The Economic Performance of the European Union

Issues, Trends and Policies

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1
The Swedish Economic Model: Lessons to be Learned

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1.1 Introduction

The European Union has not equalled the US with respect to the growth of output, productivity or employment since the early or mid-1990s. Unemployment is now higher than in the US, and employment rates are lower – both in contrast to past trends (Aiginger, 2004). Many international analyses, such as that of the OECD, the IMF and the European Commission, blame – explicitly or implicitly – high welfare costs and low market flexibility for this disappointing performance. The European socio-economic model with its emphasis on social expenditures and high taxes is seen as a barrier to competitiveness in a globalizing world. However, contradicting this assertion is the fact that the three European countries which performed best in the past fifteen years with regard to growth, employment rates and fiscal prudence, Sweden, Finland and Denmark, belong to the Scandinavian type of the European model. This is the most comprehensive type, with the highest emphasis on social cohesion, redistribution and ecological awareness. Among these, Sweden may be seen as the prototype, with its long history of welfare, and its high taxes. Sweden experienced a long and steady decline of its lead in per capita income versus the European average, accompanied with recurrent devaluations, and a deep crisis in 1992/93. Since then Sweden has ventured courageous reforms which have made it one of the best performing countries in Europe, essentially maintaining its high standards of welfare and social cohesion, while making the labour market more flexible and budgets sustainable.

The chapter is structured as follows. In the next section we define the European model. This is not only a 'social model', but also shapes incentives, efficiency and competitiveness, and has an impact on education,

innovation and health. We therefore prefer to speak of a model of European society or a socio-economic model (Aiginger and Guger, 2005, 2006). We further distinguish between different types of European models with Sweden as a member – maybe even the prototype – of the Scandinavian model type and analyse performance differences across models in the long run and since the 1990s. Section 1.3 outlines elements of change in the economic policy of the Scandinavian countries, concentrating again on Sweden. A three-tier policy strategy for the most successful countries is outlined (following Aiginger, 2004). Section 1.4 looks at some recent problems re-emerging in Sweden, and at the measures proposed by the OECD or planned by the new government. Section 1.5 discusses whether there are lessons to be learned from policy changes in Sweden for the new member countries of the EU. In an appendix we describe common elements of the strategies of Scandinavian countries which could indicate the substance of a 'Reformed European Model'.

1.2 The European socio-economic model

We follow Aiginger and Guger (2005) and define the European socio-economic model in terms of responsibility, regulation and redistribution:

- *Responsibility*. The broad responsibility of society 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 care, 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 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.

If we differentiate between types of the European model, the Scandinavian model is the most comprehensive, with a high degree of emphasis on redistribution and social benefits financed by taxes. The Scandinavian 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 Anglo-Saxon model emphasizes the responsibility of individuals for themselves, its labour market is not regulated and its competition policy is ambitious. Social transfers are smaller than in the other models, more targeted and 'means tested'. Labour relations are decentralized, and bargaining takes place primarily at the firm level. The Scandinavian, the continental and the Anglo-Saxon model are the three main models; we add a Mediterranean model and a group of countries still looking for a model – the group of new member countries. 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 generally centralized bargaining process for wages and work conditions. Employment rates, particularly those of women, are low.

The Scandinavian model applies at least in Sweden, Finland and Denmark. Some studies include Norway, but many do not, since it is rich in oil and is not a member of the EU. Whether the Netherlands are part of the Scandinavian model or nor is in debate. But unquestionably Sweden is the prototype. It has the longest history in welfare, and enjoyed a lead against the European average in GDP per capita of more than 30 per cent for a long time after World War II.

