

## Chapter 4

# Policies Targeted at Specific Workforce Groups or Labour Market Segments

*Are general reforms to support the overall functioning of the labour market sufficient to deliver good employment performance or are targeted measures to improve employment outcomes for particular groups also required? As policy priorities have shifted from lowering unemployment to raising employment rates more generally, it has become evident that there is a role for tailored policies which tackle the barriers to participation affecting groups in the working-age population who tend to be under-represented in employment or too often hold jobs that do not make full use of their productive potential. These groups include women, older workers, youth and immigrants. Which types of measures have proven to be most effective for each group? Should the scope of the Jobs Strategy also be expanded to encompass measures to address the problems faced by workers in lagging regions or informal employment?*

The 1994 Jobs Strategy was mainly focused on general reforms to support the overall functioning of the labour market and it placed little emphasis on more targeted reforms intended to improve the labour market performance of particular groups in the working-age population. Over the past decade, however, concern has been growing about the low employment rates of certain groups – such as women, older workers, youth and immigrants – especially against the prospect of population ageing.

In addition, there is growing concern in certain countries with the persistence of imbalances between different segments of the labour market. In particular, in certain countries, low-employment regions coexist with regions where there is near full employment – thus raising the issue of how the Jobs Strategy can better take into account regional employment imbalances. Moreover, in a number of member countries – specially those which joined OECD after the Jobs Strategy was adopted in 1994 – there is a high incidence of informal employment, which is a problem for a number of reasons, including that it tends to be associated with weak productivity gains, undermines tax collection and makes it difficult to manage social protection.

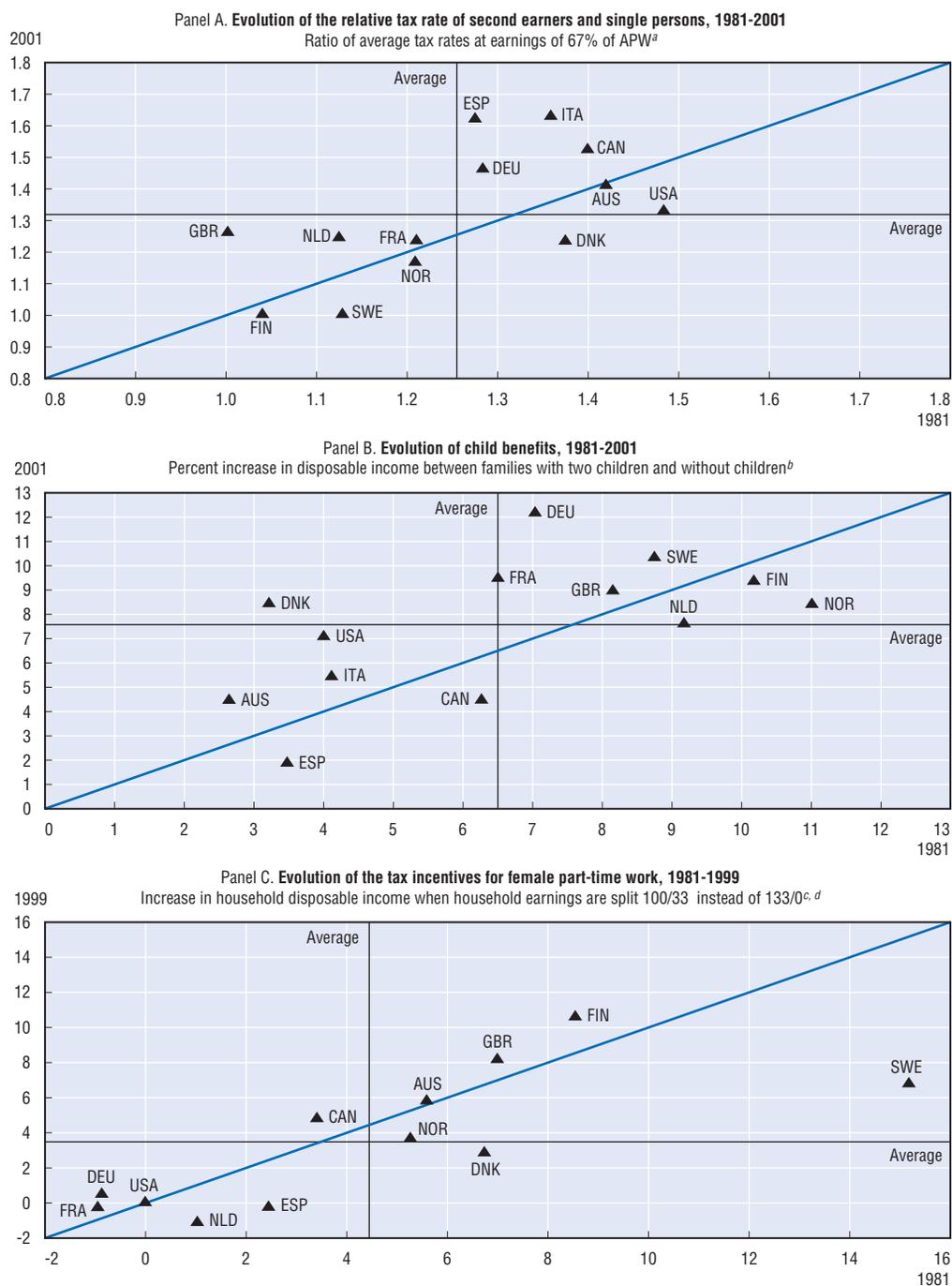
This chapter reviews policies that especially affect the labour market performance of these groups or labour market segments – bearing in mind that general reforms, as outlined in the previous chapter, will also help to address these specific labour market issues.

## 1. Promoting employment prospects of under-represented groups

### 1.1. Measures to increase participation of women

Increased female participation has been a major component in labour supply growth during past decades, as illustrated in Chapter 2. This increase has been mainly autonomous and related to the fact that more recent cohorts of women are better educated than earlier cohorts and therefore can more easily find jobs and tend to place greater priority on pursuing a career. However, as women's participation rates approach those of men, future increases become more dependent on reforms aimed at reducing remaining disincentives for women to work and encouraging the diffusion of family-friendly employment practices.

Looking at the relative taxation of household members, second earners are effectively taxed more heavily than single earners in most OECD countries (Figure 4.1, Panel A). This tax bias has increased on average for the OECD during the past two decades, especially in some southern European countries, like Italy and Spain. By contrast, this bias is smaller and has declined in most Nordic countries. In countries where this bias is substantial, a more neutral tax treatment of second earners is an obvious candidate among policies to stimulate female participation. For example, OECD research suggests that an equal tax treatment of second earners would increase female participation by 4 percentage points on average for the OECD area (see Jaumotte, 2004). There is even a case for taxing the income of second earners lighter on optimal tax grounds, given that their labour supply is more elastic compared to single earners.<sup>1</sup>

Figure 4.1. **Work incentives for women**

APW: Average production worker.

a) The spouses of second earners are assumed to earn 100% of the APW.

b) The primary earner is assumed to earn 100% of the APW, and the secondary earner 33% of the APW.

c) 100/33 refers to a situation where the primary earner earns 100% of APW and the secondary earner 33% of the APW; 133/0 refers to a situation where the primary earner earns 133% of APW and the spouse has no earnings.

d) For the Netherlands, if account is taken that the primary earner has to buy private health insurance when she/he earns 133% of APW, while her/his income falls below the income limit for the mandatory health care insurance when the household income is split (into a wage of 100% of APW for the primary earner and 33% for the secondary earner), the tax incentive to share market work between spouses amounted to 6.9% in 1999, and to 10.2% after the 2001 tax reform.

Source: OECD Tax database; OECD (1995), *The OECD Jobs Study: Taxation, Employment and Unemployment*, Paris; and OECD Tax models.

Statlink: <http://dx.doi.org/10.1787/014203526272>

The participation of women in the labour market is also influenced by policies related to family support. So far, family support in OECD countries has taken the form of childcare subsidies and child benefits. In theory, childcare subsidies stimulate female labour supply as they increase the relative return to market work.<sup>2</sup> The empirical evidence confirms that childcare subsidies raise female participation.<sup>3</sup> By contrast, child benefits do not raise the return to market work and may lead to a reduction in labour supply as they raise income and hence the demand for leisure. This form of support remains much more important than childcare subsidies in most member countries. Both child benefits and childcare subsidies have increased significantly in recent decades, and child benefits can increase the disposable income of families with two children by more than 10% (Figure 4.1, Panel B). From the perspective of raising female participation, childcare subsidies are a better alternative than child benefits, especially where high tax wedges (facing both second earners and single individuals) reduce female labour supply. Indeed, childcare subsidies are often employment-conditional. Furthermore, child-care costs can be a prohibitive barrier to employment for lone mothers desiring market work in the absence of such subsidies (OECD, 2003a, Chapter 3).

Another form of childcare support is the provision by most governments of maternity, paternity or childcare leave. In 1999, the average length of paid leave was 26 weeks, with the longest paid leave being found in France, the Slovak Republic and most Nordic countries (Jaumotte, 2003). During the past two decades, the generosity of paid parental leave has increased in all OECD countries, with the exceptions of Ireland, the United Kingdom and several countries with no legislation mandating paid leave. According to empirical studies, job-protected paid leave increases the employment rate of women significantly, by helping to reconcile work and family responsibilities, without having an adverse effect on wages (Rhum, 1998). However, this only holds when leave entitlements remain relatively short. Moderately longer leave (*e.g.* around nine months) also increases female employment rates, albeit at the price of a drop in relative wages. Yet longer parental leave (*e.g.* three years or more) makes it difficult to return to work, even when reinstatement is guaranteed (see European Foundation, 2001). The absence of job protection makes the return to work even more unlikely, especially for low-skilled workers (OECD, 2003a, Chapter 3).

Part-time working is often seen as a means to facilitate the integration of women in the labour market, by allowing them to combine market work with family responsibilities. There is a slight positive correlation between voluntary part-time work and female participation across OECD countries (see OECD, 2006a, Figure W.4.1). The tax incentive to share market work within couples – as measured by the increase of household disposable income from shared working hours – influences the decision between inactivity and activity and between full- and part-time working (Jaumotte, 2003). On average, the splitting of household income between spouses resulted in only a small increase in household disposable income in 1999 and the gain declined compared with 1981 (Figure 4.1, Panel C). Therefore, room exists for stimulating female participation by changing the tax incentives for part-time work. Childcare subsidies influence part- and full-time participation differently, having a larger impact on full-time participation (Powell, 1998; Gustafsson and Stafford, 1992).

Table 4.1 gives a synthetic review of the results of econometric estimates reported in Bassanini and Duval (2006) on the determinants of full- and part-time employment rates of women. High unemployment benefits and tax wedges discourage both part- and full-time

Table 4.1. **Determinants of full- and part-time female employment, 1982-2003**

	Full-time employment	Part-time employment	Total employment
<b>General policies and institutions</b>			
Unemployment benefits	–	–	–
Tax wedge	–	–	–
Union density	+	–	No
EPL	–	No	No
PMR	–	–	–
High corporatism	No	No	No
<b>Institutions and policies specific to women employment</b>			
Tax incentive to part-time	–	+	+
Relative marginal tax rate on 2nd full-time earner	–	No	n.a.
Relative marginal tax rate on 2nd part-time earner	+	–	n.a.
Family cash benefits	No	–	–
Number of leave weeks	+	–	n.a.
Number of leave weeks squared	–	+	n.a.
Childcare subsidies	+	No	+
<b>Control variables</b>			
Female education	+	No	+
Output gap	+	No	+

EPL: Employment protection legislation.

