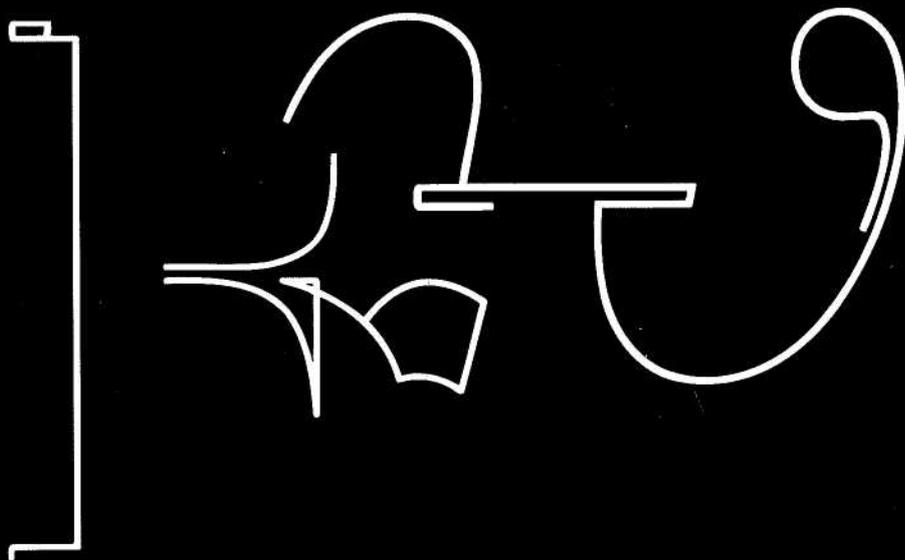
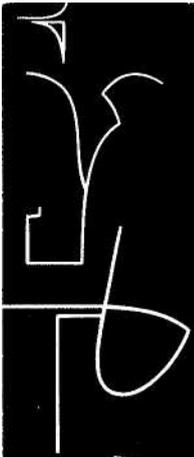


Reports to the Government



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- b. to provide a scientific structure which the Government can use when establishing priorities and which may ensure that a consistent policy is pursued;
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Reports to the Government

From Sharing to Earning

3 I

1997

Considerations for Social
Security in the 21 st Century

**Netherlands Scientific Council
for Government Policy**



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Summary

Problem definition

Projected developments for the longer term mean the Dutch social security system cannot be sustained in its present form. This observation led the Council to publish a report on the reforms which are needed in order to meet future developments. The common theme in this report is a shift in emphasis, 'from sharing to earning'. In the Council's view, this means that the social security system will in any event have to be focused much more strongly than at present on promoting labour participation.

Breathing space

Employment in the Netherlands has grown strongly over the last ten to fifteen years. Whilst the public debate has long been dominated by predictions of 'job-less growth' in the future, the total working population has increased by almost a quarter, from 5 million in 1985 to more than 6.1 million at present. The labour participation rate, which in 1985 was still ten percentage points below the European average, is now in line with the rest of Europe. There has also been a break in the trend in social security take-up. The ratio of economically inactive to economically active persons (the 'i/a ratio'), has entered a more positive (i.e. downward) trend after having risen for many years. Currently the number of benefit claimants is even declining in absolute terms - something which has never happened in the history of the Dutch social security system. This would appear to have brought the prospect of more or less full employment and a manageable social security system within reach.

Nevertheless, in the Council's view, there are strong arguments for a radical reform of the social security system. Although the performance of the Netherlands as reported above - a good performance in international perspective - has provided a breathing space, this space is only limited; the main competitors have now begun a catching-up exercise. Moreover, there are other, structural developments which substantially qualify the 'good news' reported above. The labour force is gradually ageing, whereas the demands in terms of knowledge level and employability of this labour potential are set to increase as a result of the internationalisation of the economy and accelerations in technological development. Whereas the practice today is that the majority of older employees take early retirement, without radical changes this ageing process will only increase pressure on the social security system further. In addition, a stubborn problem still remains at the lower end of the labour market, where a large group of people have not benefited at all from the growth in employment. Their productivity and employability need to be tapped. This process will not happen by itself, but will demand a much greater investment than has been evident to date.

Additionally, there is the prospect of a pensions 'time bomb' as the post-war baby boom reaches retirement age. In 2035 there will be twice as many over-65s as today, placing heavy demands on the rest of society, with its shrinking labour force. It is important to keep open the option of parallel income development between the generations, since it is far from self-evident that the imminent large increase in the generation of over-65s will lead to an acceptance by society of a substantially lower income development for this group than for those in work. Keeping open this option underlines yet again the task for policymakers of broadening the supporting base for social security by seeking to promote further increases in participation by those sections of the population able to work.

The breathing space which the Netherlands has earned for itself offers a perfect opportunity to adapt the social security system to the changing context.

This system will have to fit in with an economy which is becoming increasingly knowledge-intensive and sensitive to external developments. This also makes it necessary to make allowance for 'rainy day scenarios'. It is not enough here simply to broaden labour participation as such; to a greater extent than today, social security must be the lubricating oil supporting job changes in a properly functioning labour market. Consequently, a major policy effort is needed to increase people's empowerment, employability and flexibility, as well as a complementary demand-led policy for groups which still have difficulty entering the labour market.

Method: conceptual approaches and criteria

Social security has a twofold objective: to provide useful work for those able to work and an adequate level of benefits for those who are not (any longer) able or required to work. This means that social security is not an isolated phenomenon, but must be seen in relation to the labour market. In principle, a correlation between the two can be achieved via different paths. In thinking through the possibilities, the Council elaborated three possible solution paths and then tested these against a number of criteria. These conceptual approaches, elements of which also play a role in the political discussion, are designated as: the 'entitlements policy', the 'active integration model' and the 'supplementation policy'. The *entitlements policy* seeks to increase labour participation by making social security entitlements less generous: the idea is that 'sober' benefit entitlements will encourage people to seek work of their own accord. The *active integration model* is based on the principle that it is mainly lack of qualifications which hampers participation and prevents labour potential developing its full future value. Individualised assistance for unemployed people, coupled with a policy of permanent training for those in work, are the tools with which the quality of labour and labour productivity must be raised in order to be able to cope with the international competition. The present level of benefits and the minimum wage are sustained in this model. The *supplementation policy* aims at rewarding qualifications - even where in individual cases these fall below what the market demands - in line with market standards, and where necessary bridging the financial discrepancy by topping up (supplementing) the pay earned. This ensures that a person's earning capacity is utilised. At the bottom end of the labour market this requires a 'lowered threshold' by ending the linkage of pay to the cost of living index and lowering the minimum wage - though maintaining the social policy minimum - or else through wage cost subsidies.

These three conceptual approaches can be seen as the cornerstones marking out the domain within which a labour participation-promoting social security system will have to be developed. In order to gain a picture of the implications of these conceptual approaches, criteria are needed. The Council adopts five: equity, legitimacy, efficiency, effectiveness and sustainability. Tested against these criteria, each of the three conceptual approaches proves to have both strong and weak aspects, though none of them appears impossible. There is also no one conceptual approach which is by definition superior to the two others. The Council does however feel that, given the room for manoeuvre available to the Netherlands thanks to a long period of pay moderation, there is no pressing need to encourage participation by pursuing a minimum entitlements policy. Moreover, benefit claimants in the Netherlands have already been gradually brought into line over the last ten or twenty years with those in other European countries. This favourable economic starting position offers an excellent opportunity to shift the accent towards a long-term strategy aimed at boosting the labour productivity of the labour force, across the full breadth and throughout working life. This demands policy geared primarily to investment in people. A 'well-judged combination' of an active integration policy and a supplementation policy offers a good framework for this. Active integration policy impacts mainly on the supply side, while supplementation policy mainly

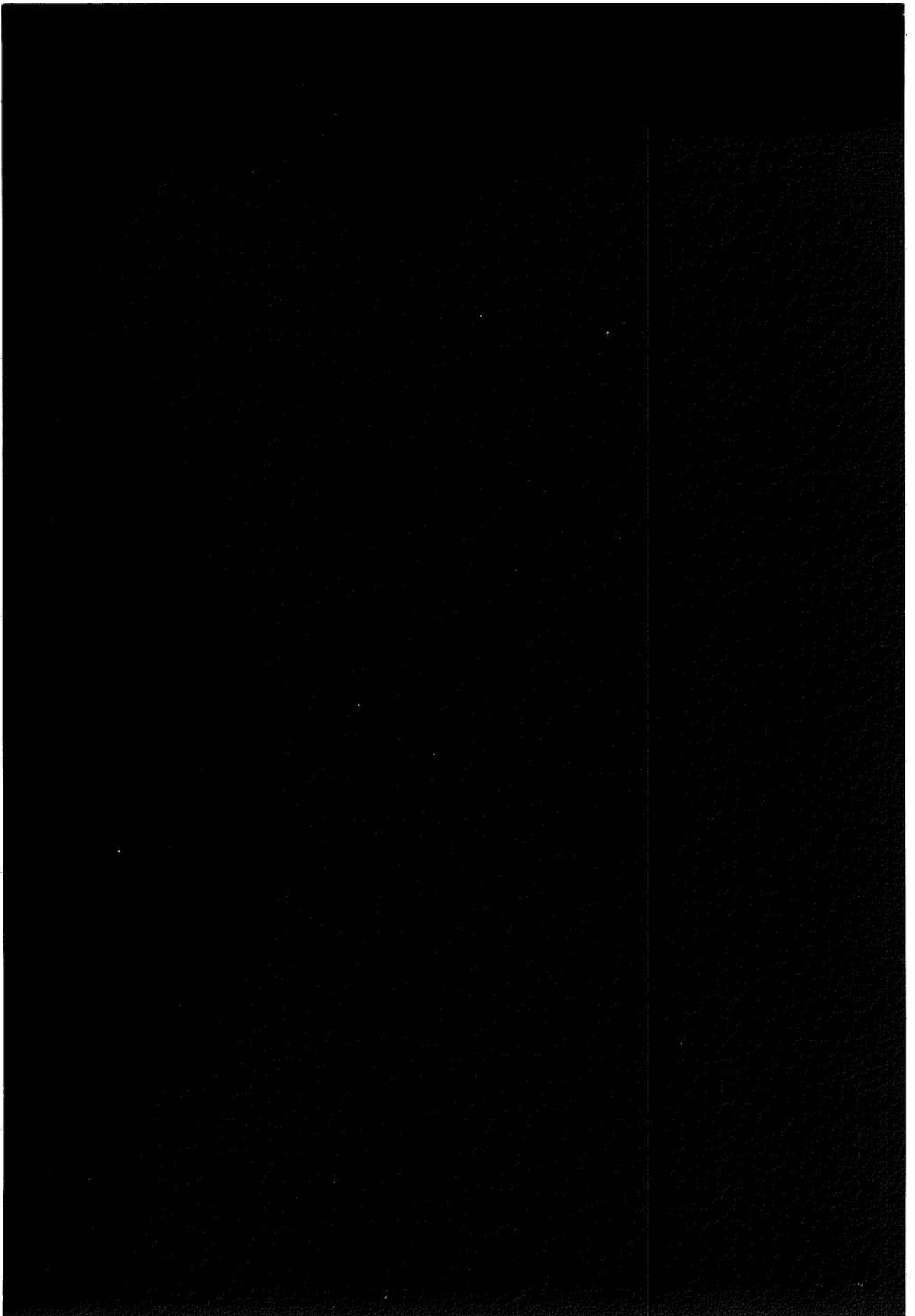
affects the demand side and the gaining of work experience. If the policy were to concentrate on one of these approaches separately, the potential contribution of the other would be unutilised. The accents in this well-judged combination can vary over time, however, depending on the economic and social climate of the moment. In the view of the Council, a generic lowering of the minimum wage is not a necessary condition at this moment for the suggested policy combination; there are other ways of realising the job-creating potential of the supplementation policy. The approach favoured by the Council does however place heavy demands on the willingness to abandon traditional protectionist patterns and to demand from - and reward accordingly - efforts from all concerned: citizens, government and employers. If these obligations to make an effort are taken insufficiently seriously, there is a strong risk that future governments will have to resort to the entitlements policy.

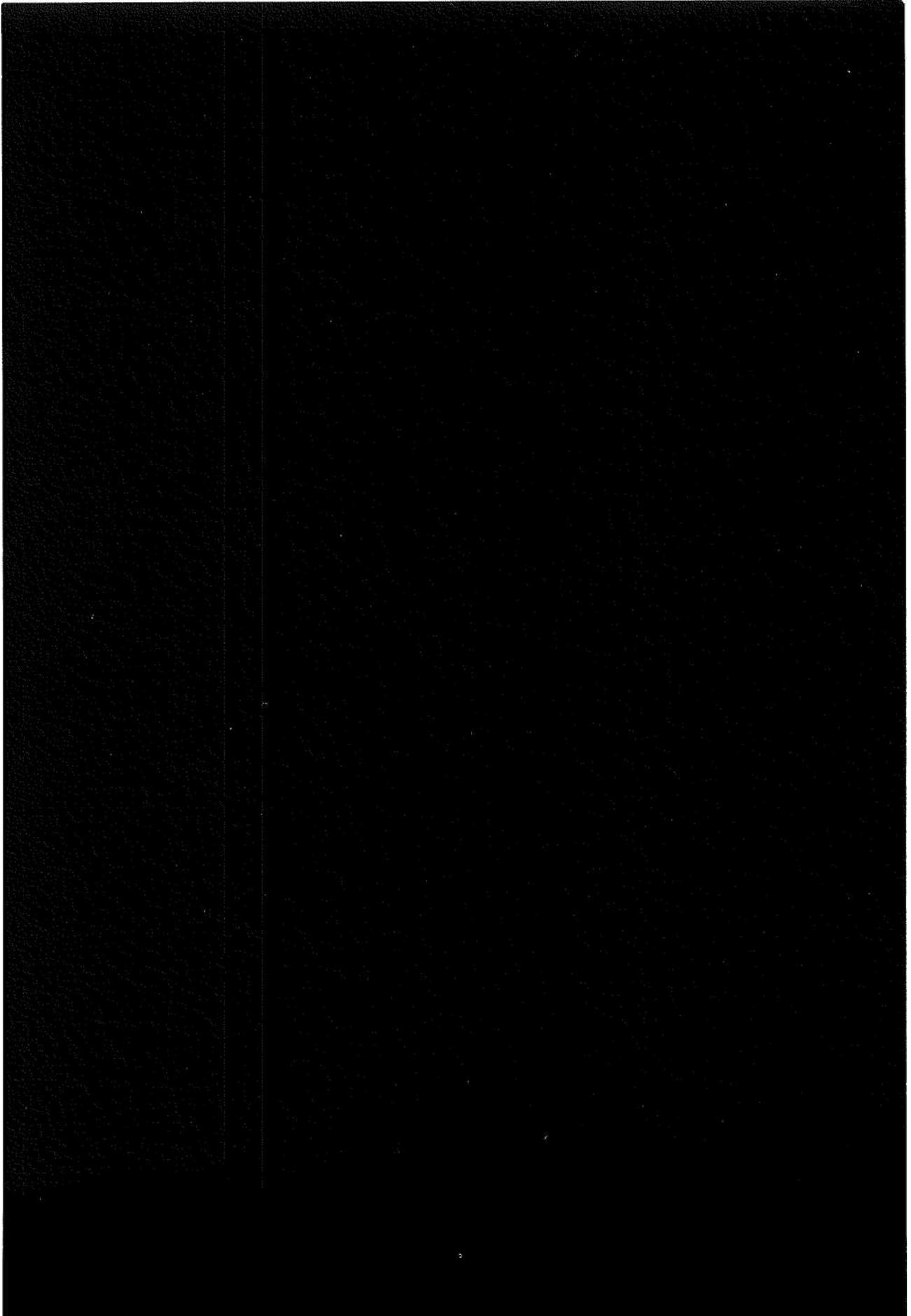
The main recommendations

1. The central plank of this report is that the relationship between client, case manager and/or employers is not a non-committal relationship, but is of a binding nature and must therefore be marked by *mutual rights and obligations*. In concrete terms this means that every benefit claimant with a recognised earning capacity has a right to intensive and tailor-made individual case management; this is the main difference between this approach and the existing claims reduction policy. Against this entitlement is the obligation to give full scope to such an individualising case management approach. The delivery system must be geared to this - structurally, administratively and financially. At structural level this means that case management must be further professionalised. Administratively, the organisations involved (public or private sector) must have sufficient freedom of movement to treat different cases differently. The funding system must also be geared to this, in an adequate budgeting of funds for services on the supply side and for payment of wage subsidies on the demand side of the labour market.
2. The Council places social security emphatically in a network of entitlements and obligations, in which *the entitlements are regulated in broad categories by law and the obligations on an individual, tailor-made basis*. To this end, a contract is in principle agreed with every benefit claimant capable of working, geared to their individual skill and ability, and comparable to an employment contract. This contract stipulates the efforts required from both sides in order to minimise the take-up of social security; this is laid down in measurable agreements, in terms of training or other provisions to equip people better for work, in terms of placement services, wage supplementation, etc. All parties involved - placement officers, clients and possibly also employers with whom further agreements have been made on training or wage subsidies - are held to their obligations on pain of sanction. For the delivery system, this represents a reversal of the burden of proof; a case manager who fails to impose sanctions in cases where this is justifiable will henceforth have to account for this.
3. Once the system is operating as described above, the *time limits on the payment of disability benefits can be scrapped*. This is because the gatekeeping function will then be being adequately fulfilled, and incapacity for work will be reliably indicated in the system of medical examinations and periodical re-examinations. The present legislative system introduced an age-dependent wage-loss compensation benefit in 1993, payable for a limited period; thereafter recipients receive the minimum basic incapacity benefit. This has led to the so-called 'disability benefits gap', which was immediately filled in Collective Labour Agreement negotiations. The Council regards the resultant complex and fragmented implementation of the Disability Insurance Act (WAO) and the Disability Benefits Act (AAW) as an undesirable state of affairs. Moreover, the present time limit is a distraction from the main issue:

the need to prevent schemes designed for those with an incapacity for work from containing a hidden unemployment component.

4. The Council devotes particular attention to the *legal guarantees* under a system which gears obligations to individual capacities. To this end the Council argues in favour of a balance of power between the case manager, client and employer, by (1) confronting actors at all levels with their responsibilities (e.g. using financial stimuli); (2) promoting competition in the implementation of specific tasks (e.g. between the Employment Service and temporary employment agencies); and (3) instituting adequate procedures for objections and appeals. The agreement made in the context of individual case management between the client, case manager and/or employer should be seen here in a legal sense as a contract and should be regulated as such.
5. The above approach demands an unambiguous and comprehensive *effort from all parties concerned*; in this respect, too, this approach distinguishes itself from the present claims reduction policy. In the past the government has taken steps towards a more or less comprehensive approach (jobs pool, Youth Work Guarantee scheme, new National Assistance Act), but these were characterised by a degree of half-heartedness: they were focused too much on the 'easy cases'. One reason for this half-heartedness was the lack of sufficient (simple) jobs. Now that the prospects for employment are improving, the Council argues for an approach in which the entire labour potential is utilised.
6. In addition to deregulation and intensification of case management, this approach also comprises a combination of continued pay moderation supported by *specific supply-side policy*, geared to empowering individuals, as well as *specific demand-side policy*. The education and health care sectors have been subjected to severe cuts in the last fifteen years, as a result of which the Netherlands is insufficiently prepared for the knowledge-intensive society and the consequences of ageing. In addition to the existing 'Melkert jobs' aimed at weaning the long-term unemployed into work, there is a need to stimulate employment in these specific sectors. In addition, in particular with regard to the problem groups at the lower end of the labour market, there is a need for a combination of provisions aimed at raising productivity and at (temporarily) stimulating specific demand by means of a supplementation policy. Pull application of the supplementation policy appears most feasible among young people. The administrative problems here are manageable and the condition that any supplementary benefit payable will be subject to their own responsibility in finding work is likely to produce the highest returns in this group.
7. The government and the two sides of industry will have to take a joint initiative to set up a *older employees policy* which prevents the imminent ageing of the labour force from placing permanent pressure on early retirement routes. People will again have to get used to working for longer. Ongoing training, relocation policy, supplements, average pay systems for calculating pensions and the (gradual) abolition of exemption from the job application duty for older unemployed people are elements of such a policy.
8. Nevertheless, there will still be specific groups with a structurally inadequate labour productivity. In order to develop their talents there is a need for more structural support through *the creation of simple jobs*, as already indicated in the previous Council report (*Social Dichotomy in Perspective*).
9. All recommendations in this report have been made against the background of the knowledge that every system of income guarantees is vulnerable to misuse and abuse, or rent seeking. This demands not only an active sanctions policy, but also the avoidance of unintended displacement of unsubsidised work by subsidised labour. In a liquid labour market, the supplementation policy is





particularly susceptible to this temptation and this therefore demands careful monitoring. On the other hand, *displacement is not by definition undesirable*; a stance whereby displacement is rejected in all cases indicates an overly static perspective. The Council would argue that in precisely those segments of the labour market where people with work experience can find work again easily, working people should increasingly be displaced by (long-term) unemployed people. The key issue is to prevent some people's length of unemployment increasing to such an extent that they lose all contact with the labour market.

Preface

This report has been prepared by an internal WRR project group chaired by Dr. D. J. Wolfson, a member of the Council. The other members of the project group upon the completion of the project were, Dr. L.J. Gunning-Schepers, another member of the Council; Mr. J.C.F. Bletz, council secretary; and staff members Mr. M.R. Gorsse, Dr. CA. Hazeu, Dr. R.M.A. Jansweijer, Dr. C.W.A.M. van Paridon and Mr. I.J. Schoonenboom (project secretary).

The WRR wishes to thank the numerous individuals and institutions who were consulted during the preparation of the report and contributed towards its preparation.

Introduction

1.1 Background

This report places the future system of social security in the Netherlands against the background of the challenges that lie ahead and of the policy debate and measures in recent years. The Council notes in this regard a growing consciousness that social security is most effectively guaranteed if the system encourages the labour force participation of the potential working population. The appreciation of paid employment and the role of social security in that respect may be related to a number of important developments. In the first place - as discussed in detail by the Council in its report *Social Dichotomy in Perspective* - the legitimisation of employment as giving meaning to life has become stronger, partly as a result of the greater consciousness of the alienating effect of the social exclusion associated with unemployment*. In addition there is a growing insight that with the ever more rapid change in job-content, individual jobs afford less and less security and that providing the chance of getting a job as such needs greater emphasis in efforts to guarantee social security. This development calls for a fundamental reappraisal of the way in which risks are dealt with. More than ever this points out the double-sided nature of solidarity. Preserving the sustainability of the system means not only that citizens must be able to rely on society for support but that society must be able to impose limits on the citizen's entitlements to benefits. And finally there is the need for a broader base of support for the inevitable growth in income transfers to the retired and the disabled.

1.1.i Challenges²

The two-fold aim of meaningful work for those who can work and an adequate and guaranteed level of benefits for those who cannot or no longer have to, poses a major challenge for the system of social security. The socio-economic constellation within which this assignment must be fulfilled is subject to radical and structural change. Employment has evolved into one of the most important integration factors in society. This process of integration does not take place in isolation but in interaction with changes in the quality and nature of employment itself and a growing diversification of life-styles. Standards once regarded as self-evident as to who is and is not required to work and the way in which they do so have consequently lost meaning. This is rapidly giving the Dutch labour market a different look. Over the past 20 years the proportion of part-time jobs has risen from 16 to 28 percent. In addition there has been a rapid growth in the number of people working in flexible jobs; these now account for 10 percent of all employment, so that the number of people in 'atypical' jobs amounts to nearly 40 percent. Internationally the Netherlands takes the lead in this regard and is an example of 'the law of the widening gap'. Initially the rigid labour system was unable to satisfy the growing demand by women for part-time work and later it was equally unable to satisfy the demand by the business section for flexible employees. While the trade union movement and government continued to pay lip-service to efforts to introduce these atypical forms of employment, the temporary employment industry specialised in this sub-market and hence contributed towards its

¹ WRR, *Tweedeling in perspectief*, Reports to the Government no. 50, The Hague, Sdu Uitgevers, 1996. An English summary of this report is available as WRR, *Social Dichotomy in Perspective*; summary of the 50th report, The Hague, 1996. ²

normalisation. Looking to the future much hinges on the further normalisation of this kind of employment; social security will need to be the lubricant for much more differentiated patterns of employment and mobility patterns than have been customary hitherto.

In addition technological developments and the growing internationalisation of the economy are increasingly testing the competitiveness of national economies. Job-content is changing ever more rapidly, and mobility - between occupations, institutions and different forms of employment - has become commonplace. The loss of job security calls for efforts to promote employability and adaptability if people are to maximise their prospects of obtaining or changing work. This in turn calls for greater self-sufficiency and adaptability - a challenge that is all the more acute now that the large post-war cohort of people in their 50s with relatively little education and training will shortly enter the ranks of the elderly and hence the danger zone. In the absence of further policies the size of the working population will continue to be squeezed in the coming years by early retirement. Given the persistence of the present trend whereby the majority of older employees take retirement before pensionable age, the ageing of the labour force would mean that the ratio of inactive to active persons would be 20 percent higher in 2010 than at present. In order to keep this ratio unchanged the participation rate in 2010 would need to be increased by no fewer than 10 percentage points.

Demographic developments also create a need to increase labour force participation in another respect. In a more structural sense the Netherlands will be confronted over the coming decades by a sharp growth in the number of people of pensionable age. In 2035 the post-war baby-boom - which was particularly pronounced and sustained in the Netherlands - will reach pensionable age. In that year there will be twice as many people aged 65 and over than at present. Maintaining a parallel growth in incomes between young and old forms a tremendous challenge. The fact that the younger elderly persons will already start dropping out of the labour force in the coming years means that this challenge will in fact be faced at an early point, subsequently becoming a structural phenomenon taking the form of a pincer movement between increasing ageing and relatively small cohorts of younger people.

In brief, the assignment for the system of social security in the future is to provide income guarantees for an ageing population that do not impede the employability and dynamism of those in work but, rather, support them. This will take place against the background of a diversification in life-styles and more rapid changes in production patterns and economic structures, with a continuing increase in the number of applications and the take-up rate for an ever-widening range of social security support. Since the developments outlined above are largely autonomous in nature and therefore all but beyond influencing, the Council has concentrated in this report on the sole policy option where proposed action is possible, namely a switch from 'sharing to earning'. This consists of increasing the labour force participation rate, both as a social goal and means of promoting equal rights between the sexes and as a means of providing the necessary foundation for meeting the challenges that lie ahead. More particularly - as foreshadowed in the Council's previous report³ - attention has been devoted to weak groups in the labour market.

^{3]} WRR, *Social Dichotomy in Perspective*, op. cit.

1. 1.2 The scope for policy in a European perspective

Fortunately there are a number of policy options for coping with these challenges. Unjustifiably, the fear that growing international policy competition is increasingly eliminating the scope for separate policies sometimes plays a background role in the debate on the future of social security. In part that fear is prompted by the impression that its social policies place the Netherlands in an economically vulnerable position within Europe. That is not however the case. In terms of EMU criteria, economic growth and the development in employment, the Netherlands is among the front-runners in Europe and - following the policy interventions in recent years - the benefits of the Dutch system of social security are no longer out of step, particularly on the basis of a net comparison after offsetting taxation on social security benefits in the Netherlands and other countries. Similarly the ratio between inactive and active persons, which was a source of concern for many years, has now fallen into line with the pattern elsewhere in Europe, although it needs to be borne in mind that other countries have also been slipping towards the Dutch pattern. But however successful the Netherlands may have been in closing the gap, the Netherlands is not yet structurally ready for the future. This applies all the more now that the definitive loss of national powers with respect to exchange rates and interest rates that lies around the corner can only increase the significance of the labour market as an adjustment mechanism within the EMU. The Council accordingly reaches the twin conclusion that while the relative improvement in the Dutch starting position admittedly provides a breathing space, policies are badly needed in order to fashion a social security system capable of coping with the challenges that are now coming into view.

