

OECD

Policies
to Create
Jobs

Meeting of the OECD Council
at Ministerial Level, 1999

Policies to Create Jobs

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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- to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and
- to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

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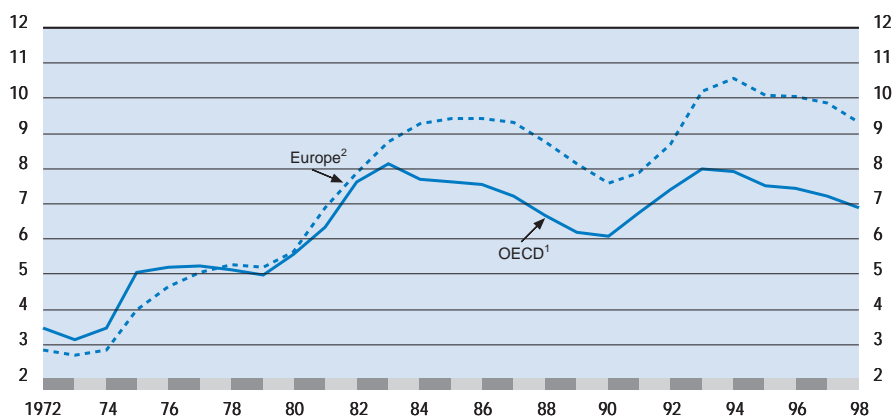
POLICIES TO CREATE JOBS

Introduction

High and persistent unemployment remains a major economic and social problem for many OECD countries. Currently, some 35 million persons, or about 7 per cent of the labour force, are unemployed across the area (Figure 1). Many, particularly in Europe, have been without a job for a prolonged period. These people, and their dependants, may be threatened by poverty in addition to loss of self-esteem and contact with working life. At the same time, many others are not

High and persistent unemployment remains a major problem...

Figure 1. **Standardised unemployment rates in European and total OECD countries, 1972-98**



1. Standardised unemployment rates for all countries except for Greece, Iceland and Turkey. Excluding Czech Republic, Hungary, Korea, Mexico and Poland.

2. EU 15, Iceland, Norway, Switzerland and Turkey.

Source: OECD, *Labour Force Statistics*.

even trying to find a job, discouraged by high unemployment or by the undesirable side effects of some policies intended to deal with it. But getting a job and keeping it does not solve all problems. There is increasing concern about precarious jobs and in-work poverty in some countries.

... but experience shows that it can be durably reduced through a comprehensive and sustained package of reforms...

The problems of high unemployment, discouragement and in-work poverty are not new. In 1994, it prompted Ministers to agree on the OECD Jobs Strategy, which contains a wide-ranging and balanced set of policies to deal with these issues (see Box 1). In 1997, a further report requested by Ministers, *Implementing the Jobs Strategy: lessons from member Countries' Experience*, drew a number of key lessons (see Box 2).

Box 1. **The OECD Jobs Strategy**

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

Box 2. Lessons from Member Countries' Experience

1. High and persistent unemployment has been the result of both conjunctural and structural forces, and it can be durably reduced.
2. Many countries have made progress in implementing the Jobs Strategy, but progress has been uneven both between countries and between different areas of policy.
3. The central issue dividing the more comprehensive reformers from the less comprehensive reformers is differences in judgement about potential conflicts between better labour market performance and concerns for equity and social cohesion.
4. There are significant synergies between structural reforms in different fields.
5. Macroeconomic conditions and their interactions with structural forces are important for labour market outcomes.
6. Overall, the Jobs Strategy remains an effective response to labour market problems in Member countries, and the EDRC has encouraged countries to press on with its implementation.

The most important of these is that implementing the Jobs Strategy could durably reduce unemployment – especially if done comprehensively, taking into account countries' institutional, cultural and social characteristics. However, policymakers have to stay the course because it takes time before reforms achieve lower unemployment.

These conclusions have been reinforced by the report prepared for the 1999 Ministerial, *The OECD Jobs Strategy: Assessing Performance and Policies*. Drawing on further country experience and additional Secretariat analysis, this report highlights the fact that where countries have taken substantial steps to implement the Jobs Strategy recommendations over the 1990s, significant effects are visible on employment and unemployment. However, this record is uneven across countries and much remains to be done.

