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**Luxembourg Income Study  
Working Paper No. 195**

**Unemployment, Employment  
and Social Exclusion**

**Anita Haataja**

**March 1999**

## UNEMPLOYMENT, EMPLOYMENT AND SOCIAL EXCLUSION<sup>1</sup>

### 1. Starting point: rising employment levels and decline in social exclusion

Unemployment has become one of the most serious social and economic problems in Europe. In 1997, every tenth member of the EU labour force was unemployed; nearly half of these were long-term unemployed. Nearly four out of ten Europeans of working age were unemployed or otherwise outside the employment; 149 million people (60,5 percent) were employed (SEC (1998) 1668). Europe has thus been plagued by high unemployment and low employment rates, as well as slow growth in the number of the employed in comparison with other OECD countries.

The EU has in the 1990s taken steps towards more integrated economic and monetary policies, but also towards greater co-operation in the field of employment policy. The Luxembourg summit (1997) adopted the first common set of aims in labour market policy for 1997. The targets set for 1999 will be monitored during the Finnish presidency of the Union, and a third set of guide lines in employment policy will be adopted then. With the Treaty of Amsterdam (1997), greater social integration and prevention of social exclusion were added to the aims of employment policy.

As the content of employment policy has expanded from reducing unemployment to increasing employment, the target group of policies has widened. Women's position in particular, and more precisely problems faced by women on the labour market have become more visible<sup>2</sup>. This has contributed towards an increased interest in different social policy models as well as income transfer and tax systems (Rubery and Fagan 1998; COM (1998) 574). Interest has, however, focused on how different arrangements encourage working, not on how they prevent social exclusion.

Social exclusion is a multidimensional phenomenon that is not easy to measure. It is not necessarily linked to low incomes (Kangas and Ritakallio 1996). Extended unemployment leads easily to exclusion from the labour market, but not necessarily to social exclusion if the level of income remains sufficient and social networks are maintained. However, the fact remains that the poor have more limited chances of fulfilling their individual and social wishes, and prolonged lack of economic resources can lead to social exclusion. Social exclusion and poverty often lead to exclusion from societal participation. If the population is increasingly divided with respect to its income and possibilities to influence society, there is a risk of a polarised society where the solidarity of the well-off towards the less well-off diminishes (Andersen 1996).

The fulfilment of the first EU employment guidelines is assessed through four indicators of developments in unemployment, and four indicators of the employment situation. The employment situation is also investigated from a macroeconomic perspective. However, the impact of changes in employment and unemployment on income distribution and social exclusion is not studied (SEC (1998) 1668). One of the reasons for this is the fact that updated statistics on incomes and wages are

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<sup>1</sup> The empirical results that this article is based on are laid out in more detail in the author's PhD thesis (Haataja 1998).

<sup>2</sup> As with the earlier guidelines, the 1999 employment guidelines consist of four main pillars, one of which is concerned with the equal opportunities of men and women in the labour market. The fourth pillar defines also the so-called mainstreaming principle of gender equality which is to be incorporated in measures concerning the other three pillars, too.

lagging behind statistics on employment. An additional problem is the lack of comparable data<sup>3</sup>. On the other hand, the points of comparison for the developments in employment in the EU have been taken from outside Europe. In particular, the high employment rate in the United States (74 percent) in comparison with that in Europe (60,5 percent in 1997) has been taken up as a challenge.

International comparisons have established that demographic changes have only a marginal impact on poverty. Changes in poverty are most strongly influenced by differences in economic growth and in the distribution of the fruits of growth (Smeeding 1997). In other words, the manner in which the state interferes with the income distribution on the markets is an important explanatory variable behind poverty (see Korpi 1980). Unemployment has as its immediate consequence 'income poverty' because earnings on the labour market decrease. On the other hand, unemployment indirectly reduces 'income poverty' because it leads to an increase in income transfers that are used to eliminate poverty (Mäkinen 1998). The role of income transfers in combating poverty depends on the extent of income transfers and the principles of redistribution, in short on the social policy model. For instance, the position of the unemployed does not need to be weak even if the unemployment security system is small as long as other forms of social policy such as economic and employment policies prevent unemployment and long-term unemployment effectively (see for instance Evans 1996; Esping-Andersen 1996).

The connections between unemployment and the threat of social exclusion can be estimated by establishing how common or deep poverty is among the employed and the unemployed. This is the first aim of this article. The article also seeks to establish possible differences between social policy models in this respect (see Esping-Andersen 1990; Korpi and Palme 1997; Mäkinen in this publication). The fact that poverty is equally common or rare among the unemployed and the employed can be due to many factors. Small differences may be due to income transfers that effectively combat poverty even in the absence of income from work. On the other hand, small differences can also be due to high poverty risks not only among the unemployed but also among the employed whose income from work is insufficient<sup>4</sup>. The second aim of this article is to assess the extent to which income transfers prevent poverty in different social policy models.

The article is structured as follows. Chapter two will outline the data and the countries that have been chosen as representatives of social policy models. This chapter will also describe the definition of poverty used here, the research methods, and other definitions. Chapter three contains the research results. The first section of this chapter focuses on the connections between poverty and unemployment or employment. The role of income transfers in preventing poverty in different social policy models will be investigated next. The incomes of the employed and the unemployed will also be compared with the average household incomes. The last chapter presents the conclusions and discusses the importance of developing indicators of income changes for the evaluation of employment policies.

## **2. The data and definitions used in the study**

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<sup>3</sup> For instance, the European Community Household Panel (ECHP) data has been used for only one extensive study that investigates the connections between unemployment and standards of living (Vogel 1997). One of the strengths of this study is that it illustrates the many and significant differences in the demographic and socio-economic structures of the European countries. These structural differences may also influence income differences between unemployed and employed households, but these connections have not yet been studied.

<sup>4</sup> Other possible reasons are short duration of unemployment spells, fast re-entry into the labour market and family structures. If unemployment is more common among men and the family relies heavily on the man's income, the poverty risk can be higher than in dual-earner families.

## 2.1 The data and research focus

Obtaining comparable data from all EU countries would be very helpful for the purposes of contemporary discussions on employment policies. As this is impossible due to incomplete data, countries from outside Europe have been included, too. There is a further reason for including these countries. European states have been claimed to suffer from ‘eurosclerosis’ that involves high unemployment and high public expenditure. In order to ‘cure’ this disease, it has been suggested that Europeans should look for good examples elsewhere, for instance in the USA.

The Luxembourg Income Study (LIS 1996) is the best available source for the purposes of this study, although it, too, suffers from certain problems and limitations<sup>5</sup>. In addition to the fact that not all EU member states are included in LIS research, the unemployed can be identified as a sufficiently comparable group only in a few countries and it is even rarer to find such data for several time cross-sections<sup>6</sup>. The LIS data are gathered so slowly that by the time they are ready, they have no relevance for day-to-day politics. However, this data does offer an opportunity to assess past developments and to produce evaluations and background information for future strategies.

