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**THE EUROPEAN EMPLOYMENT STRATEGY:
RECENT PROGRESS AND PROSPECTS FOR THE
FUTURE**

*COMMUNICATION FROM THE COMMISSION ON TRENDS AND
DEVELOPMENTS IN EMPLOYMENT SYSTEMS IN THE EUROPEAN UNION*

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When the European Council met in Essen on 9 and 10 December 1994, it once again confirmed that it saw the fight against unemployment and the promotion of equal opportunities as priorities. As the return to a process of sustained growth needed for a decisive improvement in the employment situation had to be backed up by structural reforms of the labour market, it identified five priority areas for action to overcome structural unemployment problems (Annex 1). It also asked the Member States to translate these recommendations in each area into a multiannual programme and requested the Social Affairs and Employment, and Economic and Financial Affairs Councils and the Commission to keep close track of employment trends, monitor the relevant policies in Member States and submit an annual report to the European Council, starting in December 1995, on further progress in the labour market. Finally, it asked for the specific questions of the effects of tax and support systems on the readiness both to create and take up jobs and the inter-relationship between economic growth and the environment to be examined.

The Cannes European Council in June 1995 stressed the need for the Member States to step up structural reforms of the labour markets in line with the five recommendations set out in Essen. It also asked the Council and the Commission to study the links between economic growth and the environment and the consequences for economic policy in great depth when preparing the report requested at the Essen summit, and to examine what mutual benefits could accrue from closer coordination of economic and structural policies.

This Communication represents the Commission's first contribution to the process launched in Essen. Its aim is to analyse the principal trends and the major aspects of Member States' recent policies in the areas identified as priorities in Essen with a view to identifying and promoting sound practice. It also contains the Commission's initial response to the issue of coordinating economic and structural policies raised in Cannes.

It should also provide the information needed to prepare the first annual report on employment which must be submitted to the Madrid European Council.

I SUMMARY AND CONCLUSIONS

This report concludes that a European approach to the job crisis does not mean that we have to make a choice between persistently high unemployment and growing inequality and poverty. It is possible to combat unemployment and to improve the overall employment situation without creating a new class of working poor and without giving up our high ambitions for social protection.

However, to do so, we will have to adopt an all-policy, coordinated approach along two lines, in order to:

- implement a macro-economic policy which will restore public finances and give room for business to grow and create new jobs, especially with regard to SMEs;
- implement a vigorous structural policy, first of all by replacing passive labour market policies with an active labour market policy.

This is the key aim of the European Employment Strategy that was agreed upon at the European Council in Essen 1994, and is currently being implemented. The Member States are now translating this strategy into their own multi-annual programmes, all of which should be available before the Madrid European Council. This overview report shows clearly the depth and breadth of the ongoing reform process in the labour market policies, in order to give them a more active direction. A parallel reform process is taking place in the social security system. Finally, the social partners are making changes in the systems for collective bargaining, that are contributing to a better macro-economic balance.

The result of this process will, over the coming years, gradually improve the conditions for economic and employment growth. But in order to bring about a more substantial reduction in unemployment, new and strong commitments are needed, from the Member States as well as from the social partners.

This is important in the short term for obvious economic, social and political reasons but it is even more so in the long term, considering demographic trends in the Union.

Growth and employment

1. After having reached a peak level of 11.4% in mid-1994, unemployment has only gradually declined to 10.6% recently. Both macro-economic and structural policies have to be implemented in order to reduce unemployment permanently to an acceptable level. Moreover, interaction between macro and structural measures means that implementation must be coordinated both at national and international level.
2. The Union's economy has the potential to achieve satisfactory growth and create employment. To this end the impressive achievements in terms of a stability-oriented framework should be preserved and reinforced in particular as far as the consolidation of public finances are concerned. Indeed, sound public finances and satisfactory growth go together. Sound public finances are the precondition for a sustained medium-term growth

process which, in turn, is a *sine qua non* for employment creation, although this alone cannot solve the unemployment problem. Nevertheless, satisfactory growth is the basis upon which room for manoeuvre can be created to implement efficient labour market policies.

3. While satisfactory growth in the late 1980's was interrupted by a stabilisation recession in the early 1990's, the fundamentally positive factors for growth remain in place and are even stronger in some respects. Although recent turbulence on the exchange markets have increased uncertainty, the Union is experiencing an export-led recovery which is based on fundamentally improved competitive positions of European firms and dynamic growth outside Europe. Capital profitability remains strong, thus creating the basis for job-creating investment. Both short-term and long-term interest rates have fallen, leading *inter alia* to positive effects on expectations and confidence. Finally, structural measures are being implemented in many areas. Moreover, the flexibility of labour markets is increasing.
4. Just as the objective of low inflation gained credence in the 1980's, sound public finances are the touchstone of the 1990's. All Member States have reduced or are planning to reduce their deficit to below 3% of GDP in the medium term. This policy has to be maintained and reinforced if any divergence from the consolidation path is observed. Moreover, structural deficits should be reduced significantly or even eliminated entirely in order to create the necessary room for manoeuvre. While there is little argument regarding the favourable impact of healthy public finances in fostering sustained growth over the medium term, the report concludes that fiscal consolidation, credibly implemented, could also have a significant short-term impact on investment and employment thanks to confidence in the private sector and a reduction in the risk-premium on interest rates (the so-called "crowding-in effect").
5. Wage developments continue to play an important role for labour market prospects. Nominal wage increases compatible with low inflation and real wage growth below productivity increases, as defined in the Broad Economic Policy Guidelines, are a precondition for further improving profitability of investment.
6. Full implementation of the macroeconomic part of these Broad Guidelines would enable investment-led growth of 3-3.5% per year over the period 1995-2000 to be achieved. The investment ratio would rise from 19 to 23% of GDP i.e. close to the figure outlined in the Commission's White Paper. More than 11 million new jobs would be created, resulting in a fall of the unemployment rate to some 7.5% by the end of the year 2000. The very favourable consolidation path of fiscal imbalances is due to both satisfactory growth, which eliminates the cyclical component of the deficit, and measures taken to reduce significantly the structural deficit. However, these macroeconomic policies need to be accompanied by structural measures in order to accelerate growth and to foster employability, bringing the White Paper's target of cutting unemployment by half for the year 2000 within reach.

Interaction between macro-economic and structural policies

7. In order to achieve such a favourable result without creating tensions, the Community's employment strategy is characterised by a combination of macroeconomic policies and structural policies which are mutually reinforcing at the national as well as at the Community level: structural reforms, by increasing potential output, engendering dynamism and by reducing structural unemployment, make higher employment possible without adverse inflationary pressures, thus allowing for the stability-oriented monetary policy to become less restrictive. The simultaneous introduction of coherent structural policies among Member States would therefore improve the room for manoeuvre for macroeconomic policies at both national and at the Community level.
8. Structural policies cover mainly two areas: (i) enhancing competitiveness and innovation through stimulating productivity growth and through transforming the latter into new jobs through the relative price mechanism and sectoral changes, (ii) activating labour market policies by working both on the supply side and the demand side.

On the supply side of the labour market the measures include education, training and retraining, counselling and work rehabilitation as well as measures to stimulate mobility. In brief, it is a question of getting the right person with the right competence for the right job and in this way improving the growth capacity of the economy. On the demand side the measures include incentives to create jobs which are compatible with a non-inflationary growth path. This covers more flexible working-time arrangements and local initiatives to improve services as well as an adjustment of non-wage costs. The more these measures are targeted to bring the unemployed back to work, the better price stability and employment growth can be reconciled.

9. It is important to acknowledge the interaction between the macro-and micro-dimension of economic policies designed to solve the labour market problem. Both policies have to be implemented simultaneously in order to avoid detrimental repercussions. An uncoordinated approach would reduce significantly the chance to exploit the basically favourable conditions for growth which now prevail.

Employment and the five priorities identified in Essen

10. The Communication reveals that the Member States have made a great effort to establish coherent, medium term, national employment programmes incorporating the priorities set out in Essen in the course of recent on-going reforms of the labour market.
11. These programmes should be pursued vigorously, with particular attention to:
 - commitments to increasing and improving investment in training, with priority for action to assist the unemployed and for training organised by enterprises for their workers;
 - development and better dissemination of practices in reorganising working hours, accompanied by an increase in employment, upgrading of the jobs concerned, without this being achieved at the expense of social protection or promotion of equal opportunities;
 - more sophisticated analysis of the impact of measures to reduce wage costs, especially in terms of targeting, and a more systematic search for alternative means of funding social security;
 - encouraging local development and employment initiatives, by improving the legal, fiscal, and financial environment and by generating vigorous local support;
 - stepping up of efforts to activate employment policies - especially by remodelling employment services - whilst maintaining a high level of social protection;
 - helping the groups hit hardest by unemployment:
 - young people: everyone should have enough education, training or occupational experience to ensure that he/she is employable;
 - the long-term unemployed: who should have received an opportunity for training, rehabilitation or integration before reaching the threshold of long-term unemployment;
 - women: more must be done with respect to policies for desegregating the labour market in accordance with the guidelines adopted by the Beijing Conference and the Fourth Action Programme on Equal Opportunities.

Horizontal questions

The European Councils in Essen and Cannes asked for the inter-relationship between employment and some key themes - the environment, SMEs and taxation and social protection systems - to be examined. These are dealt with in the Communication, as is the contribution of the Structural Funds to promoting employment, given the importance of this matter.

12. The contribution of SMEs to improving the employment situation must be maximised by suitable adjustments to their legal, fiscal and financial environment and by encouraging them to invest in training.
13. In order for jobs to be created in the environment, incentives - including fiscal ones - must be developed and environmental considerations must be factored into sectoral policies more effectively, especially in the field of energy, transport and agriculture. Such integration is recommended in the 5th Environmental Action Programme, and has shown to lead to a net creation of jobs. Environmental integration should therefore be intensified with a view to strengthening the competitiveness of ecobusinesses and to bringing the EU closer to sustainable development.
14. The Structural Funds, with a budget of ECU 170 billion for the period 1994 to 1999, are a key instrument of Community support for promoting employment and for measures identified by the recent European Councils in Essen and Cannes.

Investments in physical capital and increased investment in human resources must be better attuned to creating employment.

In this context all structural instruments and the Structural Funds should be implemented in such a way as to encourage measures designed to promote initial and continuing training, more employment-intensive growth and a proactive approach to solidarity, and integration and promotion of equal opportunities.

15. Various requirements must be taken into account when taxation and support systems are being reviewed in order to do away with any obstacles to creating or seeking employment:
 - the tendency in past years to increase taxation on labour, particularly on low wages, must be reversed
 - the balance between taxation and support systems must provide an incentive to create and look for jobs, whilst avoiding unemployment or low-wage employment traps
 - the main features of the European social protection systems and the high level of protection which they offer must be maintained.

Conclusions

16. The course of action on macroeconomic and structural policy identified in Essen has now been launched and it is up to the Member States to keep their macroeconomic policies on target, pursue the process of coordination of these policies with structural employment and labour market policy, especially in implementing and following up their multiannual programmes, and step up their efforts to remodel their employment systems.
17. The many exchanges of views between the Member States and the Commission on the follow-up to the recommendations made in Essen have shown the added value accruing from concertation of policy at European level with a view to identifying best practice and enabling it to spread as far as possible. Such consultation and implementation of joint aims adopted in this matter must be pursued with determination and in greater depth.

This will make it necessary to step up analysis and assessment, which will mainly be done by devising a series of joint indicators.

18. The effectiveness of measures taken by the authorities with regard to employment very largely depends on their ability to motivate social and economic players at all levels. This means that institutions throughout the territorial hierarchy must take an active part in employment strategies.

On the other hand, much of the responsibility for exploiting the increasing opportunities offered by labour market reforms lies with the social partners. The Commission therefore attaches great importance to their active participation in implementing the Essen recommendations and the contribution which they can make to their follow-up. The process of defining and implementing national multiannual programmes should be the ideal instrument for motivating the parties concerned.

II. GROWTH AND EMPLOYMENT: MACRO-ECONOMIC PROSPECTS AND POLICY REQUIREMENTS

(1) THE PRESENT RECOVERY PROCESS

Following a period of stagflation in the wake of the second oil-price shock, the Union's economy experienced an uninterrupted, steadily-accelerating recovery process throughout the 1980s. In particular the second half of the 1980s saw a brisk expansion of economic activity and a marked improvement in labour market performance. Over the period 1986-1990, GDP grew by 3.3 per cent per year in the Union. This strong growth performance was accompanied by the creation of more than 9 million additional jobs and a reduction of more than two percentage points in the unemployment rate to 7.6 per cent in 1990.

With the rate of growth exceeding potential growth for a number of years, the Union's economy was overheating at the end of the previous decade. In the Union on average, the dynamism of the economy led to capacity constraints, a substantial deterioration in external balances, a rekindling of inflationary pressures and an acceleration of wage increases. In response to these developments, monetary policy was gradually tightened since the late 1980s. However, budgetary policies remained loose and became even expansionary so that given the authorities commitment to a stability course, monetary conditions had to become very restrictive notwithstanding emerging weakness in economic activity. The fiscal impulse coming from German unification contributed to an even more distorted policy-mix. The inevitable cyclical slowdown turned into an outright recession essentially as the result of unbalanced macroeconomic policies, reflecting a stability conflict. Following growth of a scant 1 per cent in 1991-92, real GDP dropped by 0.5 per cent in 1993 whereas over the period 1992-94 more than 5½ million jobs were lost in the Union.

Since 1993, the European Union economy has experienced a stronger-than-expected recovery. Thanks to dynamic extra-EC export markets and the improved competitive position of European firms, exports have acted as the initial driving force. The growth impulses coming from the external sector were spilling over into investment, the latter is set to become the main engine of output growth. Private consumption is currently rather subdued but should gradually pick up in line with accelerating household incomes, progressively bolstered by rising employment and positive, albeit moderate, increases in real wages. Having reached a peak of 11.4 per cent in mid-1994, the rate of unemployment has decreased as expected to 10.6 per cent of the labour force.

Since the beginning of this year, and basically after the spring currency turmoil, the economic expansion in the Community appears to be losing some steam. In itself, a pause in the recovery process is not a reason to fear a premature end to the current upswing. A slowdown after several quarters of recovery is totally in keeping with historical precedents, especially since the first phase of the present cycle has been strong and since the pause largely reflects a shift in the factors shaping the recovery process (from exports to investment). Furthermore, some growth moderation appears appropriate in view of the rapid absorption of slack in capacity last year.

