1. Introduction

This paper discusses the contribution of Jan van Ours and Milan Vodopivec, the one of Per Fredriksson and Bertil Holmlund and two papers of the Danish Ministry of Finance (see the list of references). These papers deal with an important question: What can be expected from reforms of the Unemployment Insurance (UI) systems? The kind of reforms considered changes the potential duration of unemployment benefits (UBs) and more generally the time-profile of benefits. The papers also deal with availability criteria and more extensive uses of monitoring (of search intensity and job-acceptance rates) and sanctions. A critical issue is the choice of the criteria used to evaluate the reforms. Many criteria could be envisaged. The (un)employment rate, flows on the labour market, the level of poverty, the welfare of (specific groups in) the population, the (political) sustainability of UI systems are major examples.

Below, I emphasize the importance of the criterion used. The underlying question is: To what extent do UI systems explain the level of unemployment or the persistence of high unemployment? It is important to avoid some misunderstanding. Raising that question is not necessarily suggesting that unemployment is “voluntary” (about this concept, see De Vroey, 2004). Search behaviour and the decisions to accept or not a job offer play a role (not the unique one\(^1\)) in the process of exiting the unemployment pool. In addition, the level of UBs can influence wage formation and the level of (payroll) taxes for instance. The design of UBs could at the limit have negligible effects on job-search behaviour and yet influence employment through the financing of the system or through wage negotiation. These induced effects can hardly be linked to the individual responsibility of a given unemployed.

2. How changes in benefits entitlement affect the duration of unemployment (van Ours and Vodopivec)

This is a very interesting case study because it deals with reforms that are either envisaged or implemented in other European countries. Several dimensions of the Slovenian UI system were modified in 1998.\(^2\) However, the most important change was a sharp reduction in the maximum duration of unemployment insurance benefits (“potential benefit duration” or “PBD” for short). This can have three different impacts: An inducement to search more before reaching the time limit, an instantaneous effect around the expiration of UBs and an

\(^{1}\) One can raise that underlying question without neglecting the (major) role played by the availability of vacancies.

\(^{2}\) At the same time, the Slovenian authorities increased their investment in active labour market policies.
inducement to search harder afterwards since benefits are lower. The authors exploit the fact that the change in PBD varies between age groups. The reform was moreover designed in such a way that the youngest unemployed were not affected. The authors also exploit this feature. They collect data before and after the date of the reform. Their approach can be interpreted as a difference-in-difference approach applied in the context of a duration analysis.

Their results are qualitatively in line with the literature. They however end up with strong effects. To illustrate this assertion, cutting PBD by 2 (from 12 to 6 months) raises the hiring rate by 20 to 33% according to the group (Table 7 of the paper).

I have first a set of technical remarks. The identification of one of the causal effects requires that (calendar) time affects all five (age) groups in the same way. An identifying assumption cannot be tested. However, is this a valid assumption much before (after) the reform? The identification of some other causal effects requires a comparison within an age group before and after the reform. Within each group, it would be important to convince the reader that the composition of entrants is rather stable through (calendar) time? Finally, the Slovenian reform had several dimensions. Is there for instance evidence that the stricter monitoring of the unemployed was implemented in a similar way across age groups? If not, some of the measured effects could not be uniquely related to the change in PBD.

Second, one can discuss the evaluation criterion. The authors have access to administrative data that allow distinguishing the destination of exit. The criterion “access to a job” can therefore be used properly. However, is increasing the hiring rate an objective per se? There is no unique answer to that question. If, as I would claim, the welfare of the individuals, and in particular the one of the least advantaged, is a more appropriate indicator, one can raise doubts about the benefits of the Slovenian reforms. Before and even after the reform, a large proportion of the inflow remains unemployed after the end of the entitlement period to UB5s. More information about the difference between UI and unemployment assistance benefits would be welcome here.

The concern for welfare leads to Fredriksson and Holmlund’s paper.

