



**European Cooperation
in the field of Scientific
and Technical Research
- COST -**

Brussels, 19 December 2002

Secretariat

COST 283/02

DRAFT MEMORANDUM OF UNDERSTANDING

Subject : Draft Memorandum of Understanding for the implementation of a European Concerted Research Action designated as COST Action A23 "The Evaluation of European Labour Market Programmes"

Attached is the text of the abovementioned Memorandum of Understanding.

DRAFT
Memorandum of Understanding
For the implementation of a European Concerted Research Action designated as
COST A23
"The Evaluation of European Labour Market Programmes"

The Signatories to this Memorandum of Understanding, declaring their common intention to participate in the concerted Action referred to above and described in the Technical Annex to the Memorandum, have reached the following understanding:

1. The Action will be carried out in accordance with the provisions of document COST 400/01 "Rules and Procedures for Implementing COST Actions", the contents of which the Signatories are fully aware of.
2. The main objective of the Action is to increase the knowledge that is available to the European community at large of the effect of policy interventions on the functioning of the labour market by using the most advanced econometric methods based on data on individual behaviour.
3. The economic dimension of the activities carried out under the Action has been estimated, on the basis of information available during the planning of the Action, at Euro 3 million in 2002 prices.
4. The Memorandum of Understanding will take effect by being signed by at least five Signatories.
5. The Memorandum of Understanding will remain in force for a period of four years, calculated from the date of the first meeting of the Management Committee, unless the duration of the Action is modified according to the provisions of Chapter 6 of the document referred to in Point 1 above.

COST A23**The Evaluation of European Labour Market Programmes****A. BACKGROUND**

This COST Action aims at the systematic evaluation and design of labour market programmes, to reduce unemployment and to upgrade human capital, at the lowest cost for the taxpayer.

European unemployment has been at an unacceptably high level during the past 20 years. Though there is substantial variation in the labour market conditions between member states, and also in the states participating in this Action, all of them want to further labour market participation. At the Luxembourg Jobs Summit of November 1997 the European Union agreed on a European Employment Strategy, based on Employment Guidelines and translated into National Action Plans for Employment by each of the member states. More recently, at the Lisbon Summit of 2000 the European Union stated as its goal to make Europe the most dynamic and competitive region of the world. Both programmes are highly ambitious. Information and Communication Technology (ICT) had a major impact on labour markets. Demand for human capital increased rapidly, but unemployment, also long-term unemployment, persists in the lower tier of the labour market. Long-term unemployment leads to a depreciation of marketable skills, further aggravating the problem. Also, new types of labour relations require a modernisation of labour market institutions. Hence, the realisation of these programmes requires a major effort of the member states.

Though both the Employment Guidelines and the documents of the Lisbon Summit provide the main line of thinking for this policy effort, many details have to be worked out in the years to come. For example, many workers' human capital has to be upgraded. How to realise this objective? Long-term unemployed persons have to be brought back to the labour market. What kind of intervention is needed? Financial incentives can increase the attraction of being employed. How to realise these incentives? Many of the long-term unemployed are single mothers. Are childcare subsidies helpful to persuade these people to accept a job? Policies to improve the functioning of labour markets and human capital formation are therefore at the core of both initiatives. Hence, the adequate design and evaluation of these policies is an important issue.

During the past 30 years, economic research has made substantial progress in this field. Many possible pitfalls in the proper evaluation of effects of policy interventions in general, and labour market programmes in particular, have been uncovered. When people decide themselves whether or not to participate in a labour market programme (e.g. some kind of training), the group that participates tends to be a highly selective sample of the group that is eligible. This selectivity tends to throw into doubt any empirical conclusions drawn from simple evaluation studies: is the positive outcome for the group that participated in the training programme due to value added by the programme, or is this outcome due to the characteristics that made them to decide to participate in the programme in the first place? Working with well-designed econometric methods is therefore a central issue. Other research programmes addressed the issue of the optimal design of tax schemes, like the EITC (Earned Income Tax Credit) and New Deal. These incentives encourage people with low earning capacity to seek employment by reducing the tax burden at low-income levels. However, an incentive to work for the one group implies disincentives for other groups with a slightly different income or household composition, since a reduction of the tax burden for the least paid requires an increase in the marginal tax rates for higher income levels. Hence, a proper design of these tax policies is crucial. The new micro-econometrics allows a proper analysis of this type of issue. This might contribute to a substantial improvement of the effectiveness of policies that are actually implemented and therefore save a substantial amount of public funds.

