefit models.

other countries, families with children keep a small amount of family benefits when their unemployment support expires in the second year of unemployment. Australia, Ireland, New Zealand, the United Kingdom operate unlimited means-tested unemployment assistance benefits, resulting in a constant NRR over time.

Other financial support for low-income groups

Housing benefits, as well as social assistance and other benefits of “last resort” provide income top-up for those with low incomes, and a fall-back option for people not (or no longer) receiving unemployment compensation. Figure 1 shows average NRR during a long unemployment spell for someone receiving both unemployment and safety-net benefits according to formal legal rules. However, in practice, safety nets are often poorly targeted and typically reach only a fraction of low-income families who would be formally entitled.

Make-work-pay policies

The twin objectives of supporting the living standards of low-income families, and encouraging economic self-sufficiency can be in conflict with one another. OECD countries have increasingly introduced measures aimed at improving the terms of this trade-off by accentuating financial work incentives while maintaining adequate support for those with no or very low earnings. Today, practically all OECD countries operate “make-work-pay” policies of one form or another:²

- Most countries operate gradual benefit phase-outs for individuals with low (“marginal”) earnings (e.g., those working a few hours while looking for a better-paying job). Disregarding a certain amount of earnings in the income test, or ignoring marginal working hours in the eligibility test of out-of-work benefits, can provide strong incentives to supplement benefit income with a

²See Immervoll, H. and M. Pearson (2009), “A good time for making work pay? Taking stock of in-work benefits and related measures across the OECD”, IZA Policy Paper No. 3.

small amount of earnings and to seek or maintain at least some link with the labor market. But, often, steep benefit phase-outs for non-marginal work, combined with tax or social contribution burdens can mean that earning more “does not pay” (e.g., net incomes of a German lone parent are about the same whether she earns 10% or 66% of the average wage). Weak incentives to increase employment incomes further can give rise to a low-pay trap.

- Partly to address these problems, an increasing number of countries are operating employment-conditional (or “in-work”) benefits or tax credits for non-marginal workers. These support measures reduce net tax burdens below zero for some groups (*i.e.*, the benefit or tax credit exceeds tax/contribution burdens). Depending on how they are targeted, they can help to reduce the extent of in-work poverty. Because the strengthened work incentives also reduce the number of people claiming out-of-work benefits, in-work support is a potentially cost-effective redistribution measure. Some countries reduce costs further by paying in-work benefits only during an initial period following new employment in a qualifying job (Australia, Belgium, Canada, Ireland, Japan, Korea and Slovakia).

Eligibility criteria and obligations of job seekers and benefit recipients

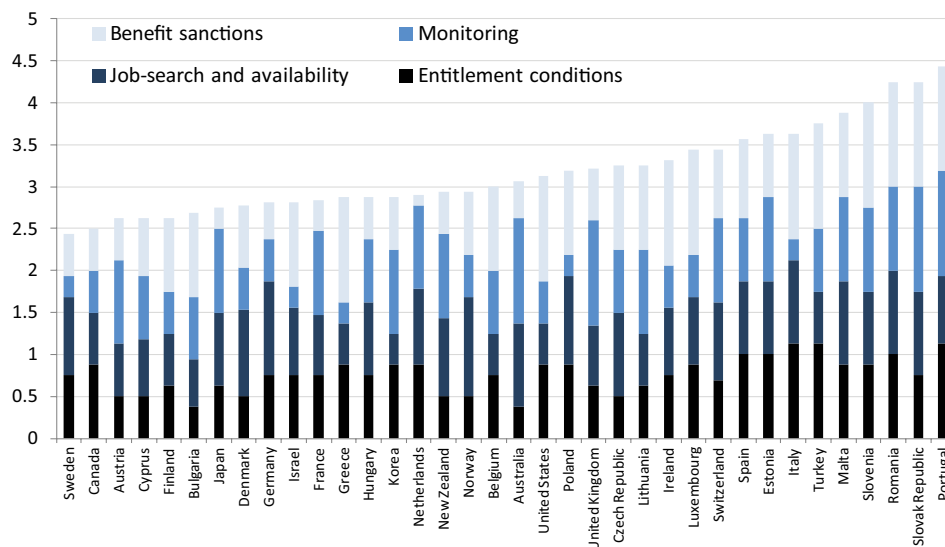
Simple “textbook” economic models of labor supply and job search regard out-of-work benefit levels as a *de-facto* wage floor,

with benefit generosity as central determining factor of people’s efforts and behavior. In reality, benefit receipt is not simply a choice but is associated with more or less well defined—and more or less demanding—eligibility conditions. Some of these conditions exclude certain individuals from the group of benefit claimants at the outset (these are sometimes referred to as *entitlement* conditions). For instance, individuals with short or interrupted employment histories may not qualify for UB, while those with assets may be excluded from receiving means-tested benefits.

