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What Can Active Labour Market Policy Do?

Richard Jackman*

Summary

■ During the 1980s, two dimensions in particular of the unemployment problem have been a source of increasing concern for policy-makers in Europe. One is the increasing rate of structural change, and the resulting decline in employment opportunities for unskilled manual workers. The other is the evidence of the corrosive effects of long spells of unemployment on individuals and societies. This paper attempts to assess the role of active labour market policies in addressing these problems. It argues that, in the absence of active policies, the combination of more rapid structural change and the indefinite availability of cash benefits can be expected to lead to a continuing growth in long-term unemployment. Even where schemes do not have much of a return to those who are on them, as much of the microeconomic evidence suggests, they may still have a substantial social return in preventing the emergence of long-term unemployment. The key requirement is to ensure that no unemployed person, who is able and willing to work, should be allowed to draw benefit for more than a limited period of time. The resources of the labour market authorities should be used to ensure that as a last resort some appropriate temporary job or training opportunity is made available by the end of this period. ■

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In introducing its 1990 *Employment Outlook*, the OECD noted that growth both in output and employment during the 1980s had been strong, and that the unemployment rate in the OECD area had fallen for six years in succession. Nonetheless, unemployment rates in most member states were significantly higher than those recorded at the previous cyclical peak in 1978–79. Further, evidence of inflationary pressure, and of high rates of capacity utilisation, suggested at that time that there was no further scope for reducing unemployment through expansion of demand. The persistent unemployment of the 1980s, it concluded "...is basically structural in nature".

Structural unemployment is held to have arisen from profound changes both in the composition of demand for labour and in the characteristics of the labour force. Most important has been the substantial shift in demand towards more highly skilled occupations and away from, in particular, unskilled and semi-skilled manual work. There have also been substantial changes on the supply side, in particular the increased labour force participation of married women, and in the forms of employment organisation, such as the growth in part-time and temporary work and in self-employment (OECD, 1990a).

Clearly the appropriate labour market response to increased structural imbalance is greater mobility across sectors. However, most OECD countries (the United States being a conspicuous exception) provide a reasonable measure of income support for unemployed people. Unemployment

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benefits reduce the incentive to incur the costs and risks of occupational or geographical mobility. Some unemployed people appear to have resigned themselves to labour market inactivity and to life on benefits. There is also concern that the benefit system is being abused, particularly among young people, by the idle and fraudulent.

In response to this situation, the OECD recommended a policy framework, which contained three main elements (OECD, 1990b):

- *Mobilising labour supply*, which includes measures such as training, placement and rehabilitation programmes for the unemployed.

- *Developing employment-related skills*, which involves reforms in education and on-the-job training.

- *Promoting a spirit of active search*, which concerns the role of the employment services in job matching and longer-term career development.

Broadly speaking, this policy framework might be represented as an endorsement of "active labour market policies", that is programmes to encourage job search and assist labour mobility, as against reliance on "passive" policies (payment of unemployment benefit) as a response to the problems of structural change.

From a structural perspective, the argument for active labour market policies seems a plausible one. If unemployment is caused by labour immobility in the face of changing demand, then encouraging labour mobility would appear to be an appropriate policy response. But this immediately raises two questions. First, economies are always subject to structural change of various sorts, yet unemployment rates vary a lot across countries and over time, so does it make sense to attribute unemployment to structural causes? Second, even if it is true that in some sense unemployment is structural, is not the adjustment to shifts in demand and technology something which prices and markets are supposed to be for? What are the causes of market failure in this context, and how far can they justify government intervention?

In Section 1 of the paper I argue, primarily on the basis of evidence from the United States, that structural changes confronting the industrialised economies are indeed more substantial than in earlier decades and that the outcome of market forces in these circumstances has been a marked increase in income inequality. In most European countries, in-

cluding Sweden, the political commitment to social insurance is likely to rule out American levels of inequality, and hence will blunt the capacity of market forces to achieve the required structural change. The problem confronting policy-makers in Sweden and elsewhere in Europe is how to achieve labour mobility without removing social protection from those whose jobs are lost in the process of change.

Section 2 of the paper offers a brief discussion of the relative merits in principle of active as against passive labour market policies in the context of the dual objectives of encouraging labour mobility and maintaining social protection. The main conclusion of the section is that active policies can maintain people's incomes without creating a disincentive to mobility, whereas cash benefits will discourage mobility.

With these considerations in mind, Sections 3 and 4 review the evidence from OECD countries on the effectiveness of active labour market policies. Section 3 surveys studies on the effects of individual programmes on the employment prospects or subsequent earnings of those participating in them. Section 4 is concerned with macroeconomic evaluations, that is whether or not countries which invest more heavily in active policies achieve higher degrees of labour mobility or lower overall unemployment rates than those which do not. It has to be said that overall the evidence is not enormously compelling, but on balance tends to suggest that active policies can have beneficial effects at both micro and macro levels.

The paper concludes, in Section 5, by suggesting that the policy choice facing the industrialised countries in this context is to strike a balance between greater reliance on the market (implying greater income inequality and lower benefits for the unemployed) on the one hand, and fuller and more effective use of active labour market policies on the other. Sweden is already at one extreme, and though its system may have served it well in holding down unemployment in the past, at current rates of unemployment it may be becoming prohibitively expensive (quite apart from exhausting administrative capacity). In these circumstances there may be an argument for relying to a greater extent on the market, which would imply widening wage differentials and a cutback in the level of unemployment benefit. I suggest that the policy to be avoided is a cutback in active measures in conjunction with an extension of income support for the unemployed.

1. Recent developments in OECD labour markets

The unprecedented severity and persistence of unemployment in many OECD countries during the 1980s has been the subject of extensive research. While many questions remain unresolved, there appears to be agreement on three main points:

(i) The sharp rise in unemployment at the beginning of the 1980s can be attributed to the supply shocks associated with OPEC II, and the adoption of restrictive monetary policies in response to these shocks. In the early 1980s, high unemployment was associated with falling inflation.

(ii) From the mid 1980s, unemployment remained high but inflation stopped falling. While this might suggest a rise in equilibrium unemployment, there is no evidence that any of the aggregative factors associated with higher equilibrium unemployment (such as trade union power, the generosity of unemployment benefits, payroll taxes or other labour costs) had increased – if anything the reverse occurred (see, e.g. Bean *et al.*, 1987).

(iii) While long-term unemployment has an important role in explaining the dynamics of high unemployment, and can exacerbate and prolong the unemployment effects of adverse shocks, it cannot of itself be an explanation of a higher permanent unemployment rate. In the UK, for example, comparing the mid-1980s with the late 1970s, while long-term unemployment rose by a factor of five over the same period short-term unemployment doubled and the increase in short-term unemployment accounted for about half the total increase in unemployment (see, e.g. Haskel and Jackman, 1988).

By the end of the 1980s, the belief that continuing high unemployment could be explained primarily in terms of a never ending hangover from the deflationary policies of the beginning of the decade was becoming increasingly hard to sustain. Theories of unemployment hysteresis (the idea that the equilibrium unemployment rate would adjust to the actual unemployment rate, so that a temporary shock to unemployment would persist indefinitely) had been couched in terms of insider/outsider models (Blanchard and Summers, 1986; Lindbeck and Snower, 1988) and in terms of the effects of long-term unemployment (Layard and Nickell, 1987; Blanchard and Diamond, 1994). But both theoretical argument

and empirical evidence (reviewed, e.g. by Layard *et al.*, 1991) appear to establish that though these factors were important, the degree of hysteresis was significantly less than 100 percent. The return of unemployment to its long-run equilibrium might be prolonged but would not be prevented by these types of factors.

The idea that worsening structural imbalance in the labour market could be the explanation of persistent high unemployment had of course been frequently proposed. But evidence on sectoral unemployment rates (surveyed, e.g. by Layard *et al.*, 1991, ch. 6) seem to suggest that while structural imbalance was a serious problem, it had got no worse during the 1980s. By the end of the decade, however, evidence on relative wages, in particular from the United States, presented a very different picture.

This section first looks at the evidence from the United States, then very briefly returns to the relative unemployment rates, and finally sets out a simple model of structural change as a framework for policy discussion.

