Editorial

Achieving a Sustainable Recovery – What Can Labour Market Policy Contribute?

Unemployment remains high, bearing heavily on youth and the long-term unemployed, and the pace of labour market recovery is flagging.

The OECD-wide unemployment rate was 7.9% in May 2012, equivalent to around 48 million people out of work – almost 15 million more than when the financial crisis began at the end of 2007. OECD economic projections from May 2012 indicate that job creation will continue to be weak in many OECD countries and that unemployment may remain around 8% in the OECD area at the end of 2013. The outlook is even more discouraging in the euro area, where unemployment is rising again and is projected to rise further before stabilising in 2013.

Persistently high levels of youth unemployment are of particular concern. The youth unemployment rate for the OECD area was just over 16% in May 2012, unchanged from one year previously. This rate varies from a low of around 8% in Germany to more than 50% in Greece and Spain. The slow pace of job growth has also been reflected in a rise in long-term unemployment. By the last quarter of 2011, more than 35% of all those unemployed in the OECD area had spent a year or more out of work and looking for a job. In EU countries, around 44% of all unemployed were long-term unemployed, on average, and the United States has recorded an unprecedented increase in the share of long-term unemployment, going from around 10% of all unemployment in 2007 to around 30% in the first quarter of 2012.

Labour market recovery is largely dependent upon a quick resolution to the euro crisis and appropriate macroeconomic policies…

In the short term, an improvement in labour market conditions is largely dependent upon a broader economic recovery and is thus shaped by factors that labour market authorities cannot control directly. For example, the recent divergence between declining unemployment in the United States and rising unemployment in many countries in the euro area reflects the impact of the banking and sovereign debt crisis in a number of European countries. The resulting stress in European financial markets, coupled with a sharp shift toward fiscal consolidation, is depressing aggregate demand and job creation in Europe.

Countries must respond to these developments with appropriate macroeconomic policy measures, including taking immediate steps to stabilise the European banking system. There is also a case for some further fiscal policy easing in those countries that still have some flexibility in this area, although this must be grounded in a credible medium-term strategy of fiscal consolidation. In addition, further monetary policy easing can play a crucial role in Europe to support growth in the short term.

… but labour market policies still have a vital role to play to boost job creation and support long-term labour supply.

Despite the macroeconomic headwinds, a well-designed package of labour market policies can play an important supportive role in helping to boost job creation. They can minimise the long-term costs of high unemployment and help to lay the foundation for a sustainable return to high employment rates and rising earnings. In particular, policy makers must ensure that the sustained period of high labour market slack does not undermine the recovery by raising the level of structural unemployment or permanently depressing labour supply. This report shows that the unemployed have become increasingly marginalised over the past few years, with a rising share of them having drifted into long-term unemployment or dropped out of the labour force due to discouragement about their job prospects. Many individuals encountering similar difficulties during earlier recessions left the workforce permanently. This was in part because public authorities sometimes viewed labour supply losses due to early retirement or to a switch to long-term sickness and disability benefits as a way to lower high unemployment figures. It is essential to avoid repeating that mistake by helping jobless workers to maintain contact with the labour market and to get back into employment as soon as possible. It is also important to ensure that the skills and motivation of jobless workers, especially those who are young and not in education, are not degraded through prolonged spells of unemployment, as this would be detrimental to their future earnings and employment prospects.

Active labour market programmes that work must play a key role…

Firstly, a comprehensive package of effective re-employment services must be available for the unemployed through private and public employment services. Considerable hiring continues despite high labour market slack, and job-search assistance should remain the first line of support for many unemployed, especially those who are job-ready. However, employers are at present very selective in their hiring strategies, making it very difficult to place some job seekers into jobs quickly. Training programmes and even publically subsidised work-experience programmes can help prevent this latter group from becoming demoralised, while preparing them to take advantage of new job opportunities when labour market conditions improve. Targeted job subsidies for new hires by employers which are tied to a *net* increase in jobs should also be considered rather than across-the-board reductions in payroll taxes, which are likely to be less cost effective. For youth, there is a need to expand or create "study and work" programmes, such as apprenticeships and other dual vocational education and training programmes. Since the number of job seekers requiring these intensive services has risen in the wake of the crisis, it is important to target programmes carefully on the most disadvantaged groups in the labour market and, when feasible, temporarily expand funding levels for the most cost-effective active labour market programmes (ALMPs).

