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## Labour/Management Programme

### THE OECD JOBS STRATEGY: The Policy Implications of Estimates of Structural Unemployment

Report on a Consultation between trade union experts and the Chairman and the Bureau of the Economic and Development Review Committee held under the OECD Labour/Management Programme (Paris, 23 October 1998)

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held under the OECD Labour/Management Programme

(Paris, 23 October 1998)

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**TABLE OF CONTENTS**

FOREWORD.....	4
<u>AGENDA</u> .....	5
<u>FINAL REPORT ON THE MEETING</u> .....	6
1. The Context of the Meeting .....	6
2. Critique of the NAIRU by the Trade Union Experts .....	7
(i) Structural and Cyclical Unemployment .....	7
(ii) National Experiences with the NAIRU .....	8
(iii) The Debate on the NAIRU .....	9
3. Labour Market Flexibility.....	10
4. Jobs Strategies Compared .....	11
ANNEX -- <u>LIST OF PARTICIPANTS</u> .....	12

## **FOREWORD**

Under the OECD Labour/Management Programme for 1998, a consultation between trade union experts and the Chairman and the Bureau of the Economic and Development Review Committee on "The OECD Jobs Strategy" was held in Paris on 23 October 1998. The meeting was prepared in collaboration with the Trade Union Advisory Committee to the OECD (TUAC).

Below you will find the agenda for this meeting, along with the overall report of the discussions of experts prepared by Professor Mary Gregory, designated as General Rapporteur for this activity.

**THE OPINIONS EXPRESSED AND ARGUMENTS EMPLOYED IN THIS REPORT  
ARE THE RESPONSIBILITY OF THE AUTHOR  
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**AGENDA**

1. Opening Remarks
2. Estimates of structural unemployment
  - The relevance of the NAIRU and the resulting policy implications
3. Labour market flexibility
  - An assessment of the impact and relative importance of the various Jobs Study recommendations on labour market reform
4. Jobs strategies compared
  - An evaluation of the OECD follow-up, the EU follow-up to the 1997 Luxembourg Jobs Summit, and the G7 Jobs Conferences

**FINAL REPORT ON THE MEETING**

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(United Kingdom)

**1. The Context of the Meeting**

The meeting was held as part of the process of regular consultation between the OECD and trade union experts within the framework of the Labour/Management Programme. The OECD were represented by the President and Vice-Presidents of the EDRC, members of the Secretariat, the Economics Department, DEELSA and PAC. Many national delegations to EDRC were also present. Trade union experts represented TUAC, EI, ETUI, ICFTU and organisations from seventeen countries.

The agenda for the meeting, in the context of the OECD's on-going review of the implementation of the Jobs Strategy, was to consider estimates of structural unemployment, and to review the strategy of enhancing flexibility in the labour market. The trade union experts wished to put forward a critique of the NAIRU and its resulting policy implications. They also wished to present their assessment of the impact and relative importance of the various Jobs Study recommendations on labour market reform, and to compare the jobs strategies of the OECD with the EU follow-up to the 1998 Luxembourg Jobs Summit and the G7 Jobs Conference.

Opening the meeting, the Chairman expressed the hope that it would be conducted in a spirit of frank discussion of issues which are of common concern. He reminded the meeting of the scope of Jobs Strategy. It was proposed, and continues to be seen from the OECD side, as an integrated set of measures, spanning the stance of macroeconomic policies, the development of technology, skills and entrepreneurship, and product market competition, as well as structural reforms in the labour market. Synergies among these various elements are seen as central to the overall effectiveness of the strategy. Critique of individual elements should be set in this context.

The spokesperson for the trade union representatives acknowledged their appreciation of the opportunity to participate in the process of debate on the on-going implementation and assessment of the strategy. In response to the Chairman's remarks, he noted that the trade union representatives supported a number of the elements of the Jobs Strategy, but disagreed with others. In particular they wished to take issue with the use of the NAIRU as the basis for the estimation of structural unemployment and the consequent policy recommendations both for macroeconomic stances and as related to labour flexibility.

## 2. Critique of the NAIRU by the Trade Union Experts

### (i) *Structural and Cyclical Unemployment*

Estimates of the NAIRU, by the OECD and national authorities, now play a key role in the formulation of macroeconomic policies. The interpretation placed on it is central to debates on unemployment and policies to combat it. This forms the starting point for the critique by the trade union experts. The central proposition which they put forward was that the conceptual basis for the NAIRU is profoundly wrong, and that framing policies with reference to it leads to wrong policy stances. These 'wrong' policies result in permanently higher unemployment. Moreover, by coupling developments in unemployment closely to inflation, the use of the NAIRU gives a deflationary bias to macroeconomic policy and risks making high structural unemployment self-fulfilling – the 'structural unemployment policy trap'.

