COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 23.04.98
COM(1998) 243 final

REPORT FROM THE COMMISSION

TO THE COUNCIL, THE EUROPEAN PARLIAMENT,
THE ECONOMIC AND SOCIAL COMMITTEE
AND THE COMMITTEE OF THE REGIONS

Social Protection in Europe 1997 — Executive summary

Social Protection in Europe 1997 — Executive summary

The political context

This is the third report on Social Protection in Europe. It sets out to monitor the progress achieved in relation to the objectives contained in the Council's Recommendation on the *convergence of social protection objectives and policies* of July 1992 (92/442/EEC) and to update the analysis of the 1993 and 1995 reports.

The Report is also intended to contribute to the debate on the future of social protection in the Union, launched by the Commission in 1995 with its Communication *Framework for Debate on the Future of Social Protection.* In March 1997, the Commission published a further Communication, *Modernising and Improving Social Protection,* which reflected the main points made in the debate and drew attention to the major implications for policy.

The report should also be seen in the context both of Member States' efforts to consolidate public finances — as pointed out in the 1997 Broad Economic Guidelines and the two Resolutions on macro-economic stability, growth and employment, adopted at the European Council in Amsterdam — and of the European Employment Strategy. At the Luxembourg Jobs Summit in November 1997, Member States broadly endorsed the Commission's proposals for employment guidelines. They agreed that benefit as well as training systems should, where necessary, be reviewed and adapted to ensure that they actively support employability. Social protection also has an important role to play in helping to achieve other aims emphasised in the 1998 Employment Guidelines which were subsequently adopted — developing entrepreneurship, encouraging adaptability of businesses and their employees and strengthening the policies for equal opportunities. A clear link has, therefore, been established at the highest level between social protection systems and the European Employment Strategy.

The main quantitative findings

The main points to emerge from the analysis of the revised ESSPROS database on social protection and the new European Community Household Panel are:

The scale of social expenditure: expenditure on social protection in the Union amounted to 28½% of GDP in 1995. This figure, however, ranged from 20% of GDP in Ireland and 21–22% in Greece, Spain and Portugal to over 30% in France, the Netherlands and the three Nordic countries, with Sweden having the highest level at almost 36%.

The pattern of social expenditure: old-age pensions are by some way the largest item of social protection expenditure in the Union, accounting for 42½% of the total in 1995, equivalent to 12% of GDP, followed by health care, amounting to around 22% of the total in the Union, as well as in all Member States, except for Denmark (only 14%), and to some 6% of GDP. Transfers to the unemployed accounted for only 8% of total expenditure in the Union (just under 2½% of GDP).

The growth of social expenditure: in most Member States, the increase in social protection expenditure has slowed down in recent years. Although social expenditure across the Union increased in relation to GDP between 1990 and 1995 (by just over 2 percentage points), this partly reflects the slowdown in GDP growth during the recession years. Between 1993 and 1995, spending grew no faster than GDP and in most countries rose by less.

Sources of finance: around 65% of the funding for social protection in the Union comes from social charges levied on employers and the people protected, most of the rest from general taxation. Employers' contributions alone accounted for some 40% of total finance in 1995.

Levels of unemployment benefit: a significant proportion of people unemployed in a number of Member States, according to the ECHP, received no unemployment benefit at all in 1993, even when out of work for three months or more. For those receiving benefit, the monthly amount averaged just over half of their net earnings for the months when they were working, though it ranged from 60–65% in Denmark, France and Ireland to only 25% in Greece and the UK.

The relief of poverty: social transfers (including private pensions, but excluding benefits in kind, such as health care) accounted for around 30% of net household income in the Union in 1993. For some 35% of households, they were the main source of income and without them just under 40% of households would have had a level of income of under half the national average (the conventional measure of poverty). After transfers, around 17% of households in the Union had a level of income below this.

Recent changes in policy

The economic and social context in which European social protection systems operate has changed considerably over the past decade or two (as analysed in the Commission Communication *Modernising and Improving Social Protection*). Over the 1990s, low economic growth has increased both the difficulties of funding social protection across the Union and, in combination with demographic and social trends, the number of people being supported. While income maintenance and prevention of social exclusion continue to be fundamental objectives of social protection systems, the aim of policy is to strengthen incentives to work and to improve the employability and adaptability of the work force. The major policy developments are:

Tightening of eligibility for benefit: in many Member States, qualifying conditions for benefit have been tightened and the contribution record required for eligibility has been lengthened.

Strengthening incentives to work: in several countries, measures have been introduced to try to ensure that income from work is always higher than from benefits through tax concessions for low-paid workers and in-work benefits as well as by reducing benefit rates.

Shifting towards more active policies: there is general recognition that providing income support alone is not sufficient to tackle problems of unemployment and social exclusion. In the 1998 Employment Guidelines agreed by the Council, Member States have committed themselves to bringing about a shift from passive to active measures aimed at increasing the employability of those out of work and helping them find a job.

Extending job creation schemes: in a number of Member States, job creation has been encouraged by selective reductions in social contributions as well as by direct subsidies. Member States, moreover, have agreed in the Employment Guidelines to investigate possible means of developing local employment opportunities in the social economy and new activities where needs are not being met by the market.

Reducing dependency and social exclusion: throughout the Union, social assistance guarantees a minimum level of income. The general tendency within Member States' social assistance schemes is to address underlying causes of poverty and social exclusion, to reduce reliance on benefits and to encourage all those able to work to find employment.

Helping people with disabilities: efforts have been made in many Member States to improve the employment opportunities of those with disabilities, through deterring discrimination and removing obstacles to them working, while at the same tightening eligibility for benefit.

Reversing the trend towards early retirement: there has been a long-term trend towards early retirement across the Union, pushing up social expenditure and depriving the economy prematurely of the skills which the people concerned have to offer. For women, this trend has been offset by a more powerful tendency for increased participation in employment, but for men, it has led to around half of men aged between 55 and 64 (ie below the official retirement age in most countries) no longer being in work. In a number of Member States, measures have been introduced to discourage early retirement, by tightening the conditions for eligibility and/or reducing the amount payable.

Encouraging partial retirement: attempts have been made (in Germany, France, Austria and Finland, especially) to encourage partial retirement by making it possible for people to receive a partial pension if they reduce their hours of work. So far, however, except in France, very few people have opted to take advantage of the possibility.

Adapting to population ageing: reform of pension systems continues to be the focus of political attention to limit the costs implied by an ageing population. In many Member States, the official retirement age has been raised, especially for women, and for both sexes is in most cases being standardised at 65, while measures have been introduced in a number of countries to reduce the pensions payable. A further tendency has been to link the pension receivable more closely to the contributions paid over a person's lifetime, so reinforcing the insurance aspect of the system. So far, there has been no general tendency to shift away from pay-as-you-go to funded schemes (from contributions covering current pensions to covering future liabilities), though there is widespread growth in occupational and private pensions.

Containing health-care costs: a common feature of recent policy developments in Member States has been to impose ceilings on expenditure of national health services or of health insurance funds. While this has generally succeeded in holding down spending relative to GDP, it has led to other concerns — about the way in which resources are effectively being rationed and the efficiency with which they are being used. In many countries, direct charges for drugs and certain services have been introduced or extended to make consumers aware of the costs involved in their supply and so encourage them to restrain their demand. In a number of Member States, governments have sought to exploit the potentially beneficial effects of market mechanisms on efficiency by separating purchasers and providers more clearly, by encouraging both to adopt more commercial attitudes and by making room for managed competition in some areas.

Providing long-term care: there is widespread debate on how caring needs should be met — whether through transfers or through the direct provision of services and how far the State should be involved. In the three Nordic EU countries, in particular, social services are well developed, though they have been increasingly subject to budget constraints. Elsewhere, adequate arrangements for helping to cover the costs of care as part of the social protection system exist in few Member States, the most notable examples being the schemes introduced in Austria in 1993 and in Germany in 1995, the former funded by general taxation, the latter by social contributions.

Targeting expenditure: Targeting resources on those most in need is of growing political concern throughout the Union. This is reflected in both the extension of means-testing — though so far in most cases this remains very limited in scale — and the imposition of taxes and/or social charges on benefit recipients, which can serve to spread the cost of funding social protection more equitably, given the increasing prosperity of many pensioners.

