

Brussels, 29 September 2009

## **Report on the social dimension of the growth and jobs strategy**

### **What is the report?**

The report is a contribution to discussions on the future shape of the EU's Growth and Jobs Strategy and looks at the way economic, employment and social policies interact. It has been prepared by the EU Social Protection Committee (SPC), which brings together experts representing each Member State together with the European Commission. The report investigates the extent to which past economic and employment growth have contributed to greater social cohesion, as well as the extent to which the modernisation of social protection systems has supported this growth. The analysis was conducted by the SPC and its indicators sub-group and the Commission. The report was adopted by the SPC on 14 September 2009.

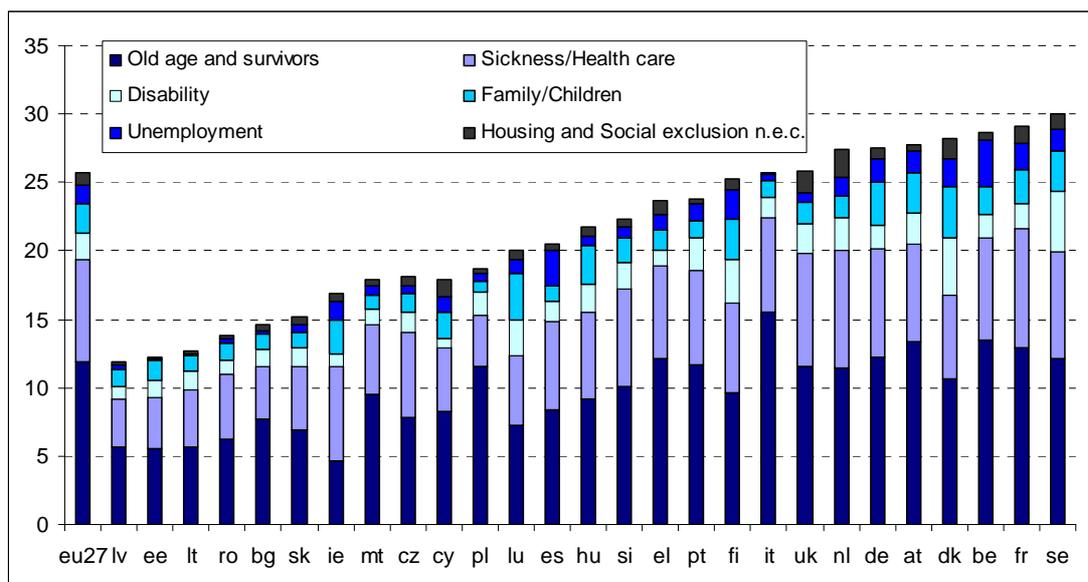
### **What is the main conclusion?**

Over the past decade, economic and employment growth has in general improved overall living standards and governments have been able to devote more resources to social policy intervention. However, poverty remains a major issue in most countries and more needs to be done to ensure that labour markets are truly inclusive and that the jobs created provide for decent living standards. During this time, social protection systems across Europe have undergone a deep modernisation and they have played a decisive role in cushioning the social impact of the recent economic and financial crisis. However, further modernisation of social protection needs to be fully articulated with growth and jobs strategies.

### **What is the role of social protection expenditure in Europe?**

Social protection plays a redistributive role over the life-cycle; insuring people against social risks and helping reduce poverty. Generally, richer countries spend a larger share of their GDP on social protection and recent economic growth has allowed many governments in the EU to devote more resources to social policy interventions. 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 and have also been the areas in which most reforms have taken place.

Figure 1 Expenditure on social protection benefits, by function, in % of GDP — 2006

