

Interactions between the social and employment objectives of the European Union

Executive summary

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Performance vis-à-vis the employment and social targets of the European Pillar of Social Rights (EPSR) Action Plan represent a central test for the success of the EPSR. The Belgian Presidency has the aim of strengthening the social agenda for the 2024-2029 period via a stronger integration of the EPSR in the European economic governance framework. Performance to date regarding the social target (AROPE) **at EU level** has not matched up to the success in increasing employment rates; a central challenge is to understand why and tease out the implications. This paper presents analysis and empirical evidence to contribute towards improved understanding of the relationship between the EU's employment and social target (at-risk-of-poverty or social exclusion rate, AROPE) indicators, including the implications of the way these are framed.

We analyse past trends of the employment rate and both the 2020 and 2030 AROPE rates and their components and examine their relationships at the EU and at Member States' level. Links between these indicators and some key demographic, economic and social policy measures are also explored. Our analysis is mainly built on quantitative data collected by Eurostat (mostly based on EU-LFS and EU-SILC), but other data sources are also used.

The developments of the employment and of the AROPE indicators over time in Europe show that the period prior to and after the Great Recession was marked by a **strong overall increase in employment rates**, reaching high levels just before the crisis and a peak in 2020 before the outbreak of the COVID-19 pandemic. The increase in employment was followed by improvements in AROPE during both pre- and post-crisis years. Still, there is a dissatisfaction with the achievements in the social field, as they could not (in general, at EU level) fully match up to those in employment, and because the EU 2020 social target (AROPE) was not achieved (although the employment target was not reached either, at EU level and in several Member States). The findings of this paper shed some lights on the extent to which one should interpret this as a failure and the extent to which these developments should be attributed to policies and to measurement (in terms of indicators and levels of analysis). The paper also contributes to the understanding of background mechanisms that channel employment growth into income poverty changes.

The **decline in the AROPE rate was not unsubstantial** in itself: from 25.8% in 2005 it dropped to 21.7% by 2021, meaning that there was a statistically significant drop in the number of persons at risk of poverty or social exclusion in the European Union. Regardless of the change in the definition of the AROPE components (specifically, the modified age brackets of the (quasi-)joblessness indicator (QJ) and replacement of the former "Severe Material Deprivation" (SMD) indicator by the "Severe Material and Social Deprivation" (SMSD) indicator), the overall trend remained the same.

The **interpretation of this as a "failure" is related to the direct comparison of social headline target to the actual decline** (i.e. when the planned reduction of the number of persons affected by AROPE-2020 by 20 million is contrasted to the actual decline by 7.8 million). The analysis of the grounding of the original targets and of the choice of the indicators for the measurement of the social developments is outside the scope of this paper. However, we present a number of facts that contribute to a better understanding of the "why"-s and "how"-s.

To account for the role of the various components in reaching the social target, **we decompose the change of AROPE aggregate indicator by change of its components** and by Member States. Poland, Romania, Bulgaria, and Hungary contributed to the AROPE decline by a combined 10.5 million persons (of which Poland alone contributed more than 5 million). There were another thirteen countries where the number of persons living in AROPE declined (by a combined 2.6 million in total). At the other end of the spectrum, Spain, Germany, the UK, France, Netherlands, and Sweden produced an increase in the number of AROPE by 5.3 million persons combined (of which Spain and Germany were the largest with 1.6 million and 1.4 million, respectively), and another five countries contribute a marginal (120 thousand people in total) addition to the AROPE aggregate. The all-European balance of these declines and increases added up to a 7.8 million decrease between 2008 and 2020, as highlighted above.

The major driver behind the overall decline of AROPE was the declining trend in the share of persons affected only by severe material (and social) deprivation, mostly in East Central European countries (converging up to the level of the core of Europe in terms of incomes), as well as in France, Italy, and Portugal. **Changes of AROP contributed negatively to the attainment of the target in most countries.** The largest increase in the number of persons living at the risk of relative income poverty was seen in Germany and the UK. **AROP rates in fact also increased** in Poland, Romania, Bulgaria, Hungary, and Czechia, but the drop in the SMD rates in these countries was sufficient to offset that. An AROP decline was seen in only a few countries (Spain and Greece).

