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Life after Lisbon

Europe's Challenges to Promote Labour Force Participation and Reduce Income Inequality



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Life after Lisbon

Europe's Challenges to Promote
Labour Force Participation and
Reduce Income Inequality

Christian van Stolk
Stijn Hoorens
Philipp-Bastian Brutscher
Priscillia Hunt
Flavia Tsang
Barbara Janta

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Executive summary

In June 2010, the Europe 2020 agenda replaced the European Lisbon Strategy that had guided European social and employment policy over the decade ending that year. Europe 2020 continues the main themes of the Lisbon Agenda by focusing on economic inclusion and territorial cohesion, but is also a response to existing and new realities – including the biggest economic downturn since the 1930s and the need to develop a smart and green economy in an increasingly interdependent world.

This review assesses two key components of the Lisbon Strategy and the Europe 2020 agenda: promoting labour force participation and reducing income inequality. Labour force participation is a basic condition for social inclusion and also facilitates longer-term social stability. The reduction of income inequality between regions and social groups is closely related to ensuring that fewer Europeans are at a disadvantage (for instance, at risk of poverty and discrimination) and lack equal opportunities.

The purpose of the study is to identify progress against these objectives, what has driven the outcomes, potential trade-offs among outcomes and future challenges. Looking at trade-offs is helpful as it addresses the real dilemmas facing policy makers in practising the art of the possible. Examining future challenges tells us something about the certainties and uncertainties inherent in policy making. While the study initially focused on what had been achieved in the Lisbon Strategy, the current economic crisis as indicated in the Europe 2020 agenda makes a look at policy challenges affecting progress with those outcomes more pressing. For instance, policy objectives may be harder to attain than before the crisis and may become obsolete.

The findings of the review can broadly be summarised as follows. Both low labour force participation and high income inequality remain significant policy problems across the European Union.

The aftermath of the economic crisis of 2008 has undone much of the progress on improving employment and growth in Europe over the last 20 years. Vulnerable groups in particular remain at risk of poverty and not being in employment and education, especially in light of trends that have shaped the labour market including changes in educational requirements and the changes in work. Going forward, these trends will remain while other trends such as the move to a low-carbon economy will come into play. Progress on the Europe 2020 agenda requires targeting the problems of social inclusion of these vulnerable groups. Our analysis shows that what is done to support the labour force participation of specific vulnerable groups does not have to come at the expense of others. Moreover, a reduction in income inequality across society may not have to impact other macroeconomic outcomes such as employment.

However, it is less clear to see what should be done specifically. The review shows that evidence on specific policy solutions is limited. We do know something about the general policy principles that appear important such as good labour market policy in general (flexible labour markets), early childhood interventions, keeping young people and other vulnerable groups in education or work, setting minimum standards for employment (e.g. minimum wage), skills training over the lifecycle of employment (incorporating employers) among others.

The insights from our analysis and review form a useful input into developing European policy discussions. The general policy principles above speak to the increased use of enabling social policy that allows individuals to achieve their full productive potential and participate in the labour market to complement other welfare approaches such as social insurance. Europe could build on the policy response focused on job placement,

training, and flexible working that it put in place after the global economic crisis. European action is relevant. Improving labour force participation and addressing income inequality across Europe requires a concerted strategy to define the principles in employment and social policy and values and mechanisms that can facilitate effective policy coordination and exchange. It is obvious that Member States could learn from each other given the differences in income inequality and labour force participation rates in Europe. Further improvements also require better information on which particular policy responses are effective. Lack of movement on income inequality and low labour force participation of vulnerable groups would mean the objectives of the Europe 2020 agenda may be difficult to achieve. More widely, differential rates of inequality and labour force participation could start to undermine European cohesion affecting the process of European integration and indeed further European integration in the future. We expand on these findings below.

