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## CHAPTER 4

# INCREASING THE SIZE OF THE EUROPEAN LABOUR FORCE: THE RELEVANT TRADE-OFFS

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### 4.1 Introduction

In March 2000, the European Summit in Lisbon subscribed to the very ambitious goal of raising the employment rate by almost 10 percentage points in less than 10 years. More precisely, the task set out in Lisbon was to increase the employment to working-age population ratio from 62.4 per cent in 1999 to 70 per cent by the year 2010, attaining at least 60 per cent in the case of women. These targets reduce the gaps between the EU and the employment-to-population ratios prevailing in the United States (respectively, 74 and 68 per cent). The economic rationale behind targets defined in terms of employment rather than unemployment rates resides mainly in the opportunity offered by a broader employment to reduce tax rates on labour without necessarily reducing the scope of redistributive policies.

Closing the gap in employment rates between the EU and the United States would also, at least in principle, allow a closing of the gap in GDP per capita between the two sides of the Atlantic as labour productivity in Europe has significantly converged towards the United States level. However, this income convergence scenario (in Lisbon the EU Heads of State promised that, by 2010, the EU would be “the most dynamic Continent of the World”) will materialize only if the EU succeeds in dramatically increasing employment rates without reductions in labour productivity. The experience of the United States over the 1990s suggests that it is possible to combine strong employment growth with productivity enhancements, but the task is dauntingly difficult, particularly in Europe.

In order to achieve the Lisbon targets, many EU countries will not only have to absorb long-term unemployment, but also to increase participation rates and reduce the size of the informal sector. Jobs involving individuals who have been on the dole for a long time and persons with a weak attachment to the labour force typically attain relatively low-productivity levels. The informal sector is itself mainly composed of low-productivity jobs surviving just because employers (often in agreement with their employees) do not pay taxes and social security contributions and/or do not apply contractual or minimum wages. Thus, creating these types of jobs is likely to *reduce* average labour productivity in the EU area because of compositional effects.

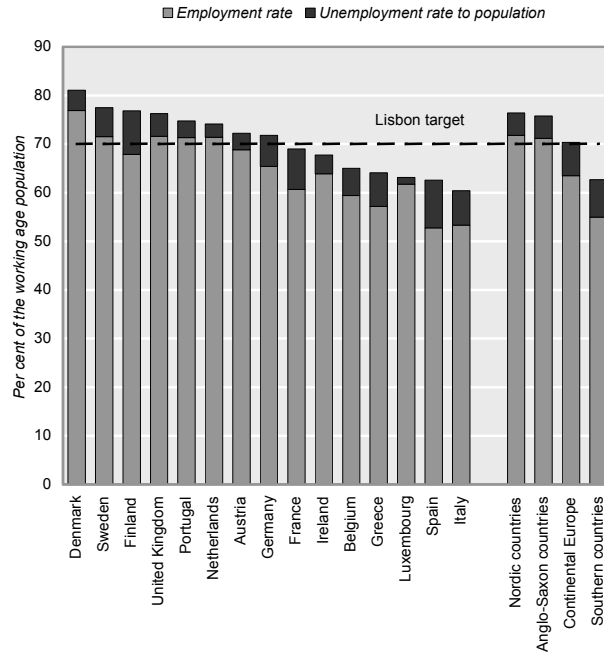
Moreover, the creation of more low-productivity jobs will challenge the labour market and social policy institutions prevailing in many EU countries. In particular, it will require some sort of relaxation of institutions, which are compressing the structure of wages from below as low-productivity jobs can only survive by paying lower wages. Faster employment growth has indeed occurred in the last decade mainly in the countries with less compressed earnings structures.

Convergence towards the Lisbon targets can be achieved without significant reductions in labour productivity and, above all, without having to phase out the redistributive institutions, which characterize the European landscape. This requires the introduction of in-work benefits and activation measures, along the lines of the Scandinavian and British welfare-to-work experience.

The purpose of this paper is to provide an overview of the main tools to be activated if this strategy is to be pursued. Thus, we will first address feasibility constraints and then dwell on specific policy proposals. In particular, section 4.1 characterizes the trade-offs, section 4.2 moves on to discuss welfare-to-work policies and section 4.3 concludes by discussing the role of other complementary policies, such as migration and reforms of European pension systems.

