Executive Summary

LEAVING NO ONE BEHIND AND STRIVING FOR MORE:

FAIRNESS AND SOLIDARITY IN THE EUROPEAN SOCIAL MARKET ECONOMY

Before the COVID-19 outbreak put Europe and the world under unprecedented public health, economic and social stress, 2020 had started with continuing positive trends in the EU. Despite the deceleration of economic growth relative to 2018, throughout 2019, the EU had the highest employment in history and the lowest unemployment levels on record, while living standards continued to improve and public finances were consolidated. On a global scale, the EU has continued to be a champion of employment, climate action and social rights, affording its populations high levels of social fairness, reinforced by intra-societal solidarity provided by strong social welfare systems. Nonetheless, important weaknesses remained, such as still relatively high youth unemployment, gender gaps, as well as disparities in social welfare and protection systems. Though low by international standards, income inequality had been hardly reduced for years while in-work poverty had risen in a majority of Member States.

Starting as a worldwide health emergency, with a significant cost in human lives and impact on the health of the EU population, COVID-19 has developed into the biggest global socio-economic crisis since the Second World War. In the EU as elsewhere, the crisis exposed and exacerbated existing vulnerabilities while revealing the fragility of some of its greatest achievements, including the free movement of people, goods and services. The impact of the pandemic on both economic output and employment is expected to be more severe than that of the last recession. The rise in unemployment in 2020 resulting from the sharp contraction of economic output will likely be contained, thanks to the Short-Time Work schemes that over forty million people across the EU have benefitted from as well as by other support schemes to firms, workers and the self employed. Nevertheless, large parts of the population still fear that they may lose their jobs and livelihoods.

The employment and social impacts of the pandemic have been unequal. While the majority of the population was forced to cope with lockdowns and social distancing for weeks, workers in certain sectors (notably healthcare and personal care, transport, agriculture, food services, accommodation, leisure and culture) were subject to higher contagion risk and/or higher income losses. Those with non-standard employment status (especially trainees and platform and temporary workers, including migrants) or a low skill level (especially those working in client-facing services) have been more exposed to job loss. Young people in particular have been disproportionately affected by disruptions in their education and training (especially those who do not benefit from digital remote educational solutions) and by difficult school-to-work transitions in the new economic context, while young workers have been often over-represented in the sectors most adversely impacted. The uncoordinated closures of borders at the beginning of the crisis hurt the Single Market and hit the incomes of EU mobile – cross border and posted – workers as well as third-country immigrants particularly hard and prevented flows from and to third countries in key occupations. Without public support measures or alternative income sources, such workers could suffer much greater income losses than, for instance, workers who can work remotely. Non-standard workers also tend to have less comprehensive social protection coverage, having poorer access to healthcare services and lower chances of income replacement if they are sick. As the pandemic seems to hit disproportionally hard those who were already at higher social risk before the crisis, it is likely to amplify pre-existing inequalities and lead to an increase in relative poverty rates.

To take control of the health emergency and bearing in mind the impact of the previous severe recession on the economy and society, the Member States' response has been quick and resolute, involving massive fiscal stimulus measures, reaching up to 20% of GDP in some countries. Within just weeks of the outbreak, the European Commission put forward a series of initiatives to support national efforts to tackle the health and economic crisis. These include more flexibility in the EU budgetary and state aid rules and two packages of support (Coronavirus Response Investment Initiative, so-called CRII and CRII+) introducing extraordinary flexibility in the use of the European Structural and Investment Funds to fight the consequences of COVID-19. The EU also adopted Temporary Support to mitigate Unemployment Risks in an Emergency (SURE), a new instrument providing funding solidarity to Member States. On May 27, the European Commission put forward a EUR 2.4 trillion recovery plan. This includes a new recovery instrument, Next Generation EU, endowed with a financial capacity of EUR 750 billion. Next Generation EU is embedded within a revamped long-term EU budget of EUR 1.85 trillion, focused on promoting a job-rich and sustainable recovery. [1] To ensure that recovery support goes hand-in-hand with investment in the EU's long-term priorities, notably green, digital and social resilience, Next Generation EU will notably fund the Recovery and Resilience Facility. This consists of large-scale financial support (EUR 310 billion in grants and up to EUR 250 billion in loans) to both public investments and reforms that promote the green and digital transition as well as social fairness and resilience and thus help prepare Member States' economies for the future**.**