Our paper examines the interactions between the employment and the social target. We **focus the analysis on the working-age population**. This, given that the EU target is for the population as a whole, constitutes a clear restriction, but, on the other hand, it also allows a more nuanced analysis of the employment-poverty relationships. This choice, by the exclusion of the older population (aged 65+), may undervalue the immense role of public expenditures to this sub-population (most notably, pensions) and somewhat reduces the validity of our results on the at-risk-of-poverty and social exclusion indicator and its components for the overall population, which is the social target in the end. The other core methodological decision of the paper is to break down the analysis to country level trends, which allows for a better understanding of what is hidden in a full European analysis, when the employment-poverty nexus is in question. Regarding the countries included in our analysis, we built our sample to include EU-28 Member States, as the United Kingdom was member of the EU for almost the whole period in question. A further methodological issue is related to the breaks in the time series. We did not take them into consideration in our analysis, although in some cases (e.g. Germany, Luxembourg) these may affect the results of the analysis, but not the main conclusions. Our analysis revealed that behind the all-European figures there **is very substantial cross-country heterogeneity in the levels and time trends of the employment and the social target indicators, as well as of the components of the latter.**

Over-time **employment trajectories** show **very substantial differences across Member States and between geographical regions**. For example, employment growth was larger in Germany and in the Netherlands than in other countries in the Continental region, while Belgium, France and Luxembourg showed less progress in this respect. There has been a strong convergence in the Northern part of Europe (between the Scandinavian and Baltic countries grouped together). In the East-Central country grouping there was no recessionary decline in Poland, and it was also small in Czechia. Other countries have shown a marked employment increase during the recovery following the Great Recession. However, the scars of the crisis prevailed for much longer in a number of countries, most importantly in Greece and some other Southern countries.

The heterogeneity within and between countries is also substantial when we observe levels and over time trends in the at-risk-of-poverty-or-social-exclusion rates. Over-time stagnation of AROPE (at low level) is seen in the group of Continental Member States (Austria, Belgium, France, Germany, Luxemburg, and the Netherlands) and in the Northern region (Denmark, Finland and Sweden). However, the decline of AROPE was substantial in most of East-Central Europe (most dramatically in Poland, Slovakia and Czechia) and in Bulgaria and Romania. Volatility of this trend was higher in the Baltic countries, while the Southern countries showed large internal heterogeneity.

Turning to the AROPE components, cross-county differentials in the **at-risk-of-poverty rate (AROP)** are also seen, but with less volatility: there was a decline of the AROP rate for the active age population of at least 2 pp in 4 of 25 countries, it increased by 2 pp or more in 9 of the 27 countries, while in the rest of the EU these relative income poverty rates stagnated (remained in a plus-minus 2 pp range of their 2005 levels). There were, however, very substantial cross-country differences in levels and in time trends for **severe material deprivation rates** across Europe. While SM(S)D rates of the active age population in the non-Southern EU-15 remained low, they were very much higher in Bulgaria and Romania at the beginning of the period (but showing a spectacular decline later on), and also in the East-Central Member States. The third component, the share of persons living in **(quasi-)jobless**

households, remained stubborn in many countries after the Great Recession. While these rates varied only marginally over time in the Continental Member States, there has been a significantly larger level of volatility over time in Southern Europe.

Both the EU and the country level analysis of the **co-movement of the employment rate and AROPE** among active age individuals shows a clear mirror image and thus, **a clear negative correlation between them**.

The negative relationship between employment and the AROPE indicator and its poverty components, respectively, is confirmed by the alternative analytical techniques we used. From the correlation analyses we show that **AROPE** rates calculated for the total population **correlate negatively with the employment** rate at a relatively high level (-0.54): an increase in employment is associated with a decrease in the at-risk-of-poverty-or-social-exclusion rate in the period between 2005 and 2020. The corresponding analysis restricted to the active age bracket results in even stronger (-0.61) correlation, underlining that there is indeed **a positive relationship between employment increase and income poverty reduction**.

This correlation is independent from other observable and unobservable factors, as it remains significant in the performed multivariate regression analysis. **Both levels and changes in individual employment are significantly and negatively associated with levels and changes in poverty outcomes**, most notably with the aggregate AROPE itself, but considerably less with AROP. Estimates for the severe material deprivation indicators stay in-between. A more substantial difference is seen when estimates for relative income poverty are compared with those for the anchored at-risk-of-poverty rate (fixed in 2008): **both the magnitude of the estimated coefficients and the explained variance are significantly larger when the anchored rate is used**.