The Finnish case will be studied in the light of household surveys (1976-85) and income distribution statistics (1990-95) in order to gain a longer perspective<sup>7</sup>. The Finnish model of social policy changed in the 1980s’ social insurance reform into so-called encompassing social policy model for the working age population. In this reform, the untaxed unemployment and sickness daily benefits that were previously linked to income ceilings were linked fully to earnings and also became taxable (Haataja 1989). After less than ten years the encompassing model that included both universal and earnings-related benefits was put to a difficult test during the recession of the early 1990s.

### *The unemployed and the employed*

Differentiating between the unemployed and the employed is not straightforward within one country, let alone in an international comparison. As unemployment often has many different definitions even within one country, we can assume that the definitions that are used in international comparisons vary even more. For instance, hidden unemployment, the chances of finding work, of gaining entitlement to unemployment benefits and of registering as unemployed vary considerably between countries (Atkinson and Micklewright 1991; Rubery and Fagan 1998).

The possibility to identify and distinguish between households that have experienced unemployment and other households has had a decisive impact on what countries could be included in the final analysis in this study. Households that have been affected by unemployment

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<sup>5</sup> Despite lissification, the harmonisation of variables, the LIS data suffers from many features that limit comparability. Some of these problems will be confronted in this study, too. On the other hand, the content of all variables does not need to be completely identical as we are interested in the general developmental trends within the countries and the differences between these trends. The exact absolute differences between the countries at a certain point of time are of secondary importance from the point of view of this study.

<sup>6</sup> For instance, in Spain there is data on the unemployed only for 1990; in the Netherlands and Belgium the unemployed can be identified only on the basis of unemployment insurance information; in Italy the unemployed could be identified only on the basis of insurances in 1991; there is no unemployment data at all for Austria and Luxembourg; for France there is unemployment insurance data only for 1981.

<sup>7</sup> At the time of writing, LIS data was available for Finland only for 1987 and 1991. The definitions of income used in the Finnish time series are not fully commensurate with the LIS variables. These differences are, however, not of practical importance for this study (see Uusitalo 1989, 95-96; Ritakallio 1994, 91).

(‘unemployed households’) were defined as follows: those households where at least one member has received unemployment benefits during the period under study. Various conditions that have been imposed on recipients of unemployment benefits, waiting days, duration and the nature of benefits mean that the ‘receiving benefits’ definition covers only a small proportion of the unemployed (narrow definition). This definition excludes for instance those long-term unemployed persons who have become dependent on means-tested social assistance, because in LIS data all means-tested benefits have been added together in the same variable. Those unemployed persons not in receipt of benefits could be identified if the country data contained a variable describing the unemployment spells of the reference person or his/her partner. The broad definition of unemployment was constructed by combining these two, namely the households that had experienced unemployment and those that had been in receipt of benefits.

Only those working age households where the reference person was between the ages of 25 and 64 were defined as ‘unemployed’ or ‘employed’<sup>8</sup>. These age limits were intended to increase the comparability of the countries as the rights to unemployment benefits and other definitions of unemployment vary even more among young persons than among those of working age.

### *Social policy models and representative countries*

One useful way of comparing the connections between policies and end results is by picking countries that can be classified into different social policy models (Esping-Andersen 1990). The countries chosen for this study represent the three main models and their combination, the so-called encompassing model (Korpi and Palme 1997). The main models are systems that function on the basis of means-testing, flat-rate and earnings-related benefits. Means-testing directs social security to the worst-off, the universal principle gives a flat-rate benefit to all and the earnings-replacement principle compensates for the loss of income in proportion to the earlier level of earnings and the contributions paid. No single principle encapsulates the entire social security system in any one country, but in most countries one of the principles is predominant. In the encompassing model, benefit systems incorporate two or even three of the above-mentioned principles.

The Nordic countries represent the encompassing social policy model. Finland, Sweden and Denmark were chosen as representatives of this model for the purposes of this study. However, in all Nordic countries the unemployed could be defined only narrowly on the basis of benefit reciprocity. This definition also sought to include the long-term unemployed because in the encompassing model the basic unemployment security system, too, functions in one way or another. In Finland, the unemployment benefit system encompasses even those who lack previous employment history and those who do not have a voluntary unemployment insurance. In Sweden, the basic unemployment security (the KAS system) presupposes previous employment history which means that the new labour market entrants are not included in the comparison. Earnings-related benefits are in both countries of limited duration, but there is no time limit to withdrawing basic security benefits. Defining the unemployed in Denmark is most problematic as some unemployed person opt for social assistance. The level of earnings-related benefits is highest in Denmark among the Nordic countries, but the earnings ceiling is low, in other words the system favours the low-waged. The duration of earnings-related benefits is longer in Denmark than in the other Nordic countries (SZW 1995). All Nordic countries are also characterised by the fact that both the unemployed and the employed are entitled for instance to the universal family benefits.

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<sup>8</sup> Please note that ‘the employed’ refers both to those who are in paid employment and to those who receive their income from other sources than paid work or unemployment benefits, for instance pensioners, housewives, and those who live on other benefits.

In the other countries the unemployed could be identified both on the basis of benefit reciprocity and unemployment spells. Germany is included as the only representative of the corporatist earned benefits-principle and Australia as the only case of means-tested, targeted social security (“wage-earners’ welfare state“, see Castles 1996). England, the USA and Canada represent the so-called liberal basic security model. The social policy systems of these countries differ in important respects. England has traditionally had a social insurance system based on flat-rate benefits, with increasing elements of means-testing. The USA has an unemployment security system characterised by low benefits of short duration and there are few benefits for persons of working age other than means-tested social assistance. In Canada, the level of unemployment benefits is higher than in the USA, and there is also a number of family benefits for persons of working age (Myles 1996).

The primary sources of national data, the periods for which data were obtained, definitions of family and the unemployment benefit systems are briefly described in appendices 1 and 2.

## 2.2 Definitions and methods

*Poverty* is here defined in accordance with the so-called *relative income principle* (Townsend 1993; Kangas and Ritakallio 1996). A households are defined as poor if its disposable income is less than half (50 percent) of the median household disposable income in any given country, and at any given time. *Relative poverty rates*, the share of households below the poverty line, give us an idea of how many households subsist on less than half of the income that an average household has at its disposal. The 50 percent poverty line is, of course, randomly chosen because income distribution varies greatly between different countries and changes over time (Haataja 1998, 82 and 184). Earlier studies have noted that despite variations in the poverty line between 40 and 60 percent of median income, the order of the countries in terms of poverty rates does not change much (Mitchell 1991; Atkinson et al 1995; Ritakallio 1994). This study does not aim to estimate poverty in itself but to study the relative poverty of unemployed and employed households and changes in poverty rates within countries over time.

