

6. SOCIAL PROTECTION AND THE SOCIAL REALITY OF EUROPE

There exists a longstanding and ongoing debate on the efficiency and equity of social protection systems in the European Union. This debate is coined mainly in terms of the sustainability of the social protection systems in the light of the ageing society, technological changes and globalisation; in many quarters also, however, questions are being asked about the adequacy of the social protection system in view of evolving family patterns, changing labour market situations and numerous reforms that have taken place during the past fifteen years.

The debate is heated and tends to be polarised along a continuum with, on one end, arguments that current systems are outdated, too expensive, and provide too many disincentives for labour market participation, and on the other end evidence showing that social protection systems are reforming and adapting to current societal changes, that the effects of an ageing society are manageable under the current configuration, and that workers need generous social protection systems if they are to adapt successfully to changing labour market situations.

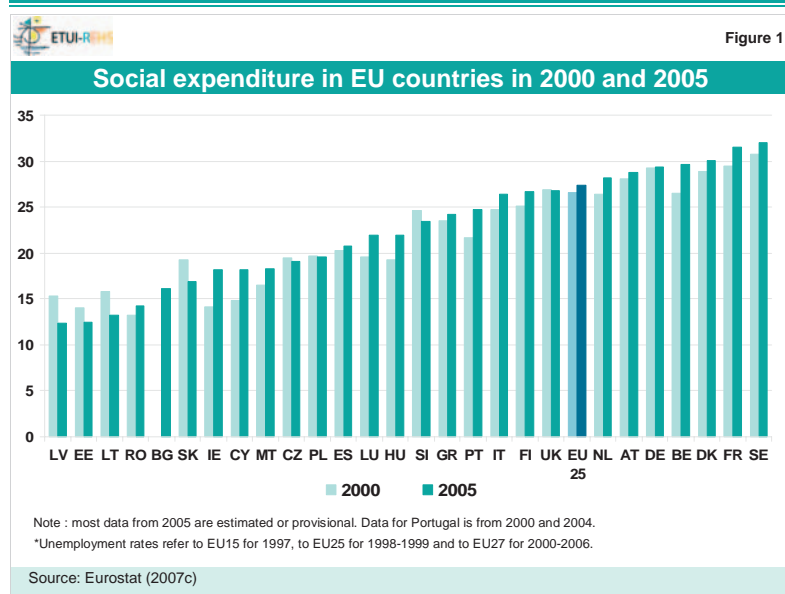
One of the biggest problems in seeking to marshal this debate tends to be the lack of comparable data that can give a good idea of the efficiency and equity of the various social protection systems to be found in the European Union. Economic methodologies – some of them quite doubtful – are being tested and promoted as able to clarify the issues at stake, but the matter is multidimensional and extremely complex. As such, it requires a multi-disciplinary approach that takes into account qualitative as well as quantitative aspects, and that examines institutions, policies, and actors, as well as capacity of implementation. This complexity notwithstanding, we shall endeavour, in this year's *Benchmarking Working Europe*, to put forward some of the existing data that can offer a hint of the efficiency of the social protection systems as they stand today, while remaining well aware that numerous recent reforms will affect both outcomes and indicators in the near or more distant future.

Themes

- 6.1. Development of social protection spending
- 6.2. The efficiency of social protection systems
- 6.3. Reforming pensions
- 6.4. Reforming unemployment benefit systems
- 6.5. Conclusions

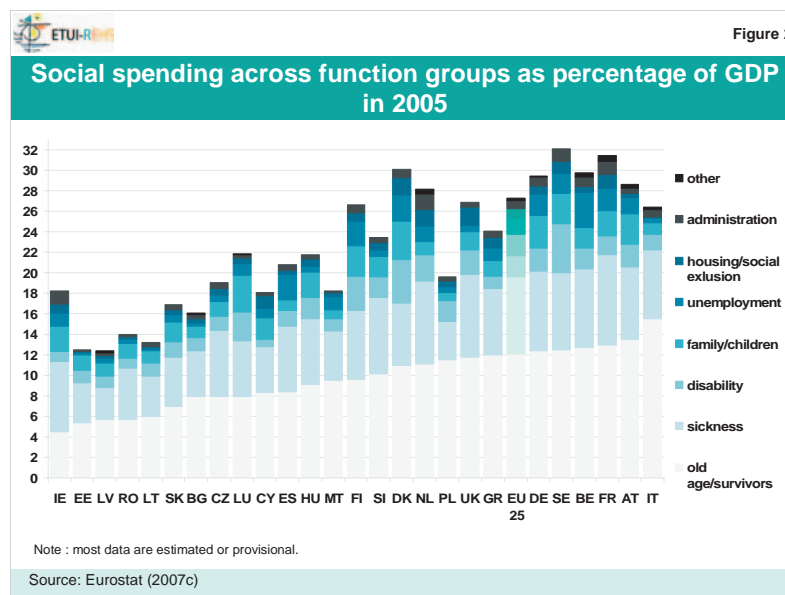
6.1. DEVELOPMENT OF SOCIAL PROTECTION SPENDING

