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## **Boosting Jobs and Incomes**

***Policy lessons from the Reassessment of the OECD Jobs Strategy***

***(Background paper prepared by the OECD Secretariat)***

## **BOOSTING JOBS AND INCOMES: POLICY LESSONS FROM THE REASSESSMENT OF THE OECD JOBS STRATEGY**

### **Introduction**

OECD countries have made some progress in increasing employment and reducing unemployment since the first Jobs Strategy was launched in 1994: the OECD average employment rate rose by 1½ percentage points to 65.5% in 2005 and the average unemployment rate fell by around one percentage point to 6½ %. The employment battle is not over, however. For one thing, progress has been uneven across countries. In particular, the unemployment rate remains stubbornly high in several large European countries. In addition, not all segments of the working-age population have benefited equally from the improvement in labour market performance. Some groups –youth, women, older, less skilled workers and immigrants – continue to face significant difficulties in the labour market.

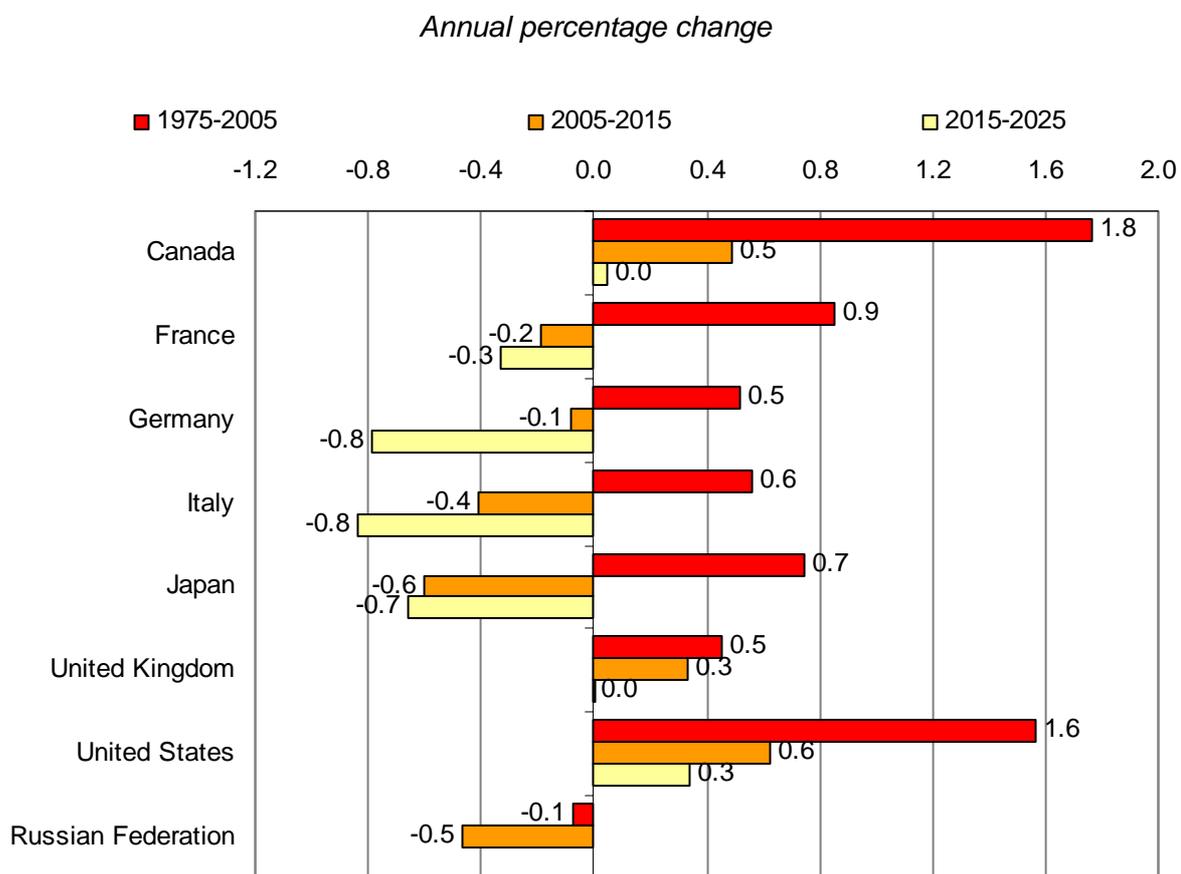
More fundamentally, population ageing represents significant challenges to labour markets. Indeed, in the absence of new measures, substantial falls in the number of persons participating in the labour force relative to the number of inactive persons are projected for a number of OECD countries in coming years. Over the next decade, labour force growth is likely to decelerate in all G8 countries and could even decline in absolute terms in France, Germany, Italy, Japan and Russia –significantly so in the latter two countries (Figure 1).

