

**ISSA Initiative
Research Findings
No. 1**

**Coordinating labour
market and social
protection policies**

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Foreword

The phrase “Strengthening the security in social security” sums up the mission of the International Social Security Association (ISSA) and captures the spirit of the ISSA Initiative. This programme, launched in 1999, is designed to contribute to national and international debates on social security through new information and new ideas. The Initiative encompasses a range of activities - research, discussion, publications - oriented towards this goal. The themes dealt with concern the impact of social security on people’s daily lives. The programme seeks to explore two basic questions:

- To what extent does social security meet people’s expectations?
- How can people’s rights to adequate benefits be strengthened?

This publication is the first in a series of *ISSA Initiative Research Findings* designed to present to a wide audience the results of studies that are pertinent to Initiative themes. A second series of *ISSA Initiative Opinion Papers* presents viewpoints on controversial social security issues.

The Initiative theme “Assessing the coverage gap”

The Initiative theme to which ISSA has accorded the highest priority is coverage. ISSA has launched an international study on this topic in fifteen countries with contrasting coverage levels selected from different regions. Work on this theme aims at assessing the proportion of the population covered by social security, identifying groups which are not covered, exploring the mechanisms that lead to exclusion, and examining experiences with policy options that have proven successful in extending coverage or which might lead to its extension.

Coordinating labour market and social protection policies

In 1999, ISSA commissioned a project entitled “Labour market shifts and social protection reforms” which studied links between coverage and employment in selected countries of the Organization for Economic Co-operation and Development (OECD).

The main questions addressed were:

1. What is the impact of current labour market changes on the effectiveness of social protection systems, that is on their capacity to provide security and help to those who need it?
2. What is the impact of current social protection reform on labour markets, that is on work incentives, employment rates and the living conditions of the various social groups?
3. What are the conditions for successful social protection and labour market policy reforms?

The project brought together an international panel of experts who dealt with these questions in a number of ways. Some provided national case studies on interactions between the labour market and social protection. Others produced comparative studies or more theoretical analyses. All of their contributions will be published in a single volume edited by Hedva Sarfati and Giuliano Bonoli and entitled *Labour market and Social protection reforms in international perspective: Parallel or converging tracks?* (Aldershot, Ashgate, forthcoming 2002).

This document deals with the project findings. The authors examine connections between developments in labour markets and in social protection reforms and focus on possibilities for improving co-ordination of public policy in these two areas.

Employment patterns affect people's access to social security. At the same time, the rules governing access to social benefits influence employers' and workers' decisions concerning employment. A better understanding of the interactions between the two spheres, the labour market and social protection, is crucial to an analysis of existing coverage patterns and to the design of public policies aimed at expanding coverage.

Dalmer D. Hoskins
Secretary General

Coordinating labour market and social protection policies

Hedva Sarfati and Giuliano Bonoli¹

Introduction

The past two decades have witnessed the unfolding of major changes and developments in labour markets and social protection systems. The highly structured labour markets that were predominant during the first three postwar decades in the advanced OECD countries, characterized by full-time, stable and full (male) employment, now seem a thing of the past. Today's labour markets continue to produce predominantly full-time stable jobs and welfare for a majority of citizens, but they also generate substantial long-term unemployment, job insecurity, low pay, poverty and social exclusion. At the same time, economic and social trends, such as economic globalization, regional integration, the ageing of the population, the considerable development of "atypical" jobs, and changes in family structures, are making it difficult for governments to deal with these problems in the traditional way. The social protection institutions that we have inherited were effective in the postwar socio-economic growth context, but seem less adequate for addressing today's problems and challenges. They tend to be costly and focus their efforts on core (male) workers, while often overlooking emerging new needs and aspirations. The combination of these diverse factors has called into question the sustainability and adequacy of existing public social protection systems and explains why they have been the subject of unprecedented debate and reform initiatives over the past two decades.

In this context of social change and pressures on labour market policies and social protection systems, the International Social Security Association project entitled "Labour market versus social protection" set out with the objective of exploring the connections between these two institutions. Its goal was to identify possible problems generated by the interactions between labour market and social protection systems, and to identify instances of successful adaptation.

Thanks to a number of national studies and comparative issue-based analyses, we were able to identify four potentially problematic areas of interaction between labour market developments and social protection systems:

1. Employment promotion and the long-term sustainability of social protection.
2. Preserving security for the most disadvantaged.
3. Decent protection for atypical workers.
4. Social protection begins in the labour market.