The conceptual basis of the NAIRU, as the rate of unemployment consistent with non-accelerating inflation, implies its identification with frictional and structural unemployment. Comparing the estimated NAIRU with the actual unemployment rate then allows the cyclical component to be derived as residual. On OECD estimates of the NAIRU for individual countries, unemployment emerges as overwhelmingly structural. In 1996 NAIRU-based structural unemployment accounted for an average of 91 percent of actual unemployment across member countries, ranging from a minimum of 79 percent to a maximum of 115 percent. This overall average was little changed from the 1986 level of 93 percent. In 1990 structural unemployment had risen to 115 percent of actual, implying more than full employment in all but three of the 24 member countries.

The implication of these estimates is that, if unemployment is to be durably reduced, the appropriate policies have to be 'structural'. Moreover, since the cyclical component is marginal, only minimal scope exists for counter-cyclical macroeconomic employment policies. Hence the NAIRU-based approach leads, as in the *Jobs Strategy*, to an emphasis on policies to promote labour market flexibility. However, if these NAIRU-based decompositions of unemployment into structural and cyclical components are wrong, then misguided economic policies could result in unnecessarily high unemployment. Detailed evidence to this effect for several countries is summarised below.

The NAIRU has a further impact on macroeconomic policy through its role as the rate of unemployment consistent with non-accelerating inflation. If unemployment is allowed to fall below the estimated NAIRU, then inflation will increase. Because of the perceived costs of inflation in the minds of policy-makers this imparts a systematic deflationary bias to the stance of macroeconomic policy.

In addition to these reasons for opposing the concept and implications of the NAIRU, the trade union experts wished to inject into the debate the further idea of the 'structural unemployment policy trap'. When, under the NAIRU approach, unemployment is estimated to be predominantly structural, policy-makers are prompted to eschew counter-cyclical policies in favour of structural reforms as the means of reducing unemployment. This abandonment of stabilisation policies causes actual unemployment to rise. Since the estimated NAIRU has been widely demonstrated to track actual unemployment closely, structural unemployment is found to have risen. By ruling out counter-cyclical macroeconomic policy the NAIRU approach transforms cyclical into structural unemployment. Structural unemployment becomes self-fulfilling: the 'structural unemployment policy trap'.

The trade union experts offered an alternative to the bifurcation of unemployment into structural and cyclical components under the NAIRU methodology. The economy should be seen not as a single labour market but as a set of interconnected sectoral markets, subject to both aggregate demand and sector-specific shocks. When shocks are sector-specific, sectors at full employment receiving a positive shock experience inflation, while those receiving negative shocks experience unemployment. Aggregate demand policy can be used to offset negative aggregate shocks without generating inflation. It can also be used to offset negative sectoral shocks, but in this case at the price of generating inflation. This view of the macroeconomic labour market deconstructs the distinction between structural and cyclical unemployment. Shocks vary from purely aggregate to sector-specific. Demand management can counter both, but its cost in terms of inflation is greater when shocks are sector-specific. Macroeconomic policy should therefore be used subtly and flexibly in response to the multi-sector character of macroeconomic activity, not rejected outright on the basis of a false separation of structural and cyclical aspects.

(ii) *National Experiences with the NAIRU*

Several members reported trade union analyses of individual country experience with NAIRU-based macroeconomic policy-making. In each case, use of the NAIRU was found to have been inappropriate and damaging.

Estimates of the NAIRU for Canada were reported as spanning a wide range – as wide as all the rates of unemployment actually observed. Even more important than this variability, trade union analysis had concluded that there was compelling evidence that these over-estimated structural unemployment by a substantial margin. No evidence could be traced of wage-driven inflation; the very modest growth in wage costs which had occurred had been largely driven by the fall-off in labour productivity growth. On the other hand the rising share of profits in national income pointed to price-setting as the source of inflationary impulses. Increases in taxes were seen as a further suspect. The broad sweep of macroeconomic policy-making in Canada for a number of years had confirmed the adverse effects of a NAIRU-based approach: the fear of inflation led to the tightening of the stance of macroeconomic policy, creating what was essentially cyclical unemployment, which then became structural.

