

A Full Employment Strategy for Europe

July 2003



HM TREASURY



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E EXECUTIVE SUMMARY

The Challenge In the new, more competitive, global economy, it is clear that Europe needs to devise modern ways of achieving our traditional economic objective: high and stable levels of growth and employment.

The Context Our policy decisions for Europe must now be made in the context of an ever more open and extensive globalisation in which the countries that will do best are the countries that are flexible, open and outward looking.

The EU has to rise to this challenge and address a number of key issues:

- first, that the causes of our disappointing employment growth are essentially structural and that economic growth alone cannot deliver the job growth we need;
- second, that demographics are against us, bequeathing us an ageing and decreasing workforce;
- third, the Lisbon targets can be met only if both unemployment and inactivity are addressed.

The response Our response must be to reform our labour markets focusing on the three areas where Government intervention can make a real difference:

- the creation of an institutional and regulatory environment which encourages job creation, promotes employment and removes barriers to higher employment and activity rates;
- setting in place, strategies, policies and services which move people from welfare to work, and make sure that work pays;
- supporting the creation of a skilled and adaptable workforce

Key issues On the basis of the analysis set out in this paper, the UK has identified the following key issues relating to the achievement of the Lisbon targets, to be addressed by Member States:

- 1) To what extent do the regulatory and institutional frameworks in Member States ensure that there is a diversity of working patterns, including part-time, that provide people with choice and the ability to combine work with family responsibilities and business with the flexibility to organise work to best meet the requirements of a modern, knowledge-based economy?
- 2) How does existing regulation act as a disincentive for employers to create new jobs that would appeal to those from a range of backgrounds – in particular, is it a disincentive for them to recruit women, young people, older workers, unskilled workers and people with disabilities or other disadvantages?
- 3) How can the Member States ensure that their benefit regimes and their employment policies are working in a coordinated way to increase the number of unemployed people moving into jobs and in particular to ensure that unemployment benefit is linked to willingness to accept training and the other help available to unemployed people?
- 4) How can the Member States ensure that “work pays” through measures that eliminate unemployment traps and poverty traps and help boost labour supply?
- 5) How can Member States ensure that employers have the skills they need to support business success and individuals have the skills they need to increase employability and encourage progression?

1 CHALLENGES FOR FULL EMPLOYMENT IN THE EU

The new global economy

1.1 In the new, more competitive, global economy, it is clear that Europe needs to devise modern ways of achieving our traditional economic objective: high and stable levels of growth and employment. Policy decisions for Europe must now be made in the context of an ever more open and extensive globalisation in which the countries that will do best are the countries that are flexible, open and outward looking.

1.2 Adapting to this globalisation requires:

- not just economic reform – completing and extending the European single market and promoting competition;
- but also a new approach to employment so that we have the skills, the incentives and the opportunities to make the most of globalisation.

1.3 But Europe has too often been unwilling to go beyond old assumptions that the labour, capital and product market flexibility necessary for productivity is the enemy of social justice. In the past, supporters of full employment have not been in the habit of thinking of flexibility as a route to full employment. And supporters of greater flexibility in our economy have seldom described its benefits as the attainment of full employment. Yet today, flexible economies are also the economies with higher employment and it is by combining the flexibility with fairness – equipping people to cope with change and tackling the insecurities that surround it – that offers the best route to full employment.

Full employment and social cohesion

1.4 In March 2000, in Lisbon, Europe's leaders committed themselves to a ten-year strategy to reform Europe's labour, capital and product markets. This is an ambitious programme driven by the vision of a European single market that can become the most competitive in the world, and a reformed social model that combines full employment with social inclusion.

1.5 This reform process is based on a shared understanding that a job is, for any adult (and, indirectly, for any dependent children), the first rung on the ladder of opportunity out of poverty and social exclusion. That is why the EU set itself challenging targets for employment: 70 per cent of its working age population in a job by 2010, including 60 per cent of women; and 50 per cent of older workers (aged 55-64). Subsequently, at the Stockholm European Council in March 2002, our leaders endorsed interim targets of 67 per cent and 57 per cent for 2005.

1.6 As the evidence below indicates, Europe must do far more if we are to reach the interim targets for 2005 and achieve the Lisbon targets for 2010 (particularly the target for older workers). Urgent and decisive action by Member States is needed to ensure that we reach these targets.

1.7 There are three underlying but vitally important considerations. The first is that the causes of Europe's disappointing record of employment growth are essentially structural. The answer lies in radical reform of our labour markets, their institutions and practices. A stable macroeconomic framework is a pre-condition of economic growth but it cannot by itself in modern conditions deliver employment growth at the rate envisaged by the Lisbon targets.

1.8 The second consideration is the demographic challenge of the dramatic changes now taking place in the balance between the working age and dependent populations across the European Union. For example, in 2000 in the EU, the population of 65 year olds as a proportion of those of working age (age 15-64) was just under 25 per cent. By 2025 it is estimated that that number will have risen to 37 percent and by 2050 it will have more than doubled, to nearly 55 per cent.¹ A decreasing working age population means that it is vitally important to raise employment rates and achievement of the Lisbon targets is fundamental to sustaining the European social model.

1.9 The third consideration is that Europe can only achieve the Lisbon targets by taking active steps to get as many as possible of Europe's 13 million unemployed into work but also by reconnecting the further 77 million people of working age who are inactive for other reasons with the labour market.

1.10 This is a critical time for European economic reform. Unemployment is once again rising sharply across the European Union and employment participation rates remain low in comparison with Europe's major international competitors. Member States must do more if they are to tackle the fundamental barriers to job creation and to get unemployed and inactive people into employment. The first steps towards the dynamic and socially inclusive EU envisaged at Lisbon, have already been made, but further actions is needed. The joint declaration from EU Finance Ministers to the European Council at Thessaloniki placed labour market flexibility and structural economic reform at the heart of the European economic policy agenda. The appointment of an Employment Taskforce, to identify necessary labour market reforms, could not be more timely.

**Objective for
the EU**

1.11 Action is urgent. We need a step change in the pace of labour market reform and a concentrated effort to implement effectively the changes which Member States (and European Councils) have agreed are priorities. There are lessons to be learned, both from each other and from outside the EU. But the time to act is now.

¹ World Population Ageing 1950 – 2050; United Nations, 2001.

2 EU EMPLOYMENT: ACHIEVING THE LISBON AGENDA

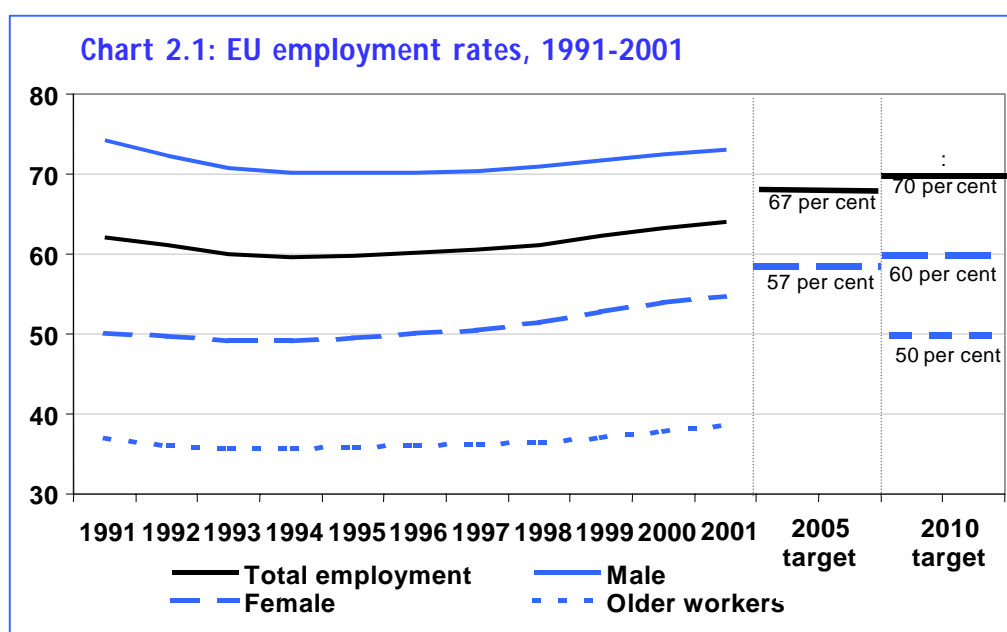
1.12 Employment opportunity for all is at the heart of the Lisbon agenda. In an economic reform programme characterised by ambitious goals, those relating to employment are among the most challenging. Reaching the targets set will require a new courage in policy-making; reaching them by the deadline agreed, a new willingness to act and implement, rather than wait and see.

