



# **Institutional moral hazard in the multi-tiered regulation of unemployment and social assistance benefits and activation**

**A summary of eight country case studies**

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# **Institutional moral hazard in the multi-tiered regulation of unemployment and social assistance benefits and activation**

**A summary of eight country case studies**

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## INTRODUCTION

In this paper, we study eight countries in which the regulation of unemployment benefits and related benefits (notably social assistance for able-bodied adults) and the concomitant activation of unemployed individuals has a multi-tiered architecture. We assess their experiences and try to understand possible problems of 'institutional moral hazard' that may emerge in the context of a (hypothetical) European Unemployment Benefit Scheme (EUBS).<sup>1</sup> In the first section of the paper, we introduce the concept of 'institutional moral hazard', and contrast it to principal-agent problems which are also observed in the regulation of unemployment in some of our case studies. In the second section of the paper, we formulate a number of caveats and nuances with regard to our focus on institutional moral hazard. We argue that one should distinguish between institutional moral hazard as an objective reality, the public perception of institutional moral hazard, and public concern for it. In the third section of the paper, we specify factors that contribute to the salience of institutional moral hazard. These factors justify the analytical grid that we use to map our eight country cases; it is presented in section 4. In section 5, we briefly document the comparative generosity of the benefit systems in the countries under review, the overall strictness of the eligibility criteria, their budgetary impact, and the role of benefits in macroeconomic stabilisation. As we explain below, an overall assessment should assess problems of (institutional) moral hazard associated with benefit systems on the backdrop of the stabilisation capacity and redistributive features of these benefit systems; we can provide comparative data on the stabilisation for four of the eight countries under review, but data limitations do not allow us to present a comparison of the redistributive features of the systems under review. Section 6 highlights some of the most relevant features of the multi-tiered regulation of unemployment in the countries which we studied. In the final section, we formulate our main general conclusions, focusing on unemployment insurance and the lessons one can learn with regard to the idea of an EUBS. A summary of all our country case studies is added in the appendix to this paper, in the form of 'country fiches'. (Eight more extensive reports on the country case studies are also available; they are added as a separate appendix to the research consortium's report on 'Feasibility and Added Value of a European Unemployment Benefit Scheme'.

We have chosen not to insert bibliographic references in this synthesis, except where it seemed necessary. The resources we used for this synthesis and for the country studies are grouped together in the bibliography to this synthesis. In the extensive country reports, the reader can identify where and how these resources have been used.

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<sup>1</sup> An upshot of this study is that we also develop insight into the complex architecture of unemployment regulation in EU Member States, with which an EUBS would interfere. Hence, this study also serves as a complement to Task 2B of the overall research project 'Feasibility and Added Value of a European Unemployment Benefit Scheme'.

Throughout the paper and the appendices, we use 'the regulation of unemployment' as a short-cut for the regulation of unemployment benefits and related benefits and the activation of unemployed individuals.

We use 'unemployment insurance' (UI) to refer to systems that should be classified as social insurance rather than as social assistance, because they create entitlements without means-testing; social assistance (SA) refers to means-tested residual systems. (In most of the countries under examination, applying this classification is straightforward, except in Australia and Austria, as is explained in the country case studies). When we focus on the benefit side of UI, we always explicitly write 'UI benefits'; when our focus is on the activation of individuals who receive UI benefits, we explicitly write 'UI activation'. The same holds for SA: we refer to 'SA benefits' to denote social assistance benefits, and we refer to 'SA activation' to denote the activation of individuals receiving SA benefits. When we write 'UI' or 'SA' without further qualification, we deliberately refer to both the benefit and the activation side of those systems.

## **1. THE CONCEPT OF INSTITUTIONAL MORAL HAZARD**

The introduction of an EUBS would create a multi-tiered system of unemployment benefits, with both the EU and Member States playing a role in it. In some countries today the regulation of unemployment already holds a multi-tiered character. In this paper we study the experiences gained with multi-tiered systems of unemployment regulation in eight such countries. In seven of the eight countries under review (the US, Canada, Germany, Switzerland, Denmark, Austria and Belgium) the multi-tiered nature of unemployment regulation is linked to a broader context of political decentralisation, but we also highlight instances of 'managerial decentralisation' and 'delegation' in those countries, when relevant (we briefly explain these terms in the next paragraphs). In one country in our sample, Australia, there is no political decentralisation; in this case, managerial decentralisation is implemented through the privatisation of activation, which also creates a multi-tiered system.

In a general sense, decentralisation is a process of redistributing or dispersing functions and powers relevant to the design or implementation of public policies, away from a central authority. *Political* decentralisation implies that different levels of government co-exist, i.e. different levels of political authorities, each with their own and separate political constituencies. *Managerial* decentralisation involves actors who do not have such a political nature. In this paper, decentralisation is typically described in terms of a 'higher' level on one hand (typically the federal or central level), and a 'lower level' (regions, provinces, municipalities...) on the other hand. However, despite these references to 'higher' and 'lower' levels, the reader should be aware that some political constitutions (such as the Belgian constitution) are not based on a hierarchical relation between the federation (Belgium) and the federated entities (the Belgian regions and communities). 'Decentralisation' always implies a degree of autonomy, which can be measured on the basis of the flexibility that is allowed at the lower level with regard to the formal regulation of a policy domain, the selection of policy goals, and/or the implementation of the policies.

We use the word 'decentralisation' when there is more than one authority or actor at the lower level; if there is only one authority or actor at the lower level, we use 'delegation'. Hence, in our usage of the term, delegation refers to one-to-one relationships between institutions. In principle, one could apply the distinction between 'political' and 'managerial' also to delegation, and discern four mutually exclusive concepts: political decentralisation, managerial decentralisation, political delegation and managerial delegation. As a matter of fact, the examples of delegation in this study always concern managerial delegation. Hence, when we write 'delegation', we mean 'managerial delegation'. In this paper, our primary interest is in decentralisation, not in delegation: in the context of the broader research project to which the paper contributes, institutional moral hazard<sup>2</sup> typically becomes politically sensitive when (i) policy *differences* can emerge *across a set* of governments at the lower level, as a consequence of institutional moral hazard, and (ii) the quality of the lower level policies affects the budget of the government at the higher level. We include only observations on the delegation of powers to a single actor at a lower level when these observations are relevant to understand the processes that shape decentralisation or centralisation in the country under examination; for instance, Germany and Austria are country cases in which delegation of policy powers to the federal public employment service (PES) is a relevant feature and is therefore included in the analysis. Hence, the absence of a reference to delegation in a country fiche does not imply that delegation does not feature in that country; it may well be the case that delegation plays a role in the regulation of unemployment (for instance, in the relationship between the government and the PES), but including it in the analysis would not add to our understanding of the dynamics of (de)centralisation in that country.

What can we learn from these national experiences with multi-tiered unemployment regulation for the design of an eventual European Unemployment Benefit Scheme? Our vantage point is what we call 'institutional moral hazard'. Economic theory defines moral hazard, briefly put, as a situation in which an insured person can affect the insured company's liability without its knowledge (Barr, 2004). We use the expression 'institutional moral hazard' to describe a situation with the following generic characteristics:

- Two levels of governments, say level A and level B, are involved in the governance of a social risk, with each of them politically accountable vis-à-vis its own political constituency (say, a national or regional parliament, or a regional or local council).

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<sup>2</sup> Besides moral hazard, there is another important concept that relates to insurance: adverse selection. Adverse selection describes a "tendency for insurance to be bought by people who are more likely to collect on the policy. This can occur when the purchasers are better informed than the insurer of their personal risk" (Barr & Diamond, 2010, p. 207). However, this concept does not apply in the context of an EUBS: we are not contemplating a private market for the reinsurance of national unemployment insurance systems, in which Member States could pick and choose the policies they prefer; participation in a EUBS would be compulsory, i.e. compulsory risk pooling would rule out adverse selection.

- Level A covers a social risk (notably lack of individual income due to unemployment, by means of a replacement income), which could, in principle (as a theoretical counterfactual), also be covered by level B instead of level A.
- Policies deliberately implemented by level B can influence the actual incidence of that social risk (at level B), and thus influence the cost to be covered by level A.
- There is a degree of asymmetric information which makes it impossible for policymakers at level A to fully disentangle the impact of pure risk factors, not controlled by B, and the impact of B's deliberate policies on the actual incidence of the risk covered by A.

To make this generic characterisation of institutional moral hazard more tangible, imagine a federal country in which UI benefits are paid and financed by the federation, whilst economic, labour market and UI activation policies are predominantly organised at the level of the federated entities (e.g. states, regions or provinces, with their own political constituency; to shorten the exposition in this paragraph, we will only refer to 'regions'). Unemployment is a risk that is not fully 'controlled' by the regions; it can be influenced, among other factors, by the international business cycle. However, policies developed at the regional level also impact regional unemployment and the cost of UI benefits to be covered by the federation. Suppose that one can, at least theoretically, conceive an institutional counterfactual, in which the regions would finance the cost of UI benefits themselves (or in which they would be completely responsible for unemployment regulation in terms of both the design and the funding of the benefit system). In the backdrop of that theoretical counterfactual, we may say that the regions are, in a sense, 'insured' by the federation with regard to the cost of UI benefits. The level of unemployment is, to some extent, an uncontrolled risk that befalls them, but their 'behaviour' also has an impact. In yet other words, for the regions, the level of unemployment is to some extent an exogenous risk, but to some extent also endogenous, depending on the quality of their policy. With reference to the well-known notion of moral hazard in individual insurance, this situation creates what we call 'institutional moral hazard'. In our usage of the term, 'institutional moral hazard' arises if there is a *possibility* for the regions to influence the cost of UI benefits, borne by the federation. Institutional moral hazard is important, so conceived, if one *expects* the regions to influence the cost of UI benefits significantly; it is less important if one does not expect the regions to influence that cost significantly. The importance of institutional moral hazard (i.e. our expectation), so conceived, depends on the precise architecture of the system. As already indicated earlier, institutional moral hazard typically becomes a sensitive political issue when there are (perceived or real) differences in the quality of the activation and employment policies implemented by the lower levels of government; however, that does not mean that institutional moral hazard does not exist when there are no such differences (it may be the case that all regional governments lack incentives to boost activation and develop policies that are suboptimal from the federal point of view).

Some of the countries in our sample present cases which fit neatly into this simple generic description with regard to their UI, notably Belgium (regions are responsible for UI activation; the federal level is responsible for UI benefits) and Canada (provinces are primarily responsible for UI activation as well as SA, the federal level

for UI benefits). With regard to UI, the Swiss case is also similar, with cantons having a large degree of autonomy with regard to UI activation. In most of the other countries, the picture is more complex. In some countries, the impact of the lower level of government on the cost of UI benefits, borne by the higher level, originates (or originated, before reforms were implemented) from the lower level's responsibility for SA and the possibility the lower level has (or had) to shift part of the SA caseload to UI, at the expense of the higher level. Or, in a more general sense, in some cases in our sample there is (or was, before reforms) a discrepancy between SA activation by the lower level and UI activation, which was seen as problematic by the higher level of government. Austria, Switzerland and Germany exemplify cases in which the interaction between SA and UI was an important issue,<sup>3</sup> triggering reform.

In some countries, the federal or central level pays the cost of activation services organised and implemented by lower levels of government. To the extent that the higher level of government provides an 'insurance for activation costs', specific forms of institutional moral hazard emerge. Simultaneously, federal or central reimbursement of activation costs (with strings attached to it in the form of conditions or 'minimum requirements' and/or financial incentives built into the reimbursement scheme) may be an instrument to fight institutional moral hazard in multi-tiered systems; we observe this in Denmark, whose case presents a mixture of all the issues mentioned in this paragraph and the previous one.

The United States presents a case in which the federal level covers part of the risk of unemployment for the states in a more subtle way than in our simple and generic characterisation of the problem (i.e. in a more subtle way than in Canada or Belgium). The American federal administration allows states to run a temporary deficit in the regular state UI system by offering the possibility of a loan, and the federal level co-finances a system of extended unemployment benefits in times of crisis and even fully funds a system of emergency unemployment benefits in support of the states. The counterpart is a sophisticated financial mechanism to ensure state fiscal responsibility for the state-run unemployment systems.

These examples do not exhaust the complexity of the cases under review; a summary description of the essential features of each of the cases is provided in an annex, in the form of 'country fiches'.

In our study of the eight country cases, we distinguish institutional moral hazard from institutional principal-agent problems. An institutional principal-agent problem is characterised, in the context of our study, by the following situation:

- The governance of a social risk involves two or more institutional actors, say actor A and actors B, C, ... Z, with only actor A being a political entity with a

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<sup>3</sup> As explained in the country case study, Austria has a system of unemployment assistance which is means-tested but displays many features of traditional unemployment insurance. In our analysis of Austria, the interaction to which we refer here is the interaction between Austrian social assistance on one hand, and unemployment insurance and unemployment assistance on the other hand.

political constituency vis-à-vis which it is politically accountable; actors B, C, ... Z enjoy a degree of managerial autonomy but are not political entities. In other words, rather than political decentralisation with political agency at all levels, in this case we observe a managerial delegation or decentralisation of powers (as indicated earlier, we use 'delegation' when only two actors, A and B, are involved). One should note that the decentralised actors B, C, ... Z can have a public character, but also a private character (e.g. in the case of governance by means of a market tender).

- Actor A (the principal) expects actors B, C, ... Z (the agents) to implement and/or develop policies with a view of achieving outcomes desired by A. However, the agents are able to act in their own best interests rather than those of the principal.
- A degree of asymmetric information exists with regard to the degree to which and the way in which the agents pursue their own interests rather than the interests of the principal.
- Hence, the principal has to develop a framework which makes the agents pursue, as much as possible, the outcomes of the principal desires. Such a framework typically encompasses (regulatory) agreements, such as *ex ante* minimum requirements with regard to the policies that are implemented by the agents and financial incentives that shape the interests of the agents, but also *ex post* evaluations based on reporting, inspections, etc.<sup>4</sup>

In the economic literature, there is some overlap between the treatment of moral hazard and the treatment of principal-agent problems, because both are characterised by asymmetric information, and both can be remedied by defining minimum (behavioural) requirements and by creating specific incentives. In this study, we will not only distinguish between the two concepts but use them in a mutually exclusive sense: situations we describe as instances of 'institutional moral hazard' will not be coined in terms of a 'principal-agent' problem, and vice versa. The essential distinction is related to the prevalence of political agency at all levels in the case of institutional moral hazard: the idea that one political entity covers a risk for which the other entity might be held politically responsible in a theoretical counterfactual is key to distinguishing institutional moral hazard from the principal-agent problems, which we

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<sup>4</sup> Some experts with whom we discussed our research disagree with our use of the concept 'principal-agent relation' in the case of an institution such as the German federal PES, the *Bundesagentur für Arbeit* (BA). They argue that the German BA is not an 'agent' of the federal government but a self-governing institution; one might add to this remark that social partners also have a role as 'principal' in the BA, if the 'principal-agent' framework is used. We recognise the validity of that criticism; it is corroborated by a typology developed by Mabbett & Bolderson (1998), who argue that multi-level governance prevails in the relationships between central governments and administering institutions in social security, rather than simple principal-agent relations. Nevertheless, in the context of this research project, we want to maintain a simple distinction between relationships between political actors and relationships involving non-political actors (including in the latter, institutions for which social partners are to some extent 'principals'). In follow-up research we will return to this question. Some experts rightly remark that we do not systematically look at principal-agent relationships between subnational political authorities and implementing institutions; this is true, but, here, we focus on selectively relationships which we consider relevant for understanding the main problem at hand.

discern in the context of managerial delegation and managerial decentralisation. However, notwithstanding this distinction, some of our country cases illustrate the overlap with regard to the remedies that are tried: 'management by objectives' and 'performance management' (or, more generally, 'new public management') are applied both to tackle principal-agent problems in managerial delegation/decentralisation and to reduce institutional moral hazard (as we label it) in a context of political decentralisation.

## **2. CAVEATS AND NUANCES WITH REGARD TO THE NOTION OF INSTITUTIONAL MORAL HAZARD**

We should signal two caveats, with regard to the terminology we use and the study's scope.

As we will show in some of the country cases, when a government level A is responsible for UI benefits whilst a lower government level B (say, a regional or local government) is responsible for UI activation, institutional moral hazard may take the form of 'parking' hard-to-activate benefit recipients in ineffective activation programmes. There may also be a deliberate policy of cost-shifting by 'dumping', e.g. when the regional or local entity, responsible for the governance of SA and bearing its budgetary burden, shifts part of the SA caseload to UI benefits, for which the federation is responsible.<sup>5</sup> Obviously, 'cost-shifting' can be tried both ways: the federation may engage in cost-shifting at the expense of the regional entity when its policies with regard to UI benefits become more stringent and people who lose UI benefits are pushed to SA (paid by the regional entity). Whilst the first instance of cost-shifting (by dumping) naturally fits into the category of 'institutional moral hazard', as we define it here, the latter example of cost-shifting sits uneasily with the concept of moral hazard: moral hazard typically refers to behaviour by the insured and not to behaviour by the insurer. Hence, we will not apply the notion of 'institutional moral hazard' to changes in policies implemented by the level of government that acts as the 'insurer'; we will then simply label this as 'cost-shifting' (in the example given here, this may be a reaction by the federation resulting from the observation that there is too much room for moral hazard for the regional level government).

A second caveat refers to the scope of our study. Institutional moral hazard emerges when decentralised political entities (e.g. regions) are 'covered' by some higher-level political entity with regard to the cost of unemployment benefits, but can influence the level of unemployment by the policies they pursue. Obviously, a whole set of policies impact employment and unemployment in a region (to pursue that example): economic policies, financial policies, industrial policies, innovation policies, education policies, activation policies, systematically shifting SA caseloads to UI or vice versa, and so on. In this study, we focus on the latter two aspects of the broad issue of institutional moral hazard, namely i) the responsibility for activation and ii) the

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<sup>5</sup> Historic examples of such 'dumping' practices were to be found in Switzerland, Canada and Austria. The federal governments of these countries have tightened UI eligibility and/or taken other measures over the years to prevent dumping of SA caseloads. For instance, some Canadian provinces would run activation programmes, financed by the federal level, that provided wages and allowed people to become eligible again for the Canadian federal UI benefits (called 'Employment Insurance' in Canada). This practice seems to have stopped, as these activation programmes have become expensive for the provinces and employment insurance eligibility is now more restricted. The Swiss and Austrian examples are discussed in the country fiches in the appendix. Shifting people from SA to UI via a specific activation instrument has also been common practice by local municipalities in Belgium, but it has not been objected to as 'dumping' or 'cost-shifting' at the expense of the Belgian federal level; it has been criticised as a poor form of activation since it did not lead to more than six months of employment.

interactions between different social programmes, such as UI and SA for able-bodied adults.

Activation has a direct impact on the degree to which *individual* moral hazard occurs in unemployment benefit systems and related benefit systems: stringent activation is one way to reduce individual moral hazard (this assertion is not self-evident; we return to it below). Thus, our study examines a subset of policies in which there is an interplay between the potential for individual moral hazard in unemployment and related benefit systems and the potential for institutional (or 'collective') moral hazard. Understanding that specific interplay between the individual and the institutional level is of critical importance, as we will try to show. By way of example, imagine an unemployment benefit scheme that does not entail much potential for individual moral hazard, because unemployment benefits are not generous and only granted for a short time span (which implies that the incentive to search for a new job is relatively strong, even when an individual benefits from this UI). In such a case, the quality of the policies deployed to activate the unemployed may be a relatively unimportant factor (i.e. relatively unimportant with regard to individual moral hazard, and hence relatively unimportant with regard to the potential for institutional moral hazard); as a corollary to the limited scope for individual moral hazard, given the non-generosity of benefits, there may be limited concern for institutional moral hazard. To be more precise: in such a case, the concern that might have existed has been 'pre-empted' by the low level of generosity of the benefits; the 'residual' concern is limited. For instance, the limited generosity of American UI benefits may explain why (residual) concern for *both* individual and institutional moral hazard is less prominent in the US when it comes to UI. The same observation seems to hold to some extent for Canada, where the generosity of UI for longer-term unemployed individuals is comparatively limited (see Figure 2 and Figure 3 in section 5, below). Conversely, if a benefit system is beset by important problems of individual moral hazard, in a multi-tiered setting there will probably be more concern for institutional moral hazard and more pressure on the lower level of government to prevent it (again, this assertion is not self-evident, and we return to it below). Recent US history provides a telling example of the close link between concern for individual moral hazard and concern for what we call institutional moral hazard: in the 1990s, these interrelated concerns led to the transition from Aid to Families with Dependent Children (AFDC) to Temporary Assistance for Needy Families (TANF).

The scope of our survey is limited in yet another way. Our description of the budgetary aspects of country-specific institutional arrangements in unemployment regulation focuses on transfers between levels of governments that are directly linked to unemployment regulation. Thus, our focus is on budgets for UI benefits, SA benefits, and activation, and the collection of revenues that serve to fund these programmes. Obviously, the financial repercussions of 'good' or 'bad' performance with regard to employment and activation go beyond these budgets: a Belgian region that is successful in creating employment will not reap the budgetary benefits of that success in the unemployment budget (which is situated at the Belgian federal level), but it will boost its income tax base (Belgium's regional budgets are financed, in part, by income taxation). In order to understand the financial incentives for Belgian regions to perform in activation and employment creation, one should take the whole

financial edifice of the country into account. Such a comprehensive review of the whole financial edifice of the eight countries under review was not possible in the context of this paper.

Next to these caveats with regard to the scope and focus of our study, we do not wish to entertain a simplistic view on the nature and importance of moral hazard. In the traditional presentation of the problem, on which we also rely in this study, moral hazard is explained on the basis of a simple economic calculus, in which 'working' is seen as a burden (generating a disutility), while the income from either work or a received unemployment benefit is seen as generating a utility. If this calculus does not take into account that people may wish to work for reasons of self-esteem, participation in social life, personal development, etc., it not only misrepresents human behaviour but also overestimates the problem of moral hazard associated with UI and SA. In a similar vein, an interpretation of the behaviour of public authorities as if they are only motivated by budgetary reasons and not by the intrinsic good of higher employment is too cynical to be true. Public authorities are motivated by the aspiration for success in their policies, for which they are accountable vis-à-vis their political constituency. In short, a narrow construal of the nature of moral hazard will exaggerate its prevalence.

Apart from this nuance with regard to the prevalence of moral hazard, one should be aware that moral hazard is an inevitable corollary of any system of insurance, be it private or public. The greater good of collective insurance is that it is able to overcome market failures. On a macro level, collective insurance serves social cohesion and economic stabilisation. Economic stabilisation contributes to economic growth. In other words, the 'cost' of moral hazard should be weighed against the benefit of social cohesion, economic stabilisation and – related to this – long-term economic growth. The observation that systems of insurance and/or solidarity entail moral hazard, is not *per se* an indictment against such systems. This holds for both individual and institutional moral hazard, as we define it. The challenge is to minimise moral hazard, given the overriding aim to organise sufficient insurance. Our study should be read in this light. Therefore, we also document the role of social benefits in macroeconomic stabilisation in the countries under review, to the extent that comparable data are available.

