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## Policy Lever 2: Activating Skills Supply

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## Key policy lessons on activating skills

### ENCOURAGE PEOPLE TO OFFER THEIR SKILLS TO THE LABOUR MARKET:

- **Identify inactive individuals and the reasons for their inactivity.** Some socio-demographic groups are more likely to be inactive than others, notably women and people with disabilities or chronic health problems, particularly if they are also low-skilled. Integrating under-represented groups into the labour force has a great potential to increase the skills base in an economy.
- **Create financial incentives that make work pay.** Costly childcare services, tax systems that make work economically unattractive, or benefit systems that offer better compensation compared with expected salaries can make it uneconomical to work. Countries can either abolish partial disability benefits or make full disability schemes exclusive to people who can no longer work. Employers can offer flexible start times and working hours, control over working hours, and, especially for women, flexible working arrangements around the time of childbirth. In some countries, people who can still work are increasingly being counted as unemployed, and are thus subject to the so-called “mutual obligation”, whereby they have to comply with job-search and training requirements or risk losing part or all of their unemployment benefits. When examining beneficiary claims, countries need to shift the focus from assessing health status to assessing the remaining capacity to work.
- **Dismantle non-financial barriers to participation in the labour force.** Inflexible working conditions can make it difficult for people with care obligations and individuals with disabilities to participate in the labour force. Part-time work is increasingly seen as a way to activate these groups. Less rigid working-time arrangements and improved working conditions, particularly for workers with health problems, can also make employment more attractive to these traditionally inactive groups. Employers, trade unions and government can work in concert to design these policies. To be effective, however, these programmes have to be combined with efforts to reduce employers’ reluctance to hire inactive individuals. In addition, since skills can atrophy or become obsolete during long periods of inactivity, these individuals may need re-training or up-skilling to improve their employability.

### RETAIN SKILLED PEOPLE IN THE LABOUR MARKET:

- **Discourage early retirement.** To keep older workers in the labour market, many countries have eliminated early-retirement schemes, increased the official pensionable age and corrected distorted financial incentives to retire early. To tackle demand-side barriers to employing older workers, some countries have tried to balance labour costs with productivity by reducing employers’ social security contributions or providing wage subsidies for older workers. Lifelong learning and targeted training, especially in mid-career, can improve employability in later life and discourage early withdrawal from the labour market. A rise in the pensionable age lengthens the period of time over which employers could recover training costs; hence, it is likely to motivate more employers and older employees to invest in training.
- **Staunch brain drain.** To reap the full benefits of initial investments in skills, countries where brain drain is a major concern should focus on retaining their skilled workers. Compulsory public-service schemes, known as “bonding”, are widely spread in African countries. Experience has shown that the best way to prevent brain drain is to provide incentives to stay, including by improving labour-market conditions locally, rather than by imposing coercive measures to prevent emigration. Brain drain also happens within countries, particularly between rural areas and urban centres. Local career-advice services can help to ensure that skilled people are fully aware and take advantage of the opportunities available within their nearby labour market.

## HOW CAN COUNTRIES ENCOURAGE PEOPLE TO SUPPLY THEIR SKILLS TO THE LABOUR MARKET?

People might have skills but decide, for various reasons, not to offer them to the labour market. Women and people with disabilities or chronic health problems, for example, are more likely to be inactive. Some young people who are neither in employment nor in education and training risk becoming disengaged from the labour market altogether and may remain at the margins of society. In addition to investing in the development of new skills, and before importing skills from outside the country, it is worthwhile to consider tapping this unused source of skills. Skilled people should also be discouraged from withdrawing from the labour market through early retirement or because they decide to leave the country to find work elsewhere.



## COUNTRIES CAN ENCOURAGE INACTIVE PEOPLE TO PARTICIPATE IN THE LABOUR MARKET

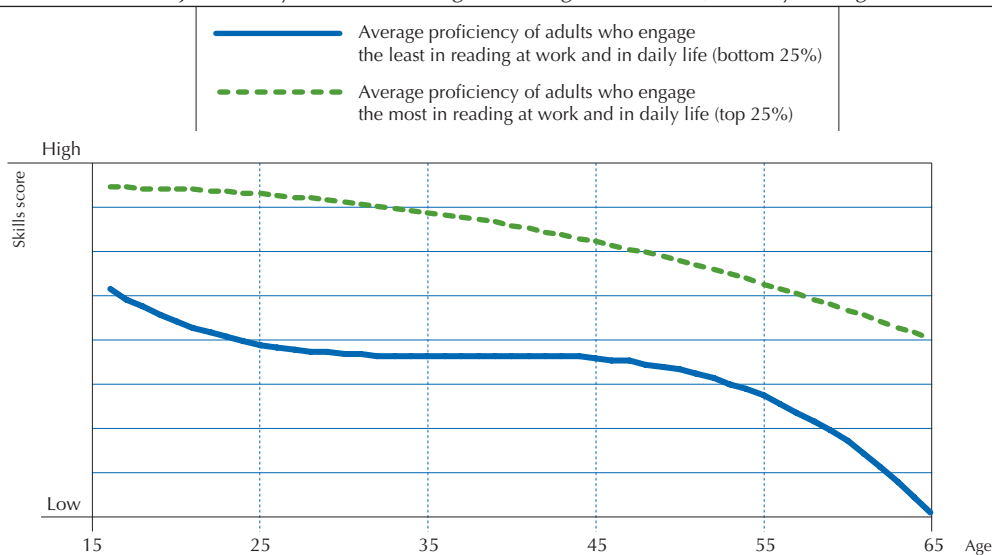
In all countries, many individuals are out of the labour force by choice, because of their personal or family circumstances, or because there are financial disincentives to work. Unused human capital represents a waste of skills and of initial investment in those skills. As the demand for skills changes, unused skills can become obsolete; and skills that are unused during inactivity are bound to atrophy over time. Conversely, the more individuals use their skills and engage in complex and demanding tasks, both at work and elsewhere, the more likely it is that skills decline due to aging can be prevented. Moreover, when adults acquire new skills, they often do so on the job; someone who isn't in the labour market will not have this advantage.

Figure 2.1 suggests that foundation skills generally depreciate with age. However, the results also suggest that the depreciation of skills may be offset by what people do at work and in their daily lives. For example, frequent engagement in reading at work and at home may help to mitigate the proficiency declines associated with aging.<sup>1</sup>

■ Figure 2.1 ■

### Unused skills may be more likely to atrophy

*Foundation skills of 16-65-year-olds, by high and low levels of reading engagement, adjusted for years of schooling and foreign-born status, country average*



Note: This figure is based on results of the PIAAC field trial. It is not based on representative samples and is therefore only illustrative.  
Source: PIAAC field trial data (2010).

