



CPB Netherlands Bureau for Economic
Policy Analysis

Wait for economic recovery

Reform labour market for older workers



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Long-term unemployment in the Netherlands

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Summary

Long-term unemployment will decline as the economy recovers, but this will not solve the problem of older long-term unemployed. Institutional reforms are needed to solve this problem.

In the aftermath of the Great Recession, the Netherlands is faced with 270,000 people who have been unemployed for more than one year, representing over 3% of the labour force. In this respect, the Netherlands is doing worse than Germany, the United States and the Nordic countries. Long-term unemployment negatively affects people's happiness as well as their employability. Moreover, for the government it also means a decline in tax revenue and an increase in social security expenditure.

As the economy recovers, long-term unemployment will go down, even without government intervention. Following earlier recessions, the decline has been around 1% and this is currently also a realistic prospect. The current relatively high level of long-term unemployment in the Netherlands is the result of a slower economic recovery than in other countries. Wage developments and the alleged inflexibility of the Dutch labour market also play a role, but to a lesser degree.

Nevertheless, certain short-term measures may help to reduce long-term unemployment. A temporary measure that could be effective is to provide unemployed people with a financial bonus when they manage to find and hold on to a job. Retraining may help people who used to work in one of the few shrinking sectors and who are therefore unable to return to their former profession.

The current long-term unemployment has however brought a persistent problem to light, namely that of the labour market for older people. More than 40% of the long-term unemployed are over the age of fifty. Older employees do not lose their job more often than others, but once they do become unemployed, their chances of ending up in long-term unemployment are nearly double the average. Employers hesitate to hire older unemployed people because these often demand a higher wage than the employers are willing to pay.

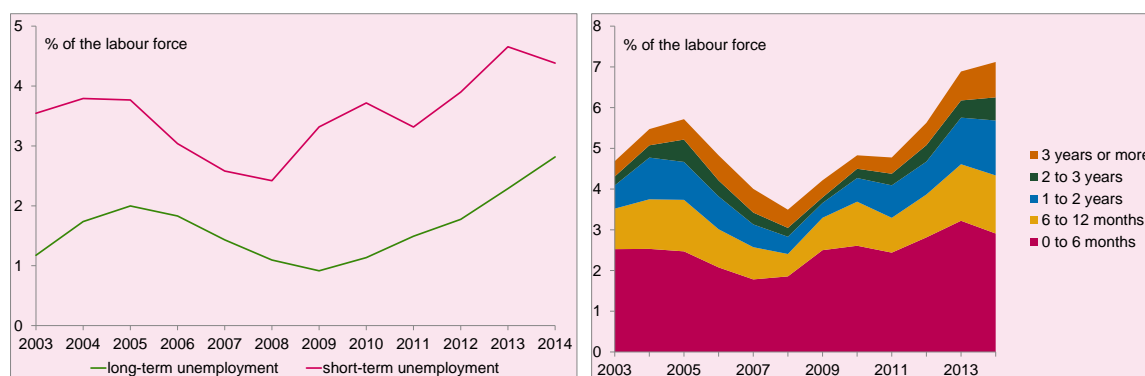
The high share of older people among the long-term unemployment is a structural problem rather than a cyclical one. Before the start of the crisis, this level was already on the rise. The current package of policy measures – largely aimed at lower wage costs – is insufficient to help the older unemployed to find another job. More fundamental reforms – such as unemployment benefits that decrease with the duration of unemployment, employment protection that is less dependent on the length of the labour contract, and less age-dependent arrangements in collective labour agreements – are necessary to permanently improve the position of the older unemployed.

1 The problem of long-term unemployment

Currently, some 270,000 unemployed people have been looking for work for more than one year.¹ This equals 3% of the labour force (Figure 1, left). Since the beginning of the Great Recession, the number of unemployed has increased threefold. The current level is the highest of the past 15 years.² Well over half of the people that have been unemployed for more than a year have been looking for a job for more than two years; one in three people even for more than three years (Figure 1, right).

Older people are over-represented within the group of long-term unemployed. Long-term unemployment among older people (aged 55 to 64) is close to 5%, compared to 3% long-term unemployment for the entire labour force. This policy brief offers explanations for the rise in long-term unemployment since the start of the Great Recession, as well as a number of possible solutions.