*The study unit* is a household. The final poverty rate is calculated on the basis of disposable income per household consumption unit. *The consumption unit* is the so-called OECD unit. *The effectiveness of income transfers in reducing poverty* is calculated as a percent of the poverty rates that are calculated for each stage of income formation<sup>9</sup>. The effectiveness of the entire income transfer institution in reducing poverty is calculated on the basis of poverty rates of market income and disposable income. The poverty line and the poverty rate are established on the basis of *disposable income* at every stage of income formation as follows:

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<sup>9</sup>  $100 * (\text{Poverty rate \% (income 1)} - \text{Poverty rate \% (income 2)}) / \text{Poverty rate \% (income 1)}$

Market income (poverty before the impact of income transfers)  
 + Income transfers without means-tested benefits (poverty before the impact of taxes and means-testing)  
 + Means-tested income transfers (poverty rates at gross income, poverty before the impact of taxes)<sup>10</sup>  
 - Taxes and other tax-like payments  
 = Disposable income (poverty after income transfers and taxes i.e. final poverty rate)

Unemployment benefits are not the only income transfer that influences the income of unemployed households. In some countries family benefits for instance can have a significant impact on the incomes of working age families, whether they experience unemployment or not.

### 3. Results

#### 3.1 Unemployment and long-term unemployment in the countries included in this comparison

In Denmark, Germany and England unemployment was in the 1980s close to the EU average. In Finland and Sweden unemployment was first clearly below the average, but the increase in unemployment in the early 1990s was most dramatic in these countries. In Sweden the unemployment rate remained below the EU average, whereas the Finnish rate grew to be one of the highest in the EU. Unemployment rates diverged more from each other in the European than in the other countries.

Long-term unemployment has been high throughout the period under study in Denmark, Germany and England and outside Europe in Australia. In contrast, in the USA and Canada the share of the long-term unemployed has been lowest. In Finland and Sweden long-term unemployment was low in the 1980s but increased in the 1990s especially in Finland to a very high level. The changes both in unemployment rate at large and in long-term unemployed are greater in Finland than in any other country included in the comparison. With respect to changes in unemployment, countries can be roughly divided into three groups between 1980 and 1995 (OECD Employment Outlook and Economic Outlook yearbooks):

- Countries where unemployment and long-term unemployment have increased strongly (Finland and Sweden)
- Countries where unemployment has increased (or remained stable at the average rate) and long-term unemployment is high (Germany, Denmark, England and Australia)
- Countries where unemployment has remained low or at an average rate, and where long-term unemployment continues to be low (the USA and Canada)

If unemployment and long-term unemployment lead to increased poverty, we would expect increased levels of poverty among the unemployed in Finland and Sweden in the 1990s. High long-term unemployment in Denmark and Germany on one hand, and in England and Australia on the other hand give rise to the expectation that the differences in the poverty rates of the employed and unemployed would be great in all these countries. In contrast, the low levels of unemployment and long-term unemployment in the USA and Canada would seem to imply that the differences in poverty rates among the unemployed and other poor households would be small. On the other hand, the low levels and short duration of unemployment benefits in the USA also give rise to the expectation that the poverty risk among the unemployed would be greater than among other households of working age.

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<sup>10</sup> In the case of Finland, only the most common income transfers based on means-testing and directed at the working age population (housing benefit and income support) are counted as means-tested income transfers. In all other countries, means-tested income transfers are the ready summary variable of all means-tested income in the LIS data.



### 3.2 Unemployment as a poverty risk

Unemployment threatens to lead to social exclusion if unemployed households experience poverty more often than other working age households. The countries included in the comparison fall into two groups in accordance with how poverty increased in unemployed households in comparison with employed households. In one group, poverty rates among the unemployed and other working age households did not differ much, whereas in the other group unemployment created an obvious poverty risk. Furthermore, countries differed over time with respect to the increase or lack of change in the poverty rates of the unemployed and the employed. The countries fell into two groups also on the basis of how unemployment and long-term unemployment were connected to poverty among the unemployed.

The research results have been presented in five-pointed diagrams that illustrate both the threats of poverty and the end results (Figure 2). Threats are the overall unemployment rate in a country, the share of the long-term unemployed and the share of households identified as unemployed households of all working age households. Information on the first two was derived from OECD statistics, and information on the latter was obtained from the research materials<sup>11</sup>. The end results are the relative poverty rates of the unemployed and the employed households. Every point in the diagram represents a socially undesirable phenomenon, namely unemployment or poverty. The smaller the unemployment and poverty rates, the closer to the origin the points and the smaller the diagrams. Where the diagrams are large, unemployment and poverty rates are high.

In the Nordic countries, the dimensions representing the poverty rates of both the unemployed and the employed are close to the origin. Poverty is low among the unemployed as well as among the employed and there are no considerable differences between poverty rates, although unemployment as a poverty risk increased particularly in Finland. In Finland, the threats of exclusion, the overall unemployment rate and the share of the long-term unemployed grew to be among the largest in the EU, but the relative poverty rate remained stable. 37 percent of working age households experienced unemployment in Finland in 1995 and poverty rates among both the unemployed and the employed were below 5 percentage.