Looking at the growth dynamics in the various types of models, the long-run dynamics are all very similar (Table 1.1). Taking 1960/1990, for example, the long-term growth rates range between 2.6 per cent and 3.6 per cent for three main European models (Anglo-Saxon, Scandinavian and continental), as well as for the Anglo-Saxon overseas group (3.6 per cent). It is higher only in the Mediterranean model, and there is little variation within models (with the lowest growth rates for the United Kingdom and New Zealand; see Table 1.1). Performance in the 1990s (1990/2005) however diverged.[1] The Scandinavian group enjoyed a growth rate of 2.5 per cent for these 15 years – despite a severe crisis in many countries in the early 1990s – while the growth rates of the countries associated with the continental model plummeted to 1.7 per cent as a result of low growth in Germany and Italy. France, Austria and Belgium surpassed the group average, but no single country reached the level of dynamics attained by the Scandinavian group.[2]

Table 1.1 Performance in growth and employment: long run versus 1990/2007

	GDP growth p.a. in %		Unemployment rate		Employment rate		GDP per capita at PPP 2005 1,000 €
	1960/1990	1990/2007	1990	2007	1990	2007	
Scandinavian model	3.4	2.5	4.7	4.1	73.5	76.8	33.6
Denmark	3.0	2.2	7.2	3.0	76.8	79.6	31.1
Finland	3.9	2.4	3.2	6.7	74.1	70.9	29.2
Netherlands	3.4	2.6	5.8	3.1	65.0	77.3	32.7
Sweden	2.9	2.3	1.7	6.1	83.0	74.8	29.8
Norway	3.8	3.2	5.2	2.6	75.0	80.2	46.2
Continental model	3.5	1.7	7.3	7.5	63.4	67.2	27.7
Germany	3.2	1.7	6.2	8.1	69.5	73.1	28.2
France	3.8	1.9	8.5	8.6	59.7	61.9	27.6
Italy	4.0	1.4	8.9	5.9	57.4	63.8	25.4
Belgium	3.4	2.1	6.6	7.5	58.3	63.1	30.5
Austria	3.5	2.3	3.1	4.2	69.2	70.0	32.0
Anglo-Saxon model Europe	2.6	2.7	7.3	5.3	70.7	72.0	29.9
Ireland	4.2	6.4	13.4	4.5	54.6	70.5	35.5
United Kingdom	2.5	2.5	6.9	5.3	71.8	72.1	29.5
Mediterrean model	4.6	2.9	10.9	8.1	55.8	66.5	24.2
Greece	4.5	3.2	6.4	8.4	54.7	56.7	24.3
Portugal	4.8	2.1	4.8	8.0	71.1	72.5	18.2
Spain	4.6	3.1	13.0	8.1	53.2	67.3	25.3
Anglo-Saxon model overseas	3.6	3.0	5.7	4.7	71.9	73.4	36.3
US	3.5	2.9	5.5	4.6	72.2	73.3	37.1
Canada	4.0	2.8	8.1	6.1	71.2	75.1	30.4
Australia	3.8	3.5	6.9	4.6	69.2	74.5	30.7
New Zealand	2.4	2.9	7.8	3.9	53.7	60.6	22.6
EU-15	3.4	2.1	8.0	7.2	64.2	68.2	27.7
Japan	6.1	1.4	2.1	3.9	74.7	76.7	27.8
Catching-up model	–	3.2	–	7.9	–	60.2	16.1
Czech Republic	–	1.9	–	5.9	–	68.0	20.2
Estonia	–	–	–	4.9	–	71.8	17.7
Cyprus	–	4.1	–	4.3	–	69.9	22.9
Latvia	–	1.4	–	5.8	–	69.6	15.0
Lithuania	–	1.3	–	4.2	–	65.8	15.2
Hungary	–	3.1	–	7.3	–	56.2	16.1
Malta	–	–	–	6.8	–	54.7	18.7
Poland	–	3.9	–	9.4	–	56.4	13.6
Slovenia	–	2.9	–	4.9	–	66.9	22.6
Slovakia	–	5.1	–	11.2	–	60.3	16.4
EU-15/US	0.96	0.71	1.45	1.57	0.89	0.93	0.75

Source: Eurostat (AMECO); as to sub-aggregates weighted average over countries; EU-15 reported.

