

SOCIAL EXCLUSION: A CHALLENGE TO MACROECONOMIC POLICY¹

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As the conclusions from the Lisbon Council in 2000 make clear,² the search for increased levels of employment with higher skills and increased economic growth has supplanted inflation as the key macroeconomic policy issue in the EU. This is part of a 10-year action programme *to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion*. Increased employment participation is central for the wider goal of improving welfare by reducing social exclusion and hence increasing social inclusion. One of three principal action areas is *modernising the European social model, investing in people and combating social exclusion*. In implementing this, the Council decided to apply *a new open method of coordination*.

There is potential conflict between achievement of the wider social objective and pursuit of prudent macroeconomic policy (Gold and Mayes 1993). Trying to improve the growth rate, investment and R&D tends to increase public spending. Tackling unemployment, deprivation and other forms of exclusion involves increased transfers through the tax/benefit system. Although the consequent ‘inflation bias’ is addressed by the monetary policy framework in the Maastricht Treaty, problems remain. At some point, below current levels in the EU, such increases in the role of the public sector can be counterproductive and by reducing incentives actually diminish the overall growth in GDP and employment (Koskela and Viren 2000).

Therefore here we suggest ways of using the new method of open co-ordination to reduce social exclusion substantially without threatening either macroeconomic prudence or the attempt to increase growth to 3% a year.

What is social exclusion? What causes it? What can reduce it?

There is no accepted definition of the terms social exclusion and inclusion in EU circles. This has actually been helpful by allowing member states to get on with tackling the problem as they each see it, without first indulging in protracted terminological debate. Social exclusion reflects the idea that some groups in society are persistently deprived of the benefits that the rest enjoy, for a variety of reasons not of their own choice. The three most obvious are unemployment, poverty and disability/ill health. The definition we offer (Mayes *et al* 2001) is that *social exclusion is a blend of multidimensional and mutually reinforcing processes of deprivation, associated with a progressive dissociation from social milieux, resulting in the isolation of individuals and groups from the mainstream of opportunities society has to offer.*

This introduces four key ingredients:

- There are many facets to social exclusion, so different combinations of circumstances can lead to the same result. No one facet is necessary or sufficient – some unemployed are not excluded while some full-time employed clearly are.
- These facets interact. Low-paid employees have less time to undergo training to improve their position and no means of paying for it, making their job less secure. They are more likely to live in poor quality housing in rough neighbourhoods and hence more exposed to threats to their health and less inclined to venture out after dark to participate in activities that improve the quality of life.
- Exclusion is not just a state but a process, as seen in the progressive decline of those who lose their jobs and the progressive difficulties of the elderly. Effective policies therefore involve early action to avoid entering this downward spiral. Waiting till people reach the bottom greatly increases the cost and the chance of failure. Unemployment is ‘scarring’ (Economic Journal 2001). Given skills and other characteristics, becoming unemployed affects the quality, wage rate, security and difficulty in obtaining employment for over a decade. Children of the excluded have a much greater chance of being excluded themselves.
- Exclusion is a relative concept. Over time, what constitutes or causes exclusion changes. In a

knowledge-driven economy, Internet access is essential, something inconceivable earlier. This is not a one way process; television and improved communications make physical remoteness less important. Exclusion is not a one-off problem that can be solved permanently.

The modern more rapidly changing economy can exacerbate exclusion. Skills become obsolete more quickly, inefficient firms are driven out of business faster, locations become noncompetitive because of distance from markets and inputs. Rural societies that were highly inclusive through the actions of the family and the local community, no longer function as people leave. Change has costs and a more dynamic economy requires more resources for education, training and infrastructure. The Lisbon strategy is rather silent on locational mobility, which is an important facet of the greater US flexibility.

Hoping for an adequate solution from economic growth without making other changes is unlikely to succeed, however good the macroeconomic management. Growth in Finland - since 1993, around 5% pa - is high by European standards. Yet while GDP has regained its previous trend path, unemployment remains well above its previous levels (Ripatti and Vilmunen 2001). This reflects not just the asymmetry (hysteresis) that downward shocks to activity shake out more labour than upward shocks of the same size re-employ but also changes in technological trends. The Lisbon Council therefore concluded that structural change and a change in the way social protection systems operate are essential to improve the employment/social inclusion content of growth.

