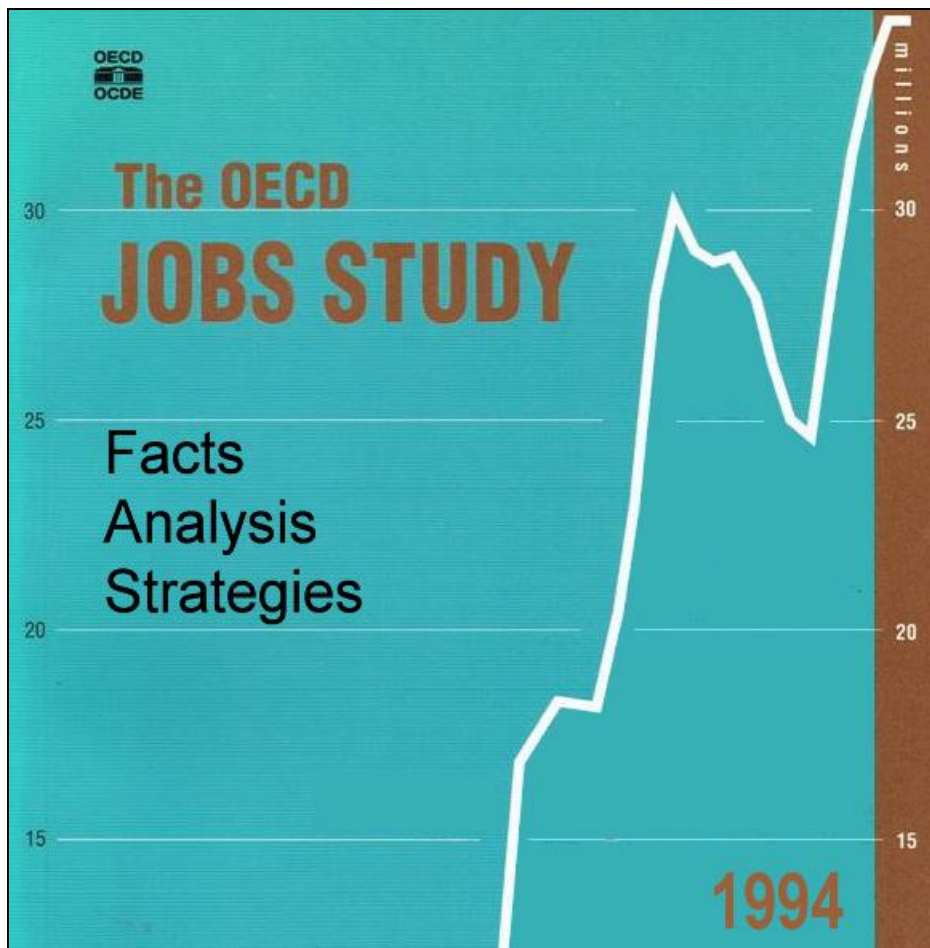


# THE OECD JOBS STUDY

## Facts, Analysis, Strategies

(1994)



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## FOREWORD

This report presents the synthesis of Secretariat work in carrying out the mandate received from Ministers in May 1992.

The Secretariat has reviewed the relevant literature, and undertaken research in a number of broad areas: macroeconomic policy; trade; technology; wage formation; labour adjustment; education and training; benefit systems and taxation. The work will be published under the title *The OECD Jobs Study: Evidence and Explanations*. In this report, references are made to individual chapters of that background material.

No avenue of research was excluded in seeking both the causes of unemployment and appropriate solutions. Numerous gaps in available data made this task more difficult, and a number of questions persist. But several converging indications point strongly to an insufficient ability to adapt to change as the fundamental cause of employment [ho]difficulties in OECD countries.

The approach reflects the essentially economic mandate of the Organisation: how, over the long term and in an increasingly integrated and competitive global economy, to make our countries prosper and innovate so as to remain at "the head of the pack"? The necessary capacity to adapt sometimes implies considerable efforts. The many benefits to be expected but also the human and economic costs which could be involved, especially in the short term, are noted in the report but have not been analysed in detail at this stage. There is no doubt, however, that the only way to achieve long-term success is to embrace change. Trying to slow the pace of change and artificially to protect uncompetitive activities would only make delayed adjustment more painful. All policies should therefore be harnessed to promote adjustment to change, while taking care to reinforce social cohesion, a condition for the long-term success of the recommended strategy.

*Jean-Claude Paye Secretary-General*

## INTRODUCTION

Unemployment is probably the most widely feared phenomenon of our times. It touches all parts of society. There are 35 million people unemployed in OECD countries. Perhaps another 15 million have either given up looking for work or unwillingly accepted a part-time job. As many as a third of young workers in some OECD countries have no job.

Economic growth will play a part in reducing unemployment. But beyond the cyclical component of unemployment is a structural element that persists even into recovery. This is harder to reduce and is even more troubling. Structural unemployment grows from the gap between the pressures on economies to adapt to change and their ability to do so. Adaptation is fundamental to progress in a world of new technologies, globalisation and intense national and international

competition. The potential gains may be even greater than those which flowed from the opening up of economies after World War II. But today, OECD economies and societies are inadequately equipped to reap the gains. Policies and systems have made economies rigid, and stalled the ability and even willingness to adapt. To realise the potential gains, societies and economies must respond rapidly to new imperatives and move towards the future opportunities. To many, the change is wrenching.

For governments, there are trade-offs and discipline involved in steering societies through the adjustment to new technologies and new forms of global trade. Their challenge will be to embrace change rather than succumb to pressure to resist it through protectionism or other measures to restrict competition.

Governments are faced with designing and redesigning a range of policies across the economy and society in order to help foster – or in some cases, stop hindering – adaptation to evolving ways of production and trade. But governments cannot meet the challenge alone. A high degree of social consensus will be needed to move forward with the necessary changes. Businesses, trade unions and workers need to be innovative to develop the new products, processes, and ways of working that will create new jobs, and help to shape skills to fit with the jobs of the future.

Some people, however, will have particular difficulty in making the needed adaptation. The most successful economies and societies will be those which plough back some of the gains from change into accelerating the process by helping them to adapt.

Even so, some in society will find it impossible to adapt to the requirements of advancing economies. Yet they, too, must benefit from the progress. Their exclusion from the mainstream of society risks creating social tensions that could carry high human and economic costs.

Part I sets out the key facts that depict today's unemployment. Part II explains these developments, and indicates the main considerations which must underlie the formulation of policy to attack the problem. Part III offers a strategy for jobs and detailed policy recommendations.

## I. KEY FACTS<sup>1</sup>

Unemployment of 35 million, some 8½ per cent of the OECD labour force, represents an enormous waste of human resources, reflects an important degree of inefficiency in economic systems, and causes a disturbing degree of social distress. The nature of unemployment – the difference between the number of people who have or seek a job (the labour force) and the number of jobs available (employment) – is depicted by a number of key facts about the people in OECD economies; the jobs that have evolved from changing industrial structures; and the behaviour of wages.

### THE PICTURE OF UNEMPLOYMENT

During the 1950s and 1960s, the total number of unemployed in the OECD area averaged below 10 million. But within just one decade, from 1972 to 1982, this number tripled. The subsequent prolonged economic expansion only trimmed back the unemployment total, to 25 million people in 1990. Since then, it has risen sharply.

*The rising trend in OECD unemployment has been uneven across the OECD area:*

In North America, unemployment rates were relatively high in the 1950s and 1960s. But there has been only a modest trend increase since 1970, albeit with large cyclical fluctuations. Unemployment peaked at just over 7½ per cent in 1992 – well below the previous peak of over 9½ per cent in the early 1980s – and is currently around 7 per cent.

By contrast, unemployment in both the European Community and Oceania has risen sharply since the mid-1970s, with the unemployment rate in both regions currently at record rates of around per cent.

The EFTA countries successfully stabilised unemployment in a range of 2 to 4 per cent until 1990. Since then, the rate has risen sharply, to almost 8 per cent.

Japan has managed to keep unemployment low, at between 1 and 3 per cent, throughout the entire post- War period. The current unemployment rate is almost 3 per cent.

Even the official number of 35 million unemployed does not reflect the full extent of joblessness. Many job seekers have given up looking for work. There is considerable involuntary part-time work. In some European countries, short-time working, or "partial unemployment", financed by unemployment benefit systems, has become common. In Japan, there is significant under-employment: firms, and in particular larger firms, hold on to their employees during cyclical downturns as part of a strategy of life-long employment. These elements of under-employment could add 40 to 50 per cent to the OECD unemployment total. Partly offsetting this, some of the unemployed may actually be working in "concealed employment" (Box 1).

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<sup>1</sup> The cut-off date for statistical information was 15th May 1994.

Some groups in the labour force face more severe unemployment than others:

In nearly all OECD countries, **young people** continue to experience a much higher rate of unemployment than do adults (Table 1) – 30 per cent or more of the youth labour force in several European countries (Italy, Spain, and Finland). The few exceptions are those countries with a traditionally strong apprenticeship system, notably Austria and Germany.

In the European Community, women have higher unemployment rates than do men, except in the United Kingdom. But in most other OECD countries, unemployment rates are higher for men.

Within countries, differences in the regional incidence of unemployment have typically been higher and much more persistent in Europe than in Australia or the United States. The regional distribution of unemployment is particularly uneven in Finland, Germany (since unification), Italy, Portugal and Spain.

The severity of unemployment depends not only on the risk of becoming unemployed but also on the probability of remaining so for a long time. There are striking differences in the share of long-term unemployment in total unemployment. In the European Community more than 40 per cent of the unemployed had been out of work for 12 months or more in 1992, compared with a third in Oceania, around 15 per cent in EFTA and in Japan, and only 11 per cent in North America.

For any given rate of unemployment (horizontal axis of Chart 4), the share of long-term unemployment is much higher in EC countries, for example, than in North America. In the EC it ratcheted up, rising sharply during the recession in the early 1980s and declining only moderately during the upswing. By contrast, in North America the share of long-term unemployment increased much less during the recession, and subsequently fell back sharply. By 1989, it had fallen almost to its 1979 level.

The incidence of long-term unemployment in total unemployment differs considerably by age. In virtually all OECD countries, older workers (age 55 and over) are most at risk of experiencing prolonged unemployment – in several EC countries more than 2 out of every 3 unemployed older workers have been out of work for more than a year. Young people typically face shorter spells. Further, their share in total long-term unemployment declined during the 1980s. Nevertheless, many young people still face prolonged unemployment: in Greece, Ireland, Italy, and Spain, for example, the incidence of long-term unemployment among unemployed youth ranges between 50 and 70 per cent.

