THE FUTURE OF SOCIAL PROTECTION

AND OF THE WELFARE STATE IN THE EU

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Unit D.2 — Social Protection

Contact: Laurent Aujean
E-mail: *EMPL-D2-UNIT@ec.europa.eu*

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Note

This report was prepared by the High-Level Group on the future of social protection and of the welfare state in the EU that met between November 2021 and December 2022.

The group was Chaired by Anna Diamantopoulou, former European Commissioner for Employment, Social Affairs and Equal Opportunities, former Minister in Greece and currently president of Athens-based think tank DIKTIO.

The group was composed of 11 members:

- **Agnieszka Chłoń-Domińczak** (dr hab., prof. SGH) is Vice-Rector for Research and Director of the Institute of Statistics and Demography at SGH Warsaw School of Economics, Poland.
- **Bernhard Ebbinghaus** is Professor of Sociology at University of Mannheim, Germany.
- **Elena Granaglia** is Professor of Public Finance at the Law Department of the University of Rome3, Italy.
- **Anton Hemerijck** is Professor of Political Science and Sociology at European University Institute (EUI).
- **Hans-Peter Klös**, has been Head of Research at the Institut der deutschen Wirtschaft Köln, Germany (till August 2022).
- **Catherine Mathieu** is an Economist at OFCE (Observatoire Français des Conjonctures économiques), Paris and President of the AIECE (Association d'instituts européens de conjoncture économique).
- **Pasi Moisio** is a Research Professor at the Finnish Institute of Health and Welfare, and an Associate Professor at the University of Turku, Finland.
- **Jozef Pacolet** is Emeritus Professor with formal duties at the University of Leuven, Belgium; previously head of the 'social and economic policy & social inclusion' unit of HIVA - Research Institute for Work and Society.
- **Yves Stevens** is a Full Professor and academic director at the University of Leuven, Belgium.
- **Dorottya Szikra** is Senior Researcher at the Centre for Social Sciences, Budapest, and Visiting Professor at the Department of Gender Studies and Department of Political Science, CEU Vienna, Austria.
- **Anu Toots** is Distinguished Professor of Social Policy in Tallinn University, Estonia.

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Foreword

The 21st century is writing its own distinct chapter in the history of the EU.

Reforms, new policies, achieving new goals and solidifying new geopolitical balances are the challenges facing our Union today.

A fundamental challenge is indeed the future of the welfare state. A European achievement that was the unsung hero of the crises and confirmed its decisive role as a factor of social cohesion and development.

In 2021, the European Commission presented an action plan for the implementation of the European Pillar of Social Rights, as a central European strategy for changes.

The High-Level Group, which I've been chairing, had as a core task to draft and present a concrete policy report on the future of the welfare state and its financing in the 21st century realities. During the preparation, discussions were made among group members of different backgrounds, schools of thought and scientific profiles.

We started by selecting four megatrends that have been affecting our economies and societies; namely: changing demographics, climate crisis, the new labour environments and digital transformation.

We analysed the state of play, deploying a large corpus of data and research studies and consulted international organisations, social partners and civil society.

We thus present a clear and concrete approach to social protection policies. This refers to all phases of the human life cycle (a life course perspective in different life cycle cohorts and the interdependencies among them).

The 20th century succeeded in guaranteeing the economic security of the elderly while the 21st must further guarantee fair lifetime employment opportunities for the youth. The miracle of the European welfare state was fundamentally rooted on income-based financial support for the weak.

Nowadays, this is not enough; there is a growing need to prioritize social investments, based on qualitative and quantitative criteria. Imperative interventions and policy mixes in the form of integrated systems and policies are required especially at both ends of the human life cycle.

A first set of policies concerns children who, as a priority, should be provided with equal opportunities, given the increasing inequity of primary income.

Another set concerns those older citizens who urgently need organized, long-term care policies, the lack of which is currently growing into a huge economic and social problem.

Both policy sets are expected, if implemented, to strengthen women's employment and encourage better functionality within families, especially when it comes to groups and minorities that suffer from discrimination.

Demographic and growth projections indeed pose great dilemmas. Changing demographics undoubtedly requires governments to increase the dedicated budget for pensions and long-term care.

The necessary policies on new forms of work and equipping young people with secure and modern skills (what we call secure capabilities) also inevitably lead to an increase of the social investments budget.

Planning for the future at least, until 2030, should be based on the principle that the welfare state is an investment with a long-term, yet strong and profitable return. On the contrary, its weakening could provoke social conflicts, lead to marginalization of important clusters within our societies and affect competitiveness and growth.

There is therefore a need for a new mix of taxation and social contributions, a crack-down on tax evasion and a war against tax havens, a concrete fiscal framework that takes into account the special and sometimes unique problems of national economies but also new ways of taxing multinational and European companies.

Economic growth and a strong welfare state always go hand in hand. They are interdependent. We cannot talk about welfare state reform without reforming and reinforcing our industries.

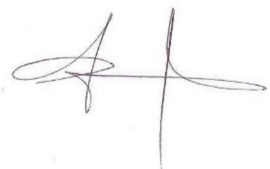
New policies for European industry and competition should constantly take into account the impact on labour markets and social protection systems at the European level.

In its one year of operation, the High-Level Group team saw the economic crisis deepen, the COVID-19 pandemic change forms, we witnessed a war on European soil, we observed an energy crisis taking an unprecedented dimension and also climate change galloping.

What became clear is that the crisis has become a normality that we must learn to live with. And this normality makes the need for a sustainable and resilient social state imperative.

We expect this report to be a first strategic compass and taken into account by governments, social partners and the Union so as to navigate through this new kind of normality.

Anna Diamantopoulou
Chair of the High-Level Group on the future of social protection and of the welfare state in the EU



Executive summary

In its report, the **High-Level Group on the Future of Social Protection and of the Welfare State in the EU** analyses the expected **impacts of key megatrends** on the social protection and on the welfare state. It describes their implications for the **design and scope of social protection systems and the financing of social protection.** Furthermore, it **develops key strategic recommendations** to both Member States and the EU. Beside longer-term trends, the report reflects on the lessons from the COVID-19 pandemic and from the Russia's war of aggression against Ukraine and its repercussions, such as the growing challenge of energy poverty.

The welfare state is affected by a number of global megatrends that shape our societies, economies and labour markets. **Demographic changes** include increasing longevity and lower fertility leading to population ageing, and changes to family structures, intra EU mobility and migration. Ageing of the population impacts the financial sustainability of social protection systems, requiring higher employment and reassessing the traditional 'borders' of economically active lives.

The **world of work is changing**. Higher employment in quality jobs is key to provide income to all households and secure sustainable financing of public expenditure. Although the employment rate has increased in recent decades, under-employment challenges remain for young people, women, older workers, people with disabilities, and those with a migrant background. Low quality jobs, in-work poverty and the high share of non-standard forms of employment associated with insecurity and lower wages are key risks that require some new forms of protection.

Digitalisation and technological change bring both risks and opportunities for labour markets and social protection. While they can generate some job losses and polarisation at least in the medium term, they can result in net employment growth overall in the long-term. Platform economy is characterised by a high share of precarious work, while gaps in skills and IT access bring the risk of increasing inequalities. At the same time, technological developments create opportunities for the organisation and efficiency of social protection, for example, health care services.

Climate change and the **green transition** are already affecting labour markets and social protection, yet they have so far not triggered a comprehensive social policy response. Although everyone is affected by climate change, the new challenges risk to aggravate already existing inequalities. The employment and social implications of the green transition need to be addressed. This includes reducing labour shortages in key occupations, supporting transitions for workers employed in sectors at risk and minimising energy poverty.

The report explores the impact of these megatrends on social and welfare policies in a **life-course perspective**, distinguishing three functions of the welfare state: **labour market regulation, social protection** and **social investment**.

Family policies have several aims, such as tackling child poverty, promoting child development and a strong start in life, ensuring a satisfactory living standard for families, and increasing women's employment. Welfare policy needs to reach beyond income protection and emphasise services provision to enable participation in social and economic life and boost employment.

Youth is becoming a longer period in life when teenagers and young adults move between education and employment, economic dependency and independency – and may also start a family. Non-standard employment, including apprenticeships and traineeships, low wages and fragmented work records often hinder access to adequate social protection for young people. A successful school to work transition remains key both for wage prospects and social security coverage and to avoid scarring effects of youth under-employment. Policy responses may include a combination of universal and targeted social protection benefits, scholarships and labour market insertion benefits.

During **working life**, collective bargaining plays a key role in achieving adequate minimum wage protection as well as ensuring a fair distribution of productivity gains. However, its protective ability has been eroded. Moreover, non-standard workers and the self-employed still experience challenges with respect to coverage by adequate, transparent and portable social protection benefits. To reconcile the flexibility needed in today's economy with adequate social guarantees, options include tax-subsidised social protection or boosting inclusion in contributory schemes. To ensure decent income for all, a key challenge for policy-makers is to combine minimum income protection with incentives to work, and with fair wages, given the high levels of low pay and in-work poverty. Life-long upskilling and reskilling measures such as active labour market policies, education and life-long training are also crucial to support workers during transition periods. Job retention schemes play a key role during economic crises to limit unemployment. Furlough periods should be used as a training opportunity.

As people approach **old age**, the transition from employment into retirement evolves as pension ages go up and more flexible arrangements to combine work and pension become available. Meeting the increasing needs of an ageing population could involve additional contributions and/or extending working lives, which require nuanced policies for older workers, including prevention measures, workplace adaptation and differentiated retirement ages. Population ageing increases the need for long-term care, which can be costly for families, confirming the importance of social protection for long-term care that assumes the costs through contributory and/or tax-financed public provision. Recognising caring tasks is also important to ensure adequate pensions, in particular for women.

Catering for the increasing needs identified in the report requires adequate, fair and sustainable **financing of social protection**. The Group contends that **social investment measures can lead to a double dividend**, reducing future spending on income protection thanks to employment and health gains, while at the same time enlarging the tax base. Constraints on attempts to raise taxes include the existing fiscal burden and the debts and deficit targets, globalisation and technological change. Social security contributions and taxation are the two main sources of financing social protection; they however impact differently the progressivity of the tax and benefit system, the employment incentives and the willingness to contribute. The overall tax burden has been stable over the last 25 years, and labour remains the main source of financing for social protection, despite a growing role of tax financing.

The group explores the ongoing policy debates regarding **improving progressivity and fairness of the overall tax and benefit system as well as alternative sources of financing**, such as indirect taxation (consumption), corporate taxation, wealth taxation, switching to new forms of taxation for the intangible economy, green taxation etc., as well as on fighting tax avoidance, evasion and fraud. The report contends that the EU economic governance rules affect the Member States' room for manoeuvre in financing social investment and social protection.

The conclusions of the report underscore the importance of an **inclusive and fair welfare state to minimise social risks and mitigate economic hardship, while supporting economic output and individual well-being**. A modern welfare state should provide strong buffers against economic shocks and invest in 'stepping stones' that help people across critical life-course transitions. Recognising there are no one-size-fits-all solutions for the diverse European welfare states, the report puts forward a list of 21 recommendations to modernise and reinforce the welfare state. They include:

- **Protect and support families with children**: for instance, childcare for all children under 3 should be free or affordable. Also, people should have access to adequate financial support and early childhood education and care services to make it easier for them to start a family. For vulnerable families, these services should be free.
- **Equal opportunities for education and training**: welfare states should guarantee equal opportunities for young people from low-income families so they can continue education and training after compulsory school, for instance with scholarships.
- **Access to social protection for all**: irrespective of the contract or form of work, everyone should have access, and contribute, to social protection. Also, social protection should be adequate and accessible throughout people's lives.
- **Quality of work**: Member States and social partners should support job quality including decent and secure income, autonomy, physical and mental health, opportunities for career development and work-life balance.
- **Lifelong learning**: all people should have opportunities to improve their skills or learn new ones. This will enhance their chances to find a job, or change jobs, against the background of the green and digital transitions. It will also support them in taking up completely new occupations, for instance in new sectors.
- **Protecting income and jobs:** learning from the Great Recession and the COVID-19 crisis, job retention schemes should be accessible for all.
- **Longer careers, adequate pensions and long-term care:** social partners and Member States should seek to promote longer careers in good health, notably via flexible working-time arrangement, adjusted workplaces, and training.
- **Better financing of the welfare state**: to respond to the rising needs and challenges, Member States need to find new sources to sustainably finance social protection and welfare, for instance through broadening the tax basis and readjusting the revenue mix (expanding progressive taxation on income, consumption, capital, and wealth as well as carbon and energy).

- **A golden rule of public finances**: the future EU fiscal governance needs to secure social protection and especially social investments needs, and to allow borrowing to invest in social infrastructures.
- **Stepping up EU capacity to secure social protection:** the EU should consider legislative initiatives to fulfil all principles of the European Pillar of Social Rights, ensure consistent enforcement across the Union, and limit unfair competition on social protection standards.

The report concludes by noting the **decisive contribution of the welfare state** to overcoming the Great Recession and the economic and social effects of the COVID-19 pandemic. It welcomes the **move of the EU towards more fiscal flexibility** that facilitates social investment.

Introduction

Social protection and welfare systems in the EU have proved to be essential in weathering the negative impact of the COVID-19 pandemic and the lockdown measures implemented in response. The welfare state has also shown an ability to react and adapt quickly to major economic shocks, including through extraordinary support measures, so enabling economies to recover smoothly, and societies to be resilient.

But the future of the EU welfare state is also being affected by a number of global 'megatrends' that will have unprecedented effects on our societies, economies and labour markets, which we have already started to feel in various ways. The most significant of these are:

- demographic changes, resulting in an ageing population and a shrinking workforce;
- a changing world of work and developments in the labour market including an increase in non-standard forms of working;
- digitalisation and technological change;
- climate change and the social implications of the green transition.

As part of its action plan for the European Pillar of Social Rights, the Commission provided support for the establishment of a High-Level Group on the Future of Social Protection and of the Welfare State in the EU (European Commission, 2021a), with a mandate to analyse the future of the welfare state, its financing and interconnections with the changing world of work, in the light of megatrends. Accordingly, the High-Level Group has sought to develop a vision of how to reinforce social protection systems and the welfare state in the light of ongoing and new challenges, in a medium to long-term perspective up to 2030, in order to inform debate at both EU and Member State level and to inspire reforms.

The work has taken account of shocks that have intensified the impact of megatrends on social protection systems and welfare policies – in particular, the Great Recession of 2008-2009, the refugee crisis of 2015 and 2016 and the COVID-19 pandemic. Moreover, after the High-Level Group was created, the effects of Russia's war of aggression against Ukraine, including the current energy crisis, have added to the social and economic challenges faced by the EU and its Member States.

The EU is a union of welfare states with different historical legacies and institutions, which are responsible for organising and financing their social protection systems. The social challenges they face are mostly common across the EU, and in many cases they also cause spill-over effects. The European Pillar of Social Rights is an important step towards a European Social Union that supports welfare states across the EU and guides their advancement based on key principles of mutual insurance, solidarity and convergence.

This perspective is reflected in the work of the High-Level Group, the results of which are presented in this Report. The starting point of the work, as set out in Chapter 1, was an analysis of the challenges and opportunities resulting from the four megatrends identified above. These megatrends affect the current and future functioning of the European welfare states, which were created and developed in different demographic, labour market and global contexts. The policy responses to the current shocks, the COVID-19 pandemic and the war in Ukraine, need to take into account the long-term effects of these megatrends.

Chapter 2 identifies policy options for adapting the welfare state in response to these challenges. These are presented from a life-course perspective, with the three main stages of early and family life, working life, and retirement and old age. At each stage of the life-course, there is a need for appropriate responses from the welfare state. It is important that these work in full harmony with one another, as they have implications across the entire life-course – for example, promoting healthy life while supporting economic participation. Policy responses also need to take account of the long-term effects of megatrends – policies, for example, that make it easier for people to take early retirement in response to job losses need to be balanced against the long-term stability of pension systems.

Sustainable welfare policies require sustainable financing. This is discussed in Chapter 3, which covers Issues relating to the dividend stemming from social investment; the need for broader sources of finance for social protection; the constraints on the public budget and improving the efficiency and fairness of the ways in which the welfare state is paid for.

The final chapter presents 21 recommendations which express the High-Level Group's vision for the future. These recommendations are focused on a limited set of key policy responses that can help to build resilient societies and welfare states in the EU. The recommendations are not exhaustive in terms of policy areas and target groups and the many other policy options indicated in the Report should also be considered.

The recommendations are addressed to the key EU and national policy stakeholders. They are designed to stimulate discussion and policy responses towards building an EU social union, including through dialogue with the social partners at European and national level.

The Report has its limitations. It builds on the existing evidence and data sources, as well as projections and scenarios that were developed before the current crisis caused by Russia's war of aggression against Ukraine. The concept of the welfare state is also very broad and not all of its dimensions could be tackled in the same level of detail.

Ensuring a resilient and sustainable future for the welfare state requires a broad consensus on the policy priorities that enable all generations to benefit from a Social Europe. We believe that this Report contributes to achieving such a consensus.

1. Megatrends affecting the welfare state

1.1 Introduction

Welfare systems that provide social protection and services are a pillar supporting European economies and societies. In recent years, the way they function has been affected by a rapidly changing environment, driven by global megatrends that bring with them unprecedented consequences.

First, **demographic changes**. Increased longevity and migration are established long-term trends. But still further changes may lead to 'population ageing' and the inversion of the 'demographic pyramid', including a drop in the birth rate, and further rises in life expectancy. Social protection systems need to adapt to significant changes in age and household structures.

The next two megatrends are closely interconnected – the **changing world of work** and **technological change and digitalisation**. In the past, each new wave of technological innovation has been accompanied by predictions of job losses due to obsolete skills. In the 1950s it was industrial automation, followed in the second half of the 20th century by computers and robots. Today, digitalisation and artificial intelligence, with their marked impact on many services, are again posing the question of whether the 'end of work' lies ahead. History tells us that technological change creates more jobs, overall, than it destroys. But there will be big variations across time, space and jobs. This raises important questions as to how welfare provision and labour market policies can reap the benefits of technological change while minimising social risks. At the same time, technological change itself opens opportunities to improve the delivery of welfare services.

Finally, **climate change and the green transition** have effects on various aspects of society, the economy, work, and the quality of life. Environmental and climate policies affect jobs, prices and many services, including those provided to households. Although everyone is affected by climate change and loss of biodiversity, not everyone is affected equally. Rapidly changing climatic conditions – floods, droughts and sudden and unexpected weather events, such as tornadoes – make societies more vulnerable, and tend to affect people in poorer households, in particular. The climate crisis is widening existing social inequalities caused by the inequitable distribution of resources and opportunities.

All these megatrends are long-term developments that will shape economies, labour markets and societies and will therefore have an impact on the welfare state in the future. The 21st century has also witnessed global crises such as the Great Recession, the COVID-19 pandemic, and most recently Russia's war of aggression against Ukraine. These undoubtedly give rise to further challenges to welfare systems. Examples include the effect of financial market instabilities on funded pensions; the partial closure of kindergartens and schools; pressure on care systems; energy poverty; refugee migration; and high labour market volatility. The challenges resulting from both the long-term megatrends and the emerging crises reinforce the need to foster social resilience and solidarity at all levels, national, European, and maybe even global.

This chapter focuses in detail on the four megatrends identified, on the risks they give rise to in the long term and which may trigger a need for welfare state intervention. Shocks such as the COVID-19 pandemic and the energy crisis caused by Russia's war of aggression against Ukraine, also have enormous social and economic consequences and profound implications for the welfare state. Looking from a long-term historical perspective, however, such global crises do not only pose challenges to the welfare state, they also open up opportunities for progress. History tells us that it was the pandemics of the 16-18th centuries that brought about the very first collective efforts to organise and finance improvements in sanitation and public health (Swaan, 1988). In fact, these efforts, along with wars, contributed to the birth of what we know today as the welfare state. Pandemics do not only affect the poor, they also affect the rich, and as a result they may make the better-off more willing to support and finance state action.

1.2 Demographic change

Demographic transition

Demographic change shapes the social and economic situation of all European countries. The welfare state in Europe was developed at a time when the number of people of working age was increasing faster than the number of children and older people. Economies and societies benefited from this 'demographic dividend' during the second part of the 20th century (Mason *et al.*, 2017). This period saw the expansion of welfare systems. In particular, old-age pensions funded on a pay-as-you-go basis led both to an increase in spending on pensions and to people retiring at an ever lower age.

Further falls in both the death rate and the birth rate have resulted in population ageing and changes in the age structure of the population. Older people make up an increasing proportion of the population, whereas the share of children, young people and those of working age are falling. From the 1990s, welfare systems started to adapt to some of the consequences of demographic change, for example by phasing out early retirement schemes and by increasing the statutory pension age, as well as by promoting active and healthy ageing.

The fertility rate in the EU fell sharply over the period 1950-2000, then rose slightly between 2000 and 2010 before falling again from 2016 onwards. This (almost) continuous decline has been shaped by a number of factors. These include economic and political stability; access to housing; the availability of childcare services and social policies that support families; reproductive healthcare; the ability to reconcile working and family lives; and the gender division of care work within the family. According to the Eurostat statistics, the overall fertility rate – the number of children for each woman of child-bearing age – fell on average in the EU from 2.4 in 1970 to 1.5 in 2020. In 1990, most Member States already had fertility rates well below 2.1, the level needed to replace the existing population.

An important factor behind declining fertility rates is childlessness, which is partly the result of people postponing parenthood, partly of conscious decisions not to have children. Childlessness has been on the rise in most developed countries. In the EU, it is highest in Austria and Spain, where over 20% of women aged 40-44 are childless. The average (mean) age of women giving birth to their first child has also risen, from 29 in 2001 to 31 in 2020. This has meant that children and young people make up a smaller proportion of the population and, according to population projections, this trend will continue in the coming decades. It suggests that a declining share of welfare expenditure will go to younger generations, although it could also allow more money to be invested in the development of each child and young person.

The average size of households has also declined with the lowest figures in the Scandinavian Member States and Germany, ranging between 1.8 and 2.0 in 2021 (according to the OECD family database). This phenomenon of smaller households, and an increasing number of single-parent families, also needs attention from policy-makers because of the economic and emotional vulnerability of people who do care work (such as single mothers or those caring for relatives with a long-term sickness or disability) or who are themselves dependent (as are an increasing proportion of older people).

Falling death rates and increasing life expectancy are important social achievements. But the rising number of older people, and more especially of frail older people, also has implications for the welfare state. According to Eurostat projections, the EU population aged 75 or over will increase from 43.8 million in 2020 to 75.4 million in 2050. This will lead to increased demand not only for longer pension payment, but also for health and long-term care – giving rise to an increased need for both financial and human resources (including well-paid care workers).

The challenges of ongoing migration mean that integration and immigration policies assume importance in the debate on the future of social protection and the welfare state. The COVID-19 pandemic and its labour market consequences have highlighted once again the ambivalent position of migrant workers in European economies. On the one hand, they are often employed in key occupations – as drivers, food-processing and agricultural workers, care givers and cleaners – that kept basic services running during the pandemic. On the other hand, they have more fragile ties to the labour market, and therefore face a higher risk of being displaced when a downturn comes. In diverse societies with unequal labour markets, neglecting these risks could lead to high long-term costs, such as pockets of poverty, exclusion and ethnic segregation.

The EU needs to attract skilled third country migrants, in line with its need for labour, but without depriving emerging economies of their most talented people. It is therefore welcome that the European Commission has recognised the crucial economic and social role that migrants already play in the EU in its migration package of April 2022 and in its commitment to making EU-wide proposals in 2023 on recognising the qualifications of non-EU nationals (European Commission, 2022a). Migration from outside the EU is not a 'silver bullet' that will offset the decline in fertility rates or ensure the sustainability of the pension system. But labour market policies to increase the participation of migrants in the workforce could generate significant extra tax revenue to help pay for welfare state spending (European Commission, 2020a).

Labour mobility within Europe also tends to widen differences in population developments between Member States. Migration outflows from central and eastern European countries (notably towards north-western Europe) lead to faster population ageing in these countries and in some cases to a 'brain drain'. The challenge is to achieve a balance, in legal and policy terms, between two essential principles of the EU – free movement of labour on the one hand, and economic and social convergence between regions on the other (European Committee of the Regions, 2020).

There is also a regional aspect to mobility. Young people often migrate to cities and more developed regions, and away from rural areas and less developed regions. This causes population ageing in the latter, with implications for the way social services are organised and delivered.

The projections and analysis presented in this chapter are based on the data available before Russia's war of aggression against Ukraine began in February 2022. This has had an impact on – among other things – migration flows and the populations in countries that received the largest number of migrants from Ukraine.

Economic dependency and the welfare state: economic and social progress for all generations

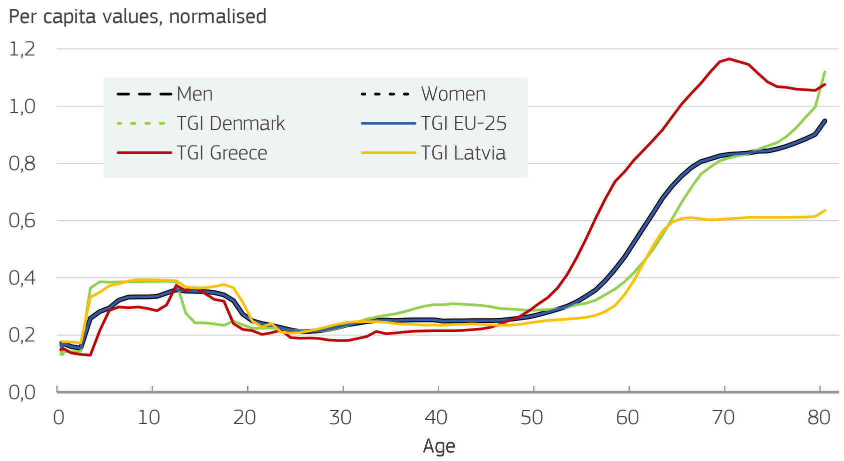
The impact of demographic trends on the sustainable financing of the welfare state is affected by a range of factors. It is not simply a case of comparing the size of the working-age population with that of the population above retirement age. The *demographic dependency* rate, using fixed age boundaries, does not necessarily equate to *economic dependency* in respect of the capacity to generate revenue to fund social expenditure. The activity rate and productivity of those working and the employment rates of older people play a critical role. Policy options, such as, in particular, raising the statutory pension age, incentives to postpone exit from work, changing the way benefits are calculated and the level of contribution rates have a crucial impact on the sustainable financing of the welfare state.

