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Labour market
Focus on active labour market policies

Madelene Nordlund and Bent Greve

Introduction
Labour market has a central function in most welfare states. Following a brief introduction to labour markets, this chapter will focus on Active Labour Market Policies (ALMPs) which consist mainly of educational and employment incentives offered to the unemployed. ALMPs aim to relieve or prevent the negative effects that spells of unemployment often bring about for the individual as well as for the labour market as a whole. The subject that researchers continually investigate is whether or not participation in ALMPs is fruitful. This chapter shows that it is difficult to make universal statements about this because the success of ALMPs seems to vary as a consequence of how they are designed, individual heterogeneity among participants and methodological issues. Nevertheless, despite the difficulty in drawing conclusions, some general tendencies with regard to the supply of ALMPs and subsequent micro-level effects of ALMPs will be highlighted.

Labour markets
The labour market is the place where labour is sold and bought. However, in all countries there is not just one labour market. There are many and very varied types of labour markets, which are divided due to local and regional differences. They are also different as a consequence of demand for different types of labour (from unskilled to skilled people with higher levels of education). Labour markets are also undergoing change as a consequence of new technology (Greve, 2017), and, this implies that activation works under a variety of and often different circumstances.

There are many varieties in the way labour market policies are decided and implemented in different countries and the way hiring and firing can be done also varies within the different understanding of flexicurity. Nordic welfare states have an overall stronger combination of high economic and job security, but not in a specific job, than is the case in other welfare state types. However, the specific combination of the different elements of economic security in case of unemployment and when and how employers under what conditions can sack a person varies across countries. The overall economic policy and business cycles also influence the level of
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Demand for labour, and the supply may also be influenced by many factors (Greve, 2018). Thus, it is within these varieties that the approach in many countries, namely to pursue an active labour market policy in order to reduce unemployment and increase employment, needs to be examined.

Depending on age groups, there may be differences in the level of participation in the labour markets. Recent years have seen an increase in participation rates for elderly workers, at least in the Nordic part of Europe (Larsen and Pedersen, 2017). This may influence both young people’s position in the labour market and the effectiveness of the active labour market policy.

**Unemployment scarring**

In what way do unemployment spells affect the unemployed? The unemployed are definitely exposed to a temporary risk of economic misfortune but they also risk suffering long-term scarring effects even after their spells of unemployment have ended. Common scarring effects include labour market exclusion or and future negative wage trajectories, and the longer the unemployment period, the greater the risk of long-term negative effects (Bentolila and Jansen, 2016). In this sense, unemployment should not only be viewed as a temporary problem that lasts as long as the jobless period. Instead it should be seen as a process that starts soon after entering unemployment and, in many cases, continues even after the person has returned to the labour market. First of all, unemployed people start to lose human capital (i.e. skills and experience) relatively quickly after the beginning of the unemployment spell (see, for instance, Becker (1993) as regards Human Capital theory). Then, after some time, potential employers will often hesitate to employ people who have been unemployed, particularly those with longer unemployment spells, because the unemployed are thought to be less reliable and productive than others, although there may be variations among occupations and the overall economic development. As time passes and their job applications continue to be rejected, the unemployed also tend to lower the intensity of their job searching and eventually stop looking for new jobs altogether. Under such circumstances there is a rapid increase in the risk of individual negative effects such as labour market exclusion or a negative wage development if there is any return to the labour market at all. To avoid such negative scarring effects, the unemployed should return to the labour market as soon as possible, since the length of the unemployment spell influences how much damage the unemployed may experience (see Layte et al. (2000) with regard to unemployment as a cumulative disadvantage on the labour market).

**Unemployment insurance**

Unemployment insurance systems regulate the conditions for the eligibility of unemployment benefit. The unemployment insurance system is by tradition called a passive measure and is used to alleviate the risk of direct economic misfortune but can also reduce the more long-term negative consequences to which the unemployed are exposed. This chapter focuses on active measures (ALMPs); but first the passive measure of unemployment insurance deserves some attention.

