

## **Comments on Kerstin Johansson: Do labor market programs affect labor force participation?**

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The main part of the economic research on labor market policies has been concerned with the effects on subsequent performance in terms of wages and employment. This paper, dealing with labor force participation and how it is affected by active labor market programs (ALMPs), makes an interesting addition to the literature. In comparison with earlier studies of the connection between ALMPs and labor force participation, the present one utilizes data from the Swedish municipalities. Such data is very useful for addressing the question at hand, since it contains a large number of cross-sectional units that can be compared. The results from the study suggest that ALMPs have a relatively large effect on the participation rate. Both the short run effect and the long run effect are positive. This suggests that one may use ALMPs to either increase the level of the labor force participation rate, or to dampen swings in the participation rate. In the following, the discussion will concentrate on two issues on which the paper does not focus and where a continued discussion may be fruitful. First, under what circumstances is there a need for policy to interfere with the individual participation decision? Second, is it possible to determine, based on actual data, whether the policy is justified or not? Both of these questions relate to an important concept in the present paper, which is the discouraged worker hypothesis.

### **1. What is the scope for policy interventions?**

The discouraged worker hypothesis plays a central role in explaining the variations in the labor force. In its mildest form, the discouraged worker hypothesis simply means that some individuals tend to leave the labor force in bad times and return to the labor force in good times, when the probability of employment is higher. This is also the essence of the theoretical framework given in Section 2 of the paper. If a worker chooses not to participate in the labor force, it is because he or she is better off compared with being in the labor force. If there

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are no externalities, or more precisely, if the private value and the social value of participating in the labor force coincides, there is no clear-cut case for policy intervention. In the model used, however, there will be at least one externality involved. Too many individuals may tend to join the labor force, since an individual does not take into consideration when joining the labor force that he or she may crowd out regular job opportunities for other persons. This would suggest that the social value of entering the labor force is less than the private value. Even though such an argument may be considered relatively unimportant, it shows that ALMPs need not be productive in promoting labor force participation.

More severe cases of the discouraged worker hypothesis may give a clear role for policy. This occurs when the private valuation of the non-participation state (relative to the participation state) is too high or too low from society's point of view. One obvious example would be when those who leave the labor force for longer periods of time, gradually lose their job skills. Even worse, they may also tend to lose their self-esteem, thereby making them less inclined to look for jobs. Being outside the labor force may also result in personal problems such as drug abuse. Another example of individuals who may be considered to be "locked out" of the labor force are those who have received early retirement on grounds of ill health. Some of these individuals may have been classified unfit for work too easily. They may want to return to work, although the insurance system encourages them to remain outside the labor force. In all these examples, there may be a role for policy, although the policy instruments do not necessarily include some form of ALMP. Therefore, one important part of the research agenda, is to address the welfare and policy implications of the genuinely discouraged, based on theoretical frameworks that take explicit account of the dynamics of the labor market.

## **2. The measurement of the discouraged worker effect**

Having concluded that the scope for policy is determined by the degree to which workers are discouraged, a natural next step would be to ask whether it is possible to address this question in empirical analysis. Admittedly, the question is hard to answer accurately within the empirical framework of the paper. To give an idea of how an analysis of "policy relevance" could be performed, let us assume that the economy has been subject to a negative shock. This will increase

the number of unemployed, some of whom will then leave the labor force. These are the discouraged workers. Let us assume further that this shock is temporary. If people then return to the labor force sufficiently quickly, we may say that it is a mild form of the discouraged worker hypothesis, implying that the role for policy is limited. On the other hand, if people do not re-enter into the labor force for a long period of time, then it is an indication of a more severe form of the discouraged worker hypothesis. In this case, however, it is not necessarily a bad thing to drop out of the labor force for a long period of time, since these individuals may have entered an educational program. Hence it may be concluded that if we cannot reject a hypothesis that temporary shocks have short-lived effects on the participation rate, there is a limited role for policy.

The above discussion suggests that it is important to address the dynamics of labor force participation. The empirical analysis in the paper contains a dynamic model describing labor force participation, although we should bear in mind that the present model cannot have permanent drop outs from the labor force unless the underlying change in the labor market is permanent. Assume that the municipal shocks are represented by changes in the job destruction rate. Then we can trace out the responses from temporary changes in the job destruction rate. According to Table 3 in the paper, the coefficients associated with the current and lagged job destruction rates are both negative. This will imply that a temporary increase in the job destruction rate will have a long lasting effect on the labor force participation rate. In other words, based on the municipal data and given that the empirical model is the correct one, we are unable at least to rule out the scope for some kind of policy. A similar exercise made using the share of the population in ALMPs yields a different insight. If there is a temporary increase in ALMPs, there is only a short-lived effect on the participation rate. Hence ALMPs do not appear to increase the labor force unless they are introduced on a permanent basis. Finally, note that all predictions here assume that the unemployment level remains unchanged. This means that the only channel by which ALMPs fail to increase the labor force in a one to one relationship is through crowding out (in) of regular employment. Since the unemployment level will generally respond to changes in the ALMPs, the effects calculated here, as well as in the paper, are only part of the total effects.