As part of a “mutual obligations” or “rights and responsibilities” strategy, those entitled in principle typically have to comply with specific behavioral requirements, notably active job-search, which can make continued benefit receipt costly for individuals who are not genuinely seeking to overcome benefit dependency. Well-defined eligibility conditions can thus ease trade-offs between adequate out-of-work benefits and fostering a back-to-work culture, so that strengthening out-of-work support does not need to translate into reduced job-search efforts.³

The importance of eligibility conditions becomes clear when considering how many unemployed actually receive benefits. A recent study reports that more than 70% of unemployed Germans and Belgians were in receipt of UB in the mid-2000s. In most countries, coverage was much lower: Fewer than 20% received UB in Italy, Slovakia, Poland, Greece, Estonia and the United States.⁴ Prior to the mid-2000s, coverage rates have dropped in two thirds of countries in that study. There can be

Figure 2. Unemployment benefits: Strictness of formal eligibility rules, 2011



Note: Higher scores for more demanding eligibility criteria. See text for definitions, measurement and calculation details.

Source: Adapted from Venn, D. (2011), “Eligibility Criteria for Unemployment Benefits”, OECD Social, Employment and Migration WP No. 131.

³ See Fredriksson, P. and B. Holmlund (2006), “Improving Incentives in Unemployment Insurance: A Review of Recent Research”, Journal of Economic Surveys, 20 (3), for a survey of theoretical models of job search.

⁴ Immervoll, H. and L. Richardson (2011), “Redistribution policy and inequality reduction in OECD countries. What has changed in two decades?”, OECD Social, Employment and Migration Working Paper No. 122. Results refer to UB. Barriers to claiming benefits can be greater still for potential claimants of minimum-income benefits. Studies on benefit take-up regularly find very high non-take-up rates for means-tested benefits in the order of 40% or more.

different reasons for these trends. Reduced employment stability is a likely driver of falling benefit coverage. But in addition, some of the countries pursuing an activation agenda have tightened conditions, reduced benefit durations, or introduced more demanding behavioral requirements.

How demanding are eligibility criteria for unemployment benefits?

The OECD and others have argued that job-search incentives and requirements can have a significant effect on aggregate unemployment.⁵ This is consistent with large (25-50%) benefit caseload reductions following welfare-to-work type reforms in the United States, Denmark, Ireland, the Netherlands and the United Kingdom. To assess countries' policies in this area, a joint project between the OECD and the European Commission has collected qualitative information on the strictness of eligibility criteria for UB in 36 OECD and EU member countries.⁶ The study covered four categories of eligibility "strictness", with one or more sub-categories:

1. Entitlement conditions

- a. employment/contribution requirements
- b. sanctions for "voluntary" unemployment

2. Job-search requirements

- a. Availability requirements during ALMP participation
- b-d. Suitability of job offers: Required occupational, geographic and other mobility

3. Monitoring of job-search activities (proof of job-search activity)

4. Sanctions for failing to comply with behavioral requirements

- a. Sanctions for refusing to accept a suitable job or participation in ALMP
- b. Sanctions for repeated refusal of job or labor market program

Figure 2 reports the overall strictness score derived in that study.⁷ In 2011, formal eligibility conditions for UB were least strict in Sweden, Canada, Austria, Cyprus and Finland. It is notable that countries with the most demanding eligibility

criteria (e.g., Portugal, Romania, Slovakia, Slovenia) tend to have strict rules in all four categories. Yet, overall, there is little cross-country correlation between different aspects of strictness (e.g., countries do not appear to trade off individual aspects of eligibility strictness against each other).

Formal eligibility criteria are clearly important – for job seekers, as well as for understanding countries' activation stance. Ultimately, however, the significance of formal rules depends on how they are implemented in practice. The formal strictness of relevant legislation can therefore be an unreliable guide to its actual impact on job search behavior. Importantly, resources available for labor market policies determine how well benefit agencies and employment services can carry out their legal monitoring and support mandates. When there are capacity constraints, redesigning formal rules may produce little effect in practice (as agencies may not be able to maintain effective contact with clients or are otherwise unable to monitor job-search activity in a suitable way).