More importantly, the major factors shaping economic activity are still pointing in the right direction: (i) the strength of external demand remains strong and the Community's competitive position continues to improve, as illustrated by the continuation this year of an expansion of

real world imports excluding the Community at about 11 per cent per year, and the positive trade balance of the Union, forecast at 1.6 per cent of GDP in 1995, against minus 0.4 per cent in 1992; (ii) capital profitability remains strong, with an index of 96,5 in 1995 for EUR15, compared to 85 on average over the period 1986-90, and nearly back at the level prevailing during the 1960's (100), and the expectation is for further significant improvements (99,3 in 1996 under current forecast); (iii) area-wide inflation is markedly lower than in previous episodes, with a stable annual rate of 3,2 per cent for EUR15 since 1994, the best performance since the 1960's, which facilitates moderate wage agreements; and which is unlikely to pick up much during the expansion given the monetary authorities' strong commitment to price stability and increased global competition; (iv) interest rates have been substantially reduced (German short-term rates are more than 200 basis points lower than at the end of 1993 and the average of the long-term interest rates for the Community are 100 basis points lower than in the Spring of 1995) and (v) the spring 95 business survey on investment intentions point to very strong investment performance (13 per cent increase in real terms this year).

(2) MACRO-ECONOMIC POLICIES FOR GROWTH AND EMPLOYMENT

The successive Broad Economic Policy Guidelines adopted by the Council since December 1993 and the Essen strategy have laid down the broad thrust of the macroeconomic policies required to achieve the Union's two major objectives. Indeed, these policies are geared towards overcoming the current growth pause and towards transforming the recovery into a strong, non-inflationary medium-term growth and employment-creating process. Simultaneously, they also aim at achieving the necessary degree of convergence to ensure a smooth transition to stage III of EMU. The latter will not only ensure that the full potential benefits of the single market will be reaped but will also strengthen the Union's growth and employment process.

The needed macro-economic framework is characterised by:

- a stability-oriented monetary policy whose task should be facilitated by appropriate wage and budgetary developments;
- nominal wage developments which are compatible with achieving and safeguarding a low-inflation environment and positive, but moderate, increases in real wages, which however remain below the annual growth of labour productivity, would lead to a further increase in capital profitability. The latter is needed to strengthen investment, in face of a higher capital/output ratio than in the 1960s. In addition, persistently high levels of real interest rates world-wide require a higher rate of profitability in order to attract investment in this order of magnitude. Improved profitability, in turn, is an essential precondition for the strong expansion of capacity and employment-creating investment. A priority in this respect is to ensure that increased profitability leads effectively to higher productive investment. Available evidence and forecasts point in that direction;
- the pursuance of significant and credible budgetary consolidation in most Member States consistent with the objectives of their convergence programmes. Strict adherence to planned fiscal consolidation and convergence programmes should lead to a confidence-induced fall in long-term interest rates and to a reduction in the risk of turbulence on foreign exchange markets. Credible fiscal retrenchment efforts, by lowering inflation expectations and short-term interest rates, would also pave the way for making the monetary conditions less restrictive. As a consequence, reinforced and swift action to significantly reduce structural budget deficits (i.e. adjusted for cyclical influences) are not an impediment to but a necessary precondition for higher and sustained growth and

employment. Especially in those countries with high budget deficits and a huge public debt (like for instance Italy), credible and front-loaded consolidation efforts are likely to lead to a sharp fall in risk premia on interest rates which in turn would help in lowering budget deficits and boosting confidence of investors and consumers. These positive crowding-in effects might well outweigh the traditional negative demand effects from fiscal consolidation, even in the short run. Experiences in countries like Ireland (1987-90) and Denmark (1982-86) clearly shows that a credible budgetary consolidation strategy can go hand in hand with higher, not lower, economic growth and employment. Counter-examples can be found in countries where a rapid and sharp deterioration in budgetary positions have undermined price and exchange rate stability as well as the credibility of monetary policy with adverse implications for economic growth and job creation.

These conditions for a return to a sustained, employment-creating growth process are now the object of a large consensus in the Community and are strongly supported by the European Social Partners¹. The existence of such a widespread consensus is an important confidence-enhancing element. Moreover, on the whole, the economic policies of the Community and the Member States appear to be following the course indicated in the Broad Guidelines. However, there is a clear need for further commitments in order to make the short and medium-term growth and employment prospects convincing.

(3) ILLUSTRATIVE MEDIUM-TERM SCENARIOS

Medium-term growth projections² show what could be the evolution of the European economy in case of a full and co-ordinated implementation of the macroeconomic part of the Broad Economic Policy Guidelines and the convergence programmes. Model simulations suggest that such policies would place the European Union on a growth path of between 3 and 3½ per cent per annum to the year 2000, based on a progressive re-utilisation of spare capacities, without overheating, and a steady strengthening of the Community's growth potential. In this process the labour supply is an important contributing factor to growth since there is a considerable potential of working force consisting of almost 18 million unemployed, a further 9 million who, according to surveys, want to work, and a further 4 million part-time workers who are prepared to work full time. However, in the short to medium-term, the limiting growth factor relies in capacity and employment creating investment. The characteristics of the optimum macroeconomic growth process would thus be :

- investment-led growth, with capital spending growing at a rate twice that of GDP (i.e. between 6 to 7 per cent per annum), adequately balanced by moderately growing private consumption (i.e. by 2½ to 3 per cent per annum). Investment growth of this order of magnitude during the period would reach the target outlined in the Commission's White Paper of an investment rate of about 23 % of GDP in the year 2000; so the Community's potential growth rate would progressively rise from below 2½ per cent currently to about 3½ per cent at the end of the period;

¹ "The Social Partners guidelines for turning recovery into a sustained and job-creating growth process". Joint Opinion elaborated by the Macroeconomic Group of the Social Dialogue, 16 May 1995.

² These macroeconomic projections were discussed by the Medium-term Expert group at its meeting of 22 June 1995. They were found consistent with the policy assumptions made. However, as any model simulation, these results are subject to some qualifications due to the fact that models are a simplification of realities.

- further progress towards price stability, with inflation dropping from a present rate of above 3 per cent to close to 2½ per cent, and greatly improved price convergence among Member States;
- trends in nominal and real wages which respect the conditions for price stability and profitability as explained in the policy requirements;
- a progressive but significant reduction in budget deficits, dropping in the medium term to well below the Maastricht reference value of 3 per cent of GDP, thereby contributing to a crowding-in of productive investment and to a significant increase in national saving which is needed for a sustainable financing of the required increase in the share of investment in GDP.

The realisation of such a growth process could lead to the creation of more than 11 million new jobs over the period 1995-2000, resulting in a fall in the unemployment rate to some 7½ per cent by the year 2000. This can be achieved through sound macro-economic policies. Although constituting an impressive performance, it would still fall short of the ambitions contained in the Commission's White Paper of cutting unemployment rate by an half. In order to achieve better results a further contribution from structural policies is needed (see Chapters III and IV).

In this context, two points should be noted. Firstly, the 3 to 3½ per cent growth range is probably the maximum that could reasonably be realised by macro-economic policies up to the year 2000 without overheating. On the other hand, the unemployment trend is very sensitive to output growth. The medium-term projection shows that an annual GDP growth rate which is only a quarter of a point lower than that projected over the period 1996-2000 would put the unemployment rate in 2000 at 9 per cent instead of 7½ per cent in the optimum scenario.

Secondly, co-ordinated, well-balanced macro-economic policies and the fall in unemployment in itself contribute to improved fiscal balance, thus making this easier to achieve. In the optimum macroeconomic medium-term scenario described above, the budget deficit could fall from 5.5 per cent of GDP in 1994 to 0.5 per cent in 2000 on average in the Union, implying a quasi elimination of the structural deficit. Of this 5 percentage points reduction, automatic budgetary effects -- due in particular to higher employment and lower interest charges on the public debt -- would amount to 2,5 per cent of GDP, the remaining discretionary fiscal action being, on *average* for the Member States, only around 2.5 per cent of GDP (structural component) of which a part is already implemented or planned for 1996. Indeed, the elimination of structural deficits is essential to launch the "crowding-in process" and to create room for manoeuvre for adopting significant structural policies.

Medium-term projections also indicate that if the required macro-economic policies are supplemented by structural reforms (such as those agreed in Essen) aimed at improving the functioning of product, service and labour markets -- but which are in conformity with the need to enhance the Union's competitiveness and the required fiscal consolidation --, prospects for growth and job creation would be substantially improved. Indeed, adjustments in the structural area are critical (i) to increase the speed limits to growth and to foster the employability of people, thus reducing the NAIRU³ limit; (ii) to augment the employment-

³ Non-accelerating inflation rate of unemployment.

content of growth and (iii) to strengthen social cohesion and assist workers to react positively to changing circumstances. Economic analyses suggest that a bold implementation of such structural policies, on top of the optimum macro-economic scenario, could lead to a drop in the unemployment rate to even about 5 per cent in 2000 compared to 7½ per cent in the macroeconomic scenario alone.

These medium-term projections do not present an overly optimistic scenario. Indeed, they are derived from macro-econometric models whose coefficients and parameters reflect observed developments and behaviours. The experience of the second half of the 1980s clearly indicate that a significant improvement in labour market situations can be realised within a relatively short period of time provided the right policies are implemented. In addition, they point to the same results than those of the Member States convergence programmes.

Conversely, in the case of a medium-term scenario characterised by a lack of co-ordinated policies and no real budgetary consolidation or convergence efforts in the Member States, which implies a continuing excessive burden on monetary policy, simulation results project a very disenchanting picture. They indicate that effective and potential output growth would remain stuck in the 2 to 2½ per cent range over the period 1997-2000. Employment creation would be very weak and the rate of unemployment, after a temporary decline to some 9¾ per cent in 1997, would resume a rising trend and reach 11 per cent of the Union's labour force in 2000. As a consequence, such a scenario would entail considerable risks of social tensions, unsustainable budgetary positions and continued exchange-rate instability in the EU.

(4) MACRO-ECONOMIC RISKS TO GROWTH AND EMPLOYMENT

Notwithstanding the fact that the present recovery - as it has been unfolding fits in well with the optimum macroeconomic growth scenario, a number of features of the current situation imply serious risks in the short term.

Firstly, a salient external shock has affected the Union. Since early 1994, the US dollar has experienced a sharp weakening against EU currencies, which in combination with a lack of policy credibility in a number of Member States has triggered pronounced intra-EU exchange rate changes. Such currency misalignments are detrimental to the Union's short-term growth outlook since they produce noticeable, adverse, effects on exports, investment and confidence. In part reflecting the influence of the currency turbulence, most "appreciating" countries (Germany, France, Belgium) has shown a slowdown, whereas most "depreciating" countries (Italy, Spain, Sweden) has experienced a less severe, or even no, correction.

In a number of countries there has been a risk of wage increases in excess of rates consistent with the price-stability objective and with the needed further rise in profitability. Early this year, the perception of this risk has contributed to postpone interest rate reductions. However, monetary policies were relaxed later when the monetary expansion and inflation were subsiding.

Furthermore, and more importantly, progress towards sounder budgetary positions has clearly been insufficient in several countries. While the short-run benefits of policy slippage are likely to be small and temporary and can rapidly be erased or over-compensated by exchange rate turbulence and surging risk premia on interest rates, its medium to long-term costs would

be substantial and permanent. Indeed, if because of impatience or dissatisfaction with the present growth moderation, policies were to move in the direction of the non-convergence scenario, medium-term growth and employment prospects in the EU would be seriously damaged. Developments on foreign exchange markets in late September amply demonstrated that these risks still persist. Growing uncertainties about the ability and resolve of several governments to rigorously implement planned fiscal consolidation efforts instantly prompted renewed turmoil, thereby putting an abrupt end to the orderly reversal of exchange rate movements experienced during the summer.

A failure to implement the required macroeconomic and structural policies in a co-ordinated way would not only lead to sub-optimal results for the Union as a whole but would also increase the risk of divergences in real economic performance which would eventually spill-over to financial markets. Indeed, model simulations indicate that in such a case, the non-convergence countries would be significantly worse off (especially due the higher risk premia on their interest rates with further negative effects on domestic demand and budget deficits) whereas converging countries would be unable to reap the full benefits of their efforts. Since such divergences would be accompanied by strong currency movements, the positive effects of structural reforms and the completion of the single markets would also be significantly reduced.

III. INTER-RELATIONSHIPS BETWEEN MACROECONOMIC AND STRUCTURAL POLICIES

The macroeconomic analysis presented above has shown that existing risks clearly underline the need for a full and co-ordinated implementation of the Broad Economic Policy Guidelines and the convergence programmes by all Member States. The Commission intends to present in the forthcoming months the results of an in-depth economic analysis of the benefits of closer co-ordination of macro-economic and structural policies between Member States in order to respond to the specific request made by the European Council in Cannes.

The employment strategy of the Community is characterised by a combination of macroeconomic and structural policies which are mutually reinforcing. While the full implementation of the macroeconomic framework of the Broad Economic Policies Guidelines will ensure a return to sustained labour-creating growth, the underlying macroeconomic policies must be accompanied by structural reforms and actions for speeding up growth, improving the employability of people and fostering job creation. The European Social Partners share this view as they stressed that "it is essential that the problems of growth, competitiveness and employment must be tackled together"⁴.

Indeed there are clear spill-overs between both kinds of policies making easier to implement reforms in a context of growth while these reforms will spur and extend the growth process. On one side, a satisfactory growth performance allows for the more palatable introduction of the needed structural policies (from an efficiency, financial and social acceptability points of view), on the other such deeper reforms improve the efficiency and competitiveness of the

⁴ See reference in footnote 1 in Chapter II.

economy, increase its potential output and dynamism, and reduce the NAIRU⁵; as a result, higher employment is possible without adverse inflationary pressures, thus allowing for the stability-oriented monetary policy to become less restrictive.

The importance of such spill-overs between macroeconomic and structural policies for the success of the employment strategy implies that Member States have clear interest to taking appropriate measures also in the structural area, according to each national characteristics, in order to choose the right balance. Furthermore, exploiting such spill-overs at the national level brings also positive impacts for the other Community's partners. A simultaneous effort of coherent structural reforms among Member States would therefore improve the room for manoeuvre for macroeconomic policies at the Community level, improving thus the growth and convergence performances within the Community. Conversely, insufficient structural efforts in some countries could produce economic divergence and policy conflicts, i.e. negative spill-overs at the macroeconomic level among Community members. Therefore, it is worth for Member States to focus also on structural measures when they co-ordinate their economic policies at the Community level.

In a medium and longer run perspective, a continuous effort to enhance competitiveness and innovation, and well functioning product and service markets, will ensure productivity growth (the major source of real wealth) and its transformation into new jobs thanks to changes in relative prices and sectoral shifts. A successful activation of the potential strong labour supply, by reduced unemployment and higher participation rates, will increase the potential (non-inflationary) GDP-growth. Such labour market policies contribute to prevent tensions in the macroeconomic growth process by :

- reducing potential labour bottlenecks and hence the inflationary risk which is an important macroeconomic obstacle to growth (the so-called NAIRU problem)
- improving human capital, i.e. reinforcing the potential growth itself
- raising the employment intensiveness of growth, i.e. increasing the number of jobs created by any given rate of growth.

