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SYSTEMS OF FINANCING LABOR MARKET POLICY:
AN INTERNATIONAL COMPARISON

Günther Schmid*

1. INTRODUCTION

In 1969, the Grand Coalition Government in the Federal Republic of Germany, composed of the Christian and the Social Democratic Parties, passed the new Labor Promotion Act (AFG = Arbeitsförderungsgesetz). The initiative in this law, however, came mainly from the Social Democrats.

The basic aim was to prevent unemployment through "active labor market policy": continuous labor market training, temporary public work, subsidized short-time working instead of temporary layoffs, and wage subsidies for hard to place people or for the job acquaintance of unskilled workers. The new policy measures were also designed to improve the labor market chances of disadvantaged people, especially the unskilled, women, the handicapped, and the elderly. Active labor market policy expenditures were also supposed to behave anti-cyclically: increasing when economic growth rates fall (or unemployment rises), decreasing when growth rates rise (or unemployment falls). This was at least the intention of the law-makers.

However, only six years later when the Social Democrats were the leading partner in the Small Coalition Government (together with the Liberals), they acted against their original intentions: expenditures for active labor market policy were cut when unemployment - due to the first oil price recession - increased, and especially hit by the budget cuts were disadvantaged groups of the labor market. The second hard test of the law - the oil price induced recession of 1981/82 - led to even larger budget cuts.

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The observation of this contra-intentional behavior gave rise to the original motivation of this study.¹⁾ Our starting hypothesis was, that the implementation of the labor promotion law (AFG) against the stated objectives of the law as well as against the spirit of its creators has - among other things²⁾ - something to do with the system of financing labor market policy. The impression was that the policy decision makers were like prisoners of their own created institutions, and that they could not escape from the dilemma originating from the financing system of labor market policy. Very briefly, this system looks like this:

In the FR of Germany, spending for both branches of labor market policy - unemployment benefits or "passive" labor market policy and "active labor market policy" measures - comes from the same fund: from the contributions of employers and employees to the Labor Market Board (BA = Bundesanstalt für Arbeit). As a consequence, expenditures of "passive" and "active" labor market policy are competing, especially during a recession, when contributions fall and expenditures for passive labor market policy rise almost automatically due to increasing unemployment. Because the regulation of unemployment insurance in FR-Germany is oriented on the "principle of equivalence", which means that contributions as well as benefits are closely related to the work history and proportional to the income (up to a ceiling), unemployment benefits have stronger "property rights" than entitlements to participate in labor market policy measures. When the Labor Market Board is running into deficit, the Federal Government is obligated to pay grants to the Labor Market Board. With increasing deficits, the political pressure to reduce the deficit is rising, too. In such a situation, two fiscal rules of thumb are usually applied: "Cut the expenditures where they arise", and "cut the expenditure items with the highest costs." Because the expenditures

1) Günther Schmid/Bernd Reissert/Gert Bruche 1987: Arbeitslosenversicherung und aktive Arbeitsmarktpolitik. Finanzierungssysteme im internationalen Vergleich, Berlin: Edition Sigma (English translation and publication in preparation).

2) Of course, there were also some other obvious reasons for the budget cuts in active labor market policy: The strong bargaining position of the small liberal coalition partner (FDP) with its principal objections against labor market intervention; the personality of chancellor Helmut Schmidt who as "world-economist" didn't believe in "active labor market policy", or the low support for active labor market policy among the trade unions, a point to which I will come back later.

for labor market training per head, for example, are higher than the expenditures for unemployment benefits per head, of course, a cut in the expenditures of the first type is plausible. Another reason is, that it is easier for the government to reduce expenditures for relatively unspecified objectives (as most measures for active labor market policy are) than to reduce expenditures for specified benefits to which individuals can successfully suit. Therefore, it is reasonable to expect that "passive" labor market policy is out-competing "active" labor market policy.

So far to the basic logic of our original hypothesis. Does this logic resist to more thorough theoretical considerations? And do we find different spending patterns in countries with other systems of financing labor market policy? I will start with a framework for the institutional analysis of financing systems (chapter 2), describe the "dependent" and "independent" variables and their hypothetical relationships (chapter 3), followed by a short description of the financing systems in our six selected countries (chapter 4), present and explain highlights of the empirical tests (chapter 5), and end with some practical conclusions (chapter 6).

2. A FRAMEWORK FOR THE INSTITUTIONAL ANALYSIS OF FINANCING SYSTEMS

There are three traditions of institutional analysis: the first goes back at least to Hobbes who derived the necessity of centrally imposed institutions from the "wolfish" and self-destructive nature of human beings. The second tradition could be labelled the "constitutionalist" or contractual approach (for instance Madison) according to which people choose voluntarily institutions in order to be able to yield the fruits of cooperation and labor division. The third approach can be connected with names like Marx and Veblen who stress the predatory character of institutions in favor of the dominant social class.

In modern theory, the Hobbesian tradition has been taken up for instance by the sociological anthropologist Arnold Gehlen who defines social institutions as "artificial instincts" which are necessary for the lack of "good" natural or animal-like instincts of human beings. This

theory was extended by structural-functional systems theory, e.g. Talcott Parsons and Niklas Luhmann, who emphasize the requirement to reduce complexity through the establishment of social institutions. The function of these institutions is to relieve human beings from the overload of complexity, i.e. from the ever-changing and uncertain environment. According to this view, financing institutions of the labor market can be defined as "decisions in advance" which determine who has to pay for the necessary costs in adjusting to ongoing structural changes or external shocks such as the oil price increases in 1974/5 and 1980/81. The problem with this approach is that it hardly delivers operational criteria for the design or assessment of institutions. The approach tends to legitimize existing institutions as those that have proved successful in a darwinistic-like selection process, and it tends to appraise the order function of institutions as such and not in terms of rational efficiency criteria or in terms of social equity principles.

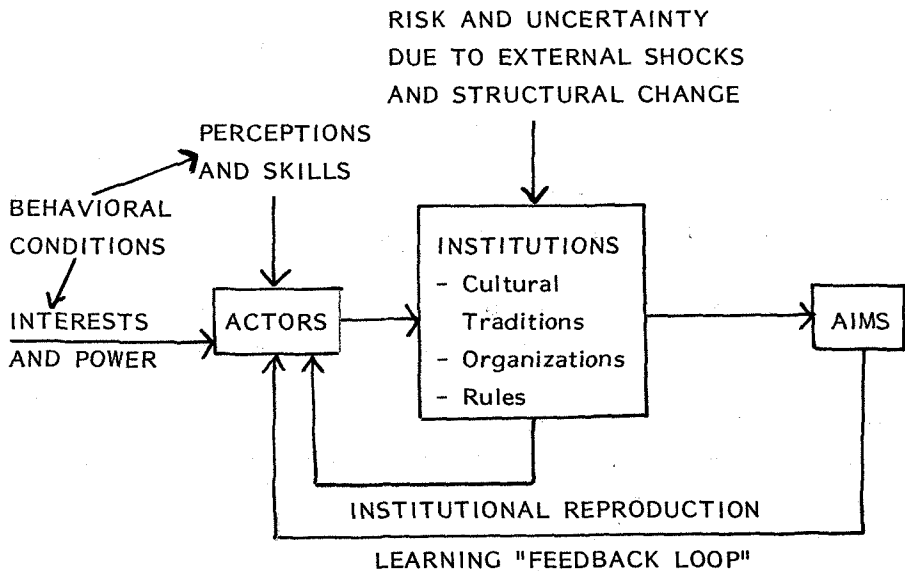
The modern version of the contractual approach is rational-choice theory. This theory is, before it is anything else, a normative theory. It tells us what we ought to do in order to achieve our aims as well as possible. It does, however, not tell us what our aims ought to be. Unlike moral theory, rational-choice theory offers conditional imperatives, pertaining to means rather than to ends (Jon Elster 1986:1). According to this approach, financing institutions can be defined as "fiscal tools" aimed at supporting certain "fiscal ends" under specified behavioral conditions. An example would be: Which type of revenues and which size of unemployment benefits ("replacement rates") assure social security and redistribution in favor of low income earners without affecting negatively the willingness to pay and incentive to work? In developing the hypotheses below, I will basically follow this "contractual" tradition. However, some caveats have to be reminded: First, the rational-choice theory runs into difficulties when contradicting aims are involved. Second, the specification of behavioral conditions relies on the assumption of rational behavior. Unless we fall into the positivistic trap that all observed behavior is rational, we have to develop criteria that are able to differentiate between actual and rational behavior. However, such criteria do yet hardly exist. We cannot avoid value judgements, and these judgements have to be made explicit. Third, the relationship between institutions

and behavioral outcome is not a deterministic one. Institutions are, at best, necessary but not sufficient conditions. The outcomes are principally indeterminate in as far as they depend on the individual perceptions and individual skills how to "handle" the existing institutional "tools". Finally, even if we were able to design ideal institutional arrangements in theory, their implementation in practice depends on power relationships. It is at this point where the third institutional tradition has to be considered.