Against this background, this year's ESDE analyses the state of play of and challenges to social fairness and inclusivity of growth in the EU. It also explores specific policies and tools that can improve the prospects of greater social fairness and enhanced solidarity in the future. It provides evidence-based groundwork for the reflection on how policy can help achieve recovery and further normalisation while meeting Europeans' expectations regarding fairness and solidarity. The report is structured as follows:

Chapter 1: Main developments and key challenges in the European social market economy

Chapter 2: Fairness in the EU: perceptions, evidence and drivers

Chapter 3: Inclusive growth and solidarity in the EU: challenges, policy levers and the way forward

Chapter 4: The role of social dialogue for fairness and inclusion

1. MAIN DEVELOPMENTS AND KEY CHALLENGES IN THE EUROPEAN SOCIAL MARKET ECONOMY

COVID-19 put a sudden stop to the continuous improvements in EU labour markets and social situations, leading to a sharp fall in output…

The COVID-19 crisis halted the positive evolution of the EU economy and of employment in the EU. In 2019, EU GDP had increased by 1.5% (1.3% in the euro area), which is 0.6 percentage points (pps.) less than the previous year and the lowest growth since the recovery that followed the downturn of 2012-2013. However, the European Commission's Summer Forecast of July 2020 projects a fall of EU GDP of as much as -8.3% in 2020. Already in 2020 Q2, after a drop of -3.3% in Q1, it fell by -11.4%. This is the sharpest decline by far since time series started in 1995. Employment dropped by -0.2% in 2020 Q1 and it shrank by -2.7% in 2020 Q2, after rising for twenty-five consecutive quarters. The lockdowns imposed across Europe in spring 2020 to stem the spread of the virus are expected to lead to a significant decrease in employment in 2020 compared with 2019. The EU unemployment rate, which in 2019 fell to the lowest level ever recorded (6.7%), is expected to rise in 2020 to 9% in the EU and 9.6% in the euro area as a result of the COVID-19 outbreak, before declining again in 2021.

9%:

The forecast for the EU unemployment rate in 2020

Prior to the pandemic, the EU employment rate had risen to 73.1% of the population aged 20-64 (72.7% in the euro area). As employment rates increased for both men and for women between 2013 and 2019, the gender employment gap remained stable at around 12 pps. From 2014 to 2018, most Member States made some progress in reducing the gender differences in pay. However, for the EU as a whole in 2018, the average gross hourly earnings of women

[1] For details on the many components of the European Commission's coronavirus response, see https://ec.europa.eu/info/live-work-travel-eu/health/coronavirus-response/recovery-plan-europe_en

were almost 15% lower than those of men. The employment rate of people aged 15-24 had reached 33.5% by 2019, but was still 1.5 pps. short of 2008 levels.

Productivity at EU level had continued to rise in 2019, albeit unevenly among Member States. Productivity per hour worked in the EU had increased by over 9% from 2010 to 2019 (about 8% in the euro area). The number of hours worked per employed person had continued its long-term decline.

...and possibly to an increasing risk of poverty and social exclusion, after many years of reduction in the numbers of Europeans at risk.

Standards of living had continued to improve until the COVID-19 outbreak. The risk of poverty and social exclusion (AROPE) in the EU had declined further to 21.6%. In 2018, 3.9 million more people had come out of poverty and social exclusion, mainly due to reductions in severe material deprivation and in the percentage of people living in very low work intensity households. However, 94.7 million Europeans were still at risk of poverty and exclusion in 2018, with poverty especially high in some rural areas. Inequality in the EU had hardly changed since 2014. People living below the poverty threshold and vulnerable (single-parent or large-family) households continued to face a higher risk of energy poverty (19%, compared with 5.3% for those above the poverty threshold) and inadequate housing conditions.

