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social expenditure was more or less the same. There were ups and downs: prior to the 1990s, economic growth in Japan was steady and at a good level, thus it was low compared to GDP; however, since 1992, when economic growth became stagnant, the growth of public expenditure has exceeded the growth rate of GDP. As you can see in this diagram, ROK is far above the others. Because of the Asian financial crisis, there have been major changes in ROK. That is the reason why the figure for ROK stands out among those of other countries.

(PowerPoint, p.10) Once again, it is often said that social expenditure is low in Japan because the society has not aged as much as those of European countries. Since an ageing of society is now certainly underway in Japan, people say that the situation in Japan might start to more closely resemble that in Europe. We have tried to come up with a graph. On the horizontal axis, we look at the ratio of the elderly; and on the vertical axis, we look at public social expenditure vis-à-vis GDP. Already, as you can see here, the population in Japan has aged to the same extent as that in Europe, but expenditures have not grown to the same extent. Again, ageing would not be a reason for claiming that social expenditure is low in Japan, given that the ageing of Japanese society has reached the same extent as the ageing of European countries.

There may be something structurally unique to Japan's public social expenditure. As we heard from Mr. Adema, in most countries, the largest share is accounted for by cash benefits of the aged among their pension benefits. (PowerPoint, p.11) It is the large portion (in purple to the left) and is accounted for by health care and medical benefits (in yellow on the right-hand side) in all countries. You can see that old age and health-care expenditures account for a

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large portion. Fractionally, it is the same for all countries, but Japan differs in some respects. As Mr. Adema said, there are social reasons for these differences.

First, if you look at unemployment, family or disability benefits, these account for a lower percentage in Japan. The pink portion here represents unemployment benefits and to the left of the pink portion are so-called affirmative labor market policies to prevent unemployment.

(PowerPoint, p.12) These are not really unemployment benefits, but social expenditures that prevent unemployment. So, those have to be combined; however, Japan's spending on unemployment-related policies is still very low. You may say that this is only natural because the unemployment rate in Japan has to be very low. If you look at past trends, compared to other countries, the unemployment rate in Japan has been very low. In recent times, the unemployment rate has been at its highest level since the end of the war, but even so it is still less than 6%, at about 5.3%.

The unemployment rate is low, which means that benefits going to the unemployed also remain low. Besides, if you look at the structural components of the system and payments, in terms of the duration of benefits, they can only be received for a short period. In Japan, the level of income guarantee is very low for the unemployed. These pages aim to explain unemployment benefits. (PowerPoint, p.14) On the next page you will see the replacement rates of unemployment benefits. The replacement rate of Japan (the third line from the top) is low compared to other countries. That is how things look.

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There may be additional reasons why Japan's social expenditure is apparently low. Lifecycle differences might affect social expenditure. For example, as you know, the Japanese population is hard-working, so retirement may come late. People remain in the labor market for a long period, which minimizes the number qualified to receive benefits. In other words, this leads to lower social expenditure. In this chart, the horizontal axis shows people who retire at about 55 years of age divided by total working population. The vertical axis shows old age-related social expenditure (Japan is indicated by blue at the bottom). Since the Japanese work hard, social expenditure is low and people remain in the labor market for a long time, often postponing retirement.

Middle aged and old people in Japan work very hard. Why is it that middle-aged men in Japan work very hard? There may be many reasons for this. This chart shows examples of various countries by age groups. The employment and benefit conditions are indicated. The black bar represents people working while not receiving pensions, or non-pension workers. (PowerPoint, p.15) The top box represents recipients of pensions without work. People work until retirement age, which is 60; after turning 60 about 40% remain in the labor market and do not receive a pension.

Now, let us go back and look at other countries. For instance, Mr. Adema is from the Netherlands, so let us take the case of the Netherlands, which is on (page 16, at the top right). (PowerPoint, p.16) The early retirement program of Holland is well known. The 55-59 age bracket is in the middle, and about half of the population in that age bracket still works. So, the pension age should not be so different between Japan and the Netherlands. In fact, people in Europe, particularly in the Netherlands, retire earlier than their counterparts in Japan.

