

**What works, for whom, and at what costs?****Discussion of Keynote Addresses by James J. Heckman and Assar Lindbeck****OECD High Level Policy Conference****Boosting Jobs and Incomes: Policy Lessons from Reassessing the OECD Jobs Strategy****Fairmont Royal York Hotel, Toronto June 15-16, 2006**

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\*these comments accompany a PowerPoint presentation

The restated OECD Jobs Strategy represents a significant step forward in strategic planning for labor market policies in advanced industrialized economies. Nevertheless, our keynote speakers have highlighted some reservations with this restated policy. I know that there are several members on the following panel who will strongly disagree with some of the views expressed thus far. However, I want to begin my discussion by highlighting areas of the Jobs Strategy where I believe we all agree. The first area is Pillar A of the Strategy. Setting appropriate macroeconomic policy that maintains price stability and reduces the risk that transitory aggregate demand shocks become persistent enhances economic performance and well-being. However, effective monetary policy needs to be complemented by responsible fiscal policy otherwise, it will be undermined.

For Pillar B, we all agree that making work pay is crucial, especially as we face one of the greatest challenges for labor market policy in the next decades -- the ageing of the workforce. (Go to slide 2). As of this year, the first of the baby boom generation have turned 60 and started to become the retiree boom generation. In its recently released report, Live Longer Work Longer, the OECD calculates that if we assume that participation patterns by age and gender remain unchanged and labor productivity growth maintains its average for the last 30 years, growth of GDP per capita would decline to around 1.7% per year over the next three decades (about 30% less than its rate for the last 30 years). However, projections of labor market participation are more of an art than a science and these projections are very sensitive to our assumptions about worker behavior.

For example (slide 3), using projections generated by the OECD, if we assume that participation rates by age and gender remain at their 2000 levels we see a leveling off of employment in the OECD occurring around 2015. If instead we assume that the participation rates by gender for those over the age of 50 converge over the next 30 years to the highest rates observed in 2000, the labor force will continue to grow until 2030 and then level off. We can get even more employment growth if we allow for convergence across all age groups to the maximum rate seen in 2000.

There is considerable variation within the OECD with respect to how quickly the ageing population will affect the size of the labor force. (Slide 4) By 2015, Europe's labor force could actually contract unless there is an increase in overall labor force participation

rates. In other words, under this scenario the number of retirees in Europe would exceed the number of young entrants by 2015. For Japan, the picture is bleaker with a large fall in its labor force apparently inevitable under any scenario.

(Slide 5) The good news is that perhaps some of Assar Lindbeck's comments about Europe's "Insider-outsider" situation are too pessimistic with respect to the future. With this demographic shift, the asymmetry in market power will shift from protected incumbent workers who will be retiring en masse to the previously more marginal workers – youth, women, and immigrants.

However, in order to raise the potential output of our economies we will need to raise labor supply and or improve labor productivity. The emphasis in the restated job strategy on tracking not only unemployment rates but also employment shares reflects this demographic challenge and a need for additional benchmarks than those used in the 1994 Jobs Strategy.

What are some of the potential sources of additional labor supply?

1.) Women – Labor force participation and education of women has increased sharply, although not uniformly, over the past 30 years within the OECD. Therefore the policy challenge is how we can raise the labor force participation rates of women in those countries that have not seen the same gains as we have seen for example in Norway and reduce their time out of the labor force. Here the summary in the Employment Outlook on the different effects childcare subsidies versus child benefits are particularly enlightening and useful for the policy debate.

2.) For those of working age, work ready, but benefit dependent, policies that raise their labor force participation will be an ongoing challenge. Not only will we need to ensure they have the appropriate skills and that work incentives are in place under a framework of "mutual obligation" but we will also need to address, as discussed by Assar Lindbeck, social norms. As Jim Heckman and others have documented, training programs for the most disadvantaged and marginally attached workers are often too little and too late to make a significant impact on labor market trajectories.

