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Subject : **Joint Report on Social Protection and Social Inclusion**

Delegations will find attached the text of the Joint Report on Social Protection and Social Inclusion, as adopted by the Council and the Commission on 10 March 2006, to be forwarded to the European Council in view of its meeting on 23-24 March 2006.

It should be noted that this report should be read in conjunction with the country profiles as set out in Addendum 1.

JOINT REPORT ON SOCIAL PROTECTION AND SOCIAL INCLUSION 2006**1. INTRODUCTION**

Europe's policies on social protection and social inclusion face major challenges. Global competition, the impact of new technologies and an ageing population shape the long-term policy context; weak growth, high unemployment and persistent inequalities need to be addressed in the short term. At Hampton Court in October, the Heads of State and Government reflected on how Europe's social systems can be sustained in the face of such challenges and how they can, at the same time, contribute to meeting them. The Commission's contribution, strongly endorsed in the Presidency's conclusions, called for "strengthening instruments like the EU's integrated guidelines for growth and jobs and reinforcing their interaction with more effective EU level co-ordination in the area of social protection."

Earlier, the review of the Lisbon strategy in spring 2005 had posed a two-fold challenge for the work under the Open Method of Coordination (OMC) for social protection and social inclusion. It found a gap between the common European objectives and the policies established to address them – for the OMC, this means that the process should move beyond identifying broad principles to focus on the effectiveness of policies. Secondly, while restating the importance of the social dimension of the strategy, it sought a concentration of policy effort on creating higher growth and more and better jobs. Thus close interaction between the social protection and social inclusion OMC, with its focus on providing a high level of social protection and social cohesion, and policies for employment and growth is required. At the same time, the European Council called on the Union and the Member States to give priority, under the social inclusion strategy, to improving the situation of the most vulnerable young people and to initiatives to prevent educational failure as a contribution to the European Youth Pact.

This second Joint Report on social protection and social inclusion responds directly to the challenge of the Hampton Court Summit and of Lisbon, and builds on the 2003 Communication "Strengthening the social dimension of the Lisbon strategy: Streamlining open coordination in the field of social protection"¹. It draws on the plans and policy statements produced by the Member States during 2005 under the three policy strands of social inclusion, pensions, and health and long-term care. It is guided by the views on the value of the OMC expressed by Member States and stakeholders. And it anticipates the structure of OMC exchanges under the future streamlined process².

2. OVERARCHING ISSUES FACING SOCIAL PROTECTION AND SOCIAL INCLUSION POLICIES.

The Commission's Communication on a new framework for the OMC outlines three overarching challenges for policies in the social protection and inclusion fields. This section uses this framework to review current policies and reform strategies.

(a) Promote social cohesion and equal opportunities for all through adequate, accessible, financially sustainable, adaptable and efficient social protection systems and social inclusion policies

Member States have to meet core social objectives efficiently and cost effectively while adapting to new challenges and circumstances. To this end, in 2003 Member States spent on aggregate around 28% of GDP in gross terms on social protection³, a figure which has edged upwards after being broadly stable over recent years, also in the context of ageing populations⁴.

¹ 2003)261

² See COM(2005)706

³ ESSPROS data

⁴ See also Economic Policy Committee: Restructuring public expenditure: challenges and achievements, January 2006.

Systems of cash transfers (other than pensions) account for 5% of GDP. Reform efforts in this area are mainly focused on strengthening incentives to take up work. Use of in-work benefits to support incomes for those making the transition to (low-paid) employment is growing, albeit slowly. Social assistance is increasingly linked closely with locally provided social and employment services as a means to achieving synergies and efficiencies. Notable reform efforts relate to long-term sickness/invalidity schemes, where many States are taking measures to ensure that they are not a form of disguised early retirement but promote job-retention and return to the labour market.

Spending on pensions, which averaged 13% of GDP in the EU (in 2003), has ensured that being old is no longer associated with being poor or being dependent on one's children. This has mainly been achieved through the provision of public pensions, and the adequacy of retirement income will continue to be a public responsibility. Successive European Councils have highlighted that increasing the effective retirement age would make the most decisive impact both to adequacy and sustainability of pension systems, especially in the light of the long-term implications for pension expenditures of increased life expectancy.