14 pps. higher risk

of energy poverty for people in households below the AROP threshold

The crisis hits vulnerable groups disproportionately hard ...

The COVID-19 crisis is likely to have increased socio-economic risks for vulnerable groups, such as single parents, children and the elderly, the disabled, migrants, minorities precarious workers (including certain categories of self-employed, platform and informal workers) and people living in areas and households with limited or no digital connectivity. Low and middle-income groups have a higher risk of income loss, due to increasing unemployment and reduced telework possibilities. Service disruptions (especially in education) may also aggravate existing inequalities in educational outcomes and social mobility and increase difficulties young people tend to have to transition from school to work.

...potentially driving up income inequalities.

Before the pandemic, the financial situation of households was improving, with the disposable income of households (GDHI) confirming its rising trend in 2018, buoyed by higher income from work. However, GDHI per capita in five Member States was still below the levels reached it before the 2008-2009 recession.

The EU has progressed towards the Sustainable Development Goals with the exception of gender equality.

The EU's overall good performance up to the crisis was also reflected in its progress towards the UN Sustainable Development Goals (SDG). Most progress was registered under SDG 16, 'Peace, justice and strong institutions' while considerable progress was made towards SDG 1, 'No poverty' and SDG 3, 'Good health and well-being', SDG 2, 'Zero hunger' and SDG 8, 'Decent work and economic growth'. However, the EU was moving away from goal SDG 5, 'Gender equality', with a growing proportion of women who were economically inactive due to caring responsibilities. This is a reminder that a few inequalities had remained in the employment and social domain before the COVID-19 crisis, which could be exacerbated by it unless they are counter-acted by policy action.

The EU has to mount its recovery efforts in a context of unrelenting long-term challenges, such as demographic ageing.

Demographic trends are expected to lead to a substantially increased old age dependency ratio, from 31.4 in 2019 to 52 in 2050). This increase is being driven by rising life expectancy (78.2 years for men and 83.7 years for women in 2018) and a low fertility rate (1.56 live births per woman in 2018). In rural areas, outmigration of the young and active population is an additional driver of the increase in the old age dependency ratio. The working-age population is likely to shrink but to be better-educated (+16.3 pps. increase in highly educated people in 2002-2019 in the 25-34 age group).

+16 percentage points

share of Europeans aged 25-34 with higher education in 2019 versus in 2002

2. Fairness in the EU: perceptions, evidence and drivers

Promoting fairness is a balancing act between the different notions of fairness people have.

Promoting fairness in the EU needs to balance the different principles Europeans espouse, notably rewarding merit, providing for basic needs, and promoting equality of opportunity or living standards. As fairness is so deeply anchored in the subjective individual experience, it is also driven by the way people perceive economy- and society-wide outcomes such as inequality (in earnings and opportunities), poverty and social mobility.

Even people below the poverty line may have very different living standards across different Member States.

In terms of the income levels needed for a decent life, people's experience may not match official definitions, such as the 60% of national median income defining the poverty line. In Member States with low income levels, less than 10% of the total population state that they could make ends meet with an income that corresponds to their 'objective' at-risk-of-poverty threshold (for their country and household size). Indeed, in some of the poorer Member States, an income at the national poverty threshold is hardly sufficient to buy food, let alone pay rent or cover other basic needs.

A different measure of relative poverty by EU-wide threshold would reveal a new picture of the geographical distribution of the European poor.

Employing a new metric of a common EU-wide poverty line (as opposed to the nationally defined AROP threshold currently used) would reveal more households in poverty in the EU. Those households are mainly located in Central and Eastern Member States and their share is especially high in some rural areas. However, in terms of *changes* in poverty one could observe a significant reduction over time of households in poverty under an EU threshold, as compared to a relatively constant number of households in poverty by national thresholds. This is primarily due to income convergence between EU countries as the lower and middle-income households by EU standards – broadly corresponding to the middle classes of Central and Eastern Member States - would be increasing faster than such an EU-wide poverty threshold.

Considering the time-dimension depicts a different picture of how extensive poverty is in the EU.

