A NEW WELFARE ARCHITECTURE FOR EUROPE?

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by

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EXECUTIVE SUMMARY

EU member countries all face similar challenges to their existing social protection systems. Demographic transformation promotes new household vulnerabilities, augments the risks of poverty, spurs a decline in fertility, and accelerates population ageing. The welfare state must manage new needs all the while that its long-term sustainability is questioned. Large parts of Europe suffer from sub-optimal employment levels and, at the same time, labour markets spur new inequalities and exclusion. These are all long-term structural changes that are unlikely to correct themselves autonomously. Hence, we face a genuine Gordian Knot: how to sustain Europe's normative commitments to social justice while aspiring to be a truly competitive force in the evolving knowledge economy.

The EU is composed of diverse policy traditions and institutional arrangements, and their ability to respond to the new socioeconomic order will accordingly vary. There is, however, wide agreement that the existing welfare edifice, by and large constructed in the postwar decades, requires fundamental rethinking so as to meet the new challenges ahead. The title of our report is provocative, suggesting the need for not just policy adjustments and piece-meal reforms but, indeed, for an entirely new 'welfare architecture'. We remain convinced that such is, in fact, needed. We also admit from the very outset that the report we here submit is, at best, a very partial instalment in what must be an ongoing, lengthy, and far more comprehensive project of reforming the 'European social model(s)'.

Our work is based on an uncommon but powerful method for diagnosing emerging risks, needs, and policy challenges. In brief, we focus on cohorts and life courses. When the future is difficult to discern, we need tools that permit us to make plausible forecasts. If we know how events at an early stage of life influence subsequent life chances, this allows us to take a 'peek' at what society might look like years or decades hence. This focus has additional advantages: firstly, social policies must promote citizens' life chances rather than merely serve as stop-gap measures and, for this reason, a dynamic life course perspective is essential. Secondly, social needs and risks bundle at different stages of peoples' life course. Ongoing change is producing radically different risk-concentrations across the life cycle. And thirdly, any acceptable solution to ageing necessitates an equitable and just inter-and intra-generational distribution of burdens and benefits.

At the expense of arguably equally urgent issues, such as health care, we focus on three welfare problematics that can be regarded as basic cornerstones of peoples' lives and of our welfare edifice. It is in childhood that the foundations of citizens' life chances are laid. A good life in the future will require far greater resources and competences and we therefore advocate a comprehensive social investment strategy in favour of children and families with children. The second problematic centres on worklife. After all, employment is for most people, during most of their lives, the prime source of welfare. Contemporary European employment policy suffers from what, we believe, are two 'blind spots'. One is the belief that more jobs will resolve the looming problem of social exclusion. A second is an incomplete understanding of the evolving tensions between family life and paid work, for women but also for men. The third welfare problematic is how to design a sustainable and equitable retirement system. How welfare assurances for the elderly are designed will deeply influence our behaviour throughout our lives. Any commitment to a secure old age must go hand-in-hand with a fair distribution of the costs between the elderly and the young.

Identifying broad policy objectives with no regard for their practical political relevance and implementation within diverse European welfare models would easily end up as a sterile academic exercise. For this reason our report includes a fourth 'problematic': the preconditions that make reform both necessary and feasible within nations as well as at the EU level. The challenges may be very similar, from Finland to Greece, but each member state has its own welfare policy legacy, distinct system of interest organisations and democratic polity. It is within such diversity that actual, concrete welfare reform will be undertaken.

Investing in Children, Families and Women

Any realistic solution to the 'Gordian Knot' must include a far more active policy directed at children and women. This is the basic theme of Chapter 1. The household constitutes the basic context for policy rethinking. If our concern is with social justice and equal opportunities, we need to design policy that diminishes the effect of intergenerational social inheritance. If our concern is with maximising our future productive potential we need to invest far more in the cognitive development of children. And if our aim is to avert social exclusion, we need to equalise the resources that citizens command beginning in childhood and youth, and extending throughout their adult lives. We know that the parental effect, combined with the economic and social conditions in childhood (especially early childhood), have an overpowering effect on subsequent school performance, career prospects and, more generally, life chances. We also know that remedial policies, such as 'activation', are only truly effective if people already possess sufficient abilities and motivation to begin with. Hence, the pursuit of all three goals stated above boil down to one overriding prescription, namely to *invest massively in children* (and, by implication, in households with children). Concretely this entails, first and foremost, the eradication of child poverty. Strong income guarantees to families with children are a must. Also a must are policies, such as universal, high quality day care, that compensate for unequal intellectual stimulus and 'social capital'. If, as is now the case in many member countries, 20 or even 30 percent of youths fail to attain the equivalent of secondary education, these same 20-30 percent risk social exclusion throughout their lives *and*, as future parents, they are likely to pass on under-privilege to their children. It also urgent that we compensate for the potentially damaging effects of family break-ups by giving strong support to mothers and lone mothers in particular. Since (multiple) welfare problems tend to concentrate in certain households, such as workless households, and since more generally mothers' employment is a truly effective solution to child poverty, it is paramount that a future child-friendly policy be linked together with women-friendly policy.

Resolving the incompatibilities that women face turns out to be also part of the remedy against childhood poverty. Our conclusions echo what is now common wisdom among policy makers across Europe: a comprehensive women-friendly policy of affordable day care and flexible leave arrangements is *sine qua non* in the pursuit of multiple goals:

more gender equality, raising female employment to offset smaller active populations and, as an added bonus, a broadening of the tax base. But, we conclude, such is necessary but *not* sufficient policy. There are three basic caveats. One, in order to make paid work truly compatible with having children, most mothers will need both secure and flexible jobs. Two, if mothers are forced into stressful or insecure jobs, this can have negative, secondary effects on their children's well-being and development; the quality of jobs is decisive. Three, a strongly gender-segregated labour market is very possibly the outcome as, increasingly, mothers pursue life-time careers. If, then, we are genuinely committed to gender equality there is no choice but also to change men's working time and career preferences. This means altering the differential incentives and opportunity costs associated with paid and unpaid work. Europe's extremely low birth rates signal widespread welfare deficiencies, that citizens are unable to have the number of children they actually desire. A return to *individually* desired birth rates is unlikely to happen unless the conventional 'women-friendly' policy package is complemented with a 'parent-friendly' employment policy. Here Europe can draw both positive and negative lessons from contemporary Scandinavia.

Working Life and Social Exclusion

Employment growth is now a core component of Europe's fight against social exclusion. There is, however, need for caution since social inclusion is also a function of the nature and quality of jobs. This is the theme of Chapter 2. At least a third of jobs in the EU are of poor quality, in the sense that they provide very few opportunities for learning and skill formation and also very little involvement in decision-making or working conditions. At best, they provide a very limited form of inclusion; at worst, such employment may inadvertently reinforce and perpetuate precariousness and marginalisation.

Low quality jobs are associated with low work satisfaction, stress and health problems. There is evidence that this, together with vulnerability to unemployment, has problematic secondary effects on family and social life. In the case of mothers, for example, we know that employment as such can be positive for children but if employment is stressful and insecure, the effect can be very negative.

Low quality jobs also provide very limited opportunities for skill enhancement. Employer training programs typically exclude those in low-skilled work who, therefore, risk skill redundancy and, worse, an erosion of their basic learning abilities. This is one key factor behind the very high unemployment rates among the less skilled. More broadly, low-skilled employment easily converts into a life-time of precariousness and marginality. The chances of moving out of poor quality jobs are low indeed. 85 percent of those who occupied such jobs in 1994 were still in this type of work in 1996.

In addition, ongoing trends in worklife have potentially negative health consequences. The intensification of work in the 1990s has been associated with growing levels of work-related stress. The rising pressures of work may very well increase disabilities and, hence, workforce withdrawal and early retirement.

Programmes designed to enhance the skills and employability of unemployed workers have not proved very effective. If people have experienced years of skill neglect or erosion, short-term training programmes will yield few positive results. It is symptomatic that the jobs to which the unemployed return tend to be even less secure and 'marginal' than low-skilled jobs in general. Hence, such programmes do little to curb the risks of long-term entrapment.

If our overriding goal is social inclusion and sustained employability for the most vulnerable workers, a first objective must be to invest more in maintaining and improving learning skills over peoples' working lives. A second objective must be to ensure that workers' physical and psychological health is adequately protected. A strategy to improve the quality of working life includes *inter alia*:

- An active role by the EU and national governments in promoting quality of life issues, developing an effective system of dissemination of best practice, and monitoring change over time.
- The inclusion of quality of working life issues as an integral part of the agenda of institutions for employee participation.
- The provision of external auditing of organisational strategies with respect to working conditions and employee health.

- A system of citizen's training entitlement. Individuals should be able to build up training credits over time. These credits should be portable between employers, and should give access to vocationally relevant training of their choice.

A New Social Contract for the Elderly

The objective of Chapter 3 is to propose strategies aimed at realising the 10 common objectives for pension policy embraced by the Commission. One key issue is how to allocate the *additional* retirement costs that inevitably accompany demographic change. The challenge is to promote intergenerational equity, intragenerational justice, and gender equality all at once.

Intergenerational equity. The large pay-as-you-go schemes in many member states are traditionally based on a defined benefit formula, which imposes all the costs of population ageing on the working population (contributions). Fixed contribution schemes, by contrast, impose all the costs on retirees. *We advocate adoption of the Musgrave (fixed relative position) principle that allows for proportional sharing among the generations as a standard litmuss test for intergenerational equity, regardless of national differences in pension design.*

Intragenerational justice. We advocate adoption of a 'Rawlsian' standard of justice – that any change in the status quo must be of the greatest advantage to the least well-off. This should constitute the benchmark for the allocation of additional retirement costs *within* both the retired and working age populations. Proportional increases in contributions or proportional reductions in benefits that do not reflect ''ability to pay'' do not satisfy this criterion. It may, accordingly, be necessary to recalibrate the traditional social insurance model of old age security.

Financing additional retirement costs with a flat payroll tax imposes all of the costs on wage income, while capital and transfer incomes are exempt. This discourages employment at the bottom of the labour market and may have especially adverse consequences for younger families. *We advocate greater reliance on general revenue financing to meet additional retirement costs, on the one hand and, on the other hand,* *the use of these revenues to create or enhance carefully targeted cross-subsidies on the benefit side to meet social objectives and to protect the least advantaged retirees.*

In particular, a carefully designed basic security system that provides a *minimum guaranteed retirement income* above the poverty line should be regarded as one among several social objectives, which we examine in Chapter 3. This will ensure income security for future generations, and would be financially feasible in most member states.

Gender Equality. The promotion of gender equality in retirement is intrinsically linked to more gender equality in working life, as examined in Chapter 1. We highlight the special importance of addressing the caring needs of the frail elderly to achieve this objective. The rising numbers of frail elderly requiring assistance is one of the major costs of population ageing. This cost has traditionally been absorbed by daughters. Such familial solutions are wholly unrealistic in a future where the demand for care is rising while the supply of unpaid caregivers will decline sharply – insofar as the EU employment objectives for women are realised.

Finally, it is vital that we adopt a new practice of measuring retirement costs and, by implication, social protection costs more generally. The open method of policy coordination among member states requires that estimates of changing retirement costs and their allocation be based on the *entire* retirement budget and not just the public sector share. *Open policy coordination requires that member states commit themselves to developing credible accounting schemes based on all three tiers of the retirement income system. This is a precondition for measuring the intergenerational, intragenerational, and gender allocation of retirement costs due to population ageing, and their re-allocation that results from future reforms.* This task is especially urgent in light of the trend toward shifting retirement costs to private sector programmes as a means to stabilise public finances.

The Politics of Reforming Social Protection Systems

European welfare states are exposed to similar policy challenges, yet these manifest themselves in terms of divergent problem loads from one country to the next. We can broadly identify three groups of countries that share rather similar welfare and institutional attributes: Scandinavia, the Anglo Saxon model, and the Continental European model. The urgency of reform, but also the capacity to undertake reforms, depends on how collective bargaining is organised and on the ability of the social partners to pursue policy concertation. It also depends on already existing policy institutions and practice, such as the nature of a country's pension system, its development of social services, its capacity to tax, or its overall employment levels. These are the core issues of Chapter 4.

To exemplify with pension policy, the success of national reform efforts varies enormously, even among countries with similar pension systems. The feasibility of reform depends to a large extent on nations' institutional capacity to orchestrate a consensus among the main political parties and, equally importantly, also among the social partners. If we are to pursue social reforms with effects far into the future, these will garner far greater public support if they flow from broad consensus. Any new social model is unlikely to succeed unless it enjoys a strong and widespread measure of trust. Generally, we see that measures that benefit the worst-off are most likely to gain broad societal support. Yet, we see very little progress with respect to active employment policy for older workers.

A core feature of innovative social policies is that they tend to delegate power for local implementation to collaborative public-private arrangements and even to wholly private actors. We see more and more decentralised co-ordination. This applies also to policy experiments at the EU level. The Luxembourg process has fostered a climate of cross-national policy-learning. The evolving open method of coordination, adopted during the Portuguese presidency, promotes a new form of multi-level governance. Here the interplay of domestic reform and supranational agenda-setting allows domestic policy makers to learn from 'best practice' elsewhere while setting commonly agreed guidelines.

One great advantage of the open method of coordination is that subsidiarity ceases to be a zero-sum relation between member states and EU institutions. It helps advance *both* substantive EU objectives for employment and welfare *and* more ambitious national reform goals. Recent developments mark a distinctive and, in some instances, already successful European response to the massive policy challenges ahead. Therefore, in sharp contrast to the diagnosis of Europe as 'sclerotic', what we see is a dynamic process of *self-transformation of the European social model(s)*.

INTRODUCTION

Anyone who has suffered an introductory economics course knows that the promotion of economic efficiency can only be justified if it enhances welfare. The European project has, so far, prioritised economic parameters and it is therefore quite natural that public opinion now demands a more social Europe. This report for the Belgian Presidency attempts to define some of the basic building blocks for a future social model. Social policy innovation on a European level must consider three fundamental constraints and one window of opportunity. One constraint is national policy sovereignty, a second is historically inherited social policy traditions that vary across the EU and a third is the broad popular support in favour of sustaining the welfare state as we know it. The window of opportunity is that all member states are urgently seeking policy remedies to cope with tough new welfare challenges.

This window of opportunity will most likely result in radical system re-design. The surge of laissez-faire liberalism in the 1980s failed to leave much of an imprint on European social policy. Evidently, most member states are not prepared to experiment with their welfare model. Hence, we can preclude *tout court* privatisation of pensions from the menu of options to the ageing challenge. Likewise, sweeping wage and job deregulation is unlikely to be the flagship of any full employment strategy. In other words, our reform scenarios must, as a first requisite, remain faithful to broadly shared welfare goals. Be it citizens, their governments, or EU institutions, the commitment to the welfare state remains solid.[2] The question is *which kind of welfare state?*

The Dutch presidency took an important step towards a more social Europe, not just because it launched the common employment strategy, but also because it brought social policy into the centre of economic strategy debates ('social protection as a productive factor'). A further powerful impulse came from the Lisbon Summit in March 2000, which placed social protection at the top of the political agenda. To quote point 7 of the EU Council's communication to the Nice European Council (December 2000) '*the European social model, with its developed systems of social protection, must* *underpin the transformation to the knowledge economy. People are Europe's main asset and should be the focal point of the Union's policies. Investing in people and developing an active and dynamic welfare state will be crucial both to Europe's place in the knowledge economy and for ensuring that the emergence of this new economy does not compound the existing social problems of unemployment, social exclusion and poverty'*.[3]

Here we are permitted a first, if quite generic, glance at what might define a common European objective, namely active promotion of the knowledge economy while stemming social exclusion and poverty. In the wake of the 1998 EU Employment Guidelines, the Social Affairs and Employment Council endorsed the pursuit of gender equalisation, making work pay, safe and sustainable pensions, the promotion of social inclusion, and the pursuit of high quality and sustainable health care. Also, in the context of the Portuguese presidency, the Belgian-British call for procedures and benchmarks to combat the causes of poverty and social exclusion was adopted by the EU Council (where children were singled out for special concern). But with few exceptions, such as the 60-percent female employment target for 2010, good intentions far exceed the number of concrete policies adopted.

European governments are acutely aware of the necessity to reconsider existing social protection systems. There is, for example, the perception that economic competitiveness demands a more active social investment strategy. To quote Commissioner Anna Diamantopoulou, "*quality in our social policies is the key to ensuring a high performance economy, and a just society*".[4] There is certainly no retreat from the principle of national policy autonomy and many member states remain as wary as ever of attempts to place social policy on any common European agenda. Nonetheless, the nascent 'open method of coordination' may promote a more active role for joint EU policy initiative if, that is, an agreement on shared aims can be reached. In this way, Europe might set common goals or even targets while leaving it to member states to decide on their implementation.

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[2] The strength of citizen support for the welfare state is, most recently, documented in Boeri et.al. (2001) and Taylor-Gooby (2001).

[3] The Council of the European Union. Document 14011/00, SOC 462 (Annex)

[4] Quoted in Minister Vandenbroucke's speech at the European Conference '*Social and Labour Market Policies: Investing in Quality* (Brussels, February 22, 2001).

For two reasons, the continued viability of the existing welfare state edifice is being questioned across all of Europe. The first is simply that the *status quo* will be difficult to sustain given adverse demographic or financial conditions. The second is that the same *status quo* appears increasingly out-of-date and ill suited to meet the great challenges ahead. Our existing systems of social protection may hinder rather than promote employment growth and competitive knowledge-intensive economies. They may also be inadequate in the face of evolving social risks and needs.

There is more than a passing similarity with the 1930's, another epoch of great upheaval and fundamental rethinking of the relation between government and citizens. Then emerged a plethora of 'models', from the American New Deal and Scandinavia's 'Peoples' Home' to social fascism. The plethora today runs from a dogmatic belief in markets to variant 'third ways'. The catchwords then were 'the people', universalism, social citizenship; the catchwords now are activation, capabilities and social inclusion.

At the risk of exaggeration one might say that the search is on for a recast welfare architecture, for a rewritten social contract. This implies normative questions of justice and visionary ideas about the institutional design of our welfare states. The former have to do with rights and reciprocity. What claims can citizens justly make on society? What is, to use Herbert Simon's expression, our collective patrimony and how should it be allocated? In brief, what principles of solidarity do we wish to realize? That said, we need also to define norms of reciprocity: what should be the realm of individual responsibility?

The question of societal design has to do with how we wish to produce welfare. This means deciding on how responsibilities ought to be divided between markets (purchased welfare), families (the reciprocity of kin) and government (solidarity). Too often, our attention is myopically focused on government. Should it shrink, grow, or do things differently? This leads to poor policy analysis because any specification of government's obligations has second-order effects on markets and families. If, for example, we decide *not to* develop public care services for the elderly, will markets and/or families compensate adequately? The real world of welfare is the product of how the three welfare pillars interact. If one pillar 'fails', there is either the possibility that the responsibility is absorbed in the two remaining pillars or, alternatively, that unsolved welfare problems mount. When we design social policies we must ask ourselves two basic questions: *can* the family, market or, alternatively, the state realistically absorb such responsibilities and, if so, would this be the *desirable* option?

Neo-liberals advocate the primacy of markets (and usually ignore the family), while conservatives favour more family and local community social responsibility. And social democracy's longstanding preference for collective solutions is anchored in its fear that both the family and the market alternative foster inegalitarian results. Europe is indeed an amalgam of ideologically distinct traditions. From this diversity we can learn a lot about which institutional option seems to perform well or poorly in the pursuit of any specified welfare goal. The choice of how to divide the responsibilities between the three cornerstones of the welfare triangle is what scholars term a choice between alternative *welfare regimes*. And it is this, in the final analysis, which we must decide upon.

Policy Making Under Uncertainty

If we detect some paralysis in contemporary policy-making, this need not be blamed on the poor quality of our elected representatives. When change is unusually sweeping, we must make decisions with a great number of unknowns: many of the basic parameters that have guided policy in the past, no longer exist. Today's decision makers (and median voters) grew up in an epoch when it was safe to assume that families were stable, that manufacturing was the fountain of jobs and productivity, and that peoples' life course was fairly standard and linear. Politicians then adopted a menu of policy 'basics' - universal education is the solution to class inequalities, the main social risks concentrate in old age or among families with large numbers of children and the chief priority is to safeguard the breadwinner because so many rely on *his* job and social entitlements.

If society is in flux, we face a double decision making problem. The first has to do with the unknowns. How, so to speak, might we penetrate the dense fog and see more clearly where we are and where should we be heading? The second is akin to the Rawlsean problem of justice. What should be the guiding principles when we simply do not know whether we, personally, will fall victim to the kinds of risks we face? [5] Here, according to Rawls' maximin principle, a rational, risk-adverse citizen would opt for egalitarianism and would accept a change of the *status quo* only if assured that the welfare of the weakest will be safeguarded. The European social debate is quite close to the Rawlsean ethos when it prioritises social inclusion and the reduction of inequalities.

Our report pursues a methodology that, we hope, helps us penetrate dense fog and reduces the unknowns. As will be explained below, the methodological tool is to identify the emerging policy challenges from the perspective of citizens' life course dynamics. It is this which informs our selective attention to a) childhood and family life; b) working life; and c) old age and retirement. [6] The report also builds upon a concern with social justice. Hence, our task is to search for a social order which makes the most of its human potential but which also guarantees citizens dignity, security and a belief in betterment.

Rewriting the Social Contract: Four Great Challenges

The 1930s and 1940s were a watershed in welfare state history precisely because the hardships of the Depression and war called for a new social contract between government and citizens. In that epoch, the urgency of reform was couched in terms of the 'social question' and the industrial class divide. The most notable achievements were progressive taxation, educational expansion, pension improvements, income maintenance, health care and job protection. The promise of more equality between the social classes was translated into a set of social citizenship guarantees. Some, like universal health care and education, spoke to the 'people', others were targeted on specific risks or life cycle phases. The single most important among the latter was, no doubt a new, inter-generational, retirement contract.

[5] I here use Rawls' concept more loosely than originally intended. Kangas (2000) presents a similar analysis which leads him to conclude that rational risk-adverse voters facing a choice between existing welfare models would most likely opt for a Scandinavian type model.
[6] To repeat, our report can only address the new welfare architecture partially. In particular, one key cornerstone of any welfare model, namely health, is not being examined.

Europe diverges in how such social contracts were put into practice. Scandinavia opted for an inclusive, general revenue financed, universal, flat-rate ‘peoples’ model. Continental Europe settled for contribution financed insurance, firmly linked to the employment contract. Britain, in tandem with other Anglo Saxon countries, began with universalism but came eventually to favour selective assistance to the poor combined with an emphasis on private welfare.

Today, regardless of model differences, all European welfare states confront a set of tough challenges because the basis upon which they were constructed is changing dramatically. New family forms are emerging, the shift to a knowledge-based economy changes skill requirements and the sustainability of our pension systems is threatened by ageing.

A new family policy

The main objective of post-war family policy was to safeguard the male breadwinner and provide relief to families with large numbers of children. On four grounds the conditions are now almost the opposite. Today, a first relevant question is how to recalibrate social protection in response to new family forms? Secondly, how to make the care of children more compatible with women's new role in employment and how, more generally, to facilitate the process of family formation? Young people face exceptionally high unemployment rates and huge barriers in housing markets. Thirdly, welfare states now need to deal more effectively with rising family instability, which often goes hand-in-hand with poverty. And fourthly, the quality of childhood matters ever more intensely. It is in childhood that citizens acquire cognitive abilities and motivation for learning, together with social and cultural capital. All are becoming increasingly indispensable for peoples' life chances, but they must be assembled in a context in which families are ever more fragile and, especially, in which mothers will no longer accept a life dedicated to housewifery. In sum, we need an arrangement that harmonises careers and parenthood and which grants children security and a positive learning environment. For these reasons, Europe urgently needs to design a new 'social contract'.

A new gender contract

The latter part of the 20th Century was marked by the Cold War, immense technological change, internationalisation and by simultaneous de-industrialisation and post-industrialisation. These macroscopic forces are, in terms of their importance for citizens' lives, rivalled by the ongoing revolution in the role of women. Everywhere the post-war social contract was built on the then realistic assumption that women would, once married, withdraw into housewifery. But over the past twenty years, women's educational attainment has come to surpass men's and the male wage advantage is in decline. In as much as the new service economy favours women, the welfare calculus of households favours increasing female labour supply. Last but not least, women themselves increasingly insist on greater economic autonomy and professional development.

The ongoing gender revolution is both irreversible and desirable. To fully reap its advantages, we must recast the nexus between work, welfare and the family. Women's employment improves family welfare and at the same time helps to sustain future welfare state finances. But it also creates issues that pertain to new social risks, such as greater family instability and new '‘atypical'’, often vulnerable, households. If the 'incompatability' problem is not resolved, it may lock European societies into a long-term low-fertility equilibrium. As we will indicate in Chapter 1, this sharply contrasts with European citizens' own stated preferences regarding their desired number of children. There is clearly a strong case for a new 'women-friendly' social contract because improving the welfare of women means improving the collective welfare of society at large.

The policy challenge boils down to two principal issues. Firstly, how to make parenthood compatible with a life dedicated to work and a career. Given where we are today, this is usually identified as the question of 'women-friendly policy'. Secondly, how to create a new and more egalitarian equilibrium between men's and women's lives – the gender equality issue.

A handful of European welfare states, especially the Nordic, but also France and Belgium, have been vanguards in harmonising parenthood and careers. Most other EU member states have, if not actively then at least verbally, begun to advocate similar 'women friendly' policy. The sheer force of women's claims may drive this, but it also gains urgency from pragmatic concerns. As in Italy and Spain, where female activity rates remain half that of Northern Europe, there is an evident need to raise participation levels; partly to meet commonly agreed employment targets and partly as a necessary component of any longer-term sustainability strategy. Member states have generally responded far less to the gender-equality challenge. It is clearly difficult to reverse centuries of acquired behaviour and the search for an immediate patent solution would probably be futile. Yet, Scandinavian experience suggests that fathers' contribution to unpaid domestic work and childcare can be augmented by welfare incentives.

Labour Markets and Social ExclusionThe third challenge to traditional welfare structures comes from the transformation of work and the proliferation of new labour market risks. We are witnessing powerful shifts in occupational skills and in patterns of work organisation resulting from intensified international competition and from an increasingly knowledge intensive economy. These, in turn, affect peoples' capacities to adapt to change and their career prospects, they generate new forms of insecurity and they give rise to new types of health risks at work.

It is by now well documented that the overall thrust is towards rising skill levels. Industrial decline affects predominantly lower skilled jobs; the most dynamic services, like finance, business and social services are skill-biased. But the dominant wave of upskilling is easily accompanied by skill polarisation because labour intensive, routine services nurture a sizeable number of low qualified jobs (the so-called MacJobs). If these are concentrated in the private sector, they are likely to offer low wages and poor working conditions. [7]

The European employment strategy aims to fight social exclusion through job expansion. In most EU member states, fiscal constraints appear to preclude a major growth of public service jobs and, hence, such *quantitative* expansion may be accompanied by an expansion of *poor quality* jobs. The threat of job polarisation is real because investment in new skills is concentrated in higher occupational classes, while low-skilled jobs offer few opportunities for training, skill enhancement, or personal development. High employment levels may nourish a low-end labour market with a class of workers locked into inferior jobs, precariousness and also seemingly contradictory, high *risks* of unemployment.

Economic change also affects employees' health. Physical dangers were the main risk in the 'old economy' whereas stress-related risks come to the fore in the 'new economy'. This is exacerbated by employers' competitive strategies, in particular by increasing workforce productivity through decentralising responsibilities, intensifying work processes and favouring non-standard forms of employment. The new forms of worker insecurity are a contributing factor. Skill change is doing away with the tradition of jobs for life and the chances of a stable career depend on one's ability to constantly adapt and acquire new competencies. In this context, traditional health regulation

[7] For the most up-to-date survey, see OECD (2001). See also Scharpf and Schmidt (2001) for an excellent synthetic analysis.

systems are losing their effectiveness. Yet those who fall victim to such new health risks face high chances of labour market marginalisation.

The employment chances of households are another source of polarisation. On one hand, we see the rise of resourceful, work and income-rich households and, on the other hand, a similar rise in vulnerable households, such as lone parents and working poor couples. Such polarisation is additionally probable due to marital instability and marital homogamy. The challenge is how to integrate employment and family policy to strengthen families' employment prospects and effectively attack household poverty.

Household vulnerabilities and inferior employment are likely to coincide and, in this case, the chances of social exclusion increase dramatically. Also here, we must distinguish between temporary and persistent deprivation. Individuals' life chances are not *per se* affected by a short stint of low pay, lone parenthood, or MacJobs. But they are if deprivation and, especially, multiple deprivations persist. Any serious pursuit of social integration must include guarantees against entrapment in deprivation.

The duration of poverty increases substantially when overall poverty *levels* are high (Duncan et.al., 1993; Bradbury et.al., 2001; OECD, 2001). This empirical relationship is absolutely critical because it suggests that lowering poverty *per se* is a first and necessary ingredient in any strategy for social inclusion. As will be examined in Chapters 1 and 2, persistent social exclusion and under-privilege constitute a growing risk and, for this reason, it is urgent to develop effective guarantees against entrapment.

Since it is abundantly clear that a negative spiral of social exclusion is primarily caused by lack of access to stable, well-paid employment, it is hardly surprising that policy is focused on either 'making work pay' or on activation and learning. The weakness of either is that it typically comes too late. A far more effective long-term strategy is preventive, starting with major social investments in childhood and youth. Those who begin life with insufficient schooling or motivation to learn will, in a knowledge economy, in all probability face a difficult life course of low wages, poor training opportunities and precarious employment. Even well designed activation programmes are unlikely to correct this. Hence, we argue that a preventive family policy, combined with an active learning policy, *is sine qua non* for a socially integrated future Europe.

The generational contract

The post-war retirement contract was based on favourable demographics and robust economic growth. Generous pay-as-you-go pensions were financially viable because real wages and the number of contributors grew. Neither are the case now and thus we are now facing the challenge of how to sustain our pension commitments.[8] Failure to reform existing pension systems may, in many countries, produce negative, secondary consequences. This is especially so in countries where financing is contribution based because rising fixed labour costs jeopardise the job prospects of young people and negatively affect job growth, especially in low-productivity, labour intensive, private services.

Rolling back public pensions might improve upon public finances but this is unlikely to affect total GDP use. Privatisation would, for most countries, imply both injustice (double payment), more inequality among pensioners and heightened insecurity. Compensating for negative demographics with "fertility incentives" is an inadequate avenue in the medium term and immigration will only realistically cover the shortfall if immigration rates become enormous. As a consequence, there is almost universal agreement that a viable new retirement contract must combine two elements. Firstly, it must ensure retirement security for both today's and tomorrow's citizens. Secondly, it must produce a reallocation of work and retirement time. In part, this can be done by raising employment rates in active ages; in part, by delaying employment exit.

The great challenge is how to ensure at the same time *intergenerational equity* (a sustainable fair distribution of the costs of future retirement between workers and retirees) and *intragenerational justice* (safeguarding the welfare of the weakest, both in working life and in retirement). As we examine in Chapter 3, one solution to the transition cost issue might be to adopt the Musgrave principle of proportional sharing among the generations. And, address intragenerational justice, to place greater emphasis on general revenue financing - both to protect the least advantaged and to meet additional retirement costs. A minimum guaranteed retirement income above the

[8] Of course, a return to strong real wage growth would diminish the problem substantially.

poverty line is not only affordable but must also be considered a precondition for any commitment to the well-being of future generations.

Still, the urgency of a new generational social contract does not stop here. Increased life expectancy means also a major challenge to health care systems and growing demand for services to the frail and disabled. A new generational contract necessitates both a renegotiation of the work-pension nexus and of the caring nexus. Since the EU is committed to gender equality and to raising women's employment rates (and since this is fundamental for sustaining welfare commitments in the first place) the traditional option of the elderly being cared for by (mostly female) family members is naturally precluded.

National or European social goals?

The aim of this report is to identify common European social objectives. The starting point must be whether Europe collectively faces broadly similar problems – this is the easiest part. The more difficult part is to establish whether approaching these collectively might be a superior strategy for all concerned.

The similarity of social objectives across Europe is quite striking. All member states are explicitly dedicated to job growth, investing in the productivity of future workers, securing the long-term sustainability of pensions and to promoting social inclusion in the quest for a more competitive knowledge-based economy. This, it is realised, easily invokes hard trade-offs. A full-employment strategy may catalyse a low-end labour market with widening wage inequalities. Sustaining welfare commitments through high taxes on labour may price less productive workers out of the market. All in all, we must often prioritise between conflicting goals. We, as authors of this report, are not in a position to assess how individual member states might prioritise. We simply adopt what we take to be the consensual position that emerges from joint EU declarations. And here the prioritisation of social inclusion stands out clearly.

This reflects a broadly shared awareness that the risks of social polarisation are real. The vocabulary differs: the French see a society of *deux vitesses*, the Germans a two-thirds' society, and the Danes divide themselves into an A-team and B-team. But there exists a broad consensus that the welfare state must find novel solutions to integrate potentially vulnerable citizens. The real threat of social exclusion is that welfare problems incur poverty more than temporary hardship, that they determine citizens' life chances and, worse, that they are reproduced from one generation to the next. The weight of social inheritance remains as strong today as in the past. This holds for educational attainment and for career chances in basically all advanced countries.[9] Two of the flagships of post-war reform, social security and mass education, undoubtedly raised welfare levels, but they failed to disconnect peoples' life chances from their social origins.

It is important to remember this as we now prepare ourselves to meet the social risks that accompany post industrial transformation. The impact of socially inherited privilege and under-privilege may easily be amplified if society is becoming polarised in terms of employment status and household resources. If our basic aim is to invest in people and combat social exclusion, we are compelled to attack more effectively social inheritance – not only for egalitarian reasons but additionally because we simply cannot afford not to. It will be far more difficult to construct a competitive, highly productive economy and a sustainable welfare state if, say, a third or a fourth of the population is condemned to marginality. We assume that there is no European government that would opt for a scenario of islands of knowledge in a sea of ignorance.

Does an effective policy for social inclusion call for common European objectives? Would we all be better placed by a strategy of co-ordination at the EU level? Or, why not simply continue to delegate such to the discretion of national politics?

One circumstance that speaks in favour of co-ordination is that broadly similar policy prescriptions are already emerging across a wide range of member states. One example

[9] As the international literacy studies show, class inheritance is also very strong in terms of cognitive abilities (OECD,2000). The two most authoritative studies are Erikson and Goldthorpe (1992) and Shavit and Blossfeld (1992).

is the desire to shift from passive income maintenance to activation. Another is the growing awareness that preventive policy is far more effective than remedial 'second chance' solutions. Even more fundamental is the widespread adoption of a yardstick of egalitarianism that privileges opportunities more than results – hence the popularity of 'life long learning', and a 'second chance'.

We see then, more stress on individual effort and responsibility, but in most member states this is couched in terms of a solidaristic guarantee that society will not abandon those who fail. In synthesis, Europe may be persuaded to unite behind what is, no doubt, an extraordinary challenge for the 21st Century, namely to disconnect as far as possible citizens' opportunities and life destiny from their origins and inherited handicaps.

One major reason why member states will need to embrace common social objectives lies in the deepening process of economic integration, with its implications of intensified commercial, monetary, and factor mobility. It will be essential to ward off a race to the bottom via tax competition or cutting employment standards. At the same time, economic integration intensifies the need to mobilise Europe's – and not just the nation's – human potential. With economic interdependency, clearly the performance of one national economy will depend ever more on conditions among its neighbours. It must be remembered that 90 percent of total EU trade occurs between member states. As our competitive edge will lie ever more in the social and human qualities of our people, every single member country will have a rising stake in the skills and abilities of EU citizens at large. It is Europe's human potential that will decide Europe's future competitive abilities.

There are also pragmatic political reasons that speak in favour of greater co-ordination at the EU-level. Europe's policy makers have, for centuries, learned from their neighbours. Indeed, the spread of social insurance across Continental Europe was originally due to policy learning from, in this case, Berlin. As governments search for workable solutions they usually learn from their own past practice or from each other through 'best' foreign practice. Facing uncertainty, rapid change and vast new challenges, governments cannot always build on the past. Accordingly, as Chapter 4 argues, member states may find that co-ordinated EU policy making offers them an attractive 'learning' environment.

Finally, and this should not be dismissed, the European Union can face severe legitimacy problems if accelerated economic integration remains void of any meaningful social progress. Individual member states perceive correctly that their welfare states are key to domestic political consensus and legitimacy and, are accordingly, wary of surrendering any authority to the EU level. Yet, the dilemma here is that these very same member states have a growing stake in European economic integration. And, as stakeholders, they will need to invest also in its popular legitimacy.

Similar Challenges for Different Welfare States

By and large, all European nations face similar risks, needs and trade-offs. There is everywhere a rise in inequalities coming from the market- and the manifestations of demographic change are similar. But it is equally true that the convergence of post-industrial challenges confronts different national welfare systems. Their ability to respond effectively to new risks will hence inevitably differ due both to their inherent strengths and weaknesses.

The Nordic countries

The Scandinavian welfare states are characteristic for their triple accent on universal income guarantees, ‘activation’ and highly developed services for children, the disabled and for the frail elderly. The broad and quite generous safety net of income guarantees is demonstrably an effective bulwark against poverty. Activation policies do appear to diminish long-term unemployment and care services to families have provided a double bonus: enabling women to have children and careers and also maximising employment levels. The Nordic approach is inevitably costly and, notwithstanding a more balanced revenue mix, its cost constitutes a potential Achilles heel of the model. [10] So far it has been able to sustain heavy taxation successfully thanks to broad support from the middle classes. Still, the deterioration of Danish health care over the past decade bears

[10] Yet, it is important to note that the total welfare resource allocation (as a percent of GDP) in Scandinavia is not greater than in the United States. The difference is simply a matter of the public-private expenditure-mix (Esping-Andersen, 1999).

witness to severe financial constraints. As the experience of Sweden during the 1990s economic slump suggests, the model relies very heavily on sustained full employment and growth. If growth remains sluggish and if market-driven inequalities and dualisms continue to strengthen, the Nordic model will be seriously tested.

No doubt, the Scandinavian welfare state is comparatively well positioned to face the exigencies of post-industrial change. It is effective in mobilising the most difficult labour reserves, such as single parents with small children, older workers, or people with disabilities. Along with Belgium, the Nordic countries are among the few OECD countries able to sustain *both* aged and child poverty at reasonably low levels. They demonstrate thereby that generous old age security is not *per se* incompatible with an active *pro-family* policy. Near-maximum employment, in turn, coincides with less early retirement and fairly high fertility. Perhaps the most important lesson to be learned from Scandinavia is its quite successful investment in preventative measures.

The Anglo-Saxon welfare states

The Anglo Saxon welfare states of Ireland and the U.K. are also traditionally based on a flat rate, general revenue financed benefit structure. But over the past decades we have seen a clear redefinition in favour of limiting government's responsibilities to acute 'market failures'. Hence, the middle classes have been encouraged to opt into the private welfare market while government has sought to target benefits more selectively to the needy. In parallel, the accent is shifting from conventional needs-tests towards work-conditional benefits. This shift is seen as a more effective response to two problems. Firstly, to what is perceived to be a widespread lack of adequate work incentives and, secondly, to the growth of low wage employment. It can, in fact, be regarded as a necessary cushion within increasingly de-regulated labour markets.

The accent on targeted and in-work benefits is often proclaimed to be an effective response to the new risk and needs structure, but this is far from certain. If benefits are work-conditional, they do not help workless citizens. To qualify, mothers with small children will, to begin with, require cheap day care. If eligibility is subject to a needs test, benefits are most likely set at a low level and coverage gaps and welfare dependency are likely to be substantial. Also, work-conditional benefits may produce unwanted externalities, such as downward pressures on wages.

The model's accent on private welfare for the majority may reinforce social dualisms and may thus relegate lower income households to the status of second-rate welfare citizens. If equality remains a priority, targeted welfare performs poorly as revealed by internationally very high poverty rates. Moreover, poverty is especially evident among the fastest growing kinds of vulnerable households (such as lone mothers and young families with children). And it is far from evident that buoyant markets will diminish welfare dependency. In the U.K., for example, the decline in unemployment in the 1990s was not accompanied by a similar decline in workless households. Without comprehensive investments in family services, the low-wage trap that, in the first place makes assistance necessary, may not disappear.

One driving principle behind more targeting and privatisation in Britain is to reduce public taxation and expenditure. This appears to have been accomplished to a degree, especially in terms of longer-term pension expenditure projections. But the secondary consequence is growing household outlays for private insurance coverage and it is doubtful whether there are any real total cost savings to be gained. The great Achilles heel here is that government's ability to raise more revenues, as well as its capacity to conduct an effective social policy, will be progressively impaired the more that citizens exit to the market. If the welfare state provides ever fewer benefits to the middle classes, their acquiescence to high taxation will gradually evaporate. The model may, therefore, face severely limited policy options to deal with pressing social problems in the future.

The Continental European welfare states

Employment-linked social insurance, such as prevails in most of Continental and Southern Europe, protects well those with stable, life-long employment, but far less those with a tenuous connection to the labour market. Hence, today it works poorly for women and for workers with irregular careers. Delayed entry into stable employment and more insecure work histories mean that citizens face difficulties accumulating sufficient pension credits. A heavy tax on employment may also impair the job prospects of young and less productive job seekers. Passive income maintenance, combined with strong job guarantees for male breadwinners, becomes problematic with rising marital instability and non-conventional households. Strong protection for the stably employed combined with huge barriers to labour market entry has, in many countries, nurtured a deepening abyss between privileged 'insiders' and precarious 'outsiders'. If strong reliance on the family, which is especially prominent in Southern Europe, absorbs many of the risks of social exclusion, it simultaneously negatively affects women's search for economic independence. As will be examined in Chapter One, reliance on the family is paradoxically a major cause of the low fertility equilibrium that exists in much of Continental and, especially, Southern Europe.

To deal with 'atypical' risks, Continental European welfare states have either relied on continued family support or they have added *ad hoc* non-contributory programs, such as social pensions and various social minima to the system. An overly transfer-biased social policy is, arguably, an ineffective response to social exclusion. There is now a clear realisation across Continental Europe that services, especially for small children and for the frail elderly, are an urgent priority. Yet, the fiscal capacity to respond is limited due to a narrow tax base combined with costly pension commitments. The model is unusually vulnerable to employment stagnation and to the rising share of people who are economically inactive. Hence, expanding employment levels among women and older workers becomes *sine qua non* for long-term sustainability.

Most Continental European welfare states find themselves in a 'welfare without work' trap, from which it is difficult to escape. Job growth in the market economy is made difficult by high wage floors and contribution burdens, and in public services because of severe fiscal constraints. In the absence of jobs, the response has been to subsidise early retirement requiring additional increases in social contributions. A common characteristic of most, but not all, Continental European welfare states is the narrow, or even non-existent, scope for investing in measures which might help people out of the 'welfare without work' trap. Here women-friendly benefits and services stand out *par excellence*.

It is in this context that the 'Dutch miracle' assumes importance. In the 1980's the Netherlands epitomised the negative aspects of an overly passive, income maintenance biased approach with comparatively very low female employment levels and record high transfer dependency ratios. The Dutch labour market success story is based on a number of interrelated policies including, first of all, protracted wage moderation and a large number of people in adequately protected part-time and temporary employment. This was combined with a fairly effective curtailment of prolonged welfare dependency but *not* to any significant erosion of social benefits. The result has been an impressive rise in female employment and in service jobs more generally.

The Aims and Scope of the Study

A first aim is to develop a *methodology* for how to develop longer-term social policy strategies with a large number of 'unknowns'. We opt for a tool that is potentially very powerful for policy making, namely analysing emerging scenarios through the lens of life course dynamics. This emphasises the cumulative nature of advantage or disadvantage over time. The status of today's young people tell us a lot about tomorrow's adults and this, in turn, affects the conditions of those who will retire decades from now.

We know from scientific research that life chances are heavily pre-determined by social origins, childhood and youth. Hence, a bad start in life is likely to result in higher risks of poverty, social exclusion and welfare dependency later on. Problems that become manifest at one stage of the life cycle are, in fact, often caused at an earlier phase of peoples' life courses. If we aim to shift from remedial to preventive policy, we should focus on the critical point in peoples' lives when vicious circles of exclusion begin.

Our report is therefore structured around the life course. The focus of Chapter One is on family welfare. The family and households are central for three reasons. Firstly, this is where most social risks condense and manifest themselves. The individual ramifications of, say, unemployment, low pay or frailty in old age depend very much on the household context. Secondly, this is where the initial process of human, social and cultural capital accumulation occurs, where individuals acquire the resources and motivations that will shape their lives. As the Swedish Prime Minister once put it, *'the quality of a society can be measured by how it treats its children'*. And thirdly, family policy is key to any resolution of the gender inequality issues which European nations want to see resolved.

Viewed through the lens of families, problematic welfare scenarios abound. One is a 'resource-polarisation scenario', pitting for example work-rich against work-poor households. Another is the 'no-kids' scenario, which might ensue if children become incompatible with women's quest for careers, or with households' need for additional wage income. We propose that a redesigned family policy is a fundamental first step towards a just and efficient European social model.

Chapter Two focuses on working life and the labour market context. This is, after all, the principal source of well-being (or social problems) for most citizens throughout most of their lives. Increasing employment rates, especially among women, is already a common objective of the EU member states. It is impossible to combat social exclusion if unemployment remains high. Higher activity rates are *sine qua non* for sustaining future pensions and for gender equality. And, not to forget, a core ingredient in long-term retirement policy includes the employment prospects of older workers. Quantitative employment growth might be nurtured by radical de-regulation of wages and job security. But if Europe remains committed to basic employment rights, truly decent earnings and gender equality, numerical employment objectives must by necessity be accompanied by *quality* improvements. Moreover, stress, work time, or skill development all influence directly family welfare, life chances and the employment prospects of older workers. To give an example, it is evident that raising mother's labour supply is an effective remedy against family poverty. Yet, if we were to unilaterally pursue such a 'work strategy' to combat poverty, we might very well catalyse other welfare problems. As we show in Chapter One, the employment of mothers is positive for children's development, but this depends very much on the quality and flexibility of working conditions. Or, to give a second example, encouraging delayed transition to retirement and promoting more active ageing will be far more realistic aims if individuals' skills were upgraded during their working lives or if their jobs did not impair their physical or mental health. We advocate stronger attention should be focused on the quality and health correlates of jobs and far stronger assurances of continuous career training and skill development.

Chapter Three turns to the third stage of the life course. All nations face the same two basic challenges: how to ensure a financially viable future pension guarantee and how to manage the inevitably high costs of care for the frail 'ultra-aged'. Not surprisingly, this is where EU efforts to define common objectives are especially advanced, as is evident for example by the European Commission's Communication of 3 July 2001, "Supporting national strategies for safe and sustainable pensions through an integrated approach" which lists a proposal of ten common objectives concerning pensions. Our aim is not to offer a once-and-for-all solution, but rather to propose some basic decision rules for how to arrive at viable pension targets in a context where trade-offs seem inevitable. Can we realistically ensure retirement guarantees in a way that is both financially sustainable and socially equitable? Will we confront trade-offs if we pursue delayed retirement and active ageing? As to the sustainability and equity issue, we propose to combine adequate welfare entitlements, including a basic income guarantee in old age, with a formula for how to distribute the financial costs of aging equitably between generations. The need to complement contributory pension insurance and private plans with a basic income guarantee in old age is enhanced by the uncertainties of how citizens' lives and careers will unfold over the coming decades. It is made additionally urgent because women's careers and, hence, insurance contribution records, are less stable. The very high tax on labour that social insurance systems impose is also problematic for job growth and, therefore, there is an even stronger argument in favour of more general revenue financing of pensions.

To reiterate, our report does not pretend to deliver policy *panacea*, solutions for all our problems, once and for all. A first, more modest, aim is to outline some of the ingredients that are necessary for a more comprehensive redesign. A second aim is to sound a warning note against some of the sweeping policy formulae that characterise contemporary debate. Take pension policy. Delaying retirement is surely a sound objective, but will it work for all? Or, take social inclusion policy. Activation seems an appealing alternative to passive income support, but can it adequately substitute for basic welfare guarantees? It is now fashionable to downplay passive and advocate active policy. This may be misguided if, as evidence suggests, activation is a costly, second-best alternative to prevention. Or, once again, take gender policy. The catchword everywhere is a 'women-friendly' policy of care services – plus – parental leave schemes. But this alone will probably not resolve the difficulties facing most working mothers.

In light of the diversity of national welfare systems, it is additionally fruitless to contemplate a single design for all nations even if they do face rather similar problems. Just as no EU member state is likely to privatise its welfare state, neither is a radical welfare-regime change likely to occur. The institutional framework of national welfare systems are historically 'locked in' and any realistic move towards common objectives must presume that such, if accepted, will be adapted to national practice.

This brings us directly to a third concern. When we undertake reforms, these will eventually produce a lock-in effect that constrains future choice. The implementation of a programme now will eventually institutionalise expectations and behaviour, and this means there will be possibly huge financial (or electoral) penalties connected with changing or abolishing it later on. Europe's social insurance based pension schemes offer an illustration. Privatisation is almost inconceivable because it entails double financing for most workers. This obviously does not imply that reform is impossible. But it does imply that we must ensure that reforms today are sufficiently adaptable given future uncertainty. And most importantly it implies that we be acutely aware of what we genuinely *wish* to lock in (and what not). Anticipating our conclusions, there is a good case for locking in a solid guarantee against social exclusion, notably against child poverty, a set of basic employment standards and adequate welfare entitlements for the elderly, including a basic income guarantee in old age.

A fourth and final thread in our report is the need to rethink policy boundaries and, in particular, the public-private welfare dichotomy. There are two issues at stake here. The first is that social welfare policy cannot be pursued distinctly from employment policy. To take an example from Chapter One, an effective anti-poverty strategy must combine female employment, quality of work improvements, social care and income maintenance. The second is that our point of reference for cost efficiency and viability should not be government revenues and outlays, but GDP use. Diminishing public health, pension or social care expenditure is unlikely to produce any real cost savings since households will compensate with market purchase or with self-servicing. If welfare is externalised to markets, this will not result in appreciably lower net household money outlays. It will, however, result in more accentuated inequalities. If welfare is internalised in the family, this will probably result in more unpaid and less paid work – in other words, in a lower GDP (*and* less tax revenue). It will prove counter-productive for gender equality, and will seriously impair our capacity to generate new employment. Put differently, when we discuss what government should or should not do, we need to simultaneously consider its consequences for markets and for families.

CHAPTER 1

A SOCIAL INVESTMENT STRATEGY FOR FAMILIES

Introduction

Any fundamental re-evaluation of existing social protection systems must, for several reasons, place heavy emphasis on families and households. The household is the basic unit that gives meaning to individuals' lives. It is here that social advantage and disadvantage are transmitted and activated; it is here that social risks and needs find primary expression; and it is also here that the primary social safety net is found. The experience of, say, substandard employment depends on the household context. It is one thing if the only earner is low paid, another if the low paid worker is but one of several income recipients. Ongoing demographic and economic trends pose severe threats to the welfare of Europe's citizens, among the young, working-age adults, and the elderly alike. Securing families' welfare is a fundamental priority if our aim is a better society in the coming decades.

The second reason is that social exclusion lies at the centre of our analysis. Social exclusion takes many forms, ranging from social isolation through labour market marginality to income poverty. Social exclusion occurs when citizens are trapped in inferior life chances. This said, our analyses must centre on childhood and the well-being of families. All available evidence indicates that this is the critical point at which peoples' life courses are shaped. Remedial policies once people have reached adulthood are unlikely to be effective unless these adults started out with sufficient cognitive and social skills. We argue that a social investment strategy directed at children must be a centre-piece of any policy for social inclusion.

Indeed, this chapter will furnish a very strong advocacy in favour of fighting child poverty and investing in the well-being and resources of Europe's children. Such a child-centred focus is motivated, firstly, by basic concerns with equality and social justice. Unequal opportunities in life chances remain today, as in the past, powerfully rooted in social inheritance from parents to their children, and the pursuit of a more just society therefore necessitates policies that weaken this effect. Secondly, it is motivated by 'efficiency' concerns. Investing in children abilities and skills will not only promote superior life chances for individual citizens, but also a more competitive and productive society. Finally, a child-centred focus is made all the more urgent because, as we shall see, there are powerful structural forces underway which increase the likelihood of low incomes and poverty among families with children. In brief, Europe's children may be increasingly vulnerable at the same time as our goal must be to improve their well-being.

The third reason is that family policy is key to any resolution of the gender inequality problems, which European nations must resolve soon and effectively. Gender equality is a goal in itself, but it gains added urgency because working mothers are key to solving problems of child poverty. What is more, the 60 percent female employment target by 2010 will be realistically attained only if we promote a broad 'women friendly' policy soon. And, finally, it will be difficult to sustain welfare commitments into the future unless we raise female employment levels substantially.

This chapter is structured around these three arguments. It examines, firstly, the risks of social exclusion, focusing especially on at-risk lone parent and work poor households. It then turns to the key role that family welfare plays in dictating citizens' life chances, particularly during early childhood. Women's paid employment emerges as a key ingredient in any strategy to combat child poverty. This, as is well-known, calls for a much more concerted strategy of equalising women's opportunities – the theme of the third and final section of the chapter. The core argument of the chapter is that any sustainable solution to social exclusion must combine child, family and women-friendly policies within an integrated strategy. The social quality and economic efficiency of 21st Century Europe will largely depend on whether we can successfully forge such a strategy.

1.1. Risks of Poverty and Social Exclusion

The post-war decades were to many a Golden Age. If we are concerned with living standards, then today's society is undoubtedly more golden simply because they have improved dramatically since then for just about all citizens in all of Europe. But if our concern is equality, then we do live in less golden times. The rise of the welfare state undoubtedly diminished social inequalities, but this achievement was in large part aided by a marked reduction in market inequalities. The post-war welfare state rode on a favourable tide.

The tide is now unfavourable because market inequalities are intensifying. This is a long-term and structural trend that stems from demographic factors (the rise of more vulnerable households) and changes in labour markets (higher risks of unemployment, precarious employment and increasing earnings disparities). Over the past two decades, primary income inequality has grown by 10 to 30 percent in most advanced countries. Yet, this need not inevitably translate into more inequitable final incomes. Table 1.1 shows that some welfare states have stemmed the inegalitarian tide; others have not.

