

# What ALMP works in recession?

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# Questions of interest

- Are ALMP more effective in a downturn?
- Should ALMP be used more (or less) in a downturn?
- Should different kind of programs be relied on more heavily in a downturn?
- We provide no definitive answers to these questions

## Objectives of the paper

1. Elaborate on the pros and cons of using ALMP more extensively in a downturn
2. Discuss why it is difficult to provide solid evidence on the question (Is ALMP more effective in a downturn?)
3. Provide some new evidence

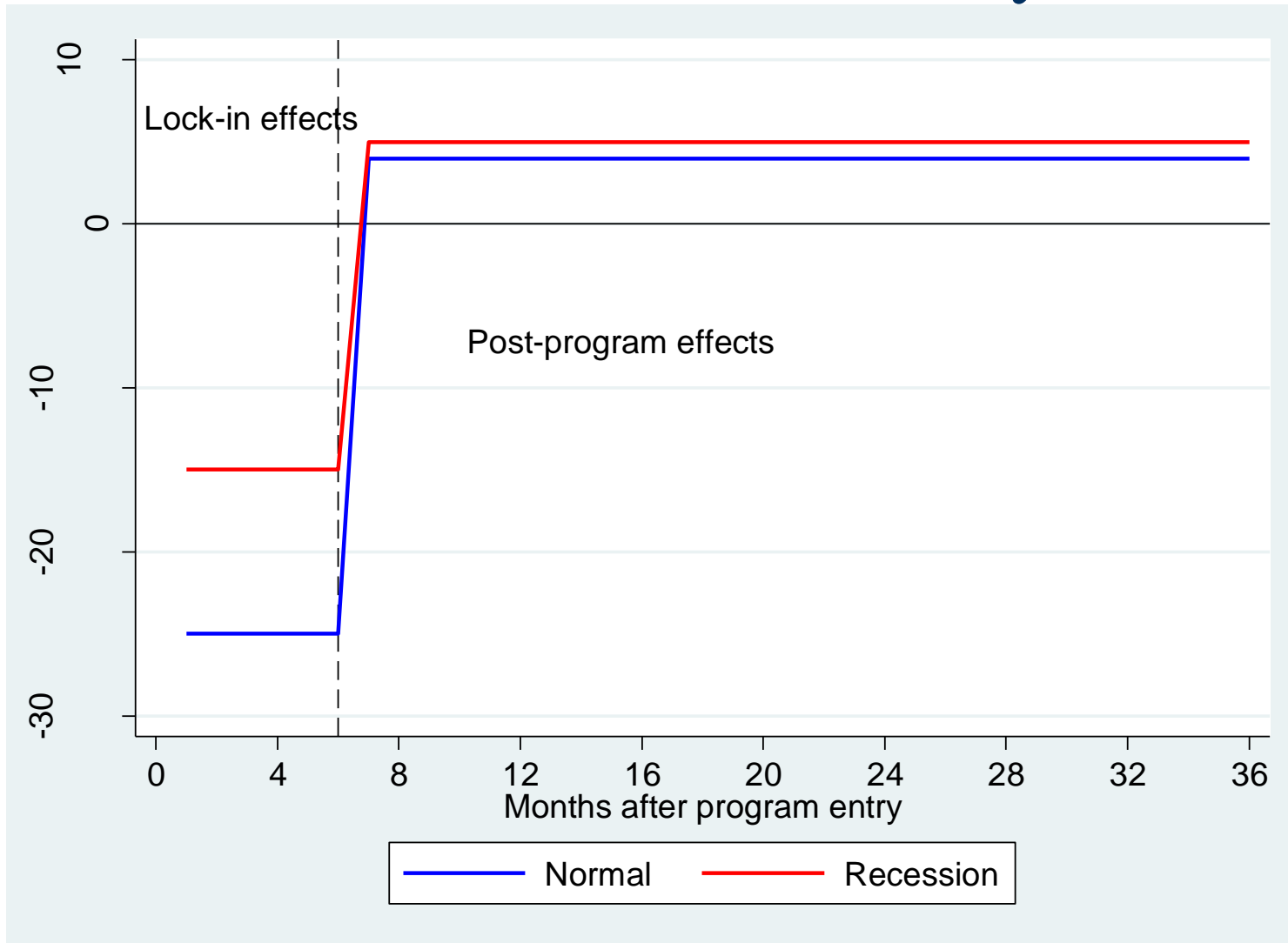
# Programs and treatment effects

- Programs are investments in current time (and money) for future increases in earnings
- Thus, it is useful to distinguish between
  - ✓ **Lock-in effects** (treatment effects occurring during program participation)
  - ✓ **Post-program effects** (treatment effects occurring after program completion)