Which policy options create that breathing space? The Council sees room for a separate Dutch social security policy to be thrashed out in both the legal/political and the socio-economic field⁴. In a legal sense the expectation is that European social policy will continue to be based on the subsidiarity principle for a considerable period and that this will leave the Member States a good deal of formal space to work out their own policies. This does not however eliminate the fear that the European countries will drag each other in a policy sense into a race to the bottom. In political terms the Council does not however consider such a development to be very likely. A community that excludes exchange rate competition will wish to keep other forms of policy competition under control. The acceptance of the social protocol to the Treaty of Amsterdam also points in this direction. It is not without reason that the reconsideration of the social security systems that have been built up in various European countries is being approached with great caution. A limited form of policy competition, by contrast, could be conducive to improvement of the 'price quality ratio' of the government product⁶.

A more important question is, accordingly, the extent to which cultural and socio-economic parameters permit the Netherlands to work out separate policies. An initial and frequently neglected indication in this respect is provided by the United States, where - contrary to an 'American Dream', perceived as it is as a shared heritage - there are substantial variations in both taxes and social security provision from state to state. Ricardo's classical theory of comparative advantage still appears intact: the competitiveness of the country, or an individual state, should never be assessed in terms of a single dimension but in terms of the interplay of forces. This argument does not just apply to the

⁴] In the same spirit the Ministry of Social Affairs and Employment, *Employment and Social Policies under International Constraints*; The Hague, VUGA, 1996, p. 14. ⁵] See Social-Economic Council, *Convergentie en overlegonomie* (Convergence and the Consultative Economy); Advisory Report 92/05, The Hague, 1992, p. 137.

degrees of freedom that the Netherlands has within the European Union but also to the Union's freedom in relation to the rest of the world. The fear that competition from Eastern European and Asia will place the Union's achievements under severe pressure disregards the importance of factors such as high productivity and the infrastructure.

With respect to the position of the Netherlands in Europe it is therefore a valid question to ask how many advantages - in terms of location, infrastructure, knowledge base or experience in transnational entrepreneurship - we wish to deploy in order to maintain the cultural tradition of a relatively broad welfare state. This is a political question demanding an answer now that the Netherlands has created opportunities to convert its relative position of disadvantage as one of the less dynamic countries in Europe into a relative lead by means of a first-mover advantage⁶. There are no a priori European factors why the Netherlands would be *obliged* to adapt the scope and level of its social security entitlements. Our country has recaptured degrees of freedom for a well-considered separate policy as long as those concerned remain conscious of the danger that the law of the inhibiting lead' can provide a temptation to neglect the necessary measures to consolidate the success of socio-economic policy.

Against this background this report explores the policy freedom to arrive at a system of social security that is capable of coping with the demands of the age and - as far as can be foreseen now - will remain tenable in the coming decades. This will require a substantial increase in the labour force participation rate. Social support for the strategy to promote participation may be expected to grow further⁷. The Council has therefore reached the conclusion that if the present policy is sustained and stepped up a return to more or less full employment can be achieved. Increasing the labour force participation rate may, how-ever, be achieved by various means. Three paths are explored in this report, in the form of three alternative conceptual approaches. None of these is without its particular pitfalls, which are also brought out in the report.

1.2 The future in historical perspective

1.2.1 The origins of the system

The criteria for the future cannot escape the past - particularly not such a turbulent history as that of social security. Insurance against unemployment, sickness and old age only came into their fruition in the Netherlands after the Second World War. This was associated with the late onset of industrialisation as well as the lack of agreement in the pre-war years on the allocation of the executive responsibilities. The 1950s and 1960s were a period of catching up with impressive legislative activity, starting with the introduction of the General Old-Age Pensions Act (AOW) in 1957, the system being provisionally completed with the National Assistance Act (ABW, 1965), the Disability Insurance Act (WAO, 1967) and the Minimum Wage Act in 1968. The building was therefore put in place in the space of a little over ten years. In the subsequent years through to the 1980s the purchasing power of the benefits was linked to pay-trends and the scope of the regulations was extended, for example with the introduction of the General Disability Benefits Act (AAW) in 1976.

] See M. E. Porter, *The Competitive Advantage of Nations*; New York, Free Press, 1990.

7] See WRR, *Social Dichotomy in Perspective*, op. cit., Ch. 4.

1.2.2 From earning to sharing and back again

The fact that the rapid expansion of the welfare state came late in the piece and also took place in a period of prosperity meant that the system was fashioned along generous lines from the outset. In addition the boom years of the 1960s were associated with a high level of social and political ambition. The debate focused in particular on the improvement and equal distribution of entitlements, while the other side of the coin - the obligations - received little attention. It was also considered unacceptable to exclude benefit-claimants from the general rise in prosperity; relative deprivation had also to be recognised as deprivation. Furthermore the trend towards individualisation in society meant that the allocation of entitlements did not stop with the traditional breadwinner but also embraced women and young people.

Initially the post-war work ethic was confirmed as there *was* still work. The resort to social security was therefore limited and benefit abuse was primarily an anecdotal phenomenon. The demand for employment, the work ethic and the stigma associated with handouts kept unemployment down. The legislator had, admittedly, operated on the premise that social security was intended as a guarantee against events which the individual could not *reasonably* influence himself, but gradually the unconditional protection of the individual was extended. The key notion of 'reasonably*' was cut back over time, among other things because the concept of 'suitable work' became interpreted more and more narrowly. The quid pro quo required by the client receded steadily into the background. Work not measuring up to the applicant's qualifications or involving a move or lengthy travel or loss of income gradually became regarded as non-suitable. The more restrictive this definition became the more open the access to social security. In this way there evolved a broadly-based claim to employment in the individual's own region in line with his or her qualifications and previous income.

More generally risks were increasingly displaced from the individual to the collective and the obligation to accept work, which had initially been axiomatic, became further qualified. Whereas social security was originally intended as an instrument to cope with objectively determined *emergency situations* for which the individual was not to blame, it became a guarantee against *undesired situations* for an individual, even in cases where the individual concerned was making little if any effort. The primary responsibility of the citizen to acquire income through participation in the labour force was therefore weakened; 'work or benefits' gradually became a matter of choice or more optional. In this way the system began to change people. Autonomous developments, such as the reduction in family size, meant that more women entered the labour market and acquired the same independent entitlements to benefits. But the system itself also resulted in a larger resort by households to benefits as a result of the growing number of divorces and the earlier independence of young people.

The conjunction of economic growth and political permissiveness in which the switch from earning to sharing could flourish did not last long. The end came in sight when wage-costs began to undermine competitiveness. The spiral effect of growing benefit payments took its toll in the form of a rising burden of taxation and social security, higher wage costs, increasing erosion of employment and consequent ratcheting up of wage costs.

Given the low base of support provided by the comparatively low labour force participation rate and the initially still generous social security system, the intensity with which labour was shed was greater in the Netherlands than in any other European country. This meant that the necessity to find the way back took place earlier and more painfully in the Netherlands than elsewhere, with the disability benefits (WAO) crisis of 1991 as the crystallisation point.

1.2.3 The policy response

Following the oil crisis of 1973 the spiralling level of social security payments was primarily regarded as a *spending cuts challenge*: how to limit the growth in the number of inactive persons, and how to contain the growing pressure this was placing on national income. From the end of the 1970s, this primarily took the form of cuts in benefits so that the set financial objectives could be attained. At the same time, however, it meant that the security element of social security was gradually undermined. It also meant that the structural problems were largely by-passed, such as the more fundamental causes of unemployment and the growing mismatch between demand and supply. Particularly at the bottom end of the labour market mismatch problems became acute, because those lacking qualifications found themselves priced out of the labour market or displaced by an oversupply of better qualified labour.

These austerity policies created the risk of losing sight of the fact that the welfare state had not been set up without reason and that it continued to play an important guarantee function. Quite apart from the growing importance of old-age and employment-disability provision, the quickening pace of economic change involves risks for labour that increase rather than reduce the need for social security as a form of bridging finance. Social security may never just be viewed as a financial charge for society; it is also a precondition for prosperity-generating dynamism and mobility. But the system does need to be geared to that end. The displacement process at the bottom of the labour market, in particular, constitutes a threat to economic dynamism in the longer term. If the combination of ageing and fewer young people will shortly create fresh labour shortages, a large element of poorly qualified individuals lacking prospects in the labour market will be a millstone around our neck. For this reason too there is every reason for a timely reintegration.

1.2.4 Outline of the future

In its outline of the future the Council therefore works on the assumption that the period of retrenchment at any cost has been finally abandoned and replaced by a policy aimed at *controllability*, i.e. the ability to allow a process to evolve in terms of its objectives. The objectives of the social security system are twofold: meaningful work for those who can work and an adequate level of benefits for those who cannot or no longer need to. The earlier observation that society and the government have rediscovered the value of labour and are retracing their steps from sharing to earning clears the way for a sharply increased drive aimed at the careful management of the knowledge and skills of the potential working population. While avoiding the policy errors made in the past, the art lies in re-establishing the balance between rights and obligations in a way that can guarantee a sustainable system of social security for the future.

The lessons drawn by the Council from the past have already been outlined. The loss of employment in the 1970s did not lead in good time to structural adjustments but was deflected into an often protracted and unsustainable resort to social security. This was accentuated by increasing ease of access to social security, the well-meaning treatment of many and a failure to face up to misuse and abuse. As a result the safety net of social security failed to act as a temporary facility, as originally intended, but, rather, acted as a basic income to replace employment. The original, axiomatic link with labour force participation has not yet been restored: the right to benefits continues to be perceived by some as more self-evident than the obligation to work. But the insight is gaining ground that social security should primarily serve as a springboard instead of a *poverty trap* with the risk that an 'underclass' of

outsiders will be created who have lost all hope of ever finding paid employment. Against this background the Council examines the preconditions in the next section for the restoration of more or less full employment and of the guarantee function of a sustainable system of social security for those unable to work. This provides the *Leitmotif* of this report.

1.3 Continuity preconditions for social security

1.3.1 Restoration of employment

First and foremost the control of entitlements to social security requires a sufficient level of employment to provide all those able to work with meaningful employment. The Council regards this as a difficult but fundamentally attainable assignment. For more than ten years now employment in the Netherlands has been growing more strongly than in the rest of Europe as the fruit of an investment climate that has gradually been improved by means of wage restraint, government spending cuts, a reduction in the tax and social security burden and a certain degree of deregulation and greater flexibility. The benefits this process has brought for employment have so far largely escaped observation since the supply of labour has grown simultaneously, so that many unemployed persons found themselves excluded from the labour process for extended periods. The influx into the labour market is, however, beginning to taper off now that women have largely made good their backlog and the impact of ageing and the falling number of young people is becoming more discernable. In macro terms a solution to the problem of unemployment is also coming within range on these grounds provided that industry and government continue to work together by continuing the successful policies of restraint and greater flexibility.

1.3.2 Improving the match between demand and supply

A new problem, however, is arising. The mismatch noted above between the qualifications sought and on offer is resulting in labour market shortages long before the market as a whole has cleared. This will mean that a point is reached at which the somewhat greater flexibility in wage-determination proves inadequate to prevent further upper pressure on wages. A second and crucial policy assignment is therefore to postpone that point until the highest possible share of the present long-term unemployed have found work. For if wages rise before that point, Dutch competitiveness slips again and employment here does not grow more rapidly than elsewhere, the 'old pool' of long-term unemployed will certainly not find work. The limited employability of a high proportion of the remaining labour force reserve requires greater wage flexibility and much greater concentration on individual cases than hitherto acknowledged. The dilemmas that arise when the balance between greater flexibility and greater concentration on individual cases is determined is examined in detail in this report. The subject is a complicated one, the road long and the time short. The Council is already concluding that the breathing-space referred to in the previous section will be no more than brief: the window of opportunity for which other countries are envying us will last only a few years. If the present policy is not to get stranded in problems on the supply-side of the labour market, it will need to be substantially stepped up. The difficult but urgently required challenge of reversing the displacement of poorly qualified individuals in good time and more generally the need to deal carefully with human talent is necessary in terms of both equity and efficiency.

Although there is much to be said for equipping the working population as effectively as possible with a view to the trends in demand, it needs to be recognised that not everyone will be able to find a place in a knowledge-intensive economy. It is not just that displacement processes have worsened the

prospects for the poorly qualified; a lot of simple jobs have simply been eliminated. A strategy of participation cannot therefore make do with intensified policies on the supply side but also requires the further development of policies to boost specific areas of demand. By selectively opening up the bottom end of the labour market room can be created for individuals with low labour productivity, especially in sectors where there are unfulfilled social needs.

1.3.3 Combating misuse and abuse

Apart from these problems of matching demand and supply in the labour market, the Council emphasises the preconditions in this report with respect to behavioural aspects, information management and legitimacy implications. These have so far received little attention but are critically important for the sustainability of social security. Behaviour, information and legitimacy provide the foundations of the classical problem of risk-cover, namely the moral hazards of hidden decisions concerning misuse and abuse which are difficult to unmask due to the information asymmetry between the insured and the insurer and which are difficult to contest on account of the legal guarantees provided by the policy. The taboo concerning individual benefit fraud may now have been punctured but there is a less widespread insight that abuse has also penetrated to the executive and administrative levels - a complication also examined by the Council in this report⁸.

The fact that abuse has assumed such a scale has in turn contributed towards the previously described normalisation of resort to benefits and the neglect of the legal obligation to make an effort to minimise damages as a *quid pro quo*: norms not only determine behaviour but also ensue from it. In addition the information problem created second-order effects: because it was so difficult to determine who belonged to the target-groups in a society that was rapidly becoming so much more diverse and which moreover attached great importance to the protection of privacy and legal equality, legal entitlements and target groups were continually expanded (type-two error) in order to ensure that nobody in the intended target group was missed (type-one error).

The distinctions on which the system had been based (married/unmarried; permanent employment or not) have become blurred due to both socio-cultural and economic developments. Efforts by the government to take account of social differentiation by means of regulation are left suspended in mid-air when the official representation of matters becomes the subject of calculating behaviour. At the same time these problems of identification and classification impede efforts to control social security by singling out particular target groups. Government policy has responded to these developments by the introduction of *customisation*, but this is likely to remain no more than an incantation as long as the conditions necessary for the success of this strategy receive insufficient attention. This report argues that customisation, in the sense of an approach in which inequality can be handled unequally to much the same extent, calls for policy freedom for administrators to treat individual cases in a way that reflects the differences in clients' capabilities and knowledge of the system. This greater administrative freedom does, however, create the risk of arbitrariness. Customisation therefore calls for legal guarantees based on checks and balances.

⁸] This subject was previously discussed in detail in the report by the Committee of Enquiry into Social Security Executive Agencies entitled *Enquête naar het functioneren van de organen belast met de uitvoering van de sociale verzekeringswetten* (Enquiry into the Functioning of Agencies Responsible for the Administration of Social Security Legislation); Parliamentary Papers, Lower House 1992/1993, 22 730, no. 8; and in WRR, *Belang en beleid; Naar een verantwoorde uitvoering van de werknemersverzekeringen* (Interest and Policy; Towards a Responsible Implementation of Employee Insurances); Reports to the Government no. 45, The Hague, Sdu Uitgeverij, 1994.

Any form of social provision or insurance is vulnerable to hidden decisions - and much more so than commercial insurance, which has greater freedom to select risks. That vulnerability rises in line with the growth in benefit entitlements. The sustainability of the system of social security can therefore only be guaranteed by *penalising* lack of effort on the part of clients more severely, neither endogenously, by sharply reducing benefit entitlements, or autonomously and while retaining the present level of entitlements, by individualising the required quid pro quo and rendering the benefit dependent on *proven efforts* before it can be paid. In the latter case the checks and balances also require that those responsible for the formulation of policy and its implementation are obliged to abide by the expectations that have been generated and the agreements reached.

1.4 The research method 1.4.1 Conceptual

approaches as uncompleted scenarios

The Council takes as its starting point the consensus that has evolved concerning the desirability of expanding labour force participation⁹. For the system of social security this means that the contribution towards such participation needs to be given much greater emphasis, in addition to the guaranteeing of financial security. This extension of the guarantee function by enlarging the prospects for obtaining employment does not however answer the question as to how the new system should be organised. The specific arrangements for a new system of this kind are in part determined by paradigmatic differences in attitudes concerning the operation of the labour market and the distribution of responsibilities among the actors playing a role in it. Paradigms form a cluster of theoretical and normative reflection and provide a guideline for the development of policy in a continually changing reality. The difficulty is, however, that they could also colour the observation of that reality, for which reason paradigmatic differences in attitude cannot be incontrovertibly resolved. It is, however, illuminating to identify them and to spell them out as problems, thereby providing building-blocks for political decision-making. This is the contribution that this report seeks to make. The policy freedoms for the development of social security are explored on the basis of three perspectives which, while they may lack any predictive power, serve as cornerstones in identifying the potential policy domain. They have in common that they seek to restore the disrupted balance between rights and obligations as a necessary precondition for arriving at virtually full employment. But the way in which sanctions should be operationalised tends to differ, as does the way in which people should be encouraged to find work. These conceptual approaches may be summarised as follows¹⁰.

The *neo-classical perspective* considers that in principle a decrease in benefits provides sufficient endogenous sanctions to get people to work; it provides the intellectual background to an *entitlements model*, based in particular on financial incentives and the minimisation of government interference. The *institutional co-ordination perspective* take the present benefits as given and supports these with intensive case-work. This line of thought provides an *active integration model*, on the basis of an enabling strategy. It differs from the present policy of regulating the volume of claimants in terms of an effective autonomous policy of sanctions on the basis of 'trigger clauses' agreed with

⁹] See also earlier Reports to the Government by the Council, such as *An Active Labour Market Policy* (no. 33, 1987) *Immigrant Policy* (no. 36, 1989), *Work in Perspective* (no. 38, 1990), *Demographic Developments and Policy* (no. 43, 1993), *Interest and Policy* (no. 45, 1994) and *Social Dichotomy in Perspective* (no. 50, 1996).

¹⁰] A separate chapter is devoted to these approaches in the original report.

the client in the latter's case management contract and by a high measure of regulatory freedom for administrators, linked to performance evaluation. The *market co-ordination perspective* reduces the minimum wage, but at the same time the present benefits - including the statutory minimum - are transformed into a ceiling on the supplementation of independent earnings. In this way it combines the thinking and the sanctions of the two preceding schools of thought into a *supplementation model*, with a view to promoting self-reliance and easing the burden on individual case management. These supplements enable labour to be tapped that remains dormant at the present minimum wage.

1.4.2 Evaluation criteria

This report presents a tentative illustration of these three paradigms, without feedback and quantitative underpinning, as 'uncompleted scenarios'. There are two reasons for such caution. To spell out the underpinning would, to begin with, demand the a priori determination of the norms, values and behavioural reactions that now in fact form the subject of debate. The Council wishes to avoid this by analysing the problems in terms of five evaluation criteria (to be weighted at a later point) - equity, legitimacy, effectiveness, efficiency and sustainability - and to indicate how alternative measures would 'score' in these terms in accordance with the adage 'what gains priority in the political process must weigh the most heavily*.

A reflection on the changing appreciation of employment, with which this chapter began, makes it clear that the effectiveness of promoting labour force participation will need to be given greater weight than in the 1970s and 1980s. In addition growing support was noted for the balance between rights and obligations implicit in the concept of equity as well as for the view that the legal guarantees of the disabled and the retired deserve better protection. This then establishes the contours of the playing field, but the game itself remains to be played. The various types of games are summarised in the action perspectives noted above, each of which interpret priorities differently.

Apart from the argument that a prior specification would bring the debate about the criteria for the future system of social security to a grinding halt it is, secondly, simply impossible to make a credible calculation of the longterm consequences of alternatives. The available econometric models have been specified on the basis of historical data. However, the various schools of thought contain so many new normative elements and as yet unknown behavioural reactions that it would not be justified to handle these in terms of coefficients based on the 'old' situation. The genuine innovation of social security therefore calls for political entrepreneurship, the courage to strike down new paths and the openness gradually to learn and to adjust course.

1.4.3 Policy analysis as an iterative process

An iterative confrontation of objectives and (constraining) criteria generates the objectives ultimately at issue, for no-one is bound by the impossible or the undesirable. The main objective of this report - work for those who wish to work and income guarantees for those who are unable to work or no longer need to - requires further specification. What does the objective of near-full employment in fact entail? What rate of unemployment is acceptable in an age of high frictional unemployment? What priorities are there within that objective? How do we deal with the displacement problem? These are all *political* questions - questions concerning the political weighing of the efforts and sacrifices that must be made in order to achieve specified objectives (what is it going to cost?). Conversely the same applies to the specification of criteria, i.e. to the question of the extent to which the ends justify the means (how much is it allowed to cost?). For these are the questions that are subject to political accountability.

Criteria governing policy choices in social security

2.1 Brief summary of the criteria

The Council has chosen five criteria with which to evaluate the three possible future strategies for social security. These are: equity, legitimacy, efficiency, effectiveness and sustainability. Equity and legitimacy relate to views about the norms and values which govern society - that is, legal opinions which affect the way society is ordered, but which can be interpreted in more than one way. As a result, *equity* is not a self-evident concept. Preferences for this or that interpretation are determined by different views of society and in particular by how much responsibility individual players are able to assume for their own social security in a rapidly changing world. *Legitimacy* relates to the extent to which the interpretation of norms and values satisfies legal rules and guarantees. Traditionally, the organisation of social security is based on the notion of redistributive justice inherent in the ability-to-pay principle. This chapter will show that the balance between rights and obligations has not been adapted quickly enough to match changing social circumstances.

By contrast, criteria such as efficiency and effectiveness can in principle be objectivised to a large degree. *Efficiency* - the principle of making the least possible sacrifice to achieve a specific goal - is based on clear theoretical economic insights. *Effectiveness* also means what it says, i.e. are the set goals - namely jobs for those who can work and adequate financial provision for those who can't - genuinely being achieved? And are they being achieved with due regard for explicitly formulated normative parameters of equity and legitimacy?

Finally, *sustainability* is a subjective appraisal based on forward-looking surveys whose conclusions become more tenuous the further they are projected into the future. This makes it an extrapolation of the classic assessment of equity and legitimacy over time, which again tries to give substance to the *guarantee function* of social security.

Basically, then, this chapter shows that an entitlements strategy is formulated by balancing different requirements emanating from different angles: in the case of equity and legitimacy, it requires a consideration of subjective *assessments*; in the case of efficiency and effectiveness, it is based to some extent on objectifiable *facts*; and in the case of sustainability once again on necessarily subjective *expectations*.

2.2 Equity

Equity relates to the *material* legitimacy of questions of distribution (who is entitled to what?) and to who decides who gets what - i.e. the question of *political* legitimacy. In an ideal democracy, only the sovereign 'wishes of the people' count. This section examines how social security systems relate to notions of freedom, equality, individualism and solidarity, as experienced by individual citizens. It does not take account of the possibility of those citizens trying to cheat the state, nor will it consider how the wishes of sovereign citizens are transformed by their own interests, preferences and by the calculations of those who represent them. In practice, representatives are always needed to implement the 'wishes of the people'. These representatives can either be elected politicians or other elected or non-elected players linked to the network of community-based organisations. All these intermediaries or lobbyists in turn have their own preferences and their own scope for calculating behaviour.

The links between social security and the labour market affect the way the system is organised. In the interests of prevention and reintegration, a policy designed to maximise labour market participation must be closely linked to labour market developments. Within the labour system, specific rules govern rights and obligations; habituation to these rules is part of the (re)integration process. The situation is of course different for retired and permanently incapacitated individuals, who have either already done their 'duty' to society or have been discharged from further fulfilment of that duty. However, a sense of equity ensures that their incomes continue to be linked to those of the working population. A review of conceptual or material equity must therefore begin with an analytical account of the structure of income from employment.

This structure can be explained by differences in labour productivity and added value, which are in turn linked to levels of education in relation to technological development. By and large, then, income disparities reflect the outcome of a race between technological development and education, as factors which respectively determine the demand for and supply of skills. According to Tinbergen, the outcome of this race and its consequences for income distribution are dictated chiefly by levels of training, given that technological developments take place largely autonomously¹¹. Failure to keep pace with technological developments will widen the gap in income distribution until the trend is reversed by an improved match between education and the labour market. This raises the question of how to share out the responsibilities between the government and the market in order to restrict the inevitable mismatch between supply and demand in a dynamic society, which can never entirely be avoided. This question is now more important than ever before, given the speed of international technological developments and the associated decline in job security. However, training alone does not provide an adequate explanation for the mismatch, since even within professional groups with a similar educational level and a similar market position, there are still substantial differences in the way in which individuals interface with the labour market. These subtler refinements, which have been studied by Sen and others, are largely attributable to differences in non-cognitive personal traits and side conditions¹². Hence work experience, talent, social skills, luck, ethnicity, gender, age, (corporate) culture and social connections or other privileges are also influential factors. Finally, Tinbergen himself cites the force of habit as the 'greatest force' influencing income distribution.

2.2.1 From explanation to standard-setting

Tinbergen's explanation of income distribution - taking into account the qualifications made - provides an empirical yardstick with which to work. However, a theoretical explanation does not automatically provide a standard against which to conduct a policy on income and social security. Here, normative theories of justice are required, which specify what is meritorious or necessary and then establish a causal and quantitative link between merit and work-related earnings or between needs and (unearned) income. The search for such an acceptable income distribution reveals two things. Firstly, that the acceptance of the refinements advocated by Sen and others appears to go hand in hand with the ideological willingness to accept government intervention. An acceptable form of distribution is not carved in tablets of stone but appears to depend on preferences concerning the scope of government interventions in the division of responsibility between individuals, the civil society and the

^{11]} See J. Tinbergen, *Income Distribution; Analysis and Policies*; Amsterdam, North Holland, 1975.

^{12]} A.K. Sen, *Commodities and Capabilities (Hennipman Lecture)*; Amsterdam, North Holland, 1985. See also K.W.H. van Beek, *To be Hired or not to be Hired, the Employer Decides: Relative Chances of Unemployed Jobseekers on the Dutch Labor Market*; doctoral thesis, University of Amsterdam, 1993.

government. Strikingly, these preferences certainly do not form a one-to-one match with existing ideological movements and party political affiliations. Proponents of a far-reaching protection of personal privacy, for example, can be found at both ends of the political spectrum - a phenomenon which can lead to a political 'devil's pact' against an active social security sanctions policy and in favour of a guaranteed minimum income. Secondly, it is one thing to accept philosophy, but quite another to establish a quantitative foundation on which to base a policy on income and security. This foundation cannot be constructed on scientific grounds; it remains normative and subject to the political process. It may therefore be useful to make a brief excursion into the main sources of political philosophy, following a range of views in which the demand for proof that government intervention can be dispensed with is gradually being turned around.