Finally, we should distinguish moral hazard as an objective reality, i.e. an empirical observation with regard to the possibility for the insured to influence the liability of the insurer in a context of asymmetric information, from the public *perception* that moral hazard is present, and from public *concern* for moral hazard: these are three different things. It may be the case that there is more concern for moral hazard than reality warrants, and vice versa. In this respect, both a gap between perception and reality, and different degrees of public sensitivity with regard to the trade-off between moral hazard (as perceived) and the social and economic objectives of collective insurance (social cohesion, economic stabilisation) can play a role. We study a domain where opinions on matters of social justice, *a priori* beliefs about human behaviour and the choice of economic paradigm are very important. Apart from the fact that the trade-off between moral hazard and cohesion and stabilisation constitutes a normative problem *par excellence*, there is less hard empirical science in this domain than one might

wish, *a fortiori* when the issue at hand is not only individual behaviour but the interaction of collective actors and political authorities.

### 3. FACTORS CONTRIBUTING TO THE SALIENCE OF INSTITUTIONAL MORAL HAZARD

In the preceding section, we draw a distinction between institutional moral hazard as an objective empirical reality, the public perception of institutional moral hazard, and normative concern surrounding it. The salience of institutional moral hazard in the multi-tiered regulation of unemployment in the eight countries under review should be assessed with these different dimensions in mind.

Since we frame the problem at hand as an insurance problem, a classical textbook analysis of moral hazard in insurance is a useful starting point. In his *Economics of the Welfare State*, Barr summarises the problem as follows. At its strongest, the condition that there should be no moral hazard requires that both the probability of the risk,  $p$ , and the insured loss,  $L$ , should be exogenous to the individual who is insured. Slightly less stringently, moral hazard can be avoided so long as individuals can influence  $p$  or  $L$  only at a cost to themselves greater than the expected gain from so doing. Where that assumption fails, customers of an insurance company can affect the insurer's liability without its knowledge, given the context of asymmetric information (Barr, 2004, pp. 111-112). One should note that the cost associated with the occurrence of the insured risk can be non-material. The loss of self-esteem and respect by fellow citizens, when being unemployed, is an important example in this context; respect by fellow citizens and self-esteem may be overriding motives for taking up a job, even if the purely financial calculus is an insufficient incentive. Below, we argue that certain aspects of activation can also constitute a 'cost' (in terms of a disutility) for the unemployed individual.

In the framework of our earlier generic example of two levels of government, level A and level B, with level A offering a collective UI policy to the governments at level B for the cost of unemployment with which governments at level B might be confronted, it seems that eight sets of factors contribute to the salience of institutional moral hazard:

- i. The generosity and design of the individual insurance policy offered to the individual via unemployment benefits and related benefits.
- ii. The generosity and design of the collective insurance policy offered by government level A to government level B, with regard to the cost of unemployment.
- iii. The activation regime linked to unemployment and related benefits.
- iv. The possibility of perverse interactions between benefit schemes for which B is fully responsible (notably SA for able-bodied adults) and UI, e.g. the 'dumping' of caseloads by B onto UI paid by A.
- v. The extent to which there is information asymmetry, i.e. the extent to which pure risk factors with which B is confronted can be disentangled from the quality of B's policies.
- vi. The existence of other mechanisms (next to spending on UI and SA) that make fiscal revenues of collective actors sensitive to employment performance in the constituency for which they are responsible.

- vii. The heterogeneity of unemployment rates across the political constituencies at level B.
- viii. The importance attached to common goals with regard to social cohesion and economic stabilisation, for which insurance is a useful instrument and moral hazard a 'cost' of the instrument.

The last factor has to be analysed on the backdrop of the historical developments of multi-tiered nation states; our country case studies testify to the importance of history.

We will not elaborate upon all these factors separately, but will add some comments about some of them. Factors (i) and (ii) can be understood on the basis of simple economic calculus (which, simultaneously, may limit their relevance, as explained in the previous section): a more generous UI policy entails a smaller incentive to find work (at the level of the individual, in the context of an individual insurance policy) or to reduce the number of unemployment benefit recipients (at the level of a lower level of government which is insured against unemployment by a higher level of government). However, apart from the generosity of the system, the design of the insurance policy plays a role: financial incentive mechanisms can organise cost-sharing between the insured and the insurer in different ways. Well-known examples of incentive mechanisms in the realm of individual insurance are also applicable to relations between institutions. Frequent claimants can be asked to pay higher premiums (the US case is an example, both at the level of individual UI, with experience rating, and in the relationship between the states and the federal level, with the FUTA system, as we will illustrate below). Co-insurance (the insured pays x per cent of any claim) is another example of a mechanism that is applicable for the prevention of institutional moral hazard. The Extended Unemployment Benefit system in the US applies 'co-insurance', so conceived; co-insurance is a feature of the Danish system with regard to both UI and SA.

Last but not least, there is a crucial distinction between the use of *block grants* to compensate lower level governments for the cost of social programmes and *open-ended funding* systems, whereby the higher level of government compensates the lower level governments on the basis of their caseload. A block grant is a transfer from a federal or central government to a lower tier of government to fund programmes, policies and administration with a predetermined size. The transfer is done in advance (before any costs are incurred) and periodically (most often annually or at longer intervals). Block grants stand in contrast to open-ended funding which is contingent on specific indicators reflecting the caseload (such as the number of unemployed) and is continuously adjusted. The amount of funding in a block grant can only be adjusted before the transfer and cannot be manipulated midway. Hence, it is hard for lower tiers of government to manipulate the amount of funding they receive. Because the size of block grants (or the calculating formula) is known in advance, it provokes discussion but it leaves little room for institutional moral hazard. Since lower tiers of government know exactly how much they will receive in advance, they can adjust their policies accordingly, which can also be seen as an advantage. However, it will be harder for lower tiers of government to react to unforeseen circumstances.

Block grants are less often coupled with detailed and continuous monitoring than open-ended funding.

Insurance normally implies open-ended funding, on the basis of the caseload, yet there may be a 'cap' on what the insurance company pays. Although it stretches the notion of 'insurance' rather far, a block grant can be interpreted as an inter-institutional insurance policy with a cap that is below the normal level of claims. In some countries, block grants have been introduced with the explicit aim to stop the institutional moral hazard that was associated (at least in perception, if not in practice) with open-ended funding. The transition, in the US, from Aid to Families with Dependent Children (AFDC), for which US states had open-ended funding, to Temporary Assistance to Needy Families (TANF), which is funded through block grants for the states, is a telling example. Canada experienced a similar transition in its SA funding: in 1996 the open-ended funded Canada Assistance Plan (CAP) was replaced by a block grant (the Canadian Health and Social Transfer, or CHST). This change in funding system emerges as one of the reasons why institutional moral hazard does not seem to be an issue in today's Canada. In a sense, when it comes to the effectiveness of the use of funds made available via these block grants, the main 'mechanism' which federal policymakers seem to rely on is the democratic political accountability of provincial governments vis-à-vis their own political constituencies.<sup>6</sup> (As a matter of fact, in the Canadian case, the block-grant nature of the funding system is one thing; the amount of money made available via the block grants is also increasingly limited compared to the cost of SA incurred by the provinces; it covers less than 10% of their cost today.)

As already indicated in section 1, in a multi-tiered setting there is interaction between, on one hand, the propensity of an individual insurance policy to generate *individual* moral hazard and, on the other hand, the concern for *institutional* moral hazard when a higher level of government 'reinsures' the cost of that insurance policy for the lower levels of government in one way or another. As a matter of fact, it would be wrong to assert that a high *objective* potential for moral hazard at the individual level entails, automatically, a high *objective* potential for institutional moral hazard at the level of institutions, and vice versa. A high objective potential for individual moral hazard makes it more difficult for the lower level of government to prevent it, which is not the same as saying that this lower level of government itself would be more prone to (institutional) moral hazard; with regard to the design of the benefit system, the two issues should be carefully distinguished. However, if the perception is that the potential for individual moral hazard is high and if this perception raises concern, it is likely that there would be more pressure on the lower level of government to fight it. In other words, the interplay between individual and institutional moral hazard is based on perception and concern. This is not to say that this interplay is unimportant or merely a matter of discourse: 'perception' and 'concern' are as much facts of

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<sup>6</sup> Cf. Gauthier (2012, p. 10): "It is the federal government's position that provinces and territories are best placed to determine program priorities and implement programs in response to them. As a result, the federal government notes that provinces and territories are directly accountable to their residents for their use of federal transfer funding."

political life and policymaking as the objective architecture of an insurance policy. But an exaggerated perception of moral hazard can result in policies that are suboptimal.

As will be shown in section 5, in some countries means-tested SA plays a much larger role in the protection of able-bodied unemployed adults than in other countries; this may explain why, for instance, in the Swiss case there is less public concern for institutional moral hazard in UI than in Belgium, despite the fact that Swiss cantons have a large degree of autonomy with regard to UI activation, whilst UI benefits are federally funded (a situation akin to the situation of the Belgian regions). A transition from entitlement-based UI benefits to means-tested SA benefits may be the result of concern for moral hazard (perceived or real). A shift from an insurance system to a means-tested residual system will obviously reduce the overall caseload, and, thus, the concern for moral hazard. Moreover, there may be less public concern for moral hazard with SA systems, because, across the board, SA clients are perceived as more 'needy' than UI clients by public opinion. However, SA benefits may generate as many problems of moral hazard as UI benefits do, for those who receive them, and SA benefits can generate specific inactivity traps, precisely because of their means-tested nature.

We should add a supplementary observation to this, which refers to factor (vii) in our list of contributory factors, heterogeneity of employment rates. In a multi-tiered setting whereby risk profiles vary greatly across constituent units (as is the case, for instance, with unemployment across Belgian regions), the link between concern for individual moral hazard and concern for institutional moral hazard will be much stronger. If the unemployment rate is much higher in some regions compared to others, a relatively 'generous and tolerant' insurance policy at the individual level, which is perceived as generating a high degree of moral hazard at the level of individuals, will be seen as a recipe for permanent redistribution across the regions, rather than as a sound basis for interregional reinsurance; hence, the pressure on the regions to 'do something about it' will increase. Conversely, a large disparity in the employment record in the constituent units of a multi-tiered system, but little concern for institutional moral hazard, leaves something to be explained by the political scientist (with regard to UI, Canada offers an example). In other words, the interaction between different contributory factors in our list is important to understanding the salience of institutional moral hazard.

Factor (iii) in our list, activation, is key in this study. However, the link between activation and institutional moral hazard should be understood correctly, as activation impacts moral hazard at the individual level. For instance, if quality training for unemployed people enlarges their opportunity set and thus increases their earning potential, the economic incentive to exit unemployment is reinforced; the concomitant (positive) reinforcement of economic incentives counteracts the impact of moral hazard in the system. In a more direct way, a system of 'close monitoring' of the search effort of unemployed individuals constitutes an additional 'cost' for the unemployed individuals, due to the continuous interference in their daily lives and the frequently repeated and personalised assessments of their 'willingness to make an effort' (Vandenbroucke & Vleminckx, 2011). 'Close monitoring' increases the incentives to exit unemployment, in a negative way, and thus counteracts moral

hazard. In short, there is a relationship, via different mechanisms, between activation and moral hazard at the individual level. We will refer to activation in the context of *institutional* moral hazard if lower levels of government implement activation policies differently, some less stringently, others more so: this may be an issue related to the implementation of policies designed at the higher level, or an issue of both design and implementation (when activation is the responsibility of the lower level).

The eighth factor in our list, the importance attached to common goals with regard to social cohesion and economic stabilisation, does not influence the incidence of (institutional) moral hazard in an objective sense; it influences the public concern that its perception raises. Transfers from the American federal level to the states may be more acceptable to American citizens, even if their impact is redistributive, than cross-border transfers are in the EU, since the feeling of belonging to one American nation is presumably much stronger than the feeling of belonging to one 'European nation'. This may explain (together with other factors, which we document in the US case) why public concern for possible institutional moral hazard with regard to federal-state transfers is less outspoken in the US than one would expect, from a European perspective. Conversely, within many of the EU Member States, the readiness to organise solidarity and to redistribute incomes may be much stronger than within many of the American states, which explains why unemployment benefits are less generous in American states than in EU Member States. So conceived, the US and the EU may exemplify, today, different *equilibria* in their public opinion: Europeans are probably less ready to reinsure their relatively generous national unemployment benefit systems at the EU level, compared to Americans, who accept a degree of federal reinsurance of relatively ungenerous state unemployment benefit systems.

Obviously, the 'factors' in our list include deliberate policies to fight moral hazard at the individual and institutional levels. Stringent activation (factor iii) is a case in point, as are financial incentives built into the benefit system at the level of individuals, or financial mechanisms affecting the budgets of lower level governments as a function of their performance (the Danish 'reimbursement system' includes such mechanisms, next to specific conditions to receive reimbursement, which are more akin to 'minimum requirements', discussed in the next paragraph). Information asymmetries (factor v) can be tackled with detailed systems of performance measurement; this is also a feature of the Danish case.

In our country case studies, we document an important feature of the institutional architecture of unemployment regulation, which we label 'minimum requirements'. Minimum requirements refer to binding policy floors set by higher levels of government for lower levels of government. Minimum requirements belong to the 'regulatory mode of policy-making' (Wallace, Pollack & Young, 2015, p. 103). Minimum requirements can apply to different 'factors' in our list. Minimum requirements play a role in Denmark and Austria (with regard to both UI activation and SA activation), in Belgium (with regard to UI activation), and in the US (with regard to UI and SA); however, the level of detail and the strictness of these requirements differs from case to case. Such minimum requirements can be the result of specific inter-institutional agreements (as in Belgium, with regard to activation), or of a consensus established among the lower level governments (as in the Swiss case,

with the non-binding guidelines issued by the inter-cantonal cooperation conference). They can be motivated predominantly by concern for individual and institutional moral hazard (Belgium is a telling case), but their motivation can also be broader, encompassing the quality of social rights for citizens (Austria is an example).

In the context of the broader research project on the feasibility and added value of a EUBS in which this paper fits, one should distinguish between minimum requirements with regard to the benefit side of UI and minimum requirements with regard to UI activation. Minimum requirements can be imposed with regard to the coverage and generosity of UI benefits, to ensure the macro-economic stabilisation effects of unemployment schemes supported by the EU; this rationale for minimum requirements (on the benefit side) is discussed in Task 1C of the broader research project. In contrast, minimum requirements with regard to activation aim to prevent behaviour from lower levels of government that negatively affect the risk for which they are (re)insured. Requirements that enforce a minimum quality and/or quantity of activation policies can prevent Member States from shirking their responsibilities to activate their UI caseload, which in the context of an EUBS would be co-financed by the EU. In other words, minimum requirements on the benefit side aim to promote an optimal design of the national insurance policy (which is reinsured by the EU), given risks that are supposed to occur exogenously, while minimum requirements for activation aim to prevent behaviour that increases the risk in an endogenous way. Since this study is concerned with institutional moral hazard, it focuses on minimum requirements in the context of activation policies. The development of EU guidelines on activation, with the Youth Guarantee being the latest step, can be seen as a prefiguration of such 'minimum requirements' with regard to the quality of national activation policies.

Another feature of the institutional architecture of unemployment regulation that we discern is the use of performance measurement and management. The behaviour and efforts of agents (or in our case sometimes lower levels of government) are monitored on the basis of indicators set *ex ante*. It is possible that performance is judged against predetermined target values for these indicators. Furthermore, financial incentives can be tied to performance. This practice is relatively common in public reforms that have been inspired by New Public Management (Mosley, 2011, pp. 6-7).

#### 4. AN ANALYTICAL GRID TO COMPARE COUNTRY CASES

The summary analysis of factors contributing to the salience of institutional moral hazard in the preceding section motivates the particular analytical grid that we use to map the countries under examination. This analytical grid simplifies the reality in our country cases somewhat (but not very much) by distinguishing only two broad types of benefits: unemployment benefits (in most of the countries conceived of as a social insurance policy, at least historically) and SA benefits for able-bodied adults (typically residual, and means-tested to some extent). For each of these broad types, we discuss the regulation of the benefits (the 'passive side' of unemployment regulation) and the regulation of activation (the 'active side' of unemployment regulation) separately; this yields four columns, corresponding to the four main policy components of what we label, by way of short-cut, the 'regulation of unemployment'. Australia is exceptional, in that there is only one major unemployment benefit, which covers nearly the whole unemployment caseload: Newstart Allowance (NSA). NSA is universal but features, qua implementation, characteristics of SA (see the country fiche on Australia in the appendix) Therefore, the Australian analytical grid has only two columns. The US is exceptional as well. Due to the fragmented US SA system, the US analytical grid includes three benefit schemes: UI, TANF and Supplemental Nutritional Assistance Program (SNAP, formerly called 'Food Stamps').

*Table 1. An analytical grid of the regulation of unemployment in multi-tiered systems*

		Unemploy ment benefits	Activation of individuals with unemploy ment benefits	Unemploy ment- related SA	Activation of individuals with SA benefits
<b>1</b>	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. design of the policy: - Formal regulation - Policy goals				
<b>2</b>	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. implementation of the policy				
<b>3</b>	Budgetary responsibility				
<b>4</b>	Budgetary transfers between levels of government?				
<b>5</b>	Structural redistribution? (measured on a per capita basis)				
<b>6</b>	Political or managerial decentralisation/delegation?				
<b>7</b>	Indicators used in the monitoring of lower-level performance by higher level (on the basis of: input, output and outcome)?				
<b>8</b>	Is a system of 'minimum requirements' applied?				

<b>9</b>	Are performance-based sanctions/rewards applied by the higher level at the lower level?				
<b>10</b>	Conclusion from 5-6-7: perception of, concern for, and approach to problems of institutional moral hazard?				
<b>11</b>	Conclusion from 5-6-7: approach to principal-agent issues?				
<b>12</b>	Contribution to macroeconomic stabilisation by the benefit system				

Source: Own compilation.

Each country is characterised on the basis of this analytical grid. For each of the country cases and for each of the four policy components shown in the columns, we describe the degree of decentralisation (i.e. the flexibility admitted at the lower level), making a distinction between decentralisation with regard to the design of policies (row 1) and decentralisation with regard to the implementation of policies (row 2). 'Design' encompasses both the formal regulation of policies (in essence, who decides about the legislation?), and the definition of policy goals.

Rows 3, 4 and 5 concern the budgetary responsibilities for benefits and activation programmes (and associated services), the way in which these budgetary responsibilities are organised, and the related distributional consequences. In row 3, we describe the division of budgetary responsibilities. Simply put, the level of government that bears the budgetary burden of a programme is the level that has the budgetary responsibility. However, we want to distinguish between multi-tiered systems in which the federal or central level directly pays out benefits to individuals (or directly provides activation services to individuals) and multi-tiered systems in which lower levels of government pay out the benefits (or provide services) and are compensated for this by a fiscal transfer from the federal or central level (for instance, a block grant, or an open-ended reimbursement system). In the latter case, there is flow of funds between governments; in the former case, there is no flow of funds between governments. (The latter case may also be labelled 'reinsurance', with the federal or central level of government re-insuring the insurance policy organised by the lower level, whilst in the former case the federal or central level plays directly the role of insurer vis-à-vis individual citizens.) This distinction is made in row 4 of the grid.

Most often, funds are transferred from the higher level of government to a lower level of government, but it is also possible that lower levels of government contribute to costs that are a federal or central responsibility. In contrast, the absence of budgetary transfers between levels of government implies that both the central/federal level of government and the lower levels of government raise their own revenues to finance their respective UI or SA responsibilities. The distinction made in row 4 is relevant to the broader research project undertaken by the Consortium: an 'equivalent EUBS' would imply transfers between the EU and national governments; a 'genuine EUBS'

would not imply transfers between the EU and national governments. As a matter of fact, the distinction highlighted in row 4 is not always straightforward to apply. As we explain below, we have chosen to describe the American system of Extended Benefits and Emergency Benefits as a system that is *not* characterised by transfers between levels of governments, because in its spirit it corresponds to what we would call a 'genuine EUBS'. However, the Extended Benefits and Emergency Benefits are disbursed to individual American citizens by the states; state accounts are reimbursed by the federal governments.

Row 5 ('structural redistribution') concerns an outcome that is independent of the budgetary technique specified in row 4. We take a *per capita* benchmark as our vantage point: we speak of structural redistribution if there is more funding *per capita* for the programme under review in some of the relevant lower level units of a country than in other units, on a structural basis. In practice, structural redistribution occurs when the size of the programme caseloads varies structurally across these units. Consider, by way of example, a federal state with regions: if the federal level is responsible for the UI budget and the UI caseload as a percentage of the population varies across the regions, then there will be a structural redistribution, at least *prima facie*.

An important issue in the overall research project to which this paper contributes concerns the 'permanent' or 'non-permanent' character of transfers associated with an eventual EUBS (see the Inception Report on 'permanent transfers', notably the description of Task 1B). The relationship between this notion of 'permanent transfers' (as distinguished from 'non-permanent transfers') and the concepts used in our analytical grid should not lead to confusion. Most of the multi-tiered systems in the eight countries under examination imply 'permanent transfers', either because the higher level of government pays individual benefits (or services) to citizens on a permanent basis, or because the higher level of government compensates the lower level via a direct flow of funds on a permanent basis. Therefore, we do not provide a separate entry in the analytical grid to distinguish 'permanent' from 'non-permanent' transfers.<sup>7</sup> However, in some cases non-permanent transfers exist (for instance, the American 'Extended Benefit' and 'Emergency Benefit' programmes, which are temporary by design); if so, the occurrence of non-permanent systems is explicitly mentioned, either in row 3 or 4.

In row 6, we indicate whether the decentralisation should be qualified as 'managerial' versus 'political', building on a distinction introduced by Mosley (2011). In the same row, we also indicate whether 'delegation' is a feature of the governance system that needs to be highlighted. As explained in section 1, if 'delegation' is not mentioned in the grid, that does not imply that the delegation of powers is absent in the regulation of unemployment in the country under examination; if it is not mentioned, it means

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<sup>7</sup> In this respect, the analytical grid we apply here differs from the initial analytical grid proposed in the tender (see Tender, Table 2); we became aware that the expression 'permanent transfers' in the initial analytical grid generated confusion between our analysis and the concepts used in the tender and the Inception Report.

that the delegation that may exist is not sufficiently relevant to our main analytical focus in this paper. Rows 7-9 concern institutional moral hazard and principal-agent issues, where relevant, and answer the following questions: Do 'higher levels' monitor the performance of 'lower levels', and, if so, how (row 7)? Can we qualify the system that is applied as one of 'minimum requirements' (row 8)? Are sanctions/rewards applied (row 9)? In row 10, we summarise this part of the analysis: How salient is institutional moral hazard (not just as an objective feature of the system, but also in terms of public perception and public concern)? If it is a salient feature, how is it dealt with? In row 11, we indicate whether principal-agent problems are an important feature of the system under review (in our survey, principal-agent problems relate to managerial decentralisation, as we define it).

Finally, in row 12, we assess the contribution of the national benefit system to macroeconomic stabilisation in the case of an employment shock, on the basis of Dolls et al., cf. Figure 1 in section 5 below (Dolls, Fuest & Peichl, 2012a; Dolls, Fuest & Peichl, 2012b).

Ideally, in such a grid one should also take on board the interplay between the broader regulation of labour markets on the one hand, and benefit and activation systems on the other hand; an important question is whether labour market institutions are homogenous or heterogeneous at the relevant lower level. Together, the regulation of employment and the broader labour market institutions make up a system that is able to deal with socio-economic risks linked to changes in economic and labour market conditions. However, the scope of this survey and the time invested in it do not allow us to take on board this broader dimension.<sup>8</sup> We recommend this for further research.

