

# Decentralisation of labour market policy may matter, but other reforms matter more

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Essentially, we agree with the key point of view of ministers Marcourt and Vandenbroucke. If “labour market policy” is restricted to “*active* labour market policies” (ALMP), aiming at the (re)integration of unemployed workers and at the preservation and enhancement of the employability of the active population, further regionalization *can* indeed make policy more coherent and therefore less costly. Nevertheless, even if ALMP should in principle be regionalized, in practise this involves a number of complications, which, if not resolved, could make the regionalization counterproductive. We will point to a number of these problems. More fundamentally, we argue that, before reflecting on the regionalization of labour market policy, we should first step back and reflect on the optimal design of labour market institutions, independently of the issue of decentralization. Labour market institutions include formal organizations, laws, rules and policies that affect the functioning of the labour market. To our opinion, to overcome the huge demographic and economic challenges that we currently face, a comprehensive reform of these institutions matters much more than the decentralization of labour market policy. Within the limits of this paper, we focus on the design of the employment protection legislation (EPL) and of unemployment insurance (UI). We restrict our attention to EPL and UI because the optimal design of these institutions are directly related to that of ALMP, which lends itself to regionalization. *This does not mean, however, that we regard reforms of other labour market institutions, such as the (early) retirement schemes, wage formation, minimum wages and the regulation of migration flows as less important.*

## 1. A fundamental reform of EPL and UI

The current EPL and UI were set up in an economic environment in which relationships between workers and firms were typically long lasting and stable. The increasing globalisation of the economy and the rapid technological and organisational changes require more flexibility of both workers and firms leading to career paths which are much more volatile both within and between firms. Current institutions must be therefore urgently reformed to reconcile this new need of more flexibility with that of security for workers. The call for “flexicurity” is not new, but there is no unanimity on the corresponding institutional model it implies. In a nutshell, we propose the following guidelines for reform, justified in a companion document (Cockx and Van der Linden, 2009).

Transform the bulk of current advance notice payments into a *unique* lay-off contribution, independently of the type of worker (blue or white-collar) and type of contract (temporary or open-ended). A small severance payment is due to cover the “psychic costs” related to dismissal (defined in the companion document). In order to make the employer accountable for the costs he imposes on society, the lay-off contribution should be made proportional to the cumulative past earnings since the moment that the worker was hired in the firm. This contribution would be used not only to finance a supplement to the current unemployment benefits, but also, as to make the worker more accountable, to finance ALMP for the

unemployed. Aside of this scheme, it makes sense to generalise the current scheme of temporary unemployment benefits for blue-collar workers to white-collar workers, but only to the extent that one introduces “experience rating” in the funding, so that again the employers are made accountable for the social costs that they induce by these temporary lay-offs.

To the extent that the Regional authorities are competent with regards ALMP, the additional funding generated by the lay-off tax can partially be used as an additional funding of Regional policy. However, the Regions should not be funded according to the proceeds of the lay-off taxes (nor on the basis of an indicator of Regional unemployment). Rather, in order to provide correct incentives they should receive a lump-sum amount plus a variable part that is positively related to the *increase* in the employment rate realised within the Region, but negatively to the average increase observed in neighbouring countries. We return to this incentive scheme below.

## 2. *Decentralised labour market policy: principles and difficulties*

The starting point of ministers Marcourt and Vandembroucke is that labour regulations, wage policy and the funding of Social Insurance and all its branches should remain within the competence of the federal authority. This is completely in line with the arguments expressed in Van der Linden (2008) which we both completely subscribe and which we don't repeat here. Remaining federal does not mean that no reforms are needed but discussing all of them is beyond the scope of this paper (some are developed in Van der Linden, 2008).

Moreover, we agree that it makes sense to transfer a number of competences which currently still are at the federal level, but which logically are part of a competency that has been transferred to the Regional level. These concern essentially ALMP that aim at reintegrating unemployed and inactive workers in the labour market. These include the variety of training and counselling programmes, and intermediation services. An optimal allocation of ALMP can only be realized to the extent that the coherent set of policy instruments are grouped within one authority level. Establishing a precise list of the policies that should be regionalized is beyond the scope of the present paper.<sup>8</sup> To avoid counter-productive effects, this can only be done by considering each policy in turn and by looking very carefully at the implications of decentralization. Then, the same exercise should be made for the group of regionalized policies taken together.

