International Organisation of Employers
Organisation Internationale des Employeurs
Organización Internacional de Empleadores
*The Global Voice of Business*

POLICY BRIEF

# INTERNATIONAL ORGANISATION OF EMPLOYERS

## JOBS & GROWTH: LINKS AND CHALLENGES

# Introduction

FINANCIAL MARKETS HAVE RECOVERED FROM THE 2009 CRISIS, AND OVERALL ECONOMIC ACTIVITY HAS ALSO EXHIBITED SIGNS OF RECOVERY, YET EMPLOYMENT OUTCOMES CONTINUE TO SHOW LITTLE IMPROVEMENT IN MANY COUNTRIES IN ALMOST EVERY REGION OF THE WORLD.

Countries are experiencing one or both of two situations: the number of additional jobs created during a period of economic expansion is insufficient to absorb the number of new entrants to the labour force; and/or the rate of growth in jobs for a given rate of output growth is slower than previously experienced. This is sometimes referred to as "jobless growth".

Regardless of the label, the experience of many economies is that the rate of employment growth fails to keep pace with that of GDP growth, i.e. GDP growth is not strong enough to stimulate significant and rapid job creation. This affects both new entrants and the long term unemployed. New entrants are unable to find a job, and may be tempted or forced into the informal economy. When job opportunities are scarce and/or jobs on offer are of poor quality, high-skilled individuals risk wasting their talents in positions for which they are overqualified. Long-term unemployment can lead to skill depreciation, loss of motivation and withdrawal from the labour market. The stigma associated with long spells of joblessness also makes it more difficult for affected workers to return to work and progress their careers. There is growing evidence that in countries that saw the biggest increases in cohorts of long-term unemployed, cyclical increases in unemployment have become structural and therefore more difficult to reverse during the economic recovery.

This situation gives rise to two main challenges: creating job opportunities for entrants to the labour market, and returning those previously unemployed to productive activities such as training, education and employment. This IOE policy brief aims to examine the reasons for slow employment growth and to review the set of instruments that can be used as a basis for policies aiming to stimulate significant job-led growth.

# Factors behind slow employment growth

TRADITIONALLY, AS DOMESTIC CONSUMPTION RECOVERS AFTER A RECESSION, JOBS ARE CREATED TO MEET THE INCREASED DEMAND FOR GOODS AND SERVICES.

In turn, the increased employment drives further demand increases in a virtuous circle. However, recent evidence suggests that this relationship is no longer automatic. There are three main reasons behind the apparent breakdown in the relationship between job creation and domestic consumption:

1. Cyclical factors: growth itself might be slow and recovery moderate. This creates a substantial time lag in translating the benefits of economic growth into tangible gains in employment.
2. Structural rigidities: factors in the economy that restrict employment expansion and/or create obstacles to the creation of jobs.
3. Structural change: previous activities may no longer be competitive and so unable to re-employ people. The new growth may be in sectors that are less employment-intensive, either because of the nature of the sector itself or as a result of technological change or heavier capital investment.

It is important to understand the underlying reasons for the failure of output growth in the economy to create jobs at a pace sufficient to clear the labour market in order to identify the proper policy tools to use. Incorrect diagnosis of the problem will not only fail to address it; it may create unanticipated additional problems that might be even more difficult to resolve.

The following sections deal with the factors that can cause slow employment growth. These are illustrative; the key point is that only by a careful analysis of the factors will it be possible to implement policy actions that will have the desired effect.

## 1. CYCLICAL FACTORS

If demand recovers only slowly, job creation will be slowed and delayed. This appears to be a central feature of the current situation in many countries. It is important to understand why demand is recovering slowly. For example, recoveries such as the one which followed the 2009 global financial crisis typically take longer (seven years) and the pace is slower because households and companies have high levels of debt they must pay down before they feel confident increasing spending. During this time, businesses are reluctant to hire and may not even bring back laid-off employees, thereby leading to lower or at best stable employment rates. In addition, an atmosphere of uncertainty may stall investments that could promote enterprise growth and employment. Seven years after the 2009 crisis, in many countries the performance of the labour market vis-à-vis the economy as a whole has largely followed this typical pattern. Whether this performance continues and whether an economy will face a prolonged period of weak labour market conditions is unknown. However, empirical evidence from the US and the UK suggests a stronger employment-growth trajectory can re-emerge.

## 2. STRUCTURAL RIGIDITIES

There may be factors in an economy that make it more rigid and less able to respond to different circumstances. These can include: the size and state of development of the country; the strength and quality of public institutions; the resource endowment; the state of the labour market; the geographic location. Several of these are discussed below.

### *i. Regulatory framework*

All economies require a policy framework of law and regulation, but the design of this framework can help or hinder economic growth and employment. Two sets of policies with a strong influence on job creation are the regulatory framework for the establishment and operation of enterprises and the regulatory framework for the labour market.

The first is, in many countries, more cumbersome than supportive. This has been well encapsulated in the World Bank's *Doing Business* measures that rank countries according to the ease of doing business. These regulations, if properly designed, can facilitate the establishment of new enterprises and the growth of existing enterprises, both of which should result in the creation of new jobs. However, as the Doing Business report makes clear, bad policy design can frustrate the formation and expansion of enterprises.

Labour market policies can also be counter-productive in times of crisis and recovery. In periods of crisis, companies may prefer to either reduce wages of existing workers or reduce hours of work in order to retain workers and their skills. Labour laws and regulations may not give enterprises the flexibility to make these choices. If demand recovers slowly or uncertainly, enterprises may wish to minimise cost and risk by relying on part-time, seasonal, or other non-traditional forms of work, but regulations may place constraints on this response. Placing much of the burden of financing social programmes on the employment relationship may raise the cost of labour to the point where in an economic recovery it is better to invest in capital or technology than to hire additional workers.

