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Labour Market Reforms and Unemployment: Lessons from the Experience of the OECD Countries

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1. The views expressed in this article are those of the author and do not necessarily represent those of the OECD or of its Member countries.

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Introduction

The OECD labour market has undergone major changes over the past two decades. The most evident of these changes is the rise in the number of job-seekers: in 1997, there were more than 35 million people unemployed in the OECD area as a whole, some 6 million more than in the mid-1980s and almost 25 million more than in the early 1970s. These figures hide profound differences across countries. In the major European countries, unemployment has increased dramatically over the past two decades and, in some of them, including Italy, Spain and France, increases that were initially cyclical have tended to become structural over time. More recently, other countries, including Finland and Sweden have experienced drastic increases in the number of job seekers in the 1990s after a long period of low unemployment. The rather gloomy picture of many continental European economies contrasts with the experience of some non-European countries which have managed to keep unemployment at low levels (e.g. Japan) or have experienced significant reductions over the 1990s (the United States, New Zealand and, more recently, Australia). Even in Europe there are a few countries that have managed to contain the number of job-seekers (e.g. Norway) or have shown clear improvements in the recent past (Ireland, the Netherlands and Denmark).

Another key feature of the European labour market is the rise in long-term unemployment and discouragement among the job-seekers. In the EU countries as a whole, about one-third of the unemployed spend more than one year without a job. Likewise, many people of working age would like to work, but are not actively searching for a job because they have become discouraged from doing so. Indeed, the non-employment rate – the ratio of inactive and unemployed people over the entire working-age population – suggests that more than 40 per cent of those in the working-age did not work in the major continental European economies, against a quarter in Japan and less than one-third in the United States. Falls in participation rates are generally recorded at the two extremes of the working age distribution: among younger and older workers. In the first case, they are associated with increased school enrolment rates, even if the latter are partly also the by-product of poor employment prospect for teenagers and young people. For older individuals facing redundancy and insecure employment prospects, going into early retirement became an attractive alternative to maintaining a foothold in the labour market, especially in countries offering generous pension benefits.

To what extent are these marked differences in labour market performances related to different labour market policies and, more generally, labour market institutions? An impressive number of studies has been devoted to this question, but the issue is still far from being settled. The OECD countries indeed show a wide range of labour market policy strategies as well as very different institutional settings that intervene in the functioning of the market. Moreover, some studies (including OECD, 1994 and 1997*b*) suggest that the success of some economies in combating unemployment has, at least partially, been the result of far-reaching reforms, while persistently high unemployment is a signal insufficient reforms in the labour market. The *Jobs Strategy* of the OECD has, in particular, outlined the importance of simultaneous and co-ordinated actions in different areas affecting the labour market (Box 1). This is because there are synergies between different actions and because actions that affect the majority of the population are generally considered fairer than those focusing on specific areas and, often, specific social groups.

Box 1. The OECD Jobs Strategy

The 1994 *OECD Jobs Study* proposed a wide-ranging programme of action to combat labour-market imbalances and promote the standards of living in the OECD countries. The *Jobs Strategy* ensuing from this programme covers macro-economic policies, policies to improve the ability of economies to adjust and adapt to rapidly changing circumstances, and those geared to enhance the long-term growth of living standards and employment opportunities, not least by increasing and upgrading human capital, fostering entrepreneurship and strengthening innovative capacity. In particular, ten recommendations were put forward (see also OECD, 1997b):

1. Set macroeconomic policy such that it will both encourage growth and, in conjunction with good structural policies, make it sustainable, i.e. non-inflationary.

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 competencies through wide-ranging changes in education and training systems.

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

10. Enhance product market competition so as to reduce monopolistic tendencies and weaken insider-outsider mechanisms while also contributing to a more innovative and dynamic economy.

The OECD work on the *Jobs Strategy* has also revealed the importance of looking at labour market reforms from a cross-country perspective, where countries can learn from each-other and best practice could be identified. This experience may also be useful for Latin American countries. Since the early eighties, the OECD economies have been confronted with much of the same challenges facing Latin American countries today. These include changes in monetary regime and the convergence towards price stability; trade expansion and, for the European countries, trade integration with the advent of the single market; globalisation and rapid technological changes. At the same time, some of the key features of the labour market in Latin America – rising unemployment, lower employment growth, high incidence of joblessness among women and the youth etc. (see Marquez, 1998) – have characterised the OECD labour markets for almost two decades and, thus, their experience may help the policy debate in Latin America.

The purpose in this paper is two-fold: i) to describe the key labour market policy and institutional settings in the different OECD countries with a particular attention to recent reforms, and ii) to present empirical evidence on the effects of these policies and institutions on labour market performances. The following elements will be considered: i) unemployment benefit systems; ii) active labour market policies; iii) employment protection legislation; iv) collective wage bargaining systems and statutory minimum wages; and, finally, v) taxes on use of labour. Moreover, the paper discusses some of the crucial aspects of the reform strategy, i.e. wide-ranging *versus* piece-meal reforms; the role of social partners in the design and implementation of reforms; and, the timing of reforms.

The structure of the paper is as follows. Section 2 discusses recent developments in the labour market, while Section 3 provides an overview of recent structural reforms in the OECD countries. Section 4 focuses on some of the key features of the reform strategy pursued by the different countries, while Section 5 offers some concluding remarks.

2 Recent labour market developments in the OECD countries

2.1 Actual and structural unemployment

Labour-market performances have worsened in the OECD area in the course of the 1990s, with a rise in the area-wide unemployment rate from 6 per cent in 1990 to 7.3 per cent in 1997 (Figure 1). There are, however, major differences across countries. The United States has experienced a substantial reduction in the number of job seekers and Japan a continuation of relatively low joblessness rates despite the protracted period of weak economic activity. On the contrary, unemployment has increased from already high rates in most European-Union (EU) economies. Among individual countries, unemployment has risen further in Spain, Italy and France. Moreover, the number of job seekers has stood up in countries like Finland and Sweden that had previously been considered relatively immune to major labour market imbalances. Notwithstanding this overall trend, there have also been encouraging signals emerging in countries like the United Kingdom, Ireland and the Netherlands where unemployment has significantly declined over the 1990s. Moreover, significant improvements have recently surfaced in Denmark and to a lesser extent in Canada.

An international comparison of labour market conditions should consider that each individual country may be in a different position of the business cycle, and thus that actual unemployment at any point in time may significantly diverge from structural (or equilibrium) unemployment. As an illustration, Panel A of Figure 2 plots estimates of structural unemployment for a number of OECD countries in 1997. These estimates are based on the so called *non-accelerating wage rate of unemployment* (NAWRU), that is to say, the unemployment rate which is consistent with a stable growth rate of wages[2]. Bearing in mind that these estimates of NAWRU are somewhat fragile reeds, Panel A suggests that the marked differences in actual unemployment rates are largely reflected in differences in their structural unemployment rates.

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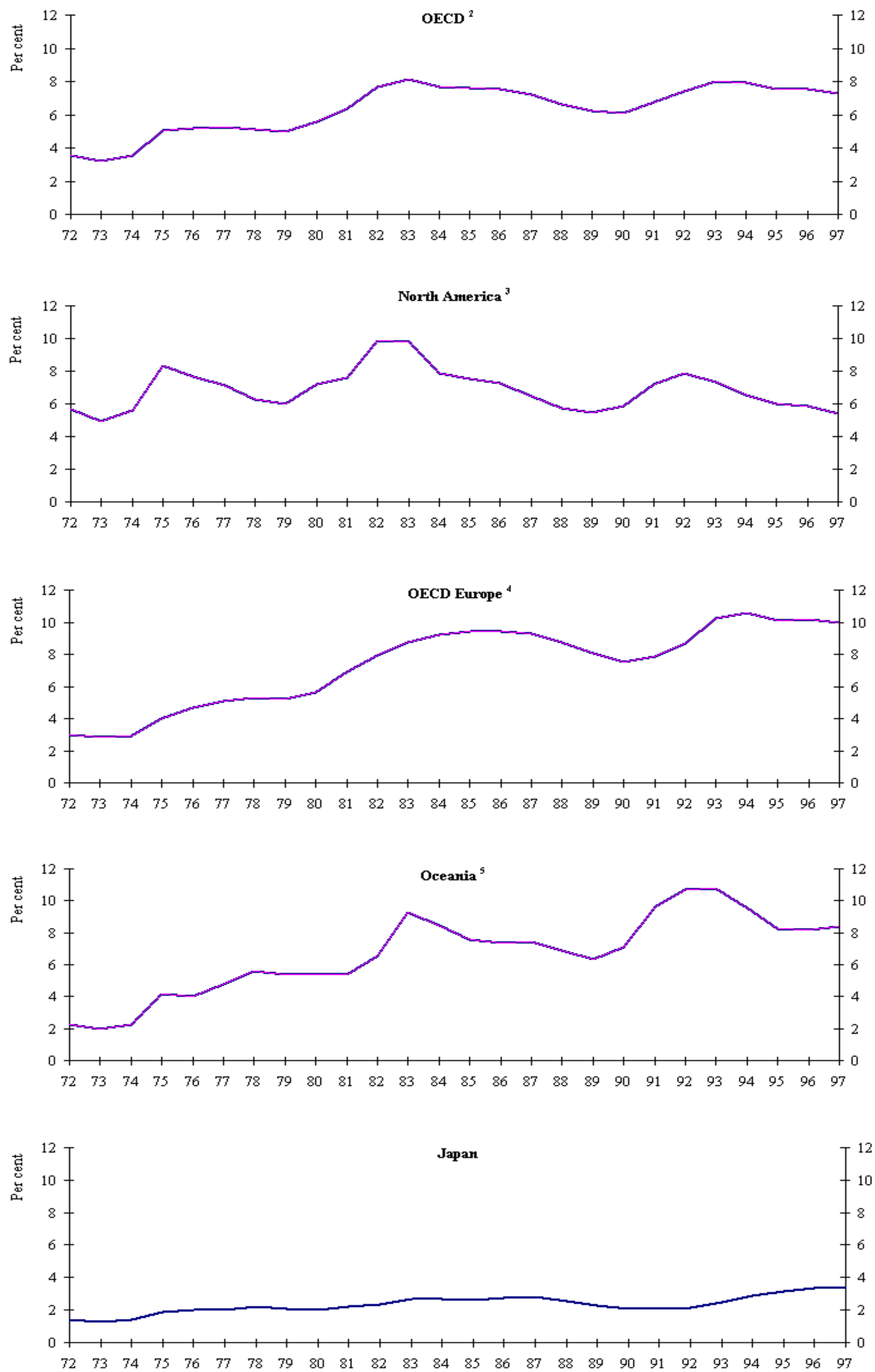
2. The estimates of the NAWRU are based on observed movements in wages and unemployment. Under the assumption that changes in wage inflation are proportional to the difference between actual unemployment and the NAWRU, the following relationship holds: $\Delta^2 \log W = -a\,(u - NAWRU), \quad a > 0$ where Δ is the first-difference operator and W and u are the wage level and the unemployment rate. Using consecutive observations and assuming that the NAWRU is constant over two contiguous observations, an estimate of α could be obtained as follows: $a = -\Delta^3 \log W / \Delta u$ From that it is possible to derive an estimate of the $NAWRU = u - \left(\Delta u / \Delta^3 \log W\right)\Delta^2 \log W$. It should be stressed that the NAWRU is, by construction, an indicator of the short-term equilibrium rate of unemployment insofar as it measures the rate of unemployment that, given the recent history of unemployment, could be associated with a stable growth rate of wages. In the presence of significant speed-limit effects and/or hysteresis, a higher (or lower) long-run equilibrium rate of unemployment could be associated with a stable wage inflation, but this rate could not be reached over one year without setting off wage inflation. See also Elmeskov and McFarlan (1993).

