European social model(s) and social Europe

Catherine Mathieu, Henri Sterdyniak

Document de travail

EUROPEAN SOCIAL MODEL(S) AND SOCIAL EUROPE

N° 2008-10
April 2008

Catherine Mathieu
Henri Sterdyniak
OFCE

EUROPEAN SOCIAL MODEL(S) AND SOCIAL EUROPE

Catherine Mathieu and Henri Sterdyniak, OFCE, Paris

Abstract

There seems to be a broad consensus in Europe that there is a European Social Model (ESM), typical of European societies and that this model should be protected and developed. But the ESM is an ambiguous notion: is it a simple description of the actual state of European societies? Is this a normative concept? Is it consistent with contemporary evolution marked by economic globalization and liberalization? Is this a political project?

Section 1 provides an assessment of 'the European Social Model'. This model has different patterns among EU-15 countries. The generally adopted classification (Esping-Andersen, 1990) sets out four social models in Europe: liberal, continental, Scandinavian and Mediterranean. Are the four models variants of a single ESM?

Section 2 compares their economic and social performances. The best economic performances are obtained by the Liberals and the Scandinavian countries; Scandinavian countries have also the best social performance. The economic performances of continental model countries are poor. Are they condemned to evolue to the liberal model, or can they move towards the Scandinavian model? Can this model be implemented in all larger open, heterogeneous and with high unemployment countries?

Section 3 discusses the need to adapt the ESM to new economic and social challenges: the ageing of populations, the rising trend in health spending, the change in family structures, the rising trend in social exclusion, the persistence of mass unemployment in some countries, of low fertility rates in some others. The section presents the actual debates, national or European, about reforms of pension system, health system, unemployment benefits, family policy and anti-poverty flight.

Section 4 presents the actual situation of 'Social Europe'. This expression may refer to the current actions of European Institutions. It may also refer to a political project: increasing gradually the level of Europe's intervention in social fields. But the objective may be to 'modernise social protection', i.e. to reduce its field and costs, or on the contrary to progressively implement common social norms in all Member States in order to reach a high and similar social protection level. The single market makes it more and more difficult for national protection systems to coexist. The respective roles of national and European institutions in the evolution of the ESM (or ESMs) are discussed. The current European strategy - the social Agenda and the Open method of coordination (OMC) – remains disconnected from national debates and reforms. Can they become more democratic and more powerful?

The conclusion presents two views on the future of the ESM. The first suggests a new architecture of welfare states in Europe, inspired by the Scandinavian model, so the impact of social protection as a productive factor increases. The second stresses the importance of guaranteeing social cohesion in the Member States, by reducing income inequalities and ensuring a high level of social protection. Yet, the improvement of the European economic framework and the development of the Social Europe are not technical issues. They require a major change in the economic policy thinking and a new alliance between social classes concerned about full employment and social cohesion.

Keywords: European social model. Social cohesion. Inequalities. Social protection.

JEL classification: H50, 130.

EUROPEAN SOCIAL MODEL(S) AND SOCIAL EUROPE *

Introduction

This text aims at providing an analysis of the European Social Model – or European Social Models(s) – and to draw future prospects for Social Europe. European societies are based on a compromise between on the one hand capitalism, private ownership and market strengths, and on the other hand, socialism, redistribution and public production. A substantial part of households' consumption is public (education, health); some risks are collectively insured (unemployment, health care, old-age, family, poverty); income redistribution is substantial through taxation and social protection. Labour legislation sets the framework of employment relations in the workplace, wage settings and dismissal procedures. There seems to be a broad consensus among EU (political or social) leaders that there is a European Social Model (ESM), typical of European societies and that this model should be protected and developed. But the ESM is an ambiguous notion (see Jepse and Serrano Pascual, 2005): is it a simple description of the actual state of European societies (which are diverse and evolving)? In this case, the concept has no specific content since it must encompass very different models, the UK, such as Sweden and Italy. Is this a normative concept: a market economy compatible with social cohesion, a minimum level of inequality, the social coverage of basic needs? Is this ideal scheme is achievable? Is it consistent with contemporary evolution marked by economic globalization and liberalization? Is this a political project? But what is its precise content? What are the social forces who support this project? Is that the goal of the European construction or a project among others?

Section 1 provides an assessment of 'the European Social Model'. This model has different patterns among EU-15 countries[1]. The generally adopted classification (Esping-Andersen, 1990) sets out four social models in Europe: liberal, continental, Scandinavian and Mediterranean. This disparity raises two questions:

- Are the four models variants of a single ESM? For instance, does the liberal model belong to the ESM?
- Should we put these four models on the same level or must we class them in terms of economic performances and social cohesion? What features of these models should be generalised in Europe or, on the contrary, abolished? Can we invent a European model that would pick out the best elements in all models or is it? Should European Institutions protect the national specificities or should they try to make the existing models converge?

In its "Golden Age" after World War II, Europe was a economic and social success story: Europe had substantially narrowed the gap in living standards vis-à-vis the United States; European welfare states combined strong growth, low unemployment and a solid social safety net in these years. Since the mid-1990s, Europe has performed rather poorly: Economic growth and productivity growth were lower than in the past and lower than in the US.

---

* This text is a development of the chapter "European Social Model(s) and Social Europe" of the Euroframe report of autumn 2007. Section 1 and 2 used the contribution of Güger, Leoni and Walterskirchen (2007).

[1] We discus here Social protection issues in the EU15 countries and do not deal with the New Members States issues.

Unemployment has been persistently high. In the last decade fact, economic performance was diverse: while both liberal market economies with a low level of state interference and the Scandinavian countries with high taxation and large welfare states performed well, large continental European economies fell behind. According to a widespread view, the continental model can be held responsible for the poor performances of the Euro area and needs to evolve towards the liberal or the Scandinavian model (see Sapir, 2005). Section 2 compares the economic and social performances of the different groups of EU countries, using economic (output growth, unemployment) and social indicators (poverty rates, income inequality). When social indicators are taken in account, the position of continental countries looks more positive, although remaining clearly below the performance of Scandinavian countries. What specificities of the continental model need to be corrected? Can the Scandinavian model be implemented in all larger open, heterogeneous and with high unemployment countries?

Section 3 discusses the need to adapt the ESM to new economic and social challenges: the ageing of populations, the rising trend in health spending, the change in family structures, the rising trend in social exclusion, the persistence of mass unemployment in some countries, of low fertility rates in some others. In face of rising trends in spending, should European models become more liberal, target social protection on the poor or should they remain universal, even if this would require some rise in contribution rates? How to combine social cohesion (hence low inequalities) and work incentives? How to raise female, older workers and socially excluded employment rates without increasing poverty among the unemployed? Should we make effort to increase the employment rates, at any cost, or should we use a part of productivity gains to reduce working hours? The section presents the actual debate, national or European, about reforms of pension system, health system, unemployment benefits, family policy and anti-poverty flight.

Section 4 presents the actual situation of 'Social Europe'. This expression is also ambiguous. It may refer to the current actions of European Institutions in social areas, which are limited by the subsidiarity principle and by European Treaties, where social issues remain mainly at the National level. It may also refer to a political project: increasing gradually the level of Europe's intervention, so that there will be a social Europe tomorrow like there is a monetary Europe today. But this project may try to 'modernise social protection', i.e. to reduce its field and costs to bring it more in line with the norms of a global world economy, or on the contrary to progressively implement common social norms in all Member States in order to reach a high and similar social protection level.

Section 5 deals with the respective roles of national and European institutions in the evolution of the ESM (or ESMs). The single market makes it more and more difficult for national protection systems to coexist: the EU has until now only organised the coexistence through systems coordination. There are three incentives for moving beyond: the functioning of the single market would be facilitated, European citizenship would be strengthened, risks of social competition would be reduced. But how move from systems based on domestic foundations to a European system? Are European citizens ready for a European solidarity?

Europe must choose between five strategies. The liberal strategy is to let social concurrence play. The sovereignist strategy aims to let each country to choose its social system. The strategy of social Europe seeks to promote social convergence with the gradual establishment of binding common social objectives. The strategy of the big bang seeks to explicitly organize a future fusion of national systems. The current European strategy to influence the evolution of the national socials systems - the social Agenda and the Open method of coordination (OMC) – is based on two non-binding pillars: the definition of common objectives and the exchange of good practices. But these procedures remain disconnected from national debates and reforms. Can they become more democratic and more powerful?

In conclusion, two views are presented on the future of the ESM. The first suggests a new architecture of welfare states in Europe, inspired by the Scandinavian model, so the impact of social protection as a productive factor increases. The second stresses the importance of guaranteeing social cohesion in the Member States, by reducing income inequalities and ensuring a high level of social protection, in particular for people who cannot work, because of their age, their handicap, their family situation or the economic situation. The disincentive effect of social protection is judged of second order and it is considered that rich countries can accept it. Yet, the improvement of the European economic framework and the development of the Social Europe are not technical issues. They require a major change in the economic policy thinking and a new alliance between social classes concerned about full employment and social cohesion.

1. From one to four models

The basic principle of the ESM is that society has to provide each individual with some basic goods and services (education, health) and that it should ensure everyone has a minimum vital income, that everyone is protected against some risks (sickness, unemployment, old-age), that some redistribution must be done in favour of some categories of the population (families, disabled people), that everyone can earn their living through a paid job, with decent working conditions and some degree of job protection. Labour Law and social dialogues regulate wage setting, relations in the workplace and lay-off procedures. By supporting social cohesion, by ensuring that important parts of the population are not durably excluded from the productive life, by ensuring a minimal level of education and health, by supporting compatibility between work and childcare, social protection is a productive factor. But, it necessarily weakens incentives to work and thus the size of the system is a delicate trade-off between fairness, social efficiency and individual incentives.

Should this trade-off change over time? According to a first view point, rising living standards should translate into lower work dependence; social protection should rise over time; productivity gains should pave the way for more leisure time and therefore economic inactivity. A rising share of economic inactivity should be financed through social protection: disabled people, old-age pensioners, child care. This trend took place until the early 1980's and has since then been reversed. Today's mainstream view is that work should pay and that people have both rights and responsibilities, that benefit entitlement needs to be conditional on duties towards the Society. Liberal ideas and globalisation constraints plead for reducing the weight of taxation. A major objective of the reform of social systems is to give people incentives to work and to work longer (workfare). Should social protection aim at ensuring that everyone has decent incomes or make sure that everyone is able to get decent earnings form their work? The issue is all the more delicate since most continental European countries still have a high level of unemployment: when the demand for labour is not sufficient, it is not useful to prompt to a sharp increase in the labour supply and unfair to penalize those who do not work

Social protection was originally highly connected with trade unions, and move progressively toward a universal coverage, more satisfactory in terms of social cohesion. Workers financially support the economically inactive, while at the same time the system provides insurance for active people (sickness, family, unemployment, pensions). The solidarity function was included in the social insurance system. But this system is fragile: workers may refuse to pay for the inactive and may prefer occupational systems.

Until the early 1980's, the ESM had also the objective of supporting economic growth and maintaining full-employment through fiscal and monetary policies. This ambition weakened in the 1980's when the reduction of inflation and macroeconomic stability became priority objectives in Europe, rather than full-employment that seemed impossible to maintain.

Social protection systems are extremely heterogeneous in the EU, which reflect different histories and different organisations of social relations. Each country manages risks in its own way. In the tradition of Esping-Andersen (1990), four models are generally considered:

- The Scandinavian (or Nordic or social-democratic) model is the most comprehensive one, with a high degree of emphasis on redistribution, social inclusion and universality. Uniform and relatively high level of social protection is entitled to all citizens, meaning that dependence of the individual on the market and on his work is lowest. They are complemented by occupational benefits agreed by social partners and covering almost all the labour force. A generous infrastructure of social services is designed to be both affordable and of high quality. High replacement rates of unemployment benefits and the health system are financed through the tax system. Taxation is very progressive while business taxes are rather low. Job protection is rather low but unemployment allowances are high with an active policy of reintegration in employment. Trade unions are strongly involved in the administration of unemployment insurance and training. The Scandinavian countries have been successful in generating high employment rates, especially for female and older workers ad at reducing gender inequalities in the labour market especially for female and older workers. A strong social dialogue and close cooperation of the social partners with the government characterise the countries that can be subsumed under this ideal-type (Denmark, Finland and Sweden).
- The liberal (or Anglo-Saxon) model emphasises the responsibility of individuals for themselves. A minimal social protection is afforded to the poor and is complemented by company or private insurance. Social transfers are smaller than in the other models, more targeted and "means tested". Accordingly, social policies usually cater to a clientele consisting of low-income groups. The state encourages market actors to co-provide services, and leaves recipients with the choice to opt between public and private providers. Private insurance and savings schemes are frequently supported by complementary state policies (e.g., tax credits, tax shelters). The labour market is not regulated; labour relations are decentralised and bargaining takes place primarily at the firm level. Unemployment allowances are low and only slightly over the subsistence minimum. Employment rates are high. Taxation is relatively low. The Anglo-Saxon model is typified in Europe by the United Kingdom and Ireland.
- In the Continental European model of social insurance: social protection is organised on occupational basis and aims at guaranteeing wage incomes. Accordingly, transfers are financed through employers' and employees' contributions. The redistributive efforts of the fiscal system are less pronounced than in Scandinavian countries. Social partners play

an important role in industrial relations and wage bargaining is centralised. The model includes strong job protection and generous unemployment allowances. The employment rate is relatively low. The tax-to-GDP ratio is high. This is the model in Germany, France, Belgium, the Netherlands and Austria.

- In the Mediterranean model, the low level of social transfers is partly counterbalanced by the strong supportive role of family networks. Families still play a significant role in the provision of security and shelter; these countries maintain some aspects of a paternalistic society, especially pronounced gender inequalities. If old-age benefits are high, family and anti-poverty benefits are low. Female employment rates are very low and the total employment rate is low. Job protection is very high but unemployment allowances are low. The Mediterranean group of countries includes Spain, Italy, Portugal and Greece.

Table 1.1. Social protection public expenditures

As a percentage of GDP

	1980	1990	1998	2006
Austria	26.9	28.2	30.0	29.5
Belgium	30.0	28.0	28.9	29.6
France	27.3	29.3	32.0	33.2
Germany	25.6	23.5	29.7	29.7
Netherlands	30.6	29.7	23.6	26.2
Average(1)	*27.0*	*26.2*	*29.8*	*30.5*
Greece	..	19.4	23.7	23.9
Spain	..	23.8 (2)	22.4	23.0
Italy	..	27.0	27.3	29.0
Portugal	13.4	17.3	21.8	27.5
Average(1)	..	..	*24.9*	*26.3*
Denmark	33.9	33.5	34.8	33.2
Finland	22.5	28.6	31.6	30.1
Sweden		42.5 (3)	37.6	35.9
Average(1)			*35.2*	*33.6*
Ireland	..	21.1	18.2	18.6
UK	22.6	21.7	24.3	26.4
Average(1)		*21.7*	*23.9*	*25.8*

(1) Weighted averages. (2) In 1995. (3) In 1993.
Source: Eurostat.

This breakdown into four models is not so clear cut when one looks at country level into more detail. Some countries have characteristics of both continental and Scandinavian countries (the Netherlands, Austria). Domestic specificities are very strong: for instance the Finnish pension system is very different from the Swedish one, although the two countries are generally considered as Scandinavian ones. France and Germany are continental countries, but they run different policies in many fields like family benefits. The UK health system is not typical of a liberal model.

The distinction needs to be refined according to the risk: relatively relevant for old age, much less relevant for family and health benefits. Systems have changed over time: health and family allowances have become universal in almost all countries; minimum incomes have been introduced in most continental countries.

Globally the differences between the four models remain (see Table 1.1). Social protection public spending amounts to 33% of GDP in Scandinavian countries, 30% in continental countries, 26% in Mediterranean countries and 23% in liberal countries. The Netherlands is the only country where the share of social protection spending has been significantly reduced. On the contrary, Portugal has converged towards continental countries and the share of social protection spending has risen in the UK.

An analysis of expenditure per function reveals divergences both between models and within models (see Table 1.2):

- Anglo-Saxon countries spend little on old-age pensions, continental countries quite a lot. The picture is more contrasted for other models. Italy spends quite a lot on pensions, Spain very little. Swedish spending on pensions differs widely from the Finnish one.
- Health spending is low in Mediterranean and Anglo-Saxon countries; high in continental ones.
- Incapacity benefits are high in the Scandinavian model, also in the Netherlands and to a lesser extent in Portugal and the UK. On the contrary, this category of expenditure is low in Mediterranean countries, in Ireland and in France.
- Family allowances are high in Scandinavian countries; this is also the case for continental countries (except for the Netherlands). By contrast, spending is low in Mediterranean countries.
- Unemployment allowances are high in the Scandinavian countries (despite low unemployment rates). This is the opposite in Mediterranean countries.
- Poverty benefits vary quite substantially within the models.

From 1992 to 2003 (table 1.3), the rise in social protection expenditure (by 1.7 percentage point of GDP) was due mainly to higher old-age spending (1.1 percentage point), health (0.5) and family (0.3) while the weight of unemployment spending, was diminishing (0.5).

- Old-age spending rose in almost all countries and especially rapidly in Portugal, in a catching-up process. It remained stable in the Netherlands while it hardly rose in Spain and decreased in Ireland, two high growth countries.
- Health spending rose rapidly in France, despite a rather high initial level, to a smaller extent in the UK and in catching-up countries (Greece, Portugal).
- Scandinavian countries and the Netherland have reduced significantly the level incapacity spending.
- Family spending rose in Germany and Italy whereas it was being reduced in Scandinavian countries.
- Unemployment spending declined in line with unemployment in Scandinavian countries, the Netherlands, Spain and the UK.
- Spending targeted at reducing poverty and social exclusion fall in Sweden but rose in France, the Netherlands and Greece.
- All in all, some elements of convergence emerged at the level of the risks, although domestic specificities remain.