The Lisbon and Stockholm employment targets

1.13 The Lisbon targets are framed in terms of the EU employment rate, that is the proportion of the 15-64 year old population in work. Agreed at the Spring Councils of Lisbon (March 2000) and Stockholm (March 2001), they comprise:

- an overall employment rate of 67 per cent in 2005 and 70 per cent in 2010;
- a female employment rate of 57 per cent in 2005 and 60 per cent in 2010; and
- an employment rate for older workers (aged 55-64) of 50 per cent in 2010.

1.14 The stark reality facing Member States is that (as Chart 2.1 illustrates), on current performance, we are going to miss the 2010 targets. As the Commission noted in its 2003 Spring Report, additional efforts are required if the EU is not to also miss its interim targets, for 2005.



Source: Eurostat

A larger challenge for a larger, older Europe

1.15 Achieving these targets, whether interim or longer term, will require ongoing and fundamental structural reform of labour markets. It is vital that Member State policies address the needs, not only of the officially unemployed, but of all of those citizens who are able to work but lack the opportunity to do so. In a long term context of adverse demographics – ageing and contracting workforces, and a rising proportion of retired people above ‘normal’ working age – the need for reform becomes greater still, and a challenge not just for 15 Member States, but for 25.

1.16 Table 2.1 compares EU15 and EU25 employment rates in 2001, alongside the 2010 targets. As is clear, EU enlargement simply makes all the more urgent those structural reforms which are already pressing in the context of an EU15.

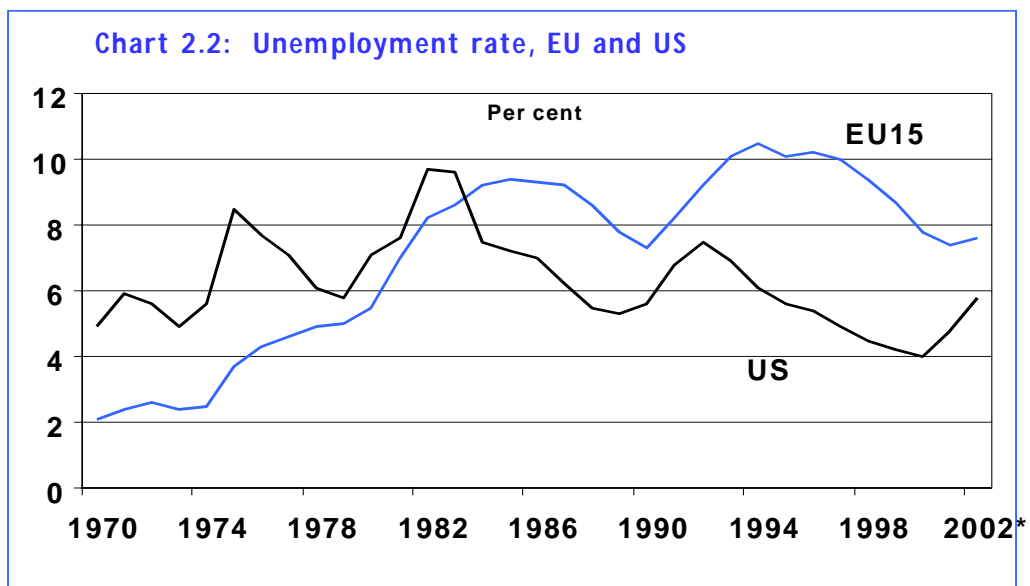
Table 2.1 Employment Rates (2001) for EU15 and EU25

	Total aged 15-64	Women aged 15-64	Older workers aged 55-64
EU15	63.8	54.7	38.2
10 New Member States	56.8	51.1	31.0
EU25	62.6	54.1	37.2
2010 Targets	70.0	60.0	50.0

Source: Eurostat; *Employment in Europe 2002*, European Commission

Tackling worklessness

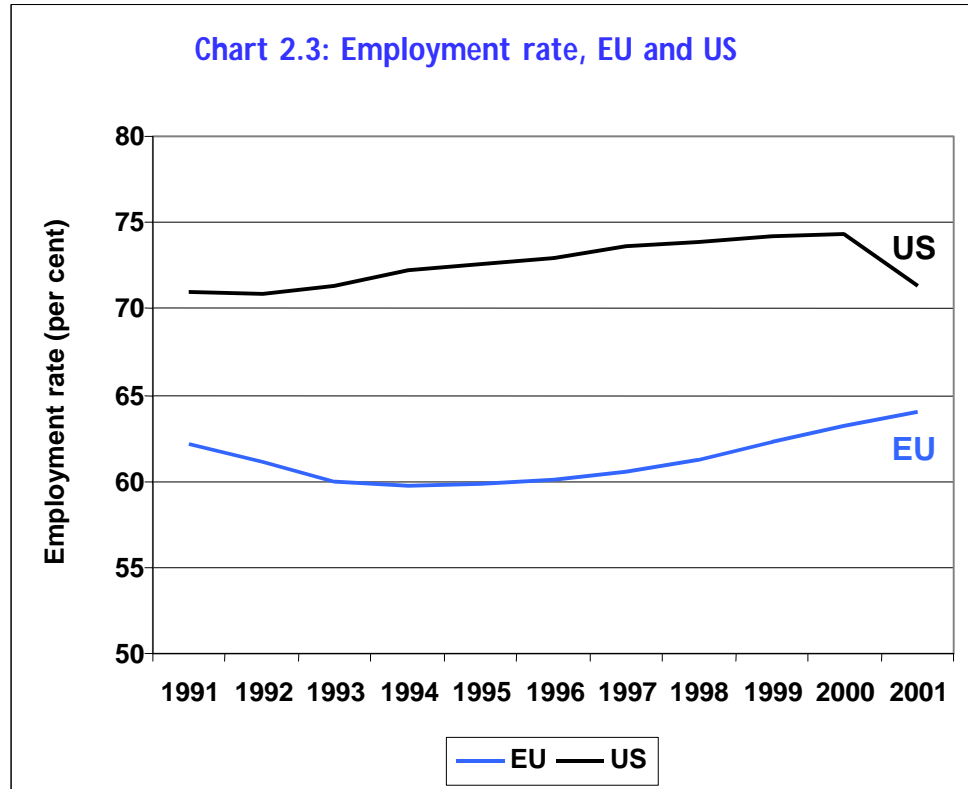
1.17 While EU unemployment has fallen since the 1990s (see Chart 2.2), it remains far too high, and reached a total of 13.8 million people at the end of 2002.² However, the number of unemployed comprises only a fraction of all of those without work, as Chart 2.4 illustrates.



* Estimate ;
Source: Eurostat

² Eurostat

1.18 EU employment growth has increased markedly since the introduction of the Luxembourg Process in 1997, but as chart 2.3 shows, performance still lags noticeably behind that in the US. In order to close the gap further on our major competitors, the EU needs to tackle these structural barriers, with targeted policies, as outlined in Chapter 3.