This paper, after setting the stage with a brief overview of the very different positions of individual OECD countries (Part 2), draws out key conclusions

... and these conclusions have been reinforced by recent analysis

Ministers may wish to focus on key issues that emerge from current work:

- from the current work which could serve as the background to a Ministerial exchange of views:
- achieving the synergies of a comprehensive reform package...*

– A comprehensive reform package, which takes advantage of synergies between policies in different areas is the most effective way forward (Part 3).
 - ... improving employment prospects for groups at the margin of the labour force...*

– Employment of groups at the margin of the labour force account for the main differences in employment/unemployment across countries (Part 4). Helping these people requires general policies to improve overall labour-market conditions supported by measures directly targeted at their specific problems.
 - ... assessing effects of reducing labour supply, and...*

– Policy may attempt to achieve short-term results by aiming to reduce labour supply, but such policies are typically ineffective (Part 5).
 - ... improving living standards*

– Policies should seek to improve living standards by fostering entrepreneurship and the development and diffusion of new technologies and by stimulating the growth of human capital (Part 6).
- Ministers may also wish to discuss ways of making work pay...*
- Employment is not always sufficient to generate a satisfactory income for the individual and high employment may not result in an income distribution regarded as satisfactory across households. Countries have therefore been seeking to reform features of their tax, transfer and benefit system so as to achieve the joint objectives of higher employment and a desired distribution of national income. Instruments used here, *i.e.* to “make work pay”, include in-work tax benefits, employment subsidies and other means of reducing the cost of labour (Part 7). An important policy issue is the scope for policies that aim simultaneously to raise living standards and to strengthen work incentives for those at the bottom of the labour market.
- ... and may wish briefly to consider future work*
- Secretariat work in this area has evolved continuously since the publication of the original *Jobs Study*. Ministers will want to consider the ways in which future work of the OECD Secretariat can best contribute to Governments’ efforts to boosting employment growth and reducing unemployment in OECD countries (Part 8).

The current situation: striking differences across countries

The record on unemployment varies considerably across countries (Table 1). Focusing on developments over the 1990s, countries such as the United States, Norway and Portugal have maintained low unemployment as well as

Some countries have been more successful than others in reducing unemployment...

Table 1. **Standardised unemployment rates in OECD countries, 1990-1998**¹
Per cent of the total labour force

	1990	1994	1998
United States	5.6	6.1	4.5
Japan	2.1	2.9	4.1
Germany ²	4.2	8.4	9.4
France	9.0	12.3	11.9
Italy	9.1	11.4	12.3
United Kingdom	7.1	9.6	6.3
Canada	8.1	10.4	8.3
Australia	7.0	9.8	8.0
Austria	3.0	3.8	4.4
Belgium	6.7	10.0	8.8
Czech Republic	..	3.8	6.5
Denmark	7.7	8.2	5.1
Finland	3.2	16.8	11.4
Greece	7.0	8.9	9.4
Hungary	..	11.0	8.1
Iceland	1.6	5.4	2.6
Ireland	13.4	14.3	7.8
Korea	2.4	2.4	6.8
Luxembourg	1.7	3.2	2.8
Mexico	..	3.7	3.2
Netherlands	6.2	7.1	4.0
New Zealand	7.8	8.1	7.5
Norway	5.3	5.5	3.3
Poland	..	14.4	10.5
Portugal	4.6	7.0	4.9
Spain	16.2	24.1	18.9
Sweden	1.7	9.4	8.2
Switzerland	1.0	3.8	3.6
Turkey	8.0	8.1	6.4
OECD total ³	5.9	7.6	6.9

1. Standardised unemployment rates for all countries except Czech Republic, Greece, Hungary, Iceland, Korea, Mexico, Poland and Turkey, where data are based on commonly used national definitions.

2. 1991.

3. Excluding Czech Republic, Hungary, Mexico and Poland.

Source: OECD Labour Force Statistics; OECD Economic Outlook (various issues).

high and/or rising employment rates, and recently US performance has even improved. In other countries, including Austria, Japan and Switzerland, there has been some deterioration but unemployment nevertheless remains low. And the United Kingdom, Denmark, Ireland, the Netherlands and New Zealand, and more recently Canada, Australia and Spain, have achieved significant falls in unemployment. By contrast, in some countries unemployment either remained high – or even increased.

