

**Netherlands Scientific Council  
for Government Policy**

# **Safeguarding social security**

**Summary of the twenty-sixth  
Report to the Government**

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## SUMMARY

### Aim of the report

The working of the highly elaborate system of social security in the Netherlands cannot be viewed in isolation from developments in society. An analysis of various interrelationships has led the Council to conclude that the existing system is not adequately geared to operating under the divergent economic and social conditions to be expected in the next few decades. The system therefore stands in need of a more radical review than that currently being carried out by the government in the light of present-day problems.

In this respect, one of the main background considerations is the fact that most people's standard of living, general development, level of education and social sophistication are now a good deal higher than they were when the present system of social security was first devised. This means that more room can now be provided for personal initiative and individual choice. At the same time, however, alternating periods of economic slump and recovery are likely to remain the pattern so that the state, as a risk-sharing community, will have to continue to impose limits on the personal freedom of choice of its citizens as regards insurance against loss of earnings. This therefore means that provision of a guaranteed minimum income should be viewed as the most important function of the social security system. To achieve this, a reconsideration is required of the way in which the government gives expression to the principle of social solidarity on the one hand and of the responsibility it accepts for the continuity of benefits above the minimum level on the other.

The labour market and social security system are closely inter-related. Social security acts as a supplementary source of financial security to paid employment and has grown in importance over time. These two sources of financial security have come into increasing conflict with one another. A solution must be found to this conflict.

Over the course of time, the current system has become highly complex and difficult to understand, both for the public and for the bodies required to administer it. Although the scope for far-reaching simplification should not be over-estimated, the Council considers that, given the important part played in the Dutch system by the social partners, substantial improvement should be possible.

The problems that have been encountered in the government's present attempts to revise the social security system have reinforced the Council in its belief that reforms must be placed in a more wide-ranging perspective. The Council hopes that its report will set in motion a thorough re-appraisal of the type of system needed to carry the country through until well into the next century.

### Problems

The existing system took shape at a time when it was believed that full employment could be maintained by government policies, and the system still bears the marks of that assumption. Since then, however, it has become evident that periods of full employment can alternate with times of large-scale unemployment, to which the system is not properly geared. In addition, pressure on the social security system has grown as the result of factors that were unforeseeable at the time, such as the ageing of the population, the decline in household size, the increase in participation by married women in the labour market and the growth in employment disability. The result of these factors has been to call into question the narrow link between employment and social security and to highlight the importance of providing a national minimum for the lowest-paid in society.

Since the system was first introduced, there has been a considerable improvement in the purchasing power of the minimum level of social benefits. Partly as a result of this increase, income differentials at the bottom end of the scale have diminished considerably. Taken together with the increasing demand for social security, this has resulted in a sharp rise in public expenditure on social security. In so far as such expenditure is passed on to company profits, investment – and hence employment – can be placed at risk.

The social security system is largely financed out of levies on labour. The high level of expenditure has resulted in high labour costs and high marginal rates of income tax and national insurance contributions. The relative prices for labour-intensive goods and services have consequently risen, thereby dampening demand for these products and encouraging producers to operate in the informal economy.

The flexibility of the labour market is notably inadequate, partly as a result of the structure of social security, based as it is on the notion of a single breadwinner per family with a full-time job. This concept, which is also behind the idea of a statutory minimum wage, no longer corresponds with reality; in many households, both partners are earning.

The present system to a large extent took shape in a social and cultural climate radically different from that of today. Marriage, with the husband as breadwinner and the wife responsible for household management and care of the children, formed the dominant way of life. Now, however, many married women have paid work outside the home and the formerly dominant way of life has lost much of its significance, both in practice and in a normative sense. These shifts have raised the question as to how far the system of social security should in the future be based on individual rights and obligations, irrespective of an individual's family situation. In addition the system has been progressively differentiated in an effort to achieve the greatest possible distributive justice and material equality. This has, however, had the effect of making the system difficult for claimants to understand and for staff to administer.

The government amendments to the system currently under consideration are primarily concerned with reducing the level of public spending on social security. Other elements include the need to bring the system into line with the third EC guideline concerning the equal treatment of men and women and the protection of the older long-term unemployed. So far, however, insufficient attention has been paid to the problem of high labour costs, lack of flexibility in the labour market and the necessary simplification of the system.

For some time now two radical alternatives to the existing system have been under discussion, especially in the literature. These are the idea of a negative income tax and a basic income. The wholesale replacement of the present regulations by either of these alternatives is not, however, to be recommended in the current circumstances in the Netherlands. Nevertheless they do contain a number of attractive features which, as the report discusses, might be capable of implementation.

### **Broad outline of the new system**

In the light of the considerations and problems summarized above, the Council has outlined a new system, consisting of four inter-related elements.

1. A *partial basic income* (PBI), to which all persons legitimately resident in the Netherlands and all persons now coming under the social security provisions would be entitled. The PBI would be fully individualized and would be equal to the difference between the national minimum for a couple and that for a single householder (at 1 January 1985 a little under 450 guilders per month). PBI would be claimable without any obligation to register formally for employment.

The introduction of a PBI would be coupled with the abolition of the legal minimum wage. The elderly, widows, persons handicapped at an early age and the permanently disabled would receive a higher-rate PBI to take them up to the national minimum (comparable with the present old age, widows' pensions and disablement benefits), and children would receive a lower PBI

(comparable to the present child benefit). The way in which this scheme would be financed and administered is examined below.

2. *General loss of earnings insurance (GLI)* for all employed persons, providing cover against loss of earnings from sickness, employment disability and unemployment in the form of a supplement topping PBI up to the national minimum for a single householder. This form of insurance would be based on the equivalence principle and financed by means of employees' and employers' contributions. The benefit rate would amount to 100 per cent of the insured element of earnings. The duration of the insurance could be set at half the number of years of employment, for a maximum of (say) six years.
3. *National assistance (NA)*, as a supplementary provision of collective social security, funded out of taxation and corresponding in broad terms with the present National Assistance Act. NA would be subject to a household means test on income and assets, although the latter would be relaxed by setting the threshold at a considerably higher level.
4. *Voluntary loss of earnings insurance (VLI)* which could be taken out by any individual to insure against loss of earnings above the national minimum. This would not take the form of full-scale privatization but would be devised in such a way as to draw the social partners into its administration.

Under this system the compulsory nature of social security above the national minimum level would be abolished. Collective provision would find expression in the PBI and NA; the GLI would offer a combination of collective and group provision, while room would be left for individual and group provision in the sphere of VLI supplements. Since the phenomenon of surpluses and shortages in the labour market is inextricably bound up with the nature of the economic system, it would not be justified to leave social security below the national minimum level to personal provision as well.

Under such a system the link between employment and income would be retained. The introduction of a *partial basic income* at the level proposed would leave sufficient incentive for people to seek employment, while at the same time meaning that for the employed, the desired collective income guarantee would not have to be generated through the labour market alone. The provision of an income floor of this kind would promote flexibility in the labour market. Less regular forms of employment contracts would gain in attractiveness for employers, a reduction in working hours would be encouraged and it would be easier to switch to various forms of part-time work. The introduction of a PBI would be coupled with the abolition of the legal minimum wage, thereby removing the need element from wage determination – which, given the increasing diversity of household types, could not be maintained indefinitely anyway. Here, too, flexibility in the labour market would be encouraged.

Depending on the financing and administration of the PBI, the following objectives could also be attained in conjunction with other elements in the system: a reduction in labour costs; discouragement of black-economy activities and a simplification of the structure of social security benefits.

The reduction in labour costs would be achieved by a reduction in gross wages and salaries combined with a widening of the tax base for public expenditure. In introducing a PBI for wage-earners, gross wages would be reduced so that the new net wage was equal to the former net wage minus PBI. The total amount of gross PBIs would, however, have to be covered by new forms of taxation, since these PBI would have to be paid to everyone, while the remaining revenue would continue to be needed for existing forms of public expenditure. For the relative decline in labour costs to be achieved, a levy-base other than wages and salaries would, therefore, need to be selected. To this end the tax field would need to be extended to corporation tax, VAT, import duties, motor vehicle tax, excise and the like, and/or extra taxes levied on scarce sources of energy and raw materials and on environmentally harmful activities. These taxes have in common that they do not increase labour costs.

A major difference with wage-cost subsidies is that under this system, the relative reduction in labour costs would also extend to the self-employed and to the government.

The reduction in labour costs and corresponding relative drop in the price of labour intensive goods and services would result in a shift in demand in the industries concerned from 'informal' back to 'formal' labour. The payment of a PBI by the government would, however, lead to an increase in the total burden of taxes and national insurance contributions burden, which would in turn stimulate the black economy. This increase would not arise if the PBI for employed persons were to be paid by companies themselves, which then offset these payments against their tax liabilities. This is not just an accounting point but a material difference, since the attractiveness of black-economy activities would decline as a result.

PBI would also be paid out as a basic income for benefit claimants, where necessary at a higher rate. In order to maintain net benefits at the same level, gross benefits would also need to be reduced by gross PBI. National insurance contribution rates would consequently fall and, because PBI would be financed out of taxes that did not bear exclusively on employment, labour as a factor of production would be less heavily taxed than at present. There would be no increase in public expenditure since these incomes already form part of it.

PBI would also be payable to all residents currently without earnings from employment or not drawing benefits. If the existing distribution among households of net income is not to be disturbed, adjustments will (depending on the means of funding adopted) be required in the taxation sphere. The payment of a PBI to this category would lead to an increase in the total burden of taxes and national insurance contributions, but much of the funding could be achieved by the abolition of compulsory social security above the national minimum and of the general-purpose investment grants for industry, which would obviously square uneasily with the intended reduction in labour costs.

The *general loss of earnings insurance* (GLI) would be compulsory for all persons in employment (i.e. including the self-employed and civil servants), and would form a necessary supplement to PBI in the event of a loss of earnings from employment. The GLI would cover loss of earnings from sickness, employment disability and unemployment up to the national minimum for a single householder, as a supplement to PBI. Since the level of PBI is equal to the difference between the national minimum for a couple and that for a single householder, a benefit claimant with a dependant partner would under the new system still draw an income equal to the national minimum for a couple. With respect to loss of earnings insurance, this would thus eliminate one of the most awkward problems of the present system, namely the choice between individualization of benefits or provision according to need. Despite the individualization of GLI benefits, no supplements would be required in order to meet minimum household needs.

Collective insurance against the risk of unemployment for the self-employed would entail problems, but not insuperable ones. Because the GLI would remain confined to the national minimum for a single householder the temptation deliberately to resort to unemployment would not be great.

For reasons of simplicity and clarity, it would be best to set the relationship between the last insured earnings from employment and GLI benefits at 100 per cent. At this percentage an increase in the number of GLI benefits can never result in extra demand for national assistance. If the rate were to be set lower, demand for national assistance could rise sharply among people whose previous earnings were below the level of the maximum insured income.

To prevent large numbers of unemployed persons and disabled persons from ending up on national assistance, the duration of GLI would be set at half the period for which contributions had been paid, up to a maximum of (for example) six years. In this way a reasonable balance would be struck between benefits and contributions (the benefit principle). In comparison with the present situation, an extension of the benefit period would run into fewer

financial objections since GLI relates only to the difference between the national minimum for a single householder and the PBI.

For most working people, the combination of the PBI and their earned income would bring them up to at least the national minimum. For those not in employment the national minimum would be achieved by the PBI and the GLI, supplemented if necessary by *national assistance* (NA). Such assistance would apply to persons not receiving higher-rate PBI or without a partner drawing sufficient income, and whose income from employment or GLI was insufficient to bring him or her up to the national minimum.

Given the fact that all employed persons (i.e. including the self-employed) would be covered by GLI, and given the duration of GLI benefits and the 100 per cent benefit rate, national assistance would be much more of a residual provision than at present. In addition, the elderly, widows, persons handicapped at an early age and the permanently disabled would qualify for higher-rate PBI. The fact that a PBI in conjunction with GLI would solve the dilemma of varying national minimum levels would, depending on the composition of the household, also reduce resort to national assistance. Particular groups that would continue to depend on NA would include those unable to build up a history of employment (i.e. school-leavers) and divorced women with young children.

To prevent the many dependent partners from applying for national assistance so as to bring their PBI up to the national minimum for a single householder, a means test covering the earnings of the employed partner would be unavoidable. Such a means test would at the least need to cover the PBI and household income from employment and GLI. To avoid thrift in the past from being excessively penalized, the means-testing of assets and income from assets would preferably be less strict than at present. The same applies to income derived from VLI.

In view of the possible incidence of large-scale unemployment, the national minimum laid down for NA purposes, and applying also to GLI, would preferably be linked to per capita national income rather than to wage developments. By making PBI equal to the difference between the national minimum for a couple and that for a single householder, changes in per capita national income would work through to all incomes, thereby reducing the pressure on the government budget and the GLI fund, especially in times of recession.

The problem of the poverty trap would continue in relation to administering national assistance since there is no practical alternative to a virtual 100 per cent withdrawal rate for any earnings. The NA arrangements would also continue to involve an invasion of privacy. Under this system of social security, however, NA would once again amount to a residual provision, as originally envisaged under the National Assistance Act. Administration of the arrangements would have to rely on civil servants, who would have to be given the freedom to act on their own authority in close consultation with individual citizens pressing their claim to national assistance.

*Voluntary loss of earnings insurance* would be a supplement to GLI, once again based on the principle of equivalence between contributions and benefits. The insurance would not be compulsory; payment of VLI contributions would be voluntary and would come out of personal disposable income in the same way as (for example) life insurance premiums. Although it would be possible for such contributions to be passed on to companies under collective agreements this would be made more difficult if employees held differing views about the scale and nature of voluntary cover. In these circumstances, any upward pressure on labour costs would therefore be reduced.

Expression would, however, be given to the group element by enabling the employers and trade unions to take part in the administration of VLI and by incorporating provision for company involvement in individual collective agreements. The government would limit its own involvement to laying down the conditions that private and group insurance arrangements would need to satisfy and to the provision of tax concessions. In the case of organizations

that offered voluntary loss of earnings insurance, there would have to be a prohibition on varying contribution rates in line with differences in the degree of risk, together with an acceptance liability. Regulations of this kind would safeguard both individual choice and the principle of responsibility for sharing the degree of risk. VLI could, therefore, be administered in a way that fell short of the wholesale privatization of social insurance above the national minimum level but which also did not amount to full collectivization. In this respect the social partners would play an indispensable role.

## 1. INTRODUCTION

### 1.1 Background to and aims of this report

A detailed examination of the present system of social security and the way in which it operates has convinced the Council of the need for a fundamental review of the system. This report seeks to make a contribution to that end. A critical, while at the same time constructive, appraisal of what has been built up over the past century is required since there have been such radical social changes, especially in recent decades, that the system will have to be adjusted if it is not to lose its relevance. These changes have taken place in both the socio-cultural and the economic field, examples including the increased desire for economic independence, the growing diversity of marital and familial patterns and the steady rise in the general level of education. Other relevant developments include the growing participation by women in the labour market and the increase in part-time employment.

An analysis of various inter-relationships has led the Council to conclude that the existing system is not adequately geared to varying socio-economic and socio-cultural circumstances. The close link between social security and labour, for example, operates to the disadvantage of labour-intensive industries and encourages the informal economy. The high transfer payments have an adverse effect on investment and hence employment. The flexibility of the labour market is hampered by continued adherence to the premise of a single breadwinner per family at a time when marital and familial patterns are in fact steadily diversifying. These - often unintended - effects cannot be remedied by partial measures but require a fundamental review of the whole system. A further consideration in favour of such a review is the fact that the level of income, general development and hence social sophistication of most of the community are now so much higher than they were when the system of social security was first brought in, thereby paving the way for greater personal provision and freedom of choice.

Alternate periods of economic recession and recovery are likely to remain the pattern in the future. This means that the state, as a risk-sharing community, will have to continue to impose limits on the personal freedom of choice of its citizens and that safeguarding the position of the lowest-paid in society must be taken as the prime function of the social security system, a premise which consistently guided the Council in formulating its views. In any review of the system, special attention will have to be paid to those groups in society which would otherwise fall below the socially acceptable poverty line. This is all the more true since there have for some years now been signs of growing competition between these population groups and the rest of society, including those drawing benefit above the national minimum. This competition was starkly evident in the most recent round of expenditure cuts, when the sense of solidarity with the lowest-paid came under such pressure that the position of the genuinely worst-off had to be redressed (at least in part) by means of ad hoc supplements.

The premise that safeguarding the position of the lowest-paid in society is the most important function of the social security system calls for a reconsideration of the way in which the government gives expression to the principle of social solidarity on the one hand and of the responsibility it accepts for the continuity of incomes above the national minimum on the other. In order to preserve the principle of social solidarity the government will have to find solutions that remain affordable in times of recession and the administration of which disturbs the economy and labour market as little as possible. In doing so, the same weight need not be assigned to its responsibility for benefits above the national minimum level as to the preservation of minimum

standards of living. The separation of these two categories of income transfers – between which little if any distinction is at present drawn as a form of public expenditure – has become possible and desirable as the result of the changes in society referred to earlier. This means that the fixed relationship between social contributions and benefit entitlement will have to be maintained for benefits above the national minimum level. This would also mean that individuals, or groups of individuals, rather than society as a whole would have to accept primary responsibility for making arrangements which, where necessary, provided an entitlement to benefits above the national minimum.

The relationship between the government, social partners and citizens as contributors and benefit claimants would need to be carefully determined in a new system. The present control and administrative structure contains valuable elements, apart from which the involvement of employers and trade unions is widely regarded as an important asset. In addition, the main political streams in the Netherlands attach great importance to a statutorily based security system for preventing poverty (by Dutch standards). It does, however, need to be borne in mind that the fundamental elements of the Dutch social security system were laid down before the Second World War. Since then the system has been elaborated, with the result that coverage is now provided against a very large number of social risks. The group of people entitled to make use of the social security regulations has also grown considerably. The system impinges on virtually every person in the country, either as a payer of taxes and social insurance contributions or as a benefit claimant. For many people, social security forms the last resort as a source of income.

Because of its far-reaching impact on society, the detailed system of income transfers has brought in its wake a large number of laws and regulations: rights, obligations and the operative procedures necessarily require a solid legal basis. The system does not, therefore, just affect the working of society but, conversely, important social, economic and administrative developments have consequences for the operation of the system. If only for this reason, the system stands in need of thorough overhaul from time to time. In doing so, it will become evident just how much the system of social security – including the present one – is the product of its setting, i.e. that it was devised to meet the needs and assumptions of a particular time and society. This can easily be overlooked.

Any system of social security must guard against interfering excessively with objectives in other areas of policy, such as the socio-economic field. Whether or not it succeeds in doing so depends primarily on the will of those involved. Where convergence is taken for granted but not worked at, the implementation of any system whatever is bound to run into difficulties.

Finally it should be noted that, contrary to everyday usage, it is not really correct to speak of the 'system' of social security when referring to the existing complex of social security regulations. The complex lacks two features characteristic of a true system, namely unity and cohesion. Given the fact that the regulations were not devised as a coherent whole but each have their own background and history, this is hardly surprising. In present-day practice, however, these regulations are inter-related in many – often unforeseen – ways, for which reason we may nevertheless employ the term 'system'.

The proposals outlined by the Council in this report will undoubtedly be compared with the recent government plans for modifying the system. Current government policy is, however, primarily concerned with cutting back public spending on social security. Other elements include the need to bring the system into line with the third EC Directive concerning the equal treatment of men and women and the protection of the older long-term unemployed. The programme of government cuts has run into particular criticism on the part of those seeking to maintain the achievements of the social security system, who argue instead for different economies in which social security would be largely spared. With a view to the future, however, the debate cannot remain confined to this level; the interaction between social security and the economic and

social system is too great. Social security can no longer be regarded as a more or less closed system, and any proposals for reform need to acknowledge this fact.

The Council hopes that this report will point the way for a long-term review of the system. The report is primarily a broad outline for change, not a blueprint for government action. For the present, the direction in which a new system should be developed is more important than a detailed elaboration of all the component parts. The report only goes into more detail where the broad outline of the system and the concrete elaboration of regulations converge closely. This means that a great deal of study and preparation is required in relation to other aspects before a start could be made with introducing a system such as that outlined in the report. The concern is, in other words, not so much with presenting specific, partial measures that could be introduced in the short term as with fundamental steps that would have to be taken in the coming periods of government. In publishing its ideas in this form, the Council's main aim is to stimulate serious consideration of a new approach towards the objectives and nature of social security: an approach that will have to be able to demonstrate its merit until well into the next century. It is high time for such a reappraisal, especially since radical changes in social security could well take place at European level over the next fifteen years – to the preparation of which this report may perhaps make a contribution.

Finally it is only to be expected that many will feel a need for a period of calm in the field of social security following the numerous changes made in recent years and the changes under contemplation by the government. Such a period of undisturbed calm is not, however, in prospect; as we have seen, economic and social developments call for fundamental reforms going beyond the present modifications to the system.

## **1.2 Functions and nature of social security**

The social security system forms a major part of the system of social income transfers. By the latter is meant the complex of official regulations on the basis of which funds obtained from taxation and national insurance contributions are re-distributed within society. Social income transfers fulfil three functions:

- a. a *safeguard function*, under which the freely disposable income of individuals and/or households is guaranteed up to a particular level. That level may be the national minimum, but it may also exceed it. Examples of these cash benefits include the present loss of earnings provisions, child benefit and the periodic national assistance provisions;
- b. a *state provision function*, under which certain goods and services are made available as in-kind benefits for individual use because the market mechanism fails to do so, or does so only ineffectively. Examples include statutory health insurance benefits and rent relief;
- c. a *regulative function*, enabling social or economic developments to be selectively influenced, as with various forms of state aid to industry; regulations of a safeguard or state-provision nature may, however, also be used in a regulative sense.

