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The European Socioeconomic Model

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Why the discussion came up

The economic performance of Europe since the beginning of the 1990s is well documented. Economic growth is now lower than it used to be and lower than in the US; Europe did not benefit from the strong growth of the world economy during 2004–6. Unemployment remains high; productivity is falling. There is less consensus, however, as to the reason for the underperformance. Some people claim that it has been the consequence of a neoliberal policy in Europe, blaming the reduction of budget deficits, insufficient wage increases, privatization of firms, the liberalization of markets and the rise in income differences. The opposite view is that Europe is doomed to slow growth and decay because of high taxes, large government, strict regulation, expensive labour and the public provision of services. We assume an intermediate position and argue that a bad mix of economic policies, reform inertia and the 'Paris Consensus'[1] are contributing to low growth rates in Europe. Too many other priorities prevent the enactment of an active, growth-oriented economic policy, as outlined in the Lisbon Strategy or in any textbook or survey on the determinants of long-term growth in an advanced economy.[2]

Two developments since the 1990s have initiated renewed interest in the discussion of social models. The first is the better performance of the two extreme models: namely, the liberal Anglo-Saxon countries and, even more surprising to mainstream economists, the Scandinavian countries, with their comprehensive 'cradle to grave' welfare state. We analyse the performance differences specifically between the Scandinavian countries and the continental economies and put them down to institutional variation.

The chapter is structured as follows. In the next section we define the European model, which in our understanding is not only a 'social model', but also shapes incentives, efficiency and competitiveness, and has an impact on security, leisure time, education and health, as well as on the 'innovation system' of the various countries. We therefore prefer to speak of a model of European society or a socioeconomic model. We will then compare the performances of Europe and the US, and of different types of model, first by examining the dynamics of GDP, productivity and employment and then by investigating a wider set of indicators. A three-tier policy strategy for the most successful countries is outlined (following Aiginger).[3] The next section presents quantitative evidence on the fiscal strategies, social expenditures, regulations, industrial relations and, most importantly, on the differences between countries and models in the level and dynamics of future investments (i.e. research, education and new technologies). The data reveal differences not only between Europe and the US, but also between European models. In the following section, we look at the differences between the traditional European welfare model and the new model now emerging in much of Europe, most specifically in the successful Scandinavian countries. The new European model certainly differs from the old welfare state model and from the US model, even though Anglo-Saxon European countries are trying to combine some elements of both. The final section will summarize the arguments put forward.

Model(s) of European society

Literature on the European social model (ESM) is abundant, but there has nevertheless been no agreement on a common definition; there is a consensus that it is reasonable to distinguish between different types of European socioeconomic model. Even here, opinions differ as to which characteristics constitute a 'model', how many of them exist and which model is applicable to which country. We claim that it makes sense to extend the horizon of the discussion beyond 'social institutions' proper. In our analysis, therefore, we include educational institutions, elements of the 'innovation system' and the 'knowledge-based society', the extent of administrative and economic regulation and the tax rates.

Our definition of the European socioeconomic model is based on terms of responsibility, regulation and redistribution:

- Responsibility: society has a broad responsibility 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 institutionalized; they are based on social dialogue, labour laws and collective agreements. The business environment is quite 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 the qualifications 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.

These three basic characteristics (responsibility, regulation and redistribution) reflect the fact that the European model is more than just a social model in the narrow sense. Indeed, it also influences production, employment and productivity and, thus, growth and competitiveness and all other objectives of economic policy. Furthermore, the European model influences social relationships, cultural institutions and behaviour, learning, and the creation and diffusion of knowledge. This is why we prefer to speak about a European socioeconomic model rather than merely a social model.

Nevertheless, the literature on the social model proper is more elaborate and has been standardized. We use this as a basis from which we can differentiate between several versions of the European model (see table 1). It is standard practice 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 Anglo-Saxon model). We believe it makes sense to differentiate between countries in which low levels of social expenditures are combined with supportive family networks and other characteristics of an agrarian society, and those countries in which less government interference is the result of an explicit policy or ideology, e.g. deregulation following a period of strong government involvement. The Anglo-Saxon model comprises countries aiming for a lower degree of intervention through the implementation of an explicit policy. We ascribe the name 'Mediterranean model' to the southern European countries. A fifth model, not yet elaborated, may emerge in the future, consisting of the new member countries (former socialist countries). Several social institutions have been founded since the transition of these countries, which lack the financial means for a comprehensive welfare system and are determined to catch up with the old member countries. We will therefore call this the 'catching-up model'. Outside Europe, the US model serves as the standard benchmark. The US is grouped together with Canada, Australia and New Zealand as the 'Anglo-Saxon overseas model'. Japan, as well as the other industrialized Asian economies, remains an outsider to this discussion.

The Scandinavian model is the most comprehensive, with a high degree of emphasis on redistribution; social benefits are financed by taxes. The Nordic model relies on institutions working closely together with the government; trade unions are strongly involved in the administration of unemployment insurance and training, and the model is characterized by an active labour market policy and high employment rates. The continental model emphasizes employment as the basis of social transfers. Transfers are financed through the contributions of employers and employees. Social partners play an important role in industrial relations, and wage-bargaining is centralized. Redistribution and the inclusion of outsiders are not high on the agenda. The liberal model emphasizes individual responsibility; its labour market is not regulated and its competition policy is rather ambitious. Social transfers are smaller than in the other models, more targeted and means-tested. Labour relations are decentralized, and bargaining takes place primarily within companies. In the Mediterranean countries, social transfers are small; families still play a significant role in the provision of security and shelter. Trade unions and employer representatives are important to the rather centralized bargaining process for wages and work conditions. Employment rates, specifically those of women, are low.