... and they do well on a wide range of measures of labour-market performance

Countries that have succeeded in cutting unemployment significantly and durably have tended – at least with a lag – to be good performers on a whole range of other observed indicators of labour-market performance. For example, countries with low unemployment rates tend to have higher rates of labour force participation. By contrast, countries with high or rising overall unemployment tend to have low employment rates for “non-core” groups such as youth and older workers. As well, they often have more involuntary part-time work, they tend to have experienced significant shifts from permanent to temporary employment and weak employment developments in the business sector.

Macroeconomic policies and structural reforms need to go hand in hand

Underlying macroeconomic conditions have improved in virtually all OECD countries...

Macroeconomic conditions have improved in most OECD countries in ways that will underpin better employment performance. Effective price stability has now been achieved in the large majority of countries with only a few still having significant inflation and only one, Japan, experiencing deflation. At the same time, government budget deficits have declined significantly over the decade of the 1990s, with only Japan, Hungary and Poland having deficits in excess of 3 per cent of GDP in 1998. Better macroeconomic fundamentals are important for several reasons. They tend to lower real interest rates. They provide more

scope for macroeconomic policies both to reduce cyclical unemployment and to stabilise output. This latter is important given the tendency observed in many countries for structural unemployment to rise from cycle to cycle.

Sound macroeconomic conditions will also make structural reform work better. For example, a relaxation of employment protection legislation may reduce segmentation in labour markets, and thereby unemployment. But if introduced during a recession, the immediate impact of such relaxation will be a surge in lay-offs. Equally, policies aimed at sharpening the incentives to search for work, such as reforms to tax and benefit systems, or of assisting the unemployed in their job-search, will show their positive effects more quickly in a favourable macroeconomic environment.

At the same time, the right structural policy environment will make macroeconomic policies work better. For example, policies that reduce structural unemployment will strengthen the credibility of monetary policies and thereby reduce risk premia in interest rates. And lower structural unemployment will strengthen government budget balances, allowing governments to reduce tax pressure or indebtedness. At the same time, the right structural policies may increase the scope for macroeconomic stabilisation. There is an observed tendency in a number of countries for inflation and real wages to adjust slowly downwards in bad times but adjust more quickly upwards in good times. Structural reform that reduces this asymmetry will therefore also make it easier for macroeconomic policies to counteract downturns.

In sum, an effective policy approach would seem to be two-handed: structural reforms over a broad field which allow a setting of macroeconomic policies consistent with a substantial and sustainable fall in unemployment. Such a comprehensive strategy is also more likely to inspire confidence among consumers and investors and so produce benefits more rapidly.

... which help structural reforms to work better

Similarly, structural reforms improve the workings of macro policies

Hence, a combination of macro and structural policies is the best strategy to reduce unemployment

Policies must seek to foster employment of groups at the margin of the labour market

The best way to foster employment of groups at the margin of the labour market is through policies aimed at reducing overall unemployment...

Employment rates of the young, adult women and older workers differ strikingly across countries, which contrasts with relatively similar employment rates for prime-age males (Figure 2). In part this reflects a voluntary choice (for example, to remain in education; to care for children or elderly relatives; or in response to incentives to retire early). However, insofar as it is involuntary, it is desirable to put in place policies aimed at improving the employment prospects of specific groups. There is evidence that employment of youth and older worker responds strongly to overall labour market conditions. This underlines importance of implementing general policies that reduce overall unemployment.