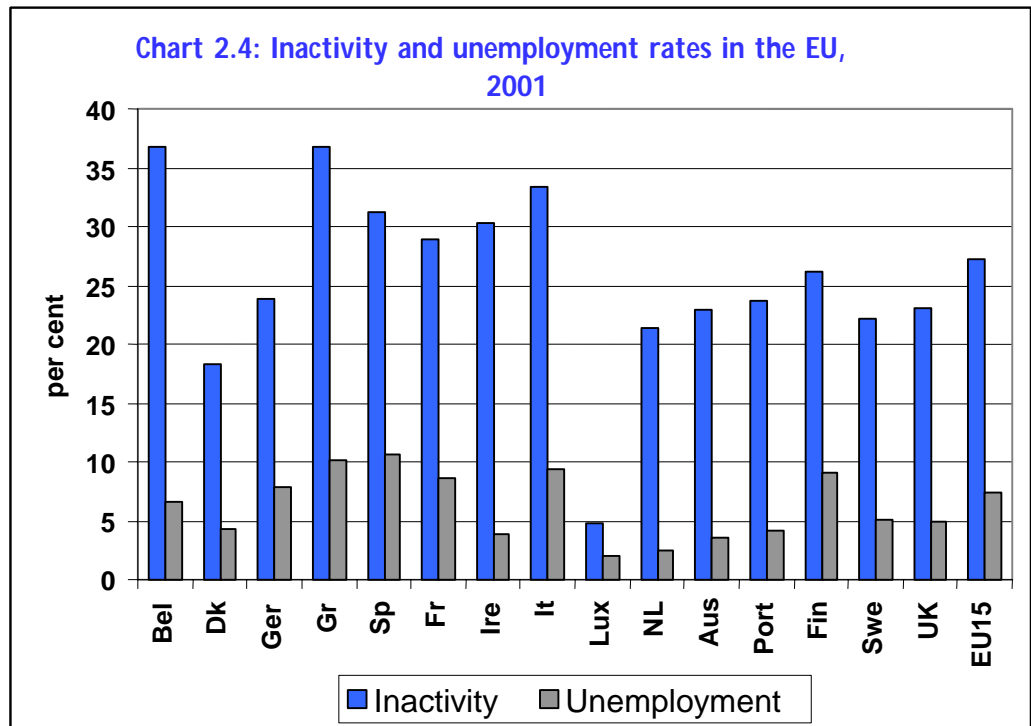
Source: Eurostat and OECD

1.19 As the Commission has noted, achieving the Lisbon employment rate target means creating at least 15 million additional jobs in the existing 15 Member States (the figure for 25 Member States will be higher). This implies a higher rate of employment growth than the EU achieved in the first five years of the Luxembourg Process, but with a much less favourable economic outlook and with more difficult labour-supply constraints. Clearly, Europe's employment growth rate will need to move much closer to that of its major competitors.

1.20 Furthermore, reaching the Lisbon employment rate targets will require more than a radical reduction in the existing unemployment total of 13.8 million people. It will mean finding jobs for a significant proportion of the 77 million working-age adults estimated to be inactive in the EU.³

1.21 Even excluding the 15-19 year old age group, many of whom are in education or training, there are still 53 million inactive people in the EU. Some people may be jobless but not recognised as unemployed due to their having become discouraged from seeking work; others may be ineligible for unemployment benefit, or be recipients of other types of benefit (e.g. disability benefit).

³ 2001 data; *Increasing labour force participation and promoting active ageing*, Report from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions (January 2002) COM(2002) 9 final

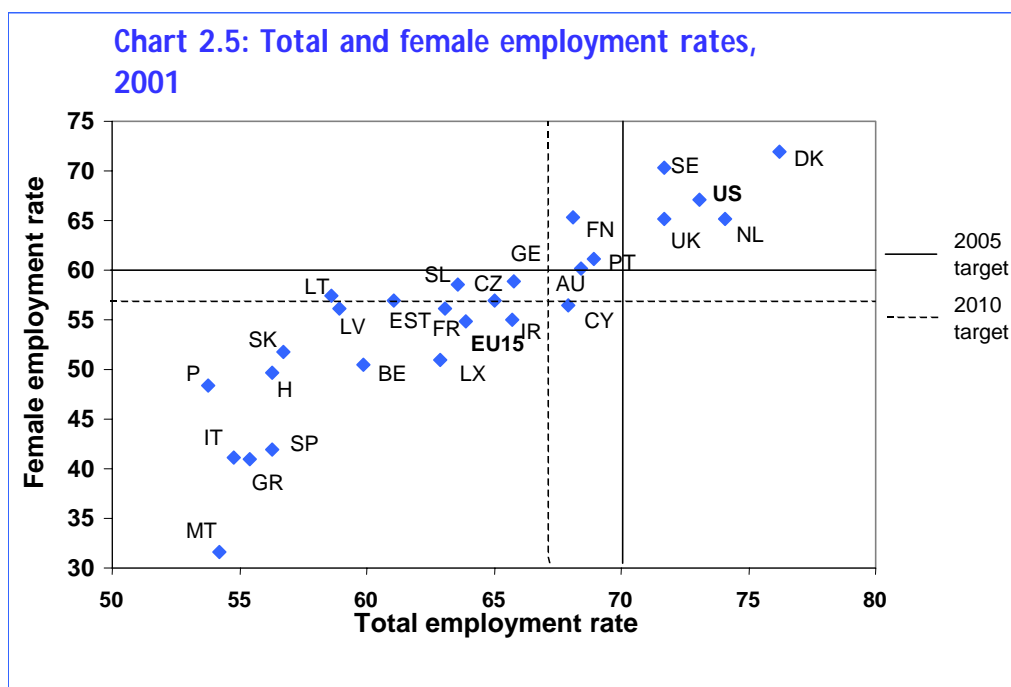


Source: European Commission; 'Employment in Europe 2002'; 2002
 Note: Inactivity and unemployment rates as a percentage of working age population (15-64)

Variations between Member States

1.22 As Chart 2.5 shows, EU15 employment rates, both for the entire working age population and for women in particular, conceal considerable variation. While the performance of the EU15 as a whole remains disappointing, some individual Member States (such as Sweden, Denmark, the Netherlands and the UK) have employment rates which both surpass the Lisbon targets and are close to or even above US levels. The Taskforce could usefully consider what these countries have done well and the barriers that are constraining performance in others.

1.23 While most new Member States have employment rates which are below the EU15 average (and a considerable distance from the 2010 target of 70 per cent), six of the ten are above the EU15 average for female employment, and only the poorest performing accession country has female employment levels lower than those in the poorest three performers among current Member States.



Sources: European Commission 'Employment in Europe 2002'; except for US (OECD Employment Outlook, July 2002)

1.24 The problem is particularly acute for older workers. While employment growth among the 55-64 age group has picked up in recent years to almost 2 per cent,⁴ this pace remains too slow to meet the 2010 target. On the basis of the 2001 working age population, around a third of the 15 million jobs still required to meet the 2010 overall employment target would need to go to workers in the 55-64 age group, in order also to meet the older workers' target (Table 2.2). Furthermore, given that demographic trends point to an expansion of this age group, meeting the 50 per cent target represents an even greater challenge than Table 2.1 suggests.