Figure 1 Stronger increase in long-term than in short-term unemployment



Source: CBS. The left-hand graph presents the long-term and short-term unemployment as a percentage of the labour force. Long-term unemployment is defined as an unemployment period of more than one year. The right-hand figure presents a subdivision of total unemployment in percentages of the labour force.

Unemployment often is a temporary situation in the transition from one job to another, but *long-term* unemployment is a problem for both the people it concerns and society as a whole. Unemployment makes unhappy, particularly when it lasts a long time.³ Even those who are working are less happy when the unemployment rate in a country is higher.⁴ Society carries the costs of unemployment by way of higher social security expenditure and lower tax revenues.

Long-term unemployment reduces labour market opportunities in two ways. People lose more of their professional skills (*scarring*) the longer they are unemployed.⁵ Furthermore, employers often consider long-term unemployment as an indication of relatively low

¹ People are considered to be unemployed when they are not in paid employment, are directly available for paid employment and are actively looking for a job. A long-term unemployed person is someone who has been unemployed for more than one year.

² Source: Eurostat. Statistics Netherlands (CBS) has only been measuring the level of long-term unemployment since 2001. According to CBS data, it is currently at the highest level since then.

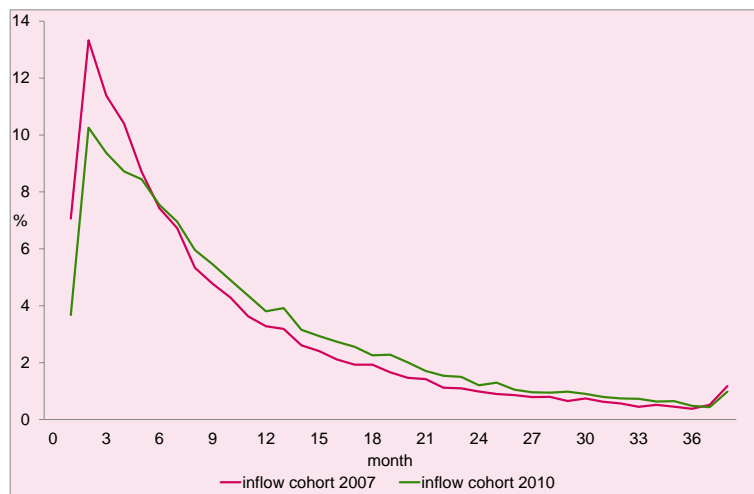
³ See Helliwell et al. (2013), O'Donnell et al. (2014) and Gallup (2013).

⁴ See Di Tella et al. (2013) and SCP (2009).

⁵ See Arulampalam et al. (2001) and Ghayad (2014).

productivity (*signalling*). This *scarring* and *signalling* reduces people's chances of finding a job, the longer the unemployment continues (Figure 2).⁶ In this way, people can become so far removed from the labour market that they are no longer considered competitive and no longer play a role in wage negotiations between employers and employees.⁷ For the Dutch economy this is an inefficient use of human capital and thus curbs economic growth.

Figure 2 Job finding probabilities for unemployment benefit recipients decrease with benefit duration, inflow cohorts 2007 and 2010



Source: CPB adaptation of data obtained from the UWV (Dutch Public Employment Service). The so-called Kaplan-Meier hazard was calculated as the outflow towards employment in month t divided by the total number of people in the related cohort who receive an unemployment benefit in that month.

Long-term unemployment may cause people to withdraw from the labour market or to become discouraged. People who do not have a job and would like to have one, but are not actively looking for work are no longer counted as part of the labour force. This means they are no longer included in unemployment statistics. In practice, the discouraged are not very different from those who are long-term unemployed. The chances of the discouraged finding employment are as low as those of the long-term unemployed; data on 2013 show that, after one year, three quarters of both groups still did not have a job.⁸ Currently, close to 100,000 people fall into the 'discouraged' category; this equals roughly 1 percentage point of the labour force. Compared to the situation in for example the United States and Denmark, the problem of discouragement in the Netherlands is relatively limited (Figure 3).⁹