PMR: Product market regulation.

n.a.: Not applicable.

No: No significant impact on employment.

+/-: Significant positive/negative impact on employment.

Source: Bassanini and Duval (2006).

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female employment and the elasticities are typically larger than for male employment, consistent with the expectation of larger labour supply elasticities for women. Unionisation promotes full-time female employment at the expense of part-time female employment, while strict EPL lowers the full-time employment rate of women.

These econometric estimates also help to assess the effects of specific policies and institutions on female employment patterns. Increasing the tax incentives to work part-time would attract more women into employment, but would also cause some women working full-time to cut their working hours. Relative marginal tax rates on second earners also matter in terms of both the decision to enter the labour force and the choice of the number of hours worked. In particular, high relative taxation of part-time work induces women who would have worked part-time otherwise to work full-time. Child benefits reduce part-time female employment only, as the income effect from child benefits is unlikely to be large enough to reduce employment of women working full-time. By contrast, childcare subsidies stimulate female full-time employment only. Finally, moderate parental leaves encourage women to work full-time while longer leaves are associated with more part-time work as women probably face difficulties when returning to work. The estimates confirm that female participation increases with education, but for full-time working only.

## 1.2. Measures to increase participation of older people<sup>4</sup>

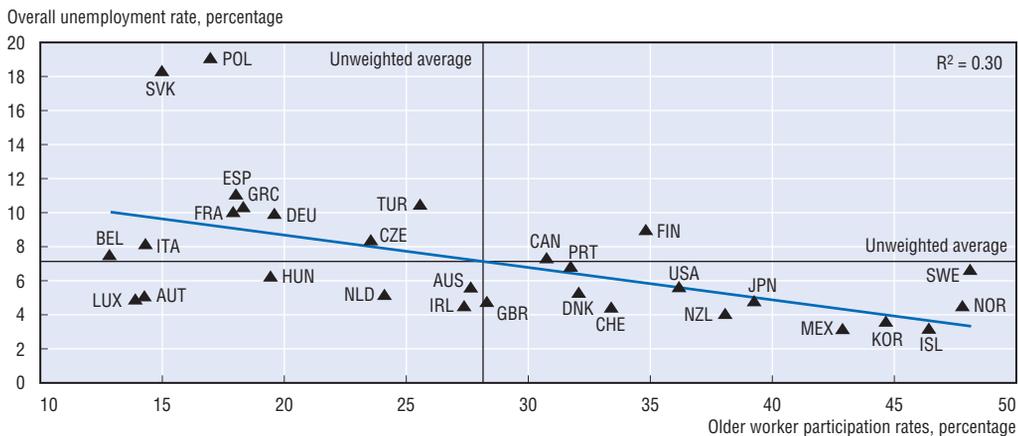
### *Barriers to employment for individuals aged 55 to 64*

The 1994 Jobs Strategy contained a recommendation to adjust policies and programmes for older workers, so as to provide them with better opportunities to continue

working and reduce the economic incentives for them to withdraw from the labour market.<sup>5</sup> There are three key barriers to employment facing older people: financial disincentives; employer barriers; and weak employability.<sup>6</sup>

**Financial disincentives.** Until the early 1990s, income transfers were often provided to older workers in order to induce early retirement. Such schemes typically had been introduced with the hope of lowering unemployment, the expectation being that older workers induced to retire early would be replaced by unemployed younger workers. However, experience has shown this view to be fallacious. As Figure 4.2 illustrates for 2004, countries with the lowest participation of older workers are also those where unemployment remains highest.

Figure 4.2. **Older worker<sup>a</sup> participation and overall unemployment in OECD countries, 2004**



a) 55 and over age group, except 55-74 for Finland, Hungary, Iceland, Norway and Sweden.

Source: OECD database on Labour Force Statistics.

Statlink: <http://dx.doi.org/10.1787/065226116824>

**Employer barriers.** Hiring and retention rates of workers decline significantly after the age of 50 in all OECD countries, although more sharply in some countries than others. The reluctance of employers to hire or retain older workers reflects both subjective and objective factors. First, there is evidence of age discrimination in all countries reflecting both negative and positive stereotypical views by employers about older workers. Second, the employment of older workers may be discouraged because rigid seniority compensation structures cause labour costs to rise faster with age than productivity. Third, employers and trade unions have sometimes collaborated to convert state subsidised early retirement schemes into a socially acceptable way of laying-off workers. Finally, mandatory-retirement rules are common in some countries.

**Weak employability.** Employment prospects for some groups of older people are poor because they have obsolete skills, are not receiving appropriate help in finding jobs if unemployed, or face unsuitable working conditions and working-time arrangements. Older workers receive far less training than younger workers in all countries, but there is considerable variation across countries in the size of this gap (as well as in the overall incidence of training). A strong policy focus on tackling youth unemployment has meant that older unemployed workers are also under-represented in active labour market programmes in most countries. Poor or inappropriate working conditions can also push

some older workers into early retirement. For example, a lack of opportunities to shift to part-time work may limit the scope for a more phased transition to retirement.

Besides these three types of age-specific barriers, the employment of older people is also influenced by the general labour market institutions and policies that affect all segments of the working-age population. Evidence from Bassanini and Duval (2006) on the effects of both specific and general barriers to the employment of older persons is summarised in Table 4.2. Their analysis confirms that certain characteristics of pension systems represents important barriers to continued employment after age 55, including a high implicit tax on continued work (see next section) and a low standard age of retirement. Among the general factors depressing employment rates for older workers are generous unemployment benefits, a high tax wedge and high union density. By contrast, strict EPL and PMR are associated with higher employment rates for this age group, probably because they reduce the risk that older workers will be laid off by their employers.

Table 4.2. **Determinants of older worker employment (55-64 age group), 1982-99**

	Total employment
<b>General policies and institutions</b>	
Unemployment benefits	-
Tax wedge	-
Union density	-
EPL	+
PMR	+
High corporatism	No <sup>a</sup>
<b>Institutions and policies specific to older worker employment</b>	
Implicit tax on continuing work	-
Standard age of eligibility to pension benefits	+
Interactions between implicit tax rate and EPL	+
<b>Control variables</b>	
Output gap	+

EPL: Employment protection legislation.

PMR: Product market regulation.

No: No significant impact on employment.

+/-: Significant positive/negative impact on employment

a) Negative coefficient becomes insignificant when Italy is dropped from the sample.

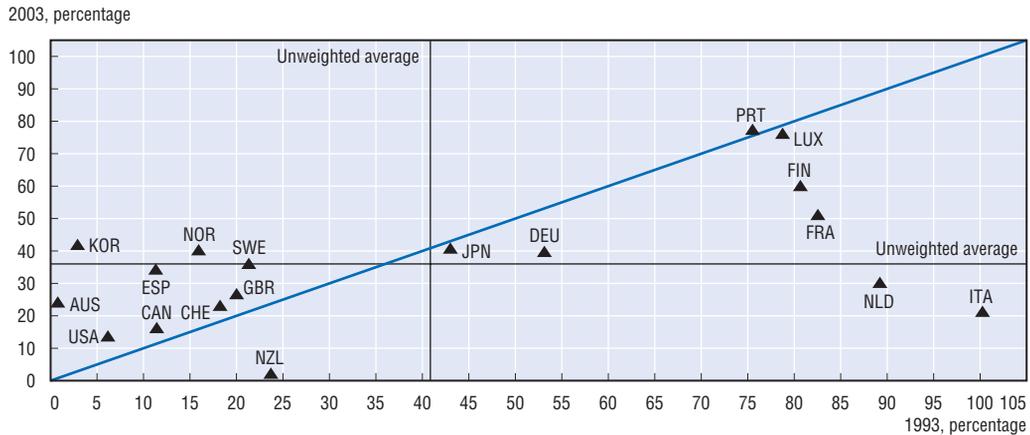
Source: Bassanini and Duval (2006).

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### Policy developments since 1994

The implicit tax on continuing work – which measures the costs of continuing to work, in terms of contributions paid and foregone benefits – provides a summary indicator of the magnitude of the financial incentives to retire.<sup>7</sup> Figure 4.3 shows the development of the implicit tax on continuing work between 1993 and 2003.<sup>8</sup> According to Figure 4.3, the incentive in 1993 to withdraw early from the labour market as a result of the presence of early retirement schemes was particular high in some continental European countries, including Finland, France, Italy, Luxembourg, the Netherlands and Portugal, while it was considerably lower in English-speaking countries, Japan, Korea, Norway, Spain and Sweden. The incentives to withdraw early embedded in the old-age pension system were also particularly high in France, Italy, Luxembourg and the Netherlands.<sup>9</sup> Over the past decade, the incentive to withdraw between the ages of 55 and 60 has been significantly reduced in a majority of OECD countries. As concerns retirement incentives between the

Figure 4.3. **Implicit tax embedded in early-retirement schemes on continuing work from age 60 to age 65,<sup>a</sup> 1993-2003**



a) The implicit tax on continued work is defined as the average annual change in pension/social wealth (i.e. the present value of the future stream of pension/social benefits), net of additional contributions paid, resulting from a decision to postpone retirement from age 60 to age 65. The calculations are made for a single worker with average earnings. For 2003, they reflect the steady-state of currently legislated systems once they have fully matured (e.g. Korea) and once recent reforms have been fully phased in, which in some cases (e.g. Italy) will take several decades.

Source: Brandt et al. (2005).

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ages of 60 and 65, progress has been more mixed. However, the average implicit tax for the OECD area declined modestly, because big reductions in several countries where the implicit tax was the highest in 1993 offset smaller increases elsewhere (Figure 4.3).

A review of reforms undertaken by OECD countries over the past ten years identifies the types of initiatives which have shaped the recent evolution of the implicit tax on continuing work (Table 4.3). A number of member countries tightened eligibility to early retirement and invalidity schemes, while others did the same with unemployment benefit provisions for older jobseekers, who have an extended duration of unemployment benefit receipt in many OECD countries and are often exempted from job-search requirements. Incentives for older workers to stay in the labour market were strengthened in Japan and Poland through provisions that facilitate combining pensions with income from work. Moreover, actuarial adjustments to early (or late) receipt of regular old-age pensions or other financial incentives to stay in the workforce were introduced in a number of countries. Eligibility criteria for invalidity schemes were also tightened in several OECD countries, although, as discussed in Chapter 3, this did not prevent the recourse to disability and sickness benefit schemes from rising in some cases (OECD, 2003d).

### New evidence

There is evidence that a three-pronged agenda of age-friendly employment policies can be effective at raising the employment rates of older persons.

**Improving financial incentives.** Reducing the implicit tax on continued work may have a substantial impact in stimulating the labour supply of older workers, as illustrated by the regression results reported in Table 4.2 and the simulations reported in Duval (2004). The first and most straightforward step in this direction is to close all early-retirement pathways. Indeed, reforming old-age pensions to close off early retirement options would have little impact as long as people have access to alternative early-retirement options.