¼ of EU working-age people were below the poverty threshold at some point during the four years of poverty measurement

Nearly one quarter (24%) of the EU working-age population have found themselves below the at-risk-of-poverty threshold at some point during the last four years of relevant surveys, as opposed to 16% when measured in the last year only. Most of the poor (69%), experiences poverty for longer than a year and 26% of them are recurrently poor (alternating between periods of poverty and non-poverty). In countries with higher poverty rates, the proportion of people who move into poverty tends to be higher than that of those who move out.

Transitions in employment status are associated with high social mobility based on income and wage.

Social mobility – be it income and wage or employment status mobility – can strongly influence perceptions of fairness, as it affects the chances individuals have to improve their situation during their life course. Not everyone has the same chances of mobility. Most movements occur in the middle of the income and wage distribution, while there is a lot of stability at the bottom and especially at the top. Naturally, wage mobility is more frequent among young people.

Empirical analysis suggests that minimum wages and potentially minimum income can play a positive role in labour markets and/or improve social situations, including in the crisis context.

Minimum wages can improve social mobility. The chapter shows that earners of minimum wage – either set through collective agreements (also called 'collectively agreed wage floors') or legislative provisions ('statutory minimum wages') - seem to have higher chances of significantly improving their wage from one year to the next than other employees. Hence, a minimum wage serves as a stepping stone towards better-paid jobs, even in the very short run. In the long run, minimum wages could be an incentive to join the labour market. Therefore, it is timely to reflect on the role that minimum wages can play in energising labour supply and protecting workers from social risks, especially in the aftermath of severe recessions such as the current one.

The chapter also explores the effect of minimum income on labour market participation. It concludes that benefitting from minimum income does not necessarly discourage the participation in the labour market. However, setting minimum income standards should be done in coordination with enhanced work incentives, to improve minimum income's impact on poverty reduction.

3. INCLUSIVE GROWTH AND SOLIDARITY IN THE EU: CHALLENGES, POLICY LEVERS AND THE WAY FORWARD

Economic growth is fair when it is inclusive.

Chapter 3 looks at fairness from the macroeconomic perspective and considers the economy-wide investments that need to be made in order to strengthen it. Economic growth can be deemed fair when it is inclusive, benefiting all income groups, particularly the poorest. High income inequality is linked with inequality of opportunity, i.e. reduced social mobility. It dampens the incentives to invest in human capital, jeopardising potential growth and calling into question the fairness of the growth model.

Recent income growth across the EU has shown a converging trend but has not been particularly inclusive at Member State level.

The top 10%

drew more income than the bottom 40% of the income distribution in the MS with the most sustained growth

Achieving inclusive growth is a formidable challenge for any society, both during high or negative growth. The chapter's analysis provides insights in this respect, which has become highly topical in the context of the COVID-19 crisis. It reviews the distribution of growth from 2007 to 2017, covering the last severe recession to hit the EU and the recovery from it. From 2007 to 2012, the bottom (lowest earning) 40% suffered disproportionately from the reduction of incomes in several Member States. In the countries hit hardest by the previous recession this group saw significant reductions in their incomes, as opposed to the moderate income decline experienced by the top 10%. During the same period, upper income groups in Member States that did not go through a recession benefitted from the economic growth more than bottom groups. The top income group witnessed the most sustained relative income gains during the recovery years as well.

Targeted policies are required to make growth more inclusive in an environment of fast structural changes and unexpected shocks.

Making future growth more inclusive could be more challenging than it was in the recent past. For instance, although rapid technological change increases productivity and has a net positive effect on job creation, it also enables the proliferation of new forms of work that are so far not fully or adequately covered by existing welfare systems, placing some workers in a precarious situation.

A successful greening of the economy implies increased social investment and fair sharing of costs.

