

The OECD JOBS STUDY



**IMPLEMENTING
THE
STRATEGY**

Unemployment in the OECD area, 1950 - 1996

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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LA MISE EN OEUVRE DE LA STRATÉGIE

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FOREWORD

A year ago OECD Ministers endorsed the *Jobs Study* which proposed a wide-ranging programme of actions to reduce unemployment and boost employment growth on a durable basis. This report reviews how far Member countries have moved and identifies priorities for further action.

Economic recovery has brought with it growth of employment, but at a less rapid pace compared with previous episodes of cyclical growth. Unemployment is falling, but slowly, and very little inroad has been made into the most intractable problems; even with the recovery, unskilled and low-skilled workers are increasingly threatened by precarious employment, long-term unemployment, and social exclusion. The central finding of the *Jobs Study* remains valid — the pressing need to deal with the inability of our economies and the workforce to adjust sufficiently rapidly to changing circumstances. Recent trends have also confirmed the long-standing differences in job creation performance across OECD countries and the different strains that, in different ways, threaten to weaken the social fabric of all Member countries.

With high and persistent unemployment still looming large for the coming years, especially in continental Europe, governments must place top priority on their efforts to exploit efficiently the synergy between macroeconomic and structural policies which will promote sustainable and job-creating growth. This should allow OECD economies to reduce the gap that exists between their needs and their abilities to adapt to new technologies, intense competition and globalisation — all sources of vast opportunity for the future.

But the challenge is great. High levels of unemployment and the ensuing social tensions cause pressures to build for various types of “quick fixes” such as protectionism or other inappropriate policies that slow the pace of adjustment.

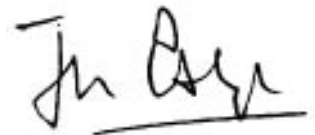
The OECD continues to support its Member countries in meeting this challenge. Following up on the *Jobs Study*, it has entered the phase of active, detailed, and multilateral monitoring of the need for and implementation of reforms. The specific policy requirements for each country are being worked out; these are being progressively enriched by the results of extensive cross-country analysis, for example on technology, productivity and employment, active labour market policies and the interactions between tax and benefit systems.

This country-specific analysis serves as the basis for an on-going process of multilateral surveillance. Most options for promoting employment in a sustainable way involve difficult tradeoffs and potential pitfalls. At virtually every turn, governments face problems of policies that are not doing enough to help — or unintentionally are downright damaging to — the people who most need help.

For example, governments can try to encourage low-skilled workers to accept low-paid jobs by providing in-work benefits in order to assure a socially acceptable income. But in doing this, governments have to be very careful to avoid exacerbating “poverty traps” — circumstances in which people who have a low-wage job are discouraged from trying to get a better one.

The same kind of tradeoff applies for regulations designed to guarantee protection to those who have jobs. While these can help promote long-term attachments of workers to their firms, thereby fostering investment in skills, they may also discourage the recruitment of the unemployed.

Each government can learn from the experience of the others — from their successes, and failures. The OECD “peer review” process — multilateral surveillance of countries by one another — provides a unique tool to that effect.

A handwritten signature in black ink, appearing to read "J.C. Paye", with a horizontal line underneath the name.

Jean-Claude Paye
Secretary-General

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I. THE CURRENT SITUATION

The recovery, which has spread recently to almost all OECD economies and is close to maturity in those which were in the vanguard (notably the United States), has generated an increase in employment. The fears which were expressed about a “job-less recovery” have proved largely unfounded. Employment growth to date is not as strong (relative to output growth) as in past recoveries, but OECD employment is now increasing at a rate of around 1¹/₄ per cent per annum, more than keeping up with the growth of the labour force.

Employment is growing, unemployment is falling slowly, but serious problems remain.

Unemployment is thus now edging down from its peak for the OECD area as a whole of around 34 million, over 8 per cent of the labour force, in 1994. Nevertheless, unemployment looks set to remain high even when the cyclical recovery is complete — perhaps coming down to only 7 per cent by the year 2000 (Chart A). This would still be slightly higher than its level in 1990, before the latest recession. Unemployment in OECD Europe has been especially high, reaching almost 21 million or over 10¹/₂ per cent of the labour force in 1994, and may still be close to 9 per cent in 2000 in the absence of further structural reforms. Thus, unemployment in most countries continues to ratchet up from cycle to cycle. In Japan, measured unemployment is low compared with the OECD average but is high by Japanese standards.

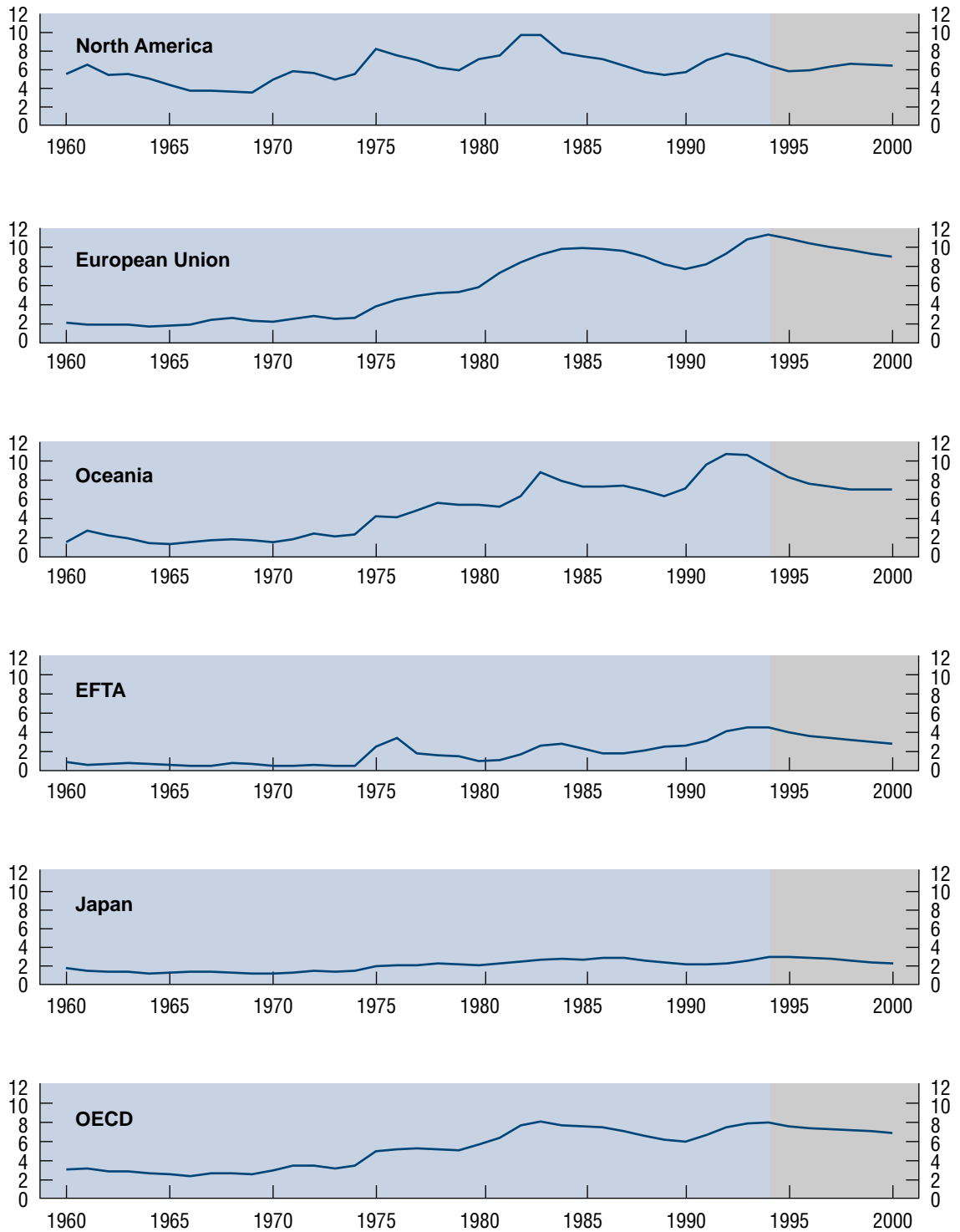
These developments mean that policy makers will continue to confront a major problem of high and persistent unemployment. The burden is unevenly spread across the labour force: young people face a much higher risk of unemployment than do adults (Table 1) and the long-term unemployed account for 40 per cent or more of total unemployment in many countries (Table 2). Some countries also face the problem of serious regional differences in unemployment.

Those European countries that have experienced high and persistent unemployment typically also have:

- youth employment/population ratios well below the OECD average;
- about average employment/population ratios for prime-age workers;
- relatively long average job tenures for prime-age workers;
- well below average employment/population ratios for older workers (Chart B); and
- both low inflows to, and outflows from, unemployment (Chart C).

These patterns suggest both a hiring problem and a benefits/unemployment trap. The former reflects the fact that young people and other first-time job seekers are facing increasing difficulties in getting a firm foothold in permanent jobs. Prime-age workers, who are typically well-established in the labour market, enjoy low unemployment in many European countries. However, many older workers, if they lose their jobs, find it very hard to get back into employment again. They can draw unemployment benefits for a long time or go on other benefit schemes such as early retirement or invalidity.

Chart A. **Unemployment rates in OECD regions,¹ 1960 to 2000**
Per cent of total labour force



1. Excluding Mexico, as historical series are not available. OECD projections for the period 1995 to 2000.
Source: OECD Secretariat estimates.

Table 1. **The profile of OECD unemployment, 1994**

Percentages

	All persons	Unemployment rates ¹		
		Women	Youths	Low skilled ² (1992)
North America	5.8	6.0	10.4	13.8
Canada	10.3	9.9	16.5	15.2
United States	6.0	6.0	12.5	13.5
Mexico ³	2.5	3.2	4.4	..
Japan	2.9	3.0	5.1	..
EU	11.1	12.6	18.6	10.0
Austria ³	4.3	4.5	4.8	5.6
Belgium	10.3	14.4	20.0	13.0
Denmark	10.1	11.2	10.6	14.1
Finland ⁴	18.2	16.7	30.5	14.9
France	12.5	13.6	23.4	12.1
Germany	6.9	6.7	5.2	8.9
Greece ³	9.6	15.3	28.8	6.1
Ireland	14.7	19.7	26.4	19.8
Italy	12.0	17.8	31.1	7.3
Luxembourg	3.3	4.4	7.1	2.0
Netherlands ⁵	7.2	11.7	7.8	8.0
Portugal	6.8	7.3	11.4	3.9
Spain	23.8	30.9	38.3	16.0
Sweden	8.0	6.7	16.6	4.6
United Kingdom	9.5	7.4	14.9	12.6
EFTA	4.4	4.5	8.2	5.0
Iceland ³	5.3	5.7	9.9	7.8
Norway	5.4	4.7	12.6	7.1
Switzerland	3.8	4.3	5.7	3.5
Turkey⁴	8.3	6.7	15.3	5.1
Oceania	9.4	9.1	16.4	11.2
Australia	9.7	9.4	16.3	11.2
New Zealand	8.1	7.8	17.4	11.2

1. For all persons, OECD standardised unemployment rates for 18 countries; EU comparable unemployment rates for Denmark, Greece and Luxembourg; and national estimates for Austria, Iceland, Mexico and Turkey. For women and youths (aged under 25), EU comparable unemployment rates and national estimates.

