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THE OPPORTUNITY TO LESSEN THE EQUITY AND
EFFICIENCY TRADE-OFF IN SOCIAL AND
EMPLOYMENT POLICY AND EDUCATION

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The opportunity to lessen the equity and efficiency trade-off in social and employment policy and education

Abstract

The article explores this efficiency and equity trade-off. While efficiency generally relates to how well an economy allocates scarce resources to meet the needs and wants of consumers, equity concerns the distribution of resources and is inevitably linked with concepts of fairness and social justice. The goal is to identify those circumstances under which equity and efficiency may not trade-off against each other. The topic of analysis is the possible reconciliation of the equity and efficiency in social and employment policy and education. Economic, political and socio-cultural inequalities fuel differences in life chances, perpetuating them across generations. It is necessary to expand people's capacities to lead fuller lives through investing in their education, health, employment and professional advance. To prosper, a society must create incentives for the vast majority of the population to invest and innovate. Each society must decide the relative weight it ascribes to each of the principles of equity and to the efficient expansion of total production and socio-economic development.

Key words: efficiency, equity, social policy, employment policy, education, Croatia

We know that equality of individuals' ability has never existed and never will, but we do insist that equality of opportunity must be sought.

Franklin Delano Roosevelt

1. Introduction

Throughout the developed world and in most transitional and post-transitional countries, in response to public budget constraints and the challenges of globalisation, demographic changes (particularly population ageing) and technological innovation, greater emphasis is being placed on improving efficiency in providing public services, particularly education, health protection and social welfare. This is, of course, highly desirable but it is frequently assumed that efficiency and equity objectives are mutually exclusive. However, there are cases where equity and efficiency may not trade off against each other.

Redistributive policies can reduce inequality and its persistence across generations by mitigating the impact of market imperfections. Two widespread policies are money transfers and educational transfers. Money transfers are mainly targeted at the poor and may be used by recipients to increase their consumption, leave additional bequests, or spend more on their children's education. Scientists and politicians worldwide disagree greatly about the effectiveness of welfare programmes and transfers, for it's often said that welfare, like other good intentions, contains the seeds of its own destruction. Furthermore, formally large outlays for welfare are no guarantee that they will be effectively targeted and used. Most economists take for granted the idea that equity and efficiency cannot be achieved together: greater equity must come at the inevitable cost of a loss of efficiency. Thus, equity and efficiency are seen as mutually conflicting goals: *the big trade off*.

The article explores this efficiency and equity trade-off. The goal is to identify those circumstances under which equity and efficiency may not trade-off against each other. The topic of analysis is the possible reconciliation of the equity and efficiency in social and employment policy and education. Markets often work imperfectly in many situations, whether because of intrinsic failures - such as those associated with asymmetric information - and/or because of policy-imposed distortions. With imperfect markets, inequalities in power and wealth translate into unequal opportunities, leading to wasted productive potential and to an inefficient allocation of resources. The idea is to discover policy situations that promote greater equity but have little effect on efficiency or - even better - policy situations where equity and efficiency complement each other and where government policies, mostly transfers from richer to poorer individuals, may perhaps even produce a more efficient society than would occur in the absence of those activities.

After Introductory notes, Section 2 gives the theoretical framework. Section 3 deals with equity and efficiency trade off in social welfare policy, Section 4 analyses efficiency and equity trade-off in employment policy. In Section 5, the author examines the possibilities of reducing equity and efficiency conflict in education. The paper finishes with conclusion and recommendation for improvement of social, employment and educational policies in the Republic of Croatia.

2. Theoretical framework

In the public finance theory, *efficiency and equity* have a number of possible definitions. Most definitions state that *efficiency* generally relates to how well an economy allocates scarce resources to meet the needs and wants of consumers. Efficiency means that all goods or services are allocated to someone (there's none left over). The criterion for economic efficiency is value. A change that increases value is an efficient change and any change that decreases value is an inefficient change. A situation that is economically efficient may be inefficient when judged on different criteria. The socially efficient level of output and or consumption occurs when social marginal benefit is equal to social marginal cost.

Equity concerns the distribution of resources and is inevitably linked with concepts of fairness and social justice. When the market equilibrium is efficient, there is no way to reallocate the good or service without hurting someone. Head (1993) distinguishes between horizontal equity in the sense of similar individuals being treated in a similar fashion, vertical equity in the sense of taxation in accordance with ability to pay and the "benefit principle" of equity - taxpayers should pay for public services in the same proportion that they use them. Osberg (1993) reminds that public policy must also consider intergenerational equity and the legal principles of procedural equity.

By equity in the social welfare, we follow Roemer (1998) and the World Bank approach (2005) that individuals should have equal opportunities to pursue a life of their choosing and be spared from extreme deprivation in outcomes. For Roemer, strict equality of opportunity is obtained when people, irrespectively of circumstances beyond their control, have the same ability to achieve advantage through their free choices. Roemer sorts people with similar circumstances into types and takes their free choices to be represented by their behaviour relative to other members of the

same type or, as he calls it, by their *relative effort*. Afterwards, he proposes that society should maximize the average advantage of all whose circumstances cause them to be least well-off relative to others who have expended the same degree of relative effort.

In some fundamental respects, equity is complementary to the pursuit of long-term prosperity. Institutions and policies that promote a level playing field - where all members of society have similar chances to become socially active, politically influential, and economically productive - contribute to sustainable growth and development. Greater equity is, thus, doubly good for poverty reduction: through potential beneficial effects on aggregate long-run development and through greater opportunities for poorer groups within any society.

