The European Social Model: from obstruction to advantage

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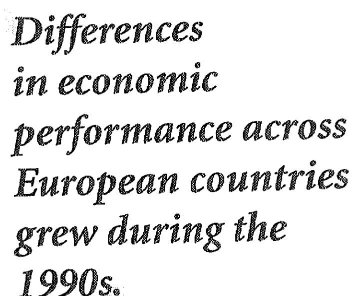
Introduction

It is well documented that the European Union can neither match past growth rates nor the growth of output, productivity or employment of the US since the early or mid-1990s. Amidst this background of low growth, it is worth noting that the world economy in 2004 to 2005 grew at an annual rate of four per cent. Unemployment is higher than in the US, and employment rates are lower – both in contrast to past trends.

Many international analyses, such as that of the OECD, the IMF and the European Commission blame explicitly and implicitly high welfare costs and low market flexibility for this disappointing growth. The European Socio-Economic model with its emphasis on social protection is seen as barrier to competitiveness in a globalising world. Calls, such as that of Vaclav Klaus, for a pure market economy without adjectives and qualifications are an extreme policy conclusion in response to these developments.



This article defines the main features of the European model and its variants. It then analyses which countries performed better than average over the past 15 years. Then the policy strategy of the successful countries is examined, looking at which model they belong to and which changes they have undergone over the past 15 years. Finally, we summarise the main features of reform, which leads us to a vision of a reformed European model that forms no barrier to growth, but rather a comparative advantage in the struggle for international competitiveness.

I. Performance differences across European countries since the 1990s

Differences in economic performance across European countries grew during the 1990s. Using nine indicators of growth of output, productivity and employment Aiginger (2004) points to Ireland as the best performing economy. It is leading in all indicators of output and productivity growth; it is also leading in employment growth, even though unemployment once was historically high and the employment rate started from a low level. Finland finishes second, placed between the second and fourth place for all indicators of output and productivity growth. Unemployment is still rather high in Finland, albeit decreasing. Sweden is ranked third; it has focused somewhat

Table 1: Performance differences across European countries 1994/2003

	Belgium	Denmark	Germany	Greece	Spain	France	Ireland	Italy	Netherlands	Austria	Portugal	Finland	Sweden	United Kingdom
Real growth of GDP	2.1	2.6	1.4	3.3	3.2	2.0	7.9	1.7	2.5	2.1	2.6	3.6	2.9	2.9
Macro productivity growth	1.0	1.8	1.2	2.5	0.9	1.2	3.7	1.1	1.0	1.7	1.7	2.2	2.2	1.8
Manufacturing growth[1]	2.3	3.8	2.5	2.2	3.1	2.2	13.5	1.9	1.7	4.7	3.0	5.7	4.1	0.8
Productivity growth in manufacturing	3.2	3.9	4.0	3.4	1.2	2.8	13.0	1.9	2.5	5.6	3.6	4.3	3.8	2.0
Potential output	2.0	2.2	1.6	2.8	3.0	2.0	7.3	1.6	2.5	2.1	2.6	2.9	2.5	2.7
Total Factor Productivity	0.7	1.6	0.6	1.7	0.4	0.8	3.6	0.7	0.8	0.8	0.7	2.5	2.1	1.4
Employment rate, average	59.4	76.3	67.7	53.3	54.6	61.7	61.2	57.2	71.7	72.9	69.2	63.7	73.3	74.9
Unemployment rate, average	8.5	5.8	8.5	10.0	15.0	10.6	8.6	10.6	4.5	4.1	5.8	12.2	7.5	6.8
Employment growth	1.1	0.7	0.2	0.8	2.2	1.0	4.0	0.7	1.8	0.3	0.9	1.3	0.6	1.1
Average rank[2]	9.6	5.8	10.0	7.2	9.2	9.8	2.9	12.1	7.9	6.8	6.8	4.6	5.6	6.9
Superrank final[3]	11	4	13	8	10	12	1	14	9	5	5	2	3	7

[1] Manufacturing in Japan and USA only until 2001. [2] Average over the rankings for each of the nine indicators. [3] Ranking of the countries using the average ranks.
Source: Aiginger (2004); WIFO calculations using AMECO.

more than Finland on productivity growth. Employment growth is lower in Sweden since the employment rate was rather high at the start of the 1990s. Denmark's rankings are better than the European average according to each single indicator, more for employment than for growth. Output growth is only marginally higher than the European average, but there was no crisis during the first part of the 1990s and Denmark already had the highest per capita GDP of all countries, so that growth rates slightly above average were quite remarkable. Setting aside Ireland as an example of a remarkable catching up process, Aiginger calls Sweden, Finland and Denmark the 'Top Three' countries.