2. Persons aged 25-64 (15 and over for Greece, Luxembourg and Iceland) with less than upper secondary education.

3. The data refer to 1993 (except for the low-skilled).

4. Unemployment rates for youths refer to 1993.

5. Unemployment rates for women and youths refer to 1993.

Sources: OECD, *Labour Force Statistics*; OECD, *Employment Outlook, 1994*; Eurostat, *Unemployment*; Eurostat, *Labour Force Survey, Results 1992*; Österreichisches Statistisches Zentralamt, *Mikrozensus*; Statistics of Iceland, *Labour Market Statistics, 1991-1993*; Office fédéral de la statistique, *Enquête suisse sur la population active*; INEGI, *Encuesta Nacional de Empleo, 1993*; State Institute of Statistics, Turkey, *Household Labour Force Survey*.

Table 2. **Incidence of long-term unemployment in selected OECD countries**

As a per cent of total unemployment

	1983		1990		1993	
	6 months and over	12 months and over	6 months and over	12 months and over	6 months and over	12 months and over
Australia	51.3	25.4	40.9	21.6	57.1	36.5
Austria ¹	..	..	25.2	13.1	30.2	17.1
Belgium	82.6	64.8	81.4	68.7	70.4	52.9
Canada	28.8	9.9	18.9	5.7	31.4	14.1
Denmark	67.2	44.3	53.3	30.0	45.5	25.2
Finland	30.0	19.2	32.6 ²	9.2 ²	52.2	30.3
France	67.0	42.2	55.5	38.0	58.2	34.2
Germany	65.8	41.6	64.7	46.8	60.1	40.3
Greece	58.4	33.2	71.9	49.8	71.0	50.9
Ireland	64.0	36.7	81.0	66.0	77.4	58.9
Italy	82.5	58.2	85.2	69.8	76.5	57.7
Japan	31.5	12.9	39.0	19.1	34.4	17.2
Luxembourg ³	(56.3)	(35.4)	(66.7)	(42.9)	(62.2)	(32.4)
Netherlands	70.7	48.8	63.6	49.3	79.1	52.3
New Zealand	..	..	38.0	18.7	52.5	33.2
Norway	20.3	6.3	40.4	19.2	45.6	27.2
Portugal	..	..	62.4	44.8	45.2	43.4
Spain	72.8	52.4	70.2	54.0	69.6	50.1
Sweden	24.9	10.3	16.0	4.7	32.0	10.9
United Kingdom	66.4	45.6	50.3	34.4	62.9	42.5
United States	23.9	13.3	10.2	5.6	20.4	11.7

1. Data for Austria are taken from registration sources.

2. Data refer to 1991.

3. Data in parentheses are based on small sample sizes and, therefore, must be treated with care.

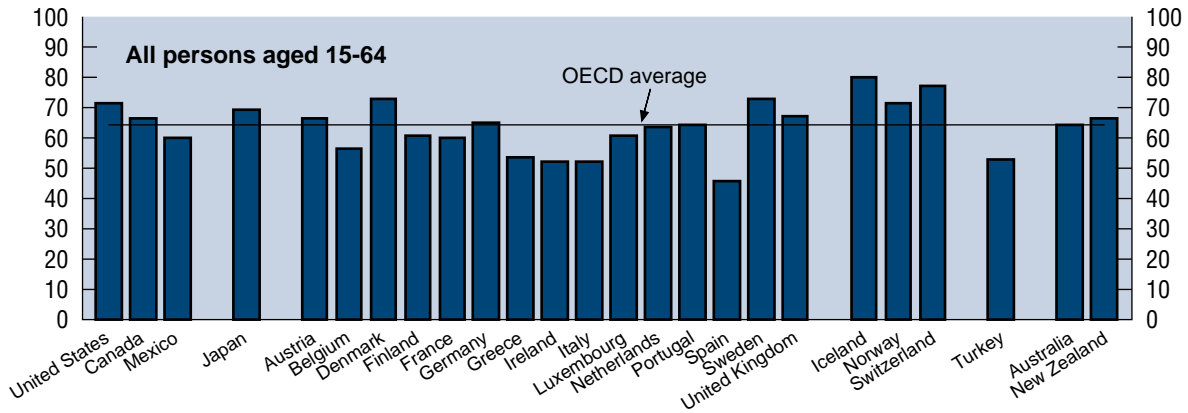
Source: OECD unemployment duration database. For further details, see OECD *Employment Outlook*, 1994, Tables P and S of the Statistical Annex.

There is a particular problem in many countries for unskilled and poorly-educated workers. All OECD countries have experienced a trend shift in demand away from unskilled jobs towards more highly skilled jobs, in part reflecting the impacts of technology and the globalisation of activities which, *inter alia*, has increased competition with low-skilled labour outside the OECD area. The result has been rates of unemployment for low-skilled workers 2 or 3 times higher than those for high-skilled workers, with a noticeable deterioration in Europe in this regard over the past 15 years. The low skilled are especially at risk of drifting into the ranks either of the long-term unemployed or of those no longer even looking for work.

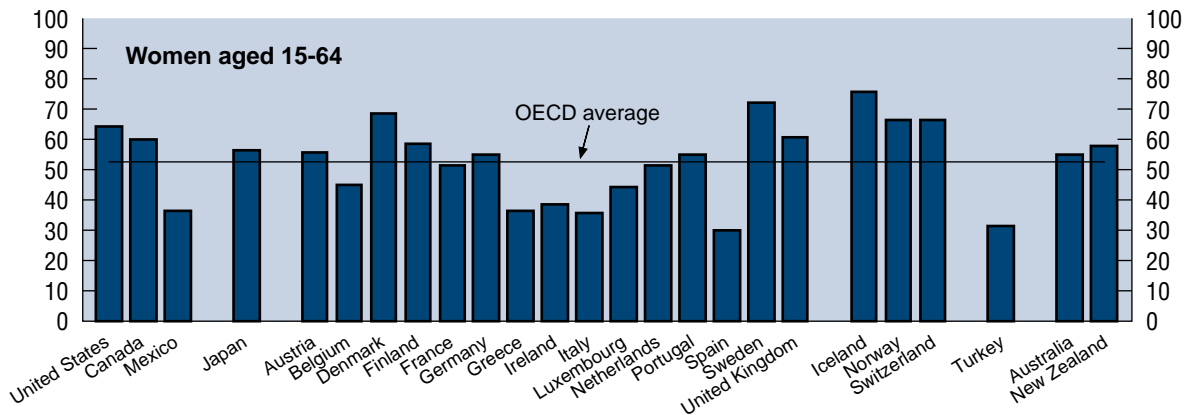
Chart B. **Employment/population ratios in OECD countries, 1993**

Percentage of each population group in employment

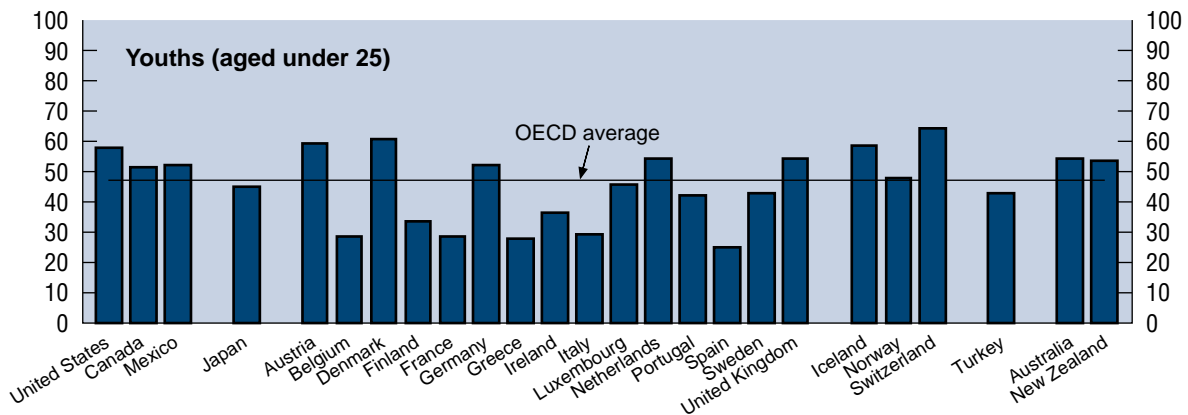
Low overall employment rates in some countries reflect...



low employment rates for women...



but also for youths...

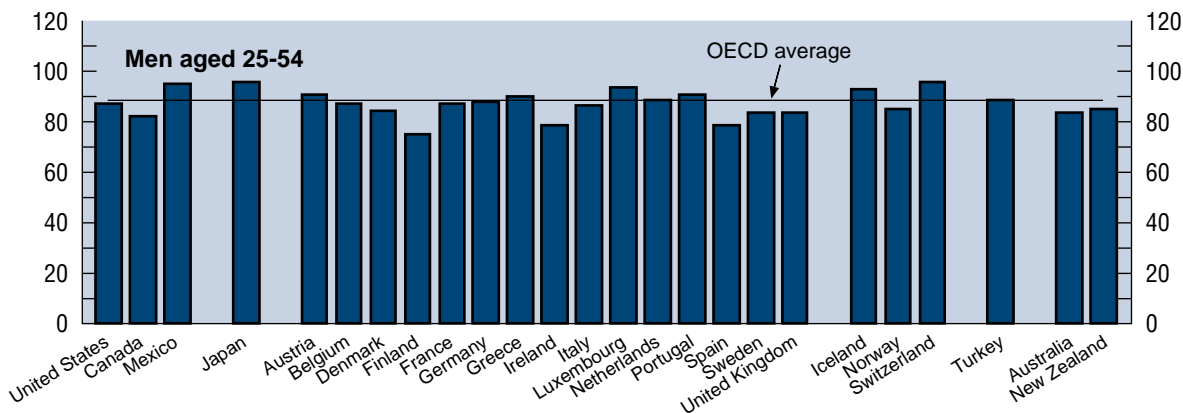


Source: The countries have been grouped into the following regions: North America, Japan, the European Union, EFTA, Turkey, and Australia and New Zealand.