Reforms are being made in most Member States to reverse the trend of previous decades which reduced the effective retirement age and cope with future increases in life expectancy. Public pay-as-you-go pension schemes are expected to remain the principal source of income of pensioners in coming decades, while the contribution of privately managed pension schemes is expected to increase in many but not all Member States. The solidarity principle continues to be important for our pension systems, by ensuring access for all workers to pension provision, a form of guaranteed minimum for older people, a replacement income and finally the recognition for pensions of time spent out of the labour market (notably caring for children or older people and periods of unemployment).

In health and long-term care, where spending averaged 8% of GDP in 2003, Member States continue to aim to ensure access for all to high quality care, while adjusting their systems to ever growing demand linked to ageing, patients' expectations and technology development. They are seeking greater effectiveness and efficiency as well as aggregate cost containment through reorganisation, prioritisation and the development of incentive structures to users and providers. Health promotion and disease prevention policies are expected to play an increasing role. To ensure that health inequalities are not aggravated by a lack of access to care, the growing use of charges and co-payments is accompanied by a wide array of reductions of fees, targeted at disadvantaged groups.

Europe's population will be slightly smaller, but significantly older in 2050. There will be two workers per elderly citizen as opposed to a ratio of four to one now. Recent long-term projections show that the pension, health and long-term care costs linked to an ageing population will lead to significant increases in public spending in most Member States by 2050. On the basis of current policies, total age-related public expenditure is projected to increase by 3.4 percentage points of GDP, while expenditure on pensions, health and long-term care alone is projected to increase by 4.4 percentage points for the EU-25 and up to 10 percentage points in some Member States⁵.

The way in which Europe can hope to meet these needs is not by giving up its ambitious social policies, but by making use of their potential contribution to economic performance. Financial sustainability can only be ensured through modernisation of institutions and delivery mechanisms, respecting the diversity of Member States social organisation.

⁵ See Economic Policy Committee/European Commission: the impact of ageing populations on public spending on pensions, health and long-term care, education and unemployment benefits for the elderly, February 2006, available under: http://europa.eu.int/comm/economy_finance/epc/epc_sustainability_ageing_en.htm. The focus of these projections is forward-looking and they are not directly comparable with ESSPROS figures as they do not include occupational private expenditure and private healthcare.

Reform in social protection has been progressing at a steady pace. As this review shows, reforms are not synonymous with cutting back, and their impact on social cohesion should be carefully monitored. Drawing from those countries with the longest experience suggests that good activation, involving integrated and tailored interventions, does not come cheaply and cannot be a quick-fix strategy.

For example, increased use of income-tested minimum retirement provisions should not weaken incentives for pension saving. Minimum social assistance levels are already, in many Member States, below the at-risk-of-poverty line and, from a social inclusion perspective, the scope for attaching conditions to them needs to be carefully monitored. The growing emphasis on benefit conditionality is not, to date, accompanied by systematic monitoring of its impact on the most marginalised groups. The trend towards decentralising responsibility to the regional and/or local level has considerable potential for integrated delivery of social protection and social services. Again, however, the impact needs to be monitored. Evaluation must also be “joined up” across different policy spheres. The growing use of health co-payments, accompanied by measures to alleviate their cost to lower income groups, has already been noted; within the most recent inclusion reports, the impact of increased health and health insurance costs is seen as an increasingly significant pressure on people in lower income groups.

(b) Interact closely with the Lisbon objectives on achieving greater economic growth and more and better jobs and with the EU's Sustainable Development Strategy.

The interaction between the OMC and the revised Lisbon process should be a dual one – social protection and inclusion policies should support growth and employment objectives, and growth and employment policies should support social objectives. Among the Member States, Belgium, Hungary and Finland offer clear examples of this dynamic interaction in their National Reform Programmes (NRPs), by placing social objectives at the heart of their Lisbon planning, stating that their medium-term economic and employment planning should support the future sustainability and development of their social policies.

Social protection and employment

Reviewing the work across the three OMC policy strands alongside the National Reform Programmes, the role that social protection can play in improving employment performance emerges strongly. However, links between the OMC and the NRPs are not always clearly drawn.

In the fight against social exclusion, "facilitating access to employment" is at the heart of Member States strategies, even more so given the increased stress on transition to work in recent reforms. Active labour market policies and a review of tax and benefit systems are being carried out, or planned, in most Member States. Where economic and employment performances have been good, and salaries and benefits were comparatively low, as in the Baltic states, employment and inclusion policies have been integrated by linking a rise in benefit levels with a rise in minimum wages, as a means both to spread the benefits of recent growth and enhance incentives to work.