1.1. Wages and employment in the United States

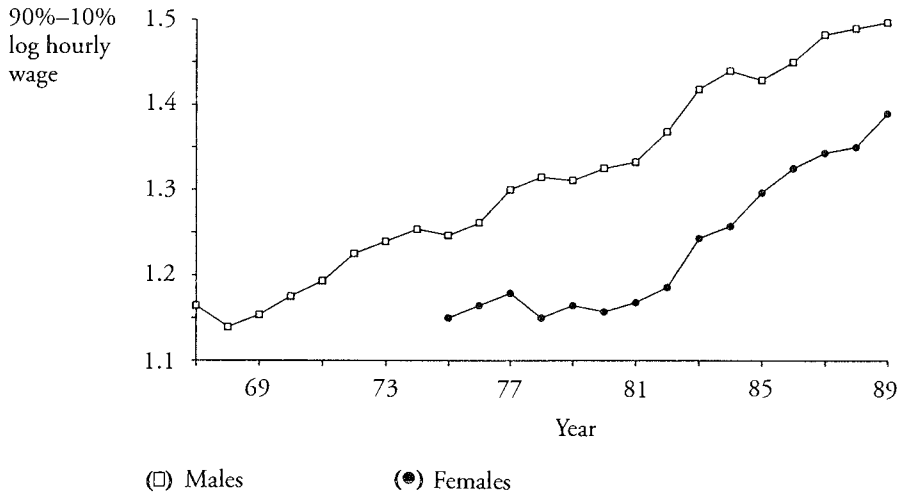
There have been three important features of the earnings distribution in the United States. First, though the dispersion of earnings had been widening since at least the late 1960s, the rate of increase has increased sharply since 1980. Second, this increase cannot be explained in terms of the economic cycle, because it persisted through a period of rapid growth during the latter part of the 1980s. And third, the relative employment rates as well as the wage rates of the skilled have been increasing, with the clear implication that the driving force comes from the demand rather than the supply side.

Of the developed economies, the US labour market is the most obviously competitive and flexible, the least subject to protection or regulation, and thus an arena in which the workings of market forces are most transparent. Unemployment in the United States, unlike in Europe, has shown virtually no trend increase since the 1950s, yet over the decades, and in particular over the last ten years, the distribution of wages has become more and more unequal (see e.g. Blackburn *et al.*, 1990 or Katz and Murphy, 1992).

These trends are illustrated in Figures 1 and 2 (Katz *et al.*, 1993). Figure 1, panel A, shows wage inequality in the United States increasing substantially: since the late 1960s in the case of men, at least since the early 1970s for women (earlier data are not available). While the growth in in-

Figure 1. Changes in wage inequality by sex in selected countries

A. United States



B. Great Britain

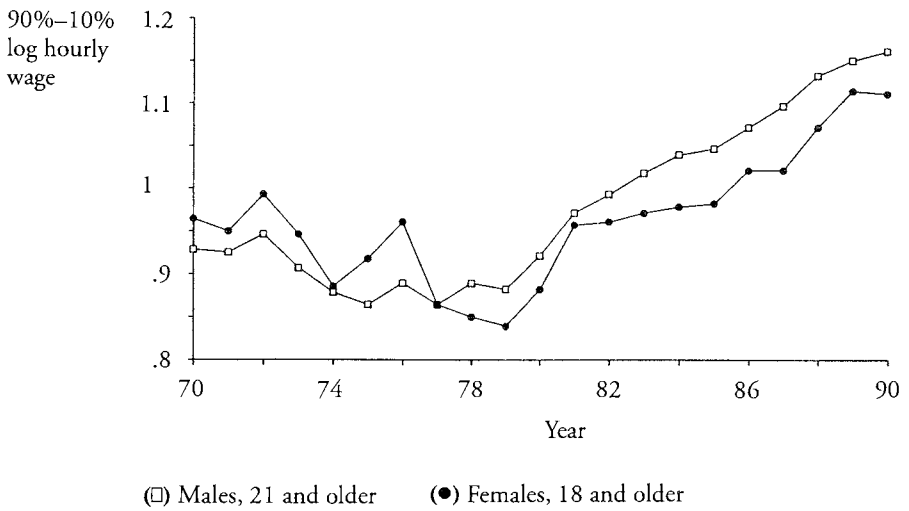
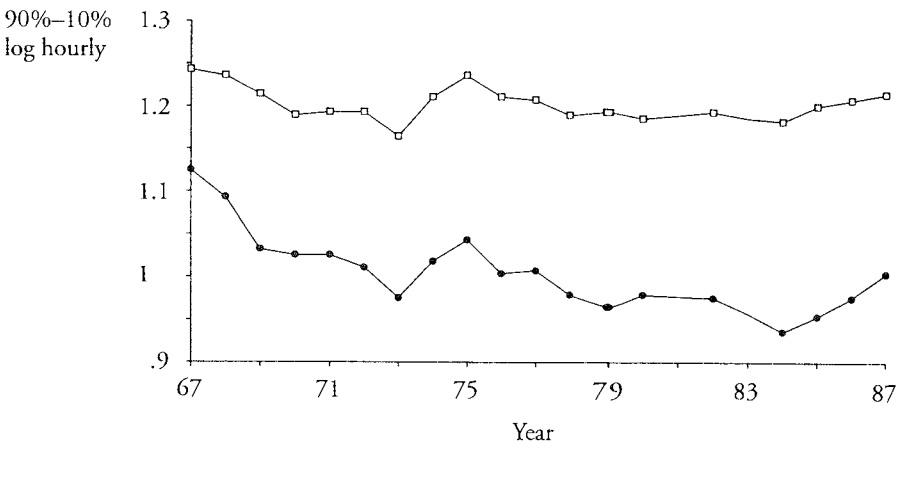
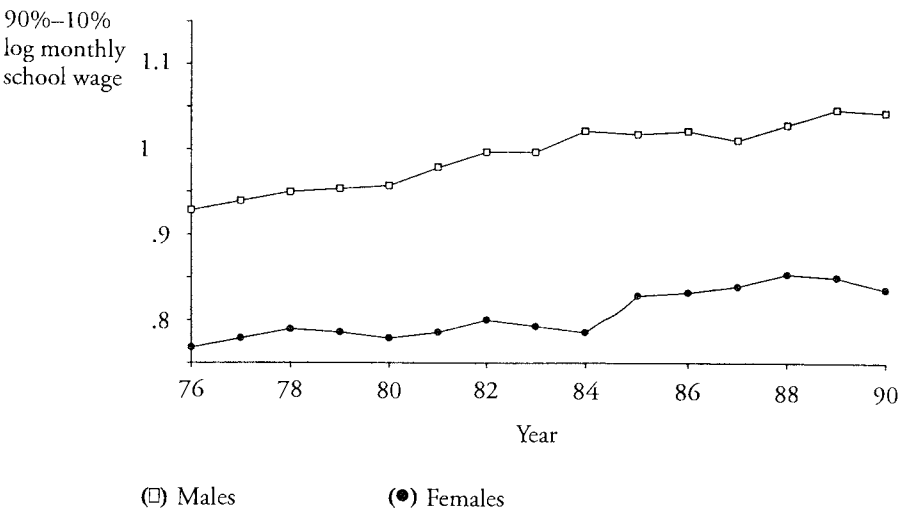


Figure 1. Continued

C. France



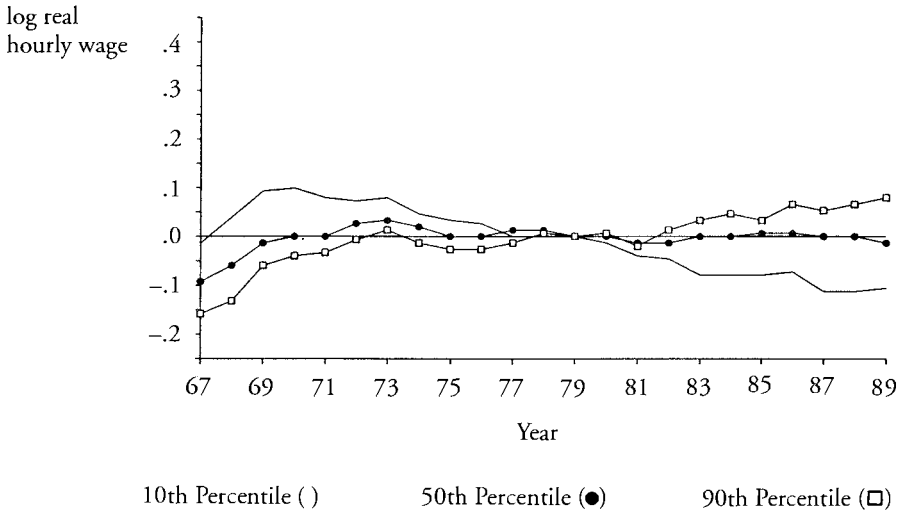
D. Japan



Source: Katz *et al.* (1993)

