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Responses to the recession:  
from 'work-first' to 'train and retain first'

Thematic Review Seminar on "The way forward – exit strategies for crisis-related measures with regards to the Europe 2020 Strategy", 29 June 2010

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## 1 KEY MESSAGES / EXECUTIVE SUMMARY

- A labour market policy that encourages external flexibility and relies on the rapid placement of workers in a recession by improving the Public Employment Services (PES) or intensifying the pressure on the unemployed will come up against its limits because of the shortage of new jobs. There are obviously limitations of a policy of the so-called 'work-first' approaches in the crisis. A new mix of "work-first", train-first and retain first approaches is needed.
- Work-sharing to retain workers can help to avoid scar effects of unemployment and excessive demands on PES and to maintain production potential and firm specific skills. It helps existing firms to create new jobs in the next economic upturn.
- There is no sense in permanently subsidizing short-time work. When the economy is growing again the regulations should be adopted to changing labour market situations. Depending on the situation in the national labour markets different policies are possible.
- In the last decade one could observe a de-emphasising of training within national labour market policies because of increasing doubts of policy makers about the effectiveness of training schemes.
- The results of the evaluations of training schemes are extremely sensitive to the time frame used. Recent studies showed positive long-term effects of training on employment and income. Since there are fewer jobs available the opportunity costs of training decrease in a crisis.
- Youth unemployment rose disproportionately in countries with school-based education and training systems while it remained lower in countries with strong apprenticeship systems. The crisis is exacerbating long-term structural problems that affect the transition from school to work.
- To avoid long-term scarring effects, the crisis should be used as an opportunity to tackle these structural problems and improve the links between education, training and the labour market.
- The costs of low education are increasing. Priority should be given to the EU target to reduce the share of school drop-outs to less than 10%.

## 2 MAIN EXPLORATION OF THE THEME

With only a short time lag, the financial crisis has gripped the real economy. In 2009, real GDP among the EU-27 declined by 4.2% compared to 2.4% in the USA. Initially, there were disturbing parallels between this crisis and the great crash of 1929. In contrast to 1929, however, national governments prevented a banking collapse through massive interventions. Furthermore, they made no attempt to reduce spending in the face of the crisis. They allowed the automatic stabilisers, such as the increased expenditure on unemployment benefits and active labour market policies, to take effect and also attempted to boost the economy by introducing economic stimulus packages of varying sizes. This renaissance of Keynesianism made it possible to halt any further decline in GDP.

In 2009, unemployment in the EU-27 rose from 7% to 8.9% and the number of vacancies has decreased sharply. A labour market policy approach that encourages external flexibility and relies on the rapid placement of workers in a recession by improving the Public Employment Services (PES) or intensifying the pressure on the unemployed will come up against its limits because of the shortage of new jobs. For this reason, there are obviously limitations to a so-called 'work-first' approaches in the crisis. The OECD is calling for an expansion of the 'train-first' approach (OECD 2009a: 14) and also sees a need in a policy based on what could be called a 'retain-first' approach (OECD 2009a: 48). Without temporary working time reductions unemployment would have increased even further. In contrast to strategies based on permanent work-sharing in the crisis such an approach is intended to be temporary and reversible.

Because of contradictory findings on the employment outcomes of training programmes for the unemployed 'the work-first' emphasis has come to define employment policy in most European countries in the last decade. Recent evaluations investigating the long-term outcomes of training programmes came to more positive evaluation of training programmes. The possible negative 'lock-in' effects of training seem to play only a minor role in a crisis characterised by a shortage of vacancies. Therefore, an economic downturn provides the right moment to expand training programmes. There are, however, capacity constraints for a rapid expansion of training which does not compromise quality.

Young people are particularly hard hit by the crisis. In most EU countries their unemployment rates have increased much faster than the unemployment rates of adults. In countries with strong apprenticeships systems young people are less affected by this crisis than in earlier recessions. Because of the strong scarring effects of youth unemployment and the danger of a lost generation, the EU target to reduce the share of school-drop-outs to less than 10% should be given priority by governments. In addition the crisis should be used as an opportunity to promote structural reforms especially improving the links between vocational training and the labour market.

