

Changing labour market and the role of subnational governments

The Copenhagen Workshop 2018



Editors: Niels Jørgen Mau Pedersen and Hyun-A Kim.
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Foreword

Jae-Jin Kim, President of KIPF³

In a world stricken by COVID-19 crisis, unprecedented levels of uncertainty, and an ever-changing world economy, the call for sound fiscal management has never been more important. While the economic repercussions of the pandemic continue to reverberate, the accelerated shift towards automation and digitalization, as well as the expansion of the informal economy, imply inevitable and profound structural changes in labor markets. This is compounded by, the overwhelmingly rapid demographic and green transitions, posing various labor market challenges ahead. Now that monetary policy space is comparatively limited under the double whammy of surging inflation and soaring unemployment rates, the way fiscal affairs are managed has become key in deciding the future labor markets, not to mention the fate of a national economy at large. In this regard, the discussion on the intergovernmental fiscal relations that involves the question of the role of subnational governments is timely and necessary. Given that intergovernmental fiscal relations manifest in diverse ways, sharing different experiences and academic knowledge will surely benefit practitioners and academics to better understand their complex nature and address the labor market challenges.

The 6th Copenhagen Workshop in 2018 indeed provided a great opportunity for the exchange of views regarding intergovernmental fiscal relations in the area of labor market policy. At this critical juncture of a permanent paradigm shift, the papers presented will serve as useful beacon in outlining desirable relationship between the central and subnational governments.

Global joint research collaboration on evolving intergovernmental fiscal relations is essential in unlocking post-crisis growth. The Korea Institute of Public Finance (KIPF) has long been devoted itself to the studies in the related field, and will continue to do so while increasing its global research engagement. As a close partner of VIVE (the Danish Center for Social Science Research), KIPF reiterates its support for the Copenhagen Workshop.

³ *President, Korea Institute of Public Finance.*

Opening Address

Niels Jørgen Mau Pedersen⁴

This seminar was the sixth seminar in Copenhagen about local government and public sector issues – this time around organised by Korea Institute of Public Finance, KIPF and the Danish Center for Social Science Research – VIVE.

From the beginning, the seminars have been inspired by the work in OECD in the Network on Fiscal Relations across Levels of Government – and this seminar is no exception. In this field, the OECD network has contributed to academic and policy-related issues since around 2005, and the Copenhagen workshops have, on a biannual basis since 2007, discussed selected items already touched upon in this network. As I see it, the Copenhagen workshops have thus complemented and extended the analyses that have been on the table in the OECD network. This time, the headline is organisation and decentralisation of public sector labour market-related tasks.

However, the workshops are of course not merely a forum for discussions aiming to complement the OECD network activities. The seminars also constitute an independent series of discussions on local government economy issues with a strong interrelationship with the OECD network activities.

Back in 2007, we first investigated an important aspect of equalisation systems, namely the calculation of expenditure needs. Then in 2009 we turned to designing grants – involving the classical choice between earmarked grants and general grants. In 2011, we moved on to looking into the balance between merit wants and decentralisation, including different kinds of regulation. In 2013, we discussed local taxation in relation to expenditures. Later, in 2015, the autonomy and control of core local expenditure on education, health and social protection was on the agenda. Now, in 2018, we delve into the issue of decentralisation of the public sector tasks related to the labour market.

Taking an overview of the whole series of workshops, the main issues become apparent. It is evident that the revenue side of local governments, especially the system of grants and equalisation, has received a great deal of attention.

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This is natural, considering the importance of a well-functioning revenue system as a prerequisite of a viable local government. However, the need for such a system originates from the idea of decentralisation of expenditures and local autonomy, which is also addressed in the workshops, and in continuation of this the embedded problems of balancing local autonomy and local authority with merit wants and public interests. Another focus of the agenda is local autonomy and central government control of local government expenditures. The investigation concerns separate expenditure areas such as education, health and – not least – social protection and labour market services. Other aspects include a wide range of institutional factors, some of which may be relevant but often also confusing factors when making comparative studies.

Introduction

Editors: Hyun-A Kim⁵, Niels Jørgen Mau Pedersen⁶

Introductory remarks

This book includes papers presented and discussed at the sixth workshop in Copenhagen in September of 2018 (see Opening address above for more on the Copenhagen workshops). These workshops deal with the public sector and matters of decentralisation – often seen from a comparative point of view. In this workshop, the focus has been the labour market and how the public sector handles the tasks assigned to the tiers of the public sector. This especially involves the role of subnational governments.

The workshop took place in the autumn of 2018, and several conditions have changed since then. Most obviously, perhaps, the economic cycle has of course developed in the years since. In some countries the macroeconomic conditions concerning employment and unemployment have been relatively favourable in recent years. We have, however, also seen noticeable shocks to the development of the national economies and labour markets linked to the COVID-19 epidemic, and most recently the war in Ukraine, and the economic prospects may now seem bleak. So, unemployment and the struggle to get a sufficiently high rate of employment may pose problems, as may shortages of labour. Due to a recent OECD paper (OECD, 2021), the labour market recovery from the COVID-19 pandemic has been strong in advanced countries, partly reflecting massive and unprecedented policy support to workers and firms. Labour shortages are now widespread across countries. We also see a relatively high level of inflation linked to increasing prices of energy, food, transportation etc.

Some of the papers are newly written, while others are existing papers that have been updated in light of more recent data. These papers are still largely based on the conditions that existed when the workshop took place in 2018, however. This temporal element should be taken into account by the reader, but it is nevertheless our impression that many of the structural questions

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regarding the public sector and its organisation remain the same –even though some reforms may have taken place since then.

Seven papers originating from the workshop are included in the present book. The study by *Daniele, Dougherty & Lembcke* treats the issues of revenue and spending decentralisation in a globalisation perspective. They investigate effects on output, employment and labour productivity from fiscal policy and multi-level governance, i.e. centralisation and decentralisation, and how greater openness of the national economy influences the outcome. – *Mau Pedersen & Houlberg* investigate the fiscal relationship between the municipalities and the central government in Denmark, highlighting how economic incentives work in a decentralised ALMP context. Several reforms of the financial system imply strengthened incentives, most notably the reform from 2016 aiming at reducing the duration of labour market benefits. Evaluation and econometrics, however, shows a variation in both the sign and size of organisational and economic effects across municipalities and groups of individuals receiving labour market benefits. *Niklasson* analyses the Swedish reforms of labour market policy over 30 years. The reforms mirror the struggle of central control versus local integration of policies and programmes. To understand how the policy develops and to make predictions about the future, various institutional theories are applied. Many organisational issues arise at the regional level, perhaps also arise at the local level but may originate at the national level of government. Furthermore, *Green* studies the development of local strategies for a changing labour market in the UK. With a high degree of institutional and fiscal centralisation, together with some devolution to the constituent nations of the UK, we see a trend of asymmetric decentralisation. Also, the analyses cover the scope of subnational governments' role in economic growth and labour market policy with examples from the West Midlands City Region in England. Again, in a Danish ALMP and so-called flexicurity context, *Kongshøj Madsen* discusses the role of local government in labour market policy and jobcentres. The comprehensive reform of Danish municipalities in 2007 and the changes in subsequent years were central elements. The study analyses the conflicts in both the content and implementation of Danish employment policy. It also contains the relieved pressure on the municipalities through greater freedom via reforms in 2015 and 2020. Several of the studies touch upon the phenomena of what is referred to as asymmetric decentralisation. *Dupré, Chatry & Moisisio* discuss this fiscal federalism issue more generally, including a description of the development in a growing number of OECD countries with differentiated assignment of responsibilities at the same level of government. Formerly, trends towards asymmetric decentralisation were mostly seen at the regional level but now such trends are especially common

in urban areas. Using economic research and policy practice arguments, the evaluation also includes an analysis of how to reap the benefits and minimise the cost of asymmetric decentralisation. Finally, *Mergele & Weber* present evidence from what is referred to as a natural experiment of public employment services, PES, in Germany under decentralisation. The study makes use of the experiences of the second wave of devolution of public employment offices, referred to as 'job centres', to the district level in 41 of German's 402 districts. The study discusses the purposes and potential benefits of decentralisation versus different types of possible cost. The econometric study finds that decentralisation reduces job placement by approximately 10 pct. However, decentralised providers expand the use of job creation schemes, which reduces job seekers' employment prospects but shifts costs to higher levels of government.

Based on the papers, we present below some of the thoughts under four headlines: the content of decentralisation, dimensions of so-called active labour market policy (ALMP), the fiscal and financial aspects of the more or less decentralised tasks and finally some further fiscal federalism topics. Here we only touch on a selection of the content of the papers and refer to the full papers in the chapters below for a more thorough treatment of the issues raised. Especially four national studies are involved – UK, Germany, Sweden and Denmark – but other international experiences are also treated, most obviously in the two chapters written by OECD advisors and experts.

Public sector labour market tasks and the content of decentralisation

First, *Daniele, Dougherty & Lembcke* take a point of view on the value of decentralisation and centralisation. With regard to decentralisation, a distinction is made between revenue on the one hand and spending decentralisation on the other, both of which are represented in the subsequent chapters. Empirically, the study uses a unique panel across regions at the OECD subnational regional level, known as the TL2-level. Corresponding with earlier studies (see Kim & Dougherty, 2018) *Daniele, Dougherty & Lembcke* find a tendency for revenue decentralisation to have a more positive effect on output, employment and labour productivity regional growth than does spending decentralisation. However, globalisation as a powerful development factor of the OECD economies may change the results regarding the effects of decentralisation. The findings demonstrate that greater openness tends to diminish the positive effects of revenue decentralisation on growth and employment. Conversely, openness also tends to soften negative effects of spending decentralisation on employment growth.

Having mentioned the two types of decentralisation above, what is understood by decentralisation in the labour market areas varies widely between the countries. Naturally, this also depends on what tasks are involved.

In the relatively centralised public sector of the UK, cf. the paper by *Green*, many job-relevant public tasks are carried out by or on behalf of national authorities. This includes the tasks related to mediating work opportunities for the long-term unemployed, AMLP and payment of social transfers to individuals. In relation to this, *Green* mentions the responsibility of central government and The Department for Work and Pensions (DWP), under which the Job Centre Plus organisations combine the functions of job broking, referrals to ALMP measures and the administration of the benefits system. In sum, many of the responsibilities are kept at the national, UK government level, if they are not devolved to the constituent nations of England, Scotland, Wales and Northern Ireland. Consequently, the tasks are not decentralised directly to subnational government, i.e. local governments, even though there has been a trend towards asymmetric decentralisation in England (see *Dupré, Chatry & Moisiu* below for more on the concept of symmetric decentralisation). When it comes to policies devoted to economic growth and development of employment opportunities at the local level, *Green* mentions different partnership constructions, most notably Local Enterprise Partnerships (LEPs). LEPs are strategic local partnerships between businesses and local authorities and operate in so-called functional economic areas, i.e. areas that geographically are expected to cover a larger area than most single local authorities.

To take a very different view on decentralisation of the public sector's labour market tasks, we mention the Danish example. *Kongshøj Madsen* describes the development in Denmark via the structural reform of local governments in 2007 with one job centre in each of the 98 local governments/municipalities. This involved going from a two-tier system, with important tasks carried out by the regional labour councils, to a predominantly one-tier system with the main responsibilities carried out by the municipalities, including ALMP, job broking and payments of most social transfers. The role of the local governments, placing emphasis on efficiency of task management, has also been gradually expanded with important financial responsibilities (see further below). The content of decentralisation in the Danish context was comprehensive although initially it went hand in hand with more administration, benchmarking and control from the central government level. The structural reform of local governments involved amalgamation of 271 municipalities into 98 new local governments and a marked increase in the average number of inhabitants per local government, cf. *Kongshøj Madsen*.

However, some of the municipalities are still rather small with less than 40,000 inhabitants and would normally not represent a functional economic area, cf. the concept in UK mentioned above or, analogously the so-called commuting areas where the majority of the locally employed population have their jobs.

In between the UK and the Danish examples of subnational governments with limited or extensive roles in the labour market area, the Swedish case illustrates the ongoing struggle of central control versus local integration of the several “silos” (policy segments) involved in providing services of ALMP, employment services and job broking to the clients. Like in the Danish case, the arguments in favour of decentralisation have been the need to integrate policies and programmes run by public employment services and those run by local governments and others. The risk of overlapping competencies may on the one hand create incentives for clients to shop around and on the other hand for the organisations to blame each other for failure, cf. *Niklasson*. This should be seen against the background of this policy area constituting a rather independent sector of the national government of Sweden, giving priority to promoting mobility across the country and dealing with macroeconomic issues. *Niklasson* describes a situation which may be referred to as a ‘mess of uncoordinated actions’ and loss of efficiency, most visibly at the regional level of government. *Niklasson* points to the different approaches to the tasks, with the national agencies generally being under a tight regime of NPM – New Public Management, while local governments have autonomy to design their own programmes and organisations. Two strategies to make the welfare systems, including job creation, more coordinated are mentioned. Firstly, a bottom-up strategy with civil servants at the local level introducing pragmatic solutions to handle experienced difficulties of inconsistencies and unnecessary competition across the public sector. Secondly, top-down strategies of the central government to encourage collaboration across organisational boundaries, or more directly a top-down reduction of overlaps. A keyword in the Swedish context seems to be collaboration across organisations, but more formal methods of coordination are also seen, primarily at the regional level of government. The regional level was chosen because challenges of job creation were regarded as too great for local government/municipalities and too particular for the national government. *Niklasson* also mentions the experiment of merging counties into larger regions (specifically including only two regions with elected assemblies), enabling them to take over the role of economic development from the national government, i.e. a devolvement of the tasks.

The Swedish asymmetry in the organisation with two regions together with several counties is also a characteristic of the German situation, which can be seen as a natural experiment, cf. *Mergele & Weber*. Germany has carried out a decentralisation reform of public employment services (PES) from the centralised job centres ('gemeinsame Einrichtungen') to the district administrations ('zugelassene kommunale Träger'). The decentralisation was implemented in two waves – first to 67 (out of 402) districts in 2005 and next to 41 other districts in 2012. *Mergele and Weber* examined the 2012 development since this was a more clear cut and isolated task re-arrangement than what happened in 2005. Since the reform involved only a fraction of the districts in Germany, it may have similarities with a controlled experiment ('natural experiment'), in making it possible to identify the total effects of possible gains versus costs of this re-organisation. This is contrary to the Danish example with a full decentralisation to all local governments in the country, though in the Danish case a gradual development also took place, but it was not examined as an experiment (Eskelinen, 2008). *Mergele and Weber* base their analysis on arguments in favour of decentralisation, which include the local governments' autonomy to tailor labour market policies to the local needs. The local governments may be more informed as to local conditions and therefore capable to act in a more satisfying manner than the central government. On the other hand, they see three possible costs of decentralising public employment services, PES, i.e. negative effects on job finding. These potential drawbacks include, first of all, a possible aim to maximise job placement in their own region instead of across regional borders. Secondly, local authorities may strive to shift fiscal costs to other levels of government, and thirdly they may seek to ease welfare recipients' job search obligations. According to the econometric German studies, it turns out that decentralisation reduces job placements by 10 pct. due to an expanded use of public job creation schemes – and hereby shifts costs to higher level of governments since the federal government bears the cost of programme participation.

ALMP and the role of subnational governments

The term Active Labour Market Policy, ALMP, and Public Employment Services, PES, is common to the descriptions of the public sector and subnational government tasks in the area. However, the emphasis varies among the analyses. The different welfare models and approaches to social policy presumably play a role – ranging from the liberal labour market regime with limited regulation and flexibility in the UK, cf. the presentation of the UK policy by

Green – to the attempts to combine a flexible labour market with strong welfare safety nets characteristic for the Nordic countries and in particular known from the Danish so-called “flexicurity” model, cf. *Kongshøj Madsen*.

In the Danish case, the concept of ALMP has also been subdivided with a distinction between passive measures/periods and active measures/periods, i.e. when the individual in ‘passive’ periods was supported mostly by public transfers to live off versus ‘active periods when the individual was activated in special jobs or training, cf. *Mau Pedersen and Houlberg*. Today, the local governments in Denmark are responsible for both the employment services and income transfers to individuals ‘ready for work’, i.e. with close contacts to the labour market and employment, and individuals ‘ready for activation’, i.e. likely in need of additional efforts to get a (permanent) job. The important role of the Danish municipalities is a vital element in the very ambitious but also very costly ALMP system, cf. *Kongshøj Madsen*. Also, the system after the reforms from 2007 and on has by some observers been associated with a risk of giving higher priority to socially-oriented issues with long-term unemployed persons with a concomitant reduced focus on the well-educated unemployed and a broad view on the labour market in general, cf. *Kongshøj Madsen*. Paradoxically, the financial reforms seem to have pulled in the other direction, i.e. in favour of unemployed persons close to employment, cf. the later section on fiscal and financial aspects.

The distinction between hard-to-place job centres and short-term unemployed persons is also relevant in the German case, cf. *Mergele and Weber*, since the job centres decentralised to districts and analysed econometrically serve only the first category. The four most common ALMP categories here are short-term classroom and on-the-job training, medium-term vocational training and re-training, wage subsidies and public job creation schemes. One concern here regarding the effect of subnational governments’ role is the possible risk of the individual districts having an incentive to match job seekers with vacancies in their own district only. This phenomenon has been termed as ‘geographical lock-in’ of job seekers and could create an uncoordinated fiscal externality among districts (Wildasin, 1991). However, *Mergele and Weber* do not find evidence in the data of such a geographical lock-in effect.

In the Swedish case, and dealing with the policy area of job creation, *Niklasson* discusses the organisation of tasks, ranging from welfare payments to programmes, e.g. skills development, run by the public employment service, by the local governments (Komvux) and the regional governments (Folkhögskola). *Niklasson* describes the situation as a classic example of an overcrowded welfare state, where programmes initiated by different levels of

government and operating under different ministries had been placed on top of each other.

A characteristic of the Swedish example is the efforts to coordinate policies and welfare systems, including local job creation. An attempt has been regionalised policies in the sense that regional actors were given a larger role, with the intention that local operations should be further integrated. The regional level was described as an appropriate level of government to handle matters related to economic development (including job creation).

Economic development has not been a prominent objective in the Danish version of ALMP, where tasks are primarily assigned to the often rather small municipalities. In the English situation, however, steering the economic growth in local communities has been an issue and until recently was taken care of by the LEPs mentioned above, i.e. partnerships within functional areas – perhaps synonymous with a regional dimension. As already mentioned, the regional level was described as an appropriate level of government to handle matters related to economic development (including job creation). On the other hand, cf. *Green*, the ALMP in the UK remains rooted in a “work-first” approach, with the speedy exit from unemployment being the core aim of policy. Besides, issues of retention and in-work progression have begun to constitute a greater part of AMLP design.

Fiscal and financial aspects of decentralised employment tasks

The system of financing the subnational tasks of employment policy is a main issue in the Danish case, cf. *Mau Pedersen and Houlberg*. This may be an example of revenue decentralisation, as mentioned by *Daniele, Dougherty & Lembeke*. Financial matters also play a role in the other countries’ arrangements, though this is not highlighted to the same degree.

It seems relevant to point out that the German so-called natural experiment, cf. *Mergele and Weber*, did not include a new financial system but retained the central financial system. In this system, the federal government covers unemployment benefits and expenditures for labour market programmes for job centre clients, while the local administrations finance their accommodation. *Mergele and Weber* do not comment on the general theoretical and hypothetical effects of the decentralisation to 41 districts *if* this move had been accompanied by a decentralisation of finance, e.g. like in Denmark. However, they observe that the financial system may nonetheless have incentive effects since decentralised job centres may have a lower tendency to impose sanctions due to the financing structure of welfare support in Germany.

Hence, decentralised job centres face weaker financial incentives to impose sanctions. However, the empirical studies do not find any indication of a negative decentralisation effect in this respect.

The limited access to own tax revenues and limited room for costly employment and labour market strategies seems pronounced in the UK, cf. the study by *Green*. This means that the finances available are limited. The UK is characterised by fiscal centralisation with local taxes amounting to only a very low fraction of GDP. Consequently, the subnational English governments' expenditures are predominantly reliant on national government for their revenues. In the context of these financial constraints, labour market strategies can be seen as 'nice to have' luxuries.

According to *Green*, the national macro-economic conditions are of foremost importance in resourcing at the sub-national level, irrespective of local economic conditions and needs. Furthermore, local councils' dependency on the central government for their funding means that the former tends to take a back seat in identifying innovative ways of raising funding. The incentive for entrepreneurial action in terms of local financing is absent, and this creates a culture of expectation and blame where local councils rely on national government to act/denounce national government when things go wrong.

In the Swedish study *Niklasson* focuses on the provision of services while ignoring the wider macroeconomic framework, including financial issues. We know from earlier studies (e.g. Skedinger et al., 2006) of the Swedish labour market area and local governments that the municipalities fund social assistance while – at that time – labour market programmes were financed by the central government, which may have incentive effects for the municipalities. We also observe that local taxes are an important financial source for Swedish local governments. This economic condition raises the question – like in the German case – of possible geographical lock-in effects of decentralising ALMP, cf. *Niklasson* and Lundin & Skedinger (2006). Theory suggests why this may be the result of local governments via labour market programmes maintaining local population and the municipal tax base by reducing migration/mobility among the unemployed. However, Lundin & Skedinger (2006) do not detect any geographical lock-in effects in their study.

Finally, the financial and funding dimension of ALMP and social transfers and associated incentives for Danish local governments are the headlines of the chapter by *Mau Pedersen & Houlberg*. The issues of incentives for local governments stemming from the financial model have been on the agenda for

numerous years in Denmark through a number of financial reforms and developments. On the one hand, the reforms have typically involved an enhanced role and increased responsibilities for local governments in employment policy and programmes and awarding of social transfers. On the other hand, the changes have concomitantly involved giving more weight to municipalities' own financial means from local taxes and central government general grants (so-called block grants). Simultaneously, the original reimbursement system (ear-marked grants) has been gradually downgraded and streamlined. As an example, cf. *Kongshøj Madsen*, following the structural reform of local governments in 2007 the municipalities took over the responsibility of paying out unemployment benefits for the unemployed persons with unemployment insurance – besides the existing responsibilities for social assistance, early retirement pensions and sickness benefits. However, as of 2010 the municipalities co-financed half of the unemployment benefits so that they also had a clear financial incentive to get this group back into employment. *Mau Pedersen & Houlberg* stress the associated challenges and difficulties for the organisers of the equalisation system in neutralising or at least mitigating distribution effects of changed incentives stemming from, for instance, reduced reimbursement rates. Also, in the Danish financial system a kind of shield exists for local government in the form of statutory arrangements compensating local governments via the block grant for fluctuations in expected revenues and needs for expenditures, cf. Jensen et al. (2021).

Further fiscal federalism issues with a focus on asymmetric decentralisation

In all the studies presented in the book, the concept *reform* in the public sector is a keyword in the descriptions and analyses of the various developments of labour market policies and the role of subnational governments. It seems that more or less profound reforms are characteristic of this policy area, regularly involving fiscal federalism issues, such as the assignment of competencies to different tiers of the public sector and their internal fiscal relations. Often, the situation may seem rather complicated and complex. In the Swedish study by *Niklasson*, various institutional theories are applied to understand the complexity and to make predictions of future developments. The theories are 'rational choice institutionalism', 'sociological institutionalism' and 'discursive institutionalism'. Each of the three theoretical approaches point to various mechanisms to explain how politics move.

Another angle on the fiscal federalism issues is presented in the chapter by *Dupré, Chatry & Moisiso*. The authors point to what is seen as a common trend in a number of OECD countries, namely a development towards what is termed asymmetric decentralisation. This kind of decentralisation implies

differentiated assignment of responsibilities at the same level of government, e.g. the local government, the regional government or the central government. Historically, the asymmetric decentralisation mostly took place at the regional level and in urban areas. Three types of asymmetric decentralisation are identified, namely political, fiscal and administrative decentralisation. The study includes all OECD countries and finds that asymmetries of decentralisation take place in both unitary and federalist countries, e.g. including an on-going reform in Finland of establishing self-ruling regions at the time of writing (2022).

The study by *Dupré, Chatry & Moisió* does not focus mainly on employment services and labour market policy. Nevertheless, it seems that the concept of asymmetries is highly useful in connection with this policy area, perhaps because of the differences in challenges for, for instance, urban versus rural areas and small versus larger municipalities. In the analysis of *Green*, it is mentioned that alongside some devolution to Scotland, Wales and Northern Ireland there has been a recent trend towards asymmetric decentralisation in England, with the focus of this being so-called ‘deals’ to large city-regions. The asymmetric approach, where the largest cities are being granted the greatest powers, has invited extensive criticism. The relevance of the asymmetric viewpoint also seems obvious in the Swedish case, cf. *Niklasson*, where different models of regionalisation prevail. In connection with the German study by *Mergele & Weber*, one might consider why the decentralisation that has taken place so far does not include all job centres but only a selection of them in two waves, which might have some links to the dimension of asymmetry. Finally, asymmetric decentralisation in the area of labour has also been a characteristic in the Danish case, cf. *Kongshøj Madsen* and *Mau Pedersen & Houlberg*, with some elements of reforms being implemented over a period of years. However, the Danish tradition of a unitary state with the same responsibilities for all local governments has been a priority for a number of years.

In their study, *Dupré, Chatry & Moisió* end with a discussion of opportunities and challenges of asymmetric decentralisation. They point out that asymmetric decentralisation *can* be Pareto improving if asymmetric treatment results in benefits in the favoured subnational governments, without leading to costs for the rest of the society. Several topics are relevant here. To pick one, it may be relevant that an asymmetric arrangement of tasks may diffuse regional tensions, cf. *Dupré, Chatry & Moisió*. Perhaps, this may also translate to equalisation tensions, which has been a serious issue in the Danish case of decentralised ALMP and employment tasks of subnational governments.

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Chapter 1

Productivity, jobs and fiscal decentralization in a global economy⁷

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Abstract

Economic globalisation is a powerful force that can create large economic gains through greater scale and efficiencies but may also expose economies to shocks that result in job losses as well as gains. How governments choose to centralise or decentralise their tax and spending powers can play an important role in the capacity of the public and private sector to weather or even gain from these episodes. This paper explores a panel of OECD regional (TL2) data to better understand the marginal effects of fiscal policy and multi-level governance choices on regional output, employment and labour productivity growth. A quite complex set of interactions are found, with tax revenue decentralisation broadly associated with job gains and higher output growth and spending decentralisation with higher labour productivity growth on average, but a tendency for fewer jobs. Greater openness tends to weaken the positive nexus between revenue decentralisation and output growth by lowering both employment and labour productivity growth, yet it also softens the negative association between spending decentralisation and employment growth, implying that globalisation calls for a relatively balanced approach to intergovernmental fiscal relations.

1.1. Introduction

Economic globalisation can create growth opportunities for regions and countries, but these opportunities are rarely equally distributed. The extent to which trade openness in regions translates into higher economic growth and the creation of jobs depends on individual countries' policies, including the chosen degree of fiscal decentralisation. Even for those regions and countries

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that manage to seize them, the benefits from globalisation are not risk-free and often come with greater exposure to international shocks. While effective social insurance is needed to minimise the risks posed by greater economic integration (Rodrik, 1997), its design and adequate funding can be limited by the pressure exerted by international capital mobility on tax policy. The contrast between different fiscal policy needs triggered by globalisation holds at the subnational level too. On the one hand, the heterogeneous impact of trade-induced shocks might justify a greater devolution of expenditure capacity to regions. On the other, greater domestic mobility of capital can discourage the decentralisation of revenues and matching of appropriate funding at the subnational level (Garrett and Rodden, 2006). Fiscal decentralisation is thus likely to shape the nexus between trade openness and regional growth (Boadway and Dougherty, 2018).

There exist several strands of work linking economic growth, trade integration and fiscal decentralisation. One strand analyses the influence of economic integration on the degree of countries' fiscal decentralisation (Ermini and Santolini, 2014): evidence on this link is mixed, reflecting the existence of both costs and benefits of decentralising in a more trade-integrated economy. Another strand focuses on the impact of aspects of fiscal decentralisation for economic growth and inequality (Bartolini, Stossberg and Blöchliger, 2016; Blöchliger, Bartolini and Stossberg, 2016; Dougherty and Akgun, 2018). A common finding from these studies is that *balanced* decentralisation, whereby countries devolve to regions both expenditure and taxing capacity, provides regions with the incentive for sound economic policies and helps in reducing regional disparities. Lastly, the work presented in this paper/chapter is related to the large strand of literature analysing the impact of trade openness on regional disparities (Autor, Dorn and Hanson, 2013; OECD, 2020; Helpman, 2018).

Despite considerable cross-country analysis, little is known of how fiscal decentralisation shapes regional growth and its possible interaction with regional trade openness. This work leverages data on economic growth and trade openness for a panel of 210 large (TL2) regions and information on the subnational share of government revenues and expenditure across 18 OECD countries to investigate this relationship.

Revenue decentralisation is positively correlated with regional output (gross value added) growth for regions featuring average trade-openness, with employment growth appearing to be the key driver. As trade integration increases, the positive relation between output growth and revenue decentralisation weakens, a pattern driven by the negative and statistically significant

marginal effect on labour productivity growth, more pronounced in regions with a trade deficit (OECD, 2022).

A theory of subnational tax competition triggered by revenue decentralisation can accommodate these facts. Greater tax competition lowers the average tax level, particularly for labour income taxes that are the type of taxes that revenue-decentralised countries increasingly rely upon (Bretschger and Hettich, 2002). Lower average income taxes can spur employment growth. In more trade-open regions, however, the tax competition stemming from revenue decentralisation is at odds with the need for greater social insurance spending for firms and workers that are more exposed to global shocks (Wolfram, 2022). Nonetheless, the positive impact of revenue decentralisation reforms on output and employment growth appears to be primarily driven by regions lagging behind the average level of income (GDP per capita) among regions in the sample at the beginning of the millennium, thus suggesting that these type of reforms can have a positive impact on the reduction of inequalities (Kim and Dougherty, 2018), particularly along the spatial dimension.

The overall effect of expenditure decentralisation is positive regardless of trade integration on labour productivity growth. But as this comes at the expense of employment growth for low trade-integrated regions, there is only a positive effect on output growth for high trade-integrated regions. As low trade-integrated regions often contend with other structural challenges there appears to be the need for a balanced approach. There appear to be benefits of devolution of taxing and spending powers proceeding in parallel, with national fiscal capacity set to guarantee minimum standards in service delivery and compensate for heterogeneous fiscal capacity among subnational governments (OECD, 2019).

Asymmetric decentralisation reforms can play a strategic role in countries characterised by a high degree of heterogeneity in the level of regional trade integration. Asymmetric decentralisation refers to a situation where the political, administrative and fiscal arrangements across jurisdictions (i.e. at the same government level) differ. For asymmetric decentralisation arrangements to be economically and politically viable, the scale and scope of the asymmetries should be clearly defined upfront (OECD, 2019). The results highlighted in this work would seem to suggest that there is room for the implementation of temporary asymmetric decentralisation arrangements in regions that are at the same the target of policies aimed at improving their global economic integration profile.

Finally, the analysis presented in this work underscores the need for more granular data on different revenue and expenditure components of local governments' balance sheet to further refine the connection between economic growth, the degree of regional tax and spending autonomy and regions' internationalisation. A joint OECD-EC project "REGOFI" is expected to soon fill parts of these data gaps by providing unique data on expenditure, revenue, debt transactions and socio-economic indicators for regional governments in OECD and EU countries from 2010 to 2016.

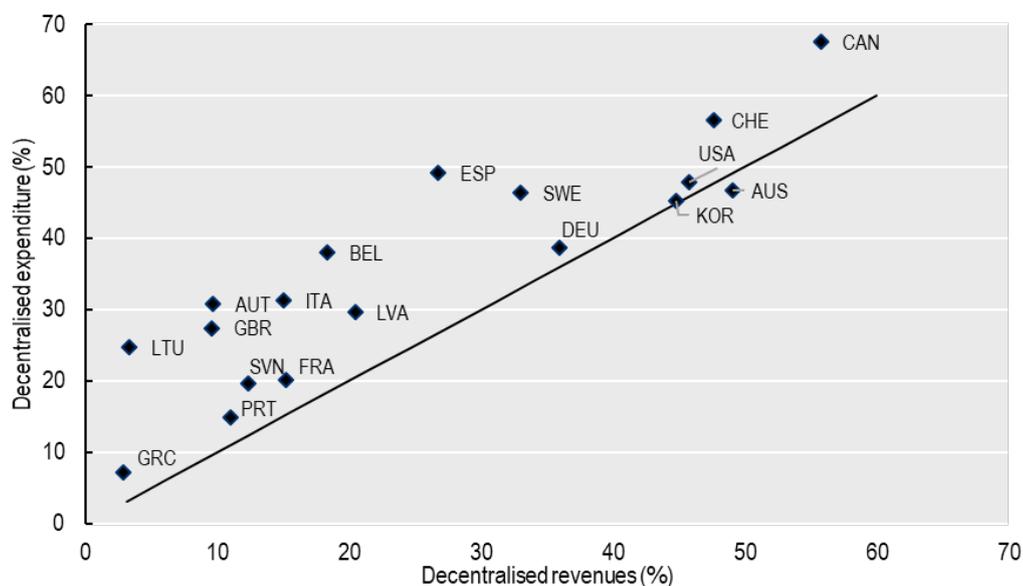
1.2. Are the trade-open also the fiscally decentralised?

Countries can be grouped into two categories depending on their fiscal decentralisation profile (Figure 1.1).¹¹ The first group comprises countries featuring a high degree of fiscal decentralisation, with respect to the share of both decentralised revenues and decentralised expenditure. This group comprises primarily federal countries, with the exception of Korea and Sweden, while the only two federal countries belonging to the second group are Austria and Belgium, which in spite of being federations have started devolving tax autonomy to regions only in recent years (OECD, 2020). The second group features countries with a low degree of decentralisation. Subnational governments collect a larger share of revenues across the broad spectrum of tax categories in federal compared to non-federal countries (Kalinina et al., 2019). Decentralised revenues thus appear overall a suitable indicator to investigate the consequences of heterogeneous evolution of tax autonomy across countries.¹²

¹¹ See the Annex for more details on fiscal decentralisation data used in this analysis.

¹² Nevertheless, the composition of decentralised revenues changes as well together with the overall share of decentralised revenues. For instance, federal countries tend to devolve more to regions/states the power to introduce tax reliefs relatively to non-federal countries. Also, in federal/more revenue-decentralised countries, subnational governments tend to rely more on taxes on property and goods and services taxes compared to less revenue-decentralised countries (Kalinina et al., 2019).

Figure 1.1. Country-level share of decentralised revenues and share of decentralised expenditure



Note: 45 degree line depicted in blue. Fiscal decentralisation indicators refer to the country average during 2014-2019.

Source: OECD Fiscal Decentralisation Database.

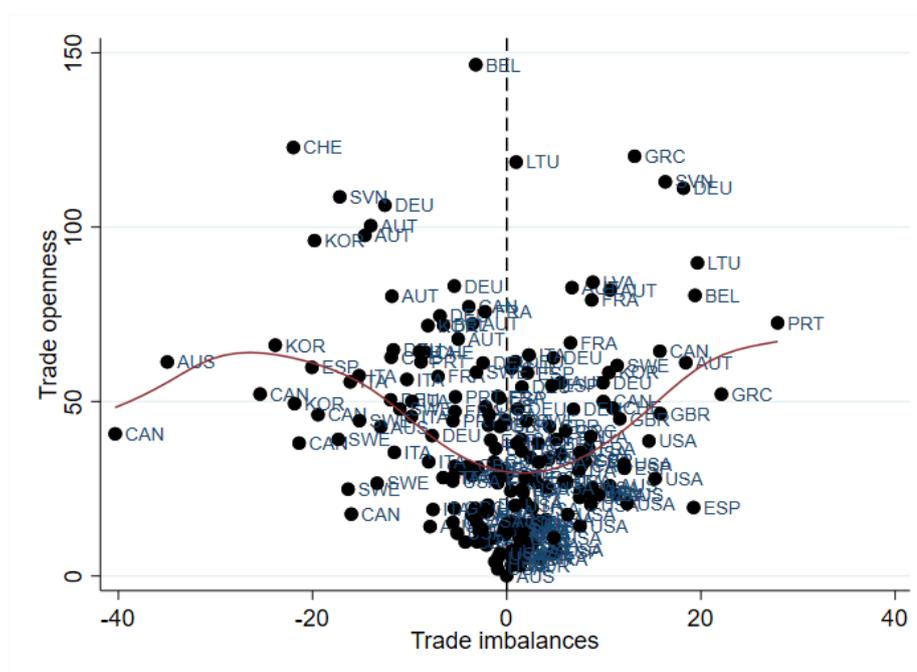
Revenue decentralisation goes hand in hand with expenditure decentralisation, as the correlation depicted in the graph shows. However, greater fiscal decentralisation tends to be associated with smaller vertical imbalances, corresponding to the difference between the share of decentralised expenditure and the share of decentralised revenues. This pattern is visible through the less frequent upwards departures of the share of decentralised expenditure from the blue 45-degree line in the right part of the graph.

Trade openness is measured at the TL2 level, which therefore represents the key geographical unit employed for this analysis, and it is given by the ratio of the sum of imports and exports in goods to regional GDP,¹³ thus excluding trade in services. The median trade openness value is 33, but the overall distribution is quite skewed with three quarters of regions featuring a score above 55, and close to 5 per cent above 100. Import trade imbalances are defined as import minus export over GDP, so that a positive value indicates that a region exhibits a trade deficit, while a negative value implies a trade surplus.

¹³ See the Annex for more details on the regional trade data used for this analysis. Yearly data from 2010 and 2019 are averaged to obtain a single trade openness score per region.

Exports and imports do not rise in tandem, as the positive correlation between trade openness and the absolute magnitude of trade deficits/surpluses shows (Figure 1.2). This entails that in the sample, two groups of regions co-exist: regions with above-median levels of trade openness and rather large trade deficits and regions with above-median levels of trade openness and trade surpluses. Regions in France, Greece, or the United Kingdom are disproportionately represented in the first group, while regions in Germany, Korea, or Portugal tend to select in the second group. The split between regions featuring trade deficits and trade surpluses is roughly equal, with 110 out of 210 regions present in the sample featuring a trade deficit.

Figure 1.2. Regional trade imbalances and trade openness



Note: Trade imbalances are equal to regional imports minus exports divided by GDP. Positive values of trade imbalances indicate a trade deficit; negative values a trade surplus. The red line is estimated via a gaussian kernel with a 5 bandwidth. The values for regional imports and exports are equal to the regional averages registered during the time span available for each individual regions.

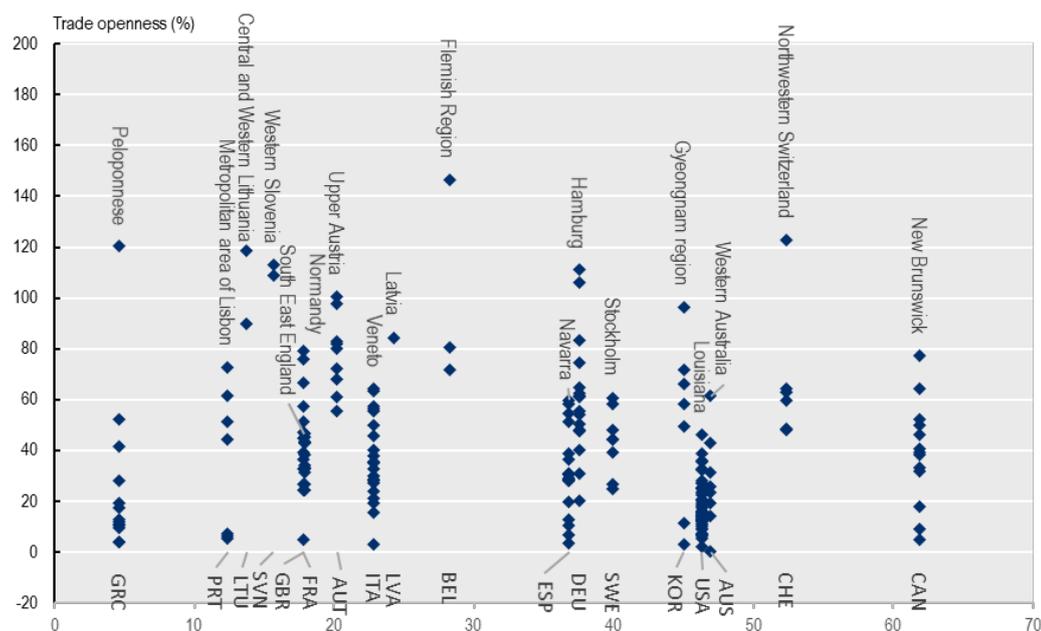
Source: OECD regional customs data, see A B.1 in Annex.

Figures A A.1 to A A.4 display the spatial distribution of trade openness distinguishing by whether the region features a trade deficit (positive trade imbalances) or a trade surplus (negative trade imbalances). More densely populated regions tend to feature greater degrees of trade openness, as the difference between European core-peripheral regions shows. Furthermore, regions where capital cities are located tend to feature more often trade deficits than

trade surpluses. Trade openness tends to be high in regions hosting the main national harbours, especially if the TL2 boundaries are close to those of the corresponding functional urban areas, as it is the case for the Flemish Region, hosting the port of Antwerp (trade surplus), the Metropolitan Area of Lisbon (trade deficit), or the region of Hamburg (trade deficit).

Trade openness is on average lower, although it does not feature necessarily more within-country dispersion, in more decentralised countries. Countries belonging to the first quartile of the fiscal decentralisation distribution are on average almost twice more trade open than countries belonging to the last one. The extent of within-country variation in the degree of trade openness on the other hand does not significantly vary with the fiscal decentralisation profile of countries. Countries such as Switzerland and Portugal are at the opposites in terms of average trade integration and fiscal decentralisation profiles, and yet they share similar levels of within-country dispersion in the degree of trade openness, with the most trade-open region being twice as much trade-open as the country average in both countries (Figure 1.3).

Figure 1.3. Regional trade openness and the degree of fiscal decentralisation



Note: Each column of dots corresponds to regions in a country; countries are positioned in ascending order according to their degree of fiscal decentralisation, where fiscal decentralisation is obtained as the sum between the share of decentralised expenditure and the share of decentralised revenues divided by two. Only the region with the highest value for trade openness per each country is labelled. The two horizontal lines are positioned in line with the average degree of trade openness in the bottom and top of countries in terms of fiscal decentralisation.

Source: OECD Fiscal Decentralisation Database and OECD regional customs data.

1.3. Growth, fiscal decentralisation and trade integration in regions

1.3.1. Empirical strategy

Regional TL2 economic development data are sourced from the OECD Regional Database. The intersection between this database and country-level fiscal decentralisation data and regional-level trade data trade delivers a set of 18 countries: Australia, Austria, Belgium, Canada, Switzerland, Germany, Spain, France, United Kingdom, Greece, Italy, Korea, Lithuania, Latvia, Portugal, Slovenia, Sweden, United States. The final sample consists of a balanced panel comprising 210 regions. All variables employed in the regression analysis are averages computed over 6-year periods $t \in \{2002 - 2007, 2008 - 2013, 2014 - 2019\}$. The joint behaviour of fiscal decentralisation, trade openness and economic growth in regions is analysed by means of a growth regression model (Crescenzi, Luca and Milio, 2016):

$$\Delta Y_{r,t} = \alpha_t + \beta Y_{r,t-1} + \gamma^{TO} TradeOpenness_r + \sum_{X=\{RevDec, SpeDec\}} \gamma^X X_{c,t-1} + \delta^X X_{c,t-1} \times TradeOpenness_r + controls_{r,t-1} + e_{r,t} \quad (\text{Eq. 1})$$

$\Delta Y_{r,t}$ is average economic growth in region r during 6-year period t expressed in terms of either Gross Value Added (GVA), or employment (EMP), or labour productivity (LP), where labour productivity is defined as the ratio between GVA and employment. According to the standard neoclassical model, labour productivity captures both total factor productivity (TFP) and the capital-labour ratio. $Y_{r,t-1}$ is the log of either GVA, employment or labour productivity averaged over the previous 6-year period, and it is added to control for Solow-style convergence. The coefficient $TradeOpenness_r$ is a time-invariant regional indicator of trade openness, while $X_{c,t-1}$ with $X = \{RevDec, SpeDec\}$ is the country-level share of decentralised revenues/expenditures averaged during the previous 6-year period.

Equation 1 further features a vector of region and country-level controls, $controls_{r,t-1}$: public debt over GDP at the country-level; the regional GVA share in the industry sector; the regional share of 25-64 years old employment with tertiary education; the regional employment ratio. The control variables are averaged with respect to the previous 6-year period. Public debt over GDP is included to capture cross-country differences in post-global financial crisis recovery speed. The GVA share in the industry sector controls for differences in structural change across regions impacting regional growth. The share of employment with tertiary education is included to capture differences in human capital. Finally, the employment ratio proxies for differences in terms of

participation to the labour force across regions. For a detailed description of the data sources employed as controls refer to Table A B.2 in Annex.

The association between regional growth and trade openness might depend on whether regions feature a trade deficit. Higher trade openness tends indeed to be associated with greater trade surpluses/deficits (Figure 1.2). The presence of a trade deficit or a trade surplus in a region, while it may be associated with the same trade openness value, is likely to shape the association between trade openness and regional growth. The findings from the literature on the gains from trade are more negative for regions/countries that are more import-dependent and thus subject to import competition (Autor, Dorn and Hanson, 2013). The heterogeneous association between regional growth and trade openness/fiscal decentralisation depending on whether the region is a net importer (i.e., features a trade deficit) is explored by adding a dummy “Trade deficit” taking value 1 if the region features a trade deficit to Equation 1 and interacting it with the fiscal decentralisation variables, regional trade openness and their interaction.

1.3.2. Results

Greater revenue decentralisation is associated with higher GVA growth (Panel A, column 1 of Table 1.1).¹⁴ For average trade openness (trade openness = 38), a 10 percentage point increase in revenue decentralisation, amounting to roughly the difference in revenue decentralisation between Spain and Italy, is associated with 0.27 percentage point higher GVA growth. This elasticity is about a third of average GVA growth in the sample, and higher than the one of 0.1 found in cross-country studies (Blöchliger and Akgun, 2018). The positive correlation between GVA growth and revenue decentralisation also holds holding constant the degree of expenditure decentralisation (panel A, column 2), which, conversely, does not appear to be statistically significantly correlated with regional GVA growth. The finding of a stronger connection between growth and revenue decentralisation compared expenditure is in line with (Blöchliger, Égert and Fredriksen, 2013; Blöchliger and Akgun, 2018).

In terms of the drivers, employment growth rather than labour productivity growth appears to be the relevant driver of the positive association between regional GVA growth and revenue decentralisation. In more revenue-decentralised countries, tax competition between subnational governments can lead to lower average taxation (Blöchliger and Pinero-Campos, 2011), with the result of smaller distortionary impact of taxation and faster factor accumulation. Evidence that in more decentralised countries the sub-central tax mix

¹⁴ A table for the full estimation results can be requested.

shifts from property to income taxes (OECD, 2021) aligns this potential channel with the preponderant role played by employment growth in shaping the positive association between GVA growth and revenue decentralisation. Alternatively, in countries where regions have greater tax autonomy, subnational governments might have an incentive to implement policies seeking to expand their tax base, thus stimulating employment growth. Finally, fiscal decentralisation might spur employment growth through an expansion in subnational public sector employment, coupled with a less than proportional reduction in central public sector employment (Martinez-Vazquez and Yao, 2009).

The positive association between revenue decentralisation and GVA growth gets smaller as trade openness increases (Panel A, column 2 of Table 1.1). The negative correlation between fiscal decentralisation and average trade openness highlighted in Section 2 entails that there are roughly two groups of regions that are best-positioned to benefit from greater revenue decentralisation. The first group comprises regions in countries with limited revenue decentralisation. These countries tend to have, on average, higher trade openness, thus implying that the marginal effect of decentralising a greater share of fiscal revenues is smaller. But, as revenue decentralisation is low, these countries would have more margin to implement deeper decentralisation reforms. The substantial degree of heterogeneity in regional trade openness in some of these countries pins down a subset of regions that would be best positioned to benefit from reforms. The second group comprises regions in countries with greater revenue decentralisation. These countries tend to be, on average, less trade open, thus implying that even if the scope of further fiscal decentralisation reforms is reduced, the marginal effect of such reforms might be larger.

The marginal effect of further revenue decentralisation on GVA growth turns negative for regions with trade openness above the last decile. This group includes some countries that are small or single-region countries where there is less of an incentive to introduce a greater devolution of fiscal policy to subnational governments. Some others are already characterised by a high degree of revenue decentralisation, so that the advantages from further decentralisation are smaller. Finally, in some others there might indeed be leeway for further revenue decentralisation.

