The structural nature of disappointing poverty trends in European welfare states:

The need for a new social contract.[1]

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Although welfare states' social spending and programs have generally expanded and diversified in many European welfare states, income poverty among the working-age population has either remained stagnant or increased over the past decades, also during periods of economic and employment growth. This paradoxical observation suggests a fading away of the effectiveness of mature welfare states on poverty reduction. Have welfare states failed to properly adapt to the great transformations of our time? Have they changed but bet on wrong horses? Or is there more to it: is the welfare state experiencing increased structural constraints on poverty reduction? And, if so, what can be done?

In this paper, we start by providing a brief overview of the dominant policy paradigms that have characterized European social policy making in recent decades. In section 2 we describe poverty trends taking a long term perspective and focusing on changes in income poverty among the working age population. In section 3 we confront these trends with the evolution of welfare state efforts. Section 4 presents the main structural causes for disappointing poverty trends. Section 5 addresses the question what can be done. Section 6 summarizes and concludes.

1) The European anti-poverty strategy, the underlying policy paradigms and the associated targets

Since the beginning of the 2000s, poverty reduction is a common objective of the European Union. The associated policy strategy aligns with the principle of social subsidiarity inherent to the European project: while the EU's influence on the social policies of member states has significantly increased in recent years (with the emblematic example being the binding Directive on adequate minimum wages issued in 2023), social matters continue to fall to a large extent within the exclusive jurisdiction of the member states. However, in successive policy agendas, the European Union has increasingly provided guiding directions for national social policies. This was the case in 2000 with the Lisbon Agenda, where the goal was the "eradication of poverty", followed by the Europe 2020 and now the European Pillars of Social Rights action plan which established also quantified targets on poverty reduction.

The underlying guiding policy paradigms can be summarized as follows: *social investment* (involving proactive investments in areas such as education, training, childcare, and other social services), *social protection* (social insurance programs, social assistance, healthcare coverage, and other forms of support that help individuals and households maintain a certain standard of living and protect them from falling into poverty during challenging circumstances), and *local social innovation* (the place-based application of innovative solutions and strategies to address specific social needs at the local level through collaboration with the third sector).

The current social agenda is built around the European Pillar of Social Rights. In line with the United Nations' global objectives for sustainable development, the European Union's Charter of Fundamental Rights and the International Labour Organisation conventions on decent work, social protection floors and social dialogue since 2017 the European Pillar of Social Rights (EPSR) is intended as a compass for a strong social Europe. The EPSR sets out 20 principles in three main areas: (1) *equal opportunities and access to the labour market* (education, professional training and lifelong learning, gender equality,

[1] See for more information and data: Cantillon, B. (2022). Poverty and the tragedy of the welfare state: Seven terms for a new social contract. In KVAB position papers (Vol. 76b): Royal Flemish Academy of Belgium for Science and the Arts.

equal opportunities, active support for employment) (2) *fair working conditions*, adequate wages, information about employment conditions and protection in the event of dismissals, social dialogue and involvement of workers, work-life balance, healthy, safe and well-adapted working environments and data protection) and (3) *social protection and inclusion* (childcare and support for children, social protection, unemployment benefits, minimum income, old age income and pensions, healthcare, inclusion of people with disabilities, long-term care, housing and assistance for the homeless, access to essential services).

The point and purpose of the Pillars and its 20 principles is "*to serve as a guide towards 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*". The EPSR action plan also includes quantitative targets. The reduction of the number of people at risk of poverty and social exclusion with at least 15 million is the key target to be achieved in 2030. The number of people at risk of poverty and social exclusion corresponds to the sum of persons who are either at risk of poverty, severely materially and socially deprived or living in a quasi-jobless household[2].

2) Disappointing poverty trends in European welfare states

Where are we? The empirical evidence on poverty trends in the past decades before the COVID-19 crisis points to qualified successes in terms of material deprivation and employment, but not in terms of relative income poverty. Within the working age population[3] in almost all EU-countries a significant employment growth went along with a marked precarization of low-skilled men and women which was, at least in part, related to a weakening of social protection systems.