Table 2.2 EU15 job creation 2000-2001, and jobs required to meet the Lisbon targets

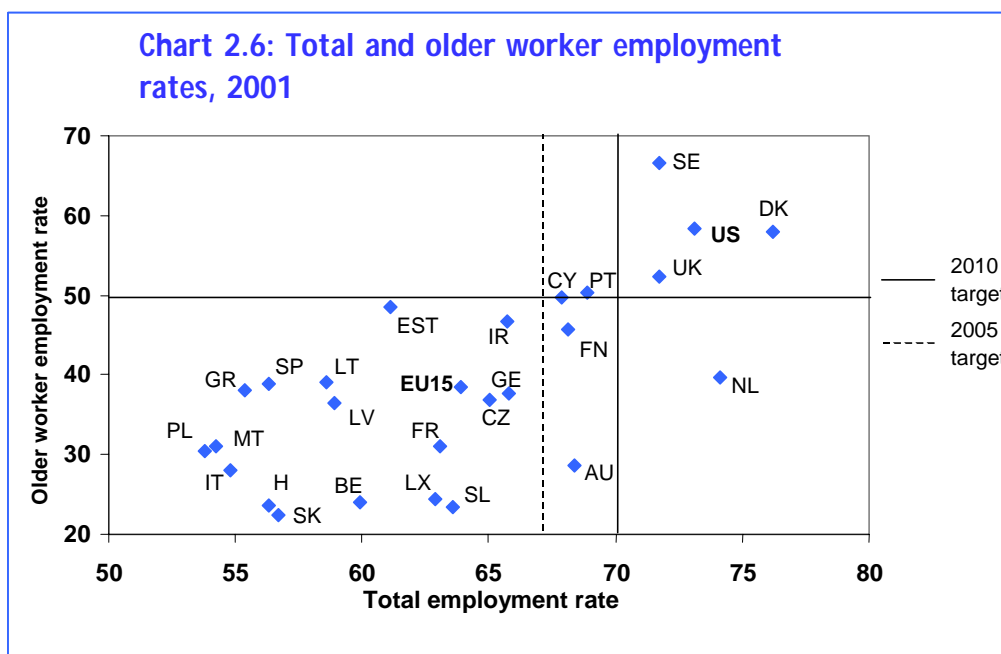
	2000 employment rate	2001 employment rate	Jobs created 2000-2001 (million)	2010 target	Jobs required 2002-2010 (million)*
Total	63.4	64.1	4.8	70.0	15.0
Female	54.1	55.0	2.8	60.0	6.3
Older workers	37.8	38.8	0.7	50.0	5.0

* Estimated on basis of 2001 working age population

Source: Eurostat; Employment in Europe 2002, European Commission

⁴ Employment growth for the 55-64 age group was 0.83 per cent in 1997-1998, 1.34 per cent in 1998-1999, 1.89 per cent in 1999-2000, and 1.85 per cent in 2000-2001. Source: European Commission, Supporting Document to the Joint Employment Report 2002 [COM(2002)621 final]

1.25 Employment declines sharply in the decade leading up to statutory or ‘normal’ retirement age. The average effective EU retirement age in 2001 was 59.9 years, though again with substantial national variations. As Chart 2.6 shows, only a quarter of people aged 55-64 are in employment in Belgium and Luxembourg; a sharp contrast not only with, for example, Sweden and Denmark, but also with some new Member States (e.g. Estonia) and with the US.



Sources: European Commission 'Employment in Europe 2002', except for US (OECD Employment Outlook, July 2002)

1.26 As Chart 2.6 also shows, some countries with relatively high overall employment rates (such as the Netherlands and Austria) nevertheless perform poorly regarding older workers. In a context of ageing populations, contracting workforces, pressure on pensions systems and longer and healthier lifespans, it is essential for both individuals and society that the decline in effective retirement age is reversed and access to the social and economic interactions of the workplace is maintained throughout the working life.⁵

1.27 Clearly, employment rates alone say nothing about the type of work undertaken, the status and income work carries, or the extent to which it is full-time, part-time, permanent, fixed term or agency. Over 33 per cent of employed women work part-time in the EU, compared with just over 6 per cent of employed men.⁶ The nature of employment, the hours worked and the rewards gained can vary substantially between countries with equivalent employment rates.

⁵ For detailed discussion of the fiscal consequences of long term economic and demographic developments, see the *Long-term public finance report; an analysis of fiscal sustainability*, HM Treasury (November 2002)

⁶ *Employment in Europe 2002*, European Commission

1.28 Nevertheless, the employment gap between the best and worst performing Member States, or between the EU15 and, for example, the US (especially, in this latter comparison, in female employment), points to a substantial economic and social cost to the EU. Employment is not solely a matter of income; it also carries immense social benefits. As recognised at Lisbon, the best safeguard against social exclusion is a job. Unemployment damages individuals' health and destroys community cohesion. Charts 2.5 and 2.6 suggest that the EU has some way to go if it is to meet the needs of all of its citizens; they also demonstrate the pressing need for structural reform to enable it to do so.

Some structural improvement...

1.29 Structural reform of labour markets serves two key purposes: it enables labour markets to adjust more quickly to economic shocks, thereby reducing the risk that an economic downturn results in damagingly high and prolonged unemployment; and it enhances the flexibility of the labour market, enabling it to generate high employment and low unemployment throughout the economic cycle. By creating a labour market which favours job creation, structural reform delivers substantial economic and social benefits across the entire population; not only to those working age citizens able to work, but also to those above or below working age, or unable to work. A buoyant jobs market provides the best security for workers.

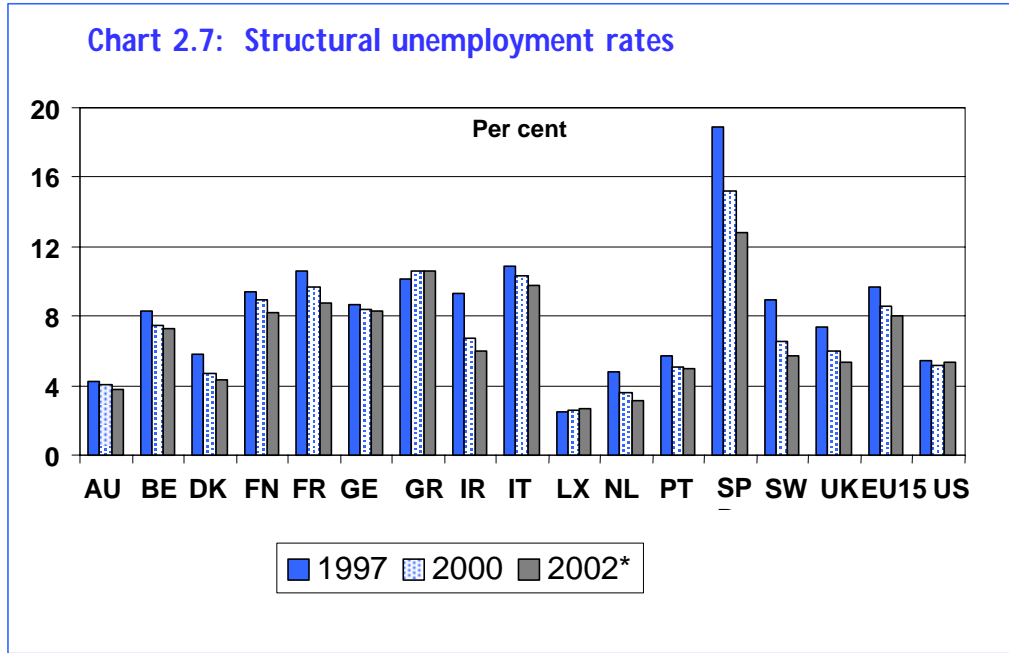
...but much more to do

1.30 As the charts above have shown, EU employment has risen in recent years and unemployment fallen. Some of this improvement undoubtedly reflects the strong economic cycle. Part, however, has been structural. So, while progress has been made, much more remains to be done.