Figure 1. **Standardised unemployment rates in OECD regions, 1972-97**[1]



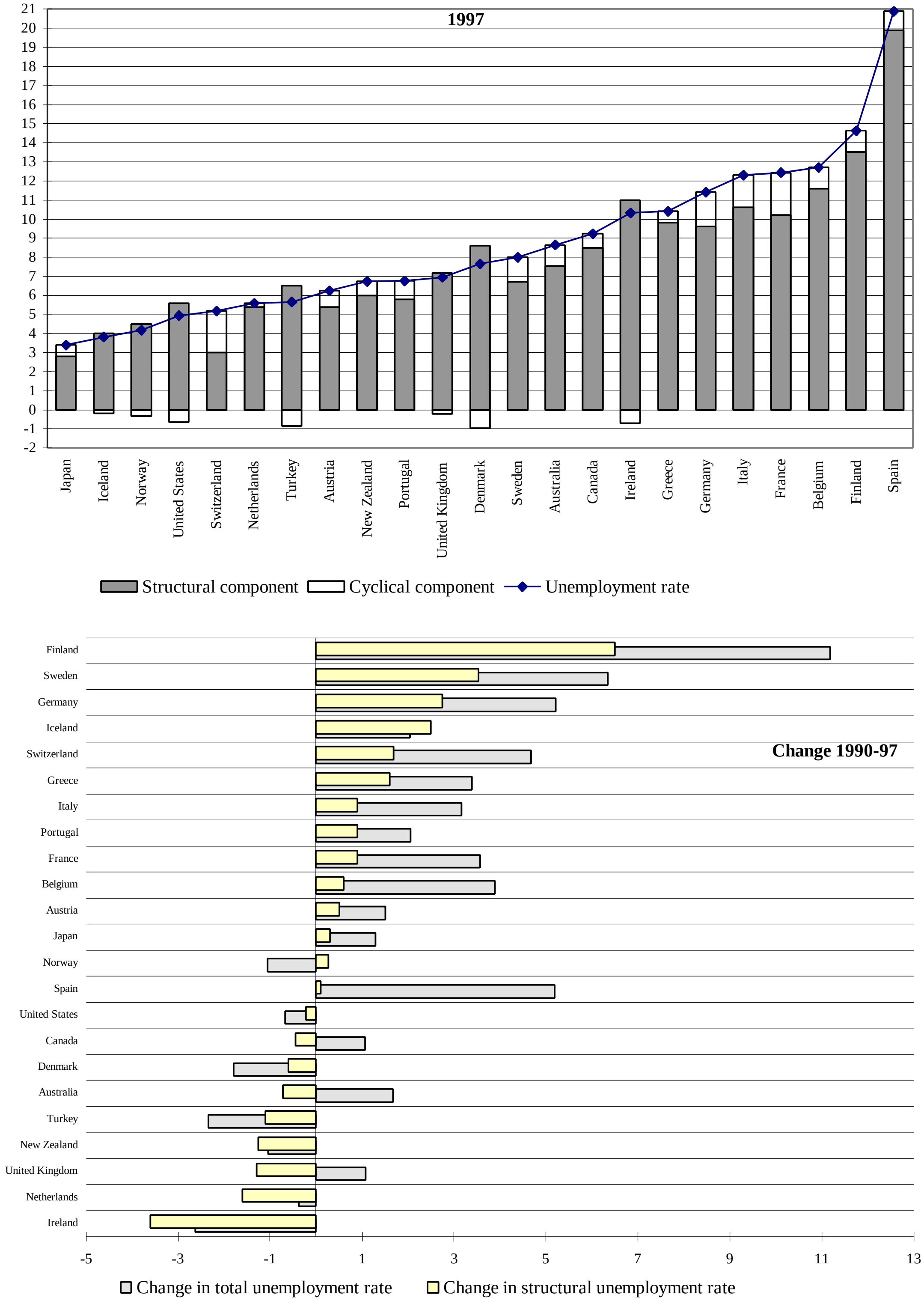
Notes:

1. Standardised unemployment rates for all countries except for Austria, Denmark, Greece, Iceland, Luxembourg and Turkey. Data for 1997 are OECD estimates.
2. Excluding Czech Republic, Hungary, Korea, Mexico and Poland.
3. United States and Canada.
4. EU15, Iceland, Norway, Switzerland, and Turkey.
5. Australia and New Zealand.

Source: OECD Labour Force Statistics.

Figure 2. **Structural and cyclical components of unemployment rates**[1]

Per cent of total labour force



1. Based on national unemployment definitions. Structural unemployment data are based on Secretariat estimates of the non-accelerating wage rate of unemployment (NAWRU) made for the OECD Economic Outlook, 60, 1996.

Source: OECD.

Panel B of Figure 2 plots changes in the NAWRU over the 1990s. Countries are ordered from left to right according to the absolute change in the NAWRU, that is, from the largest reductions to the largest increases. Most continental European countries are on the right-hand side of the panel, among the countries with the highest increases in structural unemployment. This suggests that at least part of the increase in actual unemployment in Europe is not likely to be reabsorbed in the current recovery period but will arguably require structural reforms.

The most encouraging recent development in the OECD area has been the success of countries like the United Kingdom, Ireland, the Netherlands and New Zealand in curbing their structural unemployment rates. Ireland experienced the largest reduction, although from a very high figure. In continental Europe, the Netherlands offers another promising example of a successful combat against unemployment: from being one of the countries with the highest rate of joblessness in the early 1980s, it managed to bring it down to substantially below the OECD average. On the opposite side of the world, a comprehensive reform strategy in New Zealand has offset part of the increase in unemployment that took place until the early 1990s.

2.2 Who are the unemployed in the OECD countries

There are a number of common features in the OECD countries concerning the incidence of unemployment across different population groups (Figure 3):

- *Youth* unemployment rates are generally positively associated with aggregate unemployment rates: the higher the aggregate unemployment rate, the higher the youth unemployment rate. The level of youth unemployment is, however, generally higher than the aggregate unemployment rates, with the exception of Germany -- where the access to work of young workers is facilitated by the existence of widespread apprenticeship schemes – as well as in Australia and Denmark.

- *Unskilled workers* generally face a much higher incidence of unemployment than other groups in most OECD countries. There is also a tendency for the greatest gap between unskilled unemployment and aggregate unemployment to be found in countries with relatively lower aggregate joblessness.

- *Women* are disproportionally affected by joblessness in several countries including Greece, Spain, Belgium and Italy.

- Joblessness has also a clear *regional dimension*, notably in some Southern European countries (Spain and Italy) where the very low unemployment rate of certain regions coexists with extremely high rates in others.

- The incidence of *long-term unemployment* (those without a job for 12 months or more) in total unemployment is particularly large in Europe outside the Nordic countries, and particularly so in the countries estimated to have the highest structural unemployment rates.

These basic features of unemployment incidence have remained broadly unchanged during the 1990s, with changes in the overall structural unemployment rate generally being followed by changes in the same direction of the structural unemployment rates for disadvantaged groups. For example, the countries with falling overall structural unemployment have (with only a few exceptions) experienced a reduction in long-term, youth, and female unemployment rates, and even the unemployment rate for the unskilled has declined in two of them. However, the reduction in group-specific rates has often failed to decline as much as the overall structural unemployment rate, as improved labour-market conditions have, in the first instance, been concentrated on the most employable of the structurally unemployed. The evolution of group-specific unemployment rates has been more disparate in countries with constant or increasing overall structural unemployment, partly reflecting the differences in targeting of labour-market interventions on vulnerable groups[3].

