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COMMISSION STAFF WORKING DOCUMENT

Employment and Social Developments in Europe 2014

Chapter 1:
The legacy of the crisis: resilience and challenges

Volume 1/3

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INTRODUCTION

The most severe financial and economic crisis to have hit Europe since the 1930s has had a major impact on the employment and social situation across the Union. Unemployment, poverty and inequality have seriously worsened in many countries and a return to pre-crisis levels is not foreseen before some time. Individuals and households have been obliged to develop coping strategies in the face of the deteriorating economic situation and with the prospect of only a slow and uncertain recovery. All of this is liable to have negative long-term effects on labour market participation and to lead to a permanent loss of human capital. Meanwhile, rising level of inequalities and the ability of institutions to deal with the crisis also impacted the trust in institutions.

The recession has also been a live stress-test for both social protections and labour market systems and institutions, with Member States' performances diverging in terms of economic as well as of employment and social outcomes. They have shown different degrees of *resilience* i.e. their capacity to limit the initial impact of the economic shock on labour markets and incomes; to recover quickly; and to progressively ensure a job-rich and inclusive growth.

This chapter focuses on the potential contribution of employment and social policies to resilience, paying particular attention to the effects of imbalances (such as high levels of unemployment and inequalities, under-investment in education, levels of household debt, etc.) as well as their differing mixes of social and labour market policies both prior to, and during, the crisis.

- Section 1 of the chapter reviews how labour markets and social outcomes have developed since the onset of the recession, in particular with severe impacts for some groups and countries and changes in participation to education and the labour market.

- Section 2 highlights the possible long-term consequences of unemployment and economic hardship including potential scarring effects on unemployed young people, 'coping strategies' during the crisis and the weakening trust in institutions.

- Section 3 analyses the developments of social spending in terms of its three main functions: investment, stabilisation and protection and their link to labour market outcomes as well as the potential role of better synchronising benefits to the economic cycle for the resilience of Member States and the role of the financing of social protection.

- Section 4 investigates the impact of labour market institutions such as unemployment benefits, employment protection legislation and active labour market policies during the recession as well as policy changes since 2008.

- The concluding section summarises both the findings and the main policy implications.

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1 THE LEGACY OF THE CRISIS ON THE EMPLOYMENT AND SOCIAL SITUATION

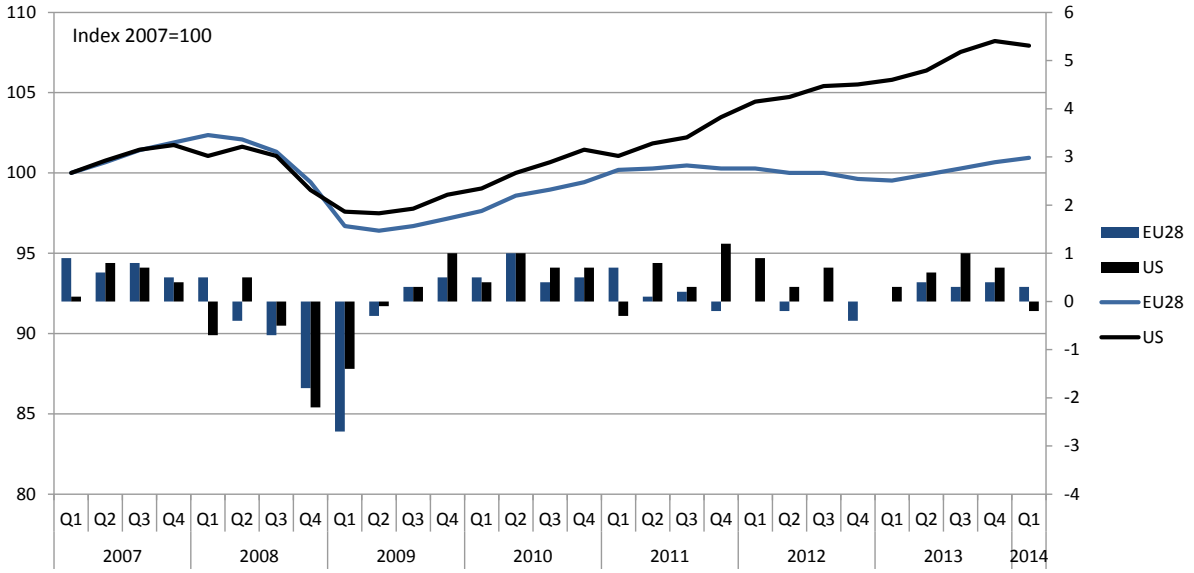
1.1 Long and protracted recession

Various impacts of the economic downturn on employment and incomes

Since 2008, the EU has experienced a recession of exceptional magnitude and duration from which it has been slow to emerge, with real GDP in 2014 exceeding pre-recession levels by only around 1 % in the EU and with euro area GDP still below its 2007 level.

This contrasts with the US where real GDP is now 8 % higher than it was in 2007. Moreover, within the EU, there is a growing gap between the countries that experienced a double dip recession in 2012 and the others. Five years into the recession, real GDP remains substantially below (5 % or more) pre-crisis levels in many countries including Italy, Spain, Portugal, Greece, Slovenia and Finland. This is especially worrying, given the long-term effects of the comparatively milder recession of the 1990s ([1]) when employment rates declined and took several years to recover, notably in the Nordic countries ([2]).

Chart 1: Real GDP in the EU, euro area and US (left), and percentage changes over the previous quarter (right)



Source: Eurostat, National Accounts, data seasonally adjusted [namq_gdp_k]

In the first phase of the crisis (2008–10) the fall in employment in most EU Member States was significantly less than the decline in economic activity especially when compared with the US ([3]).

([1]) In the 1990s, most EU countries experienced only one year of negative growth and after five years real GDP had increased by 5 to 15 %, with the exception of Sweden and Finland which experienced long and deep recessions.

([2]) Social situation monitor, Scarring effects of the crisis, Research note 06/2014.

([3]) European Commission (2010a), Employment in Europe.

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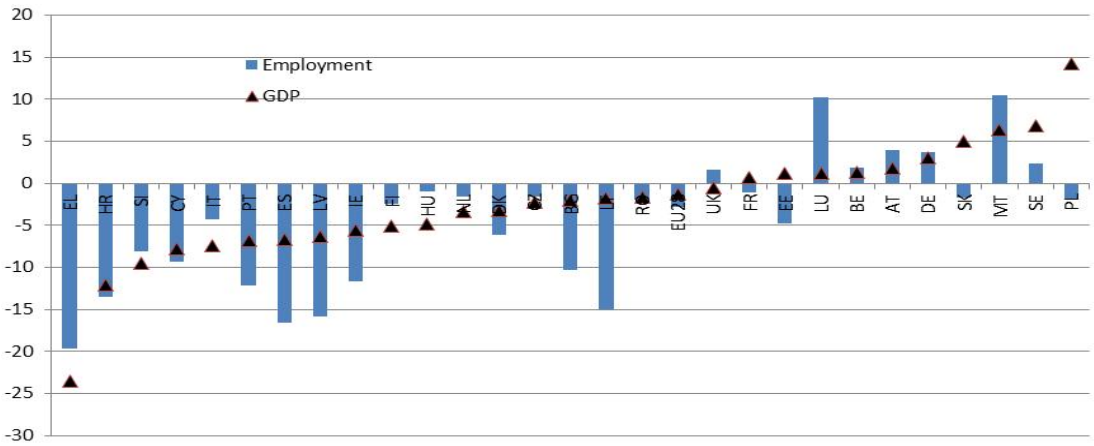
However the decline in economic activity had a much greater impact on employment in some Member States ([4]) see Chart 2. Some of this can be explained by structural factors. In Spain, for example, the disproportionate impact on employment (almost twice as large as the economic shock) ([5]), reflected the relative importance of the construction sector and the country's highly segmented labour market ([6]). In contrast, the strong decline in GDP in Germany was absorbed through a reduction of working time (as well as productivity) rather than a reduction of employment, notably due to the widespread use of short-time working arrangements (as also used in Austria and Belgium) ([7]). Finally, it should also be noted that the more or less large transmission in terms of employment and income impacted later on GDP through the channel of aggregate demand.

Chart 2: Change in GDP and employment between 2008 and 2013, EU Member States, in %



Source: Eurostat, nama_gdp_k and nama_aux_pem

Variations in the stabilising impact of national welfare systems also explain some of the differences in the impacts of job losses and reduced working time on household disposable income across different countries (GDHI, see Chart 3). For instance, in Italy, the decline in employment resulted quickly in a disproportionate drop in household incomes while the sharp decline in employment in 2009 in Spain and Ireland did not result in any immediate fall in income due to the effects of a fiscal stimulus and automatic stabilisers (though income levels did drop later as benefit payments ran out). In the UK, the moderate impact on employment was nevertheless followed by a drop in household incomes, while in Sweden and France the declines in employment levels did not translate into reduced income levels.

([4]) By contrast, in Germany the manufacturing sector was badly hit by plummeting exports but high productivity levels led to a comparatively small fall in employment relative to that in GDP.

([5]) i.e. employment volume declining by almost 7 % in the year to 2009 Q3, compared to a decline of the GDP by around 4 %.

([6]) In Poland the high share of temporary workers also explains the decline in employment that occurred despite a rather favourable change in terms of GDP (decline in growth but no recession).

([7]) The cost of adjustment was spread across the workforce instead of, in case of extensive reliance on layoffs, being concentrated on a relatively small number of workers suffering large losses of income (Cahuc and Carcillo (2011)).

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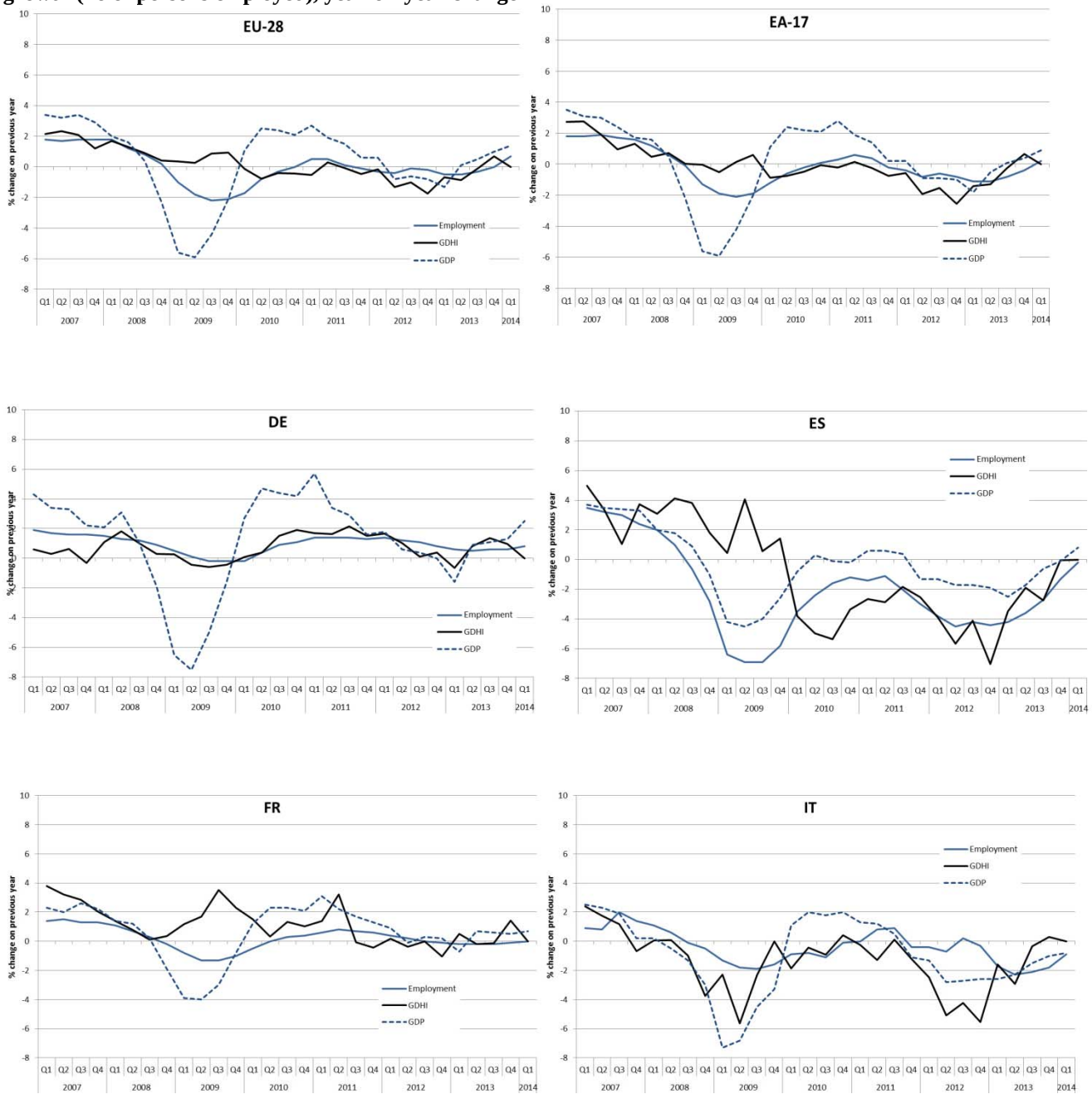
Chart 3: Real GDP growth, real Gross Disposable Household Income (GDHI) growth and employment growth (no of persons employed), year-on-year change



Source: Eurostat, National Accounts [namq_gdp_k, namq_aux_pem, nasq_nf_tr and namq_fcs_p] (DG EMPL calculations)

A strong and uneven impact on unemployment

For the EU as a whole, the unemployment rate rose from 7.0 % in 2008 to 9.6 % in 2010, reaching 10.8 % in 2013. Chart 4 shows that, in two-thirds of EU countries, unemployment increased mainly in the period up to 2010 but that in those countries that experienced a double recession, unemployment rose substantially after 2011. The impact was strongest (in terms of

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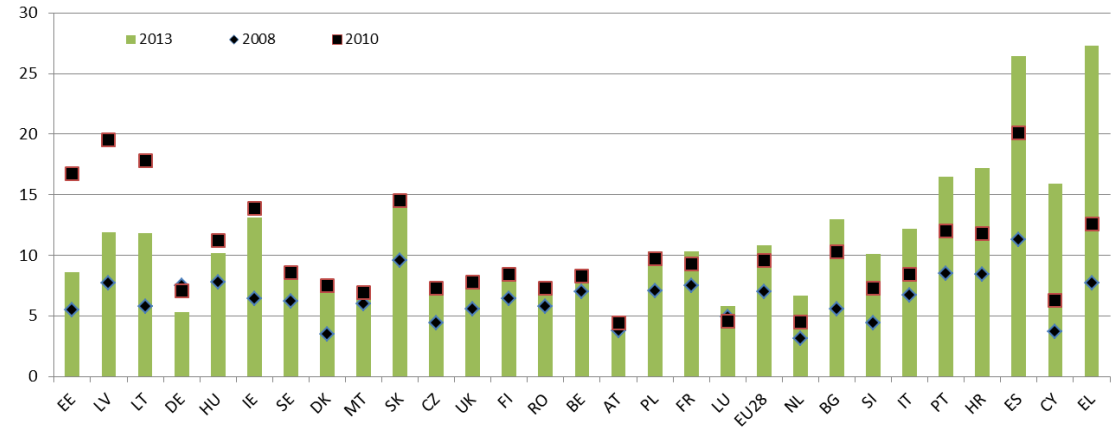
percentage points) for the young, the low-skilled and non-EU foreign workers — groups that already faced higher risks of joblessness before the recession.

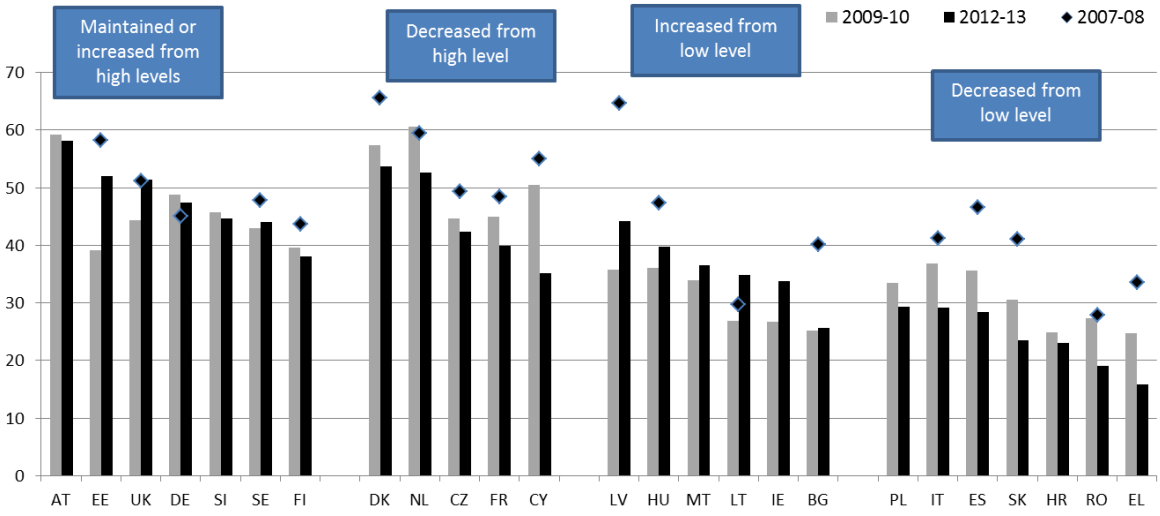
Chart 4: Unemployment rates by EU Member States, 2008, 2010 and 2013 (% of active population, 15–74)



Source: Eurostat, une_rt_a

The persistence of unemployment (likelihood to remain unemployed after one year) has increased during the crisis with 38 % of people who became unemployed in 2012 still looking for a job in 2013, compared to 27 % between 2007/08 ([8]). This persistence rate was much higher for the long-term unemployed (63 % between 2012/13, compared to 50 % between 2007/08) confirming previous research findings ([9]).

Chart 5: Exit rate from short-term unemployment (less than one year) into employment between 2012/13 and changes compared to between 2009/10



Source: Eurostat, EU-LFS, ad-hoc transition calculations based on longitudinal data. No data for BE, LU and PT. Exceptions to the reference year: NL: 2011/12 instead of 2012/13; AT, HR, PL, SI and UK: 2010/11 instead of 2009/10; DE and LT: 2008/09 instead of 2007/08. Member States with high (low) levels in 2009/10 are those

([8]) Persistence rate estimated as the ratio between the number of unemployed with a duration of 12–24 months and those unemployed for fewer than 12 months one year before.

([9]) Individual characteristics also matter: those who become long-term unemployed are likely to be those for whom finding a job was initially the most difficult. Cockx and Dejemeppe (2012) shows for various European countries that the duration dependence may be a *spurious* one.

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having an exit rate higher (lower) than 39 %. Member States with decreasing (maintaining/increasing) levels are those where the exit rate decreased by more (less) than 1.5 pp between 2009/10 and 2012/13.

While exit rates from short-term unemployment into employment ([10]) worsened in almost all Member States between 2007/08 and 2009/10, there have been divergent developments since then. In some countries, the chances to return to employment improved again between 2010 and 2013, while they worsened further in others. Labour demand is a key factor explaining differences in the exit rates out of short-term unemployment ([11]) although other factors are at play ([12]) such as differences in labour market institutions between Member States, see European Commission (2012a) and Section 4.

In 2013, the number of long-term unemployed (without work for 12 months or longer) exceeded 5 % of the active population in 2013, almost double the rate of 2008 ([13]) (see Chart 7). Given the slow pace of economic recovery in most countries, there is thus a serious risk that many long-term unemployed will remain without a job for a long time. Indeed, transition rates for the long-term unemployed into employment worsened between 2007/08 and 2009/10 in most Member States, and have stayed low since.

While most countries with high exit rates from short-term unemployment also have high exit rates for the long-term unemployed, a few countries (such as Germany and the UK) that manage to ensure rapid rates returns to employment for the short-term unemployed, have nevertheless relatively low exit rates for the long-term unemployed ([14]), see Chart 6. In these countries, a limited proportion of the unemployed become long-term unemployed but when they do, they have difficulties returning to employment.

([10]) Based on longitudinal data from the EU-LFS.

([11]) For instance, for the 22 Member States for which the data is available, there is a positive correlation (+0.59, significant at 1 %) between the exit rate from short-term unemployment (into employment) in 2012-13 and the job vacancy rate in 2012.

([12]) Recently (2010–13), changes in employment appear less correlated with the variations of the exit rates out of short-term unemployment into employment than in the initial phase of the recession (2008–10), i.e. equal to 0.70 and 0.92 respectively (both significant at 1 %).

([13]) In absolute terms, the number of long-term unemployed in the EU-28 increased from 6.2 million in 2008 to 12.3 million in 2013.

([14]) The gap between the exit rates for short versus long-term unemployed is much higher in the UK and Germany (respectively 22 and 19 pps) than the EU average (11 pps, with rates of 38 % and 27 %). On the contrary Denmark and Estonia manage to maintain high exit rates into employment also for the long-term unemployed and have relative low gaps between the two rates (respectively 8 and 6 pps).

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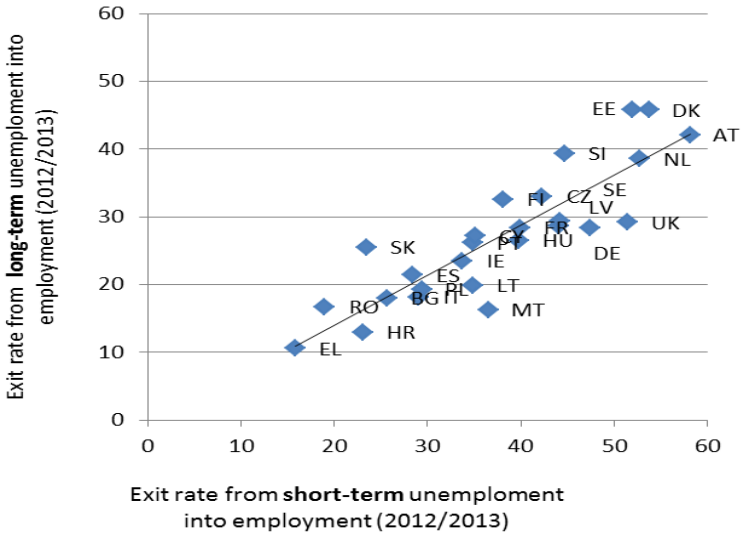
Chart 6: Exit rate from short-term unemployment (less than one year) and long-term unemployment (more than 1 year) into employment between 2012/13

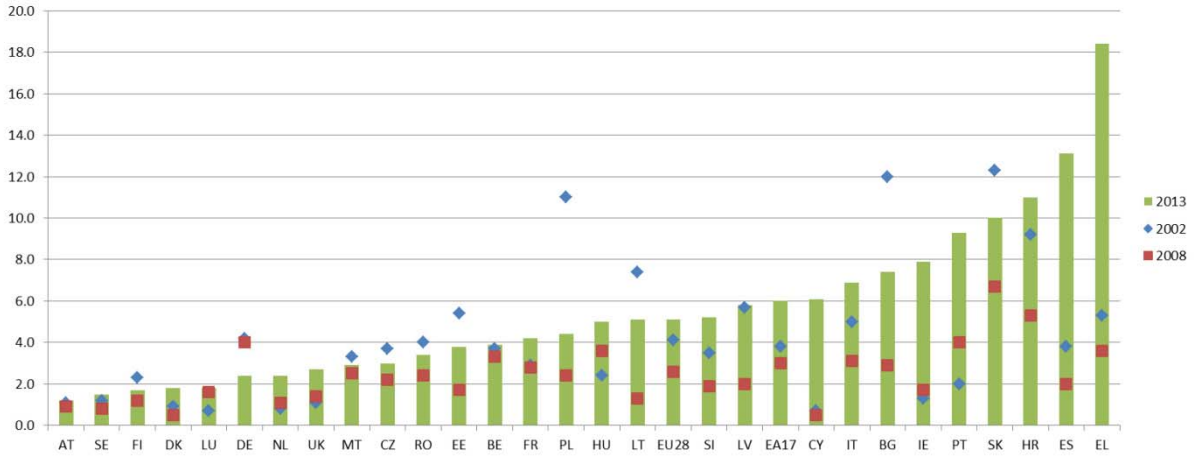


Source: Eurostat, EU-LFS, ad-hoc transition calculations based on longitudinal data. No data for BE and LU. Exceptions to the reference year: NL: 2011/12 instead of 2012/13.

