COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 19.12.2005
SEC(2005) 1774

COMMISSION STAFF WORKING DOCUMENT

Sustainable Financing of Social Policies in the European Union

COMMISSION STAFF WORKING DOCUMENT

Sustainable Financing of Social Policies in the European Union

1. INTRODUCTION AND SUMMARY

At its meeting in March 2005, the European Council asked the Commission to look at the issue of sustainable financing of the European Social Model. Since then the debate on financial sustainability has been broadened in scope to become a major deliberation on the future orientation of European economies and social policies in the context of globalisation. This debate culminated in an informal gathering of the European Council at Hampton Court on 27 October 2005. The contribution of the Commission to that meeting took the form of a comprehensive policy paper on "European values in the globalised world" and underlined the diversity of social models in the European Union while stressing their unity of purpose.[1] In preparation of this Commission contribution, the Commission services reviewed the way in which social policies are financed in the Member States and the main challenges to which these financing arrangements have to adapt. The present paper summarises the main conclusions of this review. Additional papers on specific issues (including the financial challenges of ageing) will be published separately.

According to the European Council, *"[t]he European social model is based on good economic performance, a high level of social protection and education and social dialogue. An active welfare state should encourage people to work, as employment is the best guarantee against social exclusion."* This describes more a shared ambition than a uniform reality, but it will be crucial for maintaining the means for achieving Europe's ambitious social objectives.

These policies (which embrace social protection, health, education and family support, including child and elderly care services) represent by far the biggest item in the budgets of the Member States. They have achieved a great deal in terms of poverty prevention, but Europe's relatively poor economic and employment performance poses a serious threat to the current and – given the rapid ageing of societies – even more so to the future sustainability of social policies. In fact, certain poorly designed social policies, particularly those that encourage early labour market exit and create unemployment and poverty traps, have actually contributed to undermining their own financial sustainability.

Ageing is expected to lead to significant increases in expenditure on pensions, health care and long-term care. The way in which Europe can hope to meet these needs is not by giving up its ambitious social policies, but by making full use of their potential contribution to economic performance. This means four things:

– ensuring an appropriate level of investment in developing (education, training), preserving (health) and activating human capital (through employment measures and child and elderly care services allowing parents and relatives of dependent people to stay in the workforce);

– eliminating disincentives to work;

– enhancing the efficiency of social policies and services;

– and, lastly, ensuring that the modalities of the financing of social policies contribute to employment and growth.

[1] *European values in the globalised world - Contribution of the Commission to the October Meeting of Heads of State and Government*, COM(2005) 525 final of 20.10.2005.

The European Union has an important role to play in supporting national policymakers financially through the Structural Funds, but also through policy coordination efforts within the Lisbon Process, the new Integrated Guidelines and the open methods of coordination on social protection and education. The implementation of these reforms will allow economic and social priorities to be reconciled, notably by investing in human resources and promoting the most efficient use of human capital.

2. SOCIAL POLICIES: WHAT THEY COST AND HOW THEY ARE FINANCED

Social policies represent the biggest share of government activities in the EU Member States. Spending on social protection, education and health accounts for more than 60% of general government spending in the EU15 Member States. EU countries tend to have a high level of public spending to achieve their social policy goals. Although public spending is the main lever for achieving social policy goals, governments can also influence the private sector, for instance by requiring companies to pay workers when they are sick or to provide continuous training, or by allowing the social partners to establish mandatory pension schemes.[2] Governments also use financial incentives, inter alia through tax systems to promote individual provision against social risks, investment in education and volunteer activities geared towards social objectives. Spending (public or private) is, however, not the only social policy instrument. A wide range of laws protect individuals in particular as workers, tenants or consumers. Such legislation has financial implications (costs and benefits) which are, however, outside the scope of the present paper.

2.1. The expenditure side: What is the money spent on?

A traditional way of categorising social policy spending is to distinguish different social risks or needs, such as education, poor health (giving rise to benefits in cash and in kind, i.e. care), old-age, unemployment, invalidity, family support and the loss of a main income earner in the household (survivors' benefits). However, in view of the increasing emphasis on the need to move towards more active welfare states, a different categorisation of expenditure can be useful to facilitate the understanding of what the active welfare state should try to achieve and to open a discussion on whether the current institutions and policies in the Member States are properly designed. Three main types of spending can be identified:[3]

(1) **Develop and preserve human capital and promote its efficient use:** This includes promoting equal opportunities, investment in human resources through education (5.5% of GDP[4] in EU25), training (2.3% of GDP[5]) and active labour market measures (<1% of GDP), providing support and services to families (2.2% of GDP[6]), thereby allowing parents to work and ensuring that their children do not grow up in poverty and, finally, ensuring good public health by providing access to high quality health

---

2 Such spending is included in the Eurostat data on social protection spending (ESSPROS). For a definition of social protection, see the ESSPROS manual of 1996 published by Eurostat.

