

The Impact of Welfare State to Labour Market. European Submodels Differences*

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Abstract. *In this study, we show the effects which the measures to implement welfare state have to labour market. All knows that the employment represents the most important component of the welfare state, as it supports the fulfillment of the objectives for the economic and social policies. The argument of the previous statement is very simple: the expenses for social protection are made on the basis of the returns from taxes and social contributions paid by the employed persons. The higher their number, the bigger the tax basis, and the budget for the social policy will become sustainable, even though measures for decreasing taxation would be applied to companies and to the employed population. The entire virtuous mechanism may disintegrate if a low rate of employment persists. In case of a high unemployment on a long-term, of an early exit from the labour market, of a lower integration on the labour market of women, of young persons, of aged persons and of poorly qualified persons, the social expenses will increase and the budget revenues will decrease, the result being the increase in the state's debt.*

The crisis will prove whether the increase in employment recorded since 2000 was conjunctural (determined by the favorable macro-economical evolutions) or structural (induced by the reforms implemented on the labour markets and in the social protection systems).

Keywords: employment, Lisbon Strategy, unemployment trap.

JEL Codes: D63, E24.

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1. Employment rates evolution

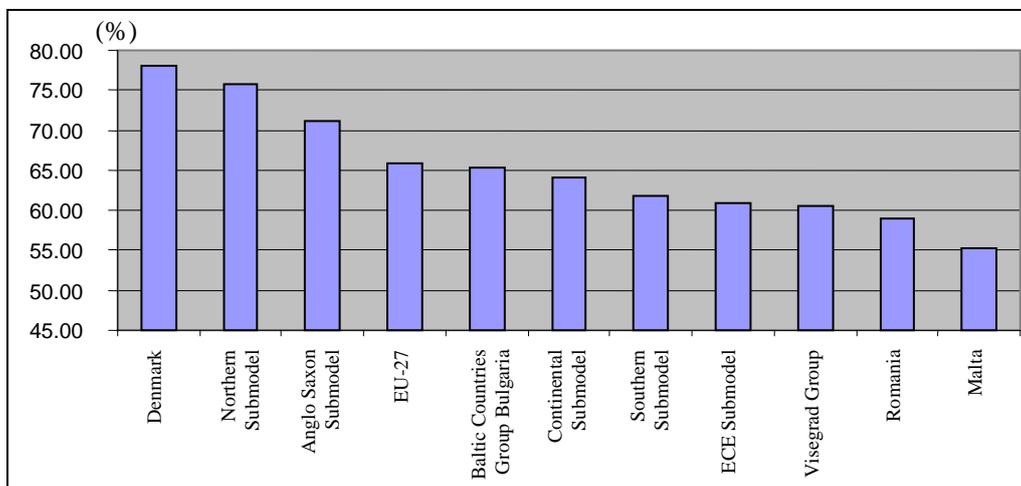
The Lisbon Strategy admitted all these potential risks for the stability of the social model and that is the reason why the main objective of EU's functioning was to increase the degree of using the labour force, an additional objective being that, until 2010, the employment rates should increase up to 70% for the active population, 60% for women and 50% for aged persons between 55 and 64 years old⁽¹⁾. In order to solve the deficit in the European employment, the policy decision makers proposed to achieve a combination of measures which could encourage the jobs creation (labour demand) and the labour force's participation (labour offer). An important element of the strategy for increasing the employment rate was constituted by the improvement of incentives in order to enter the labour market and to extend the working period. They allow the fulfillment of the proposed employment standards and they also provide long-term sustainability for the public finances.

During the period between 2000 and 2008 there were records for a 7% increase of the employed population, and this reflected in the 3.7 percents increase of the of the employment rate, up to a level of 66% in EU-27. The new member countries have quite low efficiency with reference to employment, and this negatively affects the European average. Thus, in the case of the other four sub-models (included in EU-15), the average employment rate was 67.3% in 2008, this value being 4 percents higher than the records from 2000. The employment rate for the population over 55 years old increased by 8.7 percents between 2000 and 2008, as a result of the approximate 37% increase of the employed population within this age category. Despite this evolution, the percentage of the persons who are between 55 and 65 years old and who have a job is 4.4 percents, inferior to the target of 50%. The employment rate among women increased by 5.4 percents, the value from 2008 being 59.1% for EU-27; most of this evolution was determined by the women's employment with part-time contracts. In the case of employment rates for women and for aged persons, the EU-15 countries were more efficient, as they surpassed the target of 60% settled for the first rate, being 2.5 percents lower than the target for the persons who are over 55 years old. According to this brief description of employment's trajectory, EU recorded significant progresses with reference to the categories which are more vulnerable on the labour market, the aged persons and the women.

As for employment, EU is still characterized by gaps compared to other external models of economy (such as the American one), and also by disparities

between sub-models. Regarding USA, the total employment rate was 6.3 percents lower in 2007, and that of women's employment was 7 percents lower, and for the employment of the persons over 55 years old the difference was 17 percents. Within EU, the most efficient states are the Scandinavian countries, which have fulfilled the target settled for 2010 since 2000, with reference to the total employment and the women's employment. Among the EU-15 sub-models, the Southern ones has the lowest employment rate, and among the new member countries, the Baltic economies obtained results which proved to be superior to the continental and Southern sub-model (Figure 1). Since 2000, the employment rate increased in 25 of the member states, except Portugal and Romania, our country recording the most important decrease in the percentage of the employed. This rate decreased from 63% in 2000 to 59% in 2008, under the terms of persistence in the informal labour, of early pensions, of labour force migration and of the youthful people's difficulties in entering the labour market.