Table 1.2. Social protection expenditures in 2003

As a percentage of GDP

	Total	Old-age	Health	Incapacity	Family	Unempl.	Exclusion
Austria	29.5	14.2	7.3	2.5	3.2	1.8	0.5
Belgium	29.7	13.2	8.0	2.0	2.3	3.7	0.5
France	30.9	13.4	9.4	1.5	2.8	2.4	1.4
Germany	30.2	13.0	8.4	2.4	3.2	2.6	0.8
Netherlands	28.1	11.3	8.8	3.1	1.4	1.7	1.7
Average(1)	*30.2*	*13.0*	*8.7*	*2.4*	*2.9*	*2.5*	*0.9*
Greece	26.3	13.4	7.0	1.3	2.0	1.5	1.2
Spain	19.7	8.5	6.0	1.5	0.6	2.6	0.3
Italy	26.4	16.3	6.8	1.7	1.1	0.5	0.1
Portugal	24.3	11.2	7.0	2.8	1.6	1.3	0.4
Average(1)	*23.8*	*12.9*	*6.5*	*1.7*	*1.0*	*1.4*	*0.3*
Denmark	30.9	11.5	6.3	4.2	4.1	3.0	1.8
Finland	26.9	10.0	6.8	3.6	3.1	2.7	0.9
Sweden	33.5	13.4	8.8	4.8	3.2	2.0	1.1
Average(1)	*31.1*	*12.0*	*7.6*	*4.3*	*3.4*	*2.5*	*1.2*
Ireland	16.5	3.8	4.2	0.8	2.6	1.4	0.9
UK	26.7	12.0	7.9	2.5	1.8	0.4	1.7
Average(1)	*25.9*	*11.3*	*7.6*	*2.4*	*1.9*	*0.5*	*1.6*
EU-15	**28.3**	**12.9**	**8.0**	**2.2**	**2.3**	**1.9**	**1.0**

(1) Weighted averages

Source: Eurostat.

Box 1: The difficulties of international comparisons

The differences in social protection systems make international comparisons difficult:

- Incapacity benefits are very widespread in some countries where they play the role of unemployment or early retirement allowances.

- Families can be supported through social benefits or tax allowances

- Childcare can be facilitated though social benefits or collective services (nurseries, pre-primary schools).

- In some countries (like in the UK) employees can chose to opt out public insurance if their employers provide a higher benefit

Table 1.3. Social protection expenditures in 1992

As a percentage of GDP

	Total	Old-age	Health	Incapacity	Family	Unempl.	Exclusion
Austria	27.0	12.9	7,5	1.8	2.9	1,4	0.5
Belgium	26.5	11.0	7.4	1.8	2.3	3.4	0.6
France	27.8	12.0	7.9	1.7	2.7	2.5	1.1
Germany	26.6	11.0	8.5	1.7	2.2	2.6	0.7
Netherlands	30.3	11.3	8.9	4.9	1.5	2.6	1.1
Average(1)	27.4	11.5	8.2	2.1	2.3	2.6	0.9
Greece	20.3	10.8	5.3	1.2	1.7	0.9	0.7
Spain	21.8	8.9	6.4	1.6	0.4	4.3	0.2
Italy	25.1	15.1	6.6	1.7	0.8	0.7	0.0
Portugal	16.5	6.7	5.6	2.4	1.0	0.7	0.1
Average(1)	23.0	12.0	6.4	1.7	0.7	2.0	0.1
Denmark	29.5	10.4	5.8	2.9	3.5	4.9	2.0
Finland	32.6	10.5	7.6	4.9	4.2	4.3	1.1
Sweden	37.7	13.8	8.6	4.0	4.5	4.3	2.4
Average(1)	34.3	12.0	7.3	3.9	4.1	4.5	1.9
Ireland	19.4	5.5	6.6	0.9	2.2	3.2	1.0
UK	26.7	11.5	6.6	2.5	2.3	1.9	1.8
Average(1)	26.1	11.0	6.6	2.4	2.3	2.0	1.7
EU-15	**26.6**	**11.8**	**7.5**	**2.1**	**2.0**	**2.4**	**0.9**

(1) Weighted averages
Source: Eurostat.

Models also differ in terms of degree of market regulation. From 1998 to 2003, product markets' regulation decreased in all countries, so that the ranking of countries in terms of regulation remained unchanged from liberal, Scandinavian, continental to Mediterranean countries (Table 1.4). The same ranking can be found in terms of labour regulation, with a less clear convergence.

Unemployment allowances are more generous in continental and Scandinavian countries than in liberal countries and less generous in Mediterranean countries.

Social models differ also in terms of tax structure (see Table 1.5). Direct taxation is low in liberal countries, high in continental countries, slightly less high in Mediterranean countries, where indirect taxation is more substantial; households' taxation is higher in Scandinavian countries, while company taxation is relatively low.

Table 1.4. Product and labour market regulation

	Product market regulation		Employment protection legislation			Unemployment net replacement rate
	1998	2003	1990	1998	2003	2004
Austria	1.8	1.3	2.2	2.4	2.2	73
Belgium	1.9	1.4	3.2	2.5	2.5	66
France	2.4	1.6	2.7	2.8	2.9	71
Germany	1.8	1.3	3.2	2.6	2.5	75
Netherlands	1.8	1.4	2.7	2.3	2.3	79
Average(1)	2.0	1.4	2.9	2.6	2.6	73
Italy	2.7	1.8	3.6	3.1	2.4	6
Greece	2.7	1.7	3.6	3.5	2.9	33
Portugal	2.2	1.7	4.1	3.7	3.5	72
Spain	2.1	1.5	3.8	3.0	3.1	52
Average(1)	2.4	1.7	3.7	3.1	2.8	29
Denmark	1.4	1.1	2.3	1.8	1.8	77
Finland	2.1	1.3	2.3	2.2	2.1	75
Sweden	1.8	1.1	3.5	2.6	2.6	77
Average(1)	1.8	1.2	2.9	2.3	2.2	76
Ireland	1.4	1.0	0.9	1.2	1.3	71
UK	1.1	0.9	0.6	1.1	1.1	66
Average(1)	1.1	0.9	0.6	1.1	1.1	66
US	1.3	1.0	0.2	0.7	0.7	29

(1) Weighted averages.
Source: OECD.

Table 1.5. Maximal tax rates in 2006

	Income tax	Corporate tax
Austria	50	25
Belgium	50	35.5
France	48.1	34.4
Germany	44.3	39,3
Netherlands	52	31.5
Average(1)	*47.0*	*36.3*
Italy	43	37.25
Greece	40	32
Portugal	42	22.5
Spain	45	35
Average(1)	*43.4*	*35.1*
Denmark	59.8	28
Finland	56.75	26
Sweden	56.5	28
Average(1)	*57.3*	*27.5*
Ireland	42	12.5
UK	40	30
Average(1)	*40.2*	*28.6*

(1) Weighted averages.
Source: European Commission.

Table 1.6 shows another typology, where social protection systems are broken down into: social insurance systems (benefits depend on contributions paid although there is also some redistribution), universal systems (entitlement to all citizens) and assistance systems (targeting the poor, income-tested). Besides public systems are complemented with more or less compulsory occupational systems, benefiting from tax incentives and relying more or less on public decisions and on private individual insurance systems (that benefit often from tax incentives). Each country is characterised by specific choices on each insured risk.

Table 1.6. Social benefits: A typology

	Assistance	Universal system	Social insurance	Occupational insurances	Private insurance
Pensions, long-term care, incapacity	Minimum pension	Flat pension Incapacity benefits	Pays-as-you-go systems	Company funds	Individual insurance
Family, Housing	Housing benefits, Minimum income	Universal benefits	Family tax credit or allowance		
Health	Free health care for the poor	Universal public system	Health insurance	Mutual insurance funds	Private insurance
Unemployment, Exclusion	Minimum income		Unemployment benefit		

By nature, the liberal model favours assistance systems complemented by private insurance systems. This raises the question of the level of assistance benefits and does not ensure social cohesion. The lower middle-class may turn out to be the looser, because it is not covered by social protection and pays relatively high tax and premiums. The continental model favours social insurance systems for pensions and unemployment, but these systems are complemented with assistance systems and universal systems (family, sickness, poverty). The Scandinavian model is based on universal systems complemented in practice by more or less universal occupational systems (for pensions). Disincentives to work are corrected by social control and activation policies in Scandinavian countries. The two models require the acceptance of a high level of taxation (which is easier in a homogeneous society, like in Scandinavian countries). The disparities between models make difficult to define 'the' ESM. On the other hand, it must have a specific content, if its evocation is not a fallacy. The debate on the content of MSE should be open, even if it is political and conflictual.

2. Economic and social performance of social models in Europe

2.1. Economic performances

European economic performance has deteriorated since the beginning of the nineties, compared with the past as well with the United States. Growth has been disappointingly low compared with the expectations raised by the European integration and the enlargement project. Many economists blame the high level of taxes and government expenditures, the degree of regulation, and the costs of welfare in Europe as main reasons for Europe's economic underperformance. Some emphasise the inadequacy of macroeconomic policies. Other authors emphasise the low level of investments in future (education, research, innovation).

Table 2.1. Economic performance

Real GDP growth (percent p.a.)	1970/2006	1970/1990	1990/2006
Continental Model	*2.3*	*2.7*	*1.9*
Germany	2.2	2.6	1.7
France	2.4	3.0	1.8
Belgium	2.4	2.7	2.0
The Netherlands	2.5	2.5	2.5
Austria	2.6	3.0	2.3
Mediterranean Model	*2.6*	*3.1*	*2.0*
Greece	2.8	2.3	3.1
Italy	2.3	3.1	1.3
Portugal	3.1	4.0	2.1
Spain	3.2	3.2	3.0
Scandinavian Model	*2.3*	*2.5*	*2.3*
Denmark	2.0	2.2	2.2
Finland	2.9	3.5	2.4
Sweden	2.1	2.1	2.2
Liberal Model	*2.5*	*2.3*	*2.8*
Ireland	5.2	4.1	6.7
United Kingdom	2.3	2.2	2.5
EU-15	**2.4**	**2.8**	**2.0**
United States	3.1	3.2	3.0

In the long run (1970-2006) there are rather small differences between social models in Europe: the best performers were countries with initial low level of GDP par capita (Greece, Portugal; Spain) rather than countries which belong to a particular model. During the 1970-1990 period, Continental model countries obtained the best results; Scandinavian and UK the worst. The situation had changed since 1990 (see Table 2.1): GDP per capita and real GDP growth was high in liberal and Scandinavian countries and rather low in Continental and Mediterranean countries. Is it an effect of the inadequacy of these models with globalization or a temporary failure?

It is not surprising that the catching-up process results in higher long-run growth for countries with a low initial level of GDP per head (e.g., Southern Europe, Ireland). Therefore we ran a regression of GDP growth on GDP level per head and calculated the per capita growth rate which could be expected for each country given its initial level of GDP per head in PPS (i.e., the convergence process). The difference between the actual and the 'hypothetical' growth rate per capita gives us an indicator of relative economic performance. According to this indicator, economic performance since 1970 has been the highest in Ireland and Finland; relatively weak in France, Greece and Denmark. Since 1990, the liberal and the Scandinavian countries outperform continental countries (but Austria has good outcome, France and Germany particularly bad), the Mediterranean countries have contrasting performances (bad for Italy and Portugal; good for Greece and Spain).

A cross-country diagram (see Figure 2.1) shows that countries with healthy social standards had a better economic performance. Although the Scandinavian countries display the highest level of state intervention, i.e. high taxes and large public social expenditures, these countries have performed very well in the last decade.

Employment rates (see Table 2.3) are closely related to economic performances. They are the highest in Scandinavia, followed by the Anglo-Saxon countries. Public services (child care etc.) largely explain the high employment rate in Scandinavia, they allow women to work and, in the same time, they create jobs. Marketisation of household services (low-wage service jobs) explains the high employment rate in the Anglo-Saxon countries. The classification in term of unemployment rate is practically the reverse, even if there are some anomalies, due to female activity: Sweden and France seem to have too many unemployed people; Italy and Ireland too few. In full-time equivalent employment rate, there is a gap of about 12.5% (16%) between Continental (Mediterranean) countries and Scandinavian ones.

Table 2.2. Economic performance

	Real GDP growth per capita (Percent p.a.)		Actual minus hypothetical real GDP growth per capita (Percent. points p.a.)	
	1970/2006	1990/2006	1970/2006[1]	1990/2006[2]
Continental Model	*1.8*	*1.4*	*-0.1*	*–0.2*
Germany	1.8	1.3	0.0	-0.2
France	1.8	1.3	-0.2	-0.4
Belgium	2.1	1.6	0.1	–0.1
The Netherlands	1.8	1.8	-0.1	0.1
Austria	2.3	1.8	0.2	0.2
Mediterranean Model	*2.3*	*1.6*	*0.0*	*-0.3*
Greece	2.2	2.5	-0.2	0.3
Italy	2.2	1.1	0.1	-0.6
Portugal	2.6	1.7	0.0	-0.5
Spain	2.4	2.2	0.0	0.2
Scandinavian Model	*1.9*	*1.9*	*0.0*	*0.2*
Denmark	1.7	1.9	-0.2	0.2
Finland	2.5	2.2	0.3	0.5
Sweden	1.8	1.8	0.0	0.2
Liberal Model	*2.2*	*2.3*	*0.1*	*0.4*
Ireland	4.1	5.1	1.6	3.0
United Kingdom	2.1	2.1	0.0	0.3
EU 15	**2.0**	**1.6**	**-0.1**	**-0.2**
United States	2.0	1.8	0.4	0.4

*Hypothetical growth is the rate which could be expected for each country given its initial level of GDP per capita, based on the following regression equations for 13 EU countries:

(1) $\Delta Y = 3.3103 - 0.5256 * Y_{ti}$

$R^2 = 0.66$ (13.3) (5.0)

1970/2006

(2) $\Delta Y = 2.9994 - 0.0799 * Y_{ti}$

$R^2 = 0.22$ (5.1) (2.1)

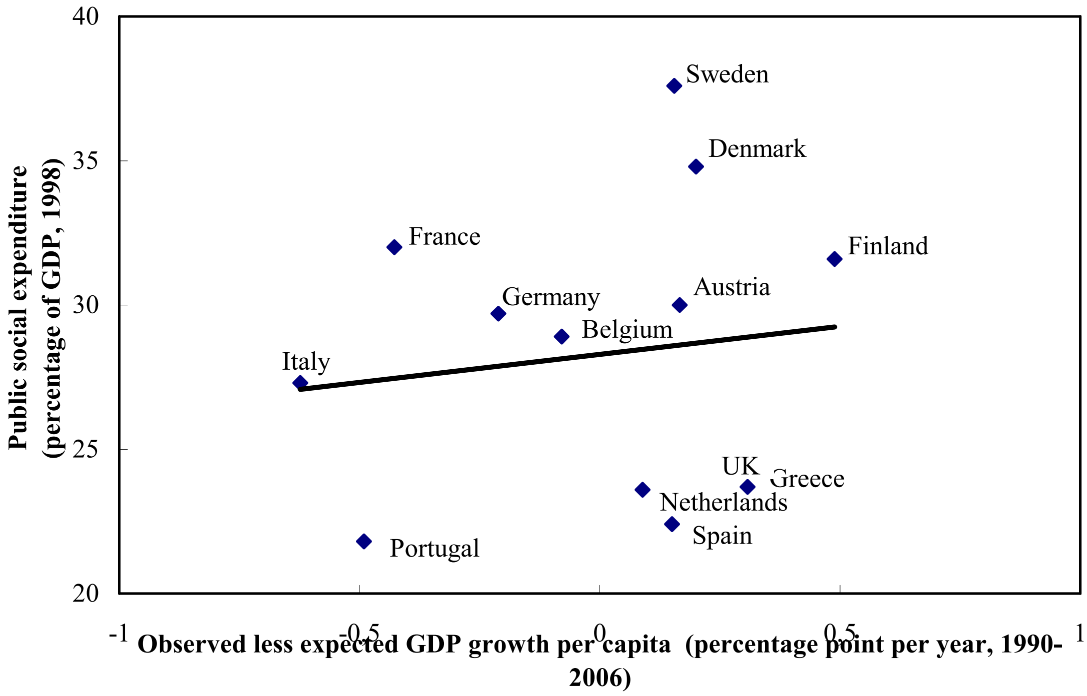
1990/2006

Y GDP per capita in 1,000 PPS, ΔY growth of real GDP per capita p.a.

EU15 countries except Ireland and Luxembourg

Source: Eurostat, OECD, WIFO calculations.

Figure 2.1. Public social expenditure and economic performance



Source: Eurostat, OECD.

Table 2.3. Economic indicators

	GDP per capita		Employment rate 2005		Unemployment rate
	1991	2006		Full-time equivalent	2006
Continental Model	*108.0*	*103.6*	*65.3*	*60.2*	*8.1*
Germany	109.7	102.1	65.4	60.4	8.4
France	104.9	99.1	63.1	59.7	9.4
Belgium	109.5	109.5	61.1	57.1	8.2
Netherlands	107.1	116.4	73.2	60.9	3.9
Austria	114.6	114.0	68.6	63.7	4.8
Mediterranean Model	*90.9*	*88.9*	*60.4*	*58.4*	*7.7*
Greece	67.5	78.9	60.1	59.2	8.9
Italy	106.0	92.2	57.6	55.5	6.8
Portugal	69.1	65.3	67.5	65.6	7.7
Spain	79.4	90.5	63.3	60.9	8.6
Scandinavian Model	*105.8*	*108.8*	*72.4*	*67.7*	*6.3*
Denmark	107.4	113.8	75.9	69.4	3.9
Finland	98.3	105.4	68.4	65.3	7.7
Sweden	108.9	107.6	72.5	68.0	7.0
Liberal Model	*92.9*	*109.4*	*71.4*	*65.3*	*5.2*
Ireland	77.3	129.7	67.6	64.6	4.4
United Kingdom	94.3	107.6	71.7	65.4	5.3
United States	**132.1**	**136.8**	**71.5**	**67.0**	**5,0**

Source: Eurostat, OECD.

Male employment rates are relatively low in Scandinavian and liberal countries because of the size of incapacity benefits (see Table 2.4). By contrast, female employment rates are very high in Scandinavian countries, while it is the opposite for Mediterranean countries, the UK and continental countries being in an intermediate position. Lastly older workers' employment rates are high in Scandinavian countries, low in continental countries and very low in Mediterranean countries (and also in Belgium and Austria). Mediterranean countries are thus characterised by a specific social choice where employment is focused on adult males. This choice is not sustainable with low fertility rates and demographic prospects in these countries. Moving towards the Scandinavian model becomes a necessity. Older workers' low employment rates may also be viewed as a social choice (like in Austria), which should be respected or as the pernicious effect of persistence of wrong economic choices made in times of high unemployment rates.