To maintain the growth in living standards in the face of population ageing, G8 countries need to raise employment rates. In order to achieve this, most will have to improve the employment prospects of older workers, as well as other under-represented groups. Success on this front would improve well-being (as remaining active longer is associated with better health in old age), as well as living standards.

Globalisation is another major factor shaping OECD labour markets. Economic history demonstrates that international economic integration holds the promise of higher economic growth and welfare creation. For such gains to be realised, firms and workers need to be able to take advantage of, and adjust quickly to, changes brought about by technological advances and

globalisation. Such adjustment pressures are likely to intensify over the coming decades as large labour-rich countries, such as China and India, become better integrated in the world economy.<sup>1</sup>

**Figure 1. Labour force growth with unchanged participation rates after 2005**



Source: OECD Demographic and Labour Force Projections database. Estimates and projections for Russian Federation are from ILO.

In short, progress achieved in restoring full employment has been uneven and population ageing makes action to improve labour market performance more urgent. Further reforms would also help reap the benefits of globalisation while minimising the cost of adjusting to change. It was against this backdrop, and the desire to take stock after a decade's experience, that OECD Labour and Employment Ministers requested the OECD in late 2003 to revisit the Jobs Strategy.

<sup>1</sup> ILO (2006) discusses emerging global employment patterns in the context of globalisation.

The restated Jobs Strategy was welcomed by OECD Ministers when they met in Toronto in June 2006.<sup>2</sup>

The key lesson from the restated OECD Jobs Strategy is that it is vital for improved labour market performance of OECD countries to build upon four pillars: i) setting appropriate macroeconomic policy; ii) reforming tax-benefit systems to remove impediments to labour-market participation and stimulate job-search; iii) adapting labour- and product-market regulations to changing demand requirements, while also addressing the risk of increased labour market dualism and social exclusion; and iv) facilitating the development of labour force skills and competencies. This note summarises the main insights and policy lessons yielded by the reassessment of the OECD Jobs Strategy for each of the four pillars. It also stresses that there is no unique “one-size-fits-all” way of building up the different pillars, although the emphasis on a stable macroeconomic framework and open product markets is widely shared.

### **Pillar 1: Sound macroeconomic policy supports good labour market performance**

Sound macroeconomic policy management contributes to sustain economic growth and employment. Policies that result in price stability and sustainable fiscal positions are reflected in lower interest rates, which in turn stimulate investment, with beneficial effects for economic growth.

Macroeconomic policy can also help reduce the extent to which increases in unemployment as a result of adverse shocks become permanent. Fiscal stabilisation is particularly important in countries that do not have national monetary policy. However, to allow fiscal policy to play a role for stabilisation purposes, it is necessary to have overall sound public finances, which has unfortunately not been the case in many OECD countries in recent years.

And ensuring that aggregate demand is not allowed to deviate too much from aggregate supply may also make people more receptive to reforms. It is therefore important that macroeconomic policy takes into account progress in the reform of product and labour markets.