2.2.2 The contributive Standard and grounds for interventionism

If market-generated wage differentials are used to deploy people efficiently, this does not mean it is automatically fair to give those people unqualified rights to the counterpart of their contribution, in accordance with what is known as the contributive standard. A full application of the contributive standard was advocated in the past by the American economist J.B. Clark¹³, but has meanwhile been almost universally abandoned. On the contrary, it is now widely recognised that the market price of inputs is too heavily dependent on the division of power and on arbitrary scarcity factors to provide a legitimate basis for income distribution. Even if the government were able to cancel out

■ positions of monopoly power through a successful competition policy, it is still unclear on what legal foundation arbitrary factors such as scarcity bonuses arising from shifts in demand for skills could be attributed fully to those people who happen to possess those skills at the time. Changes in the wage structure are important for the dynamism of the economic process; they indicate where the deployment of labour needs to be adjusted to accommodate shifts in the demand for goods and services. However, this is an *efficiency* argument, not a principle of justice for the awarding of surplus profits over and above a standard private sector wage (as a compensation for accepting risk): the market and theories of justice do not always provide a perfect fit.

Hayek, the most authoritative writer on modern non-interventionism, therefore refrains from passing judgement on the inherent equity of the market process. In the absence of a better alternative, he advocates a passive acceptance of a distribution of property rights generated by a free market - not because the market provides a justification of such a distribution but because it at least does so without prejudice. This anonymity reduces the arbitrariness which would be inherent in opting for an explicit distribution criterion: Hayek's notion of freedom embraces a 'freedom from' (in this case, freedom from arbitrary coercion) and not a 'freedom to'. Hayek is thus accepting the contributive standard not as a principle of law but on instrumental grounds because it reduces arbitrariness: 'our objection is against all attempts to impress upon society a deliberately chosen pattern of distribution, whether it be an order of equality or of inequality'¹⁴. The entitlements policy described in chapter 3, which reserves a minimum of discretionary powers for the government and the least possible encroachment of personal privacy, can be traced back to his ideas, which are still valid today. If the social risks have increased due to accelerated labour market dynamism, so have the risks of government intervention. This already shows that the ultimate choices concerning the organisation of society cannot be divorced from perceptions relating to individual self-reliance.

^{13]} J.B. Clark, *Distribution of Wealth*; London, Macmillan, 1902.

■>] F.A. Hayek, *The Constitution of Liberty*; Chicago, Aldine, 1960, p. 87.

Other theoreticians on justice, such as Rawls and Sen, explicitly go in search of the legal foundations for an acceptable form of income distribution. They refine the significance of the contributive standard by pointing out the strategic importance of a given initial distribution of ownership rights and power of decision as factors affecting income formation. Failure to take account of these factors results in a failure to understand how initial opportunities can be influenced by relevant antecedent privileges such as social background or inherited characteristics¹⁵.

According to Rawls, it is only possible to judge what is truly fair by divorcing oneself from one's own more or less privileged social position, since it is likely to colour that judgement. To this end, Rawls conducts an experiment in which a group of people are invited to express their hopes for a just society from behind a veil of ignorance about their own future position in that society. This provides the springboard for his distribution criterion: within a system of elementary and universally applicable freedoms, inequalities must be structured in such a way that they create the greatest possible benefit for the least privileged groups¹⁶. In a free society, Rawls accepts inequalities provided the least privileged are allowed to benefit from them. If economic growth demands unequal incomes, the fruits of that growth must benefit the least privileged as a matter of priority. Rawls also uses the 'veil of ignorance' to remove a major source of unfair inequality: that of 'antecedent privilege', such as social background or inherited qualities. Freedom is not just about protection from arbitrary coercion but also about creating equal opportunities (freedom to).

Sen concentrates on immanent differences in skills. He makes it clear that the ability to exact rights, turn congenital characteristics to good account or convert what has been learned into practice is unequally divided among individuals¹⁷. Rawls and Sen each in their own way put into perspective a simplistic 'newspaper boy turned millionaire' optimism by drawing attention to the popular wisdom that it is difficult to become rich if you are born poor. They put forward arguments for government intervention by pointing out the arbitrary role played by privilege in income distribution and at empirically recognisable differences in individual self-reliance. They thus put forward legal foundations for an active state-controlled labour market policy with special attention for the least privileged.

Social interaction and intervention, which were already recognisable in the arguments put forward by Rawls and Sen, are a key element for Tinbergen, who in addition to his analyses of the *creation* of income also developed a normative theory on income *distribution*. Tinbergen uses as his criterion the fundamental equality between individuals¹⁸. Using this as his point of departure, Tinbergen argues that differences in income are only justified if they allow everyone an equal chance of achieving prosperity. This does not require equal incomes but rather *compensatory differences* which give individuals their 'due' by compensating for structural handicaps which obstruct income creation, such as incapacity for work, or inevitable differences in the degree of effort or sacrifice involved in certain jobs, which some people must put up with in order to earn their income. These include differences in the length of the working

^{15]} J. Rawls, 'The Basic Structure as Subject'; *American Philosophical Quarterly*, Vol. 14, 1977, pp. 59-65.

^{16]} See J. Rawls, *A Theory of Justice*; Cambridge, Harvard University Press, 1971.

^{17]} See A.K. Sen, *Poverty and Famines; An Essay on Entitlement and Deprivation*; Oxford, Clarendon Press, 1981; 'Equality of What?'; in: A.K. Sen, *Choice, Welfare and Measurement*, Oxford, Basil Blackwell, 1982, pp. 351-369; *Commodities and Capabilities*, op. cit., and *Inequality Re-examined*; Oxford, Oxford University Press, 1992. ^{18]} J. Tinbergen, *Income Distribution: Analysis and Policies*, op. cit. Tinbergen postulates equal utility roles for everyone, which implies that different individuals would derive the same utility perception from the same level of income or power of disposal, and that differences and fluctuations in that level of income would be experienced in the same way by all individuals.

week, inconvenient working hours (split shifts, shift-work), dirty and unpleasant work, varying productive life spans in certain careers (e.g. professional sports people) and, to some extent, responsibility and risk acceptance. In the theoretical context in which earned and unearned incomes are fully able to offset handicaps, effort and sacrifices, the opportunities for achieving prosperity would be the same for everyone.

The application of these ideas to social security not only provides a legal foundation for differences in benefit levels relating to an individual's previous working life, and which may form part of an active integration policy or a supplementation policy, but also for compensatory differences in the efforts and sacrifices which clients are asked to make in return for their social security benefits. When imposing reciprocal obligations on benefit claimants, specific differences in levels of skill and self-reliance provide a basis on which to treat people *differently* in order to give them the *same* opportunities to achieve prosperity. The dilemmas inherent in the difference between Hayek and Tinbergen's ideas widen during periods of more rapid economic growth, which is why legal philosophical reflections are important when readjusting the balance between equity and the other criteria defining social policy.

2.2.3 Limitations of the theory

In the development in thinking leading from individualism towards social interaction, the burden of proof against government intervention is gradually turned around: Hayek is wary of arbitrary coercion, whereas Tinbergen argues that a social constitution must explicitly be able to justify income differentials. This spectrum of political theories supplies the argument underlying the normative assessment of social security alternatives. These are *normative theories* whose justification cannot be proved (*Sollen* not *Sein*). They serve as a source of inspiration for the political process and exposé dilemmas whose importance grows as it becomes more important to take risks, as at the present time. These theories do not by their nature lead to any concrete results; they are heuristic and hypothetical-normative by nature: 'if you want this or that, *then* you must do such and such. It's up to you to decide salary scales and to define the level and duration of social benefits in accordance with the principles you have embraced.'

The theories discussed above also reflect more substantial limitations. They are, for example, all based on a theory of statecraft which sees the relationship between the government and its citizens as a social contract and does not regard the state as a separate identity with its own, autonomous brief. It is therefore all the more remarkable that these 'contract theories' deal almost exclusively with the apportioning of rights. The *obligations* which counterbalance those rights are barely addressed. This omission is similar to the political practice of the 1960s and 1970s, which centred on an optimistic view of social policy. The lessons taught by fiscal policy - namely, that the collectivisation of social security funding (through social insurance premiums and taxes) does not in itself lead to discretion in individual claims but rather to a shifting of their consequences on to others, and that existing legal structures are not able to respond adequately - still had to be learned. Section 2.3 therefore explores in more depth the complementarity between redistributive justice and equalised opportunity as facilitating legal systems which favour the balancing of rights and obligations.

2.2.4 Solidarity and social cohesion

The overemphasis on rights described above also leads to a neglect of the reciprocity of rights and obligations inherent in the principle of solidarity. Here again, the authors quoted represent the limitations of the theory of

justice. All proceed from a view of society in which, notwithstanding their different preferences concerning the size of the transfer payments, they all tacitly assume that this solidarity covers the whole of society without exception. Nor do they see any problems regarding representation in the institutionalisation of transfer payments. The debate, which is dominated by the Anglo-Saxon tradition, is generally restricted to questions of sovereignty between the citizen and the state, without giving any credence to the consensus-creating intermediary institutions of the 'Rhineland' model. Both aspects require further study. The rest of this section is therefore devoted to the scope for solidarity and the institutional and conceptual aspects of the distribution of power.

In making the case for transfer payments, Rawls, Sen and Tinbergen more or less implicitly assume that citizens in different social categories share a mutual responsibility; without this assumption it would be difficult to generate much solidarity. A social contract is suggested which would bind parties to an agreed level of solidarity without anyone trying to buck the system. This approach centres on the 'what', as opposed to the Rhineland model which focuses more on the 'how'. The Netherlands has developed a variant of this based largely on principles of subsidiarity. In this variant, solidarity is not primarily seen in terms of an imposition by society as an indivisible whole but of the constituent relationships which make up society. These solidarity-engendering relationships represent an important value which - in this approach - the government should protect rather than undermine by assuming responsibilities which rightfully belong to others.

During the 1980s, the concept of subsidiarity came under pressure in the Netherlands. As amply demonstrated by the Buurmeijer committee of enquiry responsibilities were diluted as no-one felt responsible anymore ('*de WAO is een wees*' - 'the Disability Insurance Act is an orphan'). An important question which must be asked here is which social relationships within the civil society can be regarded as solidarity-engendering relationships. Chapter 1 discussed the extent to which economic dynamism is forcing greater mobility on people. This is reducing the importance of the traditional formats of solidarity. Risks will increasingly need to be covered at lower or higher levels. The tendency of collective labour agreements to be concluded within individual companies rather than at branch level is an example of the first, while the recent merger of trade unions is an example of the second.

The notion of undivided solidarity also needs qualifying. De Beus, for example, recently presented a theory in which he divided society into three broad categories: winners at the top, survivors in the middle and structural losers at the bottom. He claims that these three categories do not mix, which makes it difficult to mobilise them to combat major social inequalities¹⁹. In a similar vein, Van der Zwan identifies three social categories: privileged, underprivileged and disadvantaged individuals - categories which are no longer defined by social standing or class but by differences in personal qualities. These include not just cognitive skills but also characteristics such as resilience, drive and social dexterity²⁰. Strikingly, those who are now in the top stratum, which is highly susceptible to inflow and outflow, are taking themselves and their earning capacity more seriously than the old elite: 'The new elite sees itself much more as a meritocracy which has been selected on the basis of performance, and not only regards the position it has acquired as socially justified but also

¹⁹] J-W. de Beus, *Economische gelijkheid en het goede leven* (Economic Equality and the Good Life); Amsterdam, Uitgeverij Contact, 1993. ²⁰] A. van der Zwan, 'Bestaat er voor het socialisme nog een herkansing?' (Does Socialism get a Second Chance!);

Socialisme en

Democratie, Vol. 53, no. 5, 1996, pp. 257-275.

sees in this a licence for moving up the social ladder: the less fortunate are thus shown how they can apply the success formula to themselves²¹. Van der Zwan believes that the successful elite is imposing its own view of society as a social norm and warns against a revival of the pre-war phenomenon of inherited status due to congenital privileges and 'svho you know', while the emancipatory influence of education on career prospects will decrease.

Research by the Dutch Social and Cultural Planning Office (SCP) on the other hand suggests that the gradual erosion of support for income redistribution during the 1980s has been reversed since 1993²². However, this observation does not cover a long enough period to allow a confirmation that a new trend is taking place, and it is therefore advisable not to regard renewed support for solidarity as self-evident²³. If a social security system is to obtain ongoing support, it must at least function in accordance with its aims. Research conducted over a longer period by the SCP and others shows that people tend to remain consistently loyal to a good system and are unforgiving of those who abuse the system. The belief that you cannot expect to get something for nothing is firmly embedded in individuals' sense of justice, yet there is also compassion for those in genuine need. This is also reflected in a differentiated attitude to the various types of benefit. People are in favour of a full state old age pension and against limiting the duration of invalidity benefit for those who are 'genuinely incapacitated. Yet despite strong public feeling against those who abuse the benefits system, people nevertheless tend to turn a blind eye to single women on welfare who supplement their income illegally.

2.2.5 The political legitimacy of the social order

At the interface between equity and legitimacy lies the question of political appropriateness. Whose preferences (should) count? How are responsibilities allocated? Equity is about desirable situations and legitimate aspirations; legitimacy is about legally anchored compromises - if things cannot be as good as they should be, they should be as good as they can be. Whatever the case, questions of legitimacy are of decisive importance for the way in which social security is implemented. Who is social security for, and who should provide it? Voters, as the electors of a parliamentary accountable government? Employers and trade union organisations? Individuals who can arrange their social security through private insurance? Once again it is a question of ideological views about the way society should be ordered. In the Rhineland model of social consensus and policy co-ordination, it is precisely the *how* - i.e. the manner of implementation - which often determines *what* a social security system can achieve. This has been documented in detail by the Buurmeijer committee of enquiry and the Van Dijk commission, which evaluated the performance of the manpower service²⁴.

What role do the various players - government, the civil society and individuals - play in the three conceptual approaches identified earlier? In the *entitlements model*, the government plays a minimal role in the organisation of solidarity. At first glance, a restrained social insurance policy places prime

21] Ibid, p. 264.

22] See Social and Cultural Planning Office, *Sociale en Culturele Verkenningen 1996* (Social and Cultural Survey 1996); Rijswijk, 1996, p. 13.

23] See also WRR, *Social Dichotomy in Perspective*; summary of the 50th Report to the Government, The Hague, 1996, chapter 4.

24] See Committee of Enquiry into Social Security Executive Agencies, *Enquête naar het functioneren van de organen belast met de uitvoering van de sociale-verzekeringwetten* (Enquiry into the Functioning of Agencies Responsible for the Administration of Social Security Legislation); Lower House of Parliament i 992/1993 session, 22 730, no. 8; and Commission for the Evaluation of the Manpower Services Act, *Arbeidsvoorziening in perspectief; Evaluatie Arbeidsvoorzieningswet 1991-1994* (The Employment Service in Perspective; Evaluation of the Manpower Services Act 1991 -1994); The Hague, VUGA, 1995.

responsibility for obtaining and retaining employment with the individual citizen, which seems to accord with Hayek's views. In the Rhineland model of social consultation, co-operation and mutualism, however, employers and workers can be expected to conclude non-statutory top-up arrangements over and above the entitlement model, by way of collective labour agreements. Esping-Andersen sees the corporative structure as a suitable alternative to the statist approach of a broad welfare state²⁵. Those who attach importance to contractual freedom will not object to supplementary arrangements under private law. However, they will need to realise that if most schemes are non-statutory arrangements, the mini-system will only exist outside the collective labour agreements. This consequently raises the question of whether an entitlements policy does not actually delegate responsibility for social security policy onto community-based organisations, which would make co-ordination with the public responsibilities in employment and education policy difficult. If the government is only responsible for a low level of basic provision and non-governmental organisations are responsible for a broad supplemental package, this will create a series of horizontally fragmented privatised responsibilities which have in the past proved difficult to oversee²⁶.

By contrast, an *active integration model*, in the form elaborated here, is based on a dominant role for the government in the organisation of solidarity and in monitoring cohesion with employment and education policy. The much broader policy conditions governing this approach would create far less need for non-statutory top-up arrangements than under the entitlements model and thus far less risk of a private law system dictating to a statutory mechanism. Although the lessons drawn from the 1980s showed that there can only be one overall co-ordinator of social security policy, ways will nevertheless need to be found of involving employers and workers in the practical aspects of social policy, if only because prevention and reintegration take place largely within companies which are governed by private law. The focus on employability in this model points to positive opportunities for co-operation in employment policy. However, it should be recognised that an active integration policy makes far higher demands of the government to enforce a sanctions policy as a way of activating obligations than in the claims reduction policy currently being implemented. It remains to be seen whether the existing administrative regulatory tradition is up to this - a question which is explored in detail in the next section.

Finally, in a *supplementation model*, the individual himself is in principle expected to find work (with the government jobs plans acting as a safety net), with statutory supplementary benefits dictated by the individual's willingness to accept work. Although the primary responsibility of the individual is strongly emphasised, the government is responsible for providing income supplements when appropriate. This approach again makes high demands of the delivery system and again also requires close practical co-operation with employers and workers.

²⁵] G. Esping-Andersen, *The Three Worlds of Welfare Capitalism*; Cambridge, Polity Press, 1990, p. 60, in which he explains this view as follows: 'The unifying principles of corporatism are a fraternity based on status identity, obligatory and exclusive membership, mutualism, and monopoly of representation. Carried over into modern capitalism, corporatism was typically built around occupational groupings seeking to uphold traditionally recognised status distinctions and used these as the organisational nexus for society and economy'.

»] See WRR, *Belang en beleid; Naar een verantwoorde uitvoering van de werknemersverzekeringen* (Interest and Policy; Towards a Responsible Implementation of Employee Insurances); Reports to the Government no. 45, The Hague, Sdu Uitgeverij, 1994.

2.2.6 Evaluation

These theories show that the criterion of equity can be interpreted in a variety of ways in a scale that ranges from the contributive principle, the enabling principle of equal opportunities and the interventionist principle of compensatory differences. The role ascribed to the government on the basis of each of these principles and, conversely, the responsibilities attributed to individuals and community-based organisations, is very different. Rawls, Sen and Tinbergen all put forward legal foundations for far-reaching intervention by the government or the 'civil society' in income distribution and social security, and thus also advocate an active integration or supplementation policy. These authors operationalise the ideal of 'equal opportunities' not by creating formally equal *starting* opportunities (as in the constitutional provision which states that public offices are open to every Dutch citizen) but by an enabling or more directly interventionist policy which creates equal opportunities to achieve *results* by tackling the handicaps which rob equal opportunities of their true meaning. Hayek's dislike of interventionism - even the restrained, enabling variant - leads to the more arm's length entitlements policy approach. Rawls bases his distribution criterion on what individuals agree with each other through the political process concerning a redistribution policy designed to maximise the benefits to those at the bottom of the social ladder. Tinbergen feels this does not go far enough. He takes Rawls and Sen's approach to welfare distribution as a social interaction process to its ultimate conclusion. Hence it is not a question of what we agree with each other about a greater or lesser redistribution of unequal incomes, but of a recognition of fundamental equality as our point of departure, in which the incentive generated by income differentials remains restricted to compensation for demonstrable inconvenience.

What is striking is that the traditional approach to the theory of justice is limited to elaborating a view of the rights which citizens can claim for themselves in a society without addressing the obligations which social solidarity imposes, as a notion of inherent *reciprocity*. Moreover, equity is not just about content - the question of *what* - but also about institutional structure - the question of *how* - an aspect which also receives surprisingly little attention in the current tradition in the philosophy of law. This is discussed in more detail in the next section, which will show that the sustainability of the content chosen depends largely on the selected institutionalisation of the balance between rights and obligations.

2.3 Legitimacy, legal guarantees and privacy

2.3.1 Notions and systems

The Rule of Law seeks to protect citizens by providing systems of vertical and horizontal equity. Traditionally there have always been two basic distributive systems available: redistributive justice and the exchange principle of due process. Redistributive justice guarantees the rights of citizens when they are unilaterally dependent on the authority of the State, while due process - operationalised as equalised opportunity - guarantees fair trades between citizens, or between them and the government in situations, in which there is a quid pro quo based on transaction. Neither legal system encapsulates a notion of equity as such; both are merely *systems* designed to give form to what a society perceives as fair.

Redistributive justice is a system which unilaterally ascribes rights to specific categories of citizens in accordance with the law. It expresses a notion of the state in which the government, as a statutory body, is placed *over* the citizen, as well as a legal fiction that the needs (rights) of people and their ability to

offer something in return (obligations) can be made recognisable and classifiable according to social characteristics such as age, income or lifestyle. It is precisely this one-sided government monopoly on power which makes it necessary to give legal protection to the citizen, such that the interpretation of 'equality' is recognisable, transparent and verifiable for both the citizen and an independent court on the basis of external characteristics. This in turn makes it necessary to formulate rights and obligations in categories which allow little or no scope for the individualisation or subjectivisation of what could be regarded as equal treatment in unequal individual circumstances.

Such a legal system has a double information problem. In the first place, the classification of rights becomes more difficult the more individualisation grows and the more complex relationships become. This eventually leads to an unworkable proliferation of categories. Moreover, the empirical fact that people are different makes it difficult to prevent misuse and abuse of the system.

By contrast, a due process-based system of *equalised opportunity* seeks legal guarantees in the creation of equal opportunities to achieve results, in a two-sided balance of power between equal parties. These legal guarantees apply equally to relationships between citizens and between citizens and the government, in situations where the government acts as a market player, in which case the government is also bound by what has been agreed in quid pro quo transactions: a contract is a contract. Within a system of equalised opportunities, the obligation to try to minimise social security claims is translated wherever possible into specified results or outputs, for which the parties can be held accountable, while the balance of power is maintained by a system of checks and balances.

The Council sees the imposition of obligations not only as a condition for maintaining adequate support for solidarity, but also as an emancipatory goal in itself. Wherever possible, people should participate in society on an equal basis. This means that claimants who are capable of working should show that they are trying to limit their dependence on social security; also, participants on (re)training courses or reintegration schemes will be expected to make an effort comparable with what individuals in paid employment are being asked to do²⁷. But it *also* means that employers, the social security delivery system and policymakers will be expected to meet their obligations in their turn.

Since the nineteenth century, the democratic state has increasingly been seen as the guardian of redistributive justice with the task of unilaterally apportioning rights and obligations. Since its inception, the welfare state has organised individually enforceable rights which are collectively financed under *democratic coercion*. Individual action to minimise reliance on the state is still obligatory, yet it is precisely those obligations which are difficult to operationalise in a society which is becoming increasingly individualised. Under systems of equalised opportunity, ways of *individualising* the balance between rights and obligations are sought, taking account of non-categorisable differences between individuals. The key question in this section is therefore to what extent a public financing mechanism as a reflection of solidarity is sustainable and desirable without the support of an individualised reciprocal performance based on *economie or social incentives*.

In analytical terms, redistributive justice and equalised opportunity both have their strong and weak points in the implementation of the welfare state. In the next section, both systems are assessed in terms of their instrumental aspects,

²⁷ L.M. Mead argues in a similar vein in *Beyond Entitlement The Social Obligations of Citizenship*; London, Collier Macmillan Publishers, 1986, p. 10, that: 'The idea [...] is to combine requirements with support in a balance that approximates what the nondependent face outside government. This treats the dependent like other citizens in the ways essential to equality'.

based on the question of what they can contribute to the operationalisation of the ideas described in chapter 3. This will show that both systems can guarantee a high level of protection, and that the traditional preference for redistributive justice as an instrument in the modern welfare state is not as self-evident an option as is often supposed. The thesis which will be elaborated is that in all the conceptual approaches described, it is desirable to adjust the definition of *rights* in public law in line with the principle of redistributive justice, but that an active integration and supplementation policy can and must create a much bigger role for a direct confrontation of rights and obligations in equalised opportunities in order to prevent misuse and abuse of the system and to arrive at lasting solutions.

2.3.2 Redistributive justice, information asymmetry, and misuse

Under a system of redistributive justice, the government or another authority with statutory powers awards benefits to groups of citizens on the basis of seemingly objective grounds; the costs are borne collectively. At first sight this seems a highly legitimate construction: rights are allocated by or in accordance with the law and can be enforced through complaints or appeal procedures in the event of default by the government. However, redistributive justice is difficult to operationalise: because the *information* is unequally divided between the supply and demand sides, the objectivity of the grounds for allocation can be manipulated. So although the rights of clients may have been categorically established, it is often difficult to check whether these individuals have made enough of a reciprocal effort to limit their reliance on the state. The same applies to the efforts of employers and the delivery system which are also obliged to deliver their contribution to the process of prevention and reintegration. A system of regulations and redistributive justice is susceptible to 'lidden decisions', which can easily lead to misuse and abuse by providers or demanders of social security and can obscure the underlying realities. On the demand side, this is expressed in 'rent seeking', while on the supply side it takes the form of a reluctance by the officials in the delivery system to take decisions which may be unwelcome to their superior or the client.

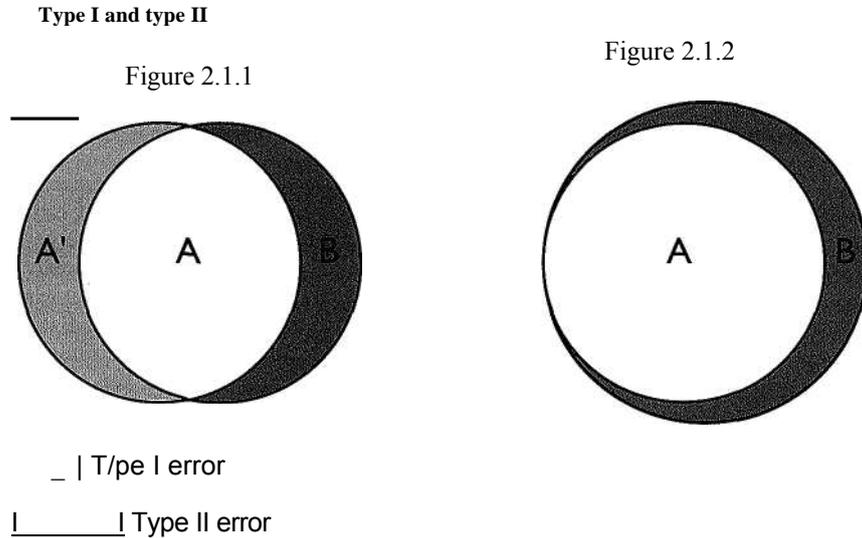
Misuse and abuse of the system complicate the work of those who are required to evaluate the legitimacy of individual claims, and of all the other parties involved in the subsequent processing of the claim. For example, is the claimant really involuntarily jobless? Have others perhaps been forced onto benefit by their employers? Is the delivery system trying to cut corners? Because of the enormous interests at stake, redistributive justice under the current level of benefit payments is constantly threatened by unintended application of the law by claim assessors and by misuse and abuse during the rest of the delivery process. Claim assessors, clients, implementing officials and policymakers all take shelter under the umbrella of the law, which even in doubtful cases is still often enforceable. This applies not just to individual cases at micro-level: the macro and meso-level of government, administration and employers also manipulate social security provisions to suit their own ends²⁸.

The restoration of sustainable conditions requires claim assessors who make few mistakes and do not allow themselves to be influenced. However, the job of assessment is becoming increasingly difficult as personal characteristics in a complex society become less recognisable and the level of benefit becomes more attractive, as in the case of an active integration or supplementation policy. In practice, a combination of identifiability problems, tendency towards

²⁸] See Committee of Enquiry into Social Security Executive Agencies, op. cit., and WRR *belang en beleid* (Interest and Policy), op. cit., specifically p. 86 et seq.

misuse and abuse and fear of being reprimanded for incorrectly failing to award benefits (type I error) often means that more generous benefits are awarded than should be (type II error). Figure 2.1.1 illustrates a type I error, where part of the target group (A) is missed (A_i), thereby leading to a type II error, in which misuse and abuse of the system occurs (B). In figure 2.1.2 the benefit provision has been extended to at least cover the whole target group (A), thereby also increasing the incidence of misuse and abuse (B).

Figure 2.1 errors



Source: CA. Hazeu, 'Het aanbod van collectieve voorzieningen' (The Supply of Collective Goods); *Economisch Statistische Berichten*, 2 January 1980, Vol. 65, no. 3236, pp. 16-21.

