

Workshop

Welfare Policy and Labour Market Transformations of the Japanese and the Swedish Models for the 21st Century

Date:andTime: September 15, 1999, Wednesday

Place: Room2(Mimer) ,Aula Magna, Stockholm University

Programme

- 10.00 A.M. Adress of welcome
- 10.05-10.50 Towards a Welfare Mix Society
Professor Naomi Maruo, Nippon University
- 10.50-11.35 Gradual Retirement in Sweden
Professor Eskil Wadensjö, Stockhloim University
- 11.35-12.15 Cultural Factors Behind Economic Decisions: The Case of Japan
Dr. Lars Vargö, Ambassador
- 12.15-13.15 Lunch
- 13.15-14.00 Changing Labour Market Structures
Professor Yasuhiko Nagayama, Tokai University
- 14.00-14.45 Wage Formation in the Kaleidoscopic Production System
Professor Bengt Stymne , Stockholm School of Economics
- 14.45-15.00 Concluding discussion

Workshop coordinator

Professor Carl le Grand, Swedish Institute for Social Research, Stockholm University

Tel. : 08 16 26 46 , Telfax: 08 15 46 70

This is a preliminary draft written as a part of the book results from the " Sweden - Japan Joint Study on Economic and Social Policy Management" The Joint Study is subsidized by the Ministry of Health and Welfare , and Univers Foundation of Japan. I welcome your comment on my paper.

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Introduction

The economic and social systems in Japan and Sweden have attracted worldwide attention in different ways. Japan has been known for its postwar economic growth and the so-called Japanese style management based on cooperative labour-management relations.

Sweden, in turn, has been considered to be "the" model of the welfare state with its comprehensive and high standard of social welfare system. The labour-management relations in Sweden have also been cooperative, although somewhat differently from the Japanese case. The Japanese cooperation between workers and employers takes place at the enterprise level mainly through daily contacts, communication and information sharing, while in Sweden both labour and employers are highly organized and cooperative at the national level.

Both countries had maintained full employment since the middle of the 1950s until the end of the 1980s. Sweden achieved full employment by combining Keynesian macro demand management and an active labour market policy. Japan, in contrast, achieved the same goal through its steady economic growth at the macro-level and the so-called lifetime employment practice at the micro-level.

The economic situations in the two countries, however, have changed in the beginning of the 1990s. The economic boom of the 1980s came to an end, and both Japan and Sweden suffered from serious depression. The depression, in the two countries, was not a mere cyclical one. As a consequence, a restructuring of the existing economic and management systems came to be an urgent issue.

The present book consists of 10 chapters. Most of papers refer to changing economies and labour markets and suggest that economic reform and the restructuring of labour markets are necessary.

In chapter 1 Wadensjö begins his paper by saying that the restructuring of the economies and labour markets leads to increased inequality and problems for some groups. After explaining main reasons for increased inequality and unemployment, he suggests programmes to counteract these problems. Wadensjö's paper suggests how to develop and restructure the labour markets and traditional employment policy.

Shimada's paper in chapter 2 summarizes the secret of success of Japanese-style management in the 1970s and 1980s and calls attention to three long-term trends that are altering the management system's environment. Shimada says that the Japanese companies must cope with growing contradictions. He identifies six key tasks and offers some comments on direction for change. For example, he says a new national target that can be shared by the people in an era of affluence is necessary. To achieve the goal, he says, the government must reinforce measures designed to halt the widening of asset differentials and fairer distribution of wealth.

Maruo's paper in chapter 3 analyses main impacts of the population ageing on economic growth, labour market and social security. Japan has changed from the youngest country among the OECD countries to one of the most aged countries in the world. Another change took place is observed in the behaviour of productive age population. It changed from increasing trend to decreasing one in the middle of the 1990s. The changes in the population are important reasons to explain the deterioration of Japan's economic performance in the 1990s. As Japan is experiencing two radical population changes, Japan is a most suitable country to confirm the impacts of the population ageing on economies and labour markets.

In the latter half of the paper, Maruo suggests two hypotheses on the Japanese model of management. First, he assumes that the combination of large wage differentials by firm size and wage differentials by age worked well as an effective incentive system, which had the essential features of "the efficiency wage theory" and "the share economy." Second, he suggests that the low share of wages and the low pay-out ratio of profit, and the resultant high growth rate of labour productivity of Japanese big companies between 1960 and 1990 can be explained by the "future pie hypothesis (life cycle income maximization hypothesis)".

However, the Japanese style management began to change when the population ageing and globalization of firms and markets proceed and the quality of technology changes. He suggests four

measures to restructure Japanese style management.

The Japanese economy is a dual economy. The labour market is dual in the sense that there are large differentials in labour productivity and wages between the large company sector and the small and medium sized business sector. In chapter 4 Nagayama explains the so-called dual labour market structure in Japan. He says that the Japanese labour market has developed towards a new type of dual structure, namely external-internal labour market structure. Workers at external labour market are mainly part-time workers and dispatched workers. Their employment conditions are obviously worse than those of permanent employees are. Their wages are usually lower than those of regularly employed workers and their social security are poor, for they are often not covered by income related employees' social insurance. As the part-time workers and dispatched workers increases, the proportion of employees who are covered by employees' social insurance to the total employees has been declining. This tendency increases "the dependency ratio (the ratio of aged population who depend on social insurance to those who burden the costs of employees social insurance.), which in turn increases the future difficulty in the financial situation of employees' social insurance funds. A comparison between the Japanese external -internal labour market and the Swedish "insider-outsider model" will be an interesting subject.

In chapter 5 le Grand, after summarizing the so-called Swedish model of industrial relations, concludes with describing some contrasts and similarities between the Japanese and the Swedish labour market. He points out that both the Japanese and the Swedish employment models have being questioned and heavily criticized during the 1990s and that both must change and adjust to meet new challenges and changing environment.

Abe's paper in chapter 6 consists of four parts. First, section 1 summarizes the changes in the Japanese economic and industrial systems, which have been observed so far in Japan. Section 2 examines emerging shifts in the area of the labour relations system. Section 3 discusses possible implications of the changes of the systems for the quality of working life. Final section suggests the possible desirable directions of the future development of the labour relations system in Japan.

In chapter 7 Lillrank and Stymne say there is a clear indication that the recent growth of economies and employment in Sweden is created by small and middle sized firms. According to their paper the labour market policies today tend to decrease the propensity of small and middle-sized firms to employ qualified labour. A reversal of tax policies, namely, the tax deduction on both owner's capital and owner's work, and a changed regional policy seem to be the most useful and least practically controversial, they conclude.