TOTAL SOCIAL PROTECTION SPENDING STABLE



Total expenditure on social protection was 27.4% of GDP for the EU25 in 2005. This figure had remained fairly stable since 2004, when it was estimated at 27.3%, and was up 0.8% from 2000.

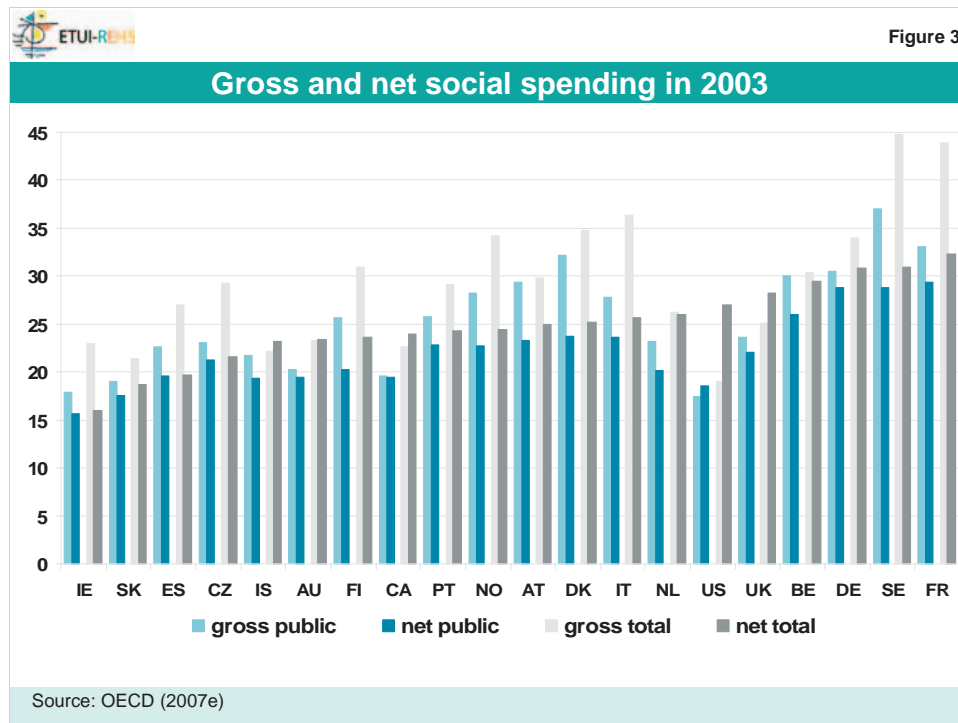
There is strong variation in the percentage of GDP spent on social protection across the EU member states, between a low of 12.4% in Latvia and a high of 32% in Sweden. Looking at the graph, it is possible to observe three groupings of countries according to the percentage of GDP spent on social protection. The eleven countries in the first group each spend less than 20% of their GDP on social protection. This group is almost entirely composed of member states that joined after 2004, the sole exception being Ireland. Countries in the second group spend between 20% and 27.5% of their GDP on social protection, 27.5% being the EU25 average. These nine countries have very different characteristics with regard to both geographical location and welfare state model, and include Spain, the UK and Finland. The seven countries in the last group spend between 27.5% and 32% of their GDP on social protection and include Nordic as well as continental welfare states. In the 2000-2005 period, growth in social protection spending across countries has been, as might be expected, unequal with significant decreases in the share of GDP spent on social protection in very low spending countries, including the Baltic states, while countries that already spend large shares of their GDP on social protection have stabilised or increased these shares.