Figure 2. Cumulative real wage growth by decile in selected countries, males

A. United States, 18–64 years old



B. Great Britain, 21 years old and older

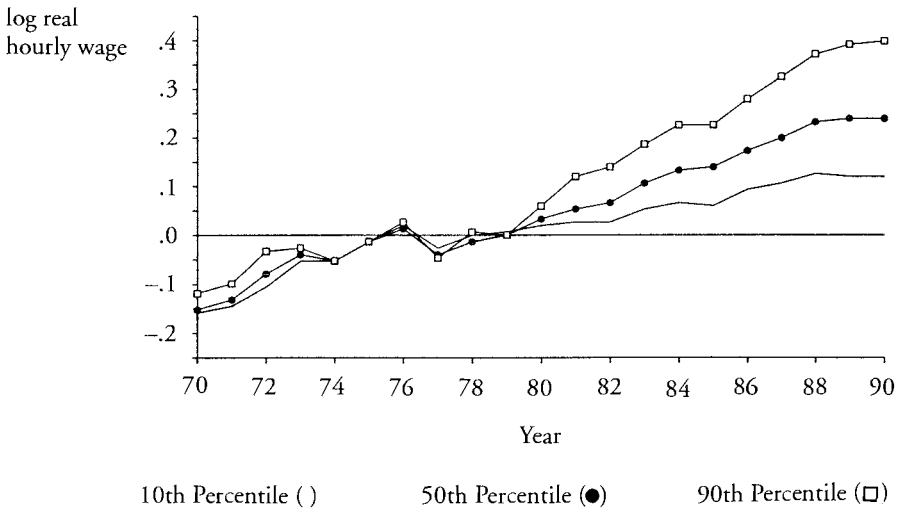
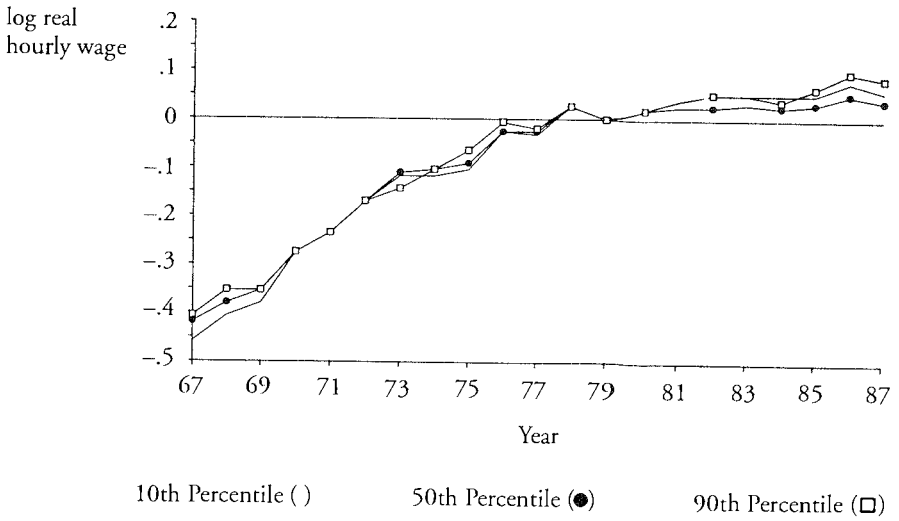
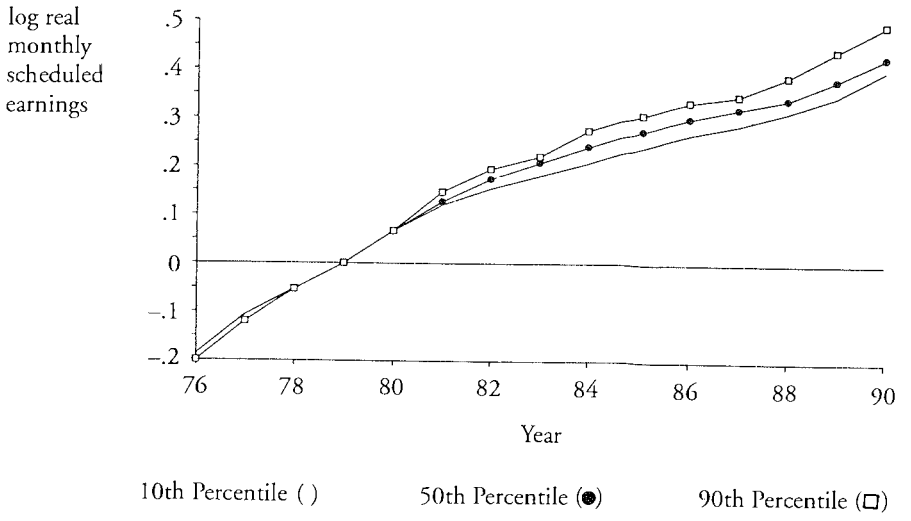


Figure 2. Continued

C. France, all



D. Japan, all



Source: Katz *et al.* (1993)

equality fluctuates, there is no clear correlation with the business cycle. Unemployment was rising between 1969 and 1971, between 1973 and 1975 and between 1979 and 1982. Although there was a sharp jump in inequality in 1982, there is no general tendency for inequality to increase at times of rising unemployment, and the fluctuations are in any event tiny relative to the trend. Similar findings for the OECD area as a whole are presented in OECD (1993, p.167).

The magnitude of the increase in inequality in the United States can perhaps be gauged from the fact that, despite substantial general improvements in living standards, the real wages of the poorest ten percent of workers are lower now than they were in 1970 (Figure 2).

Investigations of the causes of increasing inequality in the States have focused on both supply and demand factors. On the supply side the United States, in common with most European countries, has experienced a large increase in the level of education and skills in the workforce, in addition to a rapid increase in female participation. However, the relative wages of these groups have increased (Katz and Murphy, 1992). This suggests that the dominant influence has been a very substantial increase in the demand for skilled and for non-manual labour.

Shifts in the demand for labour might in principle be attributed to three types of factors: shifts in the composition of final demand for products, changes in technology and changes in the pattern of external trade. Katz and Murphy (1992) attempt to evaluate the relative importance of these factors by asking to what extent shifts in the pattern of employment can be attributed to changes in the industrial structure, and to what extent to changes in the proportions of different skills employed within each sector. They find that within each industrial sector, employment has shifted in favour of more educated and more skilled workers, and in favour of women, notwithstanding the rise in the relative wage of these groups. This shift they attribute largely to the nature of technological change in recent years, which has progressed beyond the stage of heavy machinery requiring manual strength or skills for its operation, to computers and electronics requiring intelligence in those who work with them.

There have at the same time been substantial changes in the composition of employment by industrial sector. The share of business and professional services and of health, education and welfare have risen, while the proportion employed in manufacturing and also in agriculture, distribution and retail trade has fallen. These shifts also serve to raise significantly the demand for skilled relative to unskilled labour and for women relative to men.

Despite the concern often expressed about competition from the newly industrialised, low-wage economies of South East Asia, including now China, it appears that only a relatively minor part of the decline in manufacturing can be attributed to import penetration from low-wage countries. The volume of manufactured imports from low-wage countries, even if growing, was still by the late 1980s small relative to other factors affecting the composition of employment (Blackburn *et al.*, 1990). Nonetheless it has to be recognised that traditional manufacturing industry, the mainstay of employment for manual men, is increasingly vulnerable to competition from these countries, and this factor may be becoming increasingly important as world trade continues to expand.

From a European perspective, the important point is that each of these factors is global in its scope and can be expected to affect all the industrialised economies as much as it has the United States. In the US, the shift in the demand for labour in favour of better educated and more skilled workers and in favour of women has been met in part by an increase in supply and in part by an increase in the relative wage of theses groups. The worsening job prospects of the unskilled have been offset in part by a reduction in their number due to education and training and in part by quite a steep decline in their relative wage.