In chapter 8, Inouye ' paper gives useful information about recent state of the Japanese internal and external labour markets. In the paper small and medium sized firms are contrasted each other as places to develop human resources. According to his paper, Japanese firms spend less on training and education in industry than European firms do. This is because Japanese firms save on direct costs by placing emphasis on the job training (OJT).

In chapter 9, based on the survey on Toyota automobile company Kageyama demonstrates some important factors behind Japanese industrial development. They are the selection of target industries, logistically functional business performance for the success of product sales promotion and the systematic cooperation among various firms in corporate groups. Kageyama suggests that the Japanese method of target industrial policies would be of benefits in formulating policy measures to cope with improving the unemployment situation in the European Union. However, target industries are changing from traditional ones to new industries represented by IT industry.

In the last chapter Kurata points out that three leading principles are essential to the current career development practices in Japanese large companies. The first principle is internal labour market and enterprise specific skill formation. The second principle is its long-term consideration on development and the evaluation of employee's vocational ability. The third principle is its emphasis on the importance of general ability, which would be applicable to various kinds of jobs in the company. Kurata after considering the historical background of these principles, he prospects the future trend of career development in large Japanese companies.

We may conclude firstly, that the restructuring of both Swedish and Japanese models of labour market and management are necessary to cope with the population ageing, globalization of flow – (goods and services) and stock (assets) markets, and new technological innovation.

Secondly, several papers in this book warn increasing inequality in asset and income distribution as a result of the market-oriented restructuring economies. If the market-oriented labour market policy is introduced in Japan wage differentials by firm size, by age and by gender will be reduced, while wage differentials by work ability will increase. This is rather preferable change for Japan. The problem is increasing inequality in distribution of assets and capital gains.

The experiences of bubble economies and depression in Sweden and Japan suggest that in the economies where the proportion of assets value to flow value such as GDP and national income, the fluctuations of asset prices give serious impacts on the trade cycles and income distribution. In the post welfare state, market- oriented policies must be supplemented by asset distribution policies to cope with asset inequality and asset stabilization policy to evade cumulative asset inflation and depression, which results as asset effects on private consumption and investment.

Thirdly, under the traditional mixed economy of private market sector and planned public sector, the public sector has become too large. The present welfare state will transform into an "welfare mix" society¹, where the market sector and the informal sector will play more important roles than the traditional welfare state represented by Scandinavian countries

In the second volume of Sweden & Japan joint study, we shall develop this subject.

¹ As to welfare mix, confer Richard Rose and Rei Shiratori, *The Welfare State: East and West*, Oxford University Press, New York and Oxford, 1996, Martin Rein and Eskil Wadensjo eds. *Enterprise and the Welfare State*, Edward Elgar, Cheltenham, UK·Lyme, US, 1997 and Hiroshi Kato, *Towards a Welfare Mix Society*, Chuo Keizai Sha, Tokyo, Japan, 1998.

Chapter 1 ECONOMIC POLICY AND EMPLOYMENT POLICY

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1. INTRODUCTION

The starting point for this lecture is that the restructuring of the economies of Europe leads to tendencies to increased inequalities between different groups in the labour market - long-term unemployment, marginalization, precarious working conditions, poverty and social exclusion - which in turn may lead to diminished social cohesion. The aim of the lecture is to point out measures related to the labour market which may increase social cohesion or at least counteract a diminishing of the social cohesion.

By "social cohesion" is meant the cohesion between different groups in society. If different groups lead parallel lives in separate enclaves - live in different housing areas, work in different parts of the labour markets with the least privileged group being outside the labour market - social cohesion will decline. Members of the disfavoured groups may look at themselves as not belonging to the same society as the majority of the population.

Several factors may influence the development of social exclusion and cohesion. Changes in the size and structure of the demand and supply of labour may lead to changes in the relative position of various groups in the labour market as regards unemployment and wages. Increased inequalities in the labour market may also lead to increased inequalities in housing and education.

2. INCREASED INEQUALITY AND DECREASED SOCIAL COHESION

The restructuring of the labour markets leads to increased inequality and problems for some groups: rising wage inequality, long-term unemployment, precarious working conditions, marginalization, poverty and social exclusion.¹

There have been developments in recent years on the demand side which have worked for increased inequality in the industrialized countries and various developments on the supply side which have worked for more and less inequality.

On the demand side several factors may have contributed to a changing structure of labour demand. Four factors will be mentioned here.

The liberalisation of international trade and decreased costs of transport and communication have probably resulted in the increase of high-skill industries and the decrease of low-skill industries in the high income countries.² This may lead to an increased demand for high-skilled labour and a decline in the demand for low-skilled labour in those countries.

Technological change may also have worked in favour of those groups who have higher and more recent education and led to a fall in demand for people who have only secondary education or lower as their highest education. Routine clerical work and low-skilled blue-collar work in manufacturing and other industries have been negatively influenced by the computerization of work.³

A third factor may be that organizational changes in manufacturing and other parts of the economy have led to less hierarchical organizations and less fixed definitions of jobs and resulted in an increase in demand for people who have broader occupational and social competence. An employee should not only be able to do the work tasks of the recruitment position but also a broad range of

1 For the development of rising wage inequality in the United States see for example Borjas & Ramey (1994), Blau & Kahn (1994) and Card & Lemieux (1994).

2 See for example Baldwin (1994), Burtless (1995), Krugman (1995), OECD (1992), OECD (1994a), Sachs & Schatz (1994) and Wood (1994).

3 See for example Berman *et al.* (1994) and Lawrence & Slaughter (1993).

prospective work tasks. For example, this may be a factor behind decreasing demand for people with disabilities and for people lacking proficiency in the language of the country in which they are living. The organizational changes could also be a factor behind the increasing wage inequality within detailed occupational and skill categories.

A fourth factor is that a general decline in demand (and increase in unemployment) means increases in unemployment proportional to the pre-decline unemployment rate and this means a higher increase in the unemployment percentage of unskilled than of skilled workers.⁴

On the supply side, there have been forces working both for more and for less equality in the labour market. The expansion of the educational system and the lengthening of compulsory education have led to an increased supply of skilled labour and therefore tended to reduced inequality and the increase of low-skilled immigrants have tended to widen differentials in unemployment or wages.

On the aggregate there has been a development towards more inequality in the industrialized countries in the 1980s according to skill. In non-European countries - the United States, Canada, Australia - and also in the United Kingdom, this has been mainly in the form of increased wage inequality but also an increase in non-participation. In most countries in Europe on the other hand, it has been mainly in the form of higher unemployment, especially long-term unemployment.⁵

3. GROUPS AT RISK

The development shortly outlined above negatively affects some groups in the labour market and others positively. The groups who are negatively affected will be concentrated on in this report. Some of the groups often mentioned as those meeting severe problems in the labour markets of Europe today will be presented below.