To summarise, the marginal effect of revenue decentralisation declines with greater trade integration and it turns negative for the most trade-integrated regions when considering the effects on GVA and labour productivity growth. These two facts together square with a tax-competition based mechanism

combined with the enhanced threat of profit shifting following greater trade integration. The playing field across regions in revenue-decentralised countries is indeed not level: certain regions have greater expenditure needs, due for instance to greater trade exposure and the ensuing need to spend more in social insurance, which reduces the benefits of lower taxation. At the same time, their economic structure is characterised by more globally economically integrated firms, which exposes these regions to capital flight and profit shifting, increasing the benefits of lower taxation. If the first force dominates, the taxation level in trade open regions of revenue-decentralised countries will be higher and capital investment and GVA growth lower.

The nexus between employment growth and revenue decentralisation is positive for both regions with a trade deficit and a trade surplus (panel C, column 3 of Table 1.1 (two additional figures can be requested), while the negative marginal effect of revenue decentralisation on labour productivity growth for most trade-open regions appears to be driven by regions with a trade deficit (panel C, column 3 of Table 1.1). Regions hosting capital cities are disproportionately represented in this group, which can explain – together with the rising global competition for talents and investment across cities – the negative effect of revenue decentralisation on labour productivity growth in the presence of high trade integration.

Table 1.1. Estimation results from Equation 1.
Regional growth on trade openness and fiscal decentralization

	A. Growth in Gross Value Added			B. Growth in employment			C. Growth in labor productivity		
	(1)	(2)	(3)	(1)	(2)	(3)	(1)	(2)	(3)
Share de-centralised expenditure		0.037 (0.122)	-0.081 (0.166)		-0.197* (0.103)	-0.284* (0.151)		0.307*** (0.099)	0.285** (0.127)
Share de-centralised revenues	0.275*** (0.059)	0.270*** (0.097)	0.402*** (0.142)	0.096** (0.046)	0.273*** (0.099)	0.381*** (0.143)	0.246*** (0.056)	0.019 (0.068)	0.031 (0.085)
Trade openness	0.153*** (0.056)	0.042 (0.091)	0.316** (0.138)	0.054 (0.043)	-0.022 (0.054)	0.020 (0.092)	0.128** (0.056)	0.108 (0.089)	0.365*** (0.119)
Share de-centralised expenditure # trade openness		0.074** (0.037)	-0.005 (0.051)		0.061* (0.034)	0.082* (0.042)		0.004 (0.034)	-0.097** (0.041)
Share de-centralised revenues # trade openness	-0.038** (0.019)	- 0.097*** (0.029)	-0.078* (0.041)	-0.000 (0.015)	-0.053 (0.036)	-0.093** (0.036)	-0.047*** (0.017)	-0.046* (0.025)	0.008 (0.029)
D(trade deficit=1)			0.315 (0.547)			0.299 (0.421)			0.268 (0.390)
Trade openness # D(trade deficit=1)			-0.494*** (0.180)			-0.098 (0.136)			-0.471*** (0.143)
Share de-centralised expenditure # D(trade deficit=1)			0.054 (0.219)			0.077 (0.234)			-0.080 (0.163)
Share de-centralised revenues # D(trade deficit=1)			-0.189 (0.176)			-0.169 (0.203)			0.006 (0.126)
Share de-centralised expenditure # trade openness # D(trade deficit=1)			0.150** (0.070)			-0.037 (0.074)			0.196*** (0.059)
Share de-centralised revenues # trade openness # D(trade deficit=1)			-0.039 (0.052)			0.076 (0.067)			-0.110** (0.046)
Observations	395	395	395	395	395	395	395	395	395

R-squared	0.473	0.479	0.499	0.397	0.409	0.420	0.331	0.356	0.392
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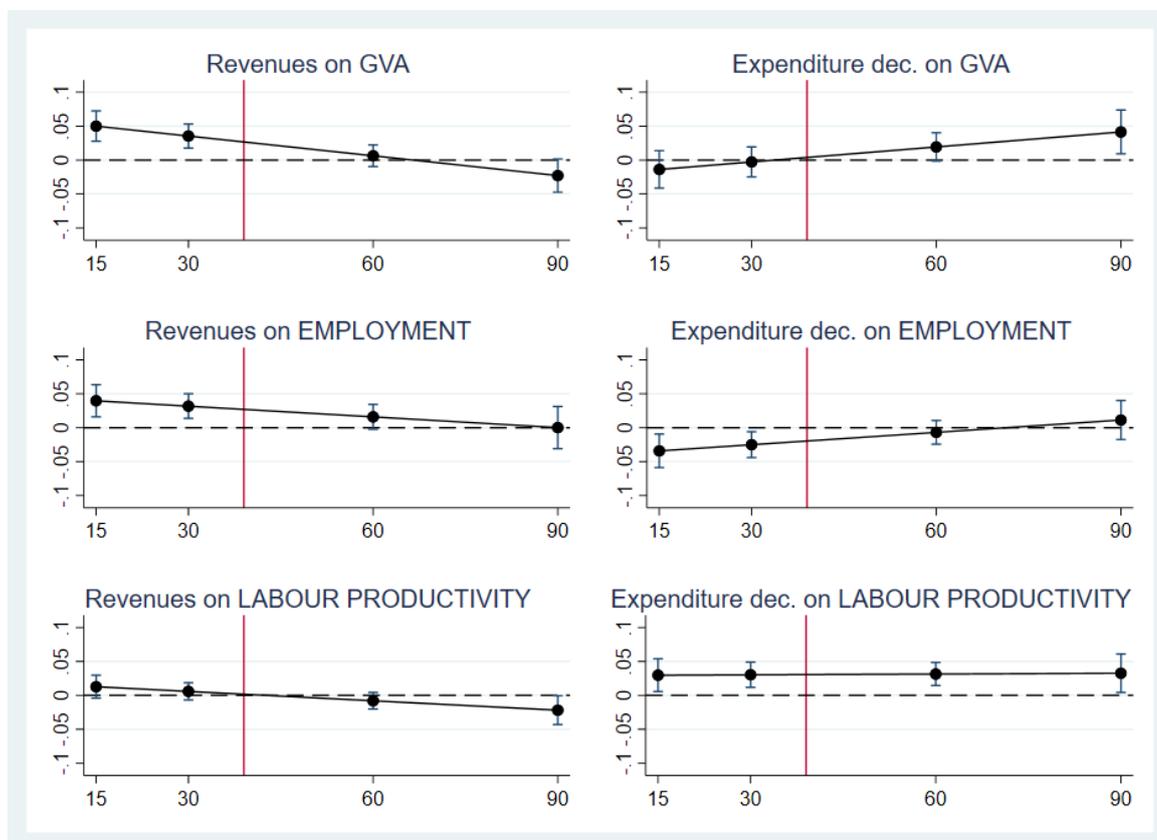
Note Table 1.1: The values for the trade openness and expenditure/revenue decentralisation are divided by 10. Trade openness is demeaned so that the non-interacted coefficient on fiscal decentralisation identifies the marginal effect at the mean value. All the regressors are lagged and refer to the previous 6-year period. Significance levels > *** p<0.01, ** p<0.05, * p<0.1. Robust standard errors in parentheses.

For expenditure decentralisation, a negative and statistically significant correlation with employment growth is found for low levels of trade integration, which weighs negatively also on output growth (Figure 1.). Expenditure decentralisation is higher than revenue decentralisation for most OECD countries, a situation denoted as “vertical imbalance” that stems from the attribution of resources that are not commensurate to subnational governments spending powers. Vertical imbalances can distort economic incentives as subnational governments have the opportunity to spend resources that they are not directly collecting (OECD, 2021). This can provide an explanation for the negative effect of expenditure decentralisation on employment growth among less trade-open regions featuring a trade surplus (panel C, column 3 of Table 1.1). The negative effect is however not passed onto output, as an increase in labour productivity counteracts the negative correlation with employment growth.

In regions with a trade deficit the impact of expenditure decentralisation on labour productivity (and also output) growth is positive for high values of trade openness (panel C, column 3 of Table 1.1) the exact opposite pattern for regions with a trade surplus. Regions with high trade-openness and a trade deficit are often those with large cities and particularly regions with capital cities. These regions tend to have high administrative capacity and often also potential to raise productivity by reducing congestion cost of agglomeration or by attracting more productive workers (OECD, 2015).

The resulting overall effect of expenditure decentralisation is thus negative on employment growth for low trade-integrated regions, positive on output growth for high trade-integrated regions, and positive regardless of trade integration on labour productivity growth. The overall positive impact on labour productivity growth does, however, depend on whether regions are running a trade surplus or a trade deficit. For regions with a trade deficit, trade openness is only positively associated with productivity growth for high levels of trade openness. Conversely in regions with a trade surplus productivity is higher for regions with low levels of trade openness.

Figure 1.4. Marginal effects of fiscal decentralisation on economic growth in TL2 regions



Note: Marginal effects of one percentage point increase in revenues or expenditure decentralisation depending on the degree of regional trade openness are estimated based on panel A/B/C column 2 model in Table 1.1. The red line indicates the average trade openness value across all regions. 90% confidence intervals are displayed.

When dropping port regions from the sample, the analysis stays qualitatively the same. However, due to reduced power in the sample, the coefficient on the interaction between revenue decentralisation and trade openness on labour productivity loses significance (an additional table can be requested).

The lack of statistical association between within-country heterogeneity in trade openness and the degree of fiscal decentralisation seen in Section 2 rules against a potentially negative impact of fiscal decentralisation on spatial disparities through the channel of heterogeneous trade openness. Yet, the connection between regional growth, trade openness and revenue decentralisation could itself depend on whether a given region is economically more or less developed. In order to estimate the heterogeneous impact of fiscal decentralisation depending on their economic development, a dummy taking value 1 if the region was lagging behind the average cross-regional level of GDP per

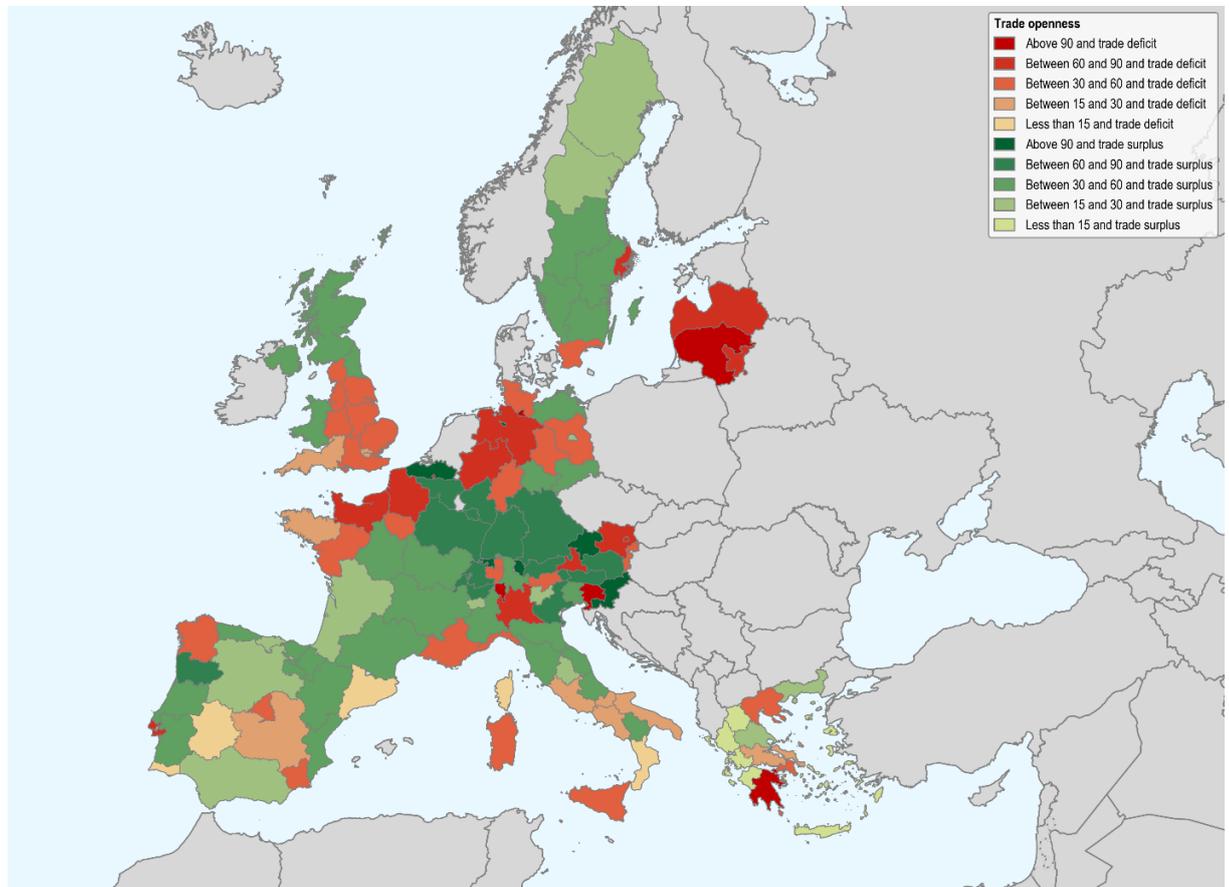
capita¹⁵ among regions in the sample is added to eq.1 and interacted with the fiscal decentralisation variables, regional trade openness and their interaction. Evidence from this interacted model shows that regions with initially lower levels of per capita GDP are in the best position to benefit from revenue decentralisation reforms. In these regions, the positive effect of revenue decentralisation reforms on employment and output growth declines with trade integration without ever turning negative and statistically significant, contrarily to the overall sample (two additional figures can be requested).

1.4. Conclusion

Fiscal decentralisation reforms shape the economic trajectory of both countries and regions. This paper highlights the degree of regional trade integration as factor that affects the impact fiscal decentralisation has on economic outcomes. The findings presented in this paper show that tax revenue decentralisation tends to be associated with job gains and higher output growth at the margin, while spending decentralisation tends to be associated with fewer jobs and higher labour productivity growth. Greater openness appears to diminish the positive effect of revenue decentralisation on output growth by lowering both employment and labour productivity growth, yet it also tends to soften the negative effect of spending decentralisation on employment growth.

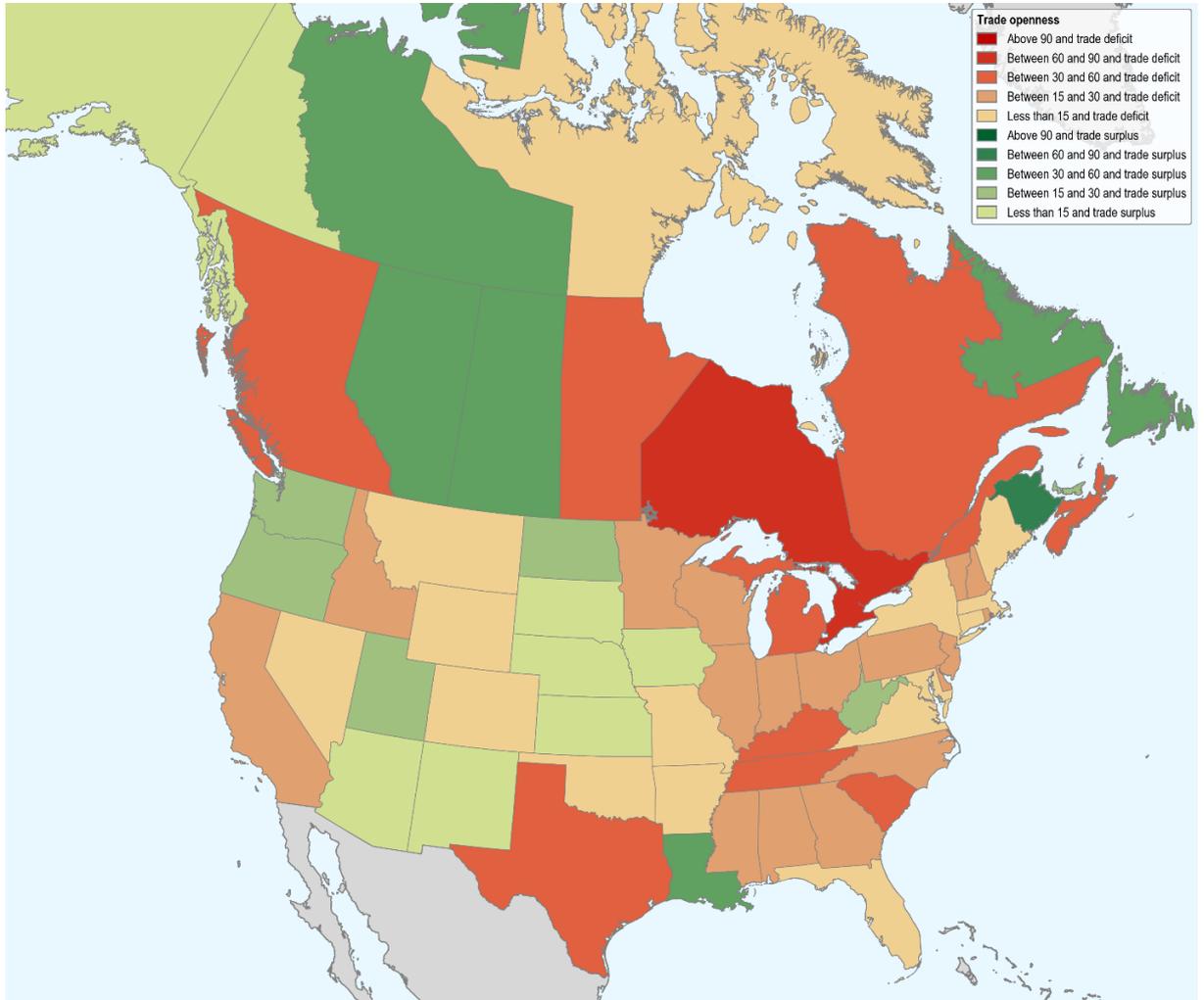
These findings resonate with the guiding principles contained in *Making Decentralisation Work: A Handbook for Policy-Makers* (OECD, 2019) as well as *Fiscal Federalism 2022* (OECD, 2021). A balanced approach to intergovernmental fiscal relations supporting the parallel devolution of taxing and spending powers is needed to minimise the risks in terms of output growth loss associated with decentralisation reforms. The setting of minimum standards guaranteed by national fiscal capacity can help prevent the opening of too large gaps in service delivery due to heterogeneous fiscal capacity across regions. Further, the implementation of temporary asymmetric decentralisation arrangements might be appropriate in regions targeted by policies seeking to strengthen their international trade relationships, with a clear definition of the content and duration of such arrangements ensuring political viability and that benefits are maximised.

¹⁵ The average is a double average calculated across regions as well as across time, i.e. it refers to average GDP per capita for the period 2002-07.

Annex A. Additional figures**Figure A A.1. Trade openness and trade imbalances in European TL2 regions**

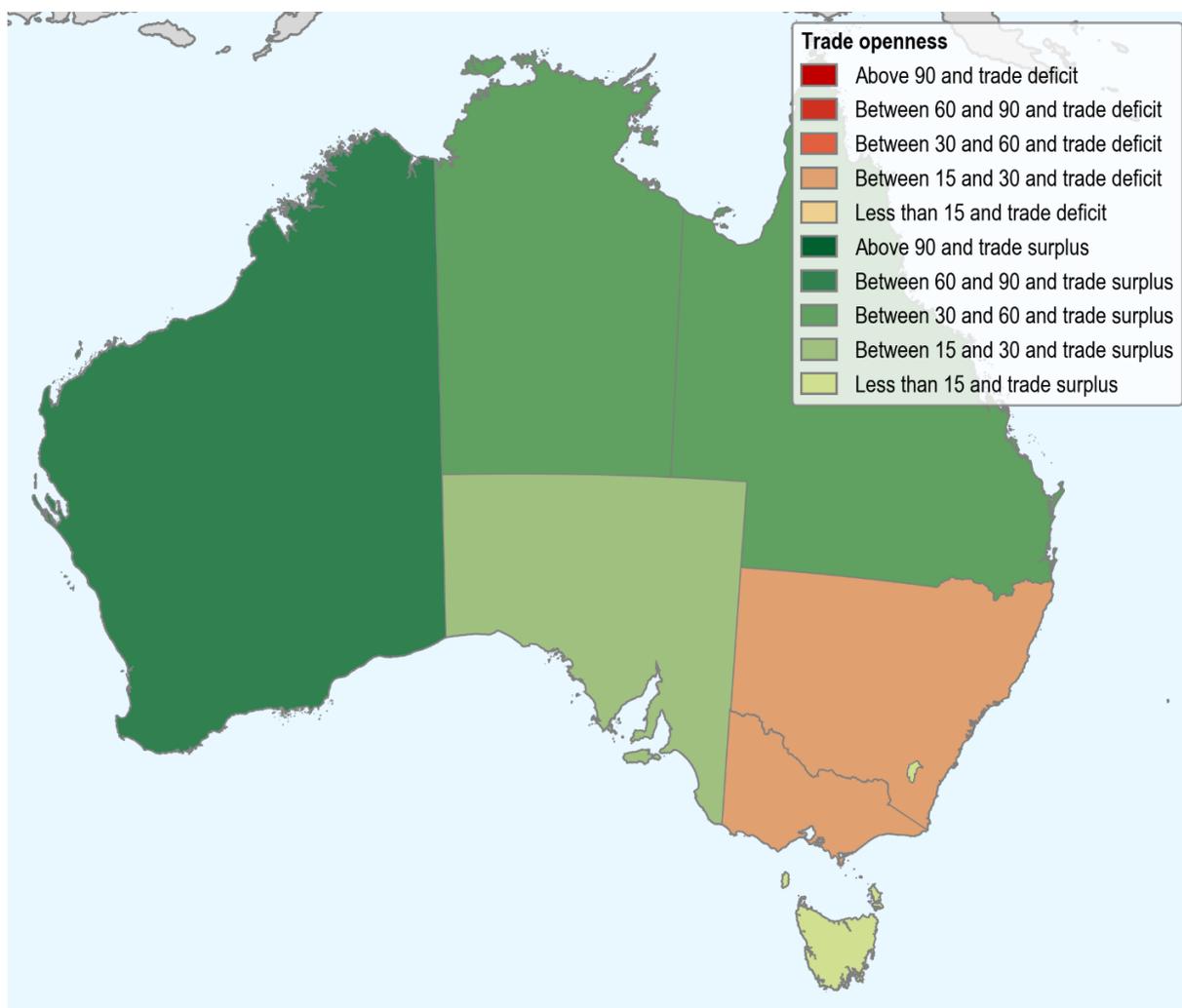
Source: Subnational trade data collected by the OECD based on national sources, An additional table can be requested for more details.

Figure A A.2. Trade openness and trade imbalances in North American TL2 regions



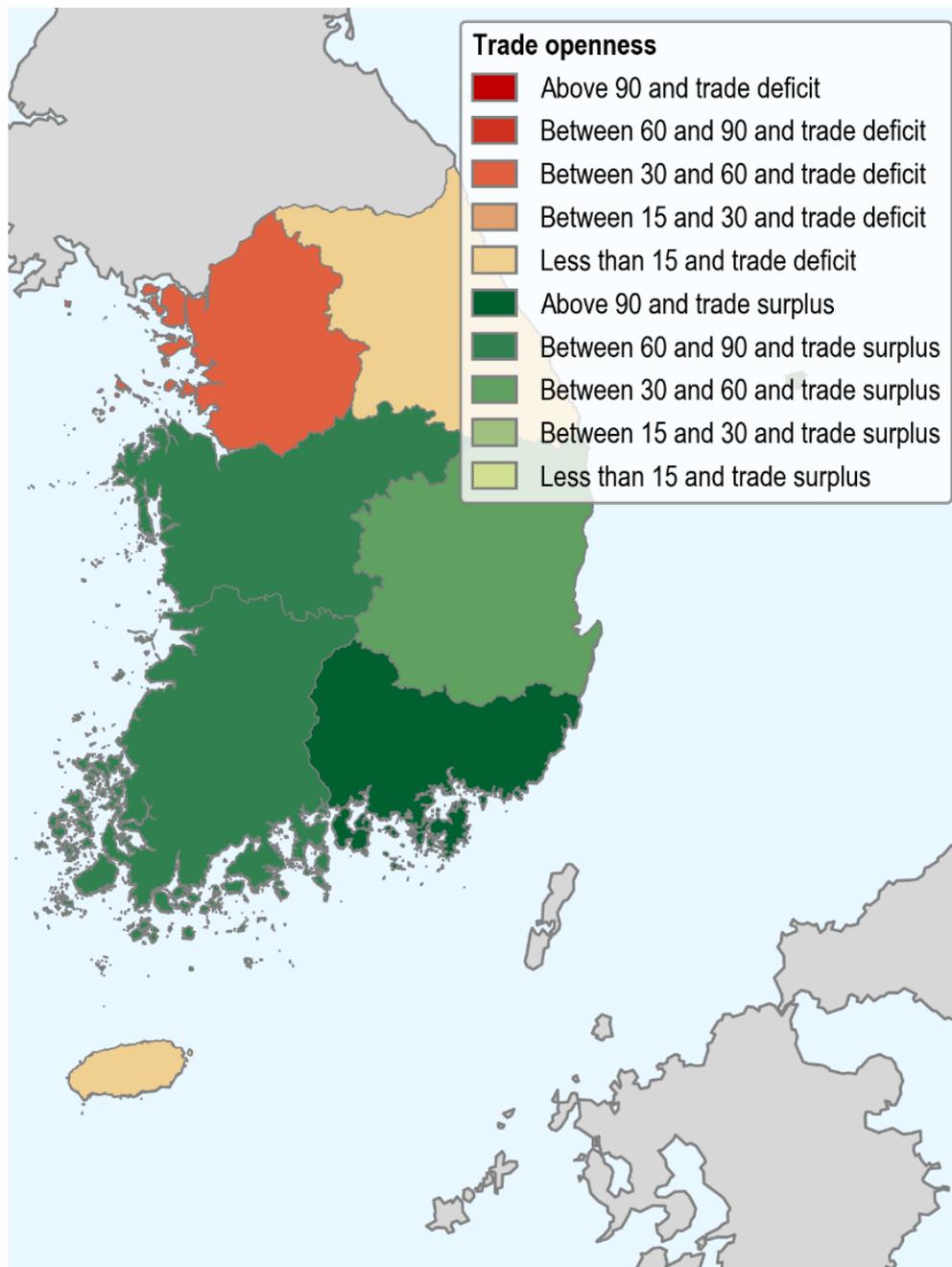
Source: Subnational trade data collected by the OECD based on national sources, An additional table can be requested for more details.

Figure A A.3. Trade openness and trade imbalances in Australian TL2 regions



Source: Subnational trade data collected by the OECD based on national sources, An additional table can be requested for more details.

Figure A A.4. Trade openness and trade imbalances in Korean TL2 regions



Source: Subnational trade data collected by the OECD based on national sources, An additional table can be requested for more details.

Annex B. Data sources**B.1. Subnational trade data**

Data on imports and exports of goods by region is collected from dedicated national websites of selected countries. Table A B.1 accounts for the corresponding national sources. The sample consists of an unbalanced region/year panel covering 18 countries from 2010 to 2020. The data contain the value for exports and imports expressed in current national currency units. Trade openness is obtained as $(M+X)/GDP$ while trade imbalances are defined as $(M-X)/GDP$. Given the interest in identifying the cross-sectional ranking between regions in terms of trade integration more than the variation over time, these two variables are averaged at the region level. We drop French Overseas Territories and the Swiss region of Ticino as they are outliers in terms of their trade openness.

Table A B.1. Overview of subnational trade data sources

Country	Source	Territorial level
Australia	Australian Bureau of Statistics, 5368.0 - International Trade in Goods and Services. Table 15a. Merchandise exports, State and Australia, FOB Value and Table 15b. Merchandise imports, State and Australia, Customs Value	2
Austria ¹	Statistics Austria compiles on behalf of the Austrian Chamber of Commerce (WKO) and the nine Austrian federal states regionalised foreign trade data by federal states	2
Belgium	Statistics Belgium, Dataset=EXTTRADEBENAT	
Canada	Statistics Canada. CANSIM database. Table 228-0060 Merchandise imports and domestic exports	2
France	Douanes. Statistiques départementales et régionales du commerce extérieur pour l'exportation de marchandises	2, 3
Germany	Spatial Monitoring System of the BBSR	2
Greece	Hellenic Statistical Authority. External Trade Survey	2
Italy	ISTAT, Inrastat System	2, 3
Korea	Statistics Korea	2
Latvia ²	The External trade database and the Business register information of the Central Statistical Bureau	2, 3
Lithuania ³	Statistics Lithuania, Lithuanian Customs: extra-EU trade Customs declarations, intra-EU trade (since 2004) Intrastat survey; Statistics Lithuania: Statistical Business Register	2
Portugal ⁴	Statistics Portugal, Statistics on external trade of goods.	2, 3
Slovenia	SURS	2
Spain	Agencia Tributaria, Ministerio de Hacienda y Función Pública	2, 3
Sweden	Statistics Sweden	2, 3
Switzerland ⁵	Swiss Federal Customs Administration FCA	2
United Kingdom	HM Revenue and Customs: Trade Statistics, UK Regional Trade in Goods Statistics	2
United States	U.S. Census Bureau: Economic Indicators Division USA Trade Online. U.S. Import and Export Merchandise trade statistics	2

Notes: 1. Austria: Austrian federal states regionalised foreign trade data by federal states. To calculate statistically reliable regional foreign trade data in compliance with the principles of the national official statistical institution, individual records are matched and reassigned by resorting to already existing data sources.

2. Latvia: Unspecified data have been adjusted for non-response as well as trade below threshold related to the trade between the member states. Other unspecified information includes trade figures about the enterprises that are not registered in the business register (foreign enterprises) but which were carried out the trade in goods activities in Latvia.

3. Lithuania: Trade data are compiled according to the Special Trade System. Data by regions were compiled by linking International Trade in Goods Statistics (ITGS) and Statistical Register of Economic Entities (Statistical Business Register) data. Intrastat adjustments for non-response and trade below exemption thresholds are not included. Data are based on the information of only successfully linked enterprises.

4. Portugal: The value for Portugal may not match the sum of the regions since head offices of some economic operators are not identified or are located abroad.

5. Switzerland: Data include gold, silver in bars and coins, electricity, returned goods and outward processing. Data omits two regions considered by FCA (the Principality of Liechtenstein and *canton* not specified); therefore, the sum of CH01-CH07 does not correspond to the official Swiss foreign trade at total level, www.swiss-impex.admin.ch.

B.2. Fiscal decentralisation indicators

The data on fiscal decentralisation come from the OECD Fiscal Network's Decentralisation database. This is an unbalanced panel covering 40 countries ranging from 1965 until 2020 and containing information on consolidated central, state and local expenditure/revenues. The main variables of interest are expenditure and revenue decentralisation, both measured as the fraction of consolidated subnational (state and local governments) expenditure (revenue) over total expenditure (revenue). The consolidated expenditure of each level of government is defined as total spending minus the inter-governmental transfer spending of that government level. The consolidated revenue of each level of government is defined as total revenue minus the intergovernmental transfer revenue of that government level.

B.3. Other data sources

Table A B.2. Data sources employment for control variables

	Data source	National/subnational level
Public debt (% GDP)	OECD National Accounts at a Glance	National
Industry (NACE B-E) GVA (% total GVA)	OECD Regional Economy Database	Subnational (TL2)
Employment 25-64 years old with tertiary education (% total employment)	OECD Regional Education Database	Subnational (TL2)
Employment 15-64 years old (% population)	OECD Regional Labour Database	Subnational (TL2)

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Chapter 2

Effects of strengthened economic incentives in a decentralized ALMP context - the 2016 reform in Denmark

Niels Jørgen Mau Pedersen and Kurt Houlberg¹⁶

Abstract

How the fiscal and administrative relationship between the central and subnational governments should be organised is a core question in the area of labour market policy in all countries characterised by fiscal federalism. Not least whether changes in these relationships and/or increased use of economic incentives are suitable ways to handle the challenges of labour markets in an era of globalisation of markets, an ageing population and new requirements for labour market skills. Denmark is among the most decentralised countries in the world, and over the last decades labour market policies have been increasingly decentralised and incentivised. The Danish government implemented a major reform in 2016 in order to increase the focus of labour market policies more on results and effects and less on processes and activities. A core element in the reform was to increase the economic incentives for municipalities to prevent long-term unemployment and reduce the length of labour market benefits. This chapter evaluates and discusses the organisational and economic effects of the reform. The evaluation shows that the reform has had both organisational and economic consequences, but also that these vary across municipalities and types of beneficiaries and that the incentives of the reform may overlap at certain points with other incentives and aims in central-local relations. Overall, the reform reduced the time it took for recipients of unemployment benefits and the recipients of social assistance closest to employment to become self-supporting, while the results were neutral or even negative for the recipients of social assistance who were farther away from employment and long-term recipients of sickness benefits.

2.1. Introduction and purpose

How the fiscal and administrative relationship between the central and subnational governments should be organised is a core question for all countries characterised by fiscal federalism (Rodden 2002; Rodden 2014). This includes the organisation of the fiscal and administrative relationship in the area of labour market policy. Labour market-oriented benefits

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– as part of social benefits – may, or may not, be seen as suitable for fiscal decentralisation (Pedersen and Frandsen 2017). On the one hand, we usually assign social benefits to the redistribution branch of the public sector, emphasising the national legal rights to receive benefits in certain well-defined situations and taking into account the mobility of recipients between local governments. On the other hand, social benefits may be seen as being closely connected with other social expenditures, e.g. on job creation, rehabilitation, continuing education/re-training, social services etc., where local governments traditionally have a more important role, stressing factors such as cost-minimisation and effectiveness, and taking into account local preferences and conditions.

For many years, Denmark has been among the most decentralised countries in the world, and over the past decades labour market policies have been increasingly decentralised and incentivised. In 2016, the government implemented a major financial reform, the subject of interest here, aiming at making local governments' labour market policies more result-oriented through an increase in the economic incentives for municipalities to prevent long-term unemployment and reduce the length of labour market benefits periods. The reform of 2016 sought to accomplish this goal in more than one way. Firstly, the reform markedly reduced the average rate of reimbursement, i.e. the central government percentage share of the outlays for labour-oriented income transfers paid out by the municipalities. Secondly, the reform gradually changed the profile of the reimbursement rates from being mainly fixed rates to being gradually decreasing rates, the longer the period of public support of an individual. Thirdly, from 2016 the rate of reimbursement does not depend on the exact income transfer scheme (e.g. early retirement benefits, unemployment benefits, cash benefits etc.).

The purpose of this chapter is to evaluate and discuss the organisational and economic effects of the 2016 reform. We base the chapter on the investigations and evaluations in Pedersen et al. (2019) and focus mainly on the role of the increased economic incentives for municipalities to reduce the length of labour market benefit periods.

In Section 2.2, we provide an overview of the Danish context of municipalities' active labour market policy (ALMP) and the background of the 2016 reform.

In Section 2.3, we present some theoretical perspectives on economic incentives in the financial system of local governments, in particular local governments' ALMP, and discuss potential dilemmas and challenges in the implementation of financial incentives for municipalities.

Section 2.4 presents the aims and contents of the 2016 reform in more detail, and Section 2.5 describes the methods and data used in the evaluation.

Sections 2.6 and 2.7 present the results of the analysis of the organisational and economic effects of the reform, respectively.

2.2. The Danish context and local labour market policies prior to the 2016 reform

Denmark is among the most decentralised countries in the world, both when it comes to fiscal decentralisation (Ivanyna and Shah, 2014; Rodden, 2014; Thiessen 2003) and local autonomy (Ladner, Keuffer & Baldersheim, 2016). Denmark deviates from most other countries in having a public sector with a large share of social benefit expenditures allocated to subnational governments. The three tiers of government today include two levels of subnational governments besides the state level: regions and municipalities. In 2007, a major structural reform was implemented. The main components of the reform were amalgamations and a reshuffling of functions among the three tiers. First, 14 counties were merged into five regions, and 271 municipalities were merged into 98 municipalities (more specifically, 239 municipalities were merged into 66 municipalities, while 32 municipalities were left untouched). The merges increased the average population size from approximately 20,000 to approximately 55,000 inhabitants, and Danish municipalities are now relatively large in comparative terms. Second, central government took over certain tasks from the counties while the municipalities took over other formerly county tasks. Today the regions are primarily responsible for hospitals, whereas the municipalities are multipurpose entities responsible for a wide set of functions, including public schools, day care, elderly care, services for handicapped, drug abusers, vulnerable children and families, and ALMP. The 2007 reform in itself did not change the functional responsibilities for ALMP, but 2½ years later the central government transferred the responsibility for insured unemployed persons from the central government to the municipalities. Accordingly, from August 2009 the municipalities have been responsible for all groups of beneficiaries in Danish ALMP – within the framework of national legislation and regulations laid out by the central government.

For each type of ALMP and each group of beneficiaries, local autonomy and discretion may be regulated by a number of dimensions of decentralisation, including decisions on the level of expenditures, who is entitled to receive benefits, the size of payments for entitled beneficiaries and how the net expenditures are financed (Pedersen & Frandsen 2017).

Important elements of the finance dimension are the basis of and the level of central government reimbursement of locally incurred expenditures. Over the past four decades, a number of reforms have reformed the reimbursement scheme, often including a reduction in the reimbursement rates. During the 90s, the municipalities undertook a larger share of the direct financing of early retirement pensions and sickness benefits (Pedersen & Frandsen 2017). The gradual development towards reduced reimbursement paralleled a general ambition in the relationship between the central and the local government sectors to move away from detailed rules and towards economic management and economic incentives.

Table 2.1 illustrates the development in reimbursement rates for labour market-oriented social benefit expenditures from 1985 to 2011.

Table 2.1. Reimbursement rates (pct.) for municipal expenditures for ALMP benefits (income transfers), by scheme, 1985-2011

	1985	1992	1997	1999	2001	2006	2011
Early retirement pension	100	50 ¹	50	35	35	35	35
Sickness benefits	75	100/50	100/50	100/50/0	100/50/0	100/50/0	100/50/30/0
Unemployment benefits	-	-	-	-	-	-	100/50/30
Social assistance	50	50	50	50	50	65/35	50/30

Source: Pedersen & Frandsen 2017, Tables 6-8.

Note: For sickness benefits, the rates are lowered in relation to the length of the period an individual can receive benefits. The table shows the different rates. Rates also vary according to “active” or “passive” measures, i.e. for unemployment benefits in 2011 and for social assistance in 2006 and 2011. ¹ For persons < 60 years of age.

Active measures vs. passive benefits

We see the reform in 2016 as a continuation of a long-standing ambition to reduce central governments’ reimbursements and increase the economic incentives at the local level. We return to the 2016 reform in Section 2.4. Before that, in Section 2.3, we discuss some theoretical perspectives on changes in economic incentives related to local governments’ ALMP.

2.3. Economic incentives and local governments’ ALMP - theoretical perspectives

In this section, we discuss some of the theoretical perspectives of the subject: how do strengthened economic incentives influence local governments’ behaviour?

The starting point is the central government's perspective. We assume that the central government has some targets for the effect of certain public sector activities that the local governments are responsible for carrying out. The local governments – the municipalities – also have some targets for their activities, but they do not necessarily coincide with what the central government is aiming at, which is a typical problem in a principal-agent relationship. This relationship implies that the local governments have the power to decide – at least partly – the volume and the content of the activity. The central government, on the other hand, has the power to influence the economic incentives, i.e. change the net price (unit cost) of the activity seen from the local government's perspective – making it cheaper or more expensive.

The instrument of the central government to do this is the design of the central-local financial system, including the fiscal transfers to the local government. More precisely, the central government can change the design of transfers from general grants to matching grants (and vice versa) and/or change the exact profile of the matching grant scheme.

General grants in this context are payments from the state to the municipalities that do not depend on the activity or use of the means from the municipalities, i.e. a lump sum of payments distributed according to objective factors, whereas matching grants are conditional grants calculated as a certain percentage of the relevant local government outlays. Such matching grants may also be called reimbursements, which is the term normally used in Denmark.

In the following, we concentrate on the theoretical perspectives, but shortly we will relate to the more specific labour market conditions and distribution of tasks among the levels of government in a Danish context.

2.3.1. The economic self-interest of municipalities – a simple model

All local governments experience a budgetary constraint, which restricts local activities. Therefore, it is likely that municipalities have a self-interest in expanding their economic constraints as far as possible so that they can offer the citizens a satisfactorily high service level at the lowest costs, e.g. measured by the local tax level. In the literature on fiscal federalism, this is termed the *fiscal interest approach* (Weingast, 2009, p. 12).

Recognising this, it is tempting for the central government to assume that they can influence local government behaviour by regulating and shaping the financial system. In the rest of this section, we discuss an approach to getting an idea of the more precise results from such an attempt.

The microeconomic model of individuals' consumer reaction to price-changes between two goods is also a useful starting point for illustrating how economic incentives from the grant system influence municipalities. The budget constraint facing local governments on the one hand and the preferences of the local governments on the other hand are mirrored in indifference curves showing different compositions of the two goods producing a certain level of local government utility. The price changes for the local governments then come about by changes in the grant system established by the central government.¹⁷

We assume that the municipality has the will and the power to choose the quantity of the local public good in question, G , and all other goods and services, X . Here G is the public good where the central government has special priorities.

G may be local government's employment efforts, with effects measured by the success of moving people from living on public labour market transfers into a situation where they become economically self-supporting individuals.

Figure 5.1, the price of one unit of G seen in relation to the price of one unit of X determines the slope of the budget constraint. The indifference curves of the local government show the locus of X/G combinations, which produce a certain level of local welfare, seen from the point of view of the local authority.

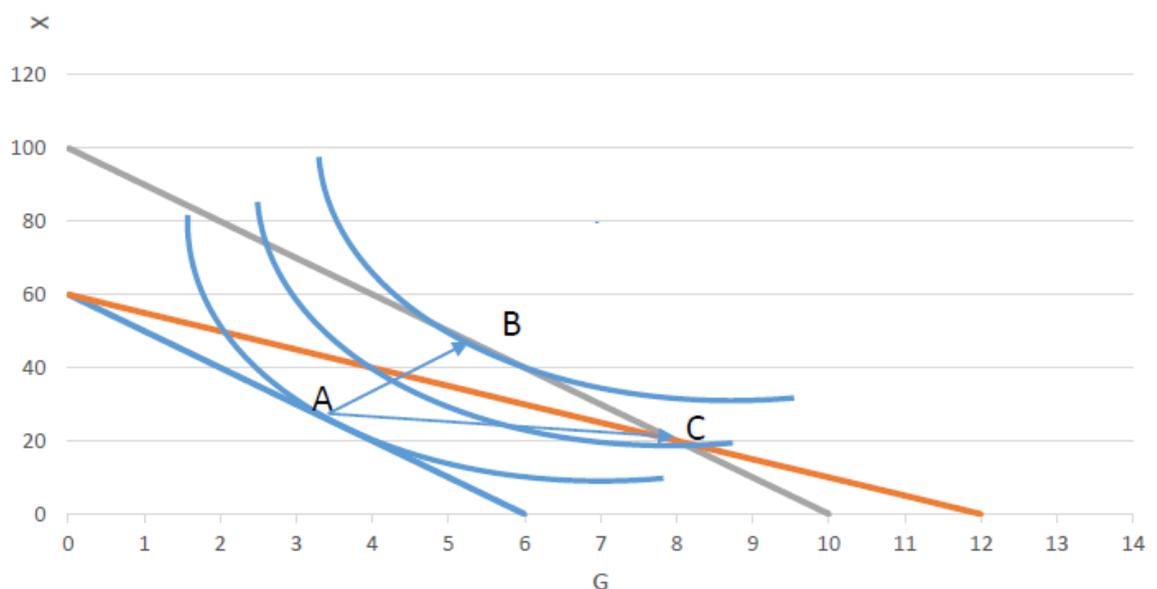
The municipal authority initially chooses the X/G combination in point A. This produces the highest possible level of local welfare within the budget constraint. If the municipality then receives a general grant from the central government of a certain amount, the budget constraint moves up and to the right in a shift parallel to the original constraint. The municipality chooses the X/G combination at B, thus demonstrating a positive income effect from the grant for both X and of G .

Introducing matching grants instead of the general grants at this point, the budget constraint again moves outwards, but the slope of the budget constraint also diminishes (in absolute terms). This illustrates that local governments obtain matching grants only by increasing the consumption of G . In other words, locally G becomes cheaper in comparison to X , and the point C represents the new equilibrium. We assume that the total transfers from the central government are the same in both situations.

¹⁷ See Boadway *et al.* (2007), King (1984), Wilde (1968).

The level of local satisfaction/welfare seems to shrink when moving from B to C since the indifference curve is now at a lower level, seen exclusively from the point of view local government. The central government obviously has other preferences and valuations of public welfare, which here overrule the local government's assessment of the citizens' well-being.

Figure 2.1 Local government behaviour with extra general grants versus matching grants



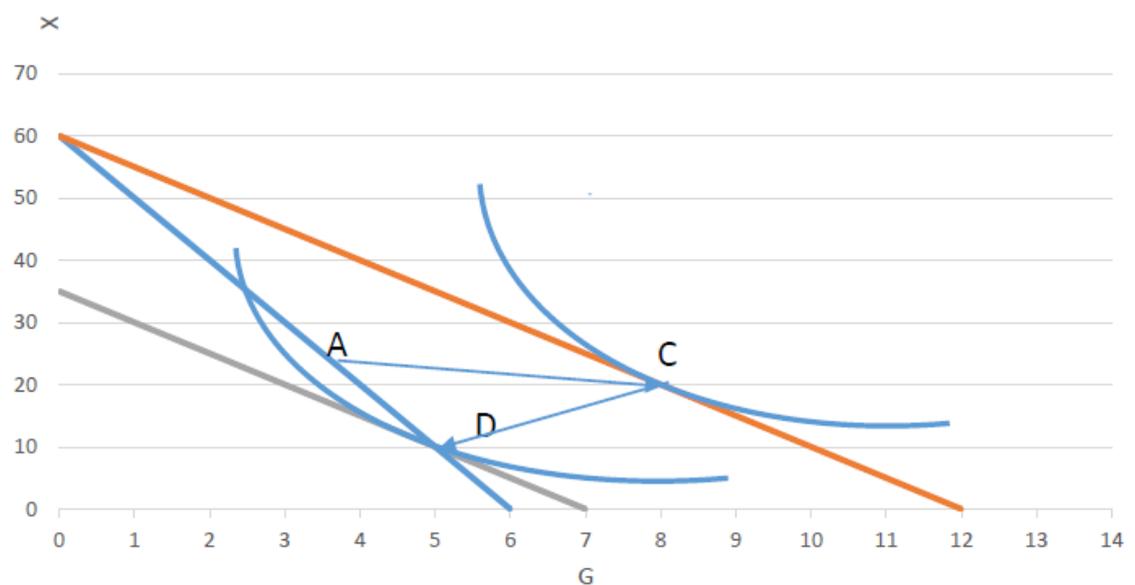
Note: Units on X/Y axis are number of 'local public goods' (employment efforts) and number of private goods (possible private consumption when taxes withheld), respectively.

In real life, the central government likely cannot ignore sufficient financing, also of the matching grants, when paying grants to the local governments.

The finance of matching grants is provided by reducing possible other general grants of the local government, cf. Figure 2.2. This moves the budget constraint inwards. If the total level of transfers from the central government must be at the same level as before the matching grants, the new point of equilibrium must both meet the requirements of being at the highest possible local welfare level and on the same budget constraint as before introduction of the matching grants. This happens at D.

When we make up the accounts, we observe that the income effect of changed grants is now neutralised since we are on the same fundamental (steep) budget constraint as before, but the effect of the change in relative prices (the flatter budget constraint) remains, which is termed the substitution effect.

Figure 2.2 Local government behaviour with extra matching grants financed by reduced general grants



Though somewhat simplified these Figures 2.1 and 2.2 show the main starting point of the theoretical perspectives on incentives: lowering prices by increasing matching grants seems uniquely to increase the amount of G , i.e. the services that the central government wish to give high priority.

Returning to the situation of a change in the reimbursement system of labour market transfers as carried out in Denmark over a number of years, it in a way appears “upside-down”. Here we have seen a reduction in the matching grants (i.e. reduced average central government reimbursement rates, cf. Section 2.2), compensated by increased general grants. However, this is just a question of signs – the basic circumstances are the same: the central government seeks to decrease the price of the activity, seen from the perspective of the local government, or increase the price of doing nothing.

The assumptions that the simple figures rest upon point to a number of factors that are relevant to discuss, including how the price is perceived by the local government, and the level of the local governments' real power, the willingness to make changes and the processes of doing so, i.e. the local manoeuvrability in ALMP activity.

2.3.2. Local perception of price distorted – the flypaper effect

When the local government is considering the magnitude of its ALMP-efforts, the application of a price to those efforts is essential. It matters how the municipality understands and perceives the reimbursement system and its financing. Put more precisely, it is a precondition for the incentives from the matching grant system to work that the municipality perceives correctly how it influences the price of the activity. In addition, it is also important that the local government understands and agrees that the general grants must not disturb those incentives.