The high incidence of long-term unemployment in most EC countries is associated with low inflow rates into unemployment. The opposite relationship – low incidence of long-term unemployment and high inflows into unemployment – holds for North America. This suggests that many EC countries have a hiring problem: while the risk

of becoming unemployed is low compared with other countries, once unemployed, a worker has relatively little chance of quickly finding another job. In the United States and Canada, on the other hand, there is a greater risk of becoming unemployed, but an unemployed person has a much better chance of being rehired quickly.

## FIVE COUNTRY EXPERIENCES

Although the way people, jobs and wages have evolved has been different in each OECD country, there are features common to groupings of countries. Five broad patterns can be picked out, characterising how labour markets have operated, how jobs have been created, and the trend and composition of unemployment:

- The European Community

Weak employment growth, most of it until the mid-1980s in the public sector, has been accompanied by strong productivity growth, achieved mostly through labour-shedding in traditional sectors rather than through shifts of production to high-technology and skill-intensive activities. Unemployment has ratcheted up over successive cycles, resulting in rising long-term unemployment. Inflows into unemployment have been relatively low but outflows even lower – suggesting poorly functioning labour markets.

- The United States

Buoyant growth of both high-skilled and low-skilled jobs in the private sector, especially in services, has been accompanied by weak average productivity growth. Wage differentials have widened, and real wages for the low-paid have fallen absolutely, resulting in growing in-work poverty. Fluctuations in unemployment have been mainly cyclical, with high inflows and outflows, a low incidence of long-term unemployment, and only a moderate trend rise in total unemployment.

- Canada/Oceania

As in the United States, employment growth in the private sector has been strong, productivity growth slow, wage differentials have widened, and real wages for low-paid workers have fallen. But there have also been important differences: systems of social protection are more extensive than in the United States; and unions have had more influence in collective bargaining. Most importantly, there has been a strong upward trend in unemployment over the past two decades.

- Japan

Japan has managed to maintain low unemployment, as measured. A well-developed internal labour market has enabled firms, in particular large firms, to adjust to structural change by shifting production to higher value-added products, and by up-skilling and redeploying their work forces accordingly. But continuing weak demand is producing clear signs of rising underemployment, either in the form of labour hoarding or of withdrawal, especially of women, from the labour force.

- The European Free Trade Association

Strong employment growth has taken place in the public sector, with little or none in the private sector; highly productive industries compete effectively on world markets; and there has tended to be relatively little wage dispersion. Unemployment has for much of the period been relatively low, due to: the role of the public sector as

an employer of last resort; bargaining systems that were sensitive to the need to preserve low unemployment; and significant investment in active labour market policies. But when the public sector stopped expanding, unemployment increased rapidly.

### *Box 1*

#### Statistical considerations

National data sources are generally reliable in their own terms, but do not lend themselves to international comparisons because they refer to features which are institutionally specific to the country in question. In other areas, only limited data are available. Some areas which stand out in these respects concern: earnings; temporary work; job creation and job destruction; turnover and mobility; occupation; enterprise-based training; migration; and the service sector generally, which – in spite of the fact that in virtually all OECD countries it covers more than 50 per cent and often 70 per cent of total employment – is often much less well reported than is the industrial sector.

Statistical concepts need to be adjusted both in order to measure new socio-economic developments accurately and to respond to emerging policy issues. Several innovations and developments of the existing statistical apparatus are needed if policy making is to be better informed:

- International conventions consider a person to be unemployed if he or she is not working, is ready to begin work within a short period and is actively looking for work. This definition excludes persons who have some but not all of the characteristics of a "fully" unemployed worker: those working few hours and seeking to work more; those who would accept a job offer but are not seeking work because they believe none is available; and those in early retirement for labour market reasons. There is thus a whole spectrum of different types of joblessness, between full-time work and full-time voluntary inactivity. While the data necessary for the construction of a suite of indicators are available in several countries, work still needs to be done to compile them regularly and improve their international comparability.
- More information is needed about persons who are not in the labour force, concerning the nature of their main activity: full-time education; care of family members; sickness; unpaid community work. Information is also needed on their main sources of income: family relations; pensions; sickness benefits; scholarships, etc.
- The volume of employment concealed from the tax and social security authorities has been estimated at around 10 per cent in several OECD countries, and higher still in a few. Continued efforts are needed to assess both the incidence of such "concealed employment" and the likely biases in official labour force statistics.
- Particularly important from a policy point of view are the links between unemployment and hardship. Several countries lack information even on the number of unemployed

supported by social assistance and welfare benefits. Moreover, available data are often too ambiguous to permit generalisations about the incidence and causes of hardship, and efforts are required to improve information on family circumstances and sources of income, in relation to work history and job search efforts.

Table 1. The profile of OECD unemployment

	Unemployment rates (1993)			
	All persons <sup>1</sup>	Youths <sup>2</sup>	Women <sup>2</sup>	Long-term unemployed <sup>3</sup>
North America	7.2	13.8	6.9	11.2
Canada	11.1	17.8	10.6	11.2
United States	6.7	13.3	6.5	11.2
Japan	2.5	5.1	2.6	15.4
EC	10.6	20.6	12.2	42.2
Belgium	9.1	19.6	13.7	59.0
Denmark	10.4	11.4	11.3	27.0
France	11.6	24.6	13.7	36.1
Germany	5.8	4.9	6.1	33.5
Greece <sup>3</sup>	9.8	24.6	15.4	49.7
Ireland <sup>4</sup>	15.8	27.9	20.1	60.2
Italy	10.2	30.6	14.6	58.2
Luxembourg	2.6	5.7	3.6	17.6
Netherlands	8.3	15.0	11.7	44.0
Portugal	5.5	12.0	6.5	30.9
Spain	22.4	43.2	28.9	47.4
United Kingdom	10.3	16.9	8.1	35.4
EFTA	7.4	12.6	7.0	13.1
Austria	4.2	4.7	4.9	16.9
Finland	17.7	30.8	15.6	8.2
Iceland	5.2	..	5.2	..
Norway	6.0	13.5	5.2	23.5
Sweden	8.1	18.4	6.6	8.0
Switzerland	3.7	6.8	4.7	20.6
Oceania	10.6	18.4	9.9	34.2
Australia	10.8	18.7	10.1	34.5
New Zealand	9.5	17.2	8.9	31.9
Turkey	7.3	13.9	6.3	43.7
OECD	7.8	15.1	8.2	28.6

1. For all persons, OECD standardised unemployment rates (national estimates for Austria, Greece, Iceland, Switzerland and Turkey; EC comparable unemployment rates for Denmark and Luxembourg). For youths (aged under 25) and women, EC comparable unemployment rates and national estimates.

2. The long-term unemployed refers to all persons unemployed continuously for one year and over. The long-term unemployed share refers to 1991.

3. Unemployment rates for youths and women refer to 1992.

## PEOPLE

The evolution of both the labour force and employment is strongly influenced by population changes which, together with migration, accounted for five-sixths of the increase in the OECD labour force in the 1980s.



**The working-age population** in the OECD is growing much more slowly ( $\frac{1}{2}$  per cent per year in the early 1990s) than it did in the 1970s (over 1 per cent per year). North America experienced a particularly sharp slowdown but, along with Oceania, it still has faster population growth than do Japan, the European Community and EFTA. The number of young people aged 15-24 peaked during the 1980s: both the population and the labour force are ageing in nearly all OECD countries. This trend is likely to accelerate over the next decade or two, with a sharp rise in the shares of older workers in the work force, and of pensioners in the population.

The working-age population and labour supply are also affected by changes in international migration. In EFTA and EC countries, net migration accounted for a significantly larger share of population growth over the 1983-92 period than 1975-83, driven in part by the influx of refugees and asylum seekers and by movements of ethnic groups (particularly German) following the opening of borders in Central and Eastern Europe and the former Soviet Union. In the traditional settlement countries, the evolution has been different. In Oceania, the relative contribution of net migration to population growth also increased, but much less than in the EFTA and EC countries. In North America, there was little change. Net migration to Japan, in contrast to the other regions, has been insignificant over the past two decades.

The size of the labour force is affected by labour force participation rates – the proportion of the working-age population in the labour force. Total participation rates in Japan (74 per cent) and the EC countries (67 per cent) have changed little over the past 30 years. But they grew significantly in EFTA, Oceania and North America, to around 75 per cent.

Participation rates have generally been rising for women and falling for men, bringing the two rates closer. In Australia and North America, the rise in women's participation rates was particularly rapid over the 1980s. Relatively unchanged female participation in the EC reflects contrasting trends among countries. In a number of them (Ireland, Italy, Greece and Spain), women still participate much less in the work force than do their counterparts in the rest of the OECD area.

Participation rates for young people generally declined over the 1980s, in part reflecting higher enrolment and retention rates in education. And increasing numbers of older workers withdrew from the labour force, often in response to early retirement schemes and disability pensions.

Average educational attainment of the labour force has continued to rise throughout the OECD area with the arrival of successive waves of new, more qualified, labour market entrants and the retirement or withdrawal of older, less-qualified workers.

## JOBS

Employment growth has been strongest in North America (1.8 per cent per year since 1960) and Oceania (1.7 per cent) and weakest in the EC (about 0.3 per cent) and EFTA (0.6 per cent), with Japan in an intermediate position (1.2 per cent). Slow growth of

jobs in the European Community coincided not only with slower population growth but also with a long-term decline in the proportion of the population in employment. Since the latter half of the 19th century, jobs have been disappearing in agriculture. Today, agriculture accounts for only 7 per cent of total OECD civilian employment, compared with 14 per cent in 1970 and almost 50 per cent in 1870. The relative importance of employment (although not of output) in industry has also decreased, down from nearly 40 per cent of OECD employment in 1970 to under 30 per cent in 1992. The counterpart has been a continual rise in the importance of employment in the service sector.

These shifts in the sectoral composition of jobs are driven by many forces for change, including, importantly, international trade and technology. International trade has generally grown faster than GDP. Most trade flows are between OECD countries, and consist to a large extent (70 to 80 per cent in the EC countries) of trade in similar products within sectors – intra-industry trade. Trade with non-OECD regions, such as the Dynamic Asian Economies (DAEs) and China, while growing fast, is still comparatively small.