The years of the COVID-19 crisis constituted a noteworthy exception to this trend. Major efforts to strengthen social protection systems ensured that at-risk-of-poverty did not increase and, in some countries, even improved[4]. However, as a general trend, in many European countries, we observe that in the good years after the financial crisis and before the health crisis, the lowest income groups did not benefit from growth of income and employment. The European Commission summarized this as follows: "*Despite policies to combat poverty and improvements over the last decade, the risk of poverty or social exclusion affected over 95.4 million Europeans in 2021. In many Member States there has been an increase over the last decade in the poverty risk for people living in (quasi)jobless households , worsening in the depth and persistence of poverty and a decline in the impact of social transfers on poverty reduction*."

The disappointing poverty trends witnessed in Europe in recent times correspond to enduring tendencies also observed in other rich welfare states across the globe. In many OECD countries, the at-risk-of-poverty rate for the population of working age has shown a slow upward trend since the 1990s. There are significant and persistent cross-country differences and periodic variations and exceptions, but overall the trends were upward, especially among low skilled citizens depending on social protection.

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[2] AROP is defined as the share of people with an equivalised disposable income (after social transfer) below the at-risk-of-poverty threshold, which is set at 60 % of the national median equivalised disposable income after social transfers. SMSD measures the proportion of the population experiencing an enforced lack of at least 7 out of 13 necessary and desirable items to lead an adequate life while. The 'low work intensity indicator' (QJH) refers to those persons living in a household where the members of working-age worked a working time equal or less than 20% of their total potential during the previous year.

[3] This paper focusses on the working age population. Among the 65+ age group, the trends varied significantly, with declining trends in some countries, rising trends in others, and a standstill in yet other member states.

[4] The explanatory memorandum of the Council Recommendation on adequate minimum incomes starts with this diagnosis : "Despite policies to combat poverty and improvements over the last decade, the risk of poverty or social exclusion affected over 95.4 million Europeans in 2021. In many Member States there has been an increase over the last decade in the poverty risk for people living in (quasi)jobless households2 , worsening in the depth and persistence of poverty and a decline in the impact of social transfers on poverty reduction." (https://data.consilium.europa.eu/doc/document/ST-12866-2022-INIT/en/pdf)

Across countries significant differences have been found but, invariably, lone-parents, low-skilled persons, migrants and benefit claimants are at greater risk. Low work intensity is a crucial dimension. The performance of the Scandinavian and continental welfare states is structurally - i.e., considered over the longer term - better than that of the liberal welfare states, although policy changes appear to have altered this general statement, as evidenced by the dramatic rise in poverty in Sweden over the past decades.

Why is it that in rich European welfare states relative income poverty among the working-age population stagnated or increased? At first sight this does not seem not to be linked to welfare retrenchment.

3) Running harder to stand still : the dual transformation of the welfare state

Disappointing poverty trends coincided with a deepening and broadening of welfare states' ends means. Despite variable courses over time and across countries, in about all countries spending-to-GDP ratios remained high, also when only working age social spending is considered. Simultaneously, despite strong employment growth, social benefit caseload stayed generally high. This was mainly related to the coverage of so called "new social risks" and work related welfare reforms associated with family and labour market changes.

Since the second half of the nineties, welfare states were committing to a process of major reorientation that has been interpreted as a "social investment turn" underlining the importance, for the long-term development of human capital, of early childhood development, training, education, life-long learning, and family reconciliation policies. While the social investment turn has been uneven, disparate, not always consistent, outcome indicators suggest that this reorientation coincided with an increase in employment and, in many countries, also with a relative increase in "new" social spending such as childcare, parental leave, activation and in-work benefits. This also contributed to significant shifts in the composition of social spending. In many European countries a gradual shift has been observed toward relatively more spending on new social risks, capacitating services and work-related policies.

However, the generosity and accessibility of cash support for the unemployed and work poor households deteriorated in many countries although with a great deal of heterogeneity across countries and time periods. In the nineties there has been an almost uniform erosion of minimum benefits for jobless households. This downward trend changed somewhat in the 2000s, when the erosion came to a halt in a number of countries while in a few countries there was evidence of a partial reversal of declining trends. Comparisons across time and space suggest, however, that the inadequacy of minimum income protection for the jobless is a long-standing and fairly universal problem in mature welfare states.