Italy is rated among the bottom three countries according to all indicators. Germany has the lowest levels of growth in output, potential output and employment. Total factor productivity is second lowest. France is below the European average in eight of nine indicators, with a slightly above average performance in employment generation (due to efforts to reduce the working week). On average, France ranks 12th with the third poorest performance of the 14 member countries. Thus the three largest continental economies are low performers.

The southern peripheral countries of Europe rank better as far as growth is concerned. Portugal, Greece and Spain successfully caught up in per capita GDP in the 1990s, although the process was slow and there were residual problems in productivity and employment. Three economies with rather high levels of per capita income, namely the Netherlands, Belgium and Austria, could not widen their lead and appear to be 'stuck in the middle' to a certain extent, as far as growth is concerned. The United Kingdom is ranked in the middle, with above average growth and low employment over the past years. Growth in manufacturing is, however, very low.

It is reassuring that other rankings arrive at similar results. The Structural Indicators of the EU Commission,

Table 2: Growth of GDP and per capita income level

	1960/1990	1990/2005	GDP per capita at PPP 2005
	Annual growth in %		1,000 €
Scandinavian Model	3.3	2.3	28.6
Denmark	2.7	2.0	28.3
Finland	3.9	2.1	26.9
Netherlands	3.4	2.2	27.3
Sweden	2.9	2.1	27.1
Norway	3.9	3.2	35.1
Continental Model	3.5	1.6	25.0
Germany	3.2	1.6	24.6
France	3.8	1.8	25.6
Italy	3.9	1.4	24.0
Belgium	3.4	2.0	27.3
Austria	3.6	2.2	28.0
Anglo-Saxon Model Europe	2.6	2.7	28.2
Ireland	4.2	6.5	31.6
United Kingdom	2.5	2.4	27.9
Mediterranean Model	4.6	2.6	21.3
Greece	4.5	2.9	19.2
Portugal	4.8	2.0	16.8
Spain	4.6	2.7	22.6
Anglo-Saxon Model Overseas	3.6	3.0	35.3
USA	3.5	3.0	36.1
Canada	4.0	2.8	29.5
Australia	3.8	3.6	28.1
New Zealand	2.4	3.1	21.8
EU 15	3.4	1.9	25.1
Japan	6.1	1.3	25.9
Catching-up Model	–	2.4	15.6
Czech Republic	–	1.2	16.5
Hungary	–	3.9	14.6
EU 15/USA	0.96	0.63	0.70

Source: WIFO calculations using Eurostat (AMECO).
As to sub-aggregates unweighted average over countries; EU 15 reported (weighted).

Table 3: Employment

	Employment rate			
	1980	1990	2000	2005
Scandinavian Model	72.2	73.4	75.1	74.5
Denmark	76.9	76.5	78.2	77.4
Finland	72.8	73.9	66.4	68.0
Netherlands	63.8	65.0	75.1	74.5
Sweden	79.8	83.0	74.6	73.6
Norway	75.4	74.8	79.1	77.9
Continental Model	64.6	63.9	65.2	66.0
Germany	67.6	69.3	69.3	69.4
France	64.7	61.2	63.4	63.7
Italy	57.9	57.4	59.0	61.9
Belgium	59.0	58.3	61.5	61.9
Austria	79.0	74.5	76.2	75.8
Anglo-Saxon Model Europe	68.8	70.6	71.6	72.5
Ireland	59.8	54.6	66.5	67.7
United Kingdom	69.4	71.6	71.9	72.8
Mediterranean Model	55.3	55.5	58.5	60.5
Greece	52.8	53.2	52.5	54.5
Portugal	73.8	70.0	71.1	70.7
Spain	52.3	53.2	57.3	59.7
Anglo-Saxon Model Overseas	70.6	77.0	78.8	75.7
USA	71.0	77.8	79.6	76.1
Canada	67.0	71.2	72.6	74.4
Australia	67.3	69.2	70.9	71.8
New Zealand	60.1	53.7	55.7	58.9
EU 15	64.3	64.3	65.8	66.7
Japan	74.4	74.6	77.3	77.1
Catching-up Model	–	–	61.8	62.0
Czech Republic	–	–	67.2	66.8
Hungary	–	–	55.3	56.2
EU 15/USA	0.9	0.8	0.83	0.88

Source: WIFO calculations using Eurostat (AMECO).
As to sub-aggregates unweighted average over countries; EU 15 reported (weighted).

as well as the European Innovation Scoreboard reveal Sweden, Finland, and Denmark to be top countries. These countries are also ranked – among the EU member countries – as first, second, and third in the World Competitiveness Report 2002 of the World Economic Forum (WEF), and among the top countries in the ratings of the IMD (2003).