2.3 Under-employment and broad unemployment rates

The unemployment rate is by far the most used, and perhaps the most reliable, indicator of labour market performance. However, it does not capture all forms of labour market slack. In the OECD countries, certain workers would like to work more hours (or full-time) but could not find such jobs. Others are available to take up work but not actively looking for it - and hence are not classified as unemployed[4]. The inclusion of these two elements in the count of labour market slack does not, however, offer a markedly different picture of cross-country disparities in labour market performances[5].

In many, especially European, countries there has also been a distinct increase in the number of job-seekers enrolled in active labour market programmes and often excluded from the count of unemployment. This creates a problem in the count of the "real" unemployment problem: increasing expenditures for - and participation in – active programmes will tend to reduce observed unemployment without any effective change in the joblessness problem. Moreover, the downward bias is likely to increase in recessionary periods when unemployment increases because more job seekers will involved in active programmes. There are significant cross-country differences: unemployed participant inflows into these programmes range from less than one per cent of the labour force in Japan and Luxembourg, to more than 10 per cent in France, Denmark, Finland and Sweden[6].

2.4 Employment dynamics

Employment performance has been a key determinant of changes in structural unemployment. With the notable exception of the United Kingdom, where the growth in private sector employment has not fully compensated the decline in public-sector employment, all countries with falling structural unemployment have experienced solid employment gains. These gains were in most of the cases due to the growth of private-sector employment. At the other end of the spectrum, the rise in structural unemployment in most of continental Europe can largely be explained by the severe contraction of private-sector employment (Figure 4).

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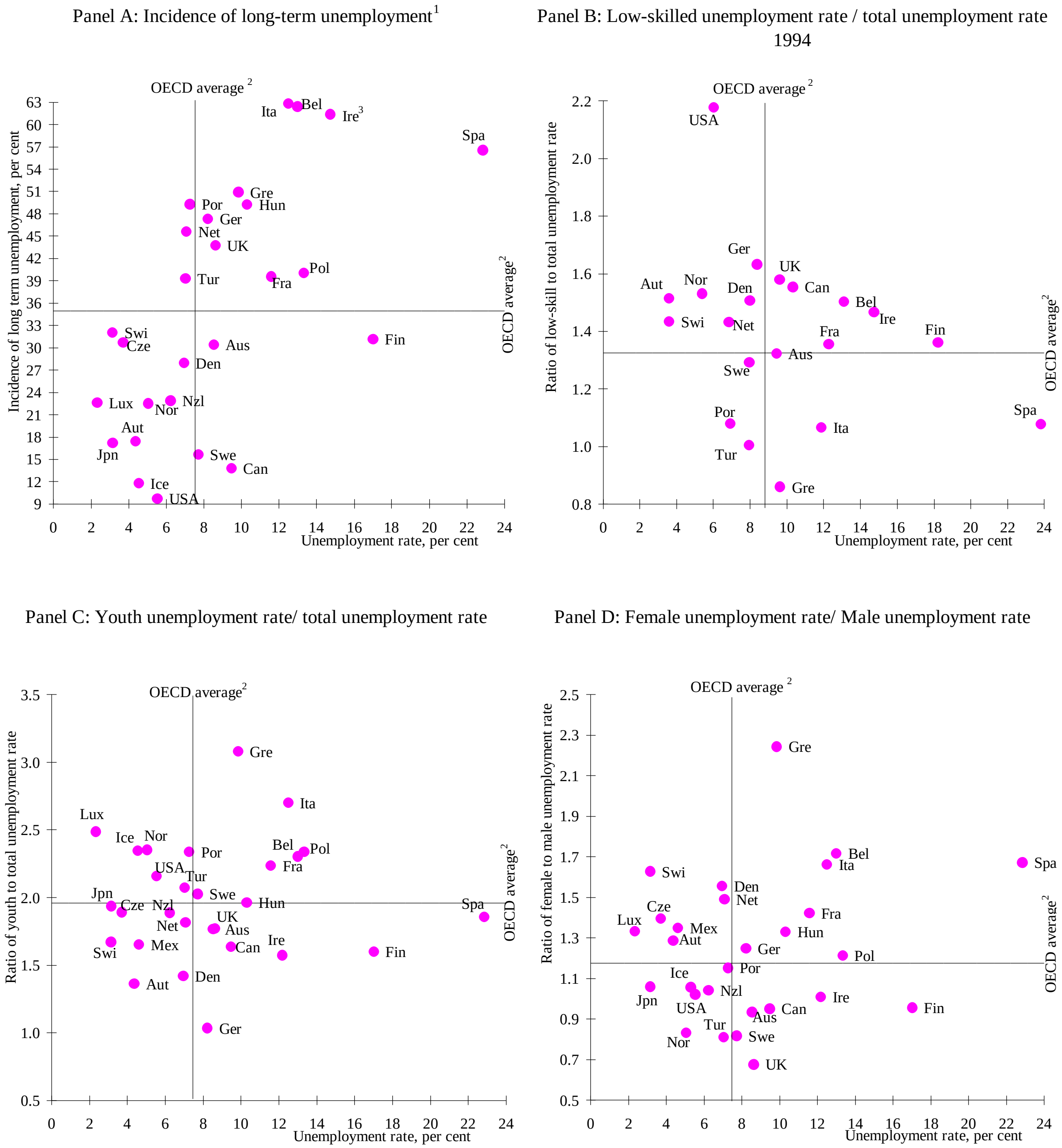
3. For example, unemployment spells are broken in several of the countries registering constant or rising structural unemployment rates (e.g. Belgium, Sweden and Finland), as the unemployed are offered jobs or training to prevent long-term unemployment. Also, labour-market policy directed at youth and the low-skilled could reduce the incidence of unemployment among these groups without affecting the overall structural unemployment due to substitution effects.

4. As a proportion of the labour force, available measures of involuntary part-time and discouragement indicate that the magnitude of overall labour market slack may be 2 to 9 percentage points above that measured by the traditional unemployment rate. In the OECD area as a whole the proportion between involuntary part-time workers and discouraged workers is one to four. Only in Japan, there are many more discouraged workers than involuntary part-time workers. See OECD, Employment Outlook (1995).

5. The correlation between the unemployment rate and the broader measure including involuntary part-time and discouraged workers was 0.84 in 1993. See also OECD, *Employment Outlook*, 1995.

6. Available information on unemployment flows also point to large cross-country disparities: in Finland and Sweden more than half of those who leave the unemployment register move into an active labour market programme, while the proportion is close (or below) 20 per cent in Germany, Italy, United Kingdom, Austria and the Netherlands.

Figure 3. **Incidence of unemployment among various social groups, 1995**



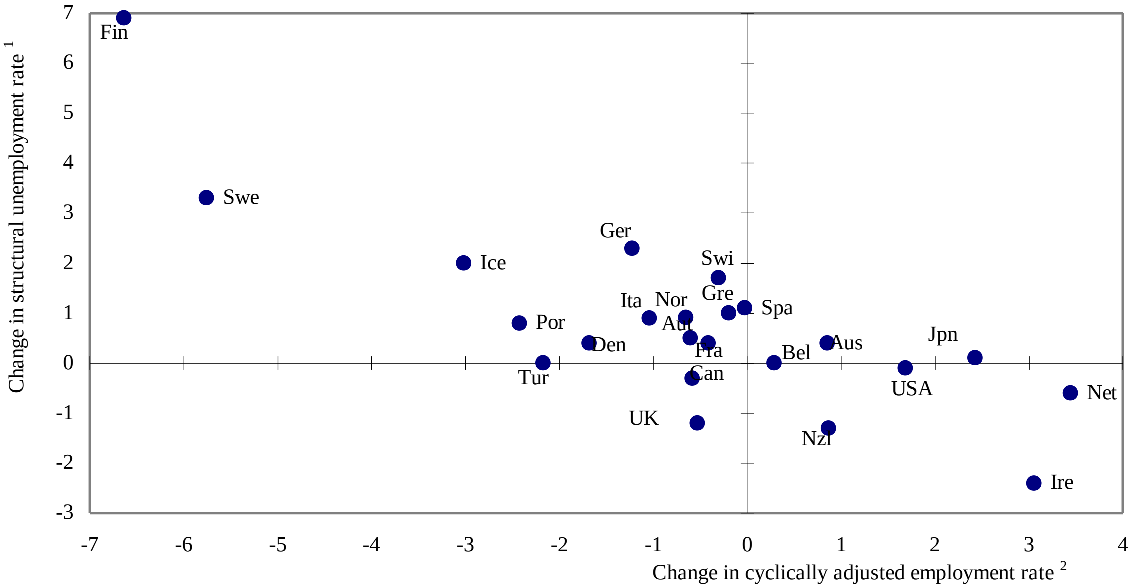
Notes:

1. The incidence is defined as the number of long-term unemployed (12 months and over) as a per cent of the total unemployed.
2. Weighted average of the countries reported in the figure.
3. 1994

Source: OECD Labour Force Statistics; *OECD Employment Outlook*, 1996; *OECD Education at a Glance*, 1996.