Institutions have never been established on the basis of unanimous decisions as the pure theory of rational-choice assumes. They often have been imposed by more or less dictatorial decisions or, at best, by democratic majority rules. And even in the latter case, these majority decisions were made under poor knowledge about the consequences of the established institutional rules. Institutions are also inherited and socialized from cradle to grave, and experiences are passed on from generation to generation. Often, institutions are not introduced deliberately but the outcome of an "organic evolution" (Schoffer 1981:21, von Hayek 1983: 71ff.) In some way, institutions are the result of a collective learning process over generations.

Institutions, therefore, reflect power relationships, mechanisms to deal with incomplete information as well as tradition. But once they have been established, they start to develop their own dynamics. Institutions may become like prisons, because their speed of change does not correspond to the speed of structural change or to completely unexpected shocks of the environment. Institutions can also be misused for interests that not any longer represent the interests of the majority ("institutional sclerosis").

Although the rational-choice approach seems to be the most suitable for questions of institutional design, the two other traditions of institutional analysis should not be dismissed: whereas the Hobbesian tradition can explain the necessity of institutions at all, the power tradition of institutional analysis can contribute to the explanation of their persistence or to their evolution. The following crude model, thus, will serve us as a guideline for the institutional analysis of financing systems:



According to this model, institutions can be defined as "decisions in advance", aimed at supporting certain aims under specified behavioral conditions and changes in the environment of social systems, which can take the form of cultural traditions (habitual reactions to external changes), organizations, and procedural or substantive rules; institutional actors are able to learn, but institutions tend also toward "self-reproduction" which can create incongruencies between existing institutional arrangements and functional requirements.

3. THE ELEMENTS OF FINANCING SYSTEMS AND THEIR EXPECTED RELATIONSHIPS

Financing systems, first of all, regulate the flows of revenues and expenditures. The behavioral response of these flows to the changing environment (price shocks, technical change, e.g.) are the main "dependent" variables of our analysis. Dependent variables of "second grade" are the effects on wealth and welfare. These two outcome indicators can be subdivided into the three analytical categories of "substance" (quantity), "social space" (quality), and "time" (dynamics):

	SUBSTANCE (quantity)	SOCIAL SPACE (quality)	TIME (dynamics)
WEALTH	Income	Any jobs	Growth Stability
	Leisure	Good jobs	Flexibility
WELFARE	Solidarity	Social integration	Social Security

Wealth in "substantive" terms is market income (e.g. wages, property) or leisure; in terms of "social space" it is the quality of jobs or having any jobs because work creates also "psychic income" (self-esteem and social communication); in terms of "dynamics", wealth can be expressed by growth, stability, and flexibility. Welfare in "substantive" terms can be summarized as the degree of solidarity, expressed e.g. by the degree of redistribution (through progressive taxes or contributions or through regressive benefits) and low wage differentials; in terms of "social space", welfare is the degree of social integration, expressed e.g. by equal opportunity or low labor market segmentation, high labor force participation of women, of minorities or handicapped, or equal opportunity in the access to labor market programmes; the "time" dimension of welfare is the degree of social security, expressed e.g. by the degree of legal entitlements to benefits ("property rights"), generosity of unemployment benefits ("replacement rates"), and duration of benefits. In the literature, these two sets of indicators are often labeled as "efficiency" (wealth) and "equality" (welfare) measures.

The most important question with respect to these "secondary" dependent variables is whether there exists a trade-off between efficiency and equality or whether there is compatibility or even complementarity between these two outcome dimensions.¹⁾ It can be shown by introspective analysis, that efficiency objectives will most likely but not

1) A lucid analysis of situations in which equality and efficiency criteria may be complementary (e.g. in markets with informational asymmetries), is provided by Andrew Schotter 1985:47-64; see also Okun 1975 as a classical essay to this topic.

necessarily be in conflict with redistributive aims. Small tradeoffs can also be expected between social security and solidarity (redistribution), whereas the relationship between social security and efficiency is ambivalent and depending much on the interference of other institutional arrangements: in combination with active labor market policy e.g., high replacement rates might even be a requirement for the acceptance of regional or occupational mobility (flexibility). High replacement rates might also be compatible with positive work incentives through the so called "entitlement effect" (Hamermesh 1979); and the effect of high replacement rates on reservation wages - and thus on wage flexibility - might be compensated by flexible wage policy on the level of corporatist collective agreements.

The question, now, is whether we can find any evidence that differences in financing labor market policy do matter with respect to patterns of financial flows and their respective impact on wealth and welfare. For this task we first have to describe carefully the characteristics of "financing systems", in other words: the "independent variables". These variables can be divided into the following categories:

- (1) type of revenues and rules of fund raising,
- (2) rules of budgeting and expending,
- (3) institutional distribution of fiscal costs and benefits.

It turned out that the collection of data and the monitoring of the regulatory framework in the selected countries became an expedition into a widely unknown land. A summarizing characteristic profile of the selected countries follows in the next chapter. In addition to the "independent variables" in the narrower sense, we had also to take into consideration the institutional context and the "problem load" under which the countries are acting: In some countries, active labor market policy is embedded as an essential element in the framework of employment policy (e.g. Sweden), in others not at all (e.g. Austria). In some countries, the "working line" is deeply rooted in cultural traditions (e.g. Sweden), in others not (e.g. USA). The countries were differently affected by the two oil price shocks, they are depending on external trade to a different degree, their educational and training system is different, and the structure of unemployment differs too, and so the mix of labor market and employment policy.

Due to the complexity of relationships, and due to the small sample of countries, it was therefore clear from the beginning that none of the mainstream econometric tests could be applied. Nevertheless, propositions derived from financial theory as well as diverse approaches of "middle range" state and labor market theory were developed. The most prominent feature that characterizes the financing of labor market is the distinction between "central state budget systems" and "labor market funds systems". Central State Budget Systems are basically financed by taxes (diverse income taxes, value added taxes, etc.) that generally are not specified for certain aims or expenditures (principle of non-affectation); Labor Market Funds Systems are basically financed by wage related contributions of employees and/or employers that generally are specified for and restricted to unemployment benefit expenditures and/or labor market policy programs. For the sake of convenience, we will therefore label these systems as "tax systems" and "contribution systems".

The following overview relates these two basic "independent variables" with our "dependent variables" described before.

Overview 1: Summary of Main Hypotheses.