… and should be adequately funded, even in countries where fiscal consolidation requires overall cuts in public spending.

New analysis in this report shows that OECD governments scaled up ALMP spending more strongly following the onset of the financial crisis than in earlier recessions, probably due to their fuller appreciation of the need to retain an activation stance even during a deep recession. However, these spending increases were modest in scale and the resources available per unemployed job seeker have declined by 21% on average (in real terms) across the OECD between 2007 and 2010. This suggests that ALMP spending should generally be spared when implementing broad spending cuts as part of current, short-term fiscal consolidation packages.

Automatic expansions of active and passive labour market programmes during recessions should be given serious consideration…

More generally, serious consideration should be given to redesigning both active and passive labour market programmes so that they automatically expand and contract in response to cyclical variations in the number of job seekers. For example, the *OECD Employment Outlook 2011* analysed how Canada adjusts the maximum benefit duration in its unemployment benefit system (Employment Insurance) with the state of the business cycle, allowing those who become unemployed during a recession to receive more months of benefits at times when it is more difficult to find a new job. Similarly, in Denmark and Switzerland, ALMP expenditures adjust automatically to changes in the level of unemployment. Once the current recovery is better established, the usefulness of a wider adoption of such business-cycle-contingent measures should be investigated urgently.

… but this would require tackling capacity constraints to expanding ALMPs during recessions.

Increasing ALMP spending during a recession is only useful if it is possible to scale up quickly cost-effective re-employment services. Unfortunately, very little is known about how feasible it is to expand these services while maintaining quality standards. It will thus be useful to carefully evaluate how effective the recent expansions have been, including the use of partnerships with private employment agencies to more rapidly expand the capacity to deliver employment services under performance-oriented contracts.

Policy makers should also consider undertaking structural reforms to improve labour market resilience to future adverse shocks.

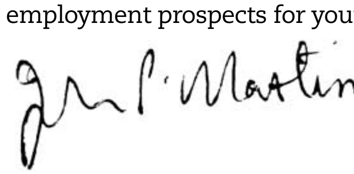
Even though the current recovery is far from complete, it is not too early to consider how labour market policies and institutions can be reformed in order to increase labour market resilience to negative economic shocks. Indeed, the labour market has proved to be more resilient in some countries than in others during the recent economic and financial crisis. While the unemployment rate rose substantially in most OECD countries, it declined significantly in Germany and remained in the range of 3.5-5.5% in a number of other countries (Australia, Austria, Japan, Korea, Luxembourg, Netherlands, Norway and Switzerland). This report identifies structural reforms that could increase resilience, allowing higher employment and earnings levels to be sustained during future recessions. The findings are encouraging in that they suggest that some of the policies known to foster strong labour market performance in the long run, such as those highlighted in the Reassessed OECD Jobs Strategy of 2006, also contribute to greater labour market resilience to adverse shocks.

Labour market reforms will be more effective if combined with other structural reforms.

A broader package of labour and product market reforms is more likely to deliver larger overall gains in job creation and labour market performance than individual reforms. For instance, several countries have recently announced or implemented reforms to tackle labour market duality by reducing the gap in employment protection between permanent and temporary workers (Greece, Italy, Portugal and Spain). The impact of these reforms both on employment growth and on the efficiency in the allocation of labour to the most productive uses could be boosted by competition-enhancing product market reforms in sectors in which there is a strong potential for job creation, such as retail trade and professional services.

More than ever, these reforms must be pursed vigorously to reduce long-term unemployment and promote better employment prospects for youth.

This is clearly a demanding time for labour market authorities. They are confronted with a slow and uneven recovery, a growing risk of increased structural unemployment in some countries and tighter constraints on public expenditures. While the constellation of challenges sketched out above is unprecedented in some respects, policy makers need to push ahead with implementing bold structural reforms, along the lines spelled out above, together with investing in those active labour market policies that work. In this way, they can best tackle long-term unemployment, boost job creation and improve employment prospects for youth.



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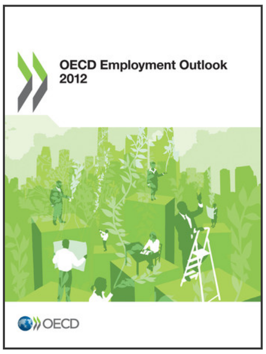

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