### 3 WORK-SHARING IN THE CRISIS

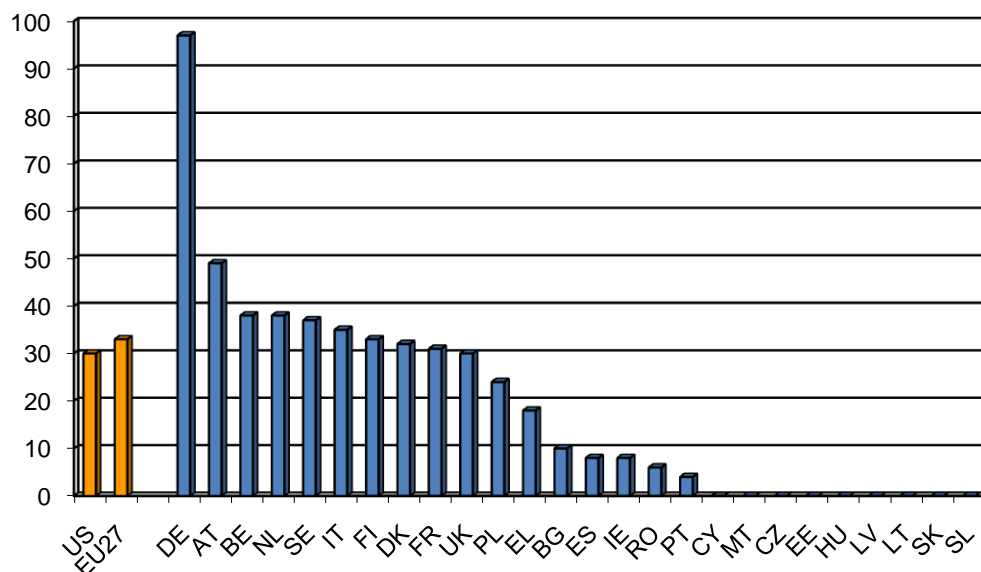
To reduce costs, companies may lay off workers who will be required when the economy starts growing again. Under these circumstances, work-sharing might be helpful in redistributing work among larger numbers of workers, thereby keeping them in employment. In other words, it might give companies the opportunity to 'reduce hours not workers'.

In contrast to strategies based on permanent work-sharing, such as reductions in weekly working hours obtained through legislation or collective bargaining, work-sharing in the crisis is meant to be temporary and reversible. As soon as demand starts growing again, companies can go back to the working-time standards that prevailed before the crisis. A second characteristic of work-sharing in the crisis is that it can be targeted at workers who are underemployed and therefore at risk of dismissal. This type of work-sharing is not generalized across the economy or an industry, but can be used by companies as required in order to avoid dismissals. A third characteristic is the variety of these work-sharing schemes. They may be with or without wage compensation, subsidised or unsubsidised, voluntary or involuntary (for workers). There are also schemes that have a strong impact on the labour market and others with a very limited impact, some that are appropriate for a short-term crisis and others for a longer downturn. Some schemes are established by law or industry-wide collective agreements, others are negotiated at plant level or, in the absence of worker representation, imposed by the employer.

Examples of individual working-time reductions in some companies are to be found in many countries. It is mainly large firms with a high share of skilled employees that offered opportunities for both paid and unpaid working-time reductions, like Permanent TSB banking units in Ireland, KPMG in London the Spanish banking group BBVA (Eurofound 2009: 79). Employees of these companies have been given the option of switching to a shorter working week or to take a sabbatical of some months. Some of the schemes are not simply intended as responses to crisis but are elements of a modern approach to human resource management that seeks to increase employees' loyalty to their company by offering flexible working times. The overall impact on the labour market of these schemes is, however, very small.

A much bigger impact on the labour market was felt as a result of large scale reductions in overtime hours - which were often the first response of companies to declining orders - and short-time working schemes. Short-term working forms part of the standard repertoire of labour market policy measures in only a limited number of EU countries. Austria, Belgium, Germany, the Netherlands, Switzerland and France, have operated subsidised short-time working or partial unemployment schemes for a long time. Before the financial crisis, these programmes were intended primarily as buffers for short-term reductions in orders but not as responses to a deep, long-term crisis. At the end of 2008, the maximum period for claiming subsidies for short-time working was increased in these countries. New industries like temporary work agencies were included, the financial conditions were improved, and the requirements for qualification relaxed. Wales is the only part of the UK in which a short-time working programme has been introduced. A number of other countries, mainly in central and eastern Europe, have also introduced short-time working schemes (Bosch 2010).