Substantive policy and institutional changes have often coincided in recent history. We identify important moments of institutional change in the detailed descriptions of the country cases (they are much more detailed than the summary in the country fiches in the appendix to this paper). These detailed descriptions can be found in a separate appendix to the Consortium's report. Further research should elaborate upon the possibility of applying both a notion of 'consistency' and of 'consistent institutional change' to assess systems of unemployment regulation. 'Consistency' would not mean that the analysis 'approves' of specific changes from a normative sense (such as social justice); instead, the term 'consistency' would signal a certain logic that has been applied simultaneously and coherently to substantive policy changes and institutional changes. The Hartz reforms in Germany seem to be a case of 'consistent institutional change'. The same might be said about the transition from AFDC to TANF in the US.

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<sup>8</sup> In this respect, the analytical grid developed in this paper differs from the initial analytical grid proposed in the tender.

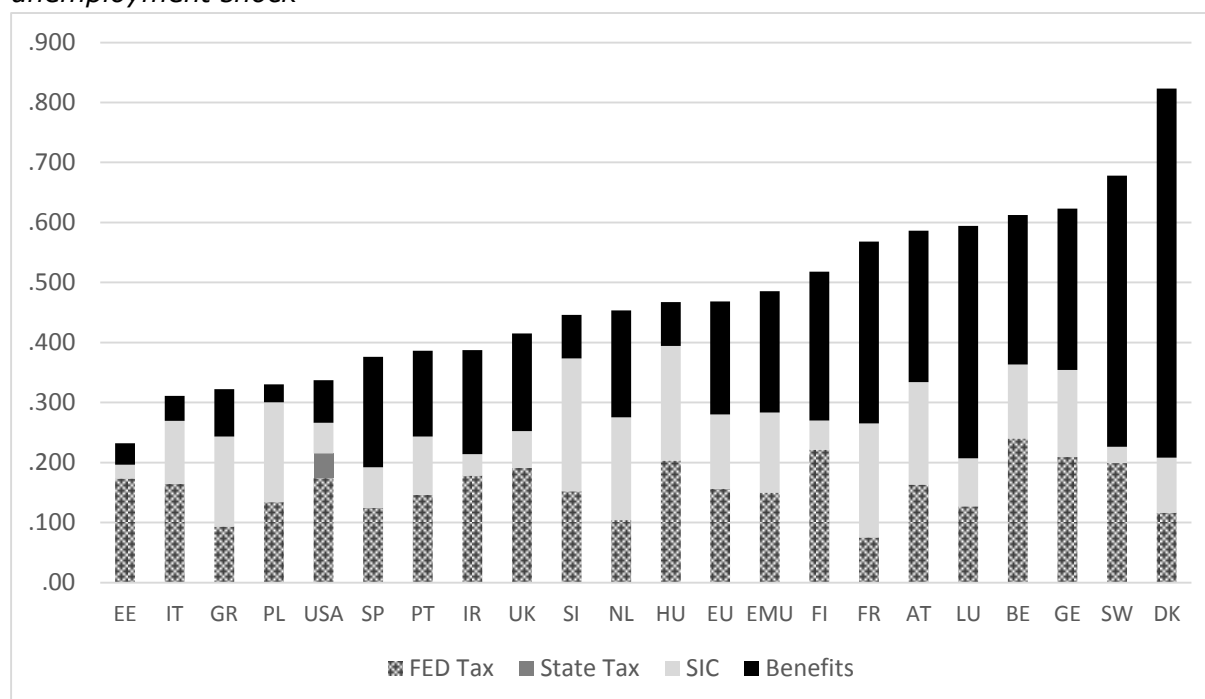
## **5. GENEROSITY, ELIGIBILITY, CONTRIBUTION TO MACROECONOMIC STABILISATION AND BUDGETARY INCIDENCE**

We start with an observation on one of the fundamental objectives of unemployment benefit schemes: macroeconomic stabilisation. Institutional moral hazard can be seen, to some extent, as an inevitable corollary of the insurance mechanisms that generate stabilisation. Simplifying for the sake of the argument in this paper, one might say that the challenge for multi-tiered social systems is to achieve as much overall stabilisation as possible, with as little institutional moral hazard as possible. The assessment by Dolls et al. of the relative importance of automatic stabilisers includes four of the eight countries in our study (the US, Germany, Belgium and Denmark).<sup>9</sup> It shows an important divide between the US on one hand and the three European countries on the other hand; in the case of an 'employment shock', macroeconomic stabilisers are less important in the US than in many other countries, while Denmark, Germany and Belgium display strong automatic stabilisers in a comparative perspective even when compared to other European countries. Moreover, the benefit system plays only a limited role in the overall automatic stabilisation capacity of the US system, whilst benefits are important drivers of stabilisation in Belgium and Germany, and very important drivers of stabilisation in Denmark. Figure 1 illustrates this:

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<sup>9</sup> Another relevant source with regard to stabilisation is: Fernando-Salgado, M., Figari, F., Sutherland, H. & Tumino, A. (2014). For the US, there is also the study by Auerbach, A. & Feenberg, D. (2000), which, however, discusses the role of the federal income tax rather than unemployment benefits as automatic stabilisers.

*Figure 1. Decomposition of income stabilisation coefficients in the case of an unemployment shock*



Source: Our own rendition of results by Dolls, Fuest & Peichl, 2012a.

Since UI benefits account by far for the largest part of stabilisation in case of an unemployment shock, the differential generosity and coverage of unemployment benefits obviously is an important explanatory factor. As explained in the US country case (see the appendix to the Consortium's report), the generosity of unemployment benefits in the US is low, notably in terms of duration: in most states the duration of regular UI benefits is limited to 26 weeks. Admittedly, one should add to this assessment of automatic stabilisers that the US administration also applies a system of Extended Unemployment Benefits and Emergency Benefits to counter the impact of recessions, which is not integrated into the assessment of the regular system by Dolls et al.<sup>10</sup> However, the basic observation remains that the generosity of the US unemployment benefit system is very limited.

The generosity of benefit systems can be gauged by gross or net replacement rates. As we explain below, this is a narrow definition of generosity, since it only applies to the individuals who are eligible for benefits. However, the comparison of replacement rates reveals as such already a strikingly diverse pattern. For the countries under

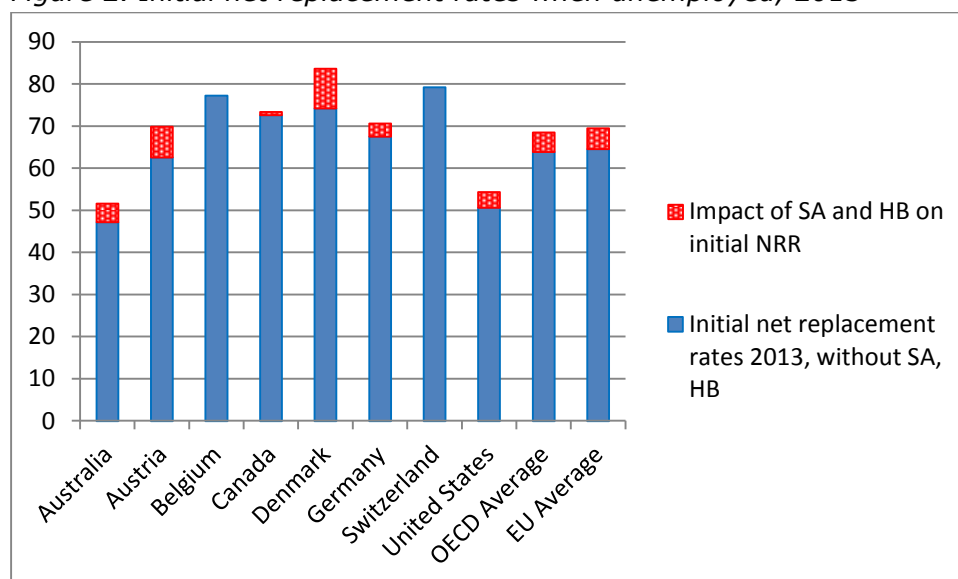
<sup>10</sup> In their baseline analysis, Dolls et al. do not account for the Extended Benefits (EB) programme in the US because it does not kick in automatically in all states. The EB programme provides an additional 13 to 20 weeks of unemployment benefits to workers receiving unemployment insurance in states that meet certain thresholds in terms of their unemployment rates. This increased duration of unemployment benefits slightly increases the stabilisation coefficient for the US and, thus, reduces its difference from the average stabilisation coefficient in the EU (Dolls et al., 2012a, NBER version of 2010, footnote 18, p. 15).

examination, Figure 2 and Figure 3 show the net replacement rates, as calculated by the OECD on the basis of its tax-benefit model for 2013, and compare these to the median net replacement rates for the whole OECD and the whole EU. The figures are averages for four family types and two earnings levels, as a percentage of the wages used. Figure 2 shows the average net replacement rates for these family types at the initial phase of unemployment. Figure 3 shows the average net replacement rates over 60 months of unemployment. We distinguish the net replacement rates for two situations, one where the family does not qualify for cash housing assistance (HB) or SA 'top-ups' (blue bars), and one where the family does qualify for such 'top-ups'; the impact of these 'top-ups' is indicated by the red bars in the figures.<sup>11</sup> Hence, the blue bars indicate the generosity (in terms of replacement rates) of UI, and the sum of the blue and the red bars indicates the generosity of the combination of UI and SA (and housing benefits). These figures show important cross-country variation with regard to the generosity of the systems, with important differences between the protection of short-term and long-term unemployed individuals, and a substantial variation in the weight of SA versus UI, notably in the case of long-term unemployment.

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<sup>11</sup> The data in Figure 2 refer to the initial phase of unemployment, but following any waiting period. Any income taxes payable on unemployment benefits are determined in relation to annualised benefit values (i.e. monthly values multiplied by 12), even if the maximum benefit duration is shorter than 12 months. The four family types are: single person, no children; single earner married couple, no children; lone parent, two children; single earner married couple, two children. For married couples, the percentage of average wage relates to the previous earnings of the 'unemployed' spouse only; the second spouse is assumed to be 'inactive' with no earnings and no recent employment history in a one-earner couple. Two levels of earnings are considered for each of the family types: 67% and 100% of the average wage. Where receipt of SA or other minimum-income benefits is subject to activity tests (such as active job search or being 'available' for work), these requirements are assumed to be met. Children are aged four and six and neither childcare benefits nor childcare costs are considered. The replacement rates are calculated after tax and including unemployment benefits and family benefits. In the situation of 'no top-ups', no SA top-ups or cash housing benefits are assumed to be available in either the in-work or out-of-work situation. In the situation with 'top-ups' (indicated with SA and HB in the figures), SA and other means-tested benefits are assumed to be available subject to relevant income conditions. Housing costs are assumed equal to 20% of average wage. Data are retrieved from the OECD's website on 8.8.2015 (with authors' own calculations for the OECD and EU average values in Figure 2, blue bars; OECD site provides median values).

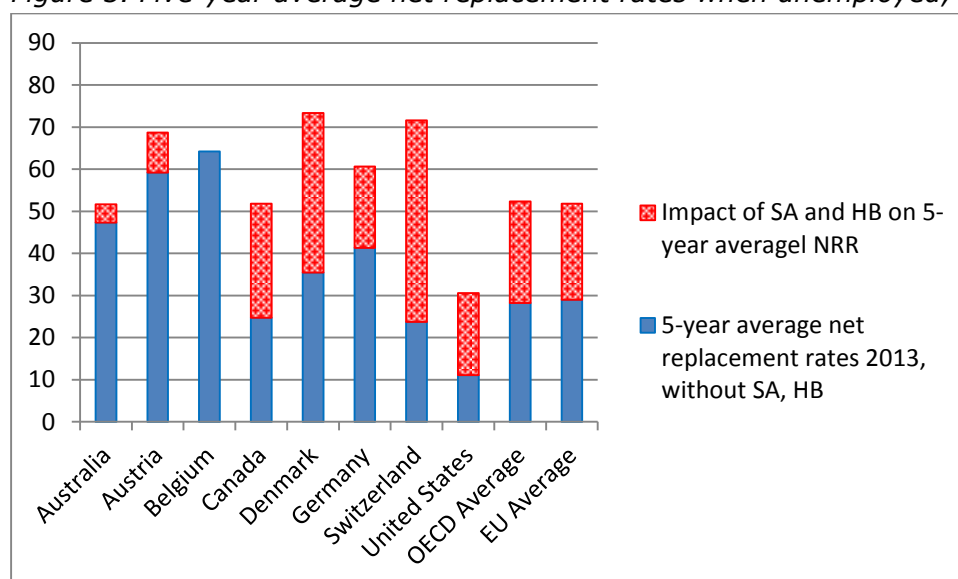
Figure 2. Initial net replacement rates when unemployed, 2013



Note: EU average refers to EU-27 (without Cyprus).

Source: OECD tax-benefit model 2013, own calculations.

Figure 3. Five-year average net replacement rates when unemployed, 2013

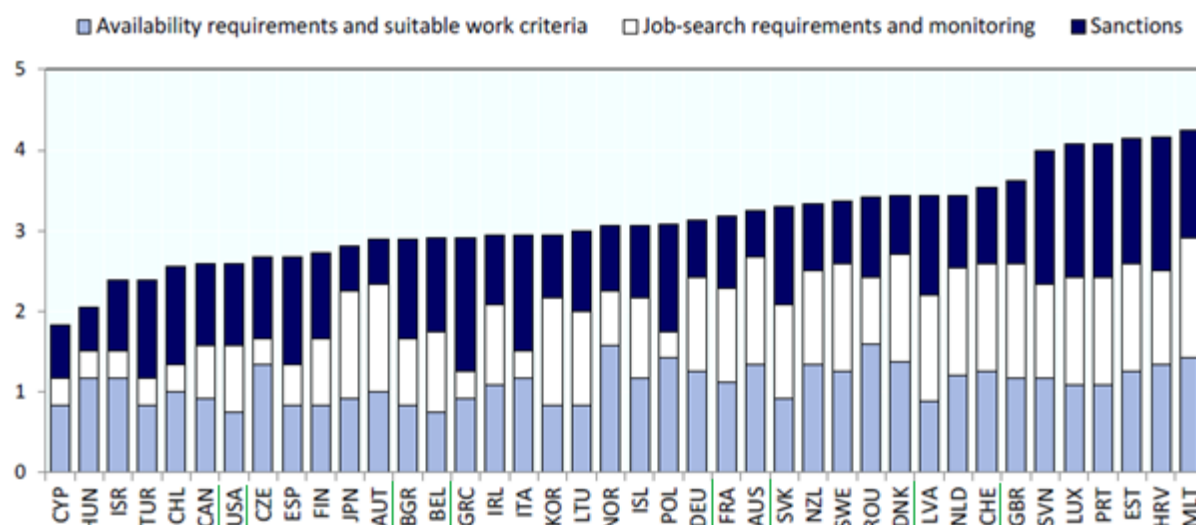


Note: Cf. Figure 2.

Source: OECD tax-benefit model 2013, own calculations.

Net replacement rates measure the generosity of benefit systems for those who are recipients; obviously, from a macro perspective, the overall generosity of a benefit system also depends on the strictness of the applied eligibility criteria. Figure 4 compares the strictness of eligibility of UI according to an OECD study by Langenbucher (2015), on which we rely in our extensive country case studies.

Figure 4. Overall strictness of eligibility criteria

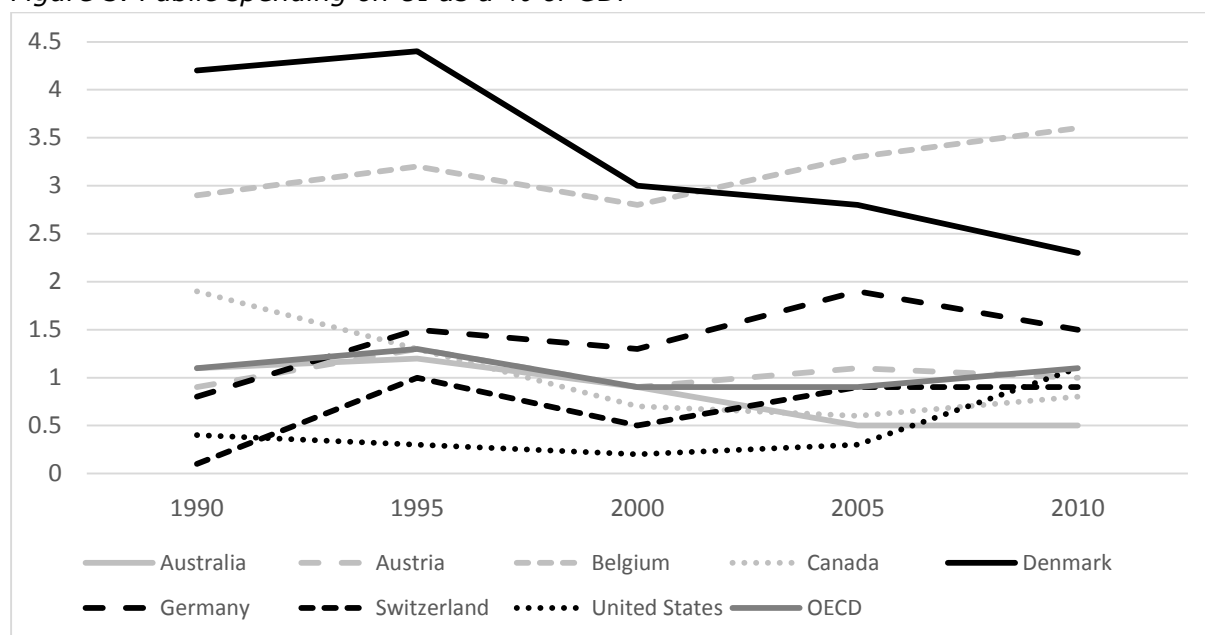


Source: Langenbucher, 2015, p. 27.

The scores for every country consist of three elements: availability requirements and suitable work criteria, the strictness of job search monitoring and the strictness of sanctions which can be applied. There is no *prima facie* correlation (either positive or negative) between the generosity of UI benefits as measured by net replacement rates and the strictness of eligibility. The US and Australia have the least generous UI benefits in our selection and the second and sixth highest scores on strictness of eligibility, for the cases we examine. While Belgium has one of the most generous UI benefits in our selection, its score on strictness of eligibility is median in that sample. The shape of the eligibility criteria is also influenced by the country-specific institutional set-up. For example, the Australian NSA functions as the unemployment benefit of last resort (there is no large Australian SA scheme) and consequently has almost universal coverage (OECD, 2012, p. 157). For that reason, the sanctions in the Australian system are amongst the least strict of the countries studied by Langenbucher: in such a context, severe sanctions for repeat offenders are seen as punitive and counterproductive (OECD, 2012, pp. 29-30, 102, 159). However, perhaps just because sanctions and entitlement conditions are so relaxed, the strictness of both job search requirements and monitoring thereof is so high that it still ranks third among the countries we examine. The Australian example highlights the difficulty of interpreting these data. Nonetheless, it is clear that there is a stark cross-country variation in the strictness of eligibility, even between countries which are relatively similar – such as Austria and Switzerland.

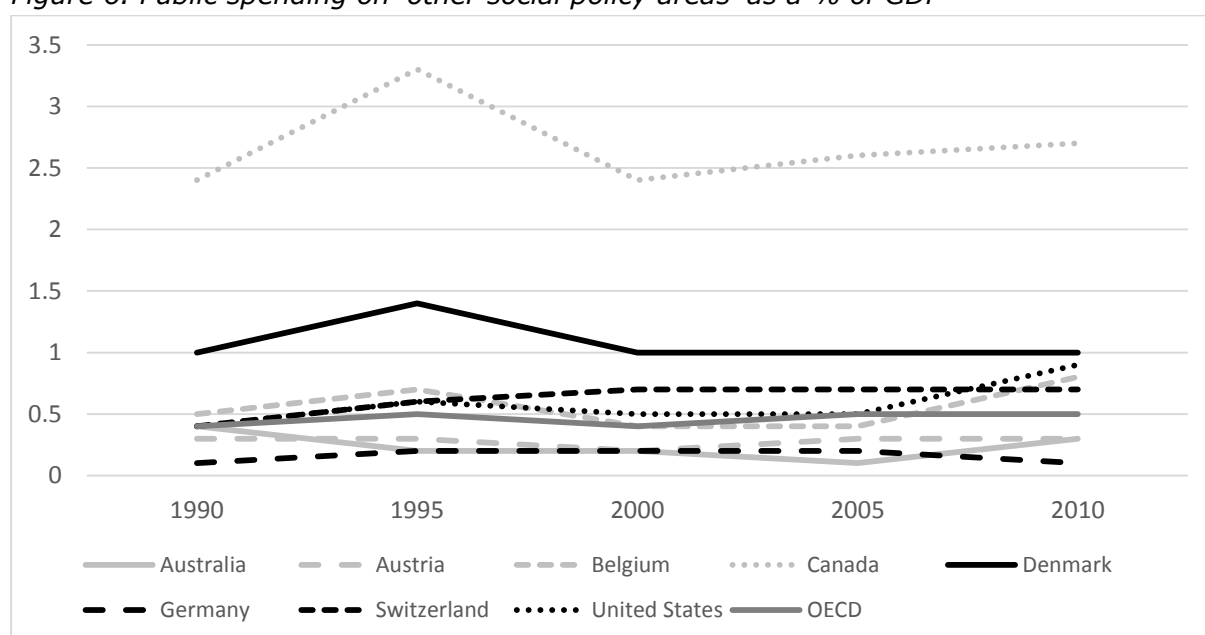
Figures 5-7 illustrate the budgetary incidence of UI and SA benefits and active labour market programmes (ALMPs) in the eight countries under review, on the basis of OECD SOCX. In order to gauge the budgetary incidence of SA benefits, we have to rely on a broader category, which is labelled 'other social policy areas' in OECD SOCX.

Figure 5. Public spending on UI as a % of GDP



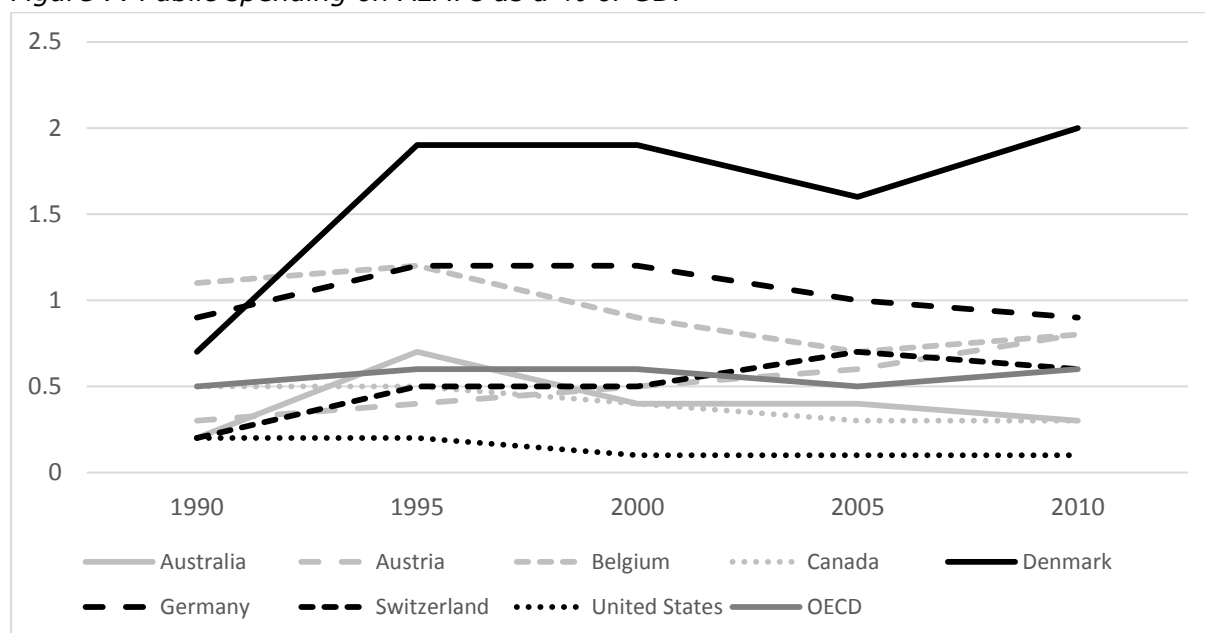
Source: OECD SOCX.