The problem of type II errors can be tackled in three ways:
 a review of legislation;
 improving the performance of claim assessors;
 greater emphasis on prevention and reintegration in the rest of the delivery process and a more effective application of sanctions.

A number of important innovations have been introduced into legislation and regulations in recent years. These include the new Manpower Services Act (1996) which increases the scope for employing difficult to place job-seekers and for a more effective response to demand for labour, and the new reap-praisal scheme for invalidity benefit, which focuses on the possibility of recovery and on reducing the unworkable intricacies in benefit categories, which have now outlived their purpose. Further attempts to raise the threshold of the benefits system, such as stricter reference requirements in the Unemployment Benefits Act or the policy of providing only basic insurance to categories of incapacity which are difficult to verify (back complaints and psychological disorders) should be approached with caution. Although the incidence of type II errors may be reduced in this way, the disadvantage is that it increases the incidence of type I errors, in so far as a reduction of the target group is not an end in itself but the result of an inability to control the incidence of type II errors. This applies especially in case of an undifferentiated level of benefit payments, which are so low that alternatives on the labour market very quickly become more attractive than this minimum benefit. Also, limiting benefit rights can never completely rule out the risk of a type II error; claim assessors will for example always have to keep an eye out for illegal earnings. However, substantial improvements can be made by shifting the emphasis in the administrative law guidelines for the delivery process from

inputs (procedures) to output targets, which specify the need to work towards prevention and reintegration wherever possible.

The performance of claim assessors will be improved by a review of the administrative guidelines to promote prevention and reintegration and improve checks and the application of sanctions. This means improving the professional skills of the officials concerned, for example through supplementary training, and inter-professional checks on client files - all of which are the direct responsibility of the government when it comes to evaluating initial claims for social security. It is also essential to create balanced appeals procedures in order to prevent jurisprudence from moving one-sidedly towards widening the grounds for upholding a claim.

More generally, however, the policy envisaged by the Council requires more than just a regulatory overhaul. A policy aimed at substantially increasing labour participation places high demands on the attitude, behaviour and co-operation of all those involved. The increasing diversity and dynamism of individual circumstances and opportunities on the labour market means that it is becoming more and more difficult for unilateral rules to dictate what individuals and organisations must do to control the number of welfare claims. Although it is possible to influence the attitudes and behaviour of those involved, it is not possible to regulate them: results are only likely to be achieved if the players are given the scope to co-operate with each other in a committed and creative way. The important thing is to ensure that obligatory undertakings designed to optimise claims are lifted out of the sphere of 'hidden decisions' by means of agreements based wherever possible on result-oriented commitments to which the various parties can be held.

2.3.3 The fallacy of composition: the sum of the parts doesn't add up

In addition to the recognition that individual behaviour can be influenced at micro-level but not 'regulated', the 1980s have also taught us another important lesson at macro-level. The problem is not only that regulations are not equipped to deal with the complex realities of today, in which reduced identifiability, misuse and abuse and type II errors complicate attempts to treat people equally. There has also been too little understanding of the empirical fact that the rights of the individual (micro) cannot be guaranteed if the overall volume of claims (macro) becomes too great. This 'fallacy of composition' described below is a familiar concept in macroeconomics, e.g. in the paradox of thrift (if too many savings are made, expenditure is reduced to such an extent that growth is impaired). Sociology also warns that the sum of the parts can surprise us, e.g. through the loss of function of positional goods: 'If everyone stands on tiptoe, no-one sees better'²⁹. In law, however, the threat posed by the fallacy of composition is not recognised³⁰. In social security, misuse and abuse at micro-level has put so much macro-pressure on labour costs, competitiveness and employment that the guarantee function of the Sickness Benefits Act, the Disability Insurance Act and the National Assistance Act has become unsustainable in the 1990s. Consequently, it has become necessary to restrict benefit claims exclusively to what is *specified* by law in order to uphold the legitimacy and credibility of the social constitution. This not only requires a careful allocation of rights by the claim assessor but above all greater efforts to encourage claimants to fulfil their obligations in order to increase the labour participation rate.

²⁹] See F. Hirsch, *Social Limits to Growth*; London, Routledge & Keegan Paul, 1977, p. 5.

³⁰] See DJ. Wolfson, *Welvaart tussen recht en macht* (Welfare wedged between Law and Power); Royal Netherlands Academy of Sciences, Proceedings of the Department of Literature, New Series, Vol. 57, no. 3, Amsterdam, Noord-Hollandsche, 1994.

However, the recent tightening of obligations and sanctions has not yet produced the hoped-for result in terms of volume; the number of former invalidity benefit claimants re-entering the labour market is particularly disappointing.

The same is true of the reintegration results of the new National Assistance Act³¹. However, it may be that, given the still largely public control of the relevant delivery system, expectations may have been set too high. The announcement of administrative sanctions alone does not automatically create an enforcement mechanism for achieving lasting results. Case managers can be encouraged to improve their performance by means of output targets, but encouragement does not make for a strategic incentive, especially when there are a limited number of job vacancies and plenty of job-seekers to fill them. "Why should I go to the trouble of forcing one illicit worker into a mainstream job when there are three other job-seekers who really want it?" This attitude is a classic example of the fallacy of composition described earlier: those who fail to enforce the law in individual cases are helping to create a climate in which the law as such is no longer enforceable.

Obviously the problems do not lie solely with the delivery system as such. There are always ways for an employer who wants to get rid of an employee or a claimant who would rather leave work anyway to *formally* satisfy their obligatory undertakings; checking their *actual* compliance is extremely difficult. Therefore sanctions are often ineffectual in providing incentives in individual cases. At the very most they can serve as a last resort in cases of gross misconduct. On the other hand, employers and benefit claimants are to a considerable extent dependent on the insight and resources of the case manager to ensure the success of a prevention and an active integration policy. In actual practice, the system is too one-sided in its dependence: the client is dependent on authorities for work, benefit payments or facilities.

Yet, the relationship is still relatively non-committal, since the case manager for his part can only hold the client to certain actions and not results. All this makes the *inherent* legitimacy of what takes place within the "black box" of case management difficult to evaluate.

2.3.4 Equalised opportunities and transaction

In analytical terms, the scope for "bidden decisions" described above provides an opportunity to combine models of redistributive justice and regulations with equalised opportunities and transaction. *Transaction* is a pattern of reciprocal, transparent and effective commitments: a system of checks and balances in which 'money' as such is not always the necessary means of exchange. For example, if the client makes a commitment to attend a specific training course, his case manager is in return obliged to check whether the course is available and the government is obliged to provide that course. In exchange for the resources and authority with which he is endowed, the case manager is accountable for the management of the delivery system. Finally, the government also accepts an obligation to the voter, e.g. to set aside enough money to pay for an adequate prevention and active integration policy. Because transactions hold the various players to results based on *effectiveness*, politicians are forced to speak out about the goals they wish to achieve and how they

³¹] See for the Disability Insurance Act, Central Planning Office, *Centraal Economisch Plan 1996* (Central Economic Plan 1996); which contains a survey to the year 2000, The Hague, Sdu Uitgevers, 1996, pp. 116-118; and Social Insurance Supervisory Council, *In en uit de WAO; Een onderzoek naar volume-ontwikkeling en werkhervatting* (In and Out of Disability Benefit; a Study of Volume Trends and Resumption of Work); Zoetermeer, 1996; for the National Social Assistance Act, see Ministry of Social Affairs and Employment, *In en uit de bijstand; De positie van bijstandsdiensten en de factoren die uitstroom bevorderen* (In and Out of Income Support; the Position of the Beneficiaries and the Factors which encourage Outflow); The Hague, 1996.

intend to achieve them. This increases the transparency and the controllability of the democratic system, since within transaction mechanisms, suppliers and consumers of social services must make commitments and allow 'hidden decisions' to become *visible*. The thesis of this report is that the sustainability and enforceability of rights, as a legal guarantee, can be better secured if they are matched by a counter-commitment to perform certain actions or achieve certain results, which is tailored in transaction to individual capacities and which reduces misuse and abuse. The legal basis for this commitment is that in a participation policy, the aim is to allocate social security provisions in a way which guides eligible members of the labour force back to the labour market (which after all also works on a give and take basis). Moreover, if a transaction mechanism is based on checks and balances, a court can assess the reasonableness of these transactions by the revealed preferences of actors and by the legitimacy of the degree of 'good mercantile practice' shown in these revealed preferences.

The reciprocity of the transaction mechanisms guarantees the link between rights and obligations throughout the entire social security 'business column'. Not only are both parties required to agree on their intentions, but they are each required to *commit* themselves to certain results in so far as it lies within their power to realise them. Naming these results gives the sanctions instrument a far greater incisiveness than is currently the case, since everyone knows what is expected of them. In a complementary system of categorising redistributive justice for *rights* and of individualising equalised opportunities for *obligations*, rights, obligations and sanctions are specified clearly enough to create workable guidelines for law enforcement and for an independent assessment to be made of the care and reasonableness with which the underlying agreements have been reached.

This endogenous balance between performance and counter-performance not only improves legitimacy but also upholds efficiency and effectiveness. Exchange processes and the negotiations which precede them are efficient in so far as they reveal and coordinate the preferences of both parties at relatively low transaction costs. They promote effectiveness in so far as they simultaneously hold clients (employers *and* employees), implementing officials and the government to results. Finally, on the supply side, transaction creates scope for individual initiative and responsibility, a development which ties in with efforts to improve quality which have already been undertaken in other branches of the public service. On the demand side, equalised opportunity and transaction lends credence to existing processes of individualisation and to the divergent trends on the labour market, both of which require tailor-made solutions within balanced guarantees of legal security. These guarantees are provided due to the fact that the client's compliance does not need to be checked against rules which cannot take account of individual circumstances, but is instead arranged through voluntary agreements made following proper negotiation, to which both parties are bound.

The ability to terminate a transaction or to sign up with another party means that the transaction mechanism is fundamentally different from the market-analogous benefit principle in the tax system, in which the government retains its monopolistic position on the supply side. This type of monopoly on delivery has led to negative experiences in the social security sector. A competitive element is therefore now being introduced. Between the two extremes of exclusive reliance on the government or industrial insurance boards and forms of privatisation based on the free play of market forces, various intermediate approaches are conceivable, such as a public system guided by internal performance competition, or parallel privatisation. In the case of parallel privatisation, the government takes part in the delivery process in order to set a standard for quality, but forces the public delivery system to deliver an optimum

service by allowing clients to go elsewhere in a competitive private system which can offer the same facilities as the government.

2.3.5 Competition policy as a condition for equalised opportunities

In analytical terms, then, there is an alternative to the regulatory approach. If reciprocity is to be systematically introduced in the division of responsibilities throughout the system, and if what the Council has termed *strategie incentives*³² must be universally felt in order to support this, a very substantial change of policy will be needed. The importance of this is still seriously underestimated in the current debate on the implementation of social security. The same applies to the importance of free will - which is not quite the same as non-commitment - as a legal guarantee. Strategic incentives and the preservation of free will require the removal of dominant positions in an active competition policy which gives clients the choice between different case managers and keeps the delivery system on its toes so that it can retain its 'market share'. Against this background, the current policy of increasing the number of organisations making up the delivery system should not be regarded as a weakening but rather as a strengthening of the material security offered to clients.

2.3.6 So how would it work?

The Council recommends that a clear distinction be made between the responsibilities of the legislator, the claim assessor and the case manager. In a constitutional state, the *legislator* sets out an individual's rights to social security based on redistributive justice in the form of manageable categories of policy conditions. The *claim assessor* then decides on the basis of the law: how the client is to be classified, e.g. involuntarily jobless, 50 percent incapacitated, etcetera;

in the event of an application for income support, whether the individual has recourse to other means of subsistence which may invalidate his claim; to what extent the client may be asked to perform a reciprocal action (a complete or partial declaration of incapacity exempts an individual pro rata from the obligation to work but not, where relevant, from the obligation to work towards his own rehabilitation).

Benefit payments begin once the claim assessor has given the go-ahead. If the claimant has a legal duty to make himself available for work, he will (if he wishes) be given some free time to look for a job. Afterwards - or straightaway, if he prefers - he is referred to the case manager.

The *case manager* - together with the client and if necessary an employer whose involvement has been pre-arranged - lays down in a verifiable mediation agreement what is expected of the client and what facilities in kind the government will provide in exchange (training, wage cost subsidy, etc). Hence the obligatory counter-performance, which is formulated in general terms by the law, can be specified in more detail on a case by case basis and, where possible, formulated in terms of a result-based obligation which takes account of different individual capacities. The client is free to choose his case manager from among competing organisations in the delivery system - this will ensure that he is not forced to accept a particular 'agreement'. Or he can opt for a second assessment with another case manager, if he doesn't get on with the first or if he and the case manager are unable to reach a satisfactory agreement. However, there will come a (pre-agreed) moment when the selected case manager is *obliged* to impose a sanction or to request a second opinion from the

^{32]} See WRR, *Belang en beleid* (Interest and Policy), op. cit.

claim assessor as to whether the claim can be upheld, if a doubt arises or is documented concerning the level of commitment shown by the client. The obligation to impose a sanction can only be waived if an adequate reason is given, for example if the government was unable to provide the facility promised or if a client appeals against an overly harsh decision.

Clients who cannot reach a satisfactory agreement with their case manager, even after a second assessment, are termed 'culpably ineligible for mediation'. They will be denied benefit under the sanctions rules to prevent them from claiming a basic income to which they are not entitled. Claimants can submit a statutory appeal against a decision by the claim assessor. Appeals against the reciprocal commitments requested by the case manager or against the sanctions policy are put before an interprofessional panel. Complaints from clients are submitted to a complaints commission in the first instance and then to a court which will assess the mediation agreement and its implementation against prevailing law.

The approach outlined above requires a far-reaching delegation of competence to the case manager, so that he is able, within the constraints of the time and facilities budget, to treat different cases differently. Degrees of freedom for the organisations in the delivery system to answer should be combined with accountability to their principals, who are in turn expected to account to the minister concerning the creativity they have applied and the positive results they have achieved. Previous experience in reviewing policy on employment and supplementary benefits has shown that the cultural about-turn required in clients and the delivery system will not come about easily. It will also take a great deal of time, if only because the increased professionalism required by the members of the delivery system cannot be realised overnight. Moreover, experience has shown that attempts to overturn established behavioural patterns are never painless and that a large proportion of the energy needed for a process of social change is wasted on pacifying interest groups and lobbyists who are part of the problem rather than of the solution³³. Finally, the extensive experience already gained with result-based agreements in other public care sectors - e.g. in education, health care and public transport - still largely needs to be tested for practical feasibility in the case of social security. For all these reasons, the introduction of a tailor-made approach in the social security sector will require more time, more political will and more decisiveness than has so far been shown.

2.3.7 Privacy

A final question regarding legitimacy is to what extent an activation of obligations based on equalised opportunities can be reconciled with the need to protect personal privacy. It appears that there is no inherent incompatibility between the two. After all, the obligatory undertaking imposed on individuals to limit their reliance on social security according to their capacity, the need for checks and the possibility of sanctions to combat misuse and abuse are already accepted aspects of our legal system. Although the Council's proposal means that clients have to deliver what they promise, it also means that they know where they stand as regards checks and sanctions. In this connection, the Council again wishes to emphasise that although there is no room for a non-committal attitude, there is scope for free will. An individual who qualifies for unemployment benefit, for example, yet who does not want anyone to check whether he has fulfilled his commitments to reintegrate himself into the labour process, will not be awarded benefit and effectively imposes sanctions

³³ See C. den Broeder and G.M.M. Gelauff, *Governance of Stakeholder Relationships; The German and Dutch Experience*; CPB Study Memorandum no. 127, The Hague, 1996.

upon himself. Similarly, anyone refusing to reveal his or her household situation relinquishes the right to claim provisions such as a single householder's supplement. Conversely, this approach also protects clients against arbitrary intrusions into their private lives by case managers. This can be achieved through an active competition policy offering a range of alternative mediation options, through the formulation of additional parameters by the government and through appeals and complaints procedures.

2.3.8 The income unit: individual or household?

Finally, the question of what income unit should be the object of social security arises at the point where legitimacy, efficiency and effectiveness intersect. Changed views about individualism and solidarity are an important reason for re-examining the foundations of the social security system. The problem can be made more manageable by dividing it into primary, secondary and tertiary income processes, each of which has its own goals, instruments and limiting conditions.

In the primary sphere of earned income, participation in the labour market is seen as an individual right. This has far-reaching consequences in terms of legal claims. For example, no distinction is made between partners. This applies both to access to the labour market and to levels of remuneration (for equal work) and to the right to an individually tailored benefit in the event of unemployment or incapacity. Once tax and social insurance contributions have been deducted, income can be divided into a 'deferred' primary share - the insured component - and a secondary share - the sustenance component. The individual right to employment and to remuneration from employment logically extends to the insured component and to pensions and claims under loss of earnings insurance based on equivalence, such as unemployment benefit and invalidity benefit. In short, in this sphere of income there appears to be no conflict between the requirements of legitimacy, efficiency and effectiveness: the protection of an individual's right to work and the efficient approach to a shrinking potential labour force goes hand in hand.

This is not the case in the secondary sphere of income transfers with a needs-based character. Whereas the individual is the most appropriate unit of allocation in quid pro quo relationships in earned and in insurance based on equivalence, the household - as the smallest and most closely-knit solidarity relationship - is the most appropriate income unit for income support and health care transfer payments. There is no place within households for a further individualised breakdown 'from outside' since this level of solidarity within households is not known to the authorities. The government therefore has no choice other than to *assume* a high level of solidarity within households, without being able to verify them. This will continue to be the case for as long as the household is regarded by a majority of the population as the most closely-knit solidarity relationship. This is likely to remain so for the time being, but it could change over the longer term, for example when there is full equality between men and women in labour market participation.

A simple rule of thumb, as suggested above - the individual as focus in the sphere of earned incomes and loss of earnings insurance, and the household as focus for the unconditional needs-based transfer payments in the secondary sphere - makes for a more transparent policy. It allows statutory maternity leave to be recognised as a compensation in the primary sphere for loss of opportunity on the labour market, and rejects the idea of subsidising child day-care for a two-earner household as an unfair claim by people who can afford to pay for it themselves. However, it is not quite as simple as that. The gain provided by the child day-care facility in fact lies in the sphere of *tertiary income*, derived from specifically targeted government subsidies. The policy target

here is not merely - or even primarily - a matter of expressing solidarity with working mothers, but of preventing women with small children to withdraw from the labour market, in order to protect their long-term employability.

Another example of the way in which concern for the sustainability of the social security system can shift the balance between legitimacy and efficiency is illustrated by the approach to the household composition of state pension claimants. The General Old Age Pensions Act unites opposing insurance and needs-based elements. The insurance component links the right to pension to (presumed) labour participation in the past; the needs-based component requires assessors to look at the composition of the household. The current system, in which 'illegally' cohabiting elderly adults together receive two individual benefits at 140 percent of the minimum wage, demonstrates just how vulnerable a sanctions policy may be. If the single person's pension were to be reduced to 60 percent of the reference income and the official reduction for cohabiting couples to 100 percent of the minimum wage were to be abolished, this would encourage the formation of legitimate households, which in turn could reduce the need for formal care, thereby possibly more than compensating for the costs of 'overpaid' benefit.

2.3.9 Evaluation

An optimal social security system cannot simply be a matter of *either* regulations *or* transactions; it must instead be a matter of both regulations *and* transactions. There can be no possibility of equal opportunities unless the client is able to withdraw from a transaction; this requires a government-imposed competition policy. Conversely, the discretionary powers of the government (or its appointed agent) in concluding a transaction are constrained by the client's entitlement to a proper assessment of his case. This is not to suggest, however, that there are not numerous opportunities for a fruitful combination of options in a public sector social security system: funding systems are as a rule income-dependent and based on the principle of redistributive justice; in the benefits sphere, the philosophy of equalised opportunities makes it possible to take account of individual capabilities when imposing a counter-commitment on the client.

Basically, then, it appears to be essential to recognise that in the activation of the *obligations* of the policy, regulations and redistributive justice tend to lead towards type I errors, in which 'the good suffer with the bad'. It therefore pays, in the interests of legitimacy and equity, to examine to what extent the 'bad' can be brought into line by tightening up the transaction element. The claim assessor's role itself cannot however be part of this transaction, since in a constitutional state, *rights* must be clearly delineated. An approach as described above is compatible with the protection of privacy and explains how, in decisions concerning income units, there is often greater affinity between considerations of legitimacy, equity and efficiency than is often thought.

2.4 Efficient management

In contrast to the criterion *equity*, it is not necessary to spend a long time considering the notion of efficiency or the theoretical conditions for optimum allocation - the balance between efficiency and effectiveness. It is known from economic theory that efficiency - delivering performance at the lowest possible cost - is generally enhanced by the introduction of competition into transactions. Over time this analytical conclusion has acquired an ideological undertone, as if 'transaction' and 'competition' were aims in themselves. This is a misunderstanding: they are *means* of minimising costs. Of course, no-one is against cost minimisation in the spending of public money, but it is still a goal alongside other goals. Communities want to use resources not only sparingly

but also effectively, and also value legitimacy, within an income distribution which is perceived as fair, coupled with good access to public facilities. It was noted in section 2.3 that these criteria require a framework of parameters when introducing transaction mechanisms - an adjustment of the 'medication', as it were. In some cases the remedy may even be worse than the disease and transaction mechanisms have to be abandoned. As in the medical world, how-ever, it is wise to keep the aim and the means well separated.

2.4.1 Costs and benefits of social security

Eanged against the costs of social security are considerable benefits. Providing financial assistance and placement services to the unemployed prevents the erosion of human capital, by giving people a breathing space to find work which matches their capabilities. More generally, if the solidarity with those who suffer income loss through no fault of their own is institutionalised, this fosters social cohesion, minimises labour unrest and enhances the investment climate. The trick is to strike the right balance between the costs and benefits of social security. Part of that balance is based on subjective perceptions concerning the desired social order, which fall outside the scope of scientific analysis and on which the Council therefore proffers no opinion. A warning is how-ever in order concerning immanent weaknesses in the process of political judgement. Time and again the public decision-making process comes under pressure owing to a strong fixation on first-order income effects in the 'income profiles'; little account is taken here of the reverse side of the coin. Thus unin-tended substitution effects are overlooked, which raise the costs and erode the benefits. A careful analysis of the income and substitution effects of govern-ment intervention therefore forms the basis of the policy research into the future of the social security system.

2.4.2 Income and substitution effects

The income effect of a benefit is expressed in the change in disposable income. It thus achieves an intended effect, assuming the recipient falls within the envisaged target group. But benefit also leads to changes in choice, in the form of substitution effects. Examples of this are:

the notorious *poverty trap*, which arises because the benefit disappears partially or entirely when paid employment is accepted;

unintended *displacement effects* of system changes, whereby benefit situations are not resolved, but simply shifted onward to a different scheme; or

changes, intended or otherwise, in individual *saving behaviour* as a result of incomplete indexation of state pensions.

These effects can seriously undermine the effectiveness of policy; we shall return to this in more detail in section 2.5. Moreover, the social security obviously has to be paid for, bringing taxpayers and premium contributors into the picture. If tax and social insurance contributions become too high for this group, they may prefer to spend their time in informal employment, or leisure time. Here we see the substitution effect as a discouraging factor, with the income effect providing an incentive in the opposite direction, to keep the available (legitimate) income intact.

In order to ascertain the net 'price' of social security, we have to look for the net effect of all these behavioural reactions. This is no simple task, because income and substitution effects in turn invoke reactions in other markets, for example where recipients and payers spend their money. Social security then appears to hamper labour participation, to the extent that it *discourages* the supply of labour (from those in work, who think that they pay too much in social security contributions; or from benefit claimants, who have ended up in a poverty trap), but also *promotes* the demand for labour (a better spread of

purchasing power will generate more work). All this means that the net price can only be approximated. In general the income effects are considered positive, to the extent that these represent the intended effects for the benefit recipients and to the extent that positive compensation in labour supply broadens the tax base. The substitution effects are generally interpreted as discouraging factors and regarded as a problem. And yet substitution effects may not always be unintended. The introduction of the early retirement scheme, for example, was expressly intended to encourage older participants in the labour market to make way for younger people, although the results initially were different: the unintended effect was that many jobs were lost as businesses intensified their rationalisation programmes, as facilitated by the new retirement option. This demonstrates yet again that it is difficult to predict behavioural effects, and even more difficult to manage them. Nonetheless, they form the analytical core of the costs and benefits of the social security system as discussed in this section.

2.4.3 Solidarity, funding and premium differentiation

Social security systems differ from private insurance because the risk selection is limited and unattractive risks are accommodated. The income support system, for example, is funded from general public resources, because the wide variety of different risks thus covered is too broad for an insurance formula. In the case of unemployment, macroeconomic and structural factors are involved which would make a fully privatised solution expensive, unreliable and difficult to implement.

Views on the division of tasks between government and market change over time, under the influence of changing circumstances. Ongoing emancipation and a long period of monetary stability, for example, have made the Dutch population ripe for a gradual privatisation of the surviving dependants' risk in the event of a person's death - a risk which can be estimated accurately in actuarial terms. More generally, reasonably predictable income risks such as illness and old age provide a framework for the choice between public and private-law arrangements. The key issue here is always to find a balance between a reasonable distribution of the burdens and the avoidance of undesired risk selection on the one hand, and the demands of efficiency and effectiveness on the other. Eliminating risk selection demands a funding system based on *risk solidarity* at national level. At the other end of the scale is a premium differentiation based on *claims history*, a differentiation which - even in the private sector - will always be 'tempered' by the high transaction costs involved in too much risk selection.

The dilemmas inherent in weighing risk selection against risk solidarity have become apparent as a result of the partial privatisation of the Sickness Benefits Act and the introduction of premium differentiation into the Invalidity Insurance Act. There is a danger here that a greater risk awareness on the part of employers will lead to discrimination against workers. One option then may be to compel employers to insure themselves against the risk of having to continue paying an employee's wages for a full year, instead of the period of two weeks as under the 'old' Sickness Benefits Act and Disability Benefits Act. In combination with this, smaller companies must be encouraged to pool risks in sufficiently large insurance contracts to minimise risk selection. Other options might include a right of recourse against the previous insurer for employers or insurers who take on or insure workers with a significant history of illness.

This does not alter the fact that efficiency and effectiveness benefit from a level of premiums which confronts employers with their social responsibility for the working conditions in their organisations. Premium differentiation based on

claims history rewards efforts in the area of prevention and reintegration - goals which have been brought within everyone's reach by the introduction of a competitive system of safety, health and welfare services. The main issue here is the early-warning function of the price mechanism, drawing attention to avoidable inactivity. In many cases a confrontation with the full social costs (the chance-per-employee of a capitalised benefit value) will not be necessary in order to encourage a company to pursue a responsible personnel policy. There is therefore scope for dampening the stimulus-response function of the level of premiums to some extent, and for limiting the duration of the market-based responsibility of the employer to a period for which the benefit claimant can still be assumed to be employable, as in the current Cabinet proposals regarding the Disability Benefits Act. Here too, therefore, it proves possible to reconcile the apparently conflicting criteria of equity, legitimacy, efficiency and effectiveness.