Imports from non-OECD countries are in substantial part labour-intensive manufactured products and primary materials, whereas exports by OECD countries very often have a relatively high skill content. Trade in manufactured goods with non-OECD countries remains in surplus, albeit diminished during the 1980s due to: a sharp contraction of the OPEC market; stagnating demand in debt-ridden developing countries; and a movement into trade deficit with the industrialising countries in Asia.

Earlier, the deterioration was concentrated in a few labour-intensive sectors, notably textiles, clothing and footwear. Over the last 10 years the pattern changed with some non-OECD trading partners: in particular the DAEs increased their market shares in knowledge-intensive sectors such as office equipment and telecommunications.

Technological change continues to alter the nature of jobs. The biggest OECD countries, with their large domestic markets, have generally had the highest share of employment in high-technology manufacturing (left side of Chart 10). But the rapidly growing international market for new technology products makes high-tech production feasible even for small countries. Thus not only Japan, but also some smaller countries (notably Ireland, Australia, Finland and Norway), have been particularly successful in strengthening their competitiveness in high-tech industries (right side of Chart 10).

Many other European countries have a relatively poor record in shifting to high-tech exports. The only large EC country that strengthened its comparative advantage significantly in high-tech products, the United Kingdom, did so not by increasing its market share for high-technology commodities, but through a large loss of market share for low- and medium-tech products in the early 1980s.

The share of OECD employment in the service sector has risen, from less than 50 per cent in 1970 to around 65 per cent in 1992. Most of the new job growth during the 1980s occurred in services such as finance, insurance and business services, and community and personal services.

In the 1980s there was a reversal of the long-term trend of declining self-employment. In 13 OECD countries, non-farm self-employment expanded faster than overall employment growth. The contribution of self-employment to overall job creation was particularly striking in Iceland, Portugal and the United Kingdom.

Part-time employment accounted for a rising share of total employment in the 1980s, particularly in Australia, Belgium, Canada, France, Ireland, the Netherlands and the United Kingdom. Women have accounted for most of the rise, much of it in services.

The share of temporary work in total employment remained relatively stable over the 1980s in many countries. But it increased quite sharply in France and Spain, reflecting a relaxation of legislation regulating employment contracts.

Job growth in the United States and Japan has taken place largely in the private sector. By contrast, some two-thirds of the 10 million jobs created in the EC and EFTA since the early 1970s have been in the public sector. During the 1980s, however, the pace of public sector job growth slowed considerably in Europe, and private sector employment, which had fallen between the mid-1970s and early 1980s, picked up. Private sector employment gains over the past decade were largest in Germany, the Netherlands and the United Kingdom. In Oceania, public employment has fallen since the late 1980s.

## WAGES: THE LINK BETWEEN PEOPLE AND JOBS

One of the main mechanisms that matches people and jobs is wage adjustment. Wages have significant consequences for employment and unemployment. The process of wage determination is strongly influenced by labour market pressures, social perceptions, legislation, and industrial relation systems, which all affect the evolution of real wages (nominal wages adjusted for price increases) and wage differentials.

Across the OECD area growth of real wages moderated after the 1979 oil-price shock in an environment of tight macroeconomic policies that reduced inflation to the low rates of the 1960s. Wage shares in national income generally fell back to, or even below, their early 1970s levels. The ensuing improvement in profits much enhanced the business investment climate.

At the same time as overall wage shares fell, there were contrasting trends in the dispersion of wages, between low- skilled and high-skilled workers. In the English-speaking countries, wage differentials widened over the 1980s. In the continental European countries on the other hand, wage differentials were either broadly unchanged, or increased only slightly after narrowing in earlier decades.

The widening of wage differentials was associated with actual falls of real wages for low-skilled male workers in Australia, Canada and, especially, in the United States. The United Kingdom, however, experienced both a sharp increase in earnings inequality and increases in real wages of the low-skilled, because of rapid growth of wages in general during the 1980s.

The United States has a much higher incidence of low pay than most other OECD countries. Over one-quarter of all full-time workers in the United States earn less than two-thirds of median earnings, compared with between one-tenth in Australia and one-fifth in the European Community. In 1990 nearly one-fifth of all full-time workers in the United States had earnings at or below the official poverty level for a four-person family (although only around 6 per cent were living in families whose total income fell below the poverty line).

All countries have experienced a shift in demand away from unskilled jobs towards more highly skilled jobs. In most countries where relative wages have been flexible (the United States, Canada, Australia), both the relative employment and unemployment rates of the unskilled changed little during the 1980s. In comparatively inflexible Europe, on the other hand, both relative employment and unemployment rates deteriorated.

The willingness of workers to accept low-paid jobs depends, in part, on the relative generosity of unemployment benefits. Unemployment benefit rates relative to average earnings – the replacement rate – are generally higher in Europe than in other OECD countries. In most countries, the replacement rate rose during the 1970s and 1980s, with substantial rises in several smaller European countries (Denmark, Norway, Finland, Portugal, Spain, Ireland, Sweden, and Switzerland). Some countries have stemmed or even reversed the rise (New Zealand, the United Kingdom and, to a lesser extent, Germany).

## II. ANALYSIS AND CONSIDERATIONS FOR POLICY

### INTRODUCTION

The unemployment picture summarised in Part I is a disturbing one, for all countries. Public discussion on the causes of high and rising unemployment is charged, and evokes explanations that, upon examination, seem ill-founded:

- Technology causes rising unemployment. This view holds that the pace of technological change should be slowed, for example through the development of a two-tier economy: one highly productive sector and the other, favoured by policy, much more labour-intensive.
- 
- Imports from low-wage countries cause higher unemployment and drag down wages of low-skilled workers. Proponents of this view regard import competition from low-wage countries and regions as unfair and support protectionism to curb what they see as social dumping.
- 
- The intensity of competition is to blame. Competition has intensified, partly as a result of globalisation (Box 2), obliging firms to become ever more efficient through processes such as mergers, downsizing or re-engineering – all of which raise the spectre of fewer and fewer stable jobs in large enterprises. The response would be to reduce the intensity of competition, using tools such as anti-dumping actions, merger control and financial regulations, job security provisions.

#### *Box 2*

##### Globalisation

Globalisation is increasingly recognised as exerting large and in some cases new influences on the economy. These are in many cases extensions or developments of the well-documented gains which result from international trade and investment flows. At the same time, globalisation is a complex phenomenon, and not all its effects, including on the labour market, are fully understood.

Globalisation refers to an evolving pattern of cross-border activities of firms, involving international investment, trade and collaboration for the purposes of product development, production and sourcing, and marketing. It is driven by firm strategies to exploit competitive advantages internationally, use favourable local inputs and infrastructure, and locate in final markets. These strategies are shaped by declining communication and transport costs, and rising R&D costs; macroeconomic trends and exchange rate fluctuations; and liberalisation of trade, investment and capital movements.

The international investment boom at the end of the 1980s amplified the importance of foreign affiliates in most economies, helped increase international sourcing, and continued the rising trend in intra-industry trade. International collaboration between firms also rose rapidly. Overall, large multinational firms have been the main actors, and, in manufacturing, globalisation involves R&D-intensive and assembly industries. Labour-intensive industries are less globalised.

Studies reported in the chapter on Trade and Foreign Direct Investment attempt to quantify the employment and earnings effects of globalisation and associated cross-border structural change. Analyses of trade in goods suggest that there has been a small negative effect on demand for unskilled labour in OECD countries due to trade with non-OECD countries, but that losses of unskilled jobs have been largely offset by jobs gained through trade in goods produced by skilled labour. The relations between trade and earnings are less clear, due to difficulty in clearly isolating trade from other effects on earnings, and to lack of necessary data. The main impact of international investment flows is felt in OECD countries, which are the major sources and destinations of investment. Net flows to non-OECD countries are small relative to fixed investment, and they are unlikely to have had a significant impact on employment to date.

However, the perceived importance and complexity of globalisation suggest the need for further work to quantify the effects of trade, investment and other elements of globalisation on employment, skills and earnings, notwithstanding conceptual problems in specifying links between them, and difficulty in obtaining necessary disaggregated price, industry and country data.

Evidence from a range of countries and experiences over the past four decades and especially over the past few years indicates that none of these suggested causes is primarily or even importantly responsible for today's unemployment.

The notion that the pace of technological progress has accelerated to the point where it results in "technological unemployment" is in fact a long-standing one. But, as argued in the chapter on Technological Change and Innovation, the evidence does not support this view. It may, of course, happen one day; but history has shown that when technological progress accelerates, so do growth, living standards and employment. Technological progress would lead to high unemployment only in a world of saturated wants or perpetual restriction of demand, conditions that have not occurred in the past, and seem unlikely in the foreseeable future. Furthermore, worries about a new era of "jobless growth" appear unfounded: the current upswing in the United States and a number of other countries has brought job growth in its train, and broadly in line with past relationships between growth and employment.

The view that competition from imports, especially from low-wage countries in Asia, is responsible for much of present-day unemployment has also been carefully considered in the chapter on Trade and Foreign Direct Investment, and in as much detail as the rather inadequate data permit. The weight of low-wage countries' exports in the overall expenditure of OECD countries on goods and services is only about 1½ per cent. The number of markets which they contest is greater, and their effect on the intensity of competition is increasing. But the judgement on present evidence is that the overall impact both of imports from these countries and their contestation of OECD markets is too small to account for a significant part of either current unemployment or falling relative wages of the low-skilled. On the other hand, these countries represent a large and growing potential market for OECD exports of goods and services, and hence represent an important source of current and future growth and employment.

In practice, most of the competition in OECD countries comes not from low-wage countries but from the OECD countries themselves. For the most part, trade between OECD countries involves trade within sectors, or even within firms, involving the exchange of intrinsically similar products, with broadly similar labour and skill contents. Globalisation is apparently further strengthening the growth of this kind of trade, making the trade between OECD countries more and more like that within OECD countries. It thereby fosters economic growth and development, which involve a turbulent process of birth and death of firms, indeed the rise and fall of whole sectors of activity, and the reallocation of production within, as well as between, regions and countries. With this growth and development comes the wholesale destruction of many jobs – around one in ten each year – together with the creation of a similar number of new ones.

Hence to seek to slow the pace of change – to resort to protectionism – would be to seek to cut off economies from the forces that have always been the mainsprings of economic growth and betterment. Furthermore, that would open a Pandora's box which, history shows, would prove almost impossible to close before all the retaliatory forces had escaped (see Box 3).

