

Regional Labour Market Policies: Scope and Limits in a Federal State

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1. *Introductory Remarks*

It goes without saying that labour markets are, much more than any other market, intimately embedded in the overall national institutional framework. This holds in particular for the European continental labour markets, characterized by a relatively high degree of social protection. This fact implies that decentralization or a “regionalization” of labour market policies in a federal setting, motivated by economic efficiency grounds needs to be evaluated by equity considerations. The latter refer to, i.e. the equal treatment of identical citizens in comparable socio-economic situations, including their equal access to social protection. This constraint on the devolution of federal policies inspired the shaping of the federal system in Belgium and in other European post-war federal states.

The close connection between working conditions (hours, retirement age ...), social rights acquired during involuntary inactive spells of time and the entitlement to legal pensions , unemployment benefits and replacement income during periods of illness, necessarily imply a uniform federal legal framework, that is at the heart of the social security system.

Because of the low degree of interregional labour mobility and of the striking and persistent differences between regional unemployment rates, one can hardly perceive the Belgian labour market as one, integrated market in contrast to e.g. the more homogeneous labour market in the Netherlands. This feature inspires the idea to regionalize some aspects of labour market policies in order to deal with the specific regional hard core problems in a more efficient way. Some of these aspects that are actually debated on the political forum will be briefly discussed in the sequel.

2. *Unemployment Benefits*

2.1 *Efficiency and Redistributive Aspects.*

Negative shocks hitting all or some regions and resulting in an increase of the unemployment rate(s), can be distinguished according to their transitory or permanent nature. A business cycle downturn hits all regions and represents a transitory negative shock, although its unemployment effect may differ regionally. The specific industrial pattern of a region, e.g. the importance of the car assembly sector and of related suppliers in Flanders, may as a result of a worldwide restructuring, either lead to a transitory period of higher unemployment or to a prolonged distressed regional labour market. The flexibility of the regional labour market, the performance of the regional intermediation agencies and the emergence of new economic activities will make the difference.

It is, from an insurance point of view, efficient to pool social risks due to transitory negative shocks that hit all regions or that are specific for some regions. “*Pooling*” social risks implies a federal insurance system, financed basically by employee and employers’ contributions. On the other hand, permanent negative shocks that cover several business cycles and lead to persistent (or “structural”) high levels of unemployment in some regions cannot be efficiently insured. They therefore call on an interregional redistributive mechanism, organized at the

federal level and sustained by federal subsidies. The redistributive dimension of the unemployment benefit system is deeply embedded in our social security system, although its relative weight in total social expenditure could be reduced by a more efficient organization of labour market policies.

The pure insurance as well as the redistributive dimension of the unemployment benefit system is subject to the well known moral hazard problem at the level of the insured. But due to the specific Belgian situation, created by the 1980 constitutional reform, an additional moral hazard problem arises. Since then, the financing, regulation and sanctioning functions have been maintained at the federal level (with the RVA –ONEM), whereas labour market intermediation, monitoring and training functions have been transferred to the regional Employment Agencies (EA). Because it is not evident that the latter do take the federal insurer's budget constraint into account, an incentive problem may arise at the regional level. Several proposals to increase the accountability of the regional EPs have been put forward in the recent past.

2.2 *Incentive Schemes for the Regions*

2.2.1 If the principle of equal access to social protection for the insured in identical situations applies, irrespective of their region of residence or of work place, unemployment benefits should be maintained uniformly across all regions. In addition, the strict adherence to the “*level playing field*” principle for firms implies uniform employers' contribution rates as well.

The difference between the unemployment impact of negative transitory shocks and of permanent ones is to a large extent reflected in the time span of uninterrupted average spells of unemployment. In addition to the impact of these negative demand shocks, regional labour supply characteristics as well as relatively high labour costs- as compared to labour productivity of the job seekers- result in regionally specific pockets of long term unemployed. Young, low skilled unemployed and older (50 +) job seekers fall into this category. But as shown by Van der Linden (e.g. 2008), the unfavourable gap between their acquired skills and their labour costs appears to be more important than their age profile. The common feature of these two groups is their long spell of unemployment, i.e. more than one year. The probability of finding a suitable job drops dramatically to zero after this initial uninterrupted spell of unemployment. Hence, unemployment benefits for these categories are more of a redistributive nature, as compared to the pure insurance dimension of the system.