Table 4.3. **Early-retirement, invalidity and old-age pension schemes: policy reforms over the 1994-2004 period<sup>a</sup>**

	Early retirement schemes	Unemployment benefits for older workers	Regular old-age pension systems	Invalidity schemes	Sickness benefits	Rehabilitation and job brokering
Australia				+		+
Austria	+		+	[+, -]	-	
Belgium	+	+				
Canada				+		+
Czech Republic		-	+	+		+
Denmark	+	+	+	[+, -]		+
Finland	+	+	+	[+, -]		+
France	[+, -]	+	+			
Germany	+	+	+	[+, -]	[+, -]	
Greece	-					
Hungary	+	+	+	+	+	+
Iceland			+			
Ireland						
Italy	+	-	+	+		
Japan	+	+				
Korea			+			
Luxembourg			+	+		+
Mexico						
Netherlands	+	+	+	+	+	+
New Zealand	+			+	+	
Norway	-	+		+		+
Poland	+		+	+	+	
Portugal	+		+			
Slovak Republic	+		+			
Spain				[+, -]	+	
Sweden	+			[+, -]	+	
Switzerland	+			[+, -]		
Turkey	+		+			
United Kingdom				+		+
United States				[+, -]	+	

a) +: Reforms following the OECD Jobs Strategy.  
 -: Reforms contrary to the OECD Jobs Strategy.  
 [+, -]: Reform elements going in different directions.

Source: OECD Economic Surveys.

Statlink: <http://dx.doi.org/10.1787/273476071425>

Then, the value of old-age pension benefits should be adjusted in an actuarially-neutral way in case of anticipated or deferred retirement.<sup>10</sup> The implicit tax on continued work can also be reduced by expanding the possibilities of older people to combine work with the receipt of a pension, though such a policy change may raise equity concerns.

In principle, the age of eligibility to a pension should not affect the actual age of retirement as rational forward-looking individuals could always chose the optimal age of retirement through lending and borrowing in capital markets. In practice, many older workers choose to retire at the age of first entitlement for either early or standard retirement benefits. This tendency lends support to policies which modify statutory retirement ages and other pension parameters in line with improvements in life expectancy.

**Changing employer attitudes and practices.** Age-discrimination legislation is important but is more effective if it is complemented by information campaigns and guidelines for promoting best practice and the benefits of age diversity in the workplace. The practice of mandatory retirement in firms is incompatible with the overall thrust of offering greater choice to workers' retirement decisions. This is why some countries are debating whether mandatory retirement should be prohibited.

Efforts to reduce labour costs of older workers have been made in certain countries by reducing the importance of seniority in wage-setting and, in some countries, introducing age-specific wage subsidies or labour tax reductions. However, to be effective, targeting these measures on age alone should be avoided. Some countries have also introduced taxes on the dismissal of older workers, but there is a growing awareness that these taxes have a negative impact on hiring older workers or lead to substitutions between workers of different ages.

**Improving employability.** As working lives are progressively extended, training becomes more critical for strengthening the employability of older worker, but should also look more profitable to both employers and employees. So far, retraining older workers ranks low among policy priorities of public and private employment services. Since the number of older jobseekers is likely to increase, this age group will have an increasing need for employment assistance though career counselling, job-search assistance and help with self-employment. In addition to negative perceptions about older-workers employability which are held by certain employers, certain economic factors increase the costs of hiring older workers. These may include seniority-based wage systems and costly employer-provided health insurance.

Inflexible working-time arrangements may discourage older workers from continuing work (Penner *et al.*, 2002). Easing barriers to part-time work could thus lead to an increase in the effective retirement age (Gustman and Steinmeier, 2004), although the net impact on effective labour supply might be smaller since some workers who would otherwise have worked full-time will reduce their hours worked. More generally, policies prolonging working careers should be accompanied by efforts to improve working conditions for older workers.

### **1.3. Promoting employment prospects of youth<sup>11</sup>**

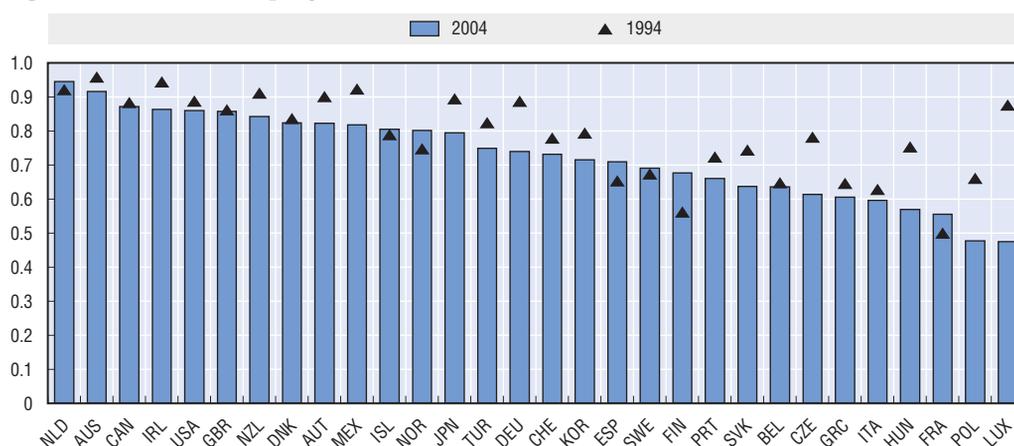
Youth in all countries face an above-average risk of unemployment, as they attempt to find a foothold in the labour market. For many youth, this is only a transitional difficulty. However, youth who are persistently unemployed (or who experience multiple spells of joblessness) may develop disadvantages that seriously compromise their long-term career prospects. It is thus a matter of major policy concern to develop young people's employability and ensure their successful entry into the labour market and subsequent access to career ladders.

These issues were treated as part of the 1994 Jobs Strategy. It recommended three orientations for promoting the position of youth in the labour market: increased wage and labour cost flexibility, reforms of initial schooling to ensure that youth enter the labour market with skills that employers value and measures to better structure the school-to-work transition.

### *The position of youth in the labour market generally has not improved since 1994<sup>12</sup>*

As already noted in Chapter 2, the situation of youth in the labour market has not improved much over the past decade, whether assessed in terms of relative unemployment or employment rates. Employment rates for youth did increase moderately in Finland, France, Norway and Spain, relative that for prime-age adults, but relative employment fell in far more countries (Figure 4.4). And it is still the case that youth are significantly more likely to be unemployed than prime-age adults in all OECD countries (Statistical Annex, Table C). In 22 of the 30 OECD countries, the unemployment rate of young adults, aged 20 to 24, is more than twice that of adults, aged 25 to 54 (OECD, 2006a, Figure W.4.2). Youth in Germany, the Netherlands, Canada, Ireland and Denmark are doing somewhat better relative to prime-age adults, as far as unemployment is concerned, than are their counterparts in the rest of the OECD.

Figure 4.4. **Youth employment rates relative to those of adults, 1994 and 2004**



Note: Data for youth refer to persons 20-24 years old, except for Switzerland (15-24 years old). Data for adults refer to persons 25-54 years old.

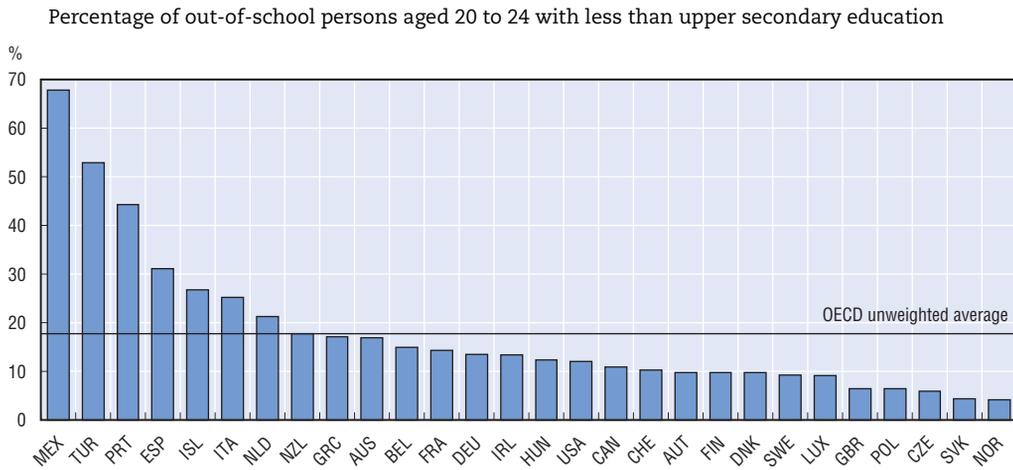
Source: OECD database on Labour Force Statistics.

Statlink: <http://dx.doi.org/10.1787/605742250776>

A significant proportion of youth continue to leave the education system without any qualification (Figure 4.5). School drop-outs – which total around 33 million in the OECD area as a whole – risk facing a particularly difficult start in the labour market, as well as continued problems later in their careers. However, dropouts represent very different proportions of the youth cohort in their respective countries, ranging from 4% in Norway to 68% in Mexico.<sup>13</sup>

Finally, a significant proportion of young people are neither in education nor in employment. Several OECD countries – notably, Turkey, Mexico, Italy, Greece and eastern European countries – show rather high rates of young adults (20 to 24 years of age) who were neither studying nor working in 2003 (Figure 4.6). However, the situation has improved notably since 1996 in some of these countries (Hungary, Poland, Greece and Mexico). The picture for teenagers, 15 to 19 years of age, is slightly better. Only about 8% of this age group are neither in employment nor attending school.<sup>14</sup> These figures underline the importance of looking at both inactivity and unemployment when analysing the situation of out-of-school youth. It is also important to note that youth who are neither studying nor active in the labour market may be exercising choices that do not imply any hardship or lack of good employment opportunities. For example, approximately one-half of inactive young male adults in Sweden are either performing military service or engaged in foreign travel.

Figure 4.5. **Share of youth leaving school without a qualification in OECD countries, 2003**



Note: For Iceland, Italy, the Netherlands and the United States, data refer to 2002; for New Zealand, data refer to 2001.

Source: OECD database on Labour Market Status by Educational Participation.