# Why would treatment effects vary w. cycle?

- **Lock-in effects** are likely smaller in recession
  - ✓ Since search effort and the state of the labor market are complements in "production" (i.e. finding a job)
- Difficult to have a prior on **post-program effects**
- "Scarring" may suggest positive effects of entering in recession
  - ✓ The "alternative" will be affected by the recession w. certainty
  - ✓ Chances are that the economy has turned for the better when the program is completed

# Treatment effects over the cycle



# Why should ALMP vary w. cycle?

1. The marginal cost to society of distorting search incentives (via programs) is lower in recession
2. Optimal to provide programs to individuals hit by structural shocks
  - ✓ If structural adjustment is higher in recession, then higher program activity in recession
3. More (less) individuals around who benefit from programs in recession (treatment effect heterogeneity)

# What kind of ALMP should vary w. cycle?

- ALMPs involve time investments (distort search incentives) to a varying degree
- A case for a relative increase in the most intensive programs in recession
- For example
  - ✓ Training (which has large lock-in effects) is likely more efficient in a downturn than programs more intimately linked to the labor market
  - ✓ Job search assistance (JSA) involve no (or marginal) time investments  $\Rightarrow$  no (or marginal) lock-in effects. JSA more apt for boom rather than recession

## Previous evidence

- The only (directly relevant) paper: Lechner & Wunsch (2009) in JOLE
- They consider training in (West) Germany (86–95)
- They use a matching approach and thus make a selection on observables assumption
- On average, their estimates imply
  - ✓ a relative decrease of months in employment by 25 % in the SR (over 6 months)
  - ✓ a relative increase of months in employment by 5 % in the LR (over 8 yrs.)



## Previous evidence

- They correlate the treatment effects with the unemployment rate at the time of entry
- When unemployment at entry is high...
  - ✓ Lock-in effects are less negative
  - ✓ LR effects more positive

# Caveats

- Objective of evaluation: estimate actual and counterfactual outcomes for a **given program** and a **given set of (eligible) individuals**
- The question of interest (Is ALMP more effective in recession?) amounts to comparing effects over time
- This raises several issues:
  1. Is it the same program?
  2. Does the unemployed population change over time?
  3. Do eligibility rules and selection rules change?