(1) COMPETITIVENESS AND EMPLOYMENT

1.1. The general mechanism

As regards policies to enhance competitiveness and innovation, their major aim is to increase the endogenous growth forces of the Union. As set out by the White Paper (Chapters 2 to 7), this should be achieved by fully exploiting the potential of the internal market and an open world trading system, by accelerating the realisation of the TENs, by investing in new technologies, by carrying through the Action Plan on the Information Society and by better exploiting the growth and employment potential offered by SMEs. Over the last year, notable progress has been made in several of these areas.

All this could accelerate the rate of growth of the EU economies via product innovation and increases in overall productivity. In fact, the growth of productivity is the major source of real income and wealth. As stressed in the White Paper and by the Social Partners, there is

⁵ Non-accelerating inflation rate of unemployment.

no contradiction between initiatives to enhance productivity growth and *net* employment creation provided that the wealth created by the sectors with high-productivity increases is adequately redistributed within the economy, enabling sectors with low productivity growth to create new jobs. Such a process also enables similar wages for similar qualifications in all sectors. One important channel of redistribution of productivity gains is decreasing relative prices in sectors with high productivity growth, increasing the purchasing power for all consumers, and thus demand for products and services in general, and especially in employment-intensive sectors with low productivity growth and increasing relative prices. For such a process to work effectively, three essential conditions must be met simultaneously:

- *relative product prices* between sector must be allowed to change in the right direction without artificial rigidities. The full working of the internal market and the achievement of convergence together with the pressure of international competition in a more open world economy are ensuring that the required flexibility of markets is maintained and strengthened throughout the Union. There is statistical evidence that this process has been and continues to be at work;
- *sectoral changes* need to be economically justified and socially acceptable. Also concerning the process of sectoral change there is clear evidence that it is going on strongly. Progress in the five key areas identified by the Essen European Council (see section IV), especially the re-direction of labour market policies from passive income support to more active measures, such as reforms and strengthening of education and training systems, are underway and will be instrumental in supporting such processes of change, while cushioning the possible adverse social costs;
- and, above all, the *rate of growth* must be high enough to maintain a positive balance between job creation and job destruction across sectors. In order to exploit fully the newly created growth potential, the medium term growth process must be able to develop without meeting macro-economic obstacles to growth (i.e. inflation and capacity constraints). If this is the case, this process will give an important contribution to the achievement of the employment targets of the Union. As mentioned under II, there are presently some risks linked to a firm and timely implementation of the policies agreed upon in the Broad Economic Policy Guidelines.

Under these conditions, the supply-side and employment effects of structural policies will be important but are difficult to quantify. This applies also to the TENs, which in addition have demand effects whose cumulative influence on the employment and unemployment levels in the year 2000 could according to model-simulations be of the order of half a point in the Union as a whole.

1.2. Functioning of product and service markets

It is important to stress that the correct functioning of product and service markets is also relevant to shift the European economy onto a high employment path.

Lack of competition, high entry barriers to new firms, poor efficiency, obstacles to the diffusion of technical progress have important implications for the functioning of the economy and, ultimately, for employment. More efficient and competitive markets for products and services can be expected to contribute to achieve a higher level of employment by better allowing for relative prices to adjust to external shocks, facilitating the faster distribution of productivity gains across economic sectors. This will give more room for higher demand and

new economic activities to emerge, thereby offering new additional jobs. These mechanisms are well illustrated by recent experiences with telecom liberalisation which resulted in lower prices, improved and new services, and faster innovation in upstream and downstream industry.

These considerations indicate that allowing market configurations to persist by fear of immediate consequences of liberalisation on existing jobs is self-defeating in the longer run. This is why the European employment strategy includes measures to improve the functioning of product and service markets.

As to product markets, the positive effects on competition of the internal market need to be supplemented by a rigorous anti-trust and competition policy. As to services -- the main source of new jobs -- it is essential to lift those constraints which unduly restrict their development and employment potential, starting by completing the internal market in the telecommunications and energy sectors.

1.3 The information society

The current transition to the information society is crucial for the Union's future competitiveness. It offers opportunities for huge productivity gains in almost all sectors of the economy. It could have profound effects on employment, both in quantitative and qualitative terms. However, job losses resulting from higher productivity gains must be seen against the background of employment opportunities in new markets which will rapidly emerge in new information services, multimedia applications, information infrastructures and a wide range of new "tele"-products. High incomes generated in these new markets and in all sectors benefiting from rapid productivity growth will increase the demand for goods and services in all other sectors of the economy. However this process must be supported by appropriate regulatory and institutional environment and a favourable macro economic climate.

Work patterns will also change. Telework is a particularly striking example. In the five largest EU countries there are already approximately 1.1 million teleworkers. Telework accords employees more flexibility in their management and use of time and offers new employment opportunities through a better response to market demand and possibilities of location-independent work. At the same time, telework will require adaptations to industrial relations systems and to the protection of workers' rights and employment conditions.

The emerging information society requires major social and economic adaptations; adaptation of the legal framework (liberalisation of telecommunication services and infrastructures, intellectual property rights, privacy, labour legislation), development of advanced telematic networks (TEN policy), corporate reorganisation and changes in the education and training systems. These changes, although underway, need a new strong commitment from the governments and more active accompanying structural policies.

(2) LABOUR MARKET POLICIES

With respect to **labour market policies**, the implementation of the common labour market strategy established at the Essen European Council is reviewed in detail in Chapter IV. This section highlights how such policies can contribute to growth and employment, without creating tensions, and to a higher employment-content of growth.

2.1 The two speed labour market

It is worth first stressing some of the negative characteristics of the European labour market, that currently reduce the Union's growth and employment capacity.

The main structural problem in the European economy is "the two speed labour market", the gap between skill requirements and skill formation. One speed exists in the transformation of working life, driven by new technology and competition between enterprises, in global and national markets. There is another, much slower speed for the supply of new skills and competences.

The existing structural problems date back to the 70's and/or 80's, with passive labour market policies resulting in high unemployment. New jobs were given mainly to new entrants in the labour market, who often offered an up-to-date education and training or were cheaper than more senior workers. Those left with obsolete skills or in the core of the long term unemployed remained unattractive to the employers with new jobs to offer.

The growing skill mismatch made some labour categories technologically obsolete and/or more substitutable with productive capital or with higher skilled labour, and therefore twisted labour demand against the use of low skilled labour. The traditional downward rigidity of wages in Europe and the burden represented by a growing tax wedge on labour also contributed to impair the employability of less skilled labour because its productivity no longer warranted the total cost of its utilisation.

These developments demonstrate that a growing share of the unemployed population cannot efficiently serve as a recruitment reserve for expanding enterprises. This is due to the rising speed of structural transformation of the labour market, with the consolidation of a core of long-term unemployed. It is worth noting that about 10 per cent of all available jobs disappear in a single year and 10 per cent new - and more productive - jobs are created. This process has a profound effect on the demand for skill and competence. In some EU countries more than 90 per cent of all vacancies are linked to requirements for experience and/or training.

In most European countries the flows of labour in and out of work of unemployment is relatively small, in particular in comparison to the US. The result is a huge difference in the average duration of unemployment. In fact, the share of long-run unemployed (i.e. more than one year) in total unemployment ranged between 30 to 60 per cent for most of Member States, whereas in the US and Canada their share was slightly above 10 per cent.

This shows that there exists a huge potential for economic growth in Europe, on the condition that simultaneously macroeconomic obstacles to growth are overcome and labour market

policies are geared to improve the skill and competence, the quality of supply, to meet the demands from growing enterprises, and give the right incentives to enterprises and job seekers to work.

This is the purpose of the European employment strategy, agreed at the Essen European Council last year.

2.2 Labour market policies and the growth process

The impact of active and more efficient labour market policies, as those proposed in Essen, operates on the growth and employment creation process by acting at three levels:

- **First**, on the functioning of the labour market itself, by increasing its transparency and its overall capacity to match job supply and demand and to get the right person to the right job (4th point of Essen conclusions)

This is the central part of the active labour market policies. It points to the crucial role of employment services regarding placement and counselling. It is also the aim of the reforms of the tax/benefit systems, seeking to activate the unemployed's job search. Measures to increase professional and geographical mobility of workers also serve this function.

While such actions do not in themselves engender new jobs, they contribute to removing bottlenecks on the market, to reducing the cost of hiring labour and facilitating the tendering of additional job vacancies. As such, they help to avoid a resumption of inflation as unemployment comes down and they help to curb the NAIRU limit by avoiding one important macroeconomic obstacle to growth i.e. an early resumption of inflation.

- **Secondly**, on the supply side, by raising the quality of human capital and the employability of the workforce (1st point Essen).

Education, training and retraining systems are key instruments in this process and the Essen Summit made investment in these areas a top priority in the new employment strategy. Better skill and competence strengthens the individuals and improve the positive flexibility of the labour market. Measures to come to grips with the hard core of long-term unemployment are fundamental, for example work rehabilitation and work experience. The training and retraining of employed workers contributes to increased productivity and to the prevention of unemployment. In all these cases, it is crucial to ensure a closer link between training and the market needs.

Action in all these fields will reinforce the growth potential in itself by acting in the same way than by a competitiveness improvement. However, while being an important ingredient of structural adjustment, it will generate its full benefit only when the economy generates enough working posts.

- **Finally**, on the demand side, by giving employers incentives to create jobs and hire those who are available in the labour market. This corresponds to the Essen objective of raising the employment intensiveness of growth (2nd, 3rd and 5th points Essen).

From a macroeconomic point of view, the achievement of a more labour-intensive growth process essentially means that more employment (in number of persons employed) will be generated by any given growth rate of real GDP. In purely statistical terms, it implies a lowering of the growth rate of apparent labour productivity (measured as real GDP growth

per employed person). Obviously, such an outcome should not be reached by destroying productivity at the firm or sector level since this would severely affect the economy's competitive position and the overall wealth creation process.

- (i) Macroeconomically, the employment-content of growth may be increased by an evolution of *relative factor prices* which favours the use of labour with respect to capital. The realisation of such an effect through changes in overall relative factor prices is, however, likely to take a considerable amount of time and may be accompanied by unpleasant side effects. Apart from this macroeconomic substitution process, there are basically two other approaches to increasing the employment-content of growth; one dealing with labour costs and another with working time.
- (ii) A *widening of the wage distribution at the lower end* would make low-productivity activities profitable that were formerly either priced out of the official market or "transferred" to foreign low-wage producers and would thus increase the labour content of growth. This downward widening of the wage scale may be obtained either as in the US by allowing market pressures to substantially lower the wages of low-skilled workers, but with serious social consequences (the "working poor" syndrome) or by a set of more pragmatic actions which reform the European social model and which are targeted at the low end of the wage scale. These measures include special entry wages for new entrants into the labour markets, a review of social benefit systems acting as implicit wage floors and reductions in non-wage costs, either temporary (eg for the unemployed) or permanent (eg to compensate for disabilities), and especially at the low end of the wage scale. The latter measures tend to minimise the impact on net wage incomes but have significant budgetary consequences which call for compensatory measures (see IV.3.c below).
- (iii) Measures related to *the reorganisation of working time and patterns*. The basic issue there is to dissociate the evolution of productivity per hour worked from productivity per person employed. A compulsory, across the board and massive reduction in working time would not provide a satisfactory answer in view of its implications for future productive capacities, wage levels and the post-2000 demographic evolution. These adverse effects are, however, avoided in the case of *specific measures of working time reduction at the microeconomic level* which are warranted by local conditions, socially accepted by all parties and are either reversible or can be seen as integrated into the secular trend of reduction in working time. Such measures, as well as those designed to make full use of the potential of *voluntary part-time work*, should be promoted. Given that most of the part-time employees are women, it is important to emphasise that this type of working pattern should be an option for all employees and to avoid reinforcing the existing segregation of the labour market. Finally, the negative consequences of reduced working hours on potential output may be alleviated and even reversed by shift-work arrangements aiming at *de-coupling capital hours from labour hours*. However, this instrument cannot be applied in a general way since, beside its important social dimension, only firms which confront supply constraints and have available an adequate "reserve" of usable manpower would be able to benefit from it.
- (iv) *the promotion of local initiatives*, for example in the fields of social services and environmental improvements, can increase the labour content of growth. It operates through the same economic mechanisms as described above or through subsidising some of these activities.

There are thus pragmatic ways to achieve a higher labour content of growth via a lowering of wage-costs and a reform of working time, together with the promotion of new fields of activities, without calling into question fundamental social values. However, these actions must not hamper the growth process itself and should thus not be in contradiction with the need to enhance the Union's competitiveness and the required fiscal consolidation. Under these assumptions, economic analyses in the framework of joint and co-ordinated policy actions suggest scope for noticeable employment gains. First estimations by the Commission services⁶ indicate, for example, that a reduction in non-wage labour costs of a magnitude of approximately 1 per cent of GDP, targeted to the lower wage groups and financed by the introduction of a Community-wide CO² / energy tax, as proposed by the Commission in 1992, could -- in addition to the environment benefits -- raise employment growth by an additional ¼ of a per cent per year and thereby create, in the medium term, approximately two million jobs in the Union as a whole. As regards working time and work organisation, a maximum use of voluntary part-time work, could also add a ¼ of a per cent to annual employment growth. As a result, under the combined impact of both measures, on top of the optimum macro-economic scenario, the rate of unemployment could drop to even about 5 cent in 2000 compared to 7½ per cent in the optimum macroeconomic scenario alone.

This analysis shows that the potential benefits of such a kind of structural actions are important. Chapter IV outlines that actions along these lines are under way in Member States. However, it needs to be stressed that measures of the magnitude as those underlying the simulation are not yet underway. This is related to the fact that these actions have unavoidable costs, social and political, even when they are neutral from an accounting viewpoint.

For the longer run, if macro-economic and structural policies manage to achieve a result as indicated by this scenario, it becomes conceivable that full employment (as in the 1960's) could be restored in the following decade, and that around the year 2020 the average participation rate in the Union could reach the high level prevalent in the Northern part of Europe and in the US. In such conditions, the demographic evolution with a marked increase of aged persons relative to the employed population would be much less of a burden. A low employment, low activity scenario would imply an increase between 1995 and 2020 in the ratio old aged/ employed from 39% to 50%. A high employment, high activity scenario would imply an increase of only 1 to 2 percentage points. Such a positive development would ease the burden on social protection and pension systems, and make reforms easier to implement.⁷

The necessary improvement in the labour market situation depends on the simultaneous implementation of sound macroeconomic and structural policies in a climate of enhanced confidence and increased social consensus.

⁶ "Taxation, employment and environment: fiscal reform for reducing unemployment", *European Economy*, n° 56, 1994.