3.) Alternatively, we can increase our labor forces by changing immigration policy and promoting the inflow of workers from other countries. This may well involve training programs, especially language training, and programs that work to better integrate workers and their families into the labor force and society more generally. Here I would disagree with Jim Heckman and argue that there are examples of language training programs that work – especially for women immigrants. These results do seem to vary by country of origin and more evaluation work on this is needed.

4.) Finally, changing the incentives to work for those "near elderly" 55-65 year olds such as lowering the implicit tax on continuing work and raising the standard retirement age could significantly alter the age when workers leave the labor market. But if we encourage mature workers to remain in the labor market longer, they will need retraining

and possibly some type of wage insurance. While Heckman has argued for only wage insurance for older workers rather than any re-training, I think that his recommendation under-estimates the ability of many older workers to undertake retraining and he under-estimates the costs of such a program with this large bulge of older workers coming at us.

I think we all agree with the notion under Pillar D (slide 7) that the development of labor force skills and competencies is critical for economic growth and well-being. There is no disagreement on this panel that we need to make sure that young people entering the labor market are highly educated. As Jim has said, skill begets skill. However, the demographic reality of the next decades means that we cannot rely on youth alone to supply all our skill needs since they will not be enough to offset the declines in labor force due to retirement of the baby boomers. Now we could consider adopting immigration policies that just hire skilled workers from around the world. But we know this will generate resentment among domestic workers and, consequently, this may well contribute to a retreat from more global economic engagement. We only have to look at the current debates on immigration policy in the US, Europe and Japan to understand the reactions of native populations to changing immigration policies. In addition, what is potentially our human capital gain is another country's brain drain. Therefore, I conclude that retraining of displaced prime age and mature adults will be a key feature of our labor market policies going forward.

(Slide 8) Now Jim Heckman has argued that the only human capital investments that matter are those for the youngest of children. Later investments are too late and ineffective. I agree with both Heckman and Lindbeck that training is not a magic elixir and that it has been used at times as merely a holding area for unemployed workers. However, training can and does matter. I have argued in the past that there are 4 C's associated with effective training systems – coinvestment (including apprenticeships, youth training wages, pay-back clauses); certification (clear credentials are critical to get workers willing to co-pay for skills); codetermination (having business, workers and the government involved in training curriculum improves quality and relevance and helps ensure that employer provided tax credits for training don't just pay for training firms would have done anyway); and cost-benefit evaluation. This last characteristic is one that I think many countries have been reluctant to undertake and I applaud the fact that the restated Jobs Strategy discusses the importance of rigorous evaluation studies. In particular, the increased availability of matched administrative individual-employer data sets since the 1994 Jobs Strategy was issued now makes it easier for countries to assess the effectiveness of their training programs, especially in Europe. But just because we find with a rigorous evaluation study that some training programs don't work we should not drop all training programs and incentives to workers and employers to undertake more training.

(Slide 9) What do we know about returns to training programs? Here the OECD Employment Outlook in various years has provided useful summaries of the returns to a range of training programs to different workers. It is important to make a distinction between employer provided training programs and government provided training programs. Training is particularly effective when provided to those actively engaged in

the labor market. Studies of employer provided training programs show large wage gains for workers and increases to firm productivity. However, these same studies show that we have a virtuous and vicious circle in human capital accumulation over the work life. Those who enter the labor market with higher education are more likely to receive employer provided training while those who enter with little education struggle to acquire more on the job. Workers in smaller firms are also less likely to receive employer provided training and workers with skill shortages often suffer from a shortage of discretionary time to undertake training off the job.

So what happens for the less educated workers, those working in small firms, or those out of work? If employers are not investing in them, then the government becomes a critical source of skills training. Here the academic research has been very informative and influential for policy makers especially the US studies that used random assignment to evaluate the effectiveness of the Job Training Partnership Act, JTPA, programs for disadvantaged adults and out of school young workers. Apart from the merits of using random assignment to raise the quality of the evaluation of these training programs, another advantage of this methodology was that it was easy to produce simple tables with two columns of results for treatments and controls. No need to talk about propensity scores, standard errors, selection bias and so on to policy makers.