The distribution of social protection spending across branches also differs across the EU member states. In EU25 12.1% of GDP was spent on old-age and survivors' pensions; somewhat less was allocated to health care and sickness benefits, with an overall average of 7.5% of GDP being spent under this heading. In comparison to the above branches, disability, unemployment and family benefits appear as relatively minor headings, with around 2% of GDP being spent in these areas. These EU25 averages conceal large variations in national spending, partly due to the overall weight of social spending in the GDP, but also due to the prioritising of specific branches within the construction of individual national social protection systems. In Ireland, where there has been a significant increase in social spending over the past years (see Figure 1), most of the increase has taken place in the areas of health care and family and child benefits. In Italy, on other hand, around 15% of GDP is spent on pensions, accounting for the bulk of all social protection expenditure.

6.1. DEVELOPMENT OF SOCIAL PROTECTION SPENDING

NET SOCIAL SPENDING SIGNIFICANTLY LOWER IN MANY COUNTRIES



The figures in Figures 1 and 2 do not, however, give a full picture of social spending. For the question arises of whether the social protection spending is financed via the state budget or privately. Then there is the crucial issue of the interaction between social protection and the taxation system. The tax system influences net social spending via three channels: by direct taxation and social contributions on social benefits; by indirect taxation on goods and services bought by benefit recipients; and, finally, by the way social policy is channelled through the tax system with tax relief being granted as an alternative to cash benefits or tax breaks awarded for specific private social benefits. For a number of years the OECD published a bi-annual study analysing this aspect, but unfortunately the most recent figures available are for 2003.

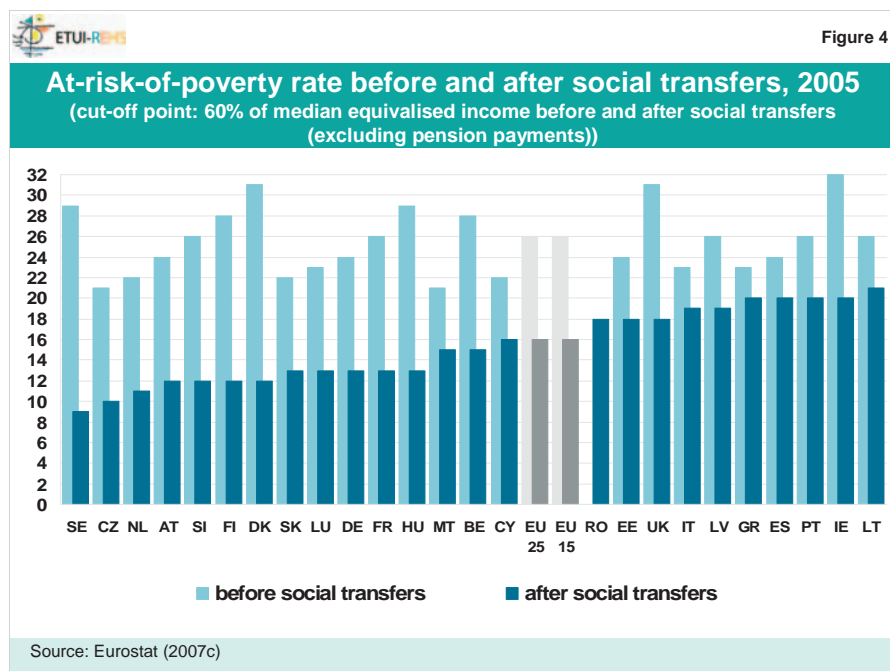
Taking into account this more complex reality of the cost of social protection somewhat changes the conclusions that could be drawn from Figure 1. Ireland remains the low spender, complementing the low public spending by higher private spending, as in the United States where public spending is at a level similar to that found in Ireland. Once private spending, and in particular its interaction with the taxation system, is taken into account, the percentage of GDP spent on social protection is quite similar to that of the Netherlands, Belgium and Denmark. Figure 3 clearly shows the importance of both private spending and taxation systems in providing social benefits and services. Reliance on gross data alone can give a biased picture of the net – and hence real – spending on social protection. It clearly emerges that when public and private spending, as well as the impact of the tax system on social expenditure, are taken into account, differences in the percentage of GDP spent on social protection across countries are diminished (Adema and Ladaique 2005). And in fact the real social expenditure is significantly lowered in most countries.