1. Employment promotion and the long-term sustainability of social protection

Over the next few decades, social protection systems will be confronted with the issue of sustainability in the face of population ageing. As is widely known, this development will put

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substantial financial pressure on social protection programmes, most notably old age pensions, health care and long-term care for older people. The impact of population ageing on the financing of social protection, however, can be significantly mitigated by an expansion in the proportion of the population who are in employment. An ageing society with an increasingly large proportion of its population in employment is more likely to withstand the demographic challenge than one in which employment rates remain stable or decline. More employment means more revenue and possibly less expenditure for social protection systems.

Recent policy initiatives, taken in a number of industrial countries, have shown that it is possible to increase employment rates for some population groups, such as prime-aged women or older workers, who are proportionately less likely to be involved in paid work.

Increasing female employment rates

Female employment rates have been increasing more or less constantly since the early 1970s throughout the OECD, but with substantial cross-national differences in the speed. In the late 1990s, as a result, there were still substantial variations in the rate of women's labour force participation across OECD countries. In 1999, these rates ranged from a high of around 75 per cent in the Nordic countries and Switzerland to a low of 45.6 per cent in Italy, a much larger variation than is the case for males.

Women's involvement in the labour market depends on a range of factors, many of which are determined by government policies. An appropriate policy mix can be conducive to higher female employment rates. To increase female labour supply, the degree of state support for financially affordable and good quality care, both for children and dependent persons, is crucial. Tax systems, and the degree to which they recognize the existence of dual earner couples, also have an impact, albeit a smaller one, on female labour supply. Welfare states, too, need to adapt in order to take account of the larger number of women in the workforce. This has been the case in particular in the Nordic countries, where typical breadwinners' schemes like sick pay have been turned into schemes for "working parents", for example by providing paid leave also in the case of a child being ill and needing care. On the demand side, the availability of part-time work and the size of service sector employment and public employment are all strongly correlated with female employment rates.

Increasing activity rates of older workers

Since the 1970s, the employment rate of older workers, generally defined as persons aged between 55 and 64, has declined throughout OECD countries. To a large extent, this has been the result of increased use of preretirement and disability insurance as a means to facilitate employment adjustment in declining industries or in sectors undergoing profound restructuring. In the 2000s, the policy objective has become to reverse this trend, and encourage older working-age individuals to remain in or re-enter the labour market.

This is an objective that can be achieved by raising the retirement age or the number of contribution years needed to be eligible for a full pension, by introducing flexible or partial pensions which enable people to receive pension benefits while remaining in gainful activity part-time, and by removing incentives for early retirement. The success of these measures, however, depends on the wider economic context. If industries are going through labour-shedding restructuring, then an increase in retirement age may prompt employers to use other instruments, such as disability or long-term unemployment benefits, in order to adjust their labour force. Some countries (essentially the United States and the United Kingdom) have also

been experimenting with active labour market policies targeted on older workers that aim at improving their employment prospects through retraining and other support measures.

Active labour market policies

More generally, employment rates can be increased by measures that facilitate employability, including training, job counselling and placement assistance. Shifting emphasis from passive income support for unemployed workers to active labour market programmes has scored success in some countries, particularly in Scandinavia, Austria and the Netherlands, and was strongly recommended by the OECD's 1994 Jobs Study and Job Strategy reports. It appears that the most successful examples of active labour market policies are those that combine work-related measures with support measures, such as help in finding childcare or with transportation. Programmes based on individual case management have also proved effective in a number of countries. While the overall evaluation of experiences with active labour market policies is positive, it should be noted that, in general, they have not come to grips with helping the core group of long-term unemployed workers.

2. Preserving security for the most disadvantaged

Since the late 1990s, social protection systems have developed in the direction of employment promotion. As discussed above, this new task taken on by social protection is important and can be of great use in improving the prospects for social protection sustainability in the medium and long terms. The reorientation of social protection towards work, however, should not go together with neglect of its old, traditional function: providing economic security to those who cannot obtain a dignified standard of living by participating in employment. The need for this function, as testified by the persistence of long-term unemployment in many European countries, is still great.