The Scandinavian model is practised in five countries, namely the three countries with the best (overall) performances over the past 15 years (which Aiginger calls the top three countries)[4] plus Norway and the Netherlands. The inclusion of the Netherlands in this group is the most contentious choice, because the Dutch model is less ambitious, redistributes less and places less emphasis on gender equality (at least up to the 1990s).[5] We pool five countries in the continental model – France, Germany and Italy, which are the three big continental

Table 1 Performance: short and long run growth of GDP; GDP per capita, employment 2005

	1960/1990	1990/2005	GDP per capita at PPP 2005	Employment rate 2005	Unemployment rate 2005
	Annual growth in %		1,000 €		
Scandinavian model	*3.3*	*2.3*	*29.0*	*74.2*	*5.6*
Denmark	2.7	2.2	28.6	77.2	4.6
Finland	3.9	2.0	26.6	68.6	8.4
Netherlands	3.4	2.2	28.7	73.6	5.1
Sweden	2.9	2.0	27.0	73.7	6.8
Norway	3.9	3.2	34.7	77.7	4.0
Continental model	*3.5*	*1.7*	*25.2*	*66.2*	*8.9*
Germany	3.2	1.6	25.0	70.0	9.5
France	3.8	1.9	25.9	63.8	9.6
Italy	3.9	1.3	23.7	62.0	7.7
Belgium	3.4	1.9	27.6	61.8	8.0
Austria	3.5	2.2	28.0	74.8	5.0
Anglo-Saxon model Europe	*2.6*	*2.7*	*27.8*	*71.9*	*4.6*
Ireland	4.1	6.5	31.9	68.6	4.3
United Kingdom	2.5	2.4	27.6	72.1	4.6
Mediterraean model	*4.6*	*2.8*	*21.8*	*63.6*	*9.1*
Greece	4.5	3.0	19.5	55.0	10.4
Portugal	4.8	2.1	17.5	70.5	7.4
Spain	4.6	2.9	23.1	64.1	9.2
Anglo-Saxon model overseas	*3.6*	*3.0*	*35.0*	*72.9*	*5.2*
USA	3.5	3.0	35.8	72.9	5.1
Canada	4.0	2.8	29.5	74.1	6.8
Australia	3.8	3.5	27.6	72.1	5.2
New Zealand	2.4	3.2	22.1	59.6	4.0
EU(15)	*3.4*	*2.0*	*25.3*	*67.2*	*7.9*
Japan	6.1	1.3	26.3	77.2	4.5
Catching-up model	—	*2.5*	*15.7*	*61.2*	*7.5*
Czech Republic	—	1.3	16.7	65.4	7.9
Hungary	—	3.9	14.5	56.2	7.0
EU(15)/USA	0.96	0.65	0.71	0.92	1.55

Source: Eurostat (AMECO). The values for a model class (Scandinavian model, etc.) are calculated as weighted average over the countries included; the value for EU(15) is that reported in the AMECO database.

countries, plus Belgium and Austria, two high-growth countries with top positions in per capita GDP.[6] It is striking that the social model typology groups Germany and France together into one group. When analysed in terms of intervention (high in France, low in Germany), mode of industrial policy (sectoral in France, horizontal in Germany) or the importance of nationalization and competition policy (with France favouring nationalized champions, while in Germany competition policy is seen as the holy grail), these two countries would be ascribed to different models. But the literature is undivided when it comes to the inclusion of France and Germany into the same group of 'social models'. There is a certain amount of disagreement as to whether Italy fits better into this group or into the Mediterranean group. Since we have placed Italy in the continental group, the Mediterranean model comprises Spain, Portugal and Greece. The Anglo-Saxon model is championed in Europe by the United Kingdom. As far as the low degree of regulation and the social system are concerned, Ireland exhibits a certain degree of similarity to the United Kingdom, but policy interventions have been intense, as is typical of a catching-up country: high shares of inward FDI, low taxes for business and a regional policy supporting small and medium-sized firms. In Europe, these strategies are now the paradigm for catching-up economies. Outside Europe, we group Canada, the US, New Zealand and Australia together, under the heading 'Anglo-Saxon overseas' model.

Economic performance: Europe vs the US, according to model type

In Europe, growth has been lagging behind that of the US since the early or mid-1990s. If we take 1995 as the starting point, the US enjoyed annual growth of 3.3 per cent as opposed to 2.1 per cent in the EU(15) (1995–2005). The difference is due to higher growth in productivity per worker, namely 2.1 per cent as opposed to 1.3 per cent and to higher growth in employment, which was 1.4 per cent as opposed to 1.1 per cent. Although Europe chose a more labour-intensive growth path, unemployment decreased only slightly from 10 per cent in 1995 to 8 per cent in 2005. The absolute difference in productivity per worker, which had narrowed throughout most of the post-war period, thus increased from 20 to 35 per cent per worker and from 5 to 9 per cent per hour (see figure 1).

Looking at the growth dynamics in the various types of model, the long-run dynamics are all very similar. Taking 1960–90, for example,

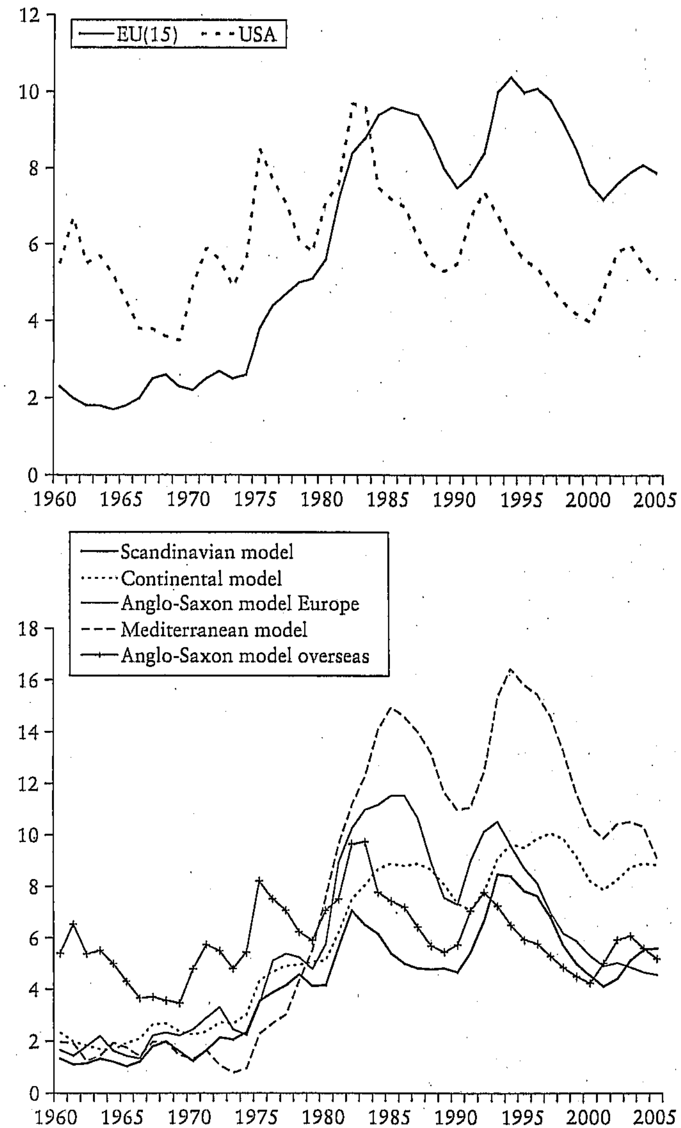

Figure 1
Unemployment
Source: Eurostat (AMECO). The values for a model class (Scandinavian model, etc.) are calculated as weighted average over the countries included; the value for EU(15) is that reproted in the AMECO database.