II. Strategies of the top performers

The top performers countries followed a three-pronged strategy with the following elements:

- to reduce or contain private and public costs, specifically to balance wage dynamics and productivity as well as public expenditure and taxes;
- to reform institutions, and to make labour and product markets more competitive, but not by means of a simple deregulation strategy, but by targeted reforms such as training, education, and increasing geographical mobility and incentives to work;
- to boost long-run growth and productivity by supporting and encouraging innovation, education and the diffusion of new technologies.

We give examples for policy changes now for the three individual countries:

Denmark

Denmark experienced its crisis between 1985 and 1992, with unemployment tripling to 9.6 per cent in 1993. The policy reaction to the crisis was a smooth and gradual reform of institutions in several policy areas, with a special form of cost moderation, an innovative reform of the labour market and a cluster-oriented industrial policy.

A mild version of cost management

In order to moderate wage increases, the automatic indexation of wages with inflation was suspended,[1] consequently, wages increased slowly between 1987 and 1994. Denmark did not devalue but fixed its currency relative to its European partners. The government set a long-run expenditure ceiling and reduced government consumption and transfers (together by four per cent of GDP). Controlling the growth of local government expenditure is important in Denmark, since local governments are responsible for education, health, and social services, and are allowed to raise taxes. The central government fixed a ceiling for the highest marginal tax rate on wages, and committed itself to reducing taxes if local authorities increased them.[2] Denmark today enjoys a budget surplus, government expenditure in relation to GDP is six per cent below peak (1994), taxes now amount to 57 per cent of GDP, as compared to 61 per cent in 1993. The overall tax rate is still 11 per cent above the EU average; social expenditures relative to GDP have remained at about 29 per cent, the fourth largest rate among EU countries.

> ***"The activation reform created a two-stage system of unemployment benefits, with unconditional support in the first phase and strong emphasis on activation in the second."***

Innovative reform of labour market institutions

Labour market reforms attempted on the one hand to spread existing work among more employees (as in sabbatical schemes), to upgrade qualifications and to activate the labour supply with some elements of the welfare-to-work concept.

Table 4: Labour market regulation

	Labour market regulation total		Trade union density				Tax take (Single person without children)		
	1990	2003	1970	1980	1990	2000	1991	2004	1991-2004
				in %					
Scandinavian Model	**2.8**	**2.3**	**52.2**	**59.3**	**55.7**	**54.3**	**45.4**	**43.2**	**–2.1**
Denmark	2.3	1.8	60	79	75	74	46.7	41.5	–5.2
Finland	2.3	2.1	51	69	72	76	44.5	43.8	–0.7
Netherlands	2.7	2.3	37	35	25	23	46.5	43.6	–2.9
Sweden	3.5	2.6	68	80	80	79	46.0	48.0	2.0
Norway	2.9	2.6	57	58	59	54	41.2	36.9	–4.3
Continental Model	**3.1**	**2.6**	**32.1**	**35.5**	**28.7**	**25.1**	**47.2**	**48.6**	**1.3**
Germany	3.2	2.5	32	35	31	25	46.4	50.7	4.3
France	2.7	2.9	22	18	10	10	–	47.4	–
Italy	3.6	2.4	37	50	39	35	48.8	45.7	3.1
Belgium	3.2	2.5	41	54	54	56	53.7	54.2	0.5
Austria	2.2	2.2	63	57	47	37	39.1	44.9	5.8
Anglo-Saxon Model Europe	**0.6**	**1.1**	**45.5**	**51.4**	**39.7**	**31.4**	**33.6**	**30.7**	**–2.9**
Ireland	0.9	1.3	53	57	51	38	39.8	23.8	–16.0
United Kingdom	0.6	1.1	45	51	39	31	33.2	31.2	–2.0
Mediterranean Model	**3.8**	**3.1**	**–**	**19.0**	**16.9**	**18.0**	**35.5**	**36.8**	**1.3**
Greece	3.6	2.9	–	39	32	27	33.0	34.9	1.9
Portugal	4.1	3.5	–	61	32	24	33.2	32.6	–0.6
Spain	3.8	3.1	–	7	11	15	36.5	38.0	1.5
Anglo-Saxon Model Overseas	**0.3**	**0.8**	**28.1**	**24.0**	**17.2**	**14.5**	**30.8**	**29.7**	**–1.1**
USA	0.2	0.7	27	22	15	13	31.3	29.6	–1.7
Canada	0.8	1.1	32	35	33	28	29.0	32.8	3.8
Australia	0.9	1.5	44	48	40	25	22.8	28.6	5.8
New Zealand	1.0	1.3	56	69	51	23	23.8	20.7	–3.1
EU 15	**2.7**	**2.3**	**37.4**	**39.7**	**32.7**	**28.9**	**42.5**	**43.5**	**0.9**
Japan	2.1	1.8	35	31	25	22	21.5	26.6	5.1
Catching-up Model	**–**	**1.8**	**–**	**–**	**54**	**24**	**–**	**44.6**	**–**
Czech Republic	–	1.9	–	–	46	27	–	43.6	–
Hungary	–	1.7	–	–	63	20	–	45.8	–
EU 15/USA	13.30	3.30	1.38	1.80	2.18	2	1.36	1.47	0.11