2.4.4 Premium differentiation and the relationship between the Disability Insurance Act and the Unemployment Benefits Act

Premium differentiation is a less obvious option in the realm of unemployment benefit. Since the Cabinet is now studying this possibility, however, the following comments can be made. What have to be covered here are essentially exogenous cyclical and structural risks which individual employers cannot influence. This places question marks against the equity of a differentiated employer's contribution. The efficiency and effectiveness of such a differentiation is also not obvious. It has the attraction of encouraging investments by employers in increased employability of their staff, mainly in order to avoid older workers being 'pensioned off' via the unemployment benefits system. In the short term this strengthens the position of insiders relative to outsiders; in the long term, however, it costs jobs. The Council nonetheless considers that there is scope for experimenting with a differentiated employer's contribution to unemployment benefits insurance for companies with a structurally uncertain or seasonal labour pattern. In exchange, these companies would be given more scope to use reduced pay arrangements, an issue to which we shall return when discussing continuity and flexibility in section 2.5.

Another difficult question is how two different regimes - premium differentiation in the invalidity benefits system and pay-as-you-go in the unemployment benefits system - can be reconciled. Better management of the gatekeeper function of claim assessors should in the future lead to more people being declared partially fit for work, with a resultant low decrease in the invalidity component in the system and a corresponding increase in the unemployment component. This could cause the incentives of premium differentiation in the invalidity benefits system to leak away because - if the pay-as-you-go method is kept in the unemployment benefits system - the weight of that premium differentiation in the partial invalidity benefits could be too small to prevent the expulsion of less productive employees.

A solution for this problem could be sought in two directions. In the domain of regulation, the present dismissal protection already offers opportunities for testing an employer's policy and refusing requests for dismissal where insufficient prevention and reintegration efforts have been made. In this case, a powerful sanctions policy will be necessary. For those favouring a more market-based solution, by contrast, increased flexibility in the dismissal policy is a possibility, linked to financial incentives. All invalidity claims which lead to dismissal would be incorporated in full in the premium basis, with no discount for partial incapacity for work. The actuarial overfunding which this creates would then be compensated by a general, undifferentiated premium discount, after deduction of a premium indemnification for employers who take on partially incapacitated workers. The legal ground for such a policy would be that

companies must be stimulated to partial incapacity for work, or must resolve it through offering appropriate jobs.

2.4.5 Competition as a condition for efficiency

Section 2.4.3 introduced competition as an instrument for creating a balance of power and an equalisation of opportunities between the supply and demand side in the social security system and between suppliers individually. In addition, competition promotes efficiency, on penalty of loss of market share. Competition compels those on the supply side to keep a sharp eye on costs and to focus on the wishes of the sovereign client. In the social security domain, however, it is not the individual client but the community as a whole which determines the goals. Consequently, determining the goals of social security as a public service, can never be left to 'market forces'. At most, a market-analogous *delivery process* can be introduced, in which the advantages of competition between members of the delivery system are exploited on the supply side, but with politicians or holding sway on the demand side.

In the power struggle surrounding sovereignty in the delivery process, much is made of the dangers of the undesired side-effects of 'market operation'. The suggestion is also aired that government is engaged in withdrawing from the social security system. This is misleading, however, since in the limitation of the operation of the Sickness Benefits Act the obligation to continue paying wages - which is the key issue here - has been transferred in full to the private sector, while in all proposals for the reform of the Disability Benefits Act the entire body of entitlements remains a public sector matter. Moreover, undesired side-effects can be made manageable, as will become apparent below in the discussion on 'opting out' and negative risk selection. In the examples given, the government is not withdrawing, but is switching from an implementing to a steering function, in order to enable it to more effectively reduce inefficiency as well as misuse and abuse.

2.4.6 Regulation costs, transaction and the 'lowest costs characteristic'

Responding to the differences between people demands a great deal from social policy. Ideally, a government respects those differences completely, but for this to be possible they must be identifiable. It was stressed earlier that this identifiability has become entangled in terms of specific cases; society has become more pluriform and values the protection of people's privacy. This increases the information and regulation costs of the social security system, both directly - because there are more opportunities for misuse and abuse - and indirectly - in a figurative sense - because people increasingly begin to perceive rules as improper. A transaction system generally lowers the information costs, because the people involved are themselves 'doing the talking' and have to reveal (more of) their actual preferences. It is a case of 'direct dealing'. On the other hand, an employment placement officer gains a greater insight during the transaction process into the factors which determine the supply of labour. A transaction model gives these officers the authority and facilities to create matches between supply and demand and makes them, in their turn, accountable for their actions.

In a competitive regime, the checks and balances of the transaction mechanism can generate compensatory differentials ('internal transfer prices') to reflect the differences between individuals through all layers of the system. They can thus also form a bridge between criteria of equalised opportunity and efficiency, which are based on mutual adaptation. As long as a competition policy ensures a balance of power, those who trade will make smaller sacrifices than those who do not. Transactions thus continue until all those concerned have found the point of the lowest societal sacrifice. In this process, the cost of

negotiation is to be taken into account and weighed against the costs of regulation referred to earlier.

2.4.7 Causality, finality and regulation costs

The question of efficiency also plays a role in the choice between causality and finality as a legal principle in insurance against illness and disability. The causality principle seeks to limit the responsibility of the employer to liability for risks which can be attributed to occupational hazards: the *risque professionnel*. The introduction of the Disability Insurance Act, however, introduced the finality principle, in which coverage as such - the *risque social* - is the prime concern, regardless of the cause of the loss of income. These legal principles, and a possible return to the causality principle, are occasionally raised for discussion again, though with little attention for the efficiency criteria which ought to weigh heavily here. In a society with a great deal of part-time work, flexiwork and telework, causality is difficult to identify, will generate a large number of controversial borderline cases and, consequently, high information costs. This points precisely in the direction of public funding on the basis of finality, if necessary in combination with sanctions for 'irresponsible' social behaviour. Examples here might include meeting the costs of sickness, disability and health care partly from alcohol and tobacco duty, or introducing compulsory insurance for sports halls. The impression remains, however, that the nature and size of the problem is exaggerated by the opponents of the finality principle: employers naturally suffer the consequences of their employees' sports injuries, but also benefit from people in good physical condition.

2.4.8 'Opting out' and negative risk selection

As indicated in section 2.3, the public delivery system can under certain conditions be made to deliver optimum performance by making the market for social security competitive. The assumption made in this report is that, in such a situation, benefit entitlements are established in public law and that market-based solutions are sought for their implementation. The question then arises as to whether a partial privatisation will lead to negative risk selection. In the case of parallel privatisation, in which the public sector continues to participate in the implementation process, negative selection can be avoided by limiting privatisation to collective contracts of such a size that the insurer will avoid the transaction costs of exclusion by equalising the good and bad risks internally. Here again it is possible to reconcile the efficiency and legitimacy requirements of a market-based structure. The situation becomes more difficult when an existing provision disappears, as happened with the abolition of the Sickness Benefits Act. If private insurers were to engage in large-scale risk selection here, this could mean that small companies will avoid taking out insurance if they consider their own risk to be relatively low. To avoid such anti-selection, the government could consider introducing compulsory insurance, by analogy with the third-party liability insurance for motor vehicles. In this case the efficiency benefits of low transaction costs would push in the direction of larger collective contracts, with internal risk equalisation. This problem is mainly of importance in an active integration policy and a supplementation policy. In an entitlements policy the entitlements are limited to such an extent that there will be maximum endogenous stimulation towards labour participation.

2.4.9 Evaluation

This section looks at the efficiency of the existing social security arrangements and the rationale of some recent innovations in this area. It reveals that a sharper eye for transaction instruments and the weighing up of regulation and transaction costs does not mean that the government is withdrawing from the

social security system. The key issues - guaranteeing the objectives of social security and establishing entitlements - *remain* a public matter. Market operation, transaction and competition policies are no more than *means* to enable the selected objectives to be approached as closely as possible. This will further labour participation and safeguard benefit entitlements for those who have to rely on them. A series of examples makes clear how a careful and well-considered use of transaction instruments can increase risk solidarity, lower the information costs and reduce misuse and abuse of the system. This shows that the tension between legitimacy and efficiency is frequently less great than often assumed.

2.5 Effective policy

In this report, the test of effectiveness is focused on the question of how far alternative ideas serve the dual objective of safeguarding the income of those relying on social security and integrating the healthy labour force into the production process. At the bottom end of the labour market the tension between security and labour participation arises around the minimum wage, indexation mechanisms, purchasing power scenarios, the poverty trap and the reservation wage. More generally, reference can be made to the importance of the education and labour market policy, the sanctions policy, the effects of the balanced budget multiplier and inverted balanced budget multiplier on other social policy schemes, the problem of the funding basis, the 'wedge' (difference between gross and net pay) and employment, and the relationship between social security, saving and investment.

2.5.1 Minimum wage, indexation mechanisms and purchasing power scenarios

The debate on whether the minimum wage hinders labour participation has been going on for some time. Initially, policy was focused on the relationship between the level of the minimum wage and the lowest collective bargaining wages. Fears that the minimum wage would exercise upward pressure on pay structures led to calls for increased differentials between the minimum wage and collective bargaining agreements. In 1981 this led to a reduction in the minimum youth wage, and in 1984 to a reduction of 3 percent in the minimum wage for adults. Since then the minimum wage has fallen further behind the average pay trend for contract wages. There has even been an acceleration in this trend since 1989, under the influence of the Linkage (Conditional Suspension) Act. Table 2.1 shows the (cumulative) percentage trend in the minimum wage, the lowest collective bargaining wages and the average collective bargaining wages in the private sector.

Table 2.1 Percentage trend in minimum wage (mw), lowest collective bargaining wages (lw) and average collective bargaining wages (aw) in the private sector

Period:	1984-1988	1989-1994
mw/lw	-3.0 2.6	8.8
	4.5	18.0
		17.9

Source: Social Economic Council, *Bijzondere wijziging minimumloon en minimumvakantiebijslag* ('Special Amendment of Minimum Wage and Minimum Holiday Allowance'); Report 96/01, The Hague, 1996, p. 20

In the period 1984-1994 the rise in the minimum wage fell well behind the average pay trend; 5.8 percent compared with 22.4 percent. The difference (not shown here) relative to gross pay trends (i.e. including incidental pay

developments) is even larger. The relationship between the minimum wage and average pay in the Netherlands no longer differs significantly from that in our main European competitors. The gap between earned and transferred incomes also increased slightly as the labour cost allowance in the wage and income tax system was increased. One complication in this policy was that the purchasing power of benefits came under pressure; these benefits were linked via the minimum wage to an index of contract wages paid in industry. As purchasing power was repaired via an increase in the general tax-free allowance, this partially erased the intended effects on job creation: the relative lowering of the minimum wage continued to stimulate the demand for work, but the stimulus of the raising of the labour cost allowance for the labour supply was largely nullified by the generally applicable increase in the tax-free allowance. Moreover, the opposing increases in the labour cost allowance and the tax-free allowance had the combined effect of narrowing the tax base, so that tax rates in the lowest income tax band were higher than would otherwise have been necessary.

Despite - or because of- all these policy tensions, a stubborn job-creation problem persists at the bottom end of the labour market. In this light, the beauty of the protective function of the minimum wage has paled somewhat. The question has to be addressed of whether a threshold in the pay structure does not by definition result in under-productive workers being excluded. An argument against a further reduction in the minimum wage is then that this would threaten the indexation mechanisms. But the very fact that the indexation of minimum incomes operates via the minimum wage shackles any participation policy. The principle of a supplementation policy is therefore to *disentangle* the pay function of the minimum wage and the needs function of those on the statutory minimum income. In this perspective the minimum wage falls further behind the index of collective bargaining wages, in order to promote labour participation, while minimum (supplementary) benefit levels are directly tied to that index at their present level.

The traditional argument against the disentanglement option is that the minimum wage should be high enough to enable a breadwinner to sustain a family 'without having to hold out the begging bowl'. This is a rather dated argument: the emergence of double-earners in the younger age categories means that the number of *breadwinners* on a minimum wage has fallen to a few thousand. Thinking about social security cannot ignore such a large - and emancipatory - social change. Nevertheless, where the traditional model still applies at minimum income level, the responsibility of the breadwinner for sustaining his/her family must be maintained. This does not however rule out the disentanglement of minimum wage and social minimum. The EU treaty obligations regarding the minimum wage also appear to leave scope for dispensation; the spirit of the law remains intact if the Social Security Supplements Act applies for breadwinners with a minimum wage, and employers are legally empowered to top up pay cheques, being compensated in their turn via a reduction in their wage tax contribution. There is then no question of holding out the begging bowl'. Another concern is that abandoning the link between the minimum wage and general wage developments could put pressure on the linkage of the social minima as such, leaving benefit claimants to their fate. Ranged against this is the fact that the present Linkage (Conditional Suspension) Act has not managed to accord those on minimum incomes any credible income protection. The credibility of indexation is evidently not determined by legislative arrangements but by the sustainability of the underlying labour market policy.

In this connection it should be emphasised that the *abolition* of the minimum wage is not one of the three conceptual approaches considered in this report. Quite apart from the Treaty obligations requiring the Netherlands to maintain a minimum wage, the Council feels that labour which adds no value does not

represent a useful interpretation of optimum participation. Conversely, a modest added value should be fully 'rewarded' in earned income. Such a view does not however rule out a substantial lowering of the minimum wage, in order to stimulate labour participation at the bottom end of the pay structure in an entitlements or supplementation model.

2.5.2 Minimum wage, poverty trap and reservation wage

More generally, participation at the lower end of the labour market suffers from a *poverty trap*, where low-paid workers see wage increases evaporate through the loss of supplementary benefits such as individual housing benefit and subsidised childcare. The poverty trap ushers in the problem of the *reservation wage*: the minimum wage for which a person is prepared to begin or continue working in the 'white' or legitimate circuit. Naturally, a high reservation wage radically affects the effectiveness of a participation strategy. Estimates of the reservation wage vary widely, which in itself indicates substantial differences in individual preference and circumstances. Yet, the thinking on the reservation wage is systematically narrowed by a one-sided fixation on financial parameters, such as the level of benefits in relation to the pay offered, a partner's income, a person's own wealth or the access to 'black', illicit work (e.g. moonlighting). This ignores important non-financial considerations which help determine the reservation wage, as well as the potential of the education and labour market policy and the importance of proper enforcement of sanctions in order to support the protective function of social security. The government document "Working towards security", for example, devotes disproportionate attention to financial dilemmas³⁴. It is for example acknowledged that the poverty trap can be limited by seeking to adopt a conservative attitude in the introduction of income-dependent schemes and by reducing benefit reduction rates as a person's own income position improves. This latter solution costs a great deal of money. Calls to limit accumulation of schemes also do little more than address the symptoms, if people are faced with high housing costs, and also require childcare facilities.

2.5.3 Motivation, continuity and flexibility

The Council would therefore stress the need to take account of fringe benefits and the immaterial motives which help determine the reservation wage. Factors such as the quality of the work and the future prospects within the labour organisation prove to be particularly important here. Are the working conditions and fringe benefits attractive (including pension provision and non-statutory provisions in the area of social security)? Is there a prospect of a more permanent employment contract? Are there opportunities to learn? Are there career prospects? Are childcare facilities available? Finally, there are large personal differences in the appreciation of 'free time', which is generally factored into economic analysis as something desirable, a 'utility', whereas in contemporary society work of itself is not a 'disutility' for many people, but an important channel for personal development. If this is the case, involuntary unemployment will be perceived as a 'disutility'¹ and will not command a high reservation wage³⁵. These examples show that one-sided attempts to reduce the reservation wage by cutting benefits ignore the complexity of the qualitative aspects of the problem and are in danger of causing 'the good to suffer with the bad'. And because the reservation wage is relevant chiefly at the lower end of the income distribution scale, a one-sided emphasis on financial determinants also leads to unequal treatment of higher and lower incomes.

³⁴] Ministry of Social Affairs and Employment, *Werken aan zekerheid; Bouwstenen voor een modern en houdbaar stelsel* (Working towards security; Building blocks for a modern, sustainable system), Lower House 1996/1997, 20 OIO, no. I.

³⁵] See D.J. Wolfson, 'Towards a theory of subsidisation', *De Economist*, vol. 138, 1990, pp. 107-122, reprinted in: *Producer Subsidies*; Gerritse (ed.), London, Pinter Publishers, 1990, pp. I -19.

The demand for flexible labour and the need for stability on the part of employees demand that attention be given to the possibilities for making flexibility and continuity in labour relations compatible. For years commercial labour pools and contracting firms have acted as intermediaries in accommodating the irregular demand patterns of individual employers. Today the temporary employment sector has developed a series of fruitful initiatives aimed at combining the demand for continuity, security and future prospects of workers with commercially feasible solutions for employers, even in times of mass dismissals. This is an indication that the reservation wage, provided sufficient attention is given to workers' interests, can be kept within bounds. The public system is currently insufficiently deregulated to follow this example. For a balanced development of the social system, however, it is very important that the pioneering work of temporary employment agencies and trade unions to make social aims attainable through transaction mechanisms should be copied in the public sector.

Further attention needs to be given to assessing how far arrangements such as labour pools and contracting firms deserve financial support by recycling money available for, as another means of contributing to a normalisation of flexible work. There is a danger here of *rent seeking* by employers who reduce their placement efforts when the government steps in. In this connection the Council would reiterate its call (see section 2.4.4) for experiments with a differentiated unemployment benefit premium, and would refer to its discussion of a supplementation policy in section 4.2.3. The question does however remain of whether the bottlenecks are not caused above all by over-regulation of the labour law.

More generally, arrangements are needed which support employees and employers in taking risks which raise the dynamism and absorption capacity of the labour market³⁶. Here again attempts must be made at finding tailor-made solutions, in the form of equalised opportunity, supported by arrangements on measurable efforts to prevent misuse of public resources.

2.5.4 Sanctions and the protective function of social security

There is too little awareness that careful use of sanctions is a necessary and even crucial condition for maintaining social security. Income transfers are by their nature implicit subsidies on existing income. Like all subsidies, they suck in claimants, including people for whom they are not intended. This makes it necessary to combat *rent seeking*, an expensive and unintended substitution effect (section 2.4.2). In the same way that a targeted subsidy such as student allowances has been balanced by the introduction of the progress-based grant, horizontal equity demands that others are also held to their obligations to avoid overburdening the welfare state.

If this does not happen, there is no way of integrating the rights of those for whom the transfers are intended. The history of the Disability Insurance Act, for example, has already shown that the income protection mechanism can be lost if society does not arm itself against abuse. In the past, unsuccessful attempts have been made to protect income effects in isolation by defining the target group ever more precisely. It was made clear earlier that this is a dead-end street in view of the statistical phenomenon that differences *within* groups become greater than differences *between* groups as those groups themselves become smaller.

³¹ See also the Ministry of Social Affairs and Employment publication *Werken aan zekerheid* (Working towards Security), op. cit.; and the Dutch Labour Party (PvdA), *Sociale zekerheid bij de tijd* (Social Security up to Date); September 1996.

The legitimacy of individualised case management was discussed extensively in section 2.3. In terms of equity too, however, the sanctions policy deserves more attention as a legitimate expression of the indissoluble duality of rights and obligations in the institutionalisation of solidarity. Belonging to a society always implies a two-way commitment, in which the citizen can appeal to his rights, but in which the community can also hold the citizen to his responsibility vis-a-vis society. For the citizen this means being acknowledged, meaning something. Society therefore has to see to it that certain categories of citizens are not reduced to outsiders. At macro-level, this two-way commitment can be seen as a sort of 'social contract' between society and the individual. At micro-level, this contract has to be specified in more detail. The two-way commitment places demands on the way in which the underlying solidarity is organised. Continuity requires that all those involved - politicians, the delivery system and clients - restrict demands on the social security system to those for whom it is intended. This can be achieved in various ways, and various parties - government, the civil society, the individual - can bear primary responsibility. But forgoing sanctions can ultimately lead to the good suffering with the bad.

The various conceptual approaches in this report all give a different answer to the problem of sanctions. In an entitlements strategy, the sanctions are endogenous: those not in work are stimulated to find work at a relatively low benefit level, in such a way that the likelihood of misuse and abuse remains small. The system runs itself, as it were, as the Tsad clients' will show little inclination to join in if the cupboard is bare. An active integration policy, operating at a higher benefit level, demands uncomfortable autonomous decisions on the application of sanctions. It was made clear earlier how consultation and a transaction system can make the information problem which arises here manageable. A supplementation policy, finally, combines the simplicity of the endogenous sanction with the greater transparency of individual case management, but is vulnerable to misuse and abuse by employers. Here again, a political judgement needs to be made as to what weighs most heavily. Once again, however, the criteria of equity, legitimacy, efficiency, effectiveness and sustainability are more closely related than is generally assumed.

2.5.5 The effects of the balanced budget multiplier and the inverted balanced budget multiplier in social policy

Changes in the social security system almost always lead to substitution effects to other elements of social policy. This dilutes interventions and displaces problems. The mass reinsurance of the 'disability benefits gap' caused by the restructuring of the Disability Insurance Act has already shown that the government's ability to steer the social security system is limited. The reassessment of those receiving disability benefit provides a very recent example: of those who were declared partially or fully fit for work after reassessment, 23 per cent were in work after one year. Half the remainder (38%) were receiving a different benefit, and the other half no benefit at all³⁷. In addition, constant shifts have taken place in the sphere of early retirement between disability schemes, unemployment schemes (extended Unemployment Benefits Act, '57.5 scheme', 'Older and Partially Incapacitated Unemployed Workers Income Scheme' (IOAW), 'Older and Partially Incapacitated former Self-employed Persons' Income Scheme' (IOAZ) and official early retirement³⁵.

³⁷] Social Insurance Supervisory Board, *In en uit de WAO*, op. cit.

³⁵] WRR, *Een werkend perspectief*, Reports to the Government no.38, The Hague, Sdu Uitgeverij, 1990, p. 233. Also available in English as WRR, *Work in Perspective*; Summary of the 38th Report to the Government, The Hague, 1990.

Leakage effects are also caused by the fact that a large number of benefit claimants receive a benefit which is little more than the social minimum. As the average level of benefit falls, reintegration stimuli will decrease, because the social minimum places a floor in the benefit level. This effect will of course vary per scheme, for example as a result of the income and asset test in the National Assistance Act. Leakage effects also occur here because at a lower benefit level benefit claimants are more likely to take up income-independent schemes such as housing benefits, student allowances and debt-cancellation schemes. All this increases the poverty trap for the labour force. The differentiation of benefits according to household situation also creates behavioural effects, since benefit claimants are invited to adapt their household structure - or its presentation - to suit the scheme, or else are encouraged to refrain from (formal) cohabitation in spite of having a flourishing relationship, because this will lead to a cut in benefit. This creates additional single-person households. Since multiple-person households are generally more self-reliant than single-person households, this not only leads to avoidable take-up of housing benefit, but also to higher costs than necessary in the health care field. In the older age groups, in particular, this latter effect can become significant.

A final leakage effect which deserves attention here is the relationship between social security, *saving and investment*. Private-law provisions and social security ('social security wealth') are complementary in people's perception. The experience with the disability benefit gap shows that less public-sector security leads to private supplementation. Uncertainty regarding the indexation of the General Old Age Pensions Act could have the same result. Private insurance premiums form part of overall labour costs. In this sense, the impact of changes is smaller than anticipated. Private pension insurance requires capital funding. This in turn leads to an increase in the level of savings and, if there is a lack of profitable domestic investment opportunities, to loss of spending, outflow of capital and reduction of the tax base.

Against the background of the many obstacles charted here on the road to efficient management and effective policy, the Council would argue that policy measures in social security should *always* be accompanied by a risk analysis of the accompanying balanced budget multiplier and inverted balanced budget multiplier effects. In particular in the current discussion regarding the future level of protection offered by the General Old Age Pension Act, such an analysis could be highly instructive.

2.5.6 Evaluation

This section points out opportunities to reduce the reservation wage by responding to the need for a permanent employment contract and the accompanying build-up of pension and social security rights, more training, opportunities to gain work experience and, more generally, by acknowledging the importance of bonding with and in the working environment. Closely related to this is the importance of permanent education and of properly attuned education and labour market policies to increase opportunities for work. There are more - and sometimes more effective - options for broadening labour participation at the lower end of the labour market than simply lowering the price of labour.

On the other hand, this section once again stresses that no system can operate without sanctions, particularly where income effects are at stake which tempt people to substitution or misuse and abuse. The protective function of the social security can only be maintained if all those involved know that they are protected in good faith against the threat of cheating by others. This is why it is so important in case of abuse to reverse the burden of proof, so that the use of sanctions can only be avoided if there are good reasons for doing so.

As an additional safeguard against misuse and abuse, section 2.5.5 calls for a risk analysis of the balanced budget and the inverted balanced budget multiplier effects in the social security system, with particular attention for the hid-den inverted balanced budget multiplier effects of 'economizing' on the General Old Age Pensions Act.

2.6 Sustainability in the longer term

The sustainability criterion introduces a dynamic aspect into the judgement of the other criteria as this is made *today*, by confronting them with a perspective on the *future*. Such confrontation helps in assessing how far the system options examined below are sustainable without requiring too much major maintenance. This section begins with a warning about the leakage losses which over time will erode the efficiency and effectiveness of any social security system, and with a plea for more respect for the safeguarding of rights as a condition for sustainable social cohesion. The issues are then discussed on the basis of the challenges presented in Chapter 1: demographic trends, the future labour market, the economic setting and individualisation. It is important to remember here that our assessment of the future is highly coloured by our perception of today. The sustainability criterion can never be anything more than an *estimate*, which sooner or later will prove to be incorrect and which thus calls for options to be kept open.

2.6.1 The unavoidable leakage losses of a 'watertight approach'

The quest for sustainable solutions is accompanied by a great deal of rhetoric about a 'watertight approach'. This is acceptable if the aim is to identify bottlenecks and approach a solution more closely; if not, then a watertight approach is no more than a constructivist slogan. Chapter 3 will show that none of the conceptual approaches examined guarantees a watertight approach. An entitlements policy, for example, tends to abstract inefficiencies in the labour market, such as a mismatch between supply of and demand for skills in a rapidly changing economic structure³⁹. For their part, an active integration and supplementation policy easily fall prey to a *social engineering urge* which under-estimates the unintended use and overestimates administrative capabilities. These difficulties lead for example to the question of how far the political management is able and willing to pursue the strict sanctions policy which is necessary for the sustainability of an active integration or supplementation policy. Ignoring these or other vulnerabilities of system options is political illusionism.

A first requirement for sustainability therefore lies in the ability to absorb the unavoidable leakage losses which are associated with every social security system. No system can be guaranteed success, if only because new answers will continually have to be found to changing circumstances. In an active integration or supplementation policy, for example, there is a great deal to be gained by substantially reducing doubtful cases in the Disability Insurance Act or National Assistance Act.

2.6.2 The need for robust protection of rights

Despite these limits to the 'makeability' of society, people continue to set high standards for the reliability and predictability of government actions. The appearance of the fire brigade is counted in minutes, a train which is five

³⁹] For a discussion of shortcomings in the market mechanism see for example E.S. Phelps, *Structural Slumps; The Modern Equilibrium Theory of Unemployment, Interest and Assets*, Cambridge, Harvard University Press, 1994; and S.K. Kuipers, 'Wanneer de veilingmeester faalt' (When the Auctioneer Fails), *Economisch Statistische Berichten*, 11 October 1995, vol. 80, no. 4028, pp. 900-903.

minutes late is officially delayed, but everyone can use the excuse of a traffic jam when travelling by his own transport - and that traffic jam is again the fault of the government. Add to this that the tolerance shown by citizens to the government is inversely proportional to the power of resistance the citizen claims when he/she does not agree with a policy. The reverse of this paradox is itself paradoxical: an unreliable government is seen as economically harmful, but the power of resistance of the public and its organisations leaves that same government little scope to pursue more than a strategy of *faits accomplis*.

