



Labour-Market Reforms in Europe: Repairing Problems or Investing to Prevent?

Torben M. Andersen and Christian Keuschnigg



European Bureau
for Policy Consulting
and Social Research
Vienna

| BertelsmannStiftung

Country abbreviations

AT	Austria	EE	Estonia	IT	Italy	PT	Portugal
BE	Belgium	FI	Finland	LV	Latvia	RO	Romania
BG	Bulgaria	FR	France	LT	Lithuania	SK	Slovakia
HR	Croatia	DE	Germany	LU	Luxembourg	SI	Slovenia
CY	Cyprus	GR	Greece	MT	Malta	ES	Spain
CZ	Czech Republic	HU	Hungary	NL	Netherlands	SE	Sweden
DK	Denmark	IE	Ireland	PL	Poland	UK	United Kingdom

Labour-Market Reforms in Europe:
**Repairing Problems or
Investing to Prevent?**

Torben M. Andersen and Christian Keuschnigg

Abstract

For most people, obtaining economic and social opportunities depends on access to labour-markets. Effective and flexible labour-markets allow economies to cope more easily with ageing and the disruptions of innovation and globalisation. Positive outcomes include the ability for women and men to reconcile work and family life adequately; young people's ability to make a smooth transition from education to work; and robust labour-market integration for immigrants, allowing them to become active contributors to the economy and the welfare state. Policymakers must strike a balance between preventive and corrective strategies. If a country fails to implement preventive measures, it must later make policy corrections on an ex post basis, which often entail very high costs. A survey of 1,058 experts evaluates both the need for reform and actual reform performance, as measured by the frequency and quality of reform, within the EU-28 countries. The survey covers five areas of social inclusion, including poverty prevention, education, labour-market access, social cohesion and non-discrimination, and health. While there is significant variation across member states, experts perceive the most urgent need for reform in the area of improving access to labour-markets; however, reform performance here is middling at best.

Table of Content

Introduction	5
Challenges and Reform Activity in Europe	9
Youth Labour-Market Access	9
Facilitating Innovation and Change	11
Resilience, Economic Security and Equality of Opportunity	16
Work, Participation and Welfare in a Greying Society	19
Gender Equality and Diverse Social Norms	22
Refugee Crisis and Migration: Participation or Alienation?	24
Summary	27
References	29
About the Authors	31

Introduction

European labour-markets are finally recovering after the financial crisis. The labour-market consequences of the crisis have been dire, and the recovery process slow. For the EU as a whole, employment rates are now back to their pre-crisis level and unemployment rates too have fallen nearly to their pre-crisis lows.

These general trends conceal large differences both across and within countries. In particular, southern European countries still suffer from high levels of unemployment. Long-term unemployment rates have generally increased in the EU; the share of youth neither in employment, education or training is high; and various groups are marginalised in the labour-market (see SJI 2016).

Various countries have displayed substantial differences both with regard to the impact of the crisis and to the recovery process. The former reflects different levels of exposure to the financial-sector crisis and subsequently different degrees of decline in aggregate demand. The latter reflects differences in national labour-market resilience and adjustment capabilities via wages, working hours, etc., as well as different policy responses, in particular fiscal policy and the degree of flexibility available to pursue counter-cyclical policies (see e.g., OECD, 2017).

Recovery from the crisis is a first important step. However, the situation was not satisfactory in many countries even before the crisis. Unemployment rates were often high. Inequality and problems of social exclusion and polarisation were on the rise. The crisis has intensified these problems. Declining levels of social cohesion and widening divides within national populations pose both political and economic challenges. The *Reform Barometer* (RB, 2016) points to a large need for reform in many countries.

Labour-markets continuously change. They must cope with megatrends including new technologies, globalisation, and ageing populations. Potentially all of these changes are associated with benefits to society in the form

About the Social Inclusion Monitor (SIM) Europe

The data for the *Social Inclusion Monitor* (SIM) Europe is based on two instruments:

- The *Social Justice Index* is based on statistical indicators, rounded out by expert assessments, and measures the status of social justice in the EU member states. The *Social Justice Index 2017* provides data for the years 2008, 2011, 2014, 2015, 2016 and 2017.
- The *Reform Barometer* uses Europe-wide surveys of social policy experts as a basis for analysing how national governments react to their respective country-specific challenges. It collects assessments of the need for reform, the extent of the reform activities, and their expected impact. A total of 1,058 experts took part in a survey in March 2016 for the *Reform Barometer 2016*, which covers the period between July 2014 and January 2016.

The survey for the *Reform Barometer* is conducted by the Bertelsmann Stiftung in collaboration with the European Bureau for Policy Consulting and Social Research Vienna and the Economic Policy Center (WPZ) at the University of St. Gallen.

Both instruments take six dimensions of social inclusion into account: poverty prevention, equal opportunity education, labour-market access, social solidarity and non-discrimination, health care and inter-generational justice.

On the basis of the results, proven experts in the field prepare in-depth analyses on selected countries and subjects, which are also used as a basis for events, such as *SIM Europe Debates* and other conferences in the capitals of EU member states. These analyses should make it possible to sketch out and compare across Europe strengths and weaknesses, challenges and opportunities for development, achievements and deficits, relapses and progress, and how societies are perceived by both themselves and others. This should show learning curves and policy success or failure over the time frame and the potential for learning from each other in the European Union. In other words, it asks: Which EU member state can learn what from whom?

of new opportunities and possibilities such as higher productivity and incomes, more product variety, and longer and healthier lives. Experience demonstrates, however, that such changes do not necessarily lead to improvements for all. These trends are associated with structural changes and disruptions that create both winners and losers. Although winners in principle could compensate losers, this does not happen automatically. There is a risk that cleavages in society will become larger in the absence of appropriate policy actions.

Globalisation and the emergence of new technologies are not new challenges, but are rather ongoing processes. It is often hard to distinguish between the two trends; however, doing so is also not very important from a policy perspective. The labour-market consequences of each are relatively similar. The effects of job creation and job destruction each have a similar skill-level bias, and more recently a routine bias as well. What this means is that the most vulnerable groups are unskilled workers and those holding jobs (so-called routine jobs) with a higher risk of being outsourced or taken over by machines (robots).

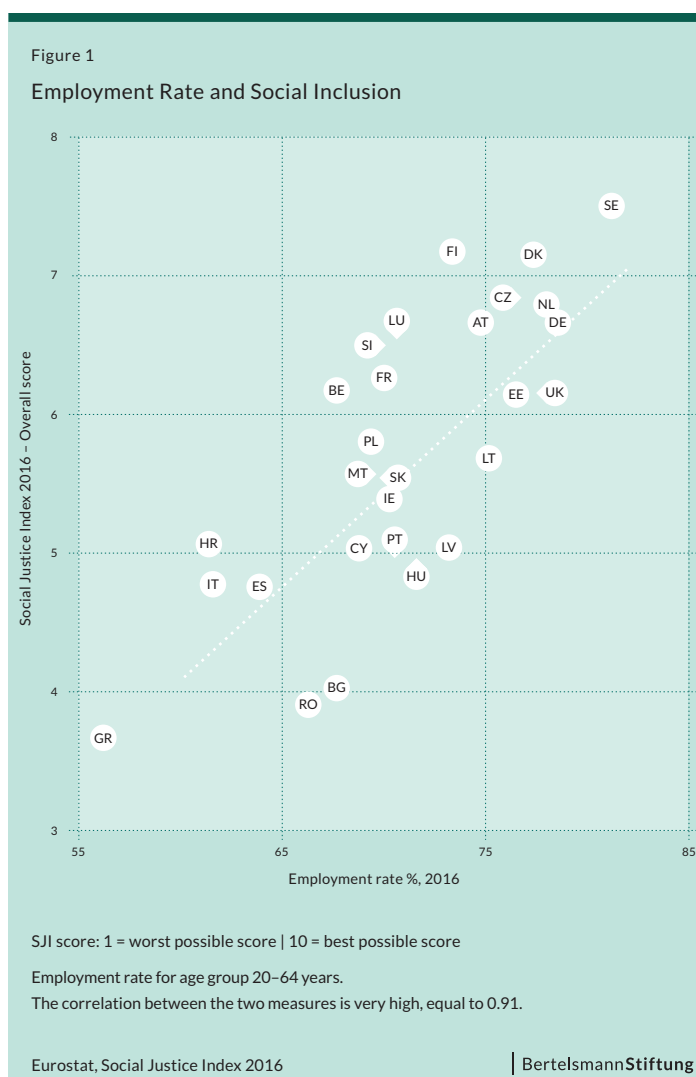
Migration is a very visible challenge. It is important to distinguish between worker migration within the EU and the immigration of refugees and economic migrants from low-income countries outside the EU. The former results from a deliberate, though controversial, policy decision intimately linked to the internal market and the common currency. The flow of refugees and economic migrants conversely depends on outside economic and political developments, and involves humanitarian questions. Immigration from low-income countries presents challenges to liberal entry regimes due to the difficulties of subsequent integration in the labour-market and in society more generally.

Ageing is affecting all EU countries. The drivers are relatively low fertility rates and increasing longevity. If pension-eligibility and retirement ages remain unchanged, the balance between the number of years people

alternately contribute to and receive benefits from welfare and pension systems is affected. For most individuals, a higher life expectancy is associated with healthy ageing. Later retirement is the obvious solution. Technically, this policy is straightforward, but politically it can be a difficult prospect. When raising retirement ages, policymakers must confront difficult questions. How can it be ensured that people are able to maintain and develop their human capital enough to extend their working life? How should one design and reform the social safety net to cope more effectively with heterogeneous health conditions, and thus afford the ability to extend working lives? Recently, a most promising and indeed striking development across all EU countries is the rise in employment rates among the elderly. The employment rate of the 55–64 age group has increased even against the background of the financial crisis. Indeed, the EU average was about 10 percentage points higher in 2016 than in 2008. Prolonging working-life thus seems economically and politically feasible.