⁷ Some Economic Implications of Demographic Trends up to 2020
European Economy N° 56, 1994.

In such a context, the current growth pause is likely to give way to a strong and employment-creating medium-term growth process. This is the rationale behind the Community employment strategy. As will be shown in Chapter IV, Member states are taking a number of initiatives implementing the labour market part of this strategy. However, new and strong commitments are required from Governments and from the social partners to maintain and reinforce this process.

IV. EMPLOYMENT AND THE FIVE PRIORITIES DEFINED IN ESSEN

Over the last two years, the Member States have shown themselves to be making a considerable effort to streamline the labour market. In many cases this has resulted in national employment plans, such as the overall plan for employment in 1994 in Belgium, Danish and Spanish reforms of the labour market in 1994, the French five-year plan of 1993, backed up by emergency measures in the summer of 1995, the Swedish employment action programme early in 1995, etc. In other Member States selective reforms have been undertaken targeting various aspects of the labour market. In general, these reforms show that there is a broad consensus on the guidelines set out in Essen, although a global "employment systems" approach as recommended by the White Paper and by the European Council cannot always be discerned in the midst of all these reforms.

(1) PROMOTION OF INVESTMENT IN VOCATIONAL TRAINING

Context

Considerable progress has been achieved over the past years in improving the initial education and training of young people. This is reflected in the increased proportion of young people remaining in education and training, which resulted in a marked fall in labour force participation of the under-25s in nearly all Member States. Enterprises, however, reduced their investment in training during the recession and stronger involvement of businesses and their workers in training is needed to attain the objective of life-long training.

Recent national measures

a) Promoting investment in training by improving systems in the Member States

Member States are reforming their education and training systems to be more responsive to different geographical, occupational, sectoral and individual needs. There is greater emphasis on **the social partners' role** in the planning, content and delivery of training and qualifications. Training delivery has been decentralised and the role of the private sector has increased significantly. In the UK, Training and Enterprise Councils deliver government training programmes in their areas and are led by private sector employers. In France, there are over 20 000 private training providers out of an estimated 60 000 in the EU as a whole.

In broad terms, Member States take responsibility for training provision for young people and unemployed people. However, in some countries there is a growing emphasis on prevention of unemployment through training and there is public provision for workers threatened by unemployment owing to industrial change.

Efforts are being made to improve the responsiveness of training systems to the needs of the market, which are changing with increasing speed. Member States are attempting to **identify and to forecast new skill needs**. For example, in Germany, the Netherlands, Austria, Sweden and the UK, job profiles and qualification content are regularly revised. The most common forecasting methods are: *vacancy analysis* (used in Belgium, for example); *analysis of the trends in qualifications* (Denmark, the Netherlands, Portugal and Finland); *labour market and sectoral and regional surveys* (Germany, Greece, Spain and Austria); and *forecasting models* (Ireland and in some regions of Italy). However, there is a common view that current methodologies are insufficient to effectively forecast changes.

Member State governments often set standards for training providers to meet before they can deliver public training programmes, but enterprises or individuals have little indication as to the quality of the training on offer. There is a trend towards improving the transparency of the market of training providers by introducing **quality standards or measures**. Systems of quality certification are being used or developed in Belgium, Denmark, France, Portugal and Greece. Germany, Austria and the Netherlands have statutory standards for continuing training provision. In the UK, quality is assessed by the outcome of the training process.

b) Promoting investment by improving the employability of people

Fewer young people entering the labour market and the impact of technological change has emphasised the importance of continuing training. In Denmark an initiative has been taken to increase adult training activities and to raise the number of adult training places by 50 000 by the year 2000, to improve the quality of their workforce. France, Austria, Finland Spain and the UK have developed **ways of recognizing and validating informal training** and/or work experience. The principle of access to training throughout working life is accepted in all Member States. Some have legal entitlements to training leave, for example Belgium, most of the German Länder and France (where training credits providing entitlements to time for off-the job training are being developed). In Denmark, up to one year can be taken on approved adult education or vocational training courses and the worker can be temporarily replaced by an unemployed person. There is also a clear trend towards encouraging individuals to take greater responsibility for identifying and meeting their own training needs and there are a variety of financial incentives to take up training. Allowances are paid to unemployed trainees. Tax relief on expenditure by individuals for training in specific occupations or leading to recognised qualifications exists in Belgium, Greece, France and the UK, where subsidised loans for education and training linked to career development are also available.

However, there are indications that those least qualified and so the most vulnerable in the labour market are least likely to receive training, along with **women and workers in small and medium-sized enterprises (SMEs)**. Member States have taken initiatives to promote access to training for women and to tailor provision to meet their needs, such as specific training courses for women in occupations or sectors traditionally occupied by men, as well as guidance and support for women returning to the labour market. Some Member States,

including Belgium, France, Ireland, Spain and Portugal, count workers in SMEs amongst priority groups for publicly funded training provision.

c) Promoting investment through new relations between training and work

A number of incentives exist to encourage firms to invest in training. Training levies expressed as a percentage of the wage bill are used in Belgium, Greece, France and Ireland, where there are also tax advantages for firms increasing investment in training. In order to implement the programmes of the European Social Fund, several Member States have had to introduce new schemes, or to strengthen existing ones, supporting business investment in the training of their workers, especially in relation to the adaptation of workers to industrial change (Objective 4 of the Structural Funds).

Economic restructuring and technological change has seen enterprises move towards **more flexible working arrangements** – for example, part-time, temporary workers and "contracting-out" of services. This has important implications for training in terms of access – part-time and temporary workers are amongst those least likely to receive training – and for the way businesses perceive their training needs. Training is increasing as a priority in the social dialogue, featuring in some collective agreements at sectoral level and in discussions in works councils at enterprise level. However, the development of new arrangements combining working time and training is still at an embryonic stage.

d) Sustaining investment and returns on investment

Member States are committed to reform and investment in their education and training systems and clear policy directions have emerged across the EU. However, the aim of promoting investment in training is set in the context of difficult decisions over public and private expenditure. Member States have sought to improve the effectiveness of training expenditure through rationalisation and improved targeting, but in the public sector clear tensions remain between pressures to reduce public spending and the need to continue reform to consolidate and complement the progress made so far. However, in the recession enterprises reduced investment in training and it is not clear that economic recovery has restored previous levels. To a degree these problems are linked to the perception that training is a cost rather than an investment. Training policies need to be seen not as a burden on the public or private purse, but as a priority.

Constraints on spending have led to greater emphasis on quality, which is reflected in efforts to improve the efficiency and effectiveness of systems, through targeting, rationalisation and by making training provision more relevant. However, the results desired or expected from the resources put into training by Member States and others – the returns on the investment – are less clear. Some Member States have set **specific indicators** in the training field. The UK has national targets for education and training defined by the qualification level of different sectors of the workforce. France and Italy have targets for the qualification level of young people. In Sweden and Finland, targets are set for the number of training places in upper secondary education. Such indicators make it easier for Member States to assess the full impact of their education and training policies on the labour market.

Prospects

Despite the strict budgetary restraints in the public and private sectors, the Member States must maintain their commitment towards increased investment in training, and this commitment needs to be shared by the authorities, the social partners, enterprises and individuals. Training must be more focused, more attuned to market needs, and better coordinated with fiscal and unemployment insurance reforms. Promotion of investment in training needs to be supported through a number of clear objectives, which should also inform the decision-making process and aim to improve the use of resources.

Quality in education and training is dependent upon the efficiency, the effectiveness and the evaluation of the systems in place, which could be promoted through:

– **development of incentives to enterprises and to individuals to promote investment in vocational training:**

these would include fiscal (tax relief, rebates, reductions, etc.), financial (grants, preferential loans, etc.), and other incentives such as training places for young people, improved access for example through new arrangements for working time and training, etc.);

– **development of measurable, quantitative and qualitative indicators, for example the introduction of targets for: the qualification levels of 18-24 year olds, 25-50 year olds, and 50+ year olds; and for the number of training places for young people and the long-term unemployed.**

these would be for Member States to define in the context of their own systems. Setting qualification targets is in line with the Essen conclusions, as they are important in improving employment prospects and as indicators of the skill levels of individuals and so help to make the market more transparent. Targets for places would underline public-sector commitment to providing training for those vulnerable in the labour market.

– **monitoring and evaluation of investment in and the impact of training measures:**

such arrangements would include monitoring public (and where possible) private expenditure on vocational training and the development of criteria for measuring the impact of training measures, such as participation rates, qualification levels, improved productivity, higher employment rates;

This would provide the basis to monitor progress in the Member States in the light of their own objectives and initiatives. Furthermore, it would help to ensure a central role for vocational training and enable those responsible for its policy and practice to take an active part in the debate on the whole question of improving employment systems.

(2) MAKING GROWTH MORE EMPLOYMENT-INTENSIVE

Context

Although the economic recovery, which has become widespread since mid-1993, has already resulted in an increase in the net job creation figures in the Union, unemployment is still high at 18 million, or almost 11% of the working population. Recent forecasts put net job creation in the Union in 1995 and 1996 at a mere 3 million, which will reduce unemployment by only 1.6 million, if we allow for the increase in the working population.

We should also stress that it takes a great deal of time for the upturn in growth to have any impact on unemployment levels. Whilst growth in GNP in the Union appeared to pick up in mid-1993, it has scarcely made any impact so far on the number of people out of work. This shows how urgently action is needed to make growth more employment-intensive in accordance with the Essen recommendations.

This aim must not be interpreted as running counter to an improvement in the general level of productivity within the Union (cf. section III). The idea here is to stimulate the supply side of employment especially by an expansion in services, by a variety of means. The Essen European Council identified three principal areas for action to achieve this aim: more flexible organisation of work, an employment-friendly wage policy and encouragement for mainly local initiatives to create jobs by meeting new needs.

Recent national measures

a) Changes in the organisation of work and working hours

In recent years many Member States have introduced reforms to organise work in a more flexible manner, mainly to adapt working hours to changes in economic activity, i.e. by calculating working hours on an annual basis (introduced in France, Belgium and Spain in 1994) and preventing redundancies by encouraging temporary reductions in working hours (B,D, F, I). Several countries have also made it easier to conclude non-standard contracts of employment for fixed-term or part-time work by relaxing the rules for employers' use of such contracts and by strengthening the rights of the workers (unemployment benefit, insurance, etc.). They have also urged the social partners to conclude agreements covering this type of situation.

The process of adjustment is still going on, as amendments to the legislation on working hours in order to achieve greater flexibility are currently being examined in Portugal (relaxing of the rules on fixed-term and part-time contracts, temporary work agencies, conditions for redundancies, etc.), Italy (draft law of June 1995), Sweden, Finland and the Netherlands.

All the Member States are looking for suitable reforms to strike a balance between the need for flexible organisation of work – which assumes that various types of employment contracts are used – and the need to protect workers' rights. Spain has thus introduced more restrictive conditions governing fixed-term contracts whilst relaxing the rules on the conditions for redundancies.

Measures establishing a link between more flexible conditions of work and job creation merit special attention. Some Member States (F, B) have provided for financial incentives (a reduction in social security contributions) to conclude agreements on a substantial reduction in working hours in return for recruitment in the same enterprise, thus enabling work to be redistributed within the enterprise. The arrangements introduced by several Member States such as DK, enabling workers to take a career break to, say, attend a training course, in exchange for taking on an unemployed person for this period, are also intended to redistribute work more widely.

In Germany, the social partners have, for the first time, accorded greater importance to guaranteeing employment in their collective agreements. In return for an undertaking by the employer not to resort to redundancies, workers are accepting a reduction in working hours accompanied by a cut in pay. Agreements of this type have been concluded in several industrial sectors, in the distributive trades and in public services in East Germany and often provide for more flexible working hours too.

Reductions in working hours can be particularly attractive for enterprises which are "**disconnecting**" working hours from plant operating hours (e.g. a 4-day week for workers with plant operating for 6 days). Such arrangements have, in fact, proved capable of increasing capital productivity significantly and being profitable even without any major reduction in real wages. The law on working hours which entered into force in Germany in 1994 made this easier by permitting more flexible working hours. In the Netherlands these practices could be encouraged by the law on working hours which is currently under discussion.

Part-time employment, which is keenly advocated by the majority of Member States, increased in 1994, accounting for 15.4% of the average total employment figure in the European Union (as against 14.7% in 1993), DK being the only country where it fell. Generally speaking, this is a beneficial trend which permits a more flexible response to employment supply and demand. The percentage of women occupying these jobs is high. According to the labour force survey, two thirds of women who had a part-time job in 1994 did not want to work full-time. However, these replies must be examined in the overall context in which women work (availability and cost of services) and anyway opinions appear to differ widely from one Member State to another. In the UK, the government estimates that 86% of those who are working part-time wish to do so, while in Sweden the Government is worried about the considerable increase in the number of women with part-time jobs (the figure having tripled between 1990 and 1994) against their will and intends to ensure that more of them have full-time employment.

It is worth considering the fact that greater flexibility in working hours is conducive to **reconciling family and working life**. In the Netherlands, the law on working hours which is currently being discussed places an obligation on employers to take into consideration the domestic duties of employees and to draw up a written declaration on the enterprise's policy in this respect.

b) Wage policy

In line with the Essen recommendation, the general trend in the Member States is towards **wage restraint**. This is mainly a result of collective agreements which, in the majority of the Member States, have remained within the limits of inflation. The authorities are urging the social partners to moderate increases in pay and to accord greater importance to employment in their agreements. In addition, some governments are taking a more direct part in wage agreements.

The Belgian plan thus provides for a freeze in real pay between 1994 and 1996 and the Irish programme on competitiveness and employment limits nominal pay increases between 1994 to 1996 to 8% (which is estimated to be far less than the rise in productivity); the central agreement of November 1993 in the Netherlands, collective agreements in Germany and the tripartite agreements in Italy (1993) and Luxembourg (1994) are all geared toward the same goals.

Some Member States use wage restraint as a direct means of redistributing productivity gains more widely, as is the case in Belgium where the "solidarity contribution" is used to fund employment, vocational training and child care measures.

Wage restraint is now being accompanied by a **search for flexibility** and real pay is now being determined more and more at enterprise level. In Spain, the 1994 reform restricted statutory pay limits and handed the reins over to the social partners. In Ireland, the aim of the tripartite agreement is to encourage wage restraint at national level with flexibility at enterprise level. In Denmark and the UK too the aim is to decentralise the process of wage negotiation to enable performance and pay to be linked more closely.

Moves are also being made to **structure pay rates for different groups of workers** to enable certain groups to obtain work (by analogy with arrangements for reducing indirect wage costs for such groups, see (3) below). In Germany, the collective agreements in some branches, such as the chemical and paper industries, concluded in 1995 provide for wages which are lower (by a maximum of 10%) than normal rates for the recruitment of the long-term unemployed. In Denmark, the social partners are examining the possibility of introducing lower wages for some "fill-in jobs". In Spain, the minimum wage is reduced for young people. In the Netherlands, the social partners are being encouraged to make provision for low-wage work for the long-term unemployed and exceptions to the minimum wage are being discussed.

