Growth has been modest, unemployment remains high, though inflation and interest rates are low.

OECD output has grown only modestly over the past two years. In the United States, growth appears relatively strong and has been associated with stable, low inflation and unemployment. In the Pacific region, Australia and New Zealand have recorded continued growth over the past few years; the upswing finally got underway in Japan in late 1995. In Europe, growth has slowed significantly from the second half of 1995 and, in some countries, unemployment rates are again rising. The OECD-area unemployment rate in the first half of 1996 is estimated to be 7.7 per cent, or over 33 1/2 million people unemployed. The latest projections suggest little improvement in unemployment over the next two years. On the more positive side, inflation is low and contained nearly everywhere, and interest rates have also declined.

Poor labour market performance endangers the social fabric as people risk getting trapped in unemployment, in low-paid jobs or in unstable temporary work...

High and persistent unemployment is only one manifestation of the poor labour market performance in many OECD countries. OECD societies also confront some worrying inequalities which are straining the social fabric. In some countries, such as the United States and the United Kingdom, earnings have become considerably more unequal. Moreover, preliminary analysis suggests that, in such countries, the increase in earnings dispersion may not be offset in the longer-run by greater relative upward mobility among those with low earnings (Chapter 3). When inequality widens, this can lead to more marginalisation, an increase in poverty, and exacerbation of budgetary pressure on existing social safety nets. The distribution of work across households in a number of countries has also become more polarised. And, while many workers in temporary jobs do get into permanent ones, a non-trivial proportion also appears to remain in temporary work or move out of jobs altogether (Chapter 1).

...leading to exclusion unless good labour market “careers” can be fostered.

The risk now facing a number of OECD countries is that labour market exclusion can easily turn into poverty and dependency. Social protection systems can alleviate poverty, but they cannot promote participation in society unless they are closely tied to measures to tackle labour market problems. Hence, a key question is: what role can governments play to enable as many people as possible to construct good labour market “careers” in a turbulent environment, while providing an adequate safety net for those still unable to compete?

OECD analysis highlights the need to make work pay, to help young people make the transition to work and to foster lifelong learning.

The OECD Jobs Study, which was endorsed by Ministers in 1994, sought to provide answers to this and related questions. Work over the past two years has confirmed that the Jobs Study recommendations were the right ones. It has also highlighted the need for co-ordinated reforms that achieve both efficiency and equity goals over time, so that unemployment can be reduced and labour market and social exclusion can be alleviated. In this context, this editorial elaborates on three core issues of the OECD Jobs Strategy: Pushing ahead with the strategy (1996): i) how to reform tax and benefit systems so as to reduce both unemployment and poverty traps; ii) how to improve young people’s ability to make a better transition into the world of work; and iii) how best to ensure the implementation of real commitments to lifelong learning in economies beset with a very large turnover in jobs.
First, tax and benefit systems must ensure that there are work incentives for all...

Making work pay. Taxes and benefits are the most direct way in which governments can affect the financial incentives to accept and to offer work (and alter the after-tax distribution of incomes). If work does not pay, people will be more reluctant to work. For the large majority of the population, there are clear financial rewards to working. However, such rewards may be lacking for a significant minority with low earnings potential. Some features of existing tax and benefit systems give rise to labour market problems, thereby contributing to higher unemployment (Chapter 2). This is not to suggest that taxes and benefits are the principal cause of high and persistent unemployment. The present malaise in OECD labour markets stems from many causes and can only be addressed by a broadly-based strategy. Nevertheless, it is undeniable that reforms to tax/benefit systems have a contribution to make in reducing unemployment in many countries.

...by reducing traps caused by high benefits or high effective tax rates, and reducing taxes on jobs – while reconciling these policies with other objectives.

Tax/benefit systems can cause labour market problems in three ways. First, they can create the so-called “unemployment trap” when unemployment and related welfare benefits are high relative to expected net earnings from taking a job so that the unemployed have little incentive to search actively for a job. Second, they can create the so-called “poverty trap” when workers earning low pay have little or no incentive to raise their earnings by increasing the amount of time and effort in work as they face very high marginal effective tax rates. Third, taxes on labour may increase its cost and reduce employment. Realistic reforms which seek to minimise the adverse effects of these traps on work incentives must take due account of the original goals of these policies. Taxes must raise revenues and benefits are intended to provide for those with inadequate incomes. Nearly all reforms which “make work pay” involve trade-offs between these objectives.