Table 2.4. Activity indicators (2005)

	Activity rate			Part-time rate
	Male 25-54	Female 25-54	55-64	
Continental Model	*93.3*	*79.4*	*46.6*	*19.9*
Germany	93.6	79.1	52.1	21.8
France	93.8	80.7	43.6	13.6
Belgium	91.8	76.8	33.5	18.1
Netherlands	91.4	77.8	47.0	35.7
Austria	92.8	79.9	33.0	16.2
Mediterranean Model	*92.8*	*67.5*	*39.6*	*12.5*
Greece	94.7	68.1	43.1	6.1
Italy	91.7	64.6	32.6	14.7
Portugal	92.5	81.8	53.8	9.8
Spain	92.4	69.0	45.9	11.4
Scandinavian Model	*91.5*	*85.5*	*65.8*	*14.2*
Denmark	91.1	84.1	62.9	18.0
Finland	90.3	85.2	56.4	11.2
Sweden	92.4	86.5	72.8	13.5
Liberal Model	*91.0*	*76.9*	*58.0*	*23.2*
Ireland	92.2	69.6	53.2	18.6
UK	90.9	77.5	58.4	23.6
United States	90.5	75.3	62.9	12.8

Source: OECD.

Activity rates have risen noticeably in Continental and Mediterranean countries in the last decade (Table 2.5), although the potential labour force has already started to decline in some countries (Germany, Greece, Italy). Unemployment rates have therefore hardly declined. Labour productivity growth has been slow in continental Europe as compared to Scandinavian or liberal countries, but it is difficult to disentangle the effect of slow technological progress from the effect of economic policy measures introduced to increase the number of unskilled jobs.

Table 2.5. Economic performance 1996-2006, in % per year

	15-64 Population	Activity rate	Unemploy-ment rate	Employment	Productivity	GDP Growth
Continental Model						
Germany	-0.3	0.7	0.0	+0.4	+1.1	+1.5
France	0.5	0.3	-0.2	+1.0	+1.2	+2.2
Belgium	0.3	0.5	-0.1	+0.9	+1.3	+2.2
Netherlands	0.6	0.7	-0.2	+1.5	+0.9	+2.4
Austria	0.7	0.0	0.0	+0.7	+1.6	+2.3
Mediterranean Model						
Greece	-0.1	0.9	-0.1	+0.9	+3.2	+4.1
Italy	-0.1	0.9	-0.4	+1.2	+0.2	+1.4
Portugal	0.3	0.7	0.0	+1.0	+1.1	+2.1
Spain	0.6	1.9	-0.9	+3.4	+0.4	+3.8
Scandinavian Model						
Denmark	0.2	0.2	-0.2	+0.6	+1.5	+2.1
Finland	0.5	0.4	-0.7	+1.6	+2.1	+3.7
Sweden	0.4	0.1	-0.3	+0.8	+2.2	+3.0
Liberal Model						
Ireland	2.5	1.2	-0.7	+4.4	+2.6	+7.1
United Kingdom	0.8	0.1	-0.2	+1.1	+1.7	+2.8
United States	1.4	-0.1	-0.1	+1.4	+1.8	+3.2

Source: European Commission, OFCE calculations.

The contemporary growth theory insists on the crucial role played by human capital accumulation and by the diffusion of knowledge on the medium-term growth rate of advanced economies. Accordingly, it can be argued that the capability to support the growth of human capital and of productivity is an acid test for the welfare state. Investments into the future may be an important reason for diverging economic developments. High investment in R&D, ICT, education and infrastructure are crucial for long-run economic development. R&D expenditure has been particularly high and strongly increasing in Scandinavia, but it has been surprisingly low in Ireland. In Germany, R&D ratios have been relatively high, but slightly decreasing. Most countries of Southern Europe have been lagging behind with respect to their use of information technologies (Table 2.6). Recent research has highlighted the vital role played by the first years of life for future cognitive development. Spending on the youngest groups of population can be scrutinised on its own account. The share of GDP that goes to child care and pre-primary education is considerably higher in Scandinavian countries and in France than in the other European countries (Table 2.6).

Table 2.6. Growth drivers: Investment in the future

	Expenditure on R&D	IT expenditure	Youth education attainment level[1]	Public expenditure for pre-primary care
	2005	2005	2005	2005
	percent of GDP		percent	Percent of GDP
Continental Model	*2.3*	*3.3*	*77.3*	*0.7*
Germany	2.5	3.1	71.5	0.4
France	2.1	3.4	82.6	1.2
Belgium	1.8	2.9	81.8	0.8
Netherlands	1.8	3.9	75.6	0.5
Austria	2.4	3.0	85.9	0.6
Mediterranean Model	*1.0*	*1.8*	*69.1*	*0.5*
Greece	0.6	1.2	84.1	0.4
Italy	1.1	1.9	73.6	0.6
Portugal	0.8	2.2	49.0	0.8
Spain	1.1	1.7	61.8	0.5
Scandinavian Model	*3.4*	*3.9*	*83.5*	*1.3*
Denmark	2.4	3.4	77.1	1.6
Finland	3.5	3.7	83.4	1.4
Sweden	3.9	4.4	87.5	1.3
Liberal Europe	*1.7*	*4.0*	*78.8*	*0.6*
Ireland	1.3	2.0	85.8	0.2
United Kingdom	1.7	4.2	78.2	0.6
EU 15	**1.9**	**3.1**	**74.6**	**0.7**
United States	2.7	4.0	–	*0.7*

Source: Eurostat. OECD, Family and Education Database [1] Percentage of the population aged 20 to 24 having completed at least upper secondary education.

Indicators on working conditions highlight the role played by human capital in the performance of European socio-economic models. Qualitative indicators support the view that Scandinavian countries come closest to achieving the aim of creating not only more, but also better jobs (Table 2.7). Whereas in Mediterranean countries only 67% workers share the opinion that they are learning new things at work, among countries belonging to the Scandinavian group almost 90% workers have a positive view of their learning curve on the job. Both Anglo-Saxon and Continental countries are between these two extreme positions, with the Netherlands as outliers that come close to the Scandinavian group. There is a strong correlation between the responses to this question and the findings with respect to the amount of training undergone by workers. Again, however, there are significant differences across countries, with the Scandinavian group at the top and Mediterranean countries at the bottom of the distribution. A similar, although less clear-cut pattern results from the answers to the question whether or not workers feel that they are able to apply their own ideas at work. Further evidence on job quality comes from cross-country differences in the share of workers who think they will be able to carry out the tasks associated with their current job at a later stage in life. On average, 70% of workers in Scandinavian countries believe that they are able to do the same job when they are aged 60. The equivalent proportion is lower in Anglo-Saxon and Continental countries. In Mediterranean countries, only 55% workers think that their current employment is suitable for older persons. These results correlate highly with satisfaction levels with working conditions.

Table 2.7. Qualitative indicators of employment situations

	Job content and training			
	Paid training in previous 12 months	Learning new things	Able to apply own ideas in work	Able to do the same job when 60
	Percent of total responses			
Continental Model	*28.0*	*71.7*	*58.7*	*63.0*
Germany	25.3	66.1	49.8	73.6
France	24.4	72.3	64.5	48.6
Belgium	40.5	74.4	64.1	52.3
The Netherlands	31.6	83.6	70.8	72.1
Austria	37.5	76.8	60.2	59.9
Mediterranean Model	*17.1*	*66.8*	*58.1*	*55.0*
Greece	13.1	61.9	56.8	40.5
Italy	16.9	71.9	58.4	59.9
Portugal	15.1	69.1	62.1	45.7
Spain	18.9	60.0	57.3	53.5
Scandinavian Model	*46.3*	*88.4*	*70.5*	*69.2*
Denmark	36.3	86.4	72.0	68.8
Finland	52.6	90.0	64.3	65.2
Sweden	51.0	89.3	73.1	69.7
Liberal Model	*38.5*	*69.2*	*59.7*	*62.7*
Ireland	37.3	76.9	68.1	53.2
United Kingdom	38.6	68.6	59.0	63.5
EU 15	**27.4**	**70.5**	**59.2**	**60.8**

Source: Fourth European Working Conditions Survey (2005); WIFO calculations.

2.2. Indicators of social performance

The political target is not only high economic performance, but also high social and environmental performance (Lisbon strategy). We chose a number of indicators to explore this (Tables 2.8):

1. Life satisfaction is the highest in Scandinavian countries (and in the Netherlands); it is the lowest in Mediterranean countries (and in France)

2. An improvement in life situation was particularly felt in the Scandinavian countries, as well as Ireland and Spain. In the other Mediterranean countries and in Continental countries (except the Netherlands) people are more pessimistic.

3. Income inequality: Scandinavian countries show the more equal income distribution. Mediterranean and liberal countries the more unequal[2].

4.Poverty rates are significantly higher in liberal and Mediterranean models, significantly weaker in Scandinavian countries.

5.Life expectancy is lower in the Anglo-American countries than in other countries (except in Denmark).

[2] It should be noted however that in the last decade, the performance of Scandinavian countries have deteriorated. The ratio between the income of 20% richest and the income of the 20% poorest increased from 3.0 to 3.4. In liberal countries, it rose from 5.0 to 5.5. On the contrary, it declined from 4.5 to 4.0 in Continental countries and from 6 to 5.6 in Mediterranean countries.

Tables 2.8. Social indicators

	Life satisfaction		Income inequality D80/D20	Poverty rate	Life expectancy	Infant rate mortality per 1.000
	2007	2007-1996	2005	2005	2004	2004
Continental Model	*72*	*2*	*4.0*	*13*	*79.1*	*4.1*
Germany	72	–6	4.1	13	78.9	4.1
France	64	1	4.0	13	79.6	3.9
Belgium	78	19	4.1	15	79.1	4.3
Netherlands	94	33	4.0	11	78.5	4.1
Austria	69	9	3.8	12	79.2	4.5
Mediterranean Model	*55*	*7*	*5.7*	*19*	*79.6*	*3.9*
Greece	34	–10	5.8	20	78.3	4.1
Italy	49	–3	5.6	19	80.2	4.1
Portugal	24	–16	8.2	20	77.5	4.0
Spain	76	32	5.4	20	79.7	3.5
Scandinavian Model	*93*	*48*	*3.6*	*11*	*79.2*	*3.5*
Denmark	94	51	3.5	12	77.3	4.4
Finland	88	36	3.6	12	78.7	3.3
Sweden	94	52	3.3	9	80.3	3.1
Liberal Model	*78*	*25*	*5.6*	*19*	*78.5*	*5.1*
Ireland	82	58	5.0	20	77.9	4.9
United Kingdom	78	23	5.6	19	78.5	5.1
EU 15	**70**	**10**	**4.7**	**16**	**79.2**	**4.1**
United States	-	-	-	-	77.5	6.9

	Fertility rate	Hours worked by year	Productivity by hours	Prisoner rate per 100.000	Trust in people
	2005	2004	2005	2005	
Continental Model	*1.59*	*1.443*	*98.3*	*97*	*0.31*
Germany	1.34	1.443	94.1	97	0.33
France	1.94	1.441	101.5	88	0.21
Belgium	1.64	1.522	110.7	90	0.29
Netherlands	1.71	1.357	105.7	127	0.59
Austria	1.40	1.550	85.1	108	0.31
Mediterranean Model	*1.33*	*1.695*	*75.0*	*115*	*0.30*
Greece	1.33	1.925	70.8	90	0.20
Italy	1.31	1.585	77.4	97	0.32
Portugal	1.40	1.694	50.3	123	0.10
Spain	1.35	1.799	76.7	143	0.35
Scandinavian Model	*1.79*	*1.586*	*85.9*	*77*	*0.63*
Denmark	1.80	1.454	87.8	77	0.64
Finland	1.80	1.736	81.5	75	0.57
Sweden	1.77	1.585	87.3	78	0.64
Liberal Model	*1.79*	*1.667*	*86.7*	*139*	*0.29*
Ireland	1.86	1.642	104.1	85	0.35
United Kingdom	1.78	1.669	85.2	143	0.29
EU-15	**1.58**	**1.565**		**109**	**0.32**
United States	2.09	1.824	100	738	0.36

Source: EIRO; OECD; UNDP.

6.Infant mortality - an indicator of the efficiency of the health system – is substantially higher in liberal countries. Denmark seems to have a specific problem.

7. The fertility rate is very low in the Mediterranean countries (as well as in Germany and Austria). It is higher in the Scandinavian countries and liberals (and in France). From this point of view, the continental model is not homogeneous.

8. Hours worked: It appears that high GDP per capita in liberal countries is largely due to a high number of hours worked. Peoples work less in Continental Countries.

9.On the contrary, **Labour productivity per hour** is relatively high in continental countries, relatively weak in Mediterranean ones.

10 Prisoners: The share of prisoners is very high in the United States, and also relatively high in the United Kingdom. It is very low in Scandinavian countries.

11. Trust in people is more common in Scandinavian countries (and in the Netherlands) than in other countries. This shows that the Scandinavian model is based on social practices that are deeply rooted in peoples' minds and that it may be difficult to extend it to other countries where such practices are not a tradition (Algan and Cahuc, 2006)

Globally, it appears a clear hierarchy of social performances: the Scandinavian countries are the betters; then, come the Continental countries; the Mediterranean and Liberals countries are less performing.

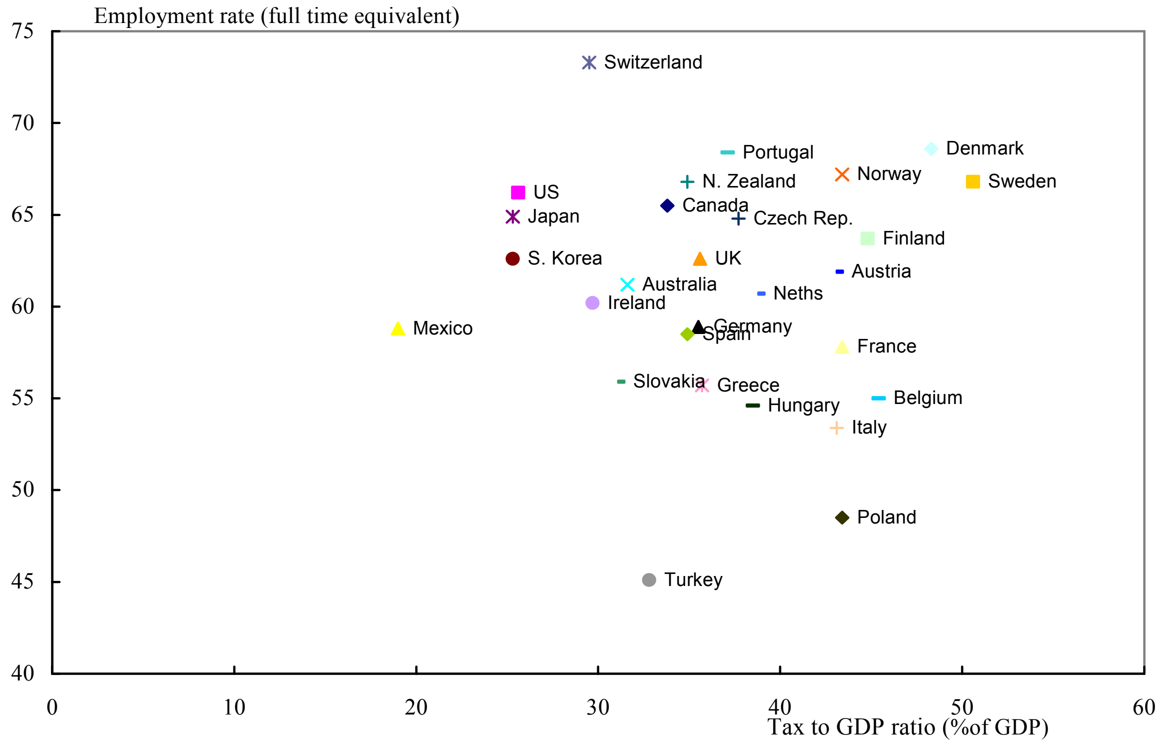
2.3. Social model and competitiveness

What factors may explain differences between these models in terms of growth and employment? Is the weight of social contributions on wages a factor? But such social contributions have a counterpart in terms of benefits and hence allow for lower wages. Moreover, as can be seen from Figure 2.2, high employment rates cannot be associated with low tax-to-GDP ratios. Similarly, there is no link between GDP growth and the weight of social protection in terms of GDP.

The two extreme model types, namely the liberal Anglo-Saxon model and the Scandinavian universalistic model have shown the best economic performance. The first model type would be in line with the hypothesis of blaming the welfare state, the second contradicts this hypothesis. The worst performance is seen for the Continental model and the Mediterranean family-oriented model, which produced low growth and high unemployment.

The liberal Anglo-American countries showed a slightly better performance during the last decade than the Scandinavian countries and a much better one than the continental European countries. However, regarding social indicators, these countries are lagging behind.

Figure 2.2. Employment rates and taxation rates (in 2003)



Source: OECD.

Two models have reached a low unemployment. The liberal model is characterized by a low labour protection, low levels of taxation, low unemployment benefits and low expenses for labour market policy. Flexibility has prevented the emergence of mass unemployment, but not the increase in inequality.

The Scandinavian countries and Austria having the highest taxes and the largest public social expenditure performed very well in economic terms during the last decades. Blaming the welfare state for low growth and weak competitiveness in the EU is not justified. The assumed trade-off between competitiveness and social justice (or efficiency and redistribution) is questionable. Economists insists on the financial burden of transfers and social services, but forget the individual and social costs of exclusion and social inequality, particularly in terms of public safety, health and labour productivity. Social cohesion, education, health and cooperative industrial relations are productive resources. Social protection can be an asset in providing education and training, facilitating labour mobility, and disconnecting the wage costs and living standards of unskilled labour. Solidarity or individual risk-taking is a matter of preferences, not of economics. The European countries have not condemned to converge towards the liberal model (See also Fitoussi, 2000). .

The Social Democratic model is characterized by high tax rates and public expenditures. These countries are highly egalitarian and homogenous; the role of trade unions is important. The flight against unemployment passed through social cohesion, work sharing, and a high of consensus between the social partners; social negotiations centralised and co-ordinated. In addition, their small size and their degree of openness promote consensus among social partners on the need of a competitiveness strategy: high spending in education, R & D, market labour flexibility.