These issues relate to long-run structural development. There is also concern about how flexibly the euro economy can react to shocks and consequences of business cycles. While the Stability and Growth Pact is unlikely to inhibit the appropriate operation of automatic fiscal stabilisers, there is more that can be done within the constraints to avoid economic shocks being turned into more persistent social problems.

No single social model in Europe and no single solution

Initially the EC thought it would need to harmonise social security systems, to enable free

movement of labour between member states without losing entitlements and prevent destabilising migration toward the ‘best’ systems.³ By 1972 harmonisation was clearly unnecessary (and impossible to agree). Producers might also have responded to the 1980s’ internal market programme by moving to regions with the lowest social costs, ie engaging in ‘social dumping’. This did not happen, but the idea has resurfaced with impending enlargement of the EU.

Social protection forms part of the fabric of society and is not readily altered without sweeping changes to the economic and social system. It is not very productive to identify particular approaches as being better than others, as their success also comes from their context. Using cluster analysis we identify four employment regimes: Anglo-Saxon/liberal; Social Democratic/Nordic; Corporatist continental; and Traditionalist Southern (Muffels *et al* 2001). Their characteristics vary considerably, with more income inequality and means-testing in the Anglo-Saxon than in the Nordic regime, more emphasis on private sector provision, less restrictive labour market legislation and less active labour market policies. Yet the resulting social exclusion is fairly similar for all except the Southern regime, where it is much greater and more persistent. It also emphasises the role of the family rather than the state, while the Anglo-Saxon regime offers more mobility.

There is also variety within regimes. While Nordic countries put greatest emphasis on active labour market measures the Netherlands also does and in many respects is the state that has changed most. The trend is clearly toward more active regimes; only the Italian and Greek seem substantially passive.

Five key features emerge from this study that must be addressed in designing a way forward. Running across them is the need for *incentives* so that all parties tend to reduce social exclusion in the way they pursue their normal interests.

- *Activation and adoption of a capabilities approach.*⁴ The excluded face an inability to escape from their unfortunate circumstances. Activation provides the ‘capabilities’ for changing their condition. The homeless can find it difficult to get access to benefits. A fixed address is necessary to receive various forms of support and for effective communication in respect of employment.

- *A focus on the individual.* Much activation requires treating people individually rather than providing general programmes. This poses a heavy administrative burden. Such measures fare poorly in simple financial cost-benefit analyses. The number of social assistance recipients has halved since the Clinton reforms in the United States but expenditure is roughly unchanged. In a static framework benefits are a cheaper means of income support than assisting people into jobs.
- *Avoiding a divided world of insiders and outsiders.* Traditional approaches tend to create divisions. In the Southern and Continental regimes it is male full-time employees who are insiders and others, especially females, outsiders. Since income levels are normally determined on a family or household basis, maintaining a one-earner or one-and-a-half-earner (one insider, one outsider) model may appear satisfactory. This will not be true if what also matters is whether each individual is an insider or outsider. The Netherlands has made the biggest break from the full-time model. The Southern regime forced many women to decide between a career and having a family.⁵ The Nordic regime tries to eliminate the need for that choice.
- *Limits to the role of the public sector.* The Nordic regime's disadvantage lies in the heavy involvement of the public sector as employer, with the consequent tax burden imposing greater disincentives. The higher the tax rates, the less the possible range of new policies to tackle remaining social exclusion. Greater public expenditure in one area is likely to be possible only with cuts elsewhere. Cutting subsidised public sector employment may not result in a one-for-one increase in employment in the nonsubsidised, but regulated, private sector. Finding a way out that does not involve an initial worsening of the problem is difficult.⁶
- *Employment for those with low capabilities.* Assisted employment programmes and encouragement of people into work can result in pay rates where families remain below designated poverty levels. High benefits mean that some of the low-skilled are virtually unemployable and low-skilled tasks are undertaken on the fringe of the labour market. Capital is substituted for labour and customers do the job themselves. It is easy to have a system that contains 'unemployment traps' – it is difficult to improve income by working.

US-style 'workfare' has an advantage in removing the stigma of being in obvious receipt of benefit. While public support may still be paid, making it more confidential reduces the social exclusion that occurs simply by being an identifiable member of a deprived group. However, if it is difficult to increase income, a poverty trap may be substituted for an unemployment trap.