6.1. THE EFFICIENCY OF SOCIAL PROTECTION SYSTEMS

ALLEVIATING POVERTY AS OBJECTIVE

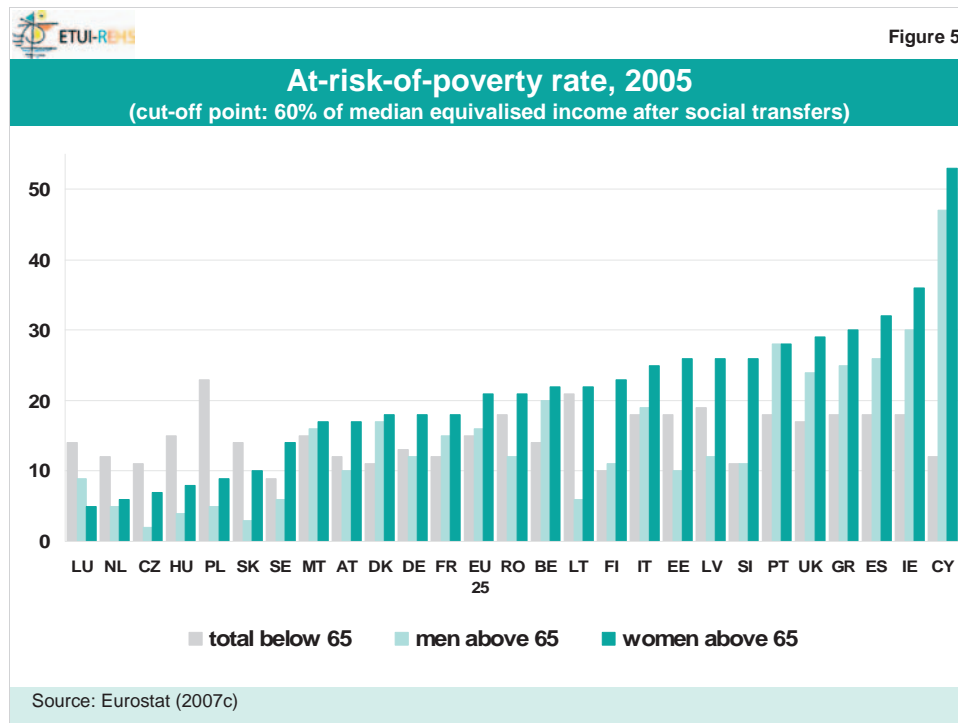
As stated in the introduction, there is an ongoing and heated debate on the efficiency of the social protection systems across the member states. With changing life and work patterns, an ageing population and demands for new services, current social protection systems are being called into question. Two main issues arise from this debate. Firstly, how to provide the services and benefits that the population expects at constant, or even decreasing, rates of spending? Secondly, how to contain costs in the light of growing demands? In the context of this discussion there has emerged a call for a new policy paradigm aimed at promoting social inclusion and activation instead of social relief and accommodating policies. The main argument is that current social protection systems and social policies are not geared towards today's needs and that there is a need for redirection in the way social benefits and services are organised and provided in order to strengthen incentives to work and create jobs.

However, there can be no doubt that the main branches of social protection spending, namely health care and pensions, are not geared principally to the aim of providing incentives to work or create jobs. A good health system is an important element in ensuring a healthy and hence productive workforce and population, just as pension provision is of vital importance for that section of the population that has already contributed to economic growth or who no longer have the capacity to work. Unemployment benefits, meanwhile, enable workers to bridge periods where they are out of work and invest their time and energy in finding the right match for their next employment. The purpose of disability and housing benefits and social inclusion is to keep families and individuals out of poverty and within the mainstream of society. Measuring the efficiency of the social protection system is an extremely complex and controversial issue. Firstly, there is the issue of establishing the real expenditure as discussed in the previous section; secondly, there is the issue of measuring the outcome of the spending, and hence the ability to achieve a set objective. Without exploring this issue in length, it might be argued that one measure of efficiency is the ability of the social protection transfers to lift the population out of a potential poverty situation. Figure 4 displays the results achieved in this respect. It will be seen that there are big differences in the ability of social transfers to lift the at-risk-of-poverty population out of that situation. This effort is dependent on numerous factors such as the types of social benefit and service provided, their coverage rate, as well as their generosity and ability to alleviate the various situations that cause poverty. In most countries – for example, Sweden, the Czech Republic and Denmark – the size of the at-risk-of-poverty population is more than halved thanks to social transfers. In some countries, including Italy, Greece, Spain and Estonia, the reduction is much smaller. The reasons for this difference are, as already mentioned, manifold and complex. However, Figure 4 shows that, while there is clearly scope for improvement, many countries do have what can be qualified as efficient systems which more than halve the at-risk-of-poverty rates.