In Europe, however, the wage structure in most countries has not become more unequal (Table 1). In the European context, the UK is something of an outlier: it has experienced an increase in inequality comparable in magnitude to that of the US, at least in part as a result of deregulation and the attrition of trade union rights in successive Employment Acts (see also Figures 1 and 2). In the EU countries other than Britain, despite falling demand for unskilled workers, in particular manual men, wages have been held up by a variety of institutional forces. These differ across countries, and include the role of trade unions in preserving wage differentials, the extension of wages determined in collective bargaining to all workers in a sector, minimum wage laws and relatively generous unemployment benefits. The obvious interpretation is that the combination of falling demand and rising real wages has led to widespread unemployment of manual workers across Western Europe.

1.2. Unemployment rates by skill and occupation

There is no disputing that unemployment rates of manual and unskilled workers are higher than those of professional and white-collar workers (Table 2). As unemployment rates overall have risen, the unemployment

Table 1. Changes in the ratios of earnings in the 1980s
Average change over period shown for each country normalised on a 5-year basis

	Top decile relative to the median (+ implies increased inequality)			Bottom decile relative to the median (– implies increased inequality)		
	M	W	T	M	W	T
Australia (1980–90)	+.027	+.022	n.a.	–.021	–.021	n.a.
Austria (1980–89)	+.015	+.025	+.010	–.008	–.004	–.002
Belgium (1983–88)	+.050	+.020	+.050	+.017	+.030	+.018
Canada (1981–90)	+.038	–.010	+.031	–.025	–.018	–.015
Denmark (1981–90)	n.a.	n.a.	+.020	n.a.	n.a.	+.008
France (1980–90)	+.054	+.012	+.020	+.001	–.011	+.008
Germany (1983–90)	+.008	+.013	+.008	+.019	+.049	+.028
Italy (1980–87)	+.073	–.033	n.a.	+.038	+.027	n.a.
Japan (1979–90)	+.044	+.041	n.a.	–.006	n.a.	n.a.
Netherlands (1979–90)	–.007	–.007	–.007	–.007	n.a.	–.003
Norway (1980–91)	n.a.	n.a.	+.009	n.a.	n.a.	+.022
Portugal (1985–89)	n.a.	n.a.	+.078	n.a.	n.a.	+.007
Sweden (1980–91)	–.053	+.014	+.001	–.025	–.018	–.015
United Kingdom (1980–90)	+.161	+.187	n.a.	–.035	–.044	n.a.
United States (1980–89)	+.101	+.105	+.032	–.014	–.033	–.027

Source: OECD Employment Outlook, 1993, Table 5.2, pp. 159–161

Table 2. Unemployment rate by occupation: various countries, 1987
Percent

	USA	Australia[a]	Austria	Canada	Finland	Germany[b]	Ireland	New Zealand	Norway	Spain	Sweden
Professional and technical	2.2	2.0	2.7	4.7	1.8	6.5	3.2	1.7	0.7	6.1	1.2
Administrative and managerial	2.6	2.1	0.9	4.5	–	4.3	3.7	1.0	0.2	2.9	–
Clerical and related	4.2	3.3	3.8	7.4	2.5	–	6.0	2.8	1.2	8.2	1.0
Sales	4.9	5.0	4.5	6.7	4.0	8.6	8.6	3.6	1.3	7.5	1.8
Service	7.7	6.1	8.4	11.6	4.1	6.6	9.7	3.9	1.6	13.0	3.2
Agriculture	7.1	3.8	1.7	10.0	2.7	3.2	2.5	5.0	0.7	13.2	2.8
Other manual	8.0	6.2	6.2	10.9	7.1	10.2	18.2	5.3	2.3	13.7	2.1
Average of above	5.4	4.5	4.8	8.2	4.0	7.4	9.3	3.7	1.4	11.4	1.7
All	6.2	8.0	4.7	8.9	5.0	7.5	17.7	4.1	1.5	20.5	1.9
Ratio of manual to non-manual unemployment rate	2.27	1.94	1.82	1.88	2.29	1.49	2.26	2.01	2.19	1.88	2.03
var (u_i/u) (%)	18.5	15.0	19.9	11.2	28.1	11.4	45.1	14.9	25.3	7.2	16.7

[a]Australia 1986, [b]Germany 1983.

Notes: Occupational classifications according to International Standard Occupational Classification. In computing the ratio of manual to non-manual unemployment rates, the first four categories are treated as non-manual.

Source of data: ILO Year Book, 1988

Source of table: Layard *et al.* (1991) pp. 288–289

Table 3. Dispersion of occupational unemployment rates

(a) var (u_i/u) (%)

Occupational categories	UK (5)	USA (7)	Australia (7)	Canada (7)	Germany (6)	Spain (7)	Sweden (8)
1973		13.1					9.6
1974	23.3	15.1					9.6
1975	14.0	20.2		12.3			7.6
1976	20.5	14.0		9.2	8.8	15.2	12.1
1977	21.0	12.3	13.8	10.7		15.7	12.5
1978	16.2	12.4	18.4	9.5	9.1	16.4	12.4
1979	24.4	15.2	14.3	10.9		19.7	12.8
1980	20.4	22.7	15.1	12.4	9.1	20.6	12.4
1981	21.2	21.1	17.2	13.3		20.0	15.9
1982	21.4	25.1	17.4	15.1	16.9	21.4	17.3
1983	22.8	21.5	25.7	13.6		21.1	15.9
1984	20.5	19.9	22.2	11.2	14.1	16.7	12.1
1985	22.3	20.6	19.7	11.3	11.4	12.9	13.3
1986		20.6	15.0	10.8		11.1	16.6
1987		18.5		11.2		7.2	16.7
Correlation between first and last year	0.87	–	0.92	0.95	0.86	1.00	0.83

(b) Ratio of manual to non-manual unemployment rates

Occupational categories	UK (5)	USA (7)	Australia (7)	Canada (7)	Germany (6)	Spain (7)	Sweden (8)
1973		1.80					1.74
1974	1.76	1.93					1.78
1975	1.74	2.18		1.89			1.65
1976	2.13	1.94		1.71	1.04	2.08	1.91
1977	2.12	1.85	1.68	1.78		2.14	1.93
1978	1.78	1.85	2.16	1.70	1.18	1.95	2.04
1979	2.27	2.04	1.97	1.80		1.99	2.02
1980	2.34	2.46	1.97	1.92	1.27	2.04	1.96
1981	2.41	2.39	1.86	1.97		1.98	2.25
1982	2.53	2.58	2.14	2.04	1.69	1.86	2.34
1983	2.57	2.46	2.36	1.97		1.75	2.22
1984	2.20	2.38	2.46	1.86	1.60	1.99	1.95
1985	2.45	2.42	2.14	1.87	1.49	1.91	1.85
1986		2.41	1.93	1.86		2.00	1.98
1987		2.27		1.88		1.88	2.02

Notes: The bar indicates a break in the series.

Sources: UK: *General Household Survey* (breakdown as in Table 1): Others: *ILO Yearbook* (breakdown as in Table 1), which amalgamates skilled and non-skilled manual workers. For the USA, Employment and Earnings uses different classifications before and after 1983, but the trend in each sub-period is as shown above.

Source of Table: Layard *et al.* (1991) p. 290

rates of manual and unskilled workers have risen by more in absolute (though not in proportional) terms than those of skilled workers. The employment of unskilled and manual workers is generally more cyclical than that of skilled and white-collar workers. Indeed, as a generalisation, the unemployment rates of different groups tend to move roughly in proportion over the cycle, so that the dispersion of unemployment rates remains roughly constant (Table 3). A larger absolute gap between skilled and unskilled unemployment rates in other words would be exactly what one would expect to observe as a consequence of depressed economic activity.

The correlation in many European countries between higher aggregate unemployment and an increased unemployment differential could thus be explained either by greater sectoral imbalance leading to higher aggregate unemployment (as in the model set out below) or by the differential effect of depressed overall activity on different sectors. But the United States economy provides unambiguous evidence of increased structural imbalance, and in the absence of any other factor explaining the persistence of higher aggregate unemployment in Europe, it seems difficult not to assume these factors important in Europe also.