## Identify inactive individuals and the reasons for inactivity

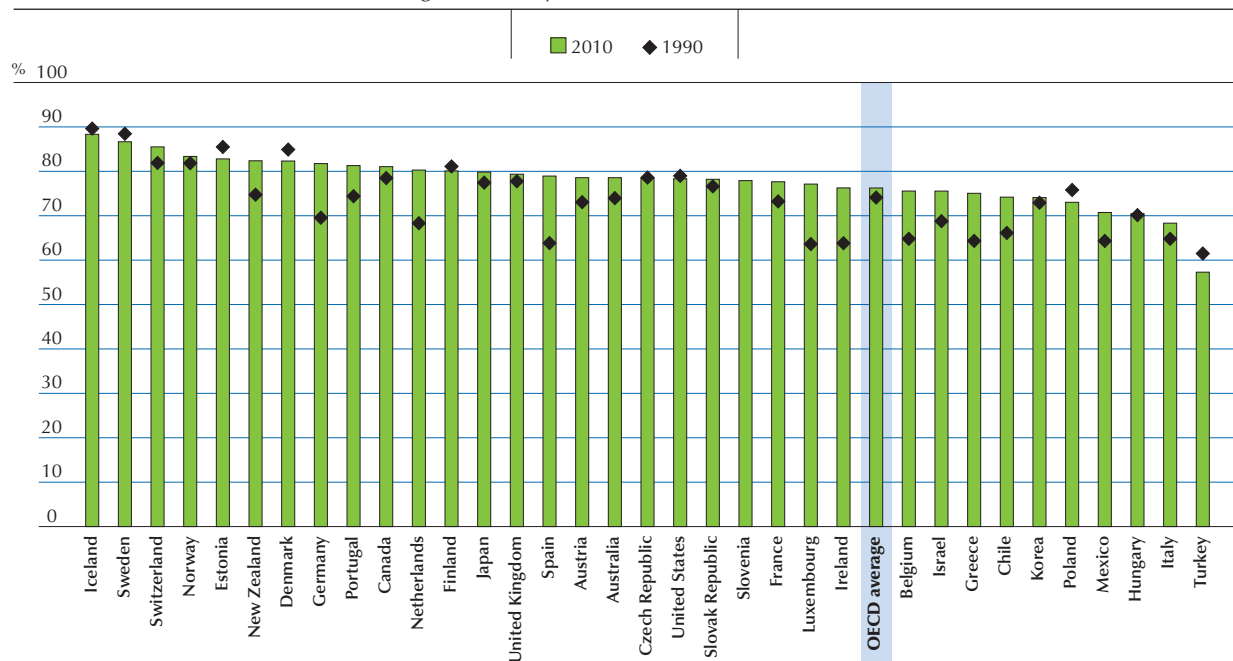
Labour-force participation rates – the sum of people in employment and in unemployment as a percentage of the working-age population – vary significantly across OECD countries, ranging from close to 90% in Iceland to below 60% in Turkey (Figure 2.2). Some socio-demographic groups, such as women and people with disabilities or chronic health problems, are more likely to show lower participation rates than others, particularly when they are poorly skilled. Because of various barriers to integration, immigrants, too, may not be full participants in the labour market.<sup>2</sup>

Variations in the composition of the labour force and in the participation rates of these socio-demographic groups translate into significant cross-country differences in what higher participation rates could mean for skills supply. The OECD projected how the labour force would develop by 2050 under different policy scenarios.<sup>3</sup> The results show that in some countries, such as Denmark, Finland, Hungary and Norway, higher participation rates among workers with disabilities could play a significant role in increasing future labour supply. In Greece, Italy and Spain, closing the gender gap offers the greatest potential for raising labour-force participation rates by 2050. Later retirement, which is also among these scenarios, would lead to labour-force growth similar to the “disability equality” scenario, with the exception of those countries in which early retirement is still particularly widespread.

■ Figure 2.2 ■

### Labour-force participation among adults, 1990<sup>1</sup> and 2010

Percentage of 25-64-year-olds active in the labour market



1. 1991 for Iceland, Mexico and Switzerland; 1992 for Hungary and Poland; 1993 for the Czech Republic; 1994 for Austria and the Slovak Republic; 1996 for Chile.

Source: OECD, *Labour Force Statistics Database*.

StatLink  <http://dx.doi.org/10.1787/888932607328>

In addition to these broad socio-economic groups, young people are also at risk of disengaging from the labour market. The OECD's Jobs for Youth study<sup>4</sup> identifies "youth left behind" as young people who have several disadvantages, including the lack of a diploma, an immigrant/minority background, residence in disadvantaged/rural/remote areas, teenage motherhood, and a prison or foster-care background. Because these groups vary in size and composition across countries, the OECD has chosen to proxy this group with the number of young people aged 15 to 29 who are neither in employment, nor in education or training (NEET). In 2010, in the 26 OECD countries for which data was available, the group of "youth left behind" represented 12.5% of 15-24-year-olds. In Europe, where the figure can be refined further to exclude youth who hold a diploma, the OECD estimates that in 2005, the most recent year for which this statistic is available, the group of "youth left behind" represented 11% of out-of-school 15-29-year-olds.

Reasons for inactivity vary. Some working-age individuals make a conscious decision to withdraw from the labour market or have major health-related work impediments. Others are willing and able to work but are prevented from doing so by a range of supply- and demand-side barriers. Because there are often multiple reasons behind inactivity, improving labour-force participation requires policy packages that combine several initiatives and participation by employers. Overall, policies can promote activity in the labour force in two ways: by making employment financially more attractive and restricting access to income-replacement schemes; and by reducing non-financial barriers to employment.

### Offer financial incentives to make work pay

For some people it simply does not pay to work. Costly childcare services, tax systems that are structured in ways that make work economically unattractive, or benefit systems that offer better compensation than expected salaries can all make it uneconomical to work. Financial incentives and well-designed tax and welfare systems can influence the labour supply among all groups, albeit in different ways.

For women or second-earners more generally, the tax and benefit systems and the way the incomes of second-earners and part-time workers are treated usually discourage re-entry into the labour market.<sup>5</sup> The tax burden on second-earners wanting to enter the labour market or increase the number of hours worked is influenced by a range of factors, including



the nature of the taxable unit. Joint or family-based systems with progressive income taxes introduce a bias towards single-earner couples, especially if the employed partner is a high-income earner and/or the inactive partner has a low earning potential. Family-based tax allowances or tax credits, and income-tested benefits related to family composition and/or income, can have similar effects.<sup>6</sup> For example, in some countries the entitlement to income support explains why employment levels are low among single parents. To encourage women – and second-earners in general – to enter or return to the labour force, many countries have individual tax systems in place. However, in nearly all OECD countries there is still some tax relief for non-employed spouses as well as some forms of family assistance that are based on total family income. These could be reformed to have a neutral effect on women's participation in the labour market.

### Box 2.1 In-work benefits policies

**For women.** Single parents are usually women, and most OECD countries target social-protection policies to this group. Nevertheless, financial benefits from being a sole parent may be a disincentive to enter or re-enter the labour market. The challenge is thus to encourage these women to return to work.