the long-term growth rates range from 2.6 per cent to 3.6 per cent for three European models (Anglo-Saxon, Scandinavian and Continental) and 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 1 above). Performance in the 1990s (1990–2005) diverged. The countries in the Mediterranean model group and those in the Anglo-Saxon European countries came closest to the US, with a growth rate of 2.8 per cent and 2.7 per cent respectively for GDP, partly because the initial starting point was at a relatively low level of GDP per capita.[7] A striking divergence occurred between the Scandinavian group, which enjoyed a growth rate of 2.3 per cent for these 15 years, despite a severe crisis in many countries in the early 1990s, when the growth rates of the countries associated with the continental model plummeted to 1.7 per cent, due to low growth in Germany and Italy. France, Austria and Belgium surpassed the group average, but did not reach the level attained by the Nordic group.

This evidence is supported and expanded elsewhere by Aiginger, who uses a set of 12 indicators on the dynamics of output, productivity and employment, as well as on the level and changes of unemployment and fiscal balances, to derive a more comprehensive 'performance evaluation' of countries since 1995. Apart from the Irish growth experience, Sweden, Finland and Denmark have been the best performers and were therefore designated by Aiginger as the 'top countries'.[8] The three big continental countries, which exhibited low dynamics, inferior employment records and high fiscal deficits, are grouped together at the lower end of the hierarchy.

In his analysis, Aiginger illustrates that the strong performance of the top countries is based upon three pillars, which comprise the foundation of the so-called three-tier strategy. First, these countries contained private and public costs in order to restore profitability and fiscal prudence. Second, they improved incentives by fine-tuning their welfare systems and deregulating part-time work and product markets. And third, they significantly increased investment in future growth, surpassing the investments of larger European economies in research input and output, in education expenditures and quality and in information technology. In contrast, the large continental economies (France, Germany and Italy) underperformed in terms of investment in growth drivers, refrained from labour market reform and constantly ran up fiscal deficits.[9]

The role of government and the importance of investing in the future

Europe has a much larger government sector, higher social expenditures and is more regulated than the US. But these tendencies differ across countries and models, and the data reveal that some important changes have been taking place.

Government revenues as a percentage of GDP are 45.1 per cent in Europe and 30.7 per cent in the US. This difference in taxation widened from 11 to 15 percentage points between 1990 and 2005, since the tax rate[10] increased by 2 per cent in Europe and decreased by 2.5 per cent in the US. Revenues as a percentage of GDP decreased slightly in the Scandinavian countries (where tax rates are still the highest) and increased in the countries associated with the continental model. Tax rates decreased in Ireland and increased marginally in the United Kingdom. They also increased in the Mediterranean countries, narrowing the difference from the lowest to the EU average to less than four percentage points (see table 2). Starting from a level lower than in Europe, the decrease in US government expenditure was somewhat greater than in the EU. However, this trend may soon be reversed, as the US has recently increased its spending. Within Europe, the decline in expenditure has been strongest in Scandinavia (by three percentage points). In the continental countries, the share of government expenditure increased in France and Germany.

The most striking differences are evident in the budget position. Europe's deficit shrank from 4.6 per cent to 2.7 per cent, while it remained at about 4 per cent in the US (with a surplus up to 2000, followed by a rapidly deteriorating balance since then). The Scandinavian countries, which had a deficit of 1 per cent in 1990, now enjoy a surplus of 2.5 per cent. This fiscal prudence is part of the change in strategies implemented by the Scandinavian countries, which have not been known before for budgetary discipline.[11] The continental countries were able to reduce their deficits from 4.5 per cent to 3.5 per cent, but this overall trend was made possible by the large reductions in Italy and Belgium, while Germany and France increased their deficits. The Mediterranean countries managed to reduce their deficits thanks to their successful campaigns for the introduction of the Euro, but deficits here have increased again somewhat since 2000. The United Kingdom enjoyed budgetary surpluses up to 2000, but in 2005 had a deficit in the 3 per cent range.

This chapter is concerned with the crucial institutional elements of the new socioeconomic model of Europe; we do not take short-term

Table 2 National finances and social expenditures

	Public revenues			Public expenditures			Budget deficit			Social expenditures	
	1990	2000	2005	1990	2000	2005	1990	2000	2005	1990	2002
Scandinavian model	*51.5*	*54.2*	*53.3*	*52.8*	*48.6*	*50.8*	*21.0*	*5.6*	*2.5*	*28.5*	*27.8*
Denmark	54.7	56.5	58.0	55.9	53.3	54.4	−1.3	3.2	3.5	27.9	29.1
Finland	53.5	55.9	53.5	48.1	48.8	51.7	5.4	7.1	1.8	24.2	25.6
Netherlands	47.4	45.6	46.4	52.5	43.4	48.2	−5.1	2.1	−1.8	29.6	26.7
Sweden	—	62.4	58.2	—	57.4	57.1	0.0	5.0	1.2	31.6	31.3
Norway	56.2	58.2	56.8	54.0	42.6	43.6	2.2	15.6	13.3	25.6	25.8
Continental model	*44.3*	*47.8*	*46.1*	*48.8*	*47.9*	*49.6*	*−4.5*	*−0.1*	*−3.5*	*24.9*	*28.1*
Germany	42.1	46.4	43.1	44.1	45.1	46.9	−2.0	1.3	−3.8	24.4	29.4
France	47.7	50.4	50.6	49.8	51.8	53.9	−2.1	−1.4	−3.2	26.5	29.0
Italy	42.6	46.2	44.9	54.3	47.0	49.2	−11.8	−0.8	−4.3	23.7	25.1
Belgium	45.5	49.1	49.0	52.2	49.1	49.2	−6.7	0.0	−0.1	25.1	26.2
Austria	49.7	49.8	47.6	52.0	51.4	49.6	−2.4	−1.6	−2.0	25.7	28.3
Anglo-Saxon model Europe	*40.0*	*40.8*	*41.0*	*41.7*	*37.0*	*44.2*	*−1.7*	*3.8*	*−3.2*	*21.6*	*25.9*
Ireland	40.0	35.9	34.9	42.8	31.5	35.3	−2.8	4.4	−0.4	17.6	15.4
United Kingdom	40.0	41.2	41.4	41.6	37.4	44.8	−1.6	3.8	−3.4	21.9	26.6
Mediterranean model	*9.6*	*39.8*	*39.9*	*12.7*	*41.4*	*41.0*	*−3.1*	*−1.6*	*−1.2*	*19.1*	*21.0*
Greece	34.5	47.9	43.7	50.2	52.1	47.4	−15.7	−4.2	−3.6	21.5	25.9
Portugal	33.6	40.1	41.3	39.9	43.0	47.3	−6.3	−2.9	−5.9	14.6	22.9
Spain	0.0	38.1	38.8	0.0	38.9	38.6	0.0	−0.9	0.2	19.4	19.7
Anglo-Saxon model overseas	*32.7*	*34.9*	*30.9*	*37.1*	*33.3*	*34.6*	*−4.3*	*1.6*	*−3.7*	—	—
USA	31.7	34.2	30.7	36.0	32.5	34.6	−4.3	1.6	−3.9	—	—
Canada	43.7	44.3	—	49.6	41.3	—	−5.9	3.1	0.0	—	—
Australia	34.3	36.3	36.6	39.2	38.9	—	−2.7	−0.6	—	—	—
New Zealand	49.2	—	—	53.8	—	—	−4.6	—	—	—	—
EU(15)	*42.7*	*46.2*	*45.1*	*48.2*	*45.3*	*47.8*	*−4.6*	*0.9*	*−2.7*	*24.4*	*26.9*
Japan	34.3	32.1	31.5	32.3	39.6	38.0	2.0	−7.5	−6.5	—	—
Catching-up model	—	*41.3*	*42.2*	—	*44.7*	*46.6*	—	*3.4*	*−4.4*	—	*20.1*
Czech Republic	—	38.5	41.2	—	42.1	44.2	—	−3.7	−3.1	—	19.9
Hungary	—	44.7	43.4	—	47.7	49.5	—	−3.1	−6.1	—	20.4
EU(15)/USA	1.35	1.35	1.47	1.34	1.39	1.38	1.08	0.58	0.69	—	—