EUR 20 billion or more

in social investment until 2030 required by the green transition

The European Green Deal is the new EU growth strategy that aims to achieve a modern, resource-efficient and competitive economy where there are no net emissions of greenhouse gases in 2050 and where economic growth is decoupled from resource use. It is also an essential element of the EU's Recovery plan. The EU's move to a resource-efficient, circular, digitised, climate-neutral and resilient economy, and the broad deployment of artificial intelligence are expected to create new jobs while other jobs will change or even disappear. In addition to the necessary investment in capital formation, this transition requires social investment (notably for re-skilling programmes) and/or unemployment benefits. The necessary social investment could amount to EUR 20 billion or more until 2030. Furthermore, additional investment in climate change adaptation and disaster risk reduction is needed to preserve jobs at risk of climate impacts, and protects citizens from the adverse consequences of disasters and climate change. However, a more ambitious transition towards climate neutrality and greater climate resilience, implying bigger shifts in the skill sets of the workforce, would require a multiple of this amount in investment. To achieve this transition in a socially fair way, the less competitive regions and Member States need help to shoulder any initial investment cost of enabling climate neutrality and generating green jobs. The Just Transition Fund foresees investment of up to EUR 100 billion between 2021 and 2027 to help Member States achieve the objective of climate neutrality by 2050. The impact of the green transition will be felt at the level of household incomes as well. For instance, energy taxation tends to affect disproportionately poorer households, as it represents a bigger part of their disposable income, and rural inhabitants with long commutes to work and basic services. To boost the progressivity of the tax system, governments may wish to consider re-investing the energy taxation revenue, by transferring it back to poor households. Microsimulations for four Member States show that levying energy taxes while recycling their revenue to households could even lower inequality and poverty rates (in addition to contributing positively to the EU's energy and climate targets).

Policy could strengthen fairness through various levers, such as closing gender gaps…

+EUR 400 billion

in pensions per year, by 2070, through narrowing gender gaps in the labour market

In this environment of rapid change, public policies can contribute to strengthening fairness by improving people's chances of more and/or higher-paid employment. Using an actuarial model, the chapter quantifies the benefits of narrowing gender-related labour market gaps in an environment of rapid population ageing. This ageing could cause the EU's average level of pensions as a percentage of wages to decline from today's 43.3% to 26.7% by 2070. Narrowing three gender-related gaps (labour force participation, earnings, working hours) could cushion this decline significantly. In the EU, there are still 15.7 million fewer women than men participating in the labour market, with the gap between the employment rates of men and women being particularly high in some rural regions. On average, these women earn 14.8% less than men. Women also work almost 6 hours less per week than men. If these gaps can be narrowed across the EU to the levels found in Sweden today, pension levels will fall less steeply – to 29.9% of wages by 2070, 3.1 pps. higher than if today's gender gaps remain. In today's values, this is equivalent to almost EUR 400 billion a year. One could also regard this amount as the annual reduction in the cost of ageing (in the form of higher future pensions).

… extending working lives and investment in higher qualifications.

+EUR 130 billion

in pensions per year, by 2070, through longer working lives

Inter-generational fairness could also benefit from longer real working lives. Postponing retirement by one additional year could increase employment by 2.2% and, in the long run, raise the value of pensions by more than 2%. By 2070, the pension-wage ratio would decline from today's 43% to 28.5%, instead of 26.7% as expected without changes, the difference corresponding to an amount of EUR 130 billion per year in today's values. Finally, the chapter demonstrates through simulations on Italy's labour market that increasing the levels of educational attainment could also contribute to lowering the cost of ageing, by raising participation rates through larger shares of people with higher education.

Short-Time Work schemes have proven their effectiveness in protecting jobs…

Subsidising one job through STW during the COVID-19 crisis might actually save more than that one job