It is evident that welfare states face an uphill battle to sustain egalitarian ambitions. Some countries, like Denmark, Norway, France, and the Netherlands have apparently won the battle insofar as disposable income inequalities have not risen. This contrasts sharply with Britain and Germany where public redistribution has actually declined in tandem with rising market inequalities. In most cases, the welfare state has only partially offset these trends. [11]

[11] The dramatic increase in Italy must be considered in terms of the very low starting point. In terms of working age households, Italy still remains one of the least redistributive.

TABLE 1.1. CHANGE IN INCOME INEQUALITY AND GOVERNMENT REDISTRIBUTION. WORKING AGE HOUSEHOLDS ONLY. 1980s-mid-1990s. 1)

	Percent Change Of Gini: Market Income	Percent Change of Gini: Disposable Income	Percent Change in Government Redistribution Effort
Belgium(85,96)	+2	+5	-6
France(84,94))	-1	-2	+3
Germany(W)(84,94)	+25	+33	-19
Italy(86,95)	+17	+15	+21.5
Netherlands(87,94)	-5	-2	-7
Denmark(87,97)	+12	+4	+17
Finland(87,95)	+29	+16	+18
Norway(86,95)	+23	+4	+50
Sweden(87,95)	+25	+1	+32
U.K.(86,95)	+9	+14	-11
US (86,95)	+11	+10	+4

1) changes in inequality based on (equivalent) household Gini coefficients for early 1980s and mid-1990s. Includes only households with head aged 24-55. Modified OECD equivalence scale used (1 for head, 0.5 for other adults, 0.3 for children). Calculations from LIS data

This 'big picture' puts into focus the menace of a polarised future society. Widening welfare gaps are unlikely to be reversed without policy intervention simply because the driving forces are of a long-term, structural nature. This is why we encounter so many pessimistic future scenarios. In one, the gulf between the post-industrial "winners" and "losers" is widening. The "winners" are those with skills and excellent mobility chances, united in high-income, dual career households. The "losers" are, above all, those with low qualifications and little schooling who are likely to circulate between low paid, precarious jobs and unemployment, as well as those in weak households such as lone mothers or work poor couples. Marital homogamy adds to the concentration of risks within households and may reinforce downward spirals of exclusion.

Europe's competitive edge will depend primarily on its human potential. Yet, the capabilities of citizens cannot be fully mobilised if our societies continue to be extremely stratified. We no longer live in a world in which low-skilled workers can support the entire family. The basic requisite for a good life is *increasingly* strong cognitive skills and professional qualifications. For example, those with low cognitive abilities and/or less than secondary education face unemployment risks that are twice the average (OECD, 2000). Likewise, family instability places mothers at great risk of poverty and welfare dependency unless they can also find well-paid jobs. Employment remains as always the *sine qua non* for good life chances, but the requirements for access to quality jobs are rising and are likely to continue to do so.

Existing social protection schemes may, perversely, magnify rather than diminish emerging risks. Consider social insurance. Its accent on long contribution histories means that it easily fails to cover women or new 'atypical' or unstable careers. Young people often represent the lion's share of unemployment but usually have no social entitlements. Families can, as is typical in Southern Europe, internalise such risks. In Italy, among the unemployed 20-30 year-olds, 90 percent depend totally on parental support. But the family solution is not a realistic option in 21st Century Europe and it is demonstrably counter-productive. As a remedy to the social risks of youth, it clearly has problematic secondary effects such as delayed independence, family formation and job insertion.

In contemporary Europe, the main policy alternative to 'a-typical' risks is needs-tested assistance programmes. Their efficacy depends on actual take-up rates and whether they create welfare traps. Targeted assistance is often set at a low level because it lacks broad popular support. As a result, unemployed youths on assistance benefits display very high poverty rates in some countries, like in France and the U.K. (Bison and Esping-Andersen, 2000). As we shall see, the same holds for lone mothers. And, returning to Table 1.1, welfare states that favour targeting, like the British and American, perform quite poorly in terms of offsetting new inequalities. We may therefore require a new policy approach to deal effectively with the new forms of social exclusion..

1.1. Social Exclusion

Fighting social exclusion is a centrepiece of 'social' Europe but it has, so far, been difficult to pin down either the phenomenon or the remedy because of the multi-dimensional nature of the problem. It is often simply an umbrella term for unemployment, welfare dependency, social isolation, or poverty and the confusion increases when 'social exclusion policy' becomes synonymous with needs-tested assistance. The phenomenon should be narrowed down. [12] Unemployment, as a status, does not necessarily mean exclusion even if associated with very little income. Similarly, a stably employed person can be quite excluded if he/she is socially isolated. A far more sensible definition (but more difficult to apply) is that a *person lacks the resources required to participate fully in society.*

This definition can embrace three distinct causal logics.[13] One - that citizens are voluntarily self-excluded, choosing unemployment and welfare dependency. Here the remedy might simply be to 'make work pay'. Two - that supply-side deficiencies or obstacles exist, such as low skills, chronic illness or lack of access to day care. 'Second chance' activation programs are now widely believed to be the proper response combined with day care provision, if needed. Three - that citizens slide into a vicious cycle of multiple and/or persistent deprivation where joblessness, poverty and social isolation interact cumulatively or become traps.

The preoccupation with social exclusion is warranted for many reasons. Firstly, as inequalities mount so does poverty. Secondly, this affects especially families with children. An ominous sign is the pervasive upward trend in assistance dependency. Thirdly, and perhaps most tellingly, the number of work poor and workless households is alarmingly high and they do not necessarily abate with falling unemployment (European Commission, 1999). This points to a progressive detachment from the labour market.

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[12] The recent Nice European Council has, in fact, taken steps in this direction. The report which Anthony Atkinson and his collaborators present to the Belgian presidency constitutes a further decisive step towards quantitative specification and precision (Atkinson et.al., forthcoming)..

[13] See Vleminckx and Berghman (2001) and Room (1995) for a comprehensive conceptual treatment. An alternative (and more manageable) definition is used in Chapter 2 of this book.

The process of exclusion can unfold very rapidly. Here we can draw lessons from Sweden during the troubled 1990s. Most would agree that Sweden boasts one of the World's most comprehensive social and employment policies, yet the business downturn, 1990-1997, was accompanied by sharp welfare erosion among the more vulnerable. Poverty rose especially among immigrants and in households with children, reflecting the high concentration of unemployment among the unskilled, youths and lone mothers. The percentage of households with a weak labour market connection almost doubled during this period, as did the share reporting severe economic difficulties (SOU, 2000).

The true extent of polarisation emerges when exclusion becomes permanent. Citizens' life chances are not at stake if low pay, unemployment, or job precariousness is mainly a transient spell for young people leaving school, newly arrived immigrants or, perhaps mothers returning to the labour market. The real danger is that a sizeable minority becomes entrapped in inferior life trajectories. Hence, we must above all understand the mechanisms that turn a deficiency into a vicious circle of long-term exclusion.

When social exclusion impairs life chances or when it creates negative externalities for society, then preventive and remedial policies must be regarded as social investments. There is an urgent need to eliminate the roots of exclusion, first and foremost because, as Anton Hemerijck states in his chapter, Europe shares a deeply entrenched normative ideal that no one should be abandoned to the naked cash nexus. Apart from this, it is also now fully recognised that the future social and economic cost of *not* doing so may be enormous. A sizeable population without adequate skills will be doubly problematic: an expensive burden on welfare state finances on both the revenue and expenditure side, and sub-optimal development of our human potential in a context of knowledge-intensive production and of shrinking active populations. Looking much further ahead, the consequences will materialise at retirement age. Today's "winners" will accumulate powerful resources and will thus one day move into a comfortable retirement. The "weak" will accumulate little and may thus culminate their lives in poverty. Policy making for social inclusion must therefore be based on life course dynamics and must begin with today's children and young people.

The hard and soft core of social exclusion

When we examine all households, poverty has remained largely stable in most countries over the 1980s-1990s, but this disguises two opposite trends. Poverty has fallen significantly among the elderly while rising among families with children. An overview centred on families with children is provided in Table 1.2.

Clearly, the trend is not perfectly uniform when we look at disposable income poverty. In Scandinavia families with children have fared better than average; in Germany, Italy, the Netherlands and the U.K., much worse.

TABLE 1.2. HOUSEHOLD DISPOSABLE INCOME POVERTY RATES AND TRENDS 1)

	All Households 1980s	All households mid-1990s	Households with children 1980	Households with children 1990s
Denmark (1987,1997)	9.7	8.4	4.3	6.9
Finland (1987,1995)	4.7	4.5	2.5	3.7
Sweden (1987, 1995)	7.2	6.2	3.5	2.2
Netherlands (1987, 1994)	5.2	8.1	5.4	7.8
France (1984, 1994)	7.4	7.5	7.4	7.0
Germany (W) (1984, 1994)	5.4	12.0	4.1	14.1
Italy (1986, 1995)	10.5	14.1	11.2	18.6
U.K. (1986, 1995)	8.2	11.7	10.5	14.3
U.S. (1986, 1997)	18.2	18.7	21.4	21.4

1) Estimated from LIS data files utilising 50 percent of median income poverty line, and modified OECD scale (see Table 1.1).[14].

[14] Here and in all the following tables we use the 50-percent poverty line, despite the fact that the EU has recently moved in favour of a 60-percent line. Our principal motivation is that this makes our data more readily comparable with existing research.

The unemployed and single mothers face, as the European Commission (1999) shows, the highest poverty risks of all – in each case almost 40 percent are poor at the EU level.[15] But the reality is more complicated due to interactions. For example, since unemployment and low earnings concentrate among younger workers there is a spill-over effect on young families more generally. We know that young families have experienced both relative income decline and rising poverty rates over the past 10-15 years in many countries (Oxley et.al., 1999). And we also know that younger workers and the low-skilled are especially vulnerable to adverse business cycles.[16] The coincidence of household and child poverty is high and this means that social exclusion now will have problematic consequences for future adults as well.

This is especially the case if income poverty is persistent. Long-term poverty is far more likely to run down a family's resources and to gradually distance it from the consumption norms of society. From available data we know that countries with high *levels* of poverty also produce far more poverty persistence. Within Europe, Greek, Italian, Spanish and British poverty rates are fairly high among families with children. If we define persistence as being poor in every single year, 1993-1996, it is in these very same countries that we detect unusually high persistency (between 4 and 6 percent of all families with children remain poor for four years). At the other extreme, persistency is exceptionally low in Denmark (0.1 percent) and France (1.7 percent).[17] If we extend the comparison to the U.S., the relationship is even clearer. Based on OECD (2001) data, the total U.S. poverty rate is a little more than 3 times the Danish and twice the Dutch. But the U.S persistency rate is 10 times the Danish and 6 times the Dutch. Among those most likely to experience long-term poverty, there is a massive over-representation of heads of households with low education and of workless households (everywhere) and of lone parent families (in some countries).

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[15] A third group are couples with 3+ children, but this is a very small population. The EU study uses a 60 percent poverty line, whereas we utilize the conventional 50 percent line.
[16] Over the 1990s economic crisis in Sweden, employment decline was concentrated among youth (<25), immigrants, and the unskilled. Immigrant employment rates dropped by 18 percentage points, and youth rates by 24 points (SOU, Vol. 41. 2000).
[17] Estimated from the 1994-1996 waves of the ECHP.

Lone parent families

Lone parent households (almost all of which are lone mothers) have grown rapidly and now account for 15-20 percent of all families with children. The rate is lower in Southern Europe, but shows signs of catching up. If by exclusion we mean poverty and/or joblessness, lone parents are an acute risk-group, especially when they are not employed. [18] Lone mother employment is very high in the Nordic countries, in Belgium, France and even substantial in Italy and Spain. But it remains low in Germany, Ireland, the Netherlands and in the U.K. (Bradshaw et.al., 1996). These differences are clearly related to day care provision and to access to part-time employment. High activity rates in Italy and Spain are more due to family solutions: co-residence with family makes lone mother employment possible. [19]

Lone mother poverty is both higher and substantially more persistent than the average, especially in the U.S. (Bradbury, et.al. 2000). Some of the variation can be attributed to social transfer generosity, but whether the mother is employed is undoubtedly the single most decisive factor. An overview is provided in Table 1.3. In some cases, lone mothers' employment has a very powerful effect, reducing the chances of poverty by a factor of almost 8 (in France and Denmark). [20] The work-effect is more modest elsewhere, perhaps connected to the nature and pay of part-time or more sporadic employment. In many countries, there is also an over-representation of the low educated among lone mothers and, hence, low wages may also play a role. An illustrative example of lone mothers' vulnerability to economic cycles comes, yet again, from Sweden in the 1990s (SOU, 2000). While the Swedish welfare state succeeded in

[18] Although poverty and deprivation are multi-dimensional phenomena, in this study I limit the analysis to the income and employment dimensions. In any case, the correlation between alternative welfare indicators (such as housing) and income is very high.
[19] The surprisingly high rate of lone mother employment in Mediteranean countries is also due to selectivity: divorce and separations are most common among highly educated and resourceful women.
[20] The poverty odds we present here derive from logistic regressions. The extremely high Swedish odds-ratio is due to the fact that very few do not work in the first place, and those few are undoubtedly very unrepresentative.

avoiding a rise in lone mother poverty, their higher unemployment translated into a 50 percent increase in social assistance dependency.[21]

The ‘work-strategy’ is no doubt very effective, but for lone mothers only conditionally so. If they work, they are more likely to be in part-time or precarious employment and earn low wages (which can be offset by tax credits or subsidies). All in all, any realistic social inclusion policy for lone mothers must inevitably combine subsidised (or more realistically free) day care with income guarantees (whether or not they work).

It is for the latter reason that cross-national differences in lone mother poverty reflect differences in the generosity of countries’ family welfare packages: Germany, Italy, Spain and the U.S. are far less effective in closing the poverty gap, while the Nordic countries are more successful. For example, pre-transfer poverty is fairly similar in Sweden, France, and Germany (at 50-55 percent), but the post-transfer poverty rate is 5, 21 and 38 percent, respectively.

[21] Another telling sign of lone mothers’ vulnerability to business cycles is that their average number of days in unemployment jumped from 28 to 44, 1992-97.

TABLE 1.3. LONE PARENT POVERTY AND THE IMPACT OF SOCIAL BENEFITS AND EMPLOYMENT. MID-1990s.

	Poverty rate		Increase in poverty odds if mother does not work 1)	Percent poverty reduction by social transfers 2)
	Mother works	Mother inactive		
Belgium	**11**	**23**	**n.a**	**n.a**
France	**13**	**45**	**7.6**	**-31.3**
Germany*)	**33**	**62**	**2.3**	**-20.2**
Italy	**25**	**79**	**4.6**	**-13.9**
NL	**17**	**41**		
Spain('90)	**---------24---------**		**3.3**	**-20.6**
Denmark	**10**	**34**	**7.8**	**-**
Finland	**---------- 5--------**			**-38.2**
Sweden	**4**	**24**	**117.6**	**-49.9**
U.K.	**26**	**69**	**6.6**	**-36.4**
U.S.	**39**	**73**	**4.6**	**-12.1**

1) compared to mothers who work, holding number of children constant.
2) Percentage point reduction of lone mother poverty (for all lone mothers) after taxes and transfers. Poverty is <50 percent of median equivalent disposable income.
*) West Germany only

Sources: estimations from LIS data bases

There is ample room for the promotion of common targets with regard to lone mothers' employment. To begin with, their employment rates vary tremendously, from 70-80 percent in Scandinavia, Austria and Portugal to a low of 30-35 percent in Ireland, the U.K. and the Netherlands (see also OECD, 2001: Table 4.2). Only in Scandinavia and the Netherlands, are lone mothers guaranteed basically free access to care for the under-

3s. The U.K. has an alternative approach with the new ‘Working families tax credit’, which includes a subsidy of 70 percent of childcare cost for lone mothers. However, this may be insufficient given typically low incomes and the high cost of private day care in Britain.

Income support to lone mothers consists typically of three kinds of benefits: normal (in some cases additional) family cash benefits, maintenance advances and social assistance. To this we should add tax-deductions, which still constitute a major ingredient in family policy in some countries but which, of course, are a very ineffective tool in the case of lone mothers (or low income families more generally). There is a very strong case in favour of abolishing tax deductions and shifting resources to direct family cash transfers.

Using the most recent (2000) MISSOC data, normal cash benefits, even when supplemented, are insufficient to eradicate poverty. Denmark and Sweden provide unusually generous benefits, but for a mother with two small children they amount to only 20 percent of the average wage (roughly 340 Euros per month). Hence there is a widespread need for additional assistance benefits. In fact, the modest poverty rates among lone mothers in countries like Belgium and Denmark are no doubt related to generous social transfers: the combination of ordinary child allowances and social assistance would, for a lone parent with 2 children, arrive at 1200 Euro (Belgium) and 1639 Euro (Denmark). In both cases this is a sufficient guarantee against poverty. At the other extreme lie Spain and Italy, where the combined benefit package hardly reaches 200 Euro (far below the poverty line). We shall show below that the additional cost to the exchequer of ensuring sufficient income guarantees is minimal.

Income-tested assistance may trap mothers in welfare dependency. This, no doubt, was very much the case in traditional American and British social assistance but it generally depends on the design rather than the generosity of assistance and additionally, on the composition of the clientele. Gustafsson et.al. (2000) compare assistance durations across 8 European cities and find much longer durations among lone mothers in Spain, Portugal and Italy (where benefits are very meagre), than in Sweden. One explanation is because lone mothers in Southern Europe may have fewer labour market skills and experience. Another explanation lies in the far lower opportunity cost of moving to a job in Sweden than elsewhere (due, undoubtedly, to free day care and better earnings). The welfare trap may lay buried in day care and employment opportunities.

These data alone speak in favour of the double strategy of supporting mothers' employment plus effective income assurance. Employment obviously presumes subsidised day care. But it also presumes access to jobs that are compatible with lone motherhood of small children, such as part-time jobs that offer sufficient flexibility and job security. The cash-benefit guarantee is necessary, firstly because it is unrealistic to rely on absent fathers' maintenance payments. Many absent fathers are also economically weak and the monitoring costs of compliance can be excessively high. Secondly it is necessary because lone mothers' job security can be very fragile (as we now witness in Sweden).[22] Hence, an exaggerated bias in favour of 'make-work-pay' policy has substantial risks.

Income poverty and workpoor households

Households are polarising in terms of employment chances. As we know, partnerships tend to be homogamous: the weak couple up with the weak; the strong with the strong. Married women's employment was traditionally concentrated among the more educated. High rates of employment among less educated mothers came later and are mainly found in Scandinavia and North America. [23]

In some countries, the signs of household polarisation are strong. In the U.K., for example, two-earner households grew from 54 to 62 percent (1983-1994) while workless households grew from 6 to 19 percent and we detect similar trends in Belgium, France and Germany (OECD, 1995; Gregg et.al., 2000; Cantillon and Van den Bosch, 2001). But, polarisation is not inevitable. In Denmark, among couples with children, double incomes are the vast majority (81 percent) and the incidence of workless households has declined sharply, to 4 percent, over the 1990s (Andersen and Hestbaek,

[22] Ottosen (2000:64) reports that Danish lone mother unemployment is 26 percent (notwithstanding near-to-full employment levels).
[23] Employment rates of highly educated mothers hover around 80 percent in North America, Scandinavia and Belgium, declining to 60-70 percent in France, Germany and Southern Europe. Among the low educated, rates are about 40-50 percent in North America and Northern Europe, but drop to 20-25 percent in countries like Italy and Spain (OECD, 2001: Table 4.1).

1999). Once again, it is women's (and mainly lower educated women's) employment that makes the difference.[24]

Within the working-age population, workless households account for 10-15 percent of all in the EU. Their numbers continue to grow in some countries and the persons affected are increasingly young. [25] A large share of the unemployed (ranging from 30 to 50 percent) belong to workless households, an indicator of how unemployment concentrates in couples. An overview of the scope of the problem and associated poverty risks is presented in Table 1.4.

Workless households are the extreme case in a broader distribution. Although workless households are especially vulnerable the changing nature of our economy and society also implies that the traditional one-earner family is increasingly at risk. We might preferably examine households along a band that stretches from fully workless through work-poor to work-rich.

Much suggests that the 'no-work household' concept itself is confused, simply because it covers too much diversity. It includes non-employed lone parents, but their share is often quite modest; in Scandinavia because the lion's share of lone mothers work; in Southern Europe because lone mothers typically move in with relatives. More generally, it combines a hard core that exhibits unmistakable signs of long-term, if not chronic, exclusion and a softer element that appears more temporarily detached from the labour market. In an attempt to map out the prototypical European workless household, the following attributes are strongly over-represented:[26]

- very low education (at EU level, 45% have less than secondary school)
- single, never-married persons (at EU level, 55%)

[24] Two earner households with full-time jobs constitute the vast majority (61 percent), compared to one at full-time with the partner at half-time (20 percent).
[25] In relation to the population aged 20-59. If, as OECD figures do, we include heads 60-65, the share is almost 5 points higher. The surprisingly high number of Danish (and Finnish) no-work households that derive from LIS data is due to conjunctural causes. Danish data refer to 1992 which was the trough of a recession. OECD's (1999) data show a decline between 1986 and 1996.
[26] The following data derive from the European Community Household Panel, 1996 Wave. Note that we exclude households with head aged 60+. Note also that these figures synthesize the European mean and thus disguise considerable national diversity. Due to substantial overlaps, these means should not be added.

- never employed women (at EU level, 49% of women)
- unemployed men (at EU level, 50% of men)
- one adult with chronic disabilities or ill health (at EU level, 33%)
- persons not looking for work (at EU level, 65%)

Such numbers suggest important heterogeneity. A very large group are women who simply never worked. Another group (predominantly men) has been distanced from the labour market. Two-thirds of those who are unemployed are long-term (1year+) and a third for more than 3 years. Poor health is clearly also prevalent. Since also two thirds do not even seek employment, it is difficult to automatically view them as simply 'excluded'. [27] All these indicators seem to point to older persons, but this is not so. Just about half of all persons in workless households are 39 years or younger and 33 percent are between 25-39. [28] Although single person households are frequent (32%), 18 percent of all households have children. This therefore indicates that there are several factors involved:

1. There is one large group (mainly of women) who probably never had any real attachment to the labour market.
2. There is a second group that is clearly outside the labour force due to illness and disabilities.
3. There is a third group (made up of more men and generally low-skilled) that appears genuinely excluded in the sense of long-term unemployment. Twenty percent among those reporting having worked once, have not worked for the past 5 years.
4. And there is a fourth group, also reporting unemployment, which must be regarded as more 'soft-core' since they have had some employment during the year.

In short, those who are fully inactive constitute about 2/3rds of all and a little less than 30 percent are unemployed and seeking work. But, the diversity among European

[27] 10 percent of these are women who care for others; about 25 percent are ill or retired (on disability mainly); 17 percent are in some form of education; and 39 percent are apparently women who never held a job (estimates from 1996 wave of the ECHP).
[28] And, as indicated, there are signs that the risk of living in no-work households is rising among the young.

countries is enormous. There are very few women who never worked in Scandinavia but many in Southern Europe. There are an abundance of single person households in Northern Europe while, in Southern Europe, single people typically live with others (usually family).

One would expect high poverty among workless households. But this varies by type and by nation, due to welfare state generosity and coverage. Table 1.4 below presents poverty estimates for households with varying levels of work intensity.

TABLE 1.4. POVERTY RATES WITHIN HOUSEHOLDS ACCORDING TO EMPLOYMENT INTENSITY (Mid-1990s).

	ALL NO-WORK HOUSEHOLDS			2PARENTS 1 WORKER	2 PARENTS 2 WORKERS
	Share (% of all Hhs.	Poverty Rate	-of which extreme poverty	poverty rate	poverty rate
Belgium	**13**	**24**	**18**	**3**	**1**
Denmark	**8**	**25**	**27**	**4**	**0**
Finland	**15**	**13**	**17**	**4**	**2**
France	**9**	**34**	**24**	**7**	**2**
Germany(W)	**8**	**46**	**45**	**6**	**1**
Italy	**10**	**35**	**52**	**21**	**6**
NL	**14**			**5**	**1**
Spain ('90)	**9**	**38**	**44**		
U.K.	**18**	**38**	**20**	**19**	**3**

Poverty measured as < 50 percent of adjusted median income.
Extreme poverty is < 33 percent.
Source: LIS data bases for no-work households, and Oxley et.al. (2001 : Table 15.5) for one and two-earner families.

The growth and decline of workless households is only partly related to unemployment trends. In Denmark they rose to 12 percent during the early-1990s, fell to 8 percent by 1995 and continued to decline in the late 1990s. This suggests a household composition that is fairly easy to re-integrate as the economy improves.[29] In contrast, the U.K. not only has a high rate of workless households, but here we see more 'hysteresis'. There has been a fairly constant growth between 1980 and 1995, with a less significant decline during the recent boom years. The composition here is likely to be more 'hard-core' (in 1996, indeed, 71 percent were discouraged workers or fully inactive).[30]

The phenomenon has been growing over the long-term in just about all countries, pointing to a possible hardening of labour market exclusion. In terms of income, the data suggest it is better being workless in Northern Europe and Belgium. The 'extreme poverty' indicator captures the income gap and in some cases (like Italy, Germany and Spain), the workless households in poverty tend to be exceptionally poor – an indication that the basic social safety of public *and* family support is weak. This instance of 'family failure' is important to note. If family support of young unemployed people by and large averts youth poverty in Southern Europe, it does not do so for those adults who are more 'excluded'. Workless households may lack resources also in the sense that they may not have access to family support.

Work-poor households rely heavily on income-tested benefits and this means that poverty is related to the generosity and take-up rate of assistance schemes. If we again revert to MISSOC data, now for couples with two children, the lower poverty rates in Scandinavia and in Belgium are clearly linked to higher social assistance benefit rates. In Denmark, assistance puts the household fairly near an average worker household income. In France and Germany, the same assisted family would arrive at roughly 40 percent. [31] As one would expect, poverty declines with the intensity of employment to almost nil among dual-earner families. This confirms the fact that women's employment is becoming more indispensable for any anti-poverty strategy.

It would be impossible, given the information available, to identify with any precision the size of the hard-core or soft-core; in part because it all depends on what we imply by 'hard-core'. If we adopt the broadest possible definition and view it as persons who more or less certainly will not respond to activation or employment incentives, the hard core might include, say, 50-60 percent of the total. This comprises mainly the chronically ill and disabled and women who never have held a job. We should also

[29] It may also reflect Denmark's strong accent on 'activation'. Largely due to activation, the number of persons receiving long-term social assistance fell by 37 percent, 1994-1999 (Socialministeriet, 2001: 10).
[30] Analyses from the 1996 wave of the European Community Household Panel.

clearly eliminate those who simply 'do not belong', such as students and apprentices (only 5 percent of all). This leaves us with about 40 percent of the workless households that can realistically be 'integrated'. [32]

With such heterogeneity, a workable social inclusion strategy needs to be multifaceted. A huge segment no doubt represents a long-term historical legacy. Especially in Southern Europe there exists a large reservoir of women with little education or employment experience. There may also exist a large segment of males that are difficult to reactivate, especially if they display multiple problems, such as low education, poor health, or alcoholism. This group is unlikely to become stably employed either by 'in-work' incentive policy or by activation and, consequently, an adequate income guarantee may be the only humane option. The high poverty rates in Germany and the UK suggest that the basic safety net may be too ungenerous. Exclusion from the labour market may easily be compounded if such households do not have enough money to participate adequately in the society within which they live.

It is clear that workless households combine legacies from the past (low educated, never-employed women) with victims of new social dynamics. Demographic change will produce rising numbers of single persons and lone parents. Additionally, and most worrisome of all, is the rapidly deteriorating position of low educated people. When we also consider marital homogamy, precariousness in the labour market will concentrate in couples.

However, there are reasons to believe that the 'hard core' of exclusion may diminish on its own over time. The number of never-employed women will naturally decrease and the more that policy supports working mothers, the more this decline should accelerate.

Regarding both men and women, clearly the most effective remedy against chronic non-employability would be preventing young people from leaving education prematurely. At the EU-level, 22 percent of today's young cohorts do not complete any form of secondary education. This share rises to 30 percent in Ireland, Italy, Spain and the U.K., but is only half in the Nordic countries. Furthermore, comparative data show that young

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[31] Calculations based on income data from Eurostat Yearbook, 1988-1998: 162).

cohorts with low schooling face especially steep hurdles during the transition from school to employment. Among 25-29 year-olds, those with less than secondary education have twice as high unemployment rates as the average. Even worse, they are much more likely to become trapped in prolonged exclusion. In France, for example, 20 percent of men with less than secondary education remain unemployed 5 years after leaving school (OECD, 1999b: Tables 7 and 16). In Denmark, persistent welfare dependency is overwhelmingly (78 percent) concentrated among those with no professional qualifications (Socialministeriet, 2001: 14).

We have some comparative evidence on longer-term entrapment in both low pay and in unskilled work. One alarming finding is that the youngest cohorts are more likely to remain trapped in unskilled jobs than was the case for earlier cohorts in Germany, Sweden and the U.K. At the same time, the chances of moving out of low skilled jobs are greater in Sweden (about a third who began as unskilled eventually leave, compared to 20 percent in the U.K.). A similar comparative scenario is evident for low-wage entrapment. Among the continuously employed, aged 25-34, those who in 1986 were low wage workers could expect 4 years more of low wage employment over the next five years in the U.K. and the U.S., about 2,5 years in Germany, France and Italy, but a much lower 1,7 years in Denmark. [33] Scandinavia appears better able to stem entrapment and the unusually high rates in Britain and America suggest that unregulated labour markets do not guarantee greater mobility.

The most realistic short-term policy for the hard-core workless is probably adequate ‘passive’ income maintenance combined with training, or sheltered employment for people with disabilities who have difficulties in entering the open labour market. The most effective long-term strategy would be to invest in prevention, which as will be argued in the following section, must start in early childhood. Table 1.5 provides a broader picture of how different factors affect poverty in workless households.

[32] One explanation for why reintegration in Denmark during economic upswings appears superior is that very few women have never held a job.
[33] For unskilled entrapment, see Allmendinger and Hinz (1996); for wage mobility, see OECD (1999b)

TABLE 1.5. THE ODDS OF POVERTY AMONG WORKLESS HOUSEHOLDS. LOGISITIC REGRESSIONS FOR SELECT COUNTRIES, AND FOR THE EUROPEAN UNION AS A WHOLE. 1996.

(includes only head of household aged 20-55)

	Denmark	Germany	Spain	U.K.	European Union
Age of Head	.95***	.97***	.99	.97*	.98***
Education	1.29	.86	.40***	.76*	.54***
Head Chronic illness	1.73	.77	1.33	.91	.84**
Head Long-term Unemployed	.30	1.57	4.64***	3.21***	1.74***
No work Income	5.14***	9.77***	4.74***	5.34***	7.70***
Children Present	.44*	1.05	1.62**	1.52**	1.03
Lone Mother	.93	1.37	.70	2.05**	1.04

Source: ECHP, wave 1996.
Explanation: odds less than 1.0 imply that the risk of poverty diminishes; odds greater than 1.0 imply that this factor raises the probability of poverty.,
***) is significant at .001 level. **) is significant at .01 level, and *) at .05 level.

Table 1.5 presents estimates for the EU as a whole and for four representative welfare models. The analyses are limited to ages 20-55 in order to exclude those in early retirement. The results summarise quite well our earlier findings. The risk of poverty rises among the young and less educated, but above all when the head of the household is long-term unemployed and when there is no earner (throughout the entire year). The poverty risk is especially severe when the head of the household is long-term unemployed in Spain and the U.K. while this implies no significant risk in Denmark – implying that Danish income support is quite effective.

The fact that chronic illness does not influence poverty suggests that welfare states protect those unable to work quite effectively.[34] The presence of children in the household raises poverty risks significantly in Spain and the U.K., while in Denmark the effect is to reduce poverty. This indicates that the generosity of family support can be decisive. Lone motherhood contributes to poverty only in the U.K. The single most overwhelming effect everywhere comes from 'workless income' over the whole year, an indication of where the core problem is buried: households become very vulnerable everywhere when they are highly distanced from the labour market.

In the immediate future, managing social exclusion for workless households will necessarily imply income support for the 'hard-core', but what can realistically be done for the 'softer core'? Here contemporary policy promotes two, not mutually exclusive, remedies: 'make-work-pay' and activation.

Make-work-pay

Make-work-pay policy is directed at work incentives. These may express themselves in poverty traps or as unacceptably high opportunity costs of taking paid employment (as in the case of the day care 'tax' on mothers' labour). Can we identify clear supply-side disincentives across the EU?

Overall, there is little scientific evidence that social benefits reduce work incentives *per se*. [35] In most EU countries, unemployment or social assistance benefit levels are simply too low to affect work motivation among all but the lowest paid workers. Interestingly, countries with unusually generous unemployment benefits often have much lower long-term unemployment *and*, at least in the Danish case, one of Europe's highest flow-rates

[34] However, this may be offset by the potentially high costs to households when a member is disabled or seriously ill. Obviously, the cost structure of health care becomes decisive for whether adequate incomes are genuinely 'adequate'.
[35] See also Chapter 2.

out of unemployment (Esping-Andersen and Regini, 2000). [36] Vice versa, long-term unemployment is especially pronounced in Italy where the majority of all unemployed (mainly youth) have absolutely no entitlement to any social benefit. [37] If we examine the economic situation of the unemployed in workless households we find that poverty rates are generally high and, in some countries, extremely high.

This is not to say that work incentive problems do not exist. It often depends on policy interactions. High social benefits may not reduce work incentives if, as in Denmark, they are combined with activation policies. Vice versa, if social benefits are reduced when partners work there may be a negative effect on spouses' labour supply. During the 1990s, EU member states have taken some steps to remedy such dependency traps. Belgium and Germany, for example, now permit some work income in combination with assistance receipt. In the Nordic countries, where unemployment benefits are individualised, the negative spousal effect disappears. Ireland and the UK, following other Anglo countries, favour the tax credit approach to supplement incomes from low-wage employment.

Such measures may reduce the number of working-poor households at the margin, but 'in-work benefits' are unlikely to be an effective solution if half of all workless households are *de facto* impossible to integrate in the labour market.

Activation

Activation refers to any policy that enhances the capabilities of citizens. In this sense, providing day care to mothers is activation. Its legacy stems from the long Swedish tradition of 'active labour market policies'. Activation policy has changed philosophy in recent years. Now it typically combines a work-motivational element with individually tailored re-integration plans. Remedial policy is believed to be effective only if it takes a long-term perspective and if it focuses on developing broad skills. Hence, it is

[36] The drastic decline in unemployment *and* in no-work households in Denmark after 1992 is, in part due to the recovery of full employment, but also to the new employment activation policies.

[37] Hence they continue to live with parents (and thus avoid poverty). Indeed, this very fact may indirectly provoke incentive effects since the reservation wage among unemployed youth equal the living standard they maintain in the parental home. Accordingly, unemployed youth are generally unwilling to move geographically even when offered a job. For an overview of the income situation among young unemployed in Europe, see Bison and Esping-Andersen (2000).

unavoidably very costly. Except for the Nordic countries (and especially Denmark), most EU member states pursue less comprehensive activation measures. We may distinguish three broad approaches. One group favours targeted (especially youth) job subsidies with some training content attached to the subsidy. In France, a third of young workers with low education find their first employment in a subsidised job (OECD, 1999b: Table 15). In Italy, subsidised training jobs account for 60-65 percent of all first youth entries into the labour market. It is not clear how much training is provided, but the policy can claim one success, namely that the rate of passage from temporary training to permanent contracts is very high. Unfortunately, it also demonstrates a basic failure in lowering (youth) unemployment (Samek Lodovici, 2000). A second group, already discussed, puts the emphasis on changing work incentives via work-conditional benefits.

The third approach, epitomised by recent Danish policy, invests heavily in across-the-board (but youth biased) re-integration. Briefly, it aims to avert prolonged exclusion by stipulating a maximum of 6 months' unemployment or assistance benefits for the under-29s (longer for older workers), upon which continued benefits are conditional on either accepting a job or education. Job assignments are often in sheltered or subsidised employment. Education offers depend on the candidate and may involve prolonged schooling (up to 18 months as a norm). The key is that integration is tailored to the profile, needs and prospects of the individual, and that it involves intensive and continuous follow-up. This is unavoidably expensive, but it is regarded as an investment in future productivity and self-reliance.

Does activation pay off? That question is almost impossible to answer because we will never know whether 'activated' persons would have succeeded (or failed) without such help. Follow-up analyses of Danish activation produce mixed results. There is firstly the interesting finding that the 'activated' are systematically more satisfied when they move from passive welfare support to activation. This may be more important than it sounds. Firstly, it suggests that welfare dependency is not an incentive problem. Secondly, inclusion in an educational or job-insertion programme arguably heightens clients' sense of belonging and participating in society. Secondly, there is some evidence that activation (and the 6-month ceiling on unemployment benefits) spurs the unemployed to seek employment more energetically. There is also solid evidence that activation has brought down long-term assistance dependency. Thirdly, overall assessments are more even. Most studies arrive at a very similar '30-30-30' conclusion, namely that about one-third of cases are clear successes in the sense that they escape fully from welfare dependency; a second third only partially escape; and a final third remain dependent on benefits. The important addendum here is that success is substantially greater among young people (less than 25). [38]

Towards a preventive strategy

There is one basic finding that overshadows all others, namely that remedial policies for adults are a poor (and costly) substitute for interventions in childhood (Heckman and Lochner, 2000). Since a person's job-prospects depend increasingly on his or her cognitive abilities, this is where it all begins. Activating or retraining adults is profitable and realistic if these same adults already come with a sufficient ability to learn. Households with limited resources can probably never be eradicated entirely, but their share can be minimised and this is our single greatest policy challenge. With this aim in mind, what does the scientific evidence tell us?

First and foremost, it all begins in early childhood. At this point, three factors are of crucial importance: health, income poverty and 'developmental priming mechanisms' such as reading to children, social stimuli and guidance. [39] Families with limited resources are likely to fall short on all three counts. A strong welfare state in the conventional sense can avert the first two factors, but if cognitive stimulation is key we must rethink policy. We cannot pass laws that force parents to read to their children, but we can compensate. One option, also examined in Chapter 2, is to ensure that parents of small children are given the possibility of low-stress employment and adequate time with their children. [40] A second, perhaps more effective option, is to promote universal, high-quality day care.

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[38] For an overview, see Ploug and Sondergaard (1999) and Socialministeriet (2001). These results seem to confirm the idea that there exists (and possibly always will) a hard-core group of citizens for whom the only realistic welfare policy is adequate (passive) income support.

[39] For an overview of existing scientific research, see Karoly et.al. (1998) and Danziger and Waldvogel (2000). For more detail, see below.

Here is a case for giving priority access to quality day care for children from vulnerable families. [41] The challenge then continues at school age. Here the evidence points to two key factors. Firstly, that family poverty (and instability) remains decisive, especially in dictating school attendance, motivation and drop-out risks. Secondly, the quality of schools and the nature of the local community interact heavily (this is especially an American problem, but it may very well transplant itself to Europe as segregated immigrant communities proliferate). The situation to avoid is that schools are inferior in deprived neighbourhoods. Education experts advocate the development of after-school programmes that yield the double advantage of supporting the intellectual development of children while alleviating pressure on working mothers.

Even if many of the roots of social exclusion emanate from childhood, there is strong evidence that the experience of poverty *per se* has a compounding, self-reinforcing effect on marginalisation. Whelan et.al. (2001) show that persistent income poverty accelerates the erosion of resources which, in turn, hardens deprivation. [42] Poverty, as we have seen, is generally triggered by lack of income from work so this is where policy should naturally focus. But we must also recognise that a work-strategy alone is far from being a sufficient measure. In other words, any serious social inclusion policy cannot avoid income guarantees that, minimally, avert cumulative resource depletion.

To sum up this section, a social inclusion strategy for Europe depends, in the immediate sense, on a combined work and income support policy. If we shift our sight further into the future, a truly effective strategy must be far more preventive. It must invest heavily in the resources of our children today. Most European welfare states fail to do this now and, if uncorrected, they will pay a heavy price tomorrow.

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[40] As discussed below there is ample evidence that mothers' employment per se does not affect negatively children's welfare or development, but there is also strong evidence that it will *if* mothers have stressful working conditions.

[41] As will be clear further on, we strongly advocate a *universal* child care policy, but within such a framework one might contemplate special measures (such as subsidies) in favour of those most at-risk. Additionally, the establishment of a comprehensive system of child care will take years, even decades, and one might therefore pursue some selectivity in favour of the most needy in the meanwhile.

[42] Their deprivation measure is a multi-indicator composite of need and social integration.

1.2. Investing in Children

There is cause for optimism *and* worry about the epoch we are entering. We shall benefit from a far more skilled production system. However, this will raise the prerequisites needed for good life chances. Those with inadequate skills or resources risk sliding into a life of precariousness and exclusion. The concentration of welfare problems within contemporary families with children and young people are accordingly of major concern. If we aim for a productive and socially integrated future society, our policy priorities should centre on today's children and youths. Solid investments in children now will diminish welfare problems among future adults.

Many believe we face a naked generational clash so that greater social allocations to children will be at the expense of the elderly or vice versa. This is, generically speaking, a fallacy. To begin with, there is no golden rule that dictates that the welfare of one implies misery for the other. On the contrary, poverty among the elderly *and* child poverty is simultaneously very low in the Nordic countries and Belgium; simultaneously very high in the U.S. and Britain. This is even more evident when we examine long-term trends. The decline in elderly poverty is internationally convergent, but long-run (1970-1990s) trends in child poverty diverge: declining steadily in the Nordic countries, fairly stable in most of Continental Europe and rising significantly in Italy, the U.K. and in the United States. Spending on the elderly may, of course, crowd out resources for the young but such a scenario can be avoided by the adoption of the kinds of decision rules advocated in Chapter 3.

Also, we must not forget the continued importance of the inter-generational social contract *within* families. Traditionally, resource flows were more likely to go from children to their elderly parents, whereas the flow is now largely reversed. Income-rich pensioners transfer large amounts of excess retirement income to their children and grandchildren (Esping-Andersen, 1999; Kohli, 1999). The inter-generational contract is becoming problematic for two reasons. On the monetary side, the timing of inheritance is becoming delayed due to increased life expectancy. Hence, rather than arriving when the offspring most need it (as young families), it is now more likely to arrive when the children are already in their prime. More generally, we see the emergence of a distorted life cycle redistribution. If excess retirement income is redistributed downward within families, the redistributive effect will be regressive: the children of rich pensioners will be favoured. Indeed, here we confront a rather problematic example of socially inherited privilege partly sponsored by the welfare state. There are both fewer daughters available to care for the elderly and also fewer grandmothers to care for small children. The result is a double caring-vacuum exactly when the need is intensifying.

With some notable exceptions, contemporary welfare states give rather low priority to families with children. This is historically rooted. Traditional family policy was more indirect, focusing on upholding the earnings power of the male breadwinner. As long as marriages were stable and breadwinners enjoyed secure, well paid employment, governments could assume the self-reliance of families in terms of both income and caring needs. Married male workers were also often paid an additional marriage supplement, which typically added 5-10 percent to men's wages (Montanari, 2000). Child allowances and other transfers mainly addressed households with large numbers of children (a large percentage had 3+ children until the 1960s).

Furthermore, family support policies entered a long era of decline in tandem with falling fertility and rising real wages (Gauthier, 1996; Wennemo, 1994; Kamerman and Kahn, 1997). [43] A small group of nations began, since the 1970s, to pursue more active family policies and during the 1990's we see a broader pan-European attempt to respond to the needs of families. See Table 1.6 [44]

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[43] The mean EU fertility rate in 1960 was 2.61; in 1990 it had dropped to 1.54.. Kamerman and Kahn's (op.cit, Table 4.9) data show that the value of family cash benefits (as a percent of disposable income for a one-earner married coupled, with 2 children) declined in 14 out of 18 countries, 1975-1990.

[44] As Table 1.6 suggests, welfare state allocations *per child* began to increase during the 1990s in several countries, most notably in Australia and in Scandinavia. Yet, as we shall see ahead the rise in child poverty continues regardless. Trends in aged poverty are discussed in Chapter 3.

TABLE 1.6. TRENDS IN INCOMES AND SOCIAL TRANSFERS AMONG FAMILIES WITH CHILDREN. MID-1980'S TO MID-1990S.

(Adjusted for Changes in Population Shares).

	Trend in disposable income	Trend in transfers
Australia	- 3.4	+6.3
Canada	+1.5	+2.9
UK	- 3.4	+1.3
USA	+2.4	+1.3
Denmark	- 0.6	+2.0
Finland	+1.6	+5.5
Norway	- 0.3	+3.5
Sweden	- 1.9	+2.0
France	+3.6	- 0.4
Germany	- 1.8	- 3.5
Italy	+0.6	0.0
Netherlands	+2.4	+0.3

Source: Data from Oxley et.al. (1999). Estimates based on equivalence scale (e= .5)

It can be seen that the income position of families with children continues to decline in many countries regardless of a rise in *per child* transfers. The causes are multiple, including the proliferation of high-risk households and the often problematic labour market conditions that young adults face. For example, the share of children who live in a workless household has increased by 32 percent in the EU since the mid-1980s

(Micklewright and Stewart, 2000: Table A4). Also, there is clear evidence that the growth in child poverty is related to widening earnings inequalities. [45]

International differences in the well-being of families with children are, no doubt, policy related. Scandinavia stands out not only because of its generous child allowances, but mainly due to its huge investments in family services and active labour market policies. Nordic child poverty rates are systematically low and, more tellingly, continue to decline; not so much because of social transfers, but primarily because fathers *and* mothers are gainfully employed and adequately paid.

This combination does not exist anywhere else. The Anglo Saxon nations favour targeted support, currently through work-conditional tax credits. The Australian and Canadian approach is more generous and, hence, child poverty has declined far more than in the UK or in the US. [46] The worrisome increase in child poverty in several Continental European nations – see the rise in 'extreme poverty' in Table 1.7 - must, likewise, be linked to social policy. The Continental social insurance tradition is ill-equipped to offer more than residual assistance benefits to needy households without established work records. With few exceptions child allowance schemes are undeveloped and ungenerous and public provision of childcare virtually non-existent. Worse, in many countries family aid is mainly based on tax deductions. Nowhere is the youth concentration of unemployment as severe as in Continental and Southern Europe. Even if Mediterranean families remain far more stable, market inequalities nonetheless generate poverty. [47]

[45] The bi-variate correlation between changes (1985-1995) in primary income Gini and child poverty rates is + .691 for 15 OECD countries. In OLS regressions, every one point increase in Gini raises child poverty by 1.1 points (estimated on the basis of data furnished by Oxley et.al. (1999)).
[46] Britain has recently improved these benefits, but we lack up-to-date data to gauge its effects on poverty.
[47] In Spain, however, child poverty has remained basically stable at 10-12 percent between 1980 and 1990. Note that our estimates (from LIS data) refer only to households with head aged 25-55.

TABLE 1.7. POVERTY RATES AND TRENDS IN FAMILIES WITH CHILDREN, 1980s-1995.

POVERTY = <50 PERCENT MEDIAN.
EXTREME POVERTY = <33 PERCENT MEDIAN

	POVERTY		EXTREME POVERTY	
	RATE 1995	TREND 1980-95	RATE 1995	TREND 1980-95
Denmark('92)	2.9	-0.2	1.3	-0.1
Finland	2.1	+0.1	0.8	-0.1
France	7.1	-0.9	1.3	-1.9
Germany	9.4	+7.1	4.0	+3.3
Italia	17.2	+7.4	9.4	+6.0
NL	8.1	+5.0	4.7	+4.1
Norway	3.4	-0.7	1.6	+0.2
Spain('90)	9.5	-0.9	3.5	-0.3
Sweden	2.2	-1.6	0.9	+0.4
U.K.	15.5	+7.0	4.7	+2.7
USA	19.3	+2.5	8.8	+1.1

Source: LIS.

Notes: the estimates refer to households with head aged 25-55 only. Poverty = 50/33 percent of median income of all child households. Equivalence scale = .5

Working-age household poverty is principally a question of unemployment, labour supply, or low earnings. [48] The deteriorating position of families with children over the past decades is due to all of these factors. As noted, child poverty rises 1.1 points for every one point increase in the Gini coefficient.

[48] Marital homogamy obviously reinforces the connection between low wage incomes (or unemployment) and household income poverty.

The case for abolishing child poverty

Child poverty is an acute problem for many reasons. We have seen, that in some member states the relative position of families with children is deteriorating, both when compared *with their own* income position a decade earlier (Tables 1.6 and 1.7), as well as when compared with the overall trend (Table 1.2). Since the 1980s child poverty has indeed risen in 6 out of the 10 countries we examine, most sharply in the U.K., Germany, and in Italy (all by about 7 percentage points). And lone mother poverty is everywhere substantially higher: still quite modest in Scandinavia (5-7 percent) but extremely high in European countries like Italy and the U.K. (with 32 percent) and Spain (23 percent); in the United States (with 45 percent) it approaches the norm.

As we have seen, this can be offset by mothers' employment, which generally lowers child poverty by a factor of 2 or 3; if lone-mothers work, poverty declines to half.[49] In other words the well-being of children depends on how market and welfare state inputs are combined.

Families with children are also vulnerable to unemployment and it is not easy to disentangle the separate effects of income poverty from the experience of unemployment on children's well-being. There is strong evidence that unemployment, even if not accompanied by poverty, has serious secondary effects. A recent Danish study shows that it doubles the chances of family break-ups and, much later, of unemployment among the children. It is also highly correlated with parental alcoholism, violence and incarceration (Christoffersen, 1996). Similar long-term consequences for life chances and family welfare also spring from child poverty. As research documents, these consequences spill over to society. We know from American research that childhood poverty is strongly associated with less schooling (2 years less), more criminal behaviour, various psychological pathologies and with lower earnings in adulthood (30 percent less). Children from poor families are also much more likely to become poor parents later and, thus, to reproduce the poverty syndrome across generations (Haveman and Wolfe, 1994;1995; Duncan et.al., 1997; Danziger and Waldvogel, 2000). European research (Gregg and Machin, 2001) comes to similar if,

[49] See Esping-Andersen (1999). The somewhat weaker reduction in lone mother households is because lone mothers are much more likely to work on a part-time basis.

perhaps, less dramatic conclusions.[50] to the extent that child poverty is indeed associated with inferior life chances, fighting child poverty should be considered a priority.

If childhood poverty translates into less education, inferior cognitive skills, more criminality and inferior lives, the secondary effect is a mass of low-productivity workers, highly vulnerable to unemployment and low pay in the 'new economy'. They will yield less revenue to tax authorities and probably require more public aid during their active years. In short, here we can identify the basis for social exclusion in tomorrow's Europe. There is mounting evidence that the harm done in childhood is very difficult to undo later. Remedial 'second-chance' policies are much more costly and far less effective than policies aimed at improving especially *early childhood* welfare (Heckman and Lochner, 2000). If the parental environment has an overpowering effect on subsequent learning and cognitive acquisition, clearly a major objective of social policy must be to lessen this potential effect.

Cognitive inequalities are strongly correlated with poverty and income inequalities more generally. [51] Regression analysis suggests that a 10 percent rise in child poverty implies a 8.5 percent increase in the share of adults that fall into the lowest (basically dysfunctional) level of cognitive abilities. [52] In turn, low cognitive abilities, like low educational attainment, are powerful predictors of unemployment.

If poverty harms children's life chances *and* if it also creates negative externalities, such as more costly social problems and less efficacious adults, we see the contours of a positive-sum strategy: minimising child poverty now will yield better earnings

[50] American data show that children (aged 16-24) from the poorest quintile are three times as likely to drop out of high school (Cornia and Danziger, 1997: 201). Buchel et.al's. (2001) data for Germany suggest that children from the bottom two quintiles (i.e. poor families) are half as likely to go to *Gymnasium* as the mean. For Britain, Gregg and Machin (op.cit) find that poor economic conditions in childhood are 5 percent more likely to lead to unemployment or to provoke problems with the police (if men) and 9 percent more (if women). Also in their study, the negative impact of childhood poverty on schooling is the key mechanism

[51] This is also a key finding in Gottschalk et. Al. (1994) and in the Gregg and Machin (2001) study. For a more comprehensive treatment, see Huston (1991).

[52] OECD's literacy studies distinguish 5 cognitive levels. The lowest (1) must be considered inherently dysfunctional, reflecting a level so poor that people are generically untrainable and able to perform only the most routine unskilled work. T-statistic in estimation = 4.38, and R^2 = .635 (N=12). A similar equation predicting low cognitive abilities with overall inequality (Gini coefficient for the working age

prospects, improved productivity and better capabilities for life long learning and retraining in the future. This will diminish the risks of old age poverty in the far future (and possibly also the need for early retirement). This will strengthen the financial sustainability of pension systems between now and 2030-40.

It is clear that there is a strong case in favour of activation and life-long learning strategies. But, and this is a crucial point, *such strategies are unlikely to work if not accompanied by a broader attack on childhood deprivation*. Unless we intervene in the mechanisms that transmit inferior resources, such as cognitive abilities, from parents to children, it will probably not be effective.

Some countries have succeeded in reducing the parental impact on children's cognitive abilities. Others far less (OECD, 2000). In the first group we find the Nordic countries with Australia. Here the impact of parents' educational level on their children's cognitive abilities is comparatively weak and, more importantly, in marked decline. In the second group we find Belgium, Germany, and the U.S. Here the parental impact is very strong and, worse, increasing.

It is not possible to isolate all the relevant factors involved in inter-generational cognitive inheritance, but some are clear and eminently subject to policy. First and foremost, the inequality of educational attainment among parents is all important and policy must therefore concentrate on closing educational gaps among contemporary youth cohorts. This means minimising secondary school drop-out rates, perhaps via special incentive schemes and more diversified (and integrated) secondary-level educational menus. If, as occurs in some member states, a third of youths leave school without a secondary-level diploma, this is likely to translate into a two-thirds society two decades hence. A concrete step one might consider is to apply the logic of 'in-work' benefits to diminish school drop-out rates, i.e. introduce *'in-school benefit schemes'* to parents. One might, for example, introduce supplementary social benefits to families that are conditional on the verified school attendance of their children.[53]

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population) yields even stronger elasticities: for each Gini-point increase, the percentage in cognitive level 1 increases by 1.3 points. (T=5.81, and R^2=.772).

