The Social Protection Committee

GROWTH, JOBS AND SOCIAL PROGRESS IN THE EU

A contribution to the evaluation of the social dimension of the Lisbon Strategy

European Commission

Directorate-General for Employment, Social Affairs and Equal Opportunities

Units E.2 and E.4

Manuscript completed in September 2009

KEY MESSAGES

<u>Message 1</u>: Over the past decade, economic and employment growth has in general improved overall living standards and many governments have been able to devote more resources to social policy intervention. However, despite the clear redistributive effect of social protection, inequalities have often increased and poverty and social exclusion remain a major issue in most EU countries, although with substantial differences across Europe.

Generally, richer countries spend a larger share of their GDP on social spending and economic growth has allowed many governments to devote more resources to social policy interventions. However, empirical evidence[1] shows that income inequalities have increased in most EU countries since the mid 80s. These trends were already flagged in the "Social Reality Stocktaking"[2]. Most increases in inequalities happened between the mid 80s and the mid 90s. In the last 10 years, in most cases inequalities have remained stable, except in some countries. Behind these overall evolutions, diverging trends were observed at different levels of the income distribution. In most countries, top incomes grew relatively faster than middle incomes. In some countries, low incomes caught up with median incomes, while in other countries inequalities also widened at the bottom of the distribution.

A major factor behind this is the **increase in earnings inequality** among full-time workers **further strengthened by the development of involuntary part-time and temporary contracts**. Labour market segmentation is an important determinant of widened earnings inequality not only because non-standard workers tend to work fewer hours per year but also because they are generally paid less per hour *after controlling for differences in education and experience*. Available data therefore suggests that, in many Member States, ceteris paribus, there is a substantial wage penalty from holding a temporary or part-time job.

Relative poverty risks increased in most Member States between the mid-1980s and the mid-1990s and in most cases they either increased or stagnated between the mid-1990s and the mid-2000s. Over this second decade a shift in poverty risks was observed from the elderly towards younger people. **Child poverty remained stable or increased** in most EU countries, while poverty risks generally decreased for the elderly (though remaining at relatively high levels in a few Member States) as a consequence of the maturing of pension systems (including reforms of minimum pensions).

The **design of the tax-benefit system is crucial** in determining the way and the extent to which it affects income inequalities and redistributes resources to the poor. Important features include the progressivity of taxes and benefits and the degree of targeting and conditionality of benefits that can create disincentive effects, if badly designed. In most

---

[1] Evidence draw from the "Growing Unequal?" OECD report http://www.criss-ineq.org and from the funded EC research project INEQ http://www.oecd.org/document/53/0,3343,en_2649_33933_41460917_1_1_1_1,00.html

[2] http://ec.europa.eu/citizens_agenda/social_reality_stocktaking/index_en.htm

countries, the redistributive effect of benefits is higher than that of taxes (notably when excluding pensions). Available evidence highlights a large variation across Member States in net cash support to low-income households (ranging from the bottom value of 20% to the top value of 87% of the poorest decile group's disposable income in different Member States). EU data show that social transfers other than pensions effectively reduce poverty risks but the degree to which they do so varies substantially across Member States (ranging from a poverty reduction effect of 50% or more in some countries to one of 19% or less in others). This also reflects differences in the size of expenditure, which vary from 12% to 30% of GDP. Further work would be needed to better understand the determinants of the efficiency and effectiveness of tax-benefit systems.

In recent years (2005-2007), it is only in countries experiencing very high average growth rates per year (above 5%) that significant improvements in the standards of living of the poor were observed (as illustrated by wide declines in anchored at-risk-of-poverty or material deprivation rates). In these countries, growth indeed appears to have helped the poor. For countries with average growth rates below 5% the nexus growth-living conditions of the poor is much less clear. In general, economic growth has made it possible to "erode" the areas of severe deprivation, particularly (though not only) in new Member States, but relative poverty has not declined and has even increased in some countries that were traditionally "good performers".

<u>Message 2</u>: Having a job remains the best safeguard against poverty and exclusion. However, recent employment increases have not sufficiently reached those furthest away from the labour market, and jobs have not always succeeded in lifting people out of poverty. Some groups still face specific hurdles such as poor access to training for the low skilled, lack of enabling services, or poor design of benefits that create financial disincentives. Labour market segmentation persists combined with a lack in job quality. The development of precarious forms of employment, often characterised by a strong gender dimension has contributed to persistently high levels of in-work poverty. Lessons need to be drawn from these facts when preventing that the crisis considerably aggravates persistent exclusion. Active inclusion strategies are not only crucial to support the most vulnerable in the crisis, but also to limit losses to human capital and preserve future growth potential.

While acknowledging the overall benefits of broader participation in the labour market, the report highlights a number of key trends showing that employment growth did not always reach the most excluded and that the jobs created did not always provide for decent living standards.

Significant progress has been made in raising employment rates across Europe, especially of women and also in reversing negative trends such as the decline in participation of older workers. Indeed, unemployment rates were significantly reduced in the EU (from 8.6% in 2000 to 7.1% in 2007) and the increased participation of women as second earners and of older workers (notably through the availability of part-time work) has helped improving the income of many households.

However, at the outset of the crisis, about one third of the working age population in the EU was out of work (unemployed or inactive). Furthermore, evidence shows that the increases in employment rates observed in all EU countries before the crisis coexisted alongside **significant numbers of workers in precarious jobs, working poor and**

jobless households. Under-employment and precarious forms of contracts mitigate the positive impact of including more people in the labour market. Single and lone parent households whose numbers have grown in the last decades tend to be more vulnerable on the labour market.

The experience of this decade has confirmed that improving access to good quality employment helps people out of poverty. Having a job remains the best safeguard against poverty and exclusion, since the risk of poverty faced by working age adults without work (unemployed or inactive) is more than 3 times higher than those in work (27% against 8%). However, a job is not always a guarantee against the risk of poverty and the **working poor** represent 1/3 of the working age adults at-risk of poverty. In 2007, 8% of the people in employment were living under the poverty threshold. In-work poverty is linked to the employment situation of the individuals such as low pay, low skills, precarious employment and under-employment. Since 2000, the **development of temporary work, part-time work** (including involuntary part-time) and sometimes **stagnating wages** have **increased the number of individuals with low yearly earnings**. These trends particularly affected women and the young. It is also important to note that for part of the workers, these jobs are not stepping stones towards better jobs.

Importantly, situations of poverty are also linked to the type of household in which people live. In-work poverty is often related to low work intensity, i.e. situations where there are too few adults working in the household, or not working enough to make a living (too few hours or only part of the year). Single and lone parent households, as well as one-earner families face the highest risks of poverty.

The last decade has also seen the persistence of **groups of people that remain outside or at the margin of the labour market**, often facing multiple barriers to enter the labour market (among which low skills, care responsibilities, age, migrant background, and other factors of discrimination, etc.). The direst situations concern those households in which nobody works. In 2007 in the EU27, 9.3% of adults in age of working were living in **jobless households** against 10.2% in 2001. These improvements have not reached families with children to the same extent and in 2007, 9.4% of children still lived in jobless households against 9.5% in 2001 and the crisis is likely to increase the number of families having to rely entirely on social benefits.

Employment growth has been mainly driven by an increase of female labour market participation and to a certain extent by the prolonged working life of older workers. However, in many countries the **women who are furthest away from the labour market** (lone mothers, the low skilled, etc) still face important barriers to find a job, and a job that pays (lack of childcare or of care for other dependants, involuntary part-time, lack of reconciliation measures). The situation of **migrants** has also hardly improved over the period. In particular, in long-standing host countries migrants have much lower employment rates than the native population, even among the second generations. The current crisis may considerably aggravate the situation of these workers who were already vulnerable before the crisis.

National experiences from past crises show that in some instances short-term responses to rises in unemployment not only resulted in individual withdrawals from the labour market, but also have had long-term negative impacts on society as a whole. **Stocks of long-term unemployed or inactive tend to persist long after recovery has set in** which points to the importance of **active social security policies**. Among the long term impacts of the crisis observed in some countries are the increasing numbers of people moving into long-term sickness and disability benefits, or early retirement schemes. Of these people, many are likely never to enter or return to the labour market.

A review of the main policy developments that were meant to address the trends described above shows that some progress has been made in enhancing activation measures across EU countries, but more needs to be done to reach the most vulnerable workers, especially concerning access to Life Long Learning, since evidence shows that **the low skilled continue to participate much less in training than the average worker**. This highlights the importance of sustained investments in education and training. The review also shows that specific activation measures are needed to reach different categories of workers: youth, women (child care and reform of family support), older workers.

The analysis also shows that while some **progress has been made in reducing financial disincentives** to take up work or work more, **attention should be paid to the adequacy of benefits**, especially in Member States with major weaknesses and loopholes in their safety nets. This shows that both goals need to be pursued at the same time. Furthermore, financial disincentives are not the only barriers to labour market participation, adequate and individualised support services play a key role. Finally, the inadequacy of safety nets is not only a cause of poverty persistence, but also an obstacle to re-integration in the labour market and society.

The report illustrates that more needs to be done to ensure that EU labour markets are truly inclusive and lead to greater social cohesion. In order to reach the most vulnerable, without necessarily increasing spending, the effectiveness of the measures described above can be reinforced if they are **integrated into active inclusion strategies.**

<u>Message 3</u>**: Past decades of reforming social protection systems have improved their long-term financial sustainability. However, there remain issues to be resolved regarding the accessibility and adequacy of social protection. Higher employment rates, longer working lives, and increased healthy life expectancies will play an important role in ensuring both adequacy and sustainability of social protection. In the case of pensions this would apply to funded as well as pay-as-you-go schemes. Efforts to modernise all functions of social protection should be sustained in order to ensure effective access to quality services for all while contributing to the efficiency of public expenditure. Notably, modernisation in health care and long-term care can improve the health of the whole population and of the work force.**

The extent to which social protection systems encourage social and active inclusion as the population ages has been a vital element in past reforms. Countries spend a larg share of their GDP on social spending and economic growth has allowed many governments to devote more resources to social policy interventions. Old-age pensions and sickness and healthcare benefits represent the bulk of spending in all EU Member States. In the last years the SPC has carried out important analytical work focusing on the adequacy and universality of protection, the sustainability of the systems, and the need to balance these two objectives through modernisation.

Pensions represent by far the greatest item of expenditure of social protection (46% in 2006). In the past years, Member States reformed their pension systems by tightening the eligibility for public pensions, reducing the projected levels of pensions relative to wages, increasing incentives for individual to work more and longer and increasing the role of privately managed pension provision. As a result, although the effect of demographic change in the absence of reforms would push public pension expenditure by around 9 percentage point of EU GDP between 2007 and 2060, recent reforms of pension systems are expected to reduce this increase to only 2.4 percentage points, so that projected expenditure would reach 12.5% of GDP in 2060.

As a consequence of the reforms the role of public pension benefits in overall pension provision would decline, though public pensions are expected to remain the major source of income for pensioners in all but a few Member States. Theoretical replacement rates which reflect pension levels relative to the last wages received are projected to drop on average by several percentage points, and some Member States should record decreases of around 20 percentage points. This negative impact on adequacy of pensions could be partially offset by extending working lives, through improving the ability and opportunities for all workers to remain in employment, by reinforcing contributivity and by improving the financial and administrative management of pension systems. For instance two additional years of contributions could raise theoretical replacement rates in the majority of Member States by 4 to 9 percentage points and help reduce the adequacy gap and the tension in the triangle of increasing contributions and declining expenditure. Replacement rates from privately pensions are also expected to increase as contribution to these pensions increase as a response to ageing and demographic changes. The current economic crisis and past studies have, however, highlighted the need to monitor the risk involved with such pensions for various socio-economic groups and have stressed the relevance of sufficient minimum pensions.

Health and long-term care systems are the second biggest social protection component and the availability, affordability and quality of care can strongly influence the likelihood of overcoming disease, avoiding mortality and ensuring independent living. The considerable improvement in the health status of the EU population in recent decades has been associated with more widely available healthcare i.e. a rising share of resources devoted to healthcare systems and a more equitable distribution of these resources. It has also been recognised that good health contributes to economic prosperity through improving labour market participation and improving productivity as well as increasing participation in other societal activities.

However, **health inequalities** exist between different EU Member States and between social groups within Member States and **have widened in recent decades**. This is partly due to the fact that some health care systems are under-resourced and that in many countries, various financial and organisational barriers prevent access to timely and effective healthcare for some groups of the population. It is also important to note that high levels of poor health in sections of the EU population imply substantial opportunity costs for the Union as they are detrimental to employment, productivity and growth. Avoidable ill-health also puts unnecessary pressure on public budgets.

Nevertheless, expenditure has risen over time and ageing, technology and growing expectations are creating further pressure on resources. Without investments in preventive measures, public expenditure on health-care is projected to grow by 1½ percentage points of GDP in the EU between 2007 and 2060. The evolution of future spending will depend on effective management and balancing of the costs and benefits of technological advancement, as well as achieving better value for money through strengthened primary care, prevention and health promotion, and through better coordination and rational use of resources.

Long-term care has been identified as an important social protection issue in view of an ageing population. Health and long-term care services are dependent on sufficient numbers of both high and low skilled staff and represent an opportunity for job creation in the care sectors.

Modernisation has happened also in other branches of social protection to improve coverage of new risks and improve responsiveness of the system, for example by increasing expenditure of active labour market measures, or by addressing financial disincentives to take-up work or work more (see message 2). Since modernising efforts have to continue in all the social protection functions to improve effective access for those that need it in a sustainable manner, it is vital to monitor all the different social protection benefit systems extensively.

Message 4: Social protection systems can play a crucial role as automatic stabilisers and sustain the productive capacity of the economy. However, Member States are in very different positions to face the crisis. In some countries, there are significant weaknesses and loopholes in social safety nets. In others with mature social protection systems that cushion the impact of the crisis, financial sustainability is questioned in the long run. Countries faced with major public finance imbalances are left with little room for manoeuvre to address the social consequences of the crisis. This raises particular concern for those who also have weaker levels of protection.

Promoting labour market participation while improving the fairness, efficiency and effectiveness of social spending will be crucial for all countries, both in view of ensuring counter-cyclicality towards economic growth and addressing fiscal imbalances.

Over the last 50 years, notably between the early 1970s and the 1990s, we have seen **a structural rise in the share of social protection expenditure** as a percent of GDP in Member States. There several reasons behind this trend. First, social protection systems are maturing and coverage is increasing. Second, new types of benefits are introduced – as happened with family, child benefits and long-term care benefits. Third, demographic and social and economic changes (e.g. evolution of family structure) can increase demand for social protection even in the context of constant set up of social protection systems. Fourth, relative price trends as well as indexation rules can lead to long term increases or declines in the share of GDP devoted to social protection – notably in the health care area. Fifth, inefficiencies in provision and lack of clear budget constraints and accountability can also contribute to long-term expenditure rises. Finally, we can observe a **hysteresis effect when increases in short-term unemployment persist and lead to long term labour market exclusion**.

The last mentioned of these effects takes place when there is a recovery on the labour market and the unemployed do not reintegrate the labour market and end up in long-term unemployment or into incapacity or early retirement benefits.

An analysis of the evolution of social spending and public deficit against the economic cycle illustrate to which extent social spending are counter-cyclical, both in bad and good times. **Social protection expenditure can be more or less responsive to the economic cycle**. Firstly, some cases reveal that reactivity to the cycle can be increased or decreased by the design of rules on granting different kinds of benefits. Eligibility criteria and benefit levels clearly affect benefit take up. Secondly, the relationship of social protection expenditure with economic growth depends on how much the growth is creating employment.

Anti-cyclical behaviour in social spending helps maintain the productive capacity of the economy as it allows for room for manoeuvre in a recession. An anti-cyclical behaviour in public spending, especially on social expenditure, is an important part of re-bounding an economy in recession. As GDP contracts, however, Government budget balances are often strained, therefore bringing to light the issue of how to finance increases in expenditure whiles avoiding ballooning deficits. Increases in social protection expenditure should be seen as part of a recovery package, rather than a permanent feature, thus acting as an automatic stabiliser. Hysteresis effects and persisting fiscal deficits accumulating over the years can thus be avoided.

Countries with mature social protection systems where social spending increases when unemployment rises and decreases substantially afterwards, tend to also show solid fiscal positions. In countries where stabilizers played their role well in times of crisis but social expenditure was not significantly reduced in good times, the fiscal situation is less favourable. In other countries, social spending does not show a strong relation to the business cycle, and have rather increased steadily since the 80s reflecting the building up of the welfare state. Others have used the latest periods of low unemployment rates to improve their safety nets and address high poverty rates through improving the situation of the most excluded from the labour market. In many countries, efforts have been made to address the lack of incentives to enter the labour market through adequate transfers, active labour market policies and a balance between rights and obligations.

At the same time, the analysis shows that there are **substantial gaps in coverage and adequacy in a number of Member States**, showing that there is a need to complete and/or reinforce social protection systems, including support for the unemployed, access to healthcare for all and ensuring adequate retirement benefits including for those with non-standard careers. In such a process it is important to learn from the mistakes of the past and create protection systems that encourage active participation and cover all the central social risks.

The analysis documents that Member States have taken steps towards **reshaping social protection systems so that they encourage activity and inclusion**. However, it is also clear that good economic performance is a precondition for well functioning social protection systems. Good employment performance has always been crucial for the sustainability of social protection systems but with ageing open labour markets that attract those who are still underrepresented in employment are becoming essential. Hence modernisation of social protection needs to go hand in hand with rapid progress with effective strategies for growth and more and better jobs.

*   *   *

Talking about health care, US President Obama said recently "If Europeans have done it, why could we not achieve it?" Indeed, this report based upon the joint experience of 27 Member States working in the context of the social OMC shows that Europeans can be proud of the achievements of their social protection systems. Not only has it very significantly contributed to avoid that the economic and financial crisis turns into a political disaster; but it has undergone, in line with the whole Lisbon strategy, a deep modernisation. However, social protection is not enough to limit or prevent poverty and exclusion. Having a job remains indeed the best safeguard against poverty and exclusion, in that sense confirming and important stance of the Lisbon Strategy. Precisely this report stresses that the virtuous circle of participation in employment and living out of poverty has not always functioned as it should have in the last decade: serious obstacles still face the most vulnerable groups, such as the low skilled, lone parent families, or migrants. In addition, some of the recent developments have not paid enough attention to interaction between flexible labour markets and quality of work, notably in relation to its impact on the gender dimension. As a consequence, while the emphasis should still be on promoting growth and jobs, fighting child poverty, engaging closely in active inclusion and more generally fighting labour market segmentation and encouraging job quality will have a crucial importance.

This is not to say that the task of modernising social protection is over: quite the contrary. Building on previous achievements, reforms should be further pursued and fully articulated with growth and employment strategies. The consolidation of pension reforms will require further efforts to promote longer working lives, which in turn makes a strong case for fighting health inequalities and improving health and safety at work.

The stance of promoting active social protection policies will not be undermined, but on the contrary should expand to domains beyond health and pensions, deserving more attention from policy makers.

Finally, looking beyond 2010, it appears that truly accessible and financially sustainable provision of basic services such as child care, health and long term care, lifelong learning, will be a key component of any post-crisis strategy.

REPORT

INTRODUCTION

The mutual interaction between economic, employment and social policies is at the centre of the Social Protection Committee's concerns. The agreed common objectives of the European strategy for social protection and social inclusion comprise an overarching goal setting out the need to ensure that adequate, accessible, financially sustainable, adaptable and efficient social protection and social inclusion policies support economic and employment growth. Symmetrically, it requires that growth and more and better jobs contribute to greater social cohesion and to the adequacy of social protection systems. In September 2007, the Committee adopted a report on how best to achieve this integration. The report stressed that successful pro-growth and employment policies need to be underpinned by modern social protection systems and improved social cohesion, which spread positive effects of growth and increase employment opportunities across all societies.

The present report goes a step further. As a contribution to the analytical underpinning of the "post-2010 Lisbon Strategy", it investigates the extent to which past growth and employment achievements since the launch of the Lisbon strategy have had an impact on social adequacy and social inclusion, and vice versa. It also tries to draw lessons from the latest evaluations of the social impact of the crisis. This analysis jointly undertaken by the SPC and its indicators sub-group and the Commission[3] builds on work carried out in the context of the OMC, reviews existing evidence, both at international and national levels and presents original analysis. The main results of this work are presented in this core report which draws from the analytical chapters in the attached supporting documents.

It aims at answering the following questions.

- Did economic growth and increases in employment support social inclusion and social protection? By which channels?
- Did higher employment rates strengthen adequacy and better access to social protection?
- To what extent did the modernisation of social inclusion and social protection schemes support economic growth, employment and benefit adequacy?
- Did growth contribute to a maturing of social inclusion and social protection schemes and to what extent does social protection act as an automatic stabiliser in the economic cycle thus promoting growth and avoid hysteresis effects?

---

[3] See composition of the SPC/ISG task force that was set up in November 2008 in annex.

TABLE OF CONTENTS

1. SETTING THE CONTEXT

1.1. The crisis put a halt to a period of overall economic and employment growth and price stability

1.1.1. A decade of overall economic and employment growth

The Lisbon Strategy was launched in 2000 following a period of relatively sustained growth in the second half of the 1990s. The European economy stagnated in 2002-2003, to rebound again in 2004. Growth came to a halt in 2008 as the world entered one of the direst financial and economic crises in years.

Over the last 15 years, the evolution of the general government debt ratio was quite closely correlated with the economic cycle. Overall, EU Member States used the period to improve public finances, and the aggregate debt of the EU-27 went below the threshold of 60% of GDP in 2007.

Since the launch of the Lisbon Strategy, EU unemployment rates were reduced from 8.7% in 2000 to 7% in 2008 and employment rates increased significantly from 62.2% in 2000 to 65.9% in 2008 and unemployment rates were reduced from 8.7% in 2000 to 7% in 2008. In spite of this improvement the results still fall short of the objectives of the 70% Lisbon Strategy. target.. The rise in employment rates was mainly driven by an increased participation of women in the labour market, and of older workers to a lesser extent. The fall in unemployment rates mainly benefited to medium skilled and prime age workers, while the low skilled and the young benefited less. Inactivity rates were also reduced during the period, from 31.5% in 2000 to 29.1% in 2008. The economic downturn will be a real test for the durability of achievements of the last decade in the labour market. The most vulnerable workers, such as the young, the low skilled or the migrants have been the most hit by the crisis.

The price environment was quite stable in the EU-15 since mid-1990s, but a change in relative prices of different consumption items was observed. Key items that weigh heavily in household expenditure (energy, education, health products and services, and transport services) became relatively more expensive. The relative decline of the prices of clothing and footwear, recreation and culture, and household equipment compensated this increase overall, but probably to a lesser extent for low income households.

Behind these overall trends, the socio-economic reality of the European Union remains very diverse. Thanks to the dynamic growth registered in the poorest countries of the EU the gap in GDP per capita continued to narrow between 2000 and 2008. However, in 2008 GDP/per capita remained below 50% of the EU-27 average in Bulgaria and Romania and exceeded 120% in 5 EU countries. Moreover, the economic convergence observed between countries hides a widening of inter-regional disparities within some countries of the EU, especially in some of the New Member States where growth has mainly been concentrated in capital regions and other urban areas.

1.1.2. The impact of the crisis

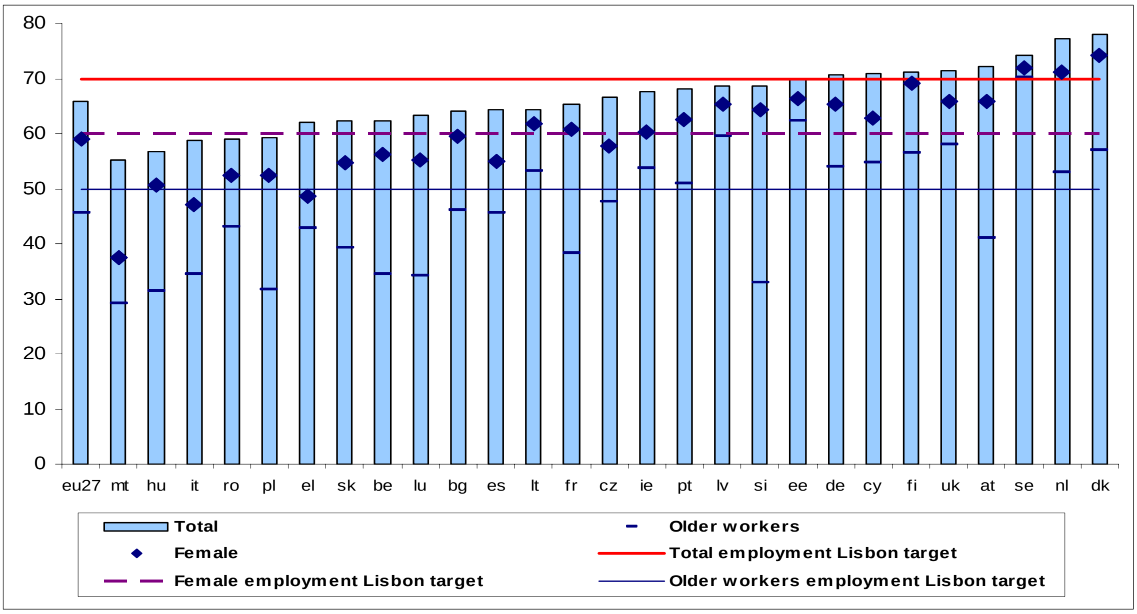
The impact of the economic crisis on the labour market is now visible. Employment growth has come to a standstill and the employment rate contracted in the first quarter of 2009 to reach 64.6% in the EU-27 against the 66.4% peak in the third quarter of 2008. Unemployment rates have started to rise from a low at 6.7% in March 2008 to reach 8.9% in June 2009 and could go up to 11% in 2010 if policies and labour market behaviour remain unchanged.

In some Member States, the recent rise in unemployment has been especially stark (see annex). In Spain it reached 18.1% in June 2009, against 11% in June 08. During the same period, it also more than doubled in Ireland (12.2% against 5.6%), in Estonia (17% against 4.6%), Lithuania (15.8% against 5.1%) and Latvia (17.2% against 6.4%).

Some categories of workers are on the front line of the crisis, including the young, the low skilled, employees holding temporary contracts, EU mobile workers, migrants and the elderly. Youth unemployment rate reached 18.3% in the EU27 in March 2009 against 14.7% at the end of 2007. In the fourth quarter of 2008, the unemployment rate of non-EU workers grew faster than for other workers and reached 16% against 14% one year before.

Past experience shows that many of those who become unemployed due to a temporary decline in labour market demand risk drifting into permanent labour market exclusion with dire consequences for both individuals and society. National experiences from past crisis shows that in some instances short-term responses to rises in unemployment not only resulted in individual withdrawals from the labour market, but also have had long-term negative impacts on society as a whole. Among the long term impacts of the crisis observed in some countries are stocks of long-term unemployed or inactive that tend to persist long after recovery has set. Increasing numbers of people are moving into long-term sickness and disability benefits, or early retirement schemes. Of these people, many are likely never to enter or return to the labour market, thus putting long term pressures on social inclusion and protection schemes. The use of disability benefits or early retirement schemes to mitigate a sudden rise in unemployment has therefore proved both costly and counter productive.

Figure 1.1: Employment rates in the EU: Total, women and older workers, 2008

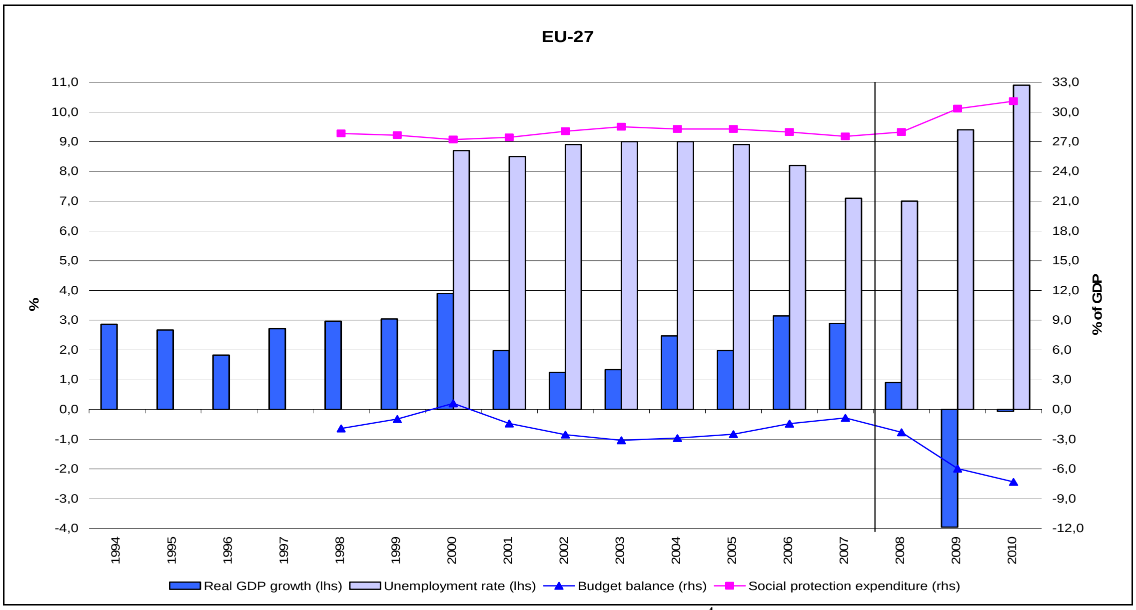


Source: Eurostat LFS

1.2. The long-term evolution of social protection expenditure

Just as social protection expenditure can help mitigate the impact of economic slowdowns and support growth in the long run, growth contributes to the building up and sustainability of social protection. The ratio of social protection expenditure as a share of GDP has declined during periods of rapid growth in the second half of 1990s, after having increased sharply in the early 1990s when growth rates were very low, reflecting a correlation between growth, employment and expenditure. In recent years (2000-2004), social protection expenditure has grown slightly more rapidly than GDP due to more dynamic developments in health care and unemployment expenditure. Clearly, policies that affect expenditure also have a direct impact on the need to adapt social protection financing. In recent years, a trend can be observed towards increased resources from general government budgets devoted to social protection, away from a reliance on social contributions levied on wages in the financing of social protection.