1.3 Reform strategies in Sweden, 1993–2002

Following crises in the late 1980s (Denmark) and the early 1990s (Sweden and Finland), the Scandinavian countries in general and Sweden in particular pursued a three-pronged strategy with the following aims (Aiginger, 2004a):

- 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 now describe these policy changes specifically in relation to Sweden which had gradually lost its position as one of the leading European countries in per capita GDP by underperforming in growth over the greater part of the post-World War II period (Figure 1.1). In the early

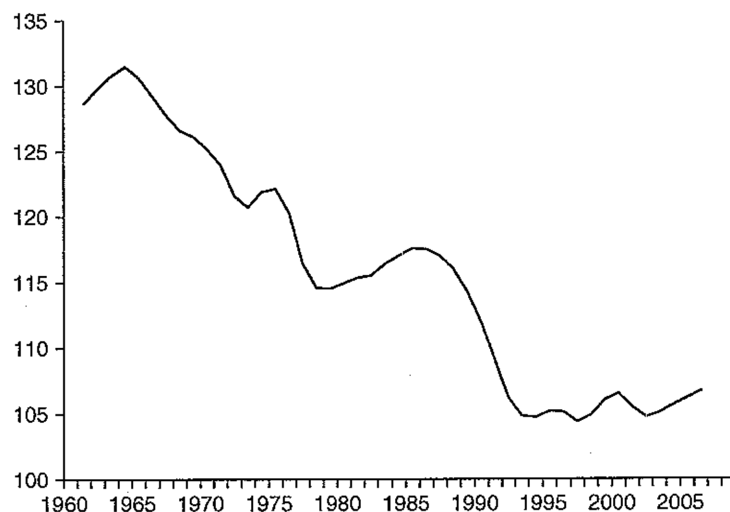


Figure 1.1 Sweden: falling down and forging ahead again
Note: GDP per capita; EU-15 = 100; moving average over three years.
Source: Eurostat (AMECO).

1990s, exports, GDP and employment decreased, leading the OECD to open its 1994 report with the comment that 'the current recession is comparable in depth to that of the 1930s' (OECD, 1994). The serious crisis – second only to that in Finland – had several causes: the Russian crisis affected Sweden more strongly than it affected continental countries, and Sweden suffered a particular crisis in its financial sectors (following deregulation without allowance for bad loans and a tax system which favoured borrowing). Competitiveness suffered from high and rising costs without parallel increases in productivity and Swedish industry remained specialized in capital-intensive basic goods subject to strong price competition (steel, paper) and without product differentiation or specialization in high-tech segments. See Lindbeck et al. (1994) for the responsibility of the welfare state from cradle to grave as the cause of Swedish problems.

1.3.1 Restoring balance

The short-run policy response was to bring costs into balance. The first element of this strategy was yet another devaluation of the Swedish krona, namely of 18 per cent versus the euro at the beginning of the 1990s. The second element in this direction was a discretionary fiscal stability package which amounted to 7.5 per cent of GDP and was negotiated between the government and the opposition Socialist Party. This consisted in part of rises in tax and in part of cuts in government expenditure. The budget cuts did include moderate cuts in benefits and transfers, but did not change the system in principle: higher incomes had to take a higher burden in the combined impact of tax increases and transfer deductions; thus both the opposition and the trade unions could accept the package. The government committed itself to long-term expenditure limits, with different targets for 27 expenditure categories (Brandner, 2003). The fiscal stability package, the long-term commitment to expenditure limits, the declining costs of the bailing-out of banks and a strong cyclical element inherent in Swedish budgets led to a switch from a deficit of nearly 10 per cent in 1993 into a persistent surplus over the past ten years (see Figure 1.2). The policy goal of government is now to have a surplus of 2 per cent for a full business cycle.

Wage moderation was tried – unsuccessfully at first – as a centralized bargaining outcome (Rehmberg moderation) which looked moderate as it was negotiated in 1991, but proved excessive in the second year. The next two-year contract for 1993–95 also proved ex post to be moderate,

