JOB SUBSIDIES AND CUTS IN EMPLOYERS’ SOCIAL SECURITY CONTRIBUTIONS: THE VERDICT OF EMPIRICAL EVALUATION STUDIES

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ABSTRACT

In many European countries and elsewhere, governments rely on employment subsidies and cuts in employers’ social security contributions to improve the employment prospects of the long-term unemployed and other vulnerable groups in the labour market.

Policy makers often justify this strategy by referring to theoretical analyses and simulations which suggest that such measures have strong positive effects on the employment and mobility chances of beneficiaries.

This paper brings together findings from recent empirical evaluation studies which have tried to gauge the actual effectiveness of such measures. Although the paper includes findings from studies which look at non- or broadly targeted measures, the emphasis is on measures which are aimed at stimulating the recruitment of long-term unemployed persons and other vulnerable groups in the labour market.

The most striking overall finding is that the net employment effects of such measures generally turn out to be substantially lower than what most theoretical models and simulations predict, even under relatively pessimistic assumptions. This finding is particularly striking because of its consistency across studies. This appears mainly due to larger than expected deadweight losses and, to a lesser extent, substitution effects.

The second striking finding is that there is little evidence that targeted subsidies have a beneficial effect on the later careers of beneficiaries. A period of subsidised employment can even have a negative impact on beneficiaries’ future employment prospects.

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Introduction

In Europe and elsewhere, employment subsidies and cuts in employers’ social security contributions are being used to improve the labour market prospects of the unemployed and other vulnerable groups in the labour market. According to OECD (2003) figures, such programmes account for a significant share of expenditure on active labour market programmes in the OECD area, on average 24 per cent. Some countries, Belgium and Ireland for example, devote half or more of their active labour market spending to such programmes; the UK and the US well under 10 per cent. An average of 0.18 per cent of GDP is spent on such programmes in the OECD as a whole, with Belgium (0.69 per cent) and Ireland (0.53 per cent) again being notable outliers. Spending on targeted employment subsidies is also significantly above the OECD average in countries like the Netherlands (0.38 per cent), France (0.34 per cent) and Spain (0.33 per cent). At the other end of the scale, the United States spends only 0.01 per cent of its GDP on employment subsidies, the United Kingdom 0.03 per cent.

The context is well-documented. Structural unemployment and, more broadly, mass benefit dependency at working age remain major features of European labour market. Unemployment rates have generally come down but the discrepancy between the ILO/OECD unemployment rate (which requires people to be active job seekers) and broader measures of unemployment remains vast in many European countries. In countries like Belgium or France, still one working aged person in four is fully dependent on social transfer income (table 1). That equals one full-time benefit recipient for every two persons in full-time employment. Note that such high levels of benefit dependency have also persisted in countries that have seen significant improvements in overall labour market conditions. The Netherlands, for example, has seen massive employment growth over the past decade; its employment rate increased a staggering 15 percentage points in as many years. Its unemployment rate dropped to 2.5 per cent in 2001. But chronic benefit dependency at working age remains a significant problem. It stood at around 18 per cent in 1999, 2 percentage points higher than in 1980.

[ Table 1 ]
Such levels of chronic benefit dependency among sections of the population who, for the most part, are work-able are widely deemed undesirable and even unsustainable - for economic, fiscal and political reasons. It is also well-documented that structural unemployment and, more broadly, chronic benefit dependency is overwhelmingly concentrated among the less skilled.

The cost of labour, especially less skilled labour, is generally perceived to be a major obstacle to the (re-)integration of such groups into the regular labour market, especially in European countries where the lowest wages are relatively high relative to average earnings and where social security contributions are substantial.

To illustrate the European, especially the Continental European context, let me give some contextual information from my own country. Belgium is first of all typical in the sense that it has a comprehensive social security system of Bismarckian design that covers the entire population of employees and that offers protection against such risks as unemployment, sickness, work incapacity, invalidity and old age. The system is co-funded by employers and employees. Employers’ contributions for the basic system (called the first pillar) are proportional to wages and amount to about 25 per cent of gross wage. In addition, employers pay extra contributions for funding general non-social security provisions like child care, educational leave, paid holiday etc. The total bill for employers amounts to around 40 per cent of the gross wage, depending on the category of worker. Furthermore, employers usually pay contributions to so-called industry funds which exist for various purposes (industry-wide training schemes, early retirement benefits, etc.) These are what are called the second pillar provisions, but their generosity and cost vary quite considerably from industry to industry. The extra costs tend to be quite substantial however.