- **The Canadian Self-Sufficiency Project (SSP).** SSP is a ten-year experimental research project on the labour-market behaviour of single parents who receive social assistance. The project, launched in 1992, involves different experimental studies. In all studies, some single parents in the experimental group received generous earning supplements, while the rest were in the control group. The studies found that financial incentives had a positive effect on the return to employment, encouraging single parents to leave welfare rolls. However, earning supplements had a much stronger effect among those sole parents with recent employment experience. Single parents who were long-term social assistance claimants showed a high rate of employment in the short term, but that declined after some time.<sup>10</sup>

**For older workers.** A few countries provide older workers with a direct wage top-up (or in-work benefit) for either finding a job or remaining in employment, although it has been claimed that employers may offer lower wages than they would without this measure.

- **Germany** and the **United States** have such schemes, providing unemployed workers who find a job with a supplement of 50% of the difference in earnings between their old and new jobs, up to a given ceiling. In countries like Germany, where unemployment benefits are high, this kind of policy encourages older workers to return to work.
- **Japan's** system only offers older workers the top-up if their reduction in earnings is of 25% or more, relative to what they were earning at the age of 60. No unemployment benefits can be claimed in this case.
- **Spain** provides an in-work tax allowance in its Personal Income Tax system, the so-called “extending labour market participation allowance” by which working taxpayers extending their labour market participation beyond the retirement age (65 years) may increase their “work-related expense allowance” (applied for all taxpayers receiving income from work) by 100%.

**For people with disabilities.** Recipients of disability benefits who enter a job generally lose entitlement to part or all of their benefits. High tax burdens are one of the main factors that discourage some individuals from entering the labour market. Nevertheless, some countries have successfully introduced measures to encourage people with disability benefits to enter the labour force by reducing taxation.

- **Back-to-Work Allowance.** In **Ireland**, when a disability recipient works at least 20 hours a week, his or her average effective tax rate drops from a level close to 100% to some 45% for former average earners (and as low as 20% for low-income workers). The allowance is phased out gradually over a four-year period.
- **Working Income Tax Benefit (WITB).** In **Canada**, in addition to WITB entitlements available to all eligible low-income workers, low-income working individuals with disabilities can be entitled to a WITB Disability Supplement. The additional supplement increases with individual earnings, at a rate of 25%, up to a maximum benefit equivalent to half of the maximum WITB entitlement for single individuals, thereby further improving their financial return from work. The supplement is reduced when income exceeds a threshold.

Source: OECD (2006; 2010a; 2011d).

For people with disabilities, incentives to withdraw from the labour force greatly depend on access to full-disability benefit schemes. There is evidence that in countries that have radically reformed their disability-benefit systems and have tightened access through stronger work incentives, benefit-recipient rates have decreased.<sup>7</sup> A number of countries have either abolished partial-disability benefits or have made full-disability schemes exclusive to people who can no longer work. In a number of countries, people who can still work are increasingly being counted as unemployed, thus becoming subject to the so-called “mutual obligation” whereby they have to comply with job-search and training requirements or risk losing part or all of their unemployment benefits.<sup>8</sup> When examining beneficiary claims, countries should shift the focus from assessing health status to assessing the remaining capacity to work.

Although incentives should be tailored to specific groups of workers, some are relevant for several groups. For instance, employment for people on disability benefits can be made relatively more attractive by making it possible to combine income from work with disability benefits through earnings-disregards and in-work benefits, respectively. Some countries no longer require that disability benefits be contingent on workers leaving the labour force and have found other ways to compensate for disability status through allowances.<sup>9</sup> Under certain circumstances, work incentives for single parents can also be strengthened by offering in-work benefits (Box 2.1).

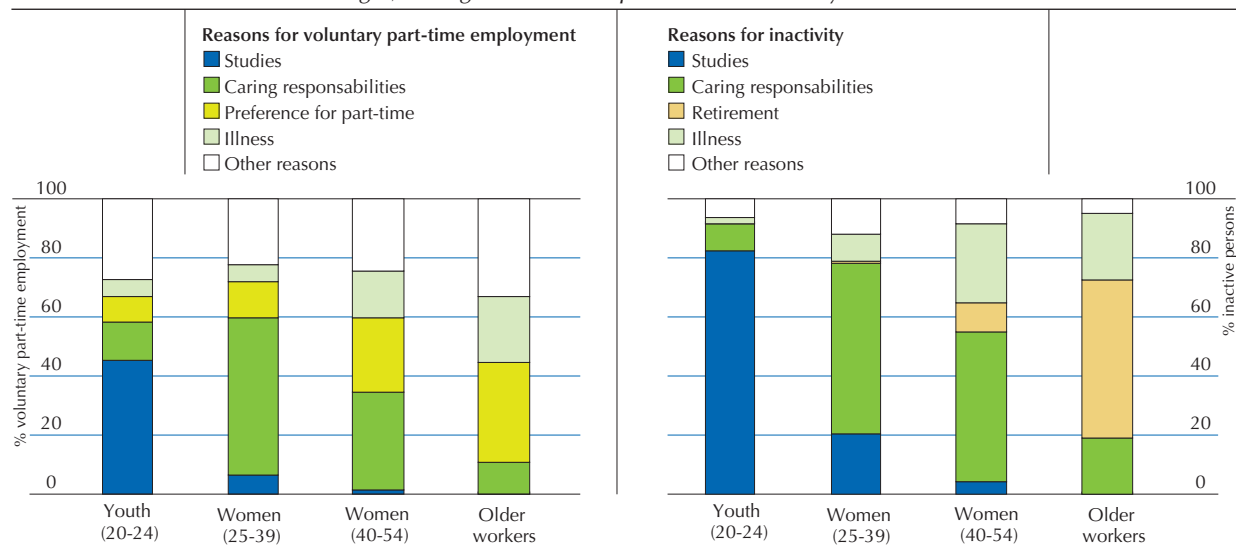
### Overcome non-financial barriers to labour-force participation

Policies can also help to dismantle the non-financial barriers to labour-force participation. For women, these are often in the form of time constraints stemming primarily from family and care obligations, both for children and for senior family members. Limited opportunities for part-time work can be a barrier to employment in these cases. The reasons people choose to work part-time or leave the labour force entirely are often closely related. For example, the main reason 25-39-year-old women cite for choosing to work part-time is their care responsibilities; the same reason is given for this group’s inactivity (Figure 2.3). This suggests that part-time work – coupled with adequate childcare facilities – can facilitate labour-market participation when caring responsibilities prevent full-time employment.<sup>11</sup>

■ Figure 2.3 ■

#### Reasons for working part-time or being inactive

Percentages, average over 21 European countries<sup>1</sup> and years 2005-07



1. Austria, Belgium, Denmark, Estonia, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, Slovenia, the Slovak Republic, Spain, Sweden, the United Kingdom.

Source: OECD (2010h).