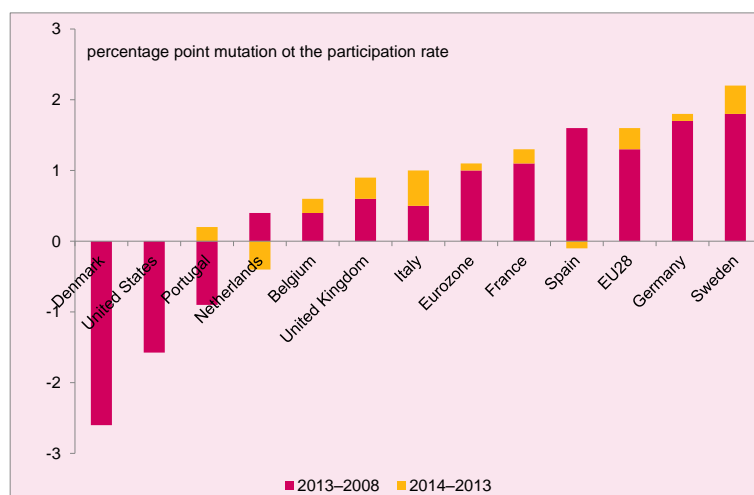
⁶ See De Groot and Van der Klaauw (2014). In addition to *scarring* and *signalling*, the reduced chances of finding a job are caused largely by the fact that highly employable people find work first. (Machin and Manning, 1999; Steiner, 2001; and Shimer, 2008).

⁷ See Krueger et al. (2014).

⁸ These data are based on the group of people who, in 2013, were either long-term unemployed or discouraged; see a soon to be published joint article by CBS and CPB.

⁹ In the United States, unemployment benefit payments are extended in times of recession; particularly to counter discouragement. Empirical research confirms that such extensions (and subsequent reductions when the economy recovers again) leads to less discouragement (Farber et al., 2015). The level of discouragement in the United States, therefore, would have been higher if benefit payments had not been extended.

Figure 3 Discouragement in the Netherlands concentrated in 2013–2014

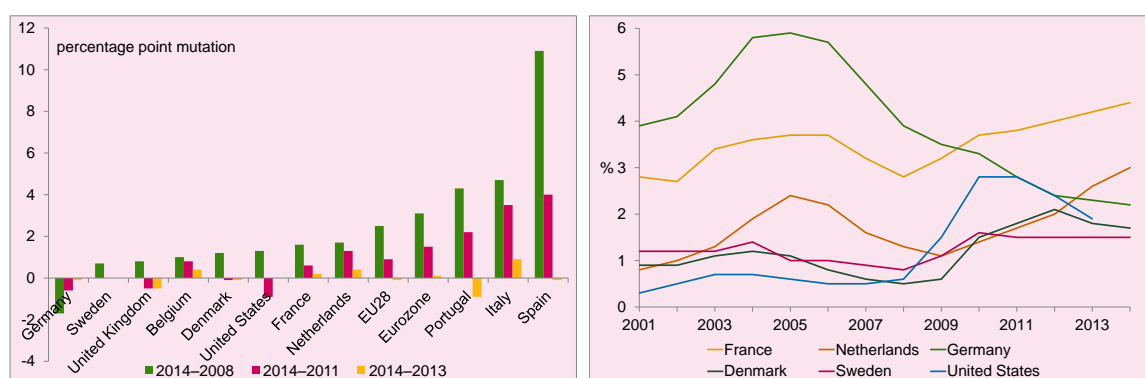


Source: CPB adaptation of Eurostat data based on activity rate.

2 Long-term unemployment rises, older people often bear the brunt

During the Great Recession, Dutch long-term unemployment rose stronger than in the surrounding countries. Even though the increase was slower than the European average, it superseded the increase faced by Anglo-Saxon and Scandinavian countries, France and Belgium (Figure 4, left). Particularly notable is the fact that the Netherlands was one of the few countries where in 2014 unemployment continued to rise (Figure 4, right). The main reason for this is that the Netherlands struggled more than other countries with a second economic dip in 2012–2013.¹⁰

Figure 4 Dutch long-term unemployment continued to rise for longer, compared to other countries



Source: OECD data. Both graphs contain (the mutation of) long-term unemployment as a percentage of the labour force. Data were not available on all countries in the figure on the left for 2014–2013.

¹⁰ See Gelauff et al. (2014).

