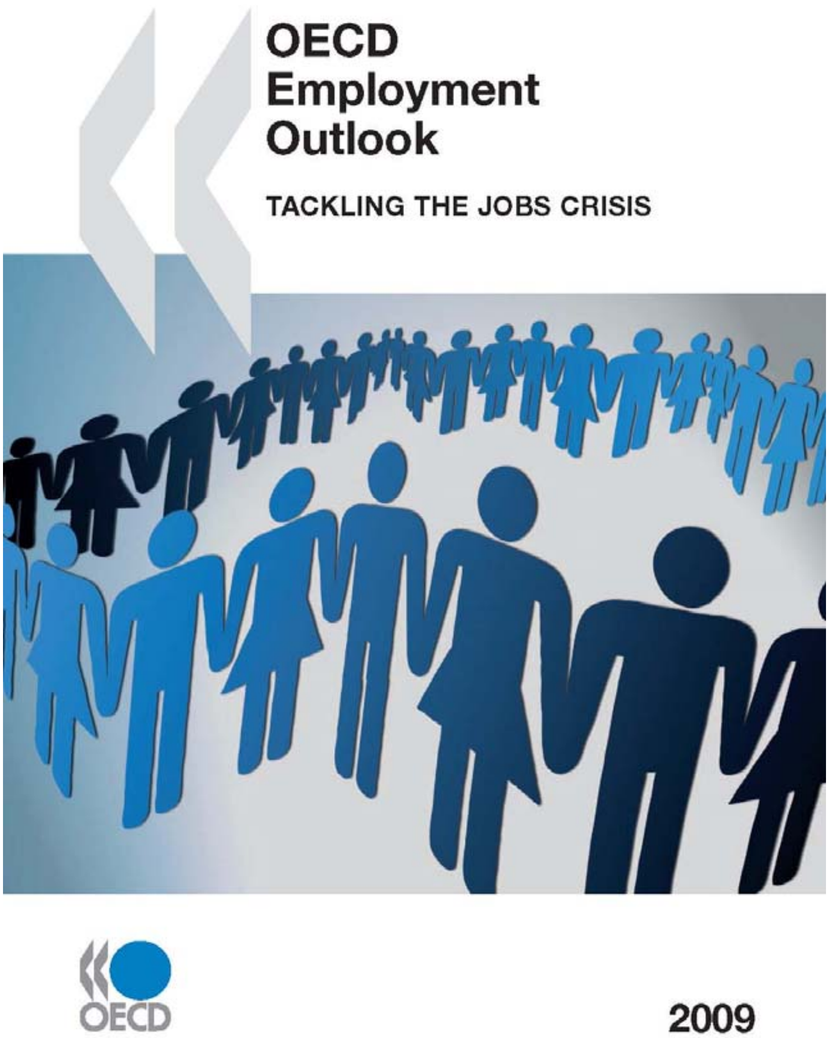

4. Making the most of income-support policies in a downturn

Most OECD countries operate extensive income-support programmes. Cash benefits provide safety nets for job losers and, more generally, for those whose resource situation is considered inadequate. With increasing unemployment and deteriorating incomes, these policies become even more important as safety nets for individual families and as macroeconomic stabilisers. Their capacity and effectiveness is, however, being severely tested by the current economic downturn.

This section considers the scope and generosity of existing income-support policies and asks whether, and how, support measures should be adapted to deal with the

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challenges occasioned by a severe recession. While increasing joblessness creates political pressures for governments to act, it is in fact not self-evident that safety nets must be modified. Well-designed income-support policies cushion the impact of income losses for economically vulnerable groups, providing some degree of income security automatically. An increase in unemployment and deteriorating incomes therefore do not necessarily translate into a need for discretionary policy intervention.

But a severe downturn with far-reaching changes in labour market conditions and earnings opportunities can produce individual risks that existing income-support systems were not designed to address. In addition, large increases in the number of people facing such risks can expose structural deficiencies in safety-net policies that are less apparent when labour markets are tight. For instance, patterns of benefit recipiency during earlier labour market downturns suggest that adequate employment-oriented safety nets are essential in order to avoid the very high long-term costs of expanding "inactive" programmes such as disability or early retirement benefits (see Carcillo and Grubb, 2006). More generally, it is critical to examine whether the balance of existing income-support measures provides an adequate degree of income security while defining credible pathways towards labour market re-integration.

Recent policy attention has mostly focussed on income support for the unemployed. A focus on this group is also suggested by the findings in Section 2 above which confirm that unemployment has been the most important driver of cyclical changes in total hours worked. The first part of the analysis below will therefore discuss *unemployment benefits*.

In addition, there are other types of transfer that can provide potentially crucial support for a broader group of individuals affected by weakening labour markets. Importantly, government transfers can play a role in keeping people in their jobs and making low-paid work more economically feasible for workers suffering earnings losses. *Partial unemployment benefits* and related *short-time working schemes* are designed to provide temporary income supplements for individuals facing working-hour reductions. Likewise, *in-work benefits* may be an effective redistribution instrument by cushioning income losses resulting from reduced working hours or wage concessions. They also encourage transitions into work for disadvantaged workers and may therefore be helpful in shortening unemployment spells and in supporting an equitable labour market recovery process.

Finally, it is essential to consider income-support measures that provide fall-back options for those not – or no longer – entitled to unemployment benefits, as well as for families on very low incomes more generally. Lower-tier transfers, such as social assistance or other *benefits "of last resort"*, can be expected to become a more critical element of income-support strategies as the recession adds to the ranks of groups who are particularly likely to draw on such safety-nets, including the long-term unemployed and non-standard workers faced with an extended period of joblessness.

4.1. Income support for job losers

Two essential functions of unemployment benefits are the provision of a degree of income maintenance during joblessness and facilitating effective job-search. While countries share these objectives, their balance – and the approaches used to achieve them – varies.