1.3. A model of structural change

To formalise these ideas in a simple analytical model, we may envisage an economy with two types of jobs, skilled (sector 1) and unskilled (sector 2). For technological and other reasons there is a shift in the pattern of demand for labour at an exogenous rate of d jobs per year. Workers acquire skills, and move from sector 2 to sector 1 at a rate in part exogenous (d_0) but in part depending on the economic incentives represented by wage and unemployment rate differentials between the two sectors. The difference between the exogenous component of the demand shift and the exogenous rate of skill acquisition ($d-d_0$) provides a measure of the "skills gap". Equilibrium requires that the growth in demand for skilled labour should equal the growth in the supply, that is:

$$d = d_0 + a_1(w_1 - w_2) + a_2(u_2 - u_1)(1-\rho) \qquad (1)$$

where w_1 is the skilled wage, w_2 the unskilled wage, u_1 the unemployment rate of skilled workers, u_2 the unemployment rate of unskilled workers, ρ the replacement rate and $a_1, a_2 > 0$. Since a_1 and a_2 measure the elasticity of skill acquisition with respect to the differential income stream thereby attained, they depend (negatively) on the costs and per-

ceived risks of skill acquisition, the discount rate and the tax rate. (In the long run, expected income in sector i is $w_i(1-u_i(1-\rho))$, but a migrant who is risk averse or who has a high discount rate may give a higher weight to unemployment. Equation (1) is a linear approximation of the logarithmic form permitting different effects of wage and unemployment rate differentials.)

Wage setting is given by

$$w_2 = w_1 - b(u_2 - u_1) \tag{2}$$

with $b>0$. This equation (with the constant term suppressed) can be interpreted as indicating that a reduction in the relative wage of unskilled workers requires an increase in their unemployment rate relative to the unemployment rate of skilled workers. Hence

$$u_2 - u_1 = (d - d_0)/(a_1 b + a_2(1-\rho)) \tag{3}$$

and

$$w_2 - w_1 = -b(d - d_0)/(a_1 b + a_2(1-\rho)) \tag{4}$$

Thus both wage and unemployment differentials are increasing in the "skills gap", $d-d_0$. With perfectly flexible wages (b approaching infinity), the unemployment differential disappears and the wage differential approaches $(d-d_0)/a_1$. The less flexible are wages (the lower the value of b) the smaller the wage differential and the bigger the unemployment differential. If b is small, the unemployment differential will also be sensitive to the replacement rate, ρ. And government intervention to facilitate labour mobility through the acquisition of skills (raising a_1 and a_2) will reduce the unemployment differential.

If governments implement policies or sustain institutions which reduce wage flexibility, that is reduce the value of b, then unemployment rate differentials will be inefficiently high, and there may be an efficiency case for subsidising labour mobility, even if individual decisions in this area are perfectly rational, and there are no other deviations of social from private costs. An immediate implication is that the payoff from participation in such programmes to the individual may be low even when the social benefits are substantial.

1.4. Long-term unemployment

Many EU countries have experienced not only high and persistent unemployment in the aggregate, but also many unemployed people experiencing very long spells out of work. In some countries (Belgium, Ireland and Italy), the proportion of long-term unemployment had risen to over 60 percent of total unemployment in 1991 (OECD, 1993, Appendix Table P). Further, many unemployed people experience repeated spells of unemployment interrupted only by brief spells in temporary jobs. Many long-term unemployed people appear to have given up looking for work and have become resigned to life on the dole.

A more elaborate model could incorporate the idea (Layard and Nickell, 1987) that long-term unemployment has little impact on wage pressure. For example, one might assume that in the low-unemployment sector 1 unemployment is short-term, but that higher overall unemployment in sector 2 implies that a proportion of workers in this sector would enter long-term unemployment. Further, the higher the overall unemployment rate, the higher in general the proportion of long-term unemployment (Haskel and Jackman, 1988). If only short-term unemployment affects wage pressure, then the model of structural imbalance set out above would solve for the short-term unemployment rate in sector 2. Any worsening of structural imbalance then raises the sector 2 short-term unemployment rate and this implies a proportionately greater increase in the long-term unemployment rate, and hence in total unemployment in sector 2.

1.5. Unemployment benefits

We may also note that the model implicitly assumes that unemployed people are able to draw benefit indefinitely and unconditionally. Any restrictions on the availability of benefit would clearly increase the incentive to acquire skills and thus reduce the unemployment differential. Most unemployment benefit systems are in principle conditional: the unemployed are expected to search for work and to accept appropriate offers, and benefit can be withdrawn if unemployed people are not prepared to apply for, or turn down, suitable jobs. But if the source of wage rigidity lies elsewhere, there will not be enough unskilled jobs to go round and making the unemployed search harder will serve no useful purpose. Hence, in many countries, the worktest is not strictly applied and is ineffective.

Likewise, though benefit duration is often limited (see Table 4), social insurance objectives require that some measure of support be given to unemployed people, especially those with dependents, so that once people have exhausted their unemployment insurance entitlement they are able to move onto some form of social assistance often at a rather similar rate. Thus for all the administrative intent to limit benefit entitlement, in many countries benefits have de facto become unconditional and indefinite.

1.6. The Swedish experience

Against this sombre background, the performance of the Swedish labour market prior to the current crisis stands out as a beacon of light. The distribution of wages in Sweden has remained one of the most equal in the world yet, until recently, Sweden achieved a very low unemployment rate. (Following standard usage, unemployment here means "open" unemployment, that is it excludes people participating in training schemes or other active labour policy measures.) A recent paper by Freeman and Björklund (1993) has evaluated various explanations of this remarkable achievement. Their main finding is that greater equality in Sweden cannot be attributed to workforce characteristics. They are able, for example, to rule out the hypothesis that greater equality can be explained by greater uniformity of educational attainment. Their conclusion is that the explanation must lie in the distinctive institutions and policies of the Swedish labour market.

In Sweden, of course, wage equality has for a long time been accepted as a prime objective of policy in its own right. To the extent that wage equality might constitute a hindrance to labour mobility, it has been regarded as precisely the purpose of active labour market policies in the Swedish model to overcome this impediment. While Freeman and Björklund make no specific assessment of the role of active labour market policy in their paper, their findings are clearly consistent with the idea that active policies are working in accordance with this principle.

2. The social insurance function of active and passive policies

In Section 1, two possible reasons for active labour market policies were examined. The first was the familiar one that the social returns from skill acquisition or job search may exceed the private in the presence of wage rigidities, unemployment benefits or other distortions (Johnson and Layard,

Table 4. Maximum duration of unemployment benefits and replacement rates

	Maximum duration		Replacement rates[a]		
	1981	1989	1972	1980	1990
EC countries					
Belgium	Indefinite	Indefinite	0.83	0.73	..
Denmark	2½ years	2½ years	..	0.60	0.47
France	3 years	2½ years	0.34	0.41	..
Germany	1 year	1 year	0.74	0.64	0.42
Ireland	15 months	15 months	..	0.43	0.35
Italy	6 months	6 months	0.11	0.14	0.08
Netherlands	..	36 months	..	0.93	0.75
Spain	2 years	2 years	..	0.39	0.40
United Kingdom	1 year	1 year	0.43	0.28	0.16
Non-EC European countries					
Austria	30 weeks	30 weeks	0.55	0.57	0.57
Finland	100 weeks	100 weeks	0.32	0.50	0.61
Norway	40 weeks	80 weeks	0.18	0.32	0.39
Sweden	60 weeks	60 weeks	0.31	0.49	0.64
Switzerland	36 weeks	50 weeks	..	..	..
Non-European OECD countries					
Canada	50 weeks	50 weeks	..	0.37	0.47
Japan	26 weeks	30 weeks	0.31	0.36	0.20
United States	39 weeks	26 weeks	0.36	0.36	0.36

Notes: .. Data not available.

[a]Replacement rates are calculated as the ratio of actual payments of unemployment insurance benefits per unemployed person to the average wage of production workers.

Sources: U.S. Department of Health and Human Sciences, *Social Security Programs Throughout the World*, various issues; OECD, *National Accounts*; OECD, *Employment Outlook*, 1991; and direct submissions by national authorities.

1986). The second, which is I think less familiar, was that active labour market policies, by acting as a self-selection mechanism, may reduce an element of the inefficiency associated with the payment of unemployment benefit. This second reason is examined in more detail in this section.

In a society committed to social protection, one economic rationale for active labour market policies is at root the same as that for the payment of unemployment benefit – namely to protect household incomes from being excessively vulnerable to fluctuations in the labour market. In the absence of private insurance provision, there is a role for government to act to support the living standards of those whose employment opportunities have collapsed. This insurance can operate through cash benefits; but it can also take the form of government provision of temporary jobs, paying a wage, or training placements in conjunction with a cash allowance.