During their life-course, Europeans, on average, become economically independent at age 25, in the sense that their income from work starts to exceed their consumption spending (Figure 1). They lose this independence around age 60, though with significant variations between Member States. Below and above those ages, additional transfer payments, both public and private, are needed to finance their consumption (including their share of public spending) (Istenič *et al*., 2016).

The biggest net public transfer payments are received by the oldest group of people, those aged 80 or over, due to their reliance on pensions and (often) long-term care. The increasing number of Europeans reaching this ('fourth') age will create increasing financial pressures. In order to finance older people's consumption mainly from public transfers, social investment is needed to stimulate higher incomes during their working lives. This means people working longer and increasing the effective retirement age. But it also means stimulating the employment of women, whose labour income over the life-course is on average much lower than men's. A larger, better trained, and more productive workforce will be needed to pay for the welfare state of the future.

The welfare state is already oriented towards older people (Gál *et al*., 2018). On average, social protection expenditure amounts to around 30% of GDP in the EU, of which old-age benefits, mainly pensions, account for almost half, whereas spending to support families and children accounts for only around 8%. The same basic pattern is evident in all Member States (Figure 1), albeit with quite large variations. Greece has relatively large transfer payments to older people, combined with low spending on those younger. Payments to older people in Greece also rise at an earlier point in the age profile, whereas this is delayed in Denmark (with transfers not peaking until the oldest age groups). There are also Member States, such as Latvia, with relatively low transfers to older people.

***Figure 1:** Age profiles of public transfers in selected Member States*



Source: Istenič et al. (2016). Based on NTA 2010 data. Note: TGI = public transfer inflows.

Spending on social protection in the EU rose over the last decade by 1.4% a year on average. Spending on pensions increased in nearly all Member States. Spending on families and children also rose in some Member States, particularly in Poland, following the introduction in 2017 of a universal child benefit (the '500+ benefit').

The fall in the number of children, and therefore in the number of people of working age in future, strengthens the need for social investment. Such investment has multiple long-term benefits – fostering economic development; increasing labour incomes; lowering the risks of unemployment and poverty by developing skills; and contributing to well-being over the life-course. It allows for extra spending per person without raising spending overall. For example, participation in early childhood education and care has increased in many Member States, while poverty among children has fallen (see Section 1.3). This approach, of investing in the early stage of life, involves a different balance of spending on the two 'dependent' generations – young people and older people – under the 'social citizenship contract' between generations.

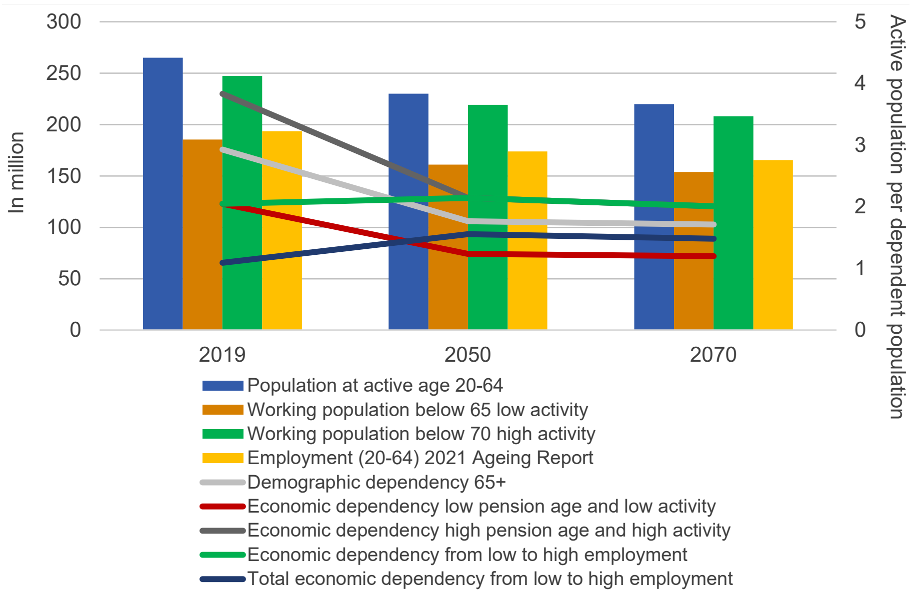
The most recent European Commission report on demographic change projects a further reduction in the size of the working-age population in the decades ahead (depending on the assumptions made about birth rates, death rates, and migration). This will lead to a worsening of 'demographic dependency' (the ratio of people of working age to those younger and older) from 2.9 in 2019 to 1.7 in 2070 (European Commission, 2020b, pp. 15 and 19). But a rise in demographic dependency does not necessarily mean greater economic dependency. This would remain unchanged if the employment rate in the 20-64 age group increased to 85% by 2070 (a figure that has already been reached in some Member States), and if at the same time the average retirement age were to rise to 70 (Figure 2). Increasing the employment rate close to 85% might in fact result in an even larger number of people in work than there is now.

The scenario above is a very ambitious one. For people to remain economically active up until the age of 70, on average, there would need to be further improvements in their health and life expectancy. It also assumes a decline in the amount of physical work needing to be performed, as a result of technological change. Supportive measures that lead to people being able to work for longer and reach retirement in good health, such as lifelong learning and age-adapted working conditions, will therefore be needed. There will also need to be more flexible arrangements for the transition from working life into retirement and support for those with age-related disabilities who are unable to work.

As the employment rate of older people increases, careful attention will need to be paid to regional differences within the EU. Theoretical simulations show that simply in order to keep the employment rate at its 2020 level, by 2040 people in some regions would have to be working until age 75, especially in some eastern and southern Member States (European Commission, 2021b). This would require a big increase in the number of women in paid work, and lower emigration. Another important factor is the number of healthy life years remaining to people as they approach old age. In 2019 this varied widely across countries – from 16.2 at age 65 in Sweden to only 4.2 in Latvia – and differed significantly between people according to their health, income and education level.

Future economic growth may allow social protection spending to increase in real terms, without harming public finances. Some optimistic predictions see GDP more than doubling in real terms over the next 50 years. Social spending could benefit from this, without taking up a larger share of national income. Some projections (which assume the current level of social protection stays the same) also show that, despite higher spending on older people, economic progress would be maintained for the rest of the population (Pacolet *et al.*, 2021). Indeed, social spending on pensioners is projected to increase by 73% in real terms over the period 2019-2070, which would still leave room for GDP per head for the rest of the population to rise by 129% (Table A2 in Annex). It is far from certain, however, that such an optimistic growth scenario will be achieved, particularly given environmental constraints. Under a less optimistic scenario, the welfare state would still need to find a way of financing the needs of the growing number of older people.

***Figure 2:** Demographic versus economic dependency in the EU*



Source: Stylised calculations based on European Commission projections. Eurostat, population statistics – population on 1 January by age, sex and type of projection [proj_19np].

Notes: Demographic dependency 65+ = pop. 20-64/pop. 65+; economic dependency low pension age and low activity = active pop. below 65, 70 % employment rate/pop. 65+; economic dependency high pension age and high activity = active pop. below 70, 85 % employment rate/pop. 70+; economic dependency from low to high employment = low in 2019; high from 2050 on; total economic dependency from low to high employment = as previous, but including inactive below 65 or 70.

Total 'age-related spending' in the EU (covering spending on pensions, healthcare, long-term care, and education) is projected to rise from 24% of GDP in 2019 to around 26% by 2070. The proportion of the population aged 65 and over would increase from about 20% to 30% (European Commission, 2021c). It should be noted that this scenario, which assumes no policy changes, implies a significant deterioration in the adequacy of pensions, in particular. While public spending on pensions is projected to remain close to the current level of 11.6% of GDP, both the benefit ratio (average pensions in relation to average wages) and coverage would fall. The assumption is that the average effective exit age from work would increase from 63.8 to 65.6. This would be accompanied by higher spending on health and long-term care, of 0.9 and 1.1 percentage points of GDP respectively. Technological and therapeutic advances in healthcare are increasingly expensive; and the growing population of older people in need of care will involve a considerable increase in long-term care costs.

Age distribution of poverty and challenges for the welfare state

The changing age structure of the population also affects the traditional ways in which resources are redistributed between (and within) generations. Children and young people are supported mainly by private transfer payments within their families, with some public support through child benefits and public services. Older people are mainly supported through public social protection, and to a lesser extent through private savings.

The welfare state in the EU faces a double challenge. On the one hand, more resources are needed for older people, due to population ageing. On the other hand, there is also pressure to devote more resources to younger generations. In particular, there is a need to give young people better access to high-quality education and training, so that they can move into high-quality jobs. This was underlined by the damage to youth employment caused by the Great Recession, with its 'scarring' effects and the risk of a 'lost generation'. Children and young people are also at greater risk of poverty than other groups. In 2020, nearly one fifth (19.5%) of all children under 18 in the EU were at risk of poverty – in other words, they were living in households with incomes below 60% of the average after social transfers. This compares with 16.3% of those of working age (18-64) and 17.3% of older people (65 and over). There is considerable variation between Member States, however, and in some countries older people are at greater risk of poverty than young people.

Between 2015 and 2021, the 'at-risk-of-poverty rate' for children and young people under 18 in the EU-27 fell from 21.4% to 19.5%, as working-age households recovered from the Great Recession. But poverty remains a major challenge to the welfare state. For people aged 65 or over, the at-risk-of-poverty rate increased from 13.7% to 16.8% over the same period. The risk of poverty among children also depends on household composition, work intensity, level of education, and the migrant background of their parent(s). Child poverty in single-parent and large families is particularly high, even in Member States that otherwise have low at-risk-of-poverty rates. Child poverty or social exclusion is a weakness of the European social model, as is unemployment or being in a precarious low-paid job among young people aged 18-24. The risk of poverty among older people is a particular problem in EU Member States in central and eastern Europe, particularly in the Baltic States, Bulgaria and Croatia.

1.3 Recent trends in employment and labour income inequalities

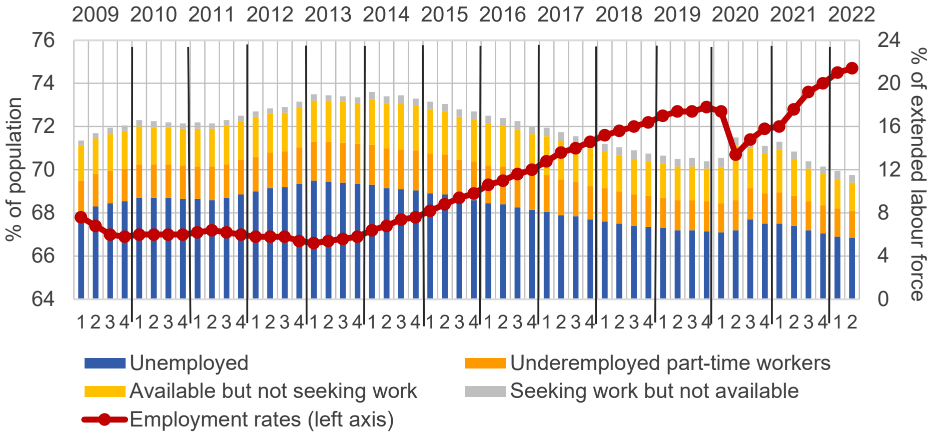
Labour markets in the EU are exposed to demographic trends (affecting the potential supply of labour), technological change, the green transition, and globalisation (including possible reshoring phenomenon). In some Member States they are also shaped by decentralisation of collective bargaining and deregulation. These developments create extensive social risks for some forms of work and for some groups – including young people, people with low skills, and migrants – which need to be mitigated by social protection. At the same time the welfare state has also to cope with structural labour market problems and periodic employment crises.

The megatrend of a changing world of work needs to be seen in a long-term perspective, although the Great Recession, the COVID-19 pandemic, and Russia's war of aggression against Ukraine, have provided informative stress tests. This section examines the challenges of how to raise employment rates, ensure a fairer share of national income for labour, foster high-quality jobs, and provide social protection for people in evolving forms of work – in particular, in non-standard employment and self-employment.

Toward a higher employment rate

A major aim of the welfare state is full employment, in order to provide income from work to all households and secure the sustainable financing of public expenditure. Since the Lisbon Strategy (2000-2010), the aim of increasing employment, particularly of women, young and older people, as well as migrants, has been on the EU policy agenda. In the light of population ageing, the subsequent 'Europe 2020' strategy set out a target of 'increasing the employment rate of the population aged 20-64 to at least 75%'; and in March 2021 a new target of 78% was set for the next decade (European Commission, 2021a). Indeed, in 2019, before the COVID-19 outbreak, 17 Member States had already reached the 75% target (according to the EU labour force survey: EU-LFS). After a drop in 2020, the EU employment rate recovered in 2021, and reached 74.8% in the second quarter of 2022. Only five Member States were still below 70% (Italy, Greece, Romania, Croatia and Spain), and eight Member States were above 80% (the Netherlands, Sweden, Estonia, Czechia, Germany, Malta, Denmark and Hungary).

*Figure 3: **Quarterly employment rate of those aged 20–64 and labour market slack, EU 2009–2022***



Source: *Eurostat (seasonally adjusted data).*

One important challenge is how to increase the proportion of women in employment, which remains below that of men: this particularly concerns women who have children relatively early, who often withdraw from the labour market due to a lack of support for reconciling work and family life. Part-time under-employment is relatively high in a number of Member States but has been falling, while some people of working age and available for work have been discouraged from seeking it (Figure 3).

At the same time, the employment rate in the EU among those aged 55-64 increased from under 40% in the early 2000s to nearly 60% in 2020. This was a result of early-retirement options being phased out and the statutory pension age being raised, and is a trend that is set to continue. (For more details, see *Eurostat website*.)

Another challenge concerns youth unemployment. Although there have been some improvements over the last two decades, young workers are still highly vulnerable. Unemployment in the EU-27 among those aged 15-24 was over 15% of those in the labour force in 2020 and 6% of the age group. In some southern and eastern Member States it was, worryingly, twice as high, with the risk of long-term scarring effects on young people's working lives. Many young workers start in temporary, low-paid and insecure jobs, which in some cases are not a transitional 'entry' phase, but a mobility trap. (For more details, see *Eurostat website*.) Moreover, nearly 18% of those aged 20-34 in the EU (nearly 30% in Italy) were neither in employment nor in education and training ('NEETs') in 2020, although this figure has fallen in almost all Member States since 2011, after the Great Recession.

Youth inactivity is a structural challenge, requiring measures to provide young people with high-quality education and training opportunities, high-quality job opportunities, and employment integration – otherwise there will be long-term consequences for social expenditure and its financing. Helping young people to find work has long been supported by EU programmes and policies, with the aim of reducing labour market scarring and increasing their economic activity over the whole of their lives. (For more details, see *Eurostat website*.)

There is also considerable scope for helping more people with disabilities to find work. Only half of the 42.8 million people of working age with disabilities in the EU are employed. In 2021 the disability employment gap (between people with disabilities and those without) stood at 23 percentage points. Employment is the best way to ensure economic autonomy and social inclusion, while at the same time it taps into people's talent and potential (European Commission, 2022b).

The COVID-19 pandemic indicated greater labour market resilience than during the Great Recession, as employment levels were less severely affected (the employment rate falling by less than 2 percentage points in 2020). This was partly due to the widespread use of job-retention (or short-time work) schemes, which kept workers attached to their employers even if working hours were reduced markedly (by more than 10% across the EU in 2020). Over 40 million workers benefited from job-retention schemes during the first COVID-19 wave (Müller and Schulten, 2020). During later waves short-time work and other measures also kept the unemployment rate more stable: it did not exceed 8% (a 1 percentage point increase) across the EU during 2021.

Although job-retention has been important in 'hoarding' employment during the pandemic, social protection measures in response to it have been inadequate in some Member States. This includes inadequate sickness pay rules, shortcomings in workplace health and safety, a lack of protection for some types of worker, and gaps in income protection for vulnerable groups (such as solo self-employed people). Many measures only protected some sections of the labour force and not necessarily all those who were most in need (Baptista *et al.*, 2021). Many part-time employees or those with fixed contracts found themselves without sufficient contributory benefits and had to rely on minimum income schemes.

Distribution of labour income

Some general long-term trends can be detected in the distribution of labour income, despite significant variations between Member States.

Firstly, labour's overall share of national income has declined since the 1990s, but has remained relatively stable since around 2000. It was lowest just before the Great Recession but has since rebounded slightly. (For more details on trends since 2001, see *Eurostat website*.) This means that the (often discussed) long-term fall in the labour share mostly took place between the late 1970s and around 2000. The labour share across the EU has not returned to the peak reached in the second half of the last century, and in several Member States has continued to fall (ETUI and ETUC, 2021; OECD and ILO, 2015), implying a general decoupling of wages from productivity growth.

Secondly, low wages are a worrying issue in personal terms, even though material deprivation and very low work intensity did fall between 2012 and 2019, indicating improvements in living standards (European Commission, 2021d, p. 39f). In 2018, 15.2% of workers in the EU were on low pay, the figure ranging from 3.6% in Sweden to 23.5% in Latvia. Even in Sweden, with an advanced welfare system, low pay has doubled since 2006. In most other Member States, wage growth for the bottom 40% has remained below the national average since the early 2000s. A success case is Portugal, in which the proportion of workers on low pay was reduced from 20.7% in 2006 to 4.0% in 2018, at least in firms with 10 or more employees (which usually pay more than smaller ones). Low pay has also fallen in central and eastern EU Member States. Low-paid jobs share some common features: they are mostly filled by people who are young, low-skilled or from a migrant background. These jobs also tend to have fixed-term contracts, and be concentrated in particular economic sectors. We therefore observe widening labour income inequality, in stark contrast to the EU goal of inclusive growth.

Another challenge is the rising amount of bogus self-employment and more generally those in involuntary solo self-employment, which risks swelling the ranks of those on low earnings (see Section 2.3 below) (Spasova and Wilkens, 2018).

As a result of these inequalities, 9% of workers in the EU were at risk of poverty in 2021 (Romania was among the worst performers, on 15.2%, while Finland was among the best with 2.8%). Poverty may derive from low work intensity and jobless households, but in-work poverty also appears strongly associated with low pay, particularly in households with children. Low wages are also strongly associated with financial insecurity – that is, the overall inability of households or individuals to cope with economic shocks such as unemployment, unexpected expenses, or high inflation and utility costs (such as those driven by Russia's war of aggression against Ukraine). Although the link between (liquid) asset poverty and low income is very close, financial insecurity also affects many white-collar intermediate workers and their families (middle-decile households), due to mortgage bills and family-related needs (OECD, 2021a).

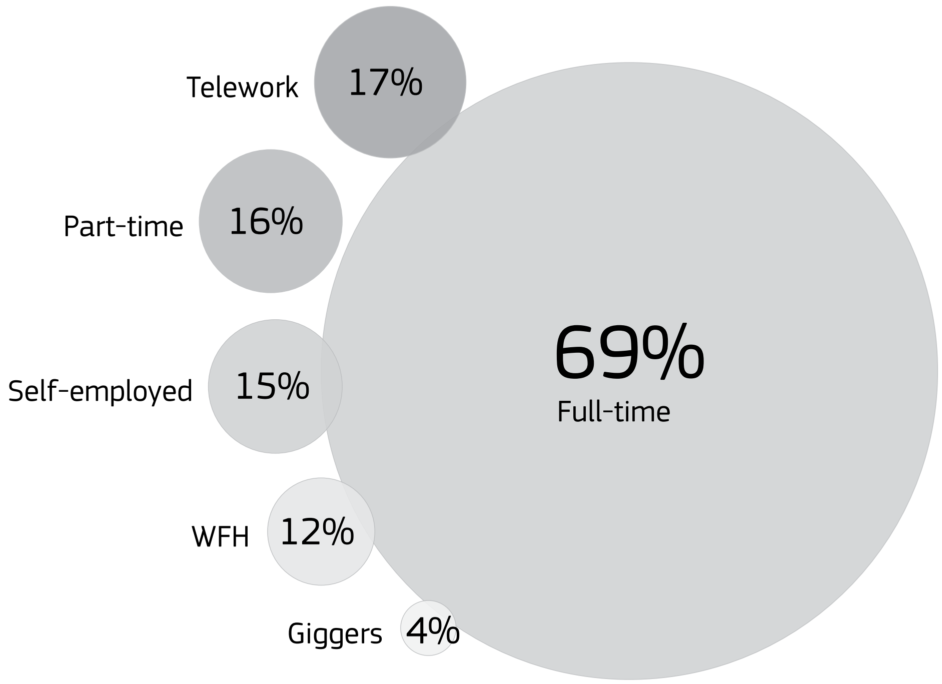
The third general trend in income distribution is that women are still being penalised by gender inequalities. This is despite wide variations between individual Member States and the overall improvements that have occurred (at least until the pandemic). The overall 'gender earnings gap' takes into account the earnings, hours worked, and employment rate of women. In 2018 it was narrowest in Portugal, Slovenia and Luxembourg, moderate in Scandinavian Member States, and widest in Italy, Austria and the Netherlands. (For more details see the *Eurostat index*, based on the structure of earnings survey and the EU-LFS.)

Fourthly, although low-paid jobs can be a stepping stone to a later career, many of them instead represent a dead end. This is particularly true in those Member States with high unemployment, and those with a large proportion of people with low skills and other vulnerabilities (Filomena and Picchio, 2021). People on low wages suffer from a lack of upward mobility, whereas those at the top rarely face downward mobility (European Commission, 2020c). There are also some signs that upward intra-generational mobility is declining in overall terms. In Italy, for example, we see not only a reduction over time in the possibility of people experiencing stable improvements, but also new risks of income loss for those of prime working age (35-45). These new risks mostly penalise women, the long-term unemployed and the youngest age groups (who also risk losing skill advantage). We therefore see not only cycles of poverty and low pay, but also a more general decline in equal opportunity for all and in the possibility of people to achieve upward mobility over the course of their lives (Raitano and Subioli, 2022). Additionally, vulnerable workers are more exposed to the effects of digitalisation and the green transition, as they have less access to training and are less able to adapt to change.

Evolving forms of work

The welfare state was designed on the assumption of stable standard employment – that is, a full-time, open-ended employment contract of a worker with a single employer, both paying social contributions. Over the last 20 years, around 60% of workers in the EU have had this kind of work contract (according to the EU-LFS for 2021). A significant proportion of people are in various forms of non-standard employment – these have become more diverse and increasingly overlap, even though their total share of employment has not changed (around 40%). It is increasingly hard to classify new jobs in legal terms – leading to a risk of inadequate social protection and labour rights. The advent of the digital economy has brought with it a whole range of new economic models, such as: the sharing economy; platform economy; gig economy; collaborative economy; on-demand economy; and peer-to-peer economy. This development poses fundamental questions for labour regulation and welfare provision.

Figure 4: Standard and non-standard employment as% total, EU 2021



Source: EU-LFS, and ETUI survey of internet and platform work 2021. Notes: The figures in the bubbles do not add up to 100% as some categories overlap. WFH = working from home.

Prevalence of non-standard forms of employment

Non-standard (or atypical) work is not new. Since the 1980s, labour law deregulation, competitive pressures, and bargaining decentralisation have all led to more flexible forms of employment.

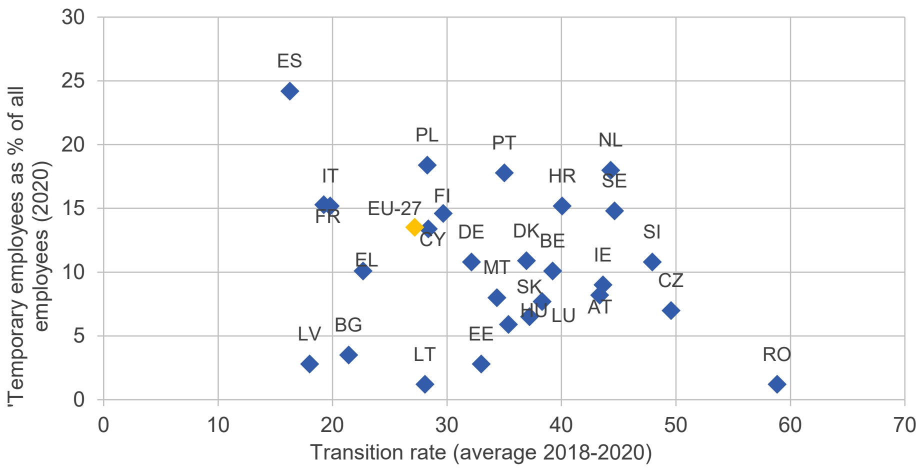
Temporary and part-time work has not increased substantially in the EU as a whole over recent years. There was a short-term reduction in temporary working in 2019-2020, caused by the pandemic. But there has also been a slight fall in its share of total waged employment over the last 10 years, from 14.2% in 2011 to 13.0% in 2021. This has been particularly marked in Poland, Portugal and Slovenia. (For more details, see *Eurostat website*.) There are the usual variations between Member States, but the shares have remained similar over recent decades.

Non-standard work is associated with insecurity and low wages, whereas standard full-time work is associated with labour regulation and social protection. This is despite improvements in the regulation of part-time work and temporary contracts over recent years. In Member States with high rates of temporary working (Spain, Italy and France) it is also harder to move from fixed-term to open-ended contracts, with a 'transition rate' of under 20% (Figure 5). There are significant differences between Member States in the proportion of jobs that are temporary, and in the rate at which people in them move to permanent ones.

Part-time work has become common in the EU. Around a fifth of all people in work are part timers, and about a third of women. The share of part-time work in total employment ranges from over 50% in the Netherlands and over 25% in Austria and Germany to below 10% in many southern and eastern Member States. (For more details, see *Eurostat website*.)

Part-time work, if it is voluntary, enables people to achieve a better balance between their professional and private lives or between work and studying, as well as to manage life-course transitions – in particular, from work into retirement. Involuntary part-time work, however, is more problematic, people being forced to work part time because of a lack of full-time jobs. While involuntary part-time work has declined in importance over the past decade, it is still significant across the EU, ranging from below 10% to over 60% of overall part-time work. (For more details, see *Eurostat website*.) All Member States with high involuntary part-time working also have high unemployment rates, indicating a lack of job opportunities.