A simple way of summarising many of the relevant institutional details is by means of *benefit replacement rates*, which express net income of a beneficiary as percentages of net income in the previous job.[76] Unemployment benefits are the "first line of defence" for those experiencing a job loss. Table 1.6 shows benefits replacement rates at different stages during an unemployment spell for prime-age individuals (Annex Tables 1.A8.1 and 1.A8.2 in OECD, 2009e show net replacement rates for younger and older workers). Results are averages over different earnings levels and family situations and account for taxes and for family-related benefits that are typically available. They refer to 2007 and, thus, to a period before any adjustments were made in response to the current downturn. In order to

Table 1.6. **Generosity of unemployment benefits**

Net replacement rates at different points during an unemployment spell, 2007[a]

In percentage

	Year 1	Year 2	Year 3	Year 4	Year 5	Five-year average
Norway	72	72	72	72	72	72
Belgium	65	63	63	63	63	63
Austria	61	58	58	58	58	59
Denmark	68	68	68	68	9	56
Ireland	50	50	50	50	50	50
Portugal	79	79	56	24	3	48
Germany	64	48	42	36	36	45
France	67	64	31	31	31	45
Finland	60	58	33	33	33	43
Australia	42	42	42	42	42	42
Spain	69	65	25	25	13	39
New Zealand	38	38	38	38	38	38
Sweden	66	63	41	8	8	37
Iceland	57	54	54	8	8	36
United Kingdom	28	28	28	28	28	28
Netherlands	71	59	3	3	3	28
Switzerland	80	40	0	0	0	24
Luxembourg	87	8	8	8	8	24
Canada	52	14	14	14	14	22
Hungary	48	13	13	13	13	20
Poland	42	16	8	8	8	16
Czech Republic	33	11	11	11	11	15
Japan	45	3	3	3	3	11
Turkey	46	0	0	0	0	9
Slovak Republic	32	3	3	3	3	9
Greece	33	5	1	1	1	8
Italy	37	0	0	0	0	7
Korea	31	0	0	0	0	6
United States	28	0	0	0	0	6
Median	***52***	***40***	***25***	***13***	***9***	***28***

a) Countries are shown in descending order of the overall generosity measure (the five-year average). Calculations consider cash incomes (excluding, for instance, employer contributions to health or pension insurance for workers and in-kind transfers for the unemployed) as well as income taxes and mandatory social security contributions paid by employees. To focus on the role of unemployment benefits, they assume that no social assistance or housing-related benefits are available as income top-ups for low-income families (covered in Figure 1.19 below). Any entitlements to severance payments are also not accounted for. Net replacement rates are evaluated for a prime-age worker (aged 40) with a "long" and uninterrupted employment record. They are averages over 12-months, four different stylised family types (single and one-earner couple, with and without children) and two earnings levels (67% and 100% of average full-time wages). Due to benefit ceilings, net replacement rates are lower for individuals with above-average earnings. See OECD (2007a) for full details.

Source: OECD tax-benefit models (*www.oecd.org/els/social/workincentives*).

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focus in the first instance on income security provided by unemployment benefits, income replacement rates refer to one-earner families and exclude housing benefits and social assistance (the role of these important benefits is discussed below).[77] Low replacement rates therefore do not necessarily imply that all families actually experience these income losses. Instead, they identify potential gaps in income security for the unemployed and, therefore, a need to draw heavily on savings, on support through minimum-income safety nets or on help from family members.

For prime-age workers entitled to unemployment benefits, net incomes during the first year of unemployment are above 60% in just under half of the countries. Income losses during the first year are smallest in Nordic and continental European countries. At the bottom of the table, low initial replacement rates for the Czech Republic, Greece, Italy, Korea, the Slovak Republic and the United States show that job-losers in these countries can be particularly hard-hit, with income losses for those not receiving any other support amounting to more than 60% during the first year of unemployment (for those losing employer-provided benefits, notably health insurance, the losses are larger still). Initial replacement rates for those receiving unemployment benefits only are also low in Australia, New Zealand and the United Kingdom. Because net replacement rates are shown as yearly averages, low values can be due to modest benefit levels, short durations (for instance, prior to federal extensions in 2008, the maximum benefit duration in a typical US state was 26 weeks) or both.

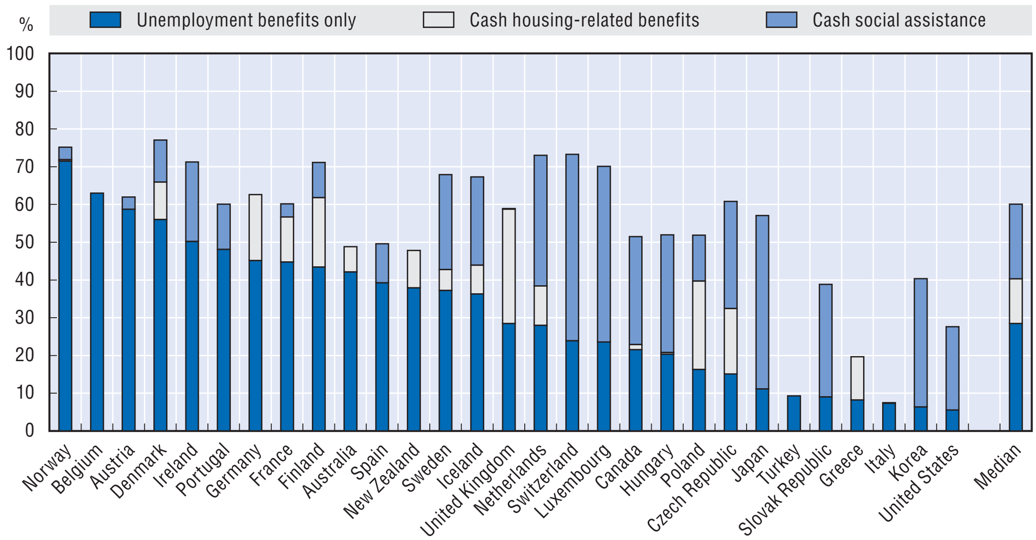
In countries operating UI benefits, net replacement rates typically decline during the unemployment spell. The gradient of the downward slope varies markedly, however. Long-term unemployed prime-age individuals in Italy, Korea, Turkey and the United States lose their entire benefit income after 12 months of unemployment or less. In several other countries, unemployment benefits are also no longer payable during the second year of unemployment, although families with children can be entitled to family benefits, which preserve a very small amount of benefit income (Canada, Hungary, Japan, Luxembourg, the Slovak Republic).

