

Executive summary

This is already the third edition of the Employment and Social Developments in Europe Review (ESDE). Starting in 2011, the newly launched analytical publication has focused on key themes and developments linked to employment and social objectives of the Europe 2020 strategy, in order to provide analytical underpinning to the European semester process, in particular to the preparation of the Annual Growth Survey 2014 and the Joint Employment Report. Its consistent efforts to combine and integrate both labour market and social inclusion aspects of the issues addressed have been a reflection of the integrated and mutually reinforcing character of the Europe 2020 goals.

Many of the themes covered in the two previous issues of this review were driven by the protracted economic and social crisis affecting all EU Member States, albeit to varying degrees. At long last, 2013 has seen the first tentative signs of economic recovery following the combined impact of active ECB policies, differentiated and growth friendly fiscal consolidations and a small rebound in internal demand. Furthermore, the rise in unemployment, even for young people, has recently flattened; even in some of the worst-hit countries. But economic growth is unlikely to be job-rich without sustained policy reforms and more effective public support and investment facilitating the labour reallocation process.

Weak labour markets have seen long-term unemployment rising in most Member States and to an all-time high in the EU. Structural unemployment and labour market mismatches have been growing. Net job destruction has been coinciding with an increase in precarious jobs even though, compared to before the crisis, the share of temporary contracts has fallen in the EU as they bore the brunt of the downturn. Part-time, especially involuntary part-time, jobs have been increasing. The threat to the future of many young people, with an EU average unemployment rate of 23%, remains acute.

Increasing hardship now sees nearly a quarter of the EU population at risk of poverty or exclusion. The biggest increase has been among those of working age as unemployment has risen and the number of jobless households has increased. In-work poverty has also risen, partly reflecting the fact that those who remain in work have tended to work fewer hours and/or for lower wages. Children in such households are also exposed to increased poverty. Growing social distress in employment and poverty are the result of the crisis and the lack of resilience of the labour market and social institutions.

These challenges have been increasing recently as the situation has worsened in many Member States. Divergences between countries have been growing, especially within the euro area. Southern EU Member States have been particularly hard hit. High unemployment, low employment, rising poverty and social exclusion, and declining household incomes in several Member States reduced aggregate demand and eroded confidence throughout the currency union and the EU as a whole.

Already the third ESDE Review.

Tentative signs of recovery...

... amidst still highly challenging labour markets...

... and social conditions.

Growing divergences in the euro area...

...have roots in unbalanced growth patterns in some Member States.

Internal devaluation has some limitations as a solution to cost competitiveness problems.

Persistent economic and social disparities within the euro area threaten core objectives of the EU.

Trends in EU public spending in recent years differed from those in other OECD countries...

...and from those in previous recessions.

Effectiveness and efficiency of social spending gained importance in the crisis...

...but its allocation has not always been adequate.

The chapter entitled Convergence and divergence in EMU — employment and social aspects takes a closer look at this issue. It shows how the seeds of the current divergence were already sown in the early years of the euro, as unbalanced growth in some Member States, based on accumulating debt fuelled by low interest rates and strong capital inflows, was often associated with disappointing productivity developments and competitiveness issues. Cost competitiveness problems built up in some Member States with labour costs increasing much more than labour productivity. The Member States with the weakest productivity performance also underperformed in human capital formation, thus compounding the problem with declining non-price competitiveness, so critical for strong external performance.

In the absence of the currency devaluation option, euro area countries attempting to regain cost competitiveness have to rely on internal devaluation. This policy, however, has some limitations. It comes with a timing issue, as the negative demand effects of wage containment precede the positive effects of improved export performance. The effectiveness of wage containment policies depends on a series of factors including the openness of the economy, the strength of external demand, and the presence of flanking policies and investments enhancing non-cost competitiveness factors and facilitating the labour reallocation process. The longer-term human capital damage resulting from increased unemployment and social hardship also need to be taken into account (hysteresis effects).

Macroeconomic instability and still growing macroeconomic, employment and social divergences might jeopardise the functioning of EMU and thus core objectives of the EU as set out in the Treaties, namely to benefit all its members by promoting economic convergence and to improve the lives of citizens in the Member States. Enhanced surveillance of employment and social developments was proposed by the Commission recently in its Communication on the Social Dimension of EMU. In the long term and after Treaty changes, an EMU-wide fiscal capacity with a shock absorption function could complement existing policy coordination instruments.

How effectively have the welfare systems in the EU in recent years fulfilled their economic and social objectives, and what possible lessons can be drawn for the future? After resisting the first phase of the recession better than some other OECD countries, the EU has seen comparatively worse labour market performance since 2011. Unemployment has risen rather than fallen and employment rates have declined. Poverty has also been on the rise since 2007 in the EU overall while it has fallen moderately in several other OECD countries. At the same time, while far from uniform across Member States, overall public expenditure levels showed trends different to those in other advanced countries.