Statlink: <http://dx.doi.org/10.1787/577218438517>

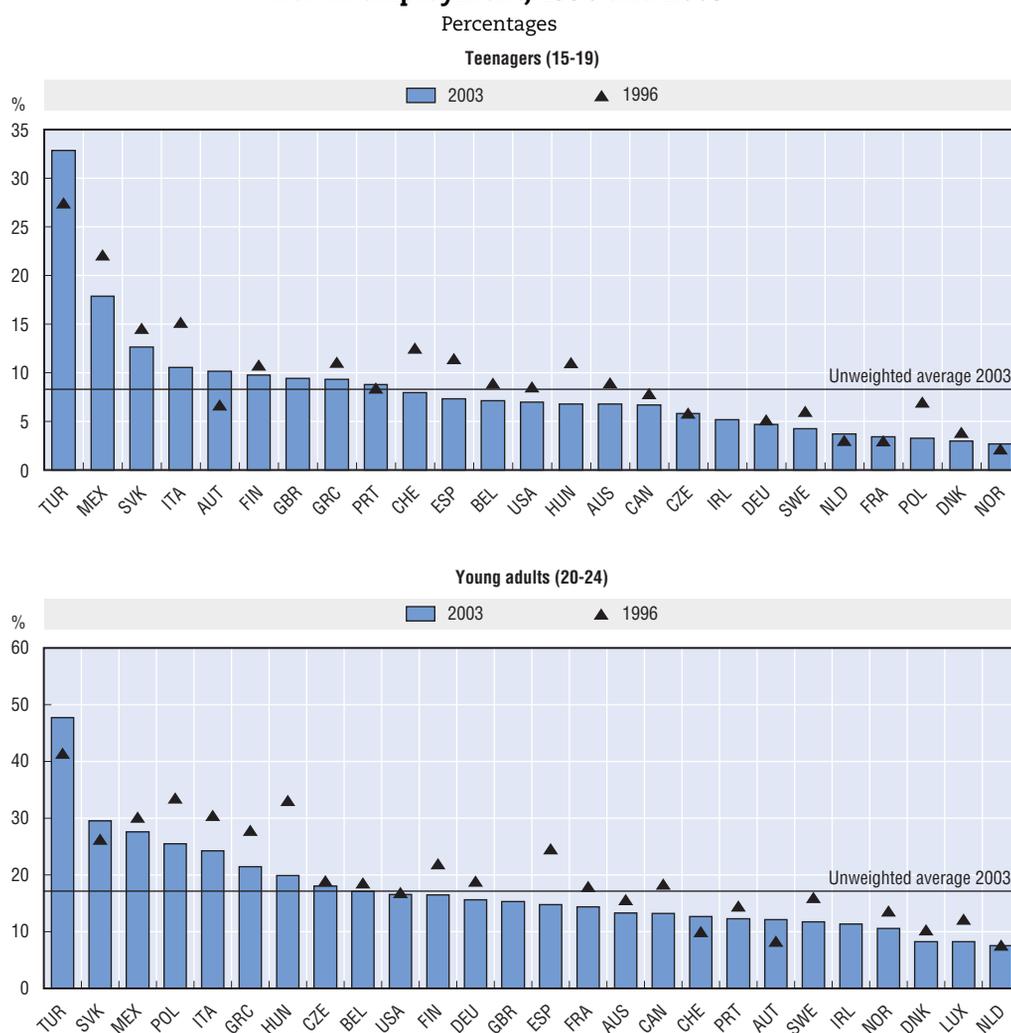
### Improving school-to-work transitions

Several countries have reinforced their educational systems with the aims of keeping young people in school until they obtain at least an upper secondary degree and of helping them to enter the labour market with better skills. While different approaches continue to co-exist across OECD countries, the predominant strategy has been to strengthen vocational training (*i.e.* curricula which emphasise the acquisition of practical, work related skills). For example, Australia initiated new vocational education and training programmes in 1996 which have since expanded rapidly. The primary aim of these programmes is to increase retention at school, until an upper secondary qualification has been acquired, while also preparing young people for the workplace. These programmes are also intended to open up possibilities for further education (see Anlezark *et al.*, 2005).

Dual schooling systems represent an alternative to vocational courses taught entirely in school setting. In the dual system, school-based learning time is associated with apprenticeships in enterprises. Although Austria, Denmark, Germany and Switzerland have long operated dual systems, the sustained good performance of these systems, as regards achieving low levels of youth unemployment, means that they continue to attract considerable attention as potential models for reforming upper secondary education in countries where the school-to-work transition functions less smoothly. Norway is a notable example of a country who recently introduced ambitious reforms inspired, in large part, by these models (Box 4.1). While such a reform strategy may hold considerable promise, countries considering reforms to their educational system that expand the role played by apprenticeship should take at least two issues into consideration, however:

- The difficulty of instituting or expanding apprenticeships tied to upper secondary education, in countries without a tradition of such measures, is not to be underestimated. For example, the long history and institutional complexity of German apprenticeships suggest that apprenticeships may only be able to thrive in the presence of powerful employer associations and with the active involvement of all social partners.

Figure 4.6. **Share of young adults and teenagers neither in education nor in employment, 1996 and 2003**



Note: For France, Italy and the United States, data refer to 2002 instead of 2003; for Germany, Finland and the Netherlands, data refer to 1997 instead of 1996; for Austria and Italy data refer to 1998 instead of 1996; for Ireland and the United Kingdom, data are not available for 1996.

Source: OECD database on Labour Market Status by Educational Participation.

Statlink: <http://dx.doi.org/10.1787/183278352480>

- Even where dual systems are already well established, it is a constant challenge to ensure that the types of training offered meets ever-changing labour market demands. A related concern is to ensure that employers will continue to offer a sufficient number of apprenticeship places – a topic currently receiving much attention in Germany, where there has been debate about whether additional public financing or new educational forms will be required.

In order to guarantee that a sufficient number of apprenticeship places are available, it is crucial to maintain employers' interest and involvement. In this respect, the level of *apprenticeship pay* is an important element in co-financing of dual training systems. The evolution of German apprenticeship wages and participation in the dual system suggests that the willingness of firms to take on apprentices can be increased by setting apprentice wages substantially below the minimum wage level for adult workers.

#### Box 4.1. **The reform of vocational education and training in Norway**

In 1994, the Norwegian government introduced important changes in the vocational education system directed at reducing school drop-outs and establishing a stronger link between school instruction and training at the workplace. The reform gave students a statutory right to three years of secondary education, including an apprenticeship. The upper secondary school was reorganised so as to combine both academic and vocational education in the same physical area, most commonly in the same buildings. The “2 + 2” scheme introduced as part of this reform offers students in a vocational track the opportunity to receive two years of school instruction and to spend either one or two years as apprentices in an enterprise. If the student chooses a two-year apprenticeship, half of that time will be spent in productive work, for which the apprentice is paid.

The new system requires that school authorities in each county will find a sufficient number of apprenticeship places that accord with the wishes of the students. If sufficient places cannot be found, the authorities must, as an exceptional provision, arrange for this part of the students' education to take place in school. Common curriculum plans for both the school and apprenticeship parts of the vocational track were developed.

Measures for institutional collaboration on a local level were established through so-called Training Circles and Offices for Vocational Training. These represent organised co-operation between two or more enterprises having a common need for trained workers or having decided to offer apprenticeship training jointly. The municipal school authorities have a secretariat that provides support and help in establishing and running the circles and offices. On the local level there is little or no formal organised co-operation between the enterprises offering apprenticeships and the schools. This does not mean that there is a complete lack of contact between the schools and the workplaces, only that the initiative for establishing co-operation is placed on each individual school teacher and each instructor in enterprises which take on apprentices. In fact, there are teachers in most schools who, as a regular part of their job, maintain such contacts with local employers.

Sub-minimum wages for youth might be justified by the existence of a training component over the transition period from school to work, even in the absence of a formal apprenticeship system. However, it is difficult to ensure that the training quid-pro-quo is offered in such a context. Furthermore and as shown in Chapter 7, the impact of minimum wage legislation on youth employment is theoretically ambiguous. While a high minimum wage may increase school dropouts and therefore labour force participation, it can also adversely affect recruitment prospects. Several cross-country or cross-region empirical studies have identified negative effects of minimum wages on youth employment (e.g. OECD, 1998; Neumark and Wascher, 1999), but others have failed to do so (e.g. Card and Krueger, 1995). Overall, the conclusion drawn on this topic in Chapter 7 is that, while significant negative effects may be found, in some cases, there is no clear cross-country empirical effect of minimum wages on youth employment.

#### ***Welfare-to-work and activation policies***

For youth who leave school without an upper secondary educational qualification, access to stable employment can be difficult to obtain. While the educational policies described in the previous section address the problem at its root, active labour market programmes represent an important option for school dropouts who are already out of the educational system. Over the past two decades, policy effort has focused more and more on

the interaction between passive and active measures, following the “mutual-obligations” principle (see Section 2 of Chapter 3). Youth have often been one of the groups most intensely targeted by these measures.

For instance, the European Union’s Employment Strategy, as formulated in 1997, called for job search assistance to be offered to youths before six months of unemployment have passed (12 months in the case of adults). EU countries with major programmes for youth that come into play before or at six months threshold include Austria, Belgium, Denmark, France, Germany, Italy, Portugal, Spain and the United Kingdom. Sweden uses a shorter period (90 days), and youth activation in Finland, for those without a vocational qualification, starts immediately. Several non-EU countries (Australia, New Zealand and Norway) also target programmes on young unemployed after six months.

There is some evidence from evaluation studies to suggest that the well being, both pecuniary and psychological, of youth is improved when they are subject to immediate activation as part of a well-designed programme based on the principle of mutual obligations (Magnac, 1997). While results are somewhat mixed, the balance of the evidence suggests that participation increases the likelihood of finding employment, at least for some of the most ambitious programmes, (e.g. the New Deal for Young People in the United Kingdom<sup>15</sup> and Work for Dole in Australia<sup>16</sup>). However, several evaluation studies conclude that these types of labour market programmes have only limited effectiveness in helping very disadvantaged youth into the labour market (see Glyn and Wood, 2001).

In terms of content and design, successful programmes appear to share some characteristics (see Martin and Grubb, 2001; and Betcherman *et al.*, 2004):

- Job-search assistance programmes are often found to be the most cost-effective for youth, providing positive returns in the form of higher earnings and employment. Some wage and employment subsidy programmes have yielded positive returns, but these types of measures tend to perform poorly in terms of their net impact on the future employment prospects of participants.
- Training programmes should be carefully tailored to local or national labour market needs. In this respect, mobilising and involving the private sector and community leaders to assess local or national demand for skills is important.
- Good targeting of the programmes is important. For instance, there is a need to distinguish between teenagers and young adults, and to devote particular attention to early school leavers. The most desirable solution to the employment problems of teenagers is to help them to remain in (or return to) school, whereas for young adults in their twenties, it is more important to help them to acquire work experience.
- It is important to make participation in programmes compulsory for youth after a period of job search of no more than six months. While this may imply an increase in costs and a reduction in the average effectiveness of the programmes,<sup>17</sup> making participation compulsory is likely to be the only way to ensure that the programmes reach the youth who are most at risk of social exclusion.

### ***Large-scale job creation and promotion***

Direct job creation schemes are often used as a complementary policy tool which can provide youth with work experience. The most recent programmes focus on requiring that the jobs created meet new or unsatisfied needs and providing appropriate support services to the participants (e.g. career guidance and counselling).

Overall, these programmes tend to be effective in the short-run, in that they directly place young people into jobs. For example, during the experience with *Nouveau Service Emplois Jeunes* in France – a large-scale programme of direct job creation in the non-profit sector – the youth unemployment rate fell from 28.5% in 1997 to 20% in 2002.<sup>18</sup> However, these types of programmes tend to be very costly and the evidence suggests that they generally are not effective at improving the labour market chances of disadvantaged youth in the long run.

Subsidised private-sector employment has also been used as a tool to address youth unemployment. It is not clear whether subsidies to employment create many net new jobs. Instead of increasing total employment, firms may simply substitute subsidised for unsubsidised workers – the “substitution effect” – or hire subsidised workers whom they would have hired even in the absence of the subsidy (the “dead-weight effect”). The available evidence shows that subsidies to employment often are subject to large deadweight loss and substitution effects, and hence have small overall net employment gains. However, substitution effects may be justified on equity grounds, when they provide the most disadvantaged groups with work experience and earnings. Little evidence is available on the impact of subsidised employment on the subsequent job and earnings prospects of young people, but it appears that programmes that alternate subsidised work within enterprises with training in specialised institutions are the most effective at fostering transitions into the regular labour market.