Modernising social protection and adapting systems to change

Systems of social protection and their reform have become a central area of policy concern across the European Union. The Commission's Communication *Modernising and Improving Social Protection in the European Union* (COM(97)102) pointed out that the financial and operational structures of most systems were established decades ago. Since then, the economic and social conditions under which they operate have changed, and will continue to do so. Demands on social protection systems have grown and constraints on their funding have tightened. This concern has been reinforced by the ageing of the population and the impending growth in the number of people of pensionable age. In the efforts to reform social protection systems, the common aims are to assure their continued effectiveness, to ensure that systems strengthen rather than obstruct economic growth and job creation, to contain the costs of providing social support to all those who need it and to shift towards a more active policy designed to get people into employment rather than merely transferring income to them when they are not working.

This new emphasis is reflected in recent European Council declarations. At Dublin at the end of 1996, the need for taxation and social protection systems to become more employment-friendly and more active in the fight against unemployment was stressed, while, at the Luxembourg Jobs Summit at the end of 1997, the Council called for a more active approach to increase the employability of those out of work. The framework for such an approach is set out in the Commission's Communication mentioned above as well as in the 1998 Employment Guidelines agreed by the Council (OJ C 30 of 28 January 1998). The main lines of action identified in the latter — improving employability, developing entrepreneurship, encouraging adaptability of businesses and their employees and strengthening the policies for equal opportunities — all have significance for the orientation of systems of social protection.

The present Report is very much focused on the themes which were the subject of the Communication and the Employment Guidelines, and which are a prominent feature of the changes being made to systems of social protection across the Union. Its specific aim is to contribute to the process of reform by reviewing and analysing these changes and so broaden understanding of the measures concerned. In part, it updates the analysis contained in the two previous *Social Protection in Europe* Reports, for 1993 and 1995 and like them is a product of the European Council Recommendation of July 1992 (92/442/EEC) to monitor the progress achieved in relation to the convergence of social protection aims and policies across the Union. (The full report is published in English, French and German; the present document which summarises the main findings is available in all 11 Community languages.)

It is based, wherever possible, on quantitative information, drawn in particular from two new sources of comparable data — the revised ESSPROS (the European System of Integrated Social Protection Statistics) on expenditure on the various elements of social welfare and their financing and the new European Community Household Panel (ECHP). The latter provides, for the first time, a comparable insight into income and living conditions in Member States, into the distribution of benefits between households and the level of income support they provide. (Both sources of data are described in the technical annex — Notes and sources — at the back of the full report and these should be consulted before drawing policy conclusions from the findings presented here.)

Outline of the Report

The Report begins by examining the changing context in which social protection systems in the Union are operating, focusing on the main demographic, social and economic developments affecting the need for support. Secondly, it analyses the scale of expenditure on social protection in Member States, its division between different functions and the relative importance of various sources of finance. Thirdly, it considers the weight of social transfers in household income and their contribution to reducing disparities in income between households. Fourthly, it reviews the major changes which have been made to social welfare systems across the Union in recent years, focusing on the period since 1995.

Four aspects of particular policy concern are analysed in some detail:

- the operation of unemployment compensation systems which in a number of Member States are being modified to give a greater incentive for people to find work;
- policy towards retirement and, in particular, towards reversing the trend for people to retire before reaching official pensionable age;
- action to contain the growing cost of health care while safeguarding the quality of service;
- long-term care for those who are infirm or too frail to look after themselves and who are imposing new demands on social welfare systems.

The changing context

While European economies are wealthier than ever before and real income, apart from brief interruptions, has continued to grow, the demands on systems of social protection have risen even more rapidly. In recent years, this has occurred, moreover, in a macroeconomic context in which, in most parts of the Union, Governments have given priority to limiting expenditure growth and consolidating public finances. (The analysis in *Competitive Europe, benchmarking the EU against the experience of Ireland and New Zealand* might help Member States decide how best to adapt their public finances and social protection systems to this new context.) Despite the growth in wealth, the scale of dependency on social transfers in most Union Member States is probably greater now than at any time during the post-war years. This seeming paradox is explained by a combination of demographic, social and economic developments which have imposed pressure on social welfare systems they were not designed to deal with.

In the first place, the population above the official age of retirement (65 in most countries) has increased in relation to the number of people of working-age and is set to rise even more dramatically in the years to come. In 1986, for each person aged 65 or over in the Union (the present 15 Member States), there were five people aged 15 to 64. By 1996, growth in the number of people of 65 and over meant that for every one person in this age group, there were only just over 4 people of working age. By 2020, on the latest projections, there will be only just over 3 people of working age in the Union for every one person aged 65 and over.

At the same time, the number of men aged between 55 and 64 no longer economically active has increased markedly, from 43% of those in this age group in 1986 to almost 50% in 1996 (the proportion of women remained much the same), largely because of the slow rate of economic growth and the inadequate rate of net job creation. If this upward trend continues, it will add to the pressure on pensions systems in future years as the growth in the relative number of people of 65 and over accelerates.

Moreover, the average age of the population of 65 and over is already increasing at the present time, intensifying the pressure on health care and social services (the average cost of providing health care alone to someone aged 65–74 is estimated to be 2–2$^1/_2$ times higher than for people under 65, for someone of 75 or over, 4–5 times higher). Whereas around 40% of those of 65 and over in the Union were 75 or over in 1996, by 2010, this is projected to rise to 47%, an increase of 33% in numbers in just 14 years (an average growth of 2% a year). Although total population in the Union is likely to increase by only 3% over this period, therefore, the 'healthcare-adjusted' rise is almost 10% (ie in terms of the increase in demand for health services implied by the prospective demographic change). Beyond 2010, though total population is unlikely to change much, the number aged 65 and over is projected to continue increasing, implying a 'healthcare-adjusted' growth in population of around $^1/_2$% a year.

Secondly, unemployment has increased markedly from the rates experienced in the earlier post-war years. In the Union as a whole, the average rate was consistently below 3% of the labour force throughout the 1950s, 1960s and early 1970s, whereas it has been persistently above 8% since 1982 — except in 1990, when it was only slightly lower. A significant proportion of people of working age have, therefore, been unable to obtain a job to contribute to the generation of income required to support those in retirement and have instead added to the need for social transfers.

The average duration of unemployment has also increased considerably since the mid-1970s. By the mid-1980s, the number in the Union who had been out of work for a year or more had risen to over 5% of the labour force, over half of the total unemployed. While it fell slightly between then and the early 1990s, as a result of the high rate of job growth, by 1996, the number had risen to around 5% of the labour force once more. Over $8^1/_2$ million people across the Union were, therefore, long-term unemployed at the last count and of these over 60%, almost $5^1/_2$ million, had been out of work for two years or more.

In consequence, whereas unemployment compensation systems were designed to provide income support for temporary spells of joblessness, in practice, for the last 10 years and more, at least half of those unemployed at any time were in need of longer term and, almost certainly more extensive, assistance. Moreover, the figures for long-term unemployment do not reveal the full extent of the increase in dependency. Up until recently, there was also a significant rise in a number of Member States (in the Netherlands and the UK, in particular) in men over 50 classified as disabled largely because of their inability to find a job.

The other major feature of economic developments which is relevant has been the substantial and ongoing increase in the proportion of women pursuing working careers. This trend spread first across much of Northern Europe in the 1960s and 1970s and then, in the 1980s, to the Southern Member States. In 1970, only around 40% of women aged 25 to 54 in the Union were in work or actively looking for work. By the mid-1980s, this figure had increased to 60% and by 1996, had reached almost 70%. In Spain and Ireland, the figure has risen from under 40% to 57% during the last decade alone. The effect of this has been to increase the demand not only for social support to help take care of children and elderly and frail parents or grandparents, but also for the individualisation of rights under the social protection system and for due account to be taken of interruptions to paid employment in the calculation of benefit entitlement.