3.1 Low-skilled workers

Increased competition from low-wage countries, technological change and a development towards an industrial organization with less narrowly defined jobs means that people with short educations are less in demand. Young people with short basic educations or without occupational competence, and low skilled refugees meet increased problems upon entering the labour market. Also low-skilled workers who lose their jobs by layoffs when firms reduce their staff or close down are at a risk. They have work experience but firms prefer many times to hire younger people with broader basic and occupational competence. Low-skilled workers have gradually encountered higher unemployment and lower wages compared to more highly skilled workers.⁶

This does not mean that there are no jobs for low-skilled workers. The service sector especially has a demand for low-skilled labour. These jobs have another character than the traditional low-skill blue-collar jobs in manufacturing, jobs in the primary sector of the labour market. The service sector jobs to a high extent are to be characterized as jobs in the secondary labour market. The quality of the low-skill jobs in the primary sector may also have declined.⁷

3.2 Disabled workers

Impairments and disabilities often lead to people becoming handicapped in the labour market. The long run trend has been that the problems for people with physical disabilities have become less severe but people with mental and psychological disabilities are meeting more severe problems. This is partly explained by structural changes in the direction towards less physically demanding jobs and more mentally demanding ones (from blue-collar to white-collar jobs), partly as a result of that disability policy has been more successful in compensating for physical handicaps. In many cases it has been possible to find jobs for people with only physical disabilities which they are able to

4 See Nickell & Bell (1995).

5 See Glyn (1995) for an overview of the evidence.

6 See Nickell & Bell (1995) for the development of unemployment according to skill categories in a number of countries.

7 See Gittleman & Howell (1995) for a study of the development of job structure and job quality in the United States, and Gregg & Wadsworth (1995) for evidence on the development of more clear division of the labour market in the United Kingdom into a primary and a secondary part.

perform with the same command as the non-disabled.

The present development towards more broadly defined jobs and faster changes, may put the tendency towards less importance of physical disabilities at a risk. Although a disability may be of no concern in the hiring position, it could be a handicap in performing certain work tasks which the employer may ask the person to perform in the future and therefore the disabled person may not be hired.

3.3 Older workers who are laid off as a result of economic restructuring

Structural changes often lead to the closure of firms, down-scales or changes in the line of production. Such changes lead to people being laid off. Older people, especially unskilled manual workers, are among those who have most difficulties in getting a new job after a layoff. Many of them do not have the skills required for new positions, the expected remaining period in the labour market is shorter for them than for younger workers and therefore the payoff period for training paid by the firm is shorter. Many countries have instituted specific programmes which facilitate early exit from the labour market for older workers.⁸ Those who are laid off are paid a compensation up to the normal retirement age (the "label" differ between countries but the effect is the same⁹). In some cases the replacement rate may be high (and be a contributing factor to why older workers are laid off) in other cases the compensation is low and the layoff may lead to poverty. Irrespective of the compensation level early exit means that older workers leave the labour market before the normal retirement age and therefore may become excluded from the social cohesion fostered by working together with other people.

3.4 Immigrants/ethnic minorities

International migration of workers to European countries became a large scale phenomenon in the 1960s. It was mainly manual workers who migrated to Western Europe from other parts of Europe, and also from non-European countries to France, the United Kingdom and the Netherlands from former colonies and also to different Western European countries from Turkey and the Middle East for example. The migration of workers became highly regulated in the end of the 1960s and early 1970s but has continued. Many refugees for example have arrived in Western Europe in the 1980s and 1990s. In several European countries the foreign-born now constitute more than 10 percent of the population (the share who have foreign citizenship is considerably lower in most countries since many immigrants have been naturalized). A growing number of second generation immigrants can be added to that percentage.

In the period of large scale worker migration most immigrants had jobs even if they were unskilled jobs in most cases. It was a period of rapid expansion of manufacturing of a capital-widening type which demanded a lot of unskilled labourers. The native-born in the western countries entered skilled occupations to an increasing extent. Occupational segregation between natives and immigrants became a fact already in the 1960s and 1970s.

The labour market situation for the immigrant population worsened in the 1980s and the 1990s. The demand for unskilled workers in manufacturing has decreased and new immigrants - mainly refugees - have arrived from countries more distant in different respects from Western Europe. A specific problem is that many of the workers who arrived in the 1960s were employed in large manufacturing companies, companies which are now to a high extent modernising their industrial organizations and down-scaling their staffs.

3.5 Young people

The youth labour market is almost always worse off compared to the labour market of adult workers in periods of low demand for labour. The first thing firms do in periods of restraint is not to layoff people but to cut down on hiring. Since youth is the period during which one enter the labour market, fewer people hired means problems for young people. Seniority rules at layoffs also means that young people, who are often the most recently hired, run into problems when firms initiate layoffs. (Often firms do not follow the seniority rule completely when carrying out major layoffs but

⁸ See for example Kohli *et al.* (1991) and Naschold & de Vroom (1994).

⁹ The label may be important. To be pensioned may give less social stigma than being a recipient of unemployment benefits or welfare payments.

instead tend to buy off older workers).

The changes in labour market described in section 2 may partly explain why young people entering the labour market have problems in getting jobs even if the labour market is not in a period of recession. Young people with low basic skills and without occupational skills are not in demand in the part of the labour market which offers good jobs - the primary labour market. Not only occupational skills but also certain social characteristics are essential for getting a job.¹⁰ Young people who do not have the occupational skills and behavioural or social attributes required by the employer will have difficulties in getting a job which can lead to their integration in the labour market. Immigrant youths have an especially precarious situation.

The groups mentioned above overlap to a high degree. For example many are immigrants as well as being young people, or disabled as well as being older workers. The main problem is not that some people are overrepresented among the unemployed or low-wage earners at a specific point of time but that some people remain unemployed or earn a low wage for prolonged periods. The individual hardship may become a severe societal problem if those who are in a difficult labour market situation also live in the same areas, for example are concentrated in some suburbs of the big cities, and also belong to the same ethnic groups. This may increase the risk that social enclaves will develop.

