



The European Social Model: fostering faster growth

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The ESM exists and has positive welfare effects

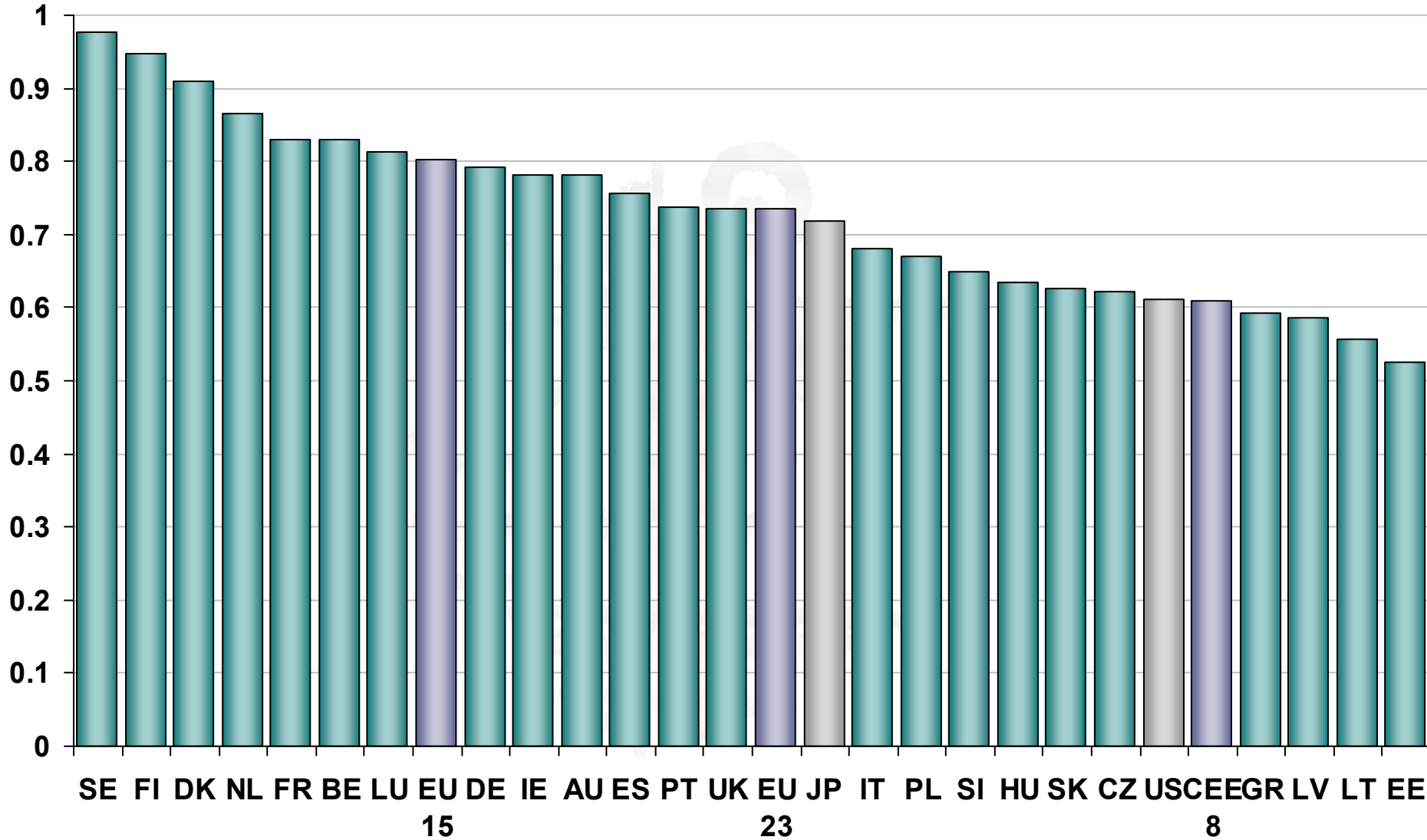
No evidence that it has a generalised negative effect on growth and employment

But trade-offs may exist and badly designed policies can be costly

EPL, flexicurity and the Nordic model – some myths

Policy implications

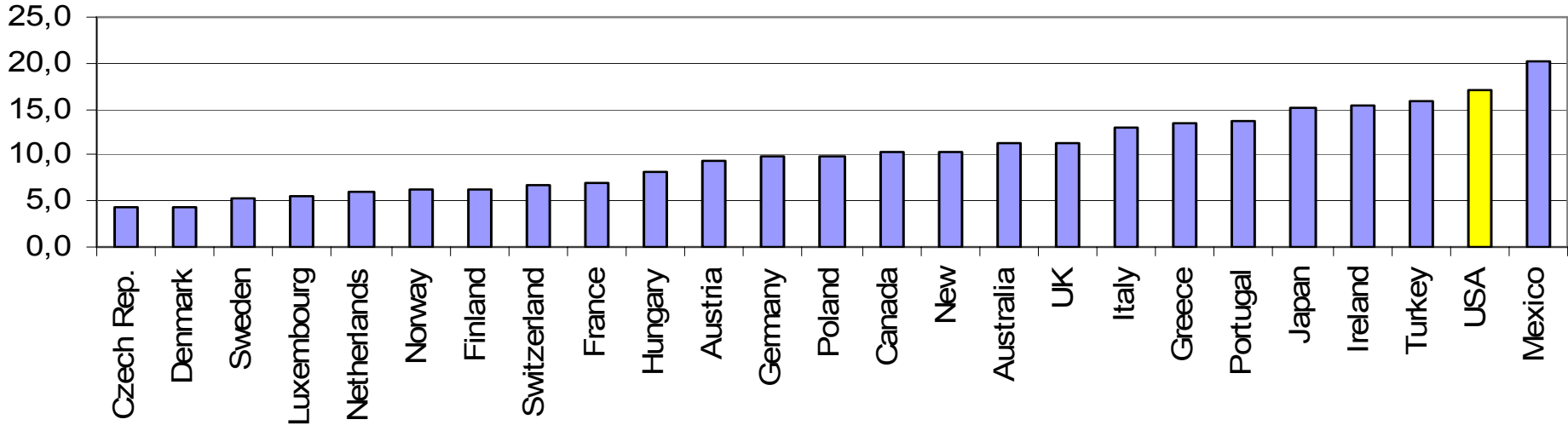
Economic security – the ESM does exist!