# Characteristics of job losers vary w. cycle



Graphs by cat

N.B. Males

# Characteristics of participants vary w. cycle

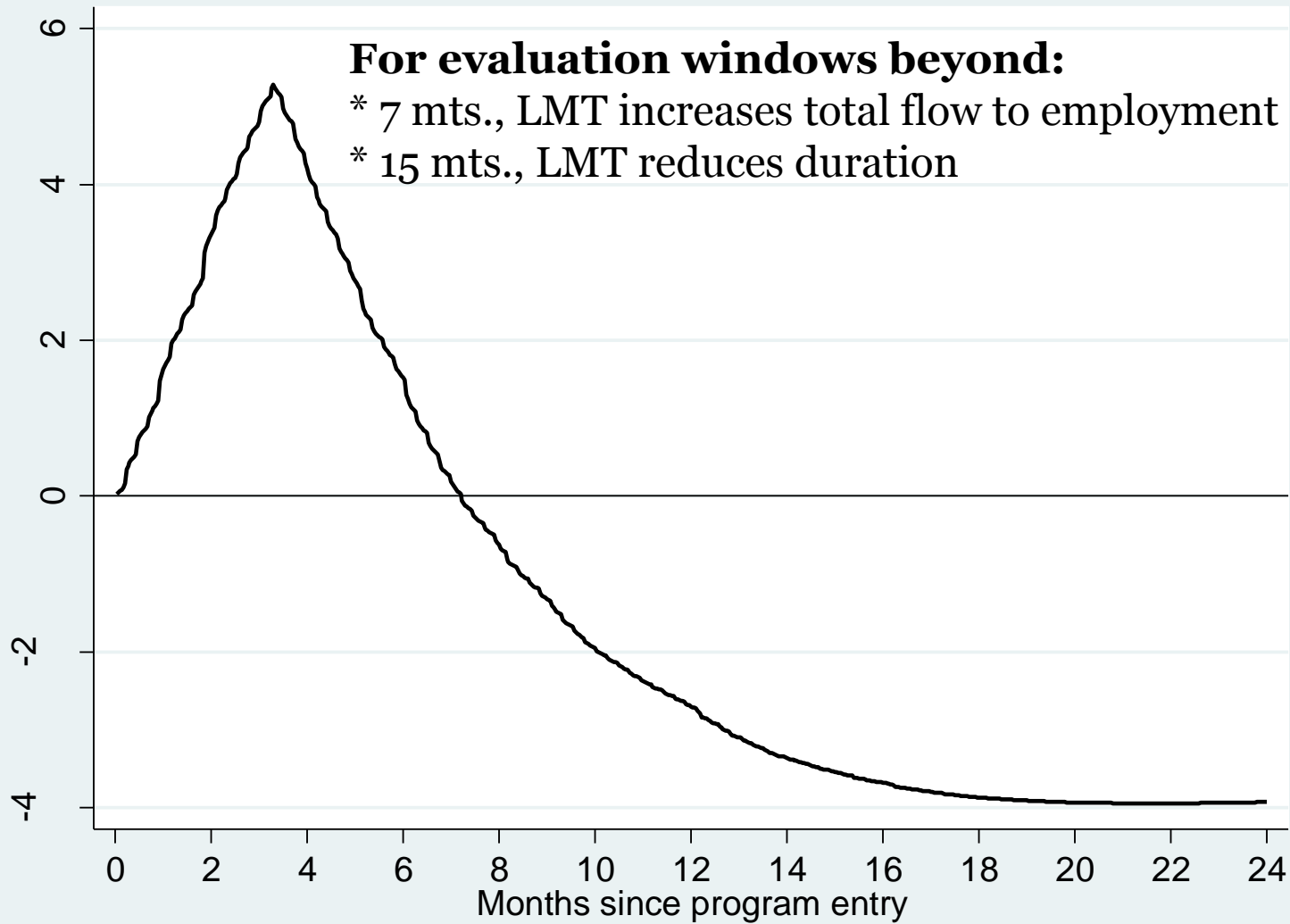
VARIABLES	(1) Recession (1992)	(2) Boom (2005)	(3) Difference: (1)-(2)
Less than high school	-0.11** (0.0053)	0.0051 (0.0087)	-0.11** (0.010)
Immigrant	-0.061** (0.0065)	-0.0042 (0.0082)	-0.057** (0.010)
Age 20–29	0.37** (0.0051)	0.13** (0.0077)	0.24** (0.0092)
Age 55+	-0.87** (0.014)	-0.28** (0.015)	-0.59** (0.020)

Selection on observables OK? (in lieu of changes in characteristics of job losers and program participants)