A second well-documented factor has to do with family instability. Lone parent families can be especially problematic since they combine low income with less parental attention to children (if mothers work). The problem is that mothers' employment – especially in lone mother households – is a key to reducing poverty risks. What is important to note, however, is that (lone) mothers' employment is not *per se* a source of childhood disadvantage. The effects are positive if mothers have rewarding jobs, but become negative if their jobs produce stress and fatigue (Lynch, 2000; Haveman and Wolfe, 1995; Duncan and Brooks-Gunn, 1997). An approach to combat childhood deprivation may therefore have to follow a combined strategy that: a) assures adequate family income, b) helps weaken the direct impact of parents on children's cognitive development, and c) improves the work environment of employed mothers – a point also emphasised in Chapter 2.

Strategies to minimise child poverty

Poverty may be brief, sporadic, or lasting. [54] It may occur when children are small (and parental earnings generally lower), or later in childhood (due to family break-ups, unemployment, or mothers' inability to work). There is a growing consensus that *early* childhood is key for subsequent development. Equally, the longer it lasts, the more harmful it is. Moreover, the household context of deprivation may be influential. As noted, divorce is very problematic and lone-mother poverty may have substantially worse consequences than similar poverty within a stable two-parent family (Haveman and Wolfe, 1995; Duncan and Brooks-Gunn, 1997). On the other hand, children's well-being improves dramatically when (and if) lone mothers re-marry or cohabitate – in either case, this almost doubles household income (Morrison and Ritualo, 2000). [55]

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[53] Here Europe can draw lessons from Brazil where the Cardoso government has sought to diminish child vagrancy by subsidies to parents whose children attend school.

[54] The duration of child poverty is clearly detrimental to the dynamics of welfare. From the rather limited comparative studies available on comparative poverty dynamics, there are pretty clear indications that persistence is positively related to overall poverty levels. The likelihood of remaining poor in 3 out of 3 years (and 5 out of 5 years) is substantially higher in the U.S. than in Europe (Duncan et.al., 1997; 1998; Bradbury et.al., 2000). Correspondingly, the likelihood of exiting poverty is lower in any given year in The US than in Europe.

[55] Although information is totally lacking, the general practice of single mothers in Southern Europe to co-reside with other relatives may have a positive effect on the children's welfare.

Today, as always, work income remains the single most powerful bulwark against poverty. But, at the lower end of the earnings scale and especially when households are excluded from employment, transfer dependency is intensifying. Yet, transfer dependency can and is being effectively reduced in some countries by the provision of childcare services. Unaffordable childcare can be a serious poverty trap for low income families. If, as is typical across much of Europe, the cost of full-time, quality care *per child* exceeds a third of mothers' expected earnings, the resulting real tax on her employment becomes prohibitive. The outcome may be undesirable: educated women with high wages will be able to afford care; low educated and women on low incomes will not be able to afford care, notwithstanding that the urgency of affordable care is greater among the latter.

Let us, for analytical purposes, reduce the issue to two basic factors: the earnings capacity of households with children (which is related to affordable day care) and the level of social transfers to which they are entitled (which may help offset the cost of children). In order to isolate the relative salience of either, we should examine two-parent and one-parent households separately. As in the previous section, we can estimate the odds ratios of child poverty given parental employment status and the size of social transfers. Table 1.8 repeats the analysis provided earlier for lone parent families, now for two-parent households with children.

TABLE 1.8. THE ODDS OF BEING POOR. THE IMPACT OF PARENTAL EMPLOYMENT AND SOCIAL TRANSFERS ON POVERTY IN TWO-PARENT FAMILIES WITH CHILDREN. LOGISTIC ODDS-RATIOS, MID-1990s.

	Father does not work	Mother does not work	Impact of social transfers	
	All families with children		All poor families	Only pre-[1)]
Denmark	2.3	3.0	0.7	0.07
Sweden	4.2	20.3	0.4	0.05
France	8.3	4.1	0.9	0.18
Germany	12.0	3.0	1.0$^{n.s}$	0.23
Italy	9.1	5.5	0.9	0.05
Spain	6.2	3.0	1.0$^{n.s}$	0.12
U.K.	8.8	2.1	0.8	0.07
U.S.	1.3	3.1	1.7	0.42

Source: LIS data

1) estimates for households poor before taxes and transfer. $^{n.s}$ denotes statistically non-significant effect.

Note: all estimates control for number children.

Table 1.8 groups countries by their general social protection characteristics, as discussed earlier. The number of children has a fairly strong effect on poverty, in particular where the family benefit package is ungenerous, i.e. falling below the Ditch et.al. (1998) country mean (estimates not shown in Table). But the impact of number children basically disappears among pre-transfer poor families, an indication that income support to low income families is more in tune with the size of the household. [56]

Also, there are important variations in the degree of male-breadwinner dependency. The relative importance of fathers' earnings is pronounced in the U.K., Germany, Italy and France, but far weaker in Scandinavia and the U.S. Generally speaking, there is no single country in which mothers' employment (controlling for fathers') would not reduce poverty substantially, typically by a factor of 4 or 5. For two-parent families, the conventional male breadwinner model raises poverty risks considerably and we arrive at a conclusion very similar to the earlier analysis of lone mothers. Mothers' employment is a key factor in any policy approach to fight child poverty.

But this does not imply that social transfers become unimportant. When we examine 'all families', the majority of which are not poor before transfer incomes, the transfer effect is only noticeable in the Nordic countries.[57] It becomes key in 'pre-poor' families, and here we have a good indicator of the efficiency of the family transfer package: very effective in all cases, except the United States and, to a lesser degree, Germany.[58] It is telling that the impact of mothers' work in pre-poor families is by far the strongest in Sweden, and not at all significant in the U.K., France, Germany, and Italy. This suggests that Sweden secures minimal child poverty by its *combined strategy* of generous transfers and support for working mothers. In Continental Europe (and the U.K.) families depend far more on either the male breadwinner or on transfers.

The cost of eliminating child poverty

What is the cost of a child? Firstly, there are the direct costs of feeding and clothing an additional member of the family. Such costs may have a marginal effect for low-income families. What has changed dramatically are the opportunity costs involved. These are best measured by the (cumulative) wage penalty that motherhood incurs. It is this part of the cost burden that contemporary families are increasingly unwilling to internalise.

[56] Bradshaw (2000) shows that even in Italy (one of Europe's least 'child friendly' transfer systems) social assistance benefits to large families with children assume a standard comparable to France or the U.K..
[57] In the U.S., the tax-transfer combination actually contributes to poverty.
[58] Note, however, that Germany has recently upgraded its child allowance scheme.

Policy makers seem to assume that the opportunity cost is simply a matter of more day care and paid leave. This is not true for countries where employers impose huge costs on motherhood. [59] If 'getting started' for a woman necessitates renouncing motherhood, the cost of children comes close to being equal to the benefits of female economic independence. This aspect of the 'cost of children' will be examined in the following section.

A policy paradox of our times is that both the societal and individual costs of childhood deprivation can be very high while the costs of eliminating the problem can be quite modest. As an experiment, let us for the moment ignore the contribution of fathers to family welfare and simply focus on the two main alternatives: lowering poverty via mothers' employment and/or via more generous family transfers. Which policy (or policy-combination) might most efficiently ensure zero child poverty – regardless of number of children? Let us use the example of Spain. Our data indicate that mothers' employment helps reduce, but not eliminate, poverty (if all mothers actually worked, Spanish child poverty would drop to approximately 3-4 percent). Here a mother-employment strategy based on subsidised childcare and the usual 'women-friendly' welfare package would be very, but not fully, effective. A second, and complementary, policy would be to raise family transfers to the rate necessary to bring families above the poverty line.

If we were to rely entirely on public transfers to attain a zero-poverty rate, the cost calculus would be a simple arithmetic function of [(#poor households x poverty gap)/GDP]. The cost of bringing all families with children above the standard poverty line would, in most countries, be cheap.[60] Since Nordic poverty rates are already close to zero, obviously the additional cost would be minute. At the other extreme, high poverty rates combined with large poverty gaps (as in the U.S.) require more substantial spending requirements. See Table 1.9.

[59] In Italy and Spain, employers routinely force female employees to contractually agree to dismissal in the case of pregnancy. Perhaps this happens rarely in Sweden but then competitive sector Swedish employers rarely employ women in the first place.
[60] Of course, by doing so we will have altered the whole distribution, including the median used for our calculations.

TABLE 1.9. THE COST OF ELIMINATING CHILD POVERTY. NATIONAL ACCOUNTS ESTIMATES. 1990s. 1)

	Number Poor Child-HH's (000's)	Poverty gap (PPP in 1995 US$) Currency)	Extra Cost as % of GDP
DK('92)	19	3951.92	0.01
SWED('95)	25	3402.67	0.01
FRA ('94)	315	1459.52	0.08
ITALY('95)	1033	2497.42	0.29
SPAIN('90)	531	1319.24	0.16
U.K.(1995)	1210	1926.61	0.26
USA(1997)	6665	3480.73	0.30

1) Poverty gap estimates are based on the objective of bringing poor families with children above 50 percent of the median adjusted disposable income line. The exercise ignores the fact that this, in itself, will alter the overall distribution and thus also the median. For comparative purposes, the poverty gap is expressed in purchasing power standards for 1995 US dollar. Thus, the different years have been standardised to 1995 and then, to take account of differences in purchasing power in different countries, standardised using purchasing power parities.

Source: LIS Databases and OECD National Accounts.

In other words, the virtual elimination of poverty in families with children could be accomplished by only a modest increase in existing social expenditures.

The cash strategy is obviously cheaper (and less urgent) when mothers work, but this implies complementary services or subsidies to ensure affordable day care. What would now be the comparable public outlay? The first step is to define a benchmark for 'affordability'. The cost of day care is a tax on mothers' employment that is purely regressive. Since mothers' employment is almost universal in Denmark and Sweden, the cost structure in these countries may provide a good benchmark. Meyers and Gornick's (2001) data suggest that the parental share of total is about one-third in Denmark (and also Belgium and France), corresponding to between 6 and 11 percent of family income. [61] In other words, the norm is that public subsidies cover two-thirds of the cost.

With this benchmark, what would be the comparable public outlay elsewhere? Across Europe, private day care costs appear surprisingly similar. In licensed urban centres, the annual, full-time per child (ages 0-3) cost is 8-9 million Lire in Italy, 5-600.000 Pts in Spain, and £4000 in Britain. [62] This would eat up about one third of a mother's expected *net* earnings. To reach the Danish 66 percent public subsidy benchmark, a rough national accounts based calculation (for the case of Spain) suggests an additional treasury outlay of roughly 3.5-4 billion Pesetas – under the assumption of two children per mother. Fairly similar costs would be expected in other countries that, like Spain, rely almost exclusively on private care provision. The actual net cost can, of course, be reduced by eliminating existing tax deductions.

If the aim is to eliminate poverty in families with children, the 'servicing strategy' is clearly more costly (and seemingly less effective) than the 'transfer strategy'. But it is vital to note that the two are interdependent. Family benefits add to household disposable income. The more generous they are, the lower the childcare subsidy will need to be. Leaving aside the complexities of a combined dual strategy, the two policies represent also two distinct philosophies with distinct secondary effects. Our 'transfer strategy' was targeted exclusively to households with less than 50 percent of median

[61] The parental co-payment share is about half that in Sweden.
[62] costs based on telephone interviews with day care centres in one or two larger cities in each country.

disposable income (and its aim was very modestly to bring families above the 50-percent line). Such targeting could be based on negative income tax methods or, as in some countries, one might simply distribute universal and equal family benefits (and simultaneously eliminate tax deductions). There are two strong arguments in favour of the latter. One, it solidifies public support for family benefits. Two, by asking childless households to finance part of the cost of children, it implicitly recognises that children contribute value to all citizens. On a life cycle basis, childless citizens are free-riders. If government is concerned with *re*-distribution in favour of the neediest households, supplements could be paid to low income households.[63]

At present, the norms governing child benefits differ widely. Predictably, Scandinavia (with Austria, Belgium and recently also Germany) is generous, granting roughly 2400-3000 Euros (per annum) to a family with two children. At the other extreme lie Greece, Italy and Spain where benefits are extremely low and/or subject to an income test. If we return to the earlier Spanish example, a Nordic-level child allowance would offset half of the childcare supplement needed among average income families.

The 'servicing strategy' was premised on explicit universalism, providing a subsidy (albeit income related) to rich and poor alike. One might of course prefer to target childcare subsidies and this would lower public outlays. [64] Besides the standard repertoire of externalities and moral hazards associated with targeting, there is actually a strong investment-based case to be made in favour of universalism. Firstly, affordable childcare will reduce the cumulative wage penalty that mothers incur by interrupting their careers. Secondly, society needs to mobilise female labour reserves to the maximum. And, thirdly, working mothers will quite likely reimburse the subsidy via higher tax payments throughout their working life. If day care minimises women's

[63] Some countries provide extra benefits to single mothers, either in the form of additional allowances (Denmark, Finland, France, Ireland) or by guaranteed maintenance allowances (Finland, Germany, Norway, Sweden).

[64] Although in this case, administrative costs are high, fraud possibly widespread and, worse of all, it may create poverty traps. A targeted servicing strategy also runs the risk of reinforcing class dualisms among families. One very strong argument in favour of universal day care systems is that they help neutralise unequal social capital among children. Note though that earlier (on p. 29), a case for selective policy started from the premise that it was a short-term measure, needed in order to let the most vulnerable groups "catch up" as childcare consumers.

employment interruptions, their cumulative lifetime earnings will be substantially higher and this means substantially higher future tax revenues.[65]

EU member states with low female employment hardly even need 'actuarial' justifications for a universalistic child care policy. To meet the new EU guideline of a 60 percent female employment rate by 2010, countries like Italy and Spain must reach close to a 25 percentage point growth over the next ten years. Regression simulation suggests that each 10 percentage point increase in day care provision results in an increase in mothers' employment rate of about 5,3 percentage points (controlling for family transfers and fertility). Hence, Italy and Spain might reach the 60-percent goal with a ten-fold increase in day care coverage (from a current 3-5 percent to approximately 40-45 percent). When we consider that the Danish 57 percent day care coverage rate was attained over three decades, countries like Italy or Spain would need to produce annual growth rates three times as high as the Danish.

The two-pronged strategy would suit the current policy scenario in much of Europe in the sense that the 'mother-employment' strategy is already on the agenda and will, according to our analyses, help reduce child family poverty substantially in its own right. The residual poverty that surely will remain would prove very inexpensive to eradicate.

Fertility and family welfare

We have so far concentrated on the monetary dimensions of family welfare. To broaden the focus, one revealing measure of family well-being is the sometimes large gap between preferred and actual number of children. When we ask European men and women (in the 25-34 age group), there is surprisingly little variation, either by sex or by nation: an EU average of 2,4 children that fluctuates (plus or minus) by only 0.2 points, except in the case of Ireland where the ideal is 2,8 children (Bien, 2001; Hank and Kohler, 2000). Examining actual fertility rates (for 1998), the 'child gap' is large in Southern Europe and disappears almost in only two cases, Denmark and the U.K. For an overview, see Table 1.10.

[65] We have tried to cash out this effect for Denmark with the result that the treasury obtains a (small) net revenue gain in the long run (Esping-Andersen, 2000).

TABLE 1.10. FAMILY WELFARE DEFICITS: THE 'CHILD GAP'

	Ratio of actual over desired number children
EU average	**0.6**
Denmark	0.8
Finland	0.7
Sweden	0.7
Belgium	0.7
France	0.7
Germany	0.7
Netherlands	0.6
Hellas	0.5
Italy	0.5
Spain	0.5
Ireland	0.7
U.K.	0.8

Source: preference data are from the International Social Survey Programme (Bien, 2001), actual fertility data (for 1998) are from Brewster and Rindfuss (2000: Table 1).

What concerns us here is not the long historical decline in fertility, nor pro-natalistic objectives, but simply families' apparent inability to arrive at desired welfare levels. Hence, we must be concerned with the obstacles that citizens face in forming families of their choosing. Recent research points to three key factors. The first is a basic 'cost' issue. It is expensive to have children and prospective parents with low incomes may simply find it unaffordable. Blau et.al. (1998), for example, estimate that a child runs to $136.320 from age 0 to 18 in the U.S. Naturally, where generous family allowances exist, the net cost is lower. Hoem and Hoem (1997) argue that births in Sweden rose in response to improved financial incentives in the 1980s, only to fall with cut-backs in the 1990s. But the sudden drop in Swedish fertility during the 1990s is, most probably, related to a complex of issues, such as heightened unemployment and insecurity. In fact, there is no systematic evidence that family benefits (nor paid parental leave provision for that matter) influence fertility (Brewster and Rindfuss, 2000; Gauthier, 1991). Income may affect fertility decisions but is mainly a symptom of other factors.

A second, and far more weighty factor lies in the increased difficulties young adults face in 'getting started'. It was not difficult to begin family formation very early in a society where women were housewives and males began a stable career following school. Today's young people spend far longer in education and then in search of stable employment. In Northern Europe and America, youths normally establish independent living during the transition, but at low incomes and often with precarious jobs. In Southern Europe, the norm is prolonged job search and continued dependence on parents, often until age 30. In either case, the transition is ever more protracted due to youth unemployment, job precariousness and the difficulty of entering the housing market, all producing what Livi Bacci (1997) calls the 'postponement syndrome'. The mean age of marriage and, hence, first childbirths has moved upwards by 2-3 years in the past decades in most EU countries. [66] The postponement syndrome is, no doubt, far

[66] There is a much higher rate of births among young Danes than elsewhere. This is probably because even unemployed youths enjoy an unusual high level of income security. Thus, Bison and Esping-Andersen (2000) found that 40 percent of unemployed Danes, aged 20-30, are parents, compared to less than 5 percent in Italy and Spain.

stronger among educated youth. [67] As Peter McDonald (2000:21) concludes in his synthesis of the issues "…a range of brilliant gender equity policies will be ineffective if unemployment rates for young people of child bearing age are high. Work-family policies can only work if there is work".

We can, as does McDonald, also turn the issue on its head and argue that even if there are plenty of jobs, young prospective parents may shun children if fertility is incompatible with employment and career preferences. This leads us to the third and, what most agree upon, fundamental factor behind the emerging low-fertility equilibrium: the incompatibilities between motherhood and work which young women face in today's society.

The traditional negative correlation between female participation and fertility has now turned positive. It would seem paradoxical that higher fertility goes together with high female employment. It is the mechanism that drives this that we need to understand in order to develop a family and gender policy, which corresponds to the 21st Century. One clue comes from those nations that managed to reverse fertility decline. Beginning in the 1960s-1970s, we see everywhere a steady fall in birth rates, hitting all time lows (1.4) in Northern Europe in the early 1980s, a little later elsewhere. The great international bifurcation begins at this point. One group of countries, mainly the Scandinavian, experience a resurgence of fertility in tandem with women's employment; most other European countries remain caught in a low fertility equilibrium even if female participation remains low. Most telling is the sharp drop in Swedish fertility during the 1990s, which coincides with a 7 percentage point decline in female employment. The core issue, obviously, has to do with how women succeed in combining paid work and children. This is part and parcel of the gender equality question and will be treated in detail in the following section.

[67] In an unpublished study, Bison and Esping-Andersen estimate that educated Italian women are equally likely to have their first child at age 25 as at age 35. Cordon and Sgritta (2000) show that the extraordinarily difficult problems of gaining stable employment in Italy and Spain – especially among

1.3. Towards a Women Friendly Welfare State

The emerging post-industrial society is, no doubt, skills- and technology-driven, as Daniel Bell (1976) prophesised. But it is also eminently women-driven. Its employment and demand dynamics stem in great part from the need of households to externalise servicing as the housewife disappears. Many of the great challenges we face have their roots in the new claims that women make on men, the welfare state, and society at large. It follows that the quality of our future society will depend on how we respond to women's new claims and aspirations.

Policy has no doubt responded to women's call for more equality. Where the revolution in women's employment, economic independence, and political participation is most advanced, this is where 'women-friendly' policy is furthest developed. The basic argument that underpins this last section is that a resolution of the gender equality dilemma is, at the same time, an unavoidable precondition for a just and efficient future Europe, indeed the key to any new welfare architecture. The simple question is, how?

Alva and Gunnar Myrdal, writing in the 1930s, pioneered 'women-friendly' policy. Since mothers then *had to* work (and since the Myrdals were guided by pro-natalist concerns), they saw the challenge as "how to assure that working mothers can also have children". Women began to move from housewifery to jobs after the 1960s and thus emerged a reformulation, namely "how to assure that mothers might also be able to work". Today we have returned, once again, to the original challenge. But the meaning is completely different since now the majority of young women *demand* to work and a growing minority even puts careers before motherhood.

The urgency with which member states and the EU now call for 'women-friendly' policy springs from commitments to equality rather than pro-natal objectives. Yet, where continued employment is difficult to harmonise with motherhood, the response is to delay and even forego births. Patterns of female labour supply are converging, but actual employment rates and fertility are not. In many countries, young women bear the lion's share of unemployment and/or of precarious employment. In Southern Europe,

educated women – is the principal reason of postponement. In Spain, 80 percent of educated women would renounce on children in order to establish themselves in a career.

the trade-off between employment and motherhood is especially severe due to the lack of affordable childcare and of part-time jobs. The result is extremely low fertility (as in Spain and Italy). Unsurprisingly, there is broad political consensus (albeit fewer concrete measures) in favour of childcare and of nurturing a more egalitarian division of domestic work. Yet, no matter how urgently affordable day care and generous leave schemes are needed, they may not resolve the real trade-offs.

There are two main factors that complicate matters. One, the heterogeneity of women's preferences and, two, differing employment and wage mechanisms between countries. For these reasons a similar pan-European policy may have dissimilar effects.

The drop in fertility is not always well understood. It is often believed that modern women, with birth control, rising education and better career opportunities, are losing interest in family and children. Recent Spanish data, for example, suggest that 40+ percent young women now prioritise jobs over children.[68] And we see the share of women with zero children rising everywhere. But this reflects constraints more than preferences. The recovery of Scandinavian fertility following the expansion of childcare and leave schemes since the 1970s is one often-cited example and the sharp fertility drop in Sweden since 1990 does not contradict this. The fall is most likely a cyclical reaction to sudden unemployment, falling incomes and perhaps also to marginal reductions in benefit entitlements. Swedish fertility has always been exceptionally high among women in public service jobs and this is exactly where the single sharpest job decline occurred (Bernhardt, 2000; Hoem, 2000; SOU, 2000).

The share of women who prefer to forego motherhood entirely remains small and we can safely assume the majority does not. It is also safe to assume that most women are no longer inclined to internalise the full cost of having children. The important issue is that the conditions depend on the individual woman. As Bernhardt (2000) and Hakim (1996; 2000) suggest, policy making should be tailored to three distinct preference sets among women:

[68] Which, oddly enough is the highest level in Europe (the EU average is 25%). See Fernandez Cordon and Sgritta (2000:14). This extraordinarily high Spanish rate is, no doubt, a mirror image of the

1. *Family-centred* women whose life time goals are marriage and motherhood. If they work, it is mainly out of necessity and therefore such women will not respond to employment incentives or activation policy. They represent perhaps a large proportion of older women, but among *young* women their share is low in Southern Europe and close to nil in Northern Europe and America.

2. *Career-centred* women who prioritise employment over motherhood, who invest heavily in their human capital and who have few, if any children. For this group 'women friendly social policy' will have little influence. They represent, according to Hakim, maybe a fifth of all women (ranging from 10-30 percent, with the highest share in North America and the UK).

3. *Dual-role* women who do want to work, but are unwilling to sacrifice motherhood. Their qualifications tend to be conventionally female, and are directed towards 'women-friendly' jobs and sectors (like teaching and social work) and they are likely to concentrate in part-time and 'soft-economy' jobs, like public sector services. This group should be the most responsive to public policy incentives, to opportunity costs, tax/ income penalties, and to employment fluctuations. In other words, 'women-friendly' policies would be most directly relevant for this group. It is clearly the largest of all groups and probably also the most expanding considering trends in female educational attainment.

With leaps and lags, most countries follow a similar trajectory, namely that family-centred women decline in favour of a dual-role norm. This is fuelled by rising education, improved job and earnings prospects – especially so where part-time work and personal and social services grow. This trend is reinforced because male earnings are simultaneously declining. Other factors include greater support for working mothers (in some countries) and improved economic incentives (where gender wage differentials are narrowing).

When we examine public support for employed women, it is crucial that we do not forget how it interacts with labour markets. Research (Waldvogel, 1998; Todd, 2001;

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difficulties which Spanish women face: the necessity to prioritise clearly is thrust upon them by the simple absence of support for motherhood.

Davies and Joshi, 2001) has re-examined the wage and job penalties that women face by marriage and motherhood. The penalty can be examined in terms of life-long, cumulative earnings effects [69]. As a rule of thumb, a full-time working woman will forego 2 percentage points *per annum* in earnings if she interrupts her career during a 5 year interim; this loss falls sharply (to 0.5 percent) if, instead, she remains on a part-time basis. For women with a long-term career commitment, full interruption implies a dramatic cumulative penalty and, hence, if the part-time option or affordable day care is unavailable, the trade-off becomes zero-sum. This, with the postponement syndrome, explains the low Mediterranean birth rates. A simpler way to measure the penalty is to compare employment among women with and without small children. See Table 1.11

[69] See Mincer and Polachek (1974). For a recent overview, see Blau et.al. (1998: chapter 6).

TABLE 1.11. CHILD-WORK TRADEOFFS FOR WOMEN

	The child penalty: activity ratios of mother/non-mothers [1] Singles	Married	The cost of children to women: potential work-years lost [2]
EU mean	.64	.72	
Austria	.81	.76	
Belgium	.78	1.00	-10
France	.73	.76	- 7
Germany	.62	.59	- 8
Italy	.79	.78	-14
NL	.72	.70	- 9
Spain	.66	.75	-15
Denmark	n.a.	n.a.	- 4
Finland	.81	.74	- 1
Sweden	1.07	1.10	- 1
Ireland	.39	.62	-14
U.K.	.52	.75	- 5

1) employment ratio of women with no kids over women with children (less than 5 years)

2) The expected years of employment for men *minus* expected years for women. These data should be considered a proxy for the cost of children to women since the comparison assumes that all women do have children (Bernhardt, 2000: Table 3).

With very little day care coverage, the huge employment gap in Germany and the UK is hardly surprising, but why also in France (where day care coverage is quite high)? And why is the employment effect moderate in Italy, Portugal and Spain? These discrepancies point to omitted factors in the contemporary debate, namely incentives within labour markets.

The dual-role women are the crucial group, policy wise. Highly educated women probably remain employed at whatever cost, but this is not true for the less educated. Their choice is more conditional, depending on the *combined effect* of women friendly policy *and* of relative earnings prospects. But, relative to what? Scandinavia's extraordinarily high female employment levels may be due to narrow sex wage differentials, which make it more attractive for the dual-role woman to stay employed. The key, in other words, lies also in wage relativities.[70] The data support this view. For highly educated women, aged 30-44, there is very little international variance in *annual* gender earnings differentials (hovering between 60-70%), but the variation is huge (essentially bi-modal) for less educated women: In Denmark and Sweden, low educated women earn 70-75 percent of comparable men; in Germany and Spain they earn about 60 percent, and in the UK only 45 percent. The French 'puzzle' does, however, not disappear: the differential is 68 percent, i.e. not far below Nordic levels (OECD, 2000). As standard economics would argue, female labour supply is powerfully driven by (relative) wage expectations. If wages are low and childcare costs high, clearly there exists a double penalty. This is the case in Germany, Spain and the UK. At the other extreme, wages are high and the implicit tax very low in Scandinavia.

It is necessary to complicate matters even further. Besides wages, working conditions are of paramount importance for the great majority of women who desire careers *with* children. As Hoem (2000) and Bernhardt (2000) show, Swedish fertility is *curvilinear*: significantly lower among the lowest and highest educated, and highest among the typical *dual role* woman with a semi-professional education, almost invariably working in the public sector. These are the women with 3+ children in Sweden. The key here is that women selectively opt for educational trajectories that are targeted towards jobs in the 'soft' economy (such as public sector). The rising birth rates in Scandinavia since the 1970s were closely related to public sector expansion of welfare, health and education services. And the sudden drop in Swedish births (from a fertility rate of 2.0 to 1.6 in 7 years) in the 1990s is probably not so much caused by marginal declines in social benefits, as by the massive drop in public service jobs. During the first half of the

[70] It is symptomatic that U.S. female employment growth has coincided with falling earnings among less skilled males and a narrowing in relative gender wage differentials.

1990s, the Swedish government reduced health and social service jobs by 12 percent. In neighbouring Denmark, no such cuts occurred, nor do we observe any decline in births.

To generalise, the supply of 'mother-friendly' jobs varies tremendously across Europe, depending mainly on the welfare state's servicing intensity. If, as in Southern Europe, medium-to-high educated women are in the competitive labour market with, very often, a precarious contractual status, they will most probably postpone births. Hence, in most of Continental Europe, the relationship between education and fertility is *inverse* to the Nordic: higher fertility among the most educated (who can afford day care) and the least educated (who are housewives), and lower among those with middle-to-high levels of education.

The policy consequences are far-reaching. We might agree on a similar pan-European standard for 'women friendly' social support. And, yet, this may not have a similar egalitarian effect. If we do not link social policies to the nature of jobs, we will go wrong. Basically, a return to high birth rates depends not just on day care, leave schemes and family benefits, but also on the availability of 'mother-friendly' jobs. Under-developed public services and the scarcity of part-time jobs, in most EU member states, constitute a barrier to women's employment *and* to fertility.

That said, it is not difficult to see why 'women-friendly' policy may inadvertently produce heavy gender-segregation in labour markets. Public sector jobs resolve much of the incompatibility problem for Scandinavian mothers, but the secondary consequence is extremely high job-segregation. Can we conceive of a model that optimises not only women's ability to work and have children, but also one that lessens segregation? This will depend on the interaction of welfare state and employer incentives. Through 'women-friendly' programmes, the welfare state inadvertently increases employers' risk associated with hiring women. Feminists have a persuasive argument when they advocate that this risk must be equalised between men and women.

Redistributing the Domestic Burden

Neither social nor labour market policy will, alone, solve the problem. At first glance, feminists' call for a more egalitarian distribution of domestic work may appear unrealistic. Even if there is evidence that husbands' unpaid hours increase when wives' decrease, they fall far short of compensating. Granted, the data do show that male partners of employed women contribute more (especially among the more educated), and that their share is rising in just about all countries. [71] But the kind of egalitarianism that feminists call for is hard to find. Should a more equal division of domestic tasks be a matter of policy? If so, can we envisage realistic means?

If we follow standard textbook economics, the answer would be, yes, public policy may be of relevance. The key here lies in career expectations. As long as womens' expected earnings lag significantly behind their partners', households will adopt unequal specialisation strategies, i.e. women will continue to shoulder the lion's share of domestic work. It is possible to narrow the cumulative career differential, either by making women's life cycles more masculine or, vice versa, by making males' more feminine. As we know, women's employment careers have become substantially more like males', especially in North America and especially among highly educated women. But the masculinisation of women's lives reaches limits if they want children, or prefer part-time employment, regardless of how 'women friendly' is policy.

We notice, however, also a (much weaker, yet significant) feminisation of male life cycles. In part this is due to unwanted factors, such as more unemployment. But, in part, it is also due to policy. Sweden is undoubtedly a test-case for the 'specialisation thesis' because here husbands' domestic hours are far higher than anywhere else (21 hours a week) and approaching wives'. Besides the doubtful possibility that Swedish males are genetically more disposed towards solidarity, this can be attributed to internationally very narrow gender earnings differentials and to welfare state incentives: full utilisation of paid parental leave requires that fathers also take leave. Fathers' use of paid parental leave time remains substantially less than mothers', but it has grown

[71] For an overview, see Bonke (1995) and Gershuny (2000). The substantially greater contribution among educated males may be due to cultural factors, or due to the fact that they are likely to be married to highly educated, professional women.

impressively over the past ten or so years (SOU, 2000). [72] The problem is that male propensity to take leave is mainly concentrated among those married to highly educated women and those working in public sector jobs.

We can provide some rough figures on the gender distribution of unpaid, domestic work. See Table 1.12. Since we compare part-time and full-time employed women with males, cross-national differences clearly do not represent overall differences in female participation levels. The United States and Scandinavia appear most egalitarian in terms of unpaid household work while, at the other extreme, Italy and Austria (and less so the U.K.) represent the traditional division of labour. Such differences are no doubt related to parental leave incentives for fathers, but probably not much considering that the American gender-ratio is basically like the Nordic.

[72] This is equally true for Denmark. During the child's first year, fathers' leave days average 40-50, mothers' 250 (Christoffersen, 1997).

TABLE 1.12. GENDER INEQUALITIES IN TIME ALLOCATION TO DOMESTIC WORK [1]. FEMALE-MALE RATIOS

	Part-time women/men	Full-time women/men
Denmark	2.0	1.7
Finland	1.9	1.7
Sweden	1.9	1.6
Austria	3.0	2.7
Italy	n.a	3.6
Germany	2.1	1.8
U.K.	2.2	2.4
U.S.	1.8	1.7

Source: OECD (2001: table 4.5)

1) the data refer to ca. 1990. Domestic work includes cleaning, cooking etc. and also caring for children.

To overcome the limits to female 'masculinisation', it is clearly necessary to change also males' incentive structure and parental leave policies are only a small part of this. Since data (and solid research) still is scarce, we cannot arrive at any clear conclusions, let alone policy guidelines. For one, intra-household time allocation decisions will depend a lot on what type of woman is involved and on the number of children. Two, it is very difficult to disentangle the effects of expected life-time earnings from the effects of welfare state incentives. Huge paid leave incentives for fathers may have no effect whatsoever if gender earnings differentials remain significant. Three, the same time-allocation decisions will also depend on gender occupational segregation. If women are predominantly concentrated in 'soft economy' jobs, as in Scandinavia, and men in the competitive sector, males' ability to respond to welfare state incentives is probably limited due, simply, to differences in basic career requirements.

It is uncontroversial to promote better employment opportunities for women, not only because they respond to women's demands but also because their employment may yield increasing social returns. In many EU countries women constitute a massive untapped labour reserve that can help narrow future age dependency rates and reduce associated financial pressures. Moreover as, women's educational attainment exceeds men's, clearly this is a highly productive reservoir. And, as we know, female employment is one of the most effective means of combating social exclusion and poverty. All this implies that 'women friendly' social policy is, simultaneously, family and society friendly. If it yields a private return to individual women, it also yields a substantial collective return to society at large. It should, accordingly, be defined as a social investment.

There exists a broad consensus on what constitutes women friendly policy: Firstly, affordable access to day care (and we have tried to specify the level of subsidisation required). Secondly, paid maternity but, arguably much more important, also paid parental-leave. A more equal division of household tasks may occur by insisting that encouraging fathers also use parental leave entitlements. Thirdly, generous provisions for work absence when children are ill. In addition, it is well established that day care and school hours are fundamental for mothers' capacity to remain employed. [73] No one questions that such a woman friendly policy approach is a fundamental precondition for a productive post-industrial society. But it is doubtful whether it is sufficient.

The central point is that public support for mothers must be complemented by appropriately designed labour market policy and, in particular, by jobs that allow mothers to combine careers and family. This is crucial not just for gender equality but also for the well-being of children. There exists no evidence that mothers' work as such is harmful to children's development. On the contrary, the better that mothers do in the labour market, the more positive is the psychological spill-over within the family. Overworked mothers can have a negative impact on children, especially if combined with insecure or stressful jobs, but far worse is unemployment. Indeed, to conclude with a finding from Danish child research, when asked, children themselves strongly prefer that both parents work (Christoffersen, 1997).

[73] The French practice of school-free Wednesdays is arguably a major impediment for working mothers.

1.4. Conclusions

There is a fatal disease among academics to complicate matters. But as the reader was warned, that there are good policy reasons involved because current policy fashion has a tendency to embrace solutions for all ills. In addressing social exclusion, there is a tendency to rely too much on activation, make-work-pay and life long learning. Similarly, there now seems to exist a sweeping formula for gender equality, namely women friendly leave schemes and childcare.

A first conclusion that emerges is that credible solutions to the challenges we face necessitate *combined strategies*. Social exclusion is driven by multiple factors, among which labour market precariousness is one. If more than half of workless households include the chronically ill or persons who have never held a job, clearly the problem will not disappear with even the best designed activation plan. Here, a more effective response is income maintenance and, in the long-term, a far stronger accent on social prevention so that the share of 'unemployable' citizens in the future will be far smaller. Since the long-term prevention strategy will work best when children are protected from poverty, one basic conclusion emerges: adequate income maintenance is a first *precondition* for either preventive or remedial longer-term strategies.

All evidence shows that the root cause of lack of resources and sub-optimal life chances lies in childhood and this is where a social investment strategy should focus. More precisely, the first 5 years of a child's life are crucial for further cognitive development, educational attainment and, eventually, for life chances. The mechanisms at work are fairly clear but not all can be influenced by public policy. Yet, we do know that poverty in childhood is a crucial factor, as is unemployment among parents and marital break-ups. Examining the data, we arrive again at the necessity of *combined strategies*. Without doubt, adequate income guarantees for families with children are *sine qua non* and there is a very good case for promoting a broad European goal of – simply – abolishing child poverty altogether. This goal can be achieved by supporting mothers' employment, which lowers poverty risks dramatically and by an adequate family benefit package. Neither can substitute for the other and the policy approach must therefore be two-pronged. Mothers are often vulnerable in labour markets. This increases the importance of an adequate basic income guarantee for families with children.

There is also a case to be made for some creative ‘affirmative action’ policy to help children. The key to a good life in the decades to come lies in solid cognitive abilities and ‘social capital’. It is therefore paramount that we minimise school dropout rates and ensure that children continue in education for as long as possible. This is not the place to discuss education policy. However, if children receive inadequate schooling and insufficient intellectual stimulation from their parents, we urgently need to promote compensatory measures so as to weaken the impact of inherited underprivilege. A first step is to ensure that children have access to good quality pre-school and day care. This is especially important for underprivileged children. Here there is a case for affirmative action. A second step is to ensure that children complete at least secondary level education. Pre-secondary level dropout rates are hugely concentrated among poor families. One possible response could be to give‘ social benefit supplements conditional on school attendance.

Policy-wise, social exclusion, family poverty and gender equality are closely linked. The links all boil down to women’s employment. There are two major conclusions that emerge. Firstly, improving the resources of women is indispensable for improving the welfare of families and of society at large. We should therefore re-think gender equality policy as societal policy. The implications are more than rhetorical because, as we have seen, gender inequalities can probably not be effectively dealt with unless we simultaneously rethink employment policy. So far, the employment part of the issue may have seemed less urgent, at least in countries where employed women tend to be the most educated. The point is that a rise in female participation will mainly come from less educated women and these are the women for whom employment conditions can be problematic.

This brings us to the second major conclusion, once again a case for a *combined strategy*. To minimise poverty and social exclusion and maximise our productive potential, our investments in women and families are key. But not even the well designed women friendly policy will suffice. Affordable day care, generous family benefits and parental leave are a first essential step. We may also promote gender equality by giving fathers more incentives to take parental leave.

But without comprehensive working life policies, we shall probably not be able to meet objectives already agreed upon by the EU, namely to create more gender equality, achieve a 60 percent female employment rate and combat social exclusion. If we do actually pursue these objectives without improving upon women's employment conditions, we are likely to see a hardening of the low-fertility equilibrium. Even if continued low fertility is limited to some member states, its repercussions will be enormous for all of Europe. We should not, and do not need to, embrace pro-natalist objectives. An increase in births will simply correspond to citizens' welfare preferences and this is what the welfare state is all about.

To conclude, to make work and having children compatible for mothers and fathers we will have to simultaneously address the family *and* work problem. This chapter has focused on the need for a new family policy. The next chapter will consider the work side of the equation.

CHAPTER 2

WORKING LIFE, SOCIAL PARTICIPATION AND WELFARE

The central policy orientation for enhancing social inclusion is currently that of increasing the employment rate. This paper argues that this can be at best a very partial solution. First, the extent to which employment offers opportunities for social participation depends crucially on the quality of jobs. At present, a substantial sector of the job market offers only a restricted possibility of social participation. An expansion of jobs in this poor quality sector will be far from ensuring meaningful social integration. Second, some current developments in the nature of employment are accentuating risks of labour market marginalisation. A process of skill polarisation, in a context of rapid technological change, is increasing the vulnerability of the low skilled, while a marked intensification of work is heightening problems of work stress at higher occupational levels. Third, existing mechanisms of re-integration of those who have experienced unemployment are inadequate for providing sustained employability. This would require a more general improvement in the quality of lower skilled jobs, so that they provide the conditions for the long-term maintenance of learning skills.

The assumption that increasing the employment rate is the key to social inclusion is not just premised on the fact that a job provides a regular source of income, but also on the view that it provides important intrinsic benefits. Employment is seen as a source of skill development and motivation. It provides opportunities for personal self-development, through the ability to use initiative and to develop decision-making skills. But a considerable proportion of jobs in the EU do not provide the opportunities for learning and skill enhancement that are assumed by the view that employment in itself ensures social integration; indeed, a significant proportion do not provide the level, or security, of income that would support full involvement in the life of the community. The people that occupy such jobs have at best a very restricted form of social participation. The central policy objectives must be concerned, then, not just with the quantitative expansion of jobs, but with the creation of types of jobs that will provide opportunities for self-development and ensure meaningful participation both at work and in the community.

Not only do certain forms of employment provide rather limited forms of participation, but there are trends in the nature of work that accentuate risks of social exclusion. The very rapid upskilling of the workforces of most countries of the EU over the last decade has tended to leave aside those in low-skilled jobs. The majority of people in such jobs have not experienced an ongoing process of skill development as part of their everyday work and they have been largely excluded from training programmes. This has made them highly vulnerable to unemployment in times of economic restructuring and has increased the difficulty of finding new work opportunities. At the same time, those in higher and intermediary occupational classes have experienced a major intensification of work effort that has severe consequences in terms both of work-related stress and the tensions between work and family life. With economic modernisation the health risks of work shift from those of physical injury to those of psychological strain. This threatens to lead to increasing numbers withdrawing from the workforce as disabled or retiring early as a result of their inability to cope with the rising pressures of work life. Again this poses major policy challenges of how to provide work environments that contain safeguards to minimise such exclusionary processes.

In the great majority of the EU countries, the emphasis in social policies has been on tackling the problem of social exclusion once people have entered unemployment. Most typically there has been a mixture of short-term activation policies for various categories of the unemployed, together with a concern to ensure that there are clear financial work incentives. Neither of these policies has proved adequate for ensuring longer-term employability. The attempt to re-skill the unemployed in a relatively short period of time can only have limited results in a context in which people have spent long periods of their working lives without learning new skills or maintaining their basic learning capacities. The emphasis on maintaining financial incentives, sometimes at the cost of severe financial deprivation for the unemployed, ignores the consistent evidence that the majority of the unemployed would wish to work on non-financial grounds. The orientation of European social policy needs to shift away from a primary reliance on short-term curative measures towards the development of a long-term preventative programme that will protect people from the risk of labour market marginalisation by ensuring continuous skill enhancement over their working lives.

Overall, to further the social integration of those in low-skilled employment, to minimise the processes within work that increase risks of social exclusion and to ensure that the unemployed are more rapidly re-integrated into work, new policies are needed to enhance the quality of jobs. In combating social exclusion, a policy of employment expansion needs to be accompanied by a major programme of improvement in the quality of working life.

Employment and Restricted Social Participation

a) Work and Personal Development

There can be little doubt that in general employment, particularly where it provides scope for individual initiative, is a source of personal stability and development. This is well supported by the research of social psychologists. Marie Jahoda (Jahoda 1982) argued that, quite apart from its importance in providing a source of income, employment provides an important source of psychological stability through providing a clear time structure to the day, a sense of participation in a collective purpose, a stronger sense of identity and a stable pattern of required regular activity. Research consistently shows that where people exercise initiative in their jobs, they have particularly high levels of job satisfaction (Gallie et al. 1998) and, indeed, there is some evidence that they develop their competencies in dealing with situations out of work (Kohn and Schooler 1983). Certainly, in all the EU countries for which there is adequate evidence, people in employment have significantly higher levels of life satisfaction than those who are jobless (Gallie and Russell 1998).

Yet, at the same time, it is important to remember that the quality of employment is highly stratified. There are sectors of employment, in which many of the assumed benefits for personal development are difficult to discern. Table 1 provides a picture for all employees in the EU of the extent to which their jobs provide opportunities for learning new things on the job, give people a say over what happens in the job and allows them to take part in decisions that affect the job. It can be seen that a considerable proportion of jobs do not have the characteristics that are usually described by those who emphasise the integrative effects of employment. On the individual measures only about a third of the workforce are in jobs offering good opportunities for learning, while only a quarter have significant initiative in decision-making on the job. Even taking those who thought such characteristics were either ‘very’ or ‘quite’ true of their jobs, only 60% thought that they could learn new things through the job, while just over half thought they could influence what happened on the job. At least four out of ten jobs, then, would have to be regarded as of rather poor quality on these criteria[74].

Table 1 Work Tasks Characteristics : Percentage saying characteristic is ‘very true’ of their jobs. (EU Employees)

	Job requires that keep learning new things	A lot of say over what happens in the job	Takes part in decisions that affect the work
All employees	31.2	23.4	26.0
Semi & non-skilled	18.5	17.7	18.7
Full-time employees	32.3	24.1	26.5
Part-time employees	22.7	15.6	20.8
Full-time semi & non-skilled	19.6	18.6	18.4
Part-time semi & non-skilled	12.2	10.7	15.9
Semi & non-skilled <45 yrs	20.8	18.1	18.5
Semi & non-skilled 45 + yrs	13.4	16.6	19.1
Ns (All Employees)	6609	6613	6613

Source: Employment in Europe Survey, 1996[75]

[74] There were significant proportions taking the extreme negative view of their jobs, saying that these features were ‘not at all true’ of their jobs. This was the case for 15% for learning opportunities, 19% for say over their job and 20% for taking part in decisions. The Third European Survey on Working Conditions also found that, although job control had slightly increased over recent years, still one-third of all employees reported having no control on either work methods, speed or the order of tasks (European Commission, 2001:73).
[75] The survey (special Eurobarometer, 44.3) was commissioned by DG V and involved national representative samples in all of the EU member states.

There are several groups in the workforce that are particularly deprived in terms of the job characteristics associated with personal development. The first is that of semi and non-skilled workers, who represent approximately a third of all employees. These are in jobs of relatively low task complexity, where little is required in the way of qualifications or training[76]. Less than one in five of these employees are in jobs where they can definitely learn new things or exercise significant influence over the way the jobs are done. Even if one takes the broader group of those who consider it is either very or quite true of their jobs, only two out of five employees consider their jobs offer such opportunities. The difference compared to other employees is particularly striking with respect to the learning opportunities provided by jobs.

Another sector of the workforce that is clearly heavily disadvantaged in terms of both regular opportunities to learn new things and the ability to exercise discretion over the job is that of part-time employees. This is not just a reflection of general occupational level. Part-time workers have less chance for self-development and control in the job than full-time employees within each occupational class. Part-timers in non-skilled work suffered from cumulative disadvantage with respect to job quality. For instance, only 12% of semi and non-skilled part-timers were in jobs that gave significant chances to learn through the work and only 11% felt they had much say over what happened in the job[77]. The proportions giving the extreme negative account of their job were notably higher: 37% reported that it was ‘not at all true’ that they had learning opportunities in their jobs and 34% with respect to the say in the job.

Finally a particularly sharply deprived group with respect to jobs that provide ongoing learning opportunities are older semi and non-skilled employees. Whereas such possibilities for self-development increased with age for professional/managerial employees and technicians and supervisors, they decreased for both skilled manual and non-skilled workers. Only 13% of non-skilled workers over the age of 45 were in jobs where they regularly had to learn new things (and among those aged 55 and over the proportion was as low as 7.5%), while 37% thought that this was ‘not at all true’ of their jobs.

[76] For details, see Gallie et al. 1998, chapter 2. These categories are operationalised in terms of the Goldthorpe-Erikson class scheme (for details, see Erikson and Goldthorpe 1992: 35-47).

The evidence also confirms that those in jobs with poor development opportunities were likely to experience a more restricted form of social participation. There is a clear association between the extent to which jobs required regular new learning and people's satisfaction both with their work and non-work lives. Those who were in jobs that did not maintain learning skills not only enjoyed their work less, but they also had less satisfactory experience of their out-of-work lives (Table 2). They were less satisfied with their family lives, their leisure activities at home and their social lives. Taking general satisfaction with their lives, whereas 42% of those who were in jobs that were strongly characterised by new learning opportunities were very satisfied with the type of life they were leading, this was true for only 25% of those in jobs that offered little or no such opportunities.

Table 2 Opportunities for Learning on the Job and Satisfaction with Life Domains (% Very satisfied)

Job requires regularly learning new things	**Work**	**Family**	**Home Leisure**	**Social Life**	**Life in General**
Not at all true	30.1	40.9	23.8	24.5	25.3
A little true	33.5	41.0	27.3	28.0	24.8
Quite true	38.8	48.0	31.1	32.7	34.9
Very true	54.2	55.9	36.7	38.0	41.7
N	6588	6593	6599	6598	6598

Source: Employment in Europe Survey, 1996

b) Work and Poverty

A central way in which employment reduces the risk of social exclusion is by protecting people against poverty. Certainly in comparison with the US, the EU has been very successful in limiting the prevalence of poverty among people in work. Nonetheless in several EU countries a significant proportion of those in work are in poverty, with less than half average household income (Marx and Verbist 1998). For instance, taking

[77] Again taking the broader category of those who said it was very true or quite true of their jobs, only

those with some work attachment, the proportions among male workers in Italy and Spain are 8.7% and 7.4% respectively (Table 3). In Germany, the Netherlands, Spain, Sweden and the UK around 5% of all female workers are in poverty. The risk of poverty while in work is particularly high in certain household situations – for instance, where people are in single adult households or in two adult households where there is only a single earner. Among those in single adult households more than 10% of workers are in poverty in Finland, Germany, the Netherlands, Norway and Sweden.

Table 3 Poverty Rates among People in Work

	Men	Women	Single Adults in Work
Belgium	0.9	0.5	1.3
Denmark	2.5	3.1	8.6
Finland	3.4	4.3	12.1
France	3.1	3.0	3.8
Germany	4.1	4.9	10.5
Italy	8.7	2.1	3.2
Netherlands	3.1	5.0	12.1
Norway	2.7	3.6	10.0
Spain	7.4	6.5	8.8
Sweden	4.8	5.6	13.5
UK	3.2	5.1	7.0
US	13.3	14.4	19.3

Source: Marx and Verbist 1998. Poverty is defined as having equivalised household income less than 50% of the mean.

The view that a significant proportion of those in work are still substantially constrained in their lives by relatively severe financial difficulties is confirmed by people's own assessments of the difficulties they face in making ends meet (Table 4). Taking the EU average approximately 15% of employees report that they have difficulty or great difficulty making ends meet. There is a very strong contrast between Northern and Southern Europe. In the Northern countries, with the exception of Ireland, less than one in ten of employees are under severe financial constraint - the proportions ranging from 7.3% in the Netherlands to 8.7% in Belgium. However, in the Southern European countries, with the exception of Italy, financial difficulty is very extensive, affecting 31% of Spanish, 35% of Portuguese and 49% of Greek employees. The pattern is very consistent across the different years.

38% thought they had opportunities to learn new things or that they had say in the job.

Table 4 Financial Difficulty among Employees (% finding it difficult to make ends meet).

	1994	1995	1996	Average
Austria		16.1	12.8	14.5
Belgium	8.3	9.0	8.7	8.7
Denmark	10.7	6.8	7.7	8.4
Finland			15.6	15.6
France	16.3	15.7	15.4	15.8
Germany	6.5	5.3	5.7	5.8
Greece	51.1	47.6	47.3	48.7
Ireland	19.8	15.4	16.9	17.4
Italy	16.8	16.3	12.6	15.2
Netherlands	7.7	6.5	7.8	7.3
Portugal	34.6	35.7	33.7	34.7
Spain	33.5	30.9	29.7	31.4
UK	11.9	13.6	12.1	12.5
EU	15.4	14.9	14.2	

Source: European Community Household Panel.
Note:The figures are taken from the 1994, 1995 and 1996 waves. The two most extreme difficulty categories are taken from the six point response set i.e. 'great difficulty' and 'difficulty'. The country sample numbers (in 1994) ranged from 2715 in Belgium to 5618 in France. Sweden did not participate in the study and Austria did not participate in the first wave and Finland in the first two waves. Luxembourg data are excluded from the separate country results on the grounds of relatively small sample numbers, but are included in the overall EU figures. The overall EU figures (based on the countries for which data was available in the particular year) are weighted to reflect country shares to overall employment.

Such financial constraints have substantial implications for the quality of people's lives. They are not only associated with lower satisfaction with work life, but also with life outside work (Table 5). Those who had difficulty making ends meet had lower levels of satisfaction with their family lives, with their home leisure and social lives. Taking an overall measure of life satisfaction, only 18% of those under severe financial constraints were 'very satisfied' compared to 39% of those who were not in financial difficulty.

Table 5 Financial Deprivation and Satisfaction with Life Domains among EU Employees (% Very satisfied)

Financial Difficulty	**Work**	**Family**	**Social Life**	**Leisure**	**Life**
Not difficult	45.9	52.2	36.2	35.5	39.1
Quite difficult	31.0	38.4	21.9	20.7	20.2
Very difficult	29.7	36.8	23.8	18.9	17.7
	6586	6597	6602	6603	6602

Source: Employment in Europe Survey, 1996

One factor that contributes to the persistence of poverty among people in work is the existence of an important sector of low paid employment. The extent and evolution of this sector clearly vary a great deal between European countries, reflecting institutional and policy differences. Taking as low-paid those who were working full-time (and full-year), but with gross earnings less than two-thirds of the median, the proportion of employees varies for instance from 6.7% in a country such as Finland to 19.9% in a country such as the UK (Nolan and Marx, 2000). Given that relatively high proportions of part-time and temporary workers are likely to be low-paid but are excluded from these figures, the prevalence of low paid work is probably rather greater than is suggested by these estimates. There are wide variations in trends over time. Between 1976 and the early 1990s, the proportion of low-paid workers in France fell from 17% to 14% of full-time adult workers, while in the UK it rose from 14% in 1977 to 20% in the mid 1990s (Bazen et al. 1998). Moreover the relative position of the low paid (comparing lowest decile to median earnings) remained stable and possibly improved over this period in France and the Netherlands, while it deteriorated in the UK. The existence of a minimum wage system is clearly an important factor in the protection of the low paid, although there can be significant differences between countries in the efficacy of procedures for updating the minimum wage.