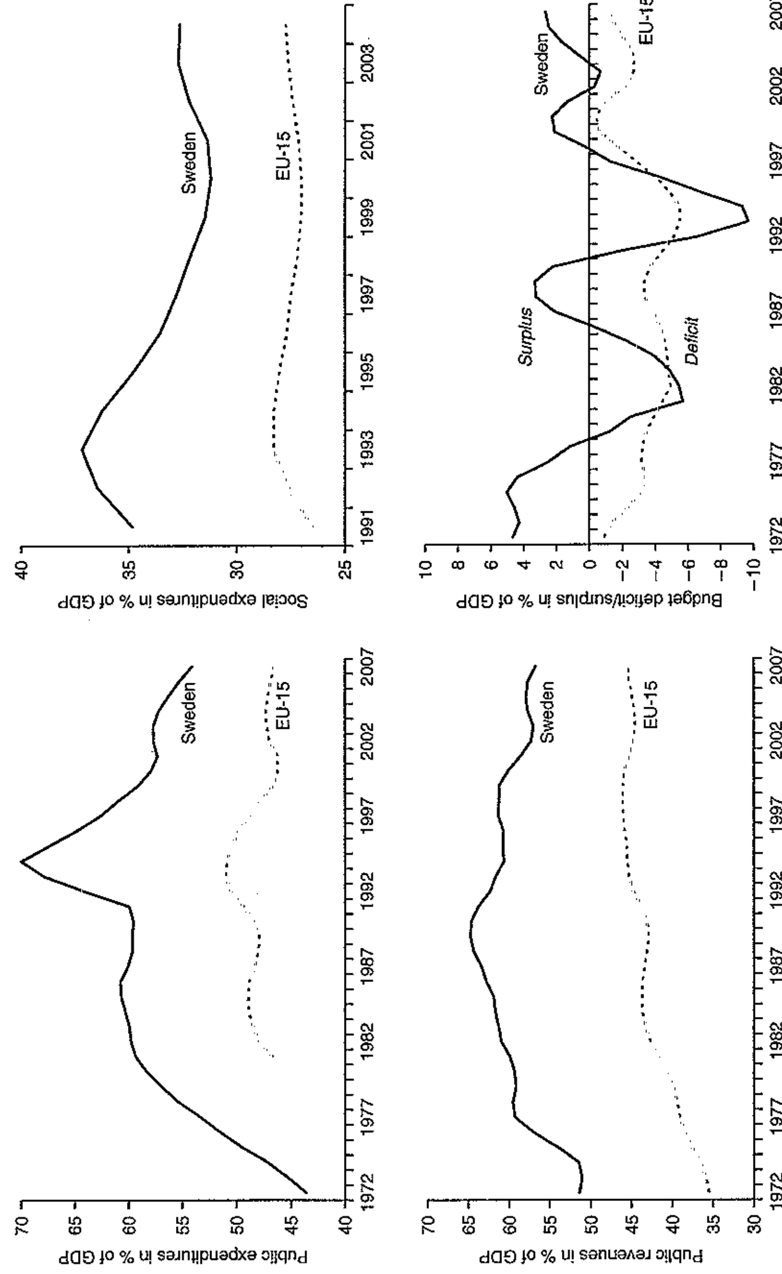


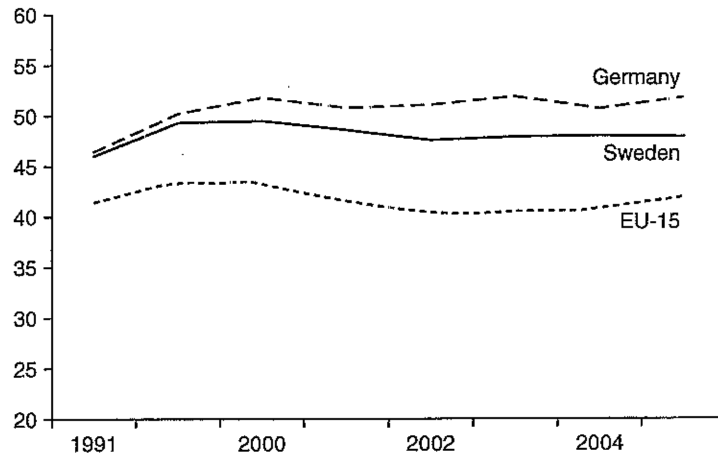
Figure 1.2 Fiscal restraint and fiscal prudence
Source: Eurostat (AMECO).

leading to the first decline in unit labour costs in post-World War II history (OECD, 1994, p. 39)