Cutting benefits is one solution, but it can have high social costs.

The simplest way to attack the unemployment trap would be to cut benefit generosity. Some countries have indeed made modest cuts (e.g. Austria, Canada, Denmark, Germany, Ireland, New Zealand and Sweden). However, the social costs of this solution may be unacceptably high and it may not increase work incentives greatly, at least in the regular labour market. Therefore, many countries have opted to put greater weight on alternative reforms.

Alternatives include restricting entitlements...

For example, some countries have taken action to increase the insurance principle. Canada, where seasonal unemployment is high, is considering reducing entitlements to those who repeatedly become unemployed, partly on the grounds that seasonality in production and employment has been exacerbated by the benefit system – both workers and firms have adapted their behaviour to it. In some other countries, such as Finland, the Netherlands and Spain, reforms affecting access to unemployment benefits, e.g. by increasing eligibility requirements, have been implemented.

...tightening controls on job-search coupled with practical assistance to help job seekers find work.

Another route to cutting the unemployment trap is to tighten administrative controls on job-search by the unemployed receiving benefits. This reform has been implemented in countries such as Australia, Belgium, Denmark, Italy, the Netherlands, Spain and the United Kingdom. It is often coupled with targeted job-search assistance and counselling provided by the public employment service. These latter services are important since a consistent message from evaluations of active labour market policies is that, properly designed and targeted, they have proven their worth in terms of being a cost-effective way of raising the probability of an unemployed job-seeker getting into work.

High marginal rates of tax and benefit withdrawal can create poverty traps...

Poverty traps create a different, but related, set of problems. If benefits for the unemployed are completely withdrawn as soon as earnings rise above zero or some very low amount, and taxes and social security contributions must be paid on these earnings, the financial disincentive to work for only a few hours would
be severe. Generally, therefore, benefits are clawed back gradually. The so-called marginal effective tax rate (METR) takes account not only of the rate at which benefits are clawed back, but also of income taxes and social security contributions. If METRs are very high, people may have little financial incentive to work more. This can be a particularly acute problem for many low-income individuals and households – hence, the term “poverty trap”.

Examples of relatively high METRs are given in Chapter 2. Many of them involve OECD countries’ policies towards families. Payments that are means-tested on family income often have a METR of 100 per cent: social assistance benefits fall into this category and, in some countries, the number of recipients of such benefits has risen sharply. Moreover, most special benefits for lone parents are means-tested. The number of people and households facing high METRs varies across countries, but some patterns are clear. Women are more affected than men. The most affected group by far is lone parents.

The trend towards greater earnings inequality in some countries, especially the deterioration of the relative and, in some cases, absolute position of the lowest paid, can be of concern in this respect (Chapter 3). Here, it matters greatly whether low-paid jobs typically serve as stepping-stones to better ones or as long-term traps. Preliminary evidence shows that upward mobility is fairly high for young workers. It is much lower for adults who experience substantial movement from low-paid jobs to non-employment. These workers are particularly vulnerable to poverty traps and, where their earnings from work have declined, there are incentives to leave the regular labour market altogether.

There are ways to reduce METRs for workers with low earnings, but they inevitably involve a trade-off: either METRs for workers and households further up the earnings distribution will increase, or income support for those on low incomes will fall. While reforms can increase work incentives for low-wage workers, the counterpart is reduced work incentives for workers higher up the earnings distribution. Some research suggests that the increase in work, induced by reforms, by the former group may be roughly equal to the decrease in work by the latter group. Irrespective of the net effect on work effort, there are very good social and long-term labour market reasons to introduce reforms that both help promote the employment of those who would otherwise be excluded from the labour market and to aid low-paid workers in general.

One reform which has attracted growing interest is employment-conditional (so-called “in-work”) benefits. These top-up the income of those in low-paid jobs. The key feature of such a benefit is that it is income tested, but payable only to those employed. Because it is phased-out as earnings rise, it is wholly targeted on low-paid workers. Such benefits are currently, in various guises, available in six OECD countries: Canada, Ireland, Italy, New Zealand, the United Kingdom and the United States.

The success of such schemes in raising work incentives is heavily contingent on a number of factors. On grounds of cost and of the necessary ratcheting-up of high METRs further up the earnings distribution, the benefit must be withdrawn from those earning close to the median wage, i.e. a relatively dense part of the earnings distribution. Thus, employment-conditional benefits are likely to be most successful in countries where the existing earnings distribution is relatively unequal and the benefits are kept fairly low relative to average earnings. Such schemes are best targeted on families with children because they have high replacement rates and, therefore, they need higher earnings to make working a more viable option than not working.
Taxes on jobs - especially employers’ insurance contributions - can be a disincentive to hiring low-wage workers...