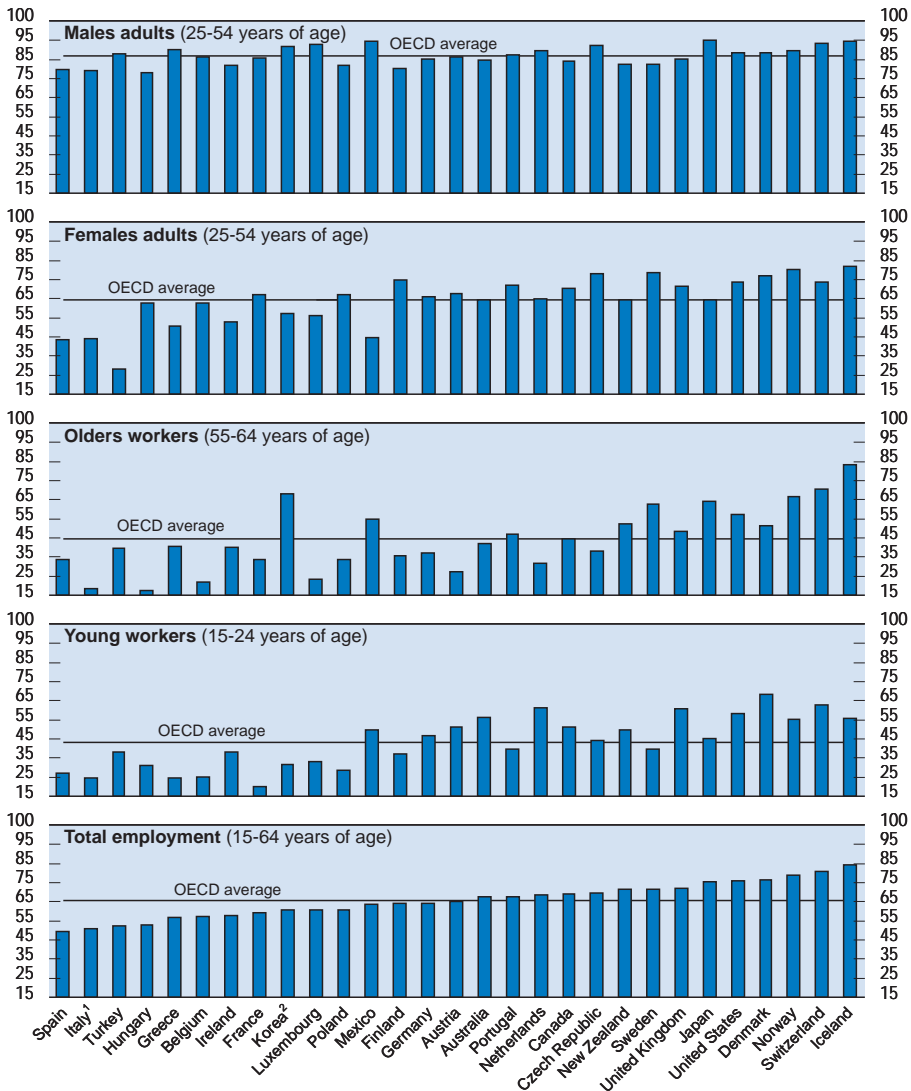
... although specific policies are also important, including developing effective pathways by which young people enter the labour force...

Specific policies are also needed. For example, education policies that properly equip young workers with the skills required to enter the labour force are essential. The transition from education to work can also be eased, not least by allowing young persons to gain some work experience while still in education. The countries most successful in that respect are those who have dual-system apprenticeship programmes (*i.e.* Germany, Austria, Denmark and Switzerland) and those who have a highly developed market for part-time work which allows an informal combination of work and school (*e.g.* the United States, the United Kingdom, Canada and Australia). It is also important that the transition not be impeded by labour costs that prevent young persons from getting a foothold in the labour market, *e.g.* by minimum wages or payroll taxes that are too high.

... liberalising excessively strict job protection; and...

A number of countries have liberalised temporary contracts and their renewal. This policy was based largely on the recognition that employers may be hesitant to hire young persons, or other persons with no immediate prior employment history, if they have to grant them strict job protection. However, if such policies are introduced in countries with excessive job protection legislation for permanent workers that is

Figure 2. Employment rates for different groups, 1997
 Employment in per cent of group-specific population



1. For Italy, adults, 25-59 years of age; older workers, 60-64 years of age.

2. For Korea, older workers, 55-59 years of age.

Source: OECD, *Labour Force Statistics*; *OECD Employment Outlook, 1998*.

not itself reformed, there is a risk that young workers, and others hired on fixed-term contracts, face prolonged employment in precarious jobs. Indeed, this may make permanent workers even more secure in their employment and thereby encourage high wage demands with negative effects on the creation of jobs.