StatLink <http://dx.doi.org/10.1787/888932607347>

Hence, even though part-time work might imply less job security, lower wages and limited career prospects, it is increasingly seen as a vehicle for activating groups with traditionally low labour-market participation.<sup>12</sup> Employers who offer flexible start times and working hours, control over working hours, and, especially for women, flexible working arrangements around the time of childbirth could make a substantial difference to labour-force participation (Box 2.2).<sup>13</sup>





### Box 2.2 **Employment conditions that facilitate participation in the labour market**

**Jobs for parents.** While some parents prefer to stay home with children regardless of childcare options, others prefer to combine home care with full- or part-time work. In **Austria, Denmark, Finland, the Netherlands and Sweden**, parental-leave programmes involve adjustments of working hours and part-time jobs. In **Portugal** and Sweden, the parental leave period can be used at different times, for example to extend holiday periods until children go to school (age six in Portugal; age eight in Sweden).

**Employers' obligations.** In order to retain workers with health problems, some countries have legislated obligations for employers that aim to reduce non-financial barriers for workers with health problems or disabilities.

- **Germany.** Employers have to offer preferential selection for within-company training to those workers with health problems or disabilities, and support their efforts to enrol in training elsewhere. Furthermore, workers with disabilities or health problems have the right to work assistance, an adapted workplace and part-time employment, if required.
- **Luxembourg.** Firms with more than 25 workers are obliged to find an appropriate job for their workers with disabilities, either a different job or the same one on a reduced schedule.
- **Spain.** Employers must keep a post open for up to two years for a worker with health problems. Moreover, former employees on disability benefits who recovered after taking leave have priority for filling suitable vacancies or for a similar job.

Source: OECD (2007a; 2010a).

For those with disabilities, it is generally the quality of employment that influences participation in the labour market. Improving the general conditions for workers with health problems should therefore be part of employer and government strategies aimed at reducing non-financial barriers to employment.<sup>14</sup> Employers and unions can help workers to retain their jobs by improving workplace safety and by being more aware of specific work needs.<sup>15</sup> Given the link between sick leave and incapacity to work, improving prevention and early-intervention measures, while avoiding “medicalisation”, is critical. For employers, effective wage subsidies or other financial incentives that compensate for losses in productivity can make it financially more attractive to retain sick workers or people with disabilities.

### **Combine activation policies with opportunities for retraining or up-skilling**

The skills of people who have stayed inactive for an extended period of time can atrophy or become obsolete. These people might require retraining or up-skilling to avoid moving from inactivity to unemployment because their skills are not in demand. Targeted (vocational) training and re-entry programmes can help people who have been outside the labour market due to care obligations or illness.<sup>16</sup> In addition, active labour market policies, primarily used to help unemployed persons find work,<sup>17</sup> are being extended to target those who are inactive but who have the capacity to work, such as single mothers or individuals with health problems. These programmes can involve work-related and job-search training as well as subsidised employment in the open labour market or in protected sectors.

Activation measures, such as individual case management that help hard-to-place unemployed persons to find work, often also work for target groups that face multiple barriers to participation. But it is a challenging task, as it is much more difficult to impose a mutual obligation on a heterogeneous group than on an individual.<sup>18</sup> And participation in activation programmes is more difficult to enforce if non-compliance carries no consequences, such as reducing or eliminating benefits. In the end, employment-related services tend to be most effective when they are personalised, which explains why these services are often targeted to specific groups and provided by private specialists.<sup>19</sup>

To be effective in increasing employment and the use of skills, these measures also need to be combined with efforts to reduce employers' reluctance to hire inactive individuals,<sup>20</sup> particularly workers with health problems or persons with disabilities.<sup>21</sup> If there aren't enough job opportunities on offer, any efforts to employ larger numbers of these workers will fail. The same holds for disengaged young people. The OECD has made a number of recommendations on how countries can use supply- and demand-side approaches to support hard-to-place young people at risk of total labour-market disengagement and long-term inactivity that can leave them languishing at the margins of society for their entire lives (Box 2.3).

### Box 2.3 Policy advice from the OECD's Jobs for Youth study

- Promote a smooth transition from school to work and early career development by:
  - using early and selective interventions to help avoid creating a large pool of youth at risk of becoming long-term unemployed, inactive or involved in informal jobs or jobs that do not make full use of their skills;
  - ensuring that youth leave education with recognised qualifications or diplomas;
  - promoting the use of internships and other forms of on-the-job learning that could help students acquire some labour-market experience before graduation; and
  - adopting a “learn/train first” approach to boost employability of low-skilled youth who have difficulty finding a job.
- Remove demand-side obstacles to better youth-employment outcomes by:
  - investing in funds that promote new skills for new jobs, targeting young entrants;
  - reducing the cost of employing low-skilled youth; and
  - pursuing efforts to reduce labour-market duality overall, particularly that of temporary vs. permanent contracts.
- Provide support for unemployed and inactive youth who are not engaged in learning by:
  - strengthening the safety net and promoting smoother employment and training pathways for unemployed youth and young workers;
  - assisting unemployed youth in their job search with appropriate measures; and
  - designing programmes for youth who are disconnected from work and education, focusing on mentoring and vocational learning and a rigorous ‘mutual obligations’ approach.

Source: OECD (2010b).

Figures on unemployment and inactivity do not tell the whole story. In countries that have a large informal sector, most notably in the developing world, official statistics do not capture the full employment picture. However, from what is known, certain socio-economic groups are over-represented in the inactive category, meaning that they do not supply their skills to the labour market. For example, in Middle East and North African (MENA) countries, there are large differences in the rates of labour-market participation between women and men. The men-to-women ratio of participation ranges from over 3.7 to one in Saudi Arabia and Syria to 1.86 to one in Qatar. Participation rates among men range from 71% in Tunisia to 93% in Qatar, while among women it ranges from 15% in Iraq to 53% in Qatar. Women find it particularly difficult to secure decent employment in Egypt, Jordan, Libya, Morocco and Tunisia. In all five countries, only about a quarter of adult women were in the labour force in 2010 (a figure that also includes discouraged workers), compared to 70%-80% participation rates among adult men (see Box 2.4).

### Box 2.4 Labour-force participation among women in MENA countries

Many countries in the Middle East and North African (MENA) region have made significant progress towards reducing gender gaps in key dimensions of education and health, but improvements in employment outcomes are limited. The increase in women's labour-force participation over the past two decades has been slight: from 22% in 1990 to 30% in 2010, almost 40 percentage points below the labour-force participation rate among men in the region.

**Patterns of employment and occupational segregation.** Women are often employed in the public sector. In **Egypt**, for example, the public sector accounts for 56% of employed women compared with 30% of men. However, female public employees tend to work in the areas traditionally regarded as “feminine”. In **Morocco**, for example, in 2009, women represented about 50% of employees in the Ministries of Health and Social Affairs, but only 4% in the General Directorate for Civil Protection and 6% in the General Directorate for National Security.

...