The Scandinavian countries were able to reform their institutions and incentives in a way to be competitive in the globalising economy (after years of under-performance). They have made their economies more flexible, while maintaining a strong security to workers by high benefit. . The resulting growth has enabled them to reduce deficits and debt. The same adaptability has not been achieved in the large countries of continental Europe. But most importantly they implemented a strategy of excellence in innovation, education and technology diffusion. The same adaptability is not to be seen in the big continental European countries.

Three elements of success may therefore be found from the experience of Scandinavian countries: the employment legislation and unemployment allowances rules which bring together a certain flexibility, significant benefits and retraining efforts ; the role of social partners in face of shocks affecting an industry or the economy, a sector or a firm; the importance of economic innovation and education.

Continental countries may have failed because of their inability to design a model able to adapt to globalisation, a model between the liberal model, source of inequalities, which their people do not wish, and a Scandinavian model that would not be easily implemented in large heterogeneous countries with no tradition of co-management between social partners and with high unemployment rates.

The dominant class has not tried to protect the European social model, but took the opportunity of globalisation and single market to try to impose structural reforms in continental Europe, as reductions in public and social spending and labour market flexibilization (Mathieu and Sterdyniak, 2007). Without macroeconomic, social and economic consistent strategy, continental countries appear as the losers of globalization and European integration and globalization, when the Scandinavian countries and liberals do better..

To varying degrees and with specific manners, the successful countries give a great importance to individual activity, whether for liberal reasons (everyone must assures its needs) or Social Democrats ones (everyone must make a contribution to the society). On the contrary, the axis of the continental social model is that the society must provide a decent income for all those who can not assure their own needs. Workfare theses become popular more than welfare ones.

At the EU level, the situation is not easy to manage. The continental model represents 50% of GDP in the EU-15, Mediterranean model 24%, but these two models are in crisis. The liberal model represents 20% and the Scandinavian model only 6%? At the EU level, the situation is not easy to address. Successful countries will not be willing to change their model and the convergence towards Scandinavian or Liberal models cannot be a choice made at the EU level. How then to encourage a change in the Continental or Mediterranean model?

3. ESM, financial constraints and new challenges

3.1 Six challenges for the Member States

The European Social Model faces six challenges: financial sustainability, globalisation, the crisis of the continental model, too low fertility rates, social changes and reforms of the funding.

1) How can the financial sustainability of the system be ensured? The pressures for higher

spending on health, old-age benefits, old-age care and fight against exclusion are almost unavoidable. They have structural causes:

- Population ageing generates a rise in pensions, health and long-term care spending.
- The rising trend in health spending is explained partly by population ageing and also by technological progress that allows for longer life expectancy but does not generally reduce the level of spending.
- The decrease in fertility rates - and thus of the number of young people - reduces the need for family benefits, especially as the number of children per family decreases, and for education spending, but the young need more education to acquire higher skills and many countries (like Germany, Italy, Spain, etc) are considering policies to increase fertility and family incentives.
- Rising female activity increases the number of families with two wage-earners and reduces the number of poor families, but implies that there is a need for substantial childcare financial support. Social evolution leads to a rise in the number of single parent families in need of support.
- The improvement in the labour market situation may allow for lower unemployment and assistance allowances but may require costly measures in order to bring people back to work (in terms of training, social contributions cuts, etc…).

How this rise in spending needs be addressed? Four global strategies may be considered.

- The first strategy consists of cutting progressively the level of benefits, for instance by indexing them to prices only or by reducing reimbursement rates for medical expenses. The drawback of this strategy is that it will lead to an uncontrolled reduction of the size of the welfare state. For instance, would it be fair that the relative situation of families or the poor is worsened? The reliability of the welfare state would be damaged without any alternative solution being socially and politically decided.
- A second strategy consists in maintaining the Welfare state, with a stabilisation of replacement rates, social minima and family benefit to wage ratios, etc. In the health area, the government, medical workers and patients would have to implement a social supervision of reimbursed spending, based on medical evaluation. As concerns pensions, the retirement age would have to increase so that the ratio of number of years in retirement/number of years at work remains stable. Such a strategy would maintain social cohesion in Europe. It may imply some rise in contributions paid by active people (for pensions and unemployment) and by all households (for health and assistance), but companies' competitiveness would not be affected and tax harmonisation in Europe should allow countries to tax their residents.
- The third strategy consists in breaking down social protection into two sectors: one sector would remain public (assistance, family and unemployment benefits) at its current level. A second sector (pensions, health) would be transferred to individual or occupational private insurances, which would allow tax-to-GDP ratios to decrease. But private health insurances may select risks and deny reimbursement of some expenses. Private health insurances would thus need to be closely supervised, be mandatory and requested to reimburse a certain basket of health care. There is no certainty that private insurance is less costly than public insurance. In the long term, private pension funds will be less costly than public funds if the rate of return of invested funds is clearly above the GDP growth rate augmented by the rate of increase of the number of years in retirement. But the transitory

phase would be costly for generations who would have to pay for older generations while simultaneously accumulating assets to provide their own pensions. There would be a gain only in the long run.

- The fourth strategy would consist of targeting social protection towards the poorer (like in the Anglo-Saxon model) and letting the market play for the rest of the population. However a two-speed framework raises issues: the wealthiest and the employees of large companies would benefit from a good insurance, while employees in small companies, employees with short-term work contracts and the socially excluded would have to rely on national solidarity. The middle class would lose in that system, because they would have to pay both for themselves and the poor while the sustainability of the system would be uncertain: ‘benefits for the poor are poor benefits’. There is a risk that the system deteriorates in losing the support of a substantial part of the population.

A solution seems to have reached a consensus view today and allows, effectively or fictively to avoid choosing between the four strategies, by raising substantially employment (for older workers and females in Southern economies). This solution would provide a double dividend in terms of old-age, unemployment and exclusion benefits and would give rooms for manoeuvre in terms of health and long-term care. This strategy however raises several issues: it often focuses on bringing unskilled workers back to work in a situation where supply for unskilled labour exceeds demand, at the risk of increasing unemployment and reducing wages of that group of workers. Rising demand for unskilled labour has a cost in terms of lower social contributions. Can this strategy be implemented through work incentives? This would mean increasing the gap between assistance and work incomes, which is often obtained by cutting assistance benefits thus in increasing the poverty risk for those who cannot find a job. For instance, it is often suggested that the retirement age should be made neutral from an actuarial point of view to give older workers an incentive to work until 65. Instead of getting a pension of 750 euro if they retire at 60, workers would be offered the possibility to get 900 euro if they decide to retire at 65 or 600 if they retire at 60. This would increase the income gap between workers, depending of whether they can or cannot work until they are 65 (e.g. between managers and manual workers). The same issue arises for the disabled and women with children. Should social benefits be reduced for economically inactive single mothers with young children or for families with one worker, although they are already the poorer households? Thus, in general, work incentives should increase workers’ incomes, for instance in increasing the offer of free childcare, rather than in reducing the incomes of those without a job, but this would strongly reduce the financial returns of the measure.

2) Could ESM survive in a global world? The answer could be positive only if social protection is not a handicap but also a factor of higher productivity and competitiveness. Social cohesion arising from the reduction of incomes inequalities, from public education and health should raise productivity, through avoiding that a large part of the population is left apart and becomes a financial weight for society. Job stability must be an incentive for companies to invest in workers and for workers to invest in their company. However, social protection, implemented in a national framework, is challenged by globalization and European construction. Globalisation tends to dismantle national societies, which reduce solidarities, both national than between salaries. Incomes inequalities rise: the wealthiest do not want anymore to pay for the poor, high skilled salaries for the unemployed; companies do not wish to locate their production in countries where social protection is too generous. Due to globalization, the rich, the managers and the companies can more easily avoid the burden of

social protection. Lastly the Internal Market places EU countries in direct competition and increases the risk of a race-to-the-bottom in social and taxation areas. In the absence of tax coordination in Europe, the possibilities of national redistribution could be reduced. For instance all countries have been obliged to abolish personal wealth taxation. Should Europe protect the EMS or be a Trojan horse for its dismantlement? But, how to manage a heterogeneous Europe where the trade-off between economic growth and social cohesion varies across countries because of both their economic situation and their history? In the future, Europe may have to choose between the liberal model, the preservation of national models through tax and social coordination or the progressive introduction of a European model.

3) The continental ESM is facing strong criticism, accused of being too costly, too protective, damaging work incentives and preventing flexibility and innovation. Must continental model resign itself to its erosion by the gradual but continuous degradation of benefits relative to wages? The liberal model (full employment through economic constraints and flexibility) raises fears while the Scandinavian model (full employment with solidarity) seems difficult to extend to large, open and heterogeneous economies where unemployment is high. Abolishing employment protection could reduce one of the main advantages of the ESM: the investment in workers in their companies, the interest for companies to train their employees. Should we abandon the objective of income equality and the fight against poverty in order to increase the work incentives? There is a great risk to accentuate the social division and to recreate a class of poor peoples with no hope of seeing their children out of poverty.

4) Should the decrease in fertility rates be accepted and possibly lead to increased immigration or should measures be taken to stop the decrease through helping childcare for mothers who stay at home and/or work? Should child poverty be reduced, through financial support for mothers who do not have a job (the poorer) or through work financial incentives (work being the best insurance against precariousness). Should family policies focus on the poorer (in order to prevent child poverty) or should they benefit all families (to support fertility)? Should benefits be in kind or cash? The experience of Scandinavian countries and of France shows that it is possible to raise female employment rates and fertility rates through a generous family policy and socially organised and financed childcare.

5) Social protection systems need to adapt to sociological changes (gender equality, couples instability). But should the measures in favour of women (like reversion pensions) be abolished, although women still have lower wage earnings and employment rates than men? Should social benefits and taxation become individual, which could be a work incentive for women but would make redistribution less accurate? With the actual fertility situation in Europe, it is not envisage undertaking a reform of taxation and benefits which would be detrimental to families with children.

6) How to finance social protection? Initially in Bismarkian countries, social protection was linked to wage-earning and thus financed by employers' and employees' contributions. Social protection has now become universal as concerns health and family. Health and family benefits should therefore be financed by general taxation, while unemployment and old-age allowances should be financed by contributions, insofar as these allowances are linked to contributions. There are thus economic justifications for reducing the share of social benefits financed by wages, especially for lower wages. It is not justified that contributions levied on activity incomes finance family or health benefits, as in most continental and liberal countries

(see Table 3.1).

Table 3.1. How main risks are financed in the EU-15

	Health (in kind)	Old-age	Unemployment	Family	Work injury
Belgium	SC+AI	SC+AI	SC+AI	SC+AI	Ass.
Denmark	AI	AI + SC (supplementary)	SC	AI	SC
Germany	SC	SC + Gov	SC	AI	SC
Greece	SC + Gov	SC + Gov	SC	SC	SC
Spain	AI	SC	SC	AI	SC
France	SC + AI	SC + AI	SC	SC + AI	SC
Ireland	AI	SC	SC + Gov	AI	SC
Italy	SC +AI	SC +Gov	SC	SC	SC
Neths	SC +AI	SC +AI	SC	Gov	—
Austria	SC	SC	SC	SC+Gov	SC
Portugal	Gov	SC	SC	SC +Gov	Ass.
Finland	AI	SC + AI +Gov	SC +Gov	Gov	SC
Sweden	Gov	SC + Gov	SC + Gov	Gov	SC
UK	SC + Gov	SC	SC + Gov	Gov	Gov

Notes: SC means funding through social contributions, AI: funding through affected tax, Gov: funding through the general budget or permanent government grant.

Source: MISSOC, European Commission.

This being said, more resources remain to be found to compensate for the reduction of contributions based on wages.[3] Four suggestions can be made.

1. A part of the burden may be transferred from workers to old-age pensioners or people with financial incomes through personal income taxation (like with the French CSG). However, pensions are expected to be cut in most EU countries and it would be difficult to add a tax increase. It would be more interesting to investigate an increase in financial incomes taxation, but the amount of potential new resources is limited.
2. VAT is deductible from investment and thus weighs only on labour. Transferring social contribution to VAT would therefore have no favourable impact on the capital/labour relative cost. In the short run, the main effect is a gain in price competitiveness since VAT weighs on imports and can be deducted from exports. It is a sort of hidden devaluation, allowing for competitiveness gains paid by rising inflation. The risk is that, following the example of Germany in 2007, EU countries introduce the same king of non-cooperative strategies, without any net advantages.
3. A contribution on added value (like the Italian IRAP) would be a tax levied on companies' value added, without export and investment deductibility and impacting on imports. The transfer of employers' contributions to a contribution on value added would raise the cost of capital and decrease labour costs which could have a positive effect on employment in countries with mass unemployment. But it is a delicate

[3] This point has been widely debated in France in 2006 (see Bernard *et al.*, 2006).

strategy which would be positive for labour intensive sectors but detrimental to capital intensive sectors.

4. Environmental taxation could provide a double dividend, in supporting employment and fighting against the deteriorations of the environment. The double dividend will be obtained only in countries in unemployment situation. The reform supposes costly adjustments by firms. It would strongly affect some sectors that could be tempted to relocate in countries with lower environmental taxation. It thus requires coordination at least at the EU-level.

Table 3.2. Taxes, as a percentage of GDP in 2005

	Labour	Capital	Environment	Consumption
Belgium	23.8	10.4	2.4	11.3
Denmark	24.8	9.6	5.8	16.1
Germany	22.3	6.4	2.5	10.1
Ireland	10.5	8.8	2.3	11.4
Greece	14.1	8.4	2.3	12.0
Spain	16.1	10.2	2.0	9.8
France	23.3	9.4	2.4	11.4
Italy	20.4	10.1	2.8	10.1
Netherlands	17.7	8.3	4.0	12.1
Austria	23.3	6.7	2.6	12.1
Portugal	14.7	6.6	3.1	12.8
Finland	23.3	6.9	3.0	13.7
Sweden	31.1	7.0	2.9	13.1
UK	14.4	11.1	2.5	11.4

Source: Eurostat.

3.2. Pension reforms

Many national reforms of pension systems have already been introduced in the EU in order to address the issue of ageing populations. In general, the strategy of raising social contributions has not been chosen. The strategies implemented include cuts in pension benefits, (often through abolishing the indexation to wages), postponement of retirement age or increase in the number of years of working life requested to be entitled to a full pension, and sometimes the introduction of a notional fund which guarantees that pension systems are automatically in balance. Pension reforms have often been complemented by the introduction of a pension fund, mandatory or favoured by tax incentives.

Cuts in pension benefits and notional funds generate considerable uncertainty on the future level of pensions. According to the projections collected by the Commission (see table 3.3), pensions cuts will be especially large in Germany, Austria, France, Italy, Portugal and Sweden. Is this socially acceptable? There is a strong risk that old-age pensioners will be tomorrow among the poorer as this was the case in the past. Only France and Sweden recognise this cut in pensions (see Table 3.4). Some countries announce they will compensate for lower pensions through the development of pension funds (Germany, Denmark, Italy). In other countries, the announcements show some inconsistency (Austria).

Most countries announce that their pension systems will be in balance owing to a strong rise in female employment (Spain, Belgium, Italy) or older workers (55-64) employment (Austria, Spain France, Italy), but these countries have not launched reforms that would promote for such rises in employment: reforming family policy and childcare and organising mobilisation of social partners.

Table 3.3. Change in public pensions as a percentage of GDP, according to the Commission

	Pension benefits, % of GDP**		Explicative factors, of which:			
	2005	2050	Trend 2050	Employment rate impact	Number of pensioners impact	Replacement ratio effect
Germany	11.1	13.0	18.6	-1.2	-0.6	-3.8
Austria	13.2	12.2	24.5	-1.4	-6.2	-4.6
Belgium	10.4	15.5	18.1	-1.6	-0.4	-0.6
Denmark	9.6	12.8	16.8	-0.4	-3.0	-0.6
Spain	8.7	15.7	21.1	-2.0	-2.5	-0.8
Finland	10.3	13.7	19.2	-1.0	-3.5	-1.0
France	12.8	14.8	21.5	-1.0	-2.0	-3.7
Ireland	4.6	11.1	12.5	-0.6	-1.5	0.8
Italy	14.3	14.7	25.8	-2.1	-3.5	-5.6
Netherlands	7.4	11.2	13.7	-0.2	-1.8	-0.5
Portugal	11.5	20.8	25.2	-0.2	-1.0	-3.2
Sweden	10.4	11.3	15.2	-0.6	-0.2	-3.0
UK	6.7	8.6	11.4			
EU-15	**10.5**	**12.8**	***18.7***	***-1.0***	***-1.8***	***-3.1***

Source: European Commission.

Table 3.4. Replacement rates at the average wage level

	2004			2050		
	1st pillar	2nd pillar	GRR/NRR	1st pillar	2nd pillar	GRR/NRR
Germany	43	0	43/63	34	15	48/67
Austria	64		65/80	69		69/84
Belgium	39	4	43/67	37	10	47/74
Denmark	45	4	48/71	39	24	64/76
Spain	90		90/97	85		85/92
Finland	57		57/63	54		54/64
France	66		66/80	49		49/63
Greece	105		105/115	94		94/106
Ireland	31	35	67/78	34	33	67/78
Italy	79		79/88	64	16	80/92
Netherlands	30	42	71/93	30	45	75/97
Portugal	75		75/91	70		70/92
Sweden	53	15	68/71	40	15	59/62
UK	17	50	66/82	19	50	69/85

Note : GRR: gross replacement ratio; NRR: net replacement ratio.
Source : Social Protection Committee (2006)

Reforms also apply to early retirement schemes (where new entrants are not allowed) and incapacity schemes (that are tightened). There is a risk that income inequalities increase among pensioners and that some pensioners - especially manual workers - become poorer if older workers' employment rates do not increase. Giving work incentives for older people may generate difficulties for the 55-64 year-old jobless and those working in declining sectors. It may also introduce strong inequalities between those who will be able to work longer and those who will have to retire earlier (manual workers, workers in declining sectors). Thus such a strategy requires specific schemes for given groups of workers (manual workers).