Coping with the changes affecting labour-markets is a major political challenge. How can employment rates be maintained and increased? A higher employment rate implies that more people are self-supporting and in control of their own lives. It is also important for material well-being (GDP), inequality and the public finances. The failure to maintain a high employment rate is associated with severe economic, social and political problems. In contrast, rising employment rates produce gains along several dimensions, as seen in Figure 1. Quite clearly, social inclusion as measured by the *Social Justice Index* is positively associated with the employment rate. The link cannot be perfect, however, since the gains from rising employment rates depend strongly on the quality of jobs. Obviously, rising employment rates as a consequence of precarious jobs concentrated among the working poor is not much of a solution to either economic or social problems. Apart from wages, the factors of job security, working conditions and work-life balance are other important quality dimensions of employment.

Policy debates frequently stress that labour-market problems need policy solutions which balance both economic and social objectives. The OECD stresses the importance of inclusive growth, and has calculated a scoreboard that includes indicators of job quantity, job quality and inclusiveness. The EU has initiated a process to develop a European Pillar of Social Rights. The proposal presents 20 principles structured around three themes: equal opportunities and access to the labour-market, fair working conditions, and social protection and inclusion. The aim is “to serve as a guide towards more efficient employment and social outcomes when responding to current and future challenges which are directly aimed at fulfilling people’s



essential needs, and ensuring better enactment and implementation of social rights” (EC, 2017). While the European Pillar of Social Rights is aimed at countries within the euro area, other EU countries have the option to join. The Pillar falls under the open method of coordination, with the main responsibility for implementation resting with the member states. Monitoring of progress will take place via a social score-board comprising a limited set of indicators assessing employment and social trends.

Challenges and Reform Activity in Europe

Youth Labour-Market Access

Youth-unemployment rates soared in the wake of the Great Recession, increasing (for those below the age of 25) in the EU-28 from 15.9% in 2008 to a peak of 23.7% in 2013, but falling to 18.7% in 2016. In 2013, the youth-unemployment rate reached as high as 58.3% in Greece, 40.0% in Italy, 38.1% in Portugal and 55.5% in Spain. The prospects facing young people in these countries remain dismal. A high proportion of 25–34 year olds are still living at home, and emigration rates are high.

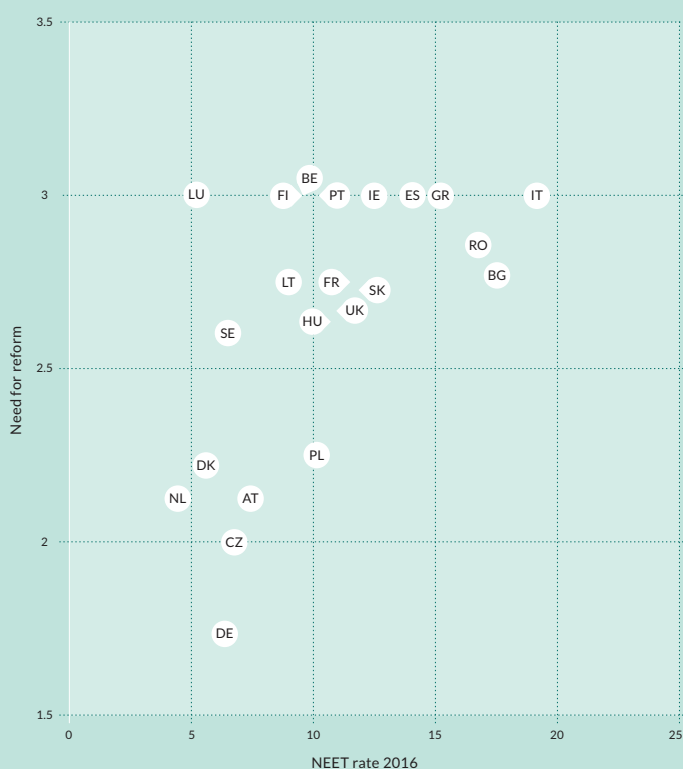
Youth unemployment and the implied generational divide is probably the most serious present threat to social cohesion, and policy initiatives in this area are particularly urgent. This is clearly expressed in the *Reform Barometer* (RB, 2016) where the policy objective of “increasing employment/decreasing unemployment” among 15- to 24-year-olds receives the highest policy-need score of any policy area. Experts also report that policy initiatives have been taken in many countries, but that given the scale and importance of the problems, these measures have not yet been sufficient. The expert scores for both reform quality and performance are rather low. Figure 2 indicates the share of youth not in employment, education or training (NEET), as well as the expert assessment of the need for reform to increase employment rates/reduce unemployment rates within the 15–24 age group. Across all EU countries, the reform need is assessed as being high, and is very high for countries with high NEET rates.

Youth unemployment causes high individual and societal costs, which makes it a major policy challenge. Entry into the labour-market is of crucial importance for labour-market prospects later in life. Entry is contingent upon factors including both the business cycle and a structural component. Youth-employment rates are generally more cyclically sensitive than the corresponding rates of other age groups. Initial unemployment may also create a scarring effect for cohorts entering the labour-market in a slump.

Structurally, youths entering the labour-market with weak qualifications are particularly vulnerable throughout their working career.

Figure 2

Rate of Youth Neither in Employment, Education or Training (NEET) and Need for Reform to Increase Employment for Youth (15–24 years)



RB reform need: 0 = no need at all | 3 = very strong need
NEET rate for age group 15–24 years.

Eurostat, Reform Barometer 2016

| BertelsmannStiftung

Even before the crisis, the share of youths not in employment, education nor training (NEETs) was high in many countries, producing substantial individual and social costs. Young people who fail to acquire relevant labour-market qualifications are a major challenge, since they face a high risk of becoming marginalised throughout their working lives. Such risks are exacerbated by technological change, globalisation and other drivers of fast-changing skill requirements. In a number of countries, labour-market entry for youth is impaired by employment-protection legislation that has detrimental effects on the quantity of job openings, a factor that is particularly critical for youth.

A major EU initiative known as the Youth Guarantee involves a commitment by all member states, given in 2013, to ensure that all young people under the age of 25 receive a high-quality offer of employment, continued education, apprenticeship or training within a period of four months after becoming unemployed or leaving formal education. While it is too early to evaluate the effects of this programme, preliminary evidence does not indicate significant effects (see e.g., Eichhorst and Rinne, 2017). There is no indication of a structural shift. Youth unemployment across EU countries has not fallen faster than average unemployment.

The complexity of the problem is reflected in the wide differences between youth-unemployment rates across European countries, even before the crisis. These differences often correlate with other performance indicators.

There seems to be no simple or common remedy for all countries. Policy reforms should be closely aligned with country structures and institutions. Although cross-country comparisons may yield important lessons, the solutions are country specific.

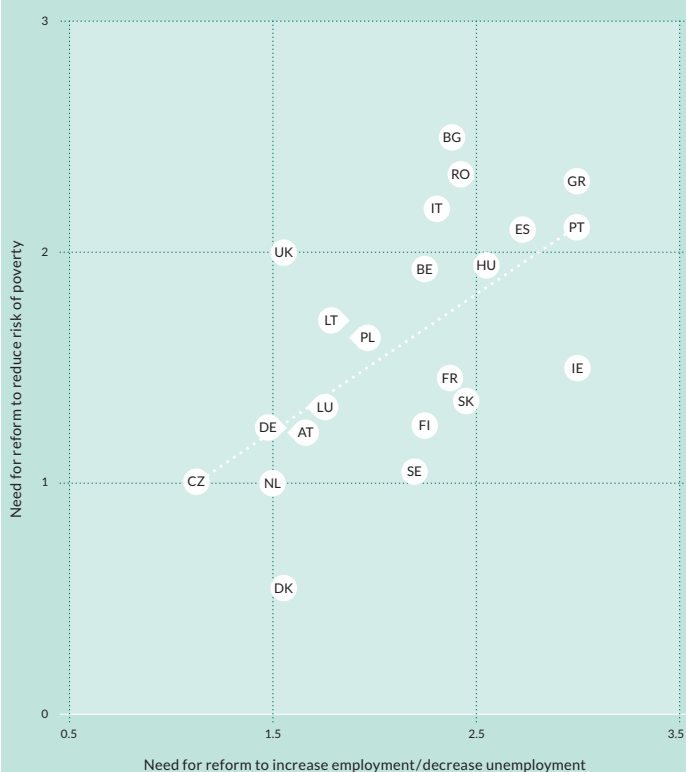
Many young people face a barrier to the completion of labour-market-relevant education due to insufficient learning during primary and secondary school. Ample empirical evidence documents the difficulty of making up for such deficiencies later in life. Hence, early intervention is very important. Basic schooling is the foundation for later labour-market careers, with improvements in early education obviously affecting the qualifications of the labour force, though with a long time lag.

The entire process, throughout the educational system, is crucial in ensuring that youth acquire labour-market-relevant educations. The school-to-work transition is particularly important, with vocational training playing an important role in this respect. Dual apprenticeship systems such as that in Germany, in which students spend time both in a vocational school and at a company (on-the-job-training), have been rather successful (see e.g., Fazekas and Field, 2013).

The design of the social safety net for youth involves difficult trade-offs. On the one hand,

Figure 3

Need for Reforms to Reduce Risk of Poverty and to Increase Employment / Decrease Unemployment, total population



RB reform need: 0 = no need at all | 3 = very strong need

The correlation between the two measures is equal to 0.61.

Reform Barometer 2016

| BertelsmannStiftung

the social safety net is particularly important for young people who have had no or only little opportunity to save for rainy days. On the other hand, it should not be so generous that it turns into a barrier to education or to job search. The design of active labour-market policies can alleviate the tension between insurance and incentives. As an example, Denmark has changed its social safety net for young people (below the age of 30) who lack a labour-market-relevant education. The reform both caps income support and makes entry into education mandatory. The experience so far has been mixed. Many individuals have enrolled in educational programmes, but it remains unclear whether they are succeeding and finding jobs. Attempts to influence the demand for youth workers, for example by lowering payroll taxes for youth in Sweden, have not been shown to produce large effects (see Skedinger, 2014).