For the United Kingdom similar evidence was reported of the range of estimates of the NAIRU being too wide to provide any realistic basis for policy. The main part of the critique focussed on the current situation. For many months now actual unemployment has been significantly below estimated NAIRUs, and widely commented on as such. Yet inflation is low, and remains stable, with core inflation around two percent. The attempt to rescue the NAIRU by casting it as a long-run concept immediately provokes the question, unanswerable for practical policy-making, of how long is the long-run? Again, national experience obtruded the role of negative demand shocks in raising unemployment, forcing the question of whether the NAIRU could reasonably be taken as independent of aggregate demand conditions. Once any influence from the demand side is allowed, the NAIRU can no longer be unique. The trade union analysis tended to see the NAIRU as self-stabilising around actual unemployment rather than the reverse.

Belgium appears to face the intractable problem of a NAIRU which has trended upwards over the 1990s in spite of the introduction of a range of policies appropriate to improving flexibility in the labour market and reducing structural unemployment. The benefit system had been applied with increasing stringency, the level of real wages had been frozen, and work incentives had been strengthened through reductions in social security contributions. These policies, all consistent with lowering the NAIRU, had seen actual and estimated NAIRU unemployment rise. On the trade union view the NAIRU is simply a black box. Policy attention should focus on issues of regional and skill mismatches, and over-education on the jobs ladder.



Wage-setting within a social framework is the most promising route to stimulating employment and fostering skill-matches.

By way of summary of their view, the trade union representatives urged that the NAIRU should be replaced by the concept of frictional and structural unemployment. The Phillips Curve framework should be jettisoned, and structural unemployment measured directly. Decomposing unemployment into a structural component, measured as the part attributable to sectoral shifts, and a cyclical component based on aggregate demand, gives a very different perspective. Unlike the NAIRU estimates, the structural component emerges as stable and much lower than current estimates of the NAIRU. This decomposition also reveals unemployment as predominantly cyclical, showing a large - and needless - rise over the 1980s, due to poor macroeconomic management. Not only is unemployment predominantly cyclical, but even structural unemployment is at least partially amenable to macroeconomic measures, although this is admittedly at the risk of increased inflation in sectors where labour markets are tight. However, the first priority must be to obtain an accurate measure of the extent of structural unemployment. Thereafter it will be appropriate to debate the cost in terms of inflation of aiming for reductions in the structural component.

In policy terms, the central point which the trade union representatives wished to urge was a move away from the recent concentration on structural policies to an emphasis on the joint use of macroeconomic and structural policies against unemployment.

(iii) *The Debate on the NAIRU*

The Chair thanked the trade union representatives for their contributions, and urged the role of effective dialogue to assist in developing the appropriate policies.

Representatives of the OECD Secretariat re-emphasised the scope of the policy recommendations in the *Jobs Strategy*; these come under ten main heads, of which proposals for increased flexibility in labour markets, related to the NAIRU, are only a part. Moreover, in advancing the *Jobs Strategy* recommendations they do not view even Europe as a single entity, and do not have a single policy package which they seek to promote universally. Rather in its work the Secretariat aims to acknowledge the diversity of national approaches, and currently endorses successes in economies with varied orientations. The Netherlands and Denmark, each with their individual model of social alliances, currently rank as successes alongside economies such as the United Kingdom and New Zealand which have chosen different routes to achieving flexibility.

From the OECD side it was suggested that they and the trade union representatives spoke much the same language. Both would acknowledge that the world is more complex and uncertain than is represented through simple models of the NAIRU. The Secretariat certainly accepts that the NAIRU is not a once-for-all datum, but can be influenced by the behaviour of economic agents; this could include agreements between employers and trades unions. The concepts of structural, frictional and equilibrium unemployment can be given differing connotations, and each is subject to measurement uncertainty, albeit to different degrees. For this reason in its work the OECD Secretariat always assesses a range of indicators before judging that the labour market has 'improved'. Typically, a high degree of correlation is present between these estimates and 'structural' unemployment. The Secretariat readily accepts the impact of the level of real interest rates on structural unemployment, which is a major reason for its emphasis on the costs of government deficits. It also sees unsustainable settings of macroeconomic policy, and macroeconomic variability more widely, as having an adverse effect on structural unemployment. It conceded that structural unemployment responded only slowly to structural measures. Overall, the

Secretariat sees no sharp dichotomy between macroeconomic and microeconomic aspects in the *Jobs Strategy*, rather synergies between policies across a wide range.