As will be seen in the next chapter, the implications for deprivation of sustained low pay may not only be for current income. It may have major consequences for people's lives long after they have left employment. In part, this will reflect differential ability to build up savings that can be drawn upon when there is no longer income from employment. But it is also due to the fact that disadvantage may roll on in the form of lower pension entitlements. This will depend upon the characteristics of the particular pension system in a country. It will be particularly serious where systems are predominantly earnings related, and less in those based on a flat-rate pension.

A solution to the problem of the 'working poor' will clearly require much broader measures than those relating specifically to low pay. Low pay does not necessarily imply that a person is in poverty (as measured say by equivalised household income below 50% of the mean). Poverty rates are defined in terms of household income, and the low pay of one household member can be offset in multi-person households by the income of others. Although a majority of employees who live in 'poor' households are low-paid, the majority of the low paid are not 'poor'. Low pay is only one component of the broader problem of low household incomes among those in work. The relationship between low pay and poverty varies between groups: poverty rates are much higher for low-paid men than for low-paid women, for single earner than for multiple earner households, and for the prime-aged than for younger low-paid workers (Marx and Verbist 1998; Nolan and Marx, 2000). The risk of poverty is particularly high for low-paid workers who live on their own. But it must be remembered that poverty estimates assume that resources are shared in the household. It is clear that particularly for women, low pay does not translate into poverty in good part because of the importance of their partner's income for the household's living standards. However, those low-paid who are currently protected by the income of a partner may experience heavy financial dependence as a result of their lack of independent resources, they may experience real financial deprivation if resources are not shared and they are at a much higher risk of poverty in the event of a breakdown in the relationship.

c) Insecure Work

A third factor that is likely to restrict opportunities for social participation is job insecurity. Many analysts have suggested that there is a long-term trend towards the growth of a larger permanently insecure sector of the workforce, reflecting the need for greater labour market flexibility in an era of intensified economic internationalisation.

Employment it is suggested is becoming polarised between a core of relatively high skilled, well-paid and secure jobs and a periphery of low-skilled, poorly paid and insecure jobs. This divide is often seen as reflected in the distinction between regular full-time contracts and diverse types of non-standard contract temporary work, part-time work and self-employment (Berger and Piore 1980) (Hakim 1987)

A serious assessment of trends in the labour market would have to conclude that such a dualistic image of the development of the employment structure is of doubtful validity, with the exception possibly of the case of Spain which has seen a unique experiment in the widespread extension of short-term contracts in the context of a very high level of protection for 'insiders'. The assumption that different types of labour market advantage and disadvantage cluster cumulatively on groups of the same contractual status is not empirically supported and indeed similar contractual statuses can conceal very diverse employment conditions (Gallie et al. 1998).

But there does appear to be a slow trend of growth of temporary jobs. By 1997 11% of male and 13% of female employees were in such jobs in the EU as a whole (European Commission 1999). In several EU countries there was a marked rise between the 1980s and 1990s in the proportion of employees who were in temporary jobs. While this growth was particularly spectacular in Spain, it was also evident in France, Ireland, Italy, and the Netherlands (as well as among men in Denmark, Germany and the UK). Temporary work and unemployment were closely interlinked. In 1994 50% of people in work who had been unemployed a year earlier were in temporary jobs, and this had risen to 56% in 1997.

Those sceptical of the view that there has been an increase in insecurity may point to the fact that these contractual changes have not led to any overall change in the stability of jobs, as indicated by job tenure. Job tenure varies considerably between the EU countries (it is shortest in the UK and Denmark and longest in Italy, followed by Belgium, Portugal and France). But an analysis by the OECD (OECD, 1997:140) of *changes* in job tenure between the mid 1980s and the mid 1990s found that there was little change in nine out of ten countries (the exception being Spain). Broadly similar findings were found for the EU countries between 1995 and 2000 (European Commission, 2001). It must be borne in mind, however, that while often taken as a proxy of security, job tenure is a questionable indicator in this respect. It reflects employee choice in the form of voluntary departures as well as factors such as contract termination and redundancy. Similar patterns of job tenure may reflect very different degrees of experienced labour market insecurity depending on how easy or difficult people find the transitions between jobs.

It is likely that the last two decades of the 20th Century saw a marked rise in the experience of labour market insecurity, as a result of the return of levels of unemployment unprecedented since the interwar period. An EU wide survey in 1996 showed that, among those who were currently employees, one in five had experienced a spell of unemployment in the previous five years (Employment in Europe Survey), and of these 56% had had a spell of unemployment that lasted six months or more. This helps account for the considerable rise in *perceived* job insecurity. While job tenures may have changed little, the transition between jobs was more likely to be associated with a spell of unemployment, leaving a lasting sense of anxiety about job stability. Satisfaction with job security fell in almost all countries in the first half of the 1990s (Table 6). Security only rose in two countries – Finland (which had exceptionally low levels in the early 90s) and Ireland (which had entered a phase of rapid improvement in its unemployment rate). Job security levels remained in general higher than in the US, although they were similar to the US in Germany and lower in both the UK and France.

Table 6 Percentage of Employees Satisfied with their Job Security

	1992	1996
Austria	66	60
Belgium	66	60
Denmark	62	58
Finland	45	57
France	56	41
Germany	62	48
Greece	59	61
Ireland	54	57
Italy	64	55
Netherlands	74	61
Portugal	59	59
Spain	64	60
Sweden	49	49
UK	52	43
US	57	47

Source: (OECD 1997)

The risk of insecurity fell particularly sharply on those in less skilled occupational positions (Table 7). This is the case whether one takes perceptions of insecurity or the (less satisfactory) indicator of tenure. The occupational classifications for average tenure and job security are differently constructed and direct comparisons should be treated with some caution. But it is clear that the broad picture is very similar. Average tenure is considerably lower among those in 'Elementary' occupations. Similarly, those in semi and non-skilled occupations are the least satisfied with their job security. Objective and subjective measures then reinforce the conclusion that those in less skilled occupations are at particularly high risk of job loss. Moreover, this is confirmed by analyses that show that in most countries the low-skilled represent a disproportionately large share of the unemployed (McIntosh, 2000).

Table 7 Occupational Class, Average Job Tenure and Satisfaction with Job Security

Occupational Class	*Average job tenure (years)*
Professional	10.6
Clerks	9.5
Technicians and associates	9.8
Craft and related trades	8.9
Plant and Machine Operators	9.8
Elementary Occupations	7.4

Occupational Class	*% ' highly satisfied' with job security*
Professional/Managerial	48.0
Lower Non-Manual	45.8
Tech/Supervisory	44.9
Skilled Manual	38.7
Non-Skilled	34.9

Source: Average Job tenure (OECD, 1997:139); Satisfaction with job security (Employment in Europe Survey).
Note : high satisfaction with job security is defined as points 6 and 7 on a 7-point scale in which point 7 is defined as 'completely satisfied'.

Finally, it is clear that job insecurity is closely related to people's broader satisfaction with different life domains. Whether one takes a fairly specific indicator of people's beliefs about the likelihood that they will lose their job involuntarily over the next twelve months or the broader measure of dissatisfaction with job security, the picture is very much the same. Lack of security is associated with lower satisfaction both with the work situation and with life out of work (Table 8).

Those in temporary jobs were less satisfied with their job[78], with their family life, with their leisure life and with life as a whole. Moreover, the shorter the term of the contract, the lower their satisfaction. The causal impact of temporary work is confirmed by longitudinal research. European panel data has shown that changes from temporary to permanent status affect job satisfaction (European Commission, 2001), while British

[78] See also the evidence from the European Community Household Survey, reported in European Commission (2001:68).

longitudinal research has shown that non-standard contracts reduce men's (although not women's) psychological well-being (Bardasi and Francesconi 2000). A very similar pattern emerges for those who were dissatisfied with their job security (although the negative effects in this case also extended to people's social lives). The worry of unemployment appears to be particularly strongly linked to people's satisfaction with their family life. These patterns of association cannot in themselves establish the direction of causality. But the general negative effect of insecurity on psychological well-being is supported by longitudinal research. Analysis of the European Community Household Panel shows that people's level of satisfaction with their activity status is driven predominantly by labour market transitions into or out of unemployment (European Commission, 2001). Indeed, the psychological pressures associated with unemployment set in from the time that people know that their jobs are at risk (Warr, 1987: 149-151).

Table 8 Unemployment Risk and Satisfaction with Life Domains among EU Employees (% Very satisfied)

	Work	**Family**	**Leisure**	**Social Life**	**Life**
Job Contract					
3 years +	40.3	46.7	26.4	28.6	28.9
1-3 years	32.8	36.9	24.5	26.7	26.6
< 1 year	22.2	29.1	21.1	30.1	19.0
Likelihood of losing job involuntarily in next 12 months					
Not likely	42.7	44.6	26.2	28.5	28.2
Quite/very likely	20.6	28.3	19.9	22.3	13.8
Satisfaction with Job Security					
Satisfied	50.8	49.6	30.0	33.6	33.5
Dissatisfied	15.9	31.0	19.4	19.0	15.5

Source: Employment in Europe Survey, 1996
Note : Satisfaction with job security is defined as points 6 and 7 on a 7-point scale in which point 7 is defined as 'completely satisfied'.

Taking an overview of the evidence that has been considered, it is clear that a substantial proportion of jobs in the EU do not offer the types of opportunities for personal development, intrinsic job interest, adequate income or reasonable stability that tend to be assumed in arguments that employment *per se* is an effective source of social integration. Rather they must be seen as providing at best a form of restricted social participation, in which the satisfaction that people obtain from their jobs is relatively low and the nature of the work imposes severe constraints on their family and social lives. The importance of such negative job characteristics for life chances clearly depends on their persistence over time. If there is a great deal of mobility, they will amount principally to short-term inconvenience. But if people remain in such jobs for any length of time, they are likely to become sources of entrapment that will curtail people's capacity for self-development and social participation.

The view that there is considerable job mobility tends to be argued in terms of people's experience of low pay. Although there is a great deal of variation between countries, in most countries studied a considerable majority of the low paid would appear to move out of this situation in a period of five years (Sloane and Theodossiou, 2000). But there are three important reservations about such evidence. First, British data suggest that the low paid consist of rather different groups. Much of the mobility can be accounted for by people who move out after only a very short period indeed. However, longitudinal analysis shows that the chances of moving out of low-paid employment fall very rapidly with increased duration of time in low-paid jobs (Stewart, 1999). Second, the extent of income mobility is very limited: those who move out of 'low-paid' work while remaining in employment tend to receive only minor increases in earnings. Finally, a considerable proportion of those who move out do not enter higher paid jobs but move into unemployment or economic inactivity. Nearly half of the low paid (45%) were 'permanent low-paid' over a four-year period if spells out of work were included (Stewart, 1999 :240). Those who leave employment fall into a 'low pay- no pay' cycle, since they have particularly high probabilities of moving back again into low paid work when they re-find a job.

It has been seen that many of the most negative aspects of jobs are associated with broad occupational class position, in particular semi and non-skilled occupations, and with temporary contracts. Whatever the mobility with respect to low pay, the evidence certainly suggests that people tend to be trapped over time in such broad sectors of the labour market. The data from the European Community Household Panel show that the great majority (85%) of those in non-skilled occupations in 1994 were in the same type of occupation in 1996. Although there was a greater mobility out of temporary work, it is notable that only a third of those in temporary work were in permanent jobs after a year, while 20% had become unemployed or economically inactive (European Commission, 2001)[79]. This suggests very limited mobility out of the poor quality job sector. An effective set of policies for social integration needs then to take into account not simply the quantity of jobs, but also how to improve the quality of low-skilled work. In particular this points to the need for policies to improve the intrinsic interest and opportunities for initiative available in such work, as well as policies to provide stronger safeguards against in-work poverty.

Employment Change and Processes of Labour Market Marginalisation

The view that policies designed to expand the employment rate will lead to higher levels of social integration assumes that people will have the capacity and motivation to stay in jobs. However, this too is likely to be crucially dependent on the quality of the jobs provided. There are aspects of the developing nature of work that appear to be increasing the labour market vulnerability of particular categories of the work force. The first of these operates primarily through an effect on skills and the second through an effect on health. Where insufficient provision is made to update skills, the lower skilled sectors of the workforce are likely to find it increasingly difficult to remain in employment. Where the demands of work lead either to physical disability or to sustained psychological stress, then people may be forced to leave employment before the formal retirement age. In systems where pensions vary with time spent in employment, this in turn may lead to inadequate pension provision and the risk of poverty in retirement.

a) Upskilling and Skill Polarisation

There is substantial evidence of a long-term process of skill upgrading in the EU countries. At one level this is evident in changes in the composition of the occupational

[79] Rather similar results were found for mobility out of 'dead-end' jobs more broadly defined in terms of low security and lack of training, with only 24% moving into jobs of 'good' or 'reasonable' quality in the following year, while 26% became either unemployed or economically inactive (European Commission, 2001:77). However, transitions into better work varied substantially by country (as was the case for transitions from temporary to permanent work).

structure, with the expansion of professional/ managerial occupations and the decline of manual work. In the UK for instance, where there is broadly comparable data over a century, manual workers declined from 75% of the workforce in 1911 to 38% in 1991, while professionals rose from 4% to 19% (Gallie 2000). It is also clear that at least in recent decades there has been a substantial process of upskilling *within* occupations that has affected a wide sector of the workforce.

Taking the EU as a whole, half of all employees have experienced a significant increase in the level of skill used in the job the last 5 years (Table 9). Indeed, in all countries other than Portugal and Belgium, more than 40% of employees had experienced an increase in skills. The proportion was particularly high in Finland (69%), the Netherlands (65%) and Ireland (60%). In contrast, only a very small proportion (6.8%) of European employees had experienced deskilling.

Table 9 Experience of Skill Change in Previous 5 Years (EU Employees)

	Significant Increase	**Little or No Change**	**Significant Decrease**
Austria	55.2	39.3	5.5
Belgium	34.7	58.5	6.8
Denmark	52.7	42.0	5.3
Finland	68.8	23.7	7.5
France	43.8	47.7	8.6
Germany	46.6	47.0	6.5
Great Britain	56.8	34.7	8.5
Greece	46.1	51.1	2.8
Ireland	60.1	36.4	3.6
Italy	54.0	39.7	6.3
Netherlands	65.1	28.5	6.5
Portugal	34.0	58.9	7.1
Spain	50.4	46.1	3.4
Sweden	53.1	39.9	7.0
All	50.3	42.9	6.8

Source: Employment in Europe Survey, 1996.
Note:N= 6384. Separate figures are not given for Northern Ireland and Luxembourg, given the small size of the samples, but the countries are included for the overall EU estimate.

This sharp rise in skill demands is likely to have reflected a number of factors. It was a period in which heightened competitiveness led to a stronger emphasis on product quality. Employers were seeking to reduce numbers and increase flexibility, which required an extension of multi-skilling. But perhaps most crucially, this was a decade that saw the rapid spread of information and computer technologies By the mid – 1990s, nearly half (46.8%) of the EU workforce were in jobs that involved some use of computerised or automated equipment and a quarter (24.7%) spent more than half their time at work using such equipment. Among those who did use computerised equipment, 59% had seen an increase in the skills used in their jobs, whereas this was the case for only 42% of other employees. Technological factors would appear to be even more important than industry exposure to international trade in driving up skill levels (Green et al. 1999).

But, with respect to the risk of social exclusion, the crucial point to note is that one occupational class fared much less well in this general context of rapidly rising skills, namely that of semi and non-skilled workers (Table 10). A majority of professional/ managerial workers (58%), lower non-manual employees (55%), technicians and associates (54%) and even skilled manual workers (52%) experienced upskilling. But, this was the case for only a minority (41%) of the semi and non-skilled workforce. It was not that there was widespread deskilling in these categories but rather that there had been little or no change in skills. This points to a polarising occupational structure in which the great majority of the workforce was experiencing skill upgrading, while the low skilled were left progressively behind.

The lack of opportunities for skill development for those in low-skilled work were reinforced by the pattern of in-career training provided by employers. Taking those who had experienced one week or more training in the previous five years, it is notable that only a small proportion of the European workforce (26%) had received any significant formal training over this period[80]. But equally striking is the extent to which this is stratified by skill level (Table 10). Nearly half (42%) of those in professional and managerial occupations had received a week or more training, compared to only 16% of skilled manual workers and 14% of semi and non-skilled workers.

[80] The data from the European Community Household Panel show that, even taking both employer-provided training and private training measures, only 28% of the employed had participated in training measures in the previous year. There was a sharp contrast by skill, with 40% of the high skilled, compared with 17% of the low-skilled participating in training (European Commission, 2001:73).

Table 10 Occupational Class and Experiences of Skill Change and Employer Training in the Last 5 Years (EU Employees)

	Significant Increase in skill requirements	**1 week + training from employer**
Class		
Professional/Managerial	57.6	42.0
Lower Non-Manual	55.2	21.8
Tech/Supervisory	53.7	32.6
Skilled Manual	51.6	16.1
Non-Skilled	40.5	14.3
Age		
<25	59.8	23.5
25-34	54.8	25.8
35-44	48.4	28.1
45-54	44.5	18.3
55+	42.2	17.8
Hours Status		
Full-Time	51.8	28.0
Part-time	43.7	15.5
Contract Length		
< 12 months	52.2	16.6
12 months – 3 years	45.2	24.0
3 Years +	51.3	28.1
Size of Workplace		
Works alone	44.2	16.9
< 10 people	48.5	19.0
10-99 people	49.1	25.8
100-499 people	48.4	35.7
500 + people	52.1	39.8

Source: Employment in Europe Survey, 1996

A number of other factors affected people’s chances of skill development. There is a marked gradient by age. Whereas a substantial majority of younger workers (20-34) had seen an increase in the skill requirements of their job, this was the case for only a minority of those over the age of 45. The pattern of employer training would again appear to be an important contributing factor. It is notable that exactly the same age gradient emerges for employer training, with older workers less likely than younger to receive significant periods of training. This may reflect a reluctance by employers to invest in the skill development of employees with relatively few years left in the organisation before retirement. Alternatively, older workers may lack the self-confidence or motivation to learn new skills. Whatever the case, the pattern implies a growing risk for older workers of falling behind in an economy of rapidly changing skills. While they may be protected temporarily by employment in specific organisational niches, they are likely to be highly vulnerable to major restructurations, where their skills may no longer be sufficiently up-to-date to switch to jobs in other organisations.

There is also a strong association between contract type and skill development. Part-time employees were much less likely to have seen their skills increase (44% compared to 52% of full-timers). Since part-timers are overwhelming female, this implies a significant gender disadvantage. The poor skill development opportunities in part-time work are partly a result of the fact that a considerable proportion of part-time jobs are low skilled. But at each skill level part-timers have less chances of skill development and their disadvantage is particularly marked in intermediate occupations levels. For instance, among lower non-manual employees, 61% of full-time employees had seen their skills increase over the previous five years compared to only 44% of part-timers. Again differences in skill development experiences are closely related to differences in training opportunities. Whereas 28% of full-time employees had received at least a week's training, this was the case for only 16% of part-timers.

Temporary work is often depicted as providing a low-skill trap. But there is no evidence overall that temporary work contracts involve significant disadvantages in skill development opportunities. Those on contracts of less than twelve months are just as likely as those on long-term contracts to have experienced upskilling. It is important to take account of the very heterogeneous nature of temporary work. Many short-term contracts are effectively entry posts to organisations with internal labour markets and provide employers with the chance to monitor the competences of new recruits (possibly particularly with respect to job characteristics that are difficult to measure at the point of hiring such as social skills and motivation). In these circumstances, the occupancy of such posts is also likely to be the phase of initial training into organisation specific skills. It is notable that for training the major divide is between those on very short term contracts (less than a year) on the one hand and those with temporary contracts of one to three years or on long-term contracts on the other. Employees on one to three years contracts are likely to be in the type of ‘entry’ jobs discussed above and in terms of training are treated in a very similar way to long-term employees.

Finally opportunities for employer training are heavily affected by the size of the workplace in which people are employed. In large workplaces, employers are more likely to have the infrastructural resources (such as personnel departments) to lay on training programmes and where there are larger numbers it is also likely to be easier to provide cover arrangements while people are absent on training. Employees in the largest organisations have roughly twice the chances of training of those in the smallest. In workplaces with less than 10 employees, only 19% of employees have received training, while in those with 500 or more employees, the figure rises to 40%.

b) The Intensification of Work and Work Stress

A second feature of the developing nature of work that is likely to generate increasing problems of labour market marginalisation is the intensification of work, with its potential implications for problems of work-related stress. Faced by increased economic internationalisation, employers have emphasised higher standards of product quality, downsized their organisations, sought higher degrees of flexibility of working practices and devolved increased responsibilities on work teams. At the same time, organisations have been undergoing rapid technological change, with the problems it poses in terms of the disruption of established working practices and heightened insecurity. The growing centrality of this issue has been recognised in diverse national studies (Gallie et al. 1998; Dejours 1998; Green 1999), although good comparative data are still rare.

The increased work effort these changes involved can be judged from employees’ reports of changes in their jobs over the previous five years. Taking the EU as a whole, 48% of employees (47% of men, 48% of women) reported a significant increase in the effort they had to put into their job. Less than 10% reported a significant decline in work effort. The proportion experiencing increased effort was highest among those aged between 20 and 54, peaking at 52% among employees aged 35 to 44. But it is notable that even among older workers, aged 55 or more, 40% reported an increase in work effort. The increase was evident in all occupational classes, but was sharpest among professional/ managerial occupations (56%) and technical/ supervisory (59%).

It seems probable that work intensification took a sharp toll in terms of work stress. Certainly employees’ own accounts suggest that there is a high prevalence of work-related stress. Nearly half of all European employees (43 %) say they work under a great deal of pressure, 36% say that they always or often find their work stressful, and 35% that they always or often come back from work exhausted. There is no evidence of systematic differences between men and women. If men are more likely to report pressure in work, women are just as likely to find the job stressful and are somewhat more likely to report that they are exhausted when they return home (Table 11). Finally, nearly half of all employees (46%) report that the stress involved in their job had increased over the previous five years and again this appears to be a very similar experience for both men and women.

Overall, the age pattern is curvilinear. Stress is relatively low among those aged 25 or less, it then rises to a peak among those aged 35 to 44 and subsequently declines again amongst older workers. But there are interesting differences in the pattern for men and women. Men’s stress levels rise sharply in the 34 to 44 age group. They then decline again among the 45 to 54 year olds, only to rise again amongst the oldest group of employees (55+). Women’s stress levels already rise markedly in the 25-34 age groups and remain relatively high right through up to the oldest age group (55+), when they decline very sharply.

Table 11 Work-Related Stress among EU Employees (%)

	Men	**Women**	**All**
Works under a great deal of pressure	46.0	39.5	43.1
Always or often finds work stressful	36.0	35.6	35.8
Always or often returns home from work exhausted	32.9	37.9	35.1
The stress involved in the job has increased in the last 5 years	45.4	46.4	45.8

Source: Employment in Europe Survey, 1996

It appears that a substantial sector of the workforce has been affected by an intensification of work and by increased levels of stress. A continuation of such trends is likely both to pose major problems for workforce stability and to increase the demands on welfare provision for those unable to cope. What factors help to account for these high and rising levels of work-related stress? A great deal more research is required to address these issues, but there are at least four aspects of current work life that are likely to be important. The first is the general increase in work effort that has accompanied the restructuring of work processes in recent years. The second is the length and unpredictability of work hours and the way these interact with people's aspirations in their family and leisure lives. The third is the sharp rise in the skill requirements of jobs and the marked increase in work effort that has accompanied new work practices. And fourth is the decline in people's sense of job security.

The intensification of work effort that has resulted from reductions in staffing levels and changes in work organisation is clearly strongly associated with high levels of work stress. An overall measure of work stress was constructed from the four indicators in Table 11. This has a mean of zero, with positive scores indicating above average levels stress and negative scores below average[81]. Those who had experienced an increase in the effort involved in their jobs in the previous five years were likely to experience much higher levels of stress than those who had had either no change or a decrease in work effort (Table 12). This raises the issue of whether the concern by employers to increase competitiveness by reducing staffing costs may not secure short-term gains at high long-term costs in terms of employee welfare.

It is also clear that the sheer length of working hours is strongly associated with higher levels of work stress (Table 12). Taking the summary work stress measure, it is notable that there is a linear relationship, in which the level of stress increases with the length of working hours. (There is also a substantial negative effect of long work hours on general life satisfaction.) A considerable proportion of employees (41.6%) also report

[81] Since it takes account of responses to a number of related questions, such a measure is likely to give us a more accurate picture of people's experience of stress. The statistical procedure estimates an underlying

having to work extra time over and above their formal hours of work. This was especially the case for men (46.0% compared to 36.1% for women). Again the pressure of extra work hours is strongly related to stress levels.

Possibly one of the factors that accounts for the particularly high levels of stress among those aged 35 to 44 is the way in which work hours interact with family responsibilities. Apart from their direct effects on tiredness and nervous strain, long and unpredictable work hours also interfered in an important way with family life. Over a third (37.4%) of those who worked 45 hours or more felt that their job prevented them from having the time they wanted with their partner and family, whereas this was the case for only 11.6% of those working less than 35 hours. Similarly, 36.5% of those working very long hours reported that they were too tired after work to do the things they would like to do at home, compared with 17.7% of those working less than 35 hours. This was clearly a potential source of tension within the family. Those who worked 45 hours or more were more than twice (18.8%) as likely as those working either less than 35 hours (8.0%) or between 35 and 44 hours (9.0%) to say that their partner always or often got fed up with the pressure of their job.

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stress factor reflected in the four separate items and gives each item a specific weight in relation to the overall measure.

Table 12 Work Experience and Work-Related Stress among EU Employees (positive scores=higher stress)

Work Experience Factors	Work Stress Score
Change in Effort	
Increase	.29
No Change	-.37
Decrease	-.24
Work Hours	
< 35 hours	-.45
35- 44 hours	-.10
45 + hours	.40
Often has to work extra time	
Strongly agree	.55
Agree	.21
Neutral	-.16
Disagree	-.42
Strongly disagree	-.63
Occupational Class	
Professional/Managerial	.08
Lower Non-Manual	-.31
Tech/Supervisory	.23
Skilled Manual	-.01
Non-Skilled	-.12
Change in Skill	
Increase	.06
No Change	-.18
Decrease	-.00
Job is Secure	
Very true	-.21
Quite true	-.05
A little true	.05
Not at all true	.12

Source: Employment in Europe Survey, 1996
Note: The measure of work stress is the score derived from the first factor of a principal components analysis based on four work stress items. Scores are relative to the mean. Higher scores indicate greater work stress.

The high stress levels of the modern economy are accentuated by the rise in the skill demands of jobs. It is notable that stress scores are particularly high among those in the expanding managerial and professional positions and among technical and supervisory employees; they are lowest among lower non-manual and non-skilled employees (Table 19)[82]. Those who have experienced an increase in the skill requirements of their jobs in recent years are also notably more likely to experience high levels of stress.

Finally, the loss of a sense of security in work in recent decades appears to be strongly related to higher work stress. The research literature on unemployment has shown that strong negative psychological effects set in from the time that people are made aware of the likelihood of redundancy. However, it is now clear that job insecurity has a much more pervasive effect in accentuating work stress. Those who feel that their jobs are insecure have much higher stress levels than others (as indeed are those who have seen the security of their jobs decline in recent years).

The challenge provided by rising levels of stress in work is then a major one, in that it appears to be an integral part of the key trends in the evolution of current patterns of work. However, there is a considerable body of research that suggests that the way in which work is organised may have an important effect in mediating the pressures of the work environment. The longer-term health consequences of high work demands are particularly severe where people have low levels of control over their work. The higher demands in work can be partly offset by the level of task discretion that people can exercise. Where people are allowed initiative to take decisions themselves about how to plan and carry out their work, they prove to be substantially more resilient in the face of high levels of work pressure (Karasek and Theorell 1990; Johnson and Johansson, 1991; Marmot and Wilkinson 1999). This points to an important area in which policy initiatives with respect to the design of jobs could help to offset some of the negative consequences of economic development.

[82] Earlier research suggested that the long-term health consequences were most severe among less skilled workers, but this may have changed given that the 1990s witnessed such a marked increase in the level of pressure on those in higher occupations and possibly on the level of work task control they could exercise.

Overall, there are good grounds for concern that the way in which current work processes are evolving may have high costs for particular sectors of employees, in a way that may lead to premature exit from the workforce. Both the lower and higher reaches of the occupational structure are affected, but by rather different factors. The process of skill polarisation, linked to the rapidity of technological and skill change, poses a real risk of increasing skill redundancy among those in lower skilled occupations. Since these have been excluded from the broader process of upskilling and are poorly covered by existing in-work training programmes, they are likely to find it increasingly difficult to adapt to changes in work systems and to retain market value. Higher in the occupational scale, among those in the technical/supervisory and professional/managerial occupations, the intensification of work processes (together with long and unpredictable hours of work) appear to underlie high and probably increasing levels of work-related stress. This could lead to substantial problems of early 'burn out' among key skilled sectors of the workforce.

Barriers to Labour Market Integration of Marginalised Groups

Much of the discussion of the barriers to re-integration into employment of marginalized groups can be grouped into three broad types of argument. The first emphasises the economic incentives to work and suggests that unemployment is to some degree voluntary. Unemployment is viewed as the result of a motivational deficit, which is linked to a system of welfare benefits that reduces the value that people attach to work. The second perspective is the 'social exclusion' thesis. Once people become unemployed, they are caught in a vicious circle of poverty and social isolation that in turn sharply reduce their opportunities for employment. The third underlines the crucial importance of skill deficit and the nature of the training provision for the updating and modification of skills. Each of these perspectives implies a rather different policy approach to the re-integration of those in a position of labour market marginalisation.

a) Welfare Regimes and Financial Disincentives

Analyses by economists of the factors reducing the employability of the unemployed have focused heavily on the issue of the motivational consequences of welfare provision for the unemployed. The underlying assumption is that people tend to regard work as a disutility, with the consequence that they would prefer to remain unemployed and receive benefits if the financial rewards of work are not substantially above their income out of work. The central argument is that the provision of financial support to the unemployed reduces the value that people attach to having paid work, raises the level of the wage at which they would be prepared to accept a job and reduces the intensity of their job search. The more generous the welfare provision and the closer it replaces the income that a person would receive in work, the more negative its impact on the work attitudes of the unemployed. If this is the case it should be true both within countries for individuals who receive differential benefit support and between countries, reflecting broader structural differences in the generosity of unemployment compensation systems.

The UK is perhaps the country in the EU that has placed the greatest policy emphasis on the need to ensure that there are strong financial incentives for the unemployed to seek work. Yet research in this country into the effects of replacement rates on the duration of time spent unemployed is remarkably inconclusive. There are major technical difficulties in defining and measuring replacement rates that have to be surmounted in such research and some of the variation in results may reflect different choices about to handle these (Atkinson and Micklewright, 1985 :188-9). But the overall pattern of results to date suggests that even if such effects can be found, they are very modest in size. For instance, a recent overview of research in this area concluded that on average the results would point to a 10% increase in the replacement rate extending the duration of unemployment by only one to one and half weeks (Spieza 2000). Just as crucially, these effects have been evident only in the first five to six months of unemployment (Narendranathan and Stewart, 1993). This makes it rather implausible that financial disincentives linked to the unemployment benefit system can be responsible for entrapment in long-term unemployment.

Apart from the rather unimpressive evidence such studies provide of the magnitude of a benefits effect, they inevitably suffer from the major problem of assuming that duration of unemployment can be taken as an indicator of employment motivation. Yet one of the functions of an unemployment benefit system is to provide people with the resources to carry out the type of job search that would be likely to lead to a job that matches the person's skills. While doubtless people can be constrained into taking the first job available, this may produce low morale, poor performance and a relatively rapid return to unemployment. A recent UK study found that those who took longer finding work tended to be more stable in their jobs afterwards (Boheim and Taylor, 2000). Clearly if the slightly extended durations of unemployment associated with higher replacement rates reflect primarily more careful job search, they are a wholly inappropriate indicator of deficient work motivation.

Studies that have focused directly on the employment commitment of the unemployed have provided a very different picture from that of neo-liberal economic theory. In the UK studies over two decades have consistently shown that the non-financial employment commitment of the unemployed is at least as high as that of people in work (Gallie and Vogler 1993; Gallie et al. 1994). This is entirely as would be expected in the light of the work of social psychologists. Far from being a disutility as is assumed by economic theory, work is regarded by most people in contemporary societies as something to be intrinsically valued (Jahoda 1982; Warr 1987). It provides an important source of psychological stability through its latent functions of giving a clear time structure to the day, a regular source of activity and a sense of involvement in a wider collective purpose. It is an essential factor underlying the individual's status in the community, their respect by others and hence their ability to have a positive sense of identity. Clearly the higher the general employment rate in a society, the greater these pressures are likely to be. To the extent that the job is of a type that allows people to exercise and develop their skills, it also provides a major potential source of personal self-realisation. In short, the expectation from such a perspective is that unemployment would be typically associated with severe psychological distress, since, far from providing people with a welcome opportunity for leisure, it cuts them off from many of the most essential sources of social integration and personal well-being. Studies both of life satisfaction and psychological well-being provide a remarkably consistent picture that this is the case. In all of the EU countries for which there is data, unemployment is associated with markedly low levels of life satisfaction and higher levels of psychological distress (Gallie and Russell 1998; Whelan and McGinnity 2000).

Finally, it should be noted that cross-cultural evidence provides little support for the view that relatively generous welfare regimes undermine employment motivation. The different countries of the EU provide very different levels of support for the living standards of the unemployed. There are major problems comparing replacement rates across countries with any precision. But, despite their diversity, the various estimates that have been made tend to converge on the fact that replacement rates in the welfare regimes of the 'Northern' countries (such as Denmark, Sweden and the Netherlands) are very substantially higher than those of a 'liberal' welfare regime such as the UK, let alone a country such as Italy where (apart from the semi-welfare provisions of the cassa integrazione for workers in larger firms in Northern Italy) support for the unemployed is virtually non-existent.

Table 13 Employment Commitment of the Unemployed

	% committed
Austria	66.7
Belgium	60.4
Denmark	82.8
Finland	57.5
France	59.4
Germany E	69.0
Germany W	48.7
Great Britain	78.3
Greece	74.8
Ireland	71.4
Italy	75.6
Netherlands	80.4
Portugal	70.7
Spain	51.7
Sweden	78.7
EU15	**63.7**
N	**5144**

Source: Employment in Europe Survey, 1996
Note: The question was: 'If you were to get enough money to live as comfortably as you would like for the rest of your life, would you want to work somewhere or would you want to remain without a job?'

The view that financial disincentives are the crucial barrier to re-integration into employment would lead to the expectation that commitment to employment would be substantially weaker in those countries with generous benefit systems than those with low levels of social protection. But the available evidence suggests that this is simply not the case. The proportion of the unemployed who would wish to work irrespective of financial reasons is similar in Sweden to that in Britain and higher than that in Italy (Table 13). Moreover, it is then highest of all in Denmark and the Netherlands. It is clear that it is perfectly compatible to have a system that provides a high level of protection of the living standards of the unemployed, while maintaining high levels of employment commitment.

The evidence to date suggests that it is unlikely that the problems the unemployed find in achieving stable employment are to any significant degree due to deficiency of work motivation resulting from the generosity of welfare benefits. The evidence from economic analysis is far from consistent, but, even where it supports the view that there is an impact of benefit levels on duration of unemployment, this effect is small and is restricted to the first five months of unemployment. Direct attitudinal evidence indicates that the unemployed in Britain are at least as committed to work as the employed.

b) The Vicious Circle of Social Exclusion

A second approach to understanding processes of entrapment among the unemployed that has gained considerable currency is that of social exclusion. The concept of social exclusion has been defined in very diverse ways (Room,1995; Silver, 1995; Paugam, 1996). But common to most is the view that the unemployed experience multiple deprivations, and in particular poverty and social isolation. Moreover social exclusion is seen as a process in which people are caught in a spiral of disadvantage. Their loss of a job both generates and is reinforced by the multiple deprivations of poverty and social isolation.

The prime mover is generally held to be a person’s labour market position: it is protracted loss of employment (or entrapment in a precarious sector of the labour market leading to recurrent unemployment) that starts the process of decline. Lack of employment leads to severe cuts in living standards. This imposes major resource constraints on job search. At the same time it makes it more difficult for people to participate in social activities. Lack of resources, combined with the stigmatic effect of unemployment, leads to a fracturing of people's social ties and growing social isolation. Tension over finances may increase conflict in the household and precipitate the dissolution of partnerships. Lack of money is likely to make it difficult for people to maintain previous patterns of sociability with friends in the community, given the importance of exchange in the maintenance of social relationships. Increased social isolation in turn may reinforce labour market marginalisation by cutting people off from regular information about employment opportunities[83].

Empirically, then, the social exclusion thesis raises two distinct questions. The first is the extent to which unemployment leads to severe financial deprivation and the rupture of social relationships. The second is whether lack of financial resources and social isolation make it more difficult for people to get back to work.

In most countries in the EU the cross-sectional evidence points to a strong association between unemployment and poverty (Hauser et al. 2000). However, the extent to which this is the case differs substantially between countries. Whereas in a country such as Denmark, less than 10% of the unemployed are below the poverty threshold (50% of the mean net equivalised household income) in the UK as much as 49% of the unemployed are in poverty (Table 14). In almost all EU countries for which there is adequate longitudinal evidence, entry into unemployment is a direct cause of a higher risk of falling into poverty (Gallie et al. 2001).

As Nolan et al. (2000) have shown the differences between countries are heavily affected by the system of social transfers. For instance, pre-transfer poverty rates among the unemployed are very similar between the unemployed in the UK and Denmark. What makes the difference is the extent to which social transfers pull the pre-transfer

[83] Other versions of the thesis have placed a strong emphasis on residential patterns – in particular, the concentration of the poor in specific urban neighbourhoods – as a factor accentuating the process of multiple deprivation. However, Nolan and Whelan (Nolan and Whelan, 1999) have shown that, while there are certainly extreme concentrations of poor in such settings, this largely reflects the individual and household characteristics of the people who live in such areas. There is little evidence that residential patterns as such lead to disadvantage over and above what would be expected in terms of such characteristics.

poor out of poverty. Moreover, they argue that the efficacy of such social transfer systems cannot be understood simply in terms of the broad type of welfare regime, as reflected in the core principles underlying the structure of welfare provision (Esping-Andersen, 1990). Rather, within given types of regime, there can be very different outcomes as a result of differences in the specific policies followed by governments. Thus the UK and Ireland can be classified together as having a broadly similar type of 'liberal' or 'liberal-minimal' system of welfare provision for the unemployed[84]. But there are major differences in the poverty risks facing the unemployed in two countries.

Table 14 Proportion of the Unemployed in Poverty in the mid-1990s.

	50% mean	60% median
Denmark	7.6	11.7
Germany [a]	41.7	41.9
France	23.3	27.1
Ireland	33.4	33.0
Italy	45.7	47.1
Netherlands	25.2	29.8
Sweden	30.4	36.3
UK	49.4	51.2

Source: Hauser et al (2000)
Note: Poverty thresholds are based on net equivalised household income (ie after taking account of transfers and taxes).

The link postulated by the social exclusion thesis between unemployment and social isolation has proved much more problematic. The classic interwar study of the impact of unemployment (Jahoda et al. 1933) suggested that unemployment led to the collapse of people's local social networks and their withdrawal from the associational life of their communities. It was particular striking that this could not be simply attributed to lack of income; people stopped participating even in free activities. However, this has

[84] For a discussion of classification schemes, see Esping-Anderson, 1990; Gallie and Paugam, 2000.

not been confirmed by post-war studies of unemployment. For most countries (France may be the exception) there is little evidence that unemployment directly increases social isolation in the sense of either of reducing the frequency of people's contacts with neighbours and friends or leading them to drop out of community organisations. Indeed, in cross-sectional data, the unemployed appear to have higher levels of sociability than the employed. But this difference disappears in longitudinal analyses that control for the individual characteristics of unemployed and employed people.

Comparisons across the EU countries suggest that patterns of sociability vary substantially between countries, reflecting long-standing cultural differences (Gallie and Paugam, 2000). In particular, levels of informal sociability are much higher in the Southern European countries than in the Northern. It is not that unemployment has a general effect of increasing social isolation but rather that people in different countries become unemployed in very different local social contexts. While in Central and Northern EU countries there is a real risk that unemployment will be accompanied by social isolation, in the Southern countries this is rarely the case.

However, even if unemployment does not produce social isolation by undercutting the frequency of social contacts, it does appear to have substantial consequences of a more qualitative type. There is evidence that it is associated with a concentration of worklessness within households and within friendship networks.

There has been a growing concern that economic trends have led to a polarisation between work rich households on the one hand and work poor households on the other. Workless households refer to households in which no adults are in work but at least one person is of working age. The evidence from the UK (Hastings 1997) (Bell et al. 1997) suggests that they consist primarily of economically inactive people, with only a third containing at least one unemployed person. The increase in long-term sickness and disability has been an important factor accounting for their increase. Moreover, an assessment of the implication of the growth of workless households needs to take account of changes in the structure of households. A major factor underlying the increase of workless households clearly has been the growth of single adult households. In the UK single adult and lone parent households constituted 39% of workless households in 1986 but 52% in 1996.

It remains the case, however, that in many EU countries there is a markedly higher probability that the spouses of unemployed men are without work than is the case for spouses of employed men. In part this reflects the fact that partners tend to share similar educational backgrounds and are located in the same labour market (which may have generally high levels of unemployment). But even when these factors have been taken into account, there is still a persisting effect (De Graff and Ultee 2000). There is some evidence that this may be affected by the nature of the unemployment benefit system. The problem appears to be less acute where unemployment benefit is allocated on a strictly individual basis than where the benefit regime takes a partner's earnings into account (Dex et al. 1995; Davies et al. 1993).

There is also some evidence that, while sociability with friends remains as frequent as when people are employed, people are increasingly interacting with other unemployed people (Gallie et al. 1993; Morris 1987). As can be seen in Table 15, taking the EU as a whole, unemployed people were nearly four times more likely than the employed to be in friendship networks in which a half or more of their friends were themselves unemployed. The reasons underlying this concentration of unemployment in social networks have not been rigorously assessed. However, just as with household concentration, it is likely that it partly reflects the fact that people are confronting the same difficulties in the local labour market. It is also likely that relationships with those in work are made more difficult by the problems of reciprocity. It may be tricky to maintain on-going social activities with people with very different levels of income, without the unemployed person feeling an uncomfortable level of dependence.

Table 15 Proportion of Friends Unemployed by Employment Status (EU Employed and Unemployed)

	Employed	Unemployed
Less than half unemployed	89.8	61.5
Half or more unemployed	10.2	38.5
N	6630	4586

Source: Employment in Europe Survey, 1996

Overall then a general social exclusion thesis fails to take account of important differences between countries in the experiences of the unemployed. Unemployment is indeed very generally linked to an increased risk of poverty, but the extent to which this is the case is strongly mediated by the nature of welfare provision in particular countries. There is no general link between unemployment and increased social isolation *per se*, but unemployed people are more or less likely to experience social isolation depending on the country to which they belong.

While the extent to which the unemployed people are subject to the multiple deprivation of poverty and social isolation is dependent on both the institutional and cultural contexts of the specific society, there can be no doubt that both types of deprivation have severe consequences for the experience of unemployment. There is now a very substantial literature that shows that the level of financial difficulty has a powerful impact on the psychological distress experienced by unemployed people (Whelan et al. 1991; Gallie 1999). Similarly, it has been repeatedly shown that the level of social support that is available to people is an important factor that helps people to cope with the stresses produced by unemployment (Warr 1987). Those who are socially isolated, whether because they meet others infrequently or because they participate in networks that are collectively cut off from the employment structure have much poorer levels of social support and suffer correspondingly from greater psychological distress.

What has been much less the subject of research is the impact of poverty and social isolation on the problems people have in getting back to work. The current evidence on social networks is inconclusive. One British study found some impact of social networks on unemployment exit rates (Hannan 1999) but an analysis of a number of EU countries failed to find any general effects of networks in either facilitating or hindering job acquisition (Gallie et al., 2001).

However, there does appear to be a very pronounced effect of poverty in making re-entry to employment more difficult (Gallie et al., 2001). This effect was found consistently in all of the EU countries for which there was longitudinal evidence and it appeared to be robust to different estimation procedures. Certainly, there are good reasons in principle for thinking that more generous levels of provision may be beneficial in terms of people's job search opportunities. Poverty may hinder effective job search by reducing people's access to information (for instance if they are no longer able to keep a telephone) and to transport (for instance if they can longer afford to have a car). The constraint it imposes on the purchase of new clothes may make it more difficult to maintain the appearance needed at interviews, while the continuous struggle to make ends meet may undermine self-confidence and self-esteem. Over the long run, reductions in spending on food may lead to dietary deficiencies that sap people's physical health. Poverty then undercuts many of the basic resources - financial, informational and physical - that are essential to effective job search.

In short, research to date confirms that there is a vicious circle of disadvantage, whereby people can be progressively marginalised from the employment structure. But the central factor underlying this process is poverty. Unemployment heightens the risk of people falling into poverty and poverty in turn makes it more difficult for people to return to work. This process appears to operate in a similar way across the different countries of the European Union. Policies to break the cycle of disadvantage need then to focus above all on the link between unemployment and poverty. There are grounds for thinking that there is real scope for intervention in this respect. For, while the broad processes appear to be rather similar in the different European societies, it is clear that the degree of vulnerability of the unemployed to poverty (and hence to the cycle of disadvantage) varies sharply between them. As was seen earlier, a critical factor accounting for this is the nature of the country's welfare policies, which provide very different levels of protection from the risk of poverty.

c) Skill Deficiency and Employability

The third perspective on the problems of employability of the unemployed focuses on the skill deficiencies of those who have lost their jobs in the context of a rapidly changing economy. Sectoral and technological change has led to a marked decline over time in the prevalence of manual jobs and particularly low-skilled manual jobs. Those in lower skilled jobs have typically had much lower levels of general education and during their careers have received far less training from their employers. They were then poorly placed both to update their skills over time and to adjust to changes in the labour market. This clearly greatly increased their vulnerability to unemployment and their difficulties in re-finding work in an employment structure characterised by the continuous upskilling of jobs.

The main response to this problem has been to multiply and generalise special training and work experience programmes for the unemployed. In the past, European countries have differed substantially in terms of the relative emphasis they gave to active and passive labour market policies. Sweden was much earlier involved in active intervention than other countries and indeed even in the mid-1990s still spent considerably more on such measures as a proportion of GDP than most other countries. The variations were and still are very substantial. In the mid-1980s, Sweden spent 2.2 % of GDP on active measures, whereas Greece spent a mere 0.2% and Spain 0.3%. In the mid-1990s, the Swedish figure had risen to 3.2%, whereas that for Greece had scarcely changed (0.3%). However, taking the overall picture, there was a rise from the 1980s to the 1990s in expenditure on active measures in the majority of the European countries.

At the same time, there has been a general shift in many countries towards some version of the ‘workfare’ principle whereby financial assistance to the unemployed has been made conditional upon accepting work. As Loedemel and Hickey (2001) have pointed out the notion of ‘workfare’ can cover a very wide range of institutional realities (for instance, a much stronger version was applied in Norway than in Denmark, France, the Netherlands, Germany and the UK). Schemes differ in the relative emphasis placed on longer-term human resource development rather than on immediate job placement. Danish schemes for instance reflected a greater priority to integration and human resource development, while the Norwegian were more concerned with labour market discipline and job placement. Nevertheless generally such programmes have tended to be justified and judged in terms of their success rates in getting people back into jobs in a relatively short space of time. This is likely to impose constraints on the extent to which they can cater for longer-term skill development needs, since the training required is likely to have very slow returns in terms of job acquisition.

One feature of the programmes is that they are usually specifically for the unemployed. This is understandable in terms of the distinctive nature of many of their short term objectives (for instance developing skills in the presentation of CVs and in techniques of job search). It also imposes some limits on the financial commitment that would be involved if they were more widely open say to those who were non-active. But it runs the risk that participation reinforces the stigmatic character of unemployment. They represent in a sense a formal recognition of failure on the labour market.

There has been little rigorous assessment of the most recent wave of ‘workfare-style’ re-integration programmes. It has to be recognised that ‘effectiveness’ evaluations of the success of such schemes in returning people to regular and stable work are inherently very tricky to conduct in a rigorous way. It is necessary to handle the counterfactual of what would have happened to the participants if they had not entered the scheme. Where schemes affect only part of a target population, the most satisfactory methodological solution is random allocation, thus providing an experimental design. But this poses considerable practical and, arguably, ethical problems. Evaluation programmes in the EU have tended to be relatively weak because of reservations about the use of the type of random allocation techniques that have been applied in the US.

In lieu most serious analyses fall back on the construction of a control group of non-participants through matching techniques, with a careful use of statistical controls to take account of factors that have been shown to affect the likelihood of participation. Developments in the use of ‘propensity scores’ have also helped to provide more convincing comparison between the experiences of participants and non-participants. But the very comprehensive nature of the new ‘workfare’ policies, which in principle are supposed to be applied to all people in a given category, make evaluation even more difficult, since there is no longer a comparison group of non-participants available. While efforts are being made to find ways of getting round this problem (for instance through ‘difference in difference’ techniques that compare over time the relative outcomes of age groups that are within the scope of the new scheme and those that are not), it is difficult not to believe that there is a considerable loss of precision in the estimates reached.

Reliable evidence on the effects of the new policies then may be very difficult to obtain. But we know from careful analyses of ‘partial’ schemes that they do appear to have some effect, although its extent is disappointingly small. For instance, the evaluation of effects of the British government’s major ‘Training for Work’ programme for the unemployed over the period 1995-7 showed that, compared to equivalent non-participants, those who had taken part in the scheme spent one extra month in seven in work and this advantage was maintained for at least a year and a half after training (Payne et al. 1999). This was not simply a matter of a higher proportion of people being hived into part-time or temporary work. But, taking the hourly wage people received, it was certainly not evident that people secured a more skilled job than those who had not participated. The rather limited effects in terms of longer-term employment stability and the quality of jobs that people obtained found in this study confirm those from the evaluation of earlier programmes (White, 1998).

Perhaps the most worrying aspect of the results to date on the jobs acquired by the unemployed is their very low level of stability. Across the EU the unemployed have a very high probability of moving into temporary jobs. UK longitudinal research has shown that the typical duration of the jobs taken by the unemployed is substantially lower than that of new jobs taken by people already in employment. The main causes of this shorter job tenure were vulnerability to lay-offs and the prevalence of temporary contracts (Boheim and Taylor, 2000). Of the jobs taken by the unemployed 14% end through quits, 22% with lay-offs and 24% through the termination of a temporary contract. Individuals who enter a job from unemployment were four times more likely to be laid off than those entering from another job and three times more likely to be in temporary employment (ibid:13,15).

Stability of employment is likely to be heavily conditioned by the quality of the jobs people get. The classic evaluation studies tell us relatively little about the nature of the jobs that people obtain. But if these involve routine work, low pay, poor work conditions, limited opportunities for skill development and job insecurity, people are likely to find themselves trapped in a sector of employment that also heavily constrains their ability to participate in the activities of the community. Such programmes can only be judged to have made a substantial contribution to re-integration if they provide people with the skills that make it possible to escape from the secondary employment sector. The provision of real choices that offer people the prospect of more stable and long-lasting careers is also likely to be important for the motivation of the unemployed to be involved in such programmes. There may be a resistance to the idea of participation in a programme that is perceived as a form of 'cooling out', attempting to make them reduce their aspirations for a job providing interesting work and good employment conditions.

As can be seen from Table 16, the jobs occupied by people with previous experience of unemployment were in several respects of even worse quality than those typical of people at the same occupational level (skilled manual and non-skilled occupations). The previously unemployed were at least four times as likely to be in jobs with short-term contracts and at least three times as likely to think that there was a high probability that they would become unemployed within the following twelve months. They were jobs with lower variety and giving fewer opportunities either for the exercise of initiative in the work or participation in decisions affecting the work. Furthermore, as with jobs more generally at this skill level, they offered very low chances of self-development through either learning on the job or employer training. These were not, then, the types of jobs that could be expected either to reverse long-term skill deficiencies or to provide the motivation and security required to ensure employment stability[85].

Table 16 Characteristics of Current Jobs by Experience of Unemployment in Previous 5 years (EU Skilled Manual and Non-Skilled Employees Only)

	Not unemployed	**< 6 months**	**6 months +**
Current Contract < 3 Years	5.6	21.9	27.3
Job very or quite insecure	29.1	51.2	54.7
Risks unemployed in 12 mths	4.9	16.8	14.8

[85] Very similar results emerge from longitudinal analyses of the European Community Household, which show that of those previously unemployed who take up a job, two thirds take up a job of relatively poor quality (European Commission, 2001:78).

Learns on Job (very true)	19.3	19.6	20.1
Received Employer Training	26.6	19.4	25.7
Completely/very satisfied with job	36.7	26.0	24.7
No variety in work	19.9	23.5	30.1
No say over way job is done	23.9	29.0	27.9
No participation in decisions that affect work	26.9	30.2	36.9

Source: Employment in Europe Survey, 1996

Overall, then, there are good grounds then for thinking that there are deeply entrenched skill deficiency barriers to sustained labour market re-integration. Given the trends in the job structure towards higher skills, longer-term employability depends crucially on access to opportunities for skill development. The unemployed typically come from jobs where there were very limited opportunities for updating skills or indeed retaining basic learning skills. While considerable effort is put into short-term remedial programmes for people when they become unemployed, they are poorly placed to engage in any intensive retraining. Moreover, they typically return to jobs that are more insecure and poorer in overall quality than those of people in the same occupational classes. These are jobs that are once more characterised by very poor opportunities for training and thus perpetuate the labour market vulnerability that comes from low skill levels. Sustained re-integration clearly requires much more extended processes of skill development than are likely to be achieved under these conditions.

In the longer-term, the foundations for a more highly skilled workforce need to be created by a much greater investment in tackling educational disadvantage in early life (see Chapter 2). But the impact of such changes inevitably will be slow and, given the rate of technical change, they will need to be reinforced by mechanisms that ensure that skills are continuously updated. An effective strategy for tackling skills deficiencies in the current workforce requires a more systematic effort to improve the quality of lower skilled work, so that learning skills are maintained and developed over people’s working lives.