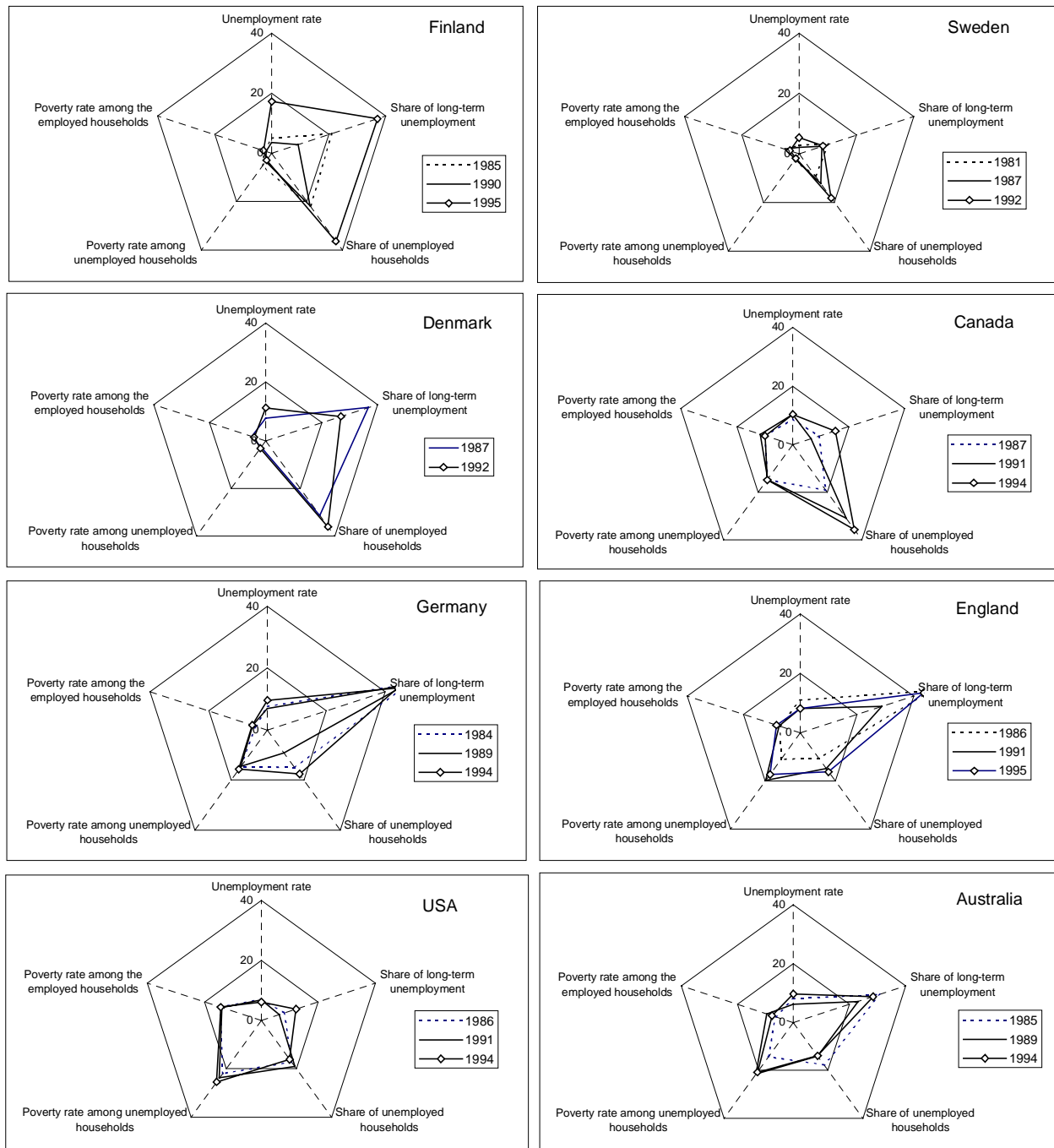
In Denmark, the unemployment rate and the share of households affected by unemployment declined somewhat between 1987 and 1992, but unemployment remained high by all definitions. The share of the long-term unemployed increased, too, without an increase in poverty among the unemployed. In Sweden, unemployment was low, but increasing, in the early 1990s. The slight growth in unemployment was evident primarily in an increase in the share of those working age households where unemployment had been experienced in the course of a year.

In Canada, long-term unemployment and the share of unemployed households have increased, but the poverty rates have remained nearly unchanged, as in the Nordic countries. However, both the unemployment rate and the poverty rate among all persons of working age were clearly higher than in the Nordic countries.

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<sup>11</sup> The fact that unemployment or the share of the long-term unemployed are low, but the share of unemployed households of working age households is high, reveals how different ways of measuring it give a different picture of how common unemployment is. Official unemployment rates are cross-sections of the situation in any given month. In contrast, the share of the unemployed households of all working age households illustrates the share of all those who have experienced unemployment in the course of a year in relation to all others. The differences are due to the fact that in the course of a year some unemployed persons find work, others become unemployed for the first time and only some have been unemployed for the whole year. In the LIS data, the exceptions are England and Germany where the periods of measurement are one week and one month respectively.

**Figure 2. The unemployment rates, the share of working age unemployed households of all working age households and the relative poverty rates of the unemployed and the employed from the early 1980s to the mid-1990s in the countries included in this comparison.**



Sources: For the overall unemployment rates: OECD Economic Outlook 1996; for the share of the long-term unemployed: OECD Employment Outlook yearbooks; for the share of unemployed households of working age households: the research data.

The diagrams for Germany, that represents the earned benefits principle, and for England where the flat-rate principle is predominant, resemble each other most at the first glance. First, the share of the

long-term unemployed is high in both countries, as is the share of the unemployed households and the average unemployment rate. Furthermore, in both countries the poverty rates among the unemployed are clearly higher than among the employed, in other words unemployment constitutes an obvious poverty risk.

The share of the households that had experienced unemployment grew in both countries, but the growth was greater in Germany than in England. The share of the long-term unemployed in England varied from one year to the next, whereas the share remained at a relatively high level in Germany. The fact that the share of the unemployed households was in both countries low in comparison with the official unemployment rates is due to the short research intervals (in England one week, in Germany one month). The fact that the poverty rate among the unemployed in Germany remained stable may be due to the lack of changes in long-term unemployment. Correspondingly the fact that the poverty risk increased among the unemployed in England may be linked to the increase in long-term unemployment in the 1990s. It has not been possible to analyse these connections in greater detail within the scope of this study. England and Germany differ also with respect to the lower poverty rates among the employed in Germany, in other words the poverty risk among the employed is somewhat lower in Germany than in England (see *Employment in Europe 1994*, 140-142).

In Australia that represents the means-testing principle, both the risks and the end results resemble those in England: the poverty rates are considerably higher among the unemployed than among the employed, and the difference in these poverty rates is increasing. In Australia, too, the share of the long-term unemployed is fairly large. However, in contrast to England, this share diminished over the period under study. It seems therefore that in the Australian case the increase in poverty among the unemployed is not directly linked to long-term unemployment.

Unemployment is a great and growing poverty risk in the USA, as it is in England and Australia. There are, however, marked differences between the situation in the latter two countries and the USA. On one hand unemployment and long-term unemployment rate in the USA are among the lowest in the countries compared here, despite the slight increase in long-term unemployment in the USA in the early 1990s. The poverty rate among the unemployed is highest in the USA, as is the poverty rate of the employed.

The case of the USA illustrates that low unemployment rate and high employment rate do not necessarily constitute an effective protection against poverty among working age people. Successful management of unemployment does not automatically imply successful elimination of the threat of social exclusion. The central tool of eliminating poverty among the unemployed is the level and nature of social security. The next chapter discusses in more detail the impact of income transfers on reducing poverty in different social policy models.

### **3.3 The effectiveness of income transfers in reducing poverty**

The shorter the duration of unemployment and the greater the market incomes of other household members, the smaller the income transfers that are needed to prevent poverty. Long-term unemployment, however, also increases market income poverty (Table 1). The market income poverty rate among the unemployed households before income transfers was on average 35 percent, and 50 percent more common than among other working age households in the countries compared here in the late 1980s and early 1990s. In Finland, long-term unemployment had become considerably more common by the mid-1990s and market income poverty was higher than on average. In contrast, in the USA and Canada long-term unemployment has been relatively low and

poverty among the unemployed, measured on the basis of market income, has been lower than on average.

