Key features of the current European employment and social situation[1]

This Chapter identifies some of the core aspects of the labour markets and social situation in the EU. It is designed to analyse the main challenges facing policy makers today and in the near future as they strive for inclusive as well as smart and sustainable growth within the Europe 2020 strategy. It does not, however, attempt to look at the quarterly developments in EU labour markets as this is regularly done in the EU Employment and Social Situation Quarterly Review[2].

The analysis starts with a look at key employment and social trends seen over recent years, stressing polarisation and divergence issues, then continues with a reminder on the main employment and social targets enshrined in the Europe 2020 strategy. The second part addresses challenges to overcome and action needed to counteract the sustained polarisation between different categories of citizens and the divergence seen across the EU in this respect.

1. Key employment and social trends in the context of Europe 2020: polarisation and divergence

Labour markets have continued to be marred by increasing divergence among Member States, whilst the average EU unemployment rate exceeded the 10% mark earlier this year. Young people are particularly hard hit, with more than one in five active Europeans aged 15-24 being unemployed. However, inactivity rates have fallen, except for among the young, where worryingly the number not in employment, education or training (NEETs) continued to rise in 2011. In addition to young people, non-nationals, the low-skilled and men are still the groups most affected by deteriorating labour market conditions. Increased part-time and temporary work, which were the main sources of job growth in 2011, point to a widespread uncertainty and an increasing segmentation of the labour market, considering the high percentages of involuntary short-term and part-time contracts, the latter affecting young people the most.

Divergence in the EU-27 and especially between the North and South of the euro area has never been so significant. For the EU as a whole mismatches with higher unemployment rates but vacancies still available are increasing overall, though, again, the picture for individual Member States is varied. This context has inevitably had a negative impact on income and poverty levels, further aggravated by the weakening the stabilizing and protective role of welfare systems over time in a context of prolonged recession. Risks of long-term exclusion are confirmed with children, youth and migrants being most affected. All these aspects contribute to the trend of increasing social polarisation in many Member States.

1.1. Divergence among Member States and social polarisation on the rise

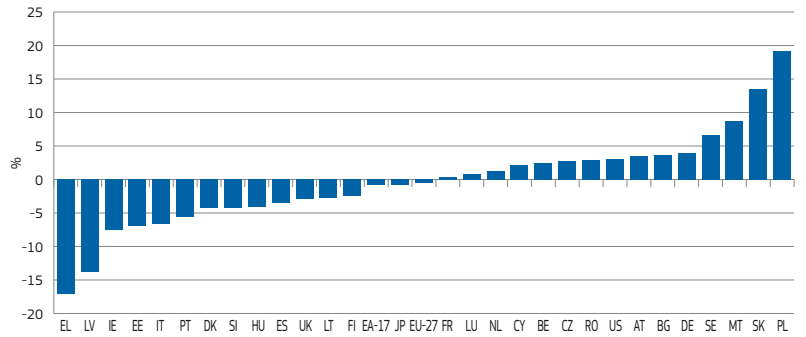
All employment and social indicators point to a growing divergence between the Southern and peripheral European countries, that seem to be trapped in a vicious circle of recession, while most of the countries of Northern and Central Europe have so far shown greater resilience. Part of this is driven by how the economy has performed overall but much of the overall performance is the result of how labour markets and social systems reacted to the severe global downturn. The shockwaves from the crisis appear to be asymmetric but the different institutional setups saw very different resistance to the generally experienced major shock from the initial financial crisis: very often countries with relatively un-segmented labour markets and strong welfare systems have fared better than those with highly segmented labour markets and weak welfare provisions. The (in)ability to cope with the shock was frequently compounded by the initial public debt and deficit levels, as well as the property market situation, and subsequent developments followed by the reaction of financial market.

Looking at GDP growth since 2007 alone, some Member States are richer than before the crisis, many are back to pre-crisis levels and some are

(1) By Frédéric Lagneaux, Isabelle Maquet-Engsted, Virginia Maestri and Monika Velikonja.

(2) See the Employment and Social Analysis website under http://ec.europa.eu/social/main.jsp?catId=113&langId=en

Chart 1: Change in GDP – second quarter 2012, compared to second quarter 2007, in percentages



Source: Eurostat, National Accounts [namq_gdp_k].

Note: Seasonally-adjusted data except for EL; data for EE, IE, LU refer to the 2007q1-2012q1 period. Millions of national currency, chain-linked volumes, reference year 2005 (including 'euro fixed' series for euro area countries).

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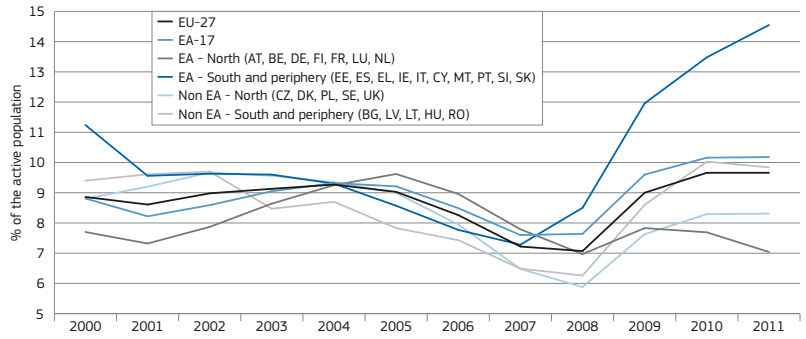
Chart 2: Diverging unemployment rates by groups of Member States since 2000



Source: Eurostat, EU-LFS, and DG EMPL calculations.

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significantly poorer (see Chart 1). While the EU-27 average is close to zero, significant divergences appear among groups of Member States.

The chart above depicts variations in real GDP between the second quarter of 2007 and the second quarter of 2012. On the one hand, many of the newer Member States maintained the trend of economic convergence, with Slovakia and Poland outperforming most significantly with real GDP increases of over 13% and 19%, respectively, over the five-year period. The Baltic countries, very severely affected in the early phase of the crisis, also show signs of a robust recovery in the recent quarters.

Among the old Member States, divergence is most striking between the North and the South and periphery of the Euro area (EA). Greece, Italy, Portugal (and also Ireland) all experienced output drops in 2008-2009, and have been on a downward slope since then. The North-South divergence is not entirely clear-cut: apart from Ireland, the UK and Denmark also underperformed economically in recent years. This may be at least partially explained by specific conditions, such as overheated property markets.

The EA countries have also seen very different developments in unemployment trends, as shown in Chart 2. Whereas labour market North-South divergence has been major issue for the EU, it has definitely become a common feature of the EA over recent years. After converging in the years up to 2004, in favour of southern and peripheral EA member countries – the average unemployment rate of the group made up of Cyprus, Estonia, Greece, Ireland, Italy, Malta, Portugal, Slovakia, Slovenia and Spain became lower than the average rate for Austria, Belgium, Finland, France, Germany, Luxembourg and the Netherlands, it changed in favour of Northern EA again in 2008. The gap was, in 2011, as high as an unprecedented 7.5 percentage points (percentage points)[3]: the average unemployment rate for the North of the EA was 7.0%, against 14.5% in the South and periphery of the EA. This gap was 'only' 3.5 percentage points in 2000, while in 2006 the situation was the opposite (-1.2 percentage points in favour of the south and periphery).

There is also growing divergence between the countries that were cushioned from the worse social impacts of the crisis, and those countries where living conditions have deteriorated markedly.

The decrease in household disposable income was most significant (above 4%) in the Southern countries, Ireland, Hungary and the Baltic States. It was the result of the further deterioration of the labour market conditions, as well as of the weakening of the cushioning impact of social expenditure over time (see section 1.3.2). In these countries, declining incomes affect the living conditions of a large part of the population, and in 2012 the decline of private consumption is expected to weaken already bleak growth prospects. In the Baltic States the rebound of the economic and labour market situation has contributed to stabilising income levels overall after 2010, but long-term unemployment and poverty remain at high levels in this region.

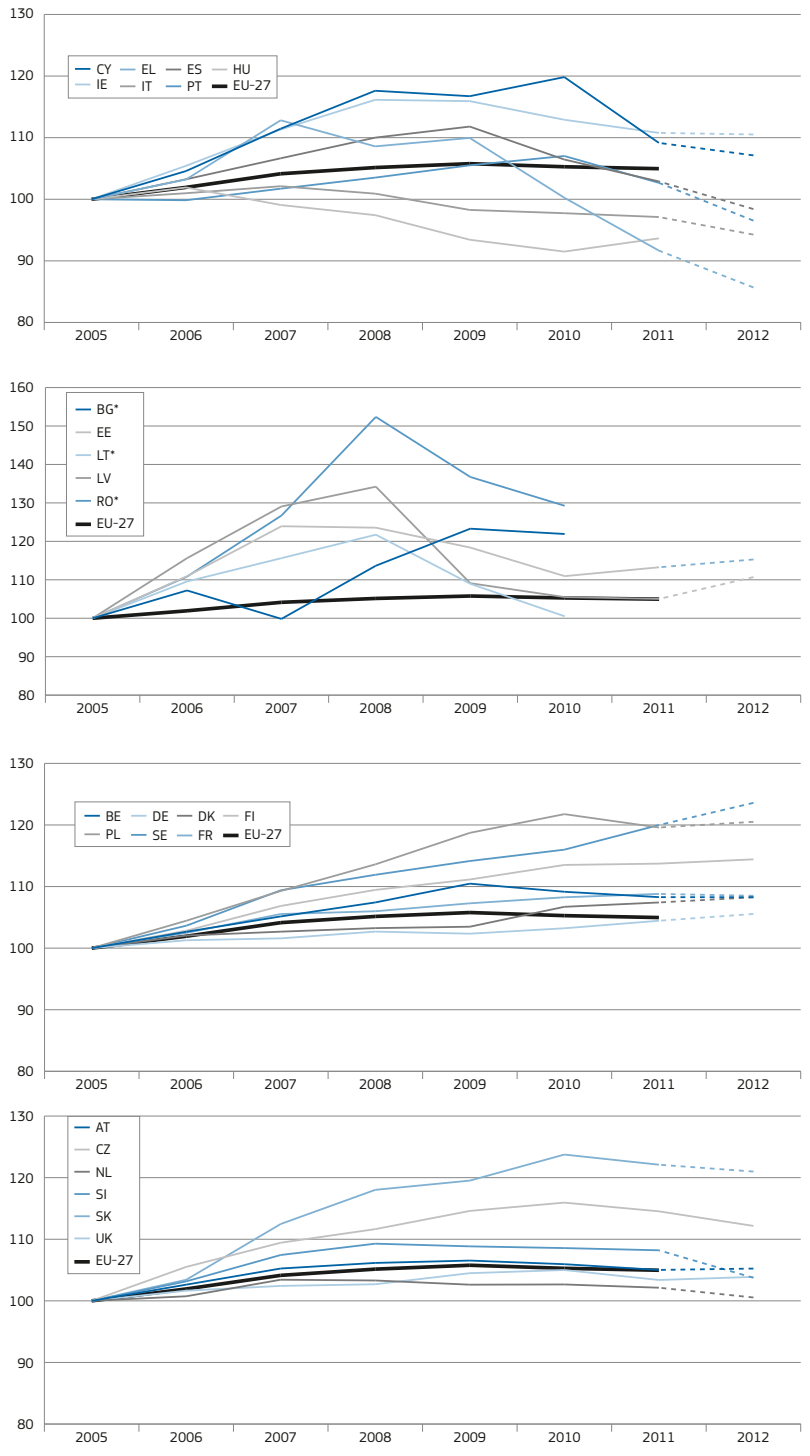
This significant decline is in stark contrast to the situation observed in Northern and Continental countries. In these Member States, the combined effect of robust automatic stabilizers (reinforced by initial discretionary measures) and more resilient labour markets in general helped mitigate the impact of the recession on overall household incomes and private demand. In these countries, while household incomes continued to increase during the crisis, some population groups were more affected than others by rising unemployment.

The crisis has revealed that external economic shocks translate differently within the EU – they are asymmetric-, and that diverging unemployment trends and the resulting social expenditure tend to exacerbate fiscal imbalances in countries facing the highest needs of adjustment and the highest threat to their social models.

Looking at both the labour market situation and the developments in income and poverty, a similar if more nuanced picture emerges, as the previous text illustrates.

(3) By way of comparison, the N-S gap was 'only' 1.5 percentage points in 2011 among the ten non-EA Member States.

Chart 3: Evolution of GHDI in real terms (2005=100) 2005 to 2011 (2012 forecast)



Source: AMECO.

Note: * Data available only until 2010.

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Economic and social divergence among the Member States has been coupled with a trend of rising social polarisation within many Member States. This trend is visible in many different ways, and, like in the case of divergence among the Member States, it is partly linked to the protracted economic downturn and partly has deeper structural and institutional causes. While social polarisation in the labour markets is observable mainly through high levels of segmentation, 'hollowing out' of the medium paid jobs[4], and the increasing problem of long-term unemployment, in the social area it is mainly displayed through higher risks of long-term exclusion and recurrent poverty spells.

(4) Discussed in detail in European Commission, 2011e: Employment and Social Developments in Europe Review 2011 (ESDE 2011).

1.2. Latest labour market developments: deepening crisis

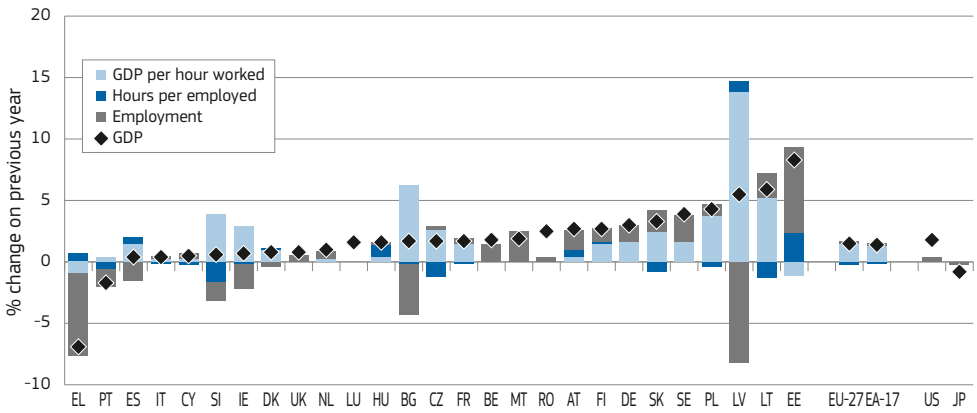
Labour markets are divergent as stressed above. This is, among other factors, the consequence of asymmetric economic shocks, in the context of a poor macro-economic situation. The prolonged crisis increasingly affects labour markets, resulting in a rise in unemployment, and long-term unemployment in particular. While inactivity remains low overall, it is high among youth. While the job matching process tends to deteriorate, there is a serious risk of continued segmentation and wages and labour costs are falling in response to the difficult labour market situation.

1.2.1. EU employment impacted by the poor macro-economic situation

Following the economic slowdown in late 2011 and the subsequent renewed if moderate recession of the European economy, the employment recovery from the 2008-2009 recession has come to a standstill. The number of people in employment in the EU grew by a modest 0.3% in 2011 of the working-age population, owing to the better first half of that year and then has stagnated until autumn 2012.

The overall pattern of jobless growth consecutive to a mild recession is reflected in the fact that most of the GDP growth corresponded to an increase in productivity and hours worked, leaving little room for employment growth. Conversely, the GDP losses in Greece and Portugal and stagnation in Spain translated into employment losses, while productivity grew in the latter two countries (see Chart 4). An employment recovery will require a level of economic growth which exceeds the trend in productivity. Strong employment policies focused on both the demand and supply sides of the labour market, as detailed in the April 2012 Employment Package, are important for bringing about a job-rich recovery where growth picks up thanks to improvements in both employment and productivity. Employment maintenance via working time reduction, as was seen in the first year of the crisis, proved to be a temporary response to the economic

Chart 4a: Change in GDP between 2010 and 2011 and underlying components



Source: Eurostat, national accounts, DG EMPL calculations.

Note: Data on hours worked and productivity missing for BE, LU, MT, RO, UK, US and JP.

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Box 1: Okun estimations – the link between the change in unemployment and GDP growth

The issue of jobless growth can also be analysed from the angle of unemployment. An Okun estimation links the change in unemployment to GDP growth[1]. In what follows, Okun estimations for the US, the euro area and some Member States were produced for the period 1995q1-2007q4.

The residuals of that estimation since 2010q1 are then analysed. Relatively small residuals indicate that growth explains unemployment developments well and in the same way as in the past. On the other hand, residuals that are persistently lower or higher than expected suggest that structural factors have changed the relationship between growth and unemployment in that country.

Over the period 1995q1-2007q4, significant Okun estimations were obtained for the US, the euro area, Germany, Spain, France, the Netherlands, Portugal and Sweden[2].

Charts 4(b) and 4(c) show the divergent developments in the residuals by country. Unemployment seems to have increased less than expected in Germany and the US. In the case of Germany, it is likely that the Hartz reforms, with their effects on activation and job creation, are an important factor behind this better unemployment development. Structural unemployment has probably declined in Germany.

The decline in the US unemployment rate was helped by a fall in the participation rate to the lowest level since 1984. While the common view sees worker discouragement as a main cause for this decline, the participation rate is also subject to a secular trend decline due to ageing.

In Spain and Portugal, the shedding of low-productivity labour implies a larger increase in unemployment than expected from the GDP evolution. This shedding is linked to sectoral aspects (focus on construction and manufacturing) and segmentation (temporary jobs not being renewed). Structural unemployment has probably increased in these two countries.

Since 2010, the residuals for France and the Netherlands hover around the zero level in a fairly narrow range, suggesting unchanged structural unemployment. The residual for the euro area, by contrast, stood above zero for most of the recent quarters.

Moreover, as the Okun estimation for the euro area has a very good fit, the size of the recent residuals are non-negligible, suggesting some rise in the euro area's structural unemployment. In other words, the improvement in Germany is not enough to balance the deterioration in Southern Member States.

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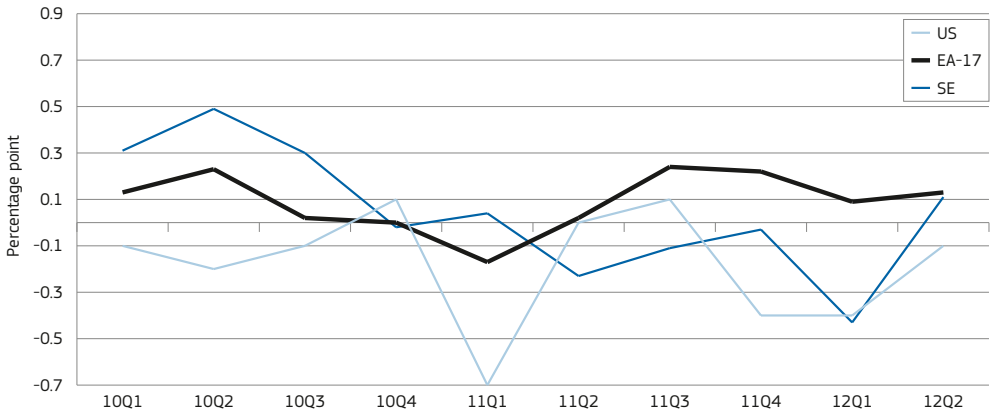
(1) 'Okun estimation' is generally called 'Okun's law'. The gap version of Okun's law links deviations from potential output to deviations from the natural rate of unemployment. This version is difficult to use in practice as potential output and the natural rate of unemployment are not observable. The basic version, in which the change in the unemployment rate in a given quarter depends on real GDP growth in that same quarter, can be analytically derived from the gap version under the assumptions of a constant natural rate of unemployment and a constant growth rate of potential output. In the estimations presented here, the lagged GDP growth rate was added as explanatory variable, as growth affects the labour market with a lag.

(2) The EU, Ireland, Greece and New Member States are not included due to data availability issues. Over the sample period, estimations were not significant for the remaining Member States (including Italy and the United Kingdom).

Chart 4b: Residuals of Okun estimations since 2010 (US, EA, SE)



Source: Commission services' estimations.

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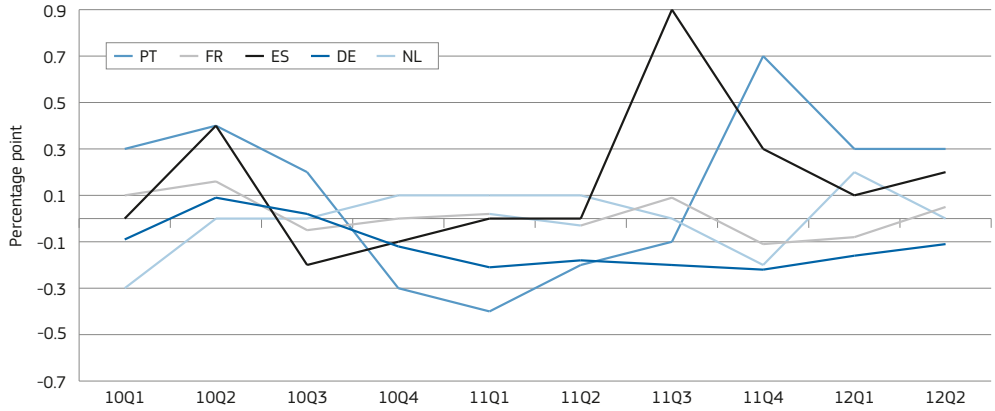
Chart 4c: Residuals of Okun estimations since 2010 (selected euro area Member States)



Source: Commission services' estimations.

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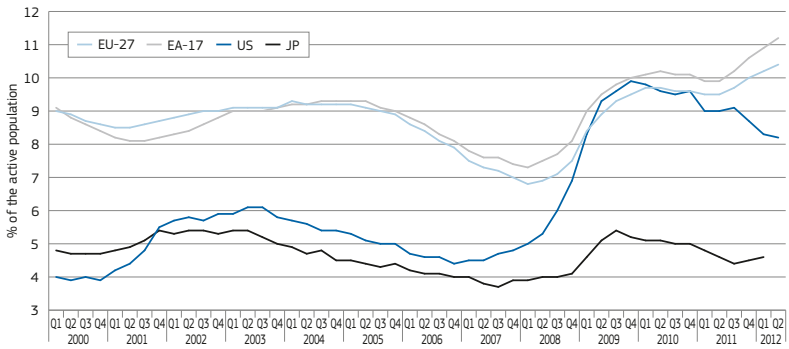
downturn and cannot be relied on as a long-term solution[5].

Box 1 complements Chart 4, providing evidence about the inter-relation between unemployment developments and GDP growth.

In this context of stagnation or at best slow economic recovery[6], the rising unemployment trend, and its more important long-term and youth components are major challenges. Since mid-2012, more than 25 million Europeans have been unemployed, 10 million of whom had been so for more than 12 months. This contrasts with the United States and Japan where unemployment has been slowly declining.

Chart 5: Unemployment rates in the EU, USA and Japan, 15-74 age group, 2000Q1 - 2012Q2



Source: Eurostat, EU-LFS, and OECD.

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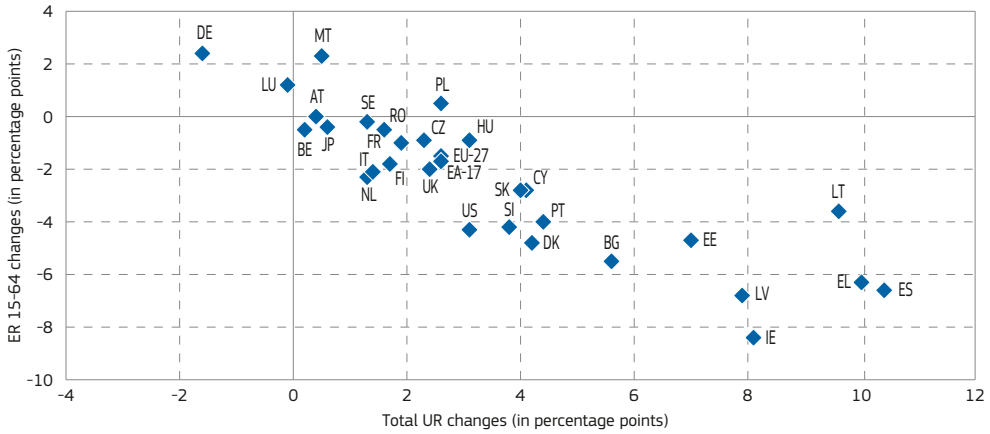
Over the whole of the period 2008-2011, the employed population shrank by 2.0%, although this percentage is still limited compared to the declines of -4.4 and -4.7% recorded by the US and Japan respectively. Likewise, in the three years to June 2011, the number of unemployed in the EU rose by 37.3%, as 6.2 million people joined the ranks of the unemployed, compared to 65.2% in the US (5.6 million people affected). Subsequently, while the unemployment rate has started to decline consistently in the US, dropping by 0.9 pp in the twelve months to June 2012 to 8.2%, in the EU, after falling somewhat in the year to March 2011 (-0.7 million, i.e. -3.0%) it began to grow again, by 0.9 pp to 10.4%. Chart 5 presents developments by quarter since 2000.

(5) For reference: (1) the serious GDP decline in 2009 (-4.3%) was driven first by a fall in employment (-1.8%), then in hours worked per employed (-1.4%) – namely in Germany, Austria and Belgium – and also in productivity (-1.3%); (2) the recovery noted in 2010 (+2.1%) is mainly explained by a rise in hourly productivity (+2.2%) and, to a lesser extent, in hours worked per person (+0.4%), while employment contracted slightly (down 0.5%).

(6) According to the latest European Commission Economic Forecast (European Commission, 2012i), employment in the EU is expected to decline by 0.4% in 2012 and by 0.2% in 2013. The projection for this year is for real GDP to contract by 0.3% in the EU and by 0.4% in the Euro area. For 2013, growth is forecast at only 0.4% in the EU and 0.1% in the Euro area.

Chart 6: Changes in unemployment rates (UR) and employment rates (ER) from 2008 to 2011 in EU Member States, EU, EA, JP and US



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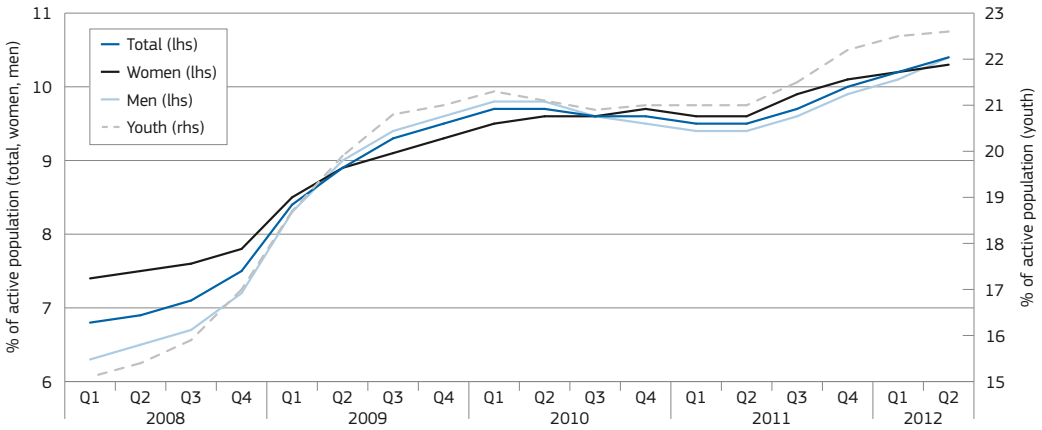
Source: Eurostat, EU-LFS and DG EMPL calculations.

Chart 7: Unemployment rates in the EU, by gender and for youth (15-24 year-olds), 2008Q1 - 2012Q2



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Source: Eurostat, EU-LFS and DG EMPL calculations.

Looking at the trends in the employment and unemployment rates in EU countries from 2008 to 2011, the effect of the economic slowdown and the persistent uncertainties in the labour markets was very pronounced. The employment rate for 15-64 year-olds, i.e. the working-age population, fell in all but five Member States, while the unemployment rate (among 15-74 year-olds) rose in all but two. The situation in the Baltic States remains worrying despite recent improvements. The situation has worsened significantly in Spain, Greece and Ireland, in terms of both rises in unemployment and contractions in employment. Not surprisingly, looking at the performances of the 27 Member States, there is a negative relationship between those two developments. The statistical correlation is negative (-87%) to a significant degree.

