

# **Generating adequate job opportunities**

**Report prepared for the  
G20 Employment Working Group**

**with inputs from  
The International Monetary Fund**

**Guangzhou, China**

**February 2–4, 2016**

## **Generating adequate job opportunities**

The starting point for the work of the G20 Employment Working Group (EWG) in 2016 under China's presidency is the set of decisions agreed upon by the G20 Leaders in late 2015. The following excerpts from their communiqué are most relevant to the present topic:

Para. 1 We are firm in our resolve to ensure growth is robust and inclusive, and delivers more and better quality jobs.

Para. 4 We reiterate our commitment to implement fiscal policies flexibly to take into account near-term economic conditions, so as to support growth and job creation, while putting debt as a share of GDP on a sustainable path. We will also consider the composition of our budget expenditures and revenues to support productivity, inclusiveness and growth.

Para. 5 Our top priority is timely and effective implementation of our growth strategies that include measures to support demand and structural reforms to lift actual and potential growth, create jobs, promote inclusiveness and reduce inequalities. ... We will also continue reviewing and adjusting our growth strategies to ensure that they remain relevant to evolving economic conditions, policy priorities and structural challenges, in particular slow productivity growth, and that they remain consistent with our collective growth ambition.

Para. 6 We are committed to ensure that growth is inclusive, job-rich and benefits all segments of our societies. Rising inequalities in many countries may pose risks to social cohesion and the well-being of our citizens and can also have negative economic impact and hinder our objective to lift growth. A comprehensive and balanced set of economic, financial, labour, education and social policies will contribute to reducing inequalities. We endorse the Declaration of our Labour and Employment Ministers and commit to implementing its priorities to make labour markets more inclusive as outlined by the G20 Policy Priorities on Labour Income Share and Inequalities. We ask our Finance, and Labour and Employment Ministers

to review our growth strategies and employment plans to strengthen our action against inequality and in support of inclusive growth.

Para. 7 Unemployment, underemployment and informal jobs are significant sources of inequality in many countries and can undermine the future growth prospects of our economies.

–G20 Leaders’ Communiqué 16 November 2015

China has launched its 2016 presidency with a priority on breaking a new path for growth and placing emphasis on outcomes, action and result-orientation. China has decided to begin the work of the EWG with a discussion of how to generate adequate job opportunities. To inform this discussion, the international organizations were asked to prepare a report that investigates practical policies and actions that can contribute to the generation of employment and ILO was asked to lead. In this spirit, and with further guidance from China, the following report covers three broad topics:

1. Pro-employment macroeconomic policies
2. Entrepreneurship for promoting employment
3. Unemployment with a special focus on youth unemployment

### **1. Pro-employment macroeconomic policies**

Seven years after the global financial crisis the G20 countries continue to face slow and uneven growth, as well as significant risks. As a result, their economies have struggled to create sufficient and decent quality jobs for all who want to work. Employment losses generated by the “Great Recession” have been only partially reversed and this has also brought concerns about human capital erosion associated with long-term unemployment and exit from the labour market. Beyond the observed slowdown of actual growth and job creation over recent years, new research also suggests that *potential* growth might have slowed down as well, and that it is expected to continue below pre-crisis rates into the medium term (IMF, 2015; Ollivaud and Turner, 2015). These new trends have ramifications not only for the G20 countries, but for other lower and middle income countries, too, particularly

those that have extensive trading relationships with countries who growth is slowing (World Bank, 2016).

Under these circumstances, China has proposed that the EWG should explore innovative approaches to break new paths for economic growth and develop pro-employment macroeconomic policy recommendations to create more and better quality jobs. The purpose of this section is to examine the range of policies that can affect growth and job creation at the macroeconomic level and suggest policies that could accelerate both going forward.

### ***Monetary policy***

Accommodative monetary policy is an important tool to support economic activity. In most G20 countries, it is oriented to achieve price stability, although in some it also targets employment. In many G20 large economies, monetary policy has been the predominant macroeconomic tool used in recent years, due to a real or perceived lack of fiscal space. Quantitative easing has helped in confronting the zero lower bound on interest rates and continued accommodative policies are much needed to continue supporting demand. However, in the current situation of weak aggregate demand at the global level, accommodative monetary policy has not produced the increase in investment needed for a strong recovery and also faces the challenge of the zero lower bound on interest rates in many economies. Further, given different points in the recovery of large economies, monetary policy setting will vary across the G20 in the foreseeable future and this is likely to cause unintended disruptions. Sudden swings in exchange rates and capital flows may further harm recovery in adversely affected economies, as well as in their key trading partners. In sum, there are limits to the potential of monetary policy to stimulate sustainable and quality job creation in most of the G20.

### ***Fiscal policy***

Given the limits and risks of continued over-reliance on monetary policy, greater use of fiscal policy would seem appropriate in many economies. However, increased levels of debt led many governments to choose to engage in fiscal consolidation despite the failure of their economies to fully recover from the crisis. This explains in part the continuing weakness in global aggregate demand. G20 Leaders recognized

this conundrum in Antalya by committing to implement fiscal policies *flexibly* to take into account near-term economic conditions, so as to support growth and job creation, while putting debt as a share of GDP on a sustainable path.

A number of G20 countries would appear to have space for stronger use of fiscal policies to stimulate growth and job creation. This would include targeted countercyclical spending on social protection benefits (which could support demand), on active labour market policies (including training and job search support that could put more of the unemployed and underemployed into suitable jobs), as well as spending on needed infrastructure and other investments. Given the slower growth in many emerging G20 and the volatility of the global economy, the expansion of automatic stabilizers such as unemployment benefits and other income support would seem to be particularly timely. It is also the case that at current near-zero interest rates many G20 countries could invest in needed public goods such as infrastructure that offer both short-term employment creation with high multipliers and longer-term productivity gains. When well-selected, such projects can offer a higher rate of return than the cost of borrowing. This would reduce *net* debt in the future (De Grauwe, 2015; Ball et al., 2014). The gains from doing this would be greater if coordinated across countries (OECD, 2015).