Is it necessary to implement today policies to cut public spending in order to have rooms for manoeuvre to pay tomorrow's pensions? This is the strategy implemented by Belgium, the Netherlands, Denmark and Spain. Finland and Sweden have chosen accumulating in public pension funds. Pension funds have a strong role in the UK, the Netherlands and Ireland. But this is no more an option for other countries where demographic deterioration is already under way. Countries like Germany, France or Italy did not have a so strong private demand to undertake fiscal consolidation strategy.

Table 3.5. Net public debt, as a percentage of GDP

	Level, end 2006	2006-1995
Germany	52	+20
Austria	42	-4
Belgium	77	-28
Denmark	7	-29
Spain	48	-21
Finland	-61	-57
France	43	+5
Greece	87	-4
Italy	95	-3
Netherlands	52	-18
Portugal	47	+22
Sweden	-16	-41
UK	42	+3

Source: Eurostat.

In the field of pensions, the Commission started to intervene in the framework of the Broad Economic Policy Guidelines (BEPGs). The objective was to avoid a rise in public pension expenditure, which could have increased government deficits and debt. Since July 2001, countries have been requested to provide projections on the long-term impact of demographic prospects in their Stability Programme. The Barcelona Council of March 2002 also invited MS to try and postpone the average effective retirement by 5 years by 2010. In 2002, the BEPGs requested the MS to 'move towards a greater reliance to funding' and to reduce public debt from now. The creation of the Social Protection Committee (SPC) and the introduction of the Open Method of Coordination(OMC) may be seen as an answer by social affairs ministers and DG Employment and Social Affairs to the attempts of the economics and finance ministers and the DG-ECFIN to address social protection issues, especially pensions.

However, even if the Commission warns on the risk that some countries may be tempted to finance pensions through government deficits, countries are well aware that their pension systems should be in balance. With all countries being committed to ensure that their systems are financially balanced (through postponing the retirement age, cutting benefits or raising contributions), the future of pensions does not threaten public finance stability. It is not easy to understand why the future of pensions should be addressed each year in the stability programmes, especially as this framework for fiscal and cyclical developments is not appropriate to tackle long-term social issues. However, the *joint report by the Commission and the Council on Adequate and Sustainable Pensions* of December 2002 includes twice the note (note 13, page 43 and note 16, page 59) saying 'Member States strategies to ensure sound and sustainable public finances are reported and assessed in the framework of the BEPG and the Stability and Growth Pact and should be in accordance with these.' Pensions contributions having a direct counterpart in terms of pension benefits should not be included in tax revenues (although the report says explicitly the opposite, page 68). They do no reduce *a priori* work incentives. For a worker, they constitute an investment in profitability (rate of growth of wage bill plus rate of growth of years in retirement) that may be compared to financial assets profitability. There is no economic justification for disconnecting totally these two types of savings, one being negative: contributions, the other one being positive: pension savings. The level of social contributions must be considered independently of the objectives of lower tax to GDP ratios, the level of pensions must be disconnected from public spending cuts.

The introduction of the OMC led to a first joint Report in December 2002. This report has three main objectives: ensuring financial sustainability of pension systems, ensuring the adequacy of pensions modernising pension systems. The report is less normative than BEPGs recommendations, reflecting the interventions of social affairs ministers. However the strategy is based on four pillars: using coming years to reduce public debt; promoting employment for the 55-64 year old; postponing the effective retirement age by 5 years; reducing the level of pensions paid by pay-as-you-go systems, making them more contributory and with higher actuarial neutrality through linking them more to years worked and age of retirement; developing pension funds.

The option of increasing contributions is rejected without any discussion. But the Report insists also on the need to ensure that pensioners do not fall into poverty, by ensuring incomes floors and on the need to ensure adequate replacement ratios. The Report recognises the need to ensure decent pensions to workers who have seen their career interrupted, or have worked part-time (which is in contradiction with the third pillar). The report recognises several risks: indexing pensions to inflation induces a risk of rising pensioner poverty, having too low pensions would not be socially sustainable. The report recognises that pay-as-you-go pension system should remain the main axis of the system. Here also some contradictions remain. The Social Protection Committee has been able to include very relevant indicators in the list of pension adequacy indicators, like pensioner poverty rates and replacement ratios ensured by the pension system.

Table 3.6. Two indicators of pension adequacy in 2004

	PT	PL	HU	AT	DE	FR	NL	SI	SK	IT	CZ	SE	EL	FI	ES	BE	UK	DK	IE
A	109	109	101	95	92	90	88	87	85	84	83	80	79	75	75	73	72	70	65
B	63	59	61	67	45	66	43	42	55	58	51	58	49	46	56	42	..	..	43

A) Relative income of 65+ in %; B) Replacement ratio in %.

In 2005, the BEPGs were transformed into a set of ‘24 integrated guidelines for employment and growth’. Three guidelines address the pension issue. Guideline 2 asks countries to tackle the issue of population ageing in reducing their public debt (but this ageing generates a rise in savings ratios, hence a higher demand for public bonds), to reform their pensions and health systems (i.e. to cut benefits) and last to increase employment rates. Guideline 17 reaffirms the objectives in terms of employment rates, especially the objective of 50% for workers aged 55-64. Guideline 18 suggests increasing the labour supply of older workers through the modernisation of social protection systems, i.e. in abolishing early retirement schemes, in reducing pensions in case of early retirement, in giving financial incentives to postpone retirement age. This induces three risk: increasing poverty among older workers if companies do not want to hire them, cutting the total level of pensions, increasing inequalities between blue-collar workers (who will have no choice but to leave their job early) and managerial workers (who will have the opportunity to work longer and to save in pensions funds).

In 2006, the joint report on social protection and social inclusion of 2006 highlights 5 issues: the definition of a minimum income for old people, the introduction of a close correlation between contributions and benefits, the lengthening of working life through more flexible retirement conditions, the development of private pensions, governance. The joint report of 2007 observes that most countries anticipate substantial falls in replacement ratios that will need to be offset through a longer working life or the development of private systems.

The golden age of retirement is finished in Europe. The risk is that financial constraints will progressively induce a strong decrease of pension/wage ratio in European countries, so that a higher proportion old people will be in poverty. The chosen strategy – the rise in older workers’ activity- is only part of the solution. In accordance with the logic of the ESM, countries should introduce pensioner minimum incomes above the at-risk-of-poverty line, and should ensure that replacement ratios are satisfactory (at least for low and middle wage earners), that specific measures apply to manual workers and that the postponement of effective retirement age accounts for the effective employment of older workers.

3.3 Health systems

Public health spending amounted to 6.4% of GDP in the EU-15 in 2005 – varying from 5.1% in Greece, 5.8% in Italy, 6% in Germany and 7.7% in France. According the Commission’s projections, they will rise to 8.1% in 2050, i.e. by 1.7 percentage point. Table 3.7 shows that there is no single relation between life expectancy and public spending. Life expectancy is high and health spending low in some countries (Italy, Greece, Cyprus, Malta) while spending is high for intermediate results in terms of life expectation in other countries (France, the Netherlands). Public health spending is low in the NMS but life expectancy is shorter in these countries than in the “old” members states.

All countries face similar problems. What is the rise in expenditure requested to match populations’ needs and the rise which is attributable to a bad governance of the system resulting from information asymmetry and wasted money? How to curb down the rise in health spending without affecting the poorest: nationalising or privatising, two speed system, spending control, rise in the share of spending paid by the patients as a disincentive to consume medical goods and services. How to control suppliers?

In the recent past, countries have tried to cut spending in several areas:

- In many countries, general practitioners have a gate-keeper role; their income depends on the number of patients they have and not on the number of consultations. Some countries have maintained a less costly public service. In both cases the risk is that the richer can get round the system in paying for practitioners outside the system, which lead to a two-speed system.

- Some countries are introduced a medical control of spending.
- Other countries let competition play between health funds (see CPB (2007) on the Dutch case and Sowa (2007) on NMS). But this is an area where competition is a delicate issue (selection risk, problem of asymmetry of information).

Table 3.7. Life expectancy and health spending

	Life expectancy in 2004-Men	Life expectancy in 2004-Women	Health expenditure per head, PPS
Sweden	78.1	82.4	2171
Italy	77.3	83.2	1548
Spain	76.6	83.4	1285
France	76.2	83.4	2267
Greece	76.4	81.4	1210
UK	76.4	80.9	2016
Cyprus	76.3	80.8	732
Austria	76.2	82.1	1910
Germany	76.1	81.7	1963
Netherlands	76.2	80.8	2388
Malta	76.2	80.7	749
Belgium	75.5	81.6	2017
Ireland	75.5	80.7	2012
Finland	75.3	81.9	1647
Luxemburg	75.0	81.4	2704
Denmark	75.2	79.6	1664
Portugal	74.2	81.0	1174
Slovenia	72.6	80.2	1321
Czech Rep.	72.4	78.8	1055
Poland	70.5	78.5	435
Slovakia	69.7	77.8	677
Hungary	68.5	76.8	827
Lithuania	66.5	77.6	400
Estonia	65.5	76.9	449
Latvia	64.9	77.6	269

Source: Eurostat.

Table 3.8. Main features of health systems in the EU

Germany	Decentralised system managed by health Funds, practitioners' associations and hospital groups. Health legislation is public. Spending is high.
Belgium	Public universal insurance. Free access to health care. 22% of spending paid by patients. Ceiling of spending to be paid by patients. High spending and high rise in spending. Introduction of an objective of rate of growth of spending.
Denmark	Universal insurance. Free hospital spending. Health care are managed by regions. 16% of spending paid by patients.
Ireland	NHS supplemented by a voluntary private insurance system (covering 44% of the population. 22% of spending paid by patients. Insufficient supply.
Greece	NHS supplemented by a private insurance system. 46% of spending remain paid by patients.
Spain	NHS supplemented by a private insurance system. GP gate-keeper. 23% of spending paid by patients. Spending is relatively low.
France	Health insurance, universal coverage and supplementary insurance. Free access. High and rising spending. Annual target for spending growth.
Italy	NHS, regionalised plus supplementary insurance. GP gate-keeping. 20% of spending paid by patients. Plan of rationalization.
Portugal	NHS and supplementary insurance. 29% of spending paid by patients. High spending.
Sweden	NHS managed by regions and towns. GP as gate keepers. 13% of spending paid by patients. High spending.
UK	NHS, free health care but long waiting time.
Netherlands	Compulsory private insurance in competition, but under regulation. High spending.
Finland	NHS managed by municipalities. GP as gate-keepers.
Austria	Health insurance, almost universal coverage with GP as gate-keepers. 26% of spending paid by patients. Relatively low spending.

In the field of health and long-term care, the OMC should allow the exchange of experience and 'good practices' in order to improve health and reduce costs. Three objectives must be simultaneously achieved, according to the Barcelona European Council of March 2002: equal access to health for everyone, high level of health quality, long-term financial sustainability. The joint report by the Commission and the Council 'Supporting national strategies for the future of health care and care for the elderly', March 2003 justifies Union's action for three reasons: health policies must comply with the internal market rules of free movement of persons, of goods and of services and free provision of services (but are these worries crucial in the health area?), the EU has a responsibility in the area of public health (Article III – 278, Treaty establishing a constitution for Europe). Last the EU must monitor the long-term sustainability of public finances (but countries should be allowed to raise their health expenditure if households agree to finance the rise). The 2004 Communication tries to make a link between health and employment, insisting on health problems for people at risk of social exclusion, employment in the health and long-term care sectors.

The 2007 Communication summarises the first year of the OMC. All countries commit themselves to entitling the access to all for adequate care, but in practice they ask for a rising share of spending to be paid by patients, even if there are cases with 100% payment and expenditure ceilings. The share of non covered health spending is higher than 30% in Portugal, Austria, the Netherlands, Latvia and Greece (48%), Cyprus (52%). Long-term care should be professional (and not left to families and women) and its funding should increase and become autonomous and guaranteed. Insufficient labour supply appears in some countries (nurses and other workers in the health sector). In some countries health supply is insufficient which generates waiting times and rationing. Some countries find they spend too much on health. But the OMC does not really address the issue of the diversity of health systems, their governance, the appropriate methods to reduce cost. Until now there have been non EU strategy promoted for health. There is a strong contradiction between recognising the need for higher spending and financial constraints (which lead to try to reduce public employment and expenditure, to prefer private to public insurance. The OMC does not address directly major issues: how to finance a rising share in health spending? How to conciliate a satisfactory level of health spending insurance and to give incentives to households to reduce their consumption? How to supervise the behaviour of health suppliers? How to finance long-term care spending: universal benefits (everyone would be entitled to long-term care spending reimbursement, but this would be very costly, assistance benefits (benefits would be targeted to the poorer and be refundable on wealth and inheritance), mandatory private insurance.

3.4. Unemployment benefits

Unemployment insurance spending is high in Scandinavian countries (in particular in Denmark and also in the Netherlands) and very low in Mediterranean countries and in the UK (see Tables 1.2 and 3.9). Two models seem efficient in terms of full-employment: the liberal model with low unemployment benefits, flexible wages, but also with full-employment being obtained at the price of a significant number of poor workers, the Danish model where unemployment benefits are high and are accompanied by substantial training efforts and activation policy for bringing the unemployed to back into employment. It is therefore difficult to set EU objectives in terms of replacement rates, but the Danish model seems more in line with the ESM.

Until recently, it was however difficult to apply the Danish model in large heterogeneous countries with high unemployment. Training and support to some groups of the population (low-skilled, long-term unemployed, older workers, the young, single mothers with young children) was difficult to implement in a context where labour demand was too low. In the years to come, the deceleration of labour supply growth and a more robust GDP growth may make it easier to implement such a policy.

The future of the incapacity benefits system is an issue in several countries, because the system is costly (Netherlands, Finland, Sweden, Denmark) and reduces activity rates significantly (Finland, Italy, Sweden, UK). Conversely, incapacity benefits can be a flexible and adapted way at the individual level to tackle the issue of older workers in declining industries. But the schemes need to remain flexible and potentially adjusted when the economy comes close to full-employment.

Table 3.9. Employment policy expenditures, 2005

	Spending % of GDP			Generosity*	
(%)	Active	Passive	Unemp. rate	Active	Passive
Germany	0.97	2.35	11.3	8.6	20.8
Austria	0.62	1.51	5.2	11.9	29.0
Belgium	1.08	2.37	8.1	13.3	29.3
Denmark	1.74	2.51	4.2	41.4	59.8
Spain	0.78	1.45	9.2	8.5	15.8
Finland	0.89	1.90	8.5	10.5	22.4
France	0.90	1.62	9.9	9.1	16.4
Greece	0.05	0.35	9.8	0.5	9.7
Ireland	0.63	0.83	4.3	14.7	19.3
Italy	0.54	0.82	7.8	6.9	10.5
Netherlands	1.33	2.02	5.2	25.5	38.9
Portugal	0.69	1.39	8.1	8.5	17.2
Sweden	1.32	1.20	7.8	16.9	15.4
UK	0.49	0.19	4.7	10.5	4.0

* Unemployment expenditures/Unemployment rate
Source: OECD.

3.5 Family Policy

Family policy has until now not been a topic for discussion and coordination at the EU level although it has been addressed in some recent reports (like the Report of the High level group on the future of social policy, May 2004). However, fertility rates are higher than 1.8 in only two countries - France and Ireland - out of the EU-15 countries and below 1.4 in six countries. Countries with very low fertility rates are likely to have very high dependency ratios in the future: Greece, Spain, Italy, Portugal and to a lesser extent Germany and Austria, despite high immigration flows. Population is likely to fall substantially in Portugal (4% until 2050), Germany (6%) and Italy (7%). Rising birth rates is a crucial issue for these countries. In particular, the preservation of their pays-as-you go pension system will be will be questioned if birth rates do not raise or net immigration does not grow substantially.

Family policy should include thee main elements:

- Allowing mothers with young children to work, which is the best way to prevent the poverty risk and to give women incentives to have children. This requires a childcare system available everywhere and financed by public spending. Countries with low fertility rates are also countries with the lowest female activity rates (Greece, Italy). *A contrario,* some countries succeed in combining high fertility rates and high female activity rates: Denmark, Finland, Sweden and France. These countries have a high level of pre-primary care and education spending (see Table 2.8) and also relatively high level of family policy expenditure (see Table 1.2).

- Ensuring that all children have a minimum income level, health and education. Accounting for the importance of education from the younger age in terms of school education and in the future society, European societies cannot spoil the potential of children of poorest classes. They must benefit from social services like specific hep for education, health and cultural activities. A minimum income must be ensured to families (even if this reduces the incentive to work for parents. Table 3.9 shows that child poverty rates are higher that adult poverty rates in many countries: the Netherlands, Italy, Spain, the UK and Portugal. Social assistance targeted at poor families should be increased.

- Family benefits and income taxation should ensure similar income levels for families and couples without children earning the same income. Table 9 shows that family benefits are too low in all EU countries: to have the same income level than a couple, a family with two children should have in extra-income of 40% according to OECD scale ; it has in fact between 13 % (Austria) and 1.5% (Spain).

Table 3.10. Activity rates and fertility rates

	Activity rates 15-55 year-old		Fertility rates
(%)	Male 2005	Female 2005	2005
Germany	93.6	79.1	1.34
Austria	92.8	79.9	1.40
Belgium	91.8	76.8	1.64
Denmark	91.1	84.1	1.80
Spain	92.4	69.0	1.35
Finland	90.3	85.2	1.80
France	93.8	80.7	1.94
Greece	94.7	68.3	1.33
Ireland	92.2	69.6	1.86
Italy	91.2	63.6	1.31
Netherlands	91.4	77.8	1.71
Portugal	92.5	81.8	1.40
Sweden	92.4	86.5	1.77
UK	90.9	77.5	1.78

Source: European Commission, 2005.

Table 3.11. Extra income for a family with two children as compared to a couple *

(%)	2006
Germany	11.3
Austria	13.3
Belgium	12.6
Denmark	8.2
Spain	1.5
Finland	7.7
France	8.2
Greece	7.9
Ireland	9.6
Italy	6.4
Netherlands	7.6
Portugal	6.1
Sweden	8.5
UK	6.6

* Husband earning the average wage, wife 33% of the average wage.

Source: Taxing wages, 2005.

At the European level, the countries should commit themselves on some objectives: availability of childcare, child poverty rates, minimal income for families with children, relative income for families with children.