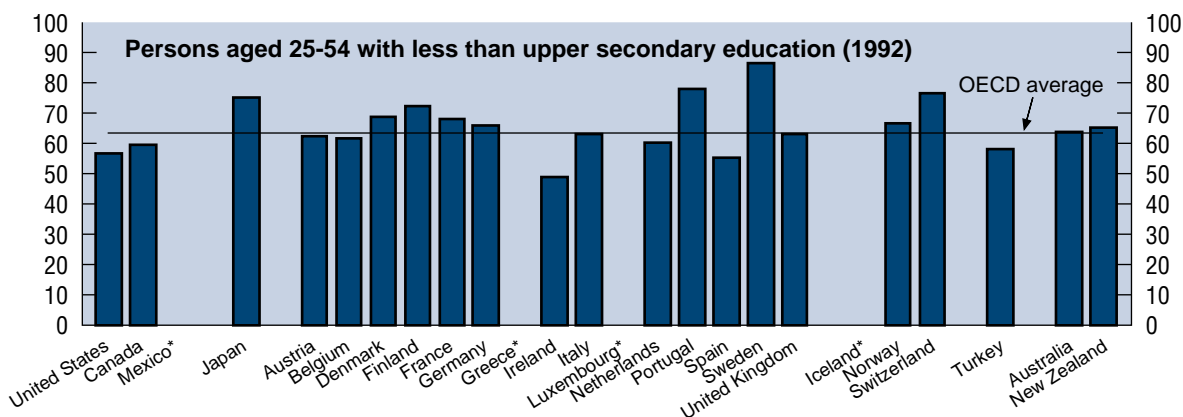
Chart B. **Employment/population ratios in OECD countries, 1993** (cont.)

Percentage of each population group in employment

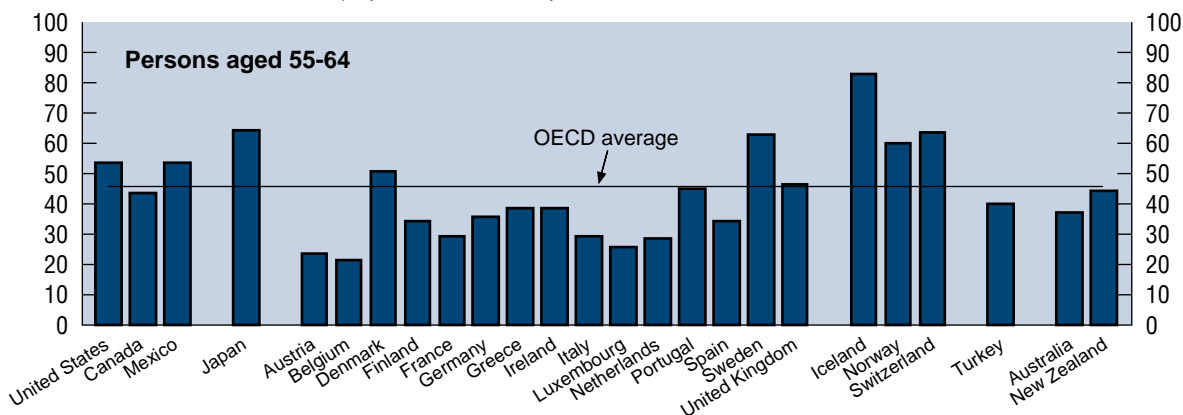
Whereas employment rates for prime working-age men are more similar.



The low skilled...



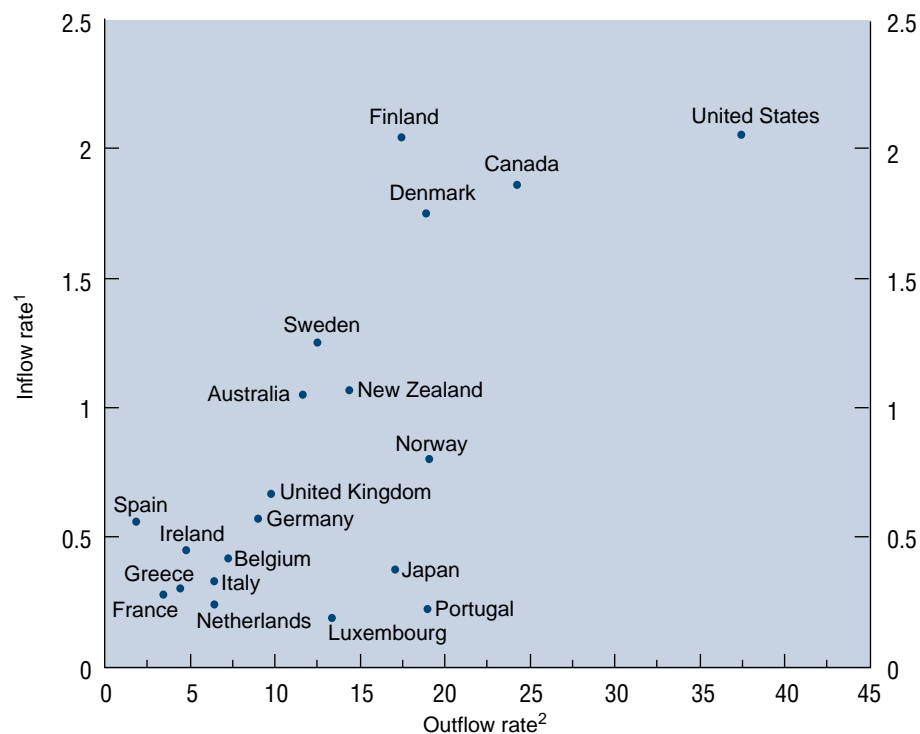
and older workers also have low employment rates in many countries.



* Data not available.

Source: The countries have been grouped into the following regions: North America, Japan, the European Union, EFTA, Turkey, and Australia and New Zealand.

Chart C. **Flows into and out of unemployment**
1993



1. The inflow rate is proxied by the number of unemployed for less than one month as a per cent of the population aged 15-64 less the unemployed.
2. Outflows are estimated as the difference between the monthly level of inflows and the monthly average change in unemployment over one year, *i.e.*

$$\text{outflows} = (I(t) + I(t - 1))/2 - (C(t) - C(t - 1))/12$$
 where: $I(t)$ and $I(t - 1)$ are the monthly inflows for years t and $t - 1$ respectively and $C(t)$ and $C(t - 1)$ the levels of unemployment for years t and $t - 1$, respectively.
 The outflow rate is expressed as a per cent of total unemployment.

Source: OECD Unemployment Duration Database.

This rather unsatisfactory picture as regards the levels and composition of employment and unemployment is particularly marked in continental Europe. In addition, there has been a widening distribution of wages in Australia, Canada, New Zealand, the United Kingdom and the United States (Table 3). The low skilled have tended to bear the brunt of these changes and, in a few countries, have even experienced falling real wages. The widening distribution of wages may be, at least over the short to medium term, part of the adjustment process offsetting some of the trend decline in the demand for unskilled workers. But it has accentuated problems of work incentives, poverty and social exclusion.

Table 3. Trends in earnings dispersion,¹ 1973-1991

	1973	1975	1979	1980	1981	1983	1985	1986	1987	1988	1989	1990	1991
Australia ²		2.00	2.00	2.02	2.09		2.13	2.21	2.16	2.22	2.23	2.24	2.29
Austria				2.64					2.70	2.74	2.76		
Belgium (both sexes)								2.48	2.51	2.54	2.36	2.30	
Canada	3.22				3.47			4.04		3.80		3.98	
Denmark (both sexes)				2.13	2.16		2.17	2.20	2.20	2.18	2.17	2.16	
France ³	3.21	3.44	3.29	3.27			3.32	3.35	3.38	3.40	3.43	3.44	3.41
Germany						2.39	2.36	2.38	2.29	2.33	2.29	2.31	
Italy ⁴			2.05	2.10		2.14		2.06	2.08				
Japan			2.61						2.75			2.86	
Netherlands							2.17					2.29	
Norway (both sexes)				2.06					2.16				1.97
Portugal (both sexes)							2.58				2.64		
Sweden ⁵	2.06				2.14		1.97	1.97		2.06			2.14
United Kingdom	2.48	2.38	2.42	2.51	2.64		2.90	2.97	3.06	3.15	3.21	3.24	3.35
United States		4.73	4.72	4.81	4.86		5.58	5.55	5.69	5.59	5.63		

1. Ratio of the lower limit of earnings received by the top 10 per cent (9th decile) of all male workers (both sexes for some countries) relative to the upper limit of earnings received by the bottom 10 per cent (1st decile)

2. Data for 1976 instead of 1975.

3. Provisional data after 1988.

4. Data for 1982 instead of 1981.

5. Data for 1974 instead of 1973, and for 1984 instead of 1985.

Source: For definitions and sources, see OECD *Employment Outlook*, 1993, Chapter 5.

II. MAIN LINES OF THE STRATEGY

A broad programme of action involving a balanced mix of policies is essential.

The *OECD Jobs Study* set out a broad programme of action designed to deal with these problems by: *i*) improving the ability of economies and of societies to adjust and to adapt to changing economic conditions; and *ii*) increasing their capacity to create knowledge and to innovate. In order to achieve these objectives, a balanced mix of macroeconomic and structural policies was elaborated under nine broad headings (see box); these have now been followed up with country-specific analysis which will form the basis for an on-going process of multilateral surveillance.

The Strategy's emphasis on a *balanced mix* of policies was deliberate. Detailed analysis of the situation and policy requirements in each OECD country and the preliminary results of cross-country analysis of certain key themes indicate that OECD countries are attempting to tackle the problems of high and persistent unemployment, rising income inequality and a marked fall in the demand for unskilled labour through actions across a wide range of areas. Naturally, the weight which countries choose to put on the different priority areas, or on specific reforms within each of these areas, differs depending, among other things, on their specific labour and product market characteristics and problems. In addition, fundamental social goals will determine policy choices in this area. In some cases, the active participation of the social partners may be essential to striking the right balance of policies, thereby contributing to effective outcomes.