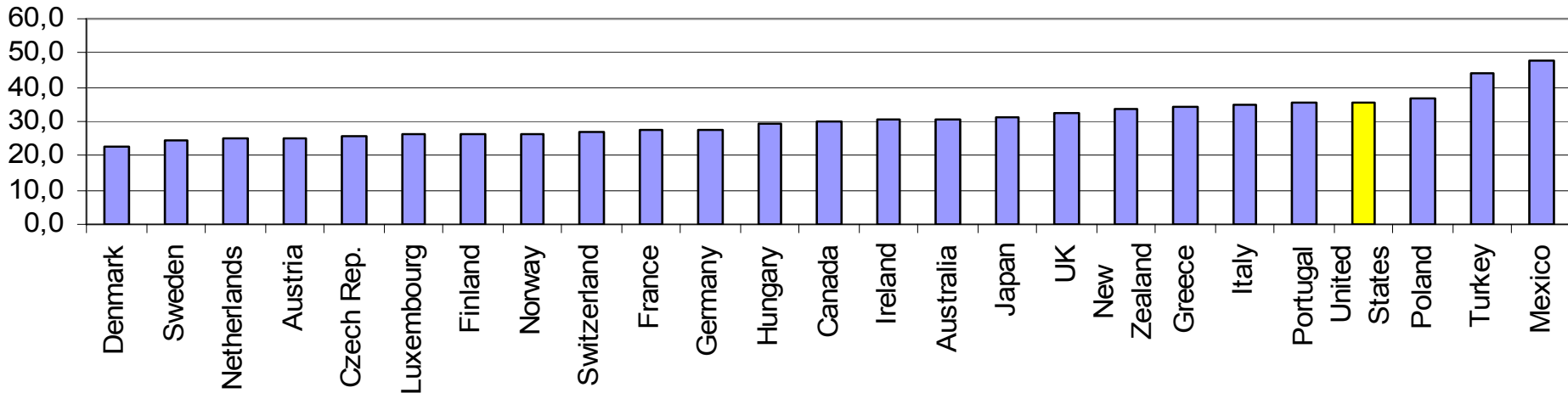
Source: Own calculations on ILO data. Cf. Andrew Watt, 'Economic security and employment: trade-off or synergy?', Transfer 4/2004