Long-term unemployment affects people over the age of 55 as well as the lower educated more often than others (Table 1). Their share in long-term unemployment (first column) is considerably larger than their share in the labour force (third column). Once people aged over 55 become unemployed, their chances of finding another job are slim and many of them face long-term unemployment. This is demonstrated by the subsequently larger share in long-term unemployment (first column) than in total unemployment (second column). To a lesser degree, this also applies to those aged between 45 and 55. Although young people are unemployed relatively often (second column), it mostly lasts only for a short period. The share of young people in long-term unemployment is considerably lower than in total unemployment.

Table 1 Long-term unemployment is concentrated among lower educated people and those over the age of 55

Age group	% of long-term unemployment in 2014	% of total unemployment in 2014	% of the labour force in 2014
15 to 25	10%	27%	16%
25 to 35	16%	19%	20%
35 to 45	18%	17%	22%
45 to 55	25%	20%	24%
55 to 65	27%	16%	16%
65 to 75	4%	2%	2%
Lower education	35%	38%	23%
Secondary education	46%	43%	43%
Higher education	19%	20%	34%

Note: calculated by CPB on the basis of the Labour force Survey. The % columns for all age groups and those for all education levels each add up to 100% (barring rounded-off differences).

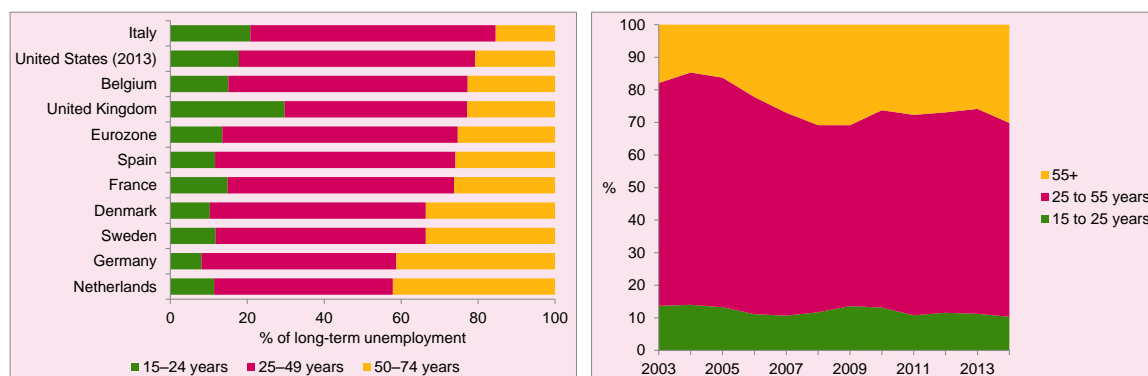
The share of older people among the long-term unemployed is higher in the Netherlands than in other countries.¹¹ In the EU, on average, around a quarter of all long-term unemployed are over the age of 50. In the Netherlands, this is more than 40% (Figure 5, left).

The large share of older long-term unemployed in the Netherlands is a structural problem rather than a cyclical one. This share already increased before the beginning of the recession (2005–2008; see Figure 5, right), and this increase coincided with the period in which the labour participation of older people rose sharply. The labour participation level of those aged 55 to 64, in the Netherlands, has increased more quickly over the past ten years than in other countries and currently is one of the highest in Europe.¹² Older people remained active on the labour market and kept looking for work, also when they lose their job. This is partly the result of the abolition of early retirement schemes and the recently implemented rise in the Dutch state pension entitlement age. The higher labour participation level of older people did not involve an equal increase in employment for this group. What in fact also rose was (long-term) unemployment.

¹¹ Unfortunately, there are no data available for a comparison of the share of lower educated, long-term unemployed people.

¹² Source: OECD website, LFS by gender and age indicators.

Figure 5 Strong concentration of long-term unemployment among older people



Source: figure on the left: Eurostat (year=2014) and for the US OECD (year=2013); figure on the right: CBS (2014).

3 Decrease in employment crucial, wages play only a modest role

What is the reason for the increase in long-term unemployment, particularly among older people? The direct explanation is the decline in employment opportunities as a result of the contracting economy. On a macro level, wages play a less prominent role.