Source: WIFO calculations using OECD (ECO/CPE/WP1(2004)9/ANN3.

Labour market policy was decentralised, jobs were subsidised for people with a reduced ability to work (so-called flexi jobs), specifically in the home service area. Paid leave schemes were introduced for childcare, education and non-specified purposes (sabbaticals). Payment of salaries continued at between 60 per cent and 100 per cent – the latter for educational purposes – for a period of up to one year. For these sabbaticals, the substitution of the person on leave was mandatory.

The 'activation reform' created a two-stage system of unemployment benefits, with unconditional support in the first phase and strong emphasis on activation in the second.[3] The unemployed were not only granted rights, but were also obliged to undertake education or job training during the activation period and recourse to means tested social security was made if they refused or failed to obtain an unsubsidised job before the end of the maximum period. The maximum duration of unemployment benefits was reduced from nine to five years, passive support from four to two years and finally to one year and then to six months for unemployed young people.

Formal labour market regulation had historically been low. Nearly all restrictions on temporary contracts were removed in the 1990s; the number of renewals, and the maximum duration of succeeding contracts was increased. The deregulation of restrictions on temporary contracts, combined with the already low amount of regulation of fixed contracts, made Denmark the country with the steepest decline in labour market regulation (it fell by 35 per cent) and the third least-regulated labour market in 1998.

Cluster policy and information technology

On the technology front, Denmark emphasized diffusion and cluster policies. A ministry for Business Policy Coordination was created to provide a favourable environment for 'national strongholds', introducing a cluster-type industrial policy in a country with traditionally low public support and a low share of technology intensive industries. The diffusion of information and communication technology was encouraged in an ICT Growth Strategy. In conclusion, research was promoted, education upgraded, and information technology embraced. Cluster policy not only in health, ICT, and biotechnology, but also in toys, entertainment and food helped to increase productivity.

Sweden

Sweden gradually lost its position as one of the leading countries in per capita GDP. In the early 1990s, exports, GDP and employment decreased dramatically, leading to a 'recession ... comparable in depth to that of the 1930s'.

Restoring balances

The short run policy reaction was to bring costs into balance. The first step was yet another devaluation of the