Relative poverty rate

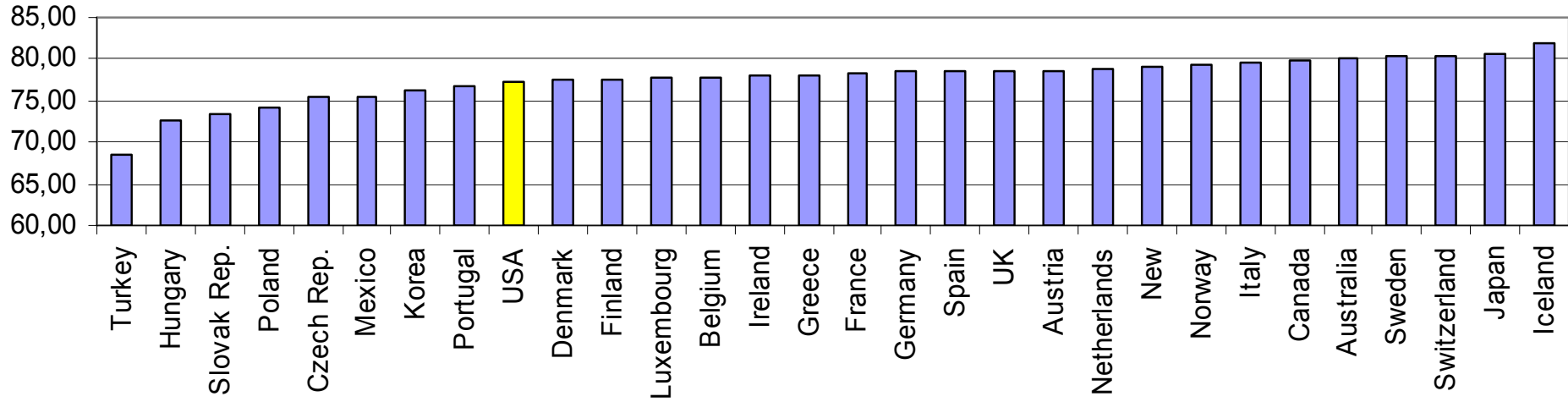


Income inequality

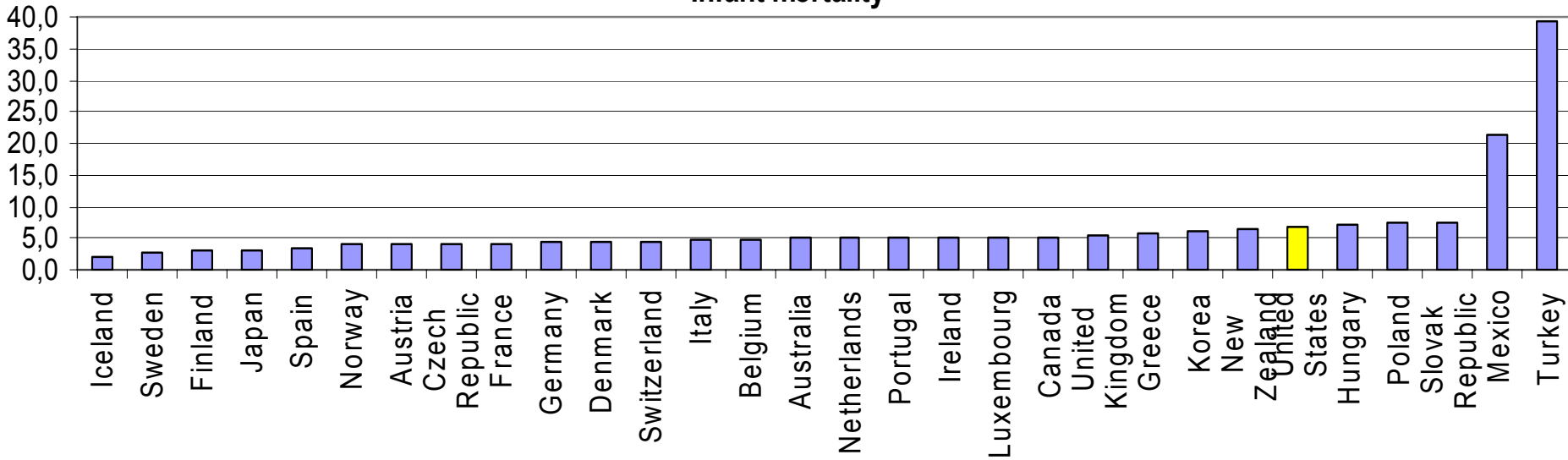




Life expectancy at birth (average for men and women)