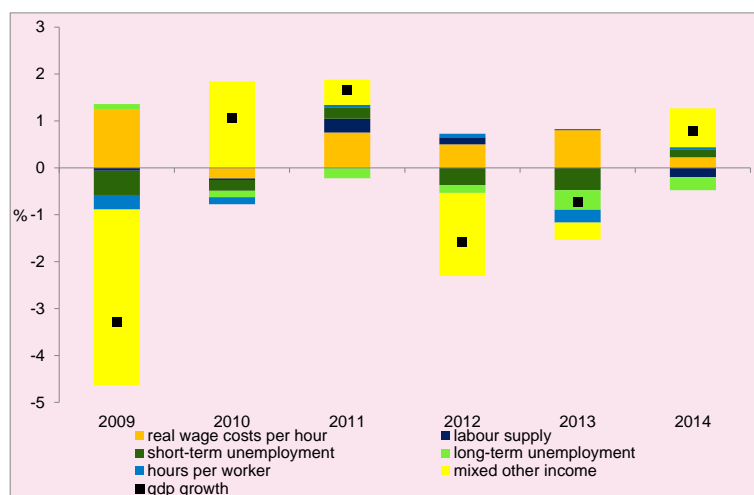
The Great Recession largely manifested itself in lower profits for both companies and the self-employed, particularly between 2009 and 2012, the years of real recession (Figure 6). A similar decline in 'other income'¹³ also occurred in most other European countries, between 2008 and 2013. Employment decreased less rapidly, because companies and the self-employed absorbed an important share of the economic recession.

The income flexibility of the self-employed – mostly independent professionals – absorbed part of the decrease in demand, without this affecting the unemployment level.¹⁴ For them, adjustment is mainly through income and less in the form of employment rate. In a depressed market, the self-employed lower their hourly rates and they get fewer assignments, causing their income to drop. They do not register themselves as being unemployed, nor are they entitled to any unemployment benefits. The average income per self-employed person decreased during the crisis, while the number of self-employed increased.

¹³ The 'other income' consists of profits from enterprise, income from self-employment, and from the increase in the capital goods supply. The income from self-employment could not be separated from the available data.

¹⁴ See CPB (2014), p. 46.

Figure 6 Economic contraction in the Netherlands was absorbed through a decrease in employment and other income



Source: CPB calculations based on OECD data, see Erken et al. (2015b).

Reader: the bars add up to the percentage of change in GDP of that year. The coloured sections indicate how the development in a certain area contributed to the GDP development. Other income consists of profits from enterprise, income from self-employment, and from the increase in the capital goods supply.

The low economic demand during the years of recession led to a decrease in employment. The largest share of this resulted in unemployment (Figure 6); first only for a short period of time, but since 2011 also in long-term unemployment.

However, a prolonged slowdown in growth not necessarily leads to a decrease in employment and an increase in unemployment. In Japan, for example, long-term unemployment has been limited to no more than 2.2% of the labour force, despite years of low economic growth.

In the Netherlands, the recession has not led to lower wage costs. If the impact of the recession had been more absorbed in wages, unemployment probably would have increased less. A recession usually has a downward impact on wages. When wage costs go down, companies are more prepared to hold on to their employees and/or to begin hiring new staff again sooner.

However, the wages of individual employees are not easily adjusted downwards.¹⁵ For half of all jobs, real wages (and sometimes also nominal wages) do not decrease. In many cases, wages keep pace with inflation. Particularly the wages of older employees and those on a relatively high income are not very flexible.

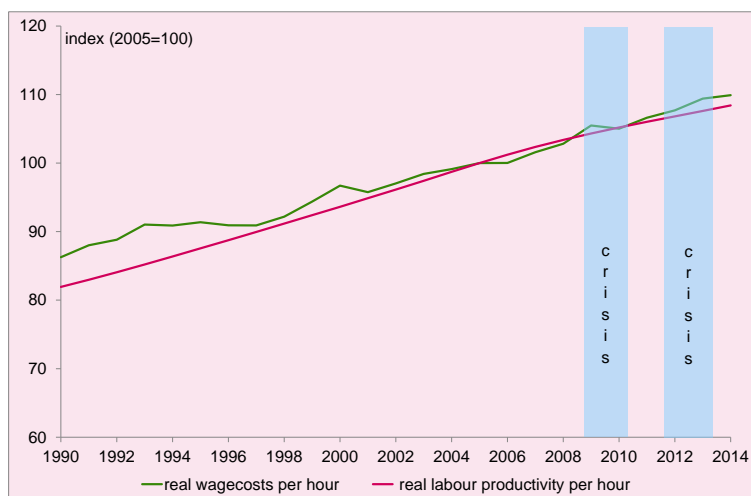
On a macro level, wage costs (per unit) have remained the same. Wage costs per hour have increased during the recession years more or less by as much as productivity per hour (Figure 7).¹⁶ The recession, therefore, was not being absorbed by cheaper production but by

¹⁵ See Deelen and Verbeek (2015).