Figure 1.2: Expenditure on social protection benefits since 1994 in the EU in relation to the fiscal situation, % of GDP



Source: AMECO database[4]

2. Economic and employment growth are not enough to reduce inequalities and combat poverty

2.1. Income inequalities vary significantly across Member States and have generally increased within Member States, especially at the top of the income distribution

Inequalities in disposable income have generally increased between the mid-1980s and the mid-2000s (OECD, 2008[5]). The Member States for which data are available are mostly characterised either by increasing inequality over both decades (this holds for the largest group of countries) or by a rise in inequality in the first decade followed by a decline in the second one. The observed rises in inequality are among the strongest in

[4] The AMECO database is based on National Accounts.
In this extract from AMECO the sum of "Social transfers in kind" and "Social benefits other than social transfers in kind" in accordance with European System of Accounts 1995 (ESA95) has been used. Generally speaking the results for total expenditure on social protection is somewhat lower than in ESSPROS. For details on the main differences compared with the European System of Integrated Social Protection Statistics (ESSPROS) in the way social benefits in cash and kind are distinguished please refer to Manual on sources and methods for the compilation of COFOG Statistics, page 65-66, Eurostat, http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-RA-07-022/EN/KS-RA-07-022-EN.PDF

[5] See “Growing Unequal?” 2008 OECD report
http://www.oecd.org/document/53/0,3343,en_2649_33933_41460917_1_1_1_1,00.html
and the funded EC research project INEQ http://www.criss-ineq.org

Finland and Sweden (starting from low levels of inequality) but also in Germany, Italy and Portugal[6] (starting from higher levels), though in recent years signs of a decline in income inequality were observed in Portugal. France and Greece experienced declines in household disposable income inequality over the time interval considered (and Ireland and Spain as well till 2000 – the year to which data are limited) (OECD, 2008). In most countries, top incomes grew relatively faster than middle incomes. In some countries, low incomes caught up with median incomes, while in other countries inequalities also widened at the bottom of the distribution, as illustrated in table 2.1.

Income inequality differs significantly across Member States, ranging from a value of the Gini coefficient for household disposable income of 0.23 for Slovenia and Sweden to the top values of 0.35 and 0.37 respectively for Latvia and Portugal (EU-SILC 2007). In other words, in 2007 in the EU, the total income received by the 20% of the population with the highest income was 4.8 times higher than the total income received by the 20% with the lowest income. This ratio varies 3.5 or less in the Czech Republic, Slovenia, Slovakia and Sweden to 6 or more in Greece, Latvia, Portugal and Romania. Relatively high income inequalities are observed also for Romania, Estonia, the UK, Lithuania and Greece.

Table 2.1 – Trends in real household income by quintiles

	Average annual change mid-1980s to mid-1990s					*Average annual change mid-1990s to mid-2000s*				
	Bottom quintile	*Middle three quintiles*	*Top quintile*	*Median*	*Mean*	*Bottom quintile*	*Middle three quintiles*	*Top quintile*	*Median*	*Mean*
BE	1.2	0.5	1.2	0.4	0.8	1.4	1.3	1.7	1.2	1.5
CZ	..	..	..	..	..	0.4	0.6	0.7	0.5	0.6
DK	1.3	0.9	0.8	0.9	0.9	0.6	0.9	1.5	0.9	1.1
DE	0.4	1.4	1.6	1.2	1.4	-0.3	0.5	1.3	0.6	0.7
IE	4.0	3.0	2.9	3.2	3.1	5.2	7.7	5.4	8.2	6.6
EL	0.3	0.1	0.1	0.3	0.1	3.6	3.0	2.7	2.9	2.9
ES	4.4	3.2	2.4	3.2	3.0	5.2	5.1	5.0	5.5	5.1
FI	0.9	0.9	1.0	0.8	1.2	1.6	2.5	4.6	2.5	2.9
FR	1.0	0.5	-0.1	0.5	0.3	0.9	0.7	1.0	0.8	0.8
IT	-1.3	0.5	1.5	0.6	0.8	2.2	1.0	1.6	1.0	1.3
LU	2.3	2.5	3.0	2.4	2.7	1.5	1.5	1.7	1.5	1.6
HU	..	..	..	..	..	0.9	1.2	1.0	1.1	1.1
AT	2.5	2.7	2.8	2.8	2.7	-2.1	-0.5	-0.4	-0.6	-0.6
NL	1.1	2.7	3.9	2.8	3.0	1.8	2.0	1.4	2.0	1.8
PT	5.7	6.5	8.7	6.2	7.3	5.0	4.1	4.4	4.2	4.3
SE	0.5	0.9	1.2	0.9	0.9	1.4	2.2	2.8	2.2	2.3
UK	0.7	2.0	4.3	1.9	2.8	2.4	2.1	1.5	2.1	1.9

Source: OECD (2008) based on OECD income distribution questionnaire

2.1.1. Demographic changes pushed towards rising income inequalities

Changes in the population structure by age and household types are also responsible for increased income inequalities in most EU countries through 'compositional effects' (linked to the fact that income is not uniformly distributed among different demographic groups). For instance, the increase in the share of people living alone (particularly

[6] Between 2005 and 2008 the Gini coefficient declined from 0.38 to 0.36 and the S80/S20 ratio decreased from 6.9 to 6.1.

pronounced in Finland and Italy) and in lone-parent households (especially in France, Germany and the UK) has pushed towards wider inequalities. By comparing actual changes in the Gini coefficient with hypothetical ones under the assumption of constant age and household structure, the "Growing Unequal" OECD report shows that indeed demographic trends raised inequality in most countries, with a relatively strong impact in France, Germany, the Netherlands and the UK. Demography therefore played a role in explaining rising inequalities, though it was not the main driver.

2.1.2. Increased earnings inequality, due to widened inequality among full-time workers as well as labour market segmentation, is a major determinant of rising income inequalities

Changes in individual earnings are one of the main drivers of household income inequality for the simple reason that earnings represent the biggest slice of household income. Both the OECD report and the INEQ project[7] highlight an increase in personal earnings inequality among full-time workers (as measured by the P90/P10 inter-decile ratio) over the last two decades (though with a few exceptions). The widening of the distribution for full-time workers has been larger at the top than at the bottom, meaning that the increase in the distance between top and middle earners has contributed relatively more to the observed increase in inequality for full-time earners.

Labour market segmentation (linked to the introduction of temporary and part-time contracts) has further strengthened the rise in earnings inequality already observed for full-time workers (Figure 2.1). In terms of annual earnings, one of the reasons for this is of course the reduced number of hours worked by part-time employees and also by many categories of temporary workers[8], of whom many are women and young people (see part 3). But on top of this, non-standard workers are also generally paid less per hour *after controlling for differences in education and experience*.[9] Findings from the INEQ project, show that temporary workers indeed experience a high wage gap relative to the others controlling for the above mentioned characteristics. These results highlight that there is, ceteris paribus, a substantial wage penalty from holding a temporary or part-time job. Eastern European countries (excluding Poland) and the UK are the only exceptions to this as such a wage penalty in these countries is significantly lower than in the other countries studied in the project. The OECD report also shows that countries with a narrower earnings distribution for full-time workers tend to display a greater widening of the distribution due to the inclusion of part-time workers.

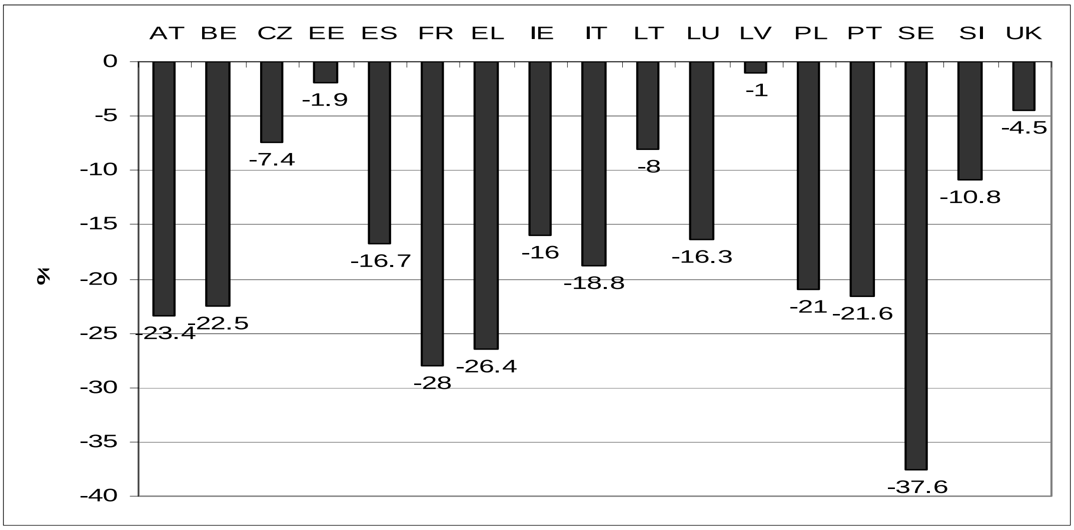
---

[7] INEQ is a research project financed under the VI EU Framework Programme and bringing together seven universities and research centres from different EU countries. The project investigates the economic and social mechanisms producing inequalities in EU and EU neighbouring countries, the effects of inequalities in society and policies aimed at reducing it. http://www.criss-ineq.org

[8] Trends illustrating this labour market segmentation are analysed in more detail in part 3 of the report.

[9] This finding emerges from empirical studies where differences across workers in age, tenure, education level (also reflecting skills and human capital), industrial sector and size of the firm of employment are controlled for. Therefore, the resulting hourly wage gap for non-standard workers does not depend on these factors.

Figure 2.1 – Net wage gaps for temporary workers (wage gap by employees working with temporary contracts – percentage values estimated through a Mincerian wage equation on net yearly wages)



Source: Franzini M. (2009), elaborations on EU-SILC 2006

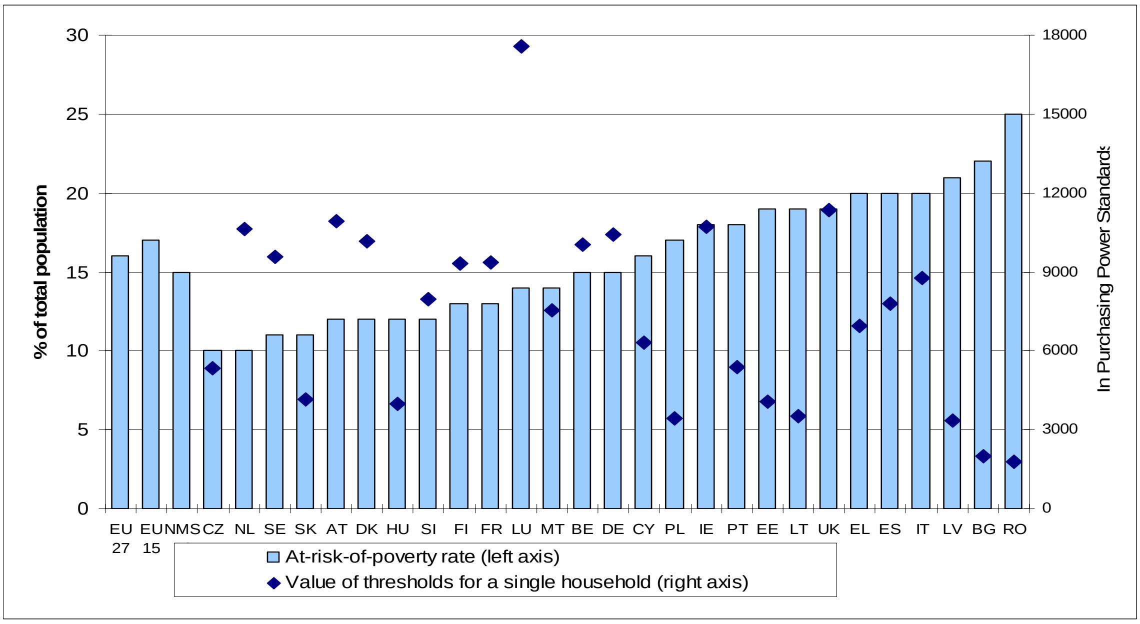
2.2. Relative poverty risks differ markedly across Member States and have increased or stagnated over the past two decades

2.2.1. Great variation is observed in relative poverty risks across the EU

The aggregate figure of 16% of the EU population at risk of poverty[10] in 2007 hides marked differences across Member States, ranging from 10-12% in the Czech Republic, the Netherlands, Slovakia, Sweden, Austria, Denmark, Slovenia and Hungary to 20-25% in Italy, Spain, Greece, Latvia, Bulgaria and Romania. However, being at -risk of poverty relates to very different living standards across the EU, as illustrated by the large differences in the levels of poverty thresholds apparent in figure 2.2 (right axis). Even when corrected for differences in the cost of living, poverty thresholds are four to five times higher in the two countries (UK and Austria) at the top of the ranking after Luxembourg (which is clearly an outlier) than in the two countries at the bottom (Romania and Bulgaria). Poverty thresholds are generally significantly lower in eastern Member States.

[10] We refer to the EU-agreed definition of relative poverty, based on the threshold of 60% of national median equivalised income, whenever not differently specified. It has to be noted that the definition currently used for income excludes non-monetary income components, such as imputed rents, the value of goods produced for own consumption, and non-cash employee income. This definition is under review by Eurostat and the Indicator's Sub-Group of the Social Protection Committee, based on new information transmitted by Member States in 2009.

Figure 2.2 – At-risk-of-poverty rates and thresholds in PPS (60% of median equivalised household disposable income; thresholds referred to single households), EU 27



Source: EU-SILC(2007)

2.2.2. Relative poverty risks have not been reduced in the last decade

Relative poverty risks have increased or stagnated in most EU countries between the mid-1980s and the mid-2000s based on OECD data (Figure 2.3).[11] The largest increases are observed in Ireland, Germany, the Netherlands and Austria, and the largest decrease in Belgium.[12] The only other countries where relative poverty decreased over this time interval are France, Greece, Denmark, Spain and Portugal[13]. The disaggregation of the data for the two decades, mid-1980s to mid-1990s and mid-1990s to mid-2000s, shows that relative poverty risks increased in most Member States in the first decade (the largest increases were in Italy, the Netherlands[14] and the UK, and the largest decreases in Belgium and Spain). In the majority of countries poverty risks increased in the second decade as well (marked increases are reported for Ireland[15], Luxembourg, Germany and Finland, while the largest decrease is displayed by Italy, though national evidence suggests that poverty rates stabilised in the period[16]). Concerning countries that are not covered in this analysis, paragraph 2.3.1 comments on very recent trends in the new

---

[11] The definition of relative poverty used by the OECD is based on the threshold of 50% of national median equivalised income. Conclusions on poverty *trends* do not differ much from those that would be drawn for the 60% threshold given that the two measures of relative poverty tend to move in the same direction (OECD, 2008).

[12] Data for Belgium in 1983 and 1995 are based on fiscal data and are not strictly comparable with those for later years. First, the unit of analysis is that of households filling a tax declaration. Second, the method used to integrate information on households who do not fill a tax declaration differs in the two years. Alternative estimates based on household surveys suggest broad stability of the poverty headcount in the late 1980s and a slight increase in the first half of the 1990s.

[13] See also reference to national data in country profiles in section 2.5

[14] Link to contrasting national evidence in the country profile in section 2.5

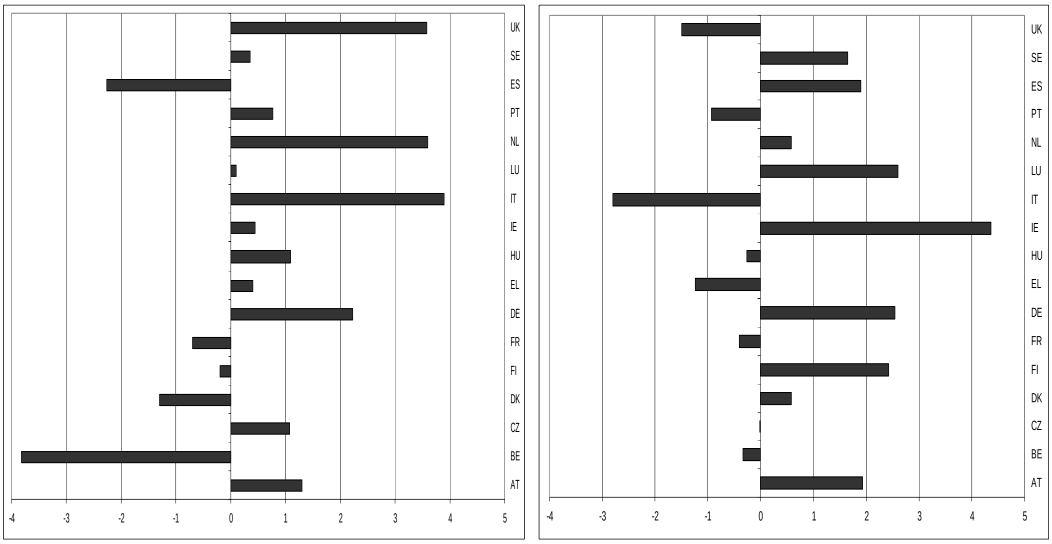
[15] More recent national evidence in the country profile in section 2.5

[16] Link to contrasting national evidence in the country profile in section 2.5

Member States based on EU SILC, and longer-term trends are discussed in the country profile of Poland.

Figure 2.3 – Trends in poverty headcounts (point changes in income poverty rate at 50% median level over different time periods)

(i) Mid-1980s to mid-1990s (ii) Mid-1990s to mid-2000s



Source: OECD 2008

2.2.3. Poverty risks have shifted away from the elderly towards younger people, and have generally increased for the working age population

OECD data (with relative poverty defined according to the 50% threshold) show that child poverty remained stable or increased in most EU countries from the mid-1990s to the mid-2000s. The largest increases are recorded for Austria, Germany and Luxembourg even if in relation to EU 27 they remain on a relatively low level. With regard to the elderly, poverty risks generally decreased between the mid-1990s and the mid-2000s (the only exceptions to this are Ireland, where the increase was particularly large[17], Finland, Sweden[18] and the Netherlands), though they remain at relatively high levels in a few Member States. Thus, the general long-term trend is a significant shift in poverty risks away from the elderly and towards younger people (OECD, 2008). Indeed, child poverty in particular has been identified as a matter of concern across EU countries. The labour market integration of parents, adequate income support and effective access to child care were highlighted as key determinants of child poverty in the SPC report adopted in January 2008[19]).

2.3. Living standards vary greatly across the EU despite improvements observed in high growth countries

2.3.1. Living standards vary greatly across the EU

Living standards vary greatly across the EU as illustrated by the large differences in the levels of poverty thresholds apparent in figure 2.4. Material deprivation rates

---

[17] More recent and contrasting trends are available in Ireland's country story in section 2.5

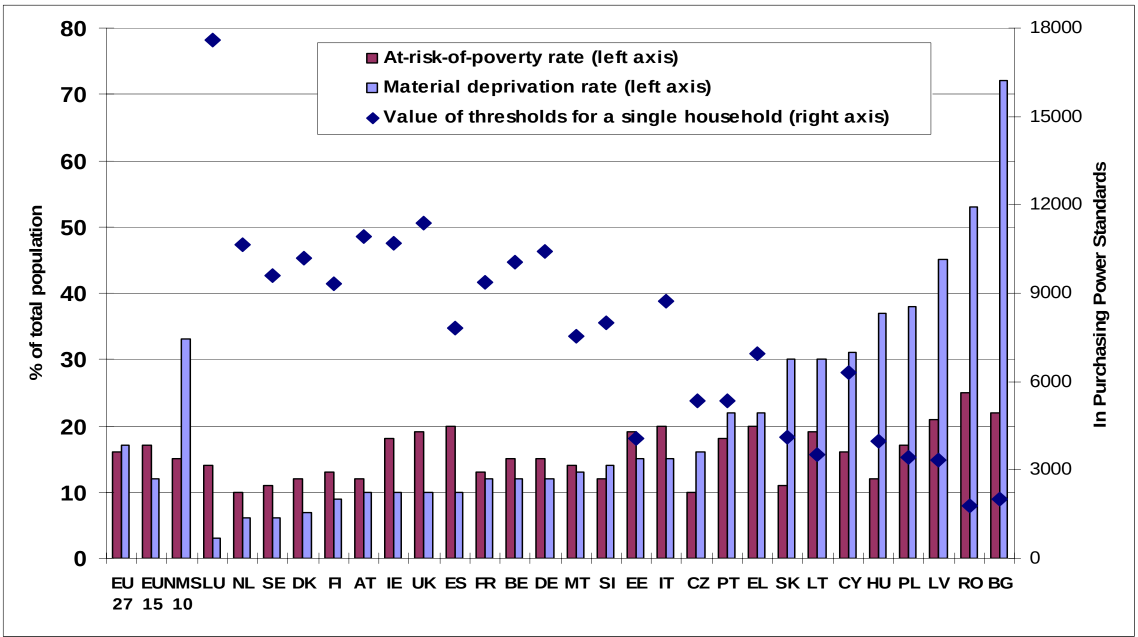
[18] For Sweden the at-risk-of-poverty rate does not take account of the effects of the housing supplement for pensioners as a targeted scheme to reduce poverty.

[19] http://ec.europa.eu/employment_social/spsi/docs/social_inclusion/2008/child_poverty_en.pdf

complement this picture by providing an estimate of the proportion of people whose living conditions are severely affected by a lack of resources. The material deprivation rate provides a headcount of the number of people who cannot afford to pay their rent, mortgage or utility bills, keep their home adequately warm, face unexpected expenses, eat meat or proteins regularly, go on holiday, or cannot afford to buy a television, a fridge, a car or a telephone[20].

17% of Europeans live in these difficult conditions. However, in Bulgaria, Hungary, Latvia, Lithuania, Poland or Romania more than 35% of people are affected. The material deprivation rate reflects better the "geography" of poverty across the EU than the at-risk-of poverty rate which defines poverty in relation to a national threshold. This is because it depends as much on the level of development of the country as on the social policies that are supposed to redistribute the benefits of growth. These disparities in material deprivation rates reflect the large differences in GDP per capita that remain between EU countries. This emphasizes that the fight against poverty in the EU will benefit from a greater economic, social and territorial cohesion within the EU. It is thereby important to anchor social inclusion policies in all the policies that contribute to these greater cohesion objectives.

Figure 2.4: At-risk-of poverty and material deprivation rates (%) and poverty thresholds (€-PPS per year for a single household); 2007



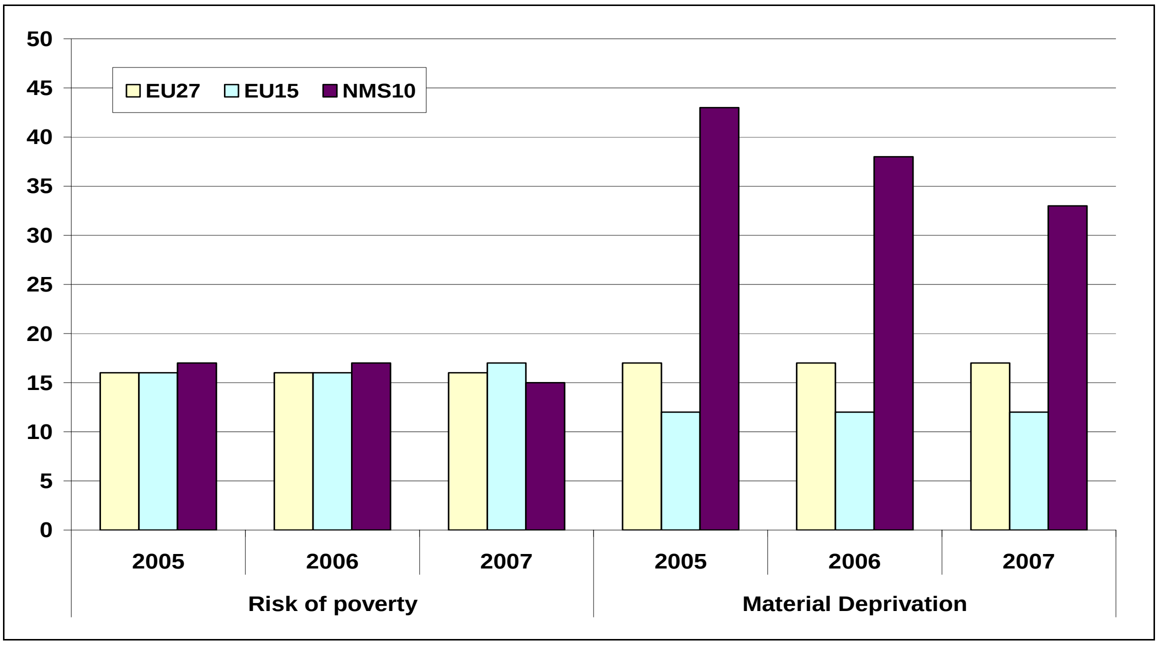
Source: EU-SILC (2007)

Figure 2.5 below also illustrates how the at-risk of poverty rate and of material deprivation measures complement each other. It shows that, over the last 3 years EU15 countries, both the risk of poverty and material deprivation remained stable. On the contrary, in the New Member States material deprivation rates have declined significantly, as well as poverty rates, even though to a lesser extent. These are very preliminary trends, but they are consistent with the analysis of anchored poverty rates presented in the next paragraph which shows that, high growth can indeed improve living standards, including of the poor.

---

[20] The indicator recently adopted by the social protection committee measures the percentage of the population that cannot afford at least 3 of the 9 items quoted above.

Figure 2.5: Trends in poverty rates and material deprivation, Total population - 2005-2007



Source: EU-SILC (2007, 2006, 2005);

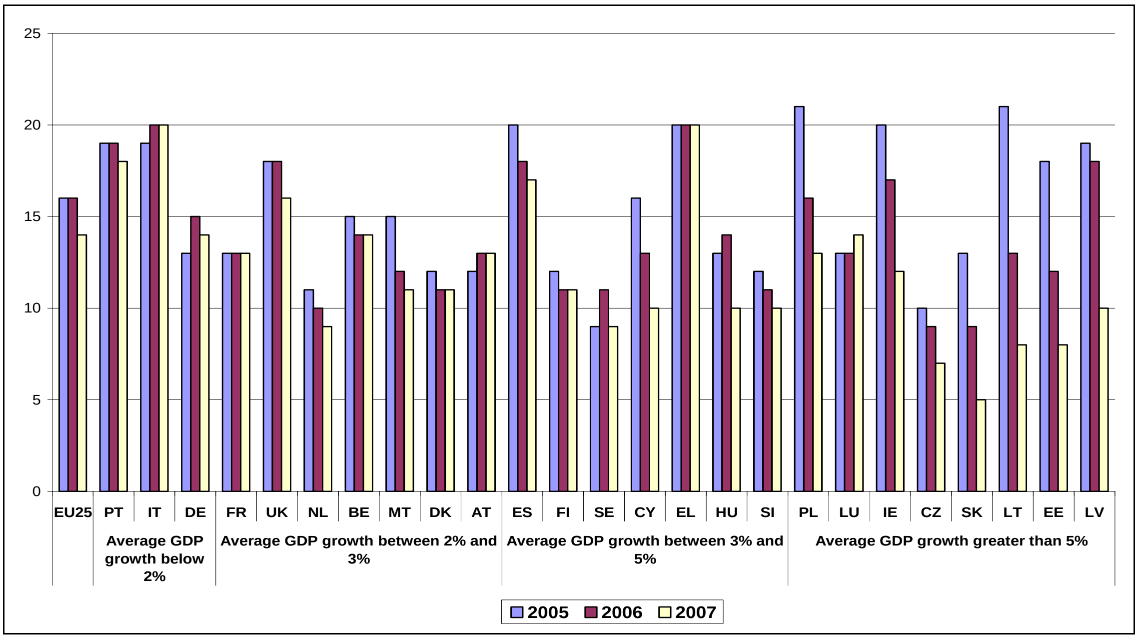
2.3.2. In recent years, economic growth has helped raising significantly the living standards of the poor only in a few countries with high growth rates.

Between 2005 and 2007 nearly all countries with high average growth rates per year (above 5%) showed wide declines in the anchored at-risk-of-poverty rate calculated in reference to the 2005 threshold (See figure 2.6)[21]. This indicator asks how many people in time t are below the at risk poverty threshold calculated in t-n[22]. If the at risk of poverty rate does not improve against contemporary poverty threshold it is still important to ask if poor households are enjoying increases in real income that raises their command over resources compared with the real incomes received in previous years. In general, the conclusion, based on this limited evidence, is that clear-cut results on the nexus growth-living conditions of the poor only emerge for the group of countries with very high growth rates (above 5%), which indeed appear to have helped the poor. For countries experiencing average growth rates below 5% (apart for the two exceptions mentioned above), the evidence on trends in anchored at-risk-of-poverty rates is mixed but changes tend to be small in size.

[21] The most relevant exception to this is Cyprus (the anchored at-risk-of-poverty rate decreased here by 6 points between 2005 and 2007), which anyway also recorded a rather high growth rate, above 4%. Malta also reported a significant decrease in anchored poverty (by 4 points) in presence of a lower but still good growth rate of 2.6%

[22] The "anchored poverty rate" is defined as the risk of poverty associated with a 60% threshold fixed at a point in time, and adjusted for inflation

Figure 2.6 – At-risk-of-poverty rate anchored at a point in time (2005) by average GDP growth, 2005-2007



Source: Eurostat — AMECO database (GDP) and EU-SILC (2007, 2006, 2005); BG and RO missing

2.4. Social protection has a clear redistributive effect in all countries, but the design of the tax-benefit system is crucial to understand large differences in the effectiveness of the systems

2.4.1. The design of the tax-benefit system is crucial in determining the way and the extent to which it affects income inequalities.