The recent history of social security illustrates the vulnerability of the protection of rights as a result of these paradoxes. For years the combination of a lack of political courage on the part of the government and the resistive power of employers and unions led to tolerance of misuse of the Disability Insurance Act as a means of disposing of excess staff. Now that an end has been brought to that situation, people who were 'discarded' without being wholly or partially incapacitated for work often find it impossible to find work again. The result is that they end up - via unemployment benefit - on income support. The next crisis of confidence is threatening in the area of state pensions, whose cost of living linkage has been undermined because no scope was offered for decoupling the minimum wage from statutory minimum incomes (see par. 2.5.1). Consequently, major structural problems are rising in private pension schemes, and older people with little supplementary pension are faced with a *fait accompli* as the level of the state pensions was kept in line with a minimum wage that followed labour market developments at a substantial distance⁴⁰.

It is of no help to argue that the government 'must be reliable'; what does help is to realise that a government which is seen as reliable and predictable reduces the perception of risk. This in turn reduces the transaction costs, and thus promotes prosperity for society as a whole. Sound policy and respect for the law are 'public capital', which must as such be sustained⁴¹. Safeguarding rights lowers transaction costs and thus forms a valuable part of the economic infrastructure. Public support also demands that transfers end up with those who are entitled to solidarity. This is why an effective sanctions policy is such an important condition for the sustainability of a social security system. In general, however, equity, efficiency and effectiveness jointly require that the safeguarding function of the social security system keeps up with the times: it must be soundly constructed, able to withstand the odd knock and not demand too much maintenance.

2.6.3 Demographic trends

The changes in the population structure can have both positive and negative effects on the success of the participation strategy and the sustainability of the social security system. One positive effect is that the combination of maturity and ageing in principle brings an equilibrium on the labour market closer. A negative effect arises however if inflexibility on the labour market induces premature wage rises, which could block the path to full employment. The positive opportunities are clear. A smaller labour supply and a larger demand for labour-intensive care mean that society will in future be less able than ever to afford to allow people to stand on the sidelines. From this perspective it is of the greatest importance that the policy effort geared to helping the potential

*] R.M.A. Jansweijer, *Gouden bergen, diepe dalen; De inkomensgevolgen van een betaalbare oudedagsvoorziening* (Golden Hills, Deep Valleys; The Income Consequences of an Affordable Old Age Pension); WRR, Preliminary and Background Studies no. 92, The Hague, Sdu Uitgevers, 1996.

⁴¹] J.M. Buchanan, *The Limits of Liberty; Between Anarchy and Leviathan*; Chicago, University of Chicago Press, 1975.

labour force enter the labour market is intensified considerably and in good time. If the present trend in the demand for labour continues for just a little while longer, an unchanged policy could lead to problems of scarcity in some segments of the labour market. The cautious pay policy which has been so successful for job creation would then come under pressure. A balanced development towards (virtually) full employment therefore demands the timely reintegration of the long-term unemployed. They can then restore their labour productivity somewhat before the pay rises which will accompany full employment rule them out of the game once and for all. Only thorough co-ordination of an intensified policy of prevention and reintegration in the social security system on the supply side, combined with the continuation for the time being of a policy of pay restraint on the demand side of the labour market, can provide the necessary supporting base for broad labour participation.

2.6.4 Changing risks on the labour market

In the policy documents on 'Flexibility and security' and 'Working towards security'⁴², the Cabinet has already extensively examined the need for better legal protection and a system of social security which covers flexible labour relations. Little can be added to the present political discussion on these topics. What can however be reiterated, is the importance of lifelong learning and the development of labour organisations which are able to combine incidental jobs, in order to reduce the reservation wage by offering more substantive career prospects. More generally, the Council would emphasise that adapt-ability must not be demonstrated merely at the bottom-end of the labour market, but throughout the entire labour force. The loss of job security demands sacrifices and a willingness to adapt not only from outsiders, but also from insiders, for example through a less conservative stance by the trade union movement to displacement, which offer outsiders opportunities to re-enter the labour market.

2.6.5 The economic environment

The economic recovery in the Netherlands is gaining strength. If the present socio-economic policy is adhered to, a longer period of virtually full employment will begin to come within reach, supported by the demographic trend. Even with some setbacks in the form of disappointing growth in world trade, all three conceptual approaches appear sustainable provided there is a willingness to pay the price for a compensatory growth in the Dutch share in world trade in order to maintain the economic base.

Of course, prudence is not a self-sustaining virtue: as unemployment falls further, greater efforts will be needed to keep the wage developments in check or, where these efforts are unsuccessful, to accelerate the rise in labour productivity. Given the present economic outlook in the longer term, none of the three conceptual approaches examined appears unsustainable, however, although with an active integration or supplementation policy stricter demands will be placed on the administrative willingness to apply sanctions in the event of abuse.

2.6.6 Individualisation and privatisation

A social security system must be able to accommodate ongoing individualisation. Major adaptations have already taken place to this end. The breadwinner principle has long been abandoned as the primary organisation principle

^{42]} Ministry of Social Affairs and Employment, *Flexibiliteit en zekerheid* ('Flexibility and Security'); Lower House 1995/1996, 24 543, no. 1, and *Werken aan zekerheid*, op. cit

of the social security system, and where it still figures - mainly in the minimum wage - its practical significance has declined sharply. Equally uncontroversial is that in a provision such as income support, ability to pay public support is important and allowance must therefore be made for the household situation of the applicant. Ongoing individualisation need not jeopardise the sustainability of the system. While there may no longer be a problem in principle, therefore, the application in practice can prove very different. Section 2.3.8 has already pointed out that individualisation gives rise to new entitlements. A quite different consequence is that, where such entitlements or the level of benefit are linked to the living situation, the sensitive issue of protection of privacy is raised. Individualisation in the sense of doing justice to individual circumstances obviously implies that the government must be able to identify those circumstances. An appeal to privacy will not always be based on facts; if the level of benefit is at stake, rent seeking via an appeal to privacy is always a danger. Reversing the burden of proof, as argued in section 2.3.7, offers a possible solution for this threat to sustainability.

2.6.7 Evaluation

Sustainability draws attention to the dynamic aspects of the weighting of the other judgements which can only be made *now*, in the light of foreseeable or assumed circumstances⁴³. The foregoing section demonstrated yet again that what is attainable and sustainable is a question of political preference and management. The Netherlands has acquired limits to freedom again in recent years in this area. Other countries do not impose compulsory conditions on the Netherlands: the Dutch social security system is not (any longer) clearly out of step with the major competitor countries, and the results of Dutch socio-economic policy - with the strongest growth in employment, the strongest currency and the lowest inflation in Europe - do not give rise to immediate fears of a deterioration in the competitive position. And yet the sustainability of the social security system urges a fundamental rethink, given the still excessive unemployment, the demographic challenge facing the Netherlands, and the many other social changes which demand adaptations of the system.

The Council feels it is time for fundamental changes in order to safeguard the social security system for the future as effectively as possible, now that some freedom has been regained for a substantive discussion. To this end the following chapter will test the three conceptual approaches distinguished in this report against the criteria developed in this chapter, to clarify the political issues at stake. At stake here is not only the extremely sensitive problem of the level of benefits, but also the - in the longer term often more important - indexation system and the principles underlying the implementation and operationalisation of the sanctions policy.

■] I.J. Schoonenboom, *Tussen utopie en dystopie* (Between Utopia and Dystopia); inaugural address, Wageningen Agricultural University, 1990.

The conceptual approaches in more detail

3.1 Introduction

This chapter illustrates the ideas in the previous chapters in terms of the ongoing political debate: the social distribution of responsibility, the content of the system, and sustainability and the instruments for enforcement. The analysis follows the layout in Table 3.1. The specifications are designed purely by way of illustration. These are not recommendations; the analysis illuminates the boundaries of the decision-making process. The numerical specification is plausible but not self-evident. In the process of implementation it turns out that the policy conditions specified here by way of example should in fact be higher or lower in order to achieve the goal of participation. The Council is not providing blueprints but an analysis in terms of criteria.

3.1.1 Common points of departure

Apart from differences the three paradigms developed here also share a number of common points of departure. They all for example call for the individualisation of benefits, with the exception of national assistance. In the latter case the element of need reduces individualisation to self-reliance, where rights and obligations are geared to the individual's social environment. For this reason mothers on social security with small children are exempted from the obligation to seek work and, in addition to the individual means test, the partner's means test continues to apply in order to dramatise the mutual responsibility in the shared household and in order to limit the reservation wage of unemployed partners (see section 2.5.2). At the same time the single householder's supplement is maintained, again on the principle of need. Subject to these qualifications the chart is based on an individual basic norm of 40 percent of the present norm for a household; this norm will not be cut if two benefit-claimants are cohabiting, although the single householder's supplement will then of course not apply. The normalised benefit can also be increased with other supplements, varying from one model to another.

All supplements to the standard benefit are subject to a reversed burden of proof on enforcement grounds (section 2.3.7). Whatever the system, national assistance therefore remains cumbersome, although the administrative burden is clearly less in an entitlements model than in the other variants, which have more supplements as well as an active mediating role for the government in the labour market. Complications is an inevitable feature of a facility facing the twin task of promoting reintegration without neglecting differences in individual circumstances.

In the case of the state pension or AOW matters are simpler as this is a non-labour-market-related facility. In principle the Council sees possibilities here for standardising the benefit norm, for example at 60 percent of the present norm for a couple. This would release the caseworker from a problem of control that could assume significant proportions in the coming decades. In addition it would encourage the formation of multi-person households with greater self-reliance and making fewer claims on publicly funded (domiciliary) care. The question remains whether a government that does not wish to influence household patterns will wish to take this argument into account. More generally effectiveness needs here too to be weighed against equity. Precisely in the case of the elderly the single householders constitute a weak group in income terms. At the least this calls for a cautious process of adjustment (along the

Table 3.1 Main elements of the labour-market approaches

	Entitlements model	Active integration model	Supplementation model
Paradigmatic points of departure			
Vision	emphasis on self-reliance	limits to self-reliance	self-development through employment given primacy
Co-ordinating mechanism	price mechanism	institutional co-ordination	market-based co-ordination
Social distribution of responsibility			
Financial solidarity	■ little	■ much	■ complementary
Government tasks	generic policies ■ minimum subsistence ■ guarantee facilitating education, labour market and manpower services policy	targeted supply-side policy « ■ subsistence guarantee at present level » « ■ tailored case-by-case management » ■ benefits dependent on clients activities	targeted demand-side policy ■ earnings from employment supplementation where required
System content minimum wage and social security policy conditions			
Minimum wage	70% of present	unchanged	low threshold for specific categories
Statutory minimum	reduced	« ■ unchanged	
Loss of earnings insurance	■ optional unemployment from employment benefits: » present duration or somewhat shorter » 70% of previous salary or 100% of new minimum wage	■ unemployment and disability benefit levels unchanged	■ earnings supplementation up to present benefit level
WAO	i WAO abolished	■ social risk (finality) ■ unlimited benefit duration	
AAW	« unchanged level with social risk cover (finality)		
ABW	« ■ individual: 40% « ■ single householders' supplements < 20% ■ optional: lone-parents' supplement « ■ lone parents' supplement < 20% « ■ activity bonus < 20% « ■ reversed burden of proof		
Sustainability and enforcement			
generic	« ■ claim assessor function ■ endogenous price incentives		»
specific		« ■ activities contracts ■ punishment and individualised sanctions policy	»

lines of delayed indexation), but it could also lead to the decision to maintain the present system (50% of the present minimum wage per person for cohabiting couples, with a single householder's supplement of 20%). The call to maintain the status quo will become louder as confidence declines that the state pension (AOW) will be kept at its present level or if there is growing concern about the quality of the supplementary pension. This would involve a much heavier burden of administration.

A second joint point of departure is that all three variants assume the full indexation of the minimum wage and benefits, including the state pension. Adjustments in levels in relation to the present system can be achieved by means of temporary limitations in indexation, but the policy conditions discussed in this chapter describe a final situation. Sustainability requires striking structural balances between sharing and earning; apart from temporary adjustment processes there is no room for differing growth-paths for wages and benefits.

The third important constant in this report is the distinction between access and implementation in the structure of social security, as set out in section 2.3.6. Access to social security is in all cases monitored by a public claim assessor. In an entitlements model the claim assessor also pays out the benefit because the level of the entitlements provides an endogenous incentive to accept work and the government confines its activities on the supply side of the labour market to facilitating policies, without intensive case-by-case management. In an active integration and a supplementation model, by contrast, the claim assessor refers an admitted client to an executive case-manager. The latter concludes a case management agreement with the client, which simultaneously provides a basis on which sanctions can be applied in the event of failure to perform the agreed activities.

Finally, none of the models investigated here draws a distinction between *risque professionnel* and *risque social* (i.e. causality and finality) in the event of employment disability. The Council advocates the *indefinite duration* of the disability provisions, subject to the condition that repeated checks are made to confirm the continuation of disability. The time-limitation under the Disability Insurance Act (WAO) is therefore reversed, except in the case of the entitlements model, where the WAO lapses. The considerations for doing so are set out in section 2.4.7, where the social ineffectiveness of risk-selection and of separating executive responsibilities is noted.

3.1.2 What is left out of the picture?

In elaborating the three schools of thought certain things are left out of the picture. To begin with this chapter concentrates on the labour market-related aspects of social security. For this reason no further consideration is given to the state pension (AOW). Yet, this benefit has both an indirect and a direct relationship with the labour market. Indirectly the premiums form part of the pay wedge and hence depress the demand for labour. A warning was provided in section 2.5.5 that if the AOW lags behind the general rise in prosperity this will result in an increase in the tax-financed cost of national assistance and domiciliary care. Furthermore, it will bring about a shift of charges within the pay wedge (from social security contribution to the payment of contributions through collective labour agreements), with the side-effect of an undesired growth in private savings, as supplementary pensions are subject to capital funding requirements. As against this, if the AOW were to rise in line with general living standards this would require major reallocations within the public sector. As in the case of setting limits on the duration of benefits under the Disability Insurance Act (WAO) this is not just a matter of equity and legitimacy but also of efficiency and effectiveness.

The direct relationship between the AOW and the labour market-related social security is that the largely unavoidable and hence in practice 'preferential' claim of the old-age pension on the pay wedge dramatises the need for a participation strategy, in order to limit the claims of the active population as much as possible. This is not just a matter of financial claims, for which reserves can to a certain extent be built up in an AOW fund or by reducing the financial deficit. In particular, it also concerns ensuring a sufficient supply of labour to continue generating the national product without undue price rises if the share of the retired in the population structure continues to rise in the next century.

The health sector and health insurance, which will also lay a greater claim on the future as a result of ageing, have been left out of account in this report; they are the subject of the report by the Council on the future of health care¹⁴. The provisions for surviving dependants are also not examined, since these form risks which, after a transitional period, can perfectly well be insured in the private sector. The same applies to the continued payment of wages in the event of sickness (pursuant to the Sickness Benefits Act), apart from the comments in section 2.4.8 on the possible desirability of an employers' obligation to take out insurance, by way of analogy to third party liability insurance for motorists. The option of premium-differentiation in the Unemployment Insurance Act is also largely by-passed, although consideration to such an option could be given within an entitlements model by imposing higher premiums in industries responsible for generating a high level of short-term unemployment. The bulk of unemployment, however, is cyclical in nature, so that the penalty of imposing a high unemployment benefit premium would add to the pressures on any industry in difficulties. Furthermore premium-differentiation could weaken the position of permanent jobs. It is therefore doubtful whether premium-differentiation could limit unemployment. More effective strategies would appear to the greater emphasis on lifelong learning and the improved organisation of flexible employment.

3.2 Entitlements model 3.2.1 Underlying principles and social division of responsibility

An entitlements model represents a neo-classical approach to economics. Here the responsibility for having and retaining work rests primarily with the individual. Changes in the *entitlements* ensure that the behaviour of the potential working population is rapidly and adequately brought in line with changes in the employment situation. In the realisation that job-security can no longer be provided in today's society, citizens themselves need to keep up their employ-ability by means of their job attitudes, training and, more generally, a willingness to change. Employment and social participation are not rights that can be exacted from the government but are matters that people must achieve through their own efforts. In order to support such efforts the poverty trap is kept small (see section 2.5.2).

Differences in self-reliance or basic resources are not emphasised under this approach. This means that the government's responsibility can remain limited. In its social services the government confines itself largely to general education, labour market and labour mediation policies. Under the freedom to contract, commerce and industry can itself make supplementary collective arrangements. The chance that this will be done rises the scantier the level of

¹⁴] WRR, *Volksgezondheidszorg*, Reports to the Government no. 52, The Hague, Sdu Publishers, 1997. Available in English as WRR, *Public Health Care; Priorities and a Sound Financial Basis for Health Care in the 21st Century*; Summary of the 52nd Report to the Government, The Hague, 1997.

public provision. And the greater the share of the supplementary collective arrangements, the greater the actual responsibility of organised trade and industry for social security, national participation policy and the prevention of a social division into insiders and outsiders⁴⁵.

An entitlements model has both a positive and a negative justification. In a positive sense it rests on the image of the emancipated, skilled and self-reliant citizen, who is able to make his own choices, and on the ideology of individualism. In a negative sense this vision rests on an apprehension of arbitrary government coercion and arbitrarily inspired non-interventionism. In addition an entitlements model reflects the doubt as to whether the government is capable of dealing with the information and management problems of an interventionist welfare state in the light of the greater complexity of society and the scepticism entertained in some quarters about continuing support for government-organised solidarity (section 2.2.4).

3.2.2 Minimum wage and policy conditions

In order to generate additional employment, the minimum wage would be reduced under an entitlements model. Such employment would however need to generate a minimum level of subsistence and to be more attractive than a benefit. Since there are virtually no single earners on a minimum wage, we are working on the basis of a minimum wage of 70 percent of the present level. That level would enable single householders to provide for their own maintenance through employment. The non-statutory welfare benefit of 40 percent could be increased by a single person's supplement of 20 percent if it could be shown that the individual in question was paying rent. If so desired an additional supplement could be paid to lone-parents - something that could be justified in terms of need. The effectiveness of the system would, however, suffer as the poverty trap would be widened: it is lone-parents, in particular, who are confronted by extra costs when they accept employment. The duration of unemployment benefit could be retained or, if so desired, could be reduced somewhat (especially for older unemployed persons, who now have a five-year entitlement) in order to narrow the poverty gap; this model would not allow for any exemption from the obligation to seek work for the older unemployed. Disability insurance would be limited to a minimum income, with premium-differentiation for employers to limit the inflow.

The neo-classical perspective underlying an entitlements model pays little heed to the information and transaction costs of the market mechanism. The costs of reducing uncertainty and of risk-selection can be appreciable in the private insurance market. Hence, collective solidarity can be efficient in such a situation (section 2.4.7). In terms of effectiveness an entitlements model runs into three limitations. A reduction in the minimum wage would not stimulate single parents to find work, as they are able to achieve 60 percent of the present minimum wage with a single person's supplement and as much as 80 percent with a lone-parents supplement. Furthermore, their reservation wage will generally be high, since the acceptance of work results in extra private costs. The entitlements model does not provide any ready-made solution for this dilemma between fairness and effectiveness. In addition an entitlements model will need to provide an appropriate period for the unemployed to find a job corresponding with their knowledge and skills. Therefore, the possibility is left open to provide a grace period during which unemployment benefits would remain scaled at 70 percent of previous earnings so as to provide full opportunity to find a job. An entitlements model that more or less forces people to take

⁴⁵ On the insider-outsider problem see O.J. Blanchard and L.H. Summers, 'Hysteresis and the European Unemployment Problem'; in: NBER *Macroeconomics Annual 1986*; by S. Fischer, (ed.), Cambridge, 1986, pp. 15-78.

whatever is on offer is destructive of human capital and depresses economic growth and is therefore not efficient. Moreover, an entitlements model has nothing to offer to the 'genuine' bottom end of the labour market. The hundreds of thousands of long-term benefit-recipients will generally find it impossible to gain a foothold in the formal labour market - even given a reduced minimum wage or reduced benefits - as long as they are not supported by an intensive individual case management with a multiplicity of reintegration facilities, as provided for under an active integration or supplementation model.

Finally the effectiveness of an entitlements model will come under pressure if employers and employees weaken the intended incentive effect by means of substantial private supplementation arrangements. If horizontal privatisation is permitted this could put the transition at risk, for in a system of horizontal privatisation the independent responsibility of trade and industry is confined to funding and controlling the volume of the non-statutory arrangements and the costs of the basic statutory facilities are passed on under the pay-as-you-go arrangements of the General Disability Benefits Act. A necessary precondition for the sustainability of supplementary non-statutory arrangements is that this should come about by means of vertical privatisation in which the private insurer provides the integral cover, including the public mini-elements⁴⁶. Although this would serve to reduce the incentive for employees it does strengthen the involvement of employers, as long as the latter can be obliged to introduce premium-differentiation on the basis of the claims history from the first premium-guilder, including the public element. Another complication is that supplementation under collective labour agreements would - at least initially - put employees not coming under such arrangements at a disadvantage. Under the neo-classical approach this would be countered because competition for labour would eventually oblige businesses without a collective labour agreement to fall into line. This would, however, undermine the original systemic reform.

3.2.3 Sustainability and enforcement

The sustainability of social security does of course depend in part on our international competitiveness. This too can change. After a lengthy period during which the Netherlands lagged behind the country is now relatively well placed in Europe. A participatory policy would consolidate that position by providing a robust basis of support for the guarantee function of social security. If the present, cautious wage policy is continued and there are no unforeseen disasters, an entitlements model is undoubtedly sustainable as long as it is not stripped of effectiveness by the non-statutory cover warned against above. Precisely on account of its soberness an entitlements model would be better equipped to counter policy-competition in countries that wish to strengthen their labour force participation. In the light of technological progress care will need to be taken, however, to ensure that the government's educational and labour market policies stay in touch with the demand for labour and that human capital is destroyed because the job-seeking period for the unemployed is too short.

In an entitlements model the sanctions have been endogenised in the incentive-effect of the low benefits or, in the event of a substantial non-statutory element and sufficient premium differentiation, in the financial incentives for

*] WRR, *Belang en beleid; naar een verantwoorde uitvoering van de werknemersverzekeringen* (Interest and Policy; towards a Responsible Implementation of Employee Insurance); Reports to the Government no. 45, The Hague, Sdu Uitgeverij, 1994, p. 78. See also J.M. Bekkering, *Private verzekering van sociale risico's* ('Private Insurance of Social Risks'), WRR, Preliminary and Background Studies no. 84, The Hague, Sdu Uitgeverij, 1994, section 5.2.

employers to treat prevention and reintegration seriously. Needless to say work in the black economy can also not be permitted under an entitlements model. This calls for vigorous government supervision of the benefit system, where one is directly confronted by the difficulties in getting by on a sharply reduced benefit. In the event that the executive agencies turn a blind eye to earnings in the black economy, an entitlements model will evolve into a basic income. Finally it remains an open question as to how the policies that trade and industry conduct vis-a-vis the unemployed in an entitlements model would square with the government's education, labour market and equal opportunities policies.

3.2.4 Evaluation

In an ideological sense an entitlements model is supported by those who would assign the government a modest role in social security and no more than a framework-setting role in the labour market. This is based on a limited interpretation of solidarity or the view that greater government involvement entails an unacceptable encroachment on privacy. There is also the more instrumental consideration that far-reaching government intervention in the price mechanism causes undue information problems that are conducive to abuse - a problem examined in detail in section 2.3.2 and to which we shall be returning in the active integration model. This does however have a price in terms of justice and social solidarity, which can reach considerable proportions.

Apart from the solidarity problem the limiting conditions of efficiency, effectiveness and sustainability also expose the strengths and weaknesses of the entitlements model. The strength of the model is that it reduces the pay wedge and hence expands the demand for labour. It also promotes self-reliance, for the latter is - at least in part - an endogenous variable. The fact that the model is based on the endogenous price incentives of low benefits and a reduced minimum wage will stimulate not just the demand for but also the supply of labour because the reservation wage is reduced. In terms of technical feasibility only the moral hazard of working in the black economy requires attention. It all looks very efficient, effective and sustainable.

A weakness in this approach is, however, that it disregards differences in skills (section 2.2.2). Nor does it devote attention to the risk that people become reduced to poverty through a cumulation of social deprivation. Ostensibly comparable people can differ in terms of their skills and abilities, the latter not just in terms of cognitive skills but also social intelligence or ability to cope with stress. Labour is anything but a homogeneous good. This is why people react differently to standardised price-incentives; what is too much of a good thing for one person will be too little for another. If people are all given the same basic rights the policy will still work out differently from individual to individual if their preferences, skills and self-reliance differ. This need not detract from the effectiveness of an entitlements model, for benefit levels and the minimum wage can be set so low that a high proportion of the target group are obliged to seek work and few are excluded by the size of the minimum wage. But the sacrifices required will differ markedly from one person to another and the grapes will be particularly sour for those who fail to find work despite making real efforts and who remain dependent on a low benefit. In this respect an entitlements model is particularly hard on people who have little to offer the labour market and on incapacitated persons who have not taken out supplementary insurance in good time.

The question therefore arises as to whether there are not better ways of promoting economic dynamism. Once again we would refer to the suggestions in section 2.5.3 to reduce the reservation wage by enlarging the internal flexi-

bility in organisations and providing greater security of employment for temporary employees. Against the background of these and other alternatives discussed in this report the Council considers that there is at present little support for the exclusive introduction of an entitlements model as outlined above. This proposition is examined in further detail in chapter 4.

3.3 Active integration model

3.3.1 Underlying principles and social distribution of responsibilities

An active integration model is based on the view that the labour market requires broadly-based institutional support in order to achieve and remain in balance. Under this view the government accepts a substantial responsibility of its own for the supply and placement of labour and for organising solidarity. To this end it invests in an integrationist labour market policy, which compensates for differences in the self-reliance and basic resources of individual citizens by means of individual case management. By way of quid pro quo an autonomous policy of sanctions holds citizens and companies to their agreements concerning efforts and results in order to limit resort to social security to the best of their knowledge and ability. This takes account of contemporary insights into the direction and governability of complex networks in which a multiplicity of actors pursue their own interests. The government in turn has an obligation to arrange for the institutional reforms and the financial resources required in order to permit and sustain an active integration policy.

The justification for an active integration policy more or less mirrors that of an entitlements model. The emphasis is placed on differences in self-reliance and skills and on the desire to compensate for those differences by means of broadly-based solidarity. This creates the risk of cutting across the individual responsibilities of individuals and companies by making them over-dependent on government involvement. The active integration model therefore requires an unambiguous input in order to cope with the information and management problems of a large-scale welfare state.

3.3.2 Minimum wage and policy conditions

In contrast to the entitlements model an active integration model is based on a picture of man in which differences in skills can build up into major differences in self-reliance, potentially leading to the segmentation of society. This calls for active government policies in the labour market. In addition the benefit levels should be such as to prevent pauperisation among those who remain unemployed for long periods through no fault of their own. Against this background the minimum wage and the loss-of-earnings insurance remain at their present levels in this model. In addition, the time limitations in the Disability Insurance Act (WAO) are abolished on the grounds that the claim assessor can reliably determine disability (and thus keep hidden unemployment at bay) and that reinsurance of the WAO gap has proved to be a socially inefficient way of robbing Peter to pay Paul (section 2.5.5). Welfare benefits are split into an individual basic benefit (means-tested and subject to partner's income) of 40 percent of the minimum wage supplemented by a maximum of three supplements. Apart from the existing single-person supplement (limited to those demonstrably paying rent, etc.) and the supplement for single parents there is the possibility of an activities supplement of up to 20 percent for activities to promote participation as agreed with the case manager. The burden of proof for all supplements resides with the client.