3.6. Fight against poverty and social exclusion

Poverty rates vary quite substantially in the EU, from around 9-12% in social-democrat countries to around 18-20% in Liberal and Southern countries (see table 3.12). Poverty results mainly from insufficient family and pension benefits and from precarious jobs, with low wages.

In almost all EU-15 countries, there is a minimum income amounting to around 50% of the median income (and thus it does not prevent individuals from falling into poverty at 60%). The minimum income system is more generous in Denmark and much less so in Southern countries. The marginal income tax rate for incomes rising from the minimum income to wages at the level of 50% of the median wage is higher than 80% in most countries; it is of course lower than 50% in Southern countries, but there are nevertheless quite a lot of unemployed or poor people in these countries.

Table 3.12. Poverty rates in the EU, 2005

	Total	0-15 year-old	16-25 year-old	Older than 65
EU-15	*16*	*18*	*18*	*20*
Sweden	9	8	23	11
Netherlands	11	16	16	5
Denmark	12	10	29	18
Finland	12	10	22	18
Austria	12	15	13	14
Germany	13	13	14	15
France	13	14	18	16
Belgium	15	19	17	21
UK	18	22	19	26
Italy	19	24	23	23
Spain	20	24	18	29
Greece	20	19	23	28
Portugal	20	24	20	28
Ireland	20	22	19	33

Source : Eurostat.

The OMC on social inclusion was launched in 2000. The objective was to bring a 'decisive contribution of the eradication of poverty and social exclusion by the year 2010', but poverty rates have hardly decreased in the EU since 2000. Social exclusion has risen in the EU from the 1980's and social protection systems have no tool or institutions to tackle this. Owing to the OMC, all countries have been requested to include the fight against poverty as a new element of their social protection system. In 2000, the Communication focused on the need for people to be in employment, the right for all to financial resources (although without imposing minimum income standards), preventing exclusion, supporting the more vulnerable, and involving all players. But contradictions were not between minimum income and work incentive, between economic modernisation of social protection (that leads companies to be more demanding on the quality of their workers) and inclusion. The joint report in 2002 showed the link between social expenditure as a share of GDP and the reduction of the at risk poverty. A large number of indicators were introduced to account for the different aspects of exclusion. The Communication from 2005 highlighted 7 priorities: being in employment; modernising social protection, inequalities in education and training, child poverty, right to decent housing, entitlement to social services, fight against discrimination. The 2007 Communication focused on the fight against child poverty. This raises the issue of the return of their parents in work, of combating school failure and of the integration of immigrant children. The fight for active inclusion aims to facilitate the return to work, but the risk is that this is obtained by deteriorating the situation of those who do not find a job.

Table 3.13. Minimum income levels in 2005

	Single people	Couple, 2 children	At-risk of poverty line	Marginal income tax**, %
Germany	672	1590	856	89
Belgium	625	1185	822	66
Denmark	1173	3333	1106	103
Greece	No minimum income		471	16
Spain	At the regional level		529	47
France	667	1264	796	80
Ireland	718	1341	936	88
Italy	250	542	719	14
Netherlands	549	1099	849	93
Austria	414	1090	900	87
Portugal	171	515	359	54
Finland	362*	1079	870	81
Sweden	364*	1094	865	98
UK	704	1690	936	78

* Excl. Housing. **
Source: European Commision.

All in all the value added of the OMC lacks visibility because no numerical targets were announced and no strategy is adopted due to the diversity of national systems. An advantage of the OMC could be to bring highlight the issue of poverty situations and to be an incentive for countries to set ambitious objectives but the work of the OMC is not really advertised. It would be more effective to set out common objectives in terms of poverty rates, child poverty rates, minimum incomes (as a % of the poverty line).

4. What future for social Europe?

'Social Europe' has various meanings. It may refer to the current intervention of European authorities in the fields of social protection and employment legislation, as a complement or sometimes as a substitute to national institutions interventions. The role of European authorities is clearly stated in European Treaties that assert that MS remain responsible for their social protection. At the same time, the logic of European construction, the rising interdependence of economies, the interconnection of economic and monetary issues lead European authorities to tend to increase their role in social issues and to pilot 'the modernisation' of national social protection systems.

But social Europe may also refer to a political project, aiming at increasing the power of European authorities in social areas: there would be a social Europe like there is today an economic or monetary Europe. This social Europe would lead to unify gradually European social systems. This would imply a transfer of sovereignty which would be questionable since the role of social partners would be reduced and there would be no guarantee on the content of this social Europe, possibly moving towards a liberal or social-democrat system. Social Europe may imply a step back in social democracy in Europe. At the same time the explicit recognition that Social Europe exists and that it should be managed in an open and democratic way, could be a progress as compared to a situation of constrained convergence.

Last, Social Europe may refer to a political project aiming at deepening the European Social Model, by unifying social protection, redistribution and employment legislation towards the top. This could take place through the gradual introduction of social norms in each country at high and progressively similar levels. But there is no consensus in Europe on the content of this social Europe.

4.1. Convergence or preservation of national specificities?

All EU countries need to reform their social protection systems in face of financing constraints, and of world and domestic social and economic changes. Since they face similar problems, this could be the opportunity to implement a convergence strategy. However, there have been up to now very few common reforms in Europe even if some convergences have been emerging. For instance, the reforms of social protection financing (like the introduction of IRAP in Italy or CSG in France, the VAT rise in Germany) have remained national. A minimum wage has been introduced in the UK but not in Germany – although this is currently debated). Two Member States only have adopted notional accounts for their pensions systems: Italy and Sweden. Moreover, the EU enlargement complicates convergence policies. Issues that were difficult to tackle in the EU-15 become almost unrealistic to address in the EU-27 (Vaugham-Whitehead, 2005). Three justifications may be given in favour of convergence: facilitating economic integration, originating a European citizenship, preventing a social competition race to the bottom.

The diversity of systems in the EU is difficult for European companies. They have to handle a variety of regimes, which is costly and raises delicate issues in terms of comparability of workers' earnings according to their workplace. Diversity will be hardly sustainable if European integration strengthens. New issues will emerge in permanence, such as: what legislation does apply to a Spanish worker working for a French company in Poland? Who will pay for the family and health allowances of this worker? But the merging of the existing systems into a single one that would facilitate the work of European companies is difficult to design. European companies could be offered to opt for a new 28th regime, but offering a choice in this area would be dangerous. A system that would cover only well-paid and healthy employees of big European companies would necessarily be more generous for these workers if they did not have to care financially for poorer European workers and the socially excluded.

Competition between continental, Anglo-Saxon, central and eastern European countries could lead to the end of the continental model that is characterised by a large redistribution between heterogeneous groups of the population. Companies will not locate their production in countries where the well-paid are too heavily taxed. The young will prefer to settle in countries where social contributions and tax rates are the lowest. In the end, the remaining systems will be those accepting strong inequalities (the Anglo-Saxon model) or benefiting to a relatively homogeneous society (the Scandinavian system). Continental countries could have no choice but move towards the liberal model through a painful period of imbalances. Europe could therefore decide to avoid a race to the bottom. However this risk has not materialised yet and the threat remains theoretical (see Table 1.1). The risk is limited because social protection is both a cost and a benefit for the economically active. In countries where social protection is high, workers are entitled to health, pension, unemployment and family benefits as a counterpart of their contributions: the system is therefore on average not a burden for workers. Assistance payments are a burden, but they are generally funded by taxation. However higher wage earners bear a specific burden in too redistributive systems; the profitability of the pay-as-you-go pensions' system can be lower than that of pension funds. The social competition requires us to great vigilance: social protection systems are doomed to be effective and not be too redistributive.

The debate around the services directive, the so-called Bolkestein directive, illustrated unsettled legal issues arising from contradictions between the Internal Market's rules and the national characteristics of employment legislation and social protection. Entitling services companies to be under 'the origin principle' and restricting the possibilities of control of employees by the authorities of the countries where they work would have allowed companies to choose their location only from social and taxation considerations and to practice tax dumping as compared to companies located in more demanding countries in terms of social standards. This would have increased substantially the field of competing goods. Moreover, the notion of services was not precisely defined, with public services (health, education) being threatened to comply to competition rules, and in particular that of not receiving public subsidies. But these services must be allowed to remain public under the rules of the ESM.

Last, European construction implies that social and political life becomes progressively 'European' which would be facilitated by the convergence of social protection systems. The objective is to 'create an ever closer union among the peoples of Europe'. European construction would be of more interest for the peoples if they could see visible implications in terms of social protection. In that respect, the European Commission tries to intervene more in social issues, although in the absence of any constitutional and democratic framework. The European Court of Justice intervenes already in the field of social protection, and some harmonisation piloted for instance by the European Parliament would be preferable to a harmonisation implemented by the ECJ alone, where the Internal Market requirements would prevail over social protection issues. Similar social protection all over EU countries would facilitate similar economic policy answers in the occurrence of shocks and hence would facilitate economic policy coordination. In the longer run, EU countries are unlikely to be able to choose deeply different strategies in the field of social protection (for instance some countries favouring the postponement of retirement age and some others a rise in social contributions).

A certain degree of convergence seems necessary, but towards which model? Can convergence take place if national models are deeply anchored in different social institutions and practices? Social systems cannot be unified at the EU level, without accounting for national traditions, debates and specificities. Building a European social protection in that way would be at the expense of the role of national social partners and would weaken the support for social protection. In most Member States, the social protection system is linked to trade unions, either through a joint management by employers and employees' trade unions

(Bismarkian model), or because trade unions have imposed it at the political level (Scandinavian model). Can the management of social protection be handed at the European level, without risk to break this link? Such a strategy could lead to unify systems towards the bottom in the name of competitiveness rather than to the development of a rejuvenated ESM.

All social protection systems are based on solidarity. Solidarity remains today widely national. Countries with low unemployment rates are not willing to pay for countries where unemployment rates are high, because they consider that high unemployment rates are due to insufficient domestic efforts. It seems unlikely that in a 20-year time scale, the French or the British will agree to pay social contributions for the pensions of the Italians or the Germans, where fertility rates will have been too low.

According to Boeri (2004) and Lejour (2007) for instance, the Treaty of Maastricht have applied the subsidiarity principle in arranging the division of competencies between individual Member States and the EU. Centralised European coordination must be justified by strong scale or external effects; but these effects are not really present in social security expenditures and labour market regulations. Boeri rejects harmonisation in the name of the respect of national preferences expressed by the democratic process and the advantage of efficiency of decentralisation. Competition should be allowed to play between national systems. It is not possible to a single European social model, as model have to account for country-specific institutional networks. There is no risk of a race-to-the-bottom in social areas. There is no evidence that social protection schemes have been dismantled in the EU. However, it could be wise to coordinate minimum incomes schemes in order to avoid the potential risk of 'social nomadism' through a last resort assistance. According to Lejour, harmonisations of social regulations would be expensive for the new Member States and will not match their level of economic development: the preferences for social standards are simply different for rich and poor countries. Differences in regulations need not in fact be harmful; they can help the economic development of new Member States because they will be able to attract more capital and strengthen their competitiveness with lower social standards. Western European consumers will ultimately also benefit from this through increased trade and specialisation. Convergence could then subsequently lead to adaptation of social policy to the EU norms. If high social standards are imposed on the new Member States immediately, this could make it more difficult for them to achieve the growth necessary to catch up with the West.

These views imply that there is no further progress for a European citizenship. Besides one may wonder what competition between social systems may mean in a situation of free movement. Will countries where redistribution is the higher be able to stand competition from less redistributive countries, knowing that the wealthiest will leave the country while the poorest will settle there? There is not evidence that competition lead to a satisfactory system.

4.2. Social Europe in action

Europe intervenes in three respects in the social area: Legislation (or hard law), financial support, coordination processes (or soft law)

4.2.1. The 'hard law'

The 'hard law' represents all legislative EU decisions. Initially, Treaties allowed European institutions to intervene in specific areas: free movement of workers, coordination of social security systems, health and safety at the workplace, gender equality and more generally fight against discrimination. The first two elements are justified by the Internal Market, the third one may be justified by the objective of not seeing economic competition run at the expense of workers; the fourth element can only be justified by the objective of building a European Society sharing common values.

The Single European Act introduced in 1987 focuses on the need for an economic and social cohesion. Qualified majority voting is allowed for some issues, like workers' protection at the workplace; collective bargaining is promoted and favoured, but harmonisation of social protection systems has not been associated with the Internal market.

The Treaty establishing a Constitution for Europe recalls the Union's objectives: '*a highly competitive social market economy, aiming at full employment and social progress [...]. It shall combat social exclusion and discrimination, and shall promote social justice and protection'*. The annual Tripartite Social Summit for Growth and employment is enshrined in the constitution. The Treaty embeds the EU Charter of fundamental rights that includes social rights but under hardly binding specifications: workers have a right to work, but not to have a job: rights are recognised as in the national legislations, no minimum benefit is stated.

The majority of the Union's actions in the social field remain subject to a unanimity vote (social security and social protection of workers, protection of workers where their employment contract is terminated, representation and collective defence of the interests of workers and employers, conditions of employment for third-country nationals legally residing in Union territory. They are clearly stated in the framework of European Treaties, notably under the principles of subsidiarity and proportionality (art. 5). Some elements are explicitly excluded from the European field (pay, right of association, right to strike and right to impose lockouts): there is for instance no possibility to set a EU minimum wage.

All in all, the Union's role in the Social field applies more to employment policy than to social protection broadly speaking. The Union has tried to promote the social dialogue and to introduce common rights for EU workers (health, safety, non discrimination). But the Union has no power in terms of organisation of social protection (pensions, health or unemployment insurance, family).

The Union faces a growing difficulty: liberal countries and the new MS are reluctant to accept binding legislation. The working time directive has thus being emptied of its content with the existence of an opt-out clause, permitting Member States not to apply the maximum 48-hour limit, on the basis of voluntary agreements with individual workers.

The European Commission and the ECJ also play an indirect role in the social field through their prerogatives in economic policy coordination (government borrowing, level of public spending), competition, free movement and free establishment.

The EU legislative actions in social protection seem to have reached a limit. There is no agreement between the Commission and the MS to make significant progress in that direction. The diversity of social models and the unanimity principle prevent any progress.

4.2.2. Financial support

Financial support in the social field is extremely limited. The ESF co-finances local projects of active labour market policies but with relatively low resources (0.1% of the EU GDP). Financial support in the social field is constrained by the absence of EU solidarity, by the denial to give own resources to the EU and the difficulty to implement transfers between countries with different incomes levels and different institutions. For instance, some have suggested that unemployment allowances be considered at the EU level and this would allow for contra-cyclical transfers. But this would mean that MS are no more responsible for their unemployment benefits systems. Moreover, it seems difficult to settle a European system where the unemployed will receive higher allowance in richest countries. It seems also difficult that countries in a full-employment situation accept to pay for countries in high employment.

Box 2. European globalisation adjustment funds

The creation of the 'European globalisation adjustment fund' was decided by the Commission in March 2006. This fund could be a positive element for the future of Social Europe. It recognises that there are workers affected by globalisation. In practice, the fund will only provide a support to the direct victims of globalisation, to workers in an industry sector directly hit by competition from low-wage countries. The fund is intended to help their reconversion (retraining, mobility). The fund will not facilitate job creation or help people keep their job, although in most cases a whole geographical area is hurt and new job opportunities are limited. With this fund, some social expenditure will be directly covered by the EU : it is an attempt to raise the EU budget and influence. However, the current expenditure ceiling is very low (500 million euros per year, i.e. 0.2% of MS unemployment allowances spending). It will not help the recovery of industrial employment in Europe. If it is recognised that globalisation as a whole makes victims (low skilled workers) and winners (high skilled workers, capital income earners), the fund does not allow for transfers of the magnitude of the challenge.

4.2.3. Coordination processes (or soft law)

Coordination processes (or soft law) include the definition of common EU objectives (BEPGs, Lisbon Agenda, Social Agenda). In the social field, they allow European authorities to intervene in areas that are not of their competence according to the Treaties. Since 2000, MS and the Commission concert according to the Open method of coordination (OMC). The objective is to stimulate converging reforms in national social models, in sharing national experience and 'best practices'.

The EPC, the SPC, the Commission and the Council give periodic guidelines on the evolution of 'social protection in the European Union', even if social protection in the EU does not exist as such and if the legitimacy of EU authorities in the field of social protection is weak. Over the last ten years, the most relevant texts have been:

- Modernising and improving social protection in the European Union (1997)

According to the Commission, social protection systems (SPS) need to be modernised in Europe. The ESM must be preserved and consolidated because the increased flexibility of economic life requests that SPS provide safety. But population ageing will have high costs, and there is also a need to increase fertility. The suggested solution is to 'make social protection more job friendly': to raise work incentives; cut means-tested benefits (at the risk of higher inequality), to turn unemployment allowances into an active support to training, to cut taxes on labour (but what would be the alternative resources?), to raise incentives to work longer, to offer integration contracts to those under minimum incomes. The financial sustainability of public pensions systems must be ensured, supplementary regimes must be supervised, schemes for long-term care must be introduced. The report suggests the introduction of market mechanisms in health insurance albeit warning against adverse selection. It is in favour of individual social rights while recognising the risks of increased poverty for some women.

- The Lisbon Strategy (March 2000)

The European Council launched the Lisbon Strategy (‘*becoming the more competitive and dynamic knowledge economy in the word, able to promote durable economic growth accompanied by a quantitative and qualitative improvement of jobs and a better social cohesion*’). Social policy is requested to adapt to external (globalisation) and domestic (ageing, Lisbon Strategy) changes. Higher employment rates (rising from 61% to 70%) will ensure Social security financing. The objective of modernisation of social protection is restated, with the four objectives mentioned earlier, and this will be achieved owing to the work of SPC and OMC: make work pay; make pension systems sustainable; promote social integration; ensure high quality and sustainability of health care. The fight against poverty and social exclusion is promoted as a priority objective, the SPC being asked to set relevant indicators.

This social element of the agenda is developed in the ‘***Agenda for social policy’*** that promotes “to strengthen the role of social policy as a productive factor”. This agenda aims at more interaction between economic, social and employment policies and to involve all people involved in the Lisbon strategic framework: fiscal policies must remain sustainable; wage moderation must be implemented; markets of goods, services and capital must be reformed; tax policies must be coordinated. The agenda does not try to harmonise social policies, but to define common objectives and facilitate coordination in the framework of the Internal market. Social protection remains under the responsibility of the MS, but some cooperation at the EU level should address the challenges of globalisation. In terms of social policy, suggestions are limited; the four objectives are simply recalled; the promotion of social inclusion is a priority objective, but without any precise suggestion.