3. **Improving Incentives in Unemployment Insurance: A Review of Recent Research (Fredriksson and Holmlund)**

In economics, what ultimately matters is an indicator of welfare (or well-being). There is however no consensus about how to measure welfare. Often, economists rely on preferences (tastes or utility functions) as they can be perceived from behaviour. In particular, there is a lot of evidence that individuals are risk averse (loosely speaking, they dislike uncertainty and search for insurance) and that effort (job-search, effort on the job) is costly (i.e. lowers the utility at least beyond a certain threshold). Now, if people dislike random variations in their income and if – for various reasons – “the market” and private savings do not insure sufficiently against the risk of a job loss, there is clearly scope for public intervention. More precisely, if the public insurer could perfectly observe and monitor job-search effort, it should perfectly insure people against the risk of losing their job. This has strong implications. Depending on specific assumptions about the shape of preferences, one of the two following

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3 For a critique, see e.g. Sen (1987).
sentences holds. Either unemployment benefits should be fixed in such a way that the utility of the individual remains at the level reached before the job loss. Or replacement ratios should be equal to 100%.\textsuperscript{4} Now, information is actually imperfect and asymmetric. In our case, this means that search effort is to a large extent a private decision that the UI agency can only imperfectly observe and monitor. Then, a single “instrument” (the UI system) cannot simultaneously achieve perfect insurance and produce the appropriate incentives to search for a job. There is a trade-off. In this realistic setting, what is the optimal way of insuring those who flow into unemployment? Is it through a flat benefit paid for a very long time (at the limit indefinitely) or is it through high benefits that decline at a certain pace with unemployment duration? Is it worthwhile to invest in monitoring techniques in order to reduce the degree of imperfection and thereby raise replacement ratios? Is it sensible to introduce a workfare system, that is a carrot and stick approach (the “carrot” being again a higher level of replacement ratios for those who comply with the rules). These are the questions raised by a very large literature that Fredriksson and Holmlund summarize.

This survey cannot cover all the literature. It nevertheless provides a broad perspective and is, to the best of my knowledge, the reference nowadays. Dealing with the above questions requires a lot of technical skills. Fredriksson and Holmlund avoid technicalities and present the major ideas in a set of basic papers. Let me briefly come back to some of the main results and comment them.

The essence of the pros and cons of declining UBs can be captured by looking at the (welfare) costs and benefits of a two-tiered benefit system (compared to a flat benefit paid for an indefinite duration). The first tier characterizes the level of benefits received at the beginning of an unemployment spell. In a way or another - details matter for the conclusions, but this is a very technical issue\textsuperscript{5} -, if (s)he is still unemployed after some time, the unemployed enters the second tier where (s)he receives a lower benefit (potentially forever). When people discount the future, a two-tiered system dominates a flat benefit. This result is not entirely general: It is based on simulations of the model (see Fredriksson and Holmlund, 2001). Hence, parameters such as the discount rate can matter.

In this model, again in a way or another, people in the second tier are unemployed for a longer duration than those in the first one. If unemployment duration causes a decline in wages - or more generally working conditions - (in case of exit to a job), one could expect that the prospect of lower wages induce people to search harder to avoid this penalty. The authors rule out this effect of unemployment duration. To the best of my knowledge, it is well documented only in the UK. In Continental Europe, heterogeneity in observed and unobserved characteristics appears to be much more important.\textsuperscript{6} With such heterogeneous intrinsic probabilities of getting a job offer, the time-profile should ideally be group-specific. It is therefore interesting to look at the Fredriksson and Holmlund (2001) model with exogenous differences in skills (or other intrinsic characteristics). Van der Linden (2003) develops such an exercise for Belgium. The UI system is quite complex in Belgium. Not all demographic groups receive declining benefits. As the model only distinguishes levels of skill, there is a first tier with an expected duration of a year followed by a second tier. This is a stylized representation of the Belgian UI system. Is this length of year optimal? The answer is

\textsuperscript{4} These are well-known properties among economists but probably not in other circles.
\textsuperscript{5} See Coles and Masters (2003, 2004).
\textsuperscript{6} See e.g. Cockx and Dejemeppe (2005) and the references they mention.
negative. As low-skilled individuals have very low probabilities of being hired, the potential benefit duration in the first tier should be close to 2.5 years in Belgium if one cares about the inter-temporal welfare of those in the first tier of the UI system.