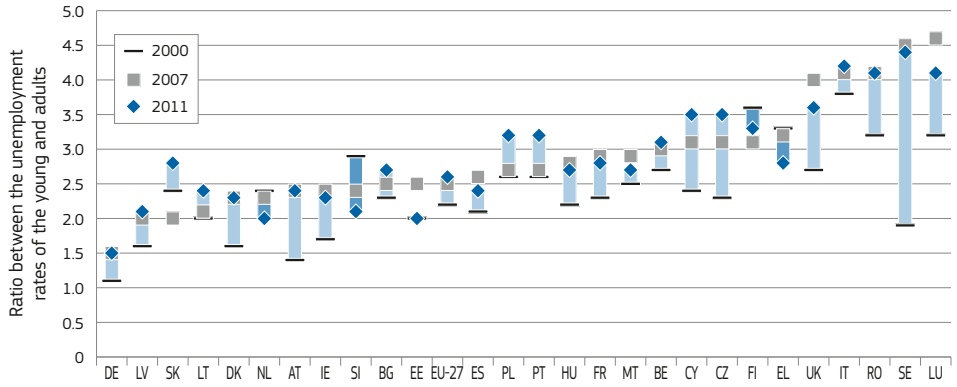
As far as the employment rate for the 15-64 year-olds is concerned, besides Germany and Luxembourg, which recorded rises of respectively 2.4 and 1.2 percentage points from 2008 to 2011, Malta made significant progress too (+2.3 percentage points), Poland showed moderate progress (+0.5 pp) and Austria's employment rate remained unchanged over the same period (see Chart 6). Employment levels in all the other Member States declined, in some cases very significantly (i.e. by more than 5 percentage points), namely in Bulgaria, Ireland, Greece, Spain and Latvia.

1.2.2. Some 2.5 million more people unemployed since spring 2011

In May 2012, the number of people unemployed in the EU exceeded the 25 million mark for the first time, at 25.2 million. It then continued to rise, to reach nearly 25.8 million in September 2012 (13.9 million men and 11.8 million women), i.e. 2.4 million more than the preceding peak recorded in April 2010 (23.3 million) and 3.1 million (1.7 million men + 1.4 million women) above the latest trough that was seen in March 2011 (22.6 million). At 10.6%, the EU unemployment rate is 1.2 percentage points higher than in March last year. Female and male unemployment rates are virtually equal (0.1 pp gap only). In the Euro area, the picture is even bleaker, as the unemployment rate has now reached 11.6%, i.e. 1.7 percentage points higher than in spring 2011.

The trend in unemployment is upward in the majority of the Member States and is most worrying for youth, as 22.8% of active people aged 15 to 24 were unemployed in the EU in September 2012 (23.3% in the Euro area). Disparities between Member States are at a historical high, with three Member States (Germany, Austria and the Netherlands) recording an unemployment rate for

Chart 8: Risks of unemployment for the young, 2000, 2007 and 2011 in Member States



Source: European Commission 2012h.

Note: Countries are shown in ascending order according to the ratio in 2007.

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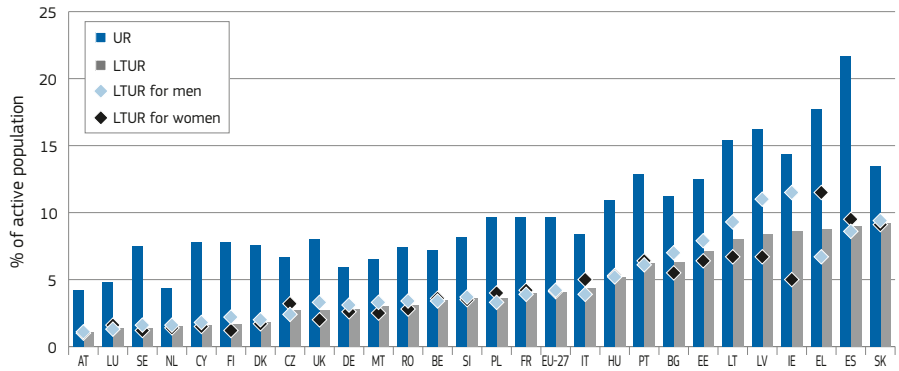
Chart 9: Unemployment and long-term unemployment rates, 2011



Source: Eurostat, EU-LFS.

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young people below 10%, while more than one young person in two wanting to work is unemployed in Greece and Spain[7].

Chart 7 presents the developments in unemployment rates by gender and age since the first quarter of 2008 in the EU-27. Although the female unemployment rate was traditionally higher than the male unemployment rate, the trend reversed with the crisis. In the second part of 2009 the EU aggregate unemployment rate for men exceeded that for women, as male-oriented sectors – construction, manufacturing industry, etc. - were hit first and hardest by the economic slowdown. But by the end of 2010, services were affected too, pushing female unemployment to higher levels again. Since then both rates have developed in parallel. Earlier this year though, while female unemployment growth was slowing somewhat, male unemployment continued to rise rapidly, which explains why it is exceeding female unemployment again. The youth unemployment rate is still more than double the overall unemployment rate (see right-hand side). It rose faster in the first phase of the crisis, tending to stabilise in early 2011 and over recent quarters.

However, differences in risks of unemployment for the young[8] among Member States can be only partially explained by the crisis. In 2007, the youth unemployment rate was already three times the adult levels in Belgium, Cyprus, Greece and Finland, while the rate was four times higher in Italy, Luxembourg, Romania, Sweden and the United Kingdom (see Chart 8). The risk of unemployment was higher for young men than for women in all Member States except Latvia, Portugal and Slovenia (in 2007 and 2011) and Lithuania, the Netherlands and Romania (in 2011).

1.2.3. Higher long-term unemployment, especially for the young

In 2011 nearly 10 million unemployed Europeans (accounting for 4.2% of the active population) had been so for more than 12 months. This is an increase of 3.7 million or 60.8% in comparison to 2008, while total unemployment rose by less than 40% in the same period. The countries with the lowest rate of long-term unemployment (less than 2%) in 2011 were Austria, Luxembourg, the Netherlands, the Nordic countries (Sweden, Finland, Denmark) and Cyprus (see Chart 9). At the other side of the spectrum are the Baltic States, Ireland, Greece, Spain and Slovakia, with 7% or more of the active population being unemployed for at least one year. Long-term unemployment is analysed in detail in Chapter 1.

In 2011, 70% of all long-term unemployed in the EU-27 were concentrated in the 6 largest Member States. Spain, a country that represents less than 10% of the EU labour force, accounted for more than

(7) A similar upward trend can be noted in terms of unemployment ratios (see also section 1.2.4). Unemployment ratio (defined as share of young unemployed persons in the whole young population), takes into account a large inactive group mainly in education in that age group and thereby gives more complete picture of the size of the unemployment problem.

(8) Ratio between the unemployment rates of the young and the adults.

Table 1: Long-term unemployment by educational level, 20-29, EU-27

	% of all LTU (20-29)		% of active population (20-29)		Growth in number of LTU (%)
	2008	2011	2008	2011	2008-2011
1. Low	41.4	40.0	6.3	12.0	72.8
2. Medium	48.4	46.1	2.7	4.8	69.7
3. High	9.9	13.7	1.2	2.7	145.8
Total	100.0	100.0	3.0	5.6	78.5

Source: Eurostat, EU-LFS, DG EMPL calculations.

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21% of the EU total (more than 2 million long-term unemployed). Moreover, Spain contributed most to the total increase in the number of long-term unemployed in the EU-27 over 2008-2011 (1.6 million out of 3.7 million). Germany represents 12% of the long-term unemployed, compared to an overall share of close to 18% of the EU labour force (same for UK with 8.5 and 13% respectively). Other Member States representing a much higher share in the long-term unemployed figures than their overall share of the EU labour force are: Greece, Portugal, Slovakia, Hungary, Bulgaria and Ireland.

By 2011, around 55% of the long-term unemployed were men and 45% were women, although, given the different participation rates, long-term unemployment rates are equal (in 2011, it was 4.1% for women and 4.2% for men, see gaps by Member State on Chart 9). Since 2008, the gender distribution has shifted, to the detriment of men, partly as a result of the job losses after the construction boom in Spain and the Baltic States. On the other hand, the analysis of transitions in and out of unemployment reveals that long-term unemployment tends to be more frequently followed by inactivity in the case of women.

The long-term unemployed have fewer chances to return to employment and therefore it is better to prevent people staying in unemployment if they are to return to a job. While only one in five of the very short-term unemployed (<6 months) is still unemployed after one year, almost one in every two long-term unemployed (>12 months) people remains so after a year. Among the short-term unemployed (<12 months), one quarter remains unemployed.

Long-term unemployment for young people increased more significantly than for adults and more among the highly educated than among other groups. One out of three young unemployed people aged 15-24 were looking for a job for more than a year in 2011, compared to 22% at the onset of the crisis. Long-term unemployment increased significantly for the highly educated young between 2008 and 2011, albeit from relatively low levels, more than doubling their share among the active population (see Table 1). The gender gap differs across skills. The share of low skilled among the long-term unemployed men is higher than for women (45.1% vs. 33.7% in 2011), whereas long-term unemployed women are more often high skilled than men (19.1% vs. 9.5% in 2011).

1.2.4. Inactivity did not increase significantly

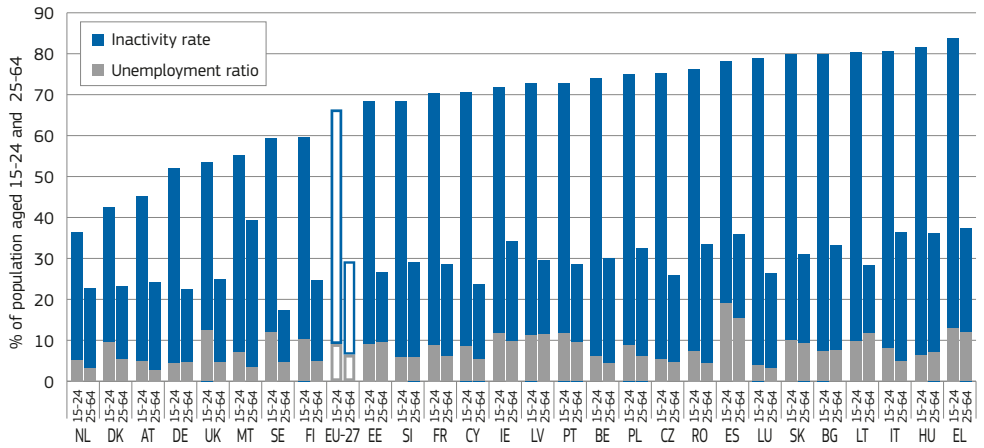
In 2011, 71.2% of the working-age population (15-64) in the EU was active on the labour market, i.e. either employed or unemployed. This is 0.2 pp higher than in 2010 and 0.4 pp up on 2008, which tends to support the weak labour market. High levels of unemployment did not, however, lead to any visible or general labour market withdrawal, as could be expected from the past in times of prolonged recession. There were nevertheless increases seen during those three years in Lithuania (+3.6 percentage points), Malta (+2.7 percentage points), Poland (+2.3 percentage points) and even Germany (+1.3 percentage points), while significant decreases were recorded in Ireland (-2.6 percentage points), Bulgaria (-1.8 percentage points) and Slovenia (-1.5 percentage points). The highest participation rates in 2011 were close to 80% (80.2% in Sweden and 79.3% in Denmark.

When comparing the development of unemployment and inactivity as a percentage of the EU population, it can be observed that, while the youth unemployment ratio rose from 6.9% to 9.1% between 2008 and 2011, the inactivity rate also rose quite significantly from 55.7% to 57.3% (up 1.6 percentage points), which mirrors, among other things, an increasing trend towards prolonging studies. On the other hand inactivity did not progress significantly among adults aged 25 and above, edging down by 0.4 pp, to 22.8%.

Chart 10 presents the specific situation in each Member State in 2011. Taking these two dimensions into account, Greece clearly tops the ranking for the young, given the continuous increase in youth unemployment over the past 2.5 years, at 83.8% (70.8% inactivity rate + 13.0% unemployment ratio), while Malta is in first place for adults, at 39.3% (36.0% + 3.3%). The Netherlands are at the bottom of the list for young people, at 36.4% (31.2% + 5.2%), and Sweden is at the bottom for adults, with only 17.3% (12.7% + 4.6%). Considering the youth unemployment ratio alone, Spain is by far the country facing the highest percentage of young people being unemployed, at 19%.

The inactivity rate for young people in the EU increased modestly over the last three years (by 1.6 percentage points up to 57.3% in 2011), but the rate and change diverged markedly among Member States. The inactivity rate augmented significantly in Ireland and to a lesser degree in Spain. This is not necessarily bad, provided

Chart 10: Unemployment and inactivity as a percentage of the young and adult population, by Member State, 2011



Source: Eurostat, EU-LFS, DG EMPL calculations.

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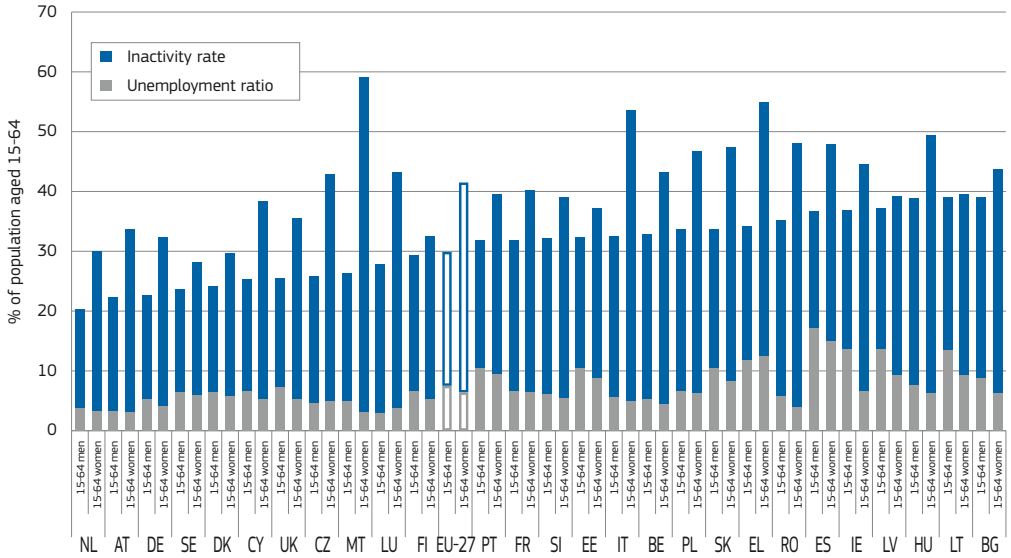
Chart 11: Unemployment and inactivity as a percentage of the male and female population, by Member State, 2011



Source: Eurostat, EU-LFS, DG EMPL calculations.

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that young people go in education or training ('inactivity for employability'), especially in the countries with low levels of participation in education and training. It seems that the crises helped to bring some youth (back) to school in Ireland, Spain and Portugal, but participation in education also increased in Luxembourg and Slovenia, which had already had high rates before. Yet, there are still a number of countries where increases in inactivity rate are much higher than increases in education and training. See Box 2 on young people not in employment, education or training.

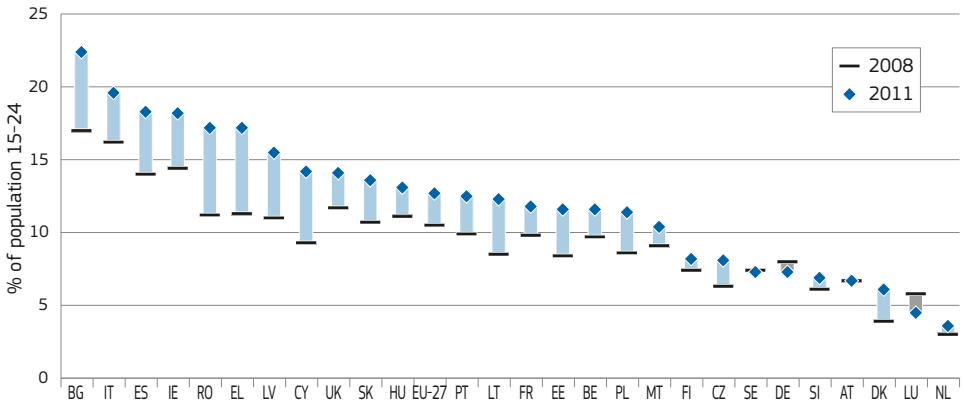
As highlighted by Chart 11 inactivity is clearly more widespread among women. 35.1% of women aged 15 to 64 were economically inactive in 2011, against 22.4% of men. Chart 11 presents the situation by Member State and gives an overall picture, presenting the sum of inactivity rates and unemployment ratios by gender. The lowest total for men was seen in the Netherlands (20.3%), and for women in Sweden (28.2%), while the highest rates were noted in Bulgaria and Lithuania for men (both 39.1%) and in Malta for women (59%). The latter is the country where the gender gap is the highest in that respect (32.7 percentage points).

Box 2: Young people not in employment, education or training (NEETs)[1]

High youth unemployment and inactivity, combined with increasingly difficult school-to-work transitions in a period of persistent uncertainty, inevitably create long-term risks of detachment from the labour market and require special attention from policy makers.

The share of young NEETs in the EU had been shrinking up until 2008, but has been growing again since then. In 2011, there were some 7.5 million young people (15-24 years) in a NEET status (12.9%), up by around 1 million (2 percentage points) in comparison to 2008 (see Chart 12). The most dramatic rises, over 4 percentage points, were recorded in Romania, Greece, Bulgaria, Cyprus, Latvia and Spain. In the majority of countries the share of women being NEET was higher than for young men. The gender gap was the highest in Romania and Greece in 2008 and 2011 although it did close somewhat (from above 5 percentage points difference to below 3 percentage points).

Chart 12: NEETs in the EU Member States, 2008-2011



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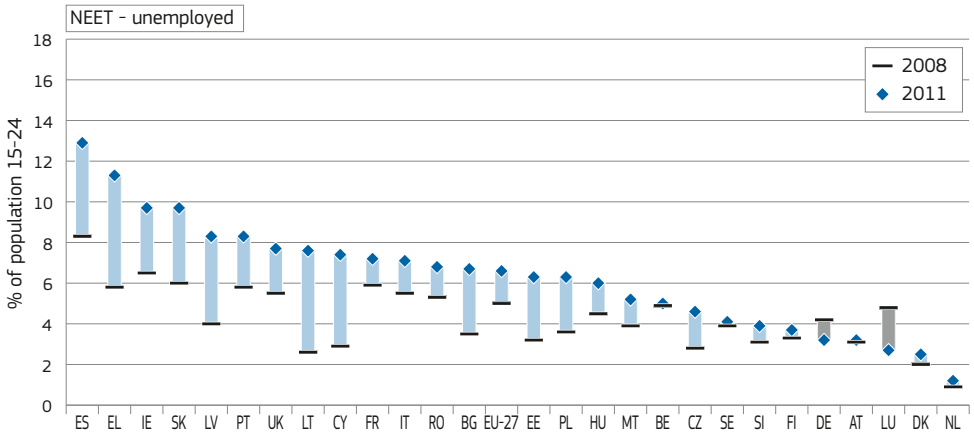
Source: Eurostat, EU-LFS.

However, the NEET rate has been still increasing, mostly due to higher unemployment and less because of higher 'inactivity not related to employability' (i.e. inactive and not in education and training) (see Chart 13). Thus, young people continue to look for jobs or go into education. To prevent increases in 'bad' inactivity, young people need support in staying in the labour market, in looking for employment or in continuing education or training. However, there are gender differences. A higher share of young men was unemployed and those shares increased between 2008 and 2011. On the other hand women had a higher share of inactivity, but it decreased in the majority of Member States between 2008 and 2011.

The highest increase in inactivity over the last three years was registered in Romania, whereas the change was more modest in Bulgaria, Italy, Belgium and Denmark. On the other hand it fell in some of the countries with high youth unemployment (e.g. Lithuania, Slovakia and Spain).

Chart 13: Components of NEET by work status in Member States, 2008 and 2011, 15-24

a) Unemployed



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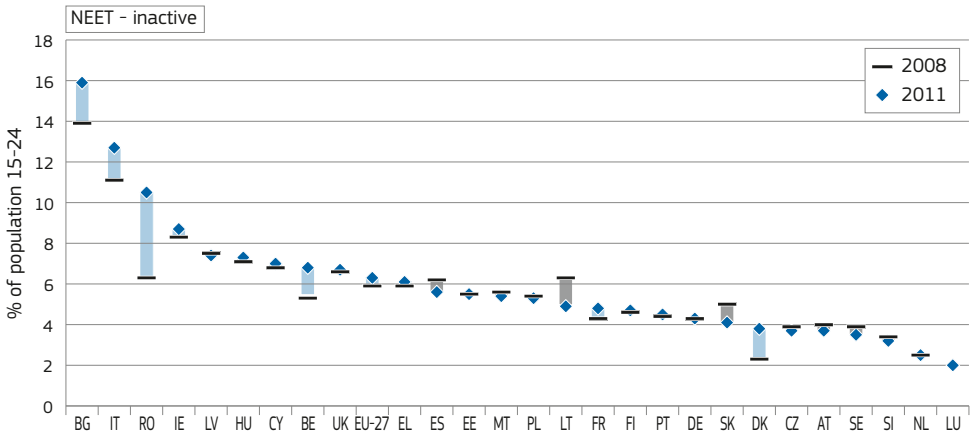
(1) The Box does not discuss two educational targets of the Europe 2020 strategy which aim at improving qualifications, skills and thereby the employability of young people (reducing the share of early leavers from education and training to below 10% and increasing the share of 30-34 year olds with completed tertiary or equivalent education to at least 40%). More information on that can be found in European Commission (2012b).

b) Inactive



Source: Eurostat, EU-LFS, edat_lfse_20.

Notes: a) Breakdown by work status shows the share of unemployed/inactive NEET in the total population aged 15-24, i.e. the data is presented in percentage points of the overall NEET rates for age 15-24. Shares add up to the total NEET. b) The share of unemployed people in DE and LU decreased. c) No data for inactive for LU in 2008.

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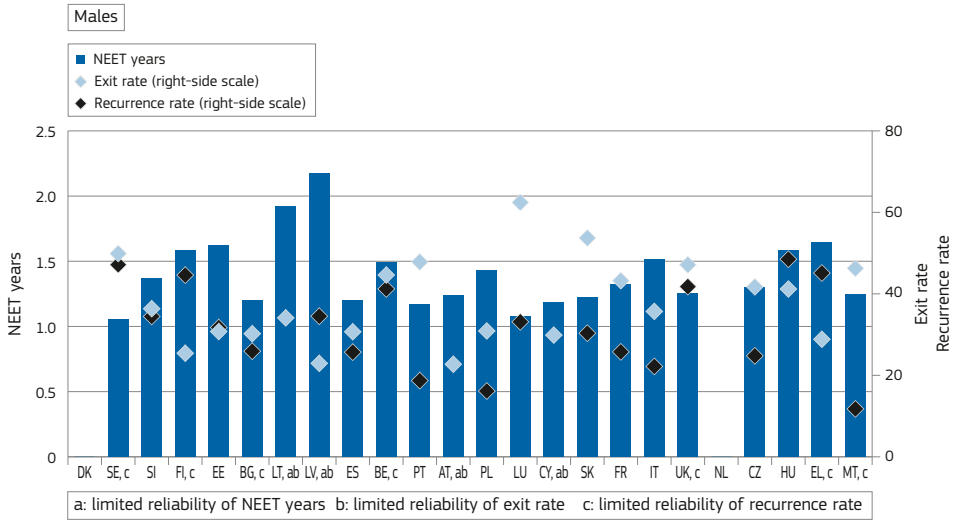
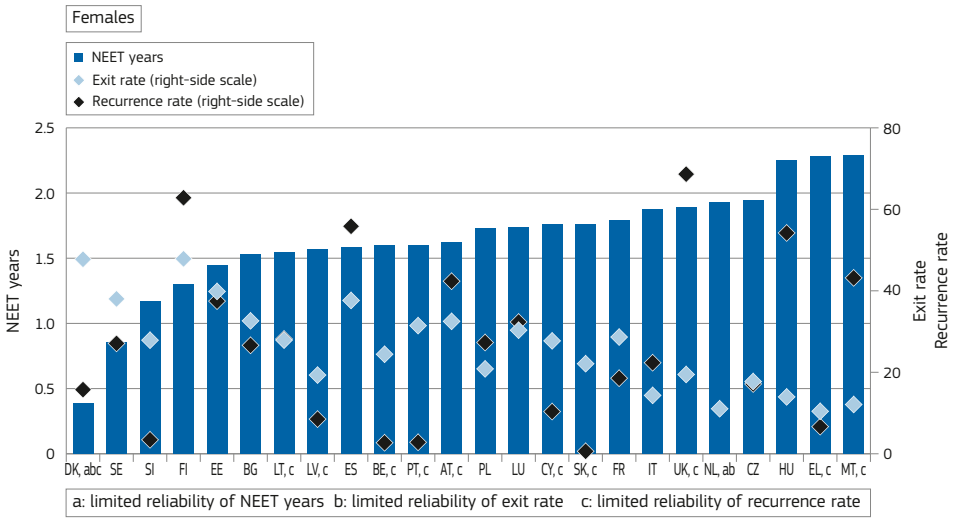
Chart 14: Incidence and experience of NEET among young (2006-2009)

a) Four years experience NEET





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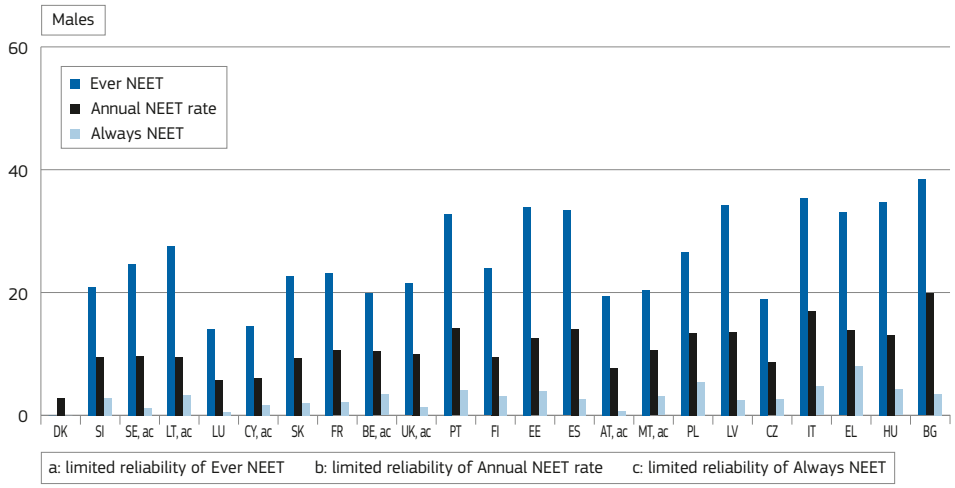
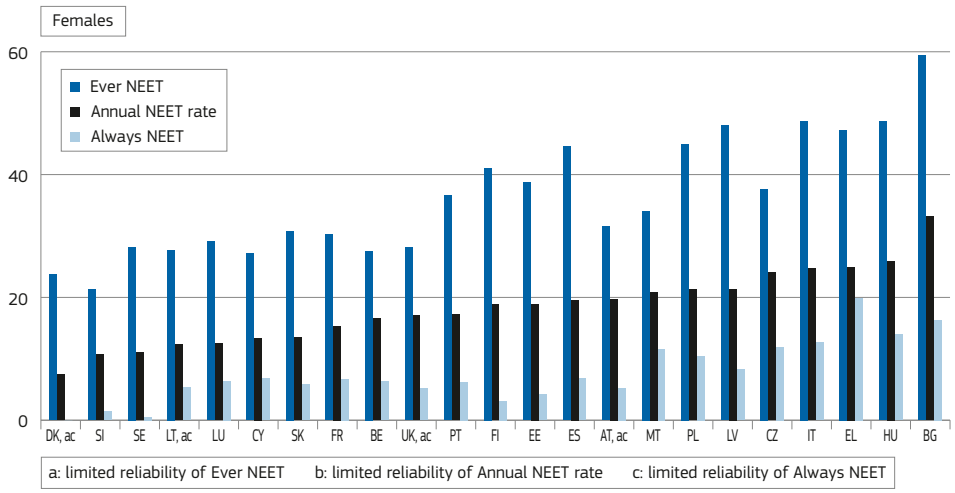
Young people go through many transitions and most of them enter the NEET category at a certain stage due to various reasons. Eurofound (2011a) identified eight key determinants that increase the probability of young people entering the NEET category: i) having some kind of disability; ii) immigration background; iii) low education; iv) living in remote areas; v) coming from a low household income; vi) having parents who experienced unemployment; vii) having parents with a low level of education and viii) coming from divorced families.