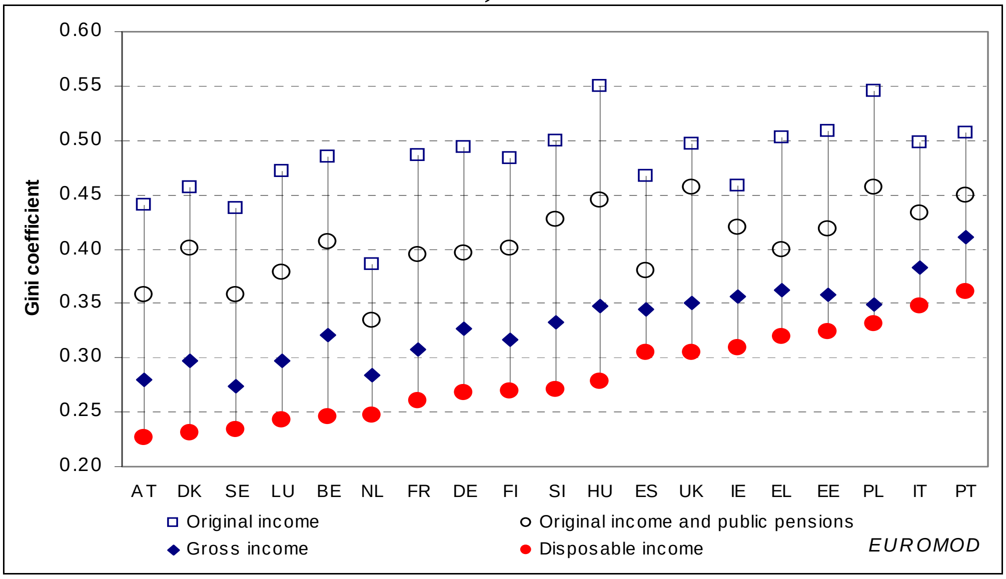
EUROMOD[23] estimates (derived using the current version of the model with tax-benefit policy rules referred to 2001, 2003 and 2005 for the different countries) show that redistribution[24] most effectively **reduced inequality** in Hungary and Belgium (with absolute changes in the respective Gini coefficients by 0.27 and 0.24), while its effects on the income distribution are at the lowest in the Netherlands[25] Portugal, Italy and Ireland (with absolute changes by 0.14-0.15). In all countries the effectiveness of benefits (including pensions) is substantially higher than that of taxes. By separating public pensions from other benefits, the difference in effectiveness between benefits and taxes is reduced but still benefits remain more effective in most cases (the only exceptions to this being Portugal, Greece and Spain).

[23] EUROMOD is a tax-benefit micro-simulation model that currently covers 19 EU countries (EU-15 plus Estonia, Hungary, Poland and Slovenia). Cash benefits, direct taxes and social contributions are calculated by the model on the basis of tax-benefit policy rules in place in the different countries. Results derived from the model are therefore based on simulated, rather than recorded, disposable income. The size of taxes and benefits derived represents an upper bound under the assumptions of full take-up and no tax evasion (Paulus A., F. Figari and H. Sutherland, 2008, 'The effect of taxes and benefits on income distribution in the EU', Chapter 7 in Social Situation Observatory Report 2008).

[24] The inequality reduction impact of redistribution is estimated by measuring the absolute difference between income inequality before and after taxes and benefits. The original income inequality affects the size of the reduction impact that can be achieved, see for instance the Netherlands.

[25] [To be eventually linked to evidence provided by national delegate in country fiche]

Figure 2.7 – Income inequality (Gini coefficient) before and after taxes and benefits: 2001, 2003, 2005[26]



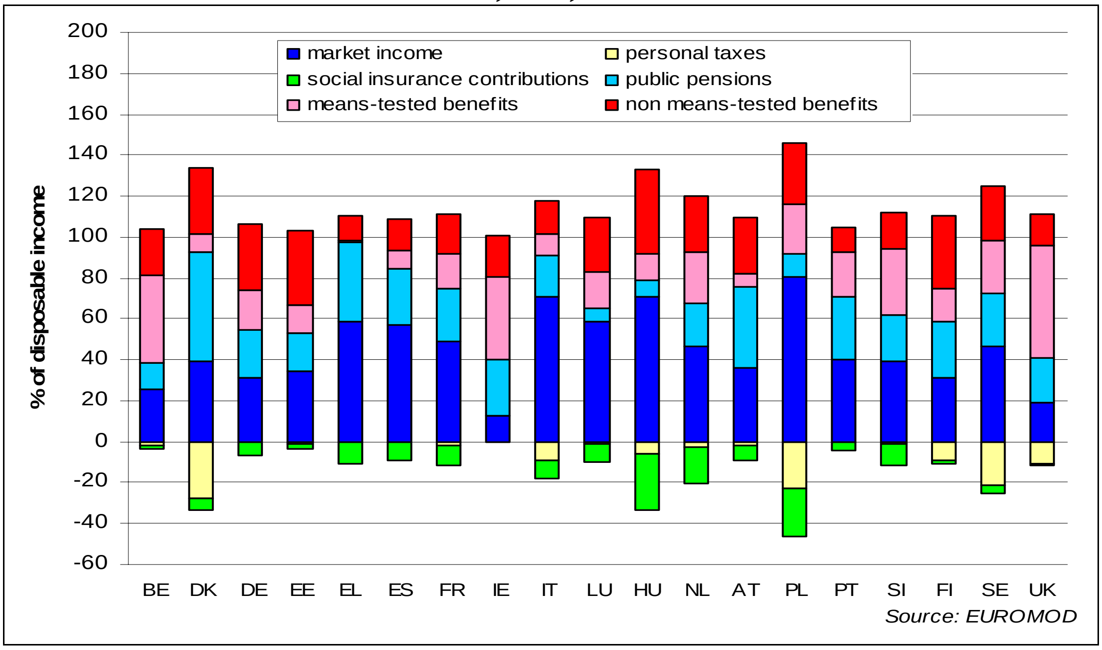
Source: Paulus, Figari and Sutherland (2008)

2.4.2. ..as well as the way and the extent to which it redistributes resources to the poor

Significant differences across Member States arise in the way and the extent to which taxes and benefits redistribute resources to the lowest income decile, as shown by EUROMOD estimates on the bottom decile group's income composition for different EU countries presented in Figure 2.8. Large differences between countries are observed in the percentage of disposable income accounted for by market income. In terms of net support to low-income households large cross-country differences are observed. Net cash support accounts for 87% and 81% of the poorest decile group's disposable income in Ireland and the UK respectively, while it only accounts for 29% in Italy and Hungary and 20% in Poland (where market income dominates as a source of disposable income).

[26] Tax-benefit policy rules refer to 2001 for DK, FR, IE, IT, SE; to 2003 for BE, DE, LU, NL, AT, PT, FI, UK; to 2005 for EE, EL, ES, HU, PL, SI.

Figure 2.8 – Household income composition, bottom decile group out of whole population: 2001, 2003, 2005[27]



Source: Paulus, Figari and Sutherland (2008)

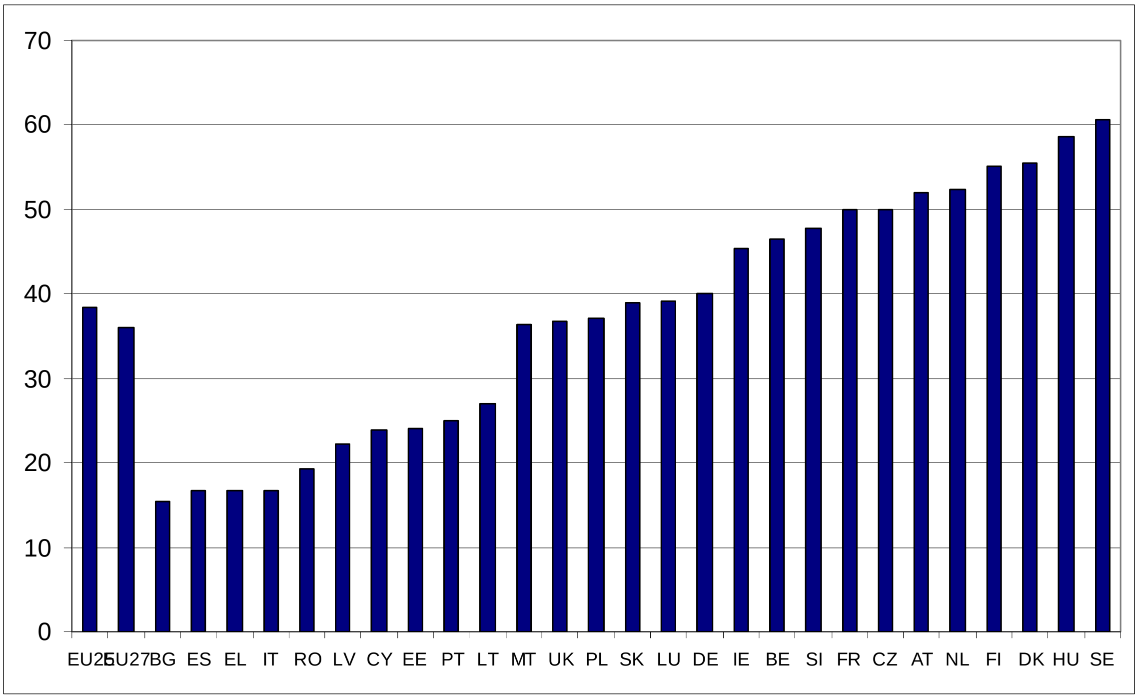
The analysis of the impact of social transfers on relative poverty risks (based on EU-SILC 2007) reveals that social transfers (*excluding public pensions*[28]) reduce the poverty risk by 36% on average in the EU-27 (Figure 2.9)[29] The poverty-reducing effects of social transfers other than pensions are stronger in Hungary, the Nordic countries, the Netherlands, Austria, France and the Czech Republic, where poverty drops by 50% or more thanks to public support (reaching the peak of more than 60% for Sweden). The weakest effects (drops by 19% or less) are reported for Bulgaria, Greece, Spain, Italy and Romania.

[27] Tax-benefit policy rules refer to 2001 for DK, FR, IE, IT, SE; to 2003 for BE, DE, LU, NL, AT, PT, FI, UK; to 2005 for EE, EL, ES, HU, PL, SI.

[28] For the purpose of this analysis, pensions are considered primary income since their role is not only to redistribute resources across income groups but also, and primarily, over the life-cycle of individuals and/or across generations.

[29] The indicator for the poverty risk before social transfers must be interpreted with caution for a number of reasons. First, no account is taken of other measures that, like social cash transfers, can have the effect of raising the disposable incomes of households and individuals, namely transfers in kind, tax credits and tax allowances. Second, the pre-transfer poverty risk is compared to the post-transfer risk with all other things being equal — namely, assuming unchanged household and labour market structures, thus disregarding any possible behavioural changes that the absence of social transfers might entail..

Figure 2.9 – Impact of social transfers (excluding pensions) on the at-risk-of-poverty rate for the total population (percentage reduction), 2007



Source: EU-SILC 2007

2.5. Lessons learnt from the diversity of experiences Member States went through over the past 20 years and in previous recessions

A number of country's stories help illustrate the variety and complexity of the interaction between growth, jobs and social inclusion and social protection

> ***Belgium:*** *Over three decades, the maturing of social protection helped reducing inequalities, while recent trends in labour market and household structures are challenging the effectiveness of the social security system*
>
> **In the decade following the oil crisis**, both income inequalities and at-risk-of-poverty rates decreased, along side with sharply rising unemployment and budget deficits and a slight fall in overall (equivalent) disposable income. This is partly explained by an important increase in female labour market participation, dual earner households, and greater reliance on unemployment benefits (when one of two earners became unemployed) and the maturing of pension systems, which helped reducing elderly poverty. Social protection expenditures grew significantly from 18% to 29% of GDP. **From mid-80s to early 90s**, both economic growth and unemployment rates were relatively high. While market inequalities started to increase and household income inequalities and at-risk-of-poverty rates stabilised, all income groups experienced a significant increase in household disposable income. Increase in social security expenditures was slowed down by more selective policies, better targeted to low income households. The level of social expenditure decreases from 29% of GDP to 27% between 1985 and 1992. **From 1992 to 1997**, the average increase in household disposable income is low and the position of lower income households hardly improves. Economic growth is less favourable and unemployment remains at a high level. Earnings and household income inequalities start rising again, as well as poverty rates. Because the limits to selectivity are reached the control of social expenditure equally affected all beneficiaries, and benefit levels were unable to

keep up with the general increase in standard of living. This was compounded by the increase in one earner families (incl. lone parents) among benefit recipients, which in turn led to a slowly growing gap between families with a labour income and families dependent solely on social transfers, often depending on one allowance only.

Denmark: *Prolonged economic and employment growth since the mid 1990s led to very high employment rates; relative poverty increased from a low level*

The recession of the beginning of the 1990s was followed in Denmark by a prolonged economic growth with annual real growth rate above 2 % until 2000. During the last decade, the economic growth was initially more moderate but still positive (until 2003) and recovered in 2004 and 2005. The periods of relative high growth corresponded to periods of low unemployment. The gini coefficient has however been relatively stable during the past 20 years, with a 3 percent point rise since mid 1990´s. The continuous growth in disposable income has been relatively fairly distributed, both between income groups and age groups. The high and rising employment rate is partly due to dedicated effort to strengthening the incentives for each individual person to work and increasing the employability of those at the margin of the labour market, resulting in the highest activity rate in the EU. However, the share of the population belonging to the low-income group is increasing since last decade, although starting from a low level reached in the period early 1980s up to the mid-1990s. The higher at-risk-of-poverty rate can be partly explained also by the increase in real terms of the low-income threshold and it has to be noted that students alone account for 1/3 of the low-income group.

Germany*: Lasting recession lead to downward mobility until the mid 2000, but first signs of a reduction in inequalities followed the recovery in 2006*

Unlike most other EU member states Germany suffered a serious economic downturn during the first half of this decade with a subsequent increase in unemployment. Beside the recession, changes in household structures, notably an increase in singles and lone parents, contributed to an increase in income distribution and in the at-risk-of-poverty rate. Since the mid 1990s Germany experienced an increase in the numbers of low paid workers, a trend that was accentuated because of the economic crisis as the proportion of middle income earners decreased significantly. Correspondingly, the proportion of the population at the margins of the income distribution increased as well, mainly due to the increases in the number of unemployed persons and welfare recipients, thus, the downward mobility was more marked than the upward mobility in higher income groups. The following economic recovery led to a reduction of inequality and the at-risk-of-poverty rate in 2006, and important reason being the decline in unemployment and the reduction in market income inequality.

Greece*: Dynamic growth since the mid-90s helped raising living standards, but high levels inequalities remain partly due to the low poverty reduction impact of social protection*

GDP growth accelerated after 1996, compared to the relatively low economic growth of the period 1980-1995. Unemployment rates continuously increased from 7% in 1990 to 12% in 2000, before gradually decreasing down to 7.6% in 2008 just before the crisis. Employment rates increased from 56.6% in 2000 to

61.4% in 2007, but the female employment rate lagged behind the EU average (47.9 against 58.3%). GDP per head between Greece and the average of EU-countries has been continuously converging since 1995 and has almost reached the average (EU-27) in 2008 (from 83 in 1995, base 100 EU-27, to 97 in 2008). It should also be underlined, that absolute poverty in terms of real purchase power started to decrease after 1994 following a long period of stability (1982-1994). However, Greece shows relatively high levels of inequality. The Gini coefficient remains stable at around 34 and the indicator S80/S20 has slightly increased from 5.3 in 1995, to 6.1 in 2006. Relative poverty remains higher than EU average even if it has decreased from 23-22% in 1995-1996 to 20-21% in 2005-2006. Over the period, the relative income of middle-class families has been improved. This was partly due to the fact that high economic growth permitted to increase gradually expenditure on social protection benefits (from 21.8% of the GDP in 1996 to 24.2% in 2006) in a social security system dominated by the universal coverage approach. As a result, the vertical redistributive role of the social security system is rather limited, as illustrated by the very low poverty reduction impact of social transfers other than pensions.

Ireland: *Strong and sustained growth, tax reforms and increased labour market participation in households helped raising household incomes overall, but to a lesser extent for those below the poverty line.*

Ireland experienced a period of strong economic growth from the early 1990's, which moved through a number of phases: In the late 1980s the economy gradually recovered from a deep and prolonged recession and real incomes declined for a variety of reasons. The unemployment rate increased from 7% in 1980 to 17% in 1987. It was followed by a strong period of economic growth, but with relatively subdued growth in employment as emigration was at a high level for most of the period and tax reforms were limited. Household incomes increased more quickly than welfare rates, which resulted in a slight increase in numbers falling below the risk of poverty line from 1987-1994. From the mid 1990s, tax reforms were concentrated at lower and middle income levels, which reduced labour costs to companies and increased net household incomes. Household incomes increased at a much higher rate than earnings, which was driven by tax reforms affecting median earners and increased number of 2 or more earners households generally. Given that most of these changes impacted on households above the risk of poverty line, the risk of poverty increased from 15.6% to 21.9% despite strong social welfare increases. Consistent and anchored poverty measures decreased over the period, reflecting real income increases for people at risk of poverty. During the beginning of this decade, employment rates levelled out. The rate of growth in household incomes fell closer to the rate of earnings growth. Social welfare rates increased at roughly the same level as 1994-2001, but reduced the risk of poverty from 19.7% in 2003 to 16.5% in 2007[30], with particularly strong decreases for 65+ year olds who tend to be welfare dependent with incomes close to the risk of poverty line.

France: *Long-term trend of reduction of inequalities and poverty, despite an increase in market income inequalities due to segmentation of the labour market and the polarisation of jobs between job-rich and job poor households.*

[30] Just using SILC data, as there appears to have been a discontinuity between LIIS/ECHP and SILC

The long term trend of reduction in inequalities and poverty which had begun in the seventies has decelerated in the nineties. While the relative situation of old-age pensioners continued to improve, the relative situation of workers and unemployed people has weakened. However, the poverty rate with a threshold calculated only among the active population is nearly stable since the 70's. The overall dispersion of wages has not changed much in the last decades (the inter-decile ratio of yearly net wages was 3.1 in 1995 and 3 in 2004). The lowest wages grew slightly more rapidly than the average reflecting increases in the legal minimum wage while the very high wages grew very strongly. However, when measuring the income on a yearly basis, market income inequalities are much wider (D9/D1 = 13) than for full-time wages. The main driver of inequality is the employment duration over the year. People at the bottom of the annual earnings distribution work, on average, for approximately 13 weeks during the year, against as compared with 51 weeks for those in the top decile. Part-time work also plays a role since people in the lowest decile worked on average 22 hours a week when people in the top decile worked 38 hours a week. The proportion of low paid workers (below 1,1 minimum wage) also increased from 13% in the early 80's to 18,4% in the mid-nineties and then declined to 16.5% in the early 2000s. This evolution was mainly due to the rise of part time work (Atkinson and alii, 2001).[31] Furthermore, the polarisation of jobs between households also increased since the early 80s: the proportion of couples with two jobs increased from 63% in 1982 to 67% in 1999 while the proportion of couples without any jobs increased from 7% to 11%.

The Netherlands*: Activation has partly mitigated the impact of increased wage dispersion and lower redistributive impact of the tax-benefit system*

The low economic growth in the beginning of the 1990s had a relatively limited effect on the unemployment rate, increasing a couple of percentage points to around 6.5% in the middle of the 1990s. It then kept falling until the beginning of this decade at the same time as the economy recovered. Income inequality has increased since the beginning of the 1980 and the strongest increase occurred in 1990 partly as a consequence of tax reductions. However, overall average income inequality in the Netherlands has been relatively stable. This is explained by a combined effect of on the one hand increased wage dispersion at the lower end of the labour market and reforms in the social security system (leading to increased inequality) to increase incentives to enter the labour market and on the other hand the related decrease in benefit dependency (leading to decrease in inequality). Relative poverty decreased from 1995 until 2002 after which it increased to almost 9 % in 2005. Based on national indicators, poverty has been decreasing Overall, the development of poverty appears to have been linked to the economic developments over this period.

Austria: *Effective public transfers and activation have helped reducing poverty by mitigating rising market income inequalities due to increasing part-time and temporary work, widening hourly wage dispersion and rising unemployment.*

Since the mid-80s, Austria has experienced growth cycles with longer periods of faster GDP growth (at about 3%) than periods of slower growth (at about 1%). At the same time, both employment and unemployment rates have steadily

[31] Atkinson, A., Glaude, M., Olier, L., Piketty, T., (2001), *Inégalités économiques*, Conseil d'Analyse d'Économique, rapport n°33, ,

increased. The volume of hours worked, however, has grown much slower than the number of people employed; there is an ever rising share of part time employees. This is due to a successful competition on export markets, to productivity growth induced through investments and a better trained workforce, to the integration of migrant workers into the regular labour supply, to flexible labour market rules. Since the mid 90s both inequalities were reduced in Austria and the slight changes in the composition of the population at risk of poverty have not been accompanied by an increase in poverty rates. This trend results from a complex combination of factors. A number of developments in the Austrian economy may have contributed to increasing inequality among households and raise poverty rates *i)* a sharp drop in the labour share in national income, ii) to the widening of the distribution of hourly wages, *iii)* to an increase of the ranks of people working part time or being employed as temporary workers, and *iv)* to the substantial rise in unemployment. However, growth oriented policies aiming at activating women and men of working age and raising future employability, have helped reducing the poverty risk of the less advantaged groups in society. Overall, public transfers (social, education, health, housing) have had the strongest impact in reducing inequality and poverty rates. It is by these means that changes in market incomes (pointing towards increasing inequality) have not been translated into a more unequal distribution of disposable household incomes.

Poland: *Following the transition, economic expansion brought higher inequalities, but improved the material situation of households.*

Following the economic transformation in Poland, unemployment increased sharply until 1994. With the exception of the beginning of the 2000s, since then the proportion of people outside the labour market has constantly decreased, although in 2008 it is still above the EU average. As a consequence, the constant increase of the poverty rate observed from the mid 1990s (up to 20.4% in 2003) came to an end in the last years. In 2008, 10,6% of total population was living below the legal poverty line, defined as a monthly income of a household qualifying the household to apply for a social benefit in cash in accordance with the legislation in force. The economic expansion in Poland brought higher income inequalities, especially above the median income. Different factors led to increased inequality, including the education level, unemployment and different situation of urban vs. rural areas (larger cities correspond to higher average income level). However, improved material situation among households is one of the reasons of a decrease in income inequalities observed since 2005.

Portugal: *High and increasing activity rates combined with a gradual increase in unemployment; high inequalities remain despite a recent decrease due to the reinforcement of social transfers*

The growth of the Portuguese economy in the second half of the 90s (4.1% annual growth average in the period 1996-2000) continued during the last decade, although in a more moderate way. This growth supported a growing activity rate reaching 74.2% in 2008 and which was due particularly to increased participation of women in the labour market, postponement of retirement age and migration flows. During the same period, however, unemployment rate has progressively increased, although from low levels (3.9% in 2000), and is now aligned to the European average. The increase of unemployment concerned especially women and younger active population (especially those aged 15-24). This situation should be seen also in conjunction with persisting weaknesses in the Portuguese society owing to structural factors, such as the entrepreneurial structure and low educational level of employed people (apart the effort that have been made in the last years for the qualification of adult people with some results). In the period of economic growth, disposable incomes have been rising since 1995, and particularly between 1998 and 2001[32]. However, **despite the improvements in the last years**, inequality remains a main issue in Portugal, mainly due to a persisting disparity in terms of wages and salaries. In 2008 the net equivalent monetary income of the 20% of population with the highest income was 6.1 times higher than that of the 20% of population with the lowest income. The poverty rate has slightly decreased from 21% in 2000 to 18% in 2008, notably due to the role played by social transfers. The risk of poverty remains high for vulnerable groups (especially unemployed, young and women) as well as for the employed (12% in 2008).

Finland: *Reforms of the tax and benefits systems have lead to a slow increase in inequalities since the mid-90s.*

During the recession in the beginning of 1990`s the disposable income of all households decreased remarkably. The decrease was strongest in 1992 and the income fell by 4-5 %. In 1995 incomes turned to an increase. Incomes started to increase again in 1995, and the increase was strongest in 1997-1999 especially in the top quintiles. At the beginning of 2000`s increase of income of the middle quintiles was more rapid than in the top quintiles. In the last year the top quintiles has increased their income more rapid then the others. As a result, the income share of the lowest quintiles has decreased. Inequality measured by Gini coefficient was quite stable in 1980`s until mid 1990`s. Since then the income distribution has been less equal. The main reason for this is that the role of taxation in minimizing income differences has weakened. At the same time the share of cash benefits of households´ income have decreased and the role of market income has increased. One reason for the gains of the top quintiles is that the share of capital income in these quintiles has increased. Capital income is less taxed than income from work.

Sweden*: Stark recession lead to long-term exclusion from the labour market and polarisation of incomes*

The economic recession in the Swedish economy in the beginning of the 1990s resulted in a dramatic increase in unemployment, although from a very low level, as well as an increase in the proportion of people outside the labour force. As a consequence, household disposable income fell for all groups in the population and despite the following recovery in the economy income did not recover until the beginning of the 2000s. In parallel, there was an increase in income inequality which peaked in 2007, after a slight decrease in the beginning of this decade. The increase in the overall inequality was mainly driven by changes at the top and bottom of the income distribution, driven mainly by those in gainful employment and those dependent on public benefits respectively. Although relative poverty decreased slightly during the first years of the recession, it has increased

[32] This trend refers to Gross disposable income (including for households). The trend for households is the same.

continuously since the mid 1990s. The increase has been larger for the non-working population and those dependent on public transfers, notably single parents and elderly and youth in single household.

***The United Kingdom**: Improved redistribution through the tax-benefit systems has partly mitigated the sharp polarisation in original incomes (earnings from work)*

The economic recession in the UK economy in the beginning of the 1990s resulted in a sharp increase in unemployment with a peak in 1993. This was followed by a steady fall in unemployment down to around 5% in the 2000 where it stayed until the second half of 2008. Income inequality rose during the 1980s but from the mid-1990s and onwards inequality has been fairly stable, though there has been a small increase in overall inequality mainly driven by changes at the very top and bottom of the income distribution. Several factors contributed to the sharp rise in poverty in the early 1990s, including higher rates of workless households, widening earnings disparities and the impact of government policies. Although government intervention through taxes and benefits plays an important role in determining the distribution of household income, over the last decade's changes in income distribution have been caused predominantly by changes in the distribution of original income rather than by changes in the impact of taxes and benefits. However, estimates of the importance of the tax-benefit system in reducing poverty indicates that if the 1996/97 tax-benefit system had remained in place, the poverty rate would have been larger. The effect was especially important in reducing poverty among children living in lone-parent families, families with children and pensioners. This would imply that, since the poverty rate actually fell during late 1990s, other factors such as demographic developments and changes in household formation, would have led to an increase in poverty without the tax-benefit reforms.

2.6. Concluding remarks

Over the past decade, economic and employment growth has in general improved overall living standards and many governments have been able to devote more resources to social policy intervention. However, despite the clear redistributive effect of social protection, inequalities have often increased and poverty and social exclusion remain a major issue in most EU countries, although with substantial differences across Europe.

Income inequalities have increased in most EU countries since the mid 80s, before stabilising in the last 10 years. In most countries, top incomes grew relatively faster than middle incomes. In some countries, low incomes caught up with median incomes, while in other countries inequalities also widened at the bottom of the distribution.

A major factor behind this is the increase in earnings inequality among full-time workers further strengthened by the increase of involuntary part-time and temporary contracts. **Labour market segmentation** is a key determinant of widened earnings inequality both because non-standard workers tend to work fewer hours per year and because they are often paid less per hour *after controlling for differences in education and experience*.

Relative poverty risks increased in most Member States between the mid-1980s and the mid-1990s and in most cases they either increased or stagnated between the mid-1990s and the mid-2000s. There was a shift in poverty risks from the elderly towards younger people. In particular, c**hild poverty remained stable or increased** in most EU countries.

In recent years, it is only in countries with very high growth (above 5%) that significant improvements in the standards of living of the poor were observed. In general, economic growth has made it possible to "erode" severe deprivation, particularly (though not only) in new Member States, but relative poverty has not declined and has even increased in some countries that were traditionally "good performers".

The **design of the tax-benefit system is crucial** in determining the way and the extent to which it affects income inequalities and redistributes resources to the poor. Important features include the progressivity of taxes and benefits and the degree of targeting and conditionality of benefits that can create disincentive effects, if badly designed. Further work would be needed to better understand the determinants of the efficiency and effectiveness of tax-benefit systems.

3. JOB CREATION AND SOCIAL INCLUSION

Significant progress has been made in raising employment rates across Europe, helping to improve gender equality and also in reversing negative trends such as the decline in participation of older workers. **The experience of this decade has confirmed that improving access to good quality employment can help reduce the risk of poverty**. Indeed, between 2000 and 2007, unemployment rates were significantly reduced in the EU as a whole from 8.6% in 2000 to 7.1% in 2007. This trend was observed in the majority of countries except in BE, LU, HU, the NL and PT (LU, NL and PT already had very low rates at the start of the period). The increased participation of women as second earners has helped improving the income of many households.

However, at the outset of the crisis, about one third of the working age population in the EU was out of work (unemployed or inactive). Furthermore, evidence shows that the significant increases in employment rates observed in all EU countries before the crisis coexisted alongside significant numbers of workers in precarious jobs, working poor and jobless households. These trends result from a complex combination of factors. Under-employment and precarious forms of contracts mitigate the positive impact of including more people in the labour market. Increases in the number of single and lone parent households also play a role.