The way unemployment insurance is formed to fit in with a certain welfare state depends on the type of welfare state in question (see also Chapters 11–16). In a social democratic type of welfare state (for instance, Sweden or Denmark), the idea is to redistribute resources with the aim of reducing inequalities among social groups. Basically, this gives rise to fairly generous unemployment benefits which cover a relatively large proportion of the unemployed. In more conservative welfare states (Germany, for instance), unemployment insurance is based on the
unemployed person’s previous achievement on the labour market. In this case, unemployment benefit is generous for those who have contributed most on the labour market but much more limited for those who have contributed less. In a liberal welfare state (for instance, the UK and the US), the unemployment insurance system is designed only for the poorest, those who would have difficulties surviving without it. In liberal welfare states, unemployment benefit is therefore limited both in coverage and duration. Thus, in general, the conditions of different unemployment insurance systems vary in terms of the level and duration of compensation for the eligible recipients and they also vary in terms of how much individuals must contribute on the labour market before receiving any benefit (see Chapters 11 and 27 as regards welfare state typologies).

There is a constantly ongoing debate regarding the most appropriate design of unemployment insurance. Generally speaking, it is important for the unemployed to return to the labour market as soon as possible to avoid the risk of longlasting negative scarring and, when seen from this perspective, generous unemployment benefit may delay a return to the labour market. In this context, Search Theory has had an influence on the choices made by countries when designing their unemployment insurance systems. Search Theory suggests that generous compensation makes the unemployed less inclined to search for jobs and more selective before accepting job offers. According to Search Theory, this behaviour by the unemployed will lengthen the unemployment spell. In contrast, less generous compensation is expected to shorten unemployment spells because a less favourable economic situation will make the unemployed more active in job searches and they will be less selective when accepting job offers (see e.g. Mortensen (1977, 1990) with regard to Search Theory). Seen from the perspective of Search Theory, unemployment insurance systems should mainly provide for the poorest and only for a limited time. However, while such a link between level and length of unemployment compensation and job probabilities has been empirically confirmed by some researchers (see e.g. Katz and Meyer, 1990; Meyer, 1990; Layard et al., 1991; Roed and Zhang, 2004), others have not been able to confirm this link (Carling et al., 1996; Bennemarker et al., 2005; Nordlund and Strandh, 2014).

Although Search Theory contributes important knowledge with regard to the search behaviour of the unemployed, it needs to be balanced by other aspects of the effects of unemployment benefit on the unemployed. In fact, it has been found that unemployment benefit can function as a human capital preserver, since generous compensation makes it easier for the unemployed to search for suitable jobs that match their skills and experience, rather than having to take the first available job. This has been found to have positive effects on post-unemployment incomes (Nordlund and Strandh, 2008). Seen from this perspective, the system should perhaps provide economic compensation over a relatively long period.

Not only does the unemployment benefit system have an impact, but also in-work tax benefits and fiscal welfare (see Chapter 3).

In this context it should also be mentioned that other incentives, apart from the economic one, seem to have an impact upon the job search behaviours and job probabilities of the unemployed. Such incentives are related to psychosocial and psychological needs (Strandh, 2000; Nordlund and Strandh, 2014) as well as to other characteristics concerning human capital, demography and of course local labour demands (Korpi, 2001; Åberg, 2001; Hjerm, 2002; the Swedish Integration Board, 2003; Addison et al., 2004; Caliendo et al., 2010). This is also due to the fact that unemployment spells have a negative impact upon people’s well-being and happiness (Greve, 2017a); however, the impact may be mitigated by generous passive labour market policy and less so by active labour market policy (Wulfgramm, 2014). Thus, economic incentives usually underlie the design of unemployment insurance in order to maximise the outflow from unemployment to employment. However, economic incentives do not explain
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Active Labour Market Policies (ALMPs)

A retrospective overview

The history of ALMPs derives from the economic and labour market depression that hit most of the Western world in the 1930s. The common belief prior to this was that self-regulating components without any public interventions would solve many of the problems to which market economies were exposed. This belief changed to some extent during the Depression because it was understood that unemployment followed by a Depression could not automatically be eliminated and, along with the increase in wealth in many Western countries, the ambition to invest in ALMPs to regulate the unemployment level grew (Keynes, 1936; Axelsson et al., 1985). As early as in the 1930s, ‘Public relief work’ was introduced in Sweden. These jobs were specially created for the unemployed in order to hold down the unemployment level and a specific feature of these interventions was that the workers received a wage equal to market wages.