The challenge for the policy-makers is to increase the probability of successfully exiting this category and to lower the number of years spent as NEET, while paying sufficient attention to gender differences. An analysis by the Commission to be published in the near future shows that the share of young people observed in NEET for four consecutive years is rather small, but gender and cross-country differences are sizable, ranging from 0.5% in Luxembourg to 8% in Greece for men and from 0.6% in Sweden to 19.9% in Greece for women (see Chart 14). Turnover in NEET status, measured as the ratio of 'ever NEET' to 'always NEET', is higher in Nordic countries. The exit rate is, on average, above 30%, but the recurrence rate is also high, especially for females in Spain (59.9% enter NEET at least twice over a four year period) and Finland (66.9%).

b) Incidence of NEET





Source: Calculations from ENEGE (European Network of Experts on Gender Equality) based on EU-SILC longitudinal data.

Notes: Sample includes young individuals (age 15-29 in 2006) who have been NEET in 2006, still in the sample in 2009. Unreliable statistics and/or countries are not shown.

Notes Chart 14 a): a) Countries shown in ascending order of NEET years for females. b) Statistics in DK and NL for males are not reliable. c) NEET years are average number of years in NEET after 2006. Statistic has limited reliability for males in LT, LV, AT and CY; and for females in DK and NL (a). d) Exit rate is share of young who were NEET in 2006 and employed in 2007. Statistic has limited reliability for males in LT, LV, AT and CY; and for females in DK and NL (b). e) Recurrence rate is share of young who were NEET in 2006, employed in 2007 and experience NEET again in the following period. Statistic has limited reliability for males in SE, FI, BG, BE, UK, EL and MT; and for females in DK, LT, LV, BE, PT, AT, CY, SK, UK, EL and MT (c).

Notes Chart 14 b): a) Countries shown in ascending order of Annual NEET years for females. b) No reliable statistics for NL. c) Ever NEET is share of young individuals who experienced at least one NEET spell over the period 2006-2009. Statistic has limited reliability for males in SE, LT, CY, BE, UK, AT and MT; and for females in DK, LT, UK and AT (a). d) Annual NEET rate: share of NEET yearly average on 2006-2009. e) Always NEET: share of young who have been NEET from 2006 to 2009. Statistic has limited reliability for males in SE, LT, CY, BE, UK, AT and MT; and for females in DK, LT, UK and AT (c).

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Young women show greater NEET persistence and lower turnover than young men, especially in Southern and Eastern Europe (Italy, Greece, Malta, Poland, Bulgaria, the Czech Republic and Hungary), where young women represent a higher share of annual NEET rate and always NEET in the 2006-2009 period and lower exit rates than men. However, once women exit NEET, recurrence is less likely. The higher persistence for young women is probably due to the fact that NEET women are more likely to be inactive rather than unemployed.

Eurofound (2012) identified some good practices in policy design and implementation that help bring young people to employment or education and training: i) Policy measures have to be diversified and should pay special attention to groups that are more likely to cumulate multiple disadvantages. ii) The labour market readiness of the beneficiaries must be taken into account. iii) Short-term solutions are not enough – young people have to be set on a long-term, sustainable pathway. iv) It is essential to involve a broad range of stakeholders, especially employers and their representatives, in the design and delivery of youth employment measures. v) Youth employment measures must be client-centred, not provider-focused. vi) Successful policies are innovative and introduce new ways of engaging disfranchised young people.

The best results of targeted help to young NEETs are achieved not only by setting requirements and targets, but also by clearly dividing responsibilities among various parties. Otherwise, each actor may cede the responsibility to activate hard-to-place workers to others. Furthermore, those who are investing in the activation of hard-to-place (young) workers should be rewarded for successful activation (European Commission 2012a).

1.2.5. Signs of deterioration in the job matching process

Chart 15 shows an unfavourable trend in the number of job flows throughout 2011, with a declining trend in job starters since late 2010, suggesting a deteriorating job finding rate and reduced job openings[9], on the one hand, and an increase in job separations driven by a renewed process of job sheddings. At the same time, the labour shortage indicator, derived from EU business survey results, returned to its level of the second half of 2011 (close to 6.5%), after a dip to 5.7% in the first quarter. So an increasing number of employers in industry are again pointing to labour as a factor restraining production. This is a worrying development, considering that the unemployment rate increased by about one percentage point at the same time (since mid-2011).

Chart 16 illustrates this: recent movements in the Beveridge curve point to a possibly substantial deterioration in the matching process since 2010. Unemployment has become more structural over the past two years.

Chart 15: Persons whose job started or ended in the last three months in the EU-27, as a share of total employment, y-o-y changes, 2006-2011 (percentage points)

Source: Eurostat, EU-LFS, DG EMPL calculations.

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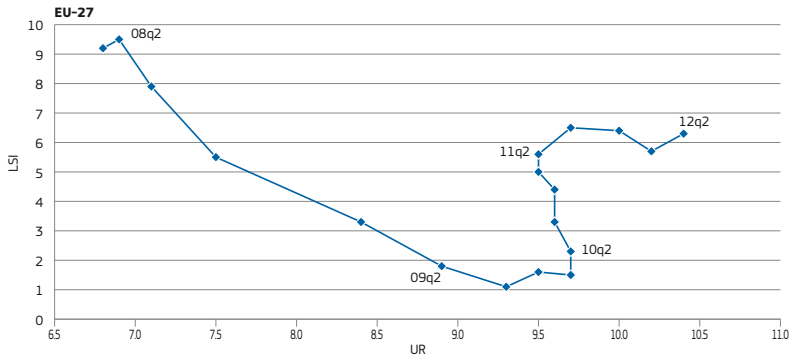
Chart 16: Beveridge curve for the EU



Sources: See Table 2.

Note: UR = unemployment rate (%); LSI = labour shortage indicator, derived from EU business survey results (% of manufacturing firms pointing to labour shortage as a factor limiting production).

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(9) The EU job vacancy rate was slightly lower than a year ago, at 1.5% instead of 1.6%.

Table 2: Beveridge curve and change (percentage points or %) in related variables, by Member State, ranked according to the change in the unemployment rate between 2010q2 and 2012q2

	UR (pps)	LSI (pps)	JVR (pps)	GDP (%)	EMPL (%)
EE	-8.4	7.5	0.5	11.4	11.0
LT	-4.8	2.3	0.2	9.2	5.2
LV	-4.7	4.6	0.2	10.2	-6.2
DE	-1.7	6.1	0.7	4.0	2.6
BE	-1.4	1.6	0.7	1.7	1.7
SK	-0.9	-1.0	0.1	6.5	2.4
FI	-0.9	3.7	0.2	2.0	1.4
SE	-0.9	-0.3	0.4	5.9	3.2
MT	-0.8	1.2	-	3.6	3.8
CZ	-0.5	1.2	0.2	1.0	0.6
HU	-0.4	9.6	0.0	0.5	1.0
AT	-0.2	1.6	0.3	4.5	3.2
RO	0.0	1.2	0.0	2.9	-
UK	0.3	11.5	-0.1	0.2	1.7
DK	0.4	0.1	-	0.8	-1.0
FR	0.4	2.2	-	2.0	0.6
PL	0.4	1.3	-0.1	7.4	1.1
NL	0.6	3.9	-0.1	1.0	0.7
EU-27	**0.7**	**4.0**	**0.1**	**1.4**	**0.3**
SI	0.8	4.8	0.0	-0.7	-2.6
LU	0.8	0.5	0.3	-	-
IE	1.2	-	0.1	1.3	-3.9
IT	2.0	0.3	-	-1.7	0.0
BG	2.2	2.8	0.1	2.6	-6.4
PT	3.5	-0.7	0.0	-4.3	-5.0
CY	4.1	-2.1	-1.0	-0.9	-1.9
ES	4.6	-0.3	-0.6	-0.8	-4.7
EL	11.4	0.8	0.5	-	-

Source: Eurostat; UR = unemployment rate (ESTAT, une_rt_q); LSI = labour shortage indicator (ESTAT, bsin_q_r2); JVR= job vacancy rate (ESTAT, jvs_q); GDP = gross domestic product (ESTAT, namq_gdp); EMPL = employment (ESTAT, namq_aux_pem).

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Box 3: Beveridge curve

The Beveridge curve compares unemployment rates to job vacancies. Shifts along the curve represent cyclical changes in the demand for labour, typically higher vacancies and lower unemployment in upturns, or lower vacancies and higher unemployment in downturns. On the other hand, shifts of the curve towards the left or the right (which can also be seen as, respectively, shifts down and up) are indicative of structural changes.

An alternative indicator for the job vacancy rate is the labour shortage indicator. The indicator is derived from EU business survey results[1]. In each first month of a quarter, companies are asked, in the business survey, which main factors are currently limiting production. Labour shortage is one of the possible options offered. The indicator is the percentage of respondents choosing this option. The indicator is timely and harmonised among Member States[2]. As a drawback, it covers only manufacturing. As the labour shortage indicator is seasonally adjusted, it allows for a short-term comparison. While the EU job vacancy rate rose moderately between the second quarter of 2010 and the second quarter of 2012 (from 1.4% to 1.5%), the EU labour shortage indicator went up much more quickly, to 6.3% (from 2.3%). As a result, the EU Beveridge curve is shifting to the right (see Chart 16). At the Member State level, the situation is very diverse.

Genuine shifts in the Beveridge curve can only be assessed after a certain time span. Nevertheless, data collected up to the second quarter of 2012 seems to suggest that, for most Member States, the Beveridge curve has a tendency to shift to the right, with a higher level of vacancies for a given unemployment rate.

Individual MS Beveridge curves were analysed in ESSQR of March 2012[3].

Since mid-2010, Germany has been the only Member State witnessing a shift to the left of its Beveridge curve, i.e. a lower level of vacancies for a given unemployment rate. It is likely that the Hartz reforms, with their effects on activation and job creation, are at least a partial explanation for this, at present, unusual shift in the curve.

(1) See also http://ec.europa.eu/economy_finance/db_indicators/surveys/method_guides/index_en.htm.

(2) The indicator is not available for Ireland.

(3) See Social Europe website on http://ec.europa.eu/social/BlobServlet?docId=7548&langId=en.

Almost half of the Member States saw a decline in their unemployment rate between the second quarter of 2010 and the second quarter of 2012. In most cases, this coincided with a slight rise in the labour shortage indicator, suggesting a very modest shift to the right of the Beveridge curve, like in the Czech Republic and Lithuania. In the cases of Belgium, Austria and Finland, shifts seem to take place along the curve, indicating an absence of structural change. As can be seen in Table 2, some newer Member States where the unemployment rate clearly declined since early-2010 still have an employment level trailing the early-2008 level, while the 'older' Member States of that group regained that level in 2011. The group of Member States which saw a rise in their labour shortage indicator as well as increases in the unemployment rate since mid-2010, are closer to the average EU Beveridge curve trend. Large Member States such as France, Italy, Poland and the United Kingdom are in this group.

Nevertheless, the latter group is very different from another group which saw quite unfavourable developments over the period concerned. In this group, unemployment rates clearly increased, while the labour shortage indicator fell. Moreover, in most cases, the labour shortage indicator and the job vacancy rate both declined[4]. This is indicative of a lack of demand, as an insufficient number of vacancies opened up to make a dent in unemployment. Unsurprisingly, Cyprus, Portugal and Spain are part of this group.

(4) In the Netherlands, the labour shortage indicator increased, but the job vacancy rate was stable. Spain saw very small increases in both indicators.

Chapter 6 assesses, in more depth, to what extent skills and educational mismatches impact on the labour market functioning.

1.2.6. Continuing segmentation in EU labour markets

Non-standard contracts signalling segmentation

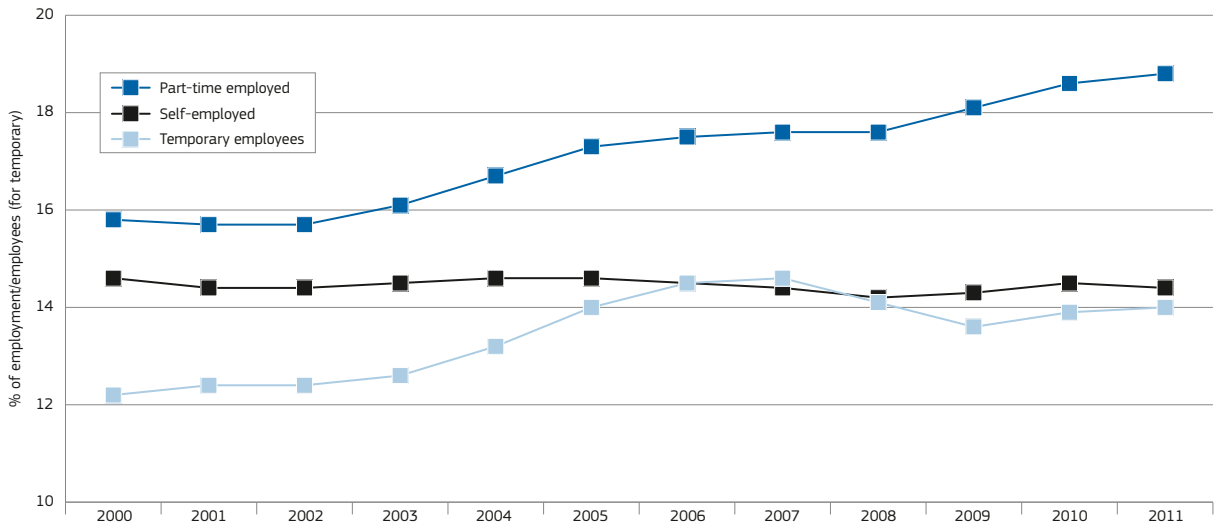
Fluctuations in the number of jobs in the EU since the crisis have been driven mainly by part-time work and temporary (short-term) contracts, while the number of self-employed did not vary much (see Chart 17). Part-time employment accounted for a significant share of the overall expansion in employment in the EU since 2000 and its growth was uninterrupted by the crisis. While the total employment figure contracted between 2008 and 2010, and the number of full-time workers shrank by 6.2 million, the number of part-timers increased by 1.1 million. This trend affected both adult women and men, as opposed to young people, who were affected by a decline in both full-time and part-time work.

Temporary contracts proved to be a major adjustment variable for companies as they have been the most reactive segment of the labour market since the crisis first broke out. The share of temporary employees in the total number of employees rose from 12.2 % in 2000 to 14.6 % in 2007, before falling to 14.1 % and 13.6 % in the two subsequent years, when the crisis started to affect the labour market. It then improved again to 13.9-14.0 % during the timid recovery in 2010-2011.

Self-employment remained relatively stable, although this may hide a significant decline in real activity. The share of self-employment remained at around 14.5 %. It rose slightly during the crisis, as their number was not affected by the crisis in the same proportion as paid employees (from 14.2 % in 2008 to 14.5 % in 2010). In 2011, it dropped down to 14.4 %. This apparent resilience may however hide a significant decline in real activity (fall in turnover and/or hours worked). Indeed, between 2008 and 2011, while the number of hours worked by employees remained relatively stable (down from 36.8 to 36.4 hours per week), it fell from 44.4 to 43.5 for self-employed.

The number of part time and temporary jobs reveals different dynamics which can be associated with the phenomena of segmentation in the labour market.

Chart 17: Part-time and temporary contracts and self-employment in the EU, working-age population (15-64), 2000-2011



Source: Eurostat, EU-LFS.

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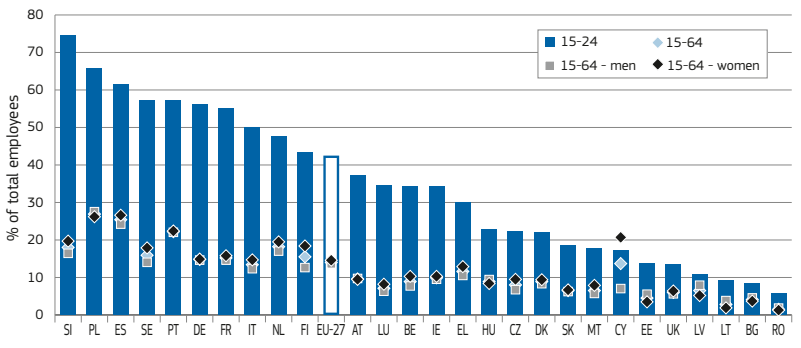
Chart 18: Temporary employment in Member States for young and working-age employees (15-64), women and men, 2011



Source: Eurostat, EU-LFS.

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were working temporarily because of a lack of permanent jobs, while the share was over 80% in Spain and Slovakia. Comparatively slightly fewer, but still a significant figure of around 60% of young people were working temporarily for the same reason in Latvia, Belgium, Greece and Romania, and one in every two people were doing so in Poland, Bulgaria and Hungary.

Temporary work and the young

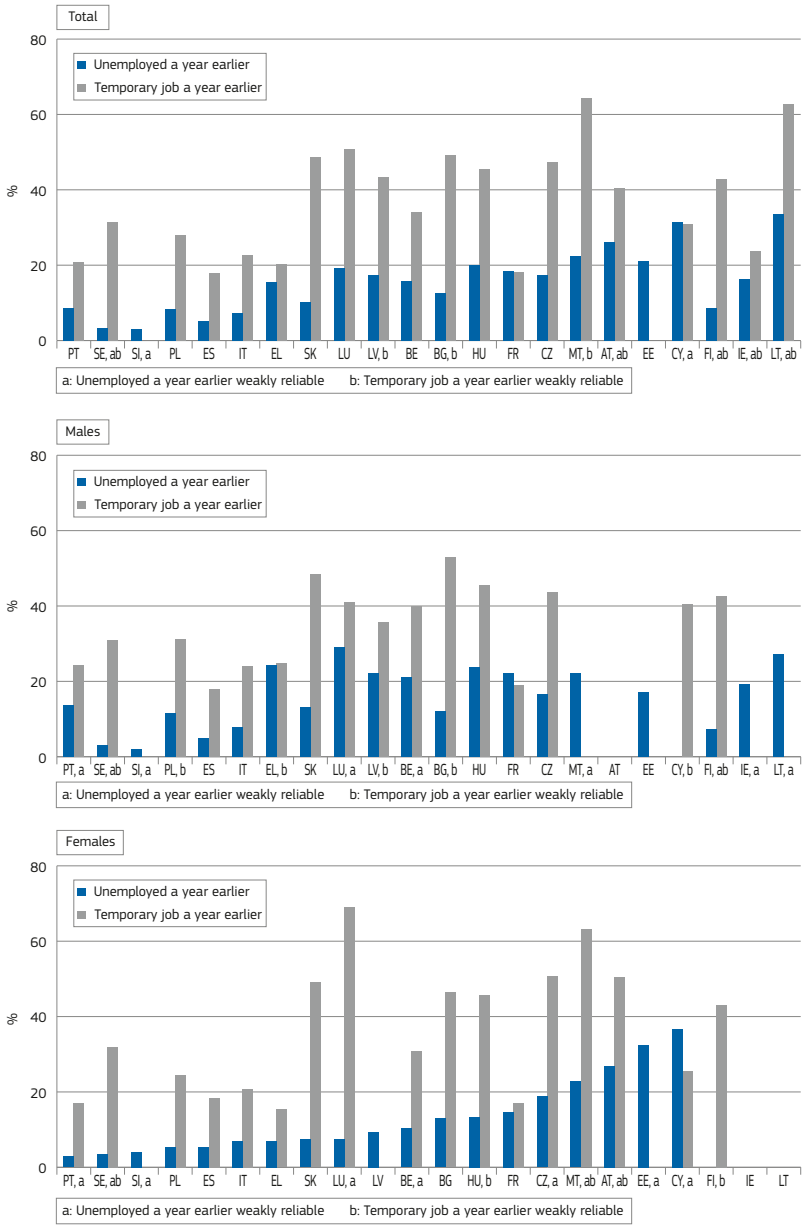
Even though high share of temporary work among the young raises concerns, it appears that temporary jobs are a

Temporary work

Young people are significantly over-represented in temporary work in Member States and their situation has been worsening over time (see Chart 18). In 2011, some 42.5% of young employees in the EU were working on temporary contracts, i.e. a rate three times higher than the average of 14.0% for working-age employees. Ten years ago, in 2001, ratio was less than three, with 35.9% of young people and 12.4% of adults on temporary contracts. The highest disproportion in the EU was found in Luxembourg and Slovenia, where the ratio of youth to adult temporary work was over 4, while the differences were smaller in Cyprus and Latvia (ratio lower than 2). Slovenia tops the ranking for young people with nearly 75% of them working temporarily. It is followed by Poland, Spain, Sweden, Portugal and Germany, where between 56% and 66% of young employees have temporary contracts. The lowest percentages (under 10%) for young employees were recorded in Romania (5.8%), Bulgaria (8.3%) and Lithuania (9.1%). Among employees, at EU level, the share of temporary workers is the same between women and men. The only significant gap is noted in Cyprus, where the gap reaches 13 percentage points.

A high share of temporary work in the Member States is involuntary, which also applies to young people. In 2011, 60.4% of the 15-64 year-old group and 36.7% of young people worked on temporary contracts because they could not find a permanent job. However, the low EU average for young people hides important differences between Member States. More than 75% of young people in the Czech Republic, Portugal and Cyprus

Chart 19: Probability of being on a permanent contract in 2009



Source: calculations from ENEGE (European Network of Experts on Gender Equality) based on EU-SILC longitudinal data.

Notes: a) Sample includes all individuals aged 15-29 in 2009 observed as unemployed or in a temporary job in 2008. Unreliable statistics are not shown. b) Countries shown in ascending order of 'Unemployed a year earlier' for females. c) Unemployed a year earlier data reliable to a low degree (a). d) Temporary job a year earlier data reliable to a low degree (b).

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stepping stone for permanent employment relative to unemployment, especially for women (see Chart 19). The importance of staying in the job, even temporarily, is especially relevant for women, while the differences are less significant for men. The probability of getting a permanent contract is much higher in the countries with a lower percentage of temporary work among the young, such as in Bulgaria, Lithuania and Latvia (below 10%); or in Malta, Slovakia and the Czech Republic (below 20%), with some exceptions such as Luxembourg, Hungary, Austria and Finland. Countries with stricter employment protection legislation, such as Greece, Portugal, France, Italy and Spain, had lower probabilities for a transition to permanent contracts, although there are exceptions, such as Luxembourg[10].

The extent of temporary work among the young reflects not only changing labour market demand but also structural features of the education systems and cultural differences. Participation in education and training is the most significant reason behind the high share of young people in temporary work in Germany and Austria, well known for their dual educational system (around 80%), and to a lesser extent in Denmark (around 55%). Temporary work among the young is also more widespread in countries that promote autonomy from an early age with public policies such as a monthly support allowance, the availability of affordable housing, free education etc. such as in Nordic countries, the UK and the Netherlands (see Oliveira et al. 2011). The young, who to a large extent stay in education, supplement their income by doing temporary or part-time work and are not actually looking for a permanent job. Over 40% of young temporary workers in the United Kingdom, Sweden and Finland did not actually want a permanent job in 2011. The leader in 'voluntary' temporary work is Slovenia, with 65.3% of the young not wanting a permanent post. Some of the reasons also apply to part-time work among young people.

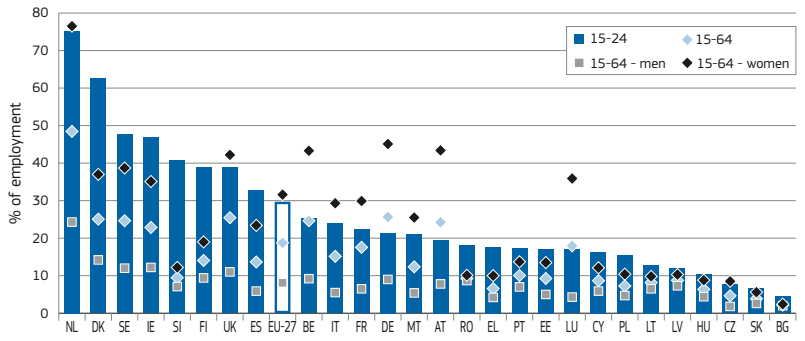
Part time work

Nearly 94% of the 632 000 jobs created in the 15-64 age group in 2011 had part-time contracts. Part-time employment accounted for a significant share of the overall expansion in employment in the EU since 2000 and its growth was uninterrupted by the crisis, in contrast to temporary employment and full time employment. The expansion of part-time work was clear from 2008, increasing by 1.2 percentage points to 18.8% in 2011. During the period when total employment contracted between 2008 and 2010, and the number of full-time workers shrank by 6.2 million, the number of part-timers was up by 1.1 million. This trend affected both adult women and men, as opposed to young people, who were affected by a decline in both full-time and part-time work.

Chart 20 shows the share of part time employment for the total workforce, by gender, and for the young, showing that the incidence of part time work is not as skewed towards the young as is the case for fixed term work. Part-time work is rather a common feature of female employment. At EU aggregate level, the gender gap was significant in 2011: 23.5 percentage points (31.6% for women against 8.1% for men). This ranking is topped by the Netherlands for all age groups and both genders. In the NL too, the gender gap is the EU's highest: 52.2 percentage points, between women (76.5%) and men (24.3%).

The crisis has not significantly increased the share of involuntary part time work, which is low overall compared to that of voluntary part-timers (see Chart 21). Declining percentages of involuntary part-time work might be read as a sign that, in some countries, and sometimes in a context of persistently uncertain labour market conditions, workers are more inclined to accept working part-time as a valuable opportunity. On the other hand, increasing percentages in countries where there is a dire labour market situation, such as Greece, may be seen as a sign that, although part-time work has not made many inroads lately, more and more part-time workers do not regard underemployment as an acceptable option. The main conclusion which can be drawn is that, while part-time work continues to progress, it does not mean it is better accepted by workers, and obviously not by young people who have been the first group to be affected by the expansion of this type of working arrangements in the recent period.

Chart 20: Part-time employment in Member States for young and working-age workers (15-64), women and men, 2011



Source: Eurostat, EU-LFS.

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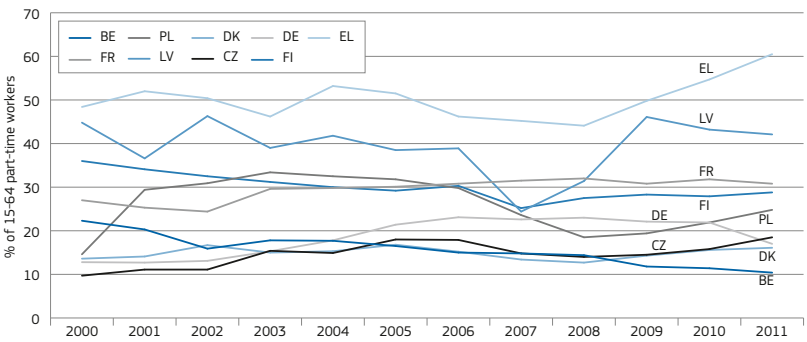
Chart 21: Involuntary part-time work in selected Member States, working-age part-time workers (15-64), 2000-2011



Source: Eurostat, EU-LFS [lfsa_eppgai].

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(10) OECD data on employment protection legislation for 2008 (Venn 2009).

While the share of female employees working part-time is roughly four times higher than for men, less than one female part-timer in four (23.1%) declared that they worked part-time involuntarily in 2011, against 36.5% of male part-timers. For young employees, of whom roughly 30% worked part-time in 2011, that percentage is 28%.

Internal flexibility, through the use of temporary contracts, part-time work and low wages, has shielded many economies from even worse labour market performances but, at the same time, it has given rise to the phenomenon of 'in-work poverty'. In the EU today, 8.4% of workers live below the poverty line.