Exit rates out of long-term unemployment seem less sensitive to changes in the economic cycle ([15]) than they are for the short-term unemployed, which suggests that an economic recovery may not bring back into employment many of those who are currently long-term unemployed. This is likely to have lasting negative consequences, such as the depreciation of human capital, negative signalling effects for potential employers and demotivation for those concerned, with further risks in terms of benefits dependency, poverty and social exclusion.

It should also be noted that 20 % of the long-term unemployed in 2013 have never worked before and are likely to need various forms of support in order to find a first job. This raises concerns regarding access to benefits and the risk of social and economic marginalisation.

Chart 7 — Long-term unemployment in % of active population for EU Member States (2002–2008–2013)



Source: Eurostat, EU-LFS [une_ltu_a]

([15]) For instance, the coefficient of correlation with changes in employment over 2008–10 is much stronger for the exit rates out of short-term unemployment into employment (0.92, significant at 1 %) than with the exit rates out of long-term unemployment (0.53, significant at 5 %).

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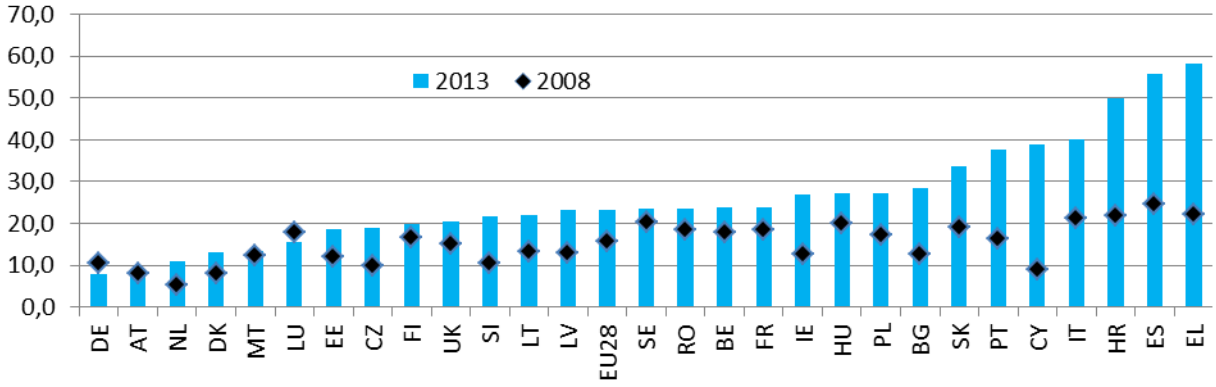
Young people tend to experience shorter spells of unemployment and higher transition rates into employment than other age groups, but this is less true now than it was in the past ([16]), with an increase in the share of long-term unemployed among the young unemployed, especially for the age group 25–34 ([17]). Significantly, however, having a tertiary degree appears to be a form of protection against long-term unemployment, albeit probably at the expense of less qualified young people competing for the same jobs.

Levels of unemployment among youth tend to vary more than total unemployment because their job prospects are more sensitive to the business cycle ([18]) and because of the variety of policies and institutions supporting school to work transitions (education and training systems, contractual arrangements, minimum wage, etc.) ([19]). In this respect, the apprenticeship systems in Germany and Austria are commonly highlighted as being mechanisms that overcome many of the obstacles and, in particular, ensure high transition rates from temporary to permanent contracts (Eichhorst et al, 2012).

Chart 8 — Youth unemployment in % of active population (aged 15–24)



Source: Eurostat, EU-LFS [lfsa_urgan]

In 2013 the proportion of young people aged 15–24 in the EU who were neither in employment, education or training (commonly called NEETs) was 13.0 % in 2013 (compared to 10.8 % in 2008), and exceeding 20 % in Greece, Bulgaria and Italy ([20]). In most countries, however, the increase in the NEET rate since 2008 has been mainly the result of an increase in unemployment, rather than inactivity ([21]), which implies that most 'newly' NEET young people are actually looking for work.

([16]) According to longitudinal data of the EU-LFS (European Commission (2012a), Chapter 1), even if young people continued to have better exit rates out of unemployment than older workers, their situation worsened since 2008. In 2010-11, they had a much higher chance of losing their job (8 %) compared to prime-age (3 %) and older (2 %) workers. In addition their transition rate back into employment had sharply diminished, from 40 to 30 %. These findings are confirmed by analysis of RWI (2014) drawing on micro-data from the EU-SILC.

([17]) Strictly speaking the group of young people is defined as those aged 15–24; however for many indicators analysis of the age group 25–34 is also meaningful as this age group has also been strongly affected by the crisis.

([18]) According to IMF (2014), the business cycle 'explains up to 70 % of changes in the youth (15–24) unemployment rates in stressed euro area countries'. It estimates that an additional percentage point of annual growth could lower the unemployment rate from 0.8 pp in Greece and Portugal to 1.9 pps in Spain.

([19]) Another factor explaining the wide variation of the youth unemployment rate across Member States is the very diverse level of participation of young people in the labour market while still being in education.

([20]) In Bulgaria, Romania and Italy the majority of young NEET were inactive, in Greece, Spain or Croatia most of them (around 70 %) were unemployed (i.e. looking for a job).

([21]) At EU level, the share of unemployed in the whole age class 15–24 has risen by 2.6 pps (from 6.6 % to 9.2 %) while the number of inactive (not in education or training) only slightly changed (by 0.3 pp, from 7.4 to 7.7 %).

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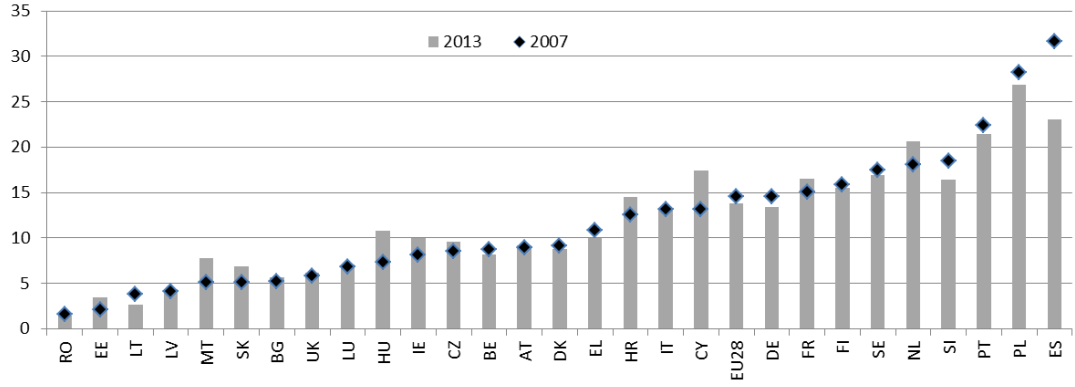
Changes affecting those in work: non-standard employment, job quality and informality

Since the recession, not only has the quantity of jobs been affected but also their quality as reflected by various indicators (see also Chapter 3). In this regard the share of part-time jobs in overall employment rose from 17.5 % in 2008 to 19.5 % in 2013, with an increase in the number of part-time jobs at a time when the number of full-time positions was falling ([22]). Moreover, there has been a sharp increase in the number of men working part-time. The rise in the share of part-time jobs also partly reflected a sectoral composition effect ([23]). At EU level, the share of involuntary part-time workers (those who work part-time because they are unable to find full-time work) has increased strongly between 2007 (22.4 %) and 2013 (29.6 %).

On the other hand, the overall share of temporary contracts among total employment has slightly declined since 2007 (from 14.6 % to 13.8 %), although with wide variations across Member States (see Chart 9). In countries like Portugal and Spain, which previously had high shares of temporary contracts, these served as an initial adjustment mechanism to the shock — while in other countries such contracts were also the first to grow, as risk-averse employers began to hire again. High shares of temporary contracts in total employment may increase employment volatility in times of economic downturn ([24])**.**

Chart 9: Temporary employment as percentage of the total number of employees



Source: Eurostat, EU-LFS [lfsa_etpgan]

Moreover, temporary contracts are associated, in some countries, with pronounced labour market segmentation, with a negative correlation between the overall share of temporary workers and the transition rates towards permanent jobs ([25]). As evidenced in European Commission (2012a) ([26]), temporary contracts often carry a wage penalty which is a particular concern in countries when the share of involuntary temporary work is high and transition rates towards better paid or permanent contracts are low.

([22]) Over 2008–13, the absolute number of part-time jobs has increased by 3.1 million (or +8 %) while the number of full-time positions declined by 9.4 million (or –5.2 %).

([23]) Some sectors (Administrative and support service activities, Human health and social work activities, education) that were less affected by the crisis had a relatively high share of part-time jobs.

([24]) Member States which had below EU average shares of temporary contracts in 2007 saw either a relatively small increase in unemployment during the recession e.g. United Kingdom, Austria, Czech Republic, Germany or a fall in their unemployment rate following a substantial initial increase as in Estonia, Latvia, Slovakia, Ireland and Hungary.

([25]) Correlation coefficient –0.69 in 2011/12 (significant at 1 %).

([26]) European Commission (2012a), Chapter 4, Table 2.

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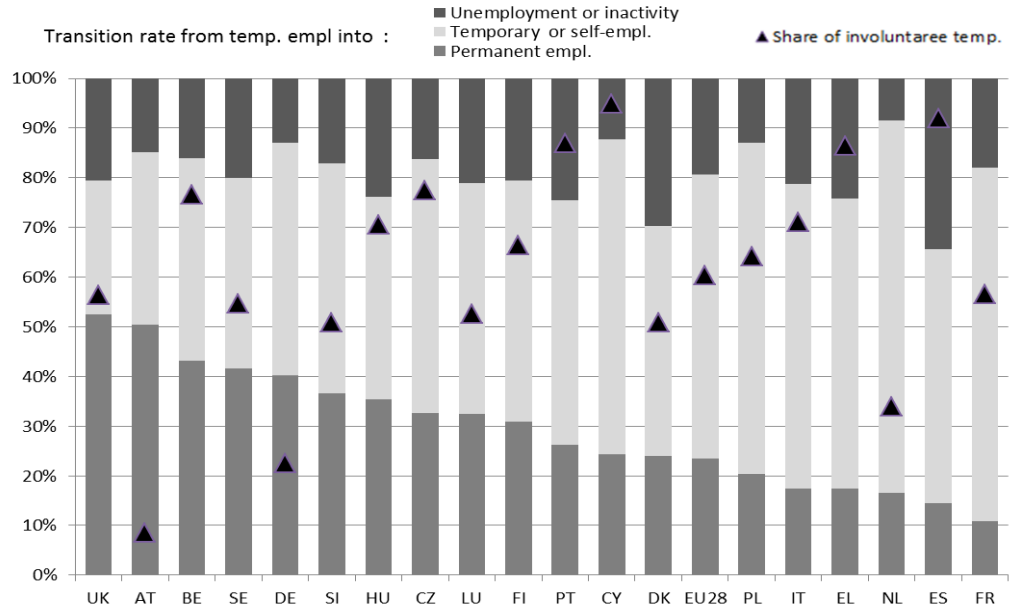
However, the usage and impact of temporary contracts varies across Member States. In some countries (e.g. Austria and to some extent, Germany) temporary contracts seem to act as a stepping stone ([27]) with high transition rates from temporary to permanent contracts, and a low share of involuntary temporary contracts ([28]). In countries such as Spain, France, Greece or Italy, though, there are low transition rates to permanent jobs and a high share of involuntary temporary contracts, with detrimental consequences for the employees' chances to access stable and better paid jobs with appropriate social protection as well as the opportunity to participate in lifelong learning ([29]). This can also be seen in the share of temporary workers becoming unemployed or inactive in the following year (around 25 % in Portugal and Greece, and 30 % or more in Denmark and Spain).

Chart 10: Transition rates from temporary to permanent employment, temporary or self-employment and unemployment or inactivity (2011/12) and share of involuntary temporary employment (2012)



Source: Eurostat, EU-LFS (lfsa_etgar) and EU-SILC (ilc_lvhl32). Exception to the reference year: Sweden (2010/2011 instead of 2011/2012).

An analysis by OECD (2014b) ([30]) reported some positive 'stepping-stone effects for non-standard work' in many countries but also confirmed that a temporary job often involves wage penalties and a greater likelihood of becoming unemployed or inactive the following year, especially in the case of young people.

People unable to find a regular job may turn to undeclared work or accept work with 'envelope' wages, see European Commission (2013). However, since undeclared work is often a last resort choice, it is strongly correlated with long-term unemployment, raising a

([27]) Another sign of *stepping stone* effect is that, in those two countries, the share of temporary contracts is high for young people (due to apprenticeship systems) but much lower for the older age groups, whereas in countries such as Spain, Poland or Portugal the share of temporary workers remains high (>20 %) among those aged 25–49.

([28]) In the Netherlands the share involuntary temporary contracts is also low and while most of the temporary workers remain in that status the year later, a rather low share (8.5 % compared to 19.3 % at EU level) fall into unemployment or inactivity.

([29]) For instance, OECD (2014a), *Employment Outlook*, shows, based on PIAAC data, that on average being on temporary contracts reduces the probability of receiving employer-sponsored training by 14 %.

([30]) OECD (2014b), 'Jobs, Wages and Inequality and the Role of Non-Standard Work', *forthcoming.*

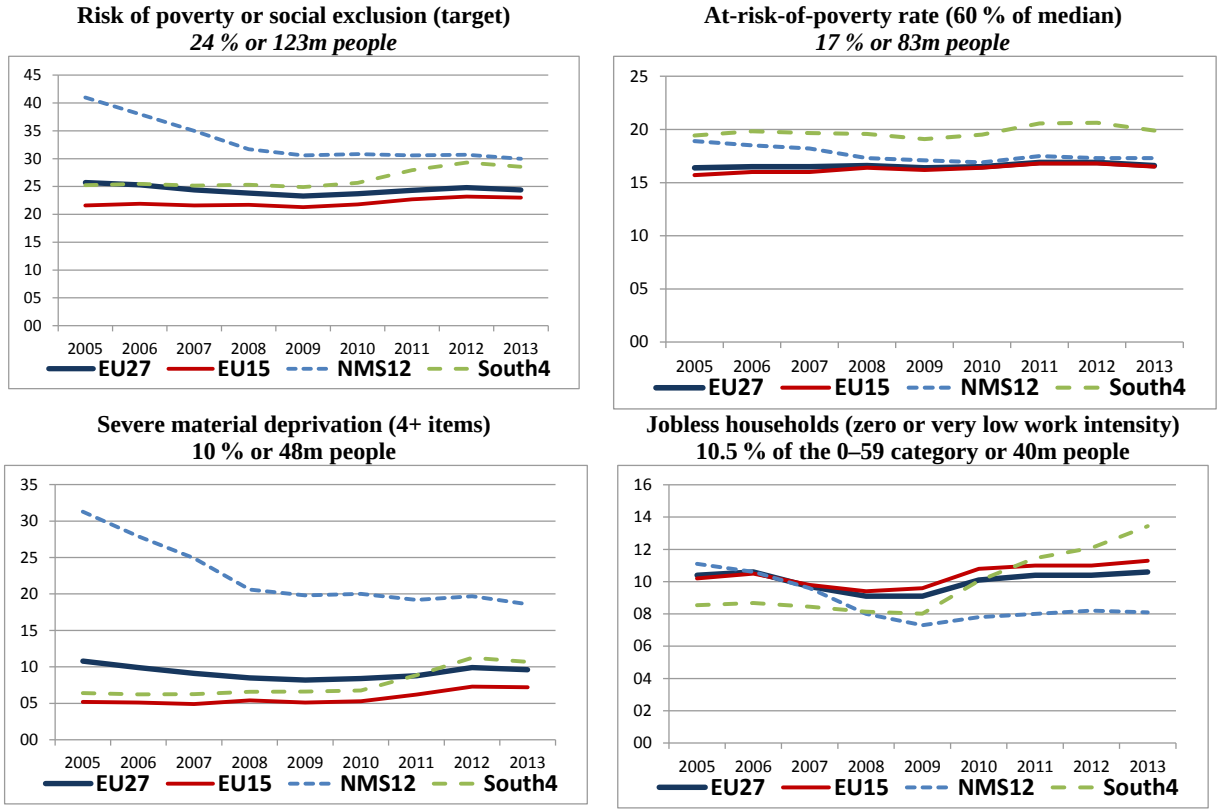
range of policy issues in terms of labour rights, entitlement to social protection, future pensions and workers' rights (see Annex 3, Extract 1).

Significant increases in poverty and social exclusion

Poverty and social exclusion in the EU has almost inevitably worsened during the crisis with little signs of improvement so far. The situation worsened even further in some countries in 2013, notably in countries where it was already high.

The main drivers of poverty and social exclusion are seen to be long-term unemployment, labour market segmentation and wage polarisation, but also the weakening of the redistributive impact of tax and benefits systems.

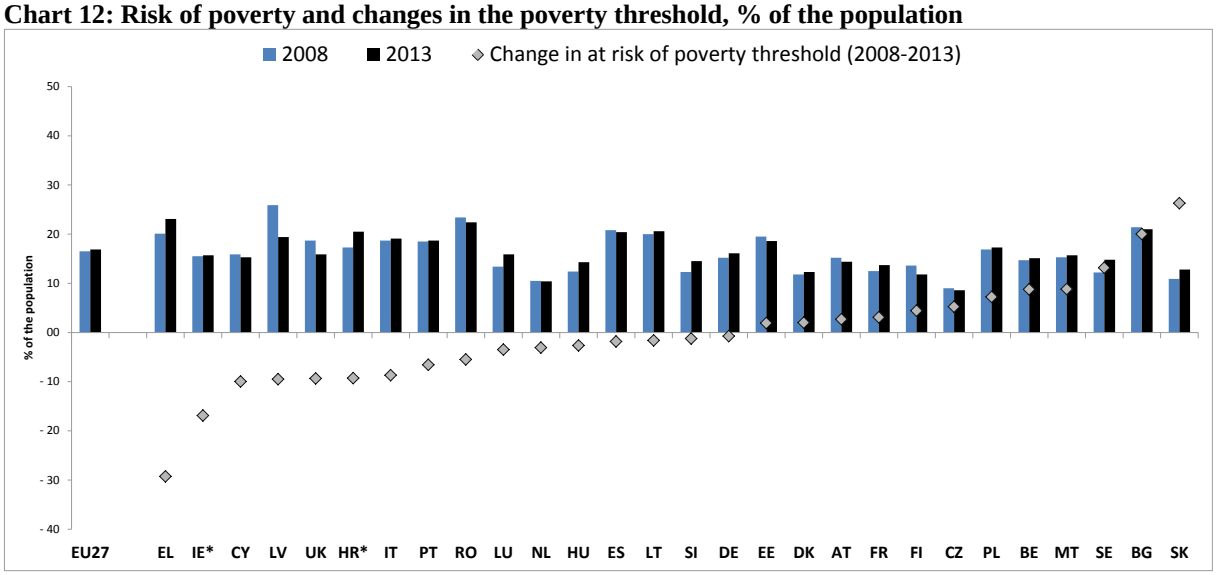
Chart 11: Evolution of the risk of poverty or social exclusion, (in %)



Source: Eurostat, EU-SILC (peps01, li02, mddd11, lvhl11)
Note: South4 refers to EL, ES, IT and PT

Overall, the risk-of-poverty rate has increased in more than ten Member States since 2008. However, declining levels of household disposable incomes in general have led to a reduction in the national poverty lines in Member States such as Latvia and Greece, meaning that decreases in the poverty rate do not necessarily indicate any improvement in absolute terms.

Chart 12: Risk of poverty and changes in the poverty threshold, % of the population



Source: Eurostat, EU-SILC (ilc_li01,ilc_li02)

As a consequence of this deteriorating situation, poverty defined in terms of severe material deprivation ([31]) has also increased across Europe, and most strongly in those Member States most affected by the crisis (ES, IT, IE, MT, UK). In some Eastern/Southern countries where deprivation had been improving before the crisis, the trend reversed and material deprivation increased dramatically after the crisis (LT, LV, EE, CY, EL, HU and to a lesser extent BG).

Working age adults have been especially affected, reflecting the deterioration of labour market conditions, with the worst hit countries being Spain, Italy, Greece, the Baltic States, but also the United Kingdom ([32]). Moreover, since many such working age adults live in households with children, child poverty has also risen across Europe as a whole. In contrast, the risk-of-poverty indicator for older people showed a significant decline in most Member States between 2008 and 2013 reflecting the fact that pensions have, to a large extent, remain unchanged during the crisis.

Due to the combination of life expectancy, lower participation in the labour market and household composition (single parent families), women are at higher risk of poverty or social exclusion than men in all Member States, with the exception of Spain and Portugal.

1.2 Participation in education and in the labour market continued to rise

Economic participation, as measured by the activity rate indicator ([33]), has continued to increase since 2008 in most Member States, in contrast to the experience in past recessions.

([31]) Severely materially deprived persons have living conditions severely constrained by a lack of resources. They experience at least 4 out of 9 of the following deprivations: cannot afford i) to pay rent or utility bills, ii) to keep the home adequately warm, iii) to face unexpected expenses, iv) to eat meat, fish or a protein equivalent every second day, v) a week holiday away from home, vi) a car, vii) a washing machine, viii) a colour TV, or ix) a telephone.

([32]) See European Commission (2014a).

([33]) The activity rate measures the share, among the working-age population, of those being economically active, i.e. either in employment or unemployed, according to the ILO definitions. While this indicator counts the total number of people in employment and unemployment and *country-comparisons* may be influenced by differences in institutional factors (such as incentives to be registered as unemployed), the

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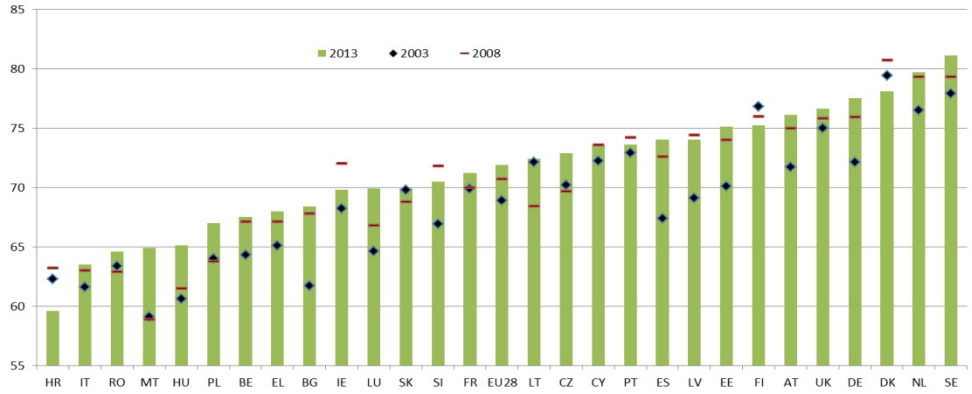
While the employment rate declined from 65.7 % in 2008 to 64.1 % in 2013 for the EU as a whole, the activity rate increased from 70.7 % in 2008 to 71.9 % in 2013. It implies that the drop in the number of jobs mainly translated into a rising number of unemployed and, only to a limited extent, a rising number of 'discouraged workers' (see section below). This EU experience also contrasts with the decline in activity rate witnessed in the US since 2008 ([34]).