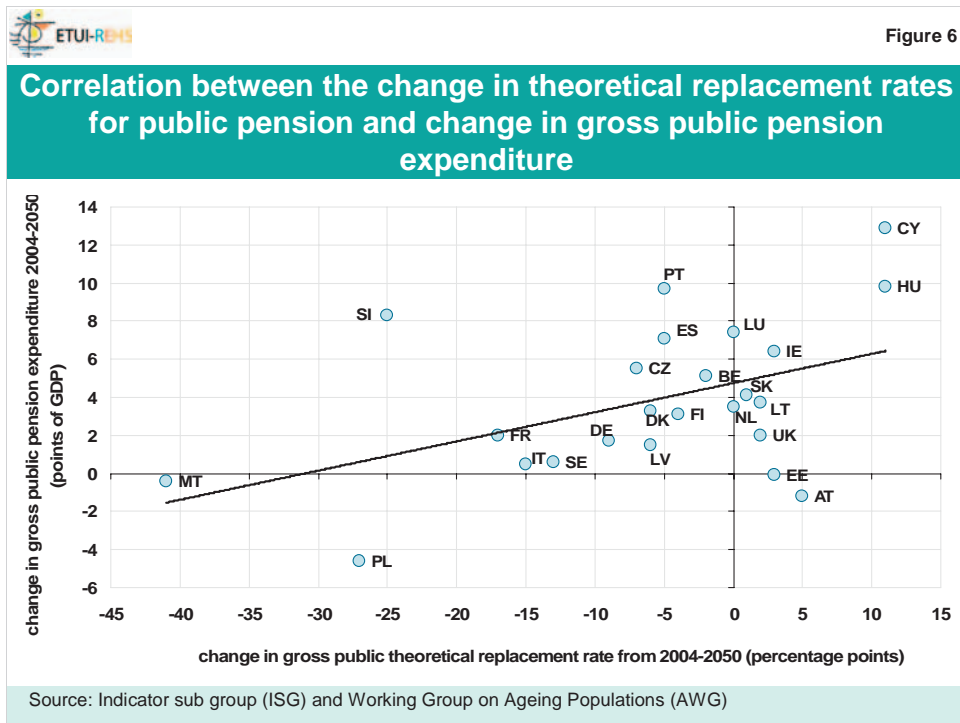


6.2. THE EFFICIENCY OF SOCIAL PROTECTION SYSTEMS

WOMEN ABOVE 65 YEARS OF AGE AT RISK OF POVERTY



As can be seen from Figure 5, over the past fifty years most member states have been able to decrease old-age poverty for men quite dramatically, while old-age poverty is still an important issue for older women, the risk-of-poverty rates being far higher for women than for men in old age (except in Luxembourg). As by far the largest part of a pensioner's income in the members states is provided by the statutory pension, there seems to be an argument that the efficiency of social protection systems in lifting people out of poverty once they have retired is succeeding for men. However, there seems to be an issue with regard to the systems' ability to provide older women with a pension sufficient to prevent their lapse into poverty. The issue of older women in poverty is well identified, but not very well dealt with policy-wise. In *Benchmarking Working Europe 2007* the effect of labour market interruptions on pension replacement rates was discussed and it was clearly shown that this has a negative effect on pension replacement rates in several of the member states. If to this is added the fact that women on a weekly, monthly, as well as life-time basis, work fewer hours, one could expect to observe higher rates of poverty among older women due to lack of pension rights. Hence there is scope for measures that, on the one hand, assure a continuous labour market participation of women and, on the other hand, take into account the lower number of hours worked over the lifetime, especially in a context where pension benefits are becoming more closely linked to contributions.