Relatively attractive policy conditions make a system vulnerable to misuse and abuse by clients, employers and caseworkers. Since the benefit alternative is more attractive than that under an entitlements model, clients' reservation

wage will be increased and employers will encounter less resistance when making redundancies. Finally the attractive benefit conditions mean that social security administrators are under pressure to turn a blind eye when exercising their role as claim assessor. Furthermore they have so far had no time, no discretion and too small a budget for proper case management. In addition, the traditional system of administration, resting as it does on the classification of individuals and regulations, is inherently unable to cope with the hidden decisions' underlying abuse.

The remedy against abuse was initially sought by defining the target-groups more precisely. This solution failed, however, to take account of the fact that differences within groups are often bigger than those between groups. This therefore creates a risk that the further refinement of the regulations will reduce the practicability without improving performance. In this way the core problem that motives are highly diverse and hidden decisions uncontrollable is not brought closer to a solution. Progress is, however, made with the independence of the claim assessor's function, which is no longer directed by interested parties.

In the meantime the view that the complexity of the subject-matter calls for *customisation* has gained much ground. In many cases the administrative and legal preconditions which tailor-made Solutions must satisfy remain inadequately recognised. This was discussed in detail in section 2.3 where it was argued that customisation calls for the careful structuring of the balance of power between client and case manager in order to create room for further deregulation and for a balanced set of responsibilities and imperatives ('incentives') throughout the implementation column. On the other hand well-structured case management provides the hard information or revealed preferences that enable the wheat to be separated from the chaff and to conduct an effective policy of sanctions - the latter being a vital prerequisite for keeping the benefit conditions of an active integration model intact.

An active integration model differs from the current employment policies by the much greater emphasis on permanent training, innovations in work experience and career counselling for the working population as a whole. In the Council's view the challenges of demographic and technological developments and the growing international competition outlined in Chapter 1 call for a coherent vision and a substantial national effort in order to increase total labour productivity and labour force participation simultaneously. This is a stiff challenge, as the highly satisfactory growth of labour force participation has to date been facilitated by the moderate growth in productivity. In the future this will not, however, be sufficient to preserve our relative position of prosperity. Within a broad approach as outlined above, priority will need to be given to the social and economic necessity of finding work for those whom it is hard to place. At issue are several hundred thousand partly 'hidden' unemployed who have all but lost touch with the labour market. Failure to mobilise this group now will mean that the upturn in employment passes them by, that there will soon be shortages in the labour market, that wages rise before equilibrium has been restored and that the gap becomes unbridgeable. Hence the need for a broad and coherent approach with activities across a wide front of training, work-experience places and wage subsidies under a supplements model to be discussed below. These are not just a few tens of thousands 'Melkert' jobs or a Youth Work Guarantee Plan but a systematic and large-scale exercise to preserve the human capital of society, starting at the bottom end of the labour market, in order to prevent the knowledge society from divid-

ing in two ⁴⁷. But attention also needs to be devoted to the more knowledge-intensive, 'high-grade' element of the economic structure in order to generate the necessary up-draught to create room for those who are still excluded.

It is frequently objected that a policy of reintegration will result in the displacement of labour from existing jobs. But in this case that is precisely the intention. If it is the aim to improve the productivity and prospects for permanent work of the unemployed in relation to those of the incumbent employees, displacement may be regarded as a sign of effectiveness. As long as the policy remains aimed at a continuous growth in employment (an 'up-draught') it will as a rule be possible for a displaced employee to find work before too long. In addition wage top-up schemes give the unemployed the opportunity to make good their lost work-experience. Those only prepared to direct the unemployed into new and additional work are not serious about a policy in which opportunities are equalised. They also fail to recognise the dynamism of the labour market - not just the dynamism today, with its resistance against earmarking certain categories of workers for certain categories of work but, in particular, the dynamism of the future. If labour is to become scarcer in the coming years it is highly important that the pool of long-term unemployed should start moving now so as to be sure that all these people will be employable in the foreseeable future with a minimum need for government subsidies ⁴⁸.

3.3.3 Sustainability and enforceability

It has been made clear above that an active integration model will be expensive and therefore needs to generate considerable returns in order to be sustainable. This is the great weakness of this school of thought: it is much more sensitive to the quality of implementation and the willingness to tackle abuse than the present policy to regulate the volume of claimants. It is against this background that we need to consider the recommendation that agreements must be made concerning *testable* obligations on the part of the unemployed, on the basis of which sanctions can be imposed when those obligations are not discharged. In the Council's view the rampant and unstructured spread of customisation must be removed from the uncontrollable bureaucratic sphere and transferred instead to that of equality of opportunities (see section 2.3.4). Such a strategy would be new in the Netherlands and an active integration policy would therefore call for a far-reaching change in culture among the executive agencies. The developments in recent years indicate that such a change is possible but will take a major effort.

An active integration model fits in well with the rapid pace of technological change. At the bottom end of the market it is concerned with permanent education and the movement of the long-term unemployed into regular, if possible unsubsidised jobs. This is based on the assumption that the work-experience and training gained by the long-term unemployed will be sufficient to increase their labour productivity to the point that an unsubsidised job comes within reach in due course. The high demands made in terms of training and trainability are particularly emphasised in this strategy because the minimum wage and statutory minimum are not reduced but rise in line with average pay trends. If average pay rises thanks to higher labour productivity, the minimum contribution required from labour will also rise. An active integration

**] See WRR, *Social Dichotomy in Perspective*; Summary of the 50th Report to the Government, The Hague, 1996; and Projectbureau Kennis voor Morgen, *Kennis maken met de toekomst; Het kennisdebat 1996-1997: analyse en aanbevelingen* (Getting to know the Future; The Knowledge Debate 1996-1997: Analysis and Recommendations); Ministry of Education, Culture and Science, Zoetermeer, 1997.

⁴⁸] See J. Hartog, 'Werkverschaffing volgens de Rekenkamer' (job Creation according to the Court of Audit); *Economisch Statistische Berichten*, 15 January 1997, vol. 82, no. 4089, pp. 44-48.

model invests in the quality of the labour potential but also increases labour costs. International competitiveness need not, however, suffer as a result if the additional expenditure also generates higher added value and if savings can be made on public expenditure by the avoidance of large-scale and protracted inactivity. If however trading partners seek to reduce wage costs by cuts in social security, the relatively high costs of an active integration model will have a particularly marked effect on relative competitiveness. In particular an excessively regulated and insufficiently dynamic active integration policy could then become unsustainable.

3.3.4 Evaluation

An active integration policy will demand a great deal of creative resolution if the inherently beneficial aspects of social security are to come into their own more effectively without eliciting the large-scale misuse which, in the past, has resulted in interventions that have undermined the guarantee function of social security. The model discussed in this section can meet both requirements: customisation provides the ability to help bridge the gap to the labour market, with case management based on an individualised active integration plan. These agreements clarify what is expected of the various actors and provide the basis for an effective policy of sanctions. The combination of deregulation, individualized agreements, competition and reverse burden of proof suggested by the Council in this report provides the possibility for reducing the information asymmetry, the sudden decisions' and abuse. An indication has been provided in section 2.3 and in this chapter of the way in which unintended behaviour throughout the system of social security can be punished by the careful identification of those responsible and by providing incentives for those responsibilities to be assumed. In this regard it is vital for clients, case-workers and employees to pledge themselves to the desired result and to convince all concerned that 'the load will no longer be laid on the willing horse' because abuse will in fact be penalised.

This is asking quite a lot of the political system. Not only must legitimation be provided for an active integration model but the latter must also be given consistent support - and that while such an individualistic model will arouse considerable resistance with appeals to assumed equal rights, mitigating circumstances and all the rest. An active integration policy is vulnerable to degeneration. A major administrative effort will be required in order to maintain a system which, on account of the level of benefits, is susceptible to fraud and which runs the risk that intrusive government involvement will create relationships of dependency that undermine self-reliance. If the latter were to occur the system would be biting itself in the tail. Against this background the independent efforts of clients, employers and welfare officers cannot be left to chance. An active integration model is only sustainable if there is the *political will* to:

delegate powers for prevention and reintegration facilities to be effectively customised in practice;

to release the necessary resources for the 'major overhaul' of human capital made necessary by the current developments; and finally to assemble the political courage to conduct the necessary sanctions policy.

Nevertheless the Council considers that a broadly-based drive could find the necessary social and political support as the realisation gains ground that no single occupational or income group would be exempted from the income-risks of job insecurity that technological developments and the globalisation of the economy involve. A positive factor is that the complication under the entitlements model of the need to tie in with the collective arrangements made by the private sector does not apply in this case as the active integration model leaves little incentive for supplementary arrangements. There is, however, a need to

keep looking for alternatives that could alleviate the heavy administrative burden of an active integration model. Against this background the Council calls for attention to the possibilities of the supplementation model.

3.4 Supplementation model 3.4.1 Underlying principles and social distribution of responsibilities

In a paradigmatic sense a supplementation model rests on a combination of the neo-classical and institutional co-ordination perspective. It combines the responsibility *of the individual* for having and retaining paid work in the entitlements model with that of the *government* for organising intensive and customised case management as provided for in the active integration model, with the addition of targeted demand stimulation. In order to dramatise people's own responsibility for labour force participation, a supplementation model in its pure form makes acceptance of paid employment a precondition for benefits and requires benefits to remain confined to incremental supplements to earnings. The fact that social security is a supplement to earnings capacity reduces the benefit load. Elements of this combination of an obligation to seek work and supplements are already recognisable in the new National Assistance Act. Under the supplementation model a 'balanced approach' involves an obligation on the part of the government to offer a work guarantee to clients who have been unable to find work despite having made demonstrable efforts. The Council considers it can only recommend a mutual obligation of this kind under the present circumstances for young people, under the new Job-Seekers Integration Act (WIW 1998). For other categories a work guarantee would be imposing an excessive burden on the government in the current labour market; any reluctance to find work would need to be tackled by means of sanctions. Given a tighter labour market a work-guarantee could in due course find wider application.

The *government's responsibility* is reflected in a dynamic labour market policy with intensive, customised case management and financial incentives for employers in the prevention field and for permanent learning in order to promote the employability of employees. As a quid pro quo for the (supplementary) benefit paid by the state, citizens and businesses enter into customised agreements imposing an obligation to limit their resort to social security. The Council therefore has in mind a 'Rhineland version' of the supplementation model. This differs in two respects from the negative income tax in the American workfare model, which is related to this model. In the first place the minimum *wage* is admittedly reduced but the minimum *income* and the policy rights under the social security system remain at their present level, except that they take the form in practice of a supplement to independent earnings from employment. Under this approach there is also little incentive for supplementary collective arrangements by the *private sector*. Secondly, the emphasis on consultation, intensive case management and the associated testable agreements (section 2.3.6) takes advantage of the Rhineland social traditions in our country.

The distribution of responsibilities under a supplementation model rests on the one hand on the presupposition of the self-reliant citizen who assumes responsibility for his or her own career and on the other on the recognition that the government and employers bear a complementary responsibility for a substantive prevention and active integration policy. The admission requirement of work-acceptance limits the poverty trap and the dependency relationship created by a system of social security. In doing so it does justice to the ideals of emancipation and independence. In addition, if the government does all in its power in a complementary active integration policy to support people in

their efforts to improve productivity, justice will be done to individual differences in know-how and ability. This takes the form of customisation in which the unequal are handled unequally to a comparable extent. And finally the legal guarantees remain unaffected by maintaining an above-minimum benefit level for those who cooperate faithfully in prevention and reintegration or who are required to resort to social security through no fault of their own.

The control of abuse and misuse under a supplementation model calls for a multiple transaction: on the one hand with the benefit-claimant, who must be induced to make a maximum effort, and on the other with the employer, as the possibility of a supplement can easily result in the *improper displacement* of unsubsidised employees by less well paid employees, whose income is in any case being supplemented. In comparison with the active integration model the burden of administration in the relationship with the benefit-claimant is to some extent alleviated because the obligation to accept a substantial level of regular work leaves less room for working in the black economy. To some extent the burden of administration is however also *aggravated*, in so far as clients are tempted to seek activities that are not commensurate with their qualifications or on a part-time basis since their earnings are being supplemented in any case. With respect to the employer the burden of administration will inevitably be increased on account of the risk of displacement noted above.

3.4.2 Minimum wage and policy conditions

In order to promote optimal labour force participation the wage-function and need-function of the minimum wage are disentangled. The wage-function permits a reduction to (for example) 50 percent of the present level, so that more activities can be admitted as formal employment, although the minimum wage continues to exist as a floor in the added value that serves to emancipate the position in question ('work must pay') and also in order to confine the identified risk of the improper displacement by employers. The reduced minimum wage maintains a division between employment, for which a counterparty is prepared to pay, and activities that need to be viewed more as leisure pursuits. The need-function of the minimum wage can be taken over by supplements to earned income. Various practical modalities are conceivable. The supplement can be granted by the benefit agency; such an approach would strongly under-score the prime responsibility of the applicant to earn a living. Alternatively the supplement could be routed through the employer, in the form of a reduction in the wage tax and social insurance contributions deducted at source. This option emphasises the employment-generating effects of a selective reduction in wage-costs. The influence of the latter can be substantial; in 1997 national insurance contributions amounted to 32.25 percent and the (variable) employees' insurance contributions to a minimum of 23 percent of income subject to social security contributions. As in the case of an active integration model, the loss-of-earnings insurance would remain at the present level, which in this case would take the form of a ceiling on supplements to independent earnings. The time-limit on disability benefits (WAO) would also be abolished. National assistance would become a basic benefit of 40 percent of the present minimum wage with the possibility of a single person's supplement, a supplement for single parents and the possibility for an activities supplement under the same limiting conditions as those under an active integration model.

In itself, a supplementation model is highly efficient - even more so than an entitlements model. In view of the fact that the lion's share of current benefits do not, under the present system, exceed the statutory minimum, the requirement to accept paid employment under a supplementation model would generate substantial savings, even if the present level of benefits were to be retained as a supplementation ceiling. In social terms it would moreover be a gain if employment with a low added (market) value were not to be eliminated by a

high minimum wage but to be deployed where useful. On the other hand it will be clear that a supplementation model makes heavy demands on implementation. For this reason it is not possible to say how much the policy could generate without knowing the implementation modalities (including the pace of introduction and the implementing agency, i.e. the employer or benefit agency) and without further specification of the time-frame for the anticipated growth in jobs. Although the problem might be alleviated because working in the black economy would become more difficult, there would be three serious problems. First of all the model would need to provide sufficient work, particularly for those at a major distance from the labour market, in order to render the obligation to accept work credible. Secondly, the poverty-trap also looms. And finally improper displacement by employers would also need to be countered.

On the face of it the availability of work is the least problematical precondition. To a certain extent the system investigated here creates paid work itself, in so far as 'black' labour is regularised and the reduction in the minimum wage creates new jobs (e.g. by the conversion of what is at present unpaid voluntary work). In addition it may be noted that employment has been growing by an average of 1.5 percent a year since 1983⁴⁹ and that the demographic developments will rapidly cut back unemployment if the policies to increase the level of employment can be sustained. At the same time - as in the case of an entitlements model - there remain several hundred thousand benefit-claimants who are unplaceable and for whom the requirement to accept work is no more than a gesture of political impotence. For these people a long-term programme of intensified case management as provided for in the active integration model will need to be instituted before the requirement of work-acceptance can be put into practice. For the time being, the safety-net of national assistance will remain indispensable for this category.

The more limited scope for working in the black economy would, it is to be hoped, mean that benefits would be less frequently improperly assigned. But the supplement guaranteed by the present level of benefits opens up a poverty-trap, in that the benefits are lost as soon as someone starts working. In order to limit the poverty-trap there are two possibilities. Where people have genuine prospects in the labour market the supplements should be temporary or depend on the efforts that people make to improve their own position, supported where necessary by training and training leave. The disadvantage of a temporary supplement is that, on the one hand, this creates a category of working poor in poorly paid jobs after loss of supplement, while on the other employers will be unlikely to take on someone on the basis of a temporary supplement. In difficult cases with structurally low labour productivity, consideration should therefore be given to a permanent supplement after renewed assessment by the claim assessor (see Chapter 4). In this respect a permanent replacement supplement for the elderly could clear the way for a demotion policy under which redundancy is reduced. Given disproportionate entitlements, a form of premium differentiation for the employer would however be necessary in order to prevent improper displacement.

The second possible solution is based on a financial incentive to look for better paid and less subsidised work, as the income above the reduced minimum wage would not then instantly be deducted in full from the supplementation. This would then introduce a statutory element of negative income tax. As a result an employee with a job between the present and the new, reduced minimum wage would earn a total income in excess of the statutory minimum. The longer the transitional period the greater the incentive, but the greater would also be the displacement problem, which is a much more real threat in a supplementation model than in an active integration model.

■] See De Nederlandsche Bank, *Annual Report 1996*; Amsterdam, 1997.

3.4.3 Sustainability and enforcement

In combination with the emphasis on training and work-experience under an active integration model, a supplementation model can provide a response to the rapid pace of technological change and the growing volatility of demand for labour. This does mean that in contrast to the United States a supplementation model cannot be set on the automatic pilot of a negative income tax and that it must be geared to a targeted supply policy in order to increase employ-ability. This again calls for customisation in the form of intensive individual case management. In that connection a supplementation model appears sus-tainable. Although the level of benefits is higher than that under an entitle-ments model the emphasis on paid employment as a precondition for a supplement introduces a franchise in the benefits. This cost limitation and the care devoted to the maintenance of human capital strengthens competitive-ness. A further advantage is the fact that marginal labour is also deployed in an economically useful way. On the other hand work, as an admission ticket for supplementary social security, reduces the problem of working in the 'black economy' but certainly does not exclude it. There is for example a risk that 'Virtual' work will be regularised, and that the supplement for those concerned will act as a basic income: an admittedly low but otherwise unconditional benefit. Another threat is that employers in a labour market in which there is still slack for large cohorts of people will snatch the benefits under a supplementation model as a permanent and generic wage-cost reduction at the bottom end of the labour market. In this case the dynamic perspective would be lost: the updraught that is designed to legitimate the displacement in a more selective active integration model based on individual agreements with employers.

3.4.4 Evaluation

To an even greater extent than the other options, a supplementation model emphasizes the value of employment as a means of social participation. The fact that the needs-finction of the minimum wage is detached from the remuneration-function will encounter particular resistance among the trade union movement. Independently of this, however, there would appear to be a social basis of support for greater emphasis on actual labour input, as an 'entry ticket' to social security⁶⁰.

On the other hand in the public debate there tends to be glib reference to the scope for effectively combating involuntary unemployment by reducing the minimum wage. Much more is required to provide the several hundred thousand inactive persons - especially the elderly and the partially incapacitated -with a chance in the labour market.

In principle the market-based co-ordination perspective of a supplementation model provides a meaningful synthesis in the tension between guarantees and adjustment that is characteristic of the sustainability of the social security system. However, as long as there remain clearly disadvantaged groups in the labour market and the level of employment is insufficient to hold everyone to the requirement of job-acceptance, a supplementation model can only be introduced on a cohort basis. Particularly during this interim period the system will be vulnerable to abuse by employers on the look-out for a bargain.

These problems do however become less constraining if unemployment eases and demand in the labour market makes it easier for people to move on or even results in a sellers' market with labour shortages. An attractive feature of this

^{60]} In 1993 59% of the respondents came down in favour of a system of workfare: Social and Cultural Planning Office, *Social and Cultural Report 1994*; Rijswijk, 1994, p. 225.

option is that it can alleviate the administrative burden of the system of social security, particularly once the labour market is more in balance and the worst risk of improper use by employers has eased. In order to relieve the pressure on the social security system it would be advisable to introduce a supplementation model for those cohorts needing little inducement to find their way to the labour market, e.g. young people.

An active integration model and a supplementation model could be effectively combined. The Council notes that the present financial resources and the currently available job-placement capacity would need to be stepped up many times over in order to achieve a fruitful combination. Under a well-structured policy those additional costs would, however, be recouped back over time. There is a good deal of policy freedom as long as the 'maintenance' and mediation costs are lower than the sum of extending the base of support and the cash value of future benefits times the success rate less any leakage losses. The ideal policy combination is examined in more detail in the next chapter.

Conclusions and recommendations

4.1 A limited breathing space

Over the past ten to twenty years the level of Dutch benefit entitlements has step by step been brought into line with that of our leading European trading partners and competitors. Starting from a position of relative backlog in Europe the Netherlands began some years ago to put its house in order and to préparé for the challenges outlined above of a plural society, demographic shifts and ongoing economic integration. These efforts are now bearing fruit since the Dutch economy is performing strongly in relation to other European countries in terms of socio-economic co-ordination, growth, job creation, low inflation and responsible financial policies⁵¹. The ratio between active and inactive persons now also stands up to international comparison. Against this background Chapter 1 referred to a window of opportunity or breathing space in which to make strategic choices of the future. The observation that the position from which the Netherlands is starting out has improved does *not* mean that our prosperity and employment are safeguarded, but that - in contrast to other European countries - we no longer have our backs to the wall and can face the future creatively. The lead that the Netherlands has opened up is, of course, temporary in nature. In due course other countries will in their turn reap the benefits of the adjustment processes which they have set in train. It is therefore a matter of using our window of opportunity to good effect.

In this regard it is highly important to bear in mind that the nature of the problem is starting to change. This calls for a reordering of priorities within the adopted strategy of labour force participation. Many years of wage-restraint and structural reductions in benefit entitlements have resulted in the strongest growth in employment in Europe for years in succession. On top of that the suspension of the linkage arrangements means that the minimum wage and statutory minimum have lagged a further 20 percent behind the already moderate growth of pay settlements. The generic demand policy, in which wages have been moderated with a view to improving competitiveness and so stimulating domestic and foreign demand, has been undeniably successful. Nevertheless this policy is gradually reaching its structural limits, both in terms of wage developments as a whole and with respect to the policies at the bottom-end of the labour market.

Although the broadening of labour force participation is bringing the end to mass unemployment in sight, it is also holding down the growth in average labour productivity. More serious still is the fact that the demand for cheap labour is not growing sufficiently at the bottom-end of the market, thereby raising doubts as to the effectiveness of further generic reductions in the minimum wage. In section 2.5.1 it was suggested that there has been a far-reaching reduction in the number of breadwinners on a minimum wage. In circumstances where the original protection function has all but lost its relevance, there would appear to be no barrier towards decoupling the minimum wage and the statutory minimum, as proposed in the supplementation model. The protection function would be served by the statutory minimum, while the reduction in the minimum wage could kindie additional employment.

⁵¹ See De Nederlandsche Bank, *Annual Report 1996*; Amsterdam, 1997, pp. 21-25.

If however this solution is politically unacceptable (at least for the time being), it would also be possible to strike down a different path. Research based on the situation at the end of the 1980s reveals that the price elasticity of the demand for labour differs from one category to another at the minimum-wage level. A reduction in the minimum wage of ten percent for males would generate only two percent more employment, but in the case of women the effect is much larger, namely eight to nine percent. Furthermore, the elasticity of demand for the less well educated was above-average in both categories⁵². The precision with which such elasticities can be measured as well as their predictive significance is disputed. In the 1990s for example the minimum wage has lagged behind average-pay trends to an even greater extent than in the second half of the 1980s (see section 2.5), but this has not led to a greater interest on the part of employees in creating jobs for the lowest pay scales. Be that as it may, these research findings can be used to develop a more specific demand policy for the bottom-end of the labour market. The differentiation in elasticities provides a point of departure for identifying target groups for which supplements or wage-increments could prove an effective instrument. In addition there is every reason to tackle the non-financial obstacles in the reservation wage.

The Council notes that the gradual reduction in the deployable labour reserve calls for a shift in emphasis towards a long-term strategy to boost labour productivity. Such a policy would be aimed at *investing in people* and its focus would consist of a combination of an active integration policy and a policy on the demand side of the market to increase the employability of the labour reserve. Employability is the ability of employees to obtain and hold down work, either within or outside the company by which they are employed.

At issue are three things: individually, widely applicable know-how and skills and willingness to be mobile and, institutionally, the development of training, recruitment and selection processes to get the right person in the right place at the right time⁵³. Employability has emerged in a short space of time as the main subject in collective bargaining, as the most important fruit of the future-oriented socio-economic consensus characteristic of Dutch labour relations. This development, which takes advantage of the window of opportunity in order to shift the emphasis from protection to mobilisation, does not call for government to slip back into a social insurance entitlements policy but for a fruitful interweaving of the education system, labour market and social security in an *individualised supply-side policy*. As public finances are brought into order, a more *specific demand-side policy* will be generated, enabling specific requirements to be targeted. Now that the end of mass unemployment is coming in sight, a generic demand-side policy based on wage-restraint remains a necessary but no longer sufficient condition for the restoration of equilibrium. The policy needs therefore to be more differentiated so as to harmonise demand and supply more effectively.

^{52]} See A. van Soest, R. Euwals and B. Donkers, *Arbeidsparticipatie, lonen, uitkeringen en werkgelegenheid; Een statisch microsimulatiemodel* (Labour Force Participation, Wages, Benefits and Employment; a Static Micro-Simulation Model); VUGA, The Hague, 1996, p. 73. In the same spirit P. de Beer, 'Laag opgeleiden: minder kans op een baan, meer kans op ontslag' (The Poorly Educated: Less Chance of a Job, Greater Chance of Dismissal); *Economisch Statistische Berichten*, 6 November 1996, vol. 81 no. 4080, pp. 908-912.

^{53]} See Socio-Economic Council, *Sociaal-economisch beleid 1996-1000* (Socio-Economic Policy 1996-2000); Advisory Report 96/05, The Hague, 1996, pp. 130-131.

4.2 A strengths/weaknesses analysis

The stimulation of flexibility and employability, individualised support to keep or bring people and work together (prevention and reintegration), purposeful action to counter misuse and abuse and the effective use of income supplements to kindie specific demand categories: this is what faces the Netherlands in order to safeguard the symbiosis of social security and labour force participation for the future. These four elements go hand in hand and call for a well-considered combination of the three conceptual approaches discussed above in an ongoing policy plan. Views may of course differ on the respective weights that should be assigned within this policy mix to equity, efficiency and sustainability. The Council is not taking a stance on any of these political aspects, but considers that the insights it has offered with respect to the relevant challenges and criteria could help in fleshing out the required policy choices. Against this background a strengths/weaknesses analysis of the policy options has been undertaken below.

The three conceptual approaches developed by the Council in previous chapters turned out each to have their own strengths and weaknesses, not just in terms of performance but also in terms of the underlying vision on social relations and socio-economic interrelationships. Is self-reliance - as a portrayal of humankind - a reality, a postulate or a desideratum? Where is the divide between nature and nurture? Can the policy choices in question also promote self-reliance instead of the dependency relations created in the past? To what extent do *Sein und Sollen* cut across one another in these attitudes? And the 64-dollar question: does the political process permit the desired policy goals with respect to social security to be unambiguously formulated as a touchstone for their effectiveness? As long as these value-laden preliminary questions are not spelled out, both the pursuit and description of social policy will remain a chimera. The Council has previously reported on various insights concerning the limits to and possibilities for alternative approaches to social security and has exposed dilemmas calling for a political response. The required choices have already been adumbrated in Chapters 2 and 3. The present chapter summarises the most important findings and develops a vision of what might be a well-considered combination of the various conceptual approaches, both for the future of social security in the longer term and in order to resolve the stubborn problems at the bottom end of the labour market.