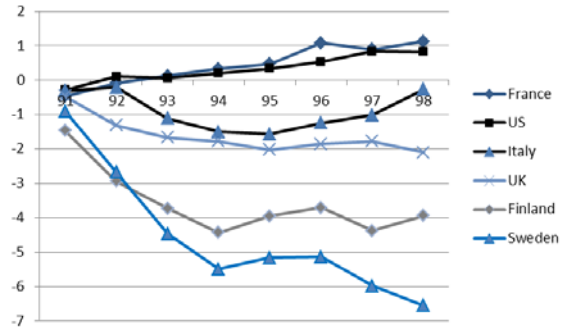
Chart 13: Activity rate across EU Member States, 2003, 2008 and 2013, in % of population aged 15–64



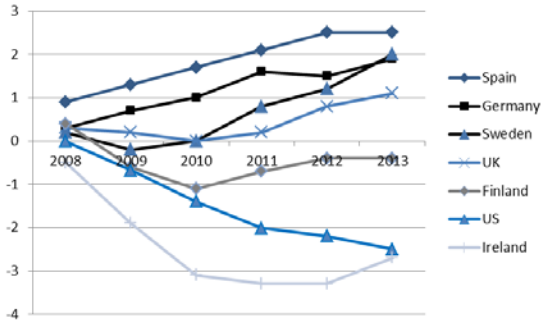
Source: Eurostat, EU-LFS [lfsi_act_a]

Reductions in activity rates in previous crises are attributed to a higher share of working-age persons withdrawing from the labour market, resulting in their decline between 1990 and 1994 and a very slow return to previous levels, substantially so for Sweden and Finland, while increasing slightly in France (and the US), see Chart 14. By contrast, since 2007, activity rates have continued to increase in many EU countries, even those strongly affected by the recession.

Chart 14: Activity rate (15–64) compared to 1990 and 2007 levels, for selected countries (in percentage points)



Source: OECD



Source: Eurostat, EU-LFS and OECD data for the US

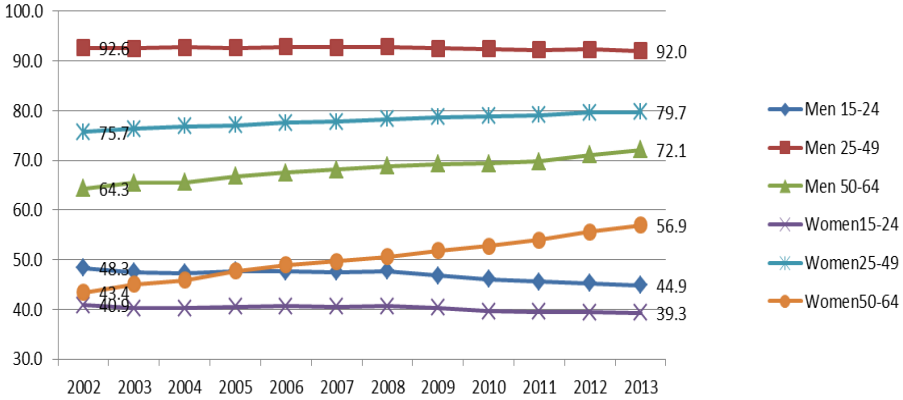
analysis of changes of activity rate *over time* remains meaningful, in particular to analyse behavioural changes compared to previous recessions.

([34]) Note that for the US, several papers (e.g. Barnes et al (2013)) show that the decline in participation since 2008 reflects, to a great extent, long-term demographic and behavioural changes rather than cyclical developments.

Increase in activity continued to be driven by women and older workers

The increase in the activity rate since 2008 has mainly been driven by the rising participation of women and older workers throughout the recession see Chart 15. This is seen to be due to a number of factors: structural increases in their activity rate due to cohort effects and rising levels of education; policy measures designed to encourage increased female and older workers participation([35]); and the fact that the initial labour market shock did not hit women and older workers as strongly as prime-age males.

Chart 15: Activity rate by group (age and sex), EU-28, 2002–2013 (in %)



Source: Eurostat, EU-LFS, [lfsi_agan]

Chart 17 shows that the decline in activity rate for prime-age men was limited (–0.8 pp) compared to the decline in their employment rate (–4.8 pps), indicating that they were the group least likely to fall into inactivity if they lost their job. LFS data for 2013 also shows that, if prime-age men become unemployed, they are more likely to receive unemployment benefits (43 %) than young people (18 %) or prime-age women (36 %), notably due to their more favourable employment histories. This is one of the factors that promote continuation of job search rather than 'discouragement' and inactivity.

Chart 16: Change in the activity rate by group (age and sex) in EU-28, 2008–2013 compared to 2002–08, in percentage points

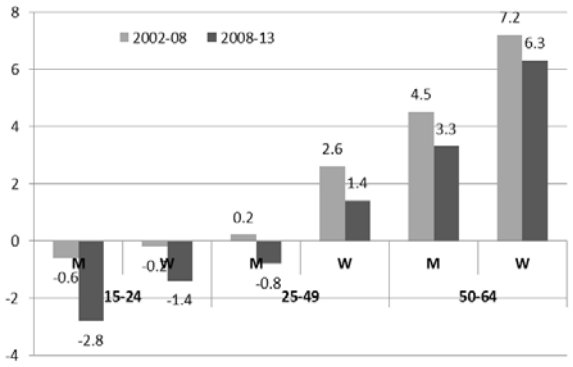
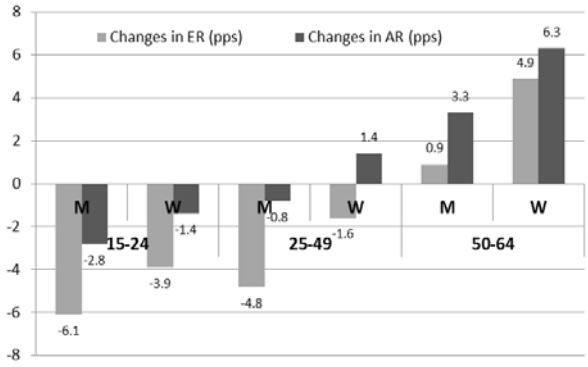


Chart 17: Change in the employment and activity rates by group (age and sex) in EU-28, 2008–2013, in percentage points



([35]) The increase in older workers participation over the last decades was also driven by an overall improvement in their health status, see European Commission (2011a), chapter 5.

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Source: Eurostat, EU-LFS, [lfsa_argan].

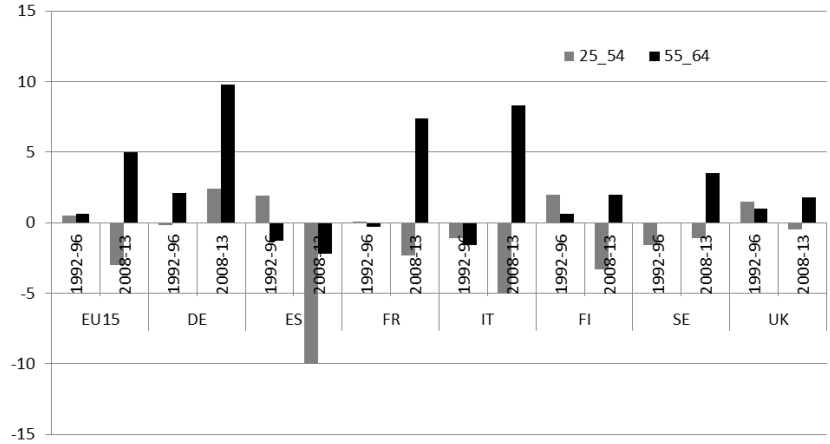
Source: Eurostat, EU-LFS, [lfsa_argan] and [lfsa_ergan].

Since 2008, the activity rates of older workers (55–64) increased substantially in most countries even in the most affected countries ([36]) while they had been decreasing during the 1990s recession ([37]). Several changes explain this difference.

- Older workers have been (in comparison to the 1990s) less affected by job losses (see Chart 18) notably because their educational levels have improved ([38]) and the sectors in which they are employed have changed. Moreover, employers are often reluctant to lay off their most experienced workers, who also often benefit from a better protection (higher severance pay) than younger workers due to longer employment histories ([39]).

- If they become unemployed, older workers are less likely than before to withdraw from the labour market not least because of policies introduced over the last two decades to extend working lives, such as reforms in pension schemes (general increase in the statutory retirement age), and early retirement schemes. Moreover, alternative options such as disability schemes have been closed or made less accessible ([40]).

Chart 18: Older workers less affected by job losses since 2008 than in the 1990s: changes in employment rates for prime-age (25–54) and older (55–64) age groups in 1992–96 and 2008–13, in percentage points, selected Member States



Source: Eurostat, EU-LFS, [lfsi_emp_a]

The continued increase in female activity rates also results from a combination of factors.

([36]) In Spain, Portugal and Ireland, decreases for men were more than offset by increases for women.

([37]) For instance: in the UK (–1.6 pps over 1990–95), Italy (–4.2 pps over 1991–95) and Germany (–2.9 pps over 1992–96) with more pronounced drops for men (respectively –5.8 pps, –7.3 pps and 4.9 pps).

([38]) Between 1992 and 2008, the overall level of education of older workers increased more quickly than for prime-age workers, even when excluding the effects of the rising level of education among women. EU-LFS data for EU-15 countries shows that the share of low-educated among male older workers dropped sharply, from 53.9 % in 1992 to 32.3 % in 2008 (–21.6 pp) compared to prime age workers (from 40.2 % to 28.2 % or –12.0 pps). The share of tertiary educated persons among older men increased more sharply than among prime-age workers.

([39]) The share of older workers under involuntary temporary contract is also much lower (4.4 % among those aged 55–64 compared to 8.1 % for prime-age and 14.7 % for young workers, i.e. EU-LFS data for EU-28 in 2013).

([40]) European Commission (2011), Chapter 5.

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- Women tend to work in sectors that are less hit by the recession ([41]) (see also European Commission (2013), Chapter 3). This seems to explain most of the better performance of women's employment during the crisis, while the 'added-workers' effects may also have played a part (see Box 1).

- There has been a structural increase in the participation of women, mainly due to rising levels of education of women over time ([42]). This has brought the behaviour of women in the labour market much closer to that of men with a rising share of dual-earner households.

- Measures supporting female participation such as flexible working arrangements, the removal of financial disincentives for second earners, childcare and elderly care facilities have also played a role, together with measures to retain older women longer in the labour market ([43]). Until 2013, there were no signs of a reversal in the policies supporting female participation (see Section 3) although this may no longer be the case in some countries that have applied major fiscal consolidation measures ([44]). Moreover, women tend to be over-represented in public and non-market service sectors that are now becoming more adversely affected by fiscal consolidation in many Member States ([45]).

Moreover, recent trends have not led to a substantial decrease in the large gender inequalities in the labour market that persist in many EU Member States to the disadvantage of women, in terms of activity and employment rates as well as in terms of part-time work and earnings.

Box 1: Some mixed evidence about 'added-worker effects' during the recession

A recession can impact on labour market participation of 'partnered' women in two ways: (a) it can discourage women from looking for a job or postpone their decision (*discouragement effect*) or (b) it can foster participation in order to compensate for the job loss of the partner (*added-worker effect*). It is hard to determine whether the increase in female participation was due partly to the latter — or whether it was entirely caused by other structural factors due to education and cohort effects. Several reports support the added worker hypothesis without being totally conclusive:

- European Commission (2011b) shows that the activity rate of married women with children was more reactive to male unemployment and that it has increased faster since 2008 than for other women*.

- OECD (2012a) shows that in many countries partnered women were more likely to have increased their working hours during the crisis than single women.

- European Commission (2012b) points out that over 2007–09, dual-earner couples had lost ground mainly to the benefit of female breadwinner couples.

- European Commission (2013) shows that over 2007–11, the share of working women with a non-working male partner increased in most Member States.

([41]) Female employment was less affected by the recession than male (respectively –0.6 % over 2008–13 against –4.7 %). While the two male-dominated sectors (manufacturing and construction) were strongly affected by the crisis, the two main female-dominated sectors (education and human health and social work) resisted well.

([42]) For instance, among women aged 25–49 (50–64) the share of those with not more than lower secondary education decreased from 41 to 22 % (64 to 38 %) between 1995 and 2013, or –19 pps (–26 pps), to the profit of the medium and high educational groups (based on EU-LFS data on EU-15).

([43]) Analysis by age and education confirms that the overall increase in female activity rate is not only due to change in the composition (i.e. increase in average level of education) and affected most sub-groups of women.

([44]) European Commission (2012b).

([45]) European Parliament (2014).

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- Bredtmann et al (2014) found that women whose partner becomes unemployed have a higher chances of entering the labour market and changing from part-time to full-time employment than women whose partner remains employed. The added worker effect varies over both the business cycle and the different welfare regimes within Europe***.

- EU-SILC*** data do not show such added-worker effect, as women's transitions from inactivity to employment and from part-time to full-time employment do not increase between 2007 and 2012.

While there is no robust evidence of an added-worker effect during the crisis, the stronger share of women in employment, hours worked and earnings and the increasing share of dual-earner households has helped to cushion the impact of the recession on household incomes (OECD (2014c)).

Notes: * However, this is not true for all countries and may be due to other effects — for instance the increase in investment in childcare facilities.** For instance, for the UK, Bryan and Longhi (2013) found an increase in job searches but only among single earner couples — which does not translate into more success in finding work (consistent with declining job-finding rate), at least in the short-term. *** *Source*: Eurostat, EU-SILC, [ilc_lvhl30]. Note that these indicators are not available for different groups of women (partnered or not, with or without children).

Limited increase in discouraged workers during the recession

The number of persons available and wanting to work but not looking for a job ([46]) (the 'discouraged workers') increased from 7.4 million in 2008 to 9.3 million in 2013 (or from 3.1 % to 3.8 % of the labour force). This increase was much lower than the increase in unemployment and long-term unemployment ([47]) and can be viewed as a positive sign insofar as it means that unemployed persons continue to look for a job and can potentially benefit from activation or (re)training.

Institutional factors can contribute to limiting the number of discouraged workers. For instance, countries where the share of discouraged workers is the highest tend to be those with relatively limited support for the unemployed or the long-term unemployed ([48]). Generally speaking, the countries that recorded increases in discouraged workers since 2008 ([49]) were those that combined a strong labour market impact of the crisis and relatively weak support services to the unemployed ([50]), whether in terms of spending on active labour market policies or income support.

There can also be other explanatory factors such as the extent to which there are, or are not, incentives to register as unemployed, the link to social assistance schemes, or the actual probability of finding a job. The availability of care services for children or dependents may also affect the labour supply given that 36 % of 'discouraged workers' in 2013 were women of prime-age (25–54), a group more likely to be affected by issues related to the combination of work and family life. This share was highest in Spain (41 %), Italy (47 %) and Greece (49 %),

([46]) These are jobless persons (neither employed nor unemployed) who do not qualify for recording as unemployed (from the ILO definition) because they are not actively looking for a job (anymore), despite the fact that they want to work and are available for work. According to Eurostat, they include 'discouraged workers but also persons prevented from job seeking due to personal or family circumstances'. However, for convenience, this section uses the term 'discouraged workers' to refer to all the inactive persons wanting to work but not looking for a job.

([47]) Since 2008, the number of unemployed increased from 16.8 million to 26.4 million in 2013, and the number of long-term unemployed almost doubled in the same period (from 6.2 million to 12.3 million).

([48]) In 2013, a very low share of long-term unemployed were receiving unemployment benefits (or assistance) in Italy (2 %), Croatia (10 %), Bulgaria (1 %), Latvia (3 %) or Estonia (4 %), all characterised by a higher than average share of discouraged workers –while the receipt rate of benefits was rather high in some of the countries displaying a low share of 'discouraged workers' such as France, Germany, Malta, Belgium and Denmark.

([49]) Croatia and Cyprus (strong increase) and Finland, Romania, Spain, Italy, Hungary, Greece and Slovenia (significant increase).

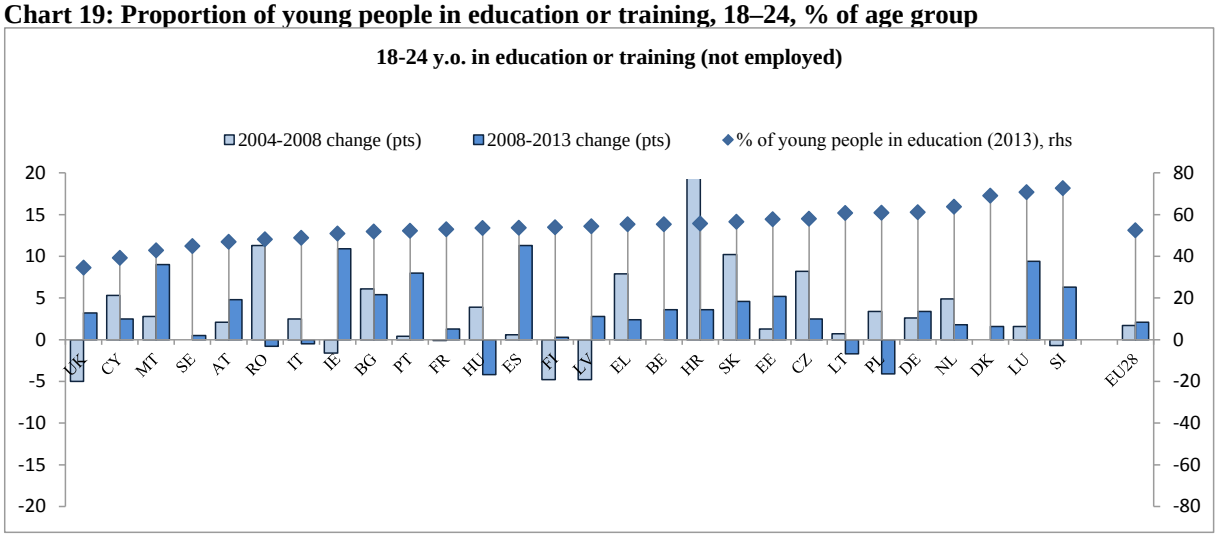
([50]) According to typology presented in Stovicek and Turrini (2012).

all countries recognised as being poor performers in terms of supporting improved work-life balance ([51]).

Remaining in education

Since 2008, an increasing number of young people have remained in, or have returned to, education, notably within the younger age group (18–24) and especially in Member States where youth unemployment was especially high (Spain, Ireland and Portugal) and where the share of young people in education had been below the EU average in 2004. In some countries however, participation in education has either stalled (Greece, Italy, Romania, the Czech Republic and Slovakia), or even declined (Poland and Hungary).

Chart 19: Proportion of young people in education or training, 18–24, % of age group



Notes: Only young people in education or training not economically active are measured. Countries are sorted by 2013 levels.
Source: EU-LFS, Social Situation Monitor calculations

Overall, educational outcomes have improved in most Member States (see Chart 20) but especially so in those countries where they were less favourable ten years ago and the share of early school leavers from education and training decreased. Delaying labour market entry by remaining in education is a rational response in times of recession, but it is not yet clear whether this will result in better labour market outcomes in terms of human capital and skills development. The long-term impact of increased educational level will notably depend on the quality of education, on whether the skills acquired are adapted to labour market needs, as well as on whether cuts in spending affect the quality of education in the short to medium term (see Section 3.3).

([51]) They display high gender employment gaps, high incidence of inactivity due to family obligations as well as relatively insufficient provision of child and/or dependent care facilities (see European Commission (2013), Chapter 3).

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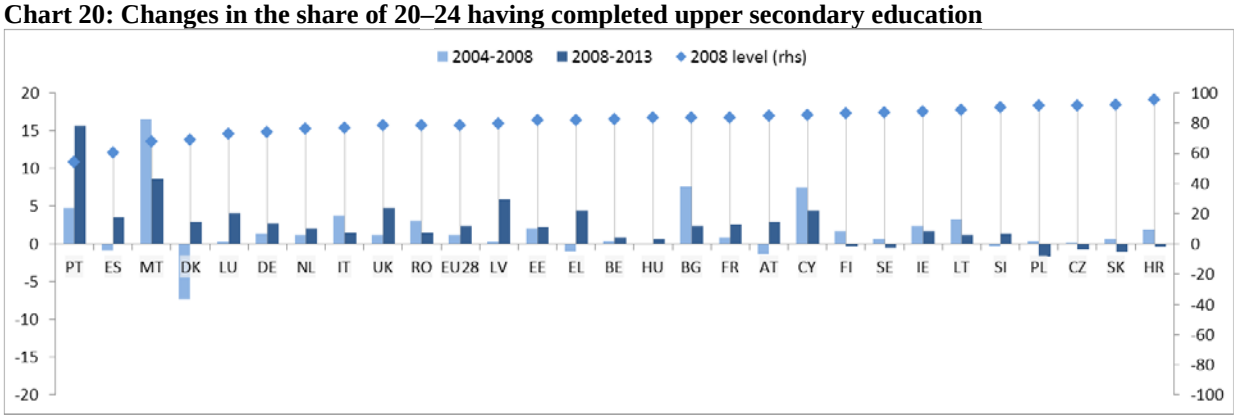
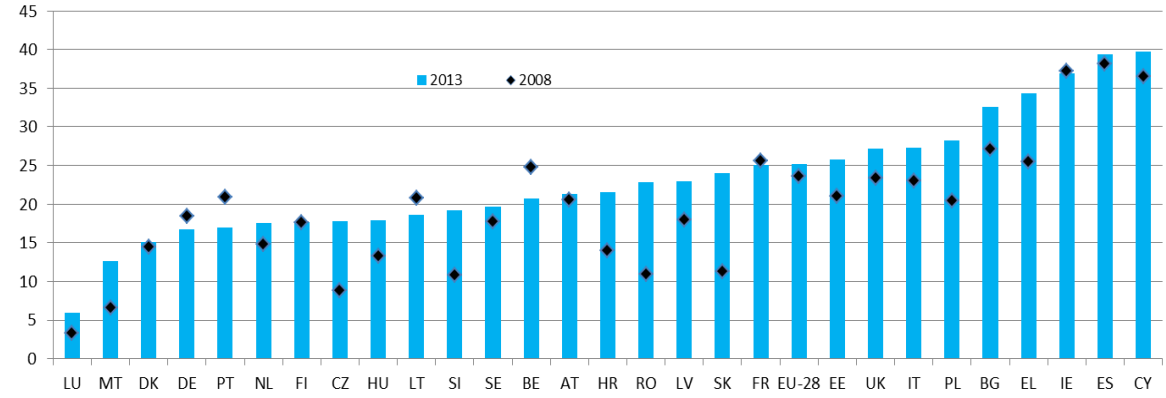
Chart 20: Changes in the share of 20–24 having completed upper secondary education



Source: Eurostat, EU-LFS [edat_lfse_08]; sorted by 2008 level.

Returns on investment in education can also be limited if they result in over-qualification. Since 2008, over-qualification ([52]) has increased, especially for those aged 25–34, as reflected in the difficulties university graduates find in obtaining jobs in line with their qualification. For this age group, the rate in 2013 was highest, at over 30 %, in Cyprus, Spain, Ireland, Greece and Bulgaria, where this skill mismatch may have made the labour market less resilient to the economic shock. Nevertheless, the rate of over-qualification has also increased in many Central and Eastern Member States which previously had lower than average rates.

Chart 21: Over-qualification rate: share of tertiary-educated workers working in low or medium-skilled occupations (in %), age group 25–34, 2008 and 2013



Source: Eurostat, EU-LFS and DG EMPL calculations. *Notes*: tertiary-educated is defined as workers having the highest level of qualification equal or above ISCED 5–6; low and medium-skilled occupations are defined as occupational groups ISCO 4 to 9.

1.3 Falling incomes and rising market income inequalities put tax and transfers systems under pressure

The deterioration of economic and employment conditions has inevitably resulted in an overall decline in household incomes in most Member States, although the impact on income

([52]) Measured as the share of tertiary-educated (ISCED 5–8) workers who are in low or medium-skilled occupations (ISCO 4–9), i.e. that theoretically do not require a tertiary education level.