### *Targeted wage subsidies*

More delicate is whether the Regions should be made responsible for the targeted wage subsidies<sup>9</sup> and for the monitoring and sanctioning of job search, of job acceptance behaviour and of mandatory participation in ALMP. We now consider these two groups of policies in turn.

One argues that federal wage subsidies directed to specific target groups should be regionalized, because this allows to accommodate these subsidies to the Regional labour market conditions. An example to support this point of view and that is often repeated in public opinion is that Wallonia and Brussels have a problem of youth employment while the employment rate of older workers is too low in Flanders. The problem would be resolved if each Region could target the wage subsidy according to its needs.

This argument is flawed for at least three reasons. First, as documented in Van der Linden (2008), all regions have a problem of low employment of both youth and older workers (if the *Regional* average is the reference). The difference between the Regions is a matter of

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<sup>8</sup> The position paper of the ministers asks for a complete regionalization of training and educational policies that are up to now still federal. They also mention other policies that should be considered for a regionalization: the ALE/PWA, outplacement, temporary work permits... Even though collective bargaining remains federal, one should maintain a role for social partners in case of a regionalization of these instruments.

<sup>9</sup> Contrary to Vandembroucke (2008), the position paper of the ministers does not ask for such a reform.

relative importance. Second, if the federal legislation entitles both youth and older workers to targeted wage subsidies, then each Region will benefit from these subsidies in proportion to the number of beneficiaries: in Wallonia and Brussels, there will be proportionally more youth who will be subsidised, in Flanders more older workers. Finally and more fundamentally, one may question whether targeted subsidies to youth and older workers are effective policy tools. It is our opinion that the exclusion of these groups from labour market participation is more linked to other reasons (notably, existing forms of labour market protection, seniority rules in wage ladders and the existing early retirement schemes). We believe that a reform of labour market protection along the aforementioned lines (coupled with a much more restrictive use of early retirement schemes) will be much more effective in integrating these target groups into the labour market.

This does not mean that targeted wage subsidies are not useful at all. In previous research (e.g. Cockx *et al.* 2005a, b) we have repeatedly pleaded for an intensification of the *structural* reduction of employer contributions for low wage-workers in which one could accommodate for the increasing relationship between wages and age (Van der Linden 2005). In addition, we have shown that *temporary* wage subsidies for (young) long-term unemployed workers may be effective. As far as we know, this conclusion cannot rigorously be extended to other demographic groups in Belgium.

If it makes sense to regionalise any subsidy, it would be the *temporary* targeted subsidies.<sup>10</sup> The reason is that this form of subsidy could be regarded as a substitute to other ALMP. Since the latter are already a Regional competence, it makes sense that the Region could decide upon the optimal policy mix it provides. Moreover, to the extent that this competence is limited to the *temporary* subsidies there is less risk of engaging in a fiscal competition between the Regions. This also justifies maintaining the competence of all structural labour cost reductions at the federal level. Note that this implies that we oppose the current possibility of Regions to offer a tax exemption to all employees living in a particular Region (the “jobkorting” in Flanders).<sup>11</sup> This opens the door to fiscal competition. If one believes that such measures are useful, they should be decided upon at the federal level.

### **Monitoring of job search**

We agree with ministers Marcourt and Vandenbroucke that it makes sense to regionalize the monitoring and sanctioning of job search, of job acceptance behaviour and of mandatory participation in ALMP's: (i) the Regional unemployment agencies ("UA's") enter in direct contact with the unemployed and are therefore better informed than the federal UA on the effort is exerted to escape unemployment; (ii) it isn't cost effective, as currently, that these tasks are divided between the two agencies. By the way, Regional UA's can already automatically induce a sanction if the information transmitted to the Federal UI agency is a withdrawal from the register of insured unemployed. Nevertheless, if one assigns the complete responsibility of monitoring to the Regional UA's, then two complications must be resolved. First, there is a risk that the function of counselling and intermediation conflicts with that of monitoring and sanctioning if they have to be realized within the same organization (Van der Linden, 2009). We need not forget that the separation in 1978 of the federal UA into two services resulted from the difficulty of integrating intermediation and monitoring within one service (Palsterman 2003). Second, the Regional UA's will under-invest in both the monitoring and the services they provide to unemployed if they are not financially rewarded for the savings they generate in terms of reduced unemployment benefit payments by the federal UA. This brings us to the proposal of ministers Marcourt and Vandenbroucke to design an appropriate funding scheme that internalises the external benefits of its actions to the federal UA.