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You might ask why Japanese middle-aged men work very hard. This shows you the situation they are in. This can be seen in terms of the sizes of the households to which the middle-aged people belong. (PowerPoint, p.20) On page 20, there is Japan (bottom right), the United States (top right), Germany (top left), and Italy (bottom left). As you can see, people in the 70-79 age bracket are usually members of larger families, with a family membership of more than five. They are part of large extended families. Many old people in Japan have an extended family structure. People say that this is shrinking in Japan, but in terms of international comparison, it is still the case in Japan old people tend to enjoy being able to live with their other family members in a large extended family structure.

(PowerPoint, p.21) One reason why social expenditure is low in Japan is the difference in family structure: old people with low incomes are taken care of by other family members; single mothers or unemployed adult children can still live with their parents; parents take care of their adult children who may not have work, or work only part-time or seasonally. If they were in Europe, for instance, they might not be able to survive. This situation used to be known in Japan as the family circle, and it is an unrealized asset. Social expenditure may be low in Japan, but if you look at family structure, generational differences, generational structures, and generational composition, Japan is different from other countries. That is my conclusion. Thank you.

Mr. Atsuhiko Yamada, Researcher, National Institute of Population and Social Security Research: Thank you very much. This concludes the first part of our program. At this point, we will take a break for 15 minutes and resume our meeting at 15.30.

Break

Mr. Atsuhiko Yamada, Researcher, National Institute of Population and Social Security

Research: We would like to begin the second half of the session. First, I would like to call upon Professor Miyajima and then Professor Seike, to give comments on the presentations made so far. Professor Miyajima, please.

COMMENTATORS' REMARKS

Professor Hiroshi Miyajima, Faculty of Economics, University of Tokyo: I have been given 15 minutes, and I would like to comment mainly on Mr. Adema's presentation. As Ms. Katsumata mentioned earlier, I think it was about five years ago that I first read the OECD Working Paper written by Mr. Adema. It was quite an impressive paper, therefore, whenever this issue arises, I try to engage in discussions in Japan. Since Mr. Adema talks about this issue in detail, I will not go into further detail.

We have been discussing social expenditure without understanding the difference between gross-basis and net-basis. Are taxes included or not included? When we discuss the net basis, perhaps the results are very different. This is very interesting and represents quite a convincing argument that overrides conventional theories. For instance, we tried to combine social security and taxation in Japan. However, The Ministry of Health, Labor and Welfare and the Ministry of Finance are organized separately, therefore, it is very difficult to combine

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the two concepts. But, this time, if we try to combine the concepts for individuals and households, income transfer or redistribution of resources, what would be the result? The social security and tax systems need to be combined from a comprehensive viewpoint.

The study by Mr. Adema made it very clear that this is very important. Mr. Adema makes several great contributions. Public expenditure, social security expenditure, and tax breaks need to be combined, and “first-round effects” were discussed. For instance, when public sector, social sector, and tax breaks are combined, policy patterns for the social purposes of each country can be made very clear. I think that is one of the great contributions made by Mr. Adema’s study. In going forward, we would like to continue further studies in this direction.

On the other hand, I would like to comment on his presentation. I must say that there is a data limitation on international comparisons and that setting a standard is a large issue, which still remains to be resolved, so it is a very difficult challenge. Setting aside those details, I would like to comment on four major points.

The first point Mr. Adema talked about concerned the Japanese tax burden including social security contribution, and he said that compared to other OECD countries, including the United States, it is low. The tax burden is low in Japan; among OECD countries, Japan is a low-tax country. How we interpret the situation in Japan is a very important point. For instance, one approach is to look at tax breaks for social purposes in Japan. Ms. Katsumata mentioned that perhaps the family is something of a hidden asset, and the family’s role can be combined with this low tax burden rate in Japan. If we confine this to social purposes, then perhaps it is possible. However, if you look at income support or social security, the sum can

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be interpreted or defined in a narrow sense, but sometimes it is defined in a very broad sense. In general, the tax rate or tax burden is very low in Japan, so we need to pay attention to that factor.

The other important point touched upon by Mr. Adema was that public expenditure, private expenditure, and tax breaks need to be combined to look at the government's social effort. However, in judging the public policy effects of the government, combining the public and social expenditure and tax policies and other legal policies legislation is somewhat questionable. For instance, if you look at tax breaks or income tax deductions, it is necessary to look at people on a taxable basis. In other words, those should be people with considerable earnings.