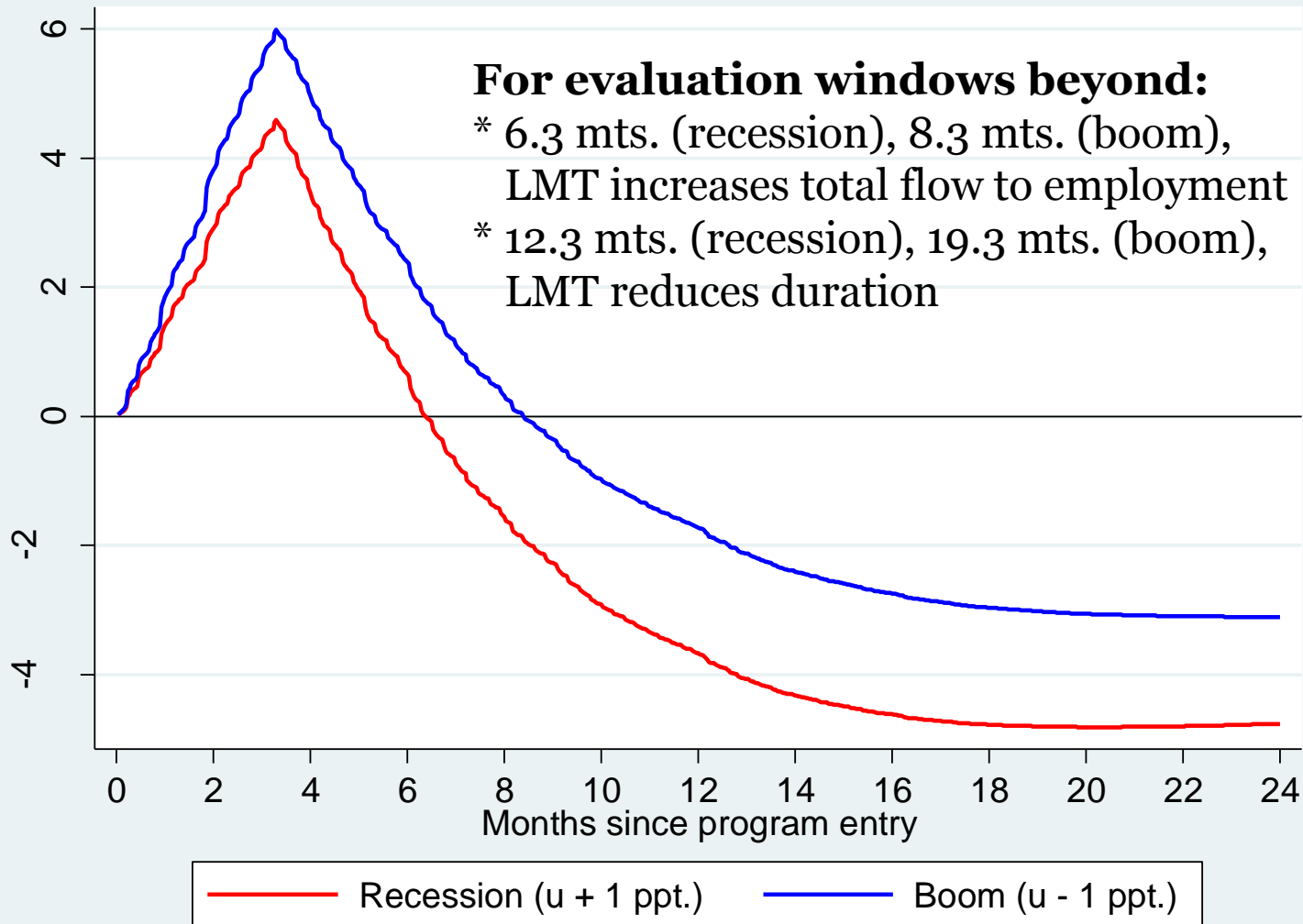
# Our evidence

- We compare two programs: an on-the-job training scheme (work practice, WP) and labor market training (LMT) (using Swedish data)
  - ✓ Selection on observables a more palatable assumption
- LMT has larger lock-in effects and hence should be relatively more efficient in a downturn
- We use the variation in unemployment (at entry) within region over time
  - ✓ Thus variation in institutional rules and selection rules that are common across regions not an issue

## Effects of WP relative to LMT, on average



# Effects of WP relative to LMT, by cycle



# Conclusions

- Reasonable case for expanding program activity in recession
  - ✓ Prime reason: the varying size of the lock-in effect in boom and recession
  - ✓ The cost of forgoing search time is lower in recession
- A case for relatively intensive programs in recession
  - ✓ E.g. training
- ALMPs affecting the returns to search (e.g. JSA) should probably be reduced in recession



# Conclusions

- The empirical evidence
  - ✓ Lechner and Wunsch (2009) find that training appears to be more effective in a downturn
  - ✓ We find that LMT is more effective than an on-the-job training scheme in recession
  - ✓ More evidence would be extremely welcome

# Caveats to the case for training

- The scale of training is not easily adapted to the state of the business cycle
  - ✓ since it features relatively large fixed costs and (hence) capacity constraints
- Unclear if training passes a cost-benefit calculation
  - ✓ In 2008, cost per training slot: ~€ 7000
  - ✓ If ex-participants are paid on the 25th percentile this requires that training prolongs employment duration by 2.5 mts. relative to work practice
  - ✓ Much larger than the effects we observe during our evaluation window (16.6 days in recession)