As noted above, the G20 Leaders also committed to consider the composition of budget expenditures and revenues to support productivity, inclusiveness and growth. Empirical analysis finds that after protracted recessions, expenditure-based consolidations have a larger short-term negative effect on employment than revenue-based consolidations (IMF, 2014). This reinforces the point that well-targeted investments in countercyclical income support programs and longer-term infrastructure investment would be suitable policies for many G20 countries, which could consider revenue increases, such as taxes, to fund them as these have less negative impact on employment. In many G20 countries tax incentives are more often given to capital than to labour, and this can have further adverse effects on job creation. A rebalancing of tax policies could also help growth and counter the growing inequality in many G20 countries, which Leaders also committed to address.

### ***Other macroeconomic policies***

Many countries hit by the crisis have experienced a period of subdued wage growth or even real wage declines. Some have actively implemented policies to lower wages, in an attempt to strengthen demand through stronger export growth. While this may help to strengthen competitiveness, it has come at a cost to workers and has also reduced domestic demand. When implemented simultaneously across many countries, such policies can contribute to the short-fall in aggregate demand that has prolonged the initial crisis and generated adverse spillovers to other countries (Decressin et al., 2015). Simulations by the ILO and UNCTAD presented to the G20 Framework Working Group (FWG) have shown that coordinated increases in wages or minimum wages by G20 countries could stimulate growth across all G20 through positive spillover effects.<sup>1</sup> In such simulations, the overall effect will depend on a number of critical assumptions, and different models use different assumptions on the relative importance of demand and functioning of the labour market more broadly.

### ***Measures to increase productivity***

The Chinese G20 Presidency has decided to place an emphasis on innovation, noting that before the financial crisis there has been a longer-term slowdown in productivity growth rates, which has contributed to the dampening of potential growth rates and reduced social welfare.<sup>2</sup> The recent slowdown of productivity growth reflects a combination of low rates of investment, with savings channelled more to financial instruments rather than the real economy, and weaker growth of multifactor productivity. As long as aggregate demand remains weak and there is overcapacity in many sectors and countries, investors are not likely to significantly increase investment in productive capacity. There are also concerns that the diffusion of new innovations from frontier firms has slowed.

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<sup>1</sup> Available at: [http://www.ilo.org/global/about-the-ilo/how-the-ilo-works/multilateral-system/g20/WCMS\\_444510/lang--en/index.htm](http://www.ilo.org/global/about-the-ilo/how-the-ilo-works/multilateral-system/g20/WCMS_444510/lang--en/index.htm)

<sup>2</sup>“Issue Note on Innovation” prepared for the first Sherpa meeting under the Chinese Presidency by the Chinese Sherpa team and circulated to G20 Governments on 3 January 2016.

Productivity growth is determined by a wide range of factors, including policies. In addition to investment and productivity-enhancing technology, a key mechanism is the ability to reallocate resources to the most productive firms. A range of policies can play a role in this process, including product market regulations, market openness and government support for innovation and skills. Labour market institutions and policies also affect productivity, both directly and in terms of how they mediate the effects of other factors that influence productivity. Recent research has added important insights into how this occurs.

## Minimum wages and productivity

Recent studies have shown that minimum wages can contribute to higher labour productivity – both at the enterprise level and at the aggregate economy-wide level. At the enterprise level, workers may be motivated to work harder. A large number of experimental studies have supported the hypothesis formulated by Akerlof in 1982 that employees consistently provide higher effort levels in response to higher wages, the so-called “efficiency wage” theory. Using a standard natural experiment design, Georgiadis (2013) for example found that the UK National Minimum Wage has operated as a kind of “efficiency wage” in the residential care homes sector, increasing motivation and leading to a reduction in the level of worker supervision required. Riley and Bondibene (2015a and 2015b) took the opportunity offered by the introduction of the National Minimum Wage in the United Kingdom and subsequent increases to identify the effects of minimum wages on productivity. They found that companies responded to these increases in labour costs by raising labour productivity. These labour productivity changes did not come about through a reduction in firms’ workforce or via capital–labour substitution. Rather, they were associated with increases in total factor productivity, consistent with organizational change, training and efficiency-wage responses to increased labour costs from minimum wages. Experimental evidence in the United States by Owens and Kagel (2010) also points to a positive relationship between minimum wages and workers’ effort, leading to the conclusion that minimum wages can generate improved outcomes where employees have higher wages and employers have the same or only slightly higher, average labour costs.

Workers may also stay longer with their employer, gaining valuable experience and also encouraging employers and employee to engage in productivity-enhancing training. Dube et al. (2012) found that in the United States a 10 per cent increase in the minimum wage results in a reduction of 2.1 per cent in turnover for restaurant workers and a 2.0 per cent reduction in turnover for teenagers.

At the aggregate macroeconomic level, increases in minimum wages can result in more productive firms replacing least productive ones – and forcing surviving firms



to become more efficient. These mechanisms can increase overall economy-wide productivity. Using data for more than 160,000 manufacturing firms in China, Mayneris et al. (2014) found that increases in city-level minimum wages resulted in lower survival probability of low-productivity firms. For surviving firms, wage costs increased without negative repercussions on employment, as productivity in those firms improved significantly, allowing them to absorb the higher labour costs without hurting their employment or profitability. These conclusions align with findings of some previous studies, such as those of Croucher and Rizov (2012) who found an improvement in labour productivity in all of the United Kingdom's low-paying sectors as a result of the introduction of the National Minimum Wage, and particularly so in larger firms. A study using cross-country aggregate data for 18 OECD countries estimated that a 10 percentage point increase in the ratio of the minimum to median wage was associated with an increase in long-run labour productivity and multifactor productivity levels of between 1.7 and 2 percentage points (Bassanini and Venn, 2007).

Qualitative surveys of employers also show that companies first and foremost try to meet the cost of higher minimum wages by investing in better work organization, training and/or equipment to make their workers more productive (Schmitt, 2013; Financial Times, 18 Nov. 2015).