Belgium is also fairly typical in the sense that it has a relatively high minimum wage, relative, that is, to median earnings. According to OECD statistics for 1997, the Belgian minimum wage amounted to around 61 per cent of full-time median earnings, compared to 68 per cent for France, 56 per cent for the Netherlands and 43 per cent for the United States. The minimum wage in Belgium is not a legal minimum wage as exists in some countries, but it is the minimum wage on which employers and trade unions have agreed at the national level. It applies to all workers. (Collective wage agreements are legally binding, i.e. they also cover
non-unionized workers.) This minimum wage has more of a benchmark purpose than anything else – it constitutes the absolute base of the wage building. "Real" minimum wages (i.e. pay scales for the youngest, least qualified and least experienced workers) are collectively negotiated at the industry level and these tend to be considerably higher than the nation-wide minimum wage. (Industries where the lowest pay scales are 20 to 30 per cent higher than the nation-wide minimum are not exceptional. In some sectors, the lowest pay scales are almost twice as high as the nation-wide minimum.) All the available evidence suggests that very few people actually work –or can work- for the nation-wide minimum. This is certainly the case in Belgium, but this is also so in countries like the Netherlands.

Figure 1 shows, again for illustrative purposes, the gross labour cost at minimum wage level (that is including social security contributions payable by the employer), the gross minimum wage itself, and net incomes for various household types (that is after social security contributions payable by the employee and personal income taxes). Clearly, the discrepancy between the gross cost of labour and the take-home income of employees is quite considerable.

Policy makers here are concerned with two things. First, that the net income of employees working for the minimum wage is too low relative to benefits, particularly for those on unemployment benefits (which in Belgium can be unlimited in time). This is a major area of policy concern and effort, but it is not the focus of the present paper. The second area of concern is with the cost of labour, particularly of less skilled labour. It is for that reason that the Belgian government has implemented various measures that aim to reduce the cost of labour, particularly at minimum wage level. This is mainly done through targeted reductions in employers’ social security contributions. These come in two forms: permanent reductions applying to low-paid workers and temporary but more substantial reductions for employers hiring people who have been long-term unemployed and other segments deemed at high risk of unemployment.

Policymakers here and elsewhere in Europe often justify this strategy by referring to theoretical analyses which suggest that such measures could have strong positive effects on
the employment chances of vulnerable groups – the long term unemployed and people with low skills. Snower (1994, 1997) and Phelps (1997, 1997b), for example, are noted advocates, on well-known grounds. Snower, for example, has claimed that well-targeted employment subsidies could reduce long-term unemployment by about a third and that the subsidy scheme would pay for itself in the longer run. Others economists (Richardson, 1998) have asserted that the indirect positive effects of employment subsidies and the like could turn out to be even more considerable in the long-term. The claim here is that the long-term unemployed constitute a labour reserve only in theory and that, consequently, they exert very little downward pressure on wages. Employment subsidies for the long-term unemployed could result, so the argument goes, in these outsiders, or at least some of them, being incorporated into the effective labour reserve, resulting in a dampening effect on wage demands and hence a further positive effect on employment.

Policy makers, at least in countries like Belgium, France and the Netherlands, also place great trust in simulations as those conducted by Bossier et al. (1995; 1998) and others (Jongen, 1998; Malinvaud, 1998; Sneessens and Shadman, 2000), which generally show selective reduction in employers’ social security contributions to have a substantial impact on employment. However, the outcomes of such simulations are sensitive to the theoretical and parametric assumptions (see for example Hui and Trivedi, 1986, Jongen, 1999; Granier and Nyssen, 1995; Nickell and Bell, 1997). Most crucially, the demand for low-skilled labour is assumed to be fairly sensitive to its cost. Most simulation models tend to use demand elasticities for low-skilled labour that are broadly supported by the empirical literature (Hamermesh, 1993), i.e. in the order of -0.4 to -0.5. However, surveys of enterprises suggest that employers tend to be very reluctant if it comes to hiring less-skilled people with specific characteristics, e.g. persons who have been unemployed for a long period of time. De Beer (1996), for example, reports some employers as saying that they would be unwilling to hire long-term unemployed persons at almost any cost. Moreover, it is legitimate to ask whether empirical estimations of the elasticity of demand provide an adequate instrument for simulating the response of employers to subsidies. Not all employers may be aware that such subsidies exist and there are usually administrative and other costs involved in applying (Katz, 1998). It may also be the case that the temporary nature of a subsidy and the costs involved in subsequent redundancies have a dissuasive effect. Such costs may be substantial.
in many cases, not only the direct administrative cost, but employers may also want to avoid strained relations with trade-unions and their work force.

So it is interesting to see what we can learn from practical experience with employment subsidies and related measures like reductions in social security contributions. This paper brings together the findings of empirical assessment studies in relation to the following two questions:

1) What is known about the employment effects of job subsidising?
2) What is known about the degree of mobility from subsidised to regular work?