Figure 6. Public spending on 'other social policy areas' as a % of GDP



Source: OECD SOCX.

Figure 7. Public spending on ALMPs as a % of GDP



Source: OECD SOCX.

Figures 5 and 7 demonstrate very different patterns of public spending across the countries under examination: spending on UI and activation is very low in the United States, while it is rather high in countries such as Belgium and Denmark. One could argue that low expenditure on unemployment benefits in the US is related to the fact that Americans are more susceptible to concern for moral hazard in social insurance than Belgians; but the 'residual' concern for institutional moral hazard in the US – given these limited levels of expenditure – is ultimately perhaps less than in a country like Belgium. Figure 5 also indicates that unemployment spending in the US fluctuates more than, for example, in Belgium (cf. the ratio between the highest and the lowest percentage over the past period for each of the countries). In other words, US spending is more cyclical but, because it is so limited, it contributes little to stabilisation.

Figure 6 should be interpreted carefully. The OECD SOCX database has a broad miscellaneous category – 'other social policy areas' – which does not only include SA programmes as we define them in our country cases. Nevertheless, these data yield a meaningful comparison. In countries with an insurance-based support system such as Belgium and Germany, the role for income-tested programmes is usually limited and aimed primarily at those who have exhausted their unemployment insurance entitlements and are eligible for unemployment assistance or social assistance. In countries such as Canada and Switzerland, the role of income-tested programmes is considerably larger. In some of the countries considered here, income-tested social programmes have seen an increase in recent years. This has been reinforced in the context of the economic crisis in order to ensure support for the least well-off.

OECD SOCX spending data on ALMPs, displayed in Figure 7, need once again to be considered with caution since its classification is restricted to measures which are 'targeted'. This excludes, for example, in-work benefits that are available to all employees whose earnings fall below a threshold (including the Earned Income Tax Credit in the United States), measures that target *all* members of a group at statistical risk, and wage subsidies for an indefinite period. Moreover, data for some of the countries, particularly the non-European ones, can suffer from the exclusion of programmes that should be included. So the coverage of ALMPs at subnational level may well be underestimated. Bearing this in mind, Figure 7 shows that spending on activation is highest in Denmark (a typical characteristic of Scandinavian welfare states), followed by Germany, Belgium (both continental welfare states, with spending levels that are generally between those of Scandinavian and Anglo-Saxon welfare states) and Austria (a hybrid of the Scandinavian and the continental type of welfare states), and that it is lowest in the US, Canada and Australia (Anglo-Saxon welfare states). In other words, we obtain a picture broadly similar to that of UI spending (see Figure 5).

It is likely that the differences in generosity and eligibility – and therefore differences in the budgetary impact – are also reflected in different redistribution patterns within the countries examined. It is important to note here that the type of redistribution we discuss in this paragraph is of a different kind to what is reflected in row 5 of the analytical grid. This (and the next) paragraph concerns interpersonal redistribution, while row 5 of the analytical grid relates to redistribution among geographical units. These two types of redistribution are related but not the same. The standard approach to measuring interpersonal redistribution used by the OECD covers gross income (market income combined with public and private transfers) and cash disposable income (gross income minus personal income tax and social contributions) (OECD, 2008, pp. 98-99).<sup>12</sup> While this approach has some limitations (OECD, 2008, pp. 117-118), its major limitation for our study is that it does not allow disaggregation of income data – specifically income from benefits – to the level of unemployment related benefits (i.e. unemployment insurance, unemployment assistance and unemployment related social assistance).

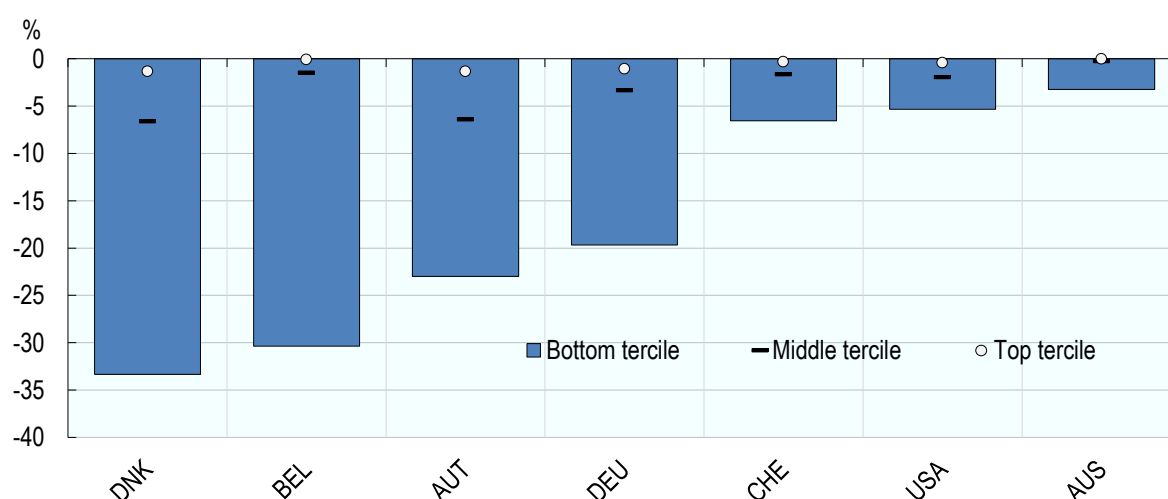
However, the OECD (2015) estimates the impact of UI on earnings volatility (Figure 8) and inequality (Figure 9). The impact of unemployment insurance is identified by focusing on the proportional differences in earnings volatility (or inequality) in the actual situation – when the unemployed receive unemployment benefits, if eligible – and a counterfactual setting in the absence of insurance (zero benefits). The earnings volatility analysis is carried out separately for three population subgroups, on the basis of (long-term) earnings terciles. The data are based on simulations over ten years for continuously active persons. The analysis should be interpreted with some caution, since it does not take into account the impact of other benefits, such as SA, or tax

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<sup>12</sup> The approach starts with factor income (income from wages, salaries, self-employment and property), market income (factor income combined with occupational and private pensions). Furthermore, disposable cash income is then often adjusted to reflect differences in household needs through an equivalised scale, resulting in equivalised disposable income.

credits, and takes unemployment rates and wage structures as given (OECD, 2015, pp. 191-192). However, it highlights the important role UI actually plays across the countries. Three clusters can be identified in Figure 8: Belgium and Denmark, in which UI has a very strong effect on earnings volatility in the bottom tercile; Switzerland, Australia and the US, in which UI has only a marginal effect on all terciles; and Austria and Germany, which are in between these two clusters. However, Danish and Austrian UI (and to a lesser extent also German) also has a low but discernible effect on earnings volatility in the middle tercile. Figure 9 displays the impact on earnings inequality in the short and long terms.<sup>13</sup> Across the board, UI has a greater impact on earnings volatility than on earnings inequality (it is more an instrument for income smoothing than for income redistribution), but the differences between the countries in terms of inequality impact are sizable: the equalising effect is relatively important in Denmark and Belgium, very weak in Australia, the US and Switzerland, and somewhere in between in Germany and Austria.

*Figure 8. The proportional change in the coefficient of variation due to effective unemployment insurance by long-term tercile*

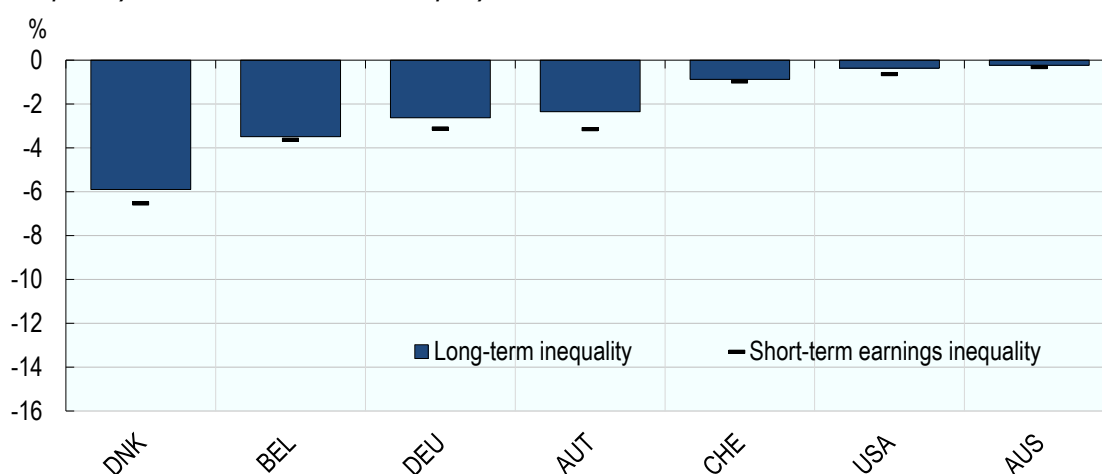


\* Based on simulations over ten years for continuously active persons. Simulations refer to individuals aged 15 to 54 in the reference year (20-54 for Denmark).

Source: OECD, 2015, p. 192.

<sup>13</sup> Long-term earnings inequality is the earnings inequality across individuals in terms of their average earnings over ten years; short-term inequality is the earnings inequality across individuals within years averaged over ten years.

Figure 9. The proportional change in the gini coefficient of short-term and long-term inequality due to effective unemployment insurance



\* Based on simulations over ten years for continuously active persons. Simulations refer to individuals aged 15 to 54 in the reference year (20-54 for Denmark).  
Source: OECD, 2015, p. 192.

With the important caveats mentioned in the previous paragraphs (most important, that this only concerns the effects of effective UI), such differences between the countries might shed some light on differences in concern for individual moral hazard, differences in the approach to activation and, by extension, differences in concern for institutional moral hazard. A large reduction of inequality, or in other words, a large redistributive effect of UI, equates to a large budgetary effort. For all cases examined here, with the partial exception of the US (only in times when UI is not extended by the federal government), UI benefits are centrally or federally funded. Also in all cases examined here, activation is decentralised or delegated to a lower level of government or government agency. For this reason, it is likely that the level of budgetary impact of benefits has some influence on activation strategies, but also – and more important – on the level of concern over whether these strategies are effectively and efficiently implemented.

## **6. IN MOST COUNTRIES, CONCERN FOR INSTITUTIONAL MORAL HAZARD IS A COROLLARY OF MULTI-TIERED UNEMPLOYMENT REGULATION**

Our survey cannot be summarised in a few straightforward conclusions. We study four interrelated policy domains (UI benefits, UI activation, SA benefits, SA activation).<sup>14</sup> In five of the eight cases, three levels of governments are involved in at least one of these policy domains (Austria, Belgium, Denmark, Germany, Switzerland, i.e. all the European cases).<sup>15</sup> Moreover, in many countries political authorities delegate the implementation of policies to (more or less) autonomous public institutions, notably PES; in two of the countries under examination, we considered it necessary to include this delegation process in our analysis. In order to grasp this complexity and to understand the essential conclusions for each of the cases, the reader should consult the country fiches in the appendix and/or the extensive case studies available as a separate appendix to the Consortium's report. This section summarily highlights some of the most relevant features of the multi-tiered regulation of unemployment in the countries which we studied. In section 7, a general conclusion is formulated, focusing on UI and the relevance of our results with regard to an eventual EUBS.

Given the limited generosity and the strictness of eligibility of American UI benefits (cf. Figures 8 and 9) and other factors documented in the US case study, one might think that, as a consequence, (residual) public concern for individual moral hazard and institutional moral hazard in UI is not important in the US. Or, as explained earlier, the US and the EU may exemplify, today, different *equilibria* in their public opinion: Europeans are probably less ready to reinsure their relatively generous national UI benefit systems at the EU level, compared to Americans, who accept a degree of federal reinsurance and co-insurance of relatively ungenerous UI benefit systems. However true that may be, such an assessment underrates the salience of moral hazard, both at the individual and the institutional level, in the American policy debate. Concerns about individual and institutional moral hazard were important drivers of US welfare reform in the 1990s, notably in the transition from AFDC to TANF. Welfare reform put SA activation much higher on the agenda, and open-ended funding of AFDC was replaced by block grants for TANF. In the domain of UI, the Federal Unemployment Tax Act (FUTA) implements a sophisticated balance between certain forms of interstate solidarity organised at the federal level and fiscal accountability for UI at the state level; hence, FUTA can be seen as a financial mechanism to prevent the institutional moral hazard that is a corollary of this solidarity. Moreover, American UI is not only limited in generosity and characterised by strict eligibility; in addition, 'experience rating' is applied to fight moral hazard with employers in their hiring and firing policies. There is also an overarching approach to 'workforce development' which aims to promote activation and training in all the states but with limited direct links with benefit schemes at the level of individuals. However, the system of workforce development has been subject to several reforms

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<sup>14</sup> Australia is an exception, since only one type of benefit is studied.

<sup>15</sup> In Canada, municipalities are involved in SA and activation regimes only in Ontario.

that all included changes in the accountability framework, which signals the importance of institutional moral hazard in this policy domain as well. All this makes the US case quite different from the other cases we examine, calling for a different understanding of the role of moral hazard in the US context. It may explain why institutional moral hazard does not seem high on today's political agenda, despite some important elements of interstate solidarity at the federal level. Simultaneously, the block grant system and 'workforce development' imply federal concerns with regard to the effectiveness and efficiency of state policies, for which specific solutions have been developed. Furthermore, when federal dollars are used directly for the financing of UI benefits, the federal government shows more concern for activation and enacts legislation that links benefits to job search requirements. In short, the American political culture creates a different constellation than the one we know in most EU countries, but concern for institutional moral hazard in the relationship between the federal administration and the states is far from absent.

Our examination of the German, Swiss and Austrian cases suggests that these countries share a policy problem but have chosen different solutions. The common feature was growing concern about the dichotomy between UI activation and SA activation, and about disparities between the SA activation record of the lower levels of government responsible for SA (the municipalities in Germany, the *Länder* in Austria and the cantons in Switzerland). However, the solutions chosen by these countries are different. In Germany, institutional reform was a logical corollary of the Hartz reforms. It was characterised by institutional integration and centralisation of unemployment regulation, with an important and forceful overarching steering role given to the federal BA (the German PES), both for UI activation (ALG I, since the Hartz reforms) and SA activation (ALG II, since the Hartz reforms). In Austria, the federal government opted for a harmonisation of UI activation and SA activation (i.e. a truly uniform approach to both caseloads) and a *de facto* harmonisation of the most important parameters of SA benefits across the *Länder*. However, Austria did not centralise SA activation in the German way. The AMS (the Austrian PES) took over the responsibility for SA activation, but PES offices were not merged with local welfare offices as in Germany. In the Austrian system, local offices have significant leeway in SA activation, but the local approaches are streamlined by standardised work processes and minimum requirements with regard to the SA activation and UI activation. In Switzerland, loopholes that allowed the shifting of caseloads from SA to UI have been closed for the most part, and institutional moral hazard at the level of the cantons (who are responsible for the both UI activation and SA activation) has been addressed, to some extent, through a system consisting of minimum requirements, performance measurement and a degressive funding formula which limits federal funding for cantons with high unemployment rates. This seems to have limited the salience of institutional moral hazard in the public debate, but mismatches between SA activation and UI activation persist in Switzerland.

Belgium and Canada, however different in size, history and political culture, display a similar architectural feature with regard to UI, which they also share with Switzerland (the Swiss case was already discussed to some extent in the previous paragraph but is revisited below). Both in Canada and Belgium, UI benefits are regulated and funded at the federal level, while UI activation is decentralised (to the provinces in Canada and

the regions in Belgium). SA benefits and activation are decentralised, to the provinces in Canada and the regions (at least since the Sixth State Reform) and municipalities in Belgium. However, there is a striking difference with regard to the salience of institutional moral hazard in UI in the Belgian and Canadian debates. Concern for institutional moral hazard in the domain of UI was very high on the agenda in Belgium and led to an important architectural and policy reform in 2004, based on a formal agreement between the federal level and the regions; this agreement boosted activation by the regional public employment services (PES) and made their approaches more uniform across the regions. The Belgian inter-institutional agreement can be interpreted as a negotiated system of 'minimum requirements', with detailed and rather constraining procedures with regard to the follow-up and activation of the UI caseload. It underscores the considerable complexity that such a multi-tiered system of regulation entails, which may be an important warning in the context of an eventual EUBS. Simultaneously, the Belgian constellation highlights the importance of the European guidelines on activation, which define a general yet important common framework for the regions and the federation.

In contrast to Belgium, in Canada, the Labour Market Development Agreement (LMDA) and a rather loose system of performance management leave the large degree of autonomy enjoyed by the provinces in the realm of activation largely intact. Moreover, the introduction of LMDAs has, to a certain extent, been the consequence of attempts by the Canadian federal government to appease the call for more autonomy by the Canadian provinces. Canadian UI is clearly less generous than Belgian UI in the case of longer-term unemployment, and, until now, the SA caseload has been rather marginal in Belgium vis-à-vis the unemployment caseload. This makes UI more important, in terms of caseload, in Belgium than in Canada.<sup>16</sup> Additionally, due to tightening of UI eligibility requirements by the Canadian federal government in the mid-1990s, the Canadian UI caseload has decreased starkly. This move can be seen as a cost shift by the federal government towards the provinces, who now serve increasingly larger SA caseloads. Moreover, Canadian provinces already had the responsibility over policy areas that overlapped with UI activation (such as education policies, SA and activation of SA). Failed constitutional reforms and a barely rejected Quebec independence referendum pressed home the message that provinces were keen to defend their competences against federal infringements. Devolution of UI activation was a way to bring activation services together at the provincial level, to ensure that those policies responded to local concerns and that any overlap was mitigated – but also to assert the political autonomy of the provinces. Together with the large discrepancy in the unemployment record of the three Belgian regions, these factors may explain why institutional moral hazard in UI is so much higher on the Belgian agenda than on the Canadian agenda. Belgium exemplifies a reform process which is, as yet, unsettled. The Sixth State Reform grants even more autonomy to the regions with regard to activation and places trust in the overall financing system of the

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<sup>16</sup> This situation is gradually changing, with increasing numbers of people living on SA in Belgium. The Canadian SA and UI caseloads have been decreasing in absolute terms, but the UI caseload has dwindled the most, to almost half the size of the SA caseload in relative terms.

federation and the regions, rather than in a specific unemployment- or employment-related mechanism that would reward the regions for successful activation policies. Simultaneously, the federal and regional governments recently agreed on a rather detailed 'normative framework' with regard to the monitoring (and, possibly, sanctioning) of unemployed individuals, which creates a permanent system of 'minimum requirements' with respect to regional policies that will be embedded in federal legislation. How all this will work out remains uncharted territory, as explained in the country fiche on Belgium.

Because of the interactions between SA and UI, we linked our discussion of the Swiss case with our discussion of the German and Austrian cases. As explained earlier, with regard to UI, the Swiss, the Belgian and the Canadian cases display similar fundamental features: centralised budgetary responsibility for UI benefits, decentralisation for UI activation. Compared to Belgium, with its strong perception of institutional moral hazard in public policy debates, the Swiss constellation is different. First of all, the generosity of UI for longer-term unemployed individuals is much less; for long-term unemployed individuals, the Swiss system relies much more on SA than the Belgian system (cf. Figure 6). It is not happenstance that the Swiss perception of institutional moral hazard was focused on the interactions between SA and UI, notably on the 'dumping of caseloads', which is not an issue in Belgium (up until now). As explained earlier, specific reforms seem to have limited the salience of institutional moral hazard in this respect in the Swiss public debate. Secondly, the autonomy of the cantons is a strong factor in the Swiss political tradition and seems to play out differently than in Belgium. Reforms have harmonised UI activation somewhat, but the differences that remain are accepted as political choices made by the cantons, whilst interregional differences in unemployment regulation are very sensitive in Belgium. Despite the persistent dichotomy between UI and SA in Switzerland, there has been no federal action to harmonise SA regulation.<sup>17</sup> Instead, in Switzerland there has been much cooperation between institutions that are responsible for (among others) SA, disability and unemployment benefits. This cooperation was done on an equal basis, reflecting the respect that the autonomy of the cantons was afforded by the federal government. The Swiss debate over SA is illustrative for how strong the political autonomy of the cantons is embedded in the system and how this influences the political perception of and concern for institutional moral hazard.<sup>18</sup>

Denmark faces similar policy challenges as other countries do, since activation for both the UI and the SA caseload is a local responsibility, while the funding of benefits is a responsibility shared by the central and local level. However, the Danish case features original solutions. Problems of institutional moral hazard have been perceived (labelled as 'non-compliance') and addressed by the 'reimbursement model', which is

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<sup>17</sup> Instead, the cantons themselves have devised some common non-binding guidelines.

<sup>18</sup> In a sense, this is comparable to the autonomy of municipalities in Belgium, which is deeply entrenched in the political system; differences in SA activation, for which Belgian municipalities are responsible, have (up until now) rarely been perceived as problems of institutional moral hazard. The autonomy of the Belgian regions is also deeply entrenched, but interregional differences in UI activation have been a hot issue.

a combination of minimum requirements, detailed monitoring of local activation efforts and financial incentives. The Danish system is designed to enforce local compliance, which underscores the perception of institutional moral hazard as a problem. Through the reimbursement model, municipalities are required to finance a part of the benefit and activation costs, the level of which depends on several factors, such as compliance with the minimum requirements or the types of services delivered. This combination makes the Danish system complex and requires a substantial administrative effort. Central regulation and administrative overload are perceived as reducing the effectiveness and efficiency of local policies, because local flexibility is too limited. The difficult balancing act between central control to prevent institutional moral hazard and local flexibility explains a succession of reforms. Currently, a new reform is underway, where, to strike a new balance, the Danish pendulum will probably swing towards more local flexibility, along with a larger local fiscal contribution.

Australia is an outlier in our eight cases. It has only one major unemployment-related benefit, the NSA, already referred to in section 4. NSA is centrally regulated and financed, and the implementation of activation policies is privatised. Policy experimentation with full privatisation in the late 1990s and early 2000s generated incentives for private agencies to 'park' their hard-to-place clients. To counter these incentives, the government implemented an increasingly strict system of minimum requirements and financial incentives. Hence, to fight principal-agent problems in the relationship between the federal government and the private agencies, Australia moved from a 'black box' model towards more and more federal oversight and control. The Australian experience suggests a trade-off between the need for control on one hand, and the need for flexibility in activation processes on the other hand. In this respect, there is a certain resemblance between the Danish and the Australian experiences.

