

OECD Employment Outlook - 2006 Edition: Boosting Jobs and Incomes

Summary in English

In 1994, following two decades of increasing unemployment, OECD countries endorsed a wide ranging set of policy recommendations to improve labour market performance –the OECD Jobs Strategy. Ten years on, the challenges faced by policy makers in most OECD countries 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 a 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.

This report examines new evidence on the policies that help improve labour market performance. It serves as analytical background for the restated OECD Jobs Strategy, presented in the accompanying policy report entitled “Boosting Jobs and Incomes: Policy Lessons from Reassessing the OECD Jobs Strategy”. The latter contains a revised set of policy recommendations to guide needed reforms.

The key lesson emerging from this work is that it is vital for labour-market performance of OECD countries to build upon four pillars, namely setting appropriate macroeconomic policy; removing impediments to labour-market participation as well as job-search; tackling labour- and product-market obstacles to labour demand; and facilitating the development of labour force skills and competencies.

Sound macroeconomic policy supports good labour market performance

Based on our empirical analysis, sound macroeconomic policy management contributes to sustain economic growth and employment. Price stability and sound budget lower real interest rates. These 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 impediments to labour market participation and job search

Reforms of taxes and welfare benefits, combined with well-designed “activation” policies, have proved effective in raising labour market participation, though these reforms need to be well designed and implemented if they are not to prove too costly for the public purse.

One way to promote work incentives is through cutting benefit levels and their duration. But new evidence also suggests that, if well-designed and implemented effectively, “activation” policies can help offset these work disincentive effects and improve re-employment chances of those out of work, while achieving social goals. Activation policies involve measures, managed through effective and well-resourced public employment services, to ensure that the unemployed look actively for work and are encouraged to find new jobs. Effective activation policies involve a mix of carrots and sticks, which can be delivered through public or private employment services, to ensure that the unemployed are well supported in their job search efforts and, in their turn, they are looking actively for work. They can be supplemented with tax-benefit reforms, including in-work benefits so as to raise financial incentives to work while attenuating in-work poverty.

Such an approach is being extended in some countries to other non-employment benefits, like sickness, disability, social-assistance and lone-parent benefits. This is essential. Indeed, in some countries, an increase in the number of people on such benefits has gone hand-in-hand with progress in reducing unemployment. Likewise, countries are adjusting pension systems to ensure that workers have an incentive to work longer, as they live longer.

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

Adapting employment regulations and wage-setting practices and promoting product-market competition

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

First, measures to promote flexible working-time arrangements and part-time work – implemented through employers-employees agreement— may help ensure greater choice for workers regarding work schedules and also help promote labour force participation of certain groups, such as young parents and older workers.

Second, too-strict legislation will hamper labour mobility, reduce the dynamic efficiency of the economy and restrain job creation. But innovative reform avenues have been found so as to instil greater labour market dynamism while also providing workers with adequate protection. This includes making legal procedures more predictable and “flexicurity” --i.e. an approach that facilitates hiring and firing decisions while also providing efficient re-employment services and income support to job losers. Partial

reforms, such as reducing protection on fixed-term contracts while leaving protection of permanent contracts unchanged, may aggravate duality, exacerbate social inequalities and lower productivity growth.

Third, real wages should adjust flexibly in response to supply- and demand-side pressures. In this regard, the report finds that both decentralised and centralised bargaining often result in better employment performance than when bargaining is at the sectoral level. Recent developments suggest that a moderate legal minimum wage generally does not undermine employment, but also that adequate allowance for wages below that level for youth and possibly other vulnerable groups is essential. Minimum wages may offer a useful complement to in-work benefits, in helping make work pay, if the latter are well designed.

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

Finally, a consistent empirical 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. In addition, addressing legal impediments and administrative hurdles to the set-up of new firms would nurture an entrepreneurial climate.

Ensuring that workers have the right skills can help create more and better-paid jobs

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.

Lifelong learning policy should first ensure that the training market functions well. Well-designed systems of recognition of skills, career guidance, information on the content and outcome of the courses on offer, and performance monitoring of training providers may help in this regard.

There are also financial and time 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. Though more research is needed in this area, 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 of training. And training leave may help reduce time constraints, especially for disadvantaged groups. In general, the active involvement of social partners in the design and implementation of lifelong learning policies can promote programmes' success.

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

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.

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, which has unfortunately not been the case in many OECD countries in recent years.

Stability-oriented macroeconomic policy may also bring forward the employment gains from labour and product market reforms. Monetary and/or fiscal policy may be needed in order to help meet the higher supply potential of the economy arising from structural reform, and thus attain macroeconomic stability earlier than if the adjustment was left to markets alone. Ensuring that aggregate demand is not allowed to deviate too much from aggregate supply may also make people more receptive to reforms.

Policy packages

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. 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. 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 four pillars of the revised strategy will need to be implemented in a manner that is consistent with national institutions and practices. There may be strong resistance to introducing some of the recommended policies 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 strong downward pressure from ageing populations. The successes achieved by some countries over the past decade show what can be achieved if there is sufficient political will to reform.