In the current political and social debate concerning the need for social security reform the accent has gradually come to lie on regulations with a safeguard function. The debate has recently gathered pace, since it is precisely these sorts of regulations to which modifications have been proposed. For this reason the Council has decided to confine itself in this report to proposals for reforming the system of income transfers with a safeguard function. In principle, therefore, income transfers with a state provision or regulative function have not been examined. This means that the report concentrates on the following acts and regulations:

- General Old Age Pensions Act (AOW)
- General Widows and Orphans Benefits Act (AWW)
- General Family Allowances Act (AKW)
- Unemployment Insurance Act (WW)
- Unemployment Provisions Act (WWV)

- Government Unemployment Assistance Regulations (RWW)
- Disablement Insurance Act (WAO)
- General Disablement Benefits Act (AAW)
- Sickness Benefits Act (ZW)
- National Assistance Act (ABW)
- legislation providing for once-only payments for the genuinely needy

The AAW and ABW do not just provide for freely disposable income transfers but also for special-purpose in-kind benefits. With a few exceptions these have not been considered separately in the report since they fall outside the main lines of the proposed system. Other regulations with a safeguard function include the Sheltered Employment Act (WSW) and the Artists' (Financial Assistance) Scheme (BKR). These too have been left out of consideration since their objectives are too specialized to fit in readily into such a broad sketch of a new system.

Payments made by pension funds and life insurance companies have also been left out of account since these do not form part of the public sector. The same applies to benefits exceeding the statutory level and to the voluntary early retirement regulations (VUT), although where necessary attention is drawn to the links between these payments and social security benefits.

As will be seen, the system of social income transfers and hence that of social security, is closely related to the tax system. An exhaustive analysis of the interrelationships between the two systems would, however, be on too large a scale, for which reason the Council has confined itself in the report to indicating a number of significant consequences which the new system of social security could have for the taxation system.

### 1.3 Structure of the report

Against the background outlined above, the Council has asked itself the basic question of how the safeguard function can be preserved in the future while at the same time maintaining certain important features of the inherited system. In developing the main lines of a new system the Council proceeded first of all to examine the problems associated with the present system and the extent to which those problems could be said to derive from the nature of the system itself. As was to be expected this did not prove straightforward, especially since the system of social security is affected by various developments in society that are to a certain extent autonomous. The interplay of forces is a complex one, in which the social security regulations sometimes play a central role and sometimes a less central one. It would be unrealistic to suggest that all the problems identified would simply disappear if the system were revised. For that purpose more would be required, but a survey of the full range of feasible and desirable measures would go beyond the scope of this report. For this reason measures outside the immediate sphere of social security will only be discussed in so far as they have a decisive bearing on the operation of the proposed system.

The next step in the survey consisted of an analysis of the most important alternatives to the system of social security to have been advanced to date. These have been examined particularly in relation to the contribution they could make to solving the problems referred to earlier. This analysis revealed each of these alternatives to contain so many shortcomings that the Council considered it justified to explore a different, fresh approach.

The nature of and reasons for this approach are set out in chapter 2. This chapter begins by outlining the principal arguments in favour of a new system. This English version of the Council's report only contains a summary of these arguments; in the original Dutch version they are discussed in greater detail. Chapter 2 also contains an overview of current developments in social security reform in the Netherlands as well as an outline of the two established alternatives to the present system which have been mentioned earlier.

In chapter 3 the Council proposes the main lines of a new social security system together with some observations on the possible consequences of this

introduction. Since not all readers of this English version of the report may be fully familiar with the present social security system in the Netherlands an appendix has been added which outlines some aspects of the major regulations in this field.

## 2. BACKGROUND TO A NEW SYSTEM

The first three sections of this chapter briefly set out the main economic, social and administrative problems that have been encountered with the present system of social security. These sections also examine developments in society that would have to be taken into account in any fundamental reform of the system; existing proposals to modify the system; and some more radical alternatives.

### 2.1 Reasons for a new system

#### 2.1.1 Growth in number of recipients

As may be seen from Table 2.1, there has been a steady rise since 1960 in the number of recipients of benefits with a safeguard function.

**Table 2.1 Growth in income transfers having a safeguard function (x 1000 persons), 1960–1984**

Category	1960	1970	1980	1981	1982 <sup>a)</sup>	1983	1984 <sup>b)</sup>
a. Old age/widows pensions	915	1203	1494	1519	1542	1561	1577
b. Sickness benefits <sup>c</sup>	92	204	268	253	240	230	227
c. Disability benefits <sup>d</sup>	158	287	663	690	711	728	744
d. Unemployment benefits <sup>e</sup>	22	59	239	359	509	619	668
e. National assistance <sup>f</sup>	40	98	125	130	141	148	157
Total	1226	1850	2789	2950	3141	3286	3373

Source: Ministry of Social Security and Employment, Social Security Financial Report 1955; Proceedings of the Lower House, 1984–1985 session, 18612, nos. 1–2, p. 14.

a) provisional figures.

b) estimates.

c) number of benefit days divided by 261.

d) Invalidity Act, Industrial Injuries Insurance Acts, Disablement Insurance Act and General Disablement Benefits Act.

e) Unemployment Insurance Act, Unemployment Provisions Act, and Government Unemployment Assistance Regulations.

f) Poor Law, National Assistance Regulations (excluding those covered by Government Unemployment Assistance Regulations and those for whom national assistance acts as a supplement to other forms of social security).

The sharp rise in the number of claimants, in particular, has led to a very marked decline in the number of employed persons per claimant, from 3.4 in 1960 to 1.3 in 1984<sup>1</sup>. There have been various reasons behind this trend.

#### *Employment*

Being the outcome of the level of employment and the number of persons offering their services in the labour market, unemployment plays an important role in determining the number of social security claimants. As may be seen from Table 2.2, the 1980s have seen a particularly sharp rise in registered unemployment.

These figures do not take any account of hidden unemployment, i.e. persons looking for work but not officially registered as unemployed. As may be seen from Table 2.3, the proportion of long-term unemployed has risen sharply in recent years. It is difficult to forecast future trends in unemployment, particularly since the likely level of output and the productivity of labour in the various sectors of the Dutch economy is uncertain.

The high birth rate since the Second World War until the mid-1960s and the increasing proportion of women entering the labour market mean that the

**Table 2.2 Registered unemployment by sex, 1980–1984 (annual average)**

	Number (1000 persons)					% of employed labour force				
	1980	1981	1982	1983	1984 <sup>a)</sup>	1980	1981	1982	1983	1984 <sup>a)</sup>
men	208.8	320.1	445.9	549.9	563	6.5	9.8	13.6	16.4	16.7
women	116.5	159.7	208.6	250.7	267	9.8	12.8	16.0	18.6	18.9
total	325.4	479.8	654.6	800.6	830	7.4	10.7	14.3	17.0	17.3

Source: Ministry of Social Security and Employment, *Labour Market Report 1984*; The Hague, 1984, p. 8

a) estimate

substantial rise in the supply of labour is likely to persist for some time yet. The growth in the labour force has, however, been restrained by the fact that young people are prolonging their education and by the large numbers of workers availing themselves of the voluntary early retirement provisions. With the decline in the birth rate since the mid-1960s, the growth in the supply of labour may be expected to decline in the course of the 1990s.

**Table 2.3 Level of long-term unemployment (12 months and over), by sex, 1981–1984 (annual averages)**

	number (x 1000 persons)				% of total unemployment			
	1981	1982	1983	1984	1981	1982	1983	1984
men	56.8	118.1	247.3	304.2	22	31	45	53
women	28.8	51.2	104.9	128.2	23	31	42	49
total	85.6	169.3	352.2	432.5	22	31	44	52

Source: Ministry of Social Security and Employment, *Labour Market Report 1984*; The Hague, 1984, p. 60.

Estimating the likely level of unemployment is even more difficult because of the possibility of substantial changes in the length of working hours. The high unemployment figures have given rise to a considerable growth in interest in a reduction in working hours in general and part-time work in particular. In turn, a reduction in working hours could have an effect on the supply of labour; married women, in particular, could be encouraged to enter or return to the labour market to secure the level of family income.

Depending on the interplay of the various factors at work, unemployment could either persist at its present high levels or decline substantially. Nor is it necessary for unemployment and economic stagnation to remain linked. The various economic situations with which a new system of social security might have to contend are shown with the aid of a matrix in Table 2.4.

**Table 2.4 Possible combinations of economic growth and growth in employment**

		High	
Economic growth	High	1	2
	Low	3	4
			High
			Growth in employment

Source: WRR

Situation 1 may be designated as 'jobless growth': the level of output and income grows strongly but the level of employment stagnates or even declines because the productivity of labour more or less keeps pace with the growth in output. If in these circumstances increasing numbers of people resorted to social security, this could in principle be financed out of economic growth. In situation 2 the growth in output exceeds the rise in the productivity of labour. In this type of 'expansion', the demand for social security is held back by a high rate of growth in employment. Unemployment ceases to expand, so that the system of income transfers no longer creates major financial and economic problems. Situation 3 is characterized by low growth figures for output, income and employment, i.e. a state of general economic stagnation. In these circumstances demand for social security would continue to rise sharply. In this instance, the lack of any growth in the level of income makes it very difficult to maintain benefits at the level considered necessary, so that per capita real national income can easily fall. Finally situation 4 combines high growth in the level of employment with the absence of economic growth. Such a situation could arise if the satiation of human wants, the exhaustion of natural resources and environmental strains set limits to growth. This scenario may be described as 'limited growth'.

Ideally, any future system of social security would be able to flourish in any one of these four situations or be capable of simple adjustment to them.

### *Sickness and employment disability*

The post-war period has seen a steady rise in the use made of the Sickness Benefits Act and the employment disability regulations. Since 1980, however, there has been a 15 per cent decline in the volume of claims under the Sickness Benefits Act, as a result of both a decline in the number of registered cases of sickness per person per year and a decline in the average duration of sickness<sup>2</sup>. In this respect the sharp rise in unemployment since 1980 has in all probability played a role.

The reasons for the steadily increasing resort to the disability schemes are many and varied. One relevant factor was in itself the introduction of these schemes. When the General Disablement Benefits Act (AAW) came into force in 1976, for example, the group of insured persons was substantially extended. Similarly the abandonment of the causality principle when the Disablement Insurance Act (WAO) was introduced in 1967 had an important effect; since that time the cause of employment disability ceased to be relevant. The insurance no longer covers just occupational hazards but employment disability of whatever origin.

Another factor of importance for the increasing demand for social security has been the ageing of the working population. The risk of invalidity rises with age: claimants aged over 45 form nearly 70 per cent of those drawing WAO benefits. The re-entry into the labour market of the disabled is also impeded by the favourable level of WAO benefits in relation to the benefits paid to the long-term unemployed. In addition, the standards laying down when absence from work may be justified on health grounds have been broadened. An illustrative statistic in this regard is the fact that since the Disablement Insurance Act was introduced, the proportion of WAO benefits paid out in relation to syndromes in which the social environment is a factor has risen from 40 per cent to 70 per cent<sup>3</sup>.

Furthermore, the employment disability schemes cover a certain amount of hidden unemployment, since the situation in the labour market is taken into account in awarding benefits. People who are partially incapacitated and otherwise unemployed generally speaking receive full disability benefit, so that the WAO and the AAW have to some extent become disguised unemployment benefit schemes. Estimates of the scale of hidden unemployment in the WAO range from 15 per cent to 45 per cent<sup>4</sup>.

Forecasts of the number of AAW/WAO benefit claimants suggest that there will continue to be a rise over the next two decades. The Central Planning Office expects the number of such claimants to be around 1,175,000 in 2010. The

Social Insurance Council anticipates a considerably smaller rise, with a total of 900,000 in 2005, followed by a decline to the current level of around 750,000 in the year 2030<sup>5</sup>.

#### *Age structure of the Dutch population*

The age structure of the Dutch population will change substantially in the coming decades (see Table 2.5). Between 1980 and 2030 the number of elderly people will double, while the number of young people aged under 15 will fall by over 30 per cent. As a proportion of the potential working population (aged 15–64) the dependent population (aged under 15 or over 64) will rise from 52 per cent to 61 per cent, a demographic development that will exert a net upward effect on public expenditure.

**Table 2.5** Age structure of Dutch population, 1980–2030

	total popula- tion (× 1000) (1)	15–64 years (× 1000) (2)	65+ (× 1000) (3)	(3) as % of (1)	(3) as % of (2)	0–14 years (× 1000) (4)	(4) as % of (1)	(4) as % of (2)
1980	14,091	9,293	1,615	11.5	17.4	3,185	22.6	34.3
1990	14,849	10,205	1,896	12.8	18.6	2,746	18.5	26.9
2000	15,316	10,407	2,093	13.7	20.1	2,816	18.4	27.1
2010	15,258	10,469	2,308	15.1	22.0	2,480	16.3	23.7
2020	14,888	9,829	2,852	19.2	29.0	2,206	14.8	22.4
2030	14,234	8,838	3,239	22.8	36.6	2,157	15.2	24.4

Source: Central Bureau of Statistics, *Prognose van de bevolking van Nederland na 1980* (Projection of population of the Netherlands after 1980); The Hague, Staatsuitgeverij, 1982.

#### *Decline in household size*

Between 1960 and 1980 the average number of people per household in the Netherlands fell from 3.5 to 2.8. This decline – which is expected to continue<sup>6</sup> – is the result of various demographic and social developments, such as the decline in the average number of children per family and the rise in the number of single householders and one-parent families. The latter two developments, in turn, have been partly caused by the sharp increase in the number of divorces and the growing number of widows.

Because benefit entitlements can depend on household composition and the earnings of other household members, the decline in average household size has placed additional pressure on the social security system. It also has the effect of increasing individual living costs, which again places the average level of benefits under upward pressure.

#### *Concluding reflections*

Over the course of time, the social security system has come to cover an ever-increasing range of social risks. As this has occurred, the relative importance of industrial injuries insurance for employees only has declined, milestones being the introduction of national insurance schemes, the abolition of the causality principle when the Disablement Insurance Act was brought in, and, as the finishing stroke of social security, the National Assistance Act. The provision of assistance to meet basic subsistence costs has become a constitutional obligation on the part of the government towards those in need. This development has created the need for a reappraisal of one of the fundamental principles of the present system of social security, namely the close link with labour in terms of both financing and the payment of benefits.

Financing by means of levies on labour commends itself if the insured risks are largely ones to which employed persons are exposed. Insurance against loss of earnings resulting from industrial accident may justifiably be regarded as a labour cost. Similarly the elimination of abrupt discontinuities in income

resulting from temporary inability to work may be regarded as an occupational hazard. Sickness and short-term unemployment may be causes of income discontinuities of this kind, and the ability to bridge a temporary loss of earnings without severe effect on income forms the background to the Sickness Benefits Act and the Unemployment Insurance Act. Many of the remaining risks against which cover is now provided, have, however, a much looser (if any) link with (paid) employment: old age, widowhood, employment disability for reasons other than industrial injury, child-care expenses and long-term unemployment. As it has evolved, the social security system is to a large extent concerned with providing cover against a broad spectrum of social risks. Instead of solely taxing earned income, therefore, there is now a case for the equal taxation of all sources of income. There are various ways in which this might be achieved, such as funding from general revenue or taxes on the added value per enterprise.

Apart from the method of funding, the benefit structure is also linked to income from employment. Net minimum benefits are coupled to the net minimum wage, while gross benefits form a fixed percentage of previous earnings and follow the development of average gross wages paid by industry under collective agreements. These linkages were instituted at a time when full employment was expected to remain sustainable, but that notion has since been superseded with the evidence of large-scale, long-term unemployment. In these circumstances the growth in per capita national income can lag substantially behind the level of earned income, for which reason it would be preferable for national minimum levels to be officially linked to changes in per capita national income instead of earned income.

In this context the question also arises of the extent to which a person's employment history should determine eligibility for benefits. Obviously, there is a need for regulations of a limited duration to guard against excessively abrupt cuts in income, but in a situation of widespread, protracted unemployment there is a less self-evident case for making the level of benefit dependent on whether or not an individual was formerly engaged in paid employment, often in the distant past. As the chances of entering the labour market have declined, so it has become more difficult to justify the existence of superior statutory provisions for the long-term unemployed with a distant employment history than for the long-term employed who never had a chance in the labour market. For this reason the construction of a statutory system of income transfers based on provision of earnings-related benefits has become more problematical. Under such a system benefits are linked to final previous earnings: The level of earnings on the day before becoming unemployed, sick or disabled. If full employment can no longer be assured, it makes more sense for the system to be devised on the basis of minimum subsistence needs, with benefits set at a minimum level irrespective of a person's employment history. A switch of this kind would not, of course, rule out the possibility of supplements and related legislative provisions. Nor is it necessary for the responsibility to provide income support to meet minimum subsistence needs to be confined to the state<sup>7</sup>.

#### 2.1.2 *Purchasing power of social security benefits*

After the essentials of the present system of social security had been laid down between 1952 and 1967, there followed a period in which the purchasing power of social security benefits improved considerably as net minimum benefits were increased up to the level of the net minimum wage. Since then the net minimum wage has served a twin function, as the minimum remuneration for a full-time job and the national minimum for a family. In the early 1970s changes in the legal minimum wage were linked to average changes in wages paid in the private sector under collective agreements (the wage index). This form of automatic indexation was applied until 1983. After 1983 indexation was not just abandoned but a cut of 3 per cent was effected in 1984. Net benefits under national insurance provisions and the National Assistance Act, and net minimum benefits under the Unemployment Insurance Act, the Unem-

ployment Benefits Act and the Disablement Insurance Act, are linked to the net minimum wage (or what is known as net-net linkage). The indexation of the minimum wage and the net-net linkage are regulated under the Adjustment Mechanisms Act of 1979. The same Act also laid down the gross-gross linkage for benefits above the national minimum: sickness and unemployment benefits based on the Unemployment Insurance Act follow collective-agreement wage developments, while other benefits follow the wage index. As from 1 January 1985 the benefit rates under the Unemployment Insurance Act, the Unemployment Provisions Act and the Disablement Insurance Act were reduced to 70 per cent of final previous earnings. Between 1981 and 1984, annual, once-only payments were made to the 'genuinely' needy, i.e. households (including one-person households) required to get by on a single minimum income. In 1984 a special supplement was added for the long-term genuinely needy. Changes in the purchasing power of benefit claimants in comparison with employers in the private sector are shown in Table 2.6.

**Table 2.6 Changes in purchasing power of various income categories, 1974-1984 (in %)**

	1974-1979 <sup>a)</sup>	1980-1984	1979-1984 <sup>a)</sup>
<i>Private sector employees</i>			
minimum +	+ 12	- 8.4	+ 2.6
modal income	+ 9	- 12.7	- 4.8
2 × modal income	+ 1	- 17.2	- 16.4
4 × modal income	- 1	- 15.7	- 16.5
<i>legal minimum wage and social security benefits</i>			
long-term genuinely needy <sup>b)</sup>	+ 19	- 6.6	+ 11.2
legal minimum wage	+ 19	- 10.6	+ 6.4
national minimum <sup>c)</sup>	+ 24.8	- 12.3	+ 9.5
modal disablement benefit claimant	+ 18	- 20.5	- 6.2

Source: WRR, based on Incomes Policy 1985;

Proceedings of the Lower House, 1984-1985 session, 18611, nos. 1-2, p. 11 and no. 5, p. 2.

a) base year: 1973

b) from 1981 including once-only payment to the genuinely needy; previously equal to changes in legal minimum wage.

c) weighted average including Disablement Insurance Act; the national minimum (General Old Age Pension) was structurally adjusted in 1973.

As the table reveals, the highest incomes have declined appreciably in relation to the lowest incomes over the past ten years. Especially at lower levels, differentials have been compressed, to the point that the differences in disposable income have become comparatively small. In 1982 nearly 90 per cent of workers in the private sector (excluding agriculture) earned an income between the minimum wage for adults and twice the modal level. The gross-income ratio between minimum and twice-modal amounted to 1:2.8, and the net-income ratio to 1:1.9. In 1982, 32 per cent of employees in the private sector were in the band between minimum and modal. Here, the gross-income ratio came to 1:1.4 and the net-income ratio to 1:1.2<sup>8</sup>.

The extent to which gross-income differentials are taxed away is evident from the high marginal rates of taxation and social insurance contributions. In a band between just above minimum to over twice-modal, incomes in 1982 were faced with a virtually identical marginal rate of some 50 per cent<sup>9</sup>.

While the surveys of purchasing power provide a good insight into changes in major income components, they also have their limitations. Persons in employment generally receive fringe wage increases (e.g. overtime), whereas benefit claimants have no such entitlement. They also take no account of the various earnings-related regulations (e.g. rent relief, home help, special rates for health insurance for the elderly, and study grants). The result is that the effective marginal burden on low incomes can reach a significantly higher percentage than that for higher incomes, where a wide range of tax concessions is often available. A further objection to the purchasing power surveys is that

they take no account of income formation in the sphere of work in and about the home. As a result, households in which both partners together work considerably longer than the standard working week would suffer a loss in living standards in relation to sole income families. Finally many households bring in more than one income, as a result of which the purchasing power of individual earned incomes and benefits does not provide a full insight into the purchasing power of households and their individual members.

Data on the income distribution of households in 1982 are shown in Table 2.7. In multi-person households, an average of 1.8 persons brought in an income. The average number of incomes per couple without children was 1.4, and for couples with children living in, 1.9.

**Table 2.7 Income position of households according to average income, 1982**

Household type	Number of households with income		Average number of persons with income per household	Disposable income		
	absolute (× 1000)	as % of total		absolute (× N.FI 1000)	as % of total	increase on 1981 (in %)
One-person households	1 002	21.0	1	21.1	58.1	2.3
Multi-person households	3 777	79.0	1.8	40.3	111.1	2.5
Non-family households	226	4.7	1.9	38.6	106.4	4.2
One-family households <sup>a)</sup>	3 333	69.8	1.7	39.6	109.2	2.4
couples without children	1 063	22.2	1.4	35.0	96.6	3.7
couples with children	2 024	42.3	1.9	42.6	117.4	2.0
1 child	639	13.4	1.8	40.1	110.5	3.0
2 children	941	19.7	1.8	41.4	114.3	3.4
3 or more children	444	9.3	2.2	48.5	133.9	-0.5
one-parent families	245	5.2	1.8	34.6	95.5	1.3
Other households <sup>b)</sup>	217	4.5	2.5	52.9	146.0	2.3
<b>Total</b>	<b>4 779</b>	<b>100</b>	<b>1.6</b>	<b>36.2</b>	<b>100</b>	<b>2.2</b>

Source: Central Bureau of Statistics, *Statistical Bulletin no. 52*; 20 December 1984, page 3.

a) without other persons

b) comprises one-family households with other persons and multi-family households.