As private expenditure, just like U.S. medical or healthcare, perhaps employees working for the major companies—medium-sized and large companies—represent such a case. As mentioned by Mr. Adema, such tax breaks (or social tax expenditure) are promoted by the government. Economically, this is quite important because of the high efficiency and use of markets. Universality for fairness or social purposes, however, cannot be fully achieved. Therefore, as was mentioned, how you combine them still requires discussion as to whether or not we can simply just add them together, or if there is another more effective way.

The estimate made by Mr. Adema is really a product of great difficulty. The process of how to treat direct tax and indirect tax seems to be confined to cash benefits. But, when it comes to in-kind benefits, how one treats these services and in-kind provision of services, methodologically is very difficult.

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How one considers VAT is another important point; therefore, perhaps we should try to treat cash benefits and in-kind services provision on an equally consistent footing. For instance, with co-payments made by patients for medical services or nursing care, how do you treat out-of-pocket payments? Perhaps we need to come up with some cash equivalent for social services, and that should be treated as a gross benefit. Co-payments or out-of-pocket payments should be treated as direct tax. This direct tax should be deducted. By so doing, in-kind services and cash benefits can be treated consistently on an equal footing basis. That is what we would like to propose. I do not know how feasible this is, so perhaps we really need to study the viability of using this approach. So, methodologically, this is an important point.

My fourth point is about the low gross expenditure levels in Japan and the United States with low levels of both direct and indirect taxes. In contrast, another group of countries, Denmark and the Netherlands, have high gross expenditure and very high levels of taxation. If the net level is the same for these two groups, what is causing the difference? If a simple comparison is made of countries that belong to that group, perhaps this ends up increasing the marginal tax burden and the tax administration cost. If that is so, economists may argue that it is much better to provide benefits in a tax-exempt manner. By so doing, we can avoid an additional tax burden and tax administration costs.

My view is slightly different: I think that the taxable level should be higher. In other words, claw-back is an important system, as mentioned by Mr. Adema. The purpose of tax is not only cost recovery, claw-back is a mechanism of benefit adjustment using the tax mechanism. I think this approach is very important.

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In the case of income tax, of course, there is the deduction and there is the minimum taxable base. Therefore, it is necessary to have benefit adjustments using taxes in accordance with income levels. The tax aims at cost recovery and it also has the function of benefit adjustment. Taxable levels should be high and gross expenditure can also be high. From my point of view, that combination is desirable. I still think that more discussion is needed to justify this point.

Thanks to the efforts of Mr. Adema, we realize the importance of a taxation system as a means of benefit adjustment. From the estimate on a macro basis, perhaps we have to look at income level or job categories. In other words, a more microscopic analysis is important. I have to ask Ms. Katsumata to look at this for the purpose of benefit adjustment. I would also like to ask Mr. Adema to look at this item in more detail in the coming years.

I would like to give detailed comments regarding the presentation made by Ms. Katsumata, but since my time has run out, I would like to finish here. Thank you.

Mr. Atsuhiko Yamada, Researcher, National Institute of Population and Social Security Research: Thank you. Without any further ado, I would like to invite Professor Seike to speak. Professor Seike, please.

Professor Atsushi Seike, Faculty of Business and Commerce, Keio University: Thank you, Mr. Moderator. As Mr. Yamada stated in his introduction, I specialize in labor economics, although I have done some research on pension effects on employment. I am not a specialist

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on social security, so I am not sure whether I can fulfill my role as a commentator. However, let me try to do my best.

As Professor Miyajima has already said, if we look at net social expenditure statistics, in the past we used to look at gross expenditures, although benefits are taxed and the beneficiary bears VAT on services. In addition, pension and medical benefits provided by companies enjoy special tax treatment. In a sense, that needs to be contemplated in connection with social expenditure. We need to look at something that is as true a form of social expenditure as possible. I believe their research is very important, because it will enable us to do so.

Although I am repeating what Professor Miyajima said about the research carried out by Mr. Adema, I do think the research is very meaningful. Ms. Katsumata and her group are focusing on this issue in Japan, and her efforts are equally important.

If we analyze the situation in Japan, as Ms. Katsumata said earlier, social expenditure in Japan is lower than that in other countries. However, we need to scrutinize this, which has become possible thanks to these statistics. They might have significant implications for the discussion on recent fiscal difficulties in Japan. There should be a transfer of income from households to government. To the extent that this was not carried out is one of the reasons for the fiscal difficulties of the government. When that is considered, the big implication of this issue can be understood.

