

Overview

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Much has been said about the gap between scientific analysis and the response to it by policymakers and politicians. Today, you have before you a former policymaker, even a politician, who knows how difficult it is to translate analysis and recommendations into concrete policy. Pruning the welfare state (by which I mean not only social security systems but also the totality of collective services, transfers, and the like)—one of the often heard recommendations—needs social acceptance in most, if not all, of the countries in Europe. A lack of complete social acceptance is not, of course, an alibi for no action. But pruning the welfare system does necessitate a well composed policy mix and the determination to implement it once the decision is taken.

Unemployment is the key priority for the European Union (EU) and its member states. This was the opinion of the European Council as stated in the "White Book" of the European Commission, which has been mentioned during these meetings. There is enough evidence about the implications of unemployment for individuals and society to underscore this high priority. Over the past twenty-five years, unemployment in the European Union has risen from 2.4 percent in 1970, to 6 percent in 1980, and to 12 percent in 1994. Unemployment in the European Union is almost twice as high as in the United States and four times as high as in Japan. Unemployment rises when the number of job seekers increases faster than the number of jobs available. Our problem in Europe is not that the labor supply has risen faster over the past years than elsewhere. On the contrary, over the last decade the numbers of job seekers in Europe grew by 0.8 percent

per year, compared to 1.7 percent per year in the United States. Our problem in Europe is that we are hardly able to create jobs. Since 1960, the number of jobs in the United States grew by 84 percent, in Japan by 46 percent, and in Europe by a mere 6 percent. This is why fighting unemployment has to be the key priority in the European Union.

The core of the problem is the bad functioning of the labor market. The market is simply too rigid. There are many reasons for this. I will concentrate this morning on one particular aspect, which in my view has to be remedied and can be remedied. The welfare state has provided member states with a relatively generous social security system to put it mildly. The system is so generous that the incentive for the unemployed to look for a job has been substantially reduced, if not completely removed. In my country, a person who finds employment at the minimum wage and nets only 20 guilders per month is better off receiving unemployment benefits. Given the fact that when you work you have some costs and expenditures, the worker is better off remaining in the benefit system rather than accepting the job. I would say this is contrary to an incentive. The cost of this generosity is higher tax levels and higher tax charges. This leads to relatively high labor costs, where the net wage is substantially reduced and is sometimes considered to be unsatisfactory. The difference between labor costs and net wages, the so-called "wedge," is far too large in many European countries.

Job losses, combined with low incentives to seek jobs, have been particularly harmful to certain types of individuals. Unemployment is concentrated to a very large extent in the lower income brackets, and this tendency is increasing. The European Union is confronted with massive immigration. Besides being low-skilled, many of these immigrants have other handicaps that reduce their ability to integrate into the labor force. They reinforce the pressure on the low-income workers, low-skilled groups, and the low-income unemployed. In the years to come, there is a risk that problems in this minority group might arise on an unprecedented level and lead to personal and societal consequences.

This is why from a policy point of view, the first priority of the fight against unemployment must be targeted at the lower segment of the

labor market. In this lower segment, most employment can be found in sectors which are to a large extent protected from international competition, such as retail trade, catering, cleaning, maintenance, repair, and personal services. To be able to reduce unemployment in the lower segment of the labor market, the labor cost for low-skill jobs must be drastically reduced. There are, of course, many ways of doing that. In the United States, the impressive growth of employment was possible because of a substantial drop in wages paid for unskilled work. During earlier sessions, we have already commented on the income inequalities in the United States. Yesterday, we were told that wage costs in Japan are also rather flexible. But in my opinion, the so-called American model, with so many people below the poverty line, is not a feasible model for Europe.

What should we do if our own model is at the limits of its capacity? Let me use the Netherlands as an example. In the Netherlands, the ratio of economically inactive individuals to economically active individuals was 44 percent in 1970, 66 percent in 1980, 82 percent in 1990, and is now 86 percent. This means that one hundred actives have to work to support 86 nonactives. Such a situation is, of course, not sustainable. It is, therefore, clear that the welfare state is at stake and that pruning the welfare state is not an asocial activity. Pruning the welfare state is instead necessary to maintain it in an acceptable form for future generations.

So for the European Union, the model we have to seek, in my view, is to bridge the gap between labor costs and net wages in such a way that unacceptable burdens on the lowest income individuals can be avoided. Some European countries are already considering reducing the tax on lower income groups. I am in favor of such a reduction because the lower tax will increase net wages, increase the gap between net wages and unemployment benefits, and accordingly create a substantial incentive for unemployed people to seek jobs. I'm also in favor of reducing labor costs for employers. The employers don't pay taxes for their workers but they do pay premiums for such social insurance elements as health costs. So, I believe a reduction of taxes will create an incentive for unemployed workers to look for a job, and a reduction in the cost of labor to employers will create an incentive for employers to create jobs. Therefore, both sides will

contribute to a better functioning of the labor market.