The results obtained by the European economies with reference to employment were those related to the reforms implemented on the labour market for adjusting to the flexicurity principles. In 2008, eight of the EU-27 countries already fulfilled the objective of 70% settled for 2010, and among them, four belong to the Northern sub-model, two belong to the continental sub-model (Austria and Germany), one to the Southern sub-model (Cyprus) and one belongs to the Anglo-Saxon sub-model (Great Britain)⁽²⁾. As for the two continental economies, the increase of the employment rate was the result of the reforms implemented on the labour market. In Germany, the Hartz reform for decreasing the unemployment assistance decreased unemployment on a long term and increased the flexibility of the labour force, and in Austria a flexicurity system was implemented, and this was considered to be even more efficient than the Danish system. On the other hand, most of the Southern economies and of those belonging to the ECE sub-model have labour markets which are not reformed, the education systems are not efficient and they have a quite high percentage of labourers in the informal sector. Moreover, they promote quite high taxes applied to labour, and this fact discourages the creation of new jobs. That is the reason why Greece, Italy, Hungary, Malta, Poland, Romania and Slovakia have an employment rate which is even lower than the European average recorded during the year when the Lisbon Strategy was elaborated.



Source: Eurostat (2009).

Figure 1. Employment rates in the European sub-models (2008)

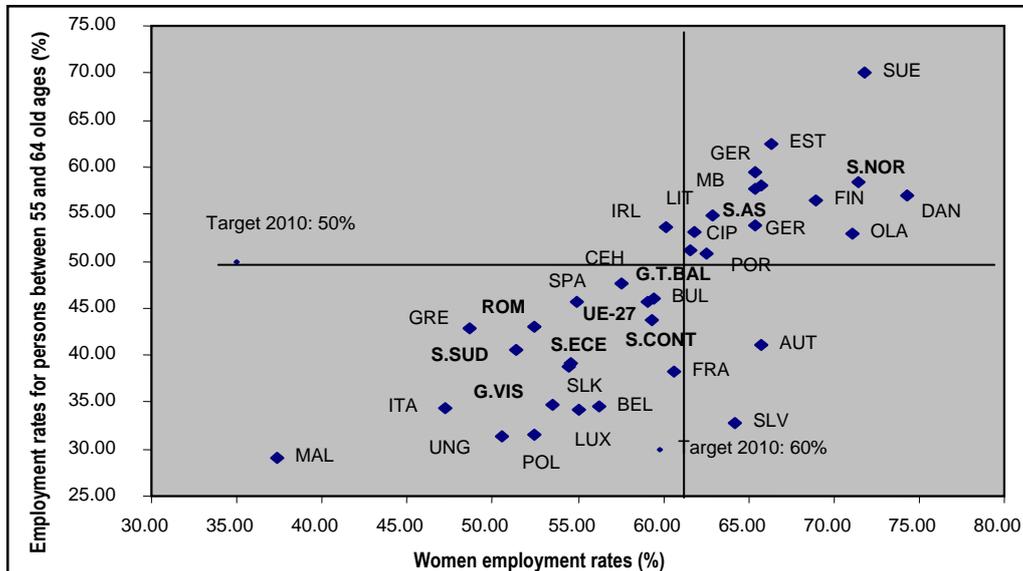
Two segments of the labour market which have benefited the most from the creation of jobs in EU since 2000 are represented by the persons who are between 55 and 64 years old and the women. The European sub-models' ranking from the point of view of the employment rates for these categories of labourers is similar to that for total employment. As for the women's employment, more than half of the member states record a percentage for employment which is superior to the threshold settled for 2010. Romania was the only economy of which employment rate decreased if compared to 2000, from 57.5% to 52%; the same observation is valid for the employment of aged persons, under the terms of a decrease by 6.4 percents up to a level which is only 7 percents below the target of 50%⁽³⁾. If in all the other economies of the ECE sub-model the economic growth induced an increase in the employment rates, for Romania the effect was exactly the opposite; this phenomenon can be explained by the existence of a very low real pensioning age for labourers, namely only 52 years old for women, and 54 years old for men (according to the World Bank).

Among the economies which fulfilled the target of 60% in 2008 for women employment, Austria and France record a negative gap, of 9 percents, respectively 12 percents compared to the limit of employment for persons between 55 and 64 years old. These economies have negatively influenced the weighted value of the continental sub-model, this being 6.5 percents below the

target of 50%. The decisions of early pensioning for the aged population implemented by the countries from the continental and Southern sub-models in the '80s generated the decrease by approximately 20 percents of the aged labourers, and the effects of these measures are also mirrored in their current efficiency. This reality supposed the implementation of radical measures for reforming the pension systems, by increasing the number of years for mandatory contributions at 45 years, as for Belgium, which recorded a rate of employment for aged persons with 15.5 percents lower than the target value.

Among the European sub-models, only the Northern and the Anglo-Saxon ones achieved the employment rates settled for 2010 since 2008, as it can be noticed in Figure 2. With reference to the employment rate for women, the values obtained by the Northern economies are the result of increase in part-time employment, and also of granting budget resources for children, which allowed the reconciling of the family life with the women's participation on the labour market. As for the employment of the aged persons, the Northern countries have recorded the highest progresses since 2000. The improvement in the functioning of the labour market for this category of labourers represents the result of the reforms which limited the access to early pensioning and stimulated them (including financially) to continue the participation on the labour market as long as possible.

The same efficiency was recorded by the group consisting of the Baltic States and Bulgaria, which obtained significant increases of the two employment rates during the period 2000-2008, and this fact made them different from the other new member countries; for example, Bulgaria recorded the highest increase rates for employment both of women and also of the aged population in EU, namely 13.2 percents, respectively 25.2 percents. The levels of the percentages for employment in the ECE sub-model can be compared to those of the Southern sub-model; compared to them, the new member states have a 3 percents higher average employment rate for women and a 1.7 percents lower of aged labourers.