1.2.7. Wages and labour costs have started to adjust

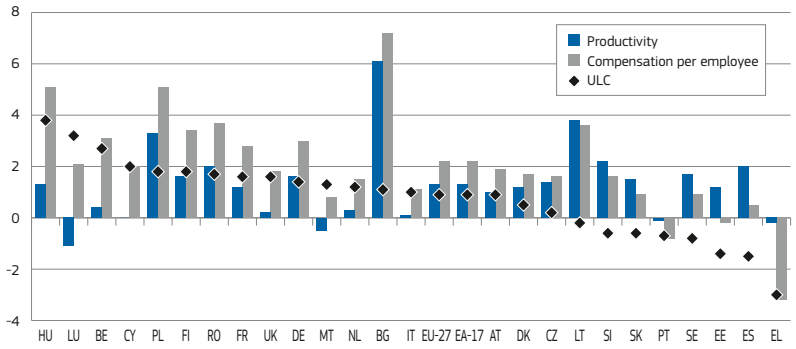
This issue is analysed in more detail in Chapter 5.

In 2011, the dynamics of nominal compensation per employee started exhibiting an increasingly clear differentiation between Member States with stronger needs to reduce unemployment and rebalance external positions and Member States with a more sustained recovery and current account surpluses. Variations in compensation per employee across the euro area range between plus 3% in Finland, Belgium and Germany to a similar rate of negative growth rate in Greece. See Chart 22. Persistent slack was mostly reflected in the dynamics of the variable components of wages, which almost offset the moderate increase stipulated by the collective bargaining agreements[11].

After having recorded significant growth in 2010, average productivity growth in the EU decelerated markedly, i.e. down from 2.6% in 2010 to 1.3% in 2011. Except for Bulgaria, Lithuania and Poland, where productivity grew by over 3%, all Member States recorded only modest labour productivity growth, with Luxembourg, Malta, Portugal and Greece even chalking up a decline in their labour productivity. Despite a slowdown of labour productivity growth, nominal unit labour costs only increased moderately in the EU and in the euro area. In Greece the unit labour cost (ULC) decreased by 3% mainly reflecting the decline in compensation per employee. By contrast, in Spain the decrease in unit labour cost was primarily generated by notable productivity growth close to 2% and moderate compensation per employee growth. In Estonia a small decrease in compensation per employee in combination with a modest increase in productivity generated a fall in its unit labour cost. See Chart 22.

In the first half of 2012, labour productivity growth in the EU continued to weaken with sharp falls in Italy, Hungary and the United Kingdom. At the same time nominal wage growth strengthened in some Member States, while it remained subdued in others such as Spain or negative in Slovenia. As a result, nominal unit labour cost developments continued to differ across Member States with, most notably, Spain further strengthening its path of negative ULC growth that started at the beginning of 2010.

Chart 22: Compensation per employee, productivity and ULC in 2011 (Annual % growth)



Source: Eurostat, National Accounts (nama_aux_lp,nama_aux_ulc).

Notes: 1) Unit labour cost (ULC) growth = growth in nominal compensation per employee adjusted for productivity growth. 2) IE: data missing, LV: structural break in data.

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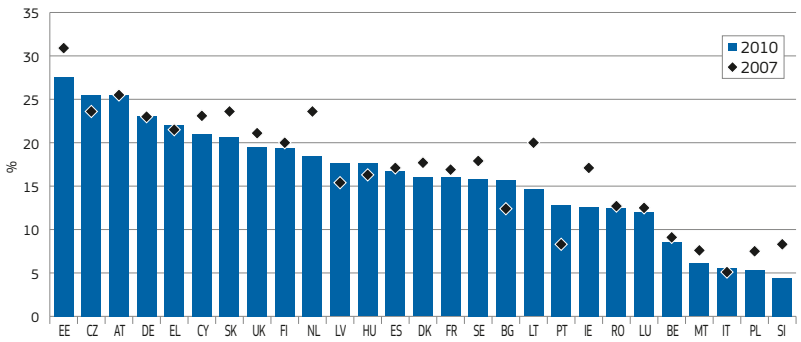
Gender pay gaps persist in some EU Member States

Chart 23 shows the unadjusted gender pay gap in the Member States for 2007 and 2010 (which is the last available observation). This indicator measures the difference between average gross hourly earnings of male paid employees and of female paid employees as a percentage of average gross hourly earnings of male paid employees.

This Chart shows some significant differences across Member States. The pay gap was just above 4% in Slovenia in 2010, but in excess of 25% in several

Chart 23: Unadjusted gender pay gap in the Member States – 2007 & 2010



Source: Eurostat (tsdsc340).

Notes: 1) The gender pay gap measures the difference between average gross hourly earnings of male paid employees and of female paid employees as a percentage of average gross hourly earnings of male paid employees in enterprises with 10 employees or more in NACE Rev. 2 aggregate B to S (excluding O). 2) EE and EL show the 2008 observation instead of the 2010 observation. 3) These are unadjusted gaps in the sense that they only take the gender dimension into account to measure the gap, i.e. no adjustment for skills, age, etc.

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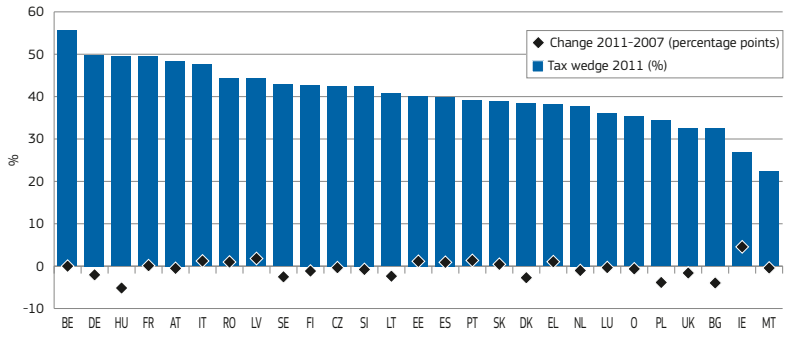
(11) See European Commission, 2012h. Also according to Eurofound 2012b, the economic and financial crisis of 2008-2010 has impacted on pay in most EU Member States leading to wage deceleration, pay freezes and sometimes pay cuts.

Chart 24: Tax wedge for a single person without children, 100% of average wage



Source: OECD, 'Taxing Wages'.

Note: 'O' refers to OECD average; data refer to 2010 for BG, LV, LT, MT and RO.

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Member States, i.e. Estonia[12], the Czech Republic and Austria.

Moreover, while some Member States recorded significant progress in closing the gender pay gap, including Lithuania (-5.4 percentage points), the Netherlands (-5.1 percentage points) and Ireland (-4.5 percentage points), several Member States experienced a sharp rise in the gender pay gap, with the largest increases recorded in Portugal (+4.4 percentage points) and Bulgaria (+3.3 percentage points).

All in all, it should be remembered that the indicators shown in Chart 23 are unadjusted in the sense that they do not take into account other personal or household characteristics such as age and education. Nevertheless, they underline the need to continue to pursue policies aimed at eradicating the drivers of these gaps.

Some reductions in the tax wedge

Labour costs are directly influenced by the tax wedge. The majority of Member States have somewhat reduced their tax wedge between 2007 and 2011 (see Chart 24). However, some with the highest percentages (Belgium, France, Austria) have not and some (Italy, Romania, Latvia) have increased it. An increase can also be noted for Spain, Portugal and Greece, a development which is unhelpful in countries facing high unemployment.

Minimum wages may have played a supportive role

In July 2012, 20 of the EU's 27 Member States had national legislation setting a minimum wage. See Chart 25.

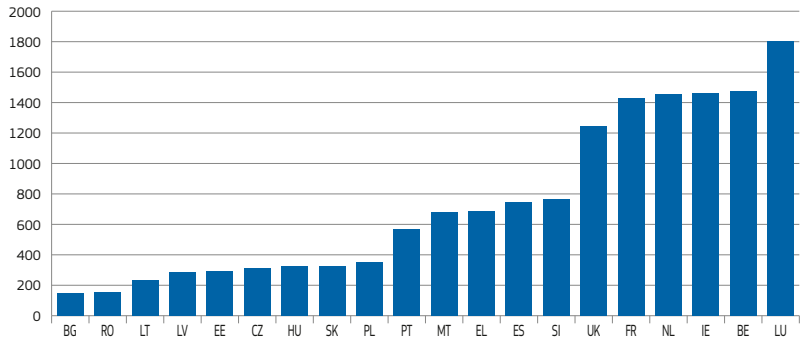
Minimum wages are by far highest in Luxembourg (about 1800 euro per month), followed by Belgium, Ireland, and the Netherlands (at about 1450 euro per month), and France (at about 1425 euro per month). Next in the ranking is the United Kingdom (1244 euro per month), followed by a group of 5 Member States (Slovenia, Spain, Greece, Malta and Portugal) where the minimum wages ranges between 565 euro (in Portugal) and 763 euro (in Slovenia).

All Member States that joined the EU in 2004 or later and having a national minimum wage recorded a minimum wage of less than 360 euro per month – except Slovenia and Malta. The lowest minimum wage is to be found in Bulgaria (148 euro) and Romania (157 euro).

When adjusted for price differentials across countries, the disparities between the Member States are reduced from a range of one to twelve (in EUR) to a range of one to five in purchasing power standard (PPS). At the opposite ends of the scale were Romania (276 PPS) and Luxembourg (1478 PPS per month). 11 Member States list a minimum wage (in PPS) that is less than half the minimum wage of Luxembourg, among them Greece and Portugal. See Chart 26.

In 2011 the minimum wage levels in the EU varied between 30% and 50% of average gross monthly earnings in industry, construction and services (except activities of households as employers and extra-territorial organisations and bodies). The highest values are reported for Greece (but note that in Greece the minimum wage was

Chart 25: Minimum wages in euro – July 2012



Source: Eurostat, Labour market (earn_mw_cur).

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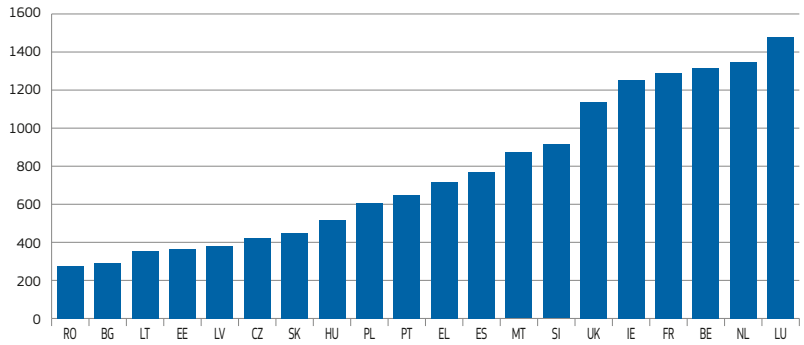
Chart 26: Minimum wages in PPS – July 2012



Source: Eurostat, Labour market (earn_mw_avgr2).

Note: The purchasing power standard, abbreviated as PPS, is an artificial currency unit. Theoretically, one PPS can buy the same amount of goods and services in each country.

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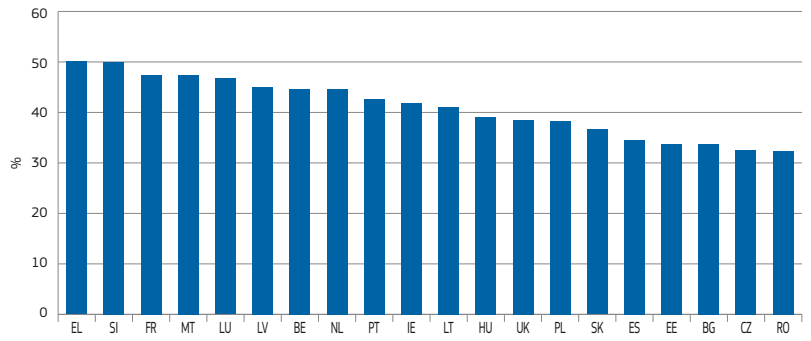
(12) Note that for Estonia the last available observation is 2008.

Chart 27: Minimum wages as proportion of the mean value of average gross monthly earnings – 2011



Source: Eurostat, Labour market (earn_mw_avgr1).

Note: BE, FR, NL, RO refer to 2010. EL covers B-S excluding O.

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substantially reduced by mid-2012, down from 876.62 euro per month in the second half of 2011 to 683.76 euro per month in the second half of 2012) and Slovenia followed by France, Malta and Luxembourg. At the lower end of the scale, Spain, Estonia, Bulgaria, the Czech Republic and Romania report minimum wages below 35 % of the average gross monthly earnings, see Chart 27.

1.3. Mixed developments in income and poverty

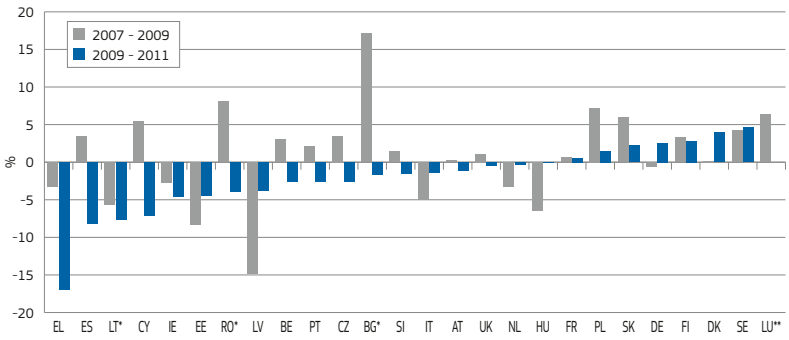
This section explores several issues related to income and poverty. It highlights the recent decline of the average household incomes in many countries and the weakening of the level of protection of the welfare state. It stresses the diverse ways in which the crisis has had an impact on income inequalities, as well as the subsequent rise in poverty and social exclusion. It also addresses the specific situation of children, youth and migrants, i.e. the most affected subgroups. Finally it confirms the risks of long-term exclusion.

1.3.1. Average household incomes have started to decline in many countries

During the crisis, job losses, reduced working hours, reduced activity among the self-employed, and in some cases pay freezes and pay cuts directly affected households' financial situation. Following a long period of decline, the share of people reporting great difficulty in making ends meet increased from 9.6 % to 10.3 % in the EU between 2008 and 2010, and by more than 4 percentage points in the Baltic States, Ireland, Greece, Hungary and Malta. This was also reflected in consumers' opinion reports which reported a deterioration of people's financial situation during the first year of the crisis.

Between 2009 and 2011, real gross household disposable income fell in ⅔ of EU countries (see Chart 28). Within the EU, the situation diverged further between countries where the situation worsened and countries where household incomes continued to increase as economic activity improved and unemployment started declining (the Nordic countries, Germany, Poland). In most countries, protracted economic and labour market conditions and the need to engage in fiscal consolidation (cuts in benefits and increases in taxes) accentuated the expected weakening of automatic stabilizers over time (e.g. end of benefit entitlement, decline in benefit generosity). As a result, real household incomes declined, especially in those where the recession was prolonged. Between 2009 and 2011, real GHDI dropped by more than 4 % in Estonia and Ireland, by more than 7 % in Cyprus and Lithuania, by more than 8 % in Spain and by nearly 17 % in Greece.

Chart 28: Change in real gross household disposable income in the first and second phases of the crisis, percent, EU-27



Source: AMECO – National Accounts.

Note: * – data is only available until 2010, ** – data is only available until 2009, – data is deflated by the HICP.

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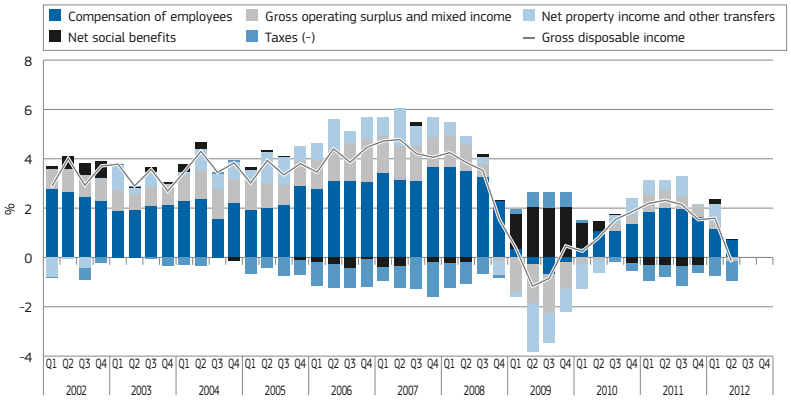
Chart 29: Contributions of components to the growth of nominal gross disposable income of households, Eurozone



Source: Eurostat/ECB.

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1.3.2. Signs of weakening of the cushioning impact of the welfare state

In the first phase of the crisis, social benefits played an important role in sustaining household incomes as illustrated in Chart 29 below. In the Eurozone, net social benefits and reduced taxes contributed positively to the change in GHDI during 2009 and in the first two quarters of 2010[13]. However, in the second phase this effect started weakening. At the end of 2010, the contribution of social benefits to the change in gross household income lessens and starts being negative. In the second quarter of 2012,

Table 3: Changes in Gross Household Disposable Income between 2007 and 2009, and between 2009 and 2011, simulation of what the change would have been at constant taxes and benefits level

	2009 vs 2007				2011 vs 2009			
	(1a)	(2a)	(3a)	(4a)	(1b)	(2b)	(3b)	(4b)
	Actual change in GHDI (in %)	Contribution of social transfers to change in GHDI (in percentage points)	Contribution of taxes to change in GHDI (in percentage points)	Change in GHDI if social transfers and taxes stayed at 2007 value (in %)	Actual change in GHDI (in %)	Contribution of social transfers to change in GHDI (in percentage points)	Contribution of taxes to change in GHDI (in percentage points)	Change in GHDI if social transfers and taxes stayed at 2009 value (in %)
DK	0.1	3.2	0.9	-4.0	3.8	4.6	-0.6	-0.2
IE	-2.7	6.1	4.3	-13.1	-6.9	2.4	-2.3	-7.0
RO*	8.1	6.4	-0.9	2.5	-3.9	1.7	6.2	-11.8
CY	5.6	2.1	0.4	3.1	-3.0	1.5	-1.0	-11.8
SI	1.4	1.3	-0.4	0.5	-1.5	1.4	0.5	-3.4
ES	3.4	4.5	2.0	-3.1	-8.1	1.3	-0.2	-9.2
HU	-6.4	2.4	0.7	-9.5	0.0	0.9	4.2	-5.1
FI	3.3	3.2	1.6	-1.5	2.8	0.7	-0.1	2.2
IT	-5.0	1.5	0.4	-6.8	-1.4	0.7	0.3	-2.4
SK	5.9	2.1	0.7	3.1	2.2	0.7	-0.2	1.8
PT	2.1	2.4	-0.2	-0.1	-2.6	0.3	-0.4	-2.6
FR	0.7	1.4	0.4	-1.2	0.6	0.1	-0.6	1.1
NL	-3.3	3.0	-2.1	-4.2	-0.3	0.1	0.7	-1.1
BE	3.0	1.4	0.7	1.0	-2.6	0.0	-1.0	-1.6
SE	4.2	4.5	3.6	-3.8	4.6	-0.4	0.0	4.9
AT	0.2	1.2	0.3	-1.3	-1.2	-0.4	-0.2	-0.5
UK	1.1	4.3	1.5	-4.7	-0.5	-0.6	0.9	-0.8
CZ	3.4	4.3	1.5	-2.4	-2.5	-0.7	-0.1	-1.7
EL	-3.1	4.5	-0.3	-7.2	-20.1	-0.8	1.4	-20.7
DE	-0.6	0.4	0.0	-0.9	2.6	-1.7	0.3	3.9
EE	-8.3	8.2	3.0	-19.5	-4.5	-2.1	-0.3	-2.1
PL*	7.2	1.6	0.4	5.2	2.4	-2.6	7.7	-2.7
LT	-5.6	4.5	5.4	-15.5	-1.3	-2.6	0.2	1.1
LV	-14.6	7.9	4.0	-26.6	-3.0	-2.7	-1.1	0.8
BG*	17.1	5.7	0.4	11.0	-1.7	-7.3	5.1	0.6
LU	6.4	2.5	-0.2	4.0	NA	NA	NA	NA
MT	NA	NA	NA	NA	NA	NA	NA	NA

Source: AMECO – National Accounts.

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[13] Chapter 3 (Welfare systems) presents a more detailed analysis by country highlighting the diversity of the impact of the crisis and of welfare responses across the EU.

GHDI decreases again after having increased for more than two years.

When we look at what happened in different countries, Table 3 shows that household incomes would have dropped significantly in most countries between 2007 and 2009 if taxes and benefits had been kept constant at the 2007 level. At the beginning of the crisis (2008-2009), the taxes levied decreased in many Member States, as original incomes dropped and tax breaks were granted as part of the stimulus packages. At the same time, the total amount of benefits distributed increased as more unemployed people became eligible. Countries where the impact of reduced taxes and increased benefits were strongest include the Nordic countries, the Czech Republic, Spain, the Baltic countries, Ireland and the UK.

Table 3 also illustrates at the macro level the weakening of the role played by the tax and benefit system in protecting households' income during the second phase of the great recession. From 2010 onwards, in many of the countries where unemployment kept increasing or remained at high levels (e.g. Portugal, Bulgaria, Ireland, Greece, Spain and Slovakia), the impact of taxes and benefits was much lower than in the first phase of the crisis, and in some cases it even contributed negatively to the change in gross household income. This may result both from the phasing out of entitlements; from fiscal consolidation measures that reduced the level or duration of the benefits, or from the tightening of eligibility rules that exclude some beneficiaries from a given scheme.

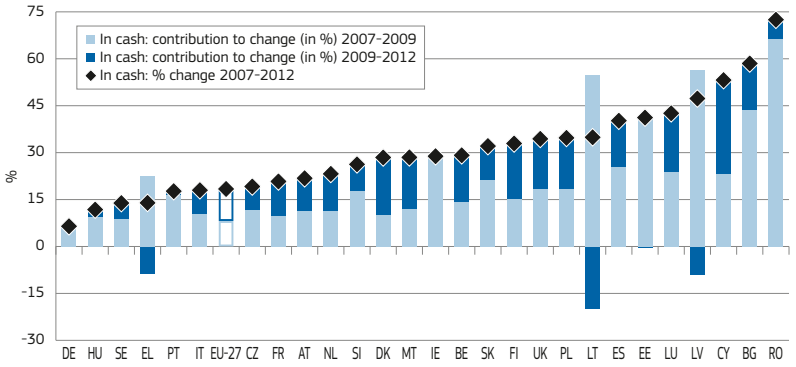
This observation is partly explained by the evolution of the spending on cash benefits (which have the most direct impact on disposable income) between 2009 and 2012. As illustrated in panel A of Chart 30 below, the total amount of cash benefits distributed decreased in Greece, Latvia and Lithuania and remained relatively stable in Hungary and Ireland even though unemployment in these countries remains well above 10% of the active population and keeps increasing (with the exception of Latvia and Lithuania where it started decreasing in 2011).

Another matter of concern is the cut in the spending on in-kind benefits that occurred, generally also between 2009-2012, in these countries (except for Latvia) and a few others where the labour market conditions are still bad (such as Spain or Portugal) (See panel B of Chart 30). A continuation of such a trend of cutting or freezing spending on services in areas such as health care, training, housing or child care could in the long term have a detrimental impact on employability and wellbeing.

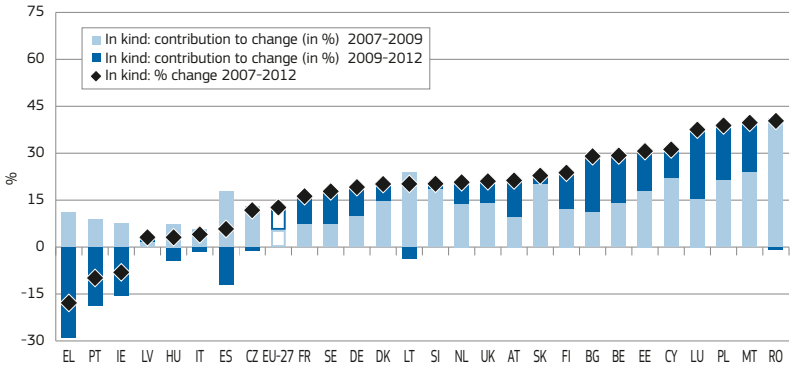
Large increases in unemployment and growing long-term unemployment lead to a significant increase in the number of people having to rely on benefits, including on social assistance. Administrative data collected by the Social Protection Committee on benefit recipients indicate that an increasing number of people rely on last resort schemes. In some countries (Bulgaria, Greece, Spain, Italy, Cyprus, Portugal and Slovenia) a growing gap between the number of unemployed and the number of benefit recipients seem to indicate that more and more people are not covered by any scheme at all.

Chart 30: Percentage change in social protection spending (in national currency, 2007-2012)

Panel A – in cash



Panel B – in kind



Source: Eurostat; National Accounts and European Commission economic forecast – Autumn 2012.

Note: data for years 2011 and 2012 are forecasts.

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Table 4: Tax reforms in 2012

	PIT	PIT progressivity	VAT standard	VAT reduced	VAT exemptions/ reduced	Environmental	Property tax
BE	TEC[2]			+	-		
BG				+		+	
CZ	+	+		+ (4 pp)			
DK	TEC[2]				-		
DE							
EE							
IE	+/-		+ (2 pp)			+	+**
EL	+/TEC[2]	+		+/-		+	+ (?)
ES	+	+			-		+
FR	TEC[2]	+	+ (1.6 pp)	+			
IT	+	+	+ (1-3 pp)			+	+
CY	+	+	+ (2 pp)	1 new	-/+		+
LV	-		+ (1 pp)	+ (2 pp)	-	+	+
LT				-		+	+
LU	+/-	+					
HU	$	-	+ (2 pp)			+	
MT	-						
NL	+/-				-	+/-	-/+(IR[3])
AT	+	+			-	+	+
PL	+	+	+ (1 pp)	+ (1 pp)	-	+	
PT	+	+	+ (2 pp)		-	+	+
RO						+	
SI						-	
SK						+	
FI	+/-				-	+	
SE							
UK	+/-						+

Source: European Commission (2012c).

Notes: The table lists tax changes implemented in 2011 and the first half 2012 including temporary but significant changes. Minor changes are not included. (?) means: implementation of previous measures [2] TEC means tax expenditure cuts; ** means: from OECD (2012c); [3] IR means imputed rent (under PIT); $ means major reform with flat rate.

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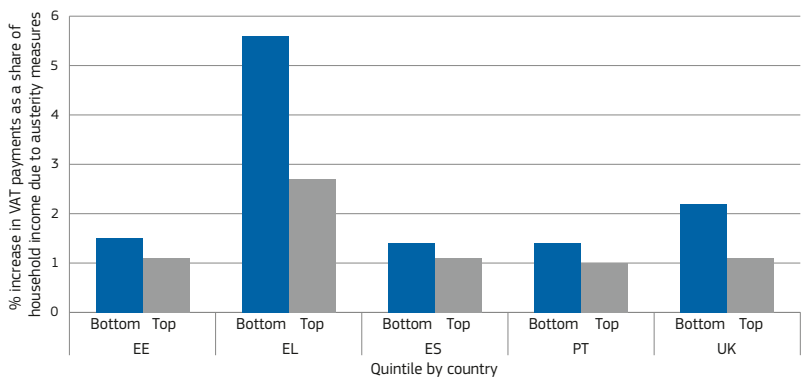
1.3.3. Signs of adverse social effects of recent tax reforms and potential for improvement

Several Member States have recently increased taxes on consumption or have been recommended to shift taxation from labour to consumption and property. Table 4 shows that most Member States recently have increased environmental taxation, VAT, property and personal income taxes, while (in some cases) increasing their progressivity.

Some of the advocated tax changes, when introduced without flanking measures aimed at the poorest, can have adverse social effects. Increases in VAT rates and the reduction in reduced rates and exemptions have a detrimental effect on poor households. Chart 31 shows the social impact of recent increases in VAT, as part of austerity measures, in Estonia, Greece, Spain, Portugal and the United Kingdom. The increase in VAT had a more severe impact on the disposable income inequality of the poorest groups. In all five countries, the relative loss of the top income group has been lower than for the bottom one. However, the socially detrimental effects of increasing VAT can be offset by increasing income support measures for the groups that would not benefit from lower labour taxes (unemployed, retired).