Taken together, *policy indicators point to a 'dual transformation' which retrenched social protection for old social risks (unemployment and ill-health), expanded social policy to new social risks (typically the balancing between work and family life) and invested in work-related reforms. This transformation of the welfare state was driven by and was a response to profound social, economic, and demographic changes. This, however, resulted in the weakening of the poverty reducing capacity of social spending.*

4) The driving causes of the dual transformation of the welfare state

The dual transformation of welfare states affected the poverty reducing impact of each of the basic institutions of the welfare state: social assistance, insurance and investment. It was *endogenously* related with structural constraints unfolding from economic transformations, modern family-hood and migration. These structural factors were reinforced by unequal political representation and changing opinions on deservingness.

The following structural causes for the dual transformation and the ensuing decline in the poverty reducing capacity of social spending can be identified:

1) the *"great decoupling" between low wage growth, on the one hand, and productivity and profit gains* on the other, together with job polarisation, have weakened the social floor and impeded the improvement of social assistance for the poor.

2) the *unequal distribution of job growth among individuals and households* and the ensuing polarisation of social risks have weakened the poverty reducing capacity of social insurances.

3) *stagnating or declining social mobility and job polarisation* have placed obstacles against the use of social investment by vulnerable groups.

1) *The evolution of low wages and the glass ceiling on social assistance*[5]

Although there are significant variations across countries, even in the best performing countries, employment rates for the low skilled over the past decades remained structurally while wage declined relative to median household incomes (and thus relative to poverty thresholds). All this matters in the context of changed skill requirements of de-industrialized economies, structural underemployment among the low skilled, the precarization of work and what has been called the "great decoupling" between productivity and profit gains on the one hand and wage growth on the other. Furthermore, the forces of economic globalisation and skill-biased technological change are also thought to be pushing down wages, especially of the least skilled in rich economies. Simultanously, increased female labour force participation and the ensuing growth in the number of work rich households has pushed up median household incomes.

In this situation it became increasingly more difficult to provide adequate social assistance for jobless households. When low wages lag behind median incomes, bringing the social floor closer to the poverty line comes at the cost of either compromising the hierarchy of incomes from work and benefits at the bottom of the distribution (thus decreasing work incentives), or incurring higher costs if in-work benefits are also increased to maintain financial incentives. The implication of all this is that lifting the minimum income floor – especially raising social assistance benefits but also social security benefits – would either require increased conditionalities, or would have reverberations throughout the whole income distribution, if the distance between incomes in and out work is to be maintained. In other words : when low wages are lagging behind median incomes closing the poverty gap requires either greater spending efforts (work-related spending on non-poor households, e.g., in-work benefits and tax credits) or imposing greater conditionalities to prevent abuses in a context where benefits are close to wages.

Scholars have termed this structural constraint on the poverty-reducing capacity of welfare states a "*social trilemma*", an *'iron triangle'* of welfare reform or a "*glass ceiling*" on poverty reduction: when wage floors decline relative to median household incomes (and thus relative to poverty thresholds) increasing social protection for the poor comes at the cost of either jeopardizing the hierarchy of incomes at the bottom of the distribution or stronger redistributive effort, if in-work taxes or benefits are also to be increased so as to maintain work incentives and to avoid in-work poverty. *As a consequence, over the years, it has become structurally more difficult (and costly) to provide adequate social assistance to job poor households.*

2) The polarization of jobs and the poverty reducing capacity of social insurance

The growth in employment has been unevenly distributed among individuals and households. Job growth benefited mainly the growing group of higher skilled men and women. This created a dual job

[5] Cantillon, B., Parolin, Z., & Collado, D. (2020). A glass ceiling on poverty reduction? An empirical investigation into the structural constraints on minimum income protections. Journal of European Social Policy, 30(2), 129-143.