One striking finding within the *Reform Barometer* is that the need for reform to reduce the risk of poverty is closely correlated with the need to increase employment rates/decrease unemployment rates (see Figure 3). This clearly points to the importance of employment as a key policy objective, but also as a preventive measure with implied positive consequences for many other aspects including poverty, social cohesion and the health of the public finances.

Facilitating Innovation and Change

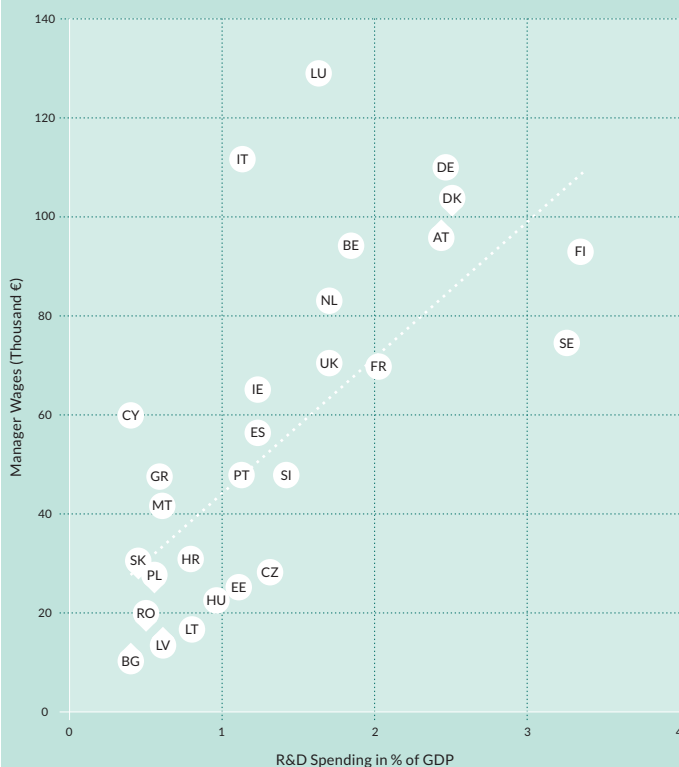
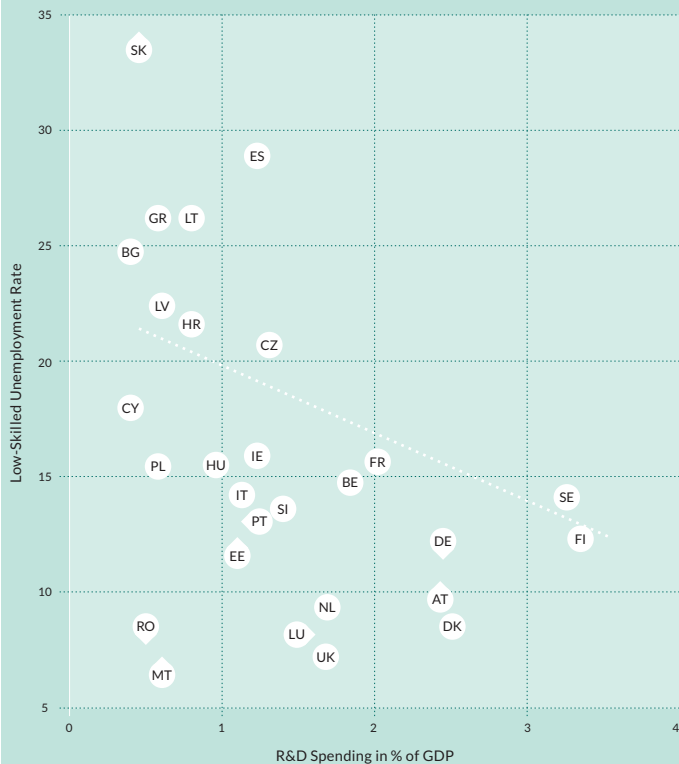
Innovation is a key source of productivity growth that drives increases in per capita income. Innovation requires private R&D investment in order to develop new products and processes, as well as public investment in basic research and education. R&D is a very highly skill-intensive activity, and production at the technological frontier is also heavily skill biased. Importantly, innovation induces structural change. New products and processes replace old ones. New skills and qualifications are required, while old ones become obsolete. Empirical evidence thus indicates that innovation has a skill bias that tends to widen the wage gap between high- and low-skilled workers. If wages are relatively inflexible, innovation contributes to diverging job opportunities. Unemployment becomes concentrated among the low skilled, while there is excess demand for the high skilled. Such lessons are evident from the IT revolution in the 1990s. Krusell et al. (2000) estimated that technological progress in the United States over about 30 years (between 1963 and 1992) raised the net skill premium by 18%. According to their estimates, skill-intensive capital investment raised the premium by about 60%, which was offset by a 40% decline due to the growth in the skilled-labour supply. Clearly, education, training and requalification can prevent a substantial widening of the income distribution. It seems quite plausible that the same experience will be repeated in the future as the transition to the digital economy comes to require new tasks and skills, and the increased use of robots replaces routine work.

Figure 4 illustrates the challenge from a European perspective. The figure plots EU member states' R&D expenditures in percent of GDP against labour-market indicators of high- and low-skilled work. Due to the long time lag

Figure 4

Labour Market and R&D:

Skill-biased Wages and Unemployment in the EU-28



R&D 2008, low-skilled unemployment rate 2016, manager wages 2014

Eurostat

BertelsmannStiftung

associated with the economic effects of R&D, we use R&D spending figures from 2008. We expect that wages will be more flexible at the upper part of the wage distribution, and less so at the lower end, where wages tend to be rigid in the downward direction due to the social safety net and possibly the presence of minimum-wage legislation. The skill bias might thus translate into rising wages at the upper end and rising unemployment (or non-participation) at the lower end. Clearly, Figure 4 illustrates that wages for the highly skilled, as proxied by manager salaries, tend to rise with member states' comparative R&D orientations. However, despite the structural change and the skill bias in R&D-driven growth, the more R&D-intensive countries actually seem to exhibit lower rather than higher unemployment rates within their low-skilled workforces. Thus, given the importance of many other institutional and structural determinants of low-skilled unemployment such as the prevalence of vocational training and life-long learning, low-skilled unemployment appears not to be an unavoidable consequence of innovation, and inclusive growth seems entirely possible.

Maintaining employment requires the development of new skills when some traditional tasks become increasingly irrelevant. In creating differential wage increases and employment prospects, technological change tends to spread out the income distribution. As innovation produces winners and losers, it also produces challenges for social cohesion and requires active reform to make growth more inclusive. Society must thus not only invest in R&D but also renew its human-capital base. It must build labour-market institutions that help workers move from downsizing firms and declining industries where jobs are insecure and pay is low to growing firms and expanding industries where career prospects are better and wages are higher. Such flexibility also seems to be a precondition for upward social mobility, as people can move up the social ladder only if they upgrade their skills and actively grasp better opportunities, be this via careers in traditional employment or start-up entrepreneurship. While the widening of the income and wealth distributions is a threat to social cohesion, one must also keep in mind

that income differences create a reward for innovation and effort. Researchers have found that an increase of 10% in the number of patents granted within a country is associated with an increase in the share of national income accruing to the top 1% of income earners by 2.4% (see Aghion et al., 2015). They have also estimated that 22% of the increase in the income share held by the top 1% of earners is associated with innovation, and found that social mobility and innovation are positively correlated. Fostering upward social mobility is a preventive policy strategy that combats poverty and reduces the income divide by helping more people climb up the social ladder. A key policy challenge in Europe should be to create a “European vision”—as opposed to an American dream—of education, entrepreneurship and inclusive growth¹.

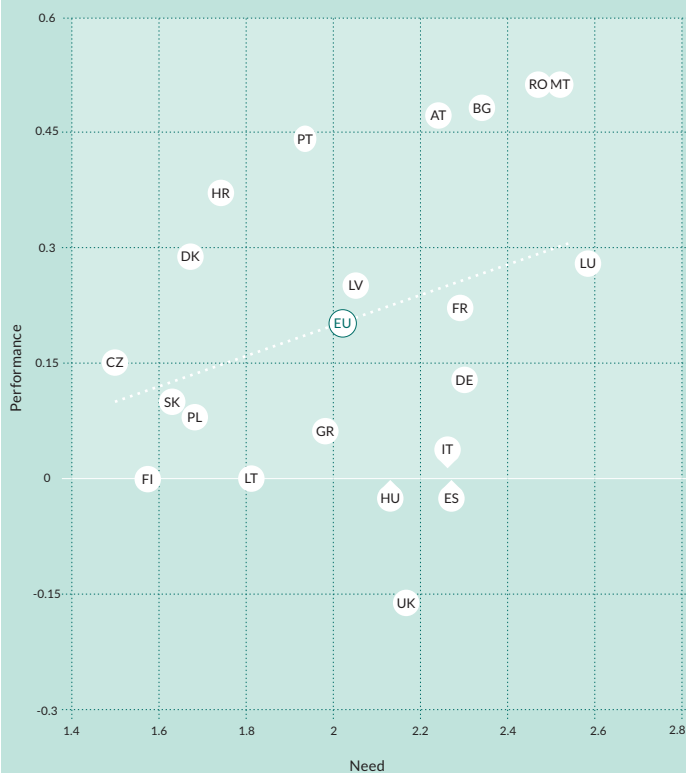
Since innovation and social mobility are truly long-term processes, success and failure in these dimensions are critical determinants for the economic possibilities facing Europe’s future generations. The most important educational investments in early schooling affect employment and earning prospects several decades later, and it takes a similar period of time for basic research to disseminate in the private sector and increase productivity and competitiveness. For this reason, a country’s R&D spending is a key investment made by present generations for the benefit of future generations, and thereby affects welfare across generations.

