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Published in:

Sit by and watch idly? Labour market policy in a period of crisis: conference report

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Citation for published version (APA):

de Beer, P. (2010). Who should take responsibility for unemployment compensation and activation? In P. de Beer, & M. Zwieters (Eds.), *Sit by and watch idly? Labour market policy in a period of crisis: conference report* (pp. 33-37). Amsterdam: Amsterdam Institute for Advanced labour Studies, University of Amsterdam.

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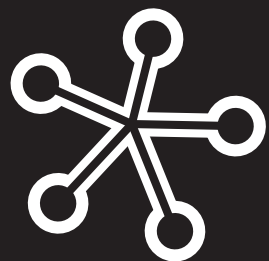


Sit by and watch idly?

Labour market policy
in a period of crisis

*AIAS conference
26 mei 2010*

Conference report



Amsterdam Institute for
Advanced labour Studies

Acknowledgement

The conference was made possible by a grant of *Stichting Instituut GAK*

Library information

P.T. de Beer, M.D. Zwiers (2010) Sit by and watch idly? Labour market policy in a period of crisis. AIAS Conference report, AIAS conference 26 May 2010 Amsterdam: University of Amsterdam

August 2010

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Photograph: www.stockxpert.com

Print: Drukkerij De Raat & De Vries

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Sit by and watch idly?

Labour market policy in a period of crisis

CONFERENCE REPORT

Edited by Paul de Beer & Merle Zwiers

AIAS

University of Amsterdam

Who Should Take Responsibility for Unemployment Compensation and Activation?

Paul de Beer - AIAS, De Burcht

In 2008, a state committee, chaired by Peter Bakker, envisioned a future without mass unemployment. The real problem of the future would be a lack of workers. The financial crisis has cruelly disturbed this rosy dream. Although the unemployment level has risen less than anticipated, nevertheless the number of unemployed has grown by 160,000 in one and a half year. During the first decade of the 21st century the unemployment rate remained below 4% of the labour force in only three years. And even though the labour force will shrink in the near future, unemployment will probably remain a common phenomenon. After all, this crisis will certainly be followed by new crises. Moreover, the thought that a shrinking labour force results in a structurally lower unemployment rate is neither supported by modern economic theory nor by empirical evidence. (EU countries with a declining labour force experienced slightly higher unemployment rates between 1997 and 2007 than countries with a growing labour force).

So, unemployment will still be one of the most important risks that working people face in the future. There are, therefore, good reasons to reconsider the design and implementation of programmes to prevent unemployment (such as dismissal protection and active labour market policies) and to mitigate the consequences of unemployment (such as unemployment benefits). Much reforms have already been implemented in this policy area in the Netherlands in the past ten years. For example, the maximum duration of unemployment insurance has been reduced from 7.5 to a little over 3 years, the administration of unemployment insurance has been transferred from bipartite sectoral bodies to one national public body (the UWV) and a market of private re-integration services has been created.

However, most political parties pleaded for new reforms as part of their platform for the general elections of 9 June 2010. Several parties want to reduce the maximum duration of unemployment insurance to one year, some others want to let employers pay for the first half year of the unemployment benefit. Some parties advocate

transferring (part of) the tasks of UWV to the municipalities, while the liberal party VVD is in favour of a larger role of private companies in the administration of social insurance.

In view of the many reforms that have already been implemented in the past but have apparently not been successful – at least, according to the political parties – it is well-advised not to carry out new radical reforms overnight. One should first carefully weigh the pros and cons. Two questions, in particular, need to be answered first.

First, what is the preferred relationship between unemployment compensation, employment protection and active labour market policies. In the past, these were largely separate policy fields, but they should be much closer related in the future.

Secondly, one should carefully distribute the responsibilities for each of these policy domains. In the past, the distribution of responsibilities has been changed frequently, but this was not based on a clear vision of the optimal distribution. For example, the social partners have been jointly responsible for the administration of unemployment insurance for most of the post-war period, while the Public Employment Service was responsible for active labour market policies and employment protection. Since 2002, the public UWV carries responsibility for both unemployment insurance, dismissal protection and activation policy, while the municipalities administer social assistance and activation policy for their clients. This has made the distribution of responsibilities much clearer. But this does not imply that the present distribution is optimal. While the municipalities are also fully responsible for financing social assistance – since they receive a lump-sum subsidy from the state – the expenses of the UWV are still reimbursed by the state – since it has no other tasks and, therefore, cannot shift funds between different programmes.