This increase in demand has been reinforced by the changing structure of households and, in particular, the growth of people living alone and of lone parent families, coupled with the decline in the extended family. The average household size declined by 5% over the 10 years 1986 to 1996. This decline was common to most parts of the Union, though the average household size remains significantly larger in the Southern Member States ($2^1/_2$ people aged 15 and over per household) than in the Northern ones (under 2 per household). It is attributable, in particular, to the substantial increase in single adult households (ie with only one person aged 15 or over), which represented almost a quarter of all households in the North of the Union in 1996 as opposed to under 20% a decade earlier.

Some 8% of single adult households in 1996 had children, though in Belgium, Austria and the UK, the figure was over 12%. The great majority of the adults concerned were women, many of them in parts of the Union not in work and dependent on social transfers — in the UK, for example, some two-thirds of lone-parent families receive income support.

Moreover, in general, if someone is unemployed in the Union, there is a much higher probability that they live either alone or in a household where the other members are out of work than in one where someone else is in paid employment and, therefore, bringing in income. In 1996, 15% of households in the Union with a working-age adult had nobody in work. In Belgium, Finland and the UK, the figure was 20% or more, much higher than the average rate of unemployment. In the UK, where unemployment fell significantly over the 10 years 1986 to 1996, the proportion of households where nobody was in work rose, while in Ireland, where unemployment fell by even more, the proportion remained unchanged.

The main quantitative findings

The scale of social expenditure

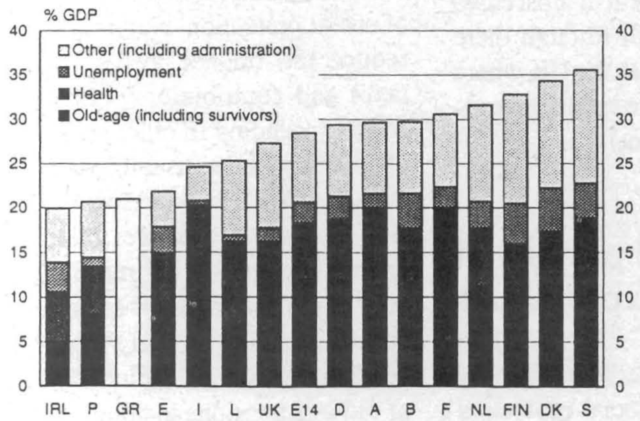
Any assessment of the scale of social protection in European countries, and the associated cost in terms of the transfers involved, can only satisfactorily be made by considering the revenue side of the public sector accounts as well as expenditure. This is, first, because social transfers are increasingly subject to tax or social charges in a number of Member States and, accordingly, part of the expenditure incurred by government returns as tax or other receipts. Secondly, effective transfers can, in principle, be made through tax concessions or allowances as well as through benefit payments and, in this case, will show up as lower receipts rather than as expenditure. Estimating the scale of such so-called tax expenditures and the revenue generated by taxes on benefits is, however, fraught with difficulty.

So far as expenditure is concerned, social protection (as defined under the new ESSPROS to include social transfers, either in cash or in kind for welfare purposes, and health care) amounted to 28½% of Union GDP in 1995. This figure, however, varied markedly between Member States, ranging from 20% of GDP in Ireland, 21% in Greece and Portugal and 22% in Spain, to 30% or more in France, the Netherlands and the three Nordic Member States, with Sweden showing the highest figure at just under 36% of GDP (Graph 1). For the rest, in Belgium, Germany and Austria, expenditure was just under 30% of GDP, while in the UK, it was around 27½% and in Italy 24½%. (Because of the newness of the system of classification, these figures are provisional and liable to change as better information becomes available — see Notes and sources in the main report.)

The variation in these figures between Member States are broadly in line with relative levels of prosperity, as measured by GDP per head, and, therefore, reflect the ability of countries to support the expenditure concerned. Nevertheless, it is evident that there are differences between countries with similar levels of prosperity in the implicit priority accorded to social protection. This, in turn, partly reflects differences in social characteristics (in the tendency for women to pursue working careers, for example, which is high in the Nordic countries and low in Italy), in the age structure of the population and in the degree of reliance on private provision (private pensions are included to varying extents in the ESSPROS data depending on the degree of social solidarity involved).

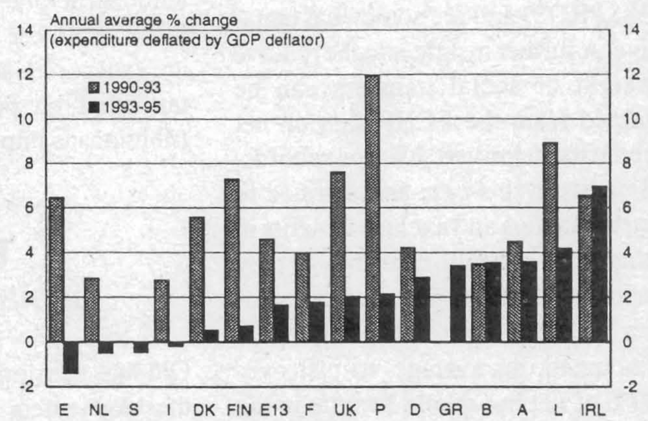
In a number of the countries, however, especially in those where social spending is high in relation to GDP, benefits are subject to tax and/or social charges, so that part of the money paid out by government comes back as receipts on the revenue side of the

1 **Total expenditure on social protection by broad function in Member States, 1995**



GR provisional data, no breakdown available

2 **Growth of social expenditure in real terms in Member States, 1990-93 and 1993-95**



DK 1990-94 and 1994-95, GR & S no data before 1993 accounts. This part, moreover, has tended to increase in recent years as governments have sought both to target protection more effectively on those most in need of support and to distribute the costs more evenly.

According to a recent study ('Net public social expenditure', *OECD, Labour Market and Social Policy Occasional Papers, No. 19*), direct taxes and social contributions levied on benefits amounted to almost 6% of GDP in the Netherlands, over 5% in Sweden, 4% in Denmark and 2½% in Germany, whereas in the UK, the figure was virtually zero. Taking account also of the revenue from indirect taxes as beneficiaries spend their transfers — which is more similar between countries — reduces expenditure on social protection in net terms to around 27% of GDP in Sweden and to between 23% and 25½% of GDP in the other four. This is much less of a difference than shown by the gross spending figures noted above. Moreover, in net terms, the UK is estimated to have slightly higher expenditure relative to GDP than Germany and the Netherlands.

These estimates relate to only five Member States for a single year (Eurostat plans to develop special modules on the effects of taxes as part of ESSPROS) and are somewhat tentative. A further insight into the relative weight of social transfers can be gained from the ECHP data on net benefits received by households. Benefits in this case are confined to cash transfers and exclude benefits in kind, such as health care, though they include all private pensions. According to these data, social transfers amounted, on average, to just over 30% of net household income in the Union in 1993 (the Union here excludes Austria, Finland and Sweden which were not covered by the first wave of the ECHP).

The pattern of variation between Member States differs from that shown by the figures for gross expenditure relative to GDP. Social transfers were highest in Belgium and France, at over 36% of net household income (though the figure for France is slightly overstated because transfers are measured gross of the relatively small amount of tax payable on them), and next highest in Italy, which is well below the Union average in terms of the expenditure figures, at just under 33%. They were similar to the average in Denmark and the Netherlands, as they were in Spain, where, like Italy, the ratio of expenditure to GDP is relatively low, below average in Germany, Ireland, Luxembourg and the UK (at around 27% of net income) and lowest, in Greece and Portugal (25% and 22%, respectively), in line with the expenditure figures.

So far no reliable estimates are available for the overall value of tax-expenditures and their exclusion is liable to distort the comparative picture which emerges from the ESSPROS and ECHP data, though the amounts involved seem in most cases to be relatively small (though there are exceptions, such as the UK where tax relief on private pension contributions is important).

The pattern of social expenditure

Old-age pensions are by some way the largest item of social protection expenditure in the Union, accounting for 42½% of the total in 1995, equivalent to 12% of GDP. The figure, however, varies from over 60% in Italy (15½% of GDP) — far more than in any other Member State (but include some transfers allocated to other items in other countries) — to 32% in Finland (10½% of GDP) and only 25% in Ireland (5% of GDP). In the latter, this partly reflects the small proportion of the population above retirement age, just as the high figure in Italy reflects the opposite, though here the large numbers retiring early reinforces the unfavourable age structure.