The Jobs Study Recommendations

The recommendations in Part III of the *Jobs Study* were grouped under nine headings:

1. Set macroeconomic policy such that it will both encourage growth and, in conjunction with good structural policies, make it sustainable, *i.e.* non-inflationary.
2. Enhance the creation and diffusion of technological know-how by improving frameworks for its development.
3. Increase flexibility of working-time (both short-term and lifetime) voluntarily sought by workers and employers.
4. Nurture an entrepreneurial climate by eliminating impediments to, and restrictions on, the creation and expansion of enterprises.
5. Make wage and labour costs more flexible by removing restrictions that prevent wages from reflecting local conditions and individual skill levels, in particular of younger workers.
6. Reform employment security provisions that inhibit the expansion of employment in the private sector.
7. Strengthen the emphasis on active labour market policies and reinforce their effectiveness.
8. Improve labour force skills and competences through wide-ranging changes in education and training systems.
9. Reform unemployment and related benefit systems — and their interaction with the tax system — such that societies' fundamental equity goals are achieved in ways that impinge far less on the efficient functioning of labour markets.

The follow-up on these recommendations

These recommendations have been followed up on a country-by-country basis with priority areas for policy reform being established as the basis for an on-going process of multilateral surveillance. Recommendations by country on macroeconomic policies (point 1) are discussed by OECD's Economic Policy Committee and published in the *OECD Economic Outlook*. Extensive cross-country analysis is being carried out in the areas of technology issues (point 2), active labour market policies (point 7), the interaction between tax and benefit systems (point 9) and the interaction between macroeconomic and structural policies (point 1).

III. IMPLEMENTING THE STRATEGY: THE MESSAGES SO FAR

This part summarises what OECD countries are doing to implement the Strategy and the main lessons and problems for policy-making which have emerged so far from the follow-up. It draws on detailed Secretariat work outlined in the final section of the box. This part begins (Section A) with a review of the main ingredients of the stable macroeconomic environment essential if structural reforms are to be effective. It then discusses structural reforms, regrouped under the two broad headings of *i*) enhancing the ability to adjust and to adapt (Section B); and *ii*) increasing the capacity to innovate and be creative (Section C). The former deals with dismantling barriers to job creation in labour and product markets, increasing the flexibility of working time, the interactions between tax and benefit systems, and active labour market policies; the latter covers upgrading skills and competences, and technology and innovation.

A common thread running through many of these areas is the high priority countries are attaching to improving the labour market prospects of unskilled workers. Upskilling is the most satisfactory solution for them, but it will take a long time to bear fruit. In the meantime, the other solutions can help improve their employment prospects over the short to medium term.

A. A stable macroeconomic environment

Changes in the structure of OECD economies that boost performance and employment will be fully effective only if macroeconomic policies are well managed.

Achieving sustained increases in employment and permanent reductions in unemployment will require sound macroeconomic policies that ensure a stable non-inflationary environment. Such an environment is essential if growth is to be sustained at high levels of capacity utilisation and if living standards are to rise in the context of a prosperity that is widely shared. Consequently, the gains that have been made in reducing inflation in recent years must be preserved. A vital element in achieving this will be restoration of fiscal positions that are sound and designed to cope with the stresses that ageing populations will imply over the longer term. Finally, structural reforms — many of which are set out below — which enhance the ability of OECD economies to adapt to change would make it more likely that pressures to use fiscal and monetary policies inappropriately could be avoided.

Credible commitments to non-inflationary monetary policy would favourably influence wage and price formation throughout the economy, and contribute to lower inflation premia in market interest rates. This would provide a favourable backdrop for decisions about current resource allocation and new investment. Considerable progress has already been made in many countries in setting ambitious inflation control objectives and communicating them to the public. A number of countries — Canada, Finland, New Zealand, Sweden and the United Kingdom — have established explicit inflation targets and several others, including Australia, France, Greece, Italy, Portugal and Spain, have announced medium-term inflation objectives. Others have established effectively fixed exchange rates vis-à-vis those of low-inflation countries. Greater autonomy for central banks in their operations is also enhancing institutional pressure for maintaining price stability in some countries — for example in France, New Zealand and the United Kingdom.

Fiscal consolidation has a key role to play nearly everywhere. Large budget deficits and rising debt-to-GDP ratios suggest that present fiscal policies are unsustainable in many countries. In the United States, chronic budget deficits together with relatively low private savings have resulted in a large deterioration in the net foreign debt position. In several other countries, including Canada, Greece, Italy, Spain, Sweden and Turkey, poor fiscal positions have resulted in large interest-rate premia with respect to major trading partners and downward pressure on currencies. Reducing deficits can be expected to raise national savings, which would help to ease upward pressures on interest rates, to finance increased investment and to promote sustainable growth in the medium term. It will also strengthen the credibility of official commitments to price stability.

Most governments have announced medium-term fiscal consolidation targets beyond 1996. Some of these targets may look ambitious but, even if they are achieved, debt-to-GDP ratios will likely remain high in the year 2000. Furthermore, over the very long term, ageing populations in OECD countries will put increasing stress on general government budgets because of increased pension payments and health-care spending.

Early action to strengthen budget positions before the pressures from ageing populations become acute would be the most effective way to ensure that fiscal positions remain sustainable over the longer term. Although specific policy requirements to implement these more ambitious consolidation efforts differ across countries, some common elements are summarised below. In general, given an overall tax burden that is already high in many OECD countries, as well as widespread political resistance to further tax increases, priority should be given to expenditure reductions.

On the expenditure side, the following measures offer scope for saving:

- In most OECD countries, there appears to be considerable room for increasing public-sector efficiency. Gains may be expected from re-assessing management and financial practices, improving public procurement practices, strengthening links between performance and pay, rationalisation of work within the public administration, elimination of overlapping in the provision of public services at different government levels, charging for the provision of services, and from contracting-out the provision of services to the private sector.
- Lower industrial and agricultural subsidies would simultaneously improve overall market efficiency and reduce expenditure. The scope for reducing assistance to industry is substantial in a number of European countries, including France, Germany, Greece, Italy, Luxembourg, Norway, Spain and Turkey, while agricultural subsidies are high in nearly all OECD countries except Australia and New Zealand.
- A fundamental reassessment of social transfers is required in many OECD countries.

Regarding old-age pension and health-care systems, possible measures include:

- Increasing participation rates by avoiding policies that discourage part-time work and encourage early retirement.
- Increasing working lifetimes by raising the retirement age. This would reduce pension payments and increase contributions at the same time. This measure should also be seen as a response to higher life-expectancy, to later entry of young people into the work-force and to less physically demanding jobs due to technical changes.
- Reducing the generosity of pension benefits and/or increasing pension contributions or other tax rates.
- Accelerating the implementation of health-care reforms with the aim of controlling costs and enhancing effectiveness. This is particularly urgent in the United States and some other OECD countries (Canada, Finland, France and Switzerland) where costs have continued to rise in recent years. These reforms involve the creation of incentives to reduce the demand for unnecessary and low-value medical services and the facilitation of medical innovations which can improve the health status of the population at lower aggregate cost.

On the revenue side, the following policy options should be considered:

- Broadening the base of direct taxes by reducing or eliminating exemptions may be an option in many countries (for example, cutting tax expenditures such as mortgage interest deductibility and taxing fringe benefits).

- In a number of countries, in particular in southern Europe and Mexico, the reduction of tax evasion could yield substantial revenues without altering statutory tax rates.

Recent experience in a number of countries indicates that the adjustments which deficit reduction will require are easiest to absorb if action is taken during an upswing in activity. Countries should, therefore, take advantage of the current upswing in order to avoid much more difficult conditions when the expansion slows.

Reforms to reduce structural rigidities in labour and product markets would strengthen the credibility of stable monetary and fiscal policies by reducing political pressure to resort to inflationary policies to resolve problems that are essentially structural. Such reforms would make wage and price formation more responsive to market conditions and facilitate adjustment to changes in the economic environment such as shifts in demand patterns or new technological developments. This would reduce the social costs of adapting to such changes, since the likelihood that the displacement of workers would lead to marginalisation, exclusion or higher long-term unemployment would diminish. Over the longer term, the favourable impact on productivity would work to raise living standards.

B. Enhancing the ability to adjust and to adapt

Dismantling barriers in labour and product markets to job creation

The demand for labour will be increased by greater wage and price flexibility and, in some countries, by lowering the relatively high tax and legislated (or bargained) costs of employing a worker.

The *Jobs Study* concluded that the private sector would create more jobs if there were fewer barriers to hiring. Among other factors, it identified high *non-wage labour costs* as contributing to low employment levels, especially among new entrants to the labour market and low-skilled workers; this may be of particular concern in the growing services sector.

Non-wage labour costs drive a wedge between the cost of a worker to an employer and the wage received. If wages and prices are relatively flexible, high non-wage labour costs are unlikely to have major negative effects on employment in the long-run. However, in countries where wages and prices are inflexible, employment will suffer if non-wage labour costs increase. Many of the job losses will fall on low-paid workers, due among other things to the existence of contribution ceilings and binding wage floors — such as legal or collectively-bargained minimum wages.

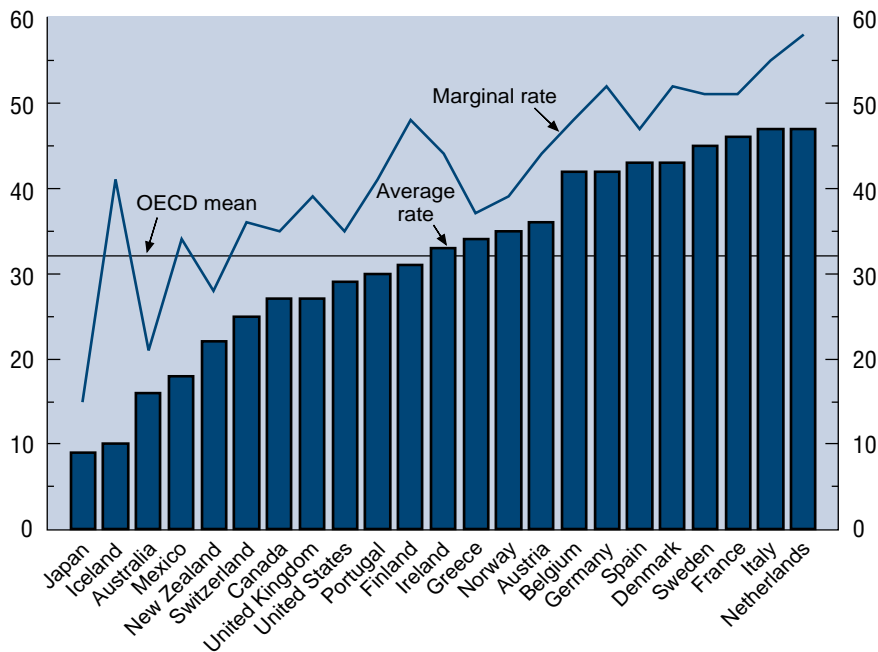
For most of these countries, tight fiscal constraints imply that non-wage labour costs for low-paid workers can only be reduced by some combination of reduced expenditures and tax-switching — or, in view of their costs, by measures that are very carefully targeted. In Canada, Denmark and Germany, it has been argued that revenue-neutral tax-switching may not be a viable option because other tax rates are already very high.