market with (nearly) full employment of the high skilled and structural underemployment of lower educated. This process was reinforced at the household level by individualization and social homogamy. Since people with similar characteristics, such as education, often find each other on the marriage market, the skewed distribution of jobs over individuals has created a polarisation between 'workrich' and work-poor households. On the one hand, the share of individuals living in jobless households decreased much less compared to individual joblessness. Simultaneously, the share of individuals living in 'work-rich' households has been larger than the increase in individual employment. This phenomenon, referred to as 'job polarization', is explained by forces of modernization that affect all mature welfare states in the same direction, such as declining household size, feminization of labour markets, and by unemployment among the low skilled which is reinforced at the household level through assortative mating.

Job polarization has a structural impact on the functioning of social security systems because it is accompanied by a polarisation of social risks. So called "old social risks" (unemployment and disability) became increasingly concentrated in low skilled, work poor households, while so called "new social risks" (typically related to the work-family balance) became more prevalent in work rich households. As a consequence, the poverty reducing capacity of the *modus operandi* of social insurances has come under pressure. Traditionally, social insurances are the strongest policy instrument to reduce poverty. This has to do with the size of the budgets involved (associated with their universal design) and with the fact that horizontal redistribution (from the healthy to the sick, from the employed to the unemployed etc.) also generates considerable vertical redistribution (from the rich to the poor). However, the concentration of social risks has put pressure on that mechanism. Increasingly, od social risks such as unemployment and disability became concentrated among low skilled, workless families, thus more correlated with an ex-ante low contributory capacity and ex post high poverty risks. These risks have, as a consequence, become less 'insurable' and have, therefore, been increasingly tied to conditionalities and/or taken over by social assistance which is inherently less adequate in poverty reduction. Meanwhile social protection against 'new social risks' (typically leave, child-care, life-long learning) has improved in many countries making social insurance spending more oriented towards work-rich households in higher income groups. As a consequence, a growing proportion of spending has been diverted to work-rich families in higher income groups. *The polarisation of social risks has thus, in a structural way, negatively affected the poverty reducing capacity of social insurance.*

3) <u>Matthew effects in social investment spending</u>

Social investment aims to move beyond redistributive, consumption-based social welfare to an "enabling welfare state". The effectiveness of capacitating services (typically childcare, education, LLL) on poverty reduction depends on a) their effective use by poor households; b) their potential to increase employment opportunities for low skilled, work poor households and c) the extent to which, in the longer term, social mobility can be effectively enhanced. However, the use of capacitating in-kind benefits tends to be socially stratified and related with work intensity : individuals with higher levels of education in work rich families tend to utilize childcare services, leave systems, and lifelong learning more frequently than lower educated, work poor households.

Therefore, increasing efforts in social investment entailed Matthew effects and diminished the poverty-reducing capacity of social spending.

The hope that enabling welfare states would contribute to greater equality of opportunity and increased upward mobility has largely proven to be illusory to date. The evidence points to a remarkable degree of constancy in relative social mobility rates across time, a strong degree of cross-national similarity and the existence of strong father-son social gradients for social risks that are statistically likely to induce poverty, particularly unemployment, low-work intensity and ill-health. There is also evidence for an immigrant-native gap in formal childcare use on top of the social class penalty. Adjusted for social class position, education and maternal employment, immigrant families are less likely to use childcare compared to native families across European countries, although important cross-country differences in the size of this gap have been identified.

Because, against the background of the '*broken social elevator*' social investment spending tend to benefit higher skilled, work rich households more than low skilled jobless households, the shift in social spending from social protection to social investment is a third structural cause for the declining poverty reducing capacity of welfare states.

4) Shifting power resources

Disappointing poverty trends despite the rise in incomes, employment, and high social spending can largely be attributed to the emergence of new social needs and mounting structural limitations of social policies on poverty reduction related to social, demographic and economic change. *They are therefore to a large extent structural or endogenous*[6] *in nature*. Political dynamics and shifts in preferences within welfare democracies reinforced these underlying constraints. The political science literature points in this context at a gradual decline and diversification of partisanship which has been explained by an ever more restricted policy space in the face of economic pressures, by income and class biases in political representation and by changing opinions on deservingness. It also has been shown that partisan effects are more pronounced in class-related programmes like unemployment benefits and sick pay than in life course-related welfare programmes.