Source: Eurostat (AMECO). The values for a model class (Scandinavian model, etc.) are calculated as weighted average over the countries included; the value for EU(15) is that reported in the AMECO database.

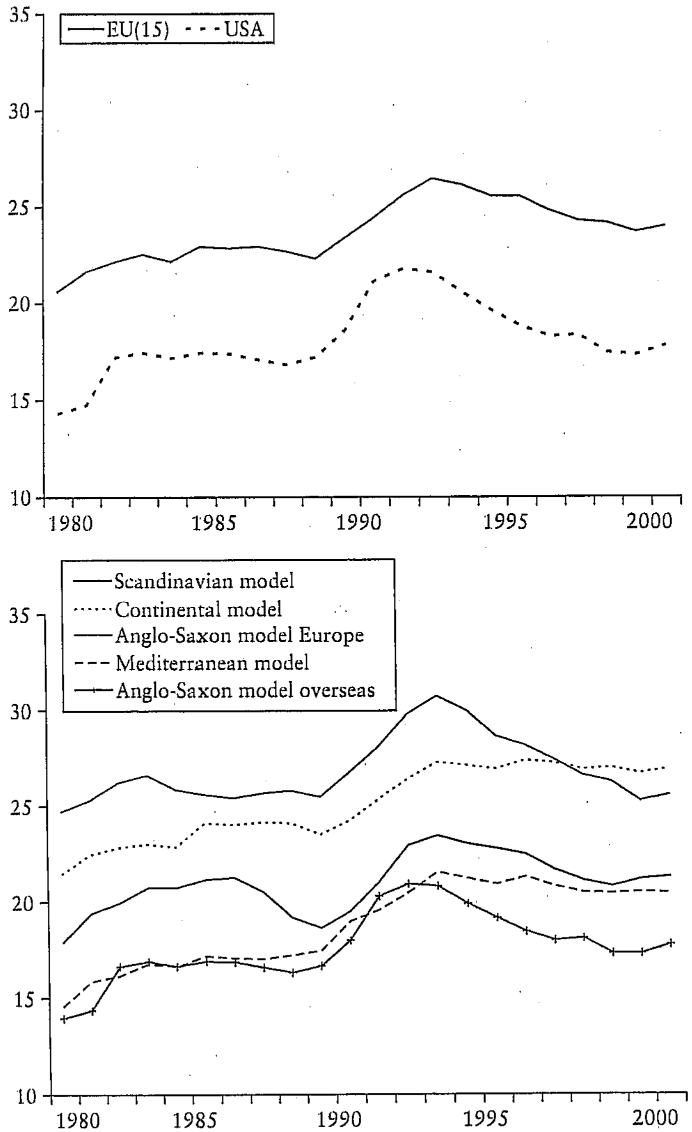

Figure 2

Public social expenditures as a percentage of GDP

Source: Eurostat (AMECO).The values for a model class (Scandinavian model, etc.) and for the EU(15) are calculated as weighted average over the countries included.

macroeconomic policies into consideration. Nevertheless, it should be kept in mind that 'even the most successful structural reform in Europe will not generate growth if the macroeconomic conditions are not right. Weakness in aggregate demand can ruin any economic party.'[12]

Regulation of product as well as of labour markets is much higher in Europe than in the US. The differences have existed for a long time (including that period in which productivity increase in Europe surpassed growth in the US); but if anything, the differences are now narrowing.[13] However, differences within European models are quite large too. The empirical data given in figure 2 were collected by OECD and are partly qualitative assessments; they are on a scale from 0 (no regulation) to 6 (highly regulated) and exist for product market regulation between 1998 and 2003 and for labour market regulation between 1990 and 2003 (see table 3).

Product market regulation across the four countries of the Anglo-Saxon overseas model is rated as low (1.3) and is quite similar in all cases, declining between 1998 and 2003 to a value of 1. It was rated as 1.9 in Europe and declined to 1.4 in 2003. The figure for Ireland and the United Kingdom is similar to that of the US – in fact marginally lower. Product market regulation in countries of the Scandinavian model equalled the European average in 1998, but, at least in Denmark and Sweden, they are now as deregulated as in the Anglo-Saxon model. The countries of the continental model started and ended with a marginally higher regulated product market, with Italy and France lagging behind Germany and Austria. The Mediterranean countries have more regulated product markets (see table 3).

