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Edited by Kil-Sang Yoo & Jiyeun Chang

Korea Labor Institute
150-010
16-2, Youido-dong, Yongdungpo-gu
Seoul, Korea
Phone: 02-782-0141, Fax: 02-786-1862
E-mail: [Http://www.kli.re.kr](http://www.kli.re.kr)

ISBN 89-7356-383-1

Active Labor Market Policies and Unemployment Insurance in Selected Countries

Edited by

**Kil-Sang Yoo
Jiyeun Chang**

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Preface

For the last decade globalization and technological advancement have dramatically altered economic and industrial structures causing an enormous shift in the labor market situation. Indeed, labor market policies must now cover a wider range of increasingly complicated issues, and nations across the globe are conducting both active and passive labor market policies to handle these diverse issues.

Employment Insurance (EI)/ Unemployment Insurance (UI) systems in each country have also undergone change in order to conform to the new environment. Although the form and function of each national EI/UI system differs, the system itself has played a major role in every country to promote labor market policy for sustainable economic growth and social integration. The Korean EI system has also made a great contribution to labor market development since its introduction in July 1995. In particular, it has contributed remarkably to overcoming the high unemployment rate after the 1997 financial crisis. And as EI/UI systems assume an even greater as the social safety net, those programs must be supplemented and improved.

On September 12-13, 2001, the Korea Labor Institute (KLI), International Labor Organization (ILO), and the Friedrich Ebert Stiftung (FES) jointly held the International Workshop on the Role of Employment/Unemployment Insurance under New Economic Environment in Seoul, Korea. At this workshop, recognized scholars and policy-makers from six OECD countries as well as distinguished representatives from international organizations shared the experiences and lessons of other countries. In addition, they reviewed the significant changes in the EI/UI system and documented the effects on labor markets. Policy-makers from Asian developing nations, who are currently working to introduce EI/UI systems in their countries, also

participated in policy discussions and learned from the experiences of the developed countries.

The goal of the international workshop was to review recent significant changes in the EI/UI system, to document their effects on labor markets and on the quality of life of workers, and to share recent experiences. This book reflects the content and process of the workshop, covering changing local labor market issues and the development of the EI/UI systems of selected OECD countries, such as unemployment insurance benefits and unemployment assistance, wage subsidy programs, vocational training programs, among others.

As President of the KLI, I express my deepest appreciation to Dr. Peter Gey, Director of the Friedrich Ebert Stiftung Korea Cooperation Office for jointly organizing the international workshop. And I express special thanks to Mr. Sergio Arzeni, Director of the OECD LEED and all of the participants from the ILO, Germany, the U.S., Canada, the U.K., Sweden, the Philippines and Thailand.

I also express thanks to Vice-president Kil-Sang Yoo and the KLI fellows who successfully organized the workshop and wrote the chapter on Korea. I also extend my deepest appreciation to the members of the publication team of the KLI.

December 2002

Wonduck Lee
President
Korea Labor Institute

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New Trends on the Labour Market, Challenges for Policies and the Need for Partnerships: OECD Perspectives

Sergio Arzeni*

1. Labour Markets in the OECD: a Tainted Recovery

The 2000 unemployment rate in the OECD area reached its lowest level since 1990, at 6.3 percent. However, the optimistic forecasts for 2002 of a continuation of these comparative low levels will have to be revised downwards in view of the terrorist attacks that occurred in the United States on 11th September 2001. The impact on employment in the OECD area is still currently unclear and cannot be quantified with precision. Economic growth had started to weaken even before these tragic world events and one certainty is that economic activity will be further depressed. Therefore in the short term, the decrease in Korean unemployment from 4.1 to 4.0 percent may not materialise and the moderate increases for the United States and for Japan may be prove more abrupt than expected. In September, the U.S. unemployment rate stood unchanged from the previous month at 4.9 percent, but was one point higher than in September 2000. Economic restructuring and rising job losses are ongoing in Japan whose latest official unemployment rate stood at five percent (six percent if

* Head of the LEED Programme of the OECD.

“discouraged” workers are taken into account). It is predicted that by the end of the year 2001, unemployment could be as high as 8 percent.

In Europe, signs of a slowdown in economic activity are also visible. In France, for example, after one year and a half of steady decline, the unemployment rate bounced back again. The issue will undoubtedly be at the centre of the French electoral campaign of 2002. In Germany, at 3.86 million — or 9.3 percent of the workforce — the jobless rate in August 2001 was higher than in the previous year. The situation had continuously improved from the 1997 peak and therefore the rise in unemployment was a first time occurrence since Chancellor Schröder took office. Additionally, the official rate does not reflect the true extent of the problem as many job seekers are either currently discouraged from entering the labour market or participating in various active labour market programmes. Neither does it reflect the strong disparities between Western and Eastern Germany (see Werner in this volume).

Looking more specifically at the Korean situation, it is striking that the country made a remarkable recovery from the 1997/1998 crisis and enjoyed a 10.7 percent growth rate in 1999. However, joblessness remains a problem even if open unemployment is low by international comparisons. Unlike the case in many OECD countries, the majority of workers do not receive any unemployment benefits and only thirty percent of those in work have a ‘regular’ (i.e. permanent) contract (OECD, 2000). As in many other countries unemployment has recently increased slightly from 3.7 percent in July to 4 percent in August 2001. One of Korea’s key challenges is to modernise its outdated industrial stock and invest more heavily in workforce training as it faces a difficult and competitive global environment. In fact, growth in the 1990s was largely driven by capital investment, but overall productivity practically stagnated. Many of the investment projects carried out in the 1990s were unproductive, a key factor behind the 1997 crisis. Korea is experiencing increased wage competition from East-Asian economies and notably China where average monthly wages are fifteen to twenty times lower.

The global slowdown in economic activity may be more entrenched than predicted and the situation on the labour market will hinge on a renewed and sustained dynamism in consumer spending. Negative perceptions of the future political and social stability may result in decreased consumer confidence and a propensity to delay spending decisions. However, current signs indicate that job losses concern specific sectors and occupations, e.g. airline and tourist-related industries. The problem of structural unemployment and mismatch will thus remain a cause for concern. Prior to the September 2001 events, analyses of Beveridge curves showed a tightening of the labour market compared to that of the previous recovery at the end of the 1980s - beginning of the 1990s (Beveridge curves plot unemployment and vacancy rates. Inward shifts indicate a tightening). However, despite the tightening, the OECD is confronted to several labour market paradoxes and mismatches. These raise a range of important challenges.

2. New Labour Market Challenges

The most pressing challenge facing advanced industrialised countries concerns the acquisition of skills and knowledge, as reflected by discourses surrounding the 'learning society' and the 'knowledge economy' (Crouch, et al., 2001). In the past few years, the move towards a knowledge economy placing a high premium on workforce skills, competencies, and mobility means that *skilled-worker shortages* have increased in frequency. Skills gaps and shortages have been reported in areas ranging from information and communication technology sectors to more traditional sectors such as construction, agriculture, and tourism. For example, the number of ICT jobs in the EU is predicted to grow from the current figure of 10 million to about 13 million in 2003. Some studies estimate the shortage in the EU as being close to one million people. Therefore, a major challenge consists in upgrading the skills of the low-qualified indigenous workforce to remove economic bottlenecks and simultaneously offer socially disadvantaged

workers a route out of unemployment that will enable them to take up more knowledge-intensive and better paid-jobs jobs (OECD, 2001b; European Commission, 2001a). In the UK, for example, twelve percent of the workforce holds no qualifications (compared with 25 percent amongst the unemployed). The average weekly pay of full-time employees with no qualifications is less than half of that for someone with a higher degree qualification (DfEE, 2000, p.15).

At the same time, the share of employment in services continued to rise in virtually all OECD countries over the 1990s, approaching nearly three-quarters of all jobs in several countries. Unsurprisingly, unfilled vacancies in various service sectors, e.g. care, retail, hospitality, financial and business services have been common in several countries. This was accompanied by significant change in the types of jobs being created. In many countries, the incidence of part-time and temporary work rose and, in some, there was a decline in job stability. A few countries also experienced a long-run rise in earnings inequality. Yet despite vigorous debate about the quality of service sector jobs, there is no simple dichotomy between the goods-producing sector and the service sector; good jobs are not primarily located in the former and bad jobs in the latter. Service sector jobs cover the entire spectrum of job quality, reflecting the range of job quality in all sectors. Jobs in hotels and restaurants and in some other personal service sectors rank poorly across a range of job quality measures. Low skilled and unskilled occupations in these sectors will continue to increase in line with the development of the leisure society. One of the means by which these types of labour shortages may be addressed is through an increased use of foreign workers. However, resorting to migrant workers still is a contentious issue. Increased immigration is frequently opposed on the basis of fears that significant inflows of foreign workers depress wages and lead to declines in the employment of low-skilled nationals. This argument barely applies to unskilled or semi-skilled occupations, often seen as unattractive by the indigenous workforce. Furthermore, given the rising shares of the elderly in the population and falling shares of the population in employment to support pension and health systems,

important policy choices will have to be made for the medium-long term. Policies aiming to raise fertility rates or encourage immigration are those most frequently mentioned. The range of possible demographic outcomes of migration (likewise fertility) over the next three decades is fairly limited, hardly slowing-down the ageing process (OECD, 1998).

At present, there is a preference for mechanisms that cater for temporary labour migration to increase labour supply, rather than policies calling for permanent immigration. Indeed while the temporary employment of foreigners appears to be becoming more widespread, admissions of new permanent foreign workers are currently very few in number, especially in the European Union. Between 1988 and 1998, in the majority of OECD countries the numbers of foreigners or immigrants have risen, but only moderately, apart from a few notable exceptions such as Austria and Luxembourg. The proportion of foreigners in the total population varies widely across the European OECD countries (see Table 1). Moreover, if the immigration of highly skilled labour particularly in high technology has been facilitated through legislative amendments, the same treatment does not apply to the lower end of the occupational scale. Given the *growing demand for unskilled and semi-skilled workers* in the tertiary sector of the economy, the remaining strict regulations concerning labour migration are somewhat of a paradox. Despite advocacy for the liberalisation of the movement of goods and capital, the movement of people remains restricted, which represents a major contradiction in an era of economic globalisation. Moreover, the demographic challenge posed by an ageing and shrinking workforce also means that adequate reform must take place in the field of pensions and welfare provision. First, a greater work/family balance is desirable to encourage a higher participation of mothers in paid employment so as to raise employment rates and respond to labour shortages. Second, a decentralisation of generic healthcare provision must take place to allow for greater proximity to the patient while at the same time encouraging the emergence of poles of excellence offering specialised state-of-the-art surgery.

Additionally, *youth unemployment* remains a cause for concern, de-

TABLE 1. FOREIGN OF FOREIGN-BORN POPULATION AND LABOUR FORCE IN SELECTED OECD COUNTRIES

(Thousands and percentages)

	Foreign population and labour force ¹⁾							
	Foreign population				Foreign labour force ²⁾			
	Thousands		% of total population		Thousands		% of total population	
	1988 ³⁾	1998 ⁴⁾	1988	1998	1988 ⁵⁾	1998 ⁶⁾	1988	1998
Austria	344	737	4.5	9.1	161	327	5.4	9.9
Belgium	869	892	8.8	8.7	291	375	7.2	8.8
Czech Republic	...	38	...	0.4	...	23	...	0.5
Denmark	142	256	2.8	4.8	65	94	2.2	3.2
Finland	19	85	0.4	1.6	...	35	...	...
France	3,597	3,263	6.3	5.6	1557	1587	6.4	6.1
Germany	4,489	7,320	7.3	8.9	1991	2522	7.0	9.1
Greece	...	228	...	2.6	...	167	...	3.8
Iceland	...	3	...	1.5	...	2	...	1.4
Ireland	82	111	2.4	3.0	35	48	2.7	3.2
Italy	645	1,250	1.1	2.1	285	332	1.3	1.7
Japan	941	1,512	0.8	1.2	86	119	0.1	0.2
Luxembourg	106	153	27.4	35.6	69	135	39.9	57.7
Netherlands	624	662	4.2	4.2	176	208	3.0	2.9
Norway	136	165	3.2	3.7	49	67	2.3	3.0
Portugal	95	178	1.0	1.8	46	89	1.0	1.8
Slovak Republic	...	611	...	14.5	...	286	...	13.0
Spain	360	720	0.9	1.8	58	191	0.4	1.2
Sweden	421	500	5.0	5.6	220	219	4.9	5.1
Switzerland	1,007	1,348	15.2	19.0	608	691	16.7	17.3
United Kingdom	1,821	2,207	3.2	3.8	871	1039	3.4	3.9

Foreign-born population and labour force

	Foreign population and labour force ¹⁾							
	Foreign population				Foreign labour force ²⁾			
	Thousands		% of total population		Thousands		% of total population	
	1991 ⁷⁾	1998 ⁸⁾	1991	1998	1991 ⁷⁾	1998 ⁶⁾	1991	1998
Australia	3,965	4,394	22.9	23.4	2,182	2,294	25.7	24.8
Canada	4,343	4,971	16.1	17.4	2,681	2,839	18.5	19.2
Hungary	...	153	...	1.9	...	70	...	1.7
United States	19,767	26,300	7.9	9.8	11,565	16,100	9.4	11.7

Notes: 1) Data are from population registers except for France(Census), Ireland and the United Kingdom(Labour Force Survey), Japan Switzerland(register of foreigners) and Italy, Portugal and Spain(residence permits). Labour Force data are from the respective force surveys or from residence or work permits. Total population for the Czech Republic, Greece, Iceland, Slovak Republic and Hungary based upon individuals aged 15 and over.

2) Data include the Unemployed except for Italy, Luxembourg, the Netherlands, Norway and the United

3) 1990 for France.

4) 1999 for France.

5) 1991 for Italy; 1989 for Belgium; and 1992 for Japan.

6) Data for Luxembourg include cross-border workers; data for Norway exclude the self-employed and for Switzerland seasonal and border workers are not included.

7) 1990 for the United States.

8) 1996 for Canada; 1999 for Hungary.

Sources: Trends in International Migration, OECE 2001; EU Labour Force Survey, results

provided by Eurostat.

spite a plethora of labour market programmes targeting this age group. In Britain for example, despite claims that over 250,000 young people had found employment through the New Deal for the Unemployed, there were signs that those with severe difficulties, particularly those living in deprived areas were most likely to be churned through the labour market (Sunley, et al., 2001). Moreover, while young people with low educational level are undoubtedly the most disadvantaged, highly educated individuals are by no means sheltered from unemployment. Faced with deteriorating employment prospects, many young people in EU countries have prolonged their education. In Germany, young people remain in education approximately until the age of 28 (Streek and Heinze, 1999) while in France, between 1990 and 1994, the number of doctoral degrees rose by 56 percent (de Lassale, et al., 1999). Given the high fluctuations in demand for scientific and academic qualifications, these highly qualified labour market entrants may be forced to lower their earning expectations and accept a certain level of “dequalification” to secure employment. The issue of “academic unemployment” certainly highlights the risk of institutional inertia. Not only are individuals challenged to adjust their learning and job search strategies to the new parameters, but educational establishments must also adapt the supply of skills and degrees to the rapidly changing global economic environment.

A further challenge is to recognise the significance of *part-time employment* and to make sure that part-time workers benefit from the same advantages and opportunities as full-timers. Roughly one in six workers in the OECD works part-time. In the past few years, the incidence of part-time work has risen sharply in some European countries, notably in the Netherlands and Belgium but has fallen in the US. In the Netherlands, 33 percent of the workforce is part-time (76 percent are women). Women dominate the part-time workforce but in some countries such as Britain, the share of men has been rising from 15 percent to 20 percent between 1990 and 2000.

Finally, a key challenge concerns the *geographical dimension* of

unemployment and social exclusion. The decrease in long-term unemployment (12 months or over) from 35 percent of total unemployment to 31.4 percent in 2000 in the OECD area is of course of positive sign but remains a cause for concern. Economic restructuring (plant closures, industrial relocation, the burgeoning of high tech industries and clustering activities) has an uneven impact upon territories. It is hence necessary to recognise that *place matters*. While a sound macro-economic policy remains crucial, national and supra-national responses are inadequate to respond to spatial disparities. No one would dispute that economic growth is a pre-condition to tackle unemployment, but growth alone is insufficient to address social inequalities, particularly given relatively low levels of labour mobility in parts of the OECD. In contrast to capital and goods labour mobility remains very low, particularly in the European Union where total migration on an annual basis is less than 0.4 percent of the resident population – 1.5 million people – compared to 2.4 percent of the population between US states (European Commission, 2001b). At the same time, demand varies significantly across areas, which makes the local delivery of public policy more salient as it is the scale at which it is more likely to reach those it is supposed to target and achieve an effective match between supply and demand.

In sum, the current labour market challenges signify that the mode and content of public policy must be rethought. As an organisation, throughout the 1990s, the OECD has emphasised the need to switch from passive to active labour market policies (ALMPs). This recommendation appears to have been translated into policy. Between 1986 and 1998, two years of approximately equal unemployment rates for the OECD as a whole, the proportion of labour market policy spending allocated to active programmes rose in two thirds of the OECD countries and the OECD average also rose very slightly from 35.0 percent to 37.3 percent. While active spending has risen only slightly as a proportion of GDP, the participant inflow has risen much faster: in 1998 over twice as many people entered ALMPs as did in 1985, and around 50 percent more than in 1992. This very likely

reflects greater use of 'lighter' active measures and reduced emphasis
o n

TABLE 2. SPENDING ON LABOUR MARKET PROGRAMMES, AS A PERCENTAGE OF GDP(1985, 1989, 1993 AND 1997 TO 2000)

	1985	1989	1993	1997	1998	1999	2000
Australia	1.67	1.04	2.51	1.74	1.59	1.51	..
Austria	1.20	1.20	1.73	1.73	1.71	1.71	1.56
Belgium	4.68	3.91	4.24	3.87	3.87	3.69	..
Canada	2.49	2.07	2.60	1.46	1.49	..	..
Czech Republic	..	..	0.30	0.32	0.36	0.50	0.52
Denmark	..	5.49	7.08	5.49	5.03	4.85	4.51
Finland	2.22	2.11	6.57	4.68	3.96	3.53	3.30
France	3.03	2.60	3.32	3.18	3.11	3.12	..
Germany ¹⁾	2.22	2.26	4.10	3.76	3.54	3.42	3.13
Greece	0.52	0.79	0.71	0.84	0.83	..	..
Hungary	..	..	2.76	1.07	1.01	0.96	0.87
Ireland	5.04	4.17	..	..	..	..	..
Italy	..	..	..	..	..	..	..
Japan	..	0.39	0.38	0.74	0.75	0.82	..
Korea	..	..	0.06	0.11	0.64	0.88	0.55
Luxembourg	1.48	0.96	0.88	0.97	..	..	..
Mexico	0.00	0.01	0.01	0.08	0.07	0.08	0.04
Netherlands	4.61	3.87	4.30	4.50	4.12	3.93	3.65
New Zealand	1.54	2.66	2.45	2.22	2.21	2.17	..
Norway	1.09	1.83	2.64	1.65	1.39	1.28	1.16
Poland	..	..	2.45	..	..	..	..
Portugal	..	0.72	1.74	..	..	..	..
Spain	3.10	2.98	3.80	2.27	2.25	2.41	2.32
Sweden ²⁾	3.00	2.22	5.67	4.13	3.88	3.50	2.72
Switzerland	0.46	0.34	1.99	2.15	1.86	1.55	1.05
United Kingdom	2.92	1.56	2.18	1.18	0.98	0.94	..
United States	..	0.62	0.79	0.42	0.42	0.42	0.38
EU ³⁾	2.83	2.49	3.56	3.05	3.03	3.11	3.03
Total OECD ³⁾	2.29	1.99	2.61	2.11	2.05	2.07	1.84

Notes: 1) Data are for Western Germany only prior to 1990; they are for the whole of Germany from 1991 onwards.

2) In Sweden, data for 1995 and 1996 are similar, as the 1995-96 fiscal year lasted from July 1st 1995 to December 31st 1996.

3) Unweighted average.

Source: OECD Database on Labour Market Programmes.

expensive programmes such as long periods of training. However, a consequence of the recent period of strong growth, low inflation and diminishing unemployment is the reduction of funds available for labour market policies, both passive and active. Overall spending on labour market measures as a proportion of GDP has remained relatively steady, but peaked in the midst of the recession of the early 1990s. Its 2000 level was below that of 1985 (see Table 2). While active measures have increased in proportion of labour market policies overall, their level has gone down in proportion of GDP since the last economic recovery (from 0.94 percent in 1993 to 0.87 percent in 1998). Within active labour market policies, vocational training has been the most affected by this reduction. In proportion of GDP, training expenditures have decreased from 0.255 percent to 0.218 percent in the OECD area.

Meanwhile, the old dichotomy between active and passive labour market policies appear to be less relevant. Indeed, several OECD economies such as the United States, the United Kingdom, Australia and New Zealand, adopted welfare-to-work measures that are essentially centred on job placements and outcomes and make benefits conditional to acceptance of the jobs or training opportunities on offer (Lødemel and Trickey, 2001; Peck, 2001). Unsurprisingly, this policy stance has resulted in more people placed into jobs. Simultaneously, sustained economic growth and strong demand for labour have facilitated the re-integration into the labour market of many workers with low qualifications and poor or no work experience. However the employment found has not always been sustained and labour market churning has remained an issue for many disaffected young people and job seekers. The aforementioned challenge of upskilling is hence also a means to promote employment sustainability.

The combination of labour shortages and reduction of funds available for training has a clear impact on the management of programmes. The public employment service has for mission to ensure an efficient functioning of the labour market, and to provide the private sector with well-qualified and sufficiently trained workers. Low

Box 1: Employment Sustainability and Upskilling: some Definitions

The concept of *employment sustainability* denotes a policy goal defined as the “maintenance of a stable and upward employment trajectory in the longer term”. Achieving employment sustainability is more than just getting a job and can also be more than staying in the same job with the same employer. It involves a continuous and uninterrupted period of employment without drops in earnings or a rapid return to benefit claiming (Kellard, et al., 2001). Employment sustainability is therefore related to several further concepts which reflect medium term goals: *employability* (the presence of skills and assets and how they are used), *job stability* (recognising the relationship between the characteristics of the job and the job holder), *job retention* (the ability to remain in work when circumstances change) and *job mobility*. *Occupational mobility* refers to progression in pay, responsibilities or status, whilst *geographical mobility* refers to an individual’s willingness or capacity to move to a new location to gain employment or to remain in employment.

Upskilling represents the central labour market policy tool through which the above medium and long-term employment goals may be achieved. Upskilling is a generic term that generally refers to training but may also include other supportive measures to equip workers with new skills and competencies. It does however differ from the concept of lifelong learning which embodies a broader educational, cultural and time perspective. Taken together, measures to promote upskilling and lifelong learning can raise the mobility and employability of workers, mitigate the costs of job displacement resulting from rapid technological change and reduce resistance to reform. Whilst upskilling refers to measures targeting workers, i.e. labour supply, the recognition that individual employability is affected by contextual factors requires this instrument to be combined with measures directed at employer demand as well as adequate personal, family and infrastructural support. They must hence be part of an integrated package towards employment sustainability at the local level.

unemployment and tight budgets for training make it more difficult for the PES to fulfil this mission. At the same time concerns over the territorial variations in local demand (both in terms of the quantity and the quality of the jobs available) are begging the question of how to achieve the best possible local fit. Decentralisation in policy design and implementation together with the formation of local partnerships have been a key responses to this challenge. It is this issue the paper now turns to.

3. Partnership with the PES

Labour shortages and reduced funding call for greater effectiveness in the implementation of active labour market policies (ALMPs) and for new ways of working. Labour mobility is often insufficient to absorb all excess demands and tackle skills bottlenecks. Part of the response to the shortage problem must then come from increasing the local labour supply and attracting into the labour market people who do not seek jobs. This represents an opportunity to re-integrate welfare recipients and to motivate those who have lost contact with the labour market, shedding light on the potential benefits for the PES to co-operate with local authorities, community-based organisations and NGOs, which often have more connections with disadvantaged groups and endeavour to identify and remove the obstacles to employment.

The reduction of funds available for training simultaneously calls for a greater co-ordination of the various training services provided at local level. This is, first, to ensure the provision of services highly needed by the private sector and, second, to eliminate duplication of activities in view of maximising efficiency in service delivery. In this perspective, sharing local information with other actors enables skills needs to be better assessed, with funds allocated accordingly. Partnerships between the PES, private training service providers, trade unions (which provide training in many countries), and employer

Box 2: Increasing the Efficiency of the Labour Market: the Case of Limburg

In Flanders, the public employment service (VDAB), along with the training service providers of the private and non-profit sector, have seen a reduction in funds available recently due to falling unemployment. However, the need for labour and specialised skills has been growing rapidly in some regions. In one of the main cities of the province of Limburg (Genk), where the labour demand in certain sectors is sharp while long-term unemployment remains high, VDAB's local office and the municipality have come together in a partnership agreement. The aim is to co-ordinate, together with willing independent training service providers, the training activities in the greater area of Genk.

Nearly all of the 23 providers in the area participate in this exercise. Although they face the risk of being merged or having their funding cut due to the eventual identification of duplicated services through the exercise, the providers value positively the net impact of being networked. As part of the partnership, they can better market their expertise. Community-based providers, working with disadvantaged groups (e.g., immigrants, young people, and women) offer a competitive advantage in the current context where expansion of the labour force is encouraged, and the partnership enables this expertise to be made known to the PES and the local authorities. Private providers can also increase their visibility to the public and the business community through the organisation of training fairs. The partnership also organises workshops to improve the efficiency of the management methods used by the providers.

VDAB, which seconded two officers, and the municipality cover the operation costs of the partnership.

Source: OECD (2001a).

organisations have been developed in many regions and have coped with this situation in a satisfactory way.

The increased interest of the PES in partnerships can be illustrated by an example from Belgium. In this example, the partnership initiative helps each partner organisation to meet its objectives. The PES promotes labour market efficiency through matching better training services and the needs of the private sector. The municipality both retains investment in the area and helps alleviate social problems. Private service providers have the opportunity to develop further, and community-based providers draw more people out of welfare, providing initial training and guiding them through further training activities provided by the PES and specialised institutions.

Similar examples of partnership involving the PES are found in many OECD countries, and this represents a major trend today. To promote sustainable development and better respond to the legitimate concerns of the population, governments today actively seek a broad partnership with civil society and the private sector. Partnerships have been established throughout the OECD area to tackle issues of economic development, employment, social cohesion and the quality of life, and share a common desire to improve governance – how society collectively solves its problems and meets its needs. Through partnerships, civil society and its NGOs, enterprises and government at different levels work together to design area-based strategies, adapt policies to local conditions and take initiatives consistent with shared priorities.

The PES is often at the heart of these partnership initiatives. Indeed, ineffective policy co-ordination often refers to a weak articulation on two axes: 1) between labour market and social policy, and 2) between labour market policy and economic development. Hence, improving policy coherence often amounts to improving co-operation between the PES and another important organisation responsible for either social affairs or economic development.

4. Partnership on Social Policy

There are good reasons to better co-ordinate social and

employment policies. Effective active labour market policies have a role to play in any strategy to assist the excluded into jobs. Even for difficult groups, experience shows that seemingly simple and low-cost interventions such as job counselling and job-search assistance, coupled with the monitoring of search behaviour of benefits recipients, can help.

In the OECD area, municipalities are often the main actors that need a functional link with the PES in social matters. In several countries, they are responsible for providing social assistance services to those who are not eligible for unemployment insurance (UI) benefits or who have seen their entitlement period expire. Although municipalities normally draw on transfers from either the national or regional government to cope with this task, the pressure exerted on municipal financial resources has often been strong in recent years, as a share of the long-term unemployed facing particular problems on the labour market fell off UI. Adding to this burden, reforms of the late-1990s reducing the generosity of unemployment insurance regimes, tightening eligibility and reinforcing the obligations to participate in ALMPs had the effect of moving many UI beneficiaries to social assistance.

Services provided to social assistance recipients vary from region to region and, in some cases, from municipality to municipality. They include direct income support, assistance towards housing, food, transportation, health care and childcare. To re-integrate welfare recipients into the labour market, municipalities have developed a range of employment services, such as placement, counselling and training. These services have, to various extents, duplicated those provided by the PES. As municipalities have little expertise in and limited resources to devote to these activities, co-operation of the PES has often been sought.

5. Partnership on Economic Development

Regional governments have also increasingly felt the need to

co-operate with the PES in the past few years. Regional governments sometimes support the provision of costly social services by municipalities, and they are pressured by voters about the social impact of industrial re-structuring. But more importantly, regional governments are often responsible for designing the economic development strategy for their area.

Increasingly, regional strategies aim to stimulate “endogenous” development, drawing on local competitive advantages and skills. They feature activities to foster entrepreneurship and self-employment, support business incubators and social enterprises and encourage the networking of firms. These activities can better be implemented in co-ordination with labour market programmes. The PES may provide technical and financial assistance, and facilitate the access of participants in regional initiatives to job subsidy schemes. In addition, training and placement activities of the PES and those of regional authorities to promote inward investment can reinforce each other and optimise their mutual impact.

6. Getting to Co-operate with the PES

Co-operating with the PES does not go without difficulty. It has proved difficult for the PES to contribute significantly to the re-employment of social assistance recipients or to participate actively in economic development initiatives. While some services provided by the PES, like placement, are available to all individuals, whether employed, unemployed or socially assisted, the access to others is restricted. ALMPs, which include job subsidies, training and assistance towards self-employment, are often funded through a specific budget allocated by the Ministry of Labour and destined for unemployed people registered to UI, while social measures for other categories of unemployed persons are provided under different jurisdictions. This separation of budgets also prevails in countries where ALMPs are funded by the UI regime, itself financed through contributions levied

on payroll and wages. Contributors (employers and employees) expect that this budget be used exclusively for UI recipients -- in countries where tripartism plays a role in this sector, trade unions and employer organisations ensure that this is actually the case.

**Box 3: A partnership on Both Decision-making and Delivery:
the Case of the United States**

The United States provide a good example of partnership in the areas of labour market and social policies. The Workforce Investment Act (WIA) of 1998 set up a legal framework for both the establishment of partnerships on workforce development and one-stop service delivery agencies. Under the WIA, state and local authorities encourage agencies responsible for administering labour market policy, education and social programmes to collaborate and create a seamless system of delivery: the one-stop career centres.

Agencies supply activities in each of three categories:

Core services: determination of eligibility; job search and placement services; career counselling; labour market information; initial assessment of skills and needs; information on programmes, services, training providers, filing for UI and financial assistance.

Intensive services: comprehensive assessment of skill level and service needs; development of an individual employment plan; job-search workshops; individual and group counselling; case management.

Training services: skills training; on-the-job training; skills-upgrading and re-training; entrepreneurial training; job-readiness training.

WIBs are established at both local and state level to plan and oversee one-stop delivery systems. Local WIBs design local workforce development plans, designate one-stop operators, identify providers of training services, negotiate local performance measures with the state board and monitor system performance. In addition, youth councils (including representatives of youth service agencies, housing authorities, parents and youth groups) are established as a sub-group to develop elements of the local plan relating to youth and co-ordinate local youth programmes.

Source: OECD (2001c).

Despite this, the PES often recognises the benefits from working in partnerships, and does engage in co-operative activities with other partners. Exchanging information with other partners (e.g., NGOs) helps the PES to meet its targets in terms of referrals to specific programmes. Local development projects can be used to give work experience to unemployed people with re-integration difficulties. Training services can be rationalised, as shown by the Belgian example.

Formalising a partnership arrangement is often felt necessary by the PES. In Austria, PES officers have found that joint projects can be carried out more efficiently in formal partnership arrangement. The Austrian government has been successful in providing the appropriate framework for this. Among the new administrative provisions established within the partnership framework, a contract is signed between the government of the *Land* and the regional office of the PES. To secure the commitment of trade unions and employer organisations, which together manage the PES in each region, the social partners sign a “supportive agreement” with the partnership.

Similar procedures have been taken on in the United States, where relationships between the local workforce investment boards (WIBs) and their partners are formalised through “memoranda of understanding” (MOU). These formal agreements seek to ensure efficient resource co-ordination in the area and to avoid service duplication.

7. A Potential Not Fulfilled

Despite a growing interest in partnership, the potential for improving the co-ordination of ALMPs, social policies and economic development strategies using this tool of governance has not been fulfilled. The OECD has just carried out a study on partnerships in seven countries, which shows that the benefits from partnership have often remained geographically limited and focused on specific issues.

Partners have participated in the joint development of projects that could meet their direct needs, but interest in pursuing co-operation — and in broadening this to other activities — has often decreased once objectives were being met.

The main obstacle to partnership effectiveness is the inconsistency of national policy frameworks. Governments have created networks of partnerships and given them goals to achieve, but without ensuring that the prospective partners from the government could take an active and consistent part in the activities to reach these goals. Public services have rarely been required to integrate in their mission the policy objectives assigned to the partnerships, in which they were expected to participate.

A concrete example is again provided by the PES, which often pays relatively little attention to regional development concerns despite the fact that it almost systematically co-steers area-based partnerships. The PES promotes geographical mobility to eliminate unemployment disparities, sometimes to the dismay of local and regional governments in depressed areas that strive to revitalise their localities and retain their younger population groups. Reducing unemployment need not be the main priority from a regional development perspective. A comprehensive strategy based on local competitive advantages, with implications for the implementation of labour market policy, may be designed to achieve multiple objectives of sustainable development, social cohesion and low unemployment.

The effect of inconsistencies in national policy frameworks is reinforced by the adoption by public services of performance management methods aimed at ensuring high levels of efficiency in reaching targets. Methods of management by objectives and results may encourage public services to take a narrow approach to implementation, even in decentralised frameworks, as they provide incentives to concentrate on the units of service output which are measured and reported. Maximising efficiency in public services sometimes generates screening effects, whereby less costly cases are served first, and can reinforce compartmentalisation in delivery.

Another major obstacle to the effectiveness of partnerships is found in the issue of accountability. Partnerships have failed to have their work monitored and evaluated properly. The accountability framework of partnerships has emphasised achievements in terms of policy results (e.g., jobs created, unemployed placed into jobs, business start-ups, etc.). However, most partnerships have been allocated few resources to achieve significant results on these criteria. To tackle this challenge, partnerships have raised funds, diversified services and multiplied projects, thus sowing the seeds of competition with partners from the public service evaluated on similar criteria.

Rarely have partnerships been evaluated by their constituencies in terms of how the latter actually benefit from working in partnership, for example by: increased use and better targeting of measures; greater responsiveness to local conditions; identification of opportunities for broader impact through joint activities; and a higher degree of satisfaction among the population. By neglecting to monitor and evaluate the performance of partnerships in improving governance, the prevailing accountability frameworks have failed to improve the working methods of either the partnerships or their constituent partners.

8. A Strategy to Improve Governance through Partnerships

Partnerships are instrumental to public services in improving the effectiveness and appropriateness of the programmes they implement and the services they deliver. Benefits from taking a cross-sector approach drawing on resources and skills across levels have been identified by PES officers as well as representatives from local government, social partner organisations and the wider civil society. Yet partnerships are not always used this way by their constituencies. Opportunities to improve governance are missed due to inconsistencies in the national policy framework and failures in accountability.

A strategy can be implemented to maximise the impact of partnerships on governance. Adopting this strategy has implications not only for partnerships, but also for their constituencies: the government, the PES and other relevant public services; local and regional governments; trade unions and employer organisations; NGOs and community-based organisations. Improving governance through partnerships requires adjustments to the strategic and accountability frameworks of partnerships and to the policy and management frameworks of the partnerships' constituencies.

8.1 Make Policy Goals Consistent at National Level

The partnership experience shows that the potential to co-ordinate policies at local level is limited by the degree of consistency across the policy objectives pursued by the various government departments at national level. In order to make partnership relevant and effective, the partners must aim at common or compatible objectives at national level, which can be pursued more concretely and attained more efficiently in partnership at local or regional level. Thus, local co-ordination work carried out by partnerships should be complemented by a similar process at central level. The creation of a network of partnerships should be accompanied by a mechanism through which local and regional experience is fed back to the top to highlight deficiencies in the national policy framework. A mechanism should also exist to facilitate the necessary trade-offs between government departments (and social partners) in view of achieving full consistency among the national policy objectives related to the goals of the partnerships. As a result, partnerships should be accountable to all the partners they need to fulfil their mission.

To make co-ordination effective, those partners should agree on the role to be given to partnerships in policy implementation and in improving governance. And to make this exercise successful, the partners should identify the benefits they expect from mutual co-operation, and what they must in turn contribute to the partnership

to make it work effectively. Evaluation criteria should be established on this basis by the partners themselves.

8.2 Adapt the Strategic Framework for Partnerships to the Needs of the Partners

While public services, including the PES, have identified an interest in working in partnership, an uneven degree of ambition among the other constituent partners sometimes undermines their incentive to actively participate in the partnership process. Strong involvement by community-based organisations and NGOs may discourage PES officers from sharing information and from engaging in open discussion on how to surmount obstacles to cross-sector decision-making. Nevertheless, experience shows that various types of partner organisations are prepared to invest in a partnership when it can help them achieve their goals. This is reflected by examples of partnerships in which the operating costs have been entirely financed by the local partners (e.g., municipalities and PES offices).

The strategic framework for partnerships should enable PES officers and local officials to achieve their own policy objectives through participation in defining and implementing the partnership strategy. This will encourage them to use the partnership as a tool to improve the quality of their own actions locally, and, in turn, stimulate wider participation and mobilisation. More particularly, strategies designed by partnerships should ensure consistency of objectives across levels of governance, and seek to consolidate those that are common to groups of local partners, such as neighbouring municipalities.

8.3 Strengthen the Accountability Framework for Partnerships

Joint co-operative actions may be accompanied by a blurred distribution of responsibility, providing partners with incentives to claim responsibility for positive results while ignoring failures. Various other ways to undermine the accountability of partnerships have also

been identified: an uneven degree of participation by partner organisations, *ad hoc* representation of their delegates, absence of mandates guiding delegates' action, and weak reporting mechanisms. Weaknesses in the accountability framework harm commitment from those institutions most responsible, such as the public services ultimately accountable to parliament, and elected municipal officials. Strong accountability is a prerequisite for effectiveness in policy co-ordination and legitimacy of resource-allocation decisions.

To strengthen the accountability of partnerships, partners from all sectors (public services, social partners, non-government) should have a clear policy on the issues addressed by the partnerships. They should, accordingly, define mandates and reporting mechanisms for their delegates. Partners should agree on appropriate representation mechanisms for each sector, and on a clear distribution of responsibility when public programmes are implemented with the partnership's involvement. They should seek to separate the functions of strategic planning and project appraisal involving public funds to avoid conflicts of interest.

8.4 Provide Flexibility in the Management of Public Programmes

In light of the partnerships' strengthened accountability framework, the degree of flexibility provided in the management of policies related to the goals assigned to partnerships may be revised to meet the growing needs of local public service offices. Insufficient flexibility provided in public management may limit the scope of the benefits that local PES officers can reap from working in partnership, preventing them from translating their participation in the definition of a local joint strategy into concrete involvement in its implementation. Further, a weak capacity to respond to local priorities by public services, social partners and local governments undermines the scope for fully co-operative relationships within partnerships to the extent that it may convey incentives to partnerships to develop their own measures

involving service delivery. Partnerships should be involved in the targeting of public programmes related to common goals, while the responsibility for implementation should remain with public services.

9. Conclusions

Strong business needs, skill shortages, reductions of funds available for training and an increasing need to better co-ordinate labour market policies with, on one side, social policies and, on the other side, economic development initiatives, have called for new methods of working. Throughout the OECD, partnerships have been formed at local and regional level, and the PES has often been at the core of these initiatives. Yet it is not because government sets up a network of partnerships across country that better co-ordination of actions will necessarily occur. Further adjustments are needed in the policy and accountability frameworks of the different partners to improve the effectiveness of collective actions and the quality of governance. The OECD has just made a series of recommendations in this regard. Applying them would:

- increase the coherence across policy goals at national level (for labour market, social affairs, education and economic development), and the degree of co-ordination in implementing programmes and actions;
- stimulate the utilisation of ALMPs and other programmes, and target them better to local needs;
- enhance the global impact of ALMPs and initiatives of other partners (local authorities, employer organisations, trade unions, NGOs, community-based organisations) through identifying and drawing on synergies;
- enforce local capacities to seize new opportunities for economic development based on proximity, competitive advantages, skills and knowledge.

This *Strategy to Improve Governance through Partnerships* is now being applied by several OECD countries, which either participated in the first stage of the OECD study on partnerships or are currently participating in its second stage. Korea should also consider the possibility of implementing this strategy.

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2

Public Employment Policy in the New Economic Environment: The United States Experience

Randall W. Eberts *
Christopher J. O'Leary *

1. Introduction

1.1 The Changing Economic and Industrial Structure

To set the economic context for employment policy in the United States (US) during the last part of the twentieth century, we consider trends in the labor force size, labor force participation, unemployment, and industrial composition of employment.

As seen in Table 1.1, the US labor force exceeded 140 million workers who were either employed or out of work but actively seeking work in the year 2000. This is more than double the labor force size of 62 million fifty years earlier. The table also shows that this growth in the labor force was greatly spurred by a sizeable increase in the labor force participation of women. The overall labor force participation rate in the US is now at a post-World War II high of 67.2 percent of the non-institutional civilian population. The female rate is near an historic peak, while the male labor force participation rate has slowly declined

* W. E. Upjohn Institute for Employment Research.

TABLE 1.1 TRENDS IN THE UNEMPLOYMENT RATE AND LABOR FORCE, 1950–2000

Year	Civilian Labor Force (in thousands)	Total	Labor force participation (%)			Long-term unemployment rate (27 weeks or more)
			Male (20 & over)	Female (20 & over)	Unemployment rate total (16 and over)	
2000	140,863	67.2	76.6	60.9	4.0	11.4
1999	139,368	67.1	76.7	60.7	4.2	12.3
1998	137,673	67.1	76.8	60.4	4.5	14.1
1997	136,297	67.1	77.0	60.5	4.9	15.8
1996	133,943	66.8	76.8	59.9	5.4	17.4
1995	132,304	66.6	76.7	59.4	5.6	17.3
1994	131,056	66.6	76.8	59.3	6.1	20.3
1993	129,200	66.3	77.3	58.5	6.9	20.1
1992	128,105	66.4	77.7	58.5	7.5	20.3
1991	126,346	66.2	77.7	57.9	6.8	12.9
1990	125,840	66.5	78.2	58.0	5.6	10.0
1989	123,869	66.5	78.1	57.7	5.3	9.9
1988	121,669	65.9	77.9	56.8	5.5	12.1
1987	119,865	65.6	78.0	56.2	6.2	14.0
1986	117,834	65.3	78.1	55.5	7.0	14.4
1985	115,461	64.8	78.1	54.7	7.2	15.4
1984	113,544	64.4	78.3	53.7	7.5	19.1
1983	111,550	64.0	78.5	53.1	9.6	23.9
1982	110,204	64.0	78.7	52.7	9.7	16.6
1981	108,670	63.9	79.0	52.1	7.6	14.0
1980	106,940	63.8	79.4	51.3	7.1	10.7
1979	104,962	63.7	79.8	50.6	5.8	8.7
1978	102,251	63.2	79.8	49.6	6.1	10.5
1977	99,009	62.3	79.7	48.1	7.1	14.7
1976	96,158	61.6	79.8	47.0	7.7	18.2
1975	93,775	61.2	80.3	46.0	8.5	15.2
1974	91,949	61.3	81.0	45.3	5.6	7.4
1973	89,429	60.8	81.3	44.4	4.9	7.9
1972	87,034	60.4	81.6	43.7	5.6	11.6
1971	84,382	60.2	82.1	43.3	5.9	10.4
1970	82,771	60.4	82.6	43.3	4.9	5.8
1969	80,734	60.1	82.8	42.7	3.5	4.7
1968	78,737	59.6	83.1	41.6	3.6	5.5
1967	77,347	59.6	83.4	41.1	3.8	5.9
1966	75,770	59.2	83.6	40.1	3.8	8.3
1965	74,455	58.9	83.9	39.4	4.5	10.4
1964	73,091	58.7	84.2	38.9	5.2	12.7
1963	71,833	58.7	84.4	38.3	5.7	13.6
1962	70,614	58.8	84.8	37.8	5.5	15.0
1961	70,459	59.3	85.7	38.0	6.7	17.0
1960	69,628	59.4	86.0	37.6	5.5	11.8
1959	68,369	59.3	86.3	37.1	5.5	15.3
1958	67,639	59.5	86.6	36.9	6.8	14.5
1957	66,929	59.6	86.9	36.5	4.3	8.4
1956	66,552	60.0	87.6	36.4	4.1	8.4
1955	65,023	59.3	87.6	35.4	4.4	11.8
1954	63,643	58.8	87.8	34.2	5.5	9.0
1953	63,015	58.9	88.0	33.9	2.9	4.3
1952	62,138	59.0	88.3	34.1	3.0	4.5
1951	62,017	59.2	88.2	34.0	3.3	6.7
1950	62,208	59.2	88.4	33.3	5.3	10.9

Source: U.S. Department of Labor, Bureau of Labor Statistics. Labor Force Statistics from the Current Population Survey [Online]. Available: <http://stats.bls.gov/sahome.html> [2001, August10].

during the past half century. Since 1950 the labor force participation

rate of women has nearly doubled from 33.3 percent to 60.9 percent, while that for males has declined from 88.4 percent to 76.6 percent.

During the decade of the 1990s, the US labor force grew by more than 15 million workers. Simultaneously, net employment expanded by about 20 million, causing the US unemployment rate to dip to 4.0 percent in 2000. The protracted economic expansion of the 1990s also witnessed a significant decline in long-term unemployment. The proportion of unemployed who were out of work for six months or more fell from more than 20 percent of all unemployed to about 12 percent of jobless workers.

It should be noted that the recent expansion has witnessed a larger proportion of the unemployed who are out of work for the long term than what occurred at the peaks of earlier business expansions. By 2000, 11.4 percent of the unemployed were long term (27 weeks or more), while the long-term share of unemployment was 9.9 percent in 1989 and 8.9 percent in 1979. It may be that with a lower overall rate of unemployment the remaining unemployed job seekers are more difficult to re-employ.

As seen in Table 1.2, unemployment among males is usually lower than for females. This difference was consistent and sizeable in years preceding the 1981-1982 recession. In 1982 and 1983, unemployment was higher among males than females and the rates have differed little in subsequent years. Civil rights legislation assures both genders equal opportunity and protection in employment. However, no special employment services have been targeting on a gender basis.

Special programs for employment assistance in the US are targeted to minorities, youth, and dislocated workers — who are long-term unemployed or lack skills demanded in their local labor market. In Table 1.2, it can be seen that unemployment rates for youth and the less educated are always higher than for the labor force as a whole. A disturbing phenomenon is the comparatively slow rate of unemployment decline for these groups in recent years while the general labor market has improved.

TABLE 1.2 TRENDS IN UNEMPLOYMENT RATES, 1965–2000

Year	Gender		Age			Education				
	Total	Male (16 and over)	Female (16 and over)	Average monthly (age 16-24)	Average monthly (age 25-54)	Average monthly (age 55+)	Less than a high school diploma	High school graduate, no college	Less than a Bachelors degree	College graduates
2000	4.0	3.9	4.1	9.3	3.1	2.6	7.9	3.8	3.0	1.5
1999	4.2	4.1	4.3	9.9	3.2	2.8	7.7	4.0	3.1	1.9
1998	4.5	4.4	4.6	10.4	3.5	2.7	8.5	4.8	3.6	1.8
1997	4.9	4.9	5.0	11.3	3.9	3.0	10.4	5.1	3.8	2.0
1996	5.4	5.4	5.4	12.0	4.3	3.4	10.9	5.5	4.1	2.2
1995	5.6	5.6	5.6	12.1	4.5	3.7	10.0	5.2	4.5	2.5
1994	6.1	6.2	6.0	12.5	4.9	4.1	12.6	6.7	5.0	2.9
1993	6.9	7.2	6.6	13.4	5.8	4.3	13.0	7.3	5.5	3.2
1992	7.5	7.9	7.0	14.2	6.4	4.8	13.5	7.7	5.9	2.9
1991	6.8	7.2	6.4	13.5	5.7	3.9	12.3	6.7	5.0	2.9
1990	5.6	5.7	5.5	11.2	4.6	3.3	9.6	4.9	3.7	1.9
1989	5.3	5.2	5.4	10.9	4.2	3.1	8.9	4.8	3.4	2.2
1988	5.5	5.5	5.6	11.0	4.5	3.1	9.4	5.4	3.7	1.7
1987	6.2	6.2	6.2	12.2	5.0	3.3	11.1	6.3	4.5	2.3
1986	7.0	6.9	7.1	13.3	5.7	3.9	11.6	6.9	4.7	2.3
1985	7.2	7.0	7.4	13.6	5.9	4.1	11.4	6.9	4.7	2.4
1984	7.5	7.4	7.6	13.9	6.1	4.4	12.1	7.2	5.3	2.7
1983	9.6	9.9	9.2	17.1	8.0	5.2	15.8	10.0	7.3	3.5
1982	9.7	9.9	9.4	17.8	7.9	5.0	12.5	8.5	6.4	3.0
1981	7.6	7.4	7.9	14.9	5.8	3.6	10.1	6.2	4.5	.2
1980	7.1	6.9	7.4	13.9	5.5	3.3	8.4	5.1	4.3	1.9
1979	5.8	5.1	6.8	11.8	4.2	3.0	7.2	4.4	3.5	2.1
1978	6.1	5.3	7.2	12.2	4.3	3.2	7.4	4.5	3.3	2.2
1977	7.1	6.3	8.2	13.6	5.1	4.1	9.0	5.6	5.0	2.8
1976	7.7	7.1	8.6	14.7	5.7	4.6	8.6	6.1	5.2	2.4
1975	8.5	7.9	9.3	16.1	6.4	4.8	10.7	6.9	5.5	2.5
1974	5.6	4.9	6.7	11.9	3.8	3.0	5.3	3.4	3.4	1.7
1973	4.9	4.2	6.0	10.5	3.2	2.7	5.4	3.3	2.9	1.7
1972	5.6	5.0	6.6	12.1	3.8	3.3	5.8	3.9	3.5	2.0
1971	5.9	5.3	6.9	12.7	4.2	3.4	6.4	4.0	3.7	2.0
1970	4.9	4.4	5.9	11.1	3.4	2.9	4.6	2.9	2.9	1.3
1969	3.5	2.8	4.7	8.4	2.3	2.0	—	—	—	—
1968	3.6	2.9	4.8	8.6	2.3	2.2	—	—	—	—
1967	3.8	3.1	5.2	8.7	2.7	2.5	—	—	—	—
1966	3.8	3.2	4.8	8.5	2.6	2.6	—	—	—	—
1965	4.5	4.0	5.5	10.1	3.2	3.1	—	—	—	—

Sources: Age data: U.S. Department of Labor, Bureau of Labor Statistics. Labor Force Statistics from the Current Population Survey [Online]. Available: <http://stats.bls.gov/sahome.html> [2001, August 10]. Educational attainment data: Supplied by the Bureau of Labor Statistics from the Current Population Survey, July 20, 2001.

Table 1.3 shows how the industrial mix of employment changed in the latter part of the twentieth century. As total employment rose so did the share of employment in the service-producing sector. From 1965 to 2000, employment in the goods-producing sector declined from 36.1 to 19.5 percent of all employment. The complementary rise in service-producing employment went from 63.9 to 80.5 percent of total employment. These figures also reflect a change away from goods-based to knowledge-based employment. In recent years electronic commerce on the internet has accelerated this shift from blue collar (production) to white collar (administrative) and pink collar (clerical) employment. For eleven main service occupations, Hecker (2001) has estimated that e-commerce will in the coming years stimulate demand in eight of them.

Within the goods-producing sector, total employment in durable goods manufacturing has been virtually flat over the past thirty-six years. During this period, employment in motor vehicle and equipment production has remained a steady share of durable goods producing employment, while there has been significant increases in the shares of employment in computer and office equipment production and electronic components and accessories production. Employment in the latter sector has more than doubled as a share of employment in durable goods manufacturing.

Employment in services has risen from 9.0 million in 1965 to 40.5 million in 2000. Service employment related to the automobile industry has grown in step with overall growth in services employment. However, employment in business services has increased at a dramatically faster pace. Business services, which includes development of computer software business applications and management consulting services, has increased nearly ten fold in thirty-six years to about 10 million workers in 2000. This component of services employment is a major part of the knowledge-based economy.

Understanding the labor market context of US employment policy requires knowledge of union density, that is, the proportion of wage and salary workers who are union members. As shown in the right

TABLE 1.3 TRENDS IN ECONOMIC AND INDUSTRIAL STRUCTURE

Year	Total U.S. em- ployment (in thousands)	Percent goods producing	Percent services producing	A. Total employed in durable goods manufac-turing (in thousands)	% of A in computer and office equipment production
2000	131,759	19.5	80.5	11,138	3.2
1999	128,916	19.8	80.2	11,111	3.3
1998	125,865	20.2	79.8	11,205	3.4
1997	122,690	20.3	79.7	11,010	3.4
1996	119,608	20.5	79.5	10,789	3.4
1995	117,191	20.7	79.3	10,683	3.3
1994	114,163	20.9	79.1	10,448	3.4
1993	110,713	21.1	78.9	10,221	3.6
1992	108,601	21.4	78.6	10,277	3.8
1991	108,249	21.9	78.1	10,569	3.9
1990	109,403	22.8	77.2	11,109	3.9
1989	107,884	23.4	76.6	11,394	4.0
1988	105,209	23.9	76.1	11,363	4.0
1987	101,958	24.2	75.8	11,154	4.1
1986	99,344	24.7	75.3	11,195	4.2
1985	97,387	25.5	74.5	11,458	4.4
1984	94,408	26.2	73.8	11,476	4.5
1983	90,152	25.9	74.1	10,707	4.4
1982	89,544	26.6	73.4	11,014	4.2
1981	91,152	28.0	72.0	12,082	3.7
1980	90,406	28.4	71.6	12,159	3.5
1979	89,823	29.5	70.5	12,730	3.0
1978	86,697	29.5	70.5	12,245	2.8
1977	82,471	29.5	70.5	11,570	2.6
1976	79,382	29.4	70.6	11,051	2.5
1975	76,945	29.4	70.6	10,662	2.6
1974	78,265	31.7	68.3	11,897	2.5
1973	76,790	32.4	67.6	11,863	2.3
1972	73,675	32.1	67.9	11,022	2.3
1971	71,211	32.2	67.8	10,604	2.4
1970	70,880	33.3	66.7	11,176	2.5
1969	70,384	34.6	65.4	11,862	2.3
1968	67,897	35.0	65.0	11,594	2.1
1967	65,803	35.4	64.6	11,408	2.0
1966	63,901	36.2	63.8	11,250	1.9
1965	60,763	36.1	63.9	10,374	1.8

Source: U.S. Department of Labor, Bureau of Labor Statistics. Nonfarm Payroll Statistics from the Current Employment Statistics [Online]. Available: <http://stats.bls.gov/sahome.html> [2001, August10].

% of A in electronic components and accessories	% of A in motor vehicles and equipment	B. Total employed in services (in thousands)	% of B in business services	% of B in auto repair services and parking	% of Total US employ- ment which is unionized
6.1	9.1	40,460	24.4	3.1	
5.8	9.2	39,055	23.8	3.1	13.9
5.9	8.9	37,533	23.0	3.1	13.9
5.9	9.0	36,040	22.2	3.1	14.1
5.7	9.0	34,454	21.2	3.1	14.5
5.4	9.1	33,117	20.6	3.1	14.9
5.2	8.7	31,579	19.9	3.1	15.5
5.2	8.2	30,197	19.0	3.1	15.8
5.1	7.9	29,052	18.3	3.0	15.8
5.2	7.5	28,336	17.9	3.1	16.1
5.2	7.3	27,934	18.4	3.3	16.1
5.4	7.5	26,907	18.4	3.3	16.4
5.5	7.5	25,504	18.2	3.3	16.8
5.4	7.8	24,110	17.7	3.3	17.0
5.4	7.8	22,957	17.2	3.3	17.5
5.6	7.7	21,927	16.8	3.3	18.0
5.7	7.5	20,746	16.2	3.3	18.8
5.3	7.0	19,664	15.0	3.1	20.1
4.9	6.3	19,021	14.3	3.1	NA
4.5	6.5	18,615	14.5	3.1	21.4
4.4	6.5	17,890	14.3	3.2	23.0
4.0	7.8	17,112	14.1	3.4	24.1
3.6	8.2	16,252	13.4	3.4	23.0
3.4	8.2	15,302	12.8	3.3	23.8
3.2	8.0	14,551	12.4	3.2	22.1
3.1	7.4	13,892	12.2	3.2	22.2
3.4	7.6	13,441	12.5	3.2	23.6
3.4	8.2	12,857	12.5	3.3	24.0
3.1	7.9	12,276	12.1	3.2	NA
3.0	8.0	11,797	11.9	—	NA
3.2	7.1	11,548	12.1	—	NA
3.2	7.7	11,169	11.9	—	NA
3.2	7.5	10,567	11.5	—	NA
3.3	7.2	10,045	11.4	—	NA
3.4	7.7	9,498	11.1	—	NA
2.9	8.1	9,036	10.6	—	NA

most column of Table 1.3, union density fell from 24.0 percent of the labor force in 1973 to 13.9 percent in 1999. There is some evidence that the steady decline is gradually reversing during the current economic expansion. Yet, dramatic declines are undeniable. Part of the overall decline in union representation results from the decline in the share of employment in manufacturing and other industries that are traditionally heavily unionized. Even so, union density has declined within these industries as well. Over this period Freeman (1989) found the largest declines to be in manufacturing (-13%), construction (-16%), transportation-communication-utilities (-15%), and mining (-17%). Union density remained low but relatively stable in service and trade industries.

To put into perspective the importance of spending on employment policy in the US economy, Table 1.4 lists UI benefit payments and total expenditures on labor market policy (including UI) as proportions of gross domestic product (GDP) for the country. Only in one year, 1975, did UI spending exceed 1 percent of GDP. In that year, three successive grants of extended UI benefits resulted in eligibility of up to 65 weeks for many claimants.¹ Spending on UI is typically in the range of one-third to one-half of one percent of GDP. Naturally the share is higher in recessions and lower in years of expanding employment. Spending on employment programs other than UI tends to average about one-tenth of one percent of GDP.²

1.2 The Labor Market Situation

In 2000, the national average unemployment rate stood at 4.0

1) See Woodbury and Rubin (1997) for details.

2) Employment policy spending as a percent of GDP is quite modest in the US compared to other Organization for Economic Cooperation and Development (OECD) member countries. Among 22 OECD countries in 1992, only Japan had a lower share of GDP devoted to employment policy. In 1992 the Japanese unemployment rate was about one-quarter the rate in the U.S. Nearly all other OECD countries spent 2 percent or more of GDP on employment policy (OECD, 1994, p. 101).

TABLE 1.4 SPENDING ON UI AND EMPLOYMENT PROGRAMS IN THE US AS A SHARE OF GDP, 1965-2000

Year	UI benefits paid (\$ millions)	UI benefits paid as a percentage of US GDP	Spending on employment programs other than UI (\$ millions)	Spending on all employment programs as a percentage of US GDP
2000	20,715	0.21	7,971	0.29
1999	19,356	0.21	7,859	0.30
1998	19,912	0.23	7,672	0.32
1997	20,287	0.25	7,690	0.34
1996	22,560	0.29	7,955	0.40
1995	22,028	0.30	8,395	0.42
1994	24,209	0.35	8,055	0.46
1993	34,882	0.53	7,648	0.65
1992	39,749	0.64	7,363	0.76
1991	27,055	0.46	6,722	0.57
1990	18,374	0.32	6,429	0.43
1989	14,588	0.27	6,078	0.38
1988	13,360	0.27	5,954	0.39
1987	14,656	0.32	5,759	0.44
1986	17,095	0.39	5,929	0.52
1985	15,830	0.38	5,650	0.52
1984	15,881	0.41	5,283	0.55
1983	26,120	0.76	5,894	0.93
1982	25,419	0.79	6,053	0.97
1981	16,487	0.54	9,828	0.86
1980	18,503	0.68	10,896	1.08
1979	9,741	0.39	11,321	0.84
1978	9,546	0.43	11,194	0.93
1977	13,291	0.67	7,251	1.04
1976	16,466	0.95	6,589	1.33
1975	18,112	1.16	4,322	1.44
1974	7,050	0.49	3,129	0.71
1973	4,605	0.35	3,485	0.62
1972	6,037	0.51	3,078	0.77
1971	6,088	0.56	2,109	0.76
1970	4,158	0.41	1,737	0.58
1969	2,258	0.24	1,682	0.42
1968	2,147	0.25	1,694	0.44
1967	2,179	0.27	1,340	0.43
1966	1,851	0.25	1,084	0.39
1965	2,283	0.33	625	0.42

Note: Benefits paid in UI programs (includes all regular and extended programs, as well as programs for ex-federal and ex-military, temporary/emergency enactments). Federal outlays for labor market policies include training and employment programs and other labor services.

Sources: U.S. Department of Labor, Office of Workforce Security. Spending data provided by Division of Fiscal and Actuarial Services, February 11, 1999 and August 17, 2001; U.S. Office of Management and Budget. Budget of the United States Government Fiscal Year 2000, Historical Tables (Washington: Government Printing Office, 1999).
Table 3.2 (Outlays by function).

percent. This is well below the level generally believed by economists in the 1980s to be consistent with price stability.³ It is also a surprising turn of events for economists who had accepted high unemployment rates during business cycle peaks as inevitable.⁴ Furthermore, while unemployment has dipped, the aggregate price level has remained virtually unchanged. This has been widely attributed to increases in worker productivity accruing to improved information technology throughout the American economy. It has been more than twenty-five years since such rates of unemployment have been experienced in the US, as seen in Table 1.1.

Late in 2000 following a series of increases in the target federal funds rate by the Federal Open Market Committee and the completion of a year 2000 computer software and hardware spending binge, the US economy began to slow. By the middle of the third calendar quarter of 2001, aggregate unemployment has risen to 4.5 percent. A significant portion of the new surplus labor is in knowledge-based sectors related to the computer hardware and software industries. At this time it is difficult to project the length and depth of the retrenchment in these sectors and how this will impact the rest of the economy.

1.3 Current Labor Market Policy Framework

Policies to regulate and support labor markets in the US have mainly been an initiative of the federal government. Historically, states and localities were reluctant to act independently to build up worker rights and protections for fear of competitively disadvantaging resident industries with added costs. Federal constitutional authority to raise revenue and control commerce among the states governed development of labor market policy in the US. Labor market support

3) See for example the papers in Layard and Calmfors (1987).

4) Summers (1986) emphasized that dislocated adult married male workers suffered as greatly as any group, and despaired at the lack of macro policy tools available to address the situation because of huge federal budget deficits and persistent threats of inflation.

initiatives usually have been forged in difficult economic times with contributions and compromise from the full political spectrum.

The core programs of the US employment policy are unemployment insurance, job training, the employment service, wage subsidies and special programs for youth. In recent years, public assistance to the needy has also become an employment-focused policy.

Labor market programs are administered and delivered by an intergovernmental network of partnerships between federal, state, county and local agencies. The resulting labor market policy framework performs a wide variety of functions, varies greatly across states and local areas, but maintains important federal standards nationwide.

1.4 Outline of the Unemployment Insurance System and Active Labor Market Policies

Employment policy in the US is composed of four main categories of programs: unemployment insurance (UI), employment service (ES), job training, and wage subsidies primarily through tax credits. Programs for social assistance to children, disadvantaged and disabled are increasingly centered around employment. Table 1.5 lists the main programs in these groups and provides participation and expenditure data as of 1996. The expenditure figures are the latest that are available for all the programs. By showing expenditures in the same year, one can gain a perspective on the relative importance, as measured by resources allocated, of the various employment and social programs in the US.

The Social Security Act of 1935 established the federal-state unemployment insurance (UI). In 1996 it paid temporary partial wage replacement to 8.7 million job seekers who were involuntarily unemployed. The system disbursed \$21.8 billion in that year.

The U.S. Employment Service (ES) is a federal-state program, which has operated since it was created by the Wagner-Peyser Act of 1933. In 1996 the ES served 18.407 million persons at a cost of \$900 million. There has been little change in the ES budget since 1996. The

TABLE 1.5 THE MAIN EMPLOYMENT AND SOCIAL PROGRAMS IN THE US, 1996

Employment Related Programs	Participants (thousands)	Expenditures (\$ billions)	Overview
Unemployment Insurance Benefits	8,700	21.8	The federal-state UI program provides temporary benefits to covered workers who lose their jobs involuntarily or who quit with good cause.
Employment Services	18,407	0.9	The federal-state public labor exchange program facilitates job placement and conducts the work test for UI claimants.
Job Training Partnership Act	1,507	3.8	Job training services for the economically disadvantaged, dislocated workers, and others with employment barriers.
Earned Income Tax Credit	19,344	26.0	A federal income tax credit for low income workers, if greater than tax due the excess can be paid directly.
Social Programs			
Aid to Families with Dependent Children	12,312	18.1	Income support to families with children lacking income due to parental absence, inability to work, or unemployment.
Supplemental Security Income	6614	28.3	Federal cash support for needy, aged, blind, or disabled persons.
Food Stamps	24910	23.7	Increases the food purchasing power of eligible low income families.
Medicaid	36118	152.9	A federal-state entitlement providing medical assistance for low-income persons who are aged, blind, or disabled. Also for certain pregnant women, children, and members of families with dependent children.

Source: Fay and Lippoldt (1999, pp. 46-47).

FY2001 appropriation was \$1 billion.

The federal government has funded public job training for the unemployed under a variety of programs since the Great Depression of the 1930s. During 1996 federal training was administered under the Job Training Partnership Act (JTPA). In 1996, more than 1.5 million persons participated in JTPA funded job training and the program budget for the year was \$3.8 billion. In 1998, the Workforce Investment Act was passed to replace JTPA. It kept many of the same programs but emphasized the integration of services through one-stop centers and gave states and local jurisdictions more discretion in providing services. The FY2001 appropriation for WIA programs totaled about \$3.6 billion.

Wage subsidies for employment in the US are usually delivered through the income tax system. Some wage subsidies seek to boost labor demand and are paid to employers, others are given to workers so that they can afford to accept work at relatively low offered wages. The largest of these programs, the Earned Income Tax Credit (EITC), is of the latter type. The EITC operates basically as a negative income tax system, granting cash rebates to workers with low annual taxable earnings. In 1996 19.3 million individuals received EITC payments totaling \$26.0 billion, making EITC the largest employment program in the US. By 1999, expenditures for EITC increased to \$31 billion.

In 1996 social programs did not have a heavy emphasis on employment. Since that time, seeking employment has become a primary requirement for most social programs. In 1996 Aid to Families with Dependent Children paid \$18.1 billion to support 12.3 million persons living in households with dependent children who lacked income due to parental absence, inability to work, or unemployment. That program has since been replaced by Temporary Assistance to Needy Families (TANF), which has a five-year lifetime limit on federal support. That time limit will soon become effective in many states.

Supplemental Security Income (SSI) provides federal cash support to needy, aged, blind, or disabled persons. In 1996 the program paid a total of \$28.3 billion to 6.6 million persons.

A federal food stamp program is administered by the U.S. Department of Agriculture. Eligible low income families may buy a limited number of food stamps per month at a significant discount to their face value. The food stamps are then presented to food sellers where the market price is paid. In 1996 there were 24.9 million beneficiaries of the program, which cost \$23.7 billion.

The largest social program is Medicaid. It is a federal-state entitlement providing medical assistance for low-income persons who are aged, blind, or disabled. Assistance is also provided to certain pregnant women, children, and members of families with dependent children. In 1996 the federal-state Medicaid program had 36.1 million participants and expenses of \$152.9 billion.

2. Unemployment Insurance Benefits and Unemployment Assistance

2.1 Background

The federal-state unemployment insurance (UI) system provides temporary partial wage replacement to involuntarily unemployed job seekers with significant labor force attachment. It is the primary means by which public funds are used to provide earnings replacement for labor force members. In the aggregate UI helps to maintain purchasing power during economic downturns. It reduces the dispersal of skilled workers when employers make temporary layoffs and helps prevent the breakdown of general labor standards during such periods. The UI system in the US incorporates some unique features that are designed to encourage employers to stabilize employment levels.

During the twentieth century, the existence of a reliable system of unemployment compensation has become a hallmark of a developed modern industrial economy. It is recognized that in an industrial and highly urbanized economy workers are separated from a subsistence level guaranteed by the land in an agrarian society. When designing a safety net for workers, developing nations are faced with two broadly differing strategies concerning unemployment insurance.

The UI approach popular in Europe emphasizes income replacement without much attention to returning to work or stabilizing employment. The American UI system presents a distinct alternative that is custom designed to operate in a competitive market economy. The system in the US emphasizes individual responsibility, while the European system views unemployment compensation as a social obligation.

At the core of most contentious issues in the federal-state system of unemployment insurance in the US is the struggle between social generosity and individual responsibility. These competing interests must be weighed to determine essential aspects of the UI system such as the scope of coverage, the requirements for benefit eligibility, the

appropriate level and duration of benefits, and the distribution of the financing burden.⁵

2.1.1 Historical background for the introduction of UI in the US

Prior to the Great Depression of the 1930s, unemployment was not regarded as much more than a temporary and occasional problem, an inevitable seasonal or cyclical malady of industrial society. Workers who experienced much unemployment were often seen as responsible for their own predicament. In cases where job and wage loss produced temporary family deprivation, local privately-funded welfare agencies were regarded as the appropriate sources of relief. In some areas, local governments provided public unemployment relief.

Public unemployment insurance proposals were advanced in a number of states before 1930, but these initiatives were not broadly accepted given prevailing attitudes. The thought of intervention by the federal government to deal with unemployment was an even more remote idea, and viewed as probably unconstitutional. Most employers did not see provision for the unemployed as their responsibility. The few who did thought that employers should provide unemployment benefit plans on a private, voluntary basis.⁶

The reality of mass unemployment during the economic collapse of the 1930s made it clear that personal deficiency was not the only cause of the problem. As joblessness reached into the homes of executives, white-collar workers, skilled mechanics--people who before that time had been little touched by unemployment--the realization grew that it could strike the industrious and efficient worker as well as the marginal, unstable, lazy worker. Moreover, the problem was not of brief duration; unemployment persisted. Personal economic hardship

5) Much of this introductory section on UI is borrowed from Blaustein, O'Leary and Wandner (1997).

6) The Upjohn Company founder, Dr. W. E. Upjohn, created a private unemployment plan in 1932 to be administered by the W.E. Upjohn Unemployment Trustee Corporation, which later used the fund to establish and support the W.E. Upjohn Institute for Employment Research.

among the jobless became widespread. Efforts to ease it overwhelmed private welfare resources and local government relief efforts. Resistance to large-scale government assistance of the unemployed could not long withstand the pressures exerted by the massive and pervasive needs of so many over so many years.

In 1932, Wisconsin enacted the first state UI law. In 1934, President Roosevelt appointed the Committee on Economic Security to study how best to establish an unemployment compensation system.⁷ Ultimately the Committee recommended a federal-state system for unemployment compensation. The recommendation was probably influenced by the knowledge that President Roosevelt favored such a system. Furthermore, the Great Depression led many to believe that unemployment is due to national rather than to local economic events. However, Congress did not wish to usurp all state authority on such matters and feared that the courts might find a wholly federal system unconstitutional.

The UI system was a key element of President Franklin D. Roosevelt's social policy initiative entitled the *New Deal*, which aimed to lift the country out of the Great Depression. The federal-state UI system had five main goals: 1) to provide temporary partial wage replacement during involuntary unemployment, 2) to prevent dispersal of an employer's workforce, 3) to promote rapid return to work, 4) to limit business downturns by maintaining aggregate purchasing power, and 5) to encourage stabilization of employment in enterprises through experience rating.

The federal-state system of UI was established by the Social Security Act of 1935. Title III of the Act established federal grants to the states to perform administrative functions for UI, and Title IX established the federal unemployment tax and related provisions.⁸ The tax provisions established incentive conditions that showed federal genius for initiating the system among states with varying degrees of

7) Much of this material is drawn from West and Hildebrand (1997).

8) Blaustein (1993), pp. 151-153.

unemployment and differing concern about worker hardship. While principles for the financing of benefits are now widely accepted, the financing of administration remains an area of federal-state contention in UI policy.

2.1.2 History of institutional change in the UI system

The federal-state UI system represented an entirely new model for intergovernmental relations. It was not a federal system like the old age insurance provisions of the Social Security Act. Neither was it a system of federal grants to the states like public assistance matching grants. A clever incentive structure was established to create the system. A uniform federal tax was imposed on payrolls, but a 90 percent credit of this tax was granted in states operating approved UI programs. Money not rebated by the federal government is used to finance program administration through grants to the states and to make loans to the states when liquidity problems arise in paying benefits.

The existing federal-state UI system is a delicate balance of power that is self-regulated to a great extent by a built-in incentive structure.⁹ Each side of the system has many faces. The federal partner includes the U.S. Congress, the federal executive branch that includes the U.S. Department of Labor — its national and regional offices — and the Office of Management and Budget, and the federal courts. The state partner includes 50 states, the federal district (DC), 2 territories (Puerto Rico and Virgin Islands), the state legislatures, many state UI advisory councils, business and labor organizations, state courts, and state UI agencies with local offices.

Legal challenges to state and federal UI laws were filed right after taxes became payable by employers on January 1, 1936.¹⁰ The United States Supreme Court on May 24, 1937 found federal law to be constitutional. The high court ruled that: 1) states enacting conforming

9) Institutional relations are explained by West and Hildebrand (1997) and Rubin (1983), while the incentive structure is described by Burgess and Kingston (1987).

10) Further detail is given by Blaustein (1993), pp. 157-158 and Rosbrow (1986), pp. 7-8.

UI laws reaped a federal tax advantage for employers, 2) states did not act under duress but were free to choose this advantage, 3) the court opinion also cited general hardship during the Great Depression and a need to respond since 1929, and 4) the court cited states' reluctance to competitively disadvantage state employers. Many political observers at the time asserted that such a ruling was only possible because of Democratic Party appointments to the court made by President Roosevelt. Since originally ruling on the constitutionality of the federal-state UI system in 1937, judicial involvement in the system has been minimal.