Tax and benefit systems also influence the demand for labour because non-wage labour costs can be a disincentive to hiring. In many countries, employers’ social security contributions are the largest of these costs and contributions may sometimes be structured in a regressive way, meaning that a large part of the burden falls on low-wage labour. Employers’ contribution rates increased in eight countries over the 1980s, often substantially, while they dropped significantly in just five countries.

...so they are being reduced in some countries, but this can create costs elsewhere.

Many countries, e.g. Belgium, France, Germany, Ireland, Italy and the Netherlands, have recognised the problem. In particular, attempts have been made to target rate reductions on either low-wage workers or new hires of the long-term unemployed. But these inevitably involve both “dead-weight” costs – some people would have been hired anyway in the absence of the cut in social security contributions – and “displacement” effects – some new workers are substituted for existing employees. As a result, these schemes are not self-financing and tax increases elsewhere to offset revenue losses may involve negative employment effects.

There are many trade-offs to be made in reforming tax and benefit systems, but also cases where improvements can be made at little cost elsewhere...

Public finance considerations are, however, only one of the multiple objectives which tax and benefit systems are pursuing: others include insuring against labour-market risk; supporting families without adequate resources; and preserving incentives to work. It is inevitable that all of these objectives cannot be achieved simultaneously. But some reforms to tax and benefit systems are an essential part of the OECD Jobs Strategy. Although cuts in benefit levels are sometimes necessary, they risk exacerbating poverty. There are, however, many avoidable barriers to employment where trade-offs may be less severe, such as those caused by administrative complexities, poor integration of the various parts of tax and benefit systems and badly-designed means-tests.

...furthermore, there are cases where short-term costs are worthwhile if the longer-term result is the integration of targeted vulnerable groups.

A strong case can be made for targeting tax and benefit reforms on groups that face particular difficulty integrating into the labour market, e.g. jobless young people trying to make the transition from educational participation to the job market, the long-term unemployed and lone parents. Such targeting is justified because the expected longer term gains from providing work experience to the target groups, thus increasing future employability, can outweigh the shorter term costs. The alternative is permanent marginalisation of part of the population from the world of work, with consequences which are apparent in too many countries.

Many young people face a range of labour market and social problems.

Youth labour market problems. The current economic and social state of many young people falls far short of what is desirable (Chapter 4). Although more youths participate longer in education, with potential long-run payoffs for them and society, as many as one-fifth leave school without the prerequisite knowledge, skills or qualifications needed for jobs in today’s economy. Youth employment rates have fallen since 1979 in most countries, often substantially, particularly among young men. Many countries have also recorded an increase in the proportion of teenagers and young adults neither in work nor in education. The proportion of the young unemployed in households where no other member is employed has also tended to increase.

Making inroads to these problems requires an improvement in general job prospects...

It is not just a “youth problem”. As long as total unemployment remains high, it is unrealistic to expect a significant improvement in youth job prospects: both the employment and unemployment rates of young people are highly responsive to the overall state of the labour market. Policies that attack the causes of high and persistent unemployment will also improve labour market outcomes for youth.
This is a necessary, but hardly sufficient, condition. Problems appear particularly severe for young, out-of-school men: in most countries their employment rates have trended downward over the past 15 to 20 years. They are likely to have the least educational qualifications among the youth population. While the evidence is limited, the collapse of this part of the youth job market must partly reflect the shift in the composition of labour demand toward more experienced and skilled workers.

Particularly for this group, policies need to focus on facilitating their access to jobs and on developing the requisite skills. This is not an easy task. A number of countries expanded their active labour market policies (ALMPs) for youths greatly during the 1980s, but the results, on average, are not encouraging. While some were helped, for many it simply represented recycling from joblessness to a brief spell on a programme and back again – the so-called “carousel effect”.

One lesson from the evaluation literature is that most ALMPs do not help out-of-school youths unless they are combined with other programmes explicitly targeted at their specific labour market needs. Many youth enter programmes with multiple disadvantages stemming from where they live, their household resources and their experience in school.