Despite these constraints many countries have taken recent actions in this domain. France has reduced employer social security contributions for youths and other low-wage workers; Belgium has reduced them for youths, low-wage workers and the long-term unemployed; Ireland has reduced them for hires of unemployed who are registered for three months or more; Portugal has reduced them across-the-board by a small amount; France and Spain have reduced them for the long-term unemployed;

Spain has also reduced them for the unemployed hired on temporary contracts, and has eliminated them for youths on apprenticeship schemes. Similar reforms are under consideration in Italy and the Netherlands. In Germany, the government has made a number of reforms aimed at stabilising contribution rates for various social insurance schemes; similar reforms are currently under consideration in Canada. In Denmark, Finland, Ireland and New Zealand, steps have been taken to reduce the marginal effective tax rates faced by low-skilled workers. In spite of these reforms, a high tax-wedge, especially for low-wage workers, remains a particular problem in Belgium, Denmark, France, Germany, Italy, the Netherlands, Spain and Sweden (Chart D).

Minimum wages are another important component of total labour costs for certain workers in some countries. High statutory minimum wages, especially when combined with high non-wage labour costs, can make it very difficult for youths and other low-skilled workers to price themselves into the labour market. Some countries, such as Canada, Mexico and the United States, by not automatically indexing minimum wages, have allowed increases in average wages and inflation to erode their relative importance. Spain

Chart D. **Average and marginal tax wedges in the early 1990s¹**
Single person receiving 66% of an average production worker's income



1. The average wedge is the sum of employees' and employers' social security contributions and personal income tax as a percentage of gross labour costs (gross wages plus employers' social security contributions). The marginal tax wedge is the percentage of any marginal increase in gross labour costs arising as a result of an increase in gross wages which is paid in employees' and employers' social security contributions and personal income tax.

Tax and wage data refer to the following years:

1991: Austria, France, Germany, Iceland, Ireland, Japan and the Netherlands.

1992: Belgium, Finland, Mexico, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland and the United States.

1993: Australia, Canada, Greece, Italy and the United Kingdom.

1994: Denmark.

Source: *OECD Tax Equations*.

has introduced a more direct reform, lowering the minimum wages which firms must pay young workers. France has addressed the problem, though in a less comprehensive manner, by offering a wide variety of exemptions, on condition that training is provided, for different categories of young workers: as a result, the average youth wage in these cases is actually lower than the legal minimum (the SMIC). In Australia, the National Training Wage allows the new workers to receive below entry-level wage rates in return for training opportunities.

A successful *wage formation system* will provide both aggregate wage flexibility, ensuring that real wages are sufficiently sensitive to changes in the unemployment rate, and relative wage flexibility, ensuring that wages appropriately reflect underlying productivity. Aggregate wage flexibility is crucial to the ability of an economy to adjust to shocks. Reforms to increase aggregate flexibility include actions to weaken the automatic adjustment of wages to prices. In Italy, the government has eliminated the automatic indexation of wages in agreement with the social partners. In Belgium, although indexation of wages continues to be practised, the government has removed certain items from the price index used for this purpose. In Mexico, the wage agreement (the “Pacto”) has reduced effective indexation while linking wages to productivity gains. In Greece, indexation has been abolished, although there is a system of mandated wage norms and catch-up clauses.

A number of ambitious reforms have been undertaken in Australia, Italy, New Zealand and Spain which have substantially increased the importance of local conditions in the wage formation process. In Australia, the industrial relations system has moved strongly from centralised wage fixing to bargaining at the level of individual enterprises based on productivity improvements. In Norway, the government is encouraging the social partners to pay more attention to local conditions when striking wage bargains, but it is unclear how effective such exhortation will be. The Netherlands is considering introducing reforms which permit firms and employees to agree to exclude themselves from sectorally negotiated wage minima. Despite the reforms implemented so far, more may have to be done before relative wages in Belgium, Finland, France, Germany, Greece, Italy, the Netherlands, Norway and Sweden have adjusted to a point where relative wage inflexibility no longer constitutes a barrier to hiring low-skilled workers.

Some of the above countries may be unwilling to increase relative wage flexibility because of a strong social preference for an egalitarian income distribution. These countries prefer to put more weight on active labour market policies, including training, to enhance the employment prospects of low-wage workers, youths and the long-term unemployed. Others seek to reconcile the two objectives — increasing relative wage flexibility and maintaining an egalitarian income distribution — by recourse to in-work benefits.

In some countries, relaxing overly strict employment protection legislation will increase the demand for labour, but care has to be taken to strike a balance that will ensure...

The *Jobs Study* recognised that by fostering a longer-term relationship between firms and employees, *employment security*, whether guaranteed by legislation or collective bargaining, encourages firms to invest in their workers’ training, which may lead to higher levels of productivity and earnings for so-called “insiders”. It noted as well that, if these regulations or agreements leave firms feeling obliged to retain workers who are no longer required, they will become more cautious in hiring, to the particular detriment of “outsiders”. The OECD Secretariat analysis has identified Belgium, France, Greece, Italy, the Netherlands, Norway, Portugal, Sweden and Spain as having problems with respect to the strictness of their employment protection legislation. Employment protection rules were particularly strict in Spain and Portugal in the 1980s; both countries have introduced reforms since then to relax these rules.

The *Jobs Study* recommended that governments establish a minimum level of employment protection and permit firms and employees to negotiate additional security when that is deemed to be mutually advantageous. It also advised countries to relax restrictions on fixed-term contracts and other forms of flexible work arrangements, while warning against the possible abuse of such contracts in countries where short contribution periods to unemployment insurance could easily inflate benefit expenditure.

... sufficient security for firms and workers to be willing to invest in long-term training.

Fixed-term contracts, temporary work brokered by private sector agencies and other forms of non-standard work arrangements are an important source of flexibility in highly regulated labour markets. For example, in Spain, an important relaxation of rules concerning fixed-term contracts contributed to a major expansion of employment in the second half of the 1980s (Chart E). Furthermore, evidence from the Netherlands and Germany suggests that non-standard work arrangements often lead to full-time work, while a significant proportion of remaining workers on non-standard contracts indicate a preference for that sort of work.

However, not all reforms have been in the direction of enhancing flexibility. Recently, the Spanish authorities partially reversed the liberalisation of the rules governing fixed-term contracts. Norway and Sweden have tightened further their regulations limiting the use of fixed-term contracts. Regulations restricting temporary work agencies are especially onerous in Belgium, Greece, Italy and Spain.

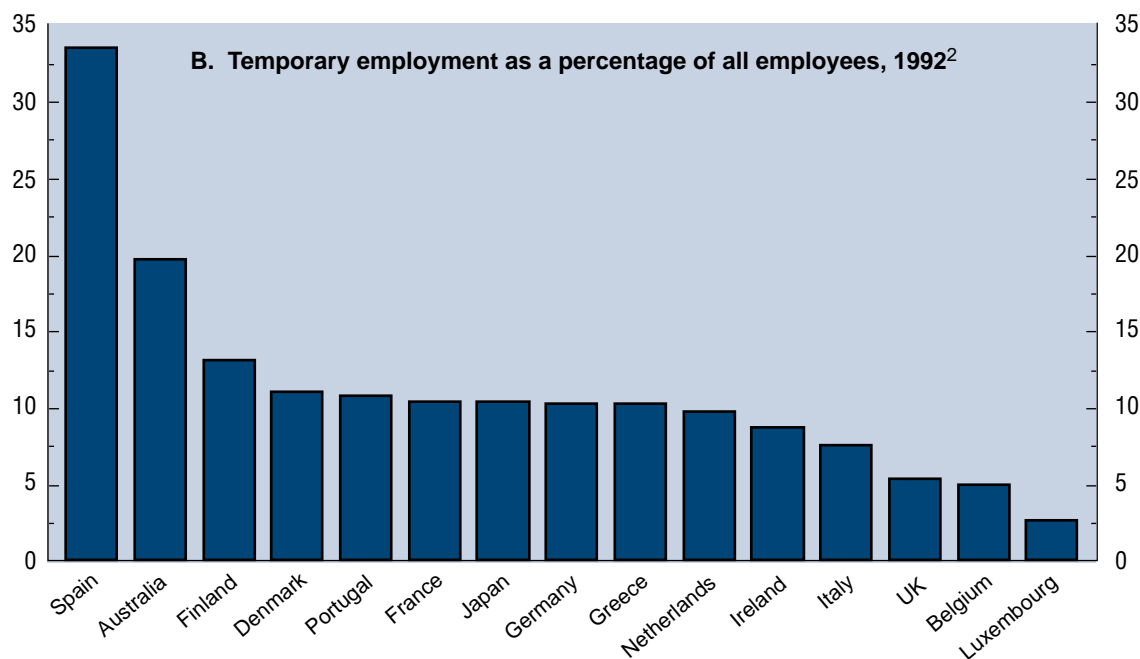
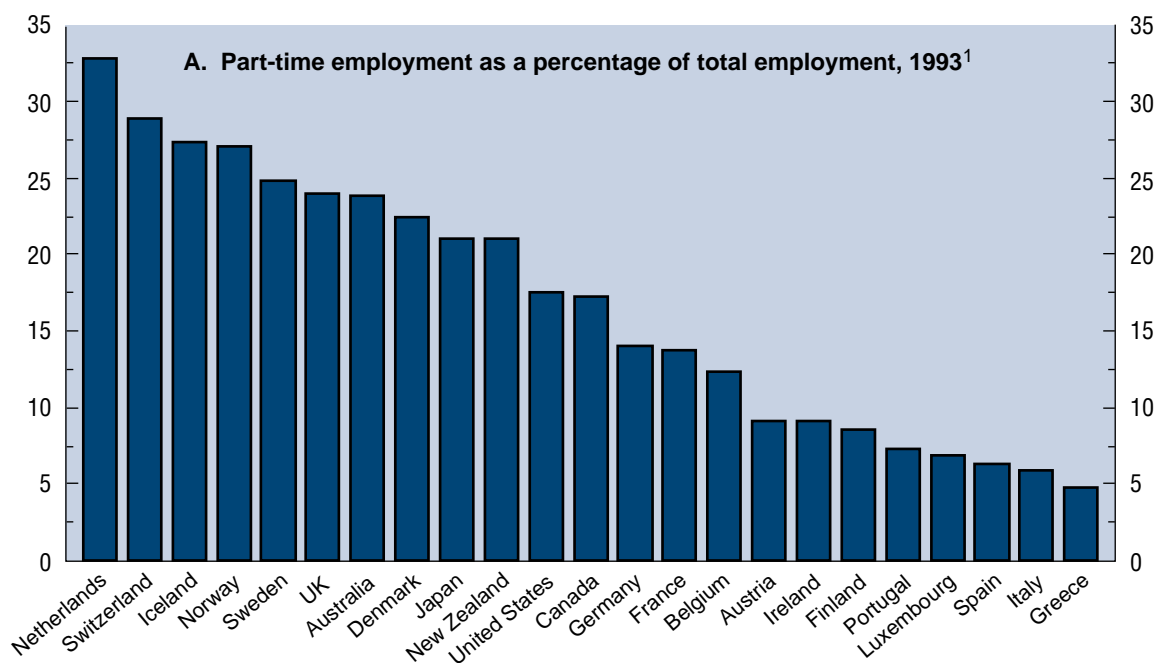
Work currently underway in the OECD Secretariat suggests that enhanced *product market competition* contributes to higher output and employment growth over the medium to longer term. While it is recognised that the structural reforms necessary to enhance product market competition may entail short-term dislocation of labour, over the longer run these policies will reduce monopolistic tendencies, weaken insider-outsider mechanisms and thereby lead to higher levels of overall employment. At the same time, they should also contribute to a more innovative and dynamic economy.