3.1. The diagnosis: despite undeniable progress, more needs to be done to ensure that labour markets are truly inclusive

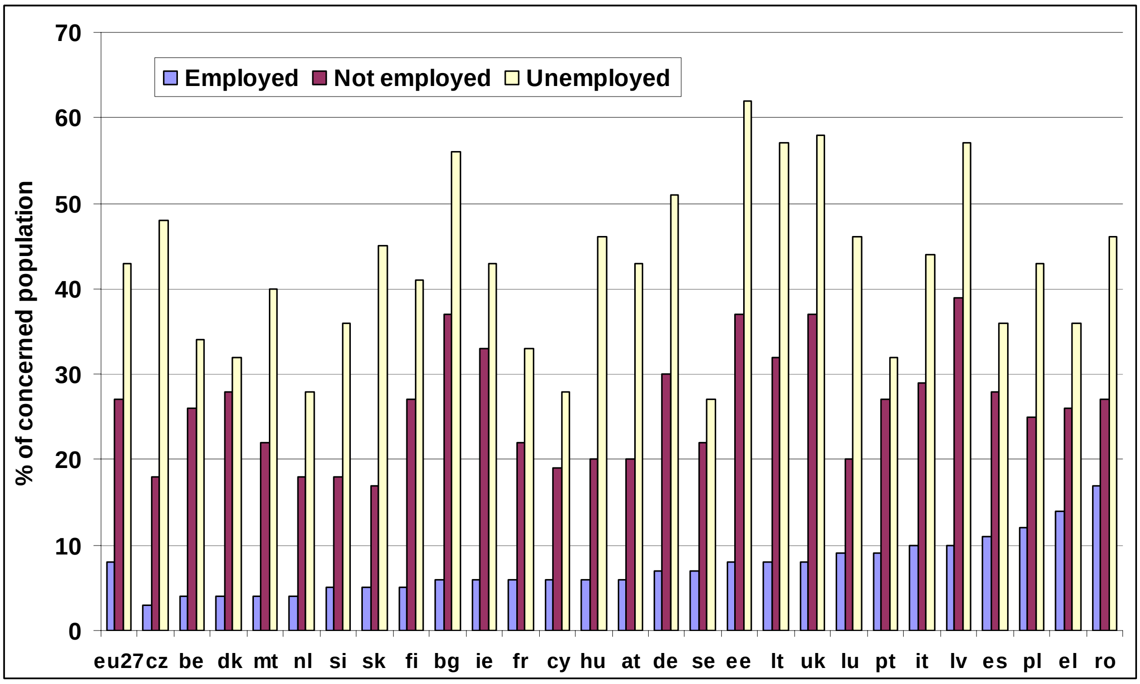
The Task Force report does not aim at explaining the complex mechanisms by which developments on the labour market impact on income inequalities overall. While acknowledging the overall benefits of including more people on the labour market, the report highlights a number of key trends showing that the EU job strategy did not always reach the most excluded and that the jobs created did not always provide for decent living standards. It illustrates that more needs to be done to ensure that EU labour markets are truly inclusive and lead to greater social cohesion.

3.1.1. Having a job remains the best safeguard against poverty and exclusion…

In the EU as a whole, the risk of poverty faced by working age adults without work[33] is more than 3 times higher than those in work (27% against 8%). This risk increases to 43% for the unemployed. This indicates that a job remains the best safeguard against the risk of poverty. It also indicates that the level of protection of the unemployed varies a lot across countries. The at-risk-of-poverty rate for the unemployed is particularly high (above 50%) in Bulgaria, Germany, Estonia, Latvia, Lithuania, and the United Kingdom. Cross-country variations can be explained by the relative generosity of the benefits but also by the categories of workers that are unemployed, as well as the type of households they live in.

[33] People out of work include the inactive (including the disabled, the retired, people with family responsibilities who are not seeking for work, etc) and the unemployed.

Figure 3.1: At-risk of poverty rate of the working age population by employment status: employed, not-employed (among whom the unemployed). 2007



Source: EU-SILC 2007

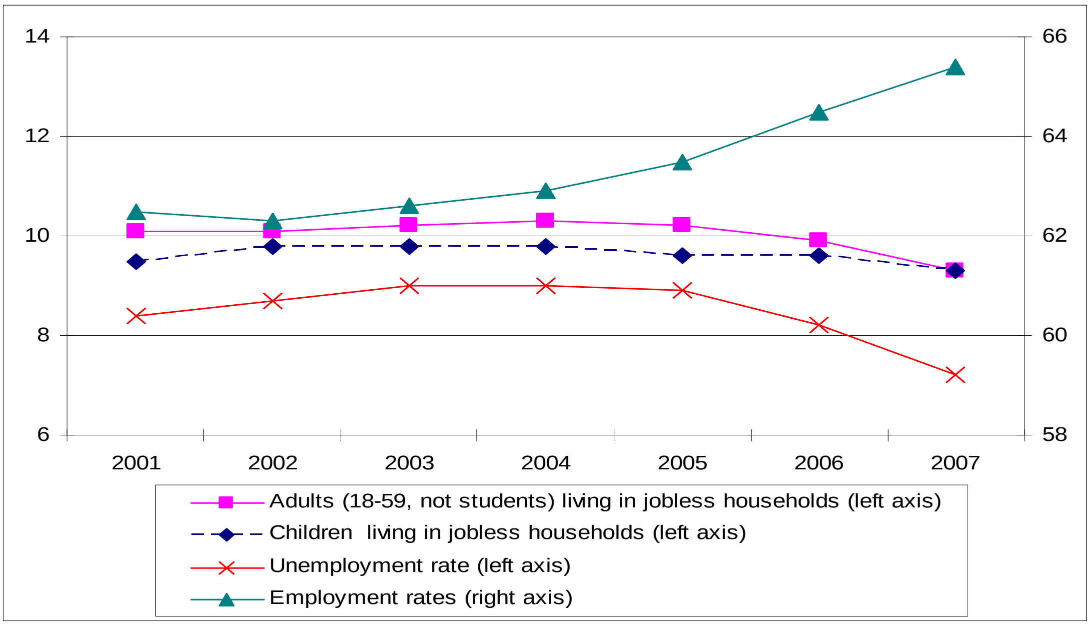
3.1.2. …but a job is no guarantee against the risk of poverty and the working poor represent a significant share of those at-risk of poverty…

In 2007, 8% of the people in employment were living under the poverty threshold. The working poor also represent more than 1/3 of the people at-risk-of poverty in age of working. Finally, in-work poverty is an important determinant of child poverty in many countries, as was highlighted in the SPC report on child poverty and well-being. In-work poverty is linked to the employment situation of the individuals such as low pay, low skills, precarious employment and involuntary part-time work. Importantly, situations of poverty are also linked to the type of household in which people live. In-work poverty is often related to low work intensity, i.e. situations where there are too few adults working in the household, or not working enough to make a living (too few hours or only part of the year). Single and lone parent households, as well as one-earner families face the highest risks of poverty (See also paragraph 3.2.2)

3.1.3. … and the job strategy did not always reach the most excluded

The direst situations concern those households in which nobody works and who therefore have to rely on social benefits. In 2007 in the EU27, 9.3% of adults in age of working (and not students) were living in jobless households against 10.2% in 2001. In 2007, 9.4% of children lived in jobless households, against 9.5% 2001 showing that the slight improvements recorded for adults have not reached families with children to the same extent.. The crisis is likely to increase the number of families having to rely entirely on social benefits. (See also point 3.3.2)

Figure 3.2: EU - Employment and unemployment rates and shares of children and adults (aged 18-59 and not students) living in jobless households; 2001-07 — %



Source: Labour Force Survey

3.2. Is labour market inclusion guaranteeing income adequacy and social inclusion?

Individual yearly earnings are a key component of household income, and as highlighted in part 2 of this report, a major factor behind increased inequalities is the increase in earnings inequality among full-time workers further strengthened by the development of involuntary part-time and temporary contracts. The report therefore reviews first the potential impact of recent labour market developments on individual yearly earnings, with a focus on the lower end of the earning distribution. It then reviews how individual earnings interact with the evolution of household structures in order to illustrate their contribution to disposable income inequalities.

3.2.1. Increased labour market segmentation: Temporary work, part-time work and sometimes stagnating wages have increased the number of individuals with low earnings

This chapter reviews structural features of the labour market such as low wages, gender pay gap, female employment patterns, precarious employment, under-employment and patterns of self-employment that can lead to **lower individual earnings**. As earnings from work are defined as the total income individuals derive from work over a whole year, it depends both on the level of their wage and on the amount of work they do during a whole year. We will not review here the micro-economic determinants that explain the increased dispersion of hourly-earnings observed over the last decade, as highlighted in part 2 of the report[34].

---

[34] An extensive review of the earnings dispersion across the EU is available in Employment in Europe Report 2005 - Chapter 4: Earnings disparities and determinants of the earnings distribution in the EU: http://ec.europa.eu/social/BlobServlet?docId=2281&langId=en. It focuses on the micro-economic determinants that impact on hourly earning disparities such as individual characteristics of workers (age, gender, skill), companies specificities, economic integration, and the institutional and bargaining framework.

According to a the 2008/09 Global Wage Report of the ILO[35], **wage inequalities have increased** since the mid 1990's in most of the EU countries reviewed with the notable exception of France and Austria. However, the report distinguishes between different patterns of evolution depending on whether inequalities widened at the top or at the bottom of the wage distribution. In most of the EU countries for which data are available[36], increases in wage inequalities have been mainly driven by the upper end of the wage distribution (DK, IE, NL, FI and the UK). In France, wage inequalities have been reduced. However, evidence shows **that in Germany, Poland, and the Czech Republic wage inequalities increased according to a "collapsing bottom" scenario.** In these countries, inequalities between the median and low wage earners have increased while inequalities between top and median earners remained fairly stable. In Germany for instance, the D5/D1 ratio increased from 1.60 in the period 1995/2000 to 1.76 in the period 2001/2007, while the D9/D5 ratio decreased from 1.83 to 1.79.

As indicated above, the level of yearly earnings also depends on the quantity of work carried out over a whole year. In particular, **working part-time** has obviously a direct impact on the level of yearly earnings at the individual level. **Temporary employment** is also likely to impact on the total number of hours worked during the year, since it is likely to increase the overall number of out-of-work spells during a given year. **Both forms of employment have significantly increased since 2000**. At the household level both forms of employment increase the risk of poverty significantly in comparison to the situation of workers working full-time or employed on permanent contracts[37]. The risk of poverty of people working part-time is 11% against 7% for those working full-time, and the risk-of poverty of people on temporary contracts is 13% against 5% for workers holding permanent contract. SILC results also show that this gap has increased over the last three years.

The share of **part-time work** in total employment has increased overall from 15.8% in 2000 to 17.6% in 2008, and from 28.7% to 30.6% for women. This increase concerns all categories of workers, and especially women and the youth. Part-time work can of course be seen as a desirable development of the labour market as long as it responds to workers preferences and desire to better reconcile work and family life (DK, LU, the NL, AT and the UK). However, 21.6% of part-time work (or 4.2% of total number of employees) is involuntary in the EU, and can be considered as a form of under-employment. This phenomenon has increased overall (+ 4.4 percentage points since 2000), and for all categories of workers. In particular, in 2008 involuntary part-time represented a significant share of total female employment in Spain (8%), France and Germany (9%), Italy (10%) and Sweden (11%).

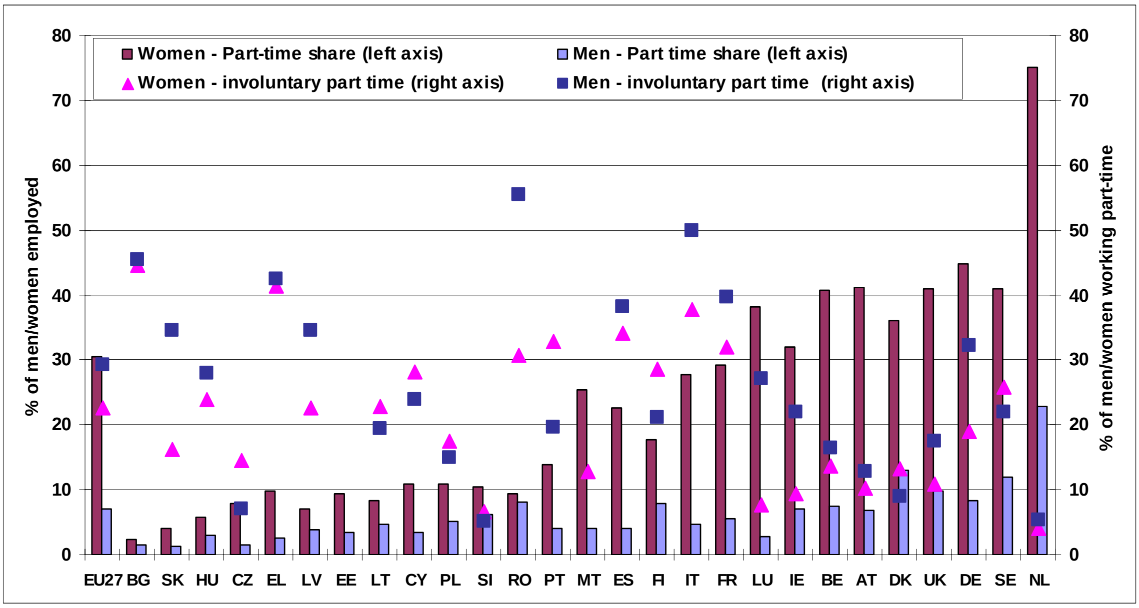
---

[35] Global Wage Report 2008/09: Minimum wages and collective bargaining: Towards policy coherence; http://www.ilo.org/global/What_we_do/Publications/lang--en/docName--WCMS_100786/index.htm

[36] Detailed data is available for 11 EU countries in the ILO report on page 96 (see above): CZ, DK, DE, IE, FR, HU, NL, PL, FI, SE, UK

[37] Indeed, the poverty risk of people working part-time or on temporary contracts is much lower than the poverty risk of the unemployed (see Figure 3.1).

Figure 3.3: EU 27- Part-time employees as a percentage of the total number of employees and share of part-time that is involuntary; by sex; 2008 (%)



Source: LFS 2008

Temporary employment represented 14% of total employment in 2008 in the EU27, and it has significantly increased since 2000 (12.2%). This increase concerned all categories of workers, and especially the youth since in 2007, 40% of people aged 15-24 were employed on a short term contract (against 35% in 2000). Temporary employment exceeds 20% in PT (23%), PL (27%) and ES (29%), but concerns less than 5% of employees in the Baltic States, Romania, Bulgaria, Malta and Slovakia. As highlighted in section 2 of this report (point 2.1.2), the INEQ project also shows evidence of net and gross **wage gaps** between temporary workers and workers with permanent contracts.

Table 3.1: EU 27- Temporary employees as a percentage of the total number of employees for a given sex and age group; 2000-2008 (%)

EU27	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total	12.2	12.5	12.4	12.6	13.2	14	14.4	14.5	14
Women	13	13.3	13.3	13.4	13.9	14.5	15	15.2	14.9
15 to 24	35.2	35.9	35.8	36.4	37.7	40.2	40.7	41.1	40
25 to 49	9.7	10	10	10.4	11.1	11.8	12.3	12.3	12
50+	6.4	6.4	6.4	6.3	6.4	6.7	7	7.1	7

Source: LFS

There is little evidence on **whether low paid or precarious jobs are stepping stones towards better jobs**. An in-depth analysis of labour market transitions calculated on the basis of EU-SILC can shed some light on this issue[38]. First results show that the chances to move from a temporary contract to a permanent job are much higher in some countries than in others. For instance between 2005 and 2006, the share of temporary employees that moved to a permanent contract was less than 25% in EL, FR, the NL, PT and IT while it was over 45% in EE, LV, LU, HU, SI, SK and the UK. As expected, in all EU countries the chances for employees on short term contracts to become unemployed or

[38] 3 Indicators of labour market transitions calculated on the basis of EU-SILC have been adopted by the Employment Committee in March 09. Data are available at (indicator 17.A4, p34; 18.A8, p61; 21.M1 p.115): http://ec.europa.eu/social/BlobServlet?docId=115&langId=en

inactive are also much greater (2 to 4 times) than for employees on permanent contracts. Concerning workers entering the labour market at a low pay level, between 2005 and 2006, the share of workers in the first earnings decile moving up to a higher decile[39] ranged from around 20% in Greece and Portugal to more than 50% in Spain, Slovenia and Slovakia. Low paid workers are also among those that are most likely to become out of work. Between 2005 and 2006, the share of first decile workers who became non-employed exceeded 20% in CZ, DK, DE, LV, HU, SE and the UK.

Taken together, these figures point to the existence of groups of workers, often young, and/or low skilled, and/or women[40], who tend to remain at the margins of the labour market as they encounter difficulties accessing stable and gainful jobs. In paragraph 3.4 of this report, we analyse whether the **most vulnerable workers** benefit from sufficient support through social protection and activation policies, and in particular to evaluate whether they **have effective access to skill upgrading schemes**.

Employment growth has been mainly driven by an increase of female labour market participation and to a certain extent by the prolonged working life of older workers. **Several characteristics of female labour force participation impact on the distribution of yearly earnings: skill levels, sector of activity, number of hours worked, and the gender pay gap**. A large share of women entered the labour market as second earners and thereby improved the income situation of households already at work. However, in many countries the women who are furthest away from the labour market (lone mothers, the low skilled, etc) still face important barriers to find a job due to lack of childcare or of care for other dependants, or lack of reconciliation measures. They also often have difficulties to find a job that pays because of involuntary part-time, and the combined effect of high marginal effective tax rates and high cost of childcare (see section 3.4).

3.2.2. In-work poverty: when a job does not provide decent income for the household

The distribution of individual yearly earnings can mainly be explain by the individual characteristics of the workers and labour market features such as those reviewed above. However, **in-work poverty** relates to the situation of people that are employed, but still live, together with the other members of their households, under the poverty threshold. In-work poverty is both linked to the individual's labour market situation (such as low pay, low skills, precarious employment and often involuntary part-time working), ant to low work intensity (i.e. too few adults working or working only a few months during the year). As illustrated in Figure 3.4 below, the risk of poverty of people employed depends on the total amount of work performed by the adult members of the households in age of working. In all households with **a work intensity below 0.5**, i.e. adults in the households realise less than half of their working potential, the risk of poverty is significantly higher. However, the risk of poverty of single earner households (work intensity=0.5) strongly depends on the presence of children in the households. In the absence of children, the

---

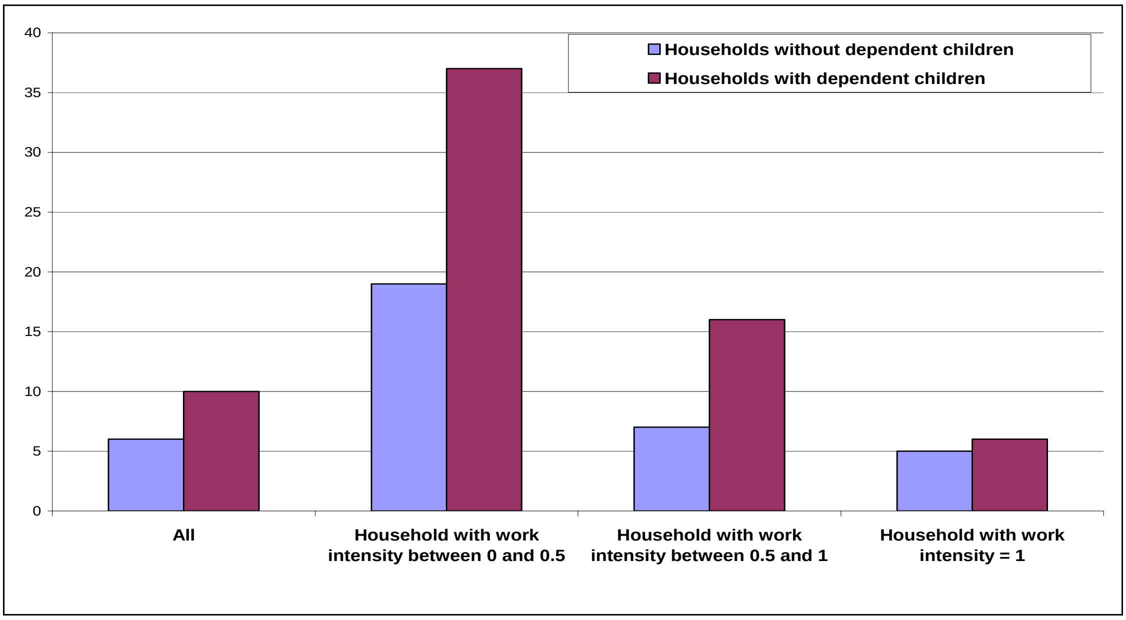
[39] The upward mobility of workers crucially depends on the age of workers since young workers are more likely to be mobile and move up the ladder than older workers. In all countries, the proportion of young workers among low wage earners and among temporary workers is high. However, this proportion varies across countries and might explain part of the differences in the results on LM transitions.

[40] The supporting document notably highlights the specific situation of the young and of women in this respect.

risk of poverty of households with several working age adults but only 1 earner is not significantly increased (7% against 6%).

On average in the EU, the in-work poverty rate of employed people is 10% if they live in households with children, against 6% if there are no children. The impact of children is only mitigated in households that realise their full "working potential". When all working age adults in the household work over the whole year (work intensity=1), the risk of poverty of workers is 5% in households with children and 6% in household without children. On the contrary, when one of the adults in the households do not work, or only works part of the time, the respective in-work poverty risks increase to 7% households without children and 16% in households with children. Finally, as expected, workers living in households with very low work intensity (below 0.5) face very high risks of poverty.

Figure 3.4: EU 25- In-work poverty risk of employed people by type of household and work intensity of the household; 2007 (%)



Source: EU-SILC 2007

Low work intensity especially plays a role in **households with children** where the single-earner family model is not sufficient anymore to ward off the risk of poverty. The SPC report on "child poverty and child well-being"[41] showed that among children living with both parents, when both are working, children face a 7% risk of poverty on average, compared with 27% for children with only one of their two parents at work (and working full-time). The risk of poverty for children in single-earner families ranges from 11-16% in DK, DE, IE, FI and SE to 30% or more in EL, ES, IT, LT, LV, PL, PT, RO, and SI. Similarly, children living in a lone parent family face a very high risk of poverty of 37%, but it is much lower (18%) if the parent works full-time. The capacity of parents to participate in the labour market depends both on policies that support parental employment (especially mothers' employment) and the reconciliation of work and family life and on the availability and affordability of enabling services (e.g. child care).

[41] See "Child poverty and Well-being in the EU, current status and way forward", 2008, Table A14a p.166 (couple with children). See also Joint Report 2008, Supporting document, p.12-13

3.3. Focus on the most excluded from the labour market

This part of the report aims at understanding whether the jobs created went to job rich or job poor households, and whether job creation worked in favour of those furthest away from the labour market (long-term unemployed, migrants, disabled, older workers), thus improving social cohesion. Did the job created help reducing the number of long-term unemployed and the number of people living in jobless households? Are the employment gaps of the most vulnerable groups (e.g. the migrants and ethnic minorities, the low skilled, the disabled) persisting? Did all categories of older workers prolong their working lives? Developments in disparities of regional employment rates will also be used to explore the territorial distribution of employment growth.

3.3.1. Long-term unemployment was significantly reduced, but to a lesser extent for older workers and the low skilled

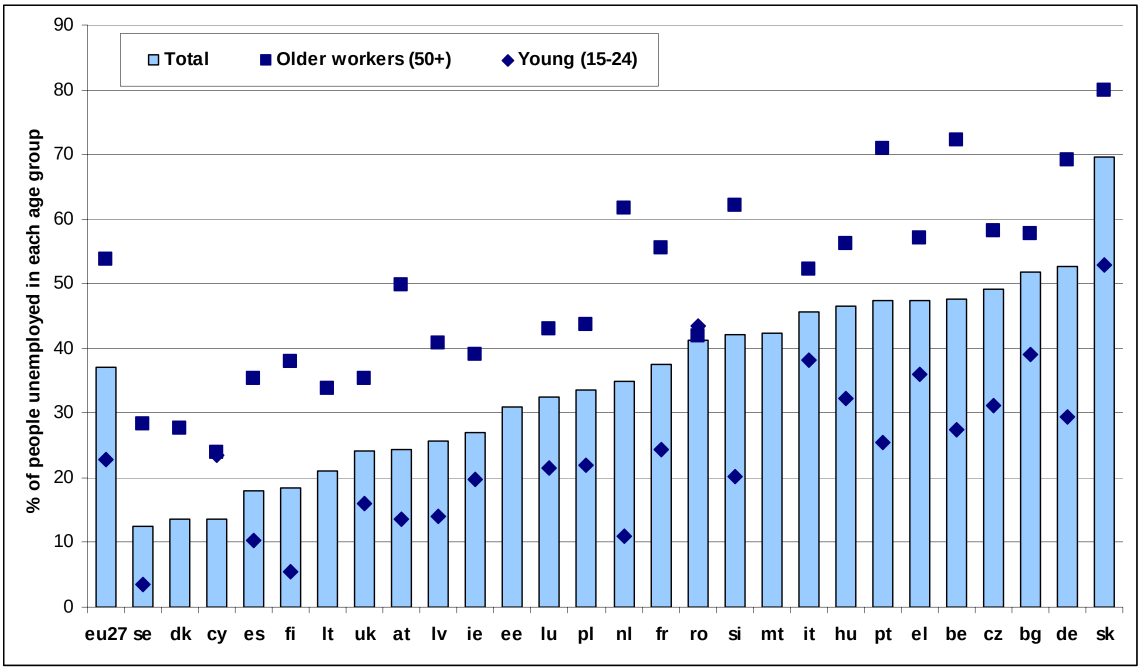
Among all the different types of joblessness, long-term unemployment is certainly one clearly associated with social distress. Long-term unemployment[42] represents a significant loss of income for the individuals concerned, who also tend to lose their skills and the self-esteem necessary to regain a foothold in the labour market, unless appropriate and timely support is provided. In 2007, **long-term unemployment** was down to 3.1% of the active population as against 4.2% in 2004, when it reached its highest level since the launch of the Lisbon Strategy. Across Member States, the share of long-term unemployed among the unemployed varies markedly from less than 15 % in SE, DK, and CY to more than 50% in BG, DE and SK.

Overall, unemployment rates decreased significantly for all age groups since 2000. However, in all countries, the long term unemployment share is much higher for **older workers** than for the young and until recently there was no significant decline in the LTU share of older workers: in 2007, it was still 60% against 59% in 2000, and the recent drop to 54% in 2008 can mainly be attributed to the impact of the crisis[43]. Figure 3.6 (drawn from Employment in Europe 2009) also shows that the overall reduction in the long-term unemployment share was mainly driven by a decline of the LTU share among workers with higher education that started in 1998, while **it remained stable for workers with lower levels of education**. This trend is consistent with the figures highlighted in section 3.4 which show that the participation in Life Long Learning of the low and medium skilled is much lower than the participation of high skilled workers.

[42] Long-term unemployment is defined as the total long-term (over 12 months) unemployed population (ILO definition) as a proportion of the total active population aged 15 years or more.

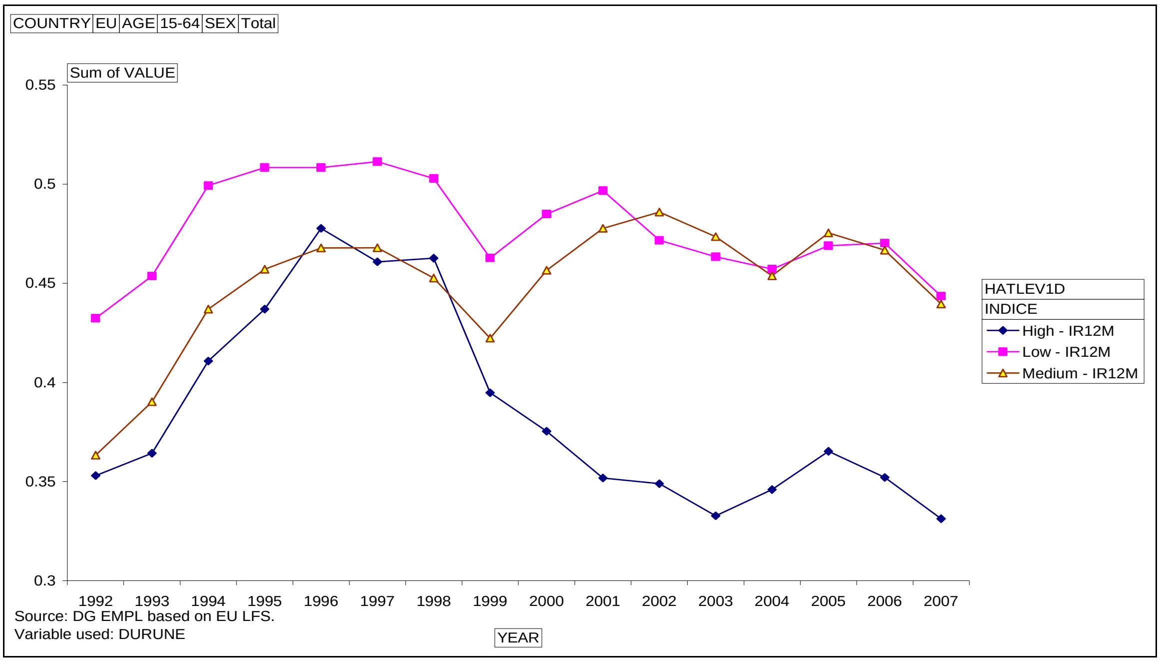
[43] Large in-flows of new unemployed reduces mechanically the LTU share in the short term.