In the US, the research indicated that training for out of school youth in was ineffective relative the adult training. The policy response to this research finding was rapid and sharp. We saw a significant shift of funds away from youth and towards adults during the 1990s. For adult workers in the US there is more promising evidence that government training programs work, especially certain types of programs and for specific demographic groups. (see slide 10)

### **What works?**

- Classroom training for displaced workers – especially math/science and health vocational -- see Jacobson, Lalonde and Sullivan (2005)
  - old dogs can learn new tricks and their investment does not seem to depreciate over time
  - in tracking the benefits need to follow for a longer time – at least 18 months

More generally, studies of the returns of training for displaced workers seem to suggest higher returns than what disadvantaged adults, especially males, experience in their training programs.

- On-the-Job training – for disadvantaged women works – so it is not the case that there are no training programs that work for disadvantaged workers.

- Re-employment bonuses work in the US

### **What helps make this work:**

- Strict performance criteria to training providers
- Smaller programs - they can better tailor program content to specific needs of participants
- Working with training providers who are well connected with local employers – relevance of training and effective matching of workers to employers

The evidence on displaced workers programs relative to training for disadvantaged adults again has had a significant impact on policy makers funding priorities. As we see in the next figure, (see slide 11 based on my own calculations of the US Department of Labor training budget Lynch (2005)) training funds in the US have moved away from youth and disadvantaged youth towards displaced workers over the 1990s rather sharply.

One of the aspects of the restated jobs strategy that has generated a high degree of skepticism from our keynote speakers is the positive role unions may play in labor market performance. (slide 12) Specifically, the OECD finds a U shaped relationship between the degree of corporatism and labor market performance. So how have micro econometric studies of the labor market helped us understand the role of unions in labor market outcomes? Black and Lynch (2004, 2001) find that US establishments with more traditional labor-management relations with little or no direct participation of employees in decision making had substantially lower productivity than unionized businesses that adopted new workplace practices – even higher than non-unionized businesses. The empirical evidence gathered using micro longitudinal surveys of businesses suggests that unions in partnership with management can act as change agents and innovate. However, in recent work I also find (Lynch (2006)) that unionized businesses are less likely to adopt workplace innovations. So at least in the U.S., suspicion and a lack of trust between labor and management can hinder the adoption of more flexible work arrangements. Yet those firms that manage to forge a partnership and get over this hurdle of suspicion do better. There are lessons from this for Europe and Asia. For those countries where the social partners are better able to work together in workplace innovation we are likely to see higher productivity growth, everything else constant.

As appropriately raised by Assar Lindbeck, we can not just focus on labor supply in thinking about components of an OECD Jobs Strategy – we need to also consider labor demand as addressed under Pillar C. More specifically how do institutions and practices affect labor demand? (Go to slide 13) This is the part of the report where I think there is the most divergence of views between the keynote speakers and some of the panel. However, I think we can all agree that the ageing of the workforce will have potentially a significant impact on this.

- The danger of an over promised and underfunded pension system is that taxes will need to be raised to fund this liability
- The OECD study highlights the significant problems with a growing tax wedge
  - Direct negative effect on demand for labor

- Creates disincentives to invest in skills training

The report should be applauded for the empirical evidence it brings to bear on the impact of the tax wedge on unemployment and employment rates. Nevertheless, there are some other issues I would have liked to have seen discussed more fully with respect to labor demand – (go to slide 14)

- Role of unions for demand for labor. Simply because unions do not appear to have an adverse impact on unemployment rates across OECD countries, we should not conclude that they would also not have any impact on total employment rates. In fact, as shown in the 2006 employment outlook there are subgroups of the working population who exhibit lower employment rates in highly unionized countries. This is the insider-outsider problem that Assar Lindbeck referred to in his comments and which is the subject of a large body of work in Europe.