3 The figures below are not fully comparable; their purpose is to indicate a rough order of magnitude of the different types of spending.

4 Of which 0.6% is private spending. Source: Eurostat UOE, 2001, 2002).

5 Spending by enterprises on continuous vocational training I 1999; Source: Eurostat, CVTS2.

6 EU15 in 2002; Source: ESSPROS. This includes cash benefits such as child allowances, benefits during maternity or parental leave and benefits in kind such as child care and home help.

care (7.5% of GDP[7]). These measures will enable the greatest possible number of people to become autonomous and to earn their own living.

(2) **Ensure that people have adequate resources when they cannot work or have retired**. This includes:

(a) Insurance against social risks: For those for whom employment is not an option (for reasons of poor health or due to the labour market situation) social protection in the form of public and private insurance against unemployment and invalidity (1.6% and 2.1% of GDP respectively[8]) ensures that a temporary or permanent inability to work will not result in poverty.

(b) Provision for income and care needs in old age: as individual life spans and care needs in old age differ, this requires a mix of savings and insurance elements which ensure that people's earnings during their working life are sufficient over the entire life cycle (benefits for old age: 10.9% of GDP, survivors' benefits 1.2%[6]).

(3) **Provide a social safety net for those without sufficient resources.** Those people who are unable to work and who do not have adequate social protection entitlements (to cash benefits and services) as described under (2 a & b) benefit from a basic social safety net guaranteeing a minimum level of resources and access to vital services (means-tested benefits amount to 2.7% of GDP, including 0.6% of GDP for housing benefits[5]).

Thus, public and private spending related to the above-mentioned policy goals amounts to more than one third of GDP. A high level of social policy spending is characteristic of highly developed countries. In the process of economic development, informal transfers to the elderly, the sick and the disabled were replaced by formal transfers through public or private social protection schemes. Health and social services were made accessible to all groups in society and became increasingly professionalised. This is reflected in a positive relationship between GDP per head and the level of social protection expenditure (including health) as a share of GDP. Thus the development of collective social protection mechanisms is part of Europe's economic development process, the social changes that go with it and the needs it generates.[9]

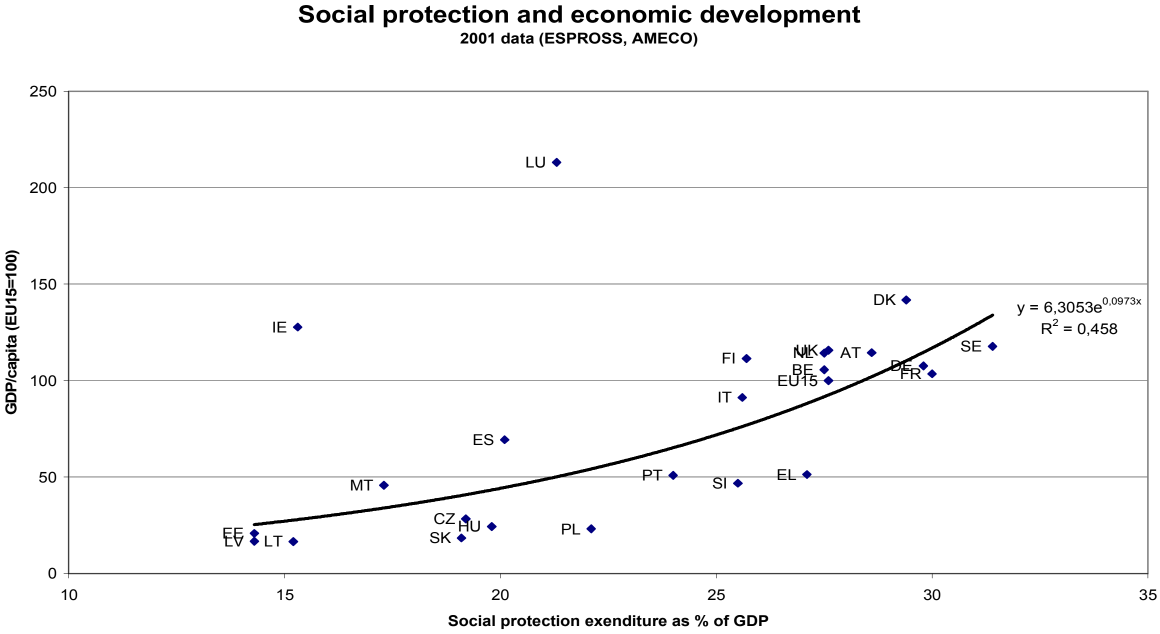
---

7 EU15 in 2002; Source: ESSPROS. It should be noted that this does not include all health care expenditure.

8 EU25 in 2001; Source: ESSPROS.

9 See also *European values in the globalised world - Contribution of the Commission to the October Meeting of Heads of State and Government*, COM(2005) 525 final of 20.10.2005.