***Figure 5:* Temporary employees as% of all employees (aged 20-64) in 2020, and transition rate (%) to permanent jobs (EU-27 and Member States, average 2018-2020)**



Source: Eurostat, [lfsa_etpgan] EU-LFS and [ilc_lvhl32] EU-SILC. Notes: Break in time series in 2020 for DE. The transition rate for LV refers to 2017; the value for SK is the average of 2019 and 2020 only.

Another atypical form of working is having **multiple jobs,** people working in two or more part-time jobs with a different employer, or combining self-employment with waged employment. In the EU, around 7.5 million people (around 4% of those employed) had 'second jobs' in 2021. The proportion of second jobs is high, and rising further, in Member States with high living standards and low unemployment. In some cases it may be partly a matter of lifestyle or the nature of service sector job markets.

In other cases, it is due to economic necessity, as the first job is too low paid or has insufficient hours of work. The proportion of the total employed with second jobs is still rather small: but there can be major repercussions for social rights, contributions and benefits, depending on whether 'mini' or second jobs are covered by the social protection system.

Self-employment: individualisation of risks

Self-employment can be a positive choice by entrepreneurs with well-defined projects and ambitions. But people struggling to find a standard job may also resort to it, such as older people before and after pensionable age, some categories of unemployed people, and first-generation migrants. Growing flexibility in the labour market has not affected the proportion of people who are self-employed, which has remained stable in the EU over the last 25 years (at around 14% of total employment). The make-up of self-employment has, however, changed. There has been a decline in the number of self-employed people with employees and an increase in the number of 'solo' self-employed. Around 68% of the 27 million self-employed people in the EU were solo self-employed in 2021. (For more details, see *Eurostat website*.) Compared with employees, the self-employed have more limited statutory access to insurance-based social protection in most Member States – in some cases they are even excluded from sickness, unemployment, and occupational injury benefits. Building up entitlement to benefit also seems more difficult for the self-employed than for salaried workers. The self-employed can also be subject to tighter eligibility conditions and shorter benefit periods than those for salaried workers. In general, self-employed people have less coverage and receive lower benefits than salaried workers because of difficulties meeting eligibility conditions (Spasova *et al.*, 2017).

In businesses with low turnover, even the minimum level of social insurance contributions may be high in proportional terms. In some cases, this may lead to non-compliance. In others to a decision not to enrol in social protection schemes (where they are voluntary) – and, eventually, to a lack of insured status, particularly among the solo self-employed. Some conventional social protection schemes (such as unemployment benefits) and employment services are not accessible to the self-employed and platform workers (European Commission, 2020d). Moreover, occupational health and safety are not regulated or regulations are not seriously enforced (such as for working hours, paid holidays, and regular health checks). Those with the least autonomy are the 'dependent self-employed' – those working only for one, or predominantly one, client, who determines the tasks that they do and their working time. These make up 2.5% of all self-employed people in the EU.

Platform work: new form of employment

Technological advances, in particular digitalisation, have led to new forms of work, such as internet-based work, telework and platform work, that often are associated with self-employment. Platform work is organised by 'digital labour platforms', which are internet-based companies that act as intermediaries between workers or self-employed people and third-party clients. The work can either be provided at a specific physical location ('on location', such as food delivery or ride-hailing) or online (such as data encoding or translation services).

The rise of the platform economy has positive aspects. It expands markets, optimises the use of spare capacity (including time), makes markets more efficient by eliminating friction between buyers and sellers of employment and other services, and offers extra earning opportunities to more people. On the other hand, platforms have rendered work more fluid, and labour markets more informal (and often more precarious), for example by further blurring the distinction between dependent employment and self-employment, so limiting access to social protection. In the digital labour market, contracting self-employment, and non-standard employment, have been used to reduce labour costs (Darvas and Midões, 2021). According to the second ETUI internet and platform work survey (2021), 17% of people of working age in 14 EU Member States were engaged in internet working, while 4.3% were involved in platform work (Piasna *et al.*, 2022). The spread of both internet and platform work was relatively similar across the Member States analysed, whereas the labour market status of platform workers varied significantly. Delivery services are the most widespread area of activity in the platform economy (International Labour Organization, 2021).

The 2021 survey referred to above found that platform working is typically (as in the case of precarious offline work) more widespread among the young and those born abroad. Platform working may therefore amplify the known risks faced by young workers (O'Reilly *et al.*, 2019; Unt *et al.*, 2023). Low entry barriers to platform jobs pose the risk of 'social dumping' (downward pay competition), which may be made worse by limited social contributions or no social protection at all. Where platform workers are treated as self-employed, they become individually responsible for their social protection, instead of the obligation being shared between the platform (and its customers) and the worker, as is normal between employers and employees. Digitalisation of work and artificial intelligence (AI) have made the issue of autonomy even more pressing. An EU Directive has therefore been proposed to determine the correct employment status of people working through digital labour platforms and to give new rights to both workers and the self-employed affected (European Commission, 2021m).

Surveys have shown that platform work is often a secondary job in addition to regular employment (Barcevičius *et al.,* 2021, p. 42). An estimated 28.3 million people in the EU work through platforms more often than just sporadically. The evidence available shows that the vast majority of these are formally self-employed. Further analysis shows that up to around 5.5 million of this group are at risk of having their employment status misclassified (Barcevičius *et al.,* 2021, p. 5).

The COVID-19 pandemic has accelerated the move away from traditional ways of working before the digital era, towards 'on-demand' workforce models. Research in the US (Fuller *et al.*, 2020) indicates that there are completely different types of technology platform in operation, ranging from digital talent platforms (such as Toptal, Freelancer, InnoCentive, and Upwork) designed to access highly skilled workers (with at least a four-year college degree), to digital platforms (such as Uber, Amazon Mechanical Turk, and TaskRabbit) that connect consumers directly to large numbers of service-providers.

Working from home: new challenges for social protection

There has been a major shift to teleworking, in which workers use information and communication technologies (ICTs) to work in a location other than their employer's premises. This trend accelerated during the COVID-19 pandemic. Before the pandemic, on average 5% of EU employees usually worked from home: but this figure rose to 12% during the first lockdown in 2020, and is expected to remain higher than before the pandemic. (For more details, see *Eurostat website*.) A hybrid model of 'blended working' – including a significantly larger proportion of teleworking – is therefore likely to emerge (OECD, 2021b, p. 318). This development poses new challenges in relation to working time and working conditions.

On the one hand, teleworking has proved to be important for many employers to ensure business continuity and safeguard the health of their employees during the COVID-19 pandemic, and it can also boost productivity (Barrero ***et al***., 2021). On the other hand, it has blurred the existing lines between work, private life, and family responsibilities, particularly for those with young children or other care responsibilities. In addition, although working from home does not alter social protection rights, there can be issues with respect to workplace representation, occupational health and safety, and tax (for example, for cross-border workers). Certain work-related costs (for IT equipment, and energy) are transferred from employers to employees and their households, and in this area, standards exist only at company level, if at all. Finally, as observed during the pandemic, working from home is possible only for a section of white-collar workers (European Commission, 2021d). Other groups have either to attend their workplace (particularly manual workers or those who provide personal services) or to be physically mobile (delivery workers). Working from home may therefore foster additional segmentation of the job market, with levels of social protection differing significantly between sectors and occupations.

The European Parliament has called for legal regulation of working time for home workers, including the right to digitally disconnect outside working hours (European Parliament, 2021). Teleworking can be associated with a better work-life balance and more autonomy, but also with longer working hours and greater isolation (Vargas Llave *et al.,* 2022). Occupational health and safety standards are difficult to enforce in the home environment (there are particular concerns relating to intensive PC work). This is especially important for those aged 45-64, who already make up a third of regular teleworkers *(Piasna et al., 2022).*

1.4 Impact of technology and digitalisation

Employment effects: volume of jobs, sectors, occupations and skills dimension

A new wave of 'jobless growth' brought about by digitalisation has been predicted in several reports (Rifkin, 1995; Brynjolfsson and McAfee, 2014; Frey and Osborne, 2013 and 2017). But forecasts of jobs at risk due to new technologies cannot be equated with actual or expected job losses due to technological advances (Arntz ***et al.***, 2016). The economic history of the last two and a half centuries shows that the jobs created by new technologies have more than compensated for the jobs destroyed by them. Research shows that this was also true of the EU between 1999 and 2010 (Gregory ***et al.***, 2019). Technological change has had strong displacement effects – for example, most workers in all advanced economies are today employed in services – but at the same time, it has created many new jobs not only in the new activities created but also through increased product demand, outweighing displacement effects and resulting in net employment growth overall. In the case of robots, research for the European Commission has found that: '*the impact of robots on European labour markets in the last couple of decades has been small and ambiguous*' (Anton ***et al.***, 2020). The strength and even the direction of this impact has varied according to the nature of the job, as well as to the countries and periods examined.

Evidence for the 1995-2015 period indicates that most Member States saw some degree of 'job polarisation' – the phenomenon where jobs in the middle of the skills range are lost while high and low-skilled jobs expand (OECD, 2019). There is similar evidence from the US and the UK (Oesch, 2013 and 2015). Another report has suggested this trend will continue in the EU (Cedefop, 2018). Job polarisation does not, however, mean a net loss of jobs. The jobs lost are mainly those involving routine tasks, leaving relatively untouched those that are harder to automate – those involving both high and low levels of skill. In fact, significant growth is expected in high-skill occupations, together with some growth for less-skilled jobs (relating to sales, security, cleaning, catering and caring). Job losses are projected in medium-skill occupations, such as skilled manual work (especially in agriculture). Cedefop projections also imply a significant decline in the amount of physical work needing to be done, but an increase in intellectual and social tasks (particularly business literacy, selling/persuading and serving/attending). They also point to a large increase in the use of ICT skills, with some increase in autonomy and a reduction in routine work. Other empirical evidence also shows an increase in service sector jobs, particularly in ICT. Trends towards upgrading the wage structure and shifting towards more autonomy, fewer routine tasks, more ICT, less physical and more social and intellectual tasks have been most prominent in the Member States that joined the EU after 2004, suggesting an upward convergence of the employment structure in the EU.

There is also evidence that new technologies, and ICT in particular, affect various segments of the labour market in different ways. There are positive effects in terms of promoting employment for young and prime-aged women, while reducing it for older women and prime-aged men. The negative effects are particularly pronounced for older women in cognitive occupations (i.e. managerial, professional and technical jobs), who tend to have low ICT-related skills, and for young men in routine manual occupations, who have been replaced by robots (Albinowski and Lewandowski, 2022).

In addition, the pandemic has greatly increased the demand for digital skills at all levels and across many occupations and sectors. All in all, the digital skills gap remains wide. In 2019, 44% of people aged 16-74 did not have basic digital skills; and in 2018-2019 there were 13.5 million vacancies for people with ICT-related skills. In 2019, 57% of companies reported difficulties recruiting ICT specialists. (For more details, see *Eurostat website*.) As has been correctly observed: '*Digital skills are required (at the appropriate level) in over 90% of current jobs and in nearly all sectors of the economy*' (European Commission, 2022c). Unfortunately, Member States seem to have made limited progress in ensuring that adults can acquire basic digital skills and the pattern of endowment of the labour force with at least basic digital skills differs significantly across the EU. Significant further efforts are needed in respect of advanced digital skills and the New European Skills Agenda in 2020 indicated the importance of digital skills as a driver for creating, utilising and benefiting from digital technologies (European Commission, 2021d, p. 125f). The pandemic revealed shortcomings in technical infrastructure, suitability of software, curricula and teaching methods, as well as in the digital competence of teachers.

Again, these patterns vary considerably between Member States, reflecting differences in the composition of industrial sectors and the structure of jobs and tasks within them (OECD 2019). This means that Member States face different levels of risks in terms of job-substitution and job-polarisation. Some Member States have already shifted quite rapidly toward more automation-proof jobs, whereas others still rely heavily on routine-intensive (industrial) employment, and therefore appear to be more vulnerable.

In general terms, there is evidence of strong demand for workers with higher levels of education and less so for low-skilled workers (Cedefop, 2018). The proportion of people aged 30-34 with higher educational attainment has increased substantially in recent years. But a significant proportion of people of working age lack basic literacy and numeracy skills, leaving them more vulnerable and less well equipped to cope with change. Digitalisation may thus deepen existing divisions in society, particularly in terms of educational attainment, migration background, occupational disability, and gender.

Finally, digitalisation may cause growing regional inequalities. In more advanced regions the welfare state will increasingly be a factor driving growth and productivity, whereas in peripheral and/or deprived regions its protective role will be more important. So far, digitalisation has contributed positively to regional resilience, by making remote working easier. But resilience is strongly linked to human capital, and highly educated workers contend with shocks better than less educated ones, hence lagging behind in digitalisation may deepen regional disparities. Areas with the highest concentrations of digital skills usually have the highest GDP per head and are often located in regions around capital cities. Opportunities brought by digitalisation

Despite the risks highlighted above, the potential opportunities brought by digitalisation should also be underlined, especially for welfare systems and service delivery.

For instance, in a digital platform economy, the extra cost of including an additional user is close to zero. Geographical borders do not play a significant role. Transaction costs for users are also low. All this makes it much easier to extend the reach of services.

Digitalisation in the health sector creates opportunities for improving healthcare systems. Supercomputers, big data analytics and AI are opening up new options in this area, for example by enabling simulations epidemics and pandemics. New digital applications also enable new ways of providing care, such as therapy monitoring and follow-up support (Schönermark *et al.*, 2019). Innovative approaches to providing healthcare could support healthcare workers better and help to improve their efficiency. A mixed approach, using digital services to complement physical services, may help to ensure access to high-quality healthcare for all. It should be noted, however, that the social benefits of pooling and sharing data can only be realised if no data protection considerations are violated.

A recent report has also documented how public social services have been investing in digitalisation during the COVID-19 crisis, especially in warehousing, demand forecasting and remote monitoring (European Social Network, 2021). Many public authorities are looking at ways of integrating health and social care data to help manage integrated services across both areas.

There are also opportunities for public administration to benefit from digitalisation. For example, one of its core tasks is to maintain registers that are tamper-proof and safely maintained and to use them to issue information and documents. ‘Blockchain’ technology – involving a decentralised, digital account book in which transactions are recorded without a central office having to authorise each individual transaction – appears to be well suited for the digitalisation of some of the core tasks of public administration, especially for the effective management of social policies. Blockchain registries provide an excellent opportunity to modernise public registries, citizen accounts and other e-government services.

Overall, there are obvious gains in economic efficiency from digitalisation. Firstly, access to digital services, such as health apps, e-learning, e-commerce, or car sharing, can be provided very cost-effectively via smartphones. Secondly, the value of a network increases in line with the number of its users. However, these conditions also favour the development of a small number of large and dominant platforms. This raises new challenges for competition policy, including in relation to regulating platforms and takeovers (Shapiro and Varian, 1999).

1.5 Emerging trend: the impact of climate change, and managing the social implications of the green transition

Climate change, environmental degradation and their consequences pose an increasing global threat. Climate-related extreme events, such as floods, droughts, and heatwaves, have become more frequent in Europe along with the rest of the world, with potentially huge human and economic losses. The European Commission has estimated these losses already average over EUR 12 billion a year (European Commission, 2021e). The weather-related catastrophic events that Europe was confronted with in 2021 can only add to this estimate.

The EU is responding to the challenge of climate change by supporting the necessary 'green transition', highlighting that the consumption of fossil energy and non-reproducible materials must be dramatically reduced (European Commission, 2020e). But the EU also aims to address the social implications of climate change. Only by collectively using the least polluting options can we as a society become 'climate neutral' – with economic activity having no net effect on the climate – which is crucial for future generations. In addition, there needs to be a recognition that climate change and biodiversity loss can reinforce inequality, undermine social fairness and threaten vulnerable groups. If no action is taken, global warming threatens to set back efforts to reduce poverty, so action to counter climate change and combat inequality complement each other.

The European Green Deal puts social fairness right at its heart. The Council of the EU has issued a Recommendation with further guidance to Member States on how to ensure the transition towards climate neutrality occurs in a socially equitable way, on how best to address the social and labour aspects of the green transition, by promoting the right employment skills, putting in place appropriate social protection and taxation measures, and making full use of the available funding options (Council of the EU, 2022a).

The European Commission has also proposed the creation of a 'Social Climate Fund' to address the social impact of measures to promote the climate transition. The fund will compensate vulnerable households, micro-enterprises and transport users that are particularly affected by energy and transport poverty (European Commission, 2021f). Member States will have to submit 'social climate plans', after consulting with local and regional authorities, economic and social partners, and civil society organisations. The fund will finance temporary, direct income-support measures to tackle price increases for road transport and heating fuel. It will also support long-lasting structural investment, including in building renovation, decarbonisation of heating and cooling, integration of renewable energy, the purchase of zero- and low-emission vehicles and the associated infrastructure, and use of public transport and shared mobility services. In December 2022, the Council of the EU and Parliament reached a provisional agreement on both an EU emissions-trading system and the Social Climate Fund.

Expected impacts of climate change on need for social protection and welfare systems

Climate change and the green transition put social protection systems under stress, as their negative effects often hit the most vulnerable groups first (see for instance: European Commission, 2019a, Chapter 5). But there is no unanimity about their precise impact so far on the need for, and financing of, social protection in the EU. It is also difficult to be sure about their future social impact.

Climate change affects human societies in many ways. Extreme weather events cause loss of human life and material damage, and also harm people's health. There are occupational health and safety risks, in particular in outdoor jobs such as in construction and agriculture. Labour productivity may be reduced, in particular in vulnerable regions in southern Member States (García-León *et al.*, 2021). People working in the agricultural sector have to ensure some business and/or job transition, while others suffer from aggravated health diseases, which also increase the need for income support. Even if such events do not affect the EU directly, they may have spill-over effects, such as triggering migration or transforming supply chains.

Social protection and assistance, including income support, is increasingly needed wherever people suffer direct economic losses due to climate-related events, such as forest fires or flooding. Moreover, private insurance is often incapable of providing adequate coverage against such risks, because the premiums needed to provide such coverage while fulfilling companies' solvency requirements, would be too costly for most of the households concerned.

The transition to climate neutrality will itself trigger new needs that the welfare state will only be able to respond to by mobilising widespread political and social support. As indicated below, the green transition can have a noticeable impact on employment, energy poverty and income inequalities.

Employment effects

The European Commission estimates suggest that the green transition may create jobs overall, provided it is accompanied by the right policies. But the effects are bound to be concentrated in particular regions and sectors. The green transition will destroy jobs in traditional industrial sectors, while creating new jobs in others. There will therefore be a need for a significant reallocation of labour and skills, with major challenges for energy-intensive industries, in particular in central and eastern Europe. Energy-intensive industries encompass sectors, such as coalmining, that are classified as 'declining' in the context of the 'just transition mechanism', which is designed to promote new sustainable economic development in the places and for the communities most affected. They also include 'transforming' sectors, such as mining, chemicals, minerals, metals and automotive industry. Employment in energy-intensive sectors in the EU remained stable at around 3% of the total over the 2010-2019 period, but with stark differences between Member States (European Commission, 2021g). Overall, just five sectors together generate close to 90% of all CO2 emissions in the EU, while accounting for less than 25% of employment and gross value added. The development of organic agriculture and measures to preserve natural diversity should create jobs in agriculture. The rise in the cost of transporting food products, together with a new concern for sovereignty in food production, may also boost job growth after decades of structural decline. In addition, the green transition will mean a further shift from material goods to services.

More generally, 'green jobs' offer significant opportunities for job-creation as the EU economy makes the transition to climate neutrality (for a definition of green skills, see: Cedefop, 2022). Labour and skill shortages represent a barrier, however. Despite positive past developments and projections, the share of the environmental goods and services sector remains relatively small (the sector is a narrow proxy for green jobs, excluding certain activities that make a substantial contribution to environmental objectives). Labour shortages are reported in several Member States, especially in science, technology, engineering and mathematics, which are key to the green transition. This highlights the urgent need to equip workers with the requisite skills, through vocational education and training, but also through adult learning.

According to Eurostat, environmental sector employment grew by 43.3% over the 2000-2019 period – and notably by 91.6% in renewable energy production. In 2019, it reached 2.2% of total employment in the EU-27, around 59% of the people concerned contributing to environmental protection and 41% to resource management. The five largest shares of employment, ranging from 3.5% to 5.1%, were in Finland, Estonia, Luxembourg, Austria and Lithuania. The smallest, 1.0% to 1.7%, were in Belgium, Germany, the Netherlands, Malta and Poland.

The structure of employment is therefore changing in response to the green transition. This may create additional opportunities to invest in jobs that bring more value-added to society, and to respond to the challenges posed by other megatrends (such as the demographic ones – for instance, extra jobs in the care sector).

Energy poverty

Replacing fossil energy and implementing carbon pricing will increase the price of energy, at least in the short term. Carbon pricing is estimated to affect the poorest people in low- and middle-income countries and may conflict with poverty-eradication targets (Dorband *et al.*, 2019).

Electricity, gas and other fuels for housing make up a relatively large proportion of the consumption of low-income households in the EU, but the proportion is not much different from that for medium-income households (*Eurostat database*). A study for the OECD has shown that the proportion of spending on energy is relatively stable across income groups within countries (Blake and Bulman, 2022). There are marked differences, nonetheless, between countries in terms of the proportion of electricity, gas and other fuels for housing in household consumption: in Finland it is 3.5%; in France 4.6%; in Belgium 5.6%; in Greece 6.3%; in Estonia 8.7%; and in Hungary 10.4% (Blake and Bulman, 2022). The structure of energy spending also differs between rich and poor households, the rich spending mainly on energy for transport, the poor mainly on energy for housing.

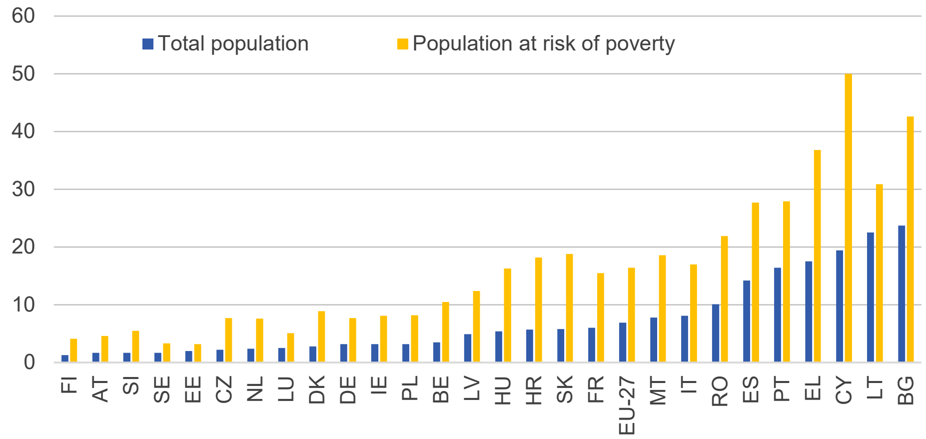
These differences have been made sharper by the energy crisis, deepened by Russia's war of aggression against Ukraine. Energy prices hit all-time highs in 2022. The deliberate reduction of gas supplies by Russia is the main cause of the rise of gas prices in the EU, affecting the price of electricity produced in gas-fired generating plants and electricity prices overall. The price of energy is expected to continue to remain high in the EU in the coming months, as it takes time to replace Russian gas supplies with supplies from other sources.

'Energy poverty' arises when energy bills represent a large proportion of consumers' income, or when households need to reduce their energy consumption to an extent that harms their health and well-being. As with the concept of poverty in general, energy poverty has been understood and measured in either absolute or relative terms. In the EU, energy (or fuel) poverty is understood in relative terms – energy costs that are too high, or energy consumption too low, compared with some average – or as the inability to pay for keeping dwellings warm or cool enough, or to avoid being in arrears on utility bills (European Commission, 2022d). As there is no single indicator that gives a clear picture of the situation in the EU, approaches should be used in combination. As an illustration, Sweden and Finland have the highest levels of energy poverty if measured either as the proportion of households whose energy spending (in absolute terms) is less than half the national average (median), or as the proportion of households whose energy spending as a share of income is more than double the average. But if it is measured as the proportion of the population not able to keep their home adequately warm, Sweden and Finland have among the lowest rates of energy poverty in the EU.

Based on the latest available data (EU SILC 2021), it is estimated that nearly 30.5 million people in the EU, or 6.9% of the population, could not afford to keep their homes adequately warm in 2021, even if this is 3.4 percentage points less than a decade ago. There are, however, wide differences between Member States in the energy poverty rate measured in these terms.

Energy poverty is shaped in each Member State and region by specific issues and needs, including poverty and deprivation, the local climate, the household ownership type, the structure of the housing stock and the type of heating services or appliances. Energy poverty is obviously closely linked to poverty and deprivation in general (Figure 6), but national and regional housing policies and conventions shape its level and distribution (Maxim *et al.*, 2016).

Figure 6: Proportion of total population and of population at risk of poverty unable to keep home adequately warm (%), EU 2021



Source: Eurostat, EU-SILC, [ILC_MDES01].

Distributional impact and triple injustice

In social terms, climate change already represents a double injustice. Its negative effects often hit the most vulnerable groups first and those most affected by climate change are not those responsible for excessive carbon emissions. Emissions from consumption by the world's richest 1% are larger than those of the poorest 50% (Oxfam, 2021). Inevitably there are large differences between Member States; and carbon inequality also exists inside countries, where again emissions from consumption are strongly correlated with income.

The green transition may itself add a third injustice, since the policy measures involved often risk imposing proportionally greater costs on those with the lowest incomes. For instance, higher taxes on fossil fuels and fertilisers increase the prices of food and energy in the short term. This hurts low-income households most, as food and energy make up a larger proportion of their spending.

The twin green and digital transitions need to be sensitive to issues of social inclusiveness and financial affordability. People with low and medium incomes are more vulnerable to their impact and costs – job losses due to automation; inability to access digital services (private and public); higher prices of energy, food and transport; or lack of finance to improve the energy efficiency of buildings. There is also a gap between 'tech-savvy' firms and those lagging behind technologically, made wider by regional economic disparities.

Achieving climate neutrality and environmental sustainability will only be possible if accompanied by measures to support those groups hit by the green transition, including by bridging disparities, not least because those for whom the transition will be hardest are those with the lowest level of emissions. Reaching the objectives of the EU Digital Decade, the Green Deal and the European Pillar of Social Rights will be crucial to close these gaps, but different and additional measures may be needed.