1.31 The **structural rate of unemployment** – illustrated in Chart 2.7 by the non-accelerating inflation rate of unemployment⁷ – fell, on Commission estimates⁸, from a peak of 10 per cent in 1994 to about 8 per cent in 2002. This decline has, however, been very unevenly distributed among Member States and, notwithstanding recent improvements, remains unsatisfactorily high. For reasons of both economic and social justice, delivering further reductions remains a central rationale for ongoing reform.

⁷ The non-accelerating inflation rate of unemployment is a stock equilibrium concept defined as the level of unemployment compatible (in the absence of shocks) with a stable inflation rate. Structural unemployment may also be analysed with respect to flows in and out of work. The Beveridge curve describes the combinations of vacancies and unemployment consistent with labour market equilibrium; improved job search and matching reduce equilibrium unemployment and induce an inward shift of the curve.

⁸ *Production function approach to calculating potential growth and output gaps – estimates for the EU Member States and the US*, C.Denis, K.McMorrow, W.Röger, Economic Papers No.176 (September 2002) DG Economic and Financial Affairs

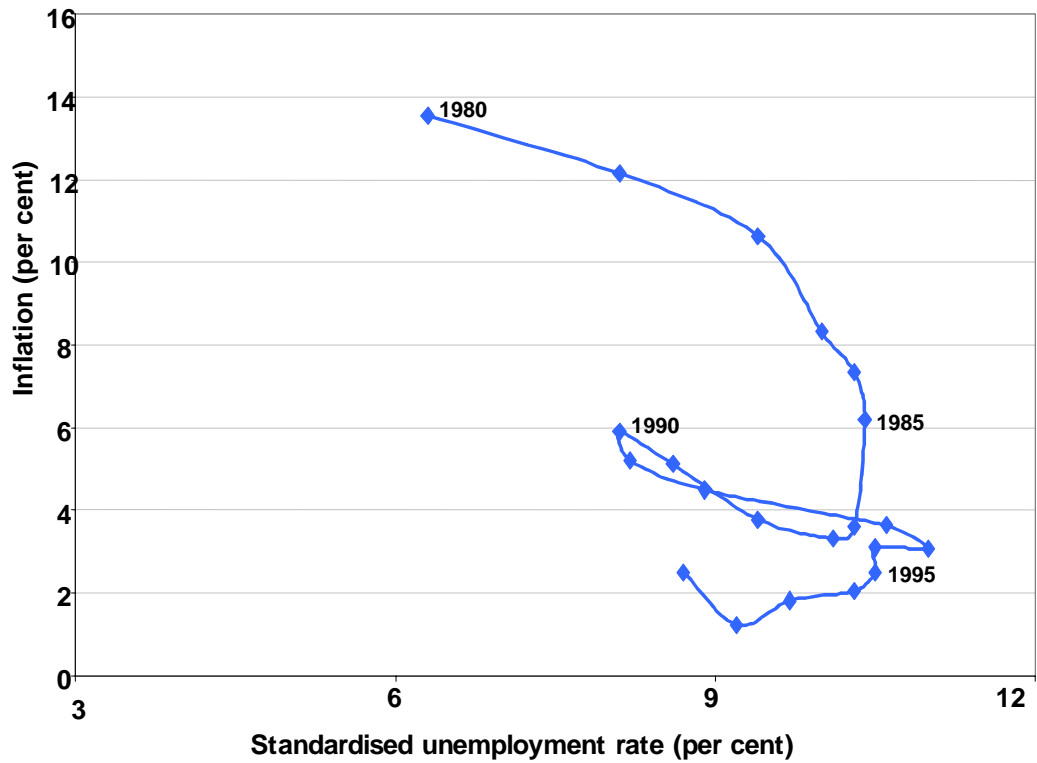


* Estimate

Source: McMorrow et al, *European Economy Economic Papers No.176 (2002)*

1.32 The **Phillips curve** describes the short-run relationship between unemployment and inflation. If unemployment is primarily structural, efforts to reduce the jobless rate below this point by boosting aggregate demand will quickly lead to rising inflation. If, however, unemployment falls because of structural improvements, this decline should occur without accelerating inflation. In the US, the Phillips curve has been horizontal since 1982; in the UK, since the mid-1990s. In both countries, the unemployment rate has fallen below that of the early 1980s, but in the context of considerably lower inflation than earlier experience would have suggested. For the EU15, as Chart 2.8 shows, the Phillips curve has also been flat since the mid-1990s, indicating (as in Chart 2.7) that the fall in unemployment has been at least partly structural. That the unemployment rate remains, however, some way above its level of two decades ago, indicates the need for further reform to improve EU labour market efficiency and individual employment opportunity.

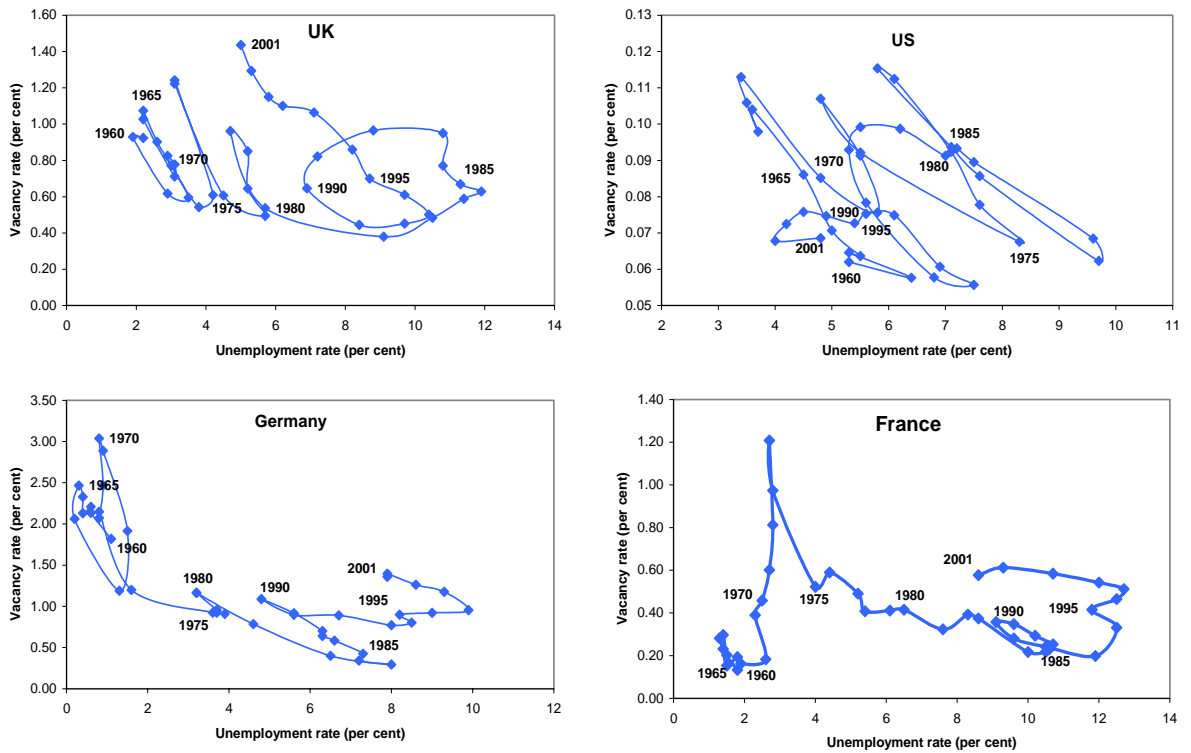
Chart 2.8: EU inflation and unemployment



Note: Inflation is all items CPI
Source: OECD

1.33 High unemployment may, if there is a ‘mismatch’ between regions or skills, co-exist with a high level of unfilled vacancies. Changes in the degree of mismatch are indicated by shifts in the **Beveridge curve**, which maps the relationship between the unemployment rate and the vacancy rate. Movements along the curve reflect the economic cycle; in a downturn, for example, hiring declines and unemployment picks up. A shift outwards in the curve, however, with both the unemployment and vacancy rates rising, suggests a structural deterioration. Labour is in demand, and labour is being supplied; but either the would-be employer and employee are not communicating effectively, or the type of labour being supplied is not the type being sought. As Chart 2.9 shows, the Beveridge curve has shifted sharply inwards in recent years in the UK and US, indicating an improvement in labour markets. It has, however, only just begun to unwind some of the deterioration of the past three decades in France and Germany.