Looking at labour market outcomes

The review shows that European policy makers over the last 30 years have had to respond to important trends that have shaped labour markets: an increase in educational requirements and attainment, a shift towards service sector employment (changes in the industry mix), a move towards white-collar jobs (occupational upgrading), female participation in the labour market, and demographic change (population ageing). The study concludes that during the Lisbon Strategy period wages have remained in line with productivity, employment rates increased and unemployment rates fell – factors that speak to important accomplishments. The improvements in overall employment and growth over the decade up to 2007 meant an increased attention towards specific vulnerable groups – such as younger and older people and migrants – who are not well integrated in the labour market but whose engagement is closely connected to Europe’s overarching societal objectives and to the sustainability of its economic objectives.

The economic crisis of 2008 that continued in 2009 undid much of the progress in improving employment and growth across Europe. Not surprisingly, vulnerable groups appear to be at particular risk of not being in employment or education at times of economic crisis, and find it difficult to

re-enter the labour market when economic conditions improve. Continued policies supporting the employment of such groups remain important because their employment may lead to higher rates of social inclusion and reduced welfare expenditure. The labour force participation of vulnerable groups will also contribute significantly to Europe achieving the objectives set in the Europe 2020 agenda.

To target such vulnerable groups, policy makers must understand what keeps them out of the labour market now and whether supporting one group will negatively affect another. We focused on how the key trends mentioned above affected the participation in the labour force of the young (16–24) and old (55–64). These two groups are receiving particular attention from policy makers. Old-age employment is seen as an answer to many of the policy challenges associated with population ageing. The old have low labour force participation rates (LFPRs), and increased participation relieves pressure on social security systems. Getting the young into employment is critical for society. Young people not in education or work are at great risk of long-term unemployment.

The study finds that while increased educational attainment and the shift to service sector employment are associated with an increase in the probability of young people working compared to the baseline of young people being in full-time education, the same trends increase the chances of young people ending up ‘not in school and not working’ compared to the baseline. Therefore some young people are at risk of exclusion from the labour market and full-time education. There also seems to be an issue around managing the consequences of the move towards white-collar jobs for the old: an increased probability that they will retire and stop working, stemming from the increase in skill requirements. Our modelling also showed that there were no significant trade-offs in the trends between the participation of the old and the young. The participation of both groups in our study does not seem to be adversely affected by increased female participation. Thus, we see clear possibilities of mutual increases and decreases in labour force participation of certain groups.¹

¹ The fact that increased participation of young and old appear to move together does not mean that there is no substitutability between groups.

Examining income inequality

Over the last decade, overall income inequality at the European level has changed little, but there are large variations across countries with some experiencing large reductions and others large increases in income inequality. The 2008 economic crisis has significantly increased income inequality in some countries. Also, groups in specific European Member States are still at a significant risk of poverty; these include women, the elderly, single-parent families and jobless households. Sustained inequality associated with societal stratification is a concern of the policy community.

Reducing sustained income inequalities in Europe may be associated with other outcomes, such as improved social capital and perceptions of happiness. In terms of health outcomes, the enlargement countries – which had striking changes in inequality – showed no consistent change in health outcomes. To some extent lower income equality is not associated with lower employment, which means addressing income inequality may not lead to labour market distortions.

With group inequality is a further concern for the policy community. ICT-led economic development has reinforced skill-based inequality and inequality within skill level groups. The review shows that compared with the United States, Europe has a particular issue with inequality *within* groups, which means that groups with the same education, age, gender and sector profiles are showing higher degrees of wage inequality in Europe. The main reason seems to be the prevalence of flexible working arrangements in Europe – which allow part-time working and career interruptions, among other things.

Anticipating future trends and uncertainties

Since the future is both uncertain and unpredictable, there are limitations to using historical evidence for taking decisions about the future. It is particularly important to anticipate plausible future trends and events. Policy challenges may involve taking decisions that are robust under different future conditions rather than those that are optimal under specific scenarios. This report highlights a number of future trends characterised by varying degrees of uncertainty. Responses to these trends require robust but resilient strategies that allow for adaptation when trend-breaks or sur-

prises occur. We have raised a number of policy challenges for a future European Union (EU) employment and labour market strategy.

Policy challenges after Lisbon

Our review acknowledges the continued importance of tackling labour force participation of vulnerable groups and managing income inequality across Europe in achieving a more fair and inclusive society. It is important for Europe to achieve the stated objectives of the Europe 2020 Agenda. In the aftermath of the economic crisis, achieving the European objectives on labour force participation and reduction of income inequality requires a concerted and renewed effort on labour force participation and income inequality from policy makers faced with cuts in public expenditure and variable demand from employers across Europe that affect unemployment rates.