### **Lessons**

The attention paid by the 1994 Jobs Strategy to the reduction of early school-leaving and the improvement of school-to-work transitions continues to be well placed. Several OECD countries have enacted important reforms along these lines – notably by introducing new forms of apprenticeships designed to increase school retention rates and reduce the share of youth who are neither in employment nor in education. However, countries that reform their educational systems in this direction should pay particular attention to ensuring the availability of a sufficient number of apprenticeship places by providing employers with the right incentives to participate in these schemes.

For those youth who are already out of the educational system and are experiencing unemployment, targeted active labour market programmes can play an important role. However, their cost-effectiveness needs to be monitored closely, especially in terms of their success at helping the most disadvantaged youth find jobs. These programmes should focus on job-search assistance activities which are often found to be the most cost-effective measures for youth, providing positive returns on both earnings and employment. Where training is envisaged, it should be designed with employers’ hiring requirements in mind. Good targeting and tight work availability requirements are also important design features to help contain overall costs, while guaranteeing focus on the neediest.

#### **1.4. Promoting employment prospects of immigrants**

In many countries, immigration is seen as one possible route to alleviate the adverse consequences of ageing populations, in conjunction with other policies. For this to be a feasible policy option in the future, it is clearly necessary that the current stock of immigrants – many having arrived only recently –, their children, and future arrivals be in some sense well “integrated” into the societies of OECD countries.<sup>19</sup> In sum, policies to improve the situation of immigrants on the labour market have taken on greater urgency since the OECD Jobs Strategy was formulated in 1994, and this is so for both economic and social reasons.

Integration into the labour market means that gradually, as immigrants pick up the host-country's language and work practices, they tend to show the same range of labour market outcomes as native-born persons with similar characteristics. This applies in particular to immigrants who arrive in the host country without pre-arranged work, such as family and humanitarian migrants or persons arriving as permanent immigrants selected on the basis of certain characteristics. The situation is different for migrants who have a job waiting for them in the host country; for them, the issue is whether they are adaptable in the face of a changing economy.

Table 4.4 shows that the unemployment rate of immigrants is generally higher than that of the native-born. However, it is only slightly higher in some countries, whereas it is as much as three times higher in others. Immigrants' employment is also generally more sensitive to economic conditions than that of the native-born.<sup>20</sup> What characterises "successful" countries from those where results are not as good is, to a certain extent, the fact that the former have a significant proportion of highly qualified labour migrants whose outcomes are favourable and tend to counterbalance those of other categories of migrants. Humanitarian and family inflows tend to have a smaller weight in these countries. Nonetheless, good overall labour market conditions and employment policies can play a significant role in facilitating integration, as can measures specifically intended to assist migrants.

There is a general perception that the labour market integration of immigrants has become more difficult. But here one needs to be careful. If one compares a period when migration for economic reasons is predominant (the 1960s) with one when migration consists more of humanitarian and family migration (the 1990s), then inevitably it will look as if outcomes are deteriorating for recent arrivals and indeed, overall. In addition, the situation differs across countries. In the countries of southern Europe, for example, which have seen high flows of labour migration in recent years, the current employment rates of new arrivals are even higher than those of the native-born population. In most other European countries, flows have been largely humanitarian and family-related for some decades, and although the differences in employment rates relative to the native-born are a cause for concern, they have improved significantly in many countries over the past decade (Table 4.5). The negative perception about progress reflects in part the fact that the immigrant population itself is more visible due to the large numbers which have arrived over the 1990s, that certain channels of entry have been abused and that the outcomes themselves still leave much to be desired, especially for children of immigrants in some countries.

The available evidence suggests that integration problems mainly concern the entry of immigrants into the labour market and over qualification. Once a foothold is acquired in the labour market, wage progression seems to be less of a problem, although initial wages following arrival tend to be relatively lower than in the past. This seems to be especially the case for highly-skilled immigrants, whose previous foreign experience is often not recognised by employers. Similarly, discrimination seems to be mainly a problem with respect to access to employment, less with respect to wages, especially for the lower skilled. Employment rates are especially low among immigrant women from countries where female participation is also low.

Table 4.4. **Unemployment rates of the native- and foreign-born populations, 15-64 years old, 2004<sup>a</sup>**

	Native-born	Foreign-born	Ratio <sup>b</sup>
<b>Men</b>			
Australia	6	6.5	1.1
Austria	4.3	11.2	2.6
Belgium	5.6	15	2.7
Canada	5.5	6.6	1.2
Denmark	4.4	14.4	3.3
France	8	13.6	1.7
Germany	10.3	18.3	1.8
Greece	6.5	6.7	1
Ireland	4.9	6.5	1.3
Italy	6.4	6.1	1
Netherlands	3.6	10.3	2.9
Portugal	5.7	9.9	1.7
Spain	7.8	11.4	1.5
Sweden	6.2	13.9	2.3
United Kingdom	4.7	7.3	1.5
United States	6.9	5.8	0.8
<b>Women</b>			
Australia	6.1	6.5	1.1
Austria	4.3	10.7	2.5
Belgium	7.5	15	2
Canada	4.9	6.8	1.4
Denmark	5.2	10.3	2
France	9.9	17.2	1.7
Germany	9.6	15.2	1.6
Greece	15.7	18.9	1.2
Ireland	3.6	5	1.4
Italy	10.1	13.1	1.3
Netherlands	4.3	10.6	2.5
Portugal	7.4	9.6	1.3
Spain	15.1	17.1	1.1
Sweden	5.2	12.2	2.3
United Kingdom	3.9	7.3	1.9
United States	5.5	6.8	1.2

a) Data refer to 2003 for Australia and to 2002 for Canada.

b) Ratio of foreign-born to native-born unemployment rates.

Source: Australian Labour Force Survey for Australia; OECD calculations based on the Survey of Labour Income Dynamics (SLID) for Canada; on the European Union Labour Force Survey (EULFS) for the European countries; and on the Current Population Survey (CPS) for the United States.

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### **Measures to improve integration into the labour market**

Selecting migrants carefully before they arrive clearly has a positive impact on integration, precisely because the immigrants concerned are selected with a view to ensuring better results on the labour market. However, many immigrants, such as recognised asylum seekers or family migrants, are admitted on the basis of international agreements or generally recognised human rights. Outcomes for these groups tend to be not as good and convergence with outcomes of natives tends to take longer than for directly selected immigrants. Indeed, in many of these cases, convergence does not occur even after ten or more years.

Table 4.5. **Employment rates of native- and foreign-born populations, 15-64 years old, 1994 and 2004**

	1994 <sup>a</sup>		2004 <sup>b</sup>	
	Native-born	Foreign-born	Native-born	Foreign-born
Australia	66.6	59.6	72.3	64.9
Austria	68.5	67.7	67.4	61.5
Belgium	56.8	46.3	62	50.2
Canada	70.1	68.2	74.6	68.5
Denmark	73.1	44.6	77.4	59.4
France	60.1	54.2	63.5	57.1
Germany	67.8	62.7	65.8	55.1
Greece	54.1	53.7	59.3	64
Ireland	52.8	49.2	65.7	64
Italy	50.8	57.9	57.4	63.5
Netherlands	65.6	47.7	75.1	59.1
Portugal	63.2	56.8	67.8	70.1
Spain	45	45.3	60.3	66.2
Sweden	75.2	53.6	74.3	61.3
United Kingdom	68.5	58.4	72.4	63.4
United States	69.8	63.8	69.1	68.5

a) Data refer to 1995 for Austria and Sweden, to 1993 for Australia and Canada, and to 1992 for Germany.

b) Data refer to 2003 for Australia and to 2002 for Canada.

Source: Australian Labour Force Survey for Australia; OECD calculations based on the Survey of Labour Income Dynamics (SLID) for Canada; on the European Union Labour Force Survey (EULFS) for the European countries; and on the Current Population Survey (CPS) for the United States.

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Acquisition of the host-country language after arrival is clearly a key element in the ability of immigrants to enter the labour market and most countries offer language training to humanitarian migrants and in some cases, to other migrants who do not have a mastery of the host-country language. The duration of language training is an issue, because employers tend to value host-country work experience and prolonged language training delays entry into the labour market. The association of vocational and language training has been shown to contribute in general to more favourable outcomes.

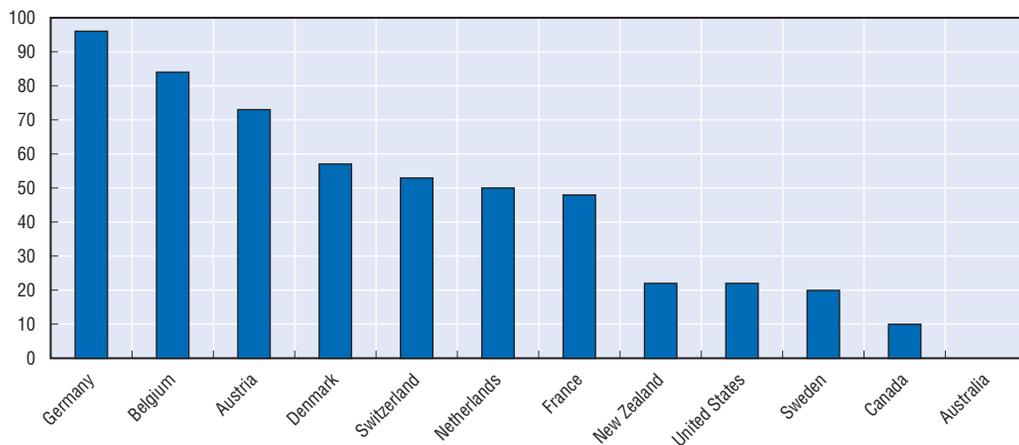
Immigrants upon arrival may have qualifications and work experience obtained in their country of origin, which employers may not always know or be equipped to recognise the value of. Programmes that ensure some recognition of qualifications and prior work experience, or that enable immigrants to obtain work experience in the host country, are often a necessary prelude to a successful entry into more permanent work. Still, evidence indicates that even after long stays in the host country, immigrants tend to occupy jobs that do not correspond to their formal qualifications to a significantly greater extent than the native-born.

Immigrants are also at a disadvantage with respect to job search, because many jobs are filled through networks or informal contacts, which recent immigrants will generally not have to the same extent as natives. In difficult economic conditions, the use of such networks apparently becomes greater, so that immigrants are disadvantaged even further. The development of such networks can be facilitated through immigrant and employer associations and the involvement of labour unions. The stock of past immigrants, if it is large and well-established, can also constitute an effective job network and reduce the costs of migration.

### The second generation

For the children of immigrants, the so-called “second generation”, one would expect, at the very least, outcomes similar to those of natives with the same socio-economic background. In many ways, the outcomes of the second generation can be viewed as the “benchmark” for the long-term success of integration policy, since migration-related labour market impediments such as lower language proficiency or non-recognition of qualifications or of experience should not in principle operate. Success of the second generation in the educational system and eventually, in the labour market, depends on how well the educational system assists children whose native language is not that of the host country or whose parents may not always be able to support effectively their children’s educational progress. Educational success is to a certain extent a function of parental education, but downstream educational and labour market outcomes will reflect how educational systems temper or compensate for the impact of home disadvantage. PISA (Programme for International Student Assessment) results show large country differences in the relative performance of immigrant and non-immigrant children (see Figure 4.7), differences which tend to decline if the socio-economic background of the household is taken into account. Further measures to better accompany children of immigrant parents would appear to be necessary in some countries.

