Active Labour Market Policy

Lecture notes

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1 Active Labour Market Policy

Question: What do we mean ALMP?

- Measures to improve the functioning of the labour market that are directed at the unemployed.

Types of ALMP

1. Job broking: Aimed at making the matching process more efficient.
2. Labour market training: Aimed at upgrading the skills of job applicants
3. Direct job creation: public sector employment alt. subsidisation of private-sector work.

2 Use of ALMP

- The use (and mix) of active labour market policies vary substantially across countries. Table 1.

3 ALMP in Theory

- Based on Calmfors, Forslund and Hemstrom (2001).

Key point: In order to understand the impact of ALMP on unemployment we need to understand the impact on employment/job creation.

- Why? If ALMP didn’t increase the number of available jobs it couldn’t reduce the unemployment rate.

Question: How can ALMP generate more jobs?

- Stylized version of the labour market (Fig 1)
  - Labour demand (downward sloping).
  - Wage setting (upward sloping) – e.g. from efficiency wage model or union model.
Total labour force considered as fixed.

- Thus ALMP can have boost employment either by
  - Increasing labour demand, or
  - Reducing wage pressure.

**Question:** What are the fundamental effects of ALMP?

1. Reduced hiring costs
   - In an economy with search frictions, hiring is costly for a firm.
   - ALMP ⇒ easier to fill a vacancy ⇒ lower hiring costs ⇒ more creation of vacancies ⇒ labour demand shifts.

2. Reduced wages pressure
   - ALMP ⇒ “tougher competition” among workers in the labour market ⇒ downward pressure on wages.
   - Let’s look at some effects in a little more detail.

### 3.1 Effects on the Matching Process

**Question:** How does ALMP improve the matching process/reducing hiring costs?

- Promotion of more active search.
- Reduction of “mismatch” by adapting the skills of the unemployed.
- Substitute for regular employment in providing experience.

### 3.2 Effects on the Labour Force

- Discouraged workers may leave the labour force.

**Aim of ALMP:** To maintain labour force participation!

- This effectively increases labour supply, putting downward pressure on wages.
- The effect should be to increase the proportion of the *population* in regular employment.
3.3 Deadweight and Substitution Effects

- However, there are potential problems to be aware of:

**Deadweight loss:** ALMP is costly. If some of those who are helped would have found work anyway, there is a *deadweight loss*.

**Substitution effect:** If helping some groups reduces the job-finding opportunities for other groups, there is a *substitution effect*.

**Improved welfare for participants:** While clearly an aim for ALMP, it can have negative side effect. By making unemployment less unattractive, it can increase wage-pressure (similar to an increase in UI).

4 Crucial Design Features

- Compensation level for those on programmes

**Insight:** If too attractive, there will be negative side effect.

**Recommendation:** Keep in line with UI benefits.

- Targeting key groups

**Insight:** Targeting groups that are particularly weak can substantially improve competition in the labour market.

**Recommendation:** Target young, long-term unemployed etc.

- Choosing the type of programme

**Insight:** Some measures (e.g. training) may reduce active search for regular employment, thus creating a “lock-in effect”.

**Recommendation:** Job search assistance may be the most powerful instrument.

5 The New Deal for Young People

**Question:** Why focus on young workers?

- High unemployment rate

- More cyclically sensitive

- High inactivity rate

- Important to get a “good start” – potential scarring effect.
5.1 A Brief Historical Background

- Labour exchanges since 1910; benefits paid since 1912.
- Benefit receipt linked to active search.
- Shifting attitudes in the 1960s:
  - More viewed as permanent support to jobless “victims”
  - Search requirements reduced.
- Further reduction in the enforcement of search requirement during the 1980s.
- Sharp increase in unemployment.
- Introduction of RESTART in 1986 made interviews with the Employment Service compulsory.
- Changes consolidated under the Job Seekers’ Allowance (JSA) in 1996.
- Previous only small use of subsidised employment.

5.2 The Structure of the New Deal

- Target group: 18-24 year olds in receipt of JSA for at least six months.
- Structure as follows:
  1. The individual enters Gateway period (for up to four months)
     - Personal advisor who gives extensive job search assistance.
  2. If still on JSA after the four month Gateway, the offered up to four options
     - Full time education/training for up to 12 months
     - Six month job in voluntary sector
     - A job on the Environmental Task Force
     - A subsidy to a prospective employer (with one day training/week)

- Importantly: Not possible to stay on benefits (No “fifth option”)
  - If option was refused, benefits refused.