The effects of appropriate increases in minimum wages on overall employment are usually small or insignificant, and in some cases positive (Kuddo et al., 2015; World Bank 2012).<sup>3</sup> Although the range of estimates from the numerous existing studies

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<sup>3</sup>The World Development Report 2013 on Jobs provides evidence that moderate changes in labour regulations, including minimum wages and EPL, are not associated with significant changes in employment or growth, so long as countries avoid the 'cliffs' of too little or excessive levels of regulation. The international labour standard dealing with minimum wages, ILO Convention 131, notes that minimum wages can protect disadvantaged groups of wage earners and provide protection against unduly low wages. In determining the level of the minimum wage, it identifies the following elements to be taken into consideration in determining the level of minimum wages: (a) the needs of workers and their families, taking into account the general level of wages in the country, the cost of living, social security benefits, and the relative living standards of other social groups; and (b) economic factors, including the requirements of economic development, levels of productivity and the desirability of attaining and maintaining a high level of employment. It stipulates that minimum wages

varies widely, meta-studies (studies of studies) in the United States and the United Kingdom found the most precise estimates of the effect of observed minimum wage increases to be clustered at or near zero employment effects (Doucouliagos and Stanley, 2009; Leonard et al., 2014; Belman and Wolfson, 2014). In China, the most recent study found no obvious positive or negative employment effects of minimum wages while some earlier studies suggested small negative effects (Wang, forthcoming). These small employment effects may partly be explained by firms reacting to increases in the minimum wage (and hence labour costs) by raising productivity, as discussed above. When present, negative employment effects may be concentrated on certain types of workers (e.g., low-skilled or young workers). Although the negative effects may be offset by gains for older or more skilled workers, the affected groups could be helped by policy measures such as targeted reductions in the cost of employing low-skilled young workers through temporary subsidies combined with increases in in-work benefits to maintain their purchasing power. Training programs to increase their skills and productivity, including on the job training, would be part of any medium term strategy, as discussed in the third section of this paper, below.

### Employment protection legislation and productivity

The link between employment protection legislation (EPL) and productivity is complicated, both at the theoretical level and in attempts to assess the link empirically. As summarized by Betcherman (2012, p. 19), “on the one hand, strict EPL could constrain the flow of workers into emerging high-productivity sectors and discourage technological change that is labour-saving. On the other hand, because of commitment signals and expected tenure effects, it could increase worker effort and incentives to invest in human capital; at the same time, it could motivate productivity-enhancing investments”.

Empirical studies tend to echo the theoretical ambiguity, with a wide array of contradictory results depending on what indicators are used to classify EPL reforms, what measures of productivity are used, what impact is actually measured and whether results are reported at industry or economy-wide levels. A long list of studies

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should be set in full consultation with representative organizations of employers and workers. ILO Convention 131, available at [www.ilo.org](http://www.ilo.org).

reviewed for this report come to widely varying conclusions, based on different methodologies and different data sets. Aggregate cross-country/time-series studies typically tend to find either a positive impact of EPL on productivity or no impact (Nickell and Layard, 1999). The most recent IMF study found that reforms of EPL had virtually no impact on total factor productivity in the medium term and negative effects in the short term in the finance and business sectors (IMF, 2015, Box 3.5). Where positive impacts are found, they may be limited to certain types of economies, such as those that are intensive in specific skills (Belot et al., 2007). A key problem with many studies is that they are unable to control for confounding factors. Some studies attempt to solve this problem by comparing either sub-national entities within the same country or by using country and industry-level data and allowing the effects of regulations to vary across industries depending on how binding they are likely to be. These studies tend to show that strict dismissal regulation has a negative impact on productivity growth as well as on the reallocation of labour across firms, industries and jobs. (see Bassanini et al., 2009; OECD, 2012 and 2013a). According to these studies, EPL reforms can increase labour reallocation, and that reallocation may be towards more productive uses, thereby fostering productivity (see for example Martin and Scarpetta, 2012). However, not all reallocation has a positive effect on aggregate productivity, as it depends on the availability of jobs in higher productivity occupations, firms and sectors and the ability of workers to move into jobs.

The OECD EPL indicators aggregate measures of regulation, including termination of permanent contracts in case of individual dismissals, termination of permanent contracts in case of collective dismissals and regulation of hiring on fixed-term contracts. Different types of reforms of EPL are likely to have different effects on productivity. For example, while relaxing strict dismissal legislation tends to have a positive impact on productivity in the industry level studies discussed above, loosening the rules to allow more extensive hiring on fixed-term (temporary) contracts has been shown to be responsible for increased firm use of temporary labour, which in turn has mainly negative implications for aggregate productivity (see ILO, 2015a). This occurs through three main channels. First, temporary workers receive less training than permanent workers. Second, fear of dismissal and low probability of contract renewal can affect worker motivation and effort, which can

affect firm productivity (Battisti and Vallanti, 2013). Third, a greater recourse to temporary and contract labour can have a negative effect on innovation and reduce incentives to invest in productivity-enhancing technologies (Kleinknecht et al., 2014; Pradhan, 2006; Galbraith, 2012). A study using industry-level panel data for Member States of the European Union found that the use of temporary contracts has a negative effect on labour productivity (Lisi, 2013). A World Bank study concludes that although temporary jobs may increase employment opportunities for some, they do not lead to net job creation as they substitute lower-paid temporary labour for permanent workers. Their main effect may be to increase the turnover within alternative types of contracts, with many workers going through several unemployment spells before obtaining a regular job (Kuddo et al., 2015).

#### Working hours and productivity

It is commonly accepted that the length or volume of working hours can affect productivity in three ways. First, the length of working hours has physiological effects due to the accumulation of fatigue, such that employees' pace of work will tend to decline as the length of hours increase (the "fatigue effect"); thus the additional output resulting from such additional hours will decline as well. Second, the length of working hours may affect the motivation of workers with the result that shorter working hours encourage workers to use their energy in more efficient ways. Finally, reductions in working hours are known to sometimes trigger productivity-enhancing changes in work organization that can reduce "non-productive time" due to inefficiencies in the production/service delivery process, scheduling, and methods of supervision. While all three of these channels mean that hourly productivity is likely to fall as working time increases, two important caveats are that: (i) hourly productivity may initially rise with hours worked, for example for part-time workers, due to fixed costs of working; and (ii) the impact of changing working time on productivity depends on how well the change accords with workers' working-time preferences (Bassanini and Caroli, 2015).

