Boosting Jobs and Incomes

POLICY LESSONS FROM REASSESSING THE OECD JOBS TRATEGY
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Foreword

In 1994, OECD countries endorsed a set of policy guidelines intended to cut high and persistent unemployment – the OECD Jobs Strategy. For a decade, this groundbreaking work became an influential blueprint in the reform process of member countries. In 2003, the Employment and Labour Ministers asked the Secretariat to reassess the Jobs Strategy in light of new evidence and emerging challenges. Given the critical importance of well-functioning labour markets for good economic and social outcomes, my predecessor as Secretary-General, Donald Johnston, assigned a very high priority to this mandate which was completed under his stewardship.

This report, together with the background analysis published as the 2006 edition of the OECD Employment Outlook, responds to such ministerial request. It puts forward a restated OECD Jobs Strategy with a comprehensive set of policy recommendations covering macroeconomic management, incentives to work and to create jobs, taxes and welfare benefits as well as skills development.

The OECD countries have a lot to gain from implementing the new recommendations emerging from this reassessment, in terms of improved labour market performance and social progress. This will also contribute to strengthen the capacities of our societies to adapt and change, and to meet the challenges posed by globalisation and population ageing. The report highlights the need for the restated jobs strategy to take into account national social preferences and circumstances. There is no single road to better labour markets. But it is essential that each country undertake a coherent policy package.

I believe that countries which will take action along the lines of the restated OECD Jobs Strategy will be rewarded by a stronger labour market and, most importantly, improved living standards.

Angel Gurría
OECD Secretary-General
BOOSTING JOBS AND INCOMES

Policy Lessons from Reassessing the OECD Jobs Strategy

The time is ripe to reassess the 1994 Jobs Strategy in light of new challenges

In the mid-1990s, the OECD formulated a set of policy recommendations intended to reduce joblessness and improve labour market performance. This took place against the background of sharp rises in unemployment over several decades. The ten broad recommendations in the OECD Jobs Strategy (see the Annex) constituted a wide-ranging programme to tackle the key challenges of that period. A decade later, the time has come to take stock of whether these policy recommendations have proved effective and how they might need to be revised and extended to respond to new challenges.

The challenges faced by policy makers in most OECD countries concerned with improving labour market performance have widened. The original Jobs Strategy focused mainly on ways to cut high and persistent unemployment. While this is still an important unfinished task in many countries, removing barriers to labour market participation has become the key priority, made more urgent by the need to limit the adverse consequences of population ageing. A further key challenge is to ensure that people and firms are able to take advantage of, and adjust quickly to, changes brought about by technological advances and globalisation. Such adjustment pressures may intensify in the future as large labour-rich countries, such as China and India, become better integrated in the world economy.

The reassessment in this report concentrates on the original policy recommendations most directly related to the functioning of the labour market. The part of the original Jobs Strategy that has not been included in this reassessment, namely recommendations to enhance the creation and diffusion of technological know-how, remains important and has been reviewed recently in detail in the OECD Growth Study. Indeed, the policy recommendations contained in that study and in the Going for Growth publications are important complements to this reassessment.

This report first gives an overview of labour market performance since 1994 (Section I), and then reviews the new insights gained from analyses and experiences of what works and what does not (Section II). Informed by this analysis, a revised subset of the original policy recommendations is then presented at the end of the report as the Restated OECD Jobs Strategy.

1. This report is based on analyses presented in the OECD Employment Outlook 2006.
I. Facts and emerging challenges

The trend increase in unemployment has been arrested or reversed in many OECD countries

Over the past decade, the trend increase in unemployment has been arrested or reversed in many OECD countries (Figure 1). In a few countries, notably Ireland, Finland and Spain, unemployment has fallen sharply. Significant reductions have also taken place in a few other English-speaking countries and Nordic countries, in some cases bringing the rates to levels last seen in the early 1970s. However, in the two largest continental European countries, unemployment has remained stuck at high levels. It has risen in some central and eastern European countries, and, from low levels, in Asian member countries.

Countries are ranked in ascending order of unemployment rates in 2005.
a) Refers to the persons aged 15 and over. Data come from Labour Force Surveys.
b) 2003 for Austria.