The employment effects

*The take-up of subsidies by employers*

The empirical evaluation material available suggests that the response to employment subsidies and cuts in employers’ social security contributions varies quite considerably (OECD, 1993; Fay, 1997; Katz, 1998; Martin, 1998). There appears to be a connection in this respect between the scope, the generosity and the duration of such initiatives. Relatively generous measures with a relative broad scope involving a substantial subsidy or reduction generally generate a greater response. Ignorance is often a reason for non-take-up, which would appear to cohere with the fact that schemes are often of an experimental, local or temporary nature. Also, employers indicate that the (perceived) bureaucratic fuss and the expenses involved often dissuade them from applying, especially in the case of schemes with restricted eligibility. Voucher schemes, whereby employees carry the right to a subsidy with them as it were, appear to be more effective if one intends to target very specific groups (Sianesi, 2001).

A survey of Belgian industrial companies employing many low-skilled workers conducted in the early 1990s found that a considerable proportion of companies –often between 50 and 60 percent- were not aware of (temporary) cuts in social security costs for the employment of certain target groups, such as youngsters or long-term unemployed persons. Small companies
in particular appeared to be inadequately informed (Lamberts, 1993). The percentage of companies that actually took advantage of the measures was even lower, as many companies that were aware of the existence of certain reductions deemed them to be (largely) inapplicable. Again, this was especially the case among smaller companies. Lamberts (1993) attributes the relatively limited familiarity with and applicability of measures to the complexity and variability of legislation. This might explain why small companies in particular were less likely to take advantage of a measure, despite the fact that they involved quite considerable, albeit temporary, cuts in social security payments. A similar survey conducted by Ameels et al. (1994) offers further indications that the perceived complexity and administrative cost is seen by employers as a reason not to make use of certain measures.

More recent research in the Netherlands focused on a measure known as SPAK (Specifieke Afdrachtskorting Lage Lonen). SPAK, introduced in 1996, encompasses a reduction in fiscal and social security payments by employers for workers whose wages do not exceed 115% of the statutory minimum wage. The reduction is highest at the level of the minimum wage and cuts employers’ contributions by around 60 per cent or 13 per cent of gross pay. SPAK is targeted at all low-paid workers, including those are already in work. A survey conducted by van Nes et al. (1998) suggests that 72% of all eligible enterprises made use of SPAK at the time of the survey. Public services are reported to make most extensive use of the measure, while the lowest percentage was recorded in business services, the wholesale trade, the hotel and catering industry, the metal industry, the building industry, and the transportation and communication sectors. Yet, some of the latter industries are often considered to be industries where the cost of less-skilled labour represents a major problem. Large companies are more inclined to make use of SPAK than smaller firms (van Nes et al., 1998). The question arises then why enterprises do not take full advantage of the possibilities offered by SPAK. According to the survey, some 12 percent of companies feel that the projected savings on labour costs would not compensate for the additional administrative cost. About two thirds of companies who would otherwise qualify for SPAK did not take the opportunity because they were unaware that the scheme existed. Ignorance appears to be a factor mostly among small and medium sized companies (van Nes et al., 1998).
Still, measures like SPAK are used to employ large numbers of workers. A similar scheme in Belgium (i.e. a small but structural reduction in social security contributions for relatively low-paid workers) applies to around 2 million workers. Even strongly targeted measures - temporary reductions or waivers generally generate a substantial response in terms of the sheer number of people benefiting.

Policy makers like to quote such figures in evidence of what they see as the strong impact of such measures on employment, ignoring the fact that there tend to be substantial deadweight losses, i.e. that many subsidised individuals would also have found employment had the employment subsidy not been in place. This is clearly not just an efficiency issue; it is also a fairness issue.

Most subsidies or reductions are aimed at specific target groups that are considered to be in need of special attention, for example the long-term unemployed (usually defined as those seeking work for over 6 months or more). But even a specific segment like the long-term unemployed is surprisingly heterogeneous, comprising high as well as low-skilled persons, youngsters and older people, people with work experience and people with no work experience, etc. There is, in other words, room for companies to recruit selectively. Indeed, there is every indication that this is occurring to a very significant extent. For example, the proportion of unskilled persons in a job with a so-called KRA-subsidy (a Dutch subsidy for engaging long-term unemployed workers) amounted to barely 11%, while they constituted half of the target group. Moreover, one in six jobs was occupied by high-skilled workers (De Beer, 1996: 256). Likewise for Belgium there is evidence that the least skilled are seriously underrepresented in subsidised jobs, although they constitute the prime target group (Bollens et al., 1996).