While, in general, high unemployment is often regarded as a primary cause of high levels of social spending, in reality, transfers to the unemployed accounted for only 8% of total expenditure in the Union in 1995 (just under 2½% of GDP) — less than spending on disability benefits and only a little higher than that on family allowances. Only in Belgium, Denmark, Finland and Sweden, was expenditure on unemployment benefits significantly above 3% of GDP (4–5% in each case).

At the same time, such expenditure is only a very partial indicator of the costs of unemployment for systems of social protection. Not only does it reduce the finance available from taxes and contributions, but it also adds to spending in other areas. Part of spending under disability benefits, housing allowances and social exclusion is also, in practice, related to unemployment — or, more generally, to job shortages — as is a large part of spending on early retirement pensions (which are included as part of old-age pensions in about half the

Member States rather than unemployment compensation, as required under the ESSPROS classification). In the Netherlands and the UK, expenditure on disability benefits was much higher than on unemployment benefits in 1995 ($4^1/_2$% of GDP and 3%, respectively), while spending on housing and social exclusion amounted to another 1% of GDP across the Union (over 2% of GDP in Denmark, Sweden and the UK).

Health care is the second largest item of expenditure, amounting to around 22% of the total in the Union, as well as in all Member States, except for Denmark (only 14%), and to some 6% of GDP, though varying from under 5% in Denmark and Italy to $7^1/_2$% in France, well above the figure in any other Member State.

The growth of social expenditure

Total spending on social protection increased from just under 26% of GDP to $28^1/_2$% over the five years 1990 to 1995 as compared with a rise of around 1% of GDP over the 1980s (on the previous ESSPROS definition). The increase was common to all Member States with the sole exception of the Netherlands, where there was a small fall. (Unfortunately, no estimates are available for the change in net terms, which is likely to have been less.)

The rise, however, reflects in large measure the slowdown in GDP growth itself during the 1990s — to under $1^1/_2$% a year as against almost $2^1/_2$% in the 1980s. Moreover, the rise was confined to the period 1990 to 1993, the years of recession when there was very little growth at all in GDP. In the two years 1993 to 1995, social spending in the Union declined on average relative to GDP, rising only in Belgium, Germany and Austria and falling elsewhere. While this was partly due to some recovery in GDP, it was also the result of a marked slowdown after 1993 in the growth of social protection itself, to some extent reflecting the stabilisation of unemployment after the large rise which occurred during the recession years.

In real terms (adjusting for general inflation), social spending grew by an average of around $4^1/_2$% a year in the Union in the three years 1990 to 1993, when GDP hardly increased at all. In the two years, 1993 to 1995, it went up by $1^1/_2$% a year (Graph 2). Only in Belgium and in Ireland (where GDP rose by over 9% a year) was there no reduction in the rate of real growth over the latter period. Even after excluding unemployment benefits, which declined in real terms between 1993 and 1995, average expenditure growth after 1993 was half the rate in the three years before.

The largest rise in social expenditure over the five years 1990 to 1995 (6–7% of GDP) occurred in Portugal, where efforts were being made to raise protection to the standards in the North of the Union, and Finland, where unemployment rose more steeply than anywhere else. By contrast, in the Netherlands, expenditure fell slightly relative to GDP, while in Ireland and Italy, the rise was well below average (under 1% of GDP), in the former, GDP and social spending growing strongly, in the latter, both growing slowly.

Apart from unemployment benefits, old age pensions and health care showed the largest rise over the period (up by 1% of Union GDP and $^1/_2$% respectively), in part reflecting the ageing of the population. Between 1993 and 1995, however, spending on health care fell relative to GDP in a number of countries, while that on old-age pensions rose in line with, or less than, the growth in GDP in most Member States.

Sources of finance

The funding of social protection continues to be the focus of much policy attention. The emphasis throughout the Union, as part of the attempt to increase job creation, has been on reducing non-wage labour costs. This objective, proposed by the Commission in its White Paper on *Growth, Competitiveness and Employment* in 1993, was confirmed by several European Councils, especially in Dublin at the end of 1996, as well as in the Employment Guidelines adopted at the end of 1997. However, so far there is little sign that the level of charges levied on labour (taxes and social contributions) has decreased. In fact, the implicit tax rate is estimated to have increased from 35% in 1981 to 42% in 1995. (Improvements in the coordination of taxation policies across the Union to address this issue are currently being discussed by the Taxation Policy Group set up be the European Council in Dublin at the end of 1996.)

The funding for social protection in all Member States comes partly from social contributions, levied mostly on income from employment, and partly from general taxation, though in a few countries (Belgium, France and Luxembourg, in particular) 'earmarked' taxes have been introduced in recent years. On the latest figures (for 1995), around 65% of finance in the Union still comes from contributions, some 60% of these paid by employers, including voluntary as well as statutory contributions (ie 40% of total funding), and 30% from taxation, virtually all of this from general taxes.

The relative weight of the two broad sources varies between countries, reflecting the historical development of the system itself. In Member States where the system has its origins in the provision of social insurance for those in employment (the so-called Bismarkian system) — the Benelux countries, France, Germany and Austria — social contributions still account for two-thirds or more of funding (as much as 77% in France). In the Nordic countries, the UK and Ireland, where the system has its origins in the provision of social welfare for those in need (the so-called Beveridge system), social contributions account for less than half of total finance (40% or less in the UK and Ireland and only 23½% in Denmark). In the South of the Union, two-thirds or more of revenue comes from contributions in Greece, Spain and Italy, but just under half in Portugal.

In all countries, except Denmark and the Netherlands, a much larger share of contributions comes from employers than from those being protected. In line with stated policy aims, however, there has been some shift to other sources during the 1990s. In the Union as a whole, the revenue raised from employers' contributions declined from 43% of the total to 39½% in the five years 1990 to 1995, while that raised from those protected rose from 22½% to 23½%. This shift was common to all Member States, except for Denmark and the Netherlands, where employers' contributions are relatively small, and Belgium. It was especially marked in Portugal and Finland, where revenue from employers' contributions was reduced by some 20% in relative terms.

In relation to labour costs, however, the evidence suggests that employers' contributions increased slightly between 1990 and 1995 across the Union, while they remained virtually unchanged relative to GDP, despite their decline as a share of total funding for social protection. Though governments have sought to relieve employers of some of the costs of financing social protection, therefore, this aim has generally been frustrated by the growth of expenditure — and funding requirements — at a higher rate than GDP and, accordingly, than the tax base from which revenue has to be raised. The increase in employers' contributions relative to labour costs (or the overall wage bill as measured by the compensation of employees) was common to all Member States for which data exist (ie excluding Greece, Luxembourg and Sweden), except Portugal and Ireland.

The other main development on the funding side, apart from the emergence of earmarked taxes, which is limited to a very few countries (in France, their share of revenue rose from 3½% in 1990 to 8% in 1995), is the increase in contributions levied on old-age pensioners and other benefit recipients. This reflects both the growing real income of pensioners and the desire to spread the cost of financing more evenly across the population. Nevertheless, only in the Netherlands (8½%) and Germany (4%) are they a significant source of funding.

Levels of unemployment benefit

Data from the ECHP for the first time enable the actual level of benefit received by those out of work to be compared across the Union (whereas previously it has been necessary to rely on the results of models — see *Social Protection in Europe, 1995*, Chapter 4 — which however well they capture the features of the benefit and tax systems in operation provide no indication of how representative the results for hypothetical cases are in reality). They indicate that, in practice, the disincentive to look for work associated with the benefit system seems to vary markedly across the Union. In the first place, around a quarter of those aged 25 to 64 in the Union in 1993 who were unemployed for at least three months received no unemployment benefit at all (though they may have received other means of support to ensure that their income did not fall below a minimum level). This proportion, however, varied from 5% or less in Belgium, Denmark, Germany and the UK and only slightly more in Ireland, to around two-thirds in Greece, Italy and Portugal (in the ECHP no comparable data exist for the Netherlands, Austria, Finland and Sweden and there are insufficient observations for Luxembourg).