Chart 1:



Social protection expenditure in chart 1 comprises public and private spending. Whereas in the US around two fifths of the total is private spending, this share is much lower in the EU Member States, where it remains well below one fifth.

The gross spending figures used in chart 1 overestimate the true cost to public budgets of social protection. Some money flows back through taxes and social insurance contributions, while tax incentives for private provision against social risks and for retirement add to the cost.[10] In Denmark, net spending is 8.6 percentage points of GDP less than gross spending (AT: 6.1, FI: 6.3; SE: 7.1).[11]

2.2. The funding side: How is the money raised?

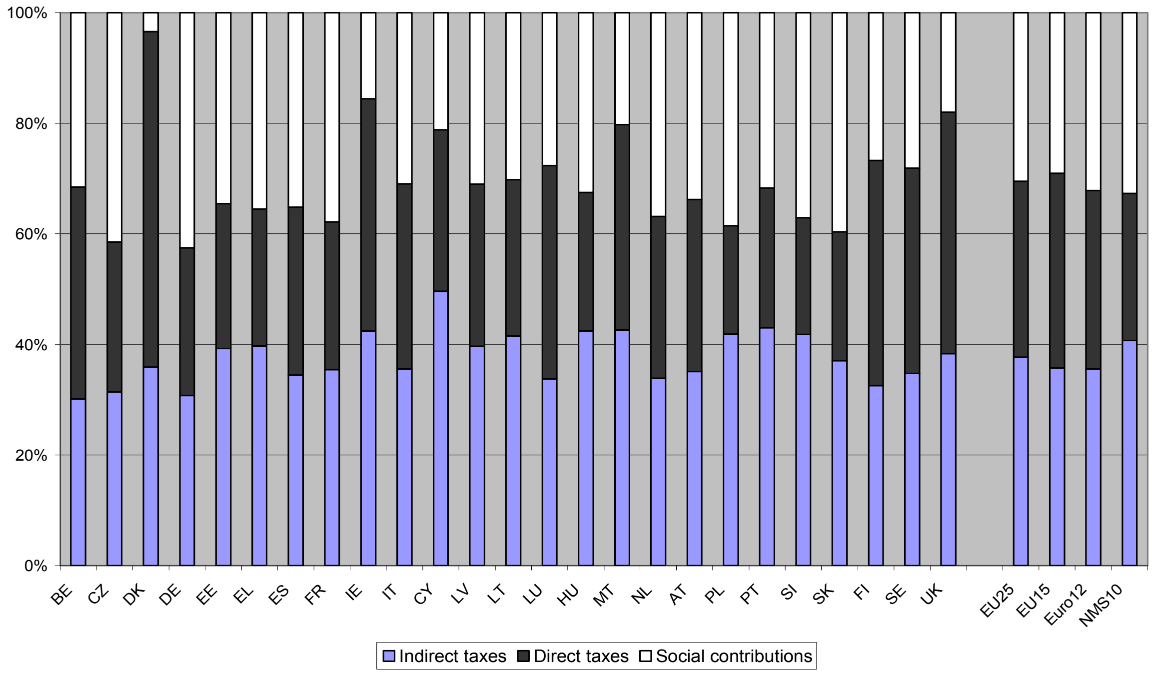
Most social protection and education spending is public expenditure, and it represents more than 60% of total general government expenditure. Thus, the largest part of government revenue raised through taxes and statutory contributions is used for funding social policies in the broad sense. While spending on education is typically financed from general tax revenue, spending on social protection (including health care) is to a large extent financed from contributions on wages paid by employers, employees and, to a lesser extent, pensioners and other recipients of social benefits. Chart 2 is based on national accounts and shows the structure of total tax and contribution revenues. For EU25 as a whole, the three types of revenue are of almost equal importance, with indirect taxes being the largest component. There are, however, major differences across countries, particularly with regard to the weight of direct taxes and social contributions.

---

10 A full assessment of the economic impact of social expenditure would, however, also have to take account of any distortions caused by the taxes and contributions; and for this it is important to look at the gross level of expenditure, as well as the design of benefit programmes and mechanisms for raising revenue.