The number of second incomes from children living at home and earning a separate income is greater than the number of second incomes earned by working married women (1981 figures). Children with jobs on average also earn more than working married women. A strikingly large number of young people still live in with their parents: 98 per cent of 16–18 year-olds and 79 per cent of 19–20 year-olds (1979 figures). Setting up a separate household does not occur on a major scale until people reach the age of 21.

The rate of participation in the labour force by married women has risen sharply. In 1960, 7.4 per cent of married women had a paid job, in 1983 36 per cent. The participation rate is particularly high among married women aged under 30. Because many married women work part time, over a quarter earn less than 25 per cent of the minimum wage, and over three-quarters no more than the minimum wage. On average working married women contribute some 25 per cent of family income<sup>10</sup>.

In 1984 the total number of households required to get by on a single minimum income was estimated at 650,000. These 'genuinely needy' consist to a large extent of benefit claimants, especially the long-term unemployed, one-parent families and single elderly householders.

Because purchasing power surveys fail to provide an adequate insight into the income position of households, the need was felt for an instrument to measure household income distribution more precisely. Both the Social and Cultural Planning Bureau and the Central Bureau of Statistics have devised methods for this purpose. Calculations made by the Social and Cultural Planning Bureau suggest that the compression of household income differentials came to a stop as early as 1977, the chief factors being the increasing number

of households dependent on social security benefits on the one hand and the increasing number of two-income families on the other. A CBS study revealed that socio-economic and demographic factors, such as changes of job or household composition, have much more influence on income distribution than the changes in wages, tax rates and national insurance contributions as taken into account in standard purchasing power surveys<sup>11</sup>.

### *Concluding reflections*

Since the inception of the social security system the purchasing power of minimum benefits has been considerably increased. Partly as a result of the increase in minimum benefits, income differentials at the bottom-end of the scale have narrowed substantially. As regards household income distribution, the increasing number of two-income families has exerted an opposite effect.

The question as to whether the level of minimum benefits is high enough is the subject of fierce debate. This underlines the fact that the national minimum is a relative one, drawn up on the basis of social perceptions and political judgements. To take one example, the desire from an equity viewpoint to compress income differentials has to be weighed against the desire to increase those differences in order to improve the operation of the labour market. If the national minimum is linked to per capita national income, certain policy choices will also have to be made from time to time.

The increasing number of two-income families has led to growing attention to household income as the most appropriate indicator when it comes to policies for the genuinely needy. Both household composition and the number of incomes per household are taken into account in awarding benefits. If continuing account is to be taken of the differences in need and economic means between the various types of households, there is little choice but for greater emphasis to be placed in incomes policy on the distribution of household incomes. The result is that it ceases to be possible adequately to assess minimum needs in terms of wage determination, since little or no account is then taken of employees' personal circumstances. In some households the legal minimum wage forms the sole income; in others there may be more than one minimum income. In the present circumstances, therefore, the legal minimum wage has ceased to be an effective means of ensuring that employed persons receive a minimum subsistence income.

#### 2.1.3 *Expenditure trends*

Expenditure on income transfers of a safeguard nature have risen greatly in recent decades (see Table 2.8).

**Table 2.8 Expenditure on income transfers of a support nature, 1960–1983<sup>a)</sup>**

year	absolute expenditure (in N.Fl. 1,000 million)	expenditure as % of net national income
1960	3.1	8.1
1965	7.2	11.5
1970	14.0	13.3
1975	35.0	18.5
1980	53.6	17.8
1983	78.6	23.4

Source: WRR, on basis of: Central Bureau of Statistics, *85 jaren statistiek in tijdreeksen* (85 Years Statistics in Time Series), The Hague, Staatsuitgeverij, 1984. Central Bureau of Statistics, *Sociale verzekering, pensioenverzekering, levensverzekering* (Social Insurance, Pensions Insurance, Life Insurance), The Hague, Staatsuitgeverij, various issues.

Social Security Financial Report 1985; proceedings of the Lower House, 1984-1985 session, 18612, nos. 1-2.

a) excludes regulations for government employees.

This growth in expenditure played a large part in the doubling of the public expenditure-burden between 1960 and 1983 to reach 70% of national income

in 1983<sup>12</sup>. Another factor has been the sharp rise in expenditure on health care. The increase in the share of income transfers in national income has been associated with a virtually identical decline in the share of income from enterprises and the self-employed (see Table 2.9).

**Table 2.9 Distribution of disposable income among various income categories, 1960–1983 (as % of net national income)**

	1960	1965	1970	1975	1980	1983
earned income of economically active persons (incl. civil servants)	36	38	39	38	37	34
other income (income from enterprises and self-employed)	27	21	18	13	10	13
income transfers to economically inactive	12	14	15	20	23	26
pension funds, etc.	4	5	6	8	9	9
government (excl. civil servants)	21	22	22	21	21	18

Source: Central Planning Office, cited in: Socio-Economic Council, *Advies hoofdlijnen gewijzigd stelsel van sociale zekerheid bij werkloosheid en arbeidsongeschiktheid* (Report on the Main Lines of a Modified Social Security System for Unemployment and Employment Disability). The Hague, 1984, p. 33.

Up to 1980 the net earnings of the economically active formed a virtually unchanged proportion of net national income. Since that date the share has declined. The share of income transfers has risen steadily and a significant part of this shift has been borne by the government, partly as a result of the explosive growth in the number of unemployment benefits since 1980. Between 1960 and 1980 the share of income from enterprises and the selfemployed declined steadily, but from 1980 onwards this trend was reversed.

The decline in the relative share of income from enterprises and the self-employed can adversely affect employment on account of the lower rate of return on capital, and declining investment can produce a further drop in employment. The availability of investment capital may also suffer from the lower volume of savings associated with higher spending on income transfers, which have to be funded by means of taxation and national insurance contributions, thereby cutting back savings formation. In addition, the government's financial deficit rose during the 1970s in response to these trends. Furthermore, benefit recipients use virtually all their income for consumption purposes. The propensity to save declines among insured persons since a reasonable continuity of income is guaranteed in the event of loss of earnings. Similarly, income transfers going beyond the scope of this report exert a negative effect on investment. Social income transfers with a state provision function are generally of an in-kind nature; savings are not possible. In the case of pensions there is a certain amount of savings formation, but in most cases these savings do not find their way into riskbearing investment.

#### *Concluding reflections*

High levels of income transfers will have an adverse effect on investment and hence employment if they are passed on to the income from enterprises and the self-employed. This is not to say that such expenditure has assumed too large a scale. The affordability of income transfers ultimately depends on the willingness of the economically active to fund such expenditure out of personal disposable income. Precisely where the limits to solidarity lie in this respect is difficult to say. The danger does, however, exist that the system affords so much security that insufficient funds will be available for investment in certain periods. In quantitative terms potential investment can suffer because the volume of savings falls too far. In a qualitative sense the potential for investment can suffer because the composition of savings changes and avoids risk-bearing investment in industry. It would therefore be advisable to examine whether positive incentives for savings formation could be incorporated into the social security system.

#### 2.1.4 *Individualization*

The fundamental elements of the present system of social security were laid down at a time that differed significantly from the present in socio-cultural respects. At that time social policy was able to build on certain assumptions to the effect that behavioural norms and role patterns were reasonably fixed. The family, consisting of a husband, wife and one or more children, was seen as the cornerstone of society and marriage was a contract entered into for life. Cohabitation – both by people of the same sex and by men and women – was not customary. Within the marriage the husband was the sole breadwinner and married women did not for preference work outside the home but managed the household and cared for the children<sup>13</sup>.

Until well into this century employment outside the home for women and children from the labouring classes remained a harsh necessity. For this reason the achievement of a situation in which the income of the male breadwinner was sufficient for the whole family was regarded as a major social achievement.

The situation at that time meant that the social security system had to deal with only two types of households: the family and single householders. This explains why minimum daily wage provisions were taken up in the loss of earnings insurance arrangements: the aim of such provisions was to prevent the benefits paid to a family with only one breadwinner from falling below the national minimum for a family. In the government's present plans to review the social security system, the minimum daily wage provisions would be replaced by supplements (see also section 2.2.1). The obverse to minimum daily wage provisions and supplements is that the benefits paid to breadwinners are reduced if a person's partner has a separate income. Nor is the partner of a married benefit claimant who applies for a breadwinner's supplement required to register for employment; similarly there is no widowers' insurance. Married working women pay independent national insurance contributions but do not obtain any extra benefit entitlements in return. Finally, the mutual responsibilities and maintenance commitments of married couples have been taken as the starting point for the National Assistance Act. Entitlement to, and the level of, national assistance is determined not by the individual's economic means but by that of the household.

Over the past twenty years the situation has changed radically. Domestic appliances and the rise in the standard of living have rendered housework less onerous and timeconsuming. There has also been a shift in social attitudes towards employment on the part of married women, which has risen appreciably in recent years. Longevity combined with smaller family size has meant that women now much more commonly have a large part of their lives ahead of them after the children leave the home. This can be an important incentive for women not to confine their activities to looking after the home. Another important factor has been the equal rights movement, which has pressed strongly for an equal division of paid and unpaid work within the family. Participation by married women in paid employment is regarded as an essential precondition for overcoming what is regarded as the subordinate position of women in both society and the family<sup>14</sup>. In addition non-marital household forms have established themselves alongside family and single households. In similar vein there has been a substantial increase in the rate of divorce and hence of lone-parent families.

The way in which non-marital household forms should be treated in the social security system creates a dilemma, especially as regards minimum benefits. On the one hand it is deemed unacceptable to impose maintenance obligations on persons who have deliberately opted for a relationship not involving marital commitments. On the other hand many people find it difficult from the viewpoint of material equality to justify the fact that persons living as though they were married should jointly receive higher national assistance or state pensions than a married couple. So far the latter consideration has weighed the more heavily for policy purposes, with efforts being made to treat

marital and nonmarital household forms as equally as possible. Apart from the objection in principle just referred to, the material equality principle presents administrative problems.

The breadwinner provisions required for this purpose amount to an implicit levy on joint income. Particularly if taken in combination with regulations falling outside the scope of this report, such as income tax and income-related concessionary charges, this implicit levy can be very high. The result is to discourage participation by women in the labour force. Arguments in favour of the implicit levy are based on the fact that the existence of two-income families renders the distribution of income among households less equal and creates the risk of a new division in society between families with two breadwinners and a high joint income from employment, and families with a single breadwinner dependent on family benefits to take them up to the minimum level.

Up to the present, the social security system has been based on the tacit assumption that citizens take little or no account of differentiations in the benefit system based on need and economic means considerations when choosing their particular household form. If, however, 'calculating' behaviour of this kind were to take place on a large scale, this would create undesirable side-effects for government policy. Citizens are not just able to adjust their marital or family status to benefit from the regulations available but can also deliberately misrepresent their living circumstances to the authorities. If such practices were to assume any sort of scale there would seem little way of effectively checking the true state of affairs.

The debate about the future of the social security system may be divided into two fundamentally different schools of thought. The first of these argues for the full-scale *individualization* of the system in a legal sense, i.e. that entitlements and obligations should be solely assigned to individuals irrespective of household situation. No account whatever would be taken of the partner's income. One of the arguments in favour of the individualization principle is that it would serve to recognize and promote the economic independence of the individual. It would also eliminate the problems that can now arise in cases where marital and non-marital household forms are treated equally. The invasion of privacy associated for example with the administration of the National Assistance Act would disappear. An individualized system would moreover be easier to administer and less susceptible to fraud. In the realization that individual economic independence is no longer fully achievable, especially for the older generations, and that it would take time for the labour market to be adjusted, proponents of individualization generally accept that its introduction would have to be gradual. The most obvious course would be for cohort-based phasing in and the stepwise individualization of the regulations<sup>15</sup>.

The second school of thought argues in favour of maintaining in principle of basing benefits on *household needs and economic means*. An important consideration in this respect is the fact that the need for individual economic independence is certainly not felt universally. Abandonment of the need and economic means principles would also have unacceptable adverse effects on the position of single householders, especially those at the national minimum level. This could of course be avoided by awarding individual benefit entitlements that were independent of the partner's income and that were also sufficient to meet individual needs (e.g. 70 per cent of the net minimum wage). This would, however, entail major risks for the labour market since multi-person households would then become entitled to benefits which, taken together, were considerably above the present subsistence level for a household, with the consequence that many people would withdraw from the labour market. On the face of it this problem could be solved by setting the level of individual benefit at 50 per cent of the net minimum wage, but this would simply render living alone impossible. Even the Equal Rights Council considers it would be undesirable if the possibilities for economic independence on the part of single householders were to be reduced in this way<sup>16</sup>.

### *Concluding reflections*

The choice between individualization and the application of needs and means testing is essentially a political one. If the desire for individual economic independence is to be taken as the starting point for official policy, a completely individualized system of income transfers would need to be introduced on a gradual basis. If the chief objective is to avoid inspection and legitimacy problems in assessing need and means, individualization is also the appropriate course. This would be all the more true if large numbers of citizens should make a calculating choice when deciding on marital status and household form. If, on the other hand, it is evident that only a small number of people will act in a calculating manner and if the government does not wish deliberately to steer citizens in the direction of individual economic independence, the continued application of the need criterion and means-testing offer advantages.

Traditional role patterns may have been eroded, but, in so far as new ones crystallize out, it cannot be assumed for policy purposes that any one or more of these will emerge as dominant. This means that a choice in favour of either the individualization principle or the need/economic means criteria in the social security system will cause tensions one way or another. As long as the diversity of household forms persists, no ready-made solution will be available. Instead, efforts will have to be made to find a solution that as far as possible steers a neutral course.

#### *2.1.5 Problems in the labour market*

Income transfers affect the operation of the labour market. They do not just affect the supply and demand for labour but are related to the informal economy and the trend towards shorter working hours. Each of these aspects is examined in turn below.

##### *The supply of labour*

Compared with other countries, social security benefits in the Netherlands are notably high in relation to earned incomes. The net-net linkage results in the fact that the minimum level of benefit payable to a married male employee is equal to the net minimum wage. This does not apply to single householders. Since 1 January 1985 the replacement rate for benefits above the national minimum (with the exception of sickness benefits) has been set at 70 per cent, but as a result of the net-net linkage this is somewhat higher for breadwinners earning up to 1.4 times the minimum wage. Apart from the replacement rate the duration of benefits is also relevant. Unemployment benefits above the minimum level are of limited duration; thereafter the claimant drops back to the national assistance level. Disablement benefits above the minimum level, by contrast, continue for as long as a person remains disabled or until he reaches retirement age. These much more favourable provisions have the effect of discouraging disablement benefit recipients from returning to the labour market, especially if their employment prospects are uncertain.

The sharp increase in the demand for social security has brought the question as to whether the relative level of benefits reduces willingness to work back into the focus of public and academic attention. Insufficient empirical material is available in the Netherlands for any general answer to be provided, but closer attention has been paid in the United States to the impact of social security on the supply of labour<sup>17</sup>. Research in that country has demonstrated the existence of a negative effect, but this turns out to be no more than a few per cent. Needless to say these findings do not necessarily apply to all countries, but even if we were to assume that the effect was somewhat larger in the Netherlands on account of the more generous social security provisions, the labour market as a whole would still not necessarily be seriously disturbed since the total number of available jobs is well short of the number of people

seeking work. This is not to deny that bottlenecks may arise in certain situations. If it becomes more attractive financially for young people to be on the dole than to undergo specialized vocational training, this can also give rise to a bottleneck that could hold back economic recovery. The same applies if the re-training of unemployed persons is impeded or insufficiently encouraged because of social security. The labour market would also be adversely affected if the level of benefits stopped people in certain circumstances from accepting work they considered to be less suitable (even if they had been unemployed for some time), for example because the pay was lower or the working conditions inferior than in their previous job.

These negative influences on the labour market will become more perceptible as the labour market gets tighter. In that case, however, the funding of unemployment relief would be much less of a problem and companies would be able to pay high wages, thereby attracting those reluctant to work back into the labour market. Furthermore, once the level of unemployment comes down, it becomes easier to conduct official checks on whether people are in fact attempting to find jobs.

### *The demand for labour*

The demand for labour is affected by social security regulations along two paths. To start with, the provision of social security preserves spending power and hence the demand for goods and services, thus generating demand for labour. The second path operates through the supply side of the production process. To a large extent, benefits are financed by levies on labour, with the overall result that the labour becomes more expensive in relation to capital. This imbalance is further accentuated by government subsidies for capital investment, which have assumed a considerable scale in the Netherlands.

If labour is expensive in relation to raw materials, this does not promote the efficient use of raw materials, and if it is expensive in relation to capital it provides a stimulus to replace labour by capital. Where this results in technological innovation the productivity of labour will generally rise, to the benefit of economic growth. A further side-effect can be the creation of new employment, thereby compensating for some of the jobs lost from technological innovation. Not all companies, however, have the same technological potential to improve labour productivity. Furthermore, the existence of ceilings for the payment of national insurance contributions implies that labourintensive enterprises with a low wage structure are more affected by such charges. Where such companies compete internationally, their ability to pass on higher wage costs in price rises will be limited. Where they operate in the domestic markets, the ability to pass these costs onto prices is constrained by the risk of depressing demand or causing it to shift into the informal labour market. In industries where the productivity of labour is comparatively low, the present method of funding social security reduces the demand for labour. The task for the future would appear to be to devise a new system of benefits and financing that did not remove the incentive to improve labour productivity but which also arrested the continued marginalization of labour-intensive activities in the economy.

The legal minimum wage can also depress the demand for labour. The minimum wage broadly follows the average pattern of collective wage agreements. If the differences in labour productivity between various industries is substantial, the minimum wage can result in a reduced demand for labour in industries where the productivity of labour is comparatively low.

### *The informal labour market*

The negative effect on the demand for labour exerted by the high levies on labour, as described above, consists not just of a shift away from labour-intensive products and services but also of a shift in demand to the 'informal' sector. The informal sector consists of three main elements. unpaid work; the mutual provision of services and payment in kind; and the black economy.

There are various factors at work serving to accentuate the incentive for such shifts provided by the high levies on labour. Technological developments have made do-it-yourself activities possible in many fields. The steady decline in average working hours has also created scope for people to perform activities in addition to their official employment, while the high marginal rates have made it attractive for people to earn part of the income or obtain casual earnings outside the official labour market.

The interplay of these factors does not just stimulate do-it-yourself activities but also encourages the supply and demand of labour outside the official labour market. Offering their services in the informal labour market may be attractive for both those in employment and benefit recipients. People with jobs are often well placed to supplement their income with informal work. In many cases, their employment will provide them with the necessary contacts, and they will have ready access to the requisite tools and materials. This means that the informal economy could continue to grow even if unemployment were to decline. It is not a phenomenon confined to times of mass unemployment but, given unchanged policies, will remain an important feature of the economy, the root cause being the differences in the productivity of labour in various industries. High levies on labour serve to accentuate the shift from the formal to the informal economy.

It is not invariably desirable to push back the informal economy. There is little cause for introducing special measures simply because technological progress and increased leisure have made it possible for people to turn their hand to do-it-yourself activities. If, however, people are forced into DIY on account of high labour costs, with a loss of quality in relation to professional work, such a process of despecialization can only be regarded as undesirable from an economic viewpoint. Individual industries can suffer dislocation if high labour costs and high marginal rates lead to a large-scale demand for and supply of labour by third parties outside the official labour market. The result is that the levy base for public revenue purposes is narrowed – thereby creating a vicious circle in which even higher levies on labour have to be imposed.

#### *Recent developments*

Various developments have been taking place in the labour market that will not leave the social security system undisturbed. In the first place the average number of hours worked per person per year is declining. If this should develop into a general reduction in working hours, households with only one breadwinner could find themselves falling below the social minimum. The National Assistance Act could in these circumstances assume a new function of supplementing the income of such households to bring them back up to the level of the national minimum. Adjustments to help prevent the income of such households from falling below the national minimum upon a general reduction in working hours would also be feasible in the sphere of taxation and national insurance contributions.

A reduction in average working hours per person could also be achieved by an expansion of part-time work. This would have a number of significant advantages in relation to a general reduction in working hours. The labour market is not homogeneous and a cross-the-board reduction in working hours would only accentuate the sectional labour shortages that already exist. Furthermore, a strategy aimed at the promotion of voluntary part-time work would leave individual households freer to decide how to apportion the distribution of employment among their members. Greater part-time work would however require a number of major adjustments to the social security system since the provisions for part-time workers are less comprehensive than those for breadwinners with a full-time job<sup>18</sup>. Furthermore it remains to be seen whether voluntary parttime work would be able to effect a significant reduction in unemployment. Nevertheless, the advantages offered by such an approach make it advisable to exploit the opportunities available as effectively and fully as possible.

An expansion of the income-supplementing function of social security could

also occur if the differences in labour productivity trends begin to result in wage differentials. To improve the operation of the labour market it would be worth considering the abolition of the legal minimum wage. The allocative function and the minimum-needs guarantee are not readily combined in the one instrument. The abolition of the minimum wage could help generate employment but, in weak industries, could also result in incomes below the existing minimum. The obvious course would then be for such incomes to be supplemented as part of the support function of social security, but this suffers from the major objection that such persons would then be faced with a marginal rate of 100 per cent, i.e. any additional earnings would be fully offset against the supplementary benefit. The effect would therefore be to exchange the problem of the minimum wage for the problem of an even larger low-income category faced with an extremely high marginal withdrawal rate.

### *Concluding reflections*

If the negative impact of social security regulations on the labour supply is on only a limited overall scale, there is no cause to reduce benefits across the board in times of mass unemployment in an effort to improve the operation of the labour market. In those instances where there are labour shortages or there is insufficient willingness to work, specific measures would be the more appropriate line of action. One possibility, for example, would be to tighten up official surveillance of benefit claimants' actual availability for work. Steps could also be taken to ensure that the pursuit of vocational training by young people was not financially unattractive. Apart from specific measures of this kind, it would also be particularly important to examine whether greater numbers of people could be helped to find jobs if the social security system were to be modified. If conditions in the labour market were to become tighter, the negative impact of social security regulations could, although limited, begin to create more substantial problems for the supply of labour. It may, however, be assumed that this problem would largely solve itself since a tighter labour market would permit additional wage increases, thereby drawing people back into the labour market.