CHART 4.2.1

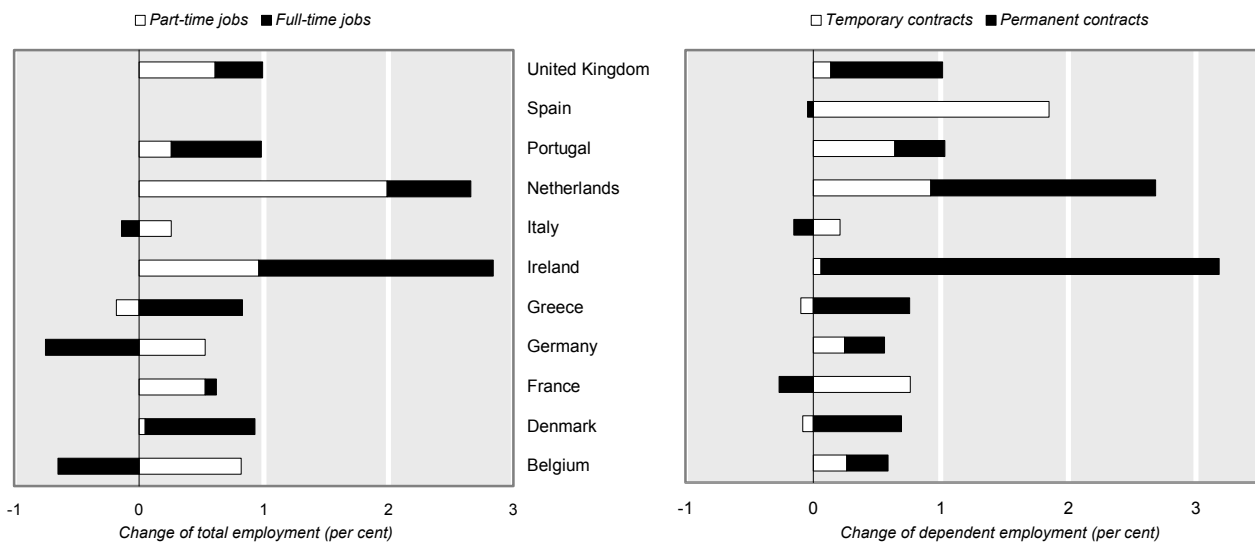
Employment and unemployment in the European Union: "How far from Lisbon?"  
(Per cent of working-age population)



Source: Eurostat, Labour Force Survey, 2001.

CHART 4.2.2

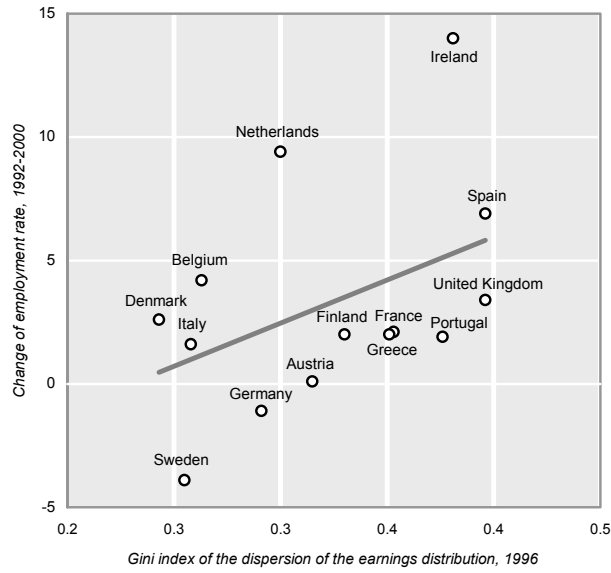
Contribution to the creation of part-time and temporary jobs, 1983-2000  
(Percentage changes)



Source: Eurostat, Labour Force Surveys, 1983-2000.

CHART 4.2.3

Employment growth and earnings inequality in the European Union, 1992-2000



Source: European Community Households Panel (ECHP) Wave 4.