The review states that tackling these policy objectives effectively requires understanding the drivers of low labour force participation and income inequality in formulating policy responses. In addition, policy makers need to understand trade-offs to ensure that what they do to address one policy problem does not have externalities. Finally, going forward many of these trends will remain and in cases such as population ageing and occupational upgrading (a move towards white collar employment) become more pressing, while other trends such as the move to a low-carbon economy will come into play.

The question remains what specific policy responses are available to European policy makers. Here the comparative evidence is more limited. On the one hand, there is an absence of systematic evaluations that outline what aspects of policy or combinations of policy are effective in specific environments. On the other hand, contextual factors make it often difficult to collect good comparable and meaningful data on policy outcomes across Europe to inform policy makers.

Our review can say something about which general policy principles appear important. For instance, for the younger and older populations, it is important – given current trends – to intervene early in childhood, keep the young in employment or school, to upgrade or learn to exploit the skills of older workers across the lifecycle of employment, to keep older workers in employment, and to promote employment in general. The latter is because

Future trend	Level of uncertainty	Policy challenges
Knowledge-based economy	Low/medium	<ul style="list-style-type: none"> • Raising the stock of workers with scarce skills in the EU labour force to fill increasing supply of knowledge-intensive jobs • Managing the increasing mismatch between demand and supply at both ends of the skill distribution to minimise the duration and negative impacts of subsequent structural unemployment
Population ageing	Low	<ul style="list-style-type: none"> • Investing in education and training to prepare young people for the labour market • Bringing more people into the labour market, including migrants, women, and the disabled, in an economically challenging climate and against increasingly anti-immigrant sentiments • Encouraging substantial and comprehensive investments in the compatibility of career and parenthood during a time of high public deficits to promote employment • Minimising the adverse consequences of conflicting interests between the young and the old • Reforming Europe's welfare systems while guaranteeing adequate social protection and equity between the generations • Creating public support for the introduction of structural reform in Europe's pension, healthcare and labour market systems
Low carbon economy	Medium	<ul style="list-style-type: none"> • Managing the employment effects of climate change mitigation policies by preparing labour markets and education systems • Dealing with the potential trade-off between shifting to a low-carbon economy and keeping unemployment low elsewhere • Addressing the impacts of climate change on migration, risk of poverty, social cohesion, and vice versa • Furthering human capital and skills as a means of raising labour productivity, and as a vehicle for social mobility, through the education system and the workplace
Aftermath of the financial crisis	Medium/High	<ul style="list-style-type: none"> • Mitigating the disproportionate impact of the crisis on vulnerable groups, including young people, elderly people, working poor, disabled people, etc., and avoiding further income inequalities, and persistently high poverty rates • Strengthening cooperation with external partners, particularly the emerging economies, so as to take better advantage of worldwide economic and social networks • Fostering creative destruction and a new social deal: introducing structural reform while guaranteeing adequate social protection and investing in human capital while under economic pressure (e.g. stimulus packages for a low-carbon economy) • Maintain public and private investment in research, education and innovation in a climate of economic downturn and budget pressures • Avoiding a race to the bottom in labour costs and conditions and not pursuing competitiveness strategies based either on low costs or on monopolisation
Future of the Union	High	<ul style="list-style-type: none"> • Identifying the role for EU employment and social strategy and the mandate of EU institutions • Developing a contingency strategy for hard regulation: in a Europe where common goals and interests are sparse, should the Commission become an honest broker, and establish a basis for mutual learning, identifying mutual interests and supporting Member States to act on them? • Identifying the common denominator with regard to employment policy issues in a highly fragmented Europe, such as working conditions, income inequality, anti-discrimination, adequate social protection, and active employment policy
Future of work	Medium/High	<ul style="list-style-type: none"> • Signalling, identifying and addressing new employment risks that merge with new ways of working. • Monitoring systems of rewarding labour and addressing potentially new trends in income inequalities and poverty • Encouraging Member States to facilitate the combination of higher education and a career with family life, as both labour participation and family formation are important determinants of economic growth and social inclusion. • Developing a contingency plan for the social inclusion strategy. Social inclusion through employment is relatively ineffective in case structural unemployment is soaring and the incentives to join the work force are low,
Future of EU social model	Medium/High	<ul style="list-style-type: none"> • Reconsidering social partners in Member States since the influence of unions is changing • Developing alternatives to employment as the only solution to social inclusion, given the need to cope with increasing structural unemployment • Supporting convergence of national social policies and common learning as all Member States are struggling to reform their policies to deal with similar challenges