In part, the very large differences in benefit durations reflect the incidence of long-term unemployment, with possible causal links going in both directions. For instance, Table G in the Statistical Annex shows that fewer than 20% of jobseekers in Korea or the United States have been continuously unemployed for six months or longer, while more than two-thirds in Belgium or Germany have been unemployed for half a year or longer. But maximum benefit durations are also long in countries with short unemployment spells (Denmark, New Zealand) and *vice versa* (Italy, the Slovak Republic). For prime-age jobseekers, durations of insurance benefit entitlements are longest in Belgium (unlimited) and Denmark (48 months). But in a number of other countries, means-tested unemployment assistance provides continued (and usually lower) benefit entitlements once insurance benefits expire (Austria, Finland, France, Germany, Greece, Portugal, Spain). Four English-speaking countries operate unlimited means-tested unemployment assistance benefits (Australia, Ireland, New Zealand, the United Kingdom), resulting in a flat replacement-rate profile.[78]

In some of these countries, net incomes of jobseekers can be heavily influenced by the availability of housing benefits, as well as social assistance and other benefits of last resort. As shown in Figure 1.19, they are therefore an important component of the overall support package: Net replacement rates in Australia, New Zealand and the United Kingdom (as well

Figure 1.19. **Unemployment benefits are only one element of safety nets for job losers**

Average net replacement rates over a five-year unemployment spell[a]



a) See notes to Table 1.6 for details on how these averages are calculated. Housing-related benefits are those available to families living in rented accommodation with rent plus other housing costs (*e.g.* utility bills) assumed to equal 20% of the average wage. In some countries, housing-related support is covered by social assistance payments instead. Social assistance in the United States also includes the value of a near-cash benefit (Food Stamps).

Source: OECD tax-benefit models (*www.oecd.org/els/social/workincentives*).

StatLink http://dx.doi.org/10.1787/706238714484

as in a number of continental European countries) are often substantially higher for those in rented accommodation who are entitled to cash rent assistance. This highlights the possibly severe financial difficulties of those not entitled to such housing support (*e.g.* owner-occupiers who lose their job). Social assistance and other minimum-income or "welfare" transfers provide a fall-back option for people not or no longer receiving unemployment compensation. Income top-ups from social assistance transfers can be significant for those receiving them. But, as will be argued below, they often fail to reach large parts of the low-income population.

Do existing systems of unemployment compensation provide adequate safety nets during a severe economic downturn? It is obvious from Table 1.6 that policy designs differ widely across countries. While rising unemployment rates will put considerable strain on benefit systems in all countries, some of them are better placed than others to provide effective income support in a recession. Where benefit protection is patchy, governments should move quickly to make necessary adjustments to ease the negative impact of weakening labour markets on income security, while ensuring that such policy measures do not stifle recovery once economic activity regains momentum. One-off payments and ad-hoc increases in benefit amounts for selected groups are expensive and unlikely to be an effective response to the complex labour market changes brought about by the downturn. Instead, the first priority is to avoid large numbers of unprotected job losers by securing effective coverage. Among the main challenges are the following:

- *Soaring numbers of benefit applications:* Can support be scaled up quickly to meet the additional demand? In previous recessions, the number of unemployment benefit claimants in OECD countries tended to rise very quickly early on during the downturn and then plateau at high levels, before ebbing slowly. With a similar profile emerging at the onset of the current downturn, the resulting jump in benefit applications has triggered substantial additional demands in terms of administrative and financial capacity. Ensuring the availability of the necessary resources is therefore a first priority in order to avoid service disruptions and delayed or reduced entitlements at a time when income support is most needed.

- *Longer unemployment spells:* As unemployment spells lengthen, beneficiaries are confronted with declining benefit payments or expiring entitlements in most countries. Such "threat points" reinforce job-search incentives and have been shown to improve job-finding rates, even before benefits are reduced. But as job vacancies dry up during a recession and demand-side restrictions become more binding, these incentives are less effective and concerns about the adequacy of income support for the growing number of longer-term unemployed become more pressing. In eastern Europe, Italy, Japan, Korea, the Slovak Republic, the United States and other countries where benefit durations are short, extensions will help to reduce the number of benefit stops experienced by jobseekers who are, in fact, available for work. Importantly, such measures should address the specific challenges of the downturn. In order to avoid delaying employment growth after the recession, credible commitments should therefore be made to keep them *temporary* (*e.g.* by tying them to a suitable labour market indicator, such as the vacancies-to-unemployment ratio). As was shown in Section 2 above, the extent and nature of recession-related labour market problems is likely to differ markedly between workforce groups. It may therefore be important to keep benefit durations suitably differentiated (for instance, Section 2 above shows that job-finding rates for young people are higher than the average for other age groups, but that the duration of unemployment spells for youthful job losers increases more strongly during a recession). Finally, extending benefit durations may be less urgent in the short term if effective and comprehensive minimum-income schemes provide a second layer of income support. Yet, with evidence consistently pointing towards substantial difficulties of moving from social assistance back into employment, there are good reasons for keeping job-ready unemployed people on unemployment benefits.
- *Increasing numbers of ineligible jobseekers:* The discussion above highlights country differences in terms of support available to those who are, in principle, eligible for unemployment benefits. But substantial shares of unemployed people do in fact not qualify for these benefits in the first place. In part, this is intended. For instance, governments may wish to maintain the link between contributions and benefit payouts and therefore exclude those with short or interrupted work histories (and sometimes those with very low earnings). But depending on entitlement conditions for unemployment benefits, growing shares of workers may remain unprotected if temporary work and other non-standard work patterns become more common.[79] They may be excluded by law (*e.g.* the self-employed in most countries, including the so-called "falsely" self-employed) or *de facto* because they are less likely to meet contribution requirements or satisfy other relevant eligibility criteria (*e.g.* temporary or part-time workers).[80] A lack of protection for these workers is of particular concern during the downturn because non-standard workers typically are more easily shed from the workforce and therefore likely to experience a disproportionate share of overall job losses. As job losses mount, any problems of non-coverage in unemployment insurance