Enhancing product market competition will weaken the market power of firms and insiders and thus assist the unemployed to price themselves into jobs.

A wide variety of government regulations as well as restrictive practices developed by professional groups and industrial associations constitute important barriers to entry in a number of sectors and countries. Such barriers are particularly important in the service sector, where much of the current potential for employment growth is located. Reform efforts are underway in most countries. Some recent examples include: France's *Loi sur l'Initiative Individuelle* has simplified some rules surrounding enterprise creation; in Italy, the Antitrust Authority has dismantled some anti-competitive practices in the provision of private services; the Netherlands has recently prohibited most horizontal price agreements and market-sharing arrangements, and has liberalised shop-opening hours. However, restrictive practices probably remain a constraint on long-run employment growth in most countries.

Considerable government efforts have focused on reducing and simplifying regulations which impose unnecessary burdens on businesses, especially small and medium-sized enterprises (SMEs), and hinder the creation of new ones. Examples include: Australia (re-evaluation of regulations issued by national institutions); Belgium (reduction of regulatory constraints on SMEs); Canada (more than 1 700 federal regulations burdensome to SMEs have been abolished or altered); Germany (recommendations made in the 1990s by various expert groups, to expand the scope for private initiative and accelerate planning and licensing procedures, have been implemented, or are likely to be so in the near future); Mexico (the introduction in 1994 of a single agency to carry out all government requirements to establish an enterprise); the Netherlands (the

Chart E. Incidence of part-time and temporary work in OECD countries



Countries are ranked in descending order of incidence of part-time and temporary work, respectively.

1. Data refer to 1992 for Austria, Belgium, Greece, Italy, Luxembourg and the Netherlands. Data refer to 1994 for Switzerland.

2. Data refer to 1991 for Australia and Finland.

Sources: For Panel A: *OECD Full-time/Part-time Database*;

For Panel B: for Australia and Finland, *OECD, Employment Outlook, 1993*; for Japan, *Annual Report on the Labour Force Survey*; for all other countries, Eurostat, *Labour Force Survey Results 1992*.

“Establishment Act” has been submitted for revision, to reduce barriers to start-up of new firms and expansion of existing ones); Sweden (in 1993 a special inter-departmental committee began work to reduce unnecessary government regulation); and, more recently, a group has been set up by the European Commission to identify unnecessary regulation. The United Kingdom has emphasised the need for deregulation and evaluation of existing regulations to identify those which should be repealed or reformed, and assessments of compliance costs must be published where proposed legislation has impacts on business. In the United States, a 1993 Presidential directive instructed all federal agencies to appoint a Regulatory Policy Officer to develop effective regulations which place minimal burdens on business; there are also guidelines to help federal agencies assess the impact of proposed legislation on SMEs, and to take steps to reduce the burden.

In cases of natural monopoly, privatisation is not sufficient to ensure efficiency; the challenge to governments is to enhance the role of market forces with a minimum of legislation. If government intervention in a sector is still required, a proper regulatory framework should be established that induces the monopoly to improve efficiency while serving public interests at the same time. Competition can also be enhanced in the public sector by making more use of contracting-out, as the United Kingdom is doing as a result of recent legislation, and through the introduction of competition in the provision of certain public services. The Swedish government is enhancing its efforts to increase consumer choice in the provision of educational and health services; Germany and the Netherlands are making similar efforts in the health care sector.

Many OECD countries are improving their competition legislation and strengthening enforcement in order to reduce anti-competitive conduct in the economy. Membership in the EU has led to, or will imply, much stricter competition legislation in Austria, Finland, Ireland, Italy, the Netherlands and Sweden. Iceland, Switzerland and Turkey have initiated similar reforms. The Japanese authorities have also been engaged in numerous initiatives to enhance competition policy; achieving effective enforcement here is particularly important. In Australia, federal and state governments have recently agreed, *inter alia*, to apply competition rules in previously sheltered sectors. Mexico adopted a new competition law in 1993 which could have significant effects.

In addition to these changes in domestic competition policies, increasing trade and the globalisation of activities (including foreign direct investment) also spur competition in product and labour markets, thereby giving an additional stimulus to productivity and innovation.

Increasing the flexibility of working time

The *Jobs Study* concluded that traditional working-time arrangements, which have been enshrined in legislation or collective agreements, may hinder labour market flexibility and, indirectly, job creation. Firms’ labour requirements vary over time and across sectors, both as a function of seasonal and cyclical fluctuations in demand and differences in production processes (most notably as between the manufacturing and service sectors). A single set of rules for all firms or sectors constrains both workers and firms, leading to reduced output and employment. More flexible working-time arrangements, arrived at via decentralised negotiations, allow a better match between firms’ labour requirements and workers’ aspirations — including flexibility desired for family or educational reasons.

More flexible working-time arrangements could enhance job creation and employment prospects, in particular by extending the opportunities for part-time work.

In France, rules concerning maximum weekly hours have been relaxed by a reform that permits firms and workers to agree to annualize working hours, thereby reducing overtime costs and thus the overall costs of employing a worker. In Spain, the 40-hour work week was annualized, minimum overtime compensation rates were abolished, new rules were introduced that permit firms to compensate workers for overtime with time off instead of pay, and a number of restrictive job demarcation rules were, or are being, abolished. A number of countries have also relaxed restrictions on shop-opening hours and week-end work.

Governments can also enhance work-time flexibility by promoting, or removing impediments to, part-time and other forms of flexible employment (see Chart E above). In France, Spain and the United Kingdom, governments now pro-rate — or have reduced — a number of social security charges and other payroll taxes, which in most cases were previously levied on part-time workers at the same rate as for full-time workers.

It is important to distinguish between voluntary work-sharing programmes, often at the enterprise level, which enable workers to reduce their hours worked (with commensurate reductions in pay) and programmes where job-sharing is imposed. There could be beneficial effects on employment, particularly in the service sector, if workers who so desired took their share of any productivity increases in the form of reduced hours rather than higher real wages. On the other hand, state-funded early-retirement programmes and across-the-board work-sharing initiatives, such as legislated reductions in the work week that are not accompanied by adjustment of remuneration to productivity changes, are not viable long-term solutions to the unemployment problem. In both cases, they may reduce labour supply in the short run. But they raise costs of production (either by raising taxes to pay for the retirement benefits or by increasing hourly wages), thereby reducing overall employment levels in the long run. The tax burden imposed by the financing of these additional expenditures also raises taxes on the remaining work-force, reducing work incentives.

Austria, Belgium, Finland, France and Germany are among countries attempting to reverse a trend decline in labour force participation by older workers. In Germany, no new entitlements to state-funded early retirement programmes are being accepted, and it has been decided to raise the retirement age gradually. The French government has repealed most of the provisions that subsidised early retirement. Belgium, Finland and France are expanding possibilities for part-time retirement in order to encourage older workers to combine some retirement income with part-time work, thereby increasing overall labour supply and reducing pension costs. In Italy, the government is attempting to reduce future pension entitlements; this reform would have positive labour market impacts, both in terms of reducing pressures for higher taxes but also by reducing employment disincentives. Governments in Austria, Germany and Norway are concerned that private firms are taking undue advantage of special income-support provisions available to older workers. A number of different reforms have recently been considered, including the claw-back of unemployment insurance benefits paid to workers receiving privately funded early-retirement benefits — which has been adopted in Norway — and an increased targeting of active labour market policies on older workers. Despite the progress that has been made, state-financed early-retirement schemes remain a problem in Austria, Belgium, Finland, Italy, Luxembourg and the Netherlands.

Taxes, benefits, employment and unemployment

Tax and benefit systems not only have an impact on the demand for labour via the tax wedge (see above) but also have major effects on the supply side: *i*) on the incentive to take a job; and *ii*) on the incentive to work harder, improve skills and move up the wages ladder. These incentives are particularly important for low-wage workers.

One crucial factor in the *decision to take a job* is the relationship between disposable incomes in and out of work. The “replacement rate”, the ratio of out-of-work income to net earnings, is determined by the level of benefits out of work, the duration of benefits, potential earnings in work and taxes and social security contributions paid on earnings. High replacement rates can lead to an “unemployment trap”, where there is little immediate financial incentive to take paid employment. Tackling this problem requires a change in the balance between incomes in and out of work. Two options have been behind recent policy changes in a number of countries, and they point to a widespread need for future action.

First, unemployment and related welfare benefits (*i.e.* incomes out of work) could be reduced where they can be considered overly generous. Unemployment benefits can contribute to a well-functioning labour market, by encouraging job search and efficient employee/job matching, but they may also lead to inefficiently long search, thereby contributing to a build up in long-term unemployment. The policy problem is broader than issues of benefit levels or duration: unemployment benefits may be too easily available without concomitant obligations on the recipient to take active steps to re-enter employment. Benefits are relatively generous in some countries, especially for the low paid. In Denmark, Luxembourg, the Netherlands, Spain, Sweden and Switzerland, a married person being paid two-thirds of the earnings of the average production worker would receive 70 per cent or more of earnings in unemployment benefits for a relatively long period if he/she were to lose their job.