In the 1940s, two Swedish economists, Gösta Rehn and Rudolf Meidner, came up with an economic model, known as the Rhen-Meidner model. In general, it was believed that low...
inflation led to high unemployment and vice versa, but Rhen and Meidner argued that it should be possible to create an economic model that brought about both low inflation and lowered unemployment rates. An important part of this model (together with other features not mentioned here) was that it contained a wage policy that promoted equal pay for equal work. This policy aimed to reduce wage spans and increase wages for the most exposed groups on the labour market. Equal wages would be set regardless of businesses’ ability to pay and consequently, the policy accelerated the closure of businesses or industries with poor profitability. This was a rational way to kick-start the modernisation of Swedish society in the post-war era, the focus being on upcoming lines of industry rather than giving support to weak sectors. The risk was that inflation would increase as a result of the economic goals but this was to be prevented through a subdued demand policy. The combination of a subdued demand policy and the solidarity wage policy increased the risk of structural unemployment, since workers were pushed into unemployment when businesses closed. To prevent the negative effects of structural unemployment, it became necessary to enable the efficient movement of workers between lines of business and ALMPs were created in this context in order to direct the unemployed back into the labour market. ALMPs would educate and train the unemployed so as to match expanding industries with a growing labour demand and they would also prevent bottlenecks during booms. Another purpose of ALMPs was to facilitate efficient matching between employers and employees through unemployment services (for more details about the Rhen–Meidner model, see e.g. Erixon, 2008).

At first, ALMPs appeared in economic policy mainly in the Scandinavian countries but, in the 1990s, an increasing number of labour market strategies including ALMPs were developed in other European countries and the USA. This was a result of the sharp rises in unemployment which OECD countries had experienced over several decades. Along with increasing unemployment rates, long-term unemployment spells also increased, and therefore it became urgent to improve the employment prospects of the unemployed; hence ALMPs were developed (See e.g. Kluve et al., 2007).

Today, many countries are having to cope with an ageing population and, in order to limit the ensuing consequences of a smaller workforce, broader actions have been taken to involve a larger number of people in work. Therefore, ALMPs have changed from being an active measure to cut unemployment levels to becoming elements of the ‘making-work-pay’ policy together with the unemployment insurance system. As pointed out earlier in this chapter, unemployment benefit has likewise changed from being welfare to becoming workfare, with the aim of improving the employability of the unemployed and other working-age persons and making them more active in their job search process. To facilitate the ‘making-work-pay’ policy, more priority has been given to the efficiency and administration of ALMPs (see e.g. Kluve et al., 2007), and that any job instead of the best match is needed (Dean, 2007).

**Types of ALMPs**

ALMPs are used to counteract labour shortages and to mobilise the workforce by holding down the overall unemployment level. At the same time, on an individual level, the unemployed get help to maintain or increase their human capital and thereby improve their future labour market prospects. These aims can be facilitated by organising different types of activities for the unemployed and also by promoting an active match between vacancies on the labour market and the unemployed.

The types of measures applied differ across countries, which makes it difficult to be precise in the description of ALMPs from a cross-national perspective. However, a study of different
countries’ expenditure on ALMPs gives an indication of how ALMPs have been prioritised as an important part of labour market policy. For instance, in 2014, Denmark, Finland and Sweden were the countries putting most money into ALMPs (from 1.07 to 1.91 per cent of GDP) while most Anglo-Saxon countries were spending much less on ALMPs (the USA and Australia, for example, spent from 0.1 to 0.26 per cent of GDP) (OECD, 2016).

In order for ALMPs to be successful, they need to be constantly adjusted in order to fit the overall labour market situation in a country. It is therefore not possible, nor even relevant, to mention particular programmes, since these vary both across countries and over time within countries. Furthermore, a closer study shows that when measures are compared at different points in time, in the mid-2000s, ALMP measures were split and renamed (Grubb and Puymoyen, 2008). The main types of ALMPs that serve rather different purposes on the labour market are briefly described below.