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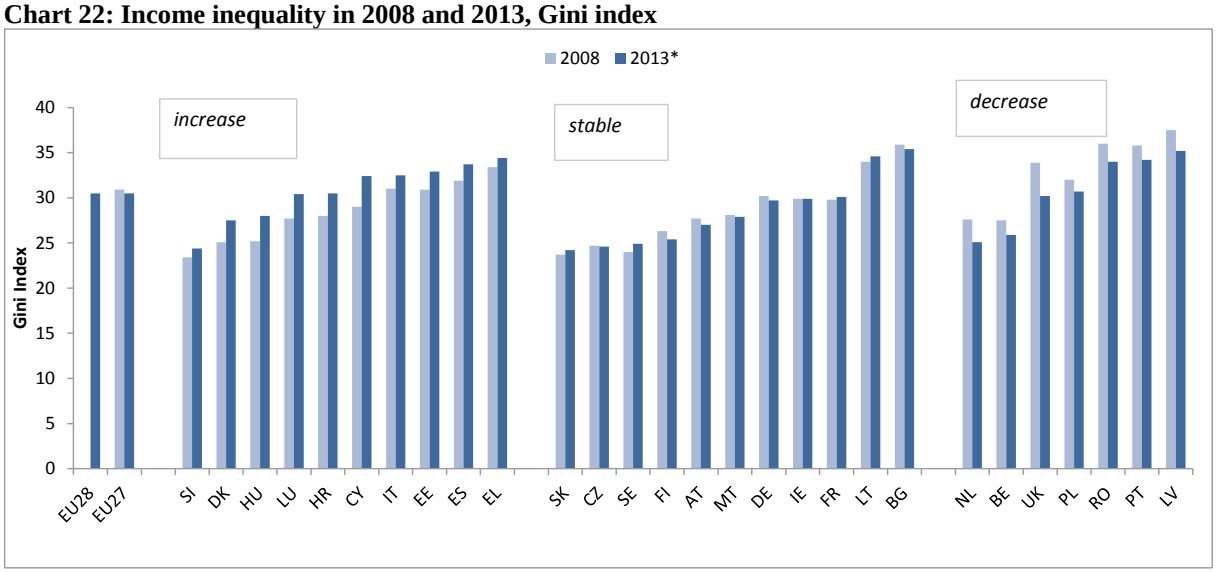
distribution has varied. Since 2008 disposable income inequalities ([53]) have increased in 10 Member States, notably in Spain, Hungary and Denmark, while they have fallen in 7 others, notably in Latvia and Portugal as well as in Belgium and the Netherlands.

Chart 22: Income inequality in 2008 and 2013, Gini index



Source: Eurostat, EU-SILC, ilc_di12.
*Note: *Data for IE refers to 2012.*

These developments reflect the ways in which rich and poor have been affected. In some countries (e.g. Spain, Hungary, Denmark), incomes at the bottom of the distribution (first quintile) were hit harder than those at the top (tenth decile) while in others (Latvia, Romania, the United Kingdom, Portugal, the Netherlands), incomes at the bottom of the distribution were relatively protected, in the sense that they fell less than those at the top.

([53]) Inequalities are measured here through the Gini index. It measures the degree of inequality of the income distribution by taking all income distribution into account. It varies from 0 to 100, with 0 corresponding to perfect equality (everyone has the same income) and 100 to extreme inequality (one person has all the income, everyone else has nothing). Other measures of inequalities (e.g. S80/S20 ratio) are also available for disposable income inequality, but not for market income inequalities. For this reason, only the Gini coefficient is used.

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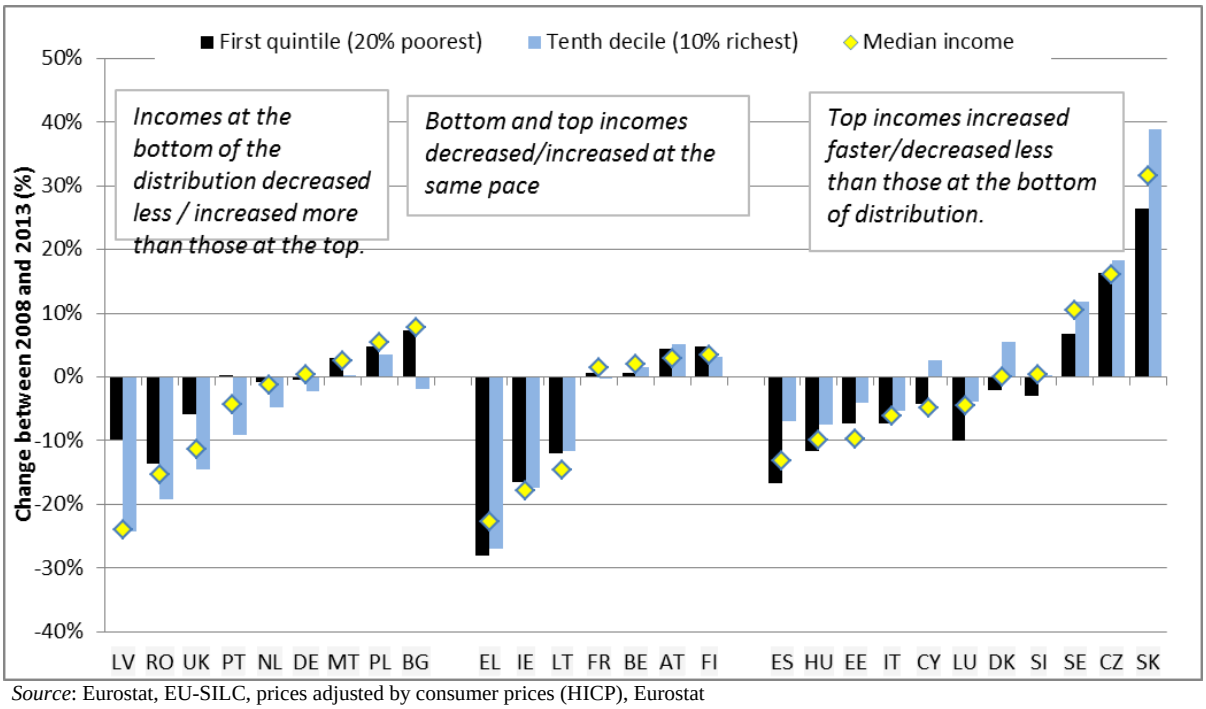
Chart 23: Incomes changes at several points of the distribution (1st quintile, median, 10th decile) — 2008–2013



Source: Eurostat, EU-SILC, prices adjusted by consumer prices (HICP), Eurostat

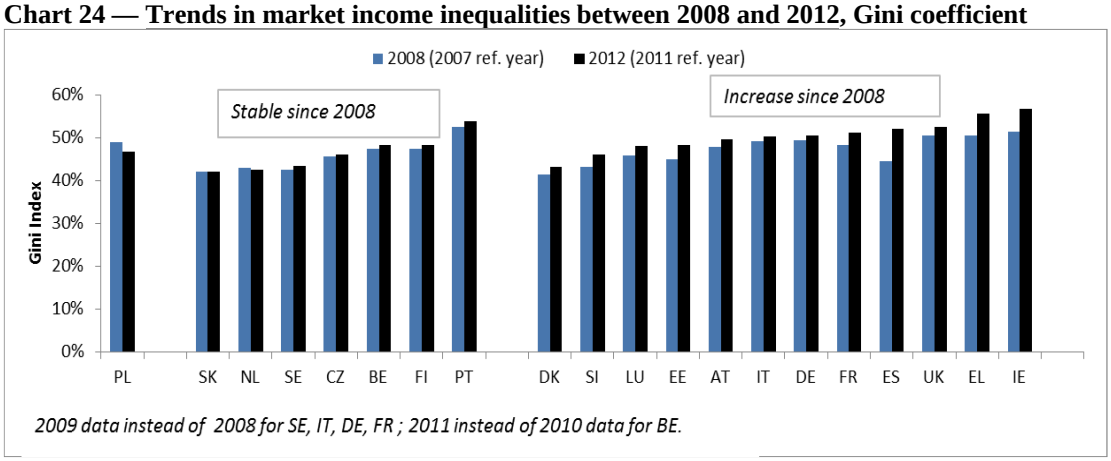
Note: The graph refers to 20 % lowest incomes and 10 % highest incomes. Asymmetrical percentiles have been chosen for the following reasons. The lowest 10 % incomes are generally considered as difficult to capture (see Atkinson-Marlier 2010). Studies on top incomes generally focus on the upper part of the distribution, often top 1pc incomes or 5pc top incomes (see OECD 2013a). Data for IE refers to 2012.

Market incomes: polarisation and upgrading in the top of the distribution

Market income inequalities (before taxes and transfers) ([54]) have increased in most Member States (see Chart 24) since 2008, as a result of both increased joblessness and increased earnings polarisation for those in work. Following the worsening of unemployment from 2008 onwards, the share of households with no income from work increased, especially in Ireland, Spain, Lithuania and Greece. In addition, the polarisation of earnings from work increased as a result of the widening of the hourly wage distribution, a greater dispersion in the quantity of work among those employed, and of the quantity of work within households.

([54]) Market incomes refer to gross earnings and capital income. Inequalities are measured based on the Gini coefficient in this Chapter.

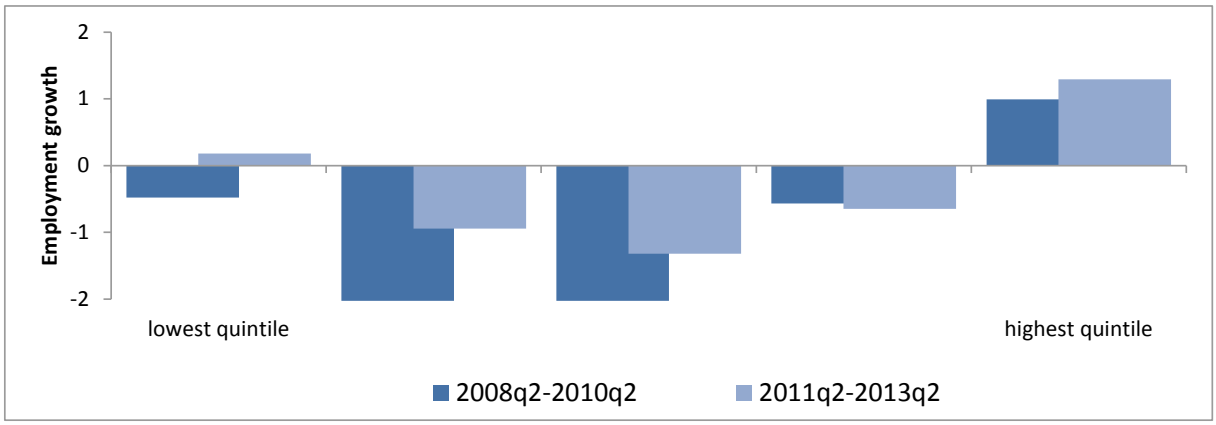
Chart 24 — Trends in market income inequalities between 2008 and 2012, Gini coefficient



Source: OECD, income distribution database
Note: year refers to SILC production year and not reference year. 2008 data not available for SE, DE, IT, FR, IT. 2012 data not available for BE. No data for HU.

In recent years, the trend towards a hollowing out of jobs at the middle of the wage distribution has continued (see Chapter 3). Top-paid jobs were resilient even in the countries where employment losses were substantial (Italy, Greece, Ireland, see Annex 1) and contributed positively to job growth in countries where the recession was milder (Austria, Belgium and Germany). Jobs at the bottom of the wage distribution either decreased less markedly than in the middle, or even expanded significantly, as in France, Greece and the UK.

Chart 25 — Net employment change (%) by job-wage quintile, 2011 Q2 to 2013 Q2, EU-28



Source: Eurostat, EU-LFS, based on Eurofound's calculations.

The increased polarisation of household market incomes can also be explained in part by the respective shares of job-rich and job-poor households. Before the recession the share of adults living in very high work intensity households was increasing with growing labour market participation of women as second earners. During the crisis, this trend reversed, with an increase in lower job intensity households and reductions in the number of high work intensity households due to unemployment and part-time work (see Chart 26), although experiences varied across Member States.

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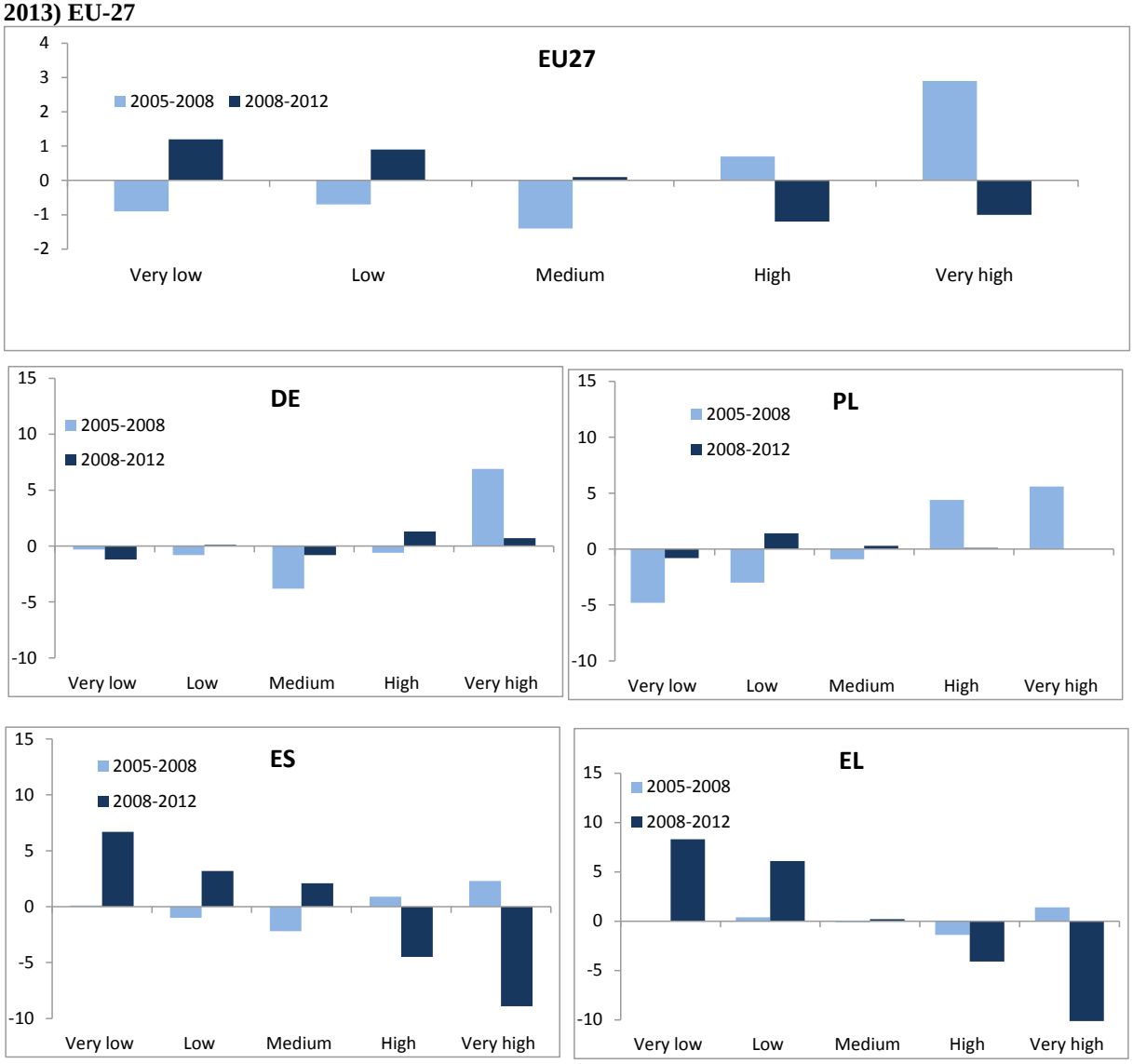
Chart 26: Changes in the distribution of population by household work intensity (2005–2008 and 2008–2013) EU-27



Source: EU-SILC, Eurostat (ilc_lvps03)

The role of tax and transfers in mitigating inequalities increased in most countries

Overall, while social spending had played a significant role in sustaining household incomes in most countries in 2008/2009, this contribution lessened from 2010 onwards ([55]). Nevertheless, the redistributive role of tax and transfer systems helped limit the increase in market income inequality (see Chart 27), as expected when a large number of workers lose their jobs. In a few countries, however, market income inequality declined while after-tax and transfers inequality increased.

([55]) See European Commission (2013c) and European Commission (2014a). The lessening observed from 2010 is explained by the increase in the number of long-term unemployed losing their entitlements along with the partial phasing-out of the measures put in place to counter the crisis and the tapering off of the impact of social spending in Member States where the economic situation improved.

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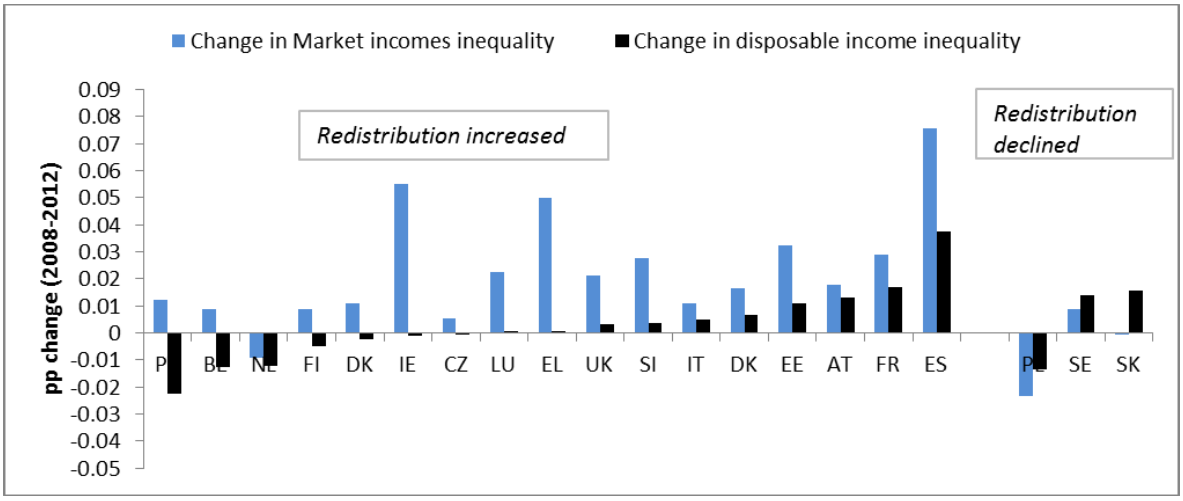
A Euromod micro-simulation study of 13 EU countries found that the policy changes undertaken between 2008 and 2013 resulted in a reduction of income in aggregate terms which directly contributed to increased hardship especially among low income households, whose budgets were already very constrained (De Agostini et al., 2014). Nevertheless the distributional effects of these changes have been broadly progressive, with some country exceptions, despite increases in VAT rates which are normally judged to be regressive.

Chart 27 — Changes in market income and disposable income inequalities (2008–2012)
Gini index



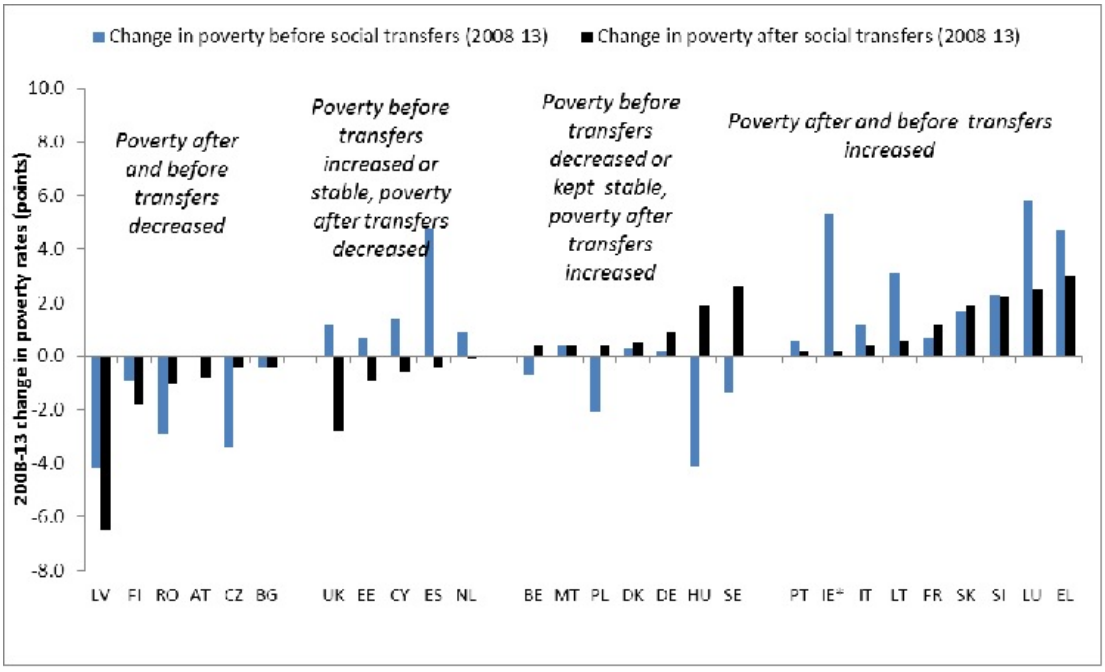
Source: OECD, income sources database.
Note: year refers to SILC production year and not reference year. 2008 data not available for SE, DE, IT, FR, IT. 2012 data not available for BE. No data for Hungary.

But the poverty reduction impact of social transfers declined in one third of countries

While the reduction of poverty that can be attributed to social transfers has changed significantly in a number of Member States since 2008, it has remained at a very low level in Greece, Bulgaria, Romania and Italy where weak or absent safety nets (unemployment benefits and social assistance) are combined with limited support for those at work. In contrast, the impact of social transfers in reducing poverty increased significantly after the crisis in Spain, Latvia, the United Kingdom, Ireland and Finland.

Changes in the impact of social transfers on reducing poverty may be due to policy changes or to changes in the composition of the population at risk of poverty (e.g. an increased share of unemployed or working poor). In some Member States which had previously had high levels of social transfers, the impact of social transfers on poverty reduction decreased significantly during the recession. This is especially the case in Sweden, Hungary, Germany, Denmark, Belgium and France (Chart 28). In some other Member States, such as the United Kingdom Spain and Ireland, social transfers contributed to smoothing the impact of the crisis on poverty. Lastly, in some Member States, the impact of transfers on reducing poverty has lowered significantly, as in the Czech Republic and Poland.

Chart 28 — Evolution of the risk of poverty after and before social transfers 2008–2013.



Source: Eurostat EU-SILC (ilc_li02)
Note: 2012 data for IE.

2 THE POTENTIAL LONG-TERM IMPACTS ON PEOPLE AND SOCIETY

The long-term impact of the prolonged recession, and the contribution of policies intended to mitigate its effects, can be reviewed in the following terms:

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- The scarring effect of early career unemployment for future employment outcomes
- The ability of households to adapt to adverse economic circumstances, drawing on their savings or going into debt, by adjusting their consumption or pulling resources
- The impacts on health and on access to healthcare
- The extent to which declining confidence in the ability of public institutions to address problems may impact on social cohesion, weaken democracies, and inhibit effective policy making.

2.1 Scarring effects of unemployment — evidence from most recent data

The scarring effects of early career unemployment on individuals: lessons from the past

There is considerable existing knowledge about 'scarring effects' for early career unemployment ([56]) based on research that pre-dates the current recession. Such research shows that, while young people tend to experience spells of unemployment more frequently than adults, they generally face shorter spells of unemployment. In this context, a higher unemployment rate among youth is generally explained by the time needed to make the transition from education to an appropriate job. However, there is evidence that unemployment among young people is less and less a 'temporary nuisance' as spells increase in length. Delays in making the transition to working life, and the lack of opportunity to acquire on-the-job skills and knowledge, can have negative consequences for the individual and society as a whole (Eurofound 2012).

These ‘scarring effects’ in early stage of a life or career can impact on future employment outcomes, earnings prospects, as well on health and general well-being ([57]). This occurs in various ways such as a depreciation (or non-accumulation) of skills, negative signalling effects for potential employers, or simply demotivation. A high level of education tends to attenuate potential scarring effects, and impacts on the channels through which they happen. In all cases, it seems that some work experience, even if limited, is key to prevention ([58]). Annex 2 contains an overview of literature on the subject.

Entering the labour market in bad times for a whole generation: attempts to measure current impact

While long-term effects are not yet fully observable, analysing the labour market trajectories of those who entered the labour market during the crisis compared to the previous generation — as carried out here —can be informative ([59]).