Chart 2.9: Beveridge curves for UK, US, Germany and France



Source: OECD and Eurostat

Conclusion 1.34 Ongoing structural reform of labour markets is vital if the EU, and especially an enlarged EU, is to reach its economic and social goals. Demographic trends render the challenge of reform all the more urgent, and its benefits all the greater. How can Member States help provide employment opportunity for all – not just for those who are unemployed, but for all of those able to work but are without work? And how can they best ensure effective, flexible and fair labour markets which create, rather than protect jobs, and which are the necessary underpinnings of the competitive, dynamic and socially inclusive EU envisaged at Lisbon? Chapter 3 turns its attention to the policies needed to turn Lisbon into reality.

3 LABOUR MARKETS WHICH DELIVER EMPLOYMENT OPPORTUNITY FOR ALL

1.35 Delivering high levels of growth and employment, and creating a more productive and competitive economy demands a new flexibility in labour, capital and product markets. Flexible markets and active labour market policies are not incompatible opposites, but can be essential allies of each other. In February 2003 the UK Government published Meeting the Challenge: Economic Reform in Europe setting out progress on the reform programme in British and European labour, product and capital markets, showing how this can allow economic efficiency and employment opportunity to advance together. In this chapter the changes needed in labour market interventions are examined in more detail.

1.36 As Chapter 2 has demonstrated, European labour markets have not been able to create the jobs and to get unemployed and inactive people into work. Why is this?

1.37 First, much traditional labour market regulation, while meeting desirable social objectives, can make it more difficult for employers to take on workers and harder for companies to respond quickly to new opportunities. This can lead to increases in the length of unemployment, marginalising those at the edges of the labour market – particularly women, the unskilled, the young, the old, the disabled and those who are economically inactive. It also is often designed with today's jobs – and in some cases, yesterday's jobs – in mind, not those of the future. For example, the huge potential growth in the service sector, where more flexible working patterns are needed. These are barriers to flexibility that cannot be quickly changed to take account of changing circumstances.

1.38 Second, Europe has successfully made use of active labour market policies to help unemployed people get back to work, but it has not given enough attention to ensuring that benefit systems and active labour market policies (through public employment services) work together to reduce unemployment. More attention needs to be given to the incentives, for those unemployed and inactive people who can, to return to work. Member States need to make greater use of a wider range of active intervention measures now available and to take steps to make work pay by careful attention to replacement ratios, tax credits etc. And they need to ensure that disability benefits and pension systems do not pull people out of the labour force when both they and the economy as a whole would benefit from their continued participation.

1.39 Third, a skilled and adaptable workforce with opportunities for all to learn new skills and update existing skills throughout their careers is fundamental to the Lisbon objective of creating the most competitive, dynamic and socially inclusive economy in the world. There are a wide variety of approaches to vocational education and training across the EU, many of which have been very successful in training new, young entrants to the labour market. But it is fair to say that no one Member State has got the approach completely right - too much training for adults, for example, is insufficiently focused on the needs of business now and in the future. Member States need to focus their training and lifelong learning strategies so that they can contribute directly to the Lisbon employment targets.

1.40 It is only by addressing all three of these issues that real progress can be made.

LABOUR MARKET REGULATION

A principled approach to policy intervention

1.41 The United Kingdom believes that minimum standards in the workplace, which are sensitive to business conditions, are essential to a modern labour market. They can boost commitment and productivity and help protect against unfair treatment. The United Kingdom supports the comprehensive framework of decent minimum standards that has developed at EU level and that safeguards the core rights of employees. Given the *acquis* that now exists at both national and EU level, any new proposals for legislation need to be rigorously assessed.

1.42 Poorly designed labour market regulation brings two main risks:

- the more difficult you make it for employers to organise working practices which can respond effectively to changes in economic circumstances, i.e. by making it less risky to take on new workers and allowing them to work flexible hours and patterns, the more you encourage them to substitute capital for labour;
- it benefits insiders at the expense of outsiders, making it riskier for firms to take on new or inexperienced staff, and thus contributing directly to unemployment.

1.43 Member States need to ensure that their employment legislation is not endangering the achievement of the Lisbon and Stockholm employment rate targets. Legislation that was designed for conditions of low unemployment may no longer be appropriate in conditions of persistently high unemployment where the overriding need is for job creation.

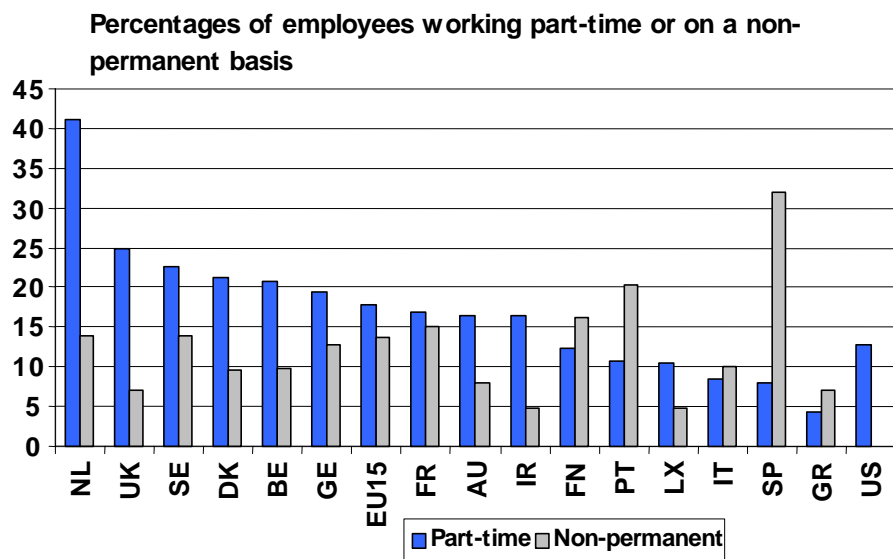
Flexible working patterns and hours

1.44 Patterns of work (and in some cases the nature of work) are changing radically and more people want to work flexible hours in order to combine work with family responsibilities, or to avoid a cliff-edge into retirement. In future (particularly in the context of an ageing EU) employment growth will depend crucially on the ability of business to organise work in flexible patterns and for people to work at the time and for the hours that they want. “The Joint Report on Increasing Labour Market Participation and Promoting Active Ageing”, 2002, observed a “massive demand for part-time work among women returnees” and went on to note, that “increased flexibility of employment, as measured by the availability of flexible working arrangements such as homework or telework, would generally increase both older people’s labour force participation and retirement age”. The problem therefore is not one of demand for part-time and flexible work, but one of supply.

1.45 We must ensure that the opportunities for expanding employment through more flexible working are not constrained by out-of-date legislation. We must also avoid putting unnecessary burdens on business. The challenge is to establish conditions that will encourage the growth of part-time work. Regulation designed to make flexible working more attractive to workers could, if it added to employers' costs, have the opposite effect.

1.46 Average working hours in all EU member states are well below the levels seen in the US or Japan. There is also considerable diversity in when those hours are worked, particularly in the proportion of those who work part-time. As chart 3.1 illustrates, those countries with the highest proportion of part-time work are also those with the highest employment levels. Most part-time work is voluntary. Survey evidence suggests that around three quarters of older inactive people looking for a job would prefer part-time work, as would a third of young entrants or unemployed.⁹ Two-thirds of prospective women-returnees would prefer a part-time job; three-quarters would accept one. Access to part-time work is thus an important plank of policies to encourage entry or re-entry into the labour force or postpone eventual retirement, as well as helping many people achieve a better work-life balance.