### *Box 3*

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 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.

Trying to slow the pace of change is not the right approach to dealing with present-day unemployment. The best approach is, rather, to strengthen the capacity to adjust to rapid change. This is all the more necessary because there appears to be a growing gap between the need to adjust and the capacity of OECD economies to adjust.

This adjustment gap has arisen from practices that have made the economy rigid. Motivated to protect people from at least the worst vicissitudes of economic life, governments, unions and businesses have progressively introduced labour market and social policy measures and practices which, in achieving their intended ends, also have had the unintended but more and more important side effect of decreasing the economy's ability, and sometimes also society's will, to adapt.

### The historical perspective

With the benefit of hindsight, the beginnings of today's unemployment problem can be traced back to the mid-1960s. In the stable post-World War II economic environment, standards of living in most OECD countries grew rapidly, narrowing the gap with the area's highest per capita income country, the United States. The OECD area's terms of trade evolved favourably and smoothly; trade and payments systems were progressively liberalised, without major problems; GDP and international trade grew strongly.

However, under the surface all was not so well. By the late 1960s, economic performance began to deteriorate. Inflation started creeping up, indicating that wage and price pressures had been building during the decade.

By the 1970s, the economic environment became turbulent. The two oil price rises, in 1973-74 and 1979-80, imparted major terms-of-trade shocks, each of the order of 2 per cent of OECD-area GDP, and each sending large relative price changes through all OECD economies. Exchange rates became volatile after the breakdown of the Bretton Woods system of fixed exchange rates. Then there came, mainly in the 1980s, waves of financial-market liberalisation and product market deregulation which greatly enhanced the potential efficiency of OECD economies, and also accelerated the pace of change. All these developments challenged the capacity of economies and societies to adapt. At the same time, the need to adapt was heightened by pervasive technological change, especially as the new information technologies appeared; and by the trend towards globalisation.

Yet, in the midst of this tumultuous period when so many forces were testing the flexibility of economies, policies to achieve social objectives were extended, with the unintended side-effect of making markets, including importantly labour markets, more rigid. This erosion of the ability to adapt to change was probably most pronounced in continental Europe and Oceania.

At the same time the public sector progressively became more important as an employer. In many European countries, and to some extent in Canada, public sector employment grew as the impediments to private sector hiring increased, as the incentive to accept work – particularly low-paying or precarious work – diminished,



and as societies demanded more publicly-provided services. In some countries, particularly the Nordic countries, the public sector absorbed much of the growth of the labour force, and across much of Europe virtually all net job creation was, until the mid-1980s, in the public sector.

In the United States, by contrast, there was a different response to new technology and globalisation. Protective labour market and social policies were less extensive; labour markets remained highly flexible; and entrepreneurship was dynamic. The state did not become such an important employer. The number of new jobs grew very fast – almost five times the rate in Europe, for example – with the great majority of them in the private sector. Many of the new jobs were highly productive, paying high wages. But many others were low-skill jobs, often filled by women. Workers in these jobs often had no option but to accept low wages, precarious conditions and few health or other benefits, because they lacked the skills needed for higher-paid jobs, and did not have the alternative of European-style social support. On the other hand, the social problems faced by many of these workers might well have been worse if inflexible labour markets had deprived them of even these jobs.

The appearance of widespread unemployment in Europe, Canada, and Australia on the one hand, and of many poor quality jobs as well as unemployment in the United States on the other, have thus both stemmed from the same root cause: the failure to adapt satisfactorily to change. Management skills, education and training attainments have failed to keep pace with the requirements of a more technologically advanced economy. Companies have not sufficiently improved the productivity of their operations; and workers have not become sufficiently trained. In the United States, where the economy is highly flexible, many of those with few skills could find only jobs with poor wages and conditions. In Europe, Canada and Oceania, by contrast, such low-wage jobs were, by and large, disallowed by society, whether through state-imposed or union-negotiated wage/income floors and employment protection. So the problem which appeared as a combination of low-wage jobs and unskilled unemployment in the United States took the form in Europe mainly of unemployment of the low-skilled. Only the Japanese economy handled the problems of this period of adjustment relatively well, although more recently it, too, has been wrestling with substantial pressures for change.

#### The social consideration

The basic policy message of this report is unambiguous: high unemployment should be addressed not by seeking to slow the pace of change, but rather by restoring economies' and societies' capacity to adapt to it. But this must be undertaken in ways which do not abandon the social objectives of OECD societies. Rather, social objectives must be met in new, more carefully-designed ways that do not have the past unintended and undesirable side effects.

Such reform of social policies is a key element – indeed it could well be critical in determining success or failure – in probably all OECD societies today. In the United States, where the individual has historically been expected to absorb, and has

absorbed, the greater part of the risk in economic life, there is nevertheless growing concern about some of the consequences of less-than-universal health cover, and education attainments that do not match today's needs. And in most OECD countries, a satisfactory level of individual or family income, with adequate access to quality education and health care, together with the promise of a just pension, are deeply rooted values.

Hence the challenge is two-fold: to look across the full range of policies that have been put in place over the last 30 years to see where, and to what extent, each may have contributed to ossifying the capacity of economies and the will of societies to adapt; and then to consider how to remove those disincentives without harming the degree of social protection that it is each society's wish to provide.

This is a daunting task. But, on the basis of all the analysis carried out to date, and of the work in a number of the main OECD committees, it is not an impossible one. The limitations that policies inadvertently but progressively put on the capacity and the will to adapt and innovate were not envisaged when many of them were conceived and implemented. Now that the problem is recognised in all its importance, it should prove possible, through more careful policy design, both to meet social objectives and to permit much more ready adaptation to change. There will probably always be some trade-off between the two; but good policy design and implementation can result in a better trade-off.

This conclusion leads in turn to a number of broad considerations: for policies to achieve more jobs; and for policies to equip people for these jobs while supporting those who lose out. Jobs and people guide policy considerations that are principally structural. But macroeconomic policy has a role too, in minimising cyclical unemployment and improving the effectiveness of those structural policies.

## THE MACROECONOMIC ENVIRONMENT

An economy's ability to create viable jobs, and to transform these as circumstances change, depends partly on the macroeconomic environment. Both macroeconomic policy and structural policy will be more successful when the synergy between them is fully exploited. A supportive macroeconomic environment includes:

- sound public finances, so that the public sector does not pre-empt national saving and thereby impede investment;
- inflation that is kept under control, so that companies and workers are not held back by uncertainty associated with distorted price signals;
- aggregate demand that is managed so that growth is neither too rapid, risking inflation, nor too slow, with the risk of deflation.

An economy's growth potential depends on adequate levels of investment, which in turn require sufficiently high flows of national saving. Since the mid-1970s, saving and investment as a share of national income have declined substantially in OECD

countries, particularly in Europe. The decline of national saving can largely be attributed to the public sector. Public consumption and transfer payments have crowded out public investment, and growing public-sector deficits have crowded out private investment and raised real interest rates. Bringing public-sector finances into better balance is a key element of a medium-term growth strategy.

A stable economic environment depends also on price stability – inflation low enough not to harm business and household decision-making. Effective structural adjustment requires that entrepreneurs, managers and workers all receive undistorted price signals from the markets. Decisions are adversely affected when relative price signals are confused by inflation. Investment and saving decisions in particular become distorted, damaging the growth of production and national wealth over the long term. Sound public finances will also contribute to price stability by avoiding undue weight having to be placed on monetary policy as the primary instrument for curtailing inflation.

In parallel, the efficiency and effectiveness – the quality – of public sector spending and taxation should be maximised. Reviewing the main activities of the public sector and implementing changes in the quality of budgets is a difficult and time-consuming task, but the rewards are potentially great, given the large size of public spending in OECD countries.

In situations where there is economic slack, and inflation pressures are contained, macroeconomic policy should create conditions for declines in interest rates. Where budget deficits put pressure on (market-determined) long-term interest rates, credible plans to reduce structural deficits should be a priority. Cutting budget deficits might also enhance market confidence in governments' economic management and increase scope to cut officially-controlled (short-term) interest rates without a loss in credibility of monetary policy or disrupting foreign exchange markets. Lower interest rates would encourage the investment and growth that create new jobs.

In situations where economic recovery is well underway, macroeconomic policy should ensure that recovery is not threatened by rising inflation. In general the appropriate course will involve some tightening of monetary conditions, while taking the opportunity of recovery to consolidate the public finances.

Experience suggests that setting macroeconomic policy in a way that aims to boost growth at a cost of higher inflation, would be likely to result in accelerating inflation. Bringing it back under control through the necessary subsequent tightening of policy would almost certainly result in lower average growth over a number of years, implying a significant cost in terms of foregone output and employment, and hence income and national saving.

## The interactions between macroeconomic and structural policies

Structural policies must operate in tandem with macroeconomic policy in any effective strategy to enhance growth and employment. 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. In such a situation, the risk of temporary rises in unemployment becoming permanent (as discussed in Box 4) is minimised. And macroeconomic policy has more chance of succeeding in supporting the desired level of demand if the structural conditions and policies prevent rigidities and allow resources to move to their most profitable uses. The less rigid the economy, the more scope there is to translate macroeconomic stimulus into faster growth rather than accelerating inflation.

### Box 4. Cyclical and structural unemployment

An oft-discussed aspect of the unemployment problem is how much is cyclical and how much is structural. The importance of this distinction lies in the widespread perception that macroeconomic policy can influence the cyclical element of unemployment, but is relatively impotent in dealing with unemployment resulting from structural causes. In general terms the structural component can be defined as that part of unemployment which is not reversed by subsequent economic upturn. In practice, however, there are many definitions of structural unemployment, and there is no unambiguous way of providing a decomposition, especially as there seem to be strong interactions between the two.

Factors that increase structural unemployment will often exacerbate cyclical unemployment; while cyclical unemployment, if it persists, may well lead to an increase in structural unemployment. For example, the tendency of "insiders" to push up real wage levels will make the response of real wages to high unemployment sluggish. Hence more cyclical unemployment will be required to attain any given adjustment in wages. But because cyclical unemployment may lead to an increasing number of "outsiders", it may in turn increase structural unemployment. Similarly the greater the generosity of unemployment benefits, the slower the labour-market adjustment following shocks. In this case, reducing unemployment too rapidly could cause inflation to reaccelerate, even though there would still seem to be a degree of cyclical unemployment. In both cases, the cyclical and structural elements of unemployment interact.