However, this point does not take into account some crucial problems, mostly related to the trade-off between work incentives and poverty prevention. In order to provide economic security to those who are "legitimately" not in employment, they must be granted decent benefits. In the context of a deregulated labour market, where low-skilled workers can only command low wages, this may generate a serious lack of incentives. If benefits are generous and wages low, the incentive structures faced by low-skilled individuals may not be favourable to employment. Policy makers face a dilemma: either they offer decent benefits and accept that some potential workers will decide not to take a job or, alternatively, they reduce benefit levels so that these remain lower than minimum wages. They thus keep work incentives intact but inflict substantial hardship on people who are genuinely unable to find jobs. This trade-off between two possible approaches to benefits for non-workers has been solved in different ways by different countries.

The fine-tuning of benefit levels for non-workers is a difficult but crucial exercise. What is at stake is the quality of life of those individuals who are regarded by society as legitimate non-workers. The solution probably lies in a carefully balanced policy mix. A combination of a minimum wage, tax credits and workfare can ensure that work does pay in most cases, so that work incentives are intact, even when non-work is compensated with decent benefits. The strategy that the Nordic countries have adopted in order to deal with the benefit levels versus work incentives trade-off is of interest here. Benefits are maintained at a high level, but they are accompanied by a series of work-oriented measures, such as rehabilitation, medical examinations, therapeutic interventions, training, placement, and individual work plans. The objective of this policy mix is to make sure that benefit recipients, where possible, are put back on an employment path. Here, the potential negative incentive effect of generous benefits is counteracted by a set of accompanying measures with the overall result of virtually eliminating

any sizeable disincentive effect, as testified by the high employment rates found in these countries. The beneficial effect of the absence of benefit-induced negative work incentives in the Nordic countries is reinforced by a comprehensive system of wage regulation, which ensures that minimum wages are among the highest in OECD countries.

3. Decent protection for atypical workers

The past two decades have witnessed a major change among labour market entrants with a whole new range of life-cycle profiles which are generally not well covered by current social protection arrangements. This is particularly the case of women, whose careers are often interrupted for several years by motherhood and caring, but it more generally affects people whose activities do not conform to the standard of a full-time uninterrupted career. In most social security systems such profiles result in diminished rights, especially in the field of pensions but also as regards unemployment and health coverage. The existence of derived rights is of little comfort to those who divorce (even though, increasingly, pension rights are split in the event of divorce) and does not reflect the current reality of gender roles.

Public pensions

With regard to public pay-as-you-go pension schemes, most European countries have introduced contribution credits that protect pension entitlement during years spent performing caring tasks. But these are generally limited in time and do not always compensate for the loss of entitlements due to career interruptions. This is obviously a more serious problem in countries, mostly in continental Europe, whose pension systems are based on contributory social insurance. Possibilities for improvement do exist, however. Switzerland, for instance, has introduced a system of contribution sharing between spouses. Contributions paid by the members of a couple are summed, divided by two, and counted separately and individually for each spouse. More generally, it seems that keeping paid employment as the only basis for social protection entitlements is becoming anachronistic. Other activities, including caring, participation in education and training, and volunteer activities for the community, should all generate social protection rights.

Private pensions

The problem seems more intractable in relation to private pension schemes, where the scope for redistributive solutions is considerably more limited. Typically, women are less likely to be covered by a private (individual or occupational) pension arrangement than men. Some countries, like Switzerland and Australia, have made occupational pension coverage compulsory. However, because generally the requirement to be affiliated to a pension fund applies only above a certain earnings threshold, coverage rates for part-time and intermittent workers remain rather low. The trend towards defined contribution pension schemes, which is very strong in the United States, but also in some European countries such as Switzerland, is going to generate additional disadvantage for workers whose careers are interrupted by spells of unemployment, most often women.

Adapting to women's career patterns

The participation of women in the labour market generates new needs and expectations that can be grouped under the heading "reconciling work and family life". Generally, the existing social protection systems established in the early post war years are not particularly effective in this area, as their main objective was to protect the income of the male breadwinner during short periods of unemployment, sickness or disability. Today, however, when parents are

increasingly expected both to perform caring tasks and to participate in the labour market, policies that help them to combine these two activities are of particular importance. This is all the more urgent for lone-parent households, whose numbers have significantly increased over the past two decades. Such policies are being developed and included in the standard policy repertoires of western democracies. Examples are the provision of childcare facilities at an affordable price, parental leave schemes, and the right to return to the same job part-time following childbearing.