R&D represents a primary competitive strategy for firms seeking to stay ahead of their competition. To remain profitable, firms must continuously create new products and brands, and improve their processes so as to contain costs and create quality improvements justifying higher prices. Innovation creates market potential and boosts sales. The most successful and productive firms must tap world markets with potentially unlimited growth opportunities. Access to global markets is all the more important for enterprises acting in a highly specialised market niche or with small domestic markets. The hidden champions in small European countries often export 80% to 100% of their production. National markets are much too small to offer growth opportunities for highly specialised innovators, especially within small countries. Access to the large common market in Europe is thus more important for smaller than for larger economies. These observations ultimately provide a rationale for the importance of the large common EU market and global free trade with regard to successful innovation and growth in Europe. Because firms with a high R&D intensity are comparatively more innovative than their peers, they need a more skilled workforce, are more productive and export intensive, and pay higher wages. Innovation and the degree of globalisation are strongly related. To some extent, innovation creates globalisation because it induces firms to serve global markets. The flip side is that import competition “forces” declining industries with below-average productivity out of business, as foreign competitors are able to serve customers better. The policy challenge is that these megatrends create winners and losers among firms and workers alike. An inclusive growth strategy cannot simply seek to prevent innovation and globalisation, factors which are the source of economic progress. The key challenge is to reap the productivity gains associated with these trends by moving labour and capital from unproductive to highly productive sectors in the economy. Research suggests that the targeted

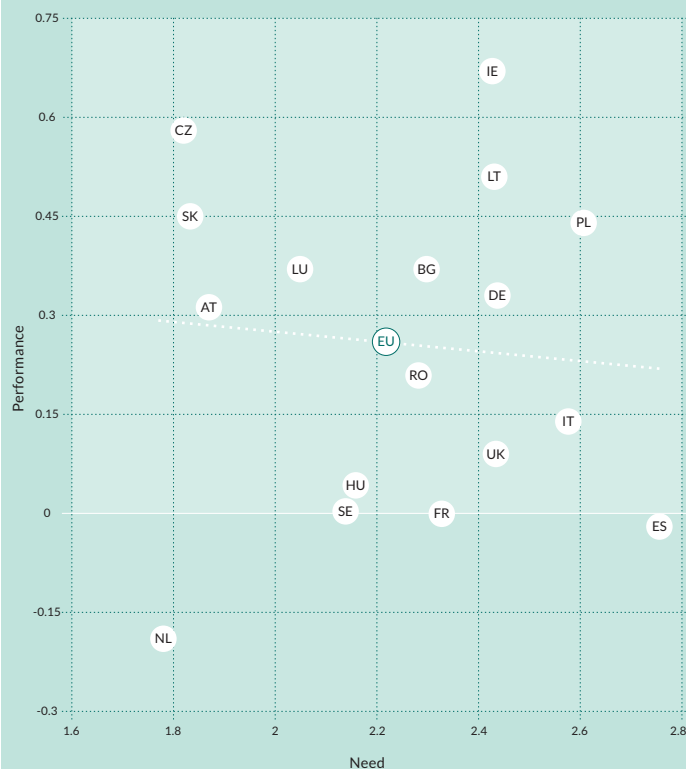
1 see Landersø and Heckman, 2017

Figure 5

Need for Performance of EU Labour-Market Reform Equitable Education



Labour Market Access



RB reform need: 0 = no need at all | 3 = very strong need

RB reform performance: +2 = best possible score | -2 = worst possible score

Reform Barometer 2016

BertelsmannStiftung

reallocation of labour and capital from declining to growing firms may account for up to half of all productivity growth.²

Ensuring inclusive growth in a rapidly changing world requires active reform. Policy-makers should push for a combination of preventive ex ante investments and corrective ex post measures. The key means of complementing R&D and innovation and facilitating upward social mobility is to invest in education at all levels, from kindergarten to vocational training to university education. The closer a country comes to the technological frontier, the more important are the roles played by tertiary education and basic research in relative terms. Since the inflow of newly educated workers and employees is only a small share of the total labour-force, any improvement in upfront education will take decades to affect the basic skills of the entire labour-force stock. Since digitisation and the use of robots are changing skill requirements at a much higher rate, life-long learning and business investment in re-qualification and retraining become all the more important.

How successful are EU member states in implementing reform that makes their welfare systems more compatible with the needs of an innovative economy? The RB 2016 surveys 1,058 experts in the EU-28 regarding the perceived need for reform, as well as the perceived intensity and quality of existing reform activity. Experts could rate the need for reform on a scale between 0 and 3. Existing reform activity is measured by the fraction of experts who answered 1 (some reform introduced) instead of 0 (no reform). The quality of reform is measured on a scale between -2 and +2, and thus reflects expert expectations that the existing reforms will have strongly negative (-2), mixed or strongly positive effects (+2). Overall performance is measured by the product of activity and quality ratings. Thus, if the activity rate were 0.4 and the quality were assessed to be 1.5, reform performance would be 0.6 ($=0.4 \times 1.5$). Figure 5 reports summary results on the two dimensions which are most important to reconcile social inclusion with innovation and

2 Bartelsman, Haltiwanger and Scarpetta (2013) estimate that labour productivity in the U.S. manufacturing sector is 50 percent higher than it would be if labour-shares were randomly allocated within industries.

structural change, i.e., equitable education and labor market access. Some countries are not included when too few survey responses are available. Hence, the lists of countries ranked in the two figure panels are not identical. Apart from these caveats, one should keep in mind that the results are based on expert opinions rather than hard data. The opinions may not be completely free of subjective bias. On the other hand, an expert assessment may reflect considerably more “soft” information, and thus offer a richer picture, than a purely statistical analysis would provide. Moreover, reliable and meaningful statistical data measuring the quality and activity of reform would be difficult to obtain. Ideally, one would hope that reform performance would be higher in countries where there is a high need for reform. However, the ability to implement reform depends on many political and institutional factors, as well as varying preferences regarding the desired welfare-state model that might be unrelated to the need for change. Thus, one cannot expect a very close relationship between these measures.

Experts perceive a quite high need for reform in the area of labour-market access. The overall rating captures a range of survey results regarding the change in employment and unemployment rates in vulnerable population groups such as the long-term and low-skilled unemployed, senior citizens, youths, women, immigrants, and refugees. Questions also refer to the prevalence of precarious employment in terms of temporary contracts, low-wage workers or in-work poverty. Figure 5 indicates that the overall assessment of the need for reform is quite high, with a cross-EU average of 2.22 (on a scale of 0 through 3). As might be expected, the need for reform is considered quite urgent in member states such as Ireland (IE) and Spain (ES) that are recovering from the euro zone crisis, as well in some eastern European countries such as Poland (PL), Lithuania (LT) and Bulgaria (BG) that are starting from comparatively poor initial conditions. The need for reform is perceived as being much below the EU average in mature and rich member states such as the Netherlands (NL) and Austria (AT). However, the expert assessments also yield important and surprising exceptions to this rule; thus, respondents also see an urgent need to improve labour-market access in some large core member states such as Italy, Germany, the United Kingdom and France, while reporting much less of a problem in the Czech Republic and Slovakia.

Regarding equitable education, EU member states’ reform performance as reflected in the expert survey is positively associated with the perceived need for reform. The performance of governments tends to be higher when there is a large need for reform. Taking the regression line as a benchmark, expert opinion identifies a number of countries with above-average performance relative to the need for reform both among old member states such as Austria, Denmark and Portugal, and among new eastern European members such as Romania and Bulgaria. In spite of a relatively high need for reform, some countries such as Italy, Spain, Hungary and, in particular, Great Britain fall considerably under baseline expert expectations. Regarding labour-market access, the expert survey reveals a much less clear-cut association between the perceived need for reform and actual reform performance. Experts see relatively little need for reform and a strong reform performance in the Czech Republic and Slovakia, while reporting a similarly strong reform performance in several high-need countries such as Lithuania and Ireland.

Resilience, Economic Security and Equality of Opportunity

Beyond high income, people demand economic security, which allows them to enjoy a comparable level of consumption and welfare both in good and bad life states. A key function of the welfare state is to absorb the labour-earning risk that results from economic fluctuations. Social insurance should support a smooth path with regard to disposable earnings after taxes and income supplements. Economic security becomes even more desirable in a dynamic and innovative economy and in times of disruption and structural change, because labour income is subject to larger risks. Firms, by their very nature, absorb risks and insure workers, paying them smooth wages and keeping up employment over time despite large fluctuations in business revenue. Economic research suggests that firms' insurance function is quantitatively important. For example, Ellul et al. (2015) argue that managers in family-controlled firms maintain closer relationships with workers and provide more insurance than do counterparts in other firms. The researchers calculate that a 10% decline in sectoral sales leads to a reduction of only 0.5% to 0.6% in real wages as an average across all firms, and of 0.7% to 0.9% in family-controlled firms. By contrast, employment levels in family firms remain roughly constant under similar conditions, while falling by about 1.2% to 1.9% in others. All firms provide substantial insurance with regard to labour earnings, but family firms do so to a greater degree, focusing more on employment than on the wage margin. However, insurance has a price. The researchers additionally find that wages are 6% to 9% lower in family firms than in their non-family-controlled counterparts, although this gap could partly depend on other factors as well.

Clearly, the ability of individual firms to provide wage and employment insurance is limited. Collective risk sharing via unemployment insurance and low levels of employment protection is required in order to diversify risk across firms. Still, the economy's crisis resilience strongly depends on the ability of firms to provide earnings insurance. The more risk is absorbed by the business sector, the less insurance needs to be provided by the welfare state. Measures to strengthen the resilience of firms are thus an investment in the sustainability of the welfare state. Reformers should focus on three important factors to strengthen economic resilience. First, firms need a sufficient equity cushion, which should be higher in innovative and globally exposed industries, which tend to be more volatile. When offering credit, banks insist on stable interest payments to limit their exposure to risk. Similarly, firms' ability to pay secure wages and keep up employment depends on having equity capital available in quantities sufficient to absorb the revenue shocks. Second, R&D intensive and highly innovative firms tend to be more resilient. Their quality advantage tends to make demand less price sensitive and more stable, which reduces revenue risk and thus enhances the ability to insure workers against macroeconomic shocks. Third, firms' crisis resilience increases if workers bear some of the risk by agreeing to flexible wage and working-time contracts. In accepting such contracts, workers help to stabilise overall employment by working less and thereby reducing the wage bill during recessions, when the ability to pay wages is low, and by working more and producing a higher wage bill during booms, when the ability to pay wages is high. On average,

compensation packages with flexible working times should be slightly more attractive and include a risk premium.