2. Policy options to adapt the welfare state in a life-course perspective

2.1 Introduction: welfare provision in a life-course perspective

The maintenance of the social citizenship contract requires co-operation between generations as they go through the three stages of the life-course – early life, working life, and old age – and experience periods of economic inactivity on the way (in childhood, education and training, unemployment, retraining, caring, and retirement). This can be achieved by sharing social benefits and fiscal burdens in a fair, efficient, and sustainable way. In exploring the policy options involved, this chapter focuses on social protection, labour market and social investment responses to the challenges identified in Chapter 1 for each stage of life.

It is important to stress that some challenges are important at all stages of life – to be cared for if sick; to have a decent and healthy living environment; to have the opportunity to develop social relations; and to be treated with equal consideration and respect. But the life-course approach is pivotal. Most needs vary according to the stage of life. Moreover, this approach prompts us to identify and strengthen the long-term benefits and synergies of social policies (Hemerijck, 2013). Political legitimacy is ensured by the trust that the population will be provided with childhood support and education in early life; adequate social protection and activation policies, and help in finding work for people of working age; and pensions in old age, alongside high-quality healthcare, and tailored lifelong training for all generations.

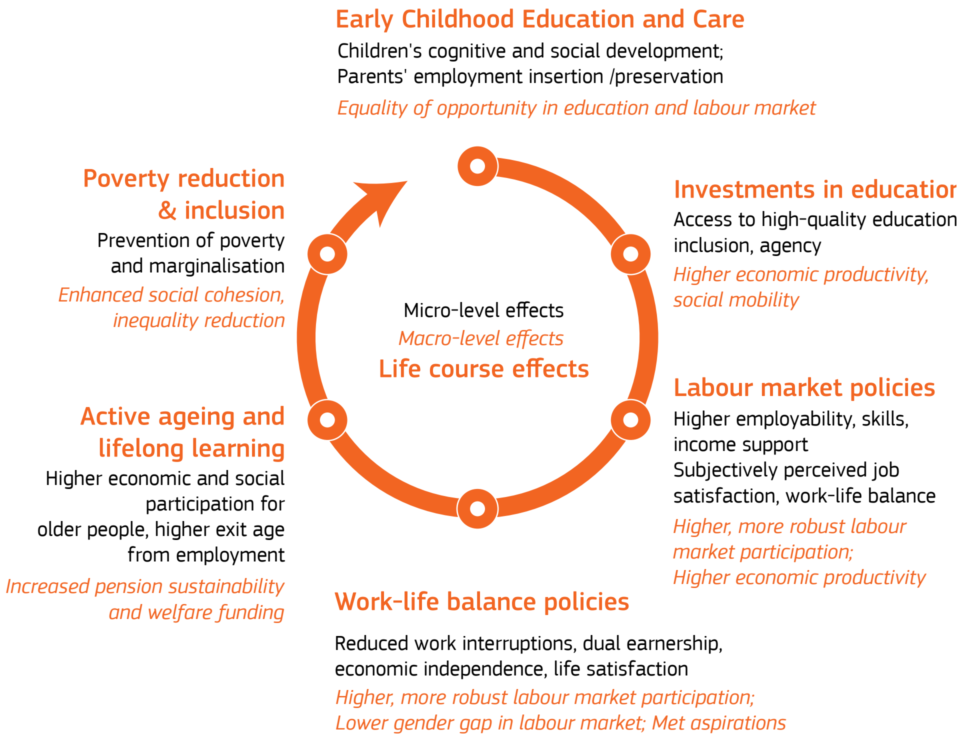
The different stages of life have blurred boundaries and are interlinked in many ways. Secure retirement, for example, is critically dependent on how people fared during their working lives, which, in turn, is strongly correlated with the quality of their childhood years. The welfare state is a common resource pool, in which many welfare gains are inherited from the past, including those that enable adults to care for the young, and the young to later care for the old.

The costs and benefits of welfare provision are distributed unequally across the life stages (see Section 1.2). Employment is arguably the core lubricant in the inter-generational social contract, because welfare provision is largely paid for by income taxes and social contributions (Genschel, 2004; Lindert, 2004). But people's economic situation is largely shaped by earlier investment in education and care and in health and living conditions. Early interventions can therefore yield important dividends in terms of sustaining the inter-generational social contract.

In light of the megatrends which form the background to this Report, the social security function of the welfare state must be complemented by a more pro-active approach – as suggested by the social investment model – under which policies strengthen people's current and future abilities. Examples include: early childhood education and care; youth support; education and training over the life-course; active labour market policies; ensuring job quality and good conditions of work; work-life balance policies; and long-term care provision. The goal is to prevent and manage risks in modern labour markets, to ensure high levels of gender-equitable employment, social cohesion, individual autonomy, and overall life satisfaction (Hemerijck, 2017).

From a life-course perspective, welfare benefits and services generate a 'multiplier' effect, whereby cumulative returns over the life-course generate a cycle of ever greater well-being – in terms of higher employment, gender equality, and reducing the transmission of poverty from one generation to the next (see Figure 7).

***Figure 7:* The Social investment life-course multiplier at micro and macro level**



Source: A. Hemerijck, S. Ronchi, I.Plavgo, Social investment as a conceptual framework for analysing well-being returns and reforms in 21st century welfare states, Socio-Economic Review, 2022, https://doi.org/10.1093/ser/mwac035.

At the 'micro' level – that of individuals and households – the multiplier indicates the way social investment, from early childhood on, improves material well-being (employment and income) and helps mitigate social risks later in life. It does this through incentives for people to acquire skills, and by making labour market transitions easier for people (especially women). At the 'macro' level, the multiplier indicates the cumulative benefits to society as a whole. These include improved productivity, higher employment, reduced gender gaps, less poverty, and later retirement – all crucial to economic growth and the fiscal sustainability of the welfare state in knowledge-based economies and ageing societies. The income protection role of the welfare state is necessary in its own right to protect people against social risks such as unemployment, ill-health and poverty, guaranteeing incomes for families, people with disabilities, or older people. But that role must go hand in hand with a social investment approach, providing services that strengthen people's own capacity to deal with such risks. The experience of the Great Recession, and then of the COVID-19 pandemic, has highlighted the key importance of both income protection at the micro level and effective demand stabilisation (i.e. countering economic downturns) at the macro level.

2.2 Early and family life

Introduction

Since the 1990s, social risks have shifted to younger generations. Megatrends, such as population ageing, digitalisation, and changing family structures, have also altered the pattern of social risks (Esping-Andersen *et al.,* 2002). In a number of Member States, child poverty is now prevalent, especially in non-traditional family structures. For young people, the transition to adult independence now takes longer; and, once it is complete, working-age adults face less stability, both in family and labour market transitions. Societies have moved away from a 'male breadwinner' industrial model to a 'dual-earner' post-industrial economy and society. Inequalities between people in the same generation are now more affected by differences in education, family structures, income and wealth. New at-risk groups have emerged since the turn of the millennium – children, young adults, families with children – especially single parents (mostly mothers) and large families – and families with workers in precarious jobs.

Family policies

Aims of family policies

Family policies have varying aims in Member States, and these aims may change over time. Table 1 lists possible family policy aims in the order of their general historical occurrence.

These aims can be seen in terms of ensuring the same income level to all families, with or without children ('horizontal equity'), or in terms of preventing child poverty, giving all children equal opportunities in life, and giving each child a solid education to meet their future needs ('vertical equity'). A third category is policies promoting women's employment by reconciling employment and care responsibilities. The most complex family policies in the EU are designed to achieve all these objectives.

Over recent decades there has been a clear convergence of family policy aims, and most Member States have also widened their range of policies. Member States that previously focused on childcare services have recently adopted options for (better paid) home-based parental care, such as Scandinavian Member States extending paid parental leave schemes. Other Member States that previously had widely available maternity and parental leave policies are now developing and/or expanding childcare services, such as Germany and some in central and eastern Europe.

This convergence has been actively promoted by the EU through 'soft' methods, such as the Barcelona targets for early childhood education and care, which set a target of 33% coverage by childcare services for children under 3, and 90% for those aged 3-6. After the Commission proposed raising these targets, the Council of the EU agreed new targets of 45% and 96% respectively (Council of the European Union, 2022c; European Commission, 2022l). In addition, the EU has used binding legislation, such as the Directive on Work-Life Balance, which requires parental leave arrangements to be shared, and provides funding.

Table 1: Various aims of family policies over time

AIMS OF FAMILY POLICIES	POLICY TOOLS
Protecting the health of mothers and infants related to pregnancy and birth	(Paid) maternity leave Health insurance Pre- and post-natal services, infant care
Preventing/tackling child poverty	Child benefits, family allowances, social assistance benefits, free meals at childcare services and schools, free afternoon care and extra-curricular activities
Increasing female employment	Creches, kindergartens, afternoon care at schools
Promoting home-based childcare (mother/parent and child bond)	Parental and childcare leave (after maternity leave)
Socialising child costs	Family benefits
Increasing birth rates	Cash transfers, particularly birth grants
Promoting gender equality	Non-transferable leave to the other parent ('daddy quota'), all-day childcare services, promoting employment for mothers, benefits for single parents (mainly mothers)
Promoting child development	Good-quality childcare services accessible to all families, early child development and care, screening programmes, specialists in childcare settings and kindergartens
Promoting parenting	Social services, parenting consultancy, sure start centres (child and parent activities)

Source: Authors' elaboration.

In the design of family policies, there is a choice between various options, such as more generous support for the first child, which could encourage more young people to have children and targeting large families, in an attempt to prevent child poverty. More generous spending on childcare for the first child primarily helps single mothers to reduce the risk of poverty later in the life-course – whereas leave policies usually benefit mothers with partners more. There is also some ambiguity in the design of child allowances, which in many countries, up until recently, were intended to allow mothers of young children to withdraw from the labour market, whereas in others, paid leave is specifically targeted at encouraging parents to take up work, by making it easier to combine it with family life.

Another fundamental policy choice is whether social protection entitlements should be individualised or family-based. One approach, common for example in the Nordic and Baltic states, involves the full individualisation of taxation and social protection, on the premise that society should not interfere with individual private choices. From this perspective, individualisation supports the autonomy of women and encourages women to take up paid employment. The opposite approach, as in France, bases entitlement on the family, stressing family solidarity (such as an obligation to pay alimony) and the need to protect single-earner and low-income families by increasing their child benefits.

Women's labour market participation and child poverty

As women's employment has expanded over the past quarter of a century, the whole relationship between work, income, and the family has become more central to the social investment model. More flexible labour markets and skill-based technological change, coupled with higher divorce rates and single-parenthood, have made economic independence, equal access to work and a satisfactory work-life balance for both men and women prerequisites for future welfare sustainability

There is an important link between (on the one hand) more developed social services for families with children, high female employment, and the growth of families with two earners and (on the other hand) lower child poverty. Across the EU, however, it is still far from easy to combine paid work with childcare obligations, and this has an impact on women in particular. Without capacitating support, many women and young couples today opt either to restrict their caring obligations, to have fewer children than they would like or to restrict participation in the labour market. Taken together, these individual responses have a negative impact on the economy (Esping-Andersen, 2015).

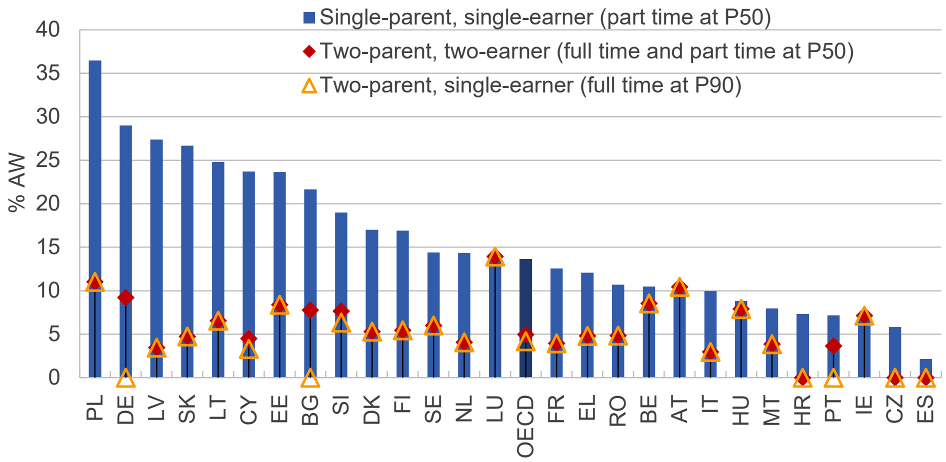
Income protection for families: cash benefits and taxation

Family benefits are the most common payment families receive throughout the EU, such as family allowance, child benefit or *Kindergeld*. These benefits are usually not tied to former employment (unlike paid leave). They are designed to cover part of the costs of having children and to reduce the poverty risk of children and families. Family benefits are often linked to the number of children. In some Member States they increase (per child) with the number or the age of children. In others, payment is only due for the second and subsequent children, with a higher amount from the third child on (as in France, and formerly Poland). This latter arrangement is designed to address the higher risk of poverty among families with three or more children. In some Member States (such as Italy and Portugal) single parents are eligible for higher amounts, although these are usually not enough to eliminate the risk of poverty entirely, especially for single parents.

Family benefits for two children in Member States generally amount of around 15% of average wages in OECD countries (Figure 8). There is much variation across countries, but in many cases the percentage is even lower. This is the prime reason why, despite public transfers, families with children experience worse living standards than households without.

The advantages of extending family benefits to the widest range of families are that the policy is relatively easy to administer, and the benefits are readily available to all families. Means-tested benefits are likely to be less popular among those with middle and higher incomes. Targeting large families (with three or more children) and single-parent families seems to be a good way of focusing help on low-income families without the trap of stigmatising them. It is also important to consider the level of minimum income benefits, which are crucial to avoiding child poverty: in most Member States these levels are not high enough to avoid the risk of poverty (*Figure 10 in Section 2.3*).

***Figure 8:** Value of family benefits in Member States for family types with two children, relative to the average wage, 2018*



Source: OECD Family Database 2022, PF 1.3. Note: P50 = average (median); P90 = 90% will equal or exceed this.

In the case of family benefits, a crucial issue is whether they are based on citizenship or residency, and are therefore accessible to migrant and refugee families – such as Ukrainians fleeing Russia's war of aggression.

The **tax treatment** of families with children is crucial for social equity. Poverty among working parents – and so also child poverty – can be prevented by the adequate use of tax credits or 'fiscal welfare', alongside family benefits for low-income parents. For middle-income families, the system of family taxation in France is worth noting, as it uses a 'family quotient' to ensure that taxes are fairly distributed between families of different sizes with similar incomes. 'Refundable' tax credits can be applied in those Member States where taxes are based on individual incomes.

Social investment in families: leave and childcare services

With regard to **family leave**, it is important to differentiate between maternity, paternity and parental leave (Koslowski *et al*., 2022). Maternity leave is exclusively available to mothers, whereas paternity leave is targeted at fathers (or the caregiver other than the mother caregiver). Leave may be paid or unpaid. There is a great variety of arrangements in Member States, but they all provide maternity and parental leave. All Member States are required to provide at least two weeks leave for the 'other parent', usually the father, under the EU Directive on work-life balance for parents and carers (Council of the EU, 2019a). This is designed to improve gender equality, promote better sharing of care responsibilities between women and men, and make it easier for mothers to take up paid employment.

In continental and eastern Member States, **childcare services** for toddlers (such as creches, nurseries, and toddler groups) are quite sharply distinguished from those for children aged 3-6 (kindergartens and pre-school). In the former, the focus tends to be on play activities and the health and well-being of children: in the latter, on more structured activities to prepare children for school. Most Nordic Member States, on the other hand, have an 'educare' system, combining early childhood education and care under a comprehensive approach, based on the needs and development of children from the earliest age until primary school. Some researchers have called for the scope of childcare services to be extended, and emphasise the importance of various social services for families, as well as extra-curricular school activities. In some Member States, such as the Netherlands and Germany (western regions), a half-day model of caring and schooling is dominant. But this reinforces gender inequalities in the labour market, because mothers are expected to pick up their children before lunch, meaning that they cannot be employed full time – but only part-time or in 'mini-jobs' (Hagemann *et al*., 2011). By contrast, full-day childcare facilities, schools, and free and high-quality extra-curricular school activities, all help to reduce class and gender inequalities.

Younger adults

Youth has been long seen as a relatively short transitional phase going from the parental home and school to independent work and family life. But due to demographic and societal trends, this transition now takes on average about seven years in the EU. Youth has become a distinct period of the life-course between the ages of 18 and 24, when teenagers and young adults swing between education and employment, and between socio-economic dependency and autonomy.

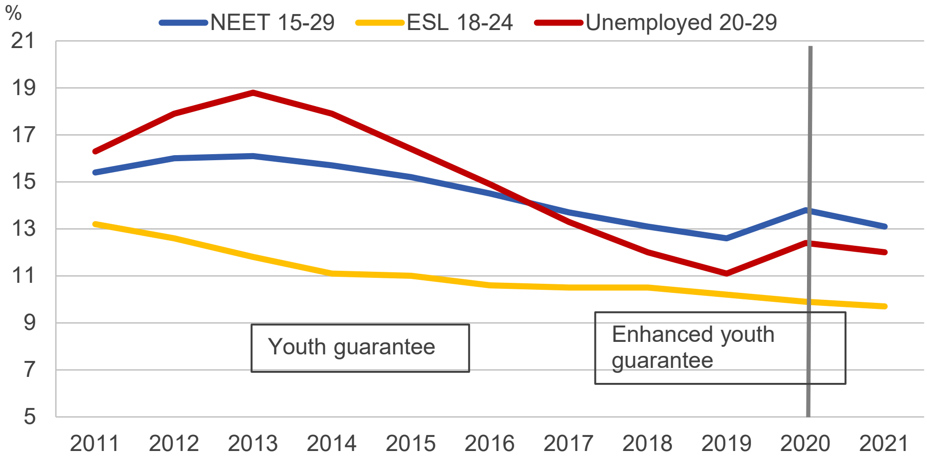
Investing in young people: education, training and labour market entry

Until now, the main focus of policy has been on the transition from school to work, in order to reduce early school-leaving and the number of young people under 25 who are not in education or employment (NEETs). EU policy initiatives are aimed at supporting the smooth entry of young adults into work. They include the Youth Employment Support Package (European Commission, 2012), which encompassed first the 'Youth Guarantee' in 2013 for those under 25 (Council of the EU, 2013), and then the Reinforced Youth Guarantee in 2020 for those under 30 (Council of the EU, 2020a). The rate of early school-leaving and of NEETs are both included in EU social policy benchmarks, such as the European Pillar of Social Rights action plan, and the 'social scoreboard'. This allows trends hampering the development of human capital to be monitored. Efforts by both the EU and Member States at systemic level have resulted in positive policy outcomes in this area. Over the last 10 years, the figures on youth unemployment, early school-leaving and NEETs have improved (Figure 9), or at least not worsened, in a large majority of Member States.

While efforts to help the most vulnerable young people have been quite successful, challenges remain. In particular, a persistent proportion of young people are neither in employment nor in education or training. Education and training matched to the needs of an evolving world of work can help to raise youth activity rates, as both are positively linked to employability, though differences between Member States in this respect are significant. (For more details, see *Eurostat website*.)

The breakdown of traditional boundaries between sectors and occupations will create a demand for new forms of cross-sectoral skills and competences. At EU level, an ambitious skills agenda was launched in 2016, and renewed in 2020, with specific initiatives on, notably, vocational education and training; increasing the number of graduates in science, technology, engineering and mathematics (STEM); fostering entrepreneurial and cross-cutting skills; an EU approach to 'micro-credentials' (certifying the outcomes of short-term learning experiences); and an initiative on individual learning accounts. The Council of the EU has also adopted a recommendation on 'blended learning' approaches to high-quality and inclusive primary and secondary education, combining learning in school and other physical environments outside school with non-digital and digital learning tools, including online distance learning (Council of the European Union, 2021).

Figure 9: Indicators of youth labour market entry disadvantages, EU-27 (%)



Source: Eurostat. Note: ESL = early school-leaving.

In the modern welfare state, education and training systems have the additional role of countering gender stereotypes in the labour market and in family life, so helping to close the gender pay gap.

Similarly, climate education and the development of green skills are emerging priorities in the 21st century. Instead of one-way instruction, there is the possibility of building on the pro-active and leading role young people have played in action on climate change.

Technological development and digitalisation create both opportunities and challenges for education and training. Building digital skills (for example, in computer coding) can be key to labour market competitiveness. But at the same time it is also important to prevent ‘technology addiction’ among young people and to educate them to avoid disinformation and internet bullying. And as digital technologies and e-learning are becoming an integral part of the education process (as highlighted during the COVID-19 crisis), it is vital to ensure that children from disadvantaged backgrounds are not left further behind – such as those with a minority or migrant background, or from remote areas.

Labour market framework for young workers

Labour regulations can also affect the employment options of young people, both negatively and positively. Traineeships have become an important entry point into the labour market: but their value depends on good learning content and working conditions, in terms of working hours, remuneration, social security coverage, and duration. It is also important to counter abuses such as the mistreatment of young workers (for example, firing them during their probation period), and tax avoidance by employers. On the other hand, highly rigid lay-off rules may make employers reluctant to hire first-time workers, even though lay-off regulations often do not protect workers during the first months in a job. A careful assessment is therefore needed of work and pay regulations from the perspective of young people. Apprenticeships are also important to consider as they can act as a springboard to jobs when underpinned by quality standards, as called for by the Council Recommendation on a European reference framework for quality and effective apprenticeships (Council of the EU, 2018).

Another challenge is to provide young people with decent jobs. Young people are more likely to be employed in non-standard jobs, where they are exposed to job and income insecurity, and where occupational safety and health regulations do not apply or are ignored. Precarious employment is more common among young people (O'Reilly *et al*., 2019); part-time and temporary work are often involuntary options (ETUI and ETUC, 2021); and young migrants, and young people generally, are over-represented among low-end platform workers (Piasna *et al*., 2022). In 2018, those under 30 earned on average 75% of the overall standard wage (according to Eurostat's structure of earnings survey). The youth wage gap is wider in Mediterranean and western Member States, and smaller in central and eastern ones.

In several Member States (including the Netherlands, Belgium, Ireland and Greece), lower minimum wages apply to young people (see Table 1 in Marimpi and Koning, 2018). In Germany, workers are not eligible for the minimum wage until they are 18 (ETUC, 2017). The effect of youth-specific minimum wages can be double-edged. They are associated with an increase in youth employment, compared with countries that apply a uniform minimum wage to all age groups (Marimpi and Koning, 2018). But at the same time they have a negative effect on income and contribution-based social security.

Generally speaking, as called for under EU employment guidelines, 'youth unemployment and the issue of young people NEET should continue to be addressed through prevention of early leaving from education and training and structural improvement of the school-to-work transition, including through the full implementation of the reinforced Youth Guarantee, which should also support quality youth employment opportunities'.

Access to social protection and housing

Work is crucial to young people's social security, especially in a welfare state that relies on contribution-based social protection. In general, most obstacles in the EU to young people accessing social protection are not specifically to do with age (Ghailani *et al*., 2021), but to non-standard jobs, and low wages, which hinder young people's access to contribution-based social security systems. Even if access is granted, contributory history requirements put young people at a disadvantage. Access by trainees (including apprentices) to social protection is denied or limited in several Member States (European Commission, 2020d; Spasova *et al*., 2021). This clearly shows that some mature welfare systems are not equipped to respond to the challenges of seamlessly integrating education and labour market systems. For future pension adequacy, as well, it is important that young people are able to build up earnings-related pension rights based on all their earnings from employment. Pension reforms have made public pensions less generous for future retirees in many Member States; at the same time, today's young people find it harder than previous generations to build up pension rights, because of the spread of non-standard work and other career uncertainties.

Besides immediate social protection rights, the position of young people in the labour market also has long-term effects on some other important aspects of welfare, such as housing autonomy. Today, 42% of those aged 25-29 in the EU live with their parents; and in southern and south-eastern Member States the figure is 60-80% (Ghailani *et al.*, 2021).

In most Member States, family allowances end at the age of 18 or 20. However, young adults (especially those aged 18-24) very often continue studying after this, and they may also be taxed as part of their family up to a certain age. In some cases, they may receive a scholarship depending on family income. They may also receive a housing allowance if they leave their parents' home. Some may have part-time and low-wage work, but most are not economically active and are supported financially by their families. Adequate support measures are particularly important to enable young adults from low-income (or lower middle-income) families to pursue higher education under good conditions. When designing their policy responses, Member States may choose between universal grants to all students, or grants that are means-tested on the basis of parental incomes.

Policy options to improve social protection for early and family life

Some conclusions can be drawn from the above discussion. First, the principles of equality and solidarity under the EU social model justify family policies. Second, the evidence indicates that pro-active family policies (typically investing in childcare services) boost total employment – and, by implication, can improve the financial sustainability of the welfare state. This association is strong in relation to female employment. Third, it is also abundantly clear that satisfactory old-age pensions rely heavily on pro-active welfare services in early family life and around young people's transition to adult independence. Although there are trade-offs in some cases (such as the choice between targeted or universal benefits), there are solutions allowing those trade-offs to be minimised. EU countries must at the same time protect children from poverty, provide families with children with a satisfactory standard of living, and develop universal services for young people and all families.

It is important that promoting gender equality should not be restricted to increasing the proportion of mothers in paid work, but should also include a more equal sharing of caring between parents.

There should be a greater emphasis on early-years support that goes beyond creches and kindergartens, such as social services for families, and extra-curricular school activities, though the welfare state is already becoming more service-oriented, especially in the first stage of the life-course. However, it is crucial for future policies to focus on the design, management and quality of service delivered. For example, it is important to provide high-quality childcare places, and to encourage parents to enrol their children in early childhood education and care services, especially parents in rural areas and from disadvantaged backgrounds.

2.3 Working lives

Introduction

Promoting employment and the inclusion of potentially employable people is crucial for both social protection and overall economic development – which in turn affects the financial sustainability of social protection. In the past, the most successful welfare systems have been those that were best at combining a low degree of market inequality with sustainable growth and high levels of social protection. The world of work has changed: but the objective of making the market economy and social protection reinforce each other remains the goal. Social protection systems, in responding to the risks entailed by the megatrends described in Chapter 1, should ensure an adequate buffer against the social risk of income inadequacy ('protection') and, at the same time, include measures to raise the potential amount of decently paid and properly insured work ('activation').