Tax shifts towards property have been strongly recommended. Nonetheless, the redistributive effect of current forms of

Chart 31: Effect of VAT reforms for the bottom and the top of the income distribution



Source: Own calculations based on data from Callan et al. (2011).

Notes: Callan et al. (2011) is based on Euromod simulations using 2008 EE-SILC, 2008 IE-SILC, 2007 EL-SILC, 2007 ES-SILC, 2007 PT-SILC and 2008/2009 FRS for the United Kingdom. VAT micro-simulations are approximations based on external information.

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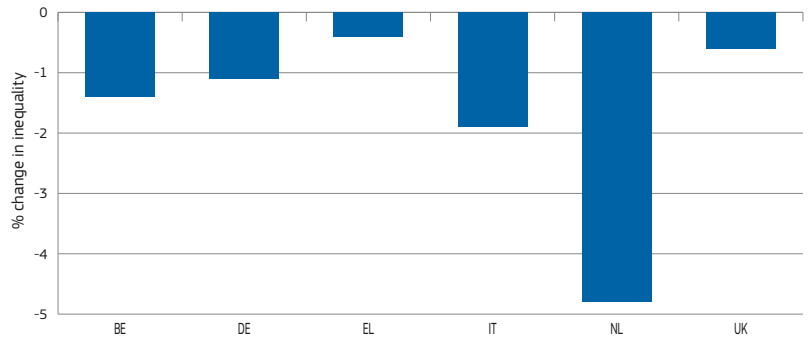
Chart 32: Change in inequality due to taxing imputed rent with lump-sum tax credit



Source: Own calculations based on data from Figari et al. (2012).

Notes: Figari et al. (2012) is based on Euromod simulations using 2006 BE-SILC, 2002 Socio-economic Panel for Germany, 2004/5 EL-HBS, 2004 IT-SILC, 2001 Socio-economic Panel for the Netherlands, 2003/4 Family Resource Survey for the United Kingdom. Inequality is measured with the Gini coefficient and refers to equivalised disposable income including imputed rent.

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property taxation is limited if not regressive (e.g. in the United Kingdom). Recent property taxation reforms did not substantially change the design of property taxes. A shift from labour to property has a large potential in terms of employment and social effects. Property is an immobile tax base and it is more difficult to evade. However, different forms of property taxation are needed in order to achieve social goals, without increasing budget deficits.

A valid alternative to property taxation is to tax the in-kind income derived from homeownership. Few Member States tax imputed rent, although it is not fully taxed. Indeed, in some Member States the taxation of imputed rent is based on cadastral values (Luxembourg, Netherlands), in some others (Belgium, Italy, Spain) it only applies to properties other than the primary residence. A well-designed taxation of imputed rent would mean that the tax burden could be lowered on labour and inequality could be reduced. Chart 32 shows the simulated social impact of taxing imputed rent while the impact of compensation with a lump-sum tax credit is shown for Belgium, Germany, Greece, Italy, Netherlands and the United Kingdom. This reform would reduce inequality, although the extent of the effect varies by country. The effect would be limited in Greece and would have the greatest effect in the Netherlands.

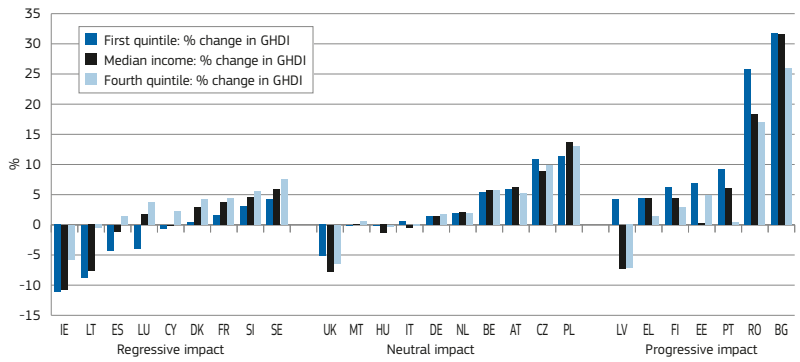
1.3.4. Diversity of trends in income inequalities during the crisis

The first phase of the crisis did not affect household income evenly across the income distribution. In one third of EU countries (on the left of Chart 33); the impact was regressive; in Ireland, Spain and Lithuania, the poorest segment of the population saw their income drop more than the rest of the population, while in France, Denmark, Sweden and Slovenia, their incomes grew significantly less than households higher up in the income distribution. In the UK, Hungary and Italy, the middle class (often workers) was most affected by the profound crisis, while in a few countries in continental Europe (Germany, Belgium, the Netherlands, Austria and Poland) the evolution of incomes was relatively even across the distribution. In Latvia, Greece and Portugal, the top incomes were proportionally more affected than the rest of the population.

This information is based on EU-SILC survey data, which only covers the first phase of the crisis. However, less precise, but more recent data points to a significant deterioration in the relative situation of the poorest segment of the population in a number of countries, including in those where they had been protected in the early phase of the crisis.

Monthly consumer surveys available up until Spring 2012 illustrate the significant deterioration of the reported financial situation of households[14] in the lowest quintiles of the income distribution in the majority of EU countries. The rise of the financial stress indicator among the lowest quintile was especially stark in Italy and Spain (10 percentage points more over a year), as well as in Greece, Ireland, and Sweden (5 percentage points more over a year), reflecting the very strong deterioration of economic conditions in these countries. In contrast, the share of lower income households reporting financial distress fell over the year to spring 2012 in Belgium, Denmark, Finland, Poland and Latvia and Lithuania. The situation of

Chart 33: Changes in household disposable income in different parts of the income distribution (% change of national currencies, 2007-2009); Member States grouped according to he degree of progressivity of the change



Source: EU-SILC.

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(14) The financial stress indicator is defined as the share of people who report having to draw on their savings or having to run into debt to keep up current expenditures.

Chart 34a: Change in population share in households in the lowest income quartile reporting financial distress across the EU (as at July 2012)

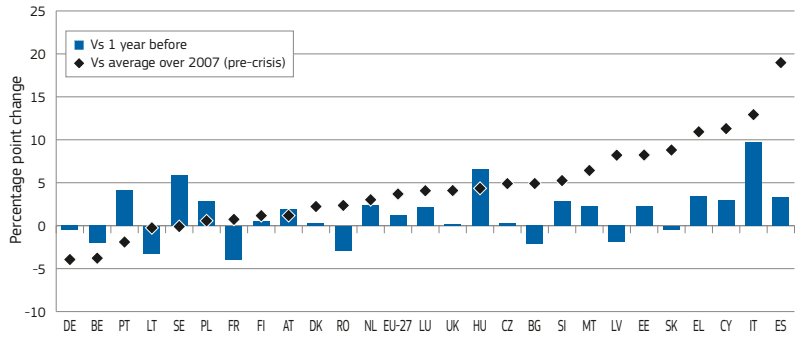


Chart 34b: Austria: Reported financial distress in households by income quartile of household (2000-2012)

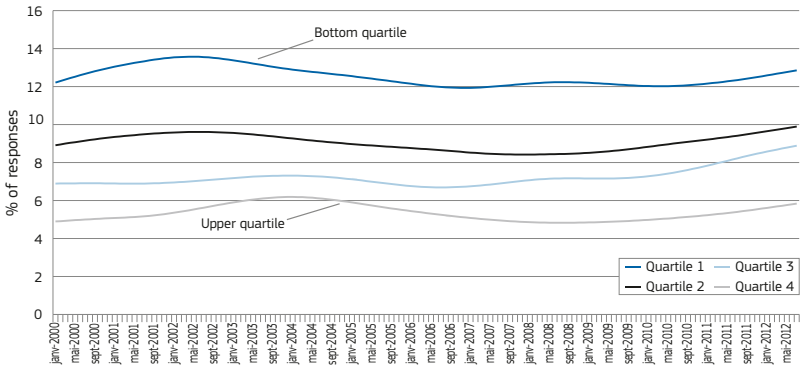
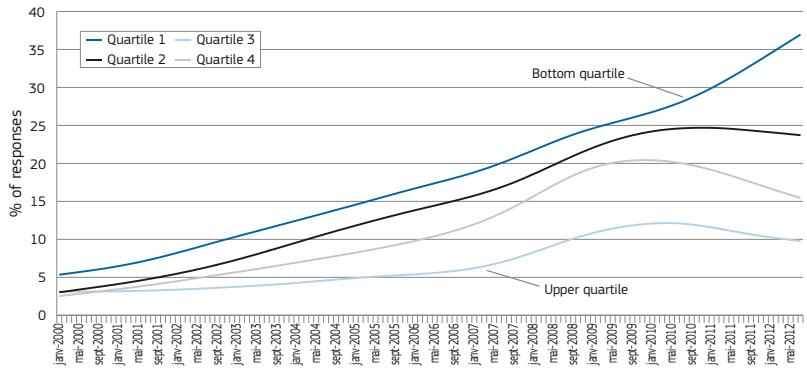


Chart 34c: Spain: Reported financial distress in households by income quartile of household (2000-2012)



Source: Joint harmonised EU consumer surveys & DG EMPL calculations.

Notes: Based on 3 month centred moving averages. Data not seasonally adjusted. Break in series for Ireland in 2009 (figures for change vs 3 months before 1.3 percentage points, and one year 7.6 percentage points.

such households in Germany changed little, but France and the UK saw rises of around 2 percentage points.

The crisis and fiscal consolidation measures had a negative effect on the incomes of households in most Member States. Evidence based on micro-simulation illustrates that in a few countries the relative situation of the poorest segments of the population worsened more than of some other segments (Lithuania, Estonia, Portugal). In some countries fiscal consolidation measures had a more progressive impact (Spain, Romania, Greece, and Latvia); however, in these countries the situation of the poorest segments of the population also worsened significantly (by more than 5 % in Greece and Latvia).

Euromod has reviewed austerity measures taken in 9 EU Member States between 2009 and 2012. Those affecting low-income groups were very diverse.

Many countries (Estonia, Greece, Spain, Latvia, Portugal and the UK) increased taxes on income or social contributions. Many also increased VAT (Estonia, Greece, Spain, Lithuania, Latvia, Portugal, Romania and the UK). In terms of taxes, Greece also introduced an emergency property tax.

Pensioners were negatively affected in Greece, Latvia, Portugal and Romania. Unemployment benefits were reduced in Greece, Lithuania, Portugal and Romania and child benefits were reduced in Estonia, Spain, Lithuania, Latvia, Portugal, Romania and the UK.

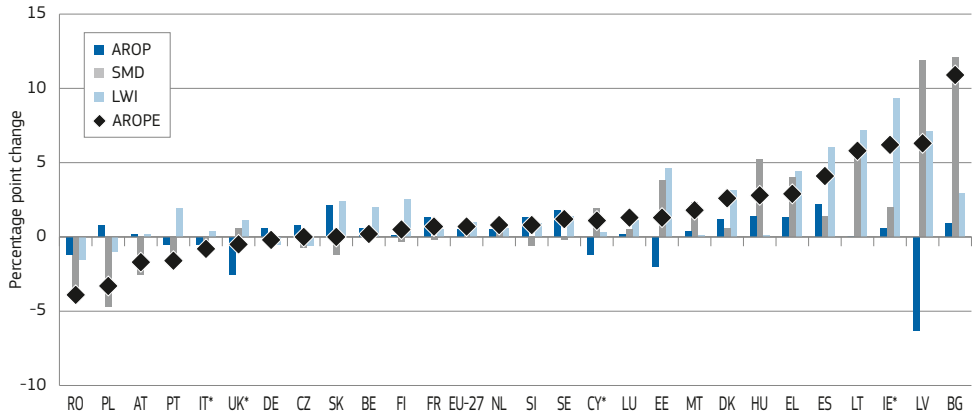
Other measures remained limited to only a few Member States: minimum wages were cut in Greece; housing benefits were cut in the UK; care benefits were cut in Spain and limited in the UK; Lithuania and Latvia did cuts in maternity/paternity benefits; and Lithuania also lowered social assistance benefits for those that are able to work and sickness benefits.

1.3.5. Poverty and social exclusion on the rise

Overall the crisis has halted the decline of the risk of poverty and social exclusion experienced since 2005, with around 24.2 % of the EU population at-risk-of-poverty or exclusion in 2011. As seen above the impact of the crisis on household incomes takes time to unfold. The small increase of the risk of poverty observed until 2011 hides more worrying trends that are likely to affect people's living conditions in the long term. The most direct effect of the deterioration of labour conditions is the rise in the share of people living in jobless households (LWI = low work intensity: households not working at all, or less than 1 day a week over a whole year). In Ireland, the Baltic States, Spain, Greece, and Denmark, the share of children and adults aged less than 59 living in jobless households increased by more than 3 percentage points between 2008 and 2011. In Bulgaria, the Baltic States, Greece and Hungary, the significant increase in severe material deprivation also illustrates the severity of the crisis and its impact of the most deprived populations.

NB: Please note that due to the last minute revision of the SILC 2011 data, Chart 35 and the statistical annex have

Chart 35: Change in the risk of poverty and social exclusion and its components in Member States between 2008 and 2011



Source: Eurostat, EU-SILC.

Notes: The income reference period is a fixed 12-month period (such as the previous calendar or tax year) for all countries except the United Kingdom for which the income reference period is the current year of the survey and Ireland for which the survey is continuous and income is collected for the 12 months prior to the survey. AROP: at-risk-of poverty rate (60% of median income); SMD: severe material deprivation; LWI: people (0-59 not students) living households with zero or very low work intensity; AROPE: at-risk-of-poverty or exclusion rate (union of all three indicators). Changes for Ireland and Italy are to 2010 instead of 2011, and for EU-27 are based on Eurostat estimates.

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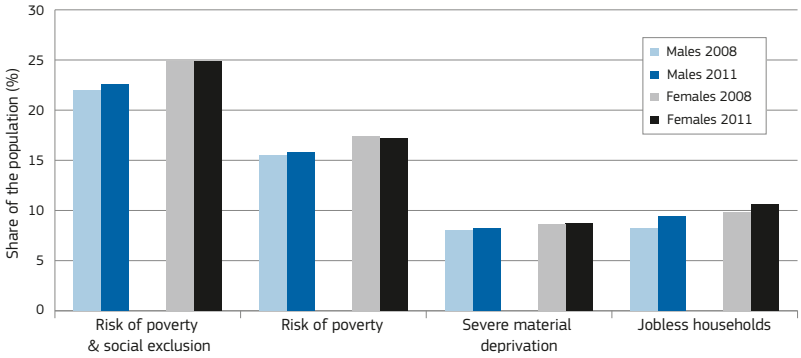
been updated to reflect the latest figures as of 30 November 2012. However the rest of the report is based on the data available on 23 November 2011.

1.3.6. Women still face a higher risk of poverty and exclusion than men

Overall, women face a higher risk of poverty and exclusion than men (24.6% against 22.6% in 2011). The crisis has not aggravated this gap so far, since prime working age men have been most directly hit by the deterioration of labour market conditions. However, some categories of women face significantly higher relative risks of poverty – such as single mothers (34% against 16% for the total population), inactive women of working age (28%), and elderly women over 75 (20.1%). The latent class analysis developed in Chapter 2 reveals that women are more often represented in groups facing higher risks of persistent poverty, notably linked to inactivity and care responsibilities. Inactivity and career breaks linked to care responsibilities have long-term impacts on future pension entitlements and are important factors of poverty among older women. While inactivity rates have not increased so far as a consequence of the crisis, retrenchments or freezes in social spending, such as on family and child benefits or child care services may hamper female participation and aggravate the situation of the most vulnerable women.

Chart 36a: Risk of poverty and social exclusion for women and men, 2008 and 2011



Source: Eurostat, EU-SILC (EU-27 Eurostat estimates).

Note: The income reference period is a fixed 12-month period (such as the previous calendar or tax year) for all countries except the United Kingdom for which the income reference period is the current year of the survey and Ireland for which the survey is continuous and income is collected for the 12 months prior to the survey.

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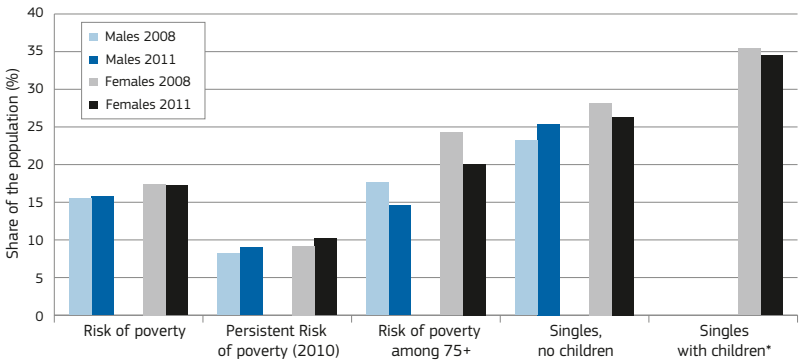
Chart 36b: Relative risk of poverty, and specific subgroups for women and men, 2008 and 2011



Source: Eurostat, EU-SILC (EU-27 estimates for 2011).

Note: The income reference period is a fixed 12-month period (such as the previous calendar or tax year) for all countries except the United Kingdom for which the income reference period is the current year of the survey and Ireland for which the survey is continuous and income is collected for the 12 months prior to the survey.
* No gender breakdown available.

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1.3.7. In-work poverty increased significantly in ⅓ of Member States

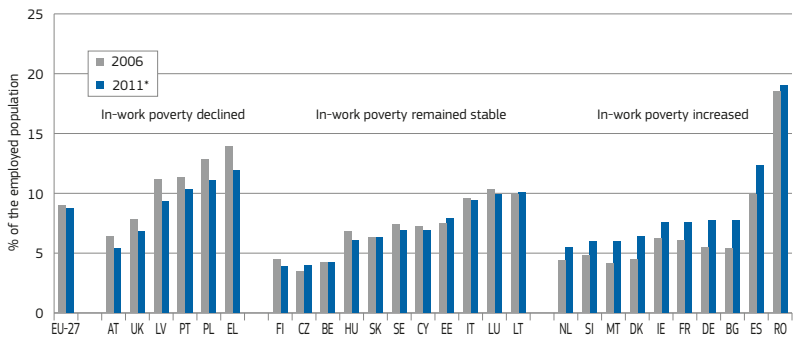
Having a job remains the best safeguard against poverty and exclusion, since the risk of poverty faced by working age adults without work (unemployed or inactive) is more than three times higher than those in work (28 % against 9 %). However, a job is not a guarantee against the risk of poverty and the working poor represent ⅓ of the working age adults at-risk-of-poverty. In 2011, 8.7 % of the people in employment were living under the poverty threshold.

In-work poverty significantly increased in ⅓ of EU countries between 2006 and 2011, including in Germany (+2 percentage points), the Netherlands or Denmark where overall economic and labour market conditions were more resilient than in the rest of the EU. Factors include wage moderation and the reduction of working hours of people in employment, notably due to the wide use of short term working arrangements.

The ESDE report 2011 (European Commission, 2011e) analysed the factors of in-work poverty in detail. As illustrated below, it is first of all linked to the employment status of workers, and related factors such as low pay, precarious employment and under-employment. The self-employed face a risk-of poverty that is more than 3 times that of employees; the risk-of-poverty of the temporary workers is twice as high as the risk faced by permanent workers, as is the case for part-time workers in comparison to the full-time worker. The increasing shares of part-time and temporary workers in the total employed population is likely to drive in-work poverty further in the coming years.

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

Chart 37: In-work poverty: at-risk-of-poverty rate of persons employed, evolution since 2006



Source: Eurostat – EU-SILC.

Notes: The income reference period is a fixed 12-month period (such as the previous calendar or tax year) for all countries except the United Kingdom for which the income reference period is the current year of the survey and Ireland for which the survey is continuous and income is collected for the 12 months prior to the survey. * 2010 values instead of 2011 for CY, IE, IT and UK; EU-27 is based on Eurostat estimate for 2011. Data for 2007 and not 2006 in RO.

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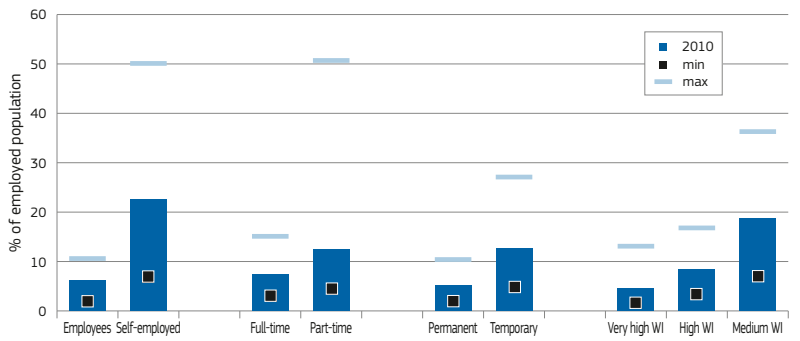
Chart 38: In-work poverty: at-risk-of-poverty rate of persons employed, per characteristics



Source: Eurostat – EU-SILC.

Notes: The income reference period is a fixed 12-month period (such as the previous calendar or tax year) for all countries except the United Kingdom for which the income reference period is the current year of the survey and Ireland for which the survey is continuous and income is collected for the 12 months prior to the survey.

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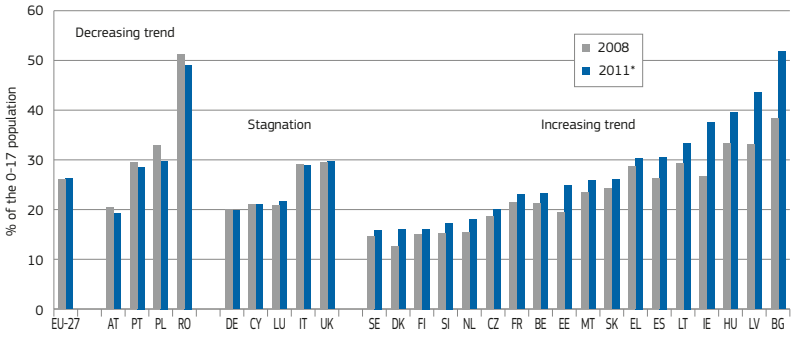
1.3.8. Working age people, children, youth and migrants have been most affected

Overall, the crisis has worsened the situation of children and young adults, already at heightened risk before the crisis. This is mainly due to the sharp rise in unemployment. Working age adults have been hit first by the economic crisis, with a direct impact for children growing up in their households. Young adults and adults of prime working age (25-54) have experienced increases in the risk of poverty or social exclusion of close to 1 percentage point at EU level, while for the elderly (65+) it is down 3.3 percentage points.

In a number of countries experiencing very severe recessions (Bulgaria, the Baltics, Ireland, Hungary, Spain and Greece) children have been significantly affected by the crisis. Lone parent households have been severely affected. For this group, the risk of poverty or social exclusion exceeds 50 %. In particular the risk of poverty or social exclusion for lone parents has worsened and increased by 9 percentage points in Ireland and Lithuania, 7 percentage points in Spain, 6 percentage points in Italy, 5 percentage points in France, 4 percentage points in Sweden and Slovakia and 3 percentage points in Denmark. Families with two adults and two children also experienced similar increases.

Young adults, who face the combined challenge of high unemployment and low income, have also been severely hit. Between 2008 and 2011 the risk of poverty or exclusion for those aged 18-24

Chart 39: Change in the share of children at-risk-of-poverty or social exclusion between 2008 and 2011



Source: Eurostat – EU-SILC.

Notes: The income reference period is a fixed 12-month period (such as the previous calendar or tax year) for all countries except the United Kingdom for which the income reference period is the current year of the survey and Ireland for which the survey is continuous and income is collected for the 12 months prior to the survey. * 2010 values instead of 2011 for CY, IE, IT and UK; EU-27 is based on Eurostat estimate for 2011.

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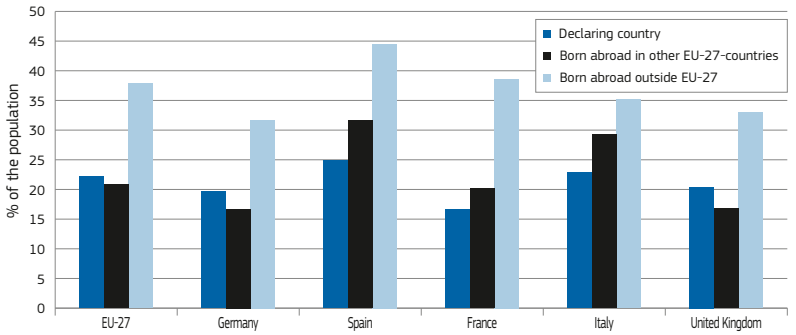
Chart 40: At-risk-of-poverty and social exclusion of people aged 18+ by country of birth, 2011



Source: Eurostat – EU-SILC 2011; 2010 data for Italy and the United Kingdom.

Notes: The income reference period is a fixed 12-month period (such as the previous calendar or tax year) for all countries except the United Kingdom for which the income reference period is the current year of the survey and Ireland for which the survey is continuous and income is collected for the 12 months prior to the survey.

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increased by 6-8 percentage points in Greece, Spain and Malta, 10 percentage points in Denmark, Ireland, Estonia and Lithuania, and as much as around 16-17 percentage points in Bulgaria and Latvia.

At EU level, the risk of poverty or exclusion among the migrant population aged 18 and over remains much higher than the overall population. The risk of poverty or exclusion for people born outside the EU-27 stood at 37.8% in 2011, compared to 20.8% for those born in the country and 22.2% for those born in another EU country. Between 2008 and 2010, people born outside the EU have seen the sharpest rises in the risk of poverty or exclusion in Spain (by 3 percentage points) while in France and Italy it has been the mobile citizens from other EU Member States.

1.3.9. Risks of long-term exclusion confirmed

The large unemployment shocks experienced at the beginning of the crisis and the rising shares of the long-term unemployed point towards serious risks of long-term exclusion faced by a significant share of the population. The analysis of the transitions in and out of poverty and in and out of long-term unemployment presented in Chapter 1 and Chapter 2 of the annual review warns against the risk of a downward spiral entrapping individuals into exclusion in the coming years.

In a number of Member States (the Baltic States, Bulgaria, Greece, Hungary, Italy, Malta, Poland, Portugal and Romania) the risk of entering into poverty is associated with few chances to get out again, meaning that individuals falling into poverty have limited chances to get back out of it in the following years. Among these countries, this situation is most worrying in Bulgaria, Romania, Estonia, Greece, Malta, Portugal and to a certain extent Italy which already experienced high rates of persistent poverty (above the EU average) before the crisis, and are now among the countries with the worst labour market conditions, characterized by very high rates of long-term unemployment, and the lowest rates of return to employment.

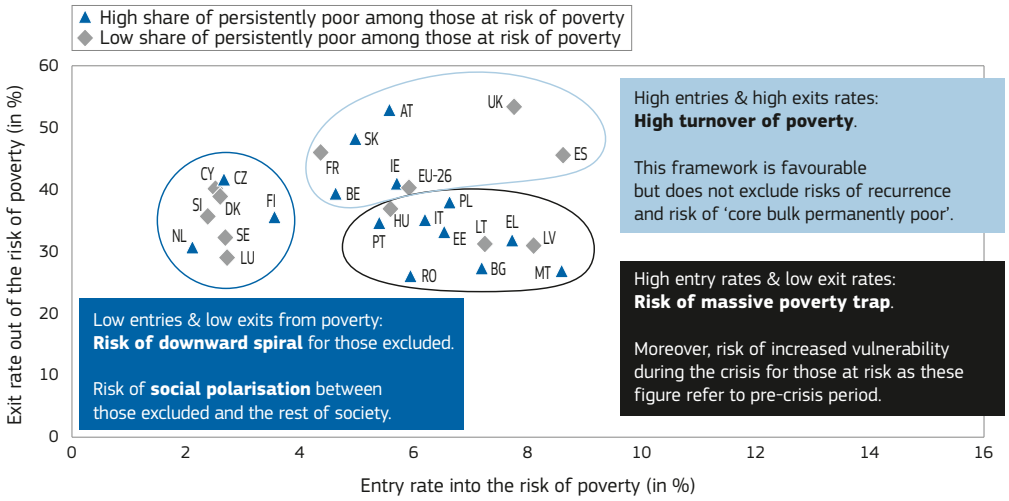
In another group of countries, which include the UK, Spain, and to a lesser extent Austria, France, Ireland Belgium and Slovakia, there is a large number of people dipping into and out of poverty, which indicates that a significant number of people are experiencing transient or recurrent poverty, who coexist with a group of people trapped into persistent poverty, representing 40% to 55% of the poor (just below the EU average).