11 Willem Adema and Maxime Ladaique: "Net Social Expenditure, 2005 Edition: More comprehensive measures of social support", *OECD Social, Employment and Migration Working Papers No. 29.*

Chart 2: The structure of tax revenues in 2003 by major type of taxes (in % of total tax burden)



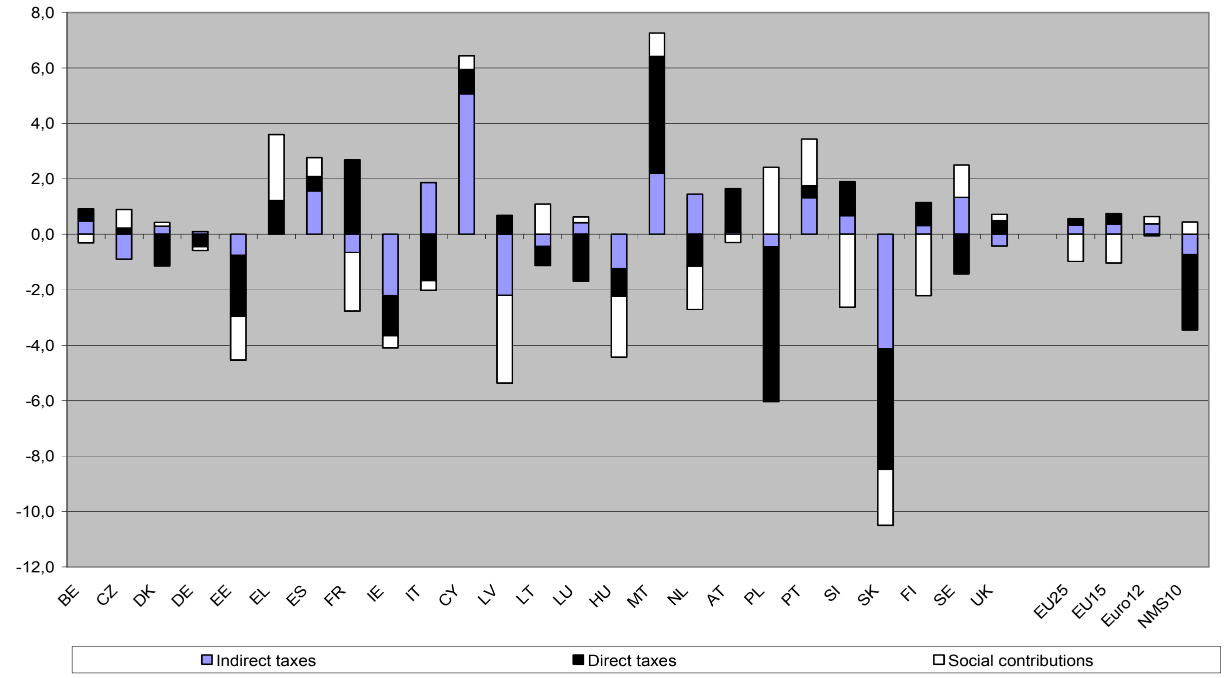
EUROSTAT's ESSPROS database on social protection allows a more detailed analysis of the sources of funding allocated to social protection schemes (including health care). In 2001, for EU25 as a whole, contributions from the general budget represent some 40% of total resources and around 60% of the financing comes from social contributions, of which the largest share – just over 3/5 – is paid by employers.

2.3. Recent trends in the funding of Social Policies

Data on the level of social protection expenditure are available for the period 1990-2002. EU15 devoted around 28% of GDP to social protection, with some fluctuations due to variations in economic growth. The composition of expenditure has changed very little over this period, with pensions and health remaining the dominant expenditure items (education expenditure,- another major item,- is not included in social protection spending).

The structure of government revenues has changed somewhat since the mid-1990s. For the EU as a whole, the importance of contribution revenue decreased by just over one percentage point of GDP, while direct and indirect taxes rose by a similar amount. However, this trend masks diverging trends in the Member States; a number of them now raise more money through contributions than in 1995. For EU15 as a whole, the contribution from general budgets to social protection expenditure rose by 2.7 percentage points of GDP since the early 1990s.

Chart 3: Evolution of major types of government revenue (1995-2003, differences in % points of GDP)



3. SUSTAINABLE FINANCING OF SOCIAL POLICIES

Social policies face two major challenges:

- The process of globalisation intensifies international competition and requires faster adaptation to a changing environment. Globalisation is not a new challenge to economic and social policies, but it amplifies the shortcomings of existing policies and brings a need for greater flexibility and adjustment capacity. The key policy challenge is to redesign economic and social policies so as to improve the functioning of labour markets while cushioning the social costs of changes caused by global competition. In practice, this means ensuring a better balance between income support for redundant workers and proper incentives and support for their reintegration into the labour market.