In order to harmonise both goals – protection and activation – three main institutional pillars should be taken into account: (a) the labour market framework, with the objectives of improving access to employment and ensuring wage-setting that supports decent pay and reduces income inequalities; (b) social protection – including both income smoothing/replacement and combating poverty – designed to offer adequate protection and to support work; and (c) social investment measures, to boost labour force skills and to support life-course transitions.

The protection role of the labour market framework

Collective bargaining, wage-setting and minimum wages

Collective bargaining plays a key role in achieving adequate minimum wage protection across the EU (European Commission, 2022c), as well as in ensuring a fair distribution of productivity gains. In so doing, it can help to maintain labour's share of national income, and reduces wage inequality and in-work poverty.

The coverage of collective bargaining has been shrinking in many Member States over the last two decades, which might be explained by decentralisation and a reduction in multi-employer bargaining at sectoral or national level, as a result of regulatory changes and changes in other factors, such as the density of employer organisations and trade union membership (European Commission, 2022c). In many cases, moreover, collective bargaining has lost the ability to protect and reward work adequately. Policy options to increase social dialogue may therefore include involving the social partners in policy-making, workers' participation, and employee ownership (while acknowledging the danger of employees taking on commercial risks). These could be supported by the EU Directive on adequate minimum wages.

Employment protection in times of crisis

A central task is to allow the flexibility needed in today's economy, while strengthening the position of the most vulnerable workers. It has been argued that a weakening of employment protections in some Member States is a way of raising employment, increasing productivity, and stopping firms migrating to less regulated countries. But the empirical evidence for this is not clear-cut and there are examples pointing to the possibility of workers being adequately protected without this reducing employment, impairing productivity, or weakening incentives to work (see the OECD database on employment protection legislation: OECD, 2020, Chapter 3).

As set out in the previous chapter, there is a growing need for policies to deal with the new challenges in the world of work, and to support the green and digital transitions. As an illustration, the policy packages that, according to the Commission Recommendation of March 2021 on effective active support to employment following the COVID-19 crisis, could be put in place by Member States include: (a) hiring and transition incentives to promote the creation of high-quality jobs, and support the employability of workers; (b) their upskilling and reskilling; and (c) providing enhanced support from employment services. There is also a need to enforce regulations on health and safety at work, as well as strengthening company prevention systems. Other policies to ease the impact of the current megatrends include promoting worker participation, introducing incentives for stable employment and disincentives for non-standard contracts, and using collective bargaining to implement vocational training, so as to protect those at risk of being excluded from employment as a result of the digital and green transitions (European Commission, 2021h).

As in wage-setting, social dialogue is crucial. During the COVID-19 crisis, the majority of policy measures enacted in 2021 in respect of business continuity, job protection and retention, the adaptation of workplaces, and income protection were agreed by, or negotiated with, social partners (Eurofound (2021), *COVID-19 EU PolicyWatch* database.

Gender equality in labour market

The gender pay gap remains wide, despite slight improvements. This is particularly worrying given the growing proportion of single-person households and single-parent (mostly women) families. Even though more women hold tertiary education degrees than men, the EU-wide unadjusted pay gap has changed only slightly over the years (For more details, see *Eurostat website.*) Narrow gender pay gaps are sometimes associated with wide gender employment gaps (such as in Italy, Romania, Poland or Spain). In such cases, narrow pay gaps may largely be the result of 'selection effects' – where women with the highest earnings potential are more likely than others to be in work, skewing the calculation (Boll and Lagemann, 2018).

There are several policy options to address these challenges and promote gender equality in the workplace. These include some that have already been launched at EU and Member State levels. They are: (a) a set of measures to ensure pay transparency – see those in the proposal for a Directive on this (European Commission, 2021i); (b) measures on access to justice; (c) the involvement of social partners in pay assessment; (d) economic incentives for business to facilitate mothers returning to work after childbirth – for example, the increased funding for childcare facilities included in Italy's recovery and resilience plan (Italian Ministry of Economy and Finance, 2021); (e) scholarship programmes to fund education, training, and upskilling for women, to make it easier for them to enter (or return to) the workforce; and (f) better policies on work-life balance, such as flexible working arrangements and family-related leave, and longer minimum periods of paternity leave under the Directive on work-life balance (European Parliament and Council of the European Union, 2019).

Access to social protection

Unemployment benefits and other income-replacement measures

As pointed out in Chapter 1, almost 40% of employment in the EU population consists of workers in non-standard jobs (such as those working part time and/or on temporary contracts) and self-employment. Unlike previous generations, people are also increasingly likely to have many different jobs and employers over their lives.

This brings new challenges in terms of protecting people against unemployment, as well as for other income-replacement schemes – above all, sickness and disability insurance schemes. This is irrespective of the substantial progress that has been made in the most recent years (and especially during the COVID-19 crisis) in extending, most often on a temporary basis, protection to non-standard workers and the self-employed (European Commission, 2022c). While recognising once again the large variation between Member States, workers in non-standard jobs, as well as the self-employed, still experience poorer levels of protection, in terms of formal, effective and adequate coverage, transparency and portability.

Several possible approaches to tackle these challenges can be identified. One is to rely on a combination of a common floor and a contribution-related benefit, as in Sweden, Norway and Finland. Workers meeting an employment condition (whether employed or self-employed) would be entitled to a basic non-contributory unemployment benefit. In addition, they might be enrolled in an employment insurance fund. For countries where the supplementary coverage would be limited, topping-up might also be made compulsory.

Alternatively, Member States could expand the coverage of existing social insurance schemes, extending protection to categories that are currently excluded or underprotected. For workers in non-standard jobs, one possibility would be to modify qualifying conditions in order to strengthen access or benefit adequacy. For the self-employed, the possibilities include organising them into a legal entity (as in Portugal) or integrating them into already existing schemes (as in Croatia, Czechia, Malta, Luxembourg, Poland and Slovenia), though different qualifying conditions may be necessary in this case (as introduced in Ireland).

Yet another possibility is to introduce new insurance schemes aimed specifically at workers in non-standard jobs and the self-employed, as in Denmark or Spain. The Danish scheme has an additional interesting feature, in that it defines access on the basis of the activities undertaken rather than by type of worker. Moreover, eligibility rules are based on total (work-related) income, which needs to be above a given level over a three-year period (Schoukens, 2022).

For dependent self-employed people, some Member States have also introduced special ‘hybrid’ types of status for social security purposes. In parallel, there is a widespread push to recognise some dependent self-employed people as employees, either through case law or legislation at national and EU level, for example the proposed Platform Work Directive (European Commission, 2021a). While EU regulations can help, the final choice is mostly up to Member States. But there is a wide range of options available.

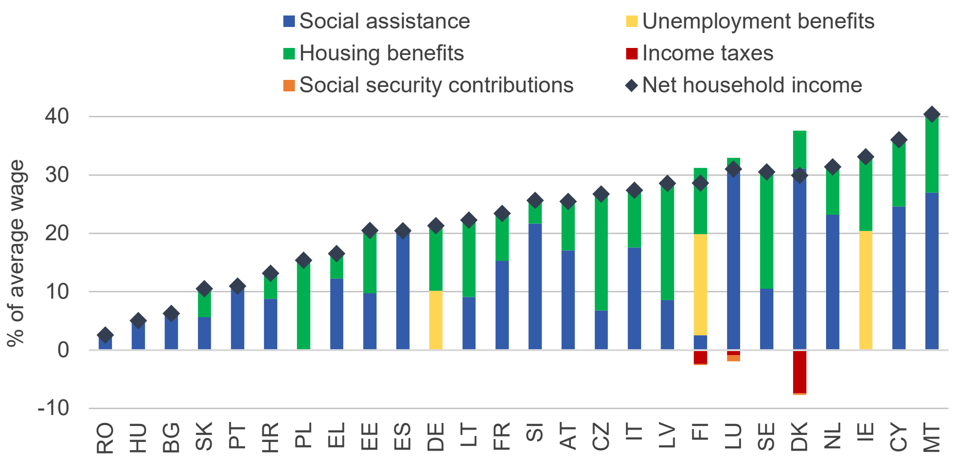
Minimum income and other social assistance benefits

All Member States have a safety net in their wider social protection systems. These schemes vary significantly in terms of the adequacy and coverage of benefits, as well as in the way they are combined with activation measures and social services (Coady *et al.*, 2021; Natili, 2020; Frazer and Marlier, 2016). In many Member States, minimum income appears too low to sustain adequate living standards. Figure 10 shows the level of net income from various social benefits for a single person who is long-term unemployed as a percentage of the national average wage. It shows huge variations between EU Member States, from less than 5% to around 40%. The structure of minimum benefits varies too. In Germany, Finland and Ireland, the minimum income scheme includes a means-tested unemployment assistance benefit, which is topped up by social assistance. In many Member States, housing benefits are available in addition to minimum income schemes. In some there is no access to social assistance for a single person who is long-term unemployed.

The adequacy of social safety nets also differs between Member States in terms of how they relate to national poverty thresholds. In 2019, minimum income benefits amounted to less than half the at-risk-of-poverty threshold in a third of Member States. A similar diversity is evident in the impact of social transfers on reducing poverty, which varies between 16% and 52% across Member States (European Commission, 2022c), though this indicator covers other benefits than minimum income.

Minimum income schemes also differ in terms of the financial incentives they provide for people to seek low-paid or part-time jobs. In many Member States, all minimum income benefits are tapered away as earnings from work are received.

Figure 10: ***Net income in Member States among single-person households in long-term unemployment (and its components), as% of national average wage (for a single adult, unemployed for 24 months or more, rented housing)***



Source: OECD tax-benefit web calculator 2022. Note: Categories of benefits that equal to zero are not displayed in the chart; these are: Gross in-work earnings, In-work benefits, Family benefits. No data for Belgium.

Apart from the usual challenges relating to minimum income, such as coverage, take-up, and the link with labour market participation, there are a number of others. These include: (a) supporting decent living conditions, and minimising the impact of growing risks such as energy poverty and regressive environmental taxes; (b) housing costs; (c) dealing with poverty among young people still living at home; and (d) combining decent out-of-work income for those in poverty with a decent wage for those in work, given the levels of low pay and in-work poverty documented in Chapter 1. To prevent vulnerable workers becoming trapped in cycles of poverty and low pay, the level of unemployment benefits needs to be co-ordinated with that of minimum income – to ensure a decent income while not discouraging work.

The Commission has made a proposal for a Council Recommendation on adequate minimum income to modernise the current EU policy framework on minimum income benefits and to ensure that they encourage active inclusion (European Commission, 2022e). The Council of the EU reached a political agreement on the proposals at the end of 2022 (Council of the EU, 2022b). In this context, it is worth taking into account the experience of Denmark and the Netherlands, which have combined rights-based, high-level minimum income benefits with support and incentives to work. In France, the minimum income is topped up by an income supplement (*prime d'activité*) to ensure that work always pays.

Tax and cash benefit policies for households in paid work ('in-work benefits') might also deserve a fresh look. Most Member States already provide in-work benefit schemes, but in different ways – in-work cash transfers, adjusted unemployment benefits and earned income tax credits. These measures are often associated with the goals of reducing in-work poverty and unemployment, as they 'make work pay' by topping up earnings that are inadequate.

Exploring new avenues to adapt social protection instruments during working age

Labour market trends (on the one side) and increased uncertainty linked to the new megatrends (on the other) risk undermining the income-support measures described above. In a quickly changing labour market with new skills requirements, workers can exhaust their unemployment benefits before they are able to find a suitable new job. If there were only minimum income support as a safety net of last resort, people would have to exhaust most of their savings and other resources before receiving help. Similarly, workers may lack the means to cope with unexpected events, even if they receive in-work benefits. For example, during the COVID-19 pandemic it was found that almost 50% of people on low incomes (those in the bottom 40% of the income distribution) lacked emergency savings, having less than the equivalent of three weeks' household income in liquid wealth; and 10% of them were already in debt (OECD, 2021c). The COVID-19 crisis has spurred all Member States and the EU to devise new measures to tackle the gaps in income protection schemes. But many of these measures are short lived, and new permanent measures are needed.

Social investment measures during working life

Active labour market policies

Active labour market policies include activation measures for the unemployed and other target groups, such as: training; job-rotation and job-sharing; employment incentives; supported employment and rehabilitation; direct job-creation; and start-up incentives. Although Member States have adapted their training policies by changing delivery models and increasing the number of places available, many adult learning systems still fail to match training investment with labour market needs (OECD, 2019).

The primary challenge for active labour market policies – in times of multiple structural changes – is to reallocate workers from sectors with a high risk of job losses to those where skilled labour is increasingly in demand. Persistent job losses in some sectors (such as hospitality, travel and tourism) and job-creation in others (technology, care services, and green activities) may leave an excess of people with some skills and a shortage in others. Reducing regional imbalances in the demand for jobs and skills may require policies to improve geographical labour mobility.

A second goal is to prevent long-term unemployment, which tends to be a good proxy for the effectiveness of active labour market policies in reaching the people in need and effectively matching them to jobs (European Commission, 2022c).

A third goal is to put in place measures targeted at women and disadvantaged groups of job-seekers, including NEETs, people with disabilities, and migrants. These measures should strengthen skills and support their labour market inclusion.

In addition, regulatory measures are needed to help disadvantaged people find work. As an example, the adoption of remote working or teleworking could be encouraged, which would particularly help people with reduced mobility or those undergoing medical treatment that makes it hard for them to work in the normal workplace.

Finally, it might be useful to take a fresh look at 'flexicurity' – the idea of an integrated strategy to overcome the tensions between (on the one hand) labour market flexibility and (on the other) employment and income security. This drew its inspiration from Danish and Dutch practices of combining labour market flexibility and security. The Commission promoted flexicurity as a 'flagship' policy in the mid-2000s: but since then the concept has rather faded from sight and there is little information on the extent to which flexicurity policies have actually been adopted in the EU.

Skills and training

As the OECD argued in a recent report: 'countries should be trying to find the right balance between a "train-first"- and a "work-first"-strategy' (OECD, 2021d). Investment in training tends to be initially more expensive than helping people to find jobs. High-quality training programmes take time to be established. The effectiveness of training measures should therefore always be evaluated, including their longer-term impact.

The COVID-19 crisis has highlighted the fact that online learning is set to be an essential part of adult learning systems in the future. 'Social distancing' has accelerated the development of digitalisation and highlighted the need for Member States to invest in digital-based training, which many have already started to do. Enabling job-seekers to train online allows greater immediate participation. Online training also allows more efficient provision of training, since the content is easier to adjust and to adapt to user timescales and needs. During the COVID-19 pandemic there was a growth of free online platforms targeting job-seekers (OECD, 2021d). To ensure these new opportunities are shared as widely as possible, job-seekers first need to be enabled to participate in online training. It will be important to help them to acquire basic digital skills and then to ensure that they have equal access to digital tools.

Green jobs offer significant opportunities for job-creation as the EU moves towards climate neutrality: but labour and skills shortages represent a barrier. The green transition is expected to create new jobs at all skills levels, notably for occupations which usually require vocational education and training (Cedefop, 2022). In the energy sector, the transition is expected to continue generating demand for low- and medium-skilled roles, with 75% of employees being forecast to be manual workers and technicians in 2050 (Murauskaite-Bull ***et al***., 2021). At the same time, there is already a shortage of skilled workers in many of these medium-skilled occupations, which are needed for the green transition today. It is therefore important to increase the attractiveness of vocational education and training more broadly as part of a career pathway, and also to invest in ensuring more workers take up reskilling and upskilling opportunities.

Short-time work schemes

Short-time work schemes can play a useful role in times of external shocks, such as the COVID-19 pandemic or Russia's war of aggression against Ukraine, which can affect particular sectors differentially. In this way, they can facilitate and support restructuring processes. Income protection beyond short-time work has proved to be a targeted, timely and temporary means of securing employment in the crisis (European Commission, 2022c, 13).

Having a concerted package of policies that boosts re-employment, alongside measures supporting job-retention, is important so that unemployed and displaced people are not left behind. Acting early during the COVID-19 crisis allowed Member States to limit the immediate risks to employment, enabling them to focus their support on vulnerable groups who had been adversely affected, but who were not covered by the initial support measures. As economies emerge from the pandemic, the balance of this financial support will need to be reviewed in relation to active labour market policies that reskill individuals as the focus moves towards reintegrating displaced workers (OECD, 2021b).

In 2020, many Member States used short-time work or job-retention schemes more widely. Lessons can be drawn as to why and how some schemes were better conceived than others, in terms of: (a) avoiding 'deadweight' or displacement effects; (b) being a more permanent, rather than a one-off feature; or (c) being funded in a sustainable way, rather than relying on tax transfers. Another dimension is the extent to which job-retention measures can be accessed by people on all types of contract.

In any case, short-time working schemes should remain part of the policy toolbox once the crises have passed. They should then be refocused on helping to modernise the economy (via associated skills development measures, for instance) without delaying structural adjustments.

Employee ownership, and ESG (Environmental, Social, and Governance) frameworks

In an economy where digital start-ups play a larger role, the need for alternative forms of worker participation is increasing – for example, employee option programmes. These programmes, which allow workers to participate in the ownership of their company or have shares in it, have attracted growing attention, with their potential to improve outcomes for companies, workers, and the economy in general, and to help reduce inequality. '*Studies across many countries indicate that employee ownership is generally linked to better productivity, pay, job stability, and firm survival, though the effects are dispersed, and causation is difficult to firmly establish*' (Kruse, 2016). Worker co-monitoring and reciprocity could help to overcome the problem of 'free riding', where individual workers take the benefits of ownership without making an equivalent contribution to performance. Financial risks could generally be minimised by higher pay and job stability among employee owners. Improving the legal and tax conditions for employee-owned companies could help to attract outside finance and highly qualified staff and to increase investment in the post-crisis phase. But so far the spread of employee ownership is limited, especially in the form of employee shares and profit participation certificates. In the final analysis, it has to be accepted that the risks to jobs and incomes are interrelated under employee ownership.

The Environmental, Social and Governance (ESG) framework can further encourage companies to pursue responsible policies in these respects and require them to explain to their stakeholders how they manage environmental and social risks and opportunities. All stakeholders – customers, suppliers, and employees as well as investors – are increasingly aware of, and interested in, how environmentally and socially sustainable an organisation's operations are.

2.4 Transition to retirement and old age

This section focuses on the transition to retirement, maintaining the adequacy of pensions, and ensuring access to high-quality and affordable healthcare and long-term care, particularly in the 'fourth age' (from 80 onwards).

In response to the increases in life expectancy described in Chapter 1, most Member States have raised their statutory pension age. The current average is around 65, an age at which average life expectancy is 84, implying nearly 20 years of retirement. At the same time, large differences in pension ages remain between Member States – and in some cases, between men and women – which do not always reflect life expectancy. Attention should also be paid to socio-economic inequalities in life expectancy and in years of healthy life, those with lower incomes, long and demanding careers, or hazardous jobs tending to have a shorter life expectancy and to spend less of their retirement in good health.

When looking at the challenges raised by demographic trends, and how policies should respond, there are important social risks to be considered in a life-course perspective:

- the increasing risk of unemployment or incapacity before people reach the statutory retirement age, in particular for those who have health issues or have had long or arduous working careers;
- the risk of income insecurity in old age, which undermines the social right to retire at a statutory retirement age – and hence the importance of having pensions that reduce the risk of poverty and maintain the living standards acquired during working lives;
- the increased risk of needing healthcare and long-term care because off frailness and illness such as dementia.

Relevance of the labour market framework to support social protection in old age

From a life-course perspective, a person's situation in old age is largely shaped by earlier events – their education and training, employment, earnings and lifestyles. Sustained employment is crucial to allow people to build up public (and private) pension entitlements. How long people go on working before they retire will depend partly on pension rules, but also on employment opportunities before and after statutory retirement age. Transition into retirement, employment in old age, and pension income all, therefore, depend on past and current labour market experience.

Assessing the impact of various policy options

Pensions are shaped by people's employment histories – how long they worked and how much they were paid – which weigh heavily in pension calculations. Spells of unemployment, perhaps during economic crises, and age-related employer policies can also affect pensions and the transition into retirement.

Two different kinds of change that can affect pensions and retirement can be distinguished:

a. those that are direct and immediate, with prolonged effects, which result from pension reform – for example, a rise in the retirement age or the introduction of partial pension pay-outs that have repercussions for people's employment and incomes in old age, the extent depending on the length of time between the adoption of the reform, its roll out, and how society responds to it;

b. those that have indirect and delayed effects – for example, an increase in flexible employment contracts that do not allow people to build up pension entitlement and potentially lead to poverty in old age; or the growth of non-standard employment that may lead to vulnerable groups not being covered.

In order to combat or prevent later problems during old age, policies need to stimulate job opportunities for all, promote investment in upskilling through lifelong learning, allow people to earn a decent living, and provide access to adequate social protection.

A person's specific labour market situation and the type of employment contract they have are important in respect of their pension entitlement. Labour law or pension scheme rules may bar access to people who do not earn enough or work enough hours, or they may exclude people on some forms of non-standard employment contract or who are self-employed. In the current labour market situation, it is essential that mechanisms exist which ensure a satisfactory level of pensions for those who have had difficult careers. Broad coverage of pension systems is important not only for reasons of adequacy, but also to avoid adverse incentives created by excluding some economic activities from pension coverage.

The gender pensions gap in old age results from gender-related differences in employment histories – women have shorter careers than men, as well as more career breaks, and are more likely to work part time because of caring responsibilities – on top of the gender pay gap itself. This pension gap is usually wider than income gaps observed during women's working lives. All contributory pension schemes tend to reproduce, if not amplify, gender pay gaps and employment differences. Narrowing the pension gap for women will require family policy and labour market measures (see previous sections), in addition to compensatory pension measures, such as credits for caring or child bonuses.

Overcoming early retirement while mitigating unemployment and disability risks

Labour-shedding by means of early retirement was put forward as a socially acceptable strategy in the context of industrial restructuring, particularly in the last quarter of the 20th century. Early-retirement pathways included bridging pensions, unemployment schemes for older workers, and pre-retirement schemes, which made it possible for people to leave the workforce prematurely, despite increasing life expectancy.

In the last decade, many Member States have taken steps to close early-retirement pathways and tightened eligibility conditions, while also raising the pensionable age. As a result, more and more people may struggle to continue working up to the pension age (European Commission, 2018 and 2021j). Instead of widespread early retirement, a more nuanced approach is therefore needed as workers approach old age. This could involve: better and more flexible working arrangements; sheltered jobs; supportive (re)integration measures by employers; differential retirement ages linked to when people started working or how arduous their jobs were; and more targeted but adequate disability pensions to prevent and address employment and health issues in later careers. Reduced working time, for example, may help people to have longer careers in healthy conditions. It is necessary to evaluate the effects of bridging schemes, early-retirement schemes and partial pensions schemes in terms of how they affect 'active ageing' strategies and pension policy goals, and how they affect the people concerned. It is also important to monitor the risk of people acquiring a long-term inability to work. Because the risk tends to increase as people approach retirement age, preventive measures need to be put in place to avoid people withdrawing from the workforce prematurely.

Lifelong learning and flexible transitions to retirement

Education and lifelong learning can also help to promote active ageing, healthy lifestyles, and planning for retirement. Employers and worker representatives need to ensure human resource management is sensitive to age issues and supports older workers, not least given the prospect of longer working lives. In particular, digital skills are gaining importance and need to be promoted among those approaching retirement.

The transition between employment and retirement will evolve further as statutory retirement ages rise, and as options to combine pension with work become more flexible. Flexible transitions such as gradual retirement could allow people to work longer as their workload is gradually reduced. Increasingly there is also a trend towards 'working pensioners' in voluntary part-time employment, helping those who need extra earnings because of their pensions being insufficient. Working beyond statutory pension age should be possible on a voluntary basis: people should neither be forced to do so by inadequate pensions, nor encouraged by social security exemptions.

'Classical' social protection and long-term care for older people

Adequate pensions in old age

The main function of the pension system is to provide adequate income in old age after retirement for a reasonable period of time, minimising the risk of poverty, and safeguarding the living standards achieved during working life. The challenges to pension systems are multiple. All forms of pensions – whether public or private, pay-as-you-go or funded – involve the sharing of risks. These risks include, but are not limited to, demographic, political and economic risks, and people's limited awareness of their pension situation.

Member States have different pensions systems, with a public 'pillar' often accompanied by supplementary (occupational and personal) pillars. Recent developments, both in terms of the pension system architecture and within individual pillars, imply a shifting of risks on to (future) pensioners themselves (European Commission, 2019b). The more pension systems rely on fragmented schemes and supplementary pillars, the greater the need to co-ordinate policies and evaluate their outcomes. In addition, pension policies should be co-ordinated with long-term care benefits and services and healthcare needs.

The public pillar usually ensures minimum income protection. Transfer payments to prevent poverty in old age can be achieved through universal basic pensions, contributory minimum pensions, and/or means-tested minimum income schemes. To enable people to meet their needs in old age, the design of such benefits should take account of poverty levels, purchasing power, and rising living standards.

The role of pensions in maintaining living standards in retirement (the 'income-replacement function') can be provided through social insurance, but also through mandatory (as in Denmark and the Netherlands) or voluntary occupational schemes, most of them on a funded basis. These schemes are usually linked to employment status, and are dependent on contributions by employers and/or employees. In addition, voluntary savings plans can top up retirement income. Public pay-as-you-go schemes remain by far the most important source of old-age income in Member States (as indicated in Section 4.1, and in Figure 4.3 of Pacolet *et al.*, 2021).

Meeting increasing pension needs remains a key responsibility of the welfare state in the context of an ageing population. In view of the ways in which pensions systems have already adjusted to population ageing (see Chapter 1), maintaining current standards of living in old age would require extending working lives even more, increasing contribution rates, increasing the rate of saving, and/or implementing measures to ensure access to affordable services in retirement.

Increased need for long-term care

Population ageing reinforces the need for long-term care for older people because of increasing life expectancy and a growing proportion of people reaching advanced old age. Traditionally, long-term care has been provided mostly on an informal basis by unpaid carers (usually family members, especially women over 50). An increasing number of Member States, though still not all, provide leave and/or pension credits for periods of caring.