Similar to OECD countries, when employed, women earn lower salaries than men in both the private and public sectors and do not have equal access to leadership training. Women are less represented in senior and leadership positions in both the private and public sectors. In 2010, women's representation in top management in national government was 14% in **Morocco**, 26% in **Egypt**, and 45% in **Tunisia**.

**Barriers to employment.** Lack of work-family balance policies is one of the main barriers to women's employment in the region. Family responsibilities are considered women's domain and marriage plays a key role in women's labour-force participation, particularly among women in the private sector. In **Morocco**, only 12% of married women join the labour force, compared with 79% of married men. In **Egypt** and **Jordan**, the share of women in private jobs falls sharply at first marriage. This pattern is observed regardless of women's level of education. In contrast, the proportion of women in public-sector jobs is less affected by marriage: 57% of married working women are employed in the public sector.

Other institutional, legal, economic and social norms also help to explain the slow progress of women in employment in the region. These include norms restricting the type and hours of work for women and requirements to get the permission of husbands or fathers to work. Some MENA countries, including **Egypt**, **Jordan** and **Yemen**, also report that safe public transport and a more suitable working environment would improve employment prospects for women, particularly for those in remote areas.

**On the reform path.** Many MENA governments have introduced measures to improve women's employment prospects (see part 4 on entrepreneurship in MENA countries). **Morocco**, for example, regularly reports on gender employment trends and women's access to leadership positions in the civil service; and measures to guarantee public-sector pay equity have been put in place in **Egypt**, **Jordan**, **Morocco** and **Tunisia**.

Source : OECD (forthcoming), *Report on the Gender Initiative*.

## COUNTRIES CAN RETAIN SKILLED PEOPLE

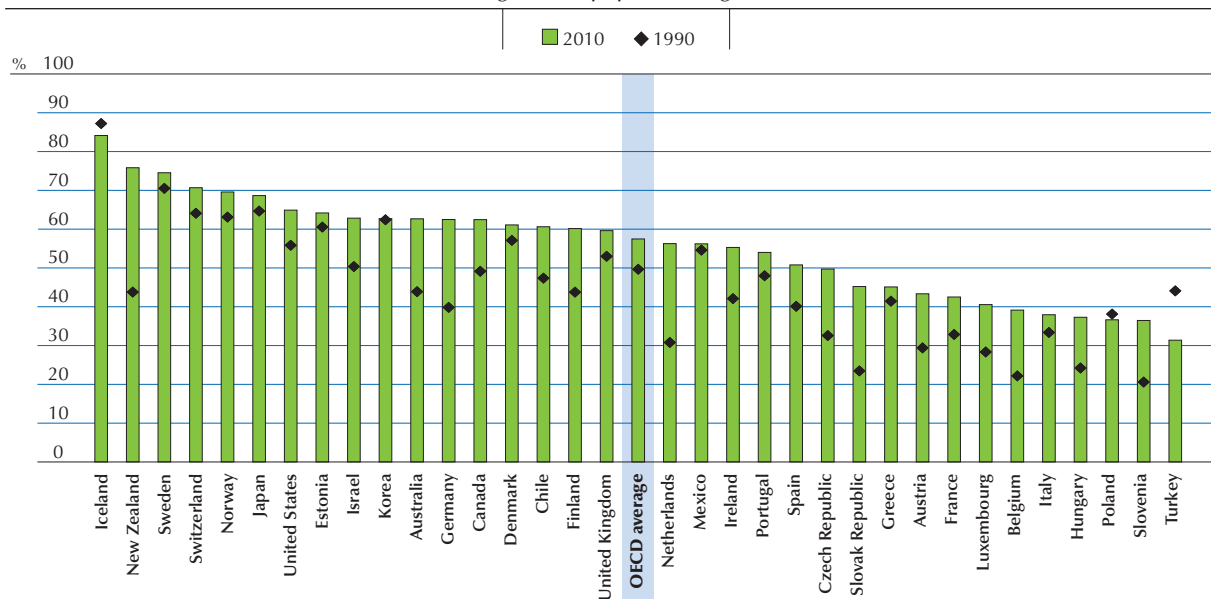
Developing skills is a substantial investment for any country. To reap the returns on this investment, skills policies need to ensure that skilled people do not withdraw from the labour market either because they retire prematurely or because they decide to move to other countries. The extent of these problems varies substantially across countries: early retirement is a particular concern in many European OECD countries, where populations are aging and social systems are not sustainable if large numbers of workers retire prematurely. Brain drain is often associated with developing countries. But several OECD countries, including Poland and New Zealand, struggle with losing skilled labour to other countries as well.

### Discourage early retirement

In about two-thirds of OECD countries, the labour-force participation rate among 55-64-year-olds stands at or below 60%, ranging from 85% in Iceland to just 30% in Turkey (Figure 2.4). On average in OECD countries, the participation rate of older workers is 19 percentage points below that of prime-age adults, but the difference between the two varies widely, from just 5 percentage points in Iceland to 53 percentage points in Slovenia.


Frequent use of early-retirement schemes and low statutory retirement ages are the key reasons for low labour-force participation rates among older workers. Indeed, the more limited use of early-retirement schemes and recent pension reforms prompted a rise in participation rates for this age group over the past two decades. In New Zealand, older workers' participation rates rose from 44% to 76% between 1990 and 2010, and very large increases were also observed in Germany, the Netherlands, the Slovak Republic and Slovenia. However, these positive developments are relatively recent; in most OECD countries, retirement ages remain well below their 1970s levels. Most older workers continue to leave the labour market well before the standard age at which they are eligible for a pension, which stands at 65 in most countries. Out of 30 OECD countries for which data are available, only in nine countries do men retire later than age 64, on average, and in only five countries, namely Iceland, Japan, Korea, Mexico and New Zealand, does the same apply to women. Cross-country differences are marked. Mexico has the highest average age at which men leave the labour market – 72.2 years – and the second highest average age for women – 69.5 years. At the other extreme, men and women retire under the age of 60, on average, in Austria, Belgium, Luxembourg and the Slovak Republic.<sup>22</sup> For older workers, leaving the labour market early tends to be definitive: an OECD study finds that fewer than 5% of 50-64-year-olds who had left employment before the official pensionable age had returned to a job one year later.<sup>23</sup>

■ Figure 2.4 ■  
**Labour-force participation among older workers, 1990<sup>1</sup> and 2010**  
 Percentage of the population aged 55-64



1. 1991 for Iceland, Mexico and Switzerland; 1992 for Hungary and Poland; 1993 for the Czech Republic; 1994 for Austria and the Slovak Republic; 1996 for Chile and Slovenia.

Source: OECD Labour Force Statistics Database.

StatLink  <http://dx.doi.org/10.1787/888932607366>

### Box 2.5 Features of pensions systems that reduce incentives to work

Although technical policy recommendations on retirement-income systems are reported by the OECD, the main policy conclusion is that details matter. System details determine whether the pension system treats individuals who participate in the labour force in different ways, and whether the pension system influences work and retirement decisions. Some technical examples are provided below, but no general guidance is offered.