¹⁶ Erken et al. (2015b) show that, in many Central European countries, wage costs have kept pace with labour productivity during the years of crisis. A downward wage adjustment in relation to labour productivity did occur in the United States and the United Kingdom. Remarkably, wage costs per hour increased faster than productivity in Italy, Spain and Ireland, the very countries that were hardest hit.

producing less. This caused employment to decrease, which ultimately has led to long-term unemployment.

Figure 7 Real wage costs and labour productivity have kept pace during the crisis, 2005 = 100



Source: Erken et al. (2015b).

Economy-wide wage moderation is not the obvious measure to tackle long-term unemployment. There are after all no indications of wages not keeping pace with labour productivity. Moreover, wage moderation is hardly aimed at addressing long-term unemployment. Generic wages do not even respond to the level of long-term unemployment (see text box). Whenever wages decrease across the entire economy, labour demand generally increases, not the specific demand for labour that could be supplied by the long-term unemployed. This group still has to wait at the end of the line.

Little downward wage pressure from long-term unemployment

Wage development is related mainly to the level of short-term unemployment. In particular, the period of unemployment of six months or less seems to have an impact on wage development. The relationship between long-term unemployment and wage development is statistically insignificant (see table). This finding is in line with comparable analyses on the United States and Europe (a). In the United States, the long-term unemployed are so far removed from the labour market that they are not considered competitive in wage negotiations. Therefore, a high level of long-term unemployment causes not enough downward wage adjustment to be a factor in employment recovery.

Impact of unemployment on wage costs smaller at prolonged unemployment

	Total	Six months	One year	Two years
Impact of total unemployment	-0.25			
Impact of unemployment shorter than ...		-1.52**	-0.80**	-0.60**
Impact of unemployment longer than...		0.35	0.53	1.16

Source: Luginbuhl (2015). The table shows the results for which real wage growth has been regressed on unemployment shorter and longer than the stated period. **provide statistical significance with a confidence level of 99%.

4 Employment protection indirectly important

The level of employment protection may also play a role in the rise of long-term unemployment during a recession, as well as in its decline once the recession is over. Long-term unemployment peaks at a lower level in countries with little employment protection and decreases faster after a recession is over.¹⁷ If it is difficult for employers to fire their employees, or if the costs involved are high, they will be hesitant to hire people, both during a recession and once the economy is recovering. After all, they run the risk of having to fire these new employees again, particularly if the recovery is fragile and therefore uncertain to continue. This would be very costly under a high employment protection level.

In the Netherlands, the relatively high level of employment protection for people with a permanent contract, in principle, is no obstacle for the growth in employment and the related reduction in long-term unemployment. There are ample possibilities for short-term contracts and for hiring independent professionals and temporary workers.¹⁸ At the termination of such contracts, no restrictions or severance payments apply.¹⁹ Dutch employers therefore do not have to hesitate to hire people. The possibilities for employing them on a flexible basis are much greater than in the 1980s and 1990s, which means long-term unemployment this time may be reduced faster than in those days.

The fact that employment protection increases with job tenure is an indirect cause of long-term unemployment and puts a break on its recovery. This form of employment protection discourages employees – in practice, particularly the older employees – with a permanent contract from wanting to change jobs. It causes them to stay in the same job for longer than would be good for their structural labour market position.²⁰ People that do change jobs are the first to get fired in a round of redundancies at their new employer, and in addition they also receive a lower severance pay. The incremental increase in severance pay will in fact be somewhat reduced from 1 July 2015, when the new Employment and Security Act (WWZ) is implemented. From then on severance pay is also no longer related to age. Nevertheless, even under the new Act, employees still have an incentive to continue working for the same employer for a long period of time.

¹⁷ See Duval et al. (2007).