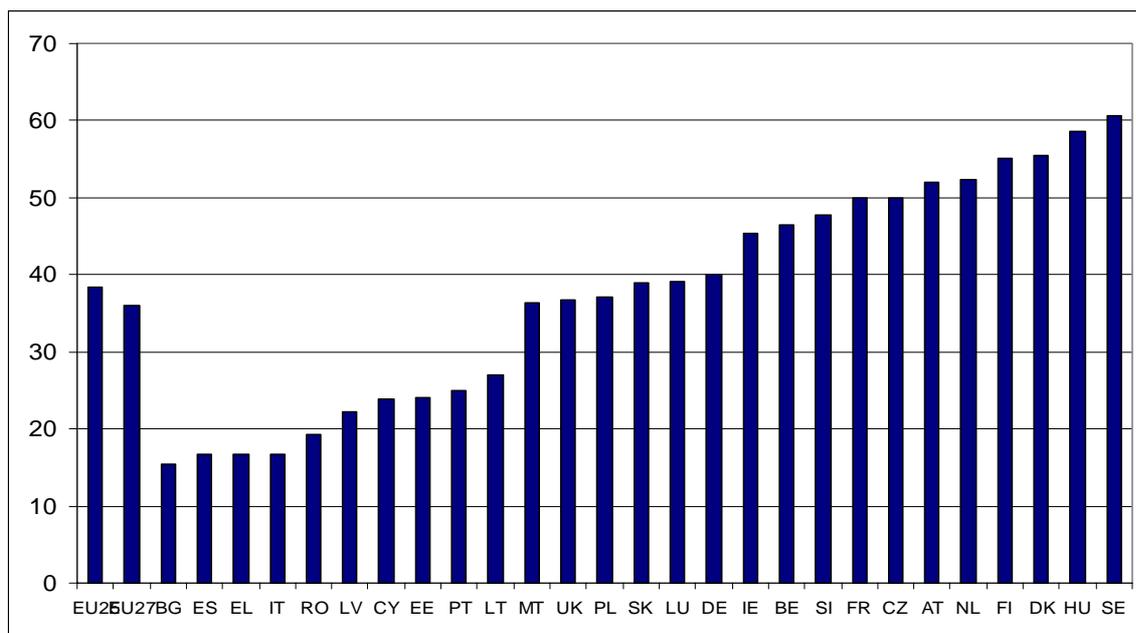


Source: Eurostat - ESSPROS 2006

### How can policies help reduce inequalities and fight poverty?

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. Available evidence highlights a large variation across Member States in net cash support to low-income households. 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 largely reflects differences in the size of expenditure, which vary from 12% to 30% of GDP, but the composition of expenditure and the quality of interventions also play an important role.

Figure 2 – Impact of social transfers (excluding pensions) on the at-risk-of-poverty rate for the total population (percentage reduction), 2007



Source: EU-SILC 2007

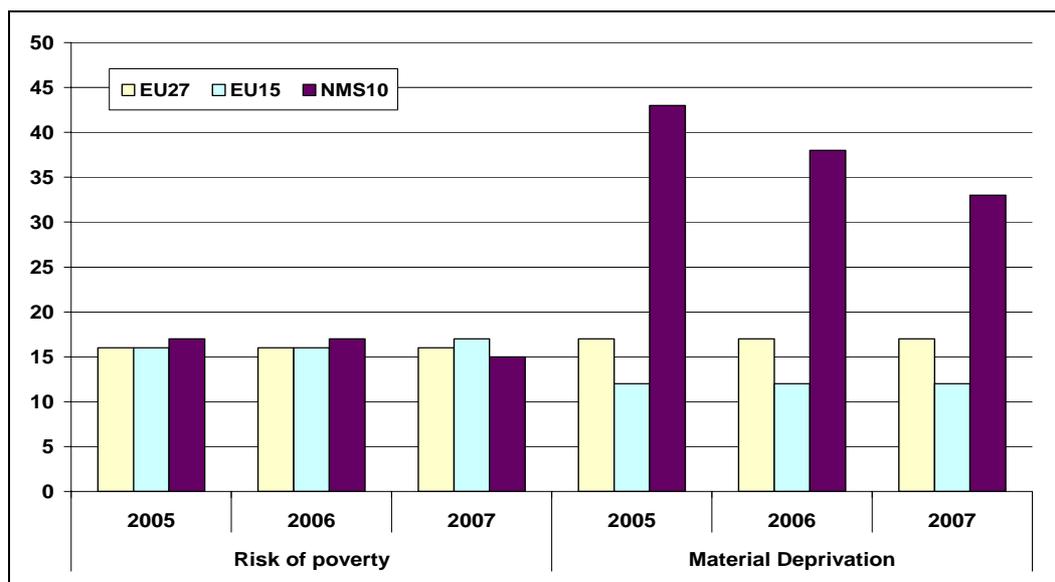
### How have inequality and poverty evolved over the past decade?