- Population ageing will require that, over the coming decades, social policies will have to cope with the needs of a rapidly growing population of older people. On the one hand, an ageing population will lead to increased pressure for spending on polices such as pensions, health care and long-term care. At the same time, however, ageing would constrain the financing base of social policies as it reduces the growth potential of an economy. This is the result of a declining labour supply (due to the shrinking of the working-age population) which could be compounded by a diminished ability to develop and adapt to new technologies in the absence of determined efforts to boost life-long learning. Slower growth will reduce tax and contribution revenues. Thus, ageing could lead to a widening gap between needs and the ability to pay.

- Only determined efforts to make social policies as employment- and growth-friendly as possible can ensure that social policies are capable of achieving their social goals, while at the same time remaining financially viable.

3.1. Demographic ageing and the widening gap between needs and the ability to finance

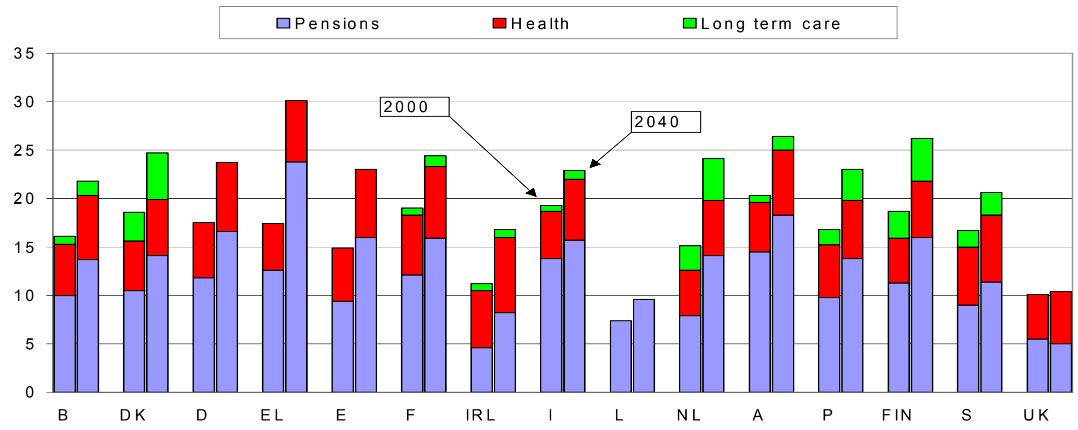
The retirement of the baby-boomers from about 2010 onwards, a continuing rise in life expectancy and shrinking cohorts of new labour market entrants will radically change Europe's population structure. According to the latest Eurostat demographic projections, the working-age population might decrease by about 50 million people while the elderly population (aged 65 and over) might increase by about 60 million. Consequently, the old-age dependency ratio (persons aged 65 and above relative to persons of the working-age 15-64 years) might more than double from the current 24.5% to 53% by 2050, implying that the EU will move from having four people of working age (15-64) for every elderly person (aged 65+) to only two. Migration flows, even on a massive scale, could[12] only offset these trends to a very limited extent.

Already today, most social protection expenditure is for the elderly. Pensions are the largest expenditure item, representing close to half of total spending on social protection. The elderly are also the main users of health care systems and they are likely to require more professional long-term care as families will be less able to provide informal care. Meeting the needs of the increasing number of elderly without overburdening the active and without reducing other important public spending – and in particular investment in the young – is the greatest challenge that social policies face. The gravity of this challenge is compounded by the fact that the shrinking working-age population and the ageing of the labour force will reduce Europe's growth potential by some ¾ of a percentage point from the current level of 2% per year, unless this trend can be countered by higher labour utilisation or productivity.

In 2001, the Commission and the Ageing Working Group (AWG) of the Economic Policy Committee produced a first set of comparable projections on the long-term budgetary impact of ageing through increased expenditure on pensions, and health and long-term care.[13] Under current policies, most countries will have to prepare for a rise in public spending in these three areas of between 4 and 8 percentage points of GDP, which would be equivalent to an increase of between 10% and 20% in the size of the government sector. There have been some major reforms since the 2001 projections, but annual assessments of the sustainability of Member States public finances show that for the EU as a whole, there is a clear risk of unsustainable debt trajectories emerging on the basis of current policies: More than half of all EU Member States, the majority of which are in the euro area, are expected to face significant risks to the sustainability of the public finances.

[12] See "confronting the demographic challenges, a new solidarity across generations", COM (2005)94.
[13] New projections for all 25 Member States should be finalised by end 2005/early 2006.