Figure 4.7. **Differences between the PISA reading scores<sup>a</sup> of natives<sup>b</sup> and those of children of immigrants, youth aged 15 years, 2003**



PISA: Programme for International Student Assessment.

a) The mean score across all OECD countries was set at 500 points, with a standard deviation of 100 points.

b) “Natives” here refers to children with native-born parents.

Source: OECD calculations based on the OECD PISA database.

Statlink: <http://dx.doi.org/10.1787/818513315507>

One reason for the generally unfavourable labour market outcomes of immigrants and their children is discrimination, especially in situations when the immigrants or their offspring are or remain in some sense “visible”. This has been demonstrated on a number of occasions by “testing” procedures, in which candidates with formally identical backgrounds except for origin or ethnicity apply for advertised jobs. It is particularly pernicious, because it violates the fundamental tenet of equal opportunity and can result in a reduced investment in human capital on the part of immigrants and their children. This can create a vicious circle in which discriminatory behaviour towards young immigrants or their children develops or is reinforced by their unfavourable employment

outcomes which in turn result in their demotivation. Discrimination, however, is in general difficult to demonstrate in practice. It requires constant vigilance on the part of public authorities and programmes to ensure public awareness of the issue.

## 2. Assisting workers in disadvantaged regions

With respect to lagging regions, the 1994 Jobs Strategy recommended to decentralise wage-setting in order for wages to better reflect regional and local conditions. Such wage flexibility was seen as particularly important in countries with low regional mobility, notably some European countries. In addition, as discussed in the following pages, specific/targeted policies may also be needed to improve job opportunities for workers living in depressed regions. The contribution that regional migration may play in reducing employment disparities is also discussed, as well as potential barriers to migration arising from housing policies.

As already discussed in Chapter 2, regional disparities in labour market performance vary significantly across countries. They are stubbornly high in Germany and Italy, where they correspond to a major regional divide, but also in Belgium and Turkey (Figure 4.8). The unemployment rate in low-unemployment regions, at around 3-5%, is very similar across countries.<sup>21</sup> By contrast, the unemployment rate in high-unemployment regions ranges from 4 to 27% in the various countries (Figure 4.9). High regional disparities generally coincide with high national unemployment and low employment, suggesting that reducing regional disparities is important to improve the overall labour market performance.

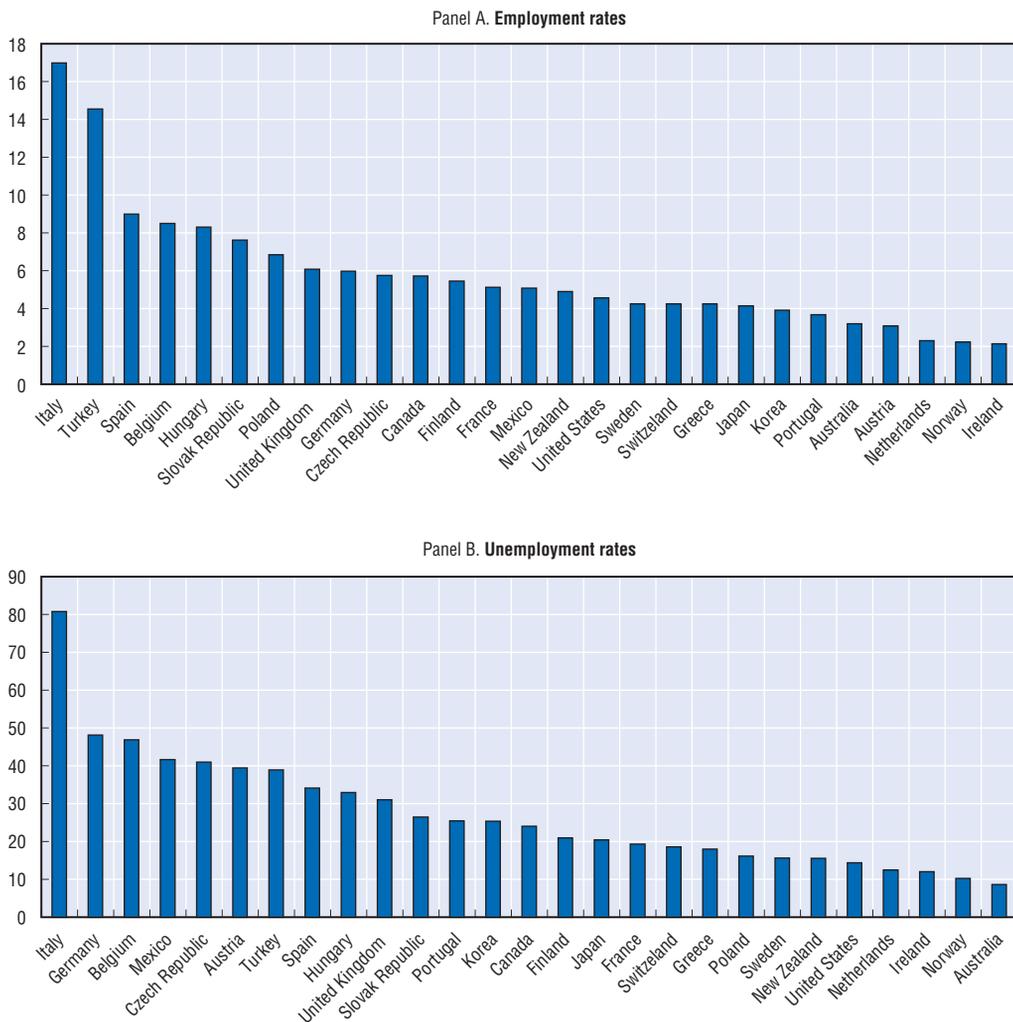
The evolution of regional employment disparities over the past decade also differed across countries, but disparities generally tend to be persistent in time and to cluster in space. The most striking evolution is Italy, where regional inequalities increased a lot (Figure 2.8). By contrast, regional disparities in unemployment rates fell in Germany, but remained quite high. Sizeable reductions also took place in Greece and Korea and significant ones in Japan and the United States. No clear correlation between the evolution of regional unemployment disparities since 1993 and that of the overall unemployment rate emerges. For example, despite a significant reduction in the overall unemployment rate, regional unemployment disparities increased over the past decade in Canada and Spain. Conversely, regional disparities in unemployment decreased in Germany, Greece and Japan, even as overall unemployment increased. Very often, it is the same regions which perform badly. About three out of four European and Asian/Pacific regions which had very low employment rates in 1993 compared with the national average were still in the same position in 2003. The figure is close to two out of three for the North American regions.

### ***Reducing regional disparities in employment creation requires further emphasis on wage flexibility***

One area of reform of labour market policies that continues to be particularly relevant to regional development is the wage-setting institutions (Chapter 3). Insufficient wage adjustment at the regional level may be partly responsible for the persistence of employment disparities. In general, regional disparities in employment are positively correlated with disparities in productivity levels (see Sestito, 2004, for Europe). Intermediary wage-bargaining systems – i.e. those relying mostly on industry-level bargaining, such as in Germany, Spain, and to a lesser extent Italy (OECD, 2004a, Chapter 3) – where outcomes are influenced mainly by the economic conditions prevailing in the leading sectors and regions, may create a gap between wages and productivity in

Figure 4.8. **Regional dispersion in labour market performance within OECD countries, 2003<sup>a</sup>**

Coefficient of variation<sup>b</sup>



a) 2000 for Japan, Korea, New Zealand and Switzerland.

b) The weighted coefficient of variation is defined as:

$$\sqrt{w_i \cdot (ER_i - ER_n)^2} / ER_n$$

Where  $w_i$  is the share of the working-age population (labour force) in region  $i$  in the national working-age population (labour force),  $ER_i$  ( $UR_i$ ) is the employment rate (unemployment rate) of region  $i$  and  $ER_n$  ( $UR_n$ ) the national employment rate (unemployment rate). Regional level 2 sub-national regions were used except for Australia, Canada, Mexico, Turkey and the United States (regional level 1).

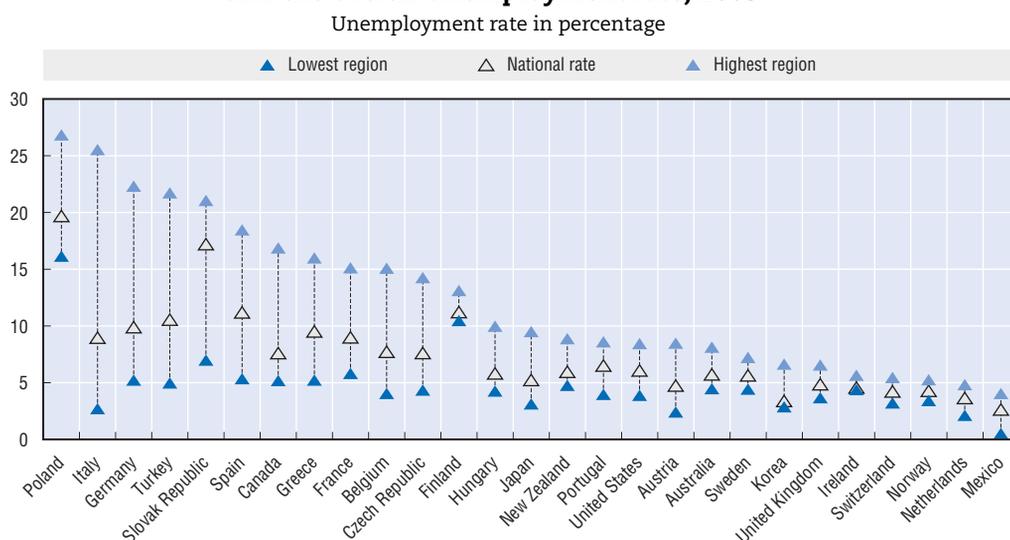
Source: OECD (2005), *OECD Employment Outlook*, Chapter 2, Paris.

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lagging regions. Such a gap would reduce the incentives for investment in those regions. This has been put forward as a key factor behind North-South regional imbalances in Italy, and East-West imbalances in Germany in a number of studies.<sup>22</sup> Decentralising wage-setting could thus help in reducing regional employment disparities, by stimulating job creation in lagging regions.

In short, the 1994 recommendations regarding wage flexibility continue to be relevant, especially since – as noted in Chapter 3 – there is much scope for more progress in this area in several member countries.

Figure 4.9. **Regional unemployment dispersion and the overall unemployment rate, 2003<sup>a</sup>**



a) 2000 for Japan, Korea, New Zealand and Switzerland.

Source: OECD (2005), *OECD Employment Outlook*, Chapter 2, Paris.

Statlink: <http://dx.doi.org/10.1787/343723238358>

### Exploiting the productive potential of low-employment regions could also help

A shift-share analysis suggests that differences in regional production structures may also play an important role, particular in countries where regional disparities are high. Initial sectoral specialisation accounts for about 30% of the average employment growth differential between less performing and better performing regions in Italy, almost 50% in Germany and 40% in Spain (OECD, 2006a, Figure W.4.3).<sup>23</sup> Depressed regions could thus benefit particularly from general macroeconomic and structural policies (innovation, education, product market regulation, labour market, etc.) favourable to growth that stimulate the emergence of new activities.<sup>24</sup>

Policies to enhance regional productivity and employment levels may also be needed.<sup>25</sup> Programmes aiming at bringing investment and jobs to depressed areas through subsidies and tax concessions have been implemented in many OECD countries. Few rigorous evaluations of such programmes are available. The available evidence cast some doubt about the efficiency of many such schemes. In the case of the Enterprise Zones in the United Kingdom, for example, deadweight effects (i.e. jobs would have been created anyway) and regional displacement (i.e. firms setting up in the Enterprise Zones were simply relocating from neighbouring areas) appeared to be sufficiently large to imply that the net employment effect was very small. Improving infrastructure may be more effective in many instances. However, it is an empirical question, in each case, whether any particular infrastructure investments could enhance the region's growth potential in a cost-effective manner.