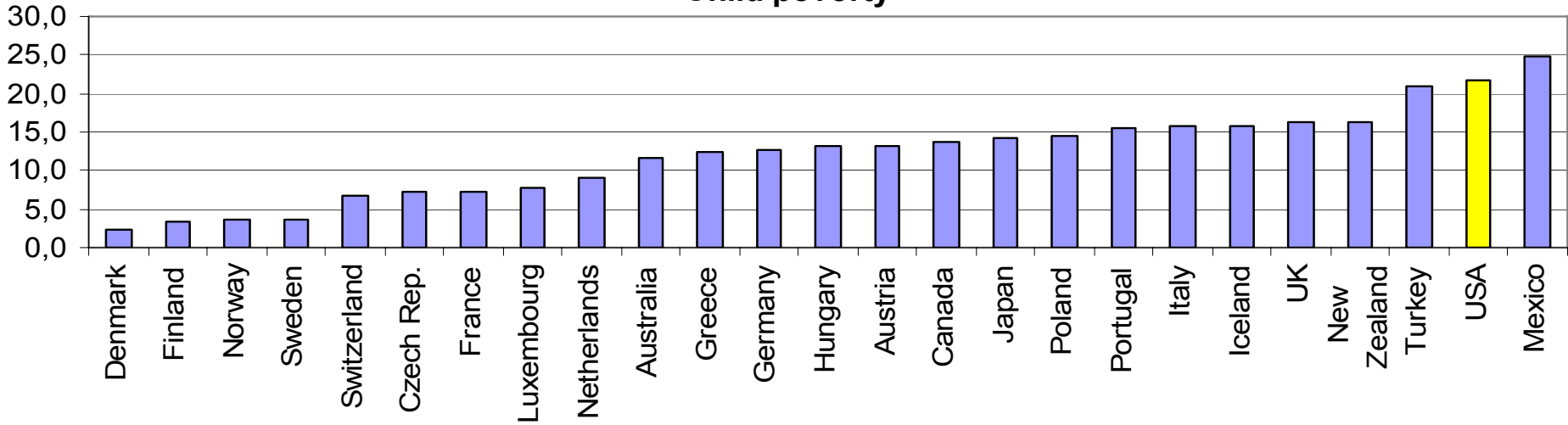


Infant mortality

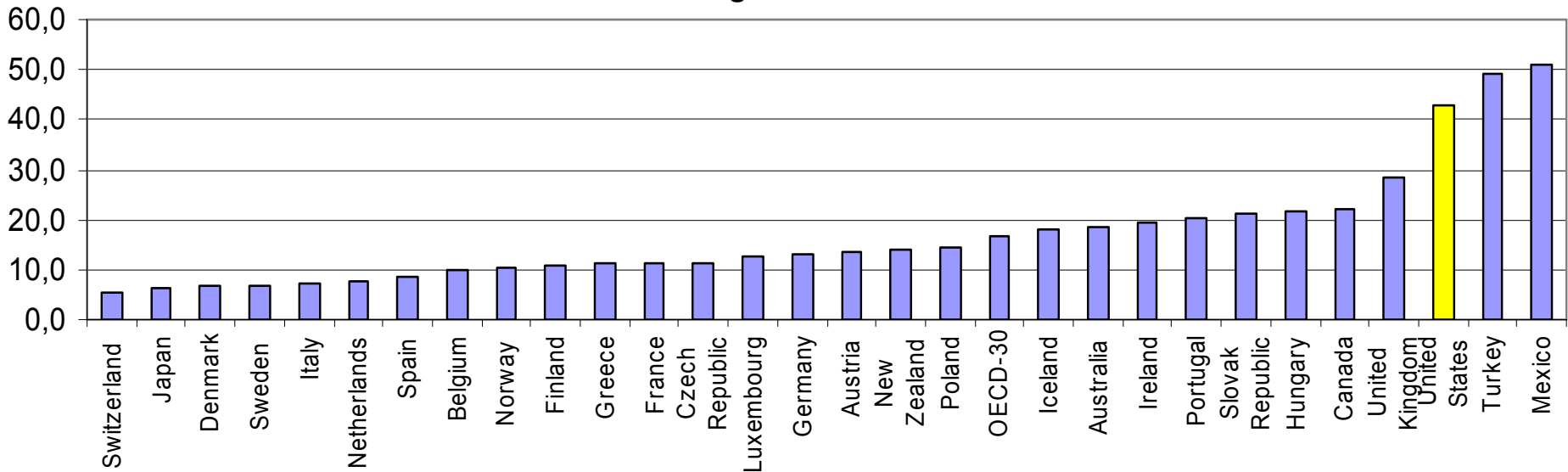




Child poverty



Teenage births 2002





In 2000 a ‘new strategic goal’ was set for the EU

‘to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion’

Implications:

- ◀ **Growth, employment and social cohesion all equally important goals**
- ◀ **Being ‘competitive’ and ‘dynamic’ and a ‘knowledge-based economy’ is a pre-condition of all three**



Growth/employment – cohesion link is controversial

Increasingly argued that social cohesion is a barrier to growth/employment, a cost, a burden (firm-based/microeconomic view)

‘First we need growth, then we can afford social cohesion’



Krugman hypothesis – choice between evils

Technology and trade ('globalisation') reduce demand for low-skill labour relative to high-skill labour

In US relative wages adjust – employment is maintained at the cost of widening income differentials and growing poverty

In EU the social model (ESM) prevents wage adjustment – Europe suffers high unemployment but maintains social cohesion

'No jobs or bad jobs'



Employment protection legislation

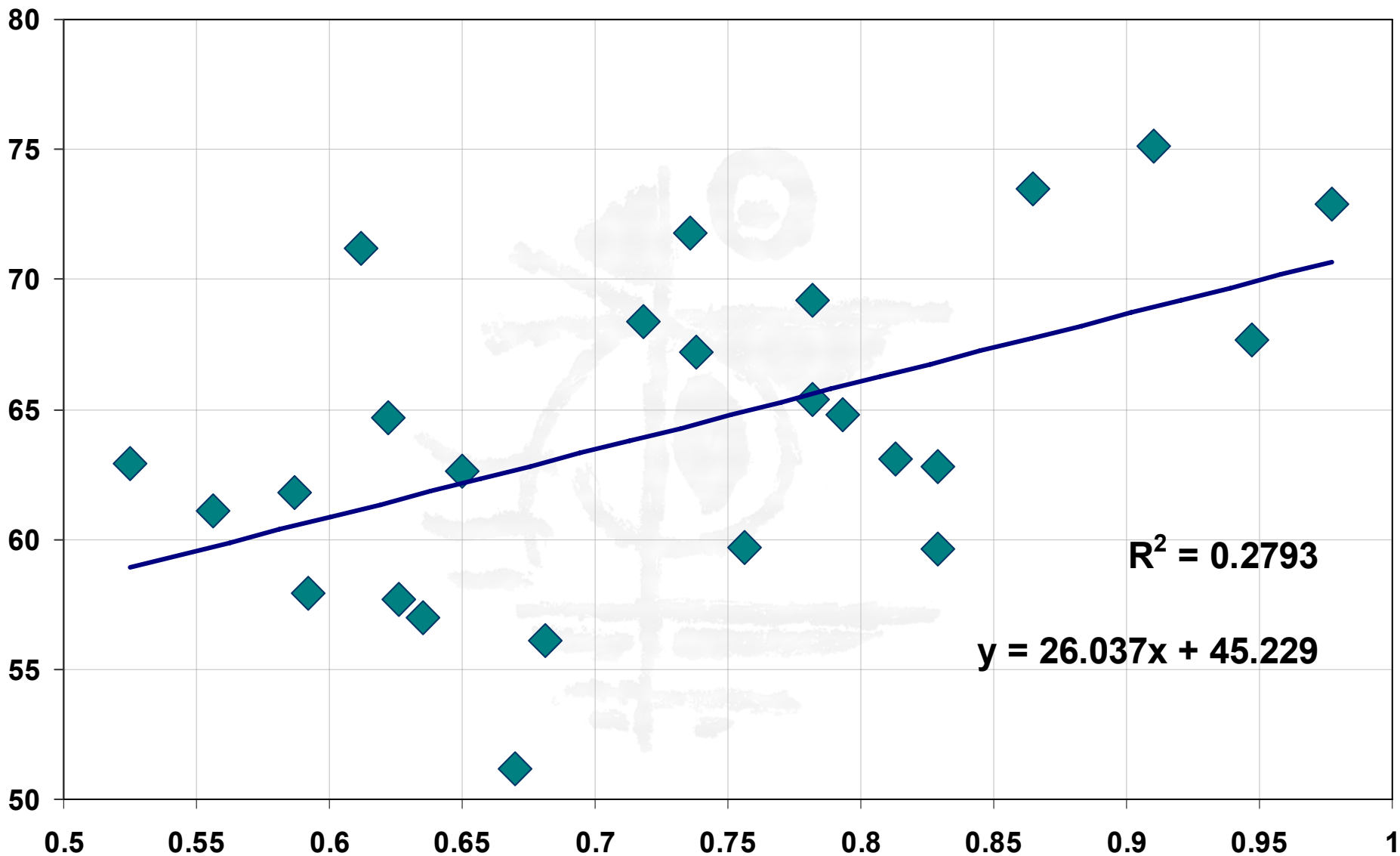
Unemployment benefit (replacement rate, benefit duration)