Many subsidies are of the same type as those granted under the Vermeend-Moor Act or RAP (Reguliere Arbeidsplaatsvariant) in the Netherlands. Both schemes offered employers a substantial 4-year reduction in social security contributions for every additional recruitment of a long-term unemployed individual. In addition, employers could claim a one-off recruitment bonus. An assessment by Koning et al. (1995) estimated the deadweight loss for
RAP at just over 42 percent (see table 3). De Koning (1993) previously arrived at a comparable estimate for the Vermeend-Moor Act. Roughly 4 in 10 long-term unemployed persons recruited with a subsidy would also have found a job without any financial incentive from the authorities. This is a relatively favourable result, as most evaluation studies estimate the deadweight loss to be considerably higher.

The British Workstart scheme of the early 1990s granted a temporary but substantial subsidy to employers offering a full-time job to a person who had been out of work for at least 2 years. An evaluation of a pilot scheme arrived at a 53 percent complete deadweight loss and a 27 percent partial deadweight loss. The latter refers to jobs that would have been offered to the target group regardless of the subsidy, but not on a full-time basis (Atkinson and Meager, 1994).

These results more in line with findings for similar measures in other countries. The deadweight loss for the Employment Incentive scheme in Ireland and the Jobstart scheme in Australia was, for example, estimated to be around 70 percent (OECD, 1993, on the basis of Breen and Halpin, 1989 and Department of Employment, Education and Training, 1989). Van der Linden (1997) estimated the deadweight loss of a series of temporary social security reductions for the employment of youngsters, unemployed persons and other weak groups that were introduced in Belgium in the early 1990s at 53 percent. (Only this overall estimate is reported although the study covered a range of very similar but not identical measures.)

A more recent Dutch study (van Polanen Petel et al., 1999) estimates the deadweight loss of a scheme known as Verminderende Langdurig Werklozen (VLW) – a reduction in employers’ social security contributions of up to around 2,140 euro per year for a period of 4 years for the recruitment of long-term unemployed persons- at between 27 and 60 percent (the broad margin is due to the statistical confidence interval applied). This study also explicitly gauged employers’ motivation for recruiting long-term unemployed persons. Some 40 percent of respondents indicated that they did so to evaluate whether the individual involved was able to function within the organisation. About a third referred to a ‘social motive’.

More recently an evaluation was made of the more general measure SPAK, which involves a permanent reduction in employers’ contributions for workers earning up to 115 percent of the
statutory minimum wage. It is not targeted exclusively at the unemployed, but at low-wage earners in general, including those already in work. One would expect the deadweight loss associated with such a more general measure to be quite substantial and this is indeed what van Polanen Petel et al. (1999) find; they estimate it at 93 percent.

Virtually all the above evaluation studies are based on interviews with employers. It is quite conceivable that these studies underestimate the deadweight loss as a result of selection distortion and opportunistic responses. An approach whereby the direct employment effects are estimated on the basis of interviews of interested parties clearly has a number of limitations. For one thing, the response rate is generally rather low. The above-mentioned assessment study of SPAK, for example, yielded a response rate of roughly 10 percent. Secondly, and probably more importantly, the estimations of deadweight loss are based on statements by the employers themselves. In most of the studies cited, employers were directly asked whether the subsidised unemployed or low-paid worker(s) concerned would have been taken on without a subsidy. The limitations of this methodology seem to be illustrated by the results of a study on a small-scale British project for long-term unemployed people in certain Scottish regions (involving a 50 to 100% subsidy over a period of 26 weeks). This study concluded that the deadweight loss amounted to no more than between 15 and 20 percent. This atypical finding may well be related to the fact that, in order to qualify, employers were required to state formally that they would not have offered the job without the subsidy (Fay, 1996).

[ Table 3 ]

Substitution cost

Another often-voiced criticism is that subsidised jobs are to the detriment of non-subsidised jobs. Targeted groups need to be clearly demarcated and this inevitably leads to distortions at the margins. As a consequence, non-subsidised employees may be excluded or not recruited for the benefit of cheaper, subsidised workers. In some instances this may actually be desirable. Therefore, the question of who benefits at whose expense is quite relevant. It may, for example, be a policy objective to have older workers replaced with young unemployed persons. Or it may be deemed desirable that a subsidy makes the labour market more
accessible for a low-skilled worker than a high-skilled employee whose long-term employment prospects are at any rate more favourable. But it is generally not the intention to create an advantage for specific segments of the labour market (e.g. young unemployed people) at the detriment of other vulnerable groups (e.g. the long-term unemployed). It is, for that matter, prohibited under the terms of most schemes to dismiss workers with the purpose of replacing them with subsidised employees.