A number of Member States outline in their NRPs the important role which immigration is expected to play in sustaining their labour markets in the future. However, acknowledgement of the challenge of integrating immigrants, a big issue in recent NAPs for inclusion, is not evident in the NRPs.

Pension reforms affect employment directly, by strengthening incentives to work longer and restricting early exit from the labour market. By tightening the link between contributions and benefits, they also encourage activity and declared work across the whole working life cycle. But the success of this approach does not solely depend on the incentive structures of pension systems. A key issue for labour market reform and future NRPs is to open labour markets for older workers and to help them to remain in work longer, including through the efficient use of ICT.

Good healthcare improves the quantity and quality of the labour force, and in particular the employability of older people. Moreover, health and long-term care sectors are large employers and will become even more so in the future. Member States placed major emphasis in their preliminary policy statements on the challenge of ensuring adequate human resources to meet future demands on the sector. How systems manage the future supply of care, including through the efficient use of new technologies, will have important employment implications. The balance between informal care (within families, outside of the labour market) and formal care (through social services or market mechanisms) will have a big impact on labour supply, particularly of women. Health issues are cited in broad terms as playing a part in future strategies by several of the new Member States, particularly Hungary.

Social protection and growth

Links between social protection and growth issues can clearly be drawn in the area of pensions. Financially sound public pensions and sustainable public finances mutually reinforce each other, which in turn supports long-term economic performance. There is general recognition of the importance of a healthy population – both the population as a whole and the older age group in particular – for economic growth. Regarding inclusion policy, the exclusion of people and groups, such as immigrants and ethnic minorities, from participation in work and society represents a waste of resources, to be addressed for economic as well as social justice reasons. At the same time, the sustainability of social protection schemes depends on growth prospects and therefore on the success of national reform strategies to promote competitiveness and productivity.

The EU's Sustainable Development Strategy⁶ outlines long-term aspirations for European society and threats and challenges to be addressed if we are to meet these aspirations. Social policy concerns form part of both the aspirations (e.g. for a cohesive society) and the challenges (e.g. gaps between rich and poor; ageing society). The

⁶ COM(2001)264 and COM(2005)37

perspective of sustainability places the long-term dimensions of social protection and social inclusion policies firmly in the policy frame, giving added impetus to focus on child poverty, through which poverty and exclusion pass from generation to generation and Europe's future human resources are diminished. More generally, it identifies a need for developing a focus on sustainability in the OMC.

(c) Strengthen governance, transparency and the involvement of stakeholders in the design, implementation and monitoring of policy

One of the key policy messages emerging from work under the OMC is that policy making, and delivery, bears fruit if all actors, branches and levels of government work together. The OMC has had some impact in reinforcing this message, particularly in the social inclusion area. All EU10 Member States have created new structures to involve civil society in their social policy planning. The implementation NAPs of the EU15 reveal a wide spread of measures to improve cooperation between central, regional and local authorities. There is clear evidence that Member States have been learning from one another. Good governance also includes the aim of mainstreaming social inclusion concerns in public policy making (including budget setting) and stronger evaluation and monitoring. In both these areas, there is progress but it has been limited. Governments should invest more on monitoring and evaluation in order to have an exchange of best practices based on robust analysis.

For pensions, it is essential that reforms, given their long-term impact, are built on consensus. Transparency in decision-making is needed so that citizens can have certainty and understanding in the often complex task of planning retirement. Commitments to automatic or regular review mechanisms help citizens to plan. Greater decentralisation of funds and increased choices regarding investment vehicles or retirement ages all increase complexity and need to be accompanied by means to provide information and guidance to citizens.

At the level of systems, the health sector shows great complexity in the roles of insurers and providers, and of central and regional/local authorities. The interface between health providers and care providers will increasingly be crucial for efficient coordination. Clarity in the roles of different institutions and good coordination between them is vital. Relations between policy makers and citizens are similarly important, given citizens' high expectations of health systems and the stress placed by all Member States on promoting prevention, healthy life styles and healthy ageing.

3. KEY CHALLENGES IN THE DIFFERENT STRANDS OF WORK UNDER THE OMC

3.1. Fighting poverty and exclusion: sustained effort but an implementation gap.

The Implementation National Action Plans (NAPs) submitted by the EU 15 and NAP updates (submitted by four of the EU10 States) show progress in several fields but, against the background of an economic performance which is at best mixed, no significant improvement in the situation. They show clear evidence of the finding in the Lisbon review of an implementation gap between what Member States commit to in common objectives and the policy effort to implement them.