Secondly, for those receiving benefit, the monthly payment averaged just over 50% of net earnings for the months that they were employed (which, it should be emphasised, could be in the jobs they moved into after they were unemployed as well as in the jobs they had before becoming unemployed), but was over 75% in Portugal (though only a third of the unemployed received anything) and around 60–65% in Denmark, France and Ireland, but only 25% in Greece and the UK (Graph 3). Benefit levels in Belgium and Germany were around the Union average, in Spain just above and Italy below. (It should be emphasised that these figures relate only to benefits linked with unemployment and the people concerned may also be in receipt of other transfers which might affect the level of benefit relative to earnings — see Chapter 4 of the full report.)

Thirdly, the proportion of the unemployed receiving benefits of 80% or more of their net earnings when in work (assuming that their average monthly earnings calculated from the ECHP data reflect the pay they receive in the jobs they move into after being unemployed), was relatively small in most of the Member States covered (around 20% or less of men in 8 of the 10 countries, all except Ireland and Portugal and under 6% in Greece, Italy, and around 20% or less of women in 7 of the countries, though around a third in Germany and France and half in Denmark).

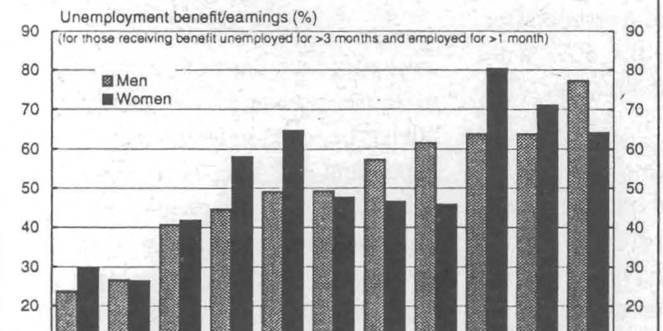
These figures need to be interpreted with some caution, however, since in a number of countries where benefit levels are low (the UK especially), various benefits in kind not included in the ECHP data, such as housing allowances, are also payable to those unemployed to supplement their income (it is also important to take account of the nature of the data, which is explained in Chapter 4 and Notes and sources in the full report). Nevertheless, though significant, these additional payments are unlikely to alter the picture substantially, partly because in many cases they are also payable to those in low-paid jobs, which most of the unemployed tend to go into when they return to work (the ECHP indicates that monthly earnings of those unemployed for part of 1993 were in most cases substantially below average — see Chapter 4 of the full report).

The relief of poverty

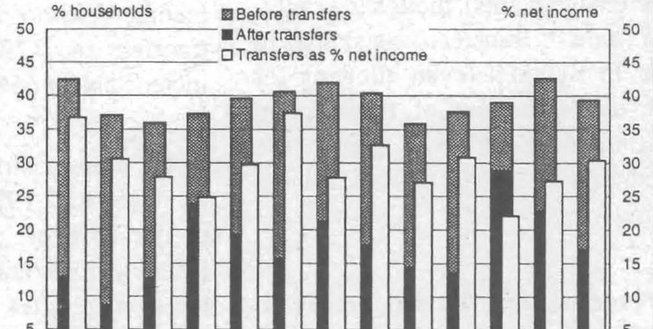
As constraints on social expenditure tighten, the concern in all Member States is increasingly to allocate revenue in the most effective way. Data on household income from the ECHP provide an insight into the extent to which transfers are targeted on the poorest in society and, as a result, succeed in alleviating relative deprivation and narrowing disparities in income distribution, though it should be stressed that this is only one of the aims of systems of social protection in the Union.

According to the ECHP, social transfers (including private pensions) in the Union accounted for around 30% of net household income in 1993, as noted above. For some 37% or so of households, they represented the main source of income. In their absence, almost 40% of households

3 Average unemployment compensation relative to earnings for men and women aged 25-64 in Member States, 1993



4 Scale of social transfers and effect on households with net income below 50% of average, 1993



would have had an income level of under 50% of the national average (a measure conventionally used as an indicator of relative poverty and agreed as a working definition by the Council of Ministers in December 1984), many none at all. This proportion varied comparatively little between countries. In Belgium, Ireland and the UK, it was around 42%, in Denmark, Germany, Greece, Luxembourg and the Netherlands, 36–37% (Graph 4).

After transfers, and after tax, an average of around 17% of households in the Union had an income level below half the national average. In the UK, Ireland and Greece, the proportion was over 20% and in Portugal, some 29%, in Spain, France and Italy, it was around the Union average (15 to 19%), in the Benelux countries and Germany, 13–14% and in Denmark, under 9%. The effect of transfers in reducing the share of households with income below 50% was greatest in Belgium and Denmark, where the reduction was around 29 percentage points, though Denmark achieved this with proportionately smaller transfers (30% of net household income) than Belgium (37%). The effect was also relatively large in France and the Netherlands (24–25 percentage points), though in France, the scale of transfers was similar to that in Belgium (even allowing for the overstatement of transfers in France noted above) and in the Netherlands, similar to that in Denmark.

By contrast, the reduction in the share in Greece was only 14 percentage points and in Portugal, only just over 10 percentage points. In terms of the scale of social transfers (25% of net household income in the former, 22% in the latter), the effect in relieving poverty in the two was very similar and in both transfers appear to be less targeted on the poorest than in other Member States (around 70% of transfers going to households with under half average income before transfers as against 77% in the Union as a whole).

Over the rest of the Union, the reduction in share was 20–23 percentage points, though again the level of transfers involved in achieving this differs between countries, being higher in Italy, for example, than in Germany (23 percentage points as against 20).

The comparatively small effect of social transfers on income distribution in Greece and Portugal also reflects their uneven allocation between households, with some receiving a substantial amount, others comparatively little. This was particularly so in the case of old-age pensions which are the major element in transfers, though it also applied to other transfers (unemployment benefits, family allowances and so on), as it did in Italy. In the case of these other transfers, over the Union as a whole, 19% went to the 17% of households with income below 50% of average after transfers and 37% to the 30% with income below 65% of average.

In the case of old-age pensions, on the other hand, 19% of transfers went to the 15% of households in the Union with income of over $1^1/_2$ times the average after transfers (28% in Greece and Portugal to the 16–17% of the households in this category, 25% in France to the 13% of households and 29% in the Netherlands to the 15% of households). In four countries, however, Belgium, Ireland, Luxembourg and, most especially, Denmark, pensions went disproportionately to lower-income households.

Recent changes in policy

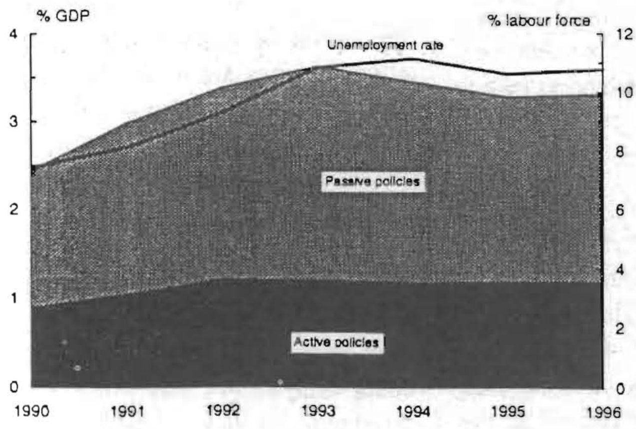
The common response of governments across Europe to the expenditure trends noted above, has been to seek ways, on the one hand, of containing the growth of spending and, on the other, of activating policy to reduce the number of people dependent on social transfers. The activation of policy has been a central theme underlying many recent reforms, the aim being to shift from a passive stance of income support to an active one of encouraging those out of work to take up paid employment, by increasing incentives to work and helping people to participate in society and working life. Measures have, therefore, been implemented to improve the employability of those out of work, to provide access to training and career guidance and to assist them in finding a job.

This approach has not been confined to those registered as unemployed but has been extended to other groups dependent on long-term state support, especially to people with disabilities but potentially able and wanting to work, lone parents and those retiring from work early. The aim has been not just to reduce dependency and expenditure, but to combat social exclusion by helping the people concerned find a more meaningful place in society and a chance to contribute to its well-being.