There is considerable empirical evidence for concluding that longer hours of work, at least above some threshold, generally are associated with lower hourly labour productivity, while shorter hours of work are linked with higher productivity. For example, comparing several OECD countries, an ILO analysis found a negative

relationship between the amount of hours worked annually per person and labour productivity measured as GDP per hour worked (ILO, 2009). Empirical results from a study in the US suggest that the use of overtime hours lowered average productivity in 18 manufacturing industries: on average, a 10 per cent increase in overtime resulted in a 2.4 per cent decrease in productivity measured by hourly output but a 7.6 per cent increase in total output (Golden, 2012). An analysis of 18 OECD countries (Cette et al., 2011) explores the association between longer annual hours and hourly productivity since 1950. This study also finds that hourly productivity falls with annual hours worked, while providing weak evidence that the decline in hourly productivity accelerates as annual hours increase until total output is estimated to stop rising once hours of work exceed a threshold 2,025 hours per year.

How working time is organized can also have important effects on productivity and enterprise performance. Some types of flexible working-time arrangements such as flexi-time and compressed workweeks can have positive effects on productivity, employee job satisfaction and satisfaction with work schedules (Golden, 2012, p. 6). Part-time work, too, may have a positive impact on productivity, although the evidence is not always positive and may depend on whether the reduction in hours worked is at the request of the worker or because of company preferences and whether it affects training investment and/or motivation. Both the length of working time and how much flexibility workers have to manage their time at work also have important implications for worker well-being, as is emphasised by the OECD's Job Quality Framework (OECD, 2014b; OECD, 2015).

#### Productivity, skills and active labour market policies

Education, skills training and lifelong learning can foster a virtuous circle of higher productivity, income growth and development. Researchers have identified numerous mechanisms by which skills can contribute positively to economic performance and productivity, in particular the role of skills in supporting the introduction of new technologies, in fostering innovation of different kinds and in facilitating knowledge transfer between regions, countries and industries (Bresnahan et al., 2002; Chun, 2003).

However, the extent to which skills will boost productivity will also depend on how they are combined with other production inputs as well as intangible assets such as those deriving from investments in innovation. Thus, although education levels have been increasing in most countries and therefore supporting skills development, this has not offset the recent weakening of productivity performance in many countries.

It is also the case that in some countries skills development has not been adequately aligned with changing labour market demands. Closer coordination among public and private education and training institutions, employers and intermediary organizations to align education and workforce development systems with workplace change can improve outcomes (OECD, 2014a).

Productivity will also depend on how well skills are used. Several factors may constrain firms' ability to make full use of the competences of their workforce. Firms may lack the necessary internal flexibility to adapt job tasks to the skills of new hires (OECD, forthcoming). Similarly, skill requirements may change as a result of factors such as the decision to offshore part of the production process (Stone and Bottini, 2012) and it may take time for the workforce to adapt to the new skill demands.

Active labour market policies (ALMPs) beyond skills development have diverse objectives, including retaining and bringing workers into employment and improving the functioning of the labour market (Calmfors, 1994; Brown and Köttl, 2015) and can also affect productivity at both micro- and macro-levels. Policies that support sustained and efficient matching of vacancies and jobseekers and increase the attachment of workers to the labour market are likely, other things being equal, to boost productivity. At the macroeconomic level, labour market policies that shift labour from lower to higher productivity sectors are likely to raise productivity.

Labour market training, especially combining classroom and on-the-job training tailored to the needs of the labour market and employers, augments the stock of human capital and improves the skills and employability of workers. Available empirical evidence in some OECD countries suggests that a 10 per cent increase in the stock of human capital through job-related training increases multifactor productivity by between 0.5 and 1.8 per cent (OECD, 2007; Ballot et al., 2006, quoted in OECD, 2007). ALMPs that improve the quality of matches of supply and

demand for labour, such as job-search assistance provided through public employment services, may engender more efficient allocation of labour.

Employment creation programs may have a positive transition effect through increasing labour market attachment for the long-term unemployed and hence prevent attrition of skills and work routine (the impact of which is enhanced when such programs include an element of training). Job preservation programs such as the German Kurzarbeit scheme and South Africa's training lay-off scheme are examples which retain skills and talent for employers during recessions.

The net impact of ALMPs depends on the sum of their direct and indirect effects. For example, Almeida et al.(2014) investigate the impact of wage subsidies in developing countries and find that, even if the policy instrument may not boost overall employment, it can still help prevent skills attrition and improve employability of the long-term unemployed.

Further research is required to build knowledge and understanding of the link between ALMPs and productivity, as few studies have analysed the productivity effects of ALMPs mainly due to data unavailability.

## **2. Entrepreneurship for promoting employment**

With insufficient job creation to absorb new labour market entrants and those still affected by the aftermath of the crisis, there has been increased attention to entrepreneurship as a means of promoting employment. Innovative entrepreneurial activities can create incomes for the entrepreneur and, where successful, create jobs for others. At the same time, entrepreneurship also carries substantial risks of failure. Chances of success depend on many factors, including access to finance, policies that support innovation, access to entrepreneurship education and training and business development services and links to networks. Given strong evidence that a significant proportion of start-ups do not survive in the long term and the possibility of displacement of existing enterprises and jobs, it is also important to provide access to adequate social insurance and social protection for those losing out in the entrepreneurial process, as well as introducing effective bankruptcy regimes to avoid negative micro- and macroeconomic spillbacks (ILO, 2015b; Kritikos, 2014). There is

also a risk that new firms knock others out of business, leaving no net impact in terms of employment (although new firms may be more productive).

Evidence of impacts of interventions by governments to support entrepreneurship depends on the type of entrepreneur targeted by the interventions. Depending on the context, entrepreneurs can be driven by choice or by necessity. Entrepreneurs by choice may select entrepreneurship among other employment alternatives to increase their income or for greater independence. Entrepreneurs by necessity, also referred to as subsistence entrepreneurs, face insufficient labour demand or formal employment opportunities. They are likely to start micro-enterprises with low productivity and precarious working conditions, typically in the informal economy. These enterprises usually do not grow, but provide income and employment for the owner and sometimes for his or her family.

### ***Impact of interventions to support entrepreneurship***

Governments and international organizations have devised a wide range of interventions to support entrepreneurship and a number of impact studies have been carried out. In general, the studies tend to follow specific programs with specific target cohorts, sometimes for short periods, and thus provide somewhat limited insights. The results suggest that the target audience is an important determinant of the impact, as is the capacity of a program to combine a range of services addressing the multidimensional constraints entrepreneurs face.