**Table 1. Poverty rates among working age households measured on the basis of market income and the share of the long-term unemployed of the unemployed in the late 1980s and early 1990s.**

	Unemployed	Employed	Difference %-points	Long-term unemployed, % 3)
Finland 95 1)	37.4	19.5	18.0	35.9
Sweden 92 2)	37.4	16.1	21.3	8.3
Denmark 92 2)	23.1	18.2	4.8	26.9
Germany 94	38.9	12.7	26.3	44.4
England 95	32.1	22.4	9.7	45.4
Canada 94	28.4	15.8	12.6	15.2
USA 94	29.4	16.7	12.8	12.2
Australia 94	49.7	16.2	33.5	36.3
Average	34.5	17.2	17.4	28.1

- 1) Source: Income distribution statistics 1995, the unemployment rate calculated according to the narrow definition.
- 2) The unemployment rate calculated according to the narrow definition, 3) Source: OECD Employment Outlook, July 1996.

Income transfers reduced poverty before means-tested income transfers on average by 44 percent (Table 2). Means-tested transfers reduced poverty by further 17 percentage points and taxation in turn increased poverty by six percentage points. The poverty reduction effect of the entire income transfer institution was in all countries compared 55 percent on average. However, there were considerable differences both between countries belonging to the same social policy model and between the social policy models. For instance, income transfers reduced the original poverty rate among the Finnish and Swedish unemployed by more than 90 percent, whereas the poverty reducing impact of income transfers in the USA was overall only 14 percent.

**Table 2. The poverty reducing impact of income transfers: reduction in poverty at different stages of income formation, the total impact and the final poverty rate (%) in working age unemployed households in the late 1980s and early 1990s.**

	Income transfers	+Means-testing	+Taxation	= Total impact	Final poverty rate
Finland 95 1) 2)	82.7	12.7	-3.2	92.1	2.9
Sweden 92 2)	87.9	9.6	-2.5	95.0	1.9
Denmark 9 2)	68.6	22.7	-4.5	86.8	3.0
Germany 94	39.4	30.9	-10.6	59.7	15.7
England 95	12.7	42.4	- 8.7	46.4	17.2
USA 94	18.3	7.5	-12.0	13.8	25.4
Canada 94	39.1	12.8	-3.8	48.1	14.8
Australia 94	54.3	4.6	-0.9	58.0	20.8
Average	43.6	17.3	-5.7	55.2	10.1

- 1) Source: Income distribution statistics 1995
- 2) The figure for the unemployed calculated according to the narrow definition.

Longitudinal study of individual countries shows that the logic of income transfers has remained relatively stable (Figures 3 and 4). Countries belonging to the same social policy model share

certain similarities. In the Nordic countries, the so-called primary income transfers that do not include means-tested benefits reduce poverty most effectively. Means-tested income transfers influence primarily the poverty rates among the unemployed but have only a slight impact on the poverty rates among other households of working age (Denmark is the only exception in this respect).

In Germany where earnings-related benefits characterise the system, every stage of income transfers reduces poverty among the unemployed significantly. Despite this, poverty among the unemployed remains widespread. Social insurance benefits have a visible effect on the poverty rate among the employed which, as in the Nordic countries, remains low. Measured against market incomes, poverty among the employed in Germany is slightly lower than in the Nordic countries: in the Nordic encompassing model, also the employed are entitled to many social security benefits.

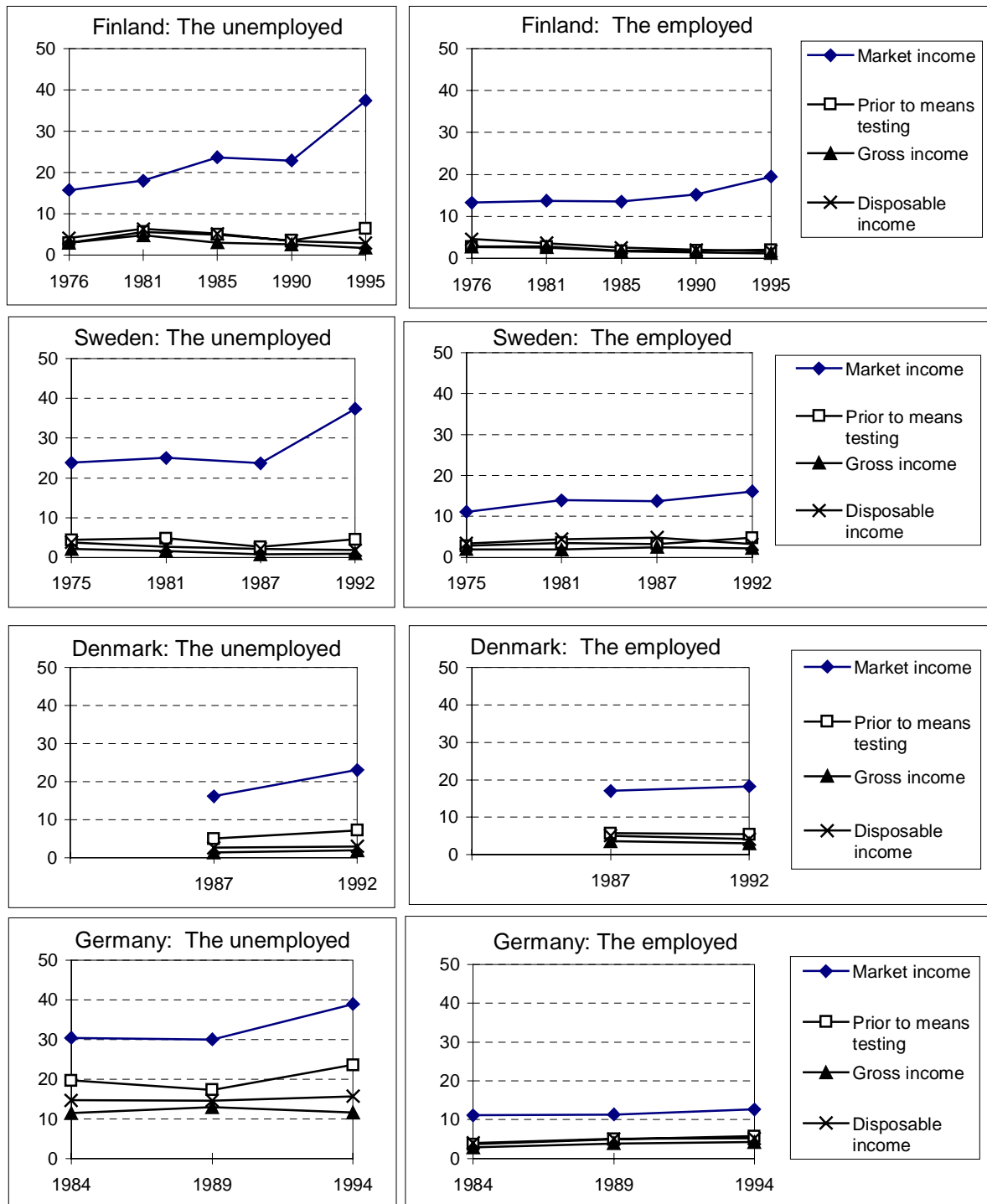
Interpreting the results for Australia is problematic due to the nature of the data. It is namely unexpected that in a country representing the means-testing principle, means-tested income transfers do not appear to have reduced poverty. This is due to the fact that the summary variable representing means-tested income transfers is used for the first time in 1989, in other words means-tested benefits were previously included in social insurance benefits.