Professor Miyajima focused on Mr. Adema's presentation, so as a division of labor, allow me to focus on the presentation made by Ms. Katsumata. At the outset, I would like to say that I

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learned a lot and I appreciated it greatly. I believe there were two major parts to her presentation.

First, she talked about the reason for low social expenditure in Japan, and many reasons have been cited: for example, since the growth rate had been high, if you make comparisons vis-à-vis GDP, the ratio is going to be small. Coming back to net and gross, the scope of social expenditure was defined in a narrow sense and that is why the outcome is low. The fact that Japanese society did not have as many elderly people as did Europe was given as another reason. Ms. Katsumata nullified each of these causes and reasons in her presentation.

Second, after focusing on the low social expenditure in Japan, Ms. Katsumata focused on the labor market; she looked at the household and at the uniqueness of social structures. If we look at unemployment benefits, on a relative basis, we have a lower number of unemployed. At the same time, the level and the duration of benefits are lower in Japan, which is why unemployment benefits in Japan are lower than in other countries. Furthermore, there are quite a lot of extended families in place in Japan, much more than in other advanced countries. The family structure in Japan tends toward extended families, which means that less money is spent by the public sector, and that has been proven by statistics. Because of this, Japanese Government needs less expenditure for income maintenance programs.

In looking at individuals, Ms. Katsumata said that, again, compared to other countries, many of the elderly are still working. I believe this is a very important point. So, basically, I highly evaluate Ms. Katsumata's presentation. However, I have some questions and suggestions that she might incorporate in her future research.

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In her analysis, she tried to incorporate some of the hidden social expenditure that was not included, as we moved from gross to net social expenditure. Even so, however, there could still be additional hidden social expenditure. For example, according to the research of Ms. Katsumata, one of the reasons for low social expenditure is the low unemployment benefits paid out. However, one of the reasons for the low unemployment rate in Japan could be the high spending on public construction works or, if we compare Japan, Europe, and the United States, there are many social and economic regulations both in Japan and in Europe, and thanks to them, the result is assured employment.

In a sense, consumers are bearing some of the cost, and it may be that such a cost should be included in social expenditure. Mr. Adema talked about the possibility of over-employment, especially in the private sector. Much of the expenditure and the employment can be borne in a form other than unemployment benefits. This is partly thanks to regulation and partly thanks to public spending. How should we consider this kind of expenditure?

Let me move onto my second point. As one who has studied labor economics, there is a question I am greatly interested in: when one thinks of social expenditure, whether it is individual and/or corporate, what are the endogenous and exogenous variables with regard to the attitude toward employment? At times, they are decided simultaneously. For example, in Ms. Katsumata's explanation, she cited as one reason for low social expenditure in Japan the strong willingness of the elderly to work. At that time, pension was explained as an exogenous variable: it has been repeatedly tested that the public pension benefit has a significant negative effect on the labor supply of the elderly in Japan. To explain low social

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expenditure, of course, you can point to the fact that more elderly are working. At the same time, you can use low social expenditure to explain why more elderly are working.

I think Mr. Adema talked about means testing and the benefits one gets from a pension being determined from earnings. There is a simultaneous decision on labor supply and pension benefits, and there could be a cause and effect relationship between the two. I am curious to know your view on this.

Also, although Professor Miyajima has already pointed it out on Mr. Adema's presentation, in the context of a low unemployment rate, and given that many elderly are working, as well as the fact that families are more or less supporting incomes, in terms of redistribution from a societal perspective, we could say that the scope of redistribution is smaller, or narrower. How would Ms. Katsumata view the narrowness of the redistribution in Japan?

Let me move on to the third point. I think further international comparisons could be made. Professor Miyajima did mention this with regard to Mr. Adema's presentation, but anytime we look at the relationship between net and gross, to whichever of the two presentations you refer, you are talking about ranking. Ranking is important, but let us go back to the basics. For example, in Scandinavian countries, on a net basis expenditure would be lower; whereas in countries such as Japan, United States, and ROK, as well as Australia, the reverse is true. On a net basis, expenditure is larger. Between these two groups of countries, this gross and the net are more or less at the same level.