This Action extends on the COST Action A13, "Changing Labour Markets, Welfare Policies, and Citizenship", period 1998-2003. That Action has a more general aim in describing the effects of unemployment in terms of marginalisation and exclusion, in providing an overview of the way in which various countries try to cope with these issues, and in giving some insight in the effectiveness of various programmes by a comparative study. This Action focuses more specifically at the evaluation and design of interventions in the labour market. As will be discussed below, evaluation and design are complicated issues that require high levels of expertise on specific issues. This Action will bring this expertise together. The conclusions of the Lisbon Summit make clear that this type of issue will remain important for the years to come, justifying a prolonged activity in this area.

COST is regarded as an appropriate tool for research co-operation in this field so as to bring researchers together from more European countries than the six countries that have participated in the preparatory work. The flexible framework of COST will also make it possible to start the networking activities based on nationally funded research.

B. OBJECTIVES AND BENEFITS

The main objective of this Action is to increase the knowledge that is available to the European community at large of the effect of policy interventions on the functioning of the labour market. This knowledge will help to design future interventions and to maximise their effectiveness at the lowest cost. The Action intends to improve our understanding, by empirical and theoretical research, of the challenges faced by policy makers to further the participation in the labour market.

More specifically, the aim of the Action is by obtaining systematic knowledge, providing guidance for policy makers. The Action will aim at obtaining simple rules of thumb reflecting robust knowledge of the effectiveness of policy interventions and providing direct help when designing new interventions. In this way, the Action supports the achievement of the goal of the EU set at the Lisbon Summit of becoming the most dynamic and competitive region of the world. The Action also aims at establishing the best practices across the countries involved and at analysing potential complementarities between policies in different areas, which favour particular combinations of policies and rule out others.

Most of the empirical research has focused at the direct effect of all type of policy interventions. Econometric techniques developed in the course of the past 20 years by James Heckman, Nobel prize laureate in 2000, allow the structural analysis of micro datasets with detailed information on thousands of individuals, like the SEP (Social Economic Panel) for the Netherlands or the BHPS (British Household Panel Survey) for the United Kingdom. This type of information provides the researcher with detailed knowledge on the behaviour of individuals in particular circumstances, and more importantly, how they change their behaviour when policy makers intervene in these circumstances. The type of micro information needed for this type of research is available in several European countries. The Action aims at an exchange of researchers of various countries so they can benefit from each other's experience with particular techniques for analysing the data and from the empirical results obtained by their application. This will improve the research quality and will allow

us to evaluate the reliability of the conclusion for variations between countries in institutional settings and in labour market conditions (for example comparing the wildly different lay off legislation in Spain and the Netherlands).

The problems related to the selectivity bias in the measurement of the direct effect and the complexity of the assessment of the indirect effects imply that the evaluation of this type of intervention requires a high level of specialised expertise in economics and econometrics.

Also, the Action aims to identify specific topics that require new research in the course of the deliberations. It is expected that the techniques will have a broader applicability than just the issues that are mentioned above - the European ambition of becoming the world's leading knowledge-based economy will raise a wide variety of questions of how best can this objective be achieved. Results of the Action will be beneficial for all European countries and of course will be disseminated worldwide.

Interaction with other disciplines will be encouraged. Finally, the aim in pursuing these questions using the highest level of expertise available in Europe is also to raise the status of European socio-economic research and, through teaching and dissemination activities, to raise the level of policy analysis done within governments. The micro-econometric and optimal design approach will remain the core of the Action.

C. SCIENTIFIC PROGRAMME

The scientific programme is therefore to concentrate this expertise for the analysis of institutions and interventions in European countries.