The literature describes the difficulties and complications in this respect under the heading: the “flypaper effect”. In short, the flypaper effect (Gamkhar & Shah, 2007, Pallesen, 2003, p. 68f.) states: “The money sticks where it hits”, i.e. general grants tend to finance extra expenditures. This applies even when the distribution of the grants rests on objective criteria.

There are two possible explanations for this phenomenon. Firstly, the local governments may simply misunderstand the character of the general grants, i.e. think that it makes local services cheaper – like a matching grant – although this is not the case. The level of information and the transparency of the system may be important factors in avoiding such misunderstandings. Secondly, the local governments may simply not believe that the distribution is objective. In such a case, it can be useful to think of the challenge to the organisers of the equalisation system since changes in equalisation are often necessary to neutralise/mitigate distribution effects of changed incentives stemming from, for instance, reduced reimbursement rates. Those organisers, i.e. the central government, have to establish a well-functioning equalisation system, which on the one hand compensates municipalities with difficult frame conditions, e.g. on the labour market, and on the other hand is not a system that rewards local governments with an insufficient employment effort. This is a complicated task. If the central government is not successful, in relation to Figure 2.2, the movement may end up being the following: $A \Rightarrow C \Rightarrow A$, instead of the intended: $A \Rightarrow C \Rightarrow D$.

2.3.3. The significance of the time horizon

If the activities of the local government take place over a time period of more than, say, one year, the time horizon of the local decision makers is important for the calculation of the price or costs of the activities.

Admittedly, many of the local government services are consumed within a short time or even immediately. This goes for services like day care, elderly care, maintenance of parks and recreational areas etc. On the other hand, sometimes it is more relevant to look at the activity as an investment, where both the investment costs and the benefits of the investment are to be included in the calculation of the price. This, however, requires a certain amount of patience and a time horizon of up to several years for calculation of the correct price of the activity.

From theories of political cycles, we know that decision makers do not necessarily have the patience to look further into the future than, say, one year, or the time of the next election. In addition, the central government fiscal policy and the management of the economy of the municipal sector may also be rather short sighted.

Again – referring to local government ALMP-efforts – it is relevant to look at the outlays in an investment perspective, i.e. a period of often more than a year. For the active job seekers who get a job relatively easy with only modest support from the municipal jobcentre, for instance, the return (thought of as savings in unemployment benefits) of the investment (thought of as extra resources spent by the jobcentre) is already harvested within one or two years, and the rate of return is not improved after year two. In contrast, long-term unemployed persons may require more on additional resources for a longer period of time to get into job, and therefore the rate of the investment – measured via net present value calculations – is at its highest when taking an 8-years investment perspective.

2.3.4. Uncertainty about the production functions and effects

In a principal-agent relationship, where the central government considers the incentives for the local, subnational sector, it has to be taken into account where the incentives are most effectively implemented. Figure 2.3 illustrates three stages in the local government production process that central government measures can be aimed at.

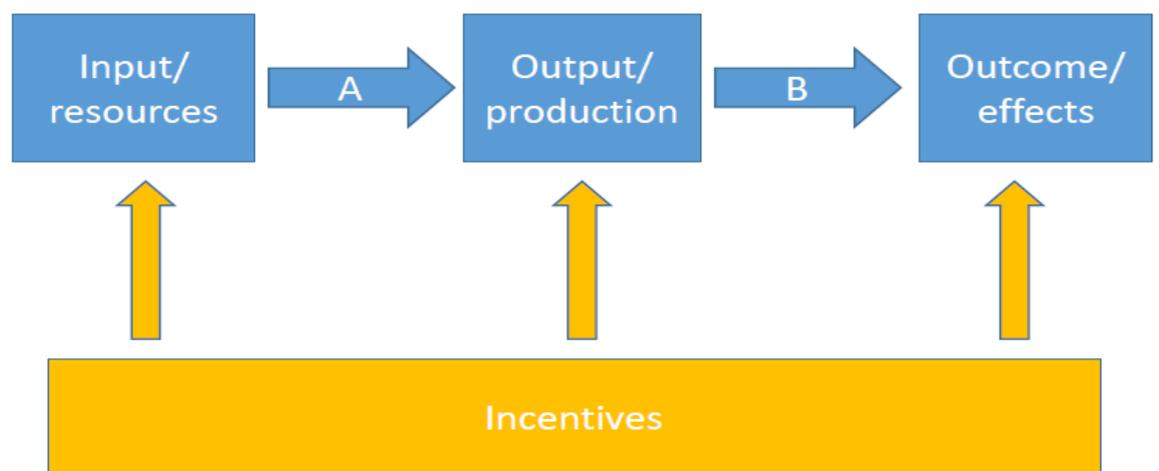
The classical way of using incentives is to influence the cost of the inputs of the municipalities. For the local jobcentres, this could be a central government reimbursement scheme of (part of) the wages for the staff, cf. the left-hand side of Figure 2.3.

However, since the target of the central government is the effects, in the present case more self-supporting individuals, other possibilities may be more relevant. As an alternative, the incentives could instead focus on the production side of the municipal activity. Again with the jobcentre as the example, the central government could have reimbursement depending on the production or output of the jobcentre, e.g. the number of upgrading

courses to unemployed persons, number of separate talks with the clients etc. However, this is still not the target of the central government.

Therefore, the central government may see the incentives connected directly to the effects as the most attractive ones. In the local ALMP case, this would come along by focusing the design of the reimbursement schemes on the municipal costs for income transfers to unemployed persons. This seems to be the most direct way to move the municipalities towards being more successful in shifting persons from unemployment to being self-supporting.

Figure 2.3 The local government production function and central government incentives



Source: Inspired by Phillips (2017), p. 4.

However, there are still factors of uncertainty that the municipality should be aware of. In particular, the link between the output/production and the outcome/effects, illustrated by the B-arrow in Figure 2.3, may not be very well described, implying that the impact of the incentives are also difficult to assess.

External and structural factors – such as the socio-demographic composition of the population, the general activity level in the country, the structure of the local labour market and decisions about production made by larger companies far away from the municipality in question – are important or even decisive for local employment. In addition, civil servants

may apply various coping strategies when implementing the policy, such as *cream-skimming* the efforts to target the groups with the best chances of success (Lipsky, 1980; Winter & Nielsen, 2008). These factors must be taken into consideration when assessing the B-link in the figure.

2.3.5. Decision-making and implementation inside local governments

The first generation fiscal federalism literature's approach to local governments' decision processes was virtually to overlook them. The Tiebout model (Tiebout, 1956) and Oates' decentralisation theorem (1972) saw the decisions of local governments as the product of aggregating the preferences of the local citizens or 'club members', with the 'median' voter possibly being decisive. This may also be the tacit assumption behind the presentation of local governments' self interest in Section 2.3.1.

To make the description of the decision-making more comprehensive, we should also consider the behaviour and motivation of the local board and the staff of the municipal organisation, as these have their own priorities. A wide range of politically and sociologically-inspired models and theories may be considered. Below, we mention a few important points of such models, along with a brief explanation.

Politically salient expenditures may be difficult to influence

There may be a contradiction between, on the one hand, being democratically elected to the local government board to prioritise according to perceived local preferences – and, on the other hand, reacting to price signals from central government-established economic incentives.

Local policy and local preferences may influence some policy and expenditure areas more than others. As a hypothesis, the politically most exposed or popular core areas – termed the politically 'salient' areas – are the least susceptible to economic incentives (Baekgaard et al., 2015). Examples of such areas are schools, day care and elderly care.

In contrast, other municipal responsibilities are less accessible, popular and salient, and therefore perhaps more susceptible to economic incentives. The Danish municipal role in the employment effort area is a clear candidate for such a less salient area: the local governments have rather limited competencies only, leaving it to the central government to regulate the size of and entitlement to benefits.

Conflicts between norms and motivation among professionals and staff

The literature recognises that public employees may be driven by other factors than economic incentives (Andersen et al., 2017).

Firstly, employees in particular professions may follow certain – written or tacit – rules of conduct for their job management and problem solving. These rules possibly stem from their education or the professional environment at the work place. Furthermore, the professional ‘logic of decorum’ may differ from the logic of the economic incentives, according to which there has to be a pay-off from the activity. Secondly, some kind of altruistic or inner pro-social public service motivation (PSM) may to some degree characterise the staff, i.e. the employees feel they to some degree work for the benefit of the community/society (Jacobsen et al., 2012). Consequently, external factors of motivation, such as economic motivation, may crowd out the inner influential factors like PSM.

For ALMP and in relation to implementation of economic incentives, the theory implies the necessity of taking into account employees’ professional norms and their attitudes towards redistribution and social policy.

The relationship between organisational-level incentives and individual-level incentives of employees

When speaking about incentives of municipalities, seen here as organisations, we must take into account that both politicians and, not least, the public employees, are ultimately the decisive agents for ALMP. However, in general organisational-level incentives may work differently from individual incentives, cf. Andersen et al. (2017, p. 31 ff.). In other words, the organisation as a collective institution may experience so-called collective action problems if it does not succeed in translating the incentives to the individual level or otherwise making the organisation incentives meaningful for the individual employee.

2.3.6. Implications from theoretical perspectives

In conclusion, the traditional economic theory of fiscal relations between local and central governments clearly imply a positive effect on municipality behaviour from incentives established by central government. However, several factors may mitigate or even neutralise the effect, and it will be relevant to ask questions – quantitative or qualitative – when we involve empirical data to enlighten the possible effects from incentives schemes, in the case of changes in a reimbursement system of income transfers intended to make ALMP more effective.

These factors include the magnitude of the incentives and the time horizon, the perception of the incentives, external and structural factors influencing the conditions and the political attention on incentives.

2.4. The 2016 reform and possible effects

2.4.1. The reform in general

In this section, we give a short description of the 2016 labour market reform.

The reform was primarily a financial reform for local governments – the focus of this chapter. The financial reform was prepared in 2014, and the Parliament passed the law in August 2015 (Ministry of Employment, 2015). The changes in the reform were implemented as of January 1, 2016. As already mentioned, the aim of the reform was to reduce the level of structural unemployment, i.e. the level of unemployment in harmony with stable prices.

It should be noted, however, that the reform cannot be seen in isolation from other more or less simultaneous labour market-oriented reforms that are relevant for the approach to ALMP in the municipalities.

The reforms in question are oriented towards the behaviour of recipients of benefits, i.e. persons receiving cash benefits, sickness or unemployment benefits or early retirement benefits. However, most of these reforms were implemented somewhat earlier than the financial reform of 2016.

Moreover, the 2016 financial reform co-occurred with other national endeavours encouraging local governments to offer unemployed persons support much earlier than before the reform. Besides, we saw an increased central government focus on enterprises and the needs of enterprises to receive the necessary labour (Pedersen et al., 2019, 22).

2.4.2. Financial elements

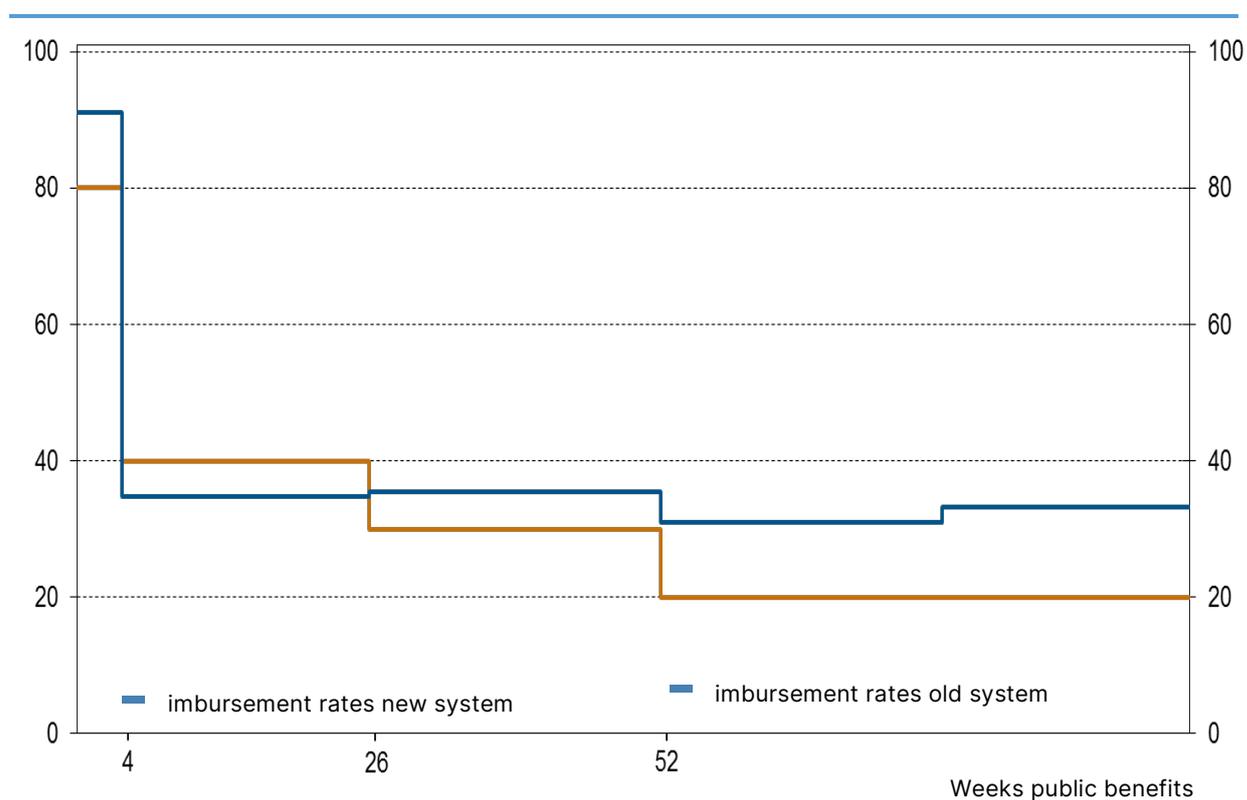
Extensive changes in the local government finance system were a vital part of the 2016 reform, aiming at making benefit-receiving individuals to be self-supporting as fast as possible.

One dimension of this change was to reduce the average rate of central government reimbursement of municipalities. The exact magnitude of this reduction varies from year to year because of a gradually phasing in of the reform. In round 2016 numbers, the average reimbursement rate was reduced by 5-6 percentage points (Pedersen et al., 2019, 19), implying an increase in municipal net expenditures of about 11 pct. The central government compensates the resulting extra financial burden for the municipalities via the general grants.

The *second dimension* of change was a new profile of reimbursement rates. From 2016, the rate of reimbursement rates of municipal expenditures on

labour market-oriented social benefits are the same for all sorts of benefits. Formerly, the level of reimbursement mainly depended on the kind of transfer (e.g. sickness benefits, unemployment benefits or early retirement benefits). It also depended on whether the person receiving benefits was in ‘active’ periods, i.e. when the individual was in special job schemes or job training, or in ‘passive’ periods, i.e. when the benefits were merely a supporting income for the individual to live off. Now, the reimbursement rates only vary according to the total length of the period a person receives labour market-oriented social benefits. Figure 2.4 illustrates the average reimbursement rates before and after the reform.

Figure 2.4 Reimbursement rates (percent) in new and old system



Source: Pedersen & Frandsen (2017).

In conclusion, the new reimbursement system from 2016 aims to strengthen the result-oriented focus of the municipalities via direct economic incentives to prevent long-term unemployment. As indicated by Figure 4, the rate of reimbursement under the new system declines over time in *steps*: From 80 percent in the first 4 weeks of receiving income transfers, down to 40 percent in weeks 5-26, 30 percent in weeks 27-52 and 20

percent in week 52 and . The former system did not generally, except in the case of sickness benefits, make use of such a stepwise decline. The figure shows the average reimbursement rates, for comparison.

Finally, it was presumed that the changes in the finance system would not have unintended economic consequences for the municipalities and the economic balance among the municipalities (Ministry of Social Affairs and the Interior, 2015). Therefore, the central government increased the general grants for local governments, as already mentioned. Moreover, it modified the equalisation system to take into account that some municipalities, especially the rural municipalities, would otherwise be at risk of financial difficulties because of a high number of persons living off income transfers in these areas. Some initial measures were introduced in the equalisation system as of 1 January 2016, and additional changes in the system were implemented in 2021.

2.4.3. Possible economic effects

Earlier studies

Increasing local self-support for unemployed individuals – via incentives for municipalities – was the essential motivation behind the 2016 reform, expressed in the political agreement and the bill.¹⁸ In the law proposal the potential effect of the reform was estimated to be 3,000 extra individuals becoming self-sufficient in 2020, saving 2.1 bn. DKK (Ministry of Employment 2015, p. 10).

A whole range of earlier reforms of the reimbursement system of labour market-oriented benefits aiming to encourage self-sufficient instead of unemployment have been implemented since the 1980s (Pedersen & Frandsen 2017, p. 90ff.). Only very few studies based on quantitative individual data have shown possible effects of the reforms, however. One thorough study (Rosholm et al., 2010) performs analyses on data for individuals. The subject of this study was a reduction in reimbursement rates in the period from 1999 to 2006 for sickness benefits, ‘flex jobs’ (special jobs that take into account functional impairments) and social assistance benefits. The study found a significant effect on the level of municipal activation activities, though, regrettably, not on the level of self-support. There were signs of fewer new individuals being recruited to the social assistance system, but simultaneously the duration of public support for the individuals was prolonged. An earlier study based on municipal-level data rather than

¹⁸ *In the bill (Ministry of Employment 2015), it was stated that (authors’ translation): “The reform is to support the municipalities to a greater extent in providing for unemployed persons the activities that help them to get closer to the labour market and to being employed instead of activities based on calculations of the highest reimbursement rate.”*

individual level data, was somewhat more optimistic regarding the positive effects of shifting from public support to self-support of roughly the same reimbursement reform, though especially for municipalities experiencing economic stress (Dørken et al., 2008).

A starting point for empirical studies of economic effects

From the preceding section, we can identify some possible themes in relation to empirical studies of economic incentives for local governments. Now, we intend to elaborate on how to make those issues operational in relation to the empirical study of the 2016 reimbursement reform.

From theory, we found that the magnitude of the incentives could be important for the significance of the effect on the level of self-support.

Firstly, the hypothesis could be that the size of the change in average reimbursement rates is decisive for the effect. In accordance with this, we notice that the change in municipal net expenditures varies for different types of benefits. The percentage change in net expenditures for unemployment benefits and social assistance benefits exceeds the increase in net expenditures for sickness benefits.

Secondly, the stepwise reduction in the reimbursement rates may imply extra activation and perhaps an extra increase in self-support when we approach a new step and the municipal net expenditures increase.

Thirdly, in relation to the empirical studies we should also, as far as possible, take into account external and structural factors that may modify or amplify the effect of the incentives. This concerns external and structural factors, such as the composition of the population in question, socio-economic characteristics, the general activity level in the area and the structure of the local labour market.

Finally, when the analysis unit is the single municipalities it is relevant to control for variation in economic pressure across the municipalities.

It is also relevant to study possible organisational effects, which may support the economic targets by giving priority to coordination and focusing on core-activities to increase the level of self-support. The aim of this part of the investigation is to illustrate the effect of the incentives on organisational matters. Changes in organisation may also in turn have repercussions for the economic effects – the employment effects – even though it may be difficult to ascertain the exact causal link.

Changes in organisation may be a sign of local governments reacting to – and understanding – the incentives in the new reimbursement schemes. Similarly, more use of business case frameworks and investment thinking in the municipalities may come from the new reimbursement scheme, since this downward-sloping rate profile may bring about such a manner of thinking. Moreover, changes in coordination efforts may also indicate effects of the new incentives from the reimbursement scheme.

Similarly, any reports of use and understanding of the reform incentives – or lack of this – in the organisation and among politicians and managers is relevant when assessing the effect of incentives. In relation to the political level, it is also relevant to know how politicians perceive the responsibility and the importance of the ALMP area, i.e. whether it is perceived as a politically salient area.

2.5. Methods and data

The design for evaluation of the organisational and economic effects of the reform is a pre/post-design. As the reform applied to all municipalities, we have no control group of municipalities not effected by the reform. Accordingly, we lack the strong validity of an experimental design for making causal inferences. Therefore, in the interpretation of the results we have to be bear in mind that other things and factors are not necessarily equal. A major point of attention is that the economic cycle has been rising in the years of reform implementation. As we have both pre- and post-reform data, however, we are able to systematically compare the pre- and post-reform situation, in order to compare the development for different groups of recipients and to control for other factors.

Three sources of data comprise the evaluation data:

- Survey data from a survey sent to all municipalities pre- and post-reform
- Qualitative interviews with a selected number of municipalities pre- and post-reform
- Register data for all individual recipients from 2013-2018 from the 'DREAM' register.

The first two of these constitute the basis for evaluation of the organisational effects and the latter constitute the basis for evaluation of the economic effects. The data are described in further detail below.

Evaluation of organisational effects

We base the evaluation of organisational effects on two rounds of surveys and qualitative interviews, conducted analogously in May 2016 and June

2018. Ideally, we would have conducted the first round before the implementation of the reform in 2016. In actual fact, though, the first round was carried out in the spring of 2016, when the municipalities were still in the early implementation phase of the reform and still uncertain about the real economic consequences of the reform. Keeping this in mind, we confidently label the 2016 surveys and interviews as the pre-reform data and the 2018 survey and interviews as the post-reform data.

The managers of the jobcentres of each municipality in all the 98 municipalities answered both the pre- and post-reform surveys. The surveys covered various organisational topics, such as the organisational setup of the jobcentre, prioritising of employees for major groups of recipients, and internal and external coordination.

The pre-reform survey had a response rate of 66 percent and the post-reform survey one of 67 percent.

For qualitative interviews in the spring of 2016 and 2018, four municipalities were selected according to an entirely different logic with regard to two criteria: the size (small and large) of the municipality and the average pre-reform length of ALMP cases (relatively long and relatively short). The visit to each of the municipalities included interviews with the mayor and the CEO, the head of the ALMP department, the manager of the jobcentre, team managers from the jobcentre and caseworkers from the job centre.

Evaluation of economic effects

The evaluation of economic effects is based on register data from 2013-2018 from the so-called 'DREAM' register. This register contains individual-level weekly data for all recipients of ALMP benefits, including data on socioeconomic characteristics like age, sex and ethnicity.

The economic effect of the reform is estimated by an econometric model called the piecewise constant duration model (see Cameron & Trivedi, 2005) using pre- and post-reform observations. As the period from 2013 to 2018 was generally characterised by economic upturn and decreasing unemployment (Pedersen et al., 2019: 46), we bound the period of analysis to 2015-2016 in order to minimise the structural differences between the pre- and post-reform periods. We split the period into two sub-periods, one before the reform and one after the reform, i.e. beginning 1.1.2016.

In the pre-reform period, we select all cases of public ALPM benefits started or running in the first week of 2015. In the post-reform period, we select cases all started or running in the first week of 2016. Within these periods,

we have some observation periods (time-windows), which we use to delimit the cases for the individual recipients we look at.

A case is considered as started if an individual in a given week receives public benefits reimbursed by the state and, in the previous month, the individual was self-supporting (i.e. did not receive public benefits), received education grants ('SU') or was not being living in Denmark.

We use the following definitions to categorise the cases:

1. A case is considered closed if in the observation period the individual has shifted to being either self-supporting or a recipient of education grants
2. A case is considered as not being closed (right-censored) if
 - a) the case is still running 104 weeks after the start of the pre-reform and the post-reform period, respectively.
 - b) or the individual instead now receives a permanent public benefit (e.g. pension), is deceased or has emigrated.

This means that a case is considered not closed, if no shift to being self-supporting is observed in the observation period.

A case is considered as running at the beginning of the observation period (left-censored), if the individual was already current when one of our time-windows had started. In this situation, we calculate the case length up until the beginning of our time-windows. This left-censored selection issue must be kept in mind when interpreting the results, as these running cases are not randomly selected and may be atypical as they, so to speak, arrive at the time-window as being not closed.

Some individuals may be observed multiple times in each period (i.e. figure in more than one case), and some may be observed as cases in both the pre-reform and the post-reform period.

We exclude cases of early retirement pension (started or running) as the possibility of these individuals shifting to being self-sufficient is close to zero in reality.

Based on the definitions and delimitations above, the econometric method for evaluation of economic effects, more specifically, is survival analysis – i.e. comparison of survival curves and hazard ratios for various recipient groups in the pre- and post-reform observation periods. In other words, a pre- and post-comparison of how long each individual case 'survives' as an ALMP case without being closed.

The causal validity of the pre-/post-design is limited by not having a control group that is unaffected by the reform. However, we increase the causal validity by controlling for a wide range of individual characteristics, including the level of employment in the preceding three years, as well as municipal-level controls for economic pressure and the overall level of unemployment in the region in the quarter before the unemployment for the individual case started. In addition, we make the estimates for separate subgroups whom the reform is not likely to affect to the same extent. For more information on design, see Pedersen et al. (2019).

2.6. Organisational effects

In this section, we present the results from the two surveys carried out in 2016 and 2018, cf. Section 2.5. We also supplement with observations from the two rounds of qualitative interviews of municipalities pre- and post-reform.

Organisational changes

Two thirds of the municipalities report that they have undergone organisational changes since the implementation of the reform. Though it is not possible to conclude whether the reform and/or other factors affecting the ALMP policy cause these changes, the qualitative interviews indicate that the reform played an essential role (along with changes in staff, managers, turns in economic cycles and changes in local priorities). Table 2.2 shows the reported characteristics of the changes. The most prominent organisational change has been to merge units, either to reduce the number of units and/or to facilitate organisational coordination for recipients, particularly those requiring an AMLP effort coordinated across ALMP employees with different professional competencies and/or other municipal departments. The qualitative interviews support this finding.

Table 2.2. Survey: Characteristics of organisational changes, 2016-2018

Organisational model	Percent
Groups of recipients have been merged, giving fewer organisational units	43.9
Groups of recipients have been split, giving more organisational units	12.2
A number of independent units dealing with particularly challenged groups of recipients have been established	17.1
Merging of groups of recipients who require particular organisational coordination	48.8
A desire to change the composition of the staff working with particular groups of recipients	19.5
Other characteristics	19.5
N	41

Note: The answers may sum to more than 100 percent as we allow multiple answers.

Besides reorganisation of units, a comparison of the situation pre- and post-survey points to a number of other significant changes in the organisational setup. These include changes in case stocks per caseworker, use of business cases and cooperation.

Reduction in the case stock per caseworker

One of the most prevalent changes is a significant reduction in the case stock per caseworker. Table 2.3 shows that the case stocks have been significantly reduced for most recipient groups, except for 'Sickness benefits', 'Resource clarification' and interventions for flex job recipients. Most notably the number of recipients per caseworker has been reduced for "Social assistance/ready for work", 'Social assistance/ready for activation' and 'Integration of refugees'. Some of these groups are not among those closest to employment. The municipalities thus seem to have increased staffing for some of the groups in need of a longer and more multifaceted AMLP effort. One reason for this could be that the economic upturn from 2016 to 2018 itself has given a more profound exogenous impetus to increased employment among the recipient groups closest to employment. However, some of the groups with the greatest expected distance to employment have not been given a significantly higher priority. This is true for 'Sickness benefits', 'Resource clarification' and 'Benefits for flex job recipients'.

Table 2.3. Survey: Average number of recipients per caseworker for groups of recipients, 2016 and 2018

Recipient group	2016	2018	Difference	Difference, pct.
Unemployment benefits	122	115	-7**	-6
Social assistance – ready for work	71	60	-11**	-15
Social assistance – ready for activation	57	50	-7**	-12
Integration of refugees	54	48	-6**	-11
Sickness benefit and job clarification	50	49	-1	-2
Educational assistance	51	46	-5**	-10
Resource clarification	44	44	-0	0
Unemployment benefits for flex job recipients	55	55	0	0
Flex job	191	169	-22	-12
N	30-46	30-44		

Statistical significance based on a one-sided T-test of difference in means between 2016 and 2018: *** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$.

The qualitative interviews indicate that the reduction in case stocks reflects a combination of conscious investments in staffing and a reduction in the number of recipients due to an economic upturn not followed by a corresponding reduction in staff. According to the interviews, the reform has made an investment scenario more meaningful to a certain extent. In the period 2016-2018, the investments aiming at those ‘ready for work’ where possibly prioritised first, but later extra focus was directed at the more long-sighted interventions to improve the employment situation for long-term unemployed individuals. Finally, in line with the investment philosophy we might see a downgrading of people with a very low chance of future jobs.

Increased use of business cases

Another remarkable change is an increased use of business cases in prioritising the ALMP efforts. Though there are significant variations across municipalities, on average the municipalities report a significantly higher utilisation of business cases in 2018 than in 2016 in the surveys, both with regard to prioritisation of administrative capacities and activation efforts.

Table 2.4. Use of business cases in prioritising the effort for the specific groups of recipients, 2016 and 2018 (mean scores)

Recipient group	Administrative capacities		Activation efforts	
	2016	2018	2016	2018
Unemployment benefits	2.74	2.92	2.89	3.08
Social assistance – ready for work	2.95	3.16	3.07	3.25
Social assistance – ready for activation	3.05	3.33	2.96	3.38**
Integration of refugees	2.80	2.93	3.05	3.29
Sickness benefit and job clarification	3.16	3.25	3.00	3.17
Educational assistance	2.93	3.05	2.91	3.24*
Resource clarification	2.44	2.75*	2.50	3.16***
Unemployment benefits for flex job recipients	2.70	2.97*	2.71	3.10**
Flex job	2.60	2.56	2.34	2.91***
N	56-57	53-60	56-58	57-59
Additive index	2.82	2.98	2.82	3.17**
Cronbach's Alpha	0.96	0.96	0.95	0.96

Mean scores based on a scale ranging from 1 (not used at all) to 5 (used to a very high degree). Statistical significance based on a one-sided T-test of difference in means in 2016 and 2018: ***p<0.01; **p<0.05; *p<0.1.

Factor analyses reveal that the use of business cases for the various recipient groups are highly correlated, for both administrative capacities and activation efforts. In 2018, around 40-60 percent of the municipalities report using business cases to 'some degree' or 'high degree' for most of the groups of recipients, while 10-20 percent report using business cases to 'a very high degree'. 10-20 percent report not using business cases at all. A correlation analysis shows that, the use of business cases increases with the size of the municipality.

Findings from the qualitative interviews also suggest a more intensive use of business cases and investment setups than in the preceding years. The interviews indicate that a reason why business cases are more related to activation efforts than to administrative capacities may be that activation but not administrative expenditures are excluded from central government economic management measures imposed on municipalities. In line with this, local government managers report some of these management measures as being counterproductive and going against the incentives to

make an extra administrative effort to increase employment for the individuals receiving income transfers.

The management measures in question are restrictive steps taken by the Danish central government after the financial crisis in 2008 and significant municipal budget overruns in 2009 and 2010 that were found to be due to excessive municipal spending. The core of these steps is the threat of sanctions (reduced block grant) for individual municipalities and/or the municipal sector as a whole, if the service expenditures exceed the budgeted service expenditures agreed upon. Here, administrative expenditures are included under service expenditures, while expenditures for activation are not.¹⁹

Use of incentives in the organisation, knowledge and political interest

For these issues, we have information from the qualitative interviews only. It seems that individual, pecuniary incentives for employees – perhaps with the exception of directors at the highest level of – are generally not in use. Such individual incentives may be counterproductive.

The job centre may ‘celebrate’ a successful ALMP with some kind of non-pecuniary reward. Also, the use of internal key figures, KPIs and evidence-based evaluations is intensified. Likewise, meetings in the job centre to review the latest quantitative ‘results’, i.e. the number of persons who have shifted to a self-supporting situation, are regularly held.

At both the political and the administrative levels, the interviewees report a pretty good knowledge of the reimbursement rates and the intentions of the change in financial system. Moreover, the political interest in this field has been increasing, though politically it still seems to be a non-salient area. In some cases – with a connection to the cyclical upturn – the politicians seem to show a special interest in the municipalities’ ability to provide the appropriate labour force for the private enterprises.

Increased coordination and cooperation

Coordination and cooperation in ALMP may have many forms and elements. One is cooperation with local companies and business communities; another is coordination and cooperation within the municipal organisation. Table 6 compares the job centre’s assessments of the level of coordination of ALMP-activities within the municipality in 2016 and 2018 along three dimensions: coordination between units in the jobcentre and

¹⁹ For more information on the so-called budget law, see Larsen & Mau Pedersen (2015, ch. 5); Suenson et al. (2016).

cooperation with the municipal departments responsible for health and social affairs, respectively.

The additive indices at the bottom of Table 1.5 show that the overall coordination is perceived to have increased significantly, both between units in the job centre and between the job centre and the health department. The profile for increased coordination, however, differs for these two dimensions of coordination. Within the job centres the levels of coordination in particular have increased for some of the recipient groups closest to employment, such as recipients of unemployment benefits and of social assistance/those ready for work. When it comes to the increase in cooperation with the health department, it is most notable for recipient groups that furthest from employment, such as recipients of social assistance/those ready for activation or ‘resource clarification’.

Table 2.5. Survey: Coordination and cooperation of the interventions for specific groups of recipients, 2016 and 2018 (mean scores)

Recipient group	Coordination between units in the jobcentre		Cooperation with the department for social affairs		Cooperation with the health department	
	2016	2018	2016	2018	2016	2018
Unemployment benefits	3.41	3.95***	1.78	1.91	1.73	1.88
Social assistance – ready for work	3.70	4.12**	2.31	2.34	2.02	2.23
Social assistance – ready for activation	3.79	4.16**	3.45	3.73**	2.97	3.33***
Integration of refugees	3.77	3.89	3.45	3.44	2.69	2.89
Sickness benefits and job clarification	3.89	4.02	3.27	3.28	3.32	3.64**
Educational assistance	3.67	3.98*	3.52	3.64	2.72	2.91
Resource clarification	3.86	4.00	3.56	3.86**	3.04	3.50***
Unempl. benefits for flex job recipients	3.40	3.84**	2.78	2.86	2.49	2.79**
Flex job	3.18	3.66**	2.54	2.63	2.05	2.27*
N	55-57	56-58	54-56	57-59	54-56	56-59
Additive index	3.64	3.95**	2.97	3.10	2.56	2.85***
Cronbach's Alpha	0.94	0.95	0.90	0.86	0.91	0.93

Mean scores based on a scale ranging from 1 (not used at all) to 5 (used to a very high degree). Statistical significance based on one-sided T-test of difference in means in 2016 and 2018: ***p<0.01; **p<0.05; *p<0.1.

Though the overall cooperation with the department for social affairs did not increase significantly, the cooperation with this department did increase significantly for the same two groups for which cooperation with the health department increased most significantly, namely recipients of social assistance including those ready for activation and ‘resource clarification’. This possibly signals an increased awareness that the recipients furthest from employment may have complex social and health-related

problems (besides unemployment), requiring a multi-professional and multi-departmental effort in order to increase their chances of becoming self-sufficient.

The qualitative interviews confirm the impression of more intense coordination in 2018 compared to 2016 – primarily within the job centres. Coordination and cooperation activities with other departments are more limited, though they are more pronounced for the group of recipients of social assistance than for people receiving unemployment benefits. From the interviews, it seems that cooperation is more challenging in a larger – more specialised – municipalities than in small municipalities.

Perceived economic effects

We provide a first impression of the economic effects as perceived by the municipalities, which may serve as a stepping-stone to the register-based analyses of the economic effects below.

Table 2.6. Change in perceived ALMP success for groups of recipients, 2016-2018

Recipient group	Less successful	No changes in results	More successful	Total	Mean
Unemployment benefits		64.3	35.7	100.0	2.36
Social assistance – ready for work		57.1	42.9	100.0	2.43
Social assistance – ready for activation		46.3	53.7	100.0	2.54
Integration of refugees		53.6	46.4	100.0	2.46
Sickness ben. and job clarific.	5.4	69.6	25.0	100.0	2.20
Educational assistance		69.6	30.4	100.0	2.30
Resource clarification		73.2	26.8	100.0	2.27
Unemployment benefits for flex job recipients	2.0	67.9	30.4	100.0	2.29
Flex job		66.1	33.9	100.0	2.34

N= 56. Mean score based on a scale from 1 (less successful) to 3 (more successful).

In the 2018 survey, the municipalities were asked to evaluate the change in their ALMP success after the implementation of the reform. Table 2.6 shows the frequencies for this self-perceived success. The perception of being more successful in 2018 than prior to the reform is most widely held with regard to recipients of ‘Social assistance including those ready for activation’ and integration of refugees, whereas the success seems to be least widespread for recipients of Sickness benefits and ‘Resource clarification’.

A factor analysis (not shown) reveals a connection between the ALPM success for recipients of Sickness benefits and ‘Resource clarification’ but with

a different pattern compared with the other recipient groups. Similarly, for the other seven recipient groups perceived ALMP success for one of these groups also increases the likelihood of perceived success for the other groups.

Summing up

To sum up, since the implementation of the reform two thirds of the municipalities have reorganised their jobcentres, not least by merging organisational units, and on average the municipalities have reduced the case stocks for case workers, increased the use of business cases and investment calculations in prioritising ALMP efforts and increased coordination/cooperation.

Internal use of pecuniary incentives for employees do not seem to be widespread, but more intense use of evidence data, KPIs etc. may nonetheless demonstrate an increased level of knowledge about and awareness of incentives. The political interest in the area is increasing, but it possibly remains a non-politically salient area.

In addition, 30-60 percent of the municipalities perceive to have increased their ALMP success since the reform strengthened the economic incentives in ALMP.

The design does not facilitate a causal conclusion, and accordingly it is not possible to deduce whether the reform has *caused* these changes. Other factors, such as changes in staffs, managers, and local policies, other reforms and not least turn in economic cycles, may have influenced the organisation of and priorities in municipal ALMP. The qualitative interviews, however, indicate that the reform played an essential role for the organisational changes.

2.7. Economic effects

In this section, we present the results of the evaluation of the reform's economic effects.

Survival curves and hazard ratios for different types of benefits

As stated in Section 2.5, we use survival curves and especially hazard ratios to show the developments.

The *survival curves* demonstrate the rate of moving from public support to self-support. Initially, the total considered population receives public benefits, but gradually they gain employment – or at least becomes self-supported. The steeper the survival curve, the faster the process.

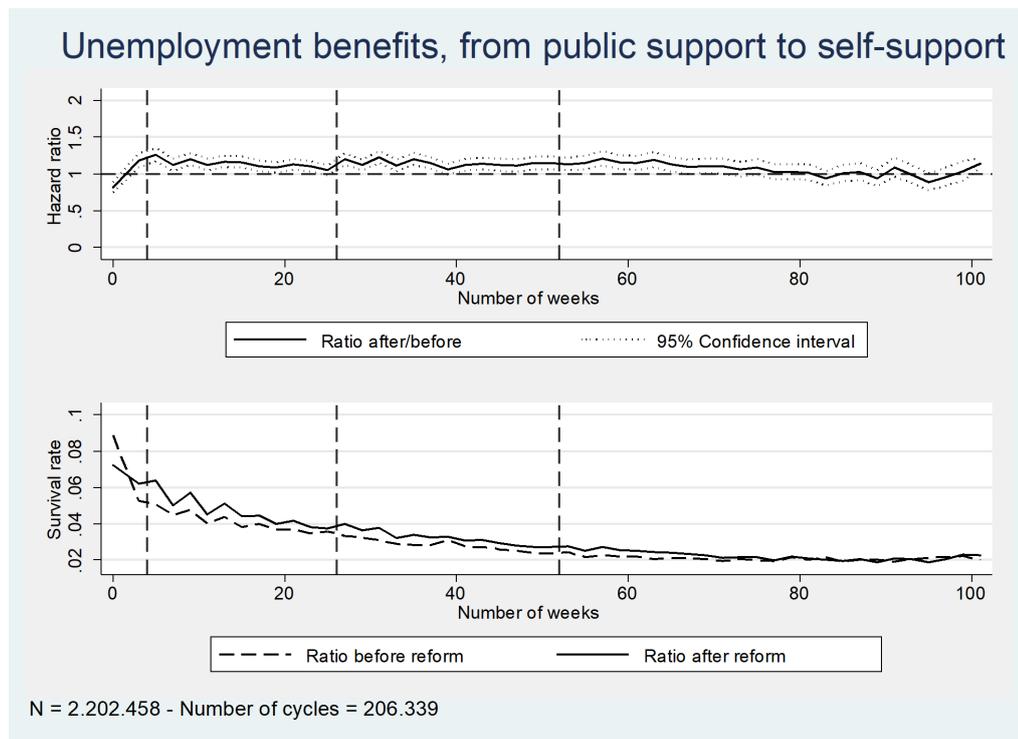
In parallel, the survival rate explicitly shows the rate of moving from public support to self-support. Thus, a rate of .5 shows that half of the population still receiving public benefits for certain average lengths of time with public support has now moved to self-support. The figures below also show the survival rate after the reform divided by the rate before the reform, i.e. the so-called hazard ratio. A value of this ratio above the 1-line means it became more likely to be self-sufficient after the reform. We use a band of confidence levels of 95 pct. to show whether this relation deviates significantly from “1” pre- and post-reform.

Developments for different types of benefits

Figure 2.5 shows the hazard ratios and survival curves for persons receiving unemployment benefits, measured at different average lengths of time on public support.

At a first glimpse, the curves do not seem to have changed much when we compare the pre- and post-reform periods. However, the individuals receiving unemployment benefits seem to get to a self-support situation a little faster after the reform than before. Similarly, the likelihood of being self-sufficient after compared with before the reform is significantly positive for most of the 104-week period, and especially for the first 52 weeks following the reform.

Figure 2.5. The effect of reimbursement reform for recipients of unemployment benefits: hazard ratios and survival curve.



For recipients of social assistance (cash benefits) the results are mixed, cf. Figure 2.6. The relation of hazard ratios after compared with before the reform actually seems to fall from week 5 to week 21, and the fall is statistically significant (or close to). For the longer periods, the effects of the reform seem to be positive, though not significant so.

The group of recipients of social assistance can be subdivided into several sub-groups. The characteristics of these sub-groups may differ widely from those of the overall group. The sub-group of so-called “ready-for-work” recipients of social assistance are generally expected to be closer to employment than the sub-group of “ready-for-activation” recipients. Figure 1.7a and 1.7b illustrate the hazards ratios for these two sub-groups of recipients of social assistance, i.e. those ready for work and those ready for activation.

Figure 2.6. The effect of reimbursement reform for recipients of social assistance: hazard ratios.

Social assistance, from public support to self-support

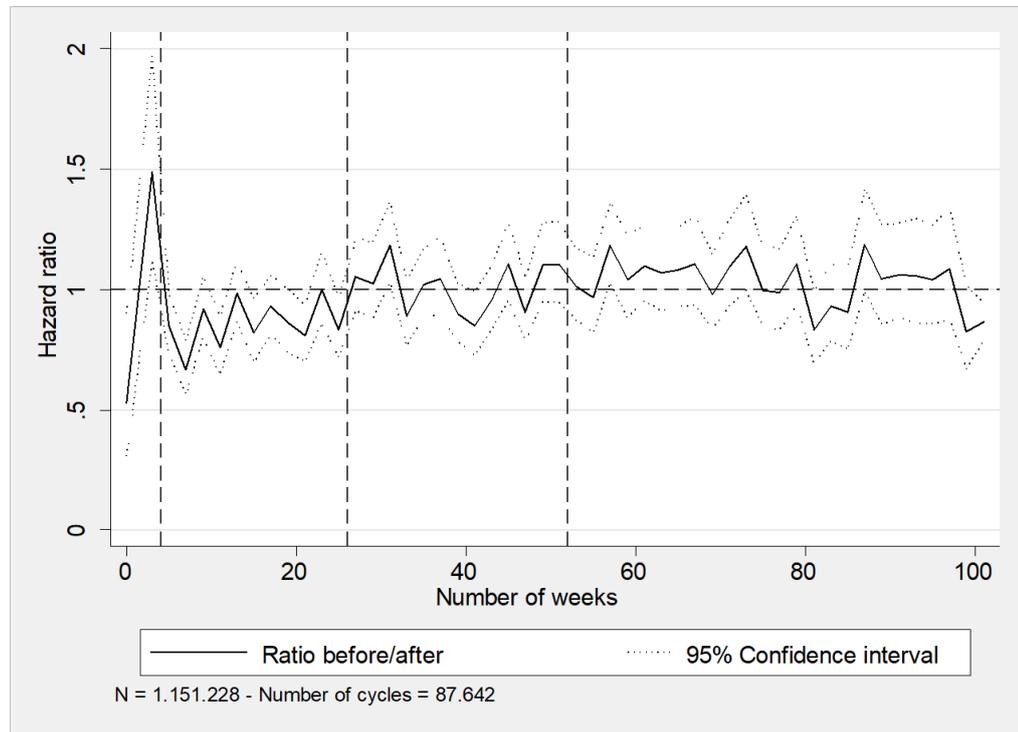
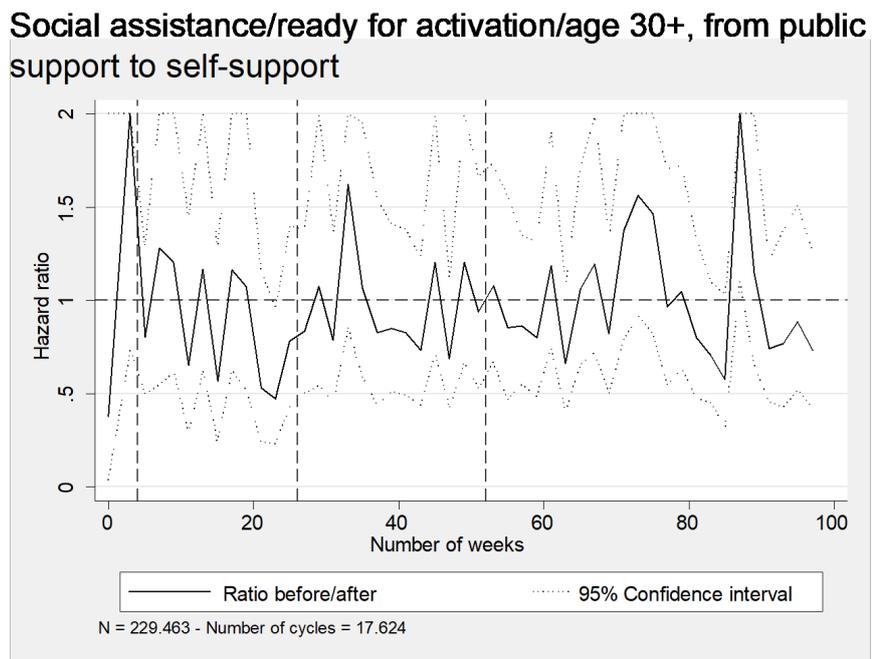
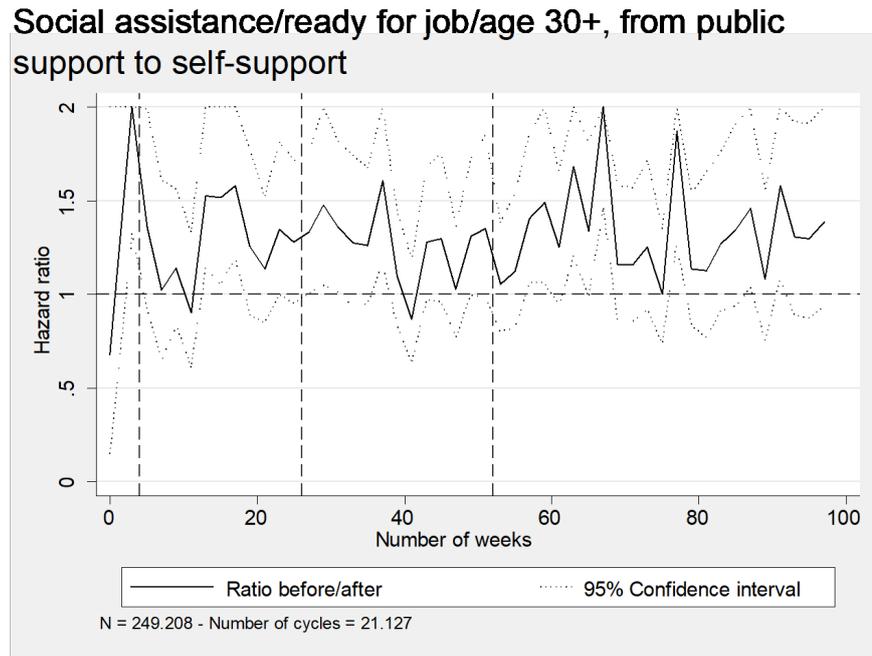


Figure 2.7a, 2.7b. The effect of reimbursement reform for recipients of social assistance, a) ready for work, b) ready for activation (age of recipients: 30+): hazard ratios.