1. In **France**, **Greece** and **Luxembourg** it is possible to retire at 60, or earlier in some cases, without any reduction in benefits. This discourages older workers from staying in work. The average reduction in benefits in earnings-related schemes for each year of early retirement is around 4.5% (the actuarially neutral level is around 6-8%).
2. **Greece**, **Spain** and the **United States** have limits to the number of years during which pension benefits can accrue in their earnings-related schemes. These policies discourage work once the maximum number of years has been achieved. Additional benefits can be accrued in Greece and the United States only if working after 65.
3. Many OECD countries used to calculate pension benefits based on a subset of years with the best or final earnings. This policy encourages people to retire once their earnings have peaked, and not to stay employed at older ages.
4. An earnings-related scheme with uniform accrual structure would provide older workers with incentives to work. In **Spain's** public-pension system, the accrual rates at younger ages are higher than those later on, discouraging older workers from remaining in work.
5. Resource-tested schemes can have negative effects on work incentives for low earners, although these schemes also target benefits for those most in need, reducing the use of higher taxes and contributions. Some countries, such as **Chile**, **the Czech Republic**, **Iceland**, **Ireland**, **New Zealand** and **Switzerland**, have managed to combine redistributive pension systems with incentives to stay in work.
6. Increments in pension benefits for people who defer claiming the pension after normal age are, on average, 5% below actuarial neutrality. Only **Canada**, **the Czech Republic**, **Japan**, **the United Kingdom** and **the United States** offer more attractive terms for deferring pensions and staying in work.

Source: OECD (2011 d).



The cross-country variation in employment rates among 55-64-year-olds can largely be explained by a country's pension system.<sup>24</sup> In fact, some pension systems include financial disincentives to stay in work (Box 2.5). On the one hand, the absolute level of pension wealth and its marginal change, embedded in the so-called “implicit tax on continuing to work” for an additional year, influences the decision to exit the labour force. Indeed, countries with the lowest implicit tax on continuing to work have the lowest withdrawal rates among older workers.<sup>25</sup>

The decision to leave the labour force is influenced by the official pensionable age and by the availability of early-retirement schemes. As a result, several policy changes can help to reduce the incentives to retire. Although most countries have eliminated early-retirement schemes, increased the official pensionable age, and corrected distorted financial incentives to retire early, pension systems still offer powerful incentives to leave work at the earliest possible opportunity.<sup>26</sup> This means that there is still considerable scope to improve financial incentives to remain in the workforce after reaching the official pensionable age. A good measure is the one adopted by the Netherlands, where an additional year's work is rewarded with a 24% increase in pension wealth, since early-retirement programmes providing benefits from age 60 to 65 were abolished.

The quality of employment can also influence decisions to retire early. There is evidence that employers' inability or unwillingness to reduce working hours tends to push workers into retirement by limiting the possibility of a phased transition out of employment.<sup>27</sup> It is also important to bear in mind that policies to reduce non-financial barriers to labour-force participation may work in tandem with other policies intended to encourage employers to hire and retain workers from some under-represented groups. For example, a rise in the pensionable age would lengthen the period of time over which employers could recover training costs, hence is likely to reduce employers' reluctance to provide for their older employees.<sup>28</sup>

After the age of 50, workers in all OECD countries are increasingly less likely to be hired or retained.<sup>29</sup> While employers often cite obsolete skills as a reason why they do not want to hire older job-seekers, age discrimination is still common. Rigid compensation structures, whereby labour costs increase with age rather than reflect workers' productivity, also play a role, although these are often circumvented through early-retirement schemes.<sup>30</sup> To tackle these demand-side barriers to employing older workers, some countries have run large anti-discrimination campaigns; others have tried to balance labour costs with productivity by reducing employers' social security contributions or providing wage subsidies in respect of older workers.<sup>31</sup> Some countries have also begun to emphasise lifelong learning and targeted training, especially in mid-career, to improve employability later in life and discourage early withdrawal from the labour force. Another measure used is to improve the match between the type of work the older worker wants to perform and remuneration. For example, older workers might prefer fewer night shifts for lower pay while younger workers may be more willing to do more night shifts for higher pay. This improved match will automatically increase demand.

### **Staunch brain drain**

Some countries incur large costs because their skilled labour leaves and the returns on investments in skills development are reaped by the new host country. As Table 2.1 shows, emigration rates also vary across countries, even within the same region. Europe, Latin America and Oceania have the highest emigration rates (in 2008, for example, the outflow from Bulgaria represented 1% of the country's total population, and from Romania and Poland it represented 0.8% and 0.6% of the respective populations),<sup>32</sup> while Africa, Asia and North America have emigration rates that are less than half those of the aforementioned regions. In all regions, the emigration rate for tertiary-educated workers is significantly higher than the total emigration rate,<sup>33</sup> although this difference is especially great for African countries. At 10.6%, the emigration rate of tertiary-educated persons born in Africa is much higher than that in other regions, although Latin America also has a relatively high rate of emigration – 8.8% – among highly skilled persons.


As noted before, losing highly skilled individuals through migration to other countries can create skills shortages in the source country. Some countries have introduced retention policies aimed to staunch brain drain. Experience has shown that the best policies are those that provide incentives to stay rather than coercive measures to prevent migration (Box 2.6). When opportunities to move abroad are widely available, coercive measures to prevent departure appear to be largely ineffective and may even increase pressure to leave, unless they are accepted as legitimate. The possibility of migrating to earn higher returns abroad can also create an incentive for people in the source countries to invest more in education and training. As not all of them will leave, there is likely to be a net addition to the stock of human capital in the source country as a result.

**Table 2.1**  
**Emigration rates by region of origin and by skills level, population aged 15 and over,**  
**2000 and 2005-06**  
*Weighted averages*