Roemer (1998) believes that there are two views of equality of opportunity. The first, which he calls the non-discrimination principle, states that in the competition for positions in society, individuals should be judged only on attributes relevant for the performance of the duties of the position in question. Attributes such as race or sex should generally not be taken into account. The second states that society should do what it can to level the playing field among persons who compete for positions, especially during their formative years, so that all those who have the relevant potential attributes can be considered. Common to both positions is that at some point the principle of equal opportunity holds individuals accountable for the achievement of particular objectives, whether they are education, employment, health or income. Thus, there is consequently a "before" and an "after" in the notion of equality of opportunity: before the competition starts, opportunities must be equalized, by social intervention if need be; but after it begins, individuals are on their own. He acknowledged that individuals bear some responsibility for their own welfare, but also that circumstances over which they have no control affect both how much effort they invest and the level of welfare they eventually attain. Thus, public action should therefore aim to equalise *advantages* among people from group with different circumstances.

Equity can be defined in terms of two basic principles:

- Equal opportunity – the outcome of one's life in its many dimensions, should reflect mostly person's efforts and talents, not his or her background. In other words, predetermined circumstances at birth – gender, race, place of birth, family origins and the social group a person is born should not matter for a person's chances in life and his or her economic, social and political success.
- Avoidance of absolute deprivation – following Rawlsian theory of moderate redistribution on the basis of a social agreement and form of inequality aversion in the space of outcome (Rawls, 1971). The individuals who conclude that agreement incorporate in it an insurance against failure and stipulate special protection for those who do the worst in life just because of the risk of outcome of economic activity. Rawls implies that society may decide to intervene protecting the livelihoods of its neediest members, even if the equal opportunity principle has been respected. In that way, Rawls tried to preserve free market economy, but also to enable redistribution in favour of the poorest. He stresses that outcomes may be insufficient and/or undesired because of bad luck, or even of a person's own failing. Society may decide

that its members will not be allowed to starve, even if they enjoy their adequate part of equal opportunity, but things somehow turned back for them.

The complementarities between equity and prosperity arise for two broad sets of reasons (World Bank, 2005). First, there are many market failures, particularly in the labour market and building human capital. As a result, resources may not flow where returns are highest. For example, some highly capable children may drop-out of regular schooling, while others, who are less able, may finish university and obtain a PHD. When markets are missing or imperfect, the distributions of resources and power affect the allocation of investment and developing opportunities. The ideal response is correcting the market failures, but where this is not practical, or is far too costly, some forms of redistribution and/or guaranteed access to services, assets, or political influence - can increase economic efficiency.

The second set of reasons why equity and long-term prosperity can be complementary follows from the fact that high levels of economic and political inequality tend to lead to economic institutions and social arrangements that systematically favour the interests of social strata (groups) with more influence. Such inequitable institutions can generate economic costs. When budgetary allocations benefit mainly the politically influential and/or when the distribution of public services favours the wealthy, all other middle and poorer social layers end up with unused possibilities and talent. These adverse effects of unequal opportunities and political power on development are all the more damaging because economic, political, and social inequalities tend to reproduce themselves over time and across generations.

Such phenomena are called *inequality traps* because they cause social immobility that is particularly pronounced for low-income citizens. Education and employment are of intrinsic value and affect the capacity of individuals to engage in economic, social, and political life. Yet children face considerably different opportunities to learn and to lead healthy lives in almost all populations, depending on asset ownership, geographic location, or parental education, among others. These inequities are usually associated with differences in an individual's "agency" - the socio-economically, culturally, and politically determined ability to shape and influence the world around oneself. Such differences create biases in the institutions and rules in favour of more powerful and privileged groups because the poor usually have less voice, less income, weaker network, and finally, less access to services than most other people.

The persistence of inequality traps – with mutual reinforcing inequalities in the political, social, economic and cultural areas – has many consequences. The most important is that, because of market failure and the way in which institutions evolve; inequality traps can influence not only the distribution but also the aggregate dynamics of economic growth and socio-political development. This in turn means that, in the long run, equity and efficiency may be complements, not substitutes.

At least three considerations are important at the outset. First, while more even playing fields are likely to lead to lower observed inequalities in educational attainment, health status, and incomes, the policy aim is not equality in outcomes. Indeed, even with true equality of opportunities, one would always expect to observe some differences in outcomes owing to differences in preferences, talents, effort, and luck. This is consistent with the important role of income differences in providing

incentives to invest in education and physical capital, to achieve employability, find decent work, and to take risks. People are clearly aware that income differentials can provide incentives for work and investment, including in education, if they are coupled with opportunities for rewards to those actions. Outcomes matter, but one should be concerned with them mostly for their influence on absolute deprivation and their role in shaping opportunities.

Second, a concern with equality of opportunity implies that public action should focus on the distributions of assets, economic opportunities, and political voice, rather than directly on inequality in incomes. Policies can contribute to the move from an “inequality trap” to a virtuous circle of equity and growth by levelling the playing field - through greater investment in the human resources of the poorest; greater and more equal access to public services – largely education and health protection - and information. The distribution of opportunities and the growth process are jointly determined. Policies that affect one probably will affect the other.

Third, there may be various short-run, policy-level trade-offs between equity and efficiency. These are well recognized and extensively documented. The point is that the (often implicit) cost-benefit calculus that policymakers use to assess the merits of various policies too often ignores the long-term, hard-to-measure but real benefits of greater equity¹. Greater equity implies more efficient economic functioning, reduced conflict, greater trust, and better institutions, with dynamic benefits for investment and growth. To the extent that such benefits are ignored, policymakers may end up choosing too little equity. One should be aware that in large part some of the economic and behavioural responses to a policy change can take time. What is fixed in the short term may be variable in the longer term or vice versa. Understanding and explaining how short-run losses may result in long-run gains for given groups, or how immediate gains may lead to eventual losses, is one of the challenges inherent to social sciences.