([56]) The focus is mainly on young people due to the strong impact of the recession and because several authors argue that long-term scarring effects are more likely to occur when unemployment is experimented early in the career, see for instance Bell and Blanchflower (2011).

([57]) The literature on scarring effects for early-career unemployment has been reviewed in Eurofound (2012); European Commission (2013), Chapter 1; European Commission (2012c); Schmillen and Umkehrer (2013); Scarpetta et al. (2010). Most of the papers claim evidence of 'true state dependence' scarring effects in individual unemployment histories but conclusions about the existence and magnitude of the effects somewhat vary.

([58]) See recent paper by IAB (2014) as well as Cockx and Picchio (2011) or Doiron and Gørgens (2008).

([59]) Such methodological approach differs from most papers on scarring effects as it measures the overall impact on a generation, rather than focusing on the scars for those individuals having experienced unemployment spells.

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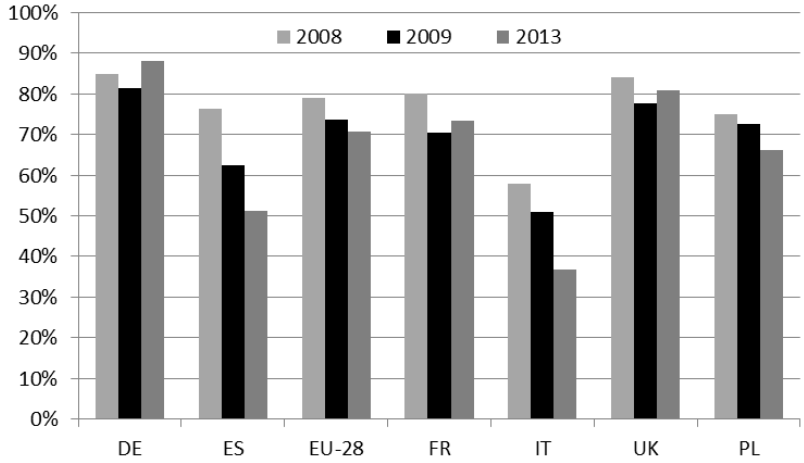
Studies comparing the outcomes of those entering the labour market in bad times (i.e. when unemployment is high or increasing) to previous or future generations ('better-off') ([60]) suggests that the negative effect of being unemployed at entry on future employment rates disappears relatively quickly (i.e. in a three-year period), though the catch-up period regarding wages can be longer, or even permanent ([61]).

These somewhat different findings (compared to most papers on scarring effects, see Annex 2) may be due to the fact that they are based on data for a whole generation rather than individuals, but they may also reflect the fact that the stigma attached to having been unemployed may be weaker in times of crisis ([62]). However, such 'scarring effects' are generally seen in terms of their long-term effects, and findings relating to experiences in the 1980s and 1990s cannot necessarily be relevant to the current period.

Chart 29 shows that, over the period of the recent crisis, the employment rate of young people (aged 20–29 and no longer in education or training) one year after having obtained their highest level of education ([63]) dropped from 79 % in 2008 to 71 % in 2013.

Chart 29: Employment rate one year after obtaining highest education level (persons 20–29, not in education or training) in 2008, 2009 and 2013



Source: Eurostat, LFS, DG EMPL calculations. Year of obtaining highest level of education is the variable HATYEAR

What appears to be important from an operational and policy perspective is whether the effects of these negative labour market experiences for current generations will persist over time. In this respect Chart 26 shows that, before the crisis, the employment rate of entrants was relatively low in the first year but steadily increased in the following years. This is not the

([60]) Such comparisons have been documented in numerous countries, notably in Austria, Canada, Germany, Japan, Norway, Sweden and the USA, see for example the review of papers conducted by Gaini et al (2012).

([61]) See for instance Oreopoulos et al. (2012) for Canada or Kahn (2010), for the US.

([62]) For instance, Biewen and Steffes (2010) argue for Germany that 'if unemployment is relatively high, the stigma connected to it is lower because it is a more widespread phenomenon'. Gaini et al (2012) also found, for France, that 'unlucky' young people (i.e. leaving school during a recession) catch up quickly (3 years) in terms of employment with 'lucky' ones (i.e. who entered the labour market during a boom).

([63]) The EU-LFS does not indicate the year of entry into the labour market and one has to use a proxy which is the 'year of obtaining highest level of education'. As young people may have continued their studies after that year without obtaining necessarily a higher level diploma, there may some bias as those having for instance a theoretical presence of 3 years in the labour market may have just entered after having been three years in education though without succeeding in getting a higher diploma.

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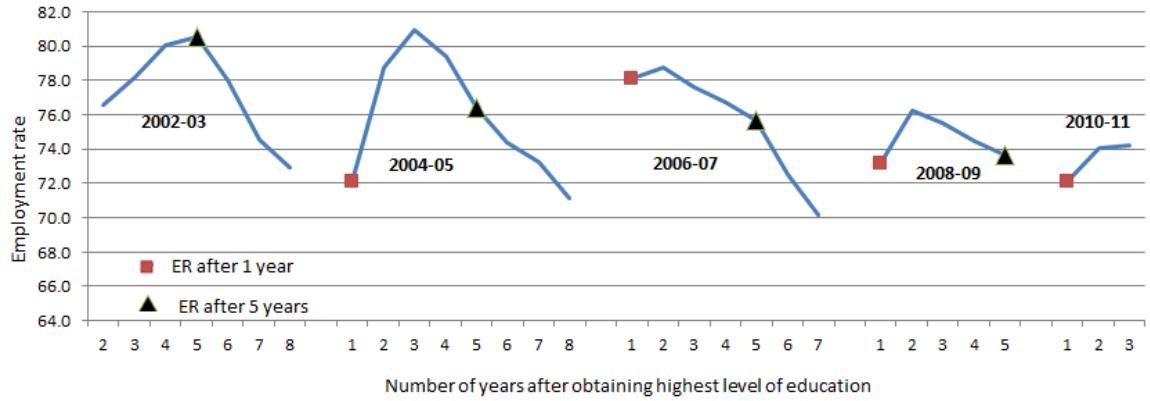
case for the cohorts of young people who left education after 2006 and have had to face the full effects of the recent recession.

In fact, some five years after entering the labour market, the employment rate of the 2008–09 cohort is below the level recorded for the two previous cohorts (2004–05 and 2006–07). While the gap between the 2008–09 generation and the previous ones diminishes over time ([64]), this is due to a worsening outcome of the previous generations rather than a real catch up effect.

Chart 30: Employment rate of young people (20–29) no longer in education or training, by number of years after obtaining highest level of education, for various cohorts (i.e. year when obtaining highest level of education), EU-28



Source: Eurostat, LFS, DG EMPL calculations. Year of obtaining highest level of education is the variable HATYEAR. *Note:* for the cohort 200607, the employment rate after 7 years is only available for those having left education in 2006; the same is true for the cohort 2008–09 after 5 years (only 2008 included) and for the cohort 2010–11 after 3 years (only 2010 included). For the cohort 2002–03, the employment rate after one year is not available and the employment rate after one year is only available for those having left education in 2003.

Since employment rates are largely influenced by the economic cycle, it is difficult to judge whether the long-term effects are already visible. In addition, it is not yet possible to observe the outcomes for a prospective generation that will hopefully be entering the labour market at a time of robust economic recovery or even to use the previous generation as a reference point.

The labour market outcomes of young people five years after completing their highest level of education vary across countries (see Chart 31). In Germany, the employment rate increased for all cohorts while in the UK, Sweden and Lithuania the 2008–09 generation seems to have suffered less than previous cohorts. In Lithuania this may be explained by the rather strong economic recovery and also by the fact that many young people migrated to other countries. In Italy and Spain (and to some extent France), sharp declines in the employment rate can be seen five years after having left education, with each generation performing worse than the previous one ([65]).

The level of education appears to have played a protective role during the recession, with the clearest evidence being in France and, to some extent, in Italy, while it is much less true in Spain. Chart 32 suggests that those who obtained a tertiary level education after 2008 have

([64]) The outcome of the 'unlucky' 2008-9 cohort is, relative to the previous one (2006-7), less unfavourable after 5 years (gap by 2 pps) than after one year (gap by 5 pps).

([65]) In Spain and Italy, the 2008-9 cohort has, five years after having left education, employment rates of around 20 and 15 pps respectively below those for the 2002-3 cohort, while it is around 10 pps for France.

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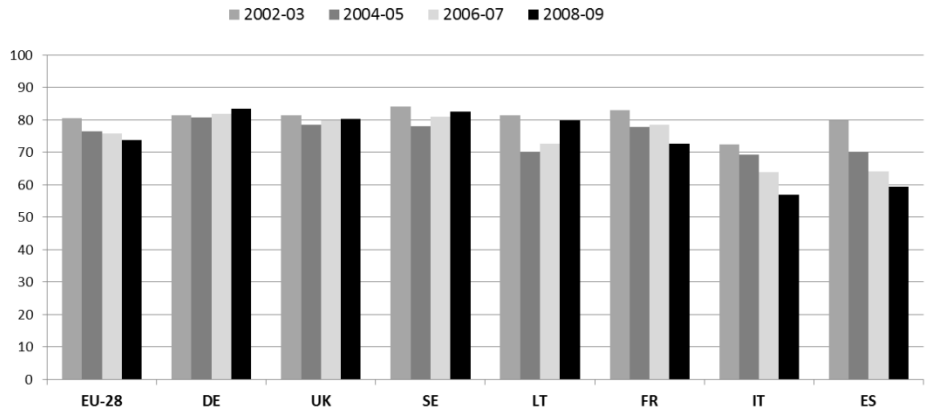
rather similar employment rates to those achieved by previous generations. In contrast, the outcomes of those having no more than upper secondary education are much worse compared with previous cohorts (Chart 33).

Chart 31: Employment rate 5 years after completion of highest level of education, by cohort by country, in % (for young people aged 20–29, no longer in education or training)



Source: Eurostat, LFS, DG EMPL calculations. Year of obtaining highest level of education is the variable HATYEAR. *Note:* for the cohort 2008–09, the employment rate after 5 years is only available for those having left education in 2008.

This protective role of higher education has been referred to in several studies drawing on the experience of past recessions, where the impact of unemployment at graduation on future income, life satisfaction and health outcomes being lower for the highly educated, see Cutler et al (2014). Likewise, a lasting effect of adverse labour market conditions at entry has been found for the low-skilled, but not the mid-skilled or high-skilled, underlining the risk of polarisation and increased inequalities, see Burgess et al (2013).

Chart 32: Employment rate 5 years after completion of highest level of education, by cohort, in % (for young people aged 20–29, no longer in education or training and having a high level of education)

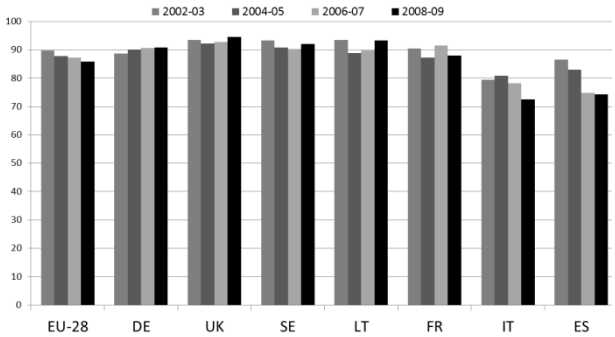
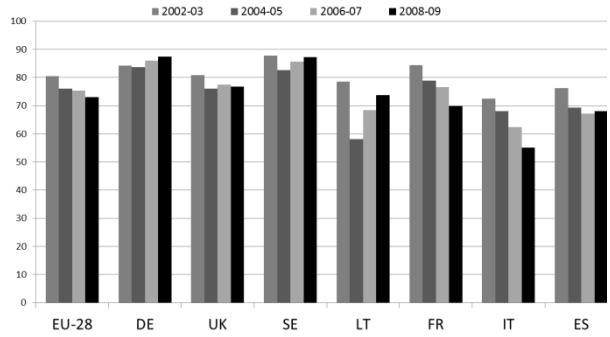


Chart 33: Employment rate 5 years after completion of highest level of education, by cohort, in % (for young people aged 20–29, no longer in education or training and having a medium level of education)



Source: Eurostat, LFS, DG EMPL calculations. Year of obtaining highest level of education is the variable HATYEAR. *Note:* for the cohort 2008–09, the employment rate after 5 years is only available for those having left education in 2008.

Another factor impacting the transitions from education to professional life is gender. European Commission (2013i) demonstrated that despite the stronger impact of the crisis on the labour market conditions of young men (particularly those aged 15–24) than young women, the latter still face worse labour market conditions overall, especially in southern and eastern EU Member States, notably due to care and family responsibilities. Nevertheless,

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educational attainment is an important factor in employment opportunities for young women and the gender gaps in employment are smaller for young people with a tertiary education.

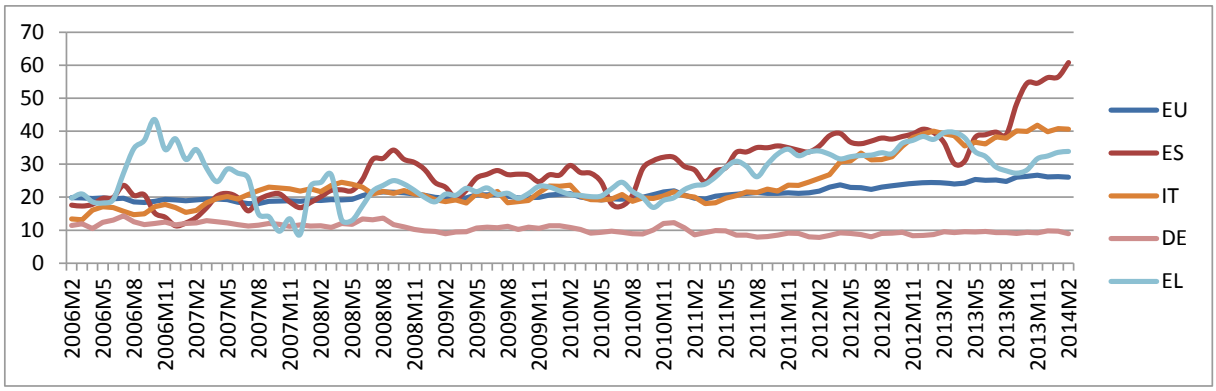
2.2 Households: running into debt, adjusting consumption and pooling resources

Running into debt

Household debt levels increased significantly in a number of Euro area countries prior to the onset of the recession (European Commission, 2014d). Household financial distress ([66]) in 2014 is now way above the long-term trend. Its recent easing in some Member States has not yet reached low-income households, who remain in the most acute financial situation (see Chart 34).

While the number of poor people with debt problems has grown as a result of the crisis, much of the increase in indebtedness has been among people who had been in well-paid employment, had lost their jobs and are now left with large outstanding mortgages on their homes with limited prospect of obtaining alternative income anytime soon (Eurofound, 2013).

Chart 34 — Financial distress of people in low-income households
Reported financial distress of the lowest quartile (share of adults reporting necessity to draw on savings and share of adults reporting need to run into debt), 2000–2014



Source: European Commission DG ECFIN, Business and Consumer Surveys (DG EMPL calculations), data non-seasonally adjusted.
Note: Three-month moving averages.

Reduced access to finance following the onset of the recession has increased the vulnerability of people and families and friends to whom they might otherwise have been able to turn to for financial support (see Chart 35) (Eurofound, 2013). In this context some people — notably those who were unemployed for over a year, unable to work due to illness or disability or retired — report being unable to turn to anybody when they need money ([67]).

([66]) Financial distress is measured as the need to draw on savings or to run into debt (*Source:* European Commission, DG ECFIN, Business and Consumers Surveys); see European Commission 2014a.

([67]) Evidence supported by qualitative reports indicates that people most hit by economic hardship face the greatest difficulties accessing credit or obtaining support from banks (see Annex 3, Extract 2).

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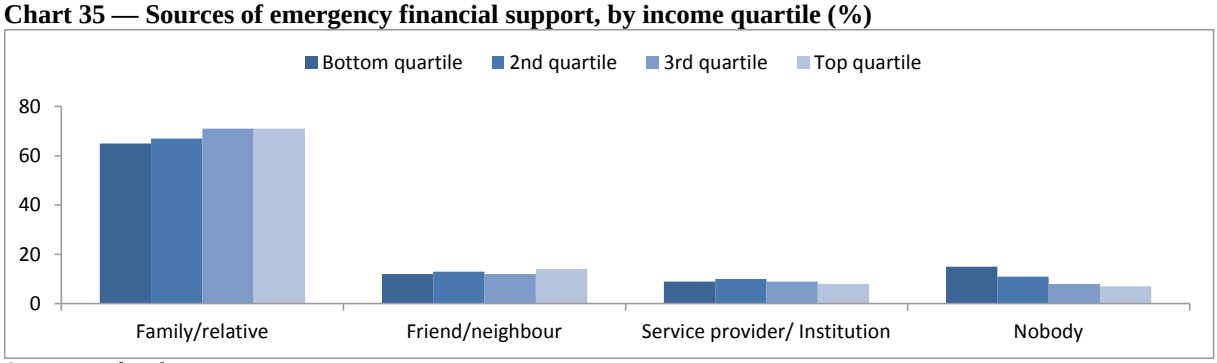
Chart 35 — Sources of emergency financial support, by income quartile (%)



Source: Eurofound

Adjusting consumption

Faced with economic hardship, people naturally adjust their consumption behaviour, and are in some cases led to cut down on essentials such as food, shelter, and healthcare. An analysis based on SILC longitudinal data (Guio and Pomati, 2014) shows that people experiencing economic hardship first cut expenditures on holidays and leisure activities, but retain a car insofar as it is necessary in order to maintain employability, while strictly limiting its use. In countries most hit by the crisis, and in poorer sections of society, this also leads to cutbacks on essentials such as food, clothing, heating and healthcare. These survey findings are further illustrated by qualitative analysis (see Annex 3, Extract 3).

Table 1: Order of renouncement to deprivation items

	EU-27	AT	BE	BG	CY	CZ	DK	EE	ES	FI	HU	IT	LT	LU	LV	MT	NL	PL	PT	RO	UK
Holidays	1	2	1	2	1	1	2	1	1	2	2	1	2	2	2	1	2	1	1	1	2
Face unexpected expenses	2	1	2	3	2	2	1	2	2	1	1	2	1	1	1	2	1	2	3	2	1
Meat/chicken/fish every second day	3	3	5	4	5	4	4	4	5	5	3	5	4	4	3	3	5	3	6	6	5
Home warm	4	6	4	1	3	5	5	6	4	6	6	4	3	5	6	6	4	4	2	5	4
Arrears	5	4	3	5	4	6	3	3	3	3	4	3	6	3	5	4	3	5	5	4	3
Car	6	5	6	6	6	3	6	5	6	4	5	6	5	6	4	5	6	6	4	3	6

Source: Guio and Pomati, 2014, own calculations based on EU-SILC 2011 longitudinal data
Note: the ranking shows the more frequent order of renouncement of items within households as long as their deprivation increases.

Pooling resources

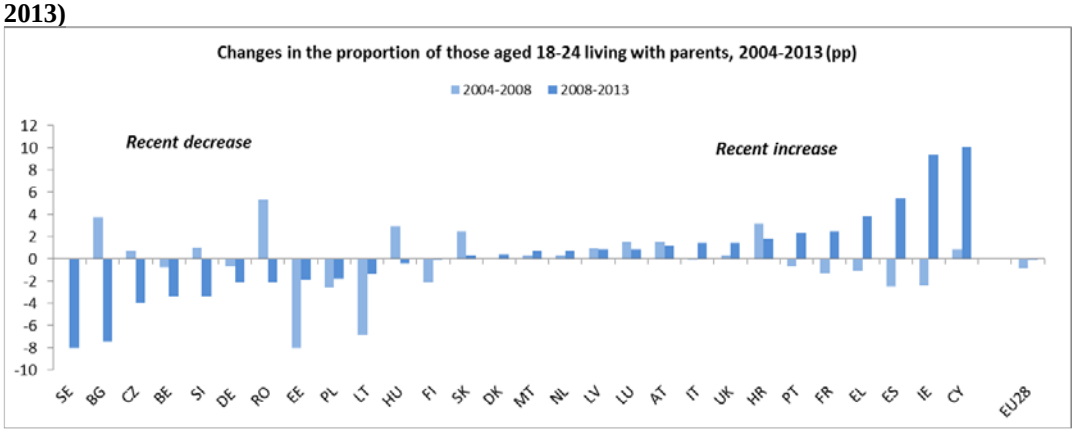
If there is insufficient income support, people experiencing hardship have to rely on other income sources, such as financial help from the family, informal work or sometimes non-governmental support (soup kitchen, food banks, etc.). A typical example in some countries would involve pooling resources within multi-generational households, with pensions received by elderly household members serving as a major source of income for all ([68]).

A study on ways in which households seek to mitigate the effects of unemployment (Bentolila, 2008) shows that in Member States where the 'welfare state fails to mitigate the consequences of unemployment, the role of family support is stronger' and that 'family networks represent an important device that allows households to insure against labour market risk.' This can lead to changes in the composition of households, with adult children staying longer or moving back to the parental home, or separated partners sharing the same property.

([68]) This trade-off between government income support and household solidarity is documented in European Commission, 2013a. It shows that Member States with widely available income support have lower shares of working age adults living in intergenerational households and depending on the pensions of the elderly.

Across the EU as a whole, there is little evidence that the recession *as such* led to any major change as regards young people living with their parents (see Chart 36) although there have been substantial increases (e.g. + 4 percentage points) in the proportion of young people living with their parents in Ireland, Spain, and Greece since 2008. Qualitative research shows that people sometimes have had no other choice than to rely on family solidarity (see Annex 3, Extract 4).

Chart 36 — Access to autonomy: changes in the share of young people living with their parents (2004–2013)



Source: Social Situation Monitor, based on LFS data.

2.3 Impact on health and access to healthcare

The potential long-term impact of the crisis on health determinants (i.e., unemployment, quality of work, precarious living conditions) is threatening to increase health inequalities between social groups and Member States. There is extensive research documenting the negative impact of economic hardship on the health status of individuals, which in a recession may be further exacerbated by greater difficulties in accessing or paying for healthcare.

Many studies report that, during recessions, individuals are more likely to suffer from depression and stress (Cooper, 2011). Otterbach (2014) also reports, on the basis of long-lasting panel data, that being unemployed or insecure in one's job has a strong negative effect on life satisfaction and health.

OECD (2014d) also notes evidence of a possible link between the economic crisis and obesity. Many families, especially in the worst hit countries, have been forced to cut food consumption or to switch to lower-priced and less healthy foods. Brenner (2013) identified unemployment as an important risk factor for heart disease mortality at the start of the 2008/9 recession. Stuckler et al. 2011, Reeves et al. 2012 reports a higher suicide rate during recessions. In Italy, the suicide rate increased by 10 % among men younger than 65 between 2006 and 2010, with an increase by 25 % within the 50–54 age group ([69]).

([69]) *Source:* Eurostat, Causes of death — crude death rate per 100 000 inhabitants [hlth_cd_acdr].

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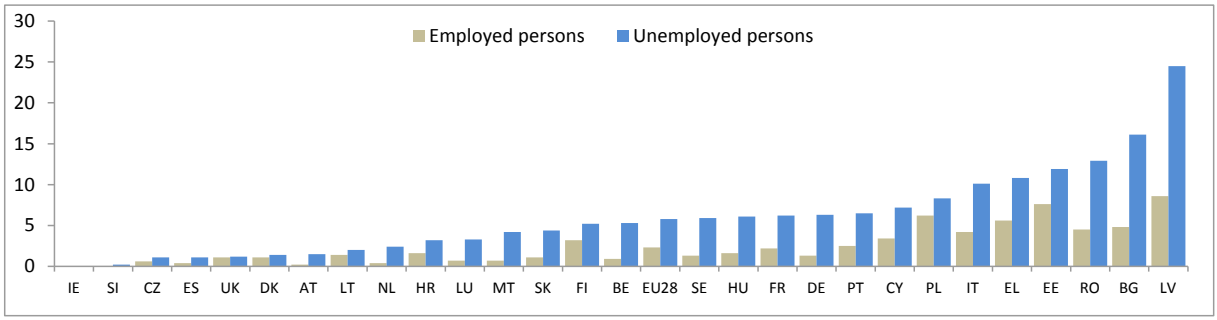
The harmful and hazardous use of alcohol and other substances are also key factors in the development of social and health inequalities in the EU, influenced by unemployment and economic downturns (European Commission, 2013, Marmot et al. 2013).