The balance between active policies and cash benefits would in principle be determined as the least cost means of achieving the social protection objective. Cash benefits have low administrative costs and may involve less government interference in the lives of individuals, but blunt the incentive to seek work or to acquire new skills, and may be subject to abuse by the fraudulent or idle. Active policies entail higher administrative costs, but may avoid the abuses to which cash benefits are susceptible and can assist rather than discourage job search and skill acquisition.

In principle, active policies can be regarded as one way of circumventing the moral hazard problem of unemployment benefit. The social protection role of benefits requires they be paid to people who (a) are unable to find work, and (b) have no other source of income. One may attempt to enforce these criteria by vigilant administration of the benefit system, but with neither the resources nor the methods of a police state, it may be hard to prevent abuse. One may, for example, require unemployed people to produce written evidence of so many job applications per week, and withdraw benefit from anyone who fails to make applications or turns down a "suitable" (as defined by the authorities) job offer. Few OECD countries have adopted so harsh a regime (Switzerland is perhaps the closest), and plainly even with such arrangements there remains scope for abuse. The costs of such administrative measures may be so high that they are feasible only when unemployment rates are very low. Of course, entitlement to benefit can be restricted, for example to those with recent work experience, or confined to a limited duration of unemployment. While these administrative restrictions may cut abuse, they may at the same time deny benefit to those who genuinely need it, for example in the case of long-term unemployed people who cannot find work.

It has been noted (e.g. by Layard and Philpott, 1991) that even where the payment of benefit is made conditional on participation in a scheme, participation rates are often not very high. Clearly, a significant proportion of unemployed people prefer being unemployed and receiving benefit to participation in a scheme. There are a number of possible reasons for this. Some benefit claimants may have other sources of income and prefer "leisure" to going on a scheme. Others may have undeclared jobs which are more attractive than, and preclude participation in, a scheme. Yet others will find they are able to get a regular job if benefit is made conditional on participation in temporary work or training scheme.

Active labour market policies can thus in a sense replace administrative criteria for the allocation of benefit by putting a price on the individual's time. They can replace administrative selection by self-selection. Most starkly, imagine the payment of benefit were made conditional on the performance of some tedious and time-consuming task. Then only people who really needed the money, and really couldn't find a job elsewhere in the economy, would apply. The disincentive effects of the benefit system would be countered, while the insurance objective would be safeguarded.

This parallels the argument recently advanced by Drèze and Sen (1989) on policies for alleviating hunger in third-world countries. They argue for supporting cash incomes rather than direct provision of food, and suggest this can best be achieved through the provision of public work programmes at the basic cash wage. Their rationale is again one of self-selection – only the really needy will take up such work, whereas it would in their view be impossible to restrict payment of cash benefit to those in need through administrative mechanisms.

The capacity of active labour market policies to operate as a self-selection mechanism depends of course on a regime in which the payment of benefit can be made conditional on participation. This may be achieved either if unemployed people can be refused benefit if they turn down a suitable place on a scheme, or, alternatively, if the duration of unemployment benefits is limited but the employment services offer temporary work or a place on a scheme for people whose benefits have expired.

It is also necessary that the programmes are time consuming, in that it is the obligation imposed on unemployed people to sacrifice their time that is the essence of the self-selection mechanism. If benefit can be withdrawn from non-participants it is not necessary that income payments to those on schemes be higher than benefits, but equally the insurance objective suggests they should be no lower: a benchmark for income payment might therefore be benefit plus expenses. It is of course still in gen-

eral desirable that participation yields a return to the individual, in the sense of raising their subsequent wages or employment prospects, but it is not relevant to the attainment of the self-selection objective.

By contrast, if participation on active labour market programmes is essentially voluntary, the programmes can of course still be beneficial, but only if they encourage activities (e.g. skill acquisition) which are socially efficient but which, in the absence of the programme, would not have taken place.

3. Microeconomic evaluation

Active labour market policies comprise a number of different types of activity. From the point of view of their economic impact they may conveniently categorised under three headings (Calmfors, 1994):

(i) *Public employment services*, which include not only standard job information and brokerage services and the provision of advice and counselling to the unemployed, but also the encouragement of job search by the provision of support and facilities and guidance with regard to placements on labour market programmes (training or temporary jobs).

(ii) *Training*, both for the unemployed and for those in work.

(iii) *Direct job creation*, which includes wage subsidies to regular (usually private-sector) employers taking on unemployed people, support for unemployed people starting up their own enterprises, and direct (i.e., public-sector) job creation.

Microeconomic evaluations are concerned with the effects of individual programmes, for example whether those participating in a particular scheme subsequently achieve higher incomes, or have better employment prospects, than might otherwise have been expected. The problem with this approach is that it cannot establish whether any improved performance of scheme participants is simply at the expense of others in the economy, or whether there is any overall effect. Macroeconomic evaluations thus attempt to measure the overall effects of policies on employment, unemployment or wages in the economy as a whole. This is the subject of the next section.

These questions have recently been very carefully reviewed by the OECD (1993) and Calmfors (1994). There is space here only to com-

ment on some of the more important results of these studies.

A first comment on the microeconomic studies is on the overall methodology. The idea of these studies is to compare the labour market outcomes of those on schemes with non-participants. But participants in schemes are by and large not chosen randomly, and in general people cannot be compelled to take part. It follows that those going onto schemes may have different characteristics from non-participants. It may be these different characteristics, rather than the effects of the scheme, that lead to different outcomes for different people. A research study can make allowance for observable differences between people – age, sex, family responsibilities, education, occupational background and so on, but it is impossible to adjust for differences in attitude, motivation, personality and other, more subjective, factors that may nonetheless be relevant to an individual's labour market prospects.

This problem, of "unobservable heterogeneity", is well known to bedevil microeconomic studies in this area (for an extensive discussion, see the papers in Jensen and Madsen, 1993). But it becomes particularly serious in the context of the insurance function of active labour market policies discussed in the previous section. Suppose, for example there were two groups amongst the unemployed: those who are productive in work but have a preference for leisure and those with low productivity who cannot find work. With payment of cash benefits both groups remain unemployed. But if cash benefits are withdrawn, the higher productivity leisure-lovers may go back to work rather than onto a scheme, and only the low productivity people end up on the schemes. If the schemes have the self-selection function described in Section 2, they in a sense partition people on the basis on differences in characteristics, and this serves to exacerbate the problem of unobservable heterogeneity.

Microeconomic evaluations can thus misrepresent the impact of active policies in two ways. First, they can fail to measure the "true" effect of a scheme on participants, because of unobserved heterogeneity. Second, they do not measure the impact of the policies on non-participants, in particular where receipt of benefit is made conditional on participation in a scheme.

3.1 Employment services

The main functions of the employment services, the bringing together of information on vacancies and the monitoring of payment of benefit, apply to all unemployed people and thus cannot be evaluated by standard

microeconomic techniques. But the counselling services of employment offices are used by some but not all unemployed people, and it is of interest to ask whether these have any effects.

In the United States, the United Kingdom and in the Netherlands, attempts have been made to evaluate these activities on an experimental basis – that is by allocating people between a "treatment" and a "control" group on some random or other basis and comparing the success in finding jobs of the two groups. These studies appear to find systematically positive effects of counselling on job prospects (OECD, 1993), though there is the risk that the quality of counselling given to a small number of people in the course of an experiment could not be replicated across the market as a whole. A general conclusion is that intensive counselling can be effective, and it should be targeted at those otherwise least likely to escape unemployment.

3.2. Training

Given the increasing disparities in wages and employment opportunities between skilled and unskilled workers, one might expect training schemes to offer a high return to those taking them. A remarkable, but consistent, finding is that the microeconomic evidence on general training schemes for unemployed adults provides very little support for such a view.

OECD (1993) examines the effects of numerous types of training schemes. A general conclusion is that programmes targeted on a small number of individuals, with a relatively high cost per head, often appear quite effective in improving the wage and employment prospects of at least some of the individuals involved. On the other hand, broader programmes covering a larger number of people at a relatively low cost per head typically seem to have little if any effect on the prospects of participants.

A good example is the effects of programmes carried out under the Job Training Partnership Act (JTPA) in the United States. Studies of the effects of JTPA show that the training component had no significant effect on the earnings or employment prospects of unemployed people generally, but special schemes, e.g. for those with poor education, did tend to improve their labour market prospects. Similarly disappointing results of studies of the effects of general training schemes in Sweden are reviewed by Björklund (1993).