Figure 4. **Change in structural unemployment and employment rate, 1990-95**

Percentage points



Correlation coeff.= -0.8

t-statistic= -6.1

2.4.1 The rise in atypical jobs

The nature of jobs created in the labour market has changed over time and across the OECD countries. For example, the incidence of atypical forms of work, i.e. part-time jobs and temporary jobs, has increased in some countries while remaining broadly stable in others. A few clear patterns can, however, be identified:

– There seems to be some correlation between the increase in temporary contracts, structural unemployment and the tightness of labour market regulations on hiring and firing (see below). Thus, the share of temporary employment in total employment ranged from 2 per cent in the United States (almost no restrictions on labour force adjustments), to almost 34 per cent in Spain (the country with the most rigid employment protection regulations for permanent contracts, see below). Moreover, in France, Italy and Spain, three of the European countries with high structural unemployment, the use of these arrangements has grown significantly over the past decade, partly compensating for the fall in permanent employment. Recent evidence for Sweden also suggests that temporary employment contracts have somewhat contained the overall drop in employment. However, the incidence of fixed-term work has also increased sharply in some of the countries posting solid employment gains in the 1990s (Australia and Netherlands), but others (e.g. Ireland) have experienced only modest increases in the incidence;

– The rapid development of part-time employment seems to be the result of different forces. It responds to the wish of a growing number of individuals to reconcile work with other activities, including child-care. In this context, the rise in part-time jobs has gone hand-in-hand with higher participation of women in the labour force, particularly in the Netherlands where activity rates for women increased by more than 15 percentage points over the past decade and almost two-thirds of all female employment work currently part-time. The rise in part-time contracts also reflects the desire of firms to increase their overall labour flexibility, notably more flexible working-time arrangements. As stressed above, part-time employment is sometimes involuntary in the sense that workers accept them it in the absence of full-time alternatives, but this explanation seems generally to account for only a small proportion of part-time jobs.

2.5 Participation rates

Most OECD countries have experienced an increase in participation rates over the past decade (Figure 5), with the most notable increases being posted by some of the countries with low and/or falling structural unemployment. On the contrary, deteriorating labour market conditions in the Nordic countries led to increased discouragement and flows out of the labour forces, thereby reducing participation rates, though they remain among the highest in the OECD area.

The most notable changes in participation rates for different groups include:

- Male participation rates have continued to decline, while female participation rates have generally remained on an upward trend over the past decade (Figure 5) and are strongly related to changes in the incidence of part-time and temporary-works;

- Participation rates for younger workers have fallen over the past decade. This is associated with increased school enrolment rates for teenagers and young people, which seems also to be influenced by the difficult labour market conditions for this group. The relationship between labour market conditions and participation rates for the youth has become even more evident in the 1990s when the largest drops in participation have occurred in Europe and in particular in those countries with rising structural unemployment[7];

- Older workers have experienced further drops in participation rates. This is closely related to the availability -- and generosity -- of early-retirement possibilities embedded in the old-age pension system or in various income-support programmes intended for, or used by, older workers.

3. Structural reforms and the labour market

How did structural reforms contribute to the observed labour market evolutions over the past decade? The following sub-section briefly describes recent reforms in the OECD countries under the headings of passive and active labour market policies, employment protection legislation, and taxes on labour use and labour market institutions[8].

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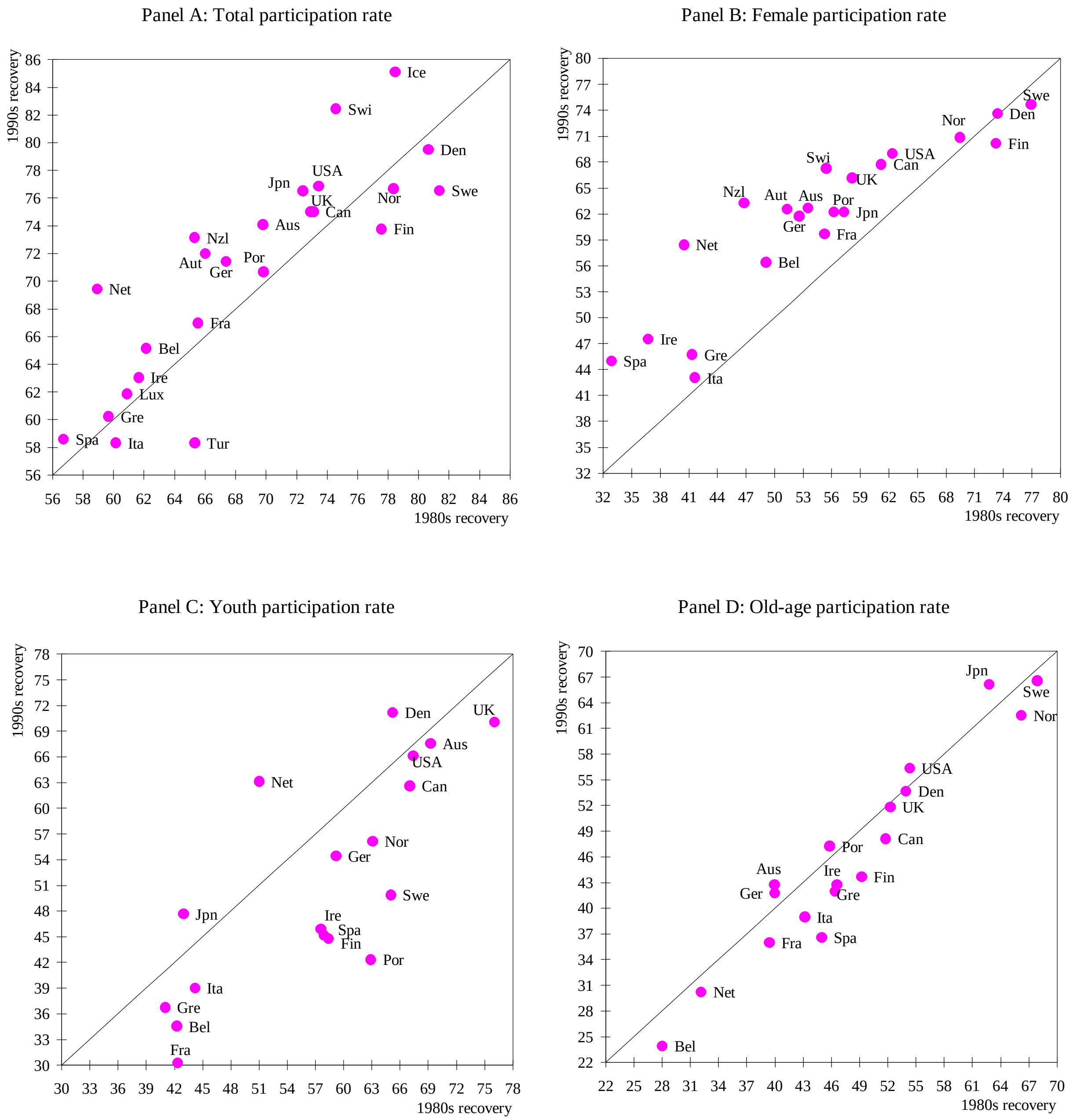
7. Participation rates for the youth fell also in the United Kingdom, despite the decline in structural unemployment. However, these rates were in 1995 still among the highest of the OECD countries.

8. For complete surveys of recent empirical studies on the determinants of structural unemployment, see Bean (1994) and Nickell and Layard (1997). Alogoskoufis *et al*. (1995) discuss the European unemployment problem in details.

Figure 5. **Participation rates by gender and age in the two last recovery periods**[1]

Per cent of relevant population group[2]



Notes:

1. Data shown for the different countries refer to the average of the first two years following a trough. The troughs are identified on the basis of the OECD estimates of output gap. See Giorno et al. , 1995 for details on the estimations of the output gap.
2. Panel A: Population of working age; Panel B: Female population of working age; Panel C: Population between 15-24 years; Panel D: Population between 55-64 years.

Source: OECD Labour Force Statistics ; *OECD Employment Outlook* , various issues.

3.1 Labour market policies: recent reforms

3.1.1 Unemployment benefit systems

Unemployment benefits respond to the need to prevent sudden drops in living standards of workers affected by a lay-off. By providing an income support, these benefits help the unemployed to search for a suitable job instead of accepting the first job offer at hand, thereby fostering the matching between labour demand and supply. Unemployment insurance benefits (UI) -- and social assistance schemes available upon termination of UI -- generally respond to these objectives, even if there are major differences in the levels of benefits, their maximum duration and the eligibility conditions. As shown in Table 1, the replacement rates are in some countries extremely high, while in others only a small fraction of the previous wage is replaced by unemployment benefits[9].

Table 1. **Unemployment benefit systems, recent developments** [1]

	Beneficiaries (% of total)[6]		"Generosity" of unemployment benefits, synthetic indicator[2]			Initial replacement rate[3]	Maximum duration
			gross rates		net rates		
	1990	1995	1985	1995	1995	(UI)[4]	(UI)[4]
Australia	..	..	22,6	27,3	31	=	=
Austria	61	57	30,2	25,8	..	43%→36%	=
Belgium	77	82	44,1	41,6	59	=	=
Canada	83	52	27,9	27,3	47	60%→55%	=
Denmark	83	84	54,0	70,3	81	=	2.5y→5y[5]
Finland	51	51	34,7	43,2	59	54%→61%	=
France	54	54	34,1	37,5	55	57%→53%	=
Germany	41	49	28,2	26,4	54	40%→37%	=
Greece	53	50	7,9	22,1	..	=	=
Ireland	26	22	28,2	26,1	37	41%→32%	=
Italy			0,3	19,7	19	15%→33%	=
Japan	36	39	9,9	9,9	45	=	=
Netherlands	46	73	51,9	45,9	69	=	2y→1.5y
New Zealand	..	..	30,9	29,8	34	=	=
Norway	94	98	38,8	38,8	62	=	=
Portugal	11	25	21,7	35,2	..	=	=
Spain	21	17	34,6	31,7	49	80%→70%	=
Sweden	57	66	27,2	27,3	67	90%→75%	=
Switzerland	99	71	21,9	29,5	62	80%→70%	250d→520d
United Kingdom	18	21	22,2	18,1	51	=	12m→6m
United States	33	36	15,0	11,8	16	=	=

1. UI = unemployment insurance benefits.

Gross benefits divided by gross wages

1. Benefit entitlements before tax as a percentage of previous earnings before tax. Data shown are averages over two income levels, three duration categories and three types of family circumstances. See Martin (1996) for further information and comparison with other indicators of generosity. The index does not take into account social assistance at the regional or local level. Nor does it take account of possibilities for the unemployed to re-qualify for unemployment benefits through participation in active labour market measures.
2. The figures refer to replacement rates in the first 3 months of joblessness for unemployed persons with a dependent spouse.
3. In countries with no UI, the figures refer to guaranteed-income schemes.
4. The extension of statutory duration was accompanied by limits on the possibility for re-qualification for UI benefits via participation in active labour market programmes, so effective limits on duration may have been tightened.