The few available studies which have looked at substitution effects (all of which have been previously mentioned) invariably provide general estimations. They rarely indicate which specific groups are prized out of the market by subsidised workers. Estimates range fairly widely, from around 20-25 percent for the Irish Employment Incentive and the British Workstart schemes to around 50 percent for the Dutch RAP and VLW schemes. Van der Linden (1997) estimates the substitution costs of a series of Belgian measures (cf. supra) at 36 percent. Such estimates suggest that substitution effects can be quite substantial but, again, the limitations of getting at reliable estimates of substitution effects on the basis of employers’ surveys are quite apparent.

A time-series analysis of the so-called Jongerenbanenplan, a Belgian scheme which was aimed at increasing employment among longer term unemployed youngsters also brought to light important substitution effects. Introduced in 1993, the measure involved a degressive reduction in employers’ social security contributions for up to three years (100 percent in the first year, 75 percent in the second and 50 percent in third) for each recruitment of a person under the age of 26 who had been unemployed for at least 6 months. The measure was implemented at the beginning of a period of economic recovery so that the overall response exceeded the initial expectations by quite a margin. Unemployment dropped significantly among long and short-term unemployed youngsters alike. However, Koevoets (2000) found that this measure still had a negative impact on the relative employment chances of short-term unemployed youngsters who saw their relative chances of employment reduced quite considerably after the implementation of the scheme.
Least empirical data is available about the displacement effects of job subsidies. These are, after all, the hardest to measure. It concerns job losses through distortion of competition, i.e. job losses caused by the fact that enterprises that do not receive subsidies lose market share. This negative impact on employment is not easy to estimate, as it is difficult to attribute an increase or decrease in market share to one single factor. Determining the relation between loss of market share and employment at a company is usually not easy. It is almost impossible to arrive at reliable estimates by means of evaluation studies on the basis of interviews with employers. Nevertheless, it is likely that displacement effects do come into play, as all empirical evaluation studies suggest that many subsidised workers would have found employment regardless of the subsidy (cf. supra). This means that the measures constitute a de facto subsidy to the companies in question, and it is quite conceivable that this is beneficial to the competitive position of the enterprise. Some 28 percent of companies receiving a subsidy under the Dutch Vermeend-Vermoor Act indicated that the subsidy had enabled them to improve their competitive position. A similar advantage was realised by 36 percent of companies obtaining subsidies under the Dutch RAP scheme (de Koning et al., 1995) and 33 percent of enterprises claiming subsidies under the Workstart programme in the UK. It seems likely that, to some extent, this gain was realised at the expense, to some extent at least, of (employment at) competing enterprises. But as already indicated, it is hard to assess how substantial these negative employment effects at companies that make no or less use of subsidised labour actually are.

Net employment effects: estimates on the basis of time series

A number of studies have tried to assess the overall employment impact through time series analysis. The approach taken in these studies is to ascertain whether the introduction of a particular measure coincided with additional job growth (or slower job destruction) that could not be attributed to any other measurable factor. The significance of these estimations therefore depends on the thoroughness with which one tests for other potential explanatory factors, such as cyclical movements of the economy. This type of evaluation was carried out for a number of US programmes, such as the Targeted Job Tax Credit (TJTC), which was in force between 1979 and 1994. It encompassed substantial tax deductions (amounting to 50 percent of wages in the first year and 25 percent in the second) for companies recruiting additional staff from disadvantaged categories, including youngsters from deprived areas,
welfare recipients, etc. By the mid-80s, the number of beneficiaries of the programme had reached 650,000. A time-series analysis specifically examined the impact of the scheme on the employment of youngsters (18 to 24-year-olds). Katz (1998) estimates the net employment effect of TJTC at around 7 percent among youngsters occupying a vulnerable position in the labour market, a figure which he finds to be consistent with a demand elasticity of –0.5.

For France, Kramarz and Philippon (2001) look at the employment effects of cuts in employers’ social security contributions on minimum wages. The French government introduced its policy of reduced contributions on minimum wages and wages just above the statutory minimum in 1993. Employers’ contributions were cut from roughly 40 percent at the beginning of the 90s to around 22 percent in 1996. The gross minimum wage, on the other hand, increased over that same period. Kramarz and Philippon (2001) look at the net employment effect of the changes in labour costs between 1990 and 1997. They compare the transition from work to non-work and vice versa of people earning around the minimum wage (or slightly over) who did not enjoy selective cuts in employers’ social security contributions. They find that an increase in labour costs at minimum-wage level had a clear negative impact on employment. (They estimated the elasticity at –1.5.) At the same time, however, they observe that reductions in the cost of minimum-wage labour did not really coincide with any net job growth, a finding which they link with anecdotal evidence that employers were not convinced that the reductions were permanent. In other words, they find an asymmetrical effect: a rise in the cost of minimum-wage labour resulted in job losses, while a reduction in the cost resulted in a substitution of low-paid workers for slightly better-paid workers.