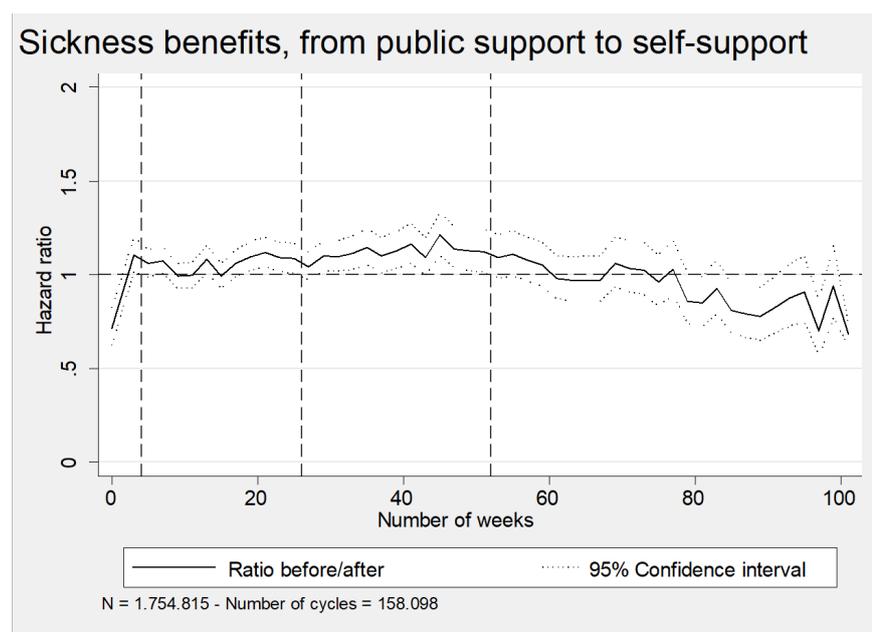
For the ready for work group, we see a positive effect on self-support, though it is only barely significant. For the ready-for-activation group, which is probably more difficult to move to self-support, we see no significant effect.

We also made estimations for other sub-groups, e.g. immigrants and young persons, and we distinguished between municipalities with relatively many and municipalities with few recipients of social assistance and persons ready for activation. We note that the former group of municipalities seemed to experience positive effects on self-support to a greater extent than other municipalities.

Finally, Figure 2.8 shows the developments for persons receiving sickness benefits. The figure indicates positive effects on self-support, most significantly from 26 to 52 weeks, i.e. the period where the reform reduced reimbursement rates most markedly from 50 to 30 pct.

It is also notable that the effect seems to be absent or even negative from 60 weeks and longer periods. This ties in with the fact that the reimbursement rate was actually increased in this period since the reimbursement rate pre-reform was nil for sickness benefits when a person had received public support for more than 52 weeks. We also note, however, that we do not generally see any sign of (clear) 'kinks' in the survival curves and hazard ratios, i.e. effects from the reimbursement steps.

Figure 2.8. The effect of reimbursement reform for recipients of sickness benefits: hazard ratios.



Summing up

Though our econometric investigation design is not an optimal design for identifying casual relationships between reform and effects, we nonetheless discover some economic effects that indicate causal relationships. We

see some positive effects, i.e. reduced periods of public support, on average, for persons who are relatively close to a route (back) to employment. However, these effects are uncertain or even seem to be negative to some extent for persons with more challenges in relation to getting employment.

2.8. Conclusion

The Danish reform of the reimbursement financing of municipal expenditures for labour market benefits aimed at creating positive incentives for municipalities to strengthen local ALMP and get more persons to be self-supported. This is perhaps especially relevant in the case of Denmark since Danish municipalities have a very prominent role in ALMP, for instance responsibility for activation and paying out of most labour markets benefits, i.e. unemployment and sickness benefits, social assistance benefits, early retirement benefits, rehabilitation benefits etc.

The investigations of the reform apply both qualitative and statistical methods. We use surveys and structured interviews of selected municipal key figures and a comprehensive register analysis of the developments of individual recipients of public benefits.

For the estimation of economic effects, we must be careful when drawing conclusions on possible casual relationships. This stems from the fact that we do not have any control-group to compare with since the reform of reimbursement rates applies to all municipalities. Moreover, the economic cyclical fluctuations may influence the results, even though we correct, as far as possible, for a wide range of characteristics before and after the reform, such as level of unemployment, socioeconomic factors, variations in economic situation etc. Furthermore, we investigate only the first year after the implementation of the reform statistically, 2016, although the qualitative analysis extends into 2018. The fact that we find positive effects for some subgroups and negative effects for others suggests that the observed effects are not driven solely by economic fluctuations. Accordingly, the results indicate that at least some of the economic effects are causally linked to the reform.

Our findings confirm that economic incentives seem to work for municipal political and administrative organisations in the ALMP area. We find significant results for the organisation of municipal tasks in the area, which constitutes the necessary environment for positive effects. We also find some positive economic effects on the level and development of self-support for recipients of labour market benefits. In possible connection with an investment attitude in the local government job centres, and perhaps cream-skimming coping strategies, it seems that the groups of recipients who are closest to the labour market, e.g. recipients of unemployment benefits and recipients of social assistance who are ready for work, get closer

to employment via the reform to some degree. In contrast, in the perspective of our investigation horizon the effects seem to be negative for recipients of social assistance who are ready for activation and recipients of sickness benefits for prolonged periods.

We illustrate the overall economic effects in Table 2.7 as well as the effects for the four sub-groups as a whole. The calculations are based on the statistical register analysis of the average expected change in periods of public support.

Table 2.7. From analysis of economic effects: expected change in length of period receiving public labour market benefits.

Recipient group	Average reduction in weeks of public benefits
Unemployment benefits	1,75
Social assistance – ready for work	4,42
Social assistance – ready for activation	-4,88
Sickness benefits	0,42
Total	0,60

Note: Calculation for all municipalities, i.e. the country as a whole. Average reduction calculated from expected length in weeks of receiving labour market benefits.

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Chapter 3

Centralization and decentralization in Swedish policies for local job creation: explaining the confusing turbulence over the past decades

Lars Niklasson²⁰

Abstract

Sweden was for a long time a role-model in active labour market policies. Sweden is now more interesting for the various reforms which have been pursued over the past 30 years to make labour market policies more efficient, in a variety of partly contradictory ways. The major theme of this struggle has been one of central control vs local integration of policies and programs, where labour market policy is one of the several “silos” (policy segments) involved in providing these kinds of services to the clients.

The chapter will apply three types of institutional theory to understand how policies develop and to make predictions of future development. The institutional theories point to different mechanisms explaining how politics moves, which means that they can be used as a kind of scenarios, simplified but providing specific insights to our understanding of how politics evolves. The perspectives provide some understanding of the difficulties involved in designing and implementing local employment strategies. Some of the difficulties occur at the local level but many originate at the national level of government.

3.1. Introduction: a mess of uncoordinated policies

Local job creation is a highly complex and politically contested policy area. Employment policy has traditionally been a strong and rather independent sector of the national government in Sweden, while most other policies related to the welfare of the citizens have been delegated to the relatively autonomous local and regional governments. The official argument was that only a national agency can promote mobility across the country, since local governments would be tempted to support local jobs over mobility. A national agency is also an instrument for the government to deal with

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macroeconomic issues. Cynics add that governments can use the agency to buy votes before upcoming elections.

The debate in the 80s and 90s was over the need to integrate policies and programs run by the public employment service with those run by the local governments and others. This related to a large set of complicated overlaps. One was that clients (including immigrants) could collect welfare payments from the public employment service, the social security administration (Försäkringskassan) as well as from local governments. The roles were overlapping, which created incentives for clients to shop around and for the organizations to blame each other for failure.

The key problem highlighted in this analysis was that relevant programs were run by many other organizations as well, in skills development, start-up promotion and other areas important for economic development, like investment in infrastructure. Skills development was one of the most contested areas of policy, with a number of similar programs, for example various training programs run by the public employment service, by the local governments (Komvux) and the regional governments (Folkhögskola). For a more detailed overview, see the evaluation by the OECD (2015).

Local staff often identified a need for coordination and even collaboration to maintain a broad set of programs. They also saw a need for streamlined regulation to create a more efficient system for skills development. For example, there was an abundance of programs for the unemployed under the age of 55 but no programs for those over 55.

The situation was a classic example of an overcrowded welfare state, where programs by different levels of government and operating under different ministries had been put on top of each other. It was an interesting time for regional and local policy entrepreneurs to try to coordinate these conflicting instruments.

The argument for coordination was that only coordination bottom-up could bring order in a segmented state. Territorial integration was seen as a remedy for functional specialization. This was in contrast to the contrary argument for separation, which was that control top-down must be increased to deal in a coherent way with difficult situations and to increase efficiency by streamlining services across the country. Over time, Sweden has tried both strategies.

The purpose of this chapter is to summarize experiences from Sweden. The chapter will give an overview of some of the efforts which have been made to bring greater coherence and efficiency to the policies. It will then

use institutionalist perspectives to explain why these policies were chosen. The paper is based on a number of studies conducted by the author over the last decades. It applies a comparative method to identify lessons from the various models of organization.

3.2. Fragmentation and suboptimality

Each of the policy areas can be discussed and evaluated on their own. However, my focus is on the overall problem of safeguarding some consistency across these areas in order to avoid fragmentation and suboptimality.

Each sector of the government operates with goals, targets and incentives for clients as well as for the organizations. The national agencies are generally under a tight regime of so called New Public Management, while local and regional governments have more autonomy to design their own programs and organizations. Overall, this leads to a situation where each organization could perform rationally and efficiently while at the same time contributing to what in Sweden is referred to as a mess of uncoordinated actions, most clearly visible at the regional level of government.

I will focus on the provision of services while ignoring the wider macroeconomic framework. There was, for example, a greater emphasis on the incentives for the unemployed to avoid unemployment over the last ten years. Benefits have been reduced and taxes have been lowered for people with low salaries to make it more rewarding to take a job. There has also been much talk about the incentives to start companies and make them grow to produce new jobs. Even though these frameworks make up the context for the services, I will limit the discussion to the provision of services rather than their combined effects on individuals and firms.

The problem with overlapping providers of services are several. One is that clients find it difficult to identify the appropriate program and provider to contact for a specific problem. Another is that rules and recommendations will vary across the providers of similar services, which creates confusion and frustration. It may even lead to a situation where the providers in effect compete over the best clients, which isn't necessarily a good thing in the public sector. Under certain circumstances, clients can act strategically to maximize benefits in the system. In the end, the lack of coordination may lead to efficiency losses which aren't obvious to the individual organizations.

There is a large literature on similar situations across the world, where government services have become complex and fragmented. Governments have responded by trying to integrate services across organizational boundaries, often through loosely organized networks. This has led to the

use of the wider term “governance” to indicate a variety of arrangements beyond the traditional forms of “government”.

There is a comprehensive literature on economic development which discusses concepts like collaboration, consensus, leadership and learning. Especially in the American context, with a highly fragmented public sector, researchers emphasize “collaborative leadership” (Chrislip & Larson 1994), cooperation through planning (Innes & Booher 2010) and collaboration for economic development (Agranoff & McGuire 2004).

Regionalism is often synonymous with creating arenas for collaboration in big city areas which consist of many small municipalities (Feiock 2004, Benjamin & Nathan 2001). Similar ways of working is found in many other Western countries, e.g. Great Britain and Australia (Beer, Haughton & Maude 2003), and in developing countries like Brazil, India and South Africa (Briggs 2008).

The interest in collaboration partly coincides with a general interest in innovation systems, which is a descriptive and pragmatic way of analyzing participants and processes of growth, how companies interact with others to come up with innovative products. The analyses concern whole countries (Nelson 1993), regions (Cooke & Morgan 1998) or industries (Niklasson 2006).

Another source of inspiration is the literature on fragmentation and integration in the public sector. So called “joined-up government” (Bogdanor 2005) is a way of networking across organizational boundaries with the intention to achieve common goals (Niklasson 2003). This point of view is especially common when it comes to regional politics in many countries (Niklasson 2007). The perspective can be applied to public activities in general, and to relations between companies. Sociologists and business economists discuss, among other things, learning in and between organizations (Stein 1996).

The criticism against collaboration is mainly found in the discussion about how the public sector should be run. The opposite of collaboration as an ideal, is a clear division of responsibilities, with goals and regulations for each and every task by itself. Under so-called New Public Management, the public sector should be run like a military hierarchy with goals and targets determined for all operations. Collaboration should be avoided, since it makes it more difficult to hold civil servants accountable for the outcomes (Bovens 1998).

Another criticism of collaboration is that it may shift power from elected politicians to the civil servants, if the agencies and other public organizations are allowed to collaborate and coordinate their activities according to circumstances (Sorensen & Torfing 2007).

Those in favour of collaboration often regard it as the second best way to deal with a blurred division of responsibilities across public organizations, for example when several agencies and levels of government deal with the issues of unemployment, exclusion, skills development or entrepreneurship. When the public sector is fragmented, it makes sense to coordinate and learn from each other in a regional context.

Some researchers even elevate collaboration to an alternative form of democracy (Hirst 1994), close to a sort of autonomy for a territory. Others emphasize the ability to solve problems as an essential, but to some extent, neglected value in a democracy (Briggs 2008).

3.3. Strategies for implementation

Swedish governments have tried a number of strategies to make the welfare systems, including local job creation, more coordinated, while at the same time pursuing other strategies for the individual sectors. For example, the government pushed for a stronger integration of the employment service in the 90s, while it simultaneously encouraged all agencies to collaborate locally and regionally to integrate services across organizational boundaries.

Interestingly, there have been strategies to coordinate services bottom-up as well as top-down. The first refers to initiatives at the local level, where civil servants introduce pragmatic solutions to handle what they think are annoying inconsistencies or unnecessary competition across the public sector. One such example is the introduction of “one door in”, for example through offices which provide information about all education and training programs available in a city, regardless of how it is funded and operated. Another example is the learning center, a place where several such training programs are provided by several organizations. Sometimes this led to innovative mixes of programs tailored to individual need (Statskontoret 2003). A third example is where the employment service and the local government funded a joint training program rather than running separate and under-critical programs competing with each other.

Coordination top-down refers to initiatives by the national government to encourage collaboration across organizational boundaries. This is different from control top-down, where the government has tried to reduce overlaps across policy sectors. Coordination top-down ranges from soft encouragement to reorganization of the public sector.

A soft kind of encouragement of collaboration was through partnerships for regional economic development plans. This became a major policy in 1995, demanding that all national agencies should adjust their operations regionally to the plans made together with other public and private actors. Common goals were to be identified and common spending strategies should be worked out. The regional plans should be a guiding principle for the local integration of services (Statskontoret 2004A).

The ambition was that all services related to the development of firms and the creation of jobs should be integrated, but in reality the outcome varied greatly across the country. The employment service and the universities were often reluctant, while the agencies for roads and railroads tended to see the benefits of a joint planning exercise. They were already involved in making regional plans for transportation, also with a broad perspective.

The work was often divided up in three categories. One set of agencies were involved in policies to support firms, for example through loans and applied research and development. Another set of organizations dealt with education and training, while a third set focused on infrastructure and transport. There is an interesting variety across the country in how the work was organized and what the focus was (Statskontoret 2004A). The group of organizations working on education and training often met through a regional council set up by the employment service.

At the same time, the government introduced several formal methods of coordination as experiments in parts of the country. All of them regionalized policies in the sense that regional actors were given a stronger role, with the intention that local operations should be further integrated. The regional level was described as an appropriate level of government to handle matters related to economic development (including job creation), since the challenges were regarded as too big for local governments to handle and too particular for the national government.

The most dramatic experiment (in two regions) was to merge old counties into bigger regions and to give their elected assemblies (county councils, Landsting) the leadership role for economic development. This role was previously held by the national government through a prefecture-like organization, a regional agency operating under the national government (so-called county administrative boards, Länsstyrelsen).

The planning framework for economic development remained the same, but the change of leadership opened up for some rethinking of strategies and stronger collaboration among organizations involved.

Another version of regionalization or devolution gave the leadership role to an indirectly elected assembly, owned by the local governments together with the regional assembly. This was often described as a compromise version (a “light version”) of the first model, giving the local governments a strong position, while the first model was sometimes seen as a promotion of regional governments over the local governments. The compromise model eventually became the most common form of leadership across the Swedish regions, but it was abolished by 2019, when the regional model was implemented across the country.

The third experiment was very different and eventually abolished too. This was a merger of the regional branches of three national agencies to form a more integrated agency in one region. It was sometimes referred to as a French model (in one region), where an integrated state met an integrated local/regional government. This model is in principle a very interesting alternative way to organize public services, but it wasn’t promoted by the government as a test of a new model but rather as a defensive action to maintain services in an isolated region, an island off the coast.

One of the agencies was the regional branch of the employment service, which means that this experiment went against the simultaneous ambition to integrate all branches of the employment service into a uniform structure under central control, i.e. the present employment service. In other words, the government applied contradictory principles to the organization of the public employment service.

In total, the mix of strategies to encourage local and regional collaboration made the situation even more complex and confusing from the perspective of the national government. Some ministries found it more relevant to design coherent national policies for their policy segments, ignoring the focus on coordination across policy segments. On the other hand, local civil servants often liked the greater room to adjust policies and programs to local needs. They saw it as an encouragement of bottom-up coordination of the public sector.

3.4. What were the effects of the experiments?

There have been evaluations of the three experiments in regional coordination of policies, all carried out by teams at Statskontoret, the Agency for public management, with myself as project leader.

In 2003 the partnership model was evaluated. The government asked for an assessment of the ambition that the partnerships should not only work out regional development plans but also operate as learning systems, designing their own monitoring and evaluation of the partnership programs. It became a first comparison of the regional partnership activities. It gave

much attention to the differences across the country, ranging from agencies doing nothing to agencies conducting very ambitious studies to learn from, even to question the programs and implementation by the partner agencies.

In addition to describing the range of activities in each region, the evaluation looked for explanations for the observed differences. A group of similar regions with different levels of joint activities illustrated that potential explanations must have to do with partnership dynamics. As the context and background characteristics, especially the room for adjustments in the implementation of policies, were more or less the same across the regions, the differences must have to do with the interaction and the attitudes of the participants.

Actors in the ambitious partnerships found plenty of reasons to collaborate, often because they had a client's perspective on what they were doing and were frustrated by overlaps and lack of coordination. They had a different mindset from actors in the less ambitious partnerships and they often had more skilled leaders who promoted common worldviews, based on academic theories, for example from economic geography. Our conclusion was that entrepreneurial civil servants and leaders were necessary for collaboration. Uninterested regional managers could close the door for the entrepreneurial civil servants to work with partners in other organizations (Statskontoret 2004a, Niklasson 2004).

The partnership evaluation provided a basis for the following evaluation of devolution of powers to two regional assemblies. Since devolution was justified as a measure to increase collaboration and efficient use of resources for the purpose of economic competitiveness, the relevant issue was the impact of the devolved leadership on the partners, rather than how the regional assemblies operated as such (Statskontoret 2004b, Niklasson 2005).

The partnerships in the experimental regions were compared to the two most successful partnerships, as well as to the capital region (for size). We found that strategic plans were only made by the two assemblies with devolved powers, which was a clear success. The regional boards ("prefectures") which didn't make such plans argued that they thought the legislation was obsolete, which is not a very Swedish response. It is fair to say that the difference illustrates that politically run organizations (the regional assemblies) like to make pro-active plans as a way to manifest its intentions and a way to start negotiating with other organizations. In the partnership programs the devolved regions were among the most ambitious, though size was a barrier in one case.

An interesting finding was that the two devolved regions opened up a process of restructuring the patterns of collaboration among local governments. New constellations were found in a bottom-up like manner, which partly had to do with the merger of counties to form the new regions. There were also stronger forms of consultation between the regional assemblies and the local governments, especially in one region, where the local governments were given a role in the decision-making of the regional assembly, an unexpected hybrid arrangement.

In 2005 an evaluation was conducted of the third experiment, the merger of agencies in an isolated region (Statskontoret 2005). A key finding was that the merged policies were affected differently. Labour market policy produced outcomes in this region which were lower than average while the other policy (forestry) was running above average. This could partly be explained by differences in potential synergies and in different degrees of support from the national “silos” (agencies).

These latter issue was very important in an experiment which was a forced merger against the will of the national agencies that had to let go of their regional branches. This is also a big difference from the other experiments, which were about encouraging independent organizations to find synergies among themselves.

To summarize the findings, collaboration and integration of policies for local job creation and more generally depend on potential synergies and a will to exploit these synergies. Willingness has to do with mindsets and attitudes, which in turn depend on personal experiences and leadership skills. The key drivers seem to be aspects of leadership such as building a joint vision and having a citizens’ perspective on what the services are good for. Strong local leadership can do a lot but will eventually need backing from the national government to overcome barriers created by the “silos”, i.e. the agencies and their specific ministries.

3.5. A coherent model was proposed - and rejected

The government set up a committee in 2003 to come up with a more coherent organization of the public sector based on an investigation of the roles played by various levels of government (Ansvarskommittén 2007). The committee made a very ambitious attempt to scrutinize the operations of the public sector. It came up with many observations on how the allocation of responsibilities could be made more efficient. To some surprise, the commission favored continued devolution and published long reports on how to organize welfare services at the national, regional and local levels.

One aspect of this was to create larger regions with greater capacity to adapt and develop policies for economic development. Some policies were

suggested to be devolved from the national to the regional governments, while other policies should be transferred from local to regional governments.

Equally surprising, not very much happened after the report was published in 2007. The report was not what the government in 2003 had hoped for. The prime minister at the time has later admitted in public that he was hoping for a chance to abolish the elected regional governments and find new solutions for health care, similar to what has happened in Norway (Sydsvenska Dagbladet 2008). That would have been a serious blow to the whole idea of devolution and regional integration of policies.

The Swedish situation is very complicated with many vested interests at the national level at the same time as local and regional politicians are pragmatic and take advantage of whatever openings the national government offer. All the major parties are split on the issue of central control versus local and regional autonomy. There is also a line of conflict behind the scenes, across the ministries, where the various positions of regionalization and centralization have their supporters (Niklasson 2015). Each ministry has a preferred way to organize the public sector and the outcome is a deadlock when several models are laid on top of each other.

One way to understand this complexity and to make predictions of future development is to use the three types of institutional theory which are popular in the social sciences (Hall & Taylor 1996). They point to different mechanisms explaining how politics moves, which means that they can be used as a kind of scenarios, simplified but providing specific insights to our understanding of how politics evolves.

“Rational choice institutionalism” explains politics as the rational pursuit of given ends. Politics is in this perspective primarily bargaining to strike deals. “Sociological institutionalism” (or “Discursive institutionalism”) highlights the role of new ideas in changing the perceived interests of the actors over the long run. “Historical institutionalism” adds the insight that chosen courses of action become paths which are difficult to deviate from.

These perspectives provide further understanding of the difficulties involved in designing and implementing local employment strategies. Some of the difficulties occur at the local level but many originate at the national level of government.

3.5.1. The first perspective: games on two levels

The first institutional perspective on the struggle over the role of the regions and the coordination of policies in Sweden highlights the various

political games that are going on. There are at least two games at the central level and several games within and around each region. In this perspective the focus is on who the actors are, what their preferences are and how the situation is structured.

Traditionally one would expect a fight between political parties but, as indicated above, there are many fractions involved. Divisions cut through the parties, where the former prime minister apparently hoped for a cross-party alliance against the regional governments. The strategy failed when the commission chairman began to see devolution as the preferred way to make the public sector coherent.

Another game is played within the top levels of the civil service, where different parts of the public sector are defending their interests behind the scenes, constituting what is variously referred to as “iron triangles”, policy networks or epistemic communities. The Swedish cabinet can only make decisions by consensus - a very important “institution” to understand Swedish politics - which gives each ministry the right to veto any suggestions they don’t approve of.

One example of the fragmentation this can lead to is the position of the employment service, which aims for national control of its instruments and is generally supported by the big unions and several economists. Ministers of Labour have tended to keep other interests at a distance, either to defend the labour market board or to reform it. In either case, integration and decentralization are secondary or even contradictory concerns for this Ministry.

In the discussion of integration of policies it should be noted that it involves several ministries. The question of devolution is “owned” by the Ministry of Finance. The specific policies are owned by their respective ministries like vocational training (Education) and transport (Enterprise). The regional development issues are owned by a section of the Ministry of Enterprise, linking development strongly but not exclusively to business development. They oversee the regional planning processes conducted by the lead organization for regional development in each region. Finally, one should add the section for economic policy of the Ministry of Finance, which owns macroeconomic policy and tends to be skeptical towards regional development policy and support for individual business in general. Any new policies will have to be accepted by all ministries or imposed by the prime minister.

Setting up the parliamentary commission in 2003 was itself an important move by the government at that time. There was a need to prepare a decision on the experiments in two regions, but the commission was given a

much greater scope. As mentioned, the prime minister in 2003 has later indicated that he was looking for an end of the experiment and even the abolishment of the regional governments.

After delivery of the report in 2007, the initiative went over to the newly elected government. Its major decision was to abstain from having an opinion on the future role and design of regions, leaving it up to the regional actors to come up with solutions. One of the main arguments was that the government wanted to avoid endless battles on how to draw new boundaries, an issue which was thought to produce many losers and, hence, something to be avoided in order to win the next elections. This set-up was an important move (a non-decision on substance) by the government. It abdicated on this issue and opened for a regional game of friends-making.

Leaders of the conservative party said that there was no demand from the people for devolution or the amalgamation of regions, and that these issues were only in the interest of local and regional elites. The government instead focused its energy on fighting unemployment and social exclusion in general, with an emphasis on stronger incentives for work in the various public support systems, an agenda much in line with macroeconomic thinking by former president Clinton and various other European governments. The focus was on reforming individual agencies like the labour market board and the social security administration, rather than collaboration to deal with overlapping problems. The role of the regions is in this perspective secondary, though there are many pro-regional statements in the policies on economic development (Ministry of Enterprise).

Obviously, there is a risk for suboptimal outcomes in the regional negotiations over mergers, creating lock-ins where regional actors settle on something which makes sense to themselves under the circumstances but where other solutions would be better from a bigger perspective. However, the regional actors are making their decisions “in the shadow of the state”, knowing that in the end it is the government which makes proposals to the parliament.

To summarize, rational choice institutionalism helps us see the games that are going on. These games are very much – but not exclusively - about power and money, where self-interest tends to dominate. Further analysis of these games can help us see solutions and barriers to solutions. The key lesson is perhaps that non-regional and non-local perspectives are present in many parties and ministries, to the extent that they now dominate national politics. They seem to be based on macroeconomic thinking where

regions are irrelevant, which is the focus of the next type of institutionalism. For devolution to come back on the agenda, a new coalition of interests based on other theories is needed.

3.5.2. The second perspective: competing logics

Sociological institutionalism can help us understand the negotiations which go on at the regional level and at the national level. In particular it can provide a broader view of how the actors make up their minds when several issues are at stake, when their “logics” come into conflict.

Health care is the backbone of the elected regions, with something of a built-in logic in the relationships established within health care, a “health care regional logic”. Patterns of collaboration are different in the area of regional economic development, which is operating according to another “regional logic”. A general interest is to create alliances which make sense from an economic perspective, supporting future growth areas around big cities or airports etc. The regional governments work with transport and have a need to connect their mid-range services with national and local services. The need for public transport is endless and the area is riddled with conflict over priorities, in regions, between regions and between means of transportation. A holistic view on transport is easier said than done.

The national agencies and their ministries have other needs which can be described as a third kind of “regional logic”. The agencies have adopted a variety of regional divisions, often dividing the country into fewer and bigger regions than the 21 counties. One of the arguments for making “6-8 regions”, as the parliamentary commission suggested, is that such a number seems reasonable to most agencies as well as for health care and regional development purposes. For those who desire regional integration of the public sector, it would be of great value to have a set of regions which the central government can connect to.

To some extent the EU is operating with a fourth “regional logic”, the NUTS2-regions used for statistical purposes and for the structural funds. These are generally not seen as regions at all, but over time the partnerships created for the structural funds may produce loyalties and open up for new possible alliances. When everything else is messy they may provide a focal point for Swedish decision-makers.

In sociological institutionalism, national and regional actors are not necessarily motivated by self-interest, but also by new ideas and what others regard as legitimate. To some extent it is rational to do what others do (“go with the flow”) instead of making a complex calculus of interests. This can explain why concepts such as “new regionalism” are adopted rapidly

in many different countries. It points to the importance of first-movers among the regions, the trend-setters which others follow. If one region takes a new course of action, it will be easier for others to follow. This is often how new policy tools spread across the country, but we haven't seen any obvious leaders in how to handle the negotiations among the regions.

This type of analysis can also explain some of the actions in the past, such as why regional governments moved into the area of regional development at all. One reason may be that a diversification of tasks could reestablish the legitimacy/status of the regional governments when health care is under attack. Their interest in regional development may have helped in adopting the "new regionalism" (Keating 1998), as well as the reverse, that the new paradigm gave increased support for the role of regional actors.

The new economic paradigm itself may be a result of the rise of economic geographers into a new "epistemic community" with a set of ideas in opposition to the epistemic community of macroeconomists. Furthermore, there was inspiration from the German case, when membership of the EU made German states a role-model for Swedish regions.

The point, according to sociological institutionalism, is that policy learning in this fashion can mean that certain details are picked up while differences in context are ignored. Such picking up of international concepts may in worst cases lead to the adoption of easy elements of these concepts while retaining contradictory policies in other areas. "New regionalism" may in practice mean different things in different countries. Such a situation is in contrast to a more rationalistic conception of politics, where actors are expected to be rational and take the context into careful consideration, adapting the new paradigm to the particulars of the individual country or region.

The regional issue itself is an example of changing expectations. In growth policy, regions are now seen as the natural arena. International economic geographers preach that economic development has a regional logic, that the best scale to handle business development is above the local level but below the national level (no matter how large or small the nation is). In more elaborate versions, there is an acknowledgement that some issues are better decided at the national level, such as how many biotech-clusters the public sector should invest in.

A final area where sociological institutionalism can be helpful is in the analysis of norms, especially the conceptions of democracy involved. It seems that actors have different views of what democracy is or should be, and that the vague discussion of democracy in the regions would benefit from making these conceptions explicit.

Devolution is partly driven by a desire to have self-rule at the regional level. Many agree that a change of leadership from appointed prefects to elected politicians makes sense, but there is less agreement on how far to go. The regional development agendas tend to be agreed by all parties; can there be more politics at the regional level and should there? Would it be better if more legislative powers were devolved or would that lead to careless spending by the regions? Would amalgamated regions have more interesting political debates? What happens if voters ignore the regional level?

In practice there is another conception of democracy already in place, a model where bargaining behind closed doors, for example in partnerships, is preferred over public debates. This is a very pragmatic (American) way of looking at the operation of the public sector. Organized interests in the Swedish regions are invited to summits where they can contribute to the agenda. Also, many partners in the partnerships are agencies acting through civil servants on behalf of the national government, giving rise to a case of “politics without politicians” in the partnerships.

To summarize, sociological institutionalism helps us pay attention to the complexity of the competing “logics” and how the “games” may be perceived differently. This is very relevant when the design of the structure is delegated to 21 individual regions. The perspective also helps us see the impact of trends and paradigms, that sometimes new ideas are accepted very quickly and sometimes refused for very long.

3.5.3. The third perspective: paths determine outcomes

Finally, historical institutionalism directs our attention to paths, such as the opening of experiments in regional coordination and devolution. The national government seemed to be on a slow path to devolution from 1995 until 2006. Driving forces were the EU, the new regionalism, regional politicians and, not least, the perception of success in the devolved regions. The speed was slowed down by other coalitions pushing in other directions, favoring conformity and national control.

The policies of the previous coalition government have tended to have negative side-effects for the regions. The focus on the employment service was not based on hostility towards regional integration, but rather on a desire to control the instruments that are important from an economist’s perspective.

On the other hand, devolution seems to have been a frightening topic, mainly due to the potential conflict it may let loose. Centralization was generally desired by the government as a means for reform of various pol-

icies such as introducing private providers for welfare services, forcing local governments to open up for competition. Furthermore, the government has also desired to separate more clearly the roles of politicians and civil servants, criticizing agencies for telling politicians what to do.

If there is a general pattern in this, it is of reducing complexity to make the public sector more governable from the center. This is a rational strategy in a majoritarian parliamentary system, where a government may not sit very long. Hence, the logic of a top-down type of democracy reinforces itself.

To summarize, historical institutionalism emphasizes the development and continuity of policies over time. One could say that devolution has built up since the 1960s and has the effect of a path on events in the 90s until now. The perspective is unable to explain why there was no enthusiasm for the commission report in 2007. Such a break with policy can be more easily explained by the other perspectives, as a change of the bargaining games and/or a change of ideas and perspectives by the central government, through a change of government in 2006.

New perspectives on job creation are central to this shift of policies, going from a focus on integration and collaboration to a focus on a macroeconomic perspective to be executed from the top down.

3.6. Where will the conflicting agendas lead?

The perspectives help us see what goes on at the national and the regional levels. Rational choice institutionalism helps us see the games that are going on. A number of conflicts are present at the national level. Some of these are biased against regional and local solutions, while the decision of the present government has been to continue devolution in all regions by 2019. Regional games are nested with the national games and vary across the country.

Sociological institutionalism helps us pay attention to the complexity of the competing “logics” and how the “games” may be perceived differently. The last point means that games are not everything. Norms and “going with the flow” of other events may have a great impact on how the situations unfold. Historical institutionalism creates a bridge between the other institutionalisms, pointing to the sequence of events, how one event has an impact on the next.

To summarize the long-term trends, we can see support for regionalization and coordination bottom-up as well as for top-down control. The present government has embraced devolution, perhaps partly because they were

trapped in the momentum of a path. There are critics in all political parties, which showed most visibly during the coalition government 2006-14, which focused on other issues. The rhetoric was dominated by macroeconomic thinking, but there was a minority opinion in favor of decentralization, at least to local governments. The government at the time focused its energy on jobs and breaking social exclusion by means of changing incentives (not by expanding and/or integrating programs). Devolution was more or less paused at the time.

The present government (since 2014) has been more in favor of devolution and also of relaxing some of the control of the employment service (Arbetsförmedlingen). These developments go together with a search for new management principles beyond New Public Management.

At the same time, other political parties have opened debates on the abolishment of the regions as well as on the abolishment, division or privatization of the employment service.

A final paradox is that when devolution is winning across the country, the support for it is perhaps the lowest ever. The path of devolution is strong, but this strength is partly a function of the great number of conflicting alternatives.

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Chapter 4

Developing more local strategies for a changing labour market: insights on constraints and opportunities in the UK

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Abstract

The UK is characterized by a high degree of institutional and fiscal centralization by international standards. Alongside some devolution to Scotland, Wales and Northern Ireland there has been a recent trend towards asymmetric decentralization in England, with the focus of this being on ‘deals’ to large city-regions. This paper rehearses selected key features of the UK labour market, outlines changes in active labour market policy and sets out the scope of sub-national government’s role in economic growth and labour market policy, with some examples from the West Midlands city-region in England. It emphasizes that that capacity and opportunities for action are constrained by reduced resources and limitations on responsibilities, and that in such an environment it is important that learning on ‘what works’ (and what does not) is shared.

4.1. Introduction

Three Rs – Realization, Resources and Responsibilities – lie at the heart of understanding the development of more local strategies for a changing labour market in the UK. At the time of writing for the symposium (in late summer 2018) the UK employment rate was at an all-time high and the unemployment rate was low by historical standards. These headlines provided a positive picture at a time when Brexit was commanding foremost attention from the UK Government. While there were spatial variations in employment and unemployment rates, all local areas had shared in improvement on key labour market indicators since the Global Financial Crisis. Given that at local level action in the UK is constrained by limited financial resources and that primary responsibility for employment and welfare lies at national level, realization of issues relating to a changing labour market might be expected to be limited – especially at subnational level.

Since late summer 2018 two major economic changes have occurred: first, the UK left the European Union (EU) on 31 January 2020 (i.e. ‘Brexit’ was

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concluded), and secondly, in March 2020 the UK entered its first lockdown of the Covid-19 pandemic. The impacts of each of these major changes are intertwined. The Brexit vote resulted in renewed emphasis on ‘areas that have fallen behind’ (McCann, 2018), while the impact of Covid-19 has been to accentuate social and spatial inequalities. What is clear is that the scale of the Covid-19 shock meant that national government took on a greater role in supporting the economy, businesses and labour market (through furlough, grant and loan schemes), while at subnational level local actors came together with new impetus to develop regional strategies for recovery.

Recognizing that national and subnational policy needs to set the foundations to enable the opportunities associated with industrial and technological change to be seized, in November 2017 the UK Government reintroduced ‘industrial strategy’ into the policy lexicon publishing an Industrial Strategy (HM Government, 2017), setting out five ‘foundations’ of economic policy:

- Ideas – encompassing R&D and innovation
- People – focusing on skills and education
- Infrastructure – emphasizing broadband, energy and transport
- Business environment – focusing on support for specific sectors and SMEs
- Places – emphasizing tackling regional disparities

It was argued that improving these foundations would help tackle several ‘Grand Challenges’ pertinent to labour market change which in a recursive fashion would help improve the foundations:

- Artificial Intelligence (AI) and the data revolution
- Clean growth – low carbon technologies across the economy
- Mobility – low carbon transport, automation, infrastructure
- Aging society – healthcare and labour market challenges

So, in strategic policy terms there was a recognition of some of the key drivers of labour market change.

The ‘People’ and ‘Places’ foundations are of particular pertinence here. Key policy objectives highlighted under the ‘People’ foundation were the establishment of an enhanced technical education system; additional investment in mathematics, digital and technical education to help address the shortage of STEM²² skills; and creation of a new National Retraining

²² *Science, Technology, Engineering and Mathematics.*

Scheme to support re-skilling. Key policy objectives under the ‘Places’ foundation were the agreement of Local Industrial Strategies building on local strengths and delivering on economic opportunities.

In March 2021 the UK Government abandoned ‘industrial strategy’ in favour of a Build Back Better Plan for Growth (HM Treasury, 2021). In some instances, Local Industrial Strategies have morphed into recovery strategies, rather than having been abandoned wholesale. Concerns about socio-spatial inequalities have been accentuated, however, and the new phrase in the policy lexicon is ‘levelling up’ (which in early January 2022 is yet to be officially defined). The basic idea of levelling up is to reduce the rising place-based economic and social inequalities in the UK, without compromising growth in already successful places.

By comparison with many OECD countries, many of the responsibilities relating to the foundations of the Industrial Strategy are retained at UK level or are devolved to the constituent nations of England²³, Scotland, Wales and Northern Ireland, rather than directly to subnational governments (i.e. local government in the UK context). Although not central in the Industrial Strategy and other policies, the direction of travel in the UK prior to the Covid-19 pandemic was towards greater local powers, freedoms and flexibilities. However, the impact of public expenditure cuts has meant that capacity for subnational governments and agencies to deliver has been constrained, even though the need to promote place-sensitive strategies has heightened.

Section 3.2 presents key features of the UK labour market. Section 3.3 traces key features of, and developments in, active labour market policy. Section 3.4 outlines the scope of sub-national governments’ role in economic growth and labour market policy, limitations on finances available and includes a focus on some developments in the West Midlands Combined Authority area. Section 3.5 concludes.

4.2. Features of the UK labour market

This contextual section sets out key features of the UK labour market: first, the liberal regime promoting flexible working; and secondly, an increasing concern with employment quality.

4.2.1. Features of a liberal labour market

In international terms the UK is characterised by its liberal labour market regime which places onus on limited regulation and flexibility. In general terms, institutional structures and approaches may be characterised as

²³ *The emphasis here is on England, which is easily the largest of the four nations, accounting for 86% of UK GVA in 2015.*

market-based, as opposed to being founded on strong social partnership principles.

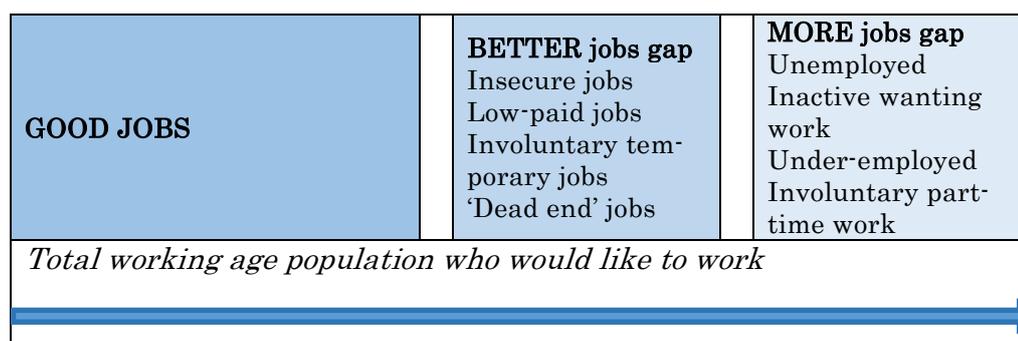
While flexibility can mean entry to employment is easier than in more highly regulated labour markets so leading to relatively low unemployment rates, Rubery et al. (2016) have suggested that UK labour market flexibility has multiple and hidden costs. They suggest that the UK ‘jobs miracle’ is exaggerated and based on low productivity jobs, that low wage employment is shrinking the fiscal base, that benefit claimants must work flexibly but still secure a full-time wage, that outsiders lose out and that long-term productivity is undermined.

On key indicators of flexibility, the incidence of temporary work is relatively low, average job tenure is also relatively low and the share of part-time employment in total employment is relatively high in the UK. In terms of statutory wage floors, a National Minimum Wage (NMW) was introduced in 1998 and its level relative to the median wage is towards the middle of the range amongst OECD countries.

4.2.2. Increasing concern with job quality

Subnationally, even when employment rates were at an historical high, prior to the Covid-19 crisis, at national level it remained the case that a significant ‘more and better jobs’ gap (see Figure 4.1) of unemployment, insecure or low paid work existed in Britain’s major cities (Pike et al., 2017). Beatty and Fothergill (2018) suggested the picture was worse in older industrial areas outside the main cities where the economy was essentially stagnant, with a substantial amount of labour market slack and poor pay and conditions. The ‘more jobs gap’ comprises individuals who cannot get any work/ the amount of work they want, suggesting a deficiency in labour demand. The ‘better jobs gap’ is made up of people in insecure and/or low-paid jobs.

Figure 4.1: The more and better jobs gap



Source: adapted from Pike et al. (2017)

Pike et al. (2017) calculated a ‘more and better jobs’ gap for 12 British city-regions. Expressed as a proportion of the population who are in the labour force (employed or unemployed) or economically inactive but saying they want to work) the ‘more and better jobs’ gap ranged in size from 41% in Newcastle (north-east England) to 32% in Bristol (south-west England). In the Birmingham city-region (in the West Midlands region) the gap was 39%.

Related to the ‘better jobs’ concept, ‘good work’ is gaining increasing prominence and traction in debates about the nature of work in its broadest sense. The context for this the rise of ‘atypical’ work forms, the growth of self-employment, agency work, temporary work, zero hours contracts and gig economy work, and associated issues such as increasing job insecurity, increasing work intensity and tight deadlines, individuals being stuck in low-paid work, growing skills under-utilisation, a significant number of workers being affected by health conditions, growing skills shortages (which have heightened during the Covid-19 crisis) and significant numbers missing out on training. The Taylor Review of Modern Working Practices (2017) helped to bring these issues to the forefront of policy debates.

Given the rise of interest in job quality, a key question concerns the extent to which concerns about qualitative, as opposed to quantitative aspects of employment have penetrated into developments in active labour market policy.

4.3. Active labour market policy: features and developments

This section outlines the key features of, and developments in, active labour market policy (ALMP).²⁴ In particular it highlights the increasing focus on job retention and progression in work.

4.3.1. Introduction and key features

The main central government department with responsibility for ALMP is the Department for Work and Pensions (DWP). DWP is concerned with delivering a modern, fair and affordable welfare system that makes a positive difference to citizens’ lives by extending opportunity, strengthening personal responsibility and enabling fulfilment of personal potential. The public employment service, Jobcentre Plus, is part of the DWP and combines the functions of job broking, referrals to ALMP measures and the administration of the benefits system.

A key feature of UK ALMP is its supply-side emphasis; indeed, Peck and Theodore (2000: 729) describe the UK approach as constituting “supply-side fundamentalism”. Traditionally UK ALMP is based on activation measures that seek to increase employment levels among the unemployed,

²⁴ Conventionally refers to welfare-to-work programmes and other employability-focused initiatives aimed at moving unemployed/ disadvantaged people into employment.

emphasising individual characteristics and responsibilities, in isolation from wider labour market factors (e.g. see Gore, 2005).

4.3.2. Selected recent developments in ALMP

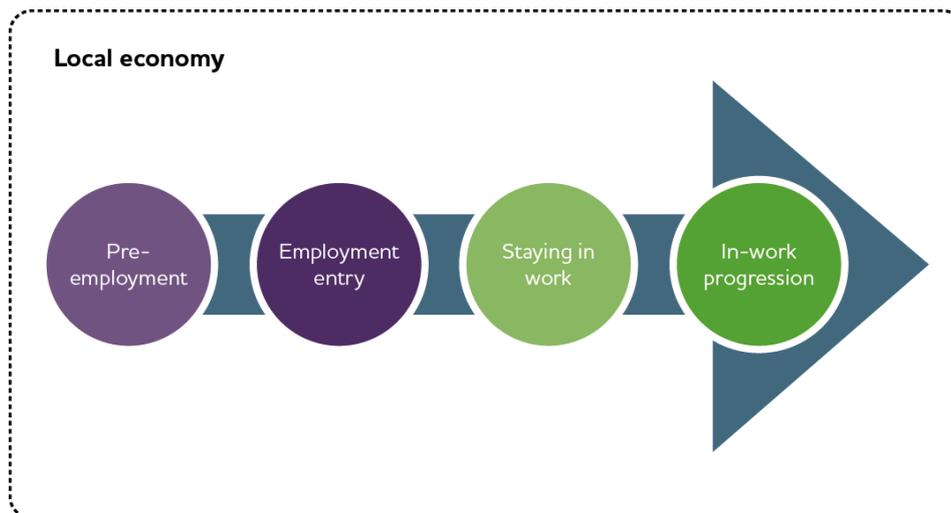
Two key policy developments are worthy of particular note: first, the introduction of Universal Credit (UC); and secondly, changes in the Jobcentre Plus estate.

UC is a new single working-age benefit payable to both those out of work, and those in work and on low pay, replacing a range of means tested social security benefits and tax credits for people of working age. The financial support provided by UC is underpinned by a new conditionality framework setting out the responsibilities of claimants, which depend on the claimants' circumstances. What is different about UC from what has gone before is the element of in-work conditionality.

A second shift relates to reform of Jobcentre Plus offices and benefit centres. The context for this is an increase in benefit claims being made online and old buildings contracts coming up for renewal. The result has been rationalisation and mergers, with some Jobcentre Plus offices being co-located with local authorities or other community services to provide joined-up services, so saving money. At local level the idea is that co-location should aid collaboration across different policy domains.

4.3.3. An increasing focus on progression

Although in broad terms, ALMP in the UK remains rooted in a 'work-first' approach, with the speedy exit from unemployment being the core aim of policy, issues of retention and in-work progression have begun to form a greater part of ALMP design. Under UC, there is an expectation (with in-work conditionality) that very low earners will seek to increase their hours and/or wages, so heightening the importance of in-work progression. In terms of the 'employment pathway' outlined in Figure 4.2, while traditionally the focus has been on pre-employment and employment entry it is now shifting to place greater emphasis on staying in work and in-work progression.

Figure 4.2: The employment pathway

Source: Green et al. (2015)

This greater focus on progression has implications for work coach advice to individuals, for how employability services are delivered, for employer engagement in ALMP (given that to date it has been focused on sectors with low barriers to entry often associated with low wages and poor opportunities for progression) and for HRM practices (Sissons and Green, 2017). It implies a need for greater collaboration across policy domains at local level – especially in the context of concerns in the UK about in-work poverty and the burgeoning debate on job quality (outlined in section 2). The ability for ALMP to help improve sustainable employment outcomes meeting the conditionality requirements of UC is dependent to a significant degree on the availability of suitable opportunities in the labour market to support progression. Yet the low-skills low-wage trap outlined in the low-skill equilibrium literature (Finegold and Soskice, 1988; Wilson and Hogarth, 2003) has proved difficult to escape and there is evidence that internal labour markets have been eroded in recent decades with the use of flatter organisational structures (Lloyd and Payne, 2012; Devins et al., 2014), meaning that in some sectors the opportunities for progression from low pay are highly constrained.

4.4. Scope of sub-national governments' role in economic growth and labour market policy

This section sets out the changing institutional structure for labour market governance in England and the range of actors involved and relationships between them. It outlines resourcing issues at the sub-national scale and then focuses on deals and asymmetric devolution of powers and budgets to support local growth, with some examples from the West Midlands Combined Authority area to illustrate key points.