labour force participation rates in these groups will also benefit from general improvements in the aggregate rate of employment. The review importantly highlights that what is done to improve the labour force participation of one group does not have to go at the expense of other vulnerable groups. In income inequality, we know that labour force participation is a key element in addressing sustained income inequality. Finally, the review highlights that within-group (same age and education levels) inequality is a significant policy concern in Europe, compared with for instance the United States. To combat income inequality, policy makers could provide basic income support and a higher guaranteed minimum income. On trade-offs between reducing income inequality and other policy objectives, the review states that what is done to reduce income inequality does not have to go at the expense of labour markets outcomes.

These policy principles emphasise the importance of enabling social policy or social investment targeted to specific groups at risk of exclusion from the labour markets or of poverty; or in other words delivering those policies such as for instance job placement and training, skills upgrading across the productive lifecycle of an individual, and early childhood interventions that enable individuals to achieve their full productive potential and participate in the labour market. As Anton Hemerijck points out in his foreword to this report, the trends shaping labour markets require different approaches to welfare provision and in particular complementing basic social insurance such as income guarantees and defined benefit schemes with ‘capacitating’ social policy mitigating new social risks. This is important. The social cost of long-term unemployment, poverty, and lacking opportunities to participate seems too substantial for policy makers to ignore. In addition, social investments do not have to come at the expense of macroeconomic performance. In fact, Nordic countries shows that generous provision of social services ranging from for instance childcare to active labour market policies and training aimed at getting individuals to participate in the labour market over the course of a lifetime can result in high labour force participation with low income inequality. The review also implies that targeting interventions at specific groups at risk of structural unemployment makes sense when considering

wider trade-offs, for instance with other groups in society.

Europe has responded to the global economic crisis by emphasising later retirement, promoting training and job placement, and extending flexible working arrangements among others. For Europe to achieve its Europe 2020 obligations, it needs to continue to make social investments in a climate of fiscal austerity. This requires political will as the return on investment of for instance early childhood interventions or training likely falls in the longer run. The economic crisis is therefore an opportunity to re-emphasise the importance of social policy and enabling social services in particular in setting policy priorities as well as a challenge given a climate of fiscal austerity could imply significant cuts to welfare provision.

Action at European level at this time seems intuitively important. Great divergence of labour force participation and income inequality rates across groups between Member States may undermine European cohesion and the current and future process of European integration. What should European action aim to address? Firstly, there is a clear need for better information among policy makers to understand which aspects of policy work in specific national and regional contexts. For instance, what do we know about the effectiveness of specific active labour market programmes across Europe? Collecting such information becomes more pressing given the challenges of future and current trends that we know about and are outlined above. Secondly, improving labour force participation and addressing income inequality across Europe requires a concerted strategy to define common principles in social and employment policy and values and mechanisms that can facilitate effective policy coordination and exchange. Clearly, differences in labour force and income inequality rates across Europe suggest that countries can learn from each other in how policy challenges have been addressed and social models have evolved. European institutions could more effectively facilitate this process.

The Europe 2020 agenda is important in framing strategies and monitoring progress. However, the key challenge for European institutions such as the European Commission will be facilitating the exchange of best practice and information on what works across Member States, with the aim at times to bring Member States closer together and seek

some convergence in how welfare systems evolve while at the same time acknowledging a degree of strategic flexibility to reflect national and regional contexts. This balancing act will be difficult given the limited European mandate in this area, but seems imperative in ensuring a competitive and inclusive Europe and supporting the current process of European integration going forward.