EFFECTS ON	FINANCING BY CONTRIBUTIONS	TAXES
REVENUES	1) higher willingness to pay, except for redistributive aims 2) higher cyclical sensitivity	1) lower willingness to pay 2) low cyclical sensitivity
EXPENDITURES	3) lower spending capacity for active labor market policy 4) relatively stable over time, however, lagged procyclical trend in case of active labor market policy 5) low or declining "activity rate" 6) probability of fiscal incongruency high	3) higher spending capacity for active labor market policy 4) relatively instable over time, however, anti-cyclical potential in case of active labor market policy 5) high or stable or increasing "activity rate" 6) probability of fiscal incongruency middle or low
WELFARE	7) generous but short-term unemployment benefits, no redistributive effects 8) trend toward exclusion in fiscal crisis ("segmentation") 9) low redistributive capacities of active labor market policy 10) low labor force participation of "marginal" groups	7) less generous but long-term unemployment benefits, some redistributive effects 8) trend toward reduction of benefits in fiscal crisis ("levelling") 9) redistributive effects of active labor market policy 10) high labor force participation of "marginal" groups
WEALTH	11) negative labor supply and labor demand incentives? 12) greater efficiency losses due to "moral hazard"?	11) lower negative labor supply and labor demand incentives? 12) smaller efficiency losses due to "moral hazard"?

Before I turn to the explanation of the hypotheses and to the presentation of the findings, I will shortly describe the countries main characteristics of financing labor market policy in the following section. A summarizing overview of this section will show, to what extent the financing systems are dominated by "contributions" or by "taxes".*)

4. FINANCING SYSTEMS IN INTERNATIONAL COMPARISON: AN OVERVIEW

The spectrum of forms of organizing and financing labor market policy in the six countries investigated extends from the concentration of all functions in a central organization to the dispersal of labor market policy functions among a multiplicity of organizations and from almost full financing through contributions to almost total financing through the central state budget. The current forms of organization and financing in the individual countries can be summarized as follows:

- In Austria the ministry for social affairs and its subordinate provincial labor offices is responsible for the design and implementation of all labor market policy. Expenditures are financed from a fund into which employers' and employees' contributions to unemployment insurance flow and which -- with certain exceptions -- may only experience short-term deficits or surpluses. Reserve funds may not be accumulated beyond a fixed limit and any deficits incurred are covered only temporarily by loans from the federal budget. There are special regulations for administrative costs as well as for bad weather and bankruptcy benefits, which are (in part) financed through the federal budget or special levies on employers.
- In the Federal Republic of Germany labor market policy expenditures are concentrated in a single organization, the Federal Employment Institute (FEI). It is an independent body whose activities are supervised in matters of law by the ministry of labor, which in certain cases may issue directions to the FEI or

*) The reader should keep in mind that these are not the only distinctive features of financing systems.

has to be consulted by it. Its activities are largely financed through the contributions from employers and employees. In contrast to the situation in Austria, there is in Germany no requirement that revenues be immediately adjusted to reflect increases in expenditures since there are no legal obstacles to the accumulation of reserve funds and any deficits incurred (after reserves have been exhausted) must be covered by a grant from the federal budget that does not have to be repayed. Means-tested benefits for the unemployed -- unemployment assistance -- is normally financed from the federal budget, i.e. from "taxes". The financing of bankruptcy benefits and the program to promote winter construction is through special levies on employers.

- In France the design, financing and implementation of "active" and "passive" measures are largely separate. Unemployment insurance (UNEDIC/ASSEDIC) is responsible for most benefit expenditures for the unemployed as well as for early retirement measures. It is financed through employers' and employees' contributions and through a state subsidy that covers a certain (and changing) percentage of expenditures. However, the state assumes no blanket responsibility for covering any deficits that may arise. When the unemployment insurance system began to run deficits at the beginning of the 1980s, a special state tax measure was introduced to provide additional resources to the unemployment insurance fund (an income tax surcharge and a solidaric contribution by public service employees and pensioners with additional earnings). The state budget through the labor ministry also finances unemployment assistance as well as the more recent (after April 1984) early retirement measures and the bulk of expenditures for active labor market policy measures, in particular the relatively extensive integration and training measures for unemployed youth. An exception are continuing education measures, which are largely financed through a special levy on firms; however, it only has to be paid in full when there are no other recognized expenditures for internal or external training.

- In Great Britain the ministry for social affairs is responsible for unemployment insurance benefits, whereas the Department of Employment and its subordinate labor market authority, the

Manpower Services Commission, is responsible for active labor market policy. Unemployment benefits are paid through the national social insurance fund, which is subordinate to the social affairs ministry and is also responsible for pensions and other social benefits. It is financed through a general social security contribution by employers and employees with a (small and variable) grant from the state budget; there is only a single social security contribution for the entire social security system. Although the amount of the contribution in Great Britain -- like in other countries -- varies with income (and the contribution rate since 1985 is even progressive, i.e. those with greater earnings pay a higher rate) the unemployment benefit is a uniform benefit (with family supplements); Great Britain is thus the only country among those investigated in which the equivalence principle (i.e. insurance principle) is not followed in determining the level of contributions and benefits in unemployment insurance. The means-tested supplementary benefit for the unemployed, which has in recent years become much more important than the unemployment benefit in providing income security for the unemployed, is financed through the central government budget. It is also the source of funding for active labor market policy.

- In Sweden the unemployment insurance is administered by trade union unemployment insurance funds, to which members pay contributions. The contributions have, however, remained very low and have over time been increasingly supplemented with funds from the state budget. This "state contribution" now accounts for about 90% of expenditures for unemployment insurance. Unemployment assistance (KAS), which - when the general conditions are met - is not means-tested, is fully financed through the state budget. Active labor market policy is designed and implemented by the labor market authority AMS on the basis of guidelines from the labor ministry. It too is fully financed through the state budget -- although funds for temporary lay-off compensation (until 1984) and income stipends for participants in continuing education and rehabilitation measures are -- like unemployment assistance and the "state contribution" to the unemployment insurance funds -- largely (2/3) refinanced from a payroll tax levied on employers; in recent years the actual percentage

refinanced in this way has, however, usually fallen short of this target figure.

- In the United States the individual states are the unemployment insurance carriers; the system of contributions and benefits is, therefore, different from state to state. In almost all individual states contributions to unemployment insurance are only paid by the employers, whereby the contribution rate is determined by experience rating, i.e. the extent to which layoffs and redundancies in the work force of individual employers generate claims on the unemployment insurance system. In addition to the unemployment insurance programs in the individual states there is also a national extended benefits program, which is financed equally from the unemployment insurance contributions of the individual states and from an additional uniform national employers' contribution to unemployment insurance. (From 1982 to 1985 there was also a special temporary program of follow-on unemployment benefits financed through federal funds.) If they incur deficits, the individual state unemployment insurance systems receive loans from the federal budget; the federal government attempts to encourage prompt repayment through sanctions including interest payments for loans. Active labor market policy programs are financed through the federal budget and implemented by individual states, local governments and other sponsors; only the funds for the placement service are financed through a portion of the unemployment insurance contributions earmarked for such national activities.¹⁾

The following overview characterizes the countries' financing systems by their main resources to finance labor market policy. Column seven of the overview reflects a crude summary index: Austria and Germany have basically "contributory systems", Great Britain is almost an ideal type for a "tax system"; Sweden and USA are predominantly "tax systems", including - however - essential elements of "contributory systems", whereas France represents equally "contributory" as well as "tax"- elements. When labor market policy is broken down by policy

1) For a comprehensive description of each country included in this study see Bruche 1984a, 1984b; Bruche/Reissert 1985; Reissert 1985 and 1987; Schmid 1984.

functions, the distinctive feature of "contribution systems" or "tax systems" becomes even more pronounced: With respect to active labor market policy instruments, Great Britain and USA (except placement services) turn out to be pure tax systems, Germany as a pure contributory system (except temporary public work).

We are now prepared for the following chapter which will show if financing systems make a difference in labor market performance.

Overview 2: Main resources for the revenues to finance labor market policy 1973-85 (average of the whole period and partly based on "guesstimates").