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<sup>10</sup> To a small extent, Regions have already implemented their own temporary wage subsidies. Currently, federal temporary targeted subsidies mainly are the so-called activation of unemployment benefits and the temporary reductions in social security contributions (whose importance has been much reduced by the inter-sectoral collective agreement 2009-10).

<sup>11</sup> Recall that for economists it does not matter which side of the market is taxed. Cuts in income taxation can eventually be translated into reductions in the wage cost.

### *Incentive funding*

To the extent that the Regional monitoring activity and their ALMP improve the matching between job seekers and job vacancies and so eventually increases employment, the Regional UA's generate a positive externality on the federal budget. Outlays on unemployment benefits are so reduced and tax receipts increased.<sup>12</sup> It makes therefore sense to reward the Regions for this positive externality. A simple way of realising this objective is to introduce a transfer from the federal authorities to the Regions that is positively related to both the average savings per *full-time equivalent* employed worker and the Regional *full-time equivalent* employment rate. It makes more sense to relate it to the employment rate than to an indicator of the unemployment rate, since this avoids the adverse incentive of rewarding the Regions by pushing unemployed workers into inactivity.

We should refine the incentive pay scheme such that it rewards only changes in the employment rate that are a consequence of the actions undertaken by the Region.<sup>13</sup> Van der Linden (2008) discusses at length the complications of identifying an outcome indicator that correctly reflects the savings generated by the Regional employment policy rather than other factors. Here we follow a more constructive and pragmatic approach by defining a refinement of the above-mentioned indicator that is far from perfect, but that remains relatively simple, while taking a number of essential complications into account.

First, the employment rate is probably more affected by the business cycle than by the Regional policy actions. For instance, without any correction for the current worldwide economic crisis, the incentive pay would sanction all the Regions, even if they were not responsible for the fall in the employment rate. We therefore propose to relate the reward to the difference between the Regional and the average employment rate in the neighbouring countries.<sup>14</sup> Second, the scheme should reward and sanction current and not past policy as to avoid that the scheme would sanction the Regions who did not perform well in the past. Therefore, it's important to normalise the transfer at some negotiated starting date. This implies that for a given employment rate the Walloon Region could receive a higher transfer than the Flemish Region if Wallonia realizes higher employment growth than in Flanders. The scheme could nevertheless take into account that it's more difficult to increase the employment rate by one percentage point if the initial level is higher in one Region than in the other. Finally, some workers living in one Region will find employment in another Region. This raises a complicated question of which Region is responsible for the employment realized in another Region. Is it the sending Region, e.g. by providing appropriate training or search incentives to its unemployed workers? Or is the employment the consequence of the Regional provision of adequate infrastructure and other favourable conditions for employment creation by firms? Since it is difficult to assign a correct weighting for each of the factors, we propose to use an adjusted employment rate in the incentive pay scheme. In the adjusted employment rate the transfer would be calculated such that a worker living in one region and working in the other would contribute for 50% to the employment rate where she lives and for the other 50% to the employment rate of the Region where she works. Obviously, this is a first proposal that may require more reflection before it's implemented.

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<sup>12</sup> The increase in tax receipts currently only affect the Regional receipts to a limited extent.

<sup>13</sup> Note that this incentive pay scheme could be partially financed by the lay-off contribution of the reform mentioned in Section I. A deep revision of the "trekkingsrechten/droits de triage" is also recommended (Van der Linden, 2008).

<sup>14</sup> An alternative would be to relate it the employment rate of the country. By doing so, the incentive scheme would, however, become a zero-sum game in which the best performing Region(s) would be always be rewarded and the worst performing Regions would be sanctioned. One could imagine, however, that all Regions perform well, in that their policy results in a growing employment rate, even if one region may relatively perform better than the other. Relating the employment norm to the neighbouring countries avoids a zero-sum game, which makes sense in this context, because it's absolute and not relative performance that matters. Note, any aggregate benchmark can suffer from imperfections due to differences in compositions (according to, say, sector of activity or demographic characteristics). Ideally, one should try to correct for these differences.

### 3. Conclusion

To face the challenges induced by the economic and demographic crisis we currently need an ambitious reform of labour market institutions and, in particular, of the employment protection legislation (EPL) for which we provide some guidelines in a companion document (Cockx and Van der Linden, 2009). The reform of EPL is much more important than the decentralisation of labour market policy. This does not mean that decentralization, if properly designed, cannot bring efficiency gains. In this perspective, the joint proposal of ministers Marcourt and Vandembroucke goes in the right direction. Still, we argued that a number of these gains are uncertain and crucially depend on their precise implementation.

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