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Why is it that we have differences among countries? I think this is another interesting point to ponder. Of course, one reason is what Ms. Katsumata called the household effect. But, if you look at Japan and Italy, which have the same kind of family arrangement, the situation of net expenditure in Italy is a bit different from that of Japan if you look at the pattern. I am curious to know your views on this.

Recently, when I was reviewing a Ph.D. thesis, I looked at the Cameron Model. In Scandinavian countries where economic scale is small, if they have a small number of industries that are highly competitive and they play a great role in the economy, labor unions would have more pressure that they can exert on society. That is why there is more expenditure on social welfare, as pointed out. So, would economic scale or the uniqueness of the industrial structures have any net and gross effect? Or, are they unrelated?

Last, but not least, inclusive of what has been said so far, there could be an argument that more or less surpasses all of this. I would like to ask both Mr. Adema and Ms. Katsumata if they consider social expenditure to be an investment, and is it possible to have an argument that social expenditure should be deemed, and I quote, "an investment?" Let us look at education. As has been said for some time, when we talk about education, it is not simply an expenditure. By investing in education, people are going to be more capable, they are going to become wiser, and thus educated people are going to make contributions to society, as well as to their personal income. Thus, educational expenditure should not be looked at merely as expenditure, but rather as a potential revenue source in the future. That is true for education.

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In affirmative employment policy, perhaps related expenditures are going to be deemed an investment to enhance overall capability, which could turn into a revenue source in the future. Perhaps this is a little too bold, but in the same line of thought, part of medical expenses could be considered an investment on health. If people are healthier, they could work longer, and thus there might be returns down the road.

As for a more indirect effect, it could be used to alleviate poverty, if you need to have a transfer system to redistribute income. If this did not exist, there would be instability in society, which incurs a cost. Thus again, poverty alleviation could be considered an investment, because this would result in less crime, for example.

If you consider all of this expenditure, then you need to consider the returns that it will bring you in the future. It might look like a different picture on a net basis. Even if it looks as though you have a lot of expenditure today, it might not be true if you look at the possible returns you reap in the future.

Theoretically, this is pretty clear, and in some aspects, it may be easier to measure the returns on investment empirically. This is true when we talk about educational expenditure or expenditure for employment policies. But, if you look at social stability, it is going to be difficult, empirically, to come up with returns in the future, especially when you attempt to quantify this. If we could come up with such measurements, then I believe that research would become more interesting. Moreover, if you look at government social expenditure, if we could prove that such returns were going to be reaped in the future, then people would be more supportive, because they would view the expenditure as an investment.

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Thank you very much. I might come back later, but for now my time is up.

Mr. Atsuhiko Yamada, Researcher, National Institute of Population and Social Security

Research: Thank you for being sensitive to time. Thank you, Professor Miyajima and Professor Seike, for your comments. Dr. Adema, what do you have to say to all these comments that have been addressed to you? Are there any additional remarks you would like to make? You have five to ten minutes for your remarks.

Mr. Willem Adema, Economist, Organization for Economic Co-operation and Development

(OECD): First, thank you very much, Professor Miyajima, for your kind remarks about how useful you thought the paper was and the study has been in the past. Thank you very much for that. It is always nice to know that it is actually read, and it is even better to know that one's work is actually appreciated. I also thank you very much for your comments. I have a few further explanations.

I think one of the points you made was about the low tax burden, and whether it would not be more efficient to take the Japanese system—where you have little claw-back—or the Danish system—which is more expensive, where you have got all this churning—all this money going around and which basically goes back to the source.

In principle, the answer is yes. But there is a point that I made at the end of my presentation about which there is a lot of confusion. So, we might want to dwell on this a little. Tax benefit systems and social systems generate redistribution in countries. But, it is not

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necessarily the case that redistribution in a social security system is more powerful than that in an income-tested social spending system.

In some countries, such as the United States or the United Kingdom, and particularly Australia, where all public benefits are income-tested, you only get social support if your income is below a certain threshold or if you do not own a house. If you own a house or have income above the test limit, you do not get anything. Now, that kind of social system is very redistributive. People always think that European social systems are very redistributive, but they are not. It is a misconception. European social security systems are largely based on social security contributions. Basically, people get, at a certain time, what they paid in before. There is some redistribution in terms of avoiding risk selection, and people do not know this before they become unemployed. The systems of Germany, Austria in particular, and Japan are very much based on that link between contribution, work record, and benefit payment at a later stage.