Table 5: Part-time employment

	Part-time employment		Men in relation to women	No full-time job wanted
	1990	2004	2004	2001
Scandinavian Model	**20.4**	**22.8**	**0.36**	**54.3**
Denmark	19.2	17.5	0.48	50.9
Finland	7.6	11.3	0.53	25.5
Netherlands	28.2	35.0	0.25	68.8
Sweden	14.5	14.4	0.41	47.6
Norway	21.8	21.1	0.31	55.3
Continental Model	**11.8**	**16.8**	**0.19**	**31.9**
Germany	13.4	20.1	0.17	18.3
France	12.2	13.4	0.20	62.4
Italy	8.8	14.9	0.20	26.3
Belgium	13.5	18.3	0.18	8.3
Austria	9.0	15.5	0.13	16.7
Anglo-Saxon Model Europe	**19.5**	**23.8**	**0.24**	**19.3**
Ireland	10.0	18.7	0.20	63.3
United Kingdom	20.1	24.1	0.25	16.4
Mediterranean Model	**5.3**	**8.1**	**0.21**	**14.5**
Greece	6.7	6.0	0.28	31.1
Portugal	7.6	9.6	0.41	22.3
Spain	4.6	8.3	0.15	9.7
Anglo-Saxon Model Overseas	**14.6**	**14.1**	**0.43**	–
USA	14.1	13.2	0.43	–
Canada	17.0	18.5	0.40	–
Australia	22.6	27.1	0.39	–
New Zealand	19.7	22.0	0.30	–
EU 15	**13.6**	**18.0**	**0.22**	**30.2**
Japan	19.2	25.5	0.34	–
Catching-up Model	–	**3.3**	**0.35**	–
Czech Republic	–	3.1	0.29	–
Hungary	–	3.6	0.43	–
EU 15/USA	**0.96**	**1.36**	**0.51**	–

Source: Ifo (DICE).
As to sub-aggregates unweighted average over countries; EU 15 weighted.

Table 6: Investment in the future

	1992	2002	1992-2002
Scandinavian Model	**13.4**	**16.0**	**2.6**
Denmark	14.4	17.8	3.4
Finland	13.8	16.9	3.1
Netherlands	13.3	14.7	1.4
Sweden	15.6	21.1	5.5
Norway	9.1	9.3	0.2
Continental Model	**11.3**	**13.3**	**2.0**
Germany	11.8	13.4	1.6
France	12.3	14.2	1.9
Italy	8.9	11.3	2.4
Belgium	12.2	15.1	2.9
Austria	11.6	14.3	2.7
Anglo-Saxon Model Europe	**13.1**	**15.2**	**2.1**
Ireland	12.7	11.3	−1.4
United Kingdom	13.2	15.5	2.3
Mediterranean Model	**8.0**	**11.3**	**3.3**
Greece	6.0	10.2	4.2
Portugal	9.8	13.9	4.0
Spain	8.1	11.1	3.0
Anglo-Saxon Model Overseas	**13.1**	**16.1**	**3.0**
USA	13.1	16.1	3.0
Canada	–	–	–
Australia	–	–	–
New Zealand	–	–	–
EU 15	**11.6**	**13.8**	**2.2**
Japan	10.4	14.5	4.0
Catching-up Model	**0.0**	**6.0**	**6.0**
Czech Republic	0.0	5.6	5.6
Hungary	0.0	6.5	6.5
EU 15/USA	**0.89**	**0.86**	**0.73**

Source: OECD (MSTI); Eurostat.
As to sub-aggregates unweighted average over countries; EU 15 weighted.

Swedish krona, namely by 18 per cent vs. the Euro. Secondly, a fiscal stability package amounting to 7.5 per cent of GDP was negotiated between the government and the Socialist party, which was in opposition at that time. The package included tax increases as well as moderate cuts in social benefits and transfers. The government committed itself to long-term expenditure limits, with different targets for 27 expenditure categories. The fiscal stability package, the expenditure ceilings, the declining costs of bailing out the banks and a strong cyclical element inherent to Swedish budgets led to a switch from a deficit of nearly ten per cent in 1993 to a surplus of about one per cent in 2002. The present policy goal of the government is to achieve a surplus of two per cent for a full business cycle.

Changing incentives

Institutional reforms redesigned competition and monetary authority. For temporary labour contracts, existing tight regulation was suspended, resulting in one of the least regulated frameworks.

An active labour market policy and low corporate taxes had long been constituent elements of the Swedish system. The responsibility of financing the first two weeks of sick leave was transferred to the employers, whose contribution to social security was in turn reduced. Compensation for the first day of sick leave was cancelled. Sickness compensation which had been as high as 100 per cent of past wages was reduced to between 65 per cent and 90 per cent depending on the length of insurance and supplementary insurance. The replacement ratios for the unemployed were reduced from 90 per cent to 80 per cent with the first five days uncompensated. Government agencies enforced competition by contracting out and providing vouchers for private schools. General practitioners were allowed to compete with public services in the health sector (OECD, Sweden 1994).