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. **Most increases in inequalities** happened between the mid-1980s and the mid-1990s. Over the last 10 years inequalities have remained stable in most countries, but a few stand out as exceptions. 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.

According to national sources gathered by the OECD, **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. Fully comparable EU data available for the last three years confirm the stagnation of relative poverty, but at the same time shows that living standards improved in the new Member States, as measured by **material deprivation rates**. The material deprivation rate, recently adopted as an EU indicator, 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.<sup>1</sup> The improvement of the material deprivation rate in the new Member States parallels the relative improvement of GDP per capita in these countries. This emphasises that the fight against poverty in the EU will benefit from a greater economic, social and territorial cohesion within the EU.

<sup>1</sup> 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 3: Trends in poverty rates and material deprivation, Total population - 2005-2007



Source: EU-SILC (2007, 2006, 2005); Without BG and RO

### Did the jobs created in the last decade help reduce poverty?

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.

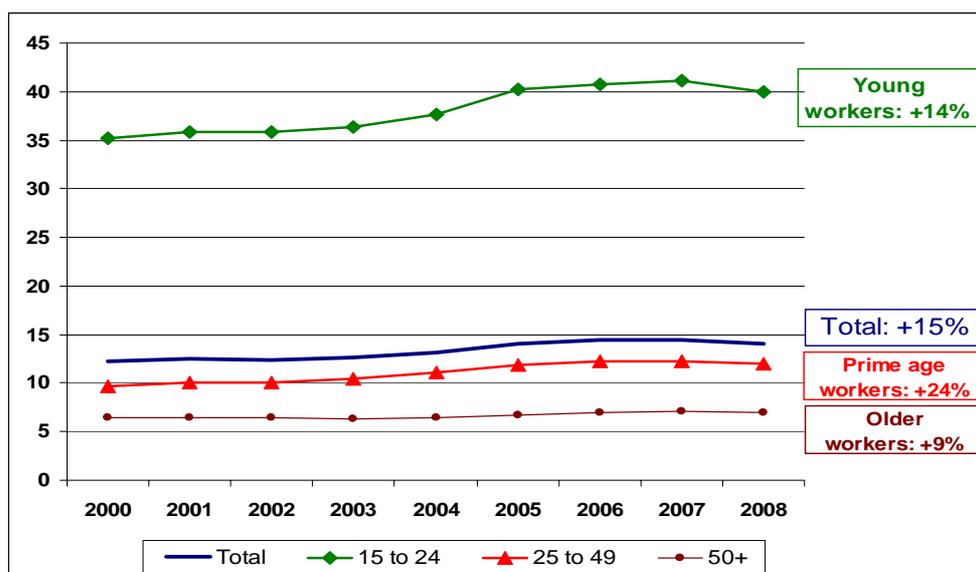
However, at the outset of the crisis, about **one third of the working age population in the EU was out of work** (unemployed or inactive). Evidence also shows that **under-employment and precarious forms of contracts mitigate the positive impact of including more people in the labour market.**

### What about in-work poverty?

The experience of this decade has confirmed **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 three 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 (see Figure 4), 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. In addition, evidence shows that **non-standard workers are generally paid less per hour after controlling for differences in education and experience**; and for many, these jobs are not stepping stones towards better jobs.

Figure 4: Increase in the share of workers holding temporary contracts, by age 2000-2007, EU27