Since initiation of the system, the federal partner has held the upper hand in guiding the direction of the system. This guidance has taken the form of federal requirements for conformity and compliance.¹¹ That is, state UI laws must conform with federal law, and actual state practice must comply with federal law. The Social Security Act of 1935 provided 12 minimal requirements. Two requirements were added about the use of UI granted funds during the early 1940s, new federal laws requiring broader coverage were appended in the 1950s, and many new requirements were added in 1970 and 1976.¹² In recent years an overriding federal concern has been controlling federal spending. Consequently, changes to the UI system have often been done as part of the budget reconciliation process, because the federal Unemployment Trust Fund (UTF) is treated as part of the federal budget.

A chronology of conformity requirements is given in Table 2.1. The original requirements concerned prompt payment of benefits, location of payments, appeals procedures, management of funds, reporting to the U.S. Department of Labor, and the requirement of experience rating as the basis for lowering contribution rates below the

11) This analysis was developed by West and Hildebrand (1997), pp. 593-596.

12) In 1939 federal law moved UI tax provisions to the Federal Unemployment Tax Act as part of the federal Internal Revenue Service (IRS) code. A 1940 federal law required that pay rates for employees of state employment security departments be merit based.

TABLE 2.1 A CHRONOLOGY OF INCREASING FEDERAL CONFORMITY REQUIREMENTS FOR STATE UNEMPLOYMENT INSURANCE SYSTEMS IN THE UNITED STATES

Original conformity requirements set in 1935 were minimal, and said states must:

- Make full payment of benefits when due
- Make benefit payments through public employment offices
- Have a fair appeals hearing process
- Transfer tax receipts immediately to the Unemployment Trust Fund (UTF) in Washington
- Use withdrawals from the state account in the UTF only to pay UI benefits
- Make required reports to the U.S. Secretary of Labor
- Provide information to any federal agency running public works or assistance
- Not deny benefits to eligible individuals
- Not pay benefits until 2 years after contributions start
- Not deny benefits for refusal to fill a vacancy resulting from a labor strike
- States may repeal their UI laws at their own discretion
- Additional employer rate reductions must be based on experience rating

Reasonable additional federal requirements were added in the 1940s and 1950s regarding:

- Interstate claims rights
- Rules for combining earnings from multiple employers to gain entitlement
- Broadened coverage
- Approved training participants are UI eligible
- States must participate in the Extended Benefits (EB) program
- Denial of benefits to workers who are not legal residents with employment privileges

Somewhat intrusive additional federal requirements since the 1950s regard:

- Intervening work required for requalification
- Denial to professional athletes
- Benefit reduction for pension income

Restrictions motivated by a desire to conserve funds in the federal budget have been:

- The Unified Budget Act of 1969
- Federal eligibility requirements for extended benefits
- Balanced Budget and Emergency Deficit Control Act of 1985
- Profiling all new claimants for those most likely to exhaust benefits
- States must make withholding of federal income tax possible for beneficiaries

federal maximum. Requirements added in the 1940s and 1950s were included mainly to simplify procedures when interstate claims were involved. In more recent years federal conformity requirements have become somewhat more specific and questionable from the state perspective, governing things such as the amount of reemployment required to qualify after a benefit denial, the non-payment of benefits to professional athletes in the off-season, and rules for reducing benefits based on pension income. After 1969, when the UI trust fund was included in the federal unified budget, several requirements were added to conserve UI funds and improve the overall budget picture. A prime example of this action is the 1994 law that required profiling claimants so that those most likely to exhaust UI benefits could be referred to reemployment services early in their unemployment spell.¹³

Federal rules have become increasingly specific. New provisions permitting use of UI trust fund money to promote self-employment limits state discretion. Eleven new restrictions are required for this program alone. Recent years have seen increased monitoring of compliance with federal guidelines for accuracy and timeliness of benefit payments, appeals, and tax contributions.¹⁴ Interestingly, there have never been conformity requirements on basic matters such as the level of the weekly benefit amount and the duration of benefits. However, the U.S. Department of Labor and federal advisory commissions have offered guidelines to states on these matters.¹⁵

Financial crises have shaped state UI programs as much as federal administrative guidelines have done so. Funding crises in the mid-1970s and early 1980s were instrumental in refocusing UI eligibility on full-time permanent labor force members. The rate of benefit increase was slowed, and the eligible target population was narrowed. As system

13) See Eberts and O'Leary (1997) for a discussion of profiling in the U.S. and elsewhere.

14) UI Performs is the current system for such monitoring. An overview is provided by Skrable (1997).

15) See O'Leary and Rubin (1997) about benefit levels and Woodbury and Rubin (1997) about benefit durations.

reserves recovered among the states in the mid- to late-1990s, political will resulted in tax relief for employers with little broadening of entitlement or benefits.

2.2 Social Protection for the Unemployed in General

2.2.1 Legislative and policy stance on welfare and the social safety-net for the unemployed

UI in the United States is social insurance. It aims to prevent workers from slipping into poverty, not to insure against all wage loss. UI pays benefits to involuntarily unemployed job seekers who have sufficient prior earnings and who are actively engaged in reemployment efforts. The maximum potential duration of benefits is about half a year, and there is no secondary program of cash assistance for labor force members who exhaust their UI entitlement, as is sometimes available in other countries.

As the US population has steadily grown, poverty has remained a persistent social problem. As seen in Table 2.2, only the strong economic expansion of the last few years has pushed the poverty rate below 12 percent. The poverty rate hovered between 12 and 15 percent of the population during the past two decades. Only about one-third of those in poverty received cash public assistance during that period. The percent of the population receiving cash public assistance dipped to 4.45 percent in 2000, but was as high as 7.78 percent in 1993.

Since the 1960s, the federal government has sought ways to reduce poverty through employment policy. This effort has evolved into a new approach that shifts responsibility from government to the individual and divests authority from the federal government to the states. It exchanges an emphasis on skill training, which will lead a family out of poverty, for an emphasis on job placement, which will quickly reduce the cost of public assistance payment.

Two pieces of legislation signed into law by President Clinton illustrate the intended change in federal human resource policy towards self sufficiency and local control: the Personal Responsibility and Work

TABLE 2.2 PROPORTIONS OF U.S. POPULATION IN POVERTY AND RECEIVING SOCIAL ASSISTANCE

Year	(1) U.S. Population (thousands)	(2) % of Population below the poverty line	(3) % of Population receiving social assistance
2000	275,130	NA	4.5
1999	272,691	11.8	4.7
1998	70,248	12.7	5.2
1997	267,784	13.3	6.3
1996	265,229	13.7	6.8
1995	262,803	13.8	7.3
1994	260,327	14.5	7.7
1993	257,783	15.1	7.8
1992	255,030	14.8	7.6
1991	252,153	14.2	7.3
1990	249,465	13.5	6.8
1989	246,819	12.8	6.3
1988	244,499	13.0	6.2
1987	242,289	13.4	6.2
1986	240,133	13.6	6.2
1985	237,924	14.0	6.2
1984	235,825	15.2	6.1
1983	233,792	14.4	6.2
1982	231,664	15.0	6.1
1981	229,466	14.0	1.8

Notes: NA : Not available.

- (3) Total AFDC/TANF (number of recipients in December of each year) plus SSI summary data (number of persons receiving federally administered payments) as a proportion of total resident population.

Sources: 1) U.S. Census Bureau. Population Estimates Program. Historical National Population Estimates [Online]. Available: <http://www.census.gov/population/www/estimates/uspop.html> [2001 August 20].

2) U.S. Census Bureau, Historical Poverty Tables, Table 5, Percent of people by ratio of income to poverty level (1.00 figures) [Online]. Available: <http://www.census.gov/hhes/poverty/histpov/hstpov5.html> [2001 August 20].

3) U.S. Administration for Children and Families, AFDC/TANF data supplied by Office of Planning, Research, and Evaluation, November 11, 2000 and August 16, 2001. U.S. Social Security Administration. *Annual Statistical Supplement to the Social Security Bulletin* (Washington, D.C.: Social Security Administration, 2000), Table 7.A9, p. 267.

Opportunity Act (PRWORA) of 1996 and the Workforce Investment Act (WIA) of 1998.

PRWORA reformed the nation's welfare laws. A new system of block grants from the federal government to the states named Temporary Assistance for Needy Families (TANF) was created, changing the nature and provision of welfare benefits in America. These block grants placed far fewer restrictions on state use of TANF funds. The fundamental requirement is for states to have most recipients working within two years of first receiving TANF benefits. States are largely free to choose the means to achieve this end. PRWORA has a strong focus on moving recipients of welfare into work and self sufficiency, and ensuring that welfare is a short-term, transitional experience and not a way of life. The philosophy behind the funding provisions is the expectation that, in exchange for flexibility in designing appropriate programs and services, each state is held accountable for moving families from welfare to self sufficiency through work.¹⁶

WIA, signed into law on August 7, 1998, shares many of the political characteristics that are found in the PRWORA. WIA reforms federal job training programs and creates a new comprehensive workforce investment system. The reformed system is intended to be customer focused, to help individuals access the tools they need to manage their careers through information and high quality services, and to help employers find skilled workers.

Over the past decade, the proportion of the population receiving public assistance not linked to labor force participation has remained relatively stable, fluctuating between 6.2 and 7.8 percent. Recent welfare reforms including welfare-to-work programs are expected to continue the recent downward trend in caseloads fostered by the booming U.S. economy of the late 1990s. Simultaneously, there has been a modest decline in the proportion of the population living below the poverty line. Over a longer time frame, the poverty rate has fallen from 22.4

16) Card and Blank (2000) present speculative and preliminary estimates of the employment effects of PRWORA welfare reform.

percent in 1957 to 11.8 percent of the non-institutional population in 1999.

2.3 Institutional Arrangements for Unemployment Compensation

2.3.1 Field of application

“The coverage provisions of state UI laws determine the employers who are liable for contributions and the workers who accrue rights under the laws.”¹⁷ Original federal requirements limited coverage to employers of 8 or more workers in each of 20 or more weeks in a year.¹⁸ UI coverage today is nearly universal with only four main exclusions remaining: agricultural workers, household workers, employees of religious organizations, and the self-employed.¹⁹

2.3.2 Daily workers and part-time workers

The UI system in the US has evolved to serve mainly full-time permanently attached members of the labor force. Both initial and continuing UI benefit eligibility issues are raised when part-time employment is considered.

The following scenarios illustrate the degree of UI coverage provided to daily and part-time workers in the US. The first two situations concern *initial* UI eligibility; the last two relate to *continuing* UI eligibility.

If a part-time job is lost and the job seeker is without work, prior earnings and hours are often not sufficient to qualify for benefits. The crux of this issue is the common practice of basing monetary eligibility on prior quarterly or annual earnings. Such measures reflect labor force attachment. The Advisory Council on Unemployment Compensation (ACUC) addressed this issue for both part-time and low-wage workers. The ACUC (1996, p. 20) recommended that “each state should set its

17) USDOL (2001c), pp. 1-1.

18) Blaustein (1993), p. 162.

19) Bassi and McMurrer (1997), p. 54-61.

law so that its base period earnings requirements do not exceed 800 times the state's minimum hourly wage, and so that its high quarter earnings requirements do not exceed one-quarter of that amount." The intent of the ACUC recommendation was to improve the likelihood that part-time and low wage workers who work at least 40 percent of the work year would be able to collect UI.

If two or more part-time jobs were held and one is lost, is the worker eligible for UI benefits? Eligibility is possible in many states, but the answer depends on the level of prior income and current income. All states will pay a weekly UI benefit to claimants with sufficient prior earnings if current weekly income drops to a low but positive level. Most states have a lump sum earnings disregard. There are eleven states that have both a disregard and a benefit reduction tax rate on earnings.

Will a beneficiary lose UI eligibility for refusing a new job because it is full-time rather than part-time? State UI laws would generally disqualify beneficiaries from the receipt of benefits. The beneficiary would lose eligibility for refusing suitable work, provided that the available job was in the usual occupation and paid a wage close to that paid for recent similar work. Thus, the UI program continues to expect that the norm for labor force participation is full-time employment and that only job seekers for such jobs should continue to receive UI.

Will a beneficiary lose UI eligibility for refusing a new job because the hours of work would conflict with required hours on a currently held part-time job? State rules would suspend UI benefit eligibility for failing to satisfy the availability requirement for job search. Current UI eligibility rules are based on the assumption that people leave full-time work and seek to return to full-time work.

2.3.3 Eligibility

Eligibility for UI benefits depends on recent earnings experience, the conditions of job separation, and continuing job search activity. Rules regarding recent earnings activity call for checking for sufficient

prior labor force attachment in UI-covered work.²⁰ Essentially these rules ensure that UI premiums have been paid before compensation is granted. Most states require at least \$1,000 in earnings during the base year to qualify for the minimum weekly benefit amount.

The conditions of job separation were set to minimize insurance problems of *moral hazard* by ensuring that the separation was involuntary and primarily due to lack of work, not due to controllable factors such as a quit, a collective bargaining dispute, or discharge for misconduct.²¹ Joblessness is compensable in all states for voluntary separations for good cause which usually includes: 1) sexual harassment, 2) illness, 3) leaving to accept other work, 4) joining the armed forces, and 5) compulsory retirement.²²

The final requirements for jobless benefits are known as continuing eligibility conditions. These are set to ensure continuing labor force attachment. They are of two types: job search requirements, and limits on refusing suitable work. The job search rules are known as “able, available, and actively seeking work” requirements. Administration of these rules is more art than science.²³

Job search requirements are not imposed on beneficiaries who are still waiting to be recalled by the employer liable for benefit charges. One of the original aims of UI was to prevent dispersal of the experienced workers of an enterprise. Employers may temporarily furlough workers, and promise the employment security agency that the workers will be recalled to their old jobs.

20) Many states also require that a certain number of hours must have been worked in the reference period called the base year.

21) The problem of moral hazard is present when the insured can affect the chance of experiencing the unfavorable outcome insured against, without being observed by the insurer. In unemployment insurance, moral hazard is present if a worker can affect the chance of being unemployed while not being detected by the state unemployment agency. The state agency will disqualify UI beneficiaries when a job separation or continuing joblessness is determined to be avoidable.

22) Nicholson (1997), p. 103.

23) Anderson (1997) examines state rules and practices in administering continuing UI eligibility.

2.3.4 Qualifying period

To qualify for benefit eligibility, earnings are considered from a base period consisting of four calendar quarters, which are usually the first four of the previous five completed quarters for administrative practicality.²⁴ States usually require at least \$1,000 in earnings during the base period, with a higher level required for higher benefits.

2.3.5 Means test

UI in the US is social insurance based on prior work experience. The application of a means test is the watershed dividing social insurance from public assistance (Blaustein 1993, p. 78). No means test is applied to determine eligibility for UI benefits in the US.

2.3.6 Maximum age

There is no maximum age limit imposed as a requirement of eligibility for UI benefits in the US. In fact, O'Leary and Wandner (2001) report that the probability of UI eligibility increases with age among workers. Table 2.3 shows the share of workers by age group among the labor force, the total unemployed, and the insured unemployed in 1998.

The figures are based on monthly averages for the year and indicate that those age 45 years and over made up one-third of the labor force, encompassed only one-fifth of those experiencing unemployment, but included one-third of all UI beneficiaries. The national average numbers suggest that older workers shoulder a proportionately small share of the unemployment burden in the US, while enjoying a higher than average chance of receiving UI compensation while jobless and seeking work.

24) Following a 1994 decision by the U.S. Court of Appeals in the Seventh Circuit case of *Pennington versus Didrickson* many states have implemented alternate benefit year (ABY) rules which consider income and hours the four most recent calendar quarters if eligibility is not established using the standard rule. The Advisory Council on Unemployment Compensation (1996), p. 19 endorsed general adoption of ABY rules.

TABLE 2.3 LABOR FORCE AND UNEMPLOYMENT CONCEPTS BY AGE FOR THE U.S., 1998

	Total	<=24	25-34	35-44	45-54	55-64	>=65
Labor force ¹⁾							
(thousands)	137,673	21,939	32,813	37,536	28,368	13,215	3,847
Percent of the labor force		15.9	23.8	27.3	20.6	9.6	2.8
Total unemployed ²⁾							
(thousands)	6,210	2,286	1,419	1,258	782	343	122
Percent of total unemployed		36.8	22.9	20.3	12.6	5.5	2.0
Percent of insured unemployed ³⁾		8.9	25.8	29.6	20.6	10.9	2.5

Notes: 1) Data from the Handbook of U.S. Labor Statistics, Third Edition, 1999, Table 1-6.

2) Data from the Handbook of U.S. Labor Statistics, Third Edition, 1999, Table 1-26.

3) Unpublished data from the U.S. Department of Labor, UI Service. Age information not available for 1.8 percent of beneficiaries.

In recent years, some countries experiencing severe labor surplus conditions have added a feature to unemployment compensation that is targeted to older workers and is intended to provide income payments as a bridge to private and/or public pension income receipt. In 1976 the Netherlands began paying benefits through age 65 to persons exhausting regular entitlement at age 60 or over, in 1981 the UK extended the duration and increased the benefit rate for long term recipients aged 60 and over, and in the mid-1980s Germany increased the maximum duration of benefits from 12 to 32 months for those aged 54 and over.²⁵ Such early retirement uses of unemployment compensation also became a popular tool for supporting the transition to a competitive labor market in the formerly planned economies of eastern and central Europe. For example, in Hungary where full public pension payments may begin at age 60 for men and 55 for women, early retirement unemployment compensation payments were offered at even younger ages beginning in 1991.²⁶ Within the past fifteen years,

25) Blackwell, Okba, and Casey (1995), p. 84.

26) In Hungary the unemployment compensation financing system partially subsidized

additional countries have relaxed work search rules for older workers, thereby permitting longer benefit durations.²⁷

There is no program in the US whereby older unemployed workers can collect UI for an extended period of time to ease transition to a public pension. Regardless of age, to continue receiving UI all beneficiaries must satisfy continuing eligibility requirements of able, available, actively seeking work, and not refusing suitable work. Given the tight labor market conditions in the US, it is unlikely that UI program features intended to remove workers from the labor force will be considered in the near future.

2.3.7 Benefits: levels and duration

The adequacy of the weekly benefit amount in performing the income maintenance function can be gauged by the percentage of lost income that the benefits replace--the replacement rate. Since the beginning of the federal-state UI program in the US, there has been general acceptance of the idea that the weekly benefit should replace one-half of the worker's lost weekly wages.²⁸ More broadly, adequacy depends on how well UI benefits help to maintain usual levels of household expenditure.

While federal law has never specified the exact rate at which lost wages must be replaced under UI, every president since Eisenhower has reaffirmed the position that "payments to the great majority of the beneficiaries should equal at least half of regular earnings" (Becker 1980, p. 11). This criterion of benefit adequacy has come to be known as *one-half for four-fifths*.

Balancing social adequacy and work incentives, state laws provide that UI will replace about one-half of prior wages between the maximum

early retirement payments for surplus workers in struggling enterprises, and fully paid such benefits when the enterprise was bankrupt (O'Leary, 1995, p. 732).

27) Australia in 1987, Belgium in 1985 and New Zealand in 1992 either eliminated or greatly relaxed the work search requirement for older unemployment compensation beneficiaries (Blackwell, Okba, and Casey, 1995, p. 85).

28) O'Leary and Rubin (1997), pp. 166-169.

TABLE 2.4 UI BENEFIT AMOUNT/DURATION AND AGGREGATE UI/LMP SPENDING AS SHARES OF GDP IN THE U.S., 1965-2000

	(1)	(2)	(3)	(4)	(5) ¹⁾	(6) ²⁾
Year	Average WBA	Ratio of average WBA to average weekly wage	Average duration of UI potential	Average duration of UI actual	UI spending as a fraction of GDP	Spending on all labor market programs as a fraction of GDP
2000	221	0.329	23.9	13.7	0.21	0.29
1999	212	0.331	23.8	14.5	0.21	0.30
1998	200	0.329	23.7	13.8	0.23	0.32
1997	193	0.335	23.9	14.6	0.25	0.34
1996	189	0.345	24.0	14.9	0.29	0.40
1995	187	0.355	24.0	14.7	0.30	0.42
1994	182	0.357	23.7	15.5	0.35	0.46
1993	180	0.360	23.9	15.9	0.53	0.65
1992	174	0.354	23.7	16.2	0.64	0.76
1991	170	0.364	23.9	15.4	0.46	0.57
1990	162	0.360	24.1	13.4	0.32	0.43
1989	152	0.354	24.2	13.2	0.27	0.38
1988	145	0.349	24.1	13.7	0.27	0.39
1987	141	0.355	23.7	14.6	0.32	0.44
1986	136	0.358	23.9	14.5	0.39	0.52
1985	128	0.353	24.1	14.2	0.38	0.52
1984	123	0.355	23.7	14.4	0.41	0.55
1983	124	0.372	24.1	17.5	0.76	0.93
1982	119	0.377	24.3	15.9	0.79	0.97
1981	107	0.359	24.2	14.4	0.54	0.86
1980	100	0.366	24.3	14.9	0.68	1.08
1979	90	0.360	24.2	13.1	0.39	0.84
1978	84	0.364	24.5	13.3	0.43	0.93
1977	79	0.364	24.1	14.2	0.67	1.04
1976	75	0.371	24.0	14.9	0.95	1.33
1975	70	0.371	24.3	15.7	1.16	1.44
1974	64	0.366	24.4	12.6	0.49	0.71
1973	59	0.361	24.3	13.4	0.35	0.62
1972	57	0.367	24.3	14.2	0.51	0.77
1971	54	0.365	24.5	14.4	0.56	0.76
1970	50	0.357	24.6	12.3	0.41	0.58
1969	46	0.344	24.4	11.4	0.24	0.42
1968	43	0.343	24.3	11.6	0.25	0.44
1967	41	0.347	24.5	11.4	0.27	0.43
1966	40	0.347	24.2	11.2	0.25	0.39
1965	37	0.338	24.1	12.2	0.33	0.42

Notes: 1) Benefits paid in the unemployment insurance programs (includes all regular and extended programs, as well as programs for ex-federal and ex-military, temporary/emergency enactments) as a proportion of the GDP.

2) Federal outlays for labor market policies include training and employment programs, other labor services, and unemployment compensation as a proportion of GDP.

- Sources: (1)-(4) U.S. Department of Labor, *Unemployment Insurance Financial Data*, ET Handbook 394 [Online]. Available: <http://www.workforsecurity.doleta.gov/unemploy/datastats.asp> [2001 August 10].
- (5)-(6) U.S. Department of Labor, Office of Workforce Security. Spending table provided by Division of Fiscal and Actuarial Services, February 11, 1999 and August 17, 2001. U.S. Office of Management and Budget. *Budget of the United States Government Fiscal Year 2000, Historical Tables* (Washington: Government Printing Office, 1999). Table 10.1 (GDP data).
- (6) U.S. Office of Management and Budget. *Budget of the United States Government Fiscal Year 2000, Historical Tables* (Washington: Government Printing Office, 1999). Table 3.2 (Outlays by function).

and minimum benefit amount for up to 26 weeks. In 1999 the weekly benefit amount averaged \$200. In recent years UI has replaced on average one-third of lost wages (Table 2.4, column 3).

While one-half wage replacement over the course of an average 15-week spell of unemployment appears to yield adequate and not excessive wage replacement, return to work incentives might be improved if the fixed nature of the weekly payment is examined. There may be ways to maintain or improve benefit adequacy while speeding return to work. This might be accomplished in part by a closer examination of partial benefit rules.

Benefit adequacy simulations suggest that current UI programs overcompensate for wage loss during short spells of unemployment, and under compensate for lengthy spells. Overall, compensation is adequate in the present UI system, but the timing of payments should be more closely examined. Particular program features to consider are the length and timing of the waiting period (O'Leary, 1996).

2.3.8 Maximum length of UI benefit provision

In the absence of severe economic conditions, which trigger benefit payments of extended duration, the maximum entitled duration of UI benefits is 26 weeks in all but two states.²⁹

29) Both Massachusetts and Washington offer regular benefit durations as long as 30 weeks. Woodbury and Rubin (1997) provide an exhaustive review and critique of

An area of excellent cooperation between the federal and state partners is that of extended UI benefits. The Extended Unemployment Compensation Act of 1970 created a permanent program for extended UI benefits when unemployment rates exceed certain preset trigger levels. The state and federal governments equally share the cost of paying benefits extended by 50 percent of the state duration up to 13 weeks under this permanent program. It has been a model of cooperation.

Since 1970 there have been several emergency programs to extend the potential duration of UI during economic recessions. These have always been temporary and enacted in a charged political environment. The permanent program has not been sufficiently responsive or generous in the political context of recession. The US system could benefit from reform in this area (Woodbury and Rubin, 1997).

2.3.9 Earnings taken as reference and earnings ceiling

The level of the weekly benefit amount (WBA) is directly related to the prior level of earnings. Having a wage-related benefit reinforces the concept that unemployment insurance is an earned right, based on contributions required by law to be paid by the worker's employer as "insurance premiums" against the risk of unemployment. The wage-related benefit is neither intended to improve a prior low standard of living, nor support a sumptuous living standard created by a high income. Because UI is a *social insurance* program with the fundamental social aim of preventing widespread poverty, all states impose UI maximum benefit rates to spread benefits as widely as is practical.

On an individual level, the wage replacement ratio is a useful measure of benefit adequacy. For a given benefit formula, the maximum weekly benefit amount determines what proportion of claimants will receive the wage replacement ratio prescribed by the benefit formula. There is little agreement on where the maximum should be set. Too high a maximum invites public criticism. Too low a

UI extended benefit programs.

maximum will prevent too many claimants from receiving a reasonable wage replacement.

Setting a maximum level on the weekly benefit amount is necessary to conserve the fund and prevent inordinately high benefits being paid to any individual claimant. Benefit maximums limit the extent to which the 50 percent concept, or other wage replacement rates intended by a benefit formula, could apply. With a 50 percent wage replacement rule, only those claimants whose wage levels were not more than twice the maximum will receive a 50 percent wage replacement. In most states, payments below the maximum are made at the rate of approximately 50 percent of lost wages, therefore the proportion of beneficiaries receiving less than the maximum is a proxy for the proportion “adequately” compensated. Becker (1980, p.13) found that roughly 34 percent of payments have been at the maximum, so that in broad terms the popular norm of adequacy—*one-half for four-fifths*—has not been met.

Over the past twenty years there has been general improvement in the fraction of claimants receiving one-half wage replacement. The gain in the extent of benefit adequacy has been steadiest in states that currently adjust their maximum by statutory rule rather than by legislative discretion. A federal standard requiring the maximum weekly benefit amount to equal or exceed two thirds of the statewide average weekly wage, would allow a majority of covered workers to receive at least 50 percent wage replacement, and would eliminate the wide variation among states in the proportion of workers eligible to receive such a percentage of lost wages.

Minimums on the weekly benefit amount are set by states to relieve the administrative burden of processing weekly payments smaller than some reasonable amount. A normative reason for setting a minimum is based on benefit adequacy concerns. The U.S. Department of Labor recommended that the minimum “be related to the weekly wages of the lowest wage group in the state for which the unemployment insurance program is considered appropriate” (U.S. Department of Labor, 1962). In most states, it is the minimum

qualifying requirement that is set in relation to the lowest income group for whom the program is considered appropriate, and the minimum benefit is a by-product of that requirement. The minimum weekly benefit and the state's minimum qualifying requirement are usually interrelated, and a change in one will often automatically provide a change in the other. For example, in a high-quarter-formula state where the minimum weekly benefit amount is set at 1/25 of the minimum qualifying income of \$1,000 in high-quarter wages, a \$200 increase in the high-quarter requirement will automatically result in increasing the \$40 minimum benefit to \$48.

2.3.10 Replacement rate (the proportion of earnings replaced by UI)

Table 2.4 presents national data for years since 1965 on four UI features: benefit amounts, replacement rates, potential and actual duration of UI receipt, aggregate UI spending as a fraction of GDP, and spending on all labor market programs as a fraction of GDP.

Most state laws approximate 50 percent wage replacement between the minimum and maximum weekly benefit amount. In 2000 UI provided an average of \$221 per week for an average of 13.7 weeks out of work. The weekly benefit replaced 32.9 percent of lost wages, and was available for an average of up to 23.9 weeks. The maximum potential duration of UI benefits is nearly uniform across states at 26 weeks.³⁰ However, individual potential duration depends on the level of prior earnings. The actual duration of UI receipt depends on entitlement and reemployment prospects in the labor market.

While most states have benefit formula intended to replace approximately one-half of lost wages, the maximum on payments guarantees that many high wage workers will receive less than half their average lost earnings, and the minimum means that some low wage workers may receive more than half their average earnings.

Wayne Vroman (1980), who provided a comprehensive review of possible wage replacement rate computations, called the series

30) Massachusetts and Washington offer up to 30 weeks.

presented in Table 2.4 a *gross narrow wage replacement ratio*, which is the one used historically. He also cited criticism that the measure underestimates the “true” replacement ratio because “unemployed workers receive lower wages than the average worker covered by the program.”³¹ Using unpublished micro data on the actual pre-unemployment earnings of beneficiaries from Illinois, Michigan, Pennsylvania, Texas, Washington, and Wisconsin for various periods during the 1980s, the Advisory Council on Unemployment Compensation (1995, p. 138) estimated that the gross narrow computation understates the true wage replacement rates by 25 to 30 percentage points.

2.3.11 Taxation of cash benefits

Beginning in 1986, income received by individuals as unemployment insurance benefits was subject to federal personal income tax. The tax treatment is now exactly the same as other labor earnings. Since nearly all state income tax rules consider as taxable the same categories of income as the federal tax code, the effect of the change to taxable status for UI income was nearly uniform throughout the country.

The taxation of benefits was introduced gradually.³² In 1978, the US Internal Revenue Code was amended to include UI benefits as taxable income for households with annual adjusted gross income of at least \$25,000, or single individuals with adjusted gross income of at least \$20,000. The income thresholds for taxability were reduced to \$18,000 and \$12,000 respectively in 1982, and were eliminated entirely in 1986.

Theoretical and empirical arguments for taxation of UI benefits date to research on UI work disincentives done by Feldstein (1974).³³

31) Vroman (1980), p. 170.

32) The following is excerpted from Advisory Council on Unemployment Compensation (1995, p. 139).

33) The following is excerpted from Advisory Council on Unemployment Compensation (1995, p. 135).

The Congressional Research Service (1992) states that the purpose of taxing benefits was to treat benefits the same as wages, to raise needed federal revenue, and to reduce the incentive to collect benefits for individuals with substantial income without having to means-test UI benefits. Overall, the taxation of UI benefits reflects a view that benefits represent a form of additional individual income.

2.4 Program Management

UI in the US is a federal-state system. As discussed above, the federal partner holds the upper hand in the relationship. A chronology of conformity requirements is given in Table 2.1. Federal rules have become increasingly specific.

Federal-state relations in UI are tested on a regular basis through the required review by the U.S. Department of Labor of proposed state legislation. The relationship has also been greatly affected in recent years by the federal budget implications of state actions. Battle lines in this regard have been clearest on the issue of administrative financing. Federal receipts from the states that are not returned to state trust fund accounts to pay benefits flow into the Employment Security Administration Account (ESAA). Money in the ESAA is used to make grants to the states to finance program administration, with some remaining money transferred to the Extended Unemployment Compensation Account (EUCA) to pay for the federal share of extended benefits.³⁴

2.4.1 Financing

Employer UI taxes on payrolls finance both benefits and program administration. Benefit financing is returned by the federal government directly to the states; administrative financing is retained by the federal government and provided to the states using a formula based on claims

34) Miller (1997, pp. 355-361) provides a clear and concise overview of funding flows. The currently 80 percent goes to ESAA with the remaining 20 percent to EUCA.

volume.

2.4.2 Employer's contributions

Currently the federal unemployment tax is 6 percent on the first \$7,000 paid to each worker each year. If a state does not have an outstanding debt to the federal unemployment account, state UI law conforms with federal law, and an individual employer has paid their state UI taxes on time, then a 90 percent credit of the federal tax is given to the employer leaving a federal UI tax rate of 0.6 percent. There is also now a 0.2 percent federal surtax, which brings the federal unemployment tax paid by employers to the US Treasury up to 0.8 percent on the first \$7,000 paid to each worker in a year. Federal law also requires the maximum state UI tax rate to be at least 5.4 percent on the first \$7,000 in earnings per year. Credits that lower the state contribution rate may be given to employers if done through a state experience rating system for UI taxes that has been approved by the US Department of Labor. The maximum UI tax rate in many states is the federally required minimum of 5.4 percent, but it is higher in most states.

2.4.3 Application of the experience rate

According to the experience rating principle, an employer's UI tax rate should move in close step with its pattern of worker layoffs. Adherence to the experience rating principle promotes several policy goals. One goal, employment stabilization, is advanced because higher tax rates discourage firms from laying off workers and cautions them to expand their employment gradually since they will be penalized if they must eventually layoff workers (Brechling and Laurence, 1995).³⁵ Experience rating of UI taxes also enhances inter-industry allocative efficiency by equalizing ratios of UI contributions to benefit payments

35) According to Topel (1984), this effect is weakened when experience rating is imperfect. Also, rigid adherence to the principle can be destabilizing if toward the end of a recession it causes UI taxes on struggling firms to rise too sharply, inducing them to postpone rehiring or to close their doors.

across industries (Tannenwald and O'Leary, 1997; Tannenwald, O'Leary, and Huang, 1999).

The federal government imposes few restrictions on state UI tax structures. State taxable wage bases must be at least as large as the first \$7,000 of each employee's annual wages. The highest tax rate imposed under any experience-rated tax schedule must be at least 5.4 percent. Otherwise, states have considerable leeway in designing their UI tax systems. Consequently, UI tax rate schedules and taxable wage bases differ sharply across states.

UI programs operate in 53 jurisdictions (50 states, the District of Columbia, the Commonwealth of Puerto Rico, and the territory of the U.S. Virgin Islands). For the tax year 2001, only two states had a taxable wage base (TWB) set at the federally required minimum of \$7,000 (Louisiana and Missouri), and 14 had a TWB between \$8,000 and \$9,000. The highest 2001 TWB were in Alaska, Hawaii, Idaho, Oregon, and Washington were the TWB ranged between \$25,000 and \$28,400.

The tax rate applied to the TWB is determined by state experience rating rules. In 2001 potential tax rates for an employer ranged from a lowest minimum rate of 0.0 percent, which was available in 14 states, to a highest maximum rate of 10.09 percent, which was possible in North Dakota. Most states set minimum tax rates greater than zero in order to get firms with low propensities to lay off workers to help cover the costs of ineffectively charged benefits.

In order to track the degree to which each state adheres to the experience-rating principle, the US Department of Labor annually publishes an "Experience Rating Index" (ERI).³⁶ The index equals the percentage of total UI benefits paid by a state that is "effectively charged," that is, charged to specific employers for the purpose of determining their experience-rated tax rate. Although a large fraction of a firm's UI tax bill is determined by its experience rating, in most states UI taxes also include assessments levied on all firms at a uniform rate.

36) Tannenwald, O'Leary and Huang (1999) proposed an alternative simulation-based index of experience rating.

These assessments cover benefits paid to workers laid off by insolvent firms, benefits charged to firms already paying the state's maximum tax rate, benefits whose costs the state feels should be shared by all employers (such as dependents' allowances), and supplementary infusions to UI trust funds when experience-rated taxes fail to replenish them adequately (solvency assessments).

Like other indicators, states' experience-rating indices exhibit cyclical variation. When a state's economy contracts, an increasing fraction of employers already at the state's maximum tax rate continues to lay off workers, and bankruptcy becomes more widespread. These events result in rising UI benefit payments that are either slowly or never recouped from the firms responsible for them. UI trust fund reserves are drawn down, triggering solvency assessments that are rarely imposed in proportion to a firm's experience rating. For all these reasons, a state's experience rating as measured by the ERI is inversely related to its insured unemployment rate. Regional differences in economic cycles around the country have caused state ERI rankings to change dramatically since the index was first reported in 1988.

Most states use either a "reserve ratio" or "benefit ratio" approach to determine a firm's experience rating. Under the reserve ratio approach, the state keeps track of each firm's cumulative UI tax payments (those made since the firm's creation) and the cumulative benefits effectively charged to the firm. Each year the state divides the difference between the firm's cumulative UI tax payments and benefit charges (the balance in the firm's "reserve account") by the firm's payroll paid to covered employees. Using the state UI tax schedule, the "reserve ratio" determines the firm's UI tax rate. Between state minimum and maximum UI tax rates, the lower the reserve ratio, the higher the tax rate.

Under the benefit ratio approach, a firm's experience rating depends solely on the benefits charged to it relative to its payroll, or "benefit ratio," during a specified period (typically three to five years). Its history of UI tax payments is irrelevant. In some benefit ratio states, a firm's benefit ratio is the firm's experience-rated tax rate. Other

benefit ratio states have schedules stipulating how a firm's tax rate varies with its benefit ratio.

An important difference between the reserve ratio and benefit ratio approaches is the speed with which the state recovers the costs of an increase in benefits charged to a firm. Under the reserve ratio approach, a firm's tax liability rises gradually after a surge in charged benefits, remains at an elevated level for several years, and then falls slowly with improving economic conditions. By contrast, under the benefit ratio approach, surges in charged benefits are paid for relatively rapidly, and tax rates fall quickly once costs have been recovered.

2.4.4 Administrative organization

Money not rebated by the federal government is used to finance program administration through grants to the states and to make loans to the states when liquidity problems arise in paying benefits. The conformity requirements originally set in the Social Security Act of 1935 addressed only rules for administration and coverage. Penalties to states for failure to conform with federal law may result in withholding state administration funds and/or denial of the 90 percent tax credit to employers.³⁷

Federal grants to states for UI administration are made by a formula based on work load factors such as the number of UI claims, appeals, and covered employers. The formula also depends on the estimated time cost of serving claimants and salaries of office staff. The time cost estimates used are based on studies done in the 1970s, with updates only as recent as 1984. Since that time, there have been many changes in practices and office technology within the states.

The federal-state struggle over administrative funding has been one of the most regular features of the system in recent years. Driven by budget tightness, the federal government has tried to conserve funds

37) Failure to conform or comply with the Federal Unemployment Tax Act (FUTA) provisions means state employers lose tax offset credits, and the state will not receive an administrative grant. Failure to conform or comply with Social Security Act provisions means the state will not receive an administrative grant.

while the states have claimed that federal holdings for administration are state entitlements that should be distributed. Davidson and Martin (1996) have viewed the standoff as a classic principal-agent problem. The federal partner is the principal seeking to administer a high quality UI program through its agents the state employment security agencies. Davidson and Martin argue that, to encourage high quality service, efficient low-cost administration, and continuous quality improvement, the administrative funding mechanism should: 1) be based on the quality of service as measured through a simple monitoring system operated by the federal partner to assess state practice, and 2) permit states to retain unspent financial grants. Special administrative grants could also be made to states with high unemployment or low population density where administrative costs are higher because of these factors but not because of inefficiency. Such a system will also have the effect of encouraging UI tax payers to monitor administrative efficiency at the local and state level, so as to increase the share of administrative grants retained for other uses including benefit payments.

In recent years, federal-state conflict about the issue of fund solvency has been waning. The federal government holds 53 separate state unemployment trust fund accounts for payment of benefits. Federal guidelines recommended by the U.S. Department of Labor and federal advisory commissions on UI have advocated forward funding of benefits. That is, reserves in state unemployment trust fund accounts should be sufficient to pay benefits if unemployment were to rise dramatically. In recent years states have generally not met the reserve adequacy standards, preferring instead to restrain tax rates and leave money in the hands of the private sector where jobs might be created. States have been content to rely on their ability to borrow from the Federal Unemployment Account (FUA) to preserve sufficient liquidity for payment of UI benefits. Federal pressure for high reserve levels may have been motivated by budgetary considerations. Interestingly, recent recommendations from the independent Advisory Council on Unemployment Compensation (1995) called for relaxed forward funding targets for states. In fact, the US Department of Labor has

helped prepare new rules to be considered as part of federal legislation that encourage improved trust fund reserves with a reward to states in the form of additional administrative financing grants.³⁸

2.5 Program Evaluation

Among social programs in the US, UI is one of the most thoroughly evaluated. In their widely read book on minimum wages, Card and Krueger (1995, p. 396) note that substantially more journal articles were published on the topic of UI in top economics journals during the preceding twenty-five years than on other government human resource programs. They counted 707 articles on UI from 1969 to 1994, with the minimum wage having the second highest number of articles at 327.

An additional body of research on UI has been compiled by the UI Service of the US Department of Labor in their Occasional Papers series.³⁹ Dating from 1977 more than one hundred monographs have appeared in this series. Many of these monographs report on research projects funded by the US Department of Labor, several of which were classically designed social experiments. These include the UI reemployment bonus experiments summarized in Robins and Spiegelman (2001), and the UI self-employment experiments summarized by Wandner (1992).

There have been two Congressionally mandated national commissions on UI in the US and both have sponsored wide ranging

38) Federal-state tension over UI administrative funding led in 1954 to the Reed Act which provides that when the reserves in the federal UI administration, loan, and extended benefits account exceed a certain threshold level the excess be returned to the states. States may use Reed Act money to finance either regular UI benefits or administrative costs. In recent years, the federal government has avoided Reed Act distributions to conserve federal money. The proposed legislation would guarantee grants to states if UI benefit reserves were sufficient and if the money was used to fund UI administration.

39) In 2000 the UI Service of the U.S. Department of Labor was subsumed into the new Office of Workforce Security (OWS). The UI Occasional Papers were renamed OWS Occasional Papers.

research on the topic. These were the National Commission on Unemployment Compensation (1980) and the Advisory Council on Unemployment Compensation (1995, 1996). Both of these collections investigated issues relating to UI coverage, eligibility, benefit adequacy, benefit duration, incentive effects, administrative accuracy and efficiency, financing of benefits, and financing of administration.

A recent volume entitled *Unemployment Insurance in the United States: Analysis of Policy Issues* and edited by O'Leary and Wandner (1997) provides an overview of research-based knowledge about the operation and effects of all aspects of UI in the US. A summary of important issues and findings follows.⁴⁰

Coverage

UI coverage has steadily expanded over the years to encompass virtually all full-time permanent wage and salary workers. Initially only employers with eight or more workers were covered, that was relaxed to four employees in 1954, and to one employee in 1970. In the early 1970s non-profit firms and state and local governments became covered. However, as coverage steadily expanded, the rate of UI reciprocity gradually fell. Beneficiaries now constitute only about 35 percent of all unemployed (Bassi and McMurrer, 1997).

Eligibility

The original focus of the UI system on prime age, full time workers, in a labor surplus economy remains largely unchanged to this day. However in the current labor shortage situation broadened UI eligibility for part-time, contingent, and self-employed workers could increase labor force participation and help ease tight labor markets (O'Leary and Wandner, 2001).

40) This discussion draws on O'Leary (2000).

Reciprocity

Even among those eligible for benefits, only about two-thirds bother to collect (Blank and Card, 1991). In addition to raising questions about social adequacy, low reciprocity may weaken the counter cyclical potential of the federal-state UI system (Burtless, 1991). Increased UI reciprocity has become a major objective of the U.S. Department of Labor. UI has acted as an automatic stabilizer for the economy. In times of economic recession, aggregate UI payments have risen to more than three-quarters of one percent of gross domestic product (GDP), while automatically falling below one-quarter of one percent of GDP in years of low unemployment.

Benefit Amount

Balancing social adequacy and work incentives, UI typically replaces about one-half of prior wages between the maximum and minimum benefit amount for up to 26 weeks, which appears to be about right (O'Leary, 1998). In 1999 the weekly benefit amount averaged \$200. During the past half century because of benefit maximums, UI has replaced on average one-third of lost wages.

The U.S. Department of Labor recently drafted regulations for states to use UI reserves to pay benefits to households where parents have chosen to take parental or family leave. This essentially expands UI eligibility to include beneficiaries who are not actively seeking work. The impact of such expansions on the ability of the UI system to finance its core objectives should be carefully evaluated.

Benefit Duration

Over the years the counter cyclical effect of UI has frequently been supplemented by temporary federal programs, which extend benefits beyond 26 weeks. Following high unemployment in the early 1980s, the federal government instituted a permanent federally funded extended-benefits program. Nonetheless, during the 1991 recession another temporary federal extended-benefits program was enacted (Woodbury and Rubin, 1997). Research about how to ideally structure

and finance an extended-benefits program should continue.

Financing Benefits

UI was established though a federal tax levied on employer payrolls, with 90 percent of the revenue returned to states that establish and operate UI programs consistent with requirements in the federal law. There is wide variation across states in UI provisions, but all comply with federal statutes as monitored by the US Department of Labor.

A key federal requirement is that taxes be experience rated, meaning that tax rates move in tandem with a firm's layoffs and UI benefit charges. Research finds that when experience rating operates without restriction it acts to stabilize employment (Topel, 1980). However, tax rate maximums, minimums, and time lags in tax adjustment weaken the response (Tannenwald and O'Leary, 1997).

The benefit financing system is designed to minimize the tendency of UI taxes to reinforce economic contractions. Reserves are replenished gradually by tax contributions after they are drawn down by benefit payments. The most severe financial strain ever experienced by the system occurred in 1975 when benefits totaled 2.2 percent of covered payrolls. From 1975 to 1987, total system reserves never exceeded 1 percent of covered payrolls (Table 2.5). By 1982, UI benefit trust funds were completely exhausted. The response among states was to tighten eligibility, which conserved funds but contributed to diminished reciprocity rates.

Recent years have witnessed a slow and modest recovery in system-wide reserves. As a proportion of total covered wages, UI taxes have hovered around one percent of total covered payrolls, being well below this level in recent years after a long economic expansion (Table 2.5). There are no strong incentives for states to provide significant forward financing of benefits, and the US Department of Labor is moving toward a first time relaxation of reserve adequacy guidelines. Indeed, a few states have moved to zero tax rates for positive balance employers. Research into the effects of broadening the federal taxable

wage base on each worker's earnings from \$7,000 per year could help inform benefit finance policy.

TABLE 2.5 FINANCING TRENDS IN THE US FEDERAL-STATE UI SYSTEM, 1948-1998

Year	Taxable wages in UI covered employment (\$ billions)	Ratio of taxable to total wages in UI covered employment	Net UI system reserves at year end (\$ billions)	Net UI system reserves as a percent of total wages	Average UI tax rate on covered payrolls
1948	78.5	0.817	7.6	7.91	1.01
1953	99.6	0.716	8.9	6.41	0.93
1958	109.2	0.637	6.8	3.99	0.84
1963	129.6	0.581	6.4	2.88	1.34
1968	171.4	0.517	11.7	3.54	0.76
1973	254.9	0.500	10.9	2.13	0.99
1978	412.0	0.496	4.6	0.55	1.41
1983	532.3	0.431	5.8	0.47	1.20
1988	705.0	0.388	31.1	1.71	0.96
1993	807.2	0.359	28.0	1.25	0.90
1998	1,022.1	0.321	48.0	1.51	0.62

Notes: Wage Replacement Rate is the average UI weekly benefit amount divided by average weekly wage in UI covered employment.

GDP - Gross domestic product.

Reserve Ratio is accumulated holdings in UI benefit trust funds divided by total payrolls in UI covered employment.

Sources: U.S. Department of Commerce, *Survey of Current Business*. Washington, DC; U.S. Department of Labor, *Unemployment Insurance Financial Data: ET Handbook* No. 394. Washington, DC: Employment and Training Administration.

Financing Administration

Unemployment tax collections retained by the federal government are used to finance program administration through grants to the states, and to make loans to the states when liquidity problems arise. Grants for administration are done by a formula based on work load factors such as the number of UI claims, appeals, and covered employers.

UI tax receipts are held in the Unemployment Trust Fund (UTF), which is part of the unified federal budget. Federal budget deficits up until the late 1990s induced the federal government to conserve funds while the states claimed that federal holdings for administration were state entitlements that should be distributed (West and Hildebrand,

1997).

Research has suggested that to encourage high quality service, efficient low cost administration, and continuous quality improvement the administrative funding mechanism should: 1) be based on the quality of service as measured through a simple monitoring system operated by the federal partner to assess state practice, and 2) permit states to retain unspent financial grants. Such a system should encourage UI tax payers to monitor administrative efficiency, so as to increase the share of administrative grants retained for other uses including benefit payments (Davidson and Martin, 1998).

States have increasingly viewed administration of UI as simply a disbursement function. Federal quality control random audits identified failure to satisfy the actively seeking work requirement, or “work test,” as prime source of payment errors. States have improved the timeliness and accuracy of payments, but to do so they have often weakened the work test which linked UI to reemployment efforts of the public employment service.

Automation of Administration

The local administration of UI is rapidly changing from in-person interviews to taking claims by telephone. The new telephone systems are being used for the filing of both new initial claims and continuing claims. It is rare now for unemployed workers to wait in line at a UI claims center. By 1998, in 35 states half or more of continued claims were taken by telephone (24 states took more than three quarters of these claims by telephone). Furthermore, 11 states took about half or more of their initial claims by telephone.⁴¹ This move to telephone claims is now accelerating.

Mechanisms to encourage return to work may be further weakened by telephone systems for initial and continued UI claims. Use of such systems is expanding rapidly. Internet based systems may follow soon. Telephone claim systems could affect both entry to the UI

41) Based on state UI Benefits Accuracy Measurement (BAM) data for 1998.

system and the duration of benefit receipt. These are important policy questions, which are now just beginning to receive research attention.

Interaction with Other Programs

The strongest linkage for UI to another program is with the Employment Service (ES), which is the public labor exchange agency in the US. Historically this link has been provided by the work test for continuing UI eligibility. Many state UI laws require registration with and active use of ES services to maintain established UI benefit entitlement. For a variety of reasons, including the fact that UI payment errors have often been due to improper application of statutory work search rules, many states have relaxed their work test.⁴² These changes have weakened the link between UI and ES.

The UI-ES linkage was renewed and strengthened in 1993 by federal legislation creating the Worker Profiling and Reemployment Services (WPRS) system. The legislation required states to establish procedures for early identification of UI beneficiaries likely to exhaust their UI benefit entitlement, and to refer these persons quickly to special reemployment services.

2.5.1 The benefit reciprocity of the unemployed by population subgroup

Table 2.6 reports on trends in UI benefit reciprocity in the US during the later part of the twentieth century. Since 1965 UI beneficiaries have remained a relatively stable proportion of all unemployed people with the proportion fluctuating between 29.0 and 50.1 percent in each year depending on the phase of the business cycle. The proportion is usually about 35 percent. However, a relatively high proportion of all unemployed receives UI in the beginning of a recession, because large numbers of workers have established UI

42) Burgess and Kingston (1987) identify the work test as a main source of UI overpayments, citing the complexity of the ES-UI monitoring as part of the problem.

TABLE 2.6 UI COVERAGE AND RECIPIENCY IN THE U.S., 1965-2000

Year	Civilian labor force (thousands)	UI covered workers (thousands)	Total unemployed (thousands)	Beneficiaries [Ave. Weekly insured unemployed] (thousands)	Beneficiaries as a proportion of all unemployed people	Beneficiaries as a proportion of civilian labor force	Beneficiaries as a proportion of UI covered workers
2000	140,863	127,858	5,655	2,110	37.3	1.5	1.7
1999	139,368	125,334	5,880	2,188	37.2	1.6	1.7
1998	137,673	122,417	6,210	2,222	35.8	1.6	1.8
1997	136,297	119,386	6,739	2,323	34.5	1.7	1.9
1996	133,943	116,125	7,236	2,596	35.9	1.9	2.2
1995	132,304	113,504	7,404	2,572	34.7	1.9	2.3
1994	131,056	110,526	7,996	2,670	33.4	2.0	2.4
1993	129,200	107,263	8,940	2,751	30.8	2.1	2.6
1992	128,105	105,187	9,613	3,245	33.8	2.5	3.1
1991	126,346	104,642	8,628	3,342	38.7	2.6	3.2
1990	125,840	106,325	7,047	2,522	35.8	2.0	2.4
1989	123,869	104,750	6,528	2,158	33.1	1.7	2.1
1988	121,669	101,987	6,701	2,081	31.0	1.7	2.0
1987	119,865	98,760	7,425	2,300	31.0	1.9	2.3
1986	117,834	95,946	8,237	2,643	32.1	2.2	2.8
1985	115,461	94,027	8,312	2,617	31.5	2.3	2.8
1984	113,544	91,378	8,539	2,475	29.0	2.2	2.7
1983	111,550	86,867	10,717	3,395	31.7	3.0	3.9
1982	110,204	86,148	10,678	4,059	38.0	3.7	4.7
1981	108,670	87,783	8,273	3,045	36.8	2.8	3.5
1980	106,940	86,918	7,637	3,356	43.9	3.1	3.9
1979	104,962	86,635	6,137	2,425	39.5	2.3	2.8
1978	102,251	83,262	6,202	2,354	38.0	2.3	2.8
1977	99,009	70,868	6,991	2,647	37.9	2.7	3.7
1976	96,158	68,009	7,406	2,991	40.4	3.1	4.4
1975	93,775	65,377	7,929	3,974	50.1	4.2	6.1
1974	91,949	66,691	5,156	2,259	43.8	2.5	3.4
1973	89,429	64,849	4,365	1,629	37.3	1.8	2.5
1972	87,034	61,221	4,882	1,849	37.9	2.1	3.0
1971	84,382	53,044	5,016	2,166	43.2	2.6	4.1
1970	82,771	—	4,093	1,805	44.1	2.2	—
1969	80,734	—	2,832	1,100	38.9	1.4	—
1968	78,737	—	2,817	1,109	39.4	1.4	—
1967	77,347	—	2,975	1,203	40.4	1.6	—
1966	75,770	—	2,875	1,060	36.9	1.4	—
1965	74,455	—	3,366	1,326	39.4	1.8	—

Sources: UI data: U.S. Department of Labor, *Unemployment Insurance Financial Data Handbook* (ET Handbook 394) [Online]. Available: <http://www.workforcesecurity.doleta.gov/unemploy/datastats.asp> [2001 August 10]. Labor force and unemployment data: U.S. Department of Labor, Bureau of Labor Statistics. Labor Force Statistics from the Current Population Survey [Online]. Available: <http://stats.bls.gov/sahome.html> [2001, August10].

TABLE 2.7 U.S. INSURED UNEMPLOYED BY GENDER AND AGE, 1994-2000

Year	Average weekly UI claimants (in thousands)	By gender		By age					
		% Male	% Female	Age <=24	Age 25-34	Age 35-44	Age 45-54	Age 55-64	Age >=65
2000	2,110	56.4	43.5	8.5	24.3	29.8	22.3	11.4	3.0
1999	1,999	56.8	43.0	8.6	25.0	29.8	21.6	11.4	2.7
1998	2,222	56.8	43.1	8.9	25.8	29.6	20.6	10.9	2.5
1997	2,323	56.2	41.1	8.4	26.4	28.7	19.5	10.2	2.4
1996	2,596	56.1	41.1	8.7	27.2	28.4	18.9	10.0	2.3
1995	2,572	57.0	40.7	8.7	28.2	28.2	18.6	9.9	2.3
1994	2,670	56.8	40.0	8.8	29.2	27.2	17.7	9.9	2.3

Source: U.S. Department of Labor, Office of Workforce Security, "Data supplied by the Division of Fiscal and Actuarial Services", February 11, 1999 and August 17, 2001.

benefit eligibility during the preceding economic expansion. As a business downturn continues, because a significant proportion of beneficiaries exhaust their entitlement the fraction of all unemployed drawing UI benefits declines.

Viewed as a share of the entire labor force, the proportion who are UI beneficiaries has moved in step with UI beneficiaries as a proportion of all unemployed. However, since the labor force tends to grow at a faster rate during business expansions than during economic downturns, the low end of this series is more exaggerated. Since 1965, UI beneficiaries as a proportion of the labor force has ranged from 1.4 to 4.2 percent.

Since 1965 UI beneficiaries as a fraction of all UI covered workers has fluctuated between 2.1 and 6.7 percent, depending on the phase of the business cycle. UI coverage expanded significantly in the 1970s. Effective in 1972, employees of small firms and non-profit organizations became covered, and in 1976 employees of state and local governmental agencies became covered. Laid off workers from these entities had a higher than average propensity for benefit receipt, which boosted the ratio of UI beneficiaries to UI covered, or insured, workers. Table 2.7 reports on the characteristics of UI beneficiaries by gender and age. Just as men have a higher labor force participation rate, men make up a larger share of UI beneficiaries. However, in recent years the gender balance of UI beneficiaries has been growing more equal. In

2000 women made up 43.5 percent of UI beneficiaries. Considering UI receipt by age, the bulk of recipients tend to be in the prime working years of 25 to 54. As seen in Table 2.4, there are great differences in UI reciprocity between very young and very old workers. Considering the ratio of insured to total unemployment (IUR/TUR), in 1998 the ratio for those under 25 years of age was 0.24 while that for workers over 54 was 1.79.

2.5.2 UI provisions for daily workers, part-time workers, and workers in small-sized firms

If a worker qualifies for UI benefits, the benefit amount and potential duration are based on their prior earnings and perhaps also on their prior hours of work, regardless of whether employment is permanent or casual, full-time or part-time, in a large or small firm. The more critical issues in these cases regard initial and continuing eligibility for benefits.

As discussed above in section 2.3.2, workers who are either regular but part-time or casually attached to the labor force experience difficulty when they apply to receive benefits. Even if they succeed in initially receiving benefits, they are in danger of losing entitlement if they are not prepared to accept a permanent full-time job.

Firm size is not relevant in determining UI coverage in the US. As mentioned above, initially only employers with eight or more workers were covered, that was relaxed to four employees in 1954, and to one employee in 1970 (effective in 1972). In the 1970s non-profit firms and state and local governments became covered.

2.5.3 Impact on unemployment

Research dating to Feldstein (1974) and Ehrenberg and Oaxaca (1976) suggests that UI payments slightly prolong unemployment spells. The average result among the many studies is that a 10 percent increase in the replacement rate is estimated to prolong unemployment by about one-half week (Decker, 1997, pp. 295-296).

2.5.4 Impacts on work incentives

Evaluation of strategies to improve reemployment incentives has informed adoption of policies that target job search workshops and self-employment assistance (Johnson and Klepinger 1994; Benus, Wood and Green, 1994).

The reemployment bonus concept was seen as a possible means to counter UI work disincentives. However, collective results from the experiments did not strongly support implementation. Using profiling models similar to those used by states as part of their WPRS systems to identify UI claimants most likely to exhaust their benefits, O'Leary, Decker and Wandner (1998) simulated targeting reemployment bonus offers to those claimants most likely to exhaust UI. They showed that such targeted offers can increase the cost effectiveness of bonus offers, by generating larger average reductions in UI benefit payments than non-targeted bonus offers.

2.5.5 Average duration of benefit spells

The maximum potential duration of regular UI benefits is 26 weeks in all states except Massachusetts and Washington where the maximum is 30 weeks. In most states the potential duration for an individual claimant depends on prior earnings and weeks of work, so that the average potential duration listed in Table 2.4 is around 24 weeks. The average actual duration of benefit receipt in a claim year is also reported in Table 2.4, it is seen to range from 11.2 weeks when unemployment is low to 17.5 weeks when unemployment is high.

As mentioned above, a 10 percent increase in the replacement rate is estimated to prolong unemployment by about one-half week. A number of studies have also examined the impact on actual UI duration caused by a change in the length of potential duration. The consensus estimate of these studies is that lengthening potential UI duration by one week prolongs spells of actual UI receipt by about one day (Decker, 1997, pp. 296-298).

2.5.6 Quality of subsequent jobs

The impact of UI receipt on the quality of reemployment jobs has been assessed in several of the same studies that looked at impacts on duration of UI receipt. These studies assess the quality of jobs by the wage rate paid. Ehrenberg and Oaxaca (1976) found that “a 10 percentage point increase in the wage replacement rate increased the reemployment wage by 7.0 percent for men and 1.5 percent for women... however subsequent studies have failed to support this finding” (Decker, 1997, p. 299). The consensus estimate is zero effect. However, none of the studies to date have satisfactorily accounted for the many corollary activities which job seekers may pursue while receiving UI benefits. These include a more careful screening of job prospects and perhaps even additional job skill training.

2.6 Policy Implications

2.6.1 Implication for future policy direction

Given the present and likely future labor shortages facing American employers, additional changes in UI to promote reemployment and labor force participation should be studied. Additional labor supply might be forthcoming if eligibility conditions were changed to permit UI access for part-time, part-year, and self-employed workers. Research suggests that labor force participation for all of these groups is more responsive to UI entitlement than that for prime age wage and salary workers.

A severe recession has not tested UI financing and claims processing capacity in nearly two decades. In preparing for the inevitable next recession, the issue is not only the adequacy of UI reserves, but the sufficiency of telephone claims and other UI administrative mechanisms in the new one-stop environment for public employment services.

Since it was first established, the federal-state UI system has provided income replacement for millions of jobless workers and security for countless others who succeeded in the labor market

knowing they had earnings insurance to fall back on. UI has become such an integral part of workplace decisions that it is taken for granted. The narrow aim of providing income security for workers is a crucial one. Achieving this at minimal cost of foregone private investment is a huge challenge. As a wealthy society, we may collectively choose to pursue other goals. We should also recognize that the focused and self-financed UI system has served its function well.

2.8 Related Issue: Public and Private Employment Service System

The United States has ratified neither ILO convention 88, which requires a free public employment service, nor ILO convention 96, which permits fee charging employment agencies. Nonetheless, the US federal government has provided funding to the states to operate free public employment service (ES) offices since passage of the Wagner-Peyser Act in 1933. This public system has coexisted with a wide variety of private employment agencies, some of which charge fees. In most states, the fees charged by private employment agencies are regulated by law.

2.8.1 Privatization issue of the employment service system⁴³

The Wagner-Peyser act mandated that ES be administered by state agencies to ensure availability of services throughout all states and allowed the U.S. Department of Labor (USDOL) to develop administrative standards for states to receive financial grants. To prevent nepotism and partisanship in hiring and promotion, USDOL required that state agencies receiving Wagner-Peyser funds use a merit system of personnel administration. This means that hiring decisions, salary adjustments, and promotions must be based on objective standards of performance.

In February 1998 the governor of Michigan issued an executive

43) This section quotes extensively from Balducchi and Pasternak (2001).

order reorganizing Michigan's ES agency. He ordered local workforce investment boards to administer ES in their regions. USDOL objected to this order on the grounds that under the governor's executive order local ES offices would neither be administered by a state agency nor staffed by state merit rated employees. The Michigan plan also limited staff-assisted services only to military veterans and disabled job seekers. The remaining 85 percent of job seekers were expected to rely on self-serve facilities including an internet-based inventory of job vacancies.

USDOL blocked further disbursement of Wagner-Peyser funding to Michigan and filed suit in federal district court seeking an injunction to stop the state's actions. At the end of July 1998, the U.S. Secretary of Labor and the Governor of Michigan reached an out-of-court settlement, which permitted "delivery of ES services by public agencies other than a state agency, provided that such agencies utilize a merit system of personnel administration and that the terms of the agreement apply only to Michigan." (Balducchi and Pasternak, 2001)

Currently the USDOL is evaluating alternatives to the Wagner-Peyser standard for ES service delivery in three states. In Colorado, services are being delivered through a county-based system using state and county merit rated staff. In Massachusetts services in four cities are being delivered through private non-profit, private profit seeking, and local public agencies. USDOL also intends to assess ES impacts in Michigan under the compromise arrangement.

The Workforce Investment Act of 1998 requires all local areas receiving federal WIA funding for job skill training to operate a one-stop-shopping center for employment services in at least one single physical location in the area. Federal funding under WIA is passed from the federal government to the state governors, who then distribute the money to local workforce development boards within the state. Pre-existing local ES offices are appealing sites for such one-stop centers in most communities. The WIA legislation and the changing technological environment may lead to changes in how the ES operates in the US.

2.8.2 Advantages and disadvantages

In seeking to reorganize the administration and delivery of ES services, the Michigan Governor asserted a responsibility to his constituency to unleash the “dynamism of the marketplace” to benefit all employers and job seekers. Exposing ES partners to market competition was expected to strengthen the system by improving efficiency of service delivery and improved service outcomes for both employers and job seekers. Encouraged by the potential gain from profits and sobered by the risks of economic loss, the market environment was presumed to exert natural pressures for staff and management of ES to achieve success. The expectation in Michigan was that such an environment would result in the great majority of service delivery activities migrating to an internet-based self-service job matching system. A prime concern of the USDOL in contesting the Michigan plan was that staff assistance is a crucial ingredient in gaining and maintaining employment success for a sizeable proportion of the ES customer base.

Market forces may rejuvenate the ES. Nevertheless, government control of ES provides many desirable features. The Wagner-Peyer Act of 1933 ensured availability of services to all citizens by requiring delivery by a state agency throughout each state. This meant that both dense urban and thin rural labor markets would be served. With government administration, however, came the risk of inferior staffing due to the risks of nepotism and political patronage. The Wagner-Peyser Act explicitly sought to neutralize this risk through the requirement that ES staffing be managed under a merit based system of personnel administration. Such a system directly promotes professionalism and high quality service to customers.

The coexistence of private for-profit employment agencies and a publicly provided ES, which is government staffed and administered by government employees, is a great strength of the US labor exchange system. In this relationship the whole has proven to be much greater than each of the separate parts could be independently. For example, the federally financed and internet-based job search tool called

America's Career Kit (ACK), which is available world-wide free of charge has become an object of envy for private for-profit entrepreneurs in the job matching business. Recently, one such firm has approached the USES with a proposal for explicit collaboration.

The symbiotic relationship between public and private labor exchange agencies in the US strengthens the information content of the labor market and improves the quality of matches between employers and job seekers. While the balance may shift over time, the public-private partnership for labor exchange in the US is likely to continue indefinitely.

2.8.3 Historical change and future directions

The ES in the US is a federal-state system of public employment offices that serve as a free public labor exchange for individuals seeking jobs and employers seeking workers. The ES was established by the Wagner-Peyser Act of 1933. Federal money raised through employer payroll taxes was used in the 1930s to transform an uneven collection of existing state ES offices in local areas into a unified system having more consistent operating procedures nationwide. The first aim of the new ES was to handle the work load of referring participants to depression era public works projects: Works Projects Administration (WPA) and Civilian Conservation Corps (CCC).

The Wagner-Peyser Act was amended in 1982 to give more authority over the ES to state governors. There are now almost 1,800 local ES offices in 54 states and territories of the US. Federal funding (in nominal dollars) for the ES has declined by nearly one-third during the past twenty years. In most states federal funding still comprises the bulk of money for operating local offices. In others, state funding is the biggest share. Through Wagner-Peyser funding, the federal government bought influence into the state employment exchange system. The mission of the ES is to bring job seekers and employers with job vacancies together. The main ES activities to meet this aim are the UI work test, job interview referral, counseling, skill and aptitude testing, job development (soliciting job vacancy listings from employers), job

clubs, job search skills, job search workshops, and job fairs. Wagner-Peyser Act labor exchange services are delivered in three tiers: 1) self-service, 2) facilitated self-service, and 3) staff assisted service. With continued federal restraint on funding, in an attempt to maintain service within a limited budget, the ES has developed America's Job Bank (AJB) which is an internet-based job matching system to serve workers and employers (<http://www.ajb.org>).

As the US labor market has matured, the share of all job seekers and employers served by the ES gradually shrank to the point where clients consisted mainly of the most hard to place in jobs. (Jacobson, 1995)

Ever since the UI system was established by the Social Security Act of 1935, there has been a close relationship between UI and the US Employment Service (ES). The systems are closely linked through ES administration of the UI work test (Balducci, Johnson and Gritz 1997). The work test in UI is the requirement that UI beneficiaries be actively seeking work.

A major renewal of the ES is now underway as a consequence of the Worker Profiling and Reemployment Services (WPRS) rules inserted in UI reforms of 1993 and the new Workforce Investment Act (WIA) of 1998. The ES is being reinvigorated by the WPRS system, which refers to ES services UI beneficiaries who are most likely to exhaust UI (Eberts and O'Leary, 1997). WPRS referrals to the ES are made early in the unemployment spell. Some commentators have claimed that the WPRS was motivated by the federal government's desire for a balanced budget and the possible effects WPRS would have on conserving UI trust funds. The main complaint of states about the WPRS is that it was an *unfunded mandate* of the federal government for the states. It added to the ES workload burden without adding revenues to the system.

2.9 Special Features of UI in the US

2.9.1 Self-employment assistance

Since the depression era beginnings of the federal-state UI program in the US, the self-employed have generally not been covered. The main reason is to avoid problems of moral hazard. With UI for self-employment, those who would pay premiums and be eligible for benefits would also manage the risk of unemployment and make decisions about work stoppage. In particular there is an inability to determine whether individuals are involuntarily unemployed, measure the economic loss of income, and determine whether an individual is employed or unemployed for a given week. UI is social insurance and extending coverage to the self-employed compromises the insurance nature of the program.

California is the only state that has a limited form of UI coverage for the self-employed. The California scheme operates on a fully reimbursable basis. This method of coverage has been used widely in the UI program first for governmental agencies and since 1972 for private non-profit firms. In 1998 reimbursable benefits accounted for 5.7 percent of all payments in the federal-state system with 42 percent of these reimbursables going to employees separated from non-profits.⁴⁴ Reimbursement may not be a particularly effective approach to UI coverage, but it is a method of avoiding the moral hazard issue, by not allowing manipulation of the system for one's own benefit (Bassi and McMurrer, 1997). Under the reimbursable approach, repayment is due in the calendar quarter following disbursement of benefits. Such a system would amount to short-term loans to self-employed for reintegration back to regular wage and salary employment. Feldstein and Altman (1998) suggested individual UI savings accounts, which could be established with pre-tax contributions and might be particularly appropriate for the self-employed.⁴⁵

44) USDOL (1998).

45) For older workers an appealing feature of Feldstein and Altman (1998) proposal is that borrowing from the government takes place when accounts are exhausted,

While the UI system is not currently structured to provide temporary income replacement to the self-employed, in several states UI beneficiaries can start their own business instead of searching for wage and salary employment.⁴⁶ While they establish their self-employment activity they can receive self-employment assistance (SEA) payments in lieu of UI weekly benefits. To date, 11 states have enacted conforming state legislation.⁴⁷

The SEA program, like similar programs in nearly 20 other OECD nations, has been very small.⁴⁸ In 1996, no state had as much as 0.5 percent of its regular UI recipients getting SEA payments. SEA participants are generally successful at starting up their own business, with about two thirds doing so. These participants differ dramatically from other UI claimants. They are older, less likely to be a minority (particularly Hispanic), more likely to be from professional, managerial and technical occupations, have higher educational attainment; and are more likely to be dislocated workers (Vroman, 1997).

When the U.S. Department of Labor began the SEA experiments in Massachusetts and Washington in the 1980s, the over-representation of older workers was not expected. Participating states imagined that the program would be particularly valuable for minorities and women. It did not turn out that way, either in the experiments or the early program operations.⁴⁹ Rather, older permanently separated workers

and Negative account balances are forgiven at retirement age.

46) A temporary UI self-employment program was established in 1993 as part of the North American Free Trade Act (NAFTA). Federal legislation in 1998 permanently gave states the option to provide self-employment assistance with UI trust fund money.

47) The 11 states are California, Connecticut, Delaware, Maine, Maryland, Minnesota, New Jersey, New York, Oregon, Pennsylvania, and Rhode Island. Among these states, Connecticut, Minnesota and Rhode Island have not yet implemented their programs.

48) Wandner (1992) provides an overview of the international experience. He also summarizes the two U.S. experiments which predated the NAFTA authorizing legislation.

49) About the experiments see Benus, Wood, and Grover (1994), about the programs see Vroman (1997).

have found SEA to a promising alternative, apparently because of their greater difficulty in finding wage and salary employment and skills acquired through years of employment.

2.9.2 Dependents allowances

The principal argument for dependents allowances is simple: workers with dependents generally have less short-term flexibility for reducing expenditures than other workers. While household heads have higher average wages than either single or married secondary workers, beneficiary studies also indicate that family heads devote a higher percentage of their higher earnings to meet non-deferrable expenses (Haber and Murray, 1966, p. 180).

The principal objection to dependents allowances has been that they introduce an element of need into unemployment insurance. Opponents argue that, although neither income nor means tests are involved, the payment of allowances and the required proof of dependents depart from the concept that benefits should be based solely on wages and payable to those who meet qualifying requirements as a matter of right.

Advocates, however, argue that allowances reflect only the general presumption that workers with dependents need more than other workers from a benefit adequacy perspective:

“The vital difference that still exists between unemployment insurance and relief is that no individual inquiry and determination is made as to whether the claimant actually needs the dependents’ benefit in order to house, feed, and clothe the dependent. The claimant merely has to establish that he has legal dependents; his personal affairs are not investigated” Haber and Murray (1966, p. 193).

Opponents have also argued that dependents allowances have too often been used as substitutes for adequate basic benefits, and that since workers with dependents tend to have higher wages than those without, the “presumptive greater needs” of these workers can be met by higher benefit maximums, without the complexities and inequities of the allowances (Dahm and Fineschriber, 1980, p. 78-81).

Originally, only the District of Columbia provided for dependents allowances. In 2001, 12 states paid higher weekly benefits to claimants with dependents. This compares with 14 states in 1990, 10 states in 1971, and 5 in 1948. The weekly benefit provisions of half of the 10 largest states took account of dependents in 1995. The states vary in the definition of compensable dependent and the amount of the allowance granted (U.S. Department of Labor, 2001, Tables 307 and 308). All include children, usually under 18, usually including stepchildren, and adopted children. All but one includes older children unable to work because of physical or mental disability. Most include a non-working spouse. Three states include parents unable to work because of disability or infirmity. Three include a brother or sister under 18 orphaned or whose living parents are dependents.

Children and non-working spouses usually can be counted as dependents if the claimant provided more than half their support and they are unemployed or have limited earnings. In almost all states, only one parent may draw allowances if both are receiving benefits simultaneously.

In seven states, the allowance for each dependent is a fixed amount. Two states make the allowance a percentage of the individual's weekly benefit amount. A few states base the allowance not only on the number of dependents but also on the amount of the claimant's earnings. In these states, the maximum weekly benefit amount and the earnings required to qualify for the maximum weekly benefit amount varies according to the number of dependents. The higher the number of dependents, generally, the higher the maximum weekly benefit amount and the higher the wage requirement for the maximum. All states have a limit on the total amount of dependents allowances payable in any week, in terms of dollar amount, number of dependents, percentage of basic benefits, or of high-quarter wages, or of average weekly wage. The dependents allowance affects the maximum benefits payable on a claim in Alaska and Rhode Island where the fixed dependents allowance is paid in any compensable week whether fully or partially unemployed.

The U.S. Department of Labor recently drafted regulations for states to use UI reserves to pay benefits to households where parents have chosen to take parental or family leave. This essentially expands UI eligibility to include beneficiaries who are not actively seeking work. The impact of such expansions on the ability of the UI system to finance its core objectives should be carefully evaluated.