## 7. CONCLUSION

As already indicated, our survey cannot be summarised in a few straightforward conclusions. Since the various EUBS proposals examined by the Consortium concern UI, our general conclusion focuses on lessons to be learned with regard to UI. This general conclusion can be summarised as follows. The relationship between central governments that fund UI benefits (or intervene in their funding in specific circumstances, as in the US) and lower levels of government that have an impact on the unemployment caseload (notably, but not only, due the fact that they are responsible for UI and SA activation) is seldom described in terms of 'insurance', 'co-insurance' or 'reinsurance'<sup>19</sup> and 'institutional moral hazard', as we coin it in this paper. Whatever the terminology that is used in the public debate in the countries under review, it seems that concern for institutional moral hazard inevitably emerges in multi-tiered systems in which a central government can be seen as 'insuring' or 're-insuring', completely or partially, the risk of unemployment for lower levels of government. Fundamentally, the salience of moral hazard in the public policy debate seems to depend on the generosity (in a broad sense, i.e. including the strictness of the eligibility criteria) of the underlying insurance policies, at the level of the individuals as well as between the levels of governments involved, and on the readiness to organise 'federal solidarity' in the national public culture. With regard to these underlying factors of generosity, solidarity and tolerance for individual and institutional moral hazard, different equilibria seem to exist in different countries.

Insofar as institutional moral hazard is an explicit public policy issue (whatever the label used to describe it in the public debate), different solutions are visible in different countries. In most of our studied cases, either centralisation, minimum requirements, conditional funding and/or more or less sophisticated financial incentives are applied to enhance the activation efforts of lower levels of government; in some countries, solutions are, at least in part, congenial to New Public Management. Also, most of the countries under examination launched important reforms over the last 20 years, motivated partly by institutional moral hazard. In some countries, the policy architecture still changes frequently, which underscores the difficulty of striking a balance between conflicting normative perspectives and interests.

What lessons can be learned from our survey for an eventual EUBS?

**1.** First of all, we should be clear about the analogy we want to draw. In order to understand the potential for institutional moral hazard in the context of an EUBS, it is analytically interesting to equate the role of the EU to the role played by the federal or central levels of government in national multi-tiered systems where the central level bears (part of) the budgetary burden of UI benefits, and to equate the role of the EU Member States to the role played by the regions, provinces or *Länder* in those systems. Such an analogy should not overlook the fact that the features of the country cases under review are quite different from the EUBS proposals studied by the

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<sup>19</sup> Throughout this paper we use the expression 'reinsurance' in a generic sense. In the other papers delivered by the Consortium, 'reinsurance' denotes a specific variant of the EUBS.

Consortium. With regard to UI benefits, there is no country case with an 'equivalent system', as defined in the Consortium's research project, i.e. a system in which an EU fund would not directly target individual citizens but transfer money to the Member States. (We decided not to describe the American system of Extended Benefits and Emergency Benefits as an instance of an 'equivalent' system; we consider only the American 'loan system' for regular UI as a true example of an equivalent system, but the latter functions on a temporary basis; cf. the country fiche on the US). In other words, we can learn a lot on the basis of such an analogy, but we should be careful when extrapolating our conclusions to specific multi-tiered systems that do not exist in the countries we study.

Next to this caveat, two further remarks need to be made with regard to the notion of institutional moral hazard as we developed it in our country case studies.

First, the relevance of an analogy between problems perceived in existing multi-tiered systems of unemployment regulation and the potential problems in the context of a hypothetical EUBS might be questioned for the following reason: the EUBS proposals under review exclude interventions in long-term unemployment (the EU benefits would be granted for a maximum of 12 months). Since the quality of activation policies may have a more significant impact on long-term unemployment than on short-term unemployment, institutional moral hazard may be more of a concern when long-term unemployment is reinsured or co-insured than in the case of short-term unemployment. In some of our case studies, we have indicated that low levels of generosity of *long-term* UI benefits may reduce concern for institutional moral hazard with regard to UI (US, Canada, Switzerland); this boils down to the same reasoning. However, for different reasons, we do not believe that this argument undermines the relevance of our case studies. In the US, the extension of benefits beyond 26 weeks (the duration of most regular state benefits) is accompanied by specific activation requirements, which suggests concern for institutional moral hazard that is not limited to the long-term unemployed. In Belgium, the minimum requirements stipulated in the *Cooperation Agreement* of 2004 focused as much on the activation of the short-term unemployed as on the activation of the long-term unemployed. More generally, if the scope of the analysis is extended beyond activation policies *sensu stricto*, poor economic policies which cause short-term unemployment may be as much a matter of concern for institutional moral hazard as poor activation policies.

The second remark is, in a sense, more fundamental. The Consortium's research project on the feasibility of an EUBS proposes specific financial mechanisms to eliminate the possibility for any country to be, on average, a net beneficiary of the scheme (see Task 1C for a more precise definition of this feature and its implementation in different EUBS variants). If such financial mechanisms are effective, they exclude permanent redistribution across Member States, and they provide an efficient remedy to institutional moral hazard in a broad but specific understanding of that concept, i.e. an understanding in which *any* redistribution across Member States is seen as the result of institutional moral hazard on one hand, and institutional moral hazard always leads to redistribution across Member States (in yet other words, 'no institutional moral hazard' and 'no redistribution' are interchangeable notions). Below, we will explain that the concept of institutional moral hazard that is relevant in the

countries which we examined is different from such an understanding, because those countries do not *a priori* exclude redistribution across their federated entities via UI (see point 4 and point 6 below).

**2.** An EUBS would interfere with very complex multi-tiered systems in European Member States, always characterised by interdependence between UI benefits, UI activation, SA benefits and SA activation policies, often by the involvement of three levels of governments, and in some cases by important managerial delegation processes. The sheer complexity of this architecture, which adds to the complexity of UI benefit schemes *as such* (examined in Task 2B of the Consortium's research project), constitutes an important challenge with regard to the idea of an EUBS, which has to be addressed.

**3.** Moral hazard in UI systems must be weighed against their stabilisation (and redistributive) capacities. The same holds for institutional moral hazard, associated with certain multi-tiered systems: if the stabilisation capacity of systems is enhanced by risk pooling at a higher level, but part of the unemployment regulation remains at the lower level (for instance with regard to activation), this division of labour inevitably implies institutional moral hazard. In other words, institutional moral hazard is 'a price to pay' to obtain better risk pooling and stabilisation.

If institutional moral hazard is a price to pay, the objective is to mitigate the trade-off between stabilisation capacity and institutional moral hazard; in other words, for desirable levels of (enhanced) stabilisation capacity, institutional moral should be minimised.

**4.** In *all* the countries under review, UI leads to a redistribution across the federated entities constituting the nation. In order to assess the extent of redistribution, one would need a detailed analysis, with regard to both the interpersonal redistributive capacity of UI and the regional and/or local incidence of unemployment. Data and time limitations did not allow for such an analysis in this study. On the basis of the data we have, it seems fair to say that this redistributive aspect is least important in the US case, whilst it is very important in the Belgian case; but there is no country in which redistribution across states, regions, provinces or local municipalities via a federal or central UI benefit system is excluded *a priori*.

**5.** In our country case studies, we see institutional moral hazard with regard to UI benefits predominantly in relation to (i) poor activation policies and (ii) the shifting of SA caseload to UI caseload; obviously, poor economic, industrial and education policies that generate low employment rates are also a matter of concern in this context. Next to these mechanisms, institutional moral hazard in a 'genuine EUBS' may take yet another form, given the specific design of some of the proposals under examination in the Consortium's research project (notably the 'top-up' proposal): EU Member States might reduce their effort with regard to UI benefits, by decreasing their generosity or coverage, at the expense of the EU.

**6.** It seems that *minimum requirements, with regard to both the quality of Member States' UI and SA activation and the quality of Member States' UI benefit systems*, would be the best strategy to fight these different forms of institutional moral hazard

arising in the context of an EUBS, next to financial mechanisms that eliminate the possibility for any country to be, on average, a net beneficiary of the scheme. First, *any* sustainable system of EUBS presupposes minimum requirements with regard to the *quality of activation*. Secondly, *some* variants of the EUBS proposal require, in addition, minimum requirements with regard to *the generosity and coverage* (i.e. the strictness of eligibility) *of UI benefits*. The latter statement should be understood well: minimum requirements with regard to the quality of the national UI benefit system may be desirable in any EUBS scheme, as a political *quid pro quo* and in order to improve the stabilisation capacity of national UI benefit systems; that is, the organisation of an EUBS may be a lever to demand improvements in national UI benefit systems, to boost their stabilisation potential. However, from the vantage point of institutional moral hazard, *sensu stricto*, the *need* for minimum requirements with regard to the benefit systems seems to be strongest in the 'genuine EUBS', and notably in the 'top-up' variant.<sup>20</sup>

Other strategies against institutional moral hazard applied within nation states (centralisation of benefit systems and/or activation policies, financial incentives built into reimbursement models) seem either too complex or to go too much against the grain of sound EU subsidiarity principles. Financial mechanisms that allow some redistribution (for instance, because they want to take into account adverse historic circumstances with which certain regions have to cope), but nevertheless aim to prevent institutional moral hazard, are inevitably complex. They are complex because they must seek to disentangle 'adverse circumstances' and 'poor quality of policies' at lower levels of government. Hence, they are much more complex than financial mechanisms that simply aim to eliminate redistribution, whatever the root causes.

In terms of governance, minimum requirements can also be administratively complex, and some of the cases in our survey suggest the existence of a trade-off between the rigidity of minimum requirements and/or control systems imposed by the central level and the necessary flexibility for effective policies at the decentralised level.

*European minimum requirements* would impose convergence in unemployment regulation across EU Member States. Pursuing convergence in social policies is a well-known challenge in the EU, certainly with regard to activation: the European Employment Strategy (EES) and, more generally, the Open Method of Coordination (OMC) have been testing grounds with regard to the potential of so-called 'soft law' in this domain. Much literature exists on the results of the EES and the OMC, showing mixed results. An *effective* soft convergence process with regard to the quality of activation (the Youth Guarantee might be an example) and with regard to the quality of unemployment benefits (not existing today but mentioned, in very generic terms, in the Five Presidents' Report on the future of EMU)<sup>21</sup> might be seen as a first step towards the establishment of such minimum requirements.

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<sup>20</sup> Cf. section 1 for the discussion on the different contexts and policy goals of minimum requirements.

<sup>21</sup> *Completing Europe's Economic and Monetary Union*, Report by J.-Cl. Juncker, in close cooperation with D. Tusk, J. Dijsselbloem, M. Draghi & M. Schultz, June 2015.

**7.** We should distinguish moral hazard as an objective reality, i.e. an empirical observation with regard to the possibility for the insured to influence the liability of the insurer in a context of asymmetric information, from the public *perception* that moral hazard is present, and from public *concern* for moral hazard: these are three different things. It may be the case that there is more concern for moral hazard than reality warrants, and vice versa. In this respect, both a gap between perception and reality, and different degrees of public sensitivity with regard to the trade-off between moral hazard (as perceived) and the social and economic objectives of collective insurance (social cohesion, economic stabilisation) can play a role. We study a domain where opinions on matters of social justice, *a priori* beliefs about human behaviour and the choice of economic paradigm are very important. Apart from the fact that the trade-off between moral hazard and cohesion and stabilisation constitutes a normative problem *par excellence*, there is less hard empirical science in this domain than one might wish, *a fortiori* when the issue at hand is not only individual behaviour but the interaction of collective actors and political authorities, as is the case with *institutional* moral hazard. This is not to say that 'perception' and 'concern' are unimportant; they are as much facts of political life and policymaking as is the objective architecture of an insurance policy. But an exaggerated perception of moral hazard can result in policies that are suboptimal and difficult to change.

In other words, political culture (and its path dependency) is crucial. The US and the EU may today exemplify different *equilibria* in their public opinion: Europeans are probably less ready to reinsure their relatively generous national unemployment benefit systems at the EU level, compared to Americans, who accept a degree of federal reinsurance of relatively ungenerous state unemployment benefit systems.

This means that the idea of an eventual EUBS cannot be dissociated from the broader challenge to enhance mutual trust among EU Member States in the overall quality of their national social fabric (Vandenbroucke, 2015).

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## **APPENDIX: COUNTRY FICHES**

**Australia**

**Austria**

**Belgium**

**Canada**

**Denmark**

**Germany**

**Switzerland**

**US**

**We first present the analytical grid; then in one or two paragraphs, *in italics*, we summarise the case, focusing on what makes it distinctive. Next follows a short explanation. An extensive analysis of each case is provided in a separate annex to the Consortium's report.**

## Country fiche Australia

### List of Abbreviations

BMA – Bilateral Management Agreement  
 CES – Commonwealth Employment Service  
 DE – Department of Employment  
 DHS – Department of Human Services  
 JSA – Job Services Australia  
 KPI – Key Performance Indicators  
 KPM – Key Performance Measures  
 NSA – Newstart Allowance  
 JS – Job Search Allowance  
 SA – Social Assistance  
 UI – Unemployment Insurance

*Table 2. Analytical grid Australia. Source: Own compilation.*

		Unemployment benefits (NSA)	Activation of individuals with unemployment benefits (NSA)
<b>1</b>	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. design of the policy: <ul style="list-style-type: none"> <li>- Formal regulation</li> <li>- Policy goals</li> </ul>	No decentralisation  The federal level (DE) regulates and sets goals.	No decentralisation  The federal level (DE) regulates and sets goals.
<b>2</b>	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. implementation of the policy	Very limited delegation to Centrelink; no decentralisation  Implementation is done by Centrelink, which is part of the federal DHS. The DE and the DHS enter into bilateral agreements, which include the job description of Centrelink.	Very limited delegation to Centrelink; low degree of decentralisation through privatisation  Activation services are delivered by private agencies. These private agencies sign contracts with the DE and receive their assignments from Centrelink.  The contracts with the DE include a Code of Practice and Communication Protocols. The federal government has legislated detailed standardised work processes (a 'service continuum'), a classification tool and a performance management system.
<b>3</b>	Budgetary responsibility	Federal  Benefits are financed out of general government revenue.	Federal  Activation is financed out of general government revenue. Payments to the private service providers are based on outcomes they achieved.
<b>4</b>	Budgetary transfers between levels of government?	n.a.  The system is completely financed at the federal level.	n.a.  The system is completely financed at the federal level.
<b>5</b>	Structural redistribution? (measured on a per capita basis)	Yes  Caseload size varies structurally across states.	Yes  Caseload size varies structurally across states.
<b>6</b>	Political or managerial decentralisation/delegation?	Delegation to Centrelink	Delegation to Centrelink, managerial decentralisation through private agencies

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7	Indicators used in the monitoring of lower-level performance by higher level (on the basis of: input, output and outcome)?	The BMA between the DE and the DHS/Centrelink includes input and output indicators.	Private agencies are subject to the 'Star Rating' performance review. This system includes mostly outcome-based indicators.  For the DE-DHS relationship, there are input- and output-based KPM and five desired outcome indicators. The DE itself monitors ten outcome-based KPI.
8	Is a system of 'minimum requirements' applied?	No,  The BMA governs the interaction between the DE and the DHS/Centrelink, but this is a bilateral agreement between two federal actors.	Yes,  An elaborate service continuum details the actions that must be taken at initial contact as well as at six other intervals for three so-called 'streams'. Clients are to be classified by the agencies according to federal classification tools. This classification determines in which stream a client belongs. Within these streams, there are different services to be provided for clients under 30. Furthermore, a federal Code of Conduct and a Communication Protocol constitute additional minimum requirements.
9	Are performance-based sanctions/rewards applied by the higher level at the lower level?	No	For private agencies: yes, reduction of the amount of fees when clients require more time to be activated. Furthermore, poor performance affects 'Star Rating' and therefore affects the possibility to attract clients and gain new contracts.  For the DE-DHS relationship: no
10	Conclusion from 5-6-7: perception of, concern for, and approach to problems of institutional moral hazard?	n.a.	
11	Conclusion from 5-6-7: approach to principal-agent issues?	Yes, principal-agent issues exist w.r.t. activation and are recognised as such.  There has been extensive experimentation with policies to control principal-agent issues ever since activation was privatised. Principal-agent issues with private agencies are addressed through a detailed 'service continuum', through payments which are contingent on outcome-based indicators, through the introduction of a single IT-system, through mandatory individual action plans for clients and through the 'Star Rating' performance management system. Principal-agent issues between the DE and the DHS/Centrelink are addressed through the BMAs and the included performance measurement.	
12	Contribution to macroeconomic stabilisation by the benefit system	The Australian case is not available in Dolls, Fuest & Peichl, 2012a.	

*The Australian system is characterised by the privatisation of the activation of the only major unemployment-related benefit – Newstart Allowance (NSA). The Australian regulation of unemployment includes four prominent actors: the Department of Employment (DE), the Department of Human Services (DHS), a federal PES called*

*Centrelink (which is currently officially part of the DHS) and private agencies for activation. The Australian experience has been marked by persistent efforts to tackle principal-agent issues. Essentially, the Australian government moved from a 'black box' approach to more and more prescription, monitoring and control. The Australian experience suggests a trade-off between the need for control on one hand, and the need for flexibility in activation processes on the other hand.*

The federal level is responsible for legislating and financing NSA and activation. However, within the federal government responsibilities are divided between the DE and DHS/Centrelink. The DE regulates the labour market and benefits and also sets policy goals – most prominently with regard to the NSA. The NSA is the only major unemployment-related benefit and therefore acts as the benefit of last resort.<sup>22</sup> Centrelink is responsible for the administration of benefits and, furthermore, for communicating with the private agencies that deliver activation services. Despite this responsibility of Centrelink, the private agencies enter into formal contracts with the DE. In other words, the DE has delegated the supervision of agencies to Centrelink but retains the responsibility for granting contracts and fees to those same agencies.

Faltering employment performance in the mid-1980s and 1990s increased the importance of activation policies. In the mid-1990s, the Australian government first started experimenting with privatisation of activation. For-profit and community service providers were used as competition for the federal PES (then called Commonwealth Employment Services or CES). Subsequent reforms (in the 1990s) replaced CES with Centrelink, which was then still an independent at-arm's-length agency (later, it was incorporated into the DHS, cf. infra). Centrelink had fewer responsibilities than CES (the responsibilities of CES were mostly administrative but it also provided some basic services) and more prominence was given to the private agencies. Full privatisation was implemented in 1998, when the federal government introduced Job Network, a system in which almost 300 private agencies would have broad flexibility to implement services.

The private agencies were contracted through tendering processes based on three levels of service intensity. The first of these tendering rounds did not yet include many minimum requirements or much supervision; the private agencies were relatively free to adopt their own strategies. Agencies were paid through commencement fees and outcome-based payments which were differentiated per service intensity level. Subsequent tendering rounds included increasingly strict minimum requirements, stricter use of a federal classification tool and more conditionality tied to payments. In short, the Australian government started to move from a 'black box' approach towards a prescribed continuum of services under which providers were paid to undertake regular interviews with each jobseeker. Included in these reforms was the expansion of the 'Star Rating' performance management system. This system measured the

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<sup>22</sup> The NSA is subject to both an income test and an asset test; cf. the information provided by the DHS website ([www.humanservices.gov.au/customer/services/centrelink/newstart-allowance](http://www.humanservices.gov.au/customer/services/centrelink/newstart-allowance)); see also Davidson & Whiteford, 2011, pp. 13-14 for an academic source.

performance of agencies based on outcome indicators. These agencies' rating determined their eligibility for a new contract with the DE.

The aforementioned reforms were a reaction to the concern that private agencies were 'parking' (e.g. placing clients in programmes that had little substance) hard-to-place clients. The incentive to do so stemmed from the funding method and the lack of minimum requirements. The private agencies were enticed to take in harder-to-place clients with commencement fees. Agencies focused on attaining the outcome-based payments for easier-to-place clients and were satisfied with just the commencement fees for the higher intensity levels. Another major overhaul followed these reforms in 2007: the introduction of Job Services Australia. This network combined several labour market programmes. It also addressed continued concern for parking of clients, by making the agencies responsible for a jobseeker for the full duration of benefit dependency as well as by removing the option to specialise in certain intensity levels. Furthermore, an even more complicated and stricter service continuum introduced a mandatory individual Employment Pathway Plan. The mandatory use of a single IT system for all service providers further limited the private agencies. This IT system simplified, but also standardised, the federal monitoring of and communication with the private agencies.

The relationship between the federal level and the private agencies is characterised by a persistent concern for principal-agent problems and a trade-off between addressing these problems by more federal control on one hand, and flexibility and efficient activation on the other hand.

The relationship between the DE and Centrelink is also characterised by principal-agent issues, although in a different way. As a successor to CES, Centrelink has considerably fewer responsibilities than CES. The relationship was governed by a partnership agreement. In 2011, Centrelink was incorporated into the DHS – this entailed the DHS becoming formally responsible for the administration of benefits, even though Centrelink still performs these duties. The DE and the DHS/Centrelink enter into Bilateral Management Agreements (BMAs). These agreements outline possible risks concerning their cooperation and includes mutually agreed upon Key Performance Measures (KPMs). Furthermore, the DE monitors its own set of Key Performance Indicators (KPIs), which also include the effectiveness and timeliness of administration and disbursement. These KPIs and KPMs do not align. Nonetheless, the BMAs are an attempt to address principal-agent issues that arise from the delegation of responsibilities by the DE to DHS/Centrelink.

## Country fiche Austria

### List of Abbreviations

AMS – *Arbeitsmarktservice Österreich* (federal PES)  
AIVG – *Arbeitslosenversicherungsgesetz* (Unemployment Insurance Act)  
BMS – *Bedarfsorientierte Mindestsicherung* (Social Assistance)  
PES – Public Employment Services  
SA – Social Assistance  
UA – Unemployment Assistance  
UI – Unemployment Insurance

Table 3. Analytical grid Austria

		Unemployment benefits and employment assistance (AIVG)	Activation of individuals with unemployment benefits and employment assistance	Unemployment- related SA (BMS)	Activation of individuals with SA benefits
1	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. design of the policy: <ul style="list-style-type: none"><li>- Formal regulation</li><li>- Policy goals</li></ul>	No decentralisation	Delegation to the AMS; low decentralisation  Formal regulation is completely federal.  Policy goals set by the federal ministry and internally transposed by the AMS (but social partners play a large role)	<i>De facto</i> low decentralisation  Federal level of government has laid down requirements and policy goals (through an agreement with the <i>Länder</i> ).	Delegation to the AMS; low decentralisation  Formal regulation is completely federal.  Policy goals set by the federal ministry and internally transposed by the AMS (but social partners play a large role)
2	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. implementation of the policy	No decentralisation  The AMS implements and administers the disbursement of benefits but has no policy autonomy (hence, no delegation).	Delegated to the AMS; medium decentralisation  The federal government has created standardised work processes and minimum requirements, but local AMS offices have significant leeway.	Medium decentralisation  <i>Länder</i> are bound by minimum requirements but are still solely responsible for implementation.	Delegation to the AMS; medium decentralisation  The federal government has created standardised work processes and minimum requirements, but local AMS offices have significant leeway.
3	Budgetary responsibility	Federal  Funded by employer- employee contribution	Federal  Funded by employer- employee contribution	<i>Länder</i> and municipalities  <i>Länder</i> are the primary responsible actors; in practice, the municipalities often contribute	Federal  Funded by employer- employee contribution

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				50% of the costs.	
4	Budgetary transfers between levels of government?	n.a.	n.a.	n.a. w.r.t. the <i>Länder</i> -federal relationship, but the <i>Länder</i> can request financial contributions from the municipalities towards the cost of SA.	n.a.
5	Structural redistribution? (measured on a per capita basis)	Yes  Unemployment rates of the <i>Länder</i> differ structurally.	Yes  Unemployment rates of the <i>Länder</i> differ structurally.	n.a.	Yes  Unemployment rates of the <i>Länder</i> differ structurally.
6	Political or managerial decentralisation/delegation?	n.a.	Delegation, with managerial decentralisation to the AMS  The AMS is an agent of the federal level.	Political	Delegation, with managerial decentralisation to the AMS  The AMS is an agent of the federal level.
7	Indicators used in the monitoring of lower-level performance by higher level (on the basis of: input, output and outcome)?	n.a.	Two sets of performance indicators  Balanced scorecard: input, output and quality measures  Annual objectives: outcome and quality measures	None	Two sets of performance indicators  Balanced scorecard: input, output and quality measures  Annual objectives: outcome and quality measures
8	Is a system of 'minimum requirements' applied?	n.a.  The legislation concerning UI and the implementation thereof is tightly regulated at the federal level.	Yes  Fixed time limit for first job offer (extra rules for young clients); job centres must engage in a personal action plan with their clients; standardised work practices concerning differentiation in intensity levels for different types of clients	Yes  The agreement between the <i>Länder</i> and the federal level stipulates a minimum subsistence level, mandatory top-ups and in-kind benefits, mandatory activation by the AMS and means and asset tests.	Yes  Fixed time limit for first job offer (extra rules for young clients); job centres must engage in a personal action plan with their clients; standardised work practices concerning differentiation in intensity levels for different types of clients
9	Are performance-based sanctions/rewards applied by the higher level at the lower level?	n.a.	Yes  Shadow of hierarchy: in the case of bad performance, first a self-evaluation and otherwise directions from a higher AMS level will follow.	n.a.	Yes  Shadow of hierarchy: in the case of bad performance, first a self-evaluation and otherwise directions from a higher AMS level will follow.