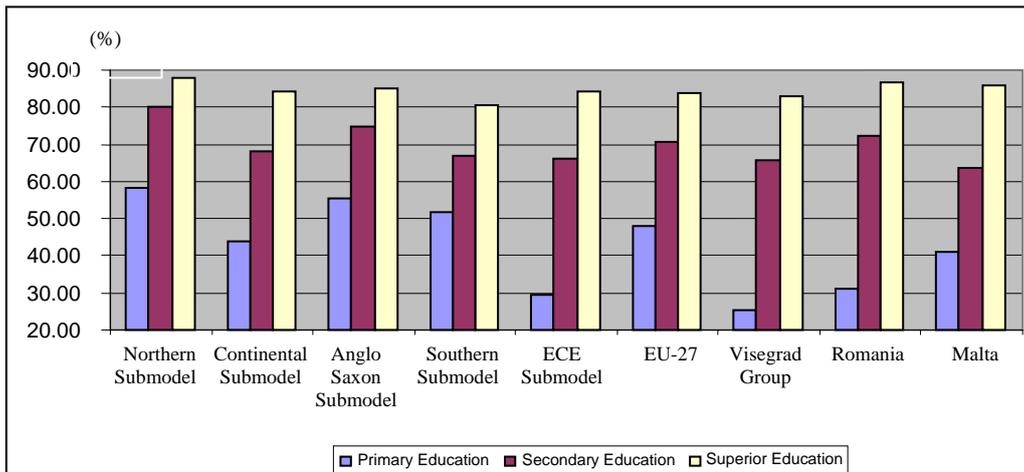


Source: Eurostat (2009).

Figure 2. Rates of employment for women and for aged persons in EU-27 (2008)

A factor which influences the persons' possibilities to get employed, and also their flexibility is their educational level. For EU-27, the average employment is 48.1% for those with primary education, 70.6% for the labourers who have secondary and post-secondary education, respectively 84% for those with superior education. In almost all the EU countries (except Italy and Hungary), the employment rates for persons with superior education is of minimum 80%, this value being with 20-25 percents higher than the rate of total employment. If for the percentage of the employment for labourers with superior education there is a convergence between the European sub-models, for the persons with primary divergences are the highest (Figure 3). Thus, for 18 out of the 27 EU economies, their employment rate is below 50%, while Portugal, Denmark and the Netherlands have an approximate rate of 62.5%. The employment rate for those who have primary education is the highest in Portugal, as this economy has the highest percentage of labourers with such an education level. Among the European sub-models, the Northern and the Anglo-Saxon ones are characterized by a superior capacity to offer jobs to labourers which only have primary education. Under the terms in which they constitute the group which is the most vulnerable to the economic changes, an increase in the employment rate among them represents a condition for decreasing the

poverty risk. The most inefficient sub-model, when referring to the insertion of the poorest qualified persons, is that of the new member countries, and among them, only Romania and Slovakia record employment rates which are slightly over 40%.



Source: Eurostat (2009).

Figure 3. Employment rates according to the education level (2008)

According to the analysis made on employment and unemployment in EU and within the sub-models, we may draw the conclusion that it is practically impossible to achieve all the three medium term targets settled by the Lisbon Strategy. Besides causes such as the weak reforming of the labor markets and of the social protection systems, especially for the Southern and for the new member countries, we may add the impact of the financial crisis, which will undermine EU's capacity to decrease the employment differences⁽⁴⁾. The decrease in the external and internal demand, caused by the economic and financial crisis, may determine a net loss of jobs, and this aspect will materialize in the increase in number of the unemployed persons and in ceasing the favorable evolutions recorded during the period between 2000 and 2008. However, the economic recession recorded in almost all the member countries has generated a fast return of the unemployment rate up to a level of 7.4% in December 2008 and to 8.3% in March 2009. These evolutions are recorded by the annual data corresponding to 2008 for a series of countries, such as Spain, Latvia, Lithuania, Estonia and Ireland, these economies recording decreases in the real GDP since the middle of the last year. The pursuit of this evolution may

partially cancel the advantage from employment and unemployment recorded during the period between 2000 and 2008.

2. The impact of the social transfers upon the participation on the labour market in EU

The modernized European social model, through the Lisbon Strategy, suggested to provide not only the sustainability of the redistribution system, but also the increase in economic competitiveness, by means of a high growth rate which could allow the increase of the employment rate; the previous measures for increasing the transfers and the taxation, taken before 2000, generated a low level of employment and the slowing down of the economic growth process within EU⁽⁵⁾. So that these objectives could not be opposite, it is necessary to reform the structure of the social transfers and the interaction method between them and the labour market, within the framework which has been settled by the flexicurity principles. According to these principles, the European Commission proposed the following measures: the increase of the incentives for entry/maintaining on the labour market, the promotion of active policies and of preventive policies for the vulnerable categories, assistance granting in searching for a job, participation to permanent training programs and providing social security. As for this last aspect, the harmonization between the social and the fiscal benefits systems has been settled in order to generate both the decrease of dependency on the insurance budget, and also the provision of social protection, as it happens in the case of the countries from the Northern sub-model.

This chapter makes an analysis of the relation between social protection and the participation on the labour market within the European sub-models in order to show the extent to which the differences between the employment rates can be explained by the incentives for employment. For this purpose, we have used a series of indicators which outline the impact of taxation upon the additional incomes. The lower the additional net revenues for entry/maintaining on the labour market, the more stimulated will be the persons to stay dependent on the social policy. This study has outlined five indicators, also used in the analyses made by the European Commission:

a) unemployment trap

According to the hypothesis of the unemployment trap, the unemployment assistance is quite high if compared to the predicted wages and they are granted during a long period of time, and this fact induces the decrease in the incentives for searching for a job. To invalidate it, the net wages should

not be lower than the unemployment assistance, respectively the social assistance, even for the poorly qualified labourers. This indicator is calculated according to the marginal rate of revenues from taxation (RMC) related to the employment of an unemployed person:

$$\text{Unemployment trap} = 1 - \text{RMC}$$

$$\text{RMC} = (\text{net wage earned by a labourer} - \text{net revenues earned by an unemployed persons}) / \text{gross salary}$$

It is calculated for an employee who obtains 67% of the average salary when being employed. For example, Germany recorded a value of *unemployment trap* of 74% in 2007; as a consequence, the difference between the net wage obtained by a German employee and the transfers he benefited from when being unemployed is 260 m.u. only, under the terms of a gross salary of 1000 m.u. The lower the marginal rate of earnings, the lower the additional earnings generated by the transition on the labour market, and this fact increases the dependence on the social protection.