Employment and participation rates have also risen

Perhaps a better indicator of the improved labour market performance over the past decade is that employment rates have increased in a vast majority of OECD countries (Figure 2). Employment increases reflected both lower unemployment and higher participation rates, and in a few countries employment rates have increased, even if unemployment has risen. However, employment rates differ markedly across countries, from below 60% in Italy, Hungary, Poland, the Slovak Republic and Turkey, to over 75% or more in some Nordic countries, New Zealand and Switzerland.
The main beneficiaries of improved labour market performance have not been prime-age men, who in any case had very high employment rates in all countries in the early 1990s, but rather two groups that have traditionally been under-represented in the labour market (Figure 3):

- **Female participation** rates have generally continued to increase during the past decade, and the unemployment rate for women has come down, though not more than for prime-age men.

- The trend decline in labour force participation among *older workers* (aged 55-64) has come to a halt or been reversed in many countries, but levels still remain low in general. Their unemployment rate has been broadly constant.

But not all traditionally under-represented groups have gained ground over the past decade:

- The unemployment rate of *young people* (aged 15 or 16 to 24) has risen somewhat relative to that of adults in most countries. It is currently on average three times as high as for prime-age men. Labour force participation rates for this age group have continued to fall in most countries, but this mainly reflects young people staying on longer in education.

- On average, the employment rate of *those with less than upper-secondary education* has not improved relative to that of those with higher educational attainments.
Some of the groups overlap.

Data for the low-skilled group refer mainly to 2003; 2002 for Iceland, Italy and the Netherlands.

Source: OECD database on Labour Force Statistics and data provided by national authorities.

Figure 3. Employment rates differ strongly across population groups

Employment rates for: prime-age men (25-54), prime-age women (25-54), older workers (55-64), low-skilled, youth (15-24)

Highest country value
Lowest country value

Immigrants have improved their labour market situation but it remains weak

Immigration has increased in most OECD countries over the past decade. On average, the employment rate of immigrants has tended to increase faster than that of nationals. However, the share of the immigrant population in work remains significantly lower than for nationals in a majority of OECD countries, especially for women. In addition, the labour market experience of immigrants differs considerably across countries, as well as within them, depending on their country of origin.

Labour markets remain segmented in some countries and earnings inequalities have tended to increase

Developments have also been disappointing in some other respects. In certain countries, mass unemployment continues to be concentrated in some regions. There is also a marked divide between informal employment and the formal labour market in some countries, which limits gains in productivity. Moreover, earnings of low-paid workers have tended to grow less than earnings of high-paid workers in a majority of countries. And a significant share of low-paid workers finds it difficult to climb the job ladder and/or experiences frequent spells out of work.
II. New evidence

*The record suggests that the Jobs Strategy remains effective, but it needs refinement to meet future challenges*

To meet key employment challenges, countries need to implement sound macroeconomic policies, remove barriers to jobs, both generally and for particular groups, as well as improve human capital. The record suggests that the 1994 Jobs Strategy remains an effective tool to strengthen labour market performance. Indeed, reforming countries have in general done better in reducing unemployment.

However, the Jobs Strategy does require some refinement in order to meet future challenges. In this regard, much has been learnt from the successes and failures of reforms regarding the design and implementation of individual policies, the extent to which they need to be complemented with new measures and how different policies interact.

**Sound macroeconomic policy supports good labour market performance**

Sound macroeconomic policy management contributes to sustain economic growth and employment. Empirical analysis confirms that price stability and sound budget balances are reflected in lower real interest rates. Lower borrowing costs in turn stimulate investment and labour productivity, and thus pave the way for higher wages and employment. Low real interest rates may also stimulate innovation, with additional potential gains for labour productivity and employment. As discussed below, macroeconomic policy also plays a role in promoting economic stability and helps bring forward the gains from structural reforms.

**Removing general obstacles to participation and job creation**

*Tax-benefit reforms and well-designed “activation” policies have proved effective in supporting labour market participation*

*The re-employment of jobseekers has been promoted by well-designed unemployment benefits and activation policies*

Two of the 1994 Jobs Strategy recommendations, namely those addressing unemployment and related benefits and active labour market programmes, emphasised the risk of benefit dependency. Indeed, high and long-lasting unemployment and other inactivity benefits risk undermining labour market performance. But new evidence also suggests that, if well-designed and implemented effectively, active labour market programmes can help offset these work disincentive effects and improve re-employment chances of those out of work, while achieving social goals.
“Mutual obligations” play a central role in this, backed by effective employment services often in combination with in-work benefits to make work pay ...