CHART 4.3.1

The design of an employment-conditional incentive: phase-in and phase-out regions

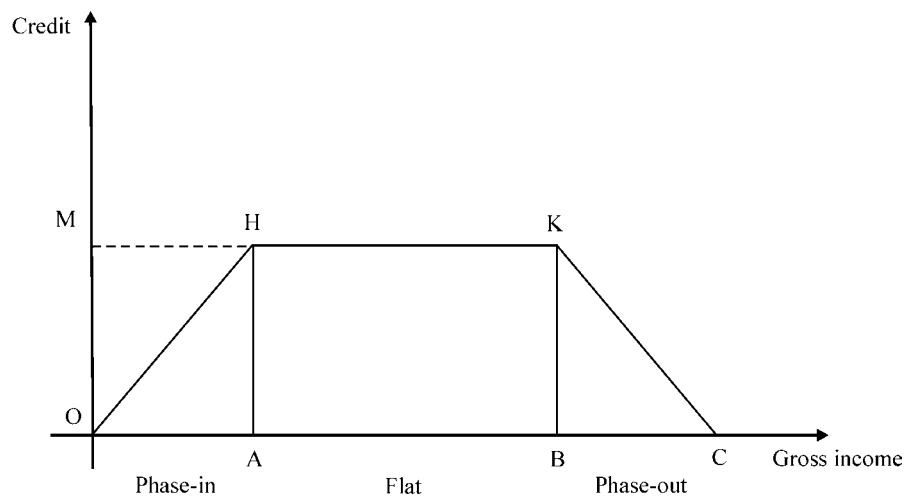
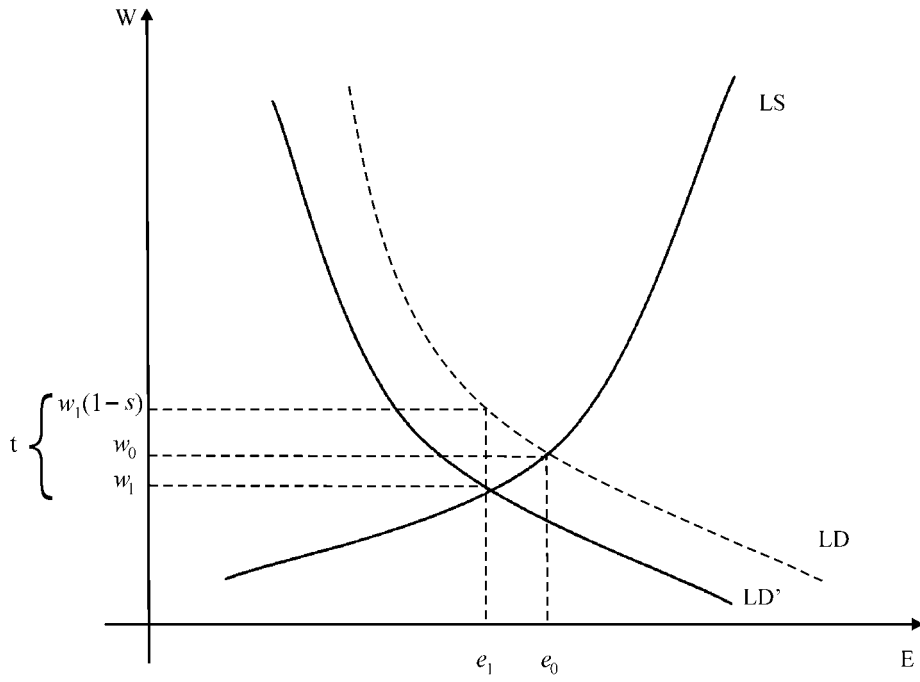


CHART 4.3.2  
Effects of wage subsidies



## DISCUSSANTS' COMMENTS

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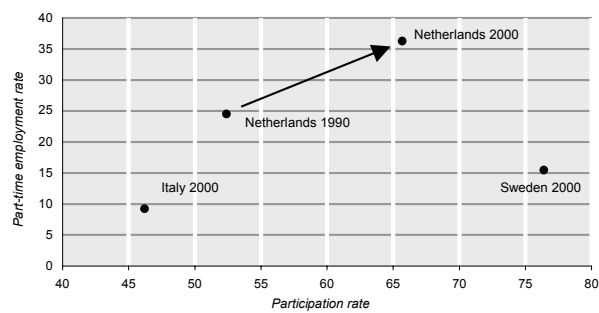
4.A Vladimir Gimpelson

and

4.B Jan van Ours

CHART 4.B.1

Participation and part-time employment rates for females  
(Per cent of population)



Source: As for table 4.B.1.