Various estimates of structural unemployment have been made by the OECD Secretariat and are examined in the chapter on Macroeconomic Developments and Policies. The broad picture across countries or regions differs significantly:

- in the *United States*, structural unemployment, at around 6 per cent of the labour force, seems to have changed little over the past decade, while the cyclical element in unemployment has recently been declining rapidly;
- in the *European Community, Canada and Oceania*, the level of structural unemployment has risen over time, to perhaps 7 to 10 per cent of the labour force, and significant cyclical unemployment is currently superimposed upon it;
- in the *EFTA countries*, 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 best moment for the introduction of structural reforms is never obvious. On the one hand, when demand is weak, structural reforms may involve labour-shedding with little compensatory job creation elsewhere. The adverse economic results diminish public support for reform. On the other hand, when economic conditions are good the need for change is often not so evident, even if change in these periods would be much less painful.

Experience over the post-war period shows that macroeconomic policy has an asymmetric influence. While bad macroeconomic policy always results in bad economic performance, good macroeconomic policy does not, by itself, guarantee good overall economic performance. Propitious economic conditions offer only a starting point in dealing with unemployment. An efficient and flexible supply side of the economy is also crucial in ensuring that practices and policies operate in ways that create new jobs and help people fill them. Hence there is a need to press ahead with structural reforms, while ensuring that macroeconomic policy is set so as to take advantage of structural changes and underpin sustainable non-inflationary growth.

## JOBS

The basic answer to employment problems lies in creating more new jobs. Although it is impossible to predict what those jobs will be, they are likely to share some basic characteristics.

New jobs are likely to appear in the service sector, which already accounts for more than half of total employment in most OECD countries. The service sector is producing a higher proportion of new jobs as the demand for new services increases. Some of these are new types of jobs; others are activities that formerly were performed within manufacturing enterprises, but now are sub-contracted; the distinction between what is "manufacturing" and what is "service" is becoming increasingly blurred.

New jobs must certainly be generated by the private sector, because in nearly all countries budget deficits and resistance to tax increases rule out significant expansion of the public sector. New jobs, particularly in tradable goods industries, will increasingly have high knowledge requirements. In a globalised world, OECD countries cannot cling to low-wage-labour products in the face of competition from low-wage countries. The main way to job creation in OECD countries must be through improved productivity in firms that have a solid capacity to innovate and use technology effectively.

Many new jobs are likely to be low-productivity, low-wage jobs. From one point of view, this is intrinsically undesirable. Yet at the same time there also are calls explicitly to foster the creation of low-productivity jobs, especially in the non-traded sector, in order to absorb significant numbers of low-skilled unemployed workers. Policy has to find a balance between these two considerations. Tax concessions or employment subsidies for the creation of low-wage jobs should probably be avoided, unless countries are persuaded that there are large social gains from such incentives.

At the same time, policies that inhibit the creation of such jobs should be avoided, or steps taken to minimise their employment-hindering effects. Efforts to improve the capacity of economies to create jobs should focus on facilitating the development and use of technology; working-time flexibility; encouragement of entrepreneurship; and a general review of policies that may be hampering job creation.

## Technology

Technology both eliminates jobs and creates jobs. Generally it destroys lower wage, lower productivity jobs, while it creates jobs that are more productive, high-skill and better paid. Historically, the income-generating effects of new technologies have proved more powerful than the labour-displacing effects: technological progress has been accompanied not only by higher output and productivity, but also by higher overall employment.

The transition from old to new technologies is a demanding process that can create mismatches between the skills that people have and those that are needed. The workers who lose their jobs and are not able to take up the new opportunities tend to remain unemployed for long periods. The gap between the workers who benefit from technological change and those who lose from it risks becoming socially divisive.

Absorption of important new technologies is typically realised only after a long learning phase, and major and often difficult organisational change in the workplace. It took at least four decades for the full benefits of the electric motor to be realised in manufacturing processes. It is increasingly apparent that the difficulties of diffusing and applying the new information technologies (IT) have been seriously underestimated. The full employment benefits of IT in particular will be realised only when they are fully adapted and integrated. In many cases this involves changing, quite fundamentally, the way that output is produced, for example by moving from fixed assembly lines to flexible production systems, which require innovative management, as well as highly-skilled workers.

Difficulties in absorbing technology have been handled differently in different countries. Japan, Germany and Sweden are considered leaders in the use of IT for advanced manufacturing processes, ahead of countries with poorly adapted industrial structures or, more importantly, firms that have been slow to re-design organisation and production systems. The United States, while behind on IT use in industrial production, has a computer orientation that produces a high rate of IT applications in computer-aided design and engineering.

Detailed information, mainly from the manufacturing sector, provides evidence that technology is creating jobs. Since 1970 employment in high-technology manufacturing has expanded, in sharp contrast to stagnation in medium- and low-technology sectors and job losses in low-skill manufacturing – at around 1 per cent per year. Countries that have adapted best to new technologies and have shifted

production and exports to rapidly growing high-technology markets have tended to create more jobs. With a shift of exports towards high-technology industries, Japan realised a 4 per cent increase in manufacturing employment in the 1970s and 1980s, compared with a 1.5 per cent increase in the United States. Over the same period the EC, where exports were increasingly specialised in relatively low-wage, low-technology industries, experienced a 20 per cent drop in manufacturing employment.

Of all the contemporary technologies, IT stands out in terms of rapid and radical development, wide applicability and speed of diffusion. IT is an enabling technology that can be applied across all sectors, including importantly the service sector, which has become the fastest-growing component of most economies. IT is the source of abundant new products, services and thereby jobs. Yet, the exploitation of IT is uneven. Diffusion is most developed in certain sectors such as assembly and process industries (usually automobiles, engineering, aerospace and electronics), with large firms apparently using advanced manufacturing technology more intensively than small firms. OECD governments are increasingly recognizing the potential employment benefits of the new technologies, and are considering measures to accelerate their effective absorption. To ensure a stream of new technologies such that economies can continually move upwards, governments typically support basic research, and, at least at the pre-competitive level, the development of generic technologies that have a broad field of application. The most immediate payoff from new technologies, however, seems likely to come from policies that encourage their diffusion and absorption.

Such policies have a number of dimensions. One consists of ensuring that markets operate efficiently and that firms have incentives to innovate. This may mean getting rid of subsidies to firms operating in specific sectors and using specific technologies. Subsidies tend to operate in exactly the opposite way from what is needed: they slow rather than stimulate adjustment; they discourage rather than encourage innovation; and they tend to become permanent.

A second policy dimension involves addressing the uncertainties and externalities associated with innovation by removing barriers and creating an infrastructure of standards, protocols, and protection of rights and data. There is also a case for encouraging the pooling of resources not only for high-risk, costly science and megascience projects, but also for the development of information-sharing and network access.

A third dimension involves adapting education and training systems to a more technology-driven world, together with the encouragement of learning for enterprises as well as individuals. There is also an important educational element involved in helping to narrow the gap between organisational best-practice models and the current methods of applying technology in most firms. Governments can encourage the new organisational systems that are critical to effective use of IT by making it easier for employers and employees to adopt flexible working time arrangements.

## Flexible Working-time

Working-time arrangements are often the outcome of historical developments. The Industrial Revolution and the spread of mass production of manufactured goods made standardised working and machine hours the most appropriate form of work organisation. But the trend towards a service economy, the growth in female labour force participation and the new technologies have increasingly rendered this model of work organisation obsolete. Nevertheless, many traditional patterns in the organisation of work and working-time remain enshrined in legislation or collective agreements. In this way, they hinder labour market flexibility and, indirectly, job creation.

Less rigid arrangements for daily, weekly, annual and life-time working hours could meet both enterprise requirements and worker aspirations. They would permit firms better to exploit their productive capacities by matching production more closely to shifts in demand. Workers and their families would also gain from new working-time arrangements tailored to their individual preferences or family circumstances. The type of working-time flexibility sought by firms may not always coincide with the aspirations of workers. The best way to resolve such conflicts is through negotiated solutions at de-centralised levels. In some countries legislative changes and changes to taxation and social security provisions would also be needed.

One important attraction of greater work-time flexibility is its potential to integrate working-time reductions with new patterns of life-long learning. More flexible working-time arrangements would also facilitate greater lifetime participation of women.

It is important, however, that new working-time arrangements be economically viable; this requires that unit production costs or tax burdens do not increase as working-time changes. For instance, heavily subsidised early retirement schemes are solutions which are not viable in the longer run because the benefits accrue to individuals or companies, whereas a significant part of the cost of such schemes is shifted to the public purse.

## Entrepreneurship

The most innovative firms – those that are best equipped to exploit future opportunities – will be characterised by dynamic entrepreneurship. Policy can encourage entrepreneurship by removing red-tape, regulations and controls that discourage new and expanding enterprises. Entrepreneurship has been particularly restrained in Europe which has created, net, few private sector jobs over the last 20 years.

The survival and expansion of new firms is impeded by policies which, often inadvertently, unduly favour "rent-seeking" in large well-established firms. Substantial government resources currently are transferred to large firms, often as job protection subsidies. Small and medium-sized enterprises typically receive very



little direct support. There is useful scope, often at relatively little budgetary cost, to improve access of new enterprises to government programmes in the areas of R&D, job creation and training.

Dynamic entrepreneurship thrives when there is a highly trained and flexible labour force, good physical infrastructure, modern telecommunications, a comprehensive network of business services, and easy access to universities and centres of technological expertise and research. Large firms can become more dynamic with small divisions or units – or by creating networks of small firms – that enhance flexibility and innovation capacity.

The birth and expansion of small firms depend also on the availability of information and advice on business planning, technology, research, equipment purchase and use, staff search and training, and access to foreign markets and export credit schemes. Again, large firms often function best in an environment where they interact with a network of smaller firms, providing information and expert services such as accounting and marketing.

Capital markets need to be able to provide the various forms of financing such as seed capital, venture and equity capital, and debt finance required for the creation and development of dynamic small businesses. Financial institutions with specialised expertise in specific sectors are the best able to assess risk in their sector of expertise, and are best placed to provide financing to promising projects.

### Disincentives to Hiring

The private sector would create more jobs if there were fewer barriers to hiring. In many cases, what is needed is to mitigate the unintended side-effects of many policies that were designed to achieve equity objectives. In some cases, this may mean a more fundamental, radical redesign of policies, together with considerable changes in attitudes and institutional practices, especially in the fields of taxation, social policy and collective bargaining.