In order to reduce labour costs for **the least productive workers**, the Netherlands froze the statutory minimum wage in 1995, and made provision for increases in 1996 to 1998 to be limited to half the average increase in pay. The social partners are also being encouraged to exploit the existing gap between minimum wages under collective agreements and the statutory minimum wage to recruit low-skilled workers.

c) Developments in policies on new sources of employment and local initiatives

Tapping new sources of employment calls for initiatives at various levels, depending on the nature of the needs to be met. Those relating to transport, communications or recycling are

best met at interregional or Union level. This is reflected in the conclusions of the European Council in Essen, which point out the need to find sources of funding for trans-European environmental protection projects. Joint environmental projects are on the drawing board at the European Commission. Investment in these forms of infrastructure will create jobs and contribute to protecting the environment.

Local development and employment initiatives are noteworthy in four respects:

- they lend themselves to activities for reintegrating the long-term unemployed, young people with problems and unemployed women;
- they are geared towards providing the best means of meeting the new needs of society through new occupations;
- they are in keeping with the aspirations of new entrepreneurs;
- they are often based in the context of a local renovation or economic and social development project in a rural or urban environment.

Since the Essen Council, when three governments, (Denmark, Ireland and Portugal for the second time) came out in strong support of the Commission's report on employment and local initiatives, appreciable progress has been made through exchanges of ideas and practice between the Member States.

Activity is gradually stirring throughout all the 17 areas⁸ identified by the Commission (domestic service projects in NL and D and neighbourhood services and quality of life in Portugal), in addition to those traditionally preferred by the Member States.

For many Member States (F, NL, D, A) local initiatives are still a key area for the **integration of the unemployed**, either by means of temporary direct aid or by reducing wage costs for enterprises or activities in the 17 above areas.

The desire to meet the new needs is giving rise to **experimentation with financial instruments** which are designed to promote the creation of a new market. One example of these are service vouchers, of which there are several national variants (adopted in 1994 in F and B and under study in D and NL), and adjustment of legal, financial or fiscal provisions to enable households to become employers or consumers of domestic services (F, DK, under study in D) or again, new individual insurance systems, mainly to cover the risk of "dependence" (A, D). These three measures are each expected to generate employment for some thirty or forty thousand people and some of them are flanked by training programmes to establish these as new occupations (P, F, NL). For the time being, however, it is not the social partners who appear to be the driving force behind this movement.

The idea of **transformation in entrepreneurial structures** does not seem to have sunk in properly yet. Self-employment, which has long been the preferred option in some countries (UK), is arousing some interest in other Member States, which would like to adapt it to ensure that very small enterprises have proper support (P, SF). Governments are also

⁸ Domestic services, child care, new information and communication technologies, help for young people with problems and integration, housing improvement, safety, local public transport, upgrading of public urban areas, neighbourhood trade, tourism, audiovisual services, cultural heritage, local cultural development, waste management, water management, protection and maintenance of nature zones, regulation, pollution control and corresponding installations.

interested in the direct contribution to job creation that associations, partnerships between the private and public sectors and non-profit making organisations can make and the steps they have taken in this area recently have mainly been to simplify the rules covering the social economy sector (P, F) or to instigate studies when this sector is still in its infancy (Irl, SF).

Finally, except in the countries already known for their liking for this approach (P, DK, Irl, UK, A, S), **the local dimension of employment initiatives** hardly figures in recent national measures. Admittedly, one cannot create dynamic interaction between employment, meeting local needs and local development until the local community has been sounded out and the ground prepared at length (to cover decentralisation, vertical partnerships between the three or four levels of public authority, involvement of all the local players and drafting of a joint economic and social strategy), a process in which local authorities have an important part to play.

Some initiatives along these lines deserve a mention, such as in France (a survey on the opportunities for creating employment in each department) and in Finland (working party on the local promotion of job creation).

Prospects

- Although the Member States have done much to relax the rules on **organisation of working hours**, the social partners are far from having exhausted the possibilities they have been offered, and priority should be given to disseminating good practice which can increase employment and productivity.

More flexible working conditions may not, however, be achieved at the expense of the level of social protection of workers, as this would be a disincentive to employment. The higher proportion of women in temporary or part-time work also raises a fundamental question with regard to the desegregation of the labour market and equal opportunities, which should be looked at more closely.

- Whilst the principle of **wage restraint** has largely been respected recently, the pressures which are making themselves felt now – with the economy picking up – for increases in real pay could well jeopardise this trend, making it even more important to be able to demonstrate the beneficial effect on employment of a policy of wage restraint. Here, a balance must be sought in collective agreements between provisions covering pay and employment, perhaps even more so than in the past.

It would also be useful to examine whether greater flexibility in the mechanisms and criteria for fixing pay at worker and enterprise level should not take precedence over a general policy of wage restraint.

- Marked progress has been made in tapping **new sources of employment**. However, this potential is still not being used to the full. In its Communication of June 1995 "A European strategy to encourage local development and employment initiatives"⁹, the

⁹ COM(95) 273 13 June 1995.

Commission identified the types of measures to create the right climate, i.e. setting up a different set of financial instruments, adjusting training and diplomas to consolidate new occupations, renewing the legal framework and introducing sufficient decentralisation of administrative action. It also stressed the support which could be given to these initiatives at Union level. The Cannes European Council took note of this Communication in June 1995 and stressed the need to propagate experiments undertaken at national level, and invited the Social Affairs Council to report to it on this matter at the meeting in Madrid in December 1995.

(3) REDUCING INDIRECT LABOUR COSTS

Context

During the period from 1980 to 1993 the tax rate on labour as a proportion of GNP went from 19% to 21% whilst the rate for other production factors fell (from 9% to 8.5%) and rose from 10% to 11% for consumption.

The Union has thus set itself the target of reducing these costs sufficiently to have an impact on decisions to take on workers, in particular low-skilled workers who are not productive enough to make up for the real costs of labour.

Recent national measures

a) Action by Member States

Several Member States (E, L, P, NL, SF) have opted for a **general reduction in social contributions**. However, some Member States, particularly the Nordic countries, have even decided to increase social security contributions based on work in order to reinforce the contributory nature of social protection and to encourage people to take up registered employment.

However, most of the Member States opt for **temporary and/or conditional reductions of social security contributions** contingent upon recruitment, particularly of problem groups such as young people, the unemployed, the long-term unemployed or the disabled. Several Member States, especially Belgium and France, reinforced such measures very recently.

The approach adopted recently by six Member States is based on **specific reductions of contributions for the lower wage groups** (B, DK, IRL, F, NL, UK). In this context it is interesting to note that the French plan for 1995 to reduce social contributions on low wages is accompanied by measures to create jobs and that the outcome is to be assessed in 18 months' time.

The approach is different in Finland, where indirect costs to SMEs have been reduced and the contribution of larger enterprises, which are generally more capital-intensive, increased.

Some national measures have been introduced in order to obtain a "**double dividend**" by funding a reduction in labour costs – designed to boost employment – by an increase in

taxation on the use of natural resources, which serves to protect the environment. In the UK, for example, VAT is now levied on energy and a new tax on waste is being introduced, coupled with a reduction in employers' social security contributions. Many steps have been taken or are under consideration to introduce taxes on energy with repercussions of varying intensity on labour costs. Denmark has also decided to raise eco-taxes to 1.4% of GNP. Luxembourg has introduced social security charges (and additional excise duties) on energy consumption. Spain has brought in a tax on effluent discharge and, in the Netherlands, a tax on energy consumption is in the pipeline which will be used to fund various ways of reducing the burden on taxpayers.

Finally, it is important not to ignore the **indirect labour costs other than social contributions**, i.e. the various forms of taxation of enterprises in the assessment of which wages play a part. In Germany, the possibility of discontinuing employers' contributions to vocational training and opting for funding through taxation is currently being studied.

b) Effect on employment: necessity of targeting and linkage

As a general reduction in non-wage labour costs can have significant budgetary consequences and as the extent of its impact is not known, it is more efficient to focus on those segments of the labour market which are more responsive to such a reduction than others. The White Paper, indeed, insisted on the need to **target** the reduction (particularly at the least skilled workers) in order to limit the budgetary cost of the measure per job saved or created. In the context of a strategy of prevention of long-term unemployment, specific targeting of the unemployed seems particularly appropriate.

However, in some Member States the measures taken to reduce non-wage labour costs have been targeted at a wide variety of groups. The multiplicity of the targeted population may have led to the impact of the measures being diluted, and administrative complexities might have discouraged employers, in particular SMEs, from taking advantage of the measures. This suggests that the programmes should focus on a few, specific targets and be as simple as possible.

Moreover, the fiscal incentives represented by such a reduction should be **linked** to, or used in conjunction with, measures (e.g. working time reorganization) resulting in net job creation.

The need to link does not apply only to the measures reducing non-wage labour costs, but also to fiscal advantages given in other forms: for example, subsidies to firms which implement approved training plans or increase their investment in training. This would ensure that investment in human capital continues once employers have recruited new workers. The need to link should, however, be seen as a short-term measure rather than a long-term one. In the long term, linkage may introduce rigidities in the labour markets. However, the priority given to employment justifies its use in the short term.

Prospects

Renewed attention needs to be paid to the need to target reductions in social contributions in order to have an optimal impact. Special attention will have to be given in the coming months to the respective impact of the different options chosen by Member States for such targeting.

Taking into account current public finance constraints, a significant reduction in non-wage labour costs cannot take place unless proper compensatory measures are implemented. Some Member States hope to compensate a reduction in non-wage labour costs by a reduction in public expenditure and/or increased tax revenues coming from economic growth. Nevertheless, because of the magnitude of the necessary reduction of public debts and public deficits, either or even both ways will not be enough and further measures have to be considered in many Member States.

Despite a general need for compensation, the different tax structures of Member States and their different histories of taxation (not just in the last fifteen years) call for flexibility as regards the choice of suitable compensatory measure. To ensure the compatibility of these measures with the internal market, a deepening of the current exchange of experience and information, coupled with increased cooperation between Member States, is necessary. One of the most stringent limitations to the margin for manoeuvre of each Member State is, within the framework of the Internal Market, the risk of certain tax bases being relocated, especially the more mobile ones, when effective tax rates applied to these bases are too different between Member States.

The Commission has already made proposals for some "safety nets" (minimum standard rate of VAT, taxation of savings, taxation of energy), which beyond their specific objectives would offer scope for budgetary compensation in addition to limiting the risk of fiscal competition between Member States.

Moreover, compensatory measures should not be thought of only as a way to stabilise total tax revenues but also as a secondary tool to facilitate the substitution of other factors of production with labour. To this end, compensatory measures should mostly be levied on non-labour factors of production rather than on consumption. Some resources, mainly the environmental ones, have been clearly over-used in the recent past, and increased taxation of these resources (taxation of either products or processes) could lead to a more balanced use of all resources. Simulations undertaken by the Commission¹⁰ suggest that taxes on the use of natural resources, such as the proposed CO₂/energy tax, introduced to finance reductions in social contributions, would be more effective in terms of employment creation than increases in other taxes, such as VAT or income tax. Thus a CO₂/energy tax raising revenues of about 1% of GDP would increase total employment in the Union by almost 1%. If the reduction in social contributions were targeted to the lowest skill or income groups, this employment increase could even be doubled, representing up to 2 million additional jobs in the Community as a whole.

The shift of the tax burden away from labour towards other factors of production should have two clear objectives. First, in the short term, to give to economic agents a clear signal that the tax system is being reformed to create (or at least not to put obstacles in the way of) employment and to provide an incentive for the use of labour. Second, in the longer term, to significantly reduce non-wage labour costs, which are still too high, in spite of recent measures taken by the Member States.

¹⁰ Taxation, employment and environment: fiscal reform for reducing unemployment", European Economy, No 56, 1994.

To this end, it should be clearly established that:

- the trend in tax structure, which has been unfavourable to labour in the last 15 years, should be reversed.
- concertation between Member States should be enhanced in this matter, so that the risks of fiscal competition inside the internal market do not prevent moving part of the tax burden from labour to non-labour factors of production or, eventually, to consumption.

(4) INCREASING THE EFFECTIVENESS OF LABOUR MARKET POLICY

Context

Although expenditure on labour market policy in the Union accounts for an average of 3.5% of GNP, two-thirds of this is devoted to income support for the unemployed and early retirees. These considerable budget resources need to be redirected, the priority being to reintegrate the unemployed in the labour market. An "activation" policy to do this should be pursued to give every unemployed person an incentive – especially financial – to look for work and, given more efficient employment services and greater geographical and occupational mobility, a better chance of finding one.

All the Member States have taken or reinforced active measures over the past few years, although the considerable and rapid increase in unemployment has kept passive expenditure high. Apart from their considerable endeavours in the area of training, which is a major aspect of an active labour market policy, to increase occupational mobility amongst workers and jobseekers (section IV.1 above), the Member States' efforts have been concentrated mainly on public employment services and motivating the unemployed to seek work.

Recent national measures

a) Employment services

Many of the Member States have taken great pains to improve the efficiency of their employment services (which, for the majority, is reflected in an increase in the percentage of corresponding expenditure in GNP between 1985 and 1993). Recently, the most significant reforms have probably been those undertaken by Austria, Denmark and the Netherlands, together with the modernisation of Greek employment services.

An efficiency drive via **structural reform** is in progress in Germany, where greater autonomy for employment offices is being studied, in Austria, where the employment services now form an autonomous public enterprise, and in the Netherlands, where, unlike in the other Member States, the move is towards greater centralisation. In Italy, the draft law of June 1995 does away with the public monopoly on placement.

The public employment services are diversifying in, for example, Germany (Start), where **temporary labour services** are being created to reintegrate the long-term unemployed. More openings are also being offered to private services: non-profit making agencies in Spain, placement offices in Germany and Austria, and temporary work agencies in Italy.

There are also moves to set up **closer links of cooperation with employers**, as with large enterprises in France, with SMEs, craftsmen and professional organisations in Germany, and with certain sectors in the Netherlands in order to identify and respond to their needs more effectively.

Employment service activity is concentrated on **priority aims**, mainly as a result of reinforcement of individual counselling services for unemployed persons who face the greatest problems, in particular young people and the long-term unemployed (B, FR, UK, S, DK). In Denmark, an activation policy has been launched whereby an individual plan of action is devised for each unemployed person, culminating in either training or employment. The Government has been very favourably impressed by the results of the plan, especially by the fact that more unemployed persons are taking part in training courses.