**Figure 1: Percentage of fall in total labour input due to fall in working hours per employee (2008-9)**



Source: <http://www.conference-board.org/economics/database.cfm> (EUROSTAT).

To date only in Germany, has employment been almost completely decoupled from the economic situation through various forms of work-sharing (Figure 1). In May 2009 the number of short-time workers reached a high of 1.5 million and has been falling since then. In spite of similar conditions the share of short-time workers was lower in other countries. It is not so clear why short-time working was used more frequently in Germany than for example in France. The following explanations seem plausible:

- the share of skilled employees is higher in German manufacturing firms which are anxious to amortise their human capital investment;
- German companies were more confident to recover after the crisis due to good export perspectives and high competitiveness;
- the political pressure from the government and from unions and works councils not to dismiss was higher in Germany than in other EU countries.

The most important arguments in favour of a 'retain-first' approach in serious crises can be summarised as follows.

- Production potential and firm specific skills can be maintained. When the economy starts to pick up employment can be increased again without the delays associated with the development of new investments and time lags.
- It helps existing firms to create new jobs in the next economic upturn and promote thereby internal structural change.
- Scar effects on employees can be avoided. In this way the costs of the crisis for individuals but also for society as a whole can be reduced.
- Excessive demands on PES can be avoided. When unemployment rises rapidly, the quality of active labour market services for unemployed individuals may decline.

e. Social cohesion is strengthened if the costs of the crisis are distributed more evenly among a greater number of employees.

In view of countries' differing responses to the crisis, it might well be asked whether a workforce stabilisation policy based on short-time working is indeed a sensible reaction. Mainstream economists tend to take a somewhat sceptical view of short-time working. In longer crises, they argue, short-time working acts as an impediment to structural change, leading in the longer term to reduced growth (Eichhorst/Marx 2009; Snower 2009). This argument is immediately convincing when expanding firms are unable to find sufficient personnel because of short-time working. However, there are no indications that this has been the case in 2009 and all the growth forecasts up to the 2010 and 2011 suggest that the situation is unlikely to change in many EU countries. There has also been a concern of sustaining struggling companies beyond their "natural life". Research in France and Germany does not support this concern. It was short-time subsidies, however, that were used to postpone dismissals in the past (Bosch 2010).

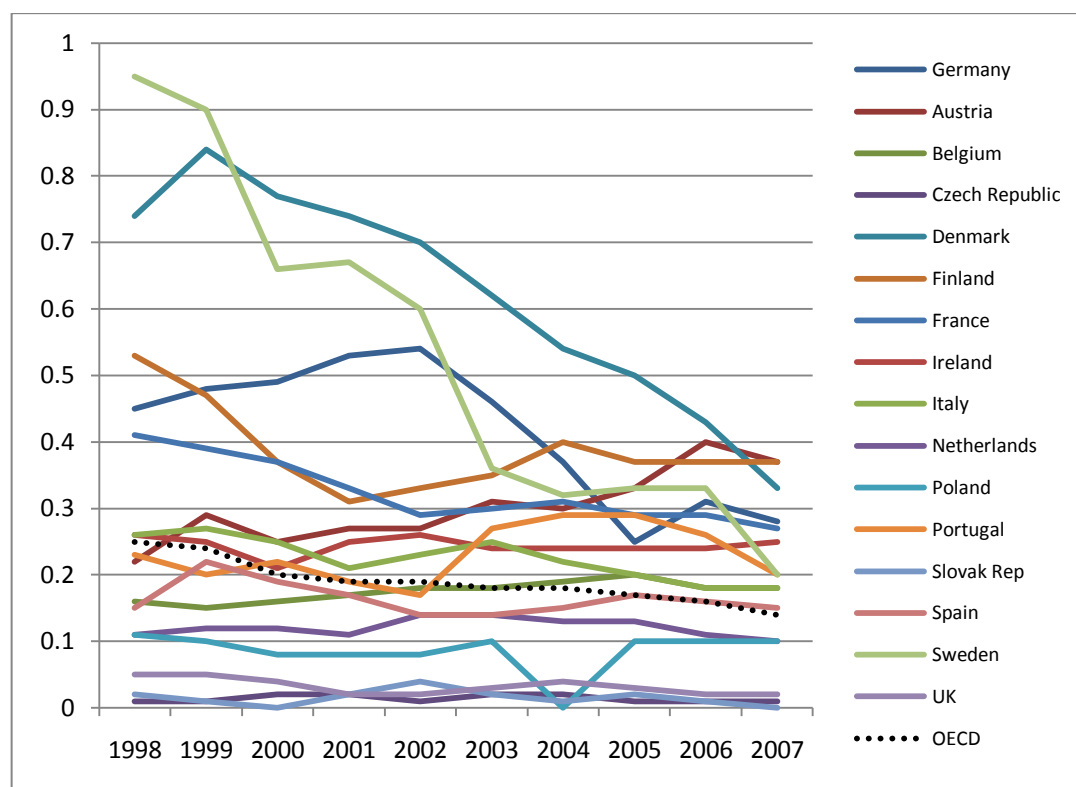
However, it is widely agreed that there is no sense in permanently subsidising jobs. For that reason, the regulations on short-time working have to be adapted to changing labour market situations. When the economy is once again growing sufficiently, it is advisable to reduce the maximum period for which short-time subsidies can be claimed. Firms' share of the costs can also be increased, so that excessive use is not made of short-time working. Depending on the situation in the national labour markets different answers may well be possible. The Netherlands with their low unemployment rates already made access to short-time work more difficult while Germany extended the 2009 scheme to spring 2012.