(1)	(2)			(3)			(4)			(5)			(6)			(7)	
Unemployment Benefits	Placement Services			Labor Market Training			Temporary Public Work			Seasonal and Cyclical Adjustments			Special Programs for Youth			Weight	
C	T	C	T	C	T	C	T	C	T	C	T	C	T	C	T	C	T
A	XXX		XXX	X	XXX	X	-	-	XX	X	-	-	-	-	-	11	3
D	XXX	X	XXX	XXX	XXX	XXX	X	XXX	XXX	-	-	-	-	-	-	15	2
F	XX	XX	XXX	XXX	X	X	-	XXX	XXX	-	-	X	XXX	X	XXX	9	9
GB	XX ¹⁾	XX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	2	17
S	XX	XX	X	XXX	XX	XX	X	XXX	XX	XX	XX	XX	XX	XX	XX	10	14
USA	XXX	X	XXX	XXX	XXX	XXX	XXX	XXX	-	-	-	-	-	-	XXX	6	10

C = contributory systems, T = tax systems

XXX = two-thirds and more, XX = between one and two-thirds, X = less than one-third

- = program non-existent or of very small significance during the period

Explanation to columns:

- (1) Including unemployment assistance or supplementary benefits, and early retirement programs
- (2) Including counselling and advising
- (3) Only training for adults, not including primary vocational training, including vocational rehabilitation
- (6) All programs aimed at integrating teen-agers into the labor market
- (7) Sum of X's not adjusted for relative significance of program items
- 1) Contributions to unemployment insurance are an integrated part of social security contributions

5. EFFECTS OF FINANCING SYSTEMS ON LABOR MARKET POLICY, ECONOMIC EFFICIENCY, AND SOCIAL WELFARE

5.1 The Impact on Revenues for Labor Market Policy

The way how financing labor market policy is organized affects first of all the flow of revenues which in turn has indirect effects on efficiency and equality functions of labor market policy. In Overview 1, two hypotheses have been stated:

(1)* Generally people are more willing to contribute to aim-specific than to general (tax) funds, because they know what they get out of the system. The willingness to pay, however, declines with increasing redistributive aims of contributory systems. The most important indirect impact of this relationship is that contributory systems tend to revenue regulation depending on the actual economic need, whereas tax systems tend to revenue regulation depending on budget constraints. In other words: In contributory systems, revenues tend to be controlled by expenditures, whereas in tax systems it is the other way round, i.e., expenditures tend to be controlled by revenue capacities.

(2) Revenues for labor market policy raised by contributions are more sensitive to the business cycle than revenues based on taxes, because they depend only on wages whereas taxes relate also to non-market income. This reduces - among others - the potential for anti-cyclical employment policy except when provisions for reserve funds are made. It increases also the need for flexible revenues regulation, i.e. adjusting revenues to expenditures.

It is not possible to test these hypotheses directly; in some way, however, our later tests on the efficiency and equality impact provide indirect evidence for it.

5.2 The Impact on Expenditures for Active Labor Market Policy

How much financial resources, now, did the countries put into active labor market policy, and can we detect any systematic relationship

* The numbering of the sub-paragraphs follows the numbering of the hypotheses in overview 1 on page 10.

between spending patterns and financing systems? Before starting to test specific hypotheses, some information on the size and structure of expenditure may be helpful. The following table displays the average expenditure level related to GDP (Gross Domestic Product), the expenditures in recession years, and the average unemployment rate.

Table 1: Average Expenditures for Active Labor Market Policy, Expenditures in Recession Years, and Average Unemployment Rate

	Average Expenditures in % of GDP	Average Expenditures		Average Unemployment Rate
		1975	1982	
A (1)	0.19	0.20	0.19	2.4
D (1)	0.68	0.77	0.82	4.5
F (1)	0.95	0.73	1.16	6.1
GB (2)	0.58	0.30	0.64	7.6
S (1)	1.95	2.34(4)	2.04(4)	2.4
USA (3)	0.49	0.46	0.31	7.1

(1) 1973-85

(2) 1974-85

(3) 1973-83

(4) 1977 resp. 1983

Source: Schmid/Reissert/Bruche 1987

Sweden displays the highest average spending level (around 2 % of GDP), Austria the lowest (0.2 %), whereas the other countries are in the middle range of 0.5 to 1 % of GDP. These marked differences are - of course - not primarily related to the financing systems. They reflect above all the different emphasis on the goal of full employment and the different role which is allocated to active labour market policy in maintaining this objective. Both Sweden and Austria have given

full employment highest priority (the average unemployment rate is 2.4 %), but have achieved this goal with completely different strategies: Sweden with a combination of expanding public sector employment, combined with work-sharing (part-time work), solidaristic wage policy, and comprehensive active labour market policy; Austria with a combination of "austro-keynesian" fiscal and monetary policy, subsidies to the relatively large part of publicly owned manufacturing industry, and reduction of labour supply (foreign workers, early retirement).¹⁾

(3) The spending pattern shown in table 1 is, however, consistent with our third hypothesis that tax financing is a necessary (however, not a sufficient) condition for allocating employment policy functions²⁾ to active labour market policy. To put the theory more strongly and in a way that can be falsified in later studies: We predict that no country will be found in which active labour market policy plays a substantial role in influencing the level of employment and being at the same time financed basically by contributions. Contribution systems require always a close connection between payment and benefits on an individual or group specific level, a connection which is not given in the case of global (or aggregate) demand or supply management. The Austrian system of financing labour market policy is particularly unable to fulfill such a function because it does not allow long-term deficit spending or the development of large financial reserves which is - to some extent - possible in the German system. This will become clearer in the following paragraph when we look at the dynamics of spending.

(4) Expenditures for labor market policy based on contributions are expected to be more stable over time than expenditures based on taxes due to the easier adjustment of contributions to expenditures on the one hand, and due to the higher property rights of labor market benefits on the other. Expenditure items financed by taxes have always to compete with other policy items; therefore, tax-based expenditures are more politicized than contributory expenditures.

1) See, among others, Meidner/Hedborg 1984, Erixon 1985, Scharpf 1987, Wagner 1985, Wadensjö 1985.

2) In other words: the function of influencing the level of employment.

Therefore, expenditures for active labor market policy dominated by tax systems will show higher variation of spending level over time than expenditures for active labor market policy dominated by contribution systems. Table 2 confirms this expectation: The "pure" tax systems, Great Britain and USA display high variation of expenditures, whereas the "pure" contribution system show low variation coefficients. The fact that also the "mixed systems", France and Sweden, have low variation coefficients lead to the tentative conclusion, that already a substantial share of "contributory elements" in financing systems lead to *stabilization effects* of expenditures. The low variation coefficient of Sweden can also be explained by the substantial share of labor market policy expenditures for disabled which do not vary with the business cycle.

Table 2: Average expenditures for active labor market policy, variation coefficient, and range of expenditures

		Expenditures in % of GDP	Variation Coefficient ^{a)}	Range of expenditures ^{b)}
A	(1)	0.19	0.15	0.09
D	(1)	0.68	0.18	0.35
F	(1)	0.95	0.21	0.59
GB	(2)	0.58	0.32	0.58
S	(1)	1.95	0.15	0.99
USA	(3)	0.49	0.34	0.59

(1) 1973-85

(2) 1974-85

(3) 1973-83

a) Standard deviation divided by average

b) Highest minus lowest spending level in period of observation

Source: Schmid/Reissert/Bruche 1987

Apart from their relative stability over time, contribution systems tend to short-term anti-cyclical and to lagged pro-cyclical reactions of expenditures for active labor market policy for two reasons: revenues fall when unemployment rises and vice versa; "property rights" in addition with possible accumulated reserves induce anti-cyclical

expenditure reactions. A surplus, however, tends to induce additional expenditures, and a long-lasting deficit tends to lead to exclusion of beneficiaries instead of rising additional revenues (see also paragraph 12). Lagged pro-cyclical reactions can also be expected when unemployment insurance and active labor market policy are integrated in a common budget (which is especially the case in Germany); unemployment benefits then tend to crowd out expenditures for active labor market policy. On the other hand, when policy is committed to anti-cyclical intervention, the budget constraints of tax-financed active labor market policy can more easily be overcome by deficit spending than in contribution systems. However, when the fiscal policy is committed to a restrictive financial policy, expenditures for active labor market policy can also fall under the budget axe despite increasing unemployment. In other words: tax systems are a necessary, however, not a sufficient condition for anti-cyclical active labor market policy.