The impact of the English basic security model diverges from the situation in other countries of the liberal model. Every stage of income formation reduces poverty. Means-tested benefits have a bigger impact in England than in most other countries, and the importance of means-testing in reducing poverty among the unemployed has increased. Although income transfers reduce market income poverty among the unemployed in England and Australia, their poverty remains at a considerably higher level than that of employed working age households.

The poverty reducing influence of the American and Canadian income transfer institutions has remained stable over a long period of time. Income transfers reduce poverty only slightly. The Canadian model is more accommodating of the unemployed than the US model. Previous studies have established that the 50 percent poverty line is relatively high in relation to the level of American social security benefits that are mostly targeted at the poor (Bishop et al 1996). Benefits targeted at the poor, however, increase the disposable income of those below the poverty line although they fail to reduce the poverty rate.

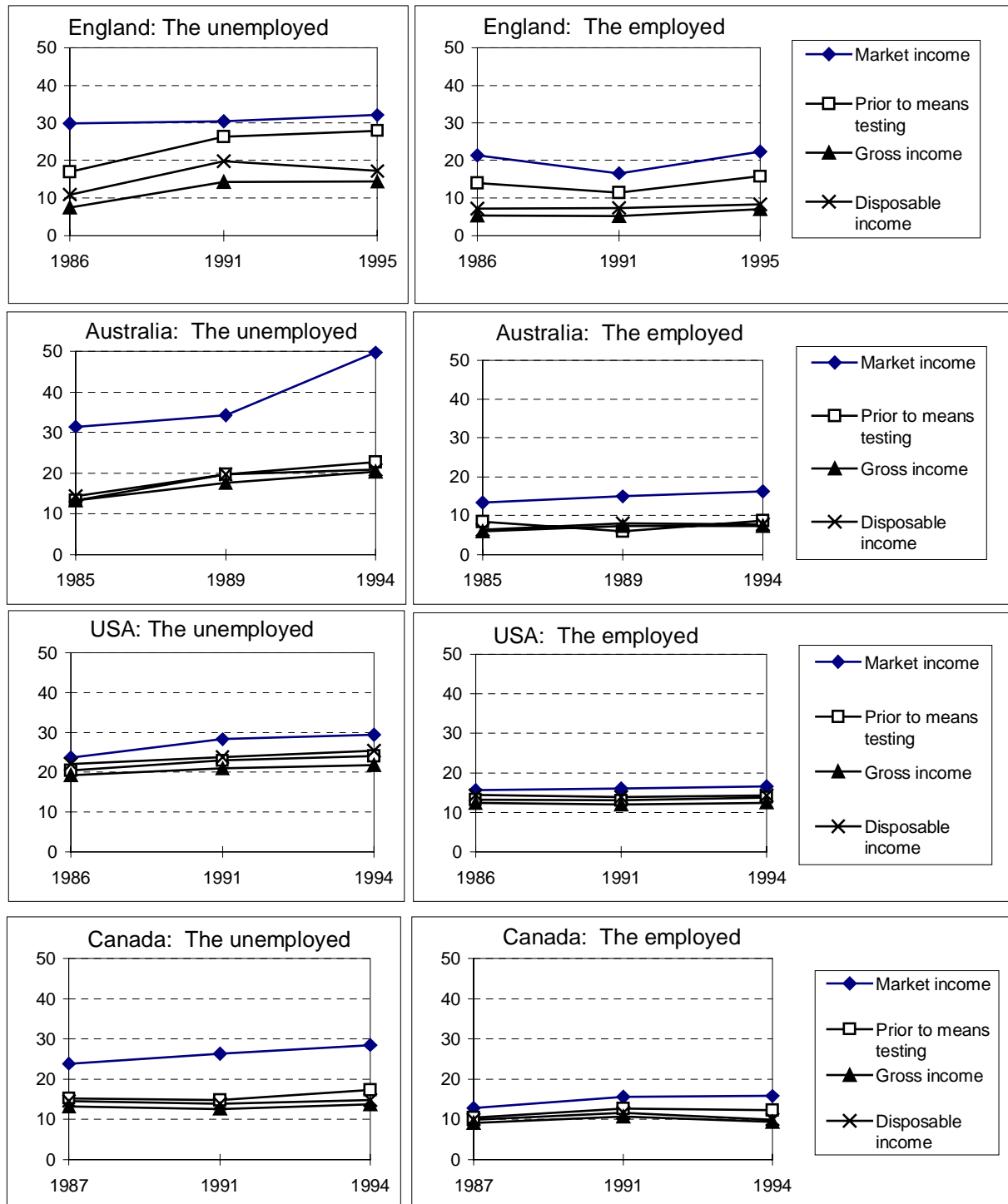
As the USA is one of richest countries in the world on the basis of its GDP, we need to establish whether the American poor are poor in comparison with poor people in other countries. Timothy Smeeding (1997) has compared the purchasing power of disposable income in 14 countries so that household incomes have been made comparable with the help of purchasing power parity. The results indicate that the poorest decile of the population in the USA was also in absolute terms poorer than the poorest decile in Finland and in 12 other developed OECD countries. High average GDP per capita does not necessarily mean a high standard of living to as large a part of the population as possible.

**Figure 3. Poverty rates at different stages of income formation in the Nordic countries and in Germany in the long run. Relative poverty rates have been calculated on the basis of the median disposable income (50%). 1)**



1) The figure for the unemployed has been calculated on the basis of the broad definition in the case of Germany, and on the basis of the narrow definition for the Nordic countries.

**Figure 4. Poverty rates at different stages of income formation in England, Australia, the USA and Canada in the long run: the relative poverty rates have been calculated on the basis of the median disposable income (50%). 1)**



1) The figures for the unemployed have been obtained by using the broad definition. The exceptions are year 1981 for Australia, and years 1979 and 1986 for England.