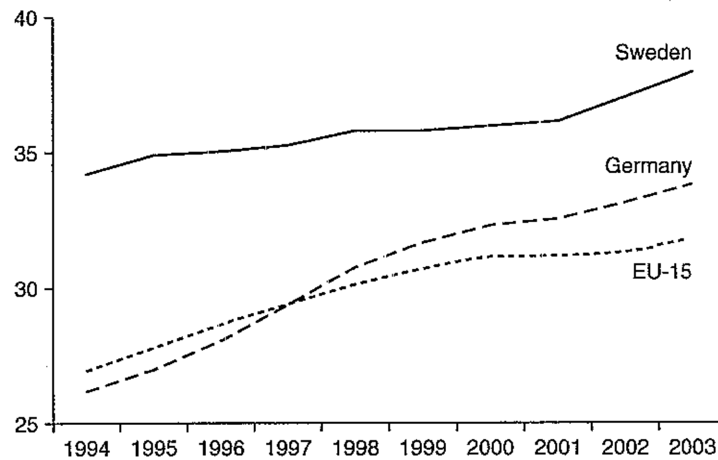
1.3.2 Changing incentives

Elements of welfare to work reforms were introduced. An active labour market policy and low capital taxes had long been constituent elements of the Swedish system (Marterbauer, 2001). Institutional reforms remodelled the competition and monetary authority with the goal that tough 'after-care' should ensure that this time the devaluation would prove successful in the long term. Labour market regulation, which had been slightly stricter than the European average in 1990, is now below the European average. The main changes related to temporary contracts, where tight regulation in 1990 was changed to one of the least regulated frameworks: the overall index for labour market regulation dropped from 3.4 in 1990 to 2.4 in 1998, the fourth lowest in Europe. The tax wedge (the difference between gross and net wages) is now lower in Sweden than in Germany (despite the generally high taxes) (Figure 1.3). Regulation of product markets had been less stringent in 1990, but further deregulation increased the difference compared to other European countries With the exception of the United Kingdom, Sweden now has the most deregulated product markets in Europe.

Regarding incentives, the responsibility for the first two weeks of sickness was transferred to employers (whose contribution to social security was reduced in turn). Compensation for the first day of sick leave was cancelled, sickness compensation which had been as high as 100 per cent, was reduced to between 65 per cent and 90 per cent depending on the length of insurance and supplementary insurance (OECD, 1994, p. 95). Replacement ratios for unemployment were reduced from 90 per cent to 80 per cent, the first five days remain uncompensated and work insurance assistance was reduced. In the public sector, transfers from central government to local governments were reduced if the local authorities increased taxes. Government agencies introduced competition, enforced contracting out, including social services and vouchers for private schools, and general practitioners were allowed to compete with public services in the health sector (OECD, 1994, p. 91). Municipalities took full responsibility for schools and care for the elderly, receiving lump-sum transfers from central government without monies being directed to specific services, thus increasing cost-consciousness as well as the ability to meet demand.



(a) Tax wedge: difference between gross and net wage



(b) Share of flexible contracts

Figure 1.3 Flexibility of labour

(a) *Note*: Tax wedge is defined as 'Income tax plus employee and employer contributions (as % of labour costs); labour costs = gross wage earnings less personal income tax plus employee social security contributions.'
Source: IFO Database for Institutional Comparisons in Europe (DICE)
(b) *Note*: Part-time plus fixed-term contracts as a percentage of all contracts
Source: Eurostat, EU Labour Force Survey and National Accounts.

1.3.3 Leader in research and ICI

Policies to enhance long-term growth included the development of pervasive and comprehensive programmes in order to promote information technology: the distribution of PCs for private use was made attractive by tax deductions, education expenses were enforced, alliances for electronic commerce were created and the use of ICI in government became compulsory. Sweden is today the European leader in information technology, having surpassed the US according to many indicators. It achieved this position and its lead in research by way of a consistent long-run government-assisted policy maintained during a severe crisis in the first half of the 1990s. High-tech schools and universities were established throughout the country; expenditures on education in Sweden have been the highest in Europe since 2001 and are increasing. The research/GDP ratio rose from 2.2 per cent in 1981 to 3.8 per cent in 1999. Research expenditures relative to GDP are higher than in the US and are among the highest in Europe. Sweden is ranked first in the set of 16 growth drivers. It had a good position already at the start, but enforced it to a larger degree than all other countries except Finland. It is among the top three countries in 15 indicators and leads in seven (Aiginger 2004b; see also Table 1.2).