In order to promote the demand for labour in the formal economy, there would be a case for considering measures to reduce the cost of labour-intensive goods and services. This could boost employment and check any undesired expansion of the informal economy. Modifications to the social security system could help produce the same result, but before exploring this angle it may be noted that measures outside the field of income transfers could also be taken, e.g. the abolition of the legal minimum wage or a lower VAT rate for labour-intensive services. Measures in the field of social security could concentrate particularly on an expansion of the levy-base for funding the system, e.g. by a levy on added value instead of on wages. Another alternative would be to fund social security out of general revenue rather than national insurance contributions.

#### *2.1.6 Complexity of the system*

One of the distinguishing features of the social security system in the Netherlands is the fact that responsibility for policy formation is shared by the government and the social partners. This shared responsibility means that the demarcation of responsibilities and powers comes in for regular discussion and that the institutional structure is a complex one. The way in which the system has evolved since the Second World War and the fact that social security is closely bound up in a financial sense with both the public and the private sector help explain the widespread support for continuing on the basis of shared responsibility. The unanimity on this score was evident in the reactions to the Government's request for advice on the reform of the social security system of 1983: reactions which in other respects diverged considerably (see also section 2.2.2).

The administration of social security suffers increasingly from the com-

plexity of the legislation and regulations. One of the main factors has consisted of the numerous recent or planned changes to the system. Legislative amendments have become much more frequent. In many cases, the available introduction period is too limited to solve the numerous technical problems that can arise when amended regulations are put into effect. Some of the amendments have also been associated with complicated transitional provisions. The modifications to and expansion of the legislation has led directly to extensive differentiation. This in turn has called for a high degree of specialization in administering the provisions, the collection of a great deal of data from varying sources, the making of complicated calculations, frequent data transfers between the various departments and agencies, the need for re-assessment of individual cases, and so on.

In virtually every part of the system use has to be made of criteria that are difficult to apply and data that are difficult to verify: involuntary unemployment, employment disability, suitable employment, daily wage, household unit, income of other members of the household unit, assets, availability for employment, and so on. Furthermore, some of these data and criteria have to be periodically collected and applied for each benefit claimant. The problems faced by clients are considerable, as are the possibilities for consciously or unconsciously providing incorrect or incomplete data. This may force the administering agency into making considered judgements that the client finds difficult to understand and accept. Deciding whether or not the associated administrative expenses are excessive is a matter of weighing the advantage of reduced complexity against the desirability of a certain amount of differentiation based on the desire for the greatest possible degree of distributive justice and material equality.

### *Concluding reflections*

If future policies should continue to stress the distributive justice aspect the margins for radical simplification would not appear great. At the same time, this does not rule out anything but the most limited improvements; one potential area would be the standardization of the concepts and criteria used in the various regulations. Another potential means of improvement would be for greater attention to be paid in policy preparation and formulation to the administrative implications of any proposed measures. Material equality will never be fully achieved in a dynamic society and any progress made in this direction by legislative refinements needs to be carefully weighed against the drawbacks associated with even greater complexity.

## **2.2 Current developments in social security reform**

### *2.2.1 Government policy*

Review of the social security system forms a central element in present government policy. In 1983 the Government asked the Socio-Economic Council and the Equal Rights Council for advice concerning the revision of unemployment and employment disability provisions and the related national assistance schemes. In this request for advice of 25 May 1983 the Government gave three reasons for conducting a review of the current system<sup>19</sup>. In the first place the Government saw a need to cut back the level of public spending – of which social security forms a major part – in the interests of economic recovery. In this respect the Government noted that the share of transfer incomes in national income has risen sharply in recent decades, while the share of profits has fallen back considerably, thereby suggesting that the rise in the cost of social security has above all been passed on to profits. A second reason for reviewing the system was that the current system was not designed to cope with the current scale and structural nature of economic non-activity. Finally the Government contended that more scope had to be created for the greater degree of individual financial independence sought within society. A major factor here was the third EC Directive<sup>20</sup>, which laid down that the equal treat-

ment of men and women under the social security system should be introduced no later than 23 December 1984.

The plans for a new system of loss of earnings insurance in the event of employment disability or unemployment as put forward in the Government's request for advice are based on the 'safety net' option. In the event of a loss of earnings from disability or unemployment, individuals would to begin with be covered by a regulation under which a benefit was payable the level and duration of which depended on final previous earnings and the person's length of employment. Provision against loss of earnings is, therefore, accorded primacy, and benefit entitlement would be determined on a strictly individual basis. The safety net would only come into operation if loss of earnings benefits were inadequate or had expired. The idea of such supplementary or substitute benefits would be to ensure that every household could provide for its minimum subsistence needs. The decision in favour of the safety net system was partly based on the consideration that any new arrangements should build on the historically evolved division of responsibilities between the government and the social partners in the field of loss of earnings regulations. Traditionally, the employers and trade unions have been responsible for the loss of earnings aspect, while the government has borne the primary responsibility for safeguarding minimum needs.

The principal features of the system of unemployment benefits proposed in the Government's request for advice of 25 May 1983 are as follows. The existing distinction between the Unemployment Insurance Act (WW) and the Unemployment Provisions Act (WWV) would lapse, to be replaced by a single unemployment benefit act. The provisions would be strictly individual, thereby eliminating the present unequal treatment between men and women under the WWV. A second feature would be the introduction of a sliding scale: up to the minimum wage the replacement rate would be 70 per cent, and on any earnings above that level, 50 per cent. This fall in the average replacement rate as income rises could therefore cut across the benefit principle, under which contributions and benefits are meant to be linked, as with unemployment insurance at present. In an effort to retain the benefit principle, the Government proposed the introduction of sliding-scale contributions. The duration of unemployment benefit would be dependent on a person's employment history but would be limited to a maximum of five years. Within this period, benefit would be reduced in six-monthly steps to the national minimum for a single householder (i.e. 70 per cent of the net minimum wage). Since it can often be difficult to quantify a person's employment history, it was proposed that, for the present, the claimant's age should be taken as the criterion for the length of the benefit period. The proposed connection between age and the unemployment-benefit period is shown in Table 2.10.

**Table 2.10 Connection between age and unemployment-benefit period under revised system (in years)**

age	benefit period
under 23	0.5
23-29	1
30-34	1.5
35-39	2
40-44	2.5
45-49	3
50-54	3.5
55-59	4
60-64	≤ 5

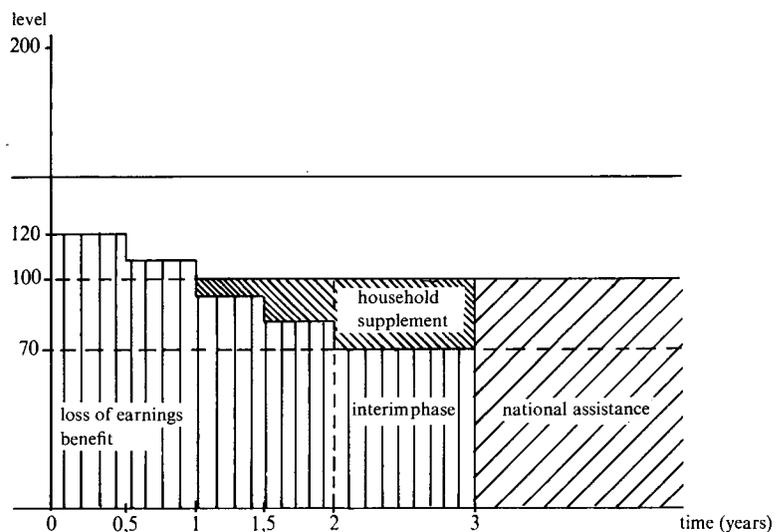
Source: Ministry of Social Security and Employment, Review of the Social Security System, Proceedings of the Lower House, 1982-1983 session, 17475, no. 6, p. 31.

Upon expiry of the unemployment-benefit period an interim phase would come into effect when the claimant would receive a follow-up benefit equal to the national minimum for a single householder for a period of twelve months, the so-called interim phase. If the level of unemployment benefit should fall

below the national minimum for the type of household in question during either of these periods, household supplement would be payable. In determining the eligibility for and level of such household supplements, account would be taken of any earned income on the part of other members of the household (i.e. an income test). There would, however, be no means test on assets. Upon expiry of the interim phase an unemployed person would be dependent on the National Assistance Act in the same way as a person lacking an employment history. Under the Government's plans there would be no question of individualizing national assistance entitlements; household units would continue to be means-tested. The Government would, however, see a certain amount of room for the personalization of benefit entitlements between the partners in a household, by assigning separate benefits to each. This would not amount to an increase in national assistance but simply to its distribution to both partners.

The new system of loss of earnings insurance as envisaged by the Government is shown in schematic form in Figure 2.1.

**Figure 2.1** Schematic diagram of the amended system of unemployment benefits in the Government's request for advice of 25 May 1983<sup>a)</sup>



Source: Ministry of Social Security and Employment, Review of the Social Security System, Proceedings of the Lower House, 1982-1983 session, 17475, no. 6, p. 59.

a) The figure relates to a person aged between 35 and 40 with a two-year entitlement to earnings-related benefits. In the example the daily wage has been set at 200 and the minimum wage at 100.

With respect to employment disability benefits the request for advice puts forward two radical changes. In the first place it proposes the introduction of a sliding scale such as that proposed for unemployment benefits, and secondly it calls for the elimination of hidden unemployment under the General Disablement Benefits Act and the Disablement Insurance Act. As it stands, account is taken in determining the degree of employment disability of the fact that the person in question will be less well placed to find suitable employment on account of his or her disability. As a result full-scale disability benefits are generally paid to people who are partially incapacitated and otherwise unemployed. This means that, up to a certain level, these benefits act as a form of unemployment benefit. The request for advice proceeds from the assumption that the resultant hidden unemployment amounts to 50 per cent. The elimination of the unemployment component means that an incapacitated person would receive a disability benefit only in proportion to the degree of his employment disability; for the rest he would be dependent on unemployment benefit. Disability benefits would not be limited in duration or reduced to the minimum level.

In the longer term, the government has in mind the equalization of unemployment and employment disability provisions and removing the limitations on the duration of the interim phase. Under these revised arrangements a claimant would be entitled to individual benefit of up to 70 per cent of the net minimum wage for the period between the expiry of loss of earnings benefit and reaching the age of retirement. Only those without an employment history would fall back on national assistance in the event of need. For the present, however, the Government does not regard the introduction of such a system as feasible.

The Social and Cultural Planning Bureau subsequently calculated the distributive and budgetary effects for 1981 of these planned changes to the system<sup>21</sup>. Unemployed persons would suffer an average drop in disposable income of some 9 per cent. In the case of the incapacitated the drop would (assuming a hidden unemployment rate of 50 per cent) be around 19 per cent. The budgetary effects would amount to a saving of 1,400 million guilders on unemployment benefits and 4,100 million guilders on disability pay-outs.

In April 1985 the Government issued a new version of its plan for revising the system<sup>22</sup>. In comparison with the request for advice of May 1983 this version contained a number of refinements and changes, the most important of which are outlined below. The sliding scale as initially proposed was dropped. Under the proposed new Unemployment Act (replacing the Unemployment Insurance Act and the Unemployment Provisions Act), unemployment benefit would be set at 70 per cent of final previous earnings. Where a person could be held responsible for being unemployed, benefit would be limited to 70 per cent of the net minimum wage; entitlement to full unemployment benefit would require official referral. Evidence of at least six months employment during the year preceding loss of employment would be required for eligibility to draw a six-months benefit, while entitlement to longer benefit would be conditional on an employment history of at least three years in the five years preceding loss of a job; periods of looking after children under 12 would count at the rate of 50 per cent towards such entitlement. Persons made unemployed after the age of 50 would receive a special Income Support benefit for the Elderly Unemployed (IOW) upon expiry of the unemployment and follow-up benefit periods. This benefit would be set at the level of the national minimum, with a means test on income but not assets. The loss of earnings and follow-up benefits would be financed out of national insurance contributions, while the supplementary benefits and special benefit for the elderly unemployed would come out of general revenue.

The benefit rate for employment disability would again be 70 per cent. Allowance would no longer be made for the unemployment element under the two disablement acts, with the exception of persons aged over 50 and already drawing disablement benefit. Here again, therefore, the Government has decided against a stepwise reduction or 'taper' in disability benefits to the minimum level in the long term; nor is any limitation of the benefit period any longer envisaged.

The third EC Directive calling for the equal treatment of men and women under social security regulations no later than 23 December 1984 has not just had its effect on the plans for revising the system outlined above but has also resulted in proposals to amend other regulations. A solution for equal treatment has now been found with respect to the general old age pension (AOW)<sup>23</sup>, besides which married women will also in future be liable to pay separate contributions. It has, however, proved particularly difficult to come up with a benefit scheme that does justice to the diversity of household forms while at the same time remaining affordable, as illustrated by the conflicting advice received from the Equal Rights Council and the Socio-Economic Council<sup>24</sup>.

An additional complication consists of the fact that the third EC Directive is not always clear as to what is and is not permitted. The concept of 'indirect discrimination', in particular, is capable of differing interpretation. In addition

there are differences of view concerning the extent to which a revision of the system of social security may be used as an instrument for promoting citizens' individual economic independence.

The scale and structural nature of unemployment have resulted in measures to broaden the possibilities for benefit claimants to perform unpaid work. These measures cover a wide range of activities, varying from traditional voluntary work to projects specially set up for the unemployed. A Benefit Claimants (Unpaid Work) Act is currently being drafted in order to regulate the provisions for employment without loss of benefit.

### *2.2.2 . Reactions to Government policy*

The Government's request for advice of 25 May 1983 elicited a great deal of reaction. For reasons of space we shall confine ourselves to discussing the standpoints adopted by the Equal Rights Council and the Socio-Economic Council (SER) and the principal reactions of the three major political parties<sup>25</sup>.

The standpoints adopted in the SER in many cases correspond closely with one another as far as the general premises of the Government's proposals are concerned. The decision in favour of a safety-net system is endorsed by the entire SER. Similarly the integration of the WW and WVV into a single piece of legislation in which men and woman are treated equally receives general endorsement. The sliding scale is, however, rejected, since it would derogate from the benefit principle – as indeed the Government's most recent version recognizes. The SER also endorses the continuing involvement by employers and trade unions in the new system.

In the case of the long-term unemployed the SER argues for superior benefit conditions to those proposed in the request for advice, so that unemployed persons would only have to fall back on the National Assistance Act (ABW) in exceptional circumstances. In the Government's most recent plans, the special benefit for the elderly unemployed would prevent people who become unemployed after the age of 50 from being forced back on to the ABW. As may be seen from Table 2.11, the SER is divided about the precise nature of earnings-related unemployment and employment disability benefits. The SER does, however, endorse the Government's standpoint that, for the present, it is not possible to move to the individualization of benefit entitlements at minimum level.

**Table 2.11 Standpoints within SER with respect to benefit conditions, benefit rates and benefit period for unemployment disability benefits in a new system of social security**

		Request for advice	Stand-point 1 FNV <sup>b</sup>	Stand-point 2 CNV <sup>c</sup>	Stand-point 3 MHP <sup>d</sup>	Stand-point 4 Crown appointees	Stand-point 5 Employers	
<b>Unemployment<sup>a</sup></b>								
Benefit conditions	referral requirement (days worked in referral year)	130	130	130	130	130	130	
	waiting period	none	none	none	none	none	none	
	Supplementary benefit condition relating to empl. history for entitlement to (higher) benefit	none	5 years for age-related increase in benefit rate	none	n.a.	5 years	6 years. Relates only to individual benefit at minimum level subject to income test	
Benefit level of earnings-related benefit	Fixed percentage	—	75%	—	70%	—	—	
	Variable percentage	according to age/employment history (see benefit conditions)	—	70-80%	—	—	—	60-70%
		according to benefit duration	gradual taper of initial level to min. level in equal 6-monthly steps	—	—	gradual taper from 70 to 65% in equal annual steps	—	—
		according to level of earned income	with respect to initial level: sliding scale 70-c.60%	—	—	—	—	—
Benefit period	earnings-related benefit	depending on age/employment history: ½-5 years	unlimited to age 65	initially max. 4 yrs (later extension subject to financial possibilities)	unlimited to age 65	unlimited to age 65 <sup>e</sup>	depending on age/employment history: 2 months-6 years	
	individual benefit at minimum level	max. 1 year — (without income or asset test)	—	unlimited to age 65 (with earned income but no asset test)	—	—	unlimited to age 65 (with income but no asset test)	

Table 2.11 (continued)

Employment disability <sup>a</sup>							
Benefit conditions	referral requirement	none	none	none	none	none	none
	waiting period	1 year	1 year	1 year	1 year	1 year	1 year
	Supplementary benefit-conditions	none	none	none	none	at least 25% employment disability	none for earnings-related benefit; income test for min. benefit
Benefit level	Fixed per-centage of earnings-related benefit		80%	75%	—	70%	—
	Variable percentage	according to age/employment history	—	—	—	—	60—70%
		according to benefit period	initially not (in long term as for unemployment)	—	—	taper from 70% to 65% in equal annual steps	—
		according to level of earnings	sliding in-70— c. 60% come	—	—	—	—
Benefit period	earnings-related benefit	initially unlimited to age 65 (in long term dependent on age/emp. history)	unlimited to age 65	unlimited to age 65	unlimited to age 65	unlimited to age 65	dependant on age/emp. history: 2 m.—5 yrs. <sup>f</sup>
	individual benefit at min. level	initially not to be applied	—	—	—	—	unlimited to age 65 (with income test)

Source: Socio-Economic Council, *Advies hoofdlijnen gewijzigd stelsel van sociale zekerheid bij werkloosheid en arbeidsongeschiktheid* (Report on the Main Lines of a Modified Social Security System for Unemployment and Employment Disability), The Hague, 1984, pp. 152–153.

a) In this chart the benefit entitlements and conditions in the case of unemployment apply equally to the unemployment component in the case of disability; under standpoint 1 the cost of benefits associated with the unemployment element (with an age-related benefit rate) would be financed out of employment disability insurance contributions.

The benefit entitlements in the case of unemployment in this chart refer only to employees who satisfy the stipulated benefit conditions; school-leavers and those re-entering the labour market (Standpoint 1) are subject to different regulations, as the SER report makes clear.

b) FNV: Federation of Netherlands Trade Unions

c) CNV: Netherlands Federation of Christian Trade Unions d) MHP: Association of Medium-Level and Senior Personnel

e) By contrast some of those supporting standpoint 4 favour an earnings-related unemployment benefit of limited duration, in line with the Government's proposals in its request for advice.

f) In contrast some of those supporting standpoint 5 favour an earnings-related benefit for the medical component of employment disability, of unlimited duration.

The standpoint adopted by the Equal Rights Council is based around the central aim of individual financial independence. Social security should enable each adult to lead an independent existence and to be financially independent from other persons. The benefit period and level should in principle be independent from family income and the marital status chosen. The Equal Rights Council rejects supplements for partners without (sufficient) separate income, since this would constitute an implicit levy on paid employment by women. This would then cut across the objective of individual financial independence. The Equal Rights Council fully endorses the individualization of the loss of earnings phase as proposed by the Government. Like the SER, it argues for an extension of the interim phase suggested in the request for advice. In order to get away from household supplements it proposes a cohort by cohort phasing out of this entitlement, so that it would be only temporary in nature. With respect to the possible individualization of national assistance the Equal Rights Council found itself divided. Some members support the introduction of an individualized entry or re-entry regulation under the Government Unemployment Assistance Regulations (RWW). Other members of the Council are unable to endorse this line, on the grounds that the funds required for such a provision might lead to an unacceptable reduction in other benefits. Major categories of benefit claimants would as a result end up below the national minimum, and even more people would be obliged to give up their economic independence. These members of the Council also fear that other elements of equal rights policy could be endangered as the result of the increase in RWW expenditure.

The three major political parties have also put forward proposals concerning the benefit conditions, period and level in a new system of employment disability and unemployment provision. The various proposals represent variants on the SER and Equal Rights Council standpoints outlined above rather than fundamentally different views, and so will not be explored here; of more relevance for the purposes of this report are the basic assumptions advanced by the major political parties, which in part amount to an enlargement of the perspective in which any review of the system should be conducted. The following more or less unanimous assumptions and premises are discernible in the reactions of the three major political parties:

- a) the Government's support for the safety-net system, and hence for a large measure of involvement by the social partners in administering the social security arrangements, is generally endorsed;
- b) simplification of the system should be a significant feature of the review: the current system has become increasingly incomprehensible both for the public and for those required to administer it, and is conducive to fraud;
- c) the existing inequalities in social security between employees, civil servants and the self-employed should be reduced;
- d) the obstacles to entry into the labour market created by the present system should be eliminated as far as possible;
- e) the review of the system should take greater account of anticipated developments in the field of part-time work and shorter working hours;
- f) with respect to individualization, the social security system should not get too far ahead of developments in the labour market: protection of the basic subsistence level for single breadwinners makes it essential for household economic means to be taken into account.

Differences between the respective premises also emerge from the reactions of the political parties. Key issues in this respect include the extent to which special arrangements should be made for the genuinely needy and the extent to which public expenditure should be reduced. The unanimity between the parties' points of departure does not, of course, rule out the possibility that other differences of view could emerge as these stances were elaborated into specific proposals for change.

This survey of major reactions to the Government's plans for modifying the system would not be complete without referring to two recent studies that

have attracted considerable attention in the public debate. These are *Om een werkbare toekomst* (Towards a Workable Future), produced by some members of the Labour Party<sup>26</sup> and *Grenzen aan de sociale zekerheid* (Limits to Social Security) produced by the Liberal party research institute<sup>27</sup>.

Both studies recommend that compulsory insurance against loss of earnings should be confined to the national minimum. Insurance against loss of earnings above the minimum level would be primarily a matter for individual responsibility and the social partners. The fact that differences in risk coverage and contribution levels will arise as a result between companies and industries is taken by the authors of the second report as desirable with a view to promoting the required dynamism of the labour market. The authors of the first report, by contrast, would counter excessive inequalities by drawing up a statutory framework for supplementary insurance. Differentiation in the non-minimum sphere would also create the risk of possible losses of accumulated social security entitlements upon change of job – similar to the problems already existing in the company pensions sphere, – which could reduce labour market mobility; for this reason statutory provision should be made enabling rights to be transferred upon change of job.