b) low-wage trap, poverty trap

This indicator refers to the situation in which a person's decision to increase his labour effort (by increasing the number of working hours, by the transition from a part-time job to a full-time job or by the desire to have a better job) does not generate earnings in terms of available revenues. This situation is characteristic for the labourers who earn low wages, in their case the previous net income being approximately equal to the net income obtained when they decided to work more. In order to calculate the value of this indicator, the marginal rate of earning (RMC) will be initially calculated, this one corresponding to the working effort:

$$\text{RMC} = \text{increase in net income} / \text{increase in gross income}$$

$$\text{Low-wage trap} = 1 - \text{RMC}$$

The lower the RMC, the more the labourers who earn quite low wages will be stimulated to stay dependent on certain social transfers and not to join the professional reorientation programs. Any additional income earned as a result of re-qualification/professional training would generate very low net additional benefits, under the terms of high taxation of the income plus. This indicator is calculated under the terms of wage increase from 33% to 66% of its average level, for a single person. As a calculation example, we have considered the same case of Germany, which recorded a value of this indicator

of 57% in 2007. Thus, when increasing the gross wage by 100 m.u. (i.e. from 33% to 66% of the average national wage), the net income of the German employee was 43 m.u., the remaining of 53 m.u. including the additionally paid taxes by increasing the effort and the previously obtained benefits.

c) the inactivity trap

In its significance, the indicator resembles the unemployment trap, illustrating the case of the inactive persons who prefer to stay dependent on the social assistance (and not on the unemployment assistance, as in the case of the other variable), rather than searching for a job and be employed. In such a case, the marginal rate of revenues from taxation outlines the additional net benefit of the decision to make the transition from the social assisted statute to that of labourer:

$$\text{Inactivity trap} = 1 - \text{RMC}$$

$\text{RMC} = (\text{net wage earned by a labourer} - \text{net revenues earned by a socially assisted person}) / \text{gross wage}$

The lower the RMC, the more stimulated the inactivity, and this will be mirrored in the national decrease of the employed population.

d) net replacement rate

This variable also constitutes a measure for the incentives of the citizens in order to entry/remain on the labour market. It can be calculated both for the unemployed, the inactive persons, and also for the aged labourers who will get retired:

$\text{Net replacement rate} = \text{Net revenues from social transfers (unemployment assistance, social assistance or pension)} / \text{Net revenues from labour.}$

The higher this rate is, the lower the incentives in obtaining a job are for the persons who are able to work.

e) tax wedge on labour cost

This indicator includes the taxation obstacles in employment and it is calculated as a ratio between the taxes paid by the company (income tax, employees' and companies' social contributions) and the total cost for labour force. This variable measures both the incentives for getting employed (the labour offer), and also the company's capacity to fire/hire labourers (the labour demand). The higher this ratio, the more difficult the company's creation of new jobs, and this fact will generate a higher unemployment rate (*ceteris paribus*)⁽⁶⁾.

The presentation of the five users of intensity in the incentives to have a job also suggests the main measures for reforming the taxation and social protection systems which should be implemented by the EU member states:

- decreasing the unemployment assistance quantum and of its granting period, the purpose being to decrease the voluntary unemployment;
- conditioning the granting of unemployment assistance with the active search for a job and with joining professional reorientation programs;
- decreasing taxation for low wages, resulting in increasing the employment of the poorly qualified labourers and their joining permanent training programs; at present, these employees compose a vulnerable group in EU, which is below the relative poverty threshold;
- decreasing the social assistance for the inactive persons, the purpose being the increase of the employment rate; this measure should be accompanied by the decrease of the companies' incentives to employ labourers *illicitly*, as many inactive persons perform activities in the underground economy;
- decreasing the taxation applied to labour, with the purpose to decrease the companies' costs and to increase the demand on the labour market; moreover, this fact would also allow the decrease of the underground economy's percentage (under the terms of strong institutional constraints).

Among the EU sub-models, the Northern and the Anglo-Saxon ones promoted *workfare* type measures, but the first of them accompanied these measures with the granting of more generous social transfers. The analysis made for the five indicators, which are specific to the incentives on the labour market in the case of the European sub-models, should not be generalized, but it has to be mainly correlated with the conditional side. The Northern countries provide a generous social security only under the terms of the active search for a job or of the postponement of pensioning. Secondly, it is necessary to make a connection with the current stage of development in the case of the countries belonging to a certain sub-model or with the current macro-economical evolutions; although an economy has a low taxation level, and consequently high incentives both for the labour demand and also for the labour offer, the unemployment rate of that economy can be increased (for example, the case of an economy in recession).

As for the problem regarding unemployment and the transfers related to it, the economical theory asserts that the existence of generous benefits and of a longer period for granting them determines the decrease of the incentives for searching for a job and it negatively affects the national employment rate and the long-term productivity of labourers. Moreover, the sustainability of the

welfare state can be negatively affected, under the terms of the absence of connection between economy and society. Starting from this reality, *most of the economies which are EU members have reformed the insurance systems and the unemployment system during the last years and they have promoted the subsequent measures for the coordination between social protection and searching for a job:*

- decreasing the unemployment assistance, as a percentage of the total net wage, in countries such as Germany, Greece, Austria, Portugal, Sweden, Slovakia, Great Britain;
- settling a ceiling for the unemployment assistance to 14% of the average national wage in Great Britain and to 31% in Ireland (for a labourer who has 20 years seniority);
- decreasing the period for its granting, even up to maximum five months in the Czech Republic;
- settling severe obligations to actively search for a job in Austria, Belgium, France, Spain, Portugal, Slovakia;
- creating individualized action plans by the national agencies and by the unemployed persons, in the Northern countries, France, Hungary and Great Britain;
- applying penalties to the unemployed persons who do not proceed in finding a job, as in Belgium, Latvia, Germany, Portugal and Italy;
- granting the unemployment assistance only depending on the observance of the condition related to the previous contribution to the social insurances; for example, a previous contribution for 12 months during the last two years in Germany and one year during the last four years in Hungary.