Economic growth rebounded, and between 1996 and 2007 GDP growth was one of the highest in Europe. Particularly impressive has been Sweden's growth of output and productivity, with the strongest results in manufacturing, particularly in the telecom industries. Sweden is still a leading welfare state, and a high tax country. It has some features that might not be expected a priori from a country with strong government: corporate taxes are generally low, the labour market is flexible insofar as wages react to unemployment; pre-tax income differences are large (the smaller differences in final incomes originate from taxes and transfers). Sweden invests in active labour market policies, with carrot and stick strategies of obligations and training. The ratio of social expenditures to GDP declined – mainly as a result of reduced expenditure on passive measures since unemployment decreased – but are still 5 per cent above the EU average after a 10 percentage point difference in the early 1990s. The overall tax rate is above the EU average by 14 points, corporate taxes were decreased from 30 per cent to 28 per cent, and are 2.5 points below the EU average. The most impressive part of the strategy is the high and increasing investment in research, in education and in telecom expenditures (see Figure 1.4). The echo of the past devaluation is reflected in the below-European average real GDP per head.

Table 1.2 Investment into the future: Sweden surpasses the US (% GDP)

	1992	2006	1992–2006
Scandinavian model	13.3	15.6	2.3
Denmark	13.95	16 93	3.0
Finland	13 34	15 90	2.6
Netherlands	12 10	13 24	1 1
Sweden	14.70	18 16	3.5
Continental model	10 8	12.5	1.7
Germany	11.40	12 86	1.5
France	11.72	13.36	1.6
Italy	8.59	10.45	1 9
Belgium	11.58	13.71	2 1
Austria	11.16	13.71	2 5
Anglo-Saxon model Europe	11.9	13 3	1.5
Ireland	10.77	9 83	–0.9
United Kingdom	11 93	13 58	1.7
Mediterrean model	7.5	10 1	2.6
Greece	5.46	8.70	3.2
Portugal	9.02	12 20	3.2
Spain	7.61	10.02	2.4
Anglo-Saxon model Overseas	11.07	13.20	2.1
USA	11.07	13.20	2 1
EU-15	10.5	12 8	2.2
Japan	10.58	14.50	3 9
EU-15/USA	0 95	0.81	–0.14

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

1.4 The recurrence of some problems

Swedish growth is proving remarkably high and stable. Between 2000 and 2007 average annual economic growth amounted to 2.8 per cent. GDP per capita, which had been only 4 per cent higher than the EU-15 average in 1998 was again 8 per cent ahead in 2007. This is still far from the 30 per cent lead that Sweden had in 1960, but is nonetheless an impressive turnaround. Unemployment is at 6.1 per cent, slightly lower than the EU average (EU-15, 7.2 per cent) but far higher than the best-performing countries (Denmark, Netherlands,

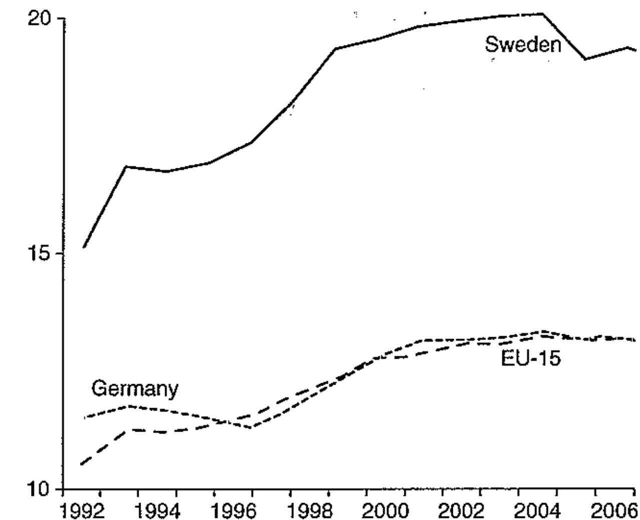


Figure 1.4 Investment into the future: expenditures in R&D, education and ICT as a percentage of GDP
Source: Eurostat, Structural Indicators

United Kingdom, Austria); youth unemployment, however, is one of the highest in Western Europe (Swedish Government, 2006, p. 52).