4.4.1. Institutions and stakeholders in labour market governance

Regular change is a key feature of the institutional architecture in England for local economic growth, employment and skills and ALMP. The period since 2010 has been one of particularly intense change as old structures have been abolished and new ones have been created. At the time of writing in early January 2022 a new restructuring of labour market governance is expected to be announced imminently.

At national level the Department for Business, Energy and Industrial Strategy (BEIS) has a remit to build an economy that works for everyone, so that there are great places in every part of the UK for people to work and for businesses to invest, innovate and grow. The Department for Education covers children's services and education, including early years, schools, higher and further education policy, apprenticeships and wider skills in England. The Department for Levelling Up, Housing and Communities and Local Government's (formerly the Ministry of Housing, Communities and Local Government) supports communities across the UK to thrive, making them great places to live and work. These work alongside the Department for Work and Pensions.

At sub-national level in 2010 the UK Government set out its approach to local economic growth in 'Local growth: realising every place's potential', based on a localism agenda (i.e. devolving power to communities) (HM Government, 2010). This involved the shift of powers to local communities and businesses, principally through the closure of the Regional Development Agencies²⁵ and the introduction of *Local Enterprise Partnerships (LEPs)*, the introduction of new incentives and powers for local authorities including business rates retention (see section 4.2) and tax increment financing, and focused investment – including through a series of Deals (see section 4.3).

The origin of the development of LEPs was an invitation from central government in June 2010 for local consortia to submit proposals for partnerships with local business and civic leaders, operating in functional economic areas, to provide the vision, knowledge and strategic leadership to set local economic priorities. 39 LEPs were established in England, comprising groupings of local authority areas, with some local authorities having membership of two LEP areas. At the time of writing in early January 2022, the future of LEPs is uncertain with a restructuring of local government expected imminently.

LEPs are strategic partnerships between businesses and local authorities, with responsibilities for steering growth in local communities. Roles set out

²⁵ There were nine RDAs in England – at NUTS 1 regional scale.

for LEPs in 2010 included working with Government to set out key investment priorities, including transport infrastructure and coordinating and supporting policy delivery, co-ordinating proposals/ bidding for funding, supporting high growth businesses, and working with local employers, Jobcentre Plus and learning providers to help local workless people into jobs. In 2014 LEPs were given responsibility for delivering part of the EU Structural and Investment Funds. Importantly delivery is implemented through partners and to some extent their contribution might be seen in the so-called ‘soft spaces’ of local economic development, where they might exert influence and help build partnerships, networks and institutional capacity. LEPs are highly dependent on local authority partners for staff and expertise and, as outlined in section 3.2, local authorities have made large cuts in areas such as local economic development.

In July 2018 the Government (HM Government, 2018) announced proposals for strengthening LEPs to supercharge economic growth and drive forward investment. A key task for LEPs was to convene local economic stakeholders to develop evidence-based Local Industrial Strategy to set out a long-term vision for their area.

Local authorities are the bedrock of local government in England. Local government in England operates under either a one tier system (unitary authorities) or a two-tier system (county and district councils). In the two-tier system county councils are responsible for: education, highways, transport planning, passenger transport, social care, libraries, waste disposal and strategic planning, while district councils (of which there are several within a county council area) are responsible for housing, leisure and recreation, environmental health, waste collection, planning applications and local taxation collections. In the one-tier system unitary authorities are responsible for education, highways, transport planning, passenger transport, social care, housing, libraries, leisure and recreation, environmental health, waste collection, waste disposal, planning applications, strategic planning and local taxation collection.

A newer innovation in local government (associated with devolution deals and promotion of local economic growth) is *combined authorities (CAs)*. Since 2011 there has been provision for local authorities to set up CAs. These are formed of two or more local government areas mostly chaired by an elected Mayor with one or more devolution deals (see section 3.3). Mayoral combined authorities are held to account by local overview and scrutiny committees and audit committees (National Audit Office, 2017). Mayors are also accountable to their electorates. Importantly many of the powers and responsibilities of mayoral Cas are concurrent with, or require agreement of, other bodies. For example, there are overlaps between CAs

and other bodies' responsibilities in employment and business support, further education and skills, economic growth.

Hence coordination and partnership with other bodies is important, but the extent of institutional change creates confusion and makes it difficult for some partners to know how best to engage.

4.4.2. Resourcing of subnational governments

The UK is characterised by fiscal centralisation with local taxes (see Table 4.1) representing only 1.6% of GDP (OECD, 2016). This is approximately 20 times less than the taxes collected at central government level and far below Sweden (15.8%) and Denmark (12.5%) and below Germany and the US (which have a federal level of government as well as central and local levels).

In a similar vein, the share of local tax revenue as a share of the total tax revenue in the UK at 4.9% is substantially smaller than most OECD countries (see Table 4.2). Hence, local taxes represent a very small proportion of the total revenue for local government in the UK: in 2012 13% of total local revenue in the UK was raised from local taxes. This is a substantially smaller proportion than recorded for other large European countries: 61% in Sweden 48% in France, 45% in Italy and 39% in Germany. As a result, local government in the UK is heavily dependent on inter-governmental transfers. In 2015 67% of local government revenue in the UK was in the form of government grants, compared with 26% in France, 37% in Germany and 40% in Italy (OECD, 2016) (see Table 4.3).

Table 4.1: Tax revenue as a percentage of GDP at central, federal and local levels in selected OECD countries, 1994, 2004 and 2014.

Country	Level/Year	Tax revenue as % of GDP		
		1994	2004	2014
Denmark	Central	31.82	31.59	38.31
	Local	14.72	14.83	12.58
Finland	Central	35.57	33.13	33.53
	Local	9.94	8.69	10.32
France	Central	37.69	37.52	39.29
	Local	4.56	4.66	5.92
Germany	Central	25.72	24.00	25.54
	State	7.68	7.36	8.06
	Local	2.77	2.50	2.54
Italy	Central	36.83	32.78	36.72
	Local	1.87	6.54	6.91
Japan	Central	19.23	19.41	24.53
	Local	6.57	6.67	7.38
Korea	Central	15.28	18.06	20.45
	Local	3.61	3.90	4.16
Spain	Central	27.82	26.77	25.41
	State	1.53	4.66	4.53
	Local	2.63	2.86	3.26
Sweden	Central	29.52	30.68	26.89
	Local	15.07	14.97	15.81
Turkey	Central	15.04	22.38	26.00
	Local	1.51	1.69	2.72
UK	Central	29.46	31.79	30.98
	Local	1.15	1.60	1.60
United States	Central	17.29	15.92	17.39
	State	5.28	5.01	5.02
	Local	3.61	3.65	3.59

Source: OECD

Table 4.2: Local tax revenue as a percentage of total general government tax revenue in selected OECD countries ranked on 2014 values, 1994, 2004 and 2014.

Country	Local tax revenue as % of general government tax revenue		
	1994	2004	2014
Japan	25.45	25.58	23.45
Sweden	33.80	32.79	37.03
Korea	19.13	17.78	16.89
Italy	4.82	16.63	15.84
Switzerland	17.87	16.19	15.18
United States	13.79	14.85	13.82
Norway	20.97	13.71	13.78
France	10.79	11.04	13.10
Spain	8.24	8.33	9.82
Turkey	9.11	7.02	9.46
Canada	10.19	9.22	9.01
Portugal	5.40	6.66	7.21
Germany	7.65	7.38	7.02
New Zealand	5.38	5.46	6.52
UK	3.77	4.79	4.90
Luxembourg	5.69	4.91	3.26
Austria	11.02	3.24	3.18

Source: OECD

These statistics indicate that local authorities are predominantly reliant on national government for their revenues. The implications of this are:

- National macro-economic conditions are of foremost importance in resourcing at sub-national level, irrespective of local economic conditions and needs.
- Dependency on national policy and decisions made at the central government level.
- The dependency of local councils on the central government for their funding means that the former tend to take a back seat in identifying innovative ways of raising funding. The incentive for entrepreneurial action in terms of local financing is absent and this creates a culture of expectation and blame where local councils rely on national government to act/ denounce national government when things go wrong.

Table 4.3: Inter-governmental transfer revenue as a percentage of total revenue for at central, federal and local levels in selected OECD countries, 1995, 2005 and 2015.

Country	Level	Intergovernmental transfer revenue as a % of total revenue		
		1995	2005	2015
Belgium	Central	0.25	0.09	0.13
	State	76.87	66.16	62.73
	Local	45.77	47.04	47.26
Canada	Central	0.46	0.39	0.26
	State	17.89	18.18	18.41
	Local	46.20	44.65	42.02
Denmark	Central	3.19	3.69	2.14
	Local	46.21	46.17	58.46
Finland	Central	3.30	0.91	1.23
	Local	33.37	28.71	29.10
France	Central	0.73	0.72	0.44
	Local	27.82	28.64	25.70
Germany	Central	1.12	0.68	0.66
	State	16.82	15.55	14.62
	Local	35.65	34.27	37.48
Ireland	Central	0.01	0.03	0.00
	Local	70.00	55.81	43.71
Italy	Central	0.65	0.94	1.28
	Local	60.54	41.31	39.89
Norway	Central	0.33	0.13	0.20
	Local	38.07	35.51	44.41
Spain	Central	1.21	1.08	4.17
	State	71.99	55.71	54.98
	Local	34.79	34.28	33.87
Sweden	Central	0.31	0.60	0.67
	Local	20.80	20.48	30.59
Switzerland	Central	2.39	3.12	0.64
	State	24.40	29.96	24.24
	Local	10.95	8.96	10.97
UK	Central		0.28	0.17
	Local	72.83	69.89	67.03

Source: OECD figures internally consolidated between the Central and Social Security sectors only.

As noted by Kitsos (2017), local government funding has been under severe pressure since 2010, with local government required to make disproportionate spending reductions. The National Audit Office (2014) estimated a 37% decrease in funding from 2010-11 to 2015-16. This decrease does not include losses from year to year increases in local authority financing in the years before 2010.

Local authorities have a statutory obligation to balance their budgets.²⁶ They provide a wide variety of services – either through direct delivery or via commissioning other public bodies, the voluntary sector or the private sector. However, the services that they are legally obliged to provide are only a subset of these. When faced with financial pressure it is services that they are not legally obliged to provide that are first to be cut. As a result, local authority expenditure is dominated by social care, accounting for 59% of non-schools service spend in 2016-17 (National Audit Office, 2017). Local authorities have seen large staff reductions, with Birmingham City Council reducing its full-time equivalent jobs from 21,000 in 2010 to 7,000 by 2018. In the context of these financial constraints labour market strategies can be seen as 'nice to have' luxuries.

Travers (2012) notes that economic development has become a major local government activity since the 1980s when radical changes to the UK economy left many areas with little alternative but to act to generate their economies. Policies ranged from land clearance, retail development, public transport, roads, housing and marketing, with pro-growth policies being the norm in many areas where unemployment was high. The decision to require local government to make disproportionate spending reductions has directly led to the need to reduce spending on pro-growth services.

4.4.3. Deals and devolution

Historically England has been characterised by centralised policymaking and limited devolution of powers to sub-national areas, although there has been devolution of selected policy areas to Scotland, Wales and Northern Ireland. The UK Coalition Government (2010-2015) initiated a series of 'deals' (City Deals, Growth Deals and Devolution Deals) with selected cities to devolve powers and resources in particular policy domains such as transport, housing, business support, skills and employment (Sissons et al., 2018). Subsequently the coverage and scope of devolution agreements was extended (National Audit Office, 2016). However the transfer of powers has been uneven between places and in terms of policy domains under consideration (O'Brien and Pike, 2015).

The process of deal-making began with *City Deals*: bespoke packages of funding and decision-making powers negotiated between central government and local authorities and/or LEPs and other local bodies. The deal-making process proceeded on the basis of city size, with the largest city-

²⁶ This is made more difficult when there are changes/ delays to funding streams. An example of this concerns business rate retention. In October 2015 the Government announced its intention to enable local government to retain all business rates (i.e. property taxes paid by occupants of non-domestic properties) raised locally in return for transfer of new responsibilities. A Local Government Bill enabling legislation for the reforms did not complete its legislative stages before the 2017 General Election. This has caused a delay in implementation. This is aside from concerns regarding the operation of a revised system – including (1) the correlation between growth in business rates revenue and growth in need at local level, and (2) the relationship between local economic growth and growth in business rates revenue.

regions proceeding first. City Deal negotiations were generally undertaken by LEPs and local authorities and in some instances, business partnerships and universities. The City Deals focused on 'unlocking growth in cities' and focused on transport, business support and skills. Examples from the West Midlands include:

- The Greater Birmingham City Deal had plans to establish a Skills for Growth Compact, create jobs through the expansion of an existing 'green deal' programme, the redevelopment of public land for housing and business and the creation of an Institute for Translational Medicine to act as a hub for the life science sector.
- The Black Country City Deal had proposals to secure 5,800 new manufacturing jobs, £120 million of private sector investment in high value manufacturing sites and 1,500 additional high value manufacturing apprenticeships.
- The Coventry and Warwickshire City Deal had proposals to support growth in 450 advanced manufacturing and engineering firms, create 15,000 jobs and secure £25 million of public sector and £66 million of private sector investment.

Concurrently in several instances a series of local *Growth Deals* were negotiated. The background to these was a requirement from Government in 2013 for LEPs to develop multi-year local Strategic Economic Plans (SEPs) to be used as a basis for negotiations on awarding of funding from the Single Local Growth Fund. The focus of the Growth Deals was on addressing local barriers to growth, with an emphasis on job creation and building new homes.

The City Deals and Growth Deals have helped cities to begin to deliver responsive and flexible local strategies through investments in housing, transport, employment, skills and business support. Some cities have used powers to make investment in support for the unemployed. However, the task of isolating the impact of City Deals and Growth Deals on employment and skills is compromised by the broader context of reform nationally and locally and the implementation of austerity measures.

Devolution deals are agreements which move funding, powers and responsibilities from central to local government in return for governance reform at a local level, typically through the creation of combined authorities and the institution of directly elected mayors (as outlined in section 3.1). Broadly their objectives relate to economic growth and rebalancing, public

service reform and enhanced local accountability. The aim is for local authorities to have more freedom to work together to drive local economic growth.

The first devolution deal was announced by the Government and the Greater Manchester Combined Authority in November 2014. By April 2018 devolution deals had been agreed with twelve areas. Devolution deals are negotiated in private between Government teams and local authority leaders. Once the deal document has been agreed and published, each council involved must then itself approve its participation in the deal.

There is some variation between the devolution deals negotiated by different areas. Sandford (2018) characterizes the deals as consisting of a ‘menu with specials’: a number of items have been made available to most areas, but each deal also contains a few unique elements or ‘specials’ (typically consisting of commitments to explore future policy options). Sandford (2018) lists the core powers devolved as:

- Restructuring the further education system – typically consists of local commissioning of the Adult Skills Budget, followed by full devolution of the budget.
- Business support – in most areas, local and central business support services were united in a ‘growth hub’.
- Employment support - devolved areas were to participate in the commissioning of welfare-to-work programmes in their areas.
- EU structural funds - a number of areas were to become ‘intermediate bodies’, which means that they, instead of the Government, would have taken decisions about which public and private bodies to give EU structural funds to.²⁷
- Fiscal powers - most deals include an investment fund and some areas piloted full retention of business rates from 2017-18 onwards.
- Integrated transport systems - many deals included the power to introduce bus franchising, which would allow local areas to determine their bus route networks and to let franchises to private bus companies for operating services on those networks. Each deal also includes a unified multi-year transport investment budget.
- Planning and land use - many deals include the power to create a spatial plan for the area.

²⁷ At the time of writing (in early January 2022) further details are awaited about the ‘Shared Prosperity Fund’ that is designed to replace structural funds post-Brexit.

The deals and devolution arrangements set out above offer some opportunities for innovation to address important local (and national) issues through 'earned autonomy'. The benefits of devolution, and their distribution, depend on the way devolution is designed and the nature and scale of devolution agreements (Tomaney, 2016). However in domains such as employment and skills it has been argued by Wilson et al. (2017) that limited flexibilities after negotiation with central government makes integrating interventions at the local scale difficult. Rather they suggest that public service reform is required for a more efficient and effective 'whole systems approach' which remedies the silo based model of funding separate institutions and programmes and advocate a model of a network of integrated One Stop Shops that bring together employment, skills, apprenticeships, careers and business support, underpinned by 'Labour Market Agreements' between local areas and central government.²⁸

4.5. Conclusions

There is an ongoing appetite for the development of more local labour market strategies in the UK. A LEED OECD (2015) report on Local Job Creation in England emphasized the seemingly endemic nature of institutional change in relation to employment, skills and economic development policy at local level and a reduction in resources available. Institutional change has continued, with a further round of major changes expected in 2022. Over the last decade, LEPs have taken on more responsibilities, but they have been affected by limited resources and capacity.

Local authorities – who are key partners for LEPs – have seen their budgets declining. A greater share of their resources is having to be directed to their statutory responsibilities, notably social care. Economic development and local employability schemes are functions that have seen cuts.

Where local authorities have merged to become CAs they often share responsibilities with local authorities, LEPs and central government, leading to some confusion at local level. CAs are heavily involved in public service reform – partly in an attempt to better join up activity across a fragmented and siloed landscape. The geographically uneven and complex nature of layers of local and sub-regional governance with a mix of statutory and non-statutory organisations and responsibilities, that have developed in a relatively ad hoc way, pose difficulties for gaining a clear line of oversight between sub-national and national policies (Green et al., 2021). Ad hoc challenge funding pots can compound problems of longer-

²⁸ They suggest that there would be five parameters for devolution: (1) service design and delivery – what services are then delivered and how; (2) budgets and financing – where funding sits, and with what decision-making powers and / or conditions; (3) determining policy – what policies are pursued for whom; (4) objective setting – who determines priorities and accompanying targets; (5) governance and partnerships – how services are co-ordinated and led, including the roles of local partners, stakeholders and employers.

term planning and coordination across geographical scales (Green et al., 2021).

In a context of a high degree of centralization devolution in England in recent years has proceeded mainly through a framework of deal making. Decentralization has been asymmetrical, with the largest cities being granted the greatest powers. Critics of the approach to devolution in England have pointed to asymmetries in these power relations between central and local governments; the limited nature of powers which have been devolved; the fuzziness of the devolution agenda and lack of a strategic approach; and, critically, the limited financial resources attached to devolution agreements.

The ‘deal-making’ process means that devolution has progressed in a piecemeal and fragmented manner. This makes joining up activities and learning across partners at local level difficult. The proliferation of ad hoc challenge funding pots seems to have compounded problems of longer-term planning and coordination across geographical scales (Green et al., 2021). Rather than a transparent offer of devolution of particular powers, the process has been one of opaque negotiations in private with individual cities (Ayers et al., 2017). Agreement of deals is subject to content being acceptable and agreeable to central government, including individual ministers and the Treasury (Tomaney, 2016), so limiting the potential terrain which devolution might cover. The overriding focus is on barriers to growth – hence the emphasis in deals on physical development of infrastructure, improving skills supply and business support (including to tackle barriers to growth of exports). These features and the limited nature of devolution agreements point to a disconnect between the promise of devolution to empower cities to set their own priorities and the reality of limits to both powers and resources being devolved. Both powers (i.e. responsibilities) and resources are clearly fundamental in the extent to which local areas can realize (in terms of shaping and implementing) place-specific approaches (Sissons et al., 2018).

In recent times central government has been pre-occupied with Brexit and Covid-19. Local responses to the Covid-19 pandemic have led a revitalisation of existing and new partnerships. Recovery frameworks include a broadening of economic development strategies and visions to cover health and well-being and inclusive growth, as well as greater emphasis on digital infrastructure and green issues alongside traditional concerns of skills, innovation and enterprise (Green et al., 2021). It has been suggested that the UK is at a point where an historic change in spatial – and national – policy is now a matter of urgency if spatial economic inequalities are to be reduced, requiring central levelling up funds to be made available to local authorities, devolution of central government spending where possible,

and with local city-region authorities enabled to construct their own financing models, raising funds from a variety of sources (Martin et al., 2021).

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Chapter 5

Flexicurity, Local Government and Active Labour Market Policy in Denmark²⁹

Per Kongshøj Madsen ³⁰

Abstract

Active labour market policy (ALMP) has over the years been the subject of both conflicts of interest and considerable restructuring. This chapter outlines these developments and their effects on the functioning of the Danish flexicurity model, which is briefly outlined in the beginning of the chapter.

The starting point for the discussion of the role of local government is the reform of the structure of the municipalities in 2007. Here the number of municipalities was drastically reduced. At the same time the responsibility for implementation of active labour market policy was to a large degree transferred to the individual municipality. At the same time the activities and results of the local job centres were to be closely monitored by the national authorities. The chapter analyses the conflicts related to the reform and the subsequent changes in both the content and implementation of Danish employment policy.

Through reforms in 2015 and 2020, the municipalities were relieved from much of the pressure that was put on them in 2007. Their degrees of freedom simply became greater. Process requirements were fewer. It was now possible to design the effort for the individual unemployed in greater accordance with the individual needs. Whether the municipalities can live up to the positive expectations behind the reforms, thus contributing to a new vitality of the challenged Danish flexicurity model, will be tested in the coming years.

5.1. The municipalities and the Danish flexicurity model

Denmark experienced in the years leading up to the financial crisis in 2008 the well-known "Fifteen minutes of world fame." The highest employment rate in the European Union, the low level of unemployment and a strong macroeconomic performance made Denmark stand out as a poster

²⁹ The chapter is a translated and updated version of Madsen, Per Kongshøj (2015): "Flexicurity, kommunerne og beskæftigelsespolitikken" in *Kommunerne i krydsild* edited by Søren Villadsen, *Nyt fra Samfundsvidenskaberne, Frederiksberg*, pp. 221-244. I thank participants in the workshop in Copenhagen in September 2018 for their useful comments to a draft version of the chapter.

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boy for Europe. Its interplay between the welfare state and the labour market was considered as a successful hybrid between the highly flexible labour market of liberal welfare states and the strong safety nets of the Scandinavian welfare regimes. Denmark seemingly had combined the dynamic forces of a liberal market economy with the security of a welfare state. The bumblebee could actually fly (Madsen, 2006).

Under the heading of "flexicurity", the Danish market model was therefore marketed as an example of a successful interaction between low job security, a flexible labour market, a high level of income security (unemployment benefits) and active labour market policy. In the wider European discourse on flexicurity Denmark was from 2006 taken as inspiration for a European Social Model, which could inspire Member States in developing their national employment strategies.

In recent years, the enthusiasm for Danish flexicurity has declined. After an unemployment benefit reform in 2010 and a gradual lowering of the replacement in subsequent years, the meshes in the safety net have become larger, and the financial crisis also did set the active labour market policy under pressure. Simultaneously the local jobcentres in the municipalities became subject to strong criticism from both national politicians and the social partners.

With a so-called "structural reform" in 2007, the responsibility for implementing active labour market policy was delegated to the municipalities. But if active market policies are an important part of the welfare state's safety net, was it then a good idea to leave the main responsibility to 98 municipalities implying the risk that efforts would bristle in as many directions? Did the municipal jobcentres have the capacity to handle the many different groups on the Danish labour market? How do you establish a national reimbursement system, which on the one hand encourages municipalities to effective action and on the other hand insures municipalities against the risk of being run over by a particularly unfortunate development on the local labour market, if for instance a large employer suddenly closes down? Thus the combination of the economic crisis and decentralization exposed local employment policy to serious pressure.

Prior to discussing the importance of the labour market and social policy of the municipalities for the Danish flexicurity model, the following section gives a brief review of the main components of the model and its robustness in relation to the economic crisis.

5.2. The three components of the Danish flexicurity model

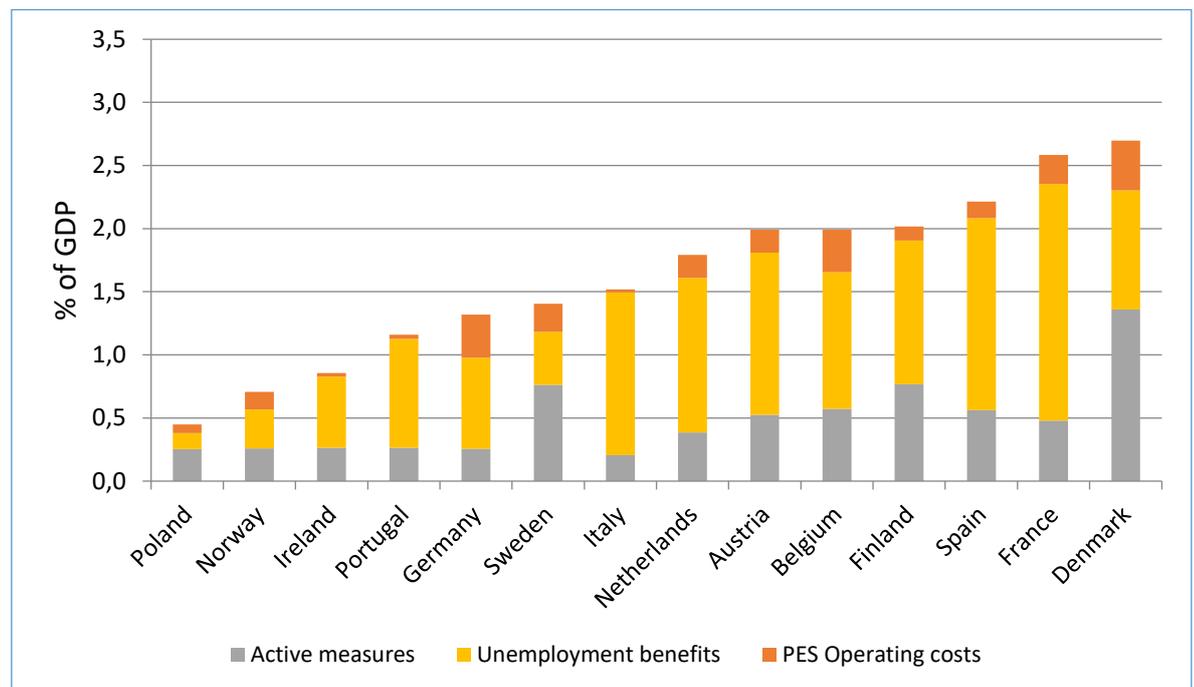
The main elements of the Danish flexicurity model are well-known. In its idealized form it is composed of the following three components:

- A labour market with a *high mobility* between jobs, which among other things is connected with a by international comparison low dismissal protection for the wage earners, who are relatively easy to dismiss. The flexible employment conditions make it easier to adapt employment to structural change caused by, for example, globalization. The employees are maintained to a lesser extent in "sunset sectors".
- An *income security* in the form of unemployment benefits or cash benefits for those affected by unemployment. This balances the low level of individual dismissal protection.
- An *employment security* provided through active labour market policies and through a well-developed system of continuing education. This strengthens the chances of the unemployed getting back to work.

Behind the model lies a long tradition of agreement-based solutions involving the social partners, where there is a continuous balancing of flexibility and security. The model's function is also supported by a large public sector, whose services support a high level of labour market participation for both men and women.

Active labour policy is one of the cornerstones of the Danish flexicurity model. A labour market reform in 1993 was first in a series of reforms that changed the Danish employment policy to be among the most ambitious in Europe. Figure 5.1 shows labour market policy expenditure as a percentage of GDP in a number of EU member states in 2015.

Figure 5.1. Expenditure on active measures, income support and operation of jobcentres in a number of EU Member States and Norway, 2019. Share of GDP.



Source: DGEmpI: Labour Market Policy Database

The picture in figure 5.1 is clear. Measured as a percentage of GDP, Denmark has the highest costs for both the overall labour market policy and the active measures. Now high costs are not in themselves a success criterion. But a large number of international comparisons indicate that real results are also achieved. Both total unemployment, youth unemployment and long-term unemployment in Denmark are relatively low when compared to the rest of the EU - also in recent years (Bredgaard & Madsen, 2018). At the same time, analyses point to a high level of mobility in the labour market (Berglund et al., 2010).

From a flexicurity perspective, the positive effects of employment policy on the labour market can be attributed to two mechanisms:

- Through active labour market policies, employment security is increasing by allowing unemployed people to improve their qualifications, both through formal education and through different types of job training. Training in job search can also help the unemployed to get a better opportunity to get back to work, even though the chances of this will naturally decrease during times of economic crisis.

- At the same time, active measures have a motivational or threatening effect in the sense that the prospect of activation can encourage an unemployed to search more eagerly for employment. In this way, the active labour market policy balances the possible "hammock effects" from the unemployment and cash benefits systems.³¹

The relationship between the two effects of active labour market policy naturally creates a clear dilemma. If the active labour market policy is to make a real improvement in the qualifications of the unemployed, it requires activation of high quality. But if the goal is to quickly scare the unemployed back into work, activation must first and foremost be perceived as unpleasant by the participants.

However, in times of rapidly increasing unemployment and fewer job openings, it is far less credible to refer the unemployed to searching for jobs only on the basis of his/hers current qualifications. At the same time, a crisis reinforces structural changes in the labour market and thus the need to retrain and upgrade the unemployed to new tasks.

Against this background, labour market policy was exposed to growing criticism during the years of economic crisis since 2008. This in the spring of 2013 resulted in the creation of the so-called Koch-Committee, which was commissioned to submit proposals for a comprehensive reform of employment efforts. The committee's first report came a year later and formed in June 2014 the basis for a comprehensive political agreement on reforming the design and organisation of active labour market policy. At the end of the paper, this latest trajectory of labour market policy will be discussed further.

5.3. Is the flexicurity model robust?

The debate about the Danish flexicurity model often appears as if the model was "invented" in recent years and is therefore closely linked to the boom from 1993 onward. It is a misunderstanding, which, however, can be explained by the fact that it was only from 2004 onwards that the word "flexicurity" was used in the public debate about the special Danish labour market model described above.

Therefore, it is important to emphasize the long historical perspective. The combination of high mobility between jobs and an well-developed unemployment benefit system has characterized the Danish labour market for several decades and has been an important factor behind the successful conversion from agriculture to industry and services, which Danish society has carried out during the post-war period. Some of the roots go even

³¹ In addition, the evaluation literature often mentions the "locking-in-effect" effect, because participants during the activation period, to a lesser extent than other unemployed are looking for work.

further back. The low dismissal protection was established with the so-called September agreement between the employers and the trade unions in 1899. The unemployment benefit system turned a 100 years in 2007 and was given its present form from 1969. The active labour market policy has also existed for several decades.

The Danish flexicurity model has thus survived through changing cyclical processes, including oil crises in the 1970s and 1980s. Although the term "flexicurity" is new, there are some rooted features of the Danish labour market, which the term seeks to capture.

Of course, this is not said that the model is immune to neither economic crises nor political opposition to one or more of its elements. When a recession hits the Danish economy, unemployment will grow - also within the framework of the Danish flexicurity model.

Similarly, there is an ongoing political debate about the flexicurity model. The unemployment benefit system is often criticized for being too generous either in terms of compensation rate or benefit period. The active labour market policy is accused of being both expensive and ineffective. From the trade union movement, there may be concerns about the short notice periods on large parts of the labour market, especially if income and employment security is reduced (Madsen, 2013).

Against this backdrop, the rest of this chapter focuses on recent employment policy reforms and the importance of municipalities for labour market policy as a driving force in the Danish labour market model.

5.4. Goodbye to national labor market policy?

The tone was struck by the so-called Structural Commission in its report No. 1434 from January 2004:³²

"The Commission has the view that the public employment efforts in a single-stranded system should be rooted in the municipalities, as the task is related to the other municipal tasks, especially in the social field." (Struktur-kommissionen, 2004, p. 47. Author's translation.)

It should not be concealed that the members of the Danish labour market community sighed deeply as they met this characteristic of employment policy as just "the active cousin of social policy". Gone was the idea of labour market policy as a comprehensive national policy area, which has the task of improving overall labour market performance through the upgrading of the entire workforce and strengthening the adaptation between

³² The "Structural Commission" (in Danish: "Strukturkommissionen") had the task of laying the ground for the reform of regional and local government, which was implemented in 2007.

labour supply and labour demand. Left was a labour market policy focusing on the unemployed - a particularly active form of social policy.

Nevertheless, the implementation of active labour market policy was in 2007 transferred to the municipalities. Not surprisingly, the municipalities were strong supporters of hereof. But the social partners were equally strong supporters of a preservation of the state employment system.

At the same time, another recommendation from the Structural Commission's report was also followed. The municipalities from 2010 would co-finance half of the unemployment benefits for the insured unemployed, so that they also had a clear financial incentive to get this group back into employment. Hitherto, the municipalities only co-financed the provision of the cash-benefits for the non-insured unemployed. This change was accompanied by a new complicated financial subsidy and compensation system which, among other things, should counteract a municipality's economy being overcome by the fact that a large local company has to turn the key.

After the reorganization of the employment system, the discussion waned. Was the municipalisation of active labour market policy a better foundation for a well-functioning Danish labour market policy? Did we get a new and better system that could ensure a more comprehensive approach than the old two-tier system, where unemployed were treated in accordance with the formal distinction between insured and uninsured unemployed - not according to their employment opportunities and problems?

The purpose of this chapter is not to deliver the final ruling in this debate. The ambition is the more modest to draw up some main themes and attention points that all actors should include in the list if the municipal employment system should have a chance to prove that the sceptics are wrong.

5.5. From two-tier to one-tier implementation of ALMP in 2007

The former organisation of the ALMP- system went back to the labour market policy reform of 1993. A radical reorganization of the PES took place. It was now re-organised into fourteen regions with regional labour councils, with a strong representation of the social partners. The regions became responsible for the implementation of active labour market policy and for the design of regional employment plans, taking into account nationally defined target groups and other guidelines. Everything was obviously not perfect under this system, but most evaluations indicated that the structure provided good opportunities for a regionally adapted and coherent employment effort. At the same time, the participation of the social partners meant a significant element of program ownership on their part.

Outside this system were the efforts for the uninsured unemployed, who were under the auspices of social policy. They lived both legally and economically their own life, although in the 1990s, there was a gradual convergence between the regulations in the two areas and, in addition, in 2001, a transfer of active employment efforts for this group to the Ministry of Employment.

From 2007 everything became very different. As already mentioned, the local organisation of employment efforts was made up of 98 jobcentres - in principle one in each municipality. However, a few municipalities have entered into in collaboration on the operation of a joint jobcentre. Jobcentres are responsible for:

- Job search and job placement of the unemployed
- Active offers for the unemployed
- Integration of newly arrived foreigners
- Follow-up on sick leave
- Business services
- External service providers (private companies, UI-funds etc.)
- Monitoring and evaluation of the policy outcome

A consultative committee - the Local Employment Council - was assigned to each jobcentre, composed of representatives of the social partners. The regional level was made up of four state employment regions, as Zealand and Lolland-Falster became a unified region. The explanation is that East Denmark, from an employment perspective, constitutes a coherent whole. The regions should monitor the efforts in the jobcentres and take care of a number of cross-cutting tasks. At this level, an advisory body was also set up - the Regional Employment Council.

Most of the appropriations for employment efforts were allocated to the local jobcentres. The local employment council was also awarded a special grant for the special business-oriented efforts. However, the grant was quite small and amounted to approx. 77 million for Denmark as a whole.

At the regional level, there was also a state grant for special targeted efforts, but similarly very limited. The main impression was that the regional employment councils had a far less economic force than the regional labour councils that they replaced. Their main responsibility was now to monitor the job-centre's performance rather than the development and prioritization of the efforts.

5.6. Strengths of the reform

There is no doubt that the reform offered a potential for strengthening employment policy. Firstly, it allowed for the coordination of the efforts

previously separated in the state public employment system for the insured unemployed and the municipal system for the unemployed beneficiaries. Now, in relation to the total group of unemployed, a wide range of competencies in the jobcentres could be used. The unification of former employees in the state employment agency and municipal case managers under a single roof created the prerequisites for cross-cutting cooperation and joint development of competencies. In addition, the new organization gave increased transparency in the administrative and political system. Viewed from the outside, companies and job seekers should now only address one place and the many cases of e.g. sickness benefits should no longer be sent back and forth between a state employment agency and the municipalities.

Finally, the legislation on active employment was now unified into a single act on the responsibility for and the management of ALMP, which defined the framework for decision-making in the overall employment system. In doing so, there was in principle better possibilities for implementing and monitoring a comprehensive national strategy in a single-stranded management system. So there was definitely something to look forward to.

5.7. But did the system actually become more need-oriented?

A first problem in relation to the 2007-reform was, of course, that the new organization of employment efforts continued to contain strong elements of dualism. In many jobcentres, the work was after 1 January 2007 still organized in different staff groups, each with management and, in practice, the responsibility for each group of unemployed. So in that sense it became often the same as the previous two-tier system.

In addition, there was the issue of the relationship between ALMP and the overall municipal economy. This criticism of the reform was based on the fact that the resources for active employment efforts would now compete with the solution of other municipal tasks such as care for the elderly, childcare and cultural services. It was not hard to imagine that many municipal politicians could be tempted to give higher priority to this type of municipal core activities rather than support to unemployed people. Differences in the rates of reimbursement for various tools in the activation effort could also lead to a municipal thinking, where the offer to the single unemployed was given, which gave the greatest benefit for the municipal economy - and not necessarily also for the unemployed.

The design of the various subsidy and refund schemes in the employment policy system is thus a key challenge. A new reimbursement reform was therefore phased in from 2016 in conjunction with the other changes in ALMP resulting from the employment reform adopted in June 2014 and implemented from 2015 (cf. below).

5.8. More administration and control

The interconnection of state and municipal IT-systems in the field of employment has caused many challenges. The development of large administrative IT-systems is not easy. Until now, it has not been possible to create a single integrated system, and therefore the job consultants spend a lot of time finding and entering information in several different systems.

In addition, the decentralization of the employment system went hand in hand with an enhanced use of detailed management, monitoring systems, indicators and benchmarking. It was true that the municipalities had been assigned an important policy area. But it was freedom not only under responsibility, but also under considerable control. It was done in the best meaning in order to guide the municipalities in the right direction for ALMP. But it also became time-consuming and claimed resources from the main task of bringing the unemployed back into employment.

5.9. Is small also beautiful?

Another important issue was the size of the new municipal units. The Structural Commission made a number of considerations to that effect and concluded cautiously:

"There is no clear basis for evaluating how large a local population, the establishment of a unified employment system would require. But it seems that municipalities with approximately 30,000 inhabitants will have sufficient financial sustainability, while it cannot be reliably assessed whether municipalities of 20,000 inhabitants would be economically viable to a unified employment system." (Strukturkommissionen, 2004, p. 4). Author's translation)

Although the size of the municipalities increased significantly after the structural reform in 2007, it was up to a third of the jobcentres that were situated in municipalities with less than 40,000 inhabitants. An important point is of course that the size of the geographical area that it is optimal for a jobcentre to cover is not quite easy to determine. The immediate answer will of course be to relate it to the size of the relevant labour market catchment areas, but here the problem is that these are not well defined, but will vary between different types of labour. Typical unskilled workers commute less than persons with higher education. An analysis for pending areas (commuting areas) from Statistics Denmark has shown that the number of pending areas in 2014 amounted to 43 for unskilled worker and only 9 for the highly educated. A pending area is defined as an area, where the majority of the locally employed population

have their jobs in the area and the majority of local jobs are occupied by people living in the area (Danmarks Statistik, 2016).

Especially for the smaller of the new municipalities, it is a risk that they will have a too narrow local focus in relation to both the unemployed and the employers. Especially for highly educated groups like academics, there is a need for efforts that goes outside the borders of the municipalities. Another risk is that a specific labour demand of a company in a particular municipality will be offered to employ the municipality's "own" unemployed, rather than qualified unemployed from neighbouring municipalities. When the jobcentre places one of the city's own unemployed in a job, it leads to savings for the municipality. At the same time tax revenues increase. It is a great temptation to operate only within the municipality. There is unfortunately no extensive empirical analyzes of this issue. In the new employment system implemented from 2015, this type of issues are sought to be counteracted by giving the employment regions a supervising and coordinating responsibility, particularly in relation to programmes for target groups with special needs.

5.10. Managing external service providers

Another aspect of the issue of the size of the new jobcentres' relates to their administrative capacity to handle the external service providers, who provide services in the form of guidance and training to the jobcentres. Purchasing external service services from private consultants, unions, unemployment insurance funds and other external service providers is nothing new. The PES and the municipalities have used them for many years. The structural reform in 2007 introduced an additional emphasis on external service providers, which was emphasized by a provision in the law that jobcentres that did not follow the recommendations of the regional authorities could be obliged to use "other service providers" to correct the situation:

"If no agreement can be reached or the employment effort is not improved as agreed, cf. paragraph 1, the Minister of Employment may, on the recommendation of the Regional Director, instruct the persons responsible for employment in the Jobcentre to use other service providers" (Act 552, paragraph 11, paragraph 2. Author's translation).

Using external service providers is no easy matter (Bredgaard & Larsen, 2006). As documented in a comprehensive Danish analysis of the area, considerable administrative resources are required both in the procurement phase and the implementation phase to ensure appropriate incentives and monitoring of target fulfilment. Particularly smaller municipalities may find it difficult to build sufficient professionalism. Partly of course, the difficulties can be overcome by regional or national framework contracts that the jobcentres can apply, but in turn, some of the local flexibility is lost, which should be part of the idea of the local implementation of ALMP.

The concrete experiences with the use of external service providers have been mixed. Current evaluators point to "a draw". However, a statement from the National Audit Authority from 2013 concludes that:

".. the effect of other service providers is less than the impact of jobcentres' efforts. The investigation further shows that far from all municipalities follow up on the results and quality of external service providers. The follow-up is essential to ensure the correct correlation between price, results and quality." (Rigsrevisionen, 2013, p.3. Author's translation.)

5.11. Focus on the unemployed - or on the whole labour market?

A further issue concerning the municipal jobcentres has already been mentioned in the introduction. Danish labour market policy has during decades evolved into an independent policy field covering the entire labour market, including the supply side, the demand side and the adjustment mechanisms between supply and demand (Bredgaard et al., 2017).

Labour market policy was thus not just a matter of doing something for the unemployed, but should deal with strengthening the overall labour market, including ensuring the upgrading of skills not only of the unemployed, but of the entire workforce. This broad role for labour market politics has not become less important as Denmark's ever stronger integration into the EU has meant that several of the well-known macroeconomic instruments such as interest rate policy, exchange rate policy and fiscal policy have become more difficult or impossible to apply at national level.

With the labour market reform of 1993, this broad perception of labour market policy was combined with regionalisation based on the assumption that the labour conditions differed in different parts of the country and therefore required a regionally adapted labour market policy.

The reform in 2007 maintained the regional level in labour market policy. At the same time, however, a significant part of the responsibility for the design and implementation of labour market policy was shifted from the regional level to the local jobcentres. In addition, there was a "dilution" in the sense that former state PES staffs, who were bearers of the labour-policy approach, became a minority in the new jobcentres. More than half of the employees had their background in the more social policy-oriented municipal administration. Therefore, there was a clear risk that the content of employment policies was shifted from the broader view on the labour market to focusing only on the unemployed in the area covered by the individual jobcentre.

The actual extent of this shift since the structural reform in 2007 is difficult to assess and there is no overall evaluation of the area. However, it is a continuous feature that critics of the reform assert that over the past decade there has been a shift - with respect to linguistics, structure and substance - from the term labour market policy to employment policy, when referring to the policy area that has the labour market as its focus.

5.12. New conditions for a national employment policy

As mentioned above, the 2007 reform introduced formally a more simple management chain, where the active labour market policy in a single Act brought together the responsibility for and the management of active employment efforts. At the national level, the Minister for Employment held the highest responsibility with advice from the National Employment Council. At the same time, municipalities' design and implementation of ALMP could be regulated through state legislation and other provisions in the same way as municipalities are subject to government regulation in a wide range of other policy areas. However, the scope of this regulation must always be assessed in conjunction with the Danish tradition of extensive local self-government. In the various policy areas, over the years, a certain tradition has been developed for how the balance between state influence and municipal self-government must be, although this obviously does not mean that the balances cannot be shifted over time. Many municipal politicians have argued in this regard that the general balance has been shifted to the benefit of the national level in recent years.

With the 2007-reform, the regional level also gained a new and less active role. Previously, the regions and regional labour councils had been given the financial resources to prioritize and implement the active employment efforts for the insured unemployed. With the reform, the vast majority of resources were transferred to the jobcentres. Thereafter for the regions and the regional employment councils, the tasks were primarily to monitor the results of the jobcentres and to prepare analyzes and forecasts for the use of jobcentres. Thus, the regional level and regional labour market

policy - compared to the earlier situation - were awarded a much smaller and more unclear role.

The 2007 reform also included a closer regulation of local employment efforts by the national authorities. In the pre-analysis of the structural reform, it was a common theme that the municipal efforts were extremely heterogeneous, implying that municipalities with the same problem pressure had very different priorities and results. With the reform, the unruly municipalities should be taken care of. The new legislation from 2007 therefore gave the Minister for Employment a number of powers to monitor and regulate the jobcentres and intervene if they were not performing satisfactory. A number of comprehensive reporting and indicator systems were introduced that made it possible to compare the jobcentres' activities and results in a wide range of areas. However, this also implied the risk that regulations and detailed monitoring lead to standard solutions and that jobcentres were more likely to meet formal performance goals rather than adapting their activities to local labour market conditions.

The management of the municipalities, however, takes place in difficult waters. The Danish tradition of significant municipal autonomy limits the state's influence, which means that a major purpose of the structural reform was precisely to establish larger and stronger municipal units. But the far-reaching decentralisation of employment policy, as reflected in the reform, opened for a new conflict area between state control and municipal self-government.

Right away you could imagine two possibilities for the process. In one case, powerful local politicians or municipal officials in the new and larger municipalities, resulting from the structural reform, would require significant control over the activities of local jobcentres. The result could be the implementation of hundreds of different employment policies in Denmark. In the second extreme, central government, perhaps as a response to attempts to manage employment policy locally would develop a strict state-of-the-art detailed regulation of the local efforts, which would lead to the use of standard solutions without regard to local conditions.

Looking at the development since the implementation of the reform, you found features of both scenarios. Basically, there is no doubt that employment policy in recent years has evolved into a new battleground for the conflicts between the different levels of the Danish political system. At the same time, it has been emphasized that the institutional changes implemented by the structural reform have also had a significant impact on policy content.

Larsen (2009) notes that the structural reform, which primarily concerned institutional and administrative conditions, also had significant content implications for the policy pursued leading among other things towards a stronger emphasis on disciplining the unemployed. On the other hand, the increased state control of decentralized efforts also promoted a more rational and evidence-based governance design that could make it increasingly difficult to design a relevant policy (Larsen, 2009).

The structural reform is thus also an example of how organizational and institutional changes can be used as tools to influence the policy content in a more discreet way than through direct reforms of the tools used.

5.13. Could the social partners be engaged after the 2007-reform?

With a labour market reform in 1993, the social partners became more prominent in the policy system around ALMP. The arguments for this were twofold. In part, the partners could provide the decision-making process with useful knowledge about a number of actual conditions in the labour market, thus improving the quality of decision making. Also, the partners' active involvement would give them a sense of greater responsibility in the implementation - an increased "program ownership".

With the structural reform in 2007, the representatives of trade unions and employer's organisations were still invited to the table at the local, regional and national level. However, the respective bodies were given the primary task of advising the Ministry and monitoring the efforts in the jobcenters. This was hardly the social partners own perception of their core task, which is much more about formulating and taking responsibility for political decisions.

Admittedly, in the portfolio of the Regional Employment Council, an option was added that they could initiate initiatives to prevent and remedy labour shortages financed by a special state grant. Similarly, the local employment councils were allocated an annual state-grant to promote special business-oriented local initiatives. However, this appropriation could only be activated, if there was consensus on the execution. In the event of disagreement between the council and those responsible for employment in the jobcenter on whether the use of funds was within the overall framework of the employment plan, the funds could not be used. In any event, the funds at both regional and local level, as already mentioned, were very limited. The risk scenario was, of course, that the partners would face barriers in engaging qualified representatives on the council's work and apply a strategy of complaining rather than constructive involvement. If you have not been involved in deciding the menu and preparing the food, you can always blame the chef for the result. However, early studies of the local employment councils show that in the first year after the reform,

members were quite satisfied with the functioning and influence of the councils (Bredgaard & Larsen, 2008).

5.14. The reforms of ALMP from 2015 and onwards

After some years of relative calm in the area of ALMP, reforms once more entered the political agenda in 2013-14. Contrary to the structural reform in 2007, focus was this time explicitly on the content of the policy. In the Government's so-called Koch-Committee, which was preparing the new reforms, five main objectives of employment policy were identified:³³

- The active employment efforts should help to bring the individual unemployed into *permanent* employment as soon as possible.
- *Upgrading of skills* should be applied, if this was necessary for the individual unemployed to be better equipped to achieve permanent employment.
- The active measures must ensure that the unemployed comply with their obligation to be available for work, but at the same time the efforts should be *based on the individual's needs* and rely more on trust and less on control.
- The jobcentres must help businesses to have access to the workforce that they need.
- The jobcentres must be cost-effective, so resources are more used on tools that help the individual in jobs.