Cutting benefit levels and their duration have succeeded in raising work incentives but, beyond certain thresholds, this may compromise social objectives. However, innovations in the design of benefit systems, combined with intensive assistance to jobseekers and close monitoring of their job-search intensity, allow reasonably generous benefits to be maintained while achieving low unemployment and high labour market participation. This has involved measures to ensure that the unemployed look actively for work and are encouraged to find new jobs – so-called “activation” policies – and that it pays to work rather than stay on benefits:

• A strategy of “mutual obligations” has played a central role in achieving greater mobilisation of labour resources in some countries. Governments have assumed a duty to provide jobseekers with effective re-employment services, counselling, training and financial incentives to enable them to find work – the “rights” side of the approach. Beneficiaries, in turn, have had to take active steps to find work or improve their employability, or else face the risk of moderate benefit sanctions – the “obligations” side of the approach.

• Employment services have been at the core of such a mutual obligations approach. They have had to maintain close contact with people on benefits in order to deliver support services to them and monitor their job-search behaviour so as to ensure constant efforts to return to work. As part of an effort to improve service delivery, there has been a growing interest in using private employment agencies. A few countries have also introduced elements of performance management in the public employment services themselves in order to reward best practices.

• Tax-benefit reforms, including in-work benefits, if well-designed, may help ensure that benefit recipients have a financial incentive to work. Recent evidence suggests that, if combined with other measures and well-targeted, the provision of in-work benefits promotes re-employment prospects of jobseekers and attenuates in-work poverty.

... but measures must be effective as they can entail high costs

Helping jobseekers through intensive assistance, close monitoring and generous benefits, as well as in-work benefits, 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 these strategies to succeed, therefore, public employment services need to reach high standards of cost-effectiveness.
Boosting Jobs and Incomes – Policy Lessons from Reassessing the OECD Jobs Strategy

Tax cuts can encourage participation ...

In general, tax reforms that increase the rewards from work can encourage labour force participation. However, for budgetary reasons, general cuts in taxes on labour income need to be accompanied by increased taxes on goods and services or on other types of income, or by lowering public spending. Targeted tax cuts for some under-represented groups, which are found to have a powerful effect on whether they work, can also be financed by imposing higher taxes on the income of other groups – in which case stronger work incentives for some go hand-in-hand with less rewards for work effort for others.

... as does better management of sickness, disability, lone parent and social assistance benefits

Finally, it has become increasingly important to address the large, and in some countries growing, number of recipients of sickness, disability, social-assistance and lone-parent benefits – an issue which has come to the fore since the formulation of the Jobs Strategy (Figure 4). In some countries, an increase in the number of people on such benefits has gone hand-in-hand with progress in reducing unemployment. The availability of benefits to support people who are unable to work due to temporary or more lasting incapacities, or for family reasons, constitutes an essential part of modern welfare systems. However, evidence suggests that a large proportion of those who enter these schemes could work and want to work – should the right conditions exist.

This highlights the importance of employment-oriented social policies. Reforms aimed at ensuring that those who can work are treated as jobseekers, and that the “mutual obligations” approach is extended to them, are starting to be applied in some countries. It will be very important to monitor and evaluate these initiatives rigorously in order to see what combination of benefits, job-search support and other services works best and how they can take into account the specific needs of these groups.

Figure 4. Between 10 and 40% of working-age individuals receive a welfare benefit

Percentage of the working-age population, 1999

- Working-age individuals receiving:
  - Other benefits
  - Disability and sickness benefits
  - Old-age and early retirement benefits
  - Unemployment benefits

a) OECD is the unweighted average for the countries shown.
b) Countries shown in ascending order of benefit dependency rates.
Source: OECD (2003), OECD Employment Outlook, Chapter 4, Paris.
Adapting employment regulations and wage-setting practices and promoting product-market competition can support job creation and boost real wages

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. The 1994 Jobs Strategy included four broad recommendations to this effect.

Labour demand can be stimulated through flexible working-time arrangements agreed between the employer and employees ...

Consistent with the Jobs Strategy recommendations, many OECD countries have taken measures to promote flexible working-time arrangements and part-time work. The stated purpose of the measures has often been to enable greater flexibility for employers to better match working-time schedules with production requirements. Ensuring greater choice for workers regarding work schedules has also helped promote labour force participation of certain groups, notably women with young children. However, more work is required to better understand the determinants of hours worked, why they differ across countries and the effects of greater flexibility on job quality.