A crude way to test this hypothesis is to correlate the expenditures for active labor market policy with the growth rate of real GDP as shown in table 3:

Table 3: Correlation Coefficients between Expenditures for Active Labor Market Policy (in % GDP) and GDP growth.

	A	D	F	GB	S	USA
Without time lag	-0.38	-0.65**	0.23	-0.11	-0.56**	0.49*
One year time lag	-0.06	0.23	0.41	-0.15	-0.38	0.19

** significant at 5% level,

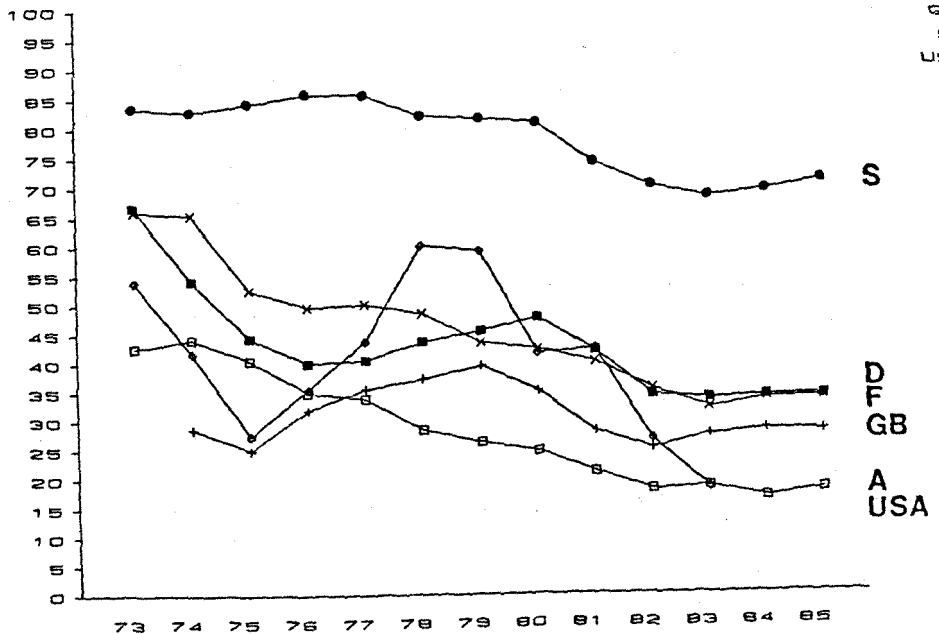
* significant at 10% level

Sweden turns out to be the only country with a relatively consistent anti-cyclical spending pattern. A closer look on budget items shows that this is mainly due to temporary public jobs which are predominantly financed by taxes. Germany displays - as predicted - a mix of short-term anti-cyclical and lagged pro-cyclical behaviour. The "pure" tax financed systems show no common pattern: here, the spending behaviour is completely depending on political and fiscal

priorities. This is especially true for the United States, where the Congress has even the right to budget initiatives.¹⁾

(5) All official statements declare absolute priority to active labor market policy: whenever possible, money should be spent for preventing unemployment instead of compensating wages of idle labor capacities. The extent to which countries are committed to and succeed to follow this objective can be measured by the "activity rate". This is defined as the proportion of expenditures for active labor market policy in percent of total expenditures (active + passive labor market policy). A high activity rate is an indicator for high commitment to active labor market policy. Contribution systems tend to decreasing activity rates when unemployment is increasing due to the crowding out effect mentioned above, and due to fiscal incongruency explained below. However, here again, tax systems are only a necessary but not a sufficient condition for high, stable or increasing activity rates, as the following figure shows:

Figure 1: Expenditures for active labour market policy in % of total expenditures ("activity-rate")



1) For a more detailed presentation and interpretation of expenditure dynamics see Schmid/Reissert/Bruche 1987.

Sweden shows the highest commitment to "active labor market policy" with only a slight decrease under the bourgeois government (1976 to 1982), and a turn to increasing rates under the social democratic government (1982 ff). A considerably lower and decreasing activity rate can be observed especially with contributory systems (Austria, Germany), and mixed systems (France). USA displays a completely instable pattern according to changing political priorities, and only the British (tax)system succeeded to have higher activity rates at the end compared to the begin of the observation period. This has also something to do with the institutional distribution of (fiscal) costs and benefits of active labor market policy to which we turn now.

(6) Contribution systems are usually organized through "parafiscal institutions" and not integrated into the state budget. However, when an unemployed person is transferred to a labor market program, receiving thereby subsistence allowances or regular market wages, there arises not only a reduction of corresponding unemployment benefits, but also an increase in taxes. When active labor market policy is financed by contributions, the probability of fiscal incongruency is higher than in the case of tax financing because these indirect positive tax effects do not flow into the parafiscal institutions: the fiscal costs tend to be much higher than the fiscal benefits (saved unemployment benefits, increasing revenues by contributions). Fiscal incongruency, however, can also arise with taxed financed labor market programs, especially in the case of horizontal fragmentation of labor market budgets (separate budgeting of active and passive labor market policy), as well as in the case of vertical fragmentation (when costs of active labor market policy and resulting benefits are unequally distributed among central and decentral state budgets). The probability of fiscal congruency, in other words, is higher in tax systems than in contribution systems, and within tax systems it is higher when the budgets are vertically and horizontally integrated. The hypothesis is: The higher the fiscal congruency, the higher the institutional incentive to apply active labor market policy measures.

Table 5 shows that the overall burden of unemployment on public budgets is similar in all the countries (cf. line 4.1). There is, however, wide variation among the countries with respect to the

composition and the institutional distribution of the fiscal costs of unemployment. This variation reflects the differences in unemployment compensation, health insurance and pension systems as well as tax systems.

To test our hypothesis, we have now to relate the institutional distribution of the costs of unemployment to the institutional distribution of the costs of active labor market policy. Fiscal congruency, then, is existing when the institutional distribution of both cost aspects has the same pattern. In other words: The institution, that is financially responsible for active labor market policy, is faced with the full opportunity costs of unemployment. If that is the case, and especially when the opportunity costs are higher than the costs for labor market programmes, then there is an institutional incentive to prefer active labor market policy instead of financing passive labor market policy.¹⁾

Table 6 presents this comparison of fiscal costs in a simplified version. It shows that "fiscal incongruency" is especially pronounced in Austria and the USA, however; for different reasons: In Austria, the fiscal responsibility for active labor market policy lies predominantly on the unemployment insurance institution, the potential benefits (or opportunity costs), however, flow to a substantial amount also to other fiscal institutions. In the USA, the pattern is almost reverse: The central state is basically responsible for carrying the costs of active labor market policy, however, the potential benefits are flowing to a substantial amount also to unemployment insurance and other fiscal institutions. This explains to some extent the fact, that "net cost calculations" (cost comparisons between active and passive labor market policy) play in both countries no significant role in the planning of labor market budgets, and that both countries have the lowest average expenditure level as well as the lowest activity rates.

Sweden and Great Britain are cases that come close to "fiscal congruency". In both countries, the fiscal costs of unemployment as

1) The alternative, of course, it to reduce the "opportunity costs", e.g. through reduction of unemployment benefits.