*Non-wage labour costs* – the social security contributions and taxes paid by employees and employers to finance social expenditure – drive a wedge between the cost to the employer of hiring a worker and the wage received by the worker. This wedge increases unemployment if wages do not fall to offset the higher taxes. Particularly in Europe, these non-wage labour costs represent a large share of the cost of labour. There are two possibilities for reducing non-wage labour costs in order to stimulate employment growth: cutting social spending and/or shifting the tax base for social spending away from payroll taxes to other taxes. Neither option is easy to implement. Curbing social spending requires a detailed scrutiny of existing and planned social programmes with a view to increasing efficiency and effectiveness, and targeting help to those who need it most. This is a difficult task, which is unlikely to yield results quickly. But given the large share of social spending in GDP, many governments are assigning a high priority to this option.

There is increasing agreement, at least in countries where the taxes are high, that part of the base for social security financing should be shifted away from taxes that add directly to labour costs. Evidence suggests that a significant revenue-neutral cut in social security contributions could increase employment over the medium term in those countries where wages and prices are sticky (see the chapter on Taxation). But it would be unrealistic to expect large long-run declines in unemployment in response to tax shifting. Contributions could, however, be cut in a way that favours the hiring of low-wage, unskilled labour by eliminating the ceilings on employer contribution rates and by reducing the income tax burden on low-skilled workers.

Wage differentials may also affect a firm's decisions about whether, and whom, to hire. Some jobs are viable only at a very low wage. A widening of wage differentials could be expected to support faster employment growth, and there is cross-country evidence that it does (see the chapter on Wage Adjustment). If wage differentials widen too far, however, low incomes may put people below the poverty line - the phenomenon of the "working poor." Societies have differing views about the acceptable degree of inequality of wage and income distribution; and these views will necessarily shape policy. In Europe, and particularly in the Nordic countries, there is a widespread and deeply-held conviction that a policy of widening differentials as a means to increase employment is unacceptable.

But the means by which societies achieve their objectives must adjust to changing circumstances. It may be necessary today, in the context of high and persistent unemployment, to give more weight to the market-clearing role of wages, while pursuing equity objectives through other instruments. The greatest concerns about wage inequality and in-work poverty generally relate to adults, and particularly those with family responsibilities. Young people and other first-time job seekers can usefully gain work experience and some income in low-wage jobs, and then move up the ladder into higher-paying jobs. Low-wage jobs are bad jobs only when people become trapped in them.

Governments have only limited influence on wage differentials: free collective bargaining determines most wage levels. Nevertheless, governments can intervene, for example by phasing out legal or administrative provisions which extend collective bargaining agreements to sectors, enterprises or regions that are not parties to the original negotiation – a widespread practice in many European countries. Such intervention could achieve greater regional and occupational wage differentiation. A less radical policy would be to encourage more so-called "opening clauses", that would permit collective agreements negotiated at centralised or sectoral levels to be renegotiated at lower levels.

Wage dispersion will be determined partly by *statutory minimum wages* which are designed to curb poverty by setting a wage floor. But they often end up damaging employment opportunities for unskilled labour. Sufficient differentiation in rates by age will prevent the minimum wage from becoming a barrier to hiring young people. Minimum wages can also be varied by region, especially in countries with significant regional differences in unemployment rates and living standards.

*Employment protection legislation* is designed to discourage dismissals by raising the cost to employers of releasing workers. But it can also make employers more reluctant to hire new workers. Countries, mainly in Europe, which have particularly stringent legislation generally have a high rate of long-term unemployment, and employers frequently resort to temporary contracts and other "non-standard" forms of employment to meet their needs for greater work-force flexibility.

At the same time legislated employment security, along with job guarantees negotiated by collective bargaining, also bring benefits. Employment security through long-term contracts can encourage investment in on-the-job training that is hindered by high labour turnover. A balance has to be struck between allowing employers greater freedom in decisions to hire and fire, and ensuring both sufficient employment security for workers and firms to be willing to invest in long-term training and protection for workers against unfair dismissal.

Along with labour market barriers to hiring, *product-market barriers* also can aggravate structural unemployment. Lack of competition in product markets allows firms to restrict output and raise prices, limiting their demand for labour. It can also foster collusion between employers and employees to restrict competition and share the resulting monopoly rents. This collusion makes it yet more difficult for the unemployed to price themselves into jobs.

Competition policy can improve the functioning of product markets. Lowering trade barriers helps in this by promoting import competition that restrains rent-sharing. Hence the importance of: rules to prevent dominant firms from erecting barriers to entry; and well-crafted rules on horizontal agreements which prohibit cartels, while allowing other forms of desirable co-operation among firms. Co-operation among national competition authorities can also improve oversight of firms operating internationally in order to obtain the benefits both of inter-firm competition and of co-operation.

## PEOPLE

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. The generation now entering work can perhaps expect six or more job changes in a working life, meaning that part of that education will have to take the form of "learning how to learn" throughout the working lifetime. 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

forward-moving and cohesive 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.

### Active Labour Market Policies

A progressive shift of resources is needed from passive income support to active measures. Active labour market policies improve access to the labour market and jobs; develop job-related skills; and promote more efficient labour markets. Active policies can strengthen the links between the growth of aggregate demand, job creation and the supply of qualified labour. And higher public spending on active measures may lead to wage moderation by strengthening the ability of "outsiders", particularly the long-term unemployed and first-time job-seekers, to compete more effectively for jobs. Intensified job placement and counselling programmes, aimed at encouraging effective job search by the unemployed, have proved especially cost-effective. Countries which reject a widening of wage dispersions as a means to increase employment will have to rely particularly heavily on active labour market, education and training policies.

A typical OECD country spends 2 to 3 per cent of its GDP on labour market policies (including unemployment benefit schemes). But there has been little progress in shifting these sizeable resources from passive policies – such as unemployment benefit – to active measures. In 1992 the average OECD country devoted just 0.9 per cent of its GDP to active measures, up only slightly from 0.7 per cent in 1985. There is considerable scope for further and more effective active policies through careful programme design, implementation and monitoring.

An effective public employment service (PES) is a key element in making active measures more effective. This involves integrating the traditional functions of job placement and payment of unemployment benefits with access to active programmes. Ensuring that the PES has access to active programmes helps job-seekers even when there are few vacancies. The availability of training or job-creation programme places can serve as a "work test" for benefit claimants.

While it is important to provide training for the unemployed, broad training programmes aimed at large groups of the unemployed have seldom proved a good investment, whether for society or for the programme participants. Careful targeting will pay dividends. All the key actors at local level – employers, trade unions, educational institutions and local government – should be involved in a combined effort to develop training programmes that respond to local needs.

Job creation measures are often an important component of active labour policies. But their impact has often been disappointing: many subsidised hires would have taken place anyway, without the subsidy; or hiring occurred only at the expense of other, unsubsidised, workers. Targeting job creation to particular groups can produce better outcomes for programme participants and for society as a whole. In general, young people and the long-term unemployed are the best targets.

## Skills and Competences

OECD countries are stressing upgraded skills and competences of their populations. But effective reforms are difficult to implement because of the many different actors and institutions involved. And the pay-off period is long. "Life-long learning" must become a central element in a high-skills, high-wage jobs strategy. This involves dismantling barriers at all levels of education and training and a sharing of the cost burden of life-long learning between the individual, business and the public purse (see the chapter on Skills and Competences).

Pre-school and early childhood development programmes can establish a solid basis for subsequent learning, especially for children from disadvantaged backgrounds. Evidence from the United States, France and the Netherlands shows that special efforts to assist disadvantaged children at the pre-primary stage pay off: children who have had pre-schooling integrate best into society, and make fewer demands on social services in later life. It is important that pre-schooling should encompass education and socialisation as well as childcare.

In primary and secondary schooling, many young people drop out or fail to acquire qualifications. In many countries, participation in all forms of education drops sharply beyond age 16. In 1991, just 57 per cent of 18-year-olds were in secondary and tertiary education across the OECD.

Young people who leave school early and underachieve do so for a complex variety of reasons, including societal problems such as marginalisation and poverty, instability of families and child delinquency. But the failure of mainstream education curricula and teaching and assessment methods to meet their learning needs is also a factor. The curriculum and teaching methods should be individualised to meet the needs of these children and to provide the necessary support and continuity from pre-school through to entry into the labour market.

For young people leaving school, policies can ease the transition to work. The "dual system" of apprenticeship training in Austria, Germany and Switzerland has attracted much attention because it is associated with relatively low youth unemployment rates. However, tradition and social consensus are so strong and unique that the system cannot easily be transplanted. Other forms of apprenticeship and work-based learning would seem appropriate in many countries. These must evolve with the evolving demands for labour. Even successful apprenticeship schemes may need to be overhauled as new jobs demand multi-skilled labour with general competences.

There must be a better balance between post-secondary education and training. In most countries the growth in enrolments in academic studies has outpaced that in technical and advanced vocational studies. There is a danger of a shortfall of further education and training, and of a surplus of academic qualifications. Vocational and academic studies should both prepare and stimulate students for entrepreneurial activities.

Enhancement of on-the-job training for adults is a major policy challenge. Individual firms are discouraged from investing in their workforces by short-term profit maximisation objectives; by the possibility – for firms individually, though not collectively – of dismissing workers with obsolete skills and hiring others with the requisite skills; and by poaching of their skilled workers by other firms. To counteract these forces, some countries have adopted a training levy/grant whereby firms are required to spend a certain proportion of their wage bill on training or else pay an equivalent levy. Such measures, so far at least, have yielded mixed results, perhaps because of problems of design and implementation.

A more radical solution would be reforms to accounting standards, which could help improve information on the value of training investments, as would agreement on, and implementation of, training standards and credentials. This could enable financial markets to account for the stock of workforce skills in a firm as part of recorded assets, in turn encouraging investors to invest in firms with proven track records in training their workforces.

### Tax/Benefit Systems

Relatively high unemployment benefit entitlements tend eventually to increase unemployment (see the chapter on Unemployment and Related Benefits). Lower benefits would increase work incentives, but would risk increasing poverty. Unemployed persons receiving benefits will have greater incentives to take low-wage jobs if benefits continue "in-work" through measures such as Family Credit in the United Kingdom, Family Income Supplement in Ireland, or the Earned Income Tax Credit in the United States (see the chapter on Taxation); or if rules for entitlement to unemployment benefits provide that a unit of income earned leads to loss of significantly less than a unit of benefit. These measures increase the incentive to take a low-paid job by creating a bigger gap between in-work incomes (after taking account of taxes and benefits) and unemployment benefits.