2.9.3 Worker profiling and reemployment services (WPRS)

Public Law 103-152, which established the Worker Profiling and Reemployment Services (WPRS) system, requires state employment security agencies to establish and utilize a system of profiling all new claimants for regular unemployment compensation. The purpose of profiling is to identify unemployment insurance claimants who are most likely to exhaust their regular benefits, so they may be provided reemployment services to make a faster transition to new employment.

Profiling entails a two-stage process. First, unemployment insurance recipients who are expecting recall or who are members of a union hall are dropped from the pool. These groups are excluded because they are not expected to undertake an active independent job search. Second, the remaining unemployment insurance recipients are ranked by their likelihood of exhausting regular unemployment insurance benefits. Beneficiaries are then referred to reemployment services in order of their ranking until the capacity of local agencies to serve them is exhausted.

Beginning in 1994, the WPRS system required special job search training for those identified as being most likely to exhaust UI benefits. To do this, many states adopted a statistical methodology that ranks dislocated workers according to their likelihood of exhausting unemployment insurance benefits.

An evaluation of the early response to WPRS was done by Dickinson, Decker and Kreutzer (2001). To estimate the impact of WPRS on claimants' UI receipt, they tracked two outcome measures: weeks of UI benefits paid and dollars of UI benefits paid.

WPRS generally reduced UI benefits received by claimants. In five

of the six states for which estimates were possible — Connecticut, Illinois, Kentucky, Maine, and New Jersey — CWPRS significantly reduced average weeks of UI benefits per claimant. The estimated UI reductions ranged from 0.21 weeks in Kentucky to nearly a full week in Maine. In four of the five states (the exception being Kentucky), WPRS also significantly reduced dollars of benefits received. The greatest reduction was \$140 per claimant in New Jersey. In South Carolina, WPRS appears to have had no impact on UI receipt. Claimants referred to WPRS services had approximately the same UI outcomes as did similar claimants not referred to services.

WPRS was also expected to help claimants return to work sooner, thereby increasing employment and earnings in the short run. Dickinson, Decker and Kreutzer (2001) found little evidence that WPRS increased the employment or earnings of referred claimants. The only significantly positive impacts on earnings occurred for some quarters in Maine and New Jersey both states where WPRS significantly reduced UI receipt.

3. Wage Subsidy Programs⁵⁰

3.1 Background

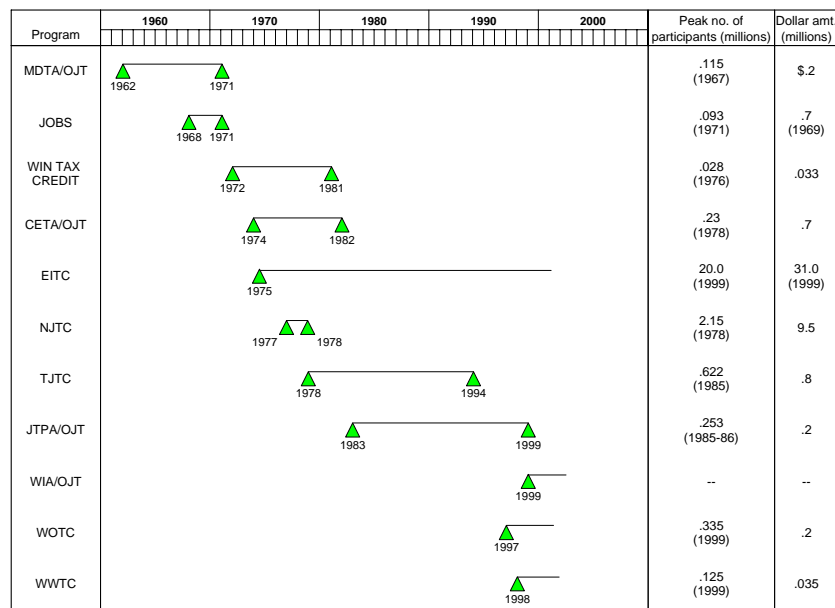
The premise of wage subsidies is that even though employers can find qualified workers to fill most of their position there is a relative small minority of workers who do not have the skills to meet the immediate needs of employers. Wage subsidies provide the financial incentive for employers to hire these marginal workers. The subsidies should be of sufficient size to make up the gap between a worker's productivity and the minimum wage the person is willing to accept, or

50) Bartik (2001) provides an excellent description and critique of wage subsidies and their effects on the economically disadvantaged, and this section benefits greatly from this source.

the minimum wage as dictated by federal or state law, or the wage set internally by the firm.

Federally provided wage subsidies in the US began in the 1960s with the introduction of the Manpower Development and Training Act (MDTA). Under this program, private-sector employers were given wage subsidies in exchange for training workers, most of whom were economically disadvantaged. As shown in Figure 3.1, this training program, referred to as OJT, has continued under the successors to MDTA, including the Comprehensive Employment and Training Act (CETA), the Job Training and Partnership Act (JTPA) and currently the Workforce Investment Act (WIA). The training that employers provide to disadvantaged workers under OJT is basically the same as they provide to most new hires. The OJT reimbursement to employers for the providing the training is roughly 50 percent of wages. OJT is the only federal wage subsidy program offered to employers that is

FIGURE 3.1 FEDERAL WAGE SUBSIDY PROGRAMS IN THE UNITED STATES



discretionary. Local employment agencies determine which employers and employees may participate.

Since the early 1970s, the federal government has offered a variety of tax credits that provide wage subsidies to employers who hire workers from targeted groups. The Work Incentive program (WIN) was the first of these programs. It was instituted in the early 1970s to encourage employers to hire welfare recipients. However, employers met the program with little enthusiasm. Fewer than 15 percent of the employers who hired eligible workers claimed the tax credit, and during its peak year of 1976 only 28,000 workers participated.

While WIN was still in place, the Carter Administration adopted a broad-based wage subsidy, the New Jobs Tax Credit (NJTC), in an attempt to stimulate the economy during the economic recession of the mid-1970s. The wage subsidy was offered in the form of a tax credit of 50 percent for the first \$10,500 (1998 dollars) of wages per employee. This program was much more successful than WIN. More than 50 percent of the eligible firms claimed the tax credit, offering jobs to two million job seekers at a cost of nearly \$10 billion (Bartik, 2001). The program lasted only two years, as the need to further stimulate the economy diminished.

Successors to the NJTC returned to the WIN approach of targeting the economically disadvantaged. The Targeted Jobs Tax Credit (TJTC), in place between 1978 and 1994, provided a 40 percent subsidy on wages up to a maximum amount for employers who hired welfare recipients, youth, disabled workers, and ex-offenders. Although the TJTC expanded the eligible list of participants beyond those included under WIN, the program was most popular among retail businesses that hired primarily disadvantaged youth.

One criticism of the TJTC was the tendency of employers to claim as tax credits workers whom they would have hired without the program. To address this problem of windfalls to business, the two successors to TJTC, the Work Opportunity Tax Credit (WOTC) and the Welfare to Work Tax Credit (WWTC), revised the application process so that only new hires would be eligible. These two programs

have also made it easier for employers to determine the eligibility of job seekers before they are hired. A broad range of economically disadvantaged individuals, similar to those covered by the TJTC, are eligible under the two programs. The WOTC and WWTC provide a wage subsidy in the form of a 40 percent tax credit of the wages paid up to a maximum amount. While broad based, these two programs together enroll fewer than 500,000 workers each year.

The Earned Income Tax Credit (EITC), which is the largest wage subsidy program, provides tax credits directly to low-income families. Implemented in 1975 as part of a general tax cut, the EITC has evolved to where it provides up to a 40 percent tax credit for incomes below a specified maximum depending upon family size. The program is broad based and currently includes families with incomes below \$31,000. In 1999, more than 19 million tax returns claimed an EITC tax credit totaling \$31 billion.

State governments have also implemented wage subsidy programs. Most of these programs have diverted welfare grants from individuals to businesses. The purpose is to provide financial incentives to help move people off the welfare rolls and onto private employers' payrolls. In addition, several experimental programs have been launched to provide wage subsidies in various amounts to businesses. Currently, only one state is operating a wage subsidy program. The Oregon JOBS Plus program provides a wage subsidy of 80 percent for up to six months. All state programs, including Oregon's, are operated on a modest scale.

3.2 Current Labor Market Policy Framework

Four federal wage subsidy programs are currently in operation. They provide financial incentives to either employers or employees to encourage job creation and work participation. All four are categorical in that they target low-wage, disadvantaged workers. Two provide tax credits directly to employers; the third provides cash wage subsidies to employers in which for training; and the fourth offers tax credits to

low-income taxpayers. The Work Opportunity Tax Credit (WOTC) and the Welfare to Work Tax Credit (WWTC) provide tax credits to employers who hire eligible workers. The on-the-job training (OJT) component of the Workforce Investment Act offers a direct wage subsidy to employers in exchange for training the targeted workers. These programs are relatively modest in the number of workers they serve and the size of their budgets. None of these programs affects more than a million workers per year and never exceeds an annual outlay of \$1 billion.⁵¹

The fourth federal program, the Earned Income Tax Credit, provides tax credits to low-income taxpayers. This program covers many more individuals than are covered by the three previously mentioned programs combined. In 1998 for example, 20 million families received tax credits under this program at a total federal cost of \$30 billion (CEA, 1998). During that year, the program lifted 4.3 million people out of poverty.

In addition, several states have implemented programs targeted at specific groups, primarily low-wage workers. These programs are much smaller in scope than the federal programs.

51) Some analysts and policy makers consider the minimum wage law to be another form of wage subsidy. It is an unfunded government mandate to businesses to establish a minimum wage for workers they hire. Currently, the federal minimum wage is \$5.15 per hour. Some states have minimum wage laws that exceed the federal minimum. The federal minimum wage provisions were established in 1938 under the Fair Labor Standards Act. Initial coverage was restricted to businesses engaged in producing goods for interstate commerce. Since then, the coverage has expanded to include about 85 percent of all jobs. There has been considerable controversy over the displacement effect of raising the minimum wage. While there is no complete consensus on the topic, a large number of studies, which include those conducted by prominent economists, suggest that the displacement effects are small and that increases in the minimum have the potential to raise workers out of poverty (Card and Krueger, 1995; Ehrenberg, 1992).

3.2.1 Legislative and policy stance on the support for employment of the underprivileged

Wage subsidy programs to employers have targeted primarily the economically disadvantaged with the intent of encouraging private-sector employers to hire these job seekers. Currently, the WOTC and the WWTC provide tax credits to employers who hire from the eligible groups of disadvantaged workers. The OJT provides incentives for businesses to train low-skill, low-income individuals with the intent of raising their skill levels so that they can become productive employees who can meet the needs of their employers. Therefore, the U.S. Congress and state legislatures have viewed wage subsidies as one approach, albeit a modest effort, to support employment of the economically disadvantaged.

The largest wage subsidy EITC, on the other hand, is a tax credit to families not employers. Consequently, it serves as a wage supplement rather than a employment incentive. While only working families are eligible for the EITC tax credit, it does not encourage job creation, except by increasing the labor supply.

3.2.2 Legislative and policy stance on the support for employers' efforts to avoid lay-off

The wage subsidy programs provide few incentives for employers to avoid layoffs. In fact, there has been some concern that the design of wage subsidies may encourage turnover. Employers can claim tax credits on new hires for only a short period of time, typically between six months to a year. Since the need for wage subsidies is based on the premise that employers will hire low-skill workers only if their effective wage is lower than the market rate, the termination of the subsidy could encourage firms to layoff some subsidized workers. Obviously, if the subsidized workers gain valuable skills during their tenure on the job, then dropping the subsidy would have less of an effect. However, a recent investigation by the U.S. General Accounting Office found the displacement effect is very limited, if it occurs at all (GAO, 2001).

An experimental program to reduce unemployment spells has

been tried in a few states. The Reemployment Bonus Demonstration Program offered wage subsidies in varying amounts to employers if they hired UI claimants within a specified period of time (Woodbury and Spiegelman, 1987). It did not provide incentives for employers to retain workers. In fact, like the other wage subsidies, one could argue that employers may have an incentive to game the system by laying off workers with the intent of rehiring them with a wage subsidy. The bonus reduced the unemployment spell by only a few days, and the take-up rate by firms was also small.

3.3 Institutional Arrangements for Wage Subsidy Programs

The institutional arrangements of the four federal wage subsidy programs currently in operation vary in several important dimensions. These dimensions include: 1) the recipient of the subsidy, 2) the form in which it is received, and 3) whether the program is discretionary or an entitlement.⁵² In this section, we describe only those programs that are currently in operation. As mentioned in the previous section, the current wage subsidy programs have evolved from previous programs with similar financial structures and administrative arrangements. With few exceptions as noted elsewhere, the magnitude of the operations and the importance of wage subsidies as a component of US employment policy have not changed significantly over the years.

As shown in Table 3.1, the majority of the current wage subsidy programs provide tax credits to employers for hiring new workers from targeted populations. In addition, most of the programs are entitlements, in that all those who meet certain eligibility requirements, regardless of whether they are employers or employees, are entitled to receive the subsidy. The exceptions are OJT, which is a discretionary wage subsidy paid in cash to employers, and the Earned Income Tax Credit (EITC), which is an entitlement wage supplement paid as a tax

52) All current programs are targeted to the economically disadvantaged population, so there is no need to list this dimension in delineating among the various programs.

TABLE 3.1 CHARACTERISTICS OF CURRENT WAGE SUBSIDY PROGRAMS

	Recipient	Form of wage subsidy	Type of program	Subsidy	Eligibility criteria
On-the-job training	Employer	Direct Payment	Discretionary	Employers are reimbursed up to 50% of wages paid for a period of 4 weeks to 26 weeks up to a maximum of \$5,000 per trainee	Only unemployed participants who have been assessed and for whom OJT has been documented as appropriate can be referred
Work opportunity tax credit	Employer	Tax Credit	Entitlement	Credit of 40% of wages up to a credit of \$2,400 for individuals retained at least 400 work hours; 25% up to \$1,500 for individuals employed 125 to 400 hours	Nine groups of job seekers qualify: long-term welfare recipient, veteran, other welfare recipients, veteran, 18-24 food stamp recipient, 18-24 resident of Empowerment Zones or Enterprise Communities, summer youth employee, vocational rehabilitation, referral, ex-felon, and SSI recipient
Welfare to work tax credit					
Earned income tax credit	Employee	Tax Credit	Entitlement	For family with no children: 7.5% up to \$353 and then phased out at \$10,380; one child: 34% up to \$2353 and phased out at \$27,413; two children: 40% up to \$3,888 and phased out at \$31,152	All U.S. citizens with valid social security number who earns less than \$31,152. Child must be related, and families with no children must be 25 to 64 years old

Source: U.S. Department of Labor, U.S. Internal Revenue Service, selected documents.

credit directly to eligible low-income families.

Many of the wage subsidy programs are administered through a partnership among federal agencies and among federal and state agencies. For example, the WWTC and WOTC are administered through the U.S. Department of Labor with cooperation from the U.S. Treasury, since the subsidy is paid out in the form of a tax credit, and with cooperation from state and local agencies, since the programs are targeted to the economically disadvantaged, the employment of whom

is the responsibility of local one-stop career centers. The EITC, although a wage supplement program designed to help lift poor families out of poverty which is typically the responsibility of the U.S. Department of Health and Human Services, is administered solely by the U.S. Treasury, since it is a tax credit obtained as part of the process in filing an annual tax return to the U.S. Internal Revenue Service.

3.3.1 Work opportunity tax credit

The Work Opportunity Tax Credit (WOTC), enacted in 1997, is the immediate successor of the long-standing Targeted Jobs Tax Credit, which served disadvantaged job seekers from 1978 to 1994.⁵³ The WOTC provides tax credits to employers who hire eligible workers. The eligible group includes welfare⁵⁴ and Supplemental Security Income (SSI) recipients; those between the ages of 18 and 24 who are members of families receiving food stamps or living in empowerment or enterprise communities; vocational rehabilitation referrals; veterans receiving food stamps; and ex-felons who are members of low-income families.

All private-sector employers who hire a new worker from this eligible group are entitled to tax credits. However, the decision to apply for certification and to file for the tax credit is up to the discretion of the employer. The WOTC can reduce employers' federal tax liability by as much as \$2,400 per new hire. The tax credit is based on a percentage of the first-year wages of qualified workers. For those eligible new hires employed 400 hours or more, the employer receives a tax credit of 40 percent of their first-year wages, up to a wage cap of \$6,000. For those employed at least 120 hours but no more than 400 hours, tax credits equal 25 percent of their wages. Summer youth wages are capped at

53) The Ticket to Work and Work Incentives Improvement Act of 1999 (P.L. 106-170) was signed into law on Dec. 17, 1999, reauthorizing the WOTC/WtW Tax Credits for a 30-month period through Dec. 31, 2001 (retroactive to the credits' expiration date of June 30, 1999).

54) The person must be a member of a family that received Temporary Assistance for Need Families (TANF) for a total of at least 9 of the 18 months before date of hire.

\$3,000. A GAO survey found that the WOTC offset, on average, 47 percent of employers' costs of recruiting, hiring, and training certified workers.

The process of receiving tax credits begins when an employer applies for and receives certification from the state employment security agency that their new hire is eligible. The job applicant gives information to the employer on or before the day a job offer is made. In this way, the employer's hiring decision is based in part on the job applicant's eligibility for the tax credit. Therefore, the program offers an incentive to hire targeted workers that the employer may not otherwise have considered.⁵⁵ There is no limit to the number of certified new hires within any one business, so long as they are eligible. After the employee is certified, the employer can file for a tax credit anytime within a three-year period after the employee has worked the required number of hours. In order to receive a tax credit, a business must have taxable earnings some time within that three-year period. WOTC is subject to a yearly cap. However, excess WOTC can be used to offset tax liabilities in preceding year or in any of 20 succeeding years.

The number of WOTC certifications has risen steadily during the first four years of the program. In 1997, 126,000 WOTC certifications were issued and by 2000, the number has increased to 370,835. In 1999, businesses claimed approximately \$200 million in tax credits under this program.

3.3.2 Welfare to work tax credit

The Welfare to Work Tax Credit (WWTC) is similar to the WOTC, but it is more generous and more narrowly targeted. Established by the Taxpayer Relief Act of 1997, the WWTC is a federal income tax credit that is designed to encourage employers to hire long-term welfare recipients, who typically have barriers to employment.

55) Both the job applicant and the employer must fill out and sign the pre-screening and certification application, so that the employer knows the applicant is a member of the economically disadvantaged target group and the applicant knows that the employer has taken his or her status into account when making the hiring decision.

This program is considered to be an important component in the group of flexible strategies designed to help people move from welfare to work and become economically self-sufficient. This tax credit can reduce employers' federal tax liability by as much as \$8,500 per new hire.

New hires who qualify for the program are: 1) members of a family that has received TANF benefits for at least 18 consecutive months ending on the hiring date; 2) members of a family whose TANF eligibility expired after the program took effect; or 3) members of a family that received TANF benefits for a total of at least 18 months (whether or not consecutive) after the date of enactment of this program if they are hired within 2 years after the date that the 18-month total is reached.

As with WOTC, all private-sector employers are entitled to the tax credits, but employers elect to file for the credit. Unlike the WOTC, the WWTC tax credit extends over two years of employment instead of one year, and the tax credit is substantially larger. The WWTC provides employers a tax credit on the first \$20,000 of eligible wages paid to qualified new hires during their first two years of employment. The credit is 35 percent of the first \$10,000 of eligible wages in the first year of employment and 50 percent of the first \$10,000 of eligible wages in the second year.⁵⁶ The certified new hires must be employed for at least 400 hours or 180 days before the employer can claim the tax credit. The maximum credit is \$8,500 per qualified employee.

The process that the employer follows to gain certification of qualified new hires and to file for tax credits under the WWTC is similar to the process they would follow under the WOTC. In fact, the same form is used for both programs. The application for certification must be submitted prior to hiring a person, and both the employer and prospective employee must fill out and sign the certification application.

56) Eligible wages include cash wages paid to an employee plus amounts paid by the employer for the following: 1) some educational assistance; 2) health plan coverage for the employee, 3) dependent care assistance. These qualifications are subject to further qualifications as specified in the legislative code.

Once the employee has worked the requisite time period, the employer can then claim a tax credit.

The number of WWTC certifications is considerably smaller than the number of WOTC certifications. In 2000, the WWTC certifications numbered 154,508 compared with 370,835 WOTC certifications. Nonetheless, WWTC program has grown at a much faster pace than the WOTC program, more than tripling in size since implementation in 1998.

3.3.3 On-the-job training

On-the-Job Training (OJT) component of the Workforce Investment Act (WIA) offers another form of wage subsidy. Under this program, employers receive a cash payment in exchange for providing training to qualified workers. This program is a training program, and it is not designed to provide direct incentives to hire workers. The basic philosophy of OJT is that for many occupations a trainee learns best by working in an actual work situation, using employer's procedures and equipment according to the employer's requirement. However, it is expected at the end of the training that the employer retain the participant for at least 6 months. It is further anticipated that because the employer has trained the participant according to their procedures and with their needs in mind, the trainee will become a long-term employee of that business.

The OJT program, in one form or another, has been part of the federal training programs since the Comprehensive Employment and Training Act (CETA) in 1974. However, under WIA much more emphasis has been placed on job search assistance than on training. Furthermore, within the training component, training has been financed through vouchers, called individual training accounts (ITA), which gives workers more discretion over the type of training they receive and who provides it. The reduction in the number of people referred to training under WIA, the change in the delivery of training, and perhaps the slow start in implementing the new WIA programs in the local offices may account for the minimal usage of OJT.

OJT is targeted primarily at unemployed participants of WIA and welfare-to-work programs. Employed workers can receive OJT if the Local Workforce Development Board determines that the individual is not earning a self-sufficient wage. Unlike the WOTC and WWTC, selection of OJT participants is determined by the local Workforce Development Board, not the employer. In fact, pre-selection by employers is strictly prohibited.

OJT is provided under a contract with an employer in the public, private non-profit, or private sector. Unlike the two tax credit programs previously mentioned, OJT is not an entitlement but applications are reviewed and approved by the local WIA administration. Through the OJT contract, occupational training is provided for the WIA participant in exchange for a reimbursement of up to 50 percent of the wage rate to compensate for the employer's extraordinary costs. The reimbursement may be for a period of between 4 weeks and 26 weeks depending upon the skill level of the job and proficiency level of the participant. An OJT contract cannot exceed the period of time required for a participant to become proficient in the occupation for which the training is being provided. In determining the appropriate length of the contract, consideration is given to the skill requirements of the occupation, the academic and occupational skill level of the participant, prior work experience, and the participant's individual employment plan. OJT funds may be used for classroom training, books, and tuition upon approval by the local WIA administration. A maximum of \$5,000 can be paid to an employer for any one trainee. Training agreements may exceed this amount, but must be reviewed and approved by the WIA administration.

The number of OJT participants has declined significantly since its peak usage during the early years of the Job Training Partnership Act (JTPA). During the 1980s, OJT participants accounted for 23 percent of the total participants in JTPA. This proportion fell to 15 percent during the early 1990s and has declined even further under WIA.

3.3.4 Earned income tax credit

The Earned Income Tax Credit (EITC) is the largest financial subsidy for work offered in the US. The purpose of the EITC is to provide a wage supplement for low-wage workers, to offset their payroll tax liability, and to encourage work. It is an entitlement program that provides a tax credit directly to the taxpayers. The credit is refundable in that workers can receive the full amount to which they are entitled even if it exceeds their income tax liability. Workers apply directly to the Internal Revenue Service for the EITC and receive the credit as part of their tax refund. It is a wage subsidy in that only those who are working are eligible for the refund.

The program started on a small scale in 1975 as part of a general tax cut. With a significant expansion in 1993, it has grown significantly during the 1990s. Credits have almost doubled during the last decade. As of 1999, 19 million tax returns claimed the EITC, totaling more than \$31 billion in refunds. As a boost to low-wage workers, this amount surpasses the combined spending by the federal and state governments under the new welfare bill. Estimates indicate that the 1999 tax credit lifted 4.1 million people out of poverty.

In 2000, families with two or more children received a subsidy of 40 cents for every dollar of earned income up to \$9,700, for a maximum credit of \$3,990. Since the subsidy is a tax credit, even families that pay no taxes can still have positive earnings can receive a refund. As shown in figure 3.2, the subsidy remains at \$3,990 until earnings reach \$12,700 and then it declines by 21 cents for each additional dollar earned. Those earning more than \$31,152 receive no tax credit from the EITC.

For many of the recipients, these tax funds will be more than enough to offset their payroll tax burdens. For example, a head-of-household filer who has two children and earns \$15,000 in wages would have earned an EITC of \$3,396 in 2000. This amount would have exceeded her pre-credit income tax liability of \$24 plus her \$1,148 portion of the payroll tax liability. It would also have been more than enough to offset her employer's \$1,148 share of the payroll tax, which

most economists believe to be borne by the employee (GAO, 2001, p. 9).

Benefits have been greatly expanded since 1993. In addition, tax credits are pegged to increases in the Consumer Price Index. The benefits are somewhat less for families with fewer children, but even families without children receive benefits. Unlike the WOTC and the WWTC which focus on new hires, the tax credit entitlement is available to anyone with positive earnings filing a tax return, regardless of whether or not they are a new worker.

3.3.5 State-administered programs

Many states have implemented wage subsidy programs. Most have been targeted at the economically disadvantaged as an effort to get them off of welfare and into jobs. The new welfare reform law gives state policymakers more discretion than before on the use of welfare funds, and many states have used all or part of an individual's welfare grant to subsidize a private employer as an incentive to hire that individual. In addition, states have established their own tax credit programs to subsidize private employers who hire or employ the disadvantaged. According to the American Public Human Services Association (1998), 32 states have adopted some sort of program that diverts welfare funds into wage subsidies for employers, and 15 states have enacted programs to provide wage subsidies to private employers who hire the disadvantaged. Almost all programs are small relative to the targeted population.

The largest two programs are the Minnesota Employment and Economic Development program (MEED) and the Oregon JOBS Plus program. The MEED operated from 1983 to 1989 and at its peak spent \$50 million per year and had 10,700 participants. Toward the end of the program, over half of the placements were in the private sector. Relative to the size of its targeted population, this program was one of the largest and most generous wage subsidy program to employers, considerably surpassing the two current federal programs. The MEED provided a wage subsidy that exceeded 80 percent of paid wages to

disadvantage workers for up to 6 months.

The Oregon JOBS Plus program stems from a 1990 ballot measure, which required the state to set up a work program for welfare recipients in six counties. In 1996, the Oregon legislature expanded the program statewide. This program offers wage subsidies to employers who hire welfare recipients, food stamp recipients, or UI recipients. The payments to employers are made in lieu of welfare payments or food stamps to individuals. Similar to the MEED program, the subsidy amounted to 80 percent of wages up to 6 months. Each employer is eligible to hire one participant, but JOBS Plus participants may not exceed 10 percent of the employer's workforce. The scale of the program is more modest than MEED. Currently, the program has less than 4,000 participants.

An example of a state-initiated, tax-based wage subsidy is Wisconsin's Community Development Zone Program. Under this program, certified employers residing within a designated community development zone can earn a tax credit against a Wisconsin income tax liability for each newly created full-time position. The tax credit is two tiered and applies only to new hires who are Wisconsin residents. When hiring a Wisconsin resident who is not a member of a targeted group, employers can receive a tax credit of up to \$6,000 for each newly created full-time (2,080 hours per year) position. When hiring a Wisconsin resident who is a member of certain targeted populations, employers can claim a tax credit of up to \$8,000 for each newly created full-time position. Individuals who are members of any one of 13 targeted groups are eligible. Most of the groups include the economically disadvantaged, including youth and Vietnam-era vets. Workers unemployed as a result of a plant closing or mass layoff are also included, regardless of income level.

3.4 Program Management

3.4.1 Financing (funding)

Budgets for the WOTC and WWTC are comprised of two

components. The first and smaller amount is used to fund services and administrative fees; the second is the revenue loss due to tax credits. For Fiscal Year 2001, \$20 million has been allotted for WOTC and WWTC activities. Funds are allocated to the states, who are responsible for carrying out the activities. The allocation formula is as follows: 1) 50 percent is allocated based on each State's relative share of total certifications issued for WOTC and for the WtW tax credit; 2) 30 percent is allocated based on each State's relative share of the civilian labor force (CLF); and 3) 20 percent is allocated based on each State's relative share of the adult recipients of Temporary Assistance for Needy Families (TANF). The tax revenue loss budgeted for 2001 was \$400 million for WOTC and \$70 million for WWTC. These amounts are budgeted to decline to \$30 million and \$10 million, respectively by FY 2005.

Under JTPA, the annual budget for OJT component of the program was \$200 million during its peak years of 1985 to 1986. The funds available in recent years have declined below this amount as the number of participants has also decreased.

Tax credits claimed under EITC reached \$30 billion in 1999. The program continues to be the largest earnings subsidy program in the history of wage subsidy programs in the US.

3.4.2 Administrative organization

WOTC/WWTC

States are expected to administer WOTC and WWTC programs in accordance with applicable regulations, including those set forth by the Wagner-Peyser Act. Regional Offices are responsible for field level review of the ES grants. This includes review and approval of State plans, analysis of expenditures and performance data, and on-site reviews. State agencies will submit detailed narrative descriptions of their plans for carrying out the following functions: 1) determining eligibility of individuals as members of targeted groups, on a timely basis, 2) issuing employer certifications, denials, or notices of

invalidation for tax credits on a timely basis and in accordance with the prescribed policies and procedures, 3) establishing and maintaining appropriate forms review, record keeping, and reporting capability related to the orderly management of WOTC/WtW certification requests, as well as other administrative functions.

OJT

The OJT is administered under the Workforce Investment Act (WIA), which in 1998 succeeded the Job Training and Partnership Act as the federal job training program. The selection of businesses and individuals to participate in the OJT program is the responsible of local Workforce Investment Boards (WIBs). The WIBs are administered by local staff and are governed (within the federal and state rules and regulations) by a local Board comprised of leaders from local businesses, non-profit organizations, and local government. The purpose of the Board is to provide input to the staff of the hiring needs within the local labor market. The WIA recognizes that local businesses have the best knowledge about their employment needs and that local service providers know best about the needs of local job seekers, particularly the economically disadvantaged.

EITC

The EITC is administered through the federal tax system by the Internal Revenue Service. Taxpayers apply for the tax credit at the same time that they file their income tax return. The amount of EITC allowed to an individual is first applied as a payment against any income tax liability of that individual. Any remaining amount is refunded to the individual. Workers can receive the credit as a lump sum payment after filing an income tax return or in advance as part of their paycheck. It has been estimated that 87 percent of the credit earned in 200 will be refunded as direct payment to taxpayers. (GAO, 2001, p. 8).

3.5 Program Evaluation

3.5.1 Utilization of the wage subsidy programs by population subgroups

US current wage subsidy programs have typically been targeted to economically disadvantaged job seekers. Except for the New Jobs Tax Credit (NJTC), enacted for a short period in the late 1970s to stimulate job growth, wage subsidies in the US have been targeted toward low-income groups. For WOTC and WWTC, the eligible group includes welfare and Supplemental Security Income (SSI) recipients; and those between the ages of 18 and 24 who are members of families receiving food stamps, as well as other low-income groups. OJT is also targeted to low-skill, low-income individuals. However, OJT is not exclusively a program for low-income workers, but it may include those from higher income groups who need training. The EITC is also targeted to low-income individuals with the purpose of raising family income above the poverty level and to allow families to keep more of their earnings by cutting their tax bill. In 2000, the EITC offered tax credits for families with two or more children with incomes under approximately \$31,000.

3.5.2 Number of beneficiaries

Wage subsidy programs to employers have not been a large component of employment programs in the US. The number of beneficiaries in the three current wage subsidy programs to employers — WOTC, WWTC, and OJT — totaled less than 500,000 in 1999. In contrast, 5.9 million people were listed as unemployed that year and 5.7 million families earned income below the poverty level. Therefore, the employer-based wage subsidy programs reach relatively few of the individuals they are targeting. Adding the EITC, a wage subsidy paid directly to working families, to the list of wage-subsidy programs increases the number of participants considerably. In 1999, 19 million tax filers claimed an EITC tax credit. Figure 3.1 shows the peak number of beneficiaries in a single year during the life of the various wage subsidy programs that have been in effect in the US. The New

Job Tax Credit registered the most beneficiaries of all the employer based wage subsidies, but pales in comparison to the number of beneficiaries of the EITC.

3.5.3 Characteristics of beneficiaries: gender, age, education level, occupation, tenure

Three of the four wage subsidy programs currently in operation are categorical programs. The characteristics of participants within these programs should be consistent with the characteristics of the groups represented. The characteristics of participants in discretionary programs, which in this case is the OJT, may differ from the characteristics of the targeted group because of the choices made by program administrators. Therefore, in this section, the characteristics of participants in one categorical wage subsidy program, the EITC, and one discretionary wage subsidy program, the OJT, will be examined.

Table 3.2 shows the characteristics of those participants in the EITC during 1999. The characteristics of all families who claimed the tax credit are compared with all families who did not, regardless of income level. Slightly less than 10 percent of all U.S. families claimed the tax credit that year. A greater percentage of the EITC participants are female, single parents, Black, and Hispanic than are those who did

TABLE 3.2 CHARACTERISTICS OF EITC PARTICIPANTS AND NONPARTICIPANTS, 1999

		Adults claiming EITC	Adults not claiming EITC
Percent of population		9.46	90.54
Age	18-19	1.33	4.97
	20-34	43.50	31.03
	35-44	31.65	24.84
	45 and over	23.53	39.16
Female		60.60	49.55
Single parent		34.54	5.91
Black (% of Adults in each group)		21.97	10.59
Hispanic		22.10	10.10
Education	< 9 years	9.54	4.14
	9-11 years	14.94	7.28
	Graduated high school only	41.62	32.54
	Post secondary	33.90	56.04

Source: Authors' calculations using the 2000 Current Population Survey

not claim the tax credit. They are also more likely to be between the ages of 20 and 44, and to have only a high school education or less. Of course, much of the difference is due to the difference in income between those who claimed the EITC tax credit and those who did not.

Table 3.3 displays the percentages for individuals within families with earnings that fall within the ranges for eligibility. Three ranges are examined, delineated by family size and the corresponding maximum income levels. As shown at the bottom of the table, the largest group participating in EITC includes families with two or more children and with earnings below \$31,000. Forty-five percent of EITC participants belong to this group. The take-up rate in this group is almost 50 percent. The EITC participants are more likely to be in the 20-to-34 age range, female, Black, and with fewer years of post-secondary education. Participants from the second most prevalent group, families with one child, share similar characteristics with the higher income group. The group of families with no children is markedly different from the other two groups. Participants are slightly older than those in

**TABLE 3.3 CHARACTERISTICS OF EITC PARTICIPANTS AND NONPARTICIPANTS
WITHIN VARIOUS FAMILY SIZE AND INCOME CATEGORIES**

		No children, income < \$10,380		One child, income < \$27,413		Two or more children, income < \$31,152	
		EITC	no EITC	EITC	no EITC	EITC	no EITC
Percentage of group		26.13	73.87	51.68	48.32	49.41	50.59
Age	18-19	0	9.68	3.70	12.78	0.41	8.31
	20-34	30.75	27.40	20.90	16.66	50.74	40.67
	35-44	24.81	6.13	51.34	35.34	38.29	34.44
	45 and over	44.43	56.80	17.46	34.19	10.59	16.57
Female		45.45	54.45	69.27	58.52	63.22	59.57
Black		18.33	11.70	23.51	16.97	23.47	14.73
Hispanic		12.73	8.11	21.16	22.49	25.23	27.93
Education	< 9 years	10.09	7.57	6.53	10.33	9.99	12.57
	9-11 years	15.07	13.03	13.58	19.01	16.88	17.53
	HS graduate only	37.76	35.34	43.92	36.87	42.22	40.21
	Post secondary	37.08	44.07	35.98	33.78	17.46	29.69
Percent across groups		21.5		33.4		45.2	

Note: The three groups correspond to the three income and family size categories designated by EITC for 1999.

Source: Authors' calculation of the 2000 current population survey.

the other two groups, with a higher representation in the 35-44 age group. The group has a lower percentage of women, but a higher proportion of Blacks and Hispanics than the non-participants in the group.

Characteristics of OJT participants during 1997 are shown in Table 3.4. Since most OJT participants are drawn from the Title II-A, comparing the characteristics of the two groups offers a useful perspective. Only 10 percent of the Title II-A participants, which numbered 141,700 participated in OJT. The only substantial difference between the two groups was that the OJT participants were more likely to be male and Hispanic, but less likely to be cash welfare recipients.

TABLE 3.4 CHARACTERISTICS OF OJT AND TITLE II-A PARTICIPANTS, 1997

	OJT	Title II-A
Percent of II-A Adult terminees in OJT	10	—
Number of II-A Adult terminees in OJT	1,417	—
Average hours in activity	393	—
% female in OJT	0.54	0.68
% black in OJT	0.30	0.34
% Hispanic in OJT	0.23	0.17
Age 22-29	0.39	0.41
Age 30-54	0.60	0.57
Age 55 or older	0.01	0.02
Less than high school education	0.21	0.21
High graduate only	0.56	0.57
Post high school education	0.23	0.22
Cash welfare recipient	0.32	0.36
Basic skills deficient	0.57	0.57
Disability	0.07	0.07
Veteran	0.09	0.07
UI Claimant	0.09	0.08

Source: SPIR National Data Book, prepared for the U.S. Department of Labor, Employment and Training Administration, by SPR Associates, 1997.

3.5.4 Effects and side effects of the program

Programs that offer wage subsidies to employers are intended to provide financial incentives to encourage businesses to employ individuals whom they might not otherwise hire. Therefore, the desired net effect of these programs is to increase the employment rate of the targeted group over and above what it would have been without the

wage subsidy. The major disadvantage of such wage-subsidy programs is the inability to target the incentives to only those individuals who would not otherwise find employment. Under a generic wage-subsidy program, businesses can receive wage subsidies for those whom they would have hired without the subsidy as well as for those whom they would not have hired without it. Businesses have no incentive to separate the two groups. The result of the deadweight loss or windfall wastage of the program is the potentially large cost per job created. The employer-based wage-subsidy programs currently in operation are designed to minimize the windfall wastage by offering a wage subsidy only for new hires and by limiting the wage subsidy to only the first year or two of the new hire's employment. While this approach reduces costs, it also reduces value of the subsidy to the firm and potentially reduces the incentive and its ability to generate additional employment.

Another problem with wage subsidy programs that pay employers for hiring economically disadvantaged workers is the stigma effect attached to workers who are members of that group. Employers may be reluctant to hire workers who are targeted by the program because they suspect that the individual is less employable due to low skills, poor employability skills, and other attributes that lead to low productivity. The stigma effect can lead to a low take-up rate by employers for the wage subsidy programs, rendering the programs less effective than they otherwise may be. Some programs have tried to circumvent this problem by not sharing with the employer that the employee is part of the targeted group, such as the case with the EITC, or by offering greater assurance to the employer of the quality of the worker through pre-screening, some training, and the assistance of job developers.

Potential displacement effects are another drawback of wage subsidy programs. This is particularly likely when the program targets specific population groups. For instance, when faced with a wage subsidy for one group of employees, a business may find it advantageous to replace a similar group of ineligible employees with the targeted group of eligible employees. In such an event, the eligible

group would displace the ineligible group, resulting in little if any increase in job creation and causing undue harm to the displaced group.

Another issue is the increase in overall wages caused by the wage subsidy. Bartik (2001) points out that the increased demand for a targeted group, as a result of the lower cost of employment due to the wage subsidy, could raise the overall wage for that group and thus for other groups that are close substitutes.

The combination of a low take-up rate and modest net employment effects are responsible for the low overall effect on net employment from wage subsidies. Katz (1998) estimates, for example, that one categorical entitlement wage subsidy program, the Targeted Jobs Tax Credit (TJTC) would have created 249,000 to 322,000 jobs at its peak in 1985, at a time when 622,000 people participated in the program.

3.5.5 Net effect of the program considering deadweight loss, displacement effect, and substitution effect

Categorical Entitlement Wage Subsidies

Formal evaluations have not been conducted for the current programs offering wage subsidies to employers—WOTC, WWTC, and the OJT under WIA. Therefore, what is known about the net effect and side effects of such programs must rely on evaluations of past programs. The program that has received the most attention is the Targeted Jobs Tax Credit (TJTC). This program, in operation between 1978 and 1994, was designed to increase the employment of economically disadvantaged job seekers. At the time of inception, job training and local employment offices issued vouchers to eligible job seekers, who in turn would present them to employers during the interview and hiring process. If the individual was hired, the employer could use the voucher to obtain certification to receive a tax credit. As the program evolved, this process was replaced by consultants, who would submit applications for all new hires, on behalf of the employers, after the hiring was made but before the first date of employment.

The TJTC and its two successors, the WOTC and WWTC, share certain similarities. Like the WOTC and WWTC, the TJTC is a categorical entitlement wage subsidy targeting disadvantaged job seekers. In addition, the wage subsidies under the TJTC were similar in magnitude to those of its two successors, the WOTC and WWTC, particularly. However, in response to the criticism about the deadweight loss potential of the certification procedure levied against the TJTC toward its waning years, the WOTC and WWTC implemented a process by which the certification had to take place before the hire date and both employer and employee had to sign the application. Therefore, the TJTC was probably subject to a greater deadweight loss effect than the WOTC and WWTC.

Net Employment Effect

Most evaluations of the TJTC suggest that tax credits offered under that program affected the hiring decisions of businesses and increased net employment. However, the results vary widely. Bartik (2001) summarizes and critiques the nearly 20 studies of the TJTC, and this discussion borrows heavily from his discussion. One reason for the wide variation in findings is the difference in methodology. Furthermore, no study used random assignment methodology to evaluate the TJTC, so results are questionable because of sample selection bias and other methodological problems.⁵⁷ Some survey results suggest that about half the firms using TJTC have changed their hiring and recruitment process in some way such as changing the sources they typically use to find job seekers (O'Neill, 1982; Christensen, 1984; U.S. GAO, 1991; Katz, 1998). Results of some econometric studies suggest that for every ten subsidized hires by firms

57) The one study of a wage subsidy program that used a random assignment approach evaluated a reemployment bonus experiment. The experiment offered a subsidy to employers who hired unemployment insurance recipients within 11 weeks of starting benefits. The evaluation, conducted by Spiegelman and Woodbury (1987), found a very small take-up rate of less than 25 percent and a deadweight loss of slightly over 25 percent.

claiming the tax credit, they increased their employment by two to four jobs (Bishop, in Bishop and Hollenbeck, 1985).

Displacement Effect

The same econometric studies that found that TJTC-subsidized firms created 2 to 4 extra jobs also found that 6 to 7 jobs were displaced. Most of the displacement affected disadvantaged blacks and welfare recipients. The most plausible reason for this displacement is the stigma effect. Toward the end of the TJTC, the program was dominated by employers who were interested in hiring disadvantaged youth, particularly in fast food restaurants. Consequently, the subsidized youth crowded out those with similarly low skills but who were not subsidized. Furthermore, because employers were fully aware of the job applicants who were subsidized and their personal characteristics, they were less likely to hire individuals within the group who exhibited characteristics associated with low employability skills and potentially low productivity.

Deadweight Loss

Studies found that deadweight loss ranged from 50 to 92 percent of the dollars spent for the TJTC. Bartik (2001) argues that a reasonable middle ground estimate is that 7 out of 10 dollars go to subsidize hires that businesses would have made without the subsidy.

Take-up Rates

The take-up rate by firms is quite small. Only a small percentage of firms that were eligible to claim tax credits under TJTC actually did so. A survey during the early years of the TJTC found that 63 percent of firms had heard of TJTC and 38 percent had used or planned to use the program. Large firms were much more likely to use the program than small firms: 23 percent for firms with more than 100 employees and less than 4 percent for firms with fewer than 50 employees (Wisconsin DHSS and Institute for Poverty Research, 1982). Of the eligible workers hired, firms claimed only 5 to 9 percent (O'Neill, 1982;

Katz, 1998). These estimates are similar to the findings of the reemployment bonus experiment that found that less than 5 percent of firms actually claimed the tax credits to which they were entitled (Spiegelman and Woodbury, 1987).

Categorical Discretionary Wage Subsidies

The on-the-job training program (OJT), which has been an element of each federal employment program since the Manpower Development and Training Act in 1962, is the primary categorical discretionary wage subsidy program. Local or state employment agencies determine the eligibility of firms to claim tax credits. The program is intended to provide training to the economically disadvantaged. Other programs of this type are few in number and are administered mostly by states, such as the Minnesota Employment and Economic Development (MEED) program. The effectiveness of such programs is similar to the results found for the entitlement categorical wage subsidy programs, with the exception that discretionary programs may be less prone to deadweight loss and displacement effects. However, possibly as a result of the discretionary nature of these various programs, there is less agreement among the various studies as to the effectiveness of these programs. Studies have found that businesses participating in OJT and in some state programs generate 2 to 8 new jobs for every ten jobs subsidized. The remaining jobs, from 2 to 8, would already have been available to the disadvantaged, leading to a deadweight loss. Bartik (2001) provides a synthesis of the various studies and concludes that every ten subsidized jobs yield about 5 new jobs, which is slightly higher than the high-end estimate of 4 new jobs for categorical entitlement wage subsidy programs.

Categorical Entitlement Wage Subsidy Programs to Individuals

The Earned Income Tax Credit (EITC) provides wage subsidies through tax credits to low-income families. It is the largest wage subsidy program administered in the US. Most evaluations of the EITC examine changes in the provisions of the wage subsidies on a specific

group potentially eligible for EITC. Since the EITC wage subsidies go to individuals and not firms, the program potentially affects labor supply rather than labor demand. The studies find modest labor supply. Positive effects on the labor supply are largest for single mothers. Several studies estimate that the financial incentives of EITC increases the number of single mothers in the labor force by 170,000 to 405,000. One study attributes half of the substantial increase in employment rates among single mothers over the 1984 to 1996 period to the EITC (Meyer and Rosenbaum, 1998). As a point of reference, the number of single mothers doubled between 1985 to 1996 from 1.1 million to 2.2 million. The labor supply of married men is also increased, but by less than for single mothers. On the other hand, the EITC reduces the labor supply of married women, by 161,000 according to some estimates. Furthermore, the EITC appears to do little to encourage the non-working poor to enter the labor force and find employment. Bartik (2001) concludes that EITC affects the labor supply decisions of only 5 percent of the 20 million households that received EITC benefits.

Consequently, the remaining 95 percent of the households view the EITC as a pure wage supplement. Estimates suggest that it has lifted 4.4 million persons from poverty in 1998. The take-up rate of the EITC is relatively high, particularly when compared with the firm-based wage subsidies. Eighty percent of households between 100 and 150 percent of the poverty level receive EITC. The rate is lower for families with other levels of income. Forty percent of households with income less than 50 percent of poverty receive EITC, whereas no one with an income of 300 percent of poverty or greater receives the tax credit.

3.5.6 Employment stability of the workers supported by the program

As mentioned in a previous section, the WOTC, WWTC and OJT contain provisions to encourage employers to retain workers. For example, if employers who have received WOTC and WWTC tax credits are found to abuse the program by not retaining workers for a sufficient length of time, then their future eligibility for these tax credits

may be in jeopardy. Under OJT, it is expected that the employer retain the participant at least 6 months after completing the training. Sanctions are also imposed on employers who abuse the use of the wage subsidies.

Few evaluations of wage subsidy programs have examined the long-run effects of the financial incentives. A study of OJT under the Manpower Demonstration and Training Act (MDTA), which was administered during the 1960s, found some deterioration in the effects of OJT after five years. Earnings were 28 percent lower after five years for participants than they were after one year (Perry, et al., 1975). However, this study provides little insight into the long-run effects of the current wage-subsidy programs, since that program differed from the current wage-subsidy programs and the MDTA program was in effect more than 30 years ago.

3.6 Policy Implication

3.6.1 Implication for future policy direction

Wage subsidies have never gained the broad support necessary for them to be a major component of the U.S. active labor market programs. Although business groups have supported the use of wage subsidies to hire additional workers, they have been reluctant to hire economically disadvantaged workers to the full extent that the programs allow. One could argue that the wage subsidies are not large enough to compensate employers for hiring less-skilled, and thus less-productive workers. Minnesota's MEED program provided subsidies exceeding 80 percent and appeared to generate more jobs than the less generous federal programs. Bartik (2001) estimated that if this program were run at the national level at the same scale that it operated at the state level, it would generate 591,000 new jobs out of 703,000 participants at a cost of \$5.1 billion dollars. This amounts to an average cost of \$8,624 per placement. Unfortunately, the long-run benefits of the program, such as retention rates, skill acquisition, and earnings growth, are not known in order to assess the effectiveness of the

program. In comparison, those economically disadvantaged workers who received federally sponsored training experienced significant gains in earnings of 15 percent over those who did not receive training. In addition, their earnings continued to grow over several years relative to those not receiving training. Furthermore, training costs are less than the subsidy amount per worker. Therefore, one would expect the current trend of de-emphasizing the already small wage subsidy program to employers to continue.

On the other hand, the wage subsidy to low-income workers has grown in popularity. Over the life of the EITC, it has received support from administrations that have been considered liberal and conservative. It is widely supported by those who believe that moving from welfare to work should be rewarded but who also recognize that many low-wage jobs will not support a family. The EITC has also gained support among those who advocate a streamlining of the welfare system, and incorporating this wage supplement in the existing tax system meets that goal. Therefore, one would expect the EITC to maintain its popularity and with a greater number of former welfare recipients having moved into the labor force, the need to shore up their earnings may even increase.

4. Government-supported Job Skill Training Programs⁵⁸

4.1 Background

4.1.1 Historical background of the introduction of job skill training program

Public works programs during the Great Depression of the 1930s included some on-the-job training. Public acceptance of the depression era *New Deal* programs instituted by President Roosevelt grew out of widespread hardship resulting from job loss. Renewed training efforts

58) This section draws heavily on O'Leary and Straits (2000).

thirty years later were greatly influenced by the political struggles fought during President Johnson's *War on Poverty*.

In the 1960s, with the civil rights movement gaining momentum, and the public assistance welfare roles expanding, the unemployed became a focal point. Women workers, blacks, and youth all continued to experience high unemployment rates despite continuing improvements in the economy. The Johnson Administration's War on Poverty was targeted toward racial minorities and youth. A major objective of the resulting legislation was to help the most disadvantaged achieve employability and secure jobs with a living wage. Some lacked work experience, and many had multiple barriers to steady employment. The belief was that the major employment problem of the disadvantaged was their lack of marketable job skills. Consequently it was agreed that the federal government needed to provide a full range of services for the poor including remedial education, occupational skill training, work experience, and counseling.

4.1.2 History of the institutional change of the EI system and job skill training program

Unemployment insurance (UI) programs operate independently of federally funded job skill training programs. For programs started after the great economic depression of the 1930s, Table 4.1 provides a chronology of public job training in the US. The Manpower Development Training Act (MDTA) of 1962 training was viewed as an anti-poverty program, and the federal government took a centralized and categorical approach to eradicating poverty. Funding from the federal government was targeted to specific groups. Funds were available on a formula basis to communities based on population and estimates of the proportion below the poverty income level.

The federal government managed funding through 12 regional offices, each of which supervised activity within four and six states. Often times competing agencies within localities bid against each other for federal funding by submitting separate proposals to regional offices for review. These disparities occurred despite preestablished criteria,

TABLE 4.1 A CHRONOLOGY OF PUBLIC JOB TRAINING IN THE UNITED STATES

Program	Training types	Eligibility	Intergovernmental relations
Manpower Development and Training Act (MDTA), 1962	Institutional and on-the-job training (OJT).	Low income and welfare recipients.	Federal funding granted directly from 12 regional offices to agencies in local areas. Administration and reporting structures similar.
Comprehensive Employment and Training Act (CETA), 1973	On-the-job training, Classroom skill training, Classroom soft training, Work experience in public agencies, and Public Service Employment (PSE)	Training was targeted to low income persons, welfare recipients, and disadvantaged youth.	Federal funding flowed to prime sponsors in substate regions which numbered about 470. Performance monitoring with results reported to the U.S. Department of Labor (USDOL).
Job Training Partnership Act (JTPA), 1982	On-the-job training, Classroom skill training, Classroom soft training, and Work experience in public agencies.	Low income, public assistance recipients, dislocated workers, and disadvantaged youth.	Federal funding through state governors to private industry councils (PICs) in each of 600 service delivery areas. PIC performance reports to governors who reported to USDOL.
Workforce Investment Act (WIA), 1998	On-the-job training, Customized classroom skill training, Classroom soft training, and Work experience in public agencies	Access to core services like job search skills and job referral is unrestricted. Training is targeted to the most difficult to reemploy.	Like JTPA, but PICs now workforce development boards with dominant private sector make-up. Monitoring is minimized.

which included ensuring a “geographically equitable” distribution of the available funds. Congress and the President determined the total amount of funds available through their annual budget negotiations.

The federal effort during the 1960s developed into a piecemeal approach, which reflected the belief that there were divergent needs among the individual groups who were the expected beneficiaries of the myriad of policies. In addition, the political reality resulted in the spreading of functions among many different departments and agencies in the federal government. Each department involved in the distribution received directives from a different piece of legislation. The grants did not interrelate with one another and often were a duplication of effort. The need for coordination at the highest levels became painfully obvious.

During the 1960s, it was not unusual to find communities with similar programs located within a few city blocks of one another targeting services to technically distinct but frequently overlapping groups. For example, a neighborhood center providing services to assist black youth in obtaining employment, and a public school providing employment services to minority youth, could easily overlap and duplicate efforts. The more ingenious clients were often able to receive similar services in more than one agency.

Since cost has always been a primary concern in service delivery, such duplication and waste was an easy target for critics of government involvement in employment policy. Advocates for more assistance argued that unemployment has a long-term cost not only in foregone production for society but also in personal hardship that cannot be easily measured. A common view among program operators was that the federal government promoted solutions, but failed to provide sufficient funding to truly address the problems. More pronounced in the 1960s was recognition at the local level that there were gross inefficiencies due to the categorical nature of programs and the centralized control by the federal government.

The 1970s brought a more comprehensive approach to addressing the problems of the economically disadvantaged. The bureaucratic buzz words "de-categorize" and "de-centralize" became the theme of the decade. Decentralization meant the transfer of authority from federal to state and local government. Authority given was defined in the legislation and regulations, it often included the responsibility for designing, implementing and to some extent, evaluating program activities. De-categorization meant that federal appropriations were no longer earmarked for specific programs. A local determination could be made after analyzing the needs of the disadvantaged population.

In addition, the Comprehensive Employment and Training Act (CETA) of 1973 introduced the concept of a local advisory board to assure that local public interest would guide program planning. The council membership and role were established in the regulations, and in some localities representation was "guaranteed" for constituencies such

as the education and labor organizations. As it turned out, advisory councils evolved differently across the country. Some were merely “rubber stamps” while others had a significant role that included on-site monitoring and local policy development. The worst-case scenarios occurred when council members took advantage of their position and provided funding to preferred organizations.

The arrival of the Reagan administration in 1981 came with a “conservative challenge on the principles, policies and programs of the liberal tradition of federal activism in economic and social affairs as it evolved in the half of the century starting with the new deal.”⁵⁹ A major objective of Reagan-era legislation was to increase earnings and employment as well as decrease welfare dependency. Classroom skill training was identified as a major weakness of existing programs, since it was often not the kind of training desired by local employers. For example, critics cited the training of welders in areas where there were no job openings for welders. Historically, the type of training was determined by the client and was not always in occupations with high labor demand and a career ladder in the local market.

The Job Training Partnership Act (JTPA) of 1982 recommended limiting training choices to skills that were in demand by local employers. JTPA also increased the private sector share of members on the advisory committees to ensure that their interests were taken into consideration. By 1982 CETA type public service employment programs were considered tabu because they were expensive and the media had extensively documented instances of fraud and abuse. More important to shaping employment policy were the large and growing federal budget and foreign trade deficits. These concerns created a policy environment ripe for a conservative swing.

It was the involvement of the private sector that promised to make a major difference in the lives of the poor by providing access to jobs that existed in local areas. While there have been many employers who have hired clients from the program, most individuals on these

59) Palmer (1983) p. 9.

boards either have a personal commitment to helping the poor or their company considers it a corporate responsibility to volunteer. Seldom did advisory board members themselves recruit employees from among those enrolled in the program.

4.2 Current Labor Market Policy Framework

The natural evolution of programs seemed to call for a range of services and programs based on individual needs. Careful assessment and a holistic, family-centered case management approach were the logical next steps, particularly if complemented by what had been learned about locally designed programs, driven by the local labor market and supported by the local private sector. However, economic conditions of the mid-1990s had improved to the point where full employment existed in most of the US.

4.2.1 Legislative and policy stance on human resource development

The Workforce Investment Act (WIA), signed into law on August 7, 1998, includes many of the political characteristics that are in the 1996 welfare reform legislation known as the Personal Responsibility and Work Opportunity Act (PRWORA). WIA reformed federal job training programs and created a new comprehensive workforce investment system. The reformed system is intended to be customer focused, to help individuals access the tools they need to manage their careers through information and high quality services, and to help employers find skilled workers. WIA embodies seven key principles:

- Streamlining services through a one-stop system. Programs and providers will co-locate, coordinate and integrate activities and information.
- Empowering job seekers through Individual Training Accounts (vouchers) and centralized information on job seeking, skills, education and related materials.
- Unrestricted universal access to core employment services is available to all job seekers.

- Increased accountability monitored through performance indicators for both state and local entities managing the workforce investment system. Performance indicators include entered employment and job retention rates.
- Strong role for the workforce investment boards and the private sector, with local, business-led boards acting as “boards of directors” focusing on strategic planning, policy development and oversight.
- Increased flexibility for the states and local workforce boards.
- Improved youth programs that link with community youth programs and recognize local labor market needs.

The success of the new workforce investment system depends on the development of true partnerships and honest collaboration among all stakeholders.

As was the case for previous employment policy legislation, WIA was achieved through legislative compromise. This time the political consensus was that entitlement programs were not working, taxes were too high, and low unemployment meant that anyone who really wanted to work could find a job.

At sub-state levels, a reduction in funding and the anticipated problems that will result when clients begin exhausting their TANF time limits has resulted in a new urgency for collaboration. There have been significant movements toward one-stop centers where clients can get access to a comprehensive list of employment services. Nevertheless, these services are often provided in a self-service environment with minimal staff intervention. Such an approach may be fine for many job seekers, but unfortunately for most welfare recipients individual attention seems to matter.

4.2.2 Program development in the transition to a knowledge-based economy and the information society

The change from JTPA to WIA happened in 1998, during the boom of the internet revolution. Several features of the WIA system

were possible because of reliance on the internet. WIA required that each workforce investment area establish at least one physical one-stop center. In practice much of the linkage is achieved through the electronic connections provided by internet web sites and electronic-mail.

Certain competitive aspects of the market for publicly financed training are practical because of the internet. Listings of eligible training institutions, their training offerings, and performance ratings on the value of services delivered to prior customers are posted on the web. Naturally, computer skills including internet software have also become types of training in demand by employers and by job seekers.

4.3 Institutional Arrangements for Government-supported Job Skill Training

The Workforce Investment Act (WIA) of 1998 emphasizes the integration and coordination of employment services. Central to achieving this aim is the federal requirement that local areas receiving WIA funding must establish one-stop centers, where providers of various employment services within a local labor market are assembled in one location. This arrangement is expected to coordinate and streamline the delivery of employment-related programs and to meet the needs of both job seekers and employers more effectively than did the previous arrangement.

Successful implementation of the one-stop system requires new management tools and techniques to help staff meet the challenges presented by the one-stop environment. A major challenge is the large volume of customers expected to use the system. Increased use of services is expected because of a reduced emphasis on program eligibility as a condition for participation in the workforce investment system. Nonetheless, resources for comprehensive assessment and counseling are limited, and front-line staff has few tools with which to help them make decisions.

A prime challenge for front-line staff is to determine which set of

services best meets the needs of customers who enter a one-stop center, and to do this in a consistent, rational, and effective manner. However, not all one-stop center staff may have sufficient experience to make informed decisions for clients participating in the wide variety of programs offered at one-stop centers. The coordination of services under the new one-stop arrangement now requires staff to serve customers with various backgrounds, whereas prior to the creation of one-stop centers, staff typically concentrated in a single program area and saw clients with similar barriers. An additional complication is the emphasis that WIA places on performance outcomes and accountability. WIA requires that program success be measured by employment, earnings, job retention, and knowledge or skill attainment.

4.3.1 Kind of programs supported by government

As mandated by WIA, one-stop centers provide a central physical location for the provision of services offered by federal and state employment programs. WIA requires that the following programs be included: Unemployment Insurance, Employment Service, Dislocated Worker and Youth Training, Welfare-to-Work, Veterans Employment and Training Programs, Adult Education, Postsecondary Vocational Education, Vocational Rehabilitation, Title V of the Older Americans Act, and Trade Adjustment Assistance. Other programs may also be included under the one-stop center's umbrella of services. One-stop centers are designed to serve customers within local Workforce Investment Areas, which usually encompass the population of one or more counties within a state. Workforce Investment Areas with large populations or which span a large geographical area may choose to establish several one-stop centers. WIA required that each state develop a system of one-stop centers that would be fully operational by July 2000. Most states met this target date.

Services provided by the one-stop centers are divided into three levels: core, intensive, and training. Services within each level are characterized by the amount of staff involvement and the extent to which customers can access the service independently. Core services

typically have the broadest access and the least staff involvement of the three categories. Many core services are accessible on a self-serve basis.

Intensive services, the next level of services within a one-stop center, require a greater level of staff involvement and access is more restricted than for core services. Services within the intensive category include individual and group counseling, case management, aptitude and skill proficiency testing, job finding clubs, creation of a job search plan, and career planning.

Training services, the third and final level of services offered by one-stop centers, use staff most intensively and are open to customers only through referrals. One-stop centers typically contract with organizations outside the centers to provide these services. Included in this set of services is adult basic skills education, on-the-job-training (OJT), work experience, and occupational skills training.

4.3.2 Eligibility conditions for each program

All adult job seekers, 18 years and older, can access core services, which include assessment interviews, resume workshops, labor market information, and interviews for referral to other services. Core services may be available in a one-stop center on a self-service basis; others may require staff intervention.

Intensive services generally require staff intervention and are provided to one-stop center clients who fail to gain reemployment through core services only.

Training services are the most intensive reemployment service. Participation in training is not restricted to any particular demographic, income, or dislocated group. In principle, federally subsidized training through WIA is available to any job seeker who demonstrates that core and intensive services are insufficient to gain regular employment.

Priority for intensive and training services must be given to recipients of public assistance and other low-income individuals where funds are limited. In addition to unemployed adults, employed adults may be served if they are in need of services to obtain or retain employment that allows for self-sufficiency. State and local areas are

responsible for establishing procedures for applying the priority and self-sufficiency requirements.

4.3.3 Selection process of participants

In practice, local workforce development areas have their own systems for selection and referral. In most cases these procedures are informal. They are usually based on the expertise of the frontline staff worker providing supporting the service choice. Such recommendations can vary greatly among staff. An effort is underway to develop a formal and systematic service referral system based on statistical analysis about what services work best for different types of job seekers. WIA differs from JTPA and other previous federal employment program in that it offers nearly universal access to services. Core services and many intensive services are accessible to most people of would like such services. A person who desires training, on the other hand, must obtain the approval of the local staff. Limited resources are available to fund training, so only those who are seen as benefitting most from training are referred to these services.⁶⁰

60) The W.E. Upjohn Institute for Employment Research is working to design, develop, test and implement a Frontline Decision Support System (FDSS) in pilot sites within the states of Georgia and Washington. The FDSS is a set of administrative tools that is being developed to help front-line staff successfully perform their duties within one-stop centers. The goal of these tools is to assist staff in quickly assessing the needs of customers and in referring customers to services that best meet their needs. FDSS includes new tools to: 1) help customers conduct a systematic search for jobs that offer the best match and to set a realistic wage goal, and 2) assist staff in determining which one-stop center services are likely to be effective in meeting the needs of specific customers in becoming employed.

Georgia and Washington were chosen because they offer an opportunity to demonstrate the adaptability and capability of the FDSS within different one-stop center operating environments. Recognizing that the computer operating systems for the one-stop centers vary among states, FDSS is being designed so that states can easily integrate the decision tools into their specific platforms. The FDSS tools are designed to be used within the data retrieval and display systems being implemented by the states for their one-stop centers. These tools will be flexible so as to permit interface with a variety of operating systems for one-stop centers.

WIA services intersect with public assistance. Welfare to work programs are partners in one-stop centers. All new applicants for public assistance and all current recipients are assessed to determine if any of the exempt classifications apply. If not, the individual is referred to a Work First service provider. Once referred to Work First the individual must participate in work and/or job seeking activities for at least 25 hours a week until they stop receiving benefits. Failure to participate in job seeking activity or work is grounds for reduction or loss of public assistance payments.

4.3.4 Benefits

The main benefit of training is acquisition of the skills provided. The various types of training financed by federal programs are listed in the next section. However, some job seekers are eligible for cash UI benefits while participating in certain training programs. The prior earnings and hours requirements for UI are discussed above. Continuing eligibility conditions for UI require that beneficiaries be able, available, actively seeking work, and that they do not refuse suitable work.

With establishment of publicly funded training under MTDA in the 1960s, several states adopted provisions permitting UI beneficiaries in approved training programs to continue receiving benefits even though they were temporarily unavailable for work. In 1970 federal UI law was changed to permit UI receipt during participation in training approved by a state commissioner of employment security. "Generally, the states have approved only vocational and basic education training. As of 1990, four states may require claimants to accept training as a condition for benefit eligibility; elsewhere, acceptance of training is voluntary." (Blaustein, 1993, pp. 287-288)

4.3.5 Job skill training provided by each program

Once eligibility is satisfied, regulations establish allowable activities.

TABLE 4.2 A TAXONOMY OF TRAINING TYPES

Training for reemployment usually refers to short term job skill training to increase readiness for local job vacancies. Skill training is intended to address unemployment which is due to a structural mismatch between job seekers and job vacancies.

Skill training

Provided in group setting is called **institutional** or **classroom** and may concern skills in general demand or it may be **customized** to fill the request for an employer with available job slots.

Alternatively, skill training may be chosen by the participant from courses available at established training or educational institutions (**vouchers**).

Skill training may also be provided in an experiential private sector workplace setting through on-the-job training (**OJT**).

When OJT is provided through a public agency it is sometimes called **work experience**.

Remedial Training

General training which seeks to remedy basic gaps in reading and mathematics skills to make job seekers ready for skill training. This is often provided through local school districts with funding from federal, state and local sources.

Classroom soft training

Provides knowledge about work place behavior skills or job search skills.

Public Service Employment (PSE)

PSE was most recently available in the United States under the Comprehensive Employment and Training Act (CETA), 1973. It involves work experience on public services or works projects. It may provide some skill training, but the main aim is income transfer and arresting deterioration of work place behaviors due to prolonged unemployment.

Table 4.2 provides a taxonomy of training types. The main training activities under WIA are:

- **Unsubsidized Employment** - This is the ultimate goal of all activities, and it is encouraged from the beginning since it is believed by some that the sooner it is accomplished the lower the cost.
- **Subsidized Private Sector Employment** - The individual is an employee of a private sector employer.
- **Subsidized Public Sector Employment** - The individual is an employee of a public sector employer. The wages are supported

by grant funds.

- **Work Experience Program** - An unpaid training assignment for individuals who lack previous employment experience and/or job readiness and who are, therefore, difficult to place in unsubsidized employment. The goal of work experience is to improve skills, attitudes and general employability of these individuals.
- **On-the-Job Training** - The individual is an employee of the employer and training is conducted on the job. Reimbursement of the extraordinary training cost is provided to the employer with grant funds. The employee is expected to retain employment with the employer.
- **Job Search and Job Readiness Assistance** - Activities that help participants become familiar with general workplace expectations and learn behavior and attitudes necessary to compete successfully in the labor market. Job search includes job clubs, counseling, and job seeking skills training.
- **Community Service Program** - Community Service Programs are projects that serve a useful purpose for the community or the public interest in fields such as health, education, urban and rural development, welfare, recreation, public facilities, public safety, and other purposes identified by the State. The Community Service Program must comply with the minimum wage requirements and other laws related to employment.
- **Post-Employment Training (Vocational Education)** - Post-employment training is defined as an occupational training component that may combine classroom, laboratory and other related activities, and which is directly related to a specific occupational field or specific job.
- **Job Skills Training** - This is a classroom activity for recipients who have a specific barrier to employment opportunities resulting from an identified need for skill training. The skills being taught must be in demand by local employers. This is only for recipients who have received a high school diploma or

equivalency. Example: English as a second language, remedial education, basic math.

- **Education directly related to employment** - This is a classroom activity (a non-occupational training activity) for recipients who have received a high school diploma.

Supportive services may also be provided. These include help with child care, transportation, and other personal matters including counseling for domestic relations or substance abuse.

Youth programs include basic skills training with a workplace context and integrated with occupational skills testing, tutoring and study skills training, alternative high school services, instruction leading to high school completion or the equivalent, mentoring, limited internships in the private sector, training and education combined with community and youth service opportunities in public agencies, non-profit agencies and other appropriate agencies, entry-level employment experience, school-to-work transition services, school-to-postsecondary transition services, school-to-apprenticeship transition services, pre-employment and work maturity skills training, and support services (included limited needs based cash payments).

4.3.6 Voucher system

Since WIA came into force in July, 2000, all workforce investment areas have issued training vouchers to eligible clients who, in consultation with WIA one-stop staff, may choose their training provider from a list of approved eligible training providers listed on the local WIA area web site. The training voucher system is intended to introduce more competitive market elements into the system, including more choice by training participants. To help inform the training choice, performance information on training providers should be available on the local WIA web site. Training performance information should include job placement rates of trainees who successfully complete the training program.

Prior to training vouchers becoming part of WIA, vouchers were

tried under JTPA in several service delivery areas. A summary of the processes tried was provided by Trutko and Barnow (1999).

Another investigation preceding WIA implementation was a formal research demonstration of training vouchers called the Career Management Account (CMA) demonstration funded by the U.S. Department of Labor and was conducted by Public Policy Associates of East Lansing Michigan (Employment and Training Administration, 1999).

The U.S. Department of Labor has commissioned Mathematica Policy Research, Inc. to do an evaluation of vouchers called the Individual Training Account Experiment. The study design is presented in Perez-Johnson et al. (2000).

4.4 Program Management

4.4.1 Financing

Funds under WIA are allocated to states with governors enjoying much more discretion than they had in prior federal training legislation. This reflects devolution of the federal role to the states. Although a more direct relationship between taxpayers and tax-supported programs has not yet materialized, many believe that the shift to the states presages an eventual shift to local government. Taxpayers may

TABLE 4.3 EMPLOYMENT PROGRAM SPENDING AS A PERCENTAGE OF GDP FOR SELECTED COUNTRIES, 1988

	PLP/GDP	ALP/GDP	ALP/(PLP+ALP)
Austria	16	0.3	14.5
Germany	1.7	1.1	39.5
France	3.7	2.4	38.9
UK	1.9	1.3	39.9
Sweden	1.2	2.6	68.7
US	0.4	0.2	26.3

Notes: PLP : Passive labor programs including UI.

ALP : Active labor programs including training.

GDP : Gross domestic product

Source: Schmid, Reissert, and Bruche (1992).

soon have the opportunity to decide program funding at the local ballot box.

As reported in Table 1.4, federal funding in the US for employment programs other than UI runs about one third the amount spent on all employment programs including UI. As seen in Table 4.3, based on 1988 data, the US tends to have a smaller share of employment program spending in active labor market programs (ALMPs) than does either France, Germany, the UK or Sweden. However, the US share in ALMPs is higher than in Austria. Overall compared to these other five countries, US direct spending on all employment policy is much lower as a proportion of GDP. It should be noted, that the US figures for employment program spending omit the Earned Income Tax Credit, which in recent years has grown to become larger than UI benefit payments each year (Table 1.5).

For program years (PY) 2000 and 2001--\$950 million was allotted by formula to the States and jurisdictions for each program year. The executive budget request to Congress for FY 2002 is \$900 million, \$50 million below the 2001 appropriation.

4.4.2 Contributions of government, employers, employees, and the unemployed

Publicly funded job training programs in the US are financed from general revenues at the discretion of the Congress and the President. As seen in Table 1.4, the level of funding as a percentage of GDP fluctuates over time with the business cycle. Funding generally rises and falls with the level of unemployment.

Since all citizens and businesses contribute to general governmental revenues, all share in the cost of government funded training programs. Unlike the UI system which levies taxes on employers and is self-financing, there is no special government levy to finance the cost of government provided training programs.

Furthermore, UI trust funds have been strongly guarded against attempts to use employer UI tax contributions to finance retraining. Provisions for payment of benefits during commissioner approved

training have been the sole relaxation of the standard, but no UI money has been directly used to finance training.

Since employer UI tax contribution rates are based on prior layoff history, employers find it difficult to accept that unemployment spells, and benefit charges could be prolonged by participation in training. Employers have successfully blocked usage of UI tax contributions directly pay for training, which potentially could provide more skilled workers for competing firms.

4.4.3 Administrative organization

Funds are allotted to the 50 States, District of Columbia, Puerto Rico and outlying areas based on a statutory formula. The States in turn allocate funds to local Workforce Investment Boards (approximately 640), by formula, to administer the program.

4.5 Program Evaluation

There have been some preliminary studies on WIA and PRWORA. However, no rigorous net impact analysis has yet been conducted. What we know is that all states and the District of Columbia have met the overall work participation rate targets for all families in 1998, the first full year of the welfare reform law. We also know that work requirements and welfare time limits have focused attention on hard to serve welfare recipients who experience multiple barriers to employment. The hard to serve include recipients with physical or mental disabilities, substance abuse problems, learning disabilities, and criminal records (ex-offenders). Environmental stresses such as housing instability, extreme poverty, lack of transportation, and care giving responsibilities are also significant barriers to employment. The three preceding federally funded training programs: MDTA, CETA, and JTPA all have been evaluated.

The Workforce Investment Act (WIA) of 1998 created one-stop-shopping centers for reemployment services. Full implementation of the WIA through administrative regulations began in July of 2000. It

will be some time before the effectiveness of the new program emphasis and delivery system can be assessed. A significant feature of the WIA for local areas is the increased private sector control over use of training funds. Workforce Development Boards (WDBs) are to have a significant majority membership from the employer community. Targeting to the most difficult to reemploy and follow-up monitoring of outcomes were retained from JTPA. The new emphasis of the WIA is on “work first.” In other words, a job is the best training. If jobs are not available, training will mostly be customized to serve employers needs, on-the-job training, and short-term training in core skills. Spending on university or college courses for the purpose of completing degree requirements will generally not be funded under the WIA.