Another lesson from the evaluation literature is that early intervention is vital in terms of improving prospects later. By the time a young person leaves school, it is usually very difficult and costly for ALMPs to overcome the handicaps of poor educational preparation and the demotivation that can accompany it. Preventing educational failure is a community and societal responsibility. Here, improving early childhood development and care is essential. Early intervention can help overcome some of the many disadvantages suffered by children from “at-risk” backgrounds and communities. This is not only a question of social equity, but also a key factor in improving the longer-term health of OECD economies.

Therefore, policies that contribute to reducing early school-leaving are critical since anything less than a sound upper-secondary education, or its equivalent vocational qualification, may be associated with low earnings capacity and is insufficient preparation for getting into the job market and for access to further learning. Tackling this problem requires the combined efforts of families, the social partners, government and the community at large. The common features of countries that do relatively well in preparing their young people for working life are ensuring diversity in content, teaching and learning methods in upper-secondary education, and in providing viable pathways back into education and training for those who leave school early.

The problems extend beyond schools and young people. The first International Adult Literacy Survey found that up to one-fifth of the population aged 16-65 in seven advanced economies can only perform at the most basic levels of literacy and numeracy [Literacy, Economy and Society, OECD and Statistics Canada (1995)]. This is far short of what is needed for employment in good jobs in today’s economy. These people are at high risk of joblessness with the slew of social costs which it entails.

High rates of job turnover (Chapter 5), significant numbers of prime-age and older workers trapped in low-paid employment, and considerable year-on-year volatility in earnings (Chapter 3) simply reinforce the point: many workers will need to be able to enhance their skills continually, if they are to have the opportunity to move up the ladder or bounce back from setbacks, such as losing their jobs.
Education Ministers recognise that system-wide change is needed to create lifelong learning... At their January 1996 meeting, OECD Education Ministers urged that high priority be placed on implementing strategies for system-wide change – from early childhood education to learning opportunities throughout life. This will require a more fluid relation between learning and work, where an initial period of full-time education is followed by various combinations of work, training and education in enterprises and educational institutions.

...requiring inter-ministerial co-ordination to help create investment in learning where it is needed... Successful strategies for lifelong learning will require greatly increased co-ordination across ministries, and rethinking of the roles and responsibilities of all who provide opportunities for learning. They will probably also require increased investment in human capital and the assurance that those with insufficient resources to fund additional education/training or who are locked in jobs where learning opportunities are limited are not left behind.

...and in particular a more equitable distribution of further education and training opportunities. Moreover, investment in further education and training is very unevenly distributed across the work force in most countries, to the great detriment of those with fewer skills and lower educational attainment. The private and social costs of such unequal access to upgrading skills and competencies are clear. A more equitable distribution of training could, therefore, enhance future productivity, thereby leading to higher growth and employment.

Governments have a role where private investment in learning falls short... Both businesses and trade unions, and the public sector have roles to play in overcoming existing barriers to investments in learning. Market forces alone are unlikely to overcome the considerable uncertainty of the returns and costs to investments, the capital constraints facing individuals or the problem of free-riding – one firm’s investment adding to the pool of abilities for others to “buy in” more cheaply than if they had undertaken the investment themselves.

...and need to look for new ways of creating learning incentives, at an acceptable public cost. Thus, the proper incentives need to be created if new resources for lifelong learning are to be mobilised without further demands on the public purse. Taking account of countries’ different circumstances and priorities, some new balance must be developed in the contributions expected of individuals, the social partners and society as a whole. Past experience with financial incentives such as training levies, subsidies or vouchers has been quite mixed. Earnings differentials can play a role as incentives for workers to invest in skills. But they are not a panacea: the structure of wages is driven by many factors other than differences in the return to human capital and those trapped in low-paid jobs often have little incentive, or the financial means, to invest in further education and training. For these reasons, Education Ministers have called on the OECD to examine carefully alternative policies and incentives to encourage lifelong learning in a cost-effective and equitable fashion.

So policies on all fronts need to be carefully co-ordinated to reduce the social damage caused when large groups are unable to participate fully in the labour market. The future prosperity of OECD countries depends on reducing economic and social exclusion in the forms of high unemployment, non-participation in the labour market, lack of access to further learning opportunities and, in some instances, growing inequalities in earnings and incomes. It is more important than ever that policies – labour, social and educational, as well as macro-economic – be co-ordinated and coherent. Designing and re-designing a range of policies, as well as institution-building, will be required. This will take time, but it is the only way to increase the adaptability and resilience of our societies.

7 June 1996