Analysis of the 2005 reports confirms the seven key policy priorities identified in last year's Joint Report. These are: to increase labour market participation, modernise social protection systems, tackle disadvantages in education and training, eliminate child poverty and enhance assistance to families, ensure decent housing, improve access to quality services and to overcome discrimination and increase the integration of people with disabilities, ethnic minorities and immigrants. The reports also highlight the concentration of multiple disadvantages in certain urban and rural communities and among some groups. Member States need to develop integrated and co-ordinated responses to multiple disadvantages and the needs of groups at particular risk such as people with disabilities, migrants and ethnic minorities (including the Roma), homeless, ex-prisoners, addicts and isolated older people. There needs to be both improved access to mainstream provision and, where necessary, targeted measures.

Three current developments emerge more strongly. These are: challenges linked to increasing immigration; rising health and insurance costs; and the need for affordable care provision for children, disabled and elderly dependants in the light of both demographic change and increasing female labour force participation.

Challenges for the future include the need for *mainstreaming* – i.e., to better integrate the NAPs with national policy making, including budgetary processes, and with the revised Lisbon process; *better governance* – i.e., better mobilisation of actors and links between different levels (national, regional and local) of government and clearer responsibility for implementation, monitoring and evaluation; and better links between the NAPs for inclusion and the *Structural Funds*, in particular the European Social Fund and the European Regional Development Fund.

3.2 Adequate and sustainable pensions: reform efforts continue

The second round of National Strategy Reports on pensions submitted in July 2005 shows substantial progress in reforms⁷ since the 2003 Joint Report. These reports highlight the interlinkages between the three broad objectives of adequacy, sustainability and modernisation. For reform strategies to be successful, all three elements must be present and considered together.

To ensure adequate and sustainable pension systems Member States are implementing the three-pronged strategy of reducing public debt, reforming pensions and increasing employment. While some Member States aim at reducing public debt in order to create room to address the sustainability of pension systems, only a few countries have succeeded to do so in recent years. Member States also pursue increasing employment and many have undertaken reforms that have begun to translate into higher employment rates of older people: disincentives to working longer have been reduced and incentives

⁷ For a more extensive discussion of the National Strategy Reports 2005, see the Commission Staff Working Document on Adequate and Sustainable Pensions.

to remain active strengthened, links between contributions and benefits have been tightened and life expectancy has been further taken into account in the pension formula. Recent reforms tend to translate into a decrease in replacement rates at a given age, which can, however, be compensated by longer working lives and more saving, thereby maintaining the objective of adequate retirement income, avoiding pensioner poverty and maintaining a reasonable degree of income in retirement. Some Member States are increasing the level of guaranteed minimum pensions; many recognise periods of care work for the calculation of pension entitlements. The provision of supplementary pensions, which in some Member States is expected to make a major contribution to maintaining living standards in retirement, has been developed and the relevant legislative framework strengthened. While the contribution of privately managed pensions is projected to increase over the coming decades, in all but a few Member States the public, pay-as-you-go schemes will remain the principal pension source. Concerns over unequal access to private pensions have been raised and some Member States are reviewing policy responses, including substantial fiscal incentives for low income workers. Linked to the greater use of privately managed pensions, Member States are moving to regulate and monitor systems to promote transparency, affordability and predictability of returns.

A new feature of recent reforms is the introduction of automatic or semi-automatic review mechanisms that ensure periodic monitoring of sources of pressure on the pension system, notably demographic trends, and force a debate on potential policy responses. Such mechanisms promote transparency of pension systems and, together with information to citizens about their pension rights, build public confidence in them.

3.3. Health and long-term care: first steps underline the importance of the issues in this field

Following the 2004 Council decision to extend the OMC to the areas of health and long-term care, Member States submitted National Preliminary Policy Statements in spring 2005. These reports identified issues for further work and contributed to the Commission's proposal for common objectives⁸.