The ageing of the population has added further impetus to these efforts. It has also served to focus increased attention on the growing costs of health care, which goes disproportionately to the elderly, and on the need for new ways of catering for those requiring long-term care.

The concern to address this new need exemplifies the prevailing attitude towards social protection across the Union. Although the emphasis is on cost containment and reducing expenditure wherever possible, the principle of maintaining a universal system which provides protection to all those in need remains unquestioned. Nevertheless, there is increasing debate on how widely social welfare systems should extend, what risks they should cover and, most pertinently, where state responsibility should end and individual responsibility take over. At the same time, there is a growing emphasis on the pursuit of active measures and the need to support policies for increasing employment, the main guidelines of which were agreed by Member States at the Luxembourg Jobs Summit.

5 Expenditure on active and passive labour market policies in the Union, 1990-96



Tightening eligibility for benefit

In several Member States (the Netherlands and Sweden, in particular), the qualifying conditions for benefit have been tightened since 1993 (the year to which the analysis above relates), while in others (Spain, Austria and Finland), the contributions record required to be eligible for benefit has been lengthened. Rates of benefit have also been reduced, as in Germany and Finland — in the latter by their non-indexation in 1995 and 1996. On the other hand, in Sweden, although the rate of benefit was reduced from 80% to 75% in 1996, after being lowered from 90% before that, the rate was restored to 80% in 1997.

The period of entitlement to insurance benefit has also been shortened in some Member States — in the UK, from one year to only 6 months on the introduction of the Job Seeker's Allowance in 1996 (payment being means-tested after that); in Denmark, from 9 years to 7 years in 1995 and to 5 years in 1996, though it remains among the longest in the Union (but for the last 3 years, intensified efforts are made to get the unemployed into active programmes). In Belgium, from 1996, benefits can be withdrawn if the person concerned has been unemployed for more than $1^1/_2$ times the regional average (instead of twice as long as before).

Strengthening incentives to work

Cuts in benefit and a tightening of eligibility criteria provide in themselves an increased incentive to work. Other measures have also been introduced in a number of countries to make it more attractive, and in some cases more feasible, for people to work rather than remain unemployed. In-work benefits, designed to increase the take-home pay from working, even in low-paid jobs, exist, at present, in only the UK (eg Family Credit) and Ireland (Family Income Supplement). Whereas so far they have been paid only to people with children, in the UK, a pilot scheme was introduced in 1996 for low-paid workers without children. In both countries, the number of people covered by in-work benefits has increased in the recent past as qualifying income levels have been raised. Lone parents have been targeted specifically, with a new benefit for these being introduced in Ireland in 1997. Help with child care for low income families, including lone parents, was also introduced recently in the UK. In the latter and elsewhere, attempts have been made to encourage the unemployed to take part-time jobs, partly to prepare them better for full-time employment — through giving them entitlement to unemployment benefits (in Belgium, or enabling them to keep some of their benefit in the UK).

Effects similar to those of in work-benefits can be also obtained by granting specific tax advantages for low-wage earners (eg in Finland, measures have been introduced to reduce the income tax paid by those on low pay, a concession which is withdrawn as earnings increase).

Shifting towards more active policies

Changes in unemployment compensation systems have generally been accompanied by measures aimed at increasing the employability of the unemployed and helping them find a job, including, for example, training to improve skill levels in line with labour market requirements and advice on job search and interview techniques. Shifting policy from passive measures of income support to active measures, however, is not so easy, especially during periods of high unemployment. Given budget constraints, it requires a restructuring of expenditure and a reform of benefit and tax systems to maximise the return on existing outlays. Although the need to shift expenditure from passive to active labour market measures was highlighted by Member States at the Essen Summit at the end of 1994 and reiterated at successive Council meetings since, the policy intention has been slow to show up in the figures on labour market expenditure. Between 1990 and 1996, there was only a small rise in the Union as a whole in spending on active in relation to passive measures, all of which has occurred since unemployment stabilised in 1994 (Graph 5). Member States have, therefore, reaffirmed their commitment to bring about such a transition in the Employment Guidelines agreed at the Luxembourg Jobs Summit.

In a number of Member States, conscious efforts have been made to improve the articulation between the provision of income support and getting the unemployed into work. In Denmark, as noted above, measures were introduced in 1995 to ensure that anyone unemployed for two years either receives a job offer or goes on a training course, which seems to have been a key factor in reducing unemployment to under 6% at the last count as against over 8% in 1994. At the same time, those under 25 with insufficient education or training have a right to education or training for at least 18 months if they have been unemployed for six months but forfeit the right to receive unemployment benefits if they do not take up the offer. In Sweden, a new programme was launched in 1996 to draw up individual action plans for job-seekers, who are able to take a year off to study while effectively receiving unemployment benefit. In the UK, a key element of the Jobseeker's Allowance, introduced in 1996, is a requirement for the unemployed to enter into an agreement specifying the steps they intend to take to find work and the services available to help them.

These programmes exemplify the increasing importance attached to providing job-search assistance to the unemployed as well as access to training or re-training courses. This importance was emphasised at the Luxembourg Jobs Summit and is a prominent feature of the Employment Guidelines agreed by Member States, which specified that:

- every unemployed young person should be offered a new start before reaching six months of unemployment, in the form of training, retraining, work practice, a job or other employability measure;
- unemployed adults should be offered a fresh start before reaching twelve months of unemployment through one of the above measures or, more generally, through individual vocational guidance.

Despite the acknowledged importance of training, however, only a small minority of the unemployed at present receive training in the Union, a situation which Member States also committed themselves to improving in the Employment Guidelines (setting a specific target of increasing the proportion to 20%).

Extending job creation schemes

In several Member States, job creation schemes are under discussion. Any assessment of the cost-effectiveness of these schemes, however, has to take account not only of the direct effect on jobs of the measures introduced but also their substitution effects (employers dismissing workers and taking on subsidised ones in their place) and deadweight costs (employers recruiting subsidised workers they would have taken on anyway).

In a number of Member States, job creation has been encouraged through selective reductions in the social contributions levied on employers as well as by direct subsidy. In Belgium, employers creating jobs for young people and long-term unemployed in socially-useful activities ('Smets jobs') receive both a large subsidy for three years and full relief from social contributions. In the UK, employers taking on people unemployed for two years or more are exempt from social contributions for a year, while in France, recruitment of the long-term unemployed is subsidised both directly and through reductions in contributions. The new French Government, moreover, is diverting the resources at present going to a range of job subsidies into plans for creating 700 thousand jobs for young people at the minimum wage.

More generally, Member States recognised at the Luxembourg Jobs Summit the potential importance of job creation at the local level in the social economy and in new activities where needs are not being satisfied by the market (eg in the environmental sector). They agreed in the Employment Guidelines to investigate measures to exploit these possibilities and to identify and, where possible, remove obstacles to their development.

Reducing dependency and social exclusion

In all Member States, social assistance is available to those unable to work for one reason or another, though in some countries, in the South of the Union, in particular, a minimum level of income has not been universally available. In Italy, there is a political discussion whether to establish a national (in place of a regional) means-tested minimum income scheme, with payments related to family size, as recommended by the Onofri Report. In Portugal, a minimum-income guarantee scheme was introduced in 1997, involving not just the provision of income support but measures to help recipients integrate into society. This is a response to the experience under longer-standing schemes elsewhere, where social transfers by themselves have not proved sufficient to overcome the problem of deprivation and social exclusion.

Indeed, a general tendency througthout the Union is to address the underlying causes of poverty and social exclusion and to avoid systems of income support becoming the means for entrenching a permanent division in society between those who contribute to its well-being and those who do not. The aim, in particular, is to help those dependent on benefits to become more self-supporting by giving them an opportunity to find a job, which means not just providing access to training and job counselling but to accommodation and adequate levels of health care and social services, such as child care facilities.