In order to improve our understanding of the best co-ordination of social benefits, employment protection and active labour market policies and the optimal distribution of responsibilities for them, AIAS has performed an in-depth study in the past four years. The main results of this study have been published in the book *Wie zorgt voor zekerheid? (Who cares for security?)* by Paul de Beer, Marcel Hoogenboom, Lucy Kok and Trudie Schils. The book concludes that there is not one optimal distribution of responsibilities. To start with, unemployment compensation, employment protection and activation policy have various goals and the weighing of these goals is not a

scientific question but a political issue. Nevertheless, it is possible to say something about which configurations are *not* optimal.

First of all, although this may be stating the obvious, a pure private model, in which the government does not interfere with benefits, dismissals and activation, is neither theoretically nor empirically feasible. There are simply too many market failures to be able to manage without government intervention.

Secondly, a pure centralised state model, although certainly feasible, since it largely resembles the current Dutch configuration, is wrought with government failures. The main problem is that a public administration hardly experiences any incentives to reduce the number of benefit claims and promote re-integration. Although the central government can try to push the public administrator to improve its performance, it cannot really force it, since there is no competing administrator to compare it with (benchmarking) or to pass its tasks onto.

Thirdly, sharing or spreading responsibilities is also not desirable. In the Netherlands, the social partners, the municipalities and the (regional) public employment service have shared responsibilities for a long time. Since both the social partners and the municipalities could shift the financial burden of benefits onto the society, this resulted in an inefficient and ineffective administration. The termination of this model in the late 1990s was therefore quite sensible.

Now, what about models that may be preferable? In general, these should comply with two conditions.

- 1) First, the same actor should be responsible for both benefit administration and re-integration activities. This makes it much easier to shift funds between benefits and re-integration and, thus, take into account the positive impact of effective activation on the number of benefit claims. This will therefore provide the right incentives for activation.
- 2) Secondly, the same actor that decides about benefits and activation should also bear the financial burden of its decisions. So, it should not be possible to shift the expenses onto another actor, such as the central government.

There seem to be two viable models that comply with both conditions. The first is a sectoral model and the second a municipal model.

In a sectoral model the social partners – trade unions and employers associations – share the responsibility for unemployment insurance and activation policies (and, possibly, dismissal protection) at the sectoral level. As a consequence, unemployment insurance and activation policies are also fully financed from sectoral funds. This model has two advantages. Arrangements regarding unemployment insurance and activation will become part of the bargaining over collective labour agreements. Thus, the social partners can weigh more generous benefits or more activation against, for example, higher wages. Wage moderation may then partly be compensated by a smaller number of unemployed and, hence, lower expenses of unemployment benefits. Moreover, the responsibility for unemployment benefits and activation will then be carried by the actores that are directly involved in and have the best knowledge of the functioning of the labour market, which might speed up the return of the unemployed to work or the changing of jobs by employees.

Although the social partners are responsible for unemployment insurance and activation policies in this model, this does not necessarily imply that they also carry out the administration themselves. They might decide to outsource the administration to private insurance and re-integration companies.

The main weakness of this model is that, as the unemployment insurance benefit expires, the long-term unemployed have to be transferred to the municipalities who administer social assistance. As a consequence, the longer the unemployment spell, the less incentives the social partners have to take costly activation measures, since both the remaining benefit duration and the probability of successful re-integration become smaller. To prevent activation efforts from declining, the social partners should get a fine for each long-term unemployed that is transferred to a municipality.

The second model that complies with both conditions is the municipal model in which the municipality carries the responsibility for all social benefits and all re-integration activities for unemployed people of working age. Thus, in addition to social assistance, the municipality is also responsible for the administration and financing of unemployment insurance and the activation of redundant workers. The main advantage of this model is that there is no longer a cut-off line between short-term

and long-term unemployed. However, an important drawback is that municipalities have no direct link with the sectoral labour market, which is still important for most dismissed workers. Thus, it will be rather difficult for them to guide employees who are recently dismissed or will be dismissed shortly, to a new job, unless they succeed in co-operating with the sectoral social partners.

As noted before, it cannot be judged on scientific grounds, which of these two models is the best. This is really a political issue. Although several political parties seem to opt for the municipal model, they are not explicit yet about the funding of unemployment insurance. Moreover, some other parties seem to be in favour of a greater responsibility for employers in the first period of unemployment, which comes close to the sectoral model. So, at the moment of writing it is not yet clear into which direction the distribution of responsibilities will change in the coming years.