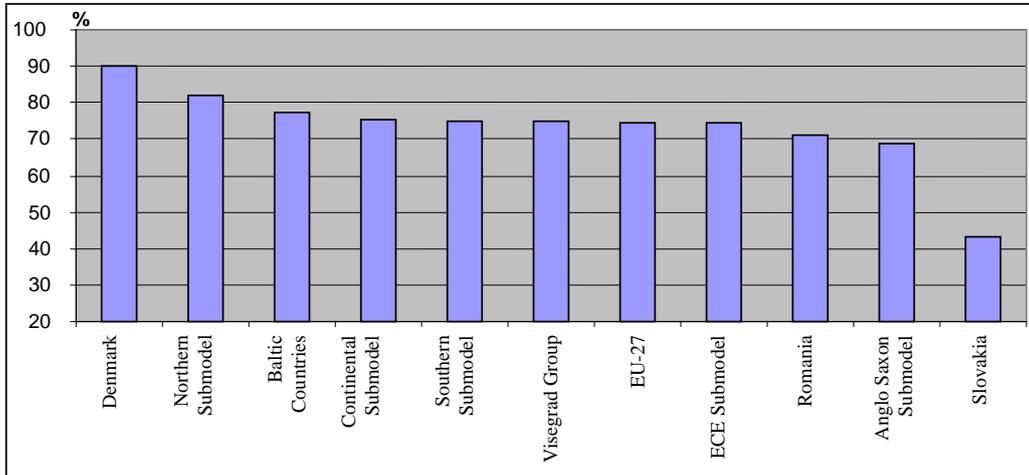
The effects of the measures implemented in the case of unemployment by the member states may be outlined by means of *the net replacement rate*, which refers to the percentage net income earned by an unemployed person out of the net wage he could obtain. In EU-25 (except Romania and Bulgaria), there is an inverse relation between the period for granting the unemployment assistance and the received benefits. Thus, the net replacement rate (for a wage of 67% of the average) decreases to 66% during the first unemployment month, to 63% after six months, reaching 53% after one year. If we did not consider the social assistance received by an unemployed person, then, after one year of being unemployed, the benefits would represent 41% of the net wage. Among the EU-25 member states, Belgium and Denmark grant unemployment assistance for a longer period of time, the first during an unlimited period, and the second on maximum four years.

2.1. Unemployment trap in EU-27

As for the indicator represented by the *unemployment trap*, we have used the methodology proposed by the European Commission, according to which analyses are made for the case of an unemployed person who obtained a wage equal to 67% of the average national wage at the previous job and who gets employed for a wage of the same percentage. We have analyzed the case of a single unemployed person, without family or children, as for such a case we have available statistic data for all the EU member countries. The values of the *unemployment trap* indicator would be different if we studied the situation of the unemployed persons who have family and children, as they would benefit from additional social assistance granted for children. Moreover, the situation of the second family member is important, as he/she could influence the quantum of the social transfers received by that family.

Making a study for the intensity of *unemployment trap* in the European sub-models (the case of a single unemployed person), we can notice, in Figure 4, that the Northern countries record the highest values for this indicator, due to the generous social assistance granted to the unemployed. In 2007, the unemployment trap for these economies was the highest, namely 82%, i.e. an unemployed person would earn an additional income of only 18% of the gross wage by getting employed. On a rough estimate, the economy which is characterized by the lowest incentives for searching for a job is Denmark, as the transition from unemployment to a job brings an additional income of only 10%. However, this economy is the one which records the lowest unemployment rate in EU, as a result of the implemented flexicurity system. As a consequence, this economy records no trade-offs between the high benefits of the unemployed and their integration on the labour market.

Compared to 2001, all the Northern countries decreased the unemployment trap by two percents as a result of reforming the insurance and unemployment systems and of a decrease of taxation applied to the employees who have low wages. The other sub-models (except the Anglo-Saxon one) recorded a high convergence of this indicator's values, the variation between them being of only one percent (75.6% for the continental sub-model and 74.6% for the new member countries). Austria, which is another economy adjusted to the flexicurity principles, had a marginal rate of income from taxation which is superior to the sub-model in which it is included, i.e. 32%, the quite higher incentives being correlated with a level which is lower than the unemployment rate in this⁽⁷⁾.



Source: Eurostat (2009).

Figure 4. *Unemployment trap within the EU-27 sub-models (2007)*

Figure 4 presents the classification within the group including the Baltic States and Bulgaria, these economies having promoted decreases of taxation and economically and socially resembling the Anglo-Saxon sub-model. The implementation of the unique quota in the Baltic States and in Romania has not generated the expected effects upon the employment incentives, in the case of the unemployed who have poorer qualifications. Their earnings were very low, if compared to those of the employees who have revenues over the national average. Thus, in the case of Latvia, the marginal rate of employment revenues was 14% in 2007, for a wage which is equal to 67% of the average and 44% for a wage which is 50% higher than the average. On the contrary, Slovakia adopted the same fiscal measure in 2004 and it recorded the most improvement of employment incentives (by 30 percents), being characterized by the lowest poverty trap in 2007. An explanation for this divergent evolution between the economies which introduced the unique quota refers to the granting of fiscal deductions to the persons who have low wages and to the decrease of the social benefits which were granted to the unemployed, and this resulted in the increase of the marginal rate related to the net employment income.

The economies which recorded an improvement of the incentives during the period 2001-2007 (Slovakia, France, the Northern countries, Romania, the Czech Republic, Slovenia, Germany, Austria, Belgium and Poland) promoted measures for decreasing the taxation and the social benefits of the unemployed and other support forms for their families; however, these incentives varied according to the unemployed person's family type. For example, in the case of

the Czech Republic, the increase of the minimum national wage and also the granting of salary deductions for families with children generated higher earnings for these families, if compared to the single unemployed persons.

