

THE OECD JOBS STUDY

At the meeting of the OECD Council at Ministerial Level in May 1992, the Ministers invited the Secretary-General to initiate a comprehensive research effort on the reasons for and the remedies to the disappointing progress in reducing unemployment. In response to this mandate, the OECD Secretariat has examined a number of broad areas: macroeconomic policy; trade; technology; wage formation; labour adjustment; education and training; benefit systems and taxation. This work will be published in September under the title "The OECD Jobs Study: Evidence and Explanations". The note which follows is a brief summary of the Policy Report based on this work which the Secretary-General presented to the Ministers at their meeting in June and which is provided as a supplement to this issue of the Economic Outlook.

Nature and dimensions of unemployment

Unemployment in the OECD area of 35 million, some 8½ per cent of the labour force, represents an enormous waste of human resources, reflects an important degree of inefficiency in economic systems, and involves a disturbing degree of social distress. The measured unemployment rate ranges from about 2¾ per cent in Japan and around 6 per cent in the United States to an average of around 11½ per cent in OECD Europe. And these figures do not include "discouraged workers" and those part-time workers who would prefer to work full time.

Unemployment has a cyclical component, which diminishes when economic growth picks up; and a structural component, which typically is not reduced by economic growth. The exact proportion of each is uncertain, but varies significantly across countries:

- In the *United States*, the cyclical element in unemployment is declining rapidly; structural unemployment, at around 6 per cent of the labour force, seems to have changed little over the past decade.
- In the *European Community, Canada and Oceania (Australia and New Zealand)*, the level of structural unemployment has risen over time, to perhaps 7 to 10 per cent of the labour force, and currently significant cyclical unemployment is superimposed upon it.
- In members of the *European Free Trade Association*, unemployment remained rather low for many years, rarely rising above 2 per cent and with relatively little cyclical variation, but recently has risen to over 7 per cent, with some of the rise probably being structural.

- In *Japan*, there is low structural unemployment, of around 2 per cent, but cyclical unemployment is now growing.

The burden of high and persistent unemployment is shared unevenly among labour force groups. In almost all OECD countries, the young and the unskilled experience very high rates of unemployment. The growing numbers of long-term unemployed, especially in Europe, have become a major concern because of the social hardship and demotivation resulting from prolonged joblessness.

Needed structural and macroeconomic action

The policy problem has both macroeconomic and structural dimensions (elaborated below in the section on recommendations). Also important are the various inter-relationships between structural and macroeconomic performance. Structural reforms will bear full fruit only in a stable macroeconomic environment, in which private sector participants can be more confident about medium-term prospects and can thereby adjust more easily to changing circumstances. And macroeconomic policy has more chance of succeeding in supporting the desired level of demand without giving rise to inflation if structural conditions and policies prevent rigidities, make economies both more innovative and adaptable, and allow resources to move to their most profitable uses.

Linked with these economic considerations is an important social dimension. An adequate degree of social protection is necessary to reassure workers, and encourage them to react positively to structural changes. At the same time, it is necessary to provide a decent minimum standard of living for those members of society who are unable to adjust.

Benefiting from structural change

Particular emphasis is placed on structural policies, because in today's globalised world the achievement of high employment with continual growth in productivity, and thereby living standards, involves adapting to, and benefiting from, continual structural change. Today the forces impelling structural change – including cheaper transport, the new information technologies, liberalised capital flows, strong competition, and an increasing mobility of people – are very strong. The potential gains from exploiting these developments are great. But their realisation depends upon a markedly enhanced capacity in OECD economies to adapt and to innovate. Hence considerable attention has to be paid to ensuring that policies do not hinder, and preferably foster, such structural change.

The process of structural change involves the continual squeezing out of low-productivity, low-wage jobs, and the emergence of higher productivity, higher wage jobs. The process is turbulent: 10-15 per cent of all jobs in an OECD economy are destroyed each year, while a broadly similar number are created.

New skills

One clear dimension to structural change has been, and continues to be, a systemic shift away from the employment of low- or narrowly-skilled labour, both in manufacturing and in services. This reflects both demand and supply-side factors, but the most important cause has apparently been technical progress, which is increasingly being reflected in a move towards a more knowledge-intensive economy. A sharp widening of wage differentials in the United States has preserved employment of some of the unskilled, but at the expense of an increase in in-work poverty; in Europe wage inflexibility has prevented the emergence of in-work poverty, but at the expense of high rates of unemployment of the low-skilled. Only the Japanese economy has handled the problems of this period of adjustment relatively well, although more recently it has been wrestling with substantial pressure for change.