Tax wedge

**Collective bargaining (union density,
centralisation/coordination of CB)**

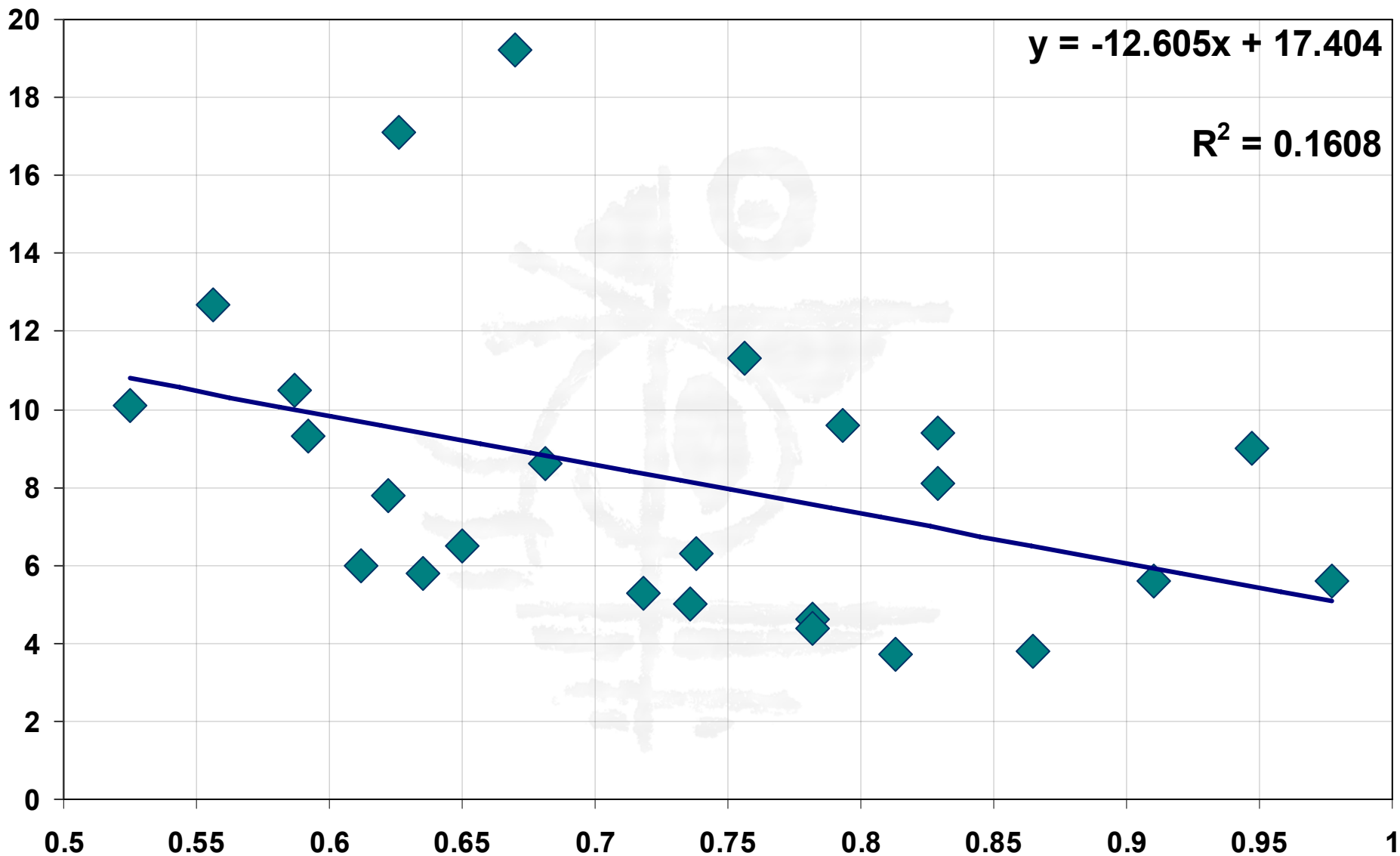
**Recent assessment of OECD Jobs Study has much more
nuanced conclusions (no role for EPL, collective bargaining
and ALMP can be positive)**

Economic security – good for employment



Source: Own calculations on ILO data. Cf. Andrew Watt, 'Economic security and employment: trade-off or synergy?', Transfer 4/2004