As far as labour markets are concerned, the differences between the Anglo-Saxon countries on the one hand and the European countries in general and the continental countries in particular are much larger. The differences between Europe and the US seem to narrow a little bit, but there were some statistical changes in 1998 which create a bias in the apparently low figures for the US and UK. Scandinavian countries have traditionally always had somewhat less regulated labour markets and they have kept this advantage. Specifically, Denmark and Finland now have considerably less regulated labour markets (indices: 1.8 and 2.1 respectively) than France (2.9), Germany or Belgium. An interesting feature is that the Scandinavian countries did not change the regulations for regular contracts (they are marginally more regulated than the continental model countries), but they did so for temporary contracts. Sweden, Denmark and the Netherlands cancelled most administrative limits for temporary contracts (while providing pro rata benefits to them), and temporary contracts are now much less

Table 3 Product and labour market regulation

	Product market regulation		Labour market regulation					
			Total			Temporary contracts		
	1998	2003	1990	1998	2003	1990	1998	2003
Scandinavian model	*1.9*	*1.3*	*2.8*	*2.3*	*2.3*	*3.0*	*1.7*	*1.7*
Denmark	1.4	1.1	2.3	1.8	1.8	3.1	1.4	1.4
Finland	2.1	1.3	2.3	2.2	2.1	1.9	1.9	1.9
Netherlands	1.8	1.4	2.7	2.3	2.3	2.4	1.2	1.2
Sweden	1.8	1.1	3.5	2.6	2.6	4.1	1.6	1.6
Norway	2.4	1.4	2.9	2.7	2.6	3.5	3.1	2.9
Continental model	*2.2*	*1.5*	*3.1*	*2.8*	*2.6*	*3.9*	*2.9*	*2.4*
Germany	1.8	1.3	3.2	2.6	2.5	3.8	2.3	1.8
France	2.4	1.6	2.7	2.8	2.9	3.1	3.6	3.6
Italy	2.7	1.8	3.6	3.1	2.4	5.4	3.6	2.1
Belgium	1.9	1.4	3.2	2.5	2.5	4.6	2.6	2.6
Austria	1.8	1.3	2.2	2.4	2.2	1.5	1.5	1.5
Anglo-Saxon model Europe	*1.1*	*0.9*	*0.6*	*1.0*	*1.1*	*0.3*	*0.3*	*0.4*
Ireland	1.4	1.0	0.9	1.2	1.3	0.3	0.3	0.6
United Kingdom	1.1	0.9	0.6	1.0	1.1	0.3	0.3	0.4
Mediterranean model	*2.2*	*1.6*	*3.8*	*3.2*	*3.1*	*3.9*	*3.5*	*3.4*
Greece	2.7	1.7	3.6	3.5	2.9	4.8	4.8	3.3
Portugal	2.2	1.7	4.1	3.7	3.5	3.4	3.0	2.8
Spain	2.1	1.5	3.8	3.0	3.1	3.8	3.3	3.5
Anglo-Saxon model overseas	*1.3*	*1.0*	*0.3*	*0.8*	*0.8*	*0.3*	*0.3*	*0.3*
USA	1.3	1.0	0.2	0.7	0.7	0.3	0.3	0.3
Canada	1.4	1.1	0.8	1.1	1.1	0.3	0.3	0.3
Australia	1.3	0.9	0.9	1.5	1.5	0.9	0.9	0.9
New Zealand	1.5	1.2	1.0	0.8	1.3	0.5	0.4	1.3
EU(15)	*1.9*	*1.4*	*2.8*	*2.5*	*2.4*	*3.0*	*2.2*	*2.0*
Japan	1.9	1.3	2.1	1.9	1.8	1.8	1.6	1.3
Catching-up model	*2.7*	*1.8*	—	*1.7*	*1.8*	—	—	—
Czech Republic	2.9	1.6	—	1.9	1.9	—	—	—
Hungary	2.4	2.0	—	1.5	1.7	—	—	—
EU(15)/USA	1.49	1.36	13.82	3.54	3.39	10.12	7.48	6.74

Source: OECD (ECO/CPE/WP1(2004)9/ANN3). The values for a model class (Scandinavian model, etc.) and for the EU(15) are calculated as weighted average over the countries included.
Index between 0 (unregulated) and 6 (regulated).
Note: administrative regulation = licence and permits system, communication and simplification of rules and procedures, administrative burdens for corporations, administrative burdens for sole proprietor firms, sector-specific administrative burdens; economic regulation = scope of public enterprise sector, size of public enterprise sector, direct control over business enterprises, use of command and control regulation, price controls, legal barriers, antitrust exemptions.

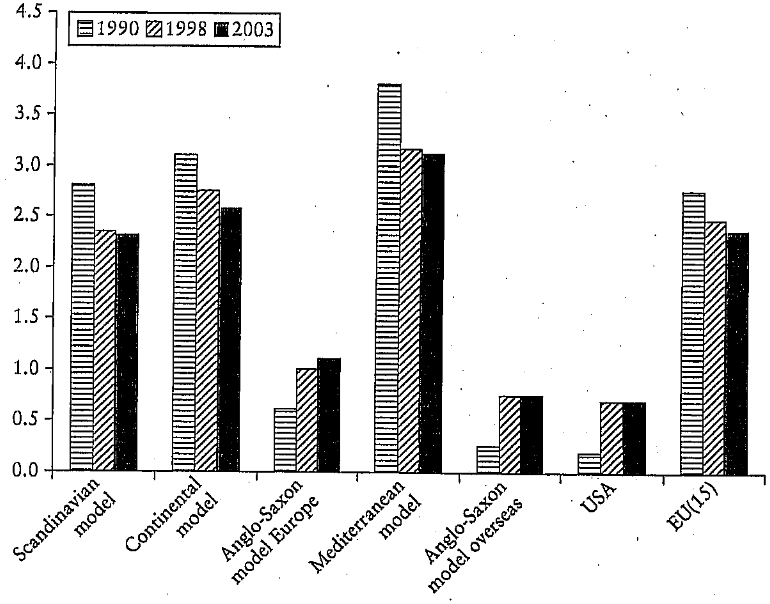

Figure 3
Labour market regulation
Source: OECD (ECO/CPE/WP1(2004)9/ANN3). The values for a model class (Scandinavian model, etc.) and for the EU(15) are calculated as weighted average over countries included.
Index between 0 (unregulated) and 6 (regulated); between 1990 and 1998 slightly changed definition: largest difference between old data and new data in the USA: 1998 old version 0,2; new version 0,7; in the United Kingdom: 1998 old version 0,6; new version 1,0.

regulated than in countries of the continental model (with the exception of Germany and Austria). Regulation is stricter for all contracts in the countries of the Mediterranean model (see figure 3).