Figure 3.5: EU 27- Long-term unemployment share: percentage of the unemployed that have been unemployed for more than 12 months; by age, 2008 (%)



Source: LFS 2008

Figure 3.6: EU - Long-term unemployment share by level of education, 1992 2007 (%)



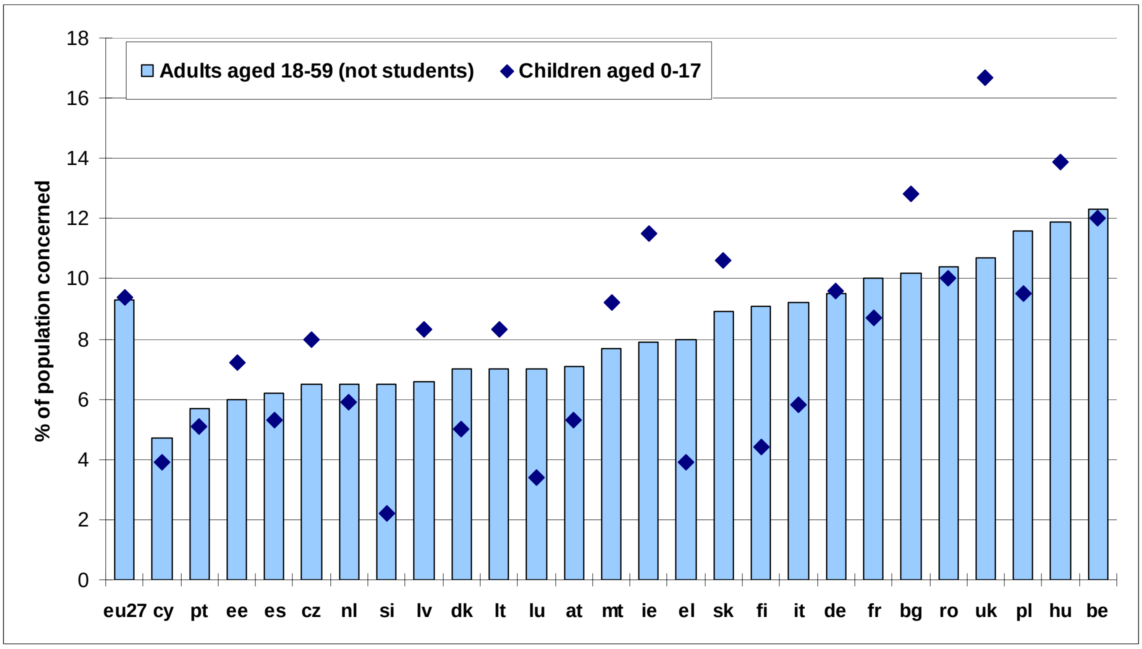
Source: Employment in Europe 2009 - Calculation by DG EMPL based on LFS

3.3.2. Nearly 10% of people still live in jobless households

However, joblessness not only affects the unemployed. It also affects the household members who depend on their income, and the impact of joblessness is most severe when nobody works in the household. In the EU-27 in 2007, despite the recent improvements observed, the share of people living in **jobless households** remained high at 9.3% for adults of working age and 9.4% for children. Joblessness is one of the main factors of poverty and exclusion. It concerns 19 million adults in the EU, among whom 23% are single adults, 10% lone parents, and 2/3 share the household with other adults who are also out-of-work[44]. The percentage of adults living in jobless households varies from 5% in CY to 13% in Belgium. While precise poverty rates cannot be calculated for this population, it is estimated that adults living in jobless households face a risk of poverty of 30% when there are no children in the household, and 60% when there are children[45].

It also concerns more than 7 million children, or 9.4% who still lived in jobless households in 2007. Variations across Member States are more marked, ranging from 2.5% in SI to 16.7% in the UK. Children living in jobless households not only suffer from a lack of resources: the absence of a working adult in the household can also affect their educational and future labour market outcomes due to the lack of a role model.

Figure 3.7: Adults (aged 18-59 and not students) and children (0-17) living in jobless households; 2007 — %



Source: Labour Force Survey (2007) — spring results; detailed household data missing for SE

3.3.3. Little progress in reducing the employment gap of migrant workers

In 2008, the **overall employment gap[46] for migrants born outside the EU had slightly increased to** 4.9 percentage points (against 4.5 p.p. in 2005). This slight increase masks very divergent trends across the EU. In countries of recent migration, the employment rates of people born outside the EU are higher than for the native-born population. In

---

[44] According to the LFS, it is estimated that 42% of adults in jobless households share their household with at least another adult (also out of work) but with no children and that 24.5% share their household with at least another adult (also out of work) and with children.

[45] The at-risk-of-poverty rates quoted here refer to a definition of joblessness that is stricter than the definition used in the indicator for people living in jobless households based on the LFS survey. According to the LFS definition, people are defined as jobless if they did not work in the last 4 weeks, whereas for calculating the poverty rate, people who have not worked over a period of 12 months are considered. Further analysis of the impact of joblessness and low work intensity is presented in chapter 3 on social inclusion.

[46] The employment gap of migrants is defined as the difference in percentage points between the employment rates of people born in the host country and of people born outside the EU. See data in EMCO indicators compendium (p. 77): http://ec.europa.eu/social/BlobServlet?docId=115&langId=en

long-standing host countries (BE, DK, DE, FR, NL, AT SE and the UK), migrants have much lower employment rates than the host population with a gap ranging from 7.6 pp in FR to 21pp in DE. In all these countries the gap remained stable or was slightly reduced between 2005 and 2008.

The employment gap for migrants depends on a number of factors, including the composition of the migrant population by age, skills level, household composition, and numbers of years spent in the host country. It also depends on the main motives for migration (family reunion, economic, humanitarian, etc), which vary considerably across the EU[47]. EU Member States have agreed to mainstream the social aspects of migration within their social inclusion and social protection policies. This is to take account of the multiple dimensions of the integration of migrants, who often face several exclusion factors simultaneously, including a higher risk of poverty and barriers in access to housing, health care or education for their children.

3.3.4. Regional disparities in employment rates were reduced, but overall regional development does not automatically lead to the reduction of poverty

The regional dispersion of employment rates across the EU has been reduced from a standard deviation of 13 in 2000 to 11.1 in 2007. This overall trend is further confirmed by the drop in the number of under performing regions. In 2007, 23 out of 268 NUTS-II regions recorded employment rates below 90% of the national average against 28 in 2005[48]. This overall progress in employment rates is partly mitigated by the persisting incidence of informal work of different forms (from subsistence agriculture to tax evasion…) in some of the poorest regions of EU[49]. In addition, a Commission working paper[50] presenting empirical evidence on regional convergence shows that, overall, poor regions of the EU-27 have been catching-up on richer regions in the last ten years, in terms of GDP/capita. However, during the same period disparities have diminished among countries (mainly the New Member States), but have increased within countries.

3.4. Some progress in supporting the labour market integration of the most excluded, but concerns remain on the effectiveness of safety nets

As already highlighted, several policy guidelines[51] embedded in the Lisbon strategy are meant to address labour market segmentation, the persistence of in-work poverty and exclusion from the labour market. On the basis of indicators identified by the Employment Committee and the SPC, as well as relevant literature, this chapter reviews the progress made by Member States in several areas with a focus on workers that are further away from the labour market. Notably, we focus on the extent to which the most vulnerable have benefited from active labour market policies; if they had an effective

[47] A detailed analysis of the labour market situation of migrants is available in 'Employment in Europe 2008': http://ec.europa.eu/social/main.jsp?langId=en&catId=113&newsId=415&furtherNews=yes

[48] See data EMCO indicators compendium (pages. 28 and 36): http://ec.europa.eu/social/BlobServlet?docId=115&langId=en

[49] See a review of 4 EU countries (PL, HU, CZ, SK) in OECD Employment Outlook 2008.Another OECD report estimates that informal employment represents between 20% and 50% of total employment in Romania, depending on the definition used: http://www.oecd.org/dataoecd/19/13/41012694.pdf

[50] "Regional convergence, growth and interpersonal inequalities across the EU" Philippe Montfort, DG REGIO, January 2009

[51] Notably guidelines 19 "inclusive labour markets" and 23 "Expand and Improve human capital"

access to life long learning, if progress has been made to reduce financial disincentives to work for people with low wages and for those with family responsibilities, whilst ensuring adequate levels of social protection.

3.4.1. Some progress in measures to support labour market integration

A number of policy tools are promoted in the context of the Lisbon Strategy to support greater labour market participation among the inactive and the unemployed and help low wage workers getting better jobs.

Participation in **life long learning** has improved overall in the EU27 from 7.1% of the people aged 25-64 in 2000 to 9.6% in 2008. However, great disparities remain across countries with participation rates among the 25-64 varying from 3% or less in RO, BG, HU and EL to more than 30% in DK and SE. The participation rates of the unemployed have increased but still stood at 8.5% 2008. After an increase in the early 2000, participation rates of the inactive stagnated and stood at 6.9% in 2008. The main issue of concern is **the very low rates and slow progress in the participation of low skilled workers** which stood at 3.8% in 2008 (against 2.8% in 2000). Furthermore, the percentage of early school leavers was still high at 15.2% in 2007 in the EU, against 17.2% in 2000. This overall progress hides the poor performance of a number of countries like BE, DK, DE, EE, ES, FR, AT and SK where no or very little progress was made.

Labour Market Policy expenditure decreased from 0.51% of GDP to 0.47% between 2005 and 2007, partly reflecting declining unemployment rates. LMP expenditure per person wanting to work has also stagnated during the period. In the mean time there was a slight shift from spending on passive measures to spending on active measures[52]. Spending on active measures per person wanting to work have increased from 1472 PPS in 2005 to 1739 PPS in 2007, while spending on "passive" measures per person wanting to work declined from 3931 PPS to 3770 PPS in 2007. The decline was mainly driven by the decline in income replacement spending, while spending on early retirement measures (8% of total passive spending) was not reduced. Further analysis would be needed to identify the factors behind the relative decrease in income maintenance spending (changes in the design of benefits, reduced benefits, etc). (See point 3.4.2)

The lack of enabling services has also been identified as an obstacle to participation in the labour market, especially for women with care responsibilities. It is also a compounding factor of child poverty. Efforts of Member States for increasing **child care provision** has helped increasing the number of children cared for in formal arrangements from 25% in 2005 to 30% in 2007 for children below 2 years. Very large differences persist between Member States, with rates ranging from 2% in CZ, PL and SK to more than 40% in BE, DK, NL and SE. In many countries the provision of childcare is mainly on a part-time basis which can hamper participation for lone parents especially. Furthermore, in the same period the share of persons with care responsibilities declaring that they are inactive or working part-time due to a lack of care services has increased from 26.7% in 2006 to 29.8% in 2008.

---

[52] "Passive measures" include income support (8) and early retirement schemes (9); "Active measures" include Training (2), Job rotation and job sharing (3), Employment incentives (4), Supported employment and rehabilitation (5), Direct job creation (6) and Start-up incentives (7)

A large number of evaluation studies were conducted in the last years to evaluate the activation policies put in place by Member Sates since the mid 90s[53]. Most macro-econometric studies found that ALMP spending tend to speed re-employment for unemployment benefit recipients and other jobseekers[54]. Such studies have also found evidence for interaction between ALMP spending and other policies. Notably, the OECD finds that that sanctions and better administration rules can also play a role, and that disincentive effects of long benefit duration are stronger than those of high replacement rates. Bassanini and Duval (2006) also find that the impact of higher unemployment benefits in raising unemployment is significantly mitigated by higher ALMP spending. This is consistent with the argument that the effective integration of the provision of ALMPs with the administration of unemployment benefits can offset part of their disincentive effects. Another interesting finding is that the aggregate unemployment rate rises less strongly in response to an adverse macroeconomic shock when ALMP spending is higher.

Microeconomic studies have recently expanded the evidence about what works and for whom. They show that the returns to different programmes vary widely and that similar programmes can yield very different outcomes, implying that the design of programmes is key. A more extensive review of the variable impact of activation policies on different sub-groups of the population is available in the supporting document. Figure 3.8 presents simple correlations between unemployment and the main policies and institutions that are supposed to impact on unemployment. High unemployment benefits, higher tax wedges, differences in Product Market Regulation and ALMPs expenditures appear to be significantly correlated with unemployment, while correlations are not significant in the case of EPL and union density.

In the case of Employment Protection Legislation, the OECD[55] notes that while the net impact of EPL on aggregate unemployment is ambiguous, there appears to be negative link between strict EPL and the employment rate of youth and prime-age women, therefore suggesting that strictness of legislation acts as a barrier to the first entry on the labour market. Moreover, differences in the strictness of EPL for regular and temporary jobs may be an important element in explaining the rise in the incidence of temporary work for youth and the low skilled.

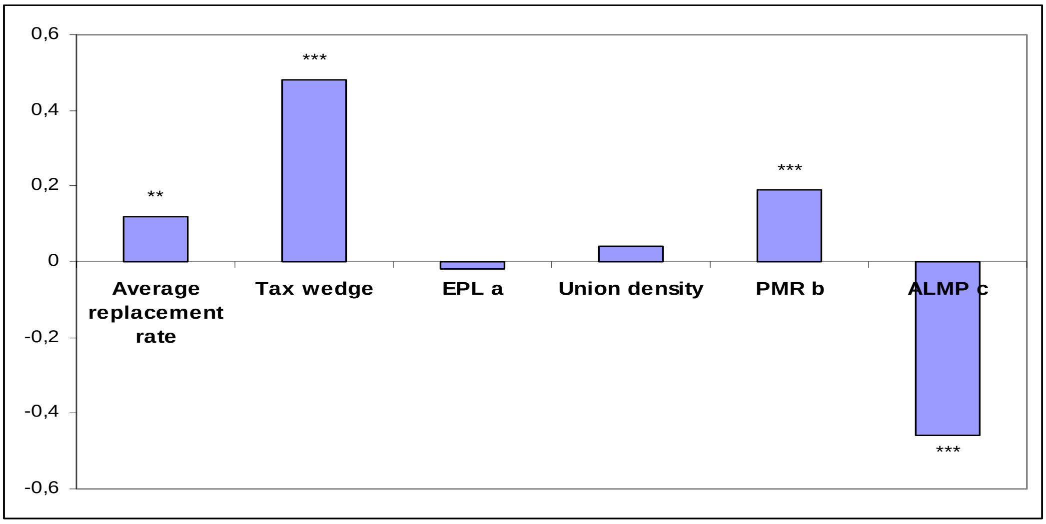
---

[53] The OECD 2006 assessment of the jobs strategy notably highlighted that disincentive effects of long benefit duration are stronger than those of high replacement rates; disincentives have a higher impact on some categories of workers. Disincentive effects can be off-set by "sanctions", better benefit administration rules and spending on active LMP. Long-term rises in non-unemployment benefit dependency has not reversed despite gains in employment, and in some countries, transfers into disability benefits should be monitored…

[54] However, these estimates are subject to the important caveat that they may reflect simultaneity bias, rather than a causal effect.

[55] OECD Employment report 2004

Figure 3.8: Correlations between unemployment and the main policies and institutions Variables purged from both country and time fixed effects, 1982-2003



Source: OECD estimates. ALMP: Active labour market programmes. EPL: Employment protection legislation. PMR: Product market regulation.
***, **, *, statistically significant at 1%, 5% and 10% levels, respectively.

3.4.2. Significant efforts to reduce financial disincentives to work, but concerns remain on the effectiveness of safety nets

One of the key areas of reform aimed at attracting more people in the labour market is to ensure that work pays and that the underlying incentive structure in the tax and benefit systems is supportive to employment. The concern is to reduce reliance on social protection and increase self-sufficiency by supporting labour market participation and "making work pay", that which is, making work an economically attractive option relative to welfare. While of interest from a work incentive perspective, the design of welfare and tax systems is also crucial from a social inclusion perspective. In reviewing tax and benefit systems, Member States also need to make sure that social transfers and income support schemes for those who remain out of the labour market are effective in relieving poverty. Balancing the two goals of increasing labour supply incentives and at the same time alleviating poverty is a challenge for policy-makers, who also have to take account of the budgetary costs that any tax and benefit reform may involve.

In February 2009, the European Commission produced a full assessment of the tax-benefit reforms aimed at making-work-pay[56], based on key indicators of financial incentives to work. Three different types of transitions are considered through the analysis of the **unemployment trap**, the inactivity **trap** and the **low wage trap**. These three indicators are agreed OMC context information [57] and are defined as marginal effective tax rates measuring the part of the additional gross wage that is taxed away in the form of increased taxes and withdrawn benefits, when the unemployed or the inactive take up a job, or when a low wage worker decides to work more.

---

[56] *Recent reforms of the tax and benefit systems in the framework of flexicurity*; European Economy Occasional papers 43, Feb 2009: http://ec.europa.eu/economy_finance/publications/publication14173_en.pdf

[57] An extensive analysis of financial incentives to work from a social inclusion perspective was published in the context of social OMC in chapter III of the technical annex to the Joint Report 2006. See: http://ec.europa.eu/employment_social/spsi/docs/social_inclusion/2006/sec2006_523_en.pdf

It has to be highlighted here that these indicators are based on typical cases whose representativeness vary across countries and on common assumptions that might not capture the nuances of Member States systems. Furthermore, we do not attempt here to evaluate the extent to which potential traps are actual ones. It is however worth mentioning that the elasticity of labour supply to changes in the tax and benefit systems appears to vary between Member States and across different population groups depending on a multitude of factors ranging from the availability and accessibility of services to the conditions of national and local labour markets. Thus, financial incentives, as measured by the trap indicators, only partly explain labour market outcomes.

The main findings of the February 2009 report are summarised below.

The main policy tools that Member States have used to lower these traps were mainly focused on low wage workers. They include reducing the tax wedge (direct labour taxation + social security contributions) on lower wages, increasing minimum wages, reducing the level or duration of unemployment benefits, introducing in-work benefits, and reviewing the design of out-of-work benefits (social assistance, child/family benefits, housing benefits, disability schemes). Indeed, important features of the reforms of benefits do not impact directly on the financial incentives but are instrumental in encouraging the return to work of the unemployed and the inactive. These include eligibility and work-availability conditions, participation in activation measures and effective enforcement of the system. While some of these tools have no impact on benefit adequacy (in-work benefits, lower the tax wedge, increased minimum wage), others may affect adequacy and lead to poverty and exclusion if the return to work is not effective or durable. **Active inclusion strategies** that are put in place in Member States could contribute to ensuring this balance.

As illustrated in table 2, between 2001 and 2007, the largest reductions in the **unemployment trap** have been achieved by France, the Slovak Republic, Finland, Sweden, Belgium and Denmark, for all types of households.. The introduction of in-work benefits contributed to these reductions in FR[58], SK, IE, and FI. Measures to reduce the tax wedge on low wages contributed to lower METRs in FR, FI, BE and PL. Increased earnings disregards helped reducing the financial disincentives to work in FR and FI. Reduction on social assistance and housing benefits were used in SK, where concerns over the adequacy of out-of work income support can be expressed as illustrated in the following paragraph.

The **inactivity trap** was also considerably reduced between 2001 and 2007 in a number of countries. In particular, for a one-earner couple with children the METR were reduced at a low wage level in France, Sweden, Austria, Spain, Finland, the Czech Republic and the Slovak Republic. The reduction is mainly due to changes in the social assistance scheme, followed by the introduction of in-work benefits (in Slovak Republic and Sweden) and changes in housing benefits (Austria). Targeted reductions in inactivity traps for certain family types were achieved also in **Hungary** (for a two-earner couple with and without children), the **UK** (for one-earner couple), **Italy** (for two-earner couple

---

[58] The French set of measures is especially comprehensive including increased earning disregards, in-work benefits and lower tax wedges on low wages. The new "Revenu de Solidarité Active" scheme that came into force on 1st July 2009 goes a step further by integrating a whole range of measures of in and out of work income support, activation and access to services into one scheme along the principles of active inclusion.

with and without children) and **Ireland** (for two-earner couple without children and single parents with children). These trends are confirmed when looking at the recent changes in $METR_{it}$ (2007), where reductions have been recorded in particular in **France, Latvia and Sweden**. A decline in the inactivity trap in France and in Latvia was driven by changes in the social assistance scheme and in Sweden by the introduction of in-work benefits.

The OECD report Benefits and Wages 2007[59], also based on these indicators, highlighted the specific impact of tax-benefits and childcare policies for work incentives. Both the availability and affordability of child care play a crucial role in allowing parents, especially of young children, to take-up a job. Lone parents with low prospective wages face the greatest disincentives to work. In some countries, high childcare costs have a strong compounding impact on financial disincentives (IE, SK, UK) for these parents, but inactivity traps deriving from the design of the tax-benefit system may also be a problem where childcare support is well developed. Child care costs can also be a powerful determinant of the net income gains in the case of second earners.

It has to be noted that the introduction of measures targeted at low wage earners such as in-work benefits and the reduction of the tax wedge on low wages, may create disincentive effects at a higher in the earnings distribution, and/or introduce a bias in the setting of wages. Such side effects can also impact on the long-term adequacy of social protection by lower contributions.

Concerns remain on the effectiveness of safety nets

Among the measures described above some are likely to have negative unintended effects. Increasing the conditionality of unemployment benefits is a way increasing incentives to take-up a job without lowering the level of benefits, but it may push people into social assistance schemes, if their efforts to find a job are unsuccessful. Lowering social assistance benefits will affect the adequacy of these schemes and undermine the individual capability to overcome dependency. It is therefore crucial to ensure both that proper mechanisms are put in place to prevent benefit dependency, and that those who have to rely on social assistance can afford a decent standard of living.

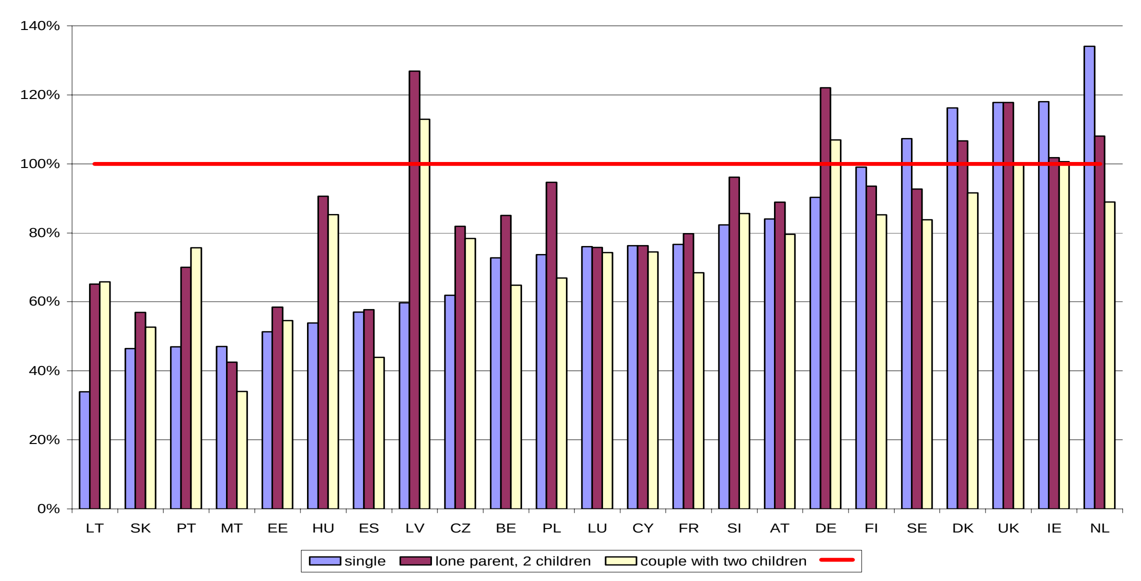
What is the financial situation of those who depend on a minimum income? Countries differ substantially in terms of the minimum safety nets they provide to workless households[60], even relative to the at-risk-of-poverty threshold, which depends on the living standards within each country (Figure 3.9). Only a few countries provide workless households with a minimum income and related (i.e. housing) benefits that are sufficient to lift them close to or above the 60% median income threshold, and this only for some family types.

---

[59] See related data in http://dx.doi.org/10.1787/141558047744

[60] This indicator reflects assumptions that households rely on social assistance benefits for the entire year, and that no other income stream (from other social protection benefits such as unemployment insurance or disability or from work) is available. This indicator based on a typical case is therefore not strictly comparable to the poverty threshold estimated on the basis of household survey data (EU-SILC). Concerning the UK, a specific and significant inconsistency between the SILC and the OECD model in the way they estimate housing benefits may explain the very high ratio for lone parents.

Figure 3.9: Net income of social assistance recipients — 2006 % of the at-risk-of-poverty threshold for 3 jobless family types, incl. housing benefits.



Only countries where non-categorical social assistance benefits are in place are considered.
Source: Joint EC-OECD project using OECD tax-benefit models, and Eurostat.

The adequacy of minimum safety nets is further affected by the fact that significant shares of people who are entitled to social assistance do not actually receive these benefits. Eligible individuals may not be aware of the existence of the programme, or their application may be unduly rejected (missing piece of information, errors in the evaluation by the administration, etc), or they may decide not to claim their benefits (because of administrative hurdles or by fear of being stigmatised). The interactions between entitlements at the individual and household level might also lead to partial non-take-up. A review of evidence carried out by the OECD[61] in 2004 shows that across the countries reviewed, take-up rates mainly vary between 40% and 80% in the case of social assistance and housing programmes[62].

Another issue concerns the social security coverage of atypical workers (defined as workers on part-time or temporary contracts) whose numbers have increased in the last decade. When becoming unemployed, temporary workers and part-time workers do not always benefit from the same level of protection than permanent workers, both in terms of eligibility and of level of benefits. A study conducted on behalf of the Commission[63] estimates that, on average in the EU, the coverage of unemployment benefits represented 90% of the coverage of permanent workers for temporary workers, and 86% for part-time workers. In BE, BG, LV, LT, PT, SI and SK it was below 60% for temporary workers.

---

61 See "Take-up of welfare benefits in OECD countries: A review of the evidence", OECD Social, Employment and Migration Working Papers No.17, 2004. See also latest evidence collected in the context of the AIM-AP project http://www.iser.essex.ac.uk/research/euromod/aim-ap-project

62 The UK is one of the only EU countries that regularly publishes take-up rates for income related benefits; see: http://www.dwp.gov.uk/asd/irb_0506_2.asp . In the UK, take up rates by households with children for income support schemes vary between 80% and 95%.

63 "Indicators on the coverage of certain social protection benefits for persons in flexible employment", Alphametrics Ltd

3.5. Concluding remarks:

Having a job remains the best safeguard against poverty and exclusion. However, recent employment increases have not sufficiently reached those furthest away from the labour market, and jobs have not always succeeded in lifting people out of poverty. Some groups still face specific hurdles such as poor access to training for the low skilled, lack of enabling services, or poor design of benefits that create financial disincentives. Labour market segmentation persists combined with a lack in job quality. The development of precarious forms of employment, often characterised by a strong gender dimension has contributed to persistently high levels of in-work poverty. Lessons need to be drawn from these facts when preventing that the crisis considerably aggravates persistent exclusion. Active inclusion strategies are not only crucial to support the most vulnerable in the crisis, but also to limit losses to human capital and preserve future growth potential.

While broader participation in the labour market generated overall benefits, employment growth did not always reach the most excluded and that the jobs created did not always provide for decent living standards. Despite the increased participation of women and older workers, at the outset of the crisis, about one third of the working age population in the EU was out of work (unemployed or inactive). Furthermore, under-employment and precarious forms of contracts mitigate the positive impact of including more people in the labour market.

A job is not always a guarantee against the risk of poverty and the **working poor** represent 1/3 of the working age adults at-risk of poverty. Since 2000, the development of temporary work, part-time work (including involuntary part-time) and sometimes stagnating wages have increased the number of individuals with low yearly earnings (especially among women and the young). For many of these workers, these jobs are not stepping stones towards better jobs. In-work poverty is also related to situations where there are too few adults working in the household, or where they are working too few hours or only part of the year. Single and lone parent households, as well as one-earner families face the highest risks of poverty.

The last decade has also seen the persistence of **groups of people that remain outside or at the margin of the labour market** (e.g. low skilled women, migrants and the young), often facing multiple barriers to enter the labour market (among which low skills, care responsibilities, age, migrant background, etc.). In 2007 in the EU27, 9.3% of adults in age of working were living in **jobless households** against 10.2% in 2001 and the crisis is likely to increase the number of families having to rely entirely on social benefits.

Some progress has been made in enhancing activation measures across EU countries, but more needs to be done to reach the most vulnerable, especially concerning **access to lifelong learning**. While some **progress has been made in reducing financial disincentives** to take up work or work more, **attention should be paid to the adequacy of benefits**, since the inadequacy of safety nets is not only a cause of poverty persistence, but also an obstacle to re-integration in the labour market and society. Financial disincentives are not the only barriers to labour market participation, **adequate and individualised support services play a key role**. In order to reach the most vulnerable, without necessarily increasing spending, the effectiveness of the measures described above can be reinforced if they are **integrated into active inclusion strategies.**

Table 3.2 - Structural Indicators on financial incentives to work, 2007

	Unemployment and welfare related benefits	Unemployment trap (67%)			Inactivity trap						Low-wage trap indicator						Net replacement rate		
		Single (67% of average wage)			Single (67% of average wage)			1 earner couple with 2 children (67% of average wage)			Single (33-67% of average wage)			1 earner couple with 2 children (average 33-67% of AW)			Single (67% of average wage)		
% of APW	Council's recommendation of Spring 2008*	2007	Change 2001-2007	Change 2006-2007	2007	Change 2001-2007	Change 2006-2007	2007	Change 2001-2007	Change 2006-2007	2007	Change 2001-2007	Change 2006-2007	2007	Change 2001-2007	Change 2006-2007	2007	Change 2001 2007	Change 2006 2007
BE		83	-2.3	0.1	66	0.1	0.9	66	-0.5	1.2	59	2.3	0.4	47	4.9	0.6	74	-8.9	0.1
DK		90	-1.7	-0.7	88	-1.9	-0.3	93	-2.5	-0.8	56	-3.3	-1.5	89	-4.5	-1.6	85	-2.0	-1.1
DE	CSR	74	-0.5	-1.2	66	0.4	-1.1	84	8.2	-1.0	57	3.9	-2.4	86	6.0	-2.2	59	-22.3	-1.4
GR	PTW	59	2.3	1.8	19	2.0	1.1	16	0.1	0.0	23	4.1	2.2	16	0.1	-0.6	49	-14.2	1.5
ES	PTW	82	1.7	1.3	44	1.6	0.3	52	-5.8	-0.8	26	1.2	-0.3	10	-18.0	-6.7	78	2.4	1.6
FR	PTW	60	-20.5	-20.8	44	-20.0	-17.5	60	-20.4	-20.7	42	-1.9	-0.6	64	-4.9	-0.8	70	-13.3	-5.1
IE	PTW	78	5.9	1.9	79	6.0	2.1	93	6.1	5.0	56	11.6	3.4	86	4.4	9.6	77	7.7	2.3
IT	PTW	72	12.5	0.2	22	2.2	0.2	-8	-0.4	-0.4	34	4.2	0.1	11	-0.6	1.0	64	14.5	0.1
LU		88	0.0	0.3	68	0.3	0.6	89	0.4	0.0	51	7.7	1.0	110	14.6	0.5	85	0.3	0.2
NL		81	1.9	-5.1	84	3.8	-0.8	92	4.7	3.9	57	-4.9	-2.6	78	-3.3	0.1	73	-6.8	-7.2
AT	PTW	68	0.6	0.2	64	-2.8	0.1	82	-6.9	1.5	38	3.1	0.8	65	-17.2	2.8	55	-12.7	0.0
PT		82	0.5	0.0	37	0.4	0.2	57	-0.1	-0.3	22	1.2	0.0	56	-1.5	-0.9	78	-7.9	0.0
FI	PTW	75	-5.4	-1.8	73	-4.3	0.9	92	-5.7	0.3	62	6.7	6.3	100	4.0	0.3	67	-7.0	-2.0
SE	PTW	82	-5.2	-4.8	73	-6.6	-4.0	90	-7.8	-4.7	47	-12.9	-7.8	80	-15.8	-8.1	76	-5.8	-5.5
UK		68	-0.6	-0.1	68	-0.6	-0.1	79	3.5	0.3	57	-0.9	-0.2	86	8.0	0.3	58	-6.0	-0.2
CY		61		-0.1	56		-0.9	104		-1.1	6		0.0	55		5.7	59		-0.1
CZ		72	4.7	8.5	66	3.5	13.3	85	-4.9	13.2	48	8.9	16.8	43	-38.6	-0.8	67	8.7	12.6
EE		63		-0.5	41		-0.2	55		2.8	24		-1.0	22		3.9	55		-0.9
HU		77	5.9	3.1	46	-4.5	3.1	59	1.6	-2.6	37	-4.6	4.7	37	9.1	4.7	73	7.9	2.6
LT	PTW	80		1.0	38		1.0	74		3.0	30		0.0	57		5.5	74		1.0
LV	PTW	86		-0.6	49		-3.4	77		-19.6	32		0.0	53		-37.5	82		-0.9
MT	CSR	62		0.0	62		0.0	69		-0.1	20		-1.3	24		0.9	59		0.2
PL	CSR and PTW	79	-1.5	-3.4	56	-4.1	-2.9	63	-3.8	-2.8	38	0.4	-3.0	72	-4.0	-4.1	70	2.5	-3.9
SK		54	-18.7	-0.5	28	-52.2	-0.4	38	-86.6	-0.3	23	-13.2	0.6	27	-93.0	0.7	61	-15.7	0.2
SI		81		-1.6	63		-1.5	83		-2.6	51		-0.6	62		-4.7	72		-2.3
RO		71	-5.6	10.0							30	1.9	-0.3	19	6.4	-0.3			
BG		74	-0.9	-2.7							16	-5.6	-4.2	19	-56.9	-4.2			

Source: Commission services, based on the joint EC-OECD METR project.