The **Kok report** (2004) reassesses the Lisbon strategy at half-way. It does not address social protection itself. Social protection is subordinated to employment policy. The ***2005 Social Agenda*** is relatively modest (12 pages). The objective of modernisation of the ESM is considered according to two major elements: (1) Employment (2) Equal opportunities and inclusion. The major new element in the Agenda is an intergenerational approach which stresses the needs of the young and families. The Commission announces that it will open a debate on national minimum income schemes

Social protection in a strict acceptation has not really emerged at the EU level. Because of divergent views between countries, there are few debates on the basic objectives of social protection and on social models. The question of the convergence between social models deserves to be raised in face of European economic integration. Social policy is often not considered for itself, with its own social protection objectives but like an element of employment polices. The BEPGs claim for public spending cuts. But social protection expenditures represent substantial budget components and are likely to be affected by these cuts. The EMU, globalisation and demographic ageing place EU countries’ social policies in front of common challenges. A common strategy would be necessary. It requires delicate choices between social concerns and economic constraints. These choices are essentially political. MS start from very different situations; they can make different choices. *Vis-a-vis* this diversity, there is no authority who could design convergence strategies; there is no democratic process that could support such strategies; there are no social forces which could carry them. The dialogue processes aim at tackling these weaknesses, but they are limited to debates between European and national technocracies, which is not sufficient.

4.3. The open method of coordination

The strategy currently implemented by the Commission consists mainly in *modernising social protection systems* through a common elaboration of the Member States piloted by the Commission through the open method of coordination.

European social policy has been unable to progress through legislation in the area of social protection although the need for strengthening European cooperation was increasing, namely to address the risks of social regression due to the deepening of the Internal Market (see Erhel and Palier, 2005). Since 1992 and the Maastricht Treaty, the number of directives proposed and adopted has diminished. The signing of the Amsterdam Treaty has not affected this trend even if the *Title on Employment* was introduced. The promotion of the social dialogue has not been more fruitful, with only three collective agreements leading to directives.

The OMC tries to reach a certain convergence in the area of social protection through a non binding coordination process, based on the exchange of information and dialogue between MS. It is in fact easier to influence national policies by other means than binding rules in the presence of interdependent and complex institutional systems. Coordination remains the only supranational tool allowing for the respect of irreducible disparities.

If the subsidiarity principle must be enforced, the OMC is a way of getting around it in social areas. In practice, MS and the Commission take part in the OMC. In each area, common general objectives are announced, action plans are elaborated and national reports are produced where MS explain the policy measures they intend to implement in order to reach the common objectives. These plans and strategies are assessed by the Commission and the Council in joint reports, delivered at European Councils. The Social protection Committee is the link between the Commission and the Council. The whole process is an intensive technocratic process.

The OMC was launched in three areas: the fight for social inclusion (2000), retirement and pension systems (2001) health and long-term care (2004). There are very few externalities in these fields that justify an intervention at the EU level. This intervention is justified by the need to induce the emergence of ESM values (in terms of social inclusion and health), by the need for making converging choices in terms of pension for economic and social reasons.

It should be noted that there is no OMC in the family area, although the performances differ widely among MS in terms of fertility rates, female employment rates, and relative family incomes.

Since 2006, was set up the rationalisation of the OMC, which aims to integrate more OMC process to the Lisbon Strategy and to the Employment Guidelines. The three subjects (social inclusion, pensions, health care) are integrated to a single document and a joint debate. This renewal was intended to give visibility to this process, but this objective has not been achieved.

4.4 What is the impact of the OMC?

Three views can be found on the usefulness of the OMS (Pochet, 2001). According to the first view, the OMC hides the very social policy at the EU level. It would allow each country to follow the policy of their choice without taking care of EU non binding recommendations.

The 'confidential' character of the OMC and its absence from national debates tends to validate this view.

According to a second view, the OMC prevents the occurrence of too large divergences that would be detrimental to European economic integration (like 'social tourism' and 'social dumping'). The OMC could also possibly allow for some convergence of strategies. This view accepts that there can be several models in Europe, albeit insisting on the need for a common framework with no risk of social dumping.

According to a third view, the OMC expresses a clear objective of social policies convergence. It would therefore have real influence and effects on MS social policies, but this effect would be visible only in the long term. Accounting for initial very different situations, the OMC would be more efficient than rules through directives.

In fact the OMC does not seem to have had a direct influence on the national reforms of social policies. In most cases, the national debate on reforms does not refer to a European strategy. In the fields of exclusion, pensions, health, many reforms were implemented before the introduction of the OMC. Last, there is an issue of political opportunity: politicians generally prefer not to mention a European reference.

However, if the OMC does not seem to have direct effects, it may still have some effect. The OMC gives more weight to social issues, primarily through its peer assessment system and the binding 'name and shame' process. There would be a learning process, or the elaboration of a common knowledge linked to the OMC and the exchange of information on national experience and best practice. The tools of the OMC (indicators, guidelines, models, justifications) are resources for national policy makers that can be used in the definition of national policies. Thus the OMC has obliged all countries to put the 'inclusion' topic on their agenda. The 'health' and 'pensions' OMC oblige countries to take a position in terms of sustainability/social needs dilemma. The pensions OMC has revealed the risk of poverty for older workers and the deterioration of dependence ratios. In this aspect, European coordination would from this respect a 'leverage effect' on national policies.

The OMC gives a new reference for social areas and allows policy-makers to legitimate their position and possibly use the OMC in the national debate. National policy-makers can agree on rules in Brussels and say at home that there are under EU constraints. The gap widens between those who take part in EU discussions and those who do not. Last some think that the European Employment Strategy had increased the involvement of social partners in the definition of labour market policies guidelines. This is however very arguable for the social OMC.

The OMC is the *a priori* impossible aggregation of contradictory national objectives, some European convergence in the respect of national specificities, since policy measures remain to be taken at the national level. However, social protection issues were debated traditionally in most EU countries with a social dialogue between the government, the civil society, employers and employees' trade unions. Despite its social focus, the OMC takes place within closed doors: national parliaments and the European Parliament do not take part in the process (reports are delivered to the Council but are not sent to the Parliament for consultation). National social forces are not involved. The OMC places the debate at an inter-government level, between high level representatives of the ministries for finance and social affairs. Can these representatives present the national strategy in terms of pensions? Can they give the view point of their countries on reforms in partner countries? The process is more a discussion between administrations and is poor in comparison with discussions at the national level where the diversity of people involved is better represented. The European and national high technocracies agree on a common strategy in the social field. The OMS represents in that respect a step back in the social and democratic debate.

4.5. The Lisbon strategy

If we take a more general view, it appears that the European Commission does not recommend a pure liberal solution, but a mixed strategy based on a sound macroeconomic policy, increasing markets flexibility, social protection reforms but also public support for research and innovation. This is the strategy embedded in the Lisbon Agenda, which raises implementation and contents issues.

The Lisbon strategy was from the beginning a technocratic project, without democratic debate, without mobilization of the European opinion, involvement of the civil society and of social partners. The strategy did not take in account the differences between the countries, the trade-off necessary between various objectives, and the differences of opinion and interest of the social forces. The majority of the objectives of the Lisbon Agenda are related to research, innovation, higher education and have little impact for the majority of people. Short-term issues were forgotten. The European institutions are used to implement policies which experts or elites consider economically sound but which are unpopular. We will discuss here the latest version of the Lisbon Agenda: the 24 integrated guidelines for growth and jobs (2005-2008) adopted in July 2005.

A sound macroeconomic strategy?

The 6 guidelines on macroeconomic strategy repeat the need for sound macroeconomic policies to support growth. Guidelines 1 and 6 repeat that countries must have medium-term budgetary positions in balance. Countries running deficits must cut their structural deficits by at least of 0.5 percentage point per year, whatever the economic context. The link between the single monetary policy and national fiscal policies is not questioned. Guideline 2 asks the MS to adapt to the ageing of their population by reducing public debt (but population ageing involves a rise in the savings rate, therefore demand for public debt), to reform their pensions and health systems (but how?) and finally to raise employment rates. But the strong growth strategy needed to reach these aims is not organized. Guideline 3 requires that public expenditure should be reallocated towards research, infrastructure, teaching. But the expenditures to be cut are not specified. Guideline 4 requires that MS make structural reforms to facilitate the implementation of sound macroeconomic policies. One could prefer the opposite: to implement coordinated expansionary macroeconomic policies to facilitate the implementation of structural reforms.

Microeconomic strategy: competition and innovation…

The central objective is to raise productivity and innovation in Europe. EU-15 GDP per capita has remained at 72% of the GDP per head in the US since 1973. But this is primarily explained by differences in employment rate, unemployment rate, and annual worked hours rather than by productivity per head. On the other hand, since 1995, labour productivity growth has slowed down in the EU-15 (1.0%) whereas it has accelerated in the US (to 2.2%). This is explained partly by the level of unemployment: innovations saving employment are hardly welcome in a mass unemployment situation.

The lessons of the burst of the NITC bubble and the collapse in equity prices are not drawn.

Growth through innovation (guideline 8), ITC (guideline 9), development and liberalization of financial markets remains the dogma. Guideline 10 recommends strengthening the “competitive advantages of the industrial base”. But this policy requires a major change with the competition policy of the Commission, which aims at reducing the government aids. Guideline 11 discusses ecological concerns, but contradictions between growth and environment are not considered. Guideline 12 recommends deepening the “Internal Market”. There too, contradictions are not accounted for: is privatisation needed from the energy sector, collective transportation system, by forgetting the long term concerns and regional planning? The problems arising from the Bolkestein Directive are overlooked: what competition between firms subjected to different social standards? Guideline 13 calls for open and competitive markets; asks for the reduction of State aid which distorts competition, while recognizing the need for curing market deficiencies, helping research, innovation, formation. Guideline 14 invites to reduce regulations, as if those were necessarily harmful. For example, should consumer protection be given up? Guideline 15 requires to foster entrepreneurship, “by a tax system which encourages the success”, which is a calling into question of the progressivity of taxation.

What employment strategy? The myth of flexibility…

The general principle remains to increase labour force availability and quality. There is no suggestion on how to increase job offers. Guideline 17 reaffirms ambitious objectives for employment rates (in 2010, 70% for the whole population, 60% for the women, 50% for the older workers). Guideline 18 suggests increasing labour demand by lowering young people’s unemployment, by giving incentives for women and older workers to work. Guideline 19 recommends increasing the gains for employment. But, the call for modernising social protection systems is worrying, if it is a question of reducing pensions or unemployment benefits or of suppressing retirement possibilities while employment opportunities for senior workers are not there yet.

Guideline 20 proposes to remove the labour mobility barriers, but the sensitive issues are not addressed: how to prevent workers from the East from exerting downward pressure on wages in the West? Guideline 21 recommends to support flexibility (by reconciling it with the job security), to better anticipate better to come and to facilitate the transitions. But the recommended strategy is not defined. The Anglo-Saxon or the Scandinavian model?

Guideline 22 proposes to ensure a trend of wages on line with the productivity and to reduce the non-wage costs. Currently the wages tend to progress less quickly than the labour productivity in the euro area: the wage share in value added dropped from 67.4% in 2000 to 66.2% in 2005. It is thus a rise than it is necessary to preach…. The fall of the social contributions cannot mean fall of the benefits (which would be the advantage for the workers and the firms to decrease the contributions if this reduction obliged them to pay premiums to private insurances?). Other resources thus should be defined.

The integrated guidelines forget that Europe suffers from an insufficient demand and that the European framework is partly responsible for it. They refuse to make the Lisbon agenda consistent with the SGP, i.e. to take account of capital expenditures to assess MS fiscal policy. The text forgets exchange rate policy. Can the euro area be competitive after a rise of 67% vis-à-vis the dollar since 2002? The text forgets social Europe. How to reconcile the freedom of circulation and establishment with the tax autonomy of the countries? How to avoid competition by lowering taxes? How to avoid social dislocation when the winners for globalisation refuse to take part in the national solidarity? The text forgets the industrial policy. Is it necessary to be limited to a policy of the competition and of reduction of the government aid?

4.6. How to adapt the ESM? National reforms or a European pilot?

Five main views can be found on the future of the ESM.

1) For Liberals, Europe and globalisation offer the opportunity to abandon an old-fashioned social-democrat model that is no more in line with the needs of modern capitalism. Social and tax competition, under the impulse of globalisation and Internal Market, will lead EU countries, especially continental ones, to dismantle progressively their employment protection systems (labour rights, minimum wage) and to liberalise their social protection systems (moving from pay-as-you go to pension fund systems, to private health care). Otherwise, companies will progressively refuse to settle in these countries and skilled workers to work, pay taxes and social contributions there. The ageing of populations and the resulting rise in pensions and health spending would not be financed in a global economy since a rise in contributions would lead young workers to move abroad. From that point of view, any harmonisation would be harmful insofar as it would postpone the necessary changes. There is a need to move towards a liberal model, through labour market flexibility, focusing social protection on the poorer while letting the market play for the rest of the population. A rise in inequalities must be accepted to be in line with world standards.

But the Liberals do not account for the fact that this move is not desired by the populations. Europe would enter a long period of social unrest, social insecurity, inter-generational conflicts unfavourable to consumption, trust and economic growth. European Societies may decide to opt or not for a liberal model. But European construction should aim at leaving the choice open.

2) For Sovereignists, the Peoples should keep the right to choose their social protection framework, all the more that it is tightly linked with domestic institutions and social forces. Europe should not intervene in existing national social rights and should be given only the task to organise the coexistence of different systems. This is the mainstream view in Nordic countries. This is also the British and some new MS view points, although for opposite reasons: the fear is that European institutions impose a system harmful for economic efficiency

For how long will domestic disparities remain consistent with the Internal Market, with the free movement of goods, capital and services? The Sovereignist view assumes that each progress in Economic Europe is associated with measures guaranteeing national sovereignty in terms of benefits, taxation and labour legislation. This is a view shared neither by the Commission, which is in favour of reducing MS prerogatives, nor by a majority of MS. Can European companies with workers in several MS operate under specific domestic legislations? Last, some country specificities are questionable (child and old-age poverty in some Liberal countries, low employment rates and fertility rates in Mediterranean countries, high unemployment in continental countries). Should European construction help the reduction in these specificities or should countries tackle these issues?

3) Very few people suggest a big bang leading to a unified system in Europe. This would raise insoluble issues: which system? How to organise in practice the transition phase while maintaining the acquired rights? All social protection systems are based on solidarity. But

solidarity remains today at the national level and there is no EU solidarity. The only system that could be easily extended would be a liberal system with a minimum solidarity. However, a move towards a single system, under the effects of increased labour mobility in Europe, the development of European companies, increased competition and possibly ECJ's decisions cannot be totally excluded. So the question of the design of a single system can be raised even if only from an intellectual point of view.

4) The proponents of a Social Europe are in favour of a progressive convergence towards a unified social model in Europe, embedding a high level of social protection. The introduction of a social and economic EU government would allow for the harmonisation of taxation and social protection to the top. Social minima (minimum incomes, replacement rates for unemployment and pensions benefits) and wage minima would be settled according to the level of domestic economic development and would increase in catching-up countries as they converge towards the best performing countries. Employees would be more involved in companies' management. Social Europe would allow for the coordination of wage increases and hence would have positive demand effects while minimising the unfavourable effects in terms of competitiveness. Europe would be able to promote its model at the world level.

Is there a need for a Social Europe, like there is a monetary Europe, a Stability Pact, an Internal Market? The answer is not straightforward. Social progress raises conflicting issues. It was driven by workers and their trade unions, who are not involved in technocratic processes in Brussels. Thus Social Europe may weaken further the weight of social democracy.

Anglo-Saxon countries and the new MS do not want to be constrained to adopt a model that is widely felt to be in crisis today in larger continental countries; a model that has failed to avoid high unemployment, rising exclusion and which financial prospects are under question. The unification, even progressive, of strongly heterogeneous systems seems difficult to implement, both at technical, political and social levels. It would require a larger homogeneity than there is today in Europe. It supposes a delicate questioning of national practices: for example, some countries do not have a national minimum wage (but minimum wages by branch) or a minimum income (social assistance being decentralized). The unification would require that a central power in Brussels is able, politically, socially and technically to pilot a complex and contradictory mechanism.

Should Europe be given more powers in the field of social protection and should the principle of qualified majority be accepted, knowing that it may lead to a harmonisation either to the top or to the bottom? Social democracy - that embeds Keynesianism and redistribution - is no more a majority view in Europe. This raises the question of democracy in Europe: can a country be constrained to adopt or be forbidden to implement a social reform? How to organise an efficient social dialogue in Europe, in order to reform and unify social protection, between many partners organised at the national level? If the more efficient model is the model where social partners agree to a fine tuning of social policy, labour law and wages, this model – like in Scandinavia and the Netherlands -, cannot be easily extended in a vast heterogeneous area.

Box 3. Enhancing Social Europe (February 7, 2007)

A declaration for « Enhancing Social Europe » was released in February 2007 by 9 of the 27 Labour Ministers (Belgium, Bulgaria, Cyprus, France Greece, Hungary Italy, Luxembourg, Spain,). It is a minority text in Europe. In particular, no Scandinavian country signed. The declaration suggests "*to strengthen the ESM… by elaborating a vision for the future of Social Europe…by promoting with a balanced approach…to adaptations related to globalisation, while ensuring social rights and protection enshrined in the European tradition"*. The four suggested directions are: employment policies and flexicurity (fighting against precarious work; developing minimal social standards); social cohesion (preserving the social goals and the universal and solidarity character of social protection systems; defining minimum incomes); equal opportunities (supporting rise in the female employment rate; strengthening family policies and network of nurseries); a better European social governance (evaluating the social impact of all Union policies; developing the European social dialogue)

5) From a Social-Liberal European point of view, European authorities should impulse progressive but converging reforms aiming at *modernising* national social protection systems. Such a convergence would be obtained through soft methods, like the BEPGs or the Lisbon Agenda, i.e. through a set of objectives elaborated by the Commission and then adopted by the European Council, and like the open method of coordination, i.e. the confrontation of domestic experience and peer pressure guided by the European Commission. Each country would however keep their autonomy in social areas. This process has the advantage of leaving national sovereignty intact. But it is necessarily slow and not visible for economic agents and populations. Moreover, its content raises questions. The BEPGs and the OMC are dialogue processes between European and national administrations and do not really involve social players, are hardly debated at the country level and in the general public. How should the process be democratised and strengthened? Currently the process is not mobilising and does not lead to the emergence of a Social Europe project, in the acceptance 2 and 3 of this concept. In practice the role of European authorities stands between supporting a specific ESM and questioning it under the name of modernisation.