Chart 3.1: Part time and temporary work, 2000



Source: European Labour Force Survey, except * = OECD

⁹ Source: 'Employment Options for the Future' survey. European Foundation for the Improvement of Living and Working Conditions;

1.47 In the UK, many employers have already introduced work-life balance arrangements. Over one quarter of all employees already work flexitime. Eight in ten employers have some work-life balance practices in place. Over 80 per cent of these employers reported a positive effect on employment relations.¹⁰ The Government has set up its Work/Life-Balance Campaign and Challenge Fund to provide advice, guidance and support to business in implementing flexible working initiatives. The rapid spread of these policies demonstrates the excellent progress that can be made through actively encouraging business to follow best practice.

1.48 Because of the particular challenges that parents of young and disabled children face in juggling work with childcare responsibilities, the Government has recently introduced targeted and proportionate legislation to help parents who want to work. Designed by an independent taskforce that included employers, small firms, trade unions and parent representatives, this new law gives parents the legal right to request to work flexibly. Their employers have a legal duty to consider such requests seriously. In addition to this, the childcare element of the Working Tax Credit, targeted towards lower- and middle-income parents, can provide support for up to 70 per cent of the costs of approved or registered childcare, thereby helping parents with young children to take their first, difficult steps back into the labour market.

KEY ISSUE: To what extent do the regulatory and institutional frameworks in Member States ensure that there is a diversity of working patterns, including part-time, that provide people with choice and the ability to combine work with family responsibilities and business with the flexibility to organise work to best meet the requirements of a modern, knowledge-based economy?

Entrepreneurship **1.49** As well as regulations dictating working patterns, legislation can also stifle entrepreneurship, prevent business start-ups and restrict the growth of small and medium sized enterprises. Examples include:

- barriers that discourage small firms taking on new employees, such as social charges and taxes based on definition by the number of employees rather than on turnover or profits;
- regulations that restrict the growth of service employment, for example shop hours, requirements for licensing or certification of professional standards; and
- administrative, legal, planning or information-related obstacles to new business formation and entrepreneurship – which can lead to a growth of undeclared economic activity.

1.50 Much employment protection developed when unemployment was low and when industrial structures were very different from today. Traditional heavy industries, with high union density, have declined. The service sector has grown rapidly and is now the main source of employment. Increasing competitive challenges from outside the EU, higher consumer expectations and rapid technological development are increasing the pressures on firms to be able to react quickly to change. Economies that cannot switch resources, including labour, to new areas of growth will stagnate. Restructuring is a fact of life and employment levels will be damaged if companies cannot adapt quickly.

¹⁰ Source: DTI Work-Life Balance Survey 2003.

1.51 There is only weak evidence that overall job turnover, or employment rates (particularly for prime age males), are influenced by employment protection laws. In some countries, such as Spain, employers have circumvented restrictive and costly rules by making more use of fixed term contracts. However, strict employment protections laws can be strongly associated with lower employment rates for women and young people.¹¹ One of the main employment challenges to meet the Lisbon targets is to bring more women into the labour market. Our main social challenge is to tackle the scourge of long-term youth unemployment. The taskforce should examine how employment protection rules, including administrative procedures, can act as a barrier to meeting these challenges.

KEY ISSUE: How does existing regulation act as a disincentive for employers to create new jobs that would appeal to those from a range of backgrounds – in particular, is it a disincentive for them to recruit women, young people, older workers, unskilled workers and people with disabilities or other disadvantages?

INCENTIVES FOR THE UNEMPLOYED AND INACTIVE

1.52 One of the most important achievements of the European Employment Strategy has been to encourage Member States successfully to establish comprehensive and effective measures to help unemployed people to find and retain jobs. Active labour market policies have an essential role to play; but they are expensive and need to be well targeted. They are likely to be more effective when part of a wider strategy of making work pay.

1.53 For example, since 1998 the New Deal for Young People (NDYP) has helped almost 415,000 job seekers aged 18-34 into jobs. Independent research estimates that long-term unemployment would be twice as high as it currently is without this programme, and that national income is £0.5 billion higher because of it.¹² A study by the National Centre for Social Research also concluded that NDYP has had a significant impact on the employability of young people.¹³

1.54 The urgent need now is to build on the success of programmes like this. Member States need to ensure that their welfare systems, which support the unemployed and inactive, are working with and not against their active employment policies, in order to provide an effective incentive for people to move from benefits to work. In particular, Member States need to consider whether there are sufficient incentives for unemployed people to take advantage of the wide range of help available to them.

1.55 The right of unemployed people to financial support from the State should be balanced by responsibility to make use of the help available to them to return to employment. There should be no option simply to decide to live on benefit when help to find work is available. In pursuing this, there are advantages to bringing together the administration of benefits with the public employment services (as has been done in the UK) in order to ensure that unemployed people are given full and immediate access to the help they need.

¹¹ Source: Nickell and Nunziata - Employment Patterns in OECD Countries

¹² 'The New Deal for Young People: implications for employment and public finances, National Institute of Economic and Social Research, December 2000.

¹³ 'New Deal for Young People: national follow-through', National Centre for Social Research, April 2000

1.56 Governments must, therefore, reform their employment and social protection systems to ensure that they offer active support and help to move people from welfare to work; and lower the costs of hiring workers to increase labour demand. There are a number of measures which Member States can consider:

- reviewing the duration, coverage, level of benefits, and, where appropriate, activation measures to ensure that welfare systems are not providing disincentives to work. In many EU countries it does not pay to take a job, because welfare payments are so high or because there is very little link to associated responsibilities : life on benefit should not be an option for those who can work;
- scrutinising tax systems to avoid a high tax wedge on earnings at the lower end of the wage distribution;
- reducing non-wage labour costs to encourage recruitment;
- implementing a system of active job search to minimise the duration of unemployment. This will help to address the particular problem of long-term unemployment - important given its high costs: alienation, deterioration of skills, social tension, reduced responsiveness of unemployment to wages (lowering flexibility);
- pensions reform to encourage flexibility in the age of retirement, reduce perverse incentives for employers to encourage early retirement and allow those who want to, to work longer; and
- reforming disability benefit systems so that they do not become a form of disguised unemployment or early retirement and that those who can work are given the support they need to return to the labour market.

Making work pay... **1.57** It is essential that active labour market measures are supported by a commitment to making work pay. Measures to ensure that tax and benefit systems make work more financially attractive than welfare, are central to this.

...in the UK 1.58 UK policy to make work pay is underpinned by the National Minimum Wage (NMW), to guarantee a decent minimum income from work while allowing wages the flexibility to respond to labour market conditions. The level of the NMW in the UK is set on the basis of a recommendation by an independent commission - involving representatives of employers, and employees; and academics - to ensure that it will not harm employment prospects. In combination with this, tax and benefit reform has played a key role in improving work incentives, through:

- the introduction of a 10 pence starting rate of income tax;
- reforms to National Insurance Contributions removing the unfair “entry fee” and raising the point at which employees start paying NICs, while leaving entitlement to contributory benefits protected;
- a Working Tax Credit (including a return to work element for the over 50s and an element to provide assistance with the costs of childcare); and
- a Child Tax Credit (allowing families more choice over how to structure work and caring responsibilities; and facilitating the take-up, by parents, of flexible forms of work).