Chart 37 shows that, in many Member States, the unmet need for healthcare is much greater among the unemployed than among the employed. Eurofound (2014, forthcoming) also identified situations in which people lost access to healthcare during the crisis ([70]). These findings are also illustrated by the qualitative analysis (see Annex 3, Extract 5).

Chart 37 — Unmet need for healthcare by employment status



Source: EU-SILC, Eurostat. Unmet need for healthcare is measured as the share of individuals renouncing healthcare because of: cost, i.e. the person cannot afford to pay for it (too expensive); the waiting list; or distance or means of transportation ([71]).

The share of the population with self-reported unmet healthcare needs in terms of medical examinations or treatment ([72]) increased between 2007 and 2011 in the majority of Member States. Despite greater needs in the wake of the crisis, many governments have cut spending on healthcare services (Eurofound, 2014), especially in countries most hit by the crisis since 2010 (OECD, 2014c). Unmet healthcare needs also increased in some Member States where per capita real expenditure in sickness, healthcare and disability is still higher than it had been in 2007 (Chart 38). This may be explained by other health expenditure being cut such as for medical equipment and investments in hospitals ([73]).

([70]) People experiencing: a) reduced disposable income, increased living cost or debt problems; b) loss of insurance; c) the 'twilight zone', being marginally beyond the entitlement threshold; d) new situations, not familiar with entitlements or entitlements not adjusted to these situations; e) reduced coverage; f) need for services particularly affected by cuts; g) being part of an increased-need patient group; h) closure of nearby healthcare providers with insufficient 'replacement services'; i) decentralised financing of healthcare services and taxes in areas affected by the crisis; j) staff shortages; and k) discrimination with increased xenophobia and crisis-induced migration.

([71]) This definition also applies to the European Core Health Indicator (ECHI) on Equity of access to healthcare service (ECHI 80) for total population and by educational level.

([72]) Unmet need may also serve as a possible proxy for health outcome as health outcomes are in part determined by access to healthcare services. The indicator on self-reported unmet need for medical care may induce some comparability issues due to cultural differences between countries. However, over time changes can be more directly linked to changes in health expenditure. http://www.echim.org/docs/Final_Report_II_2012.pdf

([73]) In Ireland, for instance, while expenditure for sickness and disability did not decrease over the period 2007–11, per capita health spending has experienced a sharp decline since 2010 (OECD, 2014c).

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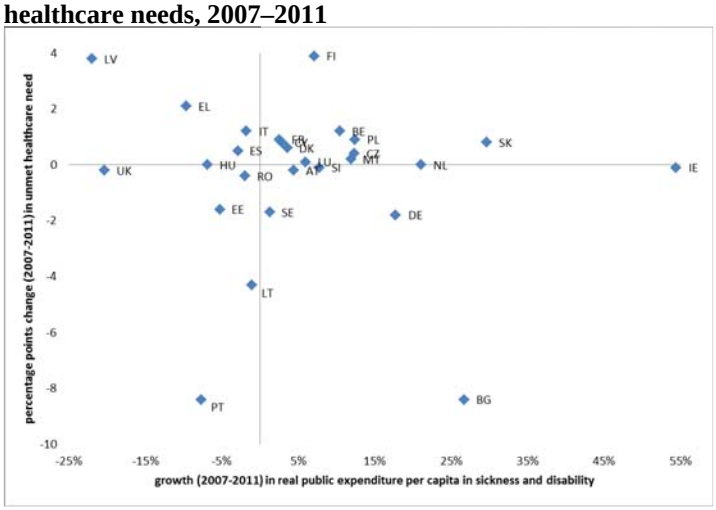
Chart 38 — Correlation of real expenditure per capita on sickness, healthcare, disability and unmet healthcare needs, 2007–2011



Source: ESSPROS for expenditure in sickness, healthcare and disability.

Clearly the relationship between expenditure and outcomes in health is not straightforward. Reforms cutting public health expenditure aimed at improving efficiency may have undesired effects ([74]), shift the burden of healthcare payments to the user's ability to pay, reduce the bundle of healthcare services, increase waiting time and affect particularly disadvantaged groups. It is also possible to reduce expenditure without reducing access or improving outcomes via cost-effective reforms. Taking into account gender-specific needs can contribute to the efficiency and sustainability of health systems. Supplementary measures of health outcomes (such as social gradient in health), a longer time-horizon and country-specific analyses are needed for a better assessment.

2.4 Weakening trust in institutions

Trust is a necessary condition for the maintenance of democratic institutions and respect for civic society rules. Since the recession, this trust has decreased across the Union, although a clear divergence can be seen between countries that were less affected by the recession and show a more positive perception of social climate and trust in institutions compared with countries that were more affected and show a more negative perception of trust in institutions (see Chart 41).

([74]) For instance, in 2006 the Netherlands introduced a dual system with obligatory private health insurance (covering short-term care) and public health expenditure (covering long-term care) increased in real terms by 10 %, while between 2000 and 2005 it grew by an annual average of 2 %.

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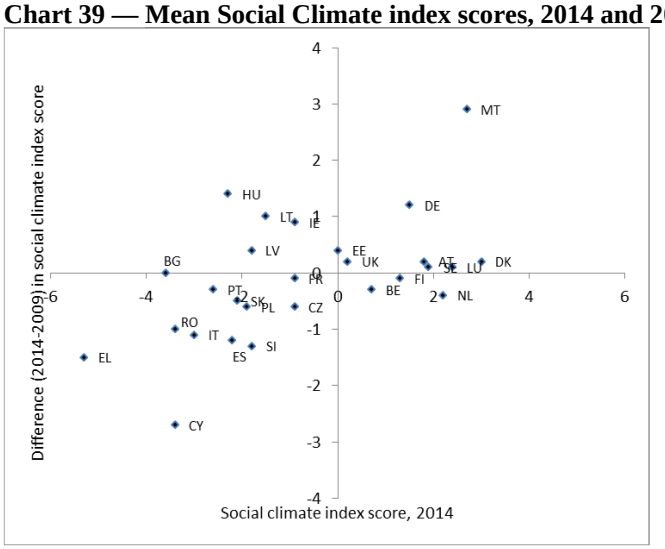
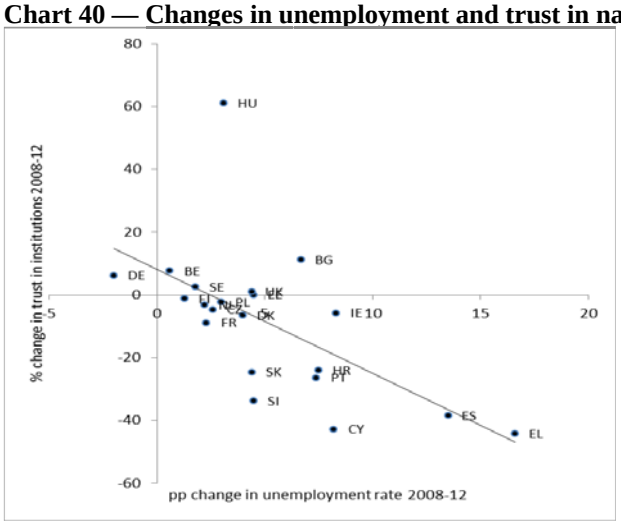
Chart 39 — Mean Social Climate index scores, 2014 and 2009–2014 change.



Source: Fabian at al. (2014) based on Eurobarometer.
Note: Numbers are mean scores of responses to fifteen questions about personal and general situations and perceived social protection and inclusion policy factors. SC-index scores have a theoretical range of –10 to +10.

Factors such as the evolution of the unemployment rate across the EU countries, appear to be closely related to these changes (Fabian, 2014) with increases in unemployment being related with lower levels of institutional trust, less favourable attitudes towards immigrants, and lower life satisfaction (also when controlling for other variables).

Chart 40 — Changes in unemployment and trust in national political institutions, 2008–12



Source: Eurostat, EU-LFS and European Social Survey, Social Situation Monitor calculations

Within the population as a whole, the unemployed have the least trust in institutions, whether at EU or national level, with trust levels in the EU having fallen much further over the course of the recession for them. Qualitative evidence demonstrates the extent to which unemployed people feel ignored by their representatives. It also illustrates the fact that, while public services are often seen as a source of support, they are sometimes rejected along with other institutions in some Member States (see Annex 3, Extracts 6 and 7).

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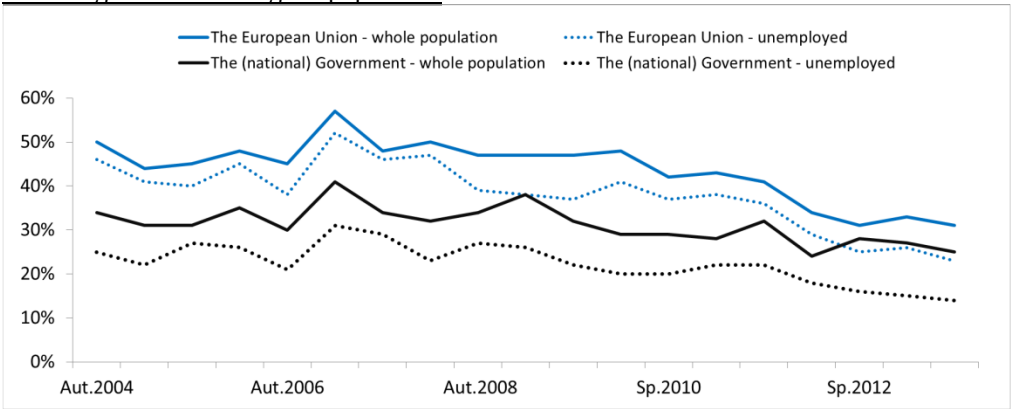
Chart 41 — Distrust in institutions over time: unemployed and whole population
Percentage of trust among the population



Source: Standard Eurobarometer 80/ Autumn 2013: TNS opinion & social, 2013

3 THE IMPACT OF THE RECESSION ON WELFARE SYSTEMS

3.1 The three functions of social spending: investment, stabilisation and protection

Social spending covers three broad functions: investment, protection and stabilisation.

- Social investment means investing in people, rather than simply compensating them, with a view to future returns in terms of employment and social participation. Expenditure in policy areas such as education, quality childcare, healthcare, training, job-search assistance and rehabilitation is seen as a productive factor for strengthening people's skills and capacities in order to prepare them for working life over the longer term (Van Kersbergen and Hemerijck, 2012).

- Social protection seeks to support and protect people against life-cycle and income risks.

- The overall objective in terms of stabilisation is to sustain households' incomes (and, consequently, aggregate demand), notably during recessions.

While there is no unique relationship between specific social policies and these three functions — investment, protection and stabilisation — specific policies may be more oriented towards one or other of these functions. For example, policies on childcare, labour market activation, rehabilitation, education or training are particularly related to the social investment function, while healthcare provision is related to both protection and investment (including the prevention of disease). On the other hand, pension systems and unemployment benefit systems may address all three social functions (European Commission, 2013e).

Box: Government and social protection data

At European level, there are two different accounting frameworks for the monitoring of social spending:

The European System of Integrated Social Protection Statistics (ESSPROS) covers social protection, defined as all interventions from public and private bodies intended to relieve households and individuals of the burden of a defined set of risks and needs ([75]).

The Classification of the Functions of Government (COFOG) covers all transactions undertaken by units in the general government sector ([76]), including government spending for the three functions discussed above (included under the COFOG functions of health, education and social protection).

Within this framework:

- Section 3.2 presents the development of government spending and benchmarks the evolution of social spending (including social protection, health and education) against other categories of expenditure.

([75]) Provided that there is neither simultaneous reciprocal nor an individual arrangement involved (see Eurostat, ESSPROS Manual, 2011).
([76]) These transactions included in COFOG correspond to those defined and recorded in national accounts under ESA95 (see Eurostat, Manual on sources and methods for the compilation of COFOG statistics, 2007).

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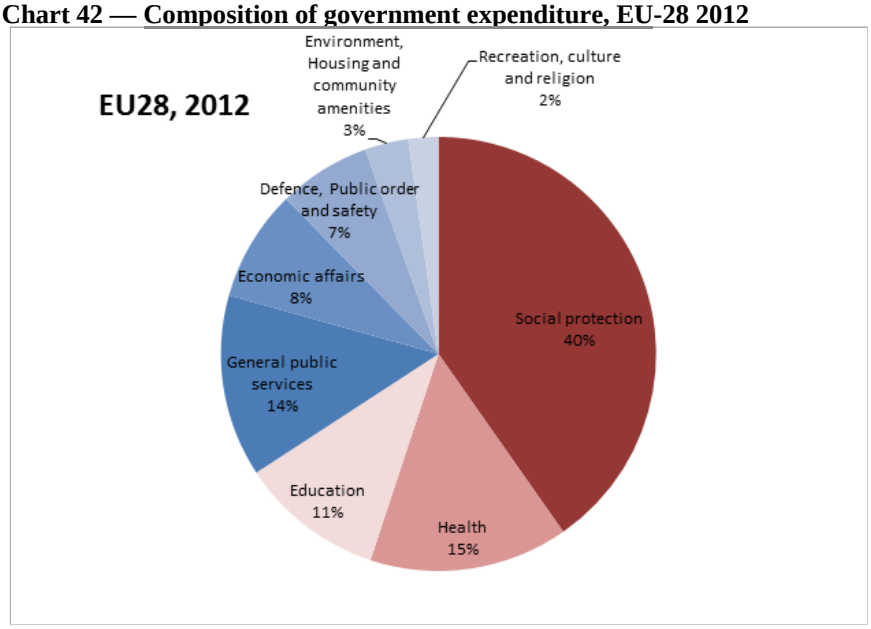
- Section 3.3 presents the changes in social investment for different population groups (children and families, youth, working age).
- Section 3.4 considers the developments of social protection as automatic stabiliser.
- Section 3.5 discusses whether changes in the financing of social protection can have an impact on the coverage of social protection.

3.2 The developments of government and social expenditure during the crisis

The development of social spending is not fully explained by cyclical factors

Social spending, including for education, health and social protection, accounts for two-thirds of total government expenditure, with social protection being the largest component (Chart 42). During the current recession, the share of total EU GDP absorbed by government expenditure increased from 46 % in 2007 to almost 50 % in 2012 with social spending increasing by 11 % while overall government expenditure increased by 8 % at EU level (Chart 43). Within these average EU figures, however, the balance and development of government expenditure between different categories can vary considerably between Member States.

Chart 42 — Composition of government expenditure, EU-28 2012



Source: COFOG.
Notes: General public services corresponds to executive and legislative organs, financial, fiscal, external affairs, foreign economic aid, general services, basic research, R&D general public services, general public services n.e.c., public debt transactions, transfers of a general character between different levels of government.

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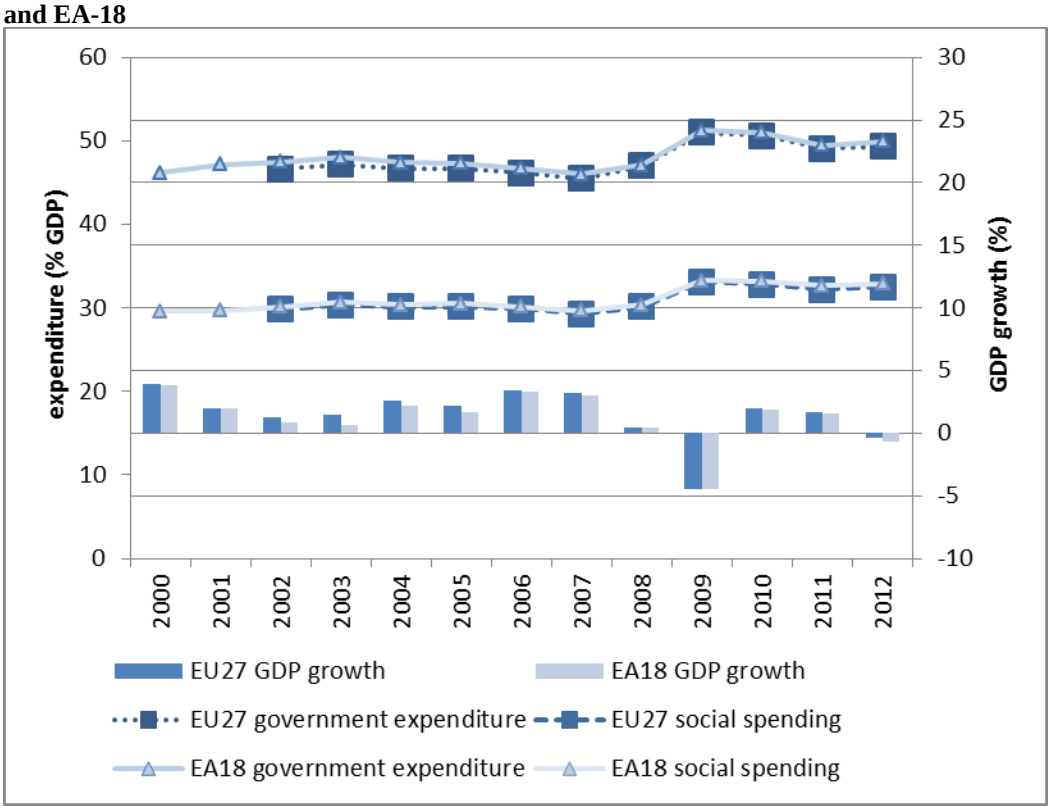
Chart 43 — Share of government and social spending (education, health, social protection) in GDP, EU-27 and EA-18



Source: COFOG. *Notes:* Social spending includes public expenditure in healthcare, education and social protection.

The counter-cyclical nature of social protection — rising in periods of recession and falling in periods of recovery — largely explains its contribution to increased government spending in the first phase of the crisis. However, this cannot explain its contribution (together with education and health expenditure) to the fall in the second phase, from 2011 to 2012 (Chart 44). In some Member States social protection was reduced proportionally more than total government expenditure, while biases towards specific categories of expenditure were not addressed (as in EL and NL) or introduced (as in ES for economic affairs ([77])).

([77]) Economic affairs corresponds to expenditure for General economic, commercial and labour affairs, Agriculture, forestry, fishing and hunting, Fuel and energy, Mining, manufacturing and construction, Transport, Communication, Other industries, R&D, Economic affairs, including expenditure for the bailout of banks.

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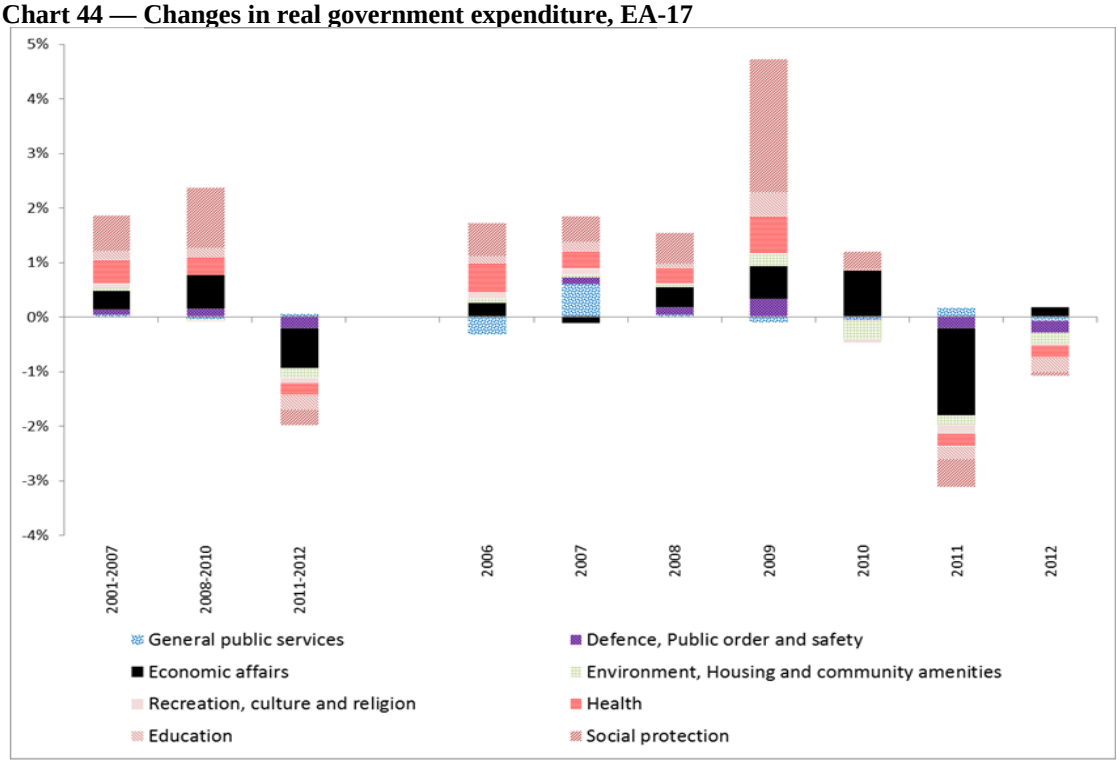
Chart 44 — Changes in real government expenditure, EA-17



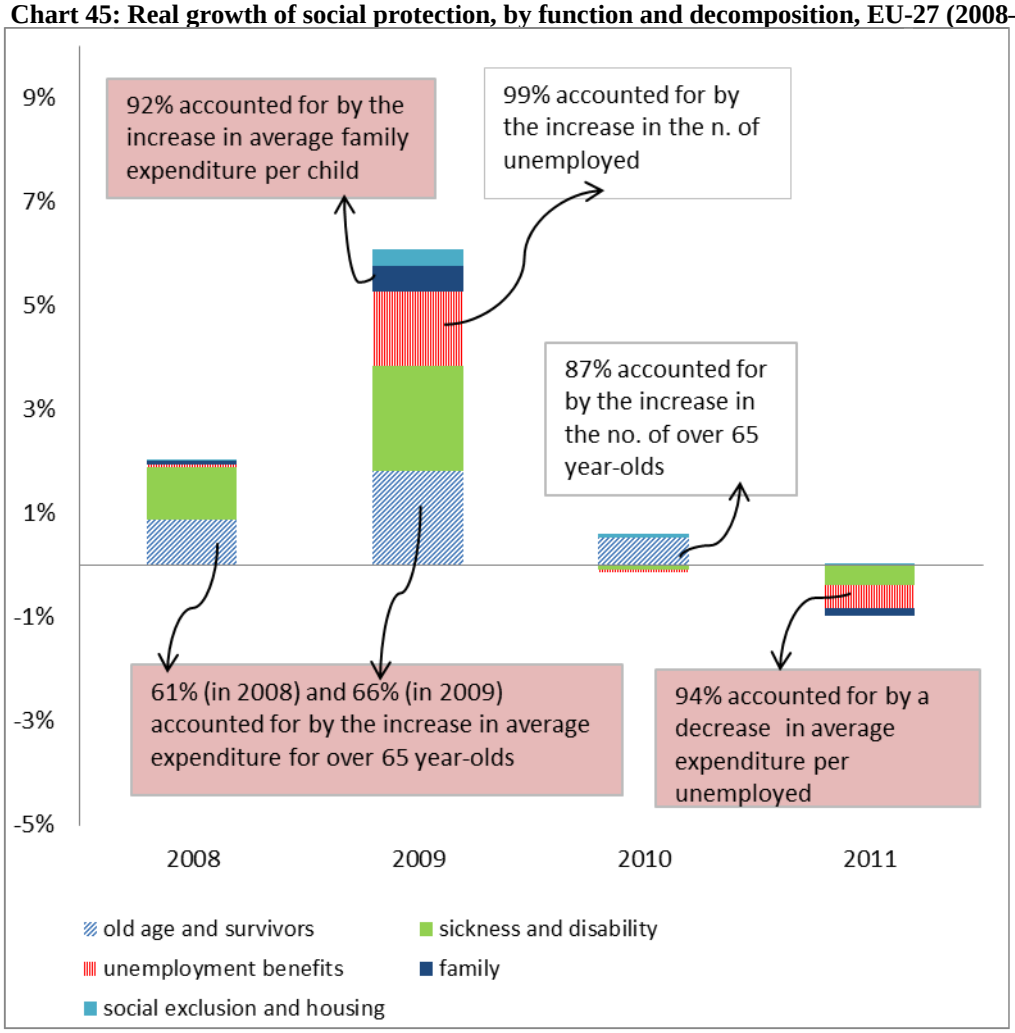
Source: COFOG

After 2010 average unemployment benefits per unemployed person and in-kind (health) benefits were reduced

In the initial phase of the crisis, increases in social expenditure were mostly due to expenditure on sickness and disability support, pension expenditure, unemployment and family expenditure on children, with the rise in pension and family expenditure per beneficiary being partly explained by the lagged effects of the indexation mechanism in place (European Commission, 2013a).