Bolstering the ability of economies to create new jobs is one facet of the strategy to reduce unemployment. But a high-productivity, high-wage job strategy can work only with qualified people to fill the new jobs. People must have a solid education. Workers will have to acquire and later re-acquire skills through training.

Active labour market policies, too, will help transform redundant qualifications into employable skills.

Many people will need help to fit the requirements of high-skill jobs. But some will be unable to meet these requirements and will be unemployed or take low-skill, low-wage jobs. The commitment to support them will be a valuable investment towards a more cohesive and caring society. As OECD economies progress, it becomes all the more important to hone the support policies and mechanisms so that they provide effective help to those who most need it.

A growing adjustment gap

While the need for a powerful capacity to innovate and to adapt has probably never been stronger, the capacity of OECD economies to adjust has been progressively diminished over the past two to three decades, often as the unintended and unexpected side effect of policies put in place to regulate markets and to provide social protection.

Thus, for example, entrepreneurship has been discouraged by a variety of red-tape regulations and controls. Firms have also been discouraged from hiring workers by: growing non-wage labour costs which drive a wedge between the worker's wage and what he or she costs the employer; minimum wages that are set too high relative to productivity levels, particularly for young people, weakening the incentive to hire them; employment protection legislation, enacted to protect those already in employment, that has operated perversely to discourage employers from taking on additional workers; and barriers to competition in product markets that have led producers to restrict output and employment and set prices artificially high.

In the areas of labour market and social policy, the levels and structure of benefit systems have variously: encouraged a disproportionate share of the labour force in some countries to become registered as disabled; and reduced work incentives for the unemployed and low-wage workers through the interaction of tax and benefit systems.

Thus a gap has been widening between the *need* to innovate and adapt and the *capacity* to do so. In the resulting environment of high and rising unemployment, pressures are growing to slow the process of change. But this can only be counterproductive: hindering change neutralises the mainspring of productivity growth and higher living standards, while weakening the capacity to create new jobs (see Box "What the Answer is *Not*").

WHAT THE ANSWER IS *NOT*

Regardless of the form that it takes – low-paid, low quality jobs or overt unemployment – the present unemployment problem in Member countries is serious. It brings with it unravelling of the social fabric, including a loss of authority of the democratic system; and it risks resulting in the disintegration of the international trading system.

Faced with this weakening of both national and international cohesion, it is scarcely surprising that pressures should surface in a number of countries for various types of “quick fixes”. There is talk in some countries of legislated, across-the-board, work-sharing. And there are vocal calls in most OECD countries for action to soften or slow down the pace of adjustment through protectionism. Experience shows, however, that such quick fixes are inappropriate ways of dealing with many of the causes that underlie much of the present unemployment problem.

Legislated, across-the-board, work-sharing addresses the unemployment problem not by increasing the number of jobs through more economic activity but through rationing gainful work. Enforced work-sharing has never succeeded in cutting unemployment significantly, not least because of worker resistance to reduced income. This “cure” must be distinguished from voluntary negotiations between workers and firms over flexible working time arrangements, which can lower costs and lead to higher employment.

Protectionism reduces overall economic welfare; increases costs to consumers, often hurting most those with lowest incomes; penalises successful enterprises; harms exports; encourages tariff factories; harms developing countries’ trade; and increases the pressures for international migration. It encourages domestic monopolies, while cutting the economy off from mainstream developments in the world outside. Producers, dependent on protection for their survival, ultimately become prepared to spend large sums to preserve its continuance. Lobbying, and even bribery and corruption, become more widespread.

Policy recommendations

Accordingly, the OECD’s policy recommendations are designed to improve the ability of economies and of societies both to cope with, and benefit from, change, by:

- enhancing the ability to adjust and to adapt; and
- increasing the capacity to innovate and be creative.

Most OECD countries face broadly these basic policy needs and constraints; hence most of the recommendations apply to most countries. At the same time, differences in country circumstances and institutions mean that there will be differences in the priorities for individual countries.

The recommendations do not apply to governments alone. In many cases responsibility for action to improve employment performance lies most directly with employers, trade unions and individual workers.

The strategy for jobs contains a range of macroeconomic and structural policies: structural reforms will be more successful in a stable macroeconomic environment; in the absence of structural reforms, growth soon becomes stifled by inflation pressures.