## 4 BRIDGING THE CRISIS THROUGH TRAINING

In the present jobs crisis it has been recommended by the OECD (2009) as well as by the European Commission (2009) that for workers facing difficulties in gaining new employment upskilling and reskilling should be considered to ensure employability in uncertain times. This recommendation is based on the fact that employment rates rise with educational attainment and that those with low educational attainment are both less likely to be labour force participants and more likely to be unemployed. A strong positive association can also be shown between the training of adults and employment outcomes (OECD 2004: 185).

Over the last decade, many EU countries attached high importance to job search activities and faster transitions from unemployment to work. This development has resulted in some countries like Denmark, Sweden, Germany and, from a much lower level, the UK in a de-emphasising of training within national active labour market policies (Heyes 2010). The reduction in expenditure on training in many EU countries can be explained by increasing doubts among policy makers about the effectiveness of training schemes. These doubts were nourished by evaluations which showed that traditional skill-based labour market policies proved to be rather ineffective.

**Figure 2: Public expenditure on training as a percentage of GDP**



Source: Heyes 2010 (OECD.Stat.Extracts).

The question therefore arises whether there is enough evidence to justify a move from a work-first to a training first approach. The findings of the evaluation of such training schemes on the labour markets prospects of unemployed workers in Europe seem to be mixed even within individual countries. It seems that the results of such evaluations are very sensitive to

the time frame used. In the short-term lock-in effects may prevail because participants in training measures are not searching for work while non-participants often succeed in finding a job. Human capital investments are, however, long-term investments and should be therefore also be investigated from a long-term perspective. In Germany, studies on the short-term effects of large scale training programmes in the 1990s did not find any positive impact while recent studies found positive medium- and long term improvements of employment chances especially for participants in West-Germany (Biewen et.al. 2006). Recent studies in Sweden found positive long-term impacts of training on employment and income (Strandh/Norlund 2008; Ohlsson/Storrie 2007).

Other reasons for the mixed results could be found in the different design and implementation of the training programmes. Training programmes within and between countries are so different in content, location of learning, duration, structure of participants, type of certificate, and implementation that labour market outcomes may easily vary. Targeted programmes which are small scale, result in transferable qualifications and have a strong on-the-job component seem to be particularly successful (Martin/Grubb 2001: 26). Furthermore, employers' skill requirements may differ between countries depending on the share of companies developing 'high road' business models with increasing needs to upskill their workforce. It seems that in an innovative environment with many firms investing in new technologies, R&D and vocational training the labour market outcomes of training programmes might be better than in less innovative economies. There are good reasons to believe that in a knowledge based economy employers' skill requirements are not 'given' but may be positively influenced by an increasing supply of well qualified workers.