are likely to become evident in countries with substantial proportions of non-standard workers. While the downturn will clearly highlight any existing gaps in unemployment protection, *ad hoc* changes to unemployment insurance rules, in the context of a recession, are unlikely to provide help for those without sufficient contributions who have already lost their job. More importantly, large shares of non-standard workers are the result of longer-term structural changes in the labour market. Rapid and isolated modifications of entitlement rules would preclude having a considered policy debate about the role of non-standard employment and its relationship to the social protection system more generally. A more promising short-run response would consist of ensuring the availability and adequacy of lower-tier assistance benefits, such as social assistance.

4.2. Support for low-earning individuals – protecting workers and jobs?

While rising joblessness is the main concern during a severe downturn, there is also likely to be an increased need for assistance for part-time and low-wage workers. Workers who escape being laid-off may, nonetheless, be compelled to accept wage concessions or a shortened work week, while job losers and labour market entrants will more often need to settle for new jobs offering lower wages or fewer hours than they could have obtained in a more robust labour market. Several different designs exist for providing income support to low–earnings individuals. They differ in terms of their distributional impacts and also create different incentives on the demand and supply sides of the labour market. For example, such schemes can be structured in a way that is intended to prevent or delay layoffs. Alternatively, benefits may be designed so as to raise re-employment probabilities of job losers.

In times of strong economic activity as well as during a recession, well-targeted transfers to low-earning workers can help strengthen their labour market attachment and reduce the incidence and severity of in-work poverty (Chapter 3). Yet, the balance of employment and redistributive effects of such transfers, and therefore their role in an overall income-support strategy, depends to a considerable extent on labour market conditions. When labour demand is strong, income supplements for low-earning individuals help to address an important supply-side barrier to higher employment. They strengthen employment among the target group by moderating any work disincentives that result from a combination of low wage levels and the operation of out-of-work benefits. However, positive employment effects alone do not explain the increased popularity of these measures. Instead, the attraction of well-designed in-work transfers is that they present a rare opportunity to escape the common trade-off between redistribution and employment. Given certain framework conditions, such as a relatively unequal earnings distribution, they direct support towards low-income families while improving work incentives at the same time (Immervoll and Pearson, 2009).

Labour supply constraints are less binding during a recession. Since much of unemployment is involuntary, the case for additional work incentives is less compelling. Instead, the attraction of in-work benefits during a downturn is that they provide income support to those affected by deteriorating earnings levels. Responding to falling product demand and possible cash-flow problems linked to tight credit markets, employers seek to reduce labour costs by scaling back production and increasing labour productivity. In-work support subsidises (low-paid) employment and can cushion some of the income loss resulting from reduced working hours. Since they make work more attractive relative to unemployment (the replacement ratio falls for those entitled to in-work support), they can

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also facilitate wage moderation, stimulating labour demand in the medium term.[81] In short, when the labour market is weak, the balance of objectives associated with in-work support arguably shifts from employment creation towards redistribution and poverty avoidance – and from creating work incentives for jobless individuals to facilitating continued work attachment for those already in employment.

Maintaining (and re-establishing) links with the labour market is particularly important in the context of rising unemployment inflows and lengthening unemployment spells (*cf.* Section 2). It also provides welcome relief for unemployment benefits and related support services, which are likely to be pushed towards capacity limits by a severe economic downturn. With high pressures on out-of-work support and re-employment services at the onset of a recession, measures that limit inflows into full-time unemployment can be attractive even if unemployment is not prevented but only delayed. A more even spread of new unemployment spells reduces demands on safety nets, which can be critical for maintaining adequate income support and service effectiveness.

Because the objectives of in-work support are partly conditioned by the broad state of the labour market, some form of support for low-income workers may be desirable during an economic downturn, even in countries where the case for these benefits would otherwise not be particularly strong. For the same reason, countries that already have such programmes in place should consider whether adjusting relevant policy parameters, such as eligibility conditions, would make them more effective during the downturn and a subsequent recovery.

Support for low-paid workers can take a number of different forms:

- In response to the current downturn, several OECD countries have introduced or reinforced *partial unemployment benefits* available to workers facing involuntary working-hours reductions.[82] Like unemployment benefits, support is time-limited, and may be conditional on participation in other work-related activities, such as job-search or training. As part of broader *short-time working schemes* or *work-sharing arrangements*,[83] compensation for reduced working hours may be paid through the employer who, in turn, receives wage subsidies that are paid conditional on continued (partial) employment of existing workers (*e.g. chômage partiel* in France). On top of explicit transfers to the employer or employee, significant implicit transfers may be provided as well (for instance, continued accumulation of full-time entitlements in pension or unemployment insurance programmes). Countries differ in term of the requirements imposed on employers which, in turn, is likely to lead to different, and often low, take-up rates across countries.[84] For instance, firms typically have to demonstrate the nature and extent of the difficulties they face, although during a severe recession, such requirements may not be enforced fully. There may also be other conditions, such as "no-layoff" agreements for the duration of the short-time working scheme (provisions typically exist that allow employers to replace individual workers). Employers may also be required to provide or arrange training during non-working hours (*e.g.* as recently introduced in the Czech Republic). An alternative to explicit requirements is to provide financial incentives for training (Austria). What is common to all these programmes is that they facilitate the temporary continuation of *existing* employment contracts and, hence, favour "old" jobs over "new" ones.[85]
- The much less common *wage insurance* schemes also operate in relation to a previous employment contract. But the crucial difference to partial unemployment benefits is