Funding under WIA will pass from the federal government to state governors by a formula. The governor will then allocate money to the WDBs by a formula, but will reserve 30 percent for discretionary projects and incentive payments to areas for outstanding performance. The administrative units for WDBs will select WIA activities based on local labor demand, and will award contracts after a bidding process. Under the WIA, the administrative unit for the WDB is prohibited from bidding for or delivering services under the WIA. The state will monitor performance in workforce investment areas, and states will prepare summary reports on monitoring to the federal government. The regional ETA offices will monitor state performance and compliance with federal law in managing WIA activities.

4.5.1 Utilization of job skill training programs by population subgroups⁶¹

Demographic information on participants in federally funded training programs is available from *Training and Employment Report of the Secretary of Labor*, U.S. Department of Labor (2000). The most recent data available in this most up-to-date report refer to program year 1995,

61) This section draws material directly from U.S. Department of Labor (2000).

which spanned the months July 1995 through June 1996. The data refer to the JTPA program, which had much more rigid targeting guidelines and eligibility rules than does WIA. Table 4.4 reports on the demographic characteristics of participants in the three largest JTPA training programs operated in PY 1995.

Adult programs are provided for under Title II-A of the JTPA act, which authorizes job training and related services for economically disadvantaged adults. Some non-disadvantaged adults facing certain barriers to employment may also receive services under Title II-A. At least 65 percent of II-A participants must fall into one of the following categories: 1) deficient in basic literacy or numeracy skills, 2) school dropouts, 3) receiving cash welfare payments, 4) criminal record (ex-offenders), 5) physically or mentally disabled, 6) homeless, or 7) a locally established category approved by a governor. In PY 1995 black participants made up 32 percent and 17 percent were of Hispanic origin, 7 percent were disabled, 41 percent were welfare recipients, and 13 percent were ex-offenders. Overall 67 percent of participants were women.

Year-round services for youth are provided for under JTPA Title II-C to economically disadvantaged young people 14 through 21 years of age who are in school, hard-to-serve youth who are in school, out-of-school youth, hard-to-serve out-of-school youth, and other young people who face barriers to employment. Upon program entry participants' basic skills, occupational skills, prior work experience, employability, interests, aptitudes, and supportive service needs are assessed and a strategy is developed which identifies, employment goals, objectives and appropriate services. In PY 1995 females constituted 58 percent of program participants, 12 percent were very young (ages 14 to 15), 34 percent were black, 24 percent were of Hispanic origin, 12 percent were disabled, and 30 percent were welfare recipients.

Dislocated worker programs were established under Title III of JTPA to provide services to persons who have lost their job for reasons such as mass layoffs or plant closings, and were unlikely to return to their prior industries. In PY 1995 females made up 51 percent of

program participants, 10 percent were over 55 years of age, 11 percent had less than a high school education, 49 percent achieved a high school diploma, 41 percent had some post high school education, 18 percent were black, 9 percent of Hispanic origin, 2 percent were disabled, 64 percent were UI recipients, 8 percent exhausted their UI entitlement, and 14 percent were military veterans.

4.5.2 Number of participants

In PY 1995 there were 336,941 participants in JTPA adult Title II-A programs, 183,148 Youth Title II-B participants, and 266,610 participants in dislocated workers Title III programs.

There were estimated to be about 346,000 adult training participants in PY 2000. In PY 2001, funding level plus carry forward funds will enable States to serve approximately 396,000, an increase of 50,000 participants above the PY 2000 level (U.S. Department of Labor, 2000).

4.5.3 Characteristics of participants: gender, age, education level etc.

Among participants in adult programs under Title II-A of the JTPA, in PY 1995 black participants made up 32 percent and 17 percent were of Hispanic origin, 7 percent were disabled, 41 percent were welfare recipients, and 13 percent were ex-offenders. Overall 67 percent of participants were women.

Participants in year-round services for youth under JTPA Title II-C in PY 1995 females constituted 58 percent of program participants, 12 percent were very young (ages 14 to 15), 34 percent were black, 24 percent of Hispanic origin, 12 percent were disabled, and 30 percent were welfare recipients.

For dislocated worker programs established under Title III of JTPA, in PY 1995 females made up 51 percent of program participants, 10 percent were over 55 years of age, 11 percent had less than a high school education, 49 percent achieved a high school diploma, 41 percent had some post high school education, 18 percent were black, 9 percent of Hispanic origin, 2 percent were disabled, 64 percent were UI

recipients, 8 percent exhausted their UI entitlement, and 14 percent were military veterans.

4.5.4 Impact on the subsequent earnings and employment of participants

This section reports on net impact evaluations of MDTA, CETA and JTPA below. However, Table 4.4 presented gross outcome measures from the JTPA performance monitoring system for PY 1995. These do not indicate the incremental value of JTPA training. Nonetheless, the gross outcomes are interesting benchmarks.

In PY 1995 the entered employment rate was 63 percent for JTPA adult Title II-A programs, 44 percent for Youth Title II-B programs,

TABLE 4.4 CHARACTERISTICS AND OUTCOMES OF JTPA TRAINING PARTICIPANTS, PY 1995

	Adult title II-A	Youth title II-B	Dislocated workers title III
Characteristics			
Number of program participants	336,941	183,148	266,610
Gender: Female (%)	67	58	51
Age: Over 55 (%)	2		10
Age: 14 to 15 (%)		12	
Education: Less than high school (%)			11
Education: High school (%)			49
Education: Post high school (%)			41
Education: College or more (%)			15
Race: Black (%)	32	34	18
Race: Hispanic origin (%)	17	24	9
Race: White (%)	48	38	69
Disabled individual (%)	7	12	2
Welfare recipient (%)	41	30	
Ex-offender (%)	13		
UI recipient (%)			64
UI exhaustee (%)			8
Veteran (%)			14
Outcomes			
Entered employment rate (%)	63	44	72
Average hourly wage (\$)	7.26	5.81	10.20
Cost per entered employment (\$)	7,143		
Cost per positive termination (\$)		3,558	
Cost per participant (\$)			2,050

and 72 percent for dislocated workers Title III programs. For these programs, the average hourly wage at reemployment was \$7.26, \$5.81 and \$10.20 respectively for these programs. The cost per entered employment was \$7,143 for Title II-A, the cost per positive termination was \$3,558 in Title II-B, and the cost per participant was \$2,050 in Title III. For the youth programs, a positive termination included not only employment but also things like completed high school, improved study habits, entered an apprenticeship and so forth.

The Manpower Development Training Act (MDTA) of 1962 was the first federal attempt to help reemployed displaced workers through job skill retraining. The main concern was job loss due to technological change (Leigh, 1990). Between September 1962 and September 1967, 601,000 people were enrolled in retraining programs organized by local areas that received federal grants directly from regional offices of the U.S. Department of Labor. At the time of the major evaluation, 74,000 were still involved in retraining programs and 30 percent had dropped out of training. Among the remainder, 90 percent obtained reemployment during the year after training, and 77 percent were employed at the time of the last follow-up survey (Mangum, 1968, p.81). These gross outcome estimates are not reliable indicators of the program's net impacts. That is, they do not answer the question of how a participant's success differs from otherwise similar non-participants? Matching participant records to Social Security (SS) earning records and drawing an appropriate comparison group from the SS records, Ashenfelter (1978) estimated positive net earnings effects of MDTA for women and zero effects for men. Assuming a 10 percent discount rate, he concluded the training program had a positive net social benefit.

The Comprehensive Employment and Training Act (CETA) of 1973 was the first training program for which the U.S. Department of Labor developed a data base specifically intended for program evaluation (Leigh, 1990, p.10). It was called the Continuous Longitudinal Manpower Survey (CLMS) and contained data on program participants, data on comparison group members drawn from the national labor force survey (Current Population Survey), and

earnings data for all subjects from national social insurance (Social Security) records. Despite the fact that CETA programs were targeted to low-income individuals while the labor force survey represented the nation, evaluation studies were greatly facilitated.

Three main findings emerged from 11 major CETA evaluations (Leigh, 1990, p.11). First, there were no measurable employment or earnings impacts for men. Impacts for women were positive and significant. Second, on-the-job training is usually more effective than classroom training. Finally, the range of impact estimates was quite wide, despite the fact that all analysts used the same CLMS data. It was journalists rather than economists, however, who brought the end to CETA. The public service employment (PSE) component of CETA became a national target for criticism when careless management of funds and enrollment of program ineligible were widely reported. The associated problem of "fiscal substitution," whereby local government agencies replaced regular staff with CETA PSE workers in order to conserve local tax payer money, was estimated by Johnson and Tomola (1977) to increase with the maturity of the program. Problems in CETA PSE increased dramatically after funding for PSE was greatly expanded in 1977 as part of an expansionary federal fiscal policy. The CETA program was not renewed in 1982, its scheduled expiration date (Leigh, 1990, p.7). Even though states gained a role in administration of CETA vis-a-vis MDTA, in the end no states were advocates for continued authorization of CETA.

The Job Training Partnership Act (JTPA) of 1982 was the result of true ideological and partisan compromise. The bill was jointly sponsored by the liberal Democratic Senator Edward Kennedy and the conservative Republican Senator Daniel Quayle. Many features of the bill reflected the compromise. Evaluation was an integral part of the program, which was said to be performance driven through a system of performance standards for participant reemployment rates and earnings. Also of note was the absence of anything remotely resembling public service employment. The performance standards system allowed governors receiving federal JTPA training grants to structure incentive

systems, thereby simplifying relationships with sub-state areas. Ostensibly, they were able to remove politics from the funding process. Governors reserved some allocations for incentive rewards paid to areas achieving high levels of performance. The performance monitoring system changed training program management and intergovernmental relations. It also complicated evaluation of programs by introducing the risk of *creaming* in program assignment.⁶² That is, program managers might select mainly the most able applicants for participation. The result is high observed reemployment rates. Nevertheless, many of the selected program participants may already possess the skills and abilities to get reemployed themselves. By comparing their success to all unemployed, the positive impact on reemployment is high, but comparing their success to others with similar characteristics the program impacts may be much smaller.⁶³ To assure an objective net impact evaluation, Congress authorized a major national evaluation of JTPA based on methods of field experimentation with random assignment of subjects both to training and to comparison groups in 16 sites across the country. Orr et al. (1995, p. 109) report that training provided to economically disadvantaged adults resulted in 11 percent greater earnings for women and 6.7 percent greater earnings for men. For both genders, the earnings gains were mainly due to increases in hours worked. There were positive net benefits to both men and women, and the net benefit to society for both genders was just over \$500 per participant (Orr, et al., 1995, p. 189).

62) The analogy is to milk where the richest part, the cream, floats to the top and can be skimmed off. Creaming is an issue in operating labor market programs because if only the most able people get reemployment assistance, then the benefit to society of the programs is not as great as it might be otherwise. Highly qualified program entrants have a good chance of becoming reemployed even without the services offered in the program, while for less qualified applicants the program services might be the only realistic path to employment.

63) An evaluation of retraining in Hungary found evidence of creaming in referral to services (O'Leary, 1997).

4.5.5 Relative effectiveness of government training program

WIA came into force July 1, 2000 and no net impact evaluations of program effects have yet been done. The previous federally funded training programs MDTA, CETA and JTPA have been evaluated. Since these programs contain elements similar to WIA, their evaluations are informative in understanding the possible effects of WIA.

Ashenfelter (1978) estimated positive net earnings effects of MDTA for women but zero effects for men. Assuming a 10 percent discount rate, he concluded that the training program had a positive net social benefit.

The CMLS of program participants combined with data from the CPS spawned a cottage industry evaluating CETA program effects. Implicitly, all of the studies had a quasi-experimental design. Taken together the wide range of impact estimates from the CETA evaluations found no measurable employment or earnings impacts for men, although impacts for women were positive and significant. The evaluation studies also found on-the-job training to be more effective than classroom training.

The JTPA system continuously monitored gross employment outcomes throughout the eighteen years of program operation. Part way through the program years, the risk of creaming in referral to program participation was mollified by the introduction of an adjustment methodology that relaxed local performance standards in areas of high unemployment and for enrollment sites where high proportions of hard-to-employ clients participated.

Congress authorized a field experiment with random assignment to evaluate JTPA. Subjects were randomly assigned both to training and to comparison groups in 16 sites across the country. The study estimated that among disadvantaged clients JTPA training boosted earnings by 11 percent women and 6.7 percent for men. For both genders the earnings gains were attributable to increased hours worked. The net benefit to society was just over \$500 per participant.

4.5.6 Self-selection bias and net-effect of training⁶⁴

Rigorous net impact evaluation studies of US employment policies date to the 1960s. Because of uncertainties over statistical methodologies and since the policies of interest were costly, large social experiments became a politically accepted mode of evaluation. For example in the years 1967 to 1971, the federal government commissioned a series of large social experiments to study if a negative income tax could replace the existing welfare system for public assistance (Keeley, et al., 1978). These studies resulted in the 1975 establishment of the Earned Income Tax Credit (EITC) (Hoffman and Seidman 1990). The EITC has grown to benefit more than 20 million workers per year at a cost exceeding \$30 billion annually. Mistakes about such policy decisions can be very costly, so evaluation studies must be sound.

Classically designed experiments are the ideal for net impact evaluation. If random assignment is achieved, modelling of behaviour and complex econometric methods are not needed to obtain estimates of the net impact of a program. With large samples randomly assigned to treatment and control groups, observable and unobservable characteristics of the two groups should not differ on average, so that any difference in outcomes may be attributed to the program. Program impact may be measured as the simple difference between the means of the samples of program participants and control group members on outcomes of interest. Because this process is easy to understand, simple unadjusted net impact estimates from field experiments are usually very influential for the purpose of guiding policy.⁶⁵

Naturally, field experiments are not without potential problems. The first type of problem concerns internal validity. Examples include errors in conducting random assignment and inconsistent experimental conditions. Failure in random assignment can lead to lack of

64) This discussion is draws heavily from O'Leary, Nesporova, and Samorodov (2001), pp. 112-114.

65) For examples of employment programs evaluated using a classically designed field experiment, see Decker and O'Leary (1995).

homogeneity across treatment and control groups, inconsistent conditions means that the same treatment was not applied in all cases. The second type of pitfalls is called external validity problems. Time horizon effects can occur when treatment subjects understand that the experimental service is only temporary rather than permanent. Learning effects can take place within a community during the course of an experiment whereby the first enrollees act differently from those enrolled some time after the experiment begins. Hawthorne effects are responses to treatments not due to the content of service, but simply due to the special attention. Displacement effects, which may be the most critical external validity concern, occur when treatment subjects improve their outcome at the expense of others who are not part of the experiment.

When there is non-random assignment to either a program participant group or the comparison group, then statistical methods of correction must be used to offset the selection bias in order to properly estimate the net impact of a program.⁶⁶ Recent surveys of microeconomic evaluations of employment programs conducted by Fay (1996) for OECD member countries and by Meager and Evans (1998) for a selected group of countries emphasize the importance of accounting for *deadweight loss* and *displacement* effects when measuring the impact of the program. With a mixed bag of findings which reveal that the net impact of different Employment programs varies widely from one population subgroup to another, the authors of both surveys argued that *targeting* of services is crucial to maximizing the social dividend from public expenditure on employment programs.⁶⁷

66) Such methods are called *quasi-experimental* because they attempt to mimic statistically the ideal of a true experiment based on random trials (Fay, 1996).

67) That is for the following reasons. When an unemployed person participates in an employment program which does not improve his/her chance of re-employment, there is a *deadweight loss* to society for the expenditure incurred. If a program manager practices creaming in selecting participants for employment programs such that the people supported would have secured employment without the assistance, then a deadweight loss also results. When an employment program participant gains re-employment at the direct expense of an otherwise similar job-

It is crucial to account for displacement and substitution effects when assessing the net social benefits of public programs. However, these factors are irrelevant at the individual level and very difficult to measure at the social level. An evaluation design using a comparison group automatically accounts for possible deadweight loss by comparing employment program participants with otherwise similar non-participants. A subgroup analysis of net impact can help provide a basis for targeting employment programs.

Quasi-experimental evaluations are often done because they are much cheaper and can be done more quickly than classical experiments. They can often be done with existing administrative data which further reduces evaluation costs. This is often the case when there is a “natural experiment,” which is an opportunity presented by a policy change or an economic event. The main problem with quasi-experimental net impact evaluations is to adequately deal with the selection bias. This is a thorny issue which often requires complex statistical techniques to properly address. Such statistical complexity diminishes the policy value of the findings. Also, like experiment-based net impact evaluations, the estimates only provide a snapshot photo at a point in time. This is distinct from the monitoring approach that gives consistent information covering a wide geographic area regularly over time.

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seeker, then *displacement* has occurred. When an employer, either government or private, receives a subsidy to hire a worker who would otherwise have been hired anyway, then *substitution* of employment programs financing for other intended spending has occurred. Johnson and Tomola (1977) provide a clear example of how to estimate the employment effects of fiscal substitution in direct job creation programs. They maintain that the degree of substitution increases as a program matures.

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3

The Adjustment of Canadian Employment Policies to Budgetary and Labor Market Shocks

GING WONG *

1. Introduction

This paper is a Canadian “story” of the transition from the former unemployment insurance (UI) program to the current employment insurance (EI) program. It is an account of how the former system, in light of changed circumstances and salient findings from evaluation research, was deemed ready for change.

There are several aspects to the background and context in which this story unfolds. They are well-known and require little elaboration. Most important is globalization, the emergence of the knowledge-based economy and society (KBES), and the new adjustment challenges these bring in their wake. Globalization is driven by burgeoning global commerce, capital movements and foreign direct investment spurred by trade liberalization. The knowledge-based economy and society is characterized by massive shifts in economic activity from goods to services, accompanied by an urgent need to invest in knowledge, innovation, research and development, and information and communication technologies (ICTs) as essential ingredients to adding value to market transactions and to productivity growth. These, in turn,

* Policy Research Initiative Privy Council Office Government of Canada.

impact directly on the quantity and quality of jobs and changing skill requirements, with obvious implications for education and training. Moreover, these structural transitions in many countries, including Canada, are heightened by the changing demographic structure and composition of the work force. Finally, there are worrisome distributional concerns associated with these transformative changes that include the rise of non-standard employment of various forms as well as the threat of income polarization and, for some individuals, outright marginalization.

Against this backdrop there was a growing perception in the early-to-mid 1990s that policies and programs that had served well in former circumstances might no longer be appropriate. Adapting to the new economic paradigm called for a new, integrated and mutually reinforcing social and economic agenda. As ultimately articulated in HRDC's *Framework for Social Goals in the 21st Century*, this called for a vision in which the overarching goal is high and sustainable quality of life as indicated by: adequate income per capital; employment opportunities; learning opportunities; a healthy, education population; a clean environment; safe places to live and work; economic security for all citizens; healthy, viable communities; and a vibrant civil society. To take account of these mutually reinforcing objectives of economic and social policy, the programs of UI/EI would have to be viewed as unified, complementary components of a coherent social policy system. On the political plane, this was also a time of radical restructuring of the responsibility for labour market policy development and a challenging opportunity to operationalize federal, provincial and community partnerships for the implementation of new policies and programs.

Against this array of changing realities, the ambitious program of evaluation studies in 1993-1995 was a crucial and influential source of evidence for the strategic policy decisions that gave rise to the EI reforms. This is important to recognize as a singular but powerful example of evidence-based policy-making that resulted from a sustained effort to mobilize rigorous evaluative research of what was

working and what was not.

The structure of this paper follows the storyline as sketched above. To set the stage, some policy reflections on the “big picture” changes and challenges are discussed in history and context, supported by analysis and stylised facts on structural changes and labour market adjustment challenges. The current labour market policy framework is then described in its recent evolution, including the role of evaluation in shaping the EI reforms. The final section reflects on the policy implications and continuing challenges.

2. History and Context

2.1 Identifying the Issues – Policy Reflections

Canada initiated a reform of many of its social policies in the 1980s and 1990s. The consensus among observers is that the reforms are deep and substantially reconstructing the social security system. Some would view these reforms as organic rather than planned; others would argue that their defining characteristic is to reduce coverage or access to social programs in a broad assault on universality.

Almost all major social programs in Canada have undergone or are experiencing changes in the transition from the universalist to post-welfare state....The post-welfare model is based on a critique of key social programs – especially UI and welfare – that sees them as costly, inefficient and ineffective. The new model seeks mechanisms that are more effective and better suited to the changing economic, social and political realities of the new century.¹

1) K. Battle (2001) refers to a new model of social policy as “post-welfare state” that is very much an emerging project.

Others have examined the inner logic of the new social policy to assess its social and political consequences. These policy reflections ask whether the new social paradigm threatens to “dis-embed” the postwar economic and social strategy of government – the “embedded liberalism” that combined economic liberalization with a commitment to social protection to contain and socialize the inherent risks and adjustment costs of economic deregulation.² In this view, the recent reforms are not seen to be a blunt instrument that is simply an assault on universality. Rather, this new paradigm represents a new face of economic liberalization in Canada that redefines the traditional approach to economic security, by shifting the balance from a heavy reliance on income transfers and labour standards to other policy instruments, especially investment in human capital. The outstanding political science question here is whether this approach is merely a new means of pursuing traditional social objectives but using policy levers better suited to a new economy, or is a retreat from the postwar commitment to social protection that extended to the entire population?

While the reform process is still unfolding, Canada’s experience of rationalizing its social security system may provide insights on policy choices and consequences of interest to the wider international community. In particular, *lessons distilled from this experience may be relevant to countries where the new context of labour market and related social policies are shaped by fiscal crisis, increased trade and globalization of production, rapid skill-biased technological change, modest growth rates, and labour market outcomes which in various ways give cause for concern.*³

To give substantive meaning to the recent Canadian reforms, however, it should be noted that the existing infrastructure of social programs was shaped by policy decisions made during the 1940s to the 1970s, and especially between 1964 and 1971. In his thoughtful

2) K. Banting (2000).

3) A. Berry (2001) discusses the 1990s context in his introduction to essays that examine labour market policies in Canada and Latin America under economic integration.

contribution to an October 1994 workshop focusing on "Social Policy in a Global Society", a senior government policy advisor summarized the achievements of modern social protection.

During this period [1964-1971], surrounding its centennial year, Canada introduced a number of separate initiatives that, when taken as a whole, established the Canadian version of the welfare state. The ground was laid for a huge expansion of postsecondary education. Helped by federal financing, the provinces set about doubling the university capacity and creating a new system of colleges. The framework for adult training was also put in place at this time. The structure of today's social assistance system was set with the passage of the Canada Assistance Plan (CAP), which provided federal, cost-shared financing for provincial social assistance of CAPs. Extensive reforms were introduced in the area of health and income security for seniors.

"Active manpower policy" was also introduced in Canada at this time. This involved a stronger government role in labour market adjustment, including counselling, training, support for mobility, and community economic development. The Royal Commission on the Status of Women put a new focus on equity in social security programming. Language and multicultural issues moved to centre stage.

At the end of this period, in 1971, there was a major expansion of unemployment insurance. Since then, there has been a paring back in some areas and additions like developmental uses, but the unemployment insurance system today is still fundamentally based on the 1971 reform. In many ways, unemployment insurance became and remains the defining Canadian social security program for adults, going well beyond the usual scope of insurance and into matters like regional development, training, and special benefits like maternity leave. Unemployment insurance represents both the

strengths and vulnerabilities of social security in Canada.

The result of these reforms was a mature welfare state. It provided Canada with the kind of safety net that has been the goal of social policy since the Great Depression, and it made sense for the society and economy that had emerged in postwar Canada.⁴

In one critical aspect, however, this welfare state did not embrace the full employment model of social security as a formula for sustainable social policy. Following Beveridge, the 1943 *Marsh Report on Social Security for Canada* offered a vision of a social security system comprising of three major elements – social insurance programs to protect against wage losses due to unemployment, illness, accident, disability, death, maternity and retirement; national health insurance; and children's allowances to bridge the gap between wages and income needs for families with children to support. Training, employment counselling and placement services were also promoted to support social insurance programs. In this vision, welfare or social assistance would play a limited role since social insurances, re-employment services and children's allowances would cover most income security needs. Sustaining such a social security system depended upon a full employment economy, however, without which (as Marsh wrote) "the social insurances structure would have no solid foundation". The postwar federal government was reluctant to commit itself to the promise of full employment; instead, it would maintain a "high and stable level of employment". That was considered sufficient to secure economic security, the fundamental purpose of the postwar social contract. In its promise of economic security for all, the postwar welfare state was seen as an instrument of social integration and social cohesion, of preserving stability in a country with long-standing and pronounced inter-regional differences.

In the thirty years since 1971, fundamental changes in the

4) P. Hicks (1995), pp. 1-2.

structure of the Canadian economy and society increasingly called into question the efficacy of existing social programming. Selected indicators of macro-level and distributional outcomes show fundamental changes in that period.⁵

- Growth rates of real GDP have declined over the past three decades from around 5 percent to less than 2 percent and show no sign of returning to pre-OPEC levels;
- There has been a significant slowdown in national income growth since the late 1980s despite no change in productivity growth, resulting from the depressed growth in employment and the employment/population ratio;
 - Real family income annual growth fell from 4 to 2 percent, while the annual rate of real individual incomes in constant dollars dropped from 9 percent to practically zero;
 - Families with both parents working almost doubled from 32 to 61 percent, and one-parent families have doubled from 8 to 16 percent;
 - One sign of a substantial change in Canadian social institutions has been the shrinkage in the average size of Canadian families (from 2.834 in 1975 to 2.412 in 1994);⁶
- Employment growth has stagnated since the late 1980s;
- After rising almost without interruption for four decades, the aggregate labour force participation rate fell every year in the first half of the 1990s, down to 65 percent in 1995-98 from its 1989 peak of 68 percent, due mainly to declines among young workers and older males;⁷
 - Men retired earlier in larger numbers, so that the retirement rates at the normal age of over age 65 declined from 26 percent to about 10 percent;

5) *Ibid.*, and G. Picot, A. Heisz (1999), pp.3-4, and Human Resources Development Canada (1994), pp.6-22.

6) For an assessment of trends in Canadian living standards that take into account the shrinking size of Canadian families, see L. Osberg (1997).

7) M. Fortin and P. Fortin (1999), p.12.

- Over 70 percent of the aggregate decline in participation was among youth, especially among students who increasingly stayed in school against the backdrop of youth unemployment rising from 10 to 18 percent;
- The incidence and duration of unemployment have worsened over the period;
 - Average unemployment rates nearly doubled from 5 to 9.4 percent;
 - Average unemployment duration increased from 14 to 22 weeks; and
- Social security spending (not counting seniors benefits) doubled as a percentage of GDP from about 7 to 14 percent. Government spending on social programs has risen much faster than the growth of the economy.

These and other factors exerted mounting pressure on the Canadian welfare state and governments, both federal and provincial, began to act on the criticisms of social programs that have been made. The need to rethink government action was clearly stated in the early 1990s: “there is a growing recognition that our programs were designed in an era that is vastly different from the world we live in today. There are now indications that programs can actually be counterproductive in some cases, and there are doubts that the various programs complement each other effectively. Piecemeal changes to individual programs are not longer good enough”.⁸

Despite this call for comprehensive reforms, most of the social security system built over the decades is still standing at the beginning of the 21st century. But the Canadian social policy infrastructure at the end of the last decade was markedly different from that of 1990. The nature of these changes reflects key concepts shaping post-welfare reforms as developed in Canada. According to an advocate and participant of reform, the new policy framework includes the following considerations:

8) Human Resources Development Canada (1994), p.3.

- broad-based and progressive income-testing replaces demogrants and needs-tested income security programs (but *not* social insurance, nor social, health and employment services);
- attention to alleged unintended work disincentive effects of social programs – e.g., marginal tax rate issues regarding income-tested social benefits, welfare wall;
- attention to interactions and links between social programs and the tax system;
- desire to right the balance between “active” and “passive” social programs, reactive and preventive approaches;
- concern to harmonize federal and provincial social programs, reduce duplication and overlap, and work together;
- concern about the financial sustainability of social programs (e.g., no more federal blank cheques through cost-sharing for social transfers to provinces);
- recognition that there are multiple players (public, private and voluntary sectors) in social policy, and the need to better utilize and combine their resources through partnership;
- increasing recognition that communities have a major role to play on social policy design as well as delivery;
- emphasis on the economic functions of social policy, especially on education and training to ensure a competitive workforce, and in supplying the social infrastructure (e.g., universal health care, education) that will support economic growth and attract a talented workforce; and
- emphasis on the need to measure the outcomes of social policy and on social reporting made available to the public and social advocacy groups.⁹

Many of these policy impulses had roots in earlier years or decades, but their full impact became clear in the 1990s, described by some as “the longest decade”.¹⁰

9) K. Battle (2001), p.196.

10) K. Banting, A. Sharpe and F. St-Hilaire (2001).

The following sections on developments in Canadian UI/EI, wage and employment subsidies, and publicly-supported training and learning elaborate on a number of these themes. Central to the policy debate are growing concerns about how well social programs work. This is the primary question of evaluation. Before undertaking this analysis of detailed changes in these programs, some stylized facts on the changing economy and labour market are introduced to better situate the policy context. This is followed by documentation of main trends in labour force activity and employment outcomes and a description of the current labour market policy framework.

3. Structural Change and Policy Challenges

3.1 Changing Economic, Social and Demographic Structures

In 1996, a Policy Research Committee of senior government officials was created as part of the *Canada - 2005* project by the Privy Council Office to understand the policy environment over the medium term and to begin planning for the next decade. Drawing upon the expertise of twenty-two federal government departments and agencies, a report was prepared for Deputy Ministers on the pressure points arising from economic, demographic and social trends.¹¹

The report considered Canada's social and economic development since World War II as having two distinct periods before and after 1973. The post-war years up to the early 1970s was a period of social and economic progress. Public investment in health, education, and other social capital seemed to support improvements in the economy. The period following the oil price shocks of the 1970s is characterized by two trends: increasing international integration and declining public expectations because of weakening economic performance. Growing unemployment, debt, inflation and the inability to sustain the existing

11) Policy Research Committee (1996).

welfare state were outcomes despite rising taxes.

A series of five complex, underlying forces were identified that influenced the labour market over a range of dimensions. The first three – globalization and North American integration, technological change, and environmental pressures – are mainly international trends that require policy responses while the latter two – demographics and the fiscal context – are domestic forces that are more amenable to proactive policy measures. Some flavour of this diagnostic and its implications for public policy is captured by the following captions from critical pressure points.¹²

As Canada becomes more economically integrated with the United States in recent years, its economic performance has lagged. If this trend continues, our capacity to remain distinct may weaken and our ability to project Canadian independence on the broader global stage may be threatened...

Taking advantage of technological change, especially in the information field, is critical to economic growth. However, it also requires potentially difficult adjustments...

The health and economic impacts of environmental change are worrisome but difficult to predict. Perhaps the greatest risk of low-probability, high-impact events lay in this area...

Over the next decade, Canada's population will grow at less than 1 percent a year, a considerably slower rate than the 1.3 percent experienced between 1970 and 1990. Slower growth is due to a declining national growth rate, which results from an ageing population with a longer life expectancy and weak fertility rates. Net population growth will come to depend primarily on immigration...

Canada's fiscal situation has improved significantly in recent years. Bringing the debt-to-GDP ratio to a sustainable level will require a decision on an appropriate target and continuing

12) *Ibid.*, pp.12-22.

operating surpluses. During this period, the federal government risks losing visibility to citizens and appearing less responsive to demands for tax reductions and new program spending than the U.S. and the provinces.

Certain qualitative dimensions of structural change also have emerged and been noted. One of the major trends in the 1990s is a pervasive sense of economic insecurity and fear of job loss. In public opinion polls conducted by EKOS beginning in 1993, some 60 percent of Canadians said they felt that they had lost all control over their economic future, with this anxiety fluctuating at a high level before dropping to nearly half at the close of the decade.¹³ This public pessimism and insecurity, according to many observers, is related to pronounced qualitative changes going on in the labour market that have reduced employment stability. These range from changes in workforce organization by employers to rely on a smaller core of permanent workers while increasing their use of contingent workers, to changes in the nature of work in which the employment relationship includes non-standard employment and contingent compensation, to demand-deficient unemployment as a consequence of restrictive macro-economic policy.¹⁴

3.2 Recent Labour Force Realities – Aggregate Trends and Relative Outcomes

Three key dimensions of labour market performance – unemployment, employment and job quality – are examined to illustrate Canada's record in recent decades.

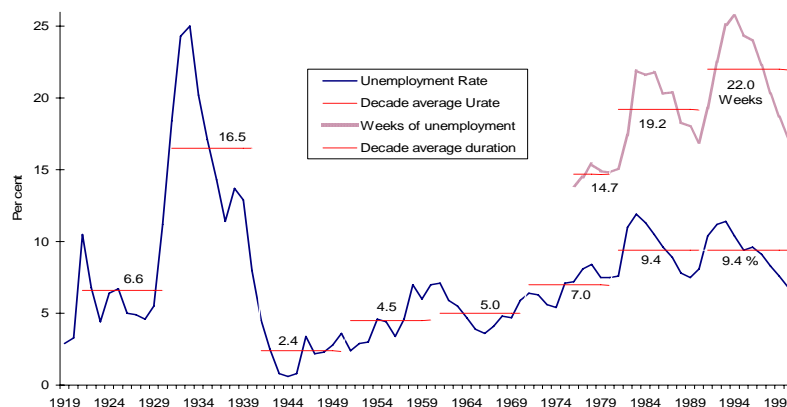
13) F. Graves (2001), pp.67-68.

14) See, for example, the critiques of L. Osberg (1997) and P. Fortin (2001). Fortin suggests that the unemployment price paid to reduce inflation was unusually high because reducing inflation becomes more costly the closer the target rate is to zero, owing to the non-linearities in the long-run Phillips curve associated with nominal wage stickiness.

3.2.1 Unemployment

The last three decades have witnessed substantial increases in the unemployment rate, from 4.7 percent in the 1960s, to 6.7 percent in the 1970s and 9.4 percent in the 1980s and 1990s. In this respect, the labour market performance in the 1980s and 1990s was the worst of the postwar period. Both decades began with sharp recessions, with

FIGURE 1. UNEMPLOYMENT RATE AND DURATION, CANADA, 1919-2000



Source: The unemployment rates from 1919-1945 are calculated annual averages based on data provided by Statistics Canada. These figures are not a perfect fit to post-war data based on the new Labour Force Survey. The 1946-1975 series is drawn from the Historical Statistics of Canada (cat. 11-516.XIE) and the 1976-2000 unemployment rates and durations are reported in the *Labour Force Historical Review* (cat. 71F0004XCB).¹⁵

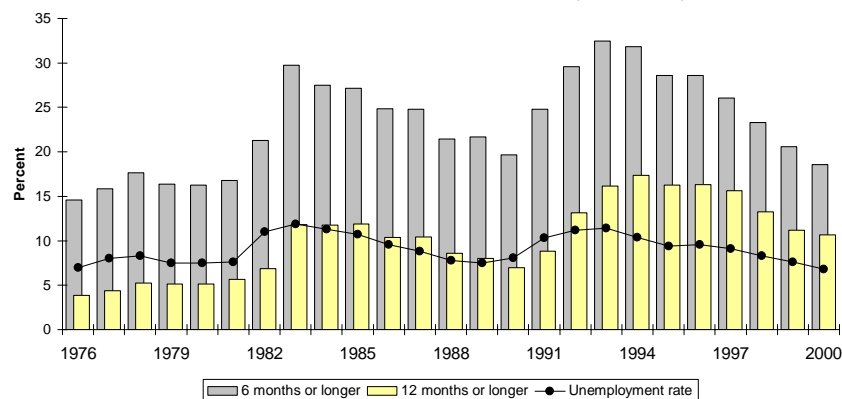
dramatic increases in unemployment, and it was not until the end of each decade that the unemployment rate returned to pre-recession levels. Taking the longer view, there is a pronounced upward secular trend to unemployment rates in the postwar period. Further, if cumulative employment losses were an impact measure of economic

15) See the note by Dave Gower on "The Interwar Labour Database (1919 to 1944)" which accompanied the Excel workbook of the same name (Statistics Canada, catalogue 71F0030XIE). I am grateful to Miles Corak of Statistics Canada for drawing my attention to this data.

downturns, then the recession of the early 1990s ranked second only to the Great Depression.¹⁶

The nature of unemployment also changed. Canadians who lose jobs are out of work longer than before. Unemployment duration averaged 22 weeks during the 1990s, a significant increase from the 19.2 weeks in the 1980s and 14.7 weeks in the 1970s. In 2000, some 10.7 percent of the unemployed were out of work for 12 months or longer, up from 3.9 percent in 1976. If we consider only those unemployed for more than 12 months, the incidence of long-term unemployment increased from 2.5 percent in 1976 to 4.4 percent in 1981, to 7.2 percent in 1991 and reached a peak of 14.8 percent in 1994 before falling to 6.7 percent in 2000. In spite of some declines in recent years, the incidence of long-term unemployment increased almost three-fold from 1976 to 2000.¹⁷

FIGURE 2. INCIDENCE OF LONG-TERM UNEMPLOYMENT, CANADA, 1976-2000



Source: *Labour Force Historical Review*, 2000 (71F0004XCB), calculations by author

There is also a strong correlation between the incidence of long-term unemployment and the aggregate unemployment rate. This means

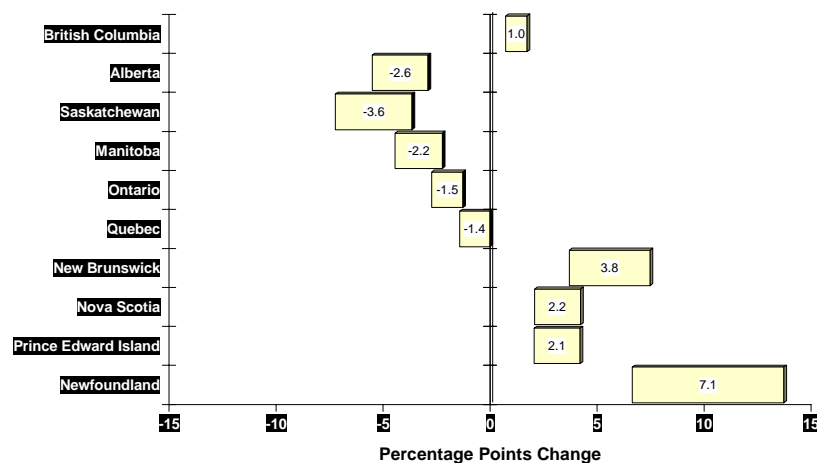
16) See Appendix Table A-1, compiled by P. Fortin (1996).

17) See the detailed profiling of the long-term unemployed in G. Wong, H. Henson and A. Roy (2001).

that in recession the incidence of long-term unemployment increases as the unemployment rate increases. It is also evident from figure 2 that the incidence declines much more slowly than the unemployment rate during the subsequent recovery. Between 1990 and 1993, the Canadian unemployment rate increased by 3 percentage points while long-term unemployment increased by 8 percentage points. In the 1993-96 recovery, the unemployment rate dropped by 1.5 percentage points while the incidence of long-term unemployment remained unchanged.

Figure 3 shows that regional unemployment disparities have worsened.¹⁸ When comparing the change in provincial unemployment rates relative to that of the national average between 1976 and 2000, all four Eastern Atlantic regions and the West coastal region witnessed increases in their relative unemployment position – dramatically for Newfoundland and New Brunswick, substantially for Nova Scotia and Prince Edward Island, and a significant one percentage point increase for British Columbia. By contrast, the prairie regions of Saskatchewan,

FIGURE 3. CHANGES IN PROVINCIAL UNEMPLOYMENT RATE RELATIVE TO NATIONAL AVERAGE, 1976, 2000



Source: *Labour Force Historical Review*, 2000 (71F0004XCB), estimates by author.

18) For an earlier, detailed discussion of relative unemployment, see S. Gera and K. McMullen (1991).

Alberta and Manitoba showed significant decreases in unemployment, and the large population regions of Ontario and Quebec also witnessed below-average unemployment rate changes.

Finally, Table 1 below illustrates the extent of unemployment concentration for different demographic groups, and changes in this concentration over time. Men's unemployment rate was better than the national average at the beginning of the period in 1976 but gradually deteriorated over time until the 1990s when it was above-average. The opposite trend was observed for women.

Among age groups, unemployment rates for the youth group (15-24 years) are substantially higher than average with a spread of 5-6

**TABLE 1. UNEMPLOYMENT RATE BY SELECTED DEMOGRAPHIC GROUPS
RELATIVE TO THE NATIONAL AVERAGE, CANADA, SELECTED
YEARS 1976-2000**

	1976	1981	1986	1991	1996	2000
National unemployment rate	7.0	7.6	(Percent)		9.6	6.8
			(Percentage points)			
Relative unemployment rate ¹⁾						
Sex						
Male	-0.6	-0.5	-0.1	0.6	0.3	0.1
Female	1.1	0.6	0.2	-0.6	-0.3	-0.1
Age						
15-24	5.2	5.1	5.2	5.5	5.7	5.8
25-54	-1.8	-1.7	-1.3	-1.0	-0.9	-1.1
55 and over	-3.1	-3.4	-2.8	-2.7	-2.3	-1.7
Marital status						
Single	4.2	4.1	4.2	4.3	4.7	4.0
Married	-1.8	-2.0	-2.1	-2.0	-2.3	-1.9
Separated/Divorced	1.3	1.1	2.9	2.5	3.1	1.5
Widowed	-1.3	-1.9	-1.3	-0.7	-1.2	-0.9
Educational attainment ²⁾						
0-10 years	0.9	1.7	2.5	5.0	5.3	5.8
11 years to high school graduation	0.1	0.0	0.6	5.0	5.6	5.7
Some post-secondary, less than univ.	-1.3	-1.8	-1.8	-1.1	-0.5	-0.3
University or higher	-3.8	-4.3	-4.8	-5.3	-4.4	-2.9

Notes: 1) Difference between demographic group and national unemployment rates.

2) Educational classifications prior to 1989 are not comparable to those after January 1990

Source: *Labour Force Historical Review*, 2000 (71F0004XCB), estimates by author

percentage points,¹⁹ while the prime age (25-54) and older workers (55 and over) experienced 1–2 percentage points lower unemployment. Over time, the relative unemployment position of older workers deteriorated but was still above-average at the turn of the century.

The story on marital status also shows longstanding unemployment differences. Single Canadians, many of whom are in the youth category, experienced a large 4 + percentage points higher unemployment rates throughout the period. Separated or divorced individuals also fared badly at about half the level of their single counterparts. Married and widowed Canadians consistently experienced lower unemployment rates than the national average.

Perhaps the most striking aggregate trend relates to the educational attainment of the unemployed. Table 1 shows the huge increase in unemployment rates of individuals with high school or less education while those with post-secondary educational qualifications did better than average but only marginally by 2000. Only university graduates observed substantially less unemployment over the period. These findings, however, are not clear-cut as the introduction of changes to the educational attainment questions in the January 1990 Labour Force Survey make the data before and after 1989 difficult to reconcile. While the old distribution can be approximated with the new questions, a break in the series cannot be avoided due to the conceptual differences introduced.

3.2.2 Employment and participation

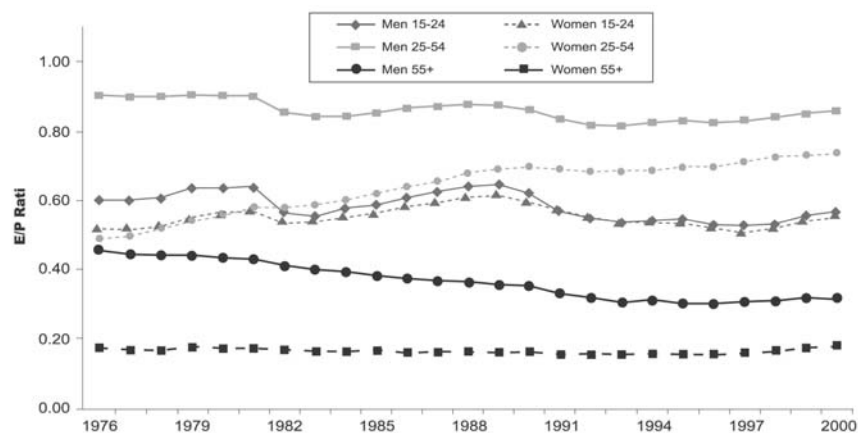
Movements in the unemployment and employment rates are often in lock-step, where a significant rise in trend unemployment usually accompanies a reduction of trend employment rates. Since 1976, the growth of employment has slowed significantly in each subsequent decade, from an annual rate of around 3 percent in the 1970s to 1.8 percent in the 1980s and 1.3 percent in the 1990s.

19) For a fuller discussion on youth unemployment, see M. Gunderson, A. Sharpe and S. Wald (2000).

The long-term trend saw an improvement in the aggregate employment rate from 57.2 percent in 1976 to 61.4 percent. However, employment rates have not evolved uniformly among the different segments of the working-age population. Quite different sex-age trends are observed for employment to population ratios. Employment growth has been strongest for prime-age workers, particularly women. Youth employment levels are still below pre-recession peaks of 1988-89 while there has been a pronounced trend decline in the employment to population ratio of older male workers, which is partly explained by large movements to earlier retirement.

Perhaps the most significant change in employment outcomes during this period was the dramatic fall in the youth participation rate in the 1990s, following strong growth in the previous decades. About 70 percent of the shortfall in the overall participation rate during the 1990s (relative to the 1989 peak) can be attributed to the youth participation rate freefall. Figure 5 shows this trend from a 71 percent participation rate high in 1989 to a 61.5 percent low in 1997 and recovering to 64.4 percent in 2000, following strong economic growth in the years 1997-2000. The reasons for this are well researched and

FIGURE 4. EMPLOYMENT TO POPULATION RATIO BY AGE AND SEX, CANADA, 1976-2000

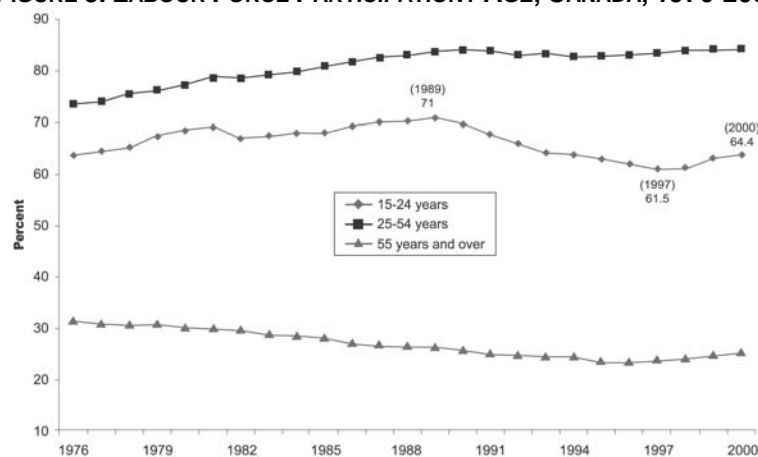


Source: *Labour Force Historical Review*, 2000 (71F0004XCB)

documented.²⁰ The major contributing factor, accounting for 44 percent of the fall in youth participation, has been the upward trend in school attendance between 1989 and 1996, particularly for the 20-24 age group. A decrease in full-time student participation in the labour force accounted for a further 38 percent of the total change in youth participation rate. Separate analyses of the student and non-student participation rates indicate that cyclically weak employment in the 1990s would explain 40-50 percent of the decline. The results further suggest that 50-65 percent of the young people who left the job market because of poor employment prospects went back to school. A closer examination of the reasons why the school enrolment rates rose indicate that most of the variation over the past 25 years, and especially the increases during the 1980s and early 1990s, are associated with the changing size of the school-age cohort.²¹ In other words, demographic change (baby boom vs. baby bust) is a key explanation behind the steep increase in school enrolment rates during this period.

Interestingly, pronounced gender-age differences are observed

FIGURE 5. LABOUR FORCE PARTICIPATION BY AGE, CANADA, 1976-2000



Source: *Labour Force Historical Review*, 2000 (71F0004XCB)

20) P. Jennings (1997) and R. Archambault and L. Grignon (1999).

21) P. Beaudry, T. Lemieux and D. Parent (1999).

when considerations are given to prevailing labour market conditions and perceived net returns to education which incorporate demographic factors. For men 15-19, the main cause for the decline in participation rates appears to be a general deterioration in labour market conditions which is balanced by the additional consideration of perceived net returns to education for men 20-24. For young women of all ages, the main driving force for the decline in participation is the perceived increased net returns to education. These observations suggest that youth labour market policies are likely to improve participation only at the cost of reduced schooling.

For the labour force as a whole, when the employment outcome of two skill groups – the high-school and university educated – is investigated as they enter and work their way through the labour market, the evidence also suggests increasing differences between age groups over time. Younger, less-educated individuals fell behind older individuals with the same level of education.²² This result for high-school educated men is particularly alarming, indicating a future of reduced employment prospects.

3.2.3 Job Quality – Earnings and Job Stability

The cohort-based analysis of employment outcomes provides a cautionary note on the practice of relying only on aggregate indicators. Trends in summary measures describe complex movements occurring simultaneously everywhere across the distribution. While mega-trends give us a clearer sense of direction and orders of magnitudes of change, it is important to recognize their different realities for a heterogeneous population and that there are often ‘winners’ and ‘losers’ in the process of change. The distribution of job quality provides a useful perspective on this, at least in terms of earnings and job stability.

Real wage trends since 1970 have been well documented. A consistent picture has emerged from numerous studies by various authors using different data sources and research strategies. To

22) P. Beaudry and D. Green (2000).

summarize the main facts:²³

- Real wages for men rose through the early 1970s and then declined through the present.
- Real wages for women continued to grow through this entire period but at a more modest rate of increase than before 1975.
- The wage distribution was compressed in the early 1970s but there has been a relatively modest increase in the dispersion of earnings and wages since then, with the gap between high- and low-wage workers widening.

Analyses of Gini coefficients as an overall measure of earnings inequality reveal that there was a small upward shift over time, though the more recent pattern is one of relative stability. Attention, however, is drawn to the fact that aggregate inequality trends are themselves a product of important offsetting trends among different population groups. While average annual earnings as a whole have changed little over the 1980s and 1990s, there have been significant changes in the real and relative earnings of various groups.²⁴ The real earnings of men with low earnings and low skill levels have fallen dramatically. The deterioration of labour market conditions for the young is reflected in the decline in their real and relative earnings through the 1980s and 1990s. The pattern is that of a significant decline during recessions, with no recovery during expansions. Consequently, each successive cohort of young workers entering the labour market over this period has earned less than the previous cohort. This long decline was particularly severe for young men, such that their earnings capacity seems to have permanently eroded during the 1981-82 recession, with no recovery until 1996.²⁵ Modest earnings increases were made

23) This discussion draws heavily on M. Browning, S. Jones and P. Kuhn (1996), pp.8-19.

24) Canadian Business Economics (1997), symposium on income distribution in Canada, especially discussions by Picot, and by Finnie.

25) R. Morissette (2000) and A. Heisz, A. Jackson and G. Picot (2001).

between 1996 and 2000 which did not offset the earlier declines in youth earnings. The one group whose average weekly wages rose as a result of strong economic growth were university-educated youth. Counteracting the long decline in youth earnings have been gains in the real and relative earnings for most groups of women (whose annual earnings are still below those of men), higher-paid men, and older workers.

Changes to the wage structure can be attributed to shifts in labour demand as well as labour supply. Recent research suggests that the kinds of technical innovations made possible by computing power tend to be 'biased' in favour of skilled versus unskilled labour. Such skill-biased technological change played a role in the decreasing demand by manufacturing firms for unskilled, production workers and may help to explain some of the recent decline in real wages of unskilled Canadians, especially men. The link between skills, education and labour market outcomes has therefore become the focus of intense research.²⁶ The data shows steadily increasing demand for skilled labour, along with decreasing demand for less-skilled workers, which seems to support the 'relative demand-shift' theory. It also shows that the growth in the supply of more educated workers exceeded the growth in demand during the 1970s, while skilled labour supply and demand grew at similar rates in the 1980s. As a result, there was only a modest increase in the earnings differential between the more- and less-educated workers, which was in marked contrast with the widening earnings inequality observed in the United States.

Another important dimension of job quality is its permanence or stability. Continued employment allows workers to accumulate job and firm-specific skills, access fringe benefits not offered to contract or temporary workers, and avoid spells of unemployment. The popular view is one of declining long-term employment and rising employment contingency. The evidence, however, suggests a more complicated story in which the trend in job stability observed for 1979-1993 was

26) C. Riddell and A. Sweetman (2000).

reversed in the years 1994-2000.

In the former 1979-1993 period, there has not been a general increased instability of in-progress jobs, at least in terms of higher probabilities of terminations for jobs of all duration. The notable exceptions were with respect to very short jobs, especially for young and low educated workers, and of very long jobs (over 11 years in duration).²⁷ This may be related to increased returns to experience in the Canadian earnings distribution and with claims that firms are moving toward a core of full-term workers and greater use of a contingent workforce of shorter term workers. This polarization of job tenures is confirmed in further analysis of new and currently held jobs from 1976-1999 by Statistics Canada that further revealed a persistent pattern of change within all demographic and industrial groups.²⁸ As such, an economy-wide explanation is plausible: "Increasingly, firms seem to be using a core of long-term employees, leaving more Canadians with less stable jobs".²⁹ In short, the general stability of currently held jobs has remained quite stable over the 1979-1993 period although the distribution of job tenures filled up with more long duration jobs, and more shorter jobs.

The story on job stability was different in the 1990s. Whereas the evidence for the 1980s suggested a "hollowing out" of the job tenure distribution, shifting from medium- to short-term jobs with less than one year retention rate, by 1993 job stability increased as the proportion of shorter-term jobs began to fall. The economy began producing fewer, not more, short-term jobs. In 1991, 55 percent of jobs had an expected retention rate of less than six months; following the weak recovery of 1993-1996, this was down to 48 percent; and between 1997-1999, during strong economic growth, this proportion continued

27) D. Green and C. Riddell (1997), for analysis of the 6 tenure categories ranging from 1-6 months to greater than 20 years reported in the March Labour Force Survey files for 1979-1991.

28) A. Heisz (1996), and A. Heisz and M. Walsh (2001).

29) A. Heisz (1996), p.35.

to fall from 42 percent to 38 percent.³⁰

The explanation for this lies in the quit and layoff rates observed in the 1990s. Typically, in a business cycle framework, quit and layoff rates moved in different directions. During the recessions of 1981-82 and 1991-92, layoff rates rose while workers were less likely to quit. During the recovery and expansion periods in the 1980s, the quit rate increased while layoffs declined. However, during the recovery and expansion cycles of the 1990s, layoffs declined as expected but the quit rates also declined. Diminished turnover from quits then reduced the demand for labour replacement hiring. Therefore, the strong employment growth of the late 1990s was driven more by rising job tenure than rising entry rates from new hires. Overall, the data suggest that labour mobility was low in the 1990s as compared to the 1980s, and may reflect a greater job insecurity and risk aversion in times of significant economic change.

In spite of the recent growth in GDP and paid employment, workers apparently remain cautious about leaving jobs to seek new ones. This suggests they are not responding to changes in economic growth in the same way as they have in past cycles. They appear more reluctant to leave their firms to seek new opportunities. This may well be a reflection of what has been a prolonged period of economic insecurity, and a resulting widespread sense that job stability remains precarious.³¹

3.3 Economic Well-being and Security

Standard measures such as the GDP per capita, labour force participation, employment and unemployment rates are quantity output indicators of economic performance. They are less useful though as measures of the economic well-being of a complex society. A new proposed index of economic well-being is developed by Lars Osberg

30) G. Picot, A. Heisz and A. Nakamura (2000), pp.18-19.

31) G. Picot, A. Heisz and A. Nakamura (2000), p.21.

and Andrew Sharpe that is capturing the attention of policy makers in Canada and elsewhere. This index is based on indices of consumption flows, stocks of wealth (including intergenerational bequest to the next generation), equality and income security.³²

Increasing the economic security of the home population has been a major goal of the welfare state. This is particularly well articulated in Article 25 of the 1948 United Nations' Universal Declaration of Human Rights, where economic security was put forward to be a basic human right.

Everyone has the right to a standard of living adequate for the health and well-being of himself and his family, including food, clothing, housing and medical care and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other loss of livelihood in circumstances beyond his control.

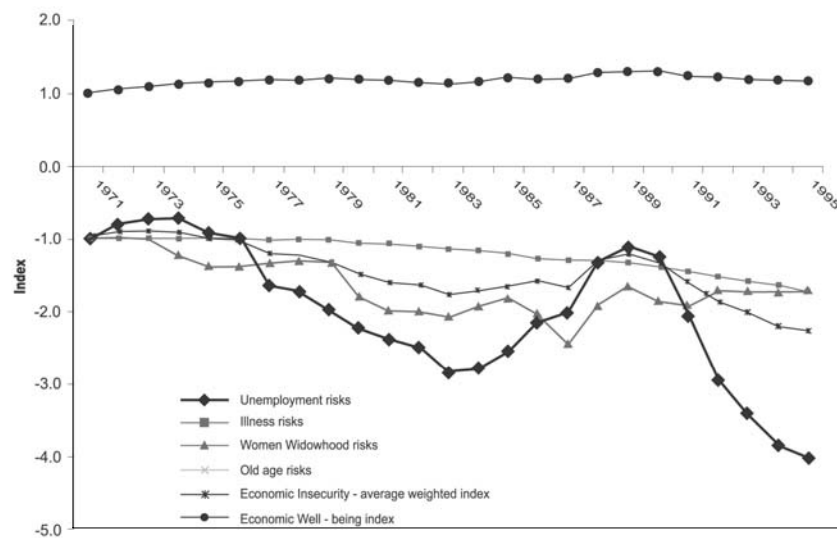
In the Osberg-Sharpe analysis to date, measures have been developed of the percentage change over time in four risks to economic security that are associated with unemployment, illness, widowhood (or single female parenthood) and old age. In each case, models are estimated of the risk of an economic loss associated with the event as a conditional probability and the prevalence of the underlying risk is weighted by the proportion of the population that it affects. "The core hypothesis underlying the measure of economic insecurity proposed here is that changes in the subjective level of anxiety about a lack of economic safety are proportionate to changes in

32) L. Osberg and A. Sharpe (2001) summarizes the extensive work to date. The main conclusion is that there is a divergence between trends in economic well-being and trends in GDP. The implication for social policy is that standard macro-economic measures are poor indicators of how the welfare state is doing in mitigating the extent of economic insecurity and economic inequality – two key dimensions of economic well-being.

objective risk”.³³

In the case of unemployment, the associated economic risk is modelled as the product of the risk of unemployment in the population and the extent to which people are protected from the income risks of unemployment. A measure of changes in the employment rate are used to proxy the risk of unemployment, as changes in the employment to population ratio reflect changes in the unemployment rate and changes in the participation rate, both cyclical and structural. The extent of social insurance protection from the financial impacts of unemployment is modelled as the product of the percentage of the unemployed who claim regular UI benefits, and the percentage of average week wages replaced by UI. Estimates are made for the proportion of the population aged 15-64 in the total population. The results of the economic risks imposed by unemployment in Canada

FIGURE 6. RECENT TRENDS IN ECONOMIC WELL-BEING AND INSECURITY, CANADA, 1971-1995



Source: Osberg and Sharpe (1998).

33) *Ibid.*, p. 29.

from 1971-1995 are illustrated below³⁴.

The results to date give a preliminary indication of trends in economic well-being from a broader perspective than that provided by GDP accounting. The general index of economic well-being showed modest improvement from 1971 until the 1990s, when there was a substantial decrease in economic security with no counterbalancing gain in average consumption.³⁵

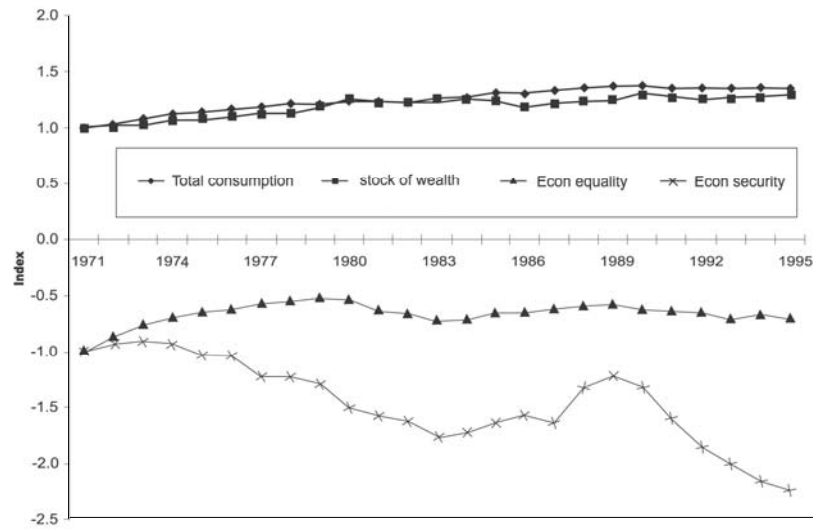
By contrast, the security component of the well-being index worsened from 1971 to 1983 before recovering to the pre-1981 recession levels thereafter. Of the economic security index, the major contributor was the risk imposed by unemployment. Its trend was more volatile and moved downwards more sharply than the trends of economic risks imposed by population illness, single parent (female) poverty, and old age poverty. Specifically, the index of unemployment risk rose 147 percent between 1971 and 1995, with three of the four components of the index contributing to the rise. The participation rate rose 16 percent from 58 percent in 1971 to 68 percent in 1995. The unemployment rate rose 53 percent from 6 percent to 10 percent. The proportion of the unemployed not receiving UI benefits increased 147 percent from 17 percent of the unemployed in 1971 to 42 percent in 1995. Only the proportion of the average weekly wage not replaced by UI showed an improvement, falling from 69 percent to 55 percent from 1971 to 1972, and remaining at that level since.

While one can argue about the inherent difficulties of the theory, construction and interpretation of index numbers,³⁶ the explicit

34) L. Osberg (1998), Appendix A, Tables 5-10.

35) Osberg and Sharpe examined explicitly the sensitivity of their index of economic well-being to the weighting of its components. Generally, the more heavily current average consumption was emphasized, the closer their index came to GDP per capita. Nevertheless, in all sensitivity tests, the consideration of a wider range of issues than those recognized in GDP accounting reduced the measured increase in economic well-being. *Ibid*, p. 35.

36) See for example, Erwin Diewert's research described in R.Harris, D. Laidler and A. Nakamura (1996) that helps position Diewert's index number work in the context of welfare economics and other related literatures. More recent papers that focus

FIGURE 7. TRENDS IN ECONOMIC WELL-BEING, CANADA, 1971-1995

Source: Osberg and Sharpe (1998).

consideration of important components of economic well-being beyond standard GDP accounting provides a better empirical basis for policy thinking. In the period from 1971-1995, measurement (and celebration) of real improvements in average consumption and wealth accumulation in Canada has seen offsets in trend evidence showing growing income inequality and economic insecurity. This supports the view that Canada, while enjoying the benefits of modest economic growth, experienced labour market outcomes that give cause for

much more on the measurement issues of interest here are W. Erwin Diewert, "Comment on CPI Biases", *Business Economics*, Vol. 31:2 (April 1996), pp. 30-35; A. Nakamura and W. E. Diewert, "Can Canada Afford to Spend Less on National Statistics?", *Canadian Business of Economics*, Vol. 4:3, (1996), pp. 33-34; W. Erwin Diewert, "The CPI Commission: Discussion", *American Economic Review*, Vol. 87:2 (May 1997), pp. 95-98; W. Erwin Diewert, "Commentary on Mathew D. Shapiro and David W. Wilcox, "Alternative Strategies for Aggregating Price in the CPI", *The Federal Reserve Bank of St. Louis Review*, Vol. 79:3, (May/June 1997), pp. 127-137; and W. Erwin Diewert, "Index Number Issues in the Consumer Price Index", *The Journal of Economic Perspectives*, Vol. 12:1, (1998), pp. 47-58.

concern.

The question for this paper in particular, and for the conference in general, is what are the policy effects from these changes? When asked to comment on the structural changes that have taken place in Canada, Rebecca Blank suggested four possible policy responses to such a labour market in transition:³⁷

First, there could be expansions of cash assistance and other forms of income support to those people who find themselves earning less and less in the labour market or having less and less access to jobs...

The second policy response is retraining and skill development for displaced and unemployed workers...

The third approach is wage and employment subsidies...

The fourth major policy option is to do nothing.

The next section attempts to describe the Canadian response to Blank's challenge, as viewed through the reforms to Canada's unemployment insurance – now Employment Insurance – system, one of the largest income maintenance entitlement programs.

4. Current Labour Market Policy Framework

The labour market policy framework that evolved in the 1990s was largely set in motion by the Labour Market Development Strategy reform of 1989 and culminated in the 1996 Employment Insurance reform. The emerging policy framework starts from the premise that social policy should facilitate adaptation to economic change by moving away from “passive” income transfers towards “active programs” that can provide a springboard for individual re-employment. To generate a culture that encourages greater individual responsibility, considerations

37) R. Blank (1997), pp.347-349.

of incentive structures are central to policy formulation. In “making work pay”, therefore, access to income benefits increasingly becomes more tightly linked to paid employment as well as to training and lifelong learning as the primary source of security in a knowledge-based society and economy. Such changes to major entitlement programs impact in a large way on community and regional employment outcomes and, therefore, are highly politically sensitive. This has put a premium on creating new governance arrangements that are more inclusive of provincial governments, and the private and third sectors. Finally, in an environment of fiscal restraint, the overall restructuring of social programming must meet the test of “cost-neutrality” (i.e., no additional draw on consolidated revenues) or “cost reduction”.

4.1 Labour Market Development Strategy (1989–1990)

Following the Canadian general election in 1988, policy work began on changes to employment and UI policies to increase the capacity of Canada’s labour force to respond to an increasingly competitive global marketplace in which it was argued that human capital and skills, rather than natural resources, generate value.³⁸ The proposed remedy was to improve productivity through higher technology, product innovation, and enhanced labour force training to change and upgrade skills. The federal level public policy vehicle for this was the 1989-1990 Labour Force Development Strategy, designed to achieve four policy goals:

- More and better private sector training;
- More use of Unemployment Insurance funds for active training and re-employment measures;
- Respond to a Charter of Rights and Freedom challenges about maternity and older workers UI coverage; and
- Reduce work disincentives in the UI program.

38) Employment and Immigration Canada (1989).

Key changes expanded the developmental uses of UI. Since 1977, UI income support had been available to claimants who were eligible for specific re-employment initiatives such as work-sharing, job creation projects and training. The 1989-90 expansion provided authority for regulations to make UI funds more widely available for training, relocation assistance, self-employment assistance, and re-employment incentives. Income benefit periods were extended to 156 weeks from the previous 104 weeks for claimants in approved training programs. As well, UI funds became available for the first time to claimants to cover training course costs, supplementary training allowances such as the care of dependent children and travel costs. The revised UI Act allowed for planned developmental use expenditures to a ceiling of 15 percent of total annual UI expenditures. In 1990, some \$13 billion in benefits were paid while \$800 million was set aside to expand developmental assistance.

By repositioning the “passive” UI benefits to pay for “active” employment programming, and by ending the federal government’s contribution to the UI Account to pay for regional extended benefits, the Labour Force Development Strategy effectively changed the financing terms for employment programming. This completed the shift of the full costs of all UI programming and much of employment programming that was previously financed from consolidated tax revenues to employer and employee premium payers.³⁹ It also signalled the tighter integration of insurance and employment benefits that favoured workers who met UI eligible weeks of work over employable social assistance recipients who were marginally attached and frequently in and out of employment. To address consistent stakeholders’ objections over UI refinancing and targeting of employment programs, the government was required to consult employee and employer organizations, through national and regional labour force development boards, on the cost and design of an annual plan for developmental uses. Sectoral councils for industry human resources planning were also

39) Human Resources Development Canada (2001), Chapter 21 of History of UI.

expanded to encourage private sector training initiatives.

On the insurance benefits side, changes were made to eligibility and duration criteria as well as to incorporate Charter and human rights decisions. On the latter, the legislation introduced 10 weeks of parental leave benefits that could be combined with sickness and maternity for an overall total of 30 weeks of special benefits that could be collected in a single benefit period. It also extended UI coverage to workers older than 65 years of age and to employees of relatives with a standard, arm's length, employment contract. On eligibility and duration, regionally extended benefits were replaced by a one-phase system based on a combination of eligible work weeks and the unemployment rate that comprised the variable entrance requirements established for 62 designated UI economic regions. The intent was to maintain longer benefit durations for people in high unemployment regions, although not at the same rate of benefits. To qualify for benefits, one needed at least 10 weeks of paid, covered employment in the 52 weeks prior to job separation, and the maximum benefit duration was 50 weeks in the high unemployment regions.

Finally, on the issue of work disincentives, the 1989-90 reforms increased penalties for claimants who quit voluntarily without just cause, refused a job or were fired for misconduct. The disqualification period was increased by 7-12 weeks and the 60 percent benefit rate was reduced to 50 percent after the disqualification. The net impact of these changes was an annual estimated savings of \$1.2 billion which were reallocated to pay for expanded benefits and a larger developmental use budget to support the training goals of the Labour Force Development Strategy (LFDS).

In the period of 1991-92, the LFDS policy regime was implemented and, as the recession broadened and deepened, claims processing and control became a greater focus than new program change. In 1993, small but significant changes were introduced to reduce the UI replace rate from 60 to 57 percent of the insurable maximum and totally eliminated benefits for unjustified separations (chiefly voluntary quitters), thereby completing the restrictions on

benefits to the “voluntarily unemployed” initiated in 1989-90. By 1994, however, with the UI Account cumulative deficit of \$5.8 billion and forecasts of an overall government deficit of \$45 billion, the new Liberal government warned that major changes would have to be made in social programs to control expenditures.

UI reforms in 1994 were probably the largest cutbacks since UI was first introduced in 1940. The main replacement rate was further reduced from 57 to 55 percent of insurable earnings, although a provision was added that introduced a dependency rate set at 60 percent for low income (less than \$390/week) UI beneficiaries with dependent children. In addition, minimum entrance requirements to qualify for UI were raised from 10 to 12 weeks of insured employment in the highest unemployment regions, and the weeks of benefit entitlement were reduced by as much as 16 weeks by a change in the benefit calculation formula, by which weeks of work earned weeks of UI coverage.

4.2 Social Security Review and Employment Insurance Reform (1994 -1996)

At the same time, on the broader policy front, the government announced a jobs and growth agenda that was premised on improving social security, fixing the business fundamentals of government spending through a deficit-reduction fiscal policy, and strengthening the performance of the Canadian economy in investment, innovation and trade. As part of this, the minister of Human Resources Development Canada (HRDC) released a discussion paper “Improving Social Security in Canada” that set directions for change and offered a range of options for redesigning federal programs in the areas of working, learning and security. It also provided a framework for a consultative process to obtain advice on the redesign of UI, employment services, and federal support for post-secondary education and social assistance. Three objectives were set for a re-thinking of social programs: helping Canadians to get and keep jobs; supporting

those most in need, especially children living in poverty; and ensuring affordability.

Five pressing UI policy issues were highlighted in the framework discussion paper and became the focal points for the reform debate.⁴⁰

- Growth over time in UI caseloads (especially in repeat use) and expenditures, rising in recessions and failing to drop back to pre-recession levels in recovery, resulting in a persistent upward drift or hysteresis;
- Rising program costs and premium rates impose increasing payroll taxes which, in the short run, discourages job creation (UI premiums represented 42 percent of federal and provincial payroll taxes and are the largest source of federal revenue next to personal income taxes);
- Concern that the UI program rules were being abused both by employers and employees to organize working time to qualify for UI and as supplementary income support that has nothing to do with insurance risks, and that the issues of abuse and repeat use may be linked;
- Concern about other unintended and distortionary program effects on the nature of available employment, perhaps stimulating the growth part-time employment of under 15 hours per week (at the expense of full-time employment) that is exempt from employers' premium contributions; and
- Erosion of worker participation in the UI program, through growth of non-standard employment excluded from UI coverage, that weakens the effectiveness of the UI program as a macroeconomic stabiliser.

What emerged from the Social Security Task Force debate on UI reform in 1994-1995 was a preliminary proposal for a new employment

40) For an insider's view on the deliberations of the Social Security Reform Task Force, see Nakamura's (1995) Presidential Address to the Canadian Economics Association where she outlined a number of the reforms that were subsequently implemented in Bill C-12. See also A. Nakamura and W.E. Diewert (1997), and A. Nakamura, G. Wong and W.E. Diewert (1999).

insurance program that would provide basic insurance for people who use the program infrequently and adjustment insurance for frequent claimants who experience recurring unemployment difficulties. These benefits might be lower than basic insurance, but frequent claimants would also get more active assistance to improve their employability. Such a proposal met with stiff opposition from labour and business groups and the parliamentary committee that reviewed the recommendations rejected the call for an officially two-tiered system.

In the Employment Insurance Act of 1996, the government responded with a more modest but clearly targeted initiatives which balanced more stringent entrance requirements and reduced benefits for repeat users with expanded benefits for part-time workers and low-income families. Taken together, the reform initiatives created a social insurance system that fully integrated two component parts – new insurance or income benefits regulations and active re-employment benefits and support measures.

4.3 EI Part I: Income Benefits

The legislation introduced four core changes to income benefits designed to reduce work disincentives, achieve a greater distributive equity among EI recipients, and made the reinvestment of some EI savings to active measures. The first two of these core changes were vigorously debated by the Task Force, are completely original and not used elsewhere to date.

1. *Hours, not weeks.* A switch from using weeks of work to hours of work as the main unit of account for determining program eligibility, with individual rather than job-based accounting; The hours-based eligibility system gives credit for every hour worked, including overtime, and provides a single universal standard upon which to establish the work history of Canadians, regardless of their rate of pay. As premiums are paid on every dollar earned up to a yearly maximum, the incentive for

employers to limit workers to less than 15 hours of work per week is eliminated. As under the old UI regime, the entrance requirement varies depending on the unemployment rate in the region where the individual lives. In high unemployment areas (above 13%), a minimum of 420 hours (12 weeks x 35 hours) are needed for eligibility. In low unemployment areas (6% and under), 700 hours (20 weeks x 35 hours) are the minimum.