Chart 4: Age-related spending in the EU15 as % of GDP: 2000 and 2040



Source: Economic Policy Committee (2001)

A greater need for spending will be felt in three areas: pensions, health care and long-term care. As regards pensions, public expenditure accounts for an average to about 10% of GDP, with variations of between around 5% and 15%. By 2050, the AWG projects that public pension spending will rise by between 3 and 5 percentage points of GDP in most Member States. The peak in pension spending will occur between 2030 and 2040. Either the projected increase in expenditure will have to be further reduced or additional resources will have to be found through higher taxes or contributions. Reducing public pension expenditure by cutting benefits could result in a major adequacy gap and increased pensioner poverty.

From a social and economic point of view it is preferable to address the pressure for an increased share of public pension expenditure in GDP by raising the level of employment, particularly of older workers. The AWG estimated that an increase in the effective retirement age by one year, for example by postponing the take-up of a disability or another non-actuarial early pension in a defined-benefit scheme, would reduce future pension expenditure by between 0.6 and 1 percentage point of GDP relative to the baseline scenario – provided these longer careers do not lead to additional benefit entitlements. With an employment rate for people aged 55-64 of just above 40% for the EU as a whole in 2004, it has considerable scope for raising the labour force participation of older workers and the effective retirement age.

Most ***health care*** expenditure is generated by people in the last years of their life when individuals' health starts to deteriorate. This is reflected in a strong positive correlation between age and health care consumption. However, there is not an automatic correspondence between greater numbers of older people and demand for health care services. A key determinant will be whether the future projected gains in life expectancy will be achieved by postponing the onset of age-related chronic diseases and disabilities or by extending the life-span of those who are already chronically ill and disabled. Non-demographic factors are likely to remain just as important as drivers of health care spending. A key issue is the role of technology, which, on the one hand, can lead to falling unit costs via more efficient equipment and treatment practices; on the other hand, new treatment possibilities can increase the demand for care and thus raise total expenditure. Depending on the balance of these forces, technology can either increase or decrease overall spending on health care. An additional key issue is the organisation of the health care system and, in particular, incentives to make rational use of its resources.

Frail elderly people also require ***long-term care*** to help them in many activities of their daily life, ranging from shopping to personal hygiene. Such care is often provided informally by relatives. The future demand for long-term care will depend on similar factors to the demand for health care, i.e. the number of elderly people (especially aged 80+) and whether disability rates increase/decrease as life expectancy grows. In addition, a shift from informal to professional care is likely to occur which would result in increased pressure for public expenditure. The availability of informal care within families may decline over time as future cohorts of frail elderly will have had fewer children, who may also live further apart from their parents and may be more engaged in professional careers. These demographic changes imply increased labour demand in the health and caring sectors which requires that training for these professions be planned, financed and developed.

3.2. Adjusting social policies in ageing societies to global competition

In view of the challenges of ageing and an increasingly competitive world economy, social policies have to become once again a greater positive factor in economic performance. Historically, there was a clear link between social policies and economic progress: the extension of welfare states coincided with high economic growth, at least during the three decades following World War II, thus illustrating that prospering economies can go hand in hand with generous welfare states. More recently, however, European economies have been underperforming over a prolonged period, and the gap in GDP per capita vis-à-vis the US has been widening since the 1980s. Europe's employment performance has been worse than in the US. The Member States have been able to maintain more social cohesion, though, with lower poverty rates and a more equal income distribution than in the US. European social policies appear to have been more successful in redistributing income through highly developed transfer schemes than they have in enabling people, through universally accessible education, training, health care and child care services to make the best use of the opportunities available in highly developed economies. Some Member States have moved to a more active welfare state, achieving high levels of employment and economic performance while maintaining high levels of social spending and strong social cohesion.

An ageing Europe cannot afford an underperforming social model and this makes it necessary to take a critical look at how social policies are conducted and financed today. Four issues in particular deserve attention:

– underinvestment in human capital and activation,

– inefficient delivery of social policies and services,

– poor incentives to work, but also to invest and save and, lastly,

– the weight of taxes and contributions and the distortions they may cause in the context of global competition.

More ***investment in human capital and its activation*** enhances the quantity and quality of the labour force. Spending in these areas clearly can be classed as investment and can yield significant public and private rates of return. Education provides a clear example of this. Human resources are essential for growth, as individual knowledge and skills raise productivity and increase a society's ability to develop and adapt to new technologies.