Labour relations

Trade union density is low and decreasing in the US, falling from 22 per cent in 1980 to 15 per cent in 1990 and 13 per cent in 2000. Over the same period, it decreased in Europe from 50 to 43 to 39 per cent. A drastic decline occurred in the UK, namely from 51 to 31 per cent, with, however, no deceleration in the 1990s relative to the '80s. Starting from a low level, it has increased slightly in the Mediterranean

Table 4 Labour relations and part-time employment

	Trade union density (%)		Collective bargaining coverage (%)		Part-time employment (as % of full-time equivalent)		Reason for part-time employment (%)	
	1980	2000	1980	2000	1979	2004	No full-time job found	No full-time job wanted
Scandinavian model	*59*	*54*	*75*	*82*	*19.7*	*22.8*	*13.4*	*54.3*
Denmark	79	74	70	80	22.7	17.5	13.6	50.9
Finland	69	76	90	90	6.7	11.3	32.8	25.5
Netherlands	35	23	70	80	16.6	35.0	2.5	68.8
Sweden	80	79	80	90	23.6	14.4	23.2	47.6
Norway	58	54	70	70	27.3	21.1	9.3	55.3
Continental model	*36*	*25*	*81*	*79*	*8.7*	*16.8*	*20.9*	*31.9*
Germany	35	25	80	68	11.4	20.1	11.9	18.3
France	18	10	80	90	8.1	13.4	25.0	62.4
Italy	50	35	80	80	5.3	14.9	33.8	26.3
Belgium	54	56	90	90	6.0	18.3	20.0	8.3
Austria	57	37	95	95	7.6	15.5	10.8	16.7
Anglo-Saxon model Europe	*51*	*31*	*70*	*30*	*15.7*	*23.8*	*9.3*	*19.3*
Ireland	57	38	—	—	5.1	18.7	14.2	63.3
United Kingdom	51	31	70	30	16.4	24.1	9.0	16.4
Mediterranean model	*19*	*18*	*53*	*68*	*7.8*	*8.1*	*24.1*	*14.5*
Greece	39	27	—	—	—	6.0	46.5	31.1
Portugal	61	24	70	80	7.8	9.6	15.9	22.3
Spain	7	15	60	80	—	8.3	21.2	9.7
Anglo-Saxon model overseas	*24*	*14*	*29*	*18*	*16.1*	*14.1*	—	—
USA	22	13	26	14	16.4	13.2	—	—
Canada	35	28	37	32	12.5	18.5	—	—
Australia	48	25	80	80	15.9	27.1	—	—
New Zealand	69	23	60	25	13.9	22.0	—	—
EU(15)	*50*	*39*	*78*	*78*	*11.0*	*16.1*	*19.2*	*34.6*
Japan	31	22	25	15	15.4	25.5	—	—
Catching-up model	—	*24*	—	*27*	—	*3.3*	—	—
Czech Republic	—	27	—	25	—	3.1	—	—
Hungary	—	20	—	30	—	3.6	—	—
EU(15)/USA	2.25	2.99	3.00	5.57	0.67	1.22	—	—

Source: ifo (DICE). The values for a model class (Scandinavian model, etc.) and for the EU(15) are calculated as weighted average over the countries included.

countries, surpassing the (low and declining) trade union density in the US. It declined by ten percentage points to 25 per cent in the continental countries, with the exception of Belgium where it is stable. Surprisingly, the very high trade union density has not changed in Scandinavia in general, with an average rate of 59 per cent and rates above 75 per cent in Sweden and Denmark. Collective agreements cover 82 per cent of employees in the Scandinavian countries (and the trend is on the rise), and they cover at least as large a share of employees in the continental countries (the rate is stable at 80 per cent). In the UK, trade union coverage of collective bargaining plunged from 70 per cent in 1980 to 40 per cent in 1990 and 30 per cent in 2000. Conversely, the trend is upward in the Mediterranean countries. Among the countries included in the Anglo-Saxon overseas model, industrial relations vary significantly: the rate is steady at 80 per cent in Australia, but has declined to 14 per cent in the US (see table 4).

Future investments

According to growth theory, the medium-term growth rate of an advanced economy depends on R&D, human capital and the speed of diffusion of new technologies. Here, we summarize expenditures on research, education and information and communication technology (as a proxy for the investments and diffusion of a new technology). Future investment was 13.1 per cent in the US in 1992 and increased to 16.1 per cent in 2002. The same expenditures amounted to 11.6 per cent in Europe and increased to 13.8 per cent. In Scandinavia, the trend mirrors that of the US in level and dynamics, while the level and dynamics of the continental countries are close to that of the EU(15). The Mediterranean countries are catching up and are presently 2.5 percentage points behind the EU average. The continental countries are the least dynamic, recently falling marginally behind the European average. In Scandinavia, expenditures on R&D and information technology have sky rocketed, in both categories exceeding those of the US. Expenditures on education and life-long learning are higher than the EU average, although their share of GDP is not increasing. The OECD PISA ratings of educational performance between countries stress the excellence of education in Scandinavia. Furthermore, other studies confirm the quality of life-long learning in these countries. The continental countries have not raised their R&D ratio, have average expenditures on education, are ranked moderate in the PISA ratings and under-invest in ICT.

Table 5 Investment into the future (growth determinants)

	Investment in the future (as % of GDP)		
	1992	1995	2002
Scandinavian model	*14.2*	*15.2*	*17.3*
Denmark	14.4	15.4	17.8
Finland	13.8	14.8	16.9
Netherlands	13.3	13.7	14.7
Sweden	15.6	17.7	21.1
Norway	—	—	—
Continental model	*11.3*	*11.8*	*13.8*
Germany	11.8	11.8	13.4
France	12.3	13.2	14.2
Italy	8.9	9.9	11.3
Belgium	12.2	12.6	15.1
Austria	11.6	11.8	14.3
Anglo-Saxon model Europe	*13.1*	*14.5*	*15.2*
Ireland	12.7	13.5	11.3
United Kingdom	13.2	14.5	15.5
Mediterranean model	*8.0*	*9.0*	*11.3*
Greece	6.0	7.6	10.2
Portugal	9.8	11.2	13.9
Spain	8.1	8.9	11.1
Anglo-Saxon model overseas	*13.1*	*14.2*	*16.1*
USA	13.1	14.2	16.1
Canada	—	—	—
Australia	—	—	—
New Zealand	—	—	—
EU(15)	*11.6*	*12.2*	*13.8*
Japan	10.4	10.7	14.5
Catching-up model	—	—	—
Czech Republic	—	—	—
Hungary	—	—	—
EU(15)/USA	0.89	0.86	0.86

Source: Eurostat; EITO. The values for a model class (Scandinavian model, etc.) are calculated as weighted average over the countries included; the value for EU(15) is that reported.