Welfare and Work : the Future Agenda

It is clear that, while undoubtedly an important precondition for improving the situation of those who are marginalized, employment does not in itself resolve the problems of social inclusion. Many jobs do not provide people with the opportunities for self-development that are necessary to participate adequately either at work or in the community, there are trends in the developing forms of work organisation that increase the vulnerability of particular groups to social exclusion and the provision of a job to those that have experienced unemployment does not ensure longer-term employability. What does this imply in terms of the types of social policies that are needed to provide effective social inclusion?

A central conclusion of this report is that the traditional social policy emphasis with respect to labour market problems, which has focussed primarily on remedial measures in the context of labour market failure, needs to be accompanied by a much more active preventative policy. In particular, there is a need for a European level programme for the improvement of the quality of working life. There are two core aspects to this : first an improvement in the quality of work conditions to provide more adequate opportunities for self-development for the low-skilled and effective mechanisms to prevent the escalation of levels of work stress and, second, a major expansion of in-career training provision. While such a programme will have initial costs, it must be seen in terms of a social investment that is likely to have very considerable medium and longer-term rewards. It will not eliminate job insecurity, although it will reduce the risks that loss of employment will lead to eventual labour market marginalisation. It must then be accompanied by a marked improvement in measures to support those in positions of job insecurity and to ease employment transitions. The objective of creating greater flexibility in employment is more likely to be realised if there is seen to be adequate institutional support for those affected by job insecurity.

a) Improving the quality of work

A substantial proportion of jobs in the EU do not offer the types of opportunities for personal development, intrinsic job interest, adequate income or reasonable stability that are assumed by those who emphasise the integrative potential of employment. The problem is very widespread in semi and non-skilled occupations, but it is particularly acute in part-time non-skilled jobs and among older workers in non-skilled jobs. There are also many indications that recent decades have seen a marked intensification of work, as a result of staffing reductions, pressure for higher quality standards, and rapid organisational change. It is likely that this underlies the high levels of reported work stress, a problem that is becoming increasingly recognised at European level (European Commission, 2000). Work stress is clearly accentuated by excessively long hours of work by many employees and by the problems that people confront in reconciling the demands of their work and family lives. A continuation of current trends is likely to pose substantial problems of premature withdrawal from the workforce even of skilled staff and will certainly act as a major barrier to attempts to extend work careers. In the longer run, this can only add to the difficulties faced by welfare systems in providing adequate social protection for those in retirement (see Chapter 4).

The development of effective protection against poor work task quality and potentially hazardous levels of stress poses new challenges for the development of policies of health and safety at work. In the past, these have been primarily designed to reduce physical risks and it is likely that they have been an important factor in the major decline in deaths and serious physical injuries at work. But policy has failed to keep up with the changing nature of work risks, which require quite different methods of assessment and control. Some Northern European countries have been experimenting with ways of improving work organisation and task quality and there is some tentative evidence that these may have had a real impact (see, for instance, Gustavsen et al. 1996). New measures need to be developed, which build upon these experiences, and ensure their integration into basic employment norms.

Any effective policy approach to improving the quality of work would require action at several levels. National governments and the EU would need to take responsibility for enhancing the salience of the issue, diffusing information about best practices and establishing a set of social indicators, derived from high quality representative national surveys, that will show trends over time in employees reports of, and satisfaction with, the different aspects of their working conditions. The feasibility of developing sensible indicators of working conditions has now been established. What is lacking is the investment to provide comparative survey samples of the size and quality that are required to provide reliable evidence about trends over time and to allow sufficient disaggregation to inform policy making about key subgroups.

A first important step in this direction has been taken by the Commission with the publication in June 2001 of the Communication '*Employment and social policies: a framework for investing in quality*' (Commission 2001). In the wake of the calls in the Lisbon, Nice and Stockholm Councils for the modernisation of the European Social Model and for greater concern with issues of quality, it argues for the need to establish a set of common indicators that would track changes over time in both the characteristics of jobs and the wider work and labour market contexts. It proposes the creation of indicators relating to ten broad domains: intrinsic job quality; skills, life-long learning and career development; gender equality; health and safety at work; flexibility and security; inclusion and access to the labour market; work organisation and work-life balance; social dialogue and worker involvement; diversity and non-discrimination and finally overall economic performance and productivity. This is clearly a potentially vast programme, covering a much wider field than that dealt with in the present paper. Hard choices will doubtless have to be taken about priorities and careful thought will be needed about the meaning and adequacy of specific indicators. The quality of available indicators is very variable, and the assumption that existing data sources will suffice could lead to the selection of inadequate measures of the underlying issues of interest. But the general approach is clearly in the right direction.

Implementation of changes will necessarily operate at a decentralised level. There are now some widely recognised general principles about the way in which job characteristics affect the experience of work. But the implementation of improvements to the work environment will vary with the specific work situation and will depend for their effectiveness upon the nature of intra-organisational decision-making processes. This underlines the importance of recent developments with respect to participation procedures and the need for them to be adequately resourced. There is now a great deal of research that shows that organisational change is most effective in meeting employee needs and enhancing employee satisfaction when it is introduced through a participative process. Improvement in the quality of work conditions should be an integral and explicit part of the extension of procedures for employee participation. Further, meaningful participation requires not only that employees should be consulted but also that they should have access to up-to-date knowledge. A system will need to be established to ensure that employee representatives have the necessary time and funding to obtain relevant training.

In the longer-term, effective action could well require the generalisation of a system of periodic ‘health audits’ in organisations, which will provide for an external evaluation of an organisation’s strategy in relationship to both physical and psychological health, of the internal system for monitoring working conditions and of the internal procedures for acting upon issues that are likely to be detrimental to the health of employees (in the broad sense of the term). Such audits would require organisations to develop systematic risk assessments, which would clearly need to take account of employees’ reports of their jobs and working conditions, as part of the evidence collected. As well as providing a strong incentive to organisations to improve their practices, such audits would provide a means for the diffusion of best practice information to individual work organisations. Such a system would require the development of specialised health-audit organisations that would be licensed to assess and approve company policies.

With respect to the pressures facing older workers, attention needs to be given to the possibility of encouraging transitions from full-time to part-time work. If governments seriously wish to increase the labour force participation of older workers, they may need to encourage the extension of contractual rights to reduce working time for people of a given age or with specific types of disability. We need to move from a system that largely provides for abrupt transitions between work and retirement to one that allows a smooth and progressive transition that favours both the optimum use of people’s skills and a work regime that is adapted to individuals’ physical well-being.

b) Maintaining and Developing Workforce Skills

The rapidly changing nature of skills in advanced economies accentuates the risk of marginalisation of those who do not have access to regular training opportunities. Current skill development and training opportunities are heavily stratified and in-career training for both skilled manual and semi and non-skilled employees is very poor across the European Union. It is also evident that there is a major problem of ensuring adequate training provision in small firms. Failure to provide for regular updating of skills increases the risk of long-term exclusion if people become unemployed, since they may well have lost many of their basic learning skills. An adequate social policy should be one in which on-going opportunities for skill improvement are seen as essential aspect of socially responsible employment.

It is clear that adequate training provision does not emerge as a spontaneous outcome of current employment relationships. This is doubtless partly because of the significant short-term costs for both employers and employees. For employers, training involves immediate costs both in terms of organisation and personnel, as well as the loss of work time. For the employee, there are substantial financial costs if training is not directly funded by the employer and there is the non-financial cost of an additional burden on already strained time budgets. Employers then are likely only to provide training where it is perceived to be most crucial to the organisation, thereby producing the heavy concentration on higher skilled employees. Employees that are excluded from employer provision are unlikely to be in a position to compensate through personal training initiatives. The extension of a more pervasive system of training provision, that will help reduce the longer-term social costs of current arrangements, will require new types of policy and a significant investment of public resources.

The cornerstone of the development of an effective training policy must lie in some system of citizen's training entitlement. This would both greatly enhance the salience of the issue and provide the stimulus for the development of appropriate institutional mechanisms. Individuals should be able to build up training credits across time that will provide a guarantee both of time for training outside the workplace (without risk to employment) and of access to financial resources that will give adequate protection of their living standards for the training period. Such credits would need to be portable between employers. Individuals should be able to have a significant choice in the way that such training credits are used. While courses would need to be certified as vocationally relevant, they would not necessarily be linked to the specific needs of the current employer. Employers could however influence the incentives for particular directions of training, for instance through provision for skills-based pay increments.

While there could be diverse funding formulas for such a programme, it would be unlikely to prove effective without substantial state subsidies for training non-skilled and older workers. This needs to be accompanied by a major programme of development work on the training practices that are best adapted to the needs of such workers. It is clear that there are many problems that are specific to these categories of workers – such as enhancing competences in situations of disability and addressing underlying problems of learning skills – which are not catered for by conventional training provision and require individualised assistance. There are already experiments in this direction in Denmark and the Netherlands that would be worth careful assessment. More generally, the extension of training provision would need to be supported by a network of specialist advice centres that could provide assessments of individual needs and information about the most suitable opportunities.

Such credit entitlements would be only one aspect of the more general training provision. A great deal of training already occurs in a relatively informal way at work and the issue is how to build upon this in a way that institutionalises a dynamic training culture in the workplace. Employers in many countries have taken steps to improve the monitoring of individual training needs through systems of individual appraisal. But in the longer term, the salience of training issues and the development of effective organisational policies would be best enhanced by making it a central component of issues that are subject to processes of consultation. This underlines again the importance of the development of participative procedures as a mechanism for improving the quality of working conditions in the broad sense of the term.

One of the most difficult problems that needs to be addressed in improving training provision is that of the relatively low levels of training in small firms. There are clearly major structural obstacles here in terms of the organisational resources available to develop training strategies and deliver adequate training provision. The solution clearly lies in the development of some type of shared training resource, on a geographical or sectoral basis, which would enable small organisations to make economies in terms of the provision and training staff. Many of the skills required, especially in the middle and lower echelons of organisations are of a relatively general type – for instance the development of information technology skills – and could be well catered for on this basis. However, given the co-ordination problems, small organisations are likely to find it difficult to create such structures themselves and hence any such institutional development will require active public intervention.

c) The Affordability of a Quality of Working Life Strategy

Inevitably proposals for the improvement of the quality of working and employment conditions in low-skilled jobs raise the issue of cost. Can this be achieved without either making such jobs too costly to be attractive to employers or imposing unacceptable burdens on governmental budgets? Is there a necessary trade off between a greater number of poor quality and a smaller number of better quality jobs?

A first point to note is that, in terms of the costs associated with job design and work conditions, perhaps the most important resource that such a programme requires is not a major investment in the technical infrastructure of firms, but managerial knowledge and skills in the organisation of work. This is likely to involve ensuring access to information and stimulating motivation rather than high cost. Second, available evidence suggests that the types of reforms in job design that are emphasised here have major positive implications with respect to both the commitment and health of employees. They tend to be associated with lower absentee and turnover rates, both of which involve high costs in term of discontinuity in production and service provision and new recruitment costs. At the same time, they involve a more effective mobilisation of workforce knowledge and are likely to be associated with higher quality work performance. They may well then be associated with improved rather than diminished competitiveness. Certainly, countries (such as Sweden and Denmark) that have moved ahead most strongly in this direction do not seem to have suffered in terms of relative economic performance.

The improvement of mechanisms to provide safeguards for employee health (psychological as well as physical) through a system of health audits may certainly increase costs of management time and may potentially reduce the short-term financial advantages that can be obtained through very intensive exploitation of the workforce in terms of hours and work pressure. However, there is a long tradition of research in industrial psychology that has shown that exceptionally long and intense patterns of working have high costs in terms of diminished quality of performance, leaving it doubtful whether they do provide economic gains over time compared to systems of work organisation better geared to employee health needs. Further, any sensible system of overall cost calculation would need to take into account the very high costs that poor work conditions impose on society more generally in terms of the need to provide care for the victims of industrial injury.

Finally, a major extension of in-career training is certainly likely to involve substantial *initial* costs, both in terms of the provision of training and work days forgone, even though the burden of these will depend upon the ways in which such reforms are phased in. But this is a clear case where budgeting has to be seen in the context of a more extended time frame. Training is a form of social investment that will lead to major economic benefits in the longer-term. The economies of the European Union are moving remorselessly to a higher skill base and to ever more rapid change in techniques and working practices. The failure to provide the workforce with the capacities to meet these new challenges will result in severe skill bottlenecks and low levels of workforce flexibility in times of change, thus leading to heavy costs in terms of sub-optimal economic performance. At the same time, the provision of adequate training in the course of people’s careers is likely to save very substantial costs with respect to programmes to financially maintain and re-integrate those experiencing labour market marginalisation. With such a crucial form of social investment, the issue is perhaps better formulated as one of whether advanced societies can afford *not* to take such steps, given their importance for human capital development and for long-term economic flexibility and performance.

Overall, whether one takes job design, improved health and safety or more extensive training, the view that better quality jobs are markedly more costly than poorer quality jobs is highly questionable if the full range of costs is taken into account. Good work organisation and well-designed job tasks are primarily a matter of good management rather than heavy financial investment. Even in the short term there is little evidence that improvements in labour standards undermine competitiveness. Indeed it can be argued that, in certain respects, they may be beneficial for performance. It must be remembered that there are major costs to efficiency arising from extensive labour turnover, ill-health in the workforce, work systems that are poorly adapted to employees needs and low employee motivation. There are also major costs to welfare systems that have to pick up those who suffer ill-health as a result of poor work practices. In the longer run, in a steadily more technologically sophisticated and high skill environment, it is clear the performance of the EU economy will depend crucially on its willingness to invest in the skills and motivation of people, and this in turn will be heavily conditioned by the importance attached to improving the quality of working life.

c) Regulating Insecurity and the Re-integration the Unemployed

A central argument of this report is that effective action against prolonged unemployment needs to begin well before an individual becomes unemployed. We need to move from a curative to a preventative concept of social policy with respect to work risks. It is the failure to update skills and to maintain learning skills that makes an individual exceptionally vulnerable at a time of employment restructuring. Improving the quality of work life, particularly with respect to opportunities for regular updating of skills, is one of the major policy measures that can be taken to ensure a more rapid and sustained re-integration of people when they become unemployed. A significant section of the unemployed, who in the majority of EU countries are drawn heavily from the lower skilled sectors of the workforce, are caught in a ‘skills trap’. They come from jobs in which there is little provision for updating skills and they return to jobs that are as poor, if not poorer, than those typical of their occupational group. The current reliance on short-term remedial training and work experience programmes is not adequate to reverse years of skill fossilisation and cannot compensate for the lack of on-going skill development when people return to work. It leads to a pattern where a substantial proportion of the unemployed return not to sustained employment but to precarious and poor quality jobs, where they are at risk of entering a cycle of recurrent unemployment.

But apart from underlining the necessity of much better resourced policies for maintaining skills across the career trajectory, a preventative policy also points to the need to consider carefully the regulations which condition the way in which organisations lay off their personnel. Given the stigmatic effect associated with unemployment and its negative effects on later job acquisition, the objective should be to reduce as far as possible the risks of a person becoming unemployed in the first place. There are two factors that are crucial in this: the length of advanced notice that an employee gets of the fact that their current job is at risk and the degree of support that they receive before the termination of their existing contracts with respect to guidance about other job opportunities and the provision of additional training to enhance their labour market position. The traditional image of redundancy is one of organisations reacting to situations of largely unanticipated crisis. But the reduction of personnel has now become a widespread policy even of highly successful and profitable firms that are engaged in strategic modifications of their operations in terms of localisation or sub-contracting policies. At least in this latter case, there should be very strong presumptions about the social responsibility of employers to provide a high level of support for the staff affected. This is likely to require a significant recasting of existing redundancy regulations.

A good deal of discussion about ways of limiting insecurity has focused around the issue of temporary work and a common suggestion is that it could be limited by extending controls over the use of temporary contracts. At the extreme, it is sometimes advocated that the use of such contracts should be strongly discouraged through reducing the grounds on which employers can resort to the use of temporary workers and through tight constraints on the length and renewability of such contracts. It has been seen that some of the claims about the likely trends in the growth in temporary work appear unduly alarmist and that the nature of temporary work is considerably more diverse than is often recognised. But, taking the longer-term perspective, it also has to be recognised that the objective of improved training rights (as well as improving maternity and paternity leave rights) implies that organisations will be confronted with increasing discontinuity in their staffing of specific posts. While the extension of flexible team working within organisations can help to offset this, it is still likely that there will be a persisting and possibly rising requirement for temporary personnel to cover organisational gaps.

Given that the need for temporary work will be driven by social as well as economic objectives, it is likely to be a persisting feature of the employment structure and the policy focus should be primarily on what can be done to improve the conditions associated with temporary work. The principal requirement is not ever-stronger restrictions on the use of temporary work, but rather better regulation of temporary work as an industry. There is no reason why temporary work agencies should not provide conditions of employment, with respect to training, holidays, consultation and even security broadly comparable with those in other industrial sectors. Given that the demand for temporary workers is likely to move in the direction of skilled staff, with the motivation needed to provide high quality work, both user and provider employers have a long-term interest in the skill development of temporary workers. The greater the investment of employers in their personnel, the more likely they are to wish to retain their staff on a longer-term basis and the lower the insecurity of employees in this sector. The proper organisation of temporary work then could do much to offset the tension between the need for greater labour flexibility and the concern to provide adequate job security.

Finally, it has to be recognised that whatever the improvements in long-term workforce training, in the management of redundancy processes, and in the employment conditions of temporary workers, the problem of recurrent crises of unemployment is unlikely to disappear from the agenda. Greater understanding of techniques of macro-economic management of the business cycle may provide greater stability in the medium term, but the advanced economies will remain exposed to relatively unpredictable external shocks in an increasingly integrated international economy. A policy that is premised exclusively on the view that the problem of the unemployed can be resolved through finding more effective ways of getting people into employment and that ignores the need to provide proper resources for those without work can only lead to unacceptable levels of poverty and distress at such times of economic difficulty. Research in the last two decades has established clearly the very high costs of unemployment in most countries in terms of both financial deprivation and psychological distress.

A European policy that is genuinely concerned about social integration will have to maintain the provision of adequate protection of living standards for the unemployed as one of its core objectives. The reluctance of some countries to do this has been rooted in the belief that relatively generous financial assistance for the unemployed inevitably poses major problems of work incentives. But the view that high levels of benefit necessarily undermine work motivation is not supported by the comparative evidence. Employment commitment is at least as high in societies with generous benefit systems as those with low benefit levels. Rather poverty constitutes a significant barrier to effective job search and therefore accentuates the problems of re-integration. EU societies currently differ substantially in terms of the principles underlying the provision of unemployment benefits and the level of protection they provide. The models for convergence should be those that provide higher levels of protection.

CHAPTER 3

A NEW SOCIAL CONTRACT FOR THE ELDERLY?

3.1 Introduction

The democratisation of retirement must surely count as one of the great achievements of the affluent democracies in the 20th century. Until recently, *retirement* in its contemporary sense – an extended period of labour force withdrawal driven not by physiological decline but by the accumulation of sufficient retirement "wealth" to make work unnecessary – was a privilege of the few. The old were more likely to be out of work than the young as a result of unemployment or disability but they did not "retire" because work was unnecessary. [86] Even as late as the 1960s, "old age" was often used as a virtual synonym for poverty in many nations. All this changed in the last quarter of the 20th century.

Markets and states, employers and workers, all played a decisive role in shaping this development. Its *sine qua non*, however, was the widespread public sector reforms of the post-war decades. By itself, rising affluence would have produced a growing share of older employees with sufficient wealth to allow for retirement in advance of physiological decline and labour market redundancy. However, it is undoubtedly true that absent the post-war expansion of mandatory public pension schemes, voluntary retirement that results from the "wealth effect" would still be significantly skewed in favour of those with higher lifetime earnings.

The institutionalisation of retirement as the normal conclusion to the economic life course has also been widely popular and can be taken as reflecting the "revealed

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[86] U.S. surveys of new retirees conducted by the Social Security Administration in the 1950s found the vast majority – 90 percent -- had "retired" because they were laid off by their last employer or due to poor health. Less than 5 percent reported retiring voluntarily or to enjoy more leisure. By the 1980s, involuntary layoff and poor health accounted for only 35 percent of retirees and the majority claimed to have left work voluntarily (Burtless and Quinn, 2001: 384).

preferences" of employers as well as workers. The cost of satisfying these preferences in the 21st century will escalate substantially as a result of the demographic transition induced in part by rising life expectancy but mainly as the result of the fertility choices made by successive cohorts since the 1960s. Apart from the American "exception," fertility rates in most developed (and some developing) countries have fallen below replacement levels so that, when combined with increasing longevity, the phenomenon of population ageing may well continue even after the baby boom works its way through the demographic age structure.[87]

It is also widely recognised that a second factor, independent of demography, has been raising "retirement" costs in the affluent nations, namely the falling age of retirement. Part of this decline might be expected simply as a result of rising affluence (the "wealth effect") so that more workers now acquire sufficient retirement wealth to exit from the labour force at earlier ages. But it is equally clear that a significant share of the decline has been "policy induced" by early exit incentives created by both firms and governments. The result is that many older workers face a situation where continued employment simply "doesn't pay." These institutional factors clearly vary among countries. We think it unlikely that one could account for the enormous variation in employment rates among Member States (Table 1) simply by reference to national differences in living standards, health status, labour demand, or cultural preferences.[88]

TABLE 1: EMPLOYMENT RATES BY AGE GROUP IN 1999

	B	**DK**	**D**	**EL**	**E**	**F**	**IRL**	**I**	**L**	**NL**	**A**	**P**	**SF**	**S**	**UK**	**EU15**
55-59	36.9	70.9	55.1	47.4	44.8	46.8	50.5	36.6	38.2	49.6	41	59.1	54.6	77.8	62.1	50.7
60-64	12.9	34	19.6	30.4	24.7	10.1	35.9	17.9	12.9	18.6	11.7	43.6	22.2	47.9	35.6	22.3

Source: Eurostat Labour Force Survey. Adapted from *The Future Evolution of Social Protection from a Long-Term Point of View.* Brussels: Commission of the European Communities, 2000.

Under conditions of population ageing the price of sustaining these institutions is rising. For some Member States, raising employment rates particularly among 55-64 year olds

87 Though there are other exceptions than the American (e.g. Norway), exceptions are rare. Even in Sweden the fertility rate had fallen to 1.5 by the end of the nineties.

88 We hasten to add, however, that institutions profoundly shape cultural preferences. Once established, the expectation that "normal retirement" occurs at age 55 or 60 may be extremely difficult to change.

provides a potentially powerful instrument for offsetting the impact of population ageing on retirement costs. Enhancing the future labour market capacities of today's young (chapter one) and improving job quality for future workers (chapter two) both young and old will play a critical role in shaping the success of EU strategies in this regard.

Our starting assumption is that like the current generation, future generations of workers will want to preserve the retirement contract. As usual, the challenge is one of choices and trade-offs. In a democratic polity, the choices will not be made by policy-makers and experts alone for empirical as well as normative reasons. As the record of policy reform in the field of old age security has shown (Myles and Pierson, 2001), only rarely is significant reform feasible in the absence of a process that generates widespread social consensus among relevant social, political and economic actors.

This process will probably generate (incremental) trade-offs that will change the parameters of the existing "contract", on the one hand, but, on the other, also reflect a willingness to absorb a non-trivial share of the additional costs of retirement induced by demographic change. Our second starting assumption is that such a result is feasible given continued economic growth. Economic growth is likely to be slower than it would be absent population ageing. However, in the OECD scenario (Turner et al., 1998: 17), real living standards in Europe, North America and Japan could be 80 to 100 percent higher by 2050 despite population ageing. While there is good reason to reform the retirement contract, there is no reason to abandon it and every reason to expect a new equilibrium point in the labour-leisure trade-off.

3.2 Managing the Transition in the EU

Since the Lisbon Summit, the EU has committed to a common project of open policy coordination with special attention on the sustainability of old age security systems in the face of population ageing. The Commission has further elaborated this mandate with a statement outlining 10 common objectives, concisely reproduced below[89]:

[89] The exact formulation of these objectives can be found in : Commission of the European Communities, *Communication from the Commission to the Council, The European Parliament and the Economic and*

1. Ensure that all older people enjoy a decent living standard and are able to participate actively in public, social and cultural life.
2. Provide access for all individuals to appropriate pension arrangements.
3. Achieve a high level of employment so that the ratio between the active and the retired remains as favourable as possible.
4. Ensure that effective incentives for the participation of older workers are offered.
5. Ensure that public spending on pensions is maintained at a level in terms of percent of GDP that is compatible with the Growth and Stability Pact. This may include setting up dedicated reserve funds if considered appropriate by the authorities.
6. Strike a fair balance between the active and the retired through appropriate adjustments to the levels of contributions and taxes and of pension benefits.
7. Ensure, through appropriate regulatory frameworks at national and European level and through sound management, that private funded pension schemes will continue to provide, the pensions to which scheme members are entitled.
8. Ensure that pension systems are compatible with the requirements of flexibility, security, and mobility on the labour market,
9. Review pension systems with a view to eliminating discrimination based on sex
10. Make pension systems more transparent, predictable, and adaptable to changing circumstances.

This is a laudable list that *grosso modo* captures the major dilemmas facing all national pension systems in the rich democracies in the first half of the 21st century. We want many things at the same time: adequate pensions combined with inter- and intra-generational justice; flexibility in the face of societal change but predictability in pension benefits.

Social Committee: Supporting national strategies for safe and sustainable pensions through an integrated approach, Brussels, 3 July 2001.

A major objective of the Member States is to ensure that inevitable increases in retirement costs do not undermine public finances (Objective #5), either by increases in public debt or by crowding out of other essential public expenditures. The statement further points to an upper, if unspecified, limit for the share of additional retirement costs to be absorbed through the public sector.

The EU objectives outlined above also commit the Member States to *managing* the distributive consequences of higher retirement costs to achieve inter-generational fairness, intra-generational solidarity and gender equality. We assume that managing public finances to contain public debt and "crowding out" effects is a *sine qua non* for achieving these objectives since both have inevitable distributive implications in the way the increase in retirement costs is allocated both within and between future generations. Moreover, debt reduction in the short term is necessary to give governments the flexibility to meet rising public costs that will result from population ageing in the long term. Nevertheless, we see no good reason *a priori* for financing debt reduction *disproportionately* from the retirement budget and, as a result, resist the conclusion that it is necessary to fix, *a priori*, an upper limit or "hard budget line" for retirement expenditures.

Second, we assume that these distributive objectives, along with those of ensuring adequacy, predictability, flexibility, and transparency, refer to the *entire* "retirement budget," not simply to the share that appears on the public side of the national ledger.[90] Current efforts by Member States to shift rising retirement costs off the public budget by encouraging diversification of the sources of retirement income among the three "tiers" of old age security make this assumption especially important. On average, it makes little difference for the working age population whether higher retirement costs are paid for out of tax revenues, occupational pensions, or personal retirement savings. "Privatisation" of retirement costs aimed at stabilizing public finances does not provide

[90] As a recent EU document points out, a "common emphasis" in recent reforms is to limit the future retirement transfers that "governments are responsible for." See, "The Future of Social Protection from a Long-Term Point of View: Safe and Sustainable Pensions," Brussels, Commission of the European Communities, 2000. But in contrast, see the discussion of these issues in Commission of the European Communities, *Communication from the Commission to the Council, The European Parliament and the Economic and Social Committee: Supporting national strategies for safe and sustainable pensions through an integrated approach*, Brussels, 3 July 2001.

a solution to the larger issue of allocating the costs of population ageing between or within generations. Measuring the allocation of rising retirement costs that result from demographic change by reference to the public budget alone under such conditions would, justifiably, erode any public trust in both the EU policy process in general and "open" policy coordination in particular.

Two implications follow from this last assumption. The first is that national benchmarks or measures of the level and distribution of rising retirement costs should be based on both "public" and "private" (= *total social*) costs, not merely the former (Adema, 1997). [91] The second is that the EU commitment to manage the allocation of costs of population ageing involves not only the redesign of public sector benefits but also a corresponding commitment to the regulation of private sector retirement wealth. The favourable tax regimes available to second and third tier retirement savings instruments clearly warrants that they too be charged with social goals.

Our aim here is not to prescribe a "one size fits all" design for pension systems in the 21st century. It is now widely understood that existing institutional designs severely restrict the menu of feasible options available to policy-makers. The large sunk costs in existing pension institutions make "regime jumping" highly unlikely for both economic and political reasons (Myles and Pierson, 2001). Rather, we take the status quo as given and focus our attention on the dynamic problem of allocating the *change* in costs associated with sustaining the retirement contract under conditions of population ageing. [92]

We do not have a crystal ball that tells us what the future will bring. We do know, however, that reforms made in the present may have huge "lock-in" effects that will constrain future generations. Sometimes "lock-in" effects are desirable: national constitutions, for example, are typically written with precisely this goal in mind.

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[91] Such a commitment was made clear in the Commission's communication of July 3, 2001 (p. 3) which states: "The present communication responds to the need for clear and integrated strategies to cope with the challenges of an ageing society for pension systems. Such strategies should not only focus on pension schemes belonging to the first pillar as the two other pillars will have an important role to play in achieving the overall objectives of pension systems".

However, we assume that the sad historical record of the social sciences in forecasting future demographic and economic developments will continue well into the future. Accordingly, we attach considerable importance to the principle that a main requirement of any new pension design (Objective # 10) is that it provides future generations with sufficient flexibility to adjust to the changing circumstances of both the old and the young.

We begin in section 3.3 with a discussion of four key dilemmas policy-makers must face when determining how the "costs" of an ageing society are to be allocated. From these, we derive four criteria or litmus tests for evaluating policy responses to these dilemmas. In the following sections, we move from principle to practise. Drawing on the wide array of national reform initiatives since the 1980s, we highlight both the benefits and trade-offs of alternative reform strategies.

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[92] Our focus on *change* rather than *level* essentially bypasses the question of judging the status quo among member states, i.e. whether the current level of retirement costs are too high or too low.

3.3 The Economics of Population Ageing: Four Dilemmas in Search of Solutions

Following Thompson (1998), we can highlight the problems facing societies with ageing populations with a simple accounting identity. The economic cost of supporting the retired population is simply the fraction of each year's economic activity given over to supplying the goods and services the retired consume or:

$$\textit{Cost of Supporting the Retired} = \frac{\textit{Consumption of the Retired}}{\textit{Total National Production}}$$

This fraction can in turn be expressed as the product of three other fractions, the *aggregate consumption* ratio, the *retiree dependency* ratio and the *retiree living standards* ratio or:

Cost of Supporting the Retired =

$$\frac{\textit{Total Consumption}}{\textit{Total Nat'l Production}} \; (X) \; \frac{\textit{Number of retirees}}{\textit{Total Population}} \; (X) \; \frac{\textit{Average consumption of retirees}}{\textit{Average consumption of total Pop.}}$$

Assuming all else remains fixed (e.g. the relative consumption of the retired and the age-specific distribution of retirement ages), population ageing raises total retirement costs. A 10 percent increase in the retiree dependency ratio results in a 10 percent increase in the cost of supporting the retired. That retirement costs for society as a whole will rise significantly in the 21st century is more or less destiny. Although the precise magnitudes may be in question, the direction is not. As Thompson (1998: 42) points out, the average retirement age would have to rise to something like 73 or 74 to offset demographic change, an unlikely scenario. Small changes in retirement age, fertility, and immigration can potentially alter magnitudes but absent a truly revolutionary reversal in fertility trends a rise in retirement costs is more or less inevitable. Though unexplained, declining fertility is a worldwide phenomenon, unlikely to be substantially reversed by public policy interventions. There (inevitably) will be more young people moving from developing to developed countries but they will quickly adopt the fertility behaviour of their host countries and want to bring their ageing parents when they move.[93]

Cost shifting to the private sector does not *per se* change this scenario. The share of total consumption of the retired rises irrespective of whether it is financed with state pensions or with investment returns from bonds and equities. Indeed, as Thompson (1998:44) observes, proposals to shift toward group or personal advanced funded accounts are often made on the grounds that retirees will receive higher returns from their contributions. If this turns out to be true, the effect of change will be to *raise* future retirement costs.

> The policy challenge, then, is to determine how these additional costs are to be allocated both within and between generations. To use Pierson's (2000) formulation, what happens when the irresistible forces of demographic change collide with the seemingly immovable preferences of current, and, presumably, future generations for an extended period of retirement. The problem facing the rich democracies is not an "equilibrium" (or point-in-time) problem but a dynamic one: How to allocate the *change* in costs as countries moves through the transition.

One solution is to leave the problem of cost allocation to markets and families.[94] In a totally privatised system based on advance funding and other personal assets, the business cycle and changes in demand for labour and capital that are uniquely attributable to population ageing would solve the problem of cost allocation by producing lucky and less lucky generations (Thompson, 1998). Some cohorts would benefit from favourable wage histories and returns to their capital and so be in a position to retire early in relative comfort. Other cohorts would be less fortunate. Families would decide about the inter-generational transmission of wealth so that

[93] Though we do not pursue the topic here, we note that to the extent higher levels of immigration form part of a strategy to offset population aging, policies aimed at successful migrant incorporation are an essential part of the policy discussion on the ageing society.

[94] On this see the exchange between Richard Epstein and David Braybrooke in Laslett and Fishkin (1992).

(perversely), *within* generations, children from wealthy families and with few siblings would be the winners.

> For many nations, however, relinquishing the problem of cost allocation to markets and families is not a feasible option for both political and economic reasons, hence utopian. Even if one believes such a choice to be desirable, it is simply not on the menu of feasible options available to most member states since they are not starting from a *tabula rasa*.[95] For example, because of the high transition costs (see below) associated with moving from a mature pay-as-you-go to a private advanced funded design, the public pension systems now in place will endure well into the future so that policy-makers have no option but to make choices about cost allocation. Even in the absence of the economic constraint, the past decade has shown that popular support for established retirement income programs is both broad and deep so that truly "radical" reform of this sort faces an equally daunting political constraint (Myles and Pierson, 2001).
>
> There are also sound normative reasons for a public role in allocating the transition costs arising from what is essentially a collective risk created by a changing population structure. We rarely expect markets to allocate the costs of wars or natural disasters. And there is no more reason to have markets allocate the transition costs of the "baby dearth" in the 21st century than of the "baby boom" of the mid-twentieth century.[96]

To throw into relief the core issues facing policy reformers, it is helpful to begin from an imaginary starting point – a "useful fiction" – in which all of the consumption of the retired comes from pensions financed from payroll taxes on the wages of the non-retired, assumptions that can be relaxed once the main elements of the story are in place.

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[95] The important distinction between *tabula rasa* choices and transformation choices is developed by Orszag and Stiglitz (1999). As they note (1999:7), the social effects of *transforming* a mature pension system into a system of individual accounts may be substantially different from the social effects of the initial choice between a public defined benefit system and individual accounts.

[96] As Hernes (1976: 516) observes, aggregative outcomes such as marriage, divorce, and fertility rates "are partly under human control and partly the result of chance processes; in part they can be affected by conscious action but to a considerable extent they are unintended." Like prices, they depend on all individuals but not on any (one) individual.

Needless to say such a starting point closely approximates the real world situation in those countries with highly developed pay-as-you-go defined benefit plans, countries that also were the most active reformers during the 1990s.

Intergenerational Equity[97]

The challenge facing policy-makers in the pay-as-you-go countries is in the first instance an intergenerational dilemma that can be illustrated by contrasting two ideal-typical pay-as-you-go designs. In the standard defined benefit model with a fixed replacement rate (FRR), retirees are entitled to a given fraction of their earnings in the form of benefits plus an adjustment factor to reflect productivity gains and higher wages in the subsequent generation. When the ratio of workers to retirees changes, workers must adjust their contribution rates accordingly. In effect, benefits drive taxes (so that taxes are the dependent variable) and *all of the costs associated with demographic change fall on contributors and their dependants.*

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[97] In the context of the issues addressed in this chapter, the principle of *equity* should be understood as referring to 'fair burden sharing', i.e. to an equitable sharing of the costs (or benefits) of demographic transition between citizens. Still, every parent who has tried to explain to younger children why it is "fair" that they are put to bed before their older siblings knows that determinations of what is equitable are often highly contested. It is not surprising, then, that the contemporary notion of "intergenerational equity" and its range of application should also be contested (Laslett and Fishkin, 1992). In some contexts, the concept is used to discuss point-in-time differences between generations currently alive (the old, the young), while in other contexts it pertains more to the legacy that one generation (all those now living) will leave to future generations (those not yet born). Here, we make use of both sense of the term (see text below). The range of outcomes considered also varies. Should policies aimed at effecting equity between generations be applied only to the activities of government or to the entire social, economic and natural infrastructure left to future generations?

> This is not the place to engage in an in-depth discussion of the normative merits of reciprocity and equiproportional burden sharing. In line with Musgrave's original approach, stated in terms of the political viability of social security arrangements, we rather note that proportionality indeed often acts as a focal point in negotiation problems (thus lending support to FRP as a benchmark). Political viability, or a policy's sustainability, is not an intrinsic feature of an ideal normative conception of justice. But it is a desideratum, and an important one, when pragmatically implementing a theory of justice. See Vandenbroucke (2001) for a further elaboration of this last point.

How might a three-generation household faced with the prospect of demographic ageing but committed to inter-generational risk sharing resolve this dilemma? Assuming they are satisfied with the status quo (current consumption levels of the generations relative to one another are neither too high or too low), the solution would undoubtedly approximate the fixed ratio or fixed relative position (FRP) model advocated by Musgrave (1986, Chapter 7).[98] Contributions and benefits are set so as to hold *constant* the ratio of per capita earnings of those in the working population (net of contributions) to the per capita benefits (net of taxes) of retirees. Once the ratio is fixed, the tax rate is adjusted periodically to reflect both population and productivity changes. Like the fixed contribution method it obviates the need for projections but allows for proportional sharing of risk. As the population ages, the tax rate rises but benefits also fall so that both parties "lose" at the same rate (i.e. both net earnings and benefits rise more slowly than they would in the absence of population ageing). [99]

French second tier pensions (AGIRC, ARRCO) come closest to approximating the Musgrave solution. In theory, second tier French pensions were designed as fixed contribution schemes.[100] In practice, however, plan administrators have discretion to adjust either benefits or contributions and thus can (and do) mediate regularly between the interests of contributors and beneficiaries (Reynaud, 1995). Though not intended as such, the plan's design would allow it to be run along the lines of a "fixed relative position" plan.[101] Basic security plans that provide a minimum guaranteed benefit indexed to (net) wages can also be thought of as providing a "fixed relative position" for less affluent retirees.

[98] The FRP principle, however, would not satisfy a concept of fairness defined by the notion that each generation ought to pay the same proportion of salary to get the same level of pension rights during retirement. On a three generational "family farm," for example, the *share* or proportion of output required to support aging parents in retirement under FRP will be larger when there are two producers in the working age generation than when there are four.

[99] An alternative to a fixed replacement rate is a pay-as-you-go design based on a fixed contribution rate (FCR). The working population is required to contribute a fixed fraction of its income for the support of retirees. In this design, taxes drive benefits so that benefits are the dependent variable. As the ratio of retirees to workers rises, benefits must decline and *all of the costs associated with demographic change fall on retirees*.

[100] For purposes of this discussion it is important to recall that we are describing a fixed contribution model in a *pay-as-you-go* design, not to be confused with a fixed contribution model in a funded scheme where benefits reflect contributions plus (or minus) realized gains (or losses) on invested contributions.

[101] For a review of recent patterns of reform see Moore (2000).

The FRP principle says nothing about what the relative position of retirees to workers and their dependants *should* be. It simply provides a rule for allocating the costs of demographic change between the generations *once* an acceptable ratio is established.[102] From the perspective of multi-generational household facing the prospect of fewer workers and more retirees in the near future, it reflects a joint commitment to maintaining the status quo in relative terms. Just as pension benefits were indexed so that wages and benefits would rise together with increases in productivity, so too FRP in essence "indexes" *both* contributions and benefits to population ageing.[103]

Our hypothetical three-generation household confronting a loss of production next year due to the retirement of one of its members, and with no near term prospect of a replacement due to past changes in fertility, faces a point-in-time decision concerning the allocation of costs between generations already alive. Such a situation is very close to the real life political choices facing policy-makers both now and in the future: Should they raise payroll taxes on younger workers, reduce benefits for retired workers (or those about to retire) or some combination of the two? This perspective is useful since all politics is, in an important sense, "point-in-time" politics, i.e. in the hands of those currently alive. If payroll taxes rise significantly relative to pension benefits for retirees (the FRR solution), they can anticipate the displeasure of workers and their employers. If, alternatively, real benefits are falling year after year relative to national living standards (the FCR solution) retirees (and those near retirement) will be unhappy. As importantly, working-age contributors will lose confidence in a contributory system that promises them very little in their own old age or at least considerably less than they are providing for current retirees. Musgrave's rationale for adoption of the FRP model is that neither of the alternatives, FRR or FCR, are *politically* sustainable under conditions of population ageing. They are based, in his terms (1986: 109), on an intergenerational contract that cannot be kept or at least generates great uncertainty about its future. The result is the sense of "injustice" and cynicism rampant among

[102] It should be clear that implementation of FRP does not preclude passing judgement on the current distribution (e.g. that it is too high or too low), making adjustments accordingly, and applying FRP thereafter.

[103] Hence, the FRP design can be distinguished from solutions that index benefits but not contributions to the higher retirement costs that result from increased longevity, the latter being essentially an FCR strategy. See also footnote 20.

many young adults over being required to contribute to a system that “won’t be there for me.”

As Musgrave (1986: 107-108) also observes, however, absent intergenerational solidarity successive “self-interested” cohorts *might* make choices that depart from the FRP design. Thus, for those entering the labour force with foreknowledge that the population is ageing, a “self-interested” response from a cohort concerned mainly with its immediate living standards (i.e. myopic choice) might lead to the preference for a model approximating the Fixed Contribution Rate since their contribution rates would not rise during their working years. These preferences, however, would change as the cohort ages and approaches retirement since now they would face an impoverished old age relative to earlier retiree cohorts. Accordingly, it is helpful to consider the implications of the three designs from the point of view of the *entire* life course of cohorts born in the future, the legacy that we will leave to our great-grandchildren.

Assuming no change in productivity, under FRC the living standards of future generations would be preserved during childhood and over their working years but they would experience a sharp decline in living standards in retirement. Under FRR, in contrast, successive cohorts would experience declining living standards in childhood and during the working years but a relatively affluent old age. FRP, in contrast, effectively smoothes the change across the entire life course and in relative terms maintains the status quo with respect to the lifetime distribution of income. In this respect, FRP is a conservative strategy based on the assumption that, on average, the lifetime distribution of income available to current generations should be preserved more or less intact into the future. Future generations may of course disagree with our judgements and conclude they want a different allocation of income over the life course. It would seem presumptuous, however, for the current generation to “lock in” future generations in advance by adopting either the FRC or the FRR design.

Under FRP, taxes/contributions will undoubtedly increase as a result of demographic ageing, though less quickly than under the FRR design. Thus the FRP principle runs counter to the notion that a “hard budget line” should be established for contribution levels or that there is an upper (“acceptable”) limit to tax levels associated with “sound public finance”. Implicitly, the assumption of an “upper limit” implies a level of taxation that will automatically trigger a general application of the FCR model ("no new taxes") in response to changes in the retirement dependency ratio. Thus far empirical evidence and historical experience makes us sceptical or at least agnostic concerning claims that there are "natural" limits to taxation levels that can be known *a priori*. Consequently, we see no sound reason for "locking in" specific upper limits as long-term policy targets and should leave such a determination to future generations consistent with Objective #10 (making pension systems more flexible in the face of societal change). As taken up below, however, we do think there is good reason for reconsidering the *mix* of taxes used to finance pay-as-you-go pension schemes.

In a dynamic context of change, "fixed replacement" (FRR), "fixed contribution" (FCR), and "fixed relative position" (FRP) can be thought of as alternative principles for the intergenerational allocation of the *change* in retirement costs attributable to changes in the retiree dependency ratio. Moreover, the choice of which principle is applied is a matter of degree. The choice is a normative one that will be determined via "politics" and it is conceivable, perhaps even desirable, that the mix of choices might change over time in response to changing circumstances. [104] We will assume, however, the FRP principle is the benchmark or litmus test for intergenerational equity, placing the burden of proof on the would-be reformer who would allocate the costs that result from demographic change in ways that depart from FRP.

One reason for expecting future departures from the FRP design in the organization of *pension* systems is because it is framed entirely in income terms, not in terms of total consumption (as specified in our earlier accounting identity). Thus, for example, the expected rise in the costs for elder care in future (see below) could warrant corresponding adjustments to either pension contributions or pension benefits depending on how such care is financed.[105]

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[104] The choice of principles might well vary according to the *source* of change in retirement costs. Thus, the FRP principle might be applied to distribute the costs that result from "demographic change" (i.e. past changes in fertility) while the FCR principle might be adopted to accommodate any decline in retirement ages and some mix of the two to changes that result from greater longevity.

[105] As discussed below, rising care costs for the frail elderly are substantially driven by gains in longevity. This raises the difficult issue of whether the rise in retirement costs that results from greater longevity should be allocated in the same fashion as those that result from changes in fertility? Since gains in longevity benefits all future generations, and younger cohorts more than older cohorts, it is not clear why such costs should be exempt from the FRP principle.

The task for policy officials is to provide the appropriate accounting frameworks so that the inter-generational allocation of costs associated with any *specific* reform is transparent to the political process. As noted above, a full accounting scheme of the allocation of retirement costs among the working and retired populations requires inclusion of both the public and private side of the national ledger. Thus, when policy changes intended to induce greater personal saving for retirement are made, the intended (or likely) effect of such change on the intergenerational allocation of retirement costs (including the possibility that retirement costs could rise) need to be established. As Osberg (1998: 135) concludes, policy models that assume there is no linkage between generations *except through the state* bear little resemblance to empirical reality.

Though we have elaborated our discussion within the context of a national pay-as-you-go design, it is important to highlight that the choice of allocative principles is independent of the financing mechanism in mandatory schemes. Many large corporate sector ("second tier") *funded* schemes have long been run along fixed replacement (defined benefit) as well defined contribution lines through the use of reserve funds to smooth out temporal fluctuations in returns. Several member states (and Canada) have been adding partial advance funding to finance existing defined benefit schemes. In a similar way, funded mandatory schemes can be designed to satisfy the FRP principle. The risks in second tier plans, as in corporate defined benefit plans, arise from uneven demographic changes across expanding and declining industries and firms.[106]

Discussions of *intergenerational* "equity" must always return to two fundamental points often ignored in such discussions (Osberg, 1998). First, the aggregate well being of future generations depends primarily on the quality and quantity of the stock of productive assets (including human capital) they inherit, not on the design of pension systems. In this sense, providing an appropriate legacy for a working age population faced with population ageing hinges more critically on the issues taken up in chapters

[106] It is for this reason that mandatory schemes designed along corporatist lines with different plans for different occupational or industrial sectors (e.g. miners) have tended to be consolidated over time.

one and two of this report than on pension reform.[107] Second, the relative size of economic differences *between* generations pales in comparison to those that exist *within* generations and it is to this topic that we turn next.

Intragenerational Justice

The *intergenerational* dilemma is compounded by at least three *intragenerational* dilemmas, one among retirees (beneficiaries), a second among the working age population (contributors), and a third by the gender divide within generations.

When Pension Systems Contract: Intragenerational Justice among the Retired

The problem on the benefit side (i.e. among the retired) can be highlighted by comparing a pension system that is expanding with one that is contracting. Expansion/contraction can take two forms: (a) an increase or decrease in the number of years of retirement; and (b) an increase or decrease in the benefits received during retirement. When retirement ages are falling, the social welfare "gains" in additional leisure and free time tend to go disproportionately to the least well off. An additional year of retirement, for example, represents a larger proportional gain for someone with a seven-year life expectancy than for someone with a 12-year life expectancy. But the reverse is also true: an additional year of employment represents a proportionately greater loss for those with shorter life expectancies. Raising the retirement age for public sector benefits has the largest effect on those without sufficient means to finance early retirement on their own and the least impact on those who do. Since health (life expectancy, disability) and wealth tend to be correlated, the equity problem is compounded.

As with changes in the retirement age, the more disadvantaged tend to gain most when income security benefits are expanding since they are less able or likely to provide income security for themselves. But, conversely, they stand to lose the most when income security systems are contracting. The standard result from studies of savings behaviour is that the savings to permanent income ratio rises with permanent income

[107] As Osberg (1998:132) writes: "Future generations will have to combine their own labour power with the physical capital, human capital, environmental resources, and social capital left to them by previous generations…. Hence, in analysing issues of intergenerational equity, it is crucial to measure accurately trends in these stocks."

and does so in a sharply non-linear fashion (Diamond and Hausman, 1984). The implication, then, is that behavioural response to lower mandatory pensions will be a function of income level: low-income families are less likely to compensate with more savings than high-income families. If the costs of population ageing are to be transferred to retirees, how can this be done so that they do not fall disproportionately on the least advantaged among the elderly? We return to this issue in part two where, drawing on recent pension reform experience, *we propose a larger role for selective inter-personal transfers in traditional contributory schemes*.

Financing Pensions: Intragenerational Justice Among the Working Population

On the contribution side, pay-as-you-go pensions are financed with a tax on wage income – the payroll tax – while income from capital and transfers are exempt.[108] The payroll tax is a flat tax, often with a wage ceiling that makes it regressive. Unlike income taxes, there are no exemptions and no allowances for family size. Low wage workers and especially younger families with children typically bear a disproportionate share of the cost as a result. These effects are potentially compounded to the extent that high payroll taxes discourage employment, especially at the lower end of the labour market where the social safety net, minimum wages, or industrial relations systems make it difficult for employers to pass such costs on to employees. In effect, charging the costs of the transition to the working age population via a payroll tax creates a huge problem of *intragenerational* equity among the working age population since the distribution of the additional costs in no way reflects ability to pay. Accordingly, in part two, *we propose a larger role for general revenue financing in contributory plans*.

Pensions and the Gender Contract

The final, if often unrecognised, dilemma facing policy-makers arises from the closely related socio-demographic correlate of population ageing, namely the revolution in gender relations and family structure in the second half of the 21st century. The decline in fertility levels that generates an ageing population is simultaneously cause and effect

[108] For purposes of this discussion, we adopt the standard assumption that payroll taxes, even when borne by the employer, are additions to labour costs which are ultimately born by labour typically in the form of lower wages.

of the dramatic increase in women's labour force participation since mid-century. Nevertheless, despite the fact that the male breadwinner family model is quickly disappearing into the mists of history, the gendered character of the intergenerational contract remains largely intact (Street and Ginn, 2001). Although dual-earner families are now the norm, women continue to bear most of the burden of reproducing and caring for the next generation and providing care for the older generation. Moreover, as Orloff (2000:3) observes, issues of gender and care-giving have become central in the contemporary period not only for reasons of gender equality but also because of their broader implications for the economy and the reproduction of the population. As a variety of EU documents highlight, the financial viability of the welfare state in the 21st century depends critically on both the revenues generated by high levels of women's labour force participation, on the one hand, and their willingness to reproduce the next generation, on the other. Working age families but primarily daughters (and daughters-in-law) are also major providers of elder care, work that generates considerable public savings in long-term care provision (Wolf, 1999). Declining fertility creates not only a larger pool of elders requiring care but also concentrates this burden on a diminished pool of potential care providers who are also more likely to be employed than in the past.

Population ageing, then, pushes issues of gender equality and gender equity to the forefront of the policy agenda of the 21st century for material not just normative reasons. Women's labour provides the social fuel that drives post-industrial economies and the ageing society that they sustain. Women workers and dual-earner families face a different set of risks and bring a new set of interests both to the bargaining table and the public policy agenda.

Women's claims for equal access to retirement benefits are essentially claims against the incomplete democratisation of retirement, for substantive not just formal equality, for retirement rights that attach to them as persons, not simply in their capacity as dependent spouses.

Equalising retirement benefits between the sexes dramatically illustrates the principle that good pensions begin at birth. Modern retirement is based on a lifetime of accumulating retirement "wealth" whether in the form of public benefits or private savings. Not surprisingly, then, proposals aimed at equalising *retirement* opportunities typically emphasise policies that equalise *labour market* opportunities (e.g. day care provision) for men and women during their working lives as much or more than policies aimed at the design or redesign of pension formulae (Ginn, Street and Arber, 2001). Nevertheless, issues of gender equality and gender equity loom large in the redesign of pensions for an ageing society.[109] Since women typically have lower lifetime earnings and longer life expectancies than men, they also depend more on public pension income in old age in most countries and tend to be disproportionately affected by reforms that reduce or restructure public sector benefits.

All of this implies two additional litmus tests for evaluating policy redesign for an ageing society. On the one hand, achieving gender *equality* requires policies and incentives that lead to the reallocation of caring work within families (i.e. between men and women) and between families and the public sector. And, on the other, gender *equity* requires acknowledgement and compensation for persistent gender *differences* in the allocation of such work.

Enhancing gender equality in retirement primarily involves enhancing gender equality over the working life. The EU has acknowledged that greater gender equality is a *sine qua non* for raising female employment levels, a topic pursued in detail in other sections of this report. *Here, we highlight the special importance of bringing the care of the frail elderly to the centre of the policy agenda to achieve this objective.* The rising numbers of frail elderly requiring assistance is one of major costs of population ageing, a cost that has traditionally been absorbed in the informal sector by daughters and daughters-in-law. Not only will their numbers decline relative to the increased demand but also they are more likely to remain employed if EU employment objectives for women are realized.

[109] Issues of pension design that are especially salient for women include: 1/ full access to earnings-related pensions for low-wage and part-time employees; 2/ elimination of minimum contribution periods as a criterion of eligibility and immediate vesting of contribution-based entitlements; 3/ enhanced child and elder care credits; 4/ credit-splitting of retirement benefits between spouses.

3.4 Redesigning the Retirement Contract

Pressures for Reform

As the pension systems put in place from the 50s through the 70s began to mature in the 80s and the 90s, policy-makers in all of the large pay-as-you-go countries set about an active agenda of reform that has not come to an end. Paradoxically, as we shall see, the trend in countries that had *not* developed large, earnings-related, pay-as-you-go schemes by 1980 was expansionary, albeit adopting a rather different design.