Social protection for long-term care has been developed in many Member States over recent decades, either in the form of social insurance (separate from, or integrated with, health insurance) or means-tested essential care. It includes a wide variety of in-kind benefits (residential, semi-residential and home-based care) and cash benefits (care vouchers, cost compensation and payments to carers). Care may be provided by public services or private (non-profit or for-profit) organisations.

The present state of development of long-term care differs significantly between Member States. The same is true for the mix of provision, and its availability, affordability and financing. Without any change in present levels of provision, population ageing alone implies a rise in long-term care spending in the EU from 1.7% of GDP in 2019 to 2.5% in 2050 (European Commission, 2021c). If further improvements in provision are to be achieved, along with an upward convergence of provision across the EU, there would have to be an even bigger increase in long-term care spending. This could be offset partly through the taxes from the jobs created in the sector, and also, where possible, reducing healthcare costs.

Long-term care can be very costly, even unaffordable, particularly if the level of need is high. As the Commission has noted: '*While people may be able to pay for care, it is often that they cannot afford care without going below a certain level of income. This remaining income is needed to cover all other normal expenses of life, like housing, food, clothing, transport, etc*.' (European Commission, 2022n). If the out-of-pocket costs of care lead to a greater risk of poverty among beneficiaries, protection cannot be considered to be adequate. This confirms the importance of social protection for long-term care, with society as a whole assuming the costs through contributory and/or tax-financed public provision.

The early days of the COVID-19 crisis were a stress test of the resilience of long-term care systems, exposing vulnerabilities linked to such overarching issues as lack of staff, underfunding, poor quality of care, limited concern for the quality of life of care recipients and their restricted autonomy, and lack of co-ordination with healthcare.

In September 2022, the European Commission presented the European Care Strategy. The strategy is intended to ensure high-quality, affordable and accessible care services across the EU, and to improve the situation for both care recipients and those providing care, professionally or informally (European Commission, 2022g). The strategy proposes a Council Recommendation on access to affordable high-quality long-term care, which calls for increased provision and mix of professional long-term care services, establishment of quality criteria and standards for providers, support for informal carers, and mobilisation of adequate and sustainable financing (European Commission, 2022f).

Healthcare and public health policies

Population ageing is driving an increase in healthcare costs (see Section 1.2), and underlines the need for an adequate healthcare policy. This includes preventive measures focusing, first of all, on promoting healthy lifestyles – access to fresh food, exercise, and social engagement – as well as early diagnosis of potential health problems (including cardiac problems, diabetes and dementia).

With the increasing proportion of old and very old people in the population, a supply of adequately trained medical staff will be needed. One of the challenges is to ensure there are enough qualified doctors and nurses with specialist skills in geriatrics. Healthcare (and long-term) care can also draw upon modern technologies to support healthy lifestyles among older people – such as remote care, telehealth, and the use of AI technologies. The COVID-19 pandemic has highlighted the need for better co-ordination of healthcare services, rehabilitation facilities, and long-term providers of care for older people transiting between institutions.

Social investment and preventive welfare strategies

Population ageing makes it necessary to develop a new social investment strategy that includes: (a) preventive measures to limit the number of people with inadequate retirement incomes; (b) policies for active ageing and healthy living; (c) providing safe homes and living environments that meet the needs of older people; and (d) better planning for retirement – for example, through savings for old age, and the take-up of skills that allow people to continue participating in economic life as well as maintaining their civic engagement.

Financial education and retirement planning

While there have been improvements in financial literacy in relation to pensions, it is important not to overestimate the impact of information, or financial and pension education, on the real-life behaviour of pension savers. As the High-Level Group on Pensions observed, the complexity of pensions presents an inherent communications challenge (European Commission, 2019b). The wide gap between self-perceived and actual pension awareness can limit people's ability to take corrective action. Retirement saving may in practice diverge substantially from theoretical models, which assume people plan for their retirement on an objective, rational and long-term basis. Another inherent challenge is how to raise pension awareness of young people early in their careers.

Housing, living environments and transport in old age

Old age poses challenges that also require living environments to be adapted. For example, if a retired couple live in a family home that is too large for them to maintain after their children have left, or if a widow or widower is living alone, they may need to move to housing that is better adapted for old age or to a retirement home.

Moreover, housing situations may differ between older people and between Member States. Some people live in mortgage-free houses that need renovation, whereas others have to continue paying off a mortgage during retirement. A third group may live in rented apartments, in either the private or social housing sector. Some older people give up their own homes and move to retirement homes or communities for convenience when still relatively healthy, whereas others are moved to long-term care facilities due to illness or frailty if they cannot be cared for at home.

There are economic concerns relating to housing and maintenance costs, but also issues of how to adapt housing and living situations in old age, particularly in the fourth age. Public policy should stimulate the modernisation of homes to make them age-friendly by adapting them to older people's needs, in addition to the investment needed for energy and environmental reasons. This investment is especially needed in this case, because older people often live in older houses, and the poorest of them live in the least well adapted housing.

Older people's housing situations are relevant when considering their retirement income, because of the costs of energy, maintenance, and necessary adaptations. To prevent poverty in old age, some Member States include housing benefits in their pensions policies, or devise housing policies that reflect people's needs in old age. The classic example is a subsidy for rented housing for people on low pensions. In other pension systems, housing costs are covered by means-tested social assistance programmes, often not particularly tailored to the situation of older people.

Different forms of (informal) co-housing arrangements already exist across the EU. These are often family-based, such as when older parents move into their adult children's homes – so leading to multigenerational households – though there are also community-based multigeneration living arrangements that provide inspiration for the future. Given the more restricted mobility of older people, urban and public transport planning also needs to accommodate their needs.

Urban planning is another element of housing policy that is important in the light of population and climate developments, ensuring accessibility via low-cost public transport to the most important nearby services – in line with the ideas behind the '15-minute city' project.[1] Urban and regional planning also requires adaptations to meet the need of the increasing proportion of very old people, including those living in rural areas, to access services.

2.5 Conclusion: policy responses to megatrends throughout the life-course

Ongoing population changes in the EU are already having a profound impact on the design of the welfare state. This is especially evident in the case of policies for old age. Member States have already begun adjusting retirement ages and pension systems in response to population ageing and increasing dependency rates, while trying to address challenges relating to the transition to retirement and pension adequacy. They are also beginning to prepare for the growing demand for long-term care and healthcare services. The possibility of people working longer is also contingent on timely investment in education and skills, in childhood and during working lives. Changing family structures and gender roles are reflected in the policy debate surrounding the issues concerned, as policy-makers face the choice between individualised and fam-

1| For details see the project website, *www.15minutecity.com*.

ily-based entitlement and between universal and targeted measures. Equal sharing of care and work responsibilities remains central to these issues, as does addressing the persistent gender pay gap.

The changing world of work implies the need for social protection systems to adapt to people being in different forms of employment and self-employment throughout the life-course, from ensuring access to family benefits and childcare, to ensuring that all types of work are effectively covered by income support during joblessness and count towards pension rights. This is all the more important for young people, who face adverse job prospects and obstacles to accessing social protection. Maintaining a strong role for social dialogue in the making of employment policies is a challenge. Labour market trends, including rapidly changing skill requirements, together with the rise of uncertainty linked to new megatrends, are forcing policy-makers to find ways of ensuring that income-support measures (such as unemployment benefits) are adequate, and of combining minimum income support with activation measures.

Technological change and digitalisation are increasingly affecting the skills landscape. These developments have enormous potential: but they may also worsen inequalities linked to skill gaps, unless these are effectively mitigated by education, training and lifelong learning measures. Digitalisation opens up new ways of administering and delivering social services, such as remote care, chatbots, AI and blockchain technology. These can play an important role in supporting healthy lifestyles and providing the care people need in old age. But attention must be paid to social inclusiveness; those lacking digital literacy and/or equipment should not be left behind.

Climate change and the green transition are already affecting labour markets: but they have so far not triggered a comprehensive social policy response. Although everyone is affected by climate change, the new challenges are inextricably linked to already existing inequalities, which risk being made worse by the climate crisis. Energy poverty was a growing social issue in the EU even before the crisis unleashed by Russia's war of aggression against Ukraine; it is a multidimensional problem that requires a comprehensive response, involving economic, social and ecological policies.

The welfare state currently only addresses parts of the climate challenge and in a fragmented way – for example, by means of health insurance, unemployment insurance, and social assistance. Climate change reinforces these risks to some extent, but increasingly constitutes a separate collective risk. According to some authors, the social investment approach can be expanded to include the ecological dimension of well-being and welfare (Hvinden ***et al***., 2022). The most important task is to identify the social groups and areas that are the most vulnerable to the eco-social transition, and how measures might target them effectively.

The current wave of inflation, with its grave social implications, calls for a strong and co-ordinated policy response in the short term. One possibility is emergency measures aimed at offsetting some of the immediate consequences of price increases – such as reduced VAT rates or excise duties on energy, or price caps. Action on energy prices is also likely to remain important in the medium term. But an important challenge for social policy is to strengthen the capacity of fiscal policy to redistribute resources, and to ensure that social protection systems are effective. This primarily requires targeted income policies that help channel public resources towards the most vulnerable groups, and ensure that essential goods and services are readily available to all. To this end, some guidance at EU level was proposed in September 2022 to help Member States better assess the distributional impact of their policies (European Commission, 2022h).

The current times pose new challenges to the governance of welfare policies. Policies are becoming more complex and mutually dependent; and governance must respond in a more agile and timely way to the different crises and problems that are emerging.

3. Financing the welfare state

Solving issues of long-term financing is vital to the future of the welfare state. Tackling megatrends (described in Chapter 1) and ensuring social protection while building people's capabilities (Chapter 2) require adequate, fair, and sustainable financing. Precisely how much will be needed to finance social protection over the coming decades will vary between Member States, but will certainly be higher due to population ageing, the challenges of the green transition and digitalisation, as well as yet unknown future economic and other crises. Welfare systems in some Member States still face the need to expand social protection to catch up with EU standards, whereas others have already achieved a comprehensive level that only requires adaptation. Similarly, financing structures vary. No specific 'one size fits all' measure is available. Yet many common considerations can be identified.

This chapter reviews the current financing structure of the welfare states in the EU, the major constraints they are facing, and possible further sources of revenue. It also considers the social and economic impact of different tax mixes – such as the generally high reliance on social contributions, which drive up non-wage labour costs. The tax system can have an important redistributive effect, thus achieving at least partially social protection goals through smart tax systems, while being either more or less progressive. Before tackling these issues, it is important to examine the double dividend from the policy options suggested in Chapter 2.

3.1 The double dividend of the social investment measures and the need for new financing arrangements

A fundamental premise for securing the financing of the future welfare state is continued and sustainable economic growth, along with raising the employment rate, not least by ensuring that labour markets are inclusive, that the overall value and quality of work improves, and that the pension age is adapted as needed. The measures advocated in this Report go in this direction, from ensuring the provision of high-quality childcare; promoting gender parity in the labour market to making sure that labour market institutions and wage-setting mechanisms lead to decent wages and encourage worker participation; using active labour market measures to raise employment and training levels; managing the trend toward later exits from work; and investing in active and healthy lifestyles.

The prospect is that these social investment measures will lead to a double dividend in the medium term. They should reduce public spending on income protection, thanks to increased employment in better jobs and to more active and healthy lifestyles – while at the same time enlarging the tax base to fund social protection. The overall idea, in brief, is that a 'social investment policy' in a life-course perspective is central to coping with the megatrends and their effects on the labour market, giving rise to 'life-course multiplier effects' of social spending. 'Starting strong' in adult life tends to prevent the occurrence of risks and reduces the demands on society to respond to them, as well as helping to enlarge the tax base.

While this double dividend is clearly achievable, its exact size is open to debate. On the one hand, there are those who see substantial potential gains in increasing the size of the economically active population. A favourable medium-term growth assumption is envisaged, in particular, by the scenarios presented in the Ageing Report by the European Commission (European Commission, 2021c), and is also in line with the forecast used in preparing the European Green Deal. Indeed, the 'EU's pathway to sustained economic prosperity', even with a reduction of 55% in greenhouse gas emissions by 2030, uses the same scenario of EU GDP growth, assuming growth in real terms of 12.5% between 2019 and 2030 and 50% between 2019 and 2050, though the latter may be optimistic. (For more details on the scenarios used, see the *European Commission website*.)

Economic prospects have been damaged by a range of recent events: the upsurge in inflation, the energy crisis, and refugee flows caused by Russia's war of aggression against Ukraine; the further developments of this war and its, largely unknown, consequences; and the long-lasting effects of COVID-19 on education, especially that of the most disadvantaged. Yet, the overall assumption is that social investment, together with coherent economic policies, will still ensure satisfactory economic growth rates. Being prepared for the worst with a well-designed, resilient welfare state, while hoping for the best outcome in respect of current challenges, should be the guiding principle.

On the other hand, there are those who are critical of the growth assumptions used in the Ageing Report and the Green Deal, in view of global warming and environmental constraints. They believe that, although economic growth may continue, the rate might not be as high as foreseen, given both recent challenges and the more structural ones produced by the green transition, technological change and globalisation.

Regardless of the differences between those two positions, there is still a need to decide how to pay for social protection. Social investments, as all investments, bear their fruits in the medium term, while needing resources immediately to finance them. And activation measures do not eliminate the need for social protection, whether it is in traditional areas (such as minimum income schemes, healthcare, and housing) or newer ones (such as to protect people in non-standard jobs, those requiring long-term care, or facing environmental risks). This means that new sources of revenue may need to be found, even if social protection spending were only to grow at the same rate as over the past 25 years (between 1995 and 2020, general government expenditure on 'social protection' in the EU increased from 19.4% of GDP to 22.0%).

A final point is that there is a need to address shortcomings in the way some Member States currently finance their social protection spending. Taxation affects two factors that are crucial for social protection, the distribution of income and incentives to work. Recent decades have seen a steady increase in the tax burden imposed on labour relative to other sources of revenue (European Commission, 2022i). Corporate tax rates have fallen and taxes on wealth and capital play a limited role, despite growing concentrations of wealth. Taxation also has an important potential role in countering the new risks associated with climate change and environmental degradation.

The need to redesign financing arrangements in order to achieve adequate, fair, and sustainable financing of social protection is, therefore, arguably non-controversial.

3.2 A bird's eye view of the current financing structure in the EU

Total government revenue of Member States in 2021 was around EUR 6.1 trillion, or 41.7% of EU GDP (EUR 14.5 trillion) (Table 2). This percentage has been broadly stable over the last 25 years (since 1995, the first year for which aggregate EU data are available), contradicting the idea that the tax burden is constantly increasing. (For more details, see *Eurostat website*.)

Table 2: Government revenue in the EU, 2021

Revenue category	% GDP	billion EUR	% total
D.2 Taxes on production and imports	13.8	2,009	33.2
D.21 Taxes on products	11.3	1,645	27.1
D.211 Value added type taxes	7.4	1,078	17.8
D.212 Taxes and duties on imports excluding VAT	0.5	79	1.3
D.214 Taxes on products, except VAT and import taxes	3.4	487	8.0
D.29 Other taxes on production	2.5	364	6.0
D.5 Current taxes on income, wealth etc.	13.3	1,937	32.0
D.51 Taxes on income	12.8	1,863	30.8
D.51a+c1 of which, taxes on individual or household income incl. holding gains	9.8	1,423	23.5
D.51b+c2 of which, taxes on the income or profits of corporations incl. holding gains	2.9	422	7.0
D.59 Other current taxes	0.5	74	1.2
D.61 Net social contributions	14.3	2,076	34.3
D.611 Employers' actual social contributions	7.3	1,065	17.6
D.613 Households' actual social contributions	5.9	861	14.2
D.612 Imputed social contributions	0.9	137	2.3
D.91 Capital taxes	0.3	46	0.8
D.995 Capital transfers from gen. government to rel. sectors representing taxes assessed but unlikely to be collected	0.1	11	0.2
Total	41.7	6,058	100.0

Source: Own calculations based on Eurostat [Main national accounts tax aggregates [GOV_10A_TAXAG]. Last update 24 October 2022.

Total social protection expenditure in the EU in 2020 was EUR 4.3 trillion (31.8% of GDP), as against EUR 3.9 trillion (28.1% of GDP) in 2019 (Table 3). 2020, however, was an exceptional year due to the extraordinary measures taken to mitigate the economic and social effects of the COVID-19 pandemic. Early estimates for 2021 point to a fall in social protection spending to 30.2% of GDP, due notably to a reduction of around EUR 50 billion in spending on unemployment benefits, reflecting the 'countercyclical' role of social spending.

Leaving aside exceptional years, around 70% of all government revenue in the EU is for welfare state spending, even leaving aside spending on education, which is an important element in social investment.

The structure of welfare state financing in the EU was relatively stable over the period 1995-2021, but with a gradual increase in the role of taxes and a slight reduction in that of social contributions. The distinction remains between the 'Bismarck' social protection systems with a focus on social insurance for those in employment financed by social contributions (usually paid by both employees) and the 'Beveridge' systems focused on universal coverage financed by taxation and, accordingly, with less of a link between contributions and benefits (see Figure 11). The most prominent example of the latter is Denmark.

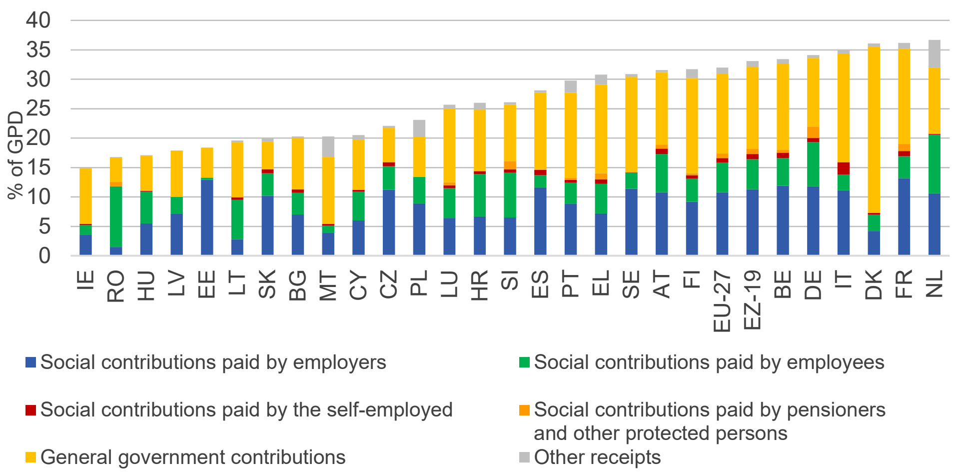
Table 3: ***EU social protection spending, total and by function, 2020***

	% GDP	billion EUR	% total
Total social expenditure	31.8	4,267	100.0
Social protection benefits	30.4	4,074	95.5
Administration costs	1.0	131	3.1
Other expenditure	0.5	62	1.4
Sickness/healthcare	8.8	1,185	27.8
Disability	2.2	299	7.0
Old age	11.7	1,571	36.8
Survivors	1.7	231	5.4
Family/children	2.5	337	7.9
Unemployment	2.2	299	7.0
Housing	0.4	53	1.2
Social exclusion n.e.c.	0.7	100	2.3

Source: Own calculations based on Eurostat, ESSPROS, [SPR_EXP_SUM]. Last update 31 October 2022.

Notes: The table shows gross expenditure. To a larger or lesser degree these benefits however are subject to tax or social contributions, which amounted to some 8% of benefit expenditure in 2015, with substantial inter-country variation. While in some countries there is almost no 'claw back' on this expenditure, in others it varies between 3% and 5-6% of GDP (Spasova, Ward, 2019). At the same time, there are 'tax expenditure' (i.e. benefits which are delivered through tax concessions or allowances) which should be added to expenditure on benefits to calculate the overall effect on government finances of social protection (see Adema and Ladaique, 2009), these latter, however, are estimated at most at 1% of GDP. n.e.c. = not elsewhere classified.

Figure 11: Financing structure of welfare spending in EU Member States, 2020



Source: Eurostat, ESSPROS. Last update 31 October 2022.

The pressure on the welfare state to readjust its financing structure has nevertheless led to some gradual change (Spasova and Ward, 2019). For example, in Bismarck-type systems, especially after the 2008 Great Recession, there was some shift from social contributions to taxes and a decline in employers' share of social contributions.

In addition, though the self-employed represent some 14% of total employment, the contributions from the self-employed account for less than 3% of overall financing of social protection, reflecting their limited access to coverage. This compares with 16.5% of total financing coming from social contributions paid by employees and the contributions paid by employers, which amount to 35.5%, with the general government (i.e. tax financing) and other receipts representing a little over 40% of the total.

The tendency for taxes to account for an increasing share of financing for social protection and for the share of social contributions to decline, seems to be due to contribution rates being kept down (in part, to avoid them pushing up the cost of labour), rather than to the share of labour in national income falling. Although there is some controversy over what has happened to the share of labour in national income, which varies according to the definition used, the time period taken and the country considered, in the EU as a whole the share of wages and salaries in GDP does seem to have remained broadly the same, at around 65%, over the last 25 years (source: AMECO database). Interestingly, this followed a period from the late 1970s to around 2000, when the labour income share was falling (Archanskaia *et al*., 2019).

3.3 Constraints on public financing

There are several constraints on attempts to raise taxes in countries where it is necessary to finance welfare needs or to remedy shortcomings in the design of the tax system.

As noted above, the overall fiscal burden in the EU is already relatively high, though 2020 was an exceptional year because of the COVID-19 pandemic. The energy crisis, however, is putting – and will increasingly put – pressure on government budgets, as may rising interest rates and military expenditure. And even before 2020, not all Member States had fully recovered from the global financial crisis that began in 2007 (Figure A1 in Annex). Public debt in the EU is expected to have risen above 90%, on average, in 2022.

At the same time, the megatrends described in Chapter 1 also affect taxation. Globalisation has allowed firms and individuals to exit countries that raise taxes or threaten to do so. This makes it harder to increase taxes on corporations or wealthy individuals and spurs competition between countries to offer the most attractive tax regime to businesses and top income earners. Technological change, for its part, has added new challenges, even though it gives rise to new opportunities to improve tax compliance (see Section 3.4.4 below). The intangible assets at the core of the digital economy make it increasingly difficult both to determine the tax jurisdiction where value is created, facilitating shifting profits to tax havens and to identify the contribution of the different factors of production to value-added. Digital platforms add further challenges because of their relative organisational instability, creating problems for collecting not only corporate taxes but taxes on income and consumption. Teleworking poses specific problems by decoupling where people are employed from where they live, while e-commerce allows people to buy from suppliers anywhere in the world, raising the question of who should have the right to tax in these situations. The answer can have very different redistributive effects.

In addition, in the EU, the public debt and annual deficit ceilings set by the Maastricht Treaty remain major constraints: according to EU Treaties, Member States in the Eurozone must bring their structural public deficits down to 0.5% of GDP so long as public debt is above 60% of GDP and to 1% of GDP when debt is below this. Even for the Member States that are not part of the Eurozone, their level of public debt is important to how they are evaluated by the international financial market. More specifically, two aspects of these fiscal constraints need to be considered in respect of welfare state resilience: (a) the long-term structural problems of needing to have a medium-term strategy for reducing public debt where this exceeds the debt threshold imposed; and (b) the substantial short-term increase in public debt relative to GDP as a consequence of a fall in the latter and the emergency spending measures needed during a crisis, such as the Great Recession or the COVID-19 pandemic.

While there are particular challenges for some Member States, the overall picture is more balanced. According to the European Commission's Autumn 2022 forecasts, inflation (as measured by the 'GDP deflator') will be 5.3% in the Eurozone in 2023, following 4.6% in 2022 (European Commission, 2022m). The structural public balance, corrected for cyclical factors, is estimated to show (in 2023) a surplus of 1.4% of GDP (Table A1 in Annex).[2] For the Eurozone, the forecast situation, therefore, seems reasonably satisfactory. In 2023, public debt would exceed 100% of GDP in six Eurozone Member States (Greece, Italy, Portugal, Spain, France and Belgium), in the 60-100% range in another six, and below 6% in the remaining eight.

The Commission has proposed a reform of EU economic governance, which includes individual national plans for fiscal adjustment and removing the blanket structural deficit ceiling (0.5% or 1% of GDP) (European Commission, 2022j). Adopting a perspective of fiscal orthodoxy (not austerity), which is met when governments borrow to finance public investment or when a fiscal deficit is necessary to stabilise economic activity, would avoid targeting an arbitrary debt level and implementing fiscal policy measures that are too tight to reach that target. The social investment strategy put forward in this Report provides a framework for assessing long-term needs for capacitating (or enabling) investment.

2| This projection is based on the Commission's estimates of the gap between potential output and actual output, although it is arguable that the Commission's methods of estimating potential output lead to an underestimate of this and hence the size of the output gap and the scale of the corrected public sector surplus. Structural public balances are corrected for net public investment and inflation-induced public debt depreciation (see also Mathieu and Sterdyniak, 2013).

3.4 Toolkit of possible adjustments

Before making specific suggestions on financing the welfare state, four general points should be made.

First, taxation can contribute to both social justice and sustainable growth, as well as financing the benefits which underpin the social citizenship contract proposed in this Report. Contrary to the rhetoric about the inevitability of a trade-off between social justice and economic growth and a fiscal crisis of the State, the problems of financing the welfare state are far from being inevitable. There are several courses open to us, which can be pursued immediately.

Second, everyone should be willing to pay their share of the costs involved, whether individuals or companies. There can be no benefits without contributions, no spending without taxation, so long as ability to pay is given. The duty to contribute is the exact counterpart of the benefits of the social citizenship contract. Free riding – taking benefits while letting others pay the costs – needs to be tackled. Everyone should play their part in maintaining a system from which everyone benefits.

Third, the distribution of costs must obviously be fair and be designed in a way that does not jeopardise sustainable growth. For example, the way social protection is financed – by taxes or social security contributions, defined-benefits or defined-contributions, pay-as-you-go or funded schemes – has a significant impact on the demand for labour. At the same time, there should be clear links between financing and common welfare goals; this is vital to encourage people to support and co-operate with the system. The more the welfare state is perceived as being fair and as promoting welfare, the more individuals are likely to be willing to sustain it. This belief underlies the suggestions made here.