¹⁸ Of all OECD countries, the differences in employment protection levels between temporary and permanent contracts are the largest in the Netherlands (CPB, 2015).

¹⁹ The new Employment and Security Act (WWZ) also includes an amount in transition compensation at the termination of temporary contracts of more than two years. However, employers still have the option to offer shorter contracts and thus to avoid having to pay the transition compensation.

²⁰ See Deelen et al. (2014a) and Deelen et al. (2014b).

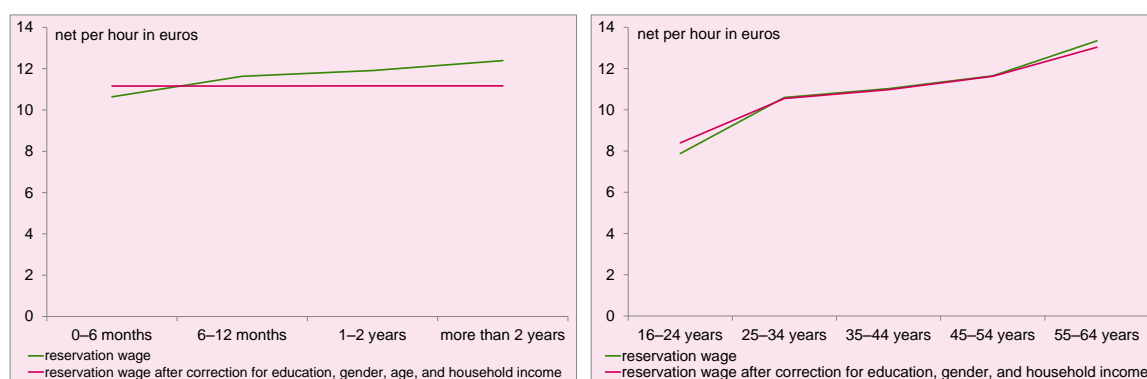
5 Social benefit design is crucial

A generous social benefit system also leads to more long-term unemployment and a slower recovery from recession. In countries with higher and longer unemployment benefits, the unemployed hold on to their high wage demand, which in turn means it takes longer for them to find a job.²¹ Such a higher ‘reservation wage’ – the lowest wage that the unemployed are willing to accept for their new job – also has a positive side: the quality of such a new job will often be higher, which leads to higher productivity for those that do find a new job.²²

In an ideal situation, reservation wage levels decrease under prolonged unemployment. This would prevent human capital being discounted through scarring and signalling. The degree by which the reservation wage reduces, in actual practice, strongly depends on the maximum duration and level of the unemployment benefits.²³ High and long-term benefits enable the unemployed to hold on to a high reservation wage. With 3 years and 2 months, the Dutch maximum duration of benefit payments is long, from an international perspective. This maximum duration will be brought down to 2 years under the new Dutch Employment and Security Act (WWZ), which will be implemented on 1 July 2015.²⁴ This will bring the Netherlands in line with countries such as Denmark, Finland and Germany. Other countries, such as the United States (5 months) and Sweden (1 year and 2 months), have a shorter maximum duration.

Unemployed people in the Netherlands are hardly prepared to accept lower wages the longer they are unemployed (Figure 8, left). Uncorrected for background characteristics, the reservation wage even increases as the duration of unemployment becomes longer. However, when corrected for these background characteristics, such as education and age, the reservation wage remains constant.

Figure 8 The reservation wage (corrected for background characteristics) hardly goes down as unemployment lasts longer (left), and increases with age (right)



Source: CPB adaptation on the basis of the Labour Supply Panel 2004–2012 (of the Netherlands Institute for Social Research (SCP)).

²¹ See Krueger and Mueller (2014).

²² See De Groot and Van der Klaauw (2014), Nekoei and Weber (2015).

²³ See the overview article by Tatsiramos and Van Ours (2014).

²⁴ In the ‘Sociaal Akkoord’ (the Dutch social agreement) of 2013, social partners agreed to ‘repare’ the duration of unemployment benefit payments, up to the original 3 years and 2 months. However, these repairs, for the time being, will not become operational.