	2005-06					2000				
	Emigrant population (thousands)	Emigration rates (in percent)				Emigrant population (thousands)	Emigration rates (in percent)			
		TOTAL	Low-educated	Intermediate-educated	High-educated		TOTAL	Low-educated	Intermediate-educated	High-educated
High-income: OECD	25 155	2.9	4.5	1.9	3.7	22 999	2.8	4.4	2.0	2.6
High-income: non-OECD	3 404	7.7	7.6	6.6	12.5	3 017	7.5	8.5	6.3	12.3
Upper-middle-income	26 468	3.8	5.3	2.5	5.2	19 565	3.0	4.2	1.9	3.6
Lower-middle-income	26 309	4.6	1.3	1.1	5.6	19 605	1.3	1.1	0.9	5.3
Low-income	8 319	0.6	0.2	0.5	5.4	6 046	0.5	0.2	0.5	4.2
<b>Africa</b>	<b>8 947</b>	<b>1.6</b>	<b>1.0</b>	<b>1.8</b>	<b>10.2</b>	<b>6 847</b>	<b>1.4</b>	<b>0.9</b>	<b>1.7</b>	<b>9.2</b>
Morocco	2 106	9.0	7.7	10.5	15.3	1 505	7.3	6.1	9.0	13.0
Other North Africa	2 403	2.2	1.8	1.9	6.2	2 151	2.3	1.8	2.0	8.1
Sub-Saharan Africa	4 437	0.9	0.4	1.1	13.2	3 191	0.8	0.4	1.0	10.2
<b>Asia</b>	<b>19 510</b>	<b>0.7</b>	<b>0.3</b>	<b>0.5</b>	<b>3.7</b>	<b>15 473</b>	<b>0.6</b>	<b>0.3</b>	<b>0.5</b>	<b>3.3</b>
China	2 723	0.3	0.2	0.1	1.7	2 063	0.2	0.2	0.1	1.8
India	2 759	0.4	0.1	0.2	4.2	1 951	0.3	0.1	0.2	3.2
Philippines	2 491	4.4	1.8	3.8	7.9	1 930	3.9	1.8	3.9	6.8
<b>Europe</b>	<b>34 281</b>	<b>4.5</b>	<b>8.8</b>	<b>3.4</b>	<b>8.6</b>	<b>28 425</b>	<b>3.9</b>	<b>6.8</b>	<b>2.9</b>	<b>6.6</b>
EU27	22 129	5.1	6.4	3.3	8.0	19 370	4.6	5.4	3.1	7.0
Turkey	2 603	4.7	5.3	3.6	5.0	2 085	4.2	4.5	3.5	3.2
<b>North America</b>	<b>2 075</b>	<b>0.8</b>	<b>1.7</b>	<b>0.4</b>	<b>1.2</b>	<b>1 910</b>	<b>0.8</b>	<b>3.5</b>	<b>0.5</b>	<b>0.7</b>
<b>Oceania</b>	<b>1 221</b>	<b>4.7</b>	<b>5.0</b>	<b>3.9</b>	<b>5.3</b>	<b>1 103</b>	<b>4.5</b>	<b>6.3</b>	<b>3.3</b>	<b>4.8</b>
<b>South America &amp; Caribbean</b>	<b>24 786</b>	<b>6.0</b>	<b>5.7</b>	<b>5.5</b>	<b>9.2</b>	<b>18 624</b>	<b>5.0</b>	<b>5.0</b>	<b>4.4</b>	<b>7.0</b>
Mexico	10 780	13.1	18.4	9.7	7.1	8 328	11.1	15.4	7.0	6.1
<b>Total</b>	<b>90 818</b>	<b>1.9</b>	<b>1.5</b>	<b>1.5</b>	<b>4.8</b>	<b>72 381</b>	<b>1.6</b>	<b>1.4</b>	<b>1.3</b>	<b>3.7</b>

Note: Weighted averages. Income groups are classified according to the World Bank classification of economies based on the 2005 GNI per capita: low income USD 955 or less, lower middle income USD 996 – USD 3 945, upper middle income USD 3 946 – USD 12 195 and high income USD 12 196 and more. Former USSR and Former Yugoslavia are classified in “Upper middle income” countries, the aggregated category North and South Korea to “High income: OECD”. Former USSR, Former Czechoslovakia and Former Yugoslavia are assigned to the region “Europe”.

Source: DIOC (2000; 2005-06) and Barro and Lee (2010).

StatLink  <http://dx.doi.org/10.1787/888932607499>

### Box 2.6 **Staunching brain drain: Retaining vs. restricting**

**Restricting policies.** Compulsory service schemes (“bonding”) are widely used to try to manage the exodus of health-care professionals from developing countries. In **Ghana**, for example, the bonding system requires that health professionals work at least five years in the country, otherwise the cost of the training must be paid back. Although bonding systems have had some success in increasing the number of doctors serving temporarily in deprived and rural areas, bonding is not successful in retaining workers. High inflation and currency depreciation may weaken the effectiveness of these systems. **Thailand** and **Mexico** have had similar experiences with bonding. In Ghana too, many doctors left without paying their bond, since there was poor monitoring of the policy. This makes it even more unlikely that those migrants will return.

**Retaining policies.** Policies that provide incentives to stay may be more successful if they tackle the perceived needs of healthcare professionals. Most of these needs are related to management and governance of the health services and to salaries and working conditions. This is why some developing countries introduced incentive schemes for health professionals that include higher salaries, improved pension and insurance systems, clothing and travel allowances, child care allowances and subsidised meals, accommodation and training. In **Thailand**, financial incentives were introduced in 1983 with allowances for physicians working in remote district hospitals; in 1995 those who agreed not to engage in private practice received an extra USD 400 per month. In **Indonesia**, higher salaries are offered to those graduates who work in very remote areas. A guarantee of a civil-service career is also featured, with free access to specialist training after the completion of the three-year compulsory contract.

Source: Mensah, Mackintosh and Henry (2005).



Brain drain is a particular challenge in many developing countries. However, the focus on the cost of high-skilled emigration in developing countries has obscured the substantial benefits of migration. Some workers, including those who are highly skilled, may not find a job in their home country because of inappropriate investment climate (highly distorted prices, poor governance, and inadequate provision of infrastructure), which reduces the demand for skills. Over the long term, countries need to raise the demand for skilled workers by improving the investment climate; but in the interim, one way to reduce unemployment among high-skilled workers is to make it easier to work abroad. Providing placement services, removing impediments to private agencies, while imposing strong regulations to prevent fraud, exploitation, and abuse, and establishing domestic qualifications and diplomas that meet international standards can help potential emigrants to find jobs that match their skills outside their home country. In addition, nationals abroad can serve as a bridge to useful technical skills, funding, and links to international markets. However, the constraint on emigration remains immigration restrictions in the more developed countries. Easing these restrictions could make a substantial contribution to development.