It seems that labour market policy is facing a difficult trade-off: Work-first measures and short term on-the-job training may have impressive outcomes in the short run whereas the long-term effects are more doubtful. Training for generally recognized certificates, on the other hand, produces longer-term advantages in the form of increased competitiveness and more stable employment rates (Strandh/Norlund 2010). Since training programmes are the most costly labour market programmes and governments under the pressure of high unemployment rates are often primarily interested in short-term effects there is the danger of an underinvestment in the human capital of the unemployed.

Not much research has been done regarding the impact of the business cycle on the labour market outcomes of training. The new German and Swedish studies (Strandh/Norlund 2010; Biewen et. al. 2006; Ohlsson/Storrie 2007) which show positive long-term labour market outcomes were conducted during very poor labour market conditions. An economic crisis may mitigate the trade-off between short-time lock-in effects and long-term positive effects of training schemes for the unemployed since there are few jobs available. However, limited capacities of training providers may constrain the expansion of training at least if high quality standards are observed. Since it takes time to set up new training facilities, up-scaling of existing programmes and greater involvement of private companies which may have idle training capacities might be a possible way to address such shortfalls.

The combination of short-time working with training also seems to be a promising policy option. Some of the countries which have introduced short-time working, such as Germany, France and Austria, have attempted to link short-time work and training in order to improve workers' employability. However, only a few firms have claimed the training subsidies. In Germany fewer than 20 000 employees attended a training course during short-time work between January and September 2009. There are structural reasons for this. Since work has to take precedence over the use of short-time working, training programmes have to be interrupted when a new order is received. Employees could have been given the option, as part of a temporary labour market programme, for example, of applying for a subsistence allowance equal to current unemployment benefit in order to take part in a training programme of their own choice while they are still in employment.

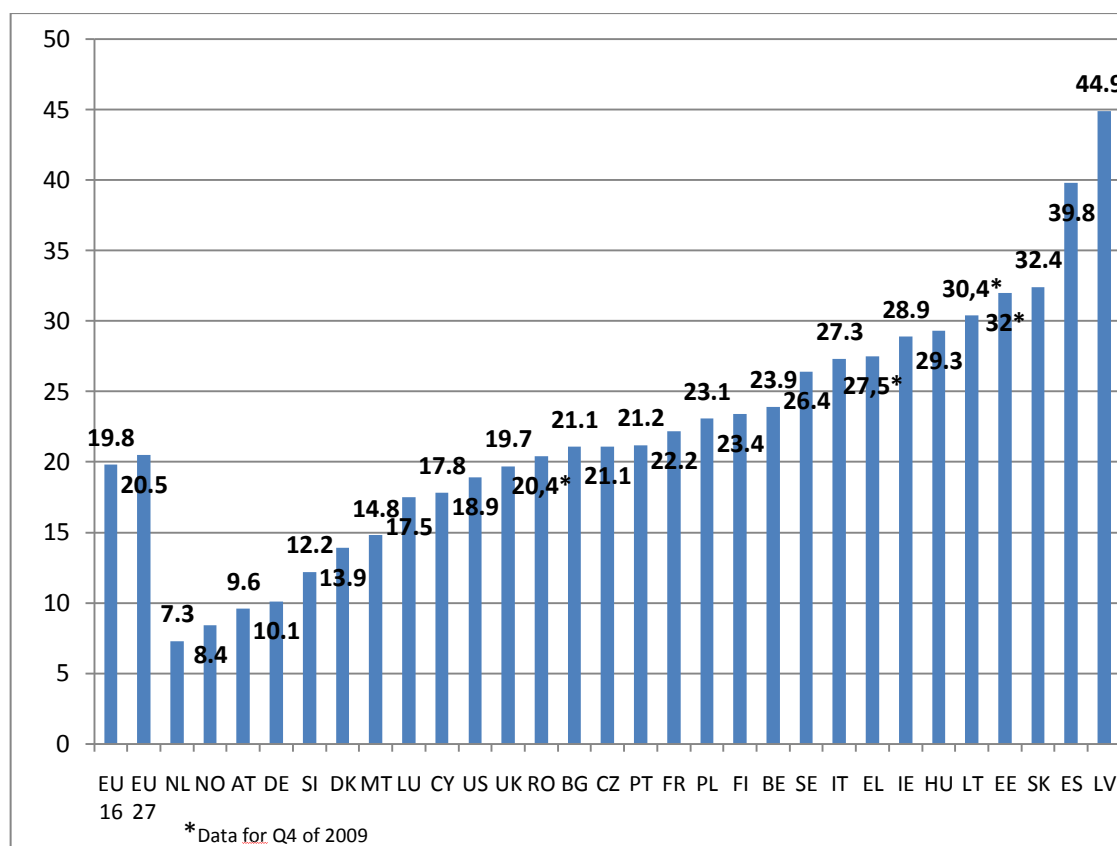
## 5 RISING YOUTH UNEMPLOYMENT: PREVENTION OF LONG-TERM SCAR EFFECTS OF UNEMPLOYMENT