#### Subsistence or small-scale entrepreneurs

The World Bank Group has a recent meta-analysis of the effectiveness of entrepreneurship programs targeted to subsistence or small-scale entrepreneurs, as this is an important group when seeking to address the incomes of the poor and the constraints they face (Cho and Honorati, 2013). The type of support they need differs from those of entrepreneurs by choice. The evidence of what works is limited. A few programs have been successful, but they tend to be small, and there is limited knowledge available about design and implementation in different contexts and with different types of beneficiaries. The key findings are:



- Entrepreneurship training programs do not have a strong track record when implemented in isolation; neither do programs to expand access to credit.
- Programs that combine training with access to credit – and access to markets – show somewhat greater potential.
- It is very challenging to formalize enterprises operating in the informal economy; most formal enterprises begin as informal enterprises.
- Given the market failures faced by subsistence entrepreneurs, interventions that complement social protection or safety net programs could be considered to increase earnings and improve the livelihoods of subsistence entrepreneurs.

These findings resonate with the impact evaluations of the ILO Start and Improve Your Business (SIYB) programs in low and middle income countries, where the evidence shows that when access to finance is paired with business training, the impact on profits is positive and sustained over time (Fiala, 2014). OECD/The European Commission (2013, 2014 and 2015) identify a number of successful policy interventions to support self-employment in Europe, including a number of large scale programs such as the Prince's Trust Youth Business in the UK, the Bridging Allowance in Germany and the Start-Up Grant in Finland. The review of these programs shows that a key success factor is to act at the same time on the combination of institutional, finance, skills and network constraints of potential small-scale entrepreneurs.

Current evaluations suggest that business knowledge and practices such as recordkeeping, registration and separation of individual and business accounts are relatively easy to change compared to other outcomes. However, improved business knowledge and practice do not necessarily translate into business growth or increased profits.<sup>4</sup> Compared to business knowledge and practice, it is more difficult to change labor market outcomes including employment levels, hours worked and earnings. (Cho et al., 2014; Valerio et al., 2014). ILO has tried to measure the quality of jobs created, beyond the income dimension (ILO, 2015b). Preliminary findings suggest there are effects on empowerment of women, but the sample is

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<sup>4</sup>This finding may be related to the timing of the post-intervention survey, since the period between program completion and the survey is typically short, and the impacts for final outcomes may not be fully materialized.

limited and more research is needed – particularly as several other studies find more limited beneficial impacts on women. Finally, not all entrepreneurship programs that proved successful in terms of business creation and income generation for the entrepreneur had significant effects on employment.

Going forward, it is critical to adopt a more systematic approach to designing, implementing and evaluating new programs. Special attention should be paid to eligibility, targeting and profiling mechanisms; selection of businesses to be supported; adaptation of core interventions (training, access to finance, advisory and mentoring services, and networking) to beneficiary needs; whether and how programs are integrated into subsectors and/or value chains; and delivery mechanisms for different services (Cho et al., 2014; ILO, 2015b).

### Young entrepreneurs

Youth entrepreneurship refers to business start-up and self-employment activities by young people. Different definitions of youth are used by different countries and programs, including the age brackets 15–24 years old and 15–29 years old.<sup>5</sup> There are several challenges for strengthening public policy in this area. The youth population is diverse (e.g. high-potential university graduates, NEETs, low-skilled youth) and different groups require different types and intensities of support. In addition, the youth entrepreneurship landscape is changing rapidly. Youth are more likely to adopt new models of entrepreneurship (e.g. social entrepreneurship) and new financial instruments are flourishing; however, policy-makers have been slow to respond to these developments.

Evaluations of impacts have found mixed results. In general, programs combining training with finance are more effective for young people. A systematic review of youth employment interventions by the World Bank and ILO finds that this

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<sup>5</sup> In terms of overall participation in entrepreneurship, the Global Entrepreneurship Monitor consistently finds that, regardless of the level of national development, the highest percentage of early-stage entrepreneurs is found in the 25–34 age group. The measure used is Total early-stage Entrepreneurial Activity (TEA), which includes individuals in the process of starting a venture and those running a new business less than 3 and a half years old. However, there is a huge drop off in the number of young people that go on to be “established business owners”, suggesting that youth start-ups tend to have low survival rates.

combination has a higher magnitude of impact compared to stand-alone measures such as skills training or wage subsidies.<sup>6</sup>

In France, an evaluation from the CréaJeunes Programme shows limited impacts from a combined training with coaching, business plan development, post-business creation support and access to finance for young unemployed people (18–32 years) from disadvantaged urban areas (Crépon et al., 2014). A study of short-term impacts of an entrepreneurship promotion intervention in Argentina that provided financial and technical assistance as a measure for out-of-welfare transitions found an increase in total working hours but no significant income effects attributable to the program overall. However, somewhat more significant income effects were seen among younger and more educated program participants (Almeida and Galasso, 2010).

The education system can play an important role in raising awareness of entrepreneurship as a viable career option and to build basic competencies (OECD, 2013b). This requires sufficient space in the curriculum to accommodate the learning objectives of "being entrepreneurial", which raises the chances for employment, and becoming an entrepreneur. This approach is practiced for example in Denmark and Ireland, where in primary education the objective is to develop critical thinking, problem solving, perseverance, creativity and self-control. In lower secondary education an emphasis is added with specific courses on subject knowledge (e.g., financial literacy), and in upper secondary, vocational and tertiary education students learn about innovation management, business growth models and internationalisation (Rasmussen and Nybye, 2013).

### High-growth start-ups

Evidence from OECD countries suggests that certain types of start-ups and young enterprises account for a large share of job creation (ILO, 2015b). A recent OECD analysis shows, for example, that among SMEs across all countries and years, young firms account for 17 per cent of employment but create 42 per cent of jobs (OECD, 2013b).

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<sup>6</sup>Kluve et al. (forthcoming).