... recognising the contribution of voluntary part-time work

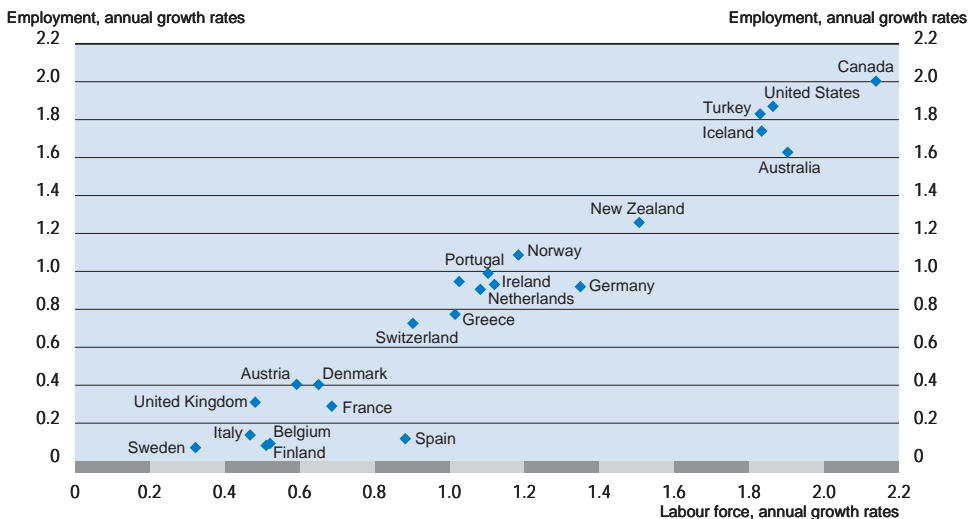
Part-time work can contribute to integrating workers at the margin into the labour force. However, concern has also been expressed that part-time work has an inferior character compared with full-time work. Nonetheless, the evidence from most countries suggests that many part-time jobs benefit both employers and employees: they provide firms with an extra degree of flexibility, and their holders with the kind of work they are interested in. Part-time work, may also, in some cases, call forth additional labour supply and additional jobs, and thereby higher output. In a few countries, however, a significant share of part-time workers seems to hold these jobs because full-time work is unavailable. These are usually countries where unemployment is high and rising and, in these cases, the problem is not so much related to part-time work as such.

Fostering early retirement or reducing working hours are not solutions

Policies to encourage early retirement in order to open jobs for younger workers tend to be ineffective and short-sighted

Countries with strongly growing labour supply have had relatively rapid growth of labour demand as well (Figure 3). Nonetheless, some countries where unemployment is high have sought to reduce labour supply in various ways, most significantly by creating incentives for older workers to retire early in the hope that employers will replace many of them with younger workers. In practice, evidence shows that while such schemes have contributed significantly to falling labour-force participation among older workers, they have been ineffectual in creating job opportunities for younger workers. In any event, early retirement schemes often create a vicious circle that damps potential output and thus national wealth: because the

Figure 3. Labour force and employment growth, 1970-97
In per cent



Source: OECD Economic Outlook (No. 64, December 1998).

incentives to retire early are strong, firms are hesitant to train older workers, and the lack of training increases their risk of job loss, which seems to justify the existence of the early retirement schemes. With the populations of OECD countries growing steadily older, it will become increasingly difficult to sustain incentives for early withdrawal, which place an increasing burden on government budgets, and on the working age population more generally.

Recently, reductions in working hours have been much discussed as a way to reduce unemployment. Annual working hours have fallen significantly in all countries over the past half century as technical progress has increased the scope for material standards of living but people have chosen to forego some of this increase in favour of more leisure. Where this has been the result of undistorted choice, it has improved welfare. However, where shorter working hours are the result of legislation, people may be less

Legislating shorter working hours will not automatically reduce unemployment

willing to forego material living standards and there is a risk that wage pressures could result which would reduce labour demand.

Jobs, while important, are not everything – policies should also raise living standards

Living standards can be raised by policies that foster entrepreneurship and better development and diffusion of technology, and that...