2.2. Low-wage trap

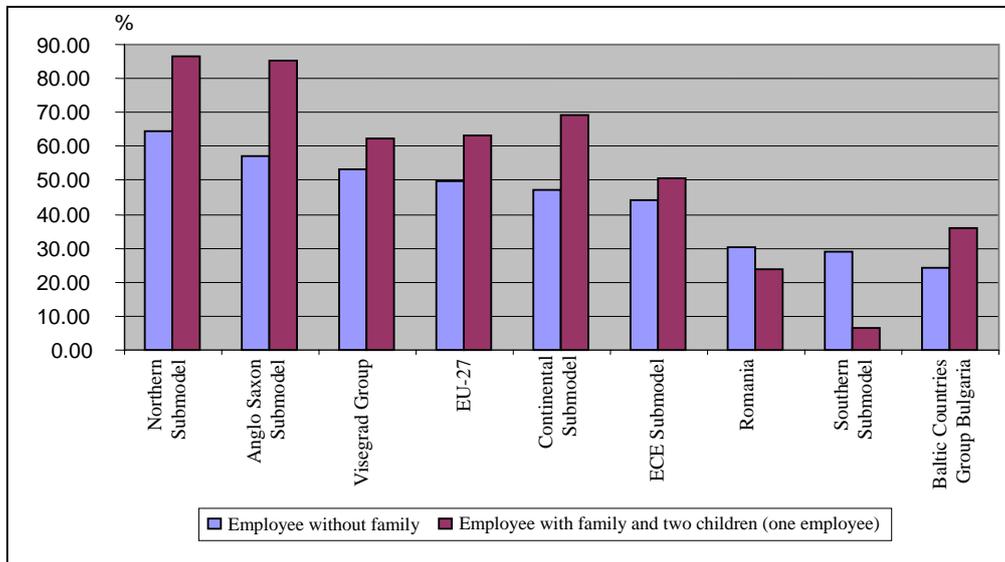
The strategies implemented by the member states with reference to the social expenses for family and for children (which have a 2.1% share in the GDP of EU-27) can also be noticed in the analysis made for the *low-wage trap* for the single labourers and for those who are the single employed members within a family with two children. We have made a comparison between the sub-models according to the indicator proposed by the European Commission, with reference to the marginal rate of income for the employees with low wages, i.e. those who earn an income of 33% of the average salary and who could transit to a job for which they could get paid 67% of the average salary. This analysis is valid for the poorly qualified labourers and for those who could transit from a part-time job to a full-time job, i.e. those categories which are potentially affected by the poverty risk. The interpretation of this indicator's evolution according to the effect upon the social cohesion can be made in two ways. On the one hand, the possible progresses in improving the incentives by decreasing taxation or their social benefits will generate a higher income by increasing the wage. On the other hand, the decrease of incentives could be generated by the increased social transfers applied to the persons who earn low incomes and to their families. In both cases, the social cohesion would be supported, but in the last case the dependency on the state would be kept.

Within the period 2001-2007, EU-27 was characterized by the increase of the low-wage trap indicator related both to the single labourers, from 55.4% to 63%, and also to the employed persons belonging to families with two children, from 48.1% to 49.7%. The risk of persisting in this situation is maintained high, especially for the families with two children in countries which belong to all the European sub-models: Germany (84%), Finland (100%), Great Britain (86%), Cyprus (115%), and Poland (74%). On the contrary, the economies which introduced the unique quota (except Romania) recorded significant increases of the additional income rate in case of salary raise, especially in the case of the employed persons coming from families with children; thus, Slovakia recorded a decrease by 93 percents from a previous level of 123%, Bulgaria recorded a decrease by 57 percents, Estonia 56 percents and Latvia 36 percents.

The reason for which the poverty trap indicator is higher for employed persons with children than for the single ones consists in granting generous

social transfers to the first category. Cyprus is the most relevant for this argument; thus, the increase in the working hours would generate an additional income of 94% of the gross wage for a single employed person and a loss of 15% for the employees which are part of a family with two children. The result is that the social system of this country does not encourage the poorly qualified labourers to find a better paid job. The situation is exactly opposite in Italy, where a single employed person would earn an additional income of 34%, and a labourer with two children would earn 113% (i.e. the negative wage trap indicator is of -13%). The economies belonging to the Southern sub-model, except Cyprus, have the lowest levels of the low-wage trap for both categories of labourers. On the one hand, these economies stimulate the poorly qualified persons to earn a higher wage, even though the labourers' flexibility is lower, and on the other hand they grant lower social benefits for families and for children.

The countries belonging to the Northern sub-model record a high value for this indicator due to the granting of generous benefits to the poor families. In all the economies belonging to the continental sub-model, the social assistance granted to families with children is mirrored in the existence of higher additional incomes for the single labourers; as a consequence, the incentives for professional training decrease if the labourer has a family and children. Romania is one of the less EU countries where the low-wage trap is higher for the single labourer than that for the labourer who has children, and this fact is explained by the existence of fiscal deductions for an employee belonging to the second category. In Figure 5 we can notice that, surprisingly, the Anglo-Saxon sub-model is similar to the Northern sub-model if we consider the values of the low-wage trap, as a result of the increase in the social benefits for the poor families (since the end of the last decade). In their opinion, it would rather be necessary to provide social protection to the employees, to the families with low earnings, than to improve the incentives for increasing the labour effort. As for the ECE sub-model, the economies which grant more from the GDP for the family's social protection, namely the countries belonging to the Visegrad Group (except Slovakia), have the tendency to implement the same strategy applied by the Northern, Anglo-Saxon and continental sub-models. On the contrary, the Baltic States, Romania and Bulgaria, through their implemented measures, resemble to the average levels of the Southern sub-model.



Source: Eurostat (2009).

Figure 5. Low-wage trap within the European sub-models (2007)

To conclude, the EU-15 countries (except the Southern ones) admit the importance of decreasing the poverty trap as a measure for increasing the incentives for requalifying/training, but they maintain its high level as a social protection measure for those employees and for their families.