One of the first questions is: “Why do inequalities of opportunity persist, if they are both unfair and inimical to the long-term prosperity”? A possible answer is that political systems do not always ascribe equal weight to everyone’s preferences. Economic and political inequalities are embedded in unequal social and cultural

¹ An example of that could be inadequacies in the Labour Code through high employment protection regulation can in the short-term help employed *insiders* (increasing their tenure), and reduce the employment possibilities for unemployed *outsiders*, but in the long-term it could cause a labour market resistant to changes, an inflexible labour force with a lack of employability and low level of economic efficiency and competitiveness. Increased efficiency may later result in economic growth, and some of the laid-off workers may find jobs in the expanding economic sectors. The combination of all these effects will determine the net impact on different groups over the long term. Inflexibility of the Croatian labour market was reflected in a high value of a composite index of the strictness of employment protection legislation (EPL) developed by OECD. EPL index is calculated as a weighted average of 22 indicators that quantify different procedures, costs, limitations and terms related to cancellation of the employment contract. Croatia was assessed by some researchers (Biondić et al., 2002) as among the strictest in Europe. When compared to other countries, Croatia had the second highest value of the index (3.6), which was significantly higher than the OECD average (2.0), EU countries (2.4) and the transition countries for which the data exists (2.2). All mentioned led to the Labour Code changes in 2003. Current reform had detached Croatia from group of countries with most protective EPL index – yet it is still positioned among most protected transitional labour markets (Matkovic and Biondic, 2003).

institutions. Policies and institutions do not arise from a benign social planner whose goal is to maximize the present value of social welfare. They are the result of a political economy process in which various groups try to protect their own interest. Some groups are more powerful than others and their interest prevail. Subordinate groups may face adverse *terms of recognition*, the framework within they negotiate their interaction with other social groups. Explicit discrimination can lead to denial of opportunities and to a rational choice to invest less at the margin.

3. The case for a trade-off in social welfare policy

Efficient and broader social protection systems can help prevent today's inequalities - sometimes generated by bad luck - from becoming entrenched and leading to tomorrow's inequities. Just as safety nets can spur households to engage in riskier activities that can yield higher returns, they can also help complement reforms that produce losers. Safety nets usually target three groups: the working poor, people viewed as unable to work and special vulnerable groups. If safety nets are designed in a manner appropriate to the local realities on the ground in each country, individual targeted interventions in these three categories can be combined to provide an effectively universal public insurance system.

The best-known discussion of the trade-offs between equity and efficiency is in the highly influential book Okun (1975) *Equity and Efficiency: The Big Trade-off*. There he introduced famous *leaky bucket* analogy - a dead-weight loss in redistributive transfers from rich to poor. Any pecuniary unit (dollar or euro) transferred from a richer individual to a poorer individual, will result in increase in income for the recipient that will be smaller than transferred amount of money. Okun believes there are four reasons for leaky buckets:

- administrative costs of redistribution,
- changes in work effort induced by redistribution,
- changes in savings and investment behaviour induced by redistribution, and
- changes in attitudes (for instance, motivation to acquire human capital) induced by redistribution.

The result is that government efforts to achieve equity inevitably result in a smaller level of total income and less efficient use of resources.

Blank (2002) asks whether if there are policies and circumstances in which equity-increasing transfers can occur without seriously reducing efficiency. If they exist, knowing what theory implies and what the data suggest is feasible, the public and policymakers will be better prepared to reform public service finance subject to political reality and to their own values. She believes that there are three policy areas where transfers seem to produce future gains. First, transfers that provide health assistance may be viewed as an investment if they reduce future health problems. Public campaigns to immunize children, for instance, appear to have substantial long-term benefits in terms of lower future health expenditures. Public expenditure programs focused on poor children's health appear to produce substantial future returns. Second, human capital outlays may have similar investment-type properties. Indeed, many transfer programs to subsidize child care or education are supported because they are considered investments in the future. Third example how transfer programs might induce long-term efficiency gains is in the area of attitudinal change. It is often argued that anti-discrimination programs in the workplace produce

substantial gains to minority populations. Some of this may occur through human capital avenues, if such programs open up new training and job opportunities. On the other hand, the equity / efficiency trade-off may be low: when transfers go to populations with no capacity to change their behaviour; when transfers go to programs that limit efficiency losses through behavioural requirements; and when commodities are subsidized that function as long-term investments and create future income gains.

Each group of vulnerable people requires similar, but mostly different means of aid. The working poor or unemployed people want unemployment insurance and social welfare benefits. People viewed as unable to work and/or special vulnerable groups need disability insurance and different types of other social transfers. For some groups cash / material benefit is not enough but they also need social services – like care and aid in user's home or residential accommodation for older and infirm people.

But, as public resources are limited, one has to keep in mind the efficiency and equity trade-off in expenditures for social welfare. How to direct the benefits and services to those with the highest level of needs? One of the major challenges of social care service delivery is how to effectively target scarce resources. Even in the most affluent societies the demand for social care outstrips the resources provided by Government. In order to ensure the equitable allocation of free of charge/ subsidised resources the following principles must be applied:

- Targeted towards those most in need;
- Financial contribution according to means;
- Transparent – it is clear to everyone how decisions are made, why some people receive free of charge services and some do not and what the service actually costs.