In a third group of countries (the Czech Republic, Denmark, the Netherlands, Slovenia, Finland and Luxembourg), entry rates are low but exit rates are also low. Despite poverty affecting a smaller part of the population in these countries, the situation reveals a potential poverty trap, especially in the Czech Republic, Finland, and the Netherlands where the share of the poor people experiencing persistent poverty exceeds 50%.

The differences observed in the dynamics of poverty, and related risks of long-term exclusion reflect the diversity of labour market conditions, and of the capacity of the welfare state to adequately protect people and to support their return to the labour market. It also depends on the significant differences still existing in the household structure and the level of work intensity of the households across EU countries.

As these figures refer to pre-crisis years, the situation is likely to have worsened further, and is especially alarming in the first group of countries (the Baltic States, Bulgaria, Greece, Italy and Malta) where long-term unemployment has increased

Chart 41: Combination of entry and exit rates in and out of poverty among the 18-64 population



Source: EU-SILC LONGITUDINAL UDB 2009 – version-3 August 2012 – DG EMPL calculations.

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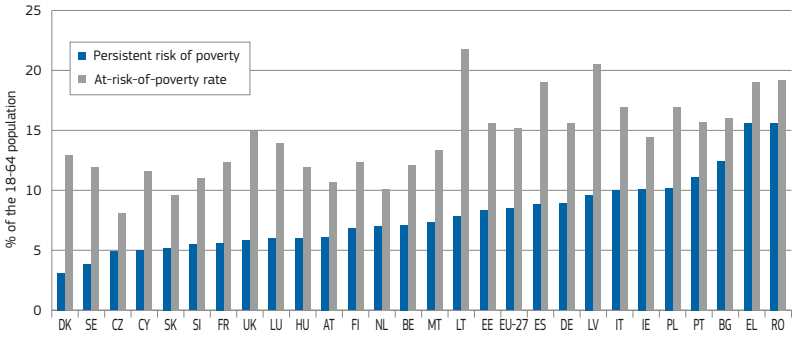
Chart 42: Share of the working age population at risk of persistent poverty compared to the share at-risk-of-poverty



Source: EU-SILC 2010.

Notes: The income reference period is a fixed 12-month period (such as the previous calendar or tax year) for all countries except the United Kingdom for which the income reference period is the current year of the survey and Ireland for which the survey is continuous and income is collected for the 12 months prior to the survey.

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most. These countries are also those where the capacity of the welfare state to prevent and tackle poverty was the weakest, and has been weakened further during the crisis by important cuts in public expenditure (see Chapter 3).

The persistent risk of poverty is also a matter of concern. In 2010, 8.5% of the working age individuals had been at-risk-of-poverty in at least 3 out of the last 4 years (including the last one). Persistent poverty is high (10% or more) in Italy, Greece, Portugal, Bulgaria, Romania, Poland and Ireland. The crisis is likely to further aggravate the situation, especially in countries with low exit rates.

1.4. The Europe 2020 targets are becoming increasingly difficult to achieve

1.4.1. Many national employment rate targets looking increasingly ambitious

In 2011 (and it is expected also in 2012) setbacks were noted with respect to the Europe 2020 strategy's aim to increase the employment rate for the 20 – 64 age group to 75%. The average employment rate remained static in 2011 at 68.6%, which is still significantly below the pre-crisis level of 70.3% (in 2008). As only marginal increases are expected for 2012 and 2013, a considerable effort will be required to reach the Europe 2020 target: some 16.7 million jobs should still be created by 2020 in the EU (compared to 2011 levels), meaning that the overall EU employment figure should increase on average by 0.9% per year. It also implies an increasing need to mobilise women (their ER was 62.3% against 75% for men aged 20-64 in 2011), older workers aged 55-64 (47.4% against 60% in the US and 65% in Japan) and other under-represented groups in the labour market.

Employment rate developments by Member State

In only one year, comparing the 2011 achievements with the situation in 2010, the gap to the 2020 targets increased in eleven Member States, decreased in fourteen and remained unchanged in two. The most significant falls in the employment rates in 2011 (more than 1 percentage points) were noted in Greece (-4.1 percentage points), Slovenia, Cyprus, Bulgaria and Portugal, while the most significant rises were seen in the Baltic States (+2.2 to +3.7 percentage points), Germany, Sweden and Malta (+1.3 to +1.4 percentage points). See Table 5, third column. At EU level, in order to achieve the 75% headline target, of the estimated 17.6 million jobs that had to be created between 2010 and 2020, 16.7 million jobs would still need to be created by 2020 within the 20-64 age group, given the gain of 0.9 million jobs

(+0.4%) in 2011. But employment did not grow enough in 2011 to compensate for the recent growth of the population (+0.3% in 2011). The employment rate therefore remained unchanged compared to 2010, at 68.6%. Substantial efforts are still needed in order to achieve the goal set for 2020, according to which employment is required to grow by 0.9% per annum on average between 2011 and 2020, whereas no major improvement is expected in either 2012 or 2013.

Table 5: Employment rates in EU Member States in 2011 and progress needed in order to meet the Europe 2020 employment target

	(age group: 20-64)					
	Employment rate in 2011 (%)	Employment rate progress on 2010 (percentage points)	Employment rate national target for 2020 (%)	Current gap to national target for 2020 (percentage points)	Jobs in 2011 (x 1 000)	Employment average annual growth needed 2011-2020 (%)
BE	67.3	-0.3	73.2	5.9	4 427	1.2
BG	63.9	-1.5	76.0	12.1	2 897	0.7
CZ	70.9	0.5	75.0	4.1	4 806	0.1
DK	75.7	-0.1	80.0	4.3	2 474	0.6
DE	76.3	1.4	77.0	0.7	37 855	0.0
EE	70.4	3.7	76.0	5.6	584	0.1
IE	64.1	-0.9	69.0 – 71.0	5.9*	1 737	1.0*
EL	59.9	-4.1	70.0	10.1	3 999	1.6
ES	61.6	-0.9	74.0	12.4	17 830	2.1
FR	69.1	0.0	75.0	5.9	25 179	0.8
IT	61.2	0.1	67.0 – 69.0	6.8*	22 465	1.3*
CY	73.8	-1.6	75.0 – 77.0	2.2*	362	1.1*
LV	67.2	2.2	73.0	5.8	945	0.2
LT	67.2	2.8	72.8	5.6	1 338	0.7
LU	70.1	-0.6	73.0	2.9	221	1.6
HU	60.7	0.3	75.0	14.3	3 768	1.9
MT	61.5	1.4	62.9	1.4	161	0.0
NL	77.0	0.2	80.0	3.0	7 703	0.3
AT	75.2	0.3	77.0 – 78.0	2.3*	3 885	0.5*
PL	64.8	0.2	71.0	6.2	15 769	0.5
PT	69.1	-1.4	75.0	5.9	4 519	0.8
RO	62.8	-0.5	70.0	7.2	8 655	0.7
SI	68.4	-1.9	75.0	6.6	902	0.9
SK	65.1	0.5	72.0	6.9	2 332	1.0
FI	73.8	0.8	78.0	4.2	2 361	0.2
SE	80.0	1.3	80.0**	0.0	4 405	0.3
UK	73.6	0.0	–	1.4***	27 214	0.5***
EU-27 national target-based	68.6	0.0	73.7 – 74.0	5.3	208 789	0.7 – 0.8
EU-27 headline	68.6	0.0	75.0	6.4	208 789	0.9

Source: Eurostat, EU-LFS.

Note: (*) IE; IT; CY; AT: taking the mean of the range into account. (**) SE has defined a national employment rate target of 'well over 80%'; for calculation purposes, 80.0% was taken into account. (***) The UK has not set a national employment rate target. However, the UK is included in the EU-27 calculation on the hypothetical assumption that its ER target for 2020 would be in line with the EU-27 headline target, at 75.0%.

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In spite of the ambitious EU headline target (75%), taking into account the targets set at national level (see fourth column at Table 5), only 13.5 million jobs[15] are expected to be created by 2020 (0.7 to 0.8% annual increase on average). Still, these national targets, although most of them remain below the EU headline target, are challenging for most Member States, as the annual employment growth needed to achieve them ranges from 2.1% in Spain (against 1.7% in 2010), 1.9% in Hungary, 1.6% in Luxembourg and Greece (against only 0.7% a year previously), 1.3% in Italy, 1.2% in Belgium, 1.1% in Cyprus, 1.0% in Ireland and Slovakia, to 0.5% or less in Germany, the Czech Republic, Estonia, Latvia, Malta, the Netherlands, Austria, Poland, Finland, Sweden and the UK (see last column of Table 5)[16]. In the latter group of countries, demographic changes play a significant role. In Sweden, although the target employment rate of 80% was reached in 2011, after a rise of 1.3 percentage points compared to 2010, employment should increase by 0.3% per year until

(15) This amount, which corresponds to the national targets (and the mean of the ranges for those countries where targets were defined as ranges) accounts for 82% of the net total number of jobs created from 2000 to 2011 in the EU in the 20-64 age group (+16.5 million), and less than 70% of those recorded from 2000 to 2008 in that same age group (+19.5 million).

(16) Sweden has defined a national employment rate target of 'well over 80%'. For calculation purposes, 80.0% was taken into account. The UK has not set a national employment rate target. However, the UK is included in the EU-27 calculation on the hypothetical assumption that its ER target for 2020 would be in line with the EU-27 headline target, at 75.0%.

2020, in order to compensate for the forecast population growth. And this turns out to be a minimum, if demographic projections were to be confirmed and given the objective of the Swedish government to achieve an employment rate of 'well over 80%' by the end of the decade.

Very different outcomes for different individual groups

Some subgroups have been more affected than others by the contraction in employment over recent years: the young (15-24), non-EU nationals and those with a low level of education were more than proportionally affected, whereas the rise in the employment rate for women was interrupted from 2008 onwards. On the positive side, the employment rate of older workers was not affected by the crisis. See Table 6.

Table 6: Employment rate trends between 2000 and 2011

		2000 (% of pop.)	2008 (% of pop.)	2010 (% of pop.)	2011 (% of pop.)	Total change (percentage points)		
						2000-2011	2008-2011	2010-2011
Total	20-64	66.5	70.3	68.6	68.6	2.1	-1.7	0.0
	15-64	62.1	65.8	64.1	64.3	2.2	-1.5	0.2
Gender	Men (20-64)	75.8	77.9	75.1	75.0	-0.8	-2.9	-0.1
	Women (20-64)	57.3	62.8	62.1	62.3	5.0	-0.5	0.2
	Men (15-64)	70.7	72.7	70.1	70.1	-0.6	-2.6	0.0
	Women (15-64)	53.6	58.9	58.2	58.5	4.9	-0.4	0.3
Gender and other age groups	Men (15-24)	40.2	40.3	36.2	35.7	-4.5	-4.6	-0.5
	Men (55-64)	46.9	55.0	54.6	55.2	8.3	0.2	0.6
	Women (15-24)	33.9	34.4	31.8	31.4	-2.5	-3.0	-0.4
	Women (55-64)	27.4	36.8	38.6	40.2	12.8	3.4	1.6
Nationality (20-64)	Nationals	69.7	70.7	69.0	69.1	-0.6	-1.6	0.1
	Other EU nat.	n.	72.3	70.2	70.6	n.	-1.7	0.4
	Non-EU nat.	n.	62.8	58.5	58.0	n.	-4.8	-0.5
Education level (20-64)	Low	54.9	56.5	53.4	53.0	-1.9	-3.5	-0.4
	Medium	69.7	71.8	69.9	69.9	0.2	-1.9	0.0
	High	82.5	83.8	82.4	82.1	-0.4	-1.7	-0.3

Source: Eurostat, EU-LFS.

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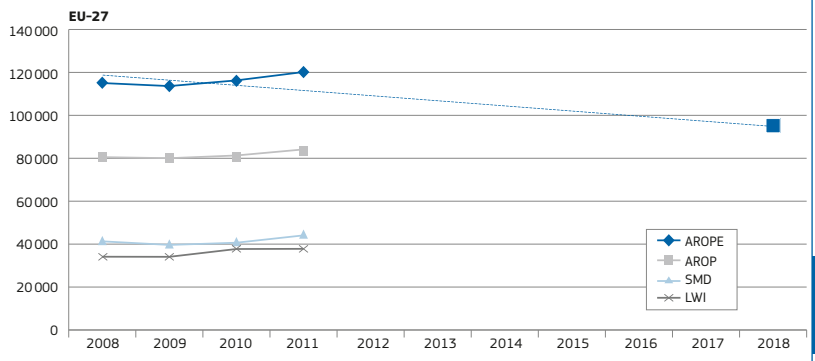
Despite significant and continuous improvements since 2000, the gender gap in terms of employment rate is still considerable, at 12.7% in the EU in 2011 (18.5 percentage points in 2000, 20-64 age group). The biggest gap between male and female employment rates was recorded in Malta (35.4 percentage points), followed by Italy (22.7 percentage points) and Greece (22.5 percentage points), all countries at the bottom of the ranking. The smallest gaps were noted in Lithuania (1.0 percentage points), Latvia (2.9 percentage points) and Finland (3.7 percentage points).

Chart 43: Evolution of the population at-risk-of-poverty or social exclusion (Europe 2020 headline target), 2008-2011



Source: Eurostat, EU-SILC (ilc_peps01). Eurostat provisional estimates for 2011.

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1.4.2. Slippage on poverty and social exclusion reduction targets

The latest Eurostat estimates (2011) available for the EU-27 population living in poverty or social exclusion, as defined by the Europe 2020 poverty and social exclusion target, show that 119.6 million people living in the EU (23.6% of the EU population) were at-risk-of-poverty or social exclusion in 2011, an increase of nearly 6 million from 2009 (see Chart 43). Based on the current information and with respect to progress on the EU 2020 target, after some slight positive development in 2009, the number of people living in poverty and social exclusion is back to the 2008 levels.

2011 data shows that the majority of Member States (Belgium, Bulgaria, Czech Republic, Denmark, Estonia, Greece, Spain, Hungary, Malta, Austria, Romania, Slovenia, Finland) are not making any progress towards their national 2020 poverty and social exclusion target but are, on the contrary, registering higher number of people in poverty or social exclusion (according to the selected national monitoring targets) than in 2008 (2008 being the baseline year for most Member States) (see

Table 7: National poverty and social exclusion targets in 2011 and progress necessary for achieving the 2020 targets

	2020 target monitoring indicator	Value of monitoring indicator for 2011 or latest available year	National 2020 target value (in 1000)	Evolution on 2008 (in 1000)
EU-27	AROPE	119.6	95 186	+4 435
BE	AROPE	2 271	1 814	+77
BG*	AROP	1 683	1 372	+51
CZ	AROPE	1 598	1 536	+32
DK	VLWI	480	325	+133
DE	LTU	1 200.19	1 332.96	-452.77
EE	AROP	232	222.7	-27
IE	consistent AROP	6.2 %* (2010)	≤ 2 %	n.a.
EL	AROPE	3 403	2 596	+357
ES	AROPE	12 371	8840	+2 031
FR	national indicator**	11.8 % (2009)	8.3 % (target for 2012)	-0.7pp (evolution 2007-2009)
IT	AROP	14 757 (2010)	12 899	-342
CY	AROPE	197	149	+15
LV	AROP and/or LWI	492	467	-96
LT	AROPE	1 080	758	+152
LU	AROPE	84	66	+12
HU	AROPE	3 051	2 344	+257
MT	AROPE	88	73.44	+8
NL	VLWI (0-64)	1 595 (2010)	1 513	-18
AT	AROPE	1 407	1 297	-125
PL	AROPE	10 196	9 991	-1 295
PT	AROPE	2 601	2 557	+156
RO	AROP	8 630	4 408	-240
SI	AROPE	386	321	+25
SK	AROPE	1 112	941	+1
FI	AROPE	949	760	+39
SE	national indicator**	12.9 %*	<14 %	n.a.
UK	relative low income (before housing costs)	18 %	<10 %	-5pp
	relative low income and material deprivation	14 %	<5 %	-3pp
	absolute low income (before housing costs)	11 %	<5 %	-2pp
	persistent low income	n.a.	to be defined by 2015	n.a.

Source: Eurostat (EU-SILC); for countries with an * – national data sources.

Notes: AROPE – at risk of poverty or social exclusion; AROP – at-risk-of-poverty; VLWI – population; ** FR national target - reduce the poverty rate anchored at a point in time by one third over the five years from 2007 to 2012; SE national target - reducing the percentage of women and men aged 20-64 who are not in the labour force (except full-time students), the long-term unemployed, or those on long-term sick leave.

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Table 7). While these figures should be read cautiously as they are conditional upon the choice of national monitoring indicator as well as the relative ambition levels of individual MS, they are indicating the general trend in progress.

Progress on the national targets should be carefully evaluated as fiscal pressures leading some Member States to scale back income support for the unemployed, for example, may lead to some people taking up jobs and thus, reducing the proportion of households with very low work intensity but at the cost of reduced household incomes and at the risk of falling below the income poverty threshold (ref. in-work poverty).

The overall ambition of individual Member States in respect of the Europe 2020 poverty reduction target is, as highlighted before, difficult to compare in an objective manner due to the different definitions of national targets chosen by some Member States. It is evident, however, that the cumulative ambition levels of Member States are well below the 20 million reduction objective signed off by European Heads of States and Governments in 2010. One should recall the gap between the EU-level headline target and the sum of national targets and announced efforts, which amounts to some 5 to 8 million, depending on methodology[17]. This alongside the current economic stagnation and the widespread lack of progress on their national targets in a number of Member States makes achieving the EU 2020 headline target very challenging. Serious progress requires stepping up efforts and targeted measures.

(17) See European Commission, 2011e.

2. Challenges and areas for policy responses: increasing employment and reducing poverty

Policy makers across the EU face tough challenges stemming from the protracted economic slowdown and related fiscal problems. In terms of employment and social policies, they need to find answers to three interlinked questions:

1) How do we increase employment, reduce poverty rates and address the polarisation of society and growing socio-economic divergence across the EU?

2) How do we support jobs and social goals by increasing (deficient) aggregate demand and improving our welfare systems, without enlarging public deficits?

3) How do we help those groups hardest hit by the difficult economic and social circumstances, in particular migrants, young people and children? How do we prevent today's youth from becoming a 'lost generation' and how do we remedy the damage already caused by high levels of youth unemployment and labour market inactivity?

In addressing the above questions, four key challenges appear to stand out: sustaining growth and jobs without increasing deficits; improving the functioning of the labour market; addressing the social consequences of the crisis; and exploring new fiscal stabilisers for better convergence.

2.1. Sustaining growth and jobs without increasing deficits

Europe needs to get back on a path of sustainable, smart and inclusive growth and to create jobs of high quality for all. Aggregate demand is lacking in many Member States – with actual output in some of them more than 4% below potential output: Greece, Spain and Portugal[18]. The Commission's Employment Package of April 2012 outlined a number of concrete measures to boost employment (and growth) in a fiscally neutral way – by explicitly taking into account that labour market policies have an impact on the supply as well as the demand side of the economy in times characterised by sharp output gaps (in many Member States). A number of complementary actions can be identified to increase effective demand in a sustainable way without increasing fiscal deficits (indeed, such increased demand will almost certainly increase tax revenue and so reduce deficits in the medium term).

In the area of labour market policies, feasible fields for action include minimum wages, taxation and social spending and all involve rebalancing in one form or another. On wages, the action would involve raising or introducing minimum wages and greater social partners involvement through exchanging views on wage developments at European level. Taxation measures would see rebalancing within income tax shifting the burden from the lower paid to the higher wage earners and rebalancing taxation away from labour onto property and onto environmental 'bads'. Social spending would be rebalanced to improve efficiency in terms of reducing inequality. More generally, a social investment approach to social protection expenditure would be taken.

The Single Market offers the necessary scale for investment and developing employment-rich activities, as well as additional adjustment potential for both labour demand and supply, as is recently shown by the increasing labour mobility from Southern Europe to Northern Europe.

2.1.1. Minimum wages

Raising (or introducing) minimum wages may have important positive effects on demand and supply in times of severe economic downturn. Indeed, on the demand side, it helps to sustain aggregate demand, which is a major driver of total employment. It also helps to close the gender pay gap and to boost wage equality, by maintaining an adequate living standard for the most vulnerable workers, thereby fostering social inclusion – which is a necessary condition for sustainable, smart and inclusive growth. Moreover, minimum wages also create an anchor underpinning prices, thereby reducing the risk of deflationary pressure in times of a severe downturn characterised by nominal interest rates close to their lower bound.

On the supply side, minimum wages constitute an incentive to find and accept paid work, if set at a level sufficiently above unemployment benefits. This is particularly the case in combination with other factors, such as activation and fiscal relief for low income from work. A minimum wage may also induce the older low-skilled workers to postpone their retirement – thereby lowering pressure for public outlays for early retirement. But, of course, too high a minimum wage can price low-skilled workers (essentially the low skilled) out of jobs. One transmission mechanism for this is the rise in the minimum wage increasing the overall wage cost, thereby negatively affecting international competitiveness.

Nevertheless, on balance, in times of severe economic downturn, raising minimum wages has the potential to increase the tax base, as overall employment increases, and reduce the outlays for unemployment benefits and in-work benefits, thereby improving the overall fiscal stance.

2.1.2. Better taxation

Rebalancing income tax

Several Member States have been recommended to shift taxation away from labour and towards other tax bases, with the primary aim of stimulating growth and employment. However, the rebalancing among different tax bases can mean a trade-off between employment and social aspects. The analysis of tax shifts from a microeconomic perspective complements the results suggested from a macroeconomic point of view and can be useful for improving the design of tax shifts. Indeed, taxes on consumption and property, for instance, are not as redistributive as income taxes, and in the case of property taxes the redistributive effect is highly dependent on their exact design. Clearly, however, the social effects of taxation are of particular relevance in times of fiscal consolidation, as it is revealed whether the rich or the poor are carrying the highest burden of tax changes. Moreover, tax shifts linked to positive social effects can have beneficial effects on aggregate demand.

Income distribution does matter for macroeconomic balances[19]. In a given year, richer people tend to save more and spend less while poorer people do the reverse. Saving can, of course, be channelled into

(18) See details in European Commission, 2012i.

(19) Stockhammer E, et al, 2011

productive investment but, as Keynes showed, in situations of insufficient demand, a higher saving propensity leads to less overall demand as output falls to leave investment as a higher similar share of the total to match higher savings. Moreover, larger shares of profits do not translate into productive investments if the erosion of the income position of workers is not accompanied by lower standards of living. In fact, financial investments by those at the top of the income distribution facilitate the increased borrowing of the rest seeking to limit the drop in their consumption (ILO, 2011).

Rebalancing income taxation could simultaneously achieve employment and social targets. Tax rates on high incomes have tended to be reduced in recent years as policy makers sought to encourage richer people to work more. The substitution effect was seen as significant with the rich working substantially more if after-tax earnings were higher. Recent research by Piketty, Saez and Stantcheva[20] suggests that this effect may be quite small[21]. According to this research, tax rates as high as 83 % could have little effect on the amount of work done by the rich while a cut of the tax rate could actually have a significant positive incentive effect on the poor to work rather than not work.

A revenue-neutral shift to taxing the rich more could have the dual benefit of increasing consumption and acting as an incentive for the poor to work rather than stay on benefits or other situations. Beyond labour supply, such a tax shift may have other implications for efficiency.

Shifting from labour to other bases

As further highlighted in Chapter 4, long advocated to raise employment, a partial switch from labour taxes to VAT and green taxes has been undertaken by several Member States. In a fiscal consolidation context the increase of consumption taxes has not been accompanied by a lower labour tax burden. Among the EU-27 Member States in which the burden of consumption taxation increased between 2009 and 2010, only seven Member States succeeded in simultaneously reducing the burden on labour taxation[22]. In all the other Member States the increased burden of consumption taxation was accompanied by an increased tax burden on labour[23].

Nonetheless, a revenue-neutral tax shift from labour to VAT increases employment. On the other hand, a revenue-neutral tax shift from labour to consumption will have an adverse social impact on particular groups, e.g. those who do not finance consumption out of labour market income. Tax shifts from labour to consumption result in trade-offs between employment and poverty targets, as further illustrated in Chapter 4. In fact, consumption taxes disproportionately penalise income poorer households in a given year. The extent of the trade-off varies by country and depends on characteristics such as labour market institutions and the distribution of saving rates. Tax reforms aimed at curtailing VAT reduced rates and exemptions have a particularly detrimental effect on the income poor.

Green taxes have been advocated in order to increase employment and GDP, while protecting the environment. Depending on how vulnerable groups can be compensated for an increase in green taxes, there is a potential for shifting taxation away from labour without generating negative distributional effects. A shift from labour to green taxes provides incentives for the creation of 'green jobs', consistent with the Europe 2020 flagship initiative *A resource-efficient Europe*. Green taxes include taxes on energy, transport, pollution and resources. Macroeconomic policy modelling shows that rebalancing from labour to environmental taxes would result in (small) increases in GDP and employment in most countries (European Commission (2011f)).

The reduction in employers' social security contribution had the greatest employment effect. Revenue from auctioning carbon emissions or other ETS schemes could reduce labour taxes in a similar way to boost jobs and growth. However, the job potential of environmental taxes may also come at the expense of fairness. Green taxes often penalized poorer income groups as they normally tax necessities. Nonetheless, the employment and social effects vary by Member State and depend on the focus of the tax base (fuel and vehicles versus electricity and heating, commuting). Another lesson is that to cushion against negative social effects, shifts towards green taxes need to be accompanied by investments enabling Member States to maintain or improve living standards while reducing the resource intensity of consumption.

Proposals to shift taxation from labour to property reveal a renewed interest in employment-friendly taxation in times of crisis. The current favourable tax treatment of housing investments in many EU countries represents a potential solution for raising more revenue from property and a way to lighten the burden on labour. Indeed, the OECD, European Commission and IMF have recently recommended that certain EU countries[24] increase their property taxation, while shifting taxes away from labour. Higher taxes on property would rebalance the bias towards housing investments. Property is a stable and immobile tax base and taxes on it are difficult to avoid or evade. However, current forms of property taxes do not always achieve social objectives. The main reasons can be summarized as relating to the design of the tax rates, the calculation of the tax base and the distribution of homeownership. One employment and social friendly alternative form of property taxation is represented by a well-designed tax on imputed rent, as illustrated in Section 5.2 of Chapter 4.

The simultaneous achievement of EU 2020 employment and poverty goals can be successfully pursued through alternative measures. In particular, the fight against tax evasion and the reduction of tax expenditures (such as mortgage interest tax relief) can positively contribute to efficiency gains while lowering poverty and inequality.

2.1.3. Effective and efficient social spending

Social expenditures are powerful stabilizers of economic activity because they help to sustain effective demand during recessions. Available data now shows the

(20) Piketty, et al, 2011.

(21) However, the elasticity of taxable income might nevertheless be high for high income individuals, e.g. due to income transformation possibilities etc.

(22) In Bulgaria +1.7 versus -5.1 %, in Slovenia 0.2 % versus -0.4 %, in France +1.3 % versus -0.7 %, in Lithuania +10.6 % versus -2.7 %, in Poland +6.2 % versus -2.7 %, in Romania +11.6 versus -4.5 %, in Sweden +1.6 % versus -1 %.

(23) Data based on the implicit tax rates on consumption and labour provided by European Commission (2012b).

(24) Such as Denmark, Finland, Germany, Italy, Norway and Sweden.

significant role that social spending played in sustaining gross household disposable income during the 2008-2009 recession in most EU countries.

The empirical evidence presented in this review shows that countries with similar levels of expenditure achieve very different results in terms of both social (poverty reduction) and economic (stabilization) outcomes, thereby suggesting that there is room for efficiency gains. Comparative analysis illustrates that the size, structure and design of social expenditure all matter for the performance of welfare systems. Long-term trends also show that the countries with the highest welfare spending are not those with the highest public debt.