There may also be a role for devolving responsibility for some employment programmes to regions. More decentralisation of employment policies can be part of a strategy to enhance overall policy effectiveness, but may be especially useful for allowing local authorities to tailor programmes to better meet the specific requirements of depressed areas. However, available evidence suggests that this should be done within an agreed framework which sets clear objectives, and central government funding should be made dependent on the achievement of the agreed objectives.

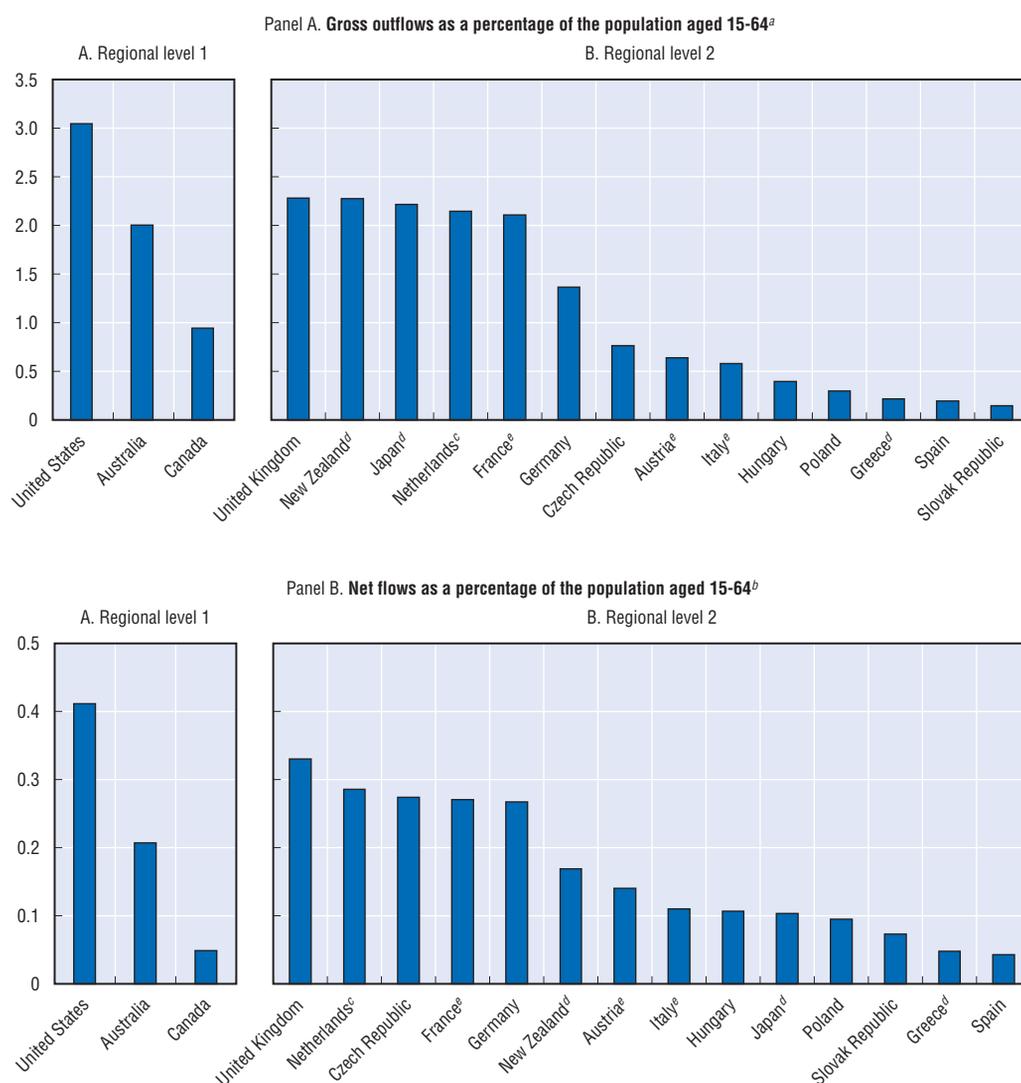
### *Housing as a potential barrier to regional mobility*

The movement of workers from depressed regions to better performing regions could, in principle, play an important role in reducing regional employment disparities. In practice, however, this role seems quite limited in most countries. Working-age individuals are much less mobile in European countries than in the United States and Australia (Figure 4.10, Panel A).<sup>26</sup> Besides, a relatively small proportion of internal gross flows corresponds to a redistribution of the working-age population among regions: net internal migration flows are quite low, below 0.3% in most cases (Figure 4.10, Panel B). Finally, looking at the direction of inter-regional migration flows over the 1998-2003 period, they do not always contribute to re-equilibrating regional employment disparities. In a majority of countries, working-age migrants tend to move from low-employment to high-employment regions and from high-unemployment to low-unemployment regions. But in others, migration flows tend to reinforce regional disparities for one of the two measures (employment or unemployment) and on both counts, as in the Czech Republic, France and the Netherlands.<sup>27</sup> This somewhat counter-intuitive result indicates that job opportunities are not the only, and perhaps not even the main, motivation for internal migration in those countries.

Mobility is not an end in itself, and there are probably some limits to the role it can play in reducing employment disparities.<sup>28</sup> Still, there may be some room to reduce barriers to mobility that are created by current housing policies:

- In addition to potential capital losses, home-owners deciding to move also often face sizeable transaction costs, under the form of stamp duties, legal fees, administrative fees and also real estate fees. Stamp duties are particularly high in Belgium and Greece, while agency fees and other non-tax fees are substantial in Portugal and also relatively high in Canada, France and the United States, possibly reflecting problems in the functioning of brokerage markets. Transaction costs tend to be lower in Nordic countries and even more so in the United Kingdom.
- Another factor potentially limiting regional migrations is that housing policies tend to favour home ownership over rental in most OECD countries, through a number of tax and subsidy incentives.<sup>29</sup> These policies contribute to high ownership rates in many countries (Table 4.6). Home ownership tends to reduce the mobility of workers since, due to higher transaction costs and the potential capital loss mentioned above, homeowners face higher costs of moving than renters.
- Another potential barrier lies in the functioning of social housing “markets”. For social housing tenants (among which the low-skilled unemployed workers are likely to be over-represented), moving to a different region to take up a new job is likely to imply losing access to social housing, thus significantly reducing the incentives to move. The problem may have become less acute with the progressive shift observed in many countries from direct social housing supply to housing allowances, which have in principle no direct disincentive effect on mobility.<sup>30</sup> However, ways may also be found to increase the mobility of social renters, for example by waiving residency or queuing requirements in the case of unemployed persons taking up a job in a new region. Doing so would require tackling the coordination problem arising from the frequent division of responsibilities in social housing management across regions and/or localities.

Finally, high housing prices in booming regions in combination with a rising trend in temporary employment observed in a number of OECD countries (see Chapter 2) may also be hampering the mobility of workers. In a tight housing market, a worker with only a

Figure 4.10. **Internal migration rates, 2003**

- a) Except for Australia and Italy for which the population of reference is the total population and for Japan for which the population of reference is the population aged more than five years.
- b) Total net migration rate is calculated as the ratio of the sum of the absolute values of regional net flows divided by two, to the total population aged 15-64.
- c) 1999.
- d) 2001.
- e) 2002.

Source: OECD (2005), *OECD Employment Outlook*, Chapter 2, Paris.

Statlink: <http://dx.doi.org/10.1787/180733165865>

temporary contract is likely to be turned away by many prospective landlords. This is also the case for low-paid workers with permanent contracts but no financial guarantee. Setting up guarantee schemes for such workers may be a way to alleviate this problem and increase the role that migration can play in reducing regional disparities in unemployment rates.

### Lessons

Decentralising wage-setting to allow regional wages to better fit regional productivity was already identified in the 1994 Jobs Strategy as an important tool to reduce regional imbalances, and room remains for further action in this area. More differences between

Table 4.6. **Housing tenure in the early 2000s**  
Percentages

	Owner-occupied	Private rented	Social rented	Others
Australia	70	20	5	5
Belgium	68	23	7	2
Canada	66	28	6	0
Denmark	51	26	19	4
Finland	64	15	17	4
France	56	21	17	6
Germany	41	44	6	5
Greece	74	20	0	6
Ireland	79	7	9	6
Italy	77	12	5	7
Netherlands	54	11	35	0
Portugal	76	15	7	2
Spain	81	11	0	8
Sweden	46	21	18	15
United Kingdom	69	10	21	0
United States	68	30	2	0

Source: OECD (2005), *OECD Employment Outlook*, Chart 2.A2.2, Paris.

Statlink: <http://dx.doi.org/10.1787/407465517848>

wages across regions could increase incentives for investment in the lagging regions and stimulate job creation. The positive effect of wage flexibility could be reinforced by the adoption of broader pro-growth macroeconomic and structural policies.

Reducing barriers to inter-regional mobility may help improve the allocation of labour resources while at the same time reducing labour shortages in high-employment regions. This requires greater attention to the interactions between housing policy and mobility incentives – an issue which should figure more prominently in the Jobs Strategy. First, housing transaction costs remain important in a number of countries, and measures could be taken to reduce stamp duties, administrative and legal fees, as well as real estate fees. Second, social housing systems could be reformed to better taking into account possible needs to move for job reasons. Finally, since temporary and/or low-paid workers – the groups most affected by non-employment problems in lagging regions – face significant difficulties in finding housing on a tight housing market, setting up guarantee schemes may improve their mobility.<sup>31</sup>

### 3. Facilitating transitions from informal work to formal employment<sup>32</sup>

In several OECD countries (and in much of the developing world), unemployment is a situation that many workers cannot afford. This is because the coverage of unemployment benefits is limited and overall household incomes are low. Often, the choice is between a declared job and work in the informal economy. Even in countries with better developed systems of social protection, informal employment may represent a common choice for certain groups in the work force.

The precise extent of informal employment is difficult to gauge.<sup>33</sup> In the case of Mexico, it is estimated that almost 18 million persons are employed in the informal economy, or 43% of total employment. The informal sector also appears to have grown in recent years. In Korea, Turkey and some countries of southern and eastern Europe, it is estimated that between 20 and 30% of wages are not declared. In other OECD countries, the overall rate of informal employment is much lower, but there is considerable undeclared work and earnings in certain sectors, like construction and personal services.

A high incidence of informal employment can have a detrimental effect on economic growth and living standards. It reduces the tax base for funding social programmes like education and health, which are important for building human capital and sustaining long-term economic growth. More generally, there may be a low-productivity/high-informality trap at work: to further expand (and get into higher value-added activities), small businesses may have to register, declare workers and pay taxes. For example, only formal businesses can have the access to legal protection, insurance and financial markets required to engage in larger scale and more complex activities. However, the perceived incentive to do this may not be high enough and the firm may renounce an opportunity to grow larger and upgrade its operations, thereby maintaining low productivity levels. In addition, a high incidence of informal employment makes it difficult to finance government spending and to effectively target and manage social protection. It may also be a source of corruption.