There is currently a concern that social care services in Croatia are not necessarily targeted to those most in need. If services are to be targeted effectively it is important that eligibility criteria are clearly defined. The proposed drafting of a new social welfare law offers an opportunity to review existing criteria for all types of service provision to determine whether (a) eligibility criteria need to be tightened or (b) further guidance and training on how to apply the criteria should be provided in order to improve the targeting of services towards those most in need. The criteria for obtaining some right should be published and available to the general public to increase awareness of the how the system operates improve transparency and provide clear grounds for appealing decisions made by state bodies.

It may be helpful to compare the Croatian social care services criteria with that of other systems. In the UK, for example, there is a national framework which identifies four levels of need:

1. Critical
2. Substantial
3. Moderate
4. Low

(Details and criteria for particular level are in Annex 1)

Owing to resource constraints, a significant number of Local Authorities in the UK state that they only provide services to those who meet the critical or substantial

need criteria. The proportion of councils in England who have set their threshold at "substantial" increased from 53% to 62% in 2006-07. The trend is expected to continue with 73% of all councils anticipating they will be operating at substantial or critical level in 2007-08.

The disadvantage of this approach is that the preventative role of service provision is virtually absent. If support can be provided when the level of need is low or moderate it may prevent the level of need becoming substantial or critical. The situation in the UK serves to illustrate that the targeting of services is about difficult choices. More expenditure at the preventative end of the spectrum means fewer resources are available for those in the most critical need. The choices are often stark but unavoidable.

Furthermore, significant savings and efficiency as well as equity could be realised through careful and better decision making on residential care. Residential care is the predominant form of care provided by the Croatian social welfare system. It should not be assumed, however, that there is overprovision throughout the residential sector. The picture is a more complex one and needs to be considered in relation to each of the main groups of service users. There appears to be an over reliance on residential care for children and people with mental health problems. For some groups, targeting of residential care is not necessarily orientated towards those who are most in need. Older people and people with intellectual disabilities could be supported in the community fall into this group. For them, it is necessary to provide out-of-institutions types of services like daily care and care and aid in user's home. These services are usually cheaper and enable stay in one's home, which is preferred by a majority of people.

Finally, for the social welfare system in Croatia it is necessary to develop a national performance framework which includes various dimensions like National Priorities and Strategic Objectives, Cost and Efficiency, Effectiveness of Service Delivery and Outcomes, Quality of Services for Users and Carers, and Fair Access (Annex 2 gives an example of a national performance framework in England).

4. The trade-off in employment policy

Employment plays a fundamental role in every society. For most of the world's people, economic opportunities are primarily determined, or at least mediated by the labour market – in formal and informal work. People are often defined, and define themselves, through what they do for a living. Scientific studies emphasise that not only is employment a primary source of status in every country, but it is also significant in providing purpose, income, social support, structure to life and a means of participating in society. The wages and employment conditions in the labour market, affect the quality of life of workers and their families, sometimes in ways ruthless or unfair.

The functioning of the labour market has a profound effect on equity – across workers, in patterns of access to work and between workers and employers as well as on efficiency and competitiveness of the whole economy. Unlike the markets for

many goods and services, labour markets are not fully competitive. They may be characterised by uneven market power (between employers and workers), by imperfect mobility of factors of production factors (particularly workers), by insufficient information, or by discrimination. These imperfections generate rents in the employment relationship, which both sides can try to capture. This can lead to unfair and inefficient outcomes when the bargaining position of worker is weak.

All governments, irrespective of income, intervene heavily in the labour market, mostly to protect workers and endow them with rights and *voice* in the employment relationship, to insure compliance with labour laws and regulations and to provide insurance against income shocks. The argument is that labour market interventions reduce inequality in labour incomes by (1) maintaining earnings at the lower end of the income distribution above the level at which they would have been in an unregulated market, and (2) reducing the vulnerability of earnings (Coudouel and Paci, 2006). Public intervention can improve market outcomes and lead to significant equity gains: more equal opportunities for workers, better working conditions and less discrimination. It can also produce gains in efficiency: by allowing full use of the labour of discriminated groups, by enhancing labour mobility and better managing income risks. (For examples of types of market failures in the labour market see Box 1).

Box 1 Examples of Types of Market Failures in the Market for Labour

The following are examples of the four prevailing types of failures of the market for labour.

Asymmetric information. In the labour market in many situations, information is available asymmetrically - one party to a transaction has more or better information than the other party. This is a particular problem in markets with less effective reputation effects, that is, markets characterised by small firms, mobile workers, and informal contractual arrangements.

Firms may find that it is expensive to discover the true characteristics of applicants, and job-seekers may find that it is difficult to discover the true characteristics of job offers.

Employees may be unable to obtain full information on job-security arrangements in their current jobs. They may make inefficient decisions about training and job-seeking.

Firms may conceal their difficult financial situations in order to prevent new job-seeking and departures by their most valuable workers.

Externalities - There are many examples of externalities in this area.

In deciding whether or not to close a branch, firms are unlikely to internalize the costs to local workers or to the government in the form of lost tax revenues and increased benefit payments.

In deciding whether or not to accept jobs, unemployed job-seekers are unlikely to take into account the costs of their refusal for firms or for the government.

If firms or workers are prepared to internalize these costs, free-riders who have failed to do so may nevertheless share in the resulting benefits. Private decision-making in the unregulated labour market is inefficient because it does not internalize these costs.

Monopoly power may result from a number of factors both in the labour market and the product market and affect both demand and supply.

The existence of technologies idiosyncratic to a particular firm means that skills obtained through on-the-job training cannot be transferred to other employers. This makes labour turnover costly. Virtually all employees and firms possess some degree of monopoly power. Labour mobility is restricted; the labour market is not competitive, and wages may not clear.