*Flexicurity related country-specific recommendations (CSR) and points to watch (PTW).

AT, IE, IT, LV, LT, PL, ES have PTW in the area of childcare (e.g. availability of childcare, childcare provision, childcare infrastructure, access to childcare). In case of EL, a broad reference to female participation is made without specifying expected policy measures. FI has a PTW that is referring to high structural unemployment; however, no explicit measure to address this issue is specified.

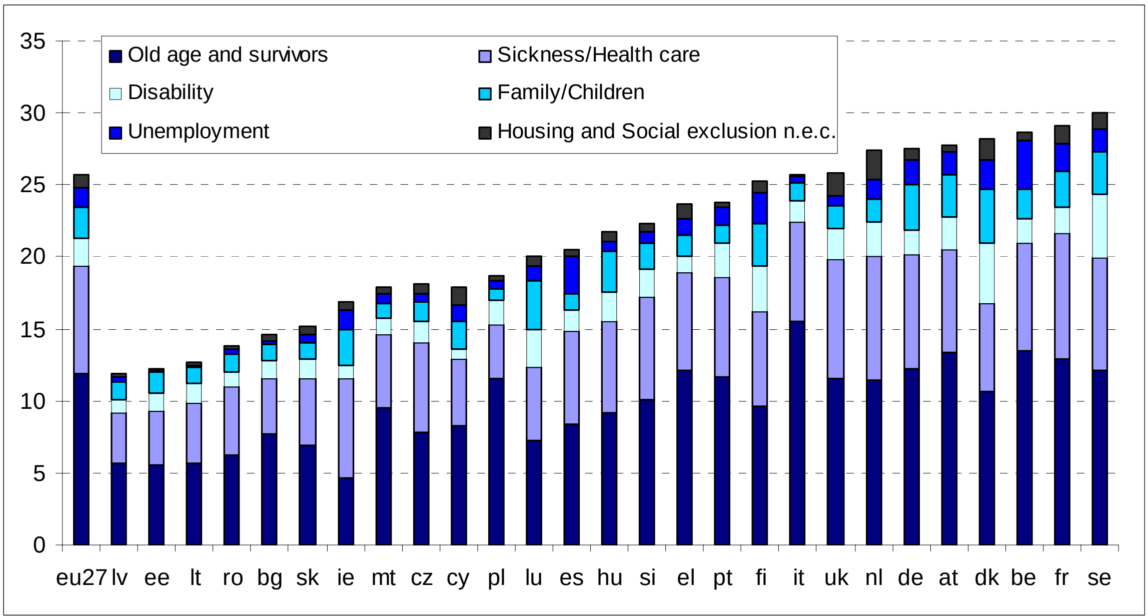
Source: Commission services. Unemployment trap and NRRs refer to the 1st month of unemployment

4. MODERNISING SOCIAL PROTECTION SYSTEMS TO PROMOTE GROWTH AND JOBS

4.1. The role of social protection in an ageing society

Social protection plays a redistributive role over the life-cycle and helps to cushion against poverty and to insure people against the financial implications of social risks. The extent to which these systems encourage social and active inclusion as the population ages has been a vital element in past reforms (please refer to section 2). Generally, richer countries spend a larger share of their GDP on social spending and economic growth has allowed many governments to devote more resources to social policy interventions.

Figure.4.1 Expenditure on social protection benefits, by function, in % of GDP — 2006



Source: Eurostat - ESSPROS 2006

The structure of social protection expenditure shows that old-age pensions and sickness and healthcare benefits represent the bulk of spending in all EU Member States. Figure 4.1 documents the wide diversity of social protection systems across Member States. Expenditure levels vary between about 12 and 30 percent of GDP. Naturally, how effectively resources are spent, how they relate to the size of the risk they need to address and how they are distributed are vital elements to consider over and above the level of spending. These commitments can be expected to grow in an ageing society, emphasizing the need for growth and an active labour market to sustain the expected costs.

The OMC has focused on these policy areas to analyse how well these systems serve their purpose and how their long term sustainability can be assured.

The following section on pensions and health and long term care carried out in the framework of the OMC focuses on:

- the adequacy and universality of protection,
- sustainability of systems,
- and the drivers that balance these two factors through modernisation.

This will also show how these two protection systems contribute to sustain growth and employment and how substantial progress on employment, both in terms of quantity and quality, are essential to achieve this balance between social adequacy and long-term sustainability.

4.2. Pension reform – progress in sustainability, emerging adequacy gaps and higher and better quality employment as an urgent need to improve balance between sustainability and adequacy

4.2.1. The main feature in pension reforms: tightening the link between work and benefits

The Social Protection Committee (SPC) has studied and analysed changes to pension systems from the early days of reform. One of the key results shows that over the last 15 years, reforms have tied pension entitlement more closely to contributory work years or directly to wages through the accumulation of contributions and the returns on their investment as a key solution to dealing with demographic ageing. Furthermore, remaining life expectancy at the age of retirement is more strongly linked to the benefit formula in several Member States. These reforms tighten the link between longer lives and longer working lives in the calculation of pension benefits, strengthening financial incentives for individuals to work more and longer. Furthermore, some Member States have reduced public debt rates, creating budgetary space to support the financing of aging when necessary.

4.2.2. Financial sustainability at the cost of adequacy?

Pensions represent by far the greatest item of expenditure of social protection (46 percent in 2006 in the EU). The projected future pressures from demographic ageing on the cost of pensions have instigated pension reforms in most Member States. Whiles demographic ageing without pension reform would lead to an increase in public pension expenditure by around 9 percentage points of EU GDP between 2007 and 2060; reforms of pension systems should curb this increase to only 2.4 percentage points, so that projected expenditure would reach 12.5% of GDP in 2060.

Two main consequences of reforms emerge. Firstly, the role of public pension benefits in overall pension provision would decline, though public pensions are expected to remain the major source of income for pensioners in all but a few Member States. Secondly, the eligibility for public pensions has been tightened, reducing the projected levels of pensions relative to wages if working lives are not prolonged.

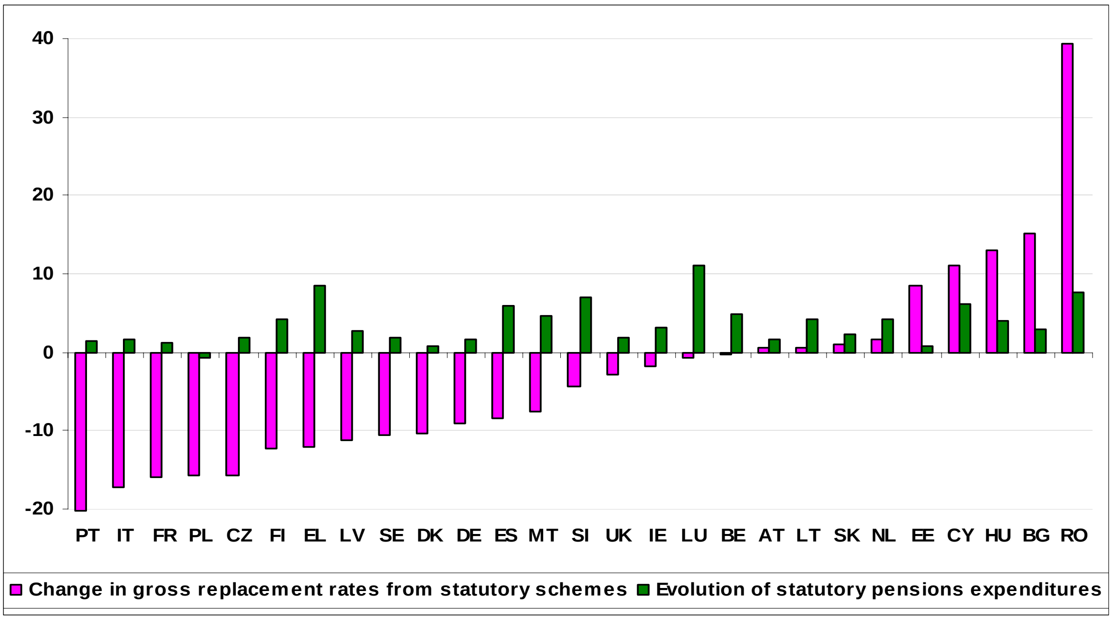
Recent analysis by the Ageing Working Group of the Economic Policy Committee (EPC) suggests that in the future, the ratio of average pensions from statutory schemes to average wages will decline substantially in a number of Member States. Furthermore, the report on "Updates of Current and prospective theoretical pension replacement rates 2006-2046" adopted by the July 2009 SPC looks at both the current and future adequacy of pensions in EU Member States[64].

Between 2006 and 2046 these are projected to drop on average by several percentage points, and some Member States record decreases of over ten percentage points at a fixed career

[64] The theoretical replacement rates measure the extent to which pension systems enable typical workers to preserve their previous living standard when moving from employment to retirement, reflecting pension levels relative to the last wages.

length (please see annex 1). This displays that at a given retirement age pension reforms have curbed the rising expenditure on pensions through a reduction in benefit levels.

Figure 4.2 Change in theoretical replacement rates for a worker retiring at 65 after 40 years, 2006-2046, and change in statutory pension expenditure, 2007 - 2045, % of GDP

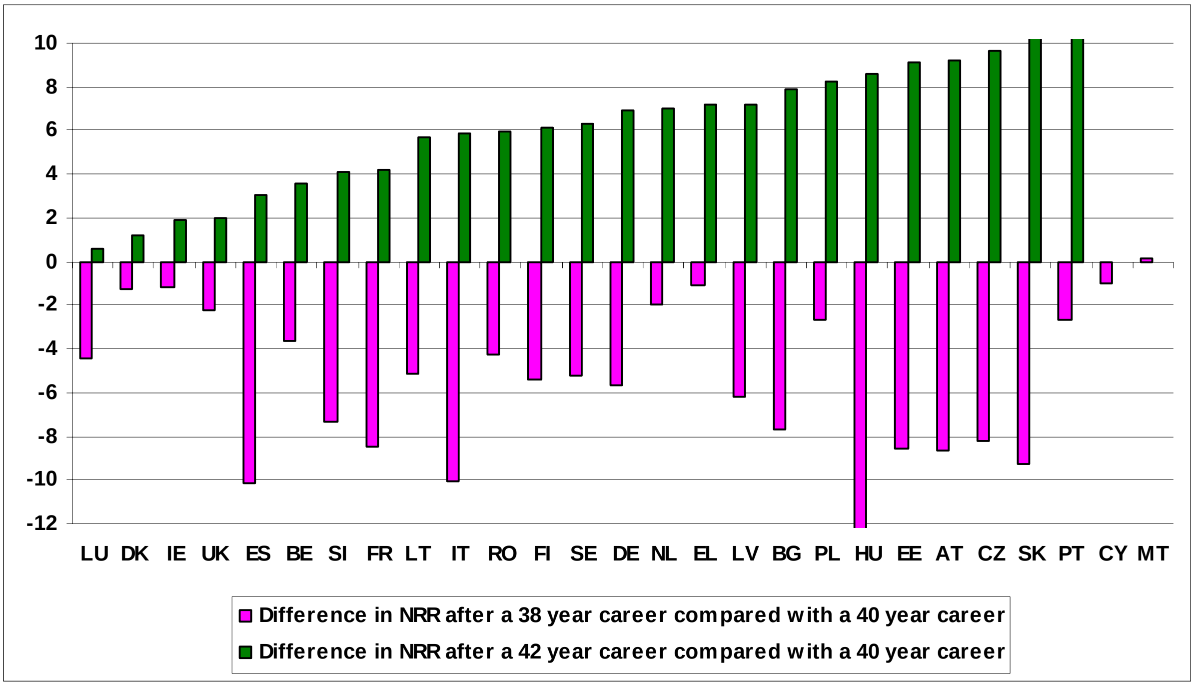


Source: SPC/ISG and EPC/AWG

4.2.3. Promoting working more and longer through pension reforms

Given longer lives, the negative impact of reforms on pension replacement rates could be offset by working longer. One of the main results of pension reforms has been to make a tighter connection between the time worked and the benefit paid out for the individual. For instance two additional years of contributions could raise a person's theoretical replacement rates in a majority of Member States.

Figure 4.3 Difference in net theoretical replacement rates for an average earner working until the age of 63 and 67 with 38 and 42 contributory years respectively as compared with working until the age of 65, 2044-2048, percentage points



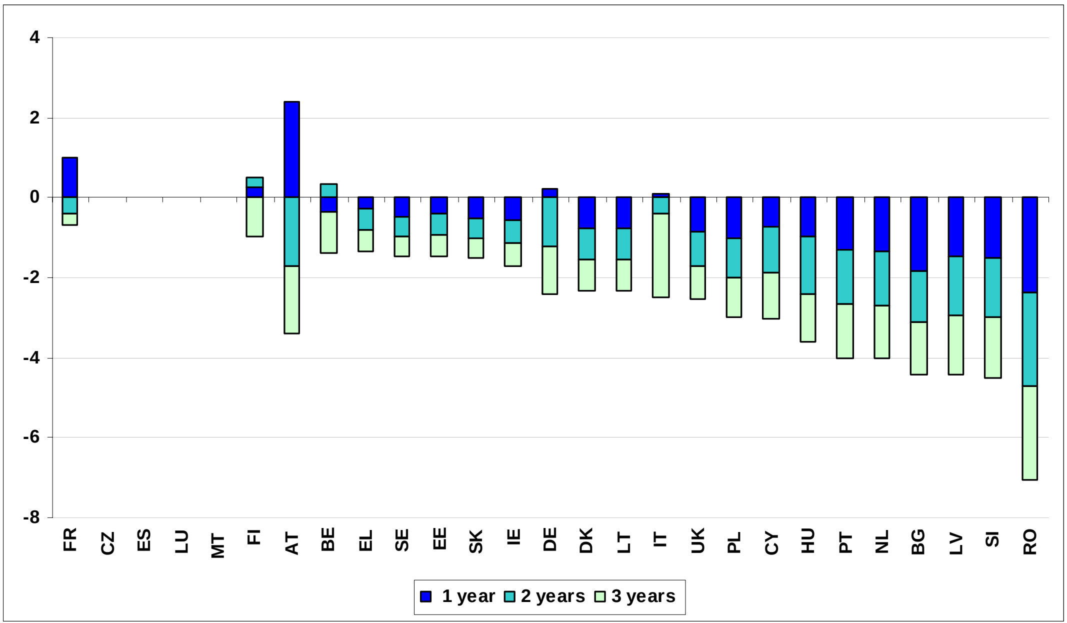
Source: SPC/ISG

4.2.4. … but we still need to protect the interests of other vulnerable groups on the labour market

Whiles increasing the individual financial incentives to prolong working lives in pension systems it is important to analyse the impact of these reforms on people unable to meet these conditions due to atypical career patterns. Future risk groups would include the low skilled, low waged women and men, individuals affected by long-term unemployment, disability or illness, men and women with caring duties and people excluded from pension coverage due to short term, temporary contracts or self-employed status. For such groups minimum income provision and minimum pensions play an important role in providing adequate living standards in old age. In many pension reforms these types of pension have been reinforced, although their impacts on work incentives need to be continuously monitored.

Income inequalities and wage gaps between employed men and women continue to persist. Whiles a main objective in reforms has been to continue to ensure adequacy in old age even for the most vulnerable, persisting labour market differences between men and women transmit into income inequalities in old age. In the EU 27, in 2007, the risk-of poverty rate for women over the age of 65 is 22 percent as compared with 16 percent for men. Part of the solution legislated by Member States to ensure that women have a decent retirement income has been equalising the pension eligibility ages for men and women. Furthermore, care burdens, which today are still mainly borne by women, and how they result in lower pension are monitored. An increasing number of countries are beginning to give pension entitlements for care-related absences from the labour market. At the same time, this is monitored together with the effects on work incentives in order to avoid that such protections become new dependency traps as caring years have a significant negative effect on women's long-term participation in the labour market in many Member States.

Figure 4.4 Accumulated difference in net theoretical replacement rates for an average earner entering the labour market at 25 and retiring at the statutory retirement age with a 1, 2 and 3 year career break for childcare compared with no break



Source: SPC/ISG

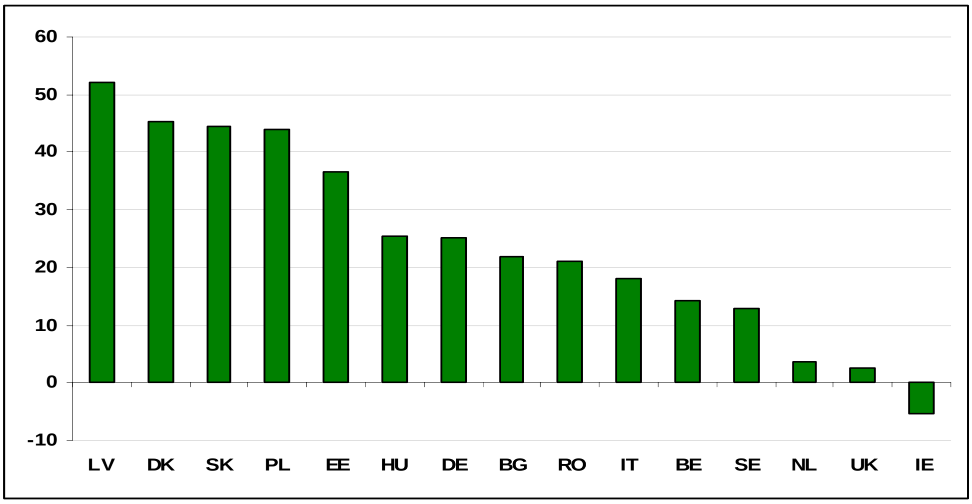
Note: the values for CZ, ES, LU and MT are equal to 0 and should not be interpreted as missing.

4.2.5. The increasing role of funded privately managed schemes: adequacy and risk

Calculations of theoretical replacement rates also show that the drop in pension adequacy is more pronounced in statutory pension systems than in private ones, although this is partly linked to a shift of contributions from statutory schemes to funded ones. Calculations of theoretical replacement rates show that nearly half of the EU Member States show double-digit percentage point declines between 2006 and 2046. By contrast, in privately managed pension schemes, future retirees are expected to accrue a higher proportion of their income from mandatory funded, occupational and/or supplementary pensions for those actually covered by these schemes. This however is also a reflection that these countries have a very low or no proportion of current retirement income from such schemes for average workers. Countries where private schemes have already been developed, such as the United Kingdom, The Netherlands, Sweden and Ireland show lower percentage increases for a typical average worker assumed to be covered by these schemes. Whiles this development increases savings and the pre-funding of future pensions it often also increases the risk and exposure of the individual to economic and financial volatility. Also as the importance of such schemes increases in overall pension income it is important to maintain that there is a high coverage of these schemes. This development needs, therefore, to be monitored in light of the growing maturity of these schemes.[65]

[65] *Updates of current and prospective theoretical pension replacement rates 2006-2046,* Social Protection Committee, July 2009.

Figure 4.5 Expected change in percentage of occupational and statutory funded schemes in total gross replacement rate in Member States with such schemes, 2006-2047, percentage points



Source: SPC/ISG

4.2.6. … The financial crisis has highlighted risks in privately managed schemes

In the wake of the financial crisis the Social Protection Committee adopted a report which tried to assess growing importance of funded pensions.[66] The report highlighted that as private pension schemes in the future will be increasingly used in more Member States to achieve the objectives of adequacy and sustainability, it has become essential to analyse the impact of their development on future pension levels.

Pension reforms in a number of Member States (or at the time candidate countries) were implemented in the period of high economic growth and boom in the stock markets. The boom made people believe that participation to funded schemes will considerably improve their income position during retirement. The financial crisis made visible that in some cases expectations of the long-term return rates of the funded pensions were excessively optimistic. Lower than expected pension funds results and lower risk adjusted rates of return will put a downward pressure on adequacy of pension income. This will be especially sensitive for the less well off who may be less able to absorb the inherent risks, bringing to light the need to further study the effects of these pensions for different socio-economic groups.

The SPC report underlines the need for better financial education. The report also stressed the importance of ensuring that investment frameworks for private pension schemes are designed in a solid prudential framework and to encourage informed choices and that the 'lifecycling' or 'lifestyling' of asset allocation is the mainstream option for everyone.

The appropriate coverage and contribution levels of private schemes depend on their role in the overall pension system. If they are a top-up to other universal retirement provision to ensure similar replacement rates for all, then coverage may only need to be targeted at certain segments of the population. However, if their role is as an essential component of retirement income for the whole population then coverage clearly needs to be very high and contribution

---

[66] *Privately managed funded pension provision and their contribution to adequate and sustainable pensions*, Social Protection Committee, 2008.

levels need to be sufficient. In the case of the latter and as funded provision forms an ever increasing share of total pension benefits, there is a role for the governments to ensure the long term pension adequacy from these schemes.

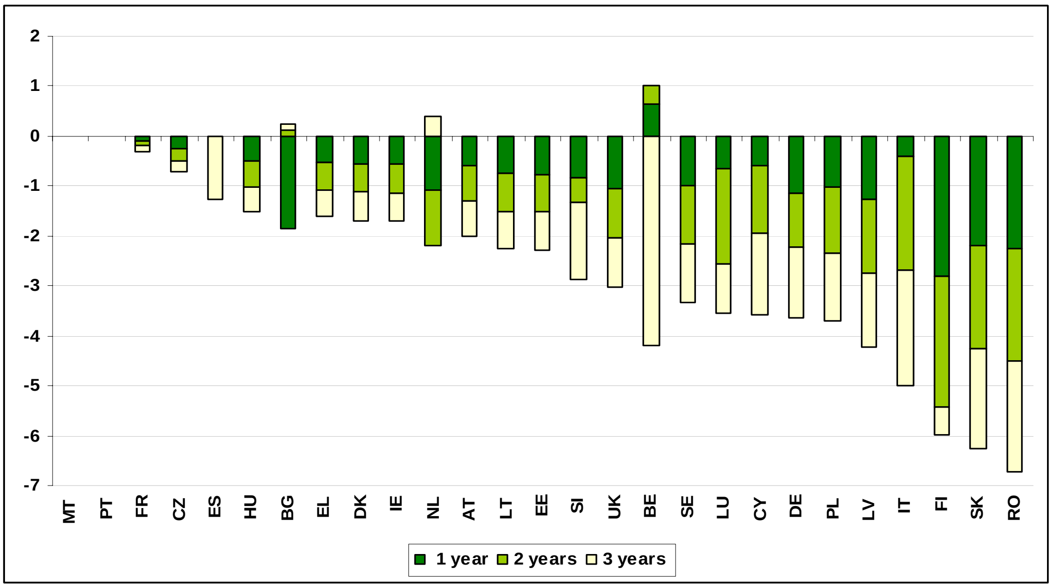
4.2.7. … and in pay-as-you-go schemes

The economic downturn has, however, also hit other types of pensions than only those with returns directly linked to the financial market. As the financial crisis filters down to the real economy, a contracting labour market in the EU is expected. The affect of high unemployment on pensions is two-fold. Higher unemployment, along with slower productivity and wage growth, affects both the tax and contributory base of pension systems, negatively reducing the revenues that pension systems rely on. Furthermore, long-term unemployment and increasing inactivity can have negative affects on the accrual of pension entitlements, having an adverse affect on individuals' pensions. Lower accruals along with minimum income safety nets can create further disincentives to work and poverty traps in the future.

In most Member States, the legislated period of pension entitlements for unemployment breaks does not stretch out for three years, resulting in a bigger drop in pension replacement rates during the second or third year of unemployment. In extreme cases these become non-income and non-contributory years. It is, therefore, vital to monitor the legnth of the period of unemployment and actively promote a return to the labour market.

Past crises have often resulted in older workers, who are a relatively vulnerable group on the labour market in the best of times, being prematurely pushed out of the labour market (please refer to section 1). Given the demographic challenges that pay-as-you-go systems are yet to face in light of demographic ageing, Member States would need to reduce the risks of older workers being pushed into using early exit pathways from the labour market, including, early retirement, unemployment and disability schemes.

Figure 4.6 Accumulated difference in net theoretical replacement rates for an average earner entering the labour market at 25 and retiring at the statutory retirement age with a 1, 2 and 3 year career break for unemployment compared with no break*



Source: SPC/ISG* The unemployment break is assumed to take place in the years just prior to old age retirement which is assumed to take place at the legislated statutory old retirement age for men. Note: the values for MT and PT are equal to 0 and should not be interpreted as missing.

4.2.8. *Labour market and pension policy need to be combined to achieve adequate and sustainable future pensions*

Whiles recent pension reforms have reduced future pressures on sustainability, if both adequacy and sustainability of pensions are to be achieved there is a need to increase employment rates and the quality of employment for all socio-economic groups.

According to the AWG calculations demographic factors (captured by changes in the old age dependency ratio) are the main contributors to the increase in the ratio of pensions to GDP between 2007 and 2060. The increase in the old age dependency ratio would push public pension expenditure in the EU on average by 8.7 pp. over the period. Nevertheless, EU Member States have introduced pension reforms that will make public pension systems more sustainable.

From the European point of view it is important to keep particular attention to the future adequacy and sustainability of pensions, as these are objectives agreed within the open method of coordination on social protection and social inclusion. There are some doubts whether the results of recent pension reforms lead to achievement of both objectives. While the AWG group calculations show a lower increase in public pension expenditure, the ISG calculations project a decrease in future replacement rates of statutory public pensions[67]. Calculations of AWG benefits ratios also confirm a general trend of declining adequacy. This entails that statutory public pensions in a majority of Member States will decline in relation to average wages, as governments strive to achieve financial sustainability, very often at the expense of adequacy.

Some Member States try to compensate for declines in adequacy by encouraging enrolment in funded pensions, often shifting part of the pension expenditure to the private funded pension provision. In some Member States, the effective contribution rates are, therefore, higher than shown in the AWG public pension expenditure calculations which do not include these pensions. SPC studies on privately managed pension provision from 2004 and 2008 have provided only partial information on the increases in contribution rates to private schemes, but for some countries where data is available, we can see additional increases in total contribution rates for the individual which may curb active labour market policy.

As an effect of the reforms introduced, Member States also project an increased participation in the labour market. The AWG calculations were based on an assumption of a moderate increase in employment rates of population aged 15-64 from 65.5% in 2007 to 69.9% in 2060. This increase reflects growing employment of women and older workers. According to the projections the improvements in the labour market should be most visible between 2007 and 2020, and starting from 2020 onwards only moderate increases in the participation rates and almost constant structural unemployment rate were assumed.[68]

The overall outcome of the AWG calculations is that the decline in average pension levels in relation to average wages and an increase in employment rates lead to a reduction in pension

---

[67] Updates of current and prospective theoretical pension replacement rates 2006-2046, http://ec.europa.eu/social/main.jsp?langId=en&catId=443&newsId=551&furtherNews=yes

[68] Ageing Report 2009, p.99.

expenditure from 8.7 pp. of GDP to 2.4 pp. between 2007 and 2060. This presents us with a situation where pensions may be inadequate for some in certain Member States and the increase in pension expenditure will need to be financed through higher contributions.

Member States can either accept this situation or may try to close the potential adequacy gap by devoting more resources to pensions through shifts in the public finances. For instance a strategy of reduction of national debt would lead to lower expenditure on interest payments and would create some room for fiscal manoeuvre. However, pension expenditure would have to compete with other ageing related expenditure needs, like healthcare or long-term care.

Another option, leading to achievement of both adequate and sustainable pensions would be to tap into the potential in the labour markets. Further increases in employment rates, going beyond what was assumed in the AWG calculations, could help reduce the tension in the triangle of increasing contributions, declining expenditure. Redesign of contribution/benefit formulas and eligibility criteria have significantly underpinned work incentives for the individuals.