Such structural measures aimed at strengthening firms' crisis resilience go well with the presence of automatic stabilisers, generally consisting of unemployment insurance and progressive wage taxation. However, in providing unemployment insurance and job protection, the government faces an important trade-off: the more generous social protection is, the less effort people spend in keeping themselves employable and in moving quickly back into work when unemployed, and the higher unemployment rates thus tend to be. This "moral hazard" calls for limits to insurance, for instance by providing a relatively low level of replacement income in order to retain a larger income gap between the conditions of work and non-work. To keep unemployment durations and the associated loss of skills and work experience to a minimum, financial incentives should be complemented by active labour-market policies including training and job-search assistance, the provision of job-market information in order to reduce skills mismatches, and efforts to monitor job searches and apply sanctions to benefit recipients who turn down acceptable job offers.

Taking a truly long-term perspective, an effective fight against inequality reduces the risk that any individual will be born on the "wrong side" of the income/wealth distribution, since this risk has less dramatic consequences if there is less inequality and poverty in the first place. The standard approach is to reduce inequality on an ex post basis through redistributive taxation and the construction of a strong social safety net. However, ex post redistribution is expensive, imposes high labour costs on firms and leads people to reduce their effort, thus dampening employment and economic growth. A greater priority should therefore be placed on fighting inequality and poverty on an ex ante basis. A first priority should be to facilitate upward social mobility by promoting education, lifelong training and individual wealth creation. A second and no less important policy goal is to foster fair competition and free market entry in order to eliminate monopoly rents and insider privileges in protected jobs, and to encourage entrepreneurship and innovation among newcomers by providing better access to markets. If more people leave poverty behind and move up the social ladder, overall poverty declines and inequality diminishes. For the same reason, inequality tends to be smaller over the perspective of a lifetime if patterns such as "poor at 20 and rich at 60" become more common. Social cohesion and empathy can only increase if more of the rich remember being poor in their earlier lives, and set an example.

Welfare policy must strike a balance between preventive (ex ante) and corrective (ex post) measures to strengthen social inclusion. The preventive arm of the welfare state includes education at all levels, lifelong training, competition policy supporting free market entry, the deregulation of protected jobs, and support for wage and working-time flexibilities (without compromising average pay and working times). These initiatives reduce market inequality and earnings risks, while at the same time encouraging growth. By contrast, the corrective arm relies on social insurance and the tax-transfer mechanism to redistribute income, taking market risk and inequality as givens. These policies are usually associated with a high tax burden and high levels of income



replacement, both factors that could stifle individual incentive and slow growth. Repairing damage on an ex post basis tends to be very expensive, though it often could have been prevented in advance. If unemployment and other social risks were instead much less widespread, and the market distribution of income and wealth were more even, there would be less need for redistribution and social insurance. The burden of the welfare state would in this case be much smaller without compromising economic security. Shifting the balance towards the preventive arm thus yields a much better chance of achieving genuinely inclusive growth with equal weight given to both the “inclusive” and “growth” aspects.

Are governments in the EU-28 able to push through reforms that could secure fiscal sustainability by striking the right balance between the corrective and preventive arms of the welfare state? Will countries be able to strengthen economic resilience and equality of opportunity? What is the expert assessment with respect to ex post redistribution and social insurance? There is not a one-to-one correspondence between the theory outlined here and the political praxis and expert assessments expressed in the *Reform Barometer*. To assess countries’ abilities to implement preventive policies,

we analyse the survey results regarding perceived need for reform and reform performance in the areas of education, lifelong learning and labour-market access. Lifelong learning, including training programmes for the unemployed, is especially important in times of structural change, since any change in upfront education affects only the quality of labour-market entrants and not the existing workforce stock. Keeping the existing stock employable in the face of fast-changing skill needs thus requires significant effort by firms and the government with regard to retraining and lifelong learning. We contrast these preventive efforts with the need and performance assessments in policy areas that are naturally associated with ex post corrective measures, such as poverty prevention and income and wealth redistribution. Figure 6 summarises the survey results of the *SIM Europe Reform Barometer 2016*.

As a cross-EU average, the perceived need for reform is highest in the areas of reducing inequality (2.32) and improving labour-market access (2.23). With regard to inequality, experts rate the quality of policy performance as being very low. However, the view of government performance in the area of labour-market access is somewhat more favourable. Interestingly, viewed across the European Union as a whole, experts do not see improvements in education as a high priority as compared to other areas of social inclusion, and rate policy performance in education rather favourably. Overall, experts see no obvious imbalance between preventive and corrective policy areas in the European Union. Reform needs and performance obviously vary widely across EU member states, reflecting very different initial conditions and institutional characteristics. The identities of the countries with the best and worst policy-need and policy-performance scores shift in different areas, leaving no clear-cut role model or underperformer across the survey as a whole.

Work, Participation and Welfare in a Greying Society

Age structures are changing significantly in all EU countries. The dependency ratio, which measures the population in the 0–14 and 65+ age groups relative to those between 15 and 64 years of age, is projected to rise from about 53% in 2013 to 78% in 2060 (European Commission, 2015). Ireland is expected to show the smallest increase (from 52% to 66%) and Slovakia the largest (from 40% to 87%).

Increasing longevity is the main driver behind these demographic shifts. Between 2013 and 2060, remaining life expectancy at the age of 65 is projected to rise from 17.7 years to 22.4 years for men, and from 21.1 to 25.6 years for women. This rising life expectancy is largely a result of so-called healthy ageing—that is, the addition of more healthy years to people's lives. This trend surely constitutes a significant welfare improvement, but presents challenges for welfare and pension systems.

The basic arithmetic of ageing is simple. The financial viability of tax-financed welfare arrangements for the old and explicitly contribution-based (both funded and unfunded) pension systems alike depends on a

balance being struck between contributions coming into the system and the benefits being paid out. For tax-financed welfare programmes, including pensions, health and care, there is no individually perceived link between taxes and benefits. Such a link arises only at the aggregate level through the public budget. In contrast, funded pension schemes directly link individual contributions and entitlements. Working more for a longer period of time generates additional contributions, which translate into higher levels of personal benefits.

Rising life expectancies can basically be addressed by the following three modes of adjustment: (i) if pensions and retirement ages are to remain unaffected, contribution levels will have to go up; (ii) if contribution rates and retirement ages are to remain unchanged, benefits will have to be reduced; or (iii) if contribution rates and benefit levels are to remain unchanged, retirement ages will have to go up, thereby implying a longer period of contribution and a shorter period in which participants will benefit from the scheme.

For tax-financed schemes, the failure to prepare for an ageing population shows up in assessments of fiscal sustainability. This is an evaluation of how ageing will affect public finances given the assumption of unchanged welfare arrangements. Most EU countries face a sustainability problem; that is, ageing will produce a systematic imbalance between revenues and expenditures if current policies are retained (see e.g., European Commission, 2015). Clearly, this is not viable. The longer the adjustment is postponed, the larger will be the burden shifted onto future generations, or the higher the risk that entitlements will ultimately have to be reduced. In fully funded individualised schemes, the challenge is basically the same, but the adjustment burden and risk rests on the individual.

Sustainability problems point to an urgent need for reforms in most EU countries, with only a few exceptions. Changes in pension systems have a long phase-in period, rendering the need for reform acute. Across EU countries, there are large differences in both the extent and scope of tax-financed welfare arrangements, private-pension savings arrangements, and the interplay between the two. Most countries have a mixture of tax-financed, employer-managed and savings-based pension arrangements, but the specific institutional configurations and arrangements differ widely. Thus, while solutions do have to be country-specific, the policy directions being taken are similar, with most countries focusing on strengthening pension-savings incentives and inducing later retirement.

Addressing the consequences of ageing by increasing retirement ages has been widely discussed. Some countries have already taken such steps, and others are planning to do so. A crucial and important underlying assumption is that a higher retirement age translates into higher employment rates for the affected age groups. If not, it is not a solution to the problem.

The *Reform Barometer* indicates a large need for reform in this area, especially to reduce the risk of poverty among senior citizens (age 65 and above). While for the total population, there is a close correlation between the need for reforms reducing the risk of poverty and those increasing employment rates/reducing unemployment rates (see Figure 3), no such relation holds for senior citizens (correlation 0.08). This strongly suggests that pension levels are more important for this age group. However, country differences with regard to the intensity of reform activity are large, although assessments of reform performance and quality result in low scores. Figure 7 plots national changes in dependency ratios against indicators of fiscal

sustainability; however, no clear pattern emerges. Some countries that show moderate or large demographic changes have only small fiscal-sustainability problems, while others face substantial problems.

As noted, employment rates among the 55–64 age group have risen in recent years in virtually all EU countries (except in Greece and Romania). Several factors, including increases in retirement ages and early retirement schemes, are responsible for this trend. Since later retirement correlates positively with the amount of education received, the changing educational structure among older workers has also been a contributing factor. However, problems remain, and no less than 70% of the experts across all member states participating in the *Reform Barometer* survey (RB 2016) point to a strong or very strong need to increase employment rates/decrease unemployment rates among older workers.