2. *Intensity. Worker side experience rating, implemented in two complementary forms*

- a. The intensity rule as a mild, generally applicable form of experience rating based upon the extent of program past use by unemployed workers, where replacement rates for the repeat users are reduced by 1 percent, up to a maximum of 5 percent, for each 20 weeks of benefits drawn in the past five years. Not counted in determining the weeks of benefits drawn in the past five years are weeks of special benefits, work sharing and other employment benefits.
- b. The experience rating of the benefit clawback for those with high enough earnings in years of benefit claim, with (i) the threshold for benefits clawback (or repayment of benefits) for those with less than 20 weeks of previous benefit receipt over the past five years being lowered from net annual earnings of \$63,570 to \$48,750 and up to 30 percent repayment of benefits above this threshold; and (ii) for those who have used UI more than 20 weeks in the past five years, the clawback begins at \$39,000 and can reach 100 percent recovery for high earners (\$73,000 or more) with over 120 benefit weeks in the five year period. Therefore, with the experience rating of the clawback, the benefit history is taken into consideration when determining the earnings threshold above which the clawback applies and in calculating the clawback amount.

3. *Tighter benefits – earnings relationship.*

- a. Claimants who work while on regular benefits and earn enough to reduce their EI cheque (i.e., above the allowable

Benefit. With the supplement, an individual's total income benefit could reach 80 percent replacement of insured earnings in 2000.

Other changes to income benefits included the following:

- *Premium reductions* based upon reduction of maximum insurable earnings from \$845 to \$750 per week or \$39,000 annual to bring it into line with changes in the average industrial wage. For worker premium payers, the payroll tax reduction in 1996 declined from \$3.00 to \$2.95 per \$100 insurable earnings. For employers, EI premiums were cut from \$4.20 to \$4.13 per \$100 of workers insurable earnings. The legislation also provided for the build-up of a reserve for future recessions.
- *Zero tolerance of EI abuse* with fraud penalties increased, up to three times the benefit rate for workers. There are also increased financial penalties for employers who engage in fraud, up to \$12,000 for each offence. Where the fraud involves employer and employee collusion, employer penalties may be equal to the full value of the fraud.
- *Two phase implementation* in recognition of major structural reforms that fundamentally change benefits eligibility and entitlement determination – July 1996 for incremental changes to the traditional policy levers and January 1997 for the introduction of the hours system, the use of divisor to determine average insured earnings, and the EI top-up of Child Tax Benefits for low-income families. The experience rating provisions were introduced so that everyone in 1996 was grandfathered in with a past usage history of zero benefit weeks. This meant that it was not until 2001 when these changes would have been in full effect, based on actual past benefit histories.

4.4 EI Part II: Employment Benefits and Support Measures

On the employment benefits side, five active re-employment benefits and support measures were introduced as core programs, including targeted wage subsidies, earnings supplementation, job creation partnerships, self-employment assistance, and skills loans and grants. The Act required these Employment Benefits and Support Measures (EBSMs) under EI Part II follow guidelines calling for harmonization with provincial employment initiatives, individuals assuming primary responsibility for securing employment, results-based accountability, local decision-making, and promotion of cooperation and partnership with provincial governments, employers and community-based organizations for delivery of labour market programming. These reforms also opened the way for better integration of the employment benefits and services being provided to EI beneficiaries with those being provided to provincial welfare beneficiaries – a pressing need given the large and growing overlap of the EI and welfare caseloads. The Act also underscored the Prime Minister's November 1995 commitment that the Government of Canada would withdraw from the purchase of labour market training, in recognition of training as an extension of the provincial education system. Purchase of training programs was phased out over a 3-year period ending June 1999.

In response to the federal government's offer to all provinces and territories to enter into bilateral agreements, eleven Labour Market Development Agreements (LMDAs) have been concluded. Alberta, New Brunswick, Manitoba, Quebec, Saskatchewan and the Northwest Territories opted for full devolution or assumption of "full transfer" responsibilities for the design and delivery of active measures. Newfoundland, Nova Scotia, Prince Edward Island, British Columbia and Yukon chose "co-management" agreements to plan, deliver and evaluate active measures jointly with the federal government. The federal government retained oversight responsibility for all EI program expenditures and responsibility for reporting to Parliament on the use

of funds collected through the EI payroll taxes.

4.5 Fiscal Framework

The financial impact of these changes was estimated to be a \$2 billion cut in annual benefits paid at maturity in 2001, including \$100,000 in administrative savings from a streamlined record of employment that must be submitted by employers. The Act provided for EI Part II spending (excluding administration costs) not exceeding a spending ceiling of 0.8 percent of total insurable earnings in any given year. For fiscal year 2000-01, planned spending is \$2.2 billion, of which an estimated \$800 million saved through the changes in the income benefits component of EI were to be reinvested in active re-employment measures. Further, a three-year \$300 million transitional jobs fund was created to generate economic and job development in chronic high unemployment areas.

4.6 Employment Insurance Implementation, Monitoring and Assessment (1996-2001)

In an unusual move, in order to ease public anxieties over the impacts of the UI/EI system overhaul and to provide public accountabilities to parliament, a statutory requirement was made for annual oversight reports to parliament on program use and EI impacts on individuals, communities and the economy, for the years 1996-2001. The Canada Employment Insurance Commission (comprised of the commissioner for labour, commissioner for employers and the deputy head of HRDC) was required to prepare an annual report to be submitted by the end of December to the Minister of HRDC who had 30 working days to table the report in parliament. The intent was to provide real-time EI monitoring and assessment information to assist the government in making mid-course corrections where required.

To date, four annual reports have been tabled and reviewed by the

parliamentary standing committee on human resource development. The fifth, to be tabled in the winter of 2001, will provide a summation of the five-year program and identify outstanding issues that may need to be addressed through additional changes to EI.

5. Evaluation Role and Impact on Policy Formulation (1992–1996)

Policy formation and decisions are informed by a variety of sources and turn on key considerations – the government agenda, a minister's political and policy judgement, timing in the electoral cycle, public interest and citizens input, media attention, stakeholder pressures, federal-provincial relations, availability of resources, bureaucratic politics and analysis being among the most prominent. All these factors, in varying degree, influence reform to major social policies.

5.1 Institutional Constraints

In the case of unemployment insurance, institutional politics have imposed important constraints to limit the ability to introduce major changes.⁴¹ Over the years, the persistence of high structural and seasonal unemployment in Atlantic Canada and large parts of Quebec, and the economic dependence of these regions on UI income support, have strengthened regional political caucuses in lobbying Cabinet to maintain existing UI transfers to individuals living and working in poorer regions. Within Cabinet and the federal bureaucracy, the Department of Finance's capacity to enforce budgetary discipline, as guardian of the fiscal framework and senior economic policy ministry, imposed a further and significant fiscal constraint on HRDC's capacity

41) The politics of reforms, drawing upon interviews with key officials, is superbly analyzed in G. Hale (1998) and a more journalistic account is given in E. Greenspon and A. Wilson-Smith (1996).

to initiate structural reforms that involved drawing down the consolidated revenues fund for social spending. A third institutional constraint was imposed by the broader trend of federal-provincial relations in the 1980s and 1990s toward more decentralized, asymmetric arrangements based on bilateral agreements between the federal government and individual provinces. Considered to be more responsive to local conditions, this was a more flexible vehicle for federal-provincial relations than the national cost-shared programming approach of the 1960s and 1970s.

To “transcend the politics of the status quo”, proposed reforms had to accommodate the institutional constraints. In the 1989 -1990 Labour Force Development Strategy, this meant accommodating Finance’s budgetary constraint by using a cyclical surplus in the UI Account rather than the traditional general government revenues to finance active labour market measures. This change increased the cost of benefits financed by UI premiums by \$2.9 billion or 30 percent in 1990.⁴² When the Social Security Review was launched in 1994, the driving force was the fiscal imperative, reinforced by a \$1.1 billion reduction in the UI training segment of HRDC’s social spending envelope within the consolidated revenue fund. This was repeated in the 1995 budget cycle, so that the plans for the Employment Insurance reforms had to find additional savings from benefit cuts to contribute to short-term deficit reduction and to pay for income and employment benefits restructuring. Finally, Finance embodied a formidable challenge function on a number of micro-policy issues, advocating the desirability of reducing work disincentives and the return to insurance principles while questioning the effectiveness of active labour market measures.⁴³

The government’s parliamentary “UI Caucus” is the second major institutional constraint to structural reform. Members of parliament from regions of chronically high unemployment accounted for about

42) *Ibid.*, p.437.

43) These micro-policy views are captured in Department of Finance papers, notably T. Sargent (1995) on UI disincentives and L. Marchildon (1995) on active employment measures.

half of the government caucus, whether Liberal or Progressive Conservative. In particular, the Atlantic and Quebec caucuses usually formed a cohesive bloc within the governing party which, together with their “regional ministers” in Cabinet, have consistently resisted reform proposals which reallocated regional UI spending, while favouring the protection of “distributive federalism” – the use of federal power to transfer tax revenues and economic opportunity from more prosperous to less prosperous regions of the country – and remedial social programs. In recognition of the blocking power of the UI caucus, employment ministers met regularly with Cabinet and caucus colleagues to discuss reform proposals with them for their political, regional and fiscal implications.

5.2 Preparing the Way: UI Evaluation

Against this backdrop of institutional constraints, new evaluation analyses informed the policy debate in ways that added substantive knowledge on impacts and effects of the UI program and that helped to shape the terms of the institutional accommodations needed to transcend the status quo. It is highly unusual to be able to document the extent to which any policy evaluation analysis is embraced in policy decisions. However, the timeliness, quality and comprehensive nature of the new knowledge generated by the UI evaluations changed the policy debate and helped to frame the EI reforms. This was fully acknowledged by the senior HRDC official responsible for the drafting of Bill C-12 in the following remarks at a 1996 insight conference:⁴⁴

While I can speak with an insider's perspective only on this one experience, I believe one can draw from its broader conclusions....My focus will be how the making of at least this one piece of social policy – the reform of the UI program – was driven by economic principles, theory and analytical

44) N. Smith (1996).

techniques....What was perhaps unique about the current UI reform is the extent to which evaluation results helped shape and support the policy process....The significance of these evaluations lay in the ability to counter social policy mythology with the closest thing to hard facts that anyone could find. In areas as emotional and opinion-laden as the bread and butter issues which lie at the heart of social policy, the ability to lay a fact on the table can go a long way....The process of conversion of the UI program into an EI program (Employment Insurance) has been a case study of how economic imperatives, analytical techniques, and principles can profoundly shape social policy.

The UI evaluation was a wide ranging set of about 25 studies undertaken by a team of academics [and some non-academic researchers] from across the country (and the US)...They extensively mined existing administrative data and broadened the information base both through new surveys and through the creation of a massive integrated research data base. The result was truly impressive and had the added authority of having been conducted at arms length. The perceived objectivity and credibility of academics gave the evaluation results much more weight in the policy debate.

This view has been echoed by some subject-matter experts. “We see the...reform as extraordinary in the Canadian context with respect to the manner in which it was shaped by economic analysis and empirical evidence”⁴⁵ While different fractions in the reform debate disagreed on the reasons for the UI impacts that were analyzed, there was little disagreement about their existence. “Proponents of competing reform approaches often disagreed on *why* the patterns and changes documented in empirical analyses were occurring, but were

45) Nakamura and Diewert (1997).

generally persuaded by the empirical evidence concerning the *existence* of the patterns and changes. This helped focus the debate on solving these problems”.⁴⁶

The broad program of evaluation of UI that began in 1993 provided the crucial information inputs for the process of EI reform. The evaluation was large, ambitious and comprehensive – a thoroughgoing diagnosis of the UI system. Focussing on the impacts of various policy and program parameters, this evaluation involved partnerships with seven universities, Statistics Canada, and scores of experts, both internal and external to government, to produce more than two dozen in-depth studies. Against the background of the momentum developed by the public policy reviews of the 1980s, the objective was to undertake a fundamental examination of the UI system that would produce credible information on program performance. As such it was consciously directed to a policy audience and the results disseminated in order to enrich the public debate.

Using a variety of data sources - including administrative data, the Labour Force Survey (LFS), the Labour Market Activity Survey (LMAS), the Survey of Consumer Finances (SCF), the Family Expenditure Survey (FAMEX), the micro-data from the Luxembourg Income Study (LIS), and a new Canadian Out-of-Employment Panel (COEP) survey – the structure of the evaluation program was designed to address four key sets of concerns which might be summed up as program rationale, impacts and effects, achievement of objectives, and alternatives.⁴⁷ Under *program rationale*, the following major issues were addressed. Why a public UI system? Where and how does UI fit in the broader schema of social security? What is the nature of the balance between income support and work (dis)incentives? How and to what extent does it address the growing phenomenon of non-standard work?

Under *impacts and effects* were a number of considerations including

46) Nakamura and Diewert (2000), p.8.

47) Wong and Roy (1992).

income redistribution, labour supply and demand, patterns of UI use, the effectiveness of UI-subsidized job search, labour market transactions, living standards while unemployed, human capital formation, and geographic mobility.

Third, as far as *achievement of broad objectives* was concerned, the basic evaluation issues were the impacts on temporary income protection, consumption smoothing, and macro-economic stabilization.

Finally, under *alternatives*, the basic questions were the following. Could the system be appropriately improved by means of certain strategic parameter changes? Should there be a fundamental rethinking of UI financing? And, what could usefully be learned from international comparisons?

Before turning to some general findings, a useful heuristic device is to think of the system in terms of a cost-benefit framework. The cost side reflects UI's role in income supplementation and would include such unintended impacts as work disincentives, UI repeat use and dependency, and inequities and anomalies in UI coverage. On the benefit side, UI's role as social insurance would encompass beneficial impacts on income redistribution, consumption smoothing, macroeconomic stabilization, and productive job search.

As far as impacts are concerned, the evaluation program showed that, in general, UI met its social insurance objectives of temporary income replacement and consumption smoothing, was important in reducing income inequality, was an efficient macroeconomic stabilizer over the business cycle, and facilitated job search that yield wage gains. On the other hand, there was strong evidence of work disincentives, misuses of the UI system on the part of both workers and employers, a culture of dependence, and inequities in patterns of usage.

While the UI evaluation may not have been initially designed to support EI reform, its timing was nevertheless such that its preliminary findings were available for the process of social security review, and the final studies constituted a major input to EI reform.⁴⁸ A central feature

48) See the bibliography in this study for a complete listing of UI/EI evaluations,

included close attention to the dissemination of information – internally through “rolling drafts” of key messages and supporting evidence, and externally through some 12,500 sets of evaluation briefs, a series of technical reports that went into second and in some cases third printing, the Internet, and numerous media interviews. Credibility was achieved through resort to an extensive network of experts, and authors were among the expert witnesses who testified to the Parliamentary Standing Committee reviewing the legislative reforms.

5.3 Policy Implications and Challenges

Future proposed reforms will be motivated by considerations similar to those which guided the 1996 EI reforms, and some of which may involve careful trade-offs. There is the public expectation that the EI program will operate in an equitable and fair manner, targets those most in need, is fiscally responsible, efficient and effective, and simple to administer. As a social insurance program, EI income benefits are predicated on risk pooling, not individual risk, providing adequate income replacement that is actuarially sound, with a positive link between premiums and benefits. The intent of the EI reforms will be tested by evidence of actual impacts through the cumulative knowledge of EI monitoring and assessment, including post-EI evaluations. As 2001 is the fifth and final year of EI full implementation, some stock-taking is forthcoming.

As part of the results-based accountability framework for employment benefits, three indicators were introduced into the Labour Market Development Agreements – the number of EI claimants receiving employment benefits returning to employment, the unpaid benefits resulting from return to work, and the proportion of active EI claimants served. Joint federal-provincial evaluations of the Part II active measures to improve the employability of participants are still in

many of which can be accessed through the HRDC Evaluation and Data Development website: http://www11.hrdc-drhc.gc.ca/edd/v_report.report_index.

their formative stages. Effectiveness can only be gauged when formal summative evaluations are completed in the future. Nevertheless, continuing evaluation of incremental effects will continue to be important for a number of reasons. First, it is important to identify anomalies and unintended effects of program design and to test through formative evaluations the varying approaches to program delivery and implementation. Second, the process of administrative devolution to the provinces is still ongoing and it will take time for institutional adaptation to change. There are subtle but important learning effects that are manifested in behavioural adjustments by EI worker clients, employers, administrative staff and other stakeholders. In analytical terms, therefore, it is necessary to distinguish between transitory and permanent effects.

The institutional constraints of the fiscal framework, EI parliamentary caucus and federal-provincial relations will continue to shape future EI reforms. The economic situation in general and the fiscal situation in particular, changed profoundly in the closing years of the twentieth century. The aggregate unemployment rate is at its lowest in many years. Reflecting the overall health of the economy is a much healthier fiscal situation which has redirected public debate about how to use the burgeoning surplus. The kinds of pressures for cost savings that characterized the early 1990s may now be giving way to new and more ambitious considerations of social policy.

In retrospect, however, the politics of social policy reform over a long period of fiscal restraint have left governments with little degrees of freedom to pursue radical, structural changes or big-bang reforms. Instead, the historical record has shown that the dominant style of reform by governments is “relentless incrementalism”, consisting of “strings of reforms, seemingly small and discrete when made, that accumulate to become more than the sum of their parts”.⁴⁹ In the case of the 1994 UI reforms and the 1996 EI reforms, these were larger leaps that redefined social insurance principles and governance

49) K. Battle (2001), p.223.

arrangements for employment program delivery and accountability. Nevertheless, for those who have assessed the policy responses to the changing nature of the labour market, the process of incremental reforms is slow to respond to the challenges.

Clearly, many of the policy changes have been in response to new and changing condition can generally be described as tinkering at the margin, leaving the basic structures intact. While workplace changes are often regarded as transformations, the policy changes are better described as transitions. This may be appropriate if it minimizes policy pendulum swings that give rise to considerable uncertainty and adjustment costs. Nevertheless, the slowness of the policy responses could also reflect the inertia of vested interests and the fact that initial conditions matter – we tend to stay with what we have.⁵⁰

Perhaps this calls for better interaction of researchers and policy makers to create policy relevant knowledge that is dynamic and forward-looking. The story of how one major evaluation has informed the policy debate documents the importance of such evidence-based research. Academic and non-academic research must be supported and sustained in order to monitor and assess workplace changes, and their policy implications, as an important input into the policy process.

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Pre-EI

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Statistical Annex

TABLE A-1. SIZE OF CUMULATIVE EMPLOYMENT LOSSES FROM CANADIAN RECESSIONS SINCE 1929 (POINT-YEARS OF EMPLOYMENT)

Period of Employment loss	Size of loss (point-years)	Rank By size of loss
1929–1942	750	1
1948–1950	9	8
1952–1955	37	5
1957–1964	76	4
1967–1972	28	6
1975–1977	17	7
1982–1986	107	3
1990–1996	225	2

Note: The employment-population ratio is the percentage of the working-age population who have jobs. In the 1929-1942 period, both employment and the population include members of the armed forces. For each recession, the period of employment loss is the period during which the employment-population ratio remains below its pre-recession peak. The cumulative employment loss is the sum, for all years in that period, of the differences between the employment ratio at the previous peak and the actual employment ratios. The employment ratio is forecast at 589 jobs per 1,000 adults in 1996, up from 586 in 1995.

Sources: Fortin (1996), Table 1, compiled from F.H. Leacy (ed.), *Historical Statistics of Canada*, Supply and Services Canada, Ottawa, 1983; and Statistics Canada, *The Labour Force* (Cat. 71-001).

TABLE A-2. EMPLOYMENT TO POPULATION RATIOS BY SEX AND AGE, CANADA, 1976-2000

Both Sex		Males			Females		
Year	Age Group						
	15 +	15-24	25-54	55 +	15-24	25-54	55 +
1976	0.57	0.60	0.90	0.45	0.52	0.49	0.17
1977	0.57	0.60	0.90	0.44	0.51	0.49	0.17
1978	0.57	0.60	0.90	0.44	0.52	0.51	0.16
1979	0.59	0.63	0.90	0.44	0.54	0.54	0.17
1980	0.59	0.63	0.90	0.43	0.56	0.56	0.17
1981	0.60	0.63	0.90	0.43	0.57	0.58	0.17
1982	0.57	0.56	0.85	0.41	0.54	0.58	0.17
1983	0.57	0.55	0.84	0.40	0.54	0.59	0.16
1984	0.58	0.57	0.84	0.39	0.55	0.60	0.16
1985	0.59	0.58	0.85	0.38	0.56	0.62	0.16
1986	0.60	0.60	0.86	0.37	0.58	0.64	0.16
1987	0.61	0.62	0.87	0.36	0.59	0.65	0.16
1988	0.62	0.64	0.88	0.36	0.61	0.67	0.16
1989	0.62	0.64	0.88	0.35	0.62	0.69	0.16
1990	0.62	0.62	0.86	0.35	0.60	0.70	0.16
1991	0.60	0.57	0.84	0.33	0.58	0.69	0.15
1992	0.58	0.54	0.82	0.32	0.55	0.68	0.15
1993	0.58	0.53	0.82	0.30	0.53	0.68	0.15
1994	0.58	0.54	0.82	0.31	0.53	0.69	0.16
1995	0.59	0.54	0.83	0.30	0.53	0.69	0.15
1996	0.58	0.53	0.83	0.30	0.52	0.70	0.15
1997	0.59	0.53	0.84	0.30	0.50	0.71	0.16
1998	0.60	0.53	0.84	0.31	0.52	0.72	0.17
1999	0.61	0.55	0.85	0.31	0.54	0.73	0.17
2000	0.61	0.57	0.86	0.32	0.56	0.74	0.18

Source: Labour Force Survey, Statistics Canada.

TABLE A-3. SUMMARY OF TRENDS IN THE COMPONENTS OF THE INDEX OF ECONOMIC WELL-BEING IN CANADA (AVERAGE ANNUAL RATE OF CHANGE)

	Consumption	Wealth	Equality	Security	Overall index (equal weighting)	GDP Per capita
1971-81	1.91	2.06	0.09	0.63	0.65	2.69
1981-89	1.09	0.25	1.24	1.14	1.00	1.89
1989-99	0.85	1.04	-0.67	-3.03	-0.14	1.13
1989-95	0.42	0.40	-1.03	-4.72	-0.88	0.25
1995-99	1.50	2.01	-0.14	-0.44	0.96	2.45

Source: Osberg and Sharpe (2001), Table 1, p.236.

TABLE A-4. TRENDS IN ECONOMIC SECURITY(AVERAGE ANNUAL RATE OF CHANGE IN UNWEIGHTED SUB-INDEX)

	Unemployment	Illness	Single-parent poverty	Elderly poverty	Overall index
1971-81	2.57	-0.42	-7.48	0.23	0.63
1981-89	4.45	-2.73	-0.70	10.11	1.14
1989-99	-6.94	-2.96	5.21	10.20	-3.03
1989-95	-8.14	-4.12	5.00	16.13	-4.72
1995-99	-5.11	-1.24	5.52	0.52	-0.44

Source: Osberg and Sharpe (2001), Table 5, p. 241.

Annex: Primer on Canadian UI/EI Program

Background

The Employment Insurance (EI), formerly UI, program is a compulsory and contributory social insurance program that provides temporary income replacement benefits to unemployed workers who are unemployed through no fault of their own, actively seeking paid employment or participating in approved employment benefit programs. Benefits are also available to those who are unable to work because of sickness, disability, pregnancy or care of newborn or newly adopted children. Financial assistance may also be provided to insured

participants or organizations, including provincial and territorial governments, under the Employment Benefits and Support Measures provisions, to assist the re-employment of eligible workers.

UI/EI Program Administration

Individuals file an application for benefits with their Social Insurance Number and Record(s) of Employment which are issued by their employer(s) as soon as they stop working, even if they are in receipt of separation money. Filing must be made within four weeks after job separation at any of the some 300 HRDC offices across Canada. Those living in remote areas can file their reports and receive their payments electronically by Teledex and Direct Deposit.

Shortly after filing a claim, claimants receive the first set of report cards to document active job search which covers the first three weeks of the benefit period. Receipt of these report cards indicates application processing but does not guarantee benefits eligibility. Reports must be filed by regular benefits claimants for each subsequent two-week period and no payment for the reporting period is issued unless a report is filed. Such report cards are not required for maternity and parental claims.

There is a two week waiting period when no benefits are paid, that represents the co-insurance obligation of the claimant, similar to the deductible in a commercial insurance policy. If the claim is in order, the claimant receives the first benefit payment within 28 days of the starting date of the claim.

Once a claim is established, claimants are encouraged to help themselves to numerous employment service options. This include self-help kiosks conveniently located in commercial locations that provide labour market information programs, labour exchange on specific job openings posted in the Job Bank. HRDC offices also offer the Electronic Labour Exchange which provides an automated skills-job matching service on the internet. CanWorkNet combines all the above employment services as an internet service accessible to anyone with a

computer and internet connection.

The national employment service is further augmented by community-based partnerships that deliver employment support measures such as employment assistance services, local labour market partnerships, and research and innovation.

Claimants are eligible to be considered for the new active re-employment benefits, including targeted wage subsidies, self-employment assistance, job creation partnerships, targeted earnings supplements and skills loans and grants. In addition to receiving income benefits, eligible individuals must have received income benefits that ended in the past three years (to permit access to active programming targeted at social assistance recipients) or have received maternity or parental benefits within the past five years. Case management is required for claimants who qualify for active re-employment benefits in order to develop an appropriate action plan.

The Employment Insurance (EI) Account is a consolidated specified purpose account (SPA) established within the Consolidated Revenue Fund by the *Employment Insurance Act*, to record transactions related to the EI program. Consolidated SPAs are used mainly where the activities are similar in nature to departmental activities and the transactions do not represent liabilities to third parties but constitute government revenues and expenditures. As such, the operations of the Account are included with the general operations of government, and the cumulative surplus in the Account reduces the national debt. At the same time, the EI Account legally cannot be in deficit nor in surplus over a three-year cycle, without the approval of the Minister of Finance.

4

Job Placement, Unemployment Insurance and Active Labour Market Policy in Germany

Uwe Blien*
Ulrich Walwei*
Heinz Werner*

1. Introduction

The following paper originated from a contribution to an international conference.¹ There was seen to be little literature available in English on job placement, unemployment benefits and the diverse measures of labour market policy in Germany. The IAB therefore decided to revise the original paper. It focuses to a considerable extent on the tasks of the German Federal Employment Service, in other words on job placement, the payment of wage-replacement benefits in the event of unemployment and on the measures of active labour

* Heinz Werner is a senior researcher and Uwe Blien and Ulrich Walwei are senior researchers and heads of department at the Institut für Arbeitsmarkt- und Berufsforschung (Institute for Employment Research – IAB).

1) The original paper was presented by Uwe Blien and Heinz Werner at the International Workshop on the Role of Employment/Unemployment Insurance under New Economic Environment, in Seoul on September 12-13 2001. This workshop was held by the Korea Labor Institute, International Labour Organization and the Friedrich Ebert Foundation. The authors decided to revise the paper for an international readership. Ulrich Walwei kindly agreed to collaborate on considerable parts of the paper.

market policy. Each chapter begins with a theoretical overview of the particular area of activity. This is then followed by the actual description of the area. The final chapter shows some new trends and refers to a number of challenges for evaluation research on labour market policy measures.

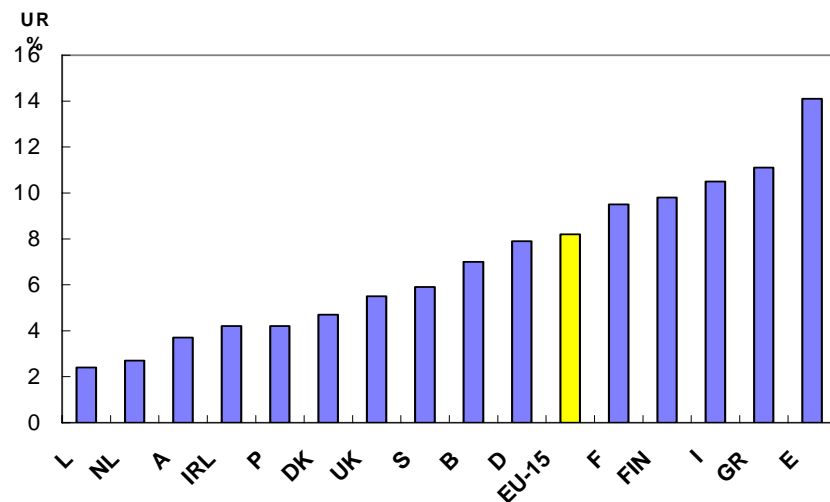
To keep up with current developments the proposals of the Commission “Modern Services on the Labour Market” set up by the Government in 2002 to reform the Public Employment Service are added in the chapter on the German Employment Service.

2. Basic Labour Market Information

Compared with other European countries, Germany has a relatively high rate of people out of work (Figure 1).

The labour market situation in Germany was marked by high, and till 1997 increasing, levels of unemployment. Since then a slight improvement has taken place (Figure 2). In 2000 approximately 3.9m

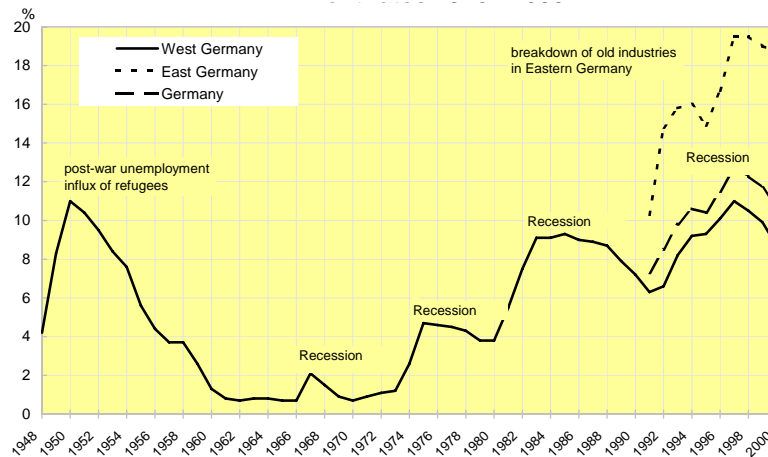
FIGURE 1. UNEMPLOYMENT RATES IN EU-COUNTRIES 2000



Source: Eurostat: Labour Force Survey

people (1997: 4.4m) were registered as unemployed in the annual average. This corresponds to an unemployment rate of 9.6 percent (national definition: registered unemployed related to the civilian labour force; 11.4 percent in 1997).

FIGURE 2. UNEMPLOYMENT RATES 1948-2000



Note: Unemployment rate=registered unemployed in relation to the labour force.

Source: Federal Employment Service (Bundesanstalt für Arbeit).

It can be assumed that there are more potential job-seekers than the registered unemployed people. Participants in certain labour market policy programmes, in particular in training measures, and the people in the so-called “hidden labour force” must also be taken into account. The former group was estimated in 2000 at 0.7m people in employment equivalents. The “hidden labour force” consists of people who are not seeking a job through the employment office and people who are not seeking work at present but who would look for and take up employment if the economic situation improved. There are approximately 1.3m people in this group.

The development of unemployment over the course of time is especially worrying, as even after an economic upswing, unemployment has remained high. During the economic recovery in the late 1980s and

early 1990s, unemployment decreased less than employment increased. As a consequence of the persistent employment crisis a process of selection among the unemployed took place and a hard core of unemployed people has developed. A large proportion of them are long-term unemployed individuals. In addition to the long-term unemployed, hard-core unemployment is also made up of people whose employment is repeatedly interrupted by periods of unemployment. These multiple spells of unemployment - also referred to as “perforated” (long-term) unemployment - do not always receive the same attention as long-term unemployment, even though they can have similar unfavourable consequences on an individual's subsequent career and chances of reintegration into the labour market.

From the point of view of labour market policy, particular attention is to be paid to the “hard core” of the unemployed: multiple spells of unemployment affect in particular young people and male workers with low skills, whereas long-term unemployment is concentrated in Germany more on older workers. It must also be pointed out that the German labour market situation is characterised by considerable regional discrepancies, especially between the western and the eastern parts of the country. Long after unification (1990) unemployment remained high in the east: in 2000 the unemployment rate in western Germany was 7.8 percent whilst the figure in eastern Germany was 17.4 percent.

Nevertheless, since the economy began to recover in 1998, employment performance in Germany has improved. After declining consistently from 1993 to 1997, employment then increased (in 1998 by 1.5 percent in the west and 1 per cent in the east)². Unemployment

2) There have been two significant revisions (in April 1999 and August 2000) to the national accounts data which are the source for total employment data. Four million “marginal workers” (with only a few hours of work per week), who were formerly excluded from the count are now included. This inclusion is in line with international recommendations on labour statistics. The result of the revision is, on the one hand, an increase in the total number of employed and, on the other hand, a reduction in the fall in employment over the 1990s. As a result growth of GDP per person employed, or productivity, is now substantially lower than in former

decreased by 0.5m people and underemployment (“hidden labour force”) by 1.0m. But employment in 2000 was still lower than in the early 1990s. With the onset of the recession the favourable developments came to a halt in 2001/2002.

Finally, it must be said that unemployment in Germany has remained high over the last decade. The goal of full employment has failed to be achieved for more than twenty years. The German recipe for success – relying on technological innovation with a well-trained workforce – is no longer producing positive results for the labour market as it did in the past.³ In order to make the best use of Germany’s substantial human resources, reforms need to slow down the increase in labour costs, enhance product-market competition and strengthen labour market flexibility.⁴ In response to these challenges, changes have to be made and are already being made in German employment policies.

3. The Public Employment Service in Germany

3.1 Functions

In contrast to many other countries, Germany’s state labour market activities are concentrated in one institution: the Federal Employment Service (Bundesanstalt für Arbeit) organises job placement, pays unemployment insurance and implements active labour market policy, e. g. employment and training schemes. The main functions of the Federal Employment Service include:

- placement in jobs and training places. Placement services are an

accounts.

3) According to a new assessment this might at least partly be due to the fact that German industry specialised on segments on the world’s product markets which are characterised by a low rate of technical progress or by an inelastic demand or by both factors (Appelbaum, Schettkat 1993 Schettkat 1997, Möller 2001).

4) OECD (1999, 2000, 2001): Economic Surveys – Germany, Paris. From the IAB see: Walwei, Werner, König (2001).

- integral part of the public employment service;
- administration and payment of unemployment benefit and unemployment assistance;
- the organisation of further training and retraining schemes for job-seekers, the implementation of job-creation and other employment schemes and the distribution of labour market information; and
- vocational guidance.

3.2 Organisational Structure of the Federal Employment Service

The Federal Employment Service is a public institution with administrative autonomy. The legal framework is set by the government. In matters that require no further government regulation, the duties of the Federal Employment Service are organised and carried out by tripartite bodies. Representatives of employees, employers and public institutions serve in the governing bodies. These are the Board of Governors (Verwaltungsrat) and the Executive Board (Vorstand). At the level of regional employment offices, the duties of autonomous administration are handled by Management Committees (Verwaltungsausschuss). The public employment service has three categories of offices: 181 local employment offices (Arbeitsämter, with about 660 branch offices), 10 regional employment offices (Landesarbeitsämter) and the head office (Hauptstelle) in Nuremberg. A staff of about 90,000 people is employed by the Federal Employment Service.

As of 27 March 2002 the management of the Federal Employment Service now consists of a newly-created three-person Executive Board, which was appointed by the Federal Government. The chairperson of this Executive Board sets the guidelines for the management. The Board of Governors, whose members have been reduced in number considerably, acts as a self-government committee.

Furthermore the Federal Government has set up a commission,

“Modern Services on the Labour Market”. The members of this commission were appointed by the Federal Government. In August 2002 this commission submitted proposals for a comprehensive reform of the future distribution of functions, a new organisational structure and an implementation concept.

The major proposals are examined below.

One of the centrepieces of the commission’s report is the transformation of the local employment offices into jobcentres. All functions relating to jobseeking will be integrated into these jobcentres, including counselling and advisory services and some elements of social services.

In order to speed up placement, procedures within the local employment offices will be streamlined and the ratio of applicants to placement offices improved. Local employment office staff will receive bonuses for reaching targets in terms of placement. Employees receiving notice of redundancy will be required to register with the local employment office immediately, so that efforts can be made to find a new before the employee actually becomes unemployed. It is hoped that with these measures the average time spent in unemployment will be reduced.

The commission had originally intended to cut general unemployment entitlement to one year. However, trade unions had vehemently opposed this and the proposal had been dropped. But the report suggests tightening up on benefit entitlement and places more responsibility on unemployed people to actively find work. The definition of what would be deemed to be a suitable offer of work is to be newly defined. For example, a single person would be expected to be more geographically than a person with family responsibilities.

A further suggestion refers to the creation of independent personnel agencies, attached to each office of the Employment Service. These agencies will hire out unemployed people to gain a foothold in the labour market. Unemployed people will be obliged to accept employment offers through these agencies. Contrary to the original proposal and under pressure from the trade unions, temporary

employees have to be paid according to the principle of “equal pay for equal work” to avoid that regular employees are being replaced by hired workers.

3.3 Funding

The main budget income (about three quarters) for the Federal Employment Service to finance its functions is derived from employers’ and employees’ social insurance contributions (in contrast to some other countries where funding of unemployment insurance is predominantly provided by employers, or taxes, or a combination of both). The current rate is 6.5 percent of the wage/salary subject to contributions up to the basis of assessment for contributions to pension insurance. Contributions are paid half by employers and half by their employees who are subject to social insurance payments. Any deficit will be covered by the government. The following people are not under obligation to contribute to this insurance:

- civil servants, students and schoolchildren;
- workers who are permanently unavailable for job placement, because of diminished work capacity;
- those with short-term or occasional jobs;
- employees with an income below € 325 (about US\$ 300);
- employees aged 65 and over.

The contributions, just like the social contributions for health, long-term care and retirement insurance, are paid by employers as part of their overall social insurance contribution. The health insurance providers as “collecting agencies” pass these contributions on to the Federal Employment Service.

Parallel to the rise in unemployment rates and the growth of long-term unemployment in Germany, not only have payments to unemployed people increased, but also active labour market policies have moved to the centre of the labour market activities. German unification brought about a growing importance of labour market

intervention. Labour market policies had to and still have to serve as a bridge over the “troubled water” of the transformation process until a sufficient number of new jobs has been created. The Federal Employment Service spent € 49.6 billion (about US\$ 44 billion) and the Federal Government € 16.2 billion on labour market policies in Germany in 1995. Expenditure on active labour market measures amounted to € 20.5 billion. Around 50percent of this spending on active measures was spent in eastern Germany. According to OECD data public expenditure on labour market measures developed as shown in Table 1. In relation to other countries Germany spends a comparatively high percentage of GDP on measures, in particular on passive schemes.

TABLE 1. PUBLIC EXPENDITURE ON LABOUR MARKET PROGRAMMES IN GERMANY

	(as a percentage of GDP)			
	1985	1991	1996	2000
Total expenditure	2.23	2.14	3.92	3.13
Active measures	0.81	1.04	1.43	1.23
Passive measures	1.41	2.52	2.49	1.89
Public employment services and administration	0.21	0.22	0.23	0.23

For reference: GDP in 2000: € 1982 billion

Source: OECD, *Employment Outlook*, various issues

4. Job-matching Through Placement Services⁵

4.1 Some Theoretical Considerations

Labour markets are not homogeneous. Jobs and skills differ greatly with respect to level and scope and there is a wide variety of labour market segments. In addition, personal attitudes on both sides of the market can play an important role. A lack of transparency causes

5) Cf. for the following Konle-Seidl and Walwei (2001).

problems of matching labour supply and demand. The fact that the required information is not cost-free makes it reasonable to have certain mechanisms or institutions that are able to carry out an efficient exchange. Examples of such channels of information are newspaper advertisements, informal contacts, or intermediaries.

The role of placement services can be regarded as that of an intermediary in the labour market. They are mediators who narrow down the set of employers and workers. By doing so they can lower costs and reduce uncertainty on both sides of the market

Only where placement services have expert knowledge of specific parts of the labour market can they expect to be brought into the search process as intermediaries. Due to the peculiarities of the labour market, the reputation of employment services is of significant importance for their actual use. This is due to the fact that the actual benefit of using placement agencies can not yet be determined on conclusion of the contract.

Positive employment effects at macro-level only result if jobs are filled by placement services which otherwise would not have been filled (or not as quickly) by other recruitment channels. The overall employment effect might be reduced because firms compete with each other, or when the filling of vacancies can only be achieved by poaching.

It must be emphasised that additional jobs can hardly be created through more job placement activities. Thus unemployment can be reduced through (public or private) job placement only on a limited scale. More job placement activities are to be regarded first and foremost as an additional and useful search channel in the filling of vacancies. As a result, the transparency on the labour market may increase followed by a probably greater turnover in employment. More movement on the labour market would, in general, lead to an improvement in the quality of job-matching, e.g. if workers employed in positions below their skill level are used in accordance with their qualifications. Greater fluctuation can, therefore, also open up better employment opportunities for the problem groups of the labour

market. If, for example, skilled workers employed in positions below their status find a better job due to more efficient placement services, semi-skilled or unskilled vacancies will have to be filled again. The positive effects of higher fluctuations can be partly offset if the firms lose people with firm-specific skills. They may respond by paying increased wages to keep these people. This might even produce additional unemployment if the wages are higher than those at a market clearing situation due to an efficiency wage mechanism.

In general, public placement services are an integral part of active labour market policies which can be delivered by local communities as well as by public employment services. In more and more countries local communities provide public placement services especially in order to find jobs for welfare recipients. This is due to the fact that they play an increasing role in delivering active labour market policies and may co-operate with the public employment service or provide placement services quite independently. However, the main public provider for placement services is still the public employment service.

4.2 The Role of Public and Private Placement Services

In principle, there are three models possible for the organisation of public and private placement services: monopoly, coexistence and market systems.

- Monopoly systems can either be strict or moderate monopolies. The purpose of strict monopolies is to ensure that the public employment service is afforded a strong position through the prohibition of private placement services of any kind and through the requirement of mandatory registration of vacancies. By contrast, in the case of moderate monopoly systems the use of the public employment service is voluntary for both employers and job-seekers (but obligatory for the unemployed receiving benefits). In moderate monopoly systems private placement services are allowed only in exceptional cases, that is,

for example for certain occupational groups (e. g. executives or entertainers).

- In coexistence systems the public employment service and private placement services operate side by side. In a free coexistence model, profit-making private placement services are allowed, without geographical restriction or limitation to certain groups of occupations. In a regulated coexistence model, licensing provisions may be introduced which create “artificial” barriers to market entry in terms of staff and operating requirements. Quality standards and monitoring by state authorities may provide some consumer protection. Over time one can observe a strong trend towards deregulation in the private placement services sector in EU countries. Now the large majority of EU countries have a coexistence model. Germany, too, belongs to this category.
- In a purely market system only private placement services provide mediation services. Such a system does not necessarily imply the absence of any public intervention. For example, matching tasks may have been contracted out from the public employment service to private placement services. Therefore, we have to distinguish between semi-market systems and pure market systems. Semi-market systems imply the existence of public intervention in search activities but no public provision. By contrast, in pure market systems public intervention is absent. A pure market system need not necessarily reflect a particularly liberal approach, but may also be a reflection of the stage of economic development reached by certain countries which can not afford to finance public employment service activities.

4.3 Job Placement Services in Germany

4.3.1 Public placement service

For more than six decades (from 1931 to 1994) a placement monopoly existed in Germany which virtually prohibited private

agencies, in particular those working on a commercial basis, from carrying out activities in the field of job placement and placement in training places, and granted the public employment service (Bundesanstalt für Arbeit) sole responsibility for job placement. Apart from a few exceptions, commercial forms of private job placement in particular were prohibited. In 1994 the picture changed. Since then the conducting of private job placement has been permitted; public and private placement services can now exist side by side, though until 2002 private placement services were only permitted with a licence from the Federal Employment Service.

Although utilisation of the public placement service is basically voluntary, there is an obligation for unemployment benefit recipients to report to the employment office at regular intervals or at least on request. In contrast there has never been an obligation on the part of employers to register job vacancies with the employment service.

TABLE 2. VACANCY SHARES OF THE GERMAN PUBLIC EMPLOYMENT SERVICE

	Hirings (in 1000s)	Inflow of registered vacancies(in 1000s)	Vacancy registration rate (as a percent)
	1	2	2/1
1985	5,836	1,553	29.6
1990	7,600	2,297	32.5
1995	5,993	2,337	42.2
2000	8,800	4,103	46.0

Source: Federal Employment Service-official statistics (different years)IAB, *Topics*, No. 46, p. 22.

Table 2 shows that liberalisation in 1994 did not lead to a decline in the performance of the Federal Employment Service. There has been a steady growth in the vacancy registration rates since the mid-1990s.

The local employment offices of the Federal Employment Service have been continuously re-organized to increase performance. Recently, measures have been implemented to reduce bureaucracy and simplify administration ("Employment Office 2000"). Decision making is now

more decentralised and local employment offices have been given greater competencies. It is planned to set up a controlling system (monitoring of efficiency) and to amplify self-service systems. At present 12 percent of job-seekers (0.5 million out of 4.2 million public employment service placings) use self-service systems (incl. Internet). The remaining 88 percent of job-seekers still consult placement officers. The information on job applicants is made available to enterprises via terminals, the Internet and via placement officers. The Federal Employment Service has a leading position in online job databases. Self-service vacancy information services for jobs and training places (SIS, AIS and ASIS)⁶ and KURS, the further training database, are available at the employment offices as well as via the Internet. The Federal Employment Service web-site www.arbeitsamt.de is the largest employment web-site in Germany. In February 2000 360,000 job offers were placed in the Vacancies for Job-seekers System (SIS) and 1.5 million job-seeker profiles were placed in the Employer Information System (AIS), which was implemented in 1998. ASIS offers 200,000 training places. Additionally, specialised job databases are implemented which cover certain market segments: managerial staff, start-ups (since 1999), IT personnel (since 2000) and engineers (2001).

The IAB employer survey of vacancies has provided information since 1994 regarding methods of filling vacancies. Table 3 shows indicators for the use and the success of various search methods. According to this information newspaper advertisements and informal channels are still the most frequently selected and most successful search methods. The surveys have only recently begun to include the Internet as a further job search possibility.

The user and success rates of the public employment service differ considerably from the official statistics. One reason for these discrepancies may be the fact that surveys rely very much on the memory of employers. Especially the large number of short-term

6) SIS (Stelleninformationssystem) – Information system on vacancies for job-seekers; AIS (Arbeitgeber-Informationssystem) – Information system on job-seekers for employers; ASIS (Ausbildungsstellen-Information) – Information on training places

vacancies must be underrepresented. This is relevant here because the public employment service has a high market share in these segments, which may explain, at least partly, its underestimation in survey data. The other possible reason for differences between administrative and survey data may be poor reliability of the vacancy and placement figures of the public employment service. A recent report by the Federal Audit Office found that the official statistics of job placements were considerably inflated. This affair led to the resignation of the president of the Federal Employment Service.

The IAB employer survey also brings to light employers' opinions regarding the public employment service. The main arguments of the enterprises for the inefficiencies of the public employment service are: the unwillingness of the unemployed to work, unsuitable applicants, and public agencies being too bureaucratic and too slow.

TABLE 3. RECRUITMENT METHODS: WAYS OF FILLING VACANCIES AND THEIR SUCCESS IN GERMANY (1994-1999)

Recruitment Methods	Western Germany						Eastern Germany					
	User rate (%)			Success rate(%)			User rate (%)			Success rate(%)		
	1994	1996	1999	1994	1996	1999	1994	1996	1999	1994	1996	1999
Wanted ads placed by company	51	50	55	42	39	35	24	23	25	16	13	13
Replies to ads placed by job-seekers	6	6	8	3	1	1	6	4	4	2	1	1
PES	32	38	38	13	13	14	37	49	54	22	34	35
PRES	2	2	5	1	2	2	2	1	2	1	1	1
Display at company gate	3	4	3	1	1	1	2	1	3	1	0	1
Internal advertisement	14	17	19	2	3	3	7	6	8	2	2	2
Selec. fr. applicants applying on own initiative	18	18	23	12	12	12	18	13	19	17	9	12
Information from staff	25	24	29	16	15	18	36	28	30	27	18	17
Without specification				10	14	8				12	22	18
Total	151	159	180	100	100	100	132	125	145	100	100	100

Source: IAB surveys of vacancies(different years) IAB, *Topics*, No. 46.

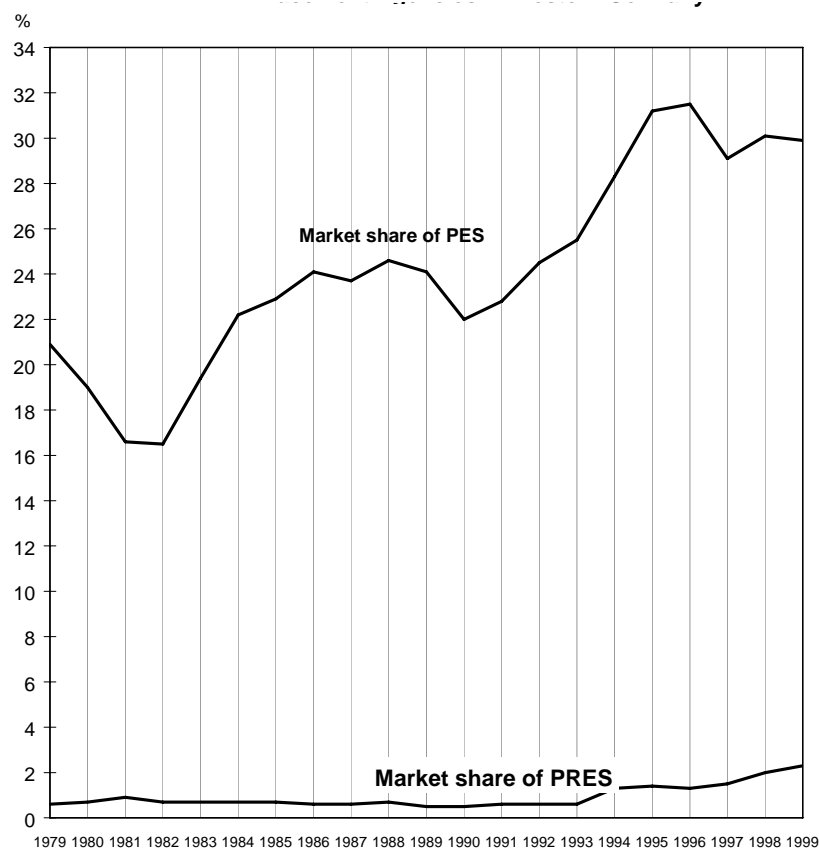
PES: Public Employment Service, PRES: Private Placement Services.

4.3.2 Private placement services

On 1 August 1994 the monopoly of the Federal Employment

Service concerning job placement ended by passing a law allowing regular activities of private placement services. Up to April 2002 (for new developments see below) these activities were connected to a licence that was granted by the Federal Employment Service if certain conditions were satisfied, e.g. personal suitability, no criminal record, and appropriate business premises.

FIGURE 3. MARKET SHARES¹⁾ OF PUBLIC AND PRIVATE JOB PLACEMENT AGENCIES IN WESTERN GERMANY(1979-1999²⁾)



Notes: 1) Defined as number of placements(>7 days) divided by the number of recruitments

2) Data for 1999 estimated

PES: Public Employment Service, PRES: Private Placement Services

When an application was made for the first time the licence was initially limited to three years. On further application it could then be extended indefinitely. In operating the employment agency, the licence-holder also had to observe some obligations. In particular, he/she may not request any fee from job-seekers. The amount to be paid by the employers to the private agency is not regulated. In general it is graded according to percentages of the remuneration, which may range from

12-15 percent of the annual gross wage.

The development of private placement services has not been spectacular. Private agencies now account for only two per cent of total job placements.

Public and private placement services can work together. Co-operation between the two has so far been rather rare, but like in other EU countries there is a new and increasing trend towards co-operation. There are bilateral agreements between the Federal Employment Service and private agencies in a lot of areas. They range from bilateral recommendations in order to increase the matching possibilities, the mutual use of job-seeker and vacancy databases, to the delegation of placement tasks to private placement services. The official view at the Federal Employment Service is that they do not compete with private agencies and that co-operation and partnership with profit-making agencies as well as with voluntary and public bodies is beneficial, and links between the public employment service and private placement services, especially at local level, will increase in the future.

Since April 2002 the latest development that must be reported is that unemployed individuals who are entitled to unemployment benefit or unemployment assistance may request a placement voucher from their employment office. The requirement for this is that they have been unemployed for three months and have not yet been placed in employment. The placement vouchers are made out for the sum of € 1500 (after a period of unemployment lasting between three and six months), € 2000 (after six to nine months) or € 2500 (after nine months) and are valid for three months. People employed in job-creation measures or structural adjustment measures are also entitled to the placement vouchers. With the placement voucher the unemployed person or employee can call in the assistance of a private placement service of his/her choice. Both the worker and the placement service must conclude a written placement contract which also includes the fee for a successful placing. The amount stated in the placement voucher is the maximum permitted.

If during the period for which the voucher is valid the activity of

the private placement service results in an employment relationship, the placement service is paid the amount on the voucher in two instalments: the first one, amounting to € 1000, at the beginning of the new employment relationship and the remaining amount when the employment relationship has lasted at least six months. If an employment relationship lasting only three to under six months was found for the unemployed person, the placement service receives € 1000.

The restrictions on conducting private job placement were largely lifted with this new regulation. A licence from the Federal Employment Service is no longer necessary, only a police certificate of good conduct and a registration of the business. There are no plans for the placement services to have to report to the labour administration e.g. concerning the placings (apart from the placement vouchers).

5. Unemployment benefit system

5.1 Some Theoretical Considerations

The essential role of an unemployment benefit system is to provide income security during spells of involuntary unemployment. From a macroeconomic point of view the unemployment benefit system is a kind of “automatic stabiliser” which supports consumption in an economic downturn. Unemployment benefits thereby contribute to consumption smoothing, at both the individual and the macroeconomic level and to the promotion of efficient job search – facilitating a better match between supply and demand on the labour market. Finally, by transferring the uncertainty of risk from the individual to the community, social insurance enhances the welfare of the community as a whole (ILO, 2000: 148).

The risk of short-term and frictional unemployment (time-lags between two jobs) can readily be covered by self-financing insurance schemes. But high unemployment resulting from national or

international recessions, may cause the expenditure of an unemployment insurance scheme to exceed its revenue. Payment of unemployment benefit under these conditions helps to mitigate the recession. However, it must of course be financed – either out of the scheme’s own reserves or from the state budget. This can be done in the form of a loan or a subsidy. Over the years, unemployment benefit schemes have preserved their viability by a variety of mechanisms, such as defining the risks in precise terms, being explicit and often restrictive about coverage, and attaching to the provision of benefits a range of controlling and other conditions, the most important of which is probably the duration of benefits.

These positive effects of social protection may sometimes be associated with negative consequences for employment or unemployment. Generous unemployment benefits may lead to an increase in the reservation wage – the wage level at which an unemployed person is prepared to take up work. In this case they increase structural unemployment. They may also lead to longer periods of time until the labour market reaches a new equilibrium after external shocks have occurred. Besides the macro-level there may also be negative effects at micro-level: high wage replacement rates associated with long duration of benefits may lead to disincentives when looking for a job or when having to decide whether or not to accept a job. Long-term unemployment may be the consequence. To tackle disincentives, countries are increasingly resorting to policies of “activation” of the unemployed (in the form of incentives and sanctions).

In the following an outline of the German unemployment benefit system is given, including social assistance – the last safety net for people out of work. The chapter closes with some remarks on new developments.

5.2 Unemployment Benefit (Arbeitslosengeld)

Unemployment benefit is an insurance benefit which is payable

monthly by cheque at a “wage-replacement rate” (Entgeltersatzquote) of 67 percent or 60 percent of the last net wage/salary paid (see below), without taking any other income or assets into account. In 2000 the Federal Employment Service spent € 23,596 million on unemployment benefits (€ 15,328 million in western Germany, the rest in eastern Germany (Bundesanstalt für Arbeit, 2001b: 63f.).

5.2.1 Qualifying conditions

The qualifying period is fulfilled by those who were employed for at least 12 months in the reference period (the last 3 years prior to registering as unemployed) and paid compulsory insurance contributions. In certain special cases (e.g. care of family members, care of children under the age of 3), periods out of paid employment are not included in the reference period. For workers who work regularly for less than 12 months in a calendar year solely due to the peculiarity of their job - so-called seasonal workers - the qualifying period is fulfilled by being employed for over 6 months and having paid compulsory contributions during that time. Foreign workers in regular employment may obtain unemployment benefit under the same conditions as German employees.

A claim to unemployment benefit presupposes that the claimant is unemployed, has registered as such at his/her local employment office and has completed his/her qualifying period. He/she cannot claim benefit from the age of 65 onwards. An unemployed person is a worker who is temporarily out of work (unemployment requirement) and in search of employment subject to social security contributions (jobsearch requirement). So called “marginal” employment – i.e. in Germany employment requiring less than 15 hours per week or for remuneration below € 325 (or self-employment to a corresponding extent) – does not exclude the possibility of registered unemployment.

The unemployment requirement encompasses availability for placement and efforts on the part of the unemployed individual to terminate the spell of unemployment. At the request of the employment office, the beneficiary must show proof of the efforts

made, provided he/she has been informed within good time of the obligation to provide such proof. Placement services are made available in principle to all those who are able and willing to work. An unemployed person who can and may carry out work under the normal conditions of the labour market is considered fit for work.

Having registered in person, those in receipt of unemployment benefit are required to report in person to the employment office if requested to do so. The previous obligation to report at least every 3 months has been dropped.

5.2.2 Rate of unemployment benefit

Unemployment benefit is payable at 60 percent of wages/salary after normal statutory employee deductions (income tax, social security contributions). The rate is 67 percent in the case of a worker with at least one dependent child (and for whom he/she receives tax allowance). No family allowance is payable. The rates of unemployment benefit vary according to the different tax rates which an employee must pay in the respective income tax classes. There is a contribution assessment ceiling which determines a maximum level of unemployment benefit. Its current (2001) figure is € 4448. The contribution assessment ceiling is adapted annually to the general development of wages.

The amount of benefit is based on the average weekly gross earnings on which social insurance was paid during the 52 weeks prior to the employee's claim. To calculate the benefits, first the deductions that employees are normally required to pay by law are subtracted from their gross earnings – for example, taxes and social insurance contributions. The above-mentioned rates are calculated from the resulting “lump-sum” net earnings. Hardship which may arise in certain circumstances is dealt with by special provisions.

Unemployment benefit is not subject to taxation. During the period of unemployment, medical insurance is maintained in one of the public health funds. The employment office also pays statutory contributions into the State pension fund for the unemployed.

5.2.3 Beginning and duration of the claim

After losing a job there is no waiting period for the unemployed person before receiving benefit. The duration of entitlement to unemployment benefit depends on the previous periods of contributory employment (during a 7-year period preceding unemployment) and the unemployed person's age according to the following table.

TABLE 4. DURATION OF ENTITLEMENT TO UNEMPLOYMENT BENEFIT

Following periods in employment subject to social security contributions totalling at least months	Duration of entitlement in months by age of unemployed person				
	under 45	45 – 46	47 – 51	52 – 56	over 57
12	6	6	6	6	6
16	8	8	8	8	8
20	10	10	10	10	10
24	12	12	12	12	12
28		14	14	14	14
32		16	16	16	16
36		18	18	18	18
40			20	20	20
44			22	22	22
48				24	24
52				26	26
56					28
60					30
64					32

According to European Union regulation, jobsearch can also be carried out in other European Union countries for up to 3 months. The unemployed person may reside there during this period and will continue to receive unemployment benefit. The duration of the claim is not interrupted in the case of holidays (up to 3 weeks) notified in time to the employment office.

5.2.4 Supplementary income

Supplementary income which an unemployed person in receipt of benefit earns from “marginal employment” (less than 15h/week) as an employee or on a self-employed basis is deducted - less income tax, professional expenses and an allowance of 20 percent of the monthly benefit (but at least € 165) - from the unemployment benefit for the calendar month in which it was earned.

5.2.5 Acceptability of the job offer

A job-seeker is not obliged to accept a job offer which pays considerably less than the reference amount on which the unemployment benefit claim is based. During the first three months of unemployment a job offer with a wage/salary that is 20 percent below that amount may be refused. In the following three months a 30 percent lower wage/salary need not be accepted. After that period (7 months) a job offer can only be refused if the wage/salary is below the level of unemployment benefit.

A total travelling time of two and a half hours a day to and from the place of work has to be accepted for a regular working time of more than six hours and less than two hours for six working hours or less. A job offer has to be accepted even if the employment is only temporary, if a temporary second residence is required or if the job offered is not in line with previous occupational training or activity.

5.2.6 Period of disqualification and lapse of entitlement

An unemployed person will be disqualified from receiving the benefit for 12 weeks (6 weeks in cases of hardship) if he/she has

terminated his/her employment contract or, through conduct contrary to the terms of the contract, has given reason for the employer to dismiss him/her and so deliberately, or through gross negligence, has brought about his/her unemployment. The same suspension of benefit applies if the unemployed person has refused to take up work offered by the employment office or to take part in a training scheme. If the unemployed person has previously given cause for a 12-week period of disqualification and has received written notification of this, any remaining entitlement to benefit will lapse if the person causes a further disqualification of at least 12 weeks.

5.2.7 Severance pay and unemployment benefit

Severance pay which the unemployed person has received or is entitled to receive due to the termination of an employment relationship does generally not lead to a reduction of the unemployment benefit claim. But the date of payment will be delayed up to a maximum of 1 year if termination is not in line with statutory employment protection periods. During this period the jobless person has to maintain his/her own health insurance payments. If the employment contract is terminated with due notice, there is no delay in payment of benefits.

5.2.8 Suspension of payment

The entitlement to unemployment benefit is suspended during a period in which the unemployed person receives remuneration. The same holds true if, because of the termination of the employment contract, the unemployed person receives holiday pay. Furthermore, almost all benefits under public law which replace remuneration (sickness benefit, pensions) cause the suspension of entitlement to unemployment benefit.

5.2.9 Partial unemployment benefit

Partial unemployment benefit is a relatively new, independent form of wage replacement which extends the unemployment insurance

system. Its aim is to protect employees who are involved in several part-time employment relationships at the same time. The loss of one of several employment relationships subject to social insurance contributions results in entitlement to partial unemployment benefit.

The condition for entitlement is that the employee was in the employment on which the claim is based for at least 12 months during the preceding two years in addition to other insured employment and is willing and able to take up new insured part-time employment (in addition to the existing employment) or full-time employment. Because of the particular risk prevailing for the unemployment insurance system in connection with this benefit, partial unemployment benefit is paid for a maximum of 6 months.

5.3 Unemployment assistance (Arbeitslosenhilfe)

Unemployment assistance serves a similar purpose to unemployment benefit, and the two form a comprehensive system of protection in the event of unemployment. But in the case of unemployment assistance, payments are subject to a means test. The regulations governing entitlement to unemployment assistance are similar to those for unemployment benefit with certain exceptions. The claims for unemployment benefit and unemployment assistance are basically regarded as integrated claims.

In 2000 the Federal Employment Service spent € 13,161 million on unemployment assistance (€ 5,094 million in eastern Germany (Bundesanstalt für Arbeit, 2001b: 64), which is refunded by the Federal Government and not paid out of the contributions to the unemployment insurance scheme.

5.3.1 Qualifying conditions

A claimant for unemployment assistance has to be registered as unemployed at the employment office and is no longer entitled to unemployment benefit. Another condition is that the claimant is in need and has drawn unemployment benefit before. There are some

exceptions to this last rule.

An unemployed person is considered to be in need if he/she cannot provide for him/herself by any other means than by claiming unemployment assistance. The means test is based on the income and assets of the unemployed person and of his/her spouse in so far as certain tax allowances are not exceeded. Some benefits are, however, not taken into account, including benefits for preventative and continuing health care, basic pension under the Federal Pensions Act and child benefit under the Federal Child Benefit Act.

5.3.2 Rate of unemployment assistance

Unemployment assistance amounts to 57 percent of net wages, i.e. after the usual statutory deductions have been made, if the unemployed person has at least one dependent child who is taken into account for tax purposes. In all other cases it amounts to 53 percent. The remuneration on which the assessment of the unemployment assistance is based is adapted annually. The Federal Employment Service pays the health and pension insurance contributions for people who draw unemployment assistance.

5.3.3 Supplementary income

The same rules apply as for unemployment benefit.

5.3.4 Duration of entitlement

As a rule, unemployment assistance is granted for an unlimited period - until the claimant reaches the age of 66. It is usually only payable for one year at a time. After that period eligibility must be proved again.

5.3.5 Reciprocity

In Germany one in four jobless people does not receive unemployment benefit or unemployment assistance. These unemployed people are mainly people who have lost their qualification for payment of benefit/assistance. Others are registered with the

employment office only for social security reasons (e. g. assessment periods for the state pension fund), or they are trying to find a job via the public employment service without being a claimant for unemployment benefit/assistance.

5.4 Other Wage Replacement Benefits

For the sake of completeness three other benefit schemes, paid by the Federal Employment Service (Bundesanstalt für Arbeit), should be mentioned briefly. They are aimed at avoiding imminent unemployment.

5.4.1 Short-time working allowance

An allowance is available to keep employees from being laid off during temporary, unavoidable work shortages when their earnings would otherwise be lost. The object is to allow businesses to retain their experienced staff wherever possible. The short-time working allowance partially makes up for the wages lost through shorter working hours. The short-time working allowance may be paid out for up to six months. Under certain conditions it may be extended to as much as 24 months.

The allowance is granted when an employer notifies the employment office of an unavoidable, temporary cut-back in capacity due to economic conditions or events beyond the employer's control. For a business to qualify, at least one-third of the staff actually employed in the department affected by the cut-back must suffer a loss of more than 10 percent of their earnings during the applicable calendar month.

The amount of the allowance is based on the difference between the lump-sum net earnings at full pay and the equivalent amount for the pay the employee is still receiving. It is 67 percent of this difference for employees with at least one dependent child and 60 percent for those without dependent children.

5.4.2 Benefits in the event of employer bankruptcy

Bankruptcy (or insolvency) benefits ensure that employees can still draw pay if their employer is insolvent, for the last three months of the employment relationship prior to the initiation of bankruptcy proceedings. The amount of bankruptcy benefit is equivalent to the net earnings due and unpaid for the period in question. There is no limit on the amount of the benefits.

The employers' liability insurance association collects the funds for these benefits annually, retrospectively, by levying contributions from the employers themselves.

5.4.3 Support payments after completion of a training scheme

Support payments are available to employees completing a programme of further vocational training who register as unemployed at the employment office after the scheme. These payments are calculated in largely the same way as unemployment benefits. They are paid for a maximum of 3 months.

5.5 Social assistance⁷

Although it is not a benefit paid only in the event of unemployment, social assistance should be mentioned here, as it represents a last safety net for people out of work who qualify for neither unemployment benefit nor unemployment assistance. Social assistance is publicly financed and granted for people in need who have no other means to support a living. Social assistance is to protect people from poverty and social marginalisation. Cost-of-living assistance (social assistance) for people in private households should cover their needs for food, housing, clothing, body care, household goods, heating and the personal things needed in daily life. The latter also include connections to the social environment and participation in cultural life to a reasonable extent.

⁷) Taken from Federal Ministry of Labour and Social Affairs (1999).

The income and financial means of people who apply for social assistance are assessed carefully by the authority which decides about the assistance. The means test includes income of the applicant's parents and children. The assistance recipient is obliged to exploit his ability to work to secure a livelihood for himself and his/her legally dependent family members. The social assistance agency is obliged to ensure that the assistance-seeker makes an effort to find work and does actually work, except in situations where the person cannot be reasonably expected to work due to particular circumstances such as physical or mental incapacity, extreme difficulty in continuing the previous type of work in the future, or if the proper up-bringing of a child would be endangered.

The assistance recipient is obliged to accept any reasonable work that is offered. Anyone who refuses to accept a reasonable type of work may lose their entitlement to cost-of-living assistance. In a first step the assistance will be reduced by at least 25 percent of the applicable standard rate.

Cost-of-living assistance has to be paid by the municipalities. Therefore, the rates may differ somewhat from region to region. Currently the average need is set at about € 1,000 per month for a couple without children or a single parent with one dependent child. The amount is € 1,500 for a couple with two dependent children. In 1997 there were about 1,800,000 adult recipients (aged between 17 and 59) of social assistance. About two fifths of them were job-seekers. If assisted children were added to this figure, there would be one million more recipients.

As in other countries, the phenomenon of the so-called welfare trap is discussed in Germany, too. The welfare trap arises when the level of social assistance is so high compared with the achievable market wage that, for financial reasons, it is not worthwhile taking up regular employment. Another disincentive to taking up employment is that, in the system currently in force, supplementary income earned by social assistance recipients is taken into account very restrictively when calculating the amount of benefit to be paid. With a marginal tax rate of

about 85 percent, social assistance recipients are acting quite rationally in economic terms when they do not offer to work. The case is similar for unemployment assistance, which permits a maximum supplementary earned income of € 165. Such regulations can contribute to increasing the duration of benefit. This case is known as an unemployment trap.

The assumption that social assistance in Germany is generally too high compared with the wages that can be earned from gainful employment is only partly true. Calculations show that for single people the difference between the level of social transfers and the market wage is still considerable but that the difference for larger households (single parents and couples with more than one child under the age of 18) can be very low (cf. Franz, et al., 1997). Of the 1.26 million needy households in 1999, however, only 242,000 (94,000 married couples and 148,000 female heads of household each with more than one child under the age of 18) came under the latter category. This would therefore not even be 20 percent of the households drawing social assistance. For this group of people, however, which is often overestimated regarding its quantitative significance, it is probably not an improvement in the possibilities of earning supplementary income and thus a greater difference to the market wage which is decisive for the employment behaviour. It is probably more the availability of affordable childcare facilities that decides the extent of employment for this target group in particular.

In order to avoid or reduce the welfare trap, two further proposals have been made, both of which are intended to increase the incentive to take up work. Firstly it is proposed that in addition to drawing social assistance, recipients may also earn income from employment ("Kombilohn"). Secondly it is proposed that low-paid workers should not have to pay social security contributions, or only reduced contributions. Model projects have already been conducted for both of the proposals. The two proposals are explained in more detail in the chapter on labour market policy, under the heading of subsidies for low-wage jobs.

5.6 Excursus: Consequences of Different Wage-replacement Benefits in the Event of Unemployment (Werner 1999, 21)

In the market-economy-oriented countries, the USA and the United Kingdom, labour market policy does not play a major role – including earnings-replacement benefits in the event of unemployment. This results in a considerable pressure to take up new employment. In contrast to this, countries such as Denmark or the Netherlands pay comparatively high unemployment benefit. The consequences of the differences in unemployment benefit payment are outlined below.

In Great Britain and the USA earnings-replacement benefits in the event of unemployment are very low and are only paid for a short period. In the USA, for instance, unemployment benefit only amounts to 25 percent–35 percent of the last wage and is paid for a maximum of 26 weeks (as is also the case in GB). This results in a kind of compulsion to work. This is why long-term unemployment is also low, since if necessary, people will also accept a poorly paid job in the hope that they will be able to move up again when the employment prospects improve. This is easier in the USA than here in Germany, since in the USA there is less stigma attached to taking up a job temporarily for which one is actually over-qualified. An application of US conditions to Germany is not being considered seriously by anybody. Continental Europe has a different tradition concerning social protection. It would already be difficult for the reason that there are not enough low-grade jobs here. These are concentrated in many cases in those jobs which constitute “marginal part-time work” or “insignificant work”. In the USA, with its different labour market system, there are jobs of the most varied types. In Germany many low-grade jobs have been cut as part of rationalisation programmes (above all in the manufacturing industry) or they have dropped out of the regular labour market and can often be found in the black economy (which seems to be small in Germany compared with other countries).

In the Netherlands and Denmark unemployment benefits are high. In return a “carrot and stick” policy is pursued in which a wide range of

employment and training schemes are offered, but at the same time a certain pressure is exerted on the unemployed to take up work: this can occur by means of a stricter interpretation of what is a 'reasonable' job, the requirement that the unemployed person regularly proves his/her job search activities, the organisation of individual advisory and activation plans, or the obligation to take up a state-subsidised job or participate in a training scheme. All in all a trend of "welfare to work" can be detected, which means that one should be better off working than drawing benefit payments.

The combination of social protection in the event of unemployment and pressure to take up work or take part in an employment or training scheme makes this regulation more acceptable to society. Taken alone such an approach does not bring about any improvement in the labour market situation, as no additional jobs are created. From the point of view of reducing unemployment, however, it does make sense if appropriate jobs are available. This is the case when the labour market is improving in general, when state-subsidised employment can be offered (job-creation measures or other forms of employment subsidy), or when a low-grade sector is already in existence (USA, GB) or is being promoted. In all other cases this measure only affects the distribution of the unemployment: the order of the people in the "queue" of unemployed is altered. This can be useful by all means when unemployed people are "reactivated" and it is possible to prevent them from slipping into long-term unemployment. Experience shows that the longer an individual is unemployed, the more difficult it is for him/her to get back into work again.

6. Measures of Active Labour Market Policy

6.1 Theoretical Reasons for Labour-market-policy Intervention

Labour market policy is aimed at balancing labour supply and labour demand. The aims are to facilitate adjustments associated with

structural change and to compensate for economic downturns. In addition to the mere payment of earnings-replacement benefits (passive labour market policy), measures of active labour market policy are intended to facilitate the search for work, to increase regional and occupational mobility, and above all to promote the reintegration of unemployed people into working life.

With regard to active employment promotion (or synonymously also active labour market policy), first the question of principle arises as to whether this set of instruments is necessary at all, and if it is necessary, then why, to what extent and with what combination of types of measure. It is possible to derive from labour market theory five reasons supporting intervention in the processes of matching supply and demand:

6.1.1 Lack of transparency

Labour markets are an example of search markets where information uncertainties prevail. Workers bring with them very different occupational skills, qualifications and personal qualities. Employers, too, ask for very different qualifications for making their products or delivering their services. Thus there is not one homogeneous labour market, but heterogeneous partial labour markets, and this with a clearly increasing tendency. In this respect services such as employment advice and job placement can be of great importance. These instruments filter information on both sides of the market and make it available to the users. In this way they create more clarity on the market, reduce information uncertainties and lead to lower search costs.

6.1.2 Mismatch

A cause of problems concerning labour market balance can also be found in a qualitative dimension. This is the case when, in spite of unemployment, vacancies can not be filled at all or at least not quickly enough. There can be three reasons for this. Information-related mismatch can be put down to poor market clarity (see the first

argument above on this subject). Regional mismatch is characterised by the vacancies being located in different regions to the unemployed people. As a rule this is expressed in unemployment rates that vary more or less considerably from region to region. Finally there can be qualification-related mismatch, when unemployment occurs particularly intensively in certain occupations, whilst other occupations suffer from shortages of skilled manpower. Firms thus ask for different qualifications from those that the job-seekers are offering. Regional mismatch can be countered with mobility aid and regional structural policy, whilst training measures can be used to deal with qualification-related mismatch.