One type of ALMP aims at promoting an efficient exchange of information between employers and employees/unemployed. It is called **Public employment services and administration.** The aim of **Public employment services and administration** is to increase the matching process by offering coaching and different types of job-search activities to the unemployed. However, another task is to administrate unemployment benefit sanctions in the event that the job-search behaviour of the unemployed is deemed insufficient.

Another type of ALMP is **training** activities through classroom education, training at workplaces and special support for apprenticeships. The focus of this type of programme is on the actual skill development of the participant. Through education and skill development, the unemployed enhance their human capital, which in turn often improves their employability and productivity. Human capital enhancement should in turn lead to better labour market prospects. The activities are often directed at skills that are expected to be in future demand on the labour market.

Apart from human capital-increasing activities, there are also programmes directed more towards **employment incentives.** The aim of this type is to give subsidies to regular employment on the regular labour market, to support direct job creation within the public sector and to give support to unemployed people who decide to set up their own business. This type of programme mainly helps the unemployed to stay active and to establish networks on the labour market. The focus is more about creating and maintaining abilities and social competences during the unemployment spell, rather than building up human capital. The challenge with this type of programme is to provide the unemployed with tasks that do not push aside the regularly employed.

In addition to or alongside the types of ALMPs mentioned here, there are also **supported employment and rehabilitation** measures directed at youth and people with disabilities, since they are particularly exposed to and at risk of labour market marginalisation.

**ALMPs from macro- and micro-level perspectives**

Economists have contributed important knowledge about effects from a macro-level perspective: what policies are effective with regard to making the labour market more efficient, and what policies can be used to address structural problems or to reduce short-term or long-term unemployment? Others focus more on the micro-level outcomes of ALMPs: to what extent ALMPs manage to increase the human capital and employability of the unemployed and to what extent ALMPs help prevent misplacements in future job situations on the labour market. In addition, some micro-level researchers look at ALMPs from yet another dimension, arguing that ALMPs can have an important purpose even if ALMP participation does not increase job
probability. Training activities, for instance, improve the skills and competences of the unemployed, giving people the opportunity to make choices in life that they would not be able to do without such training. Training can lead to important qualities that the individual needs in order to interact in society, such as being able to read, to be healthy or politically active, skills which have been found to increase with education (Ross and Wu, 1995; Ross and Mirowsky, 2010). Such qualities can of course be an achievement in themselves but they may also be crucial for individual opportunities in the process of directing/ redirecting life plans (Robeyns, 2005). For a more detailed account of how ALMPs may be viewed from a capability approach see, for instance, Sen (2001) or Nordlund (2010).

The examples above show how the benefits of ALMPs can be viewed from different perspectives. Macro- and micro-level goals often overlap but they may also be conflicting, and micro-economic evaluations may not inform on the macro-economic impact (Martin, 2014). For instance, in order to reduce the number of long-term unemployed, unemployed people should return to the labour market as soon as possible. A speedy return to the labour market means that the unemployed should accept the first available job offer. However, seen from a micro perspective a swift return to the labour market may at times come in conflict with the aim of reducing the risk of individual misplacement on the labour market. The risk of labour market misplacement increases when the unemployed are pushed to take the first available job, instead of accepting the first suitable job. A suitable job is a job where previous human capital comes into use, which in turn reduces the risk of downward social mobility (the transition of people from a higher economic group or social class to a lower) and thus increases the chance of returning to a job with an income similar to the pre-unemployment income.

ALMP outcomes are usually studied and discussed from a macro perspective. In order to present a more balanced picture, the following section focuses on the micro-level outcomes of ALMPs rather than macro-level effects.