It also highlights quite strong variations across countries, with a rather weak stabilizing impact in Italy, Greece, Spain and Portugal, even when compared to countries with similar economic shocks and level of spending. These countries are also those with the lowest poverty reduction impact (excluding pensions). Given the rigid constraints on public finances in these countries, a careful rebalancing of expenditure, rather than an increase, would be needed to reinforce both the poverty reduction impact and the stabilizing effect, in a budget neutral way. This could include reviewing the structure of spending, currently skewed towards old age benefits (in comparison to other countries), making sure that unemployment insurance covers the most vulnerable workers (those who are first to lose their jobs), or adjusting the design of schemes to make them more responsive to the economic cycle (e.g. automatic adjustment of the duration of unemployment benefits).

The weaker efficiency of unemployment spending in Italy, Greece, Spain and Portugal derives from the labour market dualism that characterizes these countries, with a core of well-protected workers and unstable jobs at the margin, and the strictness of entitlement conditions for unemployment benefits. Recent or announced labour market reforms may not prove sufficient to extend safety nets to atypical workers. The effectiveness of the extension of unemployment coverage to atypical workers (coupled with a reduction of unemployment entitlements of standard workers) in stabilizing aggregate demand also depends on a timely implementation.

Reforms to rebalance social spending between old-age and unemployment benefits and to revise the design of unemployment benefits in specific countries are expected to achieve efficiency gains in terms of both economic and social effects. Nonetheless, attention should be paid to unintended effects such as those affecting the 'unprotected' groups, generated by introducing stricter pension requirements combined with a decrease in unemployment generosity for standard workers.

Rebalancing the structure and reforming the design of social spending may not be sufficient to make social spending more efficient. The shadow economy and undeclared work reduce tax revenues, from a macro perspective, and prevent irregular workers from benefitting from full social protection, from a micro perspective. Incentives to reduce the shadow economy can be provided by the tax and benefit system, through a link between rights and contributions and a reduction of the fiscal burden on low-skilled jobs.

Means-testing of social benefits can reduce social spending while more effectively protecting the most vulnerable groups, but Chapter 3 illustrates that means tested benefits are not necessarily more effective at reducing poverty overall. Attention should also be paid to the potential work disincentives and low benefit take-up associated with targeting.

A revision of the mix between cash and in-kind benefits can lead to efficiency gains. Both cash and in-kind benefits have pros and cons and an optimal choice depends on the type of benefit. In-kind family benefits such as childcare are more employment-friendly than cash family benefits and ease the participation of women into the labour market generating virtuous effects on female employment[25] (double channel of mothers working and women employed in childcare). Child care services also contribute to preventing child poverty and the intergenerational transmission of disadvantage by securing parental incomes and giving access to quality education and care to all children. Cash housing benefits are more efficient in cushioning effective situations of temporary financial distress, while in-kind housing benefits can hamper workers' mobility, create ghetto effects and are often poorly linked with effective financial difficulties (once they are in social housing, households tend to remain there even if their income increases).

Promoting an 'active' welfare state should also contribute to a well-functioning cyclical behaviour of social spending, whereby expenditure increases in response to a shock, and then decreases in times of recovery. This is an essential aspect of the sustainability of the systems. A recent study shows that countries that invested heavily in ALMP before the crisis saw their employment levels be less severely impacted during the crisis[26]. During the years 2000-2010, a number of countries (Nordic countries, Germany or the Netherlands, for example) engaged in successful reforms to modernise the welfare state, aimed at reabsorbing high levels of long-term unemployment and/or swelling numbers of people on long-term illness or disability benefits resulting from the recession of the 1990s.

Improving the efficiency of education systems (accompanied by demand side policies such as enhanced R&D spending and innovation) is a key priority for increasing human capital and boosting productivity[27]. Some proposed interventions do not entail higher spending, while at the same time increasing future returns from human capital investments. Depending on the country, such interventions include: curricula reforms of primary and secondary schools, promotion of vocational, scientific and technological education with a greater responsiveness to the labour market and attention to innovative sectors, wider use of standardized exams, postponing early tracking, improving the governance of universities.

2.1.4. Pensions: a key part of social spending

Pensions[28] are the main source of income for about 124 million older Europeans – a share of ¼ and growing. The ageing of population is both a challenge and a testimony to the importance of ensuring adequate and sustainable pensions in the long run.

The adequacy of pensions is generally measured through three dimensions: their ability to prevent poverty, the

(25) OECD, 2012a.

(26) OECD, 2012b.

(27) OECD, 2012c.

(28) See also European Commission, 2012n.

degree to which they replace individual income before retirement and how overall household incomes of older people compare to the average household incomes of people of active age. The at-risk-of-poverty or social exclusion measure is directly linked to the poverty reduction target of the Europe 2020 strategy.

Pensions affect public budgets and labour supply in major ways and these types of impact must be considered in pension policy. Pensions also play a key role as an economic stabiliser in recessions by sustaining the purchasing power of a growing share of the population and thus contributing to sustaining economic growth. Obviously the raison d'être of pensions is to deliver retirement incomes that are adequate to allow older people to enjoy decent living standards and economic independence. Yet, employment, sustainability and adequacy issues are linked since working to an older age and postponing pension take-up will raise labour supply, improve sustainability and long-term growth and provide the basis for higher benefits.

On top of demographic challenges, the economic crisis has strengthened the rationale for pension system reforms aimed at limiting the public budget impact of the growing share of people 65+. If effective retirement ages are raised this will not just bolster the sustainability and adequacy of pensions in the longer term but will also contribute to economic growth here and now. While the reforms already adopted have achieved clear advances in the sustainability of public pensions, the Pensions Adequacy Report 2012 (PAR) reveals that these have been largely obtained at the cost of adequacy since most reforms will result in lower replacement levels unless people work longer and save more, thus leaving future adequacy contingent on changes in people's retirement and savings behaviour.

As highlighted in the White Paper on Pensions, working longer and postponing retirement represents the main opportunity to compensate for declining replacement rates in public schemes. If pension and retirement systems sufficiently and sensibly reward working longer and discourage early retirement they can contribute to ensuring that longer working careers become the key avenue to more adequate pensions. Hence pension systems can help optimise labour supply over the working life, and notably for older workers, by setting strong work incentives in their entitlement rules and restricting access to early retirement. This is already the case in several Member States, but in others these incentives are still ill-adjusted.

To fully secure adequacy, longer working lives may still need to be combined with a greater emphasis on complementary retirement savings in pension provision. Hence, adequate pensions in the future will depend on a mix of working longer with fewer career breaks and saving more through second and third pillar schemes.

Pension entitlement rules are only one side of the challenge when trying to change retirement practices and raise effective retirement ages. As pointed out in the Pensions Adequacy Report 2012, the success of pension reforms that raise the pensionable age and possibly link it (or benefit levels) to longevity gains depends crucially on the reforms being underpinned through age management in workplaces (such as age-adverse aspects of work organisation, promotion, remuneration, access to training, and hiring and firing practices) and labour market measures that enable and encourage women and men to work longer. There are clear limits to how much age management practices at work can be influenced by incentive structures in pensions. Tackling the pension adequacy challenge will therefore require determined efforts to promote longer and healthier working lives through employment and industrial relations policies. A holistic approach to working longer will be needed and governments need to work with social partners to carry out the necessary changes, including through collective agreements.

To achieve the goal of raising the effective retirement age, men and women who are physically able and willing to work after reaching pensionable age must be enabled and encouraged to do so. As pointed out in the White Paper, one of the pre-conditions for this is the removal of unwarranted mandatory retirement rules where these exist.

The limitation of early exit pathways can contribute substantially to an increase in the effective retirement age. Almost all Member States have taken steps to make eligibility conditions stricter (e.g. raising minimum age and/or contributions record) and to strengthen financial disincentives to take up early retirement. However the impact of disincentives on take-up is limited by labour market factors. So far the employment rates of older workers have been resilient to the recession but recent administrative data now suggests the take-up of early pensions is increasing in a number of countries. While general access to early exit schemes has been restricted further, access to disability benefits for the elderly has partly been extended. According to administrative data on benefit recipients collected through the Social Protection Committee, this has not triggered a systematically higher take-up of disability benefits.

Most reforms across the EU aim to increase the effective retirement age, i.e. enabling and encouraging individuals to take their retirement later or accept a (partial or full) pension while continuing professional activity. There is a wide variety of initiatives across Member States to increase the pension eligibility age, including those for old-age pensions, minimum pensions, early exit pensions, and public sector pensions.

Over the last year, nine out of the remaining 12 Member States with different retirement ages have taken steps to equalise the pensionable age for women with that for men. The pace of these reforms varies significantly, ranging from very gradual (Poland, Austria) to extremely fast (Italy to raise pensionable age for women in the private sector by 5 years over a 6-year period). Three countries (Bulgaria, Romania, Slovenia) have not planned any reform in this direction.

Linking the pensionable age or benefits to gains in life expectancy is an important mechanism to adjust pension expenditures in line with demographic changes. While some countries have introduced a life expectancy coefficient in the benefit formula, others are raising the pension eligibility age in line with longevity gains.

Increasing the flexibility of the retirement age after a minimum retirement age (to be adjusted in line with longevity gains) is a key aspect of the paradigm shift taking place in pension policy. A universal retirement age is gradually replaced by an individual decision relating to when and on what conditions to retire. This has been explicitly reflected in some Member States' legislation, e.g. by replacing statutory with 'recommended' retirement age (Sweden) or abolishing the default retirement age (UK). One can speak of an increasing shift from retirement at a certain age to retirement at a certain income, although other

factors such as health status and family commitments must be taken into account to avoid over-simplification. A flexible retirement age, linked to financial entitlements and individual preferences, has significant stabilising potential for social protection spending.

While access to minimum and guaranteed pensions have often been strengthened in reform processes, fully earnings-related pensions, whether public or private, have been altered by the shift from defined benefits to defined contribution designs which have shifted the nature of these from social protection towards systems closer to pure income smoothing schemes. By strengthening the link between earnings during professional life and retirement income, defined contribution systems also clearly show that they are not designed to compensate for labour market shortcomings. In this context, persons who have been out of the labour market for long periods or have been 'working poor' during their professional life, can face a higher likelihood of falling under the poverty threshold after retirement, depending notably on the actual minimum income provision for older people in place.

When modelling the adequacy of pension systems, projections are frequently based on the assumption of a 'typical' or ideal retiree: one with a long and unbroken career who has worked full hours and earned an average income. In practise, a large share of retirees will not fulfil these conditions. In order to achieve the Europe 2020 poverty reduction target, pension reforms need to account for different types of retirees with realistic career paths, and envisage a solution for those who do not fulfil the criteria for a full pension, such as a minimum or social pension.

While the calculations in the Pensions Adequacy Report show that statutory pensions are expected to remain the core of old-age social protection, enhancing complementary savings in occupational and private pension schemes (2nd and 3rd pillar) is an important way of sustaining the adequacy of retirement income.

The direct impact of the crisis has been heavily felt by the pre-funded segments of pension systems, triggering policy consequences in managing contributions. Financial turmoil has hurt the short-term performance of pension funds, and fiscal pressures have forced some countries to backtrack on mandatory funded tiers, while most reforms undertaken by Member States still expect complementary private savings to play a more important role in the long-run.

The financial and economic crisis impacted quite drastically on the design of a number of mandatory funded pension schemes, in particular in the new Member States. The transition costs of the recently introduced private schemes were considered as a heavy financial burden for the state budget. Mandatory funded schemes were suspended, opened for a limited period, or reduced considerably in size.

The most striking example of policy reversal on mandatory funded pensions was the nationalisation of the second pillar in Hungary; contributions were permanently reduced in Hungary and Poland. Estonia, Latvia and Lithuania temporary re-channelled part of the contribution earmarked for funded schemes back into first pillar Pay-as-you-go pensions, seeking to balance the books at a time of crisis.

2.2. Improving the functioning of the labour market

Four issues should be addressed to improve labour market functioning to get more people, especially young people, into employment and out of joblessness: segmentation, mismatches, mobility and long-term unemployment. Young people deserve special attention.

2.2.1. Focus on youth[29]

The labour market situation of young people has become an increasingly urgent social matter in the EU[30] and the integration of young people into the labour market continues to be a major policy issue for the EU and individual Member States. Despite a shrinking and increasingly better-educated youth population, young people in many Member States still face considerable problems in making the transition from education into employment. And many of those who have gained a foothold in the labour market often hold unstable jobs with unfavourable conditions and career prospects.

The young need special attention and support for various reasons. Firstly, their situation is more challenging in comparison to adults and has been deteriorating over time. They face high unemployment rates and they are increasingly affected by long-term unemployment and labour market segmentation. The second reason is the negative long-term implications of unemployment at a young age, such as the increased probability of future unemployment, the reduced level of future earnings and the higher likelihood of precarious employment. The negative impact goes beyond the labour market and may also adversely influence poverty, young people's health status, life expectancy and youngsters' beliefs as well as their civic and political participation (see Bell and Blanchflower 2010, Scarpetta et al. 2010, Simms 2011, YOUNEX project[31], European Commission 2011a, Eurofound 2011a and Eurofound 2012a). This has a negative impact not only on young people's financial and social situation or training but also for the economy and social cohesion at large[32]. Finally, the

(29) 'Young people' refers to the age group 15-24. However, the labour market situation of the older young age group (25-29) is increasingly gaining importance. More young people aged between 20 and 24 stay longer in education and training both due to the recent economic downturn as well as a result of EU educational targets. Therefore the transition process from school to work is postponed to a later age .See a more detailed presentation of youth employment across various age groups in the European Commission (2012b).

(30) State of the Union address by President Barroso to the European Parliament in September 2011 (see also http://ec.europa.eu/commission_2010-2014/president/state-union-2011/index_en.htm).

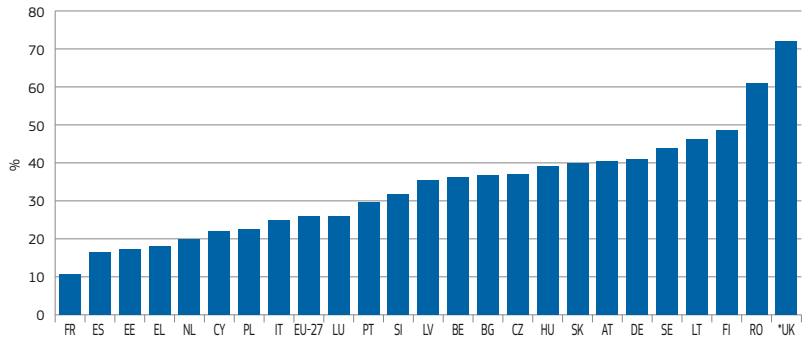
(31) YOUNEX: 'Youth, Unemployment, and Exclusion in Europe: A multidimensional approach to understanding the conditions and prospects for social and political integration of young unemployed' (http://www.younex.unige.ch/index.html). The project focused on the social and political dimension of young people's lives and investigated the effects of unemployment on the exclusion of young people from social and political spheres, including their civic and political participation, as well as the consequences on their well-being in Switzerland, Germany, Italy, France, Sweden, Poland and Portugal. The project was financed by the Seventh Framework Programme for research and technological development (FP7) of the European Union.

(32) Eurofound (2012a) estimated the economic costs of the disengagement of young people from the labour market (i.e. NEET costs) at around €153 billion or 1.2% of the aggregated GDP of EU-26 countries in 2011. This is an increase of €34 billion (0.3 pp) in comparison to 2008. The reintegration into the labour market of just 10% of NEETs would achieve a yearly saving of more than €15 billion. Malta was excluded due to missing variables. The estimation is underestimated because of certain costs, such as those related to the increased risks faced by NEETs of experiencing mental and physical health problems and of pursuing dangerous lifestyles. The analysis used the 2008 European Union Statistics on Income and Living Conditions (EU-SILC) for the age group 15-29. The NEET group was defined as those who have been unemployed or remained outside education or training for a period of six months (consecutive) or more during the 12 month reference period of the survey.

young are more exposed to systematic labour market risk (Chung et al. 2012). They are confronted with changed labour markets and more demanding employers than previous generations – there is greater pressure on them to be job-ready and to perform from day one (Sissons and Jones 2012).

While the young share several common characteristics, they are a heterogeneous group and this requires tailor made policies that go beyond a well-functioning labour market. The unemployed can be skilled or unskilled. The young might be inactive because they are in education, but also because they look after children or elderly relatives or because they are disabled or sick. Policies need to acknowledge that and include, besides general growth stimulating policies, specific measures to reduce income insecurity and poverty among the young as well as preventive measures starting in childhood to minimize the risk of the young becoming a NEET (neither employed, nor in education or training).

Chart 44: Annual transition rate from temporary to permanent jobs, 2010



Source: Eurostat, EU-SILC, Labour transitions by type of contract [ilc_lvhl32].

Note: Data unavailable for Denmark, Ireland; no data for Malta due to large year-to-year variations; * data for the United Kingdom subject to revision.

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2.2.2. Segmentation

Labour market segmentation has certainly played a role in the rapid rise in unemployment for most ages since the crisis started, specifically in Spain and Portugal. Segmentation resulted in the existence of a large temporary workforce with weaker transition possibilities to permanent jobs (see Chart 44). Recent Commission findings regarding the costs and benefits of active and passive measures (European Commission 2012a) show that segmentation of the labour market – which also includes low-wage traps, part-time traps, sectoral or occupational segregation, etc. -, increases the risk of social exclusion and the low level of employment protection of young workers.

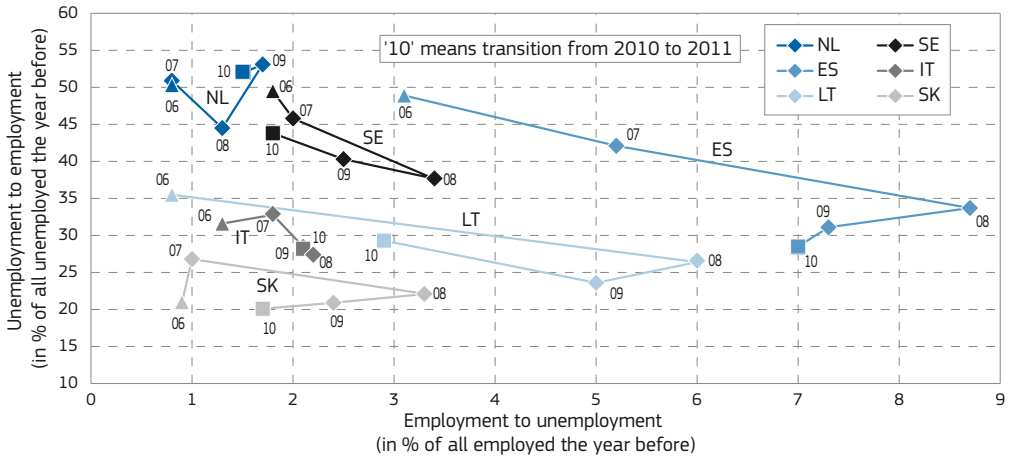
Flexicurity policies are supposed to help reduce the negative effects of segmentation. Analysing labour market segmentation involves certain difficulties as it cannot be fully observed in a direct way. A fixed-term contract is not necessarily an unfavourable contract for every worker, who may use it as a stepping stone, or it may well match his or her preferences. Using involuntary fixed-term contracts as an indicator provides a better insight regarding segmentation and over-use of fixed-term contracts. Southern and Eastern European Member States are often characterised by high levels of involuntary fixed-term workers, suggesting segmented labour markets.

Disparities in employment protection rights for permanent and fixed-term contracts have been identified as a key source of segmentation. During the crisis, a number of Member States started reviewing their labour laws to reduce protection for permanent contracts with a view to making hiring more attractive for employers. The latter has been particularly the case in some Southern and Eastern European Member States.

Many instruments combine flexibility and security element(s). Measures combining employment security and external flexibility seem to be the most prevalent. This includes measures that aim to replace traditional job protection with measures enhancing the employability of labour market outsiders while easing hiring and lay-off procedures and costs for employers, backed up by active labour market policies.

A second set of measures entails external flexibility being combined with job security, which, at a first glance, might

Chart 45: Transition rates into and out of unemployment from 2006 to 2011



Source: Eurostat, LFS, DG EMPL calculations.

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appear contradictory. These measures often contain elements to facilitate hiring and laying off, which is combined with incentives for employees to maintain their existing jobs. Most of these measures are related to new regulations on types of employment contracts in terms of their duration. Prominent examples are regulations obliging companies to provide workers with an open-ended contract after repeated use of fixed-term contracts or after a certain period of time has elapsed, thereby contributing to decreasing segmentation.

The Commission's Employment Package[33] recommends that further reforms should include measured and balanced reforms in employment protection legislation in order to remedy segmentation or to halt the excessive use of non-standard contracts and the abuse of bogus self-employment. More generally, all types of contractual arrangements should give jobholders access to a core set of rights from the signature of the contract, including access to lifelong learning, social protection, and monetary protection in the case of termination without fault.

2.2.3. Jobs and skills mismatches

Another key challenge for Europe is to improve the provision of skills in line with labour market needs and to thereby reduce the skill mismatch, which has increased significantly since the start of the crisis. Recent analysis by the European Central Bank shows that skills mismatches significantly affect the unemployment rate and are caused more by structural imbalances between labour demand and supply rather than by a lack of geographical mobility (ECB 2012).

Countries with higher levels of vertical skills mismatches (over- or under-qualification) share some common characteristics, as highlighted in Chapter 6. They tend to have lower levels of public investment on education and training, which might reduce their quality and ability to respond to changing labour market needs. A high share of business executives in those countries believes that educational systems do not fulfil business needs. Furthermore they have lower expenditure in labour market programmes and more rigid labour markets. However, higher supply of highly educated workers does not increase over-qualification problems, provided that countries create sufficient number of innovative and high-skilled jobs. Vertical mismatch is especially high in Mediterranean countries.

The young tend to be more often over-qualified than other age groups, which might reflect labour market segmentation. The over-qualification of young in the Mediterranean[34] countries, known for their labour market segmentation and high unemployment rates, has risen much more sharply than in other countries in the last decade (SEO 2012). In the high-mismatch countries, young workers, notably males, are more willing to take up part-time and/or temporary jobs which demand lower qualifications than the ones they possess, because they are happy to find a job at all after searching for a long time. If the labour market does not recover, young workers get stuck in low level jobs and do not develop their productivity as much as they could. The longer the general and especially youth unemployment levels remain high, the more and more young workers are forced in jobs below their qualifications, thereby increasing country levels of over-qualification. On the other hand, young people in countries with lower unemployment rates, such as Western Europe-Rhineland[35] countries, have more opportunities to leave jobs for which they are over-qualified once the labour market improves.

Even though young workers tend to be formally over-qualified for their jobs, their skills are less likely to be matched to their jobs than those of the older workers. However, older workers are more exposed to the risk of skills obsolescence. Increased investment in skills, both specific and transversal, is thus needed across the workforce.

Another group that is very susceptible to over-qualification are third country nationals, in particular women. The underutilisation of their human capital tends towards a persistent phenomenon in many countries and requires specific policy answers. For more details see Chapter 6.

The trend in shifting jobs to services and to more skill-intensive jobs in the EU will continue and the labour force should be prepared for this. The sectoral shift within the EU from primary sectors towards services varies across regions[36]. Whereas employment in Western EU regions and Scandinavia is shifting to information & media and to financial & business services, it is shifting towards trade & repair and transportation in Eastern and Mediterranean countries. The highest number of total job openings[37] in the EU over 2010-2020 is expected in other business services and health & social work – more than 8 million according to the 2012 CEDEFOP forecasts[38]. 80 million total job openings (7.6 new jobs and 72.4 openings due to replacement needs) in the EU over 2010-2020 will demand both high and medium skilled workers (35 million and 36 million respectively). Highly skilled workers are needed especially for new jobs, whereas medium skilled workers will be mainly needed to satisfy replacement needs. The health and social work sector will offer the most replacement jobs. The supply forecasts show that labour force qualification is expected to increase. A prominent feature of employment developments over the past decade or more is the tendency for higher level jobs – e.g. managers and white-collar professionals – to expand at the expense, in particular, of skilled and semi-skilled manual jobs and, to a lesser extent, of clerks and office workers[39].

Vocational education and training brings short-term benefits in making people, notably the young, become employed more rapidly, but it might entail some long-term costs. More favourable labour market outcomes for the young can be observed in countries where a higher proportion of students undertake traineeships or work placements as part of higher education studies or for countries

(33) European Commission, 2012k.

(34) Mediterranean countries include Spain, Greece, Italy and Portugal.

(35) Western Europe-Rhineland countries include Austria, Germany and the Netherlands.

(36) SEO Economic Research, 2012.

(37) Total job openings are the sum of expansion demand (new jobs due to economic or population growth) and replacement demand (existing jobs open in order to replace people that retire or leave the workforce).

(38) Main source are CEDEFOP forecasts published in 2012, because they provide comprehensive overviews for the whole EU, http://www.cedefop.europa.eu/EN/news/19704.aspx.

(39) As recalled by WiiW and Applica, 2012.

with apprenticeship systems (such as Germany, the Netherlands, Austria and Denmark). (See European Commission 2012e, European Commission 2012f, Brennan et al 2009). Young graduates with medium-level vocational qualifications need less time to find their first job than young people with a general education, especially those who went through an educational programme with more workplace content. However, gains in youth employment from vocational education may be offset by the fact that specialized education can reduce workers' mobility and their ability to cope with economic changes and rapid technological change (see European Commission 2012f, Hanushek et al. 2011 and Lamo et al. 2011). In designing apprenticeship schemes it is therefore important to ensure a balanced provision of both occupational skills and general skills and competences for students as well as lifelong learning possibilities for apprenticeship-type VET students (European Commission 2012f). Next to that, the importance of improving the quality of vocational training was particularly stressed in the European Semester 2012 (European Commission 2012d).

Skill mismatches may also signal poor job quality. One out of three firms in the EU experiences difficulties in hiring staff for skilled jobs, and one out of ten do so for low-skilled or unskilled jobs, but not all difficulties are due to skill mismatches. Chapter 6 demonstrates that firms with a difficult working climate are 16% more likely to face shortages of skilled workers. The health and social care sector is more likely to experience shortages of skilled workers, while the probability of shortages in the finance industry is lower. The hotels and restaurant sector as well as construction firms are more likely to face shortages of low-skilled or unskilled workers than the manufacturing sector. Job quality therefore plays a role in creating or closing skill mismatches and, despite the crisis, should not be disregarded.

2.2.4. Opportunities provided by mobility

Classical economic theory favours mobility to resolve mismatches between supply and demand. This applies to labour as well as to goods and services. The EU has long promoted the increased mobility of workers between Member States to improve resource allocation but has also spent large amounts of Regional and Social Fund money on the development of disadvantaged regions, recognising that if they lost too much of their population regional disparities would increase rather than diminish (as textbook orthodoxy would suggest).

If there are job vacancies in the North of Europe and significant unemployment in the South and people were to move from South to North to work, this would increase output in the North and reduce labour supply and perhaps unemployment in the South: clearly a potential win-win outcome[40]. This applies across all skill types with the biggest overall gains when high skilled unemployed find high skilled jobs in the North.

Small scale initiatives have been launched to move unemployed engineers from Spain to Germany. Anecdotal evidence suggests many young Greeks are also moving to Germany (and the UK) to find work. The EU is increasingly focusing on promoting such movements, notably through EURES instruments.

Preliminary analysis of flows of mobile workers during 2011 confirms the increase in mobility from Southern-European countries to the North, in particular Germany[41]. However, despite a significant increase compared to past years, current flows remain quite limited in absolute terms (and in proportion to the size of the labour markets of origin and destination countries) and can only relieve a small part of the pressure on the respective labour markets. However, if current youth and long-term unemployment in those countries were to persist or to further worsen in the medium-run, mobility to North Europe could increase at much higher levels (not reached since the post-war decades).