In Denmark, from 1998 on, everyone receiving social assistance will be given the chance to return to education or go on to a training scheme. In Germany, increased efforts have been made to get those on social assistance into active labour market programmes, while in the UK, the new Government has announced a 'welfare to work' programme aimed at reducing the number of people reliant on benefits. The latter is particularly focused on the young, the long-term unemployed, people with disabilities and lone parents. From October 1998, all lone parent who wish to work will have access to personal advice from the employment services as well as receiving assistance with child care. At the same time, however, additional benefits available to lone parents will be withdrawn for new claimants and the same level of benefit will be payable to all those with children. In the Netherlands, in similar vein, more stringent procedures for claiming social assistance have been introduced, requiring recipients to be actively seeking work and to accept any suitable job offer they receive, except if they are lone parents with a child under 5. In Luxembourg, recipients of support are required to have exhausted all other means of improving their situation and be actively seeking employment, unless they are 50 or over or disabled.

Helping people with disabilities

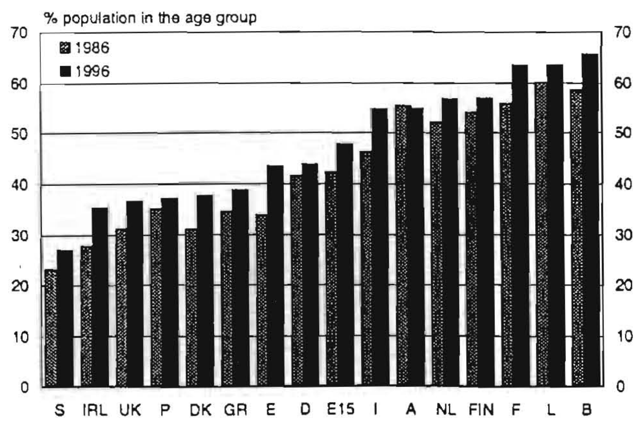
Attempts have been made across the Union to reduce the number receiving disability benefits by introducing more stringent tests for assessing incapacity for work. In the UK, a tougher medical test, which after 28 weeks on benefit is designed to assess a person's fitness to do any kind of work rather than their previous job, has been introduced, much the same as in Germany, where benefit entitlement depends on people being incapable of working at all. In the Netherlands, the financial responsibility for disability benefits has been shifted to employers whose contribution rates are now — partly — differentiated according to the number of their employees claiming disability benefits, a measure which gives an incentive both to improve health and safety at work and to continue employing those with disabilities. This has been coupled with greater stress on helping people with disabilities, but able and wanting to work, to find jobs through active employment programmes. In Austria and Finland too, the emphasis of policy has shifted from income support to rehabilitation, with entitlement to benefit needing to be re-established periodically.

Incentives for people with disabilities to look for work and help for them to do so have generally been accompanied by legislation to prevent discrimination against them in employment and in their access to goods, services and facilities of various kinds as well as by enabling measures, especially in the work place, to remove obstacles to them working — in 1993, all Member States adopted the UN *Standard Rules of Equality of Opportunity for Disabled People.* Such measures, however, while increasing equality of opportunity, will only result in additional competition on the job market, where those with disabilities will always be disadvantaged, unless there is, at the same time, sufficient growth of employment.

Reversing the trend towards early retirement

The tougher stance on disability benefits, which in many cases have been paid to those over 50 losing their job, is part of a reversal of policy towards older workers, towards encouraging them to stay in employment rather than retire early (except in agriculture where early retirement continues to be promoted under Regulation 2079/92) and represents a reaction to the fact that in 1996 almost half of men aged 55 to 64 in the Union were no longer economically active (Graph 6). Because of job shortages, however, there remains an awkward conflict between increasing the number of older people in work and reducing unemployment (though this conflict disappears once the focus of policy is, more satisfactorily, on the employment rather than on the unemployment rate, as in the Employment Guidelines).

6 **Men aged 55-64 no longer in the labour force in Member States, 1986 and 1996**



In addition to the examples noted above, those claiming early retirement pensions in Sweden now need to demonstrate that they are incapable of working, in effect, transforming the payment into an invalidity benefit, while, at the same time, the basic rate has been reduced. Eligibility criteria have also been tightened and the pension effectively reduced in Germany and Austria, coupled in the latter with an increase in the required period of contributions from 35 years to $37^1/_2$. In Belgium, the number of years of contributions necessary to qualify for a pension is being raised gradually from 20 to 35 beginning in 1997, while social contributions on early retirement pensions have been increased. In Spain, voluntary retirement before the age of 65 is now penalised, while in Greece, pensions payable to those retiring early have also been reduced.

Moreover, in Austria, further encouragement to employment of older workers has been given by a *bonus-malus* scheme, reducing social contributions for employers taking them on and imposing a penalty on those dismissing them.

Encouraging partial retirement

One means of diminishing the conflict between providing jobs for older workers and reducing unemployment is to encourage people to move from full-time to part-time employment as they approach retirement age. This, moreover, can ease the transition process for those concerned while taking extended advantage of their experience and know-how. Partial pensions to this effect have been introduced in a number of Member States in recent years. Elsewhere, however, obstacles exist for older workers wishing to work part-time (in the UK, for example, they cannot continue to work for the same employer if they draw an occupational pension).

In Austria, a partial retirement scheme has existed since 1993, enabling people to reduce hours of work and receive a proportion of the pension normally payable, though few people have opted for it, seemingly because early retirement *per se* is more attractive. In Finland, a similar scheme has existed since the end of the 1980s, but again the number involved has been small. In Germany, partial retirement has been introduced more recently for those of 55 and over, at the same time as their eligibility for early retirement was restricted. The possibility of combining a partial pension with a partial salary also exists in Luxembourg, though relatively few fewer people have so far taken up the option. More success has been achieved in France, where partial retirement has been regarded since 1993 as a solution to (full) early retirement and where the number opting for the latter has fallen while those continuing to work part-time have risen (to 27,000 in 1995).

Adapting to population ageing

The reform of pension systems, aimed at managing the cost of the impending growth in population of pensionable age — or, more accurately, the income redistribution entailed — has become a central policy aim in all countries. (The pension reforms in Italy, Sweden and France in particular were described in detail in *Social Protection in Europe, 1995*, Chapter 2, while a general economic analysis of pension reform and the future of the welfare state was recently published in *European Economy, Reports and Studies*, 4/1997.) A common response has been to raise the official retirement age of women to conform with that of men, for both cost and equity reasons — as in Germany, Greece, Portugal, the UK, and, more recently, in Belgium and Austria. In all these countries, as in most other parts of the Union, the official retirement age is being standardised at 65. This, however, is being coupled with increased emphasis on the contributions record of those retiring, so linking the pension received more closely with the payments made over a person's working career and reinforcing the insurance aspect of the system.

In addition, the effective pension payable relative to past earnings has been reduced in a number of countries by altering the calculation formula. In France, Portugal, Austria and Finland, the number of years of earnings on which the pension is based has been increased, while the method of revaluing pensions for inflation has been made less favourable, as has also occurred in Spain, Germany (through a shift in the basis from gross to net earnings) and Sweden (where pensions are not being fully indexed so long as the budget deficit remains excessive).

In other countries, the value of pension has been reduced more directly. In Greece, the rate of supplementary pension relative to earnings has been reduced and limits set on the maximum payable, resulting in a rise in pensioners receiving very low incomes and prompting the introduction in 1996 of a means-tested allowance. A similar allowance has also been recently introduced in Spain, where the number of years needed to qualify for a full pension has been raised and the coefficient applied to earnings reduced. In Germany, the new pension reform to take effect from 1999 introduces a 'demographic factor' into the pension formula to take account of the increasing life expectancy of pensioners and accordingly to reduce the standard pension (*Eckrente*) from 70% of previous net earnings to 64% by 2030, in addition to raising the pensionable age.

So far, however, there has been no general tendency to shift away from pay-as-you-go to funded schemes (ie from contributions covering present pension liabilities to covering future ones), though there is a widespread growth in the importance of occupational and private schemes to supplement basic pensions and relieve the State of part of the future funding liability. As emphasised in the recent Commission Green Paper on *Supplementary pensions in the single market*, (COM(97) 283), the growth of such supplementary schemes requires an appropriate Community-wide framework. The Green Paper also notes that the sustainability of pay-as-you-go schemes necessitates further reform of pension systems. Although reversing the trend towards early retirement can alleviate funding problems, it is unlikely to solve them completely. In this regard, it is relevant to note that there is a shift towards defined contribution systems, where contributions paid over a person's working career determine the amount received in pension, so reducing some of the difference between pay-as-you-go and funded systems.