Rather similar results emerge from studies of youth training schemes. Again the most careful studies have been of schemes in the United States.

In general, these schemes do not appear to improve either job prospects or earnings.

There are a number of possible interpretations of these results. One is that there is considerable variation in the characteristics of the unemployed, and given their age, education and occupational backgrounds, only some have the capacity to benefit from further training. Thus only training schemes targeted at these groups have economic returns. Another is that there are increasing returns to training, and only schemes with substantial inputs, which in practice means targeted schemes, actually deliver. This might be the case for example where unemployed people are unfamiliar with the type of skills being taught, or for people unaccustomed to skill acquisition through formal techniques.

Without being excessively despondent about the potential value of training schemes to those who go on them, it seems reasonable to think that amongst the unemployed those with adequate formal education who have followed non-manual careers can probably find another job, or acquire new skills, without the need for assistance. On the other hand, those with a poor educational record and with work experience in unskilled jobs may have considerable difficulties in absorbing new skills. Arguably, such groups may require some further formal education before they can make a success of a training programme.

The overall conclusion is that training schemes need to be targeted on specific groups and supported by adequate resources. A corollary is that training of this quality cannot be made generally available to all unemployed people. Thus effective training schemes cannot be a large part of a labour market policy which seeks to place every unemployed person on a scheme or in temporary work.

3.3. Direct job creation

Direct job creation schemes have taken the form of temporary subsidies for "regular" jobs in the private sector, of start-up grants for self-employment or starting new businesses, and of temporary jobs in the public sector. Evaluations of these schemes have investigated primarily what might be termed the additionality of the jobs created, though some have also considered the longer term effects on the individual's employment prospects.

One rationale for temporary jobs and business start-up schemes is similar to that of training or job counselling services. Temporary jobs can provide a stepping stone between unemployment and a permanent job in

circumstances where employers are reluctant to hire unemployed people, in particular long-term unemployed people. A start-up grant may allow a person to move into a new line of business at a time when the financial pressures of unemployment would otherwise have made it impossible. According to this rationale, these schemes should be evaluated on their longer-term effects on the individuals' employment prospects. Many studies find the survival rate of new businesses quite high (e.g. 65 percent surviving into a third year in the UK), but the evidence on the future employment prospects of those who have been on temporary jobs seems patchy and inconclusive.

There is also a second rationale, based essentially on counter-cyclical arguments. A government might in principle try to smooth out business cycle fluctuations in employment by counter-cyclical employment programmes. This rationale would justify a concern with additionality, that is whether or not the temporary jobs increase the total number of jobs in the economy. At a partial level, additionality has two distinct elements. If there is no change in behaviour by employers or the unemployed, the government may nonetheless end up subsidising some jobs which fit the criteria for the scheme. This is called "deadweight", and the deadweight element in these schemes is complete waste. The second element is called "substitution". If employers hire long-term unemployed people, who attract subsidy, rather than any other worker to fill a given vacancy, this again appears to imply that there are no net effects. But the displaced worker, presumably better qualified or otherwise more attractive than the long-term unemployed person, may find it much easier to find work elsewhere in the economy.

Further thought would suggest that partial equilibrium analysis of additionality is bound to be misleading. If the level of aggregate demand in real terms is taken as given, clearly to a first approximation so is the total number of jobs. If firms employing subsidised workers expand, they must presumably displace other firms, which will have to cut back. This is not to argue that direct job creation cannot add to the total number of jobs in the economy, but rather to suggest that any such claim can be evaluated only at a macroeconomic level.

A final rationale for direct job creation is linked to the social insurance function of labour market policies. Here, the main requirements, as noted in Section 2, are that the work be time consuming, and not so pleasant, or so well-paid, as to become as good as a regular job. It may be suggested, though, that fears on this score may be exaggerated. In Sweden, for example, we have noted that in the 1980s, Layard and Philpott

(1991) find that only about one third of those whose benefits were exhausted took such jobs, and more recent work finds a high rate of flow into regular jobs at the time of benefit exhaustion despite the availability of temporary work on these schemes (Carling *et al.*, 1994). In Denmark, on the other hand, there does appear to be a cycle of benefit dependency, where people having exhausted their benefits after 30 months go on a scheme for 6 months thereby earning the entitlement to another 30 months of benefit.

It is sometimes suggested that there is an inherent conflict between two of the desired features of temporary jobs: that they should be less pleasant in terms of pay and working conditions than regular jobs (so that they do not become an acceptable substitute for them) and that they should be as similar to such jobs as possible in order to provide the most useful work experience. This problem again can be exaggerated. There seems little evidence of people wanting to go on schemes – rather the reverse – as noted above. While it is important to be alert to this risk, at present an objective in the design of temporary work schemes of making the jobs supported similar to regular work would have the advantage of doing most to help the future employment prospects of the unemployed.

4. Macroeconomic evaluation

If a scheme improves the job prospects of an individual participant, there is always the question whether there is any net benefit to the economy, or whether scheme participants simply take jobs which would otherwise have gone to other unemployed people. Can active policies increase the number of jobs in the economy, and if so, how? Is a positive microeconomic return from a scheme either necessary or sufficient for a positive macroeconomic effect?

In principle, active policies could increase the number of jobs either by relieving structural imbalances between the different sectors of the economy or by raising the search effectiveness of (some of) the unemployed. (This latter channel has been particularly associated with arguments of Layard and others in the UK concerning the problems of long-term unemployment and apparent unwillingness of employers to take on long-term unemployed people.) In either case, active policies can create more jobs only to the extent that they are able to reduce wage pressures through increasing the "effective" supply of labour.

As the OECD points out, following earlier work by Calmfors and oth-

ers (e.g. Calmfors and Nymoen, 1990), it is far from obvious on theoretical grounds that this result is to be expected. If active policies provide unemployed people with useful training, or practical job experience, they will serve to reduce the incentive unemployed people have to look for work, or to take jobs that are less than fully satisfactory. If they make the experience of unemployment less unpleasant, as stressed recently by Calmfors and Lang (1993), they may feed directly into higher wage claims.

The fundamental question of course is whether greater investment in active policies actually reduces unemployment. Layard *et al.* (1991) offer a simple empirical analysis, which attempts to determine the main factors linked to differences in unemployment rates across countries during the 1980s. Their finding is that the higher the expenditure on active policies per unemployed person, the lower the unemployment rate. There are, however, two very basic problems with this approach. The first, as noted, e.g. by the OECD (1993), is that the result may arise from spurious correlation. If total spending on active policies adjusts less than fully to variations in unemployment, spending per unemployed person would be inversely correlated with the unemployment rate. The OECD suggests that one should measure expenditure on active policies in relation to the size of the labour force, rather than the number of people unemployed, but this suffers from the opposite bias, namely that as unemployment goes up one would expect there to be some increase in overall expenditure on active policies.

The second problem, stressed by Calmfors (1993, 1994), is that the Layard *et al.* procedure examines the effect of policy on "open" unemployment, and thus does not distinguish between the productive (increasing the number of jobs) and the cosmetic (reducing unemployment by reclassifying it as participation in a scheme) effects of labour market programmes.

4.1. Spurious correlation

The validity of the first objection clearly depends on how spending on labour market programmes is actually determined. One may assume that in each country the government has a policy on active labour market expenditures. It may entail decisions on the type and standard of service to be provided to each "client", and thus on outlay per potential client of some amount x^*. This may relate to the expected number of clients, which may be taken as a function of the expected unemployment rate u^e. It is not clear a priori whether one would expect x^* to be increasing or de-

creasing in u^e. On the one hand, the higher u^e the more costly it is to provide a high standard of service. On the other hand, the higher u^e the more serious the unemployment problem, the greater the incidence of long-term unemployment, etc. and the greater the pressure to adopt active policies.

In the short term actual expenditure per potential client, x, falls if unemployment rises above its expected level, because provision cannot be adjusted perfectly flexibly in the short run and for budgetary reasons. Hence actual expenditure per unemployed person is

$$x = x^* - b_1(u - u^e) \tag{5}$$

with

$$x^* = x_0^* - b_2 u^e, \tag{6}$$

where u is the unemployment rate, x_0^* is a measure of the policy stance, $b_1 > 0$ and $b_2 = ?$.