5) What can/should be done ?

Poverty stand still or even increase in rich European welfare states is a reason for deep concern: a) *intrinsically*, because the primary mission of the welfare state should be the improvement of the living conditions of the most vulnerable in society and b) *instrumentally*, because pressures on budgets for the working age population will not go away in the foreseeable future, on the contrary. The trends in health care and old-age pensions remain upward, while public spending related to climate change will also need to increase significantly. This raises the disquieting question whether buffers against poverty among the working-age population are bound to further deteriorate.

Families in poverty will, moreover, be disproportionately affected by the consequences of climate change. They also lack the capacity to transition to carbon-neutral lifestyles and are at particular risk from the rising costs of fossil fuels. As the acceleration of the energy transition is necessary to achieve the climate goals, reducing poverty is also imperative. This is essential not only to empower vulnerable families but also to build support for climate policies.

Against the backdrop of the rise of populist parties and the major transformations ahead of us, we urgently need to prioritize poverty reduction and design comprehensive policy agendas. But against the backdrop of the structural barriers that welfare states face and the political constellations that further complicate progress, a challenging policy conundrum arises.

Poverty reduction requires great efforts, at many levels. Adequate minimum wages and social protection, quality jobs, lifelong learning and affordable social services - they are all equally essential. And it is not enough to proclaim that these efforts are 'productive' and generate social and economic investments (although they certainly do): the inconvenient truth is that fighting poverty is neither cheap nor easy. Challenging decisions on a broad societal scale must be taken amid climate transition, aging, digitization, and global shifts. The intrinsic structural nature of the poverty problem in rich welfare democracies and the deep transformations ahead necessitate a revitalization of the social contract. For that a *deepening of democracy* must take place in such a way as to guarantee equal participation in social (and climate) policy processes and to strengthen democratic institutions. This involves the reinforcement of social dialogue, supporting social organizations that represent social

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[6] In Global Inequality, Branko Milanović puts forward the notion of 'endogenous policies': technology, openness and policy are dependent upon each other and impossible to separate from each other in any meaningful way

groups (especially the most vulnerable) providing them an informed voice, and creating democratic fora enabling fair participation of all the actors concerned. This should form the foundation for much needed societal debates on priorities and posteriorities.

Seven terms for renewed social contracts

The ensuing seven terms can feed such societal conversation.

1. *Poverty reduction and climate policy must together become top priorities*. Improving the living conditions of the vulnerable is a society-wide task, which does not only concern the 'poor'. In order to lift the social floor, also the incomes of the middle must be raised. To increase employment opportunities for the low-skilled, investments must also be made in middle-skilled jobs. Social policy research has also shown that universal settings offer the best chance for successful investment in the human capital of the more vulnerable children and adults. So conceived, there is no trade-off between policies aimed at poverty reduction and those aimed at the broader 'middle classes'.

2. *Decent work for all requires the broadening of the range of jobs.* The structural underemployment of less skilled workers is linked to the loss of low productivity labour, displacement effects and insufficient work incentives. Social investments in human capital are part of the answer, provided they prioritise the groups that are lagging behind. In addition, working conditions and wages at the lower end must improve. More opportunities must also be created in caring activities and in the circular economy. The range of work must be broadened by creating more space for the third sector, between the market and the state.

3*. Social security must be strengthened*, both in terms of accessibility and generosity. The link between paid work and social protection remains important, but a social security system more tailored to the changing world of work is needed. In order to protect new flexible forms of employment and to enhance the value of care work, the link between employment and social protection must be relaxed. This is also necessary to avoid social risks being excessively passed on to social assistance. Targeting is important but has its limits. Social security must also be further adapted to the new family-hood through a further individualisation of social rights.

4. *The social floor must be raised*. It is unacceptable that in a rich society, a significant number of working and non-working families should live on inadequate incomes. Not only minimum benefits must be raised but, in order to avoid dependency and promotion traps, also the minimum wage and wages higher up in the income distribution. Because there are limits to targeting, a partial universal but taxable basic income must be considered as a foundation under the income distribution.