Compared to the AWG assumptions of an almost 70% employment rate of the population 15-64 in 2060, an increase in the employment rate to 80% corresponding to creation of more than 28 million employment and an equivalent reduction in the number of inactive in the population would ease the pressure on public pensions by ¼. This could reduce the decline in adequacy or the expenditure growth. An additional effect of reducing the pressure by ¼ would be achieved with an increase in employment rate of population aged 65-69 by 40pp. (shift of 12 million from the population of pensioners into employment).[69]

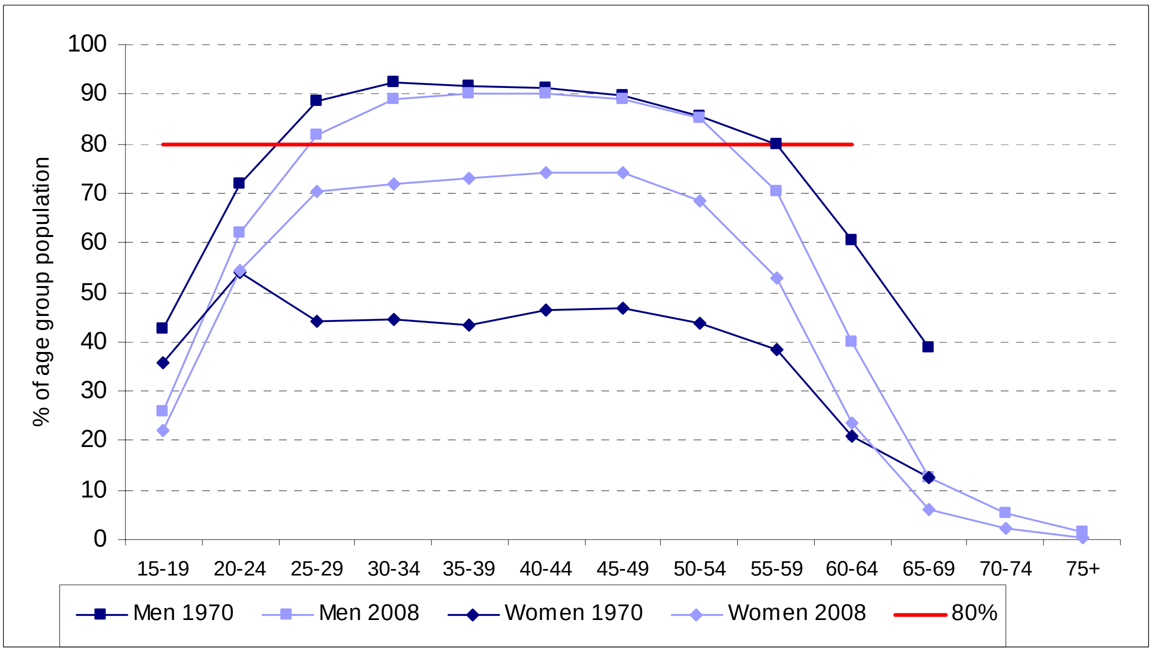
Increases in employment rates overall and of older workers can be achieved. The graph below shows clearly that employment rates of older men declined substantially since the 1970, when life expectancy was much lower than today. In 1970 there were more employed men aged 55-69 than today and more women aged 65-69. In contrast, employment rates of women aged 25-54 increased substantially by at least 25 pp.[70] Attracting more people into the labour market in the future will thus require reversal of the decline in employment of older people (especially men) observed after 1970 and reinforcement of the trend of increasing female employment. Through reforms, like increasing the retirement age, flexible retirement options and increasing contributory periods needed for a full pension, and designing work incentives into pension schemes, there is scope to bring the effective retirement age in line with expected increases in life expectancy.

---

[69] No AWG data for 65-69 age group employment rate available.

[70] More detailed analysis can be found in the chapter 2 "Active ageing and labour market trends for older workers", *Employment in Europe 2007* Report.

Figure 4.7 Employment rates by gender in the EU-15, 1970 and 2008



Source: OECD. Stat database

Pension reforms have coincided with changes in the labour market. Improving the ability and the opportunities on the labour market for senior workers to be maintained in employment is key. As shown in the section 3, short-term and part-time employment contracts, which usually offer lower wages than permanent full-time employment, are becoming more widespread on the European labour market. In consequence, a growing number of individuals rely on temporary or part-time employment and do not earn sufficient income to avoid poverty at the old age.

Recent improvements in the labour market have not been spread evenly between different categories of the labour force. Along with the rise in female participation, the employment of older workers has been one of the most dynamic components of the EU labour market in recent years. In total, between 2000 and 2006, the employment rate of people aged 55–64 rose by 7 percentage points at EU-25 level. In terms of skill levels, however, employment rate increases for those aged 55–64 have been greatest for the medium-skilled, for whom employment rates have increased by 7.2 percentage points between 2000 and 2006, exceeding even the increase for the high-skilled (5.8 percentage points). In contrast, the improvement has been more limited for low-skilled older workers for whom employment rates have risen by less than 5 percentage points during this period[71]. Also as shown before, increasing unemployment in conjunction with recent reforms that strengthened the link between contributions and benefits will significantly affect the adequacy of pensions for some.

Demographic ageing put an evident pressure on pension systems. It has made clear the need to sustain adequate social protection systems and with affordable levels of expenditure. Stronger link between contributions paid to and benefits received from pension schemes has significantly underpinned work incentives for the individuals. The adequacy and sustainability of pensions have thus become contingent on the economy and labour market's

[71] Ibidem.

ability to generate an increasing amount of quality jobs that enables more people to work more and longer. Only if growth and job processes are able to deliver that, can sustainable pensions also become adequate.

While pension reforms help pension systems achieve long term financial sustainability, if adequacy and sustainability of pensions is to be achieved, there is a need to increase employment rates and the quality of employment for all socio-economic groups.

4.3. Reconciling ageing, health expenditure and inequalities to sustain growth and employment

The social OMC has proven to provide good means to advance our understanding of healthcare reforms and promoting a learning process. The work in this area has highlighted a number of issues of relevance for the Lisbon Strategy of employment and growth.

4.3.1. Healthcare has contributed to considerable improvements in population health

Health and long-term care systems are the second biggest social protection component and the availability, affordability and quality of care can strongly influence the likelihood of overcoming disease, avoiding mortality and ensuring independent living. The considerable improvement in the health status of the EU population in recent decades has been associated with more widely available healthcare i.e. a rising share of resources devoted to healthcare systems and a more equitable distribution of these resources. For example, recent evidence for some Member States suggests that increased expenditure on health can lead an increase in the number of years in good health[72].

4.3.2. And a healthy workforce is needed to ensure high productivity and longer working lives

It has also been recognised that good health contributes to economic prosperity through improving labour market participation and improving productivity as well as increasing participation in other societal activities. High levels of population health and longer, healthier lives are crucial in the context of an ageing population to allow for longer working lives. Reducing unnecessary and premature death and disease can make a contribution to meeting the Lisbon goals of employment and growth and achieving Europe's full potential for prosperity. On the other hand, there is some evidence that longer active lives may also have a positive effect on health[73].

4.3.3. However, there are large gaps in health between and within countries…

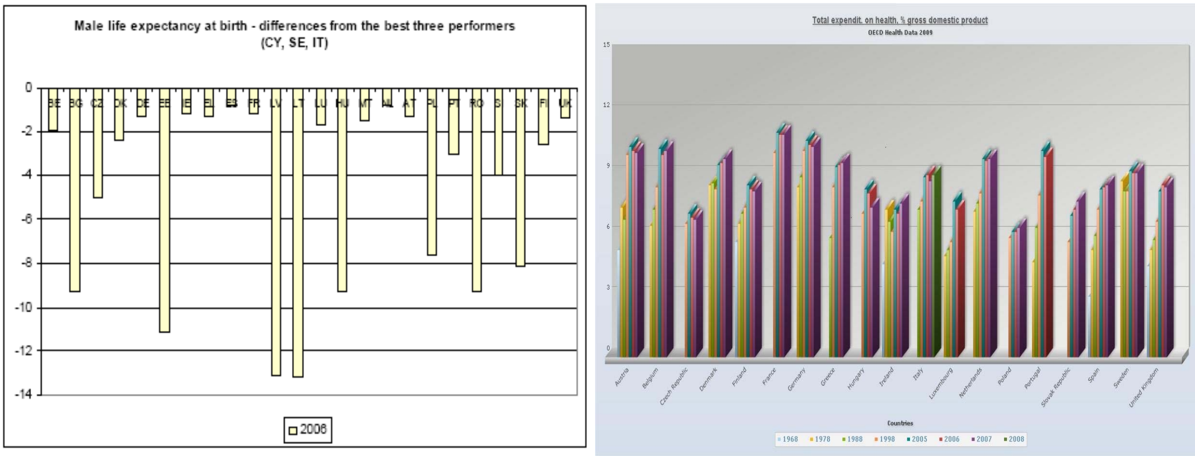
Very large gaps in the average level of health exist between different EU Member States and between social groups within Member States and have widened in recent decades. Between EU Member States there is a 14 year gap in life expectancy at birth for men and an 8 year gap

[72] http://ec.europa.eu/health/ph_information/indicators/lifeyears_en.htm

[73] Exploring the synergy between promoting active participation in work and in society and social, health and long-term care strategies, http://ec.europa.eu/employment_social/spsi/docs/social_protection/final_report_en.pdf

for women[74]. Within Member differences in life expectancy at birth between lowest and highest socio-economic groups can reach 10 years for men and 6 years for women[75].

Figure 4.8 Life expectancy gaps and health expenditure as a percent of GDP in the EU



Source: Eurostat and OECD Health Data 2009

4.3.4. … due to various access barriers that are more severe for lower socio-economic groups

Not all groups have benefited in the same way from the economic progress that delivers better health through better living and monetary conditions and from the availability and improvements in key services such as healthcare (health promotion, disease prevention, treatment and rehabilitation). Various barriers to access can be identified. It can also be shown that the larger the within-country health inequalities, the lower the overall population health. Also, those countries with the lower overall population health and higher within-country health inequalities are those with higher inequities in access to care and those spending the least on health care. Hence, improvements in access to timely and effective healthcare can have an impact on reducing mortality and disease in lower socio-economic groups and, as a consequence, improve the overall population health status. In some countries there may be a case of under resourcing requiring higher investments in healthcare.

4.3.5. …and which have important economic implications

Importantly, high levels of poor health in sections of the EU population imply substantial opportunity costs for the Union as they are detrimental to employment, productivity and growth. Avoidable ill-health also puts unnecessary pressure on public budgets. The presence of such large gaps in health therefore also calls for greater effectiveness of healthcare delivery and a rethinking of priorities in this sector.

---

[74] Monitoring progress towards the objectives of the European Strategy for Social Protection and Social Inclusion, http://ec.europa.eu/employment_social/spsi/docs/social_inclusion/2008/omc_monitoring_en.pdf

[75] http://ec.europa.eu/health/ph_determinants/socio_economics/keydo_socioeco_en.htm

4.3.6. In addition and paradoxically, expenditure has risen over time and ageing, technology and growing expectations are creating further pressure on resources

Health and long-term care expenditure represent a significant share of GDP and is on a secular rise. There is some uneasiness about spending an ever growing share of GDP on healthcare in view of ageing, technological development, growing patient expectations and increased risky behaviour (for example, alcohol abuse or obesity in children and young adults). This trend is enhanced, if combined with low economic growth, low labour market participation and high unemployment which limit increases in revenues. Additionally, rising health expenditure has appeared to have contributed relatively little to a reduction in health inequalities.

4.3.7. Hence, improving the value for money of healthcare systems through enhancing effectiveness, efficiency and priority setting have been deemed an urgent task.

There are no simple solutions and strategies need to be tailored to national features. ***The 2007 and 2009 joint reports highlight some win-win solutions*** i.e. reforms that can improve access or quality of healthcare as well as its sustainability including:

- Encouraging the use of primary care, strengthening referral systems and improving care coordination.
- Managing the introduction of new technology through technology assessment and evidence-based medicine.
- Promoting healthy life-styles and enhancing disease prevention activities.

On the other hand, **important trade-offs** between access or quality on one hand and financial sustainability on the other have also been identified including in relation to increasing cost-sharing, patient choice and competition in the sector.

4.3.8. Long-term care has been deemed a social risk and an important social protection issue in view of an ageing population

Ageing will increase the pressure on the services to provide more and better medical care and more rehabilitative, nursing and social care. Long-term care provision is currently insufficient and the barriers to accessing long-term care services are more severe than in the case of healthcare. Member States therefore want to ensure adequate and sustainable funding structures for current and future long-term needs. Such arrangements need to be coupled with healthy life-styles at old ages and strategies to keep an elderly population active.

4.3.9. Health and long-term care services are dependent on sufficient numbers of both high and low skilled staff and represent an opportunity for job creation in the care sectors

The healthcare and long-term care sectors are labour intensive and together employ a significant proportion of the population. As a result of ageing, patients' needs are likely to require increases in staff numbers. Yet, as more and more care professionals reach the retirement age it has become increasingly difficult to replace them. In some EU countries ageing is coupled with brain-drain to richer countries. These emerging staff shortages can aggravate access problems but also threaten the financial sustainability of the services. A human resources development strategy involving economic, employment and social policies is required to the sector to ensure sufficient recruitment, retention and motivation.

The modernisation of healthcare and long-term is therefore an area where Member States can benefit from information and best-practice exchange and where there is room to improve the links between economic, employment, social and health policy.

4.4. Concluding remarks

Past decades of reforming social protection systems have improved their long-term financial sustainability. However, there remain issues to be resolved and concerns about the access and adequacy of benefits persist. Higher employment rates, longer working lives, and increased healthy life expectancies will play an important role in ensuring both adequacy and sustainability of social protection. In the case of pensions this would apply to funded as well as pay-as-you-go schemes. Efforts to modernise all functions of social protection should be sustained in order to ensure effective access to quality services for all, notably in health care where modernisation can improve the health of the work force and contribute to the efficiency of public expenditure.

Modernisation has happened also in other branches of social protection to improve coverage of new risks and improve responsiveness of the system, for example by increasing expenditure of active labour market measures, or by addressing financial disincentives to take-up work or work more. Since modernising efforts have to continue in all the social protection functions to improve effective access for those that need it in a sustainable manner, it is vital to monitor all the different social protection benefit systems extensively.

5. PROVIDING ADEQUATE AND SUSTAINABLE SOCIAL PROTECTION OVER THE ECONOMIC CYCLE

The Social Protection Committee has produced major pieces of analysis of social protection systems under the perspective of universality and adequacy as well as modernisation and sustainability. The policy conclusions of such analysis are published in the Joint Reports on Social Protection and Social Inclusion, the supporting material in a number of special studies as well as in the supporting document underpinning the Joint Reports.

The downward swing in the economic cycle has accentuated the quest for adequacy and sustainability and the following emerges as key:

- the capacity of the EU social protection schemes to provide a protection looking at taking into consideration the dimensions of universality and adequacy,

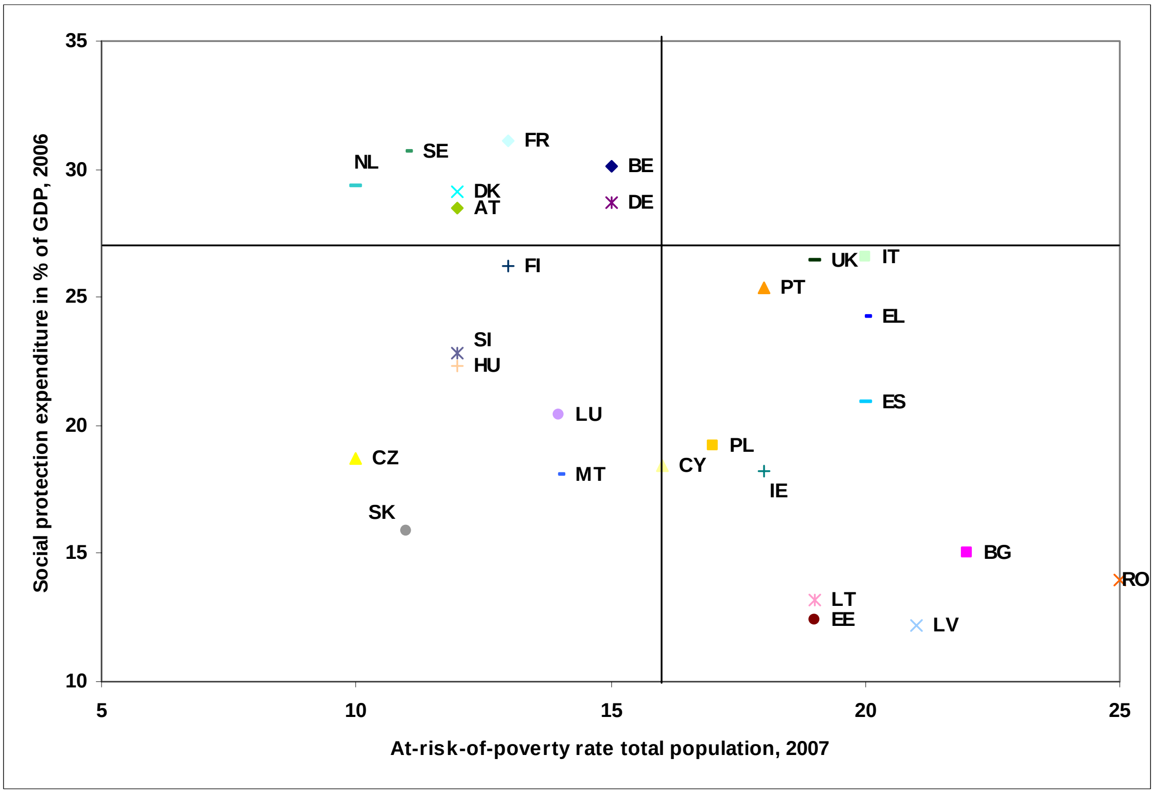
- the fiscal capacity to provide such protection through sound public finances, notably reducing public debt.

5.1. The coverage and adequacy of EU social protection systems at the onset of the crisis

The impact of the economic downturn on individuals in different Member States will vary depending not only on the force of the impact of the crisis in different countries, but also on the past situation of the economy just before the crisis. Whilst the crisis can be seen as a sort of stress test for social protection systems, there is no comprehensive information on the capacity to protect those affected by it. We can, however, look at the capacity of social protection systems to protect the individual and the ability of systems to provide protection over a longer period of time. This section considers three central social issues: unemployment, retirement and health care provision.

A number of countries appear to be in a particularly fragile position to face the crisis. In these countries, at-risk-of-poverty and material deprivation rates were already high before the crisis. Mapping the at-risk-of-poverty rate of the total population along with total social protection expenditure as a % of GDP gives a first indication of the importance of social security expenditure in reducing social vulnerability, but also of the efficiency at reducing poverty of the social protection systems before the economic crisis. Generally speaking, higher expenditure on social protection is correlated with lower at-risk–of-poverty rates as in BE, DE, DK, FR, AT, NL, and SE. Similarly, the lowest spenders have higher at-risk-of-poverty rates for the total population, BG, EE, LT, LV, RO. This puts them in a position of increased vulnerability, especially as the crisis hits these economies the hardest in terms of GDP growth and unemployment.

Figure 5.1 Total social protection expenditure and at-risk-of-poverty rate of the total population in EU Member States

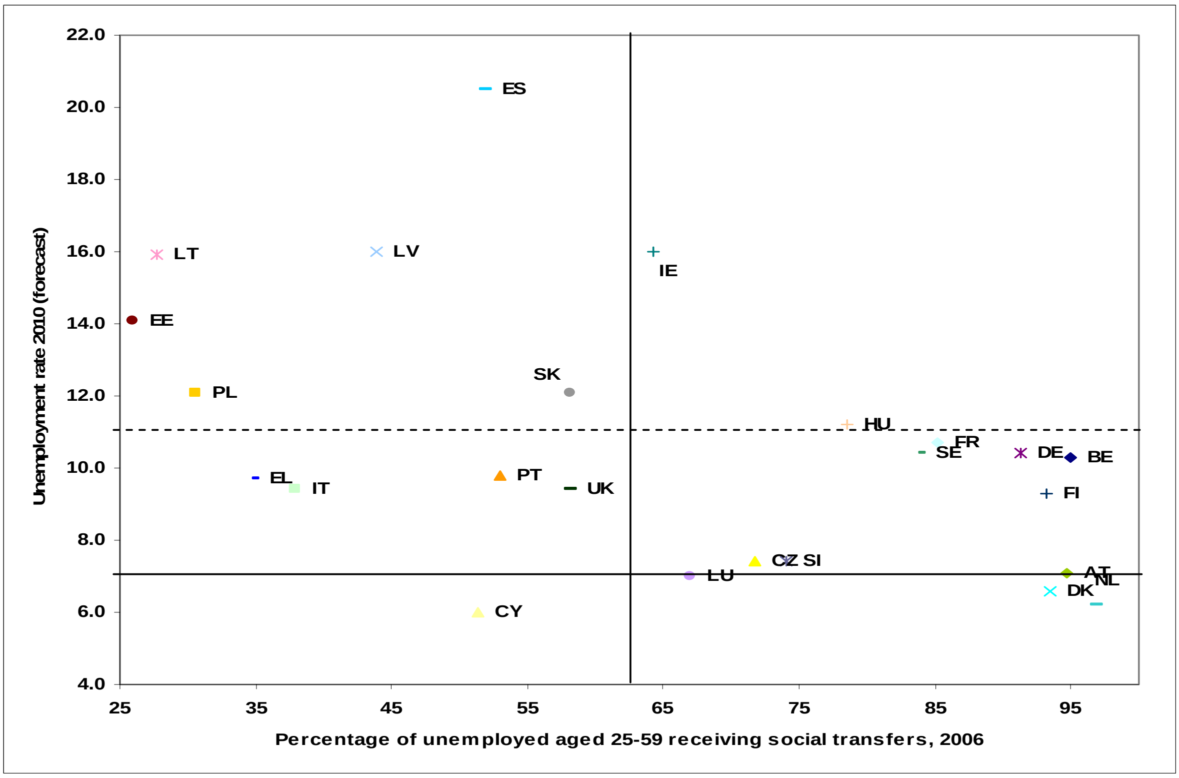


Source: ESSPROS 2006, EU-SILC 2007
Note: The horizontal and perpendicular lines depict the EU averages of the variables

5.1.1. Protecting the unemployed

The crisis has had an immediate and strong impact with large increases in unemployment rates and in many Member States low coverage of unemployment benefits is a clear sign of vulnerability for a large number of individuals. For example, due to a large fall in GDP, unemployment rates have already more than doubled in EE, LV and LT and the crisis is expected to have a strong impact on employment figures. In these countries there are already high levels of poverty for the unemployed, implying that their capacity to deal with the looming crisis is particularly weak. This is further confirmed by the extremely low proportion of the unemployed receiving benefits (less than 30%). Countries like BE, DK, FR, NL, AT, SE, DE, LU, SI and FI can be considered to have a mature social protection system well placed to protect the vulnerable in the crisis. The coverage and level of social benefits is high for the unemployed, and the risk-of-poverty rates amongst the unemployed are low. It remains to be seen whether these countries have the budgetary margin of manoeuvre to continue to do so as unemployment rates rise (please also refer to section 2).

Figure 5.2 The percentage of unemployed receiving social transfers, 2006 and forecasted unemployment rates in EU Member States, 2010



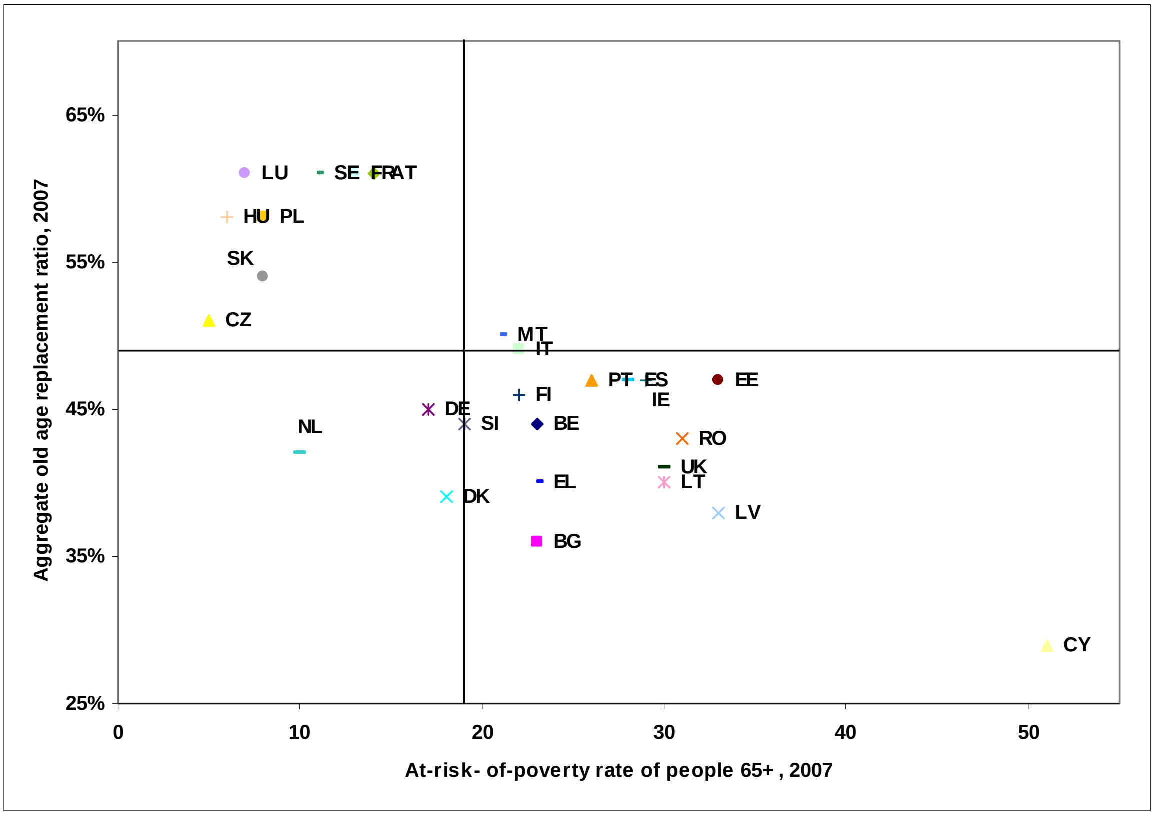
Source: LFS 2007, Commission Spring forecast 2009, EU-SILC 2007

Note: The perpendicular line depicts the EU average of the variable. The horizontal line depicts the EU average of the unemployment rate in 2007. The dotted horizontal line depicts the forecasted unemployment rate in 2010.

5.1.2. Protecting the elderly

In light of the economic crisis, older people are also a vulnerable group as they have fewer possibilities to affect their financial situation. Although pension reforms have helped lower the at-risk-of-poverty rates in many parts of the EU, in countries where elderly poverty is already high the situation is, however, not likely to improve and cutbacks on pensions or indexation due to growing budget deficits can worsen the already poor relative economic situation of current pensioners. Considering the strong impact of the financial crisis on private pension funds, special attention must be paid to effects on the economic and social protection provided by these pensions now and in the future (Please also refer to section 3).

Figure 5.3 The old age at-risk-of-poverty rate and aggregate replacement ratios in EU Member States



Source: EU-SILC 2007

Note: The horizontal and perpendicular lines depict the EU averages of the variables. Note that the aggregate replacement ratio does not include private and occupational pensions which can affect the results for Member States where such pensions are an extensive part of retirement income (e.g. IE, UK, NL).

5.1.3. Adequate protection for the sick and disabled?

In times of economic downturn it is not unusual that the demand for health care rises, as economic strains are expected to be reflected in the overall health of the population given that socioeconomic factors such as education, income and job status have a substantial effect on the health of individuals[76]. Gaps between groups can be compounded by the poor accessibility of health and social services. In such cases responses to the crisis that involve retrenchments to social protection and health systems, could lead to a substantial increase in social vulnerabilities. So far, however, only very few Member States have taken to cutbacks of this nature.

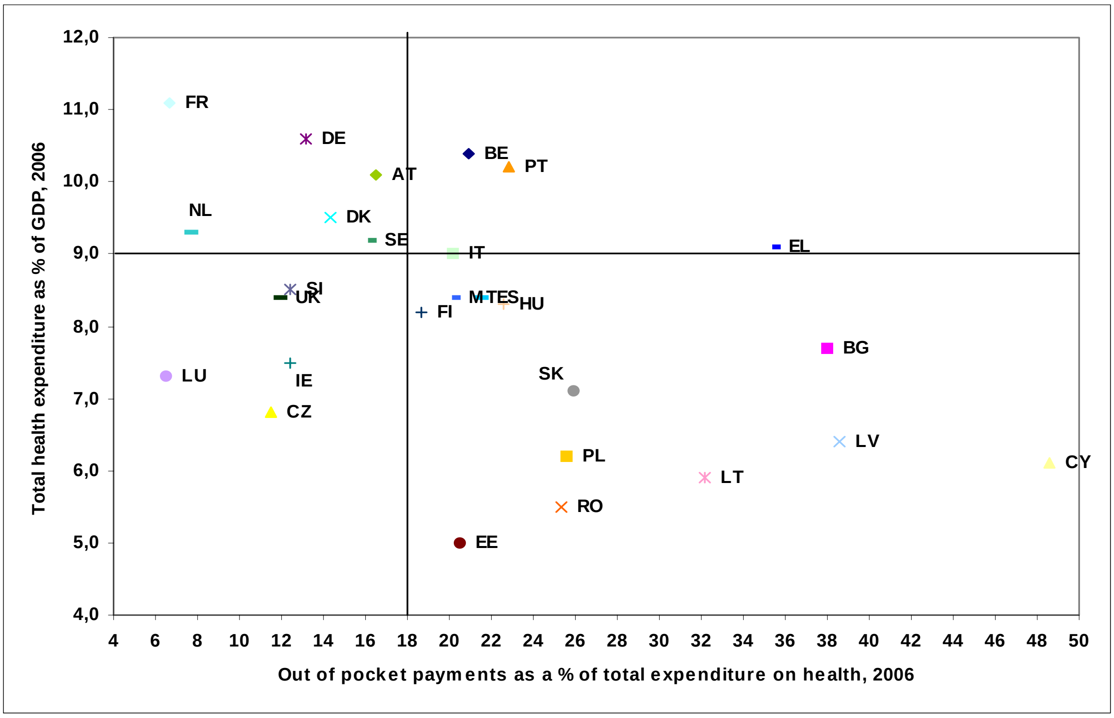
When considering the effects of the crisis on the health status of the population, those Member States with the lowest spending on healthcare and high out of pocket payments are also amongst those countries expected to be hit the hardest by the economic downturn in terms of GDP growth and unemployment. These countries include EE, LT, LV, BG, RO and SK, highlighting the risk that households with less income than before will forgo essential

---

[76] Source: Health Status and Living Conditions in an Enlarged Europe 2007 - Monitoring Report prepared by the European Observatory on the Social Situation - Health Status and Living Conditions Network, http://ec.europa.eu/employment_social/spsi/docs/social_situation/2007_mon_rep_health.pdf, p 85

healthcare. The stagnation of past health expenditure seems to suggest that the rapid and strong economic growth of the past few years has not been used to strengthen the health system. The health condition of people in vulnerable situations may therefore be a point of concern. Most other Member States that have relatively low co-payments and stronger care systems should be able to provide basic health care for all and avoid that people in a vulnerable economic and social situation don't receive necessary care. The biggest drops in budget balances of over 10 percentage points (% of GDP) between 2007 and 2010 are expected in IE, LV, ES and UK.