6.1.3 Lack of willingness to take risks

Owing to uncertain prospects for the future, short-term considerations can dominate among the labour market actors and this can lead to investments that are amortised only in the long-term not being made at all. Small establishments could shy away from extensive investment in training for example because of the danger of large firms attempting to poach their employees. A risk of getting into debt may occur for job-seekers, too, if it is only possible to secure capital for further training or for setting up a new firm by taking out a bank loan. Publicly assisted initial and further vocational training as well as measures aimed at promoting self-employment can counteract the risk-averse behaviour that is generally prevailing, especially on the part of the workers.

6.1.4 Discrimination

Discrimination against certain groups of people (e.g. women, foreigners or disabled people) on the labour market is nothing unusual. As a result of the existence of unchangeable background characteristics, employers expect a lower productivity from certain groups of people. This can lead to certain groups not being taken into consideration in recruitment decisions. The task of labour market policy in this context would be to break down justified or unjustified prejudices that

employers have against certain applicants. Besides information campaigns, instruments that could be considered in this respect are wage subsidy schemes, which can always also be seen as (partial) compensation for a really lower capacity to work, training measures and various forms of trial employment.

6.1.5 Hysteresis

Structuralisation processes as a result of the already long period of high unemployment in Germany can not be explained solely by the classical form of discrimination. Stigmatisation and reduced employability are not least also the result of long-term unemployment. The longer a spell of unemployment lasts, the greater the probability is that the unemployed experience losses of human capital and a discouragement effect when searching for work. Firstly the firms use the duration of unemployment as a “negative” signal for an applicant’s unknown productivity, secondly the longer experience with unemployment leads to a lower search intensity among the individuals affected as a result of diminishing self-confidence. When there is general underemployment, sorting processes begin which result in the weakest providers of labour being rejected. In this context labour market policy is given not only the task of effectively reintegrating long-term unemployed people into the primary labour market but also the task of using suitable preventative counselling to find at an early stage the people who would be expected to be unemployed for a longer time without labour-market-policy intervention.

In conclusion for this chapter it can be established that a multitude of studies on the causes of the level and structure of unemployment provide indications that the theoretical pre-conditions mentioned above for the use of labour-market-policy instruments are given. Nonetheless, before using them it is always also necessary to check what alternative possibilities of public intervention could be considered to solve the problem of labour market balance (cf. Eichhorst/Profit/Thode, 2001). In this context it would be necessary to discuss for example whether suitable measures for balancing labour

supply and labour demand are given in the basic conditions of labour market policy (e.g. in issues concerning wage policy and working time policy). This would go beyond the scope of this paper, however.

There is a broad spectrum of measures of active labour market policy in Germany. Most of the measures are financed from the budget of the Federal Employment Service, i.e. by the contributions paid into the unemployment insurance system. Every year about € 20-22 billion are spent on these measures, about half of it in eastern Germany. A first overview of the expenditure on active and passive measures was already given in Table 1. In the OECD comparison, Germany is in the upper mid-table. Table 5 gives a detailed overview of the use of the measures in Germany.

In the following chapter the measures are described in detail. We concentrate on the major instruments, since it is not possible to cover all the different measures.

TABLE 5. PARTICIPANTS IN MAJOR LABOUR MARKET SCHEMES – ANNUAL AVERAGES IN THOUSANDS

Scheme	1995	2001
Short-time workers	199	123
Job creation schemes	384	243
General schemes	276	167
Structural adjustment measures (SAM)	108	76
Training schemes	450	315
Rehabilitation	42	42
Language courses	42	25
Pre-retirement part-time	0	50
Total	1,554	804
Unemployed benefit recipients aged 58 and above no longer looking for work	152	223

Source: IAB, Mitteilungen aus der Arbeitsmarkt- und Berufsforschung 34/1: 25.

6.2 Measures of Further Vocational Training

The aim of further vocational training measures – in so far as they are conducted by the Federal Employment Service – is to reintegrate unemployed people into the labour market and to avoid unemployment

where it threatens. In addition these measures maintain a certain supply of up-dated and certified qualifications for the national economy. A broad range of training schemes include methods by means of which individual occupational knowledge and skills are evaluated, preserved and broadened or are adapted to new technological developments. These measures provide opportunities to promote individual careers, they offer vocational qualifications and permit the participants to work in new employment relationships.

The measures run by the Federal Employment Service require the people concerned to have already successfully completed a course of initial vocational training or to have already gained work experience, or both. They are aimed primarily at upgrading existing occupational skills. They often reflect new technological developments and structural change, or serve to certify existing occupational skills if the individuals performing the skills have not yet gained any formal vocational qualifications. Measures of this type continue to be regarded by the Federal Employment Service and the German Federal Government as important measures for the promotion of employment. More recently the Federal Employment Service has placed particular emphasis on qualifications in the field of information technology (IT) and in the electronic media sector.

The Federal Employment Service bears the directly incurred costs of the further training in all of these cases. This means in particular the fees for courses and the costs for enabling the participants to be available for the courses. This includes the costs for accommodation etc. when it is necessary for a participant to attend a course held somewhere far away from home. And in certain cases childcare costs may be paid up to a maximum of € 102.

Participants in full-time further training courses can also receive subsistence allowances from the Federal Employment Service if certain conditions are met. These conditions imply that the individuals concerned have previously been in employment subject to social security contributions for a minimum of one year. The alternative to this regulation is that the individual has previously received

unemployment benefit or subsequently unemployment assistance. This applies to full-time courses. In the case of part-time courses, in some circumstances the participants may be paid a proportional subsistence allowance.

The subsistence allowance amounts to 67 percent of the net wage for participants who have at least one dependent child in their household, otherwise the payment is 60 percent. One pre-condition in all of these cases is that participation in the further training is regarded as “necessary” by the funding agency. In cases where the person has not yet met the pre-condition of employment subject to social security contributions, but has received unemployment assistance until the start of the measure, a subsistence allowance may be paid which is equal to the level of unemployment assistance.

Expenditure (cf. Bundesanstalt für Arbeit, 2001b: 35f.) on such further training measures totalled € 6,808 million in 2000, € 4,060 million of this was incurred in western Germany and € 2,748 million in eastern Germany. During 2000 a total of 551,500 workers took part in further vocational training schemes. 337,900 in western Germany and 213,700 in eastern Germany. This implies an increase of 12.4 percent compared with the previous year. In addition to this a slight rise in the participation of special target groups was also recorded. These target groups include women, people who have not yet gained any certified vocational qualifications, the long-term unemployed etc.

- In the average for 2000, 183,500 women took part in further training measures, 106,600 in western Germany, 76,900 in eastern Germany. This represented 52.1 percent of all participants, which means that the proportion of female participants was higher both in the east and in the west than the proportion of women among the unemployed. In this way the aim is met which is formulated in section 8 of volume 3 of the Social Code, that women are to be supported at least in proportion to the size of their share of unemployment.
- At 21.2 percent, the proportion of long-term unemployed was slightly higher than in 1999. On average 74,500 long-term

unemployed people took part in further training measures. 39,000 of these were in western Germany, 35,500 in eastern Germany.

- The proportion of people without formal training qualifications rose significantly once again in comparison with the previous year, at a growth rate of 12 percent. On average 106,000 people without formal training took part in the further vocational training measures (85,900 in western Germany, 20,700 in eastern Germany). This corresponds to 30.3 percent of all the participants.

Complementary to the measures to support individual further training, there are measures to support institutions providing vocational training. The aim of these measures is to maintain or to build up an adequate offer of training in a certain region in order to meet labour market demand and the demand resulting from occupational change. The measures are orientated towards improving the employment structures of individual industries and also towards helping to improve the labour market situation.

Financial support from the Federal Employment Service can go to local authorities, to associations of such authorities, to Chambers of Industry and Commerce, to employers' associations and trade unions, to professional or charitable institutions, to foundations, to organisations with a specific aim and also to firms offering in-firm further training.

Financial support may be given in the form of subsidies or in the form of loans for investment in buildings and equipment. This support should normally not exceed 50 percent of the entire costs. If a subsidy is granted for investment in a building, then it must be limited to a maximum of 30 percent of the costs. Interest at a rate of 2 percent per year is charged on the loans.

Concerning the effectiveness of training schemes it should be noted that there has been a lively debate in more recent years in Germany. Some evaluation studies which were carried out using

econometric methods on the basis of individual data did not find any effects of participation in courses serving as further training. The participants' employment prospects were not higher than those of unemployed people who did not take part in such measures (cf. Fitzenberger, Speckesser 2000 for an overview). Other studies found small positive effects which were not very stable (cf. Fitzenberger Prey, 1997, 2000).

Recent IAB research, however, which was carried out using regional data for eastern Germany, showed that such measures resulted in significantly higher employment rates for the participants.⁸⁾ The finding of the analyses was that the growth rate of regional employment was positively related to the expenditure on training. It is not possible to assess the efficiency of the measures using this kind of analysis, since especially the comparison of gains and costs is not included, but it is possible to show that the measures had an effect.

The difference to findings from previous studies can be explained by the fact that in most of these studies the effect of a measure is assessed by using data for individual people. Normally, the employment prospects of those participating in a measure are assessed in comparison to a sample of unemployed people. In this case indirect effects of the measures are not taken into account. The regional analyses conducted by the IAB show these effects, which might include a better match between both sides of the labour market in a regional economy and the demand effect induced by the inflow of additional means, fuelling the regional economy. An additional problem that plagued most evaluation studies carried out with data for individual people is the very slim data base which limits the possibilities for finding significant training effects.

8) A newly developed approach, the so-called shift-share-regression was used, which is an extension of a technique developed by Patterson (1991). The response variable was the growth rate of employment in one industry in a special region. A number of exogenous variables were used, including the expenditure on training schemes in the previous year, measured in relation to the number of gainful employees in a region (Blien, et al., 2002).

6.3 Job Creation Measures

Job creation measures (Arbeitsbeschaffungsmaßnahmen - ABM) are a special kind of wage subsidy programme, since here the subsidy is paid in most cases not to private enterprises, but to public agencies and non-profit organisations not associated with profit maximisation. The aim of job creation measures is temporary employment for workers who require help to integrate into the regular labour market. This applies in particular to long-term unemployed people who are entitled to unemployment benefit. Projects which are promoted by the Federal Employment Service in this respect must be in the public interest and must be “additional”. The latter implies that without the support the project concerned could not be carried out or at least would not be possible at that time.

The measures are promoted by means of subsidies or loans to the institutions that implement them. These can be either individuals or legal bodies. Measures in the manufacturing industry are only carried out if they are implemented by a firm. The support amounts to between 30 percent and 75 percent of the “creditable” remuneration. Under specific conditions, which are in fact conceded to apply very often, the subsidy can reach 100 percent of the wage. The remuneration is creditable as long as it does not exceed 80 percent of the average wage that is normally paid for non-subsidised employment relationships in the labour market segment in question. Collectively agreed wages are generally assumed to be paid.

Additional subsidies and also loans can be granted for measures which are of particular importance for the labour market. Normally the support from the Federal Employment Service is paid for one year, but in certain cases this may be extended to two years. Particular measures can even be supported for 36 months if the workers concerned are guaranteed a permanent job following the measure.

Projects which especially improve the conditions for the creation of permanent jobs or which result in structural improvements on the labour market are given priority regarding support. The latter applies

for example if employment prospects are opened up to workers who have particular problems finding jobs. Priority is also given to measures that improve the social infrastructure or the environment. In this way it becomes clear that the relevant job creation measures do not only serve to provide employment for individuals. They are also carried out with general economic aims such as upgrading the public infrastructure and social relations.

Especially in eastern Germany, in the initial period following German unification, a great many public tasks were dealt with by means of these job creation measures. At the time of unification a multitude of firms had left behind considerable environmental damage and structural problems. Before new investment could be made in mining, the chemical industry or former military sites, it was necessary to eliminate their problems and to tackle environmental damage. This occurred largely by means of large-scale job creation measures, which therefore not only met the labour market aim of immediate and direct reduction of unemployment but also subsequently created conditions for a long-term development of employment.

For the reasons given, in addition to the immediate employment effect of job creation measures they are also expected to have indirect effects for the labour market. At least this is what those responsible expect of these measures. For unemployed people, work in a job creation scheme is associated with a psycho-social significance which gives the programmes a relevance beyond the preservation of qualifications and social competence.

Job creation measures contributed, especially in the eastern part of Germany, to a considerable reduction in unemployment in 2000 (cf. Bundesanstalt für Arbeit, 2001b: 37f.). In the annual average 203,600 workers were supported. The corresponding figure for the previous year was 234,100. Of the workers supported in 2000, 58,100 were in western Germany (66,300 in the previous year) and 145,500 in eastern Germany (previous year 167,800).

Job creation schemes are important for those groups of workers who require special forms of assistance. In 2000 over 82 percent of the

people in such job creation measures were (previously) long-term unemployed people, and the percentage of younger workers, i.e. those under the age of 25, was 9 percent. The proportion of women in the measures in eastern Germany was over 56 percent and it was more than 51 percent in Germany as a whole. The Federal Employment Service spent € 3,680 million on these job creation measures. This figure includes the increased support in certain sectors. Almost € 1 billion was spent in western Germany and € 2.6 billion went to eastern Germany.

The discussion surrounding the effectiveness of measures of active labour market policy is pursued even more energetically in the case of job creation schemes than it is in the case of other active labour market policy measures. On the basis of similar studies to those conducted on training measures, various research groups expound that these employment creation measures have no effect at all for the labour market, or even worse, that they are associated with a negative effect. This negative effect, which is put down to unemployed people ceasing to search for a job that is not supported, reduces the chances of being integrated permanently into the labour market (cf. Fitzenberger, for an overview). Again, other studies found unstable positive effects (Eichler Lechner, 1999).

As in the case of the promotion of training measures, a new IAB study based on regional data obtained new findings about the employment effects of job creation measures (cf. Blien, et al., 2002). This study dealt in particular with the eastern German labour market. In this case the job creation measures and the structural adjustment measures (see below for details) were dealt with together. The aim of this study was to show what effect these measures have on the regional development of employment. Again a shift-share-regression was the approach which was applied.

In fact it was possible to show quite considerable effects almost equal in size to those of the training measures. The main difference in the case of job creation measures and structural adjustment measures is that they do not have such a long-term effect as the training measures. With job creation measures the coefficient halves if the variable is

included with an additional lag of one year.

Again, there is a remarkable difference between the results of the studies conducted using microeconomic methods and individual data and the studies conducted using regional data. This can presumably be explained by the fact that with regional data the indirect effects of the measures are shown to advantage. Especially in eastern Germany, where there are still many untapped resources, the inflow of labour market policy funds has positive effects on employment there.

6.4 Structural Adjustment Measures

The aim of structural adjustment measures (SAM) is to provide temporary employment for workers who require special help to compensate for the loss of their jobs. Another aim is to counter particular problems on the local labour markets. In general the SAMs can be categorized as wage subsidies; they are very closely related to job creation measures (ABM), but follow a somewhat different conceptual scheme. The measures are designed in such a way that earnings-replacement benefits which are normally paid in the case of unemployment are used here to create employment. For this the corresponding sum of money is paid to the provider of the measures as a wage subsidy. The subsidy thus goes to the employer of the worker concerned.

One key idea that was originally connected with structural adjustment measures was to promote the structural change on the labour market and in the economy. For this reason the measures are restricted to a number of special fields. These include support for tasks involving the conservation or improvement of the environment and the improvement of the infrastructure. Another critical area is the improvement of social services or the support of establishments providing child and youth welfare activities. As in the case of job creation measures, employment in the commercial sector is only supported where it also occurs in firms.

The support is only granted for workers who were previously

unemployed or directly threatened by unemployment and who also fulfil the requirements for drawing unemployment benefit or unemployment assistance. Another pre-requisite is that the workers would not be able to find employment in the near future without the measure. The wage subsidy must not exceed the average rate for unemployment benefit or unemployment assistance. Moreover, it must not be higher than it would be in the case of a job creation measure. The provider of the measures pays the remaining costs for the employment of the person in question and of course for equipment, machinery etc. Normally the wage subsidy in the context of SAM is paid for a maximum of 36 months. The measure may only be extended to a maximum of 48 months in cases where the worker concerned is to be taken on permanently following the measure.

The SAM programmes benefit in particular the labour market in eastern Germany (cf. Bundesanstalt für Arbeit, 2001b: 38). In 2000 only 11,700 people were employed on average in SAMs in western Germany, the remaining 98,100 people were in eastern Germany. In the previous year it was still 195,700 for the whole of Germany. The sharp drop in the number of people involved in the scheme corresponds to a tightening of the conditions under which the measures may be implemented.

In eastern Germany there is a special programme which was called SAM for business enterprises. This programme was restricted to individual target groups comprising young workers, long-term unemployed people, disabled people and older workers. Within the scope of this programme a maximum subsidy level of € 693 per worker has been in place since 1 January 2000. In this special programme the number of workers assisted fell from 131,900 in August 1999 to 31,000 in December 2000. This implies a decrease of 76.5 percent in 17 months.

In addition to SAMs and job creation measures there are other measures with wage subsidies paid to firms that recruit long-term unemployed people. This programme is now funded by the Federal Employment Service, whereas it used to be financed from a special

budget of the Federal Government. From 1995 up to and including 2000, € 1.4 billion was spent on wage subsidies of this kind in western Germany. The figure for 2000 was € 223.7 million. In eastern Germany € 527 billion was spent on such wage subsidies in the period from 1995 to 2000. In 2000 it was still € 90.2 billion.

6.5 Bridging Allowance

Bridging allowances for people wishing to start up a new business are aimed at unemployed people who intend to earn their living in future by becoming self-employed. People who are entitled to unemployment benefit are entitled to this subsidy. These people are paid an allowance equivalent to the level of unemployment benefit and the contributions for social security. The social security contributions include payments made by the Federal Employment Service to the pension insurance on behalf of unemployed people. As long as the allowance for people setting up new businesses is equivalent to the level of unemployment benefit and the incidental payments incurred, this measure does not incur any extra costs.

In 2000 the Federal Employment Service approved such allowances for people wishing to set up businesses in 92,600 cases (Bundesanstalt für Arbeit, 2001b: 38f.). This was slightly fewer than in 1999, when the overall figure was 98,100. The overall flow of money amounted to € 751 million, this was almost the same as the expenditure for 1999. 62,200 cases were located in western Germany in 2000. The corresponding payments totalled € 534 million.

Besides granting financial allowances, the Federal Employment Service is included in the entire process by providing advice and information. In this way the Federal Employment Service becomes an agency which is not only of use to the unemployed and to existing firms, but also to people setting up firms on a self-employed basis and to professionals working in this field.

What is of particular importance in the case of allowances for setting up a business is the hope that this measure will lead to further

jobs being created. According to a study conducted by the Institute for Employment Research, newly established businesses in eastern Germany have created more jobs than in western Germany. Within three years, for every 100 newly established firms in eastern Germany there was an additional volume of 108 people who had been hired in these firms. In western Germany there were 94 additional workers recruited for every 100 such business start-ups (Wiessner, 2001).

6.6 Promotion of the Low-wage Sector

6.6.1 Reduction of the welfare trap

As mentioned earlier, the arrangement of social security can contribute to low-wage employment not being created in the first place or not developing. If the social transfers are high compared with the obtainable market wage, it may in certain circumstances be worthwhile remaining in social assistance instead of looking for employment. In this case a so-called welfare trap develops.

In order to overcome or reduce the welfare trap it has been proposed to permit social assistance recipients to earn an income from employment in addition to drawing benefit ("Kombilohn" [wage top-up]). This results in an incentive to take up work, since low-wage employment could constitute a way out of unemployment. It must be taken into account, however, that in some circumstances a previous social assistance recipient who was unemployed but is now in work could, as a result of the wage top-up, receive a higher disposable income than other workers (who have not previously drawn social assistance) with an identical earned income. Such an unequal treatment only seems to be justifiable – if at all – for a limited period and only up to a certain upper limit. If on the other hand all workers with a low income were to be included in the circle of the beneficiaries and thus received the same transfer payments with comparable personal circumstances, the concept of a wage top-up would probably cause a considerable need for funding.

Improving the possibilities for social assistance recipients to earn

supplementary income is basically a possible variant of a negative income tax concept. A number of more recent, empirically sound studies show that, depending on the arrangement, such approaches orientated towards negative income tax concepts can be expected to have at best slightly positive, but possibly even negative labour market effects (cf. Buslei, et al., 1999, Gern, 1999, Bassanini, Rasmussen, Scarpetta, 1999). Two reasons in particular are responsible for this: if firstly the subsistence levels are set at the current level of social assistance, improved regulations for calculating the amount of benefit to be paid lead to high burdens on the public budgets and consequently may also result in negative effects on the demand for labour in the economy as a whole. Additional costs for the public budgets would arise above all because, for reasons of equal treatment, groups of people who were previously not supported would be able to draw social transfers. Secondly, although the incentive to work is increased among certain groups (above all social assistance recipients who have not yet worked), it is weakened for other groups which were not so far supported by social transfers.

It can therefore be said that any positive labour market effects as a result of improving the possibilities of earning supplementary income are to be classed as uncertain and that in addition fiscal risks exist. Admittedly the judgment changes if the introduction of wage top-ups were linked with a reduction in the level of social assistance (e.g. for employable recipients). The supply pressure would increase even more for the assistance recipients and resources for funding improved conditions for calculating the amount of benefit to be paid would become available. Growing risks of poverty would have to be accepted with this variant, however.

6.6.2 Subsidies for low-wage jobs

Following the experiences made in the USA, there are plans in Germany to expand low-wage employment. However, in order to avoid the problem of the “working poor” which is associated with greater downward wage disparity and which can be seen in the USA, various

approaches aimed at subsidising low incomes are being discussed and tested in model projects. They are described in the following paragraphs.

Subsidisation of low wages can not be contemplated independently of the social security system. For the level of the transfer payments has the effect of a kind of “minimum wage” and can trigger off disincentives to work. However, social transfers should not generally be classed as a “disincentive”. What is behind the level of transfer payments is more an objective associated with distribution policy, namely the income that society would like to give to those who are unable to perform gainful employment for individual reasons (e.g. sickness, disadvantage) or as a result of the labour market situation.

In Germany the creation of employment – especially at the lower end of the wage scale – is hindered by at least three disincentives associated with institutional factors. A first obstacle is the so-called “marginal part-time work threshold”. This is to be seen as an obstacle to employment because it leads to a jump in social insurance contributions above an income of € 325. Above this threshold the worker has to pay the full social security contribution. A second obstacle to the creation of employment is, as already mentioned in the chapter on social assistance, the so-called “welfare trap” or “unemployment trap”. Finally also the specific construction of the measures aimed at balancing family burdens also creates disincentives. Social assistance recipients receive a substantially higher amount for each dependent child than the regular child allowance that is paid irrespective of income or alternatively the amount per child that can be deducted from the taxable income.

In order to raise the obtainable net income and thus to provide an incentive to take up work in a “low-wage job”, model projects have been started in which low-earners pay only low social security contributions or none at all. This support focuses on a subsidisation of the employers’ social security contributions (the so-called Saar Model) and a subsidisation of the employees’ social security contributions (the so-called Mainz Model), both of which are aimed at low-earners.

What must be highlighted here is a variant of the Mainz Model mentioned above which was tested in a special government programme called "Chances and incentives to take up employment subject to social security contributions" ("Chancen und Anreize zur Aufnahme sozialversicherungspflichtiger Beschäftigung" - CAST). The CAST variant of the Mainz Model has been on trial since July 2000 in two eastern German employment office areas and in four employment office areas in Rheinland-Pfalz. It is aimed predominantly at people with little (formal) qualification and the long-term unemployed, but the (fixed-term) support is not restricted to these groups. The main precondition is an employment relationship subject to social security contributions, paying a collectively agreed wage or a local wage rate and with a working week of at least 15 hours and an income of between € 325 and about € 800. For couples the lower and upper income limits are doubled. In mid-2001 recognisable acceptance problems led to the assistance conditions being modified (in particular the extension of the maximum duration of the assistance from 18 months to 36 months) which resulted in a slight increase in the assistance figures. From July 2000 until the end of December 2001 this form of assistance was granted 838 times in the participating employment office areas; on the reference date at the end of December 526 cases of this assistance were counted in the statistics.

It must be said that the use of this measure, especially in eastern Germany, has so far fallen far behind the original expectations. Apparently the development regions in eastern Germany are having particular problems with the acceptance of both of the programmes, because there seem to be other more favourable support possibilities. This applies above all for the Saar Model, with only ten cases approved in Saxony. But the Mainz Model, too, is taken up more hesitantly in Brandenburg than in Rheinland-Pfalz. As of 1 January 2002 the Mainz Model has been extended across the whole of Rheinland-Pfalz; in the meantime there are plans to extend it even further to cover the entire country. A comparative analysis of the use of different wage top-up models in Germany recently came to the conclusion that an expansion

of the Mainz Model on the basis of the use in Rheinland-Pfalz could lead to some 34,000 cases of this assistance per year in the country as a whole (Kaltenborn, 2001: 50). In view of the high unemployment level in Germany it would thus be a rather modest contribution to improving the employment problems. In addition the possible 34,000 assistance cases are to be seen at best as an upper limit of the potential labour market effect.

7. Concluding Remarks – New Developments

7.1 Job Placement and the Benefit System

Among the industrialised countries Germany belongs to the category of countries with relatively high levels of unemployment protection. (ILO, 2000: 147) These countries are characterised by a relatively high level and long duration of their unemployment insurance benefit payments, by extensive unemployment insurance coverage, and often by an additional layer of employment protection legislation aiming at greater employment security. Despite the recovery of economic growth in the OECD countries since the mid-1990s, unemployment rates are decreasing only slowly. Indeed, some of the larger countries with a high level of protection against unemployment, such as France, Germany or Italy are characterised by still high unemployment levels. However, the strong economic performance of some OECD countries demonstrates that the employment intensity of growth can still be sufficiently high to achieve substantial reductions in unemployment rates. For example, among the countries with high-level unemployment benefits, Denmark and the Netherlands have achieved the largest reduction in unemployment.

The various studies undertaken to assess the effect of unemployment benefit on unemployment and employment are summarised by the ILO (2000: 152ff.). While the duration of benefits may have some influence on the persistence of unemployment most

studies concluded that the influence of replacement ratios was neither large nor negligible.

These results are more or less confirmed by Steiner (1997), who investigated the extended benefit-entitlement periods and the duration of unemployment in West Germany. He used a panel of households (the annual Socio-Economic Panel) covering the period 1983 to 1994. The results of his econometric analysis indicated that the prolongation of entitlement to unemployment benefit increased the duration of unemployment for males, but had little effect for females. This result contradicts the popular belief that disincentive effects of the unemployment insurance system are especially severe for females by prolonging "wait unemployment" before they withdraw from the labour force. The estimation results also show, for both males and females, that only considerable reductions of the income-replacement ratio may have a sizeable effect on individual unemployment behaviour. We add that reductions plus stricter criteria for what is considered a "suitable" job may also discourage efficient job search and thus lead to allocative inefficiency in the labour market.

A more recent econometric study (Schneider/Hujer, 1999) comes to the conclusion that a reduction in unemployment benefit brings about a drop in unemployment. However, no statement is made about the size of the reduction needed to result in a substantial drop. With regard to the duration of benefit entitlement it is argued that a reduction after a certain duration of unemployment will have little effect as this group of unemployed people frequently consists of the hard-to-place unemployed. The jobs for these people simply do not exist.

"Activation" is currently the most important reform in European public employment services. It is also one of the cornerstones of the European Employment Strategy and is expected ultimately to lead to an increase in employment. Activation consists of three steps: (1) assessment of the abilities of the unemployed and his/her situation; (2) counselling on job and training opportunities; (3) after a defined period of receiving unemployment benefits, a regular job or an active labour

market measure, in terms of a subsidized job or a training scheme, has to be offered. From that moment on - as a rule before six months for youths, twelve months for adults - benefits are only available in exchange for an active participation in work or training. The German government now adopts this trend. A new law, the so-called Job-AQTIV Law (where Aqtiv stands for: a = activation, q = qualification, t = training, i = information, v = placement) suggests the following measures:

- Regular interviews with the unemployed to determine their skills and capabilities (assessment). This is followed by counselling on job opportunities and/or training schemes. The aim is to conclude a “contract” of integration with obligations on both sides;
- The assessment of the jobless can be contracted out to private agencies;
- Stricter application (e. g. for not being on time for a job interview) and enforcement of the “acceptability of job” criteria (e. g. by suspension of benefit payment);
- The introduction of “profiling” for all new jobless people. The aim is to combat ensuing long-term unemployment as soon as possible and not only after the individual concerned has become long-term unemployed. Thus, measures directed towards long-term-unemployment, can already be started when the assessment (profiling) of a person applying for unemployment compensation shows the risk of prolonged unemployment;
- Providers of re-/training measures for unemployed people will be integrated into making placement efforts for their trainees. Thus training should become better tailored to the needs of industry. Training providers who fail to place sufficient people who have successfully completed their training courses risk no longer being considered by the Federal Employment Service for further financing of their courses. Training providers may also be paid a fee for placements.
- Closer co-operation between social assistance agencies and the

Federal Employment Service. As has already been noted, social assistance is paid by the municipality. Therefore, unemployed social assistance claimants have a more restricted access to re-integration measures offered by the Federal Employment Service, which is first and foremost responsible for unemployment benefit recipients;

- Closer co-operation between the Federal Employment Service and private placement agencies. The latter can be paid a fee for the placement of an unemployed person. After a period of three months of unemployment the jobless can go to a private agency;
- “Job rotation” as a new labour market measure. Wage subsidies of up to 100percent can be paid to employers who recruit an unemployed person during the retraining period of a staff member.

7.2 Labour Market Policy and Evaluations

In-depth and international analyses (Martin and Grubb, 2001; Eichhorst, et al., 2001, 193 ff.) which do not only list the particular use of measures, but also take into account deadweight and displacement effects come to the conclusion that active labour market policy alone can not eliminate unemployment decisively. The success of active labour market policy depends quite considerably on cyclical and structural factors, on the tax, social insurance and social transfer systems and on the regulation of the labour and products markets. The effects of the measures of active labour market policy are probably to be found in general less in a lasting reduction of the unemployment level and more in a redistribution of the risks of unemployment: the chances of the problem groups in the labour market are improved – possibly at the expense of job-seekers who are not receiving assistance. Furthermore, active labour market policy can also be seen as a necessary accompaniment for strategies aimed at creating jobs (e.g. by speeding up economic growth or by means of a greater employment intensity with the given economic growth), firstly by maintaining,

expanding or adapting the human capital of the unemployed by means of active measures and secondly by increasing the resources available for structural policy (in particular infrastructure measures) – as is intended with the Job-AQTIV law that has just been passed. Thus it would depend on the limited resources for labour market policy being used as sensibly as possible to reduce structural unemployment. However, because it depends on being able to offer “tailor-made” solutions to the problems according to the different needs of each individual case, labour market policy requires a set of flexible instruments from which individual programme packages can be drawn up. The prime success criterion of labour market policy measures must be the reintegration of the participants into the so-called “primary labour market”. In this context not only the questions discussed previously as to the extent of the use of the measure arise but also the question as to the concrete implementation of the various programmes. In this respect a number of conflicts of aims emerge which should be looked into by means of further work in the field of impact research:

7.2.1 What level of benefits during the measures? Reasons for new benefit entitlements?

The level of benefits received during the measure can range, depending on the type of measure, from unemployment benefit as the minimum (e.g. in the case of training measures) to a wage orientated towards the market (e.g. in the case of job creation measures) as a maximum. What is of particular significance here is whether the participation in a measure results in new benefit entitlements (e.g. to unemployment benefit). In general it can be said that the more closely the “remuneration” from the measure is orientated towards the market wage and the more new benefit entitlements arise from participation in the measure, the less willing the programme participant is to look for alternative employment during the measure (and possibly afterwards). On the other hand it is true that the closer the remuneration from the measure is to unemployment benefit and the less benefit entitlements arise as a result of participating in the measure, the less willing the

unemployed person is to take part in the programme at all.

7.2.2 Measures within firms or external measures?

Measures within firms (e.g. trial periods of work, wage subsidies) increase the chances of the participants becoming reintegrated into the labour market, whether it is because the participants are taken on by the firm concerned or because they can apply to other firms better from a position of employment in a firm. Avoidance of the “stigmatisation effect” that threatens in the case of measures conducted outside of firms (e.g. with training providers or job-creation companies) is opposed, however, by the disadvantage of the possible deadweight effects.

7.2.3 When should the intervention take place?

The question here is whether labour market policy intervention should begin at the time when integration problems have actually become visible (e.g. at the onset of long-term unemployment) or whether labour market policy activities should be geared towards detecting people who are hard-to-place as early as possible and then intervening with measures immediately (so-called “profiling”). To the extent that early recognition of problem situations fails, the advantage of a later intervention would be the fact that assistance could be focused on the people who really need support. Deadweight effects and the costs of the measures can be reduced in this way. On the other hand, the disadvantage of a late intervention is that it might then be considerably more difficult and more costly to get the people concerned back into employment.

7.2.4 How long should the programmes last?

With regard to the duration of the programmes, too, it is not possible to give a clear recommendation. Long programmes entail the danger that participants in the measure are almost “locked up” and have neither much opportunity nor a great incentive to seek work actively. With short programmes, however, it is not always possible to

balance out the deficits of the people concerned, which are in some cases quite considerable (e.g. as regards qualifications).

7.2.5 How much “support by making demands”?

Activation requires that unemployed people can be offered either jobs or at least participation in labour market policy measures. Such activation strategies come up against limiting factors because budget restrictions only permit a very specific and not a broad utilisation of labour market policy measures and as a result of a lack of jobs not every unemployed person can be offered a job or training place. If the receipt of transfer payments is made dependent on participation in active measures, then this can be seen as a test of the people’s willingness to work. An incorrect allocation of active measures can occur, however, if they are used predominantly as a test of the unemployed individuals’ inclination to work.

The OECD concludes in its Employment Outlook of 2001 (OECD, 2001: 31) that “experience with active labour market programmes has shown the importance of more careful design and much greater emphasis on rigorous short- and long-term evaluation. Some relatively inexpensive policies (notably assistance with and active encouragement of job-search) have been found to be among the most cost-effective for substantial numbers of the unemployment. Another widely accepted priority is to continue to integrate active and passive labour market programmes and to improve the delivery of “passive” unemployment and welfare benefits, so as to encourage active participation in the labour market. As a consequence, the distinction between “active” and “passive” programmes should become less important in future.”

From the latest reform strategies pursued by the German government it can be seen that the measures of active and passive labour market policy are still regarded as important to combat unemployment and to improve the matching function of the German labour market. Many different instruments of active labour market policy are in use in Germany and they are only slightly “modernised” in

the new law. But the new Job-Aktiv Law, with its emphasis on activation of the unemployed, follows the trend observed in other countries and brings together elements of active and passive labour market policies. The multitude of instruments and the high level of expenditure is partly a consequence of the events which followed German unification more than ten years ago. The eastern part of Germany is still characterised by high levels of unemployment. Only parts of its economy can stand up to competition on the world market. In this situation a high degree of intervention in the labour market is implemented by the German state to ease the labour market situation and to make it socially more acceptable.

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5

Labor Market Trends and the Employment Insurance System in Korea

Kil-Sang Yoo*
Jaeho Keum**
Jai-Joon Hur***
Byunghee Lee***
Jiyeun Chang***

1. Introduction

1.1 Background

Korea has attempted several times to introduce an unemployment insurance system, and in fact, since the 1960s, the Korean Labor Administration has discussed the need for an unemployment insurance system. However, it was felt that the Korean economy was not developed enough to implement such a system, and efforts were limited to informal discussions within the department itself. In 1981, Korean government upgraded the Administration of Labor, forming the Ministry of Labor. In the same year, the Ministry of Labor, as well as other experts urged that mounting unemployment rates in the wake

* Vice President, Korea Labor Institute.

** Senior Fellow, Korea Labor Institute.

*** Research Fellows, Korea Labor Institute.

of the second oil crisis made it high time for Korea to introduce an unemployment insurance system. Even in the early 1980s, however, most Koreans were opposed to such a system, fearing that it would discourage the unemployed from searching for jobs, thereby resulting in a higher unemployment rate.

The 1981 discussions, however, resulted in a social consensus in favor of a uniquely Korean unemployment insurance system. In principle, the government would not deal with the issue through cash benefits. Rather, it would aim to prevent unemployment itself through stable economic growth and an efficient labor market system. In this respect, they agreed to name it the Employment Insurance System (EIS) rather than the Unemployment Insurance System.

In 1991, the Korea Labor Institute (KLI) recommended that the government introduce EIS during the Seventh Economic and Social Development Plan period (1992-1996). Korean government accepted recommendation of KLI, asking the institute to design a model for the first Korean Employment Insurance System. KLI launched the 28-man Employment Insurance Research Commission on May 18, 1992. Exactly one year later, on May 18, 1993, the commission presented its proposed employment insurance system to the government. The government, in turn, conducted public hearings to gather the opinions of various strata of society. Finally, based on the Commission's recommendations, the Employment Insurance Bill submitted to the National Assembly in September 1993, where the bill was passed unanimously on December 1, 1993, and promulgated on December 27 of the same year. The law went into effect on July 1, 1995, and the unemployment benefits, which required a minimum one-year contribution by the insured, became operational from July 1, 1996.

The Korean Employment Insurance System is a compulsory social insurance system. All employers and employees in participating enterprises must pay an insurance premium, which entitles workers to receive grants or unemployment benefits from the Employment Insurance Fund.

The traditional unemployment insurance systems in most countries concentrate on unemployment benefits. Much like German and Japanese models, however, the Korean EIS includes a set of active labor market policy measures. Unemployment benefits can discourage the unemployed from seeking work, thereby lengthening unemployment and reducing the labor supply. In order to prevent abuse of unemployment benefits, Korean EIS strictly oversees eligibility, while at the same time offering several incentives for early reemployment and vocational training.

1.2 Outline of Labor Market Policies and Employment Insurance System

The labor market policy in Korea comprises six different programs: unemployment benefits, wage subsidies, vocational training, public employment service, job creation, social assistance for low-income earners and the unemployed. The first four programs are basically under the umbrella of EIS. Only wage subsidy, vocational training and public employment service for the disabled are covered by special program for the disabled, which is financed by an employment levy for the disabled. While public employment services are financed mainly by tax revenues, a certain portion is financed by the Employment Insurance Fund.

Jobs are created under the Public Works Program, which provide temporary jobs for the low-income unemployed. Due to soaring unemployment rate after the financial crisis of November 1997, it was expanded during 1998 and 1999. Since 2000, however, it has been reduced as the unemployment rate has declined. The total number of temporary jobs created by the public works program was 219 thousand in 1998, 379 thousand in 1999, and 222 thousand in 2000. Public works programs were financed with tax revenues from both local and national governments. The vocational training program is financed by tax revenues as well as the Employment Insurance Fund. Vocational programs for insured employees is financed by the Employment

Insurance Fund, while for other, it is financed by tax revenues.

The unemployed who are covered can receive unemployment benefits if they meet the qualifications. Those who are unqualified for unemployment benefits or who have exhausted their unemployment benefits can receive social assistance as a last resort if their income is lower than the national minimum, as determined by the authorities.

In October 2000, the former Livelihood Protection Act was replaced with the National Basic Livelihood Guarantee Act. Under the new framework, social assistance is available to all citizens who cannot maintain the minimum standard of living subject to a means test and the beneficiaries are obliged to seek work unless they have no ability to work.

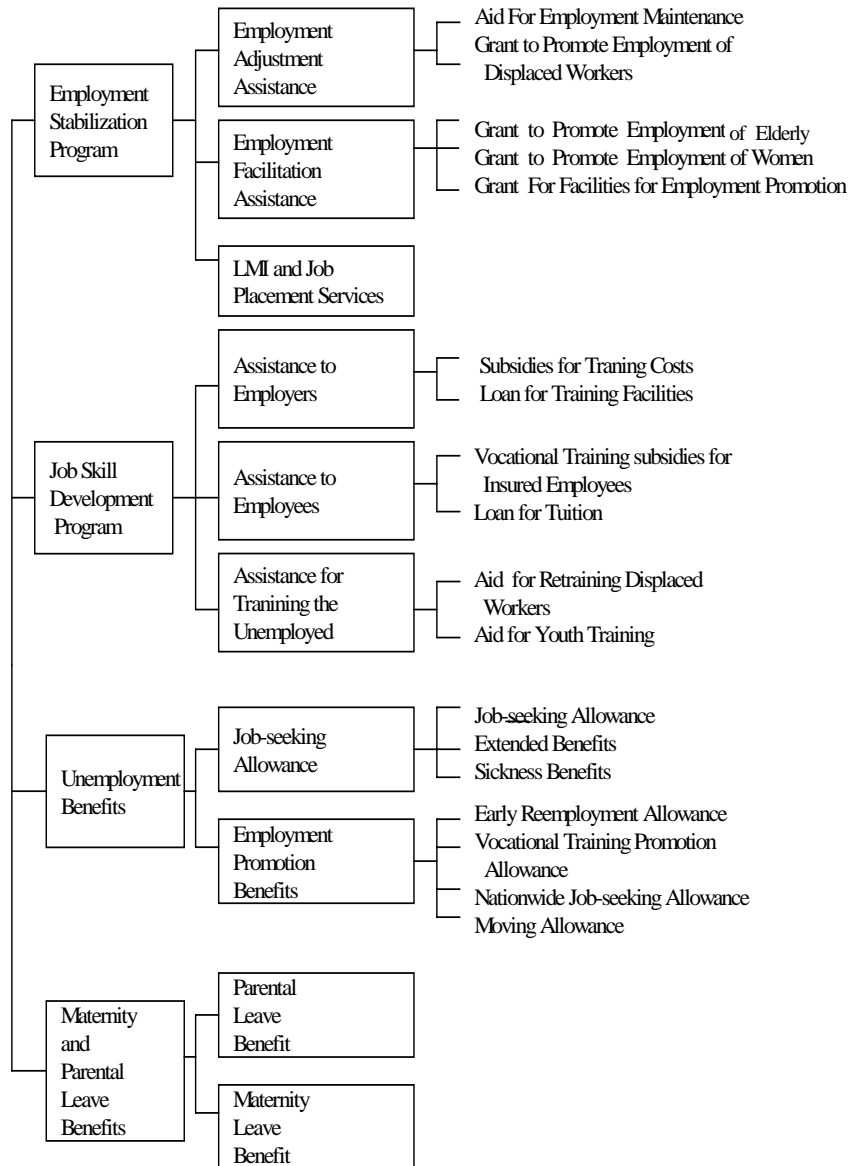
The first clause of the Korean Employment Insurance Law stipulates the principal purpose of fostering economic and social development: i) preventing unemployment and promoting employment in conjunction with the development of and improvement in vocational knowledge, skills and capabilities; ii) strengthening development of job skills of the labor force and efficient job placement services; and iii) providing financial assistance to displaced workers.

With those goals in mind, Korean EIS has created four basic programs: the Employment Stabilization Program, the Job Skills Development Program, Unemployment Benefits and Maternity and Parental Leave Benefits.

The Employment Stabilization Program (ESP) seeks to prevent massive layoffs and expedite transfers, to foster reorientation and adjustment when sudden changes in the industrial structure or technology result in extensive corporate restructuring, and to promote utilization of job seekers' skills and interests by providing accurate information on the labor market.

The Job Skills Development Program (JSDP) seeks to foster and stimulate lifelong vocational training and job skills development. JSDP provides financial incentives to encourage individual firms to invest in employee training, thereby improving labor productivity, employment stability, marketability of workers and firm competitiveness.

Unemployment Benefits aim to stabilize living conditions and promote early reemployment of displaced workers by providing unem-

FIGURE 1. STRUCTURE OF THE KOREAN EMPLOYMENT INSURANCE SYSTEM

ployment compensation. For those who are taking vocational training for reemployment, those who have found new employment in a relatively short period of time, or who are actively seeking work, there are financial benefits in EIS. This financial incentive system is to induce recipients of unemployment benefits to participate in retraining programs and actively seek new employment.

Maternity and Parental Leave Benefits will be implemented from November 1, 2001. This program was included in EIS to subsidize the costs for the protection of motherhood.

The structure of EIS is shown in Figure 1.

1.3 Financial Crisis and the Employment Insurance System

The Korean financial crisis devastated the Korean economy and labor market on a number of fronts. After the financial crisis in November 1997 and the International Monetary Fund (IMF) bailout package in December 1997, Korea experienced a GDP growth rate of -6.7 percent in 1998, after a 5.0 percent gain in 1997. This drastic downturn of the economy resulted in the highest unemployment rate that this country has even experienced. The unemployment rate, which was 2.1 percent in October 1997, soared to 4.5 percent in January 1998, 7.6 percent in July 1998, and further to 8.6 percent in February 1999. The annual unemployment rate was 2.6 percent in 1997, but it was 6.8 percent in 1998. The average number of the unemployed was 556 thousand in 1997, but it increased to 1.46 million in 1998. The average number of the employed also dropped from 21 million in 1997 to 19.9 million in 1998. Moreover, a large number of people moved into the economically inactive population as many unemployed people gave up searching for new job. As a result, the number of the economically inactive population increased from 13 million in 1997 to 13.85 million in 1998, while economically active population decreased from 21.6 million in 1997 to 21.4 million in 1998.

The financial crisis elevated the need for development of relevant

labor market programs and sound social safety nets for the unemployed. EIS has played a key role in mitigating unemployment and providing interim support for those who have suffered unemployment. In order to help displaced workers and smooth the employment adjustment process in the economic restructuring, there have been several changes in Korea's EIS after the financial crisis.

First, EIS coverage extended rapidly after the financial crisis. Until 1997, EIS applied to enterprises with thirty employees or more. It was extended to enterprises with ten employees or more from January 1, 1998, as scheduled. In February 1998, the Tripartite Commission, which is the presidential advisory board composed of representatives of government and political parties, management, and trade unions, agreed to expand the coverage of EIS to all enterprises from July 1, 1999. However, the Korean economy and labor market situation became much worse than expected as time passed. Confronted with a rapidly increasing unemployment rate, Korea expanded the coverage of EIS to enterprises with five employees or more from March 1, 1998, and to all enterprises regardless of their size from October 1, 1998.

Second, in order to help the unemployed from these smaller covered enterprises claim unemployment benefits, the qualifications for the benefits were temporarily amended. The former requirement of an insured employment period of 12 months out of the 18-month base period immediately before the layoff was shortened to six months out of a 12-months' base period from March 1, 1998, to June 30, 2000. The temporary amendment of qualification was revised to 180-day insured employment period out of 18-month base period from April 1, 2000.

Third, the amount of unemployment benefits was adjusted. The amount of the Job-seeking Allowance (JSA) is approximately 50 percent of the average wage of the three months immediately preceding the layoff, within the allowed maximum and minimum amount. The minimum amount of JSA began to increase from 50 percent of the minimum wage to 70 percent of the minimum wage from March 1, 1998, and 90 percent of the minimum wage from January 1, 2000. Also,

the amount of the Early Reemployment Allowance was increased from one-third of the remaining JSA to one-half of that from February 1, 1998.

Fourth, the Special Extended Benefits (SEB), which extends the duration of JSA by 60 days when the unemployment rate is six percent or higher in three consecutive months, was introduced in March 1998. It was implemented from July 15, 1998.

Fifth, measures for reducing unemployment were strengthened by amending the Employment Stabilization Program (ESP). The requirements and process for ESP were simplified, and the amount of assistance to an employer who averted unemployment through ESP was increased from 1998.

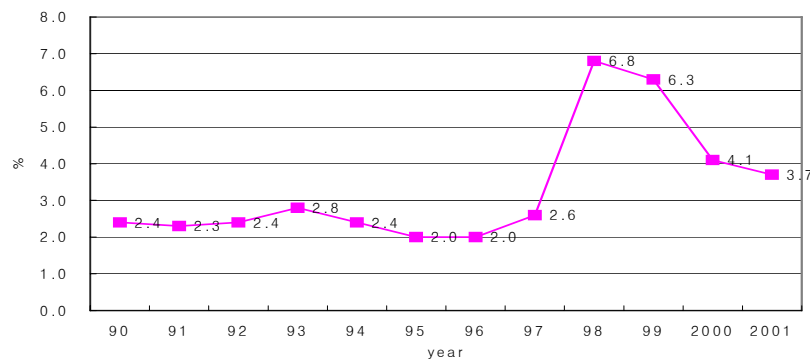
Sixth, confronting a rapid increase in expenditures for unemployment benefits and other programs, the contribution rate of EIS was increased in January 1, 1999, from 0.9-1.3 percent to 1.4-2.0 percent of the payroll, depending on the size of the enterprise.

2. Overview of Current Labor Market Conditions and Trends

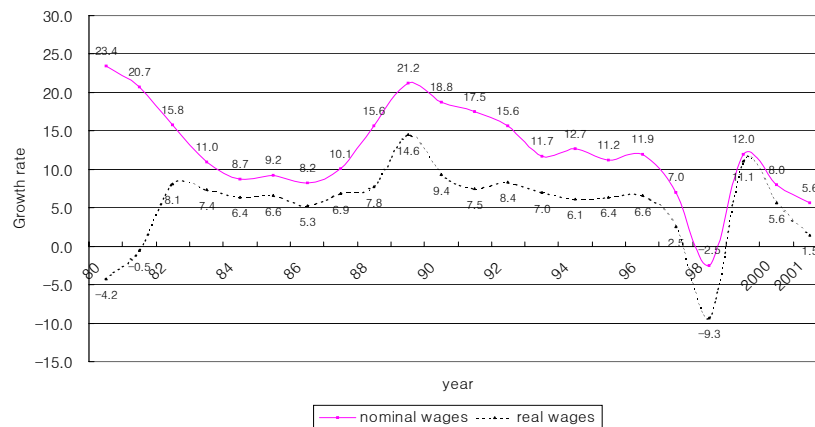
2.1 Overview of Employment and Unemployment

Due to phenomenal economic growth over the past three decades and the resulting rapid rise in the demand for labor, a serious labor shortage was already affecting Korea, even as the financial crisis hit in November 1997. The unemployment rate had remained less than 3 percent for more than 10 consecutive years as shown in Figure 2.1. Analysts argued that the rate was far below the “non-accelerating wage rate of unemployment (NAWRU).” During the 1990-1997 period the growth rate of nominal wages averaged approximately 13 percent as shown in Figure 2.2. Real wages almost doubled from 1987 to 1997. Wage increases far outstripped productivity increases, which in turn injured competitiveness of Korean goods abroad. Also, rapid wage

increases discouraged a large number of companies from investing.

FIGURE 2.1. UNEMPLOYMENT RATES

The financial crisis at the end of 1997, followed by structural reforms and macro-economic stabilization programs constricted economic activities of the labor force on a large scale. In 1998, the real GDP growth rate was unprecedented -5.8 percent, and the inflation rate rose to 7.5 percent. At the same time, the crisis accelerated the restructuring of the labor market. In order to minimize job losses, the Korean government encouraged the private sector to adopt more flexible management practices such as part-time employment, work-sharing, and flexible work hours. Wage flexibility was also an important

FIGURE 2.2. GROWTH RATES OF NOMINAL AND REAL WAGES

response to the crisis. Also, reacting to criticism that labor hoarding within firms was one cause of the financial crisis, an amendment to the Labor Standard Act was initiated by the Tripartite Commission. The amendment legally provides for the dismissal of excess labor, through which enterprises can lower labor costs and build up their competitiveness. Even though conditions for dismissals are relatively strict, and moreover, a firm is required to make efforts to rehire dismissed workers if it intends to recruit within two years, many workers lost their jobs.

In 1998, the number of employed decreased by 1.1 million, and the official unemployment rate reached 6.8%, with the number of the unemployed exceeding 1.4 million as shown in Table 2.1. Most unemployment resulted from the construction, trade and manufacturing sectors. By occupation, most were blue-collar workers such as machine operators, assemblers and manual laborers. After the financial crisis, the proportion of regular workers among the total workers decreased, while the proportion of temporary and daily workers increased as shown in Table 2.5.

Examining wage adjustments, the growth rate of nominal wages decreased from 7.0 percent in 1997 to -2.5 percent in 1998, while real wages fell by -9.3 percent in 1998. The results of collective bargaining in 1998 through July show that agreed wage increases averaged -2.4 percent. Out of 3,337 workplaces that had concluded bargaining, 2,259 agreed on a wage freeze, and another 559 workplaces even agreed on wage cuts.

As a result of the painful efforts toward economic restructuring after the financial crisis, the Korean economy is quickly recovering from the deep recession. Growth has resumed with the rebound of exports and the slow, but significant recovery of investments. Real GDP grew by 10.9 percent in 1999. Although the unemployment rate remained as high as 6.3 percent in 1999 mainly due to the lagging effects of business cycles on the labor market, it began to decrease significantly in 2000. The unemployment rate as of 2001 was 3.7

percent, with 795 thousand people unemployed.

TABLE 2.1. MAJOR EMPLOYMENT INDICATORS (AGED 15 AND OVER)

(unit: thousands, %)

	Economic activity			Unemployment	
	Economically active population	Labor force participation rate	Employment	Unemployed	Unemployment rate
1995	20,853	61.9	20,432	420	2.0
1996	21,243	62.0	20,817	426	2.0
1997	21,662	62.2	21,106	556	2.6
1998	21,456	60.7	19,994	1,420	6.8
1999	21,634	60.5	20,281	1,353	6.3
2000	21,950	60.7	21,061	889	4.1
2001	22,181	60.8	21,362	795	3.7

Source: Labor Force Survey, National Statistical Office.

However, it can hardly be said that the financial crisis is over in the labor market. The current unemployment rate is still high, especially considering the lack of a social safety net. While unemployment rates are falling, it is unlikely that they will return to the low level of 2 percent recorded before the financial crisis. Also, the overall labor force participation rate in 2001 is only 60.8 percent, which is far below than the figure of 1997. And the number of employed in 2000 is still below than that of 1997 as we can see in Table 2.1. The relatively low employment/population ratio and the number of the employed suggest that there are still a large number of discouraged workers who have stopped actively seeking work because of the economic downturn.

2.2 Changes in the Employment Structure

Thanks to high economic performance, Korea has succeeded in absorbing the new labor force that has entered the labor market. Since the first Economic Development Project in the early 1960s, employment has increased rapidly. The number of employed rose from 13.98 million in 1980 to 21.11 million in 1997 and to 21.36 million in 2001. During this period, female workers led the increase, not only in

the number of employed, but also in the labor force participation rate.

TABLE 2.2. ECONOMIC ACTIVITIES BY GENDER (AGED 15 AND OVER)

(unit: thousands, %)

		Economically active population	Labor force participation rate	Employment
Male	1980	9,019	76.4	8,642
	1985	9,617	72.3	9,137
	1990	11,030	74.0	10,709
	1995	12,433	76.5	12,153
	1996	12,636	76.1	12,345
	1997	12,772	75.6	12,420
	1998	12,893	75.2	11,910
	1999	12,889	74.4	11,978
	2000	12,950	74.0	12,338
	2001	13,012	73.6	12,467
Female	1980	5,312	42.8	5,222
	1985	5,975	41.9	5,833
	1990	7,509	47.0	7,376
	1995	8,397	48.3	8,256
	1996	8,607	48.7	8,472
	1997	8,891	49.5	8,686
	1998	8,562	47.0	8,084
	1999	8,745	47.4	8,303
	2000	9,000	48.3	8,707
	2001	9,169	48.8	8,895

Source: Labor Force Survey, National Statistical Office.

In fact, female participation rose from 42.9 percent in 1985 to 48.5 percent in 1997. Various factors such as decreasing fertility, expansion of child-care services, growth of the IT industry, and flexible work hours have contributed to this increase.

Even though the labor force participation rate increased steadily during the 1990s, mainly due to the increasingly active role of females, Korean participation rates are low by international comparison. In 1999, the overall participation rate was less than 61 percent, i.e., 4 percentage points less than the OECD average. As seen in Table 2.2, the female participation rate is particularly low. This is mainly attributable to the lack of institutional infrastructure such as child-care and maternity leave, as well as to continued sexual discrimination. Women show a strong tendency to withdraw from the labor market after losing jobs, which

partially explains their low participation rate.

Due to successful industrialization, the share of agriculture, hunting and forestry sectors in the employment market has decreased dramatically since the early 1960s. In 2001, only 10.3 percent of overall employment is in the primary industries. The employment share of the manufacturing sector also decreased after recording a 27.1% share in 1990. In contrast, service industries such as wholesale, retail, hotels & restaurants and real estate are employing workers at increasing rates.

TABLE 2.3. INDUSTRY COMPOSITION OF EMPLOYMENT

(unit: %)

	A	M & M			Service			
			M		C	W	E	R
1980	34.0	22.5	21.6	43.5	6.2	19.2	7.3	10.9
1985	24.9	24.4	23.4	50.6	6.1	22.6	8.7	13.3
1990	17.9	27.6	27.2	54.5	7.4	21.8	10.7	14.6
1995	11.7	22.6	22.5	65.7	9.5	27.1	9.3	19.8
1997	11.3	21.4	21.2	67.3	9.5	27.5	9.5	20.9
1998	12.4	19.6	19.5	68.0	8.9	27.9	10.0	22.3
1999	11.6	19.9	19.8	68.6	7.3	28.2	9.8	23.3
2000	10.9	20.2	20.2	68.9	7.5	28.2	9.8	23.4
2001	10.3	19.8	19.7	70.0	7.4	27.2	9.9	25.5

Notes: A: Agriculture, Hunting and Forestry

M & M: Mining and Manufacturing

M: Manufacturing

S: Service Sector

C: Construction

W: Wholesale, Retail, Repair, Hotels and Restaurants

E: Electricity, Transport, Storage and Financial Service

R: Real Estate and Other Services

Source: Labor Force Survey, National Statistical Office.

In terms of occupation, employment loss was most concentrated among machine operators, assemblers and manual laborers, reflecting the decreasing share of employment in manufacturing industries. In addition, a reduction in the number of clerical workers, mainly due to the office automation, can be observed in Table 2.4. The proportion of managers and (associate) professionals increased from 15.4 percent in 1994 to 18.7 percent in 2001. During the same period, the proportion

of service and sales persons also increased from 21.6 percent to 26.4 percent. From Table 2.4, we conclude that decreased employment after the financial crisis was not evenly distributed across a wide variety of occupations, but was more concentrated in the lower echelon of job clusters.

TABLE 2.4 EMPLOYMENT BY OCCUPATION

	(unit: %)				
	Legislators, managers & (Associate) Professionals	Clerks	Service & Sales	Agricultural & Fishery	Machine operators, assemblers & Manual laborers
1994	15.4	12.2	21.6	13.0	37.8
1995	16.3	12.3	21.9	11.7	37.7
1996	17.0	12.3	22.5	11.1	37.1
1997	17.5	12.2	23.1	10.8	36.5
1998	18.7	12.1	23.7	11.8	33.7
1999	19.0	10.9	23.8	10.9	35.3
2000	18.8	11.2	23.9	10.2	36.0
2001	18.7	11.8	26.4	9.7	33.3

Source: Labor Force Survey, National Statistical Office.

Compared to OECD countries, the Korean labor market shows two distinguishing characteristics. First, a large number of workers are employed in “non-regular, temporary jobs with a low degree of stability. In 2001, 51.3 percent of employees were either temporary or day laborers (See OECD 2000 for definitions of “regular” and “non-regular” employment as well as a definition of unemployment). The incidence of non-regular work is particularly high among women, older workers and the less educated, while younger and more educated male workers perform the majority of regular jobs. The proportion of “non-regular” workers showed a “U pattern” during 1990s. That is, the share of “non-regular” workers initially decreased and then increased. After the financial crisis, especially, the share of “non-regular” workers increased substantially. For example, the number of day workers rose from 1,933 thousand in the

fourth quarter of 1997 to 1,961 thousand in the same quarter of 1998.

The statistical figures of “non-regular” workers are somehow misleading because a large number of temporary workers and day workers have worked for more than one year. In the Labor Force Survey, any worker who did not receive either severance payment or medical insurance and other benefits was regarded as “non-regular” even if his/her employment exceeded one year. This practice exaggerates the real scope of the “non-regular” work. If we count these workers, the actual proportion of “non-regular” workers is estimated at roughly 26 to 30 percent.

Second, self-employment in Korea is among the highest for OECD countries. The proportion of the self-employed, including both employer and paid workers, was relatively stable at 27 to 29 percent during 1990s. Unpaid family workers account for about 10 percent of overall employment as shown in Table 2.5.

Part-time work, referring to persons working less than 36 hours per week, makes up a lesser share than other OECD countries. In 1996, the proportion of part-time workers was only 6.2 percent, and has slowly increased over the years, to reach 10.1 percent in 2001, as shown in Figure 2.3 below.

TABLE 2.5 EMPLOYMENT BY TYPE

(unit: %)

	Wage workers				Non-wage workers		
	Total	Regular ¹⁾	Temporary ²⁾	Daily ³⁾	Total	Self-employed	Unpaid family worker
1990	60.5	32.8	17.5	10.2	39.5	28.0	11.4
1992	61.0	34.8	16.9	9.3	39.0	28.5	10.5
1994	61.9	35.8	17.2	8.9	38.1	27.8	10.2
1996	62.8	35.6	18.5	8.7	37.2	27.9	9.3
1997	62.7	33.9	19.8	9.0	37.3	28.3	9.0
1998	61.0	32.3	20.0	8.7	39.0	28.9	10.1
1999	61.7	29.8	20.6	11.3	38.3	28.8	9.5
2000	62.4	29.7	21.4	11.3	37.6	28.5	9.1
2001	62.4	30.4	21.5	10.5	37.6	28.9	8.9

Notes: 1) Regular Workers: Workers whose contract terms are a minimum of one year or for an unspecified term.

2) Temporary Workers: Workers whose contract terms are shorter than one year but equal to, or longer than one month.

3) Daily Workers: Workers whose contract terms are less than one month.

Source: Labor Force Survey, National Statistical Office.

2.3 Changes in the Unemployment Structure

Among the unemployed, males outnumber females two to one, because females are more likely to withdraw from the labor market after losing a job. On the contrary, unemployed males, usually responsible for supporting a family, actively search for new job opportunities.

FIGURE 2.3. PROPORTION OF WORKERS WORKING LESS THAN 36 HOURS PER WEEK (%)

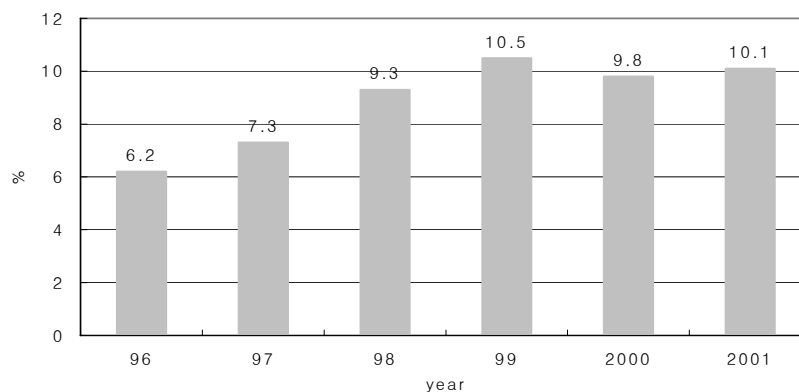


TABLE 2.6 UNEMPLOYMENT BY GENDER, AGE AND EDUCATION

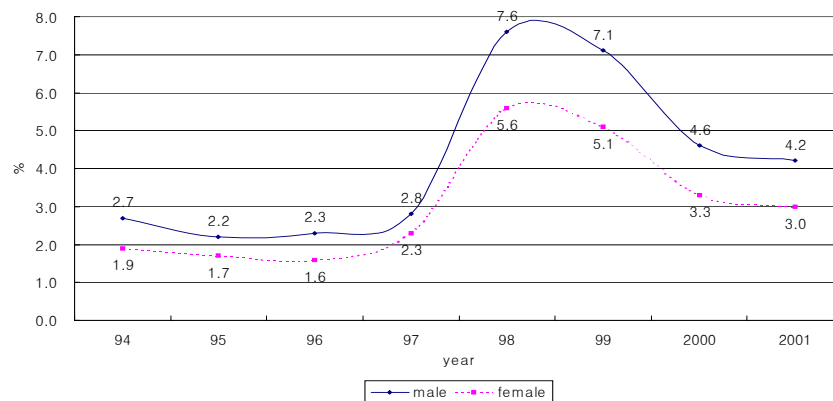
		(unit: %)				
		1997	1998	1999	2000	2001
Total		100.0	100.0	100.0	100.0	100.0
Gender	Male	63.2	67.3	67.3	67.1	66.5
	Female	36.8	32.7	32.3	32.9	33.5
Age	15 – 19	7.6	5.9	6.3	6.9	6.7
	20 – 29	48.7	36.0	33.4	35.2	37.2
	30 – 39	20.5	24.6	24.2	22.9	21.9
	40 – 49	13.1	19.2	20.4	21.0	20.5
	50 – 59	7.2	11.1	12.0	10.6	10.6
	60 and over	2.7	3.2	3.6	3.3	3.2
Education	Middle school & below	21.4	28.1	27.3	26.1	24.1
	High school	55.2	52.4	52.7	51.0	50.7

Junior college and over	23.6	19.5	20.0	22.9	25.3
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Source: Labor Force Survey, National Statistical Office.

Figure 2.4 demonstrates differences in unemployment rates between men and women during the 1990s. Before the financial crisis, there was a relatively small difference between males and females in unemployment rates. After the crisis, however, women were more likely to leave the tight labor market, while men looked more actively for jobs. As a result, the unemployment gap between male and female widened from 0.5 percentage points in 1997 to 2.0 percentage points in 1998.

FIGURE 2.4. UNEMPLOYMENT RATES BY GENDER



Unemployment patterns differ considerably based on age. The rate of youth participation in the labor force is quite low by international standards, which can be ascribed to facts: 1) More than 80 percent of high school graduates pursue a higher education and 2) Most full-time students don't have part-time jobs. However, unemployment rates among youth, just as in European countries, are relatively high as shown in Figure 2.5. Youth unemployment is structural in nature. High rates of youth unemployment may reflect a long job search process on the part of college graduates, whose parents support their basic needs. Skill mismatches between the educational curricula and labor market demands may also induce serious school-to-

work transition problems for many young entrants, especially females who studied liberal arts in college. Compare to other age groups, unemployment rates of workers aged 60 and over were consistently low, reflecting the fact that older workers, especially female older workers, are more likely to withdraw from the labor market after losing a job.

Figure 2.6 indicates the trend in unemployment rates by level of education. Traditionally, the unemployment rate was higher for 'junior college & over' than for 'high school'. However, the unemployment gap between the two groups narrowed over time, and finally reversed after the financial crisis. In year 2001, unemployment rates for 'high school' and 'junior college & over' were 4.3 and 3.8 percent respectively. Empirical analysis shows that structural adjustments after the financial crisis were associated with downward mobility of workers as less-educated workers were forced to leave their jobs in favor of higher-educated workers. Another explanation of this phenomenon is that the shrinkage of manufacturing and construction industries, which hire large number of workers with 'high school' educations, may have partially caused the rapid increase in unemployment rates of workers with a high school education. However, the unemployment gap between 'high school' and 'junior college & over' has been narrowed recently as seen in Figure 2.6.

FIGURE 2.5. UNEMPLOYMENT RATES BY AGE (%)

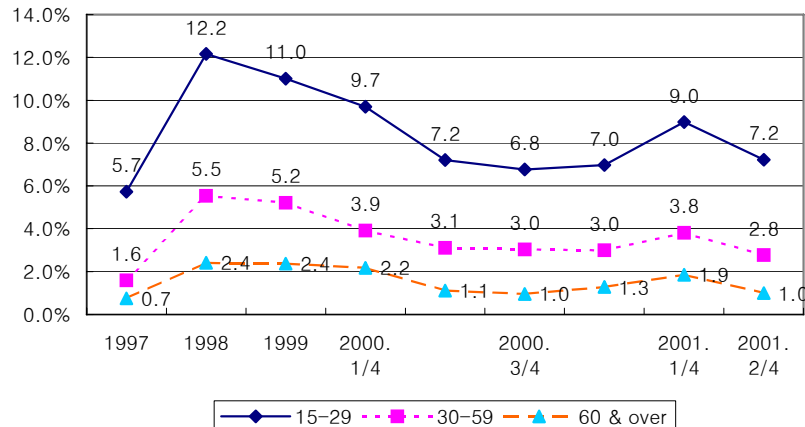
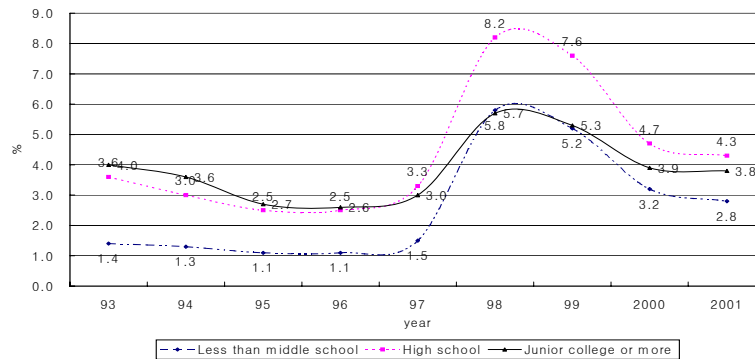


FIGURE 2.6 UNEMPLOYMENT RATES BY EDUCATION (%)

Before the financial crisis, job terminations were voluntary, as shown in Figure 2.7. The ratio of unemployed due to involuntary terminations was only 32.9 percent in 1995. However, since the crisis the ratio of unemployed due to involuntary termination has recorded a marked upward trend, from 35.7 percent in 1997 to 80.1 percent in the first quarter of 1998, suggesting that most job terminations right after the crisis were involuntary. We can observe that the ratio of unemployed due to involuntary job termination continues to fall as a result of economic recovery and structural adjustments, even though the ratio of unemployed due to involuntary termination is still over 50 percent.

FIGURE 2.7. RATIO OF INVOLUNTARY UNEMPLOYMENT (%)

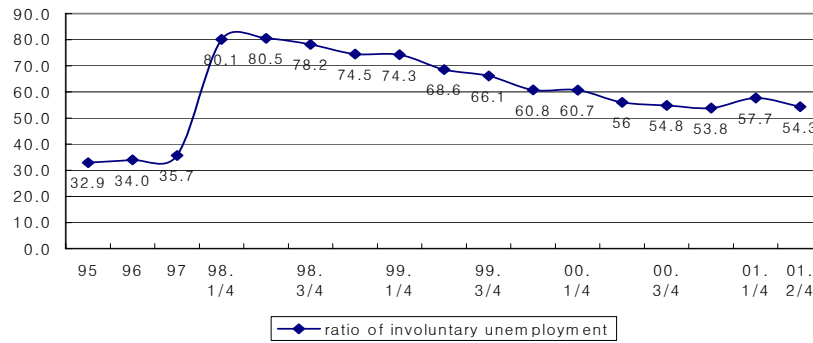
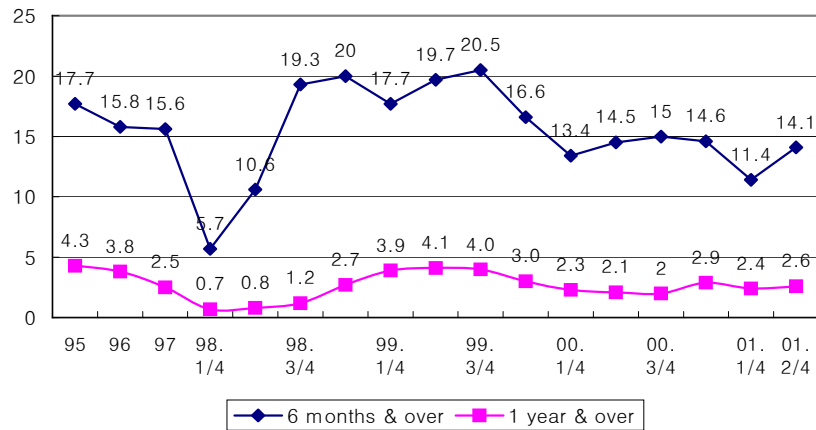
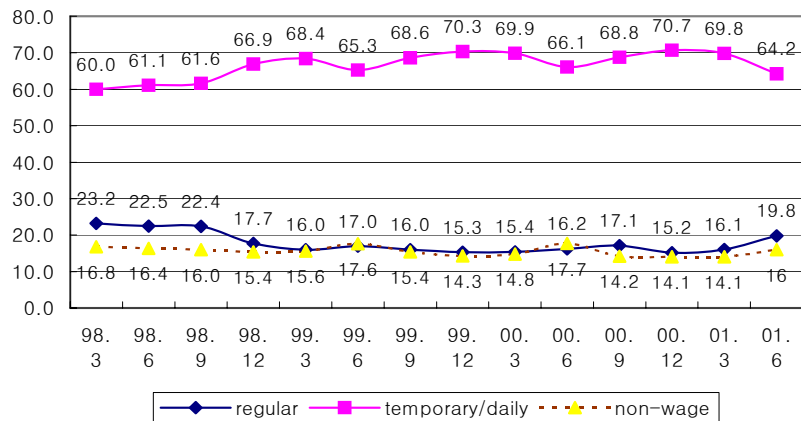


FIGURE 2.8. INCIDENCE OF LONG-TERM UNEMPLOYMENT (%)



One of the most important and least visible consequences of a deep recession is a large and expanding pool of people who have been unemployed for a long period of time. The term *long-term unemployment* is defined as unemployment for over one year. Figure 2.8 below illustrates how long-term unemployment rates have changed over time. From 1995 to the second quarter of 2001, long-term unemployment

FIGURE 2.9. UNEMPLOYMENT BY PREVIOUS JOB TYPE (%)



rates show relatively little change. Traditionally, the long-term unemployment rate has been higher for men than for women, and positively correlates with education, and this trend still prevailed after the financial crisis. Long-term unemployment appears to be much less of an issue in Korea than in other OECD countries. This is probably explained by the low level of unemployment in the past, coupled with absence, until recently, of a social welfare system.

Figure 2.9 illustrates the composition of unemployed workers by previous job type. During the reference period, more than 60 percent of unemployed were either temporary or daily workers, indicating the vulnerability of ‘non-regular’ workers.