that, rather than maintaining existing contracts, they aim at encouraging re-employment in lower-paying jobs. They do this by compensating part of the difference in pay levels between the old and new jobs. Apart from smoothing incomes of those affected by earnings losses, the aim is to speed up re-employment by broadening people's job-search to encompass lower-paying jobs. By encouraging transitions into jobs where the initial match with workers' skills is partial, wage insurance can also act as a subsidy for on-the-job training. While an early demonstration project sponsored by the Canadian Government has attracted considerable attention (Bloom *et al.*, 1999), wage insurance programmes have not been rolled out on a large scale. One exception is the United States, where older full-time workers who have lost their previous job for a specified set of trade-related reasons have been covered under the Alternative Trade Adjustment Assistance for Older Workers (ATAA) since 2002.[86] They receive up to half of the earnings shortfall, along with some health-care related financial support. Like partial unemployment benefits, wage insurance schemes are subject to specific time limits (two years in the case of ATAA). But unlike partial out-of-work benefits, which are designed to cushion the earnings loss resulting from reduced working hours, wage insurance schemes are typically targeted towards displaced workers facing lower hourly wages in their new jobs.

- *In-work benefits* are paid independently of the existence (or the characteristics) of a previous job. For example, the UK Working Tax Credit, the US Earned Income Tax Credit, the New Zealand In-work Tax Credit, or the Belgian *Bonus de l'Emploi* are targeted to a well-defined groups of low-paid workers whether or not they have previously held a better-paid job. They are also paid to those returning to employment from an out-of-work spell, as well as to first-time entrants into the labour market. One can distinguish between permanent in-work benefits (payable as long as relevant conditions such as earnings, working hours and family situation are met) and those subject to a time limit (commonly targeted to those *entering* employment). In principle, in-work benefits can be paid to all workers with "low" earnings, regardless of whether they are due to limited working hours or low wage rates. But some countries seek to distinguish between "low effort" and "low ability" in an attempt to prevent benefits from being paid to individuals who choose to work reduced hours on a voluntary basis.[87] One consequence of targeting low wages, rather than low earnings, is that benefits provide less income security during a recession when working-hours reductions are typically involuntary.

While some form of in-work income support for low earnings appears to be particularly valuable in a steep downturn, it is not simple to assess the relative advantages of these three approaches to determining who is eligible for support and how large their benefit should be. Partial unemployment benefits and wage insurance are directly targeted on the income security concerns related to declining labour demand, since eligibility and benefit amounts are tied to earnings losses associated with involuntary hours reductions or layoffs. Indeed, they are best thought of as modified versions of traditional unemployment benefits, which seek to extend income support to additional workers experiencing earnings losses due to declines in labour demand, while also promoting higher employment by either providing employers with an increased incentive to reduce dismissals or job losers with an increased incentive to become re-employed. An alternative – or complementary – approach consists of providing support that is not tied to a particular employment contract or to previous work experience. In-work benefits that depend only on current work status and income (and possibly a number of family-related characteristics) can support low-paid workers while side-stepping potential distortions between existing and new jobs. Unlike partial unemployment benefits, they also reach low-paid workers with marginal or intermittent employment, unemployed individuals taking up a new job, as well as new labour market entrants.

Due to the potentially broader coverage of in-work benefit (they are not conditional on contribution histories or previous work status), they can be more costly than partial unemployment benefits. But in-work benefits are typically more tightly targeted to low-income groups and are therefore more effective at reaching workers with the most acute needs for financial support. The appropriate targeting of in-work benefits, as well as their effectiveness, depends to a considerable extent on the number of "low-paid" jobs and on the distribution of earnings more generally.[88] Most OECD countries operating such benefits have therefore carefully customised the targeting mechanisms (Immervoll and Pearson, 2009). However, far-reaching changes in labour market conditions during and after the recession can be expected to alter the earnings distribution and, hence, the optimal degree of targeting. For instance, it is important to consider whether work requirements should be adapted to ensure that (temporary) part-time jobs qualify for in-work payments.

A second issue of programme design that is of particular relevance in the context of a severe recession concerns the *timing* of benefits payments. There are, for instance, good arguments for minimising delays between eligibility and benefit payments (tax refunds in the next year limit the effectiveness of in-work benefits as a safety-net for those experiencing earnings losses now). In addition, countries introducing or extending in-work benefits may consider doing so on a temporary basis. Time-limiting in-work benefits would, however, mainly be driven by budgetary considerations. As compared to partial unemployment benefits, there is a much smaller risk that permanently available in-work benefits would damage labour market dynamism.[89]

One of the main concerns that all forms of in-work support raise is that they can be viewed as supporting downward mobility, rather than placing the emphasis on keeping people in (or getting them into) "good" jobs. These concerns have some validity to the extent that in-work transfers lead some overqualified individuals to displace low-skilled workers, although so-called "trading down" during recessions also occurs in the absence of in-work support schemes. It is also important to recognise that these transfers primarily help to ease existing distortions favouring unemployment over low-paid work, rather than introducing distortions towards low-paid jobs. For an overall assessment of the desirability of in-work support, the issue of labour supply incentives is, in any case, likely to be less relevant during a recession when many workers face earnings losses independently of whether or not such programmes are available. In this context, measures (possibly time-limited) that direct support to low-paid workers are a valuable building block of employment-oriented safety-net polices and they may have an expanded role to play in a deep recession.