10	Conclusion from 5-6-7: perception of, concern for, and approach to problems of institutional moral hazard?	n.a.  There is no political decentralisation. Hence, there is no institutional moral hazard.	The responses in the past have eliminated most opportunities for institutional moral hazard: the AMS implements activation, and loopholes for dumping have been closed off.
11	Conclusion from 5-6-7: approach to principal-agent issues?	Yes  The principal-agent issues relating to the AMS's responsibility for activation are recognised and addressed by two systems of performance measurement and a strong role for the social partners in the governance of the AMS (who act as a check on possibly perverse incentives in the AMS).	Yes  W.r.t. the AMS: cf. row 11 in the columns on UI
12	Contribution to macroeconomic stabilisation by the benefit system	The Austrian case is not available in Dolls, Fuest & Peichl, 2012a.	

Source: Own compilation.

*The three most important actors in the Austrian regulation of unemployment are the federal (but semi-autonomous) PES (Arbeitsmarktservice Österreich or AMS), the federal government itself and the regions (Länder). Austria is interesting because it faces similar problems as Germany and Switzerland but chose a different response. Confronted by a dichotomy between SA activation and UI activation and disparities between the employment performance of the Länder, the Austrian federal government opted for a harmonisation of UI activation and SA activation and a (de facto) harmonisation of SA benefits but did not centralise SA as Germany did. Austria is characterised by a uniform activation regime for SA and UI, even though the benefits are (in part) regulated and financed by different levels of government. The Länder remain responsible for SA but with considerably less flexibility than before.*

The Austrian federal government is responsible for the legislation on UI and UA, the collection of the social contributions that finance these benefit schemes and activation thereof. The AMS is a semi-autonomous federal institution with its headquarters in Vienna, nine regional offices in the Länder and 99 local offices. The AMS administers and disburses the benefits and is responsible for both UI activation and SA activation.<sup>23</sup> The AMS itself is also financed by social contributions. The Länder are responsible for the legislation and financing of SA. However, in 2010 the federal government made an agreement with the Länder concerning minimum requirements for SA benefits. The Länder adopted this agreement in their legislation and can expand or supplement the minimum requirements as they see fit. Often, the Länder request the municipalities to contribute half of the SA costs. In Austria, the relevance of SA is relatively limited because UA is (potentially) a benefit scheme of unlimited duration. Unemployed persons who exhaust UI can try to claim UA, which limits the interaction between UI and SA due to UI-exhaustion.

Nonetheless, as in Germany and Switzerland, rising unemployment and SA caseloads (starting in the 1990s) increased the (political) salience of internal disparities. During

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<sup>23</sup> In practice, many of the services for the caseloads are provided by private agencies.

the two previous decades, there was a growing disparity between the activation of UI/UA and SA and there were disparities between the employment performance and the activation efforts of the Länder. The AMS was reformed in 1994 from a federal ministerial department to its current semi-autonomous form. In principle, it served both the UI/UA and the SA caseload. However, the Länder were still officially responsible for activation of SA. Through territorial pacts with the federal government (and the AMS), the Länder could refer their caseloads to the AMS job centres or arrange activation themselves through local social welfare offices. The option to refer SA clients to the AMS was neither standardised nor systematically implemented.

The Länder were not just responsible for SA activation, but also for regulating and financing SA benefits. This generated regional differences in the setup of SA. Combined with the differences in activation and the unsystematic referral of clients to the AMS, regionally heterogeneous unemployment rates created large differences between the Länder. These were addressed by the 2010 agreement on a nationwide means-tested minimum income security between the federal government and the Länder. The agreement laid down minimum requirements for SA which the regions then had to adopt in their legislation but could also expand upon and supplement. In practice, however, the agreement had a centralising and harmonising effect. Furthermore, it standardised the referral process for SA clients to the AMS. Contrary to what happened in Germany, the PES offices were not merged with local social welfare offices. The AMS took over responsibility for SA activation completely and the SA caseload was granted the same rights and treatment as the UI caseload. Through this complete harmonisation of activation, the agreement also closed off any possible routes for the dumping of SA caseloads on UI through programmes that renew UI eligibility. The local welfare offices remain responsible for assessing the work capacity of SA claimants. The Länder and municipalities have the incentive to send as many able-bodied SA claimants to the AMS as possible since the federal level finances activation.

Therefore, there are no clear possibilities left for institutional moral hazard in the Austrian regulation of unemployment. What is left is the prominence of the AMS and its crucial role in activation. The relationship between the federal government and the AMS raises principal-agent issues. These have been addressed in three different ways. Firstly, the AMS board of directors is supervised by a legislative body that consists of both social partners (who are in the majority) and the government. Secondly, this legislative body sets out quantitative annual objectives for the AMS as a whole, which the board of directors translates into a 'balanced scorecard' for all the local and regional offices. Thus there are two different performance measurement systems: one concerning the performance of the AMS as a whole (the annual objectives) and one that includes the performance of the local and regional branches (balanced scorecard). Finally, the federal government has legislated a system of minimum requirements which determines standardised work processes and the timing of the first interview. The standardised work processes differentiate between three broad types of services in job centres, with varying intensity. The jobseekers are categorised according to their needs and assigned to the appropriate type. The AMS itself is responsible for the assessment of clients but some federal minimum requirements apply – such as the mandatory referral to the most intensive type for jobseekers who are unemployed for

over three months. The combination of a legislative body that supervises the AMS management, the regulation concerning standardised work processes, and the performance management systems in place limit the principal-agent problems.

The Austrian regulation of unemployment was confronted with similar issues as the German and Swiss cases: heterogeneity in the employment performance and activation efforts in its constituent units, disparities in the regulation of different caseloads, and possibilities for institutional moral hazard through the interaction of benefits provided by different levels of government. Contrary to Switzerland, Austria opted for more central control, but, contrary to Germany, it did not completely take over regulation of SA and it did not merge job centres with local social welfare offices. The result is a fully harmonised activation system, one that leaves the Länder with the responsibility for SA but with considerably less flexibility than before.

## Country fiche Belgium

### List of Abbreviations

OCMW – *Openbaar Centrum voor Maatschappelijk Welzijn* (municipal social centre, responsible for SA)

CPAS – *Centre Public d'Action Sociale* (idem)

PES – Public Employment Services

SA – Social Assistance

UI – Unemployment Insurance

*Table 4. Analytical grid Belgium*

		Unemployment benefits	Activation of individuals with unemployment benefits	Unemployment- related SA benefits	Activation of individuals with SA benefits
1	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. design of the policy:  - Formal regulation  - Policy goals	No decentralisation	Total decentralisation (since Sixth State Reform)  Before Sixth State Reform: regions, but constrained by Cooperation agreement with federal level w.r.t. process organisation; since Sixth State Reform: regions completely responsible (sanctioning is also completely regionalised, but on the basis of federal unemployment regulation and federal normative framework)	No decentralisation	No decentralisation, but policy goals are formulated in a very generic and non- binding way in the federal legislation
2	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. implementation of the policy	No decentralisation  Payment of benefits is done by payment bodies (one public fund and three auxiliary funds linked to national trade union federations), but they don't have policy autonomy w.r.t. UI benefits.	Total decentralisation (since Sixth State Reform)  Before Sixth State Reform: regions, but constrained by Cooperation agreement with federal level w.r.t. administrative process organisation; since Sixth State Reform: regions completely responsible	Total decentralisation  Benefits are administered by OCMW/CPAS.	Total decentralisation (since Sixth State Reform)
3	Budgetary responsibility	Federal level  Federal social security	Regional level (since Sixth State Reform)  Before Sixth State Reform: federal lump sum subsidy supports regional	Central and municipal level	Municipalities and (since Sixth State Reform) regional level  Before Sixth State Reform: federal level

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			budgets		supports municipal budgets with some extra funding for 'leefloners' who are activated
4	Budgetary transfers between levels of government?	n.a.	n.a. (since Sixth State Reform)  Before Sixth State Reform: federal lump sum subsidy supports regional budgets	Yes  Federal state reimburses part of SA benefit cost for municipalities	n.a. (since Sixth State Reform)  Before Sixth State Reform: federal level supports regional budgets with some extra funding for 'leefloners' who are activated
5	Structural redistribution? (measured on a per capita basis)	Yes  Important structural differences in caseloads	n.a.	Yes  Structural differences in caseloads, both across regions and across municipalities	n.a.
6	Political or managerial decentralisation/ delegation?	Political	Political  Regions	Political  Municipalities	Political  Regions/ municipalities
7	Indicators used in the monitoring of lower-level performance by higher level (on the basis of: input, output and outcome)?	n.a.	Before Sixth State Reform: compliance with Cooperation agreement is monitored, but no monitoring of regional performance	No	Before Sixth State Reform: monitoring by federal level on the basis of input steering, but inconsequential; since Sixth State Reform: whether or not there will be more steering and less policy discretion by the regions is as yet unclear.
8	Is a system of 'minimum requirements' applied?	n.a.	Since Sixth State Reform: a new system of minimum requirements has been negotiated and will be embedded in federal legislation	n.a.	n.a.
9	Are performance-based sanctions/ rewards applied by the higher level at the lower level?	n.a.	No	n.a.	No
10	Conclusion from 5-6-7: perception of, concern about, and approach to problems of institutional moral hazard?	Yes  Before Sixth State Reform: Cooperation agreements of 2004 and 2013 Since Sixth State Reform: it is unclear whether the new architecture (which gives more room for manoeuvre to regions w.r.t. activation but within a new system of minimum requirements) will be seen as creating more or less institutional moral hazard		Until now, no public debate on institutional moral hazard in this domain	
11	Conclusion from 5-6-7: approach to principal-agent	n.a. (principal-agent problems might be discussed in the context of the relationships between the regional governments and their PES, but we do not include these in the analysis of the Belgian case)			

	issues?	
12	Contribution to macroeconomic stabilisation by the benefit system	Important (Dolls, Fuest & Peichl, 2012a.)

Source: Own compilation.

*Since the 1980s, Belgium has featured a specific division of labour in UI: the federal government has been responsible for UI benefits while the regions have been responsible for the PES and UI activation; however, the regions have not been responsible for monitoring the search effort of unemployed individuals (job search is a condition to be eligible for UI benefits, laid down in the federal legislation). By the beginning of the 2000s, this division of labour came to be seen as a root cause of institutional moral hazard. Institutional moral hazard was tackled by a detailed Cooperation Agreement between the federal and the regional level with regard to activation policies in 2004, which can be seen as a negotiated system of 'minimum requirements'. From 2015 onwards, the Sixth State Reform pushes the existing logic of devolution even further, by giving the regions full competence in the domain of UI and SA activation, including notably the monitoring of search efforts. Simultaneously, federal and regional authorities agreed on a common 'normative framework' for monitoring the unemployed, to ensure that the principles of the federal UI are not undermined. This means that a new form of 'minimum requirements' will be introduced but on a different institutional basis.*

*Historically, SA (the so-called 'leefloon'/'revenue d'intégration sociale') plays a residual role in Belgium; in terms of budgets and caseload, compared to UI it is relatively marginal. The legislation with regard to SA benefits and the basic principles of SA activation is federal, but the implementation is completely devolved to the municipal level. The budgetary responsibility for SA benefits hinges on a 50/50 division between the federal government and municipalities, with some variation (depending, for instance, on their activation efforts, before the Sixth State Reform). The Sixth State Reform transfers the regulatory competence with regard to SA activation from the federal to the regional level.*

*In short, before the Sixth State Reform, concern for institutional moral hazard in UI became prominent, and was tackled by the intergovernmental negotiation of a detailed system of minimum requirements with regard to UI activation. The Sixth State Reform promises increased autonomy to the regions with regard to activation of both UI and SA, but UI activation is subject to a new system of minimum requirements. How this new constellation will work out is as yet unclear.*

With regard to activation, Belgium has been a laggard. The actual shift from passive labour market policies to active labour market policies occurred very late. A systematic approach to activation, conforming to the 1997 guidelines of the European Employment Strategy, was only implemented from 2004 onwards. Before 2004, there was no systematic 'preventative' attempt to activate new entrants into unemployment across all Belgian regions; and the 'curative' approach (activating the stock of long-term unemployed) was also very disparate. By that time, the existing federal/regional division of labour had created considerable political tensions with regard to the governance of the unemployment system.

The Employment Conference of September 2003 paved the way for a policy change. The basic principles were laid down in the Cooperation Agreement of 30 April 2004. The goal was to better coordinate the instruments of the regional authorities (counselling and training) with the responsibility of the federal authorities to control the labour market availability of unemployed benefit recipients. The rights and obligations of the unemployed had to be rebalanced. Regions would intensify their activation efforts and the federal level would provide a financial contribution to contribute to the development of activation services.

The Cooperation Agreement can be interpreted as a negotiated, detailed system of 'minimum requirements'. It resulted in a marked convergence, across the three regions, with regard to the way activation was organised. The Cooperation Agreement not only fuelled activation and training efforts in all regions, but also corrected a situation that was politically unsustainable, namely the interregional imbalance with regard to sanctions as it existed in the beginning of the 2000s. That regional imbalance may be seen as a signal of 'institutional moral hazard' which undermined the legitimacy of the system. The agreement and the mutual regional and federal commitments attached to it created a strong incentive for the regional PES to step up their activation effort, but it was also perceived as a rather rigid straitjacket for the PES, with insufficient leeway to accommodate interregional differences in the caseload. This inspired the call for more regional political autonomy in the realm of activation, which was taken on board in a new round of constitutional reform, the Sixth State Reform (discussed from 2010 onwards).

In 2013, a new Cooperation Agreement was negotiated, in the same vein as the 2004 Agreement. This 2013 Cooperation Agreement will be the last agreement of this type in Belgium; from 2015 onwards, the institutional architecture changes in the context of the Sixth State Reform. The devolution of power under the Sixth State Reform includes UI activation, the monitoring of job search efforts (both the so-called 'passive' and 'active' availability of jobseekers), as well as sanctions related to this. However, UI legislation, including the normative framework defining the search efforts jobseekers must develop and the notion of 'suitable job offers', the definition of administrative checks and sanctions in particular, remain federal competences. The Sixth State Reform gives regions the full spending authority over previously earmarked funds (for activation) that were transferred to them in the context of the Cooperation Agreement. The regions will be able to spend the budget as they see fit for various forms of labour market policy in a broad sense.

In the context of this paper, the Belgian experience before 2004 can be interpreted as an archetypal case of institutional moral hazard: regional authorities were under no financial pressure to commit themselves to systematic activation, given the fact that the funding of UI benefits was federal. This changed radically with the 'minimum requirements' on activation, laid down in the intergovernmental Cooperation Agreement of 2004. Politically, the basic idea was that regional authorities and PES accepted that they had to contribute actively to the budgetary viability and public legitimacy of the federal unemployment benefit system.

In a sense, the 2004 Cooperation Agreement can be seen as a second-best solution to the problem the Belgian labour market was struggling with since the 1980s: the institutional separation between, on the one hand, control over the legality of unemployment benefits, which remained a federal competence, and, on the other hand, assistance to jobseekers, which had become a regional responsibility. The cooperation agreement marked a turning point, but it might be argued that the best solution is to combine control and guidance at a single level of government.

The Sixth State Reform has taken the call for further devolvement of activation policy on board, but it did not contain a specific approach to the institutional moral hazard associated with the ensuing division of labour. For instance, no specific intergovernmental 'financial incentive' mechanism was attached to the further devolution of powers in the domain of activation, which, *prima facie*, increases the potential for institutional moral hazard in the Belgian system. The Sixth State Reform has been voted in parliament, and the implementation is only starting now. In 2015, federal and regional authorities agreed on a common '*normative framework*' for monitoring the unemployed, to ensure that the principles of the federal UI are not undermined. This agreement, which sets out the policies with regard to monitoring and sanctioning in detail, will be given a legal basis in a royal decree. This means that a new form of 'minimum requirements' will be introduced, but on a different institutional basis. Paradoxically, the Sixth State Reform may well entail as much, or even more, intergovernmental cooperation and coordination. If successful, this could lead to a form of 'joint decision and shared implementation federalism', in which the federal government, social partners and regions shape policy together. The jury is still out with regard to the impact of this new constellation.

With regard to SA activation, the decentralisation to the local level in the past was not accompanied by stricter federal steering or monitoring (as is the case in Denmark). The federal government has little information about the way municipalities use their large autonomy in SA activation. In the context of the new constitutional reform, the competence for SA activation will be devolved to the regions. Whether or not this will lead to a more consequential central steering (by the regions) and less policy discretion at the municipal level is as yet unclear.

## Country fiche Canada<sup>24</sup>

### List of Abbreviations

CST – Canada Social Transfer  
EI – Employment Insurance  
EIA – Employment Insurance Act  
LMA – Labour Market Agreement  
LMDA – Labour Market Development Agreement  
P/T governments – Provincial/Territorial governments  
SA – Social Assistance

Table 5. Analytical grid Canada.

		Unemployment benefits (Employment Insurance Act)	Activation of individuals with employment insurance under LMDA regime (Employment Insurance Act)	Unemployment- related social assistance/ income support benefits	Activation of individuals with social assistance benefits (SA recipients can be served under both the LMA and LMDA; however, they are not eligible for all LMDA-financed services)
1	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. design of the policy: - Formal regulation - Policy goals	None  Federal level determines regulation and policy goals.	High decentralisation  Federal level determines a broad list of programmes and negotiates targets with provinces. Provinces design their own policy in accordance with prescribed list and negotiate targets.	Total decentralisation  Provinces are free to design their own social assistance scheme and set their own goals.	Under LMA regime: High decentralisation  Provinces are free to design their own programmes and set their own targets.  Under LMDA: cf. column on activation of unemployment benefits.
2	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. implementation of the policy	None	Total decentralisation	Total decentralisation	Total decentralisation  (both LMA and LMDA)
3	Budgetary responsibility	Federal	Federal	Provincial With some federal contributions through CST (less than 10% of cost, i.e. marginal).	Federal Both LMA and LMDA are federal transfers, with LMA being supplemented by some provincial contributions.
4	Budgetary transfers	n.a.	Yes (but subject to	Yes	Yes

<sup>24</sup> This describes the Canadian arrangement up to 2014, when all LMA Agreements (except in Quebec) were replaced by Canada Job Fund Agreements (JFAs). The JFAs reduced federal funding on activation for the unemployed to focus instead on people who were already working.

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	between levels of government?		review) LMDA	CST (but marginal)	Both LMA and LMDA are federal transfers, with LMA being subject to change at federal determination.
5	Structural redistribution? (measured on a per capita-basis)	Yes Caseload size varies structurally across provinces	Yes, As provinces with higher unemployment in 1996 got more money.	No Federal funds are distributed on the basis of a per capita formula.	Under LMA regime: No Federal funds are distributed on the basis of a per capita formula.
6	Political or managerial decentralisation/ delegation?	n.a.	Political	Political	Under LMA regime: Political
7	Indicators used in the monitoring of lower-level performance by higher level (on the basis of: input, output and outcome)?	n.a.	One each of input, output and outcome (crude) federal indicators, negotiated target levels. Other indicators may be agreed upon and P/T can set additional indicators/ targets	None	Under LMA regime: Input, output and outcome. Indicators federally negotiated and targets provincially set.
8	Is a system of 'minimum requirements' applied?	n.a.	No	No (except for no-residency requirement)	Under LMA regime: No
9	Are performance-based sanctions/rewards applied by the higher level at the lower level?	n.a.	No	No	Under LMA regime: No
10	Conclusion from 5-6-7: perception of, concern for, and approach to problems of institutional moral hazard?	In EI benefits: n.a.  In the interaction between EI, SA and ALMPS: institutional moral hazard exists, but federal action remains limited. Reporting only on very crude indicators with no incentive structure and no system of minimum requirements. Due to the high level of decentralisation provinces can affect federal EI caseloads with little possibility for the federal level to influence their behaviour. The crude level of performance measurement creates an information asymmetry. Poor performance can result in a larger share of the funds allocated to a certain province due to the nature of the allocation formula. Federal action is inhibited by historical factors.		Under LMA regime: n.a.  The federal level only marginally contributes to the costs of SA and therefore cannot be seen as a true 'insurer' of provincial risk. However, this is due to the transformation of CAP into CHST and later into the CST, which is the result of federal action to prevent moral hazard.  Under LMDA regime: the possibility of shifting LMDA funding from intensive to less intensive services, which can be used to service SA recipients, can be seen as a form of institutional moral hazard; however, there is also no awareness regarding a specific response to it.	
11	Conclusion from 5-6-7: approach to principal-agent issues?	n.a. (due to the political nature of decentralisation we do not apply p-a concept here).		n.a. (due to the political nature of decentralisation we do not apply p-a concept here).	
12	Contribution to macroeconomic stabilisation by the benefit system	The Canadian case is not available in Dolls, Fuest & Peichl, 2012a.			

Source: Own compilation.

*Responsibilities in the Canadian labour market governance system are divided between the federal government and the provinces. Canada is characterised by a high level of decentralisation, federal-provincial agreements concerning activation, and regional differences in the generosity of federally regulated Employment Insurance (EI) benefits. This architecture generates institutional moral hazard. However, currently, it seems institutional moral hazard is not perceived as a prominent problem. This is due to the historical development of Canadian federalism and the relatively low generosity of the unemployment-related benefit schemes (notably for unemployment of longer duration). However, institutional moral hazard played an important part in shaping Canada's multi-tiered regulation of unemployment, most importantly in its system of SA. Canada, in this sense, is akin to the US, in which concern for institutional moral hazard plays a different and less obvious role than in the other countries we examine.*

The federal level is fully responsible for EI benefits and the provincial governments are the dominant actor in SA. Both EI activation and SA activation are governed by bilateral agreements between the federal government and each province. These bilateral agreements imply an almost total devolution of active labour market policies, with the exception of programmes for specific vulnerable groups (Aboriginal people and youth) that are still managed by the federal government. As a result, the interest of the provinces and the federal level diverge: it is in the interest of the provinces to activate the SA caseload but not necessarily the EI caseload.