Some common traits of high-growth firms have also been identified in the literature (OECD, forthcoming). First, high-growth firms are “young” but not always “small”; that is, age is a stronger determinant than size in the case of high-growth firms. Second, high-growth firms are innovative but are not necessarily disproportionately found in high-tech industries; in fact, high-growth firms are more likely to be found in the services sector. Third, high-growth spurts are unpredictable and episodic, which makes rapid growth a stage of business life rather than a specific business target group. In fact, many firms after a rapid growth spurt find it hard to maintain this level of performance, with many high growth episodes followed by contractions (Aterido and Hallward-Dreimeier, 2015). These patterns also reinforces the challenges of identifying such firms ex ante and the longer run benefits of providing support to firms that have already experienced a significant growth episode.

Despite the mixed track record, the allure of being able to identify and support high performing firms remains strong. A small but increasing number of initiatives are being launched to support those high-potential enterprises, focusing on profiling individual entrepreneurship characteristics and offering financial services or co-investments through “angel investor” networks as well as non-financial support including specialized technical assistance (accounting, legal services, business advice), physical incubation (office space, facilities, product testing), mentorship and market research (Hampel-Milagrosa, et al., 2015).<sup>7</sup> An example is so-called business accelerators, which provide growth-oriented entrepreneurs with a set of soft management skills, networking opportunities and, in more limited cases, equity finance. Leadership and management skills development is the most common objective of accelerators, which is pursued through activities such as formal training, executive education, tailored advice and mentoring, linkages facilitation with investors and entrepreneurs and peer learning events (OECD, forthcoming). While the job-creation potential of these “gazelle” enterprises is clear, there is so far no evidence that the expected benefits of such sophisticated interventions are higher

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<sup>7</sup>An example is the Aspen Network of Development Entrepreneurs (ANDE), a growing network of development practitioners, established in 2009 to promote small and growing businesses (SGBs), defined as enterprises with five to 250 employees and ambition for growth.

<http://www.aspeninstitute.org/policy-work/aspen-network-development-entrepreneurs>

than their cost. To compensate for this problem, many business accelerators expect participant firms to cover part of the program costs.

### Financial services

Some interventions are not targeted to specific groups, and studies that evaluate the type of intervention can also provide insight. A common cross-cutting intervention provides entrepreneurs with access to financial services, including loans, guarantees, grants, savings products, insurance or leasing facilities. Frequently, the interventions not only aim to provide access to these services, but also attempt to lower the cost of the services. The underlying intervention model links access to finance to improved business performance and higher sales and profits, ultimately leading to increased labour demand, income and employment generation. Impact evaluation evidence from India (Duflo et al., 2013) and Mexico (Angelucci et al., 2013) shows that access to finance only, particularly through microcredit, helps people start businesses, expanding self-employment activities. However microcredits alone do not show ability to grow businesses or increase their profitability. There is also evidence of relatively low take-up, suggesting that demand for microloans is not universal (Banerjee et al., 2012). It is important to note that this evidence relates primarily to subsistence entrepreneurs, but the scalability of microfinance, its long-term impact, and, even, potential risks should not be excluded. In Germany, studies show positive employment and income effects of start-up subsidy programs for participants (Baumgartner and Caliendo, 2008; Caliendo, 2009).

Unemployment benefits can be used to enhance income security for previously unemployed entrepreneurs as they start a business. An evaluation of the French unemployment insurance system, which encouraged unemployed workers to start a new business while keeping the right to unemployment benefits for up to three years, showed increased business creation, with the new businesses as likely to succeed or fail as incumbent businesses (Hombert et al., 2014).

### Entrepreneurship training and business development services

Such programmes seek to improve skills of potential and existing entrepreneurs or provide tailored advice to start-ups and existing enterprises. Studies tend to find that

training alone has modest impacts (Grimm and Paffhausen, 2014; Cho and Honorati, 2013). Often, this type of support is combined with other interventions. For example, young people may be trained and then receive coaching, mentoring and advisory support for a fixed period of time. Many of these combined interventions are successful (e.g. Entrepreneurially into Business in Slovenia has helped more than 60 per cent of participants into self-employment or employment). In addition, another outcome from training programs is that it helps some young people decide not to start a business – which may be a positive outcome in itself. If the young person's business was certain to fail, it is better that they do not start. Supporting a young person in a failed business project can have damaging effects on their self-esteem and may push them away from the labour market. This is especially true for disadvantaged youth (e.g. NEETs).

### **3. Unemployment, with a special focus on youth unemployment**

#### ***Unemployment***

As noted above, G20 countries continue to face slow and uneven growth and potential output has declined over the recent period. As a result they have struggled to create sufficient and decent quality jobs for all who want to work. The weak global economy has caused a further increase in global unemployment, which reached 197.1 million people in 2015, a million more than in the previous year and over 27 million higher than pre-crisis levels (ILO, 2016). The increase in 2015 comes exclusively from emerging and developing countries. The employment outlook in some of these countries is expected to have worsened in recent months. Latin America, oil exporters in the Arab region and some Asian countries are projected to face more significant deterioration than is the case in other regions. Sub-Saharan Africa is generally expected to fare relatively better, although the region is also facing significant current challenges and some countries, especially in Southern Africa, suffer from extremely high unemployment, including high youth unemployment. In advanced economies, projections are for a slight decline in the number of unemployed people. The trend is positive in the United States and some Central and Northern European countries while, despite recent improvements, unemployment rates remain high in Southern Europe. And unemployment has tended to increase in advanced economies most exposed to the slowdown recorded in emerging Asian economies.

Beyond open unemployment, poor job quality remains a pressing issue worldwide. The incidence of vulnerable employment – the share of own-account work and contributing family employment, categories of work typically subject to high levels of precariousness – is declining less than was the case before the start of the global crisis. Vulnerable employment accounts for 1.5 billion people, or over 46 per cent of total employment. In Southern Asia and Sub-Saharan Africa over 70 per cent of workers are in vulnerable employment.

Addressing cyclical unemployment and stimulating quality job creation is first and foremost a macroeconomic challenge that requires reversing the current deficit of

aggregate demand and restoring strong economic growth. This has been discussed in the first section of this report.

With respect to social and income protection for the unemployed, unemployment protection schemes have proved their value during and after the financial crisis, both in providing income security to individuals and households and by helping to stabilize aggregate demand (ILO, 2014). However, even in advanced economies with relatively advanced social protection systems, on average less than half of the workforce is effectively covered by some form of unemployment benefits. Figure 1 illustrates the situation in the G20, revealing a wide variation across regions and countries.