Both studies come down in favour of individualization but at the same time reach the conclusion that this would only be possible up to a certain level. This conclusion emerges from an examination of the systems they propose. In the case of 'Towards a Workable Future', the main elements of the system are as follows:

- a) a general benefit to guarantee a minimum level of security, to be funded out of general revenue;
- b) all persons aged 18 and over would be entitled to this provision who:
  - were incapable of independently providing for their own basic needs;
  - belong to categories exempted by law from providing for their own means, either because they have reached a certain age or perform certain tasks, or because they are involuntarily unemployed;
- c) the latter group (i.e. the involuntarily unemployed) would be required actively to seek employment and to undergo re-training and transition training;
- d) the basic benefit level would be 50 per cent of the net minimum wage; single householders would receive 70 per cent;
- e) the tax unit would be the household, with allowance being made for the number of incomes and the number of persons per household; no distinction would be drawn between a married and a co-habiting couple.

In these proposals, the household is eliminated as far as possible as the benefit unit in the field of social security, except where the higher benefits for single householders are concerned. A consequence of the proposed system is that a benefit claimant's partner would be obliged to register for employment unless he or she fell into a category exempted by law. No account would be taken of the partner's income in deciding entitlement to the basic benefit. This individualization concept is not, however, extended to the taxation field, where household ability to pay is taken as the starting point. In order to prevent excessively steep marginal rates the possibility is raised of including basic benefit in the tax base where there is more than one income per household unit. In this way indirect account would still be taken of the partner's income.

Similarly the report 'Limits to Social Security' concludes that comprehensive individualization would be difficult to bring in for the present. For persons aged 18 to 65 it proposes a General Loss of Earnings Insurance Act providing entitlement to benefits in the event of sickness, employment disability, disablement and involuntary unemployment. The level of benefit would be the same for everyone, irrespective of the cause of loss of earnings. In principle this benefit would be sufficient for a single householder and completely individualized, i.e. independent of household composition and any other incomes brought in in the household. As long as full sexual equality has not been fully established within the labour market, however, this proposal is regarded as

too costly. In its place a basic benefit is proposed equal to 50 per cent of the national minimum for a couple. Single householders would qualify for a 20 per cent supplement and lone parent families for a 40 per cent loading. As seen by the authors of the report, the individualization idea would mean that a benefit claimant whose partner lacked an entitlement to benefit would receive a supplement of 50 per cent irrespective of the partner's income. Once again, however, this is regarded as unfeasible in practice given the low rate of female participation in the labour market. The extent to which the supplement would have to be withdrawn in relation to the partner's income is not specified.

In this way both studies in fact reach the conclusion that the individualization of social security will only be feasible once the labour market has been individualized.

In 'Towards a Workable Future' a concrete proposal is made to this end: the introduction of a 25-hour working week within a period of ten years.

The problem of individualizing state pensions (AOW) is essentially the same as that outlined above in relation to loss of earnings arrangements. In principle there is general support for pensions that would be sufficient for a single householder and independent of the composition of a household and any earnings by other members of the household. In contrast to other loss of earnings schemes, AOW pensions are not earnings-related. Once again there would be the problem of cost and the much lower number of women in paid employment. In view of the similarity between this problem and that of the individualization of social security, it will suffice to refer to the conflicting reports submitted on the subject by the SER and the Equal Rights Council<sup>28</sup>.

Both the Equal Rights Council and the SER take the view that unpaid employment by benefit recipients can never offer a permanent alternative to paid employment<sup>29</sup>. The SER regards working without loss of benefit as a temporary palliative that can only be justified (especially on social grounds) on account of the high level of long-term unemployment. A major objection expressed by the Equal Rights Council is the fact that working without loss of benefit could lead to the displacement of women from both paid and unpaid activities. Since the Benefit Claimants (Unpaid Work) Act is primarily designed for benefit recipients, the Equal Rights Council fears that an – in its eyes unjustified – distinction will be drawn between those seeking unpaid work while drawing benefit and those seeking unpaid work without benefit. The latter category consists primarily of women.

### 2.2.3 *Final considerations*

Government policy would appear to be primarily concerned with two objectives: adjustment of the system of social security in the Netherlands in line with the third EC guideline and cutting back public expenditure on social security by scaling down benefits. The impact of social security on the economic structure is viewed by the Government mainly in terms of its macro-economic effects, in the sense that the scale of public spending – of which expenditure on social security forms a major part – is seen as suppressing the level of investment and hence economic growth and employment. Under this approach high priority needs to be attached to reducing the macro-economic burden of taxes and national insurance contributions.

By way of logical extension, the Government has been exploring how the cuts can be spread as fairly as possible over the population groups concerned. This has led to a number of structural reforms to the system. These have taken into account the third EC guideline and made special provision to exempt older, long-term unemployed persons from asset testing.

On the basis of the foregoing analysis, however, the Council has reached the conclusion that the impact of social security on the operation of the economy extends beyond the macro-economic effects of the size of the social security bill. The outlook for employment is affected not just by the level of taxes and

national insurance contributions but also by the distribution of that burden between labour-intensive and capital-intensive industries. The Council also considers that the operation of the labour market could be substantially improved by adjustments in the structure of benefits and levies. The need for such improvement is particularly great in view of anticipated developments in the labour market such as the growth of the informal economy given unchanged official policies, the increasing interest in part-time work and the problems that could arise if a general reduction in working hours were to gather pace. These considerations lead the Council to the view that the social security system needs to be more radically reviewed than the Government has so far proposed.

Support for this view is also to be found in the reactions of the political parties referred to earlier. These called especially for changes in the system to improve the operation of the labour market, since the latter would strengthen the economy and broaden the base for social security while at the same time cutting back the need for it.

As was seen in section 2.1.4, present policies in relation to unpaid work by benefit recipients and a general reduction in working hours are certainly not designed to optimize the operation of the labour market. This report goes on to show how the dynamism of the labour market could be improved and the demand for labour increased by means of a package of adjustments in the field of primary incomes and income transfers.

From the debate on equal rights for men and women it is evident that as long as the labour market is not individualized there will be only limited scope for making benefits independent of marital and familial status and of any other household earnings. This creates a dilemma: complete individualization is not feasible under the present circumstances, and yet at the same time benefits linked to the economic means of a household discourage entry into the labour market by the non-working partner. A number of modifications are proposed below that could ease (although certainly not eliminate) this dilemma.

### 2.3 Two established alternatives

For some time now two radical alternatives have been attracting attention in the literature and the public debate which, in the light of the case for reforming the system in section 2.1, would certainly have attractive features. These are the idea of a negative income tax and a basic income.

The concept of a *negative income tax* was first proposed at the end of the 1950s. The aim of the scheme would be to overcome the demotivating and unintelligible muddle that is the present system of social security by means of a universal earnings-related cash benefit. This would amount to a social security safety net. The working of such a system was examined in detail in an earlier report by the Council<sup>30</sup>. The system is illustrated in the table below.

**Table 2.12 Relationship between primary income, income tax and net income after tax given a basic credit of 6000 guilders per annum and a tax rate on personal income of 30% (in guilders)**

Primary annual income	Income tax	Net income after tax
0	-6,000	6,000
10,000	-3,000	13,000
20,000	0	20,000 (turning point)
30,000	+3,000	27,000
40,000	+6,000	34,000

Source: WRR

As primary income increases, a decreasing net tax credit is received up to a so-called turning point, after which an increasing net amount of tax is paid. The basic amount indicates the maximum amount payable in the form of negative income tax in the absence of any primary income. Using proportional

rates, an extremely simple arrangement of social security benefits and their funding can be devised in this way, with the turning point being equal to the average primary income per resident. Superimposed on this system, income tax would of course continue to be levied to finance other forms of public expenditure.

When it comes to the practical implementation of a negative income tax, advance payments would be unavoidable since personal income would not be known in advance. Upon expiry of a certain period (e.g. one year) a settlement would then be made based on the assessed level of individual income, when it would be decided how much tax (if any) was payable or whether a cash payment was due. Negative income schemes are often based on a basic amount somewhere below what is accepted as the national minimum in the Netherlands. Negative income tax would not, therefore, amount to a fundamental break in the link between employment and income, but that link would be weakened since there would be less compulsion to work (at least in comparison with the hypothetical situation in which there were no income transfers whatever). This effect becomes greater the more that the basic amount approaches the national minimum. A negative income tax would also mean that the social partners were no longer involved in social security – which for the Netherlands would represent a radical break with tradition. As long as the basic amount were below the national minimum, it would need to be supplemented either by insurance or by national assistance.

Implementation of a system of negative income tax could be significantly simplified by transferring the basic amount in the form of monthly credits to the bank account of every adult resident. If ordinary income tax were then to be devised in such a way that the majority of the population fell under proportional rates, most taxes could take place at source. One important change, however, would be the need for a much greater flow of funds from the public sector in order to arrive at the same net result, since for most income earners the basic amount would have to be paid first before being reclaimed through taxes.

Given its impact on economic activity, this rise in the level of public expenditure could be of critical importance.

On the payment side a negative income tax administered in this way would shade over into a *basic income*. With a negative income tax, the tax base is by definition confined to primary income, whereas with a system of basic incomes the entire taxation field could be tapped. A system of basic incomes is readily implemented and simple to comprehend, especially if basic income is paid to individuals and not to household units.

The advantages of an individualized basic income set at the national minimum level have received endorsement from various quarters recently<sup>31</sup>. Its simplicity is regarded as one of the main advantages of such a system. A basic income could also act as a stimulus for an improved division between paid and unpaid, and unpleasant and pleasant work. Proponents of the system also assume that the labour market will be unable to generate sufficient full-time jobs in the future to provide everyone with an earned income equal to or above the subsistence level. Many part-time jobs, moreover, do not pay enough to support an individual, so that supplements would still be required to bring people up to the subsistence level. For this reason, those who support this approach see a need for the link between employment and income up to the subsistence level to be formally broken, as would indeed be the case if a basic income were to be introduced. Pay would in these circumstances to a large extent lose its function as an allocative instrument in the labour market. Instead of exploring ways to increase employment and the flexibility of the labour market, the allocative function of the market economy would be eliminated altogether. It is, however, a debateable point whether a basic income equal to the national minimum and paid on such a comprehensive scale could in fact be introduced in practice without excessive disruption to the market economy. If an unconditional basic income were to be set at the comparatively high level of the Dutch national minimum, serious account would have to be

taken of the possible disruption of the labour market as an allocative instrument. The precise level at which a basic income would act in this way is impossible to determine in advance; the exact importance of the financial incentive for people seeking work is not known precisely enough for categorical judgements to be made.

The effect on the supply of labour of a high basic income can only be established with certainty by trying it out. In view of the interests and risks at stake, however, it would not really be feasible to conduct a social experiment along these lines. More feasible would be the gradual introduction of a low basic income, for example of five hundred guilders a year. The basic income would then remain below the national minimum for a long time, thereby affording the possibility of timely adjustment if disruption of the labour market began to reach any sort of scale. Experience would, in other words, indicate how high the basic income could be set before it seriously affected the labour market. A basic income at national minimum level should not be ruled out in advance as a structural impossibility but should instead be viewed as an option the disruptive effect on the labour market of which is unknown.

By de-coupling employment and income up to the national minimum, this option would also pave the way for a radical change in industrial relations. The role of the social partners in social security matters would be particularly reduced, while the ultimate responsibility for the substance of social security would reside exclusively with the central government.

Given all the considerations at stake it would be unrealistic in the Dutch circumstances to spell out the way in which the present system of income transfers could be replaced by a negative income tax or a basic income. As will be seen, however, this does not mean that these alternatives lack any usable elements.

## Notes

<sup>1</sup> Financiële nota sociale zekerheid 1985 (Social Security Financial Report 1985); Proceedings of the Lower House, 1984-1985 session, 18612, nos. 1-2, p. 16.

<sup>2</sup> Socio-Economic Council, *Advies hoofdlijnen gewijzigd stelsel van sociale zekerheid bij werkloosheid en arbeidsongeschiktheid* (Report on the Main Lines of a Modified Social Security System for Unemployment and Employment Disability), The Hague, 1984, p. 31.

<sup>3</sup> E.H. Bax, 'Macro-determinanten van arbeidsongeschiktheid' (Macro-economic Determinants of Employment Disability), *Economisch Statistische Berichten*, 23 January 1985, vol. 70, no. 3490, pp. 81-89.

<sup>4</sup> *Berekend beleid* (Calculated Policy), by Hans van Fulpen, Floor van Herwaarden, Evelien Hoojmans et al., *Sociale en Culturele Studies* no. 5, Social and Cultural Planning Bureau, The Hague, Staatsuitgeverij, 1985, pp. 153-154.

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<sup>5</sup> Central Planning Office, *Vooruitberekening van het trendmatig arbeidsaanbod tussen 1980-2010* (Projection of the Secular Growth in the Labour Supply 1980-2010); The Hague, 1983.

Social Insurance Council, *Voorwaardelijke vooruitberekeningen van het aantal arbeidsongeschikten tot 2030* (Provisional Projections of the Number of Disabled Persons up to 2030); Zoetermeer, 1984.

<sup>6</sup> Bureau voor Strategisch Marktonderzoek, *Tendrapport volkshuisvesting 1982* (Housing Trends Report 1982); Delft, 1983, p. 51.

<sup>7</sup> Herziening van het stelsel van sociale zekerheid (Review of the Social Security System); Proceedings of the Lower House, 1981-1982 session, 17475, nos. 1-2.

<sup>8</sup> Inkomensontwikkeling en -verdeling (Income Trends and Distribution); Proceedings of the Lower House, 1983-1984 session, 18189, nos. 1-2, p. 17.

<sup>9</sup> Ministry of Social Security and Employment, *Allocatiefunctie van inkomensverschillen* (Allocative function of income differentials), The Hague, 1984, p. 44.

<sup>10</sup> Inkomensbeleid 1985 (Policy in Incomes 1985); Proceedings of the Lower House, 1984-1985 session, 18611, nos. 1, 2 and 5.

<sup>11</sup> *Berekend beleid*, op. cit., pp. 86-102.

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<sup>12</sup> Socio-Economic Council, op. cit., pp. 32-34.

<sup>13</sup> H.G. de Gier, 'Sociale zekerheid en maatschappelijke verandering' (Social Security and Social Change); *Sociaal Maandblad Arbeid*, February 1985, vol. 40 no. 2, pp. 109-118.

<sup>14</sup> Equal Rights Council, *Sociale zekerheid en emancipatie; advies over de herziening van het stelsel van sociale zekerheid* (Social Security and Equal Rights: Advisory Report on the Review of the Social Security System); The Hague, 1984, pp. 9–15, p. 22.

<sup>15</sup> *Ibid.*

Equal Rights Council, *Gelijke behandeling in de AOW* (Equal Treatment for General Old Age Pensions); The Hague, 1984.

<sup>16</sup> Equal Rights Council, *Sociale zekerheid en emancipatie*, op. cit., p. 29.

<sup>17</sup> Henry J. Aaron, *Economic Effects of Social Security*; Washington, The Brookings Institution, 1982. S. Danziger, R. Haveman, R. Plotnick, 'How income transfer programs affect work, savings and the income distribution: a critical review'; *Journal of Economic Literature*, September 1981, Volume XIX, pp. 975–1028.

<sup>18</sup> Federation of Industrial Insurance Boards, *Deeltijdarbeid en arbeidstijdverkorting; juridische aspecten in het kader van de ZW, WAO, AAW en WW* (Part-time Work and a Reduction in Working Hours: Legal Aspects in Relation to the Sickness Benefits Act, Disablement Insurance Act, General Disablement Benefit Act and the Unemployment Insurance Act); Amsterdam, 1984.

<sup>19</sup> Herziening van het stelsel van sociale zekerheid, op cit.

<sup>20</sup> Directive of the Council of the European Communities of 19 December 1978 concerning the progressive implementation of the principle of equal treatment for men and women in matters of social security; *Journal of the European Communities*, 10 January 1979, no. L 6/24.

<sup>21</sup> *Berekend beleid*, op. cit., pp. 152–170.

<sup>22</sup> Nederlandse Staatscourant (Government Gazette), 9 April 1985, no. 68, pp. 1–2.

<sup>23</sup> Amendment of the General Old Age Pensions Act, the General Widows and Orphans Benefits Act, the General Family Allowances Act, the Exceptional Medical Expenses (Compensation) Act and the General Disablement Benefits Act (consisting of introduction of equal treatment for men and women under the General Old Age Pensions Act and adjustment of the remaining forms of national insurance); *Proceedings of the Lower House*, 1983–1984 session, 18515, nos. 1–3 and 1984 1985 session, 18515, nos. 15 and 16.

<sup>24</sup> Equal Rights Council, *Gelijke behandeling in de AOW*, op. cit.

<sup>25</sup> Equal Rights Council, *Sociale zekerheid en emancipatie*, op. cit. Socio-Economic Council, op. cit.

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<sup>26</sup> J.A. van Kemenade, J.M.M. Ritzen, M.A.M. Wöltgens, *Om een werkbaar toekomst* (Towards a Workable Future); The Hague, 1984.

<sup>27</sup> H.F. Heijmans M. Fruitema K. Groenveld, et al., *Grenzen aan de sociale zekerheid* (Limits to Social Security), Prof. mr. B.M. Teldersstichting, Monograph 52, The Hague, 1984.

<sup>28</sup> Equal Rights Council, *Gelijke behandeling in de AOW*, op. cit.

<sup>29</sup> Equal Rights Council, *Advies Wet Onbeloonde Arbeid Uitkeringsgerechtigden* (Advisory Report on Benefit Claimants (Unpaid Work) Act); The Hague, 1984. Socio-Economic Council, *Advies Wet Onbeloonde Arbeid Uitkeringsgerechtigden* (Advisory Report on Benefit Claimants (Unpaid Work) Act); The Hague, 1984.

<sup>30</sup> WRR, *Beleidsgerichte toekomstverkenning, deel 2: Een verruiming van perspectief* (A Policy-Oriented Survey of the Future, part 2: Broadening the Perspective); Reports to the Government, no. 25. The Hague, Staatsuitgeverij, 1983, pp. 101–104.

<sup>31</sup> Peter Ashby, *Social Security after Beveridge – What next?* London, Bedford Square Press/NCVO, 1984.

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### 3. MAIN LINES OF A NEW SYSTEM

#### 3.1 Introduction

In the light of the considerations and problems described in chapter 2, the Council has formulated the main lines of a new system consisting of four elements.

1. A *partial basic income* (PBI), to which all persons legitimately resident in the Netherlands and all persons now coming under the social security provisions would be entitled. The PBI would be fully individualized and would be equal to the difference between the national minimum for a couple and that for a single householder (at 1 January 1985 a little under 450 guilders per month). PBI would be claimable without any obligation to register formally for employment.  
The introduction of a PBI would be coupled with the abolition of the legal minimum wage. The elderly, widows, persons handicapped at an early age and the permanently disabled would receive a higher-rate PBI (comparable with the present old age and widows' pensions and disablement benefits), and children would receive a lower PBI (comparable to the present child benefit). The way in which this scheme would be financed and administered is examined below.
2. *General loss of earnings insurance* (GLI) for all employed persons, providing cover against loss of earnings from sickness, employment disability and unemployment in the form of a supplement topping PBI up to the national minimum for a single householder. This form of insurance would be based on the benefit principle and financed by means of employees' and employers' contributions. The benefit rate would amount to 100 per cent of the insured element of earnings. The duration of the insurance could be set at half the number of years of employment, for a maximum of (say) six years.
3. *National assistance* (NA), as a residual provision of compulsory social security, funded out of taxation and corresponding in broad terms with the present National Assistance Act. NA would be subject to a household means test on income and assets, although the latter would be relaxed by setting the threshold at a considerably higher level.
4. *Voluntary loss of earnings insurance* (VLI) which could be taken out by any individual to insure against loss of earnings above the national minimum. This would not take the form of full-scale privatization but would be devised in such a way as to draw the social partners into its administration.

#### 3.2 Case for and nature of the new system

The various elements of the new system are discussed below, with further background reasons being provided in section 3.3.

##### *Partial basic income (PBI)*

A partial basic income would form part of a future system of social security. As discussed later, this radical change is required with a view to loosening the link between paid employment and social security, the reduction of labour costs, improving the operation of the labour market and simplifying the administration of social security in the case of unemployment, sickness and disability.

The *group of persons entitled* to a PBI would consist of all those legitimately resident in the Netherlands and all those currently coming under social insurance. Most forms of national insurance benefits are at present 'exportable', meaning that claimants may reside abroad without loss of entitlement. In so

far as national insurance benefits are currently exportable those entitled to them would also be permitted to export their PBI. As discussed later, the introduction of a PBI would be coupled with a reduction in gross wages and gross social security benefits. Dutch residents working abroad would escape these effects, thus producing an argument in favour of excluding from PBI residents with earnings from employment on which they do not pay taxes in the Netherlands.

For all persons aged 18 and over the *level* of the PBI would be set at *the difference between the national minimum for a couple and that for a single householder*. On the basis of national assistance rates as at 1 January 1985, the PBI would amount to 30 per cent of the rate for a couple, or N.Fl. 441.40 per month; for the purposes of this report this may be rounded off to N.Fl. 450 per month. This level has been selected for the PBI since it means that, in the case of unemployment, sickness and temporary employment disability benefits, an elegant solution can be found to the conflict between the objective of individualization and the ability-to-pay or material equality principle. As will be seen, this solution would also mean that given such benefits no household supplements would have to be paid to partners without income of their own.

The partial basic income would have the additional important features:

- a. official registration for employment would not be a precondition for entitlement;
- b. the PBI would be below the individual national minimum, so that people would have to seek employment in order to supplement their income. The link between employment and income would not, therefore, be completely broken, which would be of major importance for the effective operation of the labour market;
- c. entitlement to PBI would be irrespective of any other earnings on the part of the recipient;
- d. entitlement would be individualized, i.e. the level of a person's PBI would be unaffected by the composition of his or her household or any earnings of other members of that household.

Persons aged under 18 would qualify for a *lower-rate PBI* equal to the present level of child benefit. Various other categories would receive *higher-rate PBI*. Persons aged over 65, widows and orphans would receive a loading taking them up to the present levels of the state pension (AOW) and widows/orphans benefits (AWW). An increase up to the level of existing disablement benefits would apply to incapacitated persons of whom it was clear that they would never be able to take up full-time or part-time employment, including those handicapped from youth. Other disabled persons would come under the general loss of earnings insurance arrangements (see below). The higher-rate PBI payable to the elderly and the incapacitated would not be individualized but would be in line with the present payment arrangements for state pensions and disablement benefit. The standardization of the two benefit systems would be to the advantage of the new system.