Source: OECD Database on Unemployment Benefit Entitlements and Replacement Rates*; OECD Economic Surveys*.

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9. The replacement rates reported in the table are simple averages of replacement rates relative to individuals with different earnings (two-thirds of the average, average earnings and 2 times the average), a different duration of the unemployment spell (1-5 years) and a different family status (single, married with dependent spouse, married without dependent spouse). Thus reported figures cover a wide spectrum of possibilities and consequently offer a better picture of the overall generosity of the UB systems than those based on the initial replacement rates and/or the maximum duration of benefits. See Martin (1996) for details about the calculations of these replacement rates.

Overly generous benefits may have a negative impact on the labour market that more than compensate the positive effects for the individuals concerned. They may indeed raise the reservation wage and thus create a disincentive to an active job search. At the same time, generous benefits may increase the pressure on wages, thereby leading to a higher equilibrium unemployment, because trade unions will be less prone to bargain wage moderation against higher employment levels. Empirical evidence seems to support this point. Scarpetta (1996) found out an elasticity of unemployment with respect to the OECD summary measure of benefit entitlements of about 0.4, a value that is broadly in line with other aggregate analyses of unemployment as well as with micro studies on unemployment duration (see amongst others, Meyer, 1995; Holmlund, 1997).

There have been only limited changes in unemployment benefit replacement rates in the OECD countries over the past decade. As shown in Table 1, significant increases in the average replacement rate occurred in Denmark, Finland, Greece, Portugal and Switzerland because of increases in the maximum duration of benefits. Only three countries show drops in the replacement rates: in Austria and the Netherlands because benefits were not raised in line with increases in wages, and in Ireland which moved from an earning-related system to a flat rate system. Moreover, Sweden reduced the initial replacement rate from 90 per cent of the previous wage to 75 per cent.

Eligibility conditions represent another important aspect of the unemployment benefit systems and a number of countries, while leaving intact the replacement rates, have strengthened these conditions in order to improve the targeting of the systems. Thus, Belgium, Canada, Denmark, Finland, France, the Netherlands and Spain have increased the contribution period required for the benefits. Other countries have raised the minimum age of fruition, excluded workers who have quit their job or excluded the possibility of re-qualifying for the benefits through a period of training or other active programs (Denmark, Finland, Norway and Switzerland).

There is some evidence that tighter eligibility criteria may lead to lower structural unemployment. For example, Layard *et al.* (1991) suggest that the significant decline in the number of registered unemployment in the United Kingdom in the mid-1980s could be in part attributed to the tightening of eligibility conditions and, in particular, active search requirement introduced in 1986 in that country. Along the same lines, Abbring *et al.*(1995) reported a marked increase in the flows from unemployment to employment in the Netherlands after the strengthening of sanctions against those not actively searching for a job.

3.2.2 Active labour market policies

The origin of active labour market policies in the OECD area dates back from the sixties. First introduced in Sweden and in the United States, they were conceived as a means to remove bottlenecks in short term adjustments. Specific needs and constraints conditioned the timing and intensity with which other OECD countries responded to the initiative. In the seventies and eighties, as unemployment became a more pervasive problem, active labour market policies received a greater attention in most OECD countries.

Active labour market policies are generally designed to meet three main objectives: i) mobilising human resources; ii) training and retraining the labour force; and iii) improving job opportunities of disadvantaged workers such as the long-term unemployed who have lost contact with the labour market or displaced workers. These objectives materialise on the supply side, where active programmes provide training, counselling and job placement; and on the demand side, where active programmes offer subsidies and incentives that reduce the burden of economic adjustment for enterprises. Furthermore, since unemployment hits with unequal intensity different groups of the population (see above), the need for social equity becomes more pressing. In this context, an optimum combination of efficiency and equity goals is considered a paramount challenge for active labour market policies.

The OECD experience offers a number of lessons concerning the effectiveness of different active programmes in curbing unemployment and addressing equity goals[10]:

- *Employment training programmes* open to all unemployed and not targeted on specific labour market needs are generally very expensive and offer low or insignificant returns. An issue often debated in the OECD countries is whether training is more effective on-the-job or off-the-job. In the most recent past, several countries have more clearly opted for the first option, that is, work experience and practical job training. Leaving aside cost factors, this choice seems to the based on the assumption that the generally low skills of the long-term unemployed is, amongst other things, a signal of their negative reaction to direct training in the education system and that a direct involvement of these persons into a job-training scheme may increase the motivation and confidence in the programme;

- *Job search assistance* and intensified counselling do raise considerably re-employment probabilities for the unemployed in general, and the disadvantaged groups in particular. Indeed, in a number of countries there has been a distinctive move towards this approach of selective measures focusing on the most disadvantaged unemployed during the last decade[11]. In some countries, for example, employment offices have adopted special procedures to make sure that long-term unemployed are involved in different kinds of in-depth actions. Specific interviews are designed to address the unemployed towards an active approach in the labour market and in most of the cases these interviews are obligatory after a given duration of unemployment[12]. When not focusing on self-help, interviews with the long-term unemployed are used to identify specific training requirements and to adjust existing active labour market programmes to their specific needs;

- *Subsidies to employment* are generally not effective in helping the unemployed to get permanent jobs in the private sector. The positive impact they have on employment is generally accompanied by high costs. In particular, there could be *"dead-weight"* costs when participants would have obtained a new job anyway, but also costs due to *"substitution effects"* in all cases when the genuine job impact (i.e. for participants who would not have found employment without the help of these schemes) is obtained at the expense of other job seekers. In general, broadly targeted programmes appear to suffer from very high dead-weight costs, while the narrow targeting ones suffer more from the substitution effects. However, they may help the individuals to keep in contact with the labour market, thus maintaining their motivation and skills. For equity reasons, they may also be intended to provide the long-term unemployed with jobs even if this is at the expenses of the short-term unemployed;

10. See also OECD (1997a); Calmfors (1994); Calmfors and Skedinger (1995).

11. In some countries, after the first generic contact with staff of the offices further interviews are organised with specialists. These interviews generally focus on counselling and advice ranging from how to improve the job search, to the definition of training needs and to measures to overcome disability. These activities focus on self-help, like the "job clubs" in Australia, France, and the U.K., or the "job finding clubs" in Canada or the "help yourself groups" in Austria. In other countries, training centres provide short courses with a similar purpose, like in Ireland with the "job search courses" and in Denmark with "labour market introduction" courses.

12. These interviews have different names: "Newstart" in Australia, "Restart" in the Netherlands and the U.K. or the "13th month interview" in France.

- *Direct job creation in the public sector* has also been of little help in moving the unemployed into permanent jobs because they generally offer jobs with low marginal productivity and thus do not raise the attractiveness of participants for private employers. These schemes may, however, be used as a work test and as a means of helping the unemployed maintain contact with the labour market. To that end, they should be short in duration and not become a disguised form of permanent employment;

- *Aid to unemployed starting enterprises* appears to be successful for a small group of highly motivated individuals.

Table 2 shows the average annual expenditure (as a share of GDP) for active labour market programs in the OECD countries over the past decade. There are significant differences in the overall commitment of countries to active policy as well as in the orientation among the different schemes. Expenditure for active policy has generally increased over the past decade, not least because of the increase in unemployment. Indeed, expenditure per capita (the unemployed) has often declined because expenditures have not kept pace with the rise in the number of job seekers. In terms of orientation, there has been a tendency towards training and counselling activities, while employment subsidies have been somewhat contained.

Table 2. **Spending on active labour market policy: evolution over the 1985-1995**

(as per cent of GDP and as per cent of total expenditure for ALMP)

	Total expenditure for active programs (% of GDP)		Labour offices[1]		Training[2]		Employment Subsidies[3]		Direct job creation[4]		Other schemes[5]	
	1985[6]	1995[7]	1985[6]	1995[7]	1985[6]	1995[7]	1985[6]	1995[7]	1985[6]	1995[7]	1985[6]	1995[7]
Australia	0,4	0,7	26	27[6]	5	23[6]	17	8[6]	29	18[6]	23	24[6]
Austria	0,3	0,4	39	35	32	32	7	5	4	8	18	19
Belgium	1,2	1,4	14	17	9	21	0	9	64	42	13	12
Canada	0,6	0,6	38	34	54	57	0	0	3	4	5	5
Denmark	1,1	2,3	7	5	47	43	1	2	0	20	45	30
Finland	0,9	1,6	9	10	30	28	4	7	42	34	15	21
France	0,7	1,2	19	14	37	38	9	4	0	11	35	33
Germany	0,8	1,3	26	17	25	29	6	5	15	23	28	26
Greece	0,2	0,4	38	42	14	19	24	19	5	0	19	19
Ireland	1,6	..	11	..	42	..	6	..	6	..	35	..
Italy	0,5	..	18	..	13	..	0	..	0	..	69	..
Japan	0,2	0,1	19	27	19	27	56	45	6	0	0	0
Netherlands	1,1	1,1	7	16	17	15	2	1	4	8	70	59
New Zealand	0,8	0,7	12	17	11	49	5	14	69	6	3	13
Norway	0,7	1,4	18	13	17	17	3	7	29	10	33	53
Portugal	0,4	0,7	19	15	51	30	2	0	7	1	20	53
Spain	0,3	0,7	26	13	6	49	35	17	29	7	4	15
Sweden	2,1	3,0	12	9	24	26	5	9	15	18	44	38
Switzerland	0,2	0,5	45	21	5	17	0	2	0	17	50	43
United Kingdom	0,7	0,5	19	40	13	25	4	0	26	2	38	34
United States	0,3	0,2	25	35	43	20	3,5	5	3,5	5	25	35

1. Expenditures for public employment services and administration.
2. Training: Labour market training.
3. Subsidies: Subsidies to regular employment in the private sector,
4. Job creation: Direct job creation (public or non-profit).
5. Other: Youth measures, support of unemployed persons starting enterprises, and measures for the disabled.
6. 1990/91 for the United States, Japan, United Kingdom, Canada, Australia, New Zealand and Sweden; 1991 for France.
7. 1994/95 for the United States, Japan, United Kingdom, Canada, Australia, New Zealand and Sweden; 1994 for France, Belgium, Greece and Portugal.