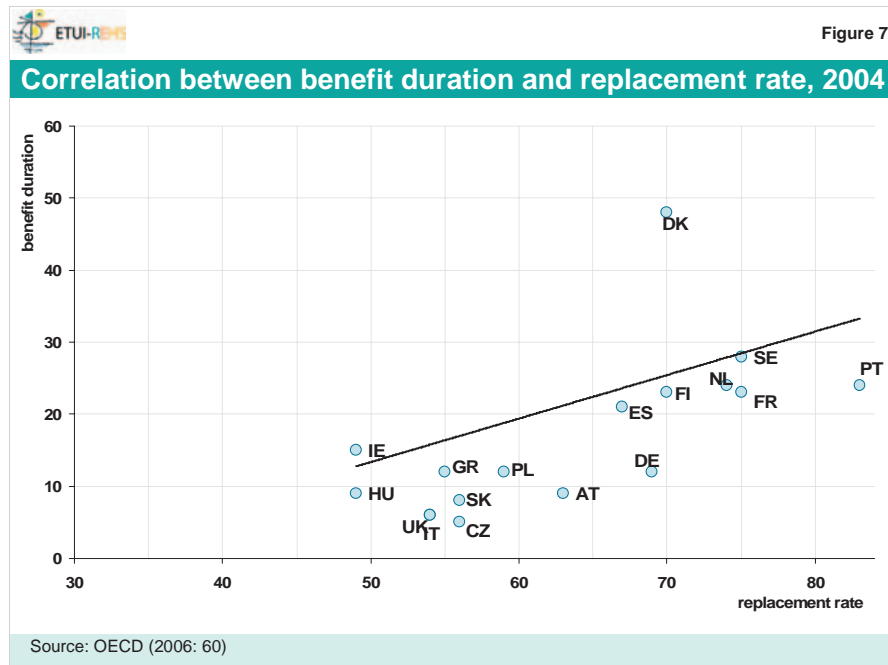


In the light of the changing configuration of the demographic landscape, most member states have, however, already undertaken quite radical reforms of their pension systems in order to make them financially sustainable. The extent of the reforms can be observed in the projected change of the rise of pension spending as a percentage of GDP. Whereas the percentage of GDP spent on social protection was projected in 2000 to rise by 8% between 2000 and 2050, the most recent computations show that the expected rise is now only 2.2%, the main reasons for this being an expected increase in employment rates, later retirement and a decrease in the replacement rate. Accordingly, there is reason to believe that the issue of sustainable financing of the statutory pension schemes has been placed on a secure footing in most European countries. However, there now seems to be reason to give more thought to the adequacy of the pension systems, insofar as the replacement rates are set to decrease. Figure 6 displays the relationship between the projected change in public pension replacement rates and the projected changes in expenditure on public pensions. It seems quite clear that the replacement rate is expected to decrease in a majority of member states, and that public spending is expected to increase by less than 4 percentage points in a majority of countries, and even to decrease in some.

In order to counterbalance the decrease in replacement rate of the statutory system, and hence either replace the statutory pension scheme or complement a rather low rate of statutory pension payment, there has been a major surge in private pension schemes over the past ten years. The development of private pension schemes has often been encouraged by public policies, by linking their development with tax incentives and introducing legislation that opens up the avenues for establishing and securing these new types of provision. However, private pension provision is designed, organised and managed in very different ways across the European member states. Furthermore, their importance in terms of coverage rates and income replacement also differs widely across the members states. As such, the issue of adequate pensions will continue to be an issue to be monitored and analysed in the light of societal changes – such as changing patterns of labour market career and changing family structures – and, especially, in the light of the recent reforms of public pension systems and the growing importance of privately managed pensions provision.

6.4. REFORMING UNEMPLOYMENT BENEFIT SYSTEMS

POSITIVE CORRELATION BETWEEN NET REPLACEMENT RATE AND BENEFIT DURATION



Another branch of the social protection system that has undergone deep change during the past ten years is the unemployment benefit system. A profound paradigm change has taken place with regard to the objectives to be fulfilled by an unemployment benefit scheme, the main aim having shifted from that of providing replacement income between jobs, and hence enabling an efficient match between the unemployed and the potential employer, towards one of being a main ingredient in an active welfare state and hence with a particular focus on providing incentives, both negative and positive, to transit towards employment as quickly as possible. All unemployment benefit schemes have undergone reforms designed to strengthen the rights and obligations of the unemployed, but also to cut back on the generosity of the systems in terms of replacement rates and duration. The activation of unemployment benefits has become the rule rather than the exception across the member states. Activation requirements relate to proof of regular job search, participation in active labour market policies either via a job placement or training, and failure to comply with these obligations can be sanctioned by benefit cuts. The rights are found in terms of support in establishing a plan for future labour market participation, as well as offers of training and job openings. However, the quality and enforcement of the rights and obligations vary widely across the member states; and there is also considerable variation in the importance accorded to providing the unemployed with income as well as enabling support. Figure 7 displays the correlation between the net replacement rate of unemployment insurance benefits at the beginning of an unemployment spell and the duration of the unemployment insurance benefit. Three observations are appropriate here. Firstly, the variation in the net replacement rate across the member states is lower than might be expected, with a low of 49% in Ireland and Hungary and a high of 75% in Sweden and France. Secondly, the greatest differences between countries are to be found in the duration of unemployment insurance benefit, with a low of five months in the Czech Republic and a high of unlimited duration in Belgium. Thirdly, there is a positive correlation between the net replacement rate and the duration of benefits, indicating that there is no trade-off between high replacement rates and duration of benefits but rather complementarities with high replacement rates being accompanied by – relatively – long durations and low replacement rates by short durations.