Trade unions or monopolistic behaviour - improving wages and work conditions for their members at the expense of consumers and non-union members - may lead to similar distortions in the wage and employment equilibrium. Particularly, when unions are co-opted by political elites or by state, their actions can have significant costs for efficiency.

Absence of markets for goods and services may distort the operation of both the demand side and the supply side of the labour market.

The investment decisions of individuals may be distorted by the inability of workers to realise the value of their human capital in the same way they sell their financial assets. Consequently, there will be underinvestment in education and training.

The inability to obtain full insurance against redundancy because of the risk of moral hazard may distort interfirm mobility.

Source: Coudouel and Paci, 2006, World Bank, 2005.

But, on the other side, inappropriate government interventions in achieve greater equity could cause costs and losses in terms of efficiency: excessive protection of formal sector insiders can cause *rationing* jobs in the formal sector and making competition in the labour market almost impossible. The rigidity of the labour market can be seen in the long, complex and expensive system involved in dismissals (including the cancellation of the employment contract, the legally set notice period and amount of severance pay). This makes turnover in the labour force much more expensive, and the high level of protection for employment reduces the flows in the labour market, and lengthens the average duration of employment. The reason for this is that the complex and expensive laying-off process means that the employer will not take on workers if he does not really believe that their work will be long-lasting and productive enough to cover the high costs incurred. The result of the complex and expensive manner of firing workers, and the formality of registering newly-hired workers, is that employers, particularly those in the category of small employers, will often not take on a replacement for a dismissed worker but rather make use of black market workers. For the outsiders, on the other hand, include workers in the informal, uncovered sectors, the unemployed, and workers with fixed-term contracts, a strict labour legislation has a negative impact in a low hiring rate and, hence, limited chance to enter employment. These groups are unlikely to have sufficient political power to bring about the required reforms, and poorer, marginalized workers (youth, women, the unemployed, the discouraged) will tend to become more marginalized.

On the labour market, there is clearly a strong association between efficiency and equity that can primarily be seen and influenced by long term unemployment and vulnerability to social exclusion. The problem of long term unemployment is significant and in many countries (including Switzerland on one side and Croatia on

another) there is a high share of the long-term unemployed - those who have been waiting for more than one two year for a job – in total unemployed. Very often, inadequate attention and/or insufficient resources are devoted to these groups. Thus, there are difficult issues to address and present a considerable challenge to policy makers everywhere. They are long standing and concern both deficiencies of education and skill and behavioural and attitudinal barriers to getting and keeping jobs.

The range of policies for mitigating long-term unemployment should be the focus of social and political discussion, but it is clear that the existing range of policies needs adjusting to focus more intensively on the addressing long-term unemployment. Policies combining job search assistance efforts with job development, working activation (including *Workfare* – obligation of recipients of social welfare cash benefits and unemployment benefit to participate in working activities for common benefit), training, and wage subsidies appear to have been somewhat successful in improving the employment and earnings of specific targeted disadvantaged groups. (For explanation about employment activation policies and introduction of workfare in Croatia see Annex 3).

In Croatia, as well as in many countries around the globe, there is a need to attempt to find the optimum ratio between the desired labour market flexibility and the required social protection. Flexibility need not be thought up in such a way as to undermine the standards of labour law, but as an expansion of the far-reaching consequences of the regulatory matter of labour and social law and improving employability. An important factor for high employability is the improvement in education system through enhancing accessibility and increase the quality of outcomes.

5. The trade-off in education

At least in theory, education is a means by which democracies attempt to equalize opportunities among citizens for economic success. Education and training policies could have a significant positive impact on economic and social outcomes, including sustainable development and social cohesion. It is commonly thought that opportunity equalization, in that dimension, is implemented by the provision of equal access to public resources to all citizens.

However, this is often not so and existing public services - like the education system - reproduce or even compound existing inequities. For example, Betts and Roemer (1999) examine the relative effectiveness of changing educational expenditures along the social marginalised groups. Their central point is that for USA *mere equalization achieves little*. Disadvantaged children from families at the bottom of the wealth distribution usually do not have the same opportunities as children from wealthier families to receive quality education and higher level of attainment. Because of their low education, these disadvantaged children can expect to find badly paid job and earn less as adults. As badly educated they will have less voice and power in the political process and will not be able to influence spending decisions to improve public schools for their children. Thus, with respect to equity, the gap in quality between rich and poor districts may widen over time (Fiske, 1996).

The mentioned conclusion is confirmed by the survey carried out by Galor and Zeira (1993) in a model of overlapping generations characterized by intergenerational altruism. Even if all individuals are of equal ability and identical preferences, the bequest of the parent determines whether the child will be a skilled or an unskilled worker, which determines in turn the size of the child's bequest to the grandchild. They suppose that there is an indivisible minimum size to human capital investment. As a result, the initial distribution of wealth determines the aggregate amount of human capital investment and the long-run growth rate. In conclusion they state "*Countries with a more equal initial distribution of wealth grow more rapidly and have a higher income level in the long run...*" and adjust better to new technology.

A disadvantage in a given dimension of opportunity is generally reinforced by disadvantages in others, combined in a way that perpetuates the stark inequalities and the cycle of underachievement. The important instrumental function of education implies that inequality in education often translates into inequality in other dimensions of welfare, but also, a person's achievements in education are influenced by inequalities in other spheres. Health outcomes for children vary with their parents' level of education. Infant mortality rates are sharply differentiated across population groups defined by various educational attainments. On the other side, economic well-being can contribute to improved educational outcomes, but in turn good education is typically an important determinant of economic status.