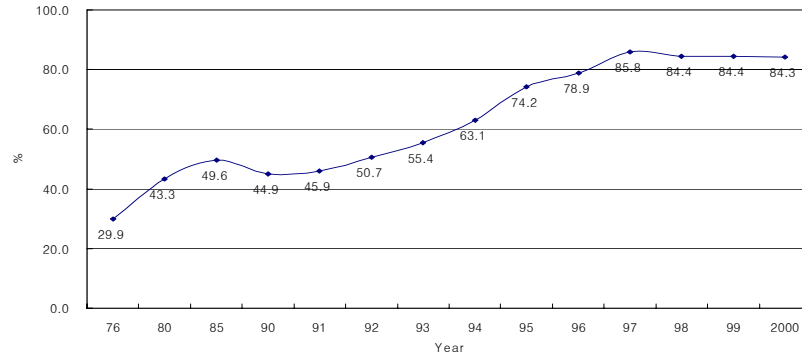
2.4 Challenges in the Labor Market

The primary problems facing the Korean labor market in the future can be summarized as (1) mismatch and (2) a widening gap among laborers. The problem of mismatch includes youth unemployment, increasing activities of women, employment of older workers, and skill mismatch, while the widening gap between laborers includes increase of non-regular workers, long-term unemployment, and decreasing job stability. However, only three issues will be

discussed here.

The first issue is the youth labor market. As of 2000, 42.1 percent of the unemployed corresponded to the 15-29 age group. Even though the unemployment rate in this age group was the highest among all age groups, the actual number of persons looking for job is probably much higher than official statistics show, since many discouraged youth aren't included. The main reason for the serious problem of youth unemployment is the large percentage of youngsters going on to higher education. As seen in Figure 2.10, more than 80 percent of the high school graduates have gone on to the college recently. This factor, coupled with the recent economic depression, has generated a large pool of unemployed among graduates.

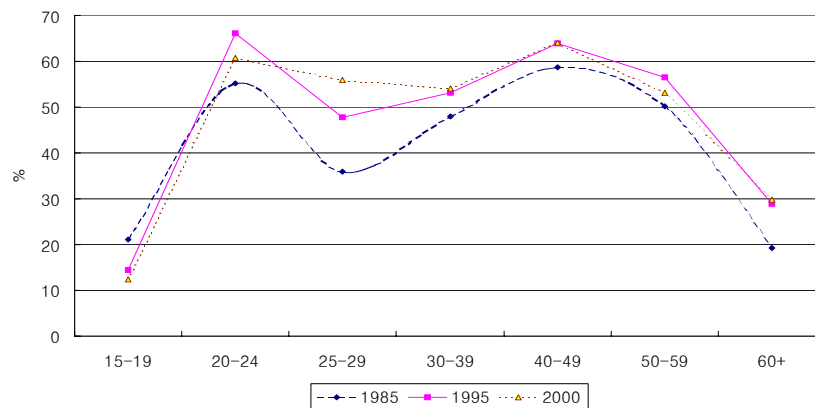
The second issue is the increasing desire on the part of women to

FIGURE 2.10 COLLEGE ENTRANCE RATE

enter the job market. In the past, female economic activity was characterized by a plateau-shaped graph pattern, as shown in Figure 2.11. However, due to various factors such as expanded education opportunities for women, development of a child-care system and changing social attitudes, more and more women are willing to participate in the labor market.

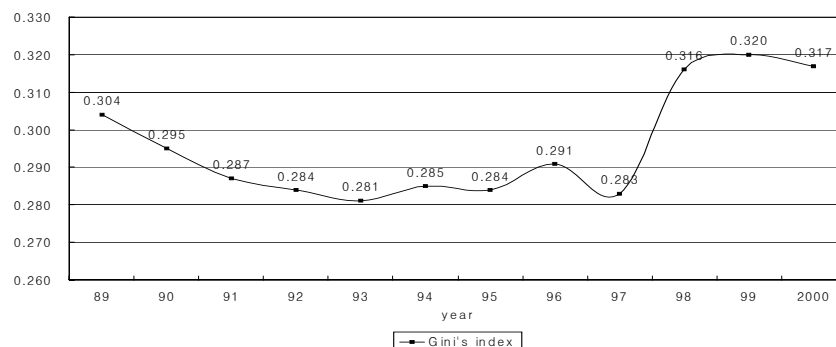
However, most female workers currently belong to the secondary labor market, and gender-based wage inequalities are large relative to other countries. Even though some improvements have been observed in recent years, there is still widespread sexual discrimination.

FIGURE 2.11 FEMALE PARTICIPATION IN THE LABOR FORCE BY AGE



The third issue concerns the worsening of the employment structure. As the proportion of ‘non-regular’ jobs has greatly increased, the income gap among workers seems to be widening recently, as seen in Figure 2.12. Since this trend toward an increased percentage of ‘non-regular (or non-standard)’ work in the labor market has been observed in many advanced countries, it is only reasonable to consider how and to what extent these ‘non-regular’ workers should be protected in terms of basic labor standards as well as in the framework of active labor market programs.

FIGURE 2.12 GINI INDEX



3. Coverage, Financing and Funds

3.1 Coverage

When the EIS was first introduced in July 1995, unemployment coverage was limited to workers employed at firms with 30 or more employees, and those in firms with more than 70 employees for the Employment Stabilization Program and the Job Skill Development Program. Given increasing unemployment and widespread low-wage earners at small size firms more vulnerable to unemployment, the extension of UI coverage was deemed critical after the financial crisis so that the EIS could care as many unemployed as possible.

Thus, the Korean government extended the coverage of UI to firms with 10 or more employees (January, 1998), to firms with 5 or more employees (March, 1998), and then, to all firms with at least one employee (in October, 1998). After a sequence of amendments of Employment Insurance Law in 1998, only those part-time workers working less than 80 hours a month and daily workers employed less than a month remained 'legitimately' excluded from EIS coverage. The coverage of two other components of EIS was correspondingly extended, with slight lag, together with coverage extension of EIS.

TABLE 3.1. CHANGES IN COVERAGE EXTENSION OF THE EIS

Date	Unemployment insurance component	Employment maintenance/Promotion & job training components
July 1, 1995	≥ 30 employees	≥ 70 employees
January 1, 1998	≥ 10 employees	≥ 50 employees
March 1, 1998	≥ 5 employees	≥ 50 employees
July 1, 1998	≥ 5 employees	≥ 5 employees
October 1, 1998	≥ 1 employee	≥ 1 employee

Source: Ministry of Labor (2000), *White Paper on Employment Insurance*, Seoul.

However, coverage is still incomplete. This incompleteness results

mainly from two different origins. Non-regular employees who work less than a month in a firm are legitimately excluded from EIS coverage (considerable part of the difference between B and C in Table 3.2.). And the insurable employees are not all covered now because of the disincentive for frequently turning over non-regular employees, regular-worker-oriented regulations such as declaration process and document forms, limited administrative capacity as well as informal characteristics of economic agents in the labor market (Hur, 2001; Hur and Yoo, 2001). As of December 2001, the compliance rate was only 73.9%, which means that there is a large gap between the coverage *de jure* and the coverage *de facto* (the difference between C and D in Table 3.2.). Many of temporary and daily employees are still excluded from EIS coverage and remain out of protection.

TABLE 3.2. EIS COVERAGE (DECEMBER 2001)

(Unit: thousand persons, %)

Employ- ment (A)	Employees (B)	Employees legitimately insurable(C)	Insured employees (D)	$(D/A) \times 100$	$(D/B) \times 100$	$(D/C) \times 100$
21,347	13,625	9,352	6,909	32.4	50.7	73.9

Source: National Statistical Office, Economically Active Population Survey Work Information Center, Monthly Statistics of Employment Insurance.

Non-regular employees have been beyond the scope of the employers' personnel management. Thus, it has not been possible for a non-regular employee who has resigned to request an employment certificate. And, if it is not impossible, there are many non-regular employees who think that it is a irksome task to request and accumulate employment records for the future possibility of receiving unemployment benefits, given those restrictions on eligibility and low probability of proper record-keeping in most of workplaces.

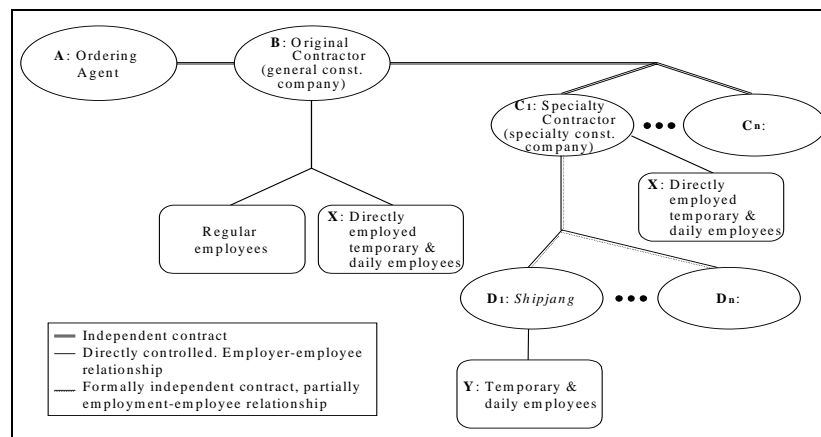
Daily employees, which explains 15 percent of the total employees, have a very particular type of employment relation. Daily employees are hired on a daily basis, generally for cash, and their employers are not accustomed to keeping records. Many of them are employed under

vague employment relationships. Employees employed by *Shipjangs* in construction are examples of this category of workers. Figure 3.1. shows in a simplified form how these *Shipjangs* fit into the employment structure in the construction industry. *Shipjangs* does not have legal status as an employer and their identity is unstable. The status of *Shipjang* is ambivalent as any experienced worker in the construction industry who can organize a worker pool can become a *Shipjang* while he is regarded as just a worker when he participates in a pool organized by another *Shipjang*.

A large number of workers come into and out of a construction site following construction process. Many specialty contractor employers who maintain traditional management style and share informality with the *Shipjang* have not conformed to the regulations. Frequent employee turnover and employment relation via *Shipjangs* have meant that labor administration control has been difficult.

This particular employment relation resulted in absence of employment career certifying mechanism and made it difficult to design eligibility and benefit rules. Regular employees could provide their employment record when it is necessary by submitting the 'employment certificate' issued by employer. But many non-regular employees have not been able to prove their work experience as their employment records were not kept by employers. Thus EIS excluded daily employees from its coverage. But the way that the EIS excluded daily employees caused coverage holes. As the EIS excluded from its coverage those workers employed less than a month, employers, where labor turnover is frequent and where the predominant number of employees are non-regular, tended not to declare those non-regular workers employed more than a month leaning on the exclusion rule.

FIGURE 3.1 STRUCTURE OF CONSTRUCTION LABOR MARKET



It was evident that the EIS had to establish employment record reporting system of daily employees and design benefit rules suitable for the particular employment relation of daily employees if the EIS were to complete its coverage.

From 2003, the coverage of EIS will be fully extended to all employees including daily employees and only employees aged 65 or more, workers in household services, civil servants and private school teachers, and fishermen engaged in coastal fishery will be legitimately excluded employees. According the newly defined employment record reporting system, employers should report employment-related information of daily workers every month to the Ministry of Labor. If the number of a daily employee's working day falls below 10 days per month, he or she will be able to claim unemployment benefit under the condition that he or she satisfies other eligibility conditions (Hur and Yoo, 2001).

3.2 Financing Rules and Contribution Rates

The Employment Insurance Fund is financed by both employees and employers. But rules are different among EIS components. The UB component is financed by equal contributions from both covered

employees and employers. Only employers are responsible for financing the costs of both ESP and JSDP. The EIS fund for the UB component also can be used for expenditure for the Maternity and Parental Leave Benefits. As for administrative costs of EIS such as wage of staff, rent for buildings, expenditure for equipments and S/W, etc, the government bore the whole of the expenditures financing from the general budget. But after the financial crisis, EIS Fund shares the administration cost with general budget.

Each component of EIS has its own rate of contribution. The sum of contribution rates in each program cannot exceed 3.0 percent of the total payroll. The contribution rate of each program is determined within the limit of contributions considering the financial situation of the Employment Insurance Fund and the prospects of economic and labor market situations.

When the EIS was first introduced on July 1, 1995, the contribution rate for the Unemployment Benefits was 0.6 percent (0.3

TABLE 3.3 CHANGES IN CONTRIBUTION RATES

(Unit: %)

	Jul. 1995~Dec. 1998	Jan. 1999~
Unemployment benefits	0.6 (0.3 by employee, 0.3 by employer)	1.0 (0.5 by employee 0.5 by employer)
Employment stabilization program	0.2 (employer only)	0.3 (employer only)
Job skill development program	0.1-0.5 depending on firm size(employer only)	0.1-0.7 depending on firm size(employer only)

Source: Ministry of Labor (2001), *White Paper on Employment Insurance*.

percent from employees and 0.3 percent from employers) of the total payroll, that for the Employment Stabilization Program was 0.2 percent, and the Job Skill Development Program has a differentiated rate based on the size of the firm between 0.1 percent and 0.5 percent. (in percent out of total payroll) However, the financial crisis of Korea in November 1997 resulted in a high unemployment rate and it was expected that high unemployment rate will prevail for several years and

expenditures will remain high for unemployment benefits and active labor market programs. Also those newly covered by the EIS in 1998 were expected to increase the unemployment benefit expenditures, becoming eligible for unemployment benefits from April 1, 1999.

Considering these factors, the Korean government decided to raise the contribution rate of each program from January, 1999. As of 1999, the contribution rate for the Unemployment Benefits is 1.0 percent (0.5 percent from employees and 0.5 percent from employers), that for the Employment Stabilization Program is 0.3 percent. The contribution rate for the Job Skill Development Program is between 0.1 percent and 0.7 percent of the total payroll depending on the size of firm.

3.3 Employment Insurance Fund

The Employment Insurance Fund (EIF) has a separate account for each component of the EIS: an account for the Employment Stabilization Program, an account for the Job Skill Development Program, and an account for Unemployment Benefits.

The EIF is managed by the Ministry of Labor. But their financial state and the year's plan are submitted to Employment Insurance Committee comprised of trade union representatives, employer representatives, government officials and specialists from academic society.

Economic circumstances can change unpredictably and often severely, producing sharp fluctuations in the level of unemployment. Thus, unemployment is subject to greater volatility compared to other contingencies of the social insurance programs. EIS revenue increases in boom and decreases in recession. In contrast, EIS expenditures decrease in economic upturn and increase sharply in recession or crisis because of the need for active or passive labor market policies. As a result, the financial state of the EIF varies counter-cyclically experiencing amplified fluctuations during economic cycles. Therefore the EIF has to dispose of reserves to meet serious economic downturns and high unemployment rate.

Further, Korean EIS has gone through continuous changes during last five years, including coverage extension, lengthening of benefit duration, etc. Also its financial structure seems to experience great change before its expenditure pattern is stabilized if daily employees are covered by the EIS and maternity protection is financed by the EIF.

It is thus difficult to set the optimum level of Korean EIS reserve fund. The reserve should not be unnecessarily high, so as not to distort economic activities of private sector economy while it should not so low as to risk depletion of the fund and default on benefit liabilities.

In 1998, the total revenue of EIF was 1.4 trillion won, and the total expenditure was 1.2 trillion won, resulting in a surplus of 179 billion won (Table 3.4.). In 1999, the total revenue of EIF was 2.0 trillion won, and the total expenditure was 1.7 trillion won, resulting in a surplus of 280 billion won (Table 3.4.). The soundness of the EIF was not deteriorated even during the crisis. In 2000, the surplus increased further to 1.2 trillion won with the total revenue of 2.3

TABLE 3.4. REVENUE, EXPENDITURE AND RESERVE OF THE EMPLOYMENT INSURANCE FUND

(Unit: million won)

		Revenue (A)	Expenditure (B)	Surplus (A-B)	Reserve
1998	Employment Stabilization Program	271,975	111,031	160,944	553,554
	Job Skill Development Program	290,553	270,768	19,785	437,012
	Unemployment Benefits	806,937	808,910	-1,973	1,179,810
	Total	1,369,465	1,190,709	178,756	2,170,376
1999	Employment Stabilization Program	373,209	202,596	170,613	724,167
	Job Skill Development Program	521,696	531,025	-9,329	427,683
	Unemployment Benefits	1,082,171	963,162	119,009	1,298,819
	Total	1,977,076	1,696,783	280,293	2,450,668
2000	Employment Stabilization Program	448,216	133,736	314,177	1,038,647
	Job Skill Development Program	537,761	503,537	34,224	461,907
	Unemployment Benefits	1,330,904	502,703	828,201	2,127,019
	Total	2,316,881	1,139,976	1,176,905	3,627,573
2001	Employment Stabilization Program	549,334	155,125	394,209	1,432,856
	Job Skill Development Program	645,950	512,138	133,812	595,719
	Unemployment Benefits	1,669,575	882,075	787,500	2,914,519
	Total	2,864,859	1,549,338	1,315,521	4,943,094

Source: Ministry of Labor.

trillion won and the total expenditure of 1.1 trillion won. As of December 2001, the total amount of the EIF reserve is approximately 4.9 trillion won which amounts to 2.9 times the total expenditure of 1999 when the expenditure marked the peak of EIS history.

There is increasing disequilibrium among the three accounts of the EIS. In particular, the reserve of Employment Stabilization Program is excessive. As for the Unemployment Benefits, the speed of reserve accumulation is too high if the reserve is not excessive.

4. Wage Subsidy Programs

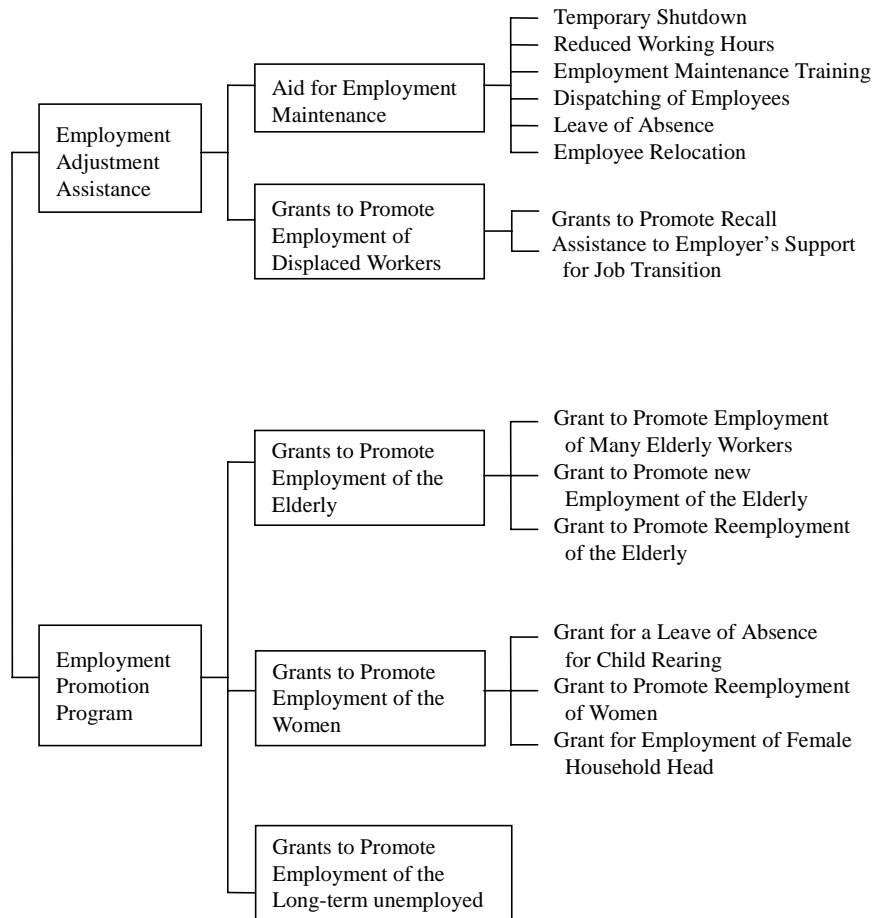
4.1 The Programs

The employment stabilization scheme aims to prevent unemployment and to stimulate reemployment. In a rapidly changing economy, each firm has to continuously adjust to changing circumstances, modifying their employment structure. Although globalization and subsequent economic competition require flexibility in the labor market, the policies to improve the labor market flexibility may result in massive unemployment and income inequality in the short run. In most cases, marginal workers will be the primary victims. Therefore, it is important to harmonize efficiency and equity in the process of employment adjustment and development of labor market flexibility, which is the major purpose of the Employment Stabilization Program (ESP). For this purpose, firms are subsidized if they make efforts to avoid massive layoffs or hire disadvantaged workers such as the elderly, female household heads, and the long-term unemployed.

Employment Adjustment subsidies are intended to aid employment adjustment. The program assists employers who make efforts to maintain employment in spite of temporary managerial difficulties. Employment Promotion subsidies assist employers who promote employment of marginal workers, such as the elderly and

female household heads. Employment Promotion Program is

FIGURE 4.1. STRUCTURE OF THE EMPLOYMENT STABILIZATION PROGRAM



composed of Grants to Promote Employment of the Elderly, Grants to Promote Employment of Women, Grants to Promote Employment of the Long-term Unemployed, and the Grants for Facilities for Employment Promotion.

4.1.1 Employment adjustment assistance

Economic changes, in particular, cause firms to continually alter

employment levels to correspond with their levels of production, creating the problem of employment adjustment. Article 16 i) of the Employment Insurance Law states, "The Ministry of Labor may assist the employer who has stabilized employment by taking proper measures for employment maintenance such as a temporary shutdown, reduced working hours, employment maintenance training, dispatching of employees, leaves of absence or relocation of employees in an effort to adjust to the changing economic environment and industrial structure." Article 16 ii) of the Employment Insurance Law promotes unemployment prevention by offering assistance to the employer who has contributed to the stabilization of the labor market by hiring displaced workers in the process of employment adjustment. Reflecting these goals and purposes, the Enforcement Ordinance regarding the Employment Insurance Law stipulates that employers who have stabilized employment through a temporary shutdown, reduced working hours, employment maintenance training, dispatching employees, leave of absence, and employee relocation as concrete means of employment adjustment are eligible for Employment Maintenance Assistance.

Aid for Employment Maintenance encourages employers to maintain employment and avoid employee layoffs in the process of employment adjustment.

An employer is qualified for Aid for Employment Maintenance when he/she satisfies the following conditions:

- (1) In the process of employment adjustment, layoffs are inevitable.
- (2) An employer has guaranteed continued employment by taking proper measures for employment maintenance.
- (3) An employer has reported the employment maintenance plan to the public employment office, and the measures for employment maintenance have been carried out according to the plan.
- (4) Before and during the period when employment maintenance measures are implemented, there should be no reduction of

employees.

4.1.1.1 Inevitability of layoffs

If the enterprise meets the following conditions, layoffs are considered inevitable.

- (1) As of the first day of record keeping for employment maintenance, the inventory of the enterprise has increased by more than 50 percent compared with the average stock of the previous year.
- (2) As of the first day of record keeping for employment maintenance, production for the month has been reduced by more than 10 percent compared to the previous month, compared to the average production of the last three months, or compared to the average monthly production of the previous year.
- (3) As of the first day of record keeping for employment maintenance, monthly sales have fallen by more than 10 percent compared to the amount of sales in the previous month, the average amount of sales in the last three months, or the average amount of monthly sales in the previous year.
- (4) As of the first day of taking measures for employment maintenance, the inventory for the month and the monthly inventory in the previous two quarters have continuously increased, or the amount of sales for the month, as of the first day of taking measures for employment maintenance, and the monthly inventory in the previous two quarters have continuously decreased.
- (5) The size of the enterprise has been reduced because sections have been abolished, organizations in the enterprise have been reduced, parts of production lines have ceased, etc.
- (6) Labor-saving facilities such as automation have been installed, or labor saving work methods or production methods have been introduced.
- (7) The public employment office recognizes that a reduction in the workforce is inevitable considering the circumstances of the

concerned industry and local economy.

- (8) When employees take over the business, more than 60 percent of the former employees have been relocated to the concerned business, and more than 50 percent of the stocks of the concerned business have been transferred to the former employees.

4.1.1.2 Proper measures and amount/Duration for employment maintenance

An employer is qualified for Aid for Employment Maintenance when the employer has stabilized employment by taking proper measures for employment maintenance such as a temporary shutdown, reduced working hours, employment maintenance training, dispatching employees, leave of absence and employee relocation.

The amount of Aid for Employment Maintenance depends on the measures an employer has taken to guarantee continued employment for the employees in the process of employment adjustment.

The maximum aid period is 180 days in total, except in the case of employee relocation, including each period of measures for employment maintenance. When an employer has taken several measures for employment maintenance on the same day, it is counted as one day.

1) Temporary shutdown

Article 45 of the Labor Standards Act of Korea requires the employer responsible for a business closure to compensate each employee for at least 70 percent of that employee's average wage rate for the three months prior to business closure. Although the compensation provides a measure of economic security for laid-off workers and their families and may prevent massive unemployment, it may also result in employment instability when the employer resorts to layoffs, as opposed to shutdowns, in order to avoid the undue expense of shutdown compensation. Therefore, the Employment Insurance Law guarantees financial assistance to employers encumbered with paying shutdown compensation resulting from industrial restructuring,

business fluctuation, and other economic reasons, with the end goal of ameliorating management difficulties and preventing massive layoffs.

In order to receive Aid for Employment Maintenance for a temporary shutdown, the employer must satisfy the following conditions:

- (1) The shutdown must be due to economic reasons and carried out during a designated period. Non-economic reasons, such as labor disputes, strikes and fires, or a violation of the time requirement are not acceptable conditions.
- (2) The shutdown ratio must exceed one-fifteenth, and shutdown compensation to workers must have been paid. The shutdown ratio is the total number of shutdown days of the insured in a month divided by the total number of required working days of the insured in a month.
- (3) The shutdown must be carried out in accordance with agreements made with the labor union organized by a majority of the employees.

When an employer maintains employment through a temporary shutdown, priority enterprises may receive Aid for Employment Maintenance totaling two-thirds of the shutdown compensation which the employer has paid during the shutdown period, while large enterprises receive 50 percent of the shutdown compensation, for up to 180 days.

2) Reduced working hours

An employer who has avoided layoffs in the face of reduced productivity or downsizing of the firm by reducing the working hours may receive Aid for Employment Maintenance under the following conditions.

- (1) The daily working hours have been reduced by 10 percent or more, or work time has been reduced by eight hours or more.
- (2) The period for reduced working hours should be one month or longer.
- (3) The actual working hours after the reduction should be shorter

than the legal minimum working hours according to the Labor Standards Act and the Industrial Safety and Health Act, which is 44 hours (42 hours for aged 18 and under) per week.

- (4) The employer must consult and negotiate with the labor union or the employee representative on the reduction of the working hours.

When an employer maintains employment by reducing working hours, the amount of Aid for Employment Maintenance is one-tenth of the average wage prior to the reduction of working hours for priority enterprises, while large enterprises receive one-fifteenth of the average wage. The maximum duration of the Aid is 180 days.

3) Employment maintenance training

In order to receive Aid for Employment Maintenance for employment maintenance training, the employer must satisfy all of the following conditions.

- (1) The employer must train workers with the purpose of enhancing their employability.
- (2) The trainees in the employment maintenance training programs should not be engaged in work during the training period.
- (3) The employment maintenance training programs should be thirty hours or more in total, and include four hours or more per training day.
- (4) The employer must consult and negotiate with the labor union or the employee representative on employment maintenance training.

When an employer maintains employment through employment maintenance training, priority enterprises may receive total training costs and two-thirds of wages the employer has paid for the trainees during the training period for up to 180 days. Large enterprises receive total training costs and 50 percent of wages, for up to 180 days.

4) Dispatching employees

An employer who has maintained workers by dispatching them to other locations when reorganization has become necessary due to reduced productivity or downsizing of the firm qualify for Aid for

Employment Maintenance.

In order to receive Aid for Employment Maintenance for dispatching employees, the employer must satisfy all of the following conditions.

- (1) The employer has kept workers on the payroll by dispatching them to his/her affiliated companies or other workplaces.
- (2) Each dispatched employee must be allowed to return to the original workplace upon release or the end of the dispatch period.
- (3) The employer must consult and negotiate with the labor union or the employee representative on dispatching employees.

When an employer maintains employment through dispatching his/her employees, priority enterprises may receive Aid for Employment Maintenance totaling two-thirds of wages the employer has paid for the dispatched/ employees, while large enterprises receive 50 percent of wages, for up to 180 days.

5) Leave of absence

An employer who has provided continued employment to insured workers through paid or unpaid leaves of absence, even when employment reduction is inevitable, qualifies for Aid for Employment Maintenance.

In order to receive Aid for Employment Maintenance for the leave of absence, the employer must satisfy all of the following conditions.

- (1) The leave of absence should be an effort to avoid reducing the workforce when such a measure is deemed necessary. The employer does not have to pay any allowance to an employee during his/her leave of absence.
- (2) The employer must obtain a written agreement from the employee regarding the leave of absence.
- (3) The leave of absence should be one month or longer.

If the leave of absence is paid, priority enterprises may receive two-thirds of the allowances the employer has paid for the employees during the leave of absence, while large enterprises receive 50 percent

of the allowances, for up to 180 days.

If the leave of absence was unpaid and the employer supplied social insurance contributions and other fringe benefits for the employees on a leave of absence, employers in priority enterprises may receive 140,000 won per person per month during the leave of absence for up to 180 days. Employers in large enterprises may receive 110,000 won per person per month for up to 180 days in such a case. ("Won" is the Korean currency unit. As of the end of 1998, 1 US dollar=1,208 won.)

If an employer trains employees who are on an unpaid leave of absence, he/she may receive total training costs, and the trainees may receive an allowance of 70 percent of the minimum wage plus 30,000 won for transportation costs during the training period, for up to 180 days.

6) Relocation of employees

The relocation of employees involves transferring employees who face layoffs to new businesses. This has the beneficial effects of preventing unemployment as well as transforming the industrial structure.

Aid for Employment Maintenance is awarded to an employer who satisfies all of the following conditions.

- (1) An employer should guarantee continued employment of the transferred workers by relocating them in the process of business reorientation to a properly equipped facility.
- (2) The number of transferred workers must comprise at least 60 percent of the insured employees at the time the reorganization proposal is submitted.
- (3) The relocation of employees has to be completed within 18 months since the employer reports the proposal to relocate the employees to the public employment office.
- (4) The employer must consult and negotiate with the labor union or the employee representative on the relocation of employees.

When an employer maintains employment through employee relocation, priority enterprises may receive Aid for Employment

Maintenance totaling two-thirds of the payroll of transferred employees that an employer has paid during the period of relocation, for up to one year. Large enterprises receive 50 percent of the payroll for up to one year from the day the employees are relocated.

4.1.2 Employment promotion program

The employment promotion program is a wage subsidy for employment of the disadvantaged. The Employment Promotion is composed of Grants to Promote Employment of the Elderly, female heads of household, and the long-term unemployed. Since enforcement of the employment insurance in July 1995, conditions and standards for the employment promotion support system changed frequently accompanying changes in the labor market, such as change in the unemployment rate, and utilization trend of detailed programs. Only the Grants to Promote Employment of the Elderly existed in the early stage of enforcement, but the Grants to Promote Reemployment of Women/ the Elderly were instituted starting in the second half of 1997 to support reemployment of women and the elderly. Then, the Grant to Promote Employment of Unemployed Female Heads of Household was established in October 1998 to support unemployed female heads of household. The Grant to Promote Employment of the Long-term Unemployed was introduced in the second-half of 1999 to promote prompt reemployment of the increasing number of the long-term unemployed, leading to the current system of the Grants to Promote Employment for disadvantaged groups, i.e. elderly, women and the long-term unemployed.

4.1.2.1 Grant to promote employment of the elderly

Grants to Promote Employment of the Elderly aid those who experience difficulties in obtaining employment under the prevailing labor market conditions. Grants to Promote Employment of the Elderly are classified into the following three categories:

(1) Grant to promote employment of many elderly workers

The Grant to Promote Employment of Many Elderly Workers is awarded to an employer whose labor force has more than six percent of workers aged 55 or over. For the number of workers aged 55 or over beyond the 6 percent minimum and below the 15 percent maximum for priority enterprises or 10 percent for large enterprises, the employer may receive the given amount per older worker per quarter, set each year by the Ministry of Labor. The amount per older worker per quarter is 150,000 won.

(2) Grant to promote new employment of the elderly

The Grant to Promote New Employment of the Elderly is awarded to an employer who has hired at least five new workers aged between 55 and 60 who have not been employed at least for 3 months. The amount of the Grant is 250,000 won for first 6 months.

(3) Grant to promote reemployment of the elderly

The Grant to Promote Reemployment of the Elderly is awarded to an employer who has re-employed workers between 45 and 60 years old within two years of their job dismissal for economic reasons, mandatory retirement, and health. The Grant is determined by the number of re-employed workers multiplied by an amount set each year by the Minister of Labor based on the industry and the size of the firm. As of 2002, the Grant per re-employed qualified employee was 300,000 won for first 6 months.

4.1.2.2 Grant to promote employment of women

Employment promotion for women includes two types of programs: (1) Grant to Promote Re-employment of Women, and (2) Grant for Employment of Female Heads of Household.

(1) Grant to promote re-employment of women

The Grant to Promote Re-employment of Women is instituted to promote reemployment of female workers who have left the workforce due to pregnancy, childbirth or childcare. The collective agreement or rules of employment of the enterprise should also specify that the employer can re-employ female workers who quit for reasons of pregnancy, childbirth or childcare. The amount of the Grant per person

is currently set at 300,000 won for six months.

(2) Grant for employment of female heads of household

The Grant to Promote Employment of Female Heads of Household is instituted to foster the employment of women who are the heads of their households. For these grants, employers should hire female heads of household who have dependants who are registered at the public employment office. As of 2002, the grant amounts to 600,000 won for six months. Grants to Promote Employment of the Long-term Unemployed are awarded to employers who newly hire those who are unemployed and have been registered for 6 months or more. As of 2002, the amount of the grant is 600,000 won per worker.

4.1.2.3 Subsidy program for employment promotion of the long-term unemployed

Under the Act amended in January 2001, the long-term unemployed are defined as those who have been unemployed for more than 6 months. The government provides a subsidy of 600 thousand won per month (since July 2002) for wages for 6 months. There is a layoff restriction period for 3 months before and 6 months after employment, similar to subsidy programs for employment of older workers and females.

4.2 Utilization

The major purpose of the employment stabilization program is to temporarily assist firms so that they can maintain their employees, and to subsidize the employment of disadvantaged workers in the labor market. The number of beneficiaries and expenditures of the subsidy programs peaked at 1999, with total subsidies for employment maintenance and promotion of new employment at 96 million won for 775 thousand beneficiaries in 1998. The amount of expenditure increased to 184 million won in 1999 and then decreased 113.6 million won in 2000.

Since the requirements of employment maintenance subsidies were relaxed, assistance levels have increased since the crisis. In 1998, a total of 74.2 million won was paid for employment maintenance of about 0.7 million workers. In 1999, 79.2 million won was spent for the total number of 0.4 million workers. Due to improvements in the labor

TABLE 4.1 EMPLOYMENT SUBSIDIES

	(Unit: million won(persons))						
	1995	1996	1997	1998	1999	2000	2001
Aid for employment maintenance	7 -	16 -	44 -	74,262 (654,370)	79,427 (370,830)	29,396 (148,495)	55,976 (260,057)
Grant for employment of displaced workers*	-	-	-	5,878 (5,179)	75,175 (101,358)	40,780 (62,661)	20,226 (31,287)
Grant for recall	-	-	-	-	517 (0.3)	1,423 (1.3)	766 (0.6)
Assistance for job transition support	-	-	-	-	-	-	43 (679)

Noet: The Program was abolished on Sept. 2001.

Source: Ministry of Labor, *White Paper on Employment Insurance*, Seoul (Each Year).

market situation, employment maintenance expenditures decreased to 29.3 million won covering 0.15 beneficiaries. On the other hand, the wage subsidies for the firms who hire the labor market disadvantaged, such as the elderly, female heads of household and the long-term unemployed, have increased continuously in recent years: A total of 42 million won in expenditures for 233 thousand beneficiaries was reported in 2001.

The grant to promote the employment of the elderly constitutes the lion's share of the wage subsidy program in terms of the number of beneficiary and the amount of expenditure. In particular, the number of beneficiaries doubled and expenditures tripled between 1998 and 2000. Because the aid program for the long-term unemployed was just launched in 1999, the program may not be fully utilized yet. Restrictions in the aid program for women still exist. To be eligible, the women must be unemployed household heads with dependents or female workers

trying to return to their former jobs after being absent for some years due to maternal or parental care leave, health problems, etc.

The utilization of grants for the employment of elderly, women and the long-term unemployed is indicated in Table 4.2. Looking at overall utilization trends, it can be pointed out, first of all, that

TABLE 4.2. WAGE SUBSIDIES FOR EMPLOYMENT PROMOTION

	(unit: million won(persons))						
	1995	1996	1997	1998	1999	2000	2001
Grant to promote the new employment of the elderly	-	-	181 (749)	2,869 (9,579)	11,246 (37,840)	20,720 (48,103)	13,508 (29,163)
Grant to promote the employment of the elderly in numbers	1,349 (23,750)	6,464 (87,640)	8,824 (110,207)	9,256 (103,579)	13,495 (150,534)	15,915 (177,520)	28,008 (223,199)
Grant for the reemployment of the elderly	-	-	0 (0)	280 (130)	672 (757)	242 (170)	1,755 (116)
Grant for the employment of female heads of household			-	0 (0)	280 (373)	672 (787)	803 (819)
Grant for the reemployment of women			2 (4)	105 (166)	112 (73)	256 (154)	214 (223)
Grant to promote the employment of the long-term unemployed					49 (128)	359 (799)	2,954 (6,262)

Source: Ministry of Labor, *White Paper on Employment Insurance*, Seoul (Each Year).

utilization for the Grants to Promote Employment of the Elderly (New/Many/Reemployment), the Grant to Promote Employment of Women (Heads of Household/Reemployment) and the Grant to Promote Employment of the Long-term Unemployed have all increased gradually since the system went into effect. In particular, the Grant to Promote Employment of the Elderly (New/Many/Reemployment), shows a dramatic utilization percentage over the years compared to other employment promotion subsidies. The Grant to Promote Employment of the Long-term Unemployed, which was instituted in the second-half of 1999, had shown a steady increase.

4.3 Program Evaluation

4.3.1 Employment adjustment assistance

Economists first criticized subsidy programs on the grounds that they could hamper or delay 'the structural adjustment' of the economy by subsidizing marginal firms that were no longer competitive on the market. However, subsidized firms were not necessarily bad firms destined to end in bankruptcy. Even reliable firms could face temporary cash flow problems in the midst of a financial crisis, especially when financial institutions were not functioning appropriately. In addition, since firms were free to decide whether to make use of subsidy programs or to lay off unneeded workers, there were no *a priori* reasons to believe that the subsidy programs prevented firms from restructuring. Thus the programs were maintained as an important labor market policy program. As a matter of fact, according to Hwang (1999), firms with the best human resources tended to utilize employment maintenance subsidies.

However, the contribution of the employment subsidy in reducing unemployment should not be exaggerated. The number of workers benefiting from the program averaged around 25,000 per month in 1998-1999. Kim et al. (1999) analyzed employment maintenance effects of those employment subsidy programs, using employer surveys as well as case studies. The estimated effect was 22.3 percent on average, which implied that the deadweight loss was in the 70 percent range. According to the assessment of PES staff members and monitoring reports, deadweight loss and substitution effects of the 'grants to promote employment of displaced workers' have been serious (Hwang, 1999; Kim et al., 2000).

The subsidy program worked not so much as an incentive, but as compensation. It is costly, as well as difficult for the labor administration to determine whether or not a firm applying for assistance is really facing inevitable employment reduction. When a business is truly in trouble, a wage subsidy program is not enough to keep unneeded workers on the payroll. Also, larger firms are better able to utilize employment maintenance subsidy programs. Small firms find

the procedure too complex to warrant use. In sum, the employment maintenance subsidy program seems to have compensated large firms.

4.3.2 Employment promotion program

4.3.2.1 Grant to promote employment of the elderly

Validity of Target Group Selection Demographic and labor market characteristics of the elderly aged 55 or over are as follows: First, it is a rapidly expanding age group. While it occupies only 15.5% of the total population today, it is expected to balloon to approximately 40% of the total population in 30 years. Major labor market policies will soon focus on the elderly, along with issues such as pensions. Second, the elderly population in Korea does not stand out in particular from the middle-aged population in terms of economic activity participation rate or unemployment rate until the 64-plus age bracket, and their labor market participation rate is relatively high compared to advanced countries. This is a reflection of their efforts to make survive economically despite the inadequate social security system, and not because of optimal labor market conditions for the elderly. Third, the elderly unemployed, constituted a higher portion of the long-term unemployed compared to the middle-aged group. The absolute majority of these individuals had held daily and temporary jobs in the past with as much as 43% engaged in physical labor. Furthermore, because 67% of the older unemployed do not have high school diplomas, it is safe to say that their employability in the labor market is very low. Based on these observations, an attempt to improve employability for the elderly unemployed through policy intervention, such as employment subsidies, appears to be the most realistic option in a society where there is no real pension system(Chang and Kim, 2001).

Degree of Utilization of the System the Grant to Promote Employment of the Elderly has witnessed a sharp increase in utilization. Compared to other programs, it has provided the largest subsidies to the most workers, resulting in the most noticeable effect. Yet, it is still not used widely enough. The grant has two main purposes: 1) supporting the return to work of middle-aged workers due to early retirement or employment restructuring, and 2) extending the period of employment for those who have reached retirement age. In reality,

however, it fails to satisfy either purpose.

Long-term Effects of Labor Market Integration Even if the wage subsidy system increases the employment of the target population for the short term, the question still remains as to how long that effectiveness will last. This question is raised because the ultimate purpose of the wage subsidy system is to prevent wearing down of skill and work incentives by enabling the disadvantaged groups of the labor market to maintain their work experience, and to integrate them into the labor market in the long-term. A follow-up survey on elderly workers hired through subsidies is essential in order to ascertain how long the employment effects of the Grant to Promote New Employment of the Elderly will continue; however, the research was unable to conduct the survey. Therefore, the question of whether the Grants offer temporary jobs to the elderly or contribute to the long-term labor market integration by providing jobs that enable them to maintain a career was examined through comparison of previous job and current job found through the subsidy (Chang and Kim, 2001).

According to the results, the ratio of workers whose previous job and current job fell into the same occupational category, that is, the workers located diagonally across the Table, is relatively high, indicating re-employment while maintaining their career. An explanation that there is a clear relationship between the previous job and the current job seems more reasonable.

Net Effect It cannot be assumed that all workers supported this way signify the net effect of the system. It is possible to raise the issue that fairly large number of these workers would have found work even without the aid of the system (dead weight loss). According to the analysis of survey results, when asked directly if they would have hired less number of workers in the absence of the subsidy, 92.3percent of the companies responded "Yes" to the question explaining that they would have hired the same number of workers even without the subsidy, showing a very high level of the dead weight effect. Compared to other countries the number does not represent an abnormally low

net effect, however, it is regarded as relatively low. However, as a result of examination through several other analyses it is difficult to accept that this response has high confidence level.

In the meantime, 18.7percent of the companies responded that they “would have hired young workers instead of elderly workers if there were no subsidy” to the question that was asked to estimate the substitution effect. Although the indicators do not indicate whether the elderly have substituted young and middle-aged workers in individual employment, it is difficult to view that the subsidy system is changing the age structure of the labor force even indirectly. This, stated differently, signifies that a concern that the Grants to Promote Employment of the Elderly may be providing additional opportunities for the elderly by influencing the opportunity structure of age groups in the labor market can be reasonable. However, if we recall the fact that this was a time of high unemployment in Korea, especially for the younger generation, it is safe to assume that the employment subsidy for the elderly prevented a good number of jobs crossing over from the elderly to the young/middle-aged workers.

4.3.2.2 Grant to promote employment of the women

Subsidy for women householders' employment promotion Although the labor market analysis we adopted cannot determine whether there is family to support, the economic participation of women householders was definitely higher than the average economic participation of women. Moreover, as these women householders showed low level of education, their employability was relatively low. They usually worked in labor, service, or sales sectors as short-term workers. Women householders have a higher tendency to become the long-term unemployed compared to other average women workers.

In most of the advanced countries, women householders are welfare recipients. Governments provide basic livelihood support to these women householders because their livelihood directly affects children in their care. Inappropriate childcare and education mean loss of opportunity for these children as well as big burden for the

governments in the future. Therefore it is only logical to support women householders and their children. However, the dominant opinion is that it is important to teach them how to fish rather than to just give them fish. In this background, the wage subsidy program is necessary to promote the employment of women householders.

At present, subsidy programs for women householders' employment promotion are not utilized at a high rate. This low utilization is a problem in itself. Therefore, there is no need to go into the discussion of long-term labor market integration effect or net employment effect. As for those women householders who received the subsidy, they are mostly in their late 30s or early 40s with lower than high school education, working as clerks or unskilled workers. They support 2 to 3 family members. They earn an average of 780 thousand won per month from a work which they got thanks to the subsidy. Mostly this is the only income in the family. In this background, it is safe to conclude that the subsidy for women householders' employment promotion helps the most marginal class and their family. They are likely to be classified as welfare beneficiaries in advanced nations. Therefore, there is relatively low financial burden or side effects even when the utilization is brought up by expanding the support. In particular, active measures such as childcare support, which directly help and motivate women workers, should put in place along with passive measures such as wage subsidy provided to the employers.

Subsidy for women's reemployment It is only natural to support women when they want to return to work after they gave birth or took leave for childcare, especially in Korea. Traditionally women are responsible for housework and childcare and there is not enough social support or private childcare service available. Compared to the past years when women were forced to quit when they were getting married or giving birth, there has been great improvement. However, it is still quite common to see women leaving their work for childbirth or childcare.

Although many recognize this as a problem, they may not agree

that the subsidy for women's reemployment is a solution. The sole purpose of this subsidy is literally the reemployment of women. This subsidy supports women's lifelong career by promoting reemployment after they left their job for childbirth or childcare. However, this program is inconsistent with other support policies that focus on continuing women's career path. Under the current act, childcare leave is granted to women. Recently revised employment insurance act grants childcare leave benefits for one year. Reemployment subsidy contrasts with these policies as it supports "reemployment" of women even when they can take advantage of maternity or childcare leaves rather than completely quitting their job. Moral hazard of employers may also become a problem because employers can benefit more from reemploying women workers than granting childcare leaves. Therefore, it is reasonable to improve childcare leave programs than to support the reemployment in the light of policy coherence.

4.3.2.3 Grant to promote employment of the long-term unemployment

Valid selection of the target group and subsidy utilization The unemployed is highly likely to become "discouraged workers" as their skills become obsolete and they lose desire to work when they remain unemployed for a longer period. This will put them in poverty creating social problems. This is why most of the governments provide policies to resolve long-term unemployment. The definition of long-term unemployment varies depending on cases. For instance, the Korean government originally provided unemployment benefits to those who were unemployed for longer than one year. However, under the recently revised programs, unemployment benefits are paid to those who are unemployed for 6 months or more. This was a change in selecting a target group.

Number and distribution of the unemployed by period determines when governments should intervene. The point is to intervene before subsidy cannot promote employment. Since when to intervene determines the eligible target group, it directly affects utilization, and the stigma and replacement effect on the beneficiaries.

Until now, the subsidy program was not effective at promoting employment due to low utilization. However, utilization is on the rise after expanding the target group. As the long-term unemployed are maintained at 100 thousands, this program should be utilized more actively.

Long-term labor market integration effect Let's look at the characteristics of the long-term unemployed in Korea. Marginal classes such as older workers or women householders are likely to become the long-term unemployed. However, they do not make up the majority. Majority of those who are unemployed for more than 6 months or 1 year are middle-aged males with relatively high level of education. Regular, temporary, and self-employed workers rather than itinerant workers tend to be unemployed for a long period as they fail to find appropriate job. Workers in this group are apparently consistent in looking for long-term jobs rather than temporary jobs even though the unemployment is being prolonged due to lack of competitiveness.

In this vein, one of the most important issues in providing subsidy for the long-term unemployed is whether they can integrate in the labor market in the long run. In other words, these workers should be able to continue their career path when they are reemployed. Analysis of former job and current job of the reemployed workers through the subsidy program shows positive results, meaning many continue their career path. Although most of the reemployed through the subsidy program work as clerks or simple laborers, they work in the same line of work as their past work experience. This analysis shows that subsidy provided to the long-term unemployed not only promotes employment but also facilitates stable integration into the labor market.

4.4 Related Issue : Aid to Harmonization between Family and Wage Work

4.4.1 Grant for a leave of absence for child rearing

Childbirth necessitates a maternity leave for childbearing,

recuperation and child rearing. The Employment Law for Gender Equality, legislated in 1987, guarantees a leave of absence for child rearing in firms that employ more than five workers or more. Therefore, the employer must allow a leave of absence for child rearing when requested by employees whose child is below one year old. The employer cannot hold this request against them, and the total period of the leave of absence for child-bearing and rearing may not exceed one year, as specified in the Labor Standard Law, Article 72. This period of absence is included in the period of continuous service.

The Grant for a Leave of Absence for Child Rearing, instituted to promote the popularization of parental leaves, is awarded to employers who have granted such a leave for more than 30 days in accordance with the Labor Standard Law, Article 71. It also specifies those days overlapping with paid maternity leave, lasting 60 days, will be discounted. Afterwards the worker must be re-employed for at least 30 days.

Each year the Minister of Labor announces the amount of the Grant per person. As of 2001, the amount of the Grant per person is set at 200,000 won.

4.4.2 Aid to Management of daycare centers

When an employer or a group of employers establish daycare centers for the children of their employees, the Employment Insurance Fund offers support for managing the daycare centers and/or loans for their establishment. The Grants for Facilities for Employment Promotion are intended to reduce daycare expenses and promote the economic activities of female workers.

Aid to Management of Daycare Centers is awarded to an employer or employers managing a daycare center for the children of their employees. The Aid subsidizes the salary of the teachers in the daycare centers. As of 2001, 650,000 won is granted toward a teacher per month for priority enterprises and 600,000 won per teacher per month for large enterprises without a time limit.

An employer or a group of employers establishing new daycare

centers for their employees' children or expanding current daycare centers may receive a loan from the Employment Insurance Fund at a low interest rate for up to 300 million won.

4.4.3 Introduction of the childcare leave payment

Korea is in the middle of the transitions of maternity rights and socialization of childcare.

The new support system for working parent's childcare leave has two folded: grant for employers whose employee leave for child rearing and income support for employees.

Since the Employment Law for Gender Equality, legislated in 1987, guarantees a leave of absence for child rearing in firms that employ more than five workers or more, the employer must allow a leave of absence for child rearing when requested by employees whose child is below one year old. The Grant for Child Care Leave, instituted to utilize the parental leaves, is awarded to employers who have granted such a leave for more than 30 days in accordance with the Labor Standard Law, Article 71. It also specifies those days overlapping with paid maternity leave, lasting 60 days, will be discounted. Afterwards the worker must be re-employed for at least 30 days. With this program, 1.4 million won were used for 401 firms in order to support their efforts to search for the temporary labor force. The number of workers who temporarily leave their workplace due to childcare was 2,226 under the program.

With the old program, only employers were aided for the worker's childcare leave, and as a result, childcare leave was not successfully utilized. From November 2001, the Parental Leave Benefit and the Maternity Leave Benefit are going to be introduced to support working parents. Parental Leave Benefit is paid for male and female workers who temporarily leave their job to take care of children aged of 1 or under. Current Maternity Leave period stated in Labor Standard Law is 60 days and paid by employer. Under the new act, the period is extended up to 90 days and the extended 30 days are paid by the EI and the tax revenue. These institutional changes have implications that the social welfare system tries to support individual worker's motherhood and childcare.

5. Job Skill Development Program

5.1 Historical Background

Vocational Training has played an important role in the process of Korea's rapid economic development. Initially, the government initiated and directed the vocational training system in order to supply the manpower necessary to industrialization. The representative framework of state-led training system was the training levy system based on the Basic Vocational Training Act(1976-1998).

Under the training levy system, enterprises with 150 employees or more had two choices: either 1) to invest a certain percentage of total wages in training their employees and/or new entrants to the labor market, or 2) to pay a training levy to the government instead of training. This system was effective in persuading employers to invest in vocational training during the authoritarian regime in the 1970s. However the training levy system forced employers to follow the government's guidelines, which hardly satisfied the training needs of individual firms.

Since the training needs of firms were not reflected on time in the government's guidelines on vocational training, most employers did not follow the government's training guidelines and preferred paying the levy to training workers. When Korea introduced EIS in 1995, the Employment Insurance Research Commission recommended that the compulsory levy system be changed to an incentive system of voluntary training within the framework of Job Skill Development Program (JSDP). JSDP is an incentive system to encourage employers' and employees' active participation in lifelong vocational training through financial support. In addition, it is designed to provide opportunities for vocational education and training to new entrants to the labor market and the unemployed to improve the occupational skills of the labor force. JSDP changed the Korean vocational training system from state-dominated, rigid and supply-driven system to private sector-

participatory, flexible and demand-driven system.

By the way, the Korean government worried about the sharp decrease in the in-plant basic training. Thus government kept the training levy system for firms with more than 1,000 employees. Thus JSDP applied only to firms with less than 1,000 employees.

The experiences from 1995 to 1998 showed that the incentive system through JSDP was more effective in inducing employers to participate in vocational training than the compulsory training levy system. So in 1997, Korea enacted the Vocational Training Promotion Act, which put into effect in January 1, 1999. The basic idea of the Vocational Training Promotion Law is the same as JSDP. Korea changed her vocational training system from a compulsory levy system to an incentive system of voluntary training by switching the Basic Vocational Training Act to the Vocational Training Promotion Act.

As all enterprises have been covered by EIS on January 1, 1999, JSDP is the most representative program of Korean vocational training system.

5.2 Structure of JSDP

JSDP is composed of three major sub-programs: Assistance to Employers, Assistance to Employees, and Assistance for Training the Unemployed¹⁾.

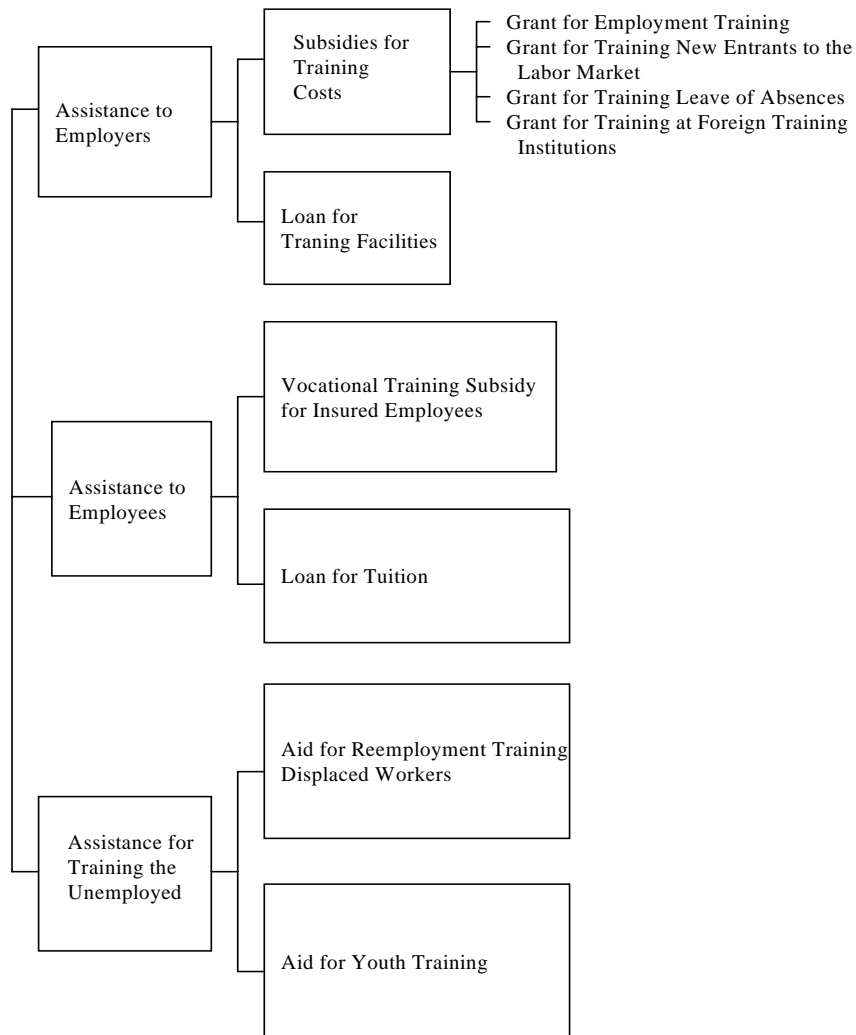
Assistance to Employers encourages employers to train their workers by subsidizing training costs. An employer is eligible for the Assistance when he/she trains employees and/or new entrants to the labor market. Assistance to Employers is composed of the Subsidies for Training Costs and the Loan for Training Facilities.

Assistance to Employees is direct support to employees participating in training programs. Assistance to Employees is composed of the Vocational Training Subsidy for Insured Employees and the Loan for Tuition.

Assistance for Training the Unemployed provides free training

1) For details, see Yoo(2000).

opportunities and training allowances for displaced workers and new

FIGURE 5.1. STRUCTURE OF THE JOB SKILL DEVELOPMENT PROGRAM

entrants to the labor market. Assistance for Training the Unemployed is composed of the Aid for Retraining Displaced Workers and the Aid for Youth Training.

5.3 Performance of the Job Skill Development Program

5.3.1 Trends of the job skill development program

Participation in the Job Skill Development Program is increasing year by year because of coverage extension and policy efforts to encourage training. The number of beneficiaries was small in the early years, but has been rapidly increasing since 1998. In 2001, the number of firms that benefited from JSDP were 91 thousand. Thus 11.3 percent of firms covered by EIS participated in JSDP. Also 1,703 thousand insured employees developed their job skills through JSDP. Thus 25.0 percent of insured employees participated in JSDP. JSDP has contributed to develop employees' vocational competency throughout the period of their working life.

Looking into the sub-program of JSDP, we can find the following characteristics.

First, employers' training in JSDP is increasing. In 2001, 1,555 thousand insured employees developed their job skills in 81 thousand firms. The number of firms that participated JSDP increased over quadruple to that of 1998.

Second, since 1998 when there was a substantial increase of unemployed workers, a lot of unemployed people from the covered enterprises received free vocational training by Assistance for Training the Unemployed. The number of participants in the training for the unemployed was 163 thousand in 1998, 226 thousand in 1999, 120 thousand in 2000, and 105 thousand in 2001. Among the total expenditure, 74.2 percent in 1998, and 40.2 percent in 2001 was used as

TABLE 5.1. TRENDS OF THE JOB SKILL DEVELOPMENT PROGRAM

	(Unit: cases, persons, billion won)						
	1995	1996	1997	1998	1999	2000	2001
Firms	380	4,529	8,863	25,912	58,288	86,692	91,385
Trainees	10,034	106,635	199,880	588,006	977,952	1,367,228	1,730,308
Amount	1.8	33.5	63.0	258.0	424.9	404.2	379.6

Source: Employment Research Center, *Employment Insurance Review*, various issues,

Korea Labor Institute.

Assistance for Training for the Unemployed.

Third, direct assistance to employees' autonomous training is small. In 2001, 35 thousand insured workers studied at technical colleges or universities using the Loan for Tuition. Also only 4 thousand people received Assistance to Vocational Training Subsidy for Insured Employees.

TABLE 5.2. PERFORMANCE OF THE JOB SKILL DEVELOPMENT PROGRAM

(Unit: cases, persons, million won, %)

Program	Firms				Trainees				Amount			
	1998	1999	2000	2001	1998	1999	2000	2001	1998	1999	2000	2001
Total	25,922 (100.0)	58,298 (100.0)	86,692 (100.0)	91,385 (100.0)	588,006 (100.0)	1,029,813 (100.0)	1,367,228 (100.0)	1,730,308 (100.0)	257,670 (100.0)	424,218 (100.0)	404,238 (100.0)	379,575 (100.0)
1. Assistance to employers												
1) Grant for training employee and new entrants to the labor market	17,741 (68.4)	43,511 (74.6)	73,411 (84.7)	80,860 (88.5)	408,603 (69.5)	781,408 (75.9)	1,220,334 (89.3)	1,555,402 (89.9)	40,409 (15.7)	82,764 (19.6)	140,474 (34.8)	170,414 (44.9)
2) Grant for training leave of absences	339 (1.3)	333 (0.6)	309 (0.4)	271 (0.3)	3,940 (0.7)	8,446 (0.8)	7,756 (0.6)	8,611 (0.5)	9,117 (3.5)	5,723 (1.4)	5,589 (1.4)	10,145 (2.7)
3) Loan for training facilities	-	11 (0.0)	12 (0.0)	-	-	-	-	-	-	3,035 (0.7)	7,978 (2.0)	-
2. Assistance to employees												
1) Vocational training subsidy for insured employees	-	-	-	-	2 (0.0)	51 (0.0)	252 (0.0)	40,045 (2.3)	1 (0.0)	40 (0.0)	59 (0.0)	3,544 (0.9)
2) Loan for tuition	7,842 (30.3)	14,443 (24.8)	12,960 (14.9)	10,254 (11.2)	12,350 (2.1)	13,552 (1.3)	18,590 (1.4)	21,691 (1.3)	16,949 (6.6)	23,484 (5.6)	34,626 (8.6)	42,963 (11.3)
3. Assistance for training the unemployed	-	-	-	-	163,111 (27.7)	226,356 (22.0)	120,296 (8.8)	104,559 (6.0)	191,194 (74.2)	306,172 (72.7)	215,512 (53.3)	152,509 (40.2)

Note: Numbers in parentheses indicate the composition percentage for each column.

Sources: Employment Research Center, *Employment Insurance Review*, various issues, Korea Labor Institute; Ministry of Labor, *Employment Insurance White Paper 2001*.

5.3.2 Assistance to employers

One of the changes under JSDP is to facilitate the voluntary training that firms need. Under JSDP, assistance for employer's training is composed of a) subsidies to firms that conduct in-plant training, and b) subsidies to firms for training courses that take place outside the

firm. JSDP, which is financed by employer contributions, supports 40 to 90 percent of training costs.

Thus JSDP has contributed to encourage firms to undertake training voluntarily. The number of employees that participated in employer-based training has increased rapidly. And most employer-based training programs under JSDP are training to upgrade employee skills.

TABLE 5.3. PERFORMANCE OF THE EMPLOYER'S TRAINING FOR EMPLOYEES

	(Unit: cases, persons, billion won, %)						
	1995	1996	1997	1998	1999	2000	2001
Firms	380 (100.0)	2,659 (58.7)	4,969 (56.1)	17,741 (68.4)	43,511 (74.6)	73,411 (84.7)	80,860 (88.5)
Trainees	9,888 (98.5)	99,222 (93.0)	184,007 (92.1)	1,408,603 (69.5)	781,408 (75.9)	1,220,334 (89.3)	1,555,402 (89.9)
Amount	1.7 (94.3)	18.4 (54.9)	28.4 (45.0)	40.4 (15.7)	82.7 (19.6)	140.5 (34.8)	170.4 (44.9)

Note: Numbers in parentheses indicate the composition percentage for JSDP.

Source: Employment Research Center, *Employment Insurance Review*, various issues, Korea Labor Institute.

But there is the big gap in the participation rate of employer's training by firm size. The participation rate of small firms in the employer's training is negligible. In 2000, the participation rate were 1.3 percent in the firms with less than 5 workers and 7.1 percent in the firms with 5-9 workers, but over 60 percent in the firms with more than 300 workers. Also the participation rate of insured employees is similar. That is, the smaller the firm size, the lower the participation rate. JSDP has not succeeded in increasing substantially training provided by small firms(OECD, 2000).

The big gap in the participation rate of employer's training by firm size induces the regressive problem of rate of benefit over contribution. The smaller the firm size, the lower the rate of benefited amount over contribution amount. So the main beneficiaries of the Assistance to Employers are large firms.

TABLE 5.4. EMPLOYER-BASED TRAINING FOR EMPLOYEES BY FIRM SIZE (2000)

(Unit: cases, persons, million won, %)

Firm size	Covered			Benefited			Participation rate		Rate of benefit over contribution (F/C)
	Firms (A)	Em- ployees (B)	Contri- bution amount (C)	Firms (D)	Em- ployees (E)	benefited amount (F)	Firms (D/A)	Em- ployees (E/B)	
1-4	483,939 (68.3)	950,913 (14.4)	24,229 (4.6)	6,422 (16.7)	17,191 (1.4)	2,630 (1.8)	1.3	1.8	10.9
5-9	97,595 (13.8)	643,500 (9.8)	10,453 (2.0)	6,947 (18.0)	14,500 (1.2)	2,327 (1.6)	7.1	2.3	22.3
10-29	70,013 (9.9)	1,017,827 (15.4)	20,152 (3.8)	10,988 (28.5)	34,135 (2.8)	4,702 (3.2)	15.7	3.4	23.3
30-49	14,757 (2.1)	468,745 (7.1)	11,711 (2.2)	4,216 (11.0)	22,794 (1.9)	2,921 (2.0)	28.6	4.9	24.9
50-69	6,066 (0.9)	281,734 (4.3)	8,276 (1.6)	2,117 (5.5)	17,467 (1.4)	2,149 (1.5)	34.9	6.2	26.0
70-99	4,949 (0.7)	321,022 (4.9)	11,083 (2.1)	1,988 (5.2)	24,503 (2.0)	3,041 (2.1)	40.2	7.6	27.4
100-149	3,649 (0.5)	354,918 (5.4)	16,072 (3.0)	1,709 (4.4)	32,349 (2.6)	3,952 (2.7)	46.8	9.1	24.6
150-299	3,793 (0.5)	600,765 (9.1)	53,315 (10.1)	2,018 (5.2)	101,286 (8.3)	11,962 (8.2)	53.2	16.9	22.4
300-499	1,293 (0.2)	348,734 (5.3)	43,710 (8.3)	826 (2.1)	94,311 (7.7)	11,864 (8.1)	63.9	27.0	27.1
500-999	992 (0.1)	413,422 (6.3)	61,118 (11.6)	631 (1.6)	125,939 (10.3)	14,229 (9.7)	63.6	30.5	23.3
1000-	982 (0.1)	1,188,174 (18.0)	263,259 (49.8)	599 (1.6)	742,879 (60.5)	86,202 (59.0)	61.0	62.5	32.7
Construction	20,231 (2.9)	7,273 (0.1)	4,861 (0.97)	28 (0.1)	319 (0.0)	56 (0.0)	0.1	4.4	1.2
Total	708,259 (100.0)	6,597,027 (100.0)	528,239 (100.0)	38,489 (100.0)	1,227,673 (100.0)	146,035 (100.0)	5.4	18.6	27.6

Source: calculated by author based on Employment Insurance Database.

5.3.3 Assistance to employees

Since the financial crisis, Korean labor market has been changed rapidly. One of the most important changes is that labor mobility is increasing after the crisis. The number of mobility between employment, unemployment and non-economic activity is increased from 1,228 thousand in 1997 to 2,071 thousand in 1999. In 2000, when the unemployment rate decreased, the number of mobility is 1,798 thousand. So, the mobility rate among the work force is increasing, that

is 3.5 percent in 1997, 5.7 percent in 1998, 5.8 percent in 1999, and 5.0 percent in 2000. Also, the mobility experiencing unemployment has been increasing since 1998.

TABLE 5.5. MONTH-TO-MONTH MOBILITY OF THE LABOR MARKET STATUS

	(Unit : Thousand persons, %)			
	1997	1998	1999	2000
E ↔ U	241 (19.6)	597 (29.6)	575 (27.8)	412 (22.9)
U ↔ N	109 (8.9)	363 (18.0)	345 (16.6)	220 (12.3)
N ↔ E	878 (71.5)	1,056 (52.4)	1,151 (55.6)	1,166 (64.8)
Total	1,228(100.0)	2,016(100.0)	2,071(100.0)	1,798(100.0)

Note: E : Employment, U : Unemployment, N : Non-economic activity.

Source: Calculated by the author based on National Statistical Office's *Economically Active Population Survey* raw data.

And many job changes involve career changes associated with industrial and occupational changes. According to the *Korea Labor and Income Panel Study*, 29.6 percent of workers change employers a year. And 47.6 percent of job-to-job movement involve career changes.

The level and pattern of labor mobility affect vocational training. The more frequently workers change employers, the less employers invest training because of the loss of training investment. Thus the

TABLE 5.6. NUMBER OF CAREER CHANGES AMONG EMPLOYER CHANGES

	(Unit : persons, %)		
Industry	Occupation	Career	
Stayer	2,355(70.3)	2,355(70.4)	2,355(70.4)
Between industries	215(6.4)	207(6.2)	274(8.2)
Within Industries	364(10.9)	369(11.0)	302(9.0)
Non employment	416(12.4)	416(12.4)	416(12.4)
Total	3,350(100.0)	3,347(100.0)	3,347(100.0)

Source: Calculation by the author based on Korea Labor Institute's *Korea Labor and Income Panel Study 1998, 1999* raw data.

change of labor market lays the responsibility to sustain and increase their employability on the workers.

The Korean training system pays less attention to employee's self-directed learning. According to Tables 3.1, the expenditure of direct assistance to employees' autonomous training is small under JSDP. So the workers' self-directed learning is insufficient. The participation rate of lifelong learning among adult workers is 17.2 percent, which is lower than those of OECD countries (National Statistical Office, *Report on the Social Statistical Survey*, 2001; OECD, *Education at a Glance*, 1998). Thus there is need to encourage the assistance to employee's self-directed learning.

5.3.4 Assistance for training the unemployed

Since the outbreak of the financial crisis, training programmes for the unemployed were rapidly expanded. Among the training programs for the unemployed, reemployment training for the unemployed, targeted to workers dismissed from enterprises covered by the EIS, was the most representative program. The number of participants in reemployment training for the unemployed under the EIS was increasing from 2 thousand in 1997, to 226 thousand in 1999 to 105 thousand in 2001.

TABLE 5.7. NUMBER OF PARTICIPANTS IN TRAINING FOR THE UNEMPLOYED

	(Unit : Thousand persons)			
	1998	1999	2000	2001
Total	331	358	216	189
Reemployment training for the unemployed	170	226	120	105
Training for employment promotion	107	69	47	38
Training for the uninsured unemployed	11	10	7	4
Knowledge-based training	-	11	10	9
Training for business start-ups	14	8	5	3
Manpower development training	29	34	27	31

Source: Ministry of Labor, *White Paper on Unemployment Policy : 1998 ~2000*, 2001.

Reemployment training for the unemployed provides the unemployed with opportunities to retrain themselves to enhance their own future employability. And it gives the unemployed training allowances to alleviate their economic difficulties. But the low reemployment rate of trainees has been criticized. The reemployment rate was around 30 percent in 2000.

Lee(2000) and Kang and Lee(2001) evaluated the reemployment outcome of participants relative to comparative groups. The data is based on the survey that was conducted on those who participated in reemployment training for the unemployed in 1998 and those who did not. The matching criteria was the length of the spell of nonemployment that preceded entry to training programs. According to quasi-experimental evaluation estimation results, the participation in training raises the hazard rate into reemployment, but training characteristics such as training contents or training institutions do not affect the hazard rate significantly. This results imply that training participation increases reemployment possibility by preventing withdrawal of participants from the labor market, but training programs make little contribution to improving skills.

The substantial expansion of reemployment training for the unemployed has affected a financial pressure on the Employment Insurance Fund for JSDP. The some critics argues that JSDP has played an ex post role for the unemployed rather than a priori role preventing unemployment.

Anyone who is dismissed from enterprises covered by EIS and hopes participating the training is eligible for reemployment training for the unemployed, irrespective of the adequacy to labor market requirements. Thus, there is need to target-specific training at disadvantaged labor market groups.

Also there is a weak collaboration between the public employment service and the training programs for the unemployed. The insufficient public employment services and weak collaboration with training services tend to limit the effectiveness of training programs. Thus, to

play a role effectively as the active labor market policy effectively, there is need to encourage counselling the unemployed, selecting the needy for training, and placing the trainees after training.

6. Unemployment Benefits

6.1 Outline of Unemployment Benefits

The Unemployment Benefits program includes a Job-seeking Allowance (JSA) and Employment Promotion Benefits (EPB). The former, which is the core of the unemployment safety net, is designed to stabilize living conditions of the unemployed and their families during unemployment, thereby facilitating a smooth job-seeking process. Since the latter is meant to foster and stimulate re-employment of insured individuals receiving JSA by providing constructive and effective job-search assistance. EPB complements JSA. Eligibility is restricted to those who qualify for JSA, and the EPB allowance, except for the Early Re-employment Benefit program, is relatively small since it is a reimbursement of actual expenses incurred in specified job-seeking activities. EPB consists of the Early Re-employment Allowance, Vocational Training Promotion Allowance, Nationwide Job-seeking Allowance and Moving Allowance.

Since receiving unemployment benefits may act to reduce claimants' efforts to seek employment, the program can lengthen the duration of unemployment. In order to minimize such side effects, the following restrictions apply:

- (1) Eligibility begins after 180 insured days out of an 18-month base period immediately before the layoff.
- (2) The unemployed must register for work at a public employment office, remain ready and able to work, and seek new employment to the best of their abilities.
- (3) The first 14 days of unemployment are considered a waiting

period, and benefits are not paid during this period.

- (4) Those who voluntarily leave their jobs without good cause or lose their jobs due to negligence do not qualify for benefits.
- (5) Payment of benefits is suspended if the claimant refuses the job placement services and/or vocational training recommended by the public employment office.
- (6) In principle, unemployment benefits are awarded for a relatively short period, ranging from 90 to 240 days.
- (7) A claimant is entitled to receive unemployment benefits for a twelve-month period beginning on the first day of unemployment, except for special cases that must be approved by the public employment office.

Since unemployment benefits are instituted to ensure the livelihood of the unemployed, the benefits are tax-free and cannot be transferred, confiscated or mortgaged.

6.2 Job-seeking Allowance (JSA)

6.2.1 Qualifications for JSA

In order to receive JSA, the claimant must satisfy the prescribed eligibility requirements. Some conditions concern the circumstances of the claimant's prior work experience and job termination, while other requirements must be met during the period when JSA is paid. Claimants may be disqualified from JSA for failing to meet any of the prescribed conditions. The eligibility requirements are intended to limit payment of JSA only to qualified insured workers who have been regular members of the labor force and who are involuntarily unemployed. They also prevent abuse of the unemployment benefit system.

The outline of the qualifying requirements and eligibility conditions for JSA are as follows:

- (1) The claimant's insured employment period should be at least 180 days out of the 18-month base period preceding the day of job loss.