However, in-work benefits have to be phased out with rising incomes and this, together with the payment of income and social security taxes, can produce very high effective marginal tax rates for those in low-wage jobs. This situation, in its extreme form, is described as a "poverty trap" (Box 5). It leaves little incentive for people in part-time or low-paid work to increase their hours of work or to invest in training that would increase their chances of getting higher-paid jobs.

#### *Box 5*

##### The poverty trap

The poverty trap arises where low-wage earners lose some or all of their benefits if their earnings rise. The poverty trap removes the incentive to work harder and move up the wages ladder.

To illustrate, consider the hypothetical case of a married man with two children whose income (including social benefits) is \$100 per week. He is offered the chance to earn some more income by working additional hours. But to do so means that he would lose some of his benefit income and, in addition, would have to pay income tax and social security contributions on his extra earnings. For each \$1 of additional wages, he would have the following costs:

income tax	25 cents
social security contributions	10 cents
lost social security benefits	50 cents
Total	95 cents

The man would be working extra hours for 5 cents in the dollar – which means he has no incentive to seek income above his basic wage. He is caught in the poverty trap, at an effective marginal rate of 95 per cent, as benefits are reduced and additional earnings are taxed.

Even though many countries have very high effective marginal tax rates for people on low incomes (see the chapter on Taxation), clearly reducing work incentives, there is limited motivation to reform because few people are affected by current poverty traps. For example, only 3 to 4 per cent of working families in the United Kingdom and 2 per cent of families in New Zealand are subject to effective marginal rates of over 70 per cent.

Despite the small numbers, most OECD countries would like to reduce or eliminate poverty traps. But it is very difficult to reduce the tax rates for those few people with low wages, without at the same time raising marginal tax rates on people with higher wages. This solution would, of course, damage work incentives for higher wage earners. The alternative is to enhance work incentives by lowering marginal tax rates on very low incomes, but also cutting benefits.

Eliminating the poverty trap might involve measures to integrate tax and benefit systems through a negative income tax or an income tax credit scheme. These schemes remove very high marginal tax rates at the lowest earnings levels, but they can prove prohibitively expensive if stringent conditions are not imposed, or if there are large associated increases in other taxes, such as on higher-wage workers. It is not clear that radical reforms of the tax/benefit system can both reduce poverty and raise work incentives.

Independent of the level of benefits relative to previous earnings, which involve questions of equity and social consensus, there is room in all countries to improve the effectiveness of benefit administration, and to reform long benefit durations or lax eligibility requirements.

## INTERNATIONAL CO-OPERATION

Governments today face greater international interdependence of their economies. Like companies, they need to "think global" so that national policies fit with and take into account the broader international context. Co-operation among countries in

order to understand the dimensions of interdependence and to ensure that international rules keep pace with changes in the global economy will help each to take full advantage of the productive employment opportunities offered by globalisation. The following six areas for policy indicate the breadth of the international agenda bearing on employment generation.

OECD countries should use the policy co-ordination process to ensure that the setting of macroeconomic policy is more consistent across countries, and that the international monetary and financial system functions in a smooth, open and orderly manner, so as to support a sound growth of trade, investment and employment. At times this may involve a common strategy. But in the current situation, given the different starting positions of OECD countries – in particular as regards cyclical positions, levels of public sector debt and the size of budget deficits – international co-operation does not require them all to be pushing in the same direction and on all fronts at the same time. Rather it requires differentiated policy responses that each country needs to take to improve both its own prospects and those of the world economy as well as international coherence of policies to achieve the common final objective of sustained non-inflationary growth of output and employment.

The successful conclusion of the Uruguay Round will strengthen multilateral trade rules and disciplines and extend them in new areas, making competition more fair and transparent. This in turn will strengthen business confidence and economic activity. But the globalisation of economic activities has revealed that a range of domestic policies in areas such as environment, competition, taxation, investment, or even perhaps labour standards also have an impact on trade. Future co-operation will need to address aspects of such policies which can restrict the further development of trade.

**Foreign direct investment** is an essential element in the strategy of firms in developing their presence in a global market or simply expanding their operations across national frontiers. Foreign investment creates jobs directly through new establishments and expanded activities in the host economy; and indirectly by strengthening both host and home economies through a two-way transfer of improved technology and management techniques and through increased competition. Further liberalisation of inward investment policies would remove distorting barriers to capital flows and reduce the risks of new restrictions. Improved international rules on investment would provide a more secure and rational basis for firms' decisions, and help to ensure that bilateral and regional initiatives do not undermine the multilateral framework.

Increased global interdependence implies greater geographic mobility of economic activity and hence of the base for taxes on income and wealth. Companies and workers are, therefore, more sensitive to the levels of taxes in different countries, and this creates a danger of tax competition: countries lowering their tax rates to attract a larger share of the global tax base. It also limits each country's room for manoeuvre in shifting taxes away from non-mobile factors of production, in particular labour.



International co-operation is essential to avoid friction among governments, to permit continued effective taxation of capital income, and to ensure that taxation policy does not unduly distort the international allocation of resources.

International migration between OECD countries has declined, whereas migration pressures from the non-OECD area are building up. Co-operation between OECD countries is necessary to respond to these pressures, notably to the rising tide of asylum seekers, so-called "economic" refugees, and illegal immigrants. Migration issues must also be included in the wider trade, investment and co-operative development activities between OECD countries and principal emigration areas, both in the developing countries and in Central and Eastern Europe.

In order to obtain the full benefit of science and technology in promoting growth and employment, there will be an increasing need to co-operate in the pooling of resources for costly, high-risk, long-term projects and facilities in basic science and megascience, as well as in pre-competitive technological research. These forms of co-operation may need to be extended to the deployment of new infrastructures in areas such as telecommunications, where the returns on investment will depend importantly on reaching agreement on common standards and protocols for different national systems.

#### FROM ANALYSIS TO STRATEGY

More than ever since World War II, today's unemployment is causing damage in ways that cannot be measured by the sheer numbers alone. High unemployment creates insecurity and resistance to organisational and technical change. Long-term unemployment lowers self-esteem, is demotivating and self-reinforcing, and is associated with health problems. The rise in youth unemployment means that many young people are losing skills or employability. Groups in society that have never before faced a high risk of unemployment, such as white-collar workers, are losing jobs, with all the personal and societal costs that implies in terms of lost potential and lost investment.

The linkage between the human cost and the economic cost of unemployment is, for the moment, not well defined. A greater understanding is needed of the relation between health, crime, drug abuse and employment problems. Such work would underpin the concern that society must help those who are unable to adapt to the new needs of changing economies.

The single most important cause of rising unemployment, as well as a growing incidence of low-wage jobs, is a growing gap between the need for OECD economies to adapt and to innovate and their capacity and even their will to do so. There is no single recipe for full employment, but there is a menu of measures that can help move OECD economies towards higher employment with good jobs.

A favourable economic and social climate is needed in which firms can create new jobs and people can adapt their skills. Companies, trade unions, people and governments face the joint challenge of adapting to the new technologies and responding to intensified competition from around the world. Building social consensus on the response to these challenges can facilitate adjustments and bolster the capacity to innovate and to exploit new technologies.

Developing a capacity to be innovative and creative in order to place OECD countries at the leading edge of advancing economies requires a different mix of measures for different countries. Every part of the social and economic policy spectrum offers answers. Not all solutions will be readily acceptable in political terms because they may involve sacrifices or challenges to the status quo. They should nonetheless be pursued.

Policy recommendations must be considered in the light of their potential to solve unemployment, or improve the quality of employment, by elevating people and jobs to a working world of the future

rather than by retaining jobs that have become obsolete. The jobs created[pk] must be durable in order to reverse high and persistent unemployment.

More immediate recommendations follow in Part III. They include only limited references to specific country experiences: further work needs to be under-taken to provide detailed country-specific policy recommendations.

### III. MAIN PLANKS OF A STRATEGY

#### INTRODUCTION

The policy recommendations below 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.

The recommendations have been developed against the background of the tight budgetary constraints faced by virtually all governments. The focus throughout is on the design of policies which facilitate and encourage participation in work, thereby keeping to a minimum the numbers of those who have to live wholly on income support.

Most 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, which should be implemented by governments in a co-ordinated manner, to arrive at a balanced mix of policies which mutually reinforce innovative and adaptive capacity and improve conditions for job creation:

1. Set macroeconomic policy such that it will both encourage growth and, in conjunction with good structural policies, make it sustainable.
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 competences through wide-ranging changes in education and training systems.

9. Reform unemployment and related benefit systems – and their interaction with the tax system – such that societies' fundamental equity goals are achieved in ways that impinge far less on the efficient functioning of labour markets.

## POLICY RECOMMENDATIONS

### 1. 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 savings and investment.*

- Macroeconomic policy should focus on assisting recovery through faster non-inflationary growth of domestic demand where there is still substantial economic slack, while policies should be adjusted promptly to avoid a rekindling of inflation when recovery is well under way.

- Over the medium term most countries need to set fiscal consolidation as a main objective in order to reduce budget deficits and public debt levels. Such consolidation will allow interest rates to be reduced and hence provide a better environment for private sector investment. If recovery proceeds more rapidly than expected, the process of consolidation should be accelerated.

- There is often room, as well as a strong case, for redirecting and improving the quality of budgets, and in particular of public spending, for example away from subsidies to existing enterprises and towards establishing better conditions for the birth and survival of new firms, and from passive measures of income support to active labour market policies.

### 2. 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/economies to create and make effective use of new technologies which form a base for the expansion of high-productivity, high-wage employment.*

- Invest in the creation of new knowledge through basic scientific research, and facilitate the access of firms to scientific and technological knowledge.

- Promote and strengthen mechanisms for international co-operation to reap economies of scale and reduce duplication in long-term R&D, especially in relation to the needs of megascience projects and networks of practising scientists and scholars.

- Reduce uncertainties which impair the creation and diffusion of new technologies:
  - Promote multilateral agreements on intellectual property rights and on international standards.
  - Promote transparency in, and where appropriate, "rules of the game" the application of GATT-consistent rules and criteria – for government support to "strategic" technologies.
  - Ensure a sound legal framework for market-driven institutions to diffuse and effectively apply new technologies (research associations, technology extension services for small business, improved industry/university links).
- Facilitate absorption of new technologies in firms through measures which:
  - Make better use of public procurement and contracts (e.g. by encouraging innovation through performance requirements, by breaking up contract size, and by encouraging supply consortia of small firms and linkages between large firms and small firms).
  - Promote investment in new information infrastructures through removing regulatory barriers to market access and establishing adequate standards, protocols and intellectual property rights to stimulate the creation of new and more effective services.