The mentioned situation is made worse by the social network that influences decision on investing in education. Calvò-Armengol and Jackson (2005) developed a model in which an individual sees higher returns to investments in human capital when their neighbours in a social network have higher levels of human capital. They show that the correlation of human capital across generations of a given family is directly related to the sensitivity of individual investment decisions to the state of the social network. Increasing the sensitivity leads to increased intergenerational correlation, as well as more costly investment decisions on average in the society. As the badly educated mostly socialise with similar badly educated peers, there is only limited possibility that they will profit in their behaviour from their better educated neighbours. Calvò-Armengol and Jackson conclude that the dependence on a social channel leads to inefficient human capital investment decisions.

The traditional concern with limited public resources for education, and commonly accepted objectives of expanding access and improving quality, policymakers face a particular unpleasant dilemma. They must choose between expanding the availability of education and providing high quality educational institutions. Analysis of the costs and benefits of educational system reform clearly shows investments that improve the quality of institutions offer exceptional rewards to society.

If the opportunities faced by children from poor families are so much more limited than those faced by children from rich strata, and if this hurts development progress in the aggregate, then public action has a legitimate role in seeking to broaden the opportunities of those who face the most adverse choices. But how to ensure that mentioned action will respect principles of efficiency and equity? The realisation of efficiency and equity trade-off in education could be obtained through improving accessibility and enhancing quality. For medium developed countries like Croatia, with high participation in primary and secondary education, particular attention

should be focused to increase participation in tertiary education and enhance its efficiency.

Excluding a number of professional and management reforms (such as curriculum reform or teacher training) that do not have an explicitly documented impact on distribution, efficiency and equity, Tiongson (2005) stresses that there are several broad changes to education policy that are directly related to equity and efficiency of educational system. They are:

- *Expenditure reform* - A government may choose to restructure its expenditures to reallocate spending from higher education to lower level of education or vice versa.
- *Financing reform* - A government may choose to reform the financing of education by introducing user fees (cost recovery).
- *Management and institutional reforms* - A country in which there is centralized management over the education system may choose to implement management reforms by decentralizing the administration of education.

Although a possible decentralisation of the education system is an important form of management and institutional reforms, we would like to direct attention to the question of introducing student fees as a type of financing reform. A common assumption has been that a *free* system of higher education (one funded entirely by the state) is, of itself, equitable because it can guaranty accessibility. In fact, this assumption has not been borne out by reality, since the main determining factor in participation is socio-economic background.

The bulk of evidence shows that there are usually significant private returns to those who participate in higher education (the average private rate of return from higher education is close to 9% across ten OECD countries - Commission of the European Communities Brussels, 2006), and that these are not entirely offset by progressive tax systems. This can have a reverse redistribution effect. This regressive effect is particularly acute where school systems exacerbate the effects of socio-economic background on educational attainment.

In order to bring about a more equitable balance between the costs funded by individuals and society and the benefits accrued by each, and to contribute to providing universities with the extra funding they need, many countries are turning to the main direct beneficiaries of higher education, the students, to invest in their own futures by paying tuition fees. Evidence also suggests that the market effects of tuition fees may improve the quality of teaching and management in universities, and reinforce student motivation. Most economists maintained that tuition fees – assuming some means tested grants and/or sufficient available students loans – are actually more equitable than free higher education in that students are everywhere disproportionately from the middle and upper classes and the taxing systems in most countries tend to be proportional or even regressive (Teixeira, Johnstone, Rosa, Vossensteyn, 2008).

Clearly, the development of tuition fees without accompanying financial support for poorer students risks aggravating inequity in access to higher education. The most disadvantaged are frequently the most risk- and debt-averse, and are more likely to balk at spending time studying, rather than earning, when private returns after

graduation are not assured. Costs of higher education could be made more bearable through the availability of various types of student financial support, be it in the form of grants, scholarship, loans or deferred payment of tuitions fees. Other financial incentives could be premiums grants to excellent students and/or those who choose science and engineering programmes.

The traditional concern with limited public resources for education, and commonly accepted objectives of expanding access and improving quality, policymakers face a particular unpleasant dilemma. They must choose between expanding the availability of education and providing high quality educational institutions. Analysis of the costs and benefits of educational system reform clearly shows investments that improve the quality of institutions offer exceptional rewards to society. However, higher public spending does not always translate into better student learning. Some progress can be made by countering the stranglehold of the interest group on the equality-enhancing reform, like improving accountability from clients directly to frontline providers. The crucial steps are to enhance the school's accountability for performance and to insure the availability of relevant information to monitor their work. The underlying reason is that it might be more salient to note that more could be achieved through re-targeting programme money and a clearer knowledge of the cost of such programmes.

Furthermore, inequities in education and training also have huge hidden costs which are rarely shown in public accounting systems. Policies which reduce such costs can deliver both equity and efficiency benefits. Thus, to achieve equity, one should take into account all the costs as well as the benefits of successful data collection, analysis and prudent cost-management. According to McKeown-Moak study (2000), this approach is self-evident precondition both with regard to enhancing efficiency and cost effectiveness and in making a case for more equitable resources usage.

Access to schooling matters - especially for very poor families – but very often, it is only a small part of the problem. Greater access needs to be complemented by supply-side policies (to raise quality) and demand-side policies (to correct for the possibility that parents may under-invest in the education of their children for various reasons). Some of the possible reasons are resources constrained households that lack money to keep their children healthy and in school and/or because of discrimination creates insignificant returns to schooling for some groups. Thus, providing financial possibilities and incentives for education is necessary, but not sufficient because it is important to eliminate the discrimination, conscious or not, that can affect investment in human capital.