Thus, the focus shifted away from bringing the unemployed quickly to work and more towards giving them a stable position on the ordinary labor market. At the same time, the efforts relative to the individual unemployed should be less dependent on control and more on trust.

On the other hand, the Committee was initially not explicit about what structural changes should accompany the proposed policy changes. However, if a change in the content of efforts to increase employment and promote a more well-functioning labor market should succeed, institutional changes must also be considered. This point was reflected in the proposal package presented by the Koch-Committee in February 2014 and in the subsequent political agreement from June 2014. The settlement was turned into legislation in the fall of 2014, and the new employment policy reform was implemented from 2015.

Broadly speaking, both the proposals and the subsequent reform followed up on the Committee's ideas of increased educational efforts, especially for

³³ The official name of the Committee was "The expert group on investigation of active employment efforts", but it was usually referred to as the Koch-Committee named after its chairman. The author of the present chapter was one of the four experts on the Committee.

those unemployed without a vocational education. This should mainly be through ordinary education and not through various short courses set up by the municipalities.³⁴ At the same time, increased emphasis was placed on regular contact between the unemployed and the jobcenter in the form of monthly meetings, which should also involve the unemployment insurance funds.

In addition, there were a number of organizational changes. The reform from 2015 put emphasis on strengthening the opportunities for a coordinated and needs-oriented effort as much as possible. Therefore, from 2016, a change of the Governments' refund system was implemented, which implied the same refund rate for all services, thus reducing the incentive for the jobcentres to focus on differences in the refund rates than on the needs of the individual unemployed. In addition, the rate of refund for the individual unemployed was reduced over time, so that municipalities would have an incentive for early and efficient efforts. Emphasis was also put on a comprehensive continuing education and training program for the staff in the jobcenters, so that competencies and cultures could be developed and integrated. Enhanced education efforts should also set standards for capacity to assess existing competences and the demand for labour. New IT-systems were developed in order to move resources from administrative routine work to meaningful contact with the jobcenter's users.

At the same time, the reform had elements of a "trust reform" both in relation to the individual unemployed and to the jobcenters. The individual unemployed was granted greater freedom of choice in terms of both practical conditions such as booking time for meetings at the jobcenter and the specific choice of activities in addition to the regular meetings with the counsellors. Jobcenters were exempt from a number of existing procedural requirements, including the requirements for re-activation of the unemployed according to a fixed schedule.

In addition, the reform emphasises that the individual jobcenters should think beyond the municipal borders and work together with respect for the various sub-sections of the labor market, which are realities for both employees and companies. Therefore, the local employment councils and the four major employment regions were abolished from the beginning of 2015. Instead, eight new regional labor market councils were established, which were to a greater extent defined by actual regional labour markets. In the councils, the social partners would assist to ensure that there would

³⁴ *The educational elements of the reform have subsequently been evaluated. In a summary from 2021 it was concluded that there can be good reasons to stick to the reform's objectives of targeted education for those with the greatest need. In addition, there is still potential for further targeting of educational efforts to the group of unemployed with the fewest competencies and supporting the job-oriented part of the offers (Styrelsen for Arbejdsmarked og Rekruttering (STAR), 2021).*

be greater cross-cutting coordination and cooperation across municipalities and agencies. They thus have an important role to play in developing a common regional employment policy strategy that can link the activities of individual jobcenters and also involve other actors in the form of educational institutions and the regional growth fora.

Following up on the administrative experiences from the reform in 2015 the Law on Active Employment Measures was revised in from January 1, 2020. The main elements in the revised legislation were that the municipalities were given greater freedom to plan the assistance to the unemployed. In the future, there will only be some simple minimum rules across target groups, so that the municipalities themselves can plan the efforts based on the needs of the individual. Some unemployed people only have to focus on applying for a job for the first time, while others have to have an active offer very early in the unemployment process. But it must no longer be central requirements that govern in detail the municipalities' choice of measure. However, a stricter follow-up of the municipalities' efforts will also be initiated, where it will be possible to take action against those municipalities that do not live up to their responsibilities. Ultimately, the national authorities can put municipalities under administration with fixed requirements for the effort. Thus the traditional dilemma between local self-government and ensuring equal treatment of citizens still prevails.

5.15. And the winner is ...

With the structural reform in 2007, municipalities were entrusted with the responsibility for implementing the overall ALMP. At the same time, significant process and reporting requirements were imposed on the jobcentres. Since 2008, the financial crisis put the municipal jobcenters under further pressure due to the imbalance between the increasing number of unemployed and the resources that were available within the framework of a tight municipal economy. The pressure was also political in the sense that it was tempting for national politicians to blame the municipalities, when their efforts were less successful. The municipalities had been given responsibility. Now they should also prove that they manage it.

With the reforms of 2015 and 2020, the municipalities were relieved from much of the pressure that was put on them in 2007. Their degrees of freedom simply became greater. Process requirements were fewer. It was now possible to design the effort for the individual unemployed in greater accordance with the individual needs. The problem will then be whether the municipalities could live up to the new freer framework, and whether the revised reimbursement system actually provides sufficient incentives for a quick and efficient response, or whether the municipalities would be

tempted to pay less attention to the weakest citizens from the point of view that no good money should be thrown after bad.

In the short term, however, the employment reforms marks a break in the cross-fire that the municipalities have been exposed to in the labor market area. Whether the municipalities can live up to the positive expectations behind the reforms, thus contributing to the new vitality of the challenged Danish flexicurity model, will be tested in the coming years. Here, the cyclical development has always the role of a wild card, which in the short term can make the difference between success and failure for labor market policy. But if the new municipal employment efforts in the long term can help to maintain the low level of segmentation and the high mobility that has characterized the Danish labor market for decades, then the reforms have not been in vain.

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Chapter 6

Asymmetric decentralisation: trends, challenges and policy implications³⁵

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Abstract

A growing number of countries in the OECD and beyond are moving toward asymmetric decentralisation, i.e. differentiated assignment of responsibilities at the same level of government. Whereas between the 1950s and the 1970s asymmetric arrangements happened mostly at a regional level, the present trend seems to apply asymmetric decentralisation mostly in case of urban areas. Such trends may be further reinforced by the current global covid-19 crisis, which has had highly asymmetric impact within countries. This paper aims to shed light on the various forms of asymmetric decentralisation. The study utilises arguments both from the economics research and from policy practices. The paper highlights the pitfalls to avoid and good practices when implementing asymmetric decentralisation policies to reap their benefits, and minimise their costs.

6.1. Introduction

Beyond structural differences across regions, regional economic disparities within countries have been rising in recent decades in OECD countries, in particular since the global 2008 crisis. OECD countries are confronted by a persistent productivity gap, which has a strong spatial dimension. The age structure and service needs of population may vary a great deal between regions within a country. In some cases there are important ethnic, historical or political differences between regions. The types of challenges faced by regions within countries, and capacities to address them thus vary extensively within countries. This has implications on the types of institutional and fiscal arrangements at the subnational level to respond to these challenges, and the potential need to differentiate them within countries.

OECD country experience shows that there is no single optimal design for decentralisation and multi-level governance (OECD, 2017). Decentralisation is not good or bad in itself. Its outcomes depend on the way the process is designed and implemented, on adequate sub-national capacity, and on

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the overall quality of multi-level governance (OECD, 2019). Decentralisation reforms are often planned and implemented with a symmetric approach, where all subnational governments are treated in the same way despite their differences. This is especially the case in unitary countries, but also many federal countries use the symmetry principle. To succeed, symmetric approach to decentralisation often requires strong equalisation mechanisms and carrying out structural reforms such as mergers of municipalities. Such policies can be politically difficult to carry out.

An alternative and perhaps a more flexible way to approach the tradeoffs of decentralisation is the asymmetric treatment of subnational governments. There can be political, economic or administrative motives for choosing a differentiated approach (Bird and Ebel, 2006). Political reasons for asymmetric arrangements are often associated with aims to take into account regional cultural or ethnic specificities. In the extreme case, the motivation can be even to alleviate tensions between regions and to weaken secessionist incentives. The economic motives for asymmetry are usually linked with efficiency considerations. In fiscal terms, asymmetric federalism or decentralisation means that subnational government units at the same level have different spending or revenue powers. Administrative asymmetry aims to advance government policies so that the different capacities of subnational governments are taken into account.

Recent research results show that asymmetric arrangements have become more common (Hooghe et al., 2016; Allain-Dupré, 2018). In 1950, around half of the countries covered by the Regional Authority Index (RAI)³⁷ had some kind of differentiated governance at the regional level. In 2010, almost two thirds of the countries measured with the RAI had implemented asymmetric arrangements in some form. This development is not very surprising, taking into account the considerable differences between regions within countries and the high costs of uniform application of decentralisation.

Asymmetric decentralisation might occur at regional level (state, province, länder), metropolitan level or local level. Here the trends in asymmetric decentralisation are changing: whereas between the 1950s and the 1970s, asymmetric arrangements happened mostly at a regional level, the present trend seems to apply asymmetric decentralisation to major urban areas. In

³⁷ *The **Regional Authority Index (RAI)** tracks regional authority on an annual basis from 1950 to 2010 in 81 countries. The sample consists of all EU member states, all OECD member states, all Latin American countries, ten countries in Europe beyond the EU and eleven in the Pacific and South-East Asia. The unit of analysis is the individual region/ regional tier. The dataset encompasses subnational government levels with an average population of 150,000 or more. Regions with a special autonomous statute or asymmetrical arrangements are also coded separately. Regional authority is measured along ten dimensions: institutional depth, policy scope, fiscal autonomy, borrowing autonomy, representation, law making, executive control, fiscal control, borrowing control, and constitutional reform.*

particular, the capital city districts have experienced a growth in asymmetric decentralisation arrangements, perhaps because the benefits of urbanisation and agglomeration economies have become more widely understood and accepted. As a result, the number of metropolitan governance authorities has increased during the past decades. Currently, around two-thirds of the metropolitan areas in the OECD have a metropolitan governance body (Ahrend, Gamper and Schumann, 2014). Beyond metropolitan governance arrangements, some asymmetric arrangements are also increasingly applied at the municipal level, with the attempt to allocate responsibilities depending on municipal capacities.

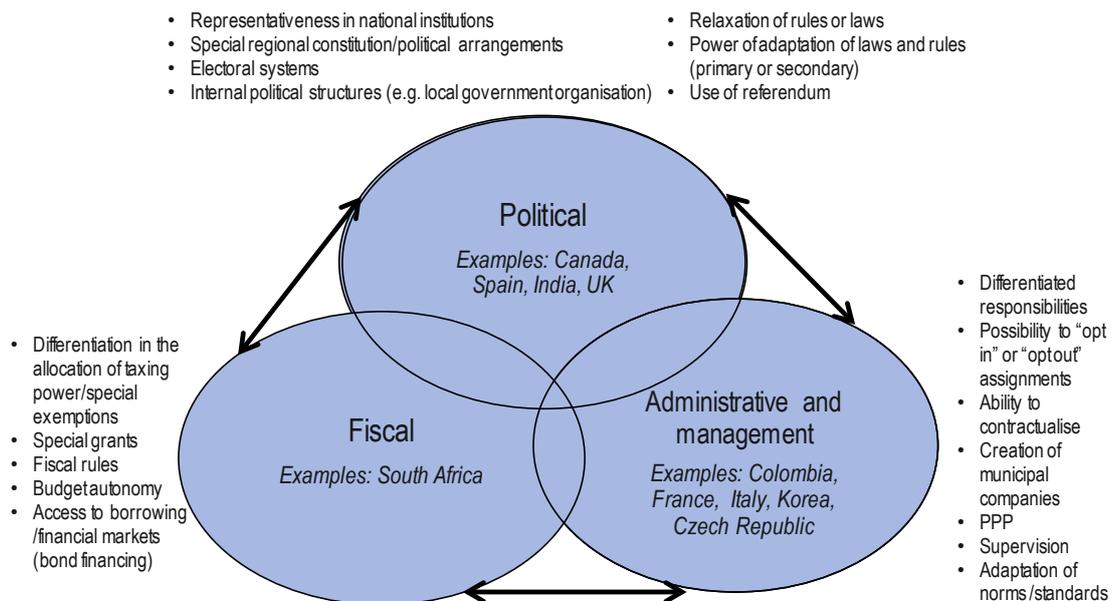
While the economic theory and empirical research on federalism often assumes homogenous subnational governments and equal treatment of all subnational governments, the economic research has not taken a strong stand - for or against - on asymmetric decentralisation (Congleton, 2006; Bird, 2003).

The COVID-19 crisis provides the latest example of the importance of asymmetric decentralisation. The crisis has had asymmetric impacts to regions and local governments, and the capacities to deal with the implications have differed considerably between subnational governments (OECD, 2020). Many countries have therefore adopted regionally differentiated strategies for both confinement and de-confinement measures. While the eventual implications of COVID-19 are still to be seen, it seems plausible to assume that the crisis can lead to more differentiation in decentralisation policies.

The purpose of this paper is to shed light on the pros and cons of asymmetric decentralisation both from the economics research and policy practice points of view. The aim is also to present new information that can contribute to asymmetric decentralisation policymaking currently underway in several countries. The paper proceeds as follows. Section 6.2 discusses the rationale for asymmetric decentralisation. Section 6.3 provides an overview of different forms and trends of asymmetric decentralisation. Section 6.4 summarises the lessons learned of asymmetric arrangements from policy making aspects and makes some recommendations on implementing asymmetric decentralisation.

6.2. Rationales for asymmetric decentralisation

There can be various motivations for treating subnational governments in an asymmetric way. This section discusses briefly the main political, administrative and fiscal incentives for asymmetric decentralisation (Figure 6.1) Asymmetric decentralisation can also be seen from three different scales: regional (state/province), metropolitan and local.

Figure 6.4. Three main types of asymmetric decentralisation

Source: (OECD, 2019).

The motivation for asymmetric decentralisation differs between unitary and federal countries. Asymmetric decentralisation is often a basic characteristic of federal countries. There are different gradients of asymmetry though. Some federal countries are rather asymmetric, such as India, Russia, Canada, Spain or Belgium. Other federal countries tend to favor symmetry, like Australia, Austria, Germany, Switzerland and the United States. However, even the most "symmetric federations" like the USA and Switzerland have elements of asymmetry (Bird, 2003[8]; Dafflon, 2006). Some federations are developing new asymmetric solutions. In Germany, for example, all Länder enjoy the same degree of legislative power and the same responsibilities, but the 2006 reform also established a right to stray from federal legislation by introducing opt-outs in six policy areas (e.g. higher education, environmental protection) for the Länder (OECD/UCLG, 2019; OECD, 2020).

In unitary states, symmetry is usually the basic principle, motivated by equity and integration of different parts of the country. Examples of such approaches include Chile, or France ("une et indivisible"). However, some unitary states have strong elements of asymmetry too (Italy, United Kingdom). Countries with important peripheral territories such as outermost regions or other outlying regions (France, Portugal, Finland) are examples of this.

Asymmetric decentralisation has become more common in unitary countries also because of need to reform the metropolitan governance. In general, there are examples of asymmetric administrative decentralisation,

giving more responsibilities to regions with greater capacities. As a result, there seems to be a greater convergence between unitary and federal countries in the trend towards differentiated governance at the subnational level.

It should also be noted that the health and economic impact of the current COVID-19 crisis differs considerably across regions, suggesting need for differentiated administrative approach. For example, preliminary analysis shows that capital regions or other metropolitan regions show a relatively higher risk of job disruption than other regions (OECD, 2020). Such development may emphasise the need for differentiated governance arrangements for metropolitan areas.

6.2.1. Political reasons

Historical, cultural and ethnic circumstances, sometimes originating already from the formation of countries, may cause a variety of political tensions in the regions or even demands for secession. In order to safeguard the unity of a nation-state, granting differential treatment, such as a partial or full autonomic status, to some regions or subnational governments, can be a tempting policy alternative. This section discusses briefly the main political motives for asymmetric decentralisation. Federalism and asymmetric decentralisation have sometimes been justified to maintain the unity of the State, and to recognise regional specificities and identities. This has been the case for example in Belgium, Canada, Spain and Switzerland (Bermeo, 2002)³⁸.

The causal relationship between secessionist movements and asymmetric decentralisation is unclear, however. In particular, federalism and asymmetric decentralisation may not always help to limit secessionist movements. Much depends on the implementation of the asymmetric arrangements and the severity of conflicts. Recent research results suggest that asymmetric decentralisation strategy does not necessarily result in reduced incentives for secessionist movements, and even the opposite development is possible (Rode, Pitlik and Borrella Mas, 2018).

Asymmetric decentralisation is by no means the only solution to preserve the unity of the state. In some countries an opposite path has been chosen. For example, in Chile a homogenous treatment of regions and subnational governments has been adopted for decades, to ensure the unity of the state. However, this situation in Chile is currently changing, as the new legislation devolves additional responsibilities to metropolitan areas and some pilot regions.

³⁸ (Bermeo, 2002) discusses federalism as a response to regional tensions.

6.2.2. Administrative motivations

Responding to capacity challenges

Subnational governments often differ in their administrative, fiscal and human resources capacities. Asymmetric decentralisation offers a method to tackle capacity challenges in public service provision. The traditional ways to address capacity problems at the subnational level of government include amalgamating subnational government units, enhancing inter-municipal or interregional cooperation or outsourcing tasks to private sector producers. One possibility is also that the central government or other higher level of government takes over some tasks from subnational government to ease the pressure on subnational governments.

Sometimes large-scale reforms, such as amalgamations of subnational governments, are not feasible due to lack of resources, or time, or political resistance. If that is the case, a more targeted solution such as asymmetric arrangement might be an attractive option to solve capacity issues.

Efficiency in implementation

Asymmetric arrangements can be motivated by *efficiency considerations*, for example if the majority of subnational governments are too weak to take charge of service provision without substantial aid and support from central government. In order to both initiate important policy measures and to utilise the efficiency benefits from decentralisation, the central government may decentralise responsibilities first to large urban areas, provided that they have the required fiscal and administrative capacity. In the same vein, at the regional level, it may make sense to decentralise responsibilities first to a limited number of provinces or counties. At later stages, the other subnational governments could follow suit, provided that they have achieved sufficient capability needed to take the responsibility of spending and revenue assignments. In this case, it is important that there is some kind of training system in place for subnational governments, and that the rules of eligibility are transparent.

Related with the previous argument, it is worth noting that asymmetric fiscal arrangements may help accommodate heterogeneous preferences among subnational governments about autonomy. While decentralisation is usually accepted by most stakeholders in principle – when responsibilities come along with resources – in practice the preparedness to receive new responsibilities or powers may vary considerably among regions and municipalities. If this is the case, a sequenced approach could ease the transition into new allocation of tasks between government levels (Bahl and Martinez-Vazquez, 2005). Examples of countries that have implemented sequenced decentralisation in the past include India, Indonesia, Mexico, Russia and Tanzania (Bahl and Martinez-Vazquez, 2005).

Perhaps paradoxically, asymmetric decentralisation can help central governments promote *national goals* for uniform service delivery. In some cases, the asymmetric approach provides a flexible alternative to simultaneous assignments. For example, if the circumstances differ significantly between regions, and designing and operating a financial aid system and normative regulation is considered too burdensome, an approach that devolves tasks on a case by case basis might be more appropriate (Bird, 2003; Bird and Ebel, 2006). It should also be acknowledged that unity is usually the ultimate policy goal, not uniformity in production.

Learning-by-doing

One important potential justification from asymmetric decentralisation reform is that the governments – both central and subnational – can learn from successes and mistakes, and take necessary steps to revise the reform if needed. In this way, asymmetric decentralisation is a form of regional *experimenting*, which enables learning and dissemination of best practices. So called “menu federalism”, where subnational governments choose voluntarily the tasks that best serve their own interests (Congleton, 2015), is a special form of such approach.

Examples of countries which have adopted explicit learning-by-doing approaches are Sweden or Chile. In Sweden, regional reform was implemented gradually and voluntarily by counties themselves already since the end of 1990s until the reform was implemented for the whole country in 2019. During the early stages of the reform, the “bottom-up regionalisation” was implemented as a gradual and experimental process (like a laboratory of regionalisation). The underlying idea was that decentralised policy making leads to more innovation in governance.

In Chile, in order to prepare regional governments to assume new responsibilities, pilot projects have been conducted to “test” new competencies assigned to regions. Pilot experiences have been conducted in metropolitan areas. For example, regions were allowed to administer one or more metropolitan areas in their jurisdiction by creating a specialised unit within the regional authority to manage at the metropolitan level, with responsibilities linked to transport, housing, environment and public works, or waste management (OECD, 2017).

6.2.3. Fiscal motives

The justifications for asymmetric fiscal decentralisation are largely the same as the benefits received from fiscal decentralisation in general: utilising better knowledge of local demand and cost factors, more transparent decision-making and possibilities to exploit local innovations in service provision.

Asymmetric fiscal decentralisation may also have equity motives. This can be the case if, for example, giving special revenue rights or taking special circumstances into account in the transfer system would enhance the overall service delivery. Asymmetric spending autonomies may also be motivated by national aims to reach uniform service levels within a country (Bird and Ebel, 2006).

As a result, asymmetric fiscal decentralisation is often justified with a variety of practical arguments and by using diverse fiscal tools, such as:

- **Improving the efficiency of service provision using differential spending assignments.** For example, some regions or subnational governments may be assigned tasks in specific services, which are otherwise provided by central government or higher level of subnational governments.
- **Taking into account the special circumstances of public service provision with differential revenue autonomies.** The subnational governments with more capacity may be given more tax autonomy than usual. Asymmetric autonomy could be used also for collecting user fees or selling property.
- **Assisting the regions with unique service needs or exceptional operating environment with differential treatment in transfer system.** This can be put in practice with special purpose grants or use of certain criteria in formula-based grants. Specific transfers may be used as an alternative to differential revenue autonomies.
- **Taking into account the special needs for public investments at subnational government level using differential fiscal rules.** Some subnational governments may be given more room for maneuver in borrowing for example.

6.3. Trends in asymmetric decentralisation

Asymmetric decentralization is an often neglected aspect of decentralisation. This is surprising, because asymmetric arrangements can be found to some degree in almost any country. In addition, there is mounting empirical evidence that asymmetric arrangements are growing in popularity, especially across unitary countries. According to (Hooghe et al., 2016), during the last seven decades or so, asymmetric arrangements have become more common. In 1950, 45% of the countries covered by the RAI, and with regions, had some kind of differentiated governance (autonomy, asymmetry, or dependency). In 2010, this figure had increased to 62% (Hooghe et al., 2016).

Asymmetric decentralisation trends are changing: whereas during the past decades the asymmetric arrangements happened mostly at regional level, the present trend seems to apply asymmetric decentralisation in large cities or for selected local governments. Large cities have experienced a growth in asymmetric decentralisation arrangements, perhaps because the benefits of urbanisation and agglomeration economies have become more widely understood and accepted. As a result, the number of metropolitan governance authorities has increased during the past decades. Currently, around two-thirds of the metropolitan areas in the OECD have a metropolitan governance body (Ahrend, Gamper and Schumann, 2014).

This section presents an overview of the forms and trends in asymmetric decentralisation by distinguishing three main types of asymmetric decentralisation: political, administrative and fiscal. The administrative and fiscal asymmetric decentralisation are also described using three different scales of policymaking: regional (state/province), metropolitan and local (Table 6.1). A summary table with examples of asymmetric decentralisation practises in various countries is provided in the end of the chapter (Table 6.2).

Table 6.2. Different scales of asymmetric decentralisation

Regional	Metropolitan	Local
<ul style="list-style-type: none"> Historically the most common form In 1950, around half of the countries covered by the Regional Authority Index (RAI) had some kind of differentiated governance at the regional level In 2010, almost two-thirds of countries in RAI had implemented asymmetric arrangements in some form Rising trend Long-term trend 	<ul style="list-style-type: none"> Since the 1950s: specific status for capital cities Since 1990s: significant increase in metropolitan governance to address specific challenges and capacities of metro regions 87 new metro structures created since 1991 compared to 14 between 1971 and 1991 	<ul style="list-style-type: none"> Different sets of responsibilities for different municipalities, depending on their capacities Municipal classifications, based on population, access to public services, budget, performance Urban/rural municipalities: classification may just statistical or lead to differentiation in funding or responsibilities

Source: (OECD, 2018).

6.3.1. Asymmetric political decentralisation

Asymmetric political decentralisation refers to situations where some regions or subnational governments have been given political self-rule that deviates from norm or average assignment. Political asymmetry is mostly justified on grounds other than purely economic ones. As was discussed in the previous section of this paper, political asymmetry is commonly practiced in order to alleviate tensions between regions and to weaken secessionist incentives (Rode, Pitlik and Borrella Mas, 2018). Some examples of asymmetries that are based mainly on political reasons include the Basque Country in Spain, Alpine regions and some islands in Italy, Scotland in the UK, Corsica in France, Aceh in Indonesia, Hong Kong in China, Aland Islands in Finland and Quebec in Canada.

One common way to categorise political and administrative asymmetric decentralisation has been to divide the policies into “*de jure*” or “*de facto*” arrangements (Martinez-Vazquez, 2007; Bird and Ebel, 2006). *De jure* asymmetric decentralisation is based on special legal status of a certain region. In some cases, the status is outlined in the constitution, but more often asymmetric treatments are established in the ordinary law (sometimes both)³⁹. Regions with special legal status often enjoy considerably broader political autonomy than other regions. *De jure* asymmetric decentralisation may be imposed directly by the central government, or the policy may be the result of a negotiation process between the central and subnational levels of government (Congleton, 2015).

Politically motivated asymmetry usually leads to administrative and fiscal asymmetry as well. While the asymmetric arrangements do not automatically mean privileges for the selected subnational governments, in practice it is often the case that political asymmetry brings clear benefits to regions with special status. This, in turn, may create competition between regions and concerns for equal treatment.

Political asymmetric decentralisation is commonly practiced among OECD countries and elsewhere. Political asymmetric decentralisation mostly takes place at the regional (state/province) level. In Italy, there are currently five regions (out of 20 regions) with special constitutional status, approved by the Italian parliament. Defined by the Italian constitution in 1948, the islands of Sicily and Sardinia, and the Alpine regions of Valle d’Aosta, Friuli-Venezia Giulia⁴⁰ and Trentino Alto Adige have been given special statute with the aim to avoid separatist movements and to protect linguistic minorities. The asymmetric decentralisation means that these regions have broad legislative powers and considerable financial autonomy. For example, the Valle d’Aosta retains 90% of all its taxes, and Sicily at times 100%. While the 2001 reform of the Italian constitution gave all the Italian regions significant powers in the legislative field, the latest developments (especially after the global financial crisis since 2009) in Italy indicate that the decentralisation trend has reversed and that recentralisation seems to be a current trend (memorandum of Council of Europe 2015). If this trend prevails, the differences in self-government between the five special regions and the 15 ordinary regions are expected to increase.

The French territory of Corsica, previously one of the French departments, gained a special regional status in 1991. Corsica has its own institutions

³⁹ *The division of asymmetric arrangements (with legal basis) into ones that are based on constitutional status and others that are based on ordinary law, is of course a simplified description of reality. In many cases, like for example in Spain, the regions may have special status both by constitution and ordinary law (Garcia-Milà and McGuire, 2007).*

⁴⁰ *The region of Friuli-Venezia Giulia has had a special status in since 1963.*

(the Corsican Assembly and the Executive Council of Corsica, each with a president) and more powers than the other regions. However, in general, the legislation governing the French regions applies also to Corsica if not defined otherwise in legislation. The regional reform implemented in 2015 reduced the number of French regions from 22 to thirteen, not including Corsica however.

In 2018, France announced that a constitutional reform will be launched in order to allow differentiated assignments of responsibilities by subnational governments. In early 2020, France started to discuss the draft law on “Decentralisation, Differentiation and Deconcentration” putting thus the concept of asymmetric decentralisation at its core. This would represent a significant move, which could fundamentally change the relationship between the French subnational and the central governments as well as between subnational governments themselves. Until now, the central government could grant derogations provided that they were generalised after five years in the country, or abandoned, in order to maintain territorial equality. The government is now considering changing this, stating that “uniformity is no longer the condition of our unity”. A reform of decentralisation, toward greater differentiation, is seen as a priority for future territorial development in France. The need for such a reform has been amplified by the COVID-19 crisis.

In Canada, while the Canadian Constitution is based on a unified approach, it does enable asymmetric arrangements for Canadian provinces. More specifically, the asymmetric decentralisation in Canada is mostly based on “menu federalism”, where the “opt in” or “opt out” choices are made available to all provinces. The province of Quebec has used this option more frequently than other provinces (Smith, 2005; Milne, 2005). In general, the province of Quebec is an example of “de jure” political asymmetric decentralisation, which is based on historical, cultural and linguistic reasons. Being the largest province and second biggest in population of Canada’s ten provinces, the French speaking Quebec is an influential member of Canada’s federal government. This is in contrast to a situation in many other countries, where the asymmetric arrangements are applied mostly to regions of small economic importance. Quebec has used specific powers for example in health care provision, pension system, with the position of French language in government, and immigration screening. As for the effectiveness of Canada’s asymmetric decentralisation model, while there seem to be continuous discussion about equal treatment of provinces in the federation, the main goal to keep the Canadian federation united has been reached (Bird and Vaillancourt, 2007).

In the United Kingdom, since the devolution in 1998-1999 of certain powers and responsibilities to regional elected bodies, local governments' organisation and functions are defined and reformed by the UK government (and Parliament) for England, and by devolved nations for Wales, Scotland and Northern Ireland.

In Portugal, there is an asymmetric organisation with two autonomous regions having legislative responsibilities in overseas territory, while there is no self-governing regions in mainland. The autonomous regions of Madeira and Azores are responsible for the financing and general supervision of local authorities within their territory, and also have the legislative power to create, dissolve and alter local government boundaries in accordance with the national laws (Box 6.1).

Box 6.1. Regions with special political status

The autonomous regions of Madeira and Azores of Portugal

According to Portuguese constitution since 1976, there are two autonomous regions in Portugal, formed by the islands of Madeira and Azores. In 2017, the population in Madeira was 23 311 inhabitants and in Azores 12 935 inhabitants. There are currently 11 municipalities and 155 parishes in Madeira and 19 municipalities and 54 parishes in Azores.

The autonomous regions of Azores and Madeira have general administrative, political and legislative powers, except for the functions of sovereignty and national representation. The spending responsibilities of Madeira and Azores are extensive, covering health and social welfare, education, roads and transport, economic development, environment, culture, regional planning, water, and tourism. They are also responsible for organization, financing and supervision of municipalities in their region.

The revenues of the Autonomous Regions are based on income tax and value added tax. Autonomous regions have also incomes from excise taxes on consumption and gambling, as well as stamp duty. The Autonomous Regions have the power to create and regulate taxes, which are effective only in the respective Autonomous Regions, defining their respective incidence, rate, settlement, collection, tax benefits and taxpayers' guarantees. They also have the power to adapt national taxes to regional specificities, in terms of incidence, rate, tax benefits and taxpayers' guarantees, within the limits set by law. In addition, the Autonomous Regions receive transfers from the State Budget. The annual amount of the transfers of the State as well as the distribution between the two Autonomous Regions are determined by quantitative criteria referred to in the Law.

The outermost regions and the EU

The nine Outermost Regions of the European Union consist of six French overseas territories (French Guyana, Guadeloupe, Martinique, Mayotte, Réunion and Saint Martin), two Portuguese autonomous regions (the

Azores and Madeira) and one Spanish autonomous community (the Canary Islands). Article 349 of the Treaty on the Functioning of the European Union recognises the specific situation of these regions and gives them a special status.

Despite the progress that they have made over the years, the outermost regions continue to face serious challenges, which are further amplified by globalisation and by climate change. Most of them need to invest in basic infrastructure - such as roads, water and waste management facilities - and their economy depends on a limited number of economic sectors. Their constraints including remoteness bring additional costs to their companies, primarily small and medium sized enterprises (SMEs), impeding their full participation in the single market.

Between 2014 and 2020, the EU is allocating EUR 13.3 billion to these regions under the European Structural and Investment Funds, with additional amounts to tackle their specific constraints, and the POSEI (Programme of Options Specifically Relating to Remoteness and Insularity), a programme under the Common Agricultural Policy.

In addition to European subsidies, the Outermost Regions benefit from specific measures or derogations to facilitate their access to the internal market in areas such as State aid and taxation, in order to mitigate the impact of their constraints and stimulate economic growth.

Furthermore, specific rules apply to the outermost regions in areas such as State aid, with regard to operating and investments aids, as well as in taxation and customs, to help boost their competitiveness. This significant public support from the EU develops infrastructure, provide services for the population, create jobs, invest in education and skills and increase businesses' competitiveness. It also helps enhance and diversify agricultural activities, preserve the environment and addresses climate change.

References: (Veiga and Camões, 2019), the European Commission Regional Policy internet pages (Navigation path: European Commission>Regional Policy>Newsroom>News>The outermost regions and the EU: a privileged, renewed and strengthened partnership), http://ec.europa.eu/regional_policy/en/newsroom/news/2017/10/24-10-2017-the-outermost-regions-and-the-eu-a-privileged-renewed-and-strengthened-partnership. Accessed 28th October 2019.

6.3.2. Asymmetric administrative decentralisation

Even if subnational governments were treated equally in terms of the legal system, there might still be asymmetry in fiscal arrangements in practice. In such “*de facto*” circumstances, there are usually administrative reasons to treat subnational governments in an asymmetric way. Administrative asymmetry aims to advance government policies so that the different capacities of subnational governments are taken into account. These arrangements can include many policies such as additional revenue bases, special

grants, or rights to extended service provision. The policies can be implemented top-down or in agreement with subnational governments⁴¹. While the arrangements usually have a national policy goal, the agreements between the central government and particular subnational government frequently benefit the subnational governments in question. In some cases, the asymmetric arrangements are lobbied by certain subnational governments (Congleton, 2015).

Administrative asymmetry may include sequencing a national policy so that the subnational governments that fulfil certain predetermined standards⁴² are given greater autonomy in spending and revenue. The rest of the subnational governments could then ‘grow into this role’ over time. When examined closely, forms of administrative asymmetry can be found in almost any country. For example, even in Switzerland, where the constitution treats all cantons as fully equal, the devolution of powers has resulted in asymmetry in practice (Dafflon, 2006).

a) Asymmetric administrative decentralisation at the regional level

Although administrative asymmetric decentralisation has been implemented especially in the 1980s/1990s, asymmetric arrangements at the regional level still form an important share of all asymmetric arrangements (Hooghe et al., 2016). This is partly reflected by the fact that political asymmetric decentralisation, which is often applied especially at the regional level, commonly leads also to administrative and fiscal asymmetry. There are however several examples of asymmetric arrangements that are motivated by administrative purposes alone. The degree of administrative asymmetry at the regional level depends both on the significance of tasks delegated to regions and the differences in the administrative capacities in the regions.

Sweden is an example of a highly decentralised country where the subnational government levels have both important tasks and strong autonomous position, and where an asymmetrical and innovative approach to decentralisation has prevailed. In Sweden, there is a long history of asymmetric decentralisation (see also Box 6.2). The geographic, demographic and socio-economic differences between counties are significant, and this has motivated the central government to permit bottom-up initiatives and reforms

⁴¹ *A bottom-up (or top-down) types of asymmetric decentralisation measures are consistent with bottom-up/top-down decentralisation in general (Bird, 2003[s]). A bottom-up approach to decentralisation includes local jurisdictions to be active in organising the local services and asking higher level governments to be supportive of these efforts. A top-down process of decentralisation comprises policies where the central government devolves or delegates some of their responsibilities downwards (Shah and Thompson, 2004).*

⁴² *Sometimes the asymmetric arrangement can be based on discretion also. This could be the case if, for example, specific rules would be difficult to define or costly to administer.*

that aim to adjust governance structures and competences according to territorial capacity. While an “across the board” regional reform is politically difficult, regional reform has been implemented gradually and voluntarily by counties themselves.

Box 6.2. Regional experiments and asymmetric decentralisation in Sweden

Sweden is one of the most decentralised countries in the world in terms of public service delivery and expenditure: about 25 percent of the country’s GDP is accounted for by subnational government expenditure, and the subnational government enjoys extensive spending, taxing and decision-making autonomy. In Sweden, nearly all redistributive tasks have been devolved from the central government to counties and municipalities. Sweden has a two-tier system of subnational government, consisting of 20 County Councils and 290 municipalities:

- County Councils (*landsting*) are run by directly elected assemblies and are mostly responsible for health services (80 percent of their budget). Counties may also engage in promoting culture, education and tourism. The responsibility for regional and local public transport is shared between the municipalities and the County Councils. Ten County Councils have responsibility for regional development policy. In addition, the municipality of Gotland which is an island, is with County Council responsibilities.
- Municipalities (*kommuner*) are also run by directly elected councils. Municipalities are responsible for basic and secondary education, kindergarten, elderly care, social services, communications, environmental protection, fire departments, public libraries, water and sewage, waste management, civil defence, public housing and physical infrastructure.

Until the late 1990s, the County Administrative Boards (central government agencies) were responsible for regional development in each county. Since 1997/1998, Sweden has launched a rather singular regional reform process. The national government has not imposed a single model on the counties but instead different regionalisation options (OECD 2010). It has promoted an asymmetric and bottom-up regionalisation as a gradual and experimental process (a laboratory of regionalisation). The underlying idea is that decentralised policy making leads to more innovation in governance. Therefore, from 1997 onwards, Sweden developed various regionalisation options in terms of political representation and responsibilities in different regions and in different phases: directly elected regional councils in the two “pilot regions” of Skåne and Västra Götaland, resulting from the mergers of respectively two and three counties; an indirectly elected regional council for Kalmar; and a municipality with regional functions for Gotland. The second wave (2002-07) started with the Parliamentary Act of 2002. This Act made it possible for counties, if all local municipalities agreed, to form regional co-ordination bodies (indirectly elected bodies i.e. in line with the Kalmar model) to co-ordinate regional development work. The third phase of experimentation, since 2007, corresponds to a renewed bottom-up demand for regionalisation. It started with the publication of the recommendation for the future of the regional level, published by the Committee on Public Sector Responsibilities in February 2007. The Committee argued for the extension of the “pilot region” model, which was assessed positively, the merger of current counties and the creation of six to nine enlarged regions in order address long-term challenges such as ageing. Since January 1st 2015 ten county councils out of 21 counties had voluntarily taken responsibility for regional development. Since beginning of

2019, the reform was extended to apply the whole country. As a result, all counties, called “regions”, are now responsible for regional development task.
Sources: (OECD, 2012; OECD/UCLG, 2019; OECD, 2017)

Finland is currently preparing a reform to establish self-ruling regions with their own directly elected regional assembly. The regionalisation reform has been motivated by health care and social services reform, which aims to transfer health and social services from the current 295 mainland municipalities and 190 inter-municipal co-operative organisations to the (still to be established) 18 counties. However, it is likely that the capital city region (the Uusimaa region) will have a differentiated model, which can be based on a mixed model of counties and inter-municipal co-operation, possibly forming five self-governing health care areas within the Uusimaa region. The government’s plan is to limit the tasks of the regions to health and social services. For example, the regional development tasks will be based on inter-municipal co-operation.

In France, in December 2017, several French deputies presented a bill aimed at implementing a differentiation and simplification of standards/norms applicable in the territories. The purpose of the bill is to replace regulatory standards with measures adapted to diversity of local situations. The law proposal is based on the observation that there is a proliferation of standards applicable to territories. The bill in question also proposes the creation of a principle of subsidiarity by entrusting the local authorities with the adaptation of the norms of application of the law. The bill just proposes to allow a differentiation of norms and standards (e.g. building, public works, environment, etc.) according to spatial or local government particularities. The proposal of bill has now evolved in the 2020 draft law on Decentralisation, Differentiation and Deconcentration, called the “3-D law” (see below).

In Russia, asymmetric decentralisation was commonly practiced after the collapse of Soviet Union, especially in the 1990s. During the last decade or so, the asymmetric arrangements have become less common, as competences of regions have been streamlined and the role of central government has increased (Martinez-Vazquez, 2007).

b) Asymmetric administrative decentralisation at the metropolitan level

In many countries, the major metropolitan areas – or the most remote rural areas - have been able to achieve a different status compared with the rest of the subnational governments. One relatively common form of institutional asymmetry is that the capital city is given a status similar to a regional government. While the focus was initially (since the 1950s) mostly

focused on capital cities only, it has been extended in the past 3 decades to other large cities within countries.

Metropolitan governance is currently a hot debate internationally. There are many reasons for this. One reason is that metropolitan populations are growing rapidly all over the world and the old governance structures may no longer be able to manage the growth. Also the demographic changes, due to ageing population and growing migration, are particularly challenging for urban form and transportation systems. In some cases, the urban infrastructure may be deteriorating and needing replacement. Also topics such as environmental issues, local democracy and citizen engagement need special attention in urban areas (Slack and Côté, 2005).

It is widely accepted that the main urban areas are “engines of growth” in the economies. It is therefore not sufficient to maintain the current levels of agglomeration economies and human capital, but instead these effects ought to be accelerated. A well-functioning metropolitan governance is one important factor for urban success, but the existing administrative borders in metropolitan areas may no longer reflect the current activities in these regions (OECD, 2017). Moreover, if the land use policies are not intensified in metropolitan areas, the promise from agglomeration economies and human capital spillovers may be missed (Glaeser and Gottlieb, 2008).

The metropolitan governance model must be planned and adapted to local circumstances (Slack and Côté, 2005). Regardless of the model, the basic features such as political representation through direct election, clear assignment of expenditure responsibilities and revenue sources, geographic boundaries that match boundaries of economic region, fiscal autonomy, adequate capacity and revenues that match expenditures, are essential elements for any successful metro governance.

Currently around two-thirds of the metropolitan areas in the OECD have a metropolitan governance body. The additional responsibilities given to metropolitan areas have been linked with infrastructure and planning tasks such as public transport, environment, spatial planning and services targeted at local business (Box 6.3).

Box 6.3. Asymmetric decentralisation and metropolitan governance in France and Italy

Some examples of metropolitan governance include the 2013 French Law on Metropolitan Areas which contemplated differentiated governance for Paris, Lyon and Aix-Marseille, to include governance structures with own taxing powers and the shift of competences from regions and departments (OECD, 2017^[1]). In France, efforts were made by the central government already during the 2000s to encourage co-operation at an urban level (spatial planning directive, DATAR calls for metropolitan projects). However, apart from the creation of urban communities in 1966, they had little success. The 2010 "Law on the Creation of Metropolitan Areas" has led to the creation of only one metropolis (Nice Côte d'Azur), confirming once again that regulation is not sufficient to induce reform. A new step was achieved in 2013 with the first discussions on the new law on metropolitan areas. Government adopted a new approach, based on governance solutions tailored to territorial specificities and local needs. The 2014 "MAPTAM" law, on the modernisation of public territorial action and metropolises, introduced a degree of diversification across French territories. 14 metropolises (more than 400 000 inhabitants) will be granted greater responsibilities than "standard" municipalities or inter-municipalities, justified by their larger size and urban nature. Among them, the three largest metropolitan areas (Paris, Lyon and Aix-Marseille-Provence which already have a specific status since the 1982 PLM law) received ad hoc different governance structures - i.e. different organisation, responsibilities and resources.

The *Métropole du Grand Lyon*, operational since January 2015, has (unlike Paris and Aix-Marseille-Provence) a particular metropolitan status: it merged the responsibilities of the existing inter-municipal co-operation entity Grand Lyon and those of the département du Rhône, covering about 1.3 million people - the only one of its kind in France. Political representatives for the metropolis will be elected through direct suffrage from 2020 onwards. This innovative "asymmetrical" approach based on "recognising the diversity of territories within the unity of the Republic" is relatively new in France (OECD 2013), where past policies were uniform across territories (except for overseas territories). It aims at adapting organisational structures and policies to the distinctive characteristics of territories at an appropriate scale. Another innovation is the setting up of two transitory inter-ministerial "prefiguration" task forces for Grand Paris and Aix-Marseille-Provence. These task forces, headed by the prefect and composed of national and local civil servants and experts, prepared the reforms and then helped in the transition process. They also work to gain support from citizens, local authorities, the private sector, and civil society (OECD, 2017).

Finally, the French metropolitan reform is a good illustration (at least in the cases of Grand Paris and Aix-Marseille) of resistance from local mayors, and possibly from the regional level. The implementation process is as crucial as the nature of the reform itself: the adoption of a law is not sufficient as it may not, or partly, be implemented in practice.

In Italy, a 2014 reform ended two decades of gridlock over metropolitan governance reform and created the legal structure for the introduction of differentiated governance in ten major metro areas—Rome, Turin, Milan, Venice, Genoa, Bologna, Florence, Bari, Naples, and Reggio Calabria—and four additional cities in special regions—Palermo, Messina, and Catania in Sicily, as well as Cagliari in Sardinia) (Allain-Dupré, 2018).

Sources: (Ahrend, Gamper and Schumann, 2014; Slack and Côté, 2005; Glaeser and Gottlieb, 2008; OECD, 2017; OECD, 2019; Allain-Dupré, 2018).

The COVID-19 crisis has shown that while the need for central government coordination has been necessary to ensure concerted actions, the subnational government level has often been at the forefront of managing the crisis. The crisis has had asymmetric impacts to regions and local governments, and the capacities to deal with the implications have differed considerably between subnational governments (OECD, 2020^[9]). Many countries have therefore adopted regionally differentiated strategies for both confinement and de-confinement measures. The crisis management has required a certain flexibility in the governance frameworks and some space for initiatives of regions and municipalities, in particular those mostly hit by the crisis. As new waves of cases have hit some regions and municipalities, the approaches to containment are much more localized as of mid 2020 – with for example localized confinements in Germany, Spain (selected municipalities in Cataluña) or the United Kingdom. The approach is increasingly differentiated within countries.

c) Asymmetric administrative decentralisation at the local level

Local governments are often responsible for a wide selection of public tasks and municipalities, and they also collect considerable revenues. It is therefore not surprising that administrative asymmetric decentralisation is frequently applied at the municipal level. These arrangements are usually linked with assignments delegated by central government to municipalities. Since the capacities of municipalities typically vary, there has been a need to somehow take the capacities of various local governments into account. Another interesting but perhaps somewhat less common motivation for asymmetric decentralisation has been to deregulate and simplify government guidance of local governments.

In the Czech Republic, in the process of decentralisation, the responsibilities of the 76 abolished state “districts” to the municipalities were largely passed on to 205 “municipalities with extended powers” in 2003. These municipalities perform central government delegated functions on behalf of smaller surrounding municipalities such as child protection and issuing passports. These functions are associated with additional funding. Smaller municipalities can also delegate additional functions to the ORP that they do not want to provide, or cannot provide because of their lack of capacities. (OECD, 2017).

In Denmark, a policy experiment known as the “Free Municipality” initiative was launched first between years 2012 and 2015, and later extended until end of 2019. In the experiment, nine municipalities were granted exemptions from government rules and documentation requirements, in order to test new ways of carrying out their tasks. The main focus in the experi-

ment was on simplification, innovation, quality and a more inclusive approach. The Free Municipality experiment is currently being evaluated until end of 2020, in order to form the basis for potential future legislation on de-bureaucratisation for all municipalities (OECD, 2017).⁴³

6.3.3. Asymmetric fiscal decentralisation

Asymmetric fiscal arrangements consist of wide variety of measures, often in combination, including special spending responsibilities, revenue bases or taxation rights and additional transfers.

a) Asymmetric fiscal decentralisation at the regional level

Over the past decades, the central government in Spain has devolved competences asymmetrically to subnational governments. The so called “Foral regime” counties that consist of the Basque Country and Navarra, have a special constitutional status. The regions in the Foral regime have an autonomous taxing authority, whereas other regions have limited local taxing authority. The Foral regime regions have responsibility for tax administration and autonomy to set rates and bases (albeit with some limitations). The main tax bases such as income, corporate, wealth, inheritance and wealth transfers are fully administered by the regional governments in the Foral regime. To compensate for the services that the central government provides to these regions, the Basque Country and Navarra regions pay an amount to the central government. In terms of spending responsibilities, the Foral regime does not differ from other Spanish regions (Garcia-Milà and McGuire, 2007). The development since the 2008 economic and financial crisis shows that in Spain the central government has aimed to tighten the fiscal control of regions and to simplify the administration. The impact of the global covid-19 crisis is yet to be seen.

b) Asymmetric fiscal decentralisation at the metropolitan level

In the United Kingdom, the capital financing of local governments provides an example of asymmetric fiscal decentralisation. While borrowing from the Public Works Loan Board has been the most common form of capital financing of local governments in the UK, also new ways have been developed to access capital finance for local infrastructure investment. For instance, the UK government has (in 2013-2014) introduced tax increment financing

⁴³ *In fact, the tradition of experimenting using the “Free municipality” initiatives began in several Nordic countries already in the 1980s. The first free municipality trials were implemented in Sweden in 1984, Denmark in 1985, Norway in 1987, and Finland in 1989. In Norway, there has been a law for continuous experimenting since 1993. The law allows voluntary experimenting in municipalities, counties and central government.*

schemes, which allow local authorities borrow against the future growth in business rate receipts.