Several Member States (especially Austria, the Netherlands and the UK) are trying to define **performance criteria** for employment services. Following an independent audit of the public employment service in the Netherlands, a major reform is under way which will establish an explicit link between performance and allocation of public funds.

b) Promotion of occupational and geographical flexibility

Measures to **promote mobility of workers** in the Union appear to concentrate, for the moment, on occupational rather than geographical mobility. Investment in continuing training and "transferable" training to enable workers to cope with industrial change is geared to this goal. As pointed out above (section IV.1), there are sound reasons for stepping up activities in this area.

Little information is available on other types of measures which would be needed to remove obstacles to occupational mobility by dismantling barriers between trades, occupations and professions.

Geographical mobility between Member States in the Union is rare, if only for reasons of language. However, one of the priorities in completing the internal market is to dismantle legal, administrative and fiscal barriers to geographical mobility. Services such as the EURES network, which links national employment agencies, are also likely to encourage and facilitate mobility of workers between Member States.

At national level the main measures comprise transport or removal grants, apart from those related to housing policy. The debate on geographical mobility is a live issue in Italy, with the north facing a shortfall in labour and the south suffering from very high unemployment. The question of geographical mobility is directly related to regional development. The Community Structural Funds allocate considerable sums of money to support Member States' policies which are designed to ensure balanced regional development by supporting economic activities and training of workers.

c) Reinforcing incentives to jobseekers and to recruitment

One major area of policy action in most of the Member states has been to review the actual functioning of tax and benefit systems, with the aim of removing potential barriers to creating

or taking up a job. A specific report was requested by the Essen European Council on this topic, and a summary of the main analysis and conclusions is annexed to this report.

In order to strengthen incentives for workers to seek work actively, **unemployment benefit** is subject to more restrictive conditions. In Denmark, stricter rules on availability for work were introduced in April 1995; in Spain, where the benefit system was reviewed in 1992 to encourage active job seeking, rights to benefit can be denied if a person refuses a suitable offer of employment or refuses to take part in community work or training. In Sweden, a person who turns down an offer of employment or training loses his/her unemployment benefit. In the United Kingdom, reform of the benefit system is under review and the new job seeker's allowance is designed to provide a greater incentive.

In Greece, there is a good illustration of activating employment policy using "multiple-use vouchers" introduced in 1995. These vouchers, which are issued to the unemployed, have a financial value and can be used by unemployed persons in various ways. They can be given to the employer on recruitment to contribute to training costs or can be cashed in by the holder to help him/her to start up an enterprise. The system is supposed to shift the responsibility for seeking work towards the unemployed and at the same time provides an incentive for employers and cuts down on red tape.

Some Member States have taken steps to ensure that too high a "**replacement rate**" (the level of unemployment and other benefits compared with wages) especially at the lower end of the wage scale, does not discourage people from looking for work, taking into account the additional costs involved (e.g. transport, family help, etc.). In the Netherlands, for example, the statutory minimum wage freeze is affecting social benefits and improving the replacement rate vis-à-vis minimum wages under collective agreements or the average wage. It is worth noting too that some benefits (Sweden) or the period for award of supplementary benefit (Denmark) have been reduced. A reform of the unemployment benefit system is being studied in Finland. In Greece, however, basic unemployment benefits were increased substantially in 1994.

Maintaining unemployment benefits or some of them to top up income from work is one way of reducing the replacement rate. The majority of the Member States have an instrument of this kind for unemployed people who wish to start up or take over an enterprise. Some Member States also allow unemployed people who take paid employment to keep part of the unemployment benefit in addition to their wages. In the United Kingdom, for example, some 600 000 families come under the family credit system, which tops up the income of people with family responsibilities and low-paid employment.

These incentives for jobseekers or workers are backed up by a whole range of **incentives to employers** in the form of employment subsidies. These play a vital part in Belgium, Denmark, Finland and Spain. Greece and Portugal also make this a key element of their employment policy and it is also on the increase in Germany and Sweden and in France with the employment plan which came into force in July 1995. Subsidies usually target specific groups, especially the long-term unemployed and young people, and should be seen in conjunction with measures to reduce indirect costs (cf. (3) above).

The Member States have geared up assessment of the effectiveness of their labour market policies. The prospects of unemployed persons finding work are improving as a result of more

intensive counselling and assistance in job hunting. By contrast, much of the expenditure on employment subsidies is apparently ineffective or results in substitution (recruitment of one person instead of another). It is particularly difficult to assess the impact of training in terms of access to employment.

Prospects

- Despite the progress which has been made, **the balance between passive and active expenditure** is far from ideal. Efforts to activate employment policies without jeopardising high social protection standards, must be stepped up and, given the budgetary constraints facing the Member States, it is vital for various approaches to activating such policy to be assessed in the process of European cooperation.
- In this respect, the experience of the past few years has identified a need to take a closer look at the **employment services** and their triple role of collectors and disseminators of information on the labour market, clearing houses for job vacancies and applications and the agents responsible for helping labour to adapt to the needs of the labour market.
- Activation of the labour market also depends on **individuals' commitment** to make their spell of unemployment an intensive period of job-seeking or preparation for a future job. The social protection system reforms undertaken are intended to encourage job-hunting.
- The potential for promoting **occupational and geographic mobility** does not seem to have been exploited to the full by the Member States. More should be done in future to pool information and experience in these areas.

(5) REINFORCING MEASURES TO HELP THE GROUPS HIT HARDEST BY UNEMPLOYMENT

Context

Unemployment in Europe is marked not only by the fact that it is high but also by its severe impact on certain population groups – young people, women and older workers – and its duration.

The unemployment rate for women is still far higher than the men in the Union (12.6% as against 5.7%; seasonally adjusted figures for May 1995). In 1994 almost 48% of the unemployed in the Union had been without a job for a year or more (and half of them for over two years). Not only has the percentage not fallen for ten years but the absolute figure has increased. The rate of long-term unemployment increases with the age of the unemployed persons, a phenomenon which is also prevalent amongst young people (with a figure of 40% amongst the 20 to 24 year olds), despite the fact that this group has the most to gain from the economic recovery. On average, slightly more women than men are victims of long-term unemployment. Finally, the risk of long-term unemployment is higher for the low-skilled.

This situation is unacceptable, not only from a human point of view or from the point of view of social cohesion, but also in terms of optimum use of human resources, especially in the light of the demographic prospects of the Union.

Recent national measures

a) Measures to assist young people

Although the youth unemployment rate is still high, the number of young people without jobs has fallen appreciably in several Member States, chiefly because of the growing percentage of young people who remain in the education system. The Member States have made great efforts to reduce the number of young people entering the labour market without proper basic education for whom the risk of unemployment is particularly high (three times the average in the Netherlands, for example). The Danish programme launched in 1993 "Education for everybody" or the recent initiative by the Netherlands to create regional registers of pupils leaving school without qualifications in order to be able to offer them suitable individual counselling (e.g. to follow a training course or acquire some experience of work) are good illustrations of such action.

In several Member States, remedial systems are provided for in the form of a guarantee of training or employment for young people who have left the education system without qualifications. In the Netherlands, the law on guaranteed employment for young people guarantees jobs in a "municipal foundation" or, since 1995, in the private sector for all young people after six months (or 12 in some cases) of unemployment. In Denmark, any person under 25 who is not entitled to unemployment benefit now has the option - since the arrangements were enhanced in July 1995 - of three months' training or employment. At the same time the assistance system was reviewed to make training courses more attractive.

Training guarantees are provided for in Belgium ("social promotion"), in Spain, in Portugal (1991 agreement with the social partners to guarantee a minimum of one year of basic training for young people, in particular for those with few or no qualifications), and in the United Kingdom with the "youth credits" programme (which offers credits that can be exchanged for training leading to a recognised qualification). In Ireland, the Youthstart programme, launched in response to the Commission's White Paper, which combines a variety of basic training instruments for people entering the labour market, targets the 18-21s and comprises preventive action, measures for young people who have left school early, basic training, vocational training and apprenticeships.

b) Measures to assist the long-term unemployed

Since the beginning of the '90s, the Member States have been at great pains to fight long-term unemployment. Some base their strategy mainly on general measures (training, counselling, help in seeking employment, recruitment aids, etc.). Others consider it necessary to take specific measures, amongst which special counselling and placement services (e.g. Programme 900 000 in France and Restart in the UK), which have apparently proved effective, and recruitment aids (in the form of subsidies, total or partial payment of wages and reduction of social contributions, etc.) are growing in importance.

It is important to consider whether measures reserved exclusively for the long-term unemployed do not entail the risk of marginalising the persons concerned, and to examine closely the respective impact of the two approaches pursued.

However, in 1995 several Member States have clearly accorded higher priority to the long-term unemployed. In April 1995, Sweden decided to set aside the majority of its employment-boosting measures to tackle long-term unemployment. In the Netherlands, a programme has just been launched to provide jobs in the public sector for 40 000 persons by 1998; these are mainly jobs in neighbourhood services (health, care, safety and child care). In France, the emergency employment plan introduced by the new government in summer 1995 provides for a substantial increase in aid for recruitment of the long-term unemployed. In the UK, a series of measures were launched or boosted as from April 1995 to provide help in finding work, sometimes combined with job experience or financial incentives for employers (work trials). In Finland, a special national programme was launched in 1995 to fight long-term unemployment.

Several of these recent plans are accompanied by quantified targets. In Finland, for example, long-term unemployment is to be halved by 1999; in France, recruitment of the long-term unemployed is to be increased from 180 000 to 350 000 per year; in the Netherlands, 40 000 jobs are to be created by 1998.

The social partners can also take action to assist the long-term unemployed (such as the agreement in Italy on reduced wages).

c) Measures to assist older workers

The question of older workers is all the more pressing in that the demographic trends in the Union argue in favour of them staying in employment. For this reason several Member States have clearly chosen to keep these people at work as long as possible, particularly Italy, where the major pension reform approved in August 1995 established more restrictive conditions for retirement and early retirement, and Austria, which recently introduced restrictions on early retirement. With the same priority in mind, the Netherlands is focusing greater attention on working conditions for older workers in enterprises.

Various specific financial incentives are provided for by some Member States, along with general measures for the unemployed and in particular for the long-term unemployed in order to help older people to get back to work. These frequently take the form of employment subsidies and reductions in social contributions. The thresholds for these measures vary widely, ranging from 45 to 60 years. In Austria, the employment services are conducting an active policy amongst enterprises to persuade them to recruit older workers.

However, some Member States are still encouraging early retirement in a crisis, such as Greece in some regions with very high unemployment or where large enterprises are restructuring.

d) Measures to assist women

Women encounter different problems in the labour market, depending on whether they are returning to work, young women without employment, women who wish to go from part-

time, temporary or informal employment to full-time employment, women who have had a career break and wish to go back to work or women who belong to disadvantaged groups.

Prevention, with a close watch being kept in education and initial training systems, is a key factor. In Finland, a special effort is being made to train girls in careers traditionally pursued by men and the "Women and vocational training in industry" project has just been launched.

In Denmark, the employment services play an active role in fighting against segregation in the labour market.

In Germany the law on employment (Arbeitsförderungsgesetz – work promotion law) contains provisions specifically for unemployed women, which have just been strengthened (1994/95). They reinforce unemployed women's rights (treating women who have had a career break to look after their children as long-term unemployed persons) and enable job creation projects mainly involving women to be singled out for support.

Austria has implemented a programme specifically for the employment of women reinforcing measures to assist them.

Prospects

- Despite all that the Member States have done, too many **young people** are still leaving the education system without proper qualifications. Progress must still be made to attain the White Paper's objective of guaranteeing that nobody under 18 is unemployed. Young people who left the education system a few years ago, did not receive any training and now run the risk of social exclusion must, above all, be brought back into the training system.

Every person entering the labour market for the first time should have enough education, training or occupational experience to ensure that he/she is employable.

- Although the Member States have obviously gone up a gear in trying to integrate the **long-term unemployed**, each individual should not have received an opportunity for training, rehabilitation or integration before reaching the threshold of long-term unemployment.
- The Commission sees considerable differences between the Member States' perception of the prominence which should be given to measures promoting **equal opportunities**, especially in respect of desegregating the labour market and integrating women with special problems. There seems to have been very little movement recently in national approaches to this issue, which was declared to be a priority by the European Council in Essen. More intensive exchanges of views and pooling of experience by the Member States, particularly to take advantage of the experience of the new members, needs to be encouraged.
- Finally, the trend – now emerging in several Member States – towards **putting a figure on the results expected** of measures to assist specific groups should be highlighted, as it has the advantage of publicising priorities and contributes to a method for assessing the results of measures to boost employment.

V. HORIZONTAL QUESTIONS

The employment strategy defined by the European Council in Essen is based on all-policy concertation for the benefit of employment. Besides macroeconomic policies and labour market policies, the European Council asked for attention to be focused on specific areas. In Essen, it asked for the "effects of tax and support systems on the readiness both to create and take up jobs" and "the interrelationship between economic growth and the environment" to be examined. In Cannes, it also stressed the key role of SMEs in creating jobs and, in more general terms, as a factor of social stability and economic vigour.

Given the key role the Community Structural Funds play in matters of employment in general, and in implementing the Essen strategy in particular, the Commission decided to discuss their contribution in this Communication.

The aim of this section is to offer a brief presentation of the above issues, without prejudice to separate reports in more detail which already exist or are in the pipeline.

(1) SME- AND EMPLOYMENT-RELATED TRENDS

SMEs are the predominant source of private-sector employment. Moreover, they continue to be a dynamic source of new job creation because they can respond more rapidly than large enterprises to new opportunities and have greater flexibility to adapt to economic circumstances. However, the employment creation potential of SMEs is hindered by a range of barriers, many of which lie outside their control.

a) SME – Employment "Snapshot"

The latest data¹¹ for a range of EU15 countries confirm the pre-eminent role of SMEs in employment creation. The 15.8 million SMEs (< 250 employees) in the European Union employ 64.2 million people and account for 41.2% of the total active population. Small enterprises (< 50 employees) alone employ 52 million people, equivalent to 32% of the total active population.

In most countries, SMEs (< 250 employees) account for more than 60% of total enterprise employment. Italy (77%) has the highest proportion of employment in SMEs among countries covered and Germany (56%) has the lowest. In all countries small enterprises (< 50 employees) account for 40% or more of total enterprise employment.