5. *Wealth and climate taxes must be included in the redistribution process*. Labour has become too narrow a basis for funding social policies; the one-sided taxation of labour weighs on workers' incomes, on the cost of labour to employers and thus on employment opportunities and on the social protection of lower-productivity workers. The redistribution base must, therefore, be further broadened. The revenues of carbon taxation could be used to fund the above-mentioned partial basic income (where the Canadian carbon dividend can serve as an example).

6. Clear agreements must be made about the *distribution of the costs of ageing*. In many rich countries poverty among the active population (and their children) is higher than among the elderly. This highlights the problem of intergenerational sharing the ageing cost. This calls for a revision of the pension contract according to the Musgrave rule that says that a pension system is intergenerationally fair if the ratio of benefits to retirees to earnings of workers is fixed.

7. *More international cooperation* and also *more local, place-based social action* are needed. Without a common compass, cooperation and mutual support, national welfare states cannot weather the challenges on their own. In Europe, the European Social Rights Pillar should be embraced, as should

recent European initiatives, such as the directive on adequate minimum wages and the recommendation on access to social protection and on adequate minimum incomes. Conversely, a great deal will also have to be generated by local social innovation. There must be more room for citizens' initiatives to address burgeoning problems, help develop new experimental dynamics and empower people in trust and confidence, on top of state-driven social investment and social protection.

6) Summary and Conclusion

The central conclusions of the rich and abundant research on poverty and social policy in Europe are that good social policies matter, and that social protection is standing tall as the great recession, COVID-19 and the inflation crisis recently revealed. Research has also shown that welfare states are shifting their targets, continuously adapting to changing conditions associated with societal transformations. As a response to economic change and modern family-hood, in recent decades, major paradigmatic shifts have taken place towards place-based social innovation and social investment. The welfare state is robust, adaptable, resilient and a strong buffer against poverty.

That is, however, where the good news ends.

Since the last quarter of the 20th century, in many European welfare states, poverty among the working age population seems to have stagnated or even grown. Trends were not unequivocal, most of the research has focused on brief periods of time while cross-country differences are considerable. However, there seems to be a common pattern of:

a) disappointing poverty trends despite growth of incomes and employment;

b) stagnating or increasing active age welfare state efforts, both in terms of spending and caseload;

c) spending shifts towards services, in-work-benefits and new social risks associated with social investment and work-oriented welfare reforms and

d) a reduced adequacy of unemployment benefits and social assistance, as the redistributive downside of work-related welfare reforms contributing.

This contributed to a dual transformation of the welfare state and a fading away of its poverty reducing capacity.

The reasons behind these trends negatively affecting the living conditions of lower skilled individuals and families are many, profound, not solely a result of political choice, but endogenously related with societal transformations. The main explanations for the fading away of the poverty reducing capacity of social spending in rich welfare states are:

a) the "great decoupling" between low wage growth, on the one hand, and productivity and profit gains on the other;
b) the polarization of jobs and social risks across households;
c) stagnating or declining social mobility;
d) political dynamics and shifts in preferences reinforcing these structural constraints on the poverty reducing capacity of each of the main institutions of the welfare state (social assistance, social insurance and social investment).

Given the deeply structural nature of disappointing poverty trends, in order to make progress were we failed in the past, against the background of climate change, ageing, and global imbalances, a reassessment of the post-war social contract is needed. That social contract must build on the achievements of the social welfare state and on the important transformative changes of the past decades, such as social investment, the growth of the third sector, and the strengthening of the cooperation between European welfare states. But new agreements are needed regarding priorities and posteriorities, the allocation of available resources, the distribution of costs and the guarantee of social rights for all. To achieve this, we require a broad societal conversation and a deepening of democracy involving the reinforcement of social dialogue, supporting social organizations that provide vulnerable social groups an informed voice, and creating democratic fora enabling fair participation of all the actors concerned.

In this paper, we have proposed seven terms to nourish that conversation.