Furthermore, the United Kingdom's Coalition Government (2010-2015) initiated a series of 'deals' (City Deals, Growth Deals and Devolution Deals) with selected cities to devolve powers and resources in particular policy domains. The City Deals and Growth Deals have aimed to help cities deliver local strategies through investment in housing, transport, employment, skills and business support. Some cities have used the Deals to make investment in support for the unemployed (Green, 2018).

In South Africa, the 278 municipalities have different fiscal and administrative capacities. The South African government has therefore adopted a differentiated decentralisation approach, in particular with respect to municipal funding. In order to accomplish this, several classifications are used to group municipalities. The 1996 Constitution provides for three categories: A (metropolitan municipalities), B (local municipalities) and C (district municipalities). Other classifications exist in other areas, such as the Municipal Infrastructure Investment Framework Investment that defines seven categories based on, among others, spatial characteristics, size of institution and budget, and population variables. The National Treasury also classifies municipalities into six "performance groups" using economic, demographic and performance variables such as access to basic services, poverty rate, municipal viability, staff vacancy, municipal debt, population density and size of the municipality's economy. As underlined by the Financial and Fiscal Commission, the different classification methodologies highlighted above recognise that municipalities need differentiated approaches that take into considerations their different characteristics and needs. However, the South African Financial and Fiscal Commission has argued that differentiation approach is not always clear, and some classifications are not always useful for making decisions or allocating resources. This is because categorisation often depends on the **policy** purpose and often detracts from looking at the linkages between rural and urban municipalities. In addition, the large volume of classification methodologies may undermine co-ordinated decision-making and intervention strategies (South African Financial and Fiscal Commission, 2012).

c) Asymmetric fiscal decentralisation at the local level

In Colombia, the country's 1101 municipalities are responsible for providing electricity, urban transport, cadastre, local planning and municipal police. Municipalities are grouped into "certified" or "non-certified" units: only certified municipalities are allowed to provide important services such as health, education, water and sanitation. If the municipality is considered

too weak or it is otherwise ineligible for service provision, the service is provided by the upper (department) government level (OECD, 2014; OECD and UCLG, 2016) (see also Box 6.4).

Box 6.4. Colombian experiences with asymmetric decentralisation

Political asymmetric decentralisation

There have been a number of political asymmetric arrangements in the Colombian multilevel governance model. At the *regional level*, a key asymmetric policy measure has been the special right of indigenous peoples to manage their own territory. There are currently about 811 indigenous territories in Colombia, and the indigenous population in Colombia is estimated at 1.5 million, which represents approximately 3,4% of the national population. The land area covered by indigenous territories (resguardos) is nearly 30% and in some departments about 70%. At the *local level*, the special status of Bogotá forms another important example of political asymmetric decentralisation in Colombia. The 1991 Constitution and the organic statute in 1993 granted Bogotá more political, fiscal and administrative autonomy than the rest of the municipalities. Since then, Bogotá has been considered as an example of successful implementation of asymmetric decentralisation in Colombia. In particular, Bogotá has been able to improve revenue collection, curb excess spending and enhance the efficiency of service provision (Fedelino and Ter-Minassian, 2010). Bogotá's current challenges are related to population growth not just in the city itself but also in the surrounding municipalities. However, forming an area-wide metropolitan governance body in Bogotá area has not yet gained enough political support. Another example of asymmetric political arrangement at the local level is the special "district" status of five municipalities (distritos especiales): Bogotá, Barranquilla, Buenaventura, Cartagena de Indias and Santa Marta (OECD, 2019^[31]). These municipalities were been selected due to their particular political, commercial, historical, industrial, cultural or environmental characteristics.

Administrative asymmetric decentralisation

The special status of six *metropolitan areas*, or áreas metropolitanas, is an example of administrative asymmetric decentralisation in Colombia. The legally recognised metropolitan governance model has been implemented in Valle de Aburrá, Bucaramanga, Barranquilla, Cúcuta, Centro Occidente and Valle del Cacique Upar (OECD, 2019). These metropolitan areas have been granted more administrative and fiscal autonomy than other urban regions. According to law, the initiative for the metropolitan governance must come from the municipalities located in the areas, and the central government then makes a separate decision on the legal status of the arrangement. The arrangement allows municipalities to manage jointly some services of area-wide importance (e.g. transport) that require administrative agreements (Sanchez-Serra, 2016^[32]). Another example of administrative asymmetric decentralisation is the inter-municipal co-operation. However, while the Colombian government has provided a new legal basis for intermunicipal cooperation with the 2011 Or-

ganic Law governing the Territorial Organisation (Ley Orgánica de Ordenamiento Territorial, LOOT), in 2016 there were only 11 cooperative structures at the municipal level that had directly followed the LOOT. The system to classify municipalities and departments has been an important administrative tool for the central government to organise differentiated policies concerning subnational governments. The current classification of municipalities into seven groups has been based on their population and revenue base. The categorisation has included a “special category” which consists of the largest cities and six other categories.

Fiscal asymmetric decentralisation

Since the capacities traditionally vary a great deal between subnational governments, the Colombian government has used a certification system to identify the subnational governments that are best capable to provide important public services. The certifications have been mostly operated by line ministries and they are sector specific (education, health, water and sewage) so that a certification in one sector has not automatically led to certification in another sector. The certified municipalities have been given more autonomy to allocate the central transfers and to organise service provision. The certified subnational governments have been in an advanced position to apply for special central government funding for projects, a policy which has been criticised because it may maintain or even fuel inequality between subnational governments (OECD, 2019).

In order to improve coordination of investments among different levels of government and to create stronger incentives for subnational governments for effective co-operative activities, the Colombian government launched a model of “Contratos Plans” in 2011. The Contratos Plans are in effect investment programmes in specific areas. The Plans are defined jointly by the national government, departments and municipalities and they are tailored to local needs. Once the agreement is made, the central government finances a large share of the programme. The latest Contrato Plans have focused on supporting areas that have been affected by the conflict, and on areas with low economic, social and environmental circumstances (OECD, 2019).

The system of royalties from mostly the mining and oil industries provides another example of asymmetric fiscal decentralisation in Colombia. There is a notable differentiation present in the distribution of royalties in Colombia. For instance, in 2013-2014, about 30% of this funding was paid to the eight most important oil- and mining-producing departments, even though they represented only 17% of the national population (OECD, 2014).

Sources: (OECD, 2014; OECD, 2016; OECD, 2019; Fedelino and Ter-Minassian, 2010; Sanchez-Serra, 2016)

In Norway, the small rural local governments with substantial tax revenue from hydropower plants provide another example of asymmetric fiscal decentralisation. The municipalities where the power plants are located receive taxes and other revenues from the power company. These revenues are considered as compensation for environmental damages, and have been important to generate local support for projects that are profitable for the society at large. The average total revenue per capita among local governments with hydropower revenue was NOK 32600 (USD 6520) in 2007. In comparison, the revenues for all other local governments was NOK 28,300 (USD 5430). (Borge, Parmer and Torvik, 2015).

In Sweden, the intergovernmental grant system is an example of “Robin Hood” equalisation, which evens out a considerable share of differences in subnational government revenue bases and service costs. A rather detailed formula is used to define the grants for subnational governments. While the transfer system is mostly based on general grants, also some discretionary grants and earmarking has been used. The so called “structural grants” are related to regional policy and their aim is to strengthen municipalities with a small population, with decreased population and/or with a problematic labour market. Structural grants mainly benefit the more remote municipalities, for example in Norrland County (OECD, 2017).

Table 6.2. Examples of practices of asymmetric decentralisation summarised in different scales and types

	Political	Administrative	Fiscal
Regional	<ul style="list-style-type: none"> • Italy: Five regions with special constitutional status. • France: The French territory of Corsica has a special regional status. • Portugal: The autonomous regions of Madeira and Azores have special legislative responsibilities • Canada: Province of Quebec has used actively the “opt in, opt out” choices available to all provinces. 	<ul style="list-style-type: none"> • Sweden: A voluntary regionalisation reform from 1990s until 2018 in terms of political representation and responsibilities in different regions and in different phases. Since the beginning of 2019 all Swedish counties have been responsible (by law) for regional development. Called now “regions”, they all have the same status. 	<ul style="list-style-type: none"> • Spain: The autonomous taxing authority of “Foral Regime” autonomous communities.
Metro-politan	-	<ul style="list-style-type: none"> • France: 14 metropolises will be granted greater responsibilities than “standard” municipalities • Italy: 14 metropolitan cities created to administer large urban areas. 	<ul style="list-style-type: none"> • UK: Special investment funding for core cities. • US: Some states assign a portion of state tax revenues to municipalities with a substantial share of the state population (New York City, St. Louis, Kansas City). • Germany: The “City-States” like Berlin have both state and local government responsibilities and revenues.
Local	-	<ul style="list-style-type: none"> • Denmark: Free municipality experiment in order to simplify regulation. • Czech Republic: Limited number of municipalities perform central government delegated functions on behalf of smaller surrounding municipalities. 	<ul style="list-style-type: none"> • Colombia: Royalty revenues for municipalities in certain mining/oil regions. • Norway: Hydropower revenues for specific municipalities. • Sweden: Special grants for the most rural/remote municipalities.

Source: (OECD, 2019).

6.4. Lessons on asymmetric decentralisation for policy-makers

There is no blueprint or optimal strategy for choosing between asymmetric or symmetric implementation because the optimal strategy is usually case specific and depends on local circumstances. Nonetheless, some observations and conclusions from the economics literature and experiences from practical implementation can be made. This section aims to shed light on the pros and cons of asymmetric arrangements from the main policy aspects.

There are both benefits and challenges associated with asymmetric decentralisation (Table 6.3). Benefits are linked to institutional and fiscal frameworks that allow better responses to local needs. In general, asymmetric decentralisation favours experimentation, learning-by-doing and innovation in policy-making. Ultimately, it represents an advanced form of place-based policy. There are some challenges, however, often associated with the cost of coordinating a complex system that may not be clear for citizens and lead to accountability challenges, notably at the metropolitan level. Other

challenges may be linked to the increasing disparities in capacity across regions, and in extreme cases to risks for national unity. This section aims to highlight policies that help to reap the benefits and to minimise the risks linked to asymmetric decentralisation.

Table 6.3. Benefits and challenges for asymmetric decentralisation policies

Benefits	Challenges
<ul style="list-style-type: none"> • Accommodate diverse preferences for autonomy across regions • Adapting the institutional and fiscal frameworks to the capacities of subnational governments • Advanced form of place-based policies • Experimenting • Sequencing decentralisation • Providing the enabling institutional environment to design territorial development strategies more targeted to local needs • Tailoring solutions for special challenges 	<ul style="list-style-type: none"> • Lack of accountability and transparency • Complexity and coordination costs • Lack of clarity for citizens • Potential risks of increased disparities (in capacities) • Secession and autonomy

Source: OECD.

6.4.1. Opportunities

Experimenting and sequencing decentralisation

Asymmetric differentiated arrangements can foster gradual learning-by-doing and develop a culture of trial-and-testing to create a practical body of knowledge. A process of adaptive learning can offer a set of benefits for the long-term efficiency of policy implementation and service delivery. Pilot experiences allow policy makers to experiment and learn while avoiding subnational governments with low capacities becoming overwhelmed by new responsibilities. With pilot experiences governments can, for example, test which indicators might facilitate the assessment of performance, or implement specific contractual arrangements with subnational governments to address specific challenges. Yet, while using this “trying and testing” approach, policy makers need to avoid the risk of perpetuating differences and inequalities across places (OECD, 2018).

Ex ante project evaluation is often difficult to carry out in practice, leading to considerable uncertainties about the eventual effects of a specific decentralisation policy. Uncertainty about the consequences of the policy may impede initiation of important decentralisation reforms. An asymmetric approach, which first devolves tasks or gives revenue powers only to a limited number of subnational governments, could provide the opportunity to collect information and better understand the effects of decentralisation. Only after gaining better understanding about the benefits and costs of decentralisation, the process could be extended to apply a wider range of subnational governments. In this way, asymmetric decentralisation can be seen

as a form of experimenting, which enables innovative approaches and "learning by doing" both for local and central government.⁴⁴ As the decision-makers cannot predict all the effects and the future outcomes, they should be able to revisit their decision-making. Asymmetric decentralisation gives them this option.

Utilising the strengths of subnational governments

Asymmetric decentralisation can be a way to utilise the varying strengths of the different subnational governments. If decentralisation is applied so that spending or revenue powers are first assigned to the subnational governments that are best capable of handling the new responsibilities, governments can obtain benefits from decentralisation (responsiveness to local needs, administrative efficiency, innovativeness, transparency, accountability and cost efficiency) even if the majority of subnational governments are not yet equipped with the capacity required for implementation.⁴⁵ Therefore, asymmetric decentralisation contributes to democratisation and efficiency of public service delivery. Since the asymmetric assignments are usually first applied in the biggest subnational governments, benefits can be substantial from the outset. Asymmetric arrangements also avoid giving spending or revenue powers to jurisdictions that are "too small, too weak, or too poor" (Congleton, 2006).

On the other hand, the smallest and weakest subnational governments may just as well be the first to benefit from asymmetric arrangements. For instance, remote and rural municipalities may be given permission for receiving special revenue bases in order to strengthen their economic position (a revenue from tax on natural resources could be such an example). Naturally, the equalising transfer systems will also have a similar effect. Central governments may also practice asymmetry in their policies, for example by providing extraordinary expert support and advice to the smallest, weakest and poorest subnational governments.

Asymmetric decentralisation also helps implement tailored governance frameworks and place-based regional policies. For example, the effects of major exogenous shocks such as natural disasters or climate change usually affects different regions differently (OECD, 2017).

Tailoring solutions for special challenges

⁴⁴ *A systematic experiment would include a careful planning and selecting a comparison group for the subnational governments that participate the program.*

⁴⁵ *Asymmetric decentralisation can be Pareto improving if asymmetric treatment results in benefits in the favoured subnational governments without causing costs for the rest of the society. Even in case costs would occur, provided there are net benefits, at least in theory it is possible to compensate the "losers".*

Differentiated institutional frameworks are often especially beneficial in major urban and metropolitan areas. It is not always practical to implement policies symmetrically if they are relevant only for a subset of subnational governments such as the main urban areas or the most remote rural regions. The economic growth in major urban areas benefits the economy in general. Therefore, the asymmetric policies that promote agglomeration economies and human capital spillovers in main metropolitan areas are highly valuable for society as a whole.

Diffusing regional tensions

Accommodating diverse preferences for political and fiscal autonomy across regions may mitigate separatist movements and help maintain political stability. These policies have been successful in the sense that wherever those policies have been applied, no secessions have occurred.

6.4.2. Addressing the challenges of asymmetric decentralisation

Successful outcomes of asymmetric decentralisation largely depend on implementation, and like any policy, carry challenges and risks that must be addressed and mitigated. This section discusses ways to avoid unwelcome and unintended effects of asymmetric decentralisation.

Finding balance between heterogeneity and equity aspects

Perhaps the most significant risk of asymmetric decentralisation relates to the fact that asymmetric arrangements (by definition) do not directly promote equal treatment of subnational governments and citizens. In some cases, asymmetric decentralisation may result in a perception that asymmetry means deviation from an overall objective of equality. Spending assignments with a clear redistributive function such as education, health and social services could be examples of such services. These considerations can be diminished if the participation in an asymmetric arrangement is kept voluntary and if the central government or other higher level of subnational government takes responsibility for service provision in non-participant areas.

Related to the previous argument, there may be a risk that asymmetric decentralisation is perceived as support for the wealthiest regions or subnational governments. The “favored” governments may be able to attract citizens and business from other subnational governments, which could accelerate the differentiated economic and social development between regions. This could result in widening regional differences and horizontal fiscal gaps, and lead to demands that such asymmetries ought to be limited (Congleton, 2006).

Asymmetric decentralisation may diminish the central government's ability to pursue national objectives and engage in coordination of public policies. For example, national goals for universal service levels and quality standards may be difficult to reach in a very heterogeneous service provision system. These considerations are diminished if asymmetric decentralisation is not very widespread, however. One should also note that centralisation is not the only method of solving coordination problems or of realizing economies of scale (Congleton, 2006).

Ensuring transparency and accountability

If widely applied, asymmetric arrangements could reduce the transparency and accountability of governance and result in complex administrative systems. These could in turn lead to inefficiency in public administration and service provision in both central and subnational levels of government (Bird, 2003; Martinez-Vazquez, 2007). Possibly, also other negative effects such as increased corruption or favoritism could result. These effects are mitigated, however, if asymmetric decentralisation is carried out as part of a wider decentralisation policy (Congleton, 2006; Bahl and Martinez-Vazquez, 2005; Congleton, 2015).

In order to ensure the continuity and the predictability of government, there usually cannot be frequent changes in asymmetric decentralisation policies. Therefore, once the asymmetric assignments have been decided and put in practice, it may not be politically easy to reverse the process. Because of this “path-dependency”, asymmetric decentralisation should be based on careful planning and agreements between all main stakeholders.

Box 6.5. Recommendations for implementing asymmetric decentralisation

- Asymmetric decentralisation should be part of a broader strategy of multi-level governance and territorial development. Asymmetric decentralisation is not an end in itself, it is a means to achieve multi-level governance goals.
- Asymmetric decentralisation should be supported by effective vertical and horizontal coordination mechanisms.
- Asymmetric decentralisation needs to go hand-in-hand with an effective equalisation system.
- The type of asymmetric decentralisation should be well defined (political, administrative/management or/and fiscal) and have a clear rationale as the objectives and instruments will differ in each case.
- The scale and scope should be clear (large part of the territory vs. restricted, regional, metropolitan, local levels; permanent vs. transitory, timing, pilot/experimental).
- The way asymmetric responsibilities are allocated should be explicit, mutually understood and clear to all actors.
- Asymmetric decentralisation approach should be based on dialogue, transparency and agreements between all main stakeholders.
- To the extent possible, participation in an asymmetric arrangement should remain voluntary. The central government or other higher level of subnational government can take responsibility for service provision in non-participant areas.
- A variety of incentives (not just financial) should be used to foster participation in voluntary schemes or pilot experiences.
- A well-defined and transparent approval system for prospective participating subnational governments should be used.
- The effects of asymmetric decentralisation should be carefully monitored on a regular basis and the results of such evaluations should be used to revise the plans if needed (including the effects on equity and national cohesion).
- A system for communicating good practices and lessons learned from the asymmetric arrangements should be organised.
- Keep a rational number of asymmetric arrangements within the same country to limit coordination costs and complexity.

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Chapter 7

Public employment services under decentralization: Evidence from a natural experiment^{46 47}

Lukas Mergele and Michael Weber⁴⁸

Abstract

This paper studies whether the decentralization of public employment services (PES) increases job placements among the unemployed. Decentralizing PES has been a widely applied reform used by governments aiming to enhance their efficacy. However, economic theory is ambiguous about its effects, and empirical evidence has been scarce. Using a difference-in-differences design, we exploit unique within-country variation in decentralization provided by the partial devolution of German job centers in 2012. We find that decentralization reduces job placements by approximately 10%. Decentralized providers expand the use of public job creation schemes which diminish job seekers' reemployment prospects but shift costs to higher levels of government

7.1. Introduction

Governments commonly maintain public employment services that match job seekers with employers to increase reemployment rates. To improve

⁴⁶ Reprinted from Journal of Public Economics volume 182 (2020) 104113, Lukas Mergele & Michael Weber, p. 1-26, with permission via author from Elsevier. Appendices are excluded – see link from Elsevier home page, Table 1-3 from the original paper to the workshop in 2018 (same content).

⁴⁷ We thank the participants of the EALE 2017 conference, the EEA 2016 Annual Conference, the ERSA 2017 conference, the ESPE 2014 Annual Conference, the SES 2014 Annual Conference, the 7th IAB GradAB Workshop, the 2015 Potsdam Workshop in Empirical Economics, the Vfs Annual Conference 2017, the 2015 Warwick Economics PhD Conference as well as the seminar audiences in Berlin, Dresden, Leipzig, and Nuremberg for their helpful comments and suggestions. In particular, we are grateful to Bernd Fitzenberger, Erik Grönqvist, Rafael Lalive, Ben Lockwood, Rajshri Jayaraman, Udo Kreickemeier, Martin Lundin, Eva Mörk, Steve Pischke, Björn Öckert, Amelie Schiprowski, Alexandra Spitz-Oener, Gesine Stephan, Marcel Thum, Fabian Waldinger, Felix Weinhardt, and Josef Zweimüller for their advice. We also thank the German Federal Ministry of Labour and Social Affairs as well as our contact persons at eleven state ministries for providing invaluable guidance on the institutional setting. Mergele gratefully acknowledges financial support through the grant RTG 1659 by the German Research Foundation (DFG), as well as excellent research assistance by Alex Graf and Alex Rebmann.

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the efficacy of these services, several countries, including Canada, Denmark, Germany, Italy, and Sweden, initiated reforms decentralizing responsibilities for public employment services to sub-national levels of government. These initiatives follow the classic theoretical argument that decentralized public employment offices are better informed about local economic conditions and preferences compared to a central agency. Hence, providing local governments with the autonomy to tailor labor market policies to these needs should result in superior policy outcomes (Oates, 1972; Faguet, 2004). However, economic theory suggests at least three arguments why local policymakers could utilize their additional power for other objectives than reducing unemployment. First, they may aim to maximize their constituency's tax base by strictly focusing on job placements within their own region. This strategy would come at the cost of lower labor market mobility across regions and lead to fiscal externalities by creating a geographical lock-in of job seekers (Wildasin, 1991; Lundin and Skedinger, 2006). Second, local policymakers could strive to shift fiscal costs to other levels of government (Weingast et al., 1981; Besley and Coate, 2003). Thus, they might favor certain active labor market policies (ALMP) or monitoring strategies even if these policies are less effective in facilitating reemployment as long as they result in fiscal gains for the local constituency, for example because costs are covered by the national budget. Third, local policymakers seeking reelection may pressure decentralized employment services to ease welfare recipients' job search obligations (Brollo et al., 2019). This could also reduce the job-finding rate if public employment services at the local level are more susceptible to political influences than at the national level.

As economic theory is ambiguous, it is an empirical question whether centralized or decentralized regimes produce better employment services. This question has remained unanswered due to empirical constraints, most importantly a lack of suitable control groups as the degree of decentralization usually varies between countries but not within them. If control groups were available, short program durations or simultaneous reforms obstructed the identification of causal effects (see Lundin and Skedinger, 2006; Boockmann et al., 2015).

In this paper, we address these challenges by exploiting a largescale German policy experiment. This policy induced permanent within-country variation in the centralization of public employment services unimpaired by simultaneous reforms. The setting enables us to make two major contributions. For one, we provide clean evidence on the effect of decentralization on job finding. We thereby uncover important transition dynamics while tracking the decentralization effect over a period of five years after the reform. For another, we examine channels for this finding by analyzing changes in the main underlying activities of employment offices. These

are providing job seekers and firms with placement services, managing active labor market programs (ALMPs), and monitoring job search efforts. In so doing, we provide an exploratory analysis to determine whether our findings are compatible with local governments following other idiosyncratic incentives that are not beneficial to job seekers.

Implemented in 2012, the German policy reform involved the devolution of public employment offices – referred to as ‘job centers’ hereafter – to the district level within 41 of Germany’s 402 districts.⁴⁹ Job centers typically serve the long-term unemployed or people with very low earnings. For these groups, job centers play a crucial role in matching job seekers with potential vacancies (Pissarides, 1979; Graversen and van Ours, 2008; Fougère et al., 2009). Before the 2012 reform, individual job center policies were determined under the guidelines, directives, and supervision of the Federal Employment Agency (FEA), in cooperation with local authorities. After 2012, authorities of the 41 treated districts were free to independently manage and stipulate these policies. The financing of job centers remained unaffected by the reform. For all job centers, the federal government covered welfare benefits and costs for active labor market programs while local authorities funded accommodation costs. We use this German policy reform to identify the causal effect of decentralizing job centers in a difference-in-differences framework. We implement the approach by estimating an aggregate stock-flow matching function using job centers that remained centralized as a control group (see Coles and Smith, 1998; Ebrahimi and Shimer, 2010). Our analysis employs an aggregate administrative data set comprising the monthly stocks and gross flows of unemployed welfare recipients and vacancies in German districts from 2007 to 2016. We find that decentralization decreases the number of new job matches by roughly 17% in the first year and up to 10% during the second to fifth post-reform years. This effect is equivalent to an increased average unemployment duration of three months. We run a battery of robustness checks including individual-level analyses, placebo tests and triple-difference models that all support our results being driven by decentralization rather than confounding factors. Having established this robust negative effect on job finding, we explore whether decentralization caused changes in the job centers placement policies that could account for these losses. We consider a shift toward placements with higher quality, a geographical lock-in of job seekers, ALMP strategies, the monitoring system, and the role of caseworkers. We again employ a difference-in-differences framework, using both aggregate and individual-level data. Most importantly, we identify an immediate and permanent shift towards public job creation programs that are ineffective in increasing reemployment rates compared to other ALMP measures (see, for instance, Card et al.,

⁴⁹ *German districts (Kreise und kreisfreie Städte) are an administrative subdivision similar to counties in the US. Job centers are organized at the district level.*

2017). We do not find evidence for a higher quality of placements, geographical lock-in effects or changes in the monitoring and counseling activities.

We conclude that job seekers did not benefit from decentralization. Decentralized job centers adjust labor market policies but in a way that does not improve job seekers' reemployment prospects as exemplified by the increase in ineffective job creation programs. Decentralized job centers potentially favored these schemes because they generate local public goods whereas the federal government covers most of the associated costs. Our findings have important consequences for public budgets. Hence, our study emphasizes that decentralization reforms necessitate a careful assessment of potential incentive problems and fiscal externalities to avoid unintended consequences.

This paper speaks to two strands of literature. First, it contributes to fiscal federalism research that has analyzed whether states should provide public goods and services at a centralized or decentralized level (see Geys and Konrad, 2010, for a review). Thus far, this literature has almost exclusively investigated decentralization with respect to public finances, education policies, environmental policies or political institutions.⁵⁰ Little attention has been paid to labor market institutions (Martinez-Vazquez et al., 2017). This gap is surprising given that policymakers worldwide have pressed ahead promoting the decentralization of labor market institutions on a large scale. Second, we address the labor economics literature dealing with individual job matching instruments. This literature has made great progress in credibly identifying causal effects of active labor market policies (e.g. Black et al., 2003; Blundell et al., 2004; Card et al., 2010; Crépon et al., 2013) but remained agnostic about the institutional environment. In particular, it has remained silent on the question under which level of centralization such services should be delivered.⁵¹

Two studies have started to address these problems. Lundin and Skedinger (2006) study a Swedish pilot reform that granted municipal authorities a voting majority in the local employment committees, the bodies responsible for designing local labor market policies. The authors find that municipalities subsequently organized more ALMP projects and hard-to-place job seekers more likely enrolled in municipal projects. Remarkably,

⁵⁰ See, for example, Baicker and Gordon, 2006; Neyapti, 2010; Baicker et al., 2012 for public finance, Ahlin and Mörk (2008), Barankay and Lockwood (2007), Galiani et al. (2008) for education policies, (Sigman, 2002; Banzhaf and Chupp, 2012; Lipscomb and Mobarak, 2017) for environmental policies, and Blanchard and Shleifer, 2001; Enikolopov and Zhuravskaya, 2007; Fan et al., 2009 for political institutions.

⁵¹ A small number of papers have compared public to private provision regimes, finding mixed results for job seeker-outcomes (see, for instance, Heinze et al., 2006; Bennmarker et al., 2013; Behaghel et al., 2014).

the official program period lasted only for three months, which was too short for employment outcomes and longer-lasting effects to be studied. Boockmann et al. (2015) examine a partial decentralization of German public employment offices from 2005 (see also Holzner and Munz, 2013) and find a negative effect of decentralization on the job-finding rate of men. Unfortunately, the empirical setting was constrained by a landmark unemployment benefit reform that directly coincided with the decentralization process. In contrast to these papers, our study has the following advantages. We observe the decentralization effect over a period of five years, are able to examine employment as well as local labor market policies, and our setting is not impaired by simultaneous reforms.

The paper proceeds as follows. Section 7.2 provides details on the German system of public employment services and its 2012 reform. Section 7.3 describes the data and our empirical strategy. Section 7.4 presents the estimated effects of decentralization, and Section 7.5 explores underlying channels. Section 7.6 examines the validity of these results and Section 7.7 concludes.

7.2. Policy background

7.2.1. German job centers

German job centers are one-stop local employment offices that play a central role in the German welfare system. As of January 2012, they served 2 million long-term unemployed job seekers and 2.4 million employed workers with very low labor incomes, or 8% of Germany's working age population.⁵² Job centers serve the residents of their district.⁵³ Their clients' poor labor market prospects give jobcenters a major role in welfare-to-work transitions (see, for instance, Fougère et al., 2009). Job centers engage in job counseling and assign clients to jobs or ALMP measures. They also monitor their clients' job search efforts and may temporarily impose cuts on unemployment benefits if a job seeker does not comply with their job-seeker obligations. These include actively searching for a new job, meeting with their caseworkers, participating in assigned ALMP measures, and accepting appropriate job offers. According to the social security code, the aim of job centers is to integrate clients into employment and allow them to live a dignified life.

Unique to Germany, two types of job centers exist that differ in their degree of local autonomy as portrayed in Table 7.1. The first column intro-

⁵² 4 Job centers do not serve short-term unemployed covered by unemployment insurance. These individuals are served in separate local employment offices. We further explain and make use of this institutional feature in Section 7.1

⁵³ Six job centers serve multiple districts, covering 16 districts in total (as of December 2011).

duces centralized job centers (*gemeinsame Einrichtungen*), which are governed by the Federal Employment Agency (FEA) in cooperation with the respective district authority. In charge of all labor market integration tasks, the FEA supervises the local employment offices using target agreements, directives, and technical supervision such that the provision of public employment services is comparatively standardized across centralized job centers. In particular, placement, ALMP, and sanction policies follow nationwide guidelines with limited strategic leeway for local adjustments. The district administration mainly provides social inclusion services, for instance in the case of drug addiction or psychological problems.

The second type of job center is decentralized with district administrations assuming responsibility for all employment services (*zugelassene kommunale Träger*, second column of Table 7.1). Unlike their centralized counterparts, these job centers operate completely independently of the FEA except for the exchange of unemployment registration data. Decentralized job centers constitute a regular part of the district administration led by the district mayor. There is no general technical supervision by the FEA. District governments only sign target agreements with their respective state governments, their sole de-jure supervisors.

Both job center types share a common legal framework and financing rules. The federal government covers unemployment benefits and expenditures for labor market programs of job-center clients while the local administrations finance their accommodation. The autonomy of decentralized job centers with regard to placement, ALMP, and sanction strategies potentially allows for a better adjustment to local labor market conditions which could improve job finding. However, the financing structure could incentivize local decision makers to implement strategies that are primarily beneficial for local budgets rather than job seekers.

7.2.2. The 2012 decentralization

Table 7.1. Job centers by type of organization.

	Centralized	Decentralized
Task responsibilities		
Placement services	FEA	District
Social inclusion services	District	District
ALMP assignments	FEA	District
Monitoring & sanctions	FEA	District
Governance		
Affiliation	FEA & district	District
Target agreements	With FEA	With state authorities
Technical supervision	FEA	Customized
Financing		
Unemployment benefits	Federal government	Federal government
ALMP measures	Federal government	Federal government
Accommodation costs	District	District

Notes.– FEA: Federal employment agency. ALMP: Active labor market programs.
Sources.– Ruschmeier and Oschmiansky (2010); Boockmann et al. (2015).

Decentralized job centers were established in two waves. The first wave, in 2005, established job centers as one-stop employment offices for the first time into the welfare system whereby decentralized job centers were set up in 67 districts of Germany's 402 districts. This wave also coincided with a large-scale reform of longterm unemployment benefits (Hartz reform, see Dustmann et al., 2014; Nagl and Weber, 2016).⁵⁴ The second wave, in 2012, devolved job centers in 41 other districts. This decentralization provides a pre-reform period and took place without other simultaneous labor market reforms. For these reasons, we focus our analysis entirely on the second wave of reform.

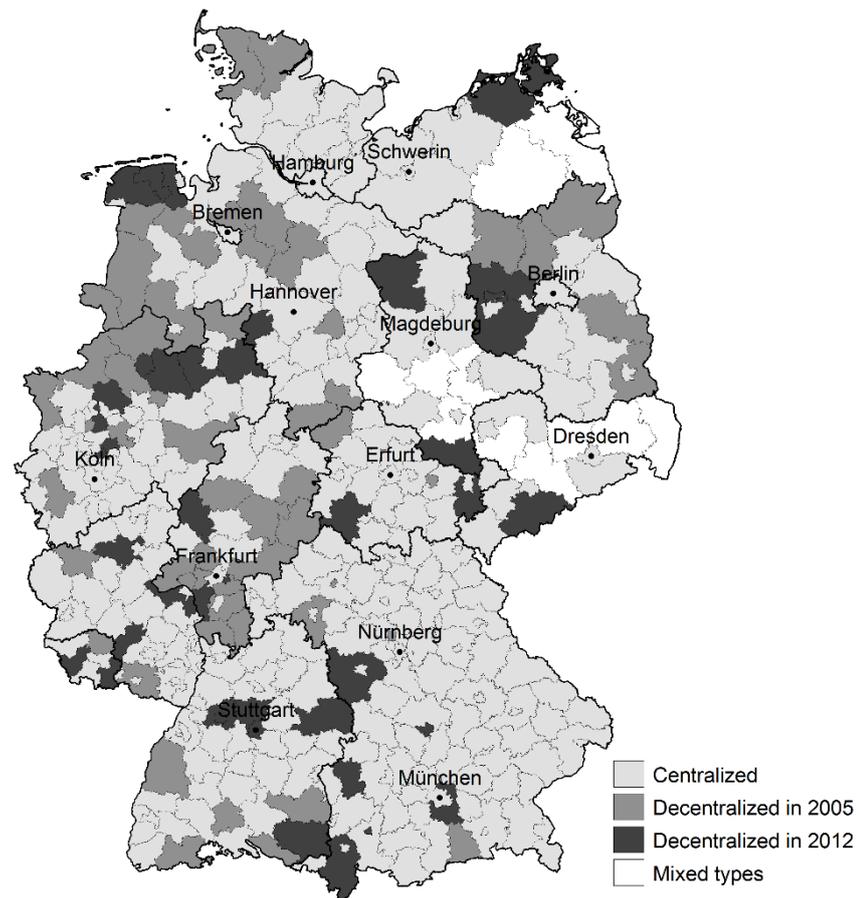
The districts to be reformed in 2012 were determined within a state-quota system. Districts willing to decentralize first had to apply to their respective state governments. The application period started on 3 August 2010 and ended on 31 December 2010. Local councils were required to back the application with a two thirds majority vote. Then, the state governments nominated those applicants allowed to decentralize. The number of nominations was subject to a quota specific to each state, proportional to the state's number of delegates in the upper house of parliament. The total quota for Germany as a whole was 41 districts. 75 districts applied. If the number of applying districts fell short of the available spots in one state, remaining places were filled by districts from other states. Those districts

⁵⁴ *An official evaluation of this decentralization wave led to inconclusive results (Deutscher Bundestag, 2008; Holzner and Munz, 2013; Boockmann et al., 2015), such that no political consensus was reached about the preferred regime. As a compromise, the co-existence of centralized and decentralized job centers was continued.*

allowed to decentralize their job centers were officially announced on 14 April 2011. Decentralization took place on 1 January 2012.

Thanks to the state-quota system, job centers were decentralized in districts all across Germany (see Figure 7.1). They do not cluster in regions with particularly poor or strong labor market conditions, nor are they disproportionately located in cities or rural areas. They also resemble one another in more general economic indicators. Table 7.2 presents major district characteristics by job center type for the preapplication year 2010.

Figure 7.1. German districts by job center type.



Notes.— Mixed types refer to districts where decentralized and centralized job centers coexist e.g. due to district mergers. *Source*. Geodata: GeoBasis-DE / BKG 2014.

As shown in the comparison of means, both groups exhibited on average the same gross domestic product, fiscal situation, population size, sectoral structure, and unemployment composition. A difference arises only for the monthly job-finding rate. As we use job finding solely as an outcome variable in our framework, district fixed-effects will account for these differences in our estimations. A simple F-Test with $F(20, 298) = 1.08$ and $p = 0.37$ also does not reject the hypothesis that the group differences in Table 7.2 are jointly different from zero. In sum, these results supply first evidence that the two groups of districts are observationally equivalent.

7.3. Data and empirical strategy

7.3.1. Data

We utilize three data sets to examine the effects of decentralization on job finding and other labor market outcomes: monthly official aggregate data at the district level (OAD), daily administrative data at the individual level (SIAB), and yearly survey data at the individual level (PASS-AD-IAB).⁵⁵ For the individual-level data sets, data access was provided via on-site use at the Research Data Centre (FDZ) of the German Federal Employment Agency (BA) at the Institute for Employment Research (IAB) and subsequent remote data access (projects fdz1537 and fdz1538). See Antoni et al., 2016; Antoni et al., 2017 for detailed data descriptions.

Monthly official aggregate data (OAD) are taken from the labor market reports of the FEA's statistical office (*Arbeitsmarkt in Zahlen*). The reports are based on data from the job centers' operational processes. They cover the universe of German job centers and all unemployed job seekers, as unemployment registration is mandatory for receiving welfare benefits. The reports provide monthly observations at the district level on unemployment, vacancies, ALMP participation, and benefit sanctions. For all variables, we readily observe stocks as well as gross flows and thus do not have to deal with time aggregation issues. For the unemployed, we also observe the demographic composition such as the share of foreign nationals, people younger than 25 years, and older than 55. We use the OAD data to study the effect of decentralization on unemployment outflows into jobs and into different ALMP programs. The sample period ranges from 2007 to 2016, i.e. from five years before to five years after the decentralization reform. This long time span allows us to check for short-term and medium-term dynamics of any decentralization effects. We note that all OAD figures are based on a legal definition of unemployment that explic-

⁵⁵ For the individual-level data sets, data access was provided via on-site use at the Research Data Centre (FDZ) of the German Federal Employment Agency (BA) at the Institute for Employment Research (IAB) and subsequent remote data access (projects fdz1537 and fdz1538). See Antoni et al., 2016; Antoni et al., 2017 for detailed data descriptions.

itly distinguishes between ‘unemployed job seekers’ and ‘ALMP participants’. As a consequence, ALMP participants are not included in the stock of unemployed, and direct ALMP-to-job transitions are not counted as job finding. We demonstrate in Section 7.4 that this has little impact on our estimate of the effect of decentralization on aggregate job finding. Table A.1 in Appendix A (see first footnote to this chapter) provides further details and descriptive statistics for the aggregate OAD data.

Table 7.2. Major district characteristics in 2010 by job center type.

Variable	Group means		P-Value for equality of means
	Decentralized in 2012	Remained centralized	
GDP per capita (in 1,000 euros)	29.670 (14.831)	29.085 (11.196)	0.766
Public debt p.c. (in 1,000 euros)	1.725 (1.403)	1.587 (1.248)	0.518
Urban district (dummy)	0.225 (0.423)	0.313 (0.464)	0.257
East Germany (dummy)	0.200 (0.405)	0.173 (0.379)	0.681
Civil labor force (in 1,000)	154.230 (96.583)	131.493 (179.278)	0.432
Employment rate	0.724 (0.170)	0.763 (0.216)	0.269
Share: Agriculture	0.021 (0.019)	0.023 (0.021)	0.527
Share: Mining and energy	0.014 (0.008)	0.013 (0.009)	0.904
Share: Manufacturing	0.204 (0.086)	0.195 (0.087)	0.535
Share: Construction	0.066 (0.024)	0.066 (0.025)	0.926
Share: Trade, transp., comm.	0.254 (0.042)	0.251 (0.039)	0.632
Share: Finance and real estate	0.142 (0.045)	0.141 (0.046)	0.824
Share: Public and priv. services	0.299 (0.056)	0.310 (0.065)	0.285
Job-center unemployment rate	0.048 (0.025)	0.047 (0.029)	0.812
Share: Young (15–24 years)	0.080 (0.016)	0.078 (0.020)	0.426
Share: Old (55–64 years)	0.123 (0.028)	0.124 (0.022)	0.843
Share: Foreign nationals	0.190 (0.130)	0.165 (0.093)	0.139
Monthly job-finding rate	0.042 (0.011)	0.047 (0.014)	0.041**
Monthly flow rate into ALMP	0.148 (0.043)	0.162 (0.051)	0.105
Monthly sanctioning rate	0.018 (0.006)	0.019 (0.006)	0.197
Observations	40	294	

Notes.— Sample as described in section 3.1. Standard deviations in parentheses. P-values given for t-test of mean equality. * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$.

Source.— German Statistical Office and Federal Employment Agency.

We complement our district-level data with two individual-level data sets. Our first individual-level data set is the weakly anonymous Sample of Integrated Labor Market Biographies (years 1975–2014, SIAB 7514). The SIAB is a high-quality administrative data set at the individual level which compiles compulsory notifications of employers to the German social security system with process data from the German unemployment and welfare system. The data covers a 2% random sample of all individuals who have been employed, unemployed or – since 2005 – on welfare in Germany. For these persons, we observe a variety of demographic variables, their daily employment biographies including wages, and their places of residence and work. We will use the SIAB data mainly to assess decentralization effects on post-unemployment outcomes. Additionally, the SIAB allows us to build an aggregate data set similar to the OAD data but with economically more meaningful definitions of unemployment. We will use this aggregated data from the SIAB to verify our results from the official labor market reports. The SIAB allows inferring periods of ALMP participation but does not report in which ALMP programs job seekers registered at decentralized job centers take part (Antoni et al., 2016, p. 22). Thereby it is impossible to draw conclusions regarding the effect of decentralization on inflows into particular ALMP programs. Observations based on the SIAB end in December 2014, effectively censoring all ongoing spells at this point in time. Appendix A.2 provides further details and descriptive statistics for the SIAB data.

Finally, we make use of the weakly anonymous data of the Panel Study ‘Labour Market and Social Security’ (PASS), which is linked to administrative data of the IAB (PASS-ADIAB, version 7515, waves 1–10). The PASS is a yearly survey particularly designed for households receiving unemployment benefit II, i. e. clients of the German job centers. This data is then linked to the above-mentioned administrative data sources. After applying our initial sample restriction (unemployed household heads receiving unemployment benefit II), the PASS-ADIAB covers about 16,157 person-year observations. Households are drawn from recipient registers of the FEA in 300 of Germany’s more than 8000 postcode areas. PASS is thus more restricted in its geographic scope and overall size but allows to study additional outcomes such as sanction durations as well as the number of contacts and counseling sessions with job center caseworkers. Its limited coverage also does not enable us to compute dynamic effects of decentralization. The PASS sample period ends in 2016. Appendix A.3 (see first footnote to this chapter) provides further details and descriptive statistics for the PASS data.

For all three data sets, we implement the same sample definitions. The sample period starts in 2007 and ends in 2014 (SIAB) or 2016 (OAD,

PASS-ADIAB), respectively. We omit aggregate and individual level observations from districts that decentralized their job centers already in 2005, although their inclusion as an additional control group does not alter our results. From the remaining regions, we omit 11 districts in which centralized and decentralized job centers co-existed due to administrative reforms. This also includes one district which was part of the 2012-reform, leaving us with a total of 40 treated districts. Our final sample covers observations from 334 out of 401 German districts.

7.3.2. Econometric model

To identify the causal effects of decentralization, we employ a difference-in-differences framework at the district level. Our treatment group comprises 40 districts whose job centers were decentralized in 2012, while our control group contains 294 districts whose job centers remained centralized throughout the sample period. We estimate econometric models both at the aggregate and the individual level. In either model, standard errors are clustered two-dimensionally by district and by month to account for unobserved correlation within these two dimensions (Bertrand et al., 2004).

For the analysis at the aggregate level, we employ a functional form that is motivated by a stock-flow matching model with Cobb-Douglas technology (Coles and Smith, 1998; Ebrahimi and Shimer, 2010).⁵⁶ Analogous to a production function, the stock-flow matching function models the gross flow from unemployment into jobs ('matches') as an output produced by the stocks of vacancies and unemployed as well as their respective inflows. We interpret the total factor productivity of the matching function as an indicator for the efficiency of the local job center in bringing unemployed back to work. The decentralization status of a job center then constitutes one component of this indicator. Log-linearizing the stock-flow matching function, our estimation equation then reads

$$Mdt = d Ddt + b_1 Udt + b_2 Vdt + b_3 \tilde{U}dt + b_4 \tilde{V}dt + ad + It + edt \quad (1)$$

where Mdt denotes matches defined as transitions from unemployment into jobs for district (i.e. job center) d and month t , our main outcome. The dummy variable Ddt indicates whether a district's job center is decentralized or not. Udt and Vdt denote the stocks of unemployed and vacancies, whereas $\tilde{U}dt$ and $\tilde{V}dt$ denote their respective inflows in this month. We include district-specific effects ad to account for time-invariant differences in matches across districts and month-fixed effects It to capture business

⁵⁶ The stock-flow matching function has received empirical support both at the micro and the macro level (Gregg and Petrongolo, 2005; Andrews et al., 2013) with strong evidence for a Cobb-Douglas functional form (see Petrongolo and Pissarides, 2001, for a survey).

cycle and seasonal fluctuations. Our parameter of interest is d , which provides the treatment effect of decentralization on the conditional outflow from unemployment to employment.

At the individual level, we employ a reduced form model of the form

$$Y_{idt} = d \text{Didt} + X_{itb} + ad + It + 4idt \quad (2)$$

where Y_{it} denotes the outcome of job seeker i in district d in month t . The dummy variable Didt is 1 for residents of decentralizing districts who register for unemployment on or after January 1, 2012, and 0 otherwise. We control for a vector X_{it} of job seeker characteristics measured at the beginning of the unemployment spell, including age, age squared, gender, foreign nationality, high school degree, professional degree, and occupational group. To capture labor market histories, we add the pre-unemployment wage and five variables to separately measure the number of days in employment in each of the five years prior to registering at the job center.⁵⁷ Analogous to our aggregate analysis, we include district-specific effects ad to account for time-invariant differences in labor market outcomes across districts and month-fixed effects It to absorb business cycle and seasonal fluctuations. If the dependent variable Y_{idt} is a binary indicator, such as the indicator of having found a job, we estimate linear probability models. Our parameter of interest is d , the average treatment effect of being registered at a decentralized job center. As the control group also includes partially treated unemployment spells that start before a job center reform and continue thereafter, our estimations of d may be attenuated – a presumption we are going to address in Section 7.4.4.

Our empirical approach relies on two main identifying assumptions.⁵⁸ First, centralized and decentralized job centers experience the same fundamental labor market trends in the absence of the policy change. Second, decentralization has no effect on job finding in unreformed districts (stable unit treatment value assumption, SUTVA). We find descriptive support for common trends in the following section and more formal support for both assumptions in Section 7.6.

7.4. The effects of decentralization on job finding

This section presents results for the effect of decentralization on job finding. We start with a descriptive analysis of the aggregate jobfinding rate and then proceed with estimating static and dynamic treatment effects

⁵⁷ Usually, job seekers register at job centers after one year in unemployment when their entitlement to the short-term unemployment benefit *UB I* expires.

⁵⁸ We have already discussed in Section 2 that the 2012 decentralization did not coincide with other reforms that could have affected the two groups of districts systematically differently.

using our aggregate OAD data. In the last part of this section, we address potential shortcomings of the OAD-based estimates using individual-level data from SIAB.

7.4.1. Descriptive results

Illustrating the effect of decentralization descriptively, Figure 7.2 shows the evolution of the seasonally adjusted average aggregate monthly job-finding rates by job center type over time. The job-finding rate is calculated as the outflow out of unemployment over the unemployment stock at the beginning of the month. The figure illustrates that in the five years before the reform, the job-finding rates' evolution was remarkably similar in both groups of job centers. This lends credibility to the common trends assumption and affirms that the reform did not target districts with particularly bright pre-treatment trends. We plot descriptive graphs for further labor market outcomes in Figs. B.1 and B.2 in Appendix B.1 (see first footnote to this chapter), again confirming parallel pre-reform trends. However, after the decentralization in January 2012, the job-finding rate of decentralized job centers dropped sharply relative to centralized job centers. It declined from about 4.5% to roughly 3% in treated districts and from approximately 5% to around 4% in non-treated districts. The gap narrows until mid-2015 but widens again thereafter and does not return to its pre-reform size. This points to permanent negative effects of decentralization on job finding.