Institutional moral hazard in Canada stems from two sources. First, the provinces are responsible for the design and implementation of the activation of EI benefit recipients, with both the activation and the benefits financed by the federal level. Secondly, provinces can deliver services that are financed by bilateral agreements concerning EI, to their own SA caseloads. It is relatively easy for the provinces to deliver services to the (primarily provincially financed) SA caseload, since not all federally financed activation services are exclusively for EI recipients.

The federal government provides no positive financial incentives for the provinces to activate EI recipients. Rather, the generosity of the federal EI scheme is dependent upon employment performance in the provinces; the higher the unemployment rate, the more generous the scheme. Secondly, the allocation formula for activation funds for EI is also, in part, contingent on the unemployment rate. In other words, to the extent that financial incentives exist, they do not stimulate effective activation but rather the opposite. Furthermore, there is no extensive federal system of minimum requirements for the activation of EI recipients. Finally, the performance measurement system to monitor the behaviour of provinces is rather crude and does not include an explicit comparison of provincial performance.

Activation of the EI caseload is financed through bilateral agreements, called Labour Market Development Agreements (LMDAs). These include services that are reserved for EI beneficiaries, but they also include less intensive services which are open to other unemployed persons as well. Until the mid-2000s, activation of SA, which was

primarily financed by the provinces,<sup>25</sup> had lagged behind that of the EI scheme. To rectify this (but also to compensate for the fact that federal ALMP funding for EI became increasingly inadequate), the federal government engaged in still other bilateral agreements (Labour Market Agreements or LMAs) which were open to everyone including SA recipients but excluding EI recipients. Provincial governments can use policies financed by LMDAs, as well as LMAs, to activate SA beneficiaries. This can be seen as a form of institutional moral hazard since federal EIA funds are used to activate the provincially financed unemployed. The federal government has implemented limited means to counter this development.

Nevertheless, the Canadian federal government seems relatively unconcerned about institutional moral hazard regarding activation. Three factors may explain this relative lack of concern. First, the relatively low generosity and coverage of the Canadian EI system mitigates the budgetary impact of increased unemployment, making institutional moral hazard less of a pressing issue. Second, there has been limited attention to how federal activation funds are distributed between provinces. Third, the specific process of Canadian devolution may have limited the public and political perception of institutional moral hazard. Historically, provinces held competences concerning training and education. In addition, the provinces were already responsible for SA activation. The devolution of the activation of the EI caseload could be regarded as a merger of overlapping competences and streamlining of public administration. Furthermore, the strong desire for autonomy (and even independence) in some provinces – most notably in Quebec – made the federal government more open-minded about devolution.

However, institutional moral hazard did play an important role in shaping SA. From the 1960s to 1996, SA was a shared-cost benefit. The federal level provided open-ended matching funds for provincial spending. This method of funding was abolished in 1996 in favour of a block grant funded system, much like in the US case. The block grant has since not increased in size,<sup>26</sup> and as a consequence, it has shifted the budgetary burden towards the provinces. The change in funding method was a result of federal concerns over provinces being overly generous. In other words, funding methods changed due to concern over institutional moral hazard and resulted in a clear shift in budgetary responsibility. Therefore, to conclude that institutional moral hazard did not play a role in Canadian regulation of unemployment would be a mistake. Specific historical and institutional developments, combined with increasingly inadequate federal funding, weakened the Canadian federal government and thus made it incapable of taking action against institutional moral hazard.

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<sup>25</sup> Currently, the provinces finance around 90% of the SA costs.

<sup>26</sup> However, it certainly did change: in the beginning both health spending, SA and social services were included in the same block grant; this was later disaggregated to health spending on one hand, and SA and social services on the other hand.

## Country fiche Denmark

### List of Abbreviations

SA – Social Assistance

UI – Unemployment Insurance

Table 4. Analytical grid Denmark

		Unemployment benefits	Activation of individuals with unemployment benefits	Unemployment- related SA benefits	Activation of individuals with SA benefits
1	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. design of the policy: <ul style="list-style-type: none"><li>- Formal regulation</li><li>- Policy goals</li></ul>	No decentralisation	Low decentralisation  Central regulation of types of policies and minimum requirements  The central level also formulates broad policy goals.  The local level translates these goals into targets.	Low decentralisation  The central level regulates SA, and the municipal level formulates policy goals.	Low decentralisation  Central regulation of types of policies and minimum requirements  The central level also formulates broad policy goals.  The local level translates these goals into targets.
2	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. implementation of the policy	No decentralisation  UI is implemented according to the Ghent system: private (social partners) parties create UI funds which disburse benefits, but they have no policy autonomy concerning UI.	Medium decentralisation  Municipalities are completely responsible through one-stop shops, with some responsibilities for UI funds. The degree of decentralisation is limited by exacting central legislation, minimum requirements and monitoring.	High decentralisation  Municipalities are completely responsible through municipal department.	Medium decentralisation  Municipalities are completely responsible through one-stop shops. The degree of decentralisation is hampered by strict central legislation, minimum requirements and monitoring.
3	Budgetary responsibility	Shared between the central and the municipal level  The UI funds fund their own administration through contributions of members.	Shared between the central and the municipal level  The municipalities fund activation and the central level partially reimburses them.  The UI funds fund their own administration through	Shared between the central and the municipal level  The municipalities fund SA and the central level partially reimburses them.	Shared between the central and the municipal level  The municipalities fund activation and the central level partially reimburses them.

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			contributions of members.		
4	Budgetary transfers between levels of government?	Yes  From the municipal to the central level	Yes  From the central to the municipal level	Yes  From the central to the municipal level	Yes  From the central to the municipal level
5	Structural redistribution? (measured on a per capita basis)	Yes  Structural differences in caseloads	Yes  Structural differences in caseloads	Yes  Structural differences in caseloads	Yes  Structural differences in caseloads
6	Political or managerial decentralisation/delegation?	n.a.	Political decentralisation	Political decentralisation	Political decentralisation
7	Indicators used in the monitoring of lower-level performance by higher level (on the basis of: input, output and outcome)?	Output	Input, output and outcome  Very elaborate monitoring system which focuses on inputs and outputs. Ministerial goals are mostly outcome-based.	Output	Input, output and outcome  Very elaborate monitoring system which focuses on inputs and outputs
8	Is a system of 'minimum requirements' applied?	n.a.  The legislation concerning UI and the implementation thereof is tightly regulated at the central level.	Yes  Relatively strict set of minimum requirements, including minimum amount of meetings and mandatory work processes	No  The legislation concerning UI and the implementation thereof is tightly regulated at the central level.	Yes  Relatively strict set of minimum requirements, including minimum amount of meetings and mandatory work processes
9	Are performance-based sanctions/rewards applied by the higher level at the lower level?	n.a.  There is no lower level of government involved in the implementation. The funds receive no performance-based rewards or sanctions.	The reimbursement model entails financial incentives for the municipalities.  Municipal costs are contingent on activation (measured in output indicators).	The reimbursement model entails financial incentives for the municipalities.  Municipal costs are contingent on activation (measured in output indicators).	The reimbursement model entails financial incentives for the municipalities.  Municipal costs are contingent on activation (measured in output indicators).
10	Conclusion from 5-6-7: perception of, concern for, and approach to problems of institutional moral hazard?	Institutional moral hazard exists, there is much awareness and the responses have been numerous.  Municipalities are subject to very detailed monitoring. This monitoring system is tied to a reimbursement and contribution model. The mandatory municipal contributions to central UI funding and the central reimbursement of municipal activation efforts are contingent on the compliance and efforts of the municipalities. A strict system of minimum requirements is applied. Reform is underway to simplify the		Institutional moral hazard exists, there is much awareness and the responses have been numerous.  Municipalities are subject to a very detailed monitoring system, which is tied to a reimbursement model. The central reimbursement of municipal activation efforts and SA costs are contingent on the compliance and efforts of the municipalities. There was also a strict system of minimum requirements applied. Reform is underway to simplify the financial system and address the	

		financial system and to address the strictness of minimum requirements. There has been much concern for the role of UI funds in the past. But besides the measures described above, the UI funds have been intrinsically loyal to government policies to ensure their existence.	strictness of minimum requirements.
11	Conclusion from 5-6-7: approach to principal-agent issues?	There are no obvious principal-agent problems concerning the implementation of the passive part of UI by private funds. The central government has tightly regulated these funds.  Principal-agent concept is not applicable to the active part of UI (due to the political nature of decentralisation)	n.a. (due to the political nature of decentralisation, we do not apply the principal-agent concept here).
12	Contribution to macroeconomic stabilisation by the benefit system	Very important (Dolls, Fuest & Peichl, 2012a)	

Source: Own compilation.

*The three most important actors in the Danish regulation of unemployment system are the central level, the Unemployment Insurance funds and the municipalities. Currently, the division of labour between the central and municipal levels generates institutional moral hazard. There is much concern for institutional moral hazard, which has been translated into a very detailed performance management system that is coupled to a reimbursement system. Both the detailed monitoring and the reimbursement system are hallmarks of the Danish model.<sup>27</sup> The trade-off between the*

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<sup>27</sup> Our conclusion may seem to contradict two OECD LEED studies (Giguère & Froy, 2009; Froy, Giguère, Pyne, & Wood, 2011). Especially the study by Giguère & Froy (2009) finds that Danish subnational employment offices have a *high* degree of implementation flexibility. Our analysis differs from these studies in two respects: (i) we have a different focus, (ii) since the period studied by the OECD LEED team, additional reforms have been introduced. Our emphasis is on the relationship between levels of government, while the OECD LEED studies place more emphasis on the relationship between job centres vis-à-vis governments; they do not factor in “the degree of separation between functions between different governance levels” (Giguère & Froy, 2009, p. 51). Moreover, they note that in their conceptualisation of flexibility “it does not matter whether central or sub-state governments are in charge of employment policy, but [it matters] that flexibility is available to actors at various levels of the system to allow for the adaptation of the orientation of programmes to contemporary economic challenges” (Froy, Giguère, Pyne, & Wood, 2011, pp. 11-12). Although the OECD LEED studies and our survey overlap to some extent (in terms of research questions), there are differences. For example, our study emphasises political authority over implementation of activation. As a result, whether lower levels of government or job centres can outsource their responsibilities or collaborate with other entities is a less prominent question than in the OECD LEED studies, in which outsourcing and collaboration are the biggest contributing factors to the assessment of flexibility (Giguère & Froy, 2009, p. 49). Additionally, since those OECD studies came out, there have been quite influential reforms. Some of these reforms have taken place in the period between the two studies and are subsequently reflected in the 2011 study; such as the detailed monitoring and reporting system (Froy, Giguère, Pyne, & Wood, 2011, pp. 42, 84). But other reforms, such as the implementation of the reimbursement model that was coupled to the system of minimum requirements, have not yet been included in either study. It is our contention that the reforms since 2010-11 have been the high watermark of central control, which is why we describe

*complexity of central controls and the need for local flexibility is a source of ongoing reform efforts.*

The central level regulates SA benefits, while the municipal level implements SA benefits; the central level regulates and implements UI benefits. Currently, the municipal level is responsible for the activation of both caseloads (UI and SA). Previously, the central level activated UI clients, but this led to discrepancies between UI activation and SA activation, much like in the Austrian, German and Swiss cases. The subsequent decentralisation of UI activation and the harmonisation of SA and UI activation within a single one-stop shop led (counter-intuitively) to more central control over municipal behaviour. But municipalities and municipal workers did not always accept federal goals as legitimate, and so-called 'compliance gaps' emerged.

The Danish reimbursement model, which generates financial incentives for local compliance, is meant to realign local and central interests. Simply put, the municipal level bears the financial burden for SA benefits and for the activation of both SA and UI. If municipalities comply with the central regulation on activation (which involves the broad design of policies, a system of minimum requirements and mandatory reporting), they are reimbursed for a part of their spending on activation and SA benefits. The level of reimbursement depends upon the specific efforts of the municipalities. UI benefits are financed by the central level, but require mandatory municipal contributions, which are also contingent upon compliance with regulation and activation efforts. Some of these central conditions comprise a system of minimum requirements, which encroaches upon municipal flexibility. This system is based on a detailed mandatory monitoring system, enforced by the regional level.

Without the minimum requirements and monitoring, the municipalities would have the incentive to 'park' clients – by placing them in programmes without meaningful impact – in order to collect the reimbursement and lower their contributions to UI costs. However, currently, institutional moral hazard still stems from municipalities relabelling old policies to fit the central system of minimum requirements (on which reimbursement is based) without actually changing the substance of those policies. Furthermore, municipalities now have the incentive to utilise those policies which attract the highest reimbursement, even if those policies would not be appropriate.

The monitoring system and the system of minimum requirements can be seen as attempts of the central level to exert influence over the municipalities in order to harmonise activation policies for UI and SA and to enforce central goals. Non-compliance has been among the most important motivations for several reforms. It could, therefore, be said that institutional moral hazard is indeed perceived as an important issue in Denmark. However, the complicated system of reporting and financing created by these reforms still generates some forms of institutional moral hazard. Furthermore, the complicated nature of reporting and financing makes the system as a whole cumbersome and difficult to oversee. This combination of factors

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Danish implementation flexibility as 'medium'. Currently, reforms are underway that will give, once again, more implementation flexibility to the Danish municipalities.

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has led to yet another round of reforms which are still underway. The system of reimbursement will probably be simplified and be applied to all benefits in a uniform way. Additionally, the reimbursements will become contingent on outcomes rather than outputs. Currently, the performance management system is mostly concerned with what municipalities do (output), rather than outcomes. By severing the link with output, municipalities will enjoy more flexibility and at the same time not be able to manipulate the system through relabelling. It is still unclear, however, how these new reforms will be implemented and what their result will be.

Finally, there has been a lot of concern for the role of the UI funds. Besides the administration and disbursements of UI benefits, these funds are also involved in the activation of UI beneficiaries, most notably they assess work-readiness. Because their clients are voluntary due-paying members, the UI funds have been perceived as being too soft. However, research has shown that these concerns are somewhat misplaced. Rather, the UI fund managers seem to be aware that their funds' role is precarious and that any misconduct might endanger their role in the entire system. Nonetheless, such concerns over the UI funds are an additional indication that concern for institutional moral hazard is very prominent in the Danish regulation of unemployment.

## Country fiche Germany

### List of Abbreviations

BA – Bundesagentur für Arbeit (the federal PES)

ALG I – *Arbeitslosenversicherung* (unemployment insurance)

ALG II – *Grundsicherung für Arbeitsuchende* but often referred to as *Arbeitslosengeld II* (SA)

SA – Social Assistance

UI – Unemployment Insurance

Table 5. Analytical grid Germany

		Unemployment benefits (ALG I)	Activation of individuals with unemployment benefits	Unemployment- related SA/ income support benefits (ALG II)	Activation of individuals with SA benefits
1	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. design of the policy: <ul style="list-style-type: none"><li>- Formal regulation</li><li>- Policy goals</li></ul>	No decentralisation	Low decentralisation  Federal level prescribes the design of policies and sets broad goals. The BA formulates its own internal targets.	No decentralisation	Low decentralisation
2	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. implementation of the policy	No decentralisation  (The BA implements and administers the disbursement of benefits but has no policy autonomy concerning UI; hence, no delegation.)	Delegation to BA and high decentralisation  The BA implements activation with significant leeway.	No decentralisation	Delegation to BA and medium decentralisation  Within joint consortia (operated by the municipalities and the BA), the BA is responsible for activation. The leeway of the BA is more limited (compared to ALG I) due to federal monitoring and some mandatory work processes.  Within the <i>Optionskommunen</i> , the activation is implemented by the municipalities themselves within the same limits as the BA.
3	Budgetary responsibility	Federal  Financed by social contributions	Federal  Financed by social contributions	Federal and municipalities  The federal level finances the major part of the benefits (financed by taxation) while the	Federal  Financed by taxation

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				municipalities contribute to housing and heating supplements.	
4	Budgetary transfers between levels of government?	n.a.	n.a.	n.a.	n.a.  Except for <i>Optionskommunen</i> , which receive federal funds to implement activation.
5	Structural redistribution? (measured on a per capita basis)	Yes  Structural differences in caseloads	Yes  Structural differences in caseloads	Yes  Structural differences in caseloads	Yes  Structural differences in caseloads
6	Political or managerial decentralisation/delegation?	n.a.	Delegation, with managerial decentralisation to the BA  The BA is an agent of the federal government.	n.a.	Delegation, with managerial decentralisation to the BA  In <i>Optionskommunen</i> : political decentralisation
7	Indicators used in the monitoring of lower-level performance by higher level (on the basis of: input, output and outcome)?	n.a.	Qualitative (but not quantitative) outcome indicators	n.a.	Outcome indicators
8	Is a system of 'minimum requirements' applied?	n.a.  The legislation concerning ALG I and the implementation thereof is tightly regulated at the federal level.	No	n.a.	Yes, but very limited  Mandatory integration agreement
9	Are performance-based sanctions/rewards applied by the higher level at the lower level?	n.a.	No  No financial incentives from the federal level to the BA. Within the BA, there are small financial bonuses for managers at the local level.	n.a.	No
10	Conclusion from 5-6-7: perception of, concern for, and approach to problems of institutional moral hazard?	n.a.  There is only a single level of government involved in the governance of ALG I.	Institutional moral hazard only exists in the <i>Optionskommunen</i> . This has been addressed through supervision by the regional authorities and quantified target agreements.		
11	Conclusion from 5-6-7: approach to principal-agent issues?	Principal-agent issues exist w.r.t. activation of ALG I caseload and this has been addressed through a system of performance measurement, NPM reforms. The BA is overseen by a tripartite supervisory board.		Principal-agent issues exist w.r.t. ALG II, specifically concerning the BA and the job centres. This has been addressed through a system of performance measurement, monitoring by the <i>Länder</i> and quantified target agreements.	

			Furthermore, the BA is overseen by a tripartite supervisory board.
12	Contribution to macroeconomic stabilisation by the benefit system	Important (Dolls, Fuest & Peichl, 2012a)	

Source: Own compilation.

*The German system is one of the most centralised cases within our selection. The extent of centralisation is the result of reforms aimed at preventing institutional moral hazard. Responsibilities are divided between the federal government, the federal PES (the Bundesagentur für Arbeit or BA) and the local level – with a supervisory role for the regional level. The German system is characterised by a difficult relationship between its actors and by a unique feature: a number of municipalities which have opted out of the default model of joint governance (together with the BA) for the activation of SA beneficiaries. Many of the German reforms have revolved around reigning in both institutional moral hazard and principal-agent issues. The most important reforms (the Hartz reforms) have served multiple purposes: to reign in municipal control over SA, harmonise the activation of UI and SA, and tackle principal-agent issues concerning the federal PES.*

The federal level legislates and funds both UI (ALG I) and SA (ALG II). The BA is the most important actor concerning activation. Before the Hartz reforms of 2002-05, two residual unemployment assistance schemes existed: unemployment assistance and SA. The federal level was predominantly responsible for unemployment assistance and the municipalities were the most important actor for the old SA scheme. Activation of both UI and assistance was implemented by the BA and activation of the old SA was in the hands of the municipalities. Due to large disparities between the SA burdens of the municipalities, some municipalities were less capable of delivering meaningful activation services. This created a twofold disparity: between the respective efforts of different municipalities on one hand, and between the activation regimes implemented by the BA and the municipalities on the other hand (much like in the Austrian, Swiss and, to some extent, the Danish systems). The Hartz reforms combined unemployment assistance and the old SA into a single unemployment-related SA scheme: ALG II. The federal level centralised regulation concerning ALG II and also took on a larger budgetary responsibility over this benefit. Activation of ALG II was to be implemented by joint consortia (one-stop shops for SA beneficiaries), which were operated simultaneously by the municipalities and the BA. Within those consortia, the BA became the responsible actor for activation, but for the beneficiaries they would act as a single entity. Therefore, currently, the BA is responsible for activation of the ALG I and the ALG II caseloads. This eliminated the possibility for institutional moral hazard with regard to benefits and activation.

These joint consortia were not unopposed. Within the consortia themselves, there was a clash of cultures between the municipal employees and the BA employees, and the municipalities saw the consortia as infringing upon their autonomy. Subsequently, the constellation was reorganised, the consortia gained an independent status and the

regional authorities (the Länder) were given the task of monitoring their overall performance. The BA remains responsible for the supervision of activation efforts. Some municipalities (Optionskommunen) have opted out of this system of joint governance over ALG II activation and have assumed the activation responsibilities themselves. This entails that, contrary to the other municipalities, the decentralisation to these municipalities can be classified as 'political decentralisation'. It required a constitutional change in order to reorganise the joint consortia and to create and maintain the Optionskommunen, because the previous constellation included unconstitutional 'mixed administration' systems. The federal government continues to fund both the activation and a large part of the benefits for the 'opting' municipalities. As a consequence, this constellation creates the potential for institutional moral hazard. This has been addressed by closer supervision by the Länder, who take over the oversight responsibilities from the BA concerning activation. However, this regional oversight has not prevented these Optionskommunen from performing differently (worse in the eyes of the BA). This indicates that the institutional moral hazard continues to exist in the Optionskommunen.

The caseloads of ALG I and ALG II are not subject to the same activation regime. Moreover, the BA has a slightly different role in both regimes. Since the Hartz reforms, the BA (concerning the ALG I regime) has acted as a semi-independent agency which both administers the passive side and implements activation. In this capacity, the BA acts as an at-arm's-length agency, subject to performance measurement and overseen by a tripartite committee. For ALG II, the BA acts as a contracted partner and is consequently subject to stronger supervision and direction from the federal level. The Hartz reforms included a reform of the BA. Ironically, it was a scandal involving the PES that set off the reforms. The old PES was found to be intentionally misrepresenting placement figures. Subsequently, the BA was reorganised along New Public Management lines, with a stronger role played by the federal government.

## Country fiche Switzerland

### List of Abbreviations

AC – *Fonds de compensation de l'Assurance-Chômage* (unemployment insurance fund)

AVIG/LACI – *Arbeitslosenversicherungsgesetz/Loi sur l'assurance-chômage* (Federal Act on Obligatory Unemployment Insurance and Insolvency Compensation)

PES – Public Employment Services

RAV/ORP – *Regionalen Arbeitsvermittlungszentren/Offices Régionaux de Placement* (regional employment offices)

SA – Social Assistance

SKOS/CSIAS – *Schweizerische Konferenz für Sozialhilfe/Conférence Suisse des Institutions d'Action Sociale* (Swiss Conference for Social Assistance)

UI – Unemployment Insurance

Table 6. Analytical grid Switzerland

		Unemployment benefits (AVIG/LACI)	Activation of individuals with unemployment benefits	Unemployment- related social assistance/inco me support benefits	Activation of individuals with social assistance benefits
1	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. design of the policy: <ul style="list-style-type: none"><li>- Formal regulation</li><li>- Policy goals</li></ul>	No decentralisation	Medium decentralisation  Federal level provides broad regulation concerning regular activation policies (which are only for UI beneficiaries) and it prescribes a system of minimum requirements.	Total decentralisation  Non-binding common guidelines by inter-cantonal cooperation conference (SKOS/CSIAS)	Total decentralisation  Non-binding common guidelines by inter-cantonal cooperation conference (SKOS/CSIAS)
2	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. implementation of the policy	No decentralisation  Disbursement and administration is performed by UI funds but they do not have any policy autonomy concerning UI.	High decentralisation  Implementation is done by regional (cantonal) job centres. Cantons formulate their own strategy: they may only provide the regular services to UI clients but the choice in which of these services are provided to whom is up to the cantons themselves.	Total decentralisation  The cantons are completely responsible for the implementation of SA, without any federal intervention whatsoever.	Total decentralisation  SA clients can receive services from regional job centres (the same as for UI clients) and from municipal welfare offices. Municipal welfare offices provide their own services, and at the regional job centres SA clients can receive regular services or additional services designed by the cantons.
3	Budgetary responsibility	Federal  The federal unemployment	Federal  Activation is financed out of the	Cantons and municipalities  It is a cantonal	Cantons, municipalities and the federal level.