The aim of ensuring access continues to be a fundamental challenge, together with pressures on public spending. Serious inequities, relating to supply difficulties, geographical barriers and gender, remain, as do disparities in how different socio-economic groups draw on health systems, and in the health outcomes they experience. In relation to long-term care, current provision is already seen as insufficient and will become more so given demographic development. However, only some Member States have incorporated the future care challenge into their social protection systems or have expanded social services to address it. The health status of elderly citizens may have a large effect on health spending. The challenge of human resources development to sustain health and long-term care services in the face both of increased demand and scarce labour resources is also widely flagged. One common response is the emphasis placed on promoting prevention, healthy lifestyles and healthy ageing. In relation to quality of provision, reforms promote the development of indicators and setting quality standards, practice guidelines and accreditation systems. Such approaches will also promote cost saving. Involving patients and promoting choice is seen as a way of building quality. Technology has clear potential to improve quality, but its impact in terms of cost requires monitoring, hence the effective management of technology will be of utmost importance.

⁸ See the memorandum of the Social Protection Committee, *Review of Preliminary National Policy Statements on Health Care and Long-Term Care*, 2005.

Member States' efforts to secure financial sustainability focus heavily on increasing efficiency and effectiveness. Reforms stress the need for coherence and better coordination between different levels of government (national, regional, local) as well as between types of care, avoiding unnecessary interventions. Family doctors have a vital role, in their curative, guiding and gatekeeping functions. Actions in this area are expected to impact positively also on access and quality. Sustainability policies also aim to boost incentives to providers and users to use resources in a rational way by promoting cost-awareness (cost-sharing) and the use of primary care. Competition among providers (and in some countries among insurers) is seen as a means to reduce costs of care and to enhance quality, however, it has to be regulated so as to best balance access by all, high quality and financial sustainability. Also policy measures, which can either prevent disability, support informal care for elderly citizens with disabilities, or which favour formal care at home rather than in institutions can have a very large impact on public spending.

Carrying forward the OMC in a streamlined context: key messages

From the analysis above, the following key messages can be distilled:

There needs to be a more strategic approach to the formulation of NAPs for inclusion, to bring about more precise, systematic and transparent setting out of policies. The OMC needs to develop a strong focus on poverty among children and their families. The multiple exclusion faced by young people from ethnic minorities in poor neighbourhoods also needs increased attention. In this context, the fundamental role of education and training to break the intergenerational transmission of poverty should also be highlighted.

As shown by projections, demographic changes will have strong effects, but social protection reforms can improve the outlook. The NSRs on pensions highlight the interlinkages between the three broad objectives of adequacy, sustainability and modernisation and the synergies and trade-offs between them. For reform strategies to be successful, notably in dealing with

increases in life expectancy, all three elements must be present and considered together. Reforms should continue to remove disincentives and strengthen incentives for working longer and need to be matched by progress in how employers and labour markets treat older workers. This will make a crucial contribution to maintaining adequacy and living standards and fighting pensioner poverty. The trend towards a decline of replacement rates provided by pensions should be carefully monitored, as well as the design of incentives to work longer, including for potential beneficiaries of minimum benefits for pensioners.

Modernisation of pension provision needs to take better account of new forms of working and of career breaks notably for care, and to ensure that women can build up their own pension rights. The development of private provision can complement public schemes, but affordability and security need to be ensured. Regular reviews enable the systems to be adapted and information on people's pension entitlements helps to build confidence.

Building on the good first steps, future exchanges on health and long-term care should focus on how to ensure access and reduce inequalities; on adapting to evolving needs and increasing patient choice and involvement; promoting quality; securing sound financing of efficient systems and appropriate aggregate cost containment; improving the coordination across different levels of government; strengthening incentives to users and providers for rational resource use; promoting prevention, active life-styles and healthy ageing; and developing human resource strategies to meet future staff shortages. There are substantial challenges in relation to long-term care: to estimate future needs and to develop the necessary provision and funding mechanisms.

The challenge of ensuring that the OMC and the revised Lisbon process mutually reinforce each other is vital. The Commission and Member States should develop the appropriate framework to ensure the best interaction, including the further improvement of indicators, to measure it. Monitoring and evaluation of social policies should be strengthened. This will

involve, for example, assessing the extent to which employment opportunities are reaching groups at highest risk of poverty and social exclusion (e.g. jobless households, the very long-term unemployed, single parents, large families, young people at risk, ethnic minorities, people with a disability) and how reforms to promote employment impact on them.

Looking across social protection systems as a whole, there needs to be a long-term and holistic approach which focuses on sustainability as a challenge not just for pensions and health; on indicators to monitor the effectiveness and efficiency of systems, policies and funding mechanisms; and on the distribution of spending across different branches and the balances to be struck between public provision and self-reliance.