- (2) The claimant must register at the public employment office as a job seeker and request JSA within twelve months after his/her job loss.
- (3) The claimant is out of work but remains willing and able to work, and is actively seeking new employment to the best of his/her ability.
- (4) The reasons for job termination should not disqualify the claimant from receiving unemployment benefits, such as voluntarily leaving a job without good cause, discharge for misconduct, etc.

6.2.1.1 Insured employment period and base period

Unemployment benefits do not cover every unemployed individual, but are for recently insured employees, for a limited time. In every country, entitlement to unemployment benefits is based on the fulfillment of conditions relating to the claimant's qualifying period of insured employment and/or the amount of earnings within a specified covered period. In any case, such insured employment or earnings must have been fulfilled within a prescribed base period or reference period. A major requirement: The claimant must demonstrate that he/she has been a part of the labor force for at least an insured employment period within a base period.

In the case of Korea, benefit requirements have undergone a number of changes during their short history. Originally, the insured employment period was twelve months out of the 18-month base period preceding the day of job loss. However, after the financial crisis in November 1997, the minimum insured employment period was temporarily amended, making that period six months instead of twelve months. Furthermore, the base period was made twelve months instead of eighteen months during the period from March 1, 1998 to March 30, 2000. This temporary relaxation of requirements was to help the unemployed from enterprises that had recently been covered by EIS to claim unemployment benefits. Between March 1, 1998 and March 31,

2000, the unemployed could claim unemployment benefits if they satisfied an insured employment period of at least six months out of the twelve-month base period preceding the day of job loss.

From April 1, 2000, the claimant's insured employment period and base period were relaxed further, and now the required insured period is 180 days out of an 18-month base period preceding the day of job loss.

The base period can be extended up to three years when the claimant has not received salaries and wages for 30 continuous days or more during the 18 months prior to job separation, due to i) disease or injury, ii) workplace closure, iii) a leave of absence due to pregnancy, childbirth or childcare, iv) service abroad at the employer's order, v) labor disputes, vi) a leave of absence for taking care of a spouse or dependants because of an injury or disease, vii) a leave of absence for military service, viii) being dispatched to a workplace not covered by EIS, ix) a leave of absence for managerial reasons, and x) unfair dismissal.

6.2.1.2 Registration as job seeker

An unemployed person claiming unemployment benefits must register as a job seeker at a public employment office immediately after his/her job loss, and must be deemed eligible by the authorities in order to receive unemployment benefits. If an unemployed person does not register as a job seeker and does not claim unemployment benefits, he/she cannot receive the benefits even if qualified.

The claim for unemployment benefits should be requested within twelve months of the claimant's job loss in order to encourage the qualified unemployed person to register as a job seeker as soon as possible after his/her job loss, as well as to promote early re-employment through assisted job placement services from the public employment office.

The twelve-month period can be extended up to three years (1) if the claimant is not able to work for more than 30 days because of i) pregnancy, ii) childbirth, iii) childcare, iv) illness or injury of the insured

individual or his/her spouse or immediate family members, and (2) if the claimant has notified the public employment office of such circumstances.

6.2.1.3 Being willing and able to work

A claimant for the benefits should be willing, able and available to work. A claimant cannot be regarded as such unless he/she is prepared to accept any offer of employment. A claimant must declare that he/she is willing, able, and available to work when registering every other week with the public employment office as an unemployed job seeker.

The public employment office makes the decision as to whether a claimant is willing, able, and available to work. The following are typical cases in which the claimant is regarded as not being willing, able, and available to work.

6.2.1.4 Actively seeking work

A person claiming unemployment benefits must show that he/she is actively seeking work. Claimants are expected to report every other week, on their reasonable efforts to search for a job. Reasonable efforts for seeking work will vary according to previous occupation, skills and knowledge of the claimant. Public employment offices will help claimants in their active job search efforts by providing job-opening information, job guidance and counseling services. A claimant is considered to be inactively seeking work if he/she has never responded to job offers and never accepted the job placement or job counseling services of the public employment office.

6.2.1.5. Restrictions on JSA

A claimant is not eligible for unemployment benefits if the following circumstances exist: voluntarily leaving a job without good cause, discharge for serious misconduct, refusal of a suitable job offer, training order or job placement services, and receipt of other types of income.

Voluntary Leave Without Good Cause A claimant who voluntarily leaves his/her job without good cause is disqualified from unemployment benefits. "Good cause" includes health conditions, working conditions, employment terms, a managerial situation in the

company or other similar circumstances.

In the process of designing Korean EIS, many people worried about moral hazard regarding unemployment benefits recipients. Employers and economic ministries strongly urged disqualification of those who left voluntarily (Yoo and Lee, 1996).

Most members of the Employment Insurance Research Commission agreed that claimants who left jobs voluntarily without good cause would not qualify for unemployment benefits.

To strengthen the role of unemployment benefits as a social safety net for the unemployed, trade unions and some experts in the field have asked the government to allow unemployment benefits to those who leave voluntarily without good cause after a certain period (Whang, 2000; Phang 1999).

Considering the opinions of trade unions and various experts, the Ministry of Labor tried to revise the Employment Insurance Act, but the Ministry of Labor recognized that there was still strong opposition to allowing unemployment benefits to those who left voluntarily without good cause.

Discharge for Serious Misconduct A claimant who lost his/her job owing to serious misconduct on the job is disqualified from unemployment benefits. The reason for discharge should be related to the claimant's work situation rather than his/her personal life, and the actions should have been willful and deliberate rather than accidental or unintentional.

Refusal of a Suitable Job Offer or Job Placement Services If a claimant has refused, without good cause, to apply for suitable employment or refused job placement services offered by the public employment office, he/she is to be suspended from receiving unemployment benefits for two weeks. In this case, the claimant's total duration of unemployment benefits is not affected. Good cause for refusing employment is closely related to the job itself, since circumstances may render particular employment unsuitable.

Refusal of a Suitable Training Order If a claimant has, without good

cause, refused or failed to avail himself/herself of a reasonable opportunity to receive vocational training suggested by the public employment office, unemployment benefits are suspended for four weeks. In this case, the claimant's total duration of unemployment benefits is not affected.

All vocational training programs ordered by the public employment office are intended to enhance the skill level of the claimant and promote regular re-employment as soon as possible. Refusal to go for training without good cause may cast doubt on his/her willingness to work and availability for work. There is a close relationship between good cause for refusing training and the suitability of the suggested training program, and a claimant may have good cause to refuse, if it is unsuitable.

Receipt of Other Types of Income and Deduction of JSA The claimant must report all earnings to the public employment office while he/she receives unemployment benefits. Such earnings include compensation from assisting others' work or any sort of side job or part-time job that cannot be considered regular employment. Part-time jobs not considered regular employment means working less than 18 hours per week or 80 hours per month.

Depending on those earnings, the amount of his/her JSA can be reduced. If the claimant's daily earnings from his/her work during the unemployment benefit period are greater than 60 percent of the claimant's daily JSA, the JSA equal to the excess amount is deducted.

Moreover, if a claimant has received 100 million won or more in severance pay or allowance from his/her former employer, his/her JSA is postponed for three months.

If a claimant receives any income from other types of social protection systems by law, that income is deducted from his/her daily JSA.

6.2.2 Waiting period

The first fourteen days of unemployment are considered a waiting period, and JSA is not paid even to qualified claimants. The Korean

government plans to shorten the waiting period from fourteen days to seven days.

6.2.3 Amount of JSA

Under Korea's EIS, the amount of JSA is based on the individual claimant's previous wage rate rather than a flat amount payable to all claimants. The amount of JSA is 50 percent of the claimant's average wage rate during the last three months immediately preceding the layoff.

The daily amount of JSA is subject to a minimum and a maximum. If the daily JSA calculated by the claimant's previous average wage rate during the last three months immediately preceding the layoff is greater than 35,000 won, the cap on the daily JSA is set at 35,000 won. If the daily JSA calculated by the claimant's previous average wage rate during the last three months immediately preceding the layoff is less than 90 percent of the minimum daily wage rate at the time of the layoff, 90 percent of the minimum daily wage rate, that is set as the minimum daily JSA. Until 1999, the minimum daily JSA was 70 percent of the minimum daily wage rate.

JSA is paid to eligible claimants every two weeks for the number of unemployed days. Hence, even when a claimant registers at the public employment office immediately following his/her layoff, the first payment is not made until the end of four weeks from the registration day, taking into account the two-week waiting period and the two-week benefit interval.

6.2.4 Maximum duration of JSA

The maximum duration of JSA varies depending on the insured employment period and the age of the claimant, ranging between a minimum of 90 days and a maximum of 240 days as shown in Table 5.1. It was 60-210 days until 1999 as shown in Table 5.2, but from January 1, 2000, the duration of JSA in each cell of Table 5.2 extended by 30 days.

Since Korea's EIS was implemented on July 1, 1995, the insured employment period of each covered employee cannot exceed five years

until June 30, 2000. Thus the actual duration of JSA is 90-180 days until June 30, 2000, depending on the insured employment period and the age of the claimant.

TABLE 6.1. DURATION OF JSA (FROM JANUARY 1, 2000)

(Unit: days)

		Insured Employment Period				
		Less than 1 year	1-3year	3-5year	5-10year	10year or more
Age	Less than 30	90	90	90	150	180
	30-50	90	120	150	180	210
	50 or older and disabled	120	150	180	210	240

TABLE 6.2. DURATION OF JSA (UNTIL 1999)

(Unit: days)

		Insured Employment Period				
		Less than 1 year	1-3year	3-5year	5-10year	10year or more
Age	Less than 30	60	60	90	120	150
	30-50	60	90	120	150	180
	50 or older and disabled	90	120	150	180	210

6.2.5 Extended benefits

JSA is paid to eligible claimants up to 90 to 240 days after the two-week waiting period within the ten-month period. However, JSA can be extended in special cases. There are three kinds of extended benefits in Korean EIS: training extended benefits, individual extended benefits, and special extended benefits.

The daily amount of each extended benefits is 70 percent of JSA. If the daily amount of extended benefits is less than 90 percent of the daily minimum wage rate, however, the daily amount of the extended benefits will be 90 percent of the daily minimum wage rate.

6.2.5.1 Training extended benefits

When a claimant receives vocational training, as ordered by the

public employment office, the duration of JSA can be extended up to 60 days for the training waiting period and two years for the training period. If a claimant undergoes vocational training on his own, however, he cannot receive the training extended benefits because he did not receive a training order from the public employment office.

The purpose of the training extended benefits is to assist in re-employment in stable occupations through vocational training, and to relieve the unemployed of the financial burden of training costs.

6.2.5.2 Individual extended benefits

When the public employment office recognizes that it is extremely difficult for a claimant to be re-employed in a short period of time, and the claimant has difficulties in maintaining his/her livelihood, the duration of JSA can be extended up to 60 days.

In order to receive the individual extended benefits, the claimant must satisfy all of the following conditions.

- (1) He/she terminated employment in one of the occupations or regions designated by the Minister of Labor due to the serious labor market conditions.
- (2) A claimant remains unemployed until the last day of JSA even though he/she received job placement services from the public employment office three times or more.
- (3) A claimant has one dependant or more aged 18 years or less, or aged 65 or over.
- (4) A claimant's daily wage rate before unemployment was not more than 35,000 won.
- (5) A claimant cannot participate in the vocational training program.

6.2.5.3 Special extended benefits

The Special Extended Benefits program is activated only when the Minister of Labor deems that labor conditions have worsened nationwide. A period for special extended benefits is announced if any

of the following conditions are satisfied during the previous three months.

- (1) The ratio of JSA recipients to insured employees is greater than 3.0 percent.
- (2) The ratio of first-time JSA claims to insured employees is greater than 1.0 percent.
- (3) The unemployment rate is greater than 6.0 percent.

Once the Minister of Labor announces a period for Special Extended Benefit, the duration of JSA for all claimants is extended for 60 days during the specified period.

The Special Extended Benefits program was introduced in 1998 when the financial crisis hit the Korean labor market. The first period for Special Extended Benefits took place July 15, 1998 to January 14, 1999, and it was extended to December 31, 1999.

6.2.6 Sickness benefits

In order to qualify for JSA, a claimant must be able to and willing to work. Therefore, a claimant who cannot work because of injury, sickness or childbirth is not eligible. When a claimant cannot receive JSA due to injury, sickness or childbirth, EIS offers a Sickness Benefits program instead.

In order to receive sickness benefits, the claimant must satisfy both of the following conditions.

- (1) A claimant is not able to work for seven days or longer due to injury, sickness or childbirth after registering at the public employment office as an unemployed person.
- (2) A claimant has not been suspended from JSA for rejecting job placement services, job guidance services or a vocational training order by the public employment office.

The daily amount of sickness benefits is equivalent to JSA. Since the sickness benefits program is a substitute for JSA, it is limited to the number of days for which JSA is not paid.

6.3 Employment Promotion Benefits

The primary purpose of unemployment benefits is to assist involuntarily laid-off workers. If claimants do not actively search for work, they are unlikely to attain early re-employment and economic stability. Thus, in order to minimize abuse of unemployment benefits and promote job search efforts, Korea's EIS features Employment Promotion Benefits, which includes the Early Re-employment Allowance, Vocational Training Promotion Allowance, Nationwide Job-seeking Allowance and Moving Allowance.

6.3.1 Early Re-employment allowance

The Early Re-employment Allowance (ERA) is an incentive pay structure, created to minimize an individual's duration of unemployment and to encourage speedy re-employment in a stable job. It is given when the recipient of JSA obtains stable re-employment before he/she reaches the halfway point of the total benefits period.

In order to receive ERA, claimants must satisfy all of the following requirements.

- (1) Calculated as of the day before a claimant starts the new job, the number of his/her remaining days of JSA must exceed one half of his/her total benefit period. The remaining days of JSA refer to the days of the total benefit period subtracted by the number of days a claimant has received JSA or Sickness Benefits.
- (2) The new employment must be deemed stable and guaranteed for more than six months.
- (3) The new employment must not be with the previous employer or anyone closely related to the previous employer.
- (4) The new employment must not have been offered prior to a claimant's resignation at the previous workplace.
- (5) The claimant must not have received ERA during the two years prior to the first day of new employment.

The amount of ERA is one half of the claimant's remaining

amount of JSA. Nevertheless, if the claimant is re-employed in small manufacturing, construction, the fishing industry or as a craftsman, operator or laborer, and later rehired by an employer who has failed to recruit employees for more than one month, the amount of ERA is the claimant's remaining amount of JSA.

Also, a subsidy is offered to job placement agents who have contributed to shortening the unemployment period of claimants of JSA by facilitating early re-employment through active vocational counseling and job placement services.

6.3.2 Vocational training promotion allowance

The Vocational Training Promotion Allowance (VTPA) is a supplement to JSA, instituted to facilitate vocational training of qualifying unemployed workers as recommended by the public employment office.

The training must take place within the unemployment benefits period. Days of absence and JSA suspension are subtracted from the duration of VTPA. The Minister of Labor determines the level of VTPA based on the expenses that the training necessitates, such as transportation and meal costs. For the 1999 fiscal year, VTPA was set at 5,000 won per day.

6.3.3 Nationwide job-seeking allowance

The Nationwide Job-seeking Allowance (NJSA) is designed to assist extensive job search efforts of qualifying individuals by subsidizing transportation and lodging costs. The search must be initiated at the recommendation of the public employment office, and claimants must satisfy all of the following eligibility requirements.

- (1) The job-seeking process must commence at the recommendation of the public employment office.
- (2) The waiting period for JSA must have expired prior to the nationwide job search.
- (3) The prospective employer either has no intention of financing the charges incurred, or pays an amount less than the total cost.

- (4) The distance between the insured job seeker's residence and the prospective employer's business location must exceed 50 kilometers.

The allowance covers transportation costs via railroad, automobile and ship, as well as lodging fees. If the prospective employer finances the cost, the insured job seeker must report it in order to receive reimbursement for any amount not covered by the prospective employer.

6.3.4 Moving allowance

The Moving Allowance subsidizes the moving costs incurred during relocation for new employment or vocational training. To receive the Moving Allowance, i) the period of employment must exceed one year, ii) the waiting period must have expired prior to reemployment or vocational training, and iii) the public employment office approved the necessity to move.

The allowance is equal to moving subsidies offered to government officials. The qualifying applicant must report any moving costs paid by the prospective employer in order to receive reimbursement for costs not covered by the prospective employer.

6.4 Mechanism for Preventing Abuse of Unemployment Benefits

In order to minimize side effects of unemployment benefits, several mechanisms have been built into the Korean EIS system.

First, claimants for unemployment benefits must register at the public employment office as job seekers, and they should be ready and able to work or to search for jobs. Each claimant should report on his/her active job search efforts every two weeks, demonstrating willingness and ability to work, and availability for work. If he/she fails to satisfy these requirements, the claimant is disqualified from receiving unemployment benefits.

Second, claimants who voluntarily quit their jobs without good reason, or were fired for serious misconduct are ineligible for unemployment benefits. In most countries, unemployment benefits are only suspended for a certain period, and claimants can still receive unemployment benefits after the suspension period, even in these cases.

Third, if a claimant refuses the job placement services of the public employment office, his/her unemployment benefits are suspended for two weeks. And if a claimant refuses the order of the public employment office to participate in a job skill development program, his/her unemployment benefits are suspended for four weeks. These regulations help ensure that claimants utilize the job placement services of the public employment office and undergo job skill development for re-employment.

Fourth, a claimant is entitled to receive unemployment benefits for only 12 months from the first day of unemployment, barring any permission from the public employment office. This encourages the claimant to register at the public employment office immediately after job loss in order to receive his/her unemployment benefits for the maximum allowed period. In other words, the government hopes that the earlier they register, the sooner they will be able to find a new job with support from the public employment office.

Fifth, unemployment benefits are awarded for a relatively short period, ranging from 90 to 240 days, depending on the insured employment period in the base period and age of the claimant. The amount of unemployment benefits is basically 50 percent of the claimant's average wage for the last three months immediately before the layoff, relatively less than in most European countries.

Sixth, in order to reduce frequent claimants on purpose, the claimant who received unemployment benefits must satisfy the required insured ensured employment period and base period for a new unemployment benefits claim.

6.5 Payment of Unemployment Benefits

Until 1997, there were few claimants for unemployment benefits because of the low unemployment rate, which stood at 2.6 percent in 1997. With the financial crisis in November 1997, however, and the drastic restructuring of the Korean economy after the crisis, unemployment soared to 6.8 percent in 1998 and 6.3 percent in 1999. During this time, total expenditures for unemployment benefits increased sharply in 1998 and 1999: from 78 billion won in 1997 to 785 billion won in 1998, 936 billion won in 1999 (see Table 6.3.). Those figures came down gradually to 471 billion won in 2000, due to the drop in unemployment rates beginning in March 1999. JSA comprised about 98 percent of the expenditure for unemployment benefits. Together with soaring unemployment, implementation of Special Expended Benefits from July 15, 1998, contributed to a sharp increase in expenditure for unemployment benefits from the second half of

TABLE 6.3. PAYMENT OF UNEMPLOYMENT BENEFITS

	(in million won, persons)				
	1997	1998	1999	2000	2001
1. Amount of Benefits					
Total	78,737	799,416	936,163	470,793	845,116
1) Job seeking Allowance	75,947	783,118	911,287	443,545	783,852
2) Employment Promotion Allowance	2,579	15,277	22,237	24,886	57,152
-ERA	2,558	15,260	22,222	24,879	57,122
-VTPA	19.4	15.1	5.0	0.4	2.3
-NJSA	0.1	1.6	9.1	6.7	27.7
-MA	0.1	1.1	0.4	0.2	0.2
3) Sickness Benefits	212	1,019	2,637	2,361	4,099
2. Number of Beneficiaries					
Total	49,117	411,686	484,772	332,692	428,156
1) Job seeking Allowance	44,334	392,569	455,355	303,859	377,752
2) Employment Promotion Allowance	4,526	17,750	25,223	24,760	44,311

-ERA	4,481	17,712	25,153	24,710	44,129
-VTPA	41	22	16	2	12
-NJSA	1	11	53	38	162
-MA	3	5	11	10	8
3) Sickness Benefits	257	1,366	4,163	4,059	6,078
3. UB Spending as a fraction of GDP	0.017	0.177	0.194	0.091	0.16

Source: Employment Research Center, *Employment Insurance Review*, Korea Labor Institute, Spring 2000.

1998. The unemployment benefits spending, in terms of a fraction of GDP, increased from 0.017 in 1997 to 0.194 in 1999, and then decreased to 0.091 in 2000. It began to increase slightly to 0.16 in 2001.

The number of unemployment recipients also sharply increased beginning in 1998, from 128 thousand in 1997 to 1,380 thousand in 1998 and 1,741 thousand in 1999. Although it decreased to 918 thousand in 2000, the number increased again, to 1403 thousand, in 2001 (see Table 6.3.).

The proportion of recipients of unemployment benefits out of the total unemployed increased from 1.9 percent in 1997 to 10.7 percent in 1999, and then decreased to 8.6% in 2000. In 2001, however, it increased sharply to 14.0 percent.

As shown in Table 6.4, the proportion of unemployment benefits recipients out of the total unemployed was extremely low until 1997, but began to rapidly increase from 1998 mainly due to the soaring unemployment rate, coverage expansion and introduction of special extended benefits. Even in 1999, however, only 10.7 percent of the unemployed received unemployment benefits, a relatively low rate compared to other countries. The major reasons for such a small proportion of the unemployed receiving unemployment benefits

TABLE 6.4. UNEMPLOYMENT BENEFITS RECIPIENT RATE

Year	As a proportion of the total unemployed	(in %)		
		As a proportion of the unemployed for less than one year		
		Out of displaced workers	Out of unemployed wage workers	Out of unemployed wage workers except daily workers

1996	0.6	-	-	-
1997	1.9	-	-	-
1998	7.9	9.7	11.5	17.5
1999	10.7	13.8	16.3	28.5
2000	8.6	10.9	12.9	21.5
2001	14.0	17.9	20.9	32.6

Source: Employment Research Center, *Employment Insurance Review*, Korea Labor Institute, Spring 2001.

follow:

- (1) Korea's EIS does not grant unemployment benefits to those who quit their job voluntarily without good reason.
- (2) More than half of those covered employees who left their jobs quit voluntarily.
- (3) The duration of unemployment benefits is relatively short in Korea's EIS system.
- (4) There are still many employees in Korea who are not insured by EIS.

In most countries, even those who quit their jobs without good reason are entitled to unemployment benefits after a certain restriction period has passed. Korea's EIS, however, does not cover those who quit their jobs voluntarily without good cause. About 70 percent of Korean jobless fall into that category, meaning that only 30 percent, i.e., those who quit due to layoffs, business closure or bankruptcy, retirement, or termination of employment contract, typically qualify for unemployment benefits.

Although unemployment benefits recipients rapidly increased after the financial crisis, the proportion of beneficiaries out of the total unemployed was only about ten percent. The last column of Table 6.4 shows the proportion of unemployment benefits beneficiaries of salaried workers unemployed less than one year (except daily workers) has been 20 to 30 percent since 1998. Because recipients are eligible only within 12 months of job loss, and since daily workers are not covered by Korea's EIS, it might be better to compare this last column with other countries.

Table 6.5 reports on the characteristics of UB recipients by gender and age. The proportion of insured female employees has increased slightly from 27.2 percent in 1996 to 31.3 percent in 2001. However, the proportion of female beneficiaries has increased from 20.1 percent in 1996 to 38.6 percent in 2001, a sharp increase over the proportion of insured female employees. Thus, as of 2001, the probability of receiving UB is much higher for women. Considering UB receipt by age, about 90 percent of recipients fall into the prime working-age bracket of 25 to 59.

TABLE 6.5 UNEMPLOYMENT BENEFITS RECIPIENTS BY GENDER AND AGE, 1996-2000

(in persons, %)

	Gender		Age<=19	Age					
	Male	Female		20-24	25-29	30-39	40-49	50-59	Age>=60
1996	79.9	20.1	0.1	1.4	5.0	20.0	31.5	33.0	9.0
1997	75.4	24.6	0.0	1.2	6.1	23.2	27.2	32.3	10.0
1998	69.7	30.3	0.0	4.3	16.6	32.3	23.0	19.5	4.4
1999	66.4	33.6	0.0	4.3	19.4	31.0	21.5	18.2	5.5
2000	62.4	37.6	0.0	3.5	19.0	31.4	22.6	17.7	5.7
2001	61.7	38.3	0.0	3.4	18.4	32.1	23.5	16.9	5.6

Source: Employment Research Center, *Employment Insurance Review*, Korea Labor Institute.

TABLE 6.6. THE TREND OF WAGE REPLACEMENT RATE (CF. THE CLASSIFICATION IS BY AGE IN THE ENGLISH TEXT BUT ANALYZED FIGURES ARE UNAVAILABLE YET.)

(in won, persons, %)

Year	Average daily amount of JSA	Average daily wage	Number of benefits recipients	Replacement rate
1996	25,446	-	16,649	-
1997	24,945	57,808	88,548	43.2
1998	24,396	56,061	421,725	43.5
1999	21,611	48,179	267,891	44.9
2000	21,129	48,627	256,531	43.5
2001	23,398	51,344	123,080	45.6

Notes: 1) The upper limit for the JSA is 35,000 won for those who left the job voluntarily before June 30, 1999 and 30,000 won from July 1, 1999 to the end of 2000. The limit was readjusted to 35,000 won.

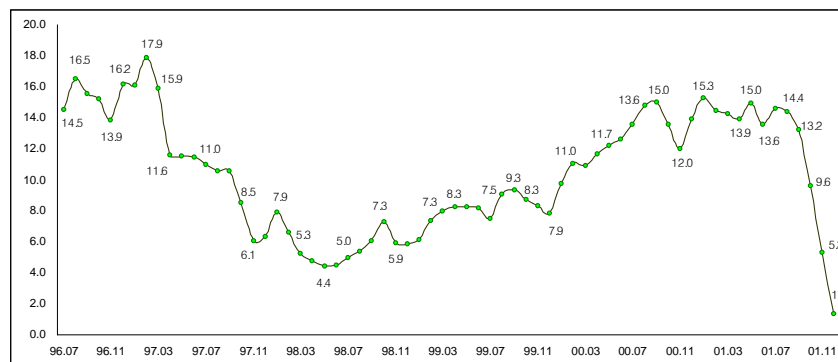
- 2) The calculation was based on the people who left the job voluntarily that year.

Source: Employment Insurance DB.

The percentage of Early Re-employment Allowance recipients out of the total unemployment benefit recipients fluctuates according to the labor market situation. Until early 1997, it was higher than 10 percent. From the second quarter of 1997, however, it began to decrease, reaching 4.2 percent in 1998 due to the soaring unemployment rate. As the labor market situation improved beginning in 1999, it began to increase. Due to the economic downturn in 2000, however, it began to decrease again.

As mentioned above, until 1999, JSA was extended for 60 to 210 days depending on the insured's employment period and age. Since implementation of Korea's EIS on July 1, 1995, however, the insured employment period of each claimant cannot exceed five years until June 30, 2000.

FIGURE 6.1. PROPORTION OF EARLY REEMPLOYMENT ALLOWANCE RECIPIENTS/UNEMPLOYMENT BENEFIT RECIPIENTS



Note: These figures are the proportions of the early reemployment allowance recipients out of the newly approved applicants from each month, so the figures from October 2001 are underestimated.

Source: Employment Research Center, *Employment Insurance Review*, Korea Labor Institute, Spring 2001.

Thus, the actual maximum duration of JSA was 60 to 150 days until 1999, depending on the insured's employment period and age. When considering the 60-day Special Extended Benefits, in effect from July 15, 1998 to December 31, 1999, the actual maximum duration of JSA was 120 to 210 days during that period. Table 6.7 and Table 6.8 show that the average duration of JSA was 98.1 days in 1998 and 103.3 days in 1999, relatively short periods of time compared to most other countries. The average duration of JSA from July 1, 1997 to June 30, 1998 was 74.6 days. Despite the fact that the average JSA period

TABLE 6.7./6.8./6.9. AVERAGE AMOUNT AND DURATION OF JOB-SEEKING ALLOWANCE BY AGE

(in thousand won/day)

	Average age of beneficiaries	Average amount of JSA per beneficiary	Average daily amount of JSA	Average duration of JSA
1998	Average	2,278	24	98.1
	Under 30	1,410	21	73.9
	30-39	2,563	27	99.7
	40-49	2,450	26	100.0
	50 or over	2,826	23	126.0
1999	Average	2,389	23	103.3
	Under 30	1,444	17	88.5
	30-39	2,394	23	104.0
	40-49	2,760	25	109.7
	50 or over	2,975	21	132.3
2000	Average	2,199	21	103.2
	Under 30	1,355	16	80.6
	30-39	2,166	22	96.2
	40-49	2,495	23	105.6
	50 or over	2,802	21	133.9
2001	Average	2,458	21	111.1
	Under 30	1,495	18	83.2
	30-39	2,394	23	102.7
	40-49	2,784	24	115.8
	50 or over	3,205	21	146.7

Source: Employment Insurance DB; Employment Insurance Center, Korea Labor Institute, *Employment Insurance Review*, volumes from respective year.

increased due to introduction of Special Extended Benefits, as well as to high unemployment rates since 1998, the actual benefits period is

relatively short in Korea. This also contributes to the low number of unemployment recipients.

Although all enterprises have been covered by EIS since October 1, 1998, there are still many employees who are excluded from EIS. As of December 2001, the total number of employees in Korea was 13.3 million, with the number of insured at 6.8 million, only 51 percent of Korea's total employees. A total of 9.4 million employees were slated for coverage by December 2000. Hence, the proportion of insured employees out of the total number of employees that should be covered is 71.2 percent, leaving more than half of the employees out of the EIS safety net. Most of them are daily workers, part-time employees, government workers and private school employees. The proportionately low unemployment coverage is reflected in the low number of unemployment benefits recipients in Korea.

Of those who have depleted their JSA benefits, the average amount of JSA per recipient was 2.3 million won for 98.1 days in 1998, 2.4 million won for 103.3 days in 1999, 2.1 million won for 103.2 days in 2000 and 2.4million won for 111.1 days in 2001 These correspond to 24 thousand won per day in 1998, 23 thousand won per day in 1999, 21 thousand won per day in 2000 and 21 thousand won per day in 2001 (see Table 6.7., Table 6.8. and Table 6.9.).

7. Administration

7.1 Administration of EIS Programs

Korea's EIS programs closely correspond to the employment policies of the government. Consequently, the Minister of Labor is in charge of carrying out EIS programs, while the Bureau of Employment Policy in the Ministry of Labor is in charge of EIS general policy and supervises the implementation of Employment Insurance programs.

When Korea introduced EIS in July of 1999, 46 local labor offices

were in charge of carrying out the Employment Insurance programs. With the expansion of coverage and the rapid increase in the unemployment rate after the financial crisis in November 1997, Korea began to set up Employment Offices from 1998 and Manpower Banks from 1996, instead of expanding local labor offices. These employment offices are special branches of the local labor offices for implementing employment insurance programs, while manpower banks deal with job placement services only. The employment offices and manpower banks are unique in that they operate on a contract basis. Workers in both offices are non-governmental personnel, whose salaries are determined according to individual performance even though they are government organizations. Of the employees in the Employment Offices and the Manpower Banks, about 80 percent are non-government personnel working on a contract basis, and other 20 percent are public servants.

Because the performance of employment offices has proven better than that of the local labor offices in the implementation of employment insurance programs, the Korean government incorporated EIS programs into the employment offices. As of June 1, 2001, there are 187 public employment services: 164 employment offices, seven manpower banks and 16 employment centers for day workers.

Information on the labor market, insured employees, covered employers, and recipients of unemployment benefits was collected and distributed by the Central Employment Information Office (CEIO) of the Ministry of Labor, but since January 1, 2001, the Korean government has outsourced CEIO to the Korean Manpower Agency.

7.2 Administration of Premium Collection

Of the four social insurance schemes in Korea, the Ministry of Labor manages Workers' Compensation (WC) and EIS. In the past, because the two insurance systems had their own history of development and administration, insurance premiums were collected independently and according to their own set of regulations. The Korea Labor Welfare Corporation (KLWC) was in charge of WC premium

collection while the Ministry of Labor collected EIS contributions.

After the financial crisis, when privatization and deregulation became government policy, the Ministry of Labor decided to outsource the administration of premium collections. Thus, since October 1, 1999, KLWC takes care of premium collection, including employment insurance contributions and WC contributions.

Besides the integrating collection services, other initiatives are being taken to streamline collection of employers' contributions.

Every year, before March 10, employers had to report the number of employees they would employ and the corresponding payroll for the year. At the same time they had to pay contributions to KLWC, settling the previous year's contribution based on the payroll.

The system has been plagued with problems stemming from information gathering, however. Many small business employers and construction companies do not keep payrolls and labor turnover is frequent; hence, they do not correctly report figures. Moreover, wage records of insured employees are not renewed every year.

Insurance premiums have been collected most of time based on employers' declaration of total payroll in the firm. As for construction companies, insurance premiums have been levied in accordance with a given percentage of the total turnover. When disputes arise between employers and KWLC, employers have to assume the burden of proof, yet they cannot present payroll records that do not exist. Therefore, employers in small firms and construction companies have complained that the criteria of premium collection are unclear, and that KWLC makes impossible requests for documents.

From 2003, small firms (with less than five employees) will only have to report employees to the Ministry of Labor and insurance premium will be calculated by KWLC based on the number of employees reported and the wage level announced every year by the Ministry of Labor. As for construction companies, general construction companies as well as subcontracting construction companies will also have to report their employees and wages.

7.3 Appeals Process

Anyone who disagrees with the decisions of employment offices on unemployment benefits and other related issues must appeal to the public employment office within 90 days of the announcement of the decision. The office receiving the appeal should send it to a judge in the regional labor office within five days of the appeal. In each regional labor office a judge examines decisions of the public employment offices on Employment Insurance, reviews the appeal and makes a decision within 30 days after receiving the appeal, and notifies to both the complainant and the employment office that made the original decision. The employment office must follow the decision of the judge.

If the complainant still disagrees with the decision of the judge in the regional labor office, he/she may re-appeal to the Employment Insurance Appeal Committee within 90 days of the decision of the judge in the regional labor office. The committee should review the case and make a decision within 50 days of the second appeal. If the complainant disagrees with the decision of the Committee, he/she may file a suit with the court.

The number of appeals and second appeals is increasing every year: There were 65 cases in 1996, 176 cases in 1997, 829 case in 1998, and 964 cases in 1999.

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6

Recent Developments of Employment/ Unemployment Insurance and Active Labor Market Policies

Kil-Sang Yoo*

1. Introduction

Globalization, informatization and rapid changes in technology have transformed the global labor market. The education and training systems have been unable to keep pace with rapidly developing technology, and this has resulted in skill mismatches in the labor market. Ironically, youth unemployment remains a serious social problem despite improved educational level of the youth. Across the globe, reforms are under way to overhaul education and training programs to reduce skill mismatches and youth unemployment. In a knowledge-based society employees must acquire new knowledge and skills throughout their careers. Indeed, lifelong learning is an integral part of today's global labor market

Globalization has also brought about corporate restructuring and fiercer competition, and this in turn has created a more flexible labor market. Due to corporate restructuring and greater labor market flexibility, the temporary job market has experienced a dramatic leap in contract, short-term and part-time jobs. This has resulted in a lack of

* Vice President, Korea Labor Institute.

job security and widening income inequality.

In addition to temporary jobs, new openings in personal service sectors, such as hotels and restaurants, have increased the demand for low skilled foreign workers. Finally, the so-called "digital divide", a result of the knowledge-based economy, will further aggravate wage disparity. The answer is more investment in the skills-development of vulnerable groups, such as unskilled workers, in order to improve their employability and to create stable, decent jobs.

Corporate restructuring and technological development have resulted in a highly mobile labor force. In response, Public Employment Services (PES) now plays a greater role: assisting workers to transit smoothly from one job to another, providing up-to-date information to both employers and job seekers and promulgating labor market policies. As a public agency, PES partners with local authorities, community-based organizations and NGOs in promoting labor market policies, supporting the employment of vulnerable groups and enhancing the effectiveness of public assistance programs. Around the world, the goal is to reap maximum benefits with minimum costs by developing policies tailored to the characteristics of each target group, and executing those policies on the local level. PES offers the most viable solution because it functions locally, providing one-stop service based on local employment related policies. In the future, PES must further develop partnerships with relevant government agencies in order to effectively coordinate and execute local labor market policies. In this context, PES must encourage its employees to develop their expertise as well as facilitate partnerships with other agencies.

In sum, new socio-economic trends are changing the face of the labor market. Therefore, labor market policies must address a wider range of increasingly complex issues. Nations of the world are introducing more diverse and target-specific labor market policies, both active and passive, to handle diverse issues. Some countries such as Germany, Austria, Japan, South Korea, and Canada that previously focused on a traditional unemployment insurance system are now channeling funds from their respective national unemployment

insurance systems into an employment insurance system, a clear sign that more countries are adopting more active labor market policies.

2. Wage Subsidy Programs

Various labor market policies have been created to promote the employment of vulnerable groups, including the long-term unemployed, older displaced workers and workers with disabilities. One example is a wage subsidy program that provides financial incentives to businesses employing workers whose productivity levels are generally not as high as others. Compensation may either go directly to a participating business or to the employees themselves.

Despite the original intention to promote employment of vulnerable groups, wage subsidy programs do pose problems. First, mainstream workers may be deprived of employment opportunities because of subsidies provided to the disadvantaged, resulting in the so-called “replacement effect.” In addition, subsidies can undermine the efficient allocation of human resources. Finally, the efficacy of a wage subsidy program is debatable, with the net effect in most participating nations at the 20 percent level (Kim and Park, 2000).

Despite these drawbacks, countries continue to create wage subsidy programs to protect the socially marginalized and to provide job opportunities rather than just cash benefits. In other words they promote productivity rather than simply providing welfare. While countries with highly active labor market policies such as Germany, Sweden and Japan provide relatively generous and diverse wage subsidy programs, countries such as the United States and Britain place higher priority on market principles and thus support limited programs.

As explained in Chapter 4, the German government's wage subsidy program reimburses employers for 30 to 75 percent of wages paid to vulnerable employees for a one-year period. In special circumstances, the government pays the entire wage for a maximum of 36 months. Along with these job-creating measures (ABM), structural

adjustment programs (SAM) facilitate corporate and economic restructuring and create temporary job opportunities for those who lose their job in that process. SAM creates jobs for the unemployed in sectors such as environmental conservation, and subsidizes wages for a maximum period of 36 months. One restriction requires that the wage subsidy in SAM must not exceed the average rate of unemployment benefits or unemployment assistance. The financial resources for the wage subsidy in Germany relies on the unemployment insurance revenues paid by both labor and business(Blien, 2001).

Sweden currently provides three types of employment subsidies, including the general employment subsidy, the reinforced employment subsidy and the special employment subsidy. Designed to promote the reemployment of the target group, the general employment subsidy covers 50 percent of the wages for a period of six months when employers re-employ workers who have been laid off for six months or more. It can be extended to twelve months in special cases. Reinforced employment subsidy, offered for a maximum of 24 months, partially subsidizes wages of individuals unemployed for more than 24 months or those who have participated in employment policy programs. The program covers 75 percent of the entire wage costs for the first six months and 25 percent for the next 18 months. For individuals who are unemployed for more than 48 months, the program assumes responsibility for 78 percent of the full wage costs for the first twelve months and 50 percent for the following six months. Finally, the special employment subsidy, covering 75 percent of the wages for 24 months, supports workers above 57 years of age who have been unemployed for more than 24 months, or those who have participated in employment policy programs. Wage subsidy programs are funded by general tax revenues in Sweden(Pettersson, 2001).

Wage subsidy programs are included as a part of the employment stabilization program of the employment insurance in Japan and South Korea. In such programs, which are financed through the employment insurance fund, employers are both the financial providers and beneficiaries. The programs partially reimburse employers for the costs

they must bear in order to minimize employee layoffs during the restructuring process. They also promote the employment of vulnerable groups such as the long-term unemployed and older workers.

At present, Japan has more diverse wage subsidy programs than South Korea. In an effort to address unemployment caused by restructuring, the Japanese government covers half of the costs (two-thirds in the case of small and medium enterprises) for a given time if employers agree not to lay off employees, and instead, grant temporary leaves or provide training. Regarding older workers, the government provides subsidies to employers who voluntarily raise the retirement age beyond 61 or who continue to employ older workers until the age of 65 for the maximum period of five years. A business that retains more than a 15 percent ratio of employees over 60 receives a monthly subsidy of 10,000 yen (or 15,000 yen in the case of small and medium enterprises) for each older worker over and above the 15 percent level. In addition, employers who improve working conditions and facilities for older workers and hire more employees in this age group receive a subsidy based on the costs for improving working conditions and facilities and the number of newly-employed older workers. Apart from these programs, the Japanese government is also implementing various wage subsidy programs to promote employment and reduce unemployment of marginal workers(Higuchi, 2001).

Wage subsidy programs in Korea are somewhat similar to those in Japan. Employers who opt to retain employees even when layoffs are needed (reasons include economic slowdown or corporate restructuring) receive subsidies from the government. For example, the government shoulders the responsibility for leave benefits equal to half-salary ($2/3$ for small and medium enterprises) when employees are granted temporary leaves. It offers $1/15$ of wages ($1/10$ for small and medium enterprises) when working hours are shortened, $2/3$ of wages ($3/4$ for small and medium enterprises) and full training costs to provide employee training. Those employers providing outplacement services will receive $1/3$ of the entailed costs ($1/2$ for small and medium enterprises) for 12 months. When laid-off workers are

reemployed within 2 years, the employer receives 1.6 million won (2 million for small and medium enterprises) for each worker. When the ratio of older workers aged 55 or over accounts for more than 6 percent of the entire payroll, the employer receives ₩ 150,000 each quarter for each worker above that 6 percent level. When employers employ older workers aged 55 or over, they receive a monthly subsidy of ₩ 250,000 per person for six months. Moreover, employers receive a monthly subsidy of ₩ 300,000 per person over a six-month period when they rehire former employees aged 45 to 60. When employers hire workers who have been unemployed for more than six months through the recommendation of a public employment office, the government pays them a monthly subsidy of ₩ 600,000 per person for six months. In addition, it promotes women in the workforce. Employers who re-employ female workers who left due to pregnancy, childbirth or childcare needs within five years, or who employ women supporting dependents, receive a six-month subsidy at a level set annually by the Minister of Labor.

The United States, on the other hand, promotes employment indirectly by providing tax credits rather than paying out a wage subsidy. In the early 1970s, the Work Incentive Program (WIN) was introduced, providing tax credits to business owners who hired welfare recipients. Employers were unhappy with the program, however. In the mid 1970s, the government introduced another program, the New Jobs Tax Credit (NJTC). That program, which granted a maximum of 50 percent tax credit to employers hiring marginal workers, was also abandoned within two years. The Targeted Jobs Tax Credit (TJTC) program implemented from 1978 to 1994 to provide a tax credit of up to 40 percent when employers hired welfare recipients, youths or disabled workers, was also deemed ineffective. The Earned Income Tax Credit (EITC) which went in effect in 1975 supports low-wage workers by granting tax credits. In 2000, families with two or more children received a subsidy of 40 cents for every dollar of earned income up to \$9,740, for a maximum credit of \$3,390. In the United States, many states administer wage subsidy programs that focus mainly on getting the economically

disadvantaged off the welfare rolls and into the job market(Eberts and O'Leary, 2001).

Like the United States, Britain has maintained a very cautious approach toward wage subsidy programs. The British government provides family income supplements to low income families with children and grants tax credits to low-income workers through the Working Families Tax Credit (WFTC), much like the Earned Income Tax Credit (EITC) in the United States. For low-wage earners with children, the WFTC provides an income guarantee (at least £ 207 per week) for those who secure full-time work. In addition, it offers a tax credit to cover 70 percent of certain childcare expenses.

The British government is making every effort to maximize the cost effectiveness of wage subsidy programs by clearly defining target groups, specifically through the New Deal. A number of New Deal programs have been implemented to promote employment by providing targeted subsidies. New Deal for Young People targets youth unemployment; New Deal for the Long-Term Unemployed assists individuals 25 or over who have been jobless for more than two years; and New Deal 50-Plus supports those aged 50 or over who have been jobless for more than six months(Groombridge, 2001).

Wage subsidy programs vary from one country to another. Wage subsidies paid directly to employers can trigger a negative impact. Employers may assume that wage-subsidy recipients will be incompetent or troublesome, and thus, be reluctant to hire them. To eliminate this effect, it would be better if wage subsidies were paid directly to eligible workers. The EITC, adopted in the United States, probably attracted the participation of so many U.S. organizations because it was designed to avoid the stigma effect. Countries that provide wage subsidies directly to employers should instead consider direct support of eligible workers through tax credits as it is done in the United States and the United Kingdom.

Countries adopting wage subsidy programs can maximize their effectiveness by clearly defining target groups. Therefore, consistent monitoring and evaluation of target group selection and cost

effectiveness are critical to the further development of wage subsidy programs.

3. Government-Supported Vocational Training

Globalization has broken down the economic boundaries between nations, resulting in cross border exchanges of both material goods and human resources. Indeed, developments in technology and information demand knowledgeable workers. If human resources lag behind in new information and technology, however, they lose not only competitiveness but employability as well. Companies who hire them will also suffer a loss of competitiveness in the world market. Both employers and employees, therefore, must invest in building human capital.

We have crossed the threshold of the 21st century into the globalization and the information age. In that revolutionary new setting, a nation's competitive capabilities and quality of life will largely depend on its human resources and the information, knowledge and technology they possess. Moreover, the employability and employment security of those workers will depend greatly on his/her job skills. And those skills can only be developed through lifelong education and training. Therefore, one of the core strategies for growth will be developing a system to produce creative, future-oriented employees. As a result, nations as well as individual enterprises throughout the world are engaged in fierce competition in a borderless world market. Now, workers not only compete with fellow countrymen, but also with workers in other countries.

Rapid changes in know-how and technology are bound to create a significant vacuum in high-demand skill areas, which could lead to massive structural unemployment. Thus it will become increasingly important in the 21st century to build up a flexible and efficient lifelong education and training system and to implement efficient and effective unemployment policies and programs. Without it, employment security

cannot be guaranteed.

No sooner do today's products and technology enter the market, than newer products and technology replace them. Consequently employers pass over new graduates, preferring to hire experienced workers who have the in-depth knowledge and technology skills to keep pace with rapid changes. Moreover, human resources have become more mobile as a result of ongoing corporate restructuring. Thus, companies would rather invest in short-term upgrade-type training than initial long-term training.

In the past, governments shared the financial burden of workplace training by providing subsidies to employers or training organizations. Currently, more governments are directly supporting employees who receive that vocational training and education. In other words, employer-led training programs of the past are giving way to employee-directed training programs. For example, the German government channels funds from its unemployment insurance fund to subsidize employed workers (who have paid social insurance for at least one year) to participate in authorized full-time courses. The subsistence allowance is set at 67 percent of the net wage for participants who have at least one dependent child and 60 percent for others. Countries like Germany and Sweden guarantee the individual training leave for individual training days, so that employed workers can proactively develop and enhance their competitiveness.

The Japanese government encourages employers to invest in vocational training by sharing the training costs under the Employment Insurance system. In addition to offering training for experienced workers, the system also shares the cost for establishing and operating job training centers for unskilled youths who are just entering the labor market, and also directly supports workers who participate in job training and education. Under that system, however, employers are responsible for financing the vocational training. Many argued that it was unreasonable for the system to provide financial incentives directly to workers who engaged in vocational training programs independently. As a result, direct support to workers comes from the fund for

unemployment benefits, paid into by both employers and employees. The Japanese government established the training support program in December 1998 as part of the unemployment benefit program. It covers 80 percent of the training costs for a maximum period of one year for those workers who have been insured by the employment insurance system for five years or more, or for those employment insureds who have been unemployed for less than one year. The goal is to encourage workers to take the initiative to develop their own skills and know-how.

The Korean government established the Job Skills Development Program as a part of the Employment Insurance project. Depending on the type of training and education, the program covers 50 to 100 percent of the costs using employment insurance funds. The program encourages voluntary participation in job training by providing direct financial support to employers. If company restructuring, bankruptcy or temporary closure threatens an employee's job security or if employees are aged 50 or over, they are encouraged to voluntarily participate in job training, a program that covers each volunteer up to one million won. Those who are duly employed with employment insurance can borrow funds for college tuition from the fund, while unemployed individuals receive free training and training allowance.

To meet vocational training needs, the United States is expanding the Individual Training Account system, a training voucher system, in order to encourage employees to develop job skills (Eberts and O'Leary, 2001). In the same context, Britain provides the Career Development Loan, the Vocational Training Loan, and the Individual Training Account. The Canadian government consolidated the Unemployment Insurance Act and the National Training Act to create the Employment Insurance Act in July 1996. Under the new system, the government provides various kinds of job training support and loans (Wong, 2001). For the least employable who need job training, the Act operates loan and financial support programs.

4. Unemployment Benefits and Unemployment Assistance

4.1 Models of Support for the Unemployed

Social support systems for the unemployed in various nations can be classified according to three main models:

Model 1: Unemployment Benefits (UB) → Extended UB → Public Assistance (PA)

Model 2: UB → Unemployment Assistance (UA) → PA

Model 3: UA → PA

Model 1 provides the majority of unemployed persons with unemployment benefits from the employment/unemployment insurance system. The system does not provide universal coverage, however, and protects only unemployed individuals who previously paid into the system for a given time and those who qualify for unemployment benefits. Moreover, qualification is determined by a work test. Unemployment benefits are usually financed by contributions of employers and employees. Since the duration of unemployment benefits is limited, additional benefits can be implemented to cover recipients whose benefits have expired when the unemployment rate is unusually high. Under such circumstances, the duration of unemployment benefits can be extended. Additional costs therefore, must be met through increased contributions or other revenue sources.

For those who do not qualify for unemployment benefits, the only form of social support is public assistance. Public assistance supports the unemployed who live below the poverty line. Public assistance is funded by the general tax revenues and provides universal coverage. On the other hand, it is an income-tested program. Model 1 generally corresponds to systems found in the United States, Japan, Canada and Korea.

Under Model 2, the first and most important social protection for the unemployed is the provision of unemployment benefits from the employment/unemployment insurance system. Similar to Model 1, the program protects only workers who are covered by the Employment Insurance system for a given time, and who qualify for unemployment benefits. Unemployed persons who do not qualify for the unemployment benefits and/or are not covered through the unemployment or employment insurance system require protection under another system, that is, the unemployment assistance system. Unemployment assistance, which is financed by the general tax revenues, provides income support to the unemployed poor. The coverage is universal, although benefits are subject to an income-test and a work-test screening. Similar to Model 1, the public social assistance is the last resort for the impoverished. However this approach to social protection for the unemployed is more efficient as it provides universal unemployment social assistance. On the other hand, no special provision exists for extended unemployment benefits during difficult periods. Germany, France, the United Kingdom, Sweden and many European countries fall under Model 2.

Model 3 resembles Model 2, except that it does not have an unemployment benefits system. Unemployment assistance is funded by general tax revenues. Benefits are provided in the form of income support to the poor unemployed. The coverage is universal, and eligibility for benefits is subject to income-test and/or work-test screening. Public social assistance, the last resort for the poor, relies heavily on public budget allocations that are subject to political manipulations especially during difficult economic periods. The social support systems of Australia and New Zealand fit Model 3.

4.2 Coverage

Both employment and unemployment insurance, in principle, cover all employees. In the early stage of the employment/unemployment insurance system, small companies with less than the

minimum number of employees were not covered. Now, however, the size of the enterprise does not matter.

Employment/Unemployment Insurance (EI/UI) usually covers full-time permanently employed workers. With increasing numbers of temporary and part-time workers coverage of the insurance system needs to be expanded. In most countries, daily workers and part-time workers who work more than a given number of hours per week (e.g. 15 hours in Germany and Korea and 17 hours in Sweden) are also covered by EI/UI. In the past, daily workers in Korea were not qualified for unemployment benefits, but 2002 legislation made daily workers eligible for unemployment benefits. The Canadian government has greatly expanded the coverage of its EI/UI since July 1996, and as a result, anyone with more than one hour's work experience qualifies for EI/UI coverage. Depending on unemployment rates, employees who work between 420 hours to 700 hours per year are eligible for employment insurance benefits. This hourly-based coverage has boosted worker morale, and also simplified the EI application process for part-time workers.

The self-employed do not qualify for unemployment benefits, but are protected in some countries by an unemployment assistance system. In Britain, for example, the Contribution-based Jobseeker's Allowance covers only employees in a company while the Income-based Jobseeker's Allowance covers the self-employed as well.

4.3 Eligibility

For the unemployed to receive unemployment benefits, they must 1) meet the qualifying requirements, 2) consistently search jobs after becoming unemployed and 3) not be restricted from unemployment benefits due to disqualifications.

The first requirement determines whether potential beneficiaries paid into the program while they were working. The second requirement is to ensure that he/she has the ability to work and intends to find another job. The third requirement minimizes possible moral hazard and prevents the

abuse of unemployment benefits.

The purpose of establishing such requirements is to support employees who genuinely need assistance and to prevent workers from leaving their jobs just to receive unemployment benefits. Unemployed individuals who do not meet any one of the above requirements cannot receive unemployment benefits.

Requirements for unemployment benefits vary from one country to another, based on characteristics of the labor market, economy, and culture. However, common criteria exist: 1) employees must contribute to the employment/unemployment insurance system for a given period of time (base period) and 2) they must be physically able to work and to actively look for new jobs. Unemployment benefits are not paid to those who voluntarily quit their jobs without good reasons, those who are fired for misconduct, or those who reject job offers or training courses.

In the 1960s when the concept of the welfare state was popular, many industrialized countries liberalized unemployment benefit requirements and increased the level of benefits. Successive oil crises in the 1970s, along with accelerated industrialization and economic restructuring raised unemployment rates. Consequently, governments across the globe began applying more stringent requirements, and reduced the extent and duration of unemployment benefits. In some countries, for example, any unemployed worker who registered at a public employment service was considered eligible. It was simply assumed that he/she was willing to work. However, beginning in the 1980s, unemployed workers requesting unemployment benefits had to prove that they had made efforts to find a new job. Currently in Britain, unemployed individuals wishing unemployment benefits must sign a Jobseeker's Agreement stipulating that they will utilize any services available in order to find job. Unemployment benefits claimants must also accept a "suitable" job offer, or unemployment benefits will be withheld for a given time. The definition of a "suitable job" has been problematic. In Germany, for example, it is defined as follows: During the first three months after layoff, jobs paying 20 percent less than the

former salary are not considered suitable. During the next four to six months, unsuitable jobs are those paying 30 percent less than the former job. After seven months, a suitable job is defined as any job that pays more than the unemployment benefits. In Sweden, unemployment benefits claimants are allowed to choose jobs considering their previous occupations, salary and location for the first five months. When the job offered requires commuting a long distance, it is not defined as a suitable job even if the pay is adequate. After five months, however, the unemployed must accept job offers regardless of location, occupation or salary. In Britain, unemployed people can look for a job that suits their salary, occupation and location needs for thirteen weeks. After that, they must accept any job offer regardless of their previous occupation, salary or location.

When an unemployed individual rejects suitable jobs offered by the Public Employment Service (PES), unemployment benefits are suspended for a given period - for one week in Japan and for two weeks in South Korea. In Germany, payments cease for eight weeks as a result of a first-time job rejection. Following the second rejection, unemployment benefits are terminated. In Britain, the benefits are suspended for two weeks after the first rejection, four weeks after the second, and 26 weeks for a third refusal. In Sweden, benefits are cut by 25 percent for a 40-day period when recipients reject an offer for the first time, by 50 percent for a 40-day period after a second refusal. They are terminated after a third refusal.

The waiting period prior to activation of unemployment benefits was cut dramatically during the 1970s, but was extended again in the 1990s. For example, in 1988, the Swedish government paid unemployment benefits immediately; however, in 1993, a five-day waiting period was established. For those who leave their jobs voluntarily, the waiting period is 45 days.

In order to prevent abuses in the unemployment insurance program, claimants who voluntarily leave their jobs without good cause are not allowed to receive unemployment benefits. For instance, the United States and Korea do not grant unemployment benefits to those

workers who voluntarily quit their jobs without good reason. Britain suspended unemployment benefits to voluntary quitters for six weeks until 1986, 13 weeks from 1987 to 1988 and 26 weeks since 1989. And when those who have left their jobs voluntarily reject the New Deal, they cannot receive unemployment benefits. The period of restriction of unemployment benefits to those who quit their jobs voluntarily without good cause is six to twelve weeks in Canada, twelve weeks in Germany, four weeks in Sweden and three months in Japan. Additionally, Japan enacted legislation in April 2001, to reduce the duration of unemployment benefits to a maximum 150 days for those who voluntarily leave their jobs.

4.4 Benefit Amounts

Benefit amounts vary from one country to the next, with Denmark paying 90 percent of the previous wage, Sweden 80 percent, Japan 60 percent to 80 percent, France 57.4 percent, Canada 50 percent to 55 percent, the United States and Korea 50 percent, Austria to 50 percent, and Italy 30 percent.

In Canada, unemployment benefits 55 percent (60 percent for a low-income earner with dependents) of his/her previous wage. In order to facilitate reemployment and minimize problems arising from moral hazard, Canada has applied the intensity rule since July 1996. In other words, replacement rates for repeated users are reduced by one percentage point, up to a maximum of five percentage points, per 20 weeks of benefits drawn in the preceding five years(Wong, 2001). Thus benefits are reduced to 50 percent of the previous wage for those recipients who had received benefits for more than 100 weeks in the past five years. This means that worker side experience rating system is applied. Also claimants who work while on regular benefits, earning enough to reduce their employment insurance checks, can earn work credit to be used against future draw on benefits.

In Germany, claimants receive 67 percent of their previous net wages if they have dependent children, and 60 percent if they have no

children to support (Berner, 2001). The British government grants a fixed amount of benefits regardless of the previous wage, but the amount varies depending on age and dependent family members.

Generally, the same amount is paid out for the duration of unemployment benefit payments regardless of the benefit period. However, in order to encourage reemployment, some countries, including Belgium, Poland, Spain, Switzerland, Chile, the Czech Republic, and Hungary, are reducing the payment in relation to the period of unemployment. For instance, since 1991, Poland pays 70 percent of the previous wage for the first three months, 50 percent for the next six months and 40 percent after that. In Spain, recipients receive 80 percent of the previous wage for the first six months, 70 percent for the next six months and 60 percent after that. Since 1984, the Swiss government has cut benefits by 5 percent after 85 days and an additional 5 percent after 170 days, except for unemployed workers with disabilities, older workers aged 55 or over and low income earners (Yoo, 2000).

Chile has a fixed-rate unemployment assistance program supported by national funds. Since 1981, Chilean unemployed workers receive 6,000 pesos per month for the first 90 days, 4,000 pesos per month for the next 90 days and 3,000 pesos per month for the following 180 days to 360 days. Since 1991, when the Czech Republic introduced its unemployment assistance system, beneficiaries have received 65 percent of their previous wage for the first 180 days and 60 percent for the next 180 days. And in Hungary, since 1990, eligible unemployed workers have received 70 percent of the previous wage after tax for the first year and 50 percent for the second year. Since July 2001, the Swedish government also reduces benefit amounts after 100 days (Yoo, 2000).

In many countries with employment/unemployment insurance systems, the number of dependent family members does not affect the benefit amount. Countries like Bulgaria, Greece, Iceland, Iran, Ireland, Malta, Norway, Spain, Uruguay, Britain, Sweden, Australia, Hong Kong and New Zealand grant an allowance for dependents in addition to

basic unemployment benefits. Countries including Germany, Finland, and Belgium calculate benefits based simply on whether or not the beneficiary has family to support, not on the number of dependent family members. Countries that have an additional family allowance system in place have set a ceiling on the total amount of benefits in order to minimize the negative effects on labor supply.

4.5 Benefit Duration

Many countries apply single benefit duration regardless of the beneficiary's insured employment period or age. In the United States, the maximum duration of regular unemployment benefits is 26 weeks in all states except Massachusetts and Washington, where the maximum is 30 weeks.

In Britain, the benefit duration was twelve months until 1996, but with the introduction of the Contribution-based Jobseeker's Allowance, it was reduced to six months. There is no limit on the duration of the Income-based Jobseeker's Allowance, however, which is paid to low-income wage-earners based on a means test.

In many countries, the benefit duration depends on the length of insured employment. This is the case in Austria, Canada, Cyprus, Egypt, France, Germany, Greece, Iceland, Ecuador, Japan, Rumania, Switzerland, Sweden, Argentina, China and Korea(Yoo, 2000).

Some countries determine the duration in relation to the age of recipients taking into account the difficulty of reemployment. In other words, older workers are entitled to receive benefits longer in countries like Germany, Japan, Sweden and Korea(Yoo, 2000). In both Korea and Japan, unemployed workers with disabilities are treated similarly to older workers in terms of the benefit duration because they face more difficulties in finding new jobs.

In Canada, benefit duration varies from 14 weeks to 45 weeks based on the number of hours worked during the last 26 weeks before unemployment and the unemployment rate of the region(Wong, 2001). On the other hand, Japan takes into account the age of the insured, the

length of employment and reasons for unemployment. Those who left their jobs voluntarily are granted a shorter period of benefits(Higuchi, 2001).

As a rule, countries that do not have the unemployment assistance system extend the unemployment benefit duration when the unemployment rate is very high. For example, the duration of extended benefits is 13 weeks in the United States, 60 days in Korea and 90 days in Japan. Additionally, in both Korea and Japan the duration of benefits is extended to a maximum of two years when recipients participate in training courses recommended by the Public Employment Services (PES).

4.6 Financing Benefits

In most countries, contributions are made by both employers and employees to finance unemployment benefit programs. In some cases, governments share the financial burden of employers and employees, while in others, either only employers or employees finance the benefits.

In the United States, employers finance the benefits, but the experience rating is applied. In Sweden, a special tax levied on employers is the major financial source of the unemployment benefits and also finances the implementation of active labor market programs. Employee also pays member fees for unemployment benefits, but those funds account for less than 10 percent of the total.

Germany, Austria, Japan and Korea implement projects to support their active labor market policies under the Employment/Unemployment Insurance system. In Germany and Austria, employers and employees pay equally into the employment insurance fund, while in Korea and Japan, only employers pay into the fund for active labor market policy projects.

4.7 Integration with Other Programs

In order to improve the efficiency labor market policies, the

Employment/Unemployment Insurance system and public assistance systems, countries make every effort to promote the integration with other programs. Cooperation with federal, state and local governments deepens the level of partnership with public and private agencies in order to enhance the effectiveness of the relevant programs and systems.

In the United States, the Worker Profiling and Reemployment Services (WPRS) system was introduced in 1993. The WPRS requires state employment security agencies to establish and utilize a system of profiling all new claimants for regular unemployment compensation. The purpose of profiling is to identify UI claimants who are most likely to exhaust their regular benefits. They can then be provided with reemployment services to make a faster transition to new employment. The Workforce Investment Act legislated in 1998 consolidates relevant services including unemployment insurance, employment services, dislocated worker and youth training, welfare-to-work, veterans employment and training programs, vocational rehabilitation through One-Stop Centers thereby enhancing the effectiveness of relevant programs.

Britain currently operates its Job Center Plus to provide integrated services including unemployment benefits, employment services, vocational training, and public assistance. New Deal Programs implemented in Britain provide in-depth counseling and individualized services to the unemployed for improved employability.

Canada is transforming its formerly passive labor market programs into active labor market programs while focusing on enhancing cooperation between federal and provincial programs and strengthening partnerships among relevant agencies.

5. Vision of the Employment/Unemployment Insurance system

The Employment/Unemployment Insurance system is a vital

social safety net for the unemployed. Especially now, with the advance of globalization and the rise of the information society, rapid changes in the industrial landscape and continuous restructuring have raised the risk of unemployment for everyone. Therefore, the role of Employment/Unemployment Insurance system as a social safety net should be supplemented and improved. While layoffs are a necessary part of restructuring designed to enhance competitiveness, a social safety net for livelihood support and reemployment promotion for the unemployed must accompany those changes.

In this context, it is important to maintain benefits provided to the unemployed at a certain level. Of the total number of unemployed in 2002, UI benefit recipients accounted for 37.3 percent in the United States (Eberts and O'Leary, 2001), 15 percent in Korea and 40 percent in Canada. In Britain, recipients of the Contribution-based Jobseeker's Allowance account for 20 percent and recipients of the Income-based Jobseeker's Allowance make up 70 percent (Groombridge, 2001). As a result, approximately 90 percent of the unemployed are covered by a social safety net.

In Korea, on the other hand, only 15 percent out of the total unemployed workers receive unemployment benefits although the proportion of employment insurance recipients is gradually increasing. It is high time to enhance the role of unemployment benefits as a social safety net, first, by improving the application of employment insurance to workers in small businesses and second, by streamlining the benefit payment system.

Unemployment benefits are designed to stabilize the livelihood of the unemployed by supplementing the decrease in their income. However, unemployment benefits can reap the maximum effect when they are linked to active labor market policies aiming to prevent unemployment. Countries including Germany, Japan, Austria, Canada and Korea have adopted core programs for active labor market policies under the framework of Employment/Unemployment Insurance in order to strengthen the link between passive and active labor market policies.

In the 1960s when advanced countries pursued welfare-state policies, the scope of social security was greatly expanded. However, since the 1970s, many countries have overhauled their social security systems to improve efficiency, especially in the wake of high unemployment. Notably, since the late 1990s when globalization triggered unlimited competition, the concept of social support changed too, under the slogan of “from welfare to work”. Countries across the world are now trying to link unemployment benefits to active labor market policies, and this trend is expected to continue well into the future.

Industrialized countries are now integrating public employment resources and expanding them into a one-stop service. They must improve the efficiency of related services, however, by enhancing coordination and cooperation between Public Employment Services (PES) and central and local governments, and between the public and private sectors. Closer coordination between relevant agencies should also be promoted.

For efficient one-stop services at the PES level, several steps much be taken: 1) further development of PES programs 2) enhancement of infrastructure for the collection, analysis and distribution of labor market information 3) recruiting professional staff to efficiently provide in-depth counseling and to provide systemic training for them. Models include the New Deal Programs in Britain, the Profiling System of Unemployment Insurance claimants in the United States and the Internet-based labor market information system.

It is also important to prevent the abuse of programs provided by the Employment/Unemployment Insurance systems and to promote work incentives. Those receiving unemployment benefits illegally can be tracked down by linking the Employment/Unemployment Insurance network with national tax revenue centers, employees' wage and taxation records and other social insurance systems. The abuse of the Employment/Unemployment Insurance systems and moral hazard issues must be minimized. Moreover, unemployment benefit recipients, especially those who tend to depend on unemployment benefits, must

be encouraged to return to work as soon as possible.

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Contributors

Sergio Arzeni is the Head of the OECD Programme on Local Economic and Employment Development (LEED) since 1994. His work focuses mostly on entrepreneurship and innovation, on job creation and social cohesion, on local clusters of SMEs and area-based approaches to economic and employment development, on local partnerships and skills up-grading. Mr. Arzeni has worked at the OECD for 20 years, previously serving as an economist for the Italian Parliament, the Italian Trade Unions and the European Commission. As an economic journalist he has contributed to several Italian and international newspapers. He holds a First Class Honours Degree in Political Science from the University of Rome and specialised on Industrial Economics at the University of Luxembourg and on International economic relations at the Brookings Institution in Washington D.C., USA.

Randall W. Eberts is Executive Director of the W.E. Upjohn Institute for Employment Research. His research includes the evaluation of employment and training programs. Dr. Eberts' current work includes developing statistical models to help identify the needs of job seekers so that they can be directed more quickly and effectively to services that best meet their needs. He and his colleagues have developed similar models for the State of Michigan's Worker Profiling and Service Referral (WPRS) system and for a pilot project for welfare-to-work participants funded by the U.S. Department of Labor. Dr. Eberts has also prepared reports for the European Commission on the U.S. experience with early identification of worker needs and the potential of service jobs to stimulate economic growth in Europe. He has also partnered with the OECD/LEED to examine the role of local partnerships in workforce development and economic development. He has published extensively in academic journals,

including *Review of Economics and Statistics*, *Journal of Labor Economics*, *Journal of Human Resources*, and *Economic Inquiry*. He has also authored and edited several books. Previous positions include Associate Professor of Economics at the University of Oregon, Visiting Professor at Texas A&M University, Assistance Vice President and Economist at the Federal Reserve Bank of Cleveland, and Senior Staff Economist on the President's Council of Economic Advisers. Dr. Eberts received his Ph.D. from Northwestern University.

Christopher J. O'Leary is a senior economist at the W.E. Upjohn Institute for Employment Research. His research on unemployment insurance has examined reemployment bonuses, profiling, benefit adequacy, and experience rating. He has evaluated training, wage subsidies, public works, self-employment, and employment service programs for labor ministries in the transition countries of Hungary, Poland, and China. For the U.S. Department of Labor he is working with Randall Eberts to develop a frontline decision support system for one-stop centers under the Workforce Investment Act. His research has also been sponsored by the World Bank, the International Labor Office, and Human Resources Development Canada. His papers have appeared in *Journal of Human Resources*, *Journal of Policy Analysis and Management*, *International Labour Review*, *New England Economic Review*, *Economics of Transition*, and *Applied Economics*. O'Leary completed undergraduate studies at the University of Massachusetts at Amherst and earned a doctorate in economics from the University of Arizona. In 1999 he was elected to the National Academy of Social Insurance.

Ging Wong is an executive with the Government of Canada who has directed portfolios related to labour market policy development, program evaluation and policy capacity building. As such, he has been an active participant in the formulation and assessment of key elements of Canadian employment policy written for this volume. He is also a founder and former government co-chair of the influential non-profit organization, the Canadian Employment Research Forum (CERF), that has improved the interaction between policy practitioners and researchers in Canada and

internationally and has created substantial contributions to knowledge of training, income security, productivity and immigration.

Ging Wong is also a standing member of a number of international advisory bodies and an active participant in World Bank and OECD missions and conferences relating to local economic and employment development, employment and public pension policy reforms, and evaluation research and practice. He holds appointments as adjunct professor at the University of Alberta's School of Business in Canada and Wuhan University's Faculty of Management in China.

Uwe Blien studied economics and sociology at the University of Regensburg, Germany, where he received his diploma in 1980 and his doctoral degree in 1986. After his studies he worked at the Universities of Erlangen-Nurnberg and Regensburg. From 1987 to 1990 he was a senior researcher and deputy of the head of a department at the Center for Survey, Research and Methodology (ZUMA) in Mannheim. Since then he has been a senior researcher at the Institute for Employment Research (IAB, Nurnberg). He is now the head of the department 3 at this institute and co-ordinator of the research on regional labour markets. In 1999 he received his post-doctoral degree (Habilitation) in economics at the University of Kaiserslautern and has now the status of a lecturer (Privatdozent) there. 1996 to 2002 he was a member of the Executive Committee of the European Association of Labour Economists (EALE). Since 2002 he is a member of the Council of the European Regional Science Association. His current research interests include analyses of the fate of different groups of persons on the labour market. Further research efforts are concentrated on the effects of unemployment on wages, the development of regions, the effects of structural changes, and the application of multilevel models.

Ulrich Walwei is deputy director at the Institute for Employment Research (Institut für Arbeitsmarkt und Berufsforschung, IAB) in Nuremberg, Germany. He is also head of the IAB department dealing with long-term labour market projections and international analyses. He has published widely on labour market regulation policies, non-standard forms

of employment such as part-time work or fixed-term contracts, active labour market policies and various international comparative labour market analyses. He has also carried out research projects for several international organizations including the European Commission and the International Labour Office.

Heinz Werner, Ph. D. Studies in economics. Current position: Senior research officer (scientific director) at the Institute for Employment Research (IAB) in Nuremberg, Germany. The IAB is part of the Federal Employment Services, with its headquarters in Nuremberg. Areas of work: International labour market issues, cross-country comparisons of employment structures and policies, European integration and the labour market, migration of workers. Various publications on these fields, partly in English. Previous periods of employment include work at the UN Economic Commission for Europe (ECE)/Geneva, the Organisation for Economic Co-Operation and Development (OECD)/Paris, the European Commission/Brussels and the International Labour Office (ILO)/Geneva. Consultant activities for a number of international organisations such as European Commission, Statistical Office of the European Communities, International Labour Office, Organisation for Economic Co-Operation and Development, International Association for Social Security, Council of Europe.

Kil-Sang Yoo is the Vice President of the Korea Labor Institute (KLI) and Director of the Employment Research Center at the KLI. He received Ph.D in Economics from the University of Hawaii in 1988. The KLI is a government-sponsored research organization devoted to conducting policy-oriented research on a wide range of labor issues in Korea, including labor market and employment policy, industrial relations and human resource management, workers' welfare, and labor laws and regulations. The Employment Research Center focuses on labor market analysis, monitoring and evaluating employment policies and the Employment Insurance System, and the Korean Labor and Panel Study. Dr. Yoo played an important role in designing Korean employment insurance system as a

coordinator of the Employment Insurance Research Commission from 1992 to 1995, and he has conducted research on the employment insurance system since the introduction of the system in Korea.

Jaeho Keum is a Senior Research Fellow and Coordinator of the Employment Insurance Team at the KLI. He also worked as a Research Fellow at the Deawoo Economic Research Institute. Dr. Keum received his Ph.D. in Economics from the University of Minnesota at Twin cities in 1992. His work mostly focuses on employment policy, employment insurance, longitudinal survey, and labor market information system.

Jai-Joon Hur is a Research Fellow of the Employment Research Center at the KLI. He received Ph.D. in Economics at the University of Paris-X-Nanterre. His current research efforts include the analysis of the labor market facing the macroeconomic shocks such as financial shocks, trade liberalization, technological changes, aging, etc.. Dr. Hur also actively participates in the advisory committees of the government (on redesigning or improving social insurance system, policies to combat unemployment, human resource development policies, free trade agreement and labor market adjustment, etc.).

Byunghee Lee is a Research Fellow of the Employment Research Center at the KLI. He received Ph. D. in Labor Economics from Seoul National University. After his studies, he worked as a Research Fellow at the Korea Research Institute for Vocational Education and Training, and served as a specialist in Presidential Commission on Education and Human Resource Policy. His research focuses mostly on unemployment, on school-to-work transition, on human resource development.

Jiyeun Chang is a Research Fellow of the Employment Insurance Center at the KLI. She received her Ph.D. in Sociology from the University of Wisconsin-Madison. Her work has been mostly focused on the Female Labor Market, and her current research interests include aging society and elderly workers in Korea.