In addition, legal rules may be formulated in very general terms, meaning that case workers can (or have to) use discretion when applying them to individual clients. This applies even more strongly in the case of lower-tier out-of-work benefits (such as minimum-income transfers). Typically, these benefit programs are the responsibility of regions or municipalities and with often strongly divergent implementation practices. These safety-net benefits are also frequently subject to budgetary limits; not everyone who is technically eligible may then receive them.⁸

Active labor market programs

Overall spending levels

Like government expenditure on "passive" income support, aggregate spending on ALMPs can be strongly counter-cyclical. However, in the past, spending *per unemployed person* has in fact often declined very significantly as unemployment rose during downturns (Figure 3, upper panel).⁹ When unemployment goes up more quickly than ALMP spending, there is a risk that it becomes more difficult to service job seekers effectively. During periods of extended labor-market weakness, independent job-search becomes more difficult and job-seekers may come to depend more heavily on job-search assistance and labor market programs.

Nordic countries show the highest spending levels, but, as a group, Continental European countries now spend only

⁵ E.g., OECD (2006a), "General policies to improve employment opportunities for all", OECD Employment Outlook.

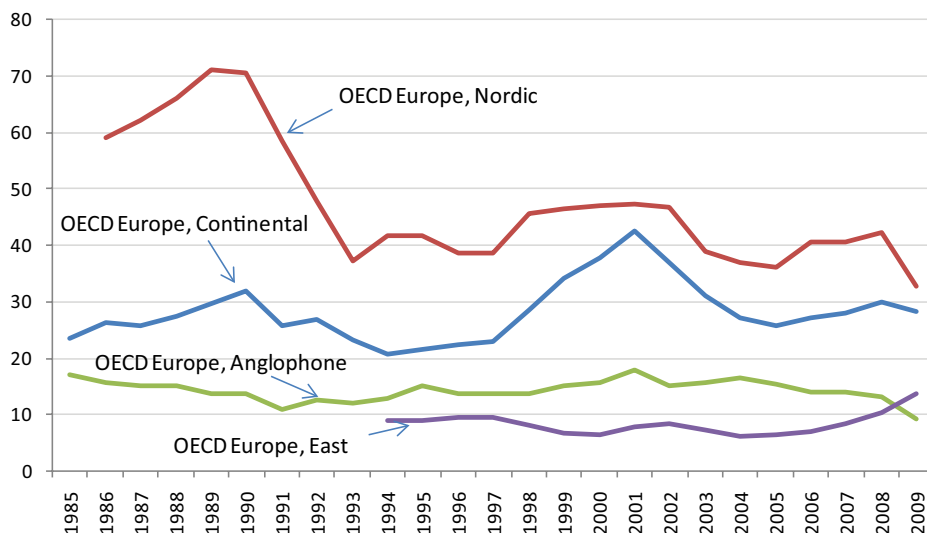
⁶ Venn, D. (2011), "Eligibility Criteria for Unemployment Benefits", OECD Social, Employment and Migration WP No. 131.

⁷ The qualitative information on each of those sub-categories was translated into scores ranging from one (least strict) to five. Scores were then combined into a composite indicator using equal weights for each of the main headings and sub-categories.

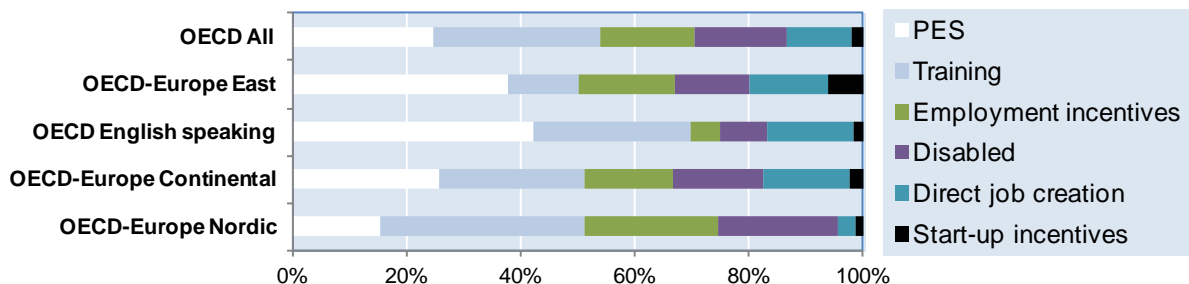
⁸ Lower-tier minimum-income programs are therefore not considered in the overview of formal eligibility rules presented in the EC/OECD study. A recent summary of formal eligibility rules is given by Immervoll, H., (2012), "Minimum-income Benefits in OECD Countries: Policies and Challenges", in D. Besharov and K. Couch (eds.), *Measuring Poverty, Income Inequality, and Social Exclusion. Lessons from Europe*. Oxford University Press.

⁹ During the past decade, two other OECD members—Japan and Korea—have spent less than English-speaking countries. Japan and Korea were, however, able to scale up spending per unemployed during the most recent economic crisis.