6.4. REFORMING UNEMPLOYMENT BENEFIT SYSTEMS

ACTIVATING UNEMPLOYMENT BENEFITS

ETUI-ROHS

Figure 8

Activity grade of benefits (share of active expenditure in total expenditure)

	1999	2004
Austria	23.7	23.6
Spain	30.5	26.9
Germany	33.6	27
Greece	37.6	27
Finland	28.5	27.4
Belgium	30.2	27.7
Portugal	28.2	29.5
France	40.8	29.7
Netherlands	30.8	33.5
Ireland	44.3	35.4
United Kingdom	26	36
Denmark	41.6	36.3
Sweden	54.3	43.2

Source: Eurostat (2007b)

Furthermore, there is evidence pointing to the fact that generous unemployment benefits have a positive impact on productivity (OECD 2007b). This can be explained by two factors. Firstly, the unemployment benefits enable the unemployed to make higher quality job matches, thereby increasing the efficiency of the allocation of the workforce. Secondly, generous unemployment benefits can also have the effect of encouraging the creation and take-up of high-productivity/high-risk jobs. Accordingly, there would seem to be support for the case of providing generous unemployment benefits, both in terms of replacement rates and duration, in order to achieve efficient allocation of the workforce and encourage the take-up of high-risk/high-productivity jobs.

In addition to income replacement, unemployment benefit systems are closely linked to active labour market programmes. As described above, there has been a general trend to focus and encourage activation of the unemployed. However, as Figure 8 shows, the policy ideas and discourse do not seem to translate into a greater distribution of unemployment-related expenditure towards the active measures. This was discussed in last years *Benchmarking Working Europe*.

Social protection systems are fundamental elements of the European social model. They are key in ensuring universally high levels of security while at the same time promoting a high level of employment and contributing to increasing productivity. However, the current configurations are being challenged in the light of technological, societal as well as demographic developments. The figures on social protection expenditure show us that, overall, there does not seem to be a retrenchment of social protection systems. On the other hand, the figures also show us that the “catch-up” effect usually observed after EU enlargement is only partly materialising at the present time. Furthermore, the ability of social protection systems to lift the population out of the risk of poverty is far from equally distributed across countries as well as across population groups, leaving older women especially at risk of poverty in all member states.

A closer look at two specific branches of social protection, namely old-age pensions and unemployment systems, can provide a hint of some of the challenges and responses currently observed. Most pension systems across the EU have undergone rather radical reform over the past ten years and more are probably to come. These reforms have generally been undertaken in the light of the ageing population and have served to assure a certain degree of financial sustainability for the member states. In most member states the reforms will lead to a decrease in replacement rates, thereby raising the issue of income adequacy in old age and how this issue is to be brought to the fore. The unemployment systems have likewise undergone rather fundamental reforms over the past ten years, with a particular focus on decreasing benefit replacement rates and duration while at the same time establishing various measures to activate and help the unemployed to find work.

However, evidence is emerging of the positive impact of generous unemployment benefits – in terms of replacement rate and duration – on productivity, thereby lending support to the original idea of unemployment benefits as enabling and ensuring efficient job matches and higher risk-taking by both employers and employees. Another finding is that the policy-making and debate focused on activating unemployment benefits does not seem to translate into attributing a higher share of expenditure on employment to active measures.

There are many other issues requiring analysis and debate in relation to social security systems and their main purpose. As society and preferences change, and new labour market patterns arise, it seems appropriate to adapt the welfare states in order to take these changes into account. Extending and improving a system does not necessarily imply a net increase in spending, but it can surely imply better allocation of the workforce, as well as a more productive and a more adaptable workforce. Whereas the recent past has been characterised by a rather imbalanced focus on making social protection systems financially sustainable, there would seem currently to be a rationale in favour of refocusing the debate on the essential aims and main purposes of a social protection system.