Leader in research and ICT

Sweden developed the most pervasive and comprehensive programmes to increase medium term growth, with a consistent long-run government assisted innovation strategy, which was prudently maintained even during the big crisis. In order to promote information technology, PCs for private use were made attractive by tax incentives, while support was provided for educational expenses, and the use of ICT by the government was made compulsory. Sweden is today the European leader in information technology, having surpassed the US according to many indicators. Expenditure on education is now the highest in Europe. Expenditure on research and development has increased from two per cent in 1981 to 3.8 per cent. It is among the top three countries in 15 indicators and leads in seven.

In summary, Sweden implemented effective tools to cut costs, including a significant devaluation and a large discretionary package of tax increases and expenditure cuts. Sweden deregulated temporary contracts, and now has one of the least regulated systems of labour and product markets. The most impressive part of the strategy was the acceleration of research, and the promotion of information technology, making Sweden a leading country in all long run growth determinants.

Finland

Finland was hit severely in the early 1990s by the double breakdown of its regional markets (in the Soviet Union) and of its product market (resource-intensive products such as textiles, wood, and paper).

Finland regained its price competitiveness in a similar manner to Sweden, through a steep devaluation of the markka in 1992 to 1993 (by 15 per cent). Nominal wages were frozen by a two-year contract in 1991, which implied a decrease in real wages in 1992 and 1993. The government tried to reduce its budget deficit, first by committing to expenditure ceilings. Secondly, the central government changed the system of grants to local authorities from one based on historical costs to a problem-oriented system (demographic, geographic, and health criteria). A 'convergence programme' to pave the way for EU membership (this included a package of additional cuts totalling 3.9 per cent of GDP) was also introduced. Taxes on capital income, environmental taxes, and indirect

Table 7: The Old Welfare Model versus a New European Model of a Reformed Welfare State

Old Model of European Welfare	The Reformed European Model
Welfare pillar	
Security in existing jobs	Promoting mobility, assistance in finding a new job
High replacement ratios	Incentives to accept new jobs (return to labour force)
Structural change in existing firms (often large firms)	Job creation in new firms, service, self employment
Comprehensive health coverage, pensions, education	Coverage dependent on personal obligations
Regulation of labour & product markets	Flexibility as a strategy for firms and as a right for employees
Focus on stable, full-time job	Part-time work as individual choice (softened by some rules)
Early retirement	Encouraging employment for elderly workface
Policy pillar	
Focus on (price) stability	Focus on growth and new technologies
Asymmetric fiscal policy (deficits)	Fiscal prudence (but flexible in crisis)
Incentives for physical investment	Research, education, and new technologies are the basis
Subsidies for ailing firms (public ownership)	Industrial areas, university nexus
Industrial policy for large firms	Start ups, venture capital, services
Local champions, permissive competition policy	Enforce current strengths (cluster and regional policy) and competition

taxes were raised, while employers – and employees' contributions to occupational pensions were decreased.

The decision to promote new technologies

An active technology policy was enacted in the early 1980s. Complementary institutions supporting cooperative networks, training, and the exploitation of inventions were created. Defining innovation as the key figure of success

> ***In all successful countries, however, the quality of government expenditure is scrutinised and public sector management is implemented.***

and sticking to this strategy was one decisive factor in Finland's success at regaining growth while facing such a severe crisis, and then forging ahead in productivity and output dynamics. The second decisive factor was the early embrace of information technology, as seen by Finnish concepts in the telecommunication society in the early 1990s. Today, Finland has the highest share of workers with tertiary education. In the overall set of indicators for the determinants of future growth, Finland is ranked second; it has made the fastest leap forward in the 1990s. What is specifically impressive is the share of research and development in GDP: this ratio had been at about 1.2 per cent in 1980, well below the EU average; it increased steadily, even during the period of crisis, reaching 3.4 per cent of GDP in 2000, nearly double the EU rate.

Summing up, Finland has partly regained competitiveness through the devaluation of its currency and moderation in wage increases. Government expenditure was contained by changing the financing of lower level government, by setting expenditure limits and implementing a cost-cutting package. Government expenditure in relation to GDP has now returned to the EU average. The budget is in surplus and debt is relatively low.

III. Socio-economic models in Europe

No generally agreed definition on the European Model exists. We define it in terms of responsibility, regulation and redistribution:

- Responsibility: a rather broad responsibility in society exists for the welfare of individuals, sheltering them against poverty, and providing support in case of illness, disability, unemployment and old age; society encourages, and actively promotes and often provides education, health, and the support of families (the latter through transfers as well as the provision of care and housing facilities);
- Regulation: labour relations are institutionalised; they are based on social dialogue, labour laws and collective agreements. The business environment is rather regulated and is shaped by social partners (on the branch and firm level). Administrative and economic regulation for product markets exists. Business start-ups depend on permits and partly on qualification of owners or managers.
- Redistribution: transfers, financial support and social services are open to all groups; differences in incomes are limited by redistributive financial transfers, taxation, taxes on property and on bequests.