Labour Force Survey

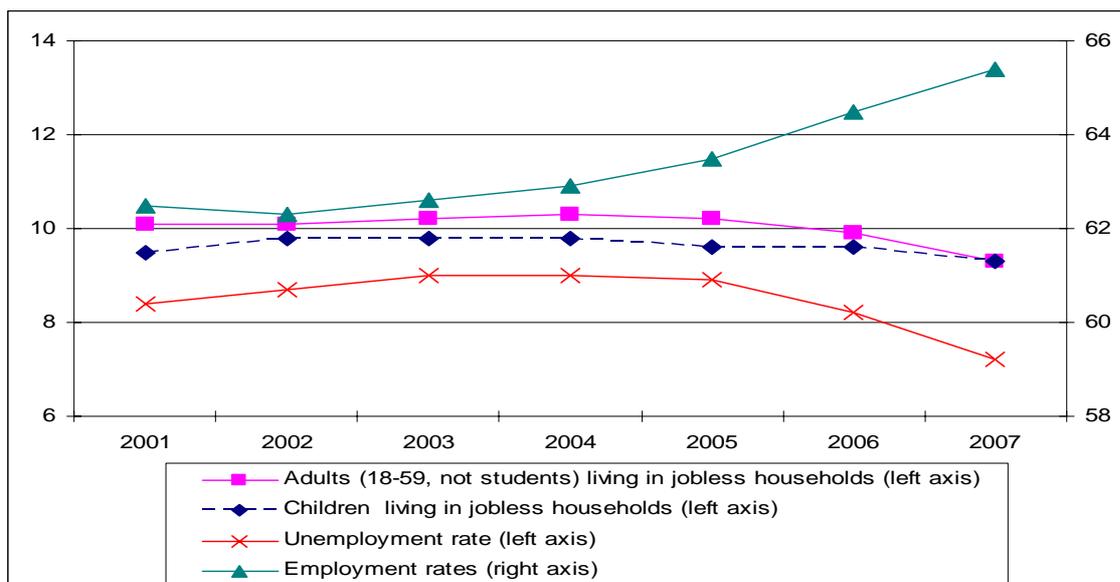
In-work poverty is also related to **low work intensity** in the household, i.e. situations where there are too few adults working in the household, or not working enough to make a living (too few hours or only part of the year). Among these, single and lone parent households not working full time, as well as one-earner families face the highest risks of poverty.

### What about vulnerable groups?

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. The crisis is likely to increase the number of families having to rely entirely on social benefits.

National experiences from past crises show that stocks of long-term unemployed or inactive tend to persist long after recovery has set in. In some countries 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. Some types of short-term responses to sudden increases in unemployment can emphasise these trends and should therefore be avoided.

Figure 5: EU - Employment and unemployment rates and shares of children and adults (aged 18-59 and not students) living in jobless households; 2001-07 — %



Labour Force Survey

### What more can be done to support those furthest from the labour market?

The report reviews the main policy developments that were meant to remove the barriers to access to the labour market and to enhance job quality. It shows that some progress has been made in enhancing activation measures across EU countries, but that access to life long learning needs to be improved, especially for the **low skilled who continue to participate much less in training than the average worker**. 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**. Furthermore, financial disincentives are not the only barriers to labour market participation, adequate and individualised support services play a key role.

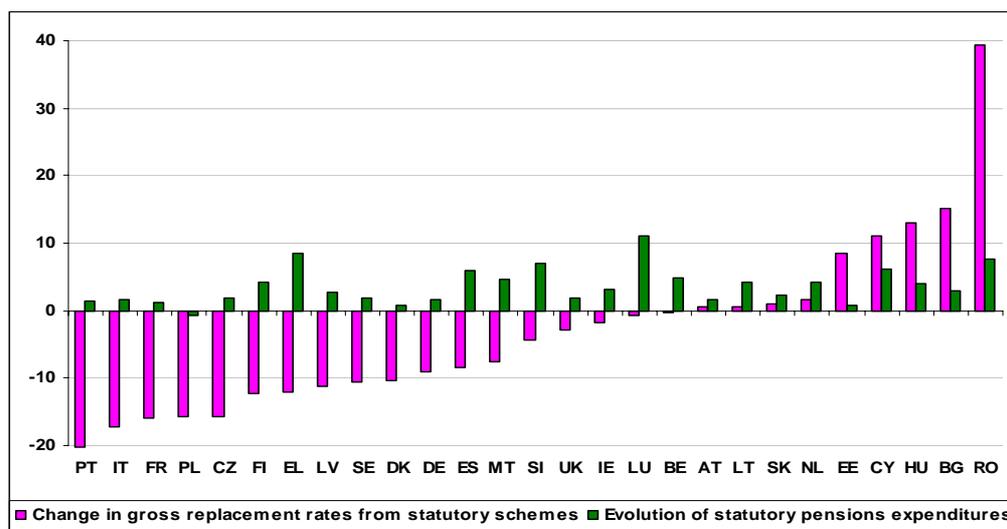
The report illustrates that in order to reach the most vulnerable, without necessarily increasing spending, the measures described above need to be **integrated into active inclusion strategies**, combining adequate income support, access to the labour market and the provision of enabling services. **Fighting labour market segmentation and encouraging job quality** will also be crucial.