... and employment protection regulations consistent with the need for labour market dynamism

The link between the stance of employment protection legislation and aggregate unemployment is uncertain in theory, and in practice is highly dependent on the specific national context. However, there is evidence that too-strict legislation will hamper labour mobility, reduce the dynamic efficiency of the economy and restrain job creation. This may worsen job prospects of certain groups, like young people, women and the long-term unemployed. Reforms in this area have proved difficult, as workers resist measures that are perceived to reduce their job security. Hence, reforms have often been partial and even sometimes counter-productive. Indeed, partial reforms – which facilitate recruitment on temporary jobs while leaving permanent contracts untouched – have been more common and may have boosted job growth in the short run. But they have also contributed to create temporary-job traps in some countries and risk perpetuating dual labour markets, with adverse effects on labour market performance in the longer run.

Innovative reform avenues have been found so as to instil greater labour market dynamism while also providing workers with adequate protection. Making legal procedures more predictable has been one useful approach as this reduces the risk to employers of judicial uncertainty about the cost of firing. Another one is “flexicurity”, i.e. an approach that facilitates hiring and firing decisions while also providing efficient re-employment services, such as intensified job-search assistance, and income support to workers in the event of lay-off. Yet another requires employers to pay regular earnings-related contributions into individual severance accounts that can be accessed by the worker, whatever the type of contract, in the case of lay-off. This implies that, when the worker leaves the firm, the employer does not incur any special firing costs.
Labour demand is also enhanced by wage flexibility, combined with tax cuts on low-paid employment...

Experience confirms the importance of policies to assure that real wages adjust flexibly in response to supply- and demand-side pressures, so as to support high levels of employment in a constantly changing economic environment. The Jobs Strategy recommendations for reforming wage-setting institutions remain largely valid. However, progress in this area has been limited since bargaining arrangements tend to be deeply embedded in countries’ social fabric. For example, few if any changes have taken place in the use of administrative extension of collective contracts, a practice mostly used in countries with sectoral bargaining structures. Experience also indicates that both decentralised and centralised bargaining often result in better employment performance than when bargaining is at the sectoral level. This is because decentralisation offers stronger relative wage flexibility and centralisation provides greater aggregate real wage flexibility.

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. A few countries that have introduced in-work benefits in order to boost employment have at the same time found it useful to introduce moderate minimum wages to ensure that the in-work benefits raise the rewards from work rather than leading to lower wages. However, such a measure has to be designed carefully since recent analysis confirms that overly high minimum wages together with high payroll taxes may affect the employment prospects of vulnerable groups.

There is indeed strong evidence that high payroll taxes and social charges significantly reduce employment, especially among low-productivity workers. The trend rise in the cost of private health plans observed in a few countries has a similar effect. Several countries have therefore reduced employers’ social security contributions on low-wage employment and, when this has led to a fall in total labour costs, countries have been rewarded with stronger hiring of such workers. However, as it can be expensive for the public purse, this is a policy that requires tight targeting, increases in taxes on goods and services or on higher earnings, or cuts in public spending. As a result, 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.

... and greater product-market competition

A consistent analytical finding is the perverse employment effect of anti-competitive product-market regulations. Such practices 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 the set-up of new firms would nurture an entrepreneurial climate. Ensuring that small firms have adequate access to credit is also important in this regard.
Ensuring that workers have the right skills can help create more and better-paid jobs

Training is associated with better job prospects but is distributed unequally over the adult workforce ...

Lifelong learning can contribute to high economic growth, while also reducing poverty and mitigating inequality. There is strong evidence that trained workers have better employment prospects than those who have not received training. Also, training facilitates transitions from temporary work arrangements into stable employment. But access to training is distributed very unequally over the adult workforce in all countries: those with the least education and skills participate much less in training.

... and can be facilitated by a well-functioning training market, co-financing arrangements ...

Lifelong learning policy should first ensure that the training market functions well. Well-designed systems of recognition of skills – acquired through formal or non-formal learning – can reduce obstacles to invest in adult learning. Likewise, a key factor discouraging individuals from investing in human capital is the complexity of the training market, including unknown quality of training courses and the resulting uncertainty about returns to training. Career guidance, as well as systems that improve information on the content and outcome of the courses on offer, can help. More generally, there is significant room in all countries for upgrading quality of provision through performance monitoring of training providers.