Productivity and competitiveness depend essentially on a well educated, highly skilled and adaptable workforce. In order to match labour supply and demand, education and training systems must ensure that individuals reach the appropriate levels of educational attainment. This increases their chances on the labour market. Indeed, people with a lower educational attainment are much more likely to be unemployed than people with higher education: in 2002, for EU25 as a whole, the unemployment rate for people with less than upper secondary education was 10.3% (employment rate: 53.7%) compared to 4.2% for higher educated people (employment rate: 84.3%). A good level of education gives access to better-paying jobs and increases the likelihood of being in employment. Social rates of return to schooling are correspondingly high and have been estimated at between 8 and 10%.[14] Investment appears to be particularly cost-effective in the earliest years of life, notably at the pre-primary school level when it can be very effective in enhancing life chances of children from disadvantaged family and community backgrounds. Investment in human capital leads to the creation of more highly productive jobs and this results in economic growth, additional tax and contribution revenues and, ultimately, more sustainable social policies.

The acceleration of technological change also makes it more urgent to keep the skills of all citizens up-to-date through life-long learning, thereby enhancing people's chances to cope with the challenges of global competition from increasingly knowledge-based economies. The training of highly-skilled personnel is essential both for developing and for applying new technologies. Finally, education and training have social benefits in terms of social cohesion and inclusion, individual and public health, reduced crime, democratic participation, better environment, and quality of life. The present low rate of technological progress in Europe is essentially due to a lack of investment in human capital because of insufficient knowledge creation (not enough R&D investment), dissemination (inadequate educational attainment and achievement) and application (insufficient take-up and use of innovation, among others in ICT).

There are indications that the ***efficiency*** of social policies and services can be improved. Expenditure levels and outcomes are not fully correlated across the EU. Comparisons across countries show that the redistributive effect of social protection depends not only on the size but also on the structure of expenditure.[15] Increased efficiency can be achieved in various ways. Competitive pressure is being used to promote more efficient health and social services. Another approach could be to involve citizens and users in decision making processes which could also create greater awareness of constraints and reform needs. Large social protection schemes allow economies of scale and low administration charges that are a fraction of what competing smaller insurance or pension schemes would require. Market imperfections caused for instance by information asymmetries, for instance in the health care sector, may also require public intervention to prevent sub-optimal outcomes. Increased efficiency in the delivery of the social policies is therefore not simply a question of state vs. markets. It requires a pragmatic look at each system’s scope for efficiency improvements and careful consideration of all available options.

Badly designed social protection schemes can create strong ***employment disincentives***. In many cases, the schemes’ rules force people to choose between employment and receiving benefits, even though many benefit recipients could still be working (e.g. part-time or

---

14 Angel de la Fuente: Human capital in a global and knowledge-based economy, Report for European Commission, Directorate-General for Employment and Social Affairs

15 See "Taking forward the fight against exclusion", report from Atkinson, Marlier, Nolan, Cantillon, chapter III, June 2005

temporary job opportunities for those receiving unemployment or invalidity benefit). The impact of such employment-unfriendly benefit designs is greatest on older workers, for whom the standard pension schemes, invalidity and unemployment benefits have provided early labour market exit pathways. By using such benefits to tackle labour market problems, many countries have encouraged a large number of well-qualified and healthy workers to withdraw prematurely from the labour market and to live on benefits. The result of such measures is that only around 40% of people aged 55-64 are still in work[16]. Younger workers, too, can be discouraged from working by bad social policy design. People with a low earnings potential, which may be due to low educational achievement and skills, will often find that having a job barely improves their living standard compared to living on benefits. These people are trapped in situations of poverty and unemployment and face high implicit marginal tax rates. In many Member States, between 30 and 40% of people of working age live on benefits rather than on earned income. Better benefit systems for people out of work, combining adequate benefits and strong activation efforts, will reduce financial disincentives to work. This needs to be considered alongside better labour market regulations which strike a balance between the legitimate interests of the employed, job seekers and employers. The emphasis of benefit systems and labour market regulations should be on providing security and protection for persons in the labour market rather than in specific jobs.

Finally, it is important to consider ***how social policies are financed***. There is a great deal of diversity across countries as to how social policies such as pension and health care are financed, and it is difficult to draw general conclusions that are appropriate for all countries and situations. What is clear, though, is that financing arrangements are critical to ensuring that social policies contribute to growth and employment while preserving overall budgetary sustainability. For pension systems, a strong link between contributions and entitlements can strengthen employment incentives and encourage older workers to stay in the labour market. For health care, financing arrangements can contribute to ensuring that both patients and medical practitioners are given the right incentives to use health care system resources in a rational manner.