Figure 3: Spending on active labor market programs per unemployed person, in percent of GDP per capita



Spending by policy area prior to the economic downturn



Note: See Statistical Annex of the OECD Employment Outlook and for definitions and limitations.

Source: Author calculations based on OECD Labor Market Program Database and OECD Labor Force Statistics; Grubb, D. and A. Puymoyen (2008), “Long time series for public expenditure on labour market programmes”, OECD Social, Employment and Migration WP No. 73.

slightly less. Per-client expenditures in English-speaking and Eastern European OECD countries are much smaller, but with opposite trends in recent years (increasing spending in Eastern Europe).

What types of labor market programs do countries prioritise? Composition of ALMP spending

The core matching functions of the PES (“job brokering”: placement and job-search assistance) form a fundamental pillar of active labor market policy. Yet, most of public ALMP

expenditures go towards programs that seek to address specific employability issues (Figure 3, lower panel). In countries with comparatively high overall spending, core PES functions (including job-matching services delivered by private providers but with public financing) typically account for less than 25% of total ALMP resources. In English-speaking countries, PES spending shares have, however, gone up as total ALMP expenditures declined (labor market programs drove falling ALMP spending levels, while core PES functions were apparently largely protected from spending cuts).

Other than PES, training is the largest spending category in most countries, accounting to one fourth to one third of total spending. However, in Eastern Europe, just over 10% of ALMP expenditures go towards training measures and English-speaking countries now spend much less on training than they did in 1990. Across the OECD, job subsidies and other demand-side employment incentives have grown more important as a spending item, while direct job creation (e.g., public works programs) have seen declining expenditure shares. Start-up incentives for new businesses are only a small part of total spending (but have been very sizable during the early transition phase in Eastern Europe). Finally, spending under the “disability” category (including supported employment and rehabilitation) has grown, reflecting a growing awareness of sickness and disability as a major labor-market issue.

Do active labor market programs “work”?

One general finding of existing studies in OECD countries is that the impact varies considerable between type of program.¹⁰ The meta-study by David Card and colleagues reports positive short-term effects (12 months after start of program) on employment for less than half of the studies they review (30% find negative employment effects, and a further 30% show no discernable effect). However, there is some evidence that outcomes “get better” when assessed over a longer time period. Training measures are generally found to have a positive impact on employment, and positive effects are not evident immediately after a training program, but take some

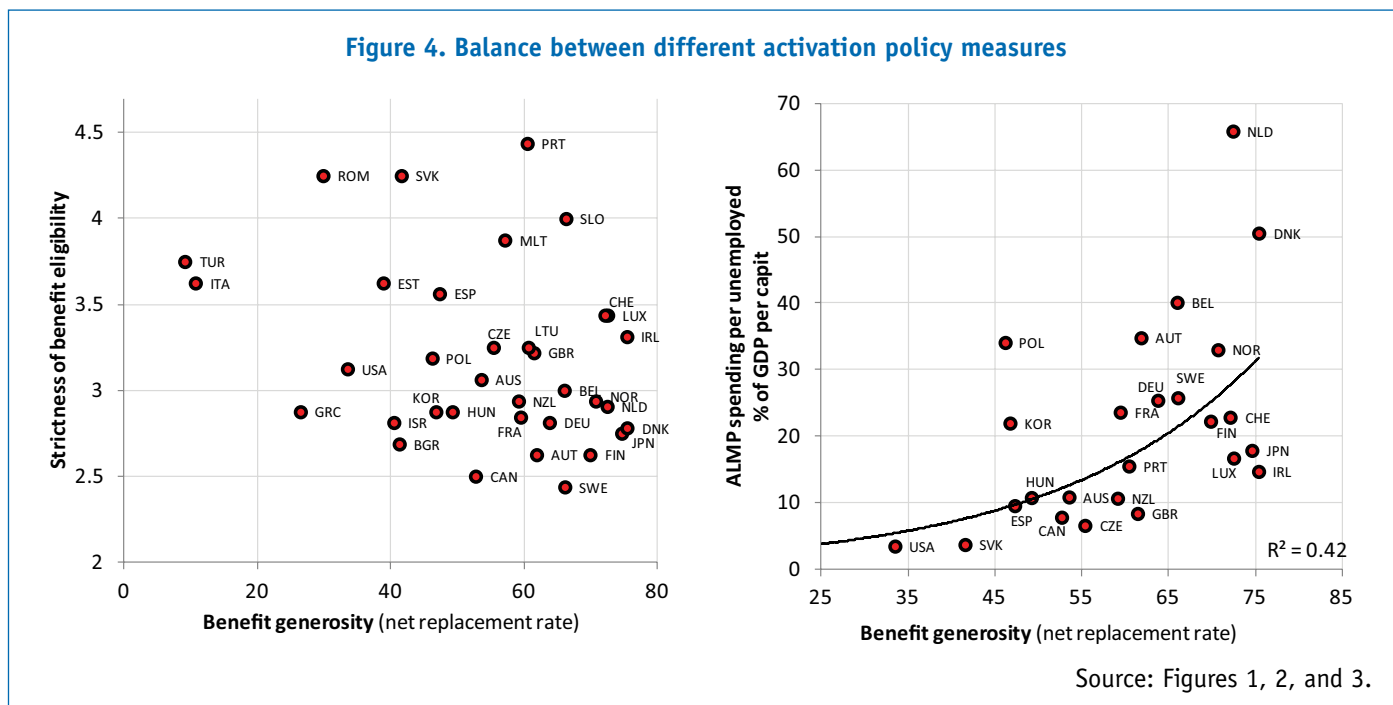
time to materialize. They also tend to be small or insignificant for men and for basic education. On-the-job training appears to perform best. Public-sector job creation programs have mostly produced negative labor-market effects (based on assessments after the program has ended). Evidence on private-sector employment subsidies does not give a strong indication either way. Results are also inconclusive for self-employment support and start-up.