Fourth, even though responsibility for taxation and social contributions, as with social spending, lies largely with Member States, the EU has an essential role to play in ensuring a level playing field – as in the recent efforts to limit the scope for multinationals, particularly high-tech giants, to exploit differences in tax regimes between Member States – and in promoting the exchange of information and good practice. This, again, contributes to fairness and efficiency and to fair competition between Member States.

The centrality of pay-as-you-go (PAYG) schemes

The first specific suggestion is that a PAYG approach is the best way to link the rights and duties of generations over time, in line with the social citizenship contract at the heart of the welfare state. Some authors have argued: '*The working generation of today assumes the responsibility of supporting today's retirees, under the supposition that it in turn will be supported by the subsequent generation of workers.* [...] *Viewing this [pay-as-you-go] arrangement as a continuing process which never ceases, we may show that the rate of return to the participants will be higher under the public system, provided that the combined rates of population and productivity growth (i.e., the growth of the tax base) will exceed the real rate of interest*.' (Musgrave and Musgrave, 1989). This is true for pensions in particular: but it is equally true of all expenditure designed to address risks over the whole life-course.

Although both PAYG and funded schemes face macro-economic, demographic and political risks, funded schemes (most often private ones) are subject to several additional risks. In the case of pensions, for example, private funded schemes are also exposed to investment and annuity market risks (Barr, 2001). Investment risks have to do with stock market fluctuations, particularly at the age of retirement. While the annuities market can provide a stable steam of income during retirement, it involves risks attached to actuarial forecasts of life expectancy. Both risks have been very evident in recent times. Funded schemes, with the important exception of those in the Netherlands, often have higher administrative costs or charges and depend on the ability to pay of employers and/or employees. Subsidies that support funded schemes have the additional risk of having regressive effects, tending to benefit savers with high incomes more than those with low incomes. In addition, funding is mostly associated with private provision, which brings with it the risk of market failure, as in the case, for example, of healthcare and long-term care (Barr, 2001). These caveats do not mean that private financing has no role to play; especially given the present importance of private schemes in pension systems across Europe and the extent to which they are regulated in Member States. They simply highlight the role of PAYG as the central plank even in a multi-pillar system.

The role both of social contributions and of taxation

In the EU, the dominant source of financing for social protection varies between different branches. Old-age benefits are mainly financed by social contributions; this is the case in nearly all types of social welfare systems, even those mainly funded by taxes. Unemployment benefits are also mainly financed by social contributions in most EU countries. For healthcare and sickness benefits, there is a distinct split between Member States with primarily tax-funded national health services, and insurance-based systems. Family and child benefits are predominantly funded by taxes, while guaranteed minimum income or social assistance is financed wholly from general taxation in nearly all Member States (Spasova and Ward, 2019).

Within a pay-as-you-go system for financing social protection, both social contributions and general taxation have a key role to play. Smoothing income over the life-course matters for people who are risk-averse and social contributions perform this role. In addition, social contributions (like all forms of obligatory contributions) give people a strong sense of entitlement; the link between payments and benefits being much more direct than in the case of taxation. Social contributions can be designed in ways that redistribute income from those better off to those worse off. While some social insurance schemes for narrow occupational groups may provide only limited redistribution, mandatory national schemes make it possible to pool risks, so that those with lower risks effectively fund those with higher risks, such as those in occupations with a greater risk of age-related disability.

Social contributions may often, however, be regressive in terms of their effect on overall incomes – for example, if ceilings on income and benefits are not aligned. In any case, their redistributive power remains limited. It may be argued that pooling risks in itself entails redistribution, not only from those not affected by the risk to those who are, but also from the better-off to the worse-off – insofar as the latter have a higher exposure to risk (such as unemployment, sickness, or lower life expectancy). In addition, the actuarial calculation can be supplemented by redistributive mechanisms. The redistributive potential of social contributions, however, remains constrained by the amount of contributions paid, which is a serious penalty for those, such as workers in non-standard jobs, who, even when they can access social protection, are often unable to make enough contributions to receive an adequate level of benefit. Because social contributions are collected from wages and add to the cost of labour, they may also deter employment.

Taxation could remedy these shortcomings. As one author has argued: '*financing social insurance from general taxation … could raise labour market participation, reduce labour market dualism and boost growth, while at the same time extending welfare support to a larger fraction of society'* (O'Reilly, 2018, p. 33). A tax-based system could, more specifically, provide income to workers who have made insufficient social contributions, because, for example, of working fewer hours than they would like. It is important, however, to avoid creating an inferior system for people in non-standard work, with the associated risks of social dumping. At the same time, companies should be prevented from making bonus payments on which no social security contributions are paid. A reasonable balance could be struck by a social protection system in which all workers are covered by a unitary (contributory) system, while general taxation (other than on employment income) fills the gaps caused by low work intensity. General taxation would, accordingly, also finance social protection that goes beyond providing earnings-related benefits – such as minimum income, universal flat-rate benefits, or more general social services (other than social investment as such). In any case, progressive taxation also fulfils an insurance goal, by increasing the revenues raised when things are going well and reducing it when things go badly (Varian, 1980). Viewed in this way, both social insurance and taxation can contribute to insurance against social risks.

Revising personal income taxation

There are two main options for reforming the taxation of personal income.

The first is to expand the tax base by limiting or reducing the many tax breaks that are currently present, from tax credits and tax allowances to tax exemptions and preferential treatment of different sources of income, such as income from capital as against income from employment (or self-employment income as against wages and salaries). One possibility in this regard would be to bring income from capital back within the scope of personal taxation, moving towards a comprehensive income base (OECD, 2018a). Interestingly, one author shows how reforms by Nordic Member States during the 1990s combined ambitious measures to broaden the tax base with the introduction of a 'dual income tax system', one that covered income from both labour and capital but still treated them in different ways (Sorensen, 2010).

As well as shrinking the tax base, tax breaks can also generate horizontal and vertical inequities – in which taxes are not related to people's ability to pay – as well as distortions and inefficiencies. Moreover, tax breaks, if tied to the consumption of services, such as health or long-term care, assume the desirability of these being provided privately, even though such services involve the risk of market failure, as noted above. If tax breaks are retained, tax credits are preferable to tax allowances, as they leave the marginal tax rate unchanged, whereas the latter may reduce it to the benefit of the better-off. Refundable tax credits are preferable to non-refundable ones, so that people who do not pay enough tax to benefit from them receive a payment instead, though their use should also be limited to areas where the risk of market failure is relatively low.

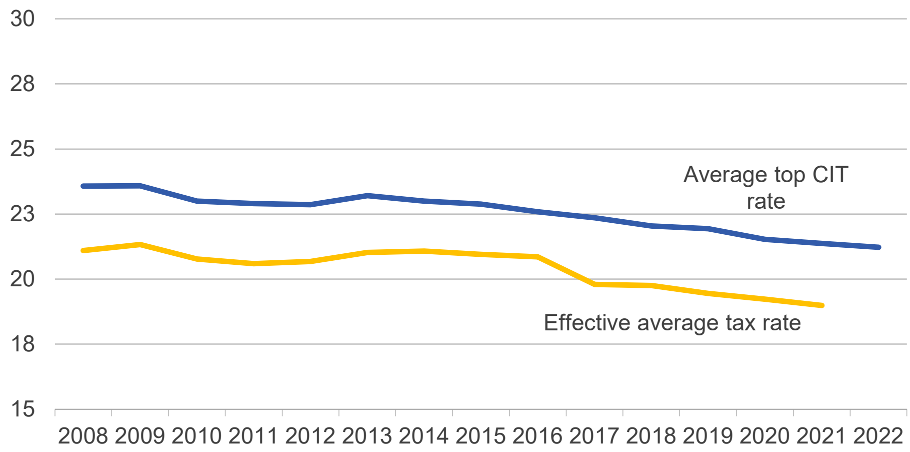
The second option for reform is to make the taxation of income more progressive. In several Member States, the rate of progressivity is actually higher in the bottom part of the income distribution, because of the combined effect of an increase in the tax rate and the withdrawal of benefits as income rises (whether they be tax credits or means-tested benefits), and because of the way top (statutory) rates of tax have been cut (Bénassy-Quéré, 2019). This trend should be reversed. It goes against the principle of ability to pay (fairness), and it discourages people on low incomes from taking up work. It also increases the 'tax wedge' (the difference in wages before and after tax), and causes poverty and employment 'traps' (where people end up worse off if they move into employment or earn more). One suggestion would be to consider taxes and benefits simultaneously, establishing a monotonous progression of marginal withdrawal rates (the combined rate at which taxes rise and benefits are withdrawn as income rises). This point is of the utmost importance as more Member States move towards means-testing of benefits. A similar approach could be taken to taxing income from additional hours worked, which could increase incentives to work.

Abolishing the preferential tax regimes for high-income taxpayers that have developed in the EU would also enlarge the tax base at the same time as making the system more progressive. There are (equally) efficiency grounds for doing so, since preferential tax regimes impose a social cost (a negative externality) on the countries financing social protection. According to one estimate: '*more than 200,000 taxpayers are currently benefitting from these schemes. Overall, preferential schemes generate a loss of revenue of over EUR 4.5 billion per year for the EU as a whole.*' (Flamant *et al*., 2021, p. 18). One option would be to extend the remit of the EU Code of Conduct Group (which is concerned with ensuring fair competition in relation to business taxes) to include personal income taxation. (For more details, see the *group's webpage*.) Another option would be to tax expatriates for a given number of years after they leave the EU.

Increasing corporate taxation. Over recent decades, both nominal and effective rates of corporate tax have tended to decline (Figure 12). Small countries are more prone to endorse aggressive fiscal planning, suffering a (relatively) small revenue loss as a result. In 2022, nominal tax rates on company profits in the EU ranged from 9% in Hungary to 31.5% in Portugal. (For more details, see *OECD website*.) In addition, a whole edifice of business subsidies reduces the effective tax base and tax yield. Individual subsidies may well be justified on grounds of efficiency or fairness – for example, to help the green transition, boost local employment, or support investment. But they are not always given for such reasons. For example, schemes that allow interest payments to be deducted for tax purposes act as a disincentive to equity investment. Some subsidies are environmentally harmful, while others go to firms operating in tax havens – Denmark, Poland and France have been exceptions in banning COVID-19-related subsidies for firms based in tax havens. Multinational companies still benefit from shifting profits to Member States with low corporate tax rates (often manipulating the prices of transactions within the group in order to push costs into high-tax countries and reduce the taxes they pay there), so enjoying a favourable treatment compared with national firms.

As with preferential personal income tax regimes, the EU has an important role to play in levelling the playing field, so eliminating the negative externalities of tax competition and ending the 'race to the bottom', as well as making multinationals pay their fair share of tax. Steps in this direction include moving further ahead with the measures envisioned by the Code of Conduct Group, as well as by the 2016 Directive on Tax avoidance (Council of the EU, 2016), adopting BEPS 2 (Base Erosion and Profit Shifting[3]), Pillars 1 and 2 – where multinationals pay taxes and on a global minimum tax rate – followed by strengthening the current provisions. Another option is to combat aggressive tax planning and 'shell company' abuses through the Directive on Administrative Co-operation and implement BEFIT (Business in Europe: Framework for Income Taxation), a new, comprehensive solution for business taxation in the EU (European Commission, 2021k).

Figure 12: ***Top corporate income tax rate and effective average tax rate (%), EU-27, 2008-2022***



Source: European Commission (2022i).

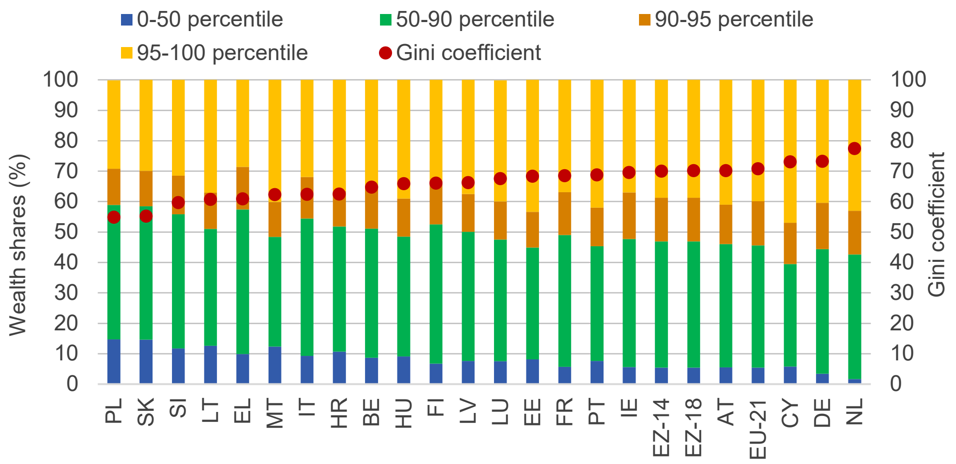
The BEPS proposals referred to above require multinationals with a global turnover of more than EUR 20 billion, and a profit rate above 10%, to allocate 25% of their net profits to Member States on the basis of the overall revenues generated in them, even if they have no physical organisation there. This would enable taxes to be collected from platform companies, in particular. The plan also includes a minimum global tax rate of 15% for multinationals with annual revenue of EUR 750 million or more, with the aim of achieving convergence of minimum tax rates at a higher level. BEFIT further supports the extension of the tax base, establishing common rules for determining the corporate tax base and for allocating profits between Member States.

Rethinking the tax mix: the role of wealth taxation. To exploit possible complementarities between taxes as well as composition effects in an unavoidably second-best world, fiscal systems need to be considered as a whole. In this perspective, there are a number of arguments for higher taxes on wealth. Most Member States tax wealth much less than labour (Table 2), despite the currently high concentration of wealth (Figure 13). Increasing taxes on wealth could help to achieve greater fairness, both in the tax system and in the distribution of resources, especially given the tendency for the accumulation of wealth to become self-reinforcing in the absence of taxation. Wealth taxes could also help to reduce the tax burden on income from employment.

3| See OECD, *What is BEPS?*

A tax on net wealth could complement taxes on income from capital, in the event that the idea of a comprehensive income tax system (see above) is rejected in favour of a dual tax system, under which tax on capital income is at a proportional rate and tax on labour income is progressive. it is should be noted in this regards that even a proportional wealth tax would be progressive in practice, given the way wealth is concentrated in the hands of a small minority.

Figure 13: Wealth shares (%) and net wealth inequality (Gini coefficient), 21 HFCS EU Member States, 2017



Source: Darvas and Midões (2021). Notes: The Gini coefficient is a way of measuring inequality, where 0 equals perfect equality and 1 equals perfect inequality. HFCS = Household finance and consumption survey. EZ = Eurozone countries.

Some wealth taxes might remain justified even if there were a broad-based tax on personal income from capital, such as inheritance and gift taxes, which limit the advantages of the social lottery, and contribute to equality of opportunity (OECD, 2018b).

As argued by one report: '*a well-designed recurrent tax on residential property can be an important element of the tax mix being able to foster growth, address policy issues related to inequality and contribute to the green transition. Nevertheless, tax revenues from recurrent property taxes are low in EU Member States*' (Leodolter *et al.*, 2022, p. 1). But instead, many Member States give tax advantages to owner-occupied property. In all cases, taxation of wealth should be neutral as between different forms of wealth, contrary to the current situation where bank accounts (typically held by the relatively less wealthy) are taxed more heavily than investment funds, pension funds and shares (OECD, 2018a).

Tax avoidance and tax evasion need also to be tackled, especially as regards financial wealth. In 2018, for example, the offshore wealth held by individuals across the EU amounted to 12% of GDP, up from under 10% in 2016 (Ecorys, 2021). Some specific measures in this respect are proposed below (Section 3.4.4).

Rethinking the tax mix: the role of indirect taxation. Indirect taxes have several advantages over direct taxes. They are less exposed to the risks of tax competition than taxes on income and profits. They can make it easier to achieve social objectives, as in the case of 'sin' taxes – taxes on things that are harmful or costly to society, such as tobacco, alcohol, sugary drinks, and gambling. The same applies to green taxes. Measures such as the EU carbon tax border adjustment mechanism, which promotes the import of goods that meet climate standards, can prevent unfair competition from countries that disregard social and environmental costs.

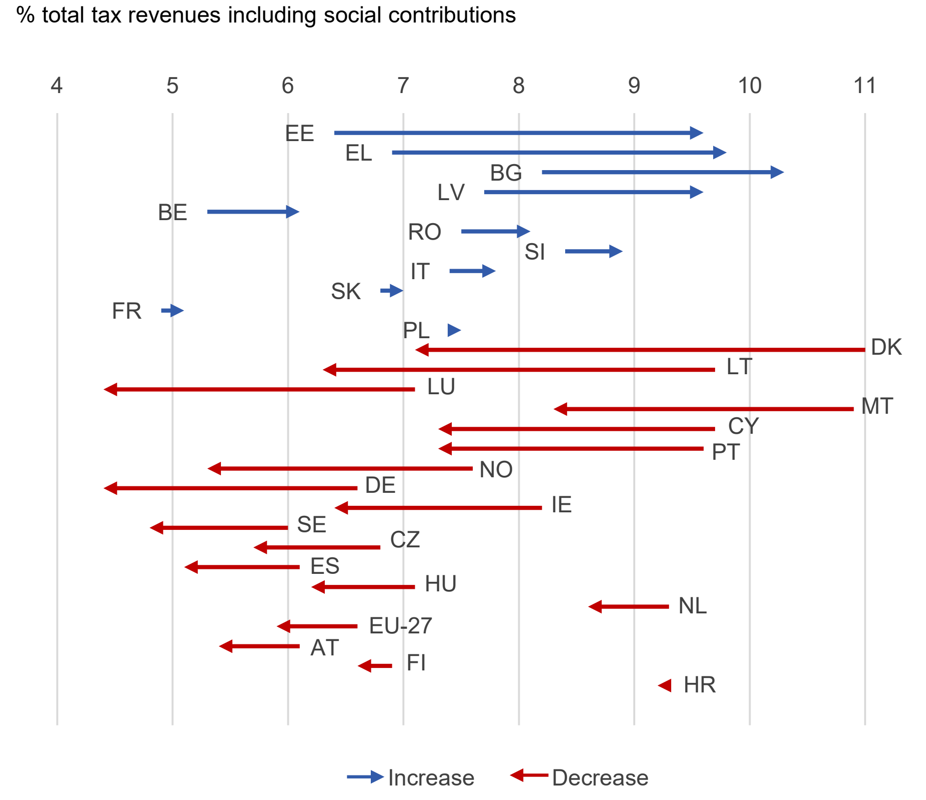
Indirect taxes, however, also have disadvantages. They can be regressive and can increase inflation. Their effects on employment should also not be overestimated, since they are paid by workers, and labour supply ultimately depends on the overall burden of taxes, which remains the same if a reduction in income tax is compensated for by an increase in indirect taxes.

In addition, the contribution of indirect taxes to the tax yield can be questioned. Successful sin taxes and green taxes may reduce consumption, and so the adverse social effects of this, but they also reduce production, and so the tax base. Figure 14 shows the decline in environmental taxes as a share of total tax revenues in those Member States – such as Sweden, Denmark and Norway – that have pioneered such taxation. Achieving the goals of the EU Green Deal and the EU 'Fit for 55' package – designed to cut greenhouse gas emissions by 55% by 2030 – will, it is hoped, lead to a general trend in this direction. In other words, the more efficient green taxes are, the less revenue they will generate in the long term.

While acknowledging those limitations, indirect taxes could provide some new revenue, including from environmental taxation, at least in the medium term (European Environment Agency, 2022). The risk of them increasing the regressive nature of the tax system could be partly offset if the revenue yielded is used to finance the welfare programmes outlined in this Report. Moreover, as argued by the European Commis-sion: '*if there is high 1) avoidance of taxes on capital income and 2) a significant proportion of consumption is ultimately financed from profits, then there is a chance that the effective burden of the VAT increase is shifted away from labour, undoubtedly stimulating employment*' (European Commission, 2006, p. 7).

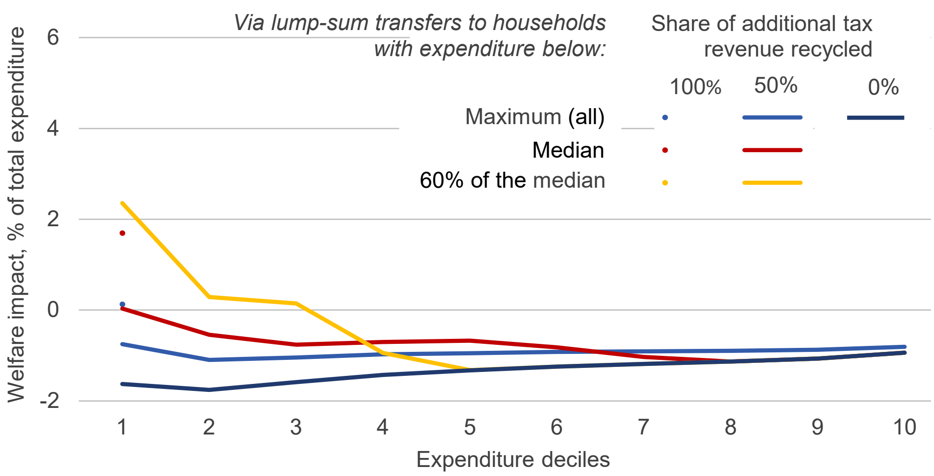
Effective climate action and welfare improvements, and even reductions in socio-economic inequalities, can go hand in hand, so long as policies are designed carefully, including proper planning for the use of revenue. Recent simulations for the Commission bear this out (European Commission, 2021l). Figure 15 illustrates possible policies to accompany carbon pricing (in this case, the proposal to extend the EU Emission Trading System to buildings and road transport). While carbon pricing can have socially regressive effects (black line) on households, if the revenue they generate is used and redistributed well, they can be avoided. Indeed, targeting support to those with the lowest levels of consumption can not only offset any regressive effects but can also help to tackle pre-existing inequalities (in some scenarios). For example, by using 50% of the new carbon tax revenue and directing lump-sum transfers to households with equivalised incomes below 60% of the median (continuous yellow line), the welfare of those in the three lowest deciles is improved relative to the baseline (with no reallocation of revenue). More generally, this shows the need to analyse the distributional impact of any changes in revenues in the future, in line with recent European Commission guidance (European Commission, 2022h).

Figure 14: Trend of environmental tax revenues in EU-27, Member States and Norway (2002–2019) (% total tax revenues including social contributions)



Source: [European Environment Agency](), *drawing on European Commission (2022i).*

Figure 15: Distributional impacts across household income groups of recycling revenues from carbon pricing in EU



Source: European Commission (2021l), based on JRC GEM-E3 analysis.

Notes: Assumptions: MIX; fragmented action; perfect labour market; profits maximisation; shadow value in non-ETS; free allowances in ETS (except electricity generation). Expenditure decile 1 = lowest level of expenditure.

Exploring new avenues of taxation. Several, relatively new, avenues of taxation have been indicated above. These include: a partial switch to taxing multinationals, including web platforms, on the basis of their revenues rather than their profits; and carbon pricing and environmental taxes. The money raised could be used to tackle any unintended consequences of the policies, as well as challenges that already exist, for example reducing the tax wedge, and supporting reskilling and upskilling.

But these are not the only avenues available. Another option is to tax excess profits, which has recently been put back on the public agenda – both by the excess profits made by energy companies following Russia's war of aggression against Ukraine and, before this, those made by big online retail companies during the COVID-19 crisis (European Commission, 2022k). Taxing excess profits also has an older justification, however – that of curbing oligopolistic power, where a very small number of companies dominate particular markets. This was precisely the original reason for introducing corporate taxation in the US. This justification acquires new strength in today's markets, where the winner takes all (or almost all). A 'web tax' aimed at the excess profits of digital service companies, based on their turnover, could be a transitional step, while waiting for the acceptance and implementation of the principle that profits should be taxed where the interaction between businesses and users or customers takes place.

A levy on financial transactions can also be justified, on grounds of fairness and efficiency. A tax on the financial sector has been discussed at the EU level for many years without result, even under the framework of enhanced co-operation between 11 Member States (Council of the EU, 2019b). Nevertheless, there remains an appetite for such a levy, which would discourage speculative trading and contribute to the progressivity of the tax system. It is also important to note that, following the December 2020 Inter-institutional agreement on new resources for the EU budget (Council of the EU, 2020b; European Commission, 2020f), the Commission intends to propose to the Council by June 2024 a new resource that: '*could take the form of a Financial Transaction Tax and a financial contribution linked to the corporate sector or a new common corporate tax base*'.

A further option for Member States is to introduce a new tax, inspired by the general social contribution (*Contribution sociale généralisée*) in France. This is a surcharge levied at source on all incomes, rather than only income from employment, tied to the financing of social protection (Carpentieri and Ceriani, eds, 2021). With such a broad base, a tax of this kind could entail relatively low rates and could also allow taxes on labour to be reduced.

Fighting tax avoidance, tax evasion and tax fraud

Tax avoidance, evasion and fraud remain a serious issue in the EU, though with significant differences between Member States. The result is an unfair distribution of the fiscal burden, but also – once again – inefficiency (caused by distortion of competition) and losses in revenue. For example, although the 'tax gap' (the difference between what should be raised, in theory, and what is actually raised) is narrowing, EU Member States lost an estimated EUR 134 billion in VAT receipts in 2019 (Poniatowski *et al.*, 2021). Recent evidence at global level also suggests a huge increase in the proportion of multinational profits made outside the headquarters country that is shifted to tax havens – from less than 2% in the 1970s to 37% in 2019, resulting in a tax loss of roughly EUR 250 billion (Zucman and Wier, 2022).

3

Several counter-measures are available at both national and international level. At the national level, reducing tax loopholes, and simplifying rules as much as possible, reduce the opportunities for tax avoidance. In this regard, technological developments could offer cost-effective ways for tax authorities to prevent and detect tax evasion and fraud (OECD, 2017).

At the EU and global levels, the OECD plan described above could contribute to reducing tax avoidance. Other measures could include requiring companies to provide a break-down of costs, revenues and profits for each country where they operate, instead of publishing the information bundled together in a single set of accounts.