7.4.2. Static treatment effects

We now investigate whether parametric estimates will support our descriptive findings. Table 7.3 reports the difference-in-differences estimates from Eq. (1) for the outflow from unemployment into employment. Each column represents a regression of log transitions into jobs on a decentralization indicator, district and month fixed effects, as well as subsequently introduced covariates. Column 1 gives the average treatment effect of decentralizing job centers while controlling only for fixed effects. The estimate implies that average monthly flows into jobs decreased by roughly 11% due to decentralization. Columns 2 to 4 refine the model's precision by adding a set of local labor market characteristics that remove cross-district differences. In particular, column 2 adds the monthly stocks of vacancies and unemployed. Building on column 2, column 3 includes the respective inflows, completing the basic stock-flow model. The coefficients of the stock-flow variables are in line with the concept of stock-flow matching. Job finding is more elastic with respect to the inflows of new vacancies rather than its stock while it is more elastic with respect to the stock of unemployed rather than its inflow. The decentralization effect remains robust and stable. Column 4 additionally controls for shares of three demographic groups that are typically hard to place into jobs, i.e. the share of unemployed below the age of 25, the share of unemployed above the age

of 55, and the share of foreign unemployed. As expected, higher shares of these hard-to-place job seekers in the group of unemployed *ceteris paribus* reduce the unemployment outflow into employment. Yet, controlling for these groups does not alter our decentralization estimate. Our finding is also robust to including linear district-specific trends into the empirical model, using interacted fixed effects and using alternative sample periods (see Tables S.1, S.2 and S.3 in Online Appendix S).

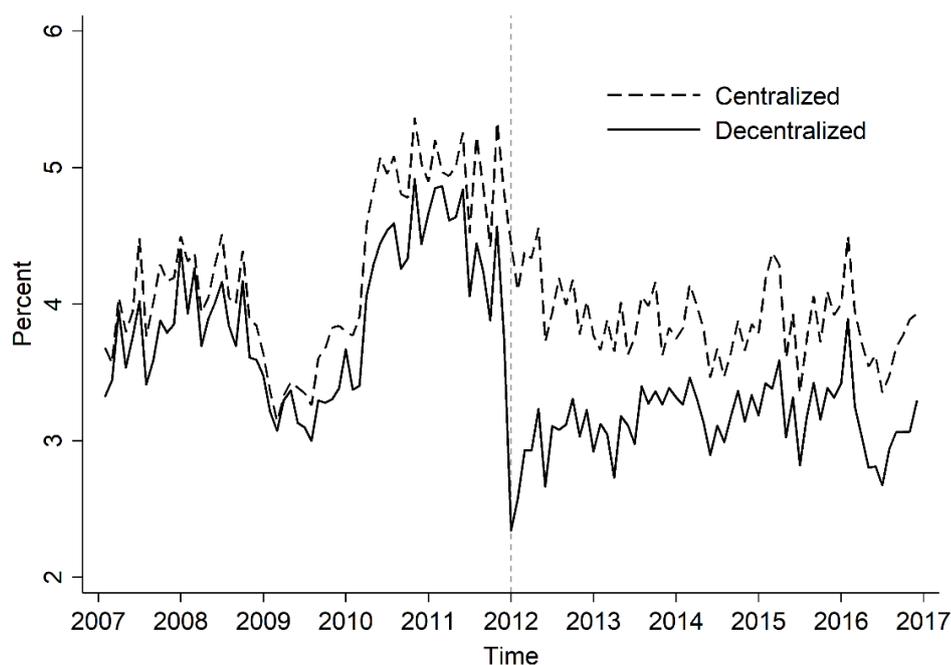
Hence, we conclude that decentralization reduced the monthly flow into jobs on average by about 10% within five years following the reform. This effect size is equivalent to an increase in the average unemployment duration by about three months.⁵⁹

7.4.3. Dynamic treatment effects

Next, we investigate whether the negative effect of decentralization is declining over time, as Figure 7.2 may suggest.

⁵⁹ *The average aggregate monthly job-finding rate in centralized districts amounts to 3.8%. Assuming a constant job-finding probability over the duration in unemployment, this implies an average unemployment duration of about 26 months. A 10% decrease of job finding, therefore, implies an increase in average unemployment duration by almost 3 months.*

Figure 7.2. Average aggregate monthly job-finding rates by job center type.



Notes.— The figure depicts the seasonally adjusted average aggregate monthly job-finding rate. It is calculated as the monthly outflow out of unemployment into employment over the unemployment stock at the beginning of the month. The time-labels on the x-axis refer to January of a given year. Source.— OAD data. Sample period 2007–2016.

We therefore modify the stock-flow matching model from Eq. (1). Adding a full series of annual leads and lags of the reform, the regression equation now reads

$$Mit = 2016 \sum_{t=2007}^{(t \neq 2011)} dt Dit + b1 U_{it} + b2 V_{it} + b3 \tilde{U}_{it} + b4 \tilde{V}_{it} + a_i + I_t + e_{it} \quad (3)$$

where t denotes years and dt are yearly coefficients. All dynamic effects are estimated relative to the pre-treatment base year 2011. Estimating quarterly effects leads to qualitatively similar but less precise results.

Figure 7.3 depicts the resulting evolution of the decentralization effect on job finding from five years before to five years after the reform. During the pre-reform period, all coefficients are statistically insignificant. This finding rules out anticipatory decentralization effects and supports the common trends assumption underlying our identification strategy.

In the first year after decentralization, monthly unemployment outflows were strongly reduced by about 17%.

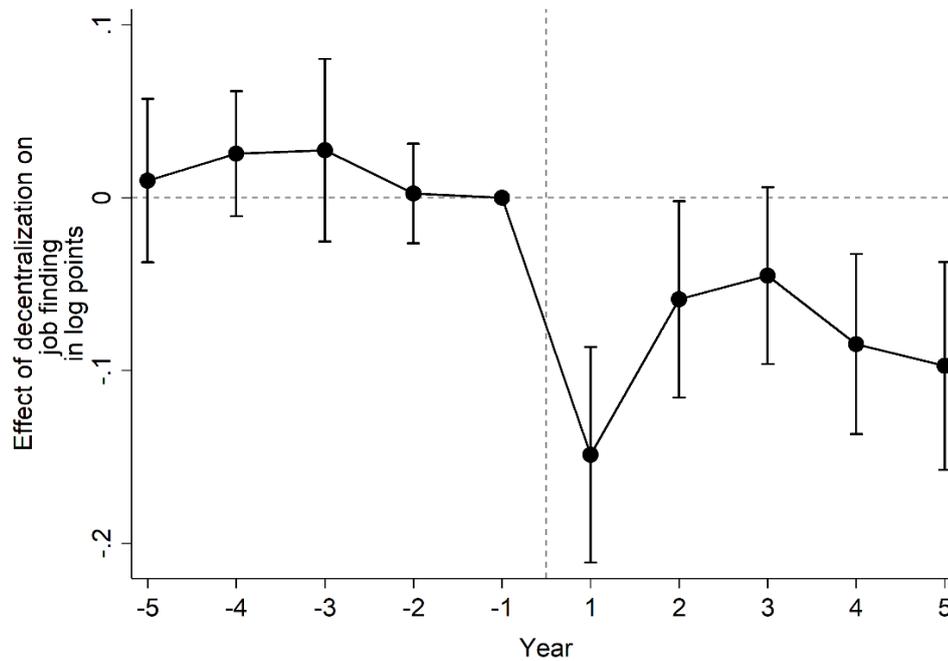
Table 7.3. Difference-in-differences: Average effect of decentralization on monthly log flows into jobs.

Table 3
Difference-in-differences: Average effect of decentralization on monthly log flows into jobs.

Variable	(1)	(2)	(3)	(4)
	Fixed effects	Stocks	Stock-flow	Controls
Decentralized	-0.119*** (0.028)	-0.124*** (0.025)	-0.096*** (0.021)	-0.100*** (0.021)
Vacancies, stock		0.029* (0.013)	-0.027** (0.011)	-0.025** (0.011)
Unemployed, stock		0.562*** (0.036)	0.372*** (0.031)	0.383*** (0.031)
Vacancies, inflow			0.110*** (0.012)	0.111*** (0.012)
Unemployed, inflow			0.331*** (0.021)	0.327*** (0.021)
Unemployed: <25 ys				-0.004** (0.002)
Unemployed: >50 ys				-0.005*** (0.002)
Unemployed: foreign				-0.004** (0.002)
Outcome mean	4.667	4.667	4.667	4.667
R-squared	0.951	0.955	0.958	0.958
Districts	334	334	334	334
Observations	39,018	39,018	39,018	39,018

Notes.— * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$. Each column presents a different estimation of Eq. (1), where the outcome is the log outflow from unemployment into employment. Decentralized is a dummy equaling 1 for districts with decentralized job centers and 0 otherwise. All continuous variables in logs. Regressions include a full set of dummies for job centers and months. Standard errors given in parentheses are clustered at the job center and the month level. Source.— OAD data. Sample period 2007–2016.

Figure 7.3. Dynamic treatment effects of decentralization on monthly flows into jobs.



Notes.— The figure depicts coefficients and their 95%-confidence intervals of yearly leads and lags of the decentralization indicator from a stock-flow regression of the log monthly flow from unemployment into jobs, as given by Eq. (3). The year 2011 is the baseline category. The regression includes a full set of dummies for job centers and months. Standard errors are clustered at the job center and the month level. The outcome mean is 4.667. Source.— OAD data. Sample period 2007–2016.

During the following years, this effect weakens over time but still amounts to almost 10% in the fifth year after decentralization. Seven expert interviews with division heads of state and federal ministries as well as job center directors suggest that the first year after the reform was influenced by the organizational transition. Employees had to adapt to new IT systems and practices. Moreover, some functions that used to be centrally provided by the FEA before had to be built up in decentralized job centers. We thus conclude that decentralization initiates a transition phase with a particularly pronounced drop in the job finding rate during the first year but also induces a more permanent and economically relevant negative effect in subsequent years that requires explanation.

7.4.4. Robustness checks using alternative sample definitions

In the remaining section, we verify that our main result is not driven by the nature of our OAD data. Two issues raise our concern. First, by excluding ALMP participants from the unemployed and the unemployment-to-employment flows, our OAD-based estimates might overstate the negative effect of decentralization on aggregate job finding. Second, some of

the decentralization effect might be driven by changes in the composition of the inflows into unemployment. Such changes are unobserved in our aggregate figures. To analyze both issues, we draw on the individual-level data from the SIAB.

First, we address the appropriate definition of unemployment. Economic theory considers any non-employed job seeker as unemployed, irrespective of enrollments into ALMP programs, while our OAD data excludes such ALMP participants. Therefore, we use the SIAB to build three OAD-style aggregate data sets with alternative definitions of unemployment. The first definition considers only official unemployment registrations, mirroring the legal unemployment definition underlying our OAD data. The second unemployment definition additionally includes periods of reported ALMP participation. The third unemployment definition further includes observational gaps, such that unemployment lasts from the first official unemployment registration at a job center until the start of the next employment spell. This definition follows a proposition by Fitzenberger and Wilke (2010) that is now widely used in the literature.⁶⁰

We then re-estimate the aggregate model (1) for each definition of unemployment. Table 6.4 presents the results. We find strong negative effects of decentralization on aggregate job finding, irrespective of the particular definition of unemployment. Even with our broadest definition, we estimate a treatment effect that is very close to our initial OAD-based results. The same holds true for the respective dynamic estimations provided in the Appendix S (see first footnote to this chapter), Table S.7. The inclusion of ALMP participants in the pool of unemployed does not affect these findings, because job seekers enrolled in ALMP participants are much less likely to find a job than other unemployed job seekers. This conclusion is also supported by Appendix B.2, which provides a descriptive overview of these transitions. In sum, the evidence implies that our main result does not depend on the exact definition of unemployment.

We now turn to our second concern. The reduction of the aggregate job-finding rate could also reflect changes in the inflow into unemployment. In fact, Table B.2 in the Appendix (see first footnote to this chapter) shows that decentralization slightly increased the share of lower qualified job seekers among the inflow into unemployment. Since lower qualified job seekers are harder to be placed into jobs, this compositional effect could add to our estimate of the negative decentralization effect. On the other hand, we also observe a decentralization-related decline in the share of

⁶⁰ *Unlike the first two unemployment definitions, this one keeps job seekers in the unemployment pool even in case of long illness, parental leave or similar events. However, in some instances, it may mistakenly also define periods of self-employment, education or other non-unemployment periods unobserved in SIAB as unemployment.*

foreign citizens and an increase in the amount of days worked prior to registering for unemployment. Both changes are rather associated with an increasing job-finding probability.

To investigate whether these compositional changes affect our results, we re-estimate the effect of decentralization directly at the individual level, using the specification of Eq. (2). We use two different outcome measures, the log duration in job-center unemployment and the probability of finding a job out of unemployment, while controlling for a range of job-seeker characteristics as well as job center and months fixed effects. We estimate the models for the raw sample and for a matched sample, where inflows of the control group are reweighted such that their average characteristics match exactly the average characteristics of the inflows of the treatment group. The re-weighting uses the entropy balancing procedure proposed by Hainmueller (2012) and is performed separately for the pre-treatment and the post-treatment period. This analysis provides us with two insights. First, it gives an estimate of the decentralization effect on job finding at the individual level. Second, by comparing the results for the raw and the matched sample, we can assess whether changes in the inflow composition affect our results.

Table 7.4. Difference-in-differences: Average effect of decentralization on monthly log flows into jobs for different definitions of unemployment

Difference-in-differences: Average effect of decentralization on monthly log flows into jobs for different definitions of unemployment.

Unemployment:	(1)	(2)	(3)
	Official unemployment	Official unemployment + ALMP	Official unemployment + ALMP + Gaps
Decentralized	-0.101*** (0.028)	-0.113*** (0.026)	-0.106*** (0.025)
Outcome mean	1.113	1.263	1.477
R-squared	0.674	0.705	0.727
Districts	334	334	334
Observations	25,257	26,032	24,866

Notes.— * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$. Each column presents a different estimation of Eq. (1). The outcome variable is the monthly log outflow out of unemployment into jobs. Decentralized is a dummy equaling 1 for districts with decentralized job centers and 0 otherwise. Regressions include the stocks and inflows of unemployed and vacancies as well as a full set of dummies for job centers and months. All continuous variables in logs. Standard errors given in parentheses are clustered at the job center and the month level.

Source.— SIAB 7514. Sample period 2007–2014.

Table 7.5 shows the results when employing the broadest definition of unemployment. The first two columns present the results for the raw sample, the last two columns present corresponding results for the matched sample. In the first column, we observe that decentralization increased the average duration in unemployment. In the second column, we find that decentralization reduces the individual probability of finding a job. Using the matched sample, we obtain quantitatively and qualitatively very sim-

ilar results. This indicates that the observed changes in the inflow composition of decentralized job centers do not affect our results. Several additional analyses corroborate this finding. Table C.1 in the Appendix (see first footnote to this chapter) shows that the larger unemployment duration is independent of the exact definition of unemployment. The findings for the probability of finding a job are more diverse. Table S.8 (Appendix S.6) confirms the similarity between the dynamic effects for the individual-level outcomes and the patterns found at the aggregate level. The models in Table S.10 then repeat the baseline analysis for our main outcomes while excluding unemployment spells first registered in the pre-treatment year 2011. The estimates are highly similar to their equivalents using the full sample, suggesting that attenuation bias through including partially treated spells in the control group is not a major concern. Similarly, Table S.11 presents models which only include unemployment spells starting before June 2013 and models where unemployment spells are capped at 365 days. Their results indicate that our main effect is also insensitive to the censoring of the SIAB data in 2014. Altogether, the individual-level analyses support our previous finding of a lower aggregate monthly job-finding rate. They also suggest that this reduction cannot be attributed to changes in the inflow composition of unemployed.

7.5. Policy adjustments

We now explore channels that might explain the negative effect of job center decentralization on job finding. As argued above, decentralization may lead to (i) higher-quality placements; (ii) a geographical lock-in of job seekers; (iii) changes in the flows into ALMP measures; (iv) changes in the monitoring and sanctioning of job seekers or (v) changes in the job center contact intensity. Finally, we will briefly discuss additional features of PES playing a potential role in the decentralization process.

7.5.1. Placement quality

Decentralizing job centers may provide gains other than higher job finding, such as improved job quality. In particular, job centers may accept a lower placement rate if they emphasize the quality rather than the quantity of their placements. In Germany, decentralized job centers may focus on stable, higher-paying placements because the districts bear the accommodation costs for households on welfare, irrespective of the employment status. In contrast, centralized job centers have an incentive to focus on the number of placements regardless of job quality as any person exiting unemployment reduces FEA expenditures.

Table 7.5. Difference-in-differences: Average effect of decentralization on individual unemployment duration and job finding.

Variable	Raw sample		Matched sample	
	(1)	(2)	(1)	(2)
Variable	Log unemployment duration	P(Exit to job)	Log unemployment duration	P(Exit to job)
Decentralized	0.090*** (0.029)	-0.032*** (0.009)	0.087*** (0.029)	-0.030*** (0.009)
Outcome mean	5.364	0.724	5.364	0.715
R-squared	0.093	0.084	0.094	0.087
Districts	344	344	344	344
Observations	121,675	121,675	121,675	121,675

Notes.— * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$. Each column presents a different estimation of Eq. (2). Unemployment includes registered unemployment, ALMP participation and observational gaps. *Decentralized* is a dummy equaling 1 for districts with decentralized job centers and 0 otherwise. Regressions include the age, age squared, the log previous daily wage, the number of days in employment for each of the five years prior to unemployment, dummies for gender, foreign nationality and high school degree, as well as a full set of dummies for professional degrees, occupational groups, job centers and months. Standard errors given in parentheses are clustered at the job center and the month level.
Source.— SIAB 7514. Sample period 2007–2014.

Table 7.6. Difference-in-differences: Average effect of decentralization on job characteristics after unemployment.

Difference-in-differences: Average effect of decentralization on job characteristics after unemployment.

Variable	(1)	(2)	(3)
	P(Regular full-time job)	P(Empl. lasts > 6 months)	Log wage change (in Euro)
Decentralized	-0.003 (0.013)	-0.005 (0.011)	0.029* (0.015)
Outcome mean	0.469	0.494	0.126
R-squared	0.210	0.039	0.377
Districts	344	344	344
Observations	88,148	88,148	88,148

Notes.— * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$. Each column presents a different estimation of Eq. (2). Unemployment includes registered unemployment, ALMP participation and observational gaps. *Decentralized* is a dummy equaling 1 for districts with decentralized job centers and 0 otherwise. Regressions include the age, age squared, the log previous daily wage, the number of days in employment for each of the five years prior to unemployment, dummies for gender, foreign nationality and high school degree, as well as a full set of dummies for professional degrees, occupational groups, job centers and months. Standard errors given in parentheses are clustered at the job center and the month level.
Source.— SIAB 7514. Sample period 2007–2014.

We assess the effect of decentralization on the placements' quality using individual-level data from SIAB. We consider three different job quality indicators: whether the new job is a regular full-time position, whether the new employment lasts for at least six months, and the log daily wage difference between the new and the previous job (Nekoei and Weber,

2017). For all quality indicators, we re-estimate Eq. (2) using individual covariates and a full set of job center as well as month fixed effects as control variables.

Table 7.6 presents our estimation results using the broadest definition of unemployment. For the full-time and job duration indicators in the first two columns, we do not observe an effect of decentralization. Column three suggests that the reform entails a moderate wage change increase of 2.9 log points. Using other definitions of unemployment confirms the results for the first two job quality indicators but also suggests a null-effect for the change in wages (Table C.2, Appendix C (see first footnote to this chapter)). Similar conclusions are proposed by the respective dynamic estimations in Table S.9 (Appendix S.6), though findings seem non-reliable for the job duration indicator due to a significant pre-reform change. Tables S.12 and S.13 show that the previous results are insensitive to the right-censoring of spells in 2014. In sum, these results imply that decentralized job centers do not achieve more stable or long-lasting placements than their centralized counterparts. If anything, there is weak evidence that decentralization is associated with moderately higher wages of new job matches, compared to jobs held before unemployment.

7.5.2. Geographical lock-in of job seekers

If local decision makers aim to maximize the tax base of their constituency, they have an incentive to match job seekers only with vacancies in their own district. This would lead to a lower mobility of job seekers across districts and could explain a lower job-finding rate under decentralization (Lundin and Skedinger, 2006). This phenomenon has been termed as ‘geographical lock-in’ of job seekers and could create an uncoordinated fiscal externality among districts (Wildasin, 1991).

To examine whether decentralization induces geographical lockin, we analyze if decentralization increased the probability of job seekers to be placed more often in jobs within their home district. We again draw on the SIAB data, which provides for each job seeker their place of residence during unemployment as well as their place of work during employment. Places can be identified at the district level. We re-estimate the individual-level Eq. (2) using as dependent variable a dummy that indicates whether the new job is located in the person’s place of residence as stated from the unemployment spell. The variable is explicitly set to zero if people move to their new place of work. Table 7.7 does not indicate any evidence that the likelihood of being placed ‘at home’ has either increased or decreased after decentralization. This result is independent of the definition of unemployment used, see Appendix C.2. There, we additionally show that geographical lock-in is also not an issue at the aggregate level.

Hence, decentralization did not increase the geographical lock-in of job seekers.

7.5.3. Active labor market policies

Changes in the assignment of job seekers into ALMP measures constitute a third potential explanation for the reductions in job finding. Decentralized job centers could use their autonomy to better tailor ALMP strategies to local economic conditions. Yet they may also promote program types that provide additional gains for the local constituency such as local public goods. Similarly, Lundin and Skedinger (2006) point out that decentralized job centers might prefer ALMP measures that help to maximize the local tax base, even if they came at the cost of higher geographical lock-in. However, an ALMP strategy that does not focus on the most effective programs for increasing reemployment rates will reduce the aggregate job-finding rate.

Table 7.7. Difference-in-differences: Average effect of decentralization on location of new jobs.

Difference-in-differences: Average effect of decentralization on location of new jobs.

Variable	(1) Job in district of residence
Decentralized	0.003 (0.012)
Outcome mean	0.631
R-squared	0.084
Districts	344
Observations	88,148

Notes.— * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$. Each column presents a different estimation of Eq. (2). Unemployment includes registered unemployment, ALMP participation and observational gaps. Decentralized is a dummy equalling 1 for districts with decentralized job centers and 0 otherwise. Regressions include the following control variables: age, age squared, the log previous daily wage, the number of days in employment for each of the five years prior to unemployment, dummies for gender, foreign nationality and high school degree, as well as a full set of dummies for professional degrees, occupational groups, job centers and months. Standard errors given in parentheses are clustered at the job center and the month level.

Source.— SIAB 7514. Sample period 2007–2014.

For German job centers, the four most common ALMP categories are short-term classroom and on-the-job training of up to 3 months (*Aktivierung und berufliche Eingliederung*), medium-term vocational training and re-training (*Berufliche Weiterbildung*), wage subsidies (*Aätigkeit*), and public job creation schemes (*Bäftigung schaffende Maßnahmen*). For all these measures, the federal government bears the cost of program par-

icipation.⁶¹ Yet, only public job-creation schemes offer the additional advantage of participants providing local public goods, such as cleaning streets, gardening parks or supporting local facilities' management. A shift towards public jobcreation schemes could therefore reduce the districts' own expenditures for these goods. Unfortunately, public job-creation schemes are very ineffective in increasing reemployment rates compared to other measures (for large-scale meta-studies, see Heckman et al., 1999; Kluve, 2010; Card et al., 2017). Wapler et al. (2018) explicitly show this program type to reduce the regional matching efficiency between job seekers and vacancies in the German context.

To assess whether decentralization caused a shift toward less effective ALMP measures, we employ our OAD data and the stockflow model from Eq. (1).⁶² This time, we use outflows from unemployment into the different ALMP programs at the district-level as the outcome variables. Table 6.8 presents the respective results. The first column indicates that decentralized job centers do not assign their clients more or less often to ALMP measures in general compared to centralized job centers. Thus, we can rule out changes in the overall use of ALMP measures accounting for the reductions in job finding. Columns 2, 3, and 4 indicate that the job center types do not differ with respect to their use of short-term training, medium-term training, and wage subsidies in a statistically significant way, although decentralized job centers tend to use these ALMP measures less intensively. Column 5 reveals that decentralized job centers sent about 30% more unemployed job seekers into job creation schemes. The lower effectiveness of this program type indicates that this policy change contributes to the observed loss in aggregate job finding. In fact, decentralization increased the average inflow rate into job creation schemes by a similar magnitude as it decreased the average aggregate job-finding rate.⁶³

One could suppose that the 'additionally' assigned participants in job creation schemes found new jobs while enrolled in the program, driving down the observed job finding flows in our OAD data and inducing a bias in our corresponding decentralization effect from Section 7.4. We argue that this is rather unlikely. First, there is large empirical evidence that job creation

⁶¹ District authorities mainly pay for accommodation costs of job seekers, see Section 7.2.

⁶² Individual-level data is not applicable for this purpose as neither SIAB nor PASS provide sufficient information on ALMP participants in decentralized job centers.

⁶³ In the post-reform period, the average aggregate monthly job-finding rate of decentralized districts was 3.1% and the average monthly inflow rate into job creation schemes was 1.2%. With treatment effects of -10% and +30% respectively, the jobfinding rate changed by $3.1\% \cdot -0.1 = -0.31$ percentage points and the job-creation inflow rate increased by $1.2\% \cdot 0.3 = 0.36$ percentage points.

schemes are a rather ineffective ALMP measure. Second, this general result seems to hold also for Germany, as a simple descriptive analysis using our SIAB data in Appendix B.2 suggests. Third, our results in Section 7.4.4 indicate that our main results are robust to including ALMP participants in the unemployment stocks and flows.

We now investigate the underlying dynamic changes in ALMP assignments. We employ Eq. (3) to estimate the year-specific impacts of decentralization on the inflows into the different ALMP programs. Figure 7.4 presents the results for our four most important program types. For short-term training, medium-term training, and wage subsidies, we do not observe systematic or permanent changes that are statistically significant at the 95%-confidence level. Inflows into medium-term training appear to be slightly reduced in year five. For job-creation schemes, in contrast, inflows increase directly after decentralization and remain at a permanently higher level.

Possibly, some local authorities used the decentralization of their job centers to shift fiscal costs from their own to the federal budget. The incentive to do so is inherent to a system where the national government covers the costs of program participation and subsequent unemployment while not being able to influence the local job centers' ALMP strategy. However, decentralization may not only shift financial but also political incentives. As additional job creation schemes lower the official unemployment figures (see Section 7.3.1 for a discussion of this problem) and allow for a better provision of public services, they may also serve as a tool for incumbent local politicians ahead of local elections. The exploratory analysis in Appendix C.4 shows that decentralized providers rely on job creation schemes more heavily ahead of communal elections but not ahead of elections at the state level, suggesting an electoral component of decentralization.

7.5.4. Monitoring and sanction strategies

Changes in the sanction strategy of local job centers constitute another potential channel that might explain lower job finding after decentralization. Sanctions are temporary reductions in unemployment benefits when job seekers do not comply with their job seeker obligations, such as search and meeting duties. Decentralized job centers may have a lower tendency to impose sanctions due to the financing structure of welfare support in Germany. The phase-out of welfare benefits is such that federally financed benefit payments will be reduced first. Sanctions large enough to reduce welfare payments beyond the welfare benefit then will also reduce the accommodation costs financed by local governments. In financial terms, spending reductions from sanctions therefore primarily benefit the central government whereas local governments' spending would only be reduced

if job seekers severely or repeatedly fail to comply with their job centers. Hence, decentralized job centers face weaker financial incentives to impose sanctions. However, ample empirical evidence confirms that stricter sanction regimes and even the credible threat of being sanctioned increase the job-finding rate (see van den Berg et al., 2004; Abbring et al., 2005; Lalive et al., 2005; Boone et al., 2009; Arni et al., 2013; van den Berg et al., 2014). Hence, we expect fewer sanctions to reduce job finding which would provide an additional explanation for our main finding.

To explore changes in monitoring and sanctions strategies, we apply the baseline model from Eq. (2) to the sanction outcomes that we obtain from the PASS data. Table 7.9 presents our estimates for the total number of sanctions received per year as well as their average duration. There is no indication for a negative decentralization effect: According to columns 1 and 2, decentralization did not alter the number of sanctions imposed. As the number of sanctions may hide differences in the duration of the benefit cuts, we next explore changes in sanction lengths. However, columns 3 and 4 suggest that decentralization also did not shift average sanction durations.⁶⁴ Hence, the potential conclusion that decentralized job centers imposed fewer or shorter sanctions is not supported by our analysis. In Table S.14 of Appendix S.7, we repeat the analysis for our job finding outcomes using PASS. This is to show that PASS is generally able to capture relevant effects of decentralization despite the smaller sample size, e.g. for duration in unemployment.

Table 7.8. Difference-in-differences: Effect of decentralization on monthly district-level log flows into active labor market policies (ALMPs).

Difference-in-differences: Effect of decentralization on monthly district-level log flows into active labor market policies (ALMPs).					
Variable	(1)	(2)	(3)	(4)	(5)
	All ALMPs	Short-term trainings	Medium-term trainings	Wage subsidies	Job creation schemes
Decentralized	0.033 (0.064)	-0.068 (0.095)	-0.057 (0.071)	-0.046 (0.074)	0.302*** (0.081)
Outcome mean	5.911	5.410	3.179	2.863	3.179
R-squared	0.939	0.860	0.806	0.839	0.822
Districts	319	319	319	319	319
Observations	37,323	37,318	35,669	36,773	35,925

Notes.— * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$. Each column presents an estimation of Eq. (1). The dependent variables are inflows of unemployed into the respective ALMP categories. Decentralized is a dummy equaling 1 for districts with decentralized job centers and 0 otherwise. Regressions include the stocks and inflows of unemployed and vacancies as well as a full set of dummies for job centers and months. All continuous variables in logs. Sample sizes vary due to missing observations. Standard errors given in parenthesis are clustered at the job center and the month level.

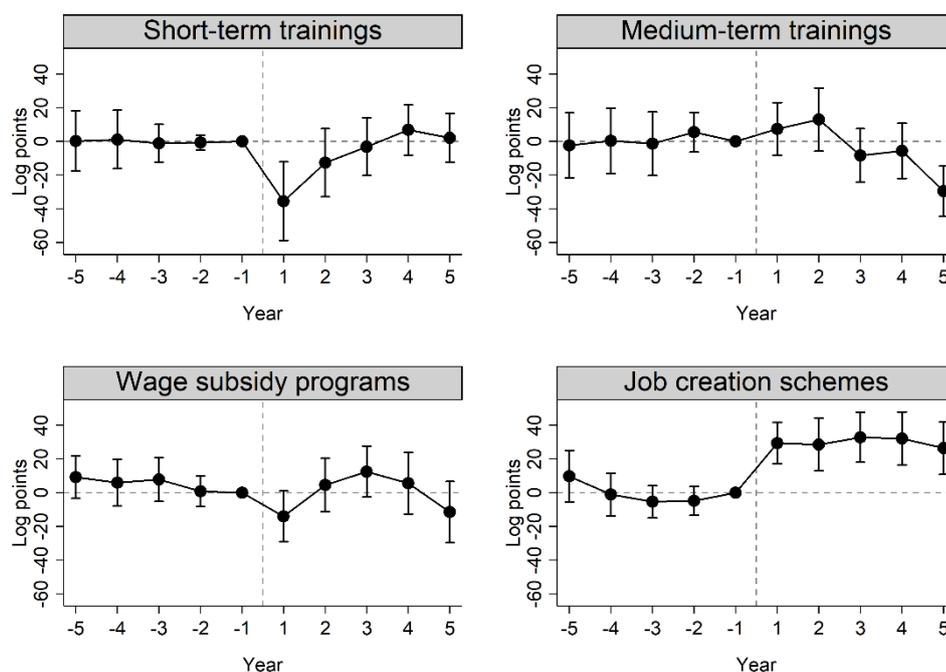
Source.— OAD data. Sample period 2007–2016.

⁶⁴ Table S.14 of Appendix S.7 (see first footnote to this chapter) repeat the analysis for our job finding outcomes using PASS. This is to show that PASS is generally able to capture relevant effects of decentralization despite the smaller sample size, e.g. for duration in unemployment.

7.5.5. Caseworkers and job counseling

Current literature is increasingly emphasizing the importance of caseworkers in the job matching process (see, for instance, Behncke et al., 2010; Hainmueller et al., 2016). Job placements will suffer from decentralization if decentralized job centers reduce the number of caseworkers or replace experienced ones with less qualified employees. In our example, however, this is not the case. Due to the law regulating the decentralization reform, about 95% of the administrative and caseworker staff in the decentralized job centers continued to work for the communal job centers after their reform. The law (§6c SGBII) also prescribed that employees and civil servants should retain their prior wages and hierarchy levels. A report for the German parliament confirmed that districts complied with the provisions of the law. Consequently, changes in the job-center personnel cannot explain permanently reduced job finding. We back up and extend this argument with an analysis based on the PASS data. In particular, we examine whether decentralization changed the number of personal contacts as well as the number of detailed consultations between job seekers and caseworkers. We then estimate the effect of decentralization on these variables using Eq. (2). Table 7.9 presents the results. Columns 1 and 2 show that the number of annual personal contacts was unaffected by decentralization. Columns 3 and 4 point out that the same holds true for detailed consultation sessions between job seekers and caseworkers. These results strongly support the insight from the parliamentary report which concluded that decentralization did not coincide with changes in the availability of caseworkers.

Figure 7.4. Dynamic treatment effects of decentralization on monthly entries into ALMP measures.



Notes.— The figure depicts coefficients and their 95%-confidence intervals of yearly leads and lags of the decentralization indicator from a stock-flow regression of the monthly inflow into different ALMP measures as given by Eq. (3). The year 2011 is the baseline category. The regressions include a full set of dummies for job centers and months. Standard errors are clustered at the job center and the month level. Outcome means are 5.410, 3.179, 2.863, and 3.179 respectively.

Source.— OAD data. Sample period 2007–2016.

Table 7.9. Difference-in-differences: Average effect of decentralization on sanctions issued and sanction durations.

Variable	(1)	(2)	(3)	(4)
	Sanctions p.a.	Sanctions p.a.	Log sanction duration	Log sanction duration
Decentralized	0.006 (0.014)	0.007 (0.014)	0.038 (0.148)	0.012 (0.143)
Controls	No	Yes	No	Yes
Outcome mean	0.077	0.077	4.519	4.519
R-squared	0.036	0.044	0.233	0.258
Observations	16,143	16,143	844	844

Notes.— * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$. Each column presents a different estimation of Eq. (2). Decentralized is a dummy equaling 1 for districts with decentralized job centers and 0 otherwise. Regressions include the age, age squared, dummies for gender and foreign nationality as well as a full set of dummies for school degrees, professional degrees, job centers and months. Standard errors given in parentheses are clustered at the job center and the survey month level.

Source.— PASS-ADIAB 7515. Sample period: 2007–2016 (Survey waves 1–10).

7.5.6. Further considerations

Finally, differences in the controlling systems possibly contribute to lower job finding through decentralized job centers. As described in Section 7.2, centralized job centers are under the technical supervision of the FEA while decentralized job centers are not. The FEA imposes a very rigorous target control system on centralized job centers that include target agreements, performance dialogs, ranking comparisons, and strict monitoring by a federal institution (Vorstand der Bundesagentur für Arbeit, 2014). Decentralized job centers have to report to state ministries but otherwise remain independent. They are members of a voluntary benchmarking program organized by the Federation of German Cities and Communes. Interview partners from ministries and job centers suggest that the FEA controlling system has tighter requirements with a stronger emphasis on quantitative outflow measures. Hence, it may partially explain why centralized job centers generate more job placements.

7.6. Sensitivity analyses

The results presented thus far suggest that decentralization decreased job finding while increasing the inflows into job creation schemes. We now assess the validity of these inferences in detail. There are three major concerns. First, the common trends assumption might be invalid due to the state-quota system inducing a selection problem or due to unobserved labor market shocks. Second, the SUTVA might be violated if labor markets extend beyond district borders and spatial spillovers between treated and nontreated districts arise. Third, our findings might rely on overly restrictive functional form assumptions and other model specifications. In the following paragraphs, we provide a battery of analyses to address each of these concerns. We will focus on our main outcome, the outflow of unemployed into jobs, and provide results for the other main outcomes in Appendix S.5 (Tables S.5 and S.6).

7.6.1. Selection and unobserved shocks

Table 7.11 summarizes the results of several checks regarding selection and the common trend assumption. The first column analyzes the districts' decision to apply for decentralization. Districts might have based this decision on some time-varying characteristics that are unobserved in our data. If applicants and non-applicants differ significantly from each other with respect to such characteristics, our decentralization estimates are biased. We control for this bias using two alternative specifications. First, we restrict our control group to the non-successful applicants and re-estimate Eq. (1). If this restriction drives our decentralization estimate down to zero, our main specification has estimated an application rather than a decentralization effect. However, column 1 of Table 7.10 demonstrates that our estimated decentralization effect on job finding is still -9% using the restricted control group. As this result is very similar to our

main result from Table 7.3, we take this analysis as initial evidence that applicants and non-applicants do not differ systematically from each other.

Table 7.10. Difference-in-differences: Average effect of decentralization on job seekers' contacts with job centers.

Variable	(1)	(2)	(3)	(4)
	Personal contacts	Personal contacts	Detailed consultations	Detailed consultations
Decentralized	-0.230 (0.666)	-0.197 (0.615)	0.185 (0.481)	0.137 (0.426)
Controls	No	Yes	No	Yes
Outcome mean	9.457	9.457	5.356	5.356
R-squared	0.128	0.180	0.082	0.107
Observations	13,201	13,201	8,050	8,050

Notes.— * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$. Each column presents a different estimation of Eq. (2). Decentralized is a dummy equaling 1 for districts with decentralized job centers and 0 otherwise. Regressions include the age, age squared, dummies for gender and foreign nationality as well as a full set of dummies for school degrees, professional degrees, job centers and months. Standard errors given in parentheses are clustered at the job center and the survey month level.

Source.— PASS-ADIAB 7515. Sample period: 2007–2016 (Survey waves 1–10). Wave 7 omitted as it does not include caseworker contact items. Detailed consultation item only available for subset of survey participants.

Table 7.11. Effect of decentralization on log monthly flows into jobs for different control and treatment groups.

Effect of decentralization on log monthly flows into jobs for different control and treatment groups.					
Variable	(1)	(2)	(3)	(4)	(5)
	Denied applicants as only controls	Denied applicants as treated	Over-subscription subsample	Conditional DiD	Triple differences
Decentralized	-0.087*** (0.025)	-0.006 (0.017)	-0.095*** (0.021)	-0.095*** (0.020)	-0.071*** (0.019)
Outc. mean	4.666	4.647	4.594	4.673	5.534
R-squared	0.943	0.960	0.952	0.952	0.975
Districts	75	294	309	330	334
Observations	8722	34,395	36,093	38,550	78,096

Notes.— * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$. Each column presents a different estimation of Eq. (1). The outcome variable is the monthly log outflow out of unemployment into jobs. Decentralized is a dummy equaling 1 for districts with decentralized job centers and 0 otherwise. Regressions include the stocks and inflows of unemployed and vacancies as well as a full set of dummies for job centers and months. All continuous variables in logs. Standard errors given in parentheses are clustered at the job center and the month level. Standard errors for column 4 were obtained by 200 bootstrap replications of the combined balancing and estimation procedure.

Source.— OAD data. Sample period 2007–2016.

Table 7.12. Assessing SUTVA and spatial effects: Effect of decentralization on monthly log flows into jobs for different model specifications.

Assessing SUTVA and spatial effects: Effect of decentralization on monthly log flows into jobs for different model specifications.

Variable	(1)	(2)	(3)
	Controls without non-treated neighbors	Spatial lag in X	X measured at commuting zone level
Decentralized	-0.093*** (0.022)	-0.100*** (0.021)	-0.133*** (0.023)
Outcome mean	4,675	4,673	4,673
R-squared	0.954	0.958	0.956
Districts	222	334	334
Observations	25,915	39,018	39,018

Notes.— * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$. Each column presents a different estimation of Eq. (1). The outcome variable is the monthly log outflow out of unemployment into jobs. Decentralized is a dummy equaling 1 for districts with decentralized job centers and 0 otherwise. Regressions include the stocks and inflows of unemployed and vacancies as well as a full set of dummies for job centers and months. All continuous variables in logs. Standard errors given in parentheses are clustered at the job center and the month level. Source.— OAD data. Sample period 2007–2016.

As an alternative control for self-selection at the district level, we define the unsuccessful applicants as a placebo treatment group and compare their outcomes to the districts that did not apply for decentralization, i.e. we estimate the effect of being interested but not actually being decentralized. If this estimate is statistically significant, applicants likely differ from non-applicants. As column 2 of Table 7.11 presents, the applicant status has no such effect on job finding. Thus, we conclude that applicants and non-applicants do not differ with respect to relevant unobserved, time-varying characteristics.

Successful and non-successful applicants will differ from each other if state governments in the state-quota process successfully chose those applicants for decentralization that were most likely to reap the greatest benefit from decentralization. Our estimated negative main decentralization effect would then be biased upwards and the true effect was even more negative. We assess this kind of selection by restricting our sample to states where the number of applicants exceeded the state quota (‘oversubscription’) and government had an actual choice among applicants. Selection would be an issue if estimating Eq. (1) results in less drastic reductions using the ‘oversubscription’ subsample than when using the baseline sample. Column 3 of Table 7.11 shows that the decentralization effect for the ‘oversubscription’ subsample is similar to our baseline estimate. Hence, selection into decentralization at the State-level is also unlikely.

We now ask whether job centers of the treatment and the control group have experienced different labor market trends for reasons unrelated to the formal selection process. If observable characteristics influence the

unobserved trends, reweighing our observations with regard to these characteristics should reinforce the validity of common trends assumption and should affect our baseline decentralization estimates significantly. Therefore, we employ a variant of the conditional difference-in-differences estimator (see Heckman et al., 1998, 1997 and Appendix S.2 for details). As column 4 of Table 7.11 indicates, our estimates of the decentralization effect on job finding hardly change due to the balancing. This implies that labor market trends of decentralized and centralized job centers did not depend on observable characteristics.

Finally, districts from the treatment and the control group could have experienced systematically different unobserved labor market shocks that affect our estimates. The widespread geographical distribution of treated districts makes such an event unlikely. Still, we explicitly assess this issue using another particularity of the German unemployment system. We exploit that in each district two different kinds of public employment services are at work: one for the short-term unemployed (local employment offices) and one for the long-term unemployed (job centers).⁶⁵ The local employment offices are all governed by the FEA and are therefore centrally organized throughout Germany. However, district-specific labor market shocks and trends should affect the unemployed registered at local employment offices and job seekers registered at job centers alike. We use the unemployed registered at the local employment offices in the same district as an additional comparison group to control for timevarying district-specific shocks in a triple differences estimation (see, for instance, Gruber, 1994). As shown by column 5 in Table 6.11, the decentralization effect on unemployment outflows from job centers is again estimated to be about -10 %. This result affirms that our preferred specification is not biased by unobserved district-specific shocks, and that the common trend assumption is likely to hold. Table S.2 in Appendix S.1 provides an alternative safeguard against regional correlated shocks by adding year by region fixed effects to the baseline model. As regions, we use either the 16 German states, or commuting zones as defined by Kropp and Schwengler (2016), as well as the 170 unemployment insurance regions (*Arbeitsagenturbezirke*)¹⁸. Our finding is also robust to these modifications.

7.6.2. Spatial spillovers

We now address the second major concern to validity, potential spillovers among districts. In particular, we worry about indirect treatment effects on non-decentralized job centers and labor market regions extending beyond district borders. Table 7.12 summarizes the results for this analysis.

⁶⁵ This is because unemployed receive unemployment insurance benefits during the first twelve months in unemployment, financed by contributions of employers and employees.

Indirect treatment effects arise if job finding in decentralized job centers declines and if centralized job centers in neighboring districts advise their clients on the ‘additional’ unmatched vacancies. This would increase job finding in centralized districts bordering a treated region. Such spillovers would dilute the control group, violate the SUTVA, and exaggerate our estimate of the true reduction in job finding. To examine this problem, we drop all units from the control group that border districts with decentralized job centers. If any spillover effects dilute our baseline specification, this change to the control group should reduce the size of the estimated treatment effects. However, column 1 of Table 7.12 confirms our baseline estimate. Combining these results with our analysis on geographical lock-in in Section 7.5.2, we conclude that decentralization did not generate spillover effects on non-decentralized districts.

In spite of this finding, there might be more complex spatial patterns with spillovers reaching beyond direct neighbors. For instance, job search competition is larger if unemployment is high and vacancies are scarce in nearby districts. To capture such effects, we estimate a standard spatial lag in X model (see LeSage and Pace, 2009). We add spatial lags for each explanatory variable in our baseline regression using row-normalized inverse distances between districts as respective spatial weights. As column 2 of Table 7.12 shows, the inclusion of spatially lagged covariates does not alter our results. To confirm this finding, we aggregate the stocks and inflows of unemployed and vacancies on the commuting-zone level based on the commuting zones definition by Kropp and Schwengler (2016). Column 3 presents our estimation of Eq. (1) employing the commuting-zone variables. The result reveals that our decentralization effect remains very similar to previous estimates, albeit with a slightly higher magnitude of about -12% . In summary, none of the three spatial approaches used suggests that geographic spillovers invalidate our main findings.

7.6.3. Model misspecification

Finally, we analyze whether our model imposes improper functional form assumptions and whether standard errors are calculated correctly. To relax the functional form assumption, we run a synthetic control approach following Abadie and Gardeazabal (2003) and Abadie et al. (2010). This method is purely data-driven and nonparametric. Nevertheless, its results, described in Appendix S.3, are highly similar to those derived from our stock-flow model in Eq. (1). We conclude that our model does not impose improper functional form assumptions.

Next, we examine whether our standard errors are correctly sized and do not overstate the significance of our findings. Serial 18 Unemployment insurance regions are an administrative unit of the FEA in between the state and district level, typically covering about three districts. correlation

in particular, which we deal with by two-way clustering standard errors at the district and month-level, is a frequent concern in difference-in-differences studies (Bertrand et al., 2004). Following Huber et al. (2013), we run an empirical Monte-Carlo simulation on our subsample of non-treated districts. In each replication, we randomly assign a placebo treatment status to 41 districts and then estimate the effect of the placebo treatment as in our main model. With 5000 replications, we find significant pseudo-decentralization effects at the 5% level in less than 5.9% of all cases. Furthermore, we inspect the distribution of the resulting t-statistics for the decentralization coefficient to confirm that it follows a normal distribution (Figure S.2 in Appendix S.4). Both checks yield adequate results and ensure that the size of our standard errors is correct.

7.7. Conclusion

Few studies have examined the impact of decentralizing public employment services, although numerous countries have implemented such reforms. In this paper, we provide the first comprehensive analysis of public employment services under decentralization and their effect on job finding and labor market policies. Exploiting a unique German policy experiment that transferred 41 federally managed job centers to the district level, we estimate that job-center decentralization reduced job finding by approximately 10% within five years. Efficiency losses are still sizable even five years after the reform's implementation. We uncover that decentralization leads to a significant increase of inflows into job creation schemes while leaving overall ALMP participation unchanged. In contrast, we do not find evidence for higher quality placements or geographical lock-in of job seekers, less strict sanction strategies, or fewer caseworker contacts.

The persistent drop in job finding combined with the increased use of job creation schemes indicates that local politicians possibly utilized decentralization to shift fiscal costs from their own to the national budget. Local administrations have tangible financial benefits from job creation scheme participants in the form of public goods, while the federal government primarily bears the costs of program participation and subsequent unemployment. As a consequence, extended benefit durations, additional job search assistance, and foregone tax revenues likely sum up to a substantial burden for public budgets.

Our findings are informative for policy makers considering to reform and decentralize public employment services. Canada, Denmark, Italy, and other countries have undergone significant decentralizations in the past but cannot evaluate the impact of their reforms because they lack a proper treatment-control-group design.

Other countries, including Germany, have been discussing whether to (further) decentralize their public employment services. Our findings imply that decentralized job centers may fail to internalize the effects of their strategies on total public budgets and individual reemployment rates. More generally, they strongly suggest the importance of carefully studying the incentive effects arising from decentralization, as ill-designed institutional structures may significantly reduce the job centers' matching efficiency.

Therefore, this analysis should serve as a starting point for further research distinguishing the impacts of decentralization under alternative financing rules and division of competences. Additional research is also necessary to study the internal structures and strategies adopted by centralized and decentralized job centers in more detail. Moreover, the interaction of localized provision modes with the political sphere is clearly under-explored. Finally, long-term effects extending beyond the temporal constraints of this paper will help to understand the consequences of decentralization more thoroughly. The decentralization of public employment services remains a crucial topic for future research.

7.8. References

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