Source: *OECD Employment Outlook* (various issues).

Empirical evidence on the overall impact of active programmes on aggregate unemployment in mixed. Scarpetta (1996) suggest a small and often not statistically significant effect on unemployment. These results are in contrast with those of Layard et al. (1991) and Nickell and Layard (1997) who found a somewhat more significant impact, but are consistent with a number of studies based on micro data. However, empirical results are suggestive of a greater impact of active policy on employment rates (Scarpetta, 1996), confirming that these policies could have a positive effect on labour force participation by keeping otherwise discouraged workers in the labour market. Moreover, the results suggests that there is not a linear relationship between spending on active programmes and the impact on unemployment, but rather there are declining returns to scale[13]. Too generous active policy may do more harms than good because they may displace many jobs. Job displacement may occur for at least two reasons. First, active programmes may increase unions' resistance to wage moderation in the face of shocks when active programmes reduce the income loss associated with open unemployment. Second, job search may be weakened if programmes fail to improve employability and skills.

3.1.3 Employment protection legislation (EPL)

Almost all OECD countries have employment protection regulations that limit the freedom of firms to hire and fire workers. These regulations govern unfair dismissals, restrictions on lay-offs for economic reasons, compulsory severance payments, minimum notice periods and administrative authorisations. By reinforcing job security, these regulations may enhance productivity performance, as workers will be more willing to co-operate with employers in the development of the production process. Long-term employment relations may also encourage employers in providing training to workers with potentially beneficial effects of human capital and labour productivity. However, if these regulations are very strict, as it is the case in many European countries, firms may become more cautious about adjusting their workforce with the ultimate effect of reducing labour turnover – movements from employment to unemployment and from unemployment back to employment (Bertola and Rogerson, 1997). Moreover, strict regulations may affect the structure of employment by indirectly promoting atypical labour contracts (see above) which offer firms the work force flexibility they would not have otherwise enjoyed, but which may act to consolidate insider power (Bentolila and Dolado, 1994).

As expected, empirical evidence (Scarpetta, 1996; Nickell and Layard, 1997) suggests that stricter EPL regulations are related to lower short-term unemployment and greater long-term unemployment and Bertola (1992) pointed out the negative effects of EPL on employment turnover. Moreover, Lazear (1990) and Scarpetta (1996) pointed to a negative impact of strict EPL on participation rates and Nickell and Layard (1997) to a positive impact on productivity growth. There is somewhat less consensus as to the overall impact of EPL on unemployment and employment levels.

Even if there are marked differences in the strictness of EPL in the OECD countries, there has been a tendency towards less constraining hiring and firing practices. In particular, there has been some relaxation of the employment protection in the case of individual and/or collective dismissals in Italy (1991), Portugal (1989, 1991) the United Kingdom (1993), Spain and, more recently, in Germany and the Netherlands. This seems to have resulted in a drop in the share of firms who perceive EPL as a constraint on workforce adjustment (Table 3).

13. In Scarpetta (1996), the empirical results of the effects of active labour market expenditure on unemployment were strongly affected by the inclusion of Sweden in the country panel. In particular, the exclusion of this country implied a stronger (and statistically significant) negative impact of active programmes on unemployment. This result could be explained by the fact that Sweden has both extremely high expenditures for active labour market programmes (four times the OECD average in the past decade) and a level of unemployment which, albeit low until recently, is comparable with those of countries which spent much less on ALMPs.

The increase in atypical job contracts has also *de facto* helped employers in coping with stringent EPL, thereby reinforcing the dichotomy between workers with standard (i.e. permanent full time) contracts and the other workers who often bear the brunt of labour market flexibility. Thus, temporary contracts have often increased in the OECD countries reducing firing costs for the firms. Spain and Italy have, for example, recently allowed temporary work agency to operate and Belgium and Finland allowed the renewal of temporary contracts with the same employer. The increase in part-time employment may also have *de facto* reduced the impact of rigid EPL, since in some countries part-time workers do not enjoy the same degree of protection as their full-time colleagues.

Table 3 **Employment protection legislation**

	Share of employers considering hiring-/firing practices as very important or important (a)				***OECD index of stringency of EPL (b)***
	All companies		*Companies with more than 500 employees*		
	1989	***1995***	***1989***	***1995***	***1989***
Belgium	57	67	51	67	10,5
France	62	57	62	57	9,5
Germany	63	62	59	66	12
Greece	55	57	75	80	11
Ireland	50	62	58	46	2,75
Italy	78	49	80	48	14,25
Netherlands	71	48	76	39	7,25
Portugal	54	33	..	36	12,5
Spain	68	65	60	66	11,25
United Kingdom	44	25	55	35	2,25
average	60	53	64	56	

1. The question in the 1994 survey was: Are the following reasons for not employing more people very important, important or not (so) important? Insufficient flexibility in hiring and shedding labour,..." The question in the 1994 survey was: "Are the following reasons for not employing more people in relation to output very important, important or not (so) important? Insufficient flexibility in shedding staff, ...".

Source: *OECD (1997), " Implementing the OECD Jobs Strategy: Member Countries' Experience", Paris.*

3.2.4 Non-wage labour costs

The OECD Jobs Study stressed that high taxes on labour might spread onto labour costs, with potentially short and long-term effects on employment. The extent to which this occurs depends upon the functioning of both product and labour markets. If markets are imperfect and workers are able to resist offsetting wage cuts, an increase in taxes on labour may result in lower employment[14]. The bargaining strength of trade unions is important in this respect, as it is the ability of firms to pay wages

14. Among others, see Tyrväinen (1995) for empirical simulations of the effects of tax increases under alternative assumptions about the degree of competition in labour markets. Daveri and Tabellini (1997) have also suggested that the impact of the tax wedge on unemployment may vary according to the degree of centralisation of wage bargaining. In continental European countries with intermediate levels of centralisation of the wage bargaining process (i.e., at the sectoral level) the effects of the tax wedge are stronger because wages do not adjust enough. On the contrary, in both highly centralised and decentralised countries, wages react more to changes in the tax wedge.

in excess of market-clearing levels which, in turn, depends upon the degree of competition in the product market. Moreover, an increase in taxes may be particularly detrimental to the employment prospects of certain categories of workers, such as low-paid workers, but not for others. For example, in the case of low-paid workers, employers may not be able to reduce wages to compensate for an increase in social security contributions if binding wage floors are established by statutory minimum wages, negotiated wage floors or high reservation wages induced by social welfare provisions.

There is no consensus as to the effects of tax wedge on the labour market. A number of studies (including Nickell and Layard, 1997) suggest a temporary negative impact of an increase in the tax wedge on employment but, as soon as the wage adjust to the new level of taxes, the negative employment effect is reabsorbed. This result is also confirmed by a study on wages and employment at the micro level in Chile (Gruber 1997) who suggests that wages adjust completely to changes in the taxes on labour. However, Daveri and Tabellini (1997) and Elmeskov, Martin and Scarpetta (1998) have suggested that the impact of the tax wedge on unemployment may vary according to the degree of centralisation of wage bargaining (see below). In continental European countries with intermediate levels of centralisation of the wage bargaining process (i.e., at the sectoral level with lacking co-ordination) the effects of the tax wedge are stronger because wages do not adjust enough. On the contrary, in both highly centralised and decentralised countries, wages react more to changes in the tax wedge.

Table 4 presents the evolutions of the tax wedge – including employees' and employers' social security contributions and income taxes – for an average production worker. There is an enormous variation in the tax wedge across the OECD countries stretching from below 25 per cent of the gross wage (Australia, Japan, Iceland and New Zealand) to values greater than 45 per cent in a number of European countries (Denmark, Germany, Italy, the Netherlands and Sweden). As shown in the table, some of the countries with high taxes on labour have recently implemented reforms. Thus, the tax wedge declined significantly in Ireland, Norway, the Netherlands and the United Kingdom, while only Germany significantly raised the tax wedge in Europe.

Since they have a direct impact on labour costs, at least in the short term, social security contributions have often be the target of reforms (third and fourth columns in Table 4). Belgium, Finland and France reduced employers' contribution rates, but the fiscal position of these countries meant that other taxes had to be raised to offset revenue losses, thereby producing negligible overall effects on the tax wedge. Social security contributions were lowered for low-productivity workers in France, Belgium and Ireland. Among the OECD countries, Italy and Greece are the only two that have raised social security contributions by more than one percentage point.

3.2 Institutional factors

*3.2.1 **Unions and the wage bargaining process***

The wage setting process can play a crucial role in determining labour-market conditions. In countries where wages are predominantly set *via* collective bargaining, wages may remain above market clearing levels despite the adverse consequences on employment. However, these effects may be moderated, or even reversed, in contexts of fully centralised wage bargaining or when there is a high level of co-ordination among employers and among unions.