The analysis also shows the significant potential of Short-Time Work (STW) schemes to mitigate the economic damage of sudden cyclical shocks. In 2009, 32% of the massive (-4.3%) GDP decline was absorbed through reductions in working hours (-1.3%), as opposed to a decline in employment. STW schemes contributed significantly to this development. While EU GDP in 2020 is forecast to shrink more (-8.3%) due to the COVID-19 crisis, the absorption capacity of the reduction in working hours is likely to be greater than in 2009, as suggested already by the change in GDP and employment in 2020 Q2. In the recent past, unemployment increased by less when STW schemes expanded in parallel to a decline in output. This finding suggests that investing in STW has a positive immediate multiplier effect: subsidising one job during an economic downturn can save more than this one job. A simple estimate of the potential costs of STW schemes reveals that their cost in the EU27 in 2020 could amount to a maximum of around EUR 33 billion for every percentage point of GDP decline if every reduced working hour needs to be subsidised. This *maximum* amount is higher than the estimated cost of higher unemployment, i.e. the cost that would incur in 2020 with no STW schemes and no absorption of the decrease in output (EUR 29 billion). However, when comparing costs, one should also take into account the aforementioned multiplier effect in STW: subsidising one worker enables firms to reduce working time for more workers, thus bringing the actual cost of STW much below EUR 33 billion. In the medium term, the cost advantage of STW schemes is likely to increase further because it spares workers from potentially long-term unemployment. However, to reap the maximum benefit of STW schemes, governments would simultaneously have to mitigate any false incentives that the subsidisation of working time reduction might induce.

...making SURE a valuable tool in mitigating the employment impact of COVID-19.

These estimates underline both the importance and the advantages of extending the reach of STW schemes through EU-wide solidarity mechanisms such as SURE for exceptional situations in the future. Short-time work in the COVID-19 crisis can protect millions of employees and the self-employed from losing their jobs and livelihoods – often for good. Hence, SURE is a vital component of an adequate and balanced response to the crisis because not all Member States will be able to shoulder the high cost of STW schemes without support.

4. THE ROLE OF SOCIAL DIALOGUE FOR FAIRNESS AND INCLUSION

Social dialogue and collective wage bargaining more specifically influence fairness and its perception.

10% higher wages

for workers under a collective bargaining agreement

Social dialogue and collective wage bargaining contribute to higher levels of fairness in the world of work by influencing working conditions, including wages. Company-level bargaining allows for a better alignment of wages with productivity, i.e. with a merit-based criterion of fairness. Sector-level agreements tend to reduce wage dispersion among workers; they support the egalitarian criterion of fairness. Coordinated bargaining regimes can combine economy- wide goals with company-level goals, balancing better merit-based and egalitarian notions of fairness. Workers who are covered by a collective bargaining agreement earn as much as 10% more than workers in comparable jobs who are not covered.

The social partners' efforts promote fairness at the workplace in various ways.

20% less bullying, 60% less sexual harassment

reported by workers in firms with workers' representation

Effective social dialogue increases fairness at the workplace between men and women and between generations, by promoting integration into the workforce and work-life balance, and by fighting gender and age discrimination, abuse, violence and harassment at work. Helping to narrow gender gaps in activity is of consequence. The total cost of women's inactivity in the workforce is estimated at around EUR 361.9 billion/year across the EU, including loss of tax revenues and payment of benefits. Also, workers employed in companies with workers' representation report up to 30% less verbal abuse, about 20% less bullying and 60% less sexual harassment. Collective wage agreements reduce the gender pay gap by up to 5%.

The social partners have keenly motivated and accompanied government responses to the COVID-19 crisis.

+5% higher wages

for female workers covered vs. those not covered by collective bargaining

The social partners have also been key contributors to responses to cyclical downturns. Whether discussing health risk mitigation for workers or macroeconomic support programmes (STW benefits and other state aids at national level and fiscal policy intervention at EU level), the social partners in most Member States have been pivotal advisers, co-designers, implementers and/or evaluators of the measures to respond to the COVID-19 crisis.

CONCLUSIONS

The COVID-19 pandemic is having profound health, economic, employment and social effects, threatening much of the social progress that the EU achieved up to the end of 2019. The EU is experiencing a greater economic shock than in 2008-2009. Output has contracted sharply and unemployment is set to rise. Inequalities and poverty are likely to intensify, underlining the need to build solidarity across socio-economic groups, generations, regions and Member States to achieve a fair, inclusive recovery that leaves nobody behind.

The pandemic has given new impetus to the EU's long-term goal of environmentally and socially sustainable growth through greening and digitalisation. To repair the damage done by COVID-19 and prepare Europe's economy and society for a future of faster structural changes, the EU and Member States will need to embrace fully the opportunities offered by the transition to a greener and more digitalised economy and build inclusiveness, solidarity and resilience into the design of all policies.