4.2.1 Policy strategy and the 'well-considered combination'

The Council considers that the room for manoeuvre currently enjoyed by the Netherlands does not create an urgent necessity to increase participation by further scaling down social insurance entitlements. The present breathing space should, instead, be utilised to enlarge the employability of the working population - which is of overriding importance in the light of economic change - by other means. The labour reserve now largely consists of the long-term unemployed and other underprivileged groups with low earning capacity. Since the effective demand for these categories is low, little is to be expected from a generic cut in benefits and the minimum wage. In order to prevent the emancipation of labour and talent called for in *Social Dichotomy in Perspective*^{B4} from failing to come about, a policy is required consisting of training, the provision of opportunities to increase individual labour productivity by means of work-experience, and specific demand stimulation, including the division of tasks to generate more jobs for people with low starting qualifications. As an additional factor, excessively low benefits lead to risk-avoidance, immobility and poor allocation in the labour market, so that social security ceases to act

^{B4}] WRR, *Social Dichotomy in Perspective*; Summary of the 50th Report to the Government no. 50, The Hague, 1996.

as a lubricant. The labour market of today and the future calls for the ability for individuals to buffer the risks of a change in status. Finally, further austerity measures in the welfare field would encounter major social and political resistance and the effect would probably be partly nullified by compensatory collective bargaining elements, with a resultant fragmentation of social security. In short, the challenge is to find an alternative to both the Anglo-Saxon model, which is unable to avoid the working poor, and the traditional Rhineland model, which does not readily reconcile income guarantees and an adequate level of employment.

This does not eliminate the fact that good use can be made at present of certain elements of the entitlements instrument. In section 2.4.7 it was argued how equity and efficiency can *both* be served by abolishing the time-limit in the Disability Insurance Act, subject to a satisfactory system for assessing claims to benefits. The sustainability of a modern system of social security necessarily calls for tighter claims assessment as well as stricter penalties. The reversal of the burden of proof in the case of applications for income supplements (section 2.3.7) and of non-imposition of penalties by caseworkers also needs to be viewed in this light.

The Council would stress, however, that a further limitation of benefit entitlements is certainly not permanently ruled out. The challenges outlined in Chapter 1 - particularly the demographic problem - call for more than just good intentions. If the intended process of simultaneous productivity improvements, growing labour force participation and a wider base of economic support does not get off the ground sufficiently or if there are serious setbacks in the international economy, further cuts in the social security field will be back on the agenda.

The 'well-considered combination'

The Council expects that the objectives for the future system of social security can be safeguarded while maintaining present benefit levels in a well-considered combination of policy instruments in which the emphasis is on an active integration policy and a supplementation policy. These two are by no means mutually exclusive. On the contrary: there is a role for both, both in terms of their own merits and in order to compensate for one another's weaknesses. The two approaches have in common an emphasis on intensive, individualised case management, as summarised in section 2.3.6. Under an active integration policy, case management is where necessary supported on the supply side by mobilisation facilities for individualised training, work-experience or job-application support going beyond the overall, generalist education policy in the entitlements model. But a specialist supply-side or active integration policy are not enough; these need to be supplemented by an individualised demand-side policy that creates additional jobs and/or grants supplements in the event of too low (initial) labour productivity. A supplementation policy is unwieldy in a slack labour market as it needs to be protected against rent seeking. As the labour market clears, however, the scope increases for the wider application of a supplementation policy. This can contribute significantly towards easing the burden on the also highly cumbersome active integration or mobilisation policy. The well-considered combination is therefore not constant over time but depends on the changing nature of the problem to be solved. A combination also affords the best opportunities in the short term for helping a significant proportion of the large pool of long-term unemployed and other hard-to-place groups to find work. In the longer term this pool is likely to become smaller, thereby expanding the scope for a supplementation policy. International competition does, however, call for continuing attention to productivity developments on the supply side of the labour market.

The possibilities for individualised supply-side and demand-side policies are examined in the sections below. Some of what is discussed is already policy or

in the process of being drafted. The Council has not however confined itself to new proposals but outlines the main elements of an overall system.

4.2.2 Individualised supply-side policy

On the supply-side of the labour market the Council argues for the substantial intensification and deepening of individual case management in order to keep people and work together (prevention) or to bring them together (reintegration). Where necessary this needs to be supported by specialist facilities to strengthen the labour market position of those concerned. This is based on the insight that people may be equal fundamentally but not in terms of income-generating characteristics and self-reliance (section 2.2.2). The Council considers that the undue reliance of the traditional Rhineland welfare state on regulations and bureaucratic procedures makes it difficult for the labour market to clear. This approach leaves too much room for rent seeking and creates too much dependence to be tenable in a dynamic social and economic environment. For this reason section 2.3 presented a more contemporary operationalisation of social security in which primacy is accorded to individual responsibility at all levels and on the part of all concerned in the administrative process (i.e. policy-makers, clients, caseworkers and employers). In this regard responsibilities are consistently supported by an active sanctions policy in order to strike a balance between rights and obligations.

Prevention

The prevention policy takes place primarily in the stage of initial training and subsequently within the employing organisation. A policy aimed at lifelong learning and careful career counselling is still in its infancy, as is thinking about the distribution of responsibility between government, industry and the individual when it comes to the shape this should take and its funding. The conclusions of the national debate on the role of knowledge and the recent breakthroughs in the consultations on career breaks and a policy to promote participation by the elderly within companies are signs that support is increasing for the improved maintenance of human capital. Special attention also needs to be paid to arrangements to maintain the know-how and skills of employees who leave the labour market temporarily for family reasons, with a view to their future prospects for a return.

Innovation and the associated review of job-contents - forced in part by the intensified competition - are an ongoing factor in private industry. Large, internationally competitive firms are paying more and more attention to career counselling and permanent training, not just in order to maintain the added value and internal flexibility of their staff but also, by increasing employability, to make it possible to take leave of staff when restructuring programmes have to be forced through and staff shed. The maintenance of human capital is also becoming an issue in small and medium-sized business⁵⁶. The more limited scale does, however, limit the possibilities for entirely independent action. The realisation is also gradually dawning that the ageing of the working population could further widen the gulf between the required and available skills. Ageing means that the relatively less skilled birth cohorts of the 1940s will be a significant factor in the working population during the coming decade. This will squeeze productivity and also require an anticipatory policy at micro-level in order to prevent the premature shedding of labour. For all these reasons the greater emphasis of the trade unions and employers on training, improvements in quality and wider employability are of major importance for the success of a participation strategy.

^{56]} See for example MKB Netherlands, *Nooit te oud om te leren; Een alternatief leerrechsysteem* (Never too Old to Learn; A Voucher System for Education as an Alternative); Delft, 1995.

Reintegration

Against the background of the more entrepreneurial management of human capital by trade and industry the internal dynamics of government involvement in reintegration processes have lagged behind. Traces of a culture of protection and regulation, which do not square easily with the emphasis of individual responsibilities and the giving and asking of accountability, remain discernible within the administration of social security. For this reason it was argued in section 2.3 that there was a need for testable efforts and results throughout the system, in order to prevent not just unintended behaviour by clients and employers but also the evasion of responsibilities by policy-makers and caseworkers. Hence too the emphasis on the legitimacy criteria that provide an operational basis for the imposition of penalties on improper use, as a necessary condition for the sustainability of customisation and as an alternative to the traditional administrative law concepts of distributive fairness and fine-mesh classification. And hence, finally, the warning that a dynamic integrationist labour market policy will require a cultural reversal calling for the setting of priorities and a phased introduction.

Nevertheless the Council is convinced that greater freedom of action for arrangements tailored to the individual is also possible in the field of social security, by way of analogy to the much greater professional responsibilities now borne in the executive sphere of health care and education. In these fields it has become accepted that the doctor provides 'customisation' in order to cure the patient and that the teacher lays down requirements for which one pupil will have to work harder than another, but also supports pupils according to need. By way of analogy with the claim assessor's function in social security, the doctor and teacher both operate within objectified access criteria that determine the *rights*: the patient must be ill and the pupil must be qualified for the education. In terms of that point of departure, however, they bear a substantial responsibility themselves as professional implementors for the process and result within a given budget of time and resources. Rights - the inputs of social security - must be established unambiguously, but the process of prevention and reintegration calls for a creative co-ordination with the individual's knowledge and abilities. Given the material, customisation is concerned not with the scissors but with the cut.

Needless to say the implementation of social security cannot be based on the professional tradition of medicine or education, and the transition to more personal initiative, professional action and responsibility will need to be phased in and to be effectively supported. Within the professional organisation as meant here, the individual actor has sufficient resources and capacities to support the reintegration of clients into the labour process with which he has been entrusted as he sees fit⁵⁷. The necessary limits to freedom call for deregulation and direction at a distance in a relationship between principal and agent, in which the latter agrees goals with his principal. The latter provides him with time and other resources related to the degree of difficulty of the assignment but otherwise does not interfere as long as the agent discharges his responsibilities as required⁵⁸.

⁵⁶] See standing committee for Social Affairs and Employment, *Implementatie van de Algemene Bijstandswet; Verslag van een rondetafelgesprek* (Implementation of the National Assistance Act; Report of a Round-table Discussion); Lower House 1996/1997, 25 271, nos. 1-4.

⁵⁷] On the management of the situational response see R.W. Rowbottom and D. Billis, *Organisational Design; The Work-Levels Approach*; Aldershot, Gower, 1987.

⁵⁸] See CA. Hazeu, *Systeem en gedrag in het wetenschappelijk onderzoek; Een model voor toedeling van taken en verantwoordelijkheden in een multi-niveau systeem, toegepast op het universitaire onderzoek*; The Hague, VUGA, 1989 (English edition: CA. Hazeu, *Science Policy: A Behavioural approach*; Aldershot, Gower, 1990; and WRR, *Belang en beleid* (Interest and Policy; Towards a Responsible Implementation of Employee Insurance); Reports to the Government no. 45, The Hague, Sdu Uitgeverij, 1994.

Once again it should be emphasised that these are *mutual* obligations, in terms of both direction and the relationship with the cliënt, from which nei-ther party can withdraw without sanction. Where possible the benefit agency will be held accountable in terms of results and otherwise in terms of testable efforts. External *competition* for the cliënt will keep the organisation as a whole on its toes and plays a crucial role in the balance of power between case-worker and cliënt. For the cliënt this translates into an *individualised support plan*, from which no one in principle is exempt and in which testable commitments are mutually laid down.

Much remains to be done in order to mobilise the resources, necessary legal framework and people for a successful active integration policy. With respect to resources the major obstacle is not that of money to step up the handling capacity, since the more effective reconciliation of demand and supply would largely pay for itself in due course, certainly now that the labour market is becoming tighter. More constraining is the availability of courses, assimilation facilities and opportunities to gain work-experience, which cannot be resolved overnight. It is also difficult to overcome a legal mentality in which a strategy of prevention and reintegration on the basis of mutual responsibility between the parties concerned tends to founder on a priori prohibitions. The integration of social security and labour market policy argued for in this report means that in a legal sense the understandings reached between the cliënt, case manager and/or employer under a system of individual case management must be regarded as an *agreement* and be regulated correspondingly (section 2.3.4). The thinking in this area is, however, still in its infancy. Above all it is not a matter of a blueprint but of a change in culture in the way that case managers act. They must come to regard their placement activities as a form of entrepreneurship. For this they must be given the necessary degree of freedom within the organisation. In its numerous contacts with the agencies concerned the Council has been confirmed in its conviction that there is support for the challenge of less regulation, a more individualised approach and the acceptance of greater competition.

Since an individualised supply-side policy is highly demanding and requires a substantial input of people and resources it is important to make greater use of the expertise that has been built up in the private temporary employment industry. The Council foresees the gradual interpenetration of the private and public employment agencies and the emergence of parallel privatisation⁵⁹, in which the conditions of competition between the two are brought into balance, for example by providing certified private agencies with access to subsidised training or assimilation facilities as well. However, despite all the efforts and the facilities to increase productivity, it will not always prove possible to achieve satisfactory placement while the demand for labour remains insufficient to absorb the supply. The next section therefore examines the strengths and weaknesses of an individualised demand-side policy.

4.2.3 Individualised demand-side policy

Demand and supply in the labour market are separated by a reservoir of registered unemployed and an unknown but probably fairly appreciable discouraged supply of labour that has not so far registered as seeking work. This large labour reserve is not, of course, a homogeneous one. It may be divided into three groups, which are discussed in turn below:

people with sufficient skills who can find jobs as soon as work becomes available;

people with low or inadequate labour productivity who, in principle, are placeable in the regular labour market; and

^{59]} See WRR, *Belang en beleid* (Interest and Policy), op. cit.

people who are not, or not yet, placeable in the regular labour market.

The boost to demand provided by generic wage-restraint is largely to the benefit of the first target group, for whom the labour market functions reasonably well. The Dutch are at present changing jobs almost as frequently as Americans, and in the vast majority of cases this is done without any significant resort to social security or public job-placement facilities. Nevertheless there are also bottlenecks on the demand-side of the regular labour market, in so far as there are unfulfilled social needs in government-funded sectors such as education and health care. Apart from the deficits already evident, lifelong learning and the requirements of the knowledge society generally call for new investments and more staff in education. In health care too there is a pressing need for 'more hands to the bed'. This need will only grow as ageing gathers pace. To some extent this is still matched by an untapped supply potential. The Council therefore argues for the selective enlargement of demand by expanding the budgets for education and health care, if so desired in combination with policies to give priority to those on reduced pay, women returning to the labour market and welfare-claimants when the jobs become available as a result. The budgetary route is preferable to an explicit supplementation policy because *both* wages and supplements form part of public expenditure.

More generally, supplements will not always be required in order to make labour cheaper and expand demand in the case of the second target group, i.e. workers with low labour-productivity who are in principle replaceable; in some cases it will be enough simply to change the way things are done or to suspend rules. An example of practices that keep labour expensive is the tendency not to make use of the room between the minimum wage and the lower end of collectively agreed pay scales. Suspension of the rules might take the form of a temporary dispensation from the statutory minimum wage, as an induction pathway for people lacking initial qualifications. In general the elasticity of demand for cheap labour may be low but it is precisely in these areas that individual case management can succeed in getting more people placed. More generally a policy that lowers the price of labour will often have the best chances of success in combination with an active integration policy and vice versa.

Partly against the background of the experience with American workfare programmes, the Council has considered the extent to which a supplementation model could be turned into a more general income supplements *policy*. Under such a policy, the low threshold represented by the minimum wage can act as a useful incentive in employment mediation for cohorts with reasonable prospects in the labour market. This is, however, subject to the precondition that sufficient investment is made in labour productivity for people in that target group to move on to the regular collective labour agreement sphere. This is important because people who are in a structurally weak labour market position due to the obligation to accept work in the 'pure' supplements model are easily squeezed if employers start resorting to improper displacement processes (section 3.4). The decisive factor in the formulation of policy is, accordingly, the availability of work for hard-to-place employees and the vulnerability of the regulations to unintended use. A number of sub-groups for whom a temporary or structural policy of supplements could play a role in the regular labour market are examined below.

Long-term unemployed

There are now three categories of 'Melkert jobs' for this target group. In the case of Melkert-I (for the public sector) and Melkert-II (for the private sector) direct supplements are payable equal to roughly half the wagebill. In the case of Melkert-III (voluntary work with retention of benefit) there is an implicit encouragement subsidy to get people back into the rhythm of employment.

These kinds of arrangements are tenable because the government is not taking on any obligation to find suitable work. The number of subsidised jobs is, moreover, subject to budgetary limits. This means that the arrangements are not open-ended and it also does not play into the hands of employers seeking to enforce a generic cut in wages for broad categories through improper displacement practices (section 3.4). As unemployment is further cut back and the labour market position of the long-term unemployed becomes stronger a more generalised income supplements policy will come in sight for the long-term unemployed, possibly although not necessarily in combination with a temporary reduction in the minimum wage. The fact that the supplement takes the form of a temporary reduction in social security deductions at source also prevents the need for the party concerned 'to hold out his hand'. In the case of 'Mekert-II' the temporariness forms a vital element in an incentive structure providing employees with the inducement to keep seeking an 'ordinary job' and preventing employers from systematically underpaying them. Agreements are reached on the duration of the support as part of individual case management.

Young people

The risk that a supplementation policy will be used improperly by employers is already lower among young people - a category that can be unambiguously defined and which is generally in demand in the labour market. For many of them a supplementation policy will not be advisable since they would get work anyway. But the category of young people is not homogeneous either. Precisely because the number of hard-to-place cases is limited, this would appear a suitable group on which to test out a supplementation policy. The administrative problems are manageable and it is precisely among such people that a policy of linking supplements to the acceptance of personal responsibility to find work is likely to show the highest returns. If the experience is favourable a pattern of expectations can then be built up, under which personal initiative is accorded primacy and the benefit is regarded as ancillary.

A supplements policy could come into its own for the problematical target group of unemployed premature school-leavers, who fail to make use of their minimum youth-wage period in order to acquire the necessary work-experience with which to make their way in the labour market⁶⁰. The notion that young people should not be on welfare is already reflected in the new Job-Seekers Integration Act (WIW 1998), which centres around the subsidisation of jobs to provide work-experience. In this piece of successor legislation to the Youth-Work Guarantee Plan (JWG), the municipality - in some cases at a reduced minimum wage - takes on unemployed young people with a view to seconding them to regular employers in the public or private sector. The individuals concerned are supported and given incentives by means of training and financial provisions in order to help them move on as quickly as possible to regular, unsubsidised jobs. Such a scheme can be effective because (1) employers are now already competing for 'attractive' young people and will therefore make little if any misuse of the scheme, (2) an alternative (welfare) income is not, in principle, being granted, and (3) the target group is small enough to guarantee work and support for all the unemployed. It is legitimate in terms of the view that young people have obligations towards a society that has helped fund their upbringing and training and do not therefore have an immediate entitlement to draw the dole.

⁶⁰ See H.A. Keuzenkamp, 'School of pizzabrommer' (School or Pizza Delivery-Boy); *Economisch Statistische Berichten*, 17 April 1996, vol. 81, no. 4054, p. 333.

Older employees

Older employees are in a vulnerable labour market position; many lag behind in terms of labour-productivity. In the first place this calls of course for an age-related personnel and training policy so as to prevent people from dropping out of the labour force prematurely. In addition consideration could be given to a facility whereby a reduction in social insurance contributions could be permitted when older people take on demonstrably lighter duties. The proceeds could be regarded as a re-placement supplement to make sure that those concerned did not suffer a loss in net income. This arrangement would also avoid the need for people to 'hold out their hand'. In order to prevent improper use by employers, the Council is thinking specifically in terms of an 'ability* provision, administered on an individual basis by the claim assessor of the unemployment and disability benefits. As the labour market position of older employees improves as unemployment comes down, room may be generated to simplify the administrative procedures, for example by giving larger employers a certain degree of independence to grant contribution reductions, depending on the number of older workers in their employ. The Council notes that a scheme for 'external demotion', (i.e. transfer to a different employer) has long been in existence among those insured under the Public Servants' Superannuation Act (ABP), who have a right to a redeployment supplement under certain conditions. In due course, once the new administrative structure of the Disability Insurance Act (WAO) is fully in place, the Council sees possibilities for redeployment support for the elderly in the private sector as well within a structural prevention and supplementation policy.

Flexiworkers

One of the requirements of equity, legitimacy and effectiveness is that a community needing flexible employment will ensure that the system of social security also provides adequate security with respect to flexible employment relationships. Particular vigilance is, however, required to prevent abuse by employees or employers of such forms of 'flexecurity'. With regard to the broad casuistry - which must otherwise remain undiscussed - the Council would single out two points for consideration. In section 2.5.3 attention was drawn to commercial labour pools and contracting firms as intermediaries which could act as a buffer to cope with irregular patterns of demand and as an instrument to reduce the reservation wage. In Belgium such arrangements do receive subsidies; in the Netherlands the case is made for a relaxation of the way in which unemployment benefits can be applied to permit 'watertight' operation. The Council would support experiments in this area arranged in such a way that the incentive for the employer to arrive independently at watertight operation would not be eliminated. A second consideration consists of the position of people who wish to change their status from employee to self-employed. Here too supplementary instruments are required to help absorb the risks in question without eliminating the incentive of self-reliance. In the sphere of social security this might include the (temporary) plugging of gaps in cover.

The third target group: structural support outside the regular labour market

No matter what efforts are made there will always be people who cannot be successfully placed in the regular labour market. In its report *Social Dichotomy in Perspective*⁶¹ the Council has argued for an emancipation of talent in which people in a structurally weak labour market position are not permanently ruled out but are given the opportunity to participate actively in society on a remunerated basis. The size of the pool that will ultimately prove resistant to a policy aimed primarily at promoting employability is unknown. Statistically, one is easily led to the conclusion that the pool is a large one. It does however need to be recognised that the present range of labour market

⁶¹ WRR, *Social Dichotomy in Perspective*, op. cit.

instruments is limited, a further factor being the present structure of demand and supply. In a dynamic perspective of growing demand and a highly intensified policy the group could well turn out to be much more limited than currently appears to be the case. On the other hand it is also clear that despite all the efforts not everyone can satisfy the requirements of a knowledge-intensive economy. A participation strategy needs to cover them as well.

Against this background the Council calls for closer attention to three sub-groups in need of systematic support:

- hard-to-train people lacking the necessary labour-productivity for the regular labour market;
- other welfare-claimants (and hard-to-place officially admitted refugees) who are not (or not yet) in training, and
- the fully incapacitated who indicate that they wish to perform paid activities in some medically responsible manner.

Clearly the majority of the *hard-to-train employees* do not fit logically into the protected work environment of the Sheltered Employment Act (WSW). The task is to create fresh room for this sub-group in the budgets of the government and the non-profit sector, where they have been reorganised out of existence. In addition the Council recommends experiments with a structural reduction in deductions at source for temporary employment agencies providing personal and household services, in so far as they take on the long-term unemployed. This would eliminate the disadvantages of the much-discussed voucher systems (with the employee receiving a position and the customer having recourse to the temporary employment agency in the case of non-performance).

In the case of the *other welfare-claimants* there will always remain a residual element of clients who, even in a watertight strategy, do not (yet) receive active job-placement support or pursue training. To date these people have received more or less systematic support without doing much to give shape to the *quid pro quo* which they may be expected to provide, in so far as they have not been exempted under (for example) a 'Care Provision Act'. This leaves open the option - either as a supplement or an alternative to the 'Melkert-III arrangement' - to examine the extent to which welfare clients would be available for publicly funded social services in the field of domiciliary care, etc.

Finally it can of course never be demanded of the completely *disabled employees* that they will keep themselves available for the labour market. Nevertheless at least a proportion of them experiences their disengagement as a severe psychological burden. Now that labour is gradually becoming scarcer again society can no longer ignore the duty to involve this group in the emancipation process as well. The Council recommends that an explicit policy be developed to help the disabled find adapted work, in so far as they themselves wish this.

The pay wedge as a limiting condition

A series of proposals were made above for the introduction of a supplementation policy, e.g. by reducing the social insurance premiums deducted at source. In itself each narrowing of the levy-base results in higher contributions and a bigger pay wedge, even if the supplements were to come out of general revenues. Tax incidence theory indicates that taxes are borne primarily by labour either directly or indirectly, as labour is less mobile than capital. For this reason too it is desirable to prevent undesired displacement; the limiting condition for the policy should be that the outflow from social security is accelerated to the point that there is a net reduction in the pay wedge.

4.3 The strategy to be pursued

As equilibrium in the labour market comes in sight the strategy at macro-economic level will need to focus on the continuing improvement of average productivity. The Council regards this as a necessary development if the Dutch economy is to provide a financial and economic base in conditions of age-ing, falling numbers of young people and growing competition for the possibility of a more or less parallel growth in prosperity for young and old and the non-disabled and disabled alike. This tautological truth may perhaps provide food for the notion that a stop should be put to wage-restraint in so far as this inhibits the growth in labour productivity. Quite apart from the fact that the function that high wages had in terms of safeguarding efficiency has for a long time been taken over in the Netherlands by the pressure of the hard guilder⁶² there is little cause to give up the policy of restraint.

The Council regards the most important strategic assignment for the future of social security as being that of sustaining wage trends and promoting a wage differentiation that is consistent with differences in productivity developments. This must be continued until unemployment has been reduced to the point that those who can only be placed with a little extra help are also given their chance. If wages rise earlier beyond growth in productivity of current employees, the 'updraught' will be lost, and there will be little hope for the category of hard-to-place individuals. In that case, the Netherlands will continue to bear the social and economic burden of a comparatively high level of structural unemployment for a long time. The Council therefore considers the continuation of moderate wage trends as a *necessary* precondition for the restoration of equilibrium as this will create room for the continuing growth of employment and for investments in work-experience in human capital, which are so vital at the bottom end of the labour market. Wage-restraint is, of course, not a *sufficient* precondition for an acceptable level of labour force participation; if the scope created as a result is translated only into higher corporate earnings or is not devoted to an individualised supply and demand policy designed to help integrate those in a weak position into the labour market, an entitlements policy will then come into sight, with a big legion of working poor.

It will be clear that the Council sets more store by a policy which, by carefully phasing in the necessary institutional requirements, first increases the productivity of the current unemployed and promotes the lasting employability of older employees and, in addition, seeks ways of increasing the productivity of the total working population in due course as well. The latter is becoming necessary in order to accommodate endogenously rising pay demands in a situation of lower structural unemployment while international competition is becoming stiffer at the same time. Under the approach the present policy of regulating the volume of claimants would gradually be transformed into a broader and deeper policy of individualised case management, with priority to two special challenges: the bottom end of the labour market and extending the employability of older workers. In this regard prevention and reintegration would go hand in hand and it is not possible to rely on the operation of the price mechanism alone, as the disappointing results with the return to the labour force of former employment disability claimants indicates.

The extra burden on the welfare system of individualised case management plans would, in itself, call for the careful phasing in of a participation and productivity strategy. Another important precondition is that the policy should not create a handout dependency but promote self-reliance. Together with the

slack in the labour market, as an exogenous factor, these two policy considerations - administrative feasibility and self-development - determine the optimal combination of an active integration and supplementation policy. In a slack market the requirement to accept work at a low threshold wage holds hard-to-place employees hostage in displacement processes on the part of employers seeking to reduce their costs at the expense (in the form of supplements) of the community. If the government is required to grant too much dispensation from the requirement to accept work - for example because too many people are still too unproductive to be deployable - the policy will lose its credibility. For these target groups the Council would for the time being place the emphasis on the individualisation of wage supplementation as an extra to an active integration policy, in which displacement can be held in check from case to case by means of agreements with employers.

As noted, the precise specification of the optimal policy combination depends on the one hand on actual developments in the labour market and, on the other, on the resolution with which the institutional reforms argued for in this report are put into practice. Also of importance are the seriousness with which abuse is punished and the possible ideological resistance towards greater government interference in the labour market. As the 'plug' of the present pool of long-term, hard-to-place unemployed is eliminated and new additions to this pool can be avoided, space will be created for a further generalisation of a supplementation policy and for less individualised assessment procedures.

The crux of this report centres on the question as to how a government which, in the eyes of many, has lost some of its capacity for action, can play such an important role in increasing labour force participation and labour productivity. This report has analysed the margins for government policy within the traditional welfare state and the traditional approach of distributive equity and come to the conclusion that this cannot be sustained. Anyone taking seriously the challenges outlined in Chapter 1 and the notion of a participation strategy as the appropriate response will need to appeal more directly to personal responsibility and to make greater efforts to set up a greater number of self-governing institutions with a view to preventing misuse and abuse - the central problem in any guarantee system. The ambitions of the co-ordination perspectives outlined in this report are only feasible to the extent that the formulated programme of requirements is in fact implemented. If not, future developments suggest that the present conditions for social security entitlements will not be sustainable in the longer term, thereby leaving only the possibility of further austerity measures, and so increasing the problem of poverty.

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