With the growing incidence of two-income families the need for a higher-rate PBI for widows will increasingly lose much of its force. The thinking behind the present regulation – namely that the married man is always the breadwinner – looks set increasingly to lose touch with reality. Reappraisal of the basis of entitlement will also be made necessary by the emergence of other durable types of relationship apart from marriage. The signs are that there will be an increasing requirement for greater differentiation in life insurance. One way of doing so would be significantly to reduce public provision for survivors and to make life insurance an increasingly private matter, with 'tailor-made' provisions. The government could promote this by tax measures (e.g. making life insurance premiums taxdeductible).

Ensuring that the introduction of a PBI in fact achieved the intended effect would depend to a large extent on the method of *financing*. This would take place as follows (a fuller description is provided in section 3.3). For wage and salary earners gross wages would be reduced in such a way that the PBI

plus the new net wage was equal to the old net wage. The amount by which the gross wage would need to be reduced will henceforth be referred to as gross PBI. At the same time that gross wages were reduced, the government would introduce new taxes on a scale sufficient to cover the total amount of gross PBI; under the scheme the government would be required to pay out net PBIs to each wage-earner, with no reduction in the remaining body of public expenditure. To help ensure that relative labour costs were reduced as intended, a tax base other than wages and salaries would need to be selected. To this end there could be a shift away from wages and salaries to other taxes such as excise, VAT, corporation tax, import duties, motor vehicle tax, wealth tax, or extra taxes on polluting activities and scarce sources of energy and raw materials. Apart from increasing these existing taxes, consideration could be given to bringing in a new form of tax on value added extending to exports. This new tax would then cover a broader base than the present VAT tax base, because VAT on exports of goods and services is refunded. If the EC were in the future to evolve into a genuine common market, this would also involve an extension of the VAT tax base. Although there are significant differences between these various kinds of taxes, they have in common the fact that labour costs would not be increased.

If the PBI were to be paid out by the government to wage and salary earners this would result in a rise in public expenditure since it would replace part of the income now received direct from employers by wage and salary earners. Instead, it is proposed that PBI should be payable by employers, who could then offset these payments against payments due to the government (e.g. pay-as-you-earn deductions and VAT). As will be shown later, this method of PBI payment to wage and salary earners would not result in any increase in the level of public spending. In the case of the selfemployed PBI could in principle be paid the same way.

Like wages and salaries, benefits too could be reduced by the gross PBI (benefit recipients would also receive a PBI). The burden of national insurance contributions would decline, while the tax burden would increase. The net effect would be a relative reduction in labour costs since national insurance bears on the factor of labour, whereas (as we have seen) the PBI would be financed in such a way as to spread taxation away from employment. This effect would be at its most marked in those cases where existing transfers are replaced by a lower or higher-rate PBI because national insurance contributions are totally replaced by taxation. This would apply to family allowances (AKW), general old age pensions (AOW), widows and orphans benefits (AWW) and, up to a certain point, disablement benefits (AAW). These changes would neither increase nor decrease the burden of taxes and social security contributions, but would alter its distribution.

In the case of all other claimants – mainly partners without income – the PBI would again be funded by the taxes referred to earlier. Their PBIs would be paid by the government, thereby increasing the level of public expenditure. In principle, it would also be possible for the PBI payable to partners without an income to be paid out by enterprises in the same way as for wage and salary earners. In these circumstances the total level of public spending would not be increased since the money would not first have to be deposited in a government account before being disbursed to the PBI claimant in question. The enterprises responsible for making payment would, however, have to be advised of peoples' personal circumstances. This would entail such major administrative drawbacks that this method of payment to partners without income may be rejected.

Various bodies would have to be drawn into the *administration* of the PBI regulations. Where payment is made by enterprises, the tax department would have to be involved to some extent – if only because some enterprises could end up paying out more in PBI than they were liable to pay in tax and would need to be reimbursed.

The payment of PBI to benefit recipients could be handled by the responsible benefit agency. Some forms of social insurance are 'exportable' and in these cases it would also be permissible for the PBI to be exported. Again, this

could best be supervised by the benefit agency in question, which could then apply to the State for reimbursement for the PBIs paid out. For the same reason the administration of lower and higher-rate PBI could best be entrusted to the agencies responsible for administering the benefits being converted into these forms of PBI (i.e. family allowances, general old age pensions, widows and orphans benefits and, in part, disablement benefits). Once a standardization of the benefit structure of the various kinds of higher-rate PBI had been achieved, it would be possible to simplify the administrative machinery. Once again, sums paid out could be reclaimed from the State.

For the rest, payment could be made the responsibility of the tax department or a municipal agency. One possibility in the latter case would be the Municipal Social Services Agency (GSD), which would have the further advantage that national assistance benefits and PBI would remain in one and the same hands. Here too the amounts paid out could subsequently be reclaimed from the State.

This method of administration would have the major advantage for both wage and salary earners and benefit claimants of not increasing the number of 'windows'.

The introduction of a PBI would have knock-on effects in various other, related areas of government responsibility. In the first place it would enable the *abolition of the legal minimum wage*. Since the number of incomes per household can vary considerably, the legal minimum wage has ceased to be an effective instrument for ensuring that households receive an income sufficient to cover basic subsistence needs. Because the PBI would establish a uniform income base, the greater pay differentials that could occur upon abolition of the minimum wage would lead to smaller differences in net income (including PBI) than would be the case if it were to be abolished in the present circumstances. The Council, indeed, regards the abolition of the legal minimum wage and the introduction of a PBI as inextricably linked with one another.

Secondly, since the PBI would result in various national insurance contributions being wholly or partially replaced by taxation, *adjustments would be required to paye-as-you-earn and income tax* if the proposed system were not to result in changes in the household distribution of net incomes. In addition, PBI would be paid out to dependent partners, thereby entailing a net shift in income in favour of households with a single breadwinner to the disadvantage of single householders and two-income families. This would also require adjustments in the tax field. Whether these were straightforward or complicated adjustments would depend on whether a simplification of the tax system is in prospect in the near future. In recent times there has been increasing support for a radical simplification of the tax system<sup>1</sup>, e.g. integration of national insurance contributions and wage and income tax, a sharp reduction in tax deductions and the introduction of proportional instead of the present progressive tax rates. Proportional tax rates would considerably simplify the determination of gross PBI and the reduction of gross wages and benefits. Proportional tax rates would also enable any undesired shifts in income between single-income households, two-income households and single householders to be redressed without undue difficulty by means of adjustments in tax thresholds. The introduction of a PBI would be considerably easier under a simplified tax system.

#### *General loss of earnings insurance (GLI)*

General loss of earnings insurance forms a necessary supplement to PBI. GLI would be compulsory *for all employed persons*. Each person officially performing paid work or in self-employment would be insured by law irrespective of the particular nature of their job or the sector in which they were employed. No distinction would be drawn between employees in the private sector, civil servants and the self-employed. The risks insured against would be unemployment, sickness and employment disability. The inclusion of self-employed persons among those insured could produce problems in relation to

unemployment insurance. The self-employed have the ability to influence the nature of this risk and until their business has ceased trading it is difficult to demonstrate that they are in fact unemployed. It may, however, be possible to find a solution to this problem, since it is already necessary under the National Assistance Act to determine whether the self-employed are entitled to national assistance benefits after their business ceases trading or, if their trading results are poor, to benefits under the Special Government Assistance Regulations for the Self-Employed. Because GLI benefits would be pegged to the national minimum the temptation deliberately to accept unemployment would be lower than if the claimable benefit were somehow to be linked to final previous earnings. In implementing the GLI, it might be necessary to impute earned income for the self-employed.

GLI would insure earnings up to a *maximum of the national minimum for an individual*, as a supplement to the PBI. On the basis of present national assistance rates, GLI benefits would therefore amount to no more than 40 per cent of the benefit payable to a couple. In view of the fact that the PBI would be equal to the difference between the national minimum for a couple and that for a single householder, a household with only one breadwinner receiving the maximum GLI benefit would under the new system still receive an income equal to the national minimum for a couple since the sum of the PBIs for the sole breadwinner and his or her partner (in each case, 30 per cent of the national assistance payable to a couple) and the maximum GLI benefit (40 per cent of the national assistance level for a couple) would be equal to the national assistance rate for a couple. By this means, one of the most intractable problems of the present system would be largely eliminated: the dilemma between choosing between minimum benefit at individual or family level.

Allowance would need to be made for the possibility that the length of the working week could display greater diversity in the future, with the result that not all working persons would earn an income equal to at least the gap between the national minimum for a single householder and the PBI. If GLI benefits were to be standardized irrespective of the number of working hours they would automatically supplement the PBI up to the national minimum. The result would be that for some working persons, earned income (plus PBI) would be lower than GLI benefits (plus PBI). If this were to occur it would frustrate the allocative function of pay, for which reason the GLI rate would need to be differentiated. The GLI would, accordingly, have to be based on the benefit principle and thus obtain the character of pure loss of earnings insurance. Below the level of the national minimum, income differentials would be reflected in the level of GLI benefits. Where GLI benefits failed to bring the PBI up to the national minimum this would not necessarily form a case for national assistance since the household might be bringing in more than one income.

For reasons of simplicity and clarity it would be best to set the relationship between the insured final previous earnings from employment and GLI benefits at 100 per cent. At this percentage an increase in the number of GLI benefits could never lead to extra demand for national assistance. If the rate were to be set lower, demand for national assistance could rise sharply among people whose previous earnings were below the level of the maximum insured income.

With reference to the *duration* of GLI, it is proposed that the benefit period be dependent on the claimant's employment history, subject to a certain maximum. With a view to the benefit principle, the obvious course would be to differentiate the benefit period according to the period over which contributions had been paid. The benefit period could, for example, be made equal to half the contribution period, up to a specified maximum. For practical reasons claimants might best be classified into a number of categories.

Upon expiry of GLI benefits, claimants would be obliged to turn to national assistance. To prevent large numbers of unemployed and incapacitated persons from ending up on national assistance, it would be desirable for the

GLI benefit period to be reasonably lengthy. The Council is therefore thinking in terms of a maximum of (for example) six years. In financial terms this would not run into many objections since the GLI relates solely to the difference between the national minimum for a single householder and the PBI. The benefit period for GLI should not be unlimited since otherwise major differences in treatment could arise in the case of longterm unemployment between those with an employment history and those who had never been able to find employment.

In determining the GLI benefit period, the years a person had devoted to looking after and bringing up young children could be wholly or partially counted towards the claimant's employment history. This would then mean that persons who had temporarily withdrawn from the labour market to care for young children would be penalized as little as possible in terms of entitlement to GLI benefit.

In setting a limit to the GLI benefit period in the case of disability, account would have to be taken of the fact that insurance of unlimited duration against industrial accidents is compulsory under International Labour Organization conventions ratified by the Netherlands, as well as under the European code for social security. One means of solving this point would be to allow a person suffering from employment disability first of all to lodge a claim for GLI benefit for the maximum period, irrespective of employment history. In the case of partial employment disability the maximum benefit period would apply for only part of the GLI benefit, in proportion to the degree of disability. Upon expiry of the GLI benefit, incapacitated persons could qualify for a higher-rate PBI. In the event of partial disability there would be a PBI loading in proportion to the degree of disability. Another approach that has been adopted elsewhere would be to draw a distinction between occupational hazards and social risks.

Under the present Unemployment Insurance Act, noninvoluntary unemployment leads to refusal of benefit, while in the case of the Unemployment Provisions Act, the Government Unemployment Assistance Regulations and the National Assistance Act, benefits can be reduced for a certain period. The latter approach is to be preferred for GLI since a number of people would otherwise be immediately thrust back on national assistance in the event of unemployment. The institution of 10-20 per cent cuts in GLI benefit would in all probability have a sufficient deterrent effect.

In working out the details of GLI a solution would also have to be found to various existing problems in relation to the unemployment, sickness and disability regulations. The question arises, for example, of the way in which part-time work, variable working hours and partial unemployment should be handled. In addition a discussion has got under way concerning the question as to whether the concept of 'suitable' employment should be enlarged. Examination of these questions would, however, go beyond the scope of this account of the main lines of an alternative system.

The *financing* of GLI would be done by means of *compulsory national insurance contributions*. A distinction could be drawn between employers' and employees' contributions. In the latter case, it would be difficult to devise any contribution base other than pay or other income from employment. Given the fact that the scheme is concerned with insurance against loss of earnings, the obvious approach would be a premium rate based on earnings. Given the limited duration of GLI benefits and the fact that GLI would be based on the benefit principle, there would need to be an upper earnings limit for contribution purposes. Strictly speaking pay should also be taken as the contribution base for employers' contributions, but other possibilities in which pay was exempted would also be feasible.

In line with the present situation, the GLI arrangements could best be *administered* by the industrial insurance boards and the linked support and advisory bodies such as the Industrial Insurance Administration Office and the Joint Medical Service (run jointly by the employers' organizations and the

trade unions). The integration and substantial standardization of the present unemployment, sickness and employment disability regulations would facilitate a certain simplification of the procedures and the administrative structure. At the same time, however, the streamlining made possible by the introduction of GLI would not be able to prevent the fact that the administration of the scheme would in various respects stay comparatively complex.

#### *National assistance (NA)*

For most working people, the combination of PBI and earned income would bring them up to at least the national minimum. For those not in employment the national minimum would be generally achieved by the PBI and the GLI. This would not, however, always apply, for which reason national assistance would continue to be required as a residual provision. The *people entitled* to national assistance would in broad terms correspond with those at present covered by the National Assistance Act. NA would apply in the first instance to persons who were not earning enough or whose GLI benefit was too low to supplement their PBI up to the level of the national minimum, and who did not have a working partner. Another group of beneficiaries would consist of unemployed persons aged 18 and over without an employment history, such as school-leavers. In addition there are various categories unable to earn an income sufficiently high to take them (together with their PBI) up to the national minimum. This group would include persons responsible for incomplete families and not entitled to GLI benefits or a higher-rate PBI, such as divorced women with small children.

Eligibility for NA would be subject to a *means test*. This would cover earned income, assets and income from assets above a certain limit, GLI benefit and the PBI. The test would be applied to household units. Extending the test to assets (and income from assets) would create difficulties since differences in the way individuals disposed of their income in the past would then count towards the eligibility (or lack thereof) for NA benefits. The result would be that a thrifty wage or salary earner was penalized in relation to his consumption-oriented counterpart. Furthermore, a means test is easier to administer if assets (and income from assets) are as far as possible left out of account, for which reason it is proposed that the asset test of assets be relaxed by setting the threshold considerably above the level currently applied under the National Assistance Act.

Under the system as proposed above the problem of the poverty trap would persist. For those eligible for national assistance support, an increase in their earnings from employment would result in an equal reduction in their NA benefits. The 'implicit tax rate' is therefore 100 per cent, but a lower withdrawal rate would lead to an increase in public expenditure, besides which there would be the danger that the sum of the NA benefit and earnings from employment (in the case of NA recipients) would exceed the earned income of persons on low pay without NA benefits. This effect could be avoided by extending the eligibility for NA to people earning more than the national minimum (although this would result in higher expenditure on national assistance).

In view of the possibility of periods of substantial unemployment, the national minimum as defined for national assistance purposes, and as also used for GLI purposes, would best be linked not to wage increases but to changes in the level of real per capita national income. In doing so, allowance would also have to be made for changes in the international terms of trade. By equating the PBI with the difference between the national minimum for a couple and that for a single householder, any changes in per capita national income automatically work through to all incomes. As a result, pressure on the government budget and the GLI would be eased in times of recession.

The *financing and administration* of national assistance would not differ radically from that of the present National Assistance Act, except that the

structure of the PBI and GLI would ensure that the number of NA claimants was appreciably smaller than at present (see section 3.3). The relaxation of asset-testing would also produce a certain simplification.

#### *Voluntary loss of earnings insurance (VLI)*

The obligation to insure against loss of earnings would cease with GLI. If individuals wished to guarantee their income beyond the level of the national minimum, they could make supplementary arrangements in the form of voluntary loss of earnings insurance (VLI). As a supplement to GLI, VLI would also be based on the benefit principle. VLI premiums paid in addition to GLI contributions would be totally voluntary and hence private, in the same way as (for example) life insurance premiums.

The contractual freedom of the parties to collective agreements means that the limitation of statutory insurance to the national minimum would not prevent supplementary provisions from being incorporated in collective agreements. In certain circumstances there may be major objections to the incorporation of VLI arrangements in collective agreements, but solutions are feasible.

In the first place there would be a problem if there were to be a general requirement for all those coming under a collective agreement with a VLI provision to take out such insurance: in this case the statutory insurance requirement would be replaced by an obligation laid down under individual collective agreements, and the voluntary element would be eroded. This objection could be met by providing for an individual joining right in collective agreements, possibly with a certain degree of compensation for employers' contributions towards the cost of premiums. Those who wished to take out no further coverage than GLI would then be permitted to do so.

Secondly, separate VLI provisions in collective agreements could, as with pensions, result in partial or total loss of VLI cover when an individual changed to another job coming under a different collective agreement. The resultant disincentive to mobility in the labour market could be overcome by making VLI individually based, so that contracts were not job-related but carried on without a break upon change of job. In this case, the VLI provisions in collective agreements would primarily concern the level of employers' contributions.

Thirdly, a system of separate VLI arrangements in individual collective agreements would suffer from the drawback of premium differentiation. Premiums in enterprises or industries with an above-average risk of unemployment, sickness or disability would be subject to above-average premiums, with the danger that proper coverage would be least affordable in precisely those jobs where it was most needed. If it were felt that this threatened to undermine the principle of responsibility for sharing the degree of risk, it would be necessary to impose a certain degree of regulation on the market for VLI. Those organizations offering VLI would have to be subject to a prohibition on setting varying contribution rates in line with differences in the degree of risk as well as an acceptance liability. In this form, VLI would therefore fall well short of the wholesale privatization of supplementary loss of earnings insurance but would also not amount to full collectivization. The proposed regulation of the market would not just safeguard the right to take out individual insurance as desired but also the responsibility for sharing the degree of risk.

The individual right to take out VLI and the fact that the premium would in principle come out of disposable income would, it is true, promote a certain degree of individual financial involvement but need not prevent VLI premiums from being passed on to companies. Passing premiums on to companies under collective agreements would, however, be difficult if employees' views on the desired nature and scale of voluntary cover differed widely; passing premiums on is only really possible in the case of expenditure covering all employees. In these circumstances, any upward pressure on labour costs would therefore be reduced.

Finally there is the danger that people facing low risks wishing to take out voluntary insurance might turn to other, cheaper forms of cover against potential loss of earnings. This risk could be averted or at least reduced by tax arrangements whereby VLI schemes that complied with certain conditions gained an edge in attractiveness. One possibility would be to make annual VLI premiums (possibly up to a certain limit) a tax concession. Where compensation arrangements existed for employers' contributions, an imputed low risk could be used.

The above format for VLI could only be realized in practice given the support of both sides of industry. Whether they would be prepared to do so would depend on various factors. In the first place it would depend on whether they considered it important for the universal requirement for insurance above the national minimum to give way to a greater degree of individual choice. A further factor would be whether the measures to safeguard freedom of individual choice as outlined above and sharing the risk liability would in practice be adequate and administratively feasible. Finally, the cooperation of the social partners will also depend on whether VLI could be set up in such a way as to build without too great a break on their traditional involvement in this area. Apart from the possible incorporation of VLI provisions in collective agreements referred to earlier, it would also be possible for the social partners to be drawn into the administration of the scheme.

Above the national minimum, for example, individuals and community organizations could take over the government's responsibilities. Under this approach, the non-compulsory element of social security could be handled by private insurance companies on the one hand and by bodies run by the social partners (e.g. a 'Voluntary Mutual Social Insurance Association') on the other. In the latter case the linkage between GLI and VLI would be guaranteed and the social partners would be able to oversee the entire PBI-GLI-VLI spectrum. Private insurance companies and organizations run by the social partners offering VLI would both be required to comply with the conditions noted earlier. With a view to efficient administration and a customer-oriented approach, the element of competition that would be brought into the provision of VLI in this way could only be regarded as beneficial.

Finally it would be essential for the VLI benefit to be excluded from the national assistance means test. If not, voluntary cover against loss of earnings lasting longer than GLI would become highly unattractive. If the third EC guideline were to obstruct such an exemption, the Netherlands would have to argue for the guideline to be adjusted. In parallel to the earlier proposals in relation to the testing of assets and income from assets, the exemption of VLI benefits could be subject to a certain maximum, beyond which NA benefits would be cut.

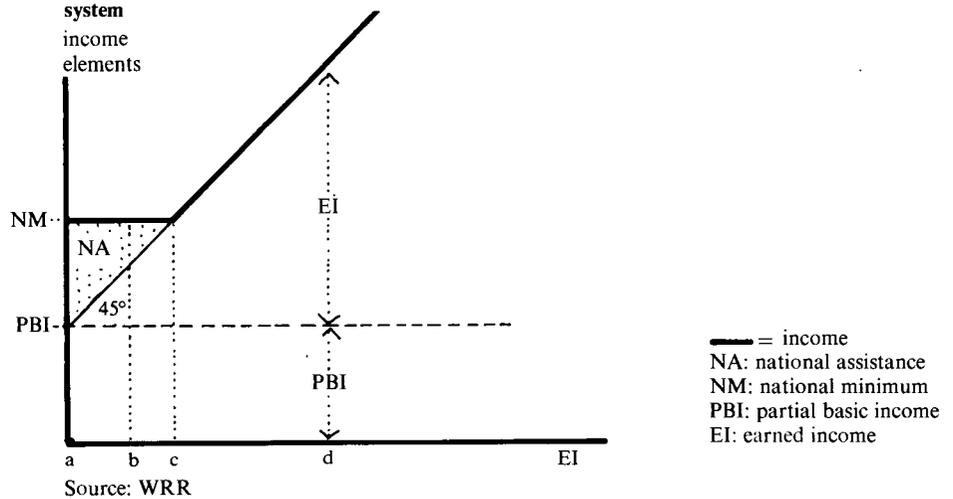
#### *The system in practice*

The way in which this system would work in practice may be illustrated in terms of the examples below for four separate categories of individual wage and salary earners.