There are also financial constraints to investments in workers’ skills. An individual firm may not have sufficient financial incentive to invest in general, as opposed to firm-specific, skills of its employees – even when this may be worthwhile for the economy as a whole. There is also evidence that financial constraints bear heavily on low-educated workers. However, given the considerable private returns generated by training, it would be a waste of public resources to fund learning activities that would have been undertaken even in the absence of the public subsidy. In general, public support has been found to be more efficient when it is matched with a contribution from the recipient individual or firm, i.e. when there is an element of co-financing. It can also be argued that the government’s part in co-financing should be greater for disadvantaged groups. Finally, constraints on taking time off during working hours can also act as a major barrier to training for individuals. To ease these time constraints, some countries have introduced training-leave schemes. In general, more research is needed in order to assess what works and what does not with respect to co-financing arrangements and training-leave schemes.

... and the involvement of employers and workers in policy design and implementation

When this is consistent with national practice, the involvement of social partners in the design and implementation of lifelong learning policies can promote programmes’ success.
Removing barriers to employment of under-represented groups and reducing segmentation of labour markets

Employment of under-represented groups can be stimulated by eliminating incentives to retire early and changes in workplace practices ...

Beyond policies that improve the functioning of labour and product markets in general, certain reforms may directly help promote employment prospects of under-represented groups:

- Older workers face a range of barriers to employment. The financial advantage of continued work can be low or nil, reflecting work disincentives embedded in pension and early-retirement systems. Many countries have undertaken pension reforms that aim at eliminating these disincentives and/or shifting them to older ages, while also ensuring that older workers who extend their careers are rewarded with higher pensions – though significant reforms are being phased in very gradually to allow people to prepare for such changes. There has also been a general trend to end new entry into special early retirement schemes. The scope for early retirement through the unemployment benefit system, where the unemployed above a certain age are exempted from job-search requirements, or through badly-designed sickness and disability benefits, is also being made more limited in many countries. Notwithstanding these reforms, the design of public pension systems and de facto early retirement systems still embodies distortions that encourage early withdrawal from the labour market in most member countries. Moreover, private occupational pension systems often encourage participants to retire at relatively young ages. Employment opportunities for older workers have also been held back by ageism in the workplace, mandatory retirement practices, widespread use of seniority pay and lack of training opportunities.

... tax reform and family-friendly policies can increase female employment ...

- Women also face obstacles through tax disadvantages, poor design of family-support policies and lack of part-time jobs. The tax treatment of second workers tends to depress female participation in most countries. Lack of suitable parental leave provisions, which help to reconcile work and family responsibilities, also reduces female participation. Moreover, childcare costs may act as a barrier for women to seek work outside the home. Such costs can be lowered by turning general child benefits into child-care support. However, there is a policy dilemma here in that child benefits are easier to target to social objectives, such as family support, than are childcare subsidies.

... and policies to avoid school failure plus closer links between education and work can reduce youth unemployment ...

- Failure of the school system to provide all young people with the basic skills needed to operate effectively in the labour market makes school-to-work transitions difficult. An effective approach has been sustained intervention to avoid early school failure, sometimes
starting before the compulsory school age. Also, countries where education alternates with work experience – with wages set at the appropriate level – tend to have low youth unemployment. And, outside the education system, the provision of targeted employment programmes and remedial education and training may help young jobseekers find a job.

Addressing regional concentration of joblessness serves overall objectives

Regional labour-market imbalances are persistent in some countries, compromising the achievement of high-employment goals. Decentralising wage-setting to allow regional wages to better fit regional productivity was already identified in the 1994 Jobs Strategy as a way to reduce regional imbalances. But little progress has been made on this front. Lack of inter-regional mobility, partly as a result of distortions and rigidities in housing markets in some countries, may aggravate regional imbalances – an issue which requires further investigation. More generally, additional research is needed to examine whether there are broader obstacles to the development of employment in lagging regions.

Finally, in some countries, promoting transitions to formal employment is of paramount importance

Finally, in many of the countries that have joined the OECD since the finalisation of the Jobs Strategy the incidence of informal employment remains stubbornly high and limits the scope for productivity gains and better living standards. The incidence of informal employment depends heavily in certain countries on i) taxation of low-paid (formal) employment vis-à-vis taxation of income from activities with a high incidence of undeclared work, like small businesses; ii) the stringency of employment regulations (which may make employers reluctant to formalise employment relationships); iii) the extent to which formal employment entails a right to pension and unemployment benefits (to make formal employment attractive to workers themselves); and iv) enforcement of the rules of the game.