It is standard practise to distinguish between a Scandinavian Model (often called the Nordic Model), a Continental Model (also known as the Corporatist Model and sometimes as the Rhineland Model) and a liberal model applicable to countries with less market interference, low transfers and underdeveloped public safety nets (the Celtic Model or the Anglo-Saxon Model Europe). We ascribe the name 'Mediterranean Model' to the southern European countries in which families still have an important role for social protection. A fifth model, not yet elaborated, may emerge in the future, consisting of the new member countries (former socialist countries). Several social institutions were founded after the transition; they are short of the financial means for a comprehensive welfare system and the determination to catch up with the old member countries. We will therefore call this fifth model the 'Catching-up Model'. Outside of Europe, the US Model serves as the standard benchmark. The USA is grouped together with Canada, Australia, and New Zealand as the 'Anglo-Saxon Overseas Model'. Japan, as well as the other industrialised Asian economies, remains an outsider in this discussion.

If we recall our ranking between the best performers and the less performing economies, we see that the three top countries belong to the Scandinavian Model, while the three big continental economies belong to the continental model. The United Kingdom and Ireland belong to the Anglo-Saxon Model, with a history of rapidly catching up after several decades of disappointing slow progress (Ireland) and a history of very uneven development in the United Kingdom (losing a large lead in per capita income until the 1970s, regaining growth dynamics in the 1990s).

Surprisingly the very long-term

perspective, the differences in growth are very small. Taking 1960 to 1990, for example, the long-term growth rates range between 3.3 per cent and 3.6 per cent for three European models (Scandinavian, Continental, and Anglo-Saxon), as well as for the Anglo-Saxon Overseas group. It is higher only in the Mediterranean Model, and there is little variation within models (with lowest growth rates for the United Kingdom and New Zealand; see Table 2).

IV. Towards a new European Model: a tentative sketch of its features

As for institutional structures and policies, the strategies of the most successful European countries (Denmark, Finland, and Sweden) differ greatly from the United States system, particularly in terms of welfare and government involvement, as well as in their commitments to redistribution and training. Their labour market policy offers a high degree of flexibility for firms (for example, easy dismissals), but there is still a significant source of security for individuals through the prevention of poverty on the one side and provision of support on the other side, when it comes to finding new jobs and upgrading qualifications. This system is therefore called 'flexicurity' and relies on 'active labour market policies'. These countries ascribe high priority to new technologies, efficient production and the competitiveness of firms. In contrast to the United States, they rely on proactive industrial policies, with government support for information technology, for agencies promoting research, for regional policies and for clusters. Many of the problems which can be expected to arise in a highly developed welfare state surfaced during the crisis, for example, costs increased faster than productivity and government expenditure increased faster than taxes. Then the governments embarked on a new strategy, improving institutions and incentives without abandoning the principles of the Welfare State and without giving up their environmental goals. We believe that the specific elements of the political reforms in these northern European countries together with similar reforms in the Netherlands, the United Kingdom and other small countries suggest that there may be a new kind of reformed European Model, which combines welfare and sustainability on the one hand, with efficiency and economic incentives on the other.[4] Some of the features of a New European Model and its difference to the traditional model are summarised in Table 7.

Government and public institutions play a proactive role in promoting innovation, efficiency, structural change, higher qualifications and lifelong learning.

The new Reformed Model, as represented by successful policy reforms, differs from the old Welfare State in the following ways:

- The social system remains inclusive and tight, with the exception that minimum standards on social benefits designed to prevent poverty depend on the input of the individual and transfers may be conditional to certain obligations; replacement rates are lower than they used to be in order to provide stronger incentives to work but still high by international standards.
- The welfare system is more service-oriented (care facilities for children, the aged and the disabled) than transfer-oriented, in order to increase equality.
- Taxes are relatively high, but in line with expenditure, aiming at positive balances in the medium term, to cover future pensions and to repay current debt.
- Wages are high, but the position of the individual is not guaranteed, as business conditions vary. The assistance and training opportunities offered to people who lose their jobs are personalised, less bureaucratic and less centralised. The public services are complemented by private agencies.
- Welfare-to-work elements have been introduced, generally on a decentralised – sometimes even private – basis; conditions vary according to the size and kind of problems, the background philosophy being one of giving help without incriminating the unemployed for being inactive.
- Part-time work and the adaptation of work to lifecycles are encouraged – not prevented. Social benefits are extended pro rata to part-time work, which is valued as a right of the individual and as an instrument of personal choice, rather than a fate preventing gender equality.
- Technology policy and the adoption of new technologies, rather than the subsidisation old industries, are a precondition for the survival of the Welfare State, and lead to more challenging and more interesting work.