In the first place there are those with an income from employment. When the PBI is added this could produce a total disposable income that was either below or above the national minimum. This case is illustrated in Figure 3.1 for a single householder. Assets (and any income from assets) have been disregarded, besides which it has been assumed that there is no entitlement to GLI benefit. Where earned income is insufficient to bridge the gap between the national minimum and PBI, this function would be fulfilled by national assistance.

In the absence of any earned income (situation a) national assistance supplements the PBI up to the level of the national minimum. In situation b earned income is insufficient to bridge the gap between PBI and the national minimum and NA tops the level up. In situation c earned income is just sufficient to bring the individual up to the national minimum, while in situation d

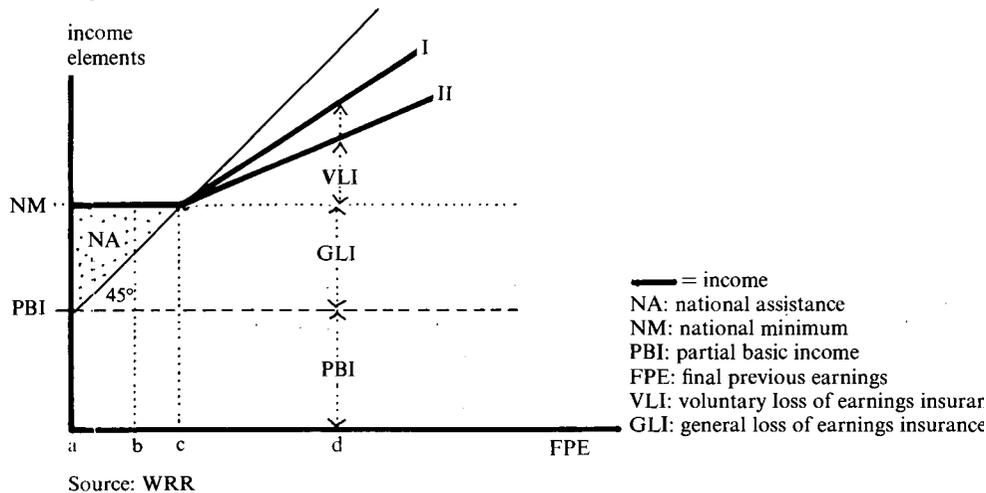
**Figure 3.1** Income elements for wage and salary earners and the self-employed under the new system



earned income plus PBI is high enough to take the individual beyond the national minimum. The pattern for members of a household would be the same, except that for NA purposes, the income of the remaining members of the household would also be taken into account.

A second group consists of persons who have been in work but have lost their job through unemployment, sickness or disability. Such persons would in all cases continue to receive a PBI, besides which they would for a certain period qualify for GLI benefit. If they had taken out voluntary loss of earnings cover they would also receive VLI benefits. This is shown in Figure 3.2. Here again any assets or income from assets have been disregarded and the position shown is that for a single householder.

**Figure 3.2** Income elements of persons drawing GLI and VLI benefits under the new system



For the reasons advanced previously, the benefit rate has been set at 100 per cent of final previous insured earnings. As the figure shows, low GLI benefits are supplemented up to the level of the national minimum out of national assistance. VLI benefits depend on the coverage selected by the insured person, as indicated by lines I and II in Figure 3.2.

A third category consists of persons who (apart from their PBI) depend entirely on VLI benefits. This situation, which may arise when the GLI benefit period has expired, is shown for a single householder in Figure 3.3.

Up to a set maximum, benefits paid under voluntary loss of earnings arrangements are not offset against national assistance. Thereafter, a 100 per cent withdrawal rate applies, so that further insurance becomes unattractive.



giving individuals more direct financial coresponsibility alongside companies and the government. For this reason compulsory social security needs to exist up to the national minimum, while above that level greater room can be created for personal responsibility. This can be done by incorporating a group and an individual element into social security beside the collective element. The latter would find expression in the form of the PBI and NA, the GLI would form a combination of the collective and the group element, and VLI would stress the group and individual element.

The individual right to take out VLI and the fact that the premium would come out of disposable income would serve to promote a sense of individual financial responsibility. The group element would find expression in the possibility for agreements to be reached in collective agreements concerning company contributions towards VLI premiums, in the possibility of drawing the social partners into the administration of the scheme, and in the possibility of tying VLI to certain conditions in consultation with the social partners. At the same time, there would also be a collective element to VLI, in so far as institutions active in the VLI market would be subject to certain conditions and specific tax measures were introduced in order to provide an incentive to take out VLI.

As long as employees hold widely differing ideas about the scale and nature of VLI coverage, it would be difficult for VLI premiums to be passed on to industry under collective agreements. Such arrangements are only properly feasible in relation to expenditure affecting all employees. In this way, as we have seen, the introduction of VLI could also help restrain upward pressure on labour costs.

Enlarging the element of individual choice below the level of the national minimum would not be desirable. Surpluses and shortages are an inherent (if only temporary) feature of any market economy. The same applies to the labour market, and periods of unemployment are the price that has to be paid. Loss of earnings insurance against that risk forms the complement. Persons in work should therefore be obliged to participate in GLI, which guarantees final previous earnings up to the level of the national minimum. The same applies to calamities such as disablement and sickness. Compulsory loss of earnings insurance for working people is therefore intended to provide a certain continuity of income so that people do not have to eat immediately into their assets (if any), draw on the incomes of other members of the household or rely on the community for support.

If it were possible to rely on full employment permanently, there would be much to be said for allowing loss of earnings benefits to run until pensionable age had been reached, but this assumption is unrealistic. Given the existence of structural unemployment it is difficult to justify a permanent income-guarantee distinction being drawn between the long-term unemployed with and without a history of employment. It is for this reason that the Council would propose that the benefit period for GLI be limited, thus giving this form of insurance the character of a gradual transition from income from employment to the general income guarantee provided for all residents in the form of national assistance.

#### *Maintenance of the link between employment and income*

Experience has shown that there can be prolonged periods in which there is not enough employment to go round for everyone wanting to work. As argued in section 2.1.1, this situation will continue to apply into the future. This does not mean that government policies designed to restore full employment are pointless, but that such policies will not always succeed. As a corollary, many of those offering their services in the labour market will, sometimes for long periods, be unable to build up entitlements to social security through employment and the linked payment of national insurance contributions. If a given income guarantee is deemed desirable for all residents, it will not therefore be possible for this to be financed exclusively through the labour market; some people will be forced onto national assistance. Moreover, if the entitle-

ments accrued from employment are of very long duration, a large difference in treatment can arise between individuals with an employment history and those never able to enter into paid employment. If this situation is regarded as undesirable, a remedy can be found by the partial de-coupling of employment and income. As argued below, however, the introduction of a collective income guarantee in the form of a basic income equal to the national minimum would go too far.

In the present economic system the operation of the market occupies an important place in the taking and coordination of economic decisions. One segment of the market economy is the labour market, in which the relationship between employment and income finds expression in a wide range of institutional forms. Although the labour market does not in practice operate flawlessly, it would be risky for the link between employment and income up to the national minimum to be broken completely. To do so would create the risk of an excessive drop in the supply of labour on account of the marked decline in financial incentives, while the incentive for labour mobility might also be lacking. A substantial reduction in the supply of labour would entail the risk that the economic base for financing a basic income equal to the national minimum might contract quickly, besides which a substantial degree of labour mobility is generally essential for a vigorous economy.

The introduction of a partial basic income would take due account of both these considerations. With a PBI set at the level proposed earlier there would remain sufficient financial incentives within the labour market, while at the same time ensuring that the desired collective income guarantees for both those available for paid employment and those dependent on them would not have to be financed through the labour market alone.

#### *Reduction in labour costs*

As discussed in section 3.2, gross wages and benefits would be reduced by an amount known as gross PBI. Since each wage and salary earner and benefit claimant would receive a net PBI and the difference between the sum of all gross and all net PBIs would continue to be required for existing forms of public expenditure, the government would at the same time have to introduce new taxes or other levies equal to the sum of all gross PBIs. The following highly simplified example may serve as illustration. It assumes a proportional rate of taxation and social security contributions of 33.33 per cent, a gross earned income or benefit of N.Fl. 30,000 per annum and a PBI of N.Fl. 6,000 per annum. The amount by which gross wages and gross benefits need to be reduced – i.e. what is known as gross PBI – comes in the example to N.Fl. 9,000. As the wage calculations below show, net income remains the same in the two cases:

<i>before</i> introduction of PBI:	gross wage	N.Fl. 30,000
	tax	– N.Fl. 10,000
	net wage	<u>N.Fl. 20,000</u>
<i>after</i> introduction of PBI:	gross wage	N.Fl. 21,000
	tax	– N.Fl. 7,000
	net wage	<u>N.Fl. 14,000</u>
	PBI	+ N.Fl. 6,000
	net income	<u>N.Fl. 20,000</u>

An important difference between the situations before and after introduction of a PBI is that in relation to the PBI paid to persons in employment, transfers to the government must increase by an average of N.Fl. 6,000 per employee (assuming, that is, that payment of PBI is made by the government). The N.Fl. 10,000 paid to the government before the introduction of PBI will remain required for public services and facilities and other forms of public expenditure. To that must now be added the N.Fl. 6,000 paid to each employee by way of PBI. If, therefore, PBI were to be paid direct by the government, the level of public spending would rise. Under the method of funding and pay-

ment described above, however, a relative decline in labour costs can be achieved while at the same time limiting the rise in public spending and leaving net incomes unchanged. We may now turn to a more detailed examination of the way in which the system would work. First of all, consideration is given as to how shifts in the distribution of net income could be countered and a rise in public spending kept down, after which the reduction in labour costs is examined more closely.

PBI would be assigned to all residents, including those lacking any earnings from employment or not drawing benefits (the latter category consisting chiefly of dependent partners). As outlined briefly in section 3.2, tax adjustments would be required if the existing distribution of income were not to be disturbed. We may confine ourselves here to adjustments necessitated by the universal introduction of a PBI. The nature of these adjustments would depend on the way in which PBI was financed. If gross wages and benefits were to be reduced by the amount of gross PBI, the required adjustment would be concentrated on sole breadwinners: the PBI for the dependent partner would then have to be taxed away from the partner earning the income. The required adjustment could also be spread over all household types, for example by reducing gross wages by  $1\frac{1}{2}$  times the amount of gross PBI. In this case a smaller increase in taxation would be required for sole breadwinners and a certain degree of tax relief would be needed for single householders and two-income families. An important feature of this approach is that labour costs would be reduced even further.

The rise in public spending could be kept down as follows. In the first place arrangements can be made for PBI to be paid not by the government but by enterprises, which could then offset these PBI payments against their tax bill. The result would be a substantial decline in money flows via the public sector. This method of limiting public spending is comparable with the way in which various deductions in the field of income tax are treated in the National Accounts, where they do not appear as a form of public expenditure. As will be seen, this is not just an accounting point. PBI for dependent partners would be paid out by the government which would lead to an increase in public spending. The remaining PBIs, however, would take the place of existing income transfers and therefore not lead to a rise in public expenditure.

In net terms, therefore, the rise in public spending can be kept limited to the sums involved in paying PBI to the dependent partners of employed persons. In approximate terms this would amount to a little under two million people or a sum in the order of 10 billion guilders. Some of this could be funded out of current public expenditure by cutting back other forms of current public expenditure. This would apply especially to the general-purpose investment grants (of which those under the Investment Account Act (WIR) are the most important), since the reduction in capital costs brought about by these subsidies would square uneasily with the general reduction in labour costs being aimed at under a PBI system. This would not entail the wholesale abolition of investment subsidies, since specific purpose grants, aimed for example at promoting technological innovation, would not be at variance with the aim of a general reduction in labour costs. In addition it needs to be borne in mind that the limitation of compulsory loss of earnings insurance to the national minimum level would result in a reduction in public expenditure.

So far no account has been taken of the increase in government expenditure flowing from other elements of the system, such as the extended duration of GLI benefits and the relaxation of the means test on assets for national assistance. In view of the high level of public expenditure at the present time, the best way of introducing the new system might be to phase it in, for example by bringing in PBI and VLI and abolishing the general-purpose investment grants. The resultant increase in employment would initially reduce the level of public spending. While the subsequent introduction of the remaining elements of the system, such as extending the duration of GLI benefit in relation to current unemployment benefit and the relaxation of the means test on assets for national assistance, would lead to an increase in public expenditure, the impact would be felt less acutely than at present.

A relative reduction in labour costs can be achieved by using a levy base other than wages and salaries for raising the taxes necessary to cover the gross PBI. The appropriate kinds of taxes were noted in the outline of PBI in section 3.2. Although there are important differences between these taxes, they have in common the fact that labour costs would not be affected if they were increased.

Because the increase in these taxes would be associated with a reduction in labour costs of the same average magnitude throughout industry, the operation as a whole would not, after allowing for competitive forces, result in any increase in the average price level. This method of financing a PBI would, however, lead to a shift in the corporate cost structure. For labour-intensive firms, the net effect of a reduction in labour costs and an increase in taxes would be favourable, while for labour-extensive firms it would not. Labour-intensive firms would therefore be in a position to lower their prices in relation to the pre-PBI situation, while labour-extensive firms would find their costs pushed up.

This shift in relative prices would affect corporate sales. Depending on the price elasticity of the various goods and services and corporate pricing policy, the sales of various labour-intensive goods and services would increase, while the sales of labour-extensive products could decline. If labour-intensive industries were to create more jobs in response to the increase in sales than were lost in labour-extensive industries because of the decline in sales there, the net result would be a boost in employment.

The proposed method of financing PBI will also induce changes on the input side of the system of production. Where technically feasible, labour-intensive processes could be brought in in response to the decline in labour costs. This would not be a matter of slowing down technological innovation but of channelling it in different directions. Since technological innovation does not depend exclusively on the price relationship between labour and capital, this would not be a matter of slowing it down but of channelling it in different directions. In many cases, the required flexibility of the system of production and the required product quality can only be achieved by using the most modern technologies. The conservation of energy and raw materials and environmental protection also provide important impulses for modern technological innovation. A reduction in labour costs does not therefore mean that technological innovation would come to a halt or that the country would come to lag behind but that technology would be deployed in a more diversified manner.

As noted in section 2.1.1, the potential for periods of structural unemployment forms an important reason for reforming the system of social security. It is therefore relevant to examine the effects that a PBI could have in times of mass unemployment. The relative decline in the price of labour-intensive goods and services will contribute towards a reduction in unemployment; the same applies to changes made on the input side of the production system upon the introduction of a PBI. Under the present circumstances, these mechanisms could bring about a substantial decline in unemployment. Such data as there are on the informal economy suggest the existence of a substantial potential demand for labour-intensive services that have at present priced themselves out of the market. The drop in prices made possible by a PBI could increase the demand for such services and also bring about a shift away from the demand for informal services to a demand for formal services. As a direct consequence there would be a reduction in expenditure on social benefits, which would in turn reinforce the decline in labour costs. In doing so, the downward spiral of high unemployment leading to high labour costs producing still higher unemployment would be overcome, to be replaced by an upward spiral: lower labour costs as the result of the PBI lead to less unemployment and hence to still lower labour costs and a further drop in unemployment.

The PBI is designed as an income floor for all, including benefit claimants such as the unemployed. Their benefits could therefore be reduced by gross PBI in the same way as wages, with the result that national insurance contributions (in the new system: GLI contributions) would be reduced. Once again, this would be to the benefit of labour-intensive firms since social security bears

to a significant extent on the labour factor, while a PBI would be financed in such a way as to exempt labour.

In this respect the self-employed could be treated as sole traders and could offset their PBI against tax liabilities. Where there was a lack of competition, the government would as usual supervise the adjustment of charges and prices to the new situation. In this way self-employment would be encouraged in labour-intensive industries, since a relative decline in prices would be possible along the same lines as that in the company sector. This is an important advantage of a PBI over a system of wage subsidies, of which the self-employed are unable to take advantage.

Given the uncertainties surrounding the assumptions that would have to be made in relation to price elasticities, the substitution of capital for labour, monetary reactions and so on, it would scarcely be possible to quantify the responses in economic behaviour that would be occasioned by a reduction in labour costs. Even the most carefully constructed estimates can prove wide of the mark. Since the introduction of a PBI would be directed particularly towards long-term effects, we have confined ourselves to a description of the mechanisms and the nature of the effects to which it would give rise. The scale of those effects is unknown and could only be determined empirically. Not that this is anything new; policies are consistently so hedged about with uncertainties that the need for adjustment in response to unforeseen side-effects must always be allowed for. In this respect a PBI would form no exception, in either a positive or a negative sense. Whether one would be prepared to accept the uncertainties surrounding the introduction of a PBI would depend on the importance attached to the effects it was designed to achieve.

#### *Discouragement of black-economy activities*

Structurally, labour-intensive activities have been placed in an unfavourable position by the combination of divergent labour-productivity trends in the various industries and comparatively even wage increases. For this reason, blackeconomy activities, or what might also be termed paid informal work, will in all probability remain a permanent feature of the economy. While these pressures on labour-intensive activities may be particularly acute at the present time, they will still remain perceptible if unemployment should begin to decline.

A PBI could help discourage paid informal work and hence check the further marginalization of formal labour-intensive activities. As matters stand, labour costs are subject to upward pressure from the level and structure of taxes and national insurance contribution, thereby depressing the demand for labour-intensive activities. By contrast, the new system would bring about a reduction in gross wages, while the method of funding would permit a relative fall in the price of labour-intensive goods and services, thereby stimulating demand for them. Especially in those cases where the quality of 'officially' produced goods and services is superior to that offered in the black economy, a relative fall in prices may be expected to discourage demand for paid informal work.

Under the present system, the official supply of labour is discouraged by the relatively high marginal tax and national insurance contribution rates and the comparable operation of the poverty trap. The method of financing PBI described above would avoid any additional marginal pressure on earnings from employment, besides which the PBI for persons in employment would be paid out by companies-which could then offset these amounts against their tax liabilities. This settlement of net amounts with the government would reduce the incentive to avoid or evade tax and national insurance liabilities. At issue, therefore, is not an accounting difference but a difference affecting the conduct of enterprises in a positive sense.

Because the poverty trap would be narrowed under a PBI providing a universal income floor, official work would be more likely than at present to lead to incomes above the national minimum level. In addition the PBI would

be set at such a level as to make it unattractive or impossible for many people wholly to supplement their income outside the formal economy.

In comparison with the present situation, this combination of factors would serve to discourage activities in the black economy.

#### *Promotion of labour-market flexibility*

As was seen in section 2.1.5, there will in all probability be an increasing requirement for flexibility in the labour market. The introduction of a GBI would establish an income floor whereby part-time work and less conventional contracts of employment would become more attractive. One effect would be to facilitate a reduction in working hours. This is generally coupled with a proportional cut in wages, but the introduction of a PBI would ensure that the loss in income would be smaller than the cut in wages. As matters stand a person working half days receives an income half that of a person doing the same work full-time. Under the new system both would receive the same PBI, so that although the full-time worker received twice the wages of the half-time worker, the overall difference would be less than 50 per cent. Shorter working hours with the object of job sharing would under a PBI therefore produce a smaller drop in income than at present.

Labour market flexibility would also be encouraged by the abolition of the legal minimum wage with which the introduction of a PBI would be linked. A PBI would establish an income floor, while the proposed method of financing would produce a decline in labour costs, thereby enhancing the growth potential of labour-intensive industries. The present legal minimum wage for adults has been made equal to the level of the national minimum for a couple, thus incorporating an income floor based on the need principle as part of the process of wage determination. This can adversely affect the level of employment in industries where labour costs are a major factor and where, given the price the consumer is prepared to pay, the marginal returns obtained from the engagement of an additional worker on the legal minimum wage do not match up to the costs. The abolition of the legal minimum wage and the associated improvement in wage flexibility could therefore make a positive contribution towards higher employment. Given the potential demand in the field of labour-intensive services, a reduction in labour costs could provide particular growth opportunities in this area.

There are further reasons why it would be desirable to eliminate the need element from wage formation. The legal minimum wage was originally designed for a family with a single breadwinner and several children, the dominant household type at the time. Since then, however, much has changed. The number of single householders has increased sharply – but they too qualify for the legal minimum wage. Nowadays it is also not uncommon for a household to bring in more than one income. The diversity in household types makes it impossible to set a single uniform legal minimum wage. The problem of the 'genuinely needy' is a direct consequence of these shifts, and is accentuated by the tendency towards a reduction in working hours in return for a cut in pay.

Another advantage of a PBI is that it does not draw a distinction between employees and the self-employed. This means that people who become unemployed will have more opportunity to strike out on their own without giving rise to the kind of unfair competition that can occur under the present regulations on unpaid employment without loss of benefits. The stifling influence of the present system on any new initiatives on the part of the unemployed will therefore be reduced, to the benefit of economic growth, and the transition from salaried employment to self-employment would be facilitated. In times such as the present, this enlargement of labour market flexibility is of considerable importance for economic recovery.

#### *Simplification of the structure of social security benefits*

So far no pat solution has been found to the question of choosing the ap-

appropriate benefit unit for national assistance purposes. Switching to individualized benefits and the abandonment of any form of means test would have far-reaching consequences. Among other things, dependent partners would then be able to claim a supplement to the PBI taking them up to the national assistance level for a single householder. In view of the shortage of jobs the requirement to register for employment would in most cases be no more than a formality, but would be a costly exercise. The individualization of NA would also lead to a sharp reduction in financial incentives in the labour market. A couple who were both receiving national assistance payments would be drawing a joint income equal to 1.4 (2 x 0.7) times the net minimum wage. In 1982 this would have amounted to more than the net modal income<sup>3</sup>. While it would be possible to avoid this by reducing NA to 50 per cent of the set benefit level for a couple, this would then come into conflict with the objective of independence for single householders dependent on national assistance. If these consequences of individualizing national assistance are to be avoided, means testing per household unit have to retain a significant role. For reasons provided earlier, a high exemption threshold for assets, income from assets and VLI benefits would be required.

A benefit structure in which no account was taken of household composition and partner's earnings would also create problems in the case of higher-rate PBI, such as the high costs and the fact that single householders would be left at a relative disadvantage.