From a sectoral perspective, the contribution to total enterprise employment of SMEs is highest in construction and services. SMEs account for 85.7% of total construction enterprise employment, with the highest percentage in Belgium (89.1%) and the lowest in France (81.4%). They account for 78% of total service enterprise employment, with the highest

¹¹ Source: Eurostat SME project, 1995; Enterprises in Europe, Third Report, 1994.

percentage again in Belgium (82.9%) and the lowest again in France (69%). They account for 51% of total industrial enterprise employment, with the highest percentage among countries covered in Portugal (68.9%) and the lowest in Germany (37.5%) and the UK (38.9%).

b) Recent employment contribution of SMEs

Recent data¹² confirm that SMEs are continuing to make a significant contribution to employment creation. In the 1988-1995 period, employment in SMEs (< 250 employees) in EUR 15 has grown by 0.25% on an annual average basis, compared with a decline of 0.5% in large enterprises. The evidence also indicates that while SMEs have tended to show a more limited acceleration of employment growth than large companies as the economic recovery has taken hold, more rapid SME job creation can be expected in future years as overcapacity diminishes.

SMEs, and micro-enterprises in particular, are playing a particularly significant and dynamic role in regions lagging behind. In most objective 1, 2 and 5b regions, SMEs have been responsible for either an aggregate increase in employment or an aggregate decrease less acute than that of large enterprises.

One should be aware of the close link between large and small companies, in the sense that small firms are often partly or wholly subcontractors. Large firms' policy of "contracting out", which has prevailed for some years, has a possible influence on SME job creation.

c) Barriers to SME employment creation in national labour markets

The capacity of SME's to maintain or to create jobs depends on a multiplicity of factors, some of them common to firms of all sizes.

The **general economic climate** is obviously a major factor, especially taking into account the spill-over effects from large firms via supply contracts and subcontracting. An improved climate, favourable to demand and investment, under the conditions described in Section III above, is therefore essential for SME's. Such a climate should also be seen as an opportunity to solve more structural problems affecting SME's job creation potential.

One of these structural problems results from **the administrative and legal environment** in which businesses work. Complex legal and administrative procedures and associated financial burdens represent a drain on the employment creation capacity of all enterprises. They reduce operating efficiency and increase costs. They have a relatively greater impact on SME's whose scale of operations is often not sufficient to absorb the overheads incurred in satisfying these requirements.

Some of these requirements are more directly related to the recruitment and management of employees. Even though it is not possible to establish a clear link between the level of **labour law** protection and that of employment, SMEs feel that labour law can impair their job creation potential, especially when it involves complex administrative burdens and when it limits flexibility in the management of the workforce (rules on atypical contracts or on

¹² Source: The European Observatory for SMEs, Third Annual Report, 1995.

working time, and conditions for dismissal). Some provisions, when they apply only above a given size, discourage firms from exceeding certain employment thresholds. It needs to be emphasized that labour law in the Union is essentially of national origin – be it based on legal or administrative provisions or on collective agreements – while Community legislation establishes minimum standards in a limited number of areas.

Creation and expansion of SMEs and related jobs are also hampered by their specific problems of **access to external sources of finance**. The **tax systems** themselves are not often designed in a way that favours SME self-financing, and tax compliance costs bear particularly heavily on them.

High indirect labour costs are perceived by SME's as a major disincentive to investment in labour.

Finally, SMEs often face important difficulties in **sourcing suitably qualified employees**. This points, on the one hand, to an improper functioning of the labour market in its "brokerage function" (see IV.4 above) and, on the other hand, to the need to improve the capacity of training systems to deliver the qualifications that are required by the market. In this context, however, it must be pointed out that SMEs invest less than large firms in the training of their own employees.

d) Important measures taken to reduce obstacles

A major part of the measures described under Section IV above in relation to the reform of the labour markets directly contribute to enhancing the job creation potential of SMEs.

As regards **training**, SMEs can benefit from the increased priority given by Member States to the vocational training of workers. A number of schemes supporting business investment in training exist (see IV.1 above), especially with the support of the Structural Funds. It is of crucial importance to ensure that SMEs take up these opportunities and understand the need for a long-term approach to investment in human resources.

As regards **labour market flexibility**, considerable progress has been made in many Member states as shown under IV.2 above. It is important to stress, however, that the need to ensure flexible management of the workforce sometimes conflicts with the objective of encouraging investment by SMEs in their human resources. Such investment requires a certain amount of workforce stability and is the best solution to the difficulties SMEs have in attracting highly qualified labour.

SMEs are also major beneficiaries of a number of **public subsidies**, either directly or in the form of reduced social charges (see IV.3 above) linked to the recruitment of workers, even though such subsidies are not often related to the size of the enterprise.

With regard to legal and administrative simplification, Member States have introduced modified procedures, derogations from reporting requirements, one-stop-shops and business impact assessments aimed at facilitating SME creation and development. As regards **administrative simplification**, in Italy, one fixed tax has replaced six former taxes, in Finland, a single advance payment procedure has been introduced for all taxes and in Ireland, a single registration form for all tax purposes has been introduced. In France, three

simplifications are due to be introduced in 1996: single social and recruitment declarations, and a single apprenticeship contract.

In Austria, simpler accounting rules have been introduced for businesses with lower turnover. In the UK and Ireland, VAT return thresholds are being increased to reduce reporting burdens. One-stop-shops to promote start-ups are to be launched in Germany and Sweden. In Belgium and Spain, it is intended to establish a single point of contact for all SMEs dealings with public services. Business Impact Assessments are carried out on legislation in the Netherlands and the UK.

Various tax derogations and reductions of corporation tax rates are the main areas of **fiscal simplification** pursued by Member States in favour of SMEs. **Tax reform** in Germany has focused on mergers and reorganisations, and now provides for a tax-neutral change of corporate form, which is of particular importance for SMEs. In France, reform of the professional tax is a priority. In Belgium, it is intended to revise the fiscal regime to reinforce the self-financing capacity of enterprises. In Ireland, it is planned to streamline existing legislation on income, corporation and capital gains tax.

Among **fiscal derogations** applied, in both the Netherlands and Spain there is a reduction in taxes for the first three years of a start-up. In Austria, the tax exemption for small enterprises has been increased. Corporation tax rates have been reduced in Germany, Spain and the Netherlands.

Conclusion

For the full employment creation potential of SMEs to be exploited, it is essential that best practice be shared and adopted throughout the Member States. In view of the importance of this subject, the European Council in Cannes, in June 1995, asked the Commission to report on current policies in favour of SMEs and on ways to improve them. The Commission is currently preparing a separate report on this subject.

(2) THE STRUCTURAL FUNDS AND EMPLOYMENT

With ECU 170 billion (including the Cohesion Fund) for the period 1994-99, the Structural Funds play a fundamental role in promoting economic and social cohesion in the Union. In this context they constitute key instruments in promoting growth and employment, especially in the Member States and regions in which they are concentrated.

Structural Fund support is provided in three main areas: infrastructures, direct assistance to the productive sector, and development of human resources. In the short term it helps create jobs, by supporting the demand for goods and services. It also makes a lasting contribution to employment, mostly by increasing and adapting physical and human capital and also by improving the functioning of the labour market.

The impact on employment depends on the amount of effort expended and the combination of action by the Funds and the Member States, which depends on the initial situation.

For Objective 1 regions, which account for 70% of Structural Fund activities, action seeks to achieve its priority of creating employment mainly by promoting growth with a view to reducing differences in per capita GNP.

For Objective 2 regions, the definition of which is based on criteria mainly linked with employment, the priority is to diversify and revive industrial areas in decline, aiming for the most immediate effect possible on employment.

As regards Objectives 5 and 6, the problem lies essentially in maintaining activity, employment and population levels in rural areas which often comprise under-developed areas which need economic diversification.

In as far as they are primarily designed to help to match supply and demand and thus to ensure that available jobs are occupied, activities focusing on the labour market are by their very nature directly linked with employment. Such activities are conducted throughout the Union:

- to integrate young people, the long-term unemployed and those threatened by exclusion (Objective 3);
- to help workers to cope with industrial change (Objective 4), thus contributing also to sustainable growth.

Despite these major contributions, Structural Fund action up to 1999 ought to take fuller account of recent and expected changes in employment policies. Whilst remaining faithful to the programming already agreed, it is important to use the margins of flexibility which become available during the implementation of existing programmes. Investment in physical capital has a crucial contribution to make. Adequate attention must also be given to other requirements for growth and employment, in line with developments in employment policy.

Issues of particular importance to future policy discussion include the following:

- **encouraging measures which contribute to more employment-intensive growth.**

This involves in particular:

- explicit recognition of the employment and human resources dimension when funding productive investment and infrastructure projects,
 - more emphasis on integrated local and rural development and employment initiatives in order to better tap new sources of employment,
 - encouragement of a more dynamic organisation of work and of working time where this is combined with increased employment.
- **providing for a fully partnership of public and private actors.**

This mainly involves motivating economic and social partners and associations more strongly by establishing regional employment plans designed to increase the scope and depth of the partnership.

- **promoting a more pro-active approach to economic and social integration, and equal opportunities.**

The shift of financing from passive to active labour market measures - which do not increase the burden on the public purse - creates urgent new requirements to adapt the range and quality of employment services. These improvements are needed to provide effective responses to the specific difficulties of the unemployed and of the most disadvantaged, in particular women, by smoothing the way to economic and social activity.

- **ensuring that adequate emphasis is given to investment in intangible capital.**

Intangible investment has become an important motor of economic growth. Emphasis on Structural Fund support to promote research, development, and innovation-responsive business organisation, and continued improvement of human capital through education and training is needed in order to contribute to the development and diffusion of new technologies and production patterns and, therefore, to long-term competitiveness and growth;

Pursuit of these priorities will necessarily have to take account of the specific situations in the different Member States and regions of the implementation of existing programmes.

(3) ECONOMIC GROWTH, THE ENVIRONMENT AND EMPLOYMENT

Ensuring economic development while protecting the environment at the same time is perceived as an important goal by 75% of the citizens of Europe¹³. This shows strong support for the goal laid down in the Maastricht Treaty, namely that the Union should achieve "sustained and non-inflationary growth respecting the environment" (Article 2). To achieve this goal, the Treaty stipulates that environmental considerations should be integrated directly into economic policies (Article 130 R). The Fifth Action Programme for the Environment, adopted by the EU in 1993, details how this can be achieved in different sectors of the economy: industry, energy, transport, agriculture, tourism.

This is a policy challenge, as economic growth involves increased demand for energy services and natural resources, and greater use of transport, which, other things being equal, lead to higher levels of emissions and industrial waste. This can be avoided if the use of natural and environmental resources is made more efficient in production processes and cleaner technologies are introduced. That is the reason why more prosperous economies tend to have lower levels of pollution per unit of GDP. The shift from manufacturing industry to services also has positive effects on the environment.

The extent to which economic growth and environmental damage are being disassociated from each other depends on government action in the form of legislation, standards, charges or other market-oriented policy instruments designed to limit certain emissions or other forms of polluting behaviour and encourage more efficient use of non-renewable natural resources.

¹³ Eurobarometer 1995.

The change in production patterns by mainstream industries has led to the emergence of new industries that produce the equipment, the technologies or the services needed for a better environmental performance of existing industries.

These new firms produce goods and services capable of measuring, preventing, limiting or correcting damage to water, air and soil. They also deal with waste- and noise-related problems. With this narrow definition, the sector has a yearly output of US\$ 250 billion in OECD countries, with an annual growth rate of 8%.¹⁴ The sales volume and its related growth rate would be far higher if we were to widen the latter definition to include R&D expenditure by public authorities and private companies as well as the fast-growing market for environment-friendly products.

As regards the meeting of new requirements in this sector, several Member States have adopted measures to stimulate the environmental sector. This aid is directed partly to existing industry, so that it can meet the new environmental standards, and partly to industries producing environmental equipment, technology or services. Italy offers tax incentives for new firms promoting energy efficiency, recycling and similar activities. Spain offers financial support for the reconversion of technology and machinery which reduces pollution. The Netherlands has introduced exemptions from taxes on dividends and interest from green investment. Sweden has set up a subsidy scheme to support jobs in the environmental industries and already encourages investment in sewage treatment, extension of central heating networks, noise reduction, the cleaning up of contaminated sites and improvement of natural areas. It also supports household investment in solar heating and firms and communities investing in sustainable processes over and above what is required by law.

In terms of international competitiveness, this very dynamic market offers opportunities and challenges for the Union. The US is by far the largest producer and consumer of environmental technologies and services (US\$ 134 billion in 1993), followed by the western European market (US\$ 94 billion in 1992) and Japan (US\$ 24 billion in 1990), according to the OECD. Even though some EU Member States are already in a strong position on these world markets, efforts should be made to strengthen the competitive position of all of them. The US, Japan and Canada have already created special programmes to support environmental businesses, in terms of research and development and export aid. Along these lines, the European Parliament has called for initiating a "Green Technology Offensive for Europe", asking for a more coordinated approach of R&D and other policies at EU level.¹⁵

The major impact of environment protection policies on growth and employment should be expected to come from the progressive introduction of clean technologies across the whole range of production activities. This will require a long-term investment strategy, which is particularly important in major economic sectors such as energy, transport or agriculture. It will also require transport users to face the full cost of their transport decisions so that they have an incentive to select the options that carry the least social cost.

Using a narrow definition of environmental industries, the 1995 Employment Report indicates that 1.5 million people are permanently employed in the EU in various environment-related

¹⁴ OECD, January 1995.

¹⁵ "Report and resolution on environmental technologies: opportunities for growth and employment", April 94, adopted in Plenary on 6 May 1994.

waste and water treatment and instrument engineering. In terms of job creation, these sectors have shown a significantly higher growth rate than the rest of the economy. Between 1985 and 1993, jobs grew in this sector by 2% per year, twice the rate in other sectors. An active policy directed at creating positive economic incentives to consumers and businesses alike could increase this figure substantially.

Significant expenditure is expected on, for example, new sewage networks, public transport equipment and infrastructure. Other activities beyond the environmental sector *strictu sensu* can also contribute substantially to a higher quality of life for citizens, such as conservation of national heritage, urban renewal, maintenance of national parks and forests, etc.

Experience in several Member States shows that strong economic growth, protection of the environment and creation of jobs are possible at the same time. Simulations undertaken by the Commission also show that integration of environmental considerations in all sectors of the economy, according to the principle of cost-effectiveness and based on market mechanisms, brings about higher economic growth, a better environment and more jobs.¹⁶ The White Paper on Growth, Competitiveness and Employment has dealt with a most important structural change by moving away from an economy in which natural resources are overused and labour underused. This could be done by changing the relative prices of these production factors, e.g. by lowering taxes and contributions on labour while increasing those on the use of natural resources. Such structural change has wide support. The Eurobarometer 1995 shows that 40% of EU citizens "agree strongly" and another 40% "agree somewhat" that income tax and social security contributions should be lowered and made up for by an increase in taxes on goods and processes which damage the environment (such as ozone-depleting chemicals, wastes, transport, carbon dioxide, energy and pesticides).