1.59 These reforms have helped to reduce the poverty and unemployment traps that deter participation in the labour market and lead to long-term unemployment and inactivity, and the associated problems of social exclusion. Together the National Minimum Wage and tax credits guarantee a minimum income, which responds to family circumstances and ensures significant gains to work. Since these reforms, the number of families who face Marginal Deduction Rates above 70 per cent has fallen by over half a million, from 750,000 in 1997 to 185,000 in 2003/04.

1.60 In summary, integration of the tax and benefit systems in the UK has proved highly successful in improving fairness for low paid workers at the same time as extending employment opportunity through removing financial disincentives to taking up and remaining in a job. For example the employment rate of lone parents has risen to 54 per cent, its highest rate in 20 years.

The regional dimension 1.61 In pursuit of full employment, governments must ensure that they address regional disparities and inflexibilities that may create disincentives to take jobs. In the UK, professionals in the South-East have often benefited from London weighting and other arrangements, where many lower paid workers have missed out. Starting this year, the UK Government plans to publish data on regional prices and inflation; remits for pay review bodies and for the public sector including the civil service will, within their nationally determined frameworks, include a stronger local and regional dimension; and the reform of housing benefit will remove disincentives to work or to move.

KEY ISSUES: How can Member States ensure that their benefit regimes and their employment policies are working in a coordinated way to increase the number of unemployed people moving into jobs and in particular to ensure that unemployment benefit is linked to willingness to accept training and the other help available to unemployed people?

How can Member States ensure that “work pays” through measures that eliminate unemployment traps and poverty traps and help boost labour supply?

LIFELONG LEARNING AND SKILLS DEVELOPMENT

1.62 A dynamic economy is built on skills: they are vital if employment is to increase. There is a strong link between the skills or qualifications of individuals and the likelihood of unemployment, employment, willingness to undertake lifelong learning, and investment by their employers in further training.

1.63 Recognising the importance of skill level as a driver of productivity and social inclusion, we need to ensure that employers have the skills they need to support business success and that individuals have the skills they need for employability and personal fulfilment. To achieve this vision it is becoming clear that action is needed on both the demand and supply side. It is important that the education and training system is more responsive to employer and learner needs, but that is not enough. Employers’ demand for skills is key to ensuring that current workforce skills are best deployed, that appropriate skills are developed, and that employer investment in training is optimal.

1.64 It is also necessary to raise demand from individuals for lifelong learning and improving the skills needed for employability. Barriers include previous poor experience with education and training, insufficient employer guidance, time pressure for example in looking after the family, financial constraints, and lack of interest partly due to poor information.

1.65 A key challenge for Member States is therefore promoting the concept of a learning society in which everyone expects, and has the opportunities, to learn and upgrade their skills throughout life.

1.66 Government policies are needed which widen access to lifelong learning for all individuals: the unemployed as well as those in employment, the low skilled as well as the highly skilled, adults as well as the young. Policies must encourage all employers to invest in their people and encourage individuals to take responsibility for continuing and updating their learning. The costs for training and skill development must be clearly shared between government, employers and individuals. Innovative and flexible ways of delivering training, including the harnessing of new technologies, must be encouraged so that training is accessible to everyone, including the most disadvantaged. e-learning, distance learning, community and family-based learning can be a more suitable route than traditional approaches for some individuals to update their skills.

Evidence from the UK and abroad

1.67 International evidence suggests that the UK suffers from significant skills shortages, particularly at the intermediate level. The UK compares well with other European countries on highly skilled workers, but we have a much higher proportion of workers with low skills. To raise UK skills the Government is acting to improve the skills of young people entering the workforce and encourage lifelong learning with increased opportunities for those already in the workforce to acquire new skills through a number of significant reforms.

1.68 Table 3.1 shows the difference in labour force skills between the UK and its major competitors. It is notable that the UK has a far higher proportion of lower skilled workers than others in its EU cohort (though similar to the US). At the other end of the spectrum, France, whose Government takes a far more interventionist approach to employer provided training, has more than one and a half times the UK's proportion of employees with above basic skills; in Germany the proportion is almost double. Such differences have implications for competitiveness, productivity and growth. For example, estimates have been presented which suggest that between half and all of the UK productivity gap with Germany can be explained by skills differences.¹⁴

Table 3.1: Labour force skills, total economy, 1999

Per cent of the work force with qualifications at levels:

	Higher	Intermediate	Low	Relative skills UK=100
US	27.7	18.6	53.7	100.5
France	16.4	51.2	32.4	105.5
Germany	15.0	65.0	20.0	105.3
UK	15.4	27.7	56.9	100

Source: Britain's relative productivity performance: update and extensions, O'Mahony and De Boer, NIESR, 2002

1.69 The Government will publish a White Paper on skills this summer which seeks to ensure that employers have the right skills to support the success of their businesses, and individuals have the skills they need to be both employable and personally fulfilled. At the heart of the skills strategy is a powerful new drive, in each major sector of the economy, to identify and deliver the skills that employers need to raise productivity. We are establishing a new network of Sector Skills Councils that will lead that drive.

¹⁴ *Britain's productivity Performance 1950-96: An International Perspective*, M. O'Mahony NIESR 1999; *Britain's Record on Skills*, R. Layard, S. McIntosh, A. Vignoles, Centre for Economic Performance, LSE, 2001.

1.70 We have already established the national and local Learning and Skills Councils to support provision of learning opportunities. And we have recently put in place a major reform programme, through Success for All, to raise the quality of provision to ensure high quality learning for all. The strategy will also set out the further changes we seek to enable providers of learning to become more responsive to the needs of employers and individuals. Alongside this we are piloting new approaches to integrate Regional Development Agencies with the Learning and Skills Council so that skill needs flowing from the regional economic strategies drive the allocation of education and training funds.

1.71 Further Government measures to improve workplace skills include the Employer Training pilots, which are taking a middle way between the heavy handed training levy approach and reliance simply on exhortation and persuasion which has not succeeded in raising the workforce skills sufficiently.

1.72 Greater emphasis is put on improving the basic skills of literacy and numeracy among the adult population within a dynamic Skills for Life strategy that is raising demand, capacity and quality of training, aiming to improve the basic skills of 1.5 million adults by 2007. The Government has also committed itself to substantially reducing the number of adults in the workforce who do not yet have a qualification at level 2 or above, equivalent to the ISCED level called Upper Secondary, targeting a 40% reduction by 2010. Both these measure aim to increase employability and employment rates as well as improving economic performance.

1.73 In delivering these aims, there is greater emphasis on workplace training closely linked with employer needs, which will ensure a closer link between the skills provided and the labour market requirements. There is a challenge for education and training providers to build on the current performance and become more focused on employers and the needs of the labour market.

KEY ISSUE: How can Member States ensure that employers have the skills they need to support business success and individuals have the skills they need to increase employability and encourage progression in work?

4 CONCLUSIONS

1.74 On the basis of the analysis set out in this paper, the UK has identified the following key issues relating to the achievement of the Lisbon targets, to be addressed by Member States:

- 1) To what extent do the regulatory and institutional frameworks in Member States ensure that there is a diversity of working patterns, including part-time, that provide people with choice and the ability to combine work with family responsibilities and business with the flexibility to organise work to best meet the requirements of a modern, knowledge-based economy?
- 2) How does existing regulation act as a disincentive for employers to create new jobs that would appeal to those from a range of backgrounds – in particular, is it a disincentive for them to recruit women, young people, older workers, unskilled workers and people with disabilities or other disadvantages?
- 3) How can the Member States ensure that their benefit regimes and their employment policies are working in a coordinated way to increase the number of unemployed people moving into jobs and in particular to ensure that unemployment benefit is linked to willingness to accept training and the other help available to unemployed people?
- 4) How can the Member States ensure that “work pays” through measures that eliminate unemployment traps and poverty traps and help boost labour supply?
- 5) How can Member States ensure that employers have the skills they need to support business success and individuals have the skills they need to increase employability and encourage progression?