**Table 2.2**  
**Activating skills supply: Key questions, indicators and resources**

Key questions	Selected indicators for self-assessment	Selected further reading and policy examples
<b>Activating people to supply their skills to the labour market</b>		
Do people in my country supply their skills to the labour market?	<ul style="list-style-type: none"> <li>▪ <b>Labour-force participation rates</b> <a href="http://stats.oecd.org/wbos/default.aspx?DatasetCode=LFS_D">http://stats.oecd.org/wbos/default.aspx?DatasetCode=LFS_D</a></li> </ul>	<ul style="list-style-type: none"> <li>▪ Online OECD Employment Database <a href="http://www.oecd.org/employment/database">www.oecd.org/employment/database</a></li> </ul>
Which inactive group in my country has the biggest potential for participation?	<ul style="list-style-type: none"> <li>▪ <b>Projected labour force according to four different scenarios on age, gender and disability-specific participation rates</b> <a href="http://www.oecd.org/LongAbstract/0,3425,en_2649_33927_46502382_1_1_1_1,00.html">www.oecd.org/LongAbstract/0,3425,en_2649_33927_46502382_1_1_1_1,00.html</a></li> </ul>	<ul style="list-style-type: none"> <li>▪ <i>Sickness, Disability and Work. Breaking the Barriers. A synthesis of findings across OECD countries</i>, 2010, OECD Publishing. <a href="http://www.oecd.org/LongAbstract/0,3425,en_2649_33927_46502382_1_1_1_1,00.html">www.oecd.org/LongAbstract/0,3425,en_2649_33927_46502382_1_1_1_1,00.html</a></li> </ul>
What is the percentage of the “population at risk” in my country?	<ul style="list-style-type: none"> <li>▪ <b>Percentage of “population at risk” among children without an immigrant background and young immigrants</b> <a href="http://www.oecd.org/document/15/0,3746,en_2649_33729_38002191_1_1_1_1,00.html">www.oecd.org/document/15/0,3746,en_2649_33729_38002191_1_1_1_1,00.html</a></li> </ul>	<ul style="list-style-type: none"> <li>▪ “Overview: Children of Immigrants in the Labour Markets of OECD and EU Countries”, in: <i>Equal Opportunities? The Labour Market Integration of the Children of Immigrants</i>, OECD Publishing. <a href="http://www.oecd.org/document/15/0,3746,en_2649_33729_38002191_1_1_1_1,00.html">www.oecd.org/document/15/0,3746,en_2649_33729_38002191_1_1_1_1,00.html</a></li> </ul>
What is the incidence and composition of part-time employment in my country?	<ul style="list-style-type: none"> <li>▪ <b>Part-time employment in OECD countries</b> <a href="http://dx.doi.org/10.1787/888932293087">http://dx.doi.org/10.1787/888932293087</a></li> <li>▪ <b>Incidence of gender inequality in part-time employment</b> <a href="http://dx.doi.org/10.1787/888932303575">http://dx.doi.org/10.1787/888932303575</a></li> </ul>	<ul style="list-style-type: none"> <li>▪ “How Good is Part-Time Work?”, in <i>Employment Outlook 2010</i>, OECD Publishing. <a href="http://www.oecd.org/document/0/0,3746,en_2649_37457_40774656_1_1_1_37457,00.html">www.oecd.org/document/0/0,3746,en_2649_37457_40774656_1_1_1_37457,00.html</a></li> </ul>
What are the main reasons for part-time work and inactivity across groups?	<ul style="list-style-type: none"> <li>▪ <b>Reasons for working part-time or being inactive</b> <a href="http://dx.doi.org/10.1787/888932293315">http://dx.doi.org/10.1787/888932293315</a></li> </ul>	<ul style="list-style-type: none"> <li>▪ “How Good is Part-Time Work?”, in <i>Employment Outlook 2010</i>, OECD Publishing. <a href="http://www.oecd.org/document/0/0,3746,en_2649_37457_40774656_1_1_1_37457,00.html">www.oecd.org/document/0/0,3746,en_2649_37457_40774656_1_1_1_37457,00.html</a></li> </ul>
<b>Retain skilled people in the labour market</b>		
Are older workers in my country active?	<ul style="list-style-type: none"> <li>▪ <b>Labour-force participation rate by age group</b> <a href="http://stats.oecd.org/wbos/default.aspx?DatasetCode=LFS_D">http://stats.oecd.org/wbos/default.aspx?DatasetCode=LFS_D</a></li> </ul>	<ul style="list-style-type: none"> <li>▪ <i>Pensions at a Glance 2011: Retirement-Income Systems in OECD and G20 Countries</i>, OECD Publishing. <a href="http://www.oecd.org/els/social/pensions/PAG">www.oecd.org/els/social/pensions/PAG</a></li> </ul>
Does my country lose substantial amounts of skilled people to other countries?	<ul style="list-style-type: none"> <li>▪ <b>Net migration as a percentage of the total resident population</b> <a href="http://dx.doi.org/10.1787/888932446759">http://dx.doi.org/10.1787/888932446759</a></li> </ul>	<ul style="list-style-type: none"> <li>▪ “Trends in Migration Flows and in the Immigrant Population” (Chapter A), in <i>International Migration Outlook 2011</i>, OECD Publishing. <a href="http://www.oecd.org/migration/imo">www.oecd.org/migration/imo</a></li> </ul>

## Notes

1. Desjardins and Warnke (2012).
2. OECD (forthcoming), *Settling in – 2012*.
3. OECD (2010a).
4. OECD (2010b).
5. Jaumotte (2004); OECD (2011a).
6. OECD (2007a); OECD (2011b).
7. OECD (2010a).
8. OECD (2007b).
9. OECD (2010a).
10. For more information see Immervol and Pearson (2009).
11. OECD (2010c), Gornick and Hegewish (2010). Multivariate analysis shows that the availability of part-time work tends to improve women's participation rates, but not by the same extent in all countries because of different preferences, see Jaumotte (2004) and Falzone (2000).
12. Gustman and Steinmeier (2004); OECD (2010c).
13. The availability of parental leave can strengthen labour-market attachment and make it more likely that women return to work after childbirth. However, the duration of parental leave also matters: if women stay out of the labour market for an extended period of time, this might have negative effects on participation in the long run due to skills deterioration (OECD, 2011c).
14. OECD (2011d).
15. OECD (2006).
16. OECD (2007b) and OECD (2010a).
17. Results from active labour-market programmes (ALMP) focusing on job training of the unemployed are mixed. One study (Kodrzycki, 2007) finds that participation in job training or general education as part of the US Job Training Partnership Act did not improve re-employment pay levels compared with use of basic re-employment services. A World Bank study by Betcherman et al. (2004) considers 159 scientific (i.e. control group-based) evaluations of active labour-market programmes, 49 of which were training programmes for the unemployed and nine retrained workers affected by mass lay-offs. The evaluations show that training measures have a more positive impact than employment subsidies or job-creation programmes, but they cost more. The authors found a number of programmes that improved employment prospects, but far fewer that improved wages. More mixed results, with some positive effects of community-college training for displaced workers, are found in Jacobson et al. (2005).
18. Carcillo and Grubb (2006).
19. OECD (2006, 2011c); Carcillo and Grubb (2006).
20. Carcillo and Grubb (2006).
21. OECD (2006, 2010a).
22. OECD (2011d).
23. OECD (2006).
24. Bassanini and Duval (2006).
25. OECD (2011d).
26. OECD (2011d).
27. OECD (2011d); Gustman and Steinmeier (2004).
28. The so-called horizon effect; see Aubert (2011).
29. OECD (2006).
30. OECD (2011d).
31. OECD (2006; 2011d; 2011a).
32. OECD (2010d).
33. OECD (2011e).





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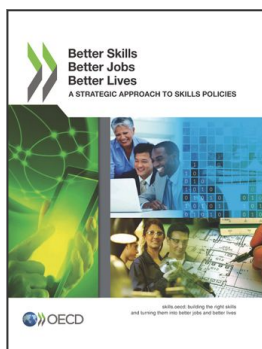
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