Towards a new European model: a tentative sketch of its features

As far as institutional structure and policies are concerned, the strategies of the most successful European countries (Denmark, Finland and Sweden, which all fall into the Scandinavian model) differ greatly

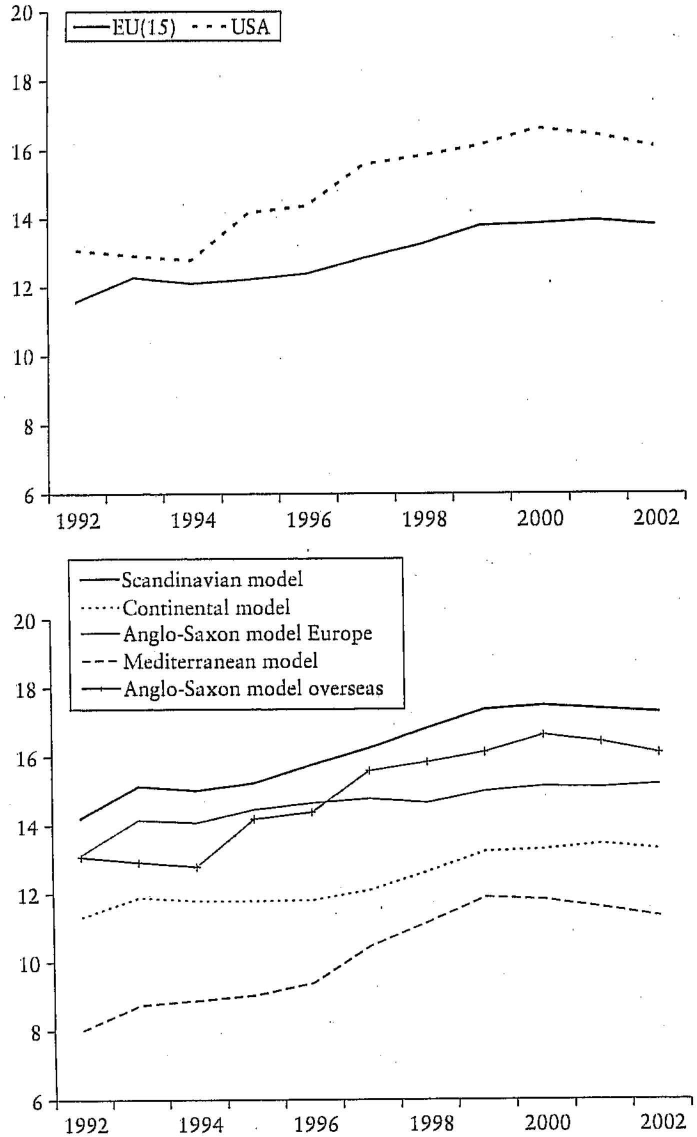

Figure 4

Investment in the future (growth determinants)

Source: Eurostat; EITO. The values for a model class (Scandinavian model, etc.) are calculated as weighted average over the countries included; the value for EU(15) is that reported.

from the US system, particularly in terms of welfare and government involvement, and also in their commitments to redistribution and training. Their labour market policy offers a high degree of flexibility for firms (e.g. easy dismissals), but is still a significant source of security for individuals through the prevention of poverty on the one hand and provision of support on the other, 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 US, they rely on proactive industrial policies, with government support for information technology, for agencies promoting research, for regional policies and for clusters.[14] These countries suffered severe financial crises in the late 1980s (Denmark) and in early '90s (Finland, Sweden). Many of the problems which can be expected to arise in a highly developed welfare state surfaced during the crises – e.g. 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 UK 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, and efficiency and economic incentives on the other.[15]

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 are still high by international standards.
- The welfare system is more service-oriented (care facilities for children, the aged and the handicapped) 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 personalized, less bureaucratic and less centralized. The public services are complemented by private agencies.

- Welfare-to-work elements have been introduced, generally on a decentralized – 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 of being inactive.
- Part-time work and the adaptation of work to life-cycles 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 subsidization old industries, are a precondition for the survival of the welfare state, and lead to more challenging and interesting work.[16]

Nevertheless, the new European model also differs from the US 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 the 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 life-long 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 conditions.
- 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.

Summary

Income per capita in the US is 40 per cent higher than in Europe and there is no trend towards convergence. Productivity per worker is 30 per cent higher in the US. Over the course of a long period during the post-war years, Europe was indeed catching up in productivity per worker and came very close in productivity per hour. However, during the past decade, the US once again increased its lead. Income per hour is the most favourable indicator of European performance, revealing a gap of less than 10 per cent, but again the difference has recently been increasing. Employment indicators show that the US created 78 million jobs between 1990 and 2003, while Europe created 42 million. Up to the 1970s, the employment rate in Europe was higher than in the US; now it is 13 percentage points lower (although the gap has recently narrowed slightly). Unemployment is higher in Europe, even excluding the significant number of people on disability or early retirement schemes, which decreases open unemployment. The number of hours worked is lower in Europe, which is partly voluntarily and partly due to the lack of full-time jobs. Leisure takes a higher priority in Europe.

International organizations (e.g. the OECD) often blame higher welfare costs and the stricter regulation of labour and product markets for the lack of dynamics in European economies ('Paris Consensus'). However, an assessment of performance differences across Europe reveals that the countries that perform best (aside from Ireland, which experienced a remarkable process of catching up, and the UK,[17] which has managed to grow faster than the EU average since the 1990s after a long period of low growth) are three Scandinavian welfare states: Denmark, Finland and Sweden. All three countries experienced periods of structural and cyclical crisis, which appeared to confirm some of the bleak predictions for welfare states in general. Over the past decade, however, they have been performing better than other European countries, with growth performances close to those of the US. At the same time, they are successfully combining welfare with higher efficiency. We highlighted the main characteristics of these countries and their reforms, enabling a tentative delineation of a new European model of a reformed welfare state. It provides an alternative model to that of the US in achieving economic efficiency, while maintaining the traditional European concerns for social welfare and environmental quality. The model thus combines security for citizens with efficiency and flexibility for firms.[18]

The fact that welfare states performed well in the 1990s does not imply that costs are irrelevant to performance. After suffering severe crises, the countries comprising the Scandinavian model realized, together with other European countries, that costs needed to be cut and fiscal balances stabilized, that incentives had to be implemented and institutions reformed. But most importantly, they realized that cost-cutting is a short-term strategy, which needs to be complemented by proactive policies to promote research, education and the diffusion of new technologies, including a commitment to use macroeconomic policy for stabilizing demand and to foster growth, in order to restore business and consumer confidence.[19] A successful new European model emphasizes cost-balancing, institutional flexibility and the reorientation of technologies. Firms are more flexible with regard to the use of labour, and workers who are laid off are efficiently assisted in their search for new jobs. Replacement ratios have been reduced and benefits are conditional to the search for employment and training efforts. Thus the new European model of the reformed welfare state has three major elements: social and environmental responsibility, flexibility and technology promotion.