While one key objective of the OECD *Jobs Strategy* is to reduce high and persistent unemployment on a durable basis, another is to foster sustainable increases in living standards. Hence several of the strategy's policy guidelines are aimed at achieving higher productivity growth. Thus, a business climate which is more favourable to entrepreneurial activity and competition in product markets should help to boost productivity growth, which should also benefit from appropriate policies to develop and diffuse new technologies, a key engine of long-term growth. At the same time, policies in these areas may have secondary effects which will help to raise employment, reduce unemployment and cushion the economy against shocks. Thus, a more competitive and entrepreneurial business sector will also lead to a more smooth and rapid adjustment to shocks.

... stimulate the growth of human capital

Education policies are particularly important in stimulating the growth of human capital and thereby future standards of living. Moreover, where education policies equip young persons with the qualifications in demand, and where skills are continuously updated through a process of lifelong learning, the need for other mechanisms to help the economy adapt may be reduced.

Policies exist which help to combine adequate work incentives with an acceptable income distribution – but they do have limits

Different countries have different approaches to the distribution of living standards

Discussion of the *Jobs Strategy* has not come up with a unique answer to the difficult question of the distribution of living standards. Some countries have argued that increased adaptability, in particular insofar as it is reflected in increased wage dispersion, less job

security for those already employed and less generous social transfers, has a price in terms of a more unequal distribution of incomes and living standards. For this reason they have been hesitant to pursue the Jobs Strategy across the full range of policies. Other countries focus more on concerns that sustained long-term unemployment will generate a dependency culture, adversely affect attitudes to work and possibly boost the underground economy, all making for higher public deficits and thus higher debt or higher taxes.

In any event, the evidence on the impact of policies on adaptability and income distribution is mixed. The prevalence of poverty is much higher for people living in households without jobs than for people in working households – even in countries with a wide dispersion of wages. Furthermore, jobs at low wages will help some young persons to get a foothold in the labour market and, subsequently, to move up the earnings scale. But, in practice, some people get stuck in low-paying jobs or alternate between such jobs and non-employment.

The double concern for employment and for income distribution is behind the search for policies to preserve an acceptable income distribution with adequate work incentives for those whom employers are only willing to hire at a low labour cost. Several countries have introduced schemes along two main lines. They either give in-work benefits to people employed at low wages or subsidise employers to hire workers at wages which are higher than they would otherwise have been prepared to pay. In both cases, these schemes are usually introduced in the context of statutory minimum wages which aim to ensure that at least part of the benefit of these schemes accrues to wage earners.

These policies may to some extent help to square the circle but they are no magic bullet. Thus, where unemployment benefits are high, providing adequate work incentives will call for either generous in-work benefits or a high wage floor combined with substantial wage subsidies. To contain the fiscal cost of these schemes, benefits and subsidies then have to be clawed back

Given the importance of employment to reducing poverty...

... countries have adopted policies to combine incentives with social equity...

... but these policies have their limits

over some income range. For workers in these ranges, this will result in reduced incentives for additional work effort or for investing in human capital. If many workers are affected by these disincentives, it could sap the dynamism and efficiency of the economy. This would have to be weighed against the benefits for low income households. Therefore, these policies work best in conditions where unemployment benefits and other non-employment transfers are not too generous, where the wage distribution is not too compressed, and where existing tax rates are not already too high.

Future work for the OECD Secretariat

Maintaining the momentum of the Jobs Strategy, through multilateral monitoring and further analysis in key areas, is essential...

Maintaining the momentum of the Jobs Strategy, especially for the large number of OECD countries where unemployment is too high and employment too low, is essential. Peer pressure and the multilateral monitoring of progress has clearly played an important role in facilitating reform, and this role is far from exhausted. At the same time, while much has been learned over the past decade about the effects of specific reforms and how they interact, there is still scope for considerable further analysis on key issues like: making work pay, and taxation and labour markets more generally; improving the education-to-work transition and fostering effective life-long learning; making optimum and fair use of flexible work arrangements; enhancing the effectiveness of active labour market policies and their interactions with passive benefits; boosting economic performance through better development and diffusion of technology and through enhancing entrepreneurship; and understanding better the sources of growth.

... and hence Ministers may invite the Secretary-General to attach priority to this work

If Ministers agree with this assessment, they may wish to invite the Secretary-General to ensure that the Secretariat devotes high priority to these activities. In addition, Ministers will want to be kept informed of progress in this crucial area, perhaps asking the Secretary-General to himself judge the appropriate scope, form and timing of future reports.

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