Figure 5.4 Total health expenditure and out of pocket payments on health in EU Member States



Source: System of Health Accounts 2006

Note: The horizontal and perpendicular lines depict the EU averages of the variables

5.2. *The role of social protection as an automatic stabiliser - the long-term fiscal capacity to provide adequate protection*

The social vulnerability of Member States, that have generally speaking experienced high growth rates in past years, will depend on the capacity of their social protection at the onset of the economic downturn and also on how that past growth has been distributed in the economy and population. Member States with larger deficits at the onset of an economic downturn have less margin of manoeuvre and will need to better the efficiency of their social protection systems in order to avoid the emergence of big income and social inequalities, as well as increasing poverty rates.

5.2.1. Long term trends in social protection expenditure

As observed since the 1970s social expenditure increases as a share of GDP during economic recessions or periods of slow growth and decreases during economic expansions. Against this background we can say that the social expenditure in the EU plays its role of an automatic stabiliser and is fluctuating with the business cycle. However, the strength of the stabilising effect is varying, as shown by example of selected Member States in figure 5.5 and the responsiveness of expenditure to the economic cycle differs across Member States (please also refer to annex 1 of the supporting document for disaggregated information on all EU 27).

Recent responsiveness of social protection systems to the business cycle partially determines their current capacity to protect people. Countries with more developed systems can afford to show a higher degree of counter cyclicality in an economic boom as compared with countries where the systems are still being expanded, meaning they can consolidate their fiscal budgets to a greater extent. Countries with large, mature social security systems and balanced budgets will thus have more budgetary room for manoeuvre at the onset of a recession and will have a better possibility to protect those most vulnerable and those most affected by a downturn.

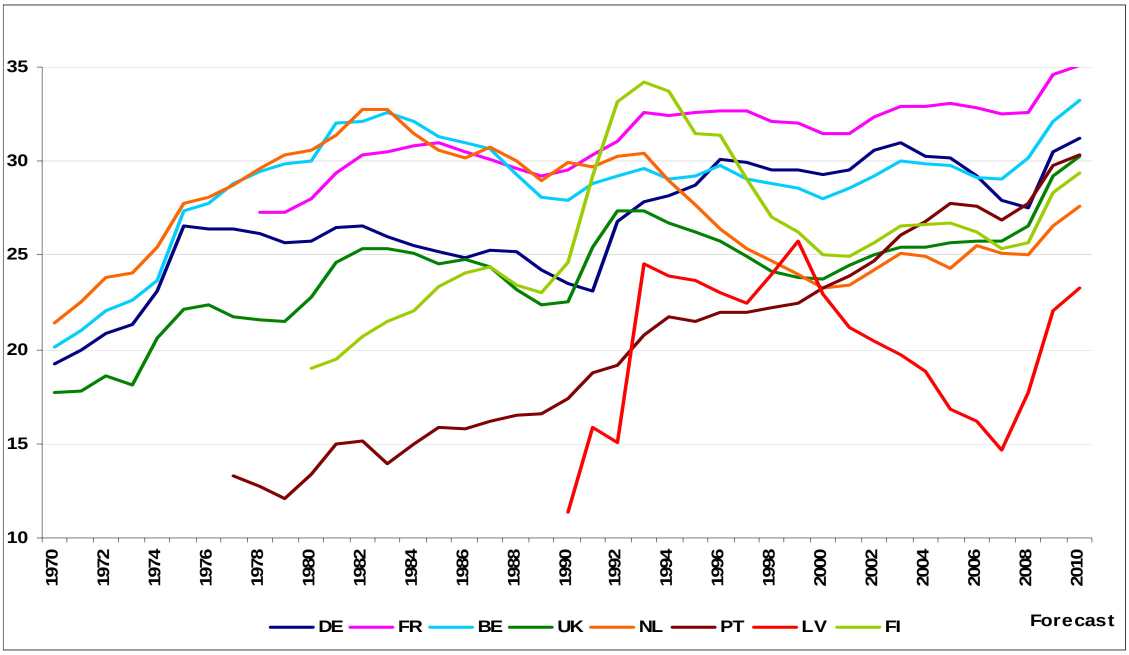
Over the last 50 years, notably between the early 1970s and the 1990s, we have seen a structural rise in the share of social protection expenditure as a percent of GDP in Member States.

There are several reasons behind this trend. First, social protection systems are maturing and coverage is increasing. Second, new types of benefits are introduced – as happened with family, child benefits and long-term care benefits. Third, demographic, social (e.g. evolution of family structure) and structural economic changes can increase demand for social protection even in the context of constant set up of social protection systems. In particular, the increased labour market participation of women and structural change towards a more knowledge intensive economy shifted the demand for labour and resulted in an increased probability for low skilled workers to become unemployed and to rely on benefits (unemployment, sickness and invalidity, early retirement and also social assistance). Fourth, relative price trends as well as indexation rules can lead to long term increases or declines in the share of GDP devoted to social protection – notably relevant in the health care area. For instance, between 1996 and 2006 the average annual price increases for health goods and services in the EU 15 were 1.1 pp. higher than the HICP. Fifth, inefficiencies in provision and lack of clear budget constraints and accountability can also contribute to long-term expenditure rises as for example discussed in the joint Commission-OECD conference in September 2008 on the efficiency of health care provision. Finally, we can observe a hysteresis effect as increases in short term unemployment might persist and lead to long term labour market exclusion.

The last mentioned of these effects takes place when an economic downturn is over and the unemployed who do not reintegrate the labour market end up in the long-term unemployment or they claim incapacity or early retirement benefits. For example, short term unemployment in an economic downturn would generally lead to an increase in the take up of unemployment benefits. After an upswing these short term unemployed should return to the labour market. If the dynamics of the labour market and social protection policies leads to people moving from short term unemployment into long-term benefit dependency this can lead to long term increasing social expenditure and a lower degree of counter cyclicality in an economic recovery period. This is the case when the unemployed are moved into other benefit systems from which the return to the labour market is more restricted such as sickness, disability, and early retirement schemes. This is often also a result of segmented labour markets that are closed to certain groups.

Active labour market policies that coincide with active social protection policies can facilitate returning individuals to the labour market and minimizing benefit dependency whiles still protecting the most vulnerable. Reforms have been made in a number of Member States in recent years with regard to the eligibility rules in benefit systems and the financial incentives for individuals to return to the labour market. As an effect of this, in some cases combined with a maturing of social protection systems, the rate of increase in social protection expenditure as a percent of GDP has slowed.

Figure 5.5 Trends in social protection expenditure in selected Member States



Source: AMECO database, national data for FI

5.2.2. Automatic stabilisation is a key instrument to achieve output stabilisation

Automatic stabilization is the capacity of public finances to attenuate the consequences of economic shocks on the level of activity. In an expansive economy, tax revenue increases more quickly (provided they are progressive) and expenditure on employment and other social security benefits increase at a slower pace or even drop. The increase of taxes and the fall of benefits lead to a reduction of the growth. The initial increase in economic activity is thus reduced by the operation of these automatic stabilizers. The situation is symmetrical when the economy faces a deceleration or a recession.

It is often argued that automatic stabilisers may be preferable to discretionary policies essentially since they are timely and more efficient. The magnitude of stabilisers depends primarily on the size of the government sector, but also on the composition of domestic expenditures. A number of estimates of the capacity of stabilization of public finances in (large) European countries have been published showing that an average of around 20-25% of economic fluctuations are smoothed through automatic stabilisers (between 15% and 35%, depending on Member States and estimates)[77]. In general, most components of social protection expenditures increase more quickly than GDP in periods of economic downturn, and more slowly than GDP in economic recovery. But, while unemployment expenditures are clearly among the most sensitive to changes in the economic conditions, the variability of social protection expenditures also reflects changes in other types of expenditures (with

[77] Sources: Creel J. and Saraceno F. Automatic Stabilisation, Discretionary Policy and the Stability Pact, OFCE, working paper n° 2008-15; Van den Noord P. (2000),The Size and Role of Automatic Fiscal Stabilizers in the 1990s and Beyond., OECD Economics Department Working Paper, n° 230.

significant variations between Member States covered). For example, in DK, FI, UK disability benefits show strong variations in economic booms and troughs, whiles in ES, FR, UK variation is strong for expenditure on family benefits and social exclusion benefits in NL (Please also refer to chapter 2 1).

5.3. A lack of responsiveness can lead to a hysteresis effect and long term increases in the level of social expenditure – a wide diversity of experiences in Member States

While the dynamics of expenditure and receipts are partly linked to the economic cycle, in the longer run, a trend of increasing share of social protection expenditure in GDP can be observed in the majority of Member States (Please refer to figure x above).

Social protection systems can be more or less responsive to the economic cycle. Firstly, some cases reveal that reactivity to the cycle can be escalated or hampered by the design of rules on granting different kinds of benefits. Eligibility criteria and benefit levels clearly affect benefit take up behaviour. Secondly, the relationship of social protection expenditure with economic growth depends on how much the growth is creating employment. Moreover, there can be also a time lag between the period of high economic growth and a rise in spending on social protection systems. In consequence, social protection expenditure could be insufficiently countercyclical, or could leave less room for manoeuvre in the face of economic slowdown.

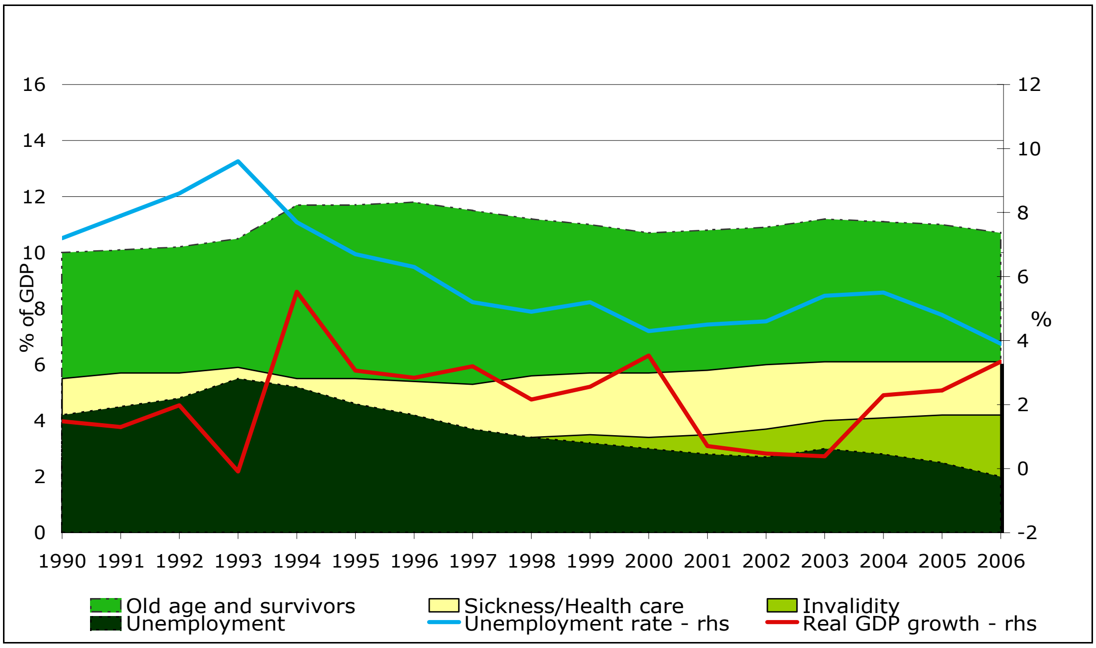
Although, often politically difficult, maintaining an anti-cyclical behaviour in social spending even as the economy enters a boom allow for room for manoeuvre in a recession. An anti-cyclical behaviour in public spending, especially on social expenditure, is an important part of rebounding an economy in recession. As GDP contracts, however, Government budget balances are often strained, therefore bringing to light the issue of how to finance increases in expenditure whiles avoiding ballooning deficits. Increases in social protection expenditure should be seen as part of a recovery package, rather than a permanent feature, thus acting as an automatic stabiliser, and avoiding a hysteresis effect and high fiscal deficits which will then accumulate over the years.

The country examples below attempt to show the past and current patterns of social protection expenditure in a number of Member States.

> ***Denmark and Sweden:*** *Tightened eligibility and benefit rules have helped reduce hysteresis in social protection expenditure and have increased counter-cyclicality*
>
> In Denmark and Sweden, the social protection system is mature and historic time series show that levels of social spending have increased every time unemployment rose and decreased substantially afterwards. Looking closer at the components of social spending, it is possible to see that labour market reforms have led to a strong decline in unemployment benefits expenditure in response to the improvement of the economic and labour market situation. However, in DK and SE disability benefits have shown an increasing trend for a long time. In Sweden, for example, since the economic crisis of the early 1990's the number of unemployed as well as those supported by different labour market measures erupted but has since declined. Instead a movement of people into sickness and disability schemes can be observed. This trend has now been reversed in the case of SE through a tightening of eligibility criteria. In Denmark social protection system was more responsive to the 2004-2007 economic recovery than to the 1998-2000 one. It seems that constant reforms of the Danish welfare system brought positive results. In both Member States strengthening the incentives for each individual person to work, increasing the employability of the workforce and improving the possibilities for the

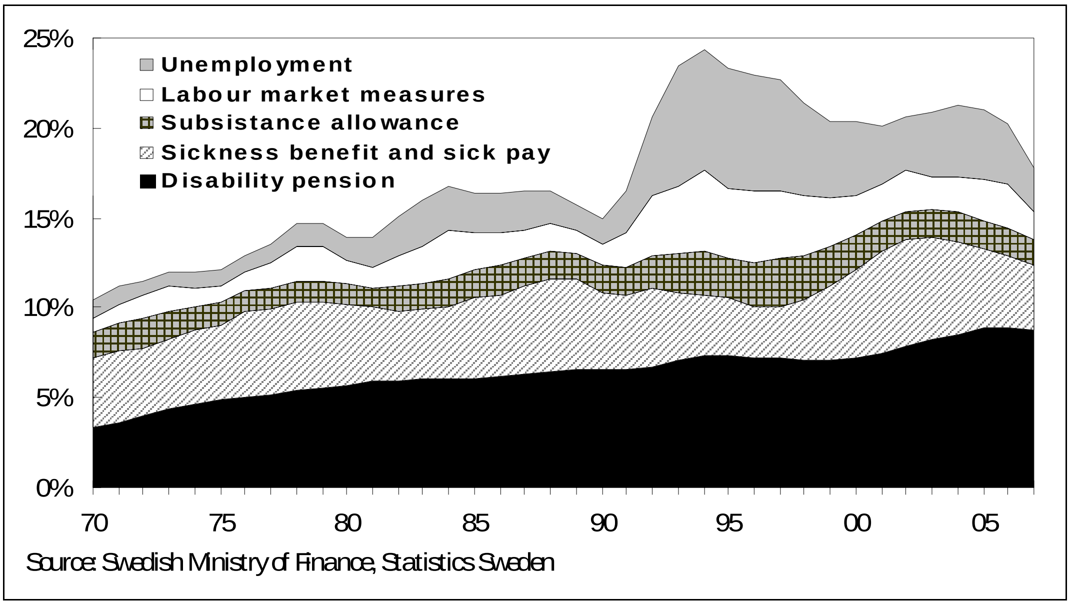
employer to employ those at the margin of the labour market have helped to achieve a greater counter-cyclicality of social protection expenditure.

Figure 5.6 Trends in social protection expenditure in Denmark since 1990



Source: ESSPROS, Eurostat

Figure 5.7 The share of people aged 20-64 (measured as full-year equivalents) receiving benefits from specified benefit systems in Sweden 1970-2007, percentage[78]

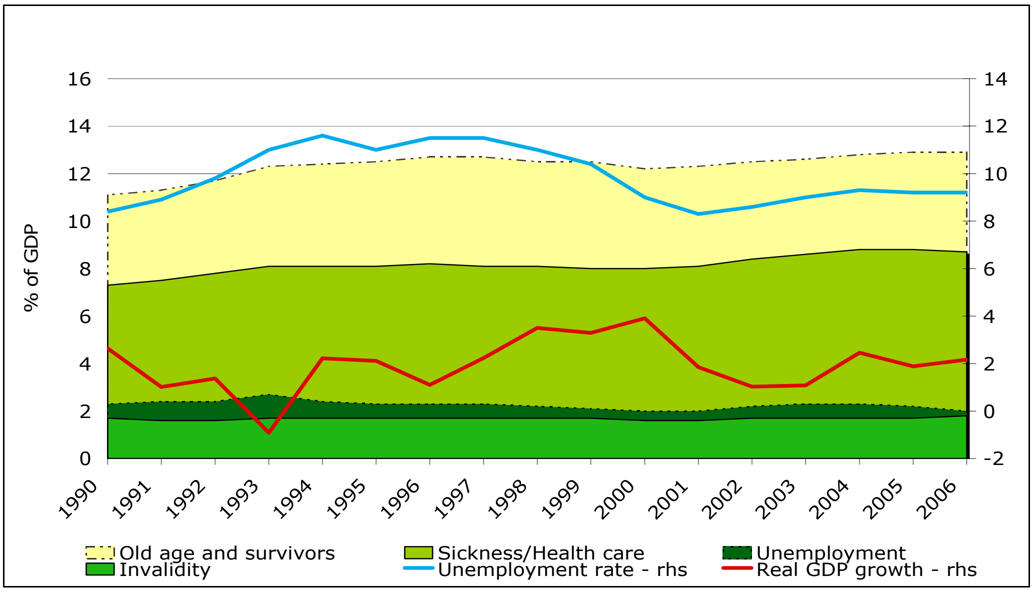


[78] A full-year equivalent is equal to full benefit withdrawal for an entire year (365 days). Two persons with a 50 percent withdrawal rate for a full year equal to one person with full rate. The drawback of this measure is that is underestimates the total share of individuals with benefits.

***France:** Curbing health care expenditure can improve the responsiveness of social protection expenditure to the economic cycle*

France shows an example of a country where despite the interdependence between the economic cycle and expenditure levels, social protection expenditure has been increasing. Social protection expenditure has shown an upwards trend driven by health and old age expenditures, while other types of expenditures have been more responsive to economic downturns than upturns. Since 1990, healthcare, pension, and social exclusion benefits expenditure has increased in relation to GDP, while unemployment benefits are relatively stable. Increases in social protection expenditure have been driven by dynamic growth in healthcare and pension expenditure.

Figure 5.8 Trends in social protection expenditure in France since 1990

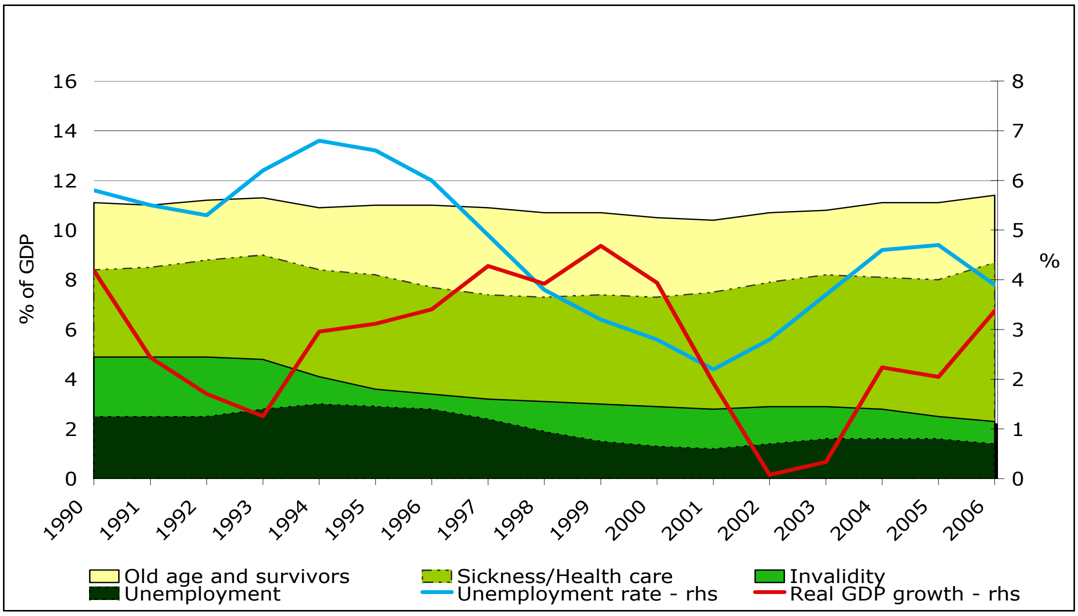


Source: ESSPROS, Eurostat

***The Netherlands:** Increasing financial incentives to work helps to decrease social protection expenditure and to increase its counter-cyclicality*

In the Netherlands, there is also a link between economic activity and employment on one side and social spending on the other side, showing that social protection expenditure is playing a role as an automatic stabiliser. The expenditure on unemployment and invalidity benefits has been reduced notably in times of economic upswing increasing the anti-cyclical nature of social protection expenditure. This has been a result of policies aimed at reducing the number of people on welfare systems by decreasing benefit levels and supportive labour market measures, increasing financial incentives and opportunities to work. Old age, sickness and health expenditure in the Netherlands has on the other hand increased continuously since 2000 which will be further augmented as the population ages.

Figure 5.9 Trends in social protection expenditure in the Netherlands since 1990



Source: ESSPROS, Eurostat

5.4. Concluding remarks

Social protection systems can play a crucial role as automatic stabilisers and sustain the productive capacity of the economy. However, Member States are in very different positions to face the crisis. In some countries, there are significant weaknesses and loopholes in social safety nets. In others with mature social protection systems that cushion the impact of the crisis, financial sustainability is questioned in the long run. Countries faced with major public finance imbalances are left with little room for manoeuvre to address the social consequences of the crisis. This raises particular concern for those who also have weaker levels of protection.

Promoting labour market participation while improving the fairness, efficiency and effectiveness of social spending will be crucial for all countries, both in view of ensuring counter-cyclicality towards economic growth and addressing fiscal imbalances.

The analysis documents that Member States have taken steps towards reinforcing social protection systems that encourage activity and inclusion. However, it is also clear that good economic performance is a precondition for well functioning social protection systems. Good employment performance has always been crucial for the sustainability of social protection systems but with ageing open labour markets that attract those who are still underrepresented in employment are becoming essential. Hence, modernisation of social protection needs to go hand in hand with rapid progress with effective strategies for growth and more and better jobs.

Annex 1. Change in theoretical replacement rates for a worker with average earnings retiring at 65 after 40 years, 2006-2046

	Change in Theoretical replacement rates in percentage points (2006-2046)						Assumptions					
	NET	GROSS Replacement Rate					Coverage rate (%)		Contribution rates**			
	Total	Total	Statutory pension	Type of Statutory Scheme (DB, NDC or DC), 2046	Occupational and supplementary pensions	Type of Occupational or Supplementary Scheme (DB or DC), 2046	Statutory pensions, 2006	Occupational and Voluntary pensions, 2006	Statutory pensions (or in some cases Social Security): Current (2006) and Assumed (2046)	Occupational and voluntary pensions: Estimate of current (2006)	Occupational and voluntary pensions: Assumption (2046)	Evolution of statutory pensions expenditures between 2007 and 2045 (source EPC/AWG)***
BE	4	5	0	DB	5	DC	100	55	16.36	NA	4.25	4,8
BG	15	15	15	DB and DC	/		NA	/	NA	/		2,9
CZ	-21	-16	-16	DB	/		100	/	28	/		1,8
DK	7	20	-10	DB	30	DC	100	78	0.9	8.8	12.7	0,8
DE	1	2	-9	DB	11	DC	90	70	19.5	NA	4	1,7
EE	11	9	9	DB and DC	/		100	/	22	/		0,8
EL	-7	-12	-12	DB	/		NA	/	20	/		8,6
ES	-12	-9	-9	DB	/		89	/	28.3	/		5,9
FR	-17	-16	-16	DB	/		100	/	20	/		1,3
IE	-11	-10	-2	DB	-9	DC	100	55	9.5	10-15	10	3,1
IT	3	-3	-17	DB and NDC	14	DC	100	22(M)/17(F)*	33	5.7	6.91	1,6
CY	14	11	11	DB	/		100	/	16.6	/		6,2
LV	-12	-11	-11	NDC and DC	/		100	/	20	/		2,8
LT	-3	1	1	DB and DC	/		89	/	26	/		4,3
LU	0	-1	-1	DB	/		92	/	24	/		11,1
HU	5	13	13	DB and DC	/		100	/	26.5	/		3,9
MT	-9	-8	-8	DB	/		100	/	30	/		4,7
NL	11	11	2	DB	10	DB	100	91	7	9.8	11.5 -12.5	4,3
AT	5	1	1	DB	/		100	/	22.8	/		1,6
PL	-19	-16	-16	NDC and DC	/		77	/	19.52	/		-0,7
PT	-20	-20	-20	DB	/		81	/	33	/		1,3
RO	52	39	39	DB and DC	/		NA	/	29	/		7,7
SI	2	-4	-4	DB	/		100	/	24.35	/		6,9
SK	2	1	1	DB and DC	/		100	/	28.75	/		2,2
FI	-11	-12	-12	DB	/		100	/	21.6	/		4,2
SE	-13	-13	-11	NDC and DC	-2	DC	100	90	17.2	4.5	4.5	1,8
UK	-4	-2	-3	DB	0	DC	100	53 (M)/56(F)	19.85% (17.25%)	9	8	1,8

Source: ISG calculations done in the OECD APEX model or national models, EPC/AWG projections * Figures as of June 2008

** Contribution rates used for statutory schemes and also eventually occupational or private schemes included in the base case, giving elements on the representativeness associated with the base case. Contribution rates correspond to overall contribution rates as a share of gross wages (from employees and employers) used as assumptions for the calculation of theoretical replacement rates. Contribution rates may differ from current levels reflecting for instance projected increases in contribution rates, in particular as regards assumptions used for second pillar schemes. DK refers to contributions to the ATP (statutory Supplementary Labour Market Pension, though it should be recalled that the financing of the first pillar mainly comes from the general budget. For CY one fourth (4%) comes from the general State budget. For LU one third (8%) also comes from the general State budget. For MT this corresponds to a repartition of 10% from the employee, 10% from the employer and 10% from the State. For PL this corresponds to old-age contributions (19.52% of wage) and disability and survivor's contribution (13% of wage). PT: this corresponds to a general estimate (ratio between overall contributions and aggregate wages declared to social security).

***Note: AWG projections figures include funded tiers of statutory schemes and statutory early retirement scheme.

Annex 2: Composition of the SPC – ISG Task Force on the Interaction of Economic, Employment and Social Policies

Chair	Raffaele TANGORRA	SPC
Support team		
Coordination	Isabelle ENGSTED-MAQUET Ruth PASERMAN / Fritz VON NORDHEIM	EC/EMPL E2 EC/EMPL E4
Support team	Asees AHUJA	EC/EMPL E4
Support team	Katia BERTI	EC/EMPL E2
Support team	Håkan NYMAN	EC/EMPL E1
Support team	Jakub WTOREK	EC/EMPL E4
Member States		
ISG Chair	David STANTON	ISG Chair
BE	Muriel RABAU	SPC
BE	Rudi VAN DAM	ISG
CZ	Zuzana ZAJAROSOVA	SPC
CZ	Milos ZDENEK	ISG
DK	Ole KJAERGAARD / Josephine KRUSE	ISG
DE	Martin KOPPERNOCK	SPC
DE	Volker SCHMITT / Ulrich BIEBER	ISG
EE	Kaupo PALTSERI	ISG
IE	Paul MORRIN / Barry SOBEY	ISG
EL	Eric GAZON	ISG
ES	Aurelio FERNANDEZ / Dolores RUIZ BAUTISTA	SPC Chair / SPC
FR	Olivier BONTOUT / Guillaume DELAUTRE	ISG
LT	Grazina JALINSKIENNE	SPC
NL	Lauris BEETS / Aart Jan BETTE	SPC
AT	Hans STEINER / Andreas SCHALLER	SPC
AT	Christian KLOPF	ISG
LU	Tom DOMINIQUE	ISG
PL	Marzena BREZA	ISG
PT	Rute GUERRA / Gisela MATOS	ISG
FI	Tiina PALOTIE-HEINO	ISG
SE	Johanna MOLLERBERG	SPC
SE	Kristoffer LUNDBERG	ISG
UK	Aaron G. GRECH	ISG
Observers		
BE	Tom BEVERS	EMCO representative
Commission	Fabiana PIERINI	EC/ECFIN DDG-B3
Commission	Jorge PINTO ANTUNES	EC/SANCO C5
Commission	Pascal WOLFF	EC/ESTAT F3

Annex 3: Countries' abbreviations

EU-27	European Union – 27 Member States
BE	Belgium
BG	Bulgaria
CZ	Czech Republic
DK	Denmark
DE	Germany
EE	Estonia
IE	Ireland
EL	Greece
ES	Spain
FR	France
IT	Italy
CY	Republic of Cyprus
LV	Latvia
LT	Lithuania
LU	Luxembourg
HU	Hungary
MT	Malta
NL	The Netherlands
AT	Austria
PL	Poland
PT	Portugal
RO	Romania
SI	Slovenia
SK	Slovakia
FI	Finland
SE	Sweden
UK	The United Kingdom