For the Netherlands, recent research is available pertaining to the impact on employment of a permanent reduction in employers’ social security contributions on low wages, the SPAK-scheme. Previous evaluation research (Polanen Petel et al., 1999) estimated the net employment effect to be 7 percent at the most. Muhlau and Salverda (2000) assert on the basis of time-series analysis that the introduction of SPAK did not cause any measurable additional employment growth, including in such sectors as the hotel and catering industry or retailing. They carried out a time-series analysis of job growth per sector, controlling for a series of factors that may influence variations in employment. Interestingly, the authors find that already expanding companies were more inclined to make use of the subsidy than
companies with a relatively stable staff level in years prior to the introduction of the subsidy. It is therefore unlikely that the employment-stimulating effects are underestimated as a result of self-selection of enterprises that are not performing well.

**Transition to the regular labour market**

We move on to the second question: what is known about the degree of mobility from subsidised to regular work?

One of the most interesting studies was conducted in the US in the 1980s (Burtless, 1985). It consisted in a controlled experiment in which a group of welfare recipients were given a voucher entitling an employer to a subsidy on recruitment of the person in question. The individuals making up a second, control group were not given a voucher, even though they qualified in principle. The individuals were assigned to one or the other group randomly, so that the groups were comparable in terms of composition. Astonishingly, it was concluded that the future employment prospects of the experimentally subsidised workers deteriorated rather than improved. The non-subsidised individuals actually performed better in the long-term than their subsidised counterparts. A second, comparable, study apparently came to a similar conclusion (Hollenbeck and Wilke, 1991, cited by Katz 1998).

An Australian study examined the effects of JOBSTART, a subsidy to employers for the recruitment of unemployed persons. Participants were screened 6 months after termination of their subsidised employment. The finding was that their prospects of employment had improved considerably (Byrne, 1994). It should be noted, however, that the study failed to correct for selection distortions. This is a serious shortcoming since beneficiaries tend to have a considerably more favourable profile than those entitled, at least in terms of their observable characteristics. This might explain why people who have completed a period of subsidised employment perform better than those who are merely entitled to the subsidy. A different study examined the effect of another Australian subsidising scheme, known as the Special Youth Employment Training Programme. After controls for selection distortion on observable variables, this study too found a positive effect on the job prospects of participants two years after the period of subsidised employment had ended (Richardson, 1998). This positive result could be due to the fact that the scheme linked the subsidy to training requirements.
In a study for Belgium, Bollens et al. (1996) studied the employment prospects of people 24, 30 and 36 months after leaving a job that entitled the employer to reduced social security contributions. They found that the employment prospects were comparable to those of previously non-subsidised unemployed persons. However, this is another study which did not involve a correction for possible selection bias. In a methodologically more advanced study, Cockx et al. (1998) examined the effects of employment subsidies on individuals’ job tenure. This study did correct for selection distortion¹ and found that there was a positive yet statistically insignificant effect of pure employment subsidies on beneficiaries’ ability to keep a job. In contrast, a significant positive effect was however measured for subsidised training programmes.

Eichler and Lechner (2002) evaluate the effect of subsidised jobs (one year time limit) for longer-term unemployed persons (over 6 months), with priority being given to unskilled youngsters, older workers, disabled workers and extremely long-term unemployed persons. They find that participants have a higher probability of being in work than non-participants with the same observable characteristics. By contrast, Bardaji (2001), in an evaluation of a similar programme in France (be it one limited to the non-market sector) finds that very few people find work after their spell of subsidised employment has ended. It would appear that the experience gained in such a subsidised job is not very highly valued. This is another study which did not correct for selection bias.

Gauging from the available evidence, subsidised jobs do not seem to have a significant positive effect on the employment chances of beneficiaries in the regular labour market.

One possible explanation for why previously unemployed workers in subsidised jobs do not move to the regular labour market at a higher rate than their counterparts who remain unemployed, at least in the short term, is that beneficiaries get locked into their subsidised jobs. Van Ours (2002) reports on an analysis of data from what he calls a “natural experiment” in the Slovak labour market in the mid 1990s. He looks at transitions to the regular labour market of participants in a subsidized job scheme the duration of which was expanded first from 6 to 9 months and then from 9 to 12 months. His finding is that short term
subsidised jobs have a positive effect on the regular job finding rate, but that the effect became exactly opposite as the maximum duration got expanded.

A second explanatory factor that has been mentioned in the literature is stigmatisation. It is argued that subsidised work has a stigmatising effect on the beneficiary, thus compromising their prospects of finding regular employment. The reasoning behind this argument is that individuals in subsidised jobs are easily perceived as lacking in ability and being unable to find a regular job. At least an unemployed person applying for a job can claim that his or her unemployment was, to a certain extent, “voluntary”, in the sense that they might have been looking for a “suitable job”. By contrast, a person with a history of subsidised work indicates that he or she is willing to work, but implicitly concedes to be unable to find a regular job.