### What have been the effects on social protection schemes?

#### Pensions

Over the last decade many Member States have reformed their pension systems in light of populations ageing. As a result of these reforms public pension expenditure is now expected to increase more moderately over the next 40 years than before. However, as a consequence of these reforms, pension levels from public pensions are expected to decline unless people work more and longer. This is illustrated in figure 7.

Figure 6: 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

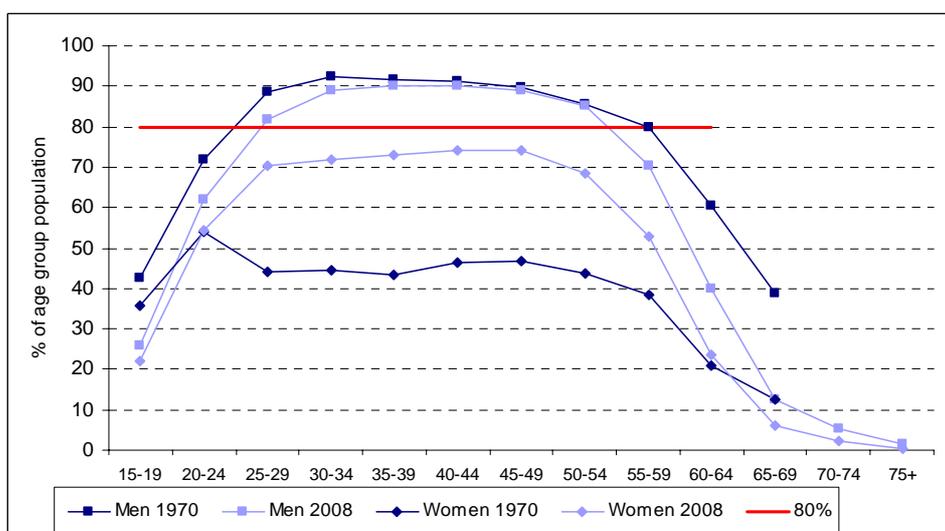


Source: SPC/ISG and EPC/AWG

Calculations show that reforms still need to be pursued and monitored and fully articulated with growth and employment strategies. Without pension reform, due to changes in the old age dependency ratio, public pension expenditure in the EU-27 would increase from 10.1% of GDP in 2007 to 18.8% in 2060. However, Member States have implemented reforms that improve long-term sustainability of pensions. As a result of these reforms and a projected increase in employment rates of the population aged 15-64 from 65.5% in 2007 to 69.9% in 2060 public pension expenditure is projected to reach only 12.5% of GDP in 2060.

The scope for increases in employment rates overall, and for older workers in particular, is still considerable. Despite substantial growth in the employment rate of older male workers over the last decade the graph below clearly indicates that employment rates of older men were substantially higher in 1970, when life expectancy was much lower than today, while longevity was shorter.