Nevertheless, the new European Model also differs from the United States model in at least the following ways:

- Even where welfare costs are streamlined and incentives improved, the welfare system offers comprehensive insurance against economic and social risks and a broad coverage of health risks.
- Environmental and social goals, as well as equity of income distribution and the prevention of poverty remain high on the political agenda.
- Government and public institutions play a proactive role in promoting innovation, efficiency, structural change, higher qualifications and lifelong learning. Public institutions also provide the largest share of education and health care, which is open to all residents, of high quality and available at affordable rates.
- Social partners (institutions representing employers and employees) negotiate wage formation, develop labour laws and co-determine economic policy in general.
- Government is large and taxes are high, even if there are mechanisms to limit increases in spending and goals for achieving a sound fiscal policy ('fiscal rules') in periods of high demand. Firms are partly sheltered from high tax rates; there are high taxes on consumption and specifically on energy.

V. Summary

This paper investigated whether the European Socio-Economic Model with its emphasis on social inclusion and ecological responsiveness is the reason for the disappointing performance of Europe since the early 1990s, with regard to dynamics of output, productivity and employment.

A common feature of successful countries is that they have undergone courageous reforms to maintain competitive by

- encouraging part time work;
- supporting the income of the least qualified;
- enforcing retraining and mobility without guaranteeing existing jobs (flexicurity);
- providing incentives for firms (low business taxes) and workers (sticks and carrots);
- enforcing cluster policy and regional policy (building on old or developing new strengths);
- introducing 'managed and balanced' flexibility (providing pro rata entitlements, giving priority to part timers, and balancing the opportunities for both sexes;
- enforcing fiscal prudence not as end in itself but as a means for regaining room for fiscal manoeuvre;
- enforcing investment in the future (R&D, education, life-long learning, technology diffusion).

Differences between the countries exist with respect to the level of taxation and government expenditure relative to GDP, to inclusiveness vs. targeting, regarding the role of government vs. the role of competition. In all successful countries, however, the quality of government expenditure is scrutinised and public sector management is implemented. The surprise is that the reforms go in the same direction, to a large extent independently of the starting model.

The overall conclusion is that the European Model is no barrier to competitiveness, if the following conditions are met:

- it is reformed in the direction of supporting dynamics and change, and improving incentives for investment and work;
- if it encourages proactive investment in the long run drivers of growth (Lisbon targets);
- if government proves to be an enabler, not a decelerator of structural change, and public sector management works;
- if fiscal prudence is not seen as an end, but a means for regaining fiscal manoeuvring capacity.

These reforms make the European Model a competitive advantage in a high-income region and turns globalization from a race to the bottom, into a race to the top, enforcing future strengths, such as innovation, education, lifelong learning and new technologies.

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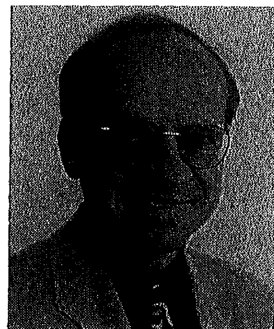
1 Wage indexation had already been restricted to some degree in 1975; Plougmann, Madson, 2002, p. 16.
2 Annual negotiations for expenditures, local taxes and bloc grants – from the central government to local authorities – constitute up to 15 per cent of their revenues (OECD, Denmark, 1994, p. 47). On the active side, the government stimulated growth in 1993/94 ("kick start"). The non-cyclical stimulus was assessed at between 1 per cent and 2 per cent of GDP in 1993 and 1994, with the largest share of the increase going to labour market initiatives and education and to growth stimulatory measures (OECD, 1994, p. 39).
3 The rule that permitted unemployment benefits to be resumed in the case that a person again became unemployed following a training period was introduced, but later cancelled.
4 For earlier suggestions along this line, see Aiginger (2004), Aiginger and Landesmann (2002); Aiginger (2002).



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