Boone, Fredriksson, Holmlund and van Ours (2002) recommend the introduction of a monitoring system of search effort during the first tier. There is a certain probability of inspection (inspection is costly). Conditional on being inspected, the probability of being sanctioned (i.e. of entering the second tier) is a decreasing function of the level of search intensity revealed thanks to the inspection. As above, when people discount the future, there are, to the best of my knowledge, no general conclusions, only simulation results. The welfare gain of the monitoring/sanction extension is achieved under plausible assumptions about the cost of such a control. Nevertheless, one should recognize that if sanctioned people can appeal against the decision, some costs could be hard to measure (courts, administrative procedure). Moreover, only formal search efforts can be monitored. Informal search means here search via social networks. When it is informal, a credible evidence of search cannot be provided to a third party (the UI agency). Those who cannot provide proofs of formal search are a mix of (at least) 3 broad categories: (a) Those who cheat and do not search for a job, (b) “discouraged” jobless people (L.T.U.) who, after a (long) period of active search, are convinced that they have no chance to get a job any more and (c) marginalized people who cumulate several problems (related to housing and health, for example) and who search in an informal way and/or are unable to keep track of their formal search activities. Even if the monitoring is done with care, I claim that it cannot disentangle these 3 groups. Due to unavoidable imperfect information, errors are made. This is particularly painful for group (c). The welfare effects of these errors could be large, depending on the level of the sanction and on the social weight attributed to the fate of group (c). The latter is an ethical matter.

Other possible side effects of monitoring and sanctions are probably noteworthy:

- Since only formal search is verifiable, it would be rational to substitute formal to informal search effort. Is there however any evidence that this is efficient?
- Clever and well-informed cheaters could produce a level of formal search effort just sufficient in order to meet the requirements without any real desire to get a job.
- One can also fear that some unemployed will accept offers to take part to active programmes – ALMP – simply to avoid a sanction. The consequence would be an increased number of non-motivated participants in such programmes. This would reduce the (already relatively low) effectiveness of active programmes.

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7 For group (b), one can argue that a specific approach is required. The “stock” of discouraged unemployed people is a major social issue in many EU countries. In some of them, these people can be found receiving disability benefits. In some others, they still are in the UI system – explaining to a large extent the gap between administrative unemployment rates and standardized EU or OECD rates. Elsewhere, they receive assistance benefits and/or are living in the streets or in jail. One thing seems to be clear. If, after a “long” unemployment duration, they do not (cannot) search for a job any more, they should not remain in the UI system. This does not imply that they should be sanctioned. They should benefit from another status than unemployment (a recognized status in the society with a corresponding allowance). This difficult issue is beyond the scope of my discussion.
To sum up, my own feeling is that declining unemployment benefits (without monitoring or with mild sanctions\(^8\)) is a less risky approach to trade off insurance and incentives. Moreover, as far as possible, the profile of these declining benefits should be linked to non-manipulable (relevant) characteristics of the claimants.

4. Availability criteria in 25 countries and evaluating labour market reforms in Europe in the 1990s (Danish Ministry of Finance)

A database on job availability rules is most welcome. In addition, the authors are right to (try to) distinguish formal rules from the actual implementation of the rules. I only have one doubt. When I look at the appendix of the “availability criteria” paper, I am sometimes astonished to see short or loose answers of Public authorities to key questions. I therefore wonder how the authors have managed to allocate a discrete score (on a 1 to 5 scale) on the basis of such information.

As far as the role of institutions is concerned, a growing literature exists where institutions and policies are taken as time-invariant. More recently, time-varying indicators of policies have been included (Boone and van Ours, 2004, Nickell et al, 2005, and the Ministry of Finance contribution to this workshop).