Thus it would be fair to say that some of the incentive problems in the comprehensive social system have not been solved and that more recently some have recurred. The OECD (2005) reports that:

- the employment rate – particularly among males – had not yet recovered to its 1990 peak, as a result of longer periods of education, late entry and low rates of immigration.
- Sickness and disability absences are much higher than in most OECD countries, mainly because sickness benefits are generous and easy to get.
- Unemployed people would get back faster to work if the unemployment insurance and Activity Guarantee Programmes were overhauled (and the 'last in first out' rule in dismissals was softened).

Now we have to recall that the OECD was always critical of Swedish economic policy, since it neither followed the free market approach, as propagated in the OECD Job Study, nor the usual recommendations

of the Paris Consensus (parodied as 'deregulate and wait' in Aiginger, 2006). But even admirers of the Swedish attempt to reconcile welfare with efficiency and full employment have to admit that keeping an economy with high social and ecological responsibility competitive needs a careful design of incentives at the margin, stringent incentives to work and offers to re-qualify. In other words a continuing reform is needed to encourage activity rates, lifelong learning and retraining. The goal to react quickly to changes in demand is of particular importance in a comprehensive social system.

Signs of strain are also showing in the budget balance. Though much better than in most other European countries, the structural surplus of the budget is below its target of 2 per cent of GDP in the 'best' years of the business cycle. The OECD calculates that Sweden has been about half a percentage point below its target for several years. Public sector reforms – though again admirable because of Sweden's top-down budget process and multi-year expenditure ceiling – do not rely on outside competition and benchmarks. Public financing still implies public production (OECD, 2005, p. 32).

As far as sickness and disability schemes are concerned, the old problem seems to recur. 'On a normal day nearly one fifth of potential work force is on sick leave or receiving a disability benefit' (OECD, 2005). The initially high sickness rate had declined as a result of, inter alia, shifting the financial load to firms and cancelling the payment for the first day off. But it returned to an all time high in 2006 (edging back in the business upswing). Government has set the target of halving the number of sick-listed people by 2008. Increasing the burden for firms (either by ensuring that they pay a share of the expenses, or by experience rating) will be one instrument; making extensions of sickness certificates more difficult (for instance not allowing this to be done by telephone) and encouraging a culture of mutual obligations are other possible solutions. Incapacity to work should not be focused on the ability to work in a particular job, but to work in general.

The unemployment insurance replacement ratio, which amounted to 80 per cent and is one of the highest in Europe, is to be lowered after 200 days, and after 300 days it will switch into a job or qualification guarantee. The precondition for unemployment insurance is raised from 70 to 80 hours of work per month and the period for meeting this minimum is extended to one year. Social contributions will be increased, with part-time workers paying the same amount as full-time workers. These changes follow the policy mix in Denmark (with more obligation and more offers to help). A carrot and stick strategy had been applied

very softly in Sweden up until now. This had prevented the reduction of unemployment to the Danish level.

1.5 Are there lessons to be learned for the new member countries?

Are there lessons to be drawn from this analysis for the development of the European socio-economic model? The first conclusion is that the European model is no barrier to competitiveness, so long as it is reformed in the direction of fostering change and growth and improving incentives and qualifications. This is clearly demonstrated by the Scandinavian countries, which now combine – after several crises, devaluations, unsuccessful fiscal consolidations – rapid growth, full employment and fiscal prudence with a comprehensive welfare system and a high priority for ecological concerns and fairness.

The second conclusion is that the successful countries had to undergo substantial changes to be able to adapt their particular versions of the European socio-economic model to the challenges of globalization. The reform strategy rested on five pillars: managed and balanced flexibility, making wages significantly higher than unemployment support or welfare subsidies and at the same time making welfare conditional on participation in government-sponsored training or retraining schemes, fiscal consolidation plus quality of government, fostering investment into the future and following a consistent long-run strategy, embedded in trust and strong institutions.

Third, as far as institutions were concerned, the Scandinavian countries always had more inclusive institutions, and less insider-outsider problems. They managed to maintain and to exploit this property: the coverage of collective agreements is increasing and trade union membership is stable, both in contrast to continental economies. The inclusiveness of institutions and the trust in society enabled these countries to deregulate contracts and to make use of part-time work and fixed-term contracts without increasing poverty and exclusion.