The analysis of the direct effect of policy interventions is greatly troubled by all kinds of selection effects. Most programmes are not assigned randomly among those who are eligible. Programme officers have a large say in who participates and who does not. Stated crudely: it is difficult to disentangle whether the policy causes what is perceived as the outcome (e.g. better education, larger employment probability, higher wage) or that the “outcome” causes the intervention. Many studies claiming the success of a particular type of intervention for job searchers have in fact measured the

reverse effect that programme officers tend to assign the programme to the best job searchers. The work of Heckman has greatly contributed to a better understanding of these problems and has led to new methods of dealing with these problems. One solution is really random assignment of programmes among those who are eligible. Another solution aims at controlling in a very sophisticated way for differences in the background of those who are eligible.

The analysis of the indirect effects of this type of policy intervention on the economy as a whole is equally important, though even more involved from a scientific point of view. Where the intervention is designed to affect a particular group of people, their change in behaviour may have indirect effects, for example on other peoples' wages, which will in turn affect their behaviour. For example, additional schooling for a particular group of workers increases the supply of this type of additionally trained worker, thereby reducing their wages and making this schooling less attractive for other workers and reducing their schooling effort. In this particular example, the indirect effect runs counter to the original aims of the policy intervention. Other indirect effects may favour the original aim of the policy. It is therefore of crucial importance to know these indirect effects beforehand when designing policy interventions. Recent theoretical research has substantially improved our understanding of this type of indirect effects, so that we are now able to extend the empirical studies of the direct effects of policy interventions with reliable estimates of their indirect effects. Indirect effects are particularly important when evaluating changes in the tax system, since a tax reduction for one group inevitably implies an increase in marginal tax rates for other groups. Several participants in this Action have developed models that include a detailed representation of the tax system.

The evaluation of existing institutions is one issue. Getting from there to policy advice on the improvement of institutions is another issue. The latter is a question of optimal design. The analysis of the optimal design of institutions is closely related to the large literature on optimal taxation that has been sparked by the work in the early seventies of James Mirrlees, Nobel prize laureate in 1999. However, the inclusion of indirect effects in this type of analyses is still in its infancy. Theoretically, the problem is that marginal tax rates lead to market distortions. However, any policy that focuses on special groups (or, more generally, any redistribution policy) implies high marginal tax rates at the borderlines between this group and other groups, to exclude those other groups from

the benefits given to this group. Hence, the incentives given to people within a particular group have to be traded against the disincentives given to people who are potentially mobile between groups. An assessment of these trade offs requires insight in the size of these incentives and disincentives. Evaluation studies are therefore a necessary input for this type of design analysis, since they provide insight in the size of these incentive effects.

In particular, the following measures and policies can be expected to be included:

- surveillance and monitoring of the actions undertaken by unemployed to obtain a new job
- training programmes for unemployed
- other types of specific support programmes for unemployed, like childcare or moving cost allowance
- policies to upgrade human capital, like income support for students and subsidies for tuition fees
- design of the social security system (experience rating, replacement rates, benefit duration etc.)
- employment protection and lay off policies
- general tax policies aimed at raising the incentive for schooling and work

The Action will take both a direct, micro-econometric approach, based on data on individual behaviour, and a broader perspective, where it will be taken into account indirect effects, for example on the wages of workers not directly involved in the policy programme. The intention is to make a contribution towards the evaluation of the policies implemented as a result of the Luxembourg and Lisbon Summits.

D. ORGANISATION

The Action will be guided by the usual COST structure with a Management Committee, working groups and general conferences. During its first year the Management Committee will formulate a work plan to ensure that the scientific programme as defined in the Technical Annex of the Memorandum of Understanding will remain at the heart of the programme.

During the first meeting working groups will be installed around relevant themes. Within these groups during the time of the Action research results will be presented and future research will be discussed and attuned. The meetings of the working groups will be rather informal; the number of members per group will therefore be small (max. of 20 experts). The following themes are envisaged:

- Programme evaluation
- Human capital policies
- Design of social security and taxes
- Employment position and legislation

In the course of time, themes might be adapted or sub themes might arise. Actual political or economic developments might lead to new insights. For each Working Group, a co-ordinator will be appointed. He or she will be part of the Management Committee and will report the results.