4. STRATEGIES TO INFLUENCE THE LABOUR MARKET POSITION OF THE DISADVANTAGED

Increasing inequalities may lead to diminishing social cohesion and therefore costs of different kinds. Costs resulting from crime¹¹, crime prevention and health care for example may increase as a result. Decreased productive capacity of the economy due to people losing human capital as a result of prolonged spells outside the labour force may be a long-run effect. In this section some options which have been put forward as policies on the national level will be discussed. The main advantages and disadvantages of the various policies will be stressed. In section 5, 6 and 7 three programmes will be discussed in more detail - measures which influence the structure of labour supply, measures influencing the structure of demand and income transfer programmes. The policies presented here are not exclusive in the meaning that it is necessary for governments to choose just one policy - a combination of policies may be the best alternative. There are also other policies which have been suggested as policies on unemployment and inequality but which will not be discussed here. Policies to stimulate capital formation constitute one example.¹²

4.1 Demand Policy (Keynesian policy)

The policy on unemployment which was favoured during the first decades of the post-war period was Keynesian policy - that unemployment should be counteracted by an expansive policy. The optimism of the early post-war period gradually withered. That expansive Keynesian policy meant higher inflation was a lesson that was learnt in the 1960s founded on the Phillips curve established by A.W. Phillips in 1958. The Phillips curve still meant that there was a rationale for Keynesian policy - a choice between different combinations of unemployment and inflation. This model was challenged in the late 1960s on theoretical grounds by Milton Friedman and Edmund Phelps. An expansive Keynesian policy not only means a higher inflation rate but also leads to an increasing inflation rate. The importance of expectations was emphasized. Their results were supported by empirical research in the 1970s. The experiences of the 1980s and 1990s underlined this lesson and also the importance of expectations. With deregulated financial markets, even attempts or plans of a more expansive policy may lead to large changes in the capital flows, leading to large increase in interest rates which curtail the attempts to lower unemployment.

The combined effect of theoretical and empirical research and the actual development of the economies has brought Keynesian policy in disrepute at least on the national level. This is not to say that all Keynesian policy is meaningless. An expansive policy may of course be a measure against

10 See Bishop (1995) for a survey.

11 For a survey on the relation between inequality and crime see Freeman (1994).

12 See for example Phelps (1994) and Rowthorn (1995).

deflationary tendencies. Keynesian policy may also be a viable policy if all the major economic powers coordinate an expansive economic policy, but a discussion of whether or not internationally coordinated policies is a possible solution is not the subject of this report.

4.2 Work-sharing in various forms

In some European countries work sharing has been put forward as a means against unemployment and inequalities in the labour market. The simple idea behind the proposal is that there is lump of working hours to be divided among the labour force. If those who have a job work fewer hours than at present, then the people who are unemployed will be able to work those hours instead. There are several varieties of the proposal and some of them will be commented on here.

The most straightforward solution is to reduce the working hours for all employed workers - if effective then the actual labour supply of those already employed will decrease. However, this may lead to an enhanced position of those who already have a strong position in the labour market (the insiders), to increased hourly wages for those groups and therefore to inflationary pressure. To counteract the inflationary pressure, a restrictive fiscal and monetary policy has to be pursued that in turns leads to higher unemployment which counteracts the immediate decrease in unemployment caused by the reduced working hours. This is not a criticism of a policy of reduced working hours but only of its use as a policy on unemployment.

A second attempt to curtail working hours for at least some groups in the labour market is to pension off mainly older workers. This type of policy has been tried in some countries with the intention of facilitating the entrance of young people into the labour market. The result has not been as planned. Although many older people have accepted early retirement, the demand for young people has not increased as a result. Older and young workers are not close substitutes in the labour market. Another problem with using early exit as a means against unemployment is that the costs for the social insurance schemes increase and if these costs are financed by payroll taxes, also the costs of labour. Another way of decreasing the labour supply and unemployment of some groups is to lengthen youth education. The same criticism is valid against this policy as against a policy on unemployment. The criticism does not exclude that the lowering of retirement age or lengthening of youth education motivated by other arguments could preferentially be carried through in periods of recession instead of in periods of prosperity.

A third, less discussed attempt, is to vary the working hours over the business cycle for example by varying personnel training, by varying the length of vacations counter-cyclical or the number of weekly working hours with the business cycle. The last type of variation is already practiced to a high extent - over-time work is much more common in periods of prosperity than in periods of recession.¹³

4.3 Measures intended to influence the structure of labour supply

In the short run changes in the structure of labour demand leads to changes in the structure of unemployment and in the wage structure. In the long run the labour supply adjusts to the changes in the labour demand. People move from declining sectors and occupations to expanding ones. The younger generation's choices regarding education are influenced by the labour market prospects associated with different types of education.

If the adjustment of supply had been rapid, changes in the structure of labour demand would have led to much fewer problems. A policy facilitating regional, occupational and sectorial mobility could be a way of speeding up the process of adjustment and counteract the tendencies towards increased inequality.

4.4 Measures intended to influence the structure of labour demand

There are many ways of influencing the structure of labour demand, but we will not include here measures which attempt to change the tide of technological change and protectionist policies.

One type of structural labour demand policy consists of subsidies to employers who hire people who belong to a group with severe labour market problems. A typical example is subsidies to firms who employ disabled workers. In recent years wage subsidy programmes have been introduced targeted towards young people and in some countries also older workers (Japan and Sweden).

¹³ See Hamermesh (1993) for a recent survey.

Another type of policy is to hire unemployed people in special public works. This type of policy could be exemplified by sheltered workshops for disabled workers.

There are many other policies which are intended to influence the structure of labour demand: regional policy is designed to influence the regional distribution, industrial policy the distribution according to industry. The idea behind these policies in many cases is to strengthen the demand for groups with high unemployment.

The organizational changes may in part be influenced by labour laws. A strict job security regulation may lead to that firms lay off people to a lower extent but also become less inclined to hire people. Labour legislation may also influence the tendencies towards the development of a dual labour market. Changes in labour law may influence labour market flexibility.

4.5 Wage policies and income transfer programmes

When comparing the United States and Europe the differences in their policies regarding wages are often stressed. Wage differences are larger in the United States but the differences in unemployment are smaller than in Europe.

If the higher unemployment rate among disadvantaged groups in Europe is explained by smaller wage differentials, a larger wage spread would be one possible way of reducing unemployment. On the other hand poverty caused by low wages would increase - the number of working poor would increase. This could, at least in principle, be compensated by social transfers (for example negative income taxes) or by payroll taxes differentiated according to wage rates or a related measure. Social transfers could also ameliorate inequalities in the labour market in other ways. Some programmes of this type will be discussed in section 7.

5. MEASURES INTENDED TO INFLUENCE THE STRUCTURE OF LABOUR SUPPLY

If the structure of labour demand changes then the structure of labour supply will also eventually change. The decrease of labour demand in the agricultural sector and the increase of labour demand in manufacturing in the major part of this century led to a gradual reorientation of the structure of labour supply. People moved to the cities and became trained for industrial work.