Social contributions, taxes on capital, labour and consumption have different impacts on the economy – and European and global economic integration may affect the ability of Member States to raise revenue through one or other type of tax or contribution. If governments competed by lowering taxes in order to attract investments, highly skilled workers or simply wealthy residents, then it would become more difficult to raise money through corporate taxes, highly progressive income taxes or wealth/capital taxes. Statutory corporate tax rates in EU 15 have been lowered from an average of 40% in 1990 to 30% in 2005. However, the yield of capital taxation – including corporate taxation – has not changed much since the mid-1980s (8% of GDP in 2003, compared to 11% for consumption taxes and 21% for taxes and contributions on labour). This suggests that, so far, tax competition has not put heavy constraints on Member States' ability to collect revenues from mobile sources. Nevertheless, it is necessary to monitor future developments and to envisage appropriate means, taking into account the principle of subsidiarity, for coordinating national tax policies, should there be indications that tax competition (or emulation) might start to erode tax bases and jeopardise the sustainability of public finances.

---

16 According to the SHARE survey covering people aged more than 50 in 8 countries of the EU (survey of health, ageing and retirement in Europe, May 2005), the ratio of working people amongst healthy individuals above 50 years old, vary from 27 % in Austria and 53 % in Sweden.

The level of labour taxation (including social security contributions) is already high in most EU Member States and there is not much scope for further increases. Heavier taxation on labour may deter the creation of additional jobs, especially for low-skilled workers, and it may also provide disincentives for labour force participation. With these concerns in mind, Prime Minister Verhofstadt's Pentathlon document presented in the spring of 2005[17] suggested a shift of the tax burden from labour to consumption and/or pollution taxes. The simulations carried out by the European Commission show that such a shift could potentially make a positive contribution in terms of employment and growth. However, there are two caveats which need to be mentioned. First, most of the effects are heavily dependent on the assumption of wage moderation despite higher prices resulting from increased consumption taxes. Second, a change in the composition of taxes needs to be assessed in a broad framework, including its impacts in terms of equity and efficiency.

4. CONCLUSION: THE EUROPEAN SOCIAL MODEL WILL ONLY SURVIVE AS AN ACTIVE WELFARE STATE

Social policies (including social protection, health, education and care services) are highly developed in the European Union, reflecting a strong attachment to social cohesion on the part of Europe's citizens. When appropriately designed, these policies make an important contribution to economic performance. They have been successful in preventing poverty during times of economic difficulties and high unemployment, but they did so at a high cost in terms of taxes and social contributions. Already during the 90's and the recent period as well, inadequate articulation between social protection provision and labour market developments generated an acceleration of expenditures compared to GDP without reducing the levels of income poverty. Tackling those inadequacies and existing weaknesses, and ensuring the financial sustainability, will become all the more important when facing the increased needs of a rapidly ageing society and the adaptability requirements caused by the globalisation of markets. Indeed, given the magnitude of the increase in expenditures caused by the demographic trends in the absence of structural reforms, in-depth reforms are absolutely vital and have become a matter of survival

What kind of structural reforms are needed to ensure the survival of the European economic and social model? They are not about giving up its basic values and principles. These remain valid for facing the challenges of globalisation, technological change and intergenerational balance and should therefore not be abandoned. This review rather points out that the financial sustainability can only be ensured through an in-depth modernisation of institutions and delivery mechanisms, respecting the diversity of Members States social organisations. This modernisation, which is absolutely vital, should safeguard the financial sustainability by ensuring that:

education, health, child and elderly care services make a real contribution to economic and employment performance by developing and preserving human capital and allowing parents and the relatives of frail elderly to stay on the labour market;

17 http://www.premier.fgov.be/fr/communautaire_groeistrategie_voor_europa_en.pdf

social insurance, health and social care services become more efficient in achieving their social goals of preventing poverty and meeting the needs of people in their old age;

the provision of social benefits to people of working age and who are able to work is coupled with employment support and the right incentives to work.

This will require determined and courageous efforts by national policy makers who will need the understanding and support of public opinion. In this respect, the EU will act jointly with the Member states in supporting their National Reform Plans in the context of the revised Lisbon strategy, combined with a strengthened Open Method of Coordination. All EU instruments set out in the Community Lisbon Programme[18] will be mobilised for that purpose, with the aim of increasing citizens' confidence in their ability to successfully accommodate the challenges of ageing, globalisation and technological innovation. This is particularly relevant for those instruments directly addressing the citizens' concerns, such as the structural funds, the Research Framework Programme and protection of the rights associated with free movement.

---

18 *Common Actions for Growth and Employment: The Community Lisbon Programme*, Communication from the Commission to the Council and the European Parliament COM(2005) 330 final of 20.7.2005