Interactions and synergies between policy areas and the role of macroeconomic policy

Exploiting policy interactions can improve employment performance in some areas

Although the Jobs Strategy was formulated in terms of ten separate broad policy guidelines, the experience gained over the past decade has highlighted the existence of interactions between different structural policy areas and between structural and macroeconomic policy areas. The analytical evidence suggests that exploitation of these potential synergies can lead to improved employment performance.

There is robust evidence for the importance of specific interactions between particular institutions and policies directed at the labour market:

- Unemployment benefits and activation policies. The disincentive effect of high and long-lasting unemployment benefits can be counteracted by the implementation of well-designed activation policies.
• *Taxes on labour income and legal minimum wages.* As noted above, higher taxes on labour income appear to have the most detrimental effects on employment when wages do not fall in response to higher taxes due to binding wage floors, thus raising labour costs for the affected workers.

Strong competition in product markets stimulates business creation and expansion, as well as labour demand. Evidence also shows that labour market reforms that enhance wage flexibility will have larger employment effects when they are carried out in an environment of strong competition in product markets than when such competition is subdued.

**Adverse macroeconomic shocks and bad structural policy settings result in unemployment ...**

There is growing consensus that interactions between macroeconomic shocks (such as shifts in productivity growth or oil price hikes) and structural policy settings play a large role in determining labour market performance. Certain structural policy settings, such as badly designed benefit systems and weak competition in product markets, may amplify the employment losses due to adverse macroeconomic shocks and/or make them more persistent.

... highlighting the importance of stability-oriented macroeconomic policies ...

The fact that shocks to the whole economy can interact with other policies to damage jobs heightens the importance of avoiding excessive macroeconomic fluctuations and cushioning adverse shocks. The stability orientation of monetary policy, often formulated as explicit or implicit inflation targets, which has taken hold in most parts of the OECD, should be helpful in this regard. Fiscal policy also plays a role in stabilising aggregate demand through built-in rules (automatic stabilisers) and potentially through discretionary changes in spending and taxation, though experience shows that the latter may result in disappointing outcomes. 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, with budget positions improving in upswings to allow for a fall in public debt relative to GDP. This has not been the case over the past cycle in many countries, which entered the downswing with a weak underlying fiscal balance that limited their scope even to allow automatic stabilisers to operate.

... that can also speed up the gains from structural policy reforms ...

Stability-oriented macroeconomic policy may also bring forward the employment gains from labour and product market reforms. Such reforms increase the output potential of the economy, with implications for macroeconomic policy:

• For monetary policy, any clear signs of downward pressure on inflation, arising if demand does not autonomously expand in line with the increased output potential, would offer scope to reduce interest rates. This would increase aggregate demand to meet the higher supply potential of the economy and thus attain macroeconomic stability earlier than if the adjustment was left to markets alone.
• For public finances, sustained higher employment implies a lasting increase in tax revenues and cuts in some spending components. If the starting point for government finances is sound, this offers scope for easing of fiscal policy and hence an additional way to raise aggregate demand to match the increase in aggregate supply. Moreover, if the easing is concentrated on taxes and spending components that have beneficial effects on the economy-wide output potential, a virtuous cycle can commence whereby reforms offer scope for even more reforms and higher output potential. For example, strengthening public finances through structural reforms can allow taxes on labour to be lowered, which in turn increases employment further, with additional beneficial effects on public finances and output potential, etc.

Policy packages

There have been different roads to success

The experience over the past two decades shows that there is no single combination of policies and institutions to achieve and maintain good labour market performance. For example, it is not necessary that all individual policies are aimed at strong labour market performance, provided that adverse stances in some policy areas are more than compensated for by favourable settings in other areas, e.g. by exploiting policy interactions. This allows some scope to tailor policy packages to suit national preferences with respect to equity, risk-taking and other objectives. However, in practice there are few feasible policy combinations to achieve satisfactory employment outcomes. A successful package needs to be coherent and embody a good overall incentive structure.

There have been two demonstrably successful broad policy packages in the recent past (Figure 5):

Figure 5. 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.