There are two main views in the literature. The first one considers that the unemployment rate is the sum of a structural unemployment rate (often called the NAIRU) and of short-run deviations (see e.g. Nickell et al, 2005). The other one considers that the evolution of the unemployment rate is explained by the interaction between long-run shits in baseline variables on the one hand and institutions and policies on the other (see in particular Blanchard and Wolderes, 2000). The Danish Ministry of Finance follows the first branch of the literature. This is the dominant viewpoint nowadays. One should however probably recall the lack of a widely accepted theory that provides the determinants of the structural unemployment rate. Compared to an approach that would try to identify a wage-setting curve and a price-setting curve, the problem of ad hoc exclusion restrictions is, as far as I understand, avoided here because you adopt a reduced form approach. Nevertheless, the lack of a well-defined theory and the data constraints can lead to an omitted variable problem. More importantly perhaps, “ALMP may have a negative effect on the unemployment rate but increasing unemployment may induce the government to expand expenditures on ALMP. The endogeneity problem also arises from the normalization of the ALMP-expenditures. If unemployment increases and there is a less than proportional increase in ALMP-expenditures a spurious negative correlation between the normalized ALMP-variable and the unemployment rate is introduced.” (Boone and van Ours, 2004). I do not see how the authors deal with such a problem. Finally, I wonder whether the choice of an unemployment rate

\(^8\) To avoid some misunderstanding, I am not claiming that UBs should be provided without any control. Any private or public insurance system needs a system of control to limit the extent of fraud: Clear evidence of misconduct such as refusal of a “suitable” job offer or simultaneous work in the “black” or “informal” economy should lead to a sanction. However, this already exists for decades in European UI systems.
criterion is the best one. An employment (rate) indicator has its own drawbacks. However, it avoids the tautological effect of ALMP\(^3\) – a problem the authors are concerned with.

5. Opening the debate?

In many but probably not all EU countries, there is a widespread perception that current reforms to UI systems and in particular the development of monitoring and sanction are nothing else than a way to cut social security expenses and to lower the well-being of the unemployed. In addition, it is often said, such an approach is inefficient since “jobs are not available”. Therefore, there is actually no intellectual debate at all. Both “sides” feel that the other one adopts a purely ideological viewpoint.

Is there an alternative? I think that under certain conditions there are limited chances to open an interesting and useful debate. First, one should make clear that reforms that reduce the extent of asymmetric information (see section 3) have as a counterpart more generous replacement ratios. This should be understood as a consequence of a welfare-maximizing approach. Second, one should recognize - and probably appreciate - the existence of cultural and ethical heterogeneities within the EU about what can be asked/imposed to a jobless individual. Combining these two elements, instead of a unique optimal approach, I advocate offering a menu of UI systems. Each system would be optimally designed under a set of “ethical judgments” characterizing (i) the importance of the well-being of each group in the population and (ii) the range of constraints and, in case of misconduct, the type of punishment each society feels just to impose to the jobless. In any case, raising the employment rate would not be the criterion used to characterize the UI systems.

Up to now, I did not say anything about the “jobs are not available” argument. If one believes that the job-search behaviour of the unemployment is a negligible phenomenon, reforming the UI system looks probably useless, if not odd or unfair. Building upon the microeconometric literature – the van Ours and Vodopivec paper being a good example -, I claim that the job-search behaviour of the unemployment matters. More theoretical analyses in general equilibrium provide additional channels that reinforce this assertion. That does not mean that firms’ behaviour is not central. The creation of vacant jobs is central. However, it is not the unique factor that affects the hiring rate of the unemployed. Nor is it an exogenous phenomenon: job-search effort has an influence on vacancy creation. So, discussing reforms of UI systems is important.

As a final remark, I would like to recall that the focus on reforms on the “supply-side” is a consequence of the evolution of economics (in particular, the growing distrust of demand management policies). Economists have probably gone too far in their policy conclusions. The current state of knowledge in economics is far from sufficient to recommend a lack of interest for the “demand side” (see Drèze, 1997, 2001).

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\(^3\) This expression has the following meaning. As someone flow out of registered unemployment and enters an ALMP, (s)he very often is no more counted as unemployed. So, in a tautological way, more ALMP means less unemployment. This problem is known for a very long time.
References