It is, however, necessary to underline that there is a distinct risk that those who leave are the most dynamic and innovative workers and they will leave behind a proportionately larger pool of demotivated or less skilled, workers. Furthermore, the outward migration of young skilled workers is likely to significantly increase the economic dependency ratio in the regions they are leaving. While short-term unemployment costs might be reduced, the longer term fiscal disadvantages of fewer workers per dependant is far from negligible, especially in Southern Member States which are already fiscally strained. This will be mitigated if the unemployed workers who leave return after several years of valuable work experience abroad. For this, their home countries need to offer a favourable environment. Nonetheless, considering the size of the highly educated section of the labour force in Southern European countries, the current levels of mobility are too low to result in a phenomenon of 'brain drain' and one should also take into account the temporary nature of mobility and the potential gains among the movers in terms of experience and skills acquisition.

2.2.5. Long-term unemployment

Long-term unemployment is probably the harshest form of joblessness. It hinges on the hopes and chances to get back into the labour market and signals a structural weakness of the EU labour market to re-absorb job losses.

A key component of policies to counteract the cyclical component of unemployment and prevent long-term unemployment is the appropriate coverage and design of unemployment benefits and social assistance. Unemployment benefits have an important function as an automatic economic stabilizer, providing an income and consumption support to the unemployed, and they also tend to decrease precautionary savings. Increased consumption expenditure raises aggregate demand and consequently also labour demand during a recession. Activation strategies include job search requirements, the obligation to make frequent visits to the employment services, sanctions, etc. Make-work-pay policies accentuate the gap between incomes in and out of work in order to make work more attractive, particularly at low-wage levels, where the risk of unemployment traps is higher. Furthermore, many Member States make unemployment benefit receipt (as well as increasingly also the collection of social assistance)

(40) See notably Labour mobility in the Euro Area, DB Research, September 2011.

(41) For more details, see European Commission, 2012l, EU Employment and Social Situation Quarterly Review, June 2012, pp. 31-40, at: http://ec.europa.eu/social/main.jsp?langId=en&catId=89&newsId=1389&furtherNews=yes

conditional on participation in active labour market policies (such as training, etc.) in order to stimulate retraining and up-skilling, and thus reduce skill mismatches.

Another strand of policies to prevent long-term unemployment is to reduce skill mismatches by providing incentives to acquire qualifications that have emerged as necessary as a result of sector change/restructuring. Such policies should take place in the context of a broader reform of the education system that provides for a better link between education and the new needs of the labour market (e.g. more apprenticeships, adaptation of the curriculum), and can be strengthened through improved life-long learning opportunities and the development of networks providing vocational training, which can equip the participants with the right skills for the labour market. Targeted active labour market policies (e.g. training) combined with income support for needy participants can further improve the results.

A third strand of policies concentrates on tackling geographical mismatches and promoting mobility. Policies to overcome geographical mismatches can be strengthened by integrating obligations to accept job offers within a reasonable geographical range (commuting area) in the activation strategies for receiving benefits or social assistance. Mobility enhancing policies, especially long-distance mobility, may be more relevant for students than for the unemployed, but can still have added value in preventing future unemployment (skills acquisition, new work opportunities in future, etc.). In light of this, grants for education abroad (e.g. Erasmus exchange programme), income support for work abroad such as grants for young researchers could be a cornerstone for preventing unemployment among the young people, who are the most likely to be mobile.

2.2.6. Longer working lives for all

The most productive and promising answer to the demographic challenge of structural longevity growth is to extend working life for men and women: prolonging it at the end, starting it earlier at the beginning and reducing interruptions over the span of the career, and increasing activity rates (especially of women). This is what is being addressed through the re-balancing of time spent in work, in retirement and in activity. A longer working life will both support the sustainability and the adequacy of pensions, as well as bring growth and general welfare gains for an economy. Higher employment rates among older workers are also a precondition for our ability to reach the 2020 target of 75% employment rate of people 20-64, just as adequate pension systems are a precondition for the achievement of the poverty reduction target.

Three key sets of factors influence the length of people's working lives and their retirement behaviour: *i)* the tax-benefit context of working life – in which social protection financing and spending have a considerable weight; *ii)* age management in work places and labour markets as it has a major impact on people's desire and ability to continue working; and *iii)* the extent of work-life balances in late careers – in which social protection also plays a certain role. In this respect, it should be noted that almost 10% of the 20-64 year old people opted for inactivity or part-time work due to personal or family responsibilities.

As pensionable ages have been raised and early exit reduced over the last decade and notably in the context of last years' fiscal consolidation efforts, the main challenge of having longer working lives with fewer interruptions has moved to the field of employment, requiring changes in work place and labour market practices which can encourage and enable women and men to work longer. Measures include improving access to life-long learning; promoting healthy working conditions and suitable jobs for older workers; fighting age discrimination; promoting alternatives to early retirement; designing employment-friendly tax-benefit systems; and developing accessible and affordable care for dependent children and frail older people.

Despite substantial growth in the employment rates of older workers in many countries over the last decade, sizeable variations across Member States remain (from 31% to 72.5%) and the potential for increasing the employment rate for women and men aged 55-64 is still enormous. In 2011 the employment rate for workers aged 55-64 ranged from 31.2 in Slovakia to 72.3 in Sweden, i.e. varying by more than a factor of 2. The rate for the EU-27 is 47.4. Eight countries had rates below 40 (Belgium, Greece, Italy, Luxembourg, Hungary, Malta, Poland, Slovenia).

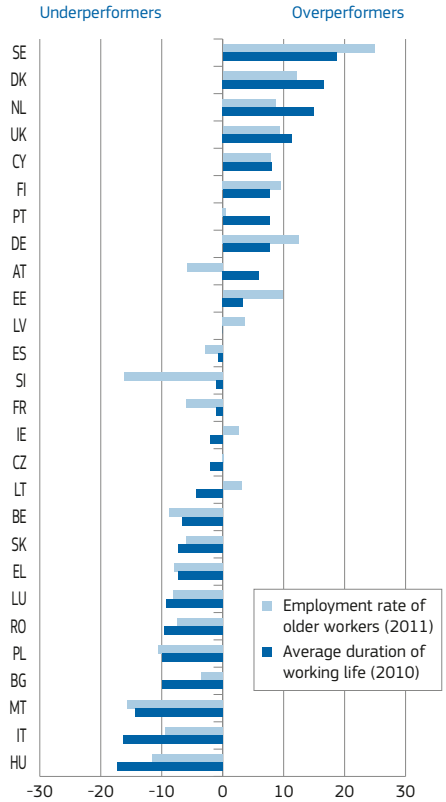
Female employment rates in the 55-64 age group ranged from just 13.8 in Malta to 68.9 in Sweden, i.e. varying by a factor of 5. The rate for the EU-27 was 40.2. Five countries had rates below 30 (Greece, Italy, Malta, Poland, Slovenia). In most of these, barriers to older female workers' employment are found in pension systems (e.g. lower pensionable age for women), in the work-life balance (e.g. insufficient access to childcare and eldercare) and in workplaces and labour markets (e.g. poor age and gender management).

Whereas the trend towards ever earlier retirement has been reversed in all Member States over the last decade, premature labour market exit is still a major problem in several countries. In 2010 the average exit age varied between 58.9 in Hungary and 65.2 years in Portugal. For the EU-27 it was 61.5 years. The exit age was below 60 in 6 Member States (Bulgaria, France, Luxembourg, Hungary, Malta, Slovakia), while 12 had exit ages at or above 62 (Cyprus, Germany, Denmark, Estonia, Finland, Ireland, Latvia, the Netherlands, Portugal, Romania, Sweden, the UK).

One crucial aspect of the strength of work incentives in pension schemes is the bonus/penalty of working longer/retiring earlier. Delaying retirement results in a higher net theoretical replacement rate in most Member States (increases of more than 10 percentage points for the average earner with respect to retirement at 65 occur in Germany, Estonia, Slovakia, Lithuania, Poland and Hungary). Early retirement (or shorter careers) result in lower replacement rates (drops of more than 10 percentage points for the average earner occur only in Latvia, Spain, France, Slovakia and the Czech Republic). However, the incentives are not symmetrical: in all but a few Member States, the increases in replacement rates gained by working two years longer are bigger than the reductions in replacement rates incurred by working two years less. Disincentives to take early retirement are thus not as strong as incentives to work longer.

In Chart 46 below, the pension-related employment challenge is illustrated by the extent to which Member States' performance deviates from the EU averages for the

Chart 46: The employment challenge: average duration of working life and employment rate of older workers, deviation from EU average; 2010



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Source: Eurostat, EU-LFS.

Note: Score for each indicator = 10 x [(indicator - EU average) / standard deviation].

duration of working life and the employment of older workers. Underperformers are listed to the left in red and overperformers in green to the right of the vertical line indicating the EU average.

2.3. Addressing the social consequences of the crisis

2.3.1. Long-term exclusion

The combined analysis of entry and exit rates in and out of poverty confirms that fighting long-term exclusion requires actions to prevent new entries into poverty and action to reach out to those who are trapped into persistent poverty. This is especially the case in countries (Baltic States, Bulgaria, Greece, Italy and Malta) that already combined a high risk of entering into poverty with low chances of getting out of it before the crisis, and that are experiencing very bad labour market conditions.

Long-term exclusion and persistent poverty have multiple causes. Individuals in persistent poverty experience intricate social difficulties, such a as lack of adequate skills, including skills obsolescence, disability or weak health status and difficulties in accessing health care, etc. Tackling long-term exclusion therefore requires a mix of interventions. Adapted training schemes, combined with income support, and appropriate access to services, such as decent housing or health care can contribute to enhancing the employability of workers as well as their capacity to fully participate in society. Employment services, benefits designed to make work pay, job search assistance, targeted hiring subsidies, lower taxation of low paid labour, an adapted work place, reconciliation measures and key enabling services such as child care and care for other dependants are key to facilitating access to the labour market for all, including for workers who have special needs or care responsibilities.

Recurrent poverty is another phenomenon requiring attention. Having been poor in the past largely determines the risk of again being poor in the future. The recurrence of poverty is symptomatic of a risk of increased social polarization, with a group of individuals in hardship clearly distinct from the rest of the society and unable to pass from one state to another in a sustainable manner.

Recurrent poverty spells have multiple causes, including precarious employment, insufficient wages (including minimum wages) and inadequate or badly designed safety nets. Action to improve the quality of jobs, skill development, and financial support helping smooth income shocks could contribute significantly to establishing secure professional trajectories and prevent individual to enter again into poverty. The design of benefits is also a key parameter. An excessively long duration or means testing, for example, create unemployment or inactivity traps and weaken the situation of those just above the poverty thresholds.

Trajectories to get away from poverty and exclusion can also be supported by labour market policies addressing segmentation and improving labour market transitions. In ES or PL for example, the share of involuntary temporary employment is high, and the transition from temporary contracts to permanent contracts is relatively low compared to the EU average, which threatens to be a source for recurrent poverty spells.

The costs of long-term exclusion

A body of academic research has analysed the consequences of poverty or exclusion for individuals and for society at large, focusing on aspects such as future earnings, loss of human capital – in terms of knowledge, skills and health status, social unrest, etc.

At the individual level, Irons (2005) show that unemployment and income losses potentially reduce educational achievement by threatening early childhood nutrition, reducing families' abilities to provide a supportive learning environment, and by forcing children to delay or abandon higher education plans. Bell and Blanchflower (2011) show that entering the labour market during a recession often leads to substantially lower lifetime earnings for graduates, increased risks of ending up in lower-level occupations, and an increased probability of participating in crime. They emphasise the delayed negative impacts of unemployment when young on well-being, health status, and job satisfaction, pointing out that short-run government savings may be at the cost of increased future expenditures associated with the negative

effects of youth unemployment and with reduced well-being. Dao and Loungani also present evidence that although the decline in earnings is generally observed for job losers in any period, it is most pronounced during a period of recession. They also document the adverse health outcomes associated with unemployment. Sullivan and von Wachter (2009) found increased mortality rate due to unemployment can persist up to 20 years after the job loss and lead to an average loss of life expectancy from 1 to 1.5 years.

Efforts to illustrate, or quantify, the costs of poverty and exclusion for society as a whole mainly rely on the observation that poverty is consistently linked to poor health, lower literacy, poor school performance for children, more crime, and greater stress for family members – and often for communities. It is therefore society as a whole that bears the costs of poverty and social exclusion, through higher public health care costs, increased policing and crime costs, lost productivity and lost tax revenues, foregone economic activity, and the intergenerational costs that flow from the likelihood that a significant number of children from poor families will also remain poor. Poverty and social exclusion is a waste of human capital both now and in the long term.

2.3.2. Child poverty

The main determinants of child poverty in the EU

The main drivers of child poverty are the exclusion of parents from the labour market (children in jobless households), in-work poverty (parents work but do not earn an adequate living), and the effectiveness of welfare support. Depending on the way parents' labour market participation and welfare support interact, countries can be grouped according to three major profiles associated with very different child poverty outcomes (see Table 8). It notably shows that countries that combine adequate family support with measures to facilitate parents' labour market participation have the best outcomes.

Group A comprises the Nordic countries, Austria, Slovenia and to a lesser extent, Cyprus and Estonia. There are fewer children at risk of poverty, and the child poverty gap is lower in these countries than in other EU Member States. This can be

Table 8: Relative outcomes of countries related to the main determinants of child poverty

Drivers…	…level of child poverty	Countries	Tentative diagnosis
Impact **of social transfers** is high Low share of children in **jobless households** **Low risk of poverty** of children whose **parents are working**	**Low risk of child poverty**	DK AT SI FI SE (CY)	***Lowest rates of child poverty*** *thanks to a good balance between income support, labour market conditions and services that facilitate labour market participation of both parents.*
Impact **of social transfers** is relatively high Relatively high share of children in **jobless households** **Low risk of poverty** of children whose **parents are working**	**Medium risk of child poverty**	CZ NL BE DE FR (LT EE)	***Low to above average rates of child poverty*** *thanks to a good income support, but the share of children living in jobless households is high.*
Impact of **social transfers** is high High share of children in **jobless households** Relatively lower risk of poverty Average level of in-work poverty	**High risk of child poverty** (low poverty gap)	IE UK HU	***Average child poverty rates****. The high impact of social transfers is mitigated by disincentives to work and lack of adequate and affordable child care for some categories of parents (e.g. lone parents)*
Low **impact of social transfers** in reducing child poverty. Limited share of children in jobless households **Very high risk of poverty** of children whose **parents are working**	**High risk of child poverty** (high poverty gap)	PL LV RO BG SK PT IT EL ES MT	***Highest rates of child poverty*** *due to insufficient support for families, both in and out of work, in terms of income and services and poor access to quality jobs, especially for second earners.*

Source: Eurostat EU-SILC 2010, European Commission (DG EMPL) calculation. Groups are obtained by cluster analysis based on scores related to the following variables: children living in a jobless household, children living in households at work and at-risk-of-poverty and the impact of social transfers on children's risk of poverty. For each of these variables, the scores reflect both the situation of children in the country versus the rest of the population, and the situation of children in the country versus the rest of Europe.

Note: LU has not been introduced in the classes as it appears as an outlier. Countries in brackets are to be considered as on the edge of the cluster.

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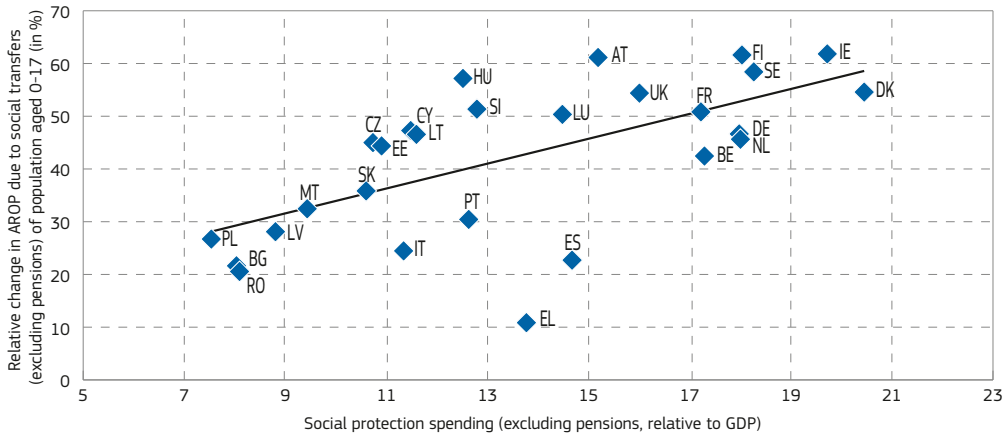
Chart 47: Relationship between social protection spending excluding pensions and child poverty reduction (2009)



Source: Eurostat. ESSPROS 2009 and EU-SILC 2010 (reference year 2009).

Note: y=2.4244x+8.9729
R^2=0.4068

excel file

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attributed to sound performance on all fronts: the high impact of social transfers in reducing child poverty, the low proportion of children in jobless households and low levels of children living in working poor households. Nordic countries achieve these goals despite a high proportion of children living in lone parent households, thanks to broad childcare provision and a wide range of reconciliation measures. While the impact of social transfers on children at-risk-of-poverty is relatively low in Cyprus and Malta, children in these countries have so far been protected against the risk of poverty by strong family structures characterised by two-adult families and complex households, in which most working age adults are at work.

Group B contains Belgium, the Czech Republic, Germany, France, the Netherlands and to a lesser extent Lithuania and Estonia. These countries achieve relatively good to below average poverty outcomes. The main matter of concern in these countries is the relatively high number of children living in jobless households. Among these countries, Germany and France are limiting the risk of poverty for children through relatively high and effective social transfers.

Group C comprises Hungary, Ireland and the UK. The main concern in these countries is the high number of children living in jobless households. In these countries, social transfers have a strong impact on the reduction of child poverty, which ensure a relatively low risk of child poverty in jobless households. However, the analysis shows that the design of transfers, compounded by a lack of adequate and affordable child care provisions, create disincentives to work for specific family types, such as lone parents who represent more than ½ of the jobless households.

Group C comprises Southern Europe Member States (Greece, Italy, Malta, Portugal and Spain) as well as most of the eastern and Baltic countries (Bulgaria, Latvia, Romania, Poland and Slovakia). These countries face a high risk of child poverty and a high relative poverty gap for children. The in-work poverty risk among families is high. Important factors seem to be: insufficient work intensity and low earnings (in Latvia, Lithuania, Poland, Portugal and Spain). In these countries, the level and effectiveness of social spending are among the lowest in the EU. Family structures and intergenerational solidarity play a role in alleviating the risk of poverty for the most vulnerable children. Living in multi-generational households and/or relying on inter-household transfers, whether in cash or in kind, may partly compensate for the lack of governmental support to parents in the most vulnerable situations.

Why are some social protection systems more effective and efficient at reducing child poverty?

Higher government spending on social protection is associated with a higher reduction in poverty rates (see Chart 47). However, some countries which invest similar shares of their GDP in social benefits, achieve very different child poverty outcomes (e.g. FI and BE or AT and ES).

Differences in the effectiveness and efficiency of social spending depend on the size, composition and design of the tax and benefit system. Analysis shows that child and family benefits have the largest impact on lifting children out of poverty; health care and unemployment benefits also play a significant role.

A recent Euromod paper[42] explores to what extent a country's effectiveness in reducing child poverty can be attributed to the size of family cash transfers (i.e. benefits and tax instruments alike) or to their design. The results confirm that the level of expenditure is significant. Nevertheless, effectiveness is highly dependent on the composition of the selected measures (universal, categorical, income selective) and the parametric choices of the inner design of policies (thresholds, benefit size determination, etc.).

As highlighted in 3.1.4, the balance between benefits in cash and in-kind also matter. For instance, Matsaganis and Verbist show that child care subsidies reduce the risk of poverty among children, make the overall income distribution less unequal, and are fiscally progressive. These effects are reinforced if a more dynamic perspective is adopted: subsidising child care helps improve

(42) Salanauskaite L, and G Verbist, 2011.

human capital and achieve higher female employment, both leading to greater prosperity and a more equitable income distribution.

An OECD study (OECD, 2011[43]) shows that net childcare costs are indeed a critical factor for parents' employment decisions. Where targeted support policies do not exist, the cost of childcare can consume a third or more of family budgets and will therefore be unaffordable, especially for low income families and lone parents. Existing barriers to employment participation of lone parents and second earners with low earning potential could be reduced by increased targeting, to low income families, of government assistance aimed at reducing the cost of childcare.

2.3.3. Migrants and ethnic minorities

In all EU countries, migrants have been especially affected by the crisis. Their already unfavourable labour market and social conditions were further aggravated. They were among the first to lose their jobs, and were often in more precarious conditions to begin with, making it more difficult for them to withstand the income shocks.

A recent Commission study on the costs and benefits of labour market policies gives some recommendations about how to best help vulnerable groups, and migrants in particular (European Commission 2012a). It suggests an extension of coverage and eligibility for the vulnerable groups in countries with ungenerous social protection. Further to that, coverage should be based on 'apparent employment relationship' or 'assimilated workers' rather than on the specific forms of employment contracts and more generous social assistance should be linked with strict job search and acceptance criteria. To achieve the best social inclusion outcomes for vulnerable groups, whose employment prospects are low and decrease from the start, the active measures should be applied from the start of unemployment. Employment incentives are specifically appropriate for vulnerable groups and should be focused on the long-term unemployed among these groups. Direct jobs and sheltered work can offer meaningful activities to migrants and other vulnerable groups. However, there is a risk of high costs of prolonged wage subsidisation and the loss of highly productive work of those who would have found a regular job otherwise. In this respect, work-integration enterprises cooperating with mainstream businesses offer a promising mechanism for up-skilling disadvantaged workers and integrating them into the main labour market.

2.3.4. Homelessness

Spending more than 40% of a household budget on housing costs is considered a heavy burden which increases the vulnerability of low income households to income shocks, and in some circumstances may lead to eviction or repossession. In the EU, ⅓ of the people at-risk-of-poverty spend more than 40% of their budget on housing. Between 2007 and 2010, this percentage increased by 3.4 percentage at EU level from 33.2% to 36.6%. In some countries, during the same period, the share of poor people facing a heavy housing cost burden nearly doubled from 22% to 40% in Spain, and from 12% to 26% in Ireland.

Homelessness has grown across the EU as many people experienced a sudden job loss or income drop in the recession. The crisis changed the profile of the homeless population. The traditional core consisting of people with long-standing social problems, the mentally disturbed and drug addicts was joined by young people and foreign nationals who have been disproportionately affected. Some countries, e.g. UK, Ireland and Estonia, suffering from a recession and the collapse of the housing bubble managed to contain the spread of homelessness through effective assistance schemes. The rise in homelessness has put extra pressure on service providers (NGOs, local authorities) which are struggling both with the increased demand for their assistance and with cutbacks in funding. The continuing austerity and the limited prospects for economic recovery are likely to make homelessness a salient social problem of the coming years.

2.4. EMU level stabilisers for better convergence

While most decisions about taxes and spending remain at the national level, EU Member States' leeway on fiscal policy is now constrained, first by the Stability and Growth Pact, reinforced by the Euro Plus Pact and the so-called six-pack. Moreover, more stringent requirements for national budgets are expected with the so-called Fiscal Compact[44]. All Member States (except the Czech Republic and the United Kingdom) have signed this intergovernmental treaty in March 2012. The Fiscal Compact requires Member States to introduce a requirement to have national budgets that are in balance or in surplus (a structural deficit of maximum 0.5% of GDP will be allowed). Such a rule will also be introduced in Member States' national legal systems at constitutional or equivalent level. The rule will contain an automatic correction mechanism that shall be triggered in the event of deviation.

These agreements do not turn the EMU, the group of states participating in the Fiscal Compact or the EU into a fiscal union. A fiscal union is based on the integration of Member States' fiscal policy whereby decisions about collection and expenditure of (some if not all) taxes are taken by common institutions, shared by the participating governments. It has been observed that there are no precedents for a monetary union without a fiscal union[45]. In the long-lasting debate of whether the EMU is a so-called 'optimum currency area', many claim that a successful currency union needs a risk-sharing system such as an automatic fiscal transfer mechanism to redistribute money to countries which are hit by asymmetric shocks. Such transfers could be organised through new levies or existing ones (such as value-added tax). In the new perspective of the Fiscal Compact, EMU-wide automatic stabilisers appear to be needed to attenuate the effects of asymmetric shocks. They would constitute an element of an EMU-level fiscal policy which would function as a complement to (increasingly restricted) national fiscal policies.

(43) The following text largely quotes the results of this study.

(44) See http://www.european-council.europa.eu/media/579087/treaty.pdf

(45) See Bini Smaghi, 2011.

EMU-wide automatic stabilisers

Enacting EMU-wide automatic stabilisers could help to dampen fluctuations in real GDP, in the case of asymmetric shocks affecting some parts of the EMU more than others (insurance function), and maybe also if asymmetric shocks affect everybody (stabilisation function).

Such instruments could serve three purposes:
(1) aid ailing Member States through transfers, avoiding social meltdown and thus potential negative externalities; in this respect they could help balance the negative effects of adjustments through 'internal devaluation';
(2) contribute to stability of the European economy through keeping up overall demand;
(3) contribute to the creation of a true single market, including for labour.

As far as economies of scale exist, they can be even more efficient than national schemes.

The desirable properties of an EMU-wide stabiliser type instrument (von Hagen and Hammond (1998)[46]) include:
(1) simplicity, both regarding financing and transfer of funds;
(2) automaticity, avoiding bureaucratic intervention;
(3) design ensuring that one way redistribution in the long run is avoided;
(4) avoidance of moral hazard;
(5) wide coverage and budget neutrality;
(6) whole amount collected must be distributed.

Prior to the financial crisis, the usefulness of redistribution to Member States hit by asymmetric shocks was questioned, as shocks to real per capita GDP in the EMU seemed to be positively correlated (symmetric). The economic crisis that started in 2008 has uncovered large asymmetries, aggravated by different sovereign debt dynamics across Europe, again strengthening the case for an automatic stabilisation mechanism. Nevertheless, as mentioned, EMU-wide automatic stabilisers would need to serve short- to medium-term problems only and avoid setting up long-term transfer flows. Structural divergence, such as in productivity levels, would need to be addressed through other means, such as product and labour market reforms and structural investments.

EMU-wide unemployment insurance

Cyclical unemployment is a key indicator of economic shocks. Moreover, given that there are significant differences and even divergent changes in unemployment rates, an unemployment insurance scheme is a natural candidate for becoming a European automatic stabiliser. This was also the choice of analysis for Italianer and Pisani-Ferry (1994).

A European scheme could be based on contributions, determined e.g. as the % of previous earnings. It would act as an automatic stabiliser, both through the revenue side (those undergoing a shock pay in less) and the expenditure side (those in a shock get more). Most likely such a scheme would benefit different countries over time, which could help its political acceptance. Back of the envelope estimation based on the number of currently unemployed show that payments from and EMU-level unemployment insurance scheme could amount e.g. to 2 % of Greek GDP – thus it could help crisis countries, but would not solve all their problems. Creating such a scheme would require considerable preparation[47].

Child basic income and other possible schemes

While not as effective a stabilizer as unemployment insurance per se (because of little cyclical increase on the expenditure side), an EMU-wide child basic income scheme, if jointly financed, would ease the situation of countries that face massive shocks. It could be a demonstration of the EU's commitment to children, to the future, and could contribute to the reduction of child poverty. It would also document the solidarity existing between people without and with children. A priori such a scheme need not be complicated and should be relatively easy to administer. Such schemes have been advocated by prominent academics including Atkinson and Marlier (2010).

Other similar schemes (always requiring common financing) could include:

- a youth grant, to promote e.g. education, staying in education, training, employment, volunteering;
- pensions, e.g. a 28th pension scheme, as proposed by Monti (2010), or a lump-sum scheme as a basic pension for all, along the lines of that advocated by Blackburn (2010);
- conditional EMU payments for MS in difficulty (cyclical grants);
- using EMU taxes as automatic stabilisers, e.g. making MS in difficulty pay less and receive more.

(46) Von Hagen, J. and Hammond, G. W., 1998; quoted in Bajo-Rubio, O. and Diaz-Roldán, C., 2003.

(47) Considerations to be addressed include: disincentives for MS with weak schemes to improve them, problems linked to the diversity of the EU situation, especially between structurally high unemployment and low unemployment countries (how to avoid low unemployment countries paying in the long term for high unemployment countries). Identifying the target population, and how the EMU scheme will interplay with current diversity of eligibility rules and generosity within EMU.

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