Table 5: The Fiscal Costs of Unemployment in Six Countries: Size, Composition, and Institutional Distribution

- Average costs for each unemployed per year in national currencies and percentages for individual revenue and expenditure items and institutions -

(1)	Expenditures for	Austria (1983)		FR Germany (1983)		France (1982)		Great Britain (1981/82)		Sweden (1982)		USA	
		ÖS	%	DM	%	FF	%	£	%	SKR	%	\$	%
(1.1)	- Unemployment compensation	65.342	47	11.400	48	22.803	48	1.481	33	33.718	38		
(1.2)	- Other social welfare benefits			600	3			128	3				
(2)	Lost revenues from												
(2.1)	- Direct taxes	24.915	18	4.300	18	2.719	6	1.089	24				
(2.2)	- Indirect taxes	5.440	4	1.500	6	2.581	5	891	20				
(3)	Lost contributions to									54.092	62		
(3.1)	- Pension systems	31.496	23	3.700	15		41	907	20				
(3.2)	- Unemployment insurance	5.684	4	1.300	5	19.382							
(3.3)	- Health insurance	5.103	4	1.200	5								
(4)	Total	137.984	100	24.000	100	47.485	100	4.495	100	87.809	100		
(4.1)	- as a percentage of the GDP per inhabitant	86		88		73		98		116			
(5)	Institutional Distribution (among public budgets):												
(5.1)	- Central government		13		23		32		64	XXXXX	XXX		
(5.2)	- State governments		5		9		-		-	X	X		
(5.3)	- Local governments		4		5		-		3	XX	X		
(5.4)	- Unemployment insurance		57		43		27		33	3	XXX		
(5.5)	- Pension system		17		15		41		-	XX	X		
(5.6)	- Health insurance		4		5								

Source: Schmid/Reissert/Bruche 1987, pp. 190-191. Calculations of the institutional distribution of unemployment costs in Sweden and in the United States were not possible; the cross-marks represent guesstimates for the weights of the relative cost burden for each institution.

Table 6: Distribution of unemployment costs among fiscal institutions compared to the distribution of fiscal responsibility for active labor market policy

	Fiscal Costs of Unemployment			Fiscal Responsibility for Active Labor Market Policy				
	Central State	Intermediate/ local states	UI ¹⁾	SI ²⁾	Central State	Intermediate/ local states	UI ¹⁾	SI ²⁾
	A	X	X	XX	X			XXX
D	X	X	XX	X			XXX	
F	XX		X	XX	XXX			
GB	XXX		XX		XXX			
S ³⁾	XXX	X		X	XXX	X		
USA ³⁾	XX	X	XX	X	XXX		X	

XXX = Share of financial burden over 60 %

XX = 30-60 %

X = 10-30 %

1) Unemployment Insurance

2) Pension and Health Insurance

3) guesstimates

well as the costs of active labor market policy have to be carried basically by the central state. As we know from analysis of the budget process, "net cost calculations" play an important role in determining the labor market budget. High activity rates in Sweden and increasing activity rates in Great Britain support the "congruency hypothesis". There is an additional incentive for active labour market policy in Sweden due to relative high opportunity costs (see table 5, line 5.3) and "fiscal congruency" at the level of local governments (see table 6) which for other countries is not the case: When Swedish municipalities reduce unemployment through their own policies, they benefit also from the reduction in costs of unemployment (especially through their high share of income taxes). They prevent also welfare payments that arise when unemployment benefits are exhausted, and they do not create "windfall profits" for other fiscal institutions. It is therefore not surprising that Swedish municipalities are more engaged in the fight against unemployment than local governments in other countries.

France and Germany are cases between "fiscal congruency" and "fiscal incongruency". Therefore, in both countries there is no pronounced fiscal institutional incentive for active labour market policy, but there is also no pronounced disincentive like in Austria or in the USA.

I turn now to the impact of financing systems on equality and efficiency outcomes. I start with equality outcomes because this is the original concern of labor market policy. The relationships between the organization of finance and equality objectives are intuitively also more plausible and empirically more easy to test.

5.3 The Impact on Social Welfare Functions

(7) Contributory Systems tend to provide more generous unemployment benefits than tax systems because of their inherent insurance or "equivalence" principle. Contributory systems are oriented on wage income guarantee during unemployment whereas tax systems tend to provide wage income compensation on a socially accepted minimum standard of living. Several consequences can be derived from these two different principles: First, contributory systems tend to contributions and benefits that are proportional to the wage income. Second, contributory systems tend to provide wage income guarantee

only for a limited period in assuming a limited period of unemployment. This assumption follows from the theory of risk and uncertainty which proves the impossibility of insuring long-term mass unemployment. Third, benefits provided by contributory systems tend to have no redistributive effect. Tax systems, on the other hand, tend to lump-sum benefits and to the provision of means-tested income compensation as long as people need it, and for both reasons they will tend to be redistributive.

In the following we concentrate only on the benefit side.¹⁾ Table 7 shows the net replacement rates according to duration of unemployment, different income groups, and (in one case) type of household. The results can be summarized in the following way:

- Great Britain is the only country in which the financing of unemployment insurance is dominated by tax principles. Although unemployment insurance contributions formally make up a substantial part of financing, they cannot be considered as pure contributions because they are integrated into the overall social insurance contribution, and these contributions are largely integrated into the overall state budget (Reissert 1986). Property rights cannot be and are not derived from this kind of contributions. Thus, income proportional benefits play only a minor role (and have been completely abolished since 1982), the supplementary benefits which replace unemployment benefits after 12 months are in principle unlimited, and the replacement rates are highly differentiated according to income groups and family status, thus reflecting a substantial capacity of interpersonal income redistribution.
- Redistributive effects are also established in France and in Sweden: these are the only countries beside Great Britain in which taxes play a considerable role in financing unemployment benefits (see overview 2). Austria, Germany and USA, on the other hand, are dominated by contributory principle. Their unemployment benefits are - as expected - to a wide extent

1) For a detailed discussion of revenue regulation, and for further details of benefit regulation see Schmid/Reissert/Bruche 1987:126-161.

Table 7: Net Replacement Rates* according to Duration of Unemployment (representative for year 1980)

Country	1 Type of Household	2 3 months		3 6 months		4 12 months		5 24 months		6 36 months			
		(1)	(2)	(1)	(2)	(1)	(2)	(1)	(2)	(1)	(2)		
A**	a, b, c,	50	55	56	55	56	50	55	40	45	40	45	46
D	a, b, c,	57	56	43	55	42	54	53	46	45	46	45	35
F ₁	a, b, c,	75	66	56	77	65	78	66	30	20	0	0	0
F ₂	a, b, c,	100	91	82	97	84	97	74	79	68	57	30	20
GB	a,	49	36	19	47	34	31	19	6	30	19	6	6
	b,	67	47	25	63	45	45	29	14	45	29	14	14
	c,	77	62	32	73	58	52	33	16	52	33	16	16
S	a, b, c,	94	62	31	91	60	86	57	28	0	0	0	0
USA**	a, b, c,	45	35	25	45	35	25	0	0***	0	0	0	0

* = Unemployment Benefit or Unemployment Assistance + Family Supplements divided by net wages of three income classes: (1) 2/3, (2) 1, (3) 2 times the average wage of a male manufacturing worker; all figures refer to men > 25 years of age. a, single, b, married without children, c, married with two children.

** = guesstimates because these countries were not included in the original study; in USA, net replacement rates vary considerably between states

(***: USA provides sometimes extended benefits.)

Source: CERC 1982, pp 53 ff.; Schmid/Reissert/Bruche 1987, Table 8:183.

proportional to wage income.¹⁾

- The extended benefits which are paid over the unemployment period of one year (unemployment assistance or supplementary benefits) are in two cases completely financed by taxes (GB, D - in Germany, however, only since 1981), in two other cases (France, sometimes USA) predominantly by taxes. Austria is in a way an exception: unemployment assistance (Notstandshilfe) is mainly funded by contributions. However, with increasing long-term unemployment, an increase of the tax-share is to be expected, too!
- Sweden and USA are the only countries in which unemployed persons fall relatively soon in the last "social security net", i.e. on welfare payrolls. This corresponds with the fact, that these are the only countries in which pure insurance principles are (at least in rudimentary form) still existing, such as waiting periods and experience rating of contributions.