In view of their large share of the Belgian unemployed population, i.e. 50.4 % in 2007, which substantially exceeds the EU-15 average of 40.5 % for the same year (*Eurostat data*), it is clear that a high priority should be given to them in the active labour market policies (LMP). The striking regional differences (2007 data) of their respective share in total unemployment, reaching about 57 % in the Brussels Capital Region and in Wallonia, as compared to Flanders (37,5 %), suggest a regional specific policy mix.

2.2.2 *The most simple incentive scheme* for the long term unemployed could be based on their regional (average) number during a reference period, agreed on by all regions. The economies in terms of benefit expenditure at the federal level would flow to the region in which the yearly average number of long term unemployed decreases on condition that the period of continuous employment exceeds x months. The transfer in favour of the region should preferably be earmarked, i.e. only used for active labour market policies. If the employment is situated in a region, different from the region of residence, the “*bonus*” could be subject to a sharing rule. Although the derived fiscal gains of an increased regional employment rate exceed the economies in terms of reduced unemployment benefits, the former should remain at the federal level in order to finance its rising ageing costs and the burden of its debt.

Symmetrical to the bonus, a penalty or “*malus*” is conceivable if the regional number of long term unemployed increases substantially in a given year. However, the practical implementation of a penalty system is hindered by the occurrence of unforeseen, regionally specific negative shocks that can be evaluated only ex post and that could be subject to divergent interpretations, drawing the incentive scheme into endless discussions.

2.2.3 A preferable and more realistic incentive scheme should be based on *regional overall employment rate targets*, defined over a medium term time span. In this way, the incentive scheme fits into the federal employment policy, aiming at substantially increasing the employment rate in order to cope with the forthcoming ageing issue. The employment rate targets should be conditioned on national growth forecasts translated into regional growth forecasts and their derived employment elasticity. For each year of the forecast period, the federal forecasted economies in terms of unemployment benefits could be allocated to the regions and corrected for ex post in a positive or negative sense. The use of employment rate targets over unemployment rate goals, also avoids classification issues of the unemployed decided on by the regional EA (e.g. according to their appreciation of suitable job opportunities). Clearly, such an incentive schema should be part of a cooperation agreement between the regions and the federal government and evaluated periodically. In addition, it does not exclude periodical audits of the regional EA by the federal insurer (RVA-ONEM) of their performance.

2.2.4. Since the characteristics of the long term unemployed *differ substantially between regions*, regionally specific employment incentives (for the unemployed as well as for the employers) should be allowed for in the framework of the federal budget for LMP. But in order to prevent interregional competition between firms for workers in times of labour scarcity, the conditions for granting these incentives, including maximum levels or rates, should be part of an overall federal legal framework. Moreover, it is conceivable to transfer the total budget for LMP *measures* in a reference year, (i.e. exclusive of the federally financed unemployment benefit component and the costs of the EA’s services), which amounted to about .89 % of GDP in 2006, (*Eurostat data, categories 2 to 7*) to the regions and make them financially accountable for future increases. In this way, the regions can apply the appropriate active labour market policy mix, within the limits of the cooperation agreement.

2.2.5 A final remark bears on the close link between regional incentives for target groups, e.g. older workers, and the *federal early retirement scheme*. The latter, although overhauled in the so called “*generation pact*”, still invites employers to shed older workers (55+) , which conflicts with incentive schemes designed for this group. An adjustment of the early retirement scheme in view of the ageing challenge would therefore render federal and regional employment policies more efficient and reduce the burden of the redistributive aspects of the unemployment insurance system.

REFERENCES

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