Public expenditure trends also differed from those in past downturns. In the early phase of the crisis (until 2009), social expenditures played a strong role in stabilising household incomes. Following the European Economic Recovery Plan (EERP) recommendations of November 2008, enhanced unemployment benefit systems played an essential role in income stabilisation, while other items of social expenditures (notably pensions and health) also played a role in maintaining aggregate demand. From 2011, however, social expenditure declined and the fiscal stimulus was phased out against the background of the sovereign debt crisis in the euro zone. Subsequently, employment and social challenges further grew during the second dip of the recession. In this context it is more important than ever to examine the role of social protection expenditure as an economic stabiliser as well as ways to maximise its effectiveness and efficiency in terms of social outcomes achieved.

The size, structure and design of social expenditure are all important for its effectiveness and efficiency. While the intensity of fiscal consolidation has differed across countries, it is also observed that Member States may achieve markedly different economic (such as automatic stabilisation) and social outcomes (such as income smoothing, poverty and inequality reduction or health outcomes) despite having similar levels of spending.

The dynamics of different types of social expenditure between 2007 and 2010 have not always been balanced. In some instances stronger increases occurred in less efficient areas with already high expenditure levels but relatively weaker social or employment outcomes. Conversely, low expenditure increases occurred in areas of initially low expenditure levels where the potential for greater impact existed.

The gender dimension is one of a number of structural labour market and social inclusion challenges, which may over time harm both the supply and demand side of labour markets in the EU. Women have historically faced unfavourable labour market and social outcomes compared to men, which is clearly reflected in persistent gender gaps in core labour market variables. Although the crisis has contributed to a contraction of gender gaps, this development has mostly been the result of male-dominant sectors being hit worse by the crisis. Meanwhile, gender differences still persist in key areas such as labour market participation, pay and the risk of poverty. Moreover, women tend to accumulate fewer total hours worked compared to men, which leads to an even wider gender employment gap than a simple comparison of employment rates would suggest. Although this gap has also narrowed during the crisis years, it is still high and persistent. While the lower labour intensity can reflect individual preferences and can be associated with some favourable effects, it still leads to diminished career opportunities, lower pay, lower prospective pensions and underutilisation of human capital resulting in lower GDP. Many societal or institutional barriers or constraints remain to be tackled in this respect.

Although Member States perform differently in terms of the gender gap in hours worked, there are some distinct patterns: in some cases a high share of women are working but with relatively shorter hours, in others female participation is lower, but once in employment, women tend to work relatively longer hours. Only some Member States succeed in combining high female employment rates with a low gender gap in total hours worked. An effective policy mix appears to include gender-equal working time, widely available flexible work, incentives for the division of unpaid work within a couple, and employment-friendly, accessible and affordable childcare with longer day-care hours.

Undeclared work remains another structural problem for European labour markets. Growing unemployment and poverty fuelled by the crisis increase the pressure on employees to accept undeclared payments, notably in small companies. To a lesser extent, the crisis also creates conditions for a possibly higher supply of undeclared services by individuals. By accepting undeclared payments and undertaking undeclared work, individuals forego their social security rights, while weakening social security systems in their entirety. New data from a large-scale survey suggests that the incidence of undeclared work in Europe has remained relatively high and, interestingly, unchanged compared to pre-crisis levels, although the intensity and drivers differ across the EU. Within the regions most affected, the lack of regular income and jobs, and insufficient trust in the effectiveness of the welfare state, count as the main reasons for performing undeclared work.

Although the regularisation of undeclared work requires country-specific action, there is scope for mutual learning at European level. Several Member States have managed to reduce the incidence of undeclared work substantially as a result of decisive measures aimed at tax compliance, incentives, awareness and sanctions. Labour market, regulatory and tax policies thus create a lot of scope for improving employment figures, as shown by several Member States that have successfully implemented reforms to regularise occasional or minor jobs.

Significant increases in poverty among those of working age are among the most tangible social impacts of the economic crisis and even a gradual reduction of unemployment level may not provide guarantees for a reversal of this situation. This ESDE review shows how taking up a job helps getting out of poverty, but only in half of the cases: much depends on the type of job found, but also on the household composition and labour market situation of the partner.