This does not generate redistribution in these countries, and it does not generate redistribution in Denmark. What does generate redistribution in Denmark is the high average tax rate. So, all the redistribution in Denmark, which is a very egalitarian society, is generated by a tax system, not by the social system.

So far, I have been saying that net data is very nice, because gross data distorts the picture. But gross data is not completely useless. The amount of churning in Denmark gives an indication of the amount of redistribution going on in that society.

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Of course, you were right in the sense that when you do international comparisons of social support, the national accounts definition does not include individual transfers. In countries in which the concept of the extended family is important, these transfers are not covered. Although the spending, in principle, is very social, it is not considered to be social in the national accounts.

If we had a good measure of family transfers in Japan, Korea, and also Southern European countries such as Italy and Spain—where younger people often stay at home until they are 30—then we might find that social spending in these countries is much higher than we believe it already is. For spending levels in Italy and Spain, this is a bit worrying. For spending levels in Japan and Korea, it may just get it closer to the average; however, for spending levels in Southern European countries, the levels would rise.

As for redistribution, private benefits are not the same as public benefits. In terms of redistribution, the social assistance benefit is the most redistributive. That is the one I just outlined, which relies on an income test, and people only get a benefit if they are below a certain threshold. Private benefits are not always like that, although they are when it concerns benefits provided by non-government institutions; however, private benefits often go to employees who have worked for them. Health-related benefit plans in the United States are very important. It is true that tax support for these programs often goes to people who are relatively well-to-do. But, public social security programs, or pensions for civil servants, are not much different. This is always a nice example. They are counted as social, so there is a redistribution issue, and I would love to explore this, as I said at the end of my explanation, but we would also have to do it for the public system.

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Your other point was whether the calculations only covered cash benefits, and yes, I should have said that up-front in my presentation. The adjustments in the presentation only cover cash benefits. They do not cover services. I know that is wrong; however, at this time, I do not have good data to make adjustments for that. There are two ways of going about this, or two things to consider. First, the current exercise is a first-round effect. I look at spending, tax paid on it, and what goes back. I could go and extend that exercise, and then ask, of all that money that goes back to the government, how much is actually spent on social spending again, or does it go to defense? That is one principle means of extending the framework, and it would be very difficult.

There are two ways to bring in services. First, some services are recorded as tax-free. For instance, a large part of public health spending is recorded tax-free, so there is no problem there. Some health items are taxed, but this varies across countries: in some countries, all health items are untaxed; in some countries, some health items are taxed. Prescription drugs are a substantial component. I would have to look at that carefully on a comprehensive basis.

The other way of doing this is to consider that all of these health services or family services basically reflect wage payments for doctors, nurses, and caregivers. Why not loosen the income tax rate on that amount of spending and just take that back? Because that goes back to the government, too. That is one way of doing it. I have thought about it, but I have not quite yet established what that would mean or what that would tell me. I know what the first-round effects mean; they mean what the government spends directly. It also means what the people

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get. But, I am not quite sure what that second step would mean conceptually, and how this would improve meaningful comparisons. I will continue to think about this.

Professor Seike had two points. One was on the impact of industrial relations on social spending. My response is that it depends on the country, but you will see that voluntary spending, in principle, could be very high in those countries. Now, of course, U.S. health spending is driven by unions and local worker organizations to ensure their workers get health insurance. To some extent, that is reflected. In European countries, sickness benefits were privatized and unions ensure that workers are paid. Much of the spending in union-run insurance systems in the Nordic countries is included in public sector payments, because there is such universal coverage.

Can social spending be productive? That is basically your question. Can it be invested? It is in some parts. Certain parts of health spending could be regarded as productive in terms of preventive health campaigns. You could regard that spending as productive, that is, as you try to avoid all sorts of disasters. As for elderly care, would that be called productive? I am not so certain. So, if you went down that road, particularly in health spending, you would have to be very careful when making a distinction between various spending items.

There is a move in other spending items to make them more active and more productive. Unemployment benefits in Europe are, nowadays, much more clearly tied to workfare or job search conditions. In the past, these items were completely passive, but some European politicians have started to regard them as being very productive. I do not totally share their opinion yet, but the move is there.