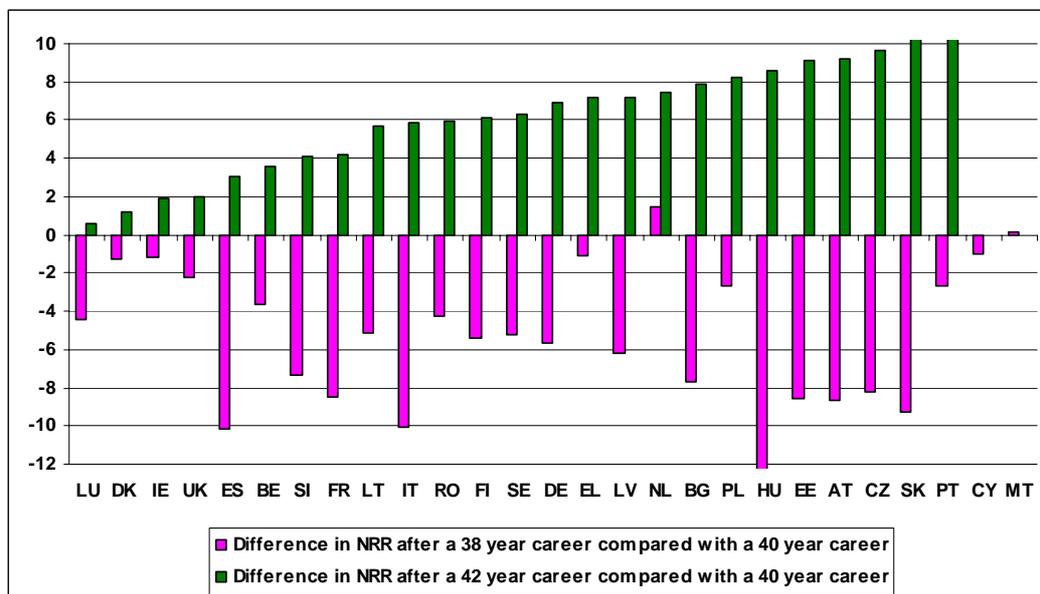
Figure 7: Employment rates by gender in the EU-15, 1970 and 2008



Source: OECD Statistical database

Through reforms countries have strengthened the financial incentives in pension systems for individuals to prolong working lives and to bring the effective retirement age more in line with increases in life expectancy. The figure below illustrates the potential economic consequences of retiring at ages 63 or 67 instead of age 65.

Figure 8: 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

At the same time the interests of vulnerable groups have been considered as in more Member States these work incentives have been balanced with protection for career breaks and strengthened minimum pension benefits.

#### Health and long-term care

The availability, affordability and quality of health and long-term care systems can strongly contribute to ensuring healthy, independent living and improving labour market participation and productivity. However, there are inequalities in health between and within countries. Between EU Member States there is a 14 year gap in life expectancy at birth for men and an 8 year gap for women. Within Member States differences in life expectancy at birth between lowest and highest socio-economic groups can reach 10 years for men and 6 years for women.

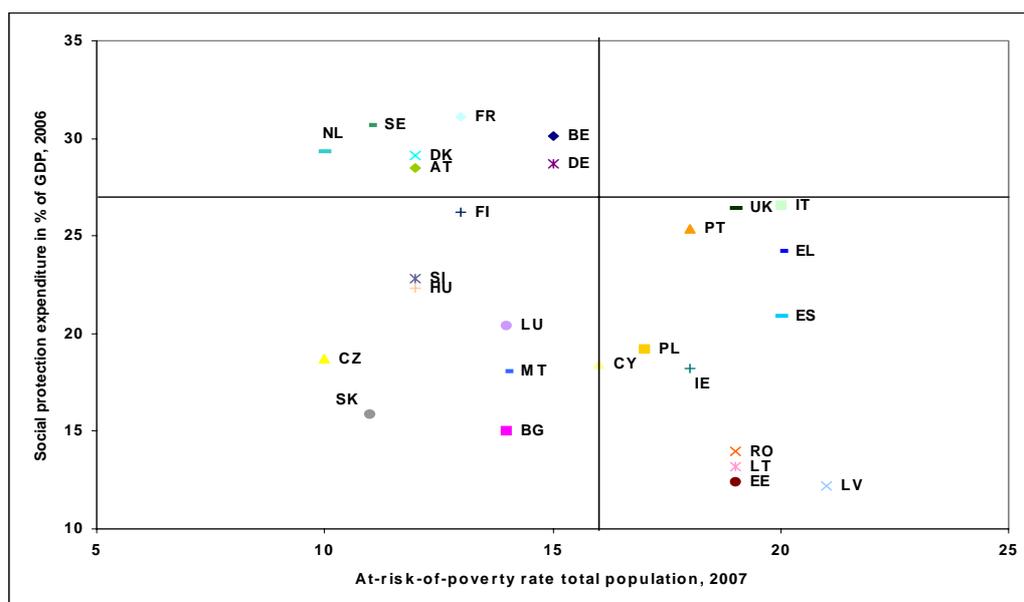
Health and long-term care expenditure represent a significant share of GDP and is on a secular rise. There is a growing share of GDP spent on healthcare in view of ageing, technological development, growing patient expectations and increased risky behaviour (for example, alcohol abuse or obesity in children 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. Hence, improving the value for money of healthcare systems through enhancing effectiveness, efficiency and priority setting have been deemed an urgent task.