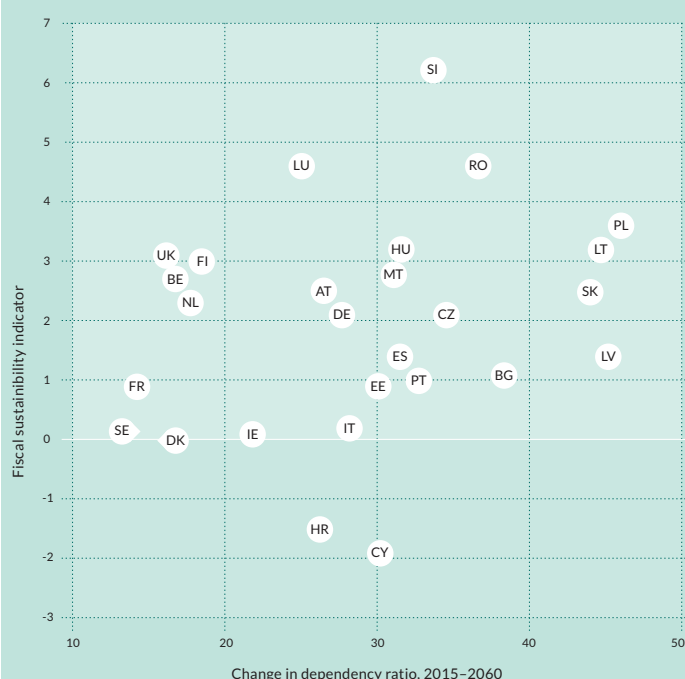
Setting retirement ages represents a particular policy challenge. Most of the population ages with relatively good health, but this is not true of all. The fact that better-educated people live longer creates a social gradient in longevity. There is also a well-known gender difference in life expectancy. A common retirement age thus implies different expected pension periods across different social groups, raising issues of justice and fairness. The policy dilemma is that there is no straightforward way to differentiate retirement ages across socioeconomic groups without raising difficult targeting problems.

The approaches chosen in Denmark and Sweden provide an interesting comparison that underlines the point about country differences. These two countries are often lumped together under the heading of the Nordic model, but actually follow quite different approaches. In Denmark, the retirement age is being raised in increments, and will later be indexed to increases in life expectancy. In consequence, the expected pension period will be the same across all cohorts. In Sweden, individuals enjoy more freedom in choosing their own retirement age. However, benefit entitlements at a given age (above the minimum retirement age) are adjusted on the basis of cohort-specific longevity measures. Thus, other things being equal, cohorts with longer longevity will have to retire later to obtain the same pension upon retirement as those belonging to cohorts with shorter longevity. The adjustment thus relies on individuals voluntarily choosing later retirement as longevity rises. These are two rather different approaches to achieving the same aim.

More flexible retirement schemes could allow for gradual reductions in working hours towards the end of individuals' working careers instead of an abrupt change from full-time work to retirement. In most countries, however, pension and social systems are designed for full-time workers. There is a need to adapt these systems to enable a more flexible transition into retirement. Firms must also adapt to make retirement more flexible.

Figure 7

Change in Dependency Ratio and Fiscal Sustainability Indicator



Fiscal sustainability indicators give the permanent changes in the public budget (% of GDP) needed to ensure long-term balance of the budget, dependency ratio is the age group 0–14 and above 65 years relative to the age group 15–64.

Eurostat, European Commission (2015b)

| BertelsmannStiftung

Longer work careers in combination with continuous changes in the labour-market create the need to maintain and update human capital to ensure workers remain employable, while also increasing resilience with respect to shifts in the labour-market. Financing and insurance in turn become more complex. Most people face earnings risks associated with skill obsolescence, but these risks manifest differently. Accordingly, the need for skill upgrading differs. It is thus necessary to expand retraining schemes while also ensuring they receive sufficient financing. An interesting innovation is the “Compte personnel d'activité” programme (<http://www.gouvernement.fr/compte-personnel-activite-cpa>) recently introduced in France, which makes workers accumulate training rights and thus creates a buffer allowing for retraining for those exposed to structural labour-market shocks.

Gender Equality and Diverse Social Norms

Women are roughly half of the adult population and represent a major part of the workforce. Many countries still show a substantial pay gap between men and women. Such a pay gap has many sources. A substantial share of the wage inequality between genders is due to differences in qualification, preferences for more or less lucrative jobs, preferences for part-time work, and other such reasons. Discrimination accounts for only that part of the wage gap that cannot be explained by economic factors. The ability to access top positions in business, political and scientific settings is a topic closely related to the wage gap. The SJI 2016 reports that women account for a lower share of parliamentarians than do men in all EU member states. While the share of female parliamentary deputies exceeds 40% in Sweden, Finland and Spain, this share barely exceeds 10% in Hungary, and is only two to three points higher in Malta and Cyprus. Women's representation in top academic positions and on company boards is little better. According to recent empirical evidence, such underrepresentation on company boards might be economically costly, since women tend to contribute different competencies that are complementary to typical male competencies (see e.g. Kim and Starks, 2016).

To achieve long-lasting progress, gender policy should aim at the early roots of men and women's diverging labour-market performances. Social norms and role models regarding work sharing in families change only slowly, as do roles and positions in the labour-market. The situation of women differs widely across member states, reflecting different norms and policy approaches. Education certainly plays a key role in shaping role models and social attitudes, but can have significant effects only after long delays. Family policy plays an important role in helping women and men to reconcile family and work life effectively. A key challenge for women is the career interruption presented by motherhood and parental leave, which is associated with a potential loss of skills and work experience, thereby slowing down career progress after the end of leave. Quite obviously, such costs are likely to produce negative effects with regard to fertility rates.

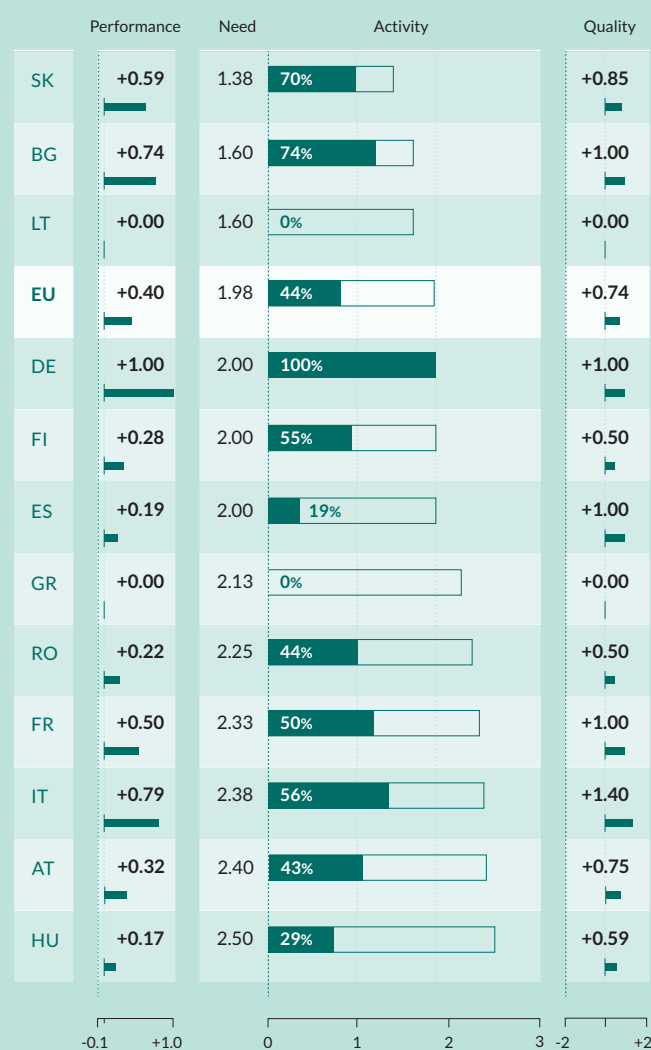
Olivetti and Petrongolo (2017) investigated how a range of different family policies can affect women's earnings, career chances, child prospects and fertility rates. Key related policy instruments include the length of

job-protected parental leave; the percentage of leave that is paid and the average rate of such pay; the provision of early childhood education and care; and firms' provision of flexible work times. Not all of these policies seem to be effective in closing the gender gap in employment and earnings while at the same time bolstering fertility rates by making it easier to reconcile work and family. Job-protected parental leave and payment rates during periods of paid leave tend to have mixed effects that are quantitatively weak if they are significant at all. Parental leave with an assured job upon return may contribute to greater gender equality up to a certain duration, beyond which the effects turn negative and counterproductive. The loss of skills and experience and the detachment from the working world during periods of prolonged parental leave may undermine women's post-leave career prospects, effectively contributing to a widening of the gender gap. While low-skilled mothers may benefit significantly, the effects of a working-life interruption tend to be more damaging for higher-skilled mothers. The research shows that early child care and childhood education, in-work benefits, and firm-provided working-hour flexibility are by far the most important and quantitatively powerful policies with regard to boosting employment rates among women, reducing the gender gap in employment rates and earnings, and raising fertility, all at the same time. For example, a half-percentage-point increase in spending on early child care (roughly one standard deviation of spending across countries in the sample, which ranges from 0.1% of GDP in Greece to 2% in Denmark) is associated with a 1.8 percentage-point increase in the employment rate among women. Making it easier to be a working mother may matter more than the length of leave or the volume of payments that new parents receive during parental leave.

How active and effective are governments in EU member states? Among the member states included in Figure 8 (several member states are missing due to insufficient response rates), Hungary and Austria seem to be laggards, with expert opinion pointing to a very high need for reform combined with low policy performance. Italy and France also show a rather high need for reform, but gender policy in these countries seems to be much more effective than the EU average, according to expert opinion. Somewhat surprising is the contrast in the assessment of the neighbouring countries of Romania and Bulgaria. Experts see a need for reform in Romania that is considerably above the average, in combination with a poor policy performance that is substantially below EU average. In striking contrast, the perceived need for reform in Bulgaria is considerable below the EU average,

Figure 8

Need and Performance in Gender Policy in the EU



Reform Barometer 2016

BertelsmannStiftung

while reform performance is much better than the EU average. The leading member states with regard to gender policy seem to be Slovakia and Bulgaria, where experts see the lowest need for reform coupled with strong reform performance.