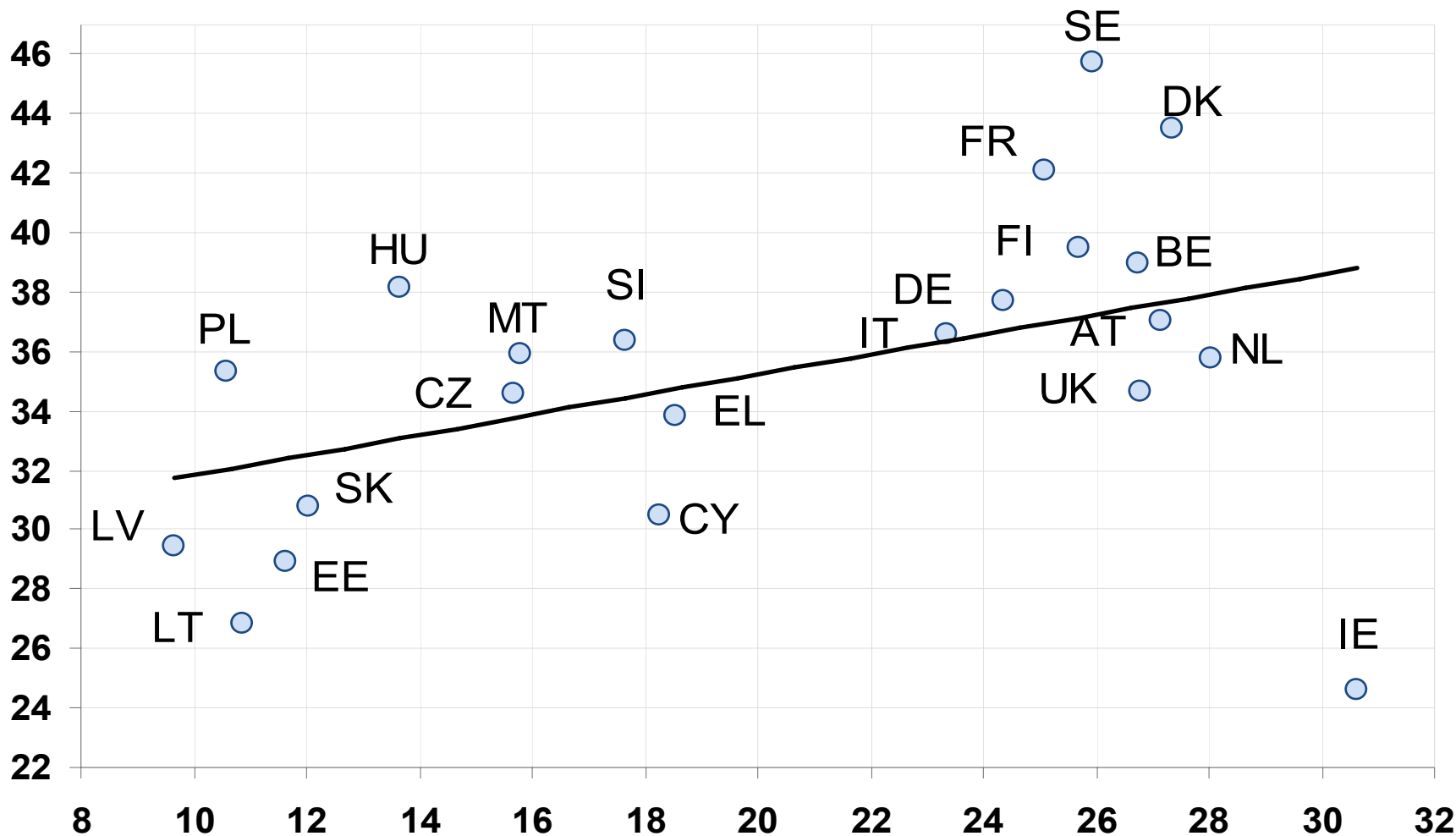
Economic security – bad for unemployment



Source: Own calculations on ILO data. Cf. Andrew Watt, 'Economic security and employment: trade-off or synergy?', Transfer 4/2004

Positive income and 'ESM spending' correlation

(ESM spending, % GDP)



Note: Luxemburg excluded, data not available for ES, PT, US

Source: AMECO (2005)

output per capita, '000 PPS



In short because its underlying model is wrong:

Markets are not perfect, real world actors confronted with uncertainty about the future, actors not always rational, externalities, lack of information, need for coordination, social choices (collective action), long-term relationships, motivation



Many policies designed and implemented to raise social cohesion can be shown also to have a positive impact on growth and employment ('productive factor')

Provision of security is key to flexibility and change management



Potential problems of security provision on incentives

Important – and exhaustively discussed – issue:

- ◀ Plausible that some people will ‘choose’ to remain unemployed if benefits are high and paid for long durations without any conditionality
- ◀ People will retire early if benefits are high relative to earned income

However (e.g.)

- ◀ Unemployment benefit also promotes efficient job search and is condition for globalisation/mobility to lead to efficient reallocation of labour
- ◀ Social benefits and services can be a condition for female LM participation
- ◀ Investment in skills suffers from market failure



Background: serious decline in EU productivity growth in context of flexibilisation, precarisation and wage moderation.