### **Pillar 2: Removing impediments to labour market participation and job search**

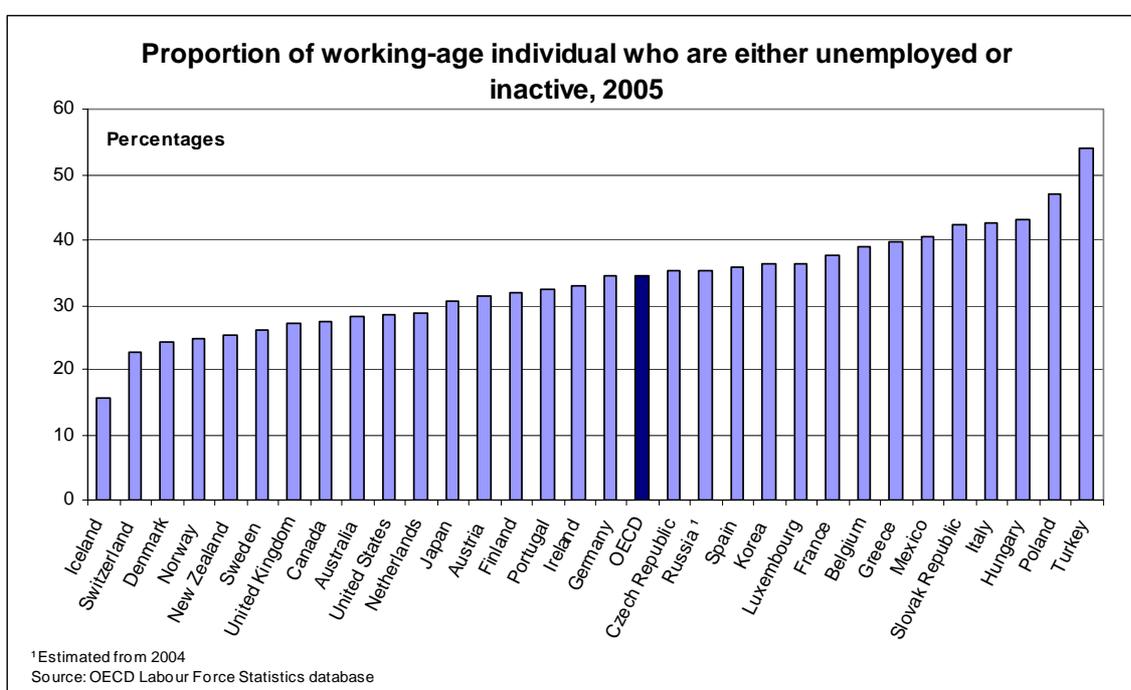
Approximately one-third of the working-age population remains unemployed or inactive in OECD countries, on average (Figure 2). Among G8 countries, Canada, Japan, the United

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<sup>2</sup> The new recommendations of the restated OECD Jobs Strategy are presented in OECD (2006a) and the background analysis in OECD (2006b). For the first Jobs Strategy, see OECD (1994).

Kingdom and the United States have lower non-employment rates than average, while the opposite is true for France, Italy and Russia. But, in all G8 countries the bulk of the non-employed are so-called “inactive”, and this is a very heterogeneous group comprising in particular housewives, full-time students, early retirees and the long-term sick and disabled. Surveys reveal that many of these inactive individuals can work and wish to work, should the right conditions exist. Therefore, it is important to remove the barriers hindering many of the inactive from working. One way to do this is via an effective welfare-to-work strategy.

**Figure 2. Non-employment rates in OECD countries and Russia**



*Promoting transitions from welfare to work*

This requires ensuring that welfare benefits are well designed –the role of welfare reform is all the more important because, in OECD countries, the majority of the non-employed receive a welfare benefit. This does not necessarily mean cutting benefits to encourage people to work, though this may be necessary in certain circumstances<sup>1</sup>. Indeed, while there is evidence that high and long-lasting unemployment benefits tend to increase unemployment, cutting benefit levels and shortening entitlement periods could run counter to social goals that some countries have chosen to pursue. In this respect, new evidence suggests that innovations in the design of benefit

systems, combined with intensive assistance to jobseekers and stronger obligations for them to search for jobs and accept job offers, can allow reasonably generous benefits to be maintained while achieving low unemployment and high labour market participation. These innovations include activation policies to ensure that the unemployed look actively for work and are encouraged to find new jobs. Recent emphasis on such policies in Germany and France is welcome.

A strategy of so-called “mutual obligations” for government and jobseekers in activation policies has played a central role in this respect. Within this framework, jobseekers have the right to effective re-employment services, counselling, training and financial incentives to enable them to find work. But they also have the obligation to take active steps to find work or improve their employability, or else face the risk of moderate benefit sanctions.