**Effects of ALMPs**

Evaluating the impact of ALMP participation is clearly important because the supply of programmes for the unemployed is economically demanding for a country. This is fraught with methodological issues and problems (Eichhorst and Konle-Seidl, 2017), and data issues (Clasen et al., 2015). Moreover, participation in ALMPs may also cause negative lock-in effects for the participants since they then miss out on the opportunity to search for vacancies on the regular labour market. With the awareness of possible lock-in effects, it is particularly important to evaluate programmes in order to reduce the risk that unemployed people are placed in activities that waste their time or even ruin their job prospects in the regular labour market. Innumerable evaluations have been carried out in order to measure the effects of ALMPs, and researchers have contributed some important knowledge on this matter. Nevertheless, the results appear to be diverse and it is difficult to identify clear cross-national patterns. A very brief summary of ALMP micro-level effects is presented below and for a more detailed overview of country-level summaries as regards design and outcomes of ALMPs see Kluve et al. (2007) and Kluve (2010); for a macro-economic evaluation see Martin (2014).

As will be shown in the following section, ALMPs can lead to an increase in human capital and higher employment probabilities among the unemployed. However, in this context it should be mentioned that there are no truly reliable methods to capture what is called the ‘counterfactual state’, i.e. what the effect would have been if the unemployed person had not participated in the ALMP in question. While research may be able to show that a particular ALMP generated positive outcomes for the individual, it cannot be said for sure that the positive
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effect is a consequence isolated to the effect of the programme. The participants may possess certain characteristics which in themselves could have an impact upon the outcome. Some participants would perhaps have found jobs even without participating in ALMPs. In such circumstances, programmes result in a deadweight loss, which is of course not desirable, since ALMPs are costly and other priorities should perhaps have been considered instead.

Training–employment incentives

Several studies have shown that employment incentives produce relatively positive outcomes, both in terms of employment probability and post-unemployment incomes (see e.g. Gerfin et al., 2002; Strandh and Nordlund, 2008; Kluve, 2010). One main factor for success seems to be the extent to which these are linked to a country’s regular labour market. To transfer from unemployment to employment the unemployed need good networks and contacts, and in several cases employment incentives seem to be able to provide this need. However, the risk here is of course that successful programmes are too closely linked to the regular labour market. If so, the design of the programme in question may push aside the regularly employed (called displacement effects) and this is of course neither the intention nor a desirable outcome of ALMP activities.

For ALMP training measures, the main factor for success would be the quality of the training/education the participants receive, together with countries’ possibilities to match the supply of training/education with future needs for competence. Evaluations show mixed results where some indicate relatively modest effects in terms of employment probabilities while others present much better effects (see Kluve (2010) for an overview in this respect). This inconclusiveness would seem to be because the content of particular programmes has an impact upon their effectiveness. For instance, while some programmes are short, others extend over a much longer period and this diversity seems to give different effects, where longer programmes produce better outcomes on employment probability than do shorter programmes (OECD, 1996; Strandh and Nordlund, 2008). Furthermore, not only is the actual human capital investment (the content of the training and the duration of training) important for the outcome, it must also be matched with the demand for labour. This effectiveness certainly differs from region to region and from time to time. Other reasons for inconclusive results may be linked to at what point in a business cycle the ALMP activity took place and how long the time span was from activity to evaluation.

The impact of different business cycles

It has been reported that many of the programme participants in the 1980s and early 2000s (boom periods) experienced different types of positive effects while those who participated in the 1990s (recession period) experienced no positive – or even negative – effects. Some argue here that programme participation is useful when there are few jobs to search for on the labour market while participation during boom periods when there are plenty of jobs available may hinder the unemployed from searching for and accepting jobs (Ackum Agell, 1996; Regnéér and Wadensjö, 1999). However, Nordlund (2011a) studied how the effects varied depending on when in a business cycle participation in ALMPs took place and found that, regardless of the state of the market, ALMPs functioned to protect the Swedish unemployed from negative effects. An important finding here was that training incentives had a bridging effect during economic downturns meaning that the investment in training activities during a recession paid off long after the end of a programme. Martin (2014) confirms that, at least for the Nordic countries, long-duration training has an impact in recession.
Heterogeneity in outcomes

ALMP participation is not equally effective for all. Even if the same ALMP investment is made in all unemployed persons, the participants will respond differently to the investment. For instance, the labour market is segregated in such a way that male and female workers are tied to relatively different labour market sectors. The labour market sector to which women, men, the young, the old, the less or more educated, etc. belong may contribute to the explanation of the heterogeneity of ALMP outcomes. Some unemployed people may actually waste their time in ALMPs while others are more fortunate and increase their labour market prospects after ALMP activities. Age and educational background are examples of individual characteristics that have been shown to be an important factor for ALMP outcomes (Hammer, 1997; Nordlund, 2011b). Furthermore, those already marginalised in the labour market may gain from some types of ALMPs while people unemployed on structural bases may gain from other types of ALMPs. These are examples, and in order to fully explain the heterogeneous nature of ALMP outcomes, more research is needed.