Assar Lindbeck rightly discusses how social norms can limit workers' behavioral responses even when excellent incentives are in place. But social norms on the employers' side matter too:

- Employer attitudes toward older workers (let alone other workers such as women and immigrants) – do they view older mature workers too old to learn? Age discrimination is mentioned in the report but this will be a challenging area for policy. Choosing arbitrary ages for anti-discrimination policies to kick in may generate perverse outcomes as noted in the 2006 Employment Outlook.
- Recent work by Bloom and van Reenen (2006) shows how poor management practices lower productivity. They find poor management practices are more likely when:
  - product market competition is weak – presumably firms are protected from getting better and insider managers are rewarded in spite of poor performance
  - When family owned businesses pass management control onto the eldest male. The incidence of family owned businesses is much higher in Europe than in the US. This is a function of both history and recent generous tax exemptions for family firms. However, one of the consequences of a higher incidence of family owned business is unwillingness by families to grow the business beyond a certain threshold since this might require that they relinquish control. There may also be resentment of transparency requirements associated with being a publicly traded firm.

Bloom and van Reenen find that product market competition and family firms account for as much as 2/3rds of the gap in management practices between the US and France and 1/3 between the US and UK. Consequently, we could well see lower

growth and more limited job creation when the incidence of family owned businesses is high. This is an area of research that warrants further research by the OECD.

(Final slide 15)

In most strategic plans we see a mission statement – here it is boosting jobs and incomes; a strategy – the 4 pillars; performance indicators (we have a lot of discussion about this in this conference); and a positioning statement. This statement identifies the unique ways an organization can tackle the issues it is confronting in its strategic plan in a way that differentiates it from all other organizations working towards the same mission. I see a special role or position for the OECD in moving forward this strategy.

- Aggregate indexes on institutions are an interesting complement to microeconometrics – there is no reason to think of this as either/or in terms of empirical work. Constructing these indices is not easy to do and the OECD staff has struggled to come up with data that can be compared across a wide range of countries. Their measures of product market regulation have been particularly useful in shifting the debate from just labor market reform to consider the impact of product market regulation reform as well. However, we need to benchmark progress using a wider range of outcomes besides the unemployment rate – e.g. total employment share, wage inequality, poverty, under-employment. Micro evaluation of what works is critical for moving the political discussion forward. I would suggest three areas of priority for this in the context of the OECD Jobs Strategy.
  - Job training – especially for older workers
  - Reduction of benefit dependency of working age population
  - Role of unions/management in productivity and innovation

Aggregate indexes do not give us enough detailed information on differences in programs that may be the critical reason why one program works and another does not. With the increased availability of administrative data in Europe, especially data that match households with employers, we can look at the impact of programs more carefully. More micro data is critical for evidence based policy analysis. This requires financial resources, cooperation by businesses and individuals, and access to data by researchers to do the evaluation. This is something the OECD is uniquely positioned to provide leadership on -- otherwise it will find itself constructing cross-country indices from the lowest common denominator.

Trade and technological change will continue to put pressure on our economy to raise the skill level of the workforce. With the added burden of a sharp increase in retirement due to the ageing of the workforce, policies to stimulate labor force participation and skills must be the top priorities for a Jobs Strategy for the next 10-15 years in the OECD. However, some countries are better positioned than others on the skill front to create an effective system of life-long learning.

As Jim Heckman has pointed out, in the United States we are now producing a greater share of low skilled youth than we did thirty years ago. Thirty years ago, 25% of 17 year olds dropped out of high school and did not return or only did a GED. That percentage today has risen to 28%. Meanwhile around the world, young people are staying in school longer and outperforming US youths with respect to math and science. For example, the 1999 Trends in International Mathematics and Science study of eighth graders showed that while the US exceeded the international average performance in math and science for 38 nations it was significantly behind 14 nations in mathematics including Singapore, Taiwan, Hong Kong, Japan, Korea, Russia, Australia, Canada, Belgium and the Netherlands. From OECD surveys on adult literacy, we have seen that one in four young people in the US can not perform arithmetic operations versus less than 5% in countries such as Germany and Sweden. We may have advantages in terms of labor market flexibility in the United States and even a comparative advantage in the production of highly educated workers. But these numbers are disturbing. Europe and Asia on the other hand have a skill base of new entrants and incumbent workers that bodes well for its ability to achieve as Jim Heckman said, “An integrated approach to skill formation that recognizes the interdependence in investments in human capital across the life cycle.”

#### References

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