The present changes in the structure of demand according to skill and sector will also lead to changes in the composition of labour supply. Changes in educational demand and the educational system and a changed pattern of mobility for those already in the labour market are responses which led to a changed structure of labour supply. The process of changing the skill composition of the labour force takes time. The educational system takes time to react and since the production of occupational skills is a time-consuming process, it will be a while before changes in the composition of enrolment lead to changes in the composition of exams.

A special problem is that the movement of low-skill workers from agriculture to manufacturing in the past meant mobility to jobs with higher wages and better job security, but the present movement from manufacturing to the service sector means a mobility to jobs with lower pay and less job security.

Another problem is that some groups fall behind. If excess demand for skilled labour and excess supply for unskilled labour evolve, those with the least ability to learn skills and change sector and occupation will meet problems in the labour market in the form of increased risk of unemployment and/or lower relative wages. Supply policies may be one way of improving the situation of groups disadvantaged by the development. The policies encouraging mobility in the labour market by training, geographic mobility and better matching by increased information will be dealt with here.

5.1 Education and training

Education and training are ways of moving people up in the skill hierarchy away from the low-skill segment. There are several different parts to that policy.

The central part of educational policy is to strengthen the general educational system so that when leaving the school system young people are better equipped to cope with the situation in the labour

market.¹⁴ To increase the quantity of highly skilled labour the enrolment rates have to increase on different levels. It is more complicated to formulate a policy which raises the quality of education. Some aspects will be underlined here.

The quality of a study programme is influenced by the quantity and quality of the factors of production diverted to it. In addition to the amount of time the student spends in education, the teacher is probably the most important factor of production. Raising the quality of the training and ability of teachers may improve the results of the educational process. An increase in the teachers' wage rate may be one way of increasing the quality even if the short-run effects of a pay raise may be a slowing down of the rise in quality. A pay raise may mean that the teachers who are already employed leave the sector to a lower extent and therefore delay the entrance of a new generation of more highly skilled teachers.¹⁵ One way to counteract such effects would be to introduce new positions for teachers with higher qualifications.

Another important aspect is to organize education in a way which gives the students incentives to devote more time and energy to their studies. The system of examination, the role of examination in enrolment for studies on higher levels and as an instrument for recruitment, is of importance in this connection.¹⁶

It is also important to note that knowledge in basic subjects (reading, mathematics, history, geography, foreign languages etc), subjects which are of great value in the further process of learning, are not enough for success in the labour market. Independent of the level of knowledge in these basic subjects it is essential for those entering the labour market to have occupational skills. Occupational skills together with "social skills" are the main factors which determine success in the labour market.¹⁷ Occupational skills can be learnt either in specific vocational schools, at the universities or at the workplace. One form of workplace training is apprenticeship programmes.

Apprenticeship programmes combine work experience and workplace training with education in school. Countries with large-scale apprenticeship programmes as Austria, Denmark and Germany have had a lower ratio between youth and adult unemployment than countries without such programmes.¹⁸ Some countries try to form vocational study lines which contain some element of the apprenticeship system inside the educational system.

Besides a general increase in the quantity and quality of youth education, special emphasis could be given to groups who are at risk, for example the young disabled, and second generation immigrant youths. The education and training of the young disabled may be decisive for if they will ever be established on the labour market or if they will have to rely on payments from the social insurance system. Second-generation immigrant youths (immigrants' children born in the country of destination) who are a new group at risk in the labour market. Not all second generation immigrants have problems when entering the labour market, it is mainly those who live in special enclaves - in the big cities or their suburbs - who are at risk. In many cases they do not learn to speak the language of the country of immigration with the same proficiency as other young people. This lack of knowledge in the language of the immigration country may both lead to problems in learning occupational skills and later in getting a job corresponding to their education in the labour market. Special resources for the education of second generation immigrant youths are important to avoid long-run labour market problems.

Most people stay in the labour market for decades. The education and training received before entering the labour market is not sufficient for the entire labour market career. Much training takes place in the firm but there are large differences between different firms and employees. Many adult workers take part in education outside the firm. Adult education and training strengthens their position in the labour market. Further education could be carried out as education of adults in the school system, by labour market training in special centres, and inside the firms. Training and

14 There are considerable differences in the educational attainment in Europe. See OECD (1995) for a comparison of those countries who are members of OECD. Shackleton (1995) contains a comparison of the training systems in the United States and major European countries.

15 See Ballou & Podgursky (1995).

16 See Bishop (1990).

17 See Bishop (1995).

18 See Soskice (1994) for a recent overview of the German apprenticeship system.

education in these and other forms can be stimulated by tax exemptions, by subsidization or by regulation.

Labour market training is a labour market programme of growing importance in many countries. The research on the effects of labour market training is growing. The results show that the outcome of labour market training varies between countries, periods, scale of the programme, specific design of the programme and the composition of the participants.¹⁹ The scale of the programme is important, the average and the marginal outcome of a placement in a labour market training programme may differ strongly. The timing of the training may also be of great importance. Starting a course in the beginning of a recession may lead to that the programme participants enter the labour market in the midst of that recession with only small chances of getting a job, maybe smaller than if they had abstained from the course and started to look for work immediately. On the other hand a course starting at the midst of a recession or at the beginning of an upswing may lead to that the participants enter the labour market at a time when the newly acquired skills are in demand. Studies of labour market training in Sweden show that the result of training (participants are compared with non-participants with similar characteristics and labour market experiences) differ strongly between groups.

Education of adult immigrants in the language of the country in which they are living may be a way of enabling them to apply for a wider range of jobs. Many immigrants live in enclaves with people mainly from the same country of origin. This decreases the incentives to learn the language of the immigration country and also makes it more difficult.²⁰

5.2 Mobility support and housing policy

Changes in labour demand according to industry also leads to changes in the structure of labour demand according to region. Demand shocks may lead to increased disparities between different regions as regards wages and unemployment. In most European countries the differences between regions are large.²¹ In some countries the order of different regions according to unemployment for example have been stable over time, while in another countries it has been reversed. The most notable characteristic is that the equilibrating mechanism is weak.

According to simplified models, the wage and unemployment differentials between regions caused by demand shocks will disappear through the equilibrating movement of capital to the regions with low wages and high unemployment, and by out-migration of labour from the same areas. These processes are slow in most cases and the differences between regions change only slowly.

There may be several reasons for why labour does not leave high unemployment areas to a greater extent. One explanation is that the costs of mobility are high. Some countries the housing market is regulated in a way that makes it costly to move. To leave a subsidized dwelling means a loss of capital. Another factor hindering mobility may be that the internal wage structure of firms is such that tenure is rewarded. It makes it costly to move for those who have jobs even if the general wage level is low in the area where they are living compared to other areas. Another factor may be that the cultural differences are considerable within the country leading to that people avoid moving even if the economic gains are large.