**Question:** Which Options Were Taken Up?

Out of the four options, education and training has been the most popular

- Education and training has been the most popular (40%)
• Subsidised employment less popular (20%) than anticipated.

Implementation: Introduced in two steps:

• Introduced in selected pilot areas (“Pathfinders”) in Jan 1st 1998.
• National rollout April 1st 1998.

You will see shortly why this two-step implementation was important for trying to identify the effect of the program.

6 Evaluating Active Labour Market Policies

Question: Did the NDYP make young workers find job more quickly?

• Estimate the impact on the job-finding rate.

Strategy: Compare “treated” with “untreated” group.

• In other words, the idea is to compare a treated group – those who have been exposed to the policy – with those who have not been exposed to the policy.

• Ideal scenario: Random allocation producing identical groups.

• Not the case with NDYP.

• Thus have to use other control groups:
  – Non-pilot areas.
  – Older age groups (25-30 year olds)

6.1 Approaches to Estimation

A Simple Differences Approach

• If allocation is random so that the treatment group and the control group can be assumed to be identical, simply look compare averages:

  \[ \text{Average treatment effect} = X_{TG} - X_{CG} \]

• If allocation is not random then the treatment group and the control group cannot be assumed to be identical, so simply comparing averages will not work.

A Changes-over-Time Approach
Suppose we compare the variable of interest (job-finding rate) how it changed when the policy was introduced

\[ X_{TG:1} - X_{TG:0} \]

(where 1 = after policy has been introduced and 0 = before policy has been introduced).

Problem: Other factors (macro-economic events) may be driving the changes.

Hence this will not be a reliable guide to the effect of the policy. We need to come up with something different.

Next idea: Combine the two approaches

A Differences-in-Differences Approach

- Consider both groups before and after the policy was introduced. Then

\[ X_{TG:1} - X_{TG:0} = \text{Effect of policy} + \text{Effect of other factors} \]

\[ X_{CG:1} - X_{CG:0} = \text{Effect of other factors} \]

- Thus, if both groups affected equally by “other factors”

\[ (X_{TG:1} - X_{TG:0}) - (X_{CG:1} - X_{CG:0}) = \text{Effect of policy} \]

### 6.2 Potential Biases

**Question:** What can go wrong?

Several biases may occur: suppose we use the older (25-30) as control group.

**Substitution.** Employers may substitute younger workers for older workers.

- This reduces the job-finding rate in the control group, thus leading the policy effect to be over-estimated.

- If so, then there should be a smaller estimated effect when comparing young workers in pilot with non-pilot areas than when comparing young and old within pilot areas.

- No evidence of this being the case.

**Equilibrium Wage Effects:**

- Increased effective search by young may put downward pressure on wages \( \rightarrow \) positive job effect for everyone: thus effect will be under-estimated.

- Suppose wage effects are local. If so, then there should be a larger estimated effect when comparing young workers in pilot with non-pilot areas than when comparing young and old within pilot areas.

- Again, no evidence of this happening.
7 Empirical Evidence

- Table 2 is taken from Van Reenen (2001).
- Looks at outflow rate during the Gateway period.

Comparing Pilot to Non-Pilot Areas

- 19-24 year olds in pilot areas were 8.9 percentage points more likely to obtain job post-policy than pre-policy.
- 19-24 year olds in non-pilot areas were 2.1 percentage points less likely to obtain job post-policy than pre-policy.
- Difference-in-difference estimate of policy effect = 8.9 – (−2.1) = 11 percentage points (HUGE!)
- Compare this to the initial job-finding rate of 25 percent.

After the National Rollout

- Smaller estimated effect of policy: 5.4 percentage points increase. Still large!

Possible Criticism

- Maybe people accept lower quality jobs.
  - Examine flows into jobs that last at least 13 months. Results similar - thus no such indication.
- Maybe people delay their exit from unemployment prior to Gateway to take advantage of the program
  - Examine outflow during month 5 and 6. No indication of this happening.

7.1 Verdict on the New Deal

- Looks very promising and cost effective.
- Key seems to be job-search assistance (carrot)

References


Reenen, J. V. (2001), ‘No more skivvy schemes? active labour market policies and the British New Deal for young unemployed in context’. The Institute for Fiscal Studies WP01/09.