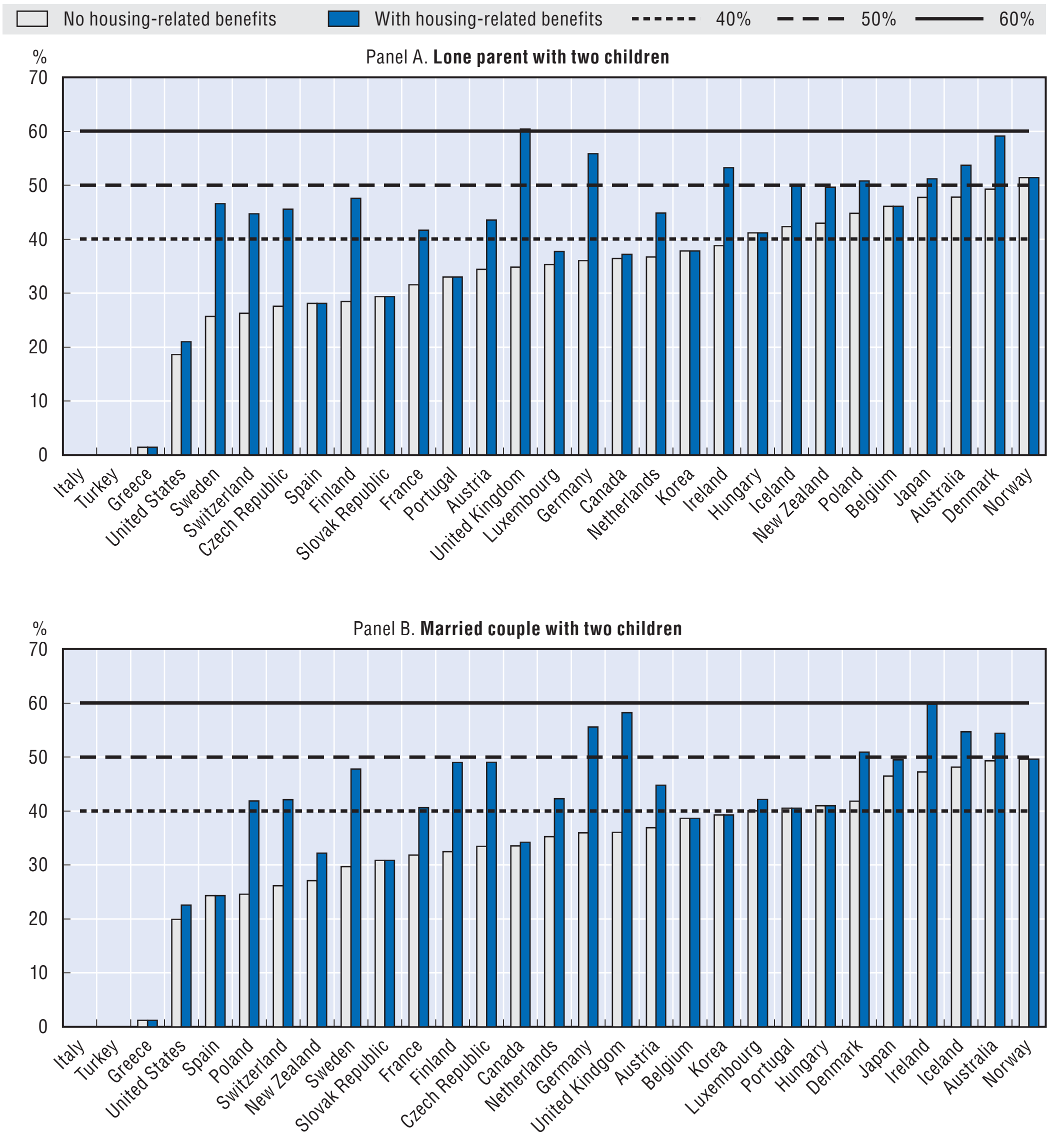
4.3. Income support for those experiencing severe hardship

Social-assistance and similar minimum-income benefits can provide timely and targeted assistance to unemployed individuals with no other entitlements, as well as those with extremely low incomes more generally (including as a top-up to unemployment benefits in some countries). As benefits of "last resort", they are essential planks of redistribution policies and therefore of particular relevance at a time when increasing numbers of families are faced with deteriorating incomes and much-reduced prospects for sustainable self-sufficiency. In addition, an attraction of investing in minimum-income support in the context of an economic downturn is that tight targeting towards low-income groups ensures that public expenditures in this area readily translate into higher private spending.

Poverty alleviation is the primary objective of minimum-income benefits. But Figure 1.20 illustrates that, in all countries, families receiving these benefits require

Figure 1.20. **Net incomes of social assistance recipients in relation to alternative poverty lines, 2007**[a]

In percentage of median household income



a) Results show benefit entitlements for a family with two children aged 4 and 6 and no other income sources. They account for all relevant cash benefits (social assistance, lone-parent benefits, other family benefits, housing-related cash support as indicated) and income-related taxes and social contributions, where applicable. US results also include the value of a near-cash benefit (Food Stamps). Comparisons with median income levels are made on an equivalised basis (equivalence scale is the square root of the household size). Median household incomes are for a year around 2005 expressed in 2007 prices.

Source: OECD tax-benefit models (*www.oecd.org/els/social/workincentives*).

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income from other sources in order to avoid high risks of falling into income poverty. In a slight majority of countries for which such calculations are available, net incomes of families without any other income sources are set above the lowest of the three commonly-used *relative* poverty lines (40% of median income), but this is only the case if housing-related assistance is available (light bars). For those who do not have access to cash housing support (dark bars), incomes are below all three poverty-cut-offs in most countries, with very substantial poverty gaps in some (there are no generally-applicable social assistance benefits in Greece, Italy and Turkey).

Sizable income poverty gaps are an important concern, more so if they go hand-in-hand with insufficient access to essential services such as healthcare (not accounted for in Figure 1.20). As more people draw on minimum-income safety nets in a recession, their effect on poverty rates and the overall income distribution becomes more apparent. The above results demonstrate that social assistance benefits by themselves are typically insufficient to ensure incomes close to the poverty line. But simply raising benefit *levels* is often not sufficient, nor should it arguably be the first priority when considering how to limit the impact of the downturn on the most vulnerable groups.