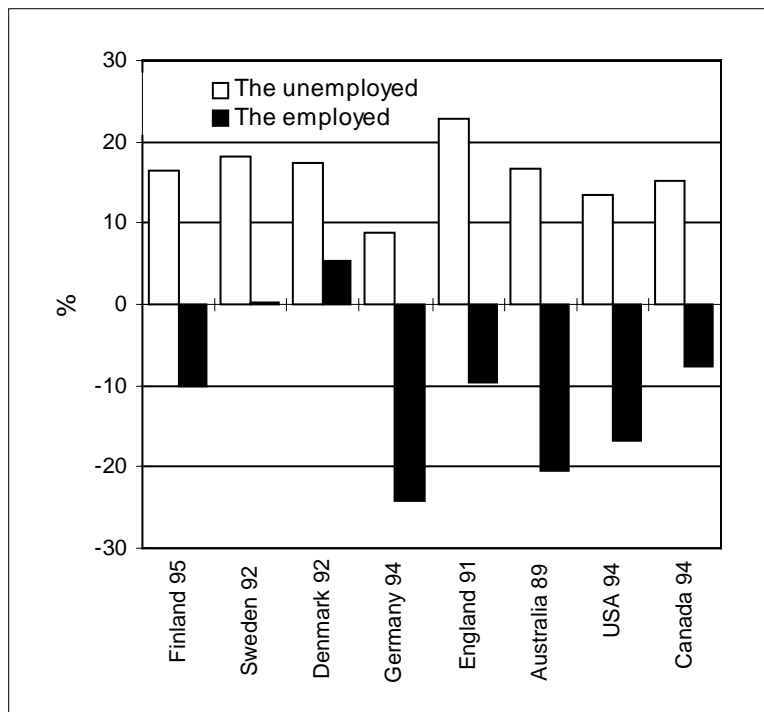
### 3.4 Income levels among the unemployed

On the basis of the low poverty rates in the Nordic countries one could assume that the income level among the unemployed does not diverge much from the income level of the total population. Correspondingly, we may assume that high poverty rates are a sign of lower than average income. However, this is not necessarily the case. The average income of the unemployed may be sufficient to lift them above, but very close to, the poverty line.

The average adjusted income levels of the unemployed and the employed are compared here with the income levels of all households. Both the average disposable incomes and the median incomes have been compared. As the results are fairly similar, only the results based on median income are presented here. The pillars in Figure 5 illustrate how much (in percentage points) the median incomes of unemployed and employed households diverge from the median income of all households. The median income of all households is represented by the value 100 in all countries.

The median incomes of working age employed households are in all countries higher than the average median income of all households. This result is to be expected as the incomes of the young and the old are usually lower than those of working age employed households and hence lower the median income of all households. The median incomes of the unemployed are correspondingly usually lower than those of all households on average. Exceptions are formed only by Sweden and Denmark towards the end of the period under study. In Sweden, the median income of the unemployed is roughly the same as the median income of all households. The reason for this may be that long-term unemployment had increased only slightly by 1992.

**Figure 5. The divergence of the median incomes (as percentage points) of unemployed and employed households from the median incomes of all households (=100) during the last year of the period under study.**



In Denmark, the income level among the unemployed is even higher than the average income. The



reason for this may be the divergence of the ‘Danish model’ from the general Nordic model with respect to unemployment benefits and the differences in the structure of unemployment (Andersen 1996). The income-replacement levels in earnings-related benefits are high and favour those on lower incomes due to the low income ceilings. The duration of earnings-related benefits is also longer than in the other Nordic countries (seven years). Long-term unemployment has been more common among Danish women than among Danish men. The Danish unemployment security system hence offers a fairly good compensation for women’s low wages (often due to part-time employment) and the income level of families does not sink much as a consequence of unemployment if the spouse is full-time employed. May be that is one reason why according to a study the Danish long-term unemployed (often married women) rarely feel that they are economically or socially excluded (mt., 19-23). For instance, in Finland long-term unemployment is more common among single men, which results a different risk and form for social exclusion (Haataja 1997).

In Finland, the poverty rate among the unemployed is one of the lowest in the countries compared here, but the median income of the unemployed was already in 1995 clearly below the median income of all households. In 1995, unemployment rarely meant income level below the poverty line, but more and more often it meant low incomes in relation to the employed households and all households. The relative levels of median incomes among the employed and unemployed were roughly same in England and Canada as in Finland. The lowest relative median incomes were found among the unemployed households in Germany, Australia and the USA. In these countries the poverty rates of the unemployed were also higher than average.

#### **4. Conclusion**

Poverty and the risk of exclusion associated with it have become more common in the 1980s and in the early 1990s. There are, however, differences in the extent of this development among the working age households in countries representing different social policy models. In some social policy models unemployment is an obvious poverty risk that pushes working age households below the poverty line. In other social policy models poverty among the unemployed does not differ markedly from poverty among other households of working age. The poverty risk of working age households does not seem to be directly connected to the unemployment rate or the share of long-term unemployment.

Countries representing four different social policy models can be classified in the light of empirical comparisons into three groups with respect to the poverty risk among the employed households (Table 3). In the first group, the position of the unemployed has not differed greatly from the position of other households of working age and the situation showed no signs of changing. The Nordic countries and Canada (representative of the liberal model) belong to this group. However, Canada differed from the Nordic countries with respect to the higher poverty rate among all people of working age. These countries can be characterised as belonging to social policy models that uphold stable homogenisation.

Among the Nordic countries, Finland and Sweden are examples of how social policy has been fairly successful in preventing relative poverty despite extensive changes in the economy and the unemployment rate. The poverty rates among the unemployed and employed have remained practically unchanged from the early 1980s until the mid-1990s despite increases in unemployment. The USA represents the other extreme. Here, unemployment was among the lowest in the countries compared, but poverty rates among both the unemployed and the employed were the highest. Nearly 15 percent of the employed remained below the poverty line.

**Table 3. The poverty rates of unemployed households in comparison with other working age households and the development of the poverty rate from the early 1980s until the early 1990s.**

Poverty rate among the unemployed has <b>increased</b>	Difference in comparison with the working age employed Great	Difference in comparison with the working age employed Small (under 5 %-points)
	# Australia 85-94 # England 86-95 ☒ USA 86-94	
Poverty rate among the unemployed has remained <b>unchanged of decreased</b>	# Germany 84-94	* Finland 76-95 * Sweden 75-92 # Denmark 87-92 ☒ Canada 87-94

Explanations of symbols:

\* Countries where unemployment and long-term unemployment increased from a low to an average or higher than average level during the period under study.

# Unemployment rate was close to the EU average or followed the trend, but long-term unemployment remained high throughout the period studied.

☒ Low or average unemployment rate and small share of the long-term unemployed.