Long-term effects

Most programmes are evaluated relatively soon (from a few months up to a couple of years) after the end of programme participation while, so far, only a few studies have measured the long-term impact (up to ten years). In the OECD report from 1996, Reutersward argued that, on the one hand, employment incentive programmes produce relatively immediate effects and can therefore be evaluated soon after the end of programme participation. On the other hand, it may be argued that evaluations regarding the outcomes of training programmes should be done much later, since this type of investment is meant to be a human capital investment, which is a long-term investment. Similarly, Strandh and Nordlund (2008) argued that the impact of training activities should to a larger extent be evaluated after a relatively long time, the reason being twofold. First, if a training programme is completed when the unemployment rate is high, there are very few jobs to search for, but as soon as the condition of the labour market improves, the participants stand ready with new improved skills that are needed on the labour market. Second, some people who enter training programmes continue on to further studies within the regular educational system after finishing the training programme, and the effects cannot therefore be correctly measured until they finish their studies four, five or even six years later (Calmfors et al., 2002). This means that more time should elapse from ALMP participation until evaluation, especially in times when demand for labour is low. Thus, the effects of such a chain of events demand a long-term approach. This may well be one reason why the outcome of training incentives often points to rather mediocre results. The real effects are quite simply not yet apparent if the time span from training activity to evaluation is short.

Overall impact

The most recent summaries and meta-analyses of the impact of ALMPs seem to confirm that the most effective intervention is activation in the private sector both in the short and long run. Next to this is training and retraining programmes (Vooren et al., 2016), who also points out that public employment schemes may even have a negative impact upon employment. Similar conclusions come from other studies, although this summary is more positively related to training and human capital accumulation than the study mentioned above:
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(1) average impacts are close to zero in the short run, but become more positive 2–3 years after completion of the program; (2) the time profile of impacts varies by type of program, with larger average gains for programs that emphasize human capital accumulation; (3) there is systematic heterogeneity across participant groups, with larger impacts for females and participants who enter from long term unemployment; (4) active labor market programs are more likely to show positive impacts in a recession.

(Card et al., 2015 p. 1)

Finally, a study related to youth unemployment also indicates positive impacts of job-search assistance, which albeit finds mixed evidence for training and wage subsidies, but also negative impacts of public work programmes (Caliendo and Schmidl, 2016).

Conclusion

This chapter began with a short account of the unemployment process, the risk of long-lasting negative scarring effects and unemployment benefit insurance systems that aim at alleviating more direct negative economic effects. To avoid more long-term negative effects, the unemployed need to return to the labour market as soon as possible, since open unemployment has a negative impact upon future labour market chances. This, as such, is sometimes used as an argument against generous unemployment benefit, since unemployment benefit is thought to lengthen the spell in unemployment. Active measures, ALMPs, can also delay labour market entrance for the unemployed because ALMPs last for quite some time and, while participating in an ALMP, the unemployed have very little time to search for jobs on the regular labour market. However, when ALMPs fulfil their purposes – when training programmes are of a high quality and the skill training is directed to match future labour demands, or when employment incentives are closely linked to the labour market – research indicates that the programmes often have positive individual effects. Thus, ALMPs may possibly delay labour market entry to some extent but it has in fact been shown that ALMPs do have the power to maintain/increase the human capital of the unemployed during a period of unemployment, which is certainly a vital factor for labour market inclusion.

Notes

1 This chapter was originally written by Madelene Nordlund, and it is based on this that the chapter is updated and slightly expanded by Bent Greve, so that it is now a common work.

2 Data for OECD countries may be found at www.oecd.org/els/benefits-and-wages-statistics.htm (accessed 13 June 2017).

References


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