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		insurance fund (AC) is 92% financed by employer and employee contributions, 6% by federal level and 2% by cantons.	AC (cf. cell 3 in the column on UI).	competence to legislate SA. Cantons can direct municipalities to co-finance SA.	The municipalities fund their own services. Federal funds (AC) are used for the regular services but those must be co-financed by the cantons as well (50%), and cantons finance 100% of the additional services they designed.
4	Budgetary transfers between levels of government?	Yes  From the cantons to the AC but these transfers are very limited (only 2% of AC funding).	Yes  Funding for activation is transferred from the AC to the cantons. Cantons contribute to the AC (however, these are marginal compared to federal funding).	n.a. with regard to the federal-cantons relationship.  In some cantons municipalities do contribute to SA costs.	Yes  Some of the SA caseload receives regular services. These regular services, however, must be co-financed (50%) by the cantons.
5	Structural redistribution? (measured on a per-capita basis)	Yes  Cantonal caseloads differ structurally.	Yes  Cantonal caseloads differ structurally. The redistributive impact is limited by a degressive formula which entails that funding per client becomes less when the unemployment rate is high. Above 10% unemployment rate the cantons receive no additional funds per client.	n.a.	Yes  But only concerning the SA caseload that receives regular services. The redistributive effect is more limited than that of UI activation because only a portion of the SA clients receive those services, which must then be co-financed by the cantons.
6	Political or managerial decentralisation/delegation?	n.a.  The UI funds act as agents for the federal level with regard to the implementation of the UI scheme, but they do not have policy autonomy.	Political	Political	Political
7	Indicators used in the monitoring of lower-level performance by higher level (on the basis	n.a.	Yes  Based on four outcome	n.a.	n.a.  The SA clients who receive

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	of: input, output and outcome)?		measures.		services at the job centres are not counted towards the outcome indicators used for the monitoring of activation of UI.
8	Is a system of ‘minimum requirements’ applied?	<p>n.a.</p> <p>The legislation concerning UI and the implementation thereof is tightly regulated at the federal level.</p>	<p>Yes</p> <p>Federal legislation dictates the timing of initial registration and the first interview and also prescribes the frequency of follow-up interviews and the definitions of ‘suitable work’ and ‘work availability’.</p>	<p>No</p> <p>The only federal stipulation concerns the cantonal duty to provide ‘a minimum subsistence level’.</p> <p>Non-binding common guidelines by inter-cantonal cooperation conference (SKOS/CSIAS)</p>	<p>No</p> <p>Non-binding common guidelines by inter-cantonal cooperation conference (SKOS/CSIAS)</p>
9	Are performance based-sanctions/rewards applied by the higher level at the lower level?	n.a.	<p>Yes</p> <p>No financial incentive structure, only a possible in-depth review (shadow of hierarchy)</p>	n.a.	n.a.
10	Conclusion from 5-6-7: perception of, concern for, and approach to problems of institutional moral hazard?	<p>Yes</p> <p>Institutional moral hazard is possible: cantons have no inherent incentives to activate. This has been addressed through a system of minimum requirements, a system of performance measurement and a degressive formula that limits federal funding for cantons with high unemployment rates.</p>		<p>Yes</p> <p>Cantons were able to shift SA caseload to UI through renewal of eligibility. These loopholes have been mostly closed. Additionally, cantons can use regular ALMPs funded by the federal AC for SA clients. This has been addressed by (an increase in) cantonal co-financing of those regular ALMPs for SA clients.</p>	
11	Conclusion from 5-6-7: approach to principal-agent issues?	<p>(n.a. to the role of UI funds w.r.t. UI benefits. The central government has tightly regulated these funds w.r.t. the administration of UI benefits.)</p> <p>P-a is not applicable to UI activation (decentralisation has a political character).</p>		<p>n.a. (due to the political nature of decentralisation we do not apply p-a concept here).</p>	
12	Contribution to macroeconomic stabilisation by the benefit system	The Swiss case is not available in Dolls, Fuest & Peichl, 2012a.			

Source: Own compilation.

*The two most important actors in Swiss regulation of unemployment are the federal government and the cantons and includes a complicated division of labour. The Swiss case is interesting due to the large role of the cantons and the strong concern for institutional moral hazard. With regard to UI, the Swiss division of labour resembles the Belgian division of labour; however, compared to Belgium, Swiss UI benefits are*

*much less generous in the case of longer-term unemployment and SA plays a much more important role. Rising unemployment rates, in combination with the division of labour between the cantons and the federal government, have caused concern for institutional moral hazard. Many of the Swiss reforms were aimed at reducing these risks, notably with regard to the interplay between UI and SA. However, perception and concern for institutional moral hazard have been mitigated by the importance attached to the autonomy of the cantons. Reforms have closed off any possibility for dumping of SA clients into UI, which, today, seems to limit the salience of institutional moral hazard. But mismatches between UI and SA have not been addressed due to the persistent claims to this autonomy by the cantons.*

The federal government is responsible for the legislation of UI and controls the UI Fund (AC). The AC, which is mostly funded by social contributions, finances UI benefits and UI activation. The UI benefit system is implemented by 38 unemployment funds.<sup>28</sup> These funds are tightly regulated by federal legislation, but they have some flexibility concerning their own organisation. UI activation is implemented by 100 regional job centres (RAV/ORP) which are controlled by the cantons. The cantons are also responsible for legislating, implementing and funding SA benefits and SA activation. They can delegate responsibilities to the municipalities concerning the funding and the implementation of activation.

Very high employment rates limited the use (and therefore the relevance) of SA until the 1990s. As unemployment rates rose in the 1990s, more and more unemployed workers exhausted their UI claims, and consequently, the SA caseload increased in size. The impact of these rising caseloads was heterogeneous, creating disparities between the cantons that were exacerbated by cantonal differences in the design of SA schemes. Since, at that point, UI activation was a federal responsibility and SA activation a responsibility of the cantons (cf. *infra*), the rising SA caseloads also revealed a structural mismatch between the uniform approach to UI activation and the very heterogeneous approach to SA activation. Contrary to the German case, the federal government did not step in, but an inter-cantonal conference (SKOS/CSIAS) devised non-binding common guidelines that somewhat harmonised the design of SA. Furthermore, inter-institutional cooperation (between institutions responsible for different types of benefits) was attempted to overcome differences between the different unemployment-related (but also disability-related) benefits. However, this type of coordination was not particularly successful.

Rising unemployment rates also underscored the salience of individual and institutional moral hazard. Not only were the rising unemployment rates a matter of concern, but the steep rise in invalidity insurance indicated that this scheme was being misused to offload UI and SA beneficiaries into invalidity pensions. In this period, UI activation was in the hands of local PES offices, which were judged on the speed with which they reintegrated their caseload. As a consequence, they had incentives to shift their hard-to-place clients to cantonal SA schemes. In turn, the cantons had incentives

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<sup>28</sup> Each canton has its own fund and the other 12 are privately organised and set up by social partners. They predate federal legislation concerning an obligatory UI scheme (AVIG/LACI).

to shift their SA caseload back into UI (through programmes that renewed UI eligibility) or to shift their caseload to federally financed (invalidity) pension schemes. In response, the federal government reformed the UI legislation (AVIG/LACI) to close off most possibilities for benefit renewal through cantonal programmes. Furthermore, the federal government created a network of 100 job centres which were to be operated by the cantons and made more funds available for activation. The federal government also legislated types of regular ALMPs which can be proposed to the UI caseload, a system of minimum requirements for the regional job centres and a performance measurement system.<sup>29</sup> Within these boundaries, the cantons are free to formulate their own activation strategy – meaning they can decide which beneficiaries receive each of the prescribed services. In practice, the strategies differ greatly.

The regional job centres are allowed to provide services to SA clients. However, these clients are not counted towards the performance measurement system, which ensures that the job centres have incentives to focus on the UI caseload. If the job centres provide the regular services to the SA clients, the cantons are obliged to co-finance these measures. The rates for co-financing of these measures has been increased, reflecting a direct concern for institutional moral hazard. Job centres may also provide services that are designed and fully financed by the cantons. In practice, however, SA clients most often receive services from municipal welfare offices. Especially in the larger municipalities, these welfare offices include dedicated activation offices. It is up to the cantons to regulate the additional non-regular services provided by the job centres and the other measures. It also falls within their competence to regulate the cooperation with municipalities. The harmonising factor, also for activation, is the SKOS/CSIAS common guidelines. However, these guidelines are broad and do not cover every aspect of the regulation of unemployment. This and the limited effects of inter-institutional cooperation mean that the mismatch between the UI and SA systems continues to this day.

Despite the system of minimum requirements and the performance monitoring, there were still no financial incentives for cantons to activate the UI caseload as effectively and efficiently as possible. The federal response has been to implement a degressive formula for the funding of ALMPs: funding is based on the rate of UI beneficiaries, but the higher that rate is, the lower the funding per beneficiary. Cantons receive no additional funds for the activation of UI beneficiaries when the registered jobseeker rate reaches a certain point – essentially, this serves as a cap on transfers from the AC to individual cantons. Thus, concern for institutional moral hazard has played a very important role in the Swiss case, but that role has been limited by the political equilibrium concerning the autonomy of the cantons.

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<sup>29</sup> We refer to policies which are federally designed specifically for the UI caseload as 'regular' ALMPs. The UI caseload may only receive these benefits, although they can also be used for other caseloads.

## Country fiche United States

### List of Abbreviations

AFDC – Aid to Families with Dependent Children

EB – Extended Benefits

EmB – Emergency Benefits

FUTA – Federal Unemployment Tax Act

MoE – Maintenance of Effort spending

TANF – Temporary Assistance to Needy Families programme

SA – Social Assistance

SNAP – Supplemental Nutrition Assistance Program

UI – Unemployment Insurance

WIOA – Workforce Innovation and Opportunity Act

WIA – Workforce Investment Act

*Table 7. Analytical grid United States*

		Unemployment benefits (Unemployment Compensation)	Activation of individuals with unemployment benefits (WIOA)	Unemployment-related SA: TANF	Activation of individuals with TANF benefits (WIOA)	Unemployment related SA: SNAP	Activation of individuals with SNAP benefits (SNAP E&T)
1	Degree of decentralisation (i.e. extent of flexibility on lower level) w.r.t. design of the policy: <ul style="list-style-type: none"> <li>- Formal regulation</li> <li>- Policy goals</li> </ul>	High decentralisation  States are primarily responsible for unemployment compensation, but in order to benefit from federal financial support (indirectly, via FUTA, and directly, in the case of EB and EmB) state regulation and policy setting must comply with federal conditions.	High decentralisation  Federal funding is linked to conditions w.r.t. state regulation and policy setting. Policy goals are federally defined but negotiated and supplemented by state level.	High decentralisation  Federal level poses conditions for state regulation and policy setting in order to receive federal funding.	High decentralisation  Federal level poses conditions for state regulation and policy setting in order to receive federal funding.  Policy goals are federally defined but negotiated and supplemented by state level.	High centralisation  The federal level designs the system but it leaves some options to the states to influence some parameters such as eligibility.	High decentralisation  The federal prescribes a policy menu and outlines the policy goals. The states design their own programmes according to these federal guidelines, which are also subject to federal approval.
2	Degree of decentralisation (i.e.	High	Total decentralisation	Total	Total decentralisation	Medium	Total decentralisation

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	extent of flexibility on lower level) w.r.t. implementation of the policy	Decentralisation		decentralisation		decentralisation	
						The federal level and the states jointly administrate the system. States have some options to adjust administration.	
3	Budgetary responsibility	<p>States and the federal level</p> <p>States: regular benefits and half of the extended benefits (but, in the recent recession, temporary full federal funding)</p> <p>Federal: compensates the employers for state taxes by FUTA, but FUTA Credit Reduction System aims to ensure state fiscal responsibility.</p> <p>Federal: state and federal administration costs, half of extended benefit costs, fully responsible for emergency benefits.</p> <p>Federal: temporary support for regular UI, via a loan system</p>	<p>Federal level</p> <p>WIOA spending is fully federal.</p>	<p>States and the federal level</p> <p>States: MoE spending</p> <p>Federal: block grants to states</p> <p>Currently the division of costs is around 40% of state spending and 60% of federal spending.</p>	<p>Federal level</p> <p>WIOA spending is fully federal.</p>	<p>Federal level</p> <p>Benefits are fully federally financed. Only administration costs are equally shared due to federal reimbursement of 50% of the state's administration costs.</p>	<p>States and federal level</p> <p>A small dotation is completely federally funded, the majority of funds are provided by the states and reimbursed for 50% by the federal government.</p>
4	Budgetary transfers between levels of governments?	<p>Yes</p> <p>On a permanent basis concerning</p>	Yes	Yes	Yes	<p>Marginal</p> <p>Only 50% of the state's administration costs</p>	Yes

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		administration purposes  On a temporary basis via the 'loan system' for regular UI (see text for a further comment)				are reimbursed, otherwise, there are no transfers.	
5	Structural redistribution? (measures on a per capita basis)	Yes  Structural differences in caseloads (however, redistribution mainly occurs in times of EB and EmB)	Yes  Funding is calculated on the basis of state shares in total unemployed. Unemployment caseloads show structural differences between the states.	Yes  The distribution of funds is partially calculated on the basis of historical (AFDC) spending patterns. Supplemental grants are implemented to mitigate the fiscal impact of disproportional negatively affected states. Funding on a per capita basis still differs structurally between states.	Yes  Funding is calculated on the basis of state shares in total unemployed. Unemployment caseloads show structural differences between the states.	**	**
6	Political or managerial decentralisation/delegation?	Political decentralisation	Political decentralisation	Political decentralisation	Political decentralisation	Political decentralisation	Political decentralisation
7	Indicators used in the monitoring of lower-level performance by higher level (on the basis of: input, output and outcome)?	??	Outcome (in WIOA plans)	Mostly input, also some output	Outcome (in WIOA plans)	Output (quality control measures)	Output and outcome
8	Is a system of 'minimum requirements' applied?	Yes  The federal level imposes an administrative framework.	Yes  The federal level imposes a broad administrative governance model, but does not prescribe a system of minimum	Yes  The federal level imposes a broad administrative governance model. This includes mandatory reporting,	Yes  The federal level imposes a broad administrative governance model. States must apply mandatory activation	Yes  States have to comply with federal regulations. The states are provided with some options to deviate from this slightly.	Yes  States have to design their programmes according to federal guidelines, assess eligibility of participants according

Institutional moral hazard in the multi-tiered regulation of unemployment  
and social assistance benefits and activation

			requirements concerning interventions. Mandatory activation requirements must be applied by states for persons receiving EB and EmB.	setting up of additional programmes and some benefit eligibility criteria. Requirements for the use of federal TANF funds are stricter than for MoE.	requirements for TANF recipients.	Additionally, states are obliged to conduct quality control reviews according to a detailed federal system.	to federal legislation and comply with federal reporting requirements.
9	Are performance-based sanctions/rewards applied by the higher level at the lower level ?	Yes  Non-compliance with federal framework or a continued deficit can result in financial sanctions (non-payment or increased federal tax rates)	Yes  Financial sanctions (and incentives for localities) for state and local performance (in WIOA plans) and financial sanctions for non-compliance with framework	Yes  Based on work participation requirements: direct cuts in grants; also indirect: through increased levels of mandatory state spending	Yes  Financial sanctions (and incentives for localities) for state and local performance (in WIOA plans) and financial sanctions for non-compliance with framework	Yes  Bonuses are awarded for lowest and most improved error rates; penalties are awarded to highest error rates.	No
10	Conclusion from 5-6-7: perception of, concern about, and approach to problems of institutional moral hazard?	<p>Yes</p> <p>Concern for institutional moral hazard is apparent in UI, SA and activation. In UI institutional moral hazard relates to the possibility of states to borrow funds and to the extension of benefits. This has been addressed through automatic repayment of state deficits, federal legislation which enforces the use of extended benefits and through additional requirements for activation during extension of benefits. A new form of institutional moral hazard might be the slashing of the duration of regular UI benefits.</p> <p>In SA, concern for institutional moral hazard is clearly present in the transition of open-ended funding systems to a conditional block grant model. Furthermore, in SNAP the potential for moral hazard exists concerning states' flexibility in determining eligibility and concerning the quality of payments made by states with federal funds. The former seems to be adequately addressed by federal regulations while the latter is addressed by a bonus/malus system. That system seems vulnerable to gaming.</p> <p>Finally, there has been a long tradition of reforms in multi-tiered education and training policies to prevent moral hazard. Currently, the WIOA includes a performance management system based on federal indicators of which the levels are determined partially on the basis of statistical analysis.</p>					
11	Conclusions from 5-6-7: approach to principal-agent problems	n.a.					
12	Contribution to macroeconomic stabilisation by the benefit system	Low (Dolls, Fuest & Peichl, 2012a)					

\*\*The redistribution effects of SNAP have, due to time constraints, not been calculated.

Source: Own compilation.

*The two most important actors in American unemployment regulation are the federal administration and the states. The US system is characterised by a strong role for the states in both UI and SA and a general (transversal) approach to 'workforce development'. At first sight, concern for institutional moral hazard seems limited in the US case, despite some important elements of interstate solidarity at the federal level. This apparently limited concern may be explained by the low generosity of UI benefits, a large state role in UI funding, federal mechanisms to promote state fiscal responsibility, and major reforms of SA in the 1990s to promote SA activation. Simultaneously, American citizens may be more ready to organise solidarity at the federal American level than EU citizens are at the EU level. However, such an assessment underrates the salience of moral hazard, both at the individual and the institutional level, in the American policy debate. However, it would be a mistake to overlook the role of institutional moral hazard in the US case, because it has played a role in shaping welfare benefits and, more recently and prominently, in UI.*

UI is based on federal-state cooperation. The states are responsible for designing the most important parameters and fund the UI state benefits. The federal level imposes minimum administrative requirements and funds the administration costs for the states. In times of crisis, the federal level also provides Extended Benefits (EB) and Emergency Benefits (EmB). The EB are co-financed by the states (but in 2009 their financing became fully federal on a temporary basis), and the EmB are fully federally financed. Furthermore, deficits in state UI systems can be financed by federal loans. In other words, the UI system incorporates elements of interstate solidarity, which take the form of co-insurance and reinsurance by the federal level and federal support for administration costs. These mechanisms are more complex than in the other cases we examine. Next to imposing minimum administrative requirements, the federal level enforces state fiscal responsibility via the Federal Unemployment Tax Act (FUTA). The US UI benefits are not generous, which may reduce concern for individual and institutional moral hazard with regard to UI. Also, the US system of 'experience rating' includes a specific mechanism to fight moral hazard with the employers.

One aspect of the US system needs a specific comment. In row 4 of the analytical grid we write that 'transfers between levels of governments' only apply in the loan system, and with regard to the support of the state administrations. In other words, we have chosen to describe the American system of EB and EmB as a system that is not characterised by transfers between levels of governments. However, from a technical point of view, the EB and EmB are disbursed to individual American citizens by the states (who also assess the individual eligibility); state accounts are reimbursed by the federal government. Hence, budgetary transfers are applied to implement EB and EmB.<sup>30</sup> Nevertheless, EB and EmB are seen as truly 'federal' benefits in the American public debate, clearly distinct from 'state benefits'. In spirit, they correspond to the 'genuine' variant of an EUBS, in which a direct link would be established between an EU fund and individual European citizens. For that reason, our classification tilts the American EB and EmB system towards the 'genuine' variant in our overall project.

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<sup>30</sup> We thank Christopher O'Leary for this information.

Obviously, this is a matter of judgment and debatable (also, given the fact, that the EB and EmB are subject to triggers, which is seen as a characteristic feature of equivalent variants of the EUBS in the Consortium's research project; cf. Task 1C).

One of the SA programmes, Temporary Assistance to Needy Families (TANF), is operated by the states according to very broad federal guidelines. States that comply with these guidelines can apply for a federal block grant. However, one of the federal requirements is that the states maintain a certain level of spending themselves (Maintenance-of-Effort or MoE spending), so costs for TANF are shared. The other, larger, SA programme (Supplemental Nutrition Assistance Program or SNAP, formerly Food Stamps) is a system designed primarily to increase the food purchasing power of eligible low-income households in order to help them buy a nutritionally adequate low-cost diet. This programme is more centralised than TANF: it is designed by the federal government and the states implement it.

UI and SA activation is part of an overarching approach to 'workforce development' (governed by the federal Workforce Investment Opportunity Act, or WIOA): workforce development aims to promote activation and training in all the states but without a link, at the level of individuals, with specific benefit schemes. As with TANF and UI, WIOA is implemented by the states according to federal guidelines. States can submit claims for WIOA funding; once approved, the federal administration finances the state WIOA programmes.

Since states have an important responsibility with regard to UI activation, the ability of states to cover their UI deficits with federal loans and federal financing of UI benefits during times of crisis generates institutional moral hazard. Institutional moral hazard in UI has been addressed by FUTA, which forces states to cover deficits that persist over two years and penalises states for not complying with administrative standards, and by additional activation requirements for individuals who receive EB or EmB. In other words, the federal government becomes increasingly concerned with institutional moral hazard in UI when federal dollars are at stake. Furthermore, since the crisis, states have used their autonomy to decrease the length of their UI programmes. During periods of EB, this could lead to extra federal costs, but it also endangers the stabilisation effects of the UI programme as a whole. This has been signalled by the federal government.

Furthermore, concern for institutional moral hazard has played an important role in shaping the accountability system of the US workforce development system. States enjoy significant autonomy in the workforce governance system, but this must be done according to federal guidelines. WIOA includes a performance management system, which has been strengthened since its last incarnation: the Workforce Investment Act (WIA).

Institutional moral hazard in SA has been addressed, among other things, by the implementation of TANF. Its predecessor (Aid for Families with Dependent Children, or AFDC) provided open-ended funding for the states and did not include elaborate activation requirements. TANF funds are limited by the size of the block grant and entail activation requirements both at the individual and the state level. Additionally, states must report their efforts and the way in which they spend their funds. Finally,

the MoE requirements address the possibility that states replace their own spending with federal funds. The federal government is concerned about the quality of the implementation of SNAP by the states and uses financial incentives to align state behaviour with federal goals.

So, although we may presume that concern for institutional moral hazard is less prominent in the US than in Europe, due to the low generosity of benefits (and more readiness to organise solidarity at the federal American level than at the EU level), it would be wrong to assume that concern for institutional moral hazard has not affected the US regulation of unemployment. FUTA, the introduction of TANF, the monitoring of WIA efforts and the additional activation requirements for individuals with EB or EmB, all bear witness of concern for institutional moral hazard.

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