One of the key element characterising industrial relations is the union density (the proportion of workers who are members of trade unions). Over the past three decades there has been a generalised tendency for a decline in the degree of unionisation, especially in some European countries where in the 1970s the large majority of workers were members of trade unions (OECD, Employment Outlook - 1997).

Yet, the degree of unionisation is not *per se* sufficient to identify workers' market power. In many countries, the administrative extension of wage agreements means that the terms and conditions of union contracts often cover workers who are not union members. By the same token, high union power in one sector can lead to spillover effects in non-union sectors.

Table 4. **Tax wedge and social security contributions**[1]

In per cent of gross wages

	Total tax wedge		Employers' social security contribution rate	
	1985	1994	1985	1994
Australia	22,9	23,5	0,0	0,0
Austria	40,3	39,7	18,6	19,1
Belgium	54,2	53,5	28,8	25,8
Canada	26,9	31,4	4,7	6,2
Denmark	47,8	45,2	2,8	0,0
Finland	38,0	39,4	5,7	3,6
France	43,4	43,6	27,5	26,2
Germany	44,5	48,3	14,5	16,3
Greece	31,4	..	17,9	21,6
Iceland	16,5	22,9	2,1	2,8
Ireland	42,4	38,4	10,9	10,9
Italy	50,0	49,9	29,9	31,5
Japan	21,6	21,6	6,8	7,0
Luxembourg	38,4	35,1	13,3	13,0
Mexico	..	26,5	15,2	16,2
Netherlands	49,9	45,6	19,2	7,3
New Zealand	27,9	24,3	0,0	0,0
Norway	41,8	36,9	13,5	11,3
Portugal	30,7	34,3	16,7	19,7
Spain	36,6	38,8	23,8	24,0
Sweden	50,9	46,8	24,0	23,2
Switzerland	28,8	28,7	9,4	9,3
Turkey	37,0	35,7	8,3	6,7
United Kingdom	37,8	33,3	9,5	9,3
United States	33,6	31,2	6,6	7,1

1. Total tax wedges include income taxes, employer and employee social security contributions, but not indirect taxes. Tax rates refer to one-earner without dependants and take into account standard tax relief.

Source: OECD, *Tax/Benefit Position of Production Workers* (various issues).

The degree of centralisation of wage bargaining is an important characteristic of industrial relations. A highly centralised wage bargaining system may allow the economy to respond in a more consistent way to adverse shocks than decentralised systems in which different groups/sectors/companies negotiate separately over wages (Tarantelli, 1986; Bruno and Sachs, 1985). However, Calmfors and Driffill (1988) have stressed that the relationship between centralisation of wage bargaining and wage outcomes is not linear, but rather *hump-shaped*[15]. This implies that both highly centralised (co-operative) bargaining structures -- such as those in Austria and the Nordic countries -- and fully decentralised (competitive) structures (United States) offer the best results. In an intermediate

15. However, the hump-shaped hypothesis has also been criticised. See in particular Soskice (1990) and the OECD (1997c).

(i.e. neither highly centralised nor highly decentralised) system -- as in many EU countries -- bargaining units are strong enough to generate dis-employment effects, but at the same time, each unit is vulnerable to other units' wage strategies without being able to influence these strategies. Especially in intermediate systems, the degree of co-operation between employers on the one hand and among trade unions on the other hand may be crucial for the labour market. Even if wages are negotiated at different bargaining tables, the co-ordination between the social partners ensures that possible externalities are taken into account and the system mimics highly centralised systems.

In the OECD countries only the New Zealand has introduced major reforms to the industrial relations legislation in the early 1990s which have radically changed the wage formation process. The *Employment Contract Act* abolished the exclusive right of trade unions to represent workers at the bargaining table and eliminated preferential treatment of union members as well as the possibility of carrying out secondary strikes. The act also abolished the long-standing award system, which had extended sectoral wage agreements to third parties. The immediate effect of this major reform was the drop in union density from 45 per cent to 30 per cent and a large contraction in the number of workers covered by sectoral wage agreements. Australia has also implemented reforms in this are since 1988 banning compulsory unionism and preferences to union members in employment. Contrary to New Zealand, a simplified award system has been maintained to guarantee a safety net of fair minimum wages and conditions. The United Kingdom has continued over the 1990s the reform process initiated in the mid-1980s. For example, closed shops and secondary picketing were banned, and greater legal responsibilities were imposed on unions for their actions. Moreover, employers can now choose not to recognise unions and bargain with individuals directly.

In the continental European countries reforms in the industrial-relation system have generally been more gradual, maintaining bargaining among the social partners as the key element of wage determination, but trying to improve co-ordination among the different levels of negotiation (national, sectoral, firm level). For example, in Italy social partners agreed in the context of the 1993 income-policy agreement to reinforce the co-ordination between the sectoral and firm-level bargaining processes. In Italy and Denmark there has also been a tendency towards a decentralisation of wage determination, with the nation-wide agreement only fixing the basic wage increases. In Belgium, wage increases determined at the sectoral levels became subject to limits negotiated at the central level, while the latter were constrained by prospective average wage increases in three neighbouring countries. Moreover, in countries like Germany and Spain, firms in difficulty can benefit from the opt-out clauses, even if such clauses are rarely used in the former because they require approval by higher level associations.

3.2.2 Minimum wage

In a number of OECD countries, wage setting also depends upon minimum wage arrangements, which are designed to bring living standards of the lowest paid workers to some minimum acceptable level. In 15 OECD countries, the government sets minimum wages unilaterally or following recommendations by a tripartite body. In a number of other countries, collective agreements at the national or sectoral level set effective minimum wages for unionised workers and, in some cases, such agreements are administratively extended to cover whole sectors of activities.

The level of the statutory minimum wages -- relative to some measure of the average wages – varies substantially across the OECD countries. When expressed relative to the mean wage of full-time workers, the statutory minimum wage tended to be highest in Belgium and France in 1996 and the lowest in the Czech Republic, Korea and Spain (Figure 6). One way to assess the effectiveness of the statutory minimum wage as a distributional policy tool is to look at its impact on the incidence of low pay and poverty. The effect of the minimum wage on earnings distribution -- and ultimately on the incidence of low pay -- depends on how wage rates above the minimum react to changes in the statutory wage floor. If spillover effects are important, the introduction of a minimum wage -- or an increase in the existing minimum -- may have a limited impact on the incidence of low pay, as old wage differentials will be restored. However, empirical evidence for some OECD countries suggests that spillover effects from increases in the minimum wages are limited and, consequently, changes in the minimum wages may indeed have an impact on low pay[16]. This is also corroborated by cross-country correlations between the level of the statutory minimum wage relative to the average wages and the incidence of low pay: countries with a relatively high minimum wage tend to have a lower incidence of low pay.

While there is some consensus on the equalising effects of the minimum wages on the distribution of wage earnings and working household income (i.e. household with at least one member in paid employment), there is little evidence suggesting that statutory minimum floors help reduce poverty[17]. This is because, a significant proportion of low-paid workers live in relatively well-off families and, at the same time, a substantial proportion of poor families in many OECD countries do not have any adults in work.

Moreover, the positive effects of the statutory minimum wage on the incidence of low pay needs to be assessed against its effects on employment, which ultimately depend upon the distribution of skills and experience across the labour force and the level at which the minimum wage truncates the wage distribution. These effects should also be seen in a dynamic perspective. The introduction of a minimum wage may increase the supply of labour with possible substitution effects across low-paid workers, i.e. more workers may enter the labour market and displace employed workers with relatively lower qualifications[18]. Likewise, high levels of the minimum wage may have detrimental effects on product market competition. Insofar as new firms offer wages that are below the sectoral average, the introduction of a minimum wage may create an implicit barrier to entry in low-pay industries, thereby reducing competition.

Empirical evidence on the sensitivity of employment to the minimum wage is not clear-cut. Low levels of the minimum wages are found to produce ambiguous effects on aggregate employment, while there seems to be a clearer consensus of the negative effects of high levels of the minimum on the employment prospects of low-productivity workers. Thus, in the United States -- where the Federal minimum wage is relatively low compared to the median wage and has tended to decline over time in relative terms due to the lack of indexation-- empirical studies do not suggest any significant impact on employment. By contrast, empirical evidence of the French minimum wage (SMIC) -- which is high relative to the median wage – points to a significant negative impact on youth employment and, in some

16. In particular, DiNardo et al. (1996) suggested that declines in the Federal minimum wage relative to average wages in the United States contributed significantly to the raise in male earnings inequality over the 1980s. Card and Kreuger (1995) also suggested that the increase in the Federal minimum in 1990 and 1991 may have contributed to reducing earnings inequality. Dickens et al. (1994) found that the minimum wages set by the Wage Councils, prior to their abolition in 1993, had a significant equalising impact on earnings distribution.

17. Card and Kreuger (1995) did not find any significant impact of changes in minimum wages on poverty in the United States. Gosling (1996) stressed that the introduction of a national minimum in the United Kingdom would have resulted in a very small reduction in poverty rate if all households were taken into account. Machin and Manning (1996) reported a significant equalising effect of a statutory minimum wage on the income distribution of employed households, but a smaller equalising impact on the income of all working-age households.