Reconciling work and family life will require adaptation of the welfare state, but also adaptation in the realm of work. Standardized working time, which has been predominant during much of the postwar period, is obviously not very suitable for workers who perform caring tasks, since they need flexible working time arrangements. In this respect, many employers are experimenting with new forms of flexible work schedules, explicitly designed to facilitate the combination of work and caring tasks. Here we are thinking of measures such as annualized working time, or even more creative proposals such as having working time calculated over the whole working life with “drawing rights” for early retirement. More working time flexibility is not necessarily an additional cost for employers if it can be adapted to fluctuations in labour demand within the company. For once, we are not seeing a trade-off but the possibility of a win-win situation, where the needs for working time flexibility of employees and employers can be addressed by the same arrangements.

4. Social protection begins in the labour market

The relationship between the degree of employment regulation and the ability of an economy to create jobs has long been the subject of disputes among economists. On the basis of a relatively large number of studies, today it is possible to say that the evidence concerning the impact of employment regulation on job creation is mixed and rather limited. Employment protection laws and mechanisms of wage setting (such as collective bargaining and minimum wages) have not been shown to be systematically conducive to lower employment levels. However, with regard to some specific population groups, several studies have highlighted a trade-off between the quality and the quantity of jobs they can obtain. These groups are essentially those who, in the past few decades, either have not been employed or have been marginalized from the labour market: particularly, low-skilled workers, women and young unemployed people. In relation to these groups, policy makers, especially in Europe, face a dilemma between the quality and the quantity of employment that their political choices may generate.

More flexibility in European labour markets may be conducive to stronger job creation in the low-skilled service sector (retail trade, hotel and catering, personal services, etc.). The risk is, however, that the jobs created as a result of labour market deregulation may be of poor quality: low-paid, unstable and with poor career prospects. This can be the case particularly with temporary employment, which is currently on the increase in many European countries.

Compensating the working poor

Some countries, most notably the United States and the United Kingdom, have chosen what could be labelled an “ex post compensatory strategy” for helping the working poor. This approach accepts the existence of a low-wage sector and job insecurity, while trying to redress some of its nastiest consequences by intervening ex post with instruments to improve the living standards of those who take up these jobs, such as tax credits. This strategy has generally been positively evaluated so far as its impact on the living standards of the working poor is concerned, but it creates new problems of administration and of exclusion of non-workers.

Selective re-regulation

Alternatively, governments can go for selective re-regulation, as not all forms of regulation are harmful to employment creation. According to an increasingly large body of research, “intelligent” forms of labour market regulation not only are beneficial in terms of the quality of employment but can also be conducive to more efficient labour markets. The persistence of long-term unemployment and social exclusion in the United Kingdom, in spite of 15 years of labour market deregulation, suggests that deregulation is not particularly conducive to an efficiently functioning labour market.

In this respect, some carefully chosen forms of intervention in the regulation of the labour market can dramatically improve the situation of the most disadvantaged workers, without impairing the ability of an economy to create the kind of jobs that are suitable for them. For instance, minimum wages, if set at economically acceptable levels, can protect the incomes of the most vulnerable workers without necessarily pricing them out of the labour market. Even a low minimum wage can have a positive impact for some disadvantaged workers, as recent experience in the United Kingdom has shown. As a result of the introduction in 1999 of a minimum wage set at £3.60 an hour, over 2 million workers benefited from wage increases of up to 40 per cent.

Perhaps ironically, labour market re-regulation is a strategy adopted by those countries, like the United Kingdom or New Zealand, that in the 1980s were at the forefront in deregulating labour markets. The British government, besides introducing a national minimum wage, has taken steps to implement European Union labour legislation in relation to working time and works councils. In New Zealand, legislation adopted in 1991 that strictly limited trade unions’ ability to bargain wage settlements collectively was reversed in October 2000. In the same vein, extension of the social protection rights of atypical workers can significantly improve their employment conditions without impairing job creation. In the Netherlands, after the expansion of part-time work dramatically increased the employment rate of women - and also of men - a key issue now is including part-time workers in good-quality social protection arrangements, such as occupational pensions.

These experiences suggest that there are limits on the extent to which deregulating labour markets has a positive effect on overall welfare in terms of delivering a decent standard of living to all. In a modern vision of effective integration between labour markets and social protection systems, the regulation of employment has a crucial role to play, and some form of labour market regulation that goes beyond basic aspects like health and safety is needed to safeguard standards of welfare. What is more, labour markets that deliver decent work with decent salaries constitute a more solid basis for the financing of social protection systems. Higher wages mean higher receipts for social programmes.