This dilemma can, however, be solved in relation to GLI by individualizing the benefit, setting the benefit rate at 100 per cent and equating PBI to the difference between the national minimum for a couple and that for a single householder. Except in the fairly exceptional case where previous earnings were insufficient to bring PBI up to the national minimum for a single householder, no supplements to GLI benefits would be required for financially dependent partners since the PBI for the dependent partner supplements PBI plus the breadwinner's individualized GLI benefits up to the national minimum for a couple. While GLI is being received, therefore, the need for a means test is eliminated. This is not the case under the Government's present proposals and, depending on household composition and the earnings from employment of other members of the household, supplements would also be required in the case of loss of earnings insurance and during the interim phase.

If the system of social security is not to be hamstrung by complicated administrative procedures, the need for means testing should be avoided as far as possible. The new system permits this more readily than the existing one. In addition, the lengthy maximum GLI benefit period and the fact that this maximum can be achieved fairly quickly set limits on the need for means testing by eliminating the need for national assistance as far as possible.

## Notes

<sup>1</sup> Flip de Kam and Floor Gerard van Herwaarden, 'Simpeltaks; naar een eenvoudig en doelmatig belasting- en premiestelsel' (Simple tax: towards a simple and efficient tax and contribution structure); *Intermediair*. 26 April 1985, vol 21, no. 17, pp. 1-19.

<sup>2</sup> *Berekend beleid* (Calculated Policy), by Hans van Fulpen, Floor van Herwaarden, Evelien Hooijmans et al., *Sociale en Culturele Studies* no. 5, Social and Cultural Planning Bureau, The Hague, Staatsuitgeverij, 1985, pp. 153-154.

<sup>3</sup> *Inkomensontwikkeling en -verdeling* (Income Trends and Distribution); Proceedings of the Lower House, 1981-1982 session, 17475, nos. 1-2.

## APPENDIX 1

### Major characteristics of the present social security system in the Netherlands

This appendix contains a brief description of the major social security laws and regulations in the Netherlands. The information is based in large part on 'Social Security in the Netherlands', a publication of the Ministry for Social Affairs and Employment, The Hague, 1982. Adjustments have been made for major changes in the system since 1982.

#### *General Old Age Pensions Act (AOW)*

The General Old Age Pensions Act covers the entire population of the Netherlands irrespective of nationality or marital status. Equally, a beneficiary's entitlements are in no way affected by the existence of other pension arrangements.

The general old age provisions are based on a period of 50 years. This means that a person is normally only entitled to draw a full pension after having been insured for 50 years. Compulsory liability to insurance ends at the age of 65, and accordingly commences at the age of 15. A person who has been insured is entitled to an old age pension attaining the age of 65.

The size of the pension is reduced when the full 50 years have not been completed. In the case of single people this amounts to a 2 per cent reduction of the single person's pension for each year they were not insured. For married couples it amounts to 1 per cent for each year one of the partners was not insured.

Pensions are uniform in the sense that they are not related to a person's earnings before retirement. Such variation as there is concerns whether a pension is intended for a single person or for a married couple. The net monthly pension for a single person is equal to 70 per cent of the net statutory minimum wage. For a married person the net pension amounts to 50 per cent of the net statutory minimum wage. If this pension provides for a partner aged under 65, the pension is increased with a supplement depending on the partner's income. If the partner has no income at all, the supplementary pension amounts to 50 per cent of the net statutory minimum wage.

Contributions are assessed and collected by the Tax Department. For this reason the income on which contributions are payable is determined as far as possible in the same manner as the income on which wages and salaries tax or income tax must be paid.

Contributions are levied as a percentage of income. This reflects the principle of solidarity on which old age insurance is based in the Netherlands, in that wealthier members of the community pay more than the poorer ones. At the same time, there is a ceiling for the payment of contributions so that the principle is not taken to extremes.

The system used for financing general old age insurance is that benefits paid in a certain year must be financed out of contributions received during that year, the so-called assessment system. This means that the percentage of income payable as contributions under the Act is determined in such a way that the total level of contributions and State subsidies received during a particular period is sufficient to cover the expenditures made by the Old Age Pensions Fund during that period.

As the old age insurance system covers the entire population of the Netherlands it was not considered to lend itself to administration on an industrial basis along the lines of the social insurance schemes, which apply exclusively to employees. Instead the Act is administered on a centralised basis by the Social Insurance Bank.

### *General Widows and Orphans Benefits Act (AWW)*

The General Widows and Orphans Benefits Act is a form of national insurance. All residents aged 15 or over are insured irrespective of nationality.

The General Widows and Orphans Benefits Act has been set up in the form of risk insurance. This means that the risk of death is only covered as long as the person on whose death the entitlement to benefits is dependent continues to be insured.

Under a system of risk insurance the survivors have a basic right to full benefits in the case of a person who has been insured for only a short period when he or she died.

In order to qualify for a widow's pension upon the death of her husband a woman must a) be a widow and b) be the widow of an insured person. The Government sees no reason for granting benefits to widows who are able to earn their own living. In broad terms, a widow will be entitled to a widow's pension if, at the time of her husband's death, she:

- a. has an unmarried child of her own, or
- b. is certified as incapacitated of work, or
- c. is aged 40 or over.

If a widow ceases to fulfil the first condition the entitlement to a pension lapses unless she has in the meantime become incapacitated of work or turned 35. Entitlement to a pension lapses if a woman ceases to be incapacitated (condition b), unless she has in the meantime turned 40. Finally it should be noted that a widow's pension is granted only until the age of 65, after which widows may receive an old age pension.

Widows who do not qualify for a widow's pension at their husband's death or whose pensions subsequently lapse receive a temporary widow's benefit for a short period in order to help them adjust to their new circumstances. The benefit may be paid over a period ranging from six to nineteen months, depending on the widow's age.

Generally speaking an orphan's pension is payable only to children who have lost both parents and who are under 16. Orphans receiving full-time education continue to receive a pension until they are 27, and disabled orphans until they are 18. The benefits paid under the Act are not fully uniform in that account is taken of whether the deceased left just a widow, a widow with children, or children only. There are two levels of benefits under the Act for widows, a higher pension where the widow is responsible for the maintenance of one or more children aged under 18, and a lower sum for the remaining widow's pensions and temporary widow's benefit. The amount of an orphan's pension depends on the age of the orphan. The net higher widow's pension equals 100 per cent of the net statutory minimum wage, the net lower widow's pension amounts to 70 per cent.

As in the case of the General Old Age Pensions Act, the system used is that benefits paid in a certain period are financed out of contributions received in the same period.

A further similarity with the Old Age Pensions Act is that the funds to meet the cost of the scheme are largely derived from a percentage levy on income. The collection of these contributions has been harmonised with the collection of old age pension contribution as regards both the assessment basis and the categories of persons covered. This enables the contributions due under both Acts to be collected from the insured as a single sum. Finally it may be noted that the maximum level of income on which contributions are payable is the same for both Acts.

The administration of this Act is conducted along the same lines as the old age pensions and is entrusted to the Social Insurance Bank. Contributions are levied and collected by the Government Tax Department.

### *General Family Allowances Act (AKW)*

The General Family Allowances Act is a general and compulsory system of family allowance insurance under which all residents of the Netherlands are in

principle entitled to family allowances from the first child onwards.

The categories covered by the Act are virtually the same as those covered by the General Old Age Pensions Act: all residents of the Netherlands aged 15 and over as well as non-residents subject to wages and salaries tax in relation with their employment in the Netherlands are compulsorily insured under the Act.

The regulations governing the scope of the General Family Allowances differ from the corresponding regulations of the General Old Age Pensions Act only in the length of the insurance period: under the latter Act, a person is insured between the age of 15 and 65, whereas under the General Family Allowances Act the period of insurance does not have an upper limit. The obligation to pay contributions ceases, however, at the age of 65.

The system of family allowances in the Netherlands is based on the principle that the person responsible for the maintenance of a child is entitled to family allowance. The Act provides for an insurance scheme funded by means of levies on income together with a government subsidy.

The contributions of persons not in employment are levied by the Tax Department in the form of an assessment. In the case of insured persons subject to salaries and wages tax or a similar deduction at source, the employee's contribution is paid to the Tax Department by the employer, who may not recover it from the employee either wholly or in part. As the Act covers the entire population of the Netherlands, responsibility for the administration of the General Family Allowances Fund was assigned to the Social Insurance Bank.

#### *Sickness Benefits Act (ZW)*

Every employee is compulsorily insured under the Sickness Benefits Act. Those receiving benefits under the Unemployment Insurance Act are also insured under the Sickness Benefits Act.

Any employee who is incapable of work, whatever the cause, is entitled to sickness benefits. For the purposes of the Sickness Benefits Acts infirmity, pregnancy and confinement are deemed equivalent to illness. The statutory benefit amounts to 75 per cent of the employee's daily wage, no benefit being paid for the first two working days. Benefits are paid for a maximum of 52 weeks.

The Sickness Benefits Act permits the payment of benefits higher than the statutory level where more favourable arrangements have been negotiated in an undertaking or branch of industry, in a collective labour agreement, for example, less than two waiting days, or the payment of benefits in excess of 75 per cent of the daily wage for longer than 52 weeks. After receiving sickness benefits for 52 weeks, the person concerned may qualify for benefits under the General Disablement Benefit Act and/or the Disablement Insurance Act.

A female employee who is insured in accordance with the Sickness Benefits Act and becomes pregnant may qualify for maternity benefits if she submits to the industrial insurance board a statement from a doctor or obstetrician confirming that she is pregnant and giving the probable date of the confinement. She is then entitled to pregnancy benefits for the last six weeks before the probable date of the confinement and up to and including the day the child is born. Thereafter she receives confinement benefits for six weeks, irrespective of whether she is capable of work. Maternity benefits amount to 100 per cent of the daily wage up to the relevant maximum.

The insurance scheme governed by the Sickness Benefits Act is funded from contributions paid by the employer and based on the employee's wage up to the maximum daily amount. The employer is permitted to deduct half of the contribution from the employee's wage up to a maximum of 1 per cent of the latter. The contribution to be paid is fixed by the industrial insurance board at a percentage of the employee's wage, and may vary according to the sector of industry (risk group) concerned.

The administration of the insurance scheme governed by this Act is entrusted to 26 recognised industrial insurance boards. Every employer is

required by law to be affiliated to the industrial insurance board relevant to his sphere of activities.

#### *Disablement Insurance Act (WAO)*

Every employee is compulsorily insured under the Disablement Insurance Act. An employee may claim benefits under the Disablement Insurance Act if he has been incapable of work for an uninterrupted period of 52 weeks, provided that he is still incapable of work on the expiry of this period. Anyone who is unable or only partly able to earn the same wage from suitable work as a comparable completely healthy person as a result of illness or infirmity is regarded as incapable of work. Suitable work means work which someone can reasonably be expected to perform in view of his training and former occupation. The level of the benefit paid under the Disablement Insurance Act depends on the degree of incapacity and on the daily wage. Various levels of incapacity are set out in the Act: a person less than 15 per cent disabled is not entitled to benefits.

The level of incapacity may be increased in certain cases if the handicap makes it more difficult to find suitable work.

Since the General Disablement Benefits Act (see below) entered into force, disablement benefit has usually consisted of a basic portion paid under this Act and an additional portion equal to the amount by which the allowance due under the Disablement Insurance Act exceeds that payable under the General Disablement Benefits Act. The Disablement Insurance Act lays down a minimum daily wage for certain groups of beneficiaries and also a maximum daily wage. The net benefit based on the minimum daily wage at an 80 per cent or higher level of incapacity is equal to the statutory net minimum wage.

The scheme is financed by contributions paid by the employee and based on the employee's wage up to a certain maximum. Since the introduction of the General Disablement Benefits Act (see below), part of the wage has been disregarded for the purpose of calculating the contribution. The scheme is administered by the 26 industrial insurance boards. The Joint Medical Service is responsible for advising the boards of the level of incapacity and of suitable work for the persons concerned.

#### *General Disablement Benefits Act (AAW)*

An insured person who has reached the age of 18 is entitled to benefit under the Act if he has been continuously incapacitated of work for 52 weeks, remains disabled at the end of that period, and received earning income during the year preceding disablement. The income requirement does not apply in the case of persons who became disabled before turning 17.

The rate of benefits under the General Disablement Act depends on the degree of incapacity and the appropriate basic rate. The Act distinguishes various categories of incapacity; no benefit is payable for incapacity of less than 25 per cent. The level of incapacity may be increased in certain cases if the handicap makes it more difficult to find suitable employment. Benefits cease on the first day of the month in which the recipient reaches the age of 65.

There are three base figures in use for determining the level of benefits:

- a. the general base figure, under which the benefits payable in the case of 80 per cent incapacity or more are equal on a net basis to 70 per cent of the net statutory minimum wage.
- b. the medium base figure, under which the benefits payable in the case of 80 per cent incapacity or more are equal to 85 per cent of the minimum wage referred to above;
- c. the high base figure, under which the benefits payable in the case of 80 per cent incapacity or more are equal to 100 per cent of the minimum wage.

The medium base figure applies to:

1. a married claimant, provided that the joint earned income of the claimant

- and his or her spouse amounts to between 15 and 30 per cent of the high base figure on the date on which benefits under the Act commence;
2. unmarried claimants with an own child or adopted child under the age of 18 belonging to their household or largely maintained by them, provided that their earned income amounts to between 15 and 30 per cent of the high base figure on the date on which benefits under the Act commence.

The high base figure applies to the same categories as those specified in 1 and 2 above if earnings amount to no more than 15 per cent of the high base figure.

Remaining categories receive benefits in accordance with the general base figure.

If both spouses are entitled to disablement benefits and the sum of those benefits exceeds 80 per cent of the high base figure, their respective benefits are reduced proportionally so that the sum of their benefits is equal to 80 per cent of this base figure.

The cost of the scheme is largely covered by means of contributions amounting to a certain percentage of insured persons' income. In the case of employees, contributions up to a certain ceiling are paid by employers while non-employed persons pay their contributions in the form of an assessment on income. The costs of benefits for persons handicapped since their youth are borne by the central government.

The General Disablement Benefits Act is administered by the 26 industrial insurance boards, while contributions are levied and collected by the Government Tax Department.

The Joint Medical Service is responsible for advising the industrial insurance boards on the degree of incapacity for work.

#### *Unemployment Insurance Act (WW)*

Every employee under the age of 65 is compulsorily insured under the Unemployment Insurance Act. An employee whose employment ceases continues to be regarded as an employee for the purposes of the Unemployment Insurance Act, unless he then engages in activities in which he can no longer be considered an employee.

Qualification for benefits depends on the involuntary nature of unemployment. Furthermore claimants must register themselves with a public employment agency as seeking employment. The Act does not specify the instances in which unemployment is to be regarded as not being involuntary, but it has been clarified in various legal rulings. Unemployment benefit amounts to 70 per cent of the daily wage, which is generally related to the wage earned at the last place of employment.

Benefit entitlement is limited to 130 days in any twelve month period, beginning on the first day on which benefit is received.

The insurance scheme governed by the Unemployment Insurance Act is administered by the 26 industrial insurance boards and the General unemployment Fund.

The contributions payable under the unemployment insurance scheme are a uniform percentage of the employee's wage and they are paid for the greater part by the employee and for the rest by the employer.

#### *Unemployment Provisions Act (WWV)*

The Unemployment Provisions Act is designed to ensure the payment of benefits to persons who are not, or no longer, entitled to benefits under the Unemployment Insurance Act. It is not an insurance scheme, and contributions are therefore not charged to finance the benefits paid. Costs are entirely met from public means.

The scheme is restricted to employed persons, an employee being defined as any person whose participation in the working population depends completely or partly on the performance of work as a wage earner. Hence the concept of 'employee' is broader under this Act than it is under the employee insurance

schemes, where it is limited by the requirement that work as a wage earner must actually be performed, or have been performed. Under the Unemployment Provisions Act persons who have never entered employment, but are nevertheless dependent on such work for their participation in the working population, also qualify for benefits. An example of persons in this situation are those who have just completed their compulsory military service.

The benefit amounts to 70 per cent of the daily wage, by which is meant the average daily wage or salary the employee would have earned if he had been doing the job he usually did before he became unemployed. The daily wage is subject to a maximum and also to a minimum in the case of breadwinners. The benefit is paid for a maximum of two years but if, at the end of those two years, the beneficiary is 60 years or older, it is continued until the age of 65.

The Unemployment Provisions Act requires an employee to be unemployed before he becomes entitled to benefit, but, unlike the Unemployment Insurance Act, he does not need to be involuntarily unemployed. In such cases, the local authority may decide, however, to set the level at less than 70 per cent for a given period and/or to disqualify the employee for some time. The local authority has the same powers in other cases specified in the Act in which the employee does not honour his obligations or acts in such a way that his unemployment continues for longer than strictly necessary. The scheme is administered by the local authorities, most of which have made their social services departments responsible for the performance of the tasks that arise under the Act.

#### *National Assistance Act (ABW)*

Any Netherlands national without sufficient means to provide for his or her essential needs is granted assistance. This consists of a monetary payment, commensurate with the applicant's circumstances and capabilities and with the degree of responsibility to provide for his or her subsistence. The assistance is designed to enable the individual, where possible, to provide for himself. The assistance granted under the National Assistance Act is complementary to all other subsistence allowances and is provided as a last resort. On the one hand, this means that assistance is provided to the extent that the applicant's own resources (income, assets) are not sufficient for him to provide for essential needs. On the other hand, it serves as a safety net if and to the extent that the help provided under other legislation and schemes (e.g. social insurance) is inadequate.

#### *Need*

The National Assistance Act expressly refers to essential needs, thus excluding subjective interpretation from the outset. The term covers the cost of food and drink, clothing, housing, heat, furniture and recreation, these being regarded as 'necessary to enable the individual to live a life worthy of a human being'. While the Minister for Social Affairs and Employment is responsible for supervising the administration of the National Assistance Act, application in individual cases is entrusted to the authorities in the municipality in which the applicant is living. The level of assistance designed to meet essential needs is governed by national rules which were laid down in the national Assistance Rates Decree of 1974, which specifies standard rates to be paid per month (or per week to some unemployed people) if the recipient does not have an income of his own. These standard rates have been linked to the net minimum wage since 1980 (Article 1 of the National Assistance Act). The rates are:

- 100 per cent of the net statutory minimum wage for married people;
- 90 per cent of the net statutory minimum wage for one-parent families;
- 70 per cent of the net statutory minimum wage for single persons aged 23 or over.
- 60 per cent of the net statutory minimum wage for single persons living in the same house.

Lower rates to unemployed young people aged 16 to 23, the rates increasing with age.

Special government schemes have been established for certain people who need assistance for a specific reason, e.g. unemployment. They lay down detailed provisions on various sections of the National Assistance Act with regard to the category concerned, the implementation of which had originally been left entirely to the discretion of the local authorities. When granting assistance to a person in such a category, local authorities must therefore take account not only of the Act but also of the relevant special scheme. Two examples of these special schemes are the following.

#### *Government Unemployment Assistance Regulations 1965 (RWW)*

Persons between the ages of 16 and 65 who are largely dependent on paid employment for a living who are not entitled, or are no longer entitled, to benefit under a statutory unemployment scheme may claim assistance under the Government Unemployment Assistance Regulations. The beneficiaries under these regulations are chiefly persons who are no longer entitled to benefits under the Unemployment Provisions Act, former self-employed persons, divorced women, persons who have worked for less than six months and school-leavers. The amount of benefit to be paid in each case is laid down in the National Assistance Rates Degree. Minors have an independent right to benefit under the Government Unemployment Assistance Regulations, and such benefit cannot be recovered from their parents. Entitlement is dependent on the person concerned seeking employment and being registered with the local employment office.

#### *Special government scheme for the self-employed*

The scheme entitles self-employed persons temporarily in financial difficulties to periodical subsistence benefits. Assistance in the form of interest-bearing or interest-free loans or even a non-repayable grant may also be provided to meet needs for working capital. Such assistance is granted only if credit cannot be obtained from third parties (e.g. bank loans or loans guaranteed by the Ministry of Economic Affairs or the Ministry of Agriculture). An essential condition for the assistance and regular benefit payments is that the self-employed person's firm must be viable and that it must therefore be able to support him again after receiving assistance. In some cases, assistance towards working capital can run into tens of thousands of guilders, there being no upper limit.

## APPENDIX 2: Abbreviations in this report

AAW	– General Disablement Benefits Act
ABW	– National Assistance Act
AKW	– General Family Allowances Act
AOW	– General Old Age Pensions Act
AWW	– General Widows and Orphans Benefits Act
CBS	– Central Bureau of Statistics
GLI	– General Loss of Earnings Insurance
NA	– National Assistance
PBI	– Partial Basic Income
RWW	– Government Unemployment Assistance Regulations
SER	– Socio-Economic Council
VLI	– Voluntary Loss of Earnings Insurance
WAO	– Disablement Insurance Act
WRR	– Netherlands Scientific Council for Government Policy
WW	– Unemployment Insurance Act
WWV	– Unemployment Provisions Act
ZW	– Sickness Benefits Act

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- V 2 I.J. Schoonenboom en H.M. in 't Veld-Langeveld, De emancipatie van de vrouw (*Women's Emancipation*) (1976)
- V 3 G.R. Muster, Van dubbeltes en kwarjes, een literatuurstudie over ongelijkheid in de Nederlandse inkomensverdeling (*Dimes and Quarters: a Literature Study on Inequality in the Distribution of Income in the Netherlands*) (1976)
- V 4 J.A.M. van Weezel a.o., De verdeling en de waardering van arbeid (*The Distribution and Appreciation of Work*) (1976)
- V 5 A.Ch.M. Rijnen a.o., Adviseren aan de Overheid (*Advising the Government*) (1977)
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- V 7 J.J.C. Voorhoeve, Internationale Macht en Interne Autonomie (*International Power and Internal Autonomy*) (1978)
- V 8 W.M. de Jong, Techniek en wetenschap als basis voor industriële innovatie – Verslag van een reeks van interviews (*Technology and Science as a base for Industrial Innovation*) (1978)
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- M 2 E.H. Hollander: Kleinschalige massacommunicatie: lokale omroepvormen in West-Europa (*Small-scale Mass Communications: Local Broadcasting Forms in Western Europe*) (1982)
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Reports nos. 13, 15, 17 and 18 have been translated into English; English summaries are available of Reports nos. 16, 18, 19, 20, 21, 25 and 26; Report no 23 has been translated into German.

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Publications in English are available at the Council's bureau.