Our fourth conclusion is that quadripartite decision-making seems to be more open for radical change than bipartite policymaking, since at least two partners (government and experts) will represent general interests. And the strong position of firm representatives and of trade unions enables the countries to cope with the burden of change and with the reintegration of losers.

The fifth conclusion is that the burden of change is acceptable if it is derived from a positive vision and if the burden is distributed in a fair

way. Complex reforms – such as increasing flexibility and security at the same time – are feasible in trusting societies. Strong and inclusive institutions will mitigate the pressure from specific interests, thus preventing Olson's petrification hypothesis (Olson, 1986). In the ideal case they will help to foster externalities (for example, innovation, education, lifelong learning) thus making the economies more competitive.

Drawing conclusions from countries which have experienced a market-oriented welfare state for decades is of limited comparative value for countries which only fifteen years ago were run as planned economies in which government and institutions played very specific roles. It is even more difficult if we acknowledge the differences between the socio-economic models within 'old' Europe. Furthermore, we need to take into account the early success of the Scandinavian model, its demise in the 1980s and the early 1990s and now the resurrection after the crisis.

Nonetheless, there are some pointers towards what policy measures might be important for the further development of the 'catching-up model':

- institutions should be inclusive, avoiding a dichotomy between outsiders and insiders;
- specific positions in existing firms, industries and individual jobs should not be guaranteed; mobility, upgrading skills, finding new jobs should, however, be encouraged;
- part-time jobs, learning on the job, transition jobs between education and permanent jobs and sabbaticals should be encouraged. Part-time, entry and exit should be a choice and the jobs should be connected with social benefits (pro rata);
- microeconomic changes and willingness to adapt to new challenges need a high and stable macroeconomic growth rate;
- the role of economic policy does not decrease in periods of integration and globalization, only the instruments change. Enforcing activities with high external effects, such as innovation, education, lifelong learning and technological excellence becomes a priority;
- the burden of change is not equally distributed by market forces; those less trained, with lower skills and newcomers have to be assisted and re-qualified if they lose jobs.

A comprehensive welfare state is no barrier to change, but it needs permanent reforms to adapt the system and to encourage people to accept new challenges. The reformed European model is based on a trusting society, high mobility, a challenging environment and excellence in innovation and education. The new member countries need not follow a specific type of the model. Maybe the Baltic countries will follow the Scandinavian type, while Slovakia, Hungary, Poland and the Czech Republic might follow the continental type. But all can learn from the past problems and the new strength of the Swedish model.

Appendix 1.1 Towards a new European model

As regards institutional structures and policies, the strategies of the most successful European countries (Denmark, Finland and Sweden) show some elements which may encourage us to speak about a 'reformed European social model'. Some of the features of a new European model and its difference to the traditional model are summarized in Table A1.1.

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, but benefits are increasingly made contingent on certain obligations; replacement rates are lower than they used to be in order to provide stronger incentives to work but still remain high by international standards.
- 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; business taxes are relatively low as compared to personal taxes, and the tax wedge for low incomes is kept low.
- 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; 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 an inevitability preventing gender equality.

Table A1.1 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 jobs	Part-time work as individual choice (softened by some rules)
Early retirement	Encouraging employment for elderly workforce
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

- Technology policy and the adoption of new technologies, rather than the subsidization of old industries, are a precondition for the survival of the welfare state, and lead to more challenging and more interesting work.

The new European model 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 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 lifelong learning. Public institutions also provide the largest share of education and health care, which is open to all residents, and is 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.

Notes

1. The countries in the Mediterranean model group and those in the Anglo-Saxon countries in Europe came closest to the US, with GDP growth rates of 2.9 per cent and 3.0 per cent, mainly since the initial starting point was at a relatively low level of GDP per capita. This holds for Spain, Portugal, Greece and Ireland; the high growth of the United Kingdom can either be interpreted by the dynamics of a 'liberal model' or by geography (trade with the US, Scandinavia) or as a reflection of slow growth in the past decades.
2. This evidence on economic performance is based on four indicators. It is supported and expanded in Aiginger (2004a), 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.

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