A third explanation for the apparently poor transition rate from subsidised to regular labour is that the type of job experience acquired in subsidised employment does not suffice to escape from the so-called ‘productivity trap’. This suggests that the weak position in the labour market of certain groups, such as the long-term unemployed, is not merely a matter of lack of job experience and contact with the labour market. Katz (1998) concludes on the basis of an evaluation of a number of US projects that employment subsidies only work in combination with training and counselling. This conclusion is in line with the results obtained by Richardson (1998) and Cockx et al. (1998). Martin and Grubb (2001) argue that such schemes also produce better outcomes when programme participants are allowed to do more regular work. In other words, they claim that private sector subsidies are more effective than public sector subsidies or public sector employment. The idea here is that the type of work experience gained in the private sector is more relevant and better transferable to regular work than public sector jobs.

**Conclusion**

Two striking findings emerge from the empirical evaluation literature on the effects of targeted employment subsidies and reductions in payroll taxes.

First, the measured net employment effects tend to be considerably lower than what most theoretical models and simulations predict, even under relatively pessimistic assumptions.
The biggest problem seems to be that most subsidised workers *who are actually recruited* would also have found a job without the subsidy. Even within fairly strictly defined target groups there is evidence of selective recruitment – the most promising workers are “skimmed off.” This seems to be the main reason why the measured deadweight loss is consistently higher than what tends to be assumed in theoretical analyses as those by Snower (1994). Furthermore, there are indications that enhanced recruitment among the target groups has a substantial negative effect on the employment chances of categories that are (narrowly) ineligible (e.g. the relatively short-term unemployed).

The second striking conclusion emerging from the empirical evaluation literature is that there is little evidence that targeted subsidies have a beneficial effect on the later careers of beneficiaries. A period of subsidised employment can even have a negative impact on beneficiaries’ future employment prospects, or so it would appear. There is speculation that this is due to a stigma effect.

Policymakers apparently face the following dilemma. A rather general measure, such as a subsidy for all the long-term unemployed, is probably the least stigmatising, but its net employment effect is likely to be rather modest. Limited additional employment among the target group would be realised at the cost of a substantial income transfer to companies. The budgetary cost for each additional job, moreover, would be rather high.

This could be resolved by defining the target groups even more sharply, so that subsidies are restricted to the very long-term, unskilled unemployed. However, the question then arises whether a subsidy, especially a temporary one, will provide a sufficiently strong incentive for employers to recruit apparently unsuitable job applicants. Moreover, there is a danger that extremely selective subsidies will have an even stronger stigmatising effect, i.e. that individuals in subsidised jobs will, more than ever before, be labelled ‘problem cases’ once they try to (re-)enter the regular labour market.
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Polanen Petel, V.C.A. van, T.W. Hu, J. de Koning en C. van der Veen (1999), Werkgelegenheidseffecten van de SPAK en VLW, Rotterdam: NEI.


Figure 1: Illustrative figure for Belgium (monthly amount in Euro)

- Labour cost at minimum wage level
- Gross minimum wage
- Net income single person
- Net income single parent
- Net income single earner, 2 kids
Table 1: Benefit dependency: benefit recipients at working age as a percentage of the working age population (15-64 years), 1980-1999 (in full-time equivalents) 1980-1999.

<table>
<thead>
<tr>
<th></th>
<th>1980</th>
<th>1990</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>17.4</td>
<td>24.4</td>
<td>23.6</td>
</tr>
<tr>
<td>Netherlands</td>
<td>15.9</td>
<td>19.9</td>
<td>17.8</td>
</tr>
<tr>
<td>Germany</td>
<td>15.2</td>
<td>18.1</td>
<td>22.4</td>
</tr>
<tr>
<td>France</td>
<td>13.9</td>
<td>20.2</td>
<td>24.2</td>
</tr>
<tr>
<td>Denmark</td>
<td>20.1</td>
<td>23.2</td>
<td>23.1</td>
</tr>
<tr>
<td>Sweden</td>
<td>16.1</td>
<td>17.0</td>
<td>20.0</td>
</tr>
<tr>
<td>UK</td>
<td>15.2</td>
<td>18.5</td>
<td>18.9</td>
</tr>
<tr>
<td>Spain</td>
<td>8.3</td>
<td>12.3</td>
<td>11.2</td>
</tr>
</tbody>
</table>

Source: National Economic Institute (NEI)/the Netherlands.)
Table 2: Brief survey of the measures discussed