At local level, there is also great scope for stimulating economic growth, improving the state of the environment and creating jobs at the same time. Concrete initiatives have been taken already by several Member States in setting up pilot programmes giving environmentally friendly jobs and training to the unemployed. In Spain 200 000 young unemployed persons have worked (for 2 years) to restore historical buildings. More than 50 cities in the Netherlands have created corps of city watchers, improving the environment and security in cities. In Berlin, unemployed workers receiving social security benefit are allowed to work 32 hours per week in jobs such as the eco-renovation of schools. In France a great number of unemployed young people have worked temporarily in national parks.

As noted earlier, the development of TransEuropean Networks will have a positive effect on employment. There will be benefits too for the environment with the more efficient use of energy and transport and a more balanced development of the territory of the European Union. It should be noted that, in the case of the Transport TENs, most of the spending will be on rail links. In response to the Essen Council conclusions the Commission is drawing up guidelines for environmental networks in selected sectors (i.e. waste and water).

In the private sector, green businesses are ready to make investments in mainstream industries more environmentally friendly. Eco-businesses produce equipment, technologies and advice for end-of-pipe pollution abatement and waste treatment. These activities are expected to move

¹⁶ Using the DRI econometric model: "Potential benefits of integration of environmental and economic policies", Graham and Trotman/ Office for Official Publications of the European Communities, 1994.

away from "cleaning" the industry to "greening" the industry, whereby the production processes themselves change. As the clean and green technologies are developed and applied, a qualitative move is made, shifting the technological frontier, essential for growth (and jobs) in a longer time perspective.

These structural changes will entail a need for enhanced training efforts. It is estimated that 80% of the people currently employed in the environment industry are relatively low-skilled. However, 20% of the workforce involved in management and technical activities are highly skilled and extensively trained. With changing technology, and as pollution control and energy efficiency become an integral part of productive processes, there will be a need for proper training for technical specialists, managers, engineers, and those involved in urban planning, landscaping, managing nature reserves, forests, etc.

Conclusion

Based on the above considerations, it can be concluded that environment protection represents an important way of creating a substantial number of new jobs. It concerns a fast growing sector within the EU, but even more so at the international level where competitive pressure increases. Appropriate policies are required to realise this job potential, i.e. through an exchange of information, encouragement of sound competition within the internal market, as well as stronger economic incentives for consumers and businesses. At the same time, such policies will facilitate the structural modifications the European economy has to go through in the field of energy, transport, industry and agriculture, as outlined in the 5th Environment Action Programme.

(4) SOCIAL BENEFITS, TAXATION AND THE LABOUR MARKET¹⁷

In the Conclusions of the Presidency at the Essen Summit of December 1994, the Councils of Labour and Social Affairs and EcoFin, with the Commission, were asked to examine "the effects of tax and support systems on the readiness both to create and to take up jobs". This mandate is to be seen in the light of the strategy for employment presented in the Commission White Paper on Growth, Competitiveness and Employment, and later reshaped into the five priorities for employment policy agreed at the Essen Summit.

This mandate responds to the policy priority given to assessing the effects of tax/benefit systems on the incentives for economic agents to take up or create jobs. There is wide consensus on the need to adapt the European social model's functioning, to meet the changing needs of our societies and to assess its impact on the labour market.

It must be noted that this approach relates only to part of the unemployment problem as a whole. In fact, much of the negative employment performance in the Community and the risks for budgetary sustainability of the social protection systems in many Member States relates mainly to macro-economic and other structural variables. In fact, a complete assessment of

¹⁷ This section presents a brief summary of a longer and more detailed report prepared for the Economic and Financial Affairs Council following the mandate given by the European Council in Essen in December 1994.

the impact of the social protection and the fiscal systems on the functioning of the labour markets requires consideration of the incentive and efficiency problems mentioned below in reaction to the social protection function which is one of the building blocks of the European social model.

However, how far the level of disposable income when out of work needs to be in relation to that when in work to constitute a significant disincentive to look for a job is open to question. Evidence suggests that, even for similar levels of income, people tend to prefer to be in work rather than be unemployed.

The report summarised below concentrates on the relation between taxation and the unemployment protection system.

a) Income tax, unemployment benefits and the promotion of employment

The systems of social protection perform three main functions towards the unemployed, namely they insure the income loss derived from falling unemployed, allow for a better matching between unemployed persons' skills and vacancy requirements, and support households' income up to socially-accepted minimum living standards in the event of unemployment.

In certain circumstances, an excessively generous system of social benefits may result in high net income replacement ratios which, when combined with long duration of benefit, may weaken the recipient's incentive to engage in active job search, and thereby stay unduly long on benefit. This longer spell out of work eventually leads the recipients to become long-term unemployed, whose reintegration into work is increasingly difficult and costly to achieve (*'unemployment trap'*).

Alternatively, in order to ensure that the household's income attains a certain socially-agreed minimum level, unemployed persons who take up a low-paid job can qualify for supplementary in-work benefits. However, the rate of benefit withdrawal and the phasing-in into the tax regime combine to create steep implicit effective marginal tax schedules on additional earnings from work. In consequence, this low-paid labour has little or no incentive to increase its own skills and productivity in order to upgrade in the earnings scale (*'poverty trap'*). Furthermore, economic, technological and regulatory barriers combine to 'lock up' these individuals into low-paid, low-productive jobs with limited alternative opportunities.

In addition, excessively generous benefit systems are often expensive in terms of use of scarce public resources, which could be devoted to alternative economic and social purposes. Moreover, problems in the design, administration and enforcement of rules may allow, in some cases, for unemployed to move or be transferred onto other social protection schemes (e.g. sickness, invalidity, early retirement), thus creating strains elsewhere in the social protection system.

Financing a developed social protection system has been one of the reasons behind the growing financial needs of the public sector. Meeting these extra needs of public receipts has resulted in an increased overall tax wedge on labour's income. Furthermore, the fiscal reforms undertaken since the early seventies in many Member States have entailed a reduction of the actual progressivity of the tax system, thereby weighing more on lower incomes.

There is broad consensus that these problems particularly affect skilled labour, who often have lower earnings from work. In addition, low-skilled labour faces a relatively greater risk of becoming unemployed because of the rapid switch now under way in the composition of labour demand towards a higher skilled workforce.

Taking into account that low-skilled labour is much more responsive to the level and expected evolution of its total cost, non-wage costs on low-paid labour are found to hamper its cost-responsiveness with regard to changes in productivity. In addition, some analyses suggest that, under certain circumstances, social benefits may help to generate wage floors which compress the lower side of the earnings distribution, and thus price less-skilled labour out of work.

One option to achieve a higher responsiveness of low-skilled labour costs would be opening up the wage scale at the lower end. Experience in the US, in particular, shows that this policy option has led to a more intense record of job creation, but has entailed serious equity and efficiency problems. The latter have been generated by the downward pressure on real earnings in the lower half of the wage scale, the creation of a class of people in work with a very low level of earnings ('*working poor*'), and the deterioration in the average working skills of the labour force. In fact, recent reforms in the US welfare system have extended the social protection system somewhat, in order to tackle the emergence of these social imbalances.

To avoid this problem, the Commission's White Paper has recommended reducing employers' social contributions, in particular on low-paid jobs, in order to achieve lower total labour costs. This policy priority, which was reiterated at the Essen Summit, is to be seen in the context of maintaining a satisfactory level of overall social protection, whilst improving the operational efficiency of labour markets and securing the budget sustainability of social protection systems.

b) Assessment of the situation in the Member States

Available evidence suggests that:

- in some cases, the gap between disposable earned income and that received on unemployment benefit is too narrow. Here, it may be assumed that benefit recipients will be caught in an '*unemployment trap*', with few incentives to take up a job. Such 'traps' would occur most often in low-income households, since net replacement ratios may be very high, especially if child allowances are taken into account (e.g. D, F, DK, IRL, NL and SF).¹⁸
- the risk for an 'unemployment trap' to occur is higher in those cases where benefit duration is also relatively long (e.g. B, DK, SF, SV, NL). Although long benefit duration *per se* does not necessarily create disincentives to work, empirical evidence suggests that too long a stay in unemployment may entail that less skilled individuals lose contact with the labour market, and thereby deteriorate their human capital. Early action is therefore needed to maintain this linkage to labour market through active labour market measures.
- in some cases of exhaustion of insured protection or failure to be eligible for benefit, the income support function is transferred to unemployment assistance (UA) benefits, which

¹⁸ In many Member States, the net replacement ratio at the lower end of the income scale is above 80 per cent and, in some cases, even exceeds 100 per cent.

implies a lower benefit ratio. However, in those cases where supplementary social benefits (e.g. housing benefits, child-care allowances) may apply, substantially higher net replacement ratios may be generated and increase the risk for 'unemployment traps' to occur.

- tight means-testing, conditionality and the earmarked nature of the social benefits often create an incentive for the unemployed to move to, or be transferred onto, other social protection schemes, with relatively generous benefits and/or looser eligibility criteria (e.g. sickness, temporary or permanent invalidity, early retirement). This problem has seemingly assumed considerable magnitude in DK, I, NL and the UK. In order to assess the potential disincentives on labour supply, as well as the overall budgetary impact of unemployment, the possibility for the unemployed to move onto welfare schemes bordering on the unemployment protection function needs to be taken into account.
- a problem of *moral hazard* arises when the multiplicity of social protection schemes and/or lax administration of them may give leeway for employers and, in some cases, employees to collude and provoke the occurrence of repeated unemployment spells. This problem is found to affect in particular sectors subject to highly seasonal demand (e.g. tourism, transport, building and civil engineering¹⁹) or undergoing state-monitored restructuring policies.
- in the Nordic countries (DK, SV, SF), a problem of *moral hazard* may occur in financing the voluntary-based unemployment protection funds, and thereby put a strain on the actual financing of these funds. The high net replacement ratios provided by social assistance benefits can be expected to reduce an individual's incentive to contribute to these funds, because a generous fall-back network of income support is in place. The actual impact of this effect has yet to be assessed.
- over the past few years, many countries have reviewed unemployment benefits to narrow down the eligibility criteria, to shorten their duration, or to improve the administration of benefit systems. They have also sought to introduce or reinforce some means-testing, as well as to check recipients' willingness and availability for work. The latter measures aim to more effectively link the income support to an active job search or to participation in active employment measures. These reforms often coincide with reforms to improve public-funded job brokerage and other public employment services.
- active labour market policies must address targeted assistance for the unemployed to return to work with a more market-oriented provision of vocational training and with technical and financial assistance at the search for a job. The Nordic countries have long experience with these active employment policies, and now all Member States are following a similar path placing greater emphasis on switching public expenditure in labour market policy from passive income-support measures towards more active policies.
- whilst the effects on aggregate labour supply are relatively small, the evidence points to part-time employees being more responsive to changes in the marginal tax rate. It is to be noted that part-time jobs have recently been a particularly important source of employment

¹⁹ This explains why these sectors often have specific unemployment protection systems, financed through experience-rated contributions based on the enterprises' employment records.

- whilst the effects on aggregate labour supply are relatively small, the evidence points to part-time employees being more responsive to changes in the marginal tax rate. It is to be noted that part-time jobs have recently been a particularly important source of employment creation, in particular for females, in many Member States. The tax regime on lower income levels should be reviewed in order to remove undue barriers to work resulting from regressive tax schedules for both income tax and social security contributions (e.g. ceilings/floors for contributions vs. tax credits).
- many Member States have introduced or resuscitated a wide range of schemes which, in most cases, provide a temporary and targeted reduction of employers' social contributions. However, in those schemes targeted to the level of earnings, attention must be paid to avoid generating excessively steep tax schedules when 'phasing into' the standard tax regime for labour with earnings close to or at the eligibility threshold for these schemes.

Conclusions

Historically, the social protection and taxation systems have developed in response to many different factors, and the potential distortionary effects on the functioning of the labour markets are only one dimension of the process. However, the difficult situation concerning both unemployment (especially long-term) and public finances justifies the need to reassess the actual functioning of the tax/benefit systems with a view to removing potential disincentives to create or take up a job.

These inefficiencies may be created, for instance, by a reduced gap between in-work and out-of-work disposable incomes (*'unemployment trap'*), the possibility of high implicit effective marginal tax rates derived from in-work benefits (*'poverty trap'*), relatively onerous non-wage costs levied on low-paid jobs, and the equity costs of an uneven structure of tax rates.

Within the Union, Member States are addressing these problems in a variety of ways. To stimulate the unemployed's willingness to take up jobs, most of the countries have opted for achieving a better targeting of benefit receipts, a tighter enforcement and control of eligibility criteria, and a closer linkage to active labour market policies. Alternatively, the UK and, to a certain extent, IRL have given more weight to the widening of the wage scale combined with a generalised eligibility for in-work benefits, so that taking up a low-paid job is encouraged by topping up incomes to a social minimum level. To promote job creation, across-the-board or selective cuts in employers' social contributions have become the major policy means to ease the burden of non-wage costs on less productive jobs, in particular for low-skilled labour.

Experience shows that policy trade-offs between generating *'unemployment traps'* and spreading *'poverty traps'* always occur, thereby suggesting that policy choices are to be made in each Member State. It is not suggested that any one approach to social protection and labour taxation is in some sense "best". In each case, however, there is some leeway for introducing further improvements, seeking both efficiency and equity, whilst contributing to a more flexible functioning of the labour market with a view to achieving a higher level of employment and securing a reduction in structural unemployment.

ANNEX

EXTRACT FROM THE CONCLUSIONS OF THE PRESIDENCY – ESSEN EUROPEAN COUNCIL
9-10 DECEMBER 1994

ECONOMIC ISSUES

Improving the employment situation

The fight against unemployment and equality of opportunity for men and women will continue in the future to remain the paramount tasks of the European Union and its Member States. The current economic recovery will help in dealing with these tasks. That recovery is not, however, in itself sufficient to solve the problems of employment and unemployment in Europe. We shall therefore have to make further efforts to solve the structural problems. In this process, an important role will be played by dialogue between social partners and politicians in which everyone concerned will have to assume their responsibilities fully.

The measures to be taken should include the following five key areas:

1) Improving employment opportunities for the labour force by promoting investment in vocational training. To that end, a key role falls to the acquisition of vocational qualifications, particularly by young people. As many people as possible must receive initial and further training which enables them through life-long learning to adapt to changes brought about by technological progress, in order to reduce the risk of losing their employment.

2) Increasing the employment-intensiveness of growth, in particular by:

– more flexible organisation of work in a way which fulfils both the wishes of employees and the requirements of competition;

– a wage policy which encourages job-creating investments and in the present situation requires moderate wage agreements below increases in productivity;

– and, finally, the encouragement of initiatives, particularly at regional and local level, that create jobs which take account of new requirements, e.g. in the environmental and social services spheres.

3) Reducing non-wage labour costs extensively enough to ensure that there is a noticeable effect on decisions concerning the taking on of employees and in particular of unqualified employees. The problem of non-wage labour costs can only be resolved through a joint effort by the economic sector, trade unions and the political sphere.