The only two countries in the Union where funded pension systems play a major role are the Netherlands and the UK. In the latter, in particular, where the basic state benefit is lower than in most other Member States, two-thirds of pensioners have an occupational or private pension. The State concentrates on taking care of the less well-off, leaving the management of pension funds largely to private insurance companies. The main recent focus of policy has been on strengthening the regulations governing these funds, to prevent their fraudulent use and the misleading selling of private schemes.

Whether a funded approach is better designed to overcome the transfer problem inherent in demographic trends remains unclear. Ultimately, the ease of securing the transfer of income from those in work to those in retirement, irrespective of how it is achieved, depends largely on the income available to be distributed and, therefore, on the economic growth sustained in the intervening period.

Containing health-care costs

The ageing of the population, together with constraints on public expenditure, has also focused policy attention on health care, the demand for which in any event tends to rise rapidly as real income increases and medical know-how expands. The widespread response in Member States has been either to limit expenditure directly where services are managed by the state or to impose ceilings on spending growth where this is determined by health insurance funds. While this has generally succeeded in holding down spending relative to GDP in recent years, it has given rise to other policy concerns — . in particular, how best to allocate expenditure to serve the needs of society as a whole and how to ensure that available resources are used efficiently.

It has, in addition, raised more fundamental questions about the relationship between public and private health sectors, about whether the former should be limited to basic care — and, if so, how this should be defined — and about the implications of this for the overall pattern of care in relation to need (and the possibility of a shift from essential to more cosmetic treatment). It has also given rise to questions about the justifiability of limiting the growth of services (and jobs) to below the level people seem willing to pay for and, in turn, about how far consumers can be relied on to make rational choices on an issue which is so important but about which there is a serious lack of information.

The tendency in most Member States has been to seek to exploit the advantages of the market while retaining control over supply. In particular, people have been encouraged to consume less and choose more rationally by making them aware of the costs involved, through the imposition and extension of charges — or co-payments — for drugs and certain kinds of treatment. In Germany, for example, charges have been raised significantly in order to avoid increases in social contributions and have been explicitly linked to the latter in an attempt to persuade the insurance funds to keep contributions down, increase efficiency and negotiate more effectively with service providers (GPs and hospitals) over terms.

The success of such a policy, as indeed of the introduction of market, or pseudo-market, mechanisms in countries, depends, in part, on there being effective competition between insurance funds, in the German case, or doctors in countries with national health systems, and consumers being able to choose between them, otherwise prices cannot serve their intended purpose. It is also desirable for there to be competition between service providers to increase the bargaining power of purchasers and to stimulate increases in efficiency. In practice, there tend to be natural limits on competition in both areas, because of the localised nature of supply and economies of scale, which are often reinforced by government to avoid, for example, the closure of local treatment centres.

Accordingly, attempts to introduce market mechanisms have not, in general, led to the increases in efficiency expected, and governments throughout the Union have been reluctant to relinquish controls on expenditure and leave this to market forces. Nevertheless, in countries where an attempt has been made, there appear to have been some gains, without any noticeable deterioration in service. These have arisen from the clearer division between purchasers and providers, the greater weight given to costs in decision-making, the collection and provision of more information on costs and the drawing up of more detailed contracts on service supply.

In the UK, for example, indicators show a small rise in productivity since reforms were introduced in 1991. In Italy and Spain, the separation of purchasers from providers and, in the former, the devolution of financial as well as organisational responsibility to the regions, seems to have led to improvements in management and clearer contractual arrangements between the two sides. In the Netherlands, the recent introduction of a system of *per capita* payments to insurance funds based on a prior assessment of the costs implied by their membership structure, in place of one where effectively costs were covered *ex post*, has led to competition over fees and pressure to contain costs and might, in turn, with partial removal of controls, lead to increased competition between providers and efficiency improvements in this area.

At the same time, the innovatory step has been taken in the Netherlands to confine the public health service to the provision of 'curative basic health care' (as well as of long-term care), and to leave other treatment ('amenity care') to the private sector and individual arrangements. The criteria used to define the latter — that it should not be medically necessary and be affordable — has, however, led to problems in practical application (not least because of the inevitably subjective nature of the concepts used) and so far very few services are excluded from the public sector.

Providing long-term care

An estimated 10% of people aged 75 and over in the Union are in need of full-time care while another 25% require part-time care. The present high growth of population in this age group is focusing increasing attention in Member States on how this expanding need should be met — whether through the social protection system, and if so, whether through transfers or the direct provision of services, either way implying increased taxes and/or social charges, or through private arrangements, implying the acceptance of an unequal burden falling on different individuals, whether they take out private insurance cover or not.

Debate has been partly prompted by the introduction in Germany in 1995 of a new social insurance scheme for long-term care (*Pflegeversicherung*), funded by social contributions (compensated by the loss of a day's holiday) and payable to both those being cared for at home and those receiving residential care. Allowances for carers are of longer-standing in the UK and Ireland, though in the former, they are payable at a relatively low flat-rate and apply only to those providing care virtually full-time, and in the latter, they are means-tested. In Austria, attendance allowances (*Bundespflegegeld*), administered by the regions but funded from general taxation, have been payable since 1993 to people needing care for at least 50 hours a month, at rates varying according to the amount of care medically assessed to be required.

Those receiving allowances in Austria are free to decide how to spend them (most going to informal care within the family). Rising unemployment, however, has led to calls for payments to be linked with employment objectives and used directly to create demand for formal social services. This is, in essence, the option chosen in the Nordic countries, where there is little distinction between health care and social services, both being freely available to all, and where, in relation to working-age population, these account for substantially more jobs than in the rest of Europe (over twice as many in Denmark and Sweden). Nevertheless, budget constraints have led to cutbacks in expenditure and growing concern about the costs of maintaining extensive social services.

Elsewhere, a draft bill was published in Luxembourg in 1996 for the introduction of a compulsory 'dependence insurance' scheme to cover assistance required by those unable to take care of themselves, the funding divided evenly between social contributions and general taxation.

Targeting expenditure

The twin concern of present policy on social protection across the Union, to contain costs and reduce dependency, is being achieved in part by increasing the effectiveness of expenditure through the adoption of a more active approach and targeting resources on those most in need. In Southern Member States, this is combined with efforts to rectify gaps in the protection provided and to balance the provision of support more equitably. In Northern Member States, debate is centred on the scope of social protection. While the consensus on maintaining the universal nature of social protection accessible to all holds firm, this does not rule out some shift in responsibility from the state to the individual or the private sector in certain areas.

Privatisation, however, in the sense of the private, profit-making, sector being involved in providing social protection has not developed very far in most countries and there is little sign, outside of the provision of supplementary pensions, of any significant growth in the foreseeable future. Nevertheless, there is evidence of increased concentration of expenditure on those in need, both through reducing benefits going to those on relatively high incomes, by setting a ceiling on the amount payable or imposing taxes and/or social charges on benefits, and through greater recourse to means-testing. The former serves not only to redistribute the net gain from transfers from the more wealthy to those further down the income scale but also to spread the cost of financing more widely, an increasingly justifiable aim given the growth in wealth of many pensioners.

Although spending on benefits subject to means-testing has generally increased in the Union (apart from in the Netherlands), it still accounted for only 11% of the total in 1995 as against 10% in 1990, and only in Ireland (where it was 34% of the total), the UK (23%) and Spain (13½%) was it more than 10%. Moreover, much of the rise was due to changes in underlying circumstances — in the growth of long-term unemployment, for example, and in the number of people not eligible for social insurance benefits — rather than a change in policy as such. In the case of unemployment compensation, almost 75% of transfers in Ireland were means-tested in 1995 (reflecting high levels of youth and long-term unemployment), 50% in the UK, 40% in the Netherlands and around 25% in Spain and Portugal.

ISSN 0254-1475

COM(98) 243 final

DOCUMENTS

EN

05 06 17

Catalogue number : CB-CO-98-264-EN-C

ISBN 92-78-35264-0

Office for Official Publications of the European Communities

L-2985 Luxembourg