The issue of informal employment was not addressed when the OECD Jobs Strategy was formulated in 1994. At the time, Korea, Mexico and eastern European countries were not members of OECD, so there was less attention to the issue of informal employment among the membership. The arrival of new members, most of which have significant informal sectors, has changed the focus. However, informal employment is also a policy concern in some longer-standing OECD member countries. Increasing concern about irregular immigration – which is often associated with informal employment – has also heightened interest in this issue.

### ***The relative taxation of wages versus profits of small firms***

Employers have a financial incentive not to declare employment – or to under-declare employee compensation – when profit taxes are lower, or are more easily evaded, than labour taxes. By contrast, setting taxes on labour lower than taxes on profits, combined with good enforcement of profit taxes, creates an incentive for employers to deduct as much labour income as possible from gross revenues – thereby encouraging employers to declare the true wages and salaries of their employees. Taxes on distributed corporate profits remain low relative to taxes on labour in a number of countries (Joumard, 2001).

This relationship also suggests that the structure of social security contributions and taxes on low-wage employment should be reassessed in countries where there is a high incidence of informal employment. For example, some contributions are capped in Mexico and Turkey, thus generating a regressive pattern of labour taxes. A shift to progressive labour taxes (i.e. a system which taxes high-wage workers at a higher rate than their low-wage counterparts) may help support demand for low-skilled labour – the abundant resource in these countries – in the formal sector. However, low-wage workers should not be exempted from participation in social insurance schemes. One of the strongest motives workers can have to work in the formal sector is precisely to acquire entitlements to these benefits. Expanding the effective coverage of low-wage workers by these programmes would also serve social goals.

### ***The importance of effective tax administration and providing adequate incentives to formality***

Greater efforts to strengthen tax and labour inspections are also needed, since undeclared work among employees is to some extent explained by the weak tax assessment regime for small businesses and the self-employed. Enforcement can be

strengthened by reinforcing tax inspection services and improving information exchange among the various government departments concerned. For example, the tax and social security files are linked in the Nordic countries and the Netherlands, which have a rather low share of informal employment, and Korea is putting a lot of effort in that direction. Two additional ways to strengthen employers' incentives to properly declare labour earnings (which otherwise will be taxed as net profit) are to: i) make value added the relevant tax base; and ii) focus the tax collection strategy on upgrading business record-keeping and accounts, rather than on the detection of work relationship.

Since under-declaration of wages is often difficult without the collaboration of the workers, another strategy for encouraging the transition to salaried employment is to reinforce workers' incentives to work in compliance with the tax and regulatory system. As was previously mentioned, a key policy lever here is to make participation in social insurance schemes sufficiently attractive to workers. A complication with pursuing this strategy is that formal employment of the head of household suffices to provide an entire family with access to certain benefits, such as health insurance. This reduces the incentive of other earners within the family to declare their activity. By contrast, unemployment benefit entitlements are largely based on individual employment status and may thus reduce incentives for undeclared work, particularly when combined with proper controls ensuring that those receiving such benefits do not also engage in undeclared work.

### ***The complex role of employment and minimum wage regulations***

Employment protection legislation in some of the countries most subject to a high incidence of informal employment (like Mexico and Turkey) is relatively strict. Although protecting workers in the event of dismissal is especially important in cases where unemployment benefits are very limited or non-existent, overly strict EPL may make employers reluctant to "formalise" employment arrangements. Minimum wages can have much the same effect.

Relaxing regulations and reducing minimum wages is not necessarily a panacea for reducing informal employment. Indeed, strict regulation of employment relationships is often used as an indirect strategy to reduce evasion of taxes and social contributions by employers, although this becomes less necessary as tax administration improves.<sup>34</sup> Moreover, severance pay is practically the only form of compensation that currently exists in the face of job loss in the formal economy in some of the countries in question.

### **Lessons**

Co-ordinated action across a number of fronts is likely to be necessary to reduce informal employment in countries where it is a serious problem. In most cases, this will include some or all of the following: making greater efforts to assess taxes and social security contributions (and applying sanctions to recalcitrant employers); moderating employment regulations where they are overly strict and minimum wages where they are too high; lowering taxes on low-paid work; and extending the social safety net, particularly unemployment benefits, to better cover low-paid workers.

## Notes

1. A large number of empirical studies have shown that female labour supply is much more responsive to net wages than is male labour supply (Evers et al., 2005).
2. Though their effectiveness may be reduced if women substitute formal for informal childcare.
3. See Anderson and Levine (2000) for the United States, Gustafsson and Stafford (1992) for Sweden and Del Boca (2002) for Italy. Some authors have questioned the direction of causality between childcare support and female participation: Chevalier and Viitanen (2002) and Gelbach (2002).
4. This section relies mainly on Duval (2004), Brandt et al. (2005) and OECD (2006c).
5. This recommendation was treated as part of the broad policy guideline of increasing working-time flexibility and received little attention for many years.
6. This discussion provides a synthesis of main lessons which emerged from the 21 country reports published in the OECD series on *Ageing and Employment Policies*.
7. For details on the assumptions underlying these calculations and the limits to their interpretation, see Duval (2003). For a full documentation of recent changes to old-age pension systems and early retirement schemes in OECD countries, see the country reports published in the OECD's series on *Ageing and Employment Policies*.
8. The 2003 value actually corresponds to the value the implicit tax rate will take once all currently legislated changes are implemented and once all existing pension systems have matured. It should be borne in mind that in some cases (e.g. Italy) these changes will be phased in over several decades.
9. For the Netherlands, the favourable tax treatment of early retirement schemes was abolished from January 2006. The calculations reflect a "typical" early-retirement (VUT) scheme.
10. Though this is the case in a number of OECD countries, the current adjustments are usually below actuarially neutral levels.
11. This section relies mainly on Quintini (2006) which provides a more detailed analysis.
12. In most of the discussion concerning labour market issues – particularly where data are based on official statistics and not derived from micro datasets – the analysis is restricted to young people between 20 and 24. In some cases, teenagers (aged 15 to 19) are also considered.
13. Looking at changes since 1998, the share of 16 and 17-year-olds who have already left the education system without an upper-secondary degree has tended to fall but remains rather high in several OECD countries (OECD, 2006a, Table W.4.1).
14. In part, this reflects the impact of compulsory schooling laws. It is interesting to note, that several countries which perform relatively well, in terms of young adults, show above average shares of teenagers neither in school nor working (e.g. Austria, Finland and the United Kingdom).
15. Wilkinson (2003) estimates the impact of the New Deal for Young People on the probability of being unemployed six months after reaching the qualifying time for the programme – coinciding with movement from the gateway period into the options. The results indicate, for men, a reduction in unemployment of around 30 000 and, for women, a reduction of around 9 000. A longer follow-up period produces a lower reduction in the probability of being unemployed, mostly due to the fact that some New Deal participants would have returned to claim unemployment benefits. Another study, by Blundell et al. (2001), finds that the New Deal for Young People (after four months spent in the Gateway stage) increased the probability of finding a job by 20%.
16. In Australia, evaluation studies offer mixed results (see for instance, Borland and Tseng, 2004; and the Department of Employment, Workplace Relations and Small Business evaluation, 2000). While evaluation studies carried out on the pilot conducted before the introduction of the programme showed relatively disappointing outcomes (Borland and Tseng, 2004), the evaluation carried out in 2000 by the Australian Government found some positive effects. The evaluation study underlines the need for further research but reaches the preliminary conclusion that Work for the Dole participants were more likely to leave income support than similar job seekers who did not participate in the programme (the prospects were 76% higher). In addition, Work for the Dole compared favourably with the suite of previous labour market programmes operating in the mid-1990s in Australia.
17. This is because those with less attachment to the labour market – that would not otherwise participate – will tend to have more difficulties in obtaining employment.
18. Note, however, that the NSEJ was implemented during a period of cyclical upswing.

19. Since they now constitute a significant proportion of the resident population in many OECD countries (Dumont and Lemaitre, 2005; OECD, 2006a, Table W.4.2), immigrants' integration and that of their children into the labour market is also a precondition for ensuring social cohesion.
20. New arrivals are particularly affected by the economic situation. The labour market situation upon arrival tends also to have an impact on the employment of immigrants in the longer run, underlining the importance of early work experience.
21. Poland – and to a lesser extent, Finland – are exceptions.
22. See, for instance, Brunello *et al.* (2001), Davies and Hallet (2001), and De Koning *et al.* (2004) who also add southern Spain to the list.
23. Using similar analysis techniques, the educational attainment of the labour force also appears to explain part of the differences in regional employment rates. However, differences in educational attainment account for much less of the total differences in employment rates than do differences in sectoral specialisation, particularly in countries with high disparities. Differences in the age structure of the working-age population seem to play only a very minor role.
24. In this respect, it is important to note that reduced wages in these regions may increase out-migration incentives. This could further lower unemployment, but might be problematic for long-run regional development prospects if the most productive workers are over-represented among the persons leaving the region.
25. This possibility is suggested by the fact that improved overall unemployment performance does not automatically lead to a reduction in regional unemployment disparities, as was discussed above (cf. Figure 2.7).
26. Migration rates shown for Australia, Canada and the United States are at the state level; they would be higher if measured for smaller regions of a size comparable with that used for most European countries.
27. See OECD (2005a), Table 2.4, p. 91.
28. First, young adults and highly-educated persons are the most mobile groups. Gross migration rates of working-age individuals with tertiary education are two to four times higher than for those with less than upper secondary education, except in the United States where the differences are less marked (see OECD, 2005a, Table 2.4, p. 91). Increased out-migration may thus have the negative effect of de-skilling the regional work force, further weakening the regional growth potential. Second, large differences in housing prices across regions probably set some endogenous limits to migration flows. As housing prices often tend to be higher in dynamic regions than in lagging ones, moving from the latter to the former to take up a new job may imply an important cost for the worker, which reduces incentives to move. This is particularly the case for home-owners, for whom moving to a region with higher housing prices would entail an important capital loss and increased interest payments. To a large extent, these variations in housing prices across regions will always exist, thus slowing mobility.
29. Germany is the main exception.
30. In most OECD countries, housing allowances take some account of the variation of rent levels across regions, either through the actual rent paid, or through some area-based benefit levels.
31. As home owners always face higher costs of moving (transaction and potential capital loss) than renters, tax and subsidy incentives to home ownership could be further reduced. However, any such choice should be made in light of the positive aspects of home ownership.
32. This section relies mainly on Chapter 5 of OECD (2004a) which provides a more detailed analysis.
33. One reason for this is that informal employment takes many different forms, including both the under-declaration of activity that is not hidden from tax and regulatory authorities (*e.g.* concealment of some part of the total hours worked or earners of declared workers) and the total concealment of activities (*e.g.* black-market activities, including self-employed workers not declaring their activity).
34. In countries where tax authorities are unable to effectively monitor business accounts and employers often under-declare employment, earnings and hours, the labour inspectorate can play an active role in limiting the degree of under-declaration. Through periodic site inspections, the labour inspectorate can ascertain the approximate number of employees. If the minimum wage is set at a high level and the regulatory structure discourages job turnover and non-standard working hours, total compensation can be estimated by assuming all workers work full time and are paid the minimum wage.