Policies intended to diminish the differences between different regions may be directed towards the demand or the supply side. Here the supply side measures - measures to increase regional policy - will be commented on.

If a person moves from unemployment in a region to a vacancy it has of course effects for the individual but there are also externalities. Even if a cost-benefit analysis may show that the benefits are larger than the costs for the society as a whole, the outcome for the potential migrant may be negative, leading to that the person abstain from moving. The existence of social transfer schemes and taxes are parts of the explanation for this types of differences.

A mobility subsidy may change the outcome of the individual calculation so it becomes positive. In most cases mobility subsidies are only for the unemployed but there are arguments for extensions. One is that the differences between regions are not only different in terms of unemployment but also in wages. Mobility subsidies leading to increased migration may contribute to an equalizing of

19 See Johannesson and Wadensjö (1994) and OECD (1993) for surveys.

20 See for example Lazear (1995).

21 See for example Tomaney (1994).

wages between regions. Another argument for granting subsidies not only to unemployed people is that if an employed person moves, an unemployed person may get that person's job instead and the effect on unemployment would be the same. Those with the lowest mobility costs (including non-economic costs) should be encouraged to move, and that is not necessarily those who are unemployed.

The expanding and contracting industries and regions do not necessarily demand the same type of skills. In many cases a combination of occupational training and migration may be necessary to get a new job.

A better functioning housing market could decrease the mobility costs and lead to higher mobility and faster and stronger reactions to shocks in the regional structure of labour demand.

5.3 External migration policy (including migration inside the European Union)

During the last decade migration to the industrialized market economies has consisted of unskilled labour to a high extent. Many refugees with higher education have arrived, few of them have been able to enter the primary labour markets in the host countries. Most migrants have come from countries outside Europe in contrast to the migration in the 1960s, which was mainly in the direction from Southern Europe to Northern Europe. In the last few years the migration of refugees inside Europe has increased and to some extent also the migration of workers, this time from Eastern to Western Europe.

The new immigrants are concentrated to those parts of the labour market which have low wages and precarious working conditions, and where temporary jobs are predominant. The unemployment among newly arrived immigrants is high, in most countries much higher than among non-immigrants or among immigrants who arrived in earlier decades. In the 1960s the newly-arrived migrants in many cases were directly recruited to jobs, now, however, many immigrants have great difficulties in getting their first job.

The concentration of immigrants to the lower segment of the labour market has become an issue for two reasons. Firstly, the immigrants' situation *per se* is a matter of concern. Secondly, the inflow of immigrants may negatively influence the situation of other groups with a weak position in the labour market.

The effects of immigration on wages has been studied in the United States especially. The main result is that effects are small and that they are concentrated to the groups who mainly compete with the new immigrants - people from the same ethnic minority (Spanish speaking people), or earlier immigrants from the same countries of origin. Studies show that the effects may be stronger for the regional labour markets with many immigrants than the average effects for the country as a whole.²²

In order to avoid immigration leading to low-skill wages dropping further labour market policy programmes that counteract the concentration of immigrants in specific areas, industries and occupation should be designed. For example, specific programmes which introduce immigrants to the labour market of the immigration country could be developed. A combination of language and occupational training and short-term subsidized employment for acquiring work experience may be one way of avoiding long periods outside the labour market after the arrival.²³ It is important to design such programmes in a flexible way. The level of basic education and occupational skills differ considerably between and within groups of immigrants coming from different countries.

5.4 Labour exchange and labour market information

The gross flows in the labour market are impressive. Many young people enter the labour market every year and many older people leave for retirement. Among those of active age many change labour market status. The flow in and out of unemployment is high. Every year many quit their jobs or are laid off. On the demand side firms are started and closed, firms expand and contract and vacancies are opened to replace people who have left their jobs. The gross flow is much larger than the net flows in the labour market.²⁴ The number of new hires is large. This indicates the importance of well-functioning systems of information gathering and spreading to job-seekers on

²² See Topel (1994).

²³ This type of programme has been introduced in Malm^o, the third biggest city in Sweden, and is now used as model in other municipalities in Sweden.

²⁴ See OECD (1994).

available vacancies.

The governmental employment exchanges are institutions which are specialized in this area, but there are many other ways in which information is spread and by which contacts are established between the two sides of the labour market. Advertisements in the newspapers, personal contacts, private employment exchanges are only a few of these. Disadvantaged groups in the labour market may also be disadvantaged regarding gathering information on the labour market and less efficient in their job search. An efficient official employment exchange which identifies the people with labour market problems and try to find jobs for them or matches them to measures is one way of strengthening the labour market situation of disadvantaged groups.

Evaluations of extra resources to the employment offices have consistently shown favourable results.²⁵ The results indicate that extra resources lead to faster job placement and better jobs for the job-seekers. The efficiency of the employment offices can also be enhanced by reallocation of resources between the employment offices and by making more efficient use of their resources. A recent study of the Swedish employment offices shows - like earlier studies of labour exchanges in Norway and the United States - that there are very large differences in efficiency between different employment offices, which indicates that there is a large scope for improving the internal efficiency.

6. MEASURES INTENDED TO INFLUENCE THE STRUCTURE OF LABOUR DEMAND

A second group of measures aims at influencing the structure of labour demand. One rationale for this is that measures that influence the demand side take only short time to introduce. To change the skill-mix of the population is a long-run venture, while the introduction of a programme subsidizing firms employing low-skilled workers takes only a short time. Programmes intended to change the structure of labour demand could be directed either towards broad groups of labour force participants or to specific groups with more severe problems. Both types of programmes will be examined but those for people who are in a weak position in the labour market will be dealt with especially.

6.1 Wage subsidies.

The general idea behind wage subsidies is the situation that the value of the productivity of some people is lower than their wage-rate and that the wage-rate does not fall below a certain minimum higher than that which enables the person to be hired. That minimum wage rate can be set by collective agreement, minimum wage laws or social conventions of what is an acceptable wage.

There are several different motives behind the introduction of wage subsidy programmes. One motive is that people who even on a long run basis have few possibilities of establishing themselves on the labour market should get a long-term job. The measure could also be used on a more short-term basis as an form of recruitment subsidy. The idea behind a recruitment subsidy is to pay the firm the extra training costs for employing a person who does not have occupational skills necessary for the job. Another rationale for subsidizing employment is to stabilize the business cycle by varying the number of subsidized jobs counter-cyclically.

Wage subsidies have been utilized in many countries in an attempt to persuade employers to employ disabled workers.²⁶ The subsidy is often paid on a long-term basis even if the intention is to train the disabled worker so that he or she will be able to get an unsubsidized job after one or a few years of subsidized employment. Many of the subsidized jobs for the disabled have been in manufacturing but the reorganization of the work organization and decline in employment in that sector has led to that the relative importance of subsidized employment of the disabled in that sector has tended to decline.