The relationship we are interested in is the impact of policy on unemployment, that is a relationship of the form

$$u = u_0 - a_1 x + a_2 z = u_0 - a_1[x_0^* - b_1(u - u^e) - b_2 u^e] + a_2 z \tag{7}$$

If the main variation in x arises from variation in x_0^*, then the estimated value of a_1 will give a reasonably good estimate of the impact of x_0^* on u. But if the main variation in x arises from variation in u, as would typically be the case in a time series regression, then, as the equation shows we are essentially correlating unemployment with itself, and will get a spurious result which says nothing about the efficacy of policy.

In this context, it is worth noting that the Layard *et al.* equation is estimated over a cross-section of countries, and examines *average* levels of expenditure and *average* levels of unemployment over a six-year period. Thus $(u - u^e)$ should in principle be close to zero for most countries. Even so, if the main variation arises from cross country variations in u^e we will again be correlating unemployment with itself, as over a six-year period u will be close to u^e. But in this case the impact of u depends on the sign and magnitude of b_2, rather than of b_1, where there are, as already noted, several factors at work and the overall effect is ambiguous and likely to be small. One may then expect that variations in x_0^* are likely to be the main factor in variations in x in the medium term.

While this approach goes some way towards reducing the spurious correlation problem, it does so at the expense of reducing the statistical power of the regression. With the number of observations limited to the number of countries for which data are available (20), the Layard *et al.* regression equation has rather few degrees of freedom (13). The finding may thus not be robust to changes in specification (see again OECD, 1993).

One way around this problem is to examine the effects of policies not on the unemployment rate but on the $u-v$ curve (or Beveridge Curve). The argument here is that while fluctuations in demand and changes in wage-setting arrangements affect an economy's position on the curve, active labour market policies, insofar as they affect the efficiency of job matching through the provision of advice and information and promote the search effectiveness of the unemployed, are amongst the factors that may be expected to shift the curve (Jackman *et al.*, 1984, 1990). Empirical implementation of this approach, on panel (pooled time series cross-section) data tends to support the view that spending on active policies shifts the $u-v$ curve inwards (Jackman *et al.*, 1990).

4.2. Cosmetic effects

While these studies make some attempt to counter the risk of spurious correlation, there remains the important question whether the schemes have a genuine effect or simply a cosmetic function of reclassifying unemployed people as scheme participants. Calmfors (1993, 1994) has reworked these analyses replacing open unemployment by the sum of open unemployment and the number participating in schemes, both as the dependent variable and in calculating expenditures in active policies per client. His findings are that the reduction in open unemployment is of the same order of magnitude as the number participating in the schemes.

In interpreting this result, it is important to start from the appropriate theoretical framework. The equilibrium unemployment rate in the medium term is the NAIRU – i.e., the unemployment rate consistent with an absence of inflationary wage pressure. The $u-v$ curve represents the "technology" matching unemployed job-seekers to vacant jobs. The appropriate measure of unemployment in each case has behavioral content, and one cannot just add in other groups (e.g. students, the armed forces, those doing voluntary work, others in temporary jobs) simply because they are not in regular employment. Likewise one cannot just add those on schemes to open unemployment unless one thinks that their behaviour will be the same as that of the openly unemployed.

One might expect in practice those placed on training schemes to behave more like other students or apprentices, and those placed in temporary work to behave more like others with temporary jobs, rather than like unemployed people. Those on schemes will have neither as much time for job search nor be under as much pressure to find work as the openly unemployed. And there may be advantages to those on schemes from "staying the course" – they may for example be able to acquire training qualifications or a reputation for reliability. Microeconomic evidence on scheme participants in Sweden finds that they search for work no more intensively than other employed people (Edin and Holmlund, 1991).

An alternative interpretation of the Calmfors results is therefore that policies are effective in making labour markets more efficient, but they do so at a cost which may be large relative to the benefits achieved. In the case of training, for example, it could be that, in terms of the model in Section 1, supporting training for an extra x percent of the workforce raises the rate of skill acquisition in the economy, and thereby reduces unskilled unemployment as a proportion of the labour force by say y percent. If it turns out that $x=y$, the Calmfors result, it would be wrong to conclude that the training policy is purely cosmetic, but reasonable to ask whether it is cost-effective. In budgetary terms, training is likely to be more expensive than open unemployment, so there is a clear resource cost. On the other hand, according to the model the policy reduces both wage and unemployment differentials across sectors, which may be counted as a social gain.

Finally, there have been investigations of the impact of policies on wages. We have already noted that to the extent that active policies "work" by increasing the effective supply of labour (rather than by raising the productivity of individual workers) they will need to exert downward pressure on wages to generate the extra jobs. Panel data estimates across OECD countries of the impact of labour market spending on wages (OECD, 1993) find that in about half the countries (10 out of the 19 for which data were available) expenditure on active policies was associated with a significant reduction in wage pressure, while in most of the others there was a negative effect but it was not statistically significant. Only in two countries, Ireland and Spain, was spending associated with an increase in wage pressure.

Taken together, one may conclude from these studies first that there is a clear tendency for high expenditure per unemployed person on active policies to be associated with lower "open" unemployment rates. Second, that spurious correlation may remain a problem but only insofar as it results

from the medium-term policy reaction function rather than from short-term inflexibilities. Third, the finding that the reduction in open unemployment is of the same magnitude as the number of people on the schemes themselves casts doubt on the cost-effectiveness of these programmes.

4.3. Overall macroeconomic effect

Finally, in terms of macroeconomic evaluation, there is what may be termed "the big picture". There are very large differences in unemployment rates across countries which persist over time and across cycles. How, for example, can one explain how Sweden achieved such low unemployment rates throughout the 1980s? While the immediate cause, as stressed by Calmfors (1993), is that Sweden chose not to pursue the severe deflationary policies adopted elsewhere in Europe in the early 1980s, what is more remarkable to the outside observer is the capacity of the Swedish economy to have sustained high activity together with unemployment rates which elsewhere in Europe would have led to headlong inflation. What structural features of the Swedish labour market allowed the Swedish government to adopt expansionary macroeconomic policies without explosive inflation?

If one were to attempt to generalise, three factors appear to stand out as critical. First is the commitment of government to the employment principle – that the thrust of labour market policy be concentrated on getting unemployed people back to work rather than on payment of cash benefit. The second is that the duration of income support for open unemployment is limited. And the third is that the labour market authorities, if they wish to protect individuals from poverty, provide a temporary job or place on a training scheme for all unemployed people who have exhausted their benefit entitlement.

5. Conclusion

This paper has argued that the European unemployment problem has arisen from a combination of structural changes in the world economy generating sharply increased wage inequality and a political commitment in most European countries to a degree of social protection which has inhibited the adjustment of the labour market to these structural changes. I have argued that in this context active labour market policies may be a better way of achieving the social insurance objective than relying solely on cash ben-

efits. Clearly cash benefits are cheaper and will no doubt remain the first line of defence, but as unemployment becomes more deeply entrenched the case for active measures becomes correspondingly greater.

None of this is to suggest that it will be possible for European economies to sustain as high a degree of equality in the future as they have in the past. A partial retreat, and an acceptance of greater wage inequality and of a less generous benefit regime, may now be inevitable, particularly for countries like Sweden which have gone furthest in the opposite direction. The more willing one is to throw people to the mercy of the market, the better the market will work to achieve structural change. The need for active policies would be correspondingly reduced.

What would appear ill-advised, however, in the Swedish context, would be to reduce the coverage of active policies in the sense of removing the guarantee of a temporary job or a place on a training scheme to unemployed people whose benefits expire. Without such a guarantee, it would surely be necessary to provide some other form of income support for unemployed people for as long as they had no income either from regular work or from a labour market programme. While there can always be adjustments at the margin (the duration of benefits might be extended from 60 to say 75 weeks, or perhaps be related to the worker's age), what matters is to retain the commitment to the employment principle in the design of policies.

Perhaps the main lesson Sweden can learn from other European countries is that where long-term unemployment is concerned, prevention is better than cure. The prospects of finding work for long-term unemployed people are very poor, and, as we have noted, attempts to assist them through training schemes or temporary work are either ineffective or very expensive.

Where unemployment is rising, the mounting costs of support for the unemployed could best be tackled first by reductions in the level of cash transfers (both unemployment benefits and payments to those on schemes) and second by reduced provision of labour market programmes not specifically targeted on the unemployed (e.g. general adult training).

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