While unemployment rates have declined in recent years in most advanced G20 economies, long-term unemployment rates have persisted or risen in many of them. The most vulnerable population subgroups, which can include young school dropouts and job losers over 50 years of age, are increasingly excluded from the job market. Having exhausted their unemployment insurance benefits and relying on social assistance and other benefits, the long-term unemployed thus face increasingly lower levels of income security and support for retraining and job search. The rise in long-term unemployment rates has also contributed to a decline in the effective unemployment benefit coverage, which today is below the level observed prior to the crisis (ILO, 2015c).

Stagnant or decreasing wages in many advanced economies, particularly at the lower end of the wage scale, have also increased pressures on unemployment protection and social assistance schemes. Contributions to these schemes, which are typically based on earnings, are lower, reducing the contributory portion of funding. Further, given that available jobs may pay very low wages, there has been perverse pressure to *reduce* benefit levels in order to avoid negative work incentives and to “make work pay”. Unemployment benefits should instead be made conditional on availability for full-time permanent work, accompanied by well-targeted active labour market policies (IMF, 2013). Recent OECD data shows that net replacement rates of unemployment benefits in advanced economies remain far below wage levels, both for low earners (67 per cent of average wage) and average earners.<sup>8</sup> The combined

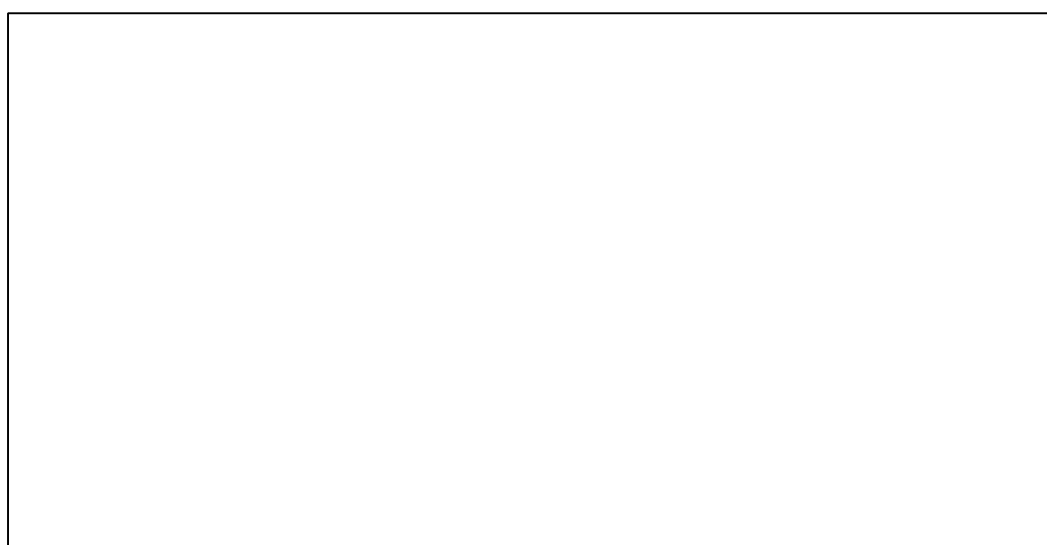
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<sup>8</sup>OECD Benefits and Wages Database, <http://www.oecd.org/els/benefits-and-wages-statistics.htm>.



effects of higher unemployment and reduced income protection provided by social protection systems are contributing to higher poverty and inequality in many countries. A better strategy to encourage the return to employment is the strengthening of in-work benefits, which ensure that the re-entry into employment is not associated with a complete loss of social protection benefits. This has been one of the elements of the reforms in countries such as France, Germany and the United Kingdom.

**Figure 1. Effective coverage of unemployment benefits in the G20 (percentages)**



Note: Latest year available. Data for Indonesia, Mexico and Saudi Arabia were not available.

Source: ILO, 2014, based on ILO Social Security Inquiry Database.

Striking the right balance between the objective of ensuring income security for the unemployed and preventing poverty and social exclusion, on the one hand, and maintaining appropriate incentives for workers to return to suitable employment, on the other hand, is a challenge. Policies to facilitate the return of unemployed to the labour market include skills upgrading, job matching and other employment services. When unemployment benefits are combined with quality job matching, jobseekers experience more stable employment in the long term (Acemoglu, 2001; Ernst, 2015). Unemployment benefits can provide the income necessary to allow dismissed

workers to upgrade their skills if linked with appropriate active labour market services. They can therefore play a key role in maintaining and enhancing human capital and fostering high levels of productivity in the medium and long term.

### ***Youth unemployment***

The global financial crisis has left a legacy of high youth unemployment in several G20 countries and made it harder for youth to move out of poor quality jobs. Prolonged periods of high youth unemployment and underemployment can have substantial negative long-term repercussions for growth and social cohesion. If young people leave school and experience early and prolonged spells of unemployment or underemployment, they may be scarred for life, facing a permanent disadvantage in the labour market which brings significant personal, social and economic costs. Available estimates suggest that early youth unemployment has serious negative effects on earnings and employment opportunities even 20 years later in some OECD countries, although the evidence does not show the same effects in lower and middle income countries. An ILO review of existing literature and analysis of recent data on young workers' earnings finds an increase over time of the wage gap between adult and young workers. The increased polarization of earnings between young workers compared to their adult counterparts has resulted in reduced purchasing power of young workers. Contrary to earlier assumptions of mainstream economic labour market theory, the increase in the youth wage gap occurred despite an increase in the average level of education of young people and a decline in their share of the working age population (Grimshaw, 2014).

Prolonged periods of joblessness for young people may also lead to risky behaviour, higher criminality, lower trust in others and in society, and a lack of civic engagement with negative consequences for social inclusion in the future (Carcillo et al., 2015).

The groups of youth most at risk of failing to gain a solid foothold in the labour market or condemned to working in poor quality jobs are those who are neither in employment nor in education and training (the so-called NEET) in advanced economies (Carcillo et al., 2015) and those with low education or skills in the

informal economy in most emerging G20 economies. They are not in school and so are not acquiring skills that may give them a better chance of progressing up the career ladder. And they are either not in employment or are in low-productivity informal employment and so are not picking up useful skills that will help them to progress. In response to the vulnerability of these groups of youth, the G20 Leaders adopted the target of reducing the share of young people who are most at risk of being permanently left behind in the labour market by 15 per cent by 2025 in G20 countries, taking into account national circumstances. They also asked the OECD and the ILO to assist in monitoring progress in achieving this goal, which will be an important aspect of G20 EWG work in 2016.