Conclusion: Debates on a new Welfare State in Europe

The European Social Model (ESM) is at the heart of the functioning of European economies and societies. Social Models are diverse in the EU, but European integration requests some coordination and convergence. We will give here two points of view. The first (from Wifo) suggests a new architecture of welfare state in Europe, inspired by the Scandinavian model, so the impact of social protection as a productive factor increases.. The second (from OFCE) stresses the importance of guaranteeing social cohesion in the Member States, by reducing income inequalities and ensuring a high level of social protection, in particular for people who cannot work, because of their age, their handicap, their family situation or the economic situation. The disincentive effect of social protection is judged of second order and it is considered that rich countries can accept it.

Key elements of a New Welfare State Architecture[4]

European societies are facing a number of demanding challenges, which will intensify in the years to come and call for institutional reforms in European welfare systems: There is, on the one hand, from a societal perspective, a process of individualisation going on that is related to women's growing preferences for personal independence and life long careers. This process entails substantial changes in demographic and family behaviour which results in new and more flexible family arrangements, meaning a declining number of children living together with both mother and father and an increasing number of single-parent families. This development mirrors new insecurities and increasing poverty risks.

On the other hand, looking at the economy and the labour market, processes of global integration, technological transformation and structural economic change are going on which result in a shift from production to knowledge-intensive service economies creating new risks on the labour market. While the number of decently paid and secure jobs of low- and medium-skilled standard production workers are rapidly declining, a dualistic perspective on the labour market is unfolding: The main route is in favour of skilled and highly professional, well-paid jobs, but at the other end a sizeable market of precarious jobs for those with weak human capital facing either low wages or unemployment. At the same time the pressure to increase wage disparities continues to rise (*Reich*, 1991).

To prevent a bleak perspective of life-long precariousness and rising poverty risks for an increasing number of people, our societies have to provide, on the one hand a highly efficient education system which leaves nobody behind and fosters life-long learning as well as strong mobility opportunities on the labour market and, on the other hand, a system of social security with a tight safety net at the low-income end but strong activating incentives and supportive instruments, e.g., active labour market policy. In knowledge-intensive post–industrial economies individuals' life chances depend on their learning abilities and their accumulation of human capital. Hence, the impact of social inheritance will become of utmost importance - "in particular with regard to cognitive development and educational attainment" as *Esping-Andersen* (2002, p. 3) pointed out. And he proceeded: "..we cannot afford *not* to be egalitarians in the advanced economies of the twenty-first century. ….there is a very good argument that equality of opportunities and life chances is becoming *sine qua non* for efficiency … Our human capital constitutes the single most important resource that we must mobilise in order to ensure a dynamic and competitive knowledge economy. We are facing huge demographic imbalances with very small working age cohorts ahead, and to sustain the elderly we must maximise the productivity of the young."

While the post-war welfare states mainly concentrated on equalising living conditions by supporting the victims of destructive outcomes of market forces through income maintenance guarantees, the policy challenge of the future is to empower people to be adequately equipped to satisfy their welfare needs within the market. Thus, social policy – as seen by the Lisbon agenda - is about to become a productive resource; i.e. a supply side policy instrument to empower and activate people to be able to succeed in the market.

The Lisbon growth strategy is based on three ambitious objectives: making Europe a zone of economic prosperity, with a high level of social protection and a responsibility in terms of

[4] From Aloïs Guger, Thomas Leoni and Ewald Walterskirchen (Wifo).

environment. If one considers that these three objectives are linked and that European construction should aim at a progressive unification of European Societies, then European construction should aim at making the European social models converge towards a single one. Increasing economic efficiency in Europe, facilitating changes and strengthening investments important for the future should be accompanied by a determined social policy. If one considers that the continental model lacks flexibility, that the Liberal model is too costly in terms of social cohesion and inequalities, then Europe should move towards a Scandinavian model, knowing that the task will not be easy because institutions and traditions that have paved the way for the success of these models does not exist in other countries or not to the same extent.

The Scandinavian system remains inclusive and tight, but social benefits are partly made dependent on the input of the individual and transfers become conditional on 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. Scandinavian countries turned out to be the best performers in combining a high level of equality and low poverty rates with high levels of employment and high economic growth (section II). Accordingly, they seem to be best prepared to tackle the emerging societal and economic challenges of the future.

As key elements for a new welfare state architecture we pick out:

- ‘A child-centred and women-friendly social investment strategy’, as *Esping-Andersen* (2002) has proposed. This strategy can be seen as the backbone of an activating reform which takes into account the preconditions of a highly flexible, knowledge-intensive society with high activity rates of economically independent men and women. While post-war welfare states provided both a high degree of income security and, together with marital stability, sufficient caring facility within the traditional family, young families today have a less stable life-course perspective both economically as well as in their partnership. At the same time, the prerequisites for a good life and working career are rising steadily. Life chances depend increasingly on investment in human capital by both parents and society in early childhood. Good cognitive abilities which have to be developed in early childhood are absolute preconditions for educational attainment and life-long learning.
- For demographic reason as well as due to the high cognitive requisites of a ‘knowledge economy’, we cannot afford to leave any child behind in her intellectual development. Accordingly, one of the key goals of reform strategies is to reduce social inheritance and to improve the cognitive potential of every child, irrespective of her social origin. Thus, policies aimed at improving the availability of affordable high-quality child-care facilities in early childhood as well as policies to prevent child poverty and safeguard welfare must be seen as social investments which are central pillars of any activating welfare state reform.
- Together with higher working-time flexibility and part-time employment possibilities, the availability of high-quality and affordable care facilities for both children and elderly is also an important precondition for parents and – in particular for women – to find their life-work balance in combining family obligations with individual career preferences. In the face of demographic ageing this is an increasingly important issue for both increasing fertility rates and women’s labour market participation. Improving the relative income of families with children should also contribute to bring fertility rates back to satisfactory

levels.

- High investment in human capital to increase educational attainment and literacy levels among younger cohorts and to institutionalise life-long learning to improve the likelihood of attending successful retraining at advanced ages, thus reducing one of the barriers to labour market participation of older workers.
- Increasing social services. The welfare state of the future will have to provide more service to meet the requirements of more individualistic societies and service economies. By providing sufficient high quality care facilities for children, the aged and the handicapped the state empowers people to combine gainful employment with family obligation, thus fostering (female) participation, welfare production and equality in the modern ageing society.
- A 'flexicurity' strategy or managed and balanced flexibility on the labour market. Increasing competition in goods and labour market due to world-wide economic integration as well as rapid technological and structural changes demand higher labour market flexibility. To prevent poverty risks, higher standards of social security are needed. Here, the Nordic – in particular Danish – experiences with 'flexicurity' offer examples of good practise by combining, on the one hand, deregulation on the labour market with extensive active labour market policy and, on the other hand, generous income protection in the case of unemployment paired with strong incentives to resume employment fast.
- Government and public institutions have to play a proactive role in promoting competition, innovation, efficiency and structural change. Technology policy and enhancing the adoption of new technologies are fostering growth and welfare. Industries hurt by globalisation must be restructured or the reconversion of their workers must be supported. This contradicts the approach that governments just need to deregulate markets and wait for the innovation and growth rebound expected to automatically follow.

Preservation and development of the European Social model[5]

Maintaining and developing the ESM is part of European Construction and is as important as the Internal Market. The ESM should have a precise content which needs to be politically debated. The ESM should include:

- In terms of pensions, a minimum income for the elderly and a decent replacement rate for workers at low or medium wage earnings.
- Retirement legislation ensuring that older workers, whom firms do not want to employ any more, do not fall into poverty. That implies that disability and early retirement schemes should not restricted before that full employment would be not assured and that firms would accepted to retain or to hire workers seniors. This also implies that the retirement reforms take in account the discrepancies between manual workers and managers, as concern life expectation and work capacities at 60 years.
- Health insurance available to all, either through a universal or an occupational insurance system associated with free health insurance entitlement to the poor. The control of health spending must be based on medical criteria or controls the income of health professionals, not by market mechanisms.

[5] From Catherine Mathieu and Henri Sterdyniak (OFCE).

- A minimum income. .
- Unemployment allowances ensuring a minimum income and a satisfactory replacement ratio for low or medium wage workers.
- Family benefits ensuring a minimum living standard for children and a satisfactory living standard for families relative to single people.
- Childcare benefits and collective infrastructure supporting female employment, especially for mothers with young children.
- Some degree of product market regulation to ensure that universal public services are provided..
- Some employment protection legislation to ensure that companies invest in their workers and that workers invest in their company
- A tax system targeting the reduction of income inequalities.

An ambitious social and economic policy needs to be financed. This requires leaving the MS the possibility to decide of their company and personal taxation, thus implementing a strategy of taxation coordination in Europe

The evolution of European systems must be done under the impulse of a democratic OMC, with a larger involvement of national social partners. Minimum social standards, increasing with the economic development of countries, should support convergence.

There is a need for an active and contra-cyclical macroeconomic policy in order to maintain full employment. This will request a robust demand (in particular through low interest rates and an appropriate exchange rate level), coordinated policy measures to address imbalances between countries (which will prevent non-cooperative strategies). The Stability Pact will need to be reconsidered to allow governments to borrow to invest in order to support growth. Being close to full employment is a prerequisite for efficient strategies of work incentives for older workers, the disabled and the unemployed.

Europe should try to design a specific model of European firms, caring about jobs, regional activity and sustainable growth.. This requests that Member States maintain a relatively high level of company taxation to give them incentives to: build homogeneous infrastructure in the country, subsidise firms locating their production in areas in difficulty, supporting economic sectors in difficulty and subsidising R&D.

Two issues are more difficult to deal with:

- Should Europe open more widely its frontiers to immigration in order to compensate for demographics slowdown? This would mean keeping unskilled jobs and some social inequalities (as in the case of the US and Anglo-Saxon countries)? Or should Europe aim first of all at maintaining full-employment, to raise skills levels and facilitate the reduction in unskilled jobs?
- Should everything be done to bring older people, disabled people and mothers with young children back to work? Yes, of course, because a job is socially rewarding and is a means of integration in the Society. But such a policy may entail a reduction in living standards for the targeted groups of the population who do not succeed to find a job. Also, is any job valuable? Is it necessarily socially useful? Productivity gains should be partly used to reduce working time and to decrease the importance of work.

The improvement of the European economic framework and the development of the Social Europe are not technical issues. They require a major change in the economic policy thinking, a new alliance between social classes concerned about full employment and social cohesion, the willingness to depart from the financial markets and multinational firms point of view. It would be easier to undertake at the European than at a National level, but it would require an agreement between peoples of each EMU Member State, which would be difficult to reach.

References

Aiginger K. and A. Guger, 2005, "The European Social Model: from an alleged barrier to a competitive advantage", *Progressive Politics*, vol. 4.3, September.

Algan Y. and P. Cahuc, 2006, "Civic Attitudes and the Design of Labour Market Institutions: Which Countries Can Implement the Danish Flexicurity Model?," *CEPR Discussion Papers,* 5489.

Bernard Y., Nicolas J-B., Delpal B., 2006: *Rapport du groupe de travail sur l'élargissement de l'assiette des cotisations employeurs de sécurité sociale,* La Documentation française, Paris.

Blanchard, O., 2006, "Is There a Viable European Social and Economic Model?", MIT*, Department of Economics, Working Paper* 06-21, July.

Boeri T. and S. Baldi, 2005, « Europe(s) sociales, convergence et compétition », Revue d'Economie Politique, n°6 Novembre-Décembre, pp.705-719.

Buti M., D. Franco and L. Pench, 1999, *The Welfare State in Europe, challenge and Reforms*, Edward Elgar.

CPB, 2003, *Social Europe*, European Outlook 1.

De la Porte C. and P. Pochet (ed.)*,*2002*, Building Social Europe through the Open Method of Co-ordination*, PIE-Peter Lang.

Delors J. and P.N. Rasmussen, 2007, *La Nouvelle Europe sociale*, mimeo, Parti Socialiste Européen.

Economic Policy Committee and the European Commission (DG ECFIN), 2006, *The impact of ageing on public expenditure: projections for the EU25 Member States on pensions, health care, longterm care, education and unemployment transfers (2004-2050)*,

Ehrel C., L. Mandin and B. Palier, 2005, " The Leverage Effect: the Open Method of Coordination in France", chapter 8 *in* Pochet and Zeitlin (2005).

Ehrel C. and B. Palier, 2005, "L'Europe sociale : entre modèles nationaux et coordination européenne », *Revue d'Economie Politique*, n°6 Novembre-Décembre, pp. 677-703.

Esping-Andersen G., 1990, *Three Worlds of Welfare Capitalism*, Polity Press, Cambridge, UK.

Esping-Andersen, G., 2002, *Why We Need a New Welfare State*, Oxford University Press, Oxford..

European Commission, 1997, Modernising and improving social protection in the European Union.

European Commission, 2000, *Agenda for Social Policy*.

European Commission, 2005, *Communication on the Social Agenda*.

European Commission (DG emploi et affaires sociales), 2004**.** *Report of the High Level Group on the future of social policy in an enlarged European Union*

European Foundation for the Improvement of Living and Working Conditions, 2006, *15 years of working conditions in the EU: Charting the trends*.

Ferrera M., A. Hemerijck A. and M. Rhodes., 2000, *The Future of Social Europe: Recasting Work and Welfare in the New Economy*, Oeiras, Celta Editora.

Fitoussi J.-P., 2000, L'avenir de l'Europe : l'ambition d'un autre contrat social, *Revue de l'OFCE*, n°75, pp. 165-182.

Garabiol P., 2005, *Le modèle social européen ou la création d'une identité sociale européenne,* Fondation Robert Schuman.

Georgopoulos T. , 2005, *La méthode ouverte de coordination européenne : « En attendant Godot »?*, Institute for European Studies, Université de Montréal, Note de recherche n°01/05

Goodin, R.E. and A. Smitsman, 2000, "Placing Welfare States: The Netherlands as a Crucial Test Case", *Journal of Comparative Policy Analysis*, vol. 2, no. 1, April, pp. 39-64.

Grahl, J. and P. Teague, 1997, "Is the European social model fragmenting?", *New Political Economy*, vol. 2, no. 3, pp. 405-426.

de Groot H.L.F., R. Nahuis R. and P.J.G., 2004, "Is the American model Miss World? Choosing between the Anglo-Saxon model and a European-style alternative", CPB Discussion Paper 40, 2004.

Hemerijck A., 2007, *Joining forces for Social Europe: Reasserting the Lisbon imperative of "double engagement" and more*, mimeo.

IGAS, 2006, *La Dimension européenne des politiques sociales*, La documentation française, Paris.

Iversen, T., 2005, *Capitalism, Democracy and Welfare*, Cambridge University Press.

Jacobsson K. and H. Schmid, 2002, « Real Integration or Just Formal Adaptation?», in De la Porte et Poche (eds.), 2002

Jepsen M. and A. Serrano Pascual, 2005, The European Social Model: an exercise in deconstruction*, Journal of European Social Policy.*

Junestav M., 2002, "Labour Cost Reduction, Taxes and Employment: The Swedish Case", in de la Porte, C. et Pochet, P. (eds.), 2002

Kleinman, M., 2002, *A European Welfare State? European Union and Social Policy in context,* Palgrave, London.

Kok W., 2004, *Facing the challenge– The Lisbon Strategy for Growth and Employment*, Report from the High Level Group.

Layard, R., 2003, *Happiness: Has Social Science a Clue?* Lionel Robbins Memorial Lectures, London School of Economics, March.

Leibfried S. and P. Pierson, 2000, "Social policy: Left to Courts and Markets?", *in* Wallace H. et Wallace W. (eds), 2000, *Policy Making in the European Union*, Oxford University Press, pp 268-286.

Leibfried, S., 2000, Towards a European Welfare State?, in: Pierson, C., Castels, F.G. (eds.), *The Welfare State Reader,* Polity Press, Cambridge, UK, 2000, pp. 190-206.

de Mooij R.A. , 2006, Reinventing the welfare state, CPB.

Mathieu C., et H. Sterdyniak, 2007, How to deal with Economic Divergences in EMU?, *Intervention,* vol 4, n°2.

Mathieu C., Th. Seguin et H. Sterdyniak, 2007, *What future for social Europe ?,* Rapport EUROFRAME-EFN autumn 2007, http://www.euroframe.org/fileadmin/user_upload/euroframe/efn/autumn2007/Annex6_OFCE.pdf

Palier B., 2000, « Does Europe matter ? Européanisation et réforme des politiques sociales des pays de l'Union européenne », *Politique européenne*. n°2, p. 7-28.

Pochet P., 2001, *Méthode ouverte de coordination et modèle social européen*, colloque de l'IEE, *The European Union: One Market, One Social Model?,* September.

Quintin O. and B. Favarel-Dapas B., 2007, L'Europe Sociale, 2ème édition, La Documentation Française, Paris.

Reich, R., 1991, *The Work of Nations*, Simon and Schuster, London.

Sapir, A., 2005, Globalisation and the Reform of European Social Models, *Bruegel Policy Brief*, November.

Scharpf F. W., 1999, *Governing in Europe : Effective and Democratic ?,* Oxford University Press.

Scharpf F. W., 2002, "The European Social Model: Coping with the challenges of Diversity", Journal of Commom Market Studies, vol. 40, n°4, pp. 645-670.

Taylor-Gooby, P. (ed.), 2001, *Welfare states under pressure*, London.

Volden C., 2002, "The Politics of Competitive Federalism: A Race to the Bottom in Welfare Benefits?", *American Journal of Political Science*, 46.2, p. 352-363.

Vaughan-Whitehead D., 2005, *L'Europe à 25, un défi social*, La Documentation française.

Wickham, J., 2002, The End of the European Social Model: Before It Began?, mimeo, January.