Refugee Crisis and Migration: Participation or Alienation?

The pace of migration both in and out of the European Union, as well as within the EU, is high. About 4.7 million people immigrated to the EU in 2015; among this group, 2.4 million persons were not EU citizens, 1.4 million immigrated to an EU country other than the one in which they were citizens, and about 850,000 returned to their native EU country.

Worker migration within the EU is a desired consequence of EU integration, and particularly of the EU internal market. It has shown a tendency to increase over time, with migration between eastern and western areas of the EU accounting for a large part of such movement. Migration into the EU is dominated by refugees and family unification. It is primarily driven by humanitarian motives, with its volume depending on external political conflicts, wars and environmental changes. However, economic motives may also play a role in explaining the migration pressure from areas such as Africa. The refugee inflow peaked in 2015.

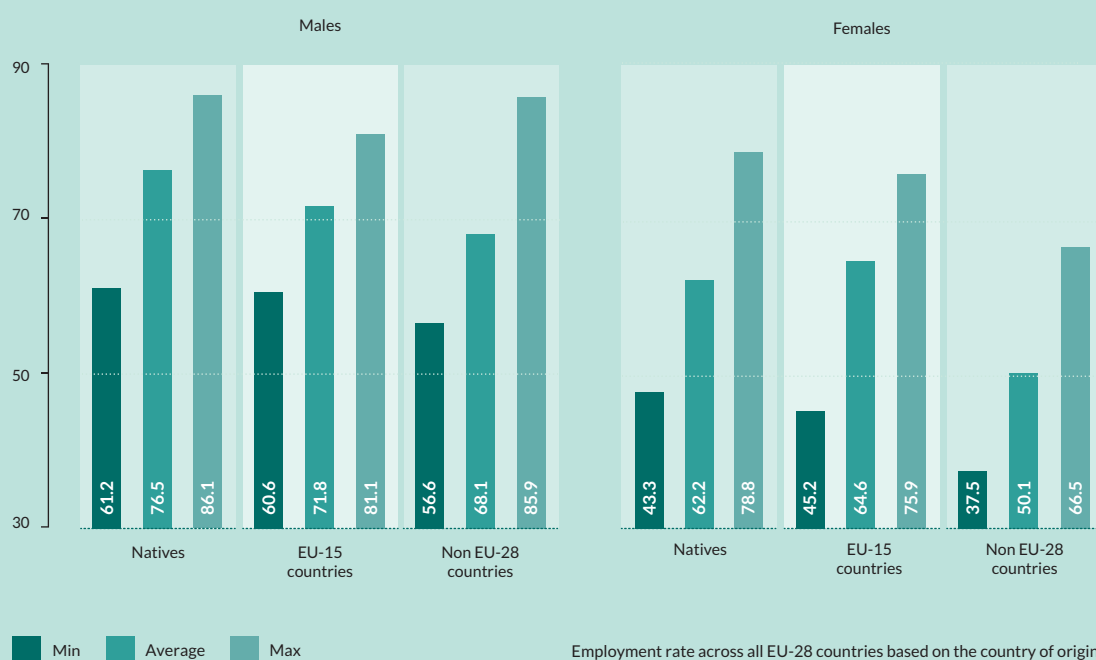
Migration has caused a heated debate. The economic side of the discussion focuses mainly on whether migration from low-income countries poses a threat to low-income groups, since they compete with migrants for the same jobs, and whether immigrants are a burden for tax-financed welfare arrangements.

The economic effects of immigration depend not only on the level of migration but also on its composition (i.e., students, economic migrants, refugees, family members of previous immigrants, etc.). This heterogeneity implies that the composition of a given group of immigrants is crucial with regard to the ultimate economic effect. It is thus impossible to make general unconditional statements regarding the economic effects of immigration.

The differences in employment levels for migrants are illustrated in Figure 9, which shows employment rates for men and women both for natives and for migrants from EU-15 countries and from outside the EU-28 countries. The employment rate for migrants from EU-15 countries is in most countries on par with that of the native population, reflecting the fact that such individuals tend to migrate for employment reasons. For migrants from outside the EU-28, employment rates are generally lower than for natives, especially for women, reflecting that a predominant share of this group enters via asylum or family-unification programmes. Country differences are large, reflecting differences in the composition of migrant populations and of labour-market structures. The data do not show differences in employment rates associated with the reason for residence (e.g., work or asylum) or the country of origin. In all EU countries, refugees have lower employment rates than natives, with the gap particularly large for women; however, this gap tends to decrease with the duration of the residence period (see e.g., Dumont et al., 2016).

Figure 9

Employment Rates in EU 15 Countries – Depending on Country of Birth, 2016



Employment rate across all EU-28 countries based on the country of origin.

Natives: persons born in the country of their current residence

EU-15 countries: persons born in an EU-15 country other than the country of their current residence

Non EU-28 countries: persons born outside of the EU-28

Min resp. Max refer to the minimum resp. maximum value observed among the EU-28 countries.
Average refers to the unweighted average employment rates across the EU-28 countries.

Eurostat, own calculations

BertelsmannStiftung

The impact on public finances is closely related to the employment performance of immigrants for the basic reason that employed individuals contribute more taxes, while those who are not employed are often entitled to some form of public support. In all EU countries, public finances are therefore very sensitive to employment rates, with larger sensitivities in the countries with more extensive welfare arrangements. In short, if immigrants show above-average employment rates, they tend to improve the health of public finances, and vice versa (see e.g., OECD, 2013b).

The labour-market challenges and tensions created by immigration are closely related to the increase in the supply of low-skilled labour. The *Reform Barometer* points to a substantial need for reform, though with some variations across countries (see RB, 2016). The close correlation between the need for reform to reduce the risk of poverty and the need for reforms to increase employment rates/decrease unemployment rates (see Figure 3) also holds for the foreign born and refugees (the correlation between the two respectively being 0.74 and 0.64). As discussed above, globalisation and technological change are associated with skill-biased growth, implying that demand for low- or less-skilled labour is declining in high-income countries. In response to this, countries find themselves in a race between technology and education, and focus on improving the skill level of the workforce in order to promote high employment rates and an acceptable wage distribution. The tension that immigration creates in high-income countries in

part arises since it tends to reinforce the skill-bias problem by increasing the supply of low- and less-skilled labour. This presents a challenge to labour-market policies. It is also a source of social tension, since groups already under pressure feel that they carry a disproportionately large share of the adjustment burden in terms of further pressure on job opportunities and wages. This nourishes the feeling that “they take our jobs”.

Recent policy initiatives have mostly focused on restricting entry. The common EU system has been placed under severe stress, and EU countries have not shared the burden of refugee inflow evenly. The difficult question of absorption capacity has to be faced. Many countries have undertaken unilateral initiatives to make entry more difficult or less attractive. There are large differences in how countries administer refugee rules. Entry rules—given the limits set by international conventions—are displaying a “race to the top” in the sense that entry is rendered easier if the potential immigrants are better educated. There is an urgent need to make EU migration policy work more effectively. Migration is a policy area where there is a clear case for cooperation, and where unilateral moves create negative externalities for other countries.

The differences across EU countries are also revealed by the *Reform Barometer* (RB 2016). The policy objectives targeting the overall situation of refugees receive a higher score among experts from EU-15 countries than among non-EU-15 countries. While some policy initiatives have been implemented here, expert assessments of both reform quality and performance are rather low.

Labour-market integration is crucial for refugees and their family members. Integration involves many dimensions including norms and culture (e.g., gender roles), discrimination, and qualifications. It is well documented that delayed entry into the labour-market decreases the ultimate likelihood of finding a job. Hence, the speed at which asylum applications are handled is important, but the issue of whether work is allowed while the application is being processed is also critical. An IMF (2016) study compares asylum rules for Italy, the United Kingdom, Germany and Sweden. Country differences turn out to be large. In Sweden, under some conditions, asylum seekers may obtain a work permit immediately, while this is not possible in the other three countries. Processing times in handling asylum applications also differ significantly across EU countries.

Immigrants from low-income countries often come with a huge qualification gap when viewed by European standards. The need to verify qualifications/experiences magnifies the problem, as do language barriers. The policy challenge is in many ways similar to the general problem of ensuring that there are sufficient jobs available for the low-skilled population. One possible remedy is the use of temporary wage subsidies (lower social contributions) or on-the-job training paths (with low starting wages), as applied in many countries. However, according to the data reported above, a huge employment gap remains.

Summary

One cannot exaggerate the importance of smooth labour-market performance as a precondition for inclusive growth, in Europe and elsewhere. For the vast majority of people, economic and social opportunities depend on labour-market access. The availability of good jobs allows people to participate in the productive economy and offers opportunities to take advantage of upward social mobility. The differential opportunities between high- and low-skilled work are an important determinant of inequality, distribution and cohesion in society. When labour-markets are dysfunctional and cannot offer jobs to those who desperately need them, as in the European countries most affected by the economic and financial crisis, a whole generation might be lost and radicalised, feeling robbed of economic opportunities. However, the challenges for European labour-markets are huge even independently of the crisis. Labour-markets must cope with the disruptions and structural change triggered by innovation and globalisation. Given the ageing of societies, they must integrate and provide more jobs for older people. They must help to reconcile work and family life for women and men, without making motherhood a career disadvantage for women. They must offer young generations a smooth transition from education to work without producing high levels of youth unemployment. They should smoothly integrate foreign immigrants, allowing them to become active contributors to the economy and the welfare state instead of remaining a burden.