In regard to the deflationary bias of macroeconomic policies, it was noted that monetary authorities have to work with some notion of economic slack. Since this is based on a comprehensive view of developments across the economy, it seemed unlikely that Central Banks would systematically mis-read the indicators. But the crucial question for policy makers was how to set policy relative to the measure of slack. Where the trade union experts had asserted a deflationary bias to policy settings, the more likely interpretation was that policy-makers evaluated the costs in terms of unemployment of rectifying excess inflation as being higher than the unemployment associated with an under-shooting of the inflation target. How far asymmetry applied would depend on the dynamics of the labour market in the individual case, and could be present, for example in Canada, but not in the United States.

From the trade union side it was recalled that the theoretical model behind the NAIRU must include a pricing equation. They saw the evidence on rising profit shares as pointing towards a role for monopoly power in product markets. The role of product markets was underlined by the Secretariat, who mentioned that a programme of research into product market competition is being implemented.

### **3. Labour Market Flexibility**

From the trade union side it was pointed out that although unemployment is a European problem the individual European economies have not all had the same experience of unemployment. Moreover, they have a diversity of social systems and labour market institutions. While the *Jobs Strategy* sets a broad policy agenda, it was clear that – consistent with the NAIRU view – it has a particular focus on certain areas viewed as affecting labour market flexibility: job protection, minimum wages, social security benefits. The OECD ‘success stories’ among member economies can now be seen to have changed over time, and to now be a wider group than those which had pushed for flexibility. The crucial questions which the trade unions wished to address were: how far were the OECD recommendations, particularly on labour market flexibility, seen as having contributed to these successes, and what is the central message which the OECD is now seeking to advance?

The trade unions on their side were seeking to promote an approach of ‘positive flexibility’. This requires a more complex and sophisticated agenda spanning pay, skills, job protection and social support. It is clear that pay and pay structures have returned as a central issue, with concern over distribution and inequality, and renewed support for the role of social partnerships. The trade unions wished to support an integrated approach against poverty, recognising that effective analysis and policy in this area involves complex interactions of poverty with low pay and social security entitlements. The trade union movement is also active in seeking to promote an active policy agenda on the development of skills at all levels of the workforce and to include life-long learning. On the issue of job protection, a balance has to be struck between employee protection on the one side and the fostering of fear and insecurity on the other. The trade unions continue to emphasise that fear and insecurity create the wrong climate for the effective management of change.

Several representatives commented favourably on the success of Denmark in achieving lower unemployment combined with policies supporting social cohesion. Effective macroeconomic policies had made a major contribution. Also important was the emphasis on the obligations of the employer alongside the rights of the unemployed. A particularly important message was that where policies were aimed at

improving labour market flexibility, these had to work through consensus if they were to be viable in the longer run.

It was reported that the OECD was recommending less compression of the earnings distribution in Sweden in order to promote employment. It was argued that any significant change in employment would require a major increase in dispersion. The preferred policy on the trade union side was intervention in education to support a narrow wage distribution rather than increased wage flexibility.

From Austria it was reported that attempts to introduce a liberal labour market had caused problems, partly involving immigration.

The OECD were urged to give greater prominence to specific institutional features and on-going policy debates in individual countries.

#### **4. Jobs Strategies Compared**

Given the EU interest in these areas comparisons were made of the EU approach with that of the OECD. Several of the trade union participants noted that the EU process involved national action plans which were drawn up in most cases in consultation with the Social Partners. This meant that there was both a national debate on the recommendations and in several cases clearer consensus on the action required to be taken. The main message which the trade union representatives wished to deliver in this respect was their feeling that under the EU approach this complex of issues was being handled more effectively. The EU were able to be more accommodating towards social partnerships and alliances for jobs because, in the trade union view, they were not impelled to deliver the types of 'hard' messages which had come to characterise OECD contributions to the policy debate.

In the discussion it was noted that there were differences of both substance and process between EU and OECD activities in this area. On substance, the respective policy strategies were to some extent overlapping. The OECD *Jobs Strategy* covered a wider set of policy areas, while the policy targets of the EU 'four pillars' strategy were wider insofar as they included the issue of equal opportunities. On process, the OECD *Jobs Strategy* had been developed some years earlier than the EU programme, and there is always scope for improving employment policies by learning from experience in different countries. Both the Secretariat and the Chairman of the EDRC expressed the desire to have future consultations and exchanges of view with trades union representatives in the context of the OECD *Jobs Strategy*.

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