One way is to emphasise product- and labour-market flexibility, though it may imply income inequalities ...

- Several successful performers combine low levels of welfare benefits and limited taxation to fund these benefits, as well as 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.

... another way combines flexibility with security, but is more expensive

- Other successful countries, characterised by a strong emphasis on coordinated collective bargaining and social dialogue, offer generous welfare benefits but activate jobseekers through the provision of 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.

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.
THE RESTATED OECD JOBS STRATEGY

The 1994 Jobs Strategy was primarily aimed at reducing high and persistent unemployment. While the key recommendations have been found to be useful in this respect, the policy focus has broadened. In particular, more weight has been given to the objective of promoting labour market participation and employment and to take into account concerns about low incomes of certain groups. With this in mind, the following offers a restatement of key recommendations of the original Jobs Strategy that were most directly related to unemployment and employment.

The Restated OECD Jobs Strategy has four pillars. All countries need to ensure that each of the four pillars is solid. However, within each pillar there may be scope for individual countries to use different policy combinations to achieve successful outcomes, taking into account policy interactions and country circumstances and objectives. Indeed, there is no single successful approach; what matters is that the policy package be coherent.

Pillar A:  
Set appropriate macroeconomic policy

A1. Macroeconomic policy should aim at price stability and sustainable public finances so as to keep interest rates low and encourage investment and labour productivity, thus strengthening economic growth with potential beneficial effects on employment; where the state of government finances permits, improvements in public finances may be used to reduce taxes or increase spending in areas that have the most beneficial impact on growth and employment.

A2. Macroeconomic policy should be used to help stabilise the economy in order to reduce the risk that transitory increases in unemployment due to adverse shocks become persistent and to ensure that the benefits of structural reforms are brought forward. This calls for:

- Monetary policy should pursue medium-term price stability by reacting to both inflationary and dis-inflationary shocks, and, within the scope given by that objective, aim to stabilise economic activity.

- Fiscal policy should aim to restore and maintain sound public finances so that automatic stabilisers can be allowed to operate, supplemented as required and feasible by discretionary policy. This is particularly important in countries that cannot employ monetary policy for that purpose.
Pillar B:
Remove impediments to labour market participation as well as job-search

Implement well-designed unemployment benefit systems and active labour market policies

B1. Unemployment benefit replacement rates and duration, as well as social assistance benefits provided to individuals who can work, should be set at levels that do not discourage job search excessively and, especially where they are relatively generous, be made conditional on strictly enforced work-availability criteria as part of well-designed “activation” measures; moderate benefit sanctions should be part of such an activation strategy.

B2. Employment services should offer unemployed workers in-depth interviews and job-search assistance; participation in effective active labour market programmes should be compulsory after a certain length of joblessness that may differ across groups (e.g. immigrants facing integration difficulties, disadvantaged youth and older jobseekers); employment services should have adequate resources to perform these tasks and their functions should be well integrated.

B3. Performance of employment services should be assessed on the basis of their long-term impact on employment and benefit caseloads; active labour market programmes should be regularly assessed in a rigorous way to ensure that inefficient programmes are terminated, and that the mix of programmes is adjusted to suit the needs of jobseekers and the labour market.

Make other non-employment benefits more work-oriented

B4. Gate-keeping measures should be strengthened to avoid individuals with substantial work capacity leaving the labour market via sickness and disability systems, while at the same time protecting adequately the needy; the degree of work capacity of people receiving such benefits should be reviewed periodically; rehabilitation with a labour market orientation should be available to those who have some work capacity; job-search support and financial incentives to go back to work should be provided for those with sufficient work capacity.

B5. Public early retirement schemes should be gradually phased out, and public and private pensions as well as other welfare systems reformed so as to remove incentives for early labour market exit.

Facilitate family-friendly arrangements

B6. Family-friendly policies, including childcare support, as well as working-time arrangements which help reconcile work and family life, should be implemented so as to remove barriers to employment for those with family commitments.

Adjust taxes and other transfer programmes to make work pay

B7. Employment should be made financially attractive vis-à-vis benefit receipt, notably through tax-benefit reform and the provision of targeted in-work benefits to make work pay, without creating excessive tax distortions or compromising public finances.
Pillar C:
Tackle labour- and product-market obstacles to labour demand

**Ensure that wages and labour costs respond to labour market developments**

C1. Ensure that minimum wages are set at levels that do not harm job creation significantly for low-productivity workers.