#### **What has the crisis shown us about adequate and sustainable social protection provision over the economic cycle?**

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 (e.g. EE, LT, LV, RO). 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 of social protection systems in reducing poverty. The graph below also illustrates the different situations Member States face at the onset of the economic crisis.

Figure 9 Total social protection expenditure and at-risk-of-poverty rate of the total population in EU Member States



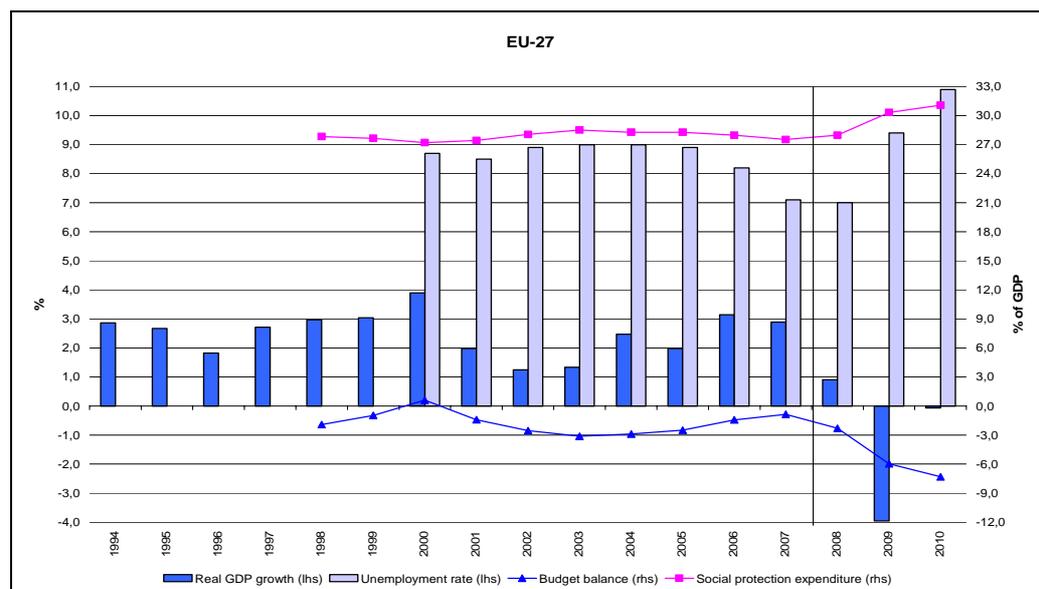
Source: ESSPROS 2006, EU-SILC 2007

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

An analysis of the evolution of social spending and public deficit against the economic cycle illustrates to which extent social spending are counter-cyclical, both in bad and good times. Ideally, 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.

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. In recent years, a trend can be observed towards increased resources from general government budgets devoted to social protection. Promoting labour market participation even while improving the fairness, efficiency and effectiveness of social spending will be crucial for all countries. This will help to ensure counter-cyclicity towards economic growth and address fiscal imbalances.

Figure 10 Expenditure on social protection benefits since 1994 in the EU in relation to the fiscal situation, % of GDP



Source: AMECO database

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 for well functioning social protection systems. Modernisation of social protection needs to be properly articulated with effective strategies for growth and more and better jobs.

### How does the experience differ at national level?

Importantly, the report has gathered a number of country stories that illustrate the diversity of experiences Member States have gone through over the past decades. In each country the impact on social cohesion differs as a function of how global trends have combined with country specific developments in the economy the labour market and policy interventions. This also helps explain why Member States are in very different positions to face the crisis, with regards to the adequacy of their safety nets, the ability of their social protection systems to act as automatic stabilisers and with regards to their long-term financial sustainability. Lessons can be learnt from each of these stories, especially at a time when Member States are facing the crisis.

See also [IP/09/1374](#)

Report by the Social Protection Committee on the post-2010 Lisbon Strategy and summary

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