#### *ii. Skills mismatch*

Many researchers have pointed to labour market mismatches as one of the reasons for weak employment trends. Sometimes, the skills that are demanded by employers are simply not available because the education system in the affected countries is weak or unresponsive to labour market needs. Education and training systems may not be sufficiently up-to-date to meet the demands in the new world of work which requires a new generation of workers with entirely different skills sets. It may be necessary to re-train individuals already in the labour force to fill jobs in different industries or jobs that have been changed by technological progress. Failure to diagnose and address these gaps may mean an economy will have simultaneously slow employment growth and elevated levels of unemployment and vacant positions.

#### *iii. Macroeconomic stability of the economy*

Macroeconomic conditions are important in fostering the confidence necessary to attract greater investment and growth opportunities, especially following an economic crisis. However, the current state of some countries shows that their economies are facing serious uncertainties. Political and social unrest, corruption, unreliable infrastructure, or an unstable economy may discourage investments. Many of these factors also drive individuals into the informal economy or encourage the most talented to emigrate, taking their job-creating skills with them.

### 3. STRUCTURAL CHANGE

Technological change is a key driver of long-term economic growth and has contributed to much of the recovery in many parts of the world after the 2009 crisis. Historically, the process of technological change has led to huge job destructions in some industries while creating job opportunities in others resulting in net job creation. However, today's rapid technological change appears to be polarising many national job markets with new jobs clustered in new low-skill and high-skill occupations. This phenomenon appears to be occurring in developed, newly industrialised, and developing countries. What is not known is whether the new technologies will ultimately create more jobs than before, or move the world to a different lower-employment equilibrium. Thus the current slowness in employment growth caused by technological change may be either overcome as the new positions are created, or represent a long term challenge to many societies. Either way, there will be major adjustments to be made and policies will be needed to support this adjustment.

## Tools to promote sustainable and fast employment growth

THE ABOVE SECTION EXPLAINED THAT SLOW RATES OF EMPLOYMENT GROWTH CAN BE CAUSED BY EITHER CYCLICAL OR STRUCTURAL FACTORS.

Once there has been sufficient analysis to identify the key factors in an economy that are causing this, policy makers can turn to the selection of the appropriate policy tools. These lie in a number of areas: macro instruments, market instruments, and framework instruments. However, complicating the policy analysis is that the policy instruments in these areas may be either cyclical or structural in nature. In most cases, it will also be necessary to deploy a set of policy measures, rather than a single policy change.

### 1. MACRO INSTRUMENTS

Macro instruments include fiscal, monetary and trade instruments. While the first two, namely fiscal and monetary, work primarily on demand conditions, trade instruments work on the supply-side and are structural. Fiscal and monetary instruments are most useful when addressing cyclical shortfalls in demand by stimulating household consumption and restoring the confidence of investors in the economy. Trade instruments, on the other hand, can act to provide improved access to new markets and to facilitate the importation of new capital and technology, which can further generate productivity gains and new market potentials.

### 2. MARKET INSTRUMENTS

Market instruments such as competition policy and market restrictions help establish how efficiently and effectively an economy operates. In this sense, they are mostly structural in nature. The removal of market restrictions like price supports, quotas and other regulations constraining entry into specified activities can act as a counter-cyclical policy as it lowers costs, thereby stimulating demand. Many of them act on the structure to encourage competition which should spur improvements in productivity and competitiveness. They should also facilitate the entry of new enterprises by lowering natural or policy-created barriers to entry. The use of some of these instruments to protect economic activities at certain stages of development can boost employment, but at other stages can lead to inefficiency and higher cost operations that will constrain future employment growth. Efforts to fight corruption and build capacity in public services can further induce employment growth on par with economic growth.

### 3. FRAMEWORK INSTRUMENTS

Framework instruments include education and training; rule of law and property rights; and infrastructure. Education and training is important in ensuring that the skills needs in the labour market are addressed. By making education and training systems responsive to the skills needs, one can help in reducing skills shortages and skills mismatches while also contributing to greater economic growth. The establishment of rule of law and property rights can guide an investor in making sound business decisions, for instance, when setting up his company. Clear rules around intellectual property, for instance, are essential in creating a safe environment for the innovator to be innovative without fearing theft or loss of their innovation. Finally, the right infrastructure needs to be in place to enable and facilitate labour mobility and to help businesses ease the financial burden of training.

## Conclusion

THE REAL PROBLEM OF "JOBLESS GROWTH" OCCURS WHEN THE RATE OF EMPLOYMENT GROWTH FAILS TO KEEP PACE WITH THAT OF GDP GROWTH, I.E. WHEN GDP GROWTH IS NOT STRONG ENOUGH TO STIMULATE SIGNIFICANT AND RAPID JOB CREATION.

In order to respond to this problem, one first needs to be clear as to the cause of the problem. As we have seen, this can occur as a result of cyclical and/or structural factors, which can exist within and outside of an economy. Many of these factors are policy-dependent. Thus, it is essential to have a clear understanding of the mix of factors affecting the employment performance of the economy before implementing the appropriate policy instrument. Policy instruments range between cyclical and structural; or can include both. It will thus be necessary to choose from among them carefully to achieve the right policy mix. No country can do it all at once. Through tripartite consultations, priorities can be selected that should have the best impact in the short run and contribute to long run improvements.

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labour and social policy matters at the international level.

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