C2. Payroll taxes on labour should be reduced, especially on low-wage earners, where these are high and the budget situation allows, and health and pension contributions should be kept under control.

C3. In countries where uncoordinated sectoral collective agreements predominate and have adverse effects on employment, individual firms, through collective agreement, should be allowed to opt-out from sectoral agreements or the administrative extension of sectoral agreements should be reformed.

**Enhance competition in product markets**

C4. Legal impediments to entry of new firms should be removed in all areas where competition is feasible, and administrative burdens on business start-ups should be reduced; start-up costs should be lowered and administrative procedures for the creation of new businesses simplified so as to nurture an entrepreneurial climate; move towards open international trade and investment in goods and services.

C5. Competition-restraining state control of business operations should be reduced.

**Facilitate the adoption of flexible working-time arrangements**

C6. Obstacles in labour legislation which impede the emergence, through employer-employees agreements, of flexible working-time arrangements should be removed; tax and social security provisions should not discriminate against part-time work or other flexible arrangements which help reconcile work and family life and promote gradual work-to-retirement transitions.

**Make sure that employment protection legislation helps labour-market dynamism and provides security to workers**

C7. Employment protection legislation should be reformed in countries where it is overly strict, by sanctioning unfair dismissal (for example by prohibiting dismissal on the basis of discrimination with respect to gender, age and ethnicity), but reducing constraints on dismissals for economic reasons; severance costs and administrative procedures should be made more predictable so as to reduce judicial uncertainty; reasonable dismissal notice periods should be provided so as to help laid-off workers find new jobs.

C8. Regulations on fixed-term and temporary contracts may need to be relaxed in some countries; in order not to aggravate labour market duality and thus undermine labour market performance in the long term, a more balanced treatment between temporary and permanent contracts should be pursued, with one option being that dismissal protection rights grow in line with seniority.

**Promote transitions to formal employment**

C9. Transitions to formal employment should be promoted through: lower taxes on low-paid employment going hand-in-hand with better compliance of other taxes (notably on small businesses); reforms of labour regulations and business registration requirements, to make firms more prone to create formal jobs; and closer ties between social protection entitlements and work to encourage workers to declare their job.
Pillar D: Facilitate the development of labour force skills and competencies

D1. In view of the key role of human capital accumulation for the achievement of economic growth and social objectives, governments should promote high-quality initial education and, in coordination with social partners where this is consistent with national practice, they should set conditions likely to improve labour force skills by:

- establishing a system of recognition of new competencies gained by adults through training and work experience, including foreign credential recognition of new immigrants;
- ensuring that training is more demand-driven and responds effectively to firms' changing skill requirements, and encouraging greater quality of training provision, including through performance monitoring of providers;
- supporting training programmes – e.g. training vouchers, training leave or schemes that help workers alternate between work and training – which include co-financing from private agents and address existing training inequalities by providing effective learning opportunities for disadvantaged groups, notably the low-educated;
- expanding the scope of apprenticeship contracts by easing age limits and allowing flexible compensation arrangements; and
- ensuring that some employment programmes are targeted to the specific needs of disadvantaged people, including through second-chance schools.

D2. In order to facilitate school-to-work transition, it is essential to:

- reduce early exits from education and ensure that young people acquire skills relevant to labour-market requirements, including by broadening vocational programmes, strengthening links between general and vocational education and improving career guidance; and
- help combine education with work, notably through improved apprenticeship systems or more informal channels.

* * *

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 as the costs will tend to be concentrated on particular and well-organised groups, whereas the benefits will be more diffused and/or go to un-organised groups. In addition, the costs will be apparent early in the reform process, while the benefits will only materialise over time.

But implementation problems should not serve as an excuse for inaction. The cost of inaction will be continued weak labour market performance and failure to realise the potential for raising living standards, at a time when they will come under 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.
Annex

The 1994 Jobs Strategy: the ten broad recommendations

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 interactions with the tax system – such that societies’ fundamental equity goals are achieved in ways that impinge far less on the efficient functioning of the labour markets.

10. Enhance product market competition so as to reduce monopolistic tendencies and weaken insider-outsider mechanisms while also contributing to a more innovative and dynamic economy.
Boosting Jobs and Incomes

POLICY LESSONS FROM REASSESSING THE OECD JOBS STRATEGY

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