As discussed in previous G20 EWG papers, tackling the youth employment crisis requires a multi-pronged approach that also includes attention to macroeconomic and labour demand; extension of coverage of social protection schemes to youth; quality and relevance of education and skills training; active labour market policies; entrepreneurship and self-employment promotion programs; addressing underemployment and low productivity; and workplace rights for young people.

First, and indispensable, is the need to strengthen demand for labour by restoring adequate economic growth and addressing the global deficit of demand. There is no solution to youth unemployment and underemployment without addressing the underlying weaknesses in growth. Beyond increasing overall demand for labour, reforms to employment protection legislation must be carefully designed to avoid increasing polarization of labour markets and increasing the insecurity of employment for all cohorts. Young people are particularly affected by trends toward greater use of temporary contracts and are over represented among the unemployed and in casual and informal employment. Not only do these arrangements mean greater labour market precariousness for young people but they may also harm their long-term career prospects because of an under-investment in their human capital. For example, an OECD study has shown that workers in temporary jobs receive less training than their peers in permanent jobs (OECD, 2014a).

While clearly the demand for labour is an important part of the equation, policy attention must also be paid to the relevance and quality of education and skills

development; targeted labour market policies to improve transitions into work, including through effective labour market intermediation and activation strategies; and interventions to increase the quality of jobs available to young people.

Quality education is a needed foundation for labour market success. Early childhood education and basic literacy provide fundamental skills on which individuals can later build. This is a precondition to the further development of skills, adaption to lifelong learning and improvement of employability. As the OECD's PISA scores underline, there is ample potential in all G20 countries to improve these basic literacy skills in reading, writing and mathematics. It is essential to identify students at-risk of dropping out of school early and offer them the necessary support to succeed in mainstream education or in alternative learning environments. Some countries have successfully set up an obligation to follow up on youth not attending school on a regular basis and offer them counselling, support and alternative option (e.g. Norway, Denmark, Sweden and New Zealand). Countries where work-based learning options, including quality apprenticeship programs, are widespread and highly valued by both employers and students (e.g. Germany, Switzerland and Australia) typically feature lower youth unemployment rates, as these pathways can contribute to smoother school-to-work transitions.

Both well-targeted active labour market programs (ALMPs) and unemployment income protection are important aspects of policies to support youth. However, not all G20 countries have well-functioning benefit and employment services and in some countries young people have little or no access to these programs. First-time jobseekers are often not covered by unemployment insurance. Young unemployed persons who have already acquired some work experience are less likely to be eligible for statutory unemployment benefit schemes as compared to older workers, as they are less likely to meet minimum contribution periods and more likely to work in forms of employment which are not covered by unemployment insurance, including temporary contracts, part-time employment and forms of precarious or informal employment (ILO, 2012). Some G20 countries, including France and Japan, have reduced the number of months of contributions required for eligibility to unemployment insurance benefits in order to improve access to income support for young people (ILO, 2012). Italy extended unemployment insurance to temporary

workers during the recent crisis. In Argentina, the Programa Jóvenes Más y Mejor Trabajo (program for more and better work for young people) promotes social and labour market inclusion for young people through cash transfers, job counselling and educational support (ILO, 2014). In China, policy efforts combining income, social protection, fiscal subsidy, financing and administration encourage young graduates to accept to work in the private sector or to start businesses in rural and urban communities and underdeveloped regions. This led to the creation of 13 million new jobs across the country in 2014, about half of which were taken by university graduates.

ALMPs may need to be reformed to be accessible to youth who need them. In recent years, access to unemployment benefits in some advanced G20 economies has been made conditional on active job-search following the “mutual obligations” principle whereby income support for the unemployed is combined with strict job-search requirements and compulsory participation in re-employment programs, under the threat of benefit loss in the event of non-compliance (OECD, 2015). Unfortunately, even in countries where the “mutual obligations” principle works well for some, identifying effective re-employment programs for unemployed and other disadvantaged youth is far from easy and many programs have yielded disappointing outcomes.

Findings from a global review of youth employment interventions (Kluve et al., forthcoming) show that investing in youth pays off. The study finds an overall positive impact of ALMPs on labour market outcomes of youth, boosting employment, earnings and business performance. However the magnitude of impact is moderate. While interventions have been more successful when targeting vulnerable youth, much depends on context and the selection and delivery of services. Good program performance is correlated with effective profiling of beneficiaries and follow-up systems. The evidence shows that programs that integrate multiple interventions are more likely to succeed, as they are better able to respond to the different needs of beneficiaries. Overall, the review shows there are no systematic differences in outcomes between services provided by public or private providers. Instead, programs implemented jointly by public and private sectors were more

likely to succeed. There is some evidence indicating a positive role of incentive systems (e.g., pay for quality of results) for services providers.

Drawing on the existing evaluation literature covering many G20 countries (OECD, 2010; Carcillo et al., 2015), successful programs appear to share the following characteristics:

- An increase in public investment, social benefits and ALMPs has an impact on youth employment, particularly in terms of labour market participation. Evidence shows that public spending on labour market policies is associated with significantly higher youth employment-to-population ratios (ILO, 2015d).
- Job-search assistance programs are often found to be the most cost-effective for youth, providing positive returns in the form of higher earnings and employment.
- Some wage and employment subsidy programs have yielded positive returns, but these measures tend to perform poorly in terms of their net impact on the future employment prospects of participants unless they are designed very carefully. In addition, subsidies have sometimes resulted in displacement of adult workers by youth, with no net gain in employment or even net reduction in unemployment.
- Training programs work best when they are carefully tailored to local or national labour market needs. Their positive long term impact on human capital is a reminder of the importance of continued investment in skills development for youth (Card et al., 2015).
- Programs that integrate and combine services and offer a comprehensive package adapted to individual needs, including remedial education but also work experience and adult mentoring, seem to be the most successful.

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