At best short-term strategy (ageing)

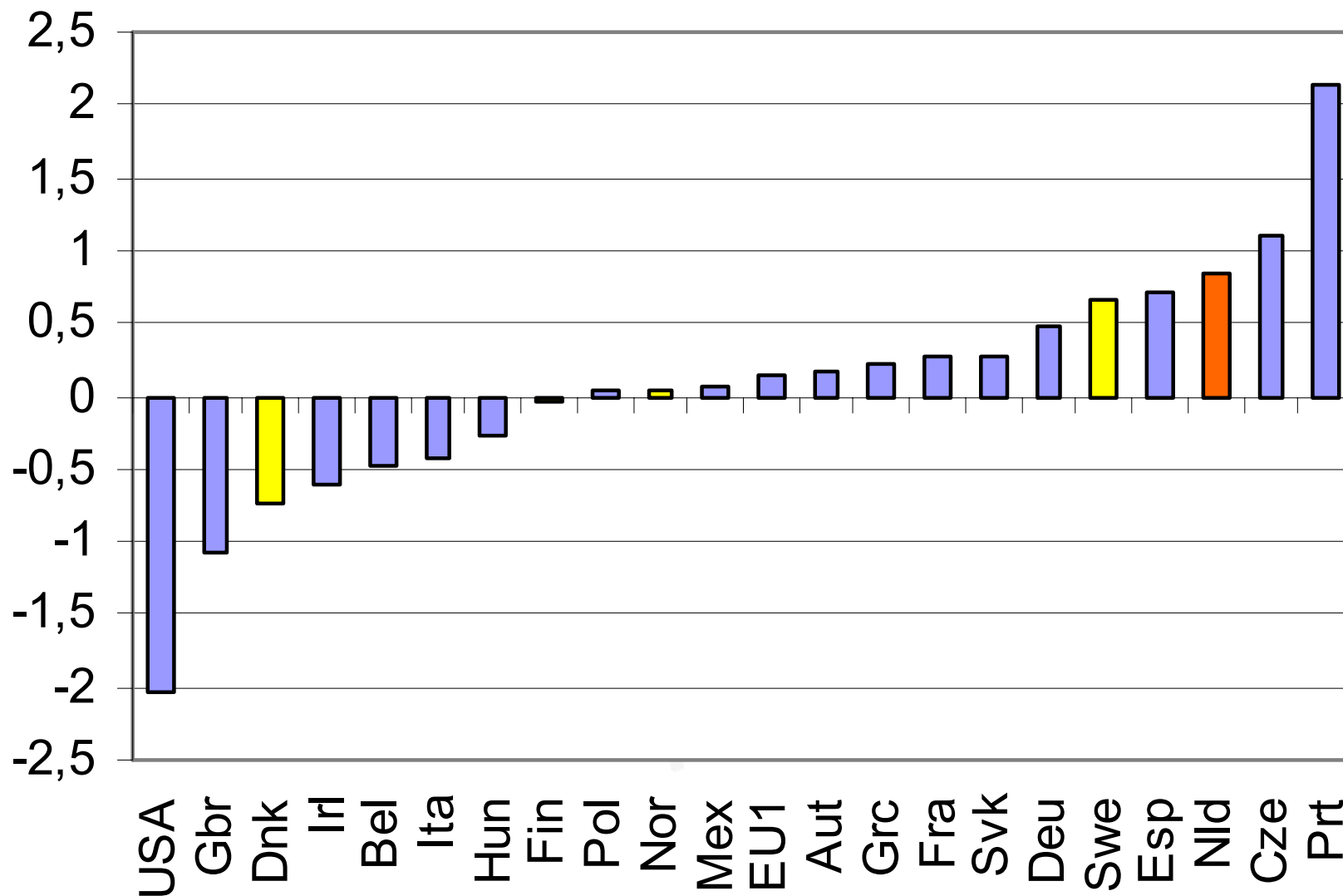
ESM features shut off low road option

Employers unable to cut wages or headcount adopt more innovative strategies

Extra-firm mobility can be useful but not a key indicator of success (firm size, internal flexibility)

Local wage flexibility versus law of one price (analogy with state subsidies)

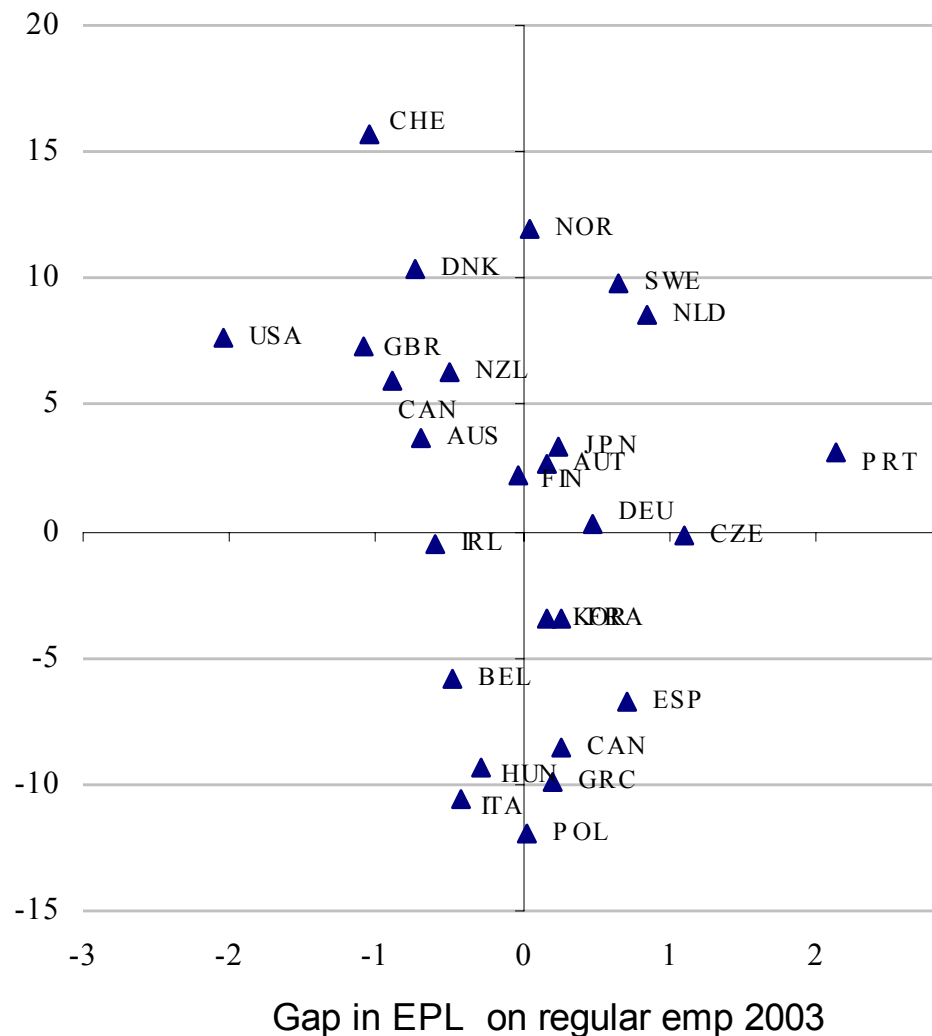
EPL: not a consistent part of Nordic/NL model