Tax havens should also be regulated much more strictly, combined with better co-operation and exchange of information between countries via the OECD Global Forum on Transparency and the Exchange of Information for Tax Purposes. This should include information on money laundering and foreign bank accounts, putting an end to banking secrecy in the EU. A global asset registry should be created, recording who owns the world's financial and real assets. Such a registry would make it possible not only to reduce tax evasion, but also to curb money laundering, monitor international capital flows, combat kleptocracy, and improve the way inequality is measured. (See *list of publications* on this issue by Zucman.) Again, technological developments could be of help in this regard. An agreement on a minimum corporation tax rate in the EU would also be useful.

Regulations and prohibitions are only part of what is needed, however. Building a climate of trust is also crucial. At the EU level, the way forward is to reduce administrative burdens (European Commission, 2021k). At Member State level, 'co-operative compliance' with revenue authorities and taxpayers working more closely together, has an important role to play. This should be combined with full transparency, about both how the burden of taxes is distributed and how public revenue is used. The same is true of civic education and the social dialogue.

In summary, there are many options for achieving an adequate, fair, and sustainable means of financing of social protection at both EU and Member State levels.

3.5 A golden rule for social investment

As already remarked, there is widespread agreement on the value of social investment for sustaining the inclusive welfare state in the EU, in terms of employment and productivity, prevention of social risks, activation, and inclusion and emancipation. But there is an important caveat, particularly in relation to Member States facing severe financial difficulties. Efforts to obtain the *long-term* benefits of social investment constantly come up against *short-term* pressure for fiscal consolidation. And although the returns to social investment are substantial, both in economic and social terms, so can be the immediate costs.

One of the lessons of the Great Recession in hindsight is that fiscal consolidation driven by EU fiscal rules deepened recessions in Greece, Italy, Spain and Portugal, triggering downward spirals of low growth, higher unemployment, larger deficits and more public sector debt (House *et al.*, 2017; Heimberger, 2016). In the Member States concerned, fiscal consolidation effectively pre-empted social investment reforms that could have raised productivity, labour force participation, and employability and made it easier to meet family responsibilities (Darvas and Tschekassin, 2015; Leschke *et al.*, 2012).

Many economists believe that a currency union requires a fiscal union too, and this idea has gained ground since the Eurozone sovereign debt crisis (see notably: Berger *et al*., 2018). The Stability and Growth Pact of 1997, which sets strict limits on levels of public debt and budgetary deficits (of 60% and 3% of GDP, respectively), is currently under review. The key policy challenge in the aftermath of the Great Recession and the COVID-19 pandemic is to develop a more flexible approach to economic and monetary union, and to EU governance in general – one that can take account of important differences between Member States in their potential for growth and competitiveness and can address their specific vulnerabilities. One of the major weaknesses of the 1997 Pact is that it did not distinguish between public investment, including estimates of real returns, and consumption expenditure. In ageing societies, the keys to long-term economic stability and growth are arguably human capital, lifetime employment, and productivity. Public policies should be designed to raise employment participation and skill levels. They should not be treated as a wasteful drain on the public purse, but as crucial for economic progress and social cohesion. So long as the budget allocated to social policy is treated purely as a cost, financial and economic management will continue to ignore the cumulative benefits of investment in health, education, employment, and social security over the life-course.

A new system is needed for monitoring public finances in the EU that would allow policy-makers to identify productive social investment, and jointly examine expenditure trends – in markets and by governments alike. At the same time, it is not necessarily straightforward, technically, to categorise social investment, quantify its budgetary impact, and include all human capital expenditure within its scope (Corti *et al*., 2022). Moreover, identifying areas of social protection spending with a high rate of return should not be an incentive for decision-makers to cut spending on less 'productive' ones. But a golden rule should be applied, allowing borrowing for social investment, in a starting phase at least, for investment in social infrastructures.

The High-Level Task Force on Investing in Social Infrastructure in Europe estimated that the investment shortfall for health, education, and social housing was EUR 142 billion per year (Fransen *et al*., 2018). A starting point should be to exempt social investment from the new Stability and Growth Pact rules, which would both allow and stimulate Member States pursue ambitious social investment strategies and accelerate productive reforms. It would also spur social innovation by helping vulnerable economies to achieve more inclusive growth. This would be a more convincing way to stabilise financial markets than the one-size-fits-all policy of fiscal consolidation, prescribed by the Maastricht Treaty, which, as we have seen, can make recessionary pressures worse and with the consequence of deepening intra-E(M)U economic divergence (Gechert *et al*., 2017).

The good news is that the EU fiscal policy response to the COVID-19 pandemic already marks a decisive change of direction towards a (re)appreciation of the way public investment in infrastructure can help to relaunch growth, foster social cohesion, and support the green transition. The NextGenerationEU package provides significant financial support for reforms and investment across the EU in response to the pandemic. At its heart is the Recovery and Resilience Facility, which opens a clear window of opportunity for *social investment reform across the Member States most affected by the Great Recession and the pandemic*. However, it is important to acknowledge that the facility is only temporary.

Given that a fully-fledged social investment strategy can bring long-term economic and social gains, EU fiscal support for social investment reform should be put on a more permanent basis and not confined to mitigating the socio-economic after-shocks of the COVID-19 crisis.

Conclusions and recommendations

Enhancing the social contract for a stronger Social Europe

The modern welfare state is based on a social citizenship contract with policies that minimise social risks and mitigate economic hardship for everyone as a matter of social right. The Great Recession and the COVID-19 pandemic have underscored the central importance of an inclusive and fair welfare state. As well as marking a strong comeback by the welfare state, the pandemic also brought with it an unprecedented leap in EU fiscal solidarity – in the form of the 'Support to mitigate Unemployment Risks in an Emergency' (SURE) and the NextGenerationEU package with its Recovery and Resilience Facility (RRF).

External shocks and internal economic and social change both require continuous updating of welfare provision, giving it the tools to uphold the social contract. A new concept of social justice, going beyond fair compensation, is called for in the light of global megatrends. Society is being simultaneously confronted by: a shift to post-industrial knowledge economies with new forms of work; more diverse, more flexible, and often more precarious employment relations with expanding activity in services; technological innovation that places a premium on skills; more, and sometimes less stable, dual-earner families; more single, and more single-parent, households; higher migration rates; and accelerated population ageing. It is evident that more diverse working and family lives require an understanding of fairness that is more sensitive to personal conditions and household circumstances. As women have entered the labour market in greater numbers, a key policy focus is to help families and people of working age through more care services and support for work-life balance. At the same time, there are the new challenges brought about by climate change and the green transition, themselves aggravated by the energy crisis. In the face of all this, recalibrating social protection and the welfare state, building on successes while learning from failures, will be a difficult task.

Welfare provision should not merely be assessed in terms of its impact on people's material conditions, but even more so in terms of fostering people's capability to fulfil personal aspirations. Slowly at first, social citizenship values have gradually shifted. Fairness is less likely to be seen as being about 'here-and-now' compensation, and more about how to pro-actively ensure 'human flourishing' and well-being. This entails nurturing the capabilities that underpin them. But more has to be done.

Modern welfare provision is crucial to supporting economic production, providing strong buffers against economic shocks, and investing in 'stepping stones' that help people across critical life-course transitions. In doing so, all members of society need to be supported, without discriminating against anyone, and with additional efforts targeted at those who are most vulnerable. However, the welfare state of today is more than just about redistributing resources and mitigating poverty. A well designed welfare state can absorb asymmetric economic shocks, provide insurance against new social risks, and ensure people receive high-quality social services through all the stages of their lives.

Across the EU, there is a growing consensus that a well-designed and robust welfare state, taking redistribution seriously, is an economically productive asset in a knowledge-based economy and an ageing society. Broadening the employment base by strengthening employability and increasing the participation of Europe's increasingly diverse population is of the utmost importance. Time is of the essence: simply waiting for the economy to pick up after crises and external shocks can easily reinforce permanent labour market inactivity despite the current and looming labour shortages as the 'baby boom' generation retires. To support people at all stages in life, making sure that no one falls between the cracks, it is essential to adopt a life-course perspective. We know that childhood, working life and old age are intimately linked. Retirement in good health correlates with a good childhood, and with a good transition from education and training into the labour market, and vice versa. There will always be moments of transition over the life-course that, if not managed properly, can cause cumulative deprivation and disadvantage. Social solidarity at such moments calls for the provision of stepping stones that allow people to progress, acting as a backstop against disadvantage, but also as a springboard for human flourishing and resilience.

The financial sustainability of the welfare state critically depends on the number of people in employment and how productive they are, as well as revenue being raised fairly from all potential sources of finance. But the reverse is also true: welfare policies can help maximise employability and productivity. In other words, to the extent that welfare policies contribute towards maximising employability and helping to raise productivity, they, among other things, support fiscal sustainability and foster social inclusion in ageing societies. A stable and equitable social contract between generations ensures the well-being of older people as societies age, but without crowding out productive resources for the young to prosper in the dynamic knowledge economy. As a result, there is more tax and social contribution revenue to guarantee the financial sustainability of inclusive welfare provision. In other words, the social contract must be fair not only between generations, but also between people of the same generation.

There are no silver bullets for the multiple challenges posed by the megatrends discussed in this Report. The demographic shift will continue, with more older people, fewer children and fewer people of working age. Low employment levels are therefore not affordable. In an era where human capital is swiftly becoming a scarce resource, there is considerable potential for employment and productivity growth by ensuring that workers are well skilled, and that households are supported through measures to help them reconcile work and family life. It is essential for society to tap into the potential of everyone, and to enable people to thrive in inclusive labour markets, by fostering high-quality jobs and gender equality, and by integrating migrants and disadvantaged groups. Labour market pressures call for: better working conditions; the availability of high-quality jobs from the very first point of entry into the labour market; support for regional and occupational mobility; and making it more possible and attractive for people to work longer, and be more flexible about when they retire. The spread of digital technology is bound to intensify. While it will affect the labour market, it may not necessarily lead to jobless growth. Indeed, digital innovation may prove essential for tackling labour market shortages as well as raising productivity, though it needs to be accompanied by measures to tackle the digital divide.

The costs of mitigating the effects of climate change will rise considerably, but so may GDP. Even in the aftermath of the deep economic crises over the last two decades, the prospect is for GDP to increase by between 20% and 50% over the next 30 years. This economic growth must be sustainable and is needed to finance further material progress and gains in well-being.

Looking at the revenues needed to finance the welfare state, the good news is that – given the stable pattern observed in the past – we can safely rely on a good third of future GDP to continue to be allocated to welfare support, largely paid for out of income taxes and social insurance contributions. On the downside, stable social spending in an era of rising needs suggests the need for new sources of finance. In our view, funding for future welfare provision should be less dependent on taxing income from work and more should come from taxes on capital, wealth, inheritance, consumption, and carbon emissions, based on the principle that the broadest shoulders should carry the heaviest burden and in line with the national context. This requires taxes to be more progressive and for the tax and contributions base to be broadened. There should also be a strong political impetus to contain tax evasion and avoidance, to eliminate harmful tax competition and social dumping.

Recommendations

The life-course perspective represents an appropriate framework for making recommendations on how to modernise and reform the welfare state. It allows us to distinguish between different population groups – children, young adults, people of working age, pensioners, and those reliant on care. At the same time it allows us to consider what combination of social services, income support, and enabling regulations and governance models are needed to achieve effective social protection and well-being over the life-course. Listed below are suggestions from a life-course perspective of the most relevant priorities and the recommendations that follow from our Report. These should be pursued in parallel with efforts to implement the many different social and employment initiatives under the European Pillar of Social Rights and its 20 principles. Spending funded by the EU, including by the recently approved Social Climate Fund, should reflect the priorities identified in this Report.

What follows should not be read as one-size-fits-all recommendations. Some Member States still need to catch up in terms of reducing poverty and redistributing income. And all Member States will need to invest in both capacitation[4] (i.e. measures which help people realise their capabilities) and insurance against risks and in combating the inter-generational transmission of disadvantages. In other words, successful implementation of our recommendations is contingent on a careful analysis of differences in social vulnerabilities and institutional dynamics, across EU Member States, as well as of the role of EU institutions in co-ordinating and facilitating these policies in conjunction with national governments, social partners and civil society.

Implementing the recommendations also requires wide agreement within society on the values and principles of the welfare state. In this respect, a strong dialogue between trade unions and employers could play a decisive role in pursuing a pro-

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gressive welfare state policy agenda at both national and EU level. Employers should also play a stronger role in fulfilling environmental, social, and corporate governance responsibilities.

A. Starting strong: nurturing child development for all

1. All children under the age of 3 should have access to high-quality, full-day early childhood education and care services, thereby fostering early childhood development, while making it easier for people to reconcile work and family life and for women to be in employment. These services should be affordable for all families and free to all those with children in need.

2. Member States should provide targeted minimum income protection and capacitating services for vulnerable families with children to prevent child poverty (which is most common in households with single parents and large families).

B. Creating a springboard for the young generation

3. Member States should have in place adequate financial support, services, and in-kind benefits to enable people – when they wish – to start a family and have children.

4. Member States should pursue the implementation of the reinforced Youth Guarantee, strengthen provision of high-quality education and training, and provide an environment that favours the creation of high-quality jobs and entrepreneurial opportunities for young people. Member States should provide an adequate allowance for young people from low-income families that enables them to pursue high-quality education and training after compulsory schooling.

C. Ensuring inclusive social protection and lifelong learning

5. All people in employment, irrespective of their work status, should be able to access and contribute to adequate social protection and contributions should take account of all sources of income. Such social protection should be accessible throughout the life-course, maintain a decent standard of living, providing appropriate income replacement and reducing the need for means-tested minimum income, as well as avoiding unfair competition on social security contributions.

6. Member States, in co-operation with the social partners at all levels, should develop an approach to the quality of work that is sensitive to life-course issues, encompassing a decent and secure income; autonomy in work tasks; good physical and mental health; opportunities for career development; and a suitable work-life balance.

7. Member States, in co-operation with the social partners, should have effective lifelong learning systems that provide opportunities for upskilling and reskilling. These should enhance employability for all people of working age, and improve the skills base for care professions, the digitalisation of work and the green transition. They should also support economic restructuring in favour of new sectors and occupations, while promoting gender balance. Access to upskilling and reskilling can be boosted by collective bargaining, training levies on employer wage bills and the development of individual learning accounts.

8. Member States should pursue the inclusion of migrants through their social and labour market policies, ensuring early and equal access to the labour market,

supported by training; recognition of skills and qualifications; language learning; and civic orientation. Combatting discrimination and exploitation is essential to fostering the inclusion of migrants in society and enabling them to fully contribute to the economy.

9. Learning from the Great Recession and the COVID-19 crisis, Member States should have in place job-retention schemes (such as short-time working) that are accessible by people in all work statuses, to maintain incomes and to avoid the loss of skills during crises in the future. For employees, such schemes minimise lay-offs while preserving employer-employee links. Periods of furlough could be used to provide further training.

D. Supporting longer careers in good health to safeguard adequate retirement incomes

10. Social partners and/or Member States should support longer working lives by promoting flexible working-time arrangements, making suitable adjustments to workplaces and providing continuous training to meet the needs of older workers and use their potential. Member States should consider targeted incentives that make it easier for people to make a gradual transition to retirement, and at a later age.

11. Faced with population ageing, Member States should pro-actively tackle poverty and maintain adequate income in old age. Considerations of financial sustainability should take account of both the revenue and expenditure side of the government accounts and the effects of increased and longer employment. Minimum benefits in old age should be high enough to effectively contribute to poverty prevention. Member States (and where schemes are collectively negotiated also the social partners) should ensure that all people of working age are included in contributory pension schemes that adequately replace income from work.

12. Periods of care giving, such as looking after children and older people – that involve people having to give up employment or to work part time, should be credited for pension purposes, including through subsidies in the case of non-public schemes.

E. Ensuring equitable and high-quality long-term care provision

13. Given the increase in long-term care needs in ageing societies, Member States should reinforce the availability of high-quality care services, including ambulant, home-based and residential care, and ensure freedom of choice. Member States should ensure that services are accessible to all and are covered by social protection (contributory or tax-financed), with a reasonable ceiling on the co-payments that families need to make.

F. Promoting inclusive and environment-friendly housing and transport

14. Member States should foster housing that is affordable, energy-efficient, and based on ‘universal design’ principles, ensuring that it is accessible to all. Support should be provided to households with low incomes or savings (in particular young people and families with children), and people with disabilities or older people with special needs. Member States should support local authorities, housing associations, and social economy organisations in this process, and the EU funds should support pilot social innovation projects.

15. To foster social cohesion and a fair green transition Member States should ensure affordable and energy-efficient public transport, with reliable networks and green alternatives. Social inclusion and equal access to public transport should be part of urban and rural planning and supported by public subsidies, with particular attention being paid to deprived areas.

G. Ensuring inclusive service provision that enhances well-being and capabilities

16. To provide effective, high-quality and comprehensive social services, Member States need to improve service provision at local level, foster co-production and professionalisation, and make the most of digitalisation opportunities. Member States should have quality standards and quality-assurance mechanisms for social services and apply them to both public and private providers. Member States should increase the involvement of non-profit and social economy organisations in the design and delivery of social services. The EU should foster more research and exchange of information on good practice to support innovations in the governance and provision of social services.

H. Ensuring sustainable financing for a resilient welfare state

17. To address the increasing financial needs of the welfare state, Member States should consider broadening the tax basis and readjusting the revenue mix beyond social contributions that add to labour costs and to expand the revenue from progressive taxes on income, consumption, capital and wealth, as well as from carbon and energy taxes. To prevent harmful tax competition and social dumping, the EU should co-ordinate Member States' efforts to pursue a common policy on capital taxation and to counter tax evasion and tax avoidance.

18. The EU and Member States should consider a European agreement on minimum tax rates on capital and harmonised EU rules on capital taxation to strengthen the potential basis for funding social protection and to help to avoid competition on social protection standards.

19. In the context of the future EU fiscal governance, social protection and especially social investments need to be secured. A 'golden rule for public finances' should allow borrowing for social investment, in a starting phase at least, for investment in social infrastructures.

I. Stepping up EU capacity to secure social protection in the future

20. The EU should consider the adoption of additional legislative initiatives in respect of employment and social policy in order to fulfil all principles of the European Pillar of Social Rights, ensure consistent enforcement across the EU, and limit any unfair competition on social protection standards.

21. Member States should guarantee to all their residents a minimum package of social rights, based on the principles of the European Pillar of Social Rights, which need to be upheld at all times, including after external shocks.

Closing note: Two cheers for the welfare state and one for the EU

The High-Level Group on the Future of Social Protection and of the Welfare State in the EU started its work at a time when the EU was experiencing a short-lived surge in growth following the COVID-19 pandemic. Since Russia's war of aggression against Ukraine began in February 2022, the clouds over Europe have darkened, begging many questions as to whether the European welfare states can stand the test of the hard times caused by war, rising energy and food prices and runaway inflation. It would be easy to imagine that there is less scope in this new context for both fiscal expansion and quantitative easing in monetary policy. But we would like to end on three blessings and lessons that should not be overlooked in the hard times ahead.

Firstly, the unsung heroes of the Great Recession were – in hindsight – the more inclusive and effective European welfare states. They were the ones to quickly recover from economic and employment shocks; and since the mid-2010s to see employment rates bounce back to higher levels than before 2008.

Secondly, in the early phase of the COVID-19 pandemic the welfare state played a critically important role, with the swift introduction and expansion of furlough schemes and the use of digitalisation to enable home working and schooling These all bought precious time while effective vaccines were developed, and, equally importantly, allowed key workers to carry on performing indispensable transport, service and care jobs.

Thirdly, by the summer of 2021, the strong economic rebound from the pandemic was sealed when the EU wisely suspended its fiscal rules, thereby strengthening fiscal solidarity and insurance against unemployment, a step that would have been unthinkable during the Eurozone sovereign debt crisis only a decade earlier.

Why is it so important to emphasise these achievements by way of conclusion? Because the prevailing view in the early years of the Great Recession was that an inclusive welfare state was unaffordable in the face of intensified global competition. Today, most politicians and policy-makers concede that we cannot afford to miss out on inclusive and capacitating welfare states.

Learning from these experiences over the past decade, the EU has gradually moved away from market-focused governance disciplining domestic policy-makers to keep high welfare state spending in check. The EU now aims to provide an environment in which an active welfare state can prosper, supported by discretionary fiscal resources for social investment. In 2017, the EU adopted the European Pillar of Social Rights, setting out 20 key principles with a balance between protective and activating policies to underpin well-functioning labour markets and welfare systems. Since the pandemic, these principles have been supported by new instruments – SURE and the RFF (Support to mitigate Unemployment Risks in an Emergency, and the Recovery and Resilience Facility) – and many legislative and policy initiatives. High-quality education and skills, affordable care and early childhood development, and inclusive social security and public health that empower and protect all residents and their families, will prove to be important ingredients for Europe's future economic, social, and political progress and resilience. A Social Europe should support the political union of national welfare states that take the high road of fair and capacitating welfare provision and social protection for all.

Annex

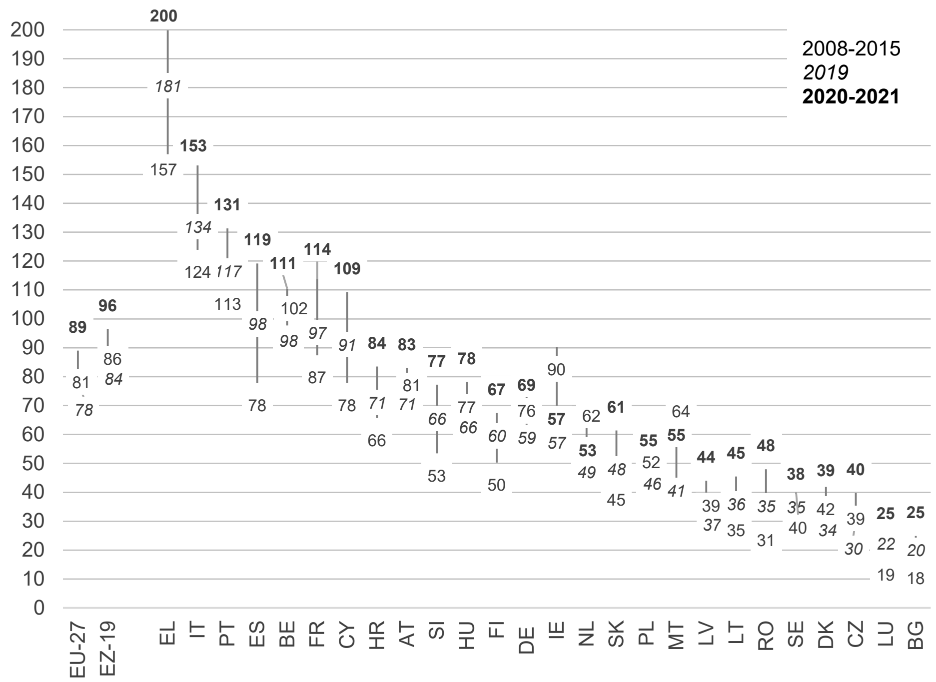
***Table A1:** Corrected structural government balances, forecasts for 2023 (as% of GDP, except for inflation[1])*

	Public balance	Cyclical balance	Net public invest-ment	Debt depreci-ation 2% inflation[2]	GDP deflator	Gap, 2% inflation	Gap, effective inflation
Eurozone	-3.7	0.0	0.7	1.8	5.3	-1.2	1.4
Germany	-3.1	-0.7	0.5	1.3	6.8	-0.6	2.6
France	-5.3	0.0	0.6	2.2	5.0	-3.5	0.8
Italy	-3.7	0.3	0.6	2.0	3.4	-0.8	1.5
Spain	-4.3	-0.1	0.6	2.3	4.2	-1.5	1.3
Netherlands	-4.0	0.8	0.9	1.0	3.4	-2.9	-2.1
Belgium	-5.8	0.1	1.2	2.1	4.9	-2.6	0.6
Austria	-2.8	0.3	1.0	1.5	6.1	-0.6	2.6

Source: Own calculations, on the basis if the European Commission AMECO database (Autumn 2022).

Notes:[1] Inflation here is measured as the growth in the GDP deflator.[2] Forecast for GDP deflator in the Commission's Autumn 2022 forecasts.

***Figure A1:** Public debt as% of GDP, EU-27 Member States*



Source: Eurostat, general government debt (% GDP), National Accounts indicator (ESA 2010) [GOV_10DD]. Averages for periods indicated, except 2019. Note: EZ19 = 19 Eurozone countries.

Table A2: Indicators of social spending on older people, 2019 and estimates for 2030 and 2070 (at 2019 prices), EU-27

	2019	2030	2070	% change or %-point change 2019-2070
GDP (in billion €)	14,049	15,839	27,877	98
Population (million)	447.2	449.1	424.0	-5
Population 65+ (million)	91.2	109.6	128.5	41
Population 65+ (% of total population)	20.4	24.4	30.3	9.9
Total pension spending (% GDP)	10.7	11.5	10.8	0.1
Old-age and early pensions (% GDP)	9.3	10.2	9.9	0.6
Survivors' pensions (% GDP)	1.4	1.3	0.9	-0.5
Total health and long-term care (LTC) spending (% GDP)	8.3	8.9	10.3	2.0
Healthcare (% GDP)	6.6	7.0	7.5	0.9
LTC (% GDP)	1.7	1.9	2.8	1.1
Total pensions + healthcare + LTC spending (% GDP)	19.0	20.4	21.1	2.1
GDP per capita (€ per capita)	31,416	35,268	65,747	109
Healthcare and LTC spending (€ per capita)	2,608	3,139	6,772	160
Healthcare (€ per capita)	2,073	2,469	4,931	138
LTC (€ per capita)	534	670	1,841	245
Spending on pensions (€ per capita)	3,362	4,056	7,101	111
Spending on pensions + healthcare + LTC (€ per capita)	5,969	7,195	13,873	132
Social spending on population 65+ (€ per capita)	4,932	5,960	12,640	156
Social spending on population 65+ (% GDP)	15.7	16.9	19.2	3.5
Social spending per pensioner (€ per capita)	24,178	24,427	41,716	73
Rest of GDP of population below 65 (€ per capita)[1]	33,271	38,766	76,194	129
Education spending (% GDP)	4.1	4.0	4.0	-0.1
Education spending (€ per capita)	1,288	1,411	2,630	104

Source: Pacolet et al. (2021). based on information from 2021 Ageing report and European Commission Spring Forecast 2021 for GDP. Education figures come directly from 2021 Ageing Report.

Note: [1] GDP excluding social spending on population 65+ relative to population less than 65.

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