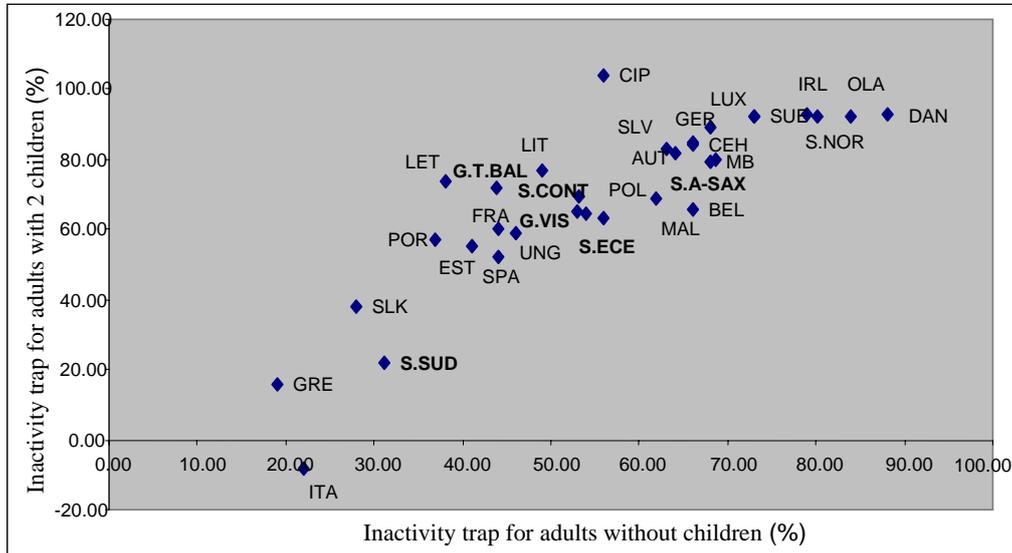
2.3. Inactivity trap

The third indicator used in the analysis of the relation between the social transfers and the employment incentives is the *inactivity trap*, which refers to the persons/the members of a poor family who had a job in the past and who are no longer eligible to benefit from the unemployment assistance, but who receive social assistance. The European Commission calculated the marginal rate of the additional net income generated by the transition from inactivity to a job according to a salary which represents 67% of the average national wage. Naturally, the value of this indicator should be significantly lower than that of the unemployment trap, assuming that the benefits of a person in his quality of social assisted are lower than those obtained by an unemployed person. This situation is not valid within the economies which belong to the Anglo-Saxon and Northern sub-models, in these cases the net incomes resulting from a

person's transition from unemployment to a job being lower and similar to those recorded in the case of the transition from inactivity to employment.

Even though the inactivity trap decrease in 12 EU member states, if compared to 2001 (from one percent for Great Britain to 52 percents in Slovakia), this corresponding to an improvement of the incentives for the inactive persons towards employment, their additional income coming from employment is still very low. The decreases were caused by the modifications brought in the social assistance schemes combined with the introduction of taxation deductions applied to the employees (as in Sweden, Slovakia, France and Latvia) and also by the changes in the subsidies granted to those who have low wages (as in Austria). According to the data which have been available since 2007, which have been used to create Figure 6, we can notice that the absence of incentives for employment is higher, especially for the families in which there is only one employed person, with or without children. Thus, in seven EU member countries (the Northern countries, Ireland, Cyprus and Luxembourg) the marginal rate of the income obtained from employment is 10% at the maximum for a family with only one employed person and two children. As a consequence, there is a high long-term risk of dependence on the social assistance programs of the Governments.

As in the case of the low-wage trap, the Northern, Anglo-Saxon and continental sub-models deals with the problem of the inactive persons as it is a problem of social protection for very poor families. Moreover, most of the EU economies (except France, Italy, Cyprus, Poland) encourage these labourers to not accept wages which are lower than 67% of the average national wage, namely the initial reference level. One of the possible motivations could be the existence of a minimum wage, but its level is lower than 45% of the average national wage. Italy is the only economy which is characterized by incomes which are higher than 80% for employment obtained by the inactive persons who have families and children and by income losses for the inactive families, even at a level of 33% of the wage they could obtain. The result is that the social benefits granted to poor families with children are very low, and this could be mirrored in the increase of the poverty risk for them.



Source: Eurostat (2009).

Figure 6. Inactivity trap within EU-27 countries (2007)

The interpretation of the data included in the chart above, only based on the strict correlation between the absence of incentives and the tendency towards inactivity, could result in the fact that the Southern economies and a part of the continental ones are characterized by quite high incentives, and this could generate a lower inactive population and, consequently, an increase in employment. On the contrary, these economies are characterized by a quite lower rate of employment, especially for the labourers who have quite lower qualifications. *As a consequence, the incentives for the labourers are not important as long as there is an absence of permanent training policies, the possibilities of this category to entry the labour market are quite low, and the companies' capacity to create new jobs is limited.* The indicators which are specific to the transition from unemployment and inactivity towards employment have an influence only upon the citizens' initiative and not that of the companies. That is the reason why the existence of a labour demand from behalf of the companies is essential so that these variables could have finality. One of the most important factors which influence the companies' activity is the sum of the taxes which they pay.

2.4. Tax wedge on labour cost

High taxation has a negative effect upon the functioning of the labour market, thus affecting both the demand and also the offer; for example, the increase of the social contributions paid by the employees will result in the increase of the companies' costs and in the decrease of the employees' available income. The effects of increase in taxes will be mirrored in the slowing down of the economic growth rate, in the maintenance of a low employment rate, in the increase of the underground economy's percentage and in additional stress upon the welfare state. The indicator used to record these effects is the *tax wedge on labour cost* related to the companies' labour costs for low wages. Within EU, the countries belonging to the Northern and continental sub-models promoted measures to increase the taxation applied to labour, in order to support the redistribution process. These measures represented a support for the welfare state on a short-term, but affected its sustainability on a medium and long-term.