Between December 2008 and December 2009 youth unemployment rose more than twice as fast as adult unemployment in the EU, in some countries like SE and IT even three times as fast. Youth unemployment rates are above 40% in LV and ES (Figure 3) Youth unemployment is more responsive to the business cycle than adult unemployment. School leavers without work experience are often losing out in the severe competition with other jobseekers for fewer vacancies. Their disproportionate presence among those holding temporary jobs and their high concentration in cyclically sensitive industries makes them particularly vulnerable.

The current crisis is exacerbating long-term structural problems that affect the transition from education and training to work. Youth unemployment rose disproportionately in countries with school-based education and training systems while it remained low in countries with strong apprenticeship systems. This development is not unexpected. Myriad studies have shown that the efficacy of VET in promoting good employment effects in good and in bad times differs considerably between countries. Strong and highly regulated apprenticeship systems reduce the likelihood of young people becoming unemployed and entering the labour market in low-skilled jobs more than school-based systems. It seems that not only the quality of training is improving the labour market prospects of young people, but also the strong involvement of social partners who organise the pathways into the labour market. It is only when the training system and the labour market are organised along the same occupational lines and by the same partners, i.e. the unions and the employers' organisations that the close linkage between the two systems can be established and maintained (Bosch/Charest 2010).

Young people in 2010 are better educated than the age cohorts in previous economic crises. A certificate of an upper secondary education is increasingly regarded as the minimum credential for successful labour market entry. Therefore the cost of low educational qualifications or an early school drop-out increased. In all EU countries young people without upper secondary education have disproportionately high rates of NEETS (not in education, not in employment).

**Figure 3: Seasonally adjusted youth unemployment rate (under 25) January 2010 in %**



Source: EUROSTAT 2010.

If unemployment is found to be temporary, subsequent negative labour market and social outcomes diminish with time. However, there is a considerable body of evidence that long term unemployment has lasting scarring effects. Kahn (2010) found for the US that graduating from college in a bad economy has large, negative and persistent effects on wages. Lifetime earnings are substantially lower than they would have been if the graduate had entered the labour market in good times. A recent study in UK showed that youth unemployment raises unemployment, lowers wages, worsens health and lowers job satisfaction even twenty five years later. No such effects could be found for spells of unemployment when the respondents were in their thirties (Bell/Blanchflower 2009). A recent survey of the Prince Trust (2010) of young people aged 16 – 25 found that NEETS are significantly more likely to feel ashamed, rejected, lost, anxious, insecure, down and depressed, isolated and unloved. NEETS were disproportionately more likely to say that they had turned to drugs and to say that their life had no direction.

The main challenge is to prevent the current generation of school leavers from becoming a lost generation. The EU target for reducing the share of early school drop-outs to less than 10% by 2020 (now 15%) should be given priority by governments. This requires special attention from education authorities to possible school drop-outs and a commitment to offer them continued education, work-based training through apprenticeships or internships, or a second chance through rights to education or training for all young people who have left the education system without upper secondary education.

The crisis also offers an opportunity to tackle the structural problems in the transition from school to work. The main emphasis should be placed on establishing links between vocational training and the labour market through the involvement of social partners and the development of curricula for transferable skills.

**6 CONCLUDING REMARK** It is likely that growth rates in the EU Member States will be lower in the coming years than in the last decade because of the severe budget cuts which are considered to be necessary to stabilise public finances. Labour market policy may play an important role in bridging not only the present crisis but also a period of slower economic growth. The mix of the three approaches - 'work-first', 'retain-first' and 'educate and train-first' for adults and young people - has been not been optimal in all EU countries. A new combination of the Scandinavian 'train-first' labour market philosophy and the Continental European 'retain-first' approach might well provide sensible policy variants for the next years and may help to prevent that the current and the future cohorts of school-leavers are becoming a lost generation.

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