(8) The distinction between contributory and tax systems leads also to a strong hypothesis with respect to the dynamic of unemployment benefits. When contributory systems run into deficits, they tend to exclude "marginal" contributors of the system from benefits or from participating in labor market programs, and thus to contribute to the segmentation of the labor market (protecting the "insiders" more than the "outsiders"); the basic reason for this is again the inherent principle of "equivalence" and the strong "property rights" of the core members. Tax systems, on the other hand, tend to reduce the level of benefits during a fiscal crisis, thereby contributing to a levelling of the labor market.

Table 8 provides a crude way to test this hypothesis. Column 1 shows the total expenditures for unemployment benefits in per cent of GDP, a figure which is basically depending on the size of unemployment. However, the comparison of expenditures' change between 1975 and 1982 with the change of unemployment already shows that the financing systems must have worked differently. For instance, unemployment doubled in Sweden, but expenditures almost tripled; in Great Britain, however, unemployment tripled, but expenditures only doubled roughly.

1) Small deviations among the higher income groups result from insurance ceilings (USA, D), or from taxing effects (A).

Table 8: Expenditures for Unemployment Benefits* and their Main Determinants

1	2		3		4			
Country	Expenditures for Unemployment Benefits in % of GDP (Change of Unemployment 1975-82 in per cent)	Expenditures for Unemployment Benefits per employed in % of Income from dependent Worker	Unemployment Receivers in % of Unemployed	Unemployment Benefit Receivers in % of Income from dependent Worker	Expenditures for Unemployment Benefits per Receiver in % of Income from dependent Worker			
	1975	1975	1975	1975	1975			
A	0.25	0.61 (106)	21	26	73	75	29	34
D	0.85	1.44 (69)	30	31	76	66	39	46
F	0.47	1.36 (103)	16	23	62	57	27	40
GB	0.81	1.80 (165)	34	24	83	84	41	29
S	0.24	0.70 (94)	22	32	63	77	34	42
USA	1.18	0.82 (14)	19	11	77	45	25	25

* Includes Unemployment Benefits, Unemployment Assistance or Supplementary Benefits, excludes Bankruptcy Allowances, Early Pension Benefits, Administrative Costs.

Source: Schmid/Reissert/Bruche 1987, Table 3:168.

Column 2 relates these expenditures to the average gross income of dependent workers (employees).¹⁾ Britain and USA are the only countries in which relative unemployment benefits decreased, however for completely different reasons as can be shown by Column 3: The proportion of people receiving unemployment benefits remained constant in the "tax system" of Great Britain, but it decreased drastically in the "contributory system" of USA. Therefore, the level of benefits must have declined as predicted, whereas the level of benefits remained constant in the USA as column 4 (relating the UI-benefits only to benefit receivers) is proving. Thus, we have clearly the expected segmentation effect in the USA (contributory system), and the levelling effect in GB (tax system).

Smaller segmentation effects are to be observed in France and in Germany. This can be explained by the extended unemployment benefits for longterm unemployed which are basically financed by taxes. Austria as a "pure" contributory system shows not yet any segmentation effect. This can be explained by the still relatively low level of unemployment which prevented so far a hard test of the system. With higher unemployment rates, however, the exclusion of unemployed from benefits should be expected. Due to the mixed financing system, no clear expectation could be developed for Sweden. It turned out that Sweden increased the benefit level as well as the receiver level which is in line with the Swedish philosophy of productive use of unemployment by high compensation (increasing thereby the acceptance of "push-mobility") and counter-action through active labor market policy.

(9) So far we have dealt with the distributive or redistributive consequences of financing systems on unemployment insurance. For the same reasons we expect analogous consequences with respect to active labor market policy. Above all it is to be expected that tax systems tend to concentrate expenditures on "problem regions" and "problem groups" whereas contributory systems tend to favour "core regions" or "core groups" of the labor market.

1) Note that these figures cannot be interpreted as indicators for the generosity of UI-systems across countries, due to - among other things - the different structure of unemployment. (It may serve as a very crude approximation of generosity). However, within one country, the figures' dynamic reflect changes in generosity assuming no substantial change in unemployment structure.

The empirical analysis is confirming this expectation. The regional distribution of active labor market policy follows largely the "problem pressure" in tax financed systems, i.e. the share of expenditures for active labor market policy in the individual regions corresponds roughly to their share of unemployment (in the tax systems of Great Britain and Sweden); in the USA, "problem regions" of unemployment are even receiving benefits from active labor market policy over-proportionally. In the contributory system of Germany, however, regions with relatively low unemployment profit more from active labor market policy than regions with high unemployment.

Comparable results can be observed with respect to personnel distribution: The tax systems of Great Britain, Sweden, and the USA concentrate expenditures for active labor market policy more on "problem groups" or guarantee at least a proportional representation of these groups among program participants. In the contributory system of Germany, however, groups especially prone to unemployment are usually underrepresented among participants in labor market programs.

(10) The tendency of contributory systems toward "centrality" will also be reflected by the size and composition of the labor force. A trade-off can be expected between the social security of the "insiders" due to their "property rights" to welfare benefits and the social integration of the working age population: the higher the degree of social security for the active labor force, the lower the degree of integration into the labor market, i.e. the lower the labor force participation. Due also to the tendency of exclusion ("segmentation") in periods of fiscal crisis, lower and/or declining labor force participation rates of "marginal groups" (e.g. young and old people) can be expected in countries with predominant contributory systems compared to countries with predominant tax systems.

Labor force participation rates displayed in table 9 confirm the hypothesis:

- Participation rates of males 15-24 decreased drastically in "contributory systems", but remained almost constant or even increased in "tax systems";

Table 9: Labor Force Participation Rates according to Sex and Age Groups in six Countries.

Country	1		2				3		4		
	Males		Females		Total		System				
	15-24	55-64	15-24	55-64	15-64	15-64					
	1970	1985	1970	1985	1970	1985	1970	1985	1970-85		
A	71.8	65.5	65.8	46.0	61.6	59.0	25.3	17.8	69.0**	68.4**	C
D	71.6	60.5	82.2	57.5	61.9	53.5	29.9	23.9	69.4	65.0	C
F	60.3	49.0	75.4	50.1	47.2	40.3	40.0	31.0	68.3	67.4	C/T
GB	74.7	71.6	91.3	66.4	56.7	63.1	39.3	34.1	73.5	73.2	T
S	67.0	65.7	85.4	76.0	59.4	66.4	44.5	59.9	75.8	83.7	T(C)
USA	71.8	75.3	80.7	59.7	50.7	63.7	42.3	41.7	69.9	75.2	T(C)

* T = predominantly tax system

C = predominantly contributory system

** Figures include only women from 15 to 59; they would be lower including women from 60 to 64.

Source: OECD 1986, Austria: unpublished figures provided by Gudrun Biffi (Wifo, Wien).

- participation rates of females 15-24 decreased in "contributory systems", but increased in "tax systems";
- participation rates of males 55-64 decreased faster in "contributory systems" than in "tax systems";
- participation rates of females 55-64 decreased in "contributory systems" more than in "tax systems" where they decreased more slowly, or remained constant or even increased (Sweden).

The overall effect is remarkable: the total labor force participation rate is significantly higher in predominant "tax systems" (Great Britain, Sweden, United States) than in predominant "contributory systems" (Austria, Germany) or in the mixed system of France, and the difference increased from 1970 to 1985.¹⁾

5.4 The Impact on Economic Wealth or Labor Market Efficiency

The last part of evaluating financing systems, i.e., their impact on wealth or efficiency criteria is the most difficult one. The reason is that even more factors interfere in determining economic wealth compared to factors determining social welfare, and the measurement of efficiency itself is rather critical. Therefore I present only the main lines of theoretical arguments, followed by some, however, rather scattered evidence.