In 2011, however, social protection expenditure declined on average in the EU-27 and in most individual Member States, mostly due to a decrease in the average expenditure per unemployed person (itself partly explained by the phasing-out of benefits for the long-term unemployed), as well as by reductions in expenditure on sickness and disability and on average family expenditure per child.

Chart 45: Real growth of social protection, by function and decomposition, EU-27 (2008–2011)



Source: ESSPROS, elaborations from ESDE 2013. *Notes:* shaded boxes correspond to changes not due to socio-demographic factors.

While declines in social expenditure in 2011 affected both cash and in-kind services, in 2012 they were concentrated on in-kind benefits. This is mainly explained by a reduction in in-kind sickness and disability benefits, although in-kind family benefits increased in many Member States despite the reduction in average expenditure per child. Such reductions in in-kind benefits are not reflected in household incomes and measurements of monetary income poverty, but they might be reflected in measures of households' access and provision of services (European Commission, 2013a).

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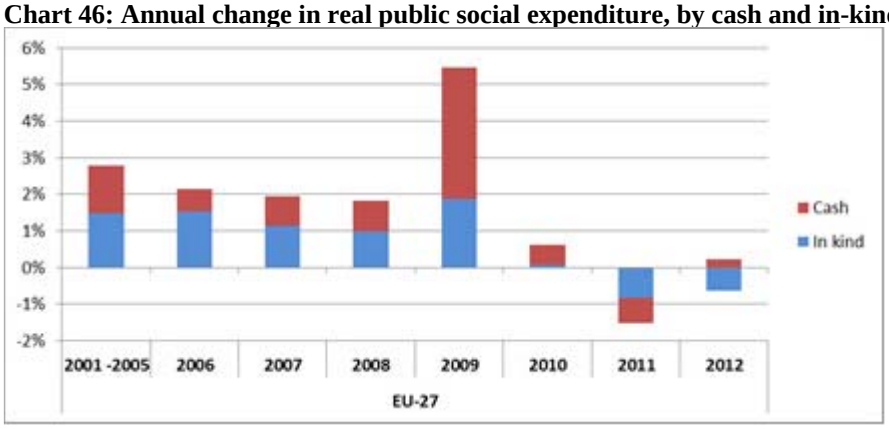
Chart 46: Annual change in real public social expenditure, by cash and in-kind benefits



Source: National Accounts

3.3 Investing in children and families, young and working-age population

Social investment as a broad policy perspective emerged in the 1990s with the aim of ensuring the sustainability of the welfare state in the face of new social risks and changing economic needs and challenges. The key aims of social investment expenditure are seen to be to promote active employment and social participation, social cohesion and stability (Van Kersbergen and Hemerijk, 2012) based on support for the development of human capital and strengthened family links to the economy through employment (Vanderbroucke et al., 2011). As such, the policy focus has been on education, active labour market policies, early childhood education, preventive healthcare, health and safety at work, and retraining and lifelong education (see the Social Investment Package).

Box: The multiple functions of childcare

There is a growing awareness of the crucial importance of addressing early child development in a positive way. Several long-term studies have highlighted the benefit of quality childcare on child development through into adulthood (see European Commission 2014e) — something that is seen as particularly important for the most disadvantaged.

The availability, the quality and the flexibility of childcare is also seen to influence the employment participation decisions of parents[1]. Widely available full-day and after-school care in the Nordic countries and France have made it easier for parents to work full-time if they wish, whereas in Austria, Germany or Luxembourg, kindergartens typically operate short days or have long breaks that may not be compatible with full-time work.

Enrolment hours can also have particular implications for female participation in the labour market. In those Member States where more women work shorter part-time hours, the offer of a formal care system is also lower. Nevertheless, as enrolment can contribute to the achievement of a work-life balance and overcome the trade-off between inactivity and part-time employment, it can still be seen as preferential to no enrolment at all. On the other side, longer enrolment hours of care tend, in practice, to be matched with longer working hours of females.

Finally, an expansion of childcare services contributes to increasing formal employment opportunities for women.

Investments in childcare are intended to help reconcile the working and family life of parents, while improving future educational performance, particularly of disadvantaged children.

Investments in education, while primarily intended to enhance the quality of lives of future generations, are also expected to raise skill levels and improve employment outcomes, while reducing inequality and poverty. Active labour market measures aim to improve and maintain employability of both the employed and the unemployed.

From a demand-side perspective, they also provide a positive stimulus by reducing costs of labour, mitigating risks for employers of recruiting new workers, and providing training support as well as financial incentives to the self-employed. Even in times of weak labour demand, they may increase employability, help the unemployed to remain active with the support of public employment services, with such measures having been found to have a positive impact as reflected in higher employment rates — see Kluve (2010).

Van Kersbergen and Hemerijk (2012) consider that, in the period leading up to the recession, a number of European welfare systems had been developing in the direction of the social investment model, and that this had resulted in increased labour market participation. At the same time, however, this focus on activation may have distracted attention away from policies designed to cover social risks, with the further risk that the recession could endanger the continuing progress of the social investment model. Some authors suggest that the crisis has increased the need for social investment, although countries most in need of social investment tend to lag behind (Kvist, 2013 ([78])).

Since the onset of the recession, the pattern of social investment expenditure has changed somewhat. While the trend towards increasing social investment in children and families through childcare has continued, investments targeted on the unemployed and on education have weakened. However, such patterns differ widely between Member States with some clearly moving towards a social investment model, while others appear to be moving away from it.

The importance of investing and protecting people

The evidence from the crisis suggests that an adequate level of social investment helps people to continue to remain active or available for work, even in periods of recession. Social investment alone may not be enough, however. For instance, increasing investments in education in most Member States during the last decades have not contained growing income inequalities, just as improved employment opportunities have not always resulted in lower levels of poverty (Salverda et al., 2014; OECD, 2011). In that respect it has been argued that more direct measures aiming at equality of outcomes may be more effective than indirect measures through educational systems (Solga, 2014).

Investments in childcare continue and are improving in some Member States

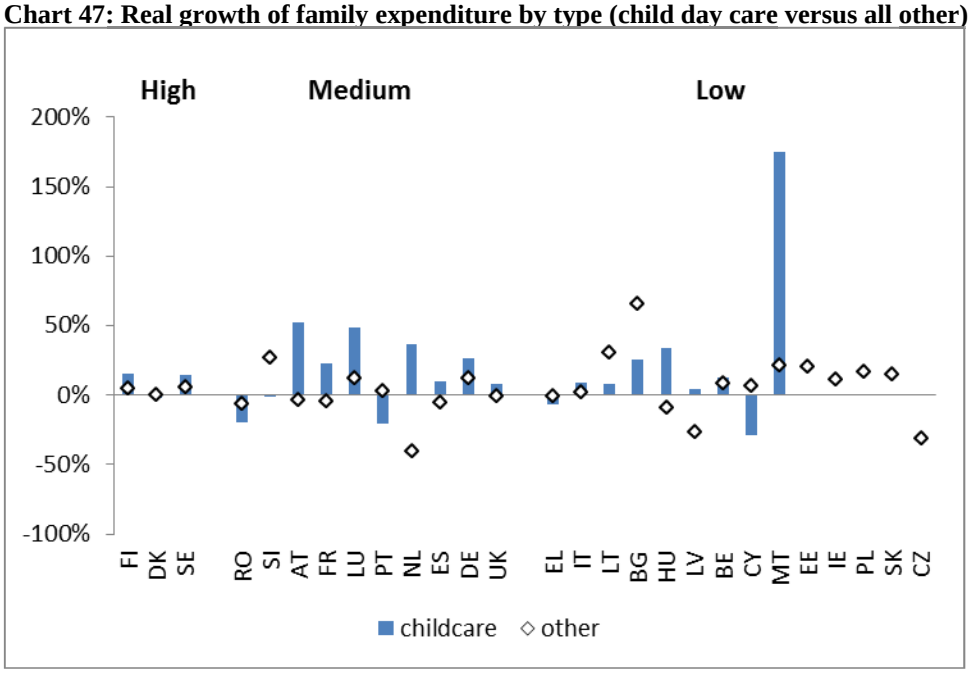
In terms of family expenditure since the onset of the recession, it is useful to distinguish between investments — as in child day care — and benefits such as income maintenance in the event of childbirth, birth grants, parental leave benefits, family or child allowances, accommodation, home help and other benefits.

Expenditure for child day care and families was on the increase before the recession but, since the onset of the crisis, increases in family expenditure have slowed although the share of

([78]) This study analyses social investment in terms of coverage it seems, not in terms of expenditure.

expenditure for childcare has been preserved and even improved in some Member States. Chart (above) shows that real expenditure for child day care has increased in most Member States since the recession, and has also increased more than other family expenditures. This has been notably the case in MT and, to a lesser extent in AT, HU, DE, FR, LU, and NL. However, child day care expenditure actually decreased in real terms between 2007 and 2011 in EL, CY, PT and RO.

Chart 47: Real growth of family expenditure by type (child day care versus all other) (2007–2011)



Source: ESSPROS. *Notes:* The ranking of Member States is based on child day care expenditure per child in terms of GDP per capita in 2007 (Group High: above 50 % of maximum value; Group Medium: between 20 % and 50 %; Group Low: below 20 %). The children population is defined from age 0 until the age at which at least 85 % of the children are enrolled in child day care. Data on child day care expenditure for EE, IE, PL, SK and CZ are not reported as they are not reliable (ESSPROS report zero spending for one or more years).

Since the recession investments in education decreased in around half of the EU-27 Member States

While investments in education had been increasing in all Member States before the recession, they began to decrease in around half of the countries as the crisis developed. Chart 48a shows the evolution of real expenditure in education between 2007 and 2012, compared to the evolution of total real government expenditure.

The reduction in investment in education was particularly strong in RO (almost 40 %), HU (more than 30 %), UK, LV, EL, IT and PT (around 20 %), especially in most recent years with anticipations of further cuts in CY, PT and the UK (European Commission, 2013f). Cuts in education have resulted in teachers' salary cuts and freezes, a reduction in the number of teachers, restrictions to financial support for students, and an increased targeting of adult education in some Member States, although budgets for ITC resources were generally preserved (European Commission, 2013f). Cuts in education spending are further aggravated by the fact that they occurred in Member States with a poor educational performance, as shown in Chart 48b. Although there is a certain correlation between expenditure in education and educational performance, more spending does not necessarily guarantee a better performance, but cuts are not a sign of progress either (Vandenbroucke, 2014). In Member States where education expenditure did increase, however, a split can be seen between those

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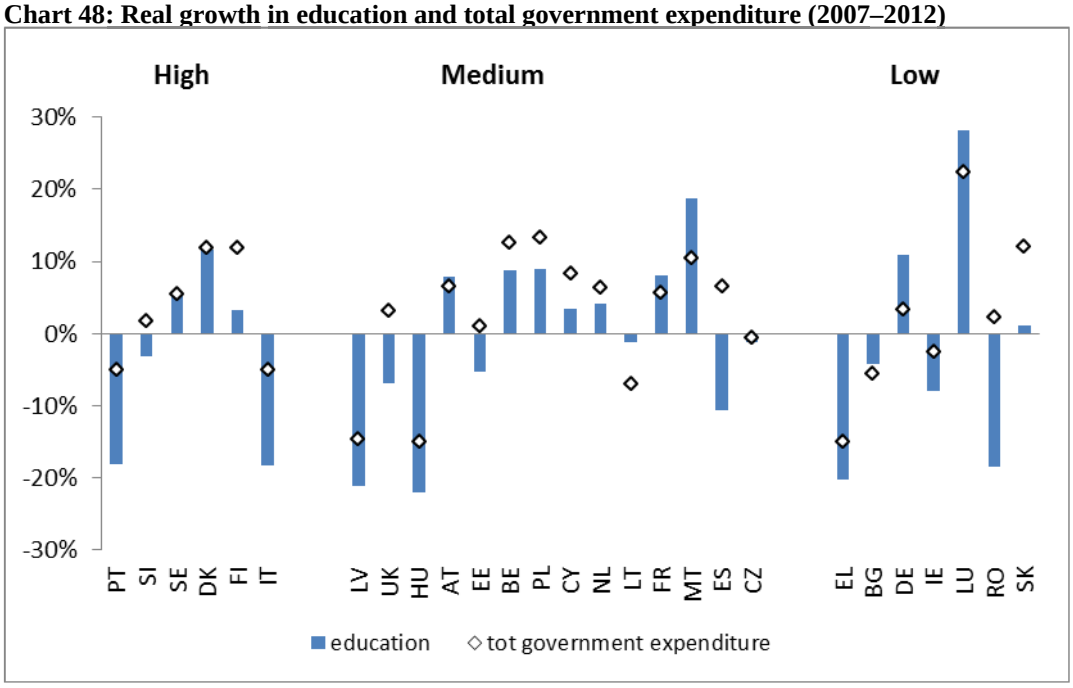
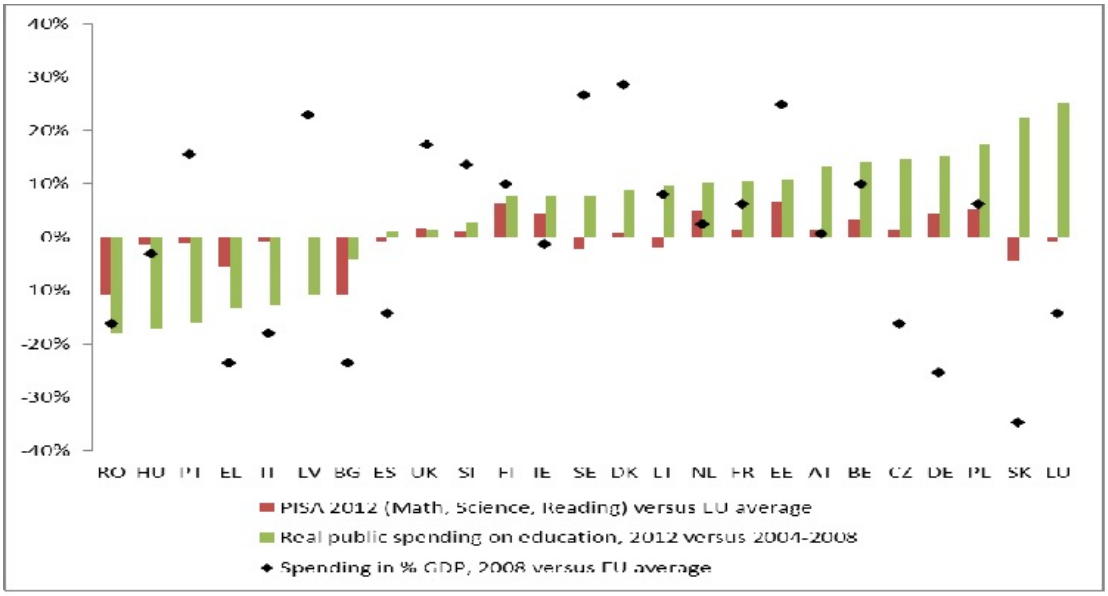
where it increased proportionally less than total government expenditure, and those where it increased more, as in SE, AT, FR, LU and, especially, in MT and DE.

Chart 48: Real growth in education and total government expenditure (2007–2012)



Source: COFOG. *Notes*: The ranking of Member States is based on education expenditure per young in terms of GDP per capita in 2007 (Group High: above 90% of maximum value; Group Medium: between 70% and 90%; Group Low: below 70%). The young population is defined from the age until less than 85% of the children are not enrolled anymore in child day care until 24.

Chart 48b: Real development in education expenditure (2012 versus 2004–2008) and relative educational performance (PISA test scores, 2012)



Source: Vandenbroucke (2014).

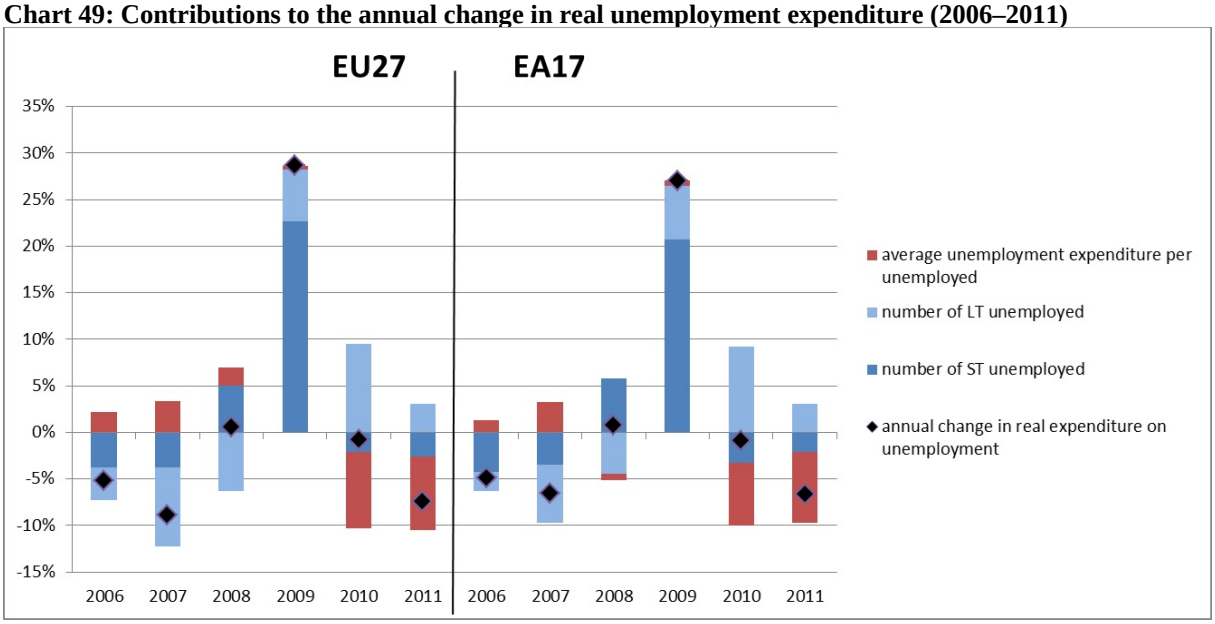
Investment in the working-age population through mostly active unemployment measures has reduced

With regard to unemployment-related expenditure, it is useful to distinguish between measures that can be categorised as primarily active (vocational training allowance, vocational training in-kind, placement services and job-search assistance) and those than can be categorised as mainly passive (full and partial ([79]) unemployment benefits, early retirement benefits for labour market reasons, redundancy compensation, mobility and resettlements and other benefits) ([80]). Measures defined as mostly passive (such as unemployment benefits) may nevertheless include an activation part through, for instance, the use of conditionality with respect to job-search requirements.

The activation component depends very much on the design of unemployment benefits, which varies considerably across Member States in terms of the strictness of the eligibility criteria for their receipt. For instance, job-search monitoring is more demanding in SK, UK, PT and NL than it is in IT, EL and SE, while job-search and availability requirements are more demanding in DE, DK and SK than they are in BE, EL and BG. Likewise sanctions are stricter in EL, SI and RO than they are in NL, DE and AT (Venn, 2012 ([81]).

While total EU unemployment expenditure had been falling prior to the recession as labour market conditions improved, developments since have been affected by divergent forces — increases in the average level of unemployment expenditure per unemployed person, on the one hand, off-set by reductions in the number of short and, especially, long-term unemployed.

Chart 49: Contributions to the annual change in real unemployment expenditure (2006–2011)



Source: ESSPROS from European Commission, 2013a.

([79]) In this framework we define partial unemployment benefits as a mostly passive measure. However, given their importance to keep people in the labour market they are analysed more in detail in Section 4.4, together with short time working arrangements.
([80]) These correspond to the types of benefits available in the ESSPROS framework. Some active measures, in particular those helping both business and the unemployed (wage subsidies, exemptions from paying employers' SSC, etc.) are not included in the ESSPROS Core system (ESSPROS Manual).
([81]) Data refer to 2010.

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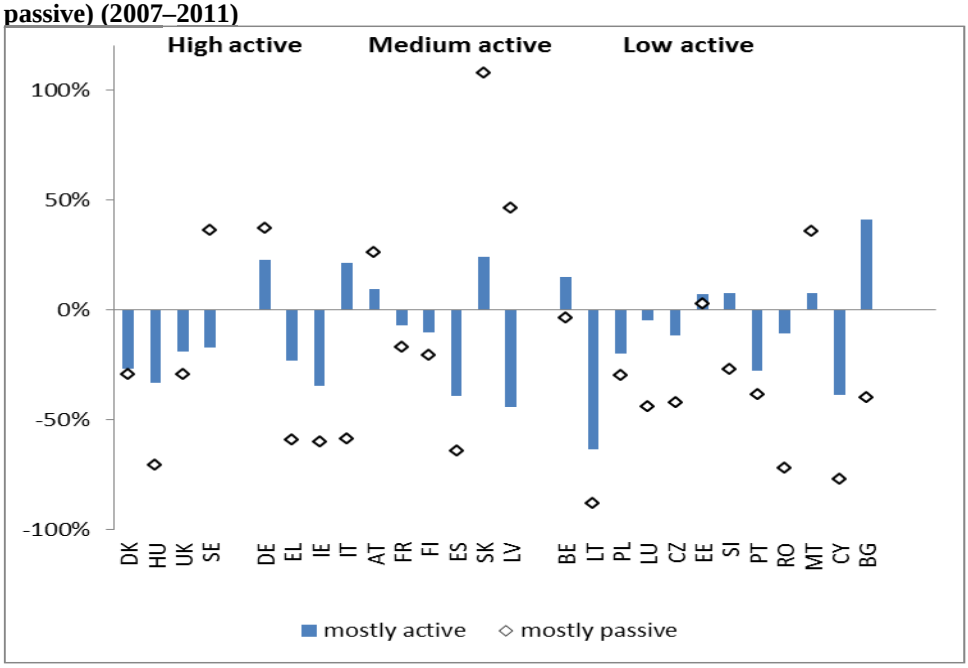
In the first phase of the crisis — from 2008 to 2009 — unemployment expenditure across the EU increased, mostly due to the increased number of unemployed (European Commission, 2013a), although it actually fell in DE as the number of unemployed decreased, but also in PL — but in the latter case due to a reduction in the average unemployment expenditure per unemployed person (European Commission, 2013a).

During the crisis, however, most Member States reduced real unemployment spending per unemployed person on measures that were primarily active, this being notably the case of LT, RO and CY, where such spending was already low, and in HU. This declining trend is particularly problematic in countries such as CY, HU and BG where the activation component within the standard unemployment benefits system was already very limited ([82]).

In most other Member States, unemployment benefit payments increased proportionally more than spending on active measures as unemployment rose and labour demand fell, although expenditure on mostly active unemployment measures did increase in some Member States which had previously invested comparatively less in these types of measures (EE and particularly MT) as well as in SE, DE, AT, SK and LV.

Chart 50: Real growth of unemployment expenditure per unemployed by type (primarily active, primarily passive) (2007–2011)



Source: ESSPROS. *Notes:* Member States are grouped according to the level of unemployment expenditure per unemployed in mostly active measures in 2007 (in % GDP). NL is missing as data breakdown is not reliable.