Human capital decisions are more a product of culture and traditions than of a cold calculation of benefits. Benefits are relevant, but the responsiveness to them may not be as large as one might have expected because negative stereotypes cause loss of self-confidence, create anxiety and affect early decision about prospective careers and attitudes towards society. If enforcing anti-discrimination laws today reduces the taste for discrimination throughout society in the future, then there could be beneficial income and productivity gains in the minority population that more than outweigh the costs of the program.

Conclusion and recommendation

To economists, efficiency is a relationship between ends and means. When a situation is called inefficient, we believe that we could achieve the desired ends with less means, or that the means employed could produce more of the ends desired. *Less* and *more* in this context necessarily refer to less and more value. Thus, economic efficiency is measured not by the relationship between the physical quantities of ends and means, but by the relationship between the value of the ends and the value of the means.

Unfortunately, in many countries – particularly developing and/or post-transitional - in providing services state magnifies rather than attenuates inequalities at birth. Economic, political and socio-cultural inequalities fuel differences in life chances, perpetuating them across generations. For a long-run and sustainable economic and social development, situation should be drastically changed. A guiding principle is to shape public action so that the acquisition of human capacities is not driven by circumstances of their birth, although it can reflect people's preferences, tastes, and talents. It is necessary to expand people's capacities to lead fuller lives through investing in their education, health, employment and professional advance. Predetermined circumstances should not constrain anyone's innovation or professional development opportunities. This implies that a good institutional environment will not block entry into new business activities and the political system will provide access to public services and goods for all.

The policy question becomes how much leakage a society is willing to accept in order to achieve a certain level of equity. While mentioned Okun's leaky bucket is a reality for many transfers programs, with adequate organization, targeting and evaluation the level of leakage can vary substantially across programs and be significantly reduced. Average estimates of the inefficiencies induced by redistributive social policies do not adequately characterize the diversity of efficiency costs across individual policies. In a number of real-world policy situations, equity and efficiency are not inevitably in conflict with each other.

There may be significant income losses in the first period generated by behavioural changes among the poor (increased subsidies for children's schooling or health may reduce parental labour supply or savings); in addition it is not enough that a program simply have positive benefits in order to argue that efficiency is enhanced. Its benefits must outweigh all of the costs associated with its required level of transfers. Probably, fewer programs actually enhance efficiency than many advocates would like to claim. The investment argument is used broadly for a wide range of child and school-related transfers; only long-term and serious program evaluation studies can prove which policies actually do function as investments.

In the labour market, the challenge for governments is to shift more jobs towards better working conditions and higher wages, and to do so not at the expense of efficiency. Labour measures should be targeted towards those more distant from the labour market, they should offer flexible and localised programmes, and must develop long-term "personalized progression routes" back to employment. Other initiatives to reduce long-term unemployment should also include special programmes to retrain workers, and to update older employees with a skill set needed for competing in a modern economy. High priority should also be given to job training for single parents

from jobless households, and parents with large families. More family-friendly policies, such as flexible time and child day-care services are also needed. Further efforts should be made to address job discrimination, including new legislation and more education and public awareness campaigns, and should be combined with eradicating physical barriers to buildings and transport.

Free access to higher education does not necessarily guarantee equity. To strengthen both efficiency and equity it is necessary to create appropriate conditions and incentives to generate higher investment from public and private sources, including, where possible through tuition fees combined with accompanying financial measures for the disadvantaged.

While aggregate effect of any reform, including social welfare and labour market reforms on efficiency and equity are not always clear – whether diverse impacts translate into inequalities in opportunities depends on how new activities open up and are accepted by the wide community, one could guess that there will be winners and losers. Outcomes depend on the ability and willingness of government to mitigate losses to particularly hard-hit social groups, possible by redistributing some of the gains accruing from winners.

To prosper, a society must create incentives for the vast majority of the population to invest and innovate. The best specific policy mix is a function of country context. Each society must decide the relative weight it ascribes to each of the principles of equity and to the efficient expansion of total production and socio-economic development. Acknowledging history as well as social and political institutions is crucial to avoid policy mistakes.

There are some golden rules and a critical relation in every programme: enabling for jobs that will more probably increase future earnings are generally more expensive and harder to implement, while preparation for and creation of jobs that are closer to *real* jobs and which are apparently more useful for the community also have a greater tendency towards the replacement of workers in the public sector. Less extensive employment and educational programmes should be planned and conducted, from which the lessons learned may help in the better application of larger programmes in the future. Furthermore, extensive additional training and education programmes, directed towards large groups of the unemployed, have rarely proven to be good investments, either for the community or for the programme participants. On the other hand, the thorough and precise targeting of programmes certainly pays off.

Finally, we need to get a better handle on what works and what does not. Too often, there is no regular evaluation of policies and programs. And when evaluations are conducted, they frequently focus on inputs to the system rather than on user achievement and long-term outcomes. This underscores the need to assess user outcomes that are related to both new and existing programs. The key element is measuring user performance directly. Without objective data about student achievement, programs and policies often proceed in unproductive directions. Indeed, past research amply demonstrates that many good guesses about policies did not in the end prove successful - making regular monitoring essential.

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Annex 1. A national framework In the UK identifies four levels of need:

- 1 Critical
- 2 Substantial
- 3 Moderate
- 4 Low

1. Need is assessed as critical when:

- life is, or will be, threatened; and/or
- significant health problems have developed or will develop; and/or
- there is, or will be, little or no choice and control over vital aspects of the immediate environment; and/or
- serious abuse or neglect has occurred or will occur; and/or
- there is, or will be, an inability to carry out vital personal care or domestic routines; and/or
- vital involvement in work, education or learning cannot or will not be sustained; and/or
- vital social support systems and relationships cannot or will not be sustained; and/or
- vital family and other social roles and responsibilities cannot or will not be undertaken.