(11) Standard neoclassical labor economics predicts that real wages fall with increasing wage related contributions, and labor supply falls, too, assuming a positive correlation between real wages and labor supply. To the extent that taxes are not related to wage income, the negative labor supply incentive must be lower in tax systems. However, it might also be that the benefits directly related to contributions might also increase labor supply ("entitlement effect") especially when possibilities of "moral hazard" are given (see below). The net effect is undetermined.

-
- 1) It would be most interesting to test this remarkable result for, e.g. all other OECD-Countries.
 - 2) The discussion above (paragraph 10), however, has shown that the "entitlement effect" does not overcome the segregation or "concentration effect".

To the extent that contributions have to be paid by employers (as additional part of wages) and these non-wages labor costs cannot be shifted ("backwards" through reduced wages, "forwards" through increased prices) to employers or consumers, contribution systems have a higher negative incentive for labor demand than tax systems. Again however, the wealth impact is indeterminate, because higher non-wage labor costs might both speed up productivity (positive wealth effect) as well as destroy potential market production (negative wealth effect).

Taking both supply and demand effects together, one can speculate that contributory systems might foster rather productivity and growth aspects of economic wealth instead of employment, and with tax dominated systems it might be the other way round. The figures in table 9 fit with this speculation, but what about productivity and growth? Before we turn to this empirical question we draw the attention to another theoretical argument.

(12) Standard neoclassical theory predicts that efficiency losses due to "moral hazard" are greater in contribution systems than in tax systems for at least two reasons: first, contribution systems imply greater property rights to benefits than tax systems due to their inherent "equivalence principle", thus inducing people to use these rights even when it is not economically necessary or by trying to cheat; second the efficiency loss might be induced through the trend of higher generosity of contribution systems that might lead to higher reservation wages not "clearing" the market or to longer search (longer duration of unemployment) or to higher quit rates (more spells of unemployment). However, these possible effects have to be weighed against potential positive wealth effects through the greater acceptance of mobility or through better matchings by longer search, among other possible positive effects.

Mainstream economics have concentrated a lot of energy on the question of unemployment insurances' incentives, especially on those which were supposed to have distorting effects on efficiency. However, our review of all empirical studies in the six countries provides not much evidence for big efficiency losses. Most studies detected only marginal work disincentive effects (if at all), however, all serious studies emphasize that it is too early to draw any firm

conclusion for policy design.¹⁾

I conclude this chapter with the presentation of efficiency indicators which provide no hard test for the anyhow soft and ambiguous hypotheses discussed above. The figures, however, tell at least one thing: Countries with the least generous unemployment insurance systems - Great Britain, USA - neither have the highest GDP growth rates nor the highest productivity growth rates; rather the contrary is true. The "pure" contributory systems are on the top with respect to GDP growth, and on the top or in the middle with respect to productivity growth (see table 10).

1) See among others: Clark/Summers 1982, Björklund/Holmlund 1986, Burtless 1986, Schmid/Reissert/Bruche 1987 (chapter 10, pp. 197-213).

Table 10: Gross Domestic Product* per capita, per employee, per working hour, and growth rates.

1	2	3	4	5	6
	GDP/capita growth	GDP per Employee 1975	GDP/Employee growth	GDP per Working Hour	GDP/Hour growth
	1975-85	1985	1975-85	1975	1975-85
A	11 007	28.4	22 087	25 716	16.4
D	14 198	27.2	27 303	34 641	26.9
F	12 560	18.6	26 723	33 130	24.0
GB	10 348	18.2	19 924	24 322	22.1
S	16 259	14.6	28 612	31 580	10.4
USA	12 677	19.6	26 667	28 309	6.2
				14.9	20.0
				18.7	21.5
					15.0
					34.2

* GDP in Dollar at 1980 prices and 1980 exchange rates
 Source: OECD, Main Economic Indicators, May 1987; OECD 1986b; National Statistics, and own calculations.

6. SOME PRACTICAL CONCLUSIONS FOR DESIGNING FINANCING INSTITUTIONS OF LABOR MARKET POLICY

In a nutshell, the message of this study can be summarized in the following way: Systems of financing labor market policy have an impact on labor market policy spending as well on the functioning of the labor market. However, the relationships are not deterministic. In most cases only conditional relationships can be detected which means: Financing institutions are only a necessary but not sufficient condition for specific functions of labor market policy. For instance, when labor market policy shall take over anti-cyclical functions, pure contributory systems are not suitable to fulfill this task properly. When labor market policy has to tackle with externalities, involved e.g. with labor market training, pure contributory systems run into difficulties. The same is true when labor market policy has to take over functions of redistributing income or functions of improving essentially the situation of disadvantaged groups in the labor market. On the other hand, there are some clear advantages of contributory systems: by establishing property rights for the members of contributions systems, they provide higher social security which in turn supports the willingness to accept technological change and mobility; and by separating the labor market budget from the overall state budget, contributory systems escape from the often destructive competition between budget items due to the chronically shortsightedness of political priorities and provide stability of expenditures as well as mutual long-term expectations which are necessary for an effective coordination of economic agents.

The analysis of financing systems in the tradition of rational choice theory, thus, is able to provide some guidelines for the "institutional design" of labor market policy. These guidelines (Schmid/Reissert/-Bruche 1987:325-334, however, cannot be applied like a recipe cookbook. Institutional reforms have to take into account the respective national traditions, and they have to consider the logical consistency of "institutional networks". Not all combinations of institutional elements are efficient. For instance, generous unemployment benefits require an institutional back-up of "push-unemployment", which means the establishment of institutions that put pressure on unprofitable firms to close or to restructure in addition to institutions which

provide mobility incentives for workers affected by this process. The latter incentives can be "institutionalized" by active labor market policy which provides productive options for idle labor capacities, such as labor market training, regional mobility, or temporary public work. Such alternative options, when implemented in an effective way, have a double function: they prevent inflationary labor market bottlenecks or sponsor non-marketable but useful public work, and they serve as legitimate control instrument against "moral hazards" connected with generous benefits.

Another reason for the limits of "institutional-choice" theory is the fact that institutions always reflect power relationships. The trivial but nevertheless important conclusion is that institutional reforms depend on politics, and politics depend on institutions. The escape from this circular conclusion would be a theory of "institutional evolution" which was not the subject of this paper. I close, however, with an example of the interrelatedness between institutions and politics which might hint on the character of issues to which an evolutionary theory would have to address. In the introduction, I alluded to the fact that German trade unions were not very supportive to active labour market policy. The same can be stated with respect to Austrian trade unions, whereas the Swedish trade unions were the main driving force behind the expansion of active labor market policy in Sweden. Is there an explanation for this remarkable difference? My tentative answer is that in contributory systems trade unions are kept in a dilemma when faced with high unemployment: An expansion of active labor market policy would immediately result in substantial increases of contributions paid by workers still employed thus leading to even higher reductions of real wages which occur in such situations. The alternative of reducing benefits is no options either. The benefits of active labor market policy would go largely to non-union members, whereas the benefits of unemployment insurance are concentrated on union members, i.e. on members regularly contributing to the collective fund. Thus, the trade unions in contributory systems opted "rationally" for keeping contributions as low as possible, and for stabilizing or even extending unemployment benefits for long-term contributory members, i.e. for elderly unemployed. A system in which the financial burden of active labor market policy is more widely distributed among all members of the society by general taxes would release this dilemma substantially. The

German trade unions are well aware of this fact, and they have proposed since years the introduction of a general labor market contribution paid by all employees (civil servants and self-employed included). So far they were not successful. A more effective strategy might be to fight for a system which establishes a regular grant to the labor market budget out of the state budget without giving up the advantages of contributory systems.

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