The model of choice for the large earnings-related programs that were created or expanded from the fifties through the seventies was the now familiar pay-as-you-go defined benefit model. Benefits would be calculated on the basis of some combination of the retiring worker's earnings history and employment history. They would be financed from revenues collected from today's workers via a payroll tax. [110]

> For the reformers of the period, the pay-as-you-go model provided a number of advantages, both financial and political. The financial viability of the pay-as-you-go design is typically framed by comparing implicit rates of return in a pay-as-you-go scheme to its major alternative, advance funding in a capitalized scheme in which contributions are invested and benefits financed from returns on investments. The return in the advance funded model depends on long term rates of return to capital (real interest rates). The implicit rate of return in schemes financed by payroll taxes is the annual percentage growth in total real wages (returns to labour). Total wages are the product of the average wage multiplied by the number of wage earners. The latter term is a function of population growth and the rate of labour force participation. Quite simply, then, the financial soundness of the pay-as-you-go design depends on high fertility and labour force growth, high rates of labour force participation, and strong real wage growth.

[110] In the start-up phase, a few countries (Canada, Sweden) adopted some measure of advance funding by investing surplus revenues to create future flows of revenue but these "investments" declined as the plans matured. Others provided for some measure of general revenue financing to meet unexpected shortfalls or to subsidize some forms of inter-personal transfers ("unearned benefits") but payroll taxes provided the bulk of the revenue.

Given the values of these parameters in the 1950s and 1960s -- rising wages and a growing workforce – and absent a demographic crystal ball, most treasury officials would have (sensibly) advised their ministers to opt for a pay-as-you-go design. Pay-as-you-go also pre-empted objections to state control over large capital pools and sidestepped widespread public distrust of capitalized pension schemes in countries where depression and war had devastated pension funds in the first half of the century. Furthermore, pay-as-you-go systems offered enormous "front-end" political and social benefits during the initial phase-in period. Since there was no preceding generation of entitled pensioners, politicians could immediately offer a potent combination of modest payroll taxes, generous promises of future pensions and, importantly, address rampant old age poverty immediately rather than waiting for the plan maturation required of an advance funded design. By the 1990s everything had changed. Figures for Canada are illustrative (Table 2).[112]

TABLE 2. REAL GROWTH IN TOTAL WAGES AND SALARIES AND REAL INTEREST RATES, CANADA, 1960S-1990S

	1960-69	1970-79	1980-89	1990-94
Real Growth in Total wages and salaries	5.1	4.8	2.1	0.0
Real Interest Rates	2.4	3.6	6.3	4.6

Source: Canada. 1996. *An Information Paper for Consultations on the Canada Pension Plan*. Ottawa: Department of Finance

Clearly by the end of the eighties a "sensible" treasury official would be advising her minister that the model put in place in the sixties was in difficulty. The conditions that favoured the pay-as-you-go design in the 1960s – strong labour force and real wage growth – had evaporated as a result of declining fertility, relative economic stagnation and high rates of unemployment. To meet future obligations, payroll taxes on current

[112] Similar, if less graphic, illustrations for selected European nations can be found in Davis (1995:37)

workers would rise inexorably into the future. In the context of relatively slow real wage growth and high levels of unemployment, the downward pressure on take-home pay created an inter-generational dilemma for trade union leaders as well as for employers and treasury officials.

> For good or for bad, a wholesale shift from pay-as-you-go to advance funding was not an option for most pay-as-you-go countries by the 1990s. Once mature, a pay-as-you-go scheme acquires a large implicit debt reflecting benefits owed to current retirees and those already earned by current workers. Over some period of time, contributors (or taxpayers) must pay twice: once to fund their own pensions and again to fund the large implicit debt built up by the existing pay-as-you-go design. Analyses of the transition costs for the major industrial countries show that the costs of servicing this debt is likely to be greater than the cost of establishing sustainable contribution rates under their pay-as-you-go pension plans (Thompson, 1998:128). To solve the public finance problem, these nations set about revising benefit formulas, financing mechanisms, and related reforms aimed at containing the growth in contribution rates that would otherwise occur. Public sector reform was often accompanied by reforms aimed at facilitating and encouraging a larger private sector share in future retirement incomes.

The pattern in another set of countries -- the “latecomers” – was rather different. These were countries that had developed no, or only modest, earnings-related pay-as-you-go schemes by 1980 and included Australia, Denmark, Ireland, the Netherlands, New Zealand and Switzerland. With the exceptions of Ireland and New Zealand, the trend among these countries since 1980 was toward pension *expansion* by means of growing coverage of employer pensions based largely on advance funding rather than pay-as-you-go financing. Switzerland and Australia introduced mandatory, advance funded, defined contribution plans for the whole of the labour market in 1985 and 1992, respectively. Denmark and the Netherlands reached the same outcome – quasi-universal employer plans – at the bargaining table.[113] The U.K. joined this group in the 1980s when participation in SERPS was made optional and employees were allowed to

[113] Danish plans are defined contribution while Dutch plans are typically defined benefit.

"contract out" of the public scheme. The U.K. was a quasi-latecomer, introducing its earnings-related pay-as-you-go scheme only in 1978 so that by the mid-eighties the implicit debt to be financed was comparatively modest.

In large measure, the latecomer countries, by adopting advance funding and (typically) defined contribution designs have avoided the *public finance* problems induced by population ageing but not the larger economic challenge. As these plans mature, the economic costs of supporting the retired will increasingly occur off budget but will be no less real. Reforms in the large pay-as-you-go countries aimed at reducing public sector costs by encouraging private sector alternatives will have a similar impact. Whether or not private sector advance funded plans also alter the economic cost of supporting the retired depends on their impact on one or other of the three ratios in the accounting equation presented earlier.

1. *Total production: If* advance funding raises the level of savings and investment, then total production may rise, and everyone enjoys higher living standards with no change in the consumption ratio. The economic literature is generally agnostic about such an outcome, however, since additional pension savings tend to displace other forms of saving.
2. If advance funding, as is often claimed, provides contributors with a higher rate of return than pay-as-you-go alternatives, then the living standards ratio will rise and total retirement costs also rise as a result. In periods when investments perform poorly, benefits will decline and retirement costs will fall.
3. Depending on fund performance, "lucky" generations will be able to retire sooner and retirement costs will rise; the reverse situation is likely for cohorts whose funds perform poorly.

The main lesson is that meeting policy objectives such as ensuring inter-generational fairness or maintaining solidarity within generations cannot be achieved without considering the retirement income system as a whole (the public and the private side of the national ledger). The average effect of an increase or decrease in retirement costs on the working age population is the same regardless of which financing mechanism is used.[114] Public sector costs in the United States are low relative to say Sweden but total retirement costs are undoubtedly higher. *Average* relative incomes of U.S. retirees are somewhat higher than in most European nations (Hauser, 1997) and health care costs are also greater.

Shifting retirement costs off the public budget does not imply politics and policy-making become irrelevant. In the "latecomer" countries, for example, future pension politics will focus less on the role of the state in "taxing and spending" and more on its role as market regulator and to provide remedies for "market failure." Similarly, regulatory policy will rise in importance in the traditional pay-as-you-go countries as initiatives to encourage expansion of second and third tier pensions begin to have effect. *Thus, the development of appropriate regulatory frameworks for second and third tier plans designed to ensure that the objectives of pension reform adopted by the Commission are met should be considered a matter of utmost priority.*

For the pay-as-you-go countries, the main target of pension reform in the 90s was to slow or freeze the rate of growth in payroll contribution rates. This aim is most dramatically represented by reforms aimed at imposing a "hard" budget line on future benefits so that, post reform, payroll taxes stabilise at a fixed level. Prior to reform, Swedish contribution rates were projected to rise from 17-18% to 24-30% in the next century. The reform aims to stabilise the contribution rate at 18.5% (Palmer 1998: 30). In Germany contribution rates were projected to rise from 22% to 36% between 2000 and 2030. The cumulative impact of reforms since 1992 stabilises the rate at approximately 22 percent (Schmael 1998).[115]

In our imaginary world where all of the consumption of retirees is financed by payroll contributions, retirement ages remain fixed and the population is ageing, putting a brake on contribution rates, as we have highlighted, places all of the costs of population ageing on the elderly and, by definition, their relative living standards must decline. The

[114] The numerous "myths" surrounding the supposed advantages of funded individual accounts have been examined (and exploded) by Orszag and Stiglitz (1999) and Thompson (1998) and we do not pursue these issues further here.

[115] In Italy, Germany and Sweden an important strategy in this regard is the introduction of a "notional accounts" design that transfers the risk of future demographic change from contributors to beneficiaries. These include indexing future benefits to increases in longevity or to future GDP growth.

potential result is a world more akin to the situation of the elderly of the 1950s than of the 1990s. Fortunately, the real world is more complex. Redesigning the retirement contract requires consideration of the three major components of the retirement income system: the age of retirement, the benefit structure and the method of financing retirement incomes. We consider each in turn.

Working Longer

Among public policy-makers (see OECD, 1998, 2000), though not necessarily their publics, there is considerable enthusiasm for solutions that keep workers in the labour force longer thereby reducing the retiree dependency ratio (see also the Commission's proposed Objectives #3 and #4). There is good reason for this enthusiasm. The three main reasons why workers exit from the labour market at advanced ages are health, wealth and labour market redundancy. Trends for two of the three suggest considerable optimism that future cohorts could retire later. The "good news" about growing old in the 21st century includes:

- *Increased longevity.* People are living longer which adds to the cost of retirement pensions but also means that somewhat later retirement will not reduce the number of years the average person will have to enjoy retirement.
- *Improved health status*: In general, the health of persons in their sixties has been rising. There is greater reported prevalence of some chronic illnesses (heart disease, hypertension) in older cohorts since these diseases are less likely to lead early death than in the past but the numbers reporting significant activity limitation has declined substantially (Pransky, 2001).
- *Changing Work Conditions*: New technologies and post-industrial job structures have reduced the number of jobs requiring strenuous physical effort (Manton and Stollard, 1994).
- *Rising educational and literacy levels* among younger cohorts should reduce one of the major barriers to continued employment among older workers and improve the likelihood of successful retraining at advanced ages.
- *Changes in labour demand:* Perhaps the strongest force working in favour of later retirement ages in the coming decades is the effect of population ageing on labour

> demand. Slower labour force growth drives up capital-labour ratios so that real wages tend to rise and interest rates to fall. Higher real wages create incentives to remain in employment. Lower interest rates reduce income flows from retirement savings. Under these conditions, healthier and more skilled workers faced with an age-neutral pension regime may increasingly "choose" to remain at work longer and employers to adapt employment conditions to be more "friendly" for older workers.

Given these favourable conditions for an extended working life, the case can also be made that the result of later retirement may be more benign than its alternative, namely reducing the living standards of retirees. If the labour market is able to generate sufficient employment to absorb older workers, a potential payoff is greater economic growth and higher living standards for all.

The European Council in Lisbon made a commitment to adopting macro-economic policies and structural reforms to enhance employment levels in general and among older workers in particular, setting a specific target of a 50% employment rate for women and men aged 55-64 by 2010. It is widely recognised that a key ingredient in meeting such targets are steps to raise female employment including measures to achieve greater equality in the labour market, better child and elder care support, and flexible work schedules. Equally important are efforts to enhance work quality (chapter 2) so as to make the employment option more attractive to older workers. Member states are also well aware of the importance of eliminating disincentives to continued employment and "making work pay" at more advanced ages.

Reversing the Downward Spiral: The Culture of Early Exit

In many countries, labour market conditions in the 1970s led to the view that early labour market exit by older workers was a socially and economically acceptable alternative to high unemployment among younger workers. Pension systems often became used as pseudo unemployment schemes and unemployment and disability schemes as pseudo pension plans. The result, as Guillemard (2001) highlights, was a downward spiral in the expectations and practises of both firms and workers. Both employers and workers began to view age 55 as a "normal" age for definitive withdrawal and those beyond 55 as essentially redundant and unemployable. The results "ricocheted" onto workers in their forties and early fifties as they became defined as employees "on their way out," workers without a future and hence inappropriate targets for retraining.

What is striking about such changes is the speed with which they became institutionalised. Rather than being viewed as a temporary stopgap measure (e.g., to respond to cyclical downturns in the economy), the introduction of early exit options quickly became established as a permanent "structural" shift by both sides to the labour contract. For many, the phrase popularised by a large Canadian firm to market financial services to older workers -- "*Freedom 55*" – became the new standard for "successful" completion of the economic life course. As Guillemard observes, altering such norms takes more than just reducing incentives for early exit but also requires creating positive incentives (for both employers and workers) to extend employment beyond the expected retirement date since both sides tend to develop large sunk costs, social as well as economic, around expected retirement timetables.[116] If, as anticipated, labour demand rises in the 21st century as a result of population ageing, the market may deliver these incentives. Guillemard, however, notes that both the Netherlands and Finland have had success in reversing the trend to early retirement not just by closing off (or narrowing) "pathways" to early exit but also by opening up new pathways for continued employment.[117]

Regulating Access to Retirement Wealth

The most powerful force driving early exit from the labour market – economic growth – is also benign but works in the opposite direction, that is to encourage retirement. As Burtless and Quinn (2001: 385) conclude, the "…simplest and probably most powerful explanation for earlier retirement is rising wealth." National GDP in the affluent democracies has grown dramatically in the last half

[116] Workers develop "life plans" in anticipation of retirement that involve career, financial and housing decisions that may affect not only them but younger family members as well. Firms develop recruitment, training, personnel and wage strategies based on assumptions about probable rates of exit.

[117] In the Netherlands, Guillemard (2001:6) notes, not only have benefits for disability been reduced, access to benefits also now depends on employee rehabilitation.

> century and some of this increase has been used to purchase more leisure. Moreover, while working years and working hours have declined for individual workers, for families they have risen, the result of higher women's participation. The increase in "family" years and hours worked helps pay for more years of retirement. For future cohorts, the same factors that make work possible to more advanced ages – better health and education – along with productivity gains will help compound the wealth effect: they will earn more and accumulate their wealth sooner. Future gains in female employment will add to this effect.

In nations where most pension "wealth" is stored up inside public pay-as-you-go retirement schemes, policy-makers have considerable discretion over the age at which individuals can gain access to it. The standard (or normal) retirement age at which people become eligible for full benefits has little impact on actual retirement ages while the minimum eligibility age has strong effects (OECD, 1998:44). Where public sector benefits provide a smaller share of retirement income, and second and third pillar schemes are important (e.g. the U.K.), the effects of raising the age of entitlement inside *public* plans may be more modest and even perverse for both distributive and macroeconomic reasons.

In the U.S., where public sector benefits provide a comparatively small (about 40%) share of retirement income, most studies conclude that even large changes in Social Security rules regarding the retirement age cause only small changes in the actual retirement age (Burtless and Quinn, 2001:405). Higher income earners with greater pension and private wealth outside Social Security are particularly immune to such changes.

There is considerable variation in this regard. High-income pensioners in Canada, Japan, the Netherlands and the U.S. receive less than 10 percent of their income from public sources and, in Britain, just over 10%. In Italy the figure is about 50 percent and in Germany and Sweden between 60 and 70 percent (OECD, 2000:44). In Canada, where high income groups depend largely on second and third tier pensions for retirement income there is a much higher level of early retirement (before age 60) among professional and managerial than among less well paid occupations (Schellenberg, 1994: 22-23). In Germany, by contrast, workers in higher status occupations are less likely to retire early than employees in lower status occupations (Kohli, 1995).

The implication is that intragenerational equity requires identical rules regulating the age of access to pension wealth in all three tiers of the pension system, especially where second and third tier pensions are already large or will acquire greater importance in the future. Where co-ordination does not take place, there are likely to be undesirable macroeconomic effects as well. The largest gains to the economy are to be had if the most productive workers (the healthy, well educated, and presumably better paid) remain in employment longer. Reform can have a potentially perverse effect if changes to retirement incentives in public sector plans mainly affect lower wage, low productivity workers.

In the more market-oriented pension regimes of the Anglo-Saxon countries and Ireland, future trends in the retirement age, not surprisingly, depend largely on regulating access to second and third tier pensions. Raising employment incentives inside *public* schemes will have modest effects and mainly impact lower wage earners that receive a larger share of their retirement income from the public budget. For Ireland and the U.K., the two EU countries among this group, the fiscal (i.e. public finance) impact of population ageing is modest or negligible in any event. In these nations, raising the average retirement age for higher income employees depends more on co-ordinating the age of access to employer plans and personal retirement savings with public sector plans, a topic to which we return below.

Policy co-ordination among public and private sectors will also grow in importance in other member states, particularly in Denmark and the Netherlands in the 21st century as the quasi-universal employer plans negotiated by the social partners in the 1980s come to maturity.

The *fiscal* (public finance) challenge posed by population ageing is greatest, however, in the remaining EU countries where large “encompassing” pay-as-you-go defined benefit plans were created to provide the vast majority of retirement income not only to those with modest incomes but to middle and upper-middle earners as well. Indeed, in many nations, public provision for the “middle classes” came first (e.g. for public sector, mainly white collar and professional, employees) and pension reform in the post-war decades was an effort by industrial workers to "catch up." The upshot, however, is that governments in these countries also have the greatest capacity for regulating retirement ages across the whole of the labour market, for upper as well as low income earners. Public sector changes also have greater impact on total retirement costs.

Making Work Pay

Traditionally, defined benefit schemes, both public and private, strongly biased the labour-leisure trade-off in favour of the latter. Defined benefit formulas typically set a maximum contribution period after which additional contributions bring no further gains in retirement benefits. This fact has been widely recognised and reform initiatives in many countries have been aimed at "making work pay" by taking steps to make pension formula increasingly age-neutral with respect to choosing retirement over continued employment.

Other reforms in the large pay-as-you-go countries during the nineties have included raising the normal retirement age in countries where it was traditionally quite low (Italy), harmonising retirement ages between men and women, and reducing benefits for those retiring before the normal retirement age, and steps to make defined benefits more age neutral.

Protecting the Least Advantaged

The challenge, of course, is to ensure that the social welfare losses (reductions in leisure time) associated with these reforms do not disproportionately affect the least advantaged, those with shorter life expectancy and low-income workers (who are often the same people). While average health status is rising among older workers, it is still the case that the proportion that is disabled rises as a cohort ages.[118] Retirement pensions are clearly a blunt instrument for dealing with the disabled minority. However, they obviate the need for, and the administrative costs of, a carefully tuned system able to identify the "truly" impaired. Meeting this challenge requires the bureaucratic and technical capacity to administer early retirement schemes for reasons of disability and labour market redundancy that are fair and perceived to be so by the larger community. The other side of an active labour market strategy aimed at reversing the "downward spiral" are better and more effective programs for the truly disabled and those whose "human capital" cannot be raised above the minimum level necessary for employment.

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[118] U.S. studies of recent Social Security recipients age 62-64 indicate that approximately 22% have impairments that prevent employment.

By definition and design, old age *insurance* is a mechanism that transfers income from those with shorter life expectancy to those with greater life expectancy.[119] The result as noted, earlier, is that falling retirement ages disproportionately benefit those with shorter life expectancies but the converse is true when retirement ages are rising. Since life expectancy is associated with economic status, old age *insurance* by definition creates an implicit transfer from the poor to the rich. Hence, this yields one clear rationale for compensating vertical transfers, a topic we turn to in the following section.

Redesigning Benefits: Intragenerational Justice among the Retired

Until the second half of the 20th century, public pension benefits reflected traditional assumptions of *social assistance* rather than contemporary notions of *social security.* Benefits were modest and aimed mainly at putting a floor under the declining wages of older workers and a modest income for their widows. Early post-war reforms hardly changed this. Where they existed, replacement rates in earnings-related public sector plans were modest. Beveridge-type reforms that introduced universal flat benefits for all, contained no notion of providing retired workers with an income sufficient to maintain pre-retirement living standards, i.e. *income security.* Germany in 1957 and Sweden in 1958 took the lead in this respect and, in varying degrees, most countries followed suit in the sixties and seventies. The aim of the new design was to provide retired workers with a retirement wage reflecting past earnings, a form of retirement insurance traditionally available only to civil servants and a minority of private sector workers through their employers. As shown in Chart 1, in most members state the average living standards of retiree population (pensioners) now differ little from the rest of the population despite differences in pension design, a result that would be reinforced if differences in home ownership among the old and the young were taken into account.[120]

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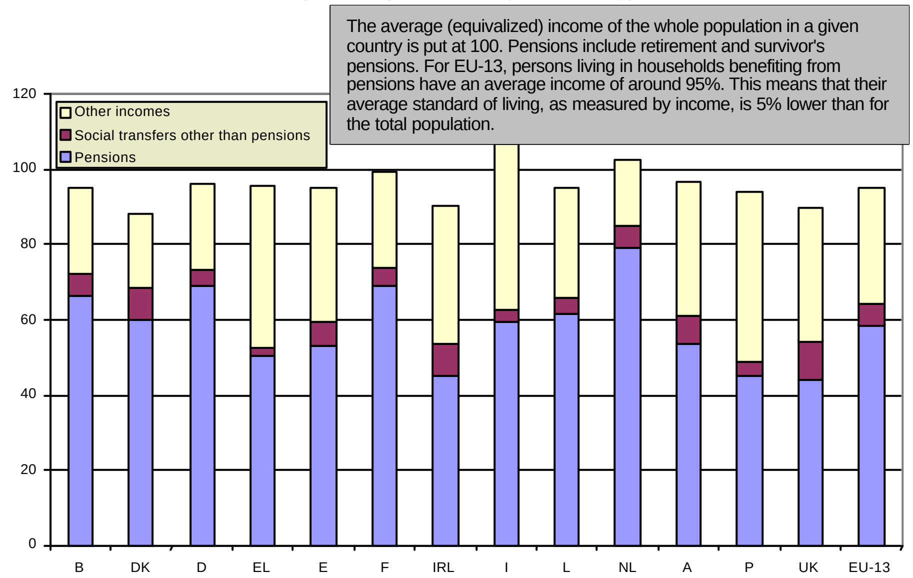
[119] In the United States, for example, it has long been noted that Social Security creates a transfer of wealth from blacks to whites.

[120] There is considerably more cross-national variation in the proportion of older persons who might be considered affluent relative to their nation-specific income distributions. LIS calculations for Italy, France, Spain and Germany show that between 30 and 34 percent of elderly households are in the top two population income quintiles. In Sweden and the U.K. the proportion is 23 percent and in Denmark and Finland 14 and 17 percent respectively.

Chart 1: Relative equivalised income of persons living in households receiving pensions **(100 = all persons in a given country)**



Source:Social Protection Committee on the Sustainability of Pensions. Brussels, May, 2001

The relative economic status of recent cohorts of retirees is not merely the result of better pensions, however. They also reflect cohort history. Today's seniors are the workers of the golden age. They have comparatively high incomes today because of relatively affluent work histories compared to earlier cohorts of old people whose adult lives were spent during depression and war. Moreover, current retirees have grown old in a period of slower real wage growth among the working age population. Had real wage growth during the past 25 years been like that of the previous 25, the elderly today would look less affluent simply because the incomes of the working age population would be much higher.

The lesson here is that the current economic situation of old people is an uncertain guide to what is good and what is bad about the current design of pension systems. It reflects not only the design of the pension system but also cohort specific life experiences. To anticipate the future we must make assumptions concerning: (a) what the economic history of today's workers will have been like when reach old age (relatively affluent or not); and (b) what the economic circumstances of the working age population in the future will be like.   How does one design a system to allocate the costs of population ageing in the face of such uncertainty. As we noted earlier, the criterion of Fixed Relative Position not only provides a benchmark for intergenerational equity but also has the advantage that it requires no assumptions about the future values of these parameters. The FRP principle essentially allows for inter-generational risk sharing to accommodate the varying fortunes of sequential generations.

Unlike, the traditional fixed replacement ratio design, however, FRP assumes that a share of these costs will be allocated to future pensioners – benefits will be lower than under the FRR design. This result raises issues of intragenerational justice among the retired: How to allocate these costs so that they are of greatest advantage (or the least disadvantage) to the least well off within the pensioner population?

Clearly, reforms that simply cut all pensioner benefits by a proportional amount (e.g. by reducing all pensions by 5 percent) do not satisfy this standard. Moreover, behavioural response to such reductions can be expected to increase inequality among the retired. The standard result from studies of savings behaviour is that the savings to permanent income ratio rises with permanent income and does so in a sharply non-linear fashion (Diamond and Hausman, 1984). The implication, then, is that behavioural response to reduced *mandatory* pensions will be a function of income level: lower income families are less likely to compensate with more *voluntary* retirement savings than higher income families.

The notion that the costs of restructuring should be born by those most able to afford it and the weakest members of society should be protected is hardly novel. But how to implement it? Here, we propose two forms of "targeting" benefits to meet this challenge drawn from the real world experience of Member States and other OECD nations.

Eliminating Old Age Poverty

Declining poverty rates among the elderly have been a distinguishing feature of all OECD countries since the 1960s. Old age poverty rates below 10 percent are now common and a number of countries have achieved rates of 5 percent or less (Hauser, 1997; Smeeding and Sullivan, 1998 and Table 3).

TABLE 3: POVERTY RATES AMONG THE POPULATION 65+, 1990s

<5%	**5%-9%**	**10%-14%**	**15%-19%**	**>20%**
Canada	Finland	Austria		Australia
Sweden	France	Belgium		U.S.
	Germany	Denmark		
	Luxembourg	Italy		
	Netherlands	Norway		
	Switzerland	Spain		
		U.K.		

Source: LIS Key Figures, Luxembourg Income Study, 2001

The most effective anti-poverty systems are not necessarily the most costly. Both high spending Sweden and low spending Canada achieve poverty rates of less than 5 percent (see also Smeeding and Sullivan, 1998) as a result of the fact that both provide guaranteed minimum benefits that raise the vast majority above standard "poverty lines." Canada provides a guaranteed annual income to the elderly and Sweden a guaranteed minimum pension. Both make benefits conditional on the presence or absence of other economic resources but in a way that departs significantly from traditional *means-tested* programs. To distinguish traditional means-testing from these modern variants it is useful to draw some distinctions.

a/ *Means-testing*: Individuals qualify for benefits on the basis of a test for both *income* and *assets,* requiring individuals to "spend" their way into poverty to qualify. Tax-back rates (the rate at which benefits are cut as other income rises) are typically high and can be in excess of 100%. Supplemental Security Income (SSI) in the United States is an example. Usually the aim is to restrict benefits to a small fraction of the population (the "poor"). Because of the intrusiveness of the means test, there is often considerable stigma attached to accepting benefits so that take up rates tend to be low.

b/ *Income-testing:* As the term suggests, income-testing is based on a test of income but not of assets so there is no requirement to spend oneself into poverty to qualify. Interest or dividends from investments are included in the test but not the underlying capital that generates the income. Tax-back rates are always *much* less than 100% so that benefits are not "for the poor alone" but often extend well into middle income groups, albeit at declining rates. The implicit model is closer to Milton Friedman's design for a negative income tax (NIT) or a guaranteed annual income (GAI) than traditional means-tests for the "poor" (see Myles and Pierson, 1997). Canada's *Guaranteed Income Supplement* for seniors is the exemplar. [121]

c/ *Pension-testing*, as practised in Sweden and Finland, is a yet more restricted type of test, including only income that comes from *public* pension programs in those countries. Unlike a Guaranteed Annual Income scheme, it functions to provide a Guaranteed Annual Pension. Individuals with earnings histories and contributions below the minimum, are provided with pension supplements on a sliding scale. Where all or most of the income of retirees comes from the public pension system, of course, the distinction between income and pension testing is merely a formal one.

Providing all citizens with a minimum guarantee above a poverty line indexed to national living standards is well within the reach of most member states since the poverty gap – the difference between family income and the poverty line – of the poor elderly is typically modest compared to that of working age families (see Table 4).

TABLE 4: THE COST OF ELIMINATING OLD AGE POVERTY, NATIONAL ACCOUNTS ESTIMATE, 1990S

Country (year)	Number of Poor HH's with old people (000's)	Poverty gap (local Currency)	Extra-cost as % of GDP
Canada (94)	118	1591	0.025
US (97)	5565.9	2931	0.201
Finland (95)	21.7	3708	0.015

[121] Every NIT model is defined by three parameters: the *guarantee level* (the level of benefit provided to people with no other income; the *tax-back rate* (the rate at which benefits are reduced as the recipient gains income); and the *break-even point* (the income level at which benefits disappear). A high guarantee level is desirable to provide people with adequate incomes and a low tax back rate is desirable to encourage people to work. But such a combination means that the break-even point is very high and so are the costs. In practice, virtually all NIT proposals are broken into two tiers in order to contain costs and to maintain work incentives. One tier is intended for people who are not expected to work (such as the elderly) with a high guarantee level, a high tax-back rate, and a low break-even level. The second tier, for those expected to work, typically has a lower tax-back rate, and a higher relative break-even point but a lower guarantee level.

Norway (95)	60.6	6612	0.043
Sweden (95)	27.2	10524	0.017
Netherlands (91)	36.9	5312	0.036
Germany (89)	633.8	3617	0.080
France (94)	664.1	8083	0.073

Notes: Extra cost as % of GDP = #poor households x poverty gap)/GDP. Estimates are based on the objective of bringing families containing persons 65+ above 50 percent of the median adjusted disposable income line. This exercise ignores the fact that this, in itself, will alter the overall distribution and, thus, also the median.
Source: LIS Databases and OECD National Accounts

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Providing retirees with a high guaranteed annual income or minimum pension is less problematic than providing such benefits to working age families since the issue of work incentives does not arise.[122] Over some range of the earnings distribution, a high guarantee level may have an impact on savings behaviour but this is likely to occur over a short time period, relatively late in the work career, when the impact of more or less savings on retirement income is known.

Building or enhancing generous basic security schemes with a minimum guarantee above the poverty line goes a long way toward addressing the multiple dilemmas facing pension reform outlined in part one. It establishes a floor beyond which the most disadvantaged pensioners bear *none* of the additional costs of population ageing and so meets at least a minimal requirement of intragenerational justice. Since a guaranteed annual income or minimum pension involves inter-personal redistribution, there is a strong case for general revenue (from income, consumption and other taxes) rather than payroll taxes as the source of financing. Payroll taxes impose all of the cost on the working age population with perverse distributional effects within the working age population. A large or rising share of general revenue financing provides a powerful tool for reallocating the costs of population ageing based on ability to pay among the retired as well as the working age population since, like the young, the old are also subject to income and consumption taxes.

[122] For working age families the level at which social benefits affect work incentives is a function of the wage distribution. When wage inequality in the lower tail of the distribution (e.g. when low wage workers earn about 40% of the median wage) a high guarantee level will have more disincentive effects than when wage inequality is more modest (e.g. where low wage workers earn about 70% of the median).

The cost of eliminating poverty among the elderly will be higher in nations with higher earnings inequality over the working life since there will be more retirees who are eligible for such benefits. One might think of these additional costs as an “inequality tax.” the cost of which must be calculated on the basis of one’s prior assumptions concerning the effects of wage inequality during the working life on employment and labour market flexibility.

The modern institution of retirement, however, rests on much more than a promise that retirees will not fall into “poverty.” Post-war retirement patterns reflect the development of institutions that promised much more, namely that the majority would be able to maintain living standards not unlike those reached during their working years.

All of this suggests that the main challenge raised by reduced public or mandatory benefits, in the presence of an adequate basic security scheme, is the probable impact on workers with average and below average earnings who under current provisions would have retirement incomes well above the guaranteed minimum. The challenge, moreover, is not gender neutral. The distribution of income security “losses” that can result from lower public pensions will have a greater impact on women since they typically have lower life-time earnings and longer life expectancies than men.

Rationalizing Redistribution In Earnings-Related Schemes

Although earnings-related pension schemes ostensibly reflect individual work histories and contributions, all systems have traditionally incorporated design features that produce significant inter-personal transfers and cross-subsidies. During the nineties, eliminating transfers and cross-subsidies that could be identified as “inequitable,” “perverse” or ”out-dated,” (such as special privileges for public employees) provided many Member States with an effective means of cost reduction. At the same time, however, it was also common to use some share of the savings to create new inter-personal transfers for risk groups now considered to have legitimate claims. This ”rationalisation” of redistributive design features to achieve equity or to more clearly realize socially desirable distributive outcomes offers policy-makers a potent tool for solving the Rawlsian problem among the non-poor.

A major feature of the Italian and Swedish reforms of the 1990s was the elimination of transfers that result from the use of final (or best) earnings formulas, a model that benefits workers with steep age-wage profiles or workers with fewer years of high earnings late in their career. Swedish pensions were traditionally calculated on the best 15 years. In Italy, the earnings record was based on the last 5 years for private sector workers and the *last year* for public sector workers. As the OECD (1988: 68) points out, final earnings formulas tend to be biased in favour of higher income groups who have steeper age-wage profiles whereas the age-wage profile of lower-income groups tends to be hump shaped or at least to flatten out sooner in the work career. Both nations modified their formulas so that, in future, benefits will reflect average earnings over the entire working life. Other countries with final or best earnings models are also moving in this direction (Table 5).

TABLE 5. CHANGE IN ASSESSED EARNINGS IN FINAL/HIGHEST EARNINGS PLANS

Country	**1986**	**1997**
Austria	10	15
France	10	25
Italy	5	Career
Norway	20	20
Spain	8	8
Sweden	15	Career

The implications of other changes are more ambiguous since they involve greater *targeting* of inter-personal transfers rather than their elimination. Adjusting the contribution period to compensate workers for irregular work histories is one method many countries have used in the past, provisions that typically benefit women. Rather than basing benefits on a work history of say 40 years, Swedish workers were eligible for maximum pensions after only 30 years of contributions. Italian workers were able to claim a pension based purely on years of service (35 years for private sector workers and 20 years for public sector workers) allowing many to retire on a full pension in their early fifties (the so-called “baby pensioners”). This created markedly different “rates of return” (and implicit transfers) based on age of labour market entry and employment sector. In both countries, the reforms reduced these transfers by basing benefits on total lifetime contributions.

The reforms, however, did not *eliminate* protection against irregular work histories; rather, social protection against irregular work careers was *targeted* on specific forms of labour market exit typically associated with child and elder care or spells of unemployment (insurable risks). In the new design women (and men) will be compensated for shorter work histories that result from child or elder care but not for providing housekeeping services to a spouse. Men (and women) will receive credit for periods of unemployment or disability (insurable risks) but not for periods of non-employment that are not insured.

The 1995 Swiss reform is especially striking since the reform was about introducing gender equality and subject to a national referendum (Bonoli 1997). As in the U.S., a married man with a dependent spouse was eligible for a “couple pension” corresponding to 150 percent of his own pension entitlement, a practise that disproportionately benefits higher income families (Meyer, 1996). Women’s organizations successfully took the lead in demanding the end of the couple pension. In the new design all contributions paid by the two spouses while married are added together, divided by two, and counted half each. Strikingly, however, couples with children below the age of 16 now receive additional credit equal to the amount of contributions payable on a salary three times the minimum pension (56 percent of the average wage). Compensation is provided for child rearing but, unlike the previous formula, not for providing housekeeping services to a spouse. The result is a cross-subsidy to families with children from those who remain childless.

These examples of the rationalisation of redistribution among retirees illustrate a more general strategy for restructuring traditional earnings-related pension schemes in ways that simultaneously enhance intragenerational equity and intragenerational equality. Redesigning contributory plans to eliminate horizontal cross-subsidies that now seem outdated or that benefit the most advantaged has proven to be a potent source of cost-reduction. At the same time, the addition of inter-personal transfers that are more adapted to meeting contemporary needs such as child and elder care credits has also been a potent tool for *modernising* traditional earnings-related schemes to meet the needs of contemporary families. If pursued aggressively, the enlargement of well targeted inter-personal transfers *inside* contributory earnings-related schemes provides policy-makers with a way of offsetting many of the negative distributional consequences that may otherwise arise from pension reform. As importantly, the result is to create a new framework for managing the distributions of costs of population ageing among both the working and retired population by refinancing the welfare state.

Refinancing Retirement Costs: Intragenerational Justice for the Young

On the financing side, application of the fixed relative position principle also implies that a proportional share of the increased retirement costs that result from population ageing will fall on the working age population, i.e. that contributions will rise. Clearly, however, allocating these costs based on a flat rate tax without deductions for children or other circumstances (i.e. flat rate payroll taxes) is inconsistent with the notion that these costs should be of greatest advantage (or the least disadvantage) to the least well off within the working age population.

> As Reynaud (1997) points out, however, a major aim of reforms aimed at rationalizing redistribution within earnings-related schemes during the nineties was to make the division between the contributory and "solidaristic" (redistributive) elements of payroll-based schemes transparent. Drawing a clear separation between the two creates the opportunity to shift financing of the solidaristic elements from payroll taxes to general revenue, relieving pressure on the former and spreading the transition costs of an ageing society to a larger revenue base.

Bonoli's (1996) interviews with party officials and labour leaders in France and Germany provide striking evidence for the self-conscious character of this strategy. In the words of a French trade unionist: "…the financing of contributory benefits … must be done through contributions based on salaries. In contrast, non-contributory benefits must be financed by the public purse." Tuchszirer and Vincent (1997) highlight a similar logic underlying the 1995 Toledo pact, an all-party agreement on the framework for reforming the Spanish social security system.

A rising share of general revenue financing in the retirement budget provides a powerful tool for reallocating the costs of population ageing based on ability to pay not only among the working age population but among the retired as well. While retirees are not subject to payroll taxes they do pay income and consumption taxes.[123] Assuming the more affluent in both populations also pay higher taxes, their share of the additional costs associated with demographic change rises proportionately with increases in the share of retirement costs financed from general revenue.

At the same time, increased transparency creates a *political* framework within which redistributive issues can be addressed. In the age of expansion, many of the redistributive features of the income security system, some of them perverse, were often concealed in complex technical provisions. This strategy was often deliberate, guided by the assumption that concealment made redistribution politically easier (Derthick, 1978). Increased transparency, in essence, re-politicises issues of how much redistribution and for whom. We should not assume from all this that the effects of reform will all be benign. Whether, for example, working women will be winners or losers as a result of raising the contribution period on the one hand while improving child and elder care credits on the other depends on both the relative value of the new credits and future patterns of labour force participation. The point, rather, is that this new architecture creates the possibility for political actors to address systematically the redistributive dilemmas created by redesigning traditional pay-as-you-go defined benefit schemes. The outcomes are clearly indeterminate but the indetermination reflects the balance of political forces and institutions of political representation rather than the impersonal forces of the market and/or demography.

[123] We do not preclude the possibility that there may be significant advantages to a system of "earmarked" social security contributions so long as such contributions are based on total income and

If pursued aggressively, if only incrementally, the pattern of reform outlined above implies a strategy that potentially alters the traditional social insurance model of old age security dramatically, at least in the long term. On the benefit side, any reductions implied by the FRP principle are partially offset by new or expanded inter-personal transfers for the less advantaged among the pensioner population. On the contribution side, these additional costs are met not through higher payroll taxes but rather through general revenue financing raised among both the retired and the non-retired based on ability to pay. The implication on the benefit side is that with time the earnings replacement function of public sector insurance scheme diminishes somewhat for higher income families (which may be taken up by second and third tier savings).[124] And, with time, the share of general revenue financing for the income security system as a whole rises. The exact mix at the "end' of the process will vary from country to country since we assume a wide variety of initial starting points and that the strategy is applied incrementally only to the allocation of the *change* in retirement costs that results from population ageing.

Pension Reform, the Gender Contract, and Caring Work

The issues related to gender equality and gender equity go well beyond those related to the allocation of increased retirement costs due to population ageing that have concerned us here. They are primarily issues of enhancing gender equality over the working life and providing compensating differentials for the uneven distribution of caring work between the sexes, issues that arise even in the absence of population ageing. As past Council documents attest (and as we emphasise above), however, they are issues whose broader economic and social importance rise dramatically *as a result of* population ageing. We have already alluded to the importance of achieving high levels of female employment in an ageing society. The challenges this poses for childcare have been addressed in Chapter One. In this concluding section, we turn to the related issue of elder care, a task that is rising exponentially in ageing societies, and one that has long been the preserve of daughters, daughters-in-law and ageing wives.

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provide for some degree of progressivity, especially in the lower tail of the distribution, and provide adjustments for family size.

While population ageing has compelled the rich democracies to confront the challenge of financing now mature systems of income security for the elderly, it has also brought to light the challenge of a related policy domain that is more or less in its infancy (OECD, 1996: 13), the provision of care to the frail elderly. While the needs of the elderly have always been at the centre of welfare state policy, the focus has traditionally been on meeting needs related to income security and mainstream (i.e. acute) health care. Care for the chronically ill, the physically frail, and the mentally confused or disabled elderly, as the OECD (1996:63) remarks, was largely a residual policy area, provided mainly in the unpaid, informal sector by female family members.

Population ageing has brought this issue to the forefront for two reasons. First, the fraction of the elderly most at risk, the "oldest old" (80+) has been growing much faster than the elderly population in general. Secondly, the capacity of the traditional pool of informal care givers (elderly wives, daughters, and daughters-in-law) who provide about three-quarters of all care to the frail elderly (OECD, 1996:63) is declining relative to this increased demand. Increased longevity means that the care provided by spouses to one another (typically by the wife) occurs at an age when care-giving capacity is diminished. Declining fertility has meant fewer non-elderly, typically female, relatives to provide support and they are more likely now to be employed. Our aim here is not to provide a systematic overview of the policy issues related to the provision of home services and long term care for the frail and disabled elderly but rather to highlight important parallels with our discussion of family and pension policy.

Like longevity, the onset and duration of frailty in old age is unpredictable and hence an insurable risk for which at this point in time there is little or no market. The emergent market for long term care insurance in the U.S. is beset with a variety of problems and still modest in scope (OECD, 1996: 39-40) reminiscent of the world before the spread of mandatory public pensions.

As recent historiography (Haber and Gratton, 1994) has shown, in the world before mandatory pensions, intense poverty in old age was still the exception, mainly associated with those elderly persons without working adult children able or willing to

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[124] We hasten to add, however, that there is no intrinsic reason why second tier employer pensions cannot incorporate inter-personal transfers to achieve desirable social objectives.

supplement the declining incomes of their ageing parents. Mandatory public pensions, in this sense, were a form of risk sharing not only against the risk of one's own longevity (i.e. for the elderly) but also against the risk of one's parent's longevity (i.e. for their working age children) and the imperative of supporting parents financially through an extended old age. Similarly, the expansion of publicly financed long term care and home help services in the contemporary period represents a welfare gain not only for the frail elderly who receive these services but also for their adult children and other family members who otherwise must provide such services directly.

As with child care, elder care still remains largely women's work and much of our discussion of the former can be applied to the latter with little modification, a fact implicitly recognized by countries that now provide elder as well as child care credits in their pension formulas. Achieving gender equality requires attention to the caring work women provide to those at both ends of the life course.

3.5 Implications of National Diversity: The Question of Starting Points

Our main focus has been on the problem of allocating the *change* in costs associated with population ageing and for the most part we have taken national differences in starting points (i.e. current pension design and outcomes) as given. We think it analytically and practically naïve to attempt to identify a single ideal-typical pension system for all member states to emulate given the deeply institutionalised diversity among them. It is well beyond the scope of the present exercise to work though the limits and possibilities for adopting the strategies outlined above within different national contexts. Nevertheless, it may be useful to highlight some of the more (and less) salient challenges. One of the major differences among Member States, of course, is the considerable national variation in employment levels and early exit among older workers (see table 3.1). Since this issue has been a major focus of the Commission in the past (e.g. the Lisbon Summit), we do not pursue it here.

Intergenerational Equity and the Principle of Fixed Relative Position

As indicated by Chart 1 (above), differences in the *average* relative position of pensioner households indicate rather modest variation in "starting points" among

Member States, at least when measured by total household income. Taking account of unmeasured differences in living standards between the old and young (e.g. unmeasured implicit income from home ownership and other assets) would no doubt raise these ratios and might introduce more cross-national variation. Some may judge these ratios to be too high while others might conclude that they are too low. However, differences in the *average* relative position of the elderly is not the main distinguishing feature among member states. Moreover, we have not insisted that commitment to FRP be absolute since either initial conditions (e.g. relatively high or low benefits) or future circumstances may create conditions that warrant departure from it. Rather, we propose FRP as the litmus test for intergenerational equity so that reforms that deviate from this principle require clear normative and analytical justification.

Intragenerational Justice

We have adopted a rather harder position with respect to immunizing the most disadvantaged among both the working age and retired populations against the costs associated with population ageing.

As indicated by the data on elderly poverty rates (Table 3.3) there is still significant variation in the extent to which national old age security systems provide protection to the most disadvantaged. We have advocated adoption of minimum guarantee at or above a standardised poverty line for all Member States. Low poverty rates among the elderly can be reached even in the absence of such guarantees (e.g. when there is low earnings inequality over the working life). However, during a period of significant change and considerable uncertainty about the distribution of jobs and earnings for future cohorts, a minimum guarantee constitutes a political "bottom-line" commitment with respect to the income security of future generations.[125]

[125] We are *not* proposing here a reinvigoration of traditional means-tested social assistance that depend on an assets test that require individuals to spend their way into poverty for eligibility. Canada's low poverty rates reflect the presence of guaranteed annual income designed as a negative income tax. Sweden reaches a similar objective with a guaranteed minimum pension (tested against public pension benefits rather than all income). The same objective can potentially be reached with relatively high universal flat benefits, albeit at greater net (after-tax) cost.

Reflecting differences in national design (see below), Member States also vary in the extent of their reliance on payroll taxes, the main challenge to intragenerational justice among the working population. High payroll taxes are characteristic of the majority but not all of the member states. For a handful of countries (e.g., Denmark, the U.K.), workers contribute instead to employer plans, typically organized as defined contribution plans in which contribution rates are immune to population ageing. The impact of population ageing in such plans is more likely to impact these workers when they retire if, as some expect, demographic ageing reduces returns to capital and hence the benefits for which they are eligible. We return to this and related issues below.

Sources of Retirement Income

National differences in the mix of income in pensioner households vary more than relative income levels and Chart 1 understates differences in this regard. Thus occupational pensions account for a large share of pension income in the Netherlands and the U.K. but a modest (Germany) or trivial (Italy) share of pension income in other nations (OECD, 2000: 44).

As we have highlighted, these differences in income sources among the retired have important implications for the types of policy tools available for implementing FRP or any other objective. In effect, nations like Italy or Germany are in a position to make point-in-time adjustments to both taxes (contributions) and expenditures (benefits). Nations like the U.K., Denmark and the Netherlands will have to rely more on regulation to achieve social objectives (e.g. by mandating pension formulae or the use of reserve funds to smooth out fluctuations in rates of return).

Differences in the pension mix also accounts for our insistence that "open" policy coordination requires that estimates of retirement costs and of the allocation of changes in costs within and between generations be based on the entire retirement budget. Open policy coordination requires in the first instance that member states commit to developing the analytical capacity to construct credible accounting schemes to measure the intergenerational, intragenerational, and gender allocation of retirement costs and of reforms to retirement income systems appropriate for national circumstances. Such a requirement is, on our view a sine qua non for achieving Objective #10 (ensuring transparency). The aim, in our view, is less about reaching specific targets and more about the capacity to monitor the *direction* of change relative to shared EU policy objectives. Is a shift to second or third tier pensions likely to lower or raise retirement costs? Will a reduction in pensions or increase in taxes be distributed in a manner consistent with a Rawlsian or some other principle of intragenerational justice?

The development of such accounting schemes is a task well beyond the scope of this paper, the talents of its authors and, for some purposes, perhaps even the current state of social science knowledge. The task is especially difficult when the likely behavioural response to reform is uncertain or unknown. In these circumstances, Objective #10 (ensuring predictability as well) suggests the task is to impose boundaries on uncertainty with appropriate regulation. It also suggests development of the appropriate analytical capacities to aid open policy coordination should be a matter of the utmost priority (and investment) for the Commission.

The Public Finance Problem

The astute reader will have remarked that we have given (too?) limited attention to what for many public officials is the main source of diversity among member states, namely the enormous variation (compare Italy and the U.K.) in the current and projected size of the public budget for retirement income. We have several reasons for what we consider to be a case of "benign neglect."

First, the public finance implications of demographic ageing have been the primary focus of entire libraries of documents prepared by international (EU, OECD) and national agencies. This is hardly surprising since a focus on the public finance problem is an occupational hazard associated with being a public policy official. The risk, however, is to conclude that for nations where the public budget for retirement is large and growing that demographic ageing is a "big" problem while in nations where the public retirement budget is modest and even stable, the problem is negligible. Our emphasis here on the *total* social costs, and their allocation, is intended in part as an antidote to the risk of such an error.

Secondly, we have taken our mandate from the policy objectives embraced by the EU among which sustainable public finances is only one among ten and with the presumption that sustainable public finances constitute a means, not an end. As stated at the outset, this is not to diminish the importance of the public finance problem since it impinges on all of the distributional issues we have raised here.

While we have emphasized *total social costs,* we would be remiss if we did not highlight the incomplete character of our discussion of this issue. Our attention has focused primarily on the implications of demographic ageing for providing *income* to future retirees. We have also noted the impact of demographic ageing on the future costs of providing long term care to the oldest old. However, we have not elaborated on the interaction of these two demands on future generations and the impact of demographic change on "total social costs" undoubtedly includes both components. To illustrate, application of the FRP principle might well have rather different implications for pension reform once pensions are included in an accounting framework that actually includes the *entire* social budget for both the young and the old rather than just the income component.

3.6 Conclusion

Unlike the World's Bank's *Averting the Old Age Crisis* (1994), our aim here is not to advocate a single, all-purpose, pension design for ageing societies in the 21st century. As soon became apparent even to World Bank officials, recommending a model that is institutionally unfeasible for economic and political reasons is not a very helpful contribution to the policy debate. Even if it were the preferred option of their officials and publics, the solution offered by *Averting the Old Age Crisis* was simply not on the menu of feasible choices available to countries such as Germany, Italy, or Sweden. [126] Similarly, it is highly unlikely that, say, Denmark will move to a Swedish design now that quasi-universal employer plans are in place. The large sunk costs in existing institutional designs make "regime-jumping" of this sort unlikely.

[126] On this see Orszag and Stiglitz's (1999: 7) discussion of *tabula rasa* choices vs. transformation choices and Myles and Pierson (2001). Institutional infeasibility is of course but one of the shortcomings of *Averting the Old Age Crisis* identified by Orszag and Stiglitz.

Nor has our discussion been concerned exclusively with the public finance problems generated by ageing populations (see for example, OECD, 1998). As we have emphasised, cost shifting to the private sector relieves the public finance side of the equation but may do little, or even exacerbate, issues of intergenerational equity and intragenerational justice.

Rather, we have taken the status quo among diverse pension regimes as given and attempted to lay out both principles and potential strategies so that any changes to the status quo satisfy principles of intergenerational equity and intragenerational justice, while contributing to the further democratisation of retirement among men and women.

The combination of a strong basic security program and appropriately designed cross-subsidies in earnings related programs provide potent tools for addressing issues of intragenerational justice among the elderly and for democratising pension entitlements among men and women. Both strategies produce a changing mix of revenue sources on the financing side from payroll to general revenue financing that makes it possible to allocate costs based on the ability to pay among both retirees and workers.

As we highlighted above, the traditional defined benefit model tends to impose all the costs of population ageing on the working age population, a solution that is inconsistent with the principle of intergenerational equity. But shifting to a model based on fixed contribution rates is equally unacceptable. As an alternative, we have advocated Musgrave’s “fixed relative position” solution in which the ratio of per capita earnings (net of contributions) and (net) benefits are set so as to hold constant the ratio of the two. Ideally estimation of the ratio would include earnings net of all taxes paid by the working population to support retirement incomes and total benefits from public sources would be estimated net of taxes paid on those benefits.[127] The advantages are several. It provides for a fair sharing of risks with regard to both population and productivity change and obviates the need for planning now based on uncertain and risky projections of the future. Since actual outcomes are unpredictable, the main requirement of any

[127] As Musgrave noted, there would be need for short-run compensatory adjustments in periods of severe unemployment, but these would not affect the long term solvency of the system.

new pension design is that it provides future generations with sufficient flexibility to adjust to the changing circumstances of both the old and the young.

The capacity of policy-makers to allocate the costs of population ageing depends critically, of course, on the national mix of states and markets in generating retirement wealth. A larger private sector does not, by definition, imply that markets are in charge, only that the strategies differ: regulation of cost allocation depends more on regulation and taxation policies when the private sector role is greater.

Paradoxically, nations where the public sector share is larger probably have had an historical advantage with respect to facing up to these issues. The maturation of public pension schemes since the 1970s combined with adverse economic conditions compelled these nations to address the fundamental issues of retirement costs well in advance of the demographic shift all nations will experience in the next quarter century. Many of the lessons to be learned from efforts to reform the large public pay-as-you-go systems have already been acquired. The trade-offs and dilemmas are known and there is some experience in addressing these problems. For the "latecomers," where advance funded employer schemes will only begin to mature several decades from now, the lessons are yet to be learned.

CHAPTER 4

THE SELF-TRANSFORMATION OF THE EUROPEAN SOCIAL MODEL(S)

4.1 The rediscovery of social policy as a productive factor

European welfare states, as we have highlighted in the previous chapters, are in varying need of reform (Esping-Andersen, 1999). In this chapter the analytical focus shifts from the 'problem-oriented' question: "What sort of new architecture of social protection is required in the face of the transformation of working life, the fragmentation of traditional family structures, and the pressures of demographic ageing?" to the 'political-institutional' question: "What kinds of policies are feasible and fair, given the tremendous differences in welfare state design and the large variation in decision-making structures across the member states of the European Union?" We live in a world of path-dependent solutions. Radical model change in Europe's comprehensive welfare states, which often appear on the policy agendas of rash politicians and international think-tanks, are institutionally ruled out. This is not to say that policy continuity necessarily presides over change. European welfare states today are far from 'sclerotic'. Reform, even radical policy change, does take place, but it is 'institutionally bounded' change.

Feasible policy reforms are conditioned by at least three distinct sets of causal factors. These are: 1) the relevant policy challenges (laid out in the first three chapters of this report); 2) variation in welfare state design; and 3) differences in structures of political decision-making (see Scharpf/Schmidt, 2000). All developed welfare states are essentially exposed to the same challenges, but these challenges manifest themselves in divergent problem constellations for different welfare systems. We can broadly identify three groups of countries that share rather similar welfare design and political institutional attributes: Scandinavia, the Anglo-Saxon model, and the Continental European model. All three clusters differ significantly in the relative vulnerability to the new pressures and challenges of post-industrial change. For the remainder of this chapter, we hope to systematically relate the discussion of available policy responses, in the areas of wage bargaining, employment policy, social services and pensions, to the true fact that different countries have to approach welfare reform in these problem areas from very different starting conditions.