An overarching theme of this essay is that policy should strike a balance between preventive and corrective labour-market policies and welfare-state strategies. The provision of education from kindergarten all the way through vocational training and university education reduces economic risk, and is a key investment with regard to facilitating upward social mobility. Reforms should also focus more on employment growth and crisis resilience within the economy at large. Firms are effectively insuring workers by providing secure employment and earnings over the economic cycle. The better they are able to absorb the risk of fluctuating sales and earnings, the lower is the volume of risk that remains to be insured by the welfare state. What a country fails to achieve in preventive measures, it must correct on an *ex post* basis, generally with very high costs. Preventive measures are effectively an investment in the sustainability of the welfare state.

It is probably safe to predict that the skill bias in employment and wages increases the strain on national redistribution mechanisms and social safety nets. In order to contain uncontrolled growth in welfare spending, and to prevent rising tax burdens from stifling economic performance, the welfare state itself needs preventive reforms that encourage labour-market participation and boost incentives for lifelong learning. To be compatible with the needs of an innovative economy, the welfare state should shift towards the flexicurity paradigm (EC, 2007) which rests on three pillars. First, unemployment insurance and welfare benefits for the long-term unemployed protect workers against bad outcomes, and makes them more ready to accept the higher employment risk associated with innovative and globally exposed industries. Second, moderately low levels of job protection offer firms the flexibility to terminate unproductive jobs that lack a future. Instead of locking up employment in unproductive sectors, such flexibility

provides the ability to reallocate labour to more productive and dynamic firms. Third, active labour-market policy can provide carrots and sticks. More active monitoring may complement financial incentives in intensifying unemployed individuals' job searches, which in turn speeds up the transition back to work. In particular, policy should provide for training and re-qualification programmes to boost employability and raise individuals' chances of finding productive employment again. Every move from unemployment into work raises the number of taxpayers and shrinks the number of welfare recipients. Moving back to employment thus increases tax revenue and reduces social spending at the same time. Labour-market participation is in this sense crucial to the welfare state's financial sustainability.

If the EU wants to offer its citizens better jobs and more opportunities, and if it wants the vision of a socially inclusive Europe to become reality (see EC, 2015 and EC, 2014), it needs courageous reform on the part of member states. How can such reform happen? Benchmarking and the dissemination of successful reform experiences in other countries may encourage mutual learning and policy innovations. Based on interviews with numerous heads of government, De Geus, Thode and Weidenfeld (2016) have collected examples of far-reaching reforms in Europe, and have extracted success factors that can improve the chances of positive reform outcomes. Similarly, the OECD's *Making Reform Happen* report identifies typical stumbling blocks and successful strategies associated with reform implementation (OECD, 2010). Clearly, existing cultures of consensus and conflict, ideological divisions, and large interest groups' relative ability to compromise can all substantially affect the probability of successful reform. Opportunities for broad reforms tend to increase in times of economic or social difficulty, as in some of the euro zone's crisis-struck countries, or when strong catch-up growth improves future prospects and makes reforms appear more attractive, as has been the case in some eastern European member states. The prospects for successful reform tend to improve if all affected interest groups are actively included in the reform process, and if costs and benefits are broadly and evenly distributed. Supporting the arguments for reform with research-derived facts, actively informing citizens about benefits and costs, and timing reforms so they fall immediately after elections can improve the feasibility of reforms implemented within the democratic process. Finally, comparative analysis such as the *Social Justice Index* and the *Reform Barometer* can be useful instruments to facilitate policy innovations in the EU-28.

References

Aghion, Philippe, Ufuk Akcigit, Antonin Bergeaud, Richard Blundell and David Hemous (2015), *Innovation and Top Income Inequality*, NBER WP 21247 (revised Nov. 2016).

Bartelsman, Eric, John Haltiwanger, and Stefano Scarpetta (2013), *Cross-Country Differences in Productivity: The Role of Allocation and Selection*, *American Economic Review* 103, 305–34.

De Geus, Aart, Eric Thode und Christiane Weidenfeld (2016), *Europe Reforms Labour Markets. Leaders' Perspectives*, Berlin/Boston: De Gruyter.

Dumont, Jean-Christophe, Thomas Liebig, Jorg Peschner, Filip Tanay and Theodora Xenogiani (2016), *How are Refugees Faring on the Labor Market in Europe? A First Evaluation Based on the 2014 EU Labor Force Survey Ad Hoc Module*, Working Paper 1/2016 European Commission and OECD.

[EC 2007] European Commission (2007), *Towards Common Principles of Flexicurity: More and Better Jobs through Flexibility and Security*, COM (2007) 359 final.

[EC 2015a] European Commission (2015a), *An Ever Closer Union Among the Peoples of Europe? Rising Inequalities in Europe and their Social, Economic and Political Impacts*, Outcomes of EU-Funded Research.

[EC 2015b] European Commission (2015b), *The 2015 Ageing Report*, European Economy 8/2014.

[EC 2017] European Commission (2017), *Proposal for a Interinstitutional Proclamation on the European Pillar of Social Rights*, European Parliament, Council, and European Commission.

Eichhorst, Werner and Ulf Rinne (2017), *The European Youth Guarantee: A Preliminary Assessment and Broader Conceptual Implications*, CESifo Forum 18, 34–38.

Ellul, Andrew, Marco Pagano and Fabiano Schivardi (2015), *Employment and Wage Insurance Within Firms: Worldwide Evidence*, CEPR DP No. 10711.

Fazekas Mihály and Simon Field (2013), *A Skills beyond School Review of Germany*, OECD Reviews of Vocational Education and Training, Paris: OECD.

IMF (2016), *The Refugee Surge in Europe: Economic Challenges*, IMF Staff Discussion Note. By Shekhar Aiyar, Bergljot Barkbu, Nicoletta Batini, Helge Berger, Enrica Detragiache, Allan Dizioli, Christian Ebeke, Huidan Lin, Linda Kaltani, Sebastian Sosa, Antonio Spilimbergo, and Petia Topalova.

Kim, Daehyun and Laura T. Starks (2016), *Gender Diversity on Corporate Boards: Do Women Contribute Unique Skills?* *American Economic Review: Papers & Proceedings* 106, 267–271.

Krusell, Per, Lee E. Ohanian, José-Víctor Ríos-Rull and Giovanni L. Violante (2000), *Capital-Skill Complementarity and Inequality: A Macroeconomic Analysis*, *Econometrica* 68, 1029–1053.

Landersø, Rasmus and James J. Heckman (2017), *The Scandinavian Fantasy: The Sources of Intergenerational Mobility in Denmark and the U.S.*, *Scandinavian Journal of Economics* 119, 178–230.

Olivetti, Claudia and Barbara Petrongolo (2017), *The Economic Consequences of Family Policies: Lessons from a Century of Legislation in High Income Countries*, *Journal of Economic Perspectives* 31, 205–230.

[RB 2016] Bertelsmann Stiftung (2017), *Social Policy in the EU – Reform Barometer 2016*, Social Inclusion Monitor Europe, Gütersloh.

[SGI 2016] Bertelsmann Stiftung (2016), *Sustainable Governance Indicators 2016: Germany Report*, Friedbert Rüb, Friedrich Heinemann, Tom Ulbricht und Reimut Zohlhnhöfer, Gütersloh.

[SJI 2016] Bertelsmann Stiftung (2017), *Social Justice in the EU – Index Report 2016*, Social Inclusion Monitor Europe, Daniel Schraad-Tischler und Christof Schiller, Gütersloh.

Skedinger, Per (2014), *Effects of Payroll Tax Cuts for Young Workers*, *Nordic Economic Policy Review* 2014:1, 125–169.

OECD (2010), *Making Reform Happen. Lessons from OECD Countries*, Paris: OECD Publishing.

OECD (2013a), *Recruiting Immigrant Workers: Germany*, Paris: OECD.

OECD (2013b), *The Fiscal Impact of Immigration in OECD Countries*, *International Migration Outlook 2013*, OECD, Paris.

OECD (2017), *Employment Outlook*, Paris.

About the Authors

Torben M. Andersen is Professor of Economics at Aarhus University, Denmark. He holds a MSc from the London School of Economics and a PhD from CORE, Belgium. He is a Research Fellow at the Centre for Economic Policy Research (CEPR, London), the Center of Economic Studies (CESifo, Munich) and the Institute for the Study of Labor (IZA, Bonn). He has had various short-term visiting positions at other universities, and been a member of the editorial boards of several international journals. He has been extensively involved in policy advice in Denmark, the Nordic countries and the European Commission. Most of his research has been on macroeconomics, public economics, labour economics and the economics of the welfare state.



Christian Keuschnigg is Professor of Economics at the University of St. Gallen and Director of WPZ Vienna, a policy research institute in Austria. He holds a doctorate in Economics from the University of Innsbruck and a PhD (Habilitation) from the University of Vienna. He was a Professor of Economics at the University of Saarland and Director of the Institute for Advanced Studies in Vienna. He is a research fellow of the Centre for Economic Policy Research (CEPR, London), the Center of Economic Studies (CESifo, Munich) and the Oxford University Centre for Business Taxation. His research interests are in public economics and related fields, including the economics of the welfare state, economic growth and European integration.



Publishing Information

© November 2017
Bertelsmann Stiftung, Gütersloh

Publishing institutions:
Bertelsmann Stiftung,
European Bureau for Policy Consulting
and Social Research Vienna

Autors:
Torben M. Andersen,
Christian Keuschnigg

Copyright:
Cover: Shutterstock/Slobodan Kunevski,
Page 31: private

Responsible: Thorsten Hellmann
Copy editing: Barbara Serfozo

Design: Lucid. Berlin
Printing: Matthiesen Druck, Bielefeld

Address | Contact

Bertelsmann Stiftung
Carl-Bertelsmann-Straße 256
33311 Gütersloh
Germany

Dr. Thorsten Hellmann
Project Manager
thorsten.hellmann@bertelsmann-stiftung.de
Phone +49 5241 8181236

European Bureau for Policy Consulting
and Social Research Vienna
Schottenring 19/9
1010 Wien
Austria

Dr. Jan Arpe
Senior Project Manager
arpe@europeanbureau.net
Phone +43 664 2188046

www.social-inclusion-monitor.eu

www.bertelsmann-stiftung.de