We proposed five mechanisms to identify mediating factors between individual employment and household level poverty outcomes. Among these **the role of the distribution of jobs is crucial**: the lower is the share of persons living in (quasi-)jobless households, the lower is the risk of poverty, an observation supported by all relevant model specifications we used in our analysis. The important role of this factor is also highlighted when **alternative simulations on the effect of job growth on relative income poverty rates** are performed. Overall, income poverty is seen to decrease in all countries when the share (weight) of the working population is increased, and the decrease is strongest if job growth is assumed to reach the (quasi-)jobless households first. When the allocation of additional jobs is simulated, taking into account the statistical likelihood of individuals to move into employment, the impact on the at-risk-of-poverty rate of the active age population is generally smaller compared to when jobs are allocated first to the unemployed and the (quasi-)jobless households. Other factors, like **the quality of jobs** and the capacity of the social protection system to reduce poverty also played an important role. The quality of newly created jobs (measured by several indicators, out of which involuntary part-time rate seems to be the most powerful) may affect poverty outcomes: a larger share of these precarious forms of employment increases the likelihood of higher poverty rates. The contribution of **various types of social protection benefits** to poverty reduction is present especially when the poverty threshold is anchored in a fixed moment in time. Finally, both the results of the regression analysis (mentioned above regarding the estimates for anchored at-risk-of-poverty rate) and of the simulations we performed indicate that the effect of **changes in the median income** on poverty outcome is substantial. We learned from the simulations that in most countries attaining the employment targets per se would not be sufficient to achieve the work intensity and relative income poverty objectives. **The way jobs are distributed among individuals and households, the evolution of the at-risk-of-poverty rates among (quasi-)jobless households, and the impact of job growth on median incomes are crucial factors** in this regard.

Our analysis of the impact of changes over recent decades in **the composition profile of households shows that taken together with changes in household employment patterns** these were a much more important driver of changes in relative income poverty rates in some Member States than others. The

proportion of couples with both partners in paid work has gone up to a varying extent and has sometimes gone together with a sharp decline in the share of couple households in the population. Having more two-earner couples means growth in a low-poverty household type but has also served to drive up mean incomes and relative income poverty thresholds substantially in some countries but much more modestly in others.

We also found that among alternative income-based macroeconomic benchmarks, GDP is only weakly correlated with relative income poverty, severe material deprivation and (quasi-)joblessness, while GNI is more strongly correlated with employment, AROP and SMD.

From a policy perspective, it is clear from our findings that **employment growth contributes positively to income poverty alleviation**. However, our analyses on the transmission mechanisms between individual employment and income poverty indicate that the distribution of the extra jobs among households is crucial. When employment growth first benefits the (quasi-)jobless households, its effect is significantly larger. This means that the impact of job growth on income poverty can be significantly enhanced by improving the distribution of extra jobs among households, as well as the quality of those jobs. The clear implication is that employment policies should focus (even) more on activating the most vulnerable.

The simulations also highlight the significance of the evolution of the at-risk-of-poverty rates among (quasi-)jobless households. This underscores the importance of **adequate social protection for households that do not benefit from employment growth**. The distributive upside of employment growth (more people in work, thus fewer people at risk of poverty) should not be affected by a distributive downside of social protection becoming less adequate.

Some lessons and priorities for **future research** on the topic are also highlighted. **Focusing the analysis on working-age households** is appropriate when the core question is the interrelationship between the employment and social target (AROPE) indicators.

Carrying out such **analysis both at the level of the EU as a whole and at the level of Member States** is key in understanding processes that take place and also facilitates the mutual learning process among the Member States.

Including both purely relative and „anchored“ indicators of income poverty into the analysis has been shown to be highly informative. Given that the latter is also included in the EU social indicators portfolio, its use in monitoring poverty trends besides the AROPE target and its components could provide a more complex picture. In addition, we find that both long-term and short-term anchoring may be of a value. This would also require a further investigation of how the anchored at-risk-of-poverty rate can be improved to overcome its weaknesses. Rolling the anchored thresholds (e.g. by every two or three years) would be an example of such a methodological work.

While (quasi-)joblessness is a constituent component of AROPE, the underlying effect of employment growth on income poverty may be more clearly identified when this component is treated separately.