The restated Jobs Strategy recommends extension of this “mutual obligations” approach to recipients of other non-employment benefits, like sickness, disability, social-assistance and lone-parent benefits, as well as tighter access to these benefits. This is essential, since experience shows that there is a risk that progress in reducing unemployment goes hand-in-hand with increases in the number of people on other non-employment benefits. For instance, the number of beneficiaries of long-term sickness and disability benefits is on the rise in several low-unemployment countries, like the United Kingdom and the United States.

There is also a case for complementing mutual obligations with tax-benefit reforms to ensure that work is financially attractive, thereby reducing the risk of in-work poverty. This can be achieved through the provision of in-work benefits such as the Earned Income Tax Credit in the United States, the Working Families Tax Credit in the United Kingdom and the Prime pour l’emploi in France. Recent evidence suggests that, if combined with other measures and well-targeted, the provision of such in-work benefits promotes re-employment prospects of jobseekers and attenuates in-work poverty. Minimum wages may offer a useful complement to in-work benefits, in helping make work pay, if set at appropriate levels.

And family-friendly policies, such as the availability of child-care support and removing obstacles to part-time employment and other flexible working arrangements, may facilitate participation of certain groups and promote transitions from welfare to work.

However, these measures can entail large fiscal costs resulting in higher taxes and/or cuts in public spending which, in turn, may have negative impacts on economic growth and employment

prospects. For a mutual obligations/activation strategy to succeed, all of the component measures need to be well-designed and implemented, with a major focus on cost-effectiveness.

### *Encouraging under-represented groups into work*

The restated Jobs Strategy emphasises the importance of raising the labour market participation of under-represented groups. Employment rates among women, older-workers, youth and the unskilled are much lower than for prime-age men (Table 1). Several policy directions are put forward to pursue this objective:

**Table 1. Employment rates for prime-age men and under-represented groups, 2005**

	Prime-age men (25-54)	Prime-age women (25-54)	Older workers (55-64)	Low-skilled <sup>2</sup>	Youth (15-24)
Canada	86.1	76.5	54.8	57.1	57.8
France	86.6	72.7	40.7	59.6	26.0
Germany	83.7	71.0	45.5	48.6	42.6
Italy	86.6	57.9	31.4	51.6	25.5
Japan	92.1	65.7	63.9	66.7	40.9
United Kingdom	87.6	74.9	56.8	53.0	58.1
United States	86.9	72.0	60.8	56.5	53.9
Russia <sup>1</sup>	84.4	79.7	40.1		31.1
G8 (unweighted average)	86.7	71.3	49.3		42.0

1) Estimates for November 2004

2) Persons aged 25-64, men and women, 2004

*Source:* OECD Labour Force Statistics database and OECD, *Education at a Glance 2006* (for data on low-skilled employment). Data for Russian Federation are labour force survey estimates from Goskomstat and ILO Laborsta websites.

- For *older workers*, the financial advantage of continued work against early retirement and drawing an old-age pension can be low or nil. In order to increase incentives to work, a number of countries have tightened eligibility to early retirement and invalidity schemes. Others have done the same with unemployment benefit provisions for older workers, who have an extended duration of unemployment benefit receipt in many OECD countries and are often exempted from job-search requirements. There have also been moves to reform old-age pension systems to make continued work at older ages more financially attractive. These changes, important as they are, need to be accompanied by legislation against age-discrimination, measures to eliminate

mandatory retirement and steep age-earnings profiles, and efforts to promote the benefits of age diversity in the workplace. Greater access to training in a lifetime perspective would reduce the risk of skills being eroded with age, and more flexible working-time arrangements as well as better working conditions would also facilitate postponed retirement.<sup>3</sup>

- *Women's* rising labour market participation has been a major component in labour supply growth during past decades. However, future increases may have to rely more heavily on reforms aimed at reducing financial disincentives for women to work and encouraging family-friendly employment practices (see above). For instance, based on taxation of second workers in families, married women are effectively taxed more heavily than men and single women in most OECD countries. In this respect, OECD research suggests that equal tax treatment of second earners would increase women's participation by four percentage points on average for the whole OECD. In addition, paid maternal leave, on condition that the period is not too long, and childcare support, as well as tax reform that increases incentives to work part-time, are all likely to increase significantly the employment rate of women.
- Many *young people* face significant problems in their transition from school to work. An effective approach has been sustained intervention to avoid early school failure, sometimes starting before the compulsory school age. There is also evidence that countries where education alternates with work experience tend to have low youth unemployment rates. Outside the education system, targeted active labour market programmes can play an important role, but their impact needs to be evaluated and monitored closely, especially in terms of their ability to help the most disadvantaged youth find a job.