England and the USA, as well as Australia of the targeted model form the group of countries where unemployment constitutes a great and growing poverty risk. The threat of polarisation among households of working age increased. In these countries income transfers either had a negligible impact (the USA) or a great, but insufficient impact on the poverty rate (Australia and England).

Germany stood out as the only representative of the model that emphasises earnings-related benefits. The situation prevailing in Germany can be characterised as stable polarisation because unemployment was there a great poverty risk but the difference between the unemployed and others was not growing. Income transfers clearly reduced poverty in Germany, but not as effectively as in the Nordic model. There is another important difference between the Nordic countries and Germany that may explain the great poverty risk among the unemployed households. The single earner (male breadwinner) family model is more common in Germany than in the Nordic countries. When the only breadwinner of the family becomes unemployed and loses earnings-related benefits, the spouse's income does not help to lift income above the poverty line. The significance of women's employment and income in reducing poverty in different countries deserves further empirical study.

It has been argued that economic internationalisation limits the opportunities of nations to control their own economy. However, countries with similar historical backgrounds and economic conditions have made different strategic decisions regarding the appropriate national economic policies. Good examples of this are Australia and New Zealand in the early 1990s (Castles 1996). High and persistent unemployment leads to waste of social capital and narrows the economic basis of the welfare state. On the other hand, low unemployment can not be regarded as wholly positive if it is reached through a labour market situation where income from work is not sufficient to exist above the poverty line and hence does not diminish the risk of social exclusion.

Minimal social security and highly uneven income distribution are not cheap, either. Poverty tends to accumulate and to bring forth more poverty. There is less social mobility in countries where income differentials are great than in countries with more even income distribution (Kangas 1998). Low social expenditure can lead to increased expenditure elsewhere and may in the end be as

expensive as high expenditure aimed at preventing poverty. Extensive poverty can for instance increase crime. In the USA, 70 percent more is spent on private security services than on public police work (Rifkin 1997). One of the traditional freedom rights, namely physical security, is increasingly dependent on the individual's ability to finance it. Prisons in the USA contain so many men of working age that the US unemployment rate would increase if this labour reserve was included in the calculations (Buchele and Christiansen 1996).

The results of this study indicate that unemployment and employment should be analysed from many different perspectives. High unemployment rates do not necessarily bring about a high risk of social exclusion if the social policy and employment models prevent poverty. Low unemployment rates do not guarantee that the employed are well off. The aims of economic and employment policy have become increasingly similar with the progress of European integration, but the decisions regarding income distribution are still made at the national level. Developing commensurate indicators is a great challenge for those wanting to monitor the employment targets and strategies in the EU. Before agreement can be reached over these matters at the international level, it is important to study the connections between employment, unemployment and changes in incomes at the national level. Who finds employment, and who fails to do so? How are the unemployed coping? How are the employed coping? How is men's income from work developing? What about women's incomes? And the incomes of the young and the elderly? How are income distribution and household incomes changing?

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**APPENDIX 1. Sources and units used in the income study.**

Country	LIS-Data Source	Original time period 1)	Family structure ( D5)	Unit
SW75	The Level of Living Survey	Year	All	Tax Unit
SW81	The Income Distribution Survey	Year	All	Tax Unit
SW87	The Income Distribution Survey	Year	All	Tax Unit
SW92	The Income Distribution Survey	Year	All	Tax Unit
DK87	The Income Distribution Survey	Year	All	Tax Unit
DK92	The Income Distribution Survey	Year	All	Tax Unit
GE81	The German Transfer Survey	Month	1 or 2	Household
GE84	The German Socio-Economic Panel Study	Month	1 or 2	Household
GE89	The German Socio-Economic Panel Study	Month	All	Household
GE94	The German Socio-Economic Panel Study	Month	All	Household
UK79	The Family Expenditure Survey	Week	1 or 2	Family
UK86	The Family Expenditure Survey	Week	All	Household
UK91	The Family Expenditure Survey	Week	All	Household
UK95	The Family Expenditure Survey	Week	All	Household
US79	The March Current Population Survey	Year	1 or 2	Household
US86	The March Current Population Survey	Year	1 or 2	Household
US91	The March Current Population Survey	Year	1 or 2	Household
US94	The March Current Population Survey	Year	1 or 2	Household
CN81	The Survey of Consumer Finances	Year	All	Family
CN87	The Survey of Consumer Finances	Year	1 or 2	Household
CN91	The Survey of Consumer Finances	Year	1 or 2	Household
CN94	The Survey of Consumer Finances	Year	1 or 2	Household
AS81	The Australian Income and Housing Survey	Year	1 or 2	Household
AS85	The Australian Income and Housing Survey	Year	1 or 2	Household
AS89	The Australian Income and Housing Survey	Year	1 or 2	Household
AS94	The Australian Income and Housing Survey	Yar	1 or 2	Household

- 1) All incomes in LIS data are annual incomes although the original period over which information is gathered is shorter in some countries.

**APPENDIX 2. Overview of the unemployment security models of the countries included in the comparison.**

<b>Social policy model</b>	<b>Unemployment insurance</b>	<b>Level of benefits</b>	<b>Duration of benefits</b>
<b>Encompassing</b>			
Finland, 1934, 1984, 1994	Voluntary, insurance and basic security	Insurance approx. 60%, no earnings ceiling, basic security means-tested flat-rate benefit	Insurance: 1 year and 11 months, no upper time limit on basic security
Sweden, before the 1994 reforms	Voluntary, insurance and basic security	Approx. 85%, with an earnings ceiling	1 year and 2 months
Denmark	Voluntary insurance or social assistance	90%, low earnings ceiling	Insurance: maximum of 7 years
<b>Corporatist</b>			
Germany, 1927, 1969	Corporatist, compulsory insurance and unemployment benefit	Approx. 60-67% of net earnings, assistance 53-57% of net earnings	Insurance: ½ - 2 years and 8 months and according to employment history, no time limit on social assistance
<b>Liberal</b>			
England, 1911, (1995)	Basic security, social insurance and social assistance	Flat-rate benefit, level dependent on the number of dependants	Insurance: 52 weeks (1/2 year)
Canada, 1940, 1971	Basic security, social assistance	50%, with an earnings ceiling	Maximum 50 weeks, employment history, unemployment rate in the area
USA, 1935	Basic security, compulsory insurance	Approx. 50%, varies between the states	Maximum 26 weeks, varies between the states
<b>Targeted</b>			
Australia, 1944, 1992	Targeted, unemployment benefit	Means-tested systems, family circumstances and age influence level of benefits	No time limit

Sources: Social Security Programs Throughout the World, 1997  
 Unemployment Benefits and Social Assistance in Seven European Countries, A Comparative Study, No.10. Ministerie van Sociale Zaken en Werkgelegenheid, Haag 1995.