### **3. 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. Governments 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.*

*More flexible working-time arrangements could result from measures that:*

- Remove obstacles in labour legislation which impede the emergence of flexible working-time arrangements, and encourage employer-employee negotiations on flexible working hours and part-time work.
- Extend part-time working in the public sector.
- Move from the household to the individual as the base for the income tax, and take measures to avoid any loss of tax allowances.

*More flexible retirement could result from measures that:*

- Reduce or remove non-neutral financial incentives for early retirement.
- Realign policies and programmes for older workers to provide them with more opportunities for participation in working life rather than incentives to withdraw.

### **4. 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 any negative connotations linked to business failure. Programmes to foster entrepreneurship and small business should be integral parts of local development strategies.*

- Lower start-up costs and simplify compliance requirements to encourage new firm start-ups

*(e.g. improve information flows to prospective entrepreneurs, make government services more user-friendly, ease reporting requirements and record-keeping).*

- Facilitate small business growth by improving information and advice for: business planning; equipment purchase; use of and access to training systems; access to technology and R&D and access to export credit guarantee schemes. Regional and local governments should be encouraged to ensure an attractive environment for small business, while taking care to avoid creating distortions in business conditions, which could lead to the creation of enterprises that are non-viable in the longer term.

- Identify and eliminate any unwarranted regulatory impediments to credit accommodation for small business. Promote the development of products that can facilitate the financing of new businesses. Encourage the establishment of financial institutions with specialised expertise in specific sectors.

## **5. 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.*

- Reassess the role of statutory minimum wages as an instrument to achieve redistributive goals, and switch to more direct instruments. If it is judged desirable to maintain a legal minimum wage as part of an anti-poverty strategy, consider minimising its adverse employment effects, including by:

- Indexing it to prices, rather than average earnings;

- Ensuring sufficient differentiation in wage rates by age and region to prevent the minimum wage from harming employment prospects for young people or low-productivity regions.

- Reduce non-wage labour costs, especially in Europe, by reducing taxes on labour (where the budget situation or expenditure reductions make this possible) and/or by shifting away from taxes on labour towards other taxes, such as those on consumption or on income, where the base could be broadened to include more non-labour income.

- Reduce or remove provisions in the structure of tax and social security contributions which discourage part-time work or the employment of additional workers. Elimination of ceilings on the wage base that is subject to contributions should be a particular target (except in those few countries where there is an actuarially precise link between contributions and benefits).

- Reduce direct taxes (social security contributions and income taxes) on those with low earnings where this would shift the structure of labour demand towards low-wage workers, while protecting their incomes.

*Over the medium term, options include:*

- Refocusing sectoral collective bargaining to framework agreements which leave enterprises free to respond flexibly to market trends, provided they adhere to overall standards. The practice of administrative extension of agreements which impose inflexible conditions should be phased out.
- Introducing "opening clauses", which allow higher-level collective agreements to be renegotiated at a lower-level.
- Stepping up competition in product markets through measures such as deregulation, lower tariff and non-tariff barriers, privatisation and a more open and vigorous competition policy, in order to reduce the ability of firms and employed "insiders" to exploit rent-sharing at the expense of employment opportunities for unemployed "outsiders".

## **6. 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.*

- Establish, via legislation or central-level collective agreements, employment security provisions which sanction unfair or discriminatory dismissals, yet allow dismissals which are required on economic grounds. More explicit long-term commitments overriding the latter provision should be negotiated at decentralised level, rather than imposed on all firms.
- Loosen mandatory restrictions on dismissals in countries where current provisions appear to seriously hinder economic restructuring and the hiring chances of new labour force entrants.
- Permit fixed-term contracts. In order to limit incentive for their use from becoming excessively widespread, mandatory protection for regular contracts could be kept relatively "light", especially at the beginning of the contract. Further, policies should avoid any subsidy to fixed-term employment through the unemployment insurance system. Ways to achieve this could include increased rates of employer contribution; or a requirement that the employer pay a special bonus at the end of a fixed-term contract.

## **7. Expand 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 reemployment. 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 the functioning of the Public Employment Service (PES).
- Integrate three basic functions under the PES: placement and counselling services; payment of unemployment benefits; and management of labour market programmes. Ensure that the inflow, processing and dissemination of information on vacancies is given adequate attention which in most countries means greater attention.
  - Ensure that claimants remain in regular contact with the PES, and that they maintain job search efforts (back-to-work plans, job clubs, reorientation interviews).
  - Eliminate the monopoly position of the PES. There is a complementary role for private placement agencies as well as temporary work agencies. Require that the PES compete in the market for short-term placements (in order to increase the flow of vacancies).
- Maintain supply-side measures such as training for the unemployed during cyclical downswings.
- ○ Target and diversify training programmes for the unemployed, based on a thorough assessment of labour market needs.
  - Allow the labour market authorities to buy and sell training places for the unemployed in the private and public training market. They should also have the possibility of supplying training courses directly in order to increase flexibility and target efficiency for difficult-to-place groups.
  - Involve employers in the design and execution of training programmes for the unemployed at the local and community level.
- Target job creation measures to workers for whom joblessness is particularly harmful to future prospects (e.g. long-term unemployed youth) or to workers whose bargaining power is relatively weak (e.g. all long-term unemployed).
- Introduce incremental employment subsidies targeted to labour force groups in particular excess supply; pay specific attention to design and enforcement mechanisms so as to minimise deadweight and displacement effects.
  - Set compensation levels in job creation programmes below what the participant could expect to get on the labour market, in order to maintain an incentive to search for regular work.
  - Associate some training with temporary employment programmes in the public sector.
  - Ensure that a significant part of public employment programmes is financed by municipalities out of local taxation and that the local PES is involved in managing the programme (so as to minimise "fiscal displacement" and maximise the quality of output).

## **8. 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.*

- Improve the quality of initial education:
  - ○ Increase the provision of pre-school programmes, especially for children



from disadvantaged backgrounds.

- Reduce early school-leaving and improve student performance through a wide range of reforms including more diversified curricula and learning methods; more scope for parents to choose schools for their children and more active involvement of parents; and better incentives for motivating teachers and more opportunities for their continuing professional development.
- Improve the school-to-work transition:
- Promote industry-education partnerships to support new forms of apprenticeship-style training and to ensure that education remains relevant to labour market needs.
- Create, at the national level, frameworks of standards for assessment, recognition and certification of training, to encourage young people to invest in skills and facilitate their mobility.
- Set the "training wage" or allowance sufficiently low relative to the average wage in the occupation or sector in order to induce firms to supply a sufficient volume of training places.
- Better prepare students in post-secondary education by providing effective career guidance and by ensuring that overall balance is achieved between more traditional academic studies and technical and advanced vocational studies.
- Improve the incentives for enterprises and workers to invest in continued learning:
- Enable workers to alternate between work and extended periods of off-the-job training over their working life (e.g. through reductions in working time that are compensated by increases in training time).
- Implement a training levy/grant scheme to stimulate enterprises to undertake more skill development or a system of "training credits" for adult workers which permits them to acquire new skills at certified training establishments or firms; pay specific attention to design and enforcement mechanisms so as to minimise deadweight and substitution effects.
- Make the value of skills relative to other factor inputs more transparent (e.g. by encouraging changes in financial accounting and reporting practices and related institutional arrangements), so that workers and firms can treat them as long-term assets.

## **9. Reform of unemployment and related benefit systems**

*Unemployment insurance (UI) 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.*

*Reform of benefit entitlements:*

- Restrict UI benefit entitlements in countries where they are especially long to the period when job search is intense and rapid job-finding remains likely.
- Reduce after-tax replacement ratios where these are high, and review eligibility conditions where these require little previous employment history before drawing benefits.
- Impose restrictive conditions on indefinite-duration assistance benefits for employable people.
- Provide support for collective short-time working, but with administrative controls which restrict payment to firms that are in temporary difficulty and are taking appropriate adjustment measures.

*Reform of tax/benefits:*

- Ensure that low-paid workers are better off when there is some work income compared with relying entirely on social benefits by providing adequate universal child benefits, low average tax rates on low-wage workers relative to benefit incomes, or in-work income supplements to low-paid workers.
- Make the rate of withdrawal of assistance benefits with respect to the earnings of the spouse significantly less than 100 per cent in countries where many women work part-time, in order to leave a worthwhile incentive for the spouse of an unemployed benefit claimant to retain a part-time job.
- Make long-term benefits conditional on participation in active labour market programmes; this is especially desirable for young people leaving school.

*Reform of benefit financing and control:*

- Improve PES information systems so as to give staff access to information on the benefit status, declared work status, and past work history and job search efforts of claimants.
- Make employers pay some of the cost of lay-offs through: a requirement that they pay the first months of UI benefit; enforcement of severance pay requirements; or experience-rating of insurance contributions.
- Retain a local financing element in assistance benefits, to discourage the view that benefits are a costless transfer to the local economy, and thereby encourage local actors to implement eligibility restrictions and unemployment-reduction measures.
- Develop mechanisms for detecting and minimising benefit fraud.

## GLOSSARY

Dynamic Asian Economies (DAEs): Hong Kong, Korea, Malaysia, Singapore, Taiwan, Thailand

English-speaking countries: Australia, Canada (not only English-speaking), Ireland, New Zealand, United Kingdom, United States

European Community (EC): Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, United Kingdom

European Free Trade Association (EFTA): Austria, Finland, Iceland, Liechtenstein, Norway, Sweden, Switzerland

GATT: General Agreement on Tariffs and Trade

GDP: Gross Domestic Product

IT: Information technologies

Nordic Countries: Denmark, Finland, Iceland, Norway, Sweden.

North America: Canada, United States (does not include Mexico for purposes of this Study)

Oceania: Australia, New Zealand

OECD Europe: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom

Organisation of Petroleum Exporting Countries (OPEC): Algeria, Gabon, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, The United Arab Emirates, Venezuela

PES: Public Employment Service R&D: Research and development UI: Unemployment insurance

## NOTE

"Chapter" refers to the background papers published as the second volume this of this study, under the title *The OECD Jobs Study: Evidence and Explanations*.