The recommendations elaborate the following broad programme of action (for full details on all the recommendations, see Part III of the Policy Report):

Set appropriate macroeconomic policy

Macroeconomic policy has two roles in reducing unemployment: over the short term it limits cyclical fluctuations in output and employment; and over the longer term it should provide a framework, based on sound public finances and price stability, to ensure that growth of output and employment is sustainable, *inter alia* through adequate levels of saving and investment.

Enhance the creation and diffusion of technological know-how

Technological development is the main force determining growth in productivity, employment and living standards in the medium and long run. While labour-saving technical progress reduces the labour inputs necessary per unit of production and hence can displace jobs in the short-run, in particular in low-skilled occupations, the higher productivity associated with process innovations increases real incomes, while the creation of new products and services generates additional demand. Policies should accordingly be aimed at improving the ability of societies and economies to create, and make effective use of, new technologies which form a base for the expansion of high-productivity, high-wage employment.

Increase working-time flexibility

Increasing short-term and lifetime flexibility of working time in contracts voluntarily entered into by employers and workers would lead to higher employment. An important element in this process would be to foster the growth of voluntary part-time work. Govern-

ments have a role to play in this process by removing obstacles to, and facilitating, reductions in working time and by reviewing existing taxation and social security provisions which discriminate against part-time work.

Nurture an entrepreneurial climate

Broadly-based policies are needed to encourage vigorous enterprise creation in the private sector. Public policy should remove regulations and practices that impede entrepreneurship and ensure that industrial assistance does not unduly favour established large firms at the expense of new small firms. These actions need to be accompanied by public education campaigns to encourage entrepreneurship and to remove negative connotations linked to business failure. Programmes to foster entrepreneurship and small business should be integral parts of local development strategies.

Increase wage and labour cost flexibility

Wages have an important allocative role to play in labour markets by providing clear signals to workers and firms. At the same time, non-wage labour costs – employers' social security contributions, pay for time not worked etc. – which drive a wedge between what employers must pay to hire a worker and the value of his/her product have become a significant proportion of total labour costs in many countries over the last two decades. Where wage movements do not offset these growing non-wage labour costs, unemployment increases. Hence, there is a need in both the public and private sectors for policies to encourage greater wage flexibility and, in countries where the scope for increasing such flexibility is limited, to reduce non-wage labour costs. Actions on these fronts would involve changes in taxation, social policy, competition policy and collective bargaining.

Reform employment security provisions

Employment security provisions operate in two directions. These provisions recognise the reality of long-term reciprocal commitments between workers and firms, and encourage firms to retain and retrain workers who would otherwise be made redundant. However, if firms perceive that employment security provisions oblige them to keep workers who are no longer wanted, they become cautious in hiring, and "screen" applicants more carefully, to the particular detriment of job-seekers with labour market disadvantages. Policy must strike a balance between giving employers more freedom over hiring and firing decisions, and providing both sufficient employment security for workers and firms to be willing to invest in long-term training and protection for workers against unfair dismissal.

Extend and enhance active labour market policies

There is a general agreement on the need to shift the focus of labour market policies from the passive provision of income support to more active measures which assist re-employment. Public spending on labour market programmes in almost all countries is still dominated by passive measures. At the same time, it is important to enhance the effectiveness of active measures. Programmes should be targeted on specific client groups, or be designed to remedy specific labour market problems. It is also important to ensure a close interaction between active measures and unemployment and related benefit systems.

Improve labour force skills and competences

Extending and upgrading workers' skills and competences must be a life-long process if OECD economies are to foster the creation of high-skill, high-wage jobs. Education and training policies should be directed at furthering this goal, as well as at achieving other fundamental social and cultural objectives. This will require a major shift in policy in some countries and, in others, sustained development of existing policies, in particular those aimed at effective action to tackle three major problem areas: the quality of initial education, including early childhood education; the transition from school to work; and investment in work-related skills, especially for the least-qualified workers.

Reform unemployment and related benefit systems

Unemployment insurance and related benefit systems were originally designed to provide temporary income support to the unemployed during the process of finding a new job. With the growth of long-term and repeat unemployment, these systems have drifted towards quasi-permanent income support in many countries, lowering work incentives. To limit disincentive effects – while facilitating labour market adjustments and providing a necessary minimum level of protection – countries should legislate for only moderate levels of benefit, maintain effective checks on eligibility, and guarantee places on active programmes as a substitute for paying passive income support indefinitely. Possibilities should be explored for making the transition from income support to work more financially attractive, through lowered income tax and social security charges on low earnings and the provision of in-work benefits to low-paid workers, and limiting the extent to which benefit is reduced when beneficiaries take a part-time job.