Policy initiatives in this area include enforcing job search (while helping individuals to search), restricting the duration of benefits and stressing the insurance role of such benefits. France has reduced both the maximum duration of benefits and replacement rates for the long-term unemployed. Germany, Ireland and Sweden have reduced replacement rates for some groups. The United Kingdom has also altered benefit entitlement for the long-term unemployed and tightened job-search requirements. Belgium and Denmark have recently tightened benefit administration. Belgium, Norway and Sweden have reformed the rules of eligibility for unemployment insurance; Norway is considering further reforms. Canada has reduced both the duration of benefits and replacement rates, and has lengthened qualification periods. The Canadian government has also proposed to restrict benefits for those who claim them regularly. Restrictions on benefit duration and levels have a social cost and can lead to greater reliance on the ultimate safety net of social assistance. In Belgium, France and Luxembourg, payment of certain benefits is linked to active “insertion” measures aimed at helping recipients into the labour market.

Second, net incomes in work could be increased through changes in taxes or benefits. While this could be achieved by generalised cuts in income tax or social security contribution rates or by increases in tax thresholds, these changes would be expensive, as receipts from all taxpayers fall, whatever their employment status or level of earnings.

Tax and benefit systems need to be reformed in ways that raise the incentive to take a job and, once in a job, the incentive to work harder, improve skills and earn more, while at the same time providing a satisfactory level of income support to those in need.

In order to minimise this fiscal cost, changes could instead be targeted on those with high replacement rates by means of employment-conditional tax credits or benefits. Examples of such policies include benefits in Ireland and the United Kingdom, and tax credits in Canada, Mexico and the United States. In most cases, this support is restricted to families with children who generally have higher replacement rates than childless couples and single people. These in-work benefits, which draw the unemployed into low-wage jobs, can be relatively inexpensive because they are phased out as incomes increase.

However, this phasing out, combined with the payment of income and social security taxes, results in *high marginal effective tax rates* which could discourage the work effort of those already employed. For example, in Ireland in 1994, those families with incomes below Irish £185 to £324 per week (depending on the number of children), were entitled to Family Income Supplement. For every pound earned in work, this benefit was reduced by 60 pence. This withdrawal of benefit is effectively a “tax” on the worker. In addition to this “tax”, income tax and social security contributions have to be paid on the increase in earnings, making it possible for the “effective” tax rate to exceed 100 per cent over a range of earnings.

This example illustrates an important policy trade-off here: the cost of encouraging people into jobs through in-work benefits may be that those in employment will face a greater disincentive to increase their work effort and earnings. Empirical studies in the United States suggest that the earned income tax credit will reduce the hours worked of most of those receiving it, but that this will be compensated for by new entrants to employment, increasing aggregate hours of work by a small amount. Policy-makers must be clear about their objectives in this area: given the social and economic hardship which prolonged unemployment can cause, increasing the number of people in employment, especially those with low wages and skills, is desirable in itself.

High marginal effective tax rates on those with low incomes give rise to the “poverty trap”. This is most acute for the increasingly large number of people who have exhausted their unemployment insurance benefits or who receive only payments that are means-tested on family income. In such circumstances, poor families can find themselves with *reduced* disposable income if one member works more. By moving to an individual basis from a family basis for entitlements for income support, and reducing the rate at which various benefits are phased out as income increases, Australia is introducing reforms which eliminate this extreme distortion, while still maintaining a system of transfers targeted to those in need.

Finally, for large groups of people not in work, unemployment benefits account for only a minor part of the income they derive from social benefits. Social assistance, housing benefits, and benefits for lone parents, sickness, disability and early retirement are in many cases individually more important than unemployment benefit. These *other benefits* can have potentially important effects on work incentives too. For example, between 1980 and 1992, the percentage of the working-age population receiving a disability pension rose from 5 1/2 to almost 8 1/2 per cent in Norway; large increases in the numbers getting long-term disability benefits were also recorded in Greece, Ireland, Luxembourg, the Netherlands, New Zealand, Portugal, Spain, Sweden and the United Kingdom. The Netherlands and Norway have introduced recent reforms tightening access to disability benefits; in addition, the Netherlands has tightened controls on those receiving benefits. In Portugal, following changes in the process of determining disability pensions, the number of people receiving them fell in 1993 and 1994.

Active labour market policies

Helping the unemployed to become competitive in the labour market is preferable to providing them only with income support. This general and widely accepted principle is the basic rationale for active labour market policies (ALMPs). If carefully designed and tightly managed, these policies have been shown to help the unemployed overcome difficulties in finding a job and in improving the functioning of the labour market more generally. Yet in the great majority of OECD countries much more is spent on passive income support than on ALMPs (Chart F), and many governments have found it difficult in recent years to accommodate a faster rise in spending on ALMPs or a switch of funds from passive to active measures.

OECD Secretariat country reviews have revealed that ALMPs often suffer from poor targeting and other design problems as well as ineffective delivery and monitoring mechanisms. The public employment service (PES) is the pivotal body in most OECD countries for the implementation of these — as well as passive — labour market policies: its organisation and resource-intensity is often crucial for the overall effectiveness of ALMPs.

Regarding design, many evaluation studies, notably in the United States, have shown that ALMPs targeted on groups with similar employment problems, for whom training contents and methods have been adapted specifically and which are implemented in a near-work setting, are the most effective. On the other hand, large-scale training programmes in a class-room setting which are broadly targeted and cater mainly for prime-age or older workers with poor educational standards, have been particularly unsuccessful. Many youth training programmes suffer, in addition, from the handicap that young people who have dropped out of the education system are difficult to motivate in a learning and class-room setting.

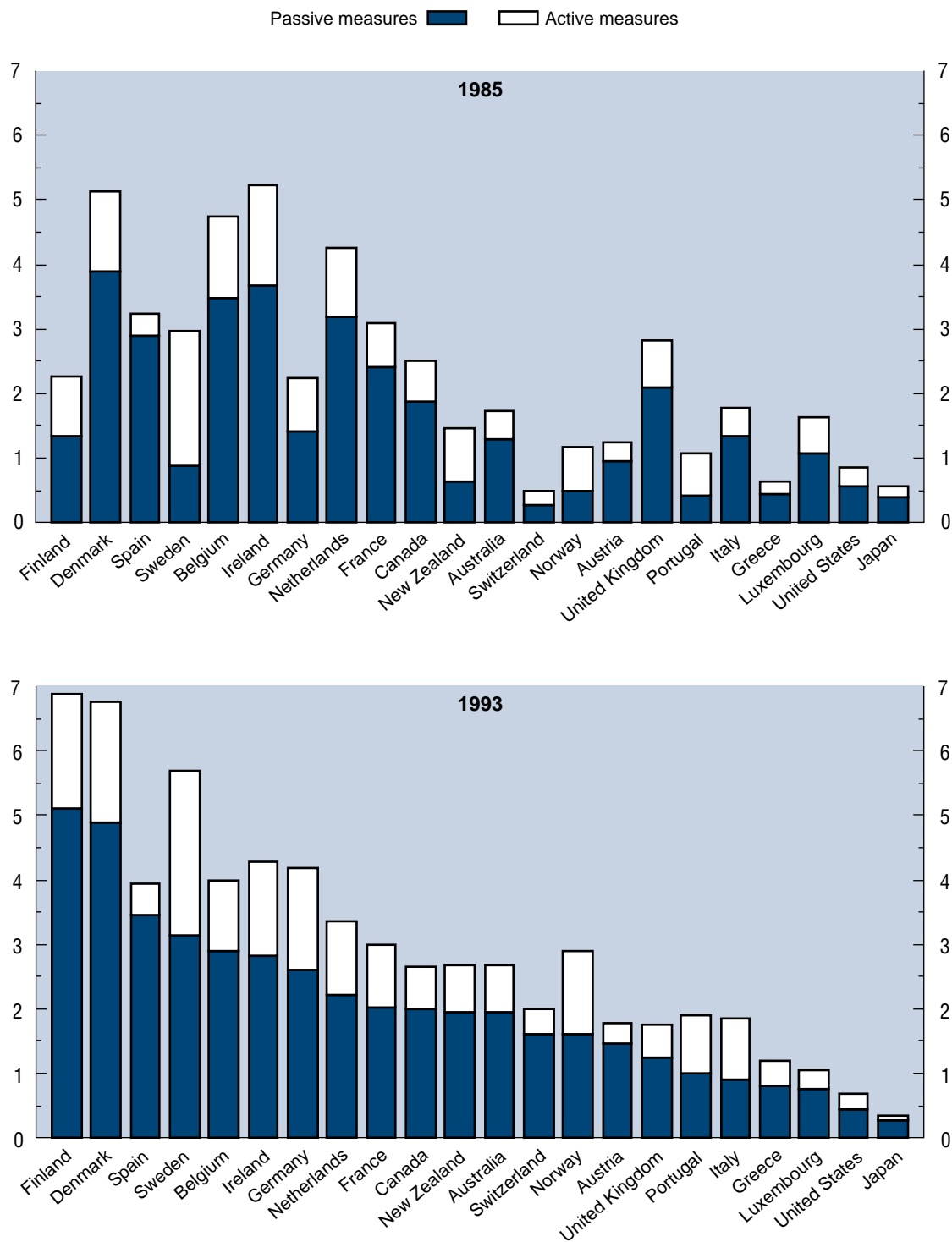
Hiring subsidies to the private sector and temporary employment programmes in the public sector may suffer from displacement and deadweight effects. As with training measures, the best results are obtained if the target groups are relatively homogeneous and if there is a chance that a temporarily-subsidised employment opportunity will contribute to making the programme participants competitive in the open market. Many OECD countries use hiring subsidies targeted on the long-term unemployed, with Australia, Germany, Sweden and the United Kingdom having recently taken new initiatives. It is important that governments monitor such programmes closely to ensure their effectiveness and minimise abuse. In this connection, there may be concern, as suggested by a recent US study, that wage subsidies targeted to a specific group can stigmatise members of that group as being poor employment prospects.

Evaluations show that targeted measures of job-search assistance and counselling, as pioneered by the United Kingdom with its re-start interviews, back-to-work plans and job clubs, have a consistently positive impact on employment and earnings of participants. Such measures are attractive also because they are relatively simple, do not require large resources and mobilise local initiatives.

The PES should be mainly geared towards monitoring and supporting the motivation and job-search efforts of the unemployed who claim income support and, if required, referring them to ALMPs. Effectiveness here is facilitated if the main PES functions — placement, benefit administration and referral to ALMPs — are integrated in the same front-line offices (as is the case in Austria, Germany, Japan, Norway,

Active labour market policies, if properly targeted and managed, will raise the employability of the unemployed, in particular the long-term unemployed who for the most part are unskilled workers.