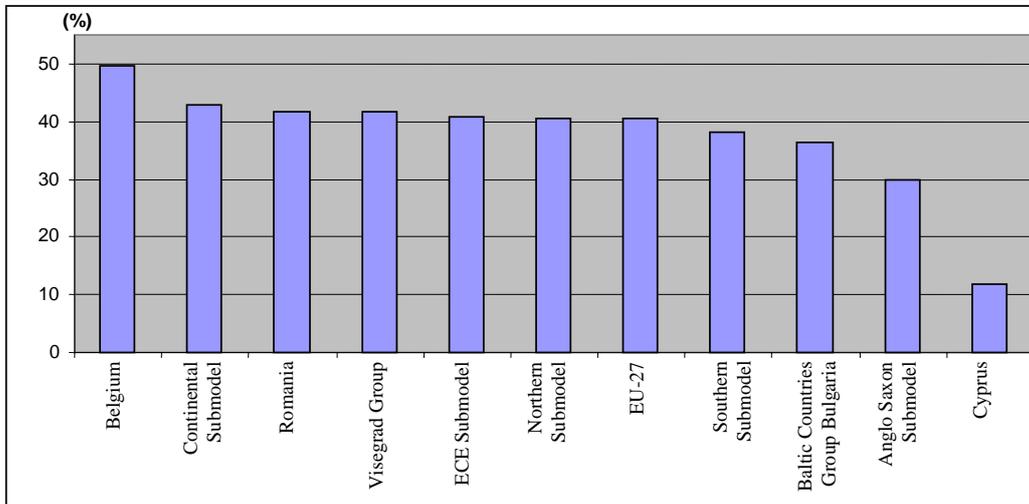
In order to respond to the new economic challenges, most of the EU economies changed their fiscal orientation, by promoting decreases or deductions of the contributions to the social insurances during the last years, all these being fiscal advantages for the labourers who earn low incomes. The main measures applied during the last eight years for decreasing the percentage of the taxes for labour were as it follows:

- decreasing the employers' and the employees' social contributions in 14 out of the 27 EU member countries during the period 2001-2007;
- decreasing the contributions paid by the companies in the account of the unemployment assistance, in Austria, under the terms of the significant decrease in the national unemployment rate;
- decreasing the social contributions of the employees who have the lowest wages, in Belgium;
- correlating the paid social contributions with the nature of the labour contract; for example, Portugal settled the decrease of the paid contributions to 50% during the next three years only under the terms of concluding a permanent labour contract;
- applying a temporary decrease of the social contributions in case of hiring unemployed persons on a long term (in Malta) and when hiring the persons who benefited from social assistance for health care (in Sweden);
- granting fiscal deductions to the employees with low wages in Belgium, Denmark, France, under the terms of increasing the wage basis below which taxes are not applied;

- conditioning the fiscal deductions applied to labourers by joining permanent training programs (Austria) or by continuing the activity on the labour market for the labourers who are over 64 years old (Denmark).

In EU-27, the percentage of the labour taxes for an employee who earns 67% of the average national income decreased from 40.9% in 2000 to 40.4% in 2007, under the terms in which 21 member states recorded a decrease in taxation. Two of the economies belonging to the Northern sub-model recorded decreases by more than 4.5 percents (Finland and Sweden), the same situation being applicable for a country belonging to the Southern sub-model (Cyprus) and for three countries from the ECE sub-model (Bulgaria, Hungary, Slovakia). The other countries belonging to this sub-model (except Estonia) also decreased the percentage of taxation, from a level which was close to the Northern and continental countries in 2000. The taxation strategy of the new member countries recorded a significant decrease of the profit tax and of the income tax, while the social contributions supported by the employer and by the employee remained quite high.

If in the case of the profit tax there are significant differences between EU-15 and the new member countries, under the terms of the existence of the unique quota in six economies, we cannot say the same thing about the percentage of the taxes supported by the companies, which are included in Figure 7. There is a convergence between four of the five European sub-models, the Anglo-Saxon one traditionally promoting lower taxes. Among the sub-models which used to be characterized by a high fiscal stress upon companies, the Northern one made a faster transition towards lower levels, by means of the favourable macro-economical evolutions. Among the new member countries, the Visegrad Group, together with Romania, are more similar to the continental sub-model, while the Baltic States and Bulgaria recorded levels which were similar to those from the Southern sub-model in 2007, the tendency recorded in 2008 being towards the average values of the Anglo-Saxon sub-model.



Source: Eurostat (2009).

Figure 7. Taxes percentage of the wage costs within the European sub-models (2007)

3. Conclusions

Under the current conditions from the European Union, the analysis made on employment and unemployment in EU and within the sub-models, we may draw the conclusion that it is practically impossible to achieve all the three medium term targets settled by the Lisbon Strategy. The weak reforming of the labor markets and of the social protection systems, especially for the Southern and for the new member countries, and the impact of the financial crisis will lower EU's capacity to decrease the employment differences. The imperativeness to implement measures for reforming the taxation systems and the protection systems in EU member states is obvious, for example: the decrease of the unemployment assistance quantum and of the period for its granting; granting the unemployment assistance should be conditioned by the active search for a job and by joining professional reorientation programs; the decrease of taxation with reference to the low wages; the decrease in social assistance for the inactive persons, so that the employment rate could be increased and the decrease in taxation for labor, in order to reduce the costs of the companies and to increase the demand on the labor market.

Notes

- (1) In 2000 approximately two thirds of the gap compared to USA was explained by two factors: a quite lower employment rate and the decrease of the working hours.
- (2) In 2007, the estimates demonstrated that it would have been necessary to create 20 million additional jobs in order to fulfil the target of 70% for EU UE-27, and this would have corresponded to an average annual increase of employment by 3% during the period 2008-2010, i.e. almost twice, if compared to the 1.2% average recorded during the period 2001-2007.
- (3) In 1999, only four of the EU countries recorded an employment rate for the persons over 55 years old, among them being Romania, too.
- (4) In October 2008, the European Commission estimated that only 250 thousand jobs would be created in 2009 in the entire EU, and in 2010 the number would be 0.5 millions, if compared to 6 millions of new jobs during the period between 2007 and 2008. Under these terms, the employment will significantly decrease in countries such as Spain, Ireland, Latvia, as a result of the real estate downfall (which contributed to the increase of the employment rate between 2002 and 2008).
- (5) The economic literature considers that certain redistributive systems automatically result in the persistence of a high unemployment rate and of the social assistance which is granted by the state.
- (6) According to Vork (2006), there is an inverse relation between the percentage of taxes for labour and the employment rate in the case of the new EU member countries, while in EU-15 there is not a significant relation between the two variables.
- (7) If the Austrian unemployed person were part of a family with two children, and the other member of the family is employed, then the additional benefit of employment would have decreased from 32% to 18%, as a consequence of the social transfers granted for children.

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