The advantage of wage subsidies compared to sheltered work (which will be presented in the next section) is mainly that people in subsidized work are integrated with non-disabled workers and not segregated to separate work-places. A problem is that the placement is sensitive to the development of the firm in which they are working. If the firm is closing down the subsidized jobs disappear and

²⁵ See Johannesson and Wadensjö (1994) and OECD (1993).

²⁶ For a comparison of the disability programmes of eight countries see Haveman *et al.* (1984).

the disabled become unemployed. As the number of closures vary with the business cycle, more disabled workers will lose their jobs at a downturn of the business cycle.

In recent years the same type of subsidies have been introduced for older workers in Japan and Sweden. The idea is that older workers who have lost their jobs before the ordinary retirement age shall be able to continue to work up to the ordinary retirement age. The general experience is that older workers who have lost their jobs have few chances of getting a new one. The intention behind the subsidy is that the employer should be compensated for any reduction in work capacity caused by age (or for prejudices regarding the work capacity of older worker). Losing a job should not entail losing contact with the labour market even for older workers.

The intention behind wage subsidies for younger workers is that the firms should be compensated for their training costs and maybe also for the lack of information regarding the work capacity of young person without work experience. The compensation has generally been a subsidy predetermined at the beginning of the job and stretching over a fairly short period. In many cases young people have received an unsubsidized job in the same firm after the end of the period of subsidized work. The subsidized job has been a kind of "trial period" intended to see if the young person has the capacity for the job.

Some countries, Sweden for example; have developed systems of wage subsidies to employers in the private and local government sectors in periods of recessions. The idea is that firms should change their planned investments in buildings and infrastructure so they are carried out in periods of recession instead of in periods of prosperity. Unemployed people or people who have a cumbersome labour market situation in other respects are given priority to the subsidized jobs, or jobs are reserved only for the unemployed.

Although wage subsidies have generally not been directed to workers according to skill or wage-level, it is of course possible to design a wage subsidy programme of that type. The advantages would be that the unemployment of low-skilled workers decreases, or their wages increase if the wage rate adjusts to the subsidy. A problem with such a subsidy (as with other subsidies to low-skilled workers) is that the incentives to acquire occupational skills diminish.

6.2 Public employment programmes.

A more direct way of influencing the structure of employment is to employ people directly in the public sectors in special workshops or in specific positions in the public sector which are not open to all applicants but only to those who have certain labour market problems or who belong to a specific group (for example a specific group of disabled). Public employment programmes represent the oldest form of labour market policy programmes. Sheltered workshops for disabled workers is one typical example, public relief works for unemployed workers another.

There are various arguments for the organization of sheltered workshops for disabled workers. The public sector could be the employer of last resort for people who are not able to get a job in the ordinary labour market neither in bad or good times even if the employers are subsidized if they hire them. Sheltered workshops in most countries are reserved for the disabled. The quality of the organization of the workshops differs greatly just as their results do according to evaluations of their activities.

The workshops have generally been in the manufacturing sector and in many cases been subcontractors of large-scale enterprises. The decline of employment in manufacturing and the changes in the methods of production is of importance for sheltered workshops for the disabled. With an advancing just-in-time philosophy spreading meaning that production for inventories disappear the sheltered workshops meet increasing problems keeping their status as subcontractors. One alternative is to enter the service sector. This is a path which is currently being followed by Samhall, the conglomerate of sheltered workshops in Sweden.

The sheltered workshops mean stability for the disabled workers. Another advantage is that the sheltered workshop develop specific competence in the organization of jobs for disabled workers. There are also disadvantages. One is that the workplaces are segregated so that disabled workers only work together with other disabled workers, another problem is that the sheltered workshops in practice work with a soft budget (if a deficit arises, it is covered by the state) which may lead to inefficiency.

Another argument for public works, as already mentioned, is to counteract the variations in the business cycle. By the use of public works it is possible to directly increase employment in periods

of recession and also to give people with labour market problems job priority. The advantages and disadvantages are partially of the same type as those for disabled workers. The crucial matter is how to organize public works in a way which combines efficiency, targeting of the disadvantaged groups, and the avoidance of crowding out private employment or public employment other than the public works.

6.3 Regional and industrial policies.

Supply policies are methods to facilitate people moving between regions, industries or occupations. Regional and industrial policies may influence labour demand by moving vacancies from areas of excess labour demand to areas of excess labour supply.

Most countries differ considerably between regions regarding employment and/or wages. Encouraging mobility of workers is one way to reduce the differences between regions. High out-migration may lead to problems in the areas of origin. The age structure may be such that few of those who remain are of active age leading to that the base for local taxes decreases, which erodes the basis for the local infra-structure. Most countries have regional policies that support low-income regions. Much of the European Union budget is also used for regional policy, either specifically stated regional policy or in its actual consequence since the agricultural support mainly goes to the less industrialized parts of the countries.

In many cases industrial policy programmes have been developed as a response to a crisis in a certain industry. The aim of the programme has often been to dampen the speed of industrial restructuring with the intention of modifying the social consequences of large-scale closures. By delaying the closures the supply-oriented measures gain more time to render effects. Large-scale closures in an industry are often combined with attempts to stimulate firms to establish branches in areas hit by industrial restructuring.

Much of the growth of employment comes about through the establishment of new firms, which in most cases are small in the beginning. Many newly established firms will close within a few years but in the long-run many will also remain and much of the growth will be in fairly newly established firms. Policies to promote the establishment and growth of new enterprises may be one way of promoting employment.

Immigrants are overrepresented among those who open new firms in some of the Western European countries. One explanation is that firms are being established in the areas that are dominated by immigrants and which provide the immigrant population with products and services associated with their home countries. Immigrants also establish other kinds of businesses, mainly in retailing and as restaurant owners. One explanation for the expansion of the immigrant firms in those sectors is that immigrants who have few other alternatives accept long days for low returns (which had meant a wage rate below the minimum wage if they had been employed).

The establishment of small businesses could also be used as a labour market programme. In Sweden, support to disabled workers for starting a small business of their own has been a measure since 1913. During the 1990s a programme of the same type has been established which is also open to non-disabled unemployed people. A large number of people have participated in the programme but it has not been evaluated yet.