### **Pillar 3: Tackling labour- and product-market obstacles to labour demand**

While tax and welfare reforms facilitate labour market participation, it is equally important that policy allows labour demand to expand so as to accommodate higher supply.

First, while there is no empirical association between employment protection legislation and total unemployment, overly strict regulations may hamper labour mobility, reduce the dynamic

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<sup>3</sup> The main findings of a thematic review, covering 21 countries, on policies to improve employment prospects of older workers can be found in OECD (2006c).

efficiency of the economy and restrain job creation, especially for so-called “outsiders” on the labour market (youth, unskilled, some women). Partial reforms, such as reducing protection on fixed-term contracts while leaving protection of permanent contracts unchanged, which has been the preferred approach in most OECD countries, may exacerbate labour market duality, reduce productivity growth and aggravate social inequalities.

But recent innovations show that legislation can be designed in a manner which protects workers without harming the employment of the most vulnerable groups in the labour market. This includes making legal procedures governing dismissals more predictable and “flexicurity” – an approach that facilitates hiring and firing decisions while also providing efficient re-employment services and income support to those who have lost their jobs. Replacing severance payments with individual saving accounts, such as those introduced in Austria recently, may also prove to be a very useful innovation in this area.

Second, it is crucial that real wages adjust flexibly in response to supply- and demand-side pressures. This is an area where the mechanisms through which employers and employees negotiate matter. Indeed, both decentralised and centralised collective bargaining often result in good employment performance. On the other hand, sectoral types of bargaining are often less effective. In countries where such bargaining arrangements have limited employment prospects for certain groups, the restated Strategy recommends that the practice of extending collective contracts should be reformed and that the social partners directly involved should be given greater scope to set wages at the local level. Recent developments suggest that a moderate legal minimum wage generally does not undermine employment, but also that adequate allowance for wages below that level for youth and possibly other vulnerable groups is essential.

Third, there is strong empirical evidence that high payroll taxes and social charges, especially when combined with high minimum wages, reduce employment significantly, especially among low-productivity workers. Tax reform to promote work incentives of low-wage workers should be implemented as an integral part of a sound fiscal and tax framework conducive to economic growth.

Finally, a new consistent analytical finding in OECD work over the past decade is the perverse employment effect of anti-competitive product-market regulations. Such practices are found to hamper the creation of new businesses in sectors where there is strong potential growth. More generally, they keep prices artificially high and therefore depress average real wages for the economy as a whole. By restricting output, they tend to reduce employment levels

in the affected sectors, except when a protected environment allows over-staffing to be maintained, and labour demand may be further reduced if wages in these sectors contain an element of product-market rents. There is further scope for improving labour market performance by lowering domestic barriers to market entry, notably in the service sectors, reducing restrictions on foreign trade and investment, and addressing administrative hurdles and costs to business creation. In addition, addressing legal impediments and administrative hurdles to setting up new firms, as well as ensuring that small firms have adequate access to credit, would nurture an entrepreneurial climate.