2. Need is assessed as substantial when:

- there is, or will be, only partial choice and control over the immediate environment; and/or
- abuse or neglect has occurred or will occur; and/or
- there is, or will be, an inability to carry out the majority of personal care or domestic routines; and/or
- involvement in many aspects of work, education or learning cannot or will not be sustained; and/or
- the majority of social support systems and relationships cannot or will not be sustained; and/or
- the majority of family and other social roles and responsibilities cannot or will not be undertaken.

3. Need is assessed as moderate when:-

- there is, or will be, an inability to carry out several personal care or domestic routines; and/or
- involvement in several aspects of work, education or learning cannot or will not be sustained; and/or
- several social support systems and relationships cannot or will not be sustained; and/or
- several family and other social roles and responsibilities cannot or will not be undertaken.

4. Needs is assessed as low when:-

- there is, or will be, an inability to carry out one or two personal care or domestic routines; and/or
- involvement in one or two aspects of work, education or learning cannot or will not be sustained; and/or
- one or two social support systems and relationships cannot or will not be sustained; and/or
- one or two family and other social roles and responsibilities cannot or will not be undertaken.

Annex 2. A national performance framework England includes the following dimensions:

- **National Priorities and Strategic Objectives** - the extent to which local level authorities with responsibility for social care services responsibilities are delivering the national priorities for social care and their own local strategic objectives;
- **Cost and Efficiency** - the extent to which local level authorities with social care services responsibilities provide cost effective and efficient services;
- **Effectiveness of Service Delivery and Outcomes** - The extent to which services are appropriate to need; in line with best practice; to agreed standards; timely; delivered by appropriately trained staff and the local authority's success in using its resources to increase self-sufficiency, social and economic participation; to increase life chances of looked after children; to provide safe and supportive services;
- **Quality of Services for Users and Carers** – User / carer perceptions and experiences of services; responsiveness of services to individual needs; continuity of provision; involvement of users / carers in assessment and review
- **Fair Access** - The fairness of provision in relation to need, the existence of clear eligibility criteria, the provision of accessible information about the provision of services.

Annex 3: Explanation about employment activation policies and introduction of workfare in Croatia from the standpoint of efficiency and equity

Conventional welfare programmes allow the welfare recipients to choose their hours of work. An alternative scheme is workfare. Able-bodied individuals receive transfer payments only if they agree to participate in work-related activity and accept employment offered. Workfare is a system that requires work-based activities as a condition of claiming benefits. It should ensure that welfare recipients follow a regular, work-based structure to their lives every day and that they do not have long gaps in their work histories. This should prevent them becoming defeatist and ill-disciplined and make them more employable. It should also encourage people to take private sector jobs, preventing dependency from arising in the first place. Some countries have avoided the use of workfare while introducing an increasingly rigorous activation agenda for long term unemployed people. There are strong sentiments about workfare. To some it is simply the articulation of reciprocal arrangements between the individual and the community; to others it is tantamount to public humiliation. The main points are as follows:

Advantages

- (1) *Workfare is based on a claim of reciprocity* – the view that social rights are conditional on labour obligation.
- (2) *Workfare cuts welfare spending* by requiring welfare recipients to work.
- (3) By making it harder to collect welfare, *it reduces caseloads and lowers the costs of welfare by reducing fraud and the black economy.*
- (4) Welfare is often viewed as corroding the work ethic. Workfare, on other side, gives people the opportunity *to gain work experience and skills* and/or *to increase level of labour discipline*, allowing them ultimately to gain the necessary preconditions for an escape from poverty.
- (5) *Workfare reduces dependency.*
- (6) *Workfare lifts people out of poverty.*
- (7) *Workfare could increase the ability of government to improve the functioning of its citizens* and could enhance social order and rule of law.

The most common criticisms are:

- (1) There are *two counter-arguments against the opinion of workfare as social reciprocity*. First, the right to do something can only be a right if there is a corresponding right not to do it. Second, that the presumption of balanced reciprocity is unfair because of those on the margin on society; there are no fair opportunities or the prospect of them.
- (2) *Workfare really does not cut welfare spending.*
- (3) *Workfare reduces fraud and the black economy* but due to the lack of convincing evidence to the contrary one can presume that the effect is of minor significance.
- (4) The programme *not only fails to provide useful training, it also erodes the skills development of its participants* because the type of jobs involved provide little more than *orientation* or *work preparation* training, rather than serious training for a craft or occupation.
- (5) Workfare as presently organized *does nothing seriously to advance the economic status or standard of living* of those forced to rely upon it because it

offers unstable jobs and very little besides subsistence wages for those locked into the programme.

(6) The programme *does not represent an adequate solution to the widespread jobs crisis.*

(7) Regarding *workfare's role in promoting functional government* it is questionable whether the state should presume to turn individuals into "functioning citizens" by obliging the poorer group to do specific activities.

(8) Workfare is *unlikely to be effective because no group directly involved favours it.*

According to different programmes (*like Beautiful Bulgaria Programme*) one third or one fourth of participants find permanent jobs. Especially successful employment-focused programmes like *Riverside model* and *Portland NEWWS* have even better results and bigger savings of public funds (around 3,000\$ per welfare recipient). If Croatian programmes enable only one third of mentioned results this would enable valuable short- and especially important long-term savings. These should be assessed through properly structured piloting and evaluation of workfare and its effects.