Older unemployed people hold on to a higher reservation wage than young people (Figure 8, right). On the one hand, this is because of the higher wages that older people had before they became unemployed, and because of more social security rights, on the other.²⁵ Older employees with a longer labour history, after all, have longer rights regarding their unemployment benefit entitlements than do young people with a shorter labour history.²⁶

A decline in long-term unemployment is slowed down by the steady reservation wage level over the duration of unemployment and the high reservation wage of older people. Despite the fact that older workers have longer work experience and thus have built up relatively much human capital, a relatively large share of this is discounted again after they lose their job. Due to the depreciation of firm and job specific human capital, older unemployed people usually have to accept a greater reduction in income if they want to get back to work.²⁷

6 Wait for recovery, but organise structural reform as well

Long-term unemployment decreases even without government interference when the economy recovers. Following the recession of the early 1990s, for example, long-term unemployment gradually decreased from 3.6% in 1995 to 0.9% by 2002.²⁸ Short-term unemployment decreases first when the economy recovers, followed, after a certain amount of time, by long-term unemployment. Employers are inclined to first hire people who have not been unemployed for long. By far most of the unemployed suffer no permanent damage from the recession.

Now that the economy is recovering, long-term unemployment is stabilising also in the Netherlands, and ultimately will decrease. In previous times of recovery, long-term unemployment decreased, with some delay, down to 1%. This is also a realistic prospect, this time round. Flexible labour relationships are more common today, which means the recovery may take fewer years than the seven that were needed after earlier severe recessions.

However, current long-term unemployed people will not all benefit from the economic recovery. For some, retraining may help them reclaim their position on the labour market. A certain share of those unemployed will not be able to return to their old profession; for example, because of a lower demand for it (e.g. due to technological developments). Particularly in postal and financial services, this appears to be the case.²⁹ Focused and timely retraining of the unemployed from these sectors may increase their chances of finding new employment. However, there is little information available about the effectiveness of current policy on this subject (see text box). In addition, a temporary wage subsidy may also be an

²⁵ See Euwals et al. (2013).

²⁶ See CPB (2013).

²⁷ See Deelen et al. (2014b) and Bosch and Ter Weel (2013). In the United States, the reservation wage levels of older people do decline the longer their unemployment continues (Krueger and Mueller, 2014).

²⁸ Following the economic crisis in the early 1980s, long-term unemployment decreased from 4.7% in 1985 to 2.3% in 1992.

²⁹ See Erken et al. (2015a). People from these sectors relatively often remain on unemployment benefits for prolonged periods of time (UWV, 2014).

effective means to combat long-term unemployment. Experience in the United Kingdom has shown that this may be successful, also on a temporary basis.³⁰ The policy instrument needs to be implemented preferably right after the benefit payments have started, and be specifically aimed at people who are highly at risk of long-term unemployment.

Effective active labour market policies?

Active labour market policies may consist of training, assistance in finding employment, wage cost subsidies and subsidised work. The Netherlands in 2014 spent around 1 billion euros on active labour market policies.^a However, not much is known about the effectiveness of this total package.^b Dutch studies have found small positive impacts on the chances of employment.^c Yet, the costs often do not outweigh the benefits, because some of the funds are not spent in the most effective areas. An example is that of training offered to people who would also have found employment without it. A second example concerns low-educated unemployed people being displaced by reintegrated higher educated people.^d

Effective active labour market policies aimed at short-term unemployed people place the emphasis on helping them to find work, while, for the long-term unemployed, training and wage cost subsidies deserve more attention. Training the long-term unemployed is a relatively attractive measure during a recession, because the chances of them missing job opportunities over the course of the training are smaller.^e Longer courses are also more effective for older people.^f An international survey of studies has shown that subsidised labour in the public sector – such as in the Netherlands with the former ‘Melkert jobs’ – are less successful than other types of active labour market policies.^f

^a See Ministry of Finance (2014) and UWV (2015).

^b See, for example, Koopmans et al. (2014).

^c See, for example, Van der Heul et al. (2003), Groot et al. (2006) and Groot et al. (2007).

^d See, for example, Crepon et al. (2013).

^e See Kluve (2010) and Forslund et al. (2011).

^f See Kluve (2010).

³⁰ The UK Employment Retention and Advancement (ERA) includes a financial bonus when people find a new job and when they manage to hold on to it, and a schooling bonus for following and finishing training courses while in employment. Because of the ERA, the chances of employment increased by more than 2 percentage points (Hendra et al., 2011). A cost-benefit analysis showed positive results.

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