Despite many important differences, most European welfare states share two distinctive generic characteristics. At the cognitive level, the European social model is based on the recognition that the normative objective of social justice can be made to contribute to economic efficiency and progress. As a so-called ‘productive constraint’, a term coined by Wolfgang Streeck, social policy can contribute to reducing uncertainty, enhance the capacity to adjust and the readiness to accept change, allow for long-term skill-investments, serve to create and stabilise collective goods, channel and mitigate industrial conflict in periods of structural adjustment, and, in turn, foster political stability and social cohesion (Streeck, 1992). The idea that a strong economy requires a strong and reliable welfare state goes against the neo-liberal assumption of the big ‘trade-off’ between economic efficiency and social justice in highly developed welfare states.

Institutionally, closely related to the recognition of productive synergies between economic and social policy, the European social model is marked by high degrees of interest organisation and comprehensive practices of policy co-operation (Anton, I can’t find concertation in the dictionary, is co-operation ok instead?) between the government and the social partners in many areas of economic and social policy. Compared to North America, European systems of industrial relations are stable; the majority of workers are covered by collective agreements. Practices of social partnership, with ‘trust’ as a constitutive element, moreover, encourage a problem-solving style of policy making, rendering collective actors the necessary social capital to overcome sectionalist interests.

Notwithstanding shared cognitive orientations and common institutional practices, the policy theory of the European social model occupies a far more difficult intellectual and political position than the neo-liberal argument of the undesirable effects of comprehensive social policy, hampering economic growth, crowding out private investment and undermining the spirit of entrepreneurship. In a nutshell, the effects of social policy and institutional arrangements on social and economic performance are contingent. Classic deficiencies are ‘poverty traps’, ‘inactivity pathologies’, and ‘insider privileges’. Under conditions of economic crisis, it should come as no surprise that basic cognitive and institutional tenets of the European social model are called into question. In the United Kingdom in the 1980s, this provoked radical social policy retrenchment.

More surprisingly, however, is that in the 1990s many EU welfare states experienced a veritable resurgence of social partnership solutions to problems of structural adjustment, on the basis of a rediscovery of the idea that the challenges of post-industrials are best met by novel synergies between social policy and economic policy (Kaufmann, 2001). Today, essentially all European governments agree that comprehensive welfare policy is an asset, not a liability, it is a ‘productive factor’ in the competitive knowledge-based society (European Council, 2001). This is captured in the commitment, formulated at the Lisbon summit (2000): ‘to become the most competitive and dynamic-knowledge based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion’. Institutionally, it is generally accepted that a productive balance between economic and social policy is best achieved through a dialogue with multiple actors, including the social partners, also at the level of the European Union. The resurgence of bi- and tripartite employment and social policy co-operation at the level of the nation-state and the creation of a multi-tiered EU social and employment policy community in recent years, we see as a dynamic process of *self-transformation of the European social model*. It is our contention that the revitalisation of the shared understanding of social policy as a productive factor, together with the revival in organised trust between the social partners at various levels of decision-making in the European Union, in effect has provided central background conditions for formulating and implementing innovative policy change across a gamut of policy areas, ranging from wage bargaining, to labour market policies, social services and pensions.

The chapter is divided into 8 sections. In section 2, we focus on the charged nature of the politics of welfare reform and the institutional capacities available in different political systems to successfully venture reform initiatives. Subsequently, in section 3 we give a synoptic overview of the main characteristics and related vulnerabilities of the Scandinavian, Anglo-Saxon and Continental welfare regimes. In the empirical sections 5 to 7, we respectively analyse regime-specific policy responses in areas of wage bargaining, under the shadow of EMU (which is specifically addressed in section 4), recent employment policy initiatives seeking to realign work and welfare, social policy efforts to reconcile career and family life, especially for working mothers and finally, attempts at pension reform in the face of ageing. The conclusion (Section 8) considers the contribution of employment and social policy initiatives at the level of the European Union.

4.2 The Charged Politics of Welfare Reform

4.2.1 Social protection adjustment on the political agenda

Welfare reform is difficult, but it happens. Over the past three decades, all the developed welfare states of the European Union have been recasting the basic policy mix upon which their national systems of social protection were built after 1945 (Scharpf/Schmidt, 2000; Ferrera/Rhodes, 2000; Kuhnle, 2000; Pierson, 2001; Leibfried, 2001). In the 1970s, against the background of the emerging problem of stagflation, policy adjustment primarily revolved around macro-economic management and wage bargaining to counter spiralling cost-push inflation and demand-gap increases in unemployment. After the mid-1980s, policy attention and action moved towards issues of economic competitiveness. In the area of employment policy, there was a decisive shift towards supply-side measures. Next to initiatives of labour market deregulation, many welfare states tried to contain the rise in open unemployment through strategies of labour supply reduction via early-retirement and disability pensions (Ebbinghaus, 2000). The destabilising consequences of large-scale subsidisation of early retirement and other forms of paid inactivity were only perceived as major policy problems when the European Monetary Union set limits to deficit and debt financing. In the wake of the Maastricht Treaty, politicians became more willing to venture measures of cost-containment, often in conjunction with the introduction of more proactive labour market policies. Next to cost-containment efforts, the institutional makeup of social security arrangements also became a target for reform in the 1990s (Hemerijck/Schludi, 2000).

In retrospect, it is perhaps surprising that policy reforms in the core ‘distributive’ areas of the welfare state arrived so late in processes of adjustment. The answer to this puzzle is largely political: the more reform efforts reach into the core ‘distributive’ areas of social protection, the more political conflict is likely to flare up. A change in macroeconomic policy does not lend itself to serious political dramatisation. A more explosive political climate is ignited when cuts in social security benefits are ventured. And as social rights are usually attached to relatively strong interest groups, like trade unions, which typically resist attacks on acquired rights, political opposition is likely to render the reform process pretty unpredictable (Pierson, 1994). If wages are sticky, as economists argue, then policies of social protection, enshrined in law, are probably even stickier. This is perhaps most true for pension benefits, which are legitimately regarded by large majorities as 'sacrosanct rights' of the elderly (Bonoli, 2001).

4.2.2 Between institutional constraints and resources

The principal site of policy change is the nation-state. Policy reforms have to be endorsed by elected governments and parliaments. Domestic political institutions exert a tremendous influence over the pace, scope, character and style of policy change. They make up the political incentive structure of policy making, determining the degree of influence and power that relevant policy actors can bring to bear on the policy process (Scharpf, 2000). At one end of the scale, strongly majoritarian Westminster political systems render single-party governments with clear mandates for adopting radical and comprehensive reform efforts. At the other end of the scale, consensual democracies, based on proportional representation with multi-member constituencies and coalition governments, are more biased towards slow, incremental, disjointed and negotiated patterns of policy change because of the many veto players that need to be accommodated.

Institutional structures are not only constraints, limiting the repertoire of feasible policy options, they also operate as resources, encouraging particular styles of decision-making (Scharpf, 1997b; 2000). It could be argued that consociational democracies and corporatist systems of industrial relations, which privilege many veto-players, encourage consensual or problem-solving styles of decision-making (Swank, 2001). This stands in sharp contrast to the prevailing self-interested bargaining style in more fragmented systems of collective bargaining, or the confrontational style in statist systems of industrial relations (Crouch, 1993).

Institutional structures not only matter at the level of the national political system, they also affect individual policy areas. In some countries the sphere of industrial relations is, for instance, fully autonomous from state intervention, as in Germany with its constitutional requirement of *Tarifautonomie*. In other countries there is a strong tradition of state intervention in industrial relations, as in Belgium and France. In corporatist political economies political authority over industrial relations is ‘shared’ by the state and the social partners. In Bismarckian social protection systems, there is a strong heritage of associational self-regulation by the social partners, as a corollary of payroll financing (see below). The upshot is that for areas where policy-making authority is shared between the state and non-state corporate actors, adjustment requires the explicit or tacit agreement of all parties involved. This obviously constrains unilateral state action (Hemerijck/Schludi, 2000).

Although the principal site for welfare reform and policy adjustment is the nation-state, the primacy on domestic politics should not be exaggerated. Today domestic reform efforts are severely constrained (EMU) and increasingly shaped (European Employment Strategy) by supranational regulation and policy initiatives. Recent advances in the process of European Integration have decisively contributed to the creation and establishment of regulatory constraints and policy-making resources above and beyond the traditional nation state (Ferrera et al, 2000).

4.2.3 Bounded policy learning

If we wish to really understand the dynamic of welfare reform, we have to open the “black box” of the cognitive and normative orientations of policy actors (Scharpf, 2000). Using Heclo’s powerful metaphor, policy making is seen as the outcome of *puzzling*—diagnosing the nature and magnitude of the problems at hand, setting priorities and identifying potentially effective solutions—and of *powering*—organising the political and societal support for the selection of particular solutions (Heclo, 1974). Policy reform is not merely ‘the contest for power’, it is just as critically dependent on ‘the play of ideas’, the extent to which policy actors agree over the cognitive definition of policy problems and the normative benchmarks of what makes up effective policy solutions. Governments may be capable of welfare adjustment through policy learning, defined by Peter Hall as the ‘deliberate attempt to adjust the goals or techniques of policy’ in the light of the consequences of past policy and new information so as to better attain effective and legitimate policy solutions (Hall, 1993).

Crises often function as important catalysts or triggering devices for policy learning. An acute sense of crisis forces policy-makers to evaluate the existing policy profiles and to consider alternative ideas. Policy failures have long lives, but inefficiencies do not live forever. At some point – a tipping point – political actors seek policy change. At such critical junctures, the authoritative nature of politics – also in multi-actor political systems – offers strategic opportunities for policy changes (Wood, 2001). A failure to respond to dramatic turns and events can lead to dramatic electoral shifts.

In most European welfare states the recessions of the mid 1970s served as an important triggering devices, discrediting many left-of-centre coalitions and providing the new conservative governments with a major opening for a restrictive policy package of fiscal consolidation, privatisation, and welfare retrenchment (Pierson, 2001). Policy mistakes are not only a waste of time; they can energise the policy process by allowing political decision-makers to overcome institutional rigidities that would persist under normal circumstances. The cathartic experience of the "Dutch disease" in the early 1980s is a good example of how policy mistakes generate positive learning effects: After a lengthy and painful period of policy immobilism, policy's self-correction in the Netherlands provoked a remarkable recovery of the Dutch economy without sacrificing core welfare goals. Italy's political and economic crisis in the early 1990s, which led to a comprehensive redesign of the Italian pension system, was to a large degree fostered by the challenge of EMU.

If inefficiencies cannot be absorbed by the existing policy profiles, this may prompt political actors into advocating 'best practices' from more elsewhere. Given time, remote policy alternatives can be learned. In the early 1980s, the Irish, given their strong Anglo-Saxon heritage, followed the British strategy of radical labour market deregulation. After government officials, trade unionists and employers discovered that this policy strategy was ineffective in countering industrial decline, Irish policy makers moved onto the uncharted waters of the Scandinavian and Continental examples of comprehensive social pacts between the social partners and the government (Hardiman, 2000).

4.3 Three Social Europes

4.3.1 Variation in policy design

Notwithstanding important commonalties in cognitive orientations and institutional practices, in terms of policy content, no two European welfare states are identical. Each welfare state displays unique features in their policy profiles and institutional make-up, based on deeply held national aspirations of equality, social justice and solidarity. Since the Second World War, domestic policy innovation in social security, social services, pension rights, minimum wages, collective bargaining procedures and dismissal protection, developed fairly autonomously in different nation states.

In terms of policy design, European welfare states vary significantly along five dimensions (Esping-Andersen, 1990; Van Kersbergen, 1995; Ferrera, 1996; 2000; Bonoli/Palier, 1997; Scharpf/Schmidt, 2000; Ferrera *et al*, 2000):

- *Eligibility and risk coverage*. Access to provisions of social protection can be based on citizenship, need, work-related contributions or private contracts.
- *Benefit structure and generosity.* Benefits can be generous or minimal, means-tested, flat-rate, earnings-related, or contribution-related. Benefit structure is also related to country-specific objectives of social protection: income maintenance, poverty alleviation or equality.
- *Methods of financing.* Financing can range from general taxation, payroll-contributions, and user charges, or some combination thereof.
- *Service intensity.* Social services can be provided for through professional (public) services, through the market, or, informally, by the (extended) family.
- *Employment regulation*. Under the heading of employment policy and regulation we group together highly diverse set of 'industrial rights', such as employment protection, (minimum) wage regulation, collective bargaining rights and procedures, and active labour market policies.
- *Industrial relations*. Of special importance is the degree of co-ordination in national systems of industrial relations, ranging from fragmented unco-ordinated systems to sectoral pattern bargaining and centralised co-ordination. Co-ordination in industrial relations is crucial to employment, primary income distribution, and the extent

which externalities like inflation and unemployment can be mitigated through co-operation (Crouch, 1993; Traxler/Blaschke/Kittel, 2001; Scharpf, 2000).

4.3.2 Variation in policy performance

The rich literature on welfare state 'models' has been able to show how the above design variables are systematically related to one another, producing distinctive but not exclusive, regimes of welfare capitalism. Basically we can distinguish between three different 'social Europes' (Esping-Andersen, 1990; Ferrera et al, 2000). Regime-specific differences in policy design are closely related to variation in employment performance, service intensity, degrees of poverty and inequality, and levels and structures of taxation or welfare state financing.

With respect to overall levels of employment, female employment, public employment and unemployment indicators, the Nordic countries, Denmark, Finland and Sweden outperform the Anglo-Saxon and Continental models of welfare (see table 4.1). The Anglo-Saxon countries, Ireland and the United Kingdom have favourable levels of employment with relatively low rates of public employment and exceptionally low rates of female employment in Ireland. The Continental countries portray a mixed picture, with above average employment performance in the north-western part of the European continent, including Austria, Belgium, France, Germany, the Netherlands and Luxembourg. Low levels of employment are evident, especially amongst women, in Mediterranean countries like Greece, Italy and Spain, but Portugal is an exception.

Table 4.1: Employment performance in the European Union (2000)

	Employment rate[a]	Un-employment rate[b]	Long-term unemploy-ment[c]	Female employment rate	Youth un-employment rate[e]	Activity rate, men aged 55-64	Public Em-ployment Ratios[d]
Denmark	76.3	4.7	1.0	71.6	5.3		22,7
Finland	67.5	9.8	2.8	64.4	11.2		14,6
Sweden	73.0	5.9	1.3	71.0	5.5		21,9
Austria	68.3	3.7	1.0	59.4	2.9		10,0
Belgium	60.5	7.0	3.8	51.5	6.5		10,3
France	62.2 [f]	9.5	3.8	55.3 [f]	7.1		14,5
Germany	65.4 [f]	7.9	4.0	57.9 [f]	4.6		9,3
Greece	55.6 [f]	11.1	-	40.9 [f]	-		6,9
Italy	53.5	10.5	6.4	39.6	11.8		8,9
Luxembourg	62.9 [f]	2.4	0.6	50.3 [f]	2.5		-
Netherlands	73.2 [f]	2.7	0.8	63.7 [f]	3.6		6,8
Portugal	68.3	4.2	1.7	60.3	4.2		12,0
Spain	55.0	14.1	5.9	40.3	11.4		7,5
Ireland	65.1	4.2	1.7	54.0	3.3		9,3
UK	71.2	5.5	1.5	64.6	8.3		9,5
EU 15	63.3	8.2	3.6	54.0[f]	7.8	69.0 [f]	11,7

[a]Total employment/population 15-64 years; [b] Standardized Ratio; [c]Long-term unemployed (12 months and over) as % of labour force; [d] % of population 15-24, 1998; [e] Unemployed as % of population aged 15-24; [f] Eurostat estimation.

Source: Employment in Europe 2000, European Commission, 2000a; OECD (1999a) (Public employment figures)

With respect to social protection, captured in terms of social expenditure ratios, levels of social transfers for unemployment and social assistance, and public spending on social services, together with information on levels of taxation, the Nordic countries, as shown by table 4.2, are by far the most generous welfare states in Europe. The price, however, that Scandinavian citizens have to pay for this generous system of social protection is a high level of taxation. The Continental countries hold an intermediate position, with Anglo-Saxon countries closing the league with low overall levels of taxation. Within the Continental cluster, the Mediterranean countries spend relatively large sums of money on pensions, most notably in Italy, which spends 16.13% of GDP on old age and survivors. By contrast, the Nordic welfare states, with their high levels of female employment, set apart substantial financial resources for social services for working families and their children.

Table 4.2: Level of Social Security in the European Union

	Social expenditures in percent of GDP[a]	Total taxation [b]	Net repl. Rate of unempl. Benefits [b]	Old Age and Survivors as percent of GDP[a]	Active labour market policy [c]	Labour market training [c]	Social exclusion[d] 1995	Family/ Children as % of GDP[a]
Denmark	30.0	52,2	81	11.49	2.01	0.48	1.1	3.90
Finland	27.2	47,3	80	9.38	1.66	0.21	0.4	3.48
Sweden	33.3	53,3	83	13.12	0.87	0.28	0.1	3.60
Austria	28.4	44,4	67	13.69	1.89	1.07	1.5	2.84
Belgium	27.5	46,5	70	11.77	1.23	0.41	0.7	2.34
France	30.5	46,1	79	13.42	0.42	0.09	0.3	2.99
Germany	29.3	37,5[c]	70	12.69	0.44	0.15	0.3	3.03
Greece	24.5	40,6	49	12.89	1.29	0.29	0.7	1.98
Italy	25.2	45,0	45	16.13	1.27	0.34	0.6	0.91
Luxembourg	24.1	-	84	10.65	0.30	0.01	0.4	3.40
Netherlands	28.5	43,3	85	11.71	1.76	0.22	0.7	1.28
Portugal	23.4	34,5	82	9.99	0.35	0.06	-	1.24
Spain	21.6	35,3	75	9.96	1.08	0.01	0.0	0.45
Ireland	16.1	34,8	57	4.01	1.37	0.35	0.5	2.04
United Kingdom	26.8	35,3	68	11.77	0.72	0.21	0.1	2.30
Average	27.7	42,6	72	12.66	1.1	0.27	0.5	2.30

[a] 1998 [b] 1997; Net replacement rates after tax; average for four different family types (single, married couple, couple with 2 children) and two earnings levels (APW-level and 66,7 percent of APW level); including unemployment benefits, family, and housing benefits in the first month of benefit receipt; it is assumed that waiting periods are met; [c]1996; [d]1995 data, or latest year available.
Sources: [a]"Statistics in Focus: Social Protection in Europe," Theme 3-15/2000. Eurostat (2000); [b]OECD (1999c): Benefit systems and work incentives, own calculations; [c] EC (there may be some overlap with other categories of expenditure)

Welfare state generosity can also be captured by distributive performance in terms of relative poverty and wage dispersion (Table 4.3). In terms of relative poverty figures, borrowed from LIS, the Anglo-Saxon countries combine comparatively high poverty rates, high levels of wage dispersion and a comparatively inegalitarian distribution of disposable household income.

The Continental welfare states display intermediate levels of income distribution. However, the spectrum is fairly wide. Belgium, Luxembourg and the Netherlands reveal comparatively favourable outcomes along all three dimensions, coming close to the Nordic welfare states in terms of distributive performance. Mediterranean Continental welfare states portray a different picture, with average levels of wage dispersion but strong disparities in terms of post-tax and transfer income distribution and poverty (Ferrera, 2000).

Table 4.3: Distributive performance 1994

	40% line	50% line	60% line	Gini-coefficient (year)[a]	Wage dispersion D9/D1[b]
Denmark	2,9	6,0	21,4	0,239 (92)	2,86
Finland				0,223 (91)	2,75
Sweden				0,229 (92)	2,78
Austria		12,1			
Belgium		11,4		0,230 (92)	2,79
France	7,7	14,9	24,5	0,324 (89)	4,11
Germany	9,9	15,2	21,4	0,300 (94)	3,84
Greece	14,8	21,8	29,3		
Italy		12,5		0,255 (91)	3,14
Luxembourg	6,5	15,4	25,9	0,235 (94)	2,93
Netherlands	4,7	8,8	19,1	0,249 (91)	3,05
Portugal	17,1	25,2	32,9		4,05
Spain	11,0	19,8	29,1	0,306 (89)	4,04
Ireland	11,2	21,6	32,9	0,328 (87)	4,18
United Kingdom	12,3	21,3	30,8	0,346 (95)	4,56
Average					

[a] Lower figures indicate a more egalitarian structure of distribution of disposable income; [b] D1 refers to the lowest income decile, D9 refers to the highest income decile (latest year available)

Sources: Eurostat, Sozialporträt Europas 1998; OECD (1996): Employment Outlook, July 1996; Gottschalk and Smeeding, 1998.

The overall picture that emerges from these three sets of performance indicators is, first and foremost, that the association between the total burden of taxation and social security contributions (measured as a share of GDP) is fairly weak (Scharpf, 2000). The most redistributive welfare states (Denmark and Sweden), have the highest tax burdens, but do better in terms of employment than the low-tax Anglo-Saxon countries. The medium-high tax Continental welfare states and the moderate-low tax Southern welfare states have the lowest employment scores. In other words, low rates of employment in Continental Europe are not related to the size of total taxation. More likely, the heavy reliance on social security contributions in Continental welfare states seem to incur strongly negative employment effects.

4.3.3 Variation in regime-specific strengths and vulnerabilities

In the face of common endogenous challenges and external pressures, different families of welfare states seem to generate their own, quite distinctive, regime-specific policy problems. The upshot is that common policy challenges have to be met by different policy strategies (Hemerijck/Schludi, 2000). It is worth summarising these regime-specific problems and vulnerabilities before we go on to assess viable regime-specific policy responses in areas of work and welfare, social services and pensions.

Scandinavian strengths and weaknesses

The Scandinavian welfare states, with their high levels of total employment, very high levels of female employment, extensive rates of public sector employment, high levels of social expenditures, high levels of taxation, low levels of income inequality and poverty, are surely more costly than the two versions of social Europe. However, they are demonstrably better adapted to the exigencies of post-industrial change – in large part due to their service intensive, women and child ‘friendly’ public policy profiles. Denmark and Sweden embarked on the road to high public employment already in the 1960s. A self-reinforcing mechanism emerged whereby the expansion of ‘welfare state jobs’ encouraged women and lone parents to enter the labour market, allowing a ‘de-familisation’ of many caring functions, which in turn fostered the demand for more social services (Fargion, 2000). Near-maximum employment coincides with less early retirement, relatively high birth rates, while mitigating the financial strains on Scandinavian pension systems. The much lower incidence of poverty also suggests the availability of a highly effective social safety net against new risks. The main difficulties confronting the Scandinavian countries today are, first of all, difficulties in financing their costly welfare states under conditions of high capital mobility, constraints of fiscal and budgetary policy, as a consequence of European monetary integration, and increased political tax resistance (Hemerijck/Schludi, 2000; Scharpf, 2001). As a result of the liberalisation of international capital markets in the 1980s, engendering pressures of tax competition, the rise of tax revenues as a share of GDP has subsided. This has led to the stagnation or decline of job opportunities in the public sector in the 1990s, especially in Sweden. In other words, there is a need to expand private sector employment to compensate for losses in public sector employment (Iversen/Wren 1998; Scharpf 2000).

Anglo-Saxon strengths and weaknesses

The Anglo-Saxon welfare states, with their medium-high levels of employment, medium-high levels of female employment in the United Kingdom, but much lower rates of female employment in Ireland, low levels of public sector care provision, low levels of taxation and moderate levels of social expenditures, have their own regime problems and advantages. In contrast to the Scandinavian model, welfare state financing and private sector service employment are not particularly problematic. Also in the area of pensions, Ireland and the United Kingdom face little fiscal strain as a result of population ageing.

The conservative road of adjustment allowed for the expansion of low pay, low skill jobs.

More severe problems are associated with the marked increase in (child) poverty and inequality in the last twenty years. Earnings at the upper end of the spectrum have grown relative to those at the bottom. The result has been a rapid polarisation of incomes (Rhodes 2000). Wage subsidies have been introduced to supplement the incomes of low paid workers and their families. Moreover, radical labour market deregulation has left the British system of industrial relations without the institutional support-bases for co-operative relations between management and trade unions and a well-trained labour force for highly competitive, highly productive, export-oriented, high-quality industrial specialisation (Rhodes, 2000).

Continental strengths and weaknesses

The regime-specific vulnerabilities of the Continental welfare states with their low levels of employment (both in the private and public sector), low rates of female participation in the labour market, low levels of public sector care provision, medium-high levels of taxation and medium-high levels of social expenditures, and high levels of benefit dependency, as well as high long-term and - in the case of Belgium, France and Italy - youth unemployment, are not related to poverty and under-qualification, as in the Anglo-Saxon countries, but rather lie in the peculiar difficulties that Continental welfare state have in creating employment. The Continental employment problem is compounded by the particular method of social insurance financing in Continental welfare state (Esping-Andersen, 1996; Scharpf, 1997a). As a consequence of social security financing out of payroll contributions from workers and employers, a complicated pattern of mutual interaction between investments, productivity, labour participation, wage costs and (non-wage) social security arrangements has been operative in most Continental welfare states since the early 1980s. Under increased competitive pressure, firms in these high-wage economies have only been able to survive if they were able to increase productivity. This was most commonly achieved through benign labour-saving investment strategies, raising productivity levels of workers through high-quality vocational training and education, but also by less benign strategies of laying off less productive or ‘too expensive’, mostly older, workers. High minimum wage floors, co-operative industrial systems with high levels of investment in vocational training and education and substantial non-wage labour costs can serve as a productivity whip. However, they can also engender an ‘inactivity trap’, whereby a virtuous cycle of productivity growth runs into a vicious cycle of high wage costs, exit of less productive workers and rising social security contributions, requiring further productivity increases on competitive firms, eliciting another round of reductions in the work force through subsidised early retirement exit. This self-reinforcing negative spiral has had an especially large impact on low-skilled workers, the young and women. The inactivity trap of the Continental welfare states reinforces existing 'insider-outsider' cleavages. In a clear manifestation of the ‘service sector trilemma’, high wage floors have blocked the expansion of private service employment, while public service employment has been constrained by fiscal overload.

Historically characterised by low levels of female participation, the Continental systems have not felt the need to promote policy measures allowing women to combine work and family (especially child rearing) responsibilities. Recent increases in female employment in Spain and Italy seem to lead to declining birth rates.

In short, the Continental welfare state is not particularly well prepared to meet the new needs of post-industrialism. On a more positive note: the Continental weakness of low levels employment is also the strength of the Continental welfare states, as they have a vast unused labour force potential.

4.3.4 Overcoming regime-specific vulnerabilities

Policy adjustment thus requires tailor-made 'regime-specific' solutions (Ferrera et al, 2000; Hemerijck/Schludi, 2000). While the Scandinavian countries are primarily faced with a 'cost' problem and a 'flexibility' problem (i.e. creating the conditions for an expansion of private services), the Anglo-Saxon countries continue to face problems of 'security' and 'poverty' in a booming labour market. Finally, the North-western Continental countries have the task of raising female employment, also as a means to maintain and transform their inclusive pay-as-you-go pension systems. The Mediterranean Continental welfare states are faced with the most difficult task of breaking down the negative side effects of "familialism".

4.4 The Constraints and Resources of EMU

The introduction of the Economic and Monetary Union (EMU) is part and parcel of the more general shift to a hard currency policy framework across the European economies since the early 1980s. EMU involves a 'paradigm shift' in macroeconomic policy (Dyson/Featherstone, 1999; Dyson, 2000). Both the indirect effects on labour market institutions (Franszese/Hall, 2000) and the direct effects of domestic budgetary and fiscal policy have major implications for welfare state spending and financing. The EMU policy framework, with its core objectives of price stability, central bank independence and sound public finances, essentially implies that (Keynesian) macroeconomic policy measures can no longer serve as a buffer shielding other areas of social policy and economic regulation from the burden of external adjustment to international competition. As nominal exchange rate adjustments are ruled out as a means of adjusting relative prices, adjustment and flexibility must be sought elsewhere in the different policy profiles of developed welfare states.

4.4.1 EMU is good for economic efficiency but may harm social justice

Many advocates of EMU, mostly economists, judging a hard currency regime from the perspective of Pareto-efficiency, defined without any reference to distributive consequences, argue that the monetary and fiscal rules in EMU are likely to have favourable effects on growth and employment, essentially via two mechanisms. In the first place, a stable macroeconomic framework will result in lower and less variable interest rates, which engenders positive effects on investment and consumption. Second, a credible environment of price stability will also affect the strategic behaviour of the labour market parties, giving rise to employment-friendly, decentralised, wage bargaining. The benefits of budgetary discipline, reinforced by the Stability and Growth Pact, allows for a 'crowding in' of private investment, which will put the economy onto a higher growth path. By reducing the scarcity of capital, this will be reflected in permanently low real interest rates. By contrast, high debts and deficits threaten the stability of the Euro, putting pressure on the European Central Bank (ECB) to bail out countries in financial distress.

In conjunction, the indirect effects on wage bargaining are likely to foster low and stable inflationary expectations, while the direct constraints on budgetary policy trigger low budget deficits and public debts, which serve to maintain stable prices. Moreover, lower deficit and debt levels create more room for manoeuvre to cope with adverse economic shocks. With the passing of time, as the Euro will gain important weight as a lead currency in the world economy, European monetary integration will encourage lower interest rates world-wide. Many proponents of the EMU policy framework, led by the President of the ECB, however, forcefully argue that the fruits of EMU do not come cheap. EMU will only bring about Pareto-efficient advantages if the hard currency regime is bolstered by structural reforms in the core domestic policy areas of developed European welfare states, i.e. wage bargaining, labour market regulation, social protection and public services.

A more sceptical note is struck on EMU by academic observers, (implicitly) reasoning from a Rawlsian position that redistributive effects of policy change are only acceptable if they serve to raise the position of the worst-off group in society. There is a general concern that EMU operates as a 'Trojan horse' for a neo-liberal policy shift across Europe, undermining the normative and institutional pillars of the European Social Model, which will constrain the scope for national differentiation in social and economic policy solutions to regime-specific problems and vulnerabilities (McNamara, 1998). Some authors go as far as to argue that the macroeconomic policy priority of 'stable prices' could even frustrate the Pareto-efficient growth potential in Europe, by triggering a vicious cycle of deflationary ‘beggar-thy-neighbour’ strategies of internal devaluation through competitive wage moderation.

4.4.2 Unwarranted fears about tax competition?

With the completion of full monetary integration in the European Union, it is also feared tax competition will intensify, leading to an under-provision of public goods, reducing the returns to immobile factors and increasing tax pressures on such factors (Maystadt, 1994; Genschel, 2001; Ganghoff, 2000). In order for countries to attract and preserve business and capital, countries will feel pressed to provide advantageous taxation and/or regulation for internationally mobile firms (Cacheaux, 2000; Steinmo, 1996). Other countries will follow suit, which in the end will cause a lower level of taxation and regulation than was previously found appropriate (Sinn, 1997). Such developments would jeopardise the current mechanisms of redistribution and solidarity in national systems of social protection (Tanzi/Bovernberg, 1990; Tanzi, 1998). Following the logic of tax competition, economic integration would result in two significant adjustments in national tax systems (Genschel, 2001):

- a decline of the level of total taxation because the exit-threat of mobile tax bases makes high taxes unsustainable;
- a change of the composition of tax revenues because governments are forced to shift the tax burden from mobile taxes, most importantly capital, to immobile bases, such as labour, consumption and real estate.

The empirical evidence, brilliantly analysed by Philipp Genschel (2001), however, suggests that tax competition has so far been limited. Firstly, there apparently has been no decrease in total taxation levels across Europe, on the contrary, there has even been an obvious increase. Secondly, there is also no clear indication for the shift from taxing mobile to immobile sources. Empirical data even show that while property and consumption taxes have in fact gone down, corporate taxes have gone up. In short, there is no evidence for the conventional logic of tax competition.

Nevertheless, the conclusion that there is no significant pressure on taxation (Garrett, 1998; Swank, 2001) is also misguided. Surely, in the absence of tax competition and in the face of increasing unemployment, rising poverty, expanding pensions and health care costs, there would most likely have been further increases in taxation. Instead, during the recession prone 1980s, most developed welfare state turned towards deficit spending to relieve new social problems and mitigate social conflict. If countries would not be affected by tax competition, there would no effective reason to use large deficits instead of increased taxation to finance increases in spending commitments. Empirical evidence shows that total tax revenues as well as tax ratios appear to be more or less 'frozen' since the mid-1970s. This observation does suggest that some kind of international downward pressure on taxation has indeed been operative. However, this does not seem to have pushed national governments onto a 'race to the bottom' downward spiral. This can be explained by the fact that governments cope with extensive prior spending commitments, which highly reduces the scope for tax decreases. Apparently, government demand for tax revenue is not merely a function of the opportunity costs of taxation. On the other hand, the downward pressure on taxes due to internationalisation completes the squeeze between which national governments are kept with respect to tax policy.

The intuitively appealing assumption that immobile tax bases are not subject to tax base erosion can also be challenged. Higher taxes on labour will increase the labour costs for employers and thus decrease labour demand. Although taxes on labour are primarily born by workers, in many cases higher tax burdens will be forwarded to employers. Employers in turn will try to shift the tax burden onto customers. In an open competitive economy, however, this will more likely to a decrease in labour demand. In addition, high taxes on labour generate incentives for workers to engage in the black economy. A similar argument can be applied to consumption taxes: consumers will want to buy products without paying taxes and producers will want to sell products without having to remit consumer taxes. The larger the difference between the price paid by the consumer (labour costs by the employer) and the final profit for the producer (actual wage for the worker), the more attractive the hidden economy becomes (Genschel, 2001).

4.4.3 External constraints as a political resource for adjustment and reform

Looking back over the 1990s, we can only conclude from a macroeconomic perspective, that the introduction of EMU has been an immense success. To be sure, easy to monitor numerical benchmarks as entry criteria for participation in EMU, a temporal constraint requiring states to qualify within a set time scale, 'peer' and ECOFIN pressure to comply, forced member states to commit to budgetary discipline within the constraints of 3% for the deficit and 60% for the debt (as % of GDP). Over the past decade, we observe a clear convergence in performance across Europe with respect inflation, public deficits and government debt ratios since the early 1990s. Today, deficit spending is no longer a viable option, both in and outside of EMU. In an environment of internationally mobile capital, welfare state reform is high on the agenda so as to lower the burden on the public budget and to dampen the growth of wage costs, irrespective of participation in EMU. Indirectly, the Maastricht criteria put considerable pressure for budgetary consolidation even for those countries that did not join EMU in the first instance. The convergence criteria have become an important yardstick for these countries as well, as –under conditions of high capital mobility – excessive spending is punished by high risk premia on their public debt and may thus trigger speculative attacks on their currencies (Scharpf, 2000).

Politically, the need to qualify significantly strengthened the relative position of many finance ministers and central bankers, at the cost of other parts and actors in the polity. The Maastricht criteria, for countries that hoped to join EMU in the first instance, clearly operated as triggering devices, helping to overcome political resistance to unpopular reform, which may have been unfeasible in the absence of the EMU beauty contest. Italy in this respect is exemplar. Maurizio Ferrera and Elisabetta Gualmini go as far as to argue that the Italian welfare state was in effect 'saved by Europe' (Ferrera/Gualmini, 2000).

4.4.4 Competitive wage devaluation and the resurgence of social pacts

Remarkably, the constraints of EMU and the Stability and Growth Pact on public spending and deficit financing have not provided policy makers with a 'window of opportunity' to launch bold strategies of labour market deregulation. To the contrary, EMU seems to have had a positive effect on the resurgence of social pacts between national government and the social partners, allowing for various market and social policy reforms that encourage welfare sustainability. It is true that in the 1980s there was strong pressure to decentralise collective wage bargaining, suggesting that national incomes policies would give way to market-regarding combinations of sectoral and company bargaining (Calmfors/Driffil, 1988). More recently, however, the shift to hard currency effectively bring social partners closer together, leading to a remarkable resurgence of social pacts and policy co-ordination between the social partners and the governments in Denmark, Finland, Ireland, Italy, the Netherlands, Spain and Portugal (Fajertag/Pochet, 2000). Especially for hard-currency latecomers, like Italy and

Portugal, EMU helped to rekindle the urge to find co-operative, positive-sum solutions to the predicament of adjustment – among which initiatives to make taxation and social protection more ‘employment friendly’ have figured prominently (Cameron, 2000; Ferrera/Gualmini, 2000; Rhodes, 2000).

Among these countries, Denmark and the Netherlands have proven to be something of a model for advocates of a ‘third way’ between neo-liberal deregulation and the traditional solidaristic European model, both in terms of its institutional rejuvenation and the imaginative reconfiguration of its policy mix (Benner/Vad, 2000; Visser/Hemerijck 1997). As the Dutch case suggests, the employment effects of wage restraint are strongest in domestic services that were previously priced out of the regular labour market. Over the last decade, productivity levels in the Netherlands have indeed come down slightly, but this should be explained by the increase in jobs for the low skilled. Finally, in the Netherlands, new jobs have mainly been created in the service sector via part-time employment. Thus, there is grounded evidence to believe that responsive wage moderation would also be beneficial to less exposed countries like Germany and France, depending on the design of the welfare state. To the extent that wage developments in the private and public sector are coupled, responsive wage settlements can lower the public sector wage bill and curtail the costs of social security and broaden the revenue basis of the welfare state (Ebbinghaus/Hassel, 1999). Finally, there is some empirical evidence from Denmark, Ireland and the Netherlands that responsive income policy co-operation allows for a smoother interplay among income, monetary, and fiscal policy, thus stimulating economic growth while keeping inflation low.

In short, caught between fiscal strain, but not of the ‘race to the bottom’ kind, which would inevitably lead to political panic, and constraints to adequately address the new social risks associated with post-industrial change, strong supporters of the welfare state increasingly acknowledge that sustaining core tenets of the European social model(s) requires significant reforms. When the logic of fiscal strain meets the reality of standing commitments and new forms of social exclusion and under-privilege, the resurgence of social pacts and tax reforms which combine rate cutting and base broadening suggests in the wake of the introduction of EMU, indicates the prevalence of a distinctly

European dynamic of a *system-wide search* for a new, economically viable, politically feasible and socially acceptable welfare architecture.

4.5 Realigning Work and Welfare

Employment - persistent unemployment and low levels of labour market participation - remains the Achilles heel of the European economy. Although unemployment has declined impressively from its peak of 11.1% in 1994 to 8.7% in 2000, long-term unemployment remains 4% of the labour force. More than 40% of European unemployed people have been out of work for more than a year. Youth unemployment in the European Union is at 8.4% only two percentage points lower than in 1994. High levels of unemployment and other forms of subsidised inactivity under early retirement, disability and social assistance schemes, are clear signs of welfare state deficiency (European Commission, 2000a).

A large majority of European citizens seeks gainful employment, not merely to earn a living, but also for reasons of security, social status, prestige, companionship and engagement in collective purposes. The evidence, based on various Employment in Europe Surveys, reviewed in Chapter 2 of our report, clearly shows that employment remains an important source of social integration and economic independence for both men and women. These findings squarely destroy the intuitively appealing thesis, advanced by conservative sociologists in the 1970s and 1980s, that the welfare state, by having dissolved the 'sacred' link between work and income, has undermined the work ethic and, as a consequence, given rise to a culture of ‘welfare dependency’.

4.5.1 The skill predicament in the new economy

European employment rates have improved significantly since the mid 1990s. A closer look behind aggregate data reveals that employment growth is skill-biased, service intensive and gender-specific. Two-thirds of net employment creation since the mid-1990s involves high skill jobs. Between 1994 and 1999, over 60% of the 6.8 million new jobs in the European economies went to women (European Commission, 2000a). By and large, all newly employed women in the 1990s have taken up service related jobs. Employment levels of workers over 55 continue to decline in the larger economies of Germany, France, and Italy, while in the Netherlands, as an exception, the employment rate of men over 55 rose by 5.5 percentage points over the past decade.

Two observations sum up overall employment trends in the European Union. The good news is that European labour markets are far less ‘sclerotic’ and ‘ossified’ than was proclaimed in the early 1990s (Siebert, 1997; OECD, 1994). Over the past decade a fair number of European economies have managed to reduce unemployment to rates close to that of the US, without abandoning their commitments to the welfare state. Apparently, there are alternative policy strategies feasible, functional and fair to the one-size-fits-all recipe of the 1994 OECD Jobs Study (Bertola, et al, 2001; Esping-Andersen/Regini, 2000a).

The bad news is that employment trends, not only in Europe but also elsewhere in the OECD-area, provide solid evidence of increasing skill polarisation in the labour market. Well-qualified people advance to better positions while the low skill groups find themselves trapped between unemployment and low quality jobs (Drèze/Sneessens, 1997). Although economists still disagree about the causes for this polarisation, the employment effects are the same: highly educated workers are the winners; their jobs have become more secure and/or better rewarded as a consequence of increased international trade and the advancement of computer technology (Lawrence/Slaugter, 1993; Freeman, 1995). Low skill and less experienced workers are the losers; they face stagnant or declining wages in the US-economy and greater difficulties in finding employment in many European economies.

4.5.2 Welfare state constraints on employment

Against the background of the secular decline in demand for low skill labour, it is worth considering the divergent character of employment trends in exposed and sheltered sectors across Europe (Scharpf, 1997a). Since the mid-1970s all European economies have experienced a structural loss in employment in the exposed sectors of the economy (table 4.4). After 1985, only the Netherlands and Ireland experienced significant increases in employment in the exposed sectors. Sweden and Finland, on the other hand, continued to suffer from further declines in industrial employment. In other member states exposed sector employment stabilised at a rate of about a third of the working population.

Table 4.4: Employment in Exposed sectors

	1975	1980	1985	1990	1997	'75-'85	'85-'97
Denmark	39.1	38.8 b	36.8	36.7	36.1	-2.3	-0.7
Finland	44.0	44.1	41.9	40.2	32.9	-2.1	-9.0
Sweden	42.4	40.9	39.2	38.6	33.7	-3.2	-5.5
Ireland	37.2	35.7	29.2	30.0	30.7	-8.0	1.5
United Kingdom	39.4	37.4	34.1	37.1	34.8	-5.3	0.7
Austria	40.8	39.3	37.5	37.8	36.4	-3.3	-1.1
Belgium	32.9	29.2	25.4	26.1	25.7 c	-7.5	0.3
France	38.8	36.2	31.2	31.9	28.8	-7.6	-2.4
Germany		39.5	35.8	36.7	35.3	-3.7	-0.5
Italy	33.7 a	33.0	28.0	27.6	27.1	-5.7	-0.9
The Netherlands	28.8	27.4	25.6	28.8	31.2	-3.2	5.6
Spain	39.3	31.5	25.7	27.5	23.8 c	-13.6	-1.9
OESO-18	38.2	36.0	34.5	34.8	33.5	-3.7	-1.0

Exposed sector: agriculture, hunting, forestry, fishing, mining and quarrying, manufacturing, electricity, gas, water, construction, transport, storage, communication, financing, insurance, real estate and business services (ISIC 1–8, except 6).

The relative decline in employment in the exposed sector since the mid 1970s is intimately related to increased international competition. This is not only because low-cost producers in Southeast Asia and Eastern Europe have entered the markets for advanced industrial goods and services. More important (given the fact that trade with the rest of the world accounts for only a small proportion of European trade) is perhaps the removal of the remaining regional barriers to the free movement of capital, firms, goods and services by the completion of the European internal market. This has required the economies of Sweden, Germany and the Netherlands, for instance, where wages, non-wage labour costs, other taxes and regulatory costs are high by international standards, to exploit all the opportunities for increasing the efficiency of production and the quality of innovation. To the extent that overall levels of employment in the exposed sectors have since 1985 remained stable, the decline in job opportunities for low skill workers was compensated for by significant increases in the demand for highly skilled and experienced workers in internationally exposed sectors (Scharpf, 1997a).

The picture that emerges from the employment trends in the sheltered sectors of the economy, presented in table 4.5, is that employment opportunities today heavily rely on the expansion of domestic services. To be sure, with an ageing population, new pensioners will demand good health care and recreation facilities, which further boosts the high skill employment potential of the service industry. Dual career households are also more inclined to buy personal services. Rising levels of female labour market participation by women potentially generates an important demand for "reproductive" social services, such as childcare, which, in turn, is likely to create additional labour market opportunities for women.

Table 4.5: Employment in Sheltered sectors

	1975	1980	1985	1990	1997	'75-'85	'85-'97
Denmark	32.6	34.5 b	37.1	37.5	38.4	4.5	1.3
Finland	25.7	27.2	30.7	33.0	30.0	5.0	-0.7
Sweden	34.9	38.5	40.5	42.0	37.1	5.6	-3.4
Ireland	20.1	20.9	20.5	21.7	26.6	0.4	6.1
United Kingdom	30.8	31.9	30.7	33.7	35.2	-0.1	4.5
Austria	21.7	24.0	25.8	27.7	31.9	4.1	6.1
Belgium	24.7	26.7	26.9	29.0	28.1 c	2.2	1.2
France	24.5	25.9	26.3	28.1	29.5	1.8	3.2
Germany		25.5	25.2	27.0	28.1	-0.3	2.9
Italy	20.7 a	21.7	24.2	26.7	24.0	3.5	-0.2
The Netherlands	24.4	25.7	25.5	31.5	34.9	1.1	9.4
Spain	17.9	17.3	17.0	21.2	22.5 c	-0.9	5.5
OESO-18	27.5	28.5	30.0	32.4	33.6	2.5	3.6

Sheltered sector: wholesale and retail trade, restaurants and hotels, community-, social-, and personal services (ISIC 6 and 9).

[a] 1977; [b] 1979; [c] 1996.

Whether the Member States of the European Union can make the most of their employment potential, is subject to a number of constraints, which are intimately linked to the scope and design of their welfare systems:

- More intense international competition in product market is driving up productivity and skill requirements in the exposed sector. Job opportunities for high skill groups in competitive sectors like international banking and insurance, finance and business services, information and communication technology, biotechnology, but also in medium-high technology sectors, machine tool production and car manufacturing, may continue to grow. Employment opportunities for the low skill groups in the exposed sector are likely to continue shrinking.
- Employment losses in the exposed sectors can be compensated for by employment gains in the sheltered service sectors. Public sector job opportunities for the high skilled, however, seem to remain stagnant. In the 1990s, most European countries have had to cope with rising costs of unemployment combined with political and economic pressures to reduce the tax burden, public debt and deficits, in order to qualify for EMU. Also the Stability and Growth Pact puts limits on the capacity of individual European countries to stimulate employment growth in the areas of education, health care and social services. Job opportunities for high skill groups in private social services are on the rise, but its growth potential is politically circumcised by constraints the welfare state places on private provisions, co-payment and vouchers in the areas of education, health care and other social services.
- Finally, employment opportunities for low skill groups in private services, retail trade, hotels, restaurants and catering, personal and some social services, are also constrained by welfare state design, in particular by prevailing levels of social protection, the height of the minimum wage, and the extent to which social security is financed through payroll contributions or from general taxation.

4.5.3 Feasible Policy responses

The challenge for effective policy responses is twofold. Feasible policy strategies are those and only those that strike the right balance between policy solutions that are responsive to common problem of the skill predicament *and* in tune with regime-specific institutional constraints and resources.

The common thread that runs through all currently popular policy remedies is the emphasis on gainful employment as the principal channel to achieve effective citizenship (Clasen, 2000). The new vocabulary of ‘employability’, ‘life long learning’, ‘activation’, ‘insertion’, ‘make work pay’, and ‘welfare to work’, signals a general shift in ideas. This shift was accompanied by a change in the balance from macroeconomic demand management towards an even greater emphasis on microeconomic supply side measures (Fay, 1997). The new policy objective is no longer to keep overt unemployment down by channelling (less productive) workers into social security programmes, but rather to maximise the rate of employment as the single most important policy goal of any sustainable welfare state. In the next paragraphs we will assess the relative merits of five types of proactive and preventive policy alternatives seeking to realign work and welfare. These are: 1) life long learning; 2) activation; 3) employment subsidies; 4) labour market desegmentation; 5) institutional recalibration in employment policy and labour market regulation.

4.5.4 Life Long Learning

Everybody's favourite solution to the skill predicament of course is to upskill workers through extended schooling, vocational training and education. To be sure, a highly educated workforce is conducive to sustained employment growth. Policy makers can do a lot to enhance the advantages of immobility, through the fostering of local networks and investments the social infrastructure and human capital (e.g. public policies for education, vocational training and life-long learning). If social and employment policies are increasingly aimed at developing the quality of human resources for a high-skill equilibrium, they can assume the role of a 'productive factor'.

The consensus over life long learning begins to weaken when it comes to debating public policy, particularly with respect to the role of the state, the market, the social partners and individual contributions in the creation of high-skill employment (Crouch et al, 1999). Leaving investment in skills to the market may result in an under-investment of private firms due to the danger of 'poaching' high-trained workers by competitors through higher wages.

The involvement of the social partners in vocational training and education and life long learning is essential for mitigating collective action dilemmas. This, however, as we have seen in Chapter 2, does not solve the pressing problem of under-investment in training for low skill workers, atypical workers, women working part-time, older workers, ethnic minorities and immigrants, who are most likely to suffer the most in cycles of economic hardship.

In the 1990s, various countries turned to demand-side financing mechanisms for education and life-long learning, such as voucher schemes, tax incentives and Individual Learning Accounts (ILAs) to promote training. ILAs can provide training opportunities to groups that do not generally participate in systems of vocational education and training. ILAs, like vouchers and co-payments, are based on the principle that: (a) individuals are best placed to choose what they need to learn and how they want to improve their skills; and (b) that costs should be shared by all the actors involved, employers, workers and government.

4.5.5 Activation

Improvements in vocational training and education and increased participation in higher education are unlikely, by themselves, to solve the problems caused by the fall in the demand for low skill labour, particularly for those who have already entered the workforce and completed their limited tenure of education. If fighting social exclusion through employment remains the principal policy goal of the European social model in the early 21st century, the learning offensive will have to be complemented with strategies of raising employment opportunities for low skill workers through other means. In the 1990s, many left-of-centre governments have experimented with various forms of ‘activation’ measures in the lower tiers of the system of social protection (Eardley, et al, 1996). Activation programs are designed to strengthen and repair the conditional ties between work and income. The underlying philosophy of activation is one of reciprocal obligations: Welfare recipients must be obliged to accept employment, training, and community care offers in order to receive benefits, while the state has the obligation to provide the services that enhance the employability of benefit claimants (Clasen, 2000). The ‘stick’ of greater conditionality is hereby tied to the ‘carrot’ of more proactive help, personal guidance and tailor-made support from (local) government officials and (regional) public employment services (Hinrichs, 2000).

As an example, the Danish ‘Active Line’ policy initiatives, widely supported by the social partners, seem to combine successful employment strategies with an extremely generous benefit system, has been singled out by the European Commission as a ‘best practice’ for others to follow. While the level of unemployment benefits remained unchanged, restrictions were introduced with respect to duration and eligibility criteria (Kvist, 2000. Young unemployed became obliged to participate in work experience and training programs on the basis of individualised action plans, formulated after three months of unemployment. Sanctions for not taking up an appropriate job or training offer were strengthened and (renewed) access to benefits was made more difficult.

4.5.6 Employment subsidies

Demand for low skilled workers can also be raised by employment subsidies. As a result of the increased use of in-work tax credits in the Anglo-Saxon welfare states of Ireland and the United Kingdom, reductions in social security contributions in the Continental welfare state of France, Belgium, Germany and the Netherlands and also in Southern welfare states like Spain and Portugal, the number of subsidised jobs has grown dramatically in the European Union.

Different wage subsidy strategies are appropriate to different welfare states. In the United Kingdom, where guaranteed minimum income arrangements at subsistence level are generally not available and unemployment benefits are low and of short duration, individual tax credits to support workers and their families who work for wages below the poverty line are very popular.

By contrast, Continental social insurance-based systems provide few employment opportunities for job seekers with low levels of vocational training and education. Because of a relatively large wedge between employers' labour costs and disposable income, many workers are not sufficiently productive to earn the cost of their labour back for their employers. For the Continental welfare states it thus makes more sense to use regressive employment subsidies to create a low-wage job-intensive service sector. Targeted wage subsidies could permit a scenario of 'labour-cheapening' and job growth, without an American style surge in poverty and inequality. This could open up a wide range of additional, economically viable employment opportunities at the lower end of the labour market. Wage subsidies are of minor importance in mainly tax-financed welfare states such as Denmark, where the tax wedge at the lower end of the income scale is already rather low. Furthermore, the state is an important employer, especially for (low skilled) women, due to a large service heavy public sector, which ameliorates the need for measures like subsidising low skill jobs.

Notwithstanding the favourable verdict on employment subsidies in Anglo-Saxon and Continental welfare states, employment subsidies are not without problems. Policy-makers should be aware of abuse by employers who can simply lower their wage rate without necessarily creating new jobs. As many Continental programs are targeted to unemployed people who have been out of work between one and three years, employers are tempted to substitute long-term unemployed for short-term unemployed, or delay hiring until the subsidy can be collected. Also, it is important to emphasise that a policy of lowering social security contributions for employers hiring low-skilled workers could harm the incentives to upgrade skills. This raises the danger that the employment subsidies lock in low-skilled workers in a secondary low-wage economy from which they cannot escape. Hereby, a 'skill trap' replaces the 'inactivity trap'. To be sure, in a graduated scheme, modelled after a negative income tax, there remains a clear incentive to seek better education and a better job.

4.5.7 Labour market desegmentation

In the wake of the recession in the early 1980s, it was generally believed that full employment was increasingly becoming a distributive problem best attacked through a redistribution of prevailing employment opportunities. The most popular strategy was compulsory working time reduction. In the 1990s the interest in compulsory working time reduction gave way to a growing interest in voluntary working sharing through the expansion of part-time work.

Intense competition, technological progress and changed family patterns have tremendously altered the conditions under which national labour markets operate (Esping-Andersen/Regini, 2000). The new social and economic policy environment requires more labour market flexibility in terms of working patterns, wages and working time. This not only to allows for a better use of human resources at the level of the firm, but also for a better fit with the social needs of workers and their families. The basic challenge for effective employment policy lies in reconciling labour market flexibility with measures to counter growing social exclusion and the emergence of a class of working poor. There is no inherent contradiction between these objectives. To the contrary, the general acceptance of flexible arrangements in the labour market is likely to be increased if flexibility is matched by a decent standard of social protection. Jonathan Zeitlin has coined this option a strategy of 'labour market desegmentation'.