Combining adequate income support, and measures promoting inclusive labour markets and access to enabling services, is needed to reduce working age poverty and its drivers. In some countries, significant shares of unemployed are not covered by standard safety nets (unemployment benefits, social assistance), and tend to rely on pensions, including elderly pensions received by other members of the household. Such situations are not supportive of returns to employment because they are not associated with any incentive structures (activation, conditionality, etc.). In contrast, adequate and widely available systems of income support do not prevent or discourage returns to employment if they are well-designed (for example, with reducing generosity over time) and accompanied by appropriate conditions (job search requirements). Analysis shows that all other things being equal, people receiving unemployment benefits have greater chances to take-up a job than non-recipients.

Gender gaps remain prominent in EU labour markets...

...but the right policy mixes can contribute to their narrowing.

Undeclared work also remains an important structural labour market challenge...

...although some Member States have been successful in reducing its incidence.

Taking up a job helps getting out of poverty only in half of the cases.

People receiving unemployment benefits have greater chances to take-up a job than non-recipients.

A longer-term view of structural factors of future job creation...

...indicates potential for relatively robust employment outlook...

...but not without appropriate policy responses addressing skill mismatches and growing labour market polarisation.

Adequate measures of social progress...

...should start playing a stronger role in guiding key policy decisions.

Conclusions: well-designed policies for a sustained recovery.

Signs of a gradual labour market recovery also offer an opportunity to take a longer-term view and to assess how the key structural factors, such as further technological progress, globalisation, demographic change and greening of the economy, are likely to impact on future job creation in the EU.

Technological progress, especially in the field of key enabling technologies and information and communication technologies (ICT), in combination with globalisation, could support the creation of new higher quality jobs, allowing the EU to exploit its comparative advantages in world markets to a fuller extent. In turn, demographic change will doubtlessly increase pressure to design and implement strategies supporting skill formation and education, in order to speed up productivity gains as the necessary major source of future growth in the environment of declining working-age populations. At the same time, ageing populations and changing family structures will also give rise to the creation of new jobs in the health and care sectors. Finally, the greening of the economy and a more intensive use of ICT should also bring about a profound change in the skill profiles that employers want and employees need.

Nevertheless, this positive outlook has a number of caveats. The benefits of these transformations can only be sustained by creating a virtuous circle of continuous innovation supporting a strong knowledge- and technology-intensive enterprise sector backed by expanding international trade. Greater investment in human capital is crucial in this respect. Moreover, some jobs will be destroyed or will benefit less from the overall improvements in job quality. Skill mismatches, gaps and shortages are likely to play an important role in this respect, while persistent unemployment in the current economic downturn may reduce the future employability of the unemployed. Such developments carry the risk of accelerating labour market polarisation, preventing realisation of the full job potential by 2020. Quick stabilisation of the economy combined with adequate policy responses, including stronger synergies between education/training systems and the needs of enterprises are necessary preconditions to mitigate this risk.

Apart from looking at recent developments and structural trends in Europe's labour markets and social situations, this ESDE Review also attempts to contribute to another important on-going debate relevant for economic, employment and social policy making. The 'Beyond GDP' debate has in recent years drawn attention to the need to complement measurement of GDP with indicators that encompass environmental and social aspects of progress. At the same time, in the global arena, discussion is now underway to set up a new post-2015 framework for sustainable development, where goals supported by indicators looking beyond GDP and including a focus on social cohesion would help direct policies towards more inclusive and sustainable growth. The limitations of GDP as a measure of key societal goals such as well-being and sustainable development are widely recognised. Alternative measurement concepts are being tested and increasingly used for policy making at regional, national and international level. Economic growth is a key component of well-being, via improvement in standards of living, but needs to be sustainable and ensure that the benefits are widely and fairly distributed across society. This has been recognised at the top political level with the adoption in 2010 of the 'Europe 2020' strategy, which is based on a vision of smart, green and inclusive growth. Nevertheless, there is widespread concern that the benefits of economic growth have not been shared fairly, and that the current crisis further widens the gap between rich and poor.

Additional indicators need to be discussed to complement the standard socio-economic accounting, so as to better measure the progress of societies, and in particular to integrate distributional measures in the monitoring of growth. Such indicators include the growth rate in real median income, income inequality as measured by one of the widely accepted inequality indicators, median income developments within specific quintiles, inequality-adjusted growth in GDP per capita, and median life satisfaction.

The nascent economic recovery in Europe is still fragile, while labour market and social conditions remain extremely challenging. Ensuring a sustained exit from the lengthy economic downturn, a job-rich recovery and a return to the path towards the Europe 2020 targets will require well-designed policies to confront the employment and social challenges. Investing in jobs and people; improving labour market functioning; increasing the effectiveness and efficiency of tax and benefit systems; supporting transitions away from unemployment and poverty; and restoring socio-economic convergence within the EMU all remain crucial priorities.