We may carve out three or four stages of development of the European social model. The model was conceived as a reaction to the consequences of industrialization; it was at this stage that European countries began to assume responsibility for the greatest risks encountered by their citizens. In the wake of World War II, the coverage of risks and persons was boosted considerably, above all in response to the poverty of the Great Depression and the desire to avoid a repetition of the economic and social turmoil that had led to war. The third phase dates back to the 1970s and '80s, when the system was completed and expanded, partly as an answer to the problems of the oil crises and rising unemployment rates. A fourth phase appears to have begun during the 1990s, in an effort to counterbalance the financial and fiscal crises confronting a number of countries. This fourth phase builds on the awareness that the welfare state could only be maintained if it is made more flexible and more future-oriented. The vision of this phase of the European socioeconomic model could be the redirection of incentives in such a way that the welfare state is able to shift from a burden (increasing costs and lowering flexibility) to a productive force. It expands the qualifications of its citizens through training programmes, offers various forms of employment, wider choices and new opportunities, supports innovation and the diffusion of technology, thus making countries competitive by relying on the capabilities available to and needed by welfare states.

Notes

1 By 'Paris Consensus', we understand the position as upheld by the OECD, as, for example, in the study on jobs and in many country reports, where it is maintained that liberalization, deregulation and flexibility are necessary and sufficient for boosting economic growth, innovation and full employment. We have to acknowledge that reports on economic growth (OECD, *The OECD Growth Project*, Paris: 2001), as well as recent statements on the monetary policy of the European Central Bank, call for a proactive economic policy, which enhances measures in innovation and macroeconomic policy respectively.

2 For a similar view, see also A. Sapir et al., *An Agenda for a Growing Europe: Sapir Report* (Oxford: Oxford University Press, 2004).

3 K. Aiginger, 'The three tier strategy followed by successful European countries in the 1990s', *International Review of Applied Economics*, 18, 4 (2004), pp. 399–422.

4 Ibid.

5 Some authors classify the Netherlands as a member of the continental model group.

6 It is interesting that at least four of the six founding members of the EU belong to this group. The Netherlands is on the borderline between the continental and the Scandinavian models, and Luxembourg is between the continental and the Anglo-Saxon models.

7 The exception with respect to the starting level is the United Kingdom, which started in 1990 from a medium position as far as per capita income was concerned and then experienced a growth rate of 2.4 per cent, but here growth over the three decades before had been rather low.

8 Aiginger, 'The three tier strategy'.

9 Ibid.

10 Revenues as a percentage of GDP comprise taxes proper, contribution to social security, duties and irregular revenues. The difference between Europe (EU(15); weighted) and the US in the revenue/GDP ratio is 45.0 per cent vs 31.6 per cent.

11 A. Alesina and S. Ardagna define episodes of loose fiscal policies for OECD countries between 1960 and 1994. Finland and Sweden lead the table with ten loose periods, Norway and Denmark have five and six respectively, while the average amounts to three per country. See their 'Tales of fiscal adjustment', *Economic Policy*, 20, 27 (October 1998).

12 M. N. Baily and J. F. Kirkegaard, *A Transformation of the European Economy* (Washington: Institute for International Economics, September 2004), p. 18, available at <http://bookstore.iie.com/merchant.mvc?Screen=PROD&Product_Code=353>. See also Sapir et al., *Agenda for a Growing Europe*; J. P. Fitoussi and F. K. Kostoris Padoa Schioppa, eds., *Report on the State of the European Union*, vol. 1 (Houndsmills: Palgrave Macmillan, 2005).

13 Papers claiming that the differences in regulation explain the underperformance of Europe as opposed to the US have therefore to claim that a given degree of regulation is more detrimental in periods of rapid change (globalization) than in 'calm' periods. In econometric studies this effect is captured by an interaction term (regulation is interacted with export ratios etc.). For an overview, see K. Aiginger, 'Labour market reforms and economic growth: the European experience in the nineties', *Journal of Economic Studies*, 32, 6 (2005), pp. 540–73.

14 Part of the difference between the US and Europe with regard to industrial policies may be in rhetoric only or in the specific instruments chosen: see C. Ketels, 'Industrial policy outside the European Union: United States and Japan', and K. Aiginger, 'Towards a renewed industrial policy in Europe', in European Competitiveness Report, 2005.

15 For earlier suggestions along this line, see Aiginger, 'The three tier strategy', K. Aiginger and M. Landesmann, *Competitive Economic Performance: The European View,* Conference on Transatlantic Perspectives on US–EU Economic Relations: Convergence, Conflict & Cooperation, Harvard University, April 2002, WIFO Working Paper No. 179 (Vienna: WIFO, June 2002); K. Aiginger, *The New European Model of the Reformed Welfare State*, European Forum Working Paper 2/2002, Stanford University (December 2002).

16 The policies pursued by the leading countries have many similarities with the economic policy recommendations of the Steindl-Kalecki tradition, as described in A. Guger, M. Marterbauer and E. Walterskirchen, *Growth Policy in the Spirit of Steindl and Kalecki*, WIFO Working Papers 240 (Vienna: WIFO, 2004).

17 The policy strategy of the UK has some striking similarity to the Scandinavian model (welfare-to-work programmes and a recently high emphasis on improving infrastructures after a period of insufficient investment) but also remarkable differences (lower taxes and regulation, more targeting of transfers).

18 This combination can be considered to be in the tradition of Josef Steindl and Michal Kalecki. See J. Steindl, *Maturity and Stagnation in American Capitalism* (Oxford: Blackwell, 1952) and M. Kalecki, *Selected Essays in the Dynamics of the Capitalist Economies, 1937–1970* (Cambridge: Cambridge University Press, 1971).

19 G. Tichy, 'Die 'Neue Unsicherheit' als Ursache der europäischen Wachstumsschwäche', *Perspektiven der Wirtschaftspolitik*, 6, 3 (2005), pp. 385–407.

GLOBAL EUROPE, SOCIAL EUROPE

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