Some countries are evolving towards a social investment model, while others are departing from it

Some of the Member States with relatively high levels of social investment appear to have maintained the resilience of their systems during the recession, as measured in terms of levels

([82]) Based on Venn (2012) scoring of job-search, monitoring and job sanctions.

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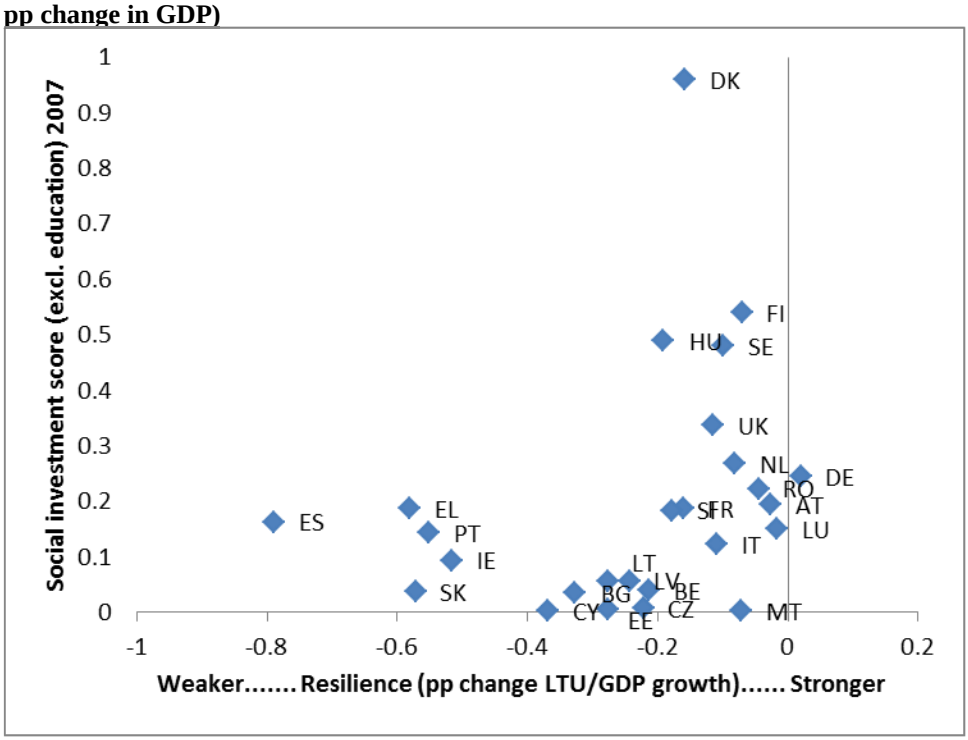
of LTU and GDP — this being particularly noticeable in the case in DE, which managed to decrease LTU. However Chart 82 suggests that, while social investment may improve resilience, it is also subject to decreasing returns with, for example, the high level of social investment in DK seen to be doing more to ensure initial low levels of LTU than to contain the effects of economic shocks on LTU.

Chart 51: Correlation between social investment (excluding education) and resilience (pp change in LTU / pp change in GDP)



Notes: The social investment score is based on 2007 values of child day care and mostly active unemployment expenditure per unemployed, where both areas are assigned equal weight. Resilience is measured by the ratio between the pp change in LTU in 2009–2010 and GDP growth in 2008–2009. PL is not reported in the chart as it did not have a negative economic shock in this period. For NL the social investment score is based only on education and child day care expenditure as data for mostly active unemployment measures are not reliable in ESSPROS.

Table 2 summarises the development in real terms of social investment in specific areas (education, unemployment, family) across Member States since the recession. This assessment of the evolution towards a social investment model takes into account the orientation of welfare systems before the recession, with Member States divided into three groups (low/medium/high), based on the level of investment in child day care per relevant child population, mostly active unemployment expenditure per unemployed and education expenditure per relevant young population in 2007. The overall score of social investment is measured by assigning equal weights to the three areas and the growth over 2007–2011 corresponds to the average growth in the three areas.

Member States that started with low levels of social investment and whose investments were subsequently reduced further (Low/Decreased in the Table) represent a particular concern. Member States starting from low levels, but where social investments increased, are promising as it seems that they can expect the highest returns. In some Member States, social investment increased in some areas, while not in others. For instance, in PL investment in

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education increased, while it decreased in child day care and active unemployment measures in real terms.

During the recession social investments were concentrated more on children than on young people and adults, and also on addressing life-cycle risks (such as parenthood) than on income groups risks (such as unemployment). Continuing previous trends, investments in children and families have increased in most Member States, with the exception of CY, RO, EL and PT.

The majority of Member States with previously medium and low levels of expenditure for childcare converged towards the EU average, especially MT (where an ambitious reform was initiated) and AT, LU and NL. In these Member States, which continue to invest in childcare from low to moderate levels, the employment of mothers increased significantly, while previous progress in CY and PT in this respect has been reversing.

Table 2: Summary developments in social investment (real terms, 2007–2011)

		Between 2007 and 2011		
Investments in 2007 in …		Decreased	Stable	Increased
Education	High	PT, SI, IT		**DK, FI, SE**
	Medium	IE, HU, LV, UK, EE, ES	LT, CZ	BE, MT, NL, AT, PL, CY, FR
	Low	**BG, EL, RO**	SK	DE, LU
Active unemployment	High	DK, HU, UK		**SE**
	Medium	EL, IE, FR, FI, ES, IT		DE, AT, SK, LV
	Low	**RO, CY, LT, CZ, PT, PL, LU, BE, SI, BG**		MT, EE
Family	High		DK	**SE, FI**
	Medium	RO, PT	SI	ES, FR UK, DE, AT, NL, LU
	Low	**EL, CY**	EE, IE, PL, SK	IT, HU, BE, MT, LV, LT, BG
Overall	High	DK	FI	**SE**
	Medium	EL, ES, IT, HU, PT, RO , SI, UK		AT, BE, DE, FR, LU, LV, NL
	Low	**BG, CZ, LT, PL, IE, CY**	EE	MT, SK

Notes: In the rows Member States are grouped according to expenditure in child day care per relevant child population, education expenditure per relevant young population and mostly active unemployment expenditure per unemployed in 2007. In the columns Member States are grouped according to the real evolution of expenditure between 2007 and 2011. Stable real growth is defined for changes between 1.5 % and –1.5 % for education expenditure, –4 % and +4 % for mostly active unemployment and family expenditure. The level of overall expenditure in 2007 is based on the social investment score, which assign an equal weight to the three areas. Member States can be in the 'high' group only if they do not have 'low' expenditure in any of the three areas. The overall trend is based on the average growth in the three areas. For NL the social investment score is based only on education and child day care expenditure as data for mostly active unemployment measures are not reliable in ESSPROS.

Likewise, investment in the education of young people has been reducing, in contrast to previous trends, with particularly serious cuts in EL, RO and IT where starting levels were already relatively low. Such cuts in education expenditure come on top of the effects of the recession itself on young people. Cuts in tertiary education were also severe in some Member States (Chart 52). The combined effect of decreasing expenditure on education and increased

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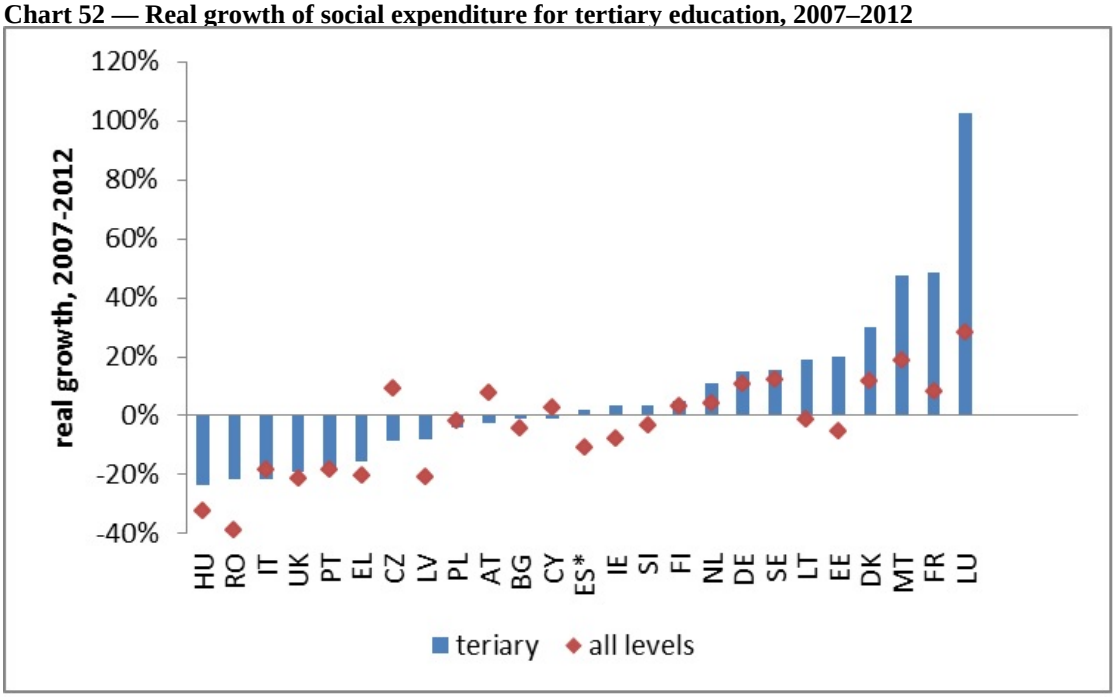
number of students entering education — notably apparent in ES, PT, IE, EE — is also liable to adversely affect the quality of education they are likely to receive ([83]).

Chart 52 — Real growth of social expenditure for tertiary education, 2007–2012



Sources: COFOG. *Notes:* 2011 for ES.

Over the course of the crisis, the balance of unemployment measures shifted from active towards passive. This might possibly be justified on the grounds that total spending on active measures such as training may not necessarily need to increase proportionally as the number of newly unemployed people increase. On the other hand, it could equally be the case that governments felt that, as they needed to cut spending in order to meet budgetary targets, this was the easier or more politically acceptable option.

Table 2 summarises the change in the selected dimensions of social investment ([84]) (education, active unemployment measures, childcare) in its final row. It demonstrates that a number of Member States are progressing towards a social investment model, while others are clearly departing from it. In the first group there are a few countries starting from already relatively high levels of social investment (SE) and a few from relatively low levels (in particular MT), but most were coming from medium levels of social investment.

The second group consists of Member States that already had relatively low levels of social investment (especially CZ, RO and CY), but also by Member States which had previously medium to high levels of social investment. As shown in Chart 51, increasing social investment in Member States starting from low levels yields the highest returns in terms of resilience.

([83]) This conclusion needs to be refined as we are talking about a share of young people, not an absolute number.
([84]) The inclusion of investments in education in the assessment of the level of social investment (low, medium, high) often change the ranking of Member States with respect to the case in which this expenditure is excluded. In EL, IE, IT, LU, RO and, especially, in AT, DE, ES and NL the inclusion of education worsen the ranking in terms of social investment. In CY, EE, HU, LV, UK and, in particular, PT the inclusion of education improves their ranking in terms of social investment.

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3.4 The development of social protection as an automatic stabiliser

Member States with well-functioning welfare systems were more resilient during the recession

Social protection expenditure had been increasing by 2 % a year on average in the period 2001–2005 but, following the impact of the crisis it increased considerably in 2009 (by 6 %), driven particularly by increased unemployment benefits expenditure, but also by sickness and disability and old age and survivor expenditure. This cyclical growth in social protection spending continued until 2011, but then declined in the face of the persistent weakness in the economy.

The decline in social protection by 2012 can thus be seen as the result of both cyclical and structural factors, with part of the decline being explained by the long-term unemployed losing their entitlement to benefits, but also by the phasing-out of stimulus measures initially put in place to counter the crisis, and by expenditure consolidation measures.

The impact of budget consolidation on social protection spending can be seen by comparing what happened in this recession with what had gone before. In previous recessions, social expenditure was still counter-cyclical after 3 years, while in 2012 it continued adjusting downward as the output gap deteriorated (European Commission, 2013a). Such a pro-cyclical adjustment of social protection clearly limits its stabilisation contribution, raising concerns about its contribution in case of future recessions.

A more detailed prior analysis (European Commission, 2013a) shows that, while the increase in unemployment expenditure in 2009 was driven by the increase in the number of unemployed, the increase in family and, to a lesser extent, pension expenditure was driven by an increase in average expenditure per (potential) beneficiary. This reflects the workings of the indexation mechanism of benefits which tend to be based on the previous year's rate of inflation, such that the rise in family and pension benefits in 2009 can probably be explained by the high inflation in 2008, even though the rate of inflation in 2009 was low.

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Table 3 — Family benefits, indexation mechanism changes 2007–2013

		2013			
		No indexation	**Automatic indexation (lag)**	**Automatic indexation (more timely)**	**Discretionary indexation**
2007	**No indexation**	AT, EE, LV, LU, PL, ES			
	Automatic indexation (lag)	IE	BE, CY**, CZ, DK, FI, HU, IT, LT*, NL	SI	
	Automatic indexation (more timely)			FR	
	Discretionary indexation	EL			BG, DE, MT, PT, SK, SE, UK

Source: MISSOC. *Notes:* * adjusted in CPI increase more than 1.1.

Table 3 shows that most Member States did not adjust their indexation mechanism for family benefits. Only Slovenia went in this direction by replacing the annual indexation with a semester indexation, while Ireland and Greece lost their indexation mechanism altogether. In most Member States with no indexation or a discretionary mechanism, family expenditure was more stable in 2009 compared to other countries (European Commission, 2013a). However, the outcome for countries with a discretionary indexation mechanism depended on the discretionary measure adopted. In Bulgaria, for instance, family expenditure increased.

However, systems were not designed for a prolonged crisis…

The crisis showed that Member States with a better coverage and more adequate unemployment benefits achieved better automatic stabilisation. However, while these systems proved adequate in the first phase of the crisis in sustaining household income, they were not designed for a prolonged crisis. In some Member States unemployment benefits had a low coverage, while in most they lacked automatic triggers to adapt to a prolonged crisis although discretionary decision can also be made in order to make unemployment benefits more anti-cyclical (European Commission, 2013a). In particular, the duration and the strictness of the eligibility criteria of unemployment benefits can be extended and relaxed, respectively, in order to accommodate the more difficult labour market conditions of recessions. Section 4.4.1 illustrates the discretionary measures taken by Member States over the crisis.

… but they did not improve automatic triggers in case of future recessions

In general, more relaxed eligibility conditions, higher replacement rate, a longer duration of unemployment benefits, and last resort support such as social assistance, seem to have worked better to improve the coverage of long-term unemployed (see Section 4.1.1) and stabilise incomes in times of crisis. However, this was only a first step and, fiscal constraints apart, it seems clear that unemployment benefits need to be better designed and better synchronised with the economic cycle in order to make them more counter-cyclical, while improving the use of last resort schemes, and avoid possible unemployment traps when the economy recovers.

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While changes can be made through either discretionary decisions or automatic triggers (European Commission, 2012a), Member States relied more on discretionary measures in the first time of the recession with, for instance, FR and PT extending out of work benefits at the onset of the recession. However, some of the countries most affected by the crisis, especially the Southern Member States with already weak safety nets, did not significantly strengthen income support through discretionary measures (OECD, 2014c).

Automatic triggers for unemployment benefits — in particular for partial unemployment benefits — were already in place in some Member States (in LU, IT, PT ([85])). In others (e.g. DK) active unemployment measures were adjusted to labour market conditions (OECD, 2014c). However, recent changes have not, in general, introduced automatic triggers which would help enhancing the counter-cyclicality of unemployment benefits and improve their stabilisation function, while containing expenditure in times of expansion and avoiding possible traps. It is also clear that, while discretionary measures can be effective, their timing is not always optimal, underlining the case for a greater use of automatic triggers.

3.5 The development in the financing of social protection: risks and opportunities

The share of social security contributions in the financing of social protection has decreased for both cyclical and structural reasons

Tax-benefit systems work as automatic stabilisers, which meant that they had a positive effect in terms of maintaining gross household disposable income in all Member States in the first phase of the crisis. However, this also represented a further challenge to government financing as tax revenues declined in line with falling GDP, while expenditure levels did not, although the overall impact of these different adjustments on government budgets varied greatly between Member States (Mourre et al., 2013).

Social transfers played an important role throughout Europe (Dolls, 2012) and, during the first phase of the crisis, the contribution of social transfers to Gross Household Disposable Income was three times greater than taxes, while taxes did not play an effective stabilising role in all Member States (European Commission, 2013a ([86])). Social security contributions are estimated to be less sensitive to the cycle than indirect taxes, while personal and corporate income taxes are the most sensitive (Mourre et al., 2013).

The crisis accelerated the declining importance of social security contributions in the financing of social protection, although the trend changed in 2011 in the EA-18 Member States (Chart 53). Those Member States with the option of earmarking taxes have used it to balance the effects of the reduced financing of social protection from social security contributions, but currently only six Member States have this facility ([87]). The sharp decline in the financing of social protection from social security contributions in 2009 was mostly due to cyclical factors but structural factors also contributed.

Indeed, changes in social protection financing did not affect all benefits equally, nor all tax sources with the decreasing importance of social security contributions in total receipts being

([85]) Based on MISSOC.

([86]) See Chapter 6 of European Commission, 2013a.

([87]) In Germany the shift from social security contributions to VAT was only politically earmarked (see email Volker).

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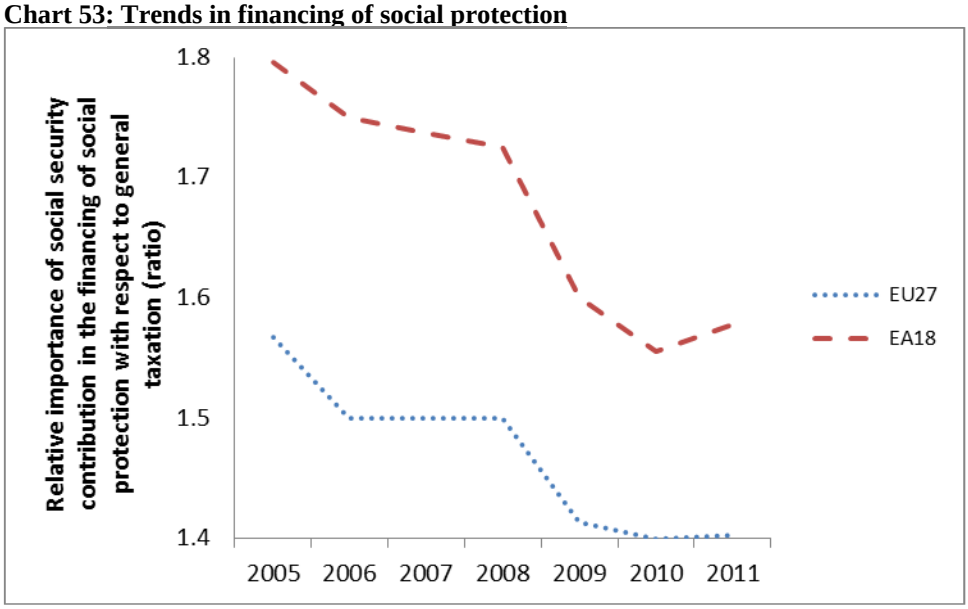
mostly caused by a declining share of social security contributions being funded by levies on employers (Social Protection Committee, 2014). The shift in financing between 2007 and 2011 was concentrated on pensions and, to a lesser extent, health, while no clear trends are observed in the financing of family and unemployment benefits (Social Protection Committee, 2014).

Chart 53: Trends in financing of social protection



Source: ESSPROS.

In the context of increased pressure on the level of deficits, Member States were recommended to shift taxation away from labour, and in particular social security contribution, towards less growth-hampering tax bases such as consumption and property (European Commission, 2013g; European Commission, 2013h). In 2014, BE, IT, LV, AT, CZ, ES and, implicitly, FR and DE received a Country Specific Recommendation on shifting the tax burden away from labour, while HU and RO have been recommended to lower the tax burden on labour and NL to reduce tax disincentives on labour. Since the beginning of the crisis, BG, CZ, DK, DE, FR, LT, NL, SI, FI, SE and UK have reduced the tax wedge on low wage earners ([88]).

A key choice is often between cutting employee or employer social security contributions depending on whether the aim is to stimulate labour demand or labour supply. In some countries, cuts in employee social security contributions have been targeted to specific groups such as the unemployed or younger people, while employment incentives, often provided through a discount in social security contributions paid by the employer, were increasingly used in BE, CZ, ES, MT and, in particular, in SK and LU.

While cyclical factors seems to better explain the acceleration in the declining weight of social security contributions since the crisis, differences between Member States in the evolution of the financing of social protection suggest that structural changes may play a role. For example, tax reforms may explain why the increasing weight of general taxation in the

([88]) The source of this data is the ECFIN Tax and benefits indicators database based on the change between 2008 and 2013/2012 in the tax wedge for a single person without children, with earnings at 67 % of a full-time production worker.

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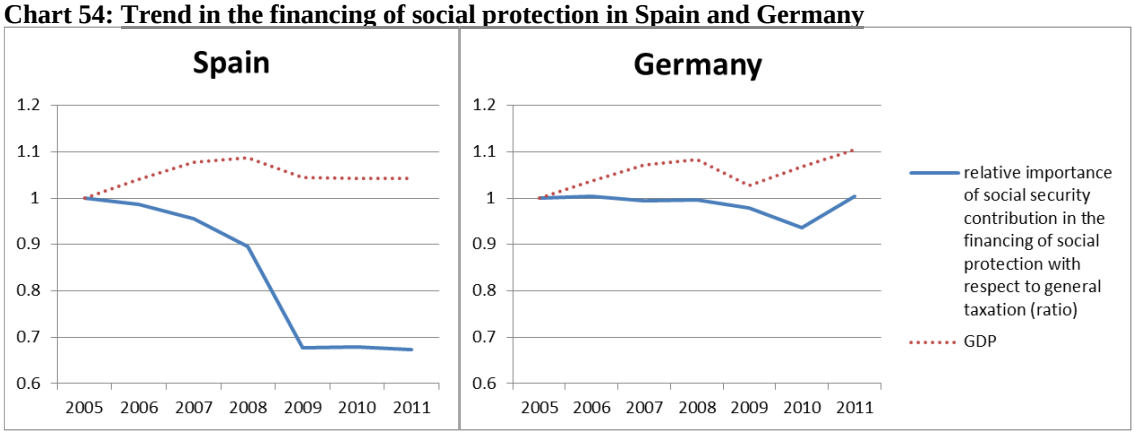
financing of social protection continued in 2011 in Spain, alongside the stabilization of the economy, while it reverted in Germany (Chart 54).

Chart 54: Trend in the financing of social protection in Spain and Germany



Source: ESSPROS and NA. Notes: index year is 2005.

Is a shift away from insurance-based systems an opportunity for better inclusion?

The shift away from social security contributions as a source of government funding has implications for the financing of social protection, and simply changing the structure of the financing of social protection without modifying the rules determining benefit entitlements may not be sustainable in the long-run.

On the one hand, a shift away from social security contributions as a financing source could pave the way for more universal and egalitarian social benefit systems ([89]) given that insurance-based contributory systems, as notably developed for pensions in recent decades, are likely to have magnified labour market inequalities and reduced the potential of social expenditure for promoting inclusion ([90]).

On the other hand, a shift away from social security contributions to indirect taxes could limit the scope for indirect taxes to act as automatic stabilisers across the economic cycle. Moreover, any weakening of the link between contributions and benefits could be problematic in countries with high levels of tax evasion and undeclared work, although better returns from State's spending are associated with lower levels of undeclared work (European Commission, 2013a).

([89]) Nonetheless, the redistributive impact of such shift depends also on the type of taxes increased to compensate for the reduction in social security contributions.
([90]) Hills (2003) lists fives reasons for the stuck up of contributory benefits: the reality of the labour market, the complexity of the system, the insufficient accumulation of contributions for adequate benefits, weak link between work records and actual contributions, weak link between contributions and benefits.

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