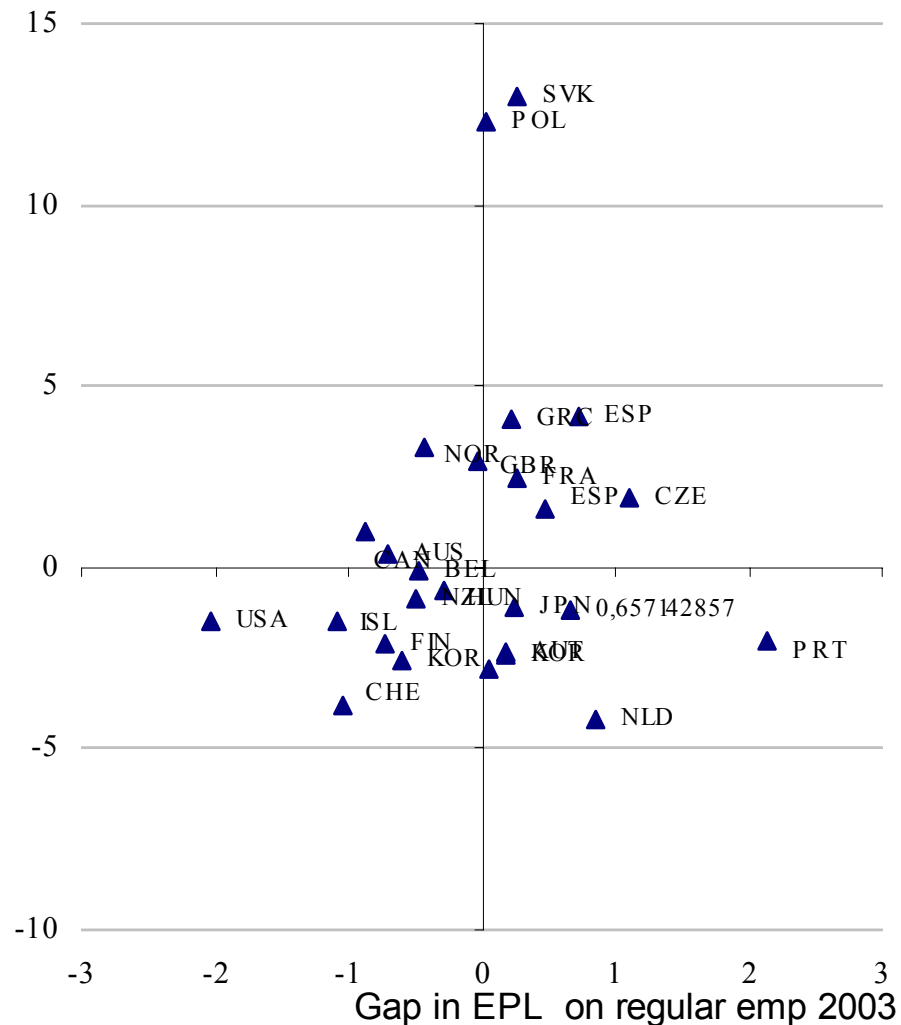
EPL and participation/unemployment rates – no correlation



Gap in participation rates



Gap in unemployment rates





DK	1993	1994	1995
Labour market			
Employment growth (%)		2.0	0.9
NSRIR (%)	10.8	6.3	
CAPB (pp GDP)	-2.2	-0.3	
Real GDP (%)	0.0	5.5	

Major UB reform



1. **Make the case for the positive effect of many ‘social’ institutions also for growth and employment**
2. **Be prepared to accept reform of those that demonstrably harm jobs and growth, provided change is negotiated**
3. **Promote an alternative structural reform package that addresses real causes of low employment and productivity**
4. **Be careful with models and ‘best practice’ – take account also of macro environment/policy**
5. **Insist on the need for a coordinated macroeconomic policy that does not restrict public and private investment in Europe’s future but rather continually tests the productive capacity of the economy**