6.4 Industrial organization/regulation²⁷

The labour market is regulated by law, collective agreements, and social conventions and customs. Labour market regulation may cover, for example, the rules for employment protection, co-determination, times for notification of layoffs and rules for temporary jobs. The variations in the forms and extent of regulations are large in Europe. The relative level of regulation may vary according to different dimensions. This explains that rank orders according to the level of regulation vary between different studies. It is, however, possible to see a pattern. Some countries have a low degree of regulation by law like Denmark and the United Kingdom, others, like the Southern European countries, have a much more regulated labour market.²⁸ The Nordic countries - Finland, Norway and Sweden - (Denmark is the exception) have a degree of regulation somewhere in

²⁷ Buechtemann (1993) contains a number of articles analyzing employment security in the United States and France, Germany, Italy and the United Kingdom.

²⁸ For a comparison of the EC countries see Mosley & Kruppe (1993).

between.

The Scandinavian countries and Germany have strong unions and the legal regulation is partly substituted, partly complemented by the regulation made by collective agreements.

There are a growing number of studies of the effects of labour market regulations. Most of them concern the rules for employment security. One conclusion is that the average level of employment is not particularly influenced by the level of employment security. Another conclusion is that employment varies less in a highly regulated system. A third conclusion is that young people have greater difficulties in establishing themselves on the labour market if it is highly regulated. A fourth conclusion is that a highly regulated system combined with options for temporary employment strengthens tendencies toward the development of a dual labour market system. It is important to emphasise that research in this field is not very extensive, which means that the conclusions are likely to change as new studies are presented.

In some countries the government has tried to strengthen the position of weak groups in the labour market by way of different forms of regulations, for example by quota legislation and special job security rules for the disabled. A problem with quota legislation for the disabled is that it is difficult to define who is disabled and who is not. If the employers have to pay a fee for employing fewer disabled workers than the number set by the quota (or are compensated if they employ more) they have incentives to get people who are already employed or people they intend to employ in any case, classified as disabled. That type of problem is not present if the quota is based according to age, gender, race or country of origin. Such characteristics are not possible to change and therefore not possible to influence for the employer.

7. INCOME TRANSFER PROGRAMMES AND THE TAX SYSTEM

The disposable income of a household is determined not only by the market income of its members but also by the taxes paid and the social transfers received. Low or unstable earnings may be compensated by transfer payments. Inequality in earnings may not lead to inequality in disposable incomes.

The ultimate safety net for most people is the system of income transfers. The most important systems are the old age pension system for the old, unemployment insurance for the unemployed, the disability pension system for the disabled, and various forms of support for families with children. The design of these systems is important in avoiding the development of poverty traps. To those systems could be added social assistance, the last resort.

A few decades ago older people were highly overrepresented among the poor. In addition to assistance from their children, social assistance was common as a complement to the often meagre pensions. In the post-war period the old age pensions have gradually been enhanced and the prevalence of poverty among elderly people has declined. There may be some sign of a reversal of the trends - the ordinary age of retirement has risen in several countries and proposals for changing the pension systems have been put forward, changes which may lead to lower pensions especially for those with low earnings in their active years.

The organization of unemployment compensation differs considerably much between European countries. The compensation level varies and also the maximum compensation period. Proposals have also been put forward in this area and in some cases carried through implying lower compensation level. The motivations behind these changes have been that generous compensation means lower incentives for job search, and also higher deficits of the state budget. The empirical evidence of the effects of the unemployment insurance system on job search, however, are not unambiguous.

A group with special problems are single parents (in practice almost always single mothers). In many countries this group is highly overrepresented among the poor. This is of special concern since this also means that many children live in poor households, which may be of importance for their establishment on the labour market.

The disability pensions are the most important source of income for the disabled. In many European countries the number of disability pensioners has increased dramatically in the last decades, mainly among those aged 55-64. The explanation for this expansion is not deteriorating health in that age group but changing rules regarding eligibility and compensation probably in combination with

decreased demand for older workers. Disability pensioning has become a pathway out of the labour force.

Social welfare is the safety net for people who are not eligible for compensation from other social insurance schemes and when the compensation from those schemes is below a minimum level. Social welfare gradually became of less importance in the period of the post-war era which was characterized by high growth rates, low unemployment and the improvement of the social insurance schemes. In the last 20 years which has been characterized by high unemployment, social welfare has again become an important source of income for many.

The income transfer programme is a way of diminishing inequality. However, these programmes may also lead to some problems. Maybe the most important is that the programmes may diminish the work incentives. Only a few examples will be mentioned here.

The disability pension schemes may lead to people leaving the labour force. For young people it may mean that they stay outside the labour force for decades. If we believe that work is a factor that integrates people into the society this is a serious problem. For older workers, disability pensioning may mainly mean that retirement takes place at an earlier age. The economic and social consequences may be small for the individual - but the effects on the public budget may not be desirable.

Generous unemployment compensation may discourage people from looking for work as eagerly as with less generous payments, and higher unemployment may be the result. On the other hand, low compensation may mean that people search for work too short a time and accept work of too low quality. A match of low quality between the jobs and workers may be the result. The effects of the compensation rate on unemployment duration vary between different studies. The maximum period of replacement may be of importance for the pattern of search. Studies show that many leave unemployment close to the time of benefit exhaustion, in many cases getting a job. The explanation may be an adjustment of the reservation wage, more intensive search activities from the unemployed, but also that the employment offices give priority to those who are close to exhausting their benefits.

Another way of equalizing the structure of disposable income than through social transfers according to age, disability, etc. is to have a system in which taxes and social transfers are related to the earnings of the household (or maybe the wage rate), a negative income tax for example. A problem is that a negative income tax may influence the work incentives, leading to a decline in labour supply.

The effects of taxes and social transfers on work incentives is a general problem with all social transfer and tax systems. The change in disposable income may be small or even negative for a low-skilled worker who begins a job instead of continuing in a social transfer scheme. The transfer-tax system may lead to poverty traps.

8. A COHERENT POLICY

Increasing inequalities in the labour and housing markets, increasing differences in standards of living and the social exclusion of large groups may lead to diminishing social cohesion. If the causes are mainly technological change, change in industrial organization and in the patterns of trade, the factors working in the direction of greater inequalities may be around for a long time. There may however be ways of countervailing the effects of those developments.

The first line of defence is macro-economic policy. High unemployment leads to increasing inequalities in the labour market, differences between those who are employed and those who become long-term unemployed or leave the labour market unable to find any job. Unemployment higher than NAIRU has to be avoided. A problem is that the NAIRU has increased in most countries in recent decades - a policy that attempts to go back to earlier low levels of unemployment by only fiscal and monetary policy will lead to high inflation.

The main programmes available to counteract increasing inequality are supply side policies, demand side policies, and social transfer programmes.

Labour supply policies

1. Educational programmes are the main programmes to adjust the composition of labour supply to the changes in labour demand. The school system and the system for higher education are the main instruments used to change the composition of the inflow of labour supply. As change in the