Labour market desegmentation is essentially about negotiating a relaxation of employment protection for the stable, full-time, core workforce and linking these new standards to increased protection for the peripheral, unstable, part-time, and temporarily employed in the rest of the economy. While a lower standard of protection against dismissal might affect overall employment levels only a little (since a more rapid rise in employment during an economic upswing is likely to be outweighed by a faster cutback in jobs during a downturn), long-term unemployment with its highly undesirable hysteresis effects might well be kept at a more modest level than in countries with high and rigid standards of employment protection (Schmidt, et al, 1996).

Policy experience in the Netherlands renders a telling example of how through a concerted effort of labour market desegmentation, problems of labour market marginalisation can be avoided (Barrell and Genre 1999). With the 1995 flexi-security agreements between the social partners, the legal position of part-time workers, as well as temporary workers, was strengthened in exchange for a slight loosening of legislation concerning the dismissal of (full-time) employees.

Also in the more 'insider biased' Continental systems of Southern Europe, strategies of labour desegmentation are not necessarily ruled. In Italy various steps that favour part-time and temporary work (for example the True package in Italy). For the UK, the introduction of a statutory minimum wage is a good step in the direction of labour market desegmentation.

4.5.8 Institutional recalibration in employment policy and regulation

The policy changes, highlighted above, also triggered processes of institutional recalibration (Ferrera, et al, 2000), i.e. a reconfiguration the division of labour between public and private actors and levels of governance in the provision of welfare and the promotion of employment. Three developments stand out. These are: (1) the liberalisation of public employment service systems; (2) the widening scope of co-ordination and issue-linkage between and across the traditionally institutionally separated issue areas of social protection and employment provision; and, finally (3) initiatives and experiments with sub-national employment pacts in response to employment problems associated with regional economic decline and underdevelopment. The proliferation of supply-side approaches to labour market policy has come in tandem with a major restructuring in many national systems of Public Employment Services. In a number of countries, this has involved a liberalisation of the rules and regulation governing private employment agencies; the use of market-type mechanisms, such as contracting out and organisational reforms, including, among other things, separating purchasers and providers. The demonopolisation of the Public

Employment Service, in some countries, went hand in hand with the regionalisation, decentralisation, and sometimes, tripartisation of institutional responsibilities, so as to include the expertise of organised interests, especially employers, in the reformed job placement organisations. The shift towards activation, especially the introduction of work requirements in social assistance, has blurred the traditional division between the policy areas of social protection and labour market policy. Activation requires better and more cross-sector policy co-ordination between these two traditionally highly separated policy domains of benefit provision and job placement and reintegration. Many large countries, suffering from serious regional disparities in employment problems, have in the past decade initiated 'regional employment pacts'. In trying to develop 'bottom up', ad hoc, but nonetheless highly integrative networks, linking up issues of regional and urban economic development and employment revitalisation, such as territorial pacts, often supported by EU programs give room to very extensive partnership involvement – including third sector voluntary organisations (European Commission, 2000c; Regalia, 2001; Evers, 2001). In terms of regulation, these developments share in a shift away from 'heavy' legislated or rule-governed labour market regulation and employment policy to 'lighter' forms of decentralised co-ordination, including the social partners, also private actors, and third-party groups.

4.5.9 Beyond proactive policies

Despite the predominant political rhetoric of life long learning, public policy resources have quite justifiably concentrated on assisting the low skilled and the unemployed, who are most adversely affected by the skill predicament that haunts the knowledge-based economy. Activation, targeted employment subsidies, concerted efforts at labour market desegmentation and experiments with regional pacts, constitute important steps towards expanding labour market participation, which in turn – when successful - can also serve to broaden the revenue basis of the welfare state. Banking on the large reservoir of social and political support for a comprehensive welfare state in Europe, from the perspective of political legitimacy, such focused policy initiatives are consistent with the prevailing norms of economic independence, self-respect and social integration through gainful employment. To the extent that these initiatives are also the outcome of policy co-operation and consensus building with the social partners, they are most likely to be effectively implemented.

Although paid employment offers the best safeguard against poverty and social exclusion, not everyone is employable. Policies concentrating on skill redundancies, lack of experience and labour market deficiencies do little to counteract cultural problems like employers' reluctance to employ people from disadvantaged groups – including disabled, older people, people from ethnic minorities, former drug addicts and criminals (Lødemel/Trickey, 2000). Large numbers citizens with serious social and personal problems, because of child abuse, alcohol and drug related problems, face multiple barriers to employment. Often such 'unactivatable' participants end up in a carousel, rotating between unemployment and activation. For these disadvantaged groups, policy makers have to settle for basic income support plus less ambitious, but nevertheless costly, measures of social activation, aimed to bolster self-respect through socially useful forms of 'non-work', so as to prevent further marginalisation and social exclusion (Vandenbroucke, 1999).

4.6 Reconciling work and family life

Strategies of labour market desegmentation, advocated above, are inherently related to the feminisation of the labour market. Female employment in EU labour markets has been on the rise since the 1970s. In the period of 1994 to 1999, women accounted for the majority of the job growth in the European Union (OECD, 2000). While it is tempting to speak of a converging trend towards higher levels of female employment across the EU, substantial differences in participation rates remain. The Nordic countries show female employment rates that measure levels close to their male counterparts (well above 70% for both Sweden and Denmark), which can for a large part be explained by a large service biased public sector. In the United Kingdom, high levels of female employment, at 63% in 1999, are associated with a large service sector. Labour market deregulation has led to a swift growth of part-time jobs, especially for women, under relatively unfavourable conditions. With respect to the Continental welfare states, there are clear differences in employment performance between the Mediterranean and the North-western Continental countries. In 1999, the female employment rates of Spain (37.3%), Greece (40.3%) and Italy (38.1%) were more than 10% behind the European average of 52.6%, whereas the female employment in Germany (57.1%), the Netherlands (61.3%) and Austria (59.7%) all exceeded that average by at least 4%. Notwithstanding the dismal employment statistics for the southern continental countries, it should be emphasised that there is a great deal of dynamism with respect to female employment in the Mediterranean welfare states in recent years. In Italy, for example, 85% of the newly created jobs since 1998 have gone to women (European Commission, 2000a). Furthermore, in Spain, female employment rates, in the 25-54 age group, have gone up from 30.5% in 1980 to 60% in 1999. While female employment rates have gone up in the EU, fertility rates have been (in some countries quite drastically) decreasing (see also chapter 1).

4.6.1 The central role for public policy

A number of demand and supply factors critically shape female employment patterns (Daly, 2000). On the demand side, the availability of part-time work, service intensity in the sectoral profile of the economy, and the size of the public sector, all engender positive effects on rates of female employment. Beyond these structural conditions, higher wages and a company car are not overriding determinants for a woman to accept a job offer. By the same token, policy incentives of activation and 'making work pay' do not by themselves lead to highly increased participation rates for women. This is because the majority of women in the European Union aspire to motherhood. In essence, a woman's decision to enter the labour market and to accept a job essentially revolves around conditions of public policy that allow her to reconcile work and family life. What matters are childcare facilities, leave arrangements, professional care for the elderly and the treatment of female earned incomes in the tax system. Below we elaborate on four policy strategies that are of key importance to female employment patterns (see also Behning and Serrano Pascual, 2001: 330). These are: 1) access to high quality day care provision; 2) provision for maternity and parental leave; 3) family friendly employment opportunities; 4) basic social security coverage and individualised tax systems.

4.6.2 Child care

The key to Scandinavian female employment success is the presence of high quality, accessible and affordable, public childcare facilities. About 80% of the children in the important age group of 3 to 6 are looked after in day care facilities in Denmark and Sweden. The development of such facilities has largely occurred in a period in which the Scandinavian welfare states were drastically expanding by way of creating vast numbers of public sector jobs in the areas of health, education, social services and public administration. The resulting increases in (mainly) female employment rates subsequently caused an increased demand for childcare, which governments were not reluctant to provide, since this opens up additional job opportunities. With the exception of France, the other EU member states have comparatively underdeveloped systems of childcare. Where in the Scandinavian countries the dominant pattern of work already in the 1970s and 1980s shifted towards a dual breadwinner model, the dominant pattern in the Anglo-Saxon and Continental countries remained the male breadwinner/female caregiver model for a long time. While this model still dominates the southern Continental countries, a slight transition towards a 'one and a half breadwinner model' can be distinguished in the North western continental and Anglo-Saxon countries. Furthermore, while stimulating female employment, emphasis in the Nordic countries was put on the development of childcare facilities, in close relation to the expansion of the public service sector, the main focus for most continental countries was the development of flexible work opportunities. In this respect the Dutch case is exemplar (see below). The dramatic drop in birth rates in Mediterranean countries is closely related to the low availability of childcare, an undesirable legacy of traditional familialism. To be sure, expanding childcare facilities would better allow working mother to reconcile career and family life. As a secondary effect, this would also mitigate the dire straits of population ageing by way of raising employment and birth rates. Furthermore, the development of professional elderly care services would help to shift informal caring responsibilities away from the female family members (OECD, 2000). The big question is whether such a strategy of 'de-familisation' is feasible under current economic and social conditions?

Recent policy initiatives, especially in the Netherlands, are directed towards expanding the availability of childcare facilities provided or subsidised by the organisations where parents are employed. The Netherlands now even has the highest rate of firm-provided and privately subsidised day care facilities. While the Dutch example shows that childcare facilities do not necessarily need to be provided by the government, private provision generally favour high skilled and full time workers. The ambition of the so-called National Childcare Strategy in the UK, on the other hand, is to establish childcare facilities in every neighbourhood and to promote measures that enable parents to balance paid work with the needs of their children. Workers receiving Working Family Tax Credits, who are usually low skilled/low paid workers, are credited 70 per cent of their childcare costs. Furthermore, opening hours play a significant role in the accessibility of childcare facilities. In a fair number Continental welfare states, day care institutions generally only open in the mornings, which severely constrains the possibilities for women to take on full-time or even large part-time jobs.

4.6.3 Maternity and parental leave

In order to not only facilitate women entering the labour market, but also staying in, favourable provision of parental leave arrangements are of critical importance. The duration and generosity of transfers for maternity or parental leave are of key importance, as highlighted in Chapter 1. In addition to a usually fully paid maternity leave, the Nordic countries generally offer a generous parental leave, which can also be taken up by fathers. In the UK, parental leave provisions are underdeveloped. The Thatcher government even strongly advocated to remove parental leave for fathers from the scope of the EU Parental Leave Directive of 1984. Progress has, however, been made under New Labour. The National Action Plan of 1999 contains an extension of Maternity Allowance to those under the lower earnings limit. In the majority of Continental welfare states there are provisions for either fully or partly paid maternal leave, but additional parental leave schemes are not all that generous, leading to low take-up rates. In Mediterranean countries parental leave is unpaid.

An additional problem with parental leave is that mothers take up leave, while fathers continue with their full-time careers, largely because of household financial constraints, which in turn reinforces traditional cultural barriers. The introduction of specific leave arrangements for fathers could contribute to a shift in the balance of family care. However, for financial reasons discussed above, these arrangements should be quite generous in order to be effective.

Provisions that allow for a return, after maternity leave, to an old or access to a new job are of crucial importance to the continuity of female employment. The lack of incentives to return to work, the cumulative wage penalty, caused by interrupted working careers, also discourages continuity in female employment patterns. Again this not only negatively influences the (financial) advantages of having a job for women, but also puts pressure on fertility rates by way of creating disincentives for having children in the case of full time employment. The introduction of a legal guarantee that gives parents the right to return to work, after having cared for young children, as in Finland, is worth considering.

4.6.4 Family friendly employment opportunities

Family friendly employment patterns are in essence flexible with respect to working hours. Empirical evidence shows that high and rising levels of employment are usually connected with above-average part-time ratios. Part-time work increases the possibility for women to care for their children while at the same time being employed. If part-time work is recognised as a normal job, supported by access to basic social security, and allows for normal career development and basic economic independence, part-time jobs can generate higher gender equality and active security of working families.

Growth in part-time employment in the Scandinavian countries has subsided in the most recent years. This is caused by both already very high levels of female employment and the highly developed systems for reconciling work and family life, which renders part-time employment not *necessary* when women want to both work and care. Both the Anglo-Saxon countries and the Continental welfare states have in the past decade experienced a steady growth in part-time employment. These high rates are for a large part responsible for the high female participation and employment rates in those countries. The increases in part-time employment, however, have in both cases been caused by different factors. In the Anglo-Saxon countries, the expansion of part-time work is for a large part the product of labour market deregulation in the 1980s. Part-time work in the UK and Ireland is mainly a coping solution of low skill and low paid female workers. This compounds already high (child) poverty rates, especially in the United Kingdom. In the northern Continental countries, high rates of part-time employment should be associated with favourable conditions. In this respect, the case of the Netherlands is an interesting example. The 2000 Working Hours Act gives part-timers an explicit right to equal treatment in all areas negotiated by the social partners, such as wages, basic social security, training and education, subsidised care provision, holiday pay and second tier pensions. As a result, earnings differences between full-time and part-time jobs have narrowed to 7%. Dutch employers essentially recruit part-time workers to strengthen organisational flexibility, not as a means to pursue low-price competition, as is the case in the United Kingdom. Furthermore, 68.8% of all female workers are employed on a part-time basis in the Netherlands, which means that further increases in female employment rates are increasingly harder to achieve through part-time employment. In the Mediterranean countries, if women are employed, they tend to do so on the basis of a full-time contract. Also due to the ‘insider bias’ in those countries, favourable conditions for part-time employment are hard to 'trade' for loosened regulation with respect to the dismissal of full-time employed.

4.6.5 Basic social security, pensions and taxation

Since women are more likely to compromise their careers for family reasons, they will, most notably in PAYG systems, accumulate lower pension entitlements than their partners. Moreover, tax splitting in income taxation puts a disproportional burden on the second income earners (mostly women). A fully individualised tax system treating both women and men exactly the same favours highly egalitarian employment patterns. Minimum basic pensions, independent from contributions, effectively protect women with very low labour market participation. A number of continental states have undertaken efforts to make access to basic pensions easier for part-time and temporary employees. In addition, bringing part-time work, home and tele-work and intermittent employment within the scope of the statutory social protection system can serve as a viable option in stimulating such flexible work agreements.

4.6.5 Timing is crucial

The Employment Title of the European Union states that raising the employment rate should be the main focus of national policy. The experience with the Luxembourg process has resulted in a shift in focus, away from 'regular' private-sector labour market incentives to a more specific policies aimed at reconciling work and family life (Behning and Serrano Pascual, 2001). Beyond important demand side incentives for flexible employment opportunities, of key importance are supply (semi-)public policies with respect to childcare, maternity and parental leave arrangements.

The Scandinavian countries offer mothers the widest array of choices; mothers can take leave from the labour market for the purpose of caring for their children or they can remain in the labour market, both full-time and part-time, while relying on high quality professional care services. The Continental logic privileges maternal caring to assist the family with, instead of substitute for, private or family care. The Dutch case with favourable conditions for part-time work for both men and women offer the option of one-and-a-half-income families, reducing the household's narrow dependency on the wages of the male breadwinner and its job security. Such families are a better defence against child poverty, while providing more flexibility in career and working hours, child rearing and care for the elderly than in single breadwinner continental welfare states. In the Mediterranean countries, women have limited choice: unpaid parental leave provisions, absent childcare facilities, female employment unfriendly taxes and pensions are all inconsistent with the core challenges of post-industrial change, despite a large share of ‘unused labour force potential’.

A casual glance at the overall policy performance would suggest that the Continental and Anglo-Saxon welfare states should make the best of their backward position by simply emulating Scandinavian ‘best practices’. It should, however, be remembered that the Swedish success in expanding female employment on a mass scale in the 1970s was based on a Keynesian full employment strategy when governments were still a position to do so. The expansion of a service-intensive public sector has had a lasting positive side-effect of strengthening middle-class support for the family-friendly Scandinavian welfare state (Fargion, 2000). Under current economic and political conditions, expansionary options are ruled out. Under the shadow of EMU and the Stability and Growth Pact and the ongoing fear for tax competition, the Scandinavian policy response of the 1970s is no longer available. The ‘second best’ of the Dutch sequence of policy change is more instructive for most other Continental welfare states. Initially, female employment increases were achieved by way of enhancing employment conditions for relatively small part-time jobs. Once part-time work has contributed to quite a drastic increase in female employment, additional growth will have to be sought through improvements in the area of childcare. The shift towards larger part-time jobs, under conditions of favourable economic growth, thus puts pressure on the government and private employers to jointly increase and subsidise the expansion of childcare facilities. As a consequence, the Netherlands has the highest incidence of employer based childcare provision, often subsidised by state, in the European Union (OECD, 2001).

4.7 The quest for fair and sustainable pensions

Demographic ageing constitutes one of the most pressing policy problems for most EU Member States in the coming decades. This is the key theme of Chapter 3. The macroeconomic effects of population ageing are very disturbing. Without sustained improvements in factor productivity or ground-breaking changes in labour force participation, output growth is expected to slow down. And in the absence of effective pension and labour market reforms, projected pension expenditures will greatly outpace projected pension contributions, resulting in large deficit in pension funds, which in turn will put public finances in distress. While life expectancy has been increasing everywhere, there are considerable differences with respect to birth rates and employment opportunities for elderly workers across the Member States of the EU. In the past two decades, the biggest drops in birth rates have taken place in Continental welfare states like Germany, Italy, Greece, and Spain. The Scandinavian countries stand out, together with Belgium, France, Luxembourg, the United Kingdom and Ireland, with birth rates of above 1.5%. Employment opportunities for elderly workers aged 55-64 have again declined most conspicuously in Continental welfare states. Employment rates for elderly workers are currently well below 30% in Austria, Belgium, Italy and Luxembourg. In Sweden and Denmark, together with the United Kingdom and Portugal, employment rates for elderly workers are close to 50%, with Sweden taking the lead with 63%. In short, from a demographic point of view, the Continental welfare states with low birth rates and low levels of employment for elderly workers, which prevail in Southern Europe, are really doubly deficient.

The demographic vulnerabilities of Continental welfare states are moreover compounded by design-characteristics in public pension systems. Except for the Netherlands, all Continental welfare states have public mandatory PAYG systems, financed through wage based social contributions. Despite this common feature, continental pension systems display a wide variety, most notably between northern and southern continental states. Most importantly, PAYG financing invokes high non-wage labour costs with serious negative consequences for employment opportunities at the lower end of the earnings scale (Scharpf, 1997; Schludi, 2001). Secondly, PAYG systems are suspected to lead to lower rates of return than is true for fully funded systems (Hinrichs, 2001). Low levels of pre-funding, high dependency ratios, together with low levels of employment of elderly workers, put significant pressure on public finances. Table 4.6 captures the comparative vulnerabilities of different pension systems with respect to contribution rates, the share of pre-funding, old-age dependency ratios, employment rates of elderly workers, the prevalence of pre-funding, the weight of pension fund assets and overall public pension expenditures.

Table 4.6 Main indicators of pension reform challenges

Country	Contri-bution rate (1995)	Share of pre-funding [f]	Dependency ratio [a]		Empl. rate 55-64 yrs, [b]	Pension fund assets, % of GDP		Public pensions, % of GDP	
			2000	2050	1999/2000	1996 [c]	1999 [d]	1998 [c]	Change 2000 – peak year [a]
Denmark	1.0	High	24.1	41.9	54.6	75[e]	45.2	11.8	4.5
Finland	17.9	Medium	24.5	48.1	41.2	40.8	19.7	11.5	4.7
Sweden	19.8	Medium	29.6	46.1	64.6	32.6	42.7	11.1	1.7
Ireland	15.7	-	19.4	44.2	43.8	45.0	59.1	3.0	4.4
UK	13.9	High	26.4	46.1	50.5	74.7	106.1	5.3	0.0
Austria	22.8	Low	25.1	55.0	29.2	1.2	3.3	15.0	3.1
Belgium	16.4	-	28.1	49.7	25.0	4.1	6.1	9.5	3.7
France	19.8	Low	27.2	50.8	29.3	5.6	5.1	12.7	3.9
Germany	18.6	Low	26.0	53.3	37.8	5.8	6.8	12.4	4.3
Greece			28.3	58.7	38.4	12.7	3.0	12.1	
Italy	29.6	Low	28.8	66.8	27.3	3.0	6.7	14.2	1.7
Luxemb.			23.4	41.8	26.3	19.7		10.6	
Netherl.	14.5	High	21.9	44.9	35.3	87.3	115.1	5.0	6.2
Portugal	13.9	-	25.1	48.7	51.7	9.9	13.4	9.8	6.2
Spain	28.3	Low	27.1	65.7	36.6	3.8	2.4	9.6	8.3
EU-15	16.6		25.7	50.8	39.4	28.1	31.1	10.2	4.1

Sources: [a] AWG report on the Impact of ageing populations on public pension systems; [b] EUROSTAT; [c] OECD, in the Communication on The Contribution of Public Finances to Growth and Employment: Improving Quality and sustainability; [d] Progress Report European Pension Reforms, Merrill Lynch, 2001; [e] The Danish figure has been provided by Danish authorities, probably includes the pre-funding of public pension schemes;[f] Blöndal and Scarpetta 1998; Roseveare e.a. 1996; Leinert/Esche 2000, sum of public, occupational, hybrid and private schmes; high (>50%), medium (>40%, <50%), low (<40%).

By contrast, funded pensions systems, which prevail in Great Britain, Ireland, the Netherlands and Denmark face far less fiscal strain as a result of population ageing. The basic idea behind funded systems is that each age cohort is in principle responsible for its own old age in so far as this exceeds the basic minimum. Denmark and the Netherlands combine Beverdigean basic pensions, financed out of the general tax revenues, with a funded Bismarckian extension of earnings-related occupational pensions, which allows for a better risk diversification combined with higher rates of return (Manow/Seils, 2000). As low-wage earners are typically less able to accumulate sufficient contributions through private pension schemes, well functioning basic pension plans, together with targeted subsidies of the contributions of low-wage earners by the state can be more effective (Hemerijck/Schludi, 2000). Also, because private and occupational pensions are perceived as part of private consumption rather than as part of the tax wedge, funded systems seem to generate fewer work disincentives.

From the point of view of financial sustainability, it is understandable that the World Bank advocates, under current economic conditions, a ‘one size fits all’ transformation of public PAYG pension schemes into a three-pillar model, along the line of the Dutch and Danish model. Two caveats however need to be raised. First of all, three pillar pension systems do not reduce the burden on the national economy and the population at large, of supporting an ageing population. The standard of living of pensioners can only be provided from the real income of the active population (Gillion, 1999). From an institutional perspective, second, World Bank policy prescriptions are even more misleading. Countries with already mature pension systems cannot start from a *tabula rasa* in their adjustment trajectories. We live in a world of path-dependent solutions. Already a partial shift from a PAYG towards a funded system imposes a double financial burden for at least one generation. This, as we shall see below, does not rule out radical change and innovation in pension systems. However, policy solutions have to be sought that build on and improve prevailing principles and practices.

4.7.1 Balancing sustainability and fairness in pension reform

Policy makers simultaneously must solve a sustainability problem – the search for economically effective solution to the pressures of ageing – and a distributive problem - agreement over a fair distribution of the costs and benefits between the generations. In terms of sustainability, within the macroeconomic context of the European Union, reforms have to adhere to the fiscal constraint of EMU and the Stability and Growth Pact. Sound macroeconomic policies are best able to guarantee a favourable economic environment for the future sustainability of pension systems. In terms of fairness, we have argued in Chapter 3 all generations bear responsibility for problems associated with demographic ageing. This normative position on intergenerational equity has led to advocate a fixed relative position (FRP) benchmark, stipulating a balance between contributions and benefits which hold constant the ratio of per capita earnings of those in the working population (net of contributions) to the ratio of earnings per capita (net of taxes) of retirees. In terms of intra-generational justice, we have added the Rawlsian proviso, that any change in the status quo, resultant from reforms, must be of the greatest advantage to the least well off within both the retired and the working age population.

The pursuit of the goals of sustainability, inter- and intra-generational equity and justice requires comprehensive policy action covering the policy areas of employment policy, public finances, and social protection. We can distinguish between a number of broad categories of policy measures that engender major implications for fair and sustainable pensions in the face of ageing. Most importantly of course are employment policy changes, largely dealt with in Section 4 of this chapter, that allow rising levels of employment, particularly of women and older workers, limit the use of pre-retirement and declines in unemployment. To be sure, by raising employment rates, difficult choices between higher contributions and lower pension benefits can be avoided. However, it is evident that such measures have so far proven to be insufficient in dealing with the problem of ageing. Additional categories of viable reform options are: 1) debt reduction and reserve funds; 2) parametric changes to existing pension systems; 3) more ground-breaking transitions in pension system design; 4) pension flexicurity; and, 5) ‘active ageing'.

4.7.2 Debt reduction and reserve funds

Systematic reductions in the debt ratio form vital elements of any effective policy strategy. If member states will be able to redeem the national debt over the next twenty years, interest payments would become available as funds for reallocation in order to meet the needs of an ageing population more effectively when anticipated increases in old age expenditure start to bite twenty years hence. Moreover, budget surpluses will reduce future interest payments and therefore help to ensure long-term financial stability without the need for sharp cuts in benefit levels. Surpluses can be used to create special pension reserve funds, which provide countries with some breathing space in the future. In the 1990s, a fair number of countries, notably the Netherlands, France, Portugal, Ireland, and most recently Belgium, have started building up such funds that can be used to maintain adequate pension provision when the baby-boom generation retires, while for now putting fiscal policy, and thereby the growth potential of the economy, on a sounder footing.

4.7.3 Parametric changes to existing pension systems

A variety of parametric measures have been put to use to strengthen the actuarial link between contributions and benefits. These include incremental adjustments in the retirement age, replacement rates and indexation provisos.

A dominant feature to improve sustainability of pension systems is raising contribution rates, which has been done in Denmark, Finland, Greece, Germany and the Netherlands. It should be noted that these measures, when simply applied 'across the board', like in Denmark by way of an extraordinary charge of 1 percent levy on all income from work and social transfers, are usually to the disadvantage lower income earners. At the same time, some Continental countries, among which Germany and the Netherlands, have established ceilings to contribution rates, tied to commitments not to reduce replacement rates.

Raising the retirement age is often thought of a good way to extend the duration of working careers, measuring up to higher contribution and shorter benefit periods. Continental countries like Austria, Belgium and Germany, have now equalised the legal retirement ages of men and women and men, or are in the process of doing so, pressed by EU equality law. In those countries, the legal retirement age is now 65, while France still holds a retirement age of 60. By raising at least the effective retirement age, total contributions made by the worker increase, while pension outlays go down.

Increasing the number of years used to define the reference earnings or defining the average earnings over the whole employment career instead of taking into account only the 'best' years both usually lead to reductions in benefit levels. In Finland for example, pension benefits are now calculated on the basis on the last ten years, previously four. But also in Italy, the reference period has been extended as part of the encompassing package of pension reforms.

Changes to indexation rules for pensions are enacted in a wide range of countries, such as Finland, Sweden, Austria, Germany, France and Italy. Such changes can be helpful in tampering pension liabilities. For example, in Sweden, a new indexation proviso was also adopted stating that if pension liabilities exceed assets then pension indexation automatically falls behind the income index until the balance between assets and liabilities has been restored. Furthermore, Austria and Germany have moved from gross to net wage indexation, while France and Italy have shifted from wages to prices. By and large, adjustments in indexation have been legitimated by the argument that the primary purpose of pensions is to preserve the purchasing power of pensions and not to compensate pensioners for future productivity improvements. From an equity point of view, however, redistribution of increased economic prosperity would be guaranteed better if pensions were indexed to wages.

Notably in Southern European countries, restrictive reforms, necessary for budgetary reasons, are combined with the upgrading of minimum social security and pension benefits. By doing so, the level of fairness is maintained (or even raised), which can prove important in creating consensus with the trade unions. Central for the trade unions in agreeing with the so-called Toledo Pact was that the ‘solidaristic’ character of the Spanish social security system would be maintained. Moreover, in Italy, higher income earners were confronted by adjustments to indexation rules, extension of the reference period for full pension earnings, while lower income earners were compensated through measures and increases in minimum pensions for recipients with no other source of income.

4.7.4 Ground-breaking transitions in pension system design

Radical and fundamental changes to pension systems are often hard to enact. This does not mean, however, that ground-breaking reforms are ruled out.

The flat-rate nature of the British welfare state, financed out of the public purse, enabled Conservative governments, already in the 1980s to ‘residualize’ old age social security (Ferrera et al, 2000). The earnings-related benefits of the public supplementary pension scheme (SERPS) were cut, while the middle classes were given incentives to ‘opt out’ and take out private occupational pension insurance. Hereby public finances were freed from one the most difficult pension policy problems – coping with accumulated pension liabilities. This, however, at the price of massive increases in poverty and inequality among the aged. The Blair government, bent on decreasing both inequality and poverty amongst pensioners, has in 1999 enacted a new “Stakeholder Pension”, aimed at providing pensions for people with insecure employment, supported by a minimum income guarantee. In the long run, the minimum income guarantee should increase in line with earnings to allow pensioners to benefit from rising prosperity of the country as a whole.

Both Italy and Sweden have taken steps towards a pension system based on a defined-contribution scheme, instead of a defined-benefit scheme. This means that the costs associated with demographic change will ultimately fall on the retirees, and not anymore on the contributors. The way in which these drastic reforms are carried out is very incremental. The 'phasing in' of a new system allows for a long transition period, which enables younger age cohorts to anticipate a decline in prospective pension benefits by building up supplementary private pension entitlements. Radical, though incremental, changes like these are more viable if accompanied by incentives to take up supplementary (private) pension schemes.

With respect to increased pre-funding, so far little progress has been made in Continental welfare states. Germany has gone furthest with reforms to encourage savings to private occupational pension and through the use of direct transfers and tax advantages. Second and third pillar schemes now enjoy favourable tax status in many countries. As tax deduction is more advantageous to people with higher incomes, German policy makers are planning to support contributions to supplementary pension schemes for low-income earners through state subsidies.

Ground-breaking reforms, in most political systems, except for the a-typical Westminster model of democracy, are almost impossible to achieve without broad political support. In Sweden, first a broad political consensus between the social democrat and bourgeois parties was achieved, which led to an innovative compromise. Subsequently, this reform plan was brought to the social partners. In Italy, societal support from the trade unions was a *sine qua non* for the shift to defined-contribution system. More recently, in Germany, the Schroeder government sought to gain support from the Christian Democrats. However, for strategic reasons the Christian Democrats opted for a confrontational course. The government did finally gain the approval by the Bundesrat, as not only the SPD-led laender, but also Berlin and Brandenburg, which are ruled by grand coalitions, supported the reform. The other CDU laender still refused.

4.7.5 Pension flexicurity

Under pension flexicurity, we list policy initiatives that provide effective answers to the challenges of flexible employment and changing household patterns. Interrupted careers cause a disproportional gap in acquired pension rights. Countries like Austria, Belgium, France and Germany now add contribution years to the insurance records to parents who raise children in order to mitigate the negative effects of interrupted careers. Austria has also introduced pensions credits for mothers or fathers with children and in Germany parents are credited 3 insurance years. In the Netherlands, part-time and temporary workers are granted access to basic pension and health care entitlements.

4.7.6 'Active ageing'

To cope with demographic ageing, European policy makers, gathered in Stockholm Council in the Spring 2001, have come to advocate 'active ageing', presented as a complete policy reversal, away from early exit strategies towards keeping older people in the work force by raising the effective retirement age through policy measures making it possible to combine part-work and delayed retirement. In Finland, part-time retirement was already introduced in the late 1980s, allowing older workers to gradually move into retirement. Tax allowances for elderly who remain in work and for those working part-time, as introduced in Denmark, can also enhance the position of older (part-time) workers. In a small number of Continental countries, employees of a certain age can opt to reduce their hours of work progressively until they reach retirement age in exchange for a partial pension. So far, especially Continental welfare states have thus far abstained from more proactive policies to raise the employability of older workers and to counter widespread age discrimination of employers, a highly problematic leftover from the early exit legacy in Continental Europe.

4.7.7 The politics of renegotiating the contract between the generations

While we observe important changes in many pension systems, which goes to show, as Klaus Hinrichs put it that 'Elephants can be moved', the degree of success of reform efforts varies considerably, even among countries with similar pension system design profiles (Hinrichs, 2001). In retrospect, we emphasise that in order to move elephants, changes do not necessarily have to be radical. A combination of parametric reforms, together with a gradual phasing in of system changes, provides room for current workers to take adaptive measures by taking on (private) second or third tier supplementary pensions. In conjunction with appropriate tax incentives, a change towards defined-contribution pensions, relieving some of the fiscal pressure from the public pension system, is realistic.

The political feasibility of such reforms, however, depends to large degree on the institutional capacities of different political system to orchestrate a reform consensus among major political parties and/or between the government and the social partners, especially the trade unions (Schludi, 2001). Political consensus and societal support proved to be critical in the success of the ground-breaking reform initiatives in Sweden, Italy, and more recently Germany. As for Sweden and Italy, the shift from a defined-benefits to a defined-contribution format involved steps into the unknown, they were enacted through a careful and farsighted orchestration of consensus, whereby politicians and social interests committed each other to look beyond the political cycle and narrow institutional self-interest. Ex negativo, the absence of co-operation among mainstream French parties and the social partners can be considered to be an important cause for the lack of progress in reforming the French pension system (Bonoli/Palier, 1997; Levy, 2000).

In the southern European countries, reform initiatives were part and parcel of encompassing ‘package-deals’ in the run-up towards EMU, covering wider areas of social protection, over which the trade unions had an important say. This has been the case in Spain, with the Toledo Pact, as well as in Italy, where on the basis of trade union consent cuts in pension benefits for the ‘better off’ were ‘traded’ for enhancements in the positions of the lower income earners. By way of such practices of issue-linkage, governments in Italy, Spain and also Portugal managed to maintain union support while making substantial changes in their pension systems, leading to sometimes impressive improvements in public finances. The social partners, especially the trade unions, were apparently able to internalise the trade-off between increasing pension demands and the fact that those pensions need to be financed out of contributions from the working age population (Myles/Pierson, 2001). Using such methods of ‘positive co-ordination’ within a welfare state, on the basis of a common agreement on overarching policy goals, drastically increases the scope of effective policy reform (Hemerijck/Schludi, 2000).

With the exception of the Scandinavian countries, so far little progress has been made to support the employability of older workers, beyond establishing a number of incentives for gradual and flexible retirement, by an active job policy for older workers. The critical appraisal of Anne Marie Guillemard (1999) concerning the lack substantial reforms in France, essentially applies to all Continental welfare states. The policy debate on ageing tends to focus on pensions. Proposals for delaying the retirement age, by simply increasing the number of years of contributions to old-age funds required for a full pension, are insufficient incentives to encourage people to work longer. Extending working life longer calls for an active employment policy.

4.8 Deepening Social Europe through Open Co-ordination

4.8.1 The new European employment and social protection agenda

European integration has in the 1990s given a new impetus to the construction of Social Europe. Ever since the Dutch Presidency in 1997, European initiatives in the area of employment policy and social protection have gained momentum (Rhodes, 2000). Today, social policy is no longer the 'stepchild' of European integration (Lange, 1993). The turning point has been the insertion of an Employment Chapter in the Amsterdam Treaty (1997). The inauguration of the European Employment Strategy (EES), under the Luxembourg Presidency, ventured a new mode of cross-national policy making by monitoring and benchmarking. The Lisbon summit marked a true watershed in the Europeanisation of employment and social policy. With respect to employment, the heads of state and governments agreed to a concrete quantitative commitments to increase the rate of total employment in the European Union to 70% and to over 60% for women by 2010. With respect to social protection, the Lisbon Council proposed to extend the open method of co-ordination to new policy initiatives for fighting poverty, combating social exclusion, and modernising systems of social protection. At the Nice Council in December 2000, European leaders agreed over an ambitious Social Agenda. Subsequently, the Swedish Presidency placed the issue of demographic ageing at the centre of the European social policy debate, adding to the Lisbon targets to raise employment for men and women aged 55 to 64 to 50% by 2010.

It is true that until mid-1990s, EU employment and social policy initiatives conspicuously lagged behind the completion of the Single Market and the introduction of EMU. Many influential observers at the time feared that the process of European integration would exclusively remain a 'market making' exercise of 'negative integration', eliminating constraints on trade and distortions of competition, without countervailing initiatives of 'positive integration' in the area of common employment and social policy (Scharpf, 1997a; 1999; Streeck, 1992). To be sure, while the Single European Act (1986) strengthened the legal basis for collective action by the

Commission by extending qualified majority voting on issues of the internal market, social policy reform remained subject to unanimous consent, which clearly inhibited ambitious European-wide employment and social policy initiatives. The failed attempt to include a 'social chapter' in the Maastricht Treaty, because of the British veto, surely exemplified the overriding logic of 'negative integration' in the integration process.

Actually, a far more critical impediment to the Europeanisation of employment and social policy, is that the institutional reality that the European Union, as semi-sovereign political entity, is confronted with a 'space' for employment and social policy that is already occupied by strongly entrenched national social policy regimes (Leibfried/Pierson, 1996). As a consequence, naive proposals for social policy harmonisation are incompatible with the massive differences in policy design and institutional structures across Europe's developed welfare states. In a similar vein, it should be emphasised that national policy makers are generally unwilling to transfer social and labour market policy competences to EU institutions, as national welfare states are inherently bound by national identities and domestic democratic legitimacy (Scharpf, 1999).

Thus while European economies were clearly becoming more interdependent in the final decades of the 20th century, national diversity in employment and social policy was jealously guarded, despite the widespread fear that the introduction of EMU would possibly unleash a process of regime competition and social dumping. It is definitely true that the process of European economic and monetary integration has stimulated, indirectly through 'spill-over' effects, important reforms in wage bargaining, employment policy and social protection across Europe in recent years. Nonetheless, as we have highlighted above, the spectre of 'social dumping' has not been corroborated by recent domestic experience. Moreover, ground-breaking initiatives at the level of the EU in the areas of employment policy and social protection suggests that processes of policy learning have not been confined to domestic employment policy, social services and pensions. On all these issues, recent European initiatives have made important inroads.

In retrospect, it seems that the central policy lesson drawn from recent experience is that: if the European Union as a social policy player, under current institutional conditions, is too weak to be able to overshadow the nation-state, its employment and social policy agenda should be directed towards backing national reform efforts in the direction of Union-wide policy ambitions and objectives. This lesson, drawn from accumulated frustrations with harmonisation and the genuine fear of social dumping, under the shadow of EMU, was functional to the insertion of an employment chapter in the Amsterdam Treaty, the institutionalisation of the European Employment Strategy and the extension of the open method of co-ordination to a wide range of social policy issues.

4.8.2 From Essen to Stockholm

The European Employment Strategy has its roots in the Delors White Paper on 'Growth, Competitiveness and Employment (1993), which propagated intimate co-ordination of national efforts to fight employment and enhanced intra-Union communication on 'best practices'. At the European Council of Essen in December 1994, European leaders adopted a medium-term strategy for the fight against unemployment. Five priority objectives were identified: investment in vocational training and life-long learning, increasing the employment intensity of economic growth through flexible employment patterns and wage restraint, reduction in non-wage labour costs, improvement in active labour market policies and targeted measures to help the long-term unemployed. In terms of institutional procedures, the Essen Council proposed to introduce novel evaluation procedures of annual reporting on policy experience in order to monitor progress. At the European Summit in Dublin in December 1996, the intention was voiced to add an employment chapter to the revised treaty. Agreement was reached to establish a High-Level Employment and Labour Market Committee. Pressed by representatives of the European Parliament, finally, the heads of state and governments agreed, at the 1997 Intergovernmental Conference, to introduce an employment title into the Amsterdam Treaty. Hereby employment was officially raised to the status of 'common concern' for European policy.

The employment chapter (Title VIII, articles 125-130), first of all, stipulates an obligation for member states to participate in processes of policy co-ordination around a common policy strategy defined by the Council in accordance with objectives laid out in the treaty. Second, the chapter does not confer competencies on the part of the Community to regulate or interfere in domestic labour markets. Third, institutionally, the employment chapter formally accords an important public status to the social partners in the process, both at the level of the EU in formulating guidelines and at the level of individual nation-states with respect the drafting of national action plans (NAPs) (article 138 (ex art. 118a)) so as to foster and deepen the social dialogue.

Agreement over the employment title, its specific procedures and institutional format, was politically enhanced by the victory of New Labour in the British general election of May 1997. Blair instantly proclaimed to be in favour of a European employment strategy. Shortly after, France also came round to endorse the employment strategy (even before the election that was ultimately won by the left under Jospin). Meanwhile, social unrest in Belgium, Germany, Italy, and France in 1995-1997 added to the fear of competitive social dumping under the shadow of EMU. When proposals for a centralised - demand-side - macroeconomic policy response to the predicament of mass unemployment were rejected, European leaders started to show a greater willingness to accompany the move towards EMU with a European employment strategy. This prompted a search for a new policy approach, capable of bolstering domestic reform initiatives and capacities, while at the same time acknowledging a responsibility of Europe for employment (Larsson, 1998).

Even before the employment title in the Treaty of Amsterdam was ratified (in 1999), the Council adopted during a special Employment Summit in Luxembourg in November 1997 a set of 19 employment guidelines, grouped under the headings of employability, entrepreneurship, adaptability and equal opportunity (Goetschy, 1999; 2000). These catchwords were politically significant as they infused the notions of equality, security, participation and employment with entrepreneurial values of flexibility and competitiveness, a Third Way compromise between British neo-liberalism and more traditional social democratic preferences (Hemerijck/Visser, 2001).

In 1998, the EES was formalised into a new policy routine. Member States were required to report on the implementation of the guidelines to the Commission and the Council in annual NAPs. Governments were expected to involve trade unions and employer organisations in the elaboration and implementation of these NAPs. On the basis of the annual evaluation, after advice from the Commission, the Council was allowed to issue recommendations, taken by qualified majority voting, to individual member states to revise their policies. Such advice, however, does not carry the penalty of sanctions (Pochet, 1999). Its effect is entirely based on public exposure, ‘peer pressure’ and the loss of face in Brussels.

Contrary to what sceptics might have feared when the Luxembourg process started, the first results, on the basis of the Joint Employment Reports in 1998, 1999, and 2000, reveal substantive progress. In 1999, following the second evaluation exercise of the NAPs, the Council took a critical stance and identified eight areas where national implementation remained insufficient: youth unemployment; preventing long term unemployment; tax and unemployment benefit reforms; job creation in services sector; modernisation of work organisation; making taxes more employment friendly; the fight against gender inequalities; and improving indicators and statistical tools (Mosley/Maier, 1999). The Joint Report on Employment 2000 highlights a clear reorientation of national policies from passive and reactive to active and preventive policy measures, in full consistence with the employability guidelines.

Progress on the agenda of social policy has also come a long way since the Council recommendations of 1992 on social protection and social assistance (Falkner, 1998). On the basis of the communications ‘The Future of Social Protection: a Framework for a European Debate’ of 1995 and ‘Modernising and Improving Social Protection in the EU’ of 1997, the Commission presented in July 1999 their proposal for “A Concerted Strategy for Modernising Social Protection”, a framework for closer co-operation in the field of social protection, again based on the exchange of policy experience through annual reporting with a view to identifying best practices (European Commission, 1993; 1997; 2000d). A High Level Working Group on Social Protection, reminiscent of the Employment Committee, was agreed during the Finnish Presidency in 1999. The Lisbon Summit ventured to draw up European guidelines for social protection, which would be implemented in the same manner as the Employment Guidelines; setting common objectives that are ambitious and realistic, using clear indicators whenever possible; ensuring necessary flexibility for member states to implement policy; and closer co-operation among member states (European Commission, 2000b). During the French Presidency, European leaders agreed on objectives with regard to the fight against poverty and social inclusion. At the December European Council in Nice, common objectives were endorsed and integrated into the Treaty, which also formally established the Social Protection Committee (article 144) (European Commission, 2000d; European

Council 2000). Most recently, the Swedish Presidency put forward proposal to apply the method of open co-ordination to health- and elderly care, most notably with respect to pensions (European Commission, 2000e; European Council, 2001). It is very likely that the Belgian Presidency will come up with a proposal on how to apply the method of open co-ordination in the field of pensions and propose an appropriate timetable.

4.8.3 The open method of co-ordination

The Lisbon Summit raised the status of the open method of co-ordination to a policy modus in its own right broadly applicable to all kinds of issues in European policymaking. The open method of co-ordination constitutes a practice of cross-national policy learning by benchmarking and monitoring, on the basis of commonly agreed European guidelines and domestic National Action Plans. The objective is not to achieve a common policy in selected issue areas, but rather to institutionalise processes for sharing policy experience and the diffusion of best practices. The conclusions of the Lisbon Summit list a number of key elements of the open method of co-ordination:

- setting short, medium, and long term guidelines for the EU with specific timetable for their achievement;
- establishing performance indicators and benchmarks tailored to each member state to allow comparison of best practice;
- translating targets from European guidelines to national policy responses;
- periodic monitoring, evaluation and peer review and evaluation with an emphasis placed on mutual learning processes.

Benchmarking and monitoring are central to the open method of co-ordination. Benchmarking requires (a) collection of data on outcomes and policies that lead to them; (b) assessment of the outcomes and study of how policies leading to these outcomes actually work; and (c) some determination about whether the institutional environment surrounding the policy is similar to that of the observing organisation or system (Romanelli, 1999). The ‘open method of co-ordination’, adopted by the European Union during the Lisbon Summit in the Spring of 2000, is exemplar for a so-called ‘contextualised’ method of benchmarking, allowing for intensive consultation over the setting and modifying of guidelines and national action plans, with ongoing and repetitive feedback on implementation progress (Hemerijck/Visser, 2001).

Not all currently popular benchmarking exercises are as contextualised as the open method of co-ordination. Most often, a normative format of 'decontextualised' benchmarking prevails, leading up to the selection of one example of 'excellence' for all others to follow. In the area of employment policy, the OECD Jobs Strategy (OECD, 1994) is a fine example of decontextualised benchmarking. The weakness of decontextualised benchmarking is that its lessons, void of policy experience and institutional context, remain shallow. It should not come as a surprise that a 'key reason cited for slow and sporadic implementation of the OECD Jobs Strategy is the *perception* that undertaking reform involves conflict with policy objectives concerning equity and social cohesion'. Best practices only show the way when they are institutionally 'pulled in' by domestic actors. A quote from the Joint Employment Report 1999 is instructive for the emphasis on 'contextualised' monitoring and benchmarking in the EES:

"The purpose of peer review is to submit policies which are considered by individual member states as examples of good practice to multilateral and independent expert assessment, with a view to their dissemination. The essence of this method is an examination of the transferability of a policy presented by a 'host country' by several interested 'peer countries'. The core activity in each peer review is a seminar complemented with a site visit. It is a structured activity based on a number of expert papers prepared in advance specifically for this exercise. The conclusions of the evaluation will be published by the Commission" (European Commission, 2000b)

The key advantage of the open method of co-ordination for the advancement of social Europe lies in its potential of reconciling national diversity and democratic accountability at the level of the nation-state with common policy ambitions and measures of policy effectiveness through benchmarking and monitoring. As an iterative process, the open method of co-ordination provides ample opportunities to tackle employment and social problems in a medium-term perspective. This allows for a significant degree of de-politicisation of the issues at stake, while encouraging a problem-solving style of policy making. Moreover, the open method of co-ordination grants opportunities of acting in policy areas of 'common concern' where Community competencies are relatively weak, where traditional regulation is infeasible and impracticable. The experience with EES reveals that member states seem to be more willing to accept initiatives of Community action into these areas, and to agree over quantitative targets for common objectives, precisely because the EU does not have legally binding powers over them (Zeitlin, 2001). Compared to the alternative of mutual recognition and its inherent dangers of regulatory competition, the open method of co-ordination allows member states to move at different speeds in the same direction (Mosher, 2000).

The open method of co-ordination constitutes a powerful stimulus for policy learning and innovation. Taking learning seriously highlights the importance of ascertaining the possible *and* the willingness to experiment beyond existing routines. Ex post monitoring and benchmarking encourages national actors to take each others experiences, best practices but also pressing policy problems, seriously. It offers them the possibility of acquiring information through standardised evaluative accounts. Relying on elaborate, if not to say cumbersome, methods of negotiated guidelines, targets, deadlines and evaluation procedures, the strategy allows for pragmatism in dealing with regime-specific contingencies and vulnerabilities. Potentially, the open method of co-ordination opens a window of opportunity to establish so-called 'problem oriented networks', in which participants agree over generalised norms of performance assessment. In such a setting actors consider themselves to be participating in a collective learning process.

The open method of co-ordination can potentially stimulate 'learning ahead of failure' (Hemerijck/Visser, 2001). It may expand the repertoire of potentially effective policy responses, that is, trials that policy makers might not have discovered through the examination of their own policy experience or history. By adopting innovations associated with success from elsewhere, policy makers may thus avoid some of the costs of pure trial and error learning. In this sense, the open method of co-ordination marks a step towards a *preventive* labour market policy (Klemmer *et al.*, 2000).

In terms of policy content, the experience of the European Employment Strategy does seem to confirm a growing responsiveness of domestic and EU-policy makers to the demands of the new world of work (European Commission, 2001a; 2001b). This is clearly exemplified by the new 1999 guidelines on gender mainstreaming, including suggestions on policies on career breaks, parental leave and part-time work that are of particular importance to reconciling work and family life (Bercusson, 2000).

Institutionally, the EES also served as a powerful indirect force for the extension of social partnership involvement in the formulation and review of guidelines (through participation in the Employment Committee) and in co-ordination with other policy areas (through the macroeconomic dialogue). By way of stipulating social partnership involvement in the formulation and implementation of National Action Plans, moreover, countries like France and the United Kingdom, where social partnership traditions are historically rather weak, are stimulated to explore the advantages of social dialogue and social pacts.

The open method of co-ordination is not without weaknesses (Porte et al, 2001). Some observers fear that ‘soft’ policy co-ordination and its lack of real sanction will crowd out ‘hard’ legislation where regulation is called for. Moreover, to rush into social benchmarking by reference to rather vague objectives harbours the risk of inflation discrediting the process. We maintain that open co-ordination and legislation should be deployed in tandem, as they have their own specific strengths and weaknesses. To be sure, health and safety at work and regulation of second pillar pensions requires legislation. Open co-ordination is especially useful in policy areas where Community competencies are institutionally constrained and to the extent that policy objectives are ambitious, precise and realistic. One of the most sensitive issues, especially in the areas of social protection and inclusion, is the quality and quantity of available statistics on performance and indicators for social policy progress. Finally, as guidelines drive processes of open co-ordination, a key political question is how and to what extent feedback learning processes contribute to the improvement of guidelines.

4.8.4 Harmonisation, convergence, and hybridisation

The open method of co-ordination illustrates a new mode of multi-level governance in which both processes of domestic reform and supranational agenda-setting are intertwined in such ways that allow domestic policy actors to learn from each others policy problems and successes, while setting commonly agreed guidelines and be inspired by ‘best practices’ elsewhere to deal with their own problems. Under the open method of co-ordination, as argued by Jonathan Zeitlin, subsidiarity is no longer a zero-sum relation between member states and EU institutions, in which particular issues should be allocated to one jurisdiction or the other, leading to member states to resist the far-reaching expansion of Community competencies in the social sphere. By contrast, the open of co-ordination is a positive sum-game of ‘Europeanisation’ and ‘re-nationalisation’. Open co-ordination thus serves both the advancement of substantive EU objectives in employment and social policies and more ambitious national policies in the ongoing recalibration of the European social model. Zeitlin maintains that such progress, under the EES, was achieved, not so much despite, but precisely because of the cross-national diversity in policy goals and institutional arrangements, to the extent that the opportunities for mutual learning through articulated exploration of alternative solutions to common problems are enhanced rather than diminished by the breadth of variation in experience, ideas, and ideals among the participants.

With the recent extensions of the open method co-ordination to core areas of social protection, including pensions, European welfare states have become subject to a web of EU procedures, which serve to shape, together with domestic institutional capacities, national approaches to welfare state reform. Welfare reform in the first decade of the 21st century will increasingly involve a combination of *domestic learning, learning from and with others,* possibly *ahead of failure* in Europe, the upcoming litmus test being pensions. And while the open method of co-ordination rejects ambitions of harmonisation, joint policy learning can surely invite policy convergence as a by-product of a growing consensus over effective policy responses. While the ‘common guidelines’ differ, as ‘soft’ alternatives to legalistic regulations and directives, from the ‘hard’ Maastricht criteria for EMU, one could nevertheless legitimately claim on the basis of recent experience that ‘soft law’ guidelines in the areas of employment and social protection are immanently more preferable and practicable than long-awaited and watered down social directives. Moreover, innovative combinations of domestic policy (failure induced) learning and supranational learning (ahead of failure) may cause considerable hybridisation in welfare and labour market policy, that have thus far tended to cluster in different regimes, characterised by high degrees of path dependency.

4.8.5 The EU contribution to the self-transformation of the European social model(s)

Recent national reform initiatives mark a distinctive, and sometimes already successful European response to the massive policy challenges ahead. In the second half of the 1990s, a number of important breakthroughs contributed to the deepening of Social Europe, serving to advance domestic reform efforts with the benefits of European employment and social policy initiatives. The insertion of the employment title in the Amsterdam Treaty, the European Employment Strategy, the extension of the open method of co-ordination to issues of social protection and social inclusion, the ambitious Social Agenda of Nice, all contradict the scenario, popular in the early 1990s, that EMU would provoke a process of competitive labour market and social policy deregulation. Quite to the contrary, it seems, in retrospect, EMU, first, at the level of the nation-state, triggered the resurgence of national social pacts. This is particularly true for countries, like Italy, which faced the greatest difficulties in living up to the new hard currency regime of EMU (Fajartag/Pochet, 2000). Secondly, at the level of the Union, EMU, supported by the changing balance in political power across the member states of the European Union to the centre-left, provided a window of opportunity for agreement over the European Employment Strategy, on the basis of a 'management by objectives' approach to policy-making, mitigating some of the risks of regulatory competition through joint monitoring and benchmarking. The achievements since the mid-1990s have not only established a central role of EU institutions in employment and social policy. More important, they significantly reinforce and help recast, under conditions, the two core normative-cognitive and institutional underpinnings of the European social model. As such, they make up the European contribution to what we see as a dynamic process of *self-transformation of the European social model*.

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