Chart F. **Expenditure on active and passive labour market measures**¹
As a percentage of GDP



1. Countries are ranked in descending order of their 1993 expenditure on passive measures.
Source: OECD, *Employment Outlook*, 1994.

Spain, Sweden and the United Kingdom) or at least involve close co-operation between the responsible office networks. Insufficiently close co-operation, in particular between placement offices and benefit agencies, is a problem in Belgium, Denmark, Ireland, the Netherlands and the United States. In Finland and France, integration of the benefits system and the PES is considered not possible because the benefit system is administered by the social partners. Nevertheless, the authorities have recently implemented reforms seeking to improve co-ordination and information sharing between these agencies.

The proportion of total PES staff time spent on job-search assistance and counselling tends to be low in most countries. It could be enhanced by reassignment away from tasks of lower priority. For example, in Italy (despite some recent easing) and Spain, a considerable amount of available staff time is consumed by paperwork (notably the compulsory registration of employment contracts) and by national and regional overhead administrations (over one-third of total PES staff in each country). In some Nordic countries, the PES traditionally devotes non-negligible resources to vocational guidance of a general nature which, too, would merit reconsideration.

Another route for improving job-search assistance and counselling is to seek the co-operation of private placement agencies, as practised by the Netherlands and Switzerland. Denmark, Finland and Germany have recently abandoned the monopoly of the PES by permitting private placement agencies to operate. Belgium has recently announced regional measures enhancing the role of private placement agencies. Australia has taken a further innovative step in this area. In order to encourage more effective case management, especially of the long-term unemployed, it has subjected the Commonwealth Employment Service to competition from community and private-sector case managers.

While, in principle, many ALMPs could be administered largely on the basis of objective criteria, such as age or the duration of unemployment, it is more effective, albeit more costly, if PES officers screen applicants so that the broad criteria can be tailored to individual cases, allowing for better decisions on the suitability of particular programme options. Some evidence from the US Employment Service suggests that the individual treatment approach shortened unemployment duration and yielded benefits that greatly exceeded costs. Individual treatment also permits the PES — in the absence of sufficient vacancies — to control work availability and thus benefit entitlements. In Italy and Spain, some of the largest active measures, *e.g.* subsidised hirings through exemptions or reductions of social security contributions, are administered almost entirely on the basis of broad general criteria, with little or no consideration given to individual or labour market circumstances. Benefit sanctions in the case of refusal to participate in ALMPs could be made more stringent in a number of countries; country analysis suggests that this is particularly the case in France, Germany and the Netherlands.

The situation in some of the Nordic countries is also preoccupying although, traditionally, the PES is expected to decide case by case what programme suits a particular client. This task has often been neglected under the pressure of rising case loads; ALMPs, in fact if not in intent, mainly function as a vehicle for re-establishing entitlements to unemployment insurance benefits rather than as a means to getting the unemployed back into paid employment. Motivated by these concerns, Denmark and Finland have recently introduced legislative reforms that give the PES a more pro-active role, requiring that any use of ALMPs be based on individual action plans.

C. Increasing the knowledge base and innovative capacity

Upgrading skills and competences

Over the longer term, reforms in the areas of education, school-to-work transition and training will be essential to ensure that workers have the skills and competences needed to help them find well-paid jobs and to underpin long-term growth.

The Jobs Strategy accords a high priority to the upgrading of skills and competences, which are currently deficient in a number of respects. Overcoming these deficiencies necessitates actions across a wide range of areas, involving in particular: the quality of early schooling, including early childhood development; the transition from school to work; and investment in work-related skills.

Pre-school and early childhood development programmes should be an integral part of a longer-term, preventive strategy to reduce school failure. It is particularly important to ensure that children from disadvantaged backgrounds have equal opportunities to participate in these programmes. The evidence suggests that early childhood interventions of high quality can pay large dividends later on. Thus, it is disappointing that increases in participation in such programmes have been slow in many countries in recent years.

Although completion rates from *initial schooling* have increased since the 1980s, about 15 to 20 per cent of young persons in most OECD countries still leave school with no qualification. Strategies for combating school failure have focused on diversifying upper secondary education to meet a wider spectrum of learning needs and student preferences. Recent actions in this vein include targeting pupils with learning disabilities (Belgium), curriculum reforms aimed at overcoming inequities across different socio-economic groups (Ireland), changes in governance providing for greater school autonomy and involvement of parents and industry in new partnerships (Portugal), and the establishment of content- and performance standards (Australia, Canada, the United Kingdom and the United States).

High youth unemployment rates (see Table 1) indicate continuing problems with the *school-to-work transition* in most countries. Countries are following three principal approaches to improve the transition: *i*) augmenting the supply of high-quality vocational and training opportunities and redressing the balance between technical and academic education; *ii*) creating frameworks for the assessment, recognition and certification of training; and *iii*) introducing co-financing arrangements to better align the sharing of costs and benefits.

Efforts to increase the supply of vocational skills have to be seen in the context of the increased participation rates in upper-secondary and tertiary education during the 1980s and early 1990s, which were concentrated in academic studies. To redress this academic bias, countries have attempted to strengthen upper secondary and post-secondary vocational studies (France), create or reinforce apprenticeship-style training (Australia, Canada, France, Italy, Portugal, United Kingdom, and the United States), and increase the capacity for advanced technical studies by developing tertiary-level polytechnic institutions (Austria, Finland and Switzerland). A major thrust of new policy initiatives is to make the university system more flexible and responsive to the emerging needs of the economy. Countries have upgraded their more technically-oriented higher education institutions into universities (Australia and United Kingdom), fostered institutional autonomy and competition between polytechnics as well as between private trainers and university (New Zealand), and made it easier for students to move between the apprenticeship system and tertiary studies (Germany).

Several countries have launched initiatives to improve the visibility, relevance and marketability of vocational and technical education. Australia has established the Australian Qualifications Framework which provides a nationally consistent yet flexible framework for all post-compulsory qualifications. New Zealand is implementing a single national framework for the recognition of school, vocational and higher academic qualifications. The United Kingdom has introduced a system of General National Vocational Qualifications to award upper secondary completion certificates for a combination of academic and vocational studies, and a National Vocational Qualification for training that meets agreed workplace standards. Germany has attempted to put qualifications for part-time vocational studies on an equal footing with those from intermediate general education, and university entrance certificates are being awarded from vocational institutions. Japan has taken steps to ensure that qualifications acquired in special training schools can be recognised and given credit by the universities. Canada has established a system for the recognition of prior learning on the basis of testing. But these steps, while promising, are still rather modest in relation to the perceived need to enhance the recognition of skills and competences and ensure their value within the education system or on the labour market.

Countries are also experimenting with new forms of co-financing, *i.e.* sharing the cost of expanded provision of education and training between the public purse, employers and students/trainees. An example of this co-financing is Australia's National Training Wage noted above.

Some countries are also seeking ways of ensuring that students pay more of the costs of investing in higher education. Australia has introduced an income-contingent loan scheme, covering approximately one-fifth of the average cost of a course, with the loan being paid back through the tax system when the graduate's income exceeds a certain threshold. New Zealand is reducing the public share of support for tertiary institutions. The Netherlands is moving towards a system where students pay a larger share of tertiary education costs. Aside from these initiatives, there has been little progress towards co-financing arrangements in other countries, despite considerable increases in tertiary enrolments. Finland, for example, now aims to double tertiary enrolments by the end of the decade, with no student fees.

In a context of *life-long learning*, the evidence suggests that on-the-job-training typically produces higher rates of return than public training programmes. But private firms are extremely reluctant to invest heavily in training low-skilled workers: the least-qualified adults are typically only a quarter to a third as likely as highly qualified adults to participate in job-related continuing education and training. Training levies, according to the evidence from Australia and France, have not had major impacts in increasing training opportunities for the least-skilled workers, in part because they are frequently taken up by the more skilled members of the labour force.

Public programmes have a mixed record in compensating for this lack of investment in training the least skilled. Only if carefully targeted and monitored have programmes for groups such as displaced unskilled workers, the long-term unemployed and social benefit recipients been found to increase employment prospects and future earnings — such results have been reported in some studies for Canada, Norway and Sweden. But other programmes in Germany and the Netherlands showed no net impacts. One of the few studies to estimate cost-effectiveness reported good results in the United States, though not in providing basic remediation, a necessary condition to assist the most unskilled adults. But, even where they prove to be effec-

tive, such programmes generally have limited overall impact on enhancing the employment and earnings prospects of the least-skilled workers because of their small size relative to existing needs.

Technology and innovation

Appropriate use and diffusion of technological development and innovation are also crucial to sustained improvement of economic performance, national wealth and employment over the long term.

Historically, innovation and technological development have been at the root of economic progress, increasing national wealth and expanding employment. Hence, it is reasonable to expect that the current advance of technology and innovation will have similar impacts. However, there is a growing gap between those who believe in the growth and employment potential of new technologies, and large parts of the public which are more sceptical regarding such potential. This scepticism implies that more extensive assessment of the linkages between technology and jobs is needed to inform policy choices.

Work to reinforce the analytical basis of this assessment is underway in the OECD Secretariat. Preliminary results from this work point to the strategic role of new knowledge, in the form of advanced technologies, information infrastructure, and other forms of innovation, in fuelling economic growth and job creation, and the essential role of government in establishing an economic climate that fosters competitive markets, innovation and knowledge diffusion in firms and among workers.

Specifically, the evidence indicates that, while economy-wide productivity gains from the new technologies have been limited and slow to materialise, successful innovative firms exist in all sectors of the economy. Technology and innovation are important components of successful strategies for such growing firms, thereby making a critical contribution to economic growth and job creation.

The full benefit of science and technology cannot, however, be realised without complementary changes in the organisation of work and production. Such changes appear to shift the balance of advantages towards smaller operating units. This has reinforced interest in the role of new, mainly small and medium-sized enterprises in employment creation. Policy can foster an environment supportive of the success of such firms by *inter alia* encouraging: regulatory reform; greater entrepreneurship; open markets; and the diffusion of technology and innovation throughout the economy.

To maximise the benefits of advances in knowledge, a wide range of policies and practices may also have to be altered including: corporate governance; intellectual property regulation; capital market structure; education and training policies; forms of work organisation; and other policies and practices that affect how firms turn new knowledge into innovation and innovation into growth and job creation. One aspect of this is a need for governments to put in place a framework to accommodate and facilitate the development of global information flows.

Technological change contributes, among other factors, to the growing gap in the relative demand for skilled and less-skilled labour. Recent advances in technology must be complemented by the education and training policies discussed above which would ensure effective upskilling. This, in turn, would make a major contribution to defusing the public scepticism towards the new technologies.

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