The open method of coordination as a way forward

The EU's open method of coordination might seem like window-dressing. Medium-term objectives are agreed among the member states and a set of generalised guidelines developed to try to achieve them. In an annual cycle of actions based on more specific and quantifiable targets, each member state sets out an implementation plan. The European Commission monitors progress and draws conclusions to assist the next cycle of the programme. The difference from the 'harder' methods of coordination is the lack of compulsion. Each member state can choose measures it finds best for its economic and social structures and traditions; following the same path is presumed inefficient.

The main example of open coordination is employment, although the Broad Economic Guidelines can be seen in that light. The National Action Plans in the Employment Strategy have developed using measures contributing to four main pillars: - employability; entrepreneurship; adaptability; equal opportunities. Member states have responded rapidly to comparisons produced by the Commission. Governments do not like to be low in league tables; hence there has been a rapid take-up of ideas applied by others, thus stimulating a process of mutual learning. Some programmes may be nothing more than relabelling of existing activities. Nonetheless, the inclusion of quantitative measures limits the extent to which actions are largely insubstantial.

A set of guidelines for increasing social inclusion

Reforming social protection so as to reduce social exclusion in the framework of the Lisbon Council strategies seems ideal for applying the open method of coordination and has been adopted.

We therefore suggest a set of guidelines, following the same format as the European Employment Strategy (Begg *et al* 2001).

- **Guidelines for a European Social Welfare Strategy**

1 Participatability ensuring more people are able to participate in economic and social activity

- providing individuals with capabilities to facilitate labour market participation
- easing obstacles in housing, transport and relocation
- remedial education and training
- improving access to health care for vulnerable groups

2 Productive social protection

- shifting toward active labour market schemes
- rebalancing incentives
- developing pilot schemes

3 Mobilising economic and social actors

- improving the information flow among government agencies involved
- involving social partners and NGOs
- motivating and supporting voluntary sector activities
- making more effective use of local strengths

4 Equality of treatment

- clarifying rights and obligations
- ensuring benefits takeup by those at risk, especially the elderly
- setting thresholds for guaranteed minimum resources
- movement of labour – especially in cross-border regions
- gender equality

The issue in the first pillar is giving people the capability to participate in society. Labour mar-

ket participation comes first, and this is already being addressed in the Employment Guidelines - hence the emphasis on housing, communication, mobility, education, skills and health. Secondly, the nature of social protection needs to be changed so as to support active participation. While this involves switching to more active policies and gearing incentives to the same end, mutual learning will be stimulated if member states develop pilot schemes, generating more experience to draw on. However, it is essential to try to get all of the actors who can influence greater inclusion to work at assisting each other. This is difficult because it involves all layers of government, down to the most local, as well as the private and voluntary sectors. Coordination can be encouraged but not compelled. 'Equal treatment' is core to social protection and fairness. There is a major difficulty in trying to decide where to put the resources. The biggest impact on the number of socially excluded comes from tackling the least excluded/more capable. Conversely, the greatest per capita benefit comes from including the most excluded. Similarly dealing with those most at risk is most effective in stopping people sliding (further) into exclusion. The implication is that we should seek to ensure that every societal group has a minimum level of participation capability. Hence the fourth pillar aims at achieving equality of treatment in this sense, as in the Employment Guidelines.

Concluding remarks

Social exclusion is not a problem that can be solved but rather one that can be addressed with varying degrees of success. We have tried to set out a balanced approach to handling it as part of the Lisbon Council's ten-year strategy for development of the EU. This balance needs at least four ingredients:

- structural change to encourage the rate of growth, principally in terms of increasing the economy's ability to respond rapidly and with little cost to new opportunities and unfavourable shocks
- investment in skills, education, technology infrastructure and systems – a build-up of capabilities
- reform of the system of social protection to encourage participation and reduce social exclusion
- a prudent macroeconomic framework of sound fiscal policy and price and financial stability.

These are complementary. They are not alternatives. Pursuing some without regard to their interaction could easily be counterproductive.

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² European Council (2000, p.11).

³ Those with the greatest risks would move to the regimes with the greatest benefits and those with the lowest risks (higher expected incomes) would gravitate to the lowest tax regimes. This might generate a rush to the bottom, to the detriment of the disadvantaged.

⁴ The concept of *activation* should not be confused with 'active' policies.

⁵ One of the consequences of this has been a marked decline in the birth rate.

⁶ Governments hope growth will provide a way out, as it simultaneously reduces the demand for welfare payments and raises revenues. More effort can then be put on the remaining socially excluded and on tax rate cuts to increase incentives.