#### **Pillar 4: Ensuring that workers have the right skills**

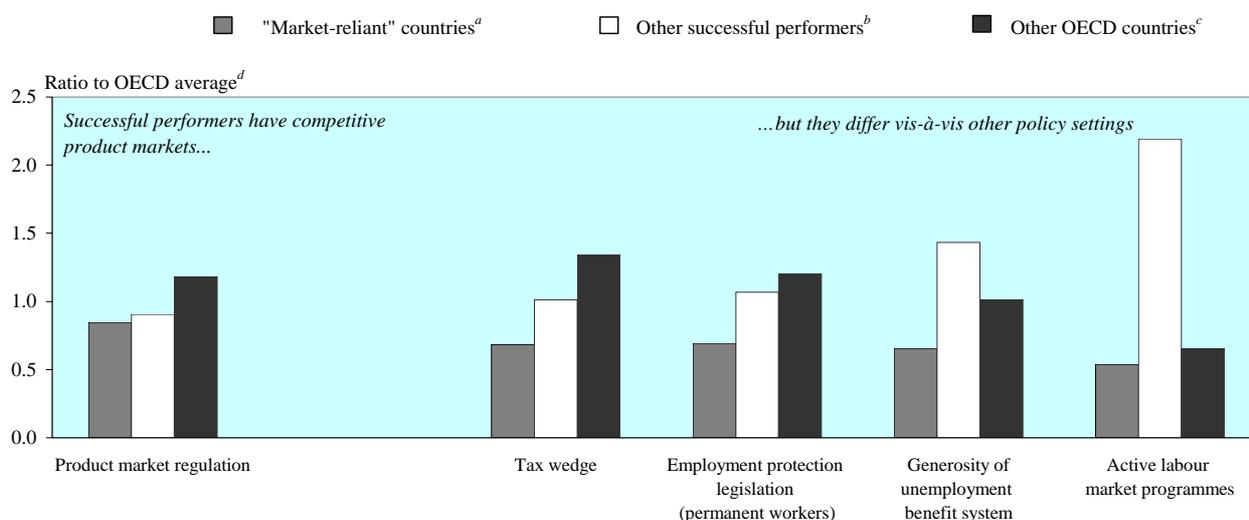
The restated OECD Jobs Strategy stresses the contribution that lifelong learning can make to support high economic growth, while also reducing poverty and mitigating inequality. Trained workers have better employment prospects than those who have not received training. Also, training makes it easier to move from temporary work arrangements into stable employment. But access to training is distributed very unequally over the adult workforce in all countries: those people with the least education and skills participate much less in training.

The OECD has found that well-designed systems of recognition of skills, career guidance, information on the content and outcomes of the courses on offer, and performance monitoring of training providers may help ensure that the training market works well. In addition, public support has been found to be more efficient when it is matched with a contribution from the recipient firm or individual, in other words when there is an element of *co-financing* of training. And training leave may help reduce time constraints on participating in such activity, especially for disadvantaged groups. Where this is consistent with national practice, the active involvement of social partners in designing and implementing lifelong learning policies can help make the programmes successful.

#### **Different roads to good labour market performance**

The restated OECD Jobs Strategy highlights the possibility of different reform packages (Figure 3).

Figure 3. Countries have pursued different policy packages



Note: The indicators shown in this figure refer to 2003; 2002 for active labour market programmes.

a) Includes Australia, Canada, Japan, Korea, New Zealand, Switzerland, the United Kingdom and the United States. The average employment rate for this group in 2003 was 70.9%.

b) Includes Austria, Denmark, Ireland, the Netherlands, Norway and Sweden. The average employment rate for this group in 2003 was 71.9%.

c) The average employment rate for this group in 2003 was 61.2%.

d) For each of the indicators, OECD average is equal to one.

Source: OECD (2006), *OECD Employment Outlook*, Chapter 6, Paris.

On the one hand, several successful performers combine low levels of welfare benefits and limited taxation to fund these benefits with light employment protection legislation. Collective agreements play a limited role in these countries. The result is high employment rates, achieved at a low cost for the public purse, but also relatively wide income disparities. On the other hand, other successful countries, characterised by a strong emphasis on co-ordinated collective bargaining and social dialogue, offer generous welfare benefits but activate jobseekers by providing training opportunities and other active labour market programmes. In these countries, employment regulations are more restrictive than is the case with other successful performers. These countries have achieved high employment and low income disparity, but at a high budgetary cost. There is also concern about insufficient incentives to work longer hours in some of these countries.

A common feature of the two different packages is an emphasis on macroeconomic stability and strong product market competition. In addition, most of the successful countries provide strong job-search support.

### What lessons for the future?

The four pillars of the revised strategy will need to be implemented in a manner that is consistent with national institutions and practices. There may be strong resistance to introducing

some of the recommended policies but the cost of inaction will be continued unsatisfactory labour market performance and failure to realise the potential for raising living standards, at a time when they will come under strong downward pressure from ageing populations.

The successes achieved by some countries over the past decade show what can be achieved if there is sufficient political will to reform.

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