<table>
<thead>
<tr>
<th>Measure</th>
<th>Target Group</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vermeend-Moor Act (Nl)</td>
<td>long-term unemployed</td>
<td>reduced social contributions for a period of 4 years; one-off recruitment bonus</td>
</tr>
<tr>
<td>RAP (Nl)</td>
<td>long-term unemployed</td>
<td>reduced social security contributions for a period of 4 years; recruitment bonus (increases with period of unemployment)</td>
</tr>
<tr>
<td>Workstart (UK)</td>
<td>long-term unemployed</td>
<td>temporary wage subsidy</td>
</tr>
<tr>
<td>Jobstart (Aus)</td>
<td>long-term and quasi long-term unemployed</td>
<td>temporary wage subsidy</td>
</tr>
<tr>
<td>Employment Incentive (Ireland)</td>
<td>long-term unemployed</td>
<td>temporary wage subsidy</td>
</tr>
<tr>
<td>Jongerenbanenplan (Belgium)</td>
<td>unemployed youngsters</td>
<td>temporary, regressive reduction in social contributions</td>
</tr>
<tr>
<td>VLW (Nl)</td>
<td>long-term unemployed</td>
<td>reduced social security contributions for a period of 4 years</td>
</tr>
<tr>
<td>SPAK (Nl)</td>
<td>low-paid</td>
<td>permanent reduction in social contributions</td>
</tr>
<tr>
<td>CIE (France)</td>
<td>long-term unemployed, unskilled, welfare recipients, disabled</td>
<td>temporary reduction in social security contributions</td>
</tr>
</tbody>
</table>
Table 3: Summary of some important findings

<table>
<thead>
<tr>
<th>Name (country)</th>
<th>Deadweight</th>
<th>Substitution</th>
<th>Displacement</th>
<th>Sum (deadweight +substitution)</th>
<th>Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Targeted Measures</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vermeerd-Moor Act</td>
<td>80-85%</td>
<td>28%</td>
<td></td>
<td>&gt; 80%</td>
<td>De Koning et al. (1995)</td>
</tr>
<tr>
<td>(Netherlands)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RAP (Netherlands)</td>
<td>42%</td>
<td>47%</td>
<td>36%</td>
<td>&gt; 89%</td>
<td>De Koning et al. (1995)</td>
</tr>
<tr>
<td>Workstart (UK)</td>
<td>55%</td>
<td>25%</td>
<td>33%</td>
<td>&gt; 80%</td>
<td>Atkinson and Meager (1994)</td>
</tr>
<tr>
<td>Jobstart (UK)</td>
<td>67-79%</td>
<td>-</td>
<td>-</td>
<td>&gt; 67%</td>
<td>OECD (1993); Byrne (1994)</td>
</tr>
<tr>
<td>Employment Incentive (Ireland)</td>
<td>70%</td>
<td>21%</td>
<td>4%</td>
<td>95%</td>
<td>OECD (1993); NERA (1995)</td>
</tr>
<tr>
<td>Voordeelbanenplan (Belgium)</td>
<td>53%</td>
<td>36%</td>
<td>-</td>
<td>&gt; 89%</td>
<td>Van der Linden (1995)</td>
</tr>
<tr>
<td>VLW (Netherlands)</td>
<td>27-60%</td>
<td>37-63%</td>
<td>-</td>
<td>57-87%</td>
<td>NEI (1999)</td>
</tr>
<tr>
<td>CIE (France)</td>
<td>19-39%</td>
<td>37-63%</td>
<td></td>
<td>57-87</td>
<td>Belleville (2001)</td>
</tr>
<tr>
<td><strong>General Measures</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SPAK (Netherlands)</td>
<td>93%</td>
<td>-</td>
<td>-</td>
<td>93%</td>
<td>NEI (1999)</td>
</tr>
<tr>
<td>SPAK (Netherlands)</td>
<td>Close to 100%</td>
<td>-</td>
<td>-</td>
<td></td>
<td>Muhlau and Salverda (2000)</td>
</tr>
</tbody>
</table>
Van der Linden evaluates the following measures: a reduction in employers’ contributions for a period of 8 months for the recruitment of youngsters or long-term unemployed individuals, a degressive reduction in employers’ contributions for the recruitment of youngsters after a training period, a temporary subsidy for unemployed persons within the framework of certain projects, the schemes in Wallonia known as “Primes plus” and “Prime d’employ” and incentives for the recruitment of disabled persons.

Interestingly, measures aimed at stimulating job growth are often implemented at a time when the economy is already recovering. This has been the case in the US (Katz, 1998), and also in other countries. This underlines how vitally important it is that one corrects for other policy and circumstantial factors when evaluating a measure (Van Trier, 1998).

The authors emphasize that the results obtained are quite sensitive to the manner in which one corrects for selection distortion. More specifically, the assumption concerning the distribution of non-observed heterogeneity appears to be crucial.