Instead, and similar to the discussion of unemployment benefits above, a necessary condition for minimum-income benefits to be effective is that they are *available and accessible*. Studies of non-take-up regularly find large shares of low-income families who do not appear to receive means-tested benefits to which they would be entitled (Hernanz *et al.*, 2004; Bargain *et al.*, 2007). Non-take-up rates are often close to or above 50% which very much inhibits the poverty-reducing power of these benefits. Although non-take-up may sometimes be a rational decision (those with small entitlements or short expected durations of low-income status may decide that applying is not worth the effort), evidence shows that barriers to receiving benefits can hit the poorest families in particular.[90]

A number of measures can help reduce these barriers. Clearly-defined legal entitlements are more transparent and create more certainty for the benefit claimant than "first-come-first-serve" systems whereby a pre-determined budget limits total benefit programme expenditure (causing possible shortfalls, especially during periods of rapidly rising benefit claims). Information campaigns can improve knowledge about available support measures, as can one-stop-shops which provide information about different types of programmes in one location. By creating a single contact point for claimants, one-stop-shops can also be one element of efforts to streamline the application process. Finally, organisational measures, such as safeguarding claimant anonymity or extending benefit agency opening hours, can limit the burden and stigma associated with claiming safety-net benefits.[91]

A closely related aspect of targeting and effective coverage is the set of *behavioural requirements* associated with benefit receipt. All minimum-income benefits impose at least some behavioural requirements on benefit recipients (such as regular confirmation of circumstances). As part of a welfare-to-work approach, a number of OECD countries have introduced or strengthened *work-related requirements* in recent years. One important question is whether such welfare-to-work measures are effective at a time when large numbers of benefit recipients are competing for a rapidly declining number of job vacancies. On the basis of on-going OECD work, it is possible to identify several issues that are relevant when considering whether aspects of existing work-related behavioural requirements should be adapted in view of weaker labour markets:

- By definition, recipients of last-resort benefits generally have little other public income support to fall back on. Too strict an application of behavioural eligibility conditions could result in extremely low incomes for those excluded from benefit payments. Concerns about those potentially falling through the cracks' become more acute if potential beneficiaries fail to live up to their responsibilities, not because they are unwilling but because they are unable to comply.
- Existing evidence showing positive employment effects relates to periods of relatively strong labour markets.[92] When unemployment is high, welfare-to-work measures can be expected to be significantly less effective at putting welfare recipients back into work. In addition, they may even damage the prospects of more employable jobseekers, including unemployment benefit recipients, as job-search assistance and other activation measures are diverted from more to less employable benefit clients.
- The personal characteristics and labour market difficulties of social assistance recipients tend to be very heterogeneous. Claimants include those facing severe employment barriers, more job-ready individuals, as well as workers with irregular jobs, very low earnings or difficult family situations. As recent job losers (or unemployment benefit recipients) are added to this group, a significant number of social assistance recipients could work or have relatively recent work experience.
- Some work-related eligibility conditions are certainly more difficult to meet during a recession (*e.g.* to find work within a certain period of time), but others are not (*e.g.* providing evidence of job-search or participating in active labour market programmes). It is important to recognise that, where they exist, work-related requirements can take different forms.
- The experience of previous downturns shows that the long-term costs of entirely passive social transfers are very large. In recognition of these costs, several OECD countries have invested heavily in reforms creating active and activating social safety nets. Going back on these efforts carries the risk of creating a momentum towards long-term benefit recipiency and inactivity that would be very difficult to reverse once established and would create high costs in terms of both poverty levels and labour market performance lasting well beyond the current downturn.

Together, these considerations imply that there is arguably a need for policy responses in order to maintain credible welfare-to-work approaches during a recession. Adjustments are also needed in the way existing provisions, including work-related behavioural requirements, are administered. First, more resources are required in order to maintain the same level of service, as much as is feasible, for a rising number of benefit clients and, probably, longer benefit durations. Second, the administration of work-related requirements and work-support measures needs to be applied in a suitably differentiated and targeted manner that accounts for clients' needs and labour market prospect. This needs to be based on a detailed understanding of each client's characteristics and the particular difficulties they are facing. Because of the heterogeneity of social assistance recipients, these challenges are not new. But they become much more critical as the number and composition of social assistance clients changes and the competition for work intensifies. Finally, for groups with severe labour market difficulties, fewer job vacancies would suggest a shift in priorities away from direct re-integration into the open labour market and towards maintaining and improving skills and job-readiness. Resource requirements for training programmes and subsidised employment, such as community service jobs, are likely to increase significantly as a result.

Notes

76. OECD (2007a) provides a detailed account of institutional parameters, including eligibility and qualifying conditions, as well as benefit amounts and durations. Updates of this information, as well as a benefit calculator, are also available on the Internet at *www.oecd.org/els/social/workincentives*.

77. Net replacement rates are higher for families where there is a second earner and the earnings loss is therefore only partial (likewise, they can be lower in households where more than one person is affected by unemployment). In many countries, means-tested social assistance programmes provide a fall-back option for those with no, or very low, entitlements to unemployment benefits. Net replacement rates for those entitled to (and also receiving) such minimum-income benefits can therefore be higher. To focus attention on the scope of unemployment benefits, it is, however, useful to exclude social assistance benefits in a first step.

78. In Ireland and the United Kingdom, a non-means-tested and flat-rate insurance benefit is available during an initial period of unemployment. For a family with no other incomes, the amounts of the insurance and assistance benefits are similar, however.

79. Although trends are far from uniform across OECD countries, the share of temporary employment in EU15 countries has increased by about 20% during the past decade (to 14.8% in 2007). Temporary work accounts for more than 20% of total employment in Poland and Portugal, while almost every third employment contract in Spain is non-permanent. Outside of Europe, Japan has seen a particularly strong expansion of non-standard forms of employment.