18. In Spain, the statutory minimum wage those aged 16 and under was raised to the level for those aged 17 in 1990. As a consequence, the employment rate of teenagers dropped significantly, while that of young workers (20-24 years of age) rose (Dolado *et al.*, 1996). In France, it has been estimated the recent reduction of social security contributions on low wages (up to 133 % of SMIC) could have produced 75 000 more jobs at the SMIC, but at the expenses of job losses estimated at 20 000 among those with higher wages, due to substitution effects. See Conseil Supérieur de l'Emploi des Revenues et des Coûts, "L'Allègement des Charges Sociales sur les Bas Salaires- Rapport au Premier Ministre", Paris 1996.

cases, on overall employment[19]. Hence, the choice of the level of the minimum wage as well as of its adjustment with age is crucial in the design of the statutory minima.

4. Different approaches to structural reforms

As described above, most OECD countries have implemented labour market reforms in the recent past. Yet, the coverage and intensity of reforms vary a great deal across countries, which explains why only in a few of them have the effects of the reforms clearly emerged in the labour market. There are a number of elements that should be taken into account when trying to relate structural reforms and labour market developments. These include: i) the intensity of the reform strategy; ii) the coverage of reforms; and iii) the time elapsed from the introduction of reforms to the observation of their potential impact on the labour market.

4.1 Similarities in the reform strategy

As stressed in OECD (1997*b*), there are a number of similarities in the reform strategy pursued by the four countries that have the most progressed in the combat against unemployment. At the time when major reforms were introduced, all of them faced serious economic disequilibria that urged immediate and serious actions. Macroeconomic stabilisation measures were also considered as an integral part of the reform strategy. Despite alternative successes, by 1997 the four countries posted relatively low inflation (below 2 per cent in Ireland, Netherlands and New Zealand), general government balances either in surplus (Ireland and New Zealand) or with a deficit of less than 2.5 per cent of GDP (United Kingdom and the Netherlands).

The wide scope of the reform package is another common aspect of the reform strategy in the four countries as well as in Canada and Australia. Not only have the reforms affected many elements of the labour market, but they have also been accompanied by measures aimed at fostering competition in the product market *via* deregulation and the privatisation of state enterprises in the United Kingdom, the Netherlands and New Zealand. Thus, wage moderation -- which has generally been a component of the labour market adjustment process -- has translated into lower prices rather than higher producers' rents.

As stressed by Coe and Snower (1996), labour market policies and institutions have complementary effects on the labour market and thus reforms in these areas are also complementary. In this context, the wide-ranging dimension of reforms in the United Kingdom, the Netherlands, New Zealand, and, more recently, Canada and Australia has most likely been a key determinant of their success in curbing unemployment and improving overall labour market conditions. The beneficial effects stemming from the complementarity of reforms have also been accompanied by a relatively greater support from the population at large and workers in particular. By changing legislation on industrial relations, social security, employment protection or other areas affecting most workers -- including those who play a dominant role in the wage bargaining process -- the reforms were more powerful than those in continental European countries that typically affected people at the margin, with very little impact on core groups.

19. There is also a fairly significant relationship between the level of the minimum wages relative to the average wage and the incidence of employment at (or below) the minimum. Thus, in the United States in the mid-1990s (and Canada in the mid-1980s) around 5 per cent of full-time workers had their wage at or less than the statutory minimum. On the contrary, in France more than 10 per cent of employees in the private and semi-private sector, excluding agriculture, were receiving wages at the level of the SMIC.

4.2 *The role of social partners*

A central issue dividing the reform strategy has been the involvement of social partners in the design and implementation of reforms. The Netherlands and Ireland carried out their reforms through a consensual process, which was considered as vital for their successful implementation. In Ireland, several aspects of the reforms were subject to a formal trilateral bargaining between unions, employers and the government (and recently extended to cover other 'outsiders' such as representatives of the unemployed). These tripartite agreements typically committed the government to some action, including tax reduction in a framework of sound fiscal policy, in exchange for moderate wage demands.

In the Netherlands, the 1982 tripartite agreement (Wassenaar) determined a protracted period of wage moderation (real wages have remained practically stable over the past 15 years); a reduction of statutory minimum wages, especially among young workers; a greater flexibility in working time arrangements, including a reduction in the weekly working hours and greater possibilities for part-time jobs. Subsequent reforms allowed temporary contracts and private temporary work agencies. Moreover, the governments engaged in a reduction in taxes on labour and capital and employers have accepted further improvement in product market competition.

By contrast, reforms in the United Kingdom and New Zealand were not implemented through a formal process of consensus and the unions were largely excluded from the process. As stressed above, in both countries, an important part of the reform programme involved far-reaching changes in their industrial-relations systems that left little scope for consensus. Notwithstanding the fact that some groups have faced adjustment costs, reforms met with considerable acceptance by the general public, and in both countries there has been little political support for wholesale reversal of them.

4.3 *Timing of reforms*

It takes time before the beneficial effects of structural reforms surface in the labour market. Workers and firms have to adapt to the new conditions set by the reforms and there might be short-term adjustment costs. Thus, it is not surprise that the countries that have shown the most evident signs of improvement in their labour market conditions (Ireland, the Netherlands, the United Kingdom and New Zealand) are also those that introduced major reforms in the mid- to late-eighties. In the most recent period, Australia, Denmark, Canada, Italy and Spain have also introduced important policy reforms, and, at least in the first two countries, these reforms have already manifested their positive effects on the labour market.

The time lag required for structural reforms to produce beneficial effects on the labour market underlines the importance of stable macroeconomic conditions. Over the past decade, countries that managed to minimise macroeconomic fluctuations have avoided strong increases in actual unemployment and estimated structural unemployment. On the contrary, those with large fluctuations in unemployment have also experienced stronger increases in unemployment, as part of the increases, which were initially cyclical, have become structural. Greater fluctuations may generate a climate of uncertainties which could lead to higher cost of capital and reduced incentives for engaging in productivity-enhancing innovation activity. Moreover, such an environment may reduce the scope for wage moderation. In this context, it has been argued (OECD, 1997*b*) that the United Kingdom and New Zealand may have not experienced a reduction in structural unemployment as early as the scope of their structural reforms would have suggested because cyclical fluctuations increased over the past decade. Along the same lines, the large fluctuations in unemployment in Spain over the past decade led to a rise in structural unemployment despite the significant reforms undertaken. In contrast, stabilisation measures in Netherlands, together with labour market reforms, have both gone in the direction of reducing structural unemployment.

5. Concluding remarks

This paper presented an overview of labour market conditions in the OECD countries and shed light on recent structural reforms. Labour market conditions vary a great deal across the OECD countries and the discrepancies have increased over the past decade. Most countries have undertaken actions, but the coverage and intensity of reforms has been disparate.

In countries like the United States, Japan and Norway, existing policy settings prevented a significant deterioration in labour market conditions in the first place, and no major reform was required. In other, mainly European, countries labour market conditions have further deteriorated with a rise in structural unemployment and low participation rates. Yet, only the United Kingdom, Ireland, Netherlands and New Zealand have undertaken wide-range structural reforms over a sufficient long time to make a significant impact on structural unemployment. More recently, Canada and Australia have carried out substantial reforms, though the results have only very recently started to surface in the labour market.

The experience of countries that have succeeded in curbing unemployment suggests that results generally lag behind the introduction of reforms and, consequently, the reform process needs to be pursued consistently for a long period to bear fruits. Noteworthy, pursuing a wide-ranging approach to structural reforms is likely to bring better results than concentrating in a few areas because it allows exploiting synergies. Moreover such an approach insures that both the benefits and inevitable short-term costs of adjustment are widely shared among the population and do not discriminate against a few groups. There are also significant differences in the way structural reforms have been implemented in the different countries, reflecting each country' initial conditions as well as the institutional setting and national traditions.

There are a number of lessons that can be drawn from empirical evidence on the role of different labour market policies on unemployment. And recent reforms implemented in the OECD countries can be seen under this perspective:

- The "generosity" of income support schemes is an important factor in explaining cross-country differences in structural unemployment. Unemployment benefits that are overly generous in terms of either the duration or the level of support tend to raise reservation wages and lengthen the duration of the unemployment spells. Recent experience from the OECD countries has been disparate: some of them have raised benefit levels and/or lengthened their maximum duration, while others have reduced either one or the other aspect of the system. In a number of cases, actions have focused on eligibility, availability or willingness-to-work requirements as well as rules concerning temporary layoffs.

- There is little evidence that active labour market programmes significantly improve labour market conditions, although well targeted measures may help groups with specific needs. Over the recent past, expenditure for active policy has generally increased, not least because of the increase in unemployment. Recognising the need for well-targeted measures, there has been an orientation towards training and counselling activities, while employment subsidies have been somewhat contained.

- Strict employment protection rules tend to reduce employment turnover and the supply of vacancies and, according to some studies, led to higher structural unemployment and, especially, lower participation rates. Accordingly, there has been a tendency towards less constraining hiring and firing practices in a number of OECD countries, even if in some of them reforms focused on temporary contracts, leaving intact the protection for permanent workers.

- High taxes on labour use might be reflected in labour cost developments with adverse effects on employment in the short and, potentially, the long run. There are wide differences in the average tax wedge across the OECD countries and recent reforms have not reduced these disparities. Some countries have taken actions to reduce high marginal tax rates on low incomes, while others, mainly English-speaking countries, have taken measures to reduce unemployment traps through the use of employment-conditional benefits.

- Empirical evidence emphasises the importance of wage flexibility in reducing unemployment. Aggregate wage flexibility tend to neutralise adverse shocks to aggregate labour demand, while relative wage flexibility helps attaining better matching of labour demand and supply across different groups. This is an area where the experience of OECD countries has varied the most. Major steps towards decentralised wage bargaining have been made in New Zealand and Australia, while a number of European countries have pursued tripartite wage agreements but have in some cases tried to improve the co-ordination between the different levels of bargaining (i.e. national, sectoral and firm level). Significant reductions in statutory minimum wages relative to the average wage have taken place in some European countries, and others have reduced non-wage labour costs for low-wage workers.

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