The Management Committee will meet every year with the aim of discussing the results and preparing further steps. The institutions initiating this Action and the researchers involved have substantial experience with this type of research. The fact that these institutions are among the best ranked in this field in Europe is a guarantee for experience and quality.

The institutions involved in the Action will see it as one of their main tasks to educate a new generation of researchers. These have to be equipped with the most modern econometric techniques available, but also have to be aware of the pitfalls as described above. Therefore, exchange of young researchers (PhD students in the medial phase of their PhD studies) will be an important element in this Action. After all, among them are many of the future policy makers on government and European level.

During the Action, knowledge acquired will be disseminated as soon as possible through all means available (see section G).

Summarised:

- Yearly meetings of the Management Committee
- Two General Conferences
- Regular meetings of the Working Groups (workshops)
- Exchange of PhD students.

E. TIMETABLE

The duration of the Action is four years. During this period results will be published in reports to national governments, in international journals, by national and international conferences outside the scope of this Action, by dissertations etc.

The preliminary programme reads as follows:

Year one:

- Meeting of the Management Committee: decide on themes and corresponding Working Groups, invite European experts to join Working Groups
- Working Groups: Working Group meetings and reports to MC

Year two:

- Meeting of Management Committee, discussing reports from Working Groups, planning First General Conference, decide on new themes and corresponding Working Groups
- Working Groups: workshops and reports of results to Management Committee

End of year two:

- First General Conference, discussing results of all Working Groups, plenary meeting of all Working Group members

Year three:

- Meeting of Management Committee: evaluating General Conference, evaluating results, decide on new themes and corresponding Working Groups
- Working Groups: workshops and reports of results to Management Committee

Year four:

- Meeting of Management Committee: preparing final General Conference
- General Conference: attended by all researchers involved in this Action, final results will be presented

F. ECONOMIC DIMENSION

The following COST countries have actively participated in the preparation of the Action:

The Netherlands (proposing country)

Denmark

France

Spain

Sweden

United Kingdom

There are regular contacts with research institutes in other countries, like Germany, Belgium, Ireland, Portugal and Hungary, though these countries have not been involved in the preparation of this Action. It is conceivable that these countries will get involved formally in the Action.

Emphasis is put on the fact that participants from all countries in Europe are invited to join the Action. Also Central and Eastern European labour markets can benefit from the results. The high level of expertise in economics and econometrics in Eastern Europe offers good prospects for an extension of the Action into that direction.

On the basis of national estimates provided by the representatives of these countries, the economic dimension of the activities to be carried out under the Actions has been estimated, in 2002 prices, at roughly Euro 3 million. This estimate is valid under the assumption that all the countries mentioned above but no other countries will participate in the Action. Any departure from this will change the total cost accordingly.

G. DISSEMINATION PLAN

To come to results interaction between researchers in Europe is of the utmost importance. The first audience to be addressed therefore is researchers all over Europe working in the same field. They will be addressed by publications in highly regarded international journals and during seminars and conferences, where the best researchers in the field present their latest findings.

Since results of the Action are intended to improve the functioning of the European labour market, a second target audience is the policy makers on European and national levels. Government Departments can be reached by non-technical reports on the evaluation of their policy interventions. Crucial is the education of the employees of the research division at Government Departments: graduated econometricians and economists are very often among them. Therefore, the education of PhD's is crucial for the dissemination of the results. Various participants in the Action have played a role in policy committees for evaluation of labour market policies, both at the national and the EU level, and will do so in the future. This Action improves their knowledge and overview on the issue and will therefore lead to a better quality of their advice in the future. Moreover, this Action will seek direct ways to help policy makers in improving the design of labour market policies.

Once the co-operation under this Action is firmly established, the scope of research will be broadened: the techniques are expected to have a broader applicability than just the issues that are mentioned above. This means that the network will be open to similar specialists from other countries and to other social scientists willing to bring quantitative techniques to bear on other important issues.