An important consideration when interpreting impact evaluations is that programs will often impact outcomes other than employment, e.g., incomes of ‘sanctioned’ individuals and their families. There is still very limited information on the distributional effects of different activation approaches. Careful distributional assessments should be a crucial element of policy evaluations as activation measures typically affect disadvantaged groups.

Overall policy stance on activation

To characterise countries’ overall activation stance, it is useful to examine the balance of the different measures (ALMPs as well as financial incentives, eligibility criteria and job-seeker obligations).

Figure 4 shows two scatter plots of indicators presented earlier. Taken at face value, there is no indication that benefit eligibility is generally stricter in countries with generous out-of-work benefits (left-hand panel). Eligibility is strict in some



¹⁰ Card, D., J. Kluwe and A. Weber, (2010), “Active labour market policy evaluations: A meta-analysis”, *Economic Journal*, 120; Greenberg, D. H., C. Michalopoulos and P. K. Robins (2003), “A meta-analysis of government-sponsored training programs”, *Industrial and Labor Relations Review*, 57; OECD (2005), “Labour market programmes and activation strategies: Evaluating the impacts”, *OECD Employment Outlook*.

countries with high NRR (Slovenia, Portugal), but others with even more generous out-of-work benefits have fairly light eligibility requirements (Nordic countries, Japan). Benefits in Turkey, Italy, Estonia and Slovakia (as well as in non-OECD Romania) are both low and subject to demanding eligibility conditions. Overall, there is no correlation: Some countries may seek to offset possible work disincentives of generous benefits (the clients' "rights") with relatively demanding client responsibilities. In others, benefits are generous (or tight) both in terms of benefit amounts and in terms of client beneficiary obligations.

By contrast, there is an apparent link between ALMP spending and NRR across countries (right-hand panel). Active policy "effort" (ALMP spending), tends to be greater in countries where benefits are generous (in part, this is driven by Denmark and the Netherlands, but the link remains significant when these countries are excluded).

Conclusion

Although knowledge gaps remain, the experience in the OECD area provides useful pointers for World Bank client countries seeking to strengthen activation policies. One conclusion from a review of existing evidence is that well-designed policies can have a positive impact on employment outcomes for participants, but that many existing policies

have in fact failed to prove effective or cost efficient. Systematic evaluation and sustained policy commitment are therefore needed in order to decide which policies should be expanded, adapted or ended, and which individual programs might work best if employed as a package in combination with others.

The impact of individual programs on aggregate employment or beneficiary caseloads is often fairly modest. This is not necessarily surprising and need not be discouraging given that most measures are highly targeted, investment of public resources is limited, and program durations are short. But it also suggests that there is scope for better co-ordination between policy domains. For instance, job-search incentives and requirements could be closely co-ordinated with job-search assistance and financial incentives and benefit conditionality can increase participation in employment services. To the extent that these services are effective, this should result in better employment prospects, and a possible virtuous cycle of reduced caseloads and improving service quality.

But institutional contexts, labor-market conditions and potential client groups differ across countries – and these differences can be very large between high, middle and lower-income countries. Knowledge exchange and peer learning are more likely to translate into directly useful policy insights if they are anchored in a solid understanding of domestic policy challenges and capacities.