One additional advantage of this approach would be that for the time being the level and duration of these benefits could remain untouched. I say for the time being because there will be effects on the purchasing power of this group due to wage moderation as a consequence of these policy changes. The restraint of wages resulting from such a system would also, of course, contribute to wage moderation, which in turn would contribute strongly to the creation of more jobs. For instance, success in restraining wages in my country has certainly contributed to the creation of jobs during the 1980s.

Calculations teach us that the measures I have advocated can be extremely costly from a budgetary point of view. Respecting the existing tax structure—that is, not changing the division between the more prosperous and the less prosperous people—would require extremely high budgetary expenditures. That money has to be found through economies in the budget. I am afraid that by respecting existing systems, it will not be possible politically to fund such activities by cutting back spending on other programs. And that means that if one does respect the existing system, one would have to perhaps shift part of the financing from charges on labor to other sources of revenues.

This morning we have discussed that point, but I would like to emphasize two things. First, I am advocating that these tax reductions be given to all workers so that disincentives could be avoided—even though the disincentives for **high** income individuals is perhaps much less than for low income individuals. The second point I would like to emphasize is that, for instance as mentioned in the White Paper of the European Commission, you could envisage taxes on energy. I know this is a very difficult issue, but a tax on energy could very well fit in a long-term, sustainable energy policy. Of course, I am aware this cannot be done on a national base. It has to be done at least Communitywide and preferably even throughout the Organization for Economic Cooperation and Development (OECD). By implementing an energy tax you could save costs on labor and keep the system going by financing from other sources. Some model calculations that have been made in Europe indicate that substantial job gains could result

from such a tax on energy.

You might say perhaps this approach, rather simple in its concept, is a bit of a "push and pull" approach. But it would be a two-handed approach with incentives for supply and for demand. But I don't think that is enough. When jobs become available, when people are more prepared to move, an active labor market policy remains necessary, or perhaps becomes even more indispensable. I would roughly follow the recommendations which have been made during the sessions. I'm not going into all the details, but I would like to offer one observation here.

Since I agree that active labor market policies are useful, financial resources devoted to these policies should not be reduced as sometimes seems to be the case. Because the cost of these policies can be great and other **political** priorities competing for these funds will be squeezed, if the starting position for the **unemployed** is substantially improved, one might expect the people concerned (the unemployed) to react positively. A comprehensive set of opportunities from training to job experience and special arrangements for the disabled should be offered, but one shouldn't have the right to reject every opportunity. "Push and pull," okay, but also if **necessary**, "the carrot and the stick." Refusal to take a job should not be permissible. A group of people will nonetheless remain which cannot be accommodated to jobs. There will remain a group of unemployed. As a last resort, one could consider the creation of additional jobs in the public sector for this remaining group in such a way that other workers are not displaced by doing so.

What I am suggesting today is, of course, not a panacea for all the evils of unemployment. I haven't mentioned many well known measures and I won't go into these measures today. But, I would like to underscore the fact that international coordination, even cooperation, could be very useful in creating a positive environment for economic growth. In that respect, it is very important that for instance the agreement of **Marrakech** should be ratified as soon as possible. Protectionist tendencies, which are obviously working in the world, should be avoided as much as possible. As I reflect on the history of the approval of trade agreements and the difficulties in getting them

ratified, I don't think the worries about protectionism are completely groundless.

In the European Union there already exists a forum for coordination, the increased coordination of budgetary and monetary policies, with exclusive competencies for the EU in the domains of trade, competition policy, and merger matters. And so far, the European Union with all of its ups and downs—and there are many ups and many downs—could serve as an example for the OECD, where prospects for international cooperation are rather gloomy.

It has been said that economic growth of about 4 percent is needed to reduce unemployment in the European Union to acceptable levels. It may not be very difficult for Asian countries to achieve this rate of growth, but such a rate is not possible for Europe without considerable effort. What I have suggested this morning is limited. Youths are the hardest hit group. The hard core of the unemployed—the low-skilled and the long-term unemployed—are primarily young people. I am not pessimistic. During the 1950s and 1960s in Europe we imported labor. Massive unemployment is not a "natural" order. I believe it can be reversed in an acceptable way. Perhaps there is not an easy starting point, but the European Union was able to create millions of jobs during the 1980s. It must be possible to substantially reduce unemployment while maintaining a decent standard of living for those who remain unemployed.

Author's Note: For this address I have used elements of a report written under my direction on low market segment unemployment in the Netherlands.