80. Among OECD countries in 2007, initial employment or contribution requirements were strictest in the Slovak Republic (three years), Turkey (600 working days) and the United Kingdom (two years), followed by Belgium, Poland and Spain (468, 365 and 360 working days, respectively), as well as Austria, Denmark, Germany, Italy, Sweden and Switzerland (all 12 months). On the other end of the spectrum, prime-age workers in nine countries satisfy both contribution and employment requirements with 6 months of full-time work or less (Canada, France, Greece, Iceland, Japan, Korea, Netherlands, Norway, United States). There are no employment or contribution conditions for (means-tested) unemployment benefits in Australia and New Zealand. In addition to work-history requirements, benefit rules may however stipulate other conditions which may preclude access to unemployment insurance for part-time workers, even if they have long and relatively stable work records. For instance, in a number of US States, minimum requirements on previous earnings can make part-time low-paid workers ineligible for unemployment insurance.

81. When labour markets do not fully clear (that is, when there is significant involuntary unemployment), models of "imperfect" labour markets are useful for thinking about how social and fiscal policies affect wages and unemployment. Models that account for some degree of wage rigidity (due, for instance, to the existence of strong unions) suggest that both replacement rates and tax burdens exert a positive influence on wage levels and this is confirmed by a number of empirical studies (Hersoug, 1984; Holmlund and Kolm, 1995, Lockwood and Manning, 1993; Sorensen, 1997). Moreover, the wage-moderating effect of lower replacement rates is stronger during periods of high unemployment (Graafland and Huizinga, 1999).

82. In some countries, these benefits are extended versions of existing programmes aiming at reducing recurring work-force adjustment costs in seasonal industries, such as tourism or construction. Similar benefits that are not restricted to seasonal industries may also be available, on a case-by-case basis, to workers in firms that are demonstrably subject to difficult business conditions or are undergoing restructuring processes on a significant scale (e.g., Transferkurzarbeitergeld in Germany).

83. Short-time working programmes are often referred to as "work-sharing." While short-time working programmes represent a form of work-sharing, this chapter uses the term short-time working in order to avoid confusion with work-sharing policies that seek to increase the number of jobs available based on mandated or collectively-negotiated reductions in standard working hours. Such policies were implemented in some European countries in the past, notably in France, in an attempt to combat structural unemployment. However, as national norms on standard working hours cannot be changed easily, work-sharing of this kind is unlikely to be an effective instrument to counteract cyclical increases in unemployment. For more on worksharing policies of this kind, see Boeri et al. (2008).

84. The short-term constraints faced by firms in financial difficulty may be such that they prefer not to participate in these schemes in order to avoid the immediate costs that they involve, even though partial unemployment benefits subsidise short-time working arrangements and may therefore be beneficial to the firm in the longer term.

85. Benefits available to any part-time worker satisfying the relevant contribution and job-search requirements are less common. The (voluntary) unemployment insurance in Denmark pays benefits to part-time employed individuals who have lost, and are looking for, full-time employment. This benefit is also available to part-time workers whose part-time contract is entirely separate from the former full-time contract (*e.g.*, with a new employer).

86. Topoleski (2008) provides a current summary of programme features. Baicker and Rehavi (2004) consider programme history and effects on re-employment and wages.

87. For instance, eligibility to the UK Working Tax Credit is subject to a minimum working-hours criterion. Entitlements to the Belgian *Bonus de l'Emploi* are based on *hourly* wage rates rather than earnings. This has the advantage that it does not favour part-time jobs, especially for second earners.

88. As a redistribution device, in-work benefits are particularly attractive in countries where earnings inequality is high, but less effective when earnings are more equally distributed. See, e.g., Immervoll et al. (2007).

89. In fact, since in-work benefits strengthen the incentives for working in low-paid jobs, they can be expected to support outflows from unemployment during a subsequent recovery. An issue that governments should monitor carefully, however, is whether targeted in-work support gives rise to so-called "low-wage traps." As in-work benefits are ordinarily phased out above a certain earnings level, this may reduce incentives for working more or for advancing on the wage ladder via investing in training. During a labour market downturn with large numbers of individuals experiencing involuntary earnings losses, the high marginal effective tax rates associated with this targeting mechanism cushion income losses, and therefore become somewhat of a virtue. But steep benefit phase-outs at relatively low earnings levels could delay earnings growth once the labour market starts picking up.

90. For instance, earlier calculations for the United States show that full benefit take-up would have reduced the number of persons in extreme poverty by 70% (Zedlewski et al., 2002). Note that the extreme poverty threshold used in this study is 50% of the US federal poverty line, which, in turn, is much lower than the relative poverty thresholds shown in Figure 1.20.

91. In the United States, the continued steep increase in Food Stamps (now SNAP, Supplemental Nutrition Assistance Program) recipiency numbers to over 11 million (serving a population of over 30 million) has, in part, been attributed to organisational changes along these lines (a further explanation put forward is the tightening of requirements for other types of welfare programmes).

92. For instance, a number of studies indicate that so-called 'work-first' measures appear to be good at increasing employment and reducing benefit dependency but are often ineffective in lifting the individuals concerned and their families out of poverty on a *sustainable* basis (Moffitt, 2008; Bolvig *et al.*, 2003; Cancian *et al.*, 2003). In an economy with sufficient demand for low-skilled workers, work-focussed behavioural requirements for social-assistance recipients can boost *earnings and employment*. But because of more demanding benefit eligibility criteria and the resulting drop in beneficiary numbers, they may do little to increase average *incomes*. By contrast, work-support measures, such as childcare support or in-work benefits, have been shown to have a more modest effect on employment, even if they are well-